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## THESIS

**NEGLECTED ISSUES AND POSSIBLE STRATEGIES FOR  
THE IRAQI ECONOMY AFTER THE 2003 INVASION**

by

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December 2008

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**NEGLECTED ISSUES AND POSSIBLE STRATEGIES FOR THE IRAQI  
ECONOMY AFTER THE 2003 INVASION**

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Submitted in partial fulfillment of the  
requirements for the degree of

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## **ABSTRACT**

National interests and plans for the future play an important role in international relations. Because the Middle East encompasses one of the most important resources – oil, ongoing events in the area have impacted world economic conditions. For this reason, this thesis touches on the Iraqi economic situation after the 2003 invasion, since it plays a crucial role in the global economy and security. Beginning with the wrong policies of the Baath regime in the pre-invasion period, this thesis continues with the main problems of Iraq in the economic realm, then focuses on the three neglected issues—the informal economy, deterioration in social capital, and the insurgency and criminal gangs. All of these issues require great attention to build and maintain a secure and stable environment in Iraq. Then, the thesis gives some lessons learned to date, and solution propositions as strategies at the local level. It then concludes with general strategic points to look at in the future.

During the thesis research, the latest formal reports were used to reveal the current situation in Iraq. Scholarly interpretations were cited from various scholars to evaluate the aftermath of the 2003 invasion in Iraq in broad sense.

Finally, this thesis emphasizes the required remedies for a better Iraqi economy, and possible future expectations from U.S. decision makers.

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# I. INTRODUCTION

## A. GENERAL

National interests and plans for the future play an important role in international relations. Because the Middle East encompasses one of the most important resources – oil, ongoing events in the area have impacted world economic conditions. And, because Iraq has the world's third largest reserves of oil, its role in the world's economy is particularly critical regarding the future of the world's economic stability. Since the economic stability of Iraq will be critical in determining that country's recovery, this thesis will examine those factors and conditions likely to result in the development of a strong, viable economic system in that country.

Specifically, through scrutinizing events and then revealing the consequences of the current economic structure in Iraq, the general question of this thesis is: what was the economic situation in Iraq after the invasion in 2003, what has happened to date, and what can be done to develop the Iraqi economy? More broadly, the economic issues that have been neglected to date and their effects on the economic consequences will be surveyed. The author concludes that Iraq must struggle against many diverse issues in order to build a stable and prosperous economy. To achieve better results in establishing that economy, foreign powers should execute tangible and objective steps to support Iraq. Thus, it may well be easier to convince not only Iraq's people, but foreign entrepreneurs to invest and bring the Iraqi economy into the global arena. However, environmental factors such as violence, lack of security, and uncertainty for the future affect those possibilities. In order to reveal the consequences of economic debt, some important factors such as the informal economy, the effects of the insurgency, the lack of a governmental central authority in controlling corruption, and damage in social capital will be examined.

## **B. IMPORTANCE**

After five years of conflict and political uncertainty, economic factors are likely to become more and more important in creating an environment for stability in that war-torn country. Numerous approaches have been attempted to restart the economy, yet the results to date have been disappointing. The results of research undertaken for this thesis should break new ground by identifying a strategy that is expected to have a good chance at success. Clearly, if a solid economic foundation is established, the pull of the insurgency should lessen, and with that, hope for the future of Iraq should increase.

## **C. PROBLEMS AND HYPOTHESES**

Since the invasion of Iraq in March 2003, the Iraqi population, in general, has been living under the poverty line. Looking back to the last century, the government in Iraq was not able to establish a legitimate nation-state system. Actually, today's problems at the state level were inherited from the wrong policies of former Iraqi leaders. It is apparent that the overthrow of Saddam Hussein left behind many problems that require deliberate effort, responsibility, and a long-term strategy to be solved.

Looking at the 1970s, Iraq was in a good situation in terms of economic conditions. However, the eight-year Iran-Iraq War, and the two years following the invasion of Kuwait plunged the Iraqi economy into a great recession.<sup>1</sup> Because Saddam Hussein's government exploited oil revenues to hold power, the infrastructure, agriculture, and other crucial job sectors were neglected. Thus, it became inevitable for Iraq to become dependent mostly on oil for income. The reliance and access to oil revenues created huge economic differences among the Iraqi people. As a consequence, the other job sectors have not developed as they should have; the needs of the government and the people were met by huge amounts of imported goods. This situation seemed to reveal that a qualified labor

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<sup>1</sup> Abbas Alnasrawi, *Iraq's Burdens: Oil, Sanctions, and Underdevelopment*, (London: Greenwood Press, 2002), 62-64.

force was not necessary. However, when oil income diminished suddenly, the country went into turmoil. Apparently, most of the GDP was dependent on oil revenue, and the declining oil revenue has affected the inflation rate and the lack of industrial improvement has caused people to look for alternative income resources, which have emerged as an informal economy.

It appears that the problems of Iraq, in terms of economic recession, have created a multi-functional phenomenon. After the invasion in 2003, those problems resulted in catastrophic consequences. The Iraqi post-war economy fits the descriptions of several models: "Transition economy, failed state, rentier economy, post-conflict economy, and failed-take off economy."<sup>2</sup> Those models cover almost all of the problematic areas in the Iraqi economy. The thesis author's assessment, based on scholarly interpretations and executed policies, concludes that establishing a free-market system in Iraq can pave the way toward joining the global economy. Building a secure environment and rebuilding a legitimate economic system may appeal to foreign investors, reduce the insurgency, and control corruption. Getting away from an oil revenue-dependent state can give opportunities to improve the other job sectors, decline unemployment, diminish an informal economy, and decrease the vast authority of the central government in the economic arena. All of these solutions have some resemblance in terms of executed policies. However, in this thesis, while evaluating the current situation from the "god view" as an epitomized survey, the effects of the insurgency, the informal economy, and the effects of deterioration in social capital in the financial sector will be argued in detail.

#### **D. ACADEMIC DEBATES**

Executed policies and implementations in Iraq, since the invasion in May 2003, reveal that objectives have not been reached successfully. Maybe some improvements or some implementations, including great efforts for a better

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<sup>2</sup> Robert Looney, "Failed Economic Take-Offs and Terrorism in Pakistan: Conceptualizing a Proper Role for U.S. Assistance," *Asia Survey*, XLILV, no. 6 (2004): 771-793.

prospect of economic structure have been made; however, it is difficult to say that those policies work properly today. To expect better results, a secure and stable environment can and should encourage all public and privatized sectors. In the article published in 2004, Christopher Foote, William Block, Keith Crane, and Simon Gray argue that, "Reconstruction spending will create jobs and raise incomes this year, but sustained economic growth will depend on whether Iraq's future leaders pursue the pro-market approaches that the Coalition has advocated. If the Iraqi economy is to reach its potential, it will need to go even farther than the Coalition did, implementing some reforms that the Coalition did not pursue because of security concerns."<sup>3</sup>

To evaluate the outcomes of the invasion, it is crucial to scrutinize the tangible consequences of economic data:

After the end of hostilities, the greatest effect of the 2003 war on Iraq's economy was the subsequent decline in oil and electricity production. Oil production had been running at 2.5 million barrels per day before the war. It dropped to near zero in April; exports ceased until June 2003. Electricity generation fell by about 25 percent, regaining pre-war levels in October 2003. Based in part on these figures, the International Monetary Fund (2003, p. 22) estimates that Iraq's GDP fell by about 22 percent in dollar terms for 2003.<sup>4</sup>

One year later, in 2005, the "National Strategy for Victory in Iraq" was published; it explains the economic objectives that refer to the aforementioned consequences. The strategic approach for better results in economics was explained:

Our efforts have focused on helping Iraq restore its neglected infrastructure so it can provide essential services to the population while encouraging economic reforms, greater transparency, and accountability in the economic realm. The international community has been instrumental in these efforts, but there is room for the

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<sup>3</sup> Christopher Foote and others, "Economic Policy and Prospects in Iraq," *The Journal of Economic Perspectives*, Vol. 18, No. 3 (2004): 48.

<sup>4</sup> *Ibid.*, 55.

international community to do more. Foreign direct investment, over time, will play an increasing role in fueling Iraq's economic growth.<sup>5</sup>

On the other hand, evaluated results and ongoing economic life in Iraq reveal that those objectives have not been reached. Emphasizing those consequences, Robert E. Looney argues as follows:

The Coalition's failures were marked by a very different set of conditions. Failure often coincided with high social cost. For instance, the coalition's inability to end fuel price subsidies reflected its fears of sparking mass unrest. Also, most failed initiatives were afflicted by security disruptions, such as looting and sabotage that precluded sustained progress. Lack of powerful patrons was another handicap typical of unsuccessful projects. For instance plans for agricultural reconstruction languished with a committed CPA sponsor. Funding problems also characterized failed projects. Many projects ran into disabling delays when they encountered the complex U.S. government procurement process.<sup>6</sup>

Because the invasion has been ongoing for eight years, lessons learned from what has been accomplished or failed in terms of economic results, can be a vital legacy, which can be used as guidance for the future. Robert Looney gives those lessons in several headlines; each of them includes vast purposes:

- "Reconstruction entails painful trade-offs rather than easy choices;
- high hopes and lofty promises are no substitute for sound planning and prudent expectations;
- control expectations to realistic levels;
- for any actions, develop several contingency plans;
- economic reconstruction depends upon adequate security; yet security depends on successful reconstruction;

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<sup>5</sup> The White House, National Security Council, *National Strategy for Victory in Iraq 2005*, November 2005, 22, [http://www.whitehouse.gov/infocus/iraq/iraq\\_national\\_strategy\\_20051130.pdf](http://www.whitehouse.gov/infocus/iraq/iraq_national_strategy_20051130.pdf) (accessed May 5, 2008).

<sup>6</sup> Robert Looney, "The Economic Challenge: Building a Viable New Iraq," In *After the Dictator: the Rebirth of Iraq*, edited by Barry Rubin. New York: M.E. Sharpe, (2007): 8.

- reconstruction requires coordination of short-term initiatives and long-term structural reforms;
- don't over-rely on market forces in a conflict setting;
- ongoing reforms require empowered owners;
- broad-based participation is critical for maintaining reform momentum, but requires overcoming centralization tendencies;
- overcoming and controlling corruption is extremely difficult.”<sup>7</sup>

Exploiting those learned lessons paves the way for integrating the Iraqi economy into the global field, and more broadly, opens a new window for the steps of a transformation process. Thus, a sense of achievement regarding economic progress can be gained by implementation of the following suggestions:

“Political inclusion and consensus-building;

Establishing professional security forces;

Tackling corruption;

Creating a transparent and efficient oil sector;

Developing a solid budgetary framework; and

Improving governance by building and consolidating effective national institutions.”<sup>8</sup>

As mentioned above, political outcomes and dynamics will determine what kind of objectives can be achieved in the short, medium and long run. Although contemplated projects and plans define “what should be done,” the current

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<sup>7</sup> Looney, “The Economic Challenge: Building a Viable New Iraq,” 9-11.

<sup>8</sup> Ibid., 21.

political milieu at that time will be a crucial factor in determining what is possible. These general ongoing issues cover almost all the frustrated areas of the economic situation.

## **E. PRE-INVASION PERIOD**

Before the invasion, Iraq witnessed some wrong governmental policies. It can be said that two main factors played significant roles in Iraq's developing process, since its independence. The first one is its geographic location, which gives a good opportunity for a prosperous economy because of having the third largest oil reserves in the world, and the other one is its demographic shape, which has caused many obstacles in terms of building a stable nation-state system for many years. Looking at the past, it is important to focus on the importance of oil revenue, and the misbehaviors of the Saddam Regime regarding governing the country for its own benefits, since its establishment.

The oil industry in the Middle East was shaped according to the trade policies of major oil companies, especially after the collapse of the Ottoman Empire. Moreover, these major companies' relations with oil resources engendered new improvements in terms of the oil industry, and close connections emerged among the countries that have oil-rich territories in the Middle East, and international economic regulations.<sup>9</sup> Focusing on Iraq, five oil companies exploited the oil resources there: "British Petroleum, Exxon, Mobil, Shell, and Compagnie Francaise des Petroles."<sup>10</sup> However, since oil revenue has been the most important source of income for the Iraqi government, dependence on oil income—thus on these oil companies—became necessary in this manner. From this phenomenon, being dependent on foreign companies in an economic arena reveals that the expenditures should be planned according to the amount of income, and the relations with these companies, including their political behaviors. Strategies of the oil companies in the Middle East have great effects

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<sup>9</sup> Alnasrawi, *Iraq's Burdens: Oil, Sanctions, and Underdevelopment*, 19.

<sup>10</sup> Ibid.

on shaping the economic future of those oil-producing countries. A concession system and those companies' joint behaviors, in terms of oil prices, have been two major factors.<sup>11</sup>

Looking to the past, the relations of the Iraqi government with oil companies seemed volatile; disagreements with those companies sometimes showed up as low oil production. As a vital settlement, Iraq built its own oil company in order to regulate and understand national oil policy in its territory.<sup>12</sup> Improvements and investments in this field developed Iraq's social and industrial sides. However, the Iran-Iraq War and then the invasion of Kuwait caused terrible consequences in the economic field, thus oil production could not stay in a stabilized trend, but decreased dramatically in these periods.<sup>13</sup> In fact, the main cause of the invasion of Kuwait can be interpreted as an offensive economic behavior of Saddam Hussein, since interdependence on oil companies was affecting the development level of oil-producing countries.

Thus, the invasion of Kuwait became inevitable. Shortly afterward, the consequences of that invasion affected the economy of Iraq; the United Nations Security Council imposed an embargo on Iraq, and that situation paved the way for the other oil-producing countries to increase their oil production.<sup>14</sup>

What happened between 1950 and 1990 in terms of economic implementations in Iraq seems almost as devastating; strategies and investments in an economic field, within political decisions, were not collaborated in a plausible manner. Relying on oil production income only and ignoring the other investment sectors, such as agriculture and industry, made the Iraqi economy dependent almost completely on one resource, and although required investment programs were scheduled, more than half of those ad hoc investment funds were

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<sup>11</sup> Alnasrawi, *Iraq's Burdens: Oil, Sanctions, and Underdevelopment*, 25.

<sup>12</sup> *Ibid.*, 26.

<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid.*, 31-33.



not spent.<sup>15</sup> Therefore, the agriculture and industry sectors have not developed much. Due to the high percentage of the population of Iraq that were working in rural areas, investing in agrarian sectors would be a crucial factor. Also, ignoring investments in rural areas affected the industrial field, which affected the prospect of Iraqi development in the long run. In a nutshell, in this aforementioned period, the behaviors of Iraqi governments for a better usage of income, depending on oil production, did not change, and improvements in the economic and political arenas could not be achieved.

Why the economic situation and the level of life have been volatile and terrible in Iraq, especially after the beginning of Iran-Iraq War, lie on the Iraqi governments' insistence on increasing its oil-production income, and their neglecting policies over the other production sectors of Iraq. Disappointing results in the Iran-Iraq War for Iraqi governance caused a dramatic decline in economic and social life standards. More broadly, at the end of the Iran-Iraq War, Iraq plunged into a turmoil that was caused by destroyed industrial fields, a damaged oil exporting system, the lack of privatization, an increased level of inflation, and the proliferation of unemployment.<sup>16</sup> Additionally, in, preparing its military force for the Iran-Iraq War, the Iraqi government increased its military expenditures, and that situation created an imbalance between income and expenditures.<sup>17</sup> Finally, the consequences of this war were devastating; Iraq did not witness what it expected and focused on increasing its oil revenue in order to relieve its economy from suffering. However, the Iraqi government accused the Gulf States of manipulating a decline in oil prices, which had a further negative effect on the Iraqi economy.<sup>18</sup> Furthermore, since Kuwait and the United Arab Emirates did not agree with Iraq about increasing oil prices per barrel, Saddam

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<sup>15</sup> Alnasrawi, *Iraq's Burdens: Oil, Sanctions, and Underdevelopment*, 38-43.

<sup>16</sup> *Ibid.*, 62.

<sup>17</sup> *Ibid.*, 61-63.

<sup>18</sup> *Ibid.*, 64.

Hussein decided to invade Kuwait on August 2, 1990.<sup>19</sup> Since the economic power of Iraq was weak after the Iran-Iraq war, that invasion exacerbated its political and economic situation, especially when United Nation Security Council executed sanctions. The purposes of those sanctions were withdrawal of Iraqi military forces from Kuwait borders, and maintaining a secure environment in the Middle East. The strategy of the United States Air Force was to destroy the main facilities of the adversary, and damage the public's morality.<sup>20</sup> Public view against the current government would be hatred and many grievances. Besides those attacks, the sanctions that were imposed on the economic and social fields exacerbated the atmosphere of Iraq; many people—especially children—died because of the lack of medical supplies. Criticizing that situation out of the scope, it is apparent that the U.N. Security Council did not show enough of a response to the Iraqi citizens' terrible situation. As a dramatic explanation, it was argued that, "even when the Sanctions Committee eventually recognized the existence of urgent humanitarian needs in Iraq in March 1991, nothing was done to alter the situation. This meant that the bulk of the enormous food needs of the Iraqi people—more than 10,000 tons per day of food grain alone—were unmet."<sup>21</sup>

It is apparent that it was mostly oil revenue and the wrong foreign policies of the Ba'ath regime that changed the fate of Iraq, It was especially Saddam Hussein's authority over the Iraqi citizens, and his foreign policy in the Middle East, that brought Iraq into turmoil. Those incorrect policies left a legacy that requires an essential strategy and much time to rebuild Iraq as a stable country. While doing that, it is important to figure out the main requirements for the Iraqi economy.

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<sup>19</sup> Alnasrawi, *Iraq's Burdens: Oil, Sanctions, and Underdevelopment*, 64.

<sup>20</sup> *Ibid.*, 66-67.

<sup>21</sup> *Ibid.*, 73.

## **F. GENERAL FRAMEWORK**

Today, the general situation in Iraq is uncertain in every facet of life, including the economic, social, political and demographic areas. The level of economy reflects how the things are going in Iraq. Because economy includes immense factors regarding a country's development level, here a few general problems will be touched on here. More broadly, three neglected issues—the informal economy, the insurgency and criminal gangs, and deterioration in social capital—will be emphasized in detail. Then, with a look to the future, what kind of lessons have been learned since 2003, what kind of strategies have been executed at the local level, and what can be done more for a better future will be evaluated. Finally, a short summary will conclude the main points, and look for future expectations.

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## II. FACTORS EXACERBATING THE PROBLEMS OF THE IRAQI ECONOMY

### A. GENERAL PROBLEMATIC AREAS AND STRATEGIES

The invasion of Iraq in 2003 has left diverse consequences, which in turn affect the current life, and make the close future uncertain in many cases. Although the purpose of the invasion was to impede global terrorism, the aftermath of this action has not convinced the global vision. Five years after the invasion, economic results have not shifted to a prosperous level like other problematic areas, such as security and the stabilization of central governance. More broadly, implementing the planned strategies regarding economic development steps have not reached what was aimed for, although some success has been achieved. Actually, Iraqi citizens are hesitating about the achievement of the economic development projects on time, because of some obstacles.<sup>22</sup> According to the U.S inspector general, the improvement programs have been impeded by “violence, corruption and mismanagement.”<sup>23</sup> So, the efforts in that case do not seem to work well, since the money left for rebuilding development plans appears to be wasted because of mismanagement and an insecure environment.<sup>24</sup> That situation has affected the planned strategies regarding the prosperous economy, especially for short term economic improvements that have been impeded by those obstacles.

Looking at the roots of these problems, Saddam Hussein’s legacy in the economic arena seems to be lingering. Also, that regime’s uncertain and wrong economic policies, and misleading economical behavior has exacerbated the

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<sup>22</sup> Robert Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” *Middle East Review of International Affairs*, Vol.12, No.1 (2008): 26.

<sup>23</sup> Tom Regan, “US Inspector General for Iraq Paints ‘Grim’ Picture of Reconstruction Effort,” *Christian Science Monitor*, November 1, 2005, <http://www.csmonitor.com/2005/1101/dailyUpdate.html> (accessed July 12, 2008).

<sup>24</sup> Ibid.

general situation with “internal conflicts, wars, and sanctions.”<sup>25</sup> Therefore, it would not be easy to cope with this legacy; great efforts have been made for recovering and amending the negative impacts of weakening forces, which had been concrete for years.<sup>26</sup> Those efforts include, “...the restoration of government economic functions, after looting and state collapse; the prevention of currency collapse, hyperinflation, and economic chaos; the rebuilding of infrastructure ravaged by war, sanctions, looting, and neglect; the rehabilitation of a health care system cut off from medical advances for two decades; the dismantling of corrupt, dysfunctional state economic controls; and the stimulation of the growth of a private sector that had been stunted by government interference.”<sup>27</sup>

The coalition met some difficulties regarding the pre-planned economic aims because of some obstacles. At the time of the invasion, the Coalition Provisional Authority could not impede the illicit infrastructure, be successful in impressing the foreign entrepreneurship, execute economic development strategies, rebuild state-owned sectors, and support the creation of job opportunities.<sup>28</sup> Those failed policies have played an exacerbating role in terms of future plans in the economic realm. Although Saddam Hussein was overthrown, expectations have not been met because of the aforementioned impediments. Parallel to this, there were other problematic areas, such as electricity production, and combating corruption, which are the key points for multipurpose solutions. More broadly, the U.S. Congress could not spend more than \$18.4 billion for the rebuilding of problematic areas.<sup>29</sup>

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<sup>25</sup> Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” 26.

<sup>26</sup> Anne Ellen Henderson, “The Coalition Provisional Authority’s Experience with Economic Reconstruction in Iraq,” *Unite States Institute for Peace, Special Report No. 138* (2005), <http://www.usip.org/pubs/specialreports/sr138.html> (accessed July 20, 2008).

<sup>27</sup> Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” 26-27.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

Many of the problems in the economic field were engendered and worsened because of misperceptions and wrong policies after the war.<sup>30</sup> As an explicit result, oil production consists of approximately 74 percent of the GDP.<sup>31</sup> Dependence on oil revenue weakened the other industrial and agricultural sectors, and that situation affected the investment sectors and productivity of the Iraq in a negative way.

Another huge obstacle in this vein was the creation of falsified prices of production due to intervening by the central governance into economic life.<sup>32</sup> Thus, the misrepresented prices plunged economic results into inefficiency, and recession became inevitable. That consequence then diminished the role of private sectors in the economic field.

Furthermore, looking at the social life reveals that there is an unfair situation in every facet of living. These include “health, education, public services, and social services to low-income groups, the disabled, internally displaced persons, and other vulnerable groups across geographic areas.”<sup>33</sup> Explicitly, unemployment is too high, thus poverty is also widespread. Because turmoil is a prominent factor, it is almost impossible to lessen unemployment without regulations to secure the environment. Overall, economic prosperity seems unlikely to increase rapidly; the rate of income for an average family decreased dramatically. A United Nations Development Program (UNDP) household survey suggests that while the richest 20 percent of the population earns close to half of the income (approx.44 percent), the poorest 20 percent of the population earns 7 percent of the income.<sup>34</sup> So it is apparent that most of the Iraqi population is living under the poverty line. The social structure in Iraq plays

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<sup>30</sup> Robert Looney, “The Viability of Shock Therapy in Iraq,” *Challenge*, Vol. 47, No. 5, (September-October 2004): 86-103.

<sup>31</sup> Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” 27.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid., 28.

<sup>34</sup> Ibid.

an exacerbating role in this consequence. Uncontrolled business opportunities and informal relations with the central authority pave the way for economic recession. Thus, for the near future, without crucial changes in social life, those dramatic unbalanced income statuses are likely to remain for some time.

## **B. INITIAL ECONOMIC PROBLEM STRATEGIES**

After the invasion of Iraq in 2003, initial strategies regarding a prosperous economy could not be successful because of unsuitable approaches. Since the environment in Iraq was not suitable for economic reconstruction implementations, the expectations could not be achieved. The Coalition Provisional Authority (CPA) decided to execute a neo-liberal approach in terms of economic developments, however, the planned implementations could not fit the current Iraqi economy because of the lack of a secure and stabilized environment.<sup>35</sup> Actually, a neo-liberal approach comes with the empirical data and tangible plans that demand solving the problems on a very concrete ground. However, in the CPA's development plan, there were some crucial absent points regarding reshaping the economy: "A sound legal system for contracts, a functioning financial sector, and the initial absence of a national currency."<sup>36</sup> Without these critical supportive elements, expecting better results would be unrealistic. In addition, a neo-liberal approach aims to use private investment in order to exploit the financial gains with the assistance of free market prices.<sup>37</sup> However, the central authority, lack of regulations in legal systems, and the insecure atmosphere social life have caused the investors and entrepreneurs to keep themselves away from economic investments.

There is a general idea about the neo-liberal approach, that it is not suitable for finding job opportunities or the recuperation of the economy, but it

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<sup>35</sup> Robert Looney, "A Return to Ba'athist Economics? Escaping Vicious Circles in Iraq," *ORIENT/Jg. 45/2004/Heft 3/S. 385-400*: 389-390. [http://web.nps.navy.mil/~relooney/Rel\\_Orient04.pdf](http://web.nps.navy.mil/~relooney/Rel_Orient04.pdf) (accessed May 18, 2008).

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.



often results in expenditures that result in increased regional and personal income disparities.<sup>38</sup> Thus, this situation causes regional inequality, and lack of economic growth, and lack of beneficial recovery steps engender skeptical approaches in the public's mind against executed implementations. Parallel to this, Sabri Zire al-Saadi argues that, "In Iraq, without economic vision and realistic policies, the goodwill of spending efforts may end in chronic structural problems, high inflation, leading to political and social disturbances. As a matter of fact, since the war ended, the implemented economic measures and the actual expenditures have neither increased domestic production and productive employment, nor improved the living standards of the majority of the people."<sup>39</sup> Thus, it is apparent that the consequences of implementations were the result of CPA miscalculations.

One of the CPA miscalculations was the de-Ba'athification program, which was implemented in May 2003 by the CPA.<sup>40</sup> Although the program was aimed at eroding the negative effects of Saddam's legacy, executed policies exacerbated the ongoing situation. Approximately 120,000 people became jobless.<sup>41</sup> However, many of them had been in a good career positions, such as doctors, professors, nurses and other skill-required sectors; their purpose in joining the Ba'ath Party was to get opportunities in their professions, live better, and not to support the Ba'athist ideology.<sup>42</sup> As expected, many crucial sectors in productive fields were damaged, and incomes decreased the consuming rate, which affected the other trade sectors negatively.<sup>43</sup> More broadly, the

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<sup>38</sup> Looney, "A Return to Ba'athist Economics? Escaping Vicious Circles in Iraq," 390.

<sup>39</sup> Sabri Zire Al-Saadi, "Iraq's Post-War Economy: A Critical Review," *Middle East Economic Survey*, April 5, 2004, <http://www.globalpolicy.org/security/issues/iraq/attack/consequences/2004/0405econreview.htm>, (accessed September 1, 2008).

<sup>40</sup> Looney, "A Return to Ba'athist Economics? Escaping Vicious Circles in Iraq," 391.

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid.

educational system was damaged by the de’Ba’athification rules due to many professors being dismissed from universities such as Basra, Baghdad and Tikrit; and the vantage point of the education system was severely destroyed because of the lack of scholars, who were very good citizens.<sup>44</sup> But, although it was a delayed action, L. Paul Bremer III, head of the U.S.-led Coalition Provisional Authority, shifted his prejudiced ideas about the many Ba’athist scholars, and allowed them to get their jobs back again.<sup>45</sup>

Another effort of the CPA was to rebuild the Iraqi economy and to opportunities to Iraqi companies. By doing that, the CPA hoped that Iraqi firms would exploit the allocated aid by the U.S, which included \$18.6 billion.<sup>46</sup> But, due to the lack of enough capital, no Iraqi companies could take advantage of the opportunity, and the benefits the CPA offered went to foreign companies who did have the required capital.<sup>47</sup> Rebuilding projects could not be successful as far as getting money to Iraqi entrepreneurs and this situation again dismayed the Iraqis because of poverty and the uncertainty of the future.

Actually, the intent of the de-Ba’athification program was “justice, accountability, reconciliation, and economic compensation.”<sup>48</sup> However, both the aforementioned consequences and initial benchmark assessment reports verified that although a few implementations been successful, expected results could not be fully achieved.<sup>49</sup>

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<sup>44</sup> Daniel del Castillo, “In Iraq, Daunting Task for Higher Education,” *The Chronicle of Higher Education*, Volume 50, Issue 3, September 12, 2003, <http://chronicle.com/free/v50/i03/03a03701.htm>, (accessed September 2, 2008).

<sup>45</sup> Nicholas Riccardi, “Iraqi Teachers Learn Hard Political Lesson,” *Los Angeles Times-World*, May 14, 2004, <http://articles.latimes.com/2004/may/14/world/fq-teachers14>, (accessed September 2, 2008).

<sup>46</sup> Looney, “A Return to Ba’athist Economics? Escaping Vicious Circles in Iraq,” 394.

<sup>47</sup> Ibid.

<sup>48</sup> The White House, *Initial Benchmark Assessment Report*, July 12, 2007, <http://www.whitehouse.gov/news/releases/2007/07/20070712.html> (accessed September 2, 2008).

<sup>49</sup> Ibid.

### C. INTERNAL MIGRATION

Another devastating consequence of the unstable environment after the invasion is increased internal migration, which has exacerbated the social and economic situation in Iraq. According to the report of the International Organization for Migration (IoM), because of the sectarian treatment, approximately 1.4 million Iraqis decided to move to a safe environment.<sup>50</sup> That movement also affected the demographic structure of Iraq and had a negative effect on the public's morale. Actually, this movement began in 2003, with the movements of considerable average and high-level business operations to Arab countries. Thus, the situation caused lots of Iraqi workers to leave Iraq. Furthermore, this movement played a vast role in terms of increasing uncertainty in the economic realm. The main purpose of that increasing migration was having a secure environment, and living without sectarian violence. Looking at Northern Iraq, except for the Kurdish Regional Government zone, diverse sectarian provinces such as Diyala, Nineveh and Ta'mim (Kirkuk) are typical examples of problematic areas in terms of economic consequences. In Sunni areas, many Sunnis have left multi-sectarian communities to go to heavily populated Sunni provinces, and many non-Sunnis have had to leave those provinces. In Baghdad, relocated people have multiplied by two since February 2006. In the central and southern provinces, many of the Shia have abandoned Baghdad and moved to the nine heavily Shia-populated provinces of central and southern Iraq.<sup>51</sup> Those replacements, in different regions of Iraq, have exacerbated the Iraqi economy, by reducing the opportunity of having a local job, accessing healthcare and fuel, and increased inflation rates for prices of food and merchandise.<sup>52</sup> Because of these consequences, some precautions have been taken. For example, Karbala now makes it mandatory for new residents to prove that they have neighbors to

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<sup>50</sup> Robert Looney, "The Iraqi Economy II: Economic Programs at the Local Level," *Economic Development and Comparative Economic Systems-NS-3042 Course Slides*, (Naval Postgraduate School, Monterey, C.A, August 2008), 9.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid., 11.

support them.<sup>53</sup> The results may not be recognized in the short-term, but that kind of local restriction can hopefully be a successful step for local stabilization, which makes economic stability more likely.

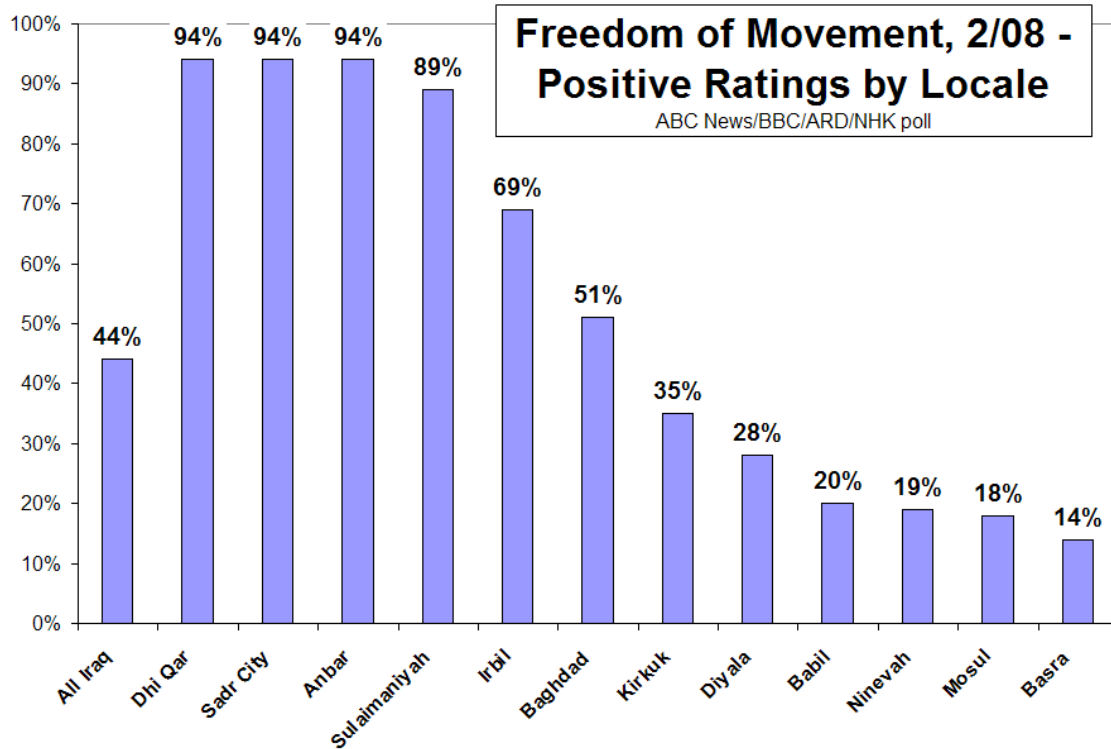


Table 1. Internal Migration<sup>54</sup>

#### D. UNEMPLOYMENT

After the invasion in 2003, the living standards of Iraqi citizens declined suddenly because of the damaged employment sectors. Economic recession affected the income rate of the people, and the jobless bulge has increased dramatically. According to the July 2003 chairman’s report, “unemployment in Iraq is estimated to be over 60 percent. Business leaders and independent economists assert that the employment situation has deteriorated considerably in

<sup>53</sup> Looney, “The Iraqi Economy II: Economic Programs at the Local Level,” 11.

<sup>54</sup> Anthony H. Cordesman, “The Iraq War: Key Trends and Developments,” *Center for Strategic and International Studies*, May 7, 2007, 118, [http://www.csis.org/media/csis/pubs/080506\\_iraq\\_status\\_trend.pdf](http://www.csis.org/media/csis/pubs/080506_iraq_status_trend.pdf) (accessed July 10, 2008).

the aftermath of the war.”<sup>55</sup> Thus, handling the rebuilding process makes it necessary to convince the citizens of Iraq to create job opportunities in order to execute tangible implementations regarding a better economy in the future. These tangible implementations could not be met at the period just after the invasion in 2003, as state-owned enterprises proved incompetent in the economic field.<sup>56</sup>

The aftermath of destroying the Iraqi army revealed a worse-case scenario in terms of the unemployment problem. When the CPA decided to dismiss the army personnel, this decision proliferated the unemployment rate, and created tension and hatred among the young jobless soldiers. The unemployed 300,000 former soldiers became a great potential risk, not only as an obstacle for economic and political improvements, but as a danger to U.S. security precautions.<sup>57</sup> This situation, in turn, has exacerbated the security level of the environment of Iraq, and paved the way to the proliferation of illegal activities in the following years. More broadly, the high unemployment rate has caused a favorable milieu for potential volunteers to join criminal gangs and militias, and the lack of basic services in lots of provinces was a big trump to well organized adversary groups to take over the roles of government.<sup>58</sup> These problems still exist today. Parallel to this, according to the Crisis Group Middle East Report, “Iraq faces a huge unemployment problem, not just involving former insurgents but generally among the young population, Sunni or Shiite. This will

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<sup>55</sup> Richard G. Lugar, “Iraq: Meeting the Challenge, Sharing the Burden, Staying the Course,” *A Trip Report To Members Of The Committee On Foreign Relations United States Senate*, July 2003, 14, <http://www.globalpolicy.org/security/issues/iraq/occupation/2003/0730iraqreport.pdf> (accessed September 9, 2008).

<sup>56</sup> Ibid.

<sup>57</sup> Ibid.

<sup>58</sup> Frederick W. Kagan, “Choosing Victory: A Plan for Success in Iraq, Phase I Report,” *American Enterprise Institute for Public Research*, January 5, 2007, [http://www.aei.org/docLib/20070111\\_ChoosingVictoryupdated.pdf](http://www.aei.org/docLib/20070111_ChoosingVictoryupdated.pdf) (accessed August 20, 2008).

need to be addressed if only to prevent young Iraqis from being drawn into militias, insurgent groups or criminal gangs.”<sup>59</sup>

It should be noted that according to some statistics, the unemployment rate in Iraq seems lower than it really is. According to the World Bank Report in 2005, some surveys show that the unemployment rate is 30 percent, however, overall unemployment is around 50 percent.<sup>60</sup> Furthermore, some data may create controversial situations. According to the Central Intelligence Agency (CIA) estimations, unemployment is between 18% and 30%; however, if salaries are compared with the basic living standard requirements, unemployment between the sixteen and thirty-year-old age groups is around 40–60 percent, especially in problematic areas.<sup>61</sup> There is no doubt that unemployment exacerbates social life in Iraq, and does not bode well for counterinsurgency strategies and precautions against criminal activities.

## E. INFLATION

One of the economic consequences of the invasion of 2003 is that it negatively affected inflation. Like the other deteriorated sectors of the Iraqi economy, the increased inflation rate is exacerbated by criminal activities, violence, and corruption, where these obstacles have caused increasing prices and constraints in basic requirements.<sup>62</sup> Looking at the inflation rate from 2003 to the present in Iraq, results are volatile, but executed implementation programs

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<sup>59</sup> “Iraq after the Surge II: The Need for a New Political Strategy,” *International Crisis Group, Middle East Report*, no.75, April 30, 2008.

<sup>60</sup> Faris Hadad-Zervos, “The World Bank in Iraq: Iraqi Ownership for Sustainability,” *Iraq Country Unit, Middle East Department Middle East and North Africa Region The World Bank*, July 2005, 3, <http://siteresources.worldbank.org/IRFFI/Resources/WBPaperIraqFaris.pdf> (accessed July 24, 2008).

<sup>61</sup> Anthony H. Cordesman, “Transferring Provinces to Iraqi Control: The Reality and the Risks,” *Center for Strategic and International Strategies*, September 2008, [http://www.csis.org/component/option,com\\_csis\\_pubs/task,view/id,4858/](http://www.csis.org/component/option,com_csis_pubs/task,view/id,4858/) (accessed September 20, 2008).

<sup>62</sup> Takatoshi Kato, “Meeting on the International Compact with Iraq,” *International Monetary Fund United Nations Headquarters*, New York, March 16, 2007, <http://www.imf.org/external/np/speeches/2007/031607.htm> (accessed August 27, 2008).

prove that it is going better. In the last 5 years, inflation has been a crucial problem in terms of economic recession, but current data shows that it is improving. For example, in 2003, the inflation rate was 36.3 percent, in 2004, it was 31.7 percent, in 2005, it was 31.7, and in 2006, it increased to 53.2.<sup>63</sup> According to the International Monetary Fund (IMF) data in 2007, “annual consumer price inflation peaked at a rate of almost 77 percent in August, fell back to around 52 percent in September-November, and increased again to almost 65 percent in December. The underlying rate of inflation (excluding fuel and transportation) has been stable, in the range of 30–35 percent.”<sup>64</sup>

Monetary policies play a vast role in terms of maintaining stabilized and low-rate inflation. The IMF has executed a very tight policy against inflation, so “the exchange rate of the Iraqi dinar was pegged to the U.S. dollar through most of the year, at a rate close to ID 1,477 per U.S. dollar. From mid-November this policy has been adjusted to permit a gradual appreciation of the dinar; the daily auction-rate declined to ID 1,325 per U.S. dollar at end-December and reached ID 1,290 per U.S. dollar by end-January.”<sup>65</sup> On top of this, government expenditure programs have been controlled and have increased the durability of the Iraqi dinar.<sup>66</sup> Looking at the 2008 session, implemented policies look successful where confidence in security issues has increased domestic expenditures and caused a reduction in the inflation rate.<sup>67</sup>

The effect of confidence has had a positive impact in gaining control of inflation. According to the Special Inspector General for Iraq’s Reconstruction

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<sup>63</sup> Robert Looney, “The Iraqi Economy I: Overview History and Key Issues,” *Economic Development and Comparative Economic Systems-NS-3042 Course Slides*, (Naval Postgraduate School, Monterey, C.A), August 2008, 38.

<sup>64</sup> Rodrigo de Rato, “Second Supplementary Memorandum of Economic and Financial Policies for 2007,” *International Monetary Fund*, February 2007.

<sup>65</sup> *Ibid.*

<sup>66</sup> Looney, “The Iraqi Economy I: Overview History and Key Issues,” 38.

<sup>67</sup> “The International Compact with Iraq,” *Annual Review May 2007-April 2008*, 6, <http://www.iraqcompact.org/annualreview/ICI%20Annual%20Review%202007-8.pdf> (accessed June 6, 2008).

(SIGIR) report, “on June 22, 2008, the Central Bank of Iraq (CBI) announced a one point reduction in the interest rate it pays on commercial bank deposits—signaling confidence that underlying inflation is under control.”<sup>68</sup> The Following figure epitomizes the rates since January 2005.

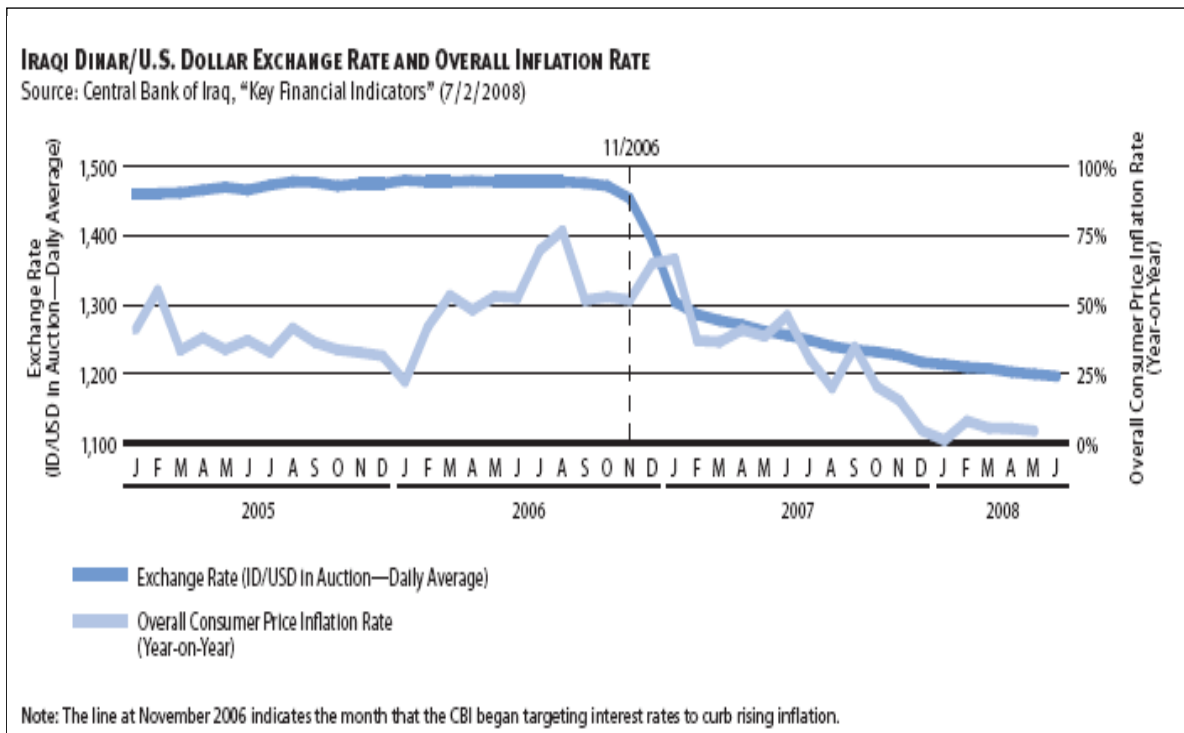


Figure 1. Iraqi Dinar / U.S. Dollar Exchange Rate and Overall Inflation Rate<sup>69</sup>

## F. THREE NEGLECTED PROBLEMATIC ISSUES

Economic issues are very volatile in Iraq. However, there are three dynamics that impede economic development strategies and expectations, and should be handled together in this vein. Those dynamics are “the growth and dynamics of the shadow or informal economy, deterioration in social capital, and

<sup>68</sup> Office of the Special Inspector General for Iraq Reconstruction, *Quarterly Report to the United States Congress*, July 30, 2008, 52, [http://www.sigir.mil/reports/quarterlyreports/Jul08/pdf/Report\\_-\\_July\\_2008.pdf](http://www.sigir.mil/reports/quarterlyreports/Jul08/pdf/Report_-_July_2008.pdf) (accessed September 6, 2008).

<sup>69</sup> Ibid.



the evolving relationship between tribes, gangs and the insurgency”.<sup>70</sup> Since the invasion in March 2003, these problems are maintaining their prevalence and increasing domestic turmoil. Therefore, these dynamics should be scrutinized carefully and in a reciprocal manner.

### **1. The Informal Economy**

The economic sector of Iraq has witnessed a volatile atmosphere for many decades. Within the impact of the sanctions around the 1990s, and the consequences of the invasion in 2003, the economic sector of Iraq has been damaged, which needs crucial implementations in terms of prosperity. One of the important but neglected issues by decision makers in this vein is Iraq’s growing informal economy. Proliferated by the devastating consequences of the invasion, the informal economy of Iraq has increased dramatically. However, it is not fair to imply that the informal economy occurred suddenly after the invasion.

Looking at the pre-invasion period, the economy of Iraq had relied on mostly oil revenue, although Iraq is also known as an agricultural country. Nevertheless, the economic policy of the Ba’ath regime chose to exploit mostly the oil sector, which diminished the other sectors, such as agriculture and industry. When the sanctions were implemented throughout the 1990s, the governmental sector was severely damaged, thus it paved the way for the private sector to increase its employment sector until the time of invasion in 2003.<sup>71</sup> Therefore, many people worked in the private sector, but many jobs were related to the informal economy. Because the central authority collapsed, and control of economic data was almost impossible, people were just looking for income to stay alive. Thus, uncontrolled trade increased dramatically.

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<sup>70</sup> Robert Looney, “The Iraqi Impasse: Sustaining Economic Reconstruction During War Time,” *International Journal on World Peace*, Vol. XXIII, no.4, (2006):1.

<sup>71</sup> Robert Looney, “Economic Consequences of Conflict: The Rise of Iraq’s Informal Economy,” *Journal of Economic Issues*, Vol. XL, no.4, (December 2006): 3.

In Iraq, the incomes from the informal economy can be divided into two categories: “legitimate and illegitimate income opportunities.”<sup>72</sup> Because many households cannot earn enough money for living, they look for different alternatives. Legitimate income opportunities include, “flea markets, street selling of small quantity goods, small scale food production, transport, and repair and recovery services.”<sup>73</sup> On the other side, there is an illegal choice of the informal sector. Illegitimate income opportunities include, “smuggling, corruption, kidnapping for ransom, extortion, and larceny.”<sup>74</sup> Each of them is possible to witness in Iraq. Because the control of security and rules of law were severely damaged after the invasion, illicit income choices have become attractive for jobless people. Broadly, there is a controversial situation in Iraq today. The informal economy seems an easy way for increasing income for citizens where formal sectors have weakened because of the conflict.

In general, being dependent on oil revenue weakened the agriculture sector in Iraq because of the growth of the oil sector; this situation diminished the rate of exports in the agriculture sector.<sup>75</sup> That hindrance of developments in the other job sectors disappointed domestic producers, and possibly impeded the improvement of the formal sector. Not only the level of prosperity in the economy, but also the volatile environment affected the size of the informal economy in Iraq. It was argued that, “security concerns continue to stifle private investment, both domestic and foreign, and prevent market mechanisms from playing their anticipated role.”<sup>76</sup> Thus, the, unsafe environment has diminished possible job creation opportunities. When a government executes unsuccessful policies such

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<sup>72</sup> Document of the World Bank, “Rebuilding Iraq: Economic Reform and Transition,” *Middle East and North Africa Region Social and Economic Development Group*, February 2006, 33, [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/02/22/000090341\\_20060222100550/Rendered/PDF/35141.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/02/22/000090341_20060222100550/Rendered/PDF/35141.pdf), (accessed July 27, 2008).

<sup>73</sup> Ibid.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid., 34.

<sup>76</sup> Ibid., 33.

as high tax rates, uncontrolled management, and ignorance of the unemployment rate, those factors also cause the expansion of the informal economy. It was argued that, "...high taxes and a large but restricted (often by unionization or party membership) bureaucracy have tended to be associated with substantial informal sectors, with the latter acting, in part, as an employment ladder to the public sector."<sup>77</sup>

Another crucial factor affecting the size of the informal economy is a country's tendency toward openness to the world markets. This transparent trade policy tries to impede the economic deformity that government can cause, and reduce the tendency of domestic entrepreneurs to have an interest in the informal economy.<sup>78</sup> It was pointed out that,

...the relative size of a country's informal economy (as a share of Gross National Product (GNP)) is related to its progress in opening up to the world economy. Those countries that are relatively closed and inward oriented (like Iraq around the year 2000) tend to have large informal economies, while those countries open to the pressures of globalization have much smaller informal economies. Furthermore, the informal sector becomes significantly smaller as countries increase their control over corruption.<sup>79</sup>

As it is apparent that Iraq is in this group of countries, since the Saddam Hussein governance did not handle the economy with an outward orientation, instead it stayed mostly domestic, and an inward-oriented economy prevailed.

There are several factors affecting the size of the informal economy in Iraq. Especially, after the overthrow of the Saddam Hussein, uncertainty, rapid increase in crimes, and disability of controlling the corruption have all increased the informal sector.<sup>80</sup> One of those factors is Iraq's uncertain demographic

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<sup>77</sup> Document of the World Bank, "Rebuilding Iraq: Economic Reform and Transition," 33.

<sup>78</sup> Ibid.

<sup>79</sup> Ibid.

<sup>80</sup> Ibid., 5.

shape.<sup>81</sup> Actually, it is very difficult to make an accurate estimate of the Iraqi population, which plays a vital role in the informal economy. In addition, the growth rate of the population is not certain. The IMF's assessment in 2004 was 2.7 percent per year.<sup>82</sup> Compared with the developing countries, this rate seems high. Therefore, this high rate has created distortion in social life, and within the low income rates, people have looked for different job opportunities, which increased the size of the informal economy. It was argued that, "slow job creation in the public sector, and the inability of the formal private sector to absorb all surplus labor, combined with rapid population growth, produce a pool of workers who can find employment only in the country's expanding informal economy."<sup>83</sup>

Another important factor in this vein is the high rate of unemployed youth. The sanctions and post-conflict uncertainties created a great fall in economic income, thus severely damaged job opportunities paved the way for increasing the size of the informal economy.

Another dimension of the informal economy is institutional limitations and difficulties in transitional patterns.<sup>84</sup> There are several factors in this vein<sup>85</sup>:

- 1- Looking at the regime in Iraq, political liberalization has caused an increase in the informal economy,
- 2- After the overthrow of Saddam Hussein, free trade began to expand into daily life, and people's demands increased; this factor then increased the selling of imported products on the streets, which again expanded the size of the informal economy,

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<sup>81</sup> Document of the World Bank, "Rebuilding Iraq: Economic Reform and Transition," 5.

<sup>82</sup> International Monetary Fund, "Iraq: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding," September 24, 2004, <http://www.imf.org/External/NP/LOI/2004/irq/01/index.htm> (accessed September 7, 2008).

<sup>83</sup> Document of the World Bank, "Rebuilding Iraq: Economic Reform and Transition," 33.

<sup>84</sup> Looney, "Economic Consequences of Conflict: The Rise of Iraq's Informal Economy," 8.

<sup>85</sup> Ibid.

- 3- The lack of developments in the rule of law in Iraq is also another issue regarding this problem,
- 4- Another factor is the proliferation of inflation, which caused an increase in the size of informal economy in some parts of Iraq.

It is apparent that there are many dimensions affecting the size of the informal economy. However, the most important factor is the lack of control of corruption by the Iraqi government.

After the invasion, the lack of central authority also caused an increase of corruption in Iraq. This uncontrolled environment has paved the way for increasing the informal economy. Parallel to this, it was noted that, "The most critical factor affecting the size of the informal economy is no doubt the inability of the Iraqi government to control corruption. In addition, given the insurgency and uncertainty surrounding political developments, it is safe to say that large segments of the population have reverted to survival relationships."<sup>86</sup> In addition, an insecure environment has affected the benefits of oil production because of the violence. "According to the January 2007, Special Inspector General for Iraq Reconstruction (SIGIR) report, Iraq's petroleum sector faces technical challenges in procuring, transporting and storing crude and refined products, as well as managing pricing controls and imports, fighting smuggling and corruption, improving budget execution, and managing sustainability of operations."<sup>87</sup> However, it is difficult to accept that U.S decision makers have given great attention to this issue in terms of economic development plans. It was argued that, "While planning the reconstruction, US authorities did not conduct a survey of the country's capabilities and needs, and did not develop a strategically integrated national development plan for Iraq. It did not realistically plan to deal with the challenges posed by a state-run economy and corruption, what

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<sup>86</sup> Looney, "The Iraqi Impasse: Sustaining Economic Reconstruction During War-Time," 8.

<sup>87</sup> Anthony H. Cordesman, "Progress in Iraq: The December Report on Measuring Stability and Security in Iraq," *Center for Strategic and International Studies*, December 2007, 6, [http://www.csis.org/media/csis/pubs/071220\\_progress\\_in\\_iraq.pdf](http://www.csis.org/media/csis/pubs/071220_progress_in_iraq.pdf) (accessed July 12, 2008).

effectively had become a command kleptocracy.”<sup>88</sup> This clarifies that corruption is an important issue to be held at a strategic level, because the solution in this debate depends on long-term plans and other crucial factors such as security and legitimacy.

## **2. Deterioration in Social Capital**

One of the crucial factors affecting a country's social and economic situation is its quality of social capital. This phenomenon can be assumed in a kind of unwritten and intangible sense, which combines socio-politic relations within mutual support. According to the World Bank publications, “social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions. Increasing evidence shows that social cohesion is critical for societies to prosper economically and for development to be sustainable.”<sup>89</sup> In a broader context, social capital looks like a key element for many issues in terms of social, economic and political development. Thus, it is likely that this element gathers the ideas, demands, needs and capital of a country's citizens in a reciprocal manner, which refers to social interdependency.

In the economic dimension, social capital reveals itself as a prominent factor especially in transitioning countries. It was argued that social capital is assumed to be a social behavior based on trustworthiness, that relations among citizens of a country can pave the way for flourishing both economic and non-economic achievements in every facet of life.<sup>90</sup> Thus, strong social capital in a country results in a prosperous economy and highly motivated integrity. Social

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<sup>88</sup> Onur Ozlu, “Iraqi Economic Reconstruction and Development,” *Center for Strategic and International Studies*, April 2006, 1, <http://www.comw.org/warreport/fulltext/0604ozlu.pdf> (accessed July 9, 2008).

<sup>89</sup> The World Bank, “What is Social Capital,” [http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTTOSOCIALCAPITAL/0,,contentMDK:20185164~menuPK:418217~pagePK:148956~piPK:216618~theSitePK:401015,00.html#what\\_is\\_social\\_capital](http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTTOSOCIALCAPITAL/0,,contentMDK:20185164~menuPK:418217~pagePK:148956~piPK:216618~theSitePK:401015,00.html#what_is_social_capital) (accessed September 12, 2008).

<sup>90</sup> Social Capital Theory, *Theories Used in IS Research*, <http://www.istheory.yorku.ca/Socialcapitaltheory.htm>, (accessed September 11, 2008).

capital and trust can expedite the process of financial negotiations by serving better information, mutual coordination, and reciprocal profits, which strengthen social ties.<sup>91</sup> In scrutinizing this phenomenon in the Iraqi case, deteriorated socio-political ties and a skeptical milieu in the economic field, defined how social capital has been diminished and ignored by the coalition decision makers to a certain extent. Exemplifying this situation, it was argued that, “increased social capital has been linked to everything from a vibrant civil society, economic efficiency, reduced crime and poverty rates, higher educational achievement and better health.”<sup>92</sup> The fact that lies beneath the power of social capital is no doubt trust. However, the lack of trust in Iraq has exacerbated not only the economic development level, but it has escalated tension among different tribes, which in turn has revealed a proliferation of criminal activities and the informal sectors in the Iraqi economy. The lack of trust in any facet of life in Iraq created a vague atmosphere, and relations have weakened where corruption has prevailed in the central governance.

Actually, the prevalence of tribes in social life became dominant before the invasion of Iraq in 2003. When the sanctions began around the 1990s, the authority of the central government diminished; thus the Ba’ath regime decided to execute a survival policy that used tribes for local authority and supportive units.<sup>93</sup> When Saddam Hussein came in power, he used tribes for his ideology and political intentions. It was noted that, “under Saddam’s dictatorship, many of Iraq’s Sunni tribes enjoyed considerable perquisites and privileges that ensured at least some degree of loyalty to the regime. Many tribal shaykhs received payments, access to weaponry, and a blind eye from Baghdad to smuggling and

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<sup>91</sup> The World Bank, “The Role of Social Networks in Economic Action,” <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTSOCIALDEVELOPMENT/EXTTSOCIALCAPITAL/0,,contentMDK:20186616~isCURL:Y~menuPK:418214~pagePK:148956~piPK:216618~theSitePK:401015.00.html>, (accessed September 10, 2008).

<sup>92</sup> Christopher Scanlon, “The Problems with Social Capital,” July 19, 2003, <http://www.theage.com.au/articles/2003/07/18/1058035195873.html>, (accessed September 11, 2008).

<sup>93</sup> Looney, “The Iraqi Impasse: Sustaining Economic Reconstructions,” 17.

other illegal activities.”<sup>94</sup> It is apparent that this policy regarding the weak central authority shifted the roles of the tribes from local governance alone to illicit activities. In the same vein, it was argued that, “Saddam Hussein delegated more power and autonomy to tribes after the Gulf War in 1991 when he lost control of large sections of the country for them to supervise in exchange for more autonomy over tribal affairs.”<sup>95</sup> Thus, social deterioration has been witnessed because of incompetent security measures. Ignorant policies of the Ba’ath regime paved the way for criminal activities such as “looting, smuggling, and hijacking,”<sup>96</sup> and social relations became polarized in a hesitating manner.

These incorrect policies regarding the Iraqi population have shaped local networks far away from a strong social capital system. The lack of central authority combined with the poor policies of the coalition forces regarding the nation-state system, have increased the uncertainty of relations in the future, and caused a dramatic decrease in trust. It was noted that, “many discussions of the benefits of social capital frequently present increased economic efficiency and savings in health, education and law enforcement as the strongest argument for trusting one another.”<sup>97</sup>

The necessity of trust in social capital proves its importance where social and economic ties are damaged in a country. Since trust specifies the competence of social capital in many fields, the lack of trust cannot build a successful social capital chain. Thus, the quality of social capital can be used as a guide for recognizing the affordability and flexibility of a country’s current economic and social ties. Long-term plans and strategies can be improved according to those relations. However, it is difficult to see required achievements

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<sup>94</sup> Amalzia Baram, “The Iraqi Tribes and the Post –Saddam System,” *Brookings Institution*, (December 3, 2007): 3.

<sup>95</sup> Hussein D. Hassan, “Iraq: Tribal Structure, Social, and Political Activities,” *CRS Report for Congress*, March 2007, 3.

<sup>96</sup> Looney, “The Iraqi Impasse: Sustaining Economic Reconstructions,” 18.

<sup>97</sup> Christopher Scanlon, “The Problems with Social Capital”.



in Iraq regarding social capital. The way that U.S. decision makers have followed in this regard could not achieve tangible results where the consequences of the invasion increased social distrust and economic recession. Many studies in this vein epitomize that, and although foreign institutions have tried to strengthen social capital, they have a caused recession in social capital.<sup>98</sup> According to Joseph Kasper, who is a U.S. major in Iraq and focused on social capital issues criticized that, both the legacy of Saddam Hussein, in terms of his dichotomized policy in social capital, and increased turmoil after the 2003 U.S. invasion, diminished the level of trust among the Iraqi citizens.<sup>99</sup> He also continued that neither the Iraqi nor American decision makers' impatient behaviors matched the basics of social capital logic, where Iraqi citizens are given important positions not only at the decision-making level, but must also be the ones to carry them out, even though such assignments may take longer to complete.<sup>100</sup>

As noted above, trust is such a crucial factor for the prosperity of economic conditions where it supports mutual motivation regarding easy access for exchanging the productions or services in a reciprocal manner.<sup>101</sup> Thus, trust seems a likely advantage for social connection as it consolidates relationships and gives required notions for financial transactions in every facet of the economy.

Martin Raiser explains that in an economic transaction, there are three different relationships among the groups and these three cause the emergence of three different types of trust. The first one is related to family relations that refer to economic activities in existing economies and exemplify the main theme

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<sup>98</sup> Shankar Vedantam, "One Thing We Can't Build Alone in Iraq," *The Washington Post*, October 29, 2007, A03, [http://www.washingtonpost.com/wp-dyn/content/article/2007/10/28/AR2007102801477\\_pf.html](http://www.washingtonpost.com/wp-dyn/content/article/2007/10/28/AR2007102801477_pf.html), (accessed June 14, 2008).

<sup>99</sup> Ibid.

<sup>100</sup> Ibid.

<sup>101</sup> Looney, "The Iraqi Impasse: Sustaining Economic Reconstructions," 11.

of house economy, and it is called an 'ascribed trust'.<sup>102</sup> The second one refers to a kind of relationship called a 'process-based trust'; that people in this relationship have known each other for many years. Many business networks are described as having this kind of long-term relationship.<sup>103</sup> The third one refers to a kind relationship between individuals, who have little knowledge about the other side's typical features in economic transactions, called 'extended trust',<sup>104</sup> Among these three different types of trust, the last one has great importance, since economic transactions occur between large numbers of unrelated individuals and are a key factor for a contemporary economic system.

Focusing again on the Iraqi case, it is apparent that many Iraqi business networks are related to ascribed trust and those networks are restricted to the informal economy and surrounded by tribes, family relations and the same ethnic identities that work mostly with an unwritten agreement.<sup>105</sup> The functions of ascribed trust are very important to Iraqi citizens as they benefit mostly from the informal economy for their household income. Because formal sectors have been destroyed and because there is suffering due to uncontrolled corruption and lack of security, people trust the informal sectors to be the best choice for their income in the short term.

On the other hand, process-based trust plays an exacerbating role in terms of economic development in Iraq. Since this kind of trust includes long-term relationships between individuals, ties between former Ba'ath government members and the criminal groups that flourished during the sanctioned period of the 1990s, resemble the existence of this kind of trust.<sup>106</sup> Today, the insurgency and criminal gangs, and ties among those illicit activities characterize the

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<sup>102</sup> Martin Raiser, "Trust in Transition," *European Bank*, Work Paper no.39, (April 1999): 4.

<sup>103</sup> Ibid.

<sup>104</sup> Ibid.

<sup>105</sup> Looney, "The Iraqi Impasse: Sustaining Economic Reconstructions," 13.

<sup>106</sup> Ibid., 14.

existence of process-based trust in Iraq. Therefore, long-terms relations and the lack of a strong central control have paved the way for the process-based networks where the insurgency has been inflamed violently. The negative effects of process-based networks in the economic field can be explained in a few words:<sup>107</sup>

Damaged formal economy and proliferation of the informal sectors within the impact of vague borders among illicit activities, formal, and informal sectors;

blackmailing, kidnapping, looting, extortion and severe violence against innocent citizens to exploit their fear;

the legal or illegal utilization of trade in profitable natural resources;

increased decentralization in the financial and productive fields.

The last mentioned extended trust does not have the dominance it needs in the Iraqi economy. Although extended trust networks play a crucial role in contemporary economic systems, the dominance of the informal economy in Iraq does not bode well for the prospect of modern economic ties. There is no doubt that extended trust is a key factor for the Iraqi economy where plausible solutions can be executed within this kind of economic relations; however, the lack of financial support has limited modern economic occurrences, and intrusion of the informal sectors into the labor market dominate the ascribed-trust networks.<sup>108</sup> Without crucial implementations in the economic field, social capital will continue deteriorating due to the lack of modern economic tying systems.

### **3. The Insurgency and Criminal Gangs**

After the invasion in 2003, violence and turmoil increased in a devastating manner. Weak central authority and tribal loyalties exacerbated the level of violence. For the same reason, criminal activities have been a big obstacle, not only for building a new secular and democratic country, but also for

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<sup>107</sup> Looney, "The Iraqi Impasse: Sustaining Economic Reconstructions," 14.

<sup>108</sup> Ibid., 16.

improvements in the economic field.<sup>109</sup> Therefore, the insurgency and criminal gangs have plunged the Iraqi domestic market into recession and exacerbated the poor Iraqi economy. Parallel to this, it was noted that, “street crime has been a serious problem since the war ended. In the late summer of 2003, a World Bank assessment team reported that crime was among the top four obstacles to private-sector investment, along with poor access to finance, telecommunication problems and macroeconomic instability.”<sup>110</sup> In fact, there is a great connection among the informal economy, the insurgency and corruption. If a secure environment cannot be maintained, it is almost impossible to create job opportunities, which in turn will affect the economic improvement in the long run.

In the same vein, it was noted that there is a great relation between “...unemployment, poverty, deterioration of living standards, violence, and terrorist attacks.”<sup>111</sup> In this volatile environment, it is crucial to build and maintain a secure milieu, which can pave the way for further economic development programs. It was argued that rebuilding law and order would be an essential way to hinder violence and crime, which in turn will create a feeling of security in the workforce, and increase productivity.<sup>112</sup> On the other hand, it is a disappointing reality that insurgent groups have opportunities to conduct their attacks. It has been argued that, “...the insurgents often have excellent intelligence from sources within the Iraqi government, Iraqi forces, the Iraqis supporting Coalition forces and government activities, and Iraqi industry. This enables them to locate

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<sup>109</sup> Sabri Zire Al-Saadi, “Iraq’s National Vision, Economic Strategy, and Policies,” *Strategic Insights*, Volume V, Issue 3, (March 2006): 2, <http://www.ccc.nps.navy.mil/si/2006/Mar/saadiMar06.pdf> (accessed August 10, 2008).

<sup>110</sup> Christopher Foote and others, “Economic Policy and Prospects in Iraq,” 55-56.

<sup>111</sup> Al-Saadi, “Iraq’s National Vision, Economic Strategy, and Policies”.

<sup>112</sup> Rachel Bronson, “Transforming Iraq’s Economy,” *Council of Foreign Relations*, June 11, 2003, [http://www.cfr.org/publication/6041/transforming\\_iraqs\\_economy.html](http://www.cfr.org/publication/6041/transforming_iraqs_economy.html) (accessed August 12, 2008).

soft targets, hit at key points in terms of Iraq's economy and aid projects, and time their attacks to points of exceptional vulnerability."<sup>113</sup>

The insurgency is also a virulent action in terms of damaging the main income resource in Iraq, namely oil. Because of the lack of security and control over illegal groups, the economy has been affected in a frustrating manner. As it was reported, "damage to pipelines, fires, poor maintenance, and attacks have combined to slow production of refined products and crude oil for export, primarily in central and northern Iraq. Production and exports in the south remain the primary driving force of Iraq's economy, although aging infrastructure and maintenance problems impede near-term increases in production and exports."<sup>114</sup>

Robert Looney defined the important elements of the insurgency and criminal gangs in a collaborative manner. This model, named the Third Generation (3G2) Gang Model, exemplifies many different causes of criminal issues and illegal activities. In this model, parallel to the problems mentioned above, it was explained that because of a state's underdeveloped economic level, violence and crime networks cannot be impeded by this state where the economy cannot support security precautions.<sup>115</sup> That environment is now what is prominent in Iraq, and the lack of central authority does not seem to be able to cope with the insurgency and criminal gangs. In Iraq, the insurgency increased, especially after the collapse of the previous regime, and the main influence

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<sup>113</sup> Anthony H. Cordesman, "Iraq's Evolving Insurgency," *Center for Strategic and International Studies*, December 2005, 138, [http://www.csis.org/media/csis/pubs/051209\\_iraqiinsurg.pdf](http://www.csis.org/media/csis/pubs/051209_iraqiinsurg.pdf) (accessed June 9, 2008).

<sup>114</sup> Anthony H. Cordesman, "Iraq's Sectarian and Ethnic Violence," *Center for Strategic and International Studies*, April 2007, 92, [http://www.csis.org/media/csis/pubs/070402\\_iraq\\_spring.pdf](http://www.csis.org/media/csis/pubs/070402_iraq_spring.pdf) (accessed June 12, 2008).

<sup>115</sup> Looney, "The Iraqi Economy II: Economic Programs at the Local Level," 22.

shifted “from street to sub-national level.”<sup>116</sup> Corruption and inadequate state security policies caused an expansion of the gangs.<sup>117</sup>

This model separates criminal gang actions into three generations. The first generation includes classical street groups, which do not act as a major threat; their shape is far from an agile structure and they commit only occasional crimes.<sup>118</sup> The second generation includes major threat activities that have a relation with the insurgency; their structure is more seasoned and their financial supports come from the informal economy activities, such as ransom, illicit oil export and drugs.<sup>119</sup> The last generation is a major problem for a state’s security and regime. This third generation criminal group’s shape is highly seasoned and full of political goals.<sup>120</sup> They consist of government officials, who shifted to the illicit activities, and behave as a real government where they have the ability to serve the public.<sup>121</sup> So, criminal networks are revealed as a main impediment to security and the formal economy. Insurgents and criminal gangs have impeded not only security and social life, but also economic developments.

When criminal activities become dominant, it also affects the formal sectors of the economy.<sup>122</sup> This in turn, caused the jobless youth to choose to join criminal gangs that offer financial support with stealing and looting in Iraq.<sup>123</sup> Unfortunately, because of the proliferation of criminal activities and the insurgency, political and economic foundations were damaged, especially after the invasion in 2003. For example, “the prestigious Transparency International

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<sup>116</sup> Looney, “The Iraqi Economy II: Economic Programs at the Local Level,” 22.

<sup>117</sup> Ibid.

<sup>118</sup> Ibid.

<sup>119</sup> Ibid.

<sup>120</sup> Ibid.

<sup>121</sup> Ibid.

<sup>122</sup> Robert Looney, “The Business of Insurgency: The Expansion of Iraq’s Shadow Economy,” *The National Interest*, (Fall 2005): 1.

<sup>123</sup> Ibid.

Corporation ranks Iraq as the most corrupt country in the Middle East. The country's current ranking is 129<sup>th</sup> out of 145 nations worldwide, with the country's corruption actually worsening between 2003 and 2004."<sup>124</sup>

Because of instability, the lack of control over corruption, and the high rate of unemployment, violence and crime rates have increased in Iraq, especially after the overthrow of the Saddam regime. In this dangerous environment, police forces have not been able to cope with the turmoil created by insurgents and criminal gangs, and the worse thing is the unacceptable intentions of staff officials that join the government in order to steal the state's income.<sup>125</sup> This situation seems to be a catastrophic failure at the state level, where many implementation programs try to recover the damaged economy.

Since the oil is the most important income source in Iraq, it is plausible to expect some informal activities in terms of oil revenue. Because of the poverty and economic crisis, some dishonest officials make deals with criminal groups to purchase the oil at the official price level, and then to sell at higher prices on the black market.<sup>126</sup> Fortunately, government has taken some important precautions in this field, and "...has begun to clamp down on those officials and gas station owners who are allowing the gasoline to leak into the black market."<sup>127</sup> However, those precautions do not seem to be enough to cope with the current illicit oil trade. Since the invasion of Iraq in 2003, uncontrollable locations of this territory have increased dramatically. Thus, insurgents and criminal gangs have figured out a way to control many of the distribution points in Iraq, and exploited the differences between the official, subsidized market prices and much higher prices by exporting illicitly out of Iraq.<sup>128</sup> This is a typical way for insurgents to find

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<sup>124</sup> Looney, "The Business of Insurgency: The Expansion of Iraq's Shadow Economy," 2.

<sup>125</sup> Ibid.

<sup>126</sup> Ibid., 3.

<sup>127</sup> Ibid.

<sup>128</sup> Ibid.

financial support. More broadly, that situation not only increases their income, but also instigates the opposite groups against the invasion of Iraq. As a numeric result, it was noted that, “CPA officials estimated in early 2004 that smugglers were able to steal up to \$200,000 worth of oil every day.”<sup>129</sup>

There is a reciprocal linkage between insurgents and criminal gangs. Criminals generally work with insurgents, and they conduct their political will by kidnapping people, which reveals a “street-level hostage economy.”<sup>130</sup> When insurgents kidnap people, they give them to criminal gangs for money, and gangs sell them back to the insurgent groups when the situation becomes available.<sup>131</sup> A worrisome consequence of criminal activities is that insurgents target highly educated citizens. This in turn, affects the development of the economy in a devastating manner. When insurgents kidnap the scholars, doctors, and businesspersons, this turmoil results in an abandonment of the country by the others where the formal economy is so terribly damaged.<sup>132</sup> Again, living with fear and suspicion erodes the possible grounds for the formal sectors, and the informal economy remains alive by these illicit activities.

Related to the security issue, in July 2008, the Congressional Research Service report pointed out the importance of security, that exemplified the devastating results of insurgent activities in this manner. It was explained that, rebuilding projects and current infrastructures have been demolished by the attacks of insurgents.<sup>133</sup> For example,

...in June 2007, eight of the twelve 400-kV transmission lines were out of service, greatly reducing the electricity supply to Baghdad. Major pipelines continue to be sabotaged, shutting down oil exports. Along with criminal activity and poor equipment, insurgent

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<sup>129</sup> Looney, “The Business of Insurgency: The Expansion of Iraq’s Shadow Economy,” 3.

<sup>130</sup> *Ibid.*, 4.

<sup>131</sup> *Ibid.*

<sup>132</sup> *Ibid.*

<sup>133</sup> Curt Tarnoff, “Iraq: Reconstruction Assistance,” *CRS Report for Congress*, May 22, 2008, 30, [http://assets.opencrs.com/rpts/RL31833\\_20080522.pdf](http://assets.opencrs.com/rpts/RL31833_20080522.pdf) (accessed July 10, 2008).



attacks are estimated to be responsible for the loss of \$16 billion in oil revenue during a two year period from 2005-2006.<sup>134</sup>

Thus, it is apparent that spending money on reconstruction projects has become futile, and rebuilding costs have increased dramatically because of the lack of security and required precautions. For example, “a 2006 SIGIR survey of major U.S. contractors found security costs to range from a low of 7.6% to a high of 16.7%. Unanticipated security costs as well as the related need to shift \$1.8 billion from water and power projects to the training and equipping of Iraqi forces has meant that infrastructure programs could accomplish less than originally anticipated.”<sup>135</sup>

In the same vein, money spent by coalition forces could not be fruitful regarding security and reconstruction efforts, and many expenditures have been wasted. In his occasional paper, Joseph J. Collins criticized the current situation and pointed out that, although many millions have been spent, oil and electricity production is not at the expected level, and capacity is limited in order to execute the rebuilding processes.<sup>136</sup> The main causes lie under the lack of security and instability. Moreover, the effects of corruption and incompetence have weakened the economic situation so that stabilization efforts have not done well in terms of economic development. It was noted that, “according to a 2007 U.S. Government report, after the United States spent nearly \$6 billion and completed nearly 3,000 reconstruction projects, the new government of Iraq has agreed to take possession of just 435 of them, worth only half a billion dollars. The rest remain idle or have been turned over to weak local governments.”<sup>137</sup> It reveals that economic developments play a vast role in every facet of life, especially where

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<sup>134</sup> Tarnoff, “Iraq: Reconstruction Assistance,” May 22, 2008, 30.

<sup>135</sup> *Ibid.*, 28-29.

<sup>136</sup> Joseph J. Collins, “Choosing War: The Decision to Invade Iraq and it’s Aftermath,” *Institute for National Strategic Studies, Occasional Paper 5*, (April 2008): 15.

<sup>137</sup> *Ibid.*

turmoil and criminal activities prevail. Since these weak governments remain for some time, impeding local crimes and the insurgency have become extremely difficult.

Criticizing the policies executed in Iraq, some errors reveal themselves to be a problem with security issues, which Washington explained as deficiencies. They are: the Incompetence of the military to stop plundering and violence encouraged the insurgents and criminal gangs; the lack of security forces to maintain stability in Iraq paved the way for criminal groups and their purposes; and troublesome financing and agreement systems, which diminished the rebuilding and development projects, have become a benefit for insurgents.<sup>138</sup> More to the point, these problems have caused a brain drain, and many people with average incomes have disappeared.<sup>139</sup> This situation affected the social life in Iraq negatively, and the morality of the citizens was destroyed because of the incompetence of security forces on the ongoing illicit occurrences by insurgents. Furthermore, although it has been four years since the insurgency, it was stated that, "...the United States still does not have the ground troops in its base force to support the kind of troop rotations and in-country force levels necessary to create an appropriate level of security that, in turn, could help to move us in the direction of political success in the insurgency."<sup>140</sup>

A survey by the Brookings Institution epitomizes the current situation in Iraq regarding security and stability among developing countries. The following table shows the weakness of the states according to some aspects. Iraq, in this vein, exemplifies a low grade in security and political stability because of the existing insurgency, and uncontrolled territory by central governance.<sup>141</sup> Moreover, Iraq is at the fourth level among the worst countries in the economic

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<sup>138</sup> Collins, "Choosing War: The Decision to Invade Iraq and it's Aftermath," 16.

<sup>139</sup> *Ibid.*, 20.

<sup>140</sup> *Ibid.*, 23.

<sup>141</sup> Susan E. Rice and Stewart Patrick, "Index of State Weakness in the Developing World," *Brookings Global Economy and Development, The Brookings Institution*, (2008): 15.

arena, the lack of rule of law and incompetent security measures, which exacerbate human right abuses. Merging these three factors, the insurgency plays a provocative role in every facet of problematic areas.

	ECONOMIC BASKET	GNI PER CAPITA	GDP GROWTH	INCOME INEQUALITY	INFLATION	REGULATORY QUALITY
ECONOMIC	1. Somalia (#1) 2. North Korea (#15) 3. Zimbabwe (#8) 4. Iraq (#4) 5. Eritrea (#14)	1. Burundi (#5) 2. Dem. Rep. of Congo (#3) 3. Liberia (#9) 4. Malawi (#46) 5. Ethiopia (#19)	1. Zimbabwe (#8) 2. East Timor (#43) 3. Liberia (#9) 4. Micronesia (#103) 5. Seychelles (#126)	1. Namibia (#82) 2. Lesotho (#53) 3. Central African Republic (#7) 4. Botswana (#102) 5. Bolivia (#64)	1. Zimbabwe (#8) 2. Angola (#11) 3. Burma (#17) 4. Guinea (#23) 5. Eritrea (#14)	1. Somalia (#1) 2. North Korea (#15) 3. Burma (#17) 4. Zimbabwe (#8) 5. Turkmenistan (#35)
POLITICAL	POLITICAL BASKET	GOVERNMENT EFFECTIVENESS	RULE OF LAW	VOICE & ACCOUNTABILITY	CONTROL OF CORRUPTION	FREEDOM
	1. Somalia (#1) 2. Burma (#17) 3. North Korea (#15) 4. Turkmenistan (#35) 5. Zimbabwe (#8)	1. Somalia (#1) 2. North Korea (#15) 3. Comoros (#31) 4. Iraq (#4) 5. Dem. Rep. of the Congo (#3)	1. Somalia (#1) 2. Afghanistan (#2) 3. Iraq (#4) 4. Zimbabwe (#8) 5. Dem. Rep. of the Congo (#3)	1. Burma (#17) 2. North Korea (#15) 3. Somalia (#1) 4. Turkmenistan (#35) 5. Libya (#86)	1. Somalia (#1) 2. North Korea (#15) 3. Burma (#17) 4. Equatorial Guinea (#25) 5. Afghanistan (#2)	Somalia (#1)* North Korea (#15)* Burma (#17)* Turkmenistan (#35)* Uzbekistan (#36)* Libya (#86)* Syria (#59)* Cuba (#62)*
SECURITY	SECURITY BASKET	CONFLICT INTENSITY	GROSS HUMAN RIGHTS ABUSES	TERRITORY AFFECTED BY CONFLICT	INCIDENCE OF COUPS	POLITICAL STABILITY & ABSENCE OF VIOLENCE
	1. Afghanistan (#2) 2. Dem. Rep. of Congo (#3) 3. Somalia (#1) 4. Sudan (#6) 5. Iraq (#4)	1. Sudan (#6) 2. Somalia (#1) 3. Sri Lanka (#56) 4. Dem. Rep. of Congo (#3) 5. Afghanistan (#2)	1. Sudan (#6) † 1. Iraq (#4) † 2. Dem. Rep. of the Congo (#3) † 2. Colombia (#47) † 3. Afghanistan (#2)	1. Colombia (#47) 2. Afghanistan (#2) 3. Somalia (#1) 4. Nepal (#22) 5. Dem. Rep. of Congo (#3)	1. Fiji (#76) 2. Thailand (#79) 3. Guinea-Bissau (#18) 4. Mauritania (#37) 5. Sao Tome & Principe (#61)	1. Iraq (#4) 2. Somalia (#1) 3. Dem. Rep. of Congo (#3) 4. Afghanistan (#2) 5. Nepal (#22)
SOCIAL WELFARE	SOCIAL WELFARE BASKET	CHILD MORTALITY	ACCESS TO CLEAN WATER AND IMPROVED SANITATION	UNDER- NOURISHMENT	PRIMARY SCHOOL COMPLETION	LIFE EXPECTANCY
	1. Afghanistan (#2) 2. Dem. Rep. of Congo (#3) 3. Somalia (#1) 4. Sierra Leone (#13) 5. Niger (#21)	1. Sierra Leone (#13) 2. Angola (#11) 3. Afghanistan (#2) 4. Niger (#21) 5. Liberia (#9)	1. Ethiopia (#19) 2. Chad (#16) 3. Somalia (#1) 4. Niger (#21) 5. Guinea (#23)	1. Eritrea (#14) 2. Dem. Rep. of Congo (#3) 3. Burundi (#5) 4. Comoros (#31) 5. Tajikistan (#42)	1. Central African Republic (#7) 2. Guinea-Bissau (#18) 3. Niger (#21) 4. Burkina Faso (#44) 5. Chad (#16)	1. Botswana (#102) 2. Lesotho (#53) 3. Zimbabwe (#8) 4. Zambia (#32) 5. Central African Republic (#7)

Note: Number in parenthesis indicates each country's overall rank.  
 \*The countries marked with an asterisk all received the lowest possible score on the Freedom House indicator.  
 †For Gross Human Rights Abuses, Sudan and Iraq both received the worst score; Dem. Rep. of Congo and Columbia both received the second lowest score.

Table 2. Worst Performers by Basket and by Individual Indicator <sup>142</sup>

A recent specific research by the Center for Strategic and International Studies (CSIS) shows that in four provinces—Baghdad, Salah ad Din, Ninewa, and Diyala—the violence remains very high, but overall this is a general

<sup>142</sup> Rice and Patrick, "Index of State Weakness in the Developing World," 15.

catastrophic problem in Iraq.<sup>143</sup> Violence occurs because of the lack of security, and crime rate increases where turmoil is prevailing, which in turn has a link with insurgency.

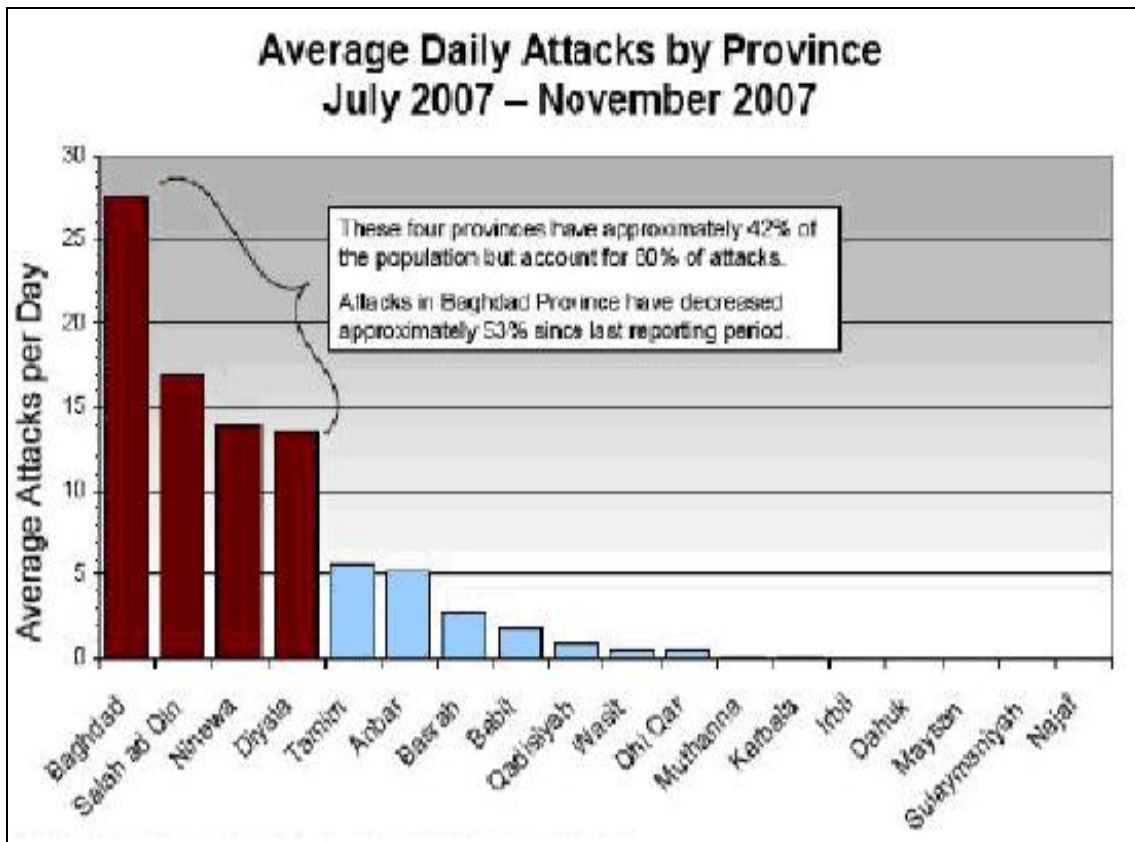


Figure 2. Average Daily Attacks by Province (July 2007-November 2007)<sup>144</sup>

<sup>143</sup> Anthony H. Cordesman, "Creating a Stable and Secure Iraqracy, The Continuing Need for Strategic Patience," *The Center for Strategic and International Studies*, February 2008, 7, [http://www.csis.org/media/csis/pubs/080213\\_situationiniraq.pdf](http://www.csis.org/media/csis/pubs/080213_situationiniraq.pdf) (accessed July 24, 2008).

<sup>144</sup> Cordesman, "Creating a Stable and Secure Iraqracy, The Continuing Need for Strategic Patience," 8.

### **III. LOOKING TO THE FUTURE**

In the previous chapter, some of the general problems, and more broadly, three neglected issues—the informal economy, deterioration in social capital, and the insurgency and criminal gangs—were scrutinized in a comparative manner. From the invasion of Iraq in 2003 to date, several solutions have been attempted to reach a prosperous economic level in Iraq. However, it is not possible to say that all the executed policies regarding economic prosperity have met with good results. Since it has been more than five years after the invasion in 2003, decision makers had some experiences that can make the current situation better in Iraq. In the following chapter, some of the lessons learned will be discussed, and then possible strategies for the future will be explained.

#### **A. LESSONS LEARNED**

Several lessons have been revealed regarding economic poverty in Iraq. Because of the volatile demographic shape of Iraq, turmoil within local groups caused big obstacles to economic development strategies. For example, because of plundering and attacks conducted by insurgents, many of the Coalition's improvement projects failed, which in turn affected the long term policies for prosperity.<sup>145</sup> When these projects were not accomplished, it created a lack of trust and social demoralization in the public eye. It was not only security issues, but also some wrong policies that affected the situation in Iraq. The lack of prioritization in critical sectors by the Coalition Provisional Authority (CPA) resulted in unsuccessful plans such as ignoring agricultural improvement and shifting required funding to electricity reconstruction projects.<sup>146</sup> This situation caused the agricultural sector to falter, and lots of job opportunities were lost.

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<sup>145</sup> Looney, "Impediment to Stability in Iraq: The Illusive Economic Dimension," 29.

<sup>146</sup> Ibid.

Many projects were postponed and became futile when complicated acquisition processes caused long delays by U.S government.<sup>147</sup>

There are more experiences in terms of rebuilding the Iraqi economy, and implementing better projects for the future. However, it is important to criticize the CPA's misconceptions on this issue. When a country is invaded by another country to fix its social, political, economical and military problems, firstly, the planned projects should be executed reciprocally with the indigenous citizens of this invaded country. Otherwise, neither side can compromise, and then many planned projects can fail. Looking back on the situation in Iraq, in order to execute rebuilding projects in a quick time, the CPA usually ignored Iraqi decision makers and the voice of indigenous citizens; moreover, those Iraqi citizens' interpretations were not evaluated in the decision-making process.<sup>148</sup> Many efforts could not reach success as expected; time and money were often wasted. What's more, the CPA's expectations for the future were far from rational. When a project is planned, the problems should be handled in a realistic manner, and different points of view should be gathered for a better evaluation of the problems. In this point, the CPA's quick solution propositions for the problems in order to rebuild the country to the prewar level failed, and Iraqi citizens witnessed these unsuccessful attempts, which were worrisome for their future.<sup>149</sup>

While focusing on the reconstruction projects for a prosperous economy, environmental factors such as security should be carefully considered. In order to build and maintain a viable economy, a stabilized and secure environment should be maintained. Otherwise, the efforts for economic development can and will be damaged by the effects of the insurgency and criminal groups, which were explained in the previous chapter. When the CPA focused on the economic reconstruction projects, it ignored the security issues, which have priority in this

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<sup>147</sup> Looney, "Impediment to Stability in Iraq: The Illusive Economic Dimension," 29.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid., 29-30.

realm, and those neglected issues caused a big delay in economic reconstruction efforts.<sup>150</sup> The main reason for this delay was the increasing crime rates, and the lack of trust, which created fear and disturbance in Iraqi citizens' minds. In this respect, the Special Inspector General for Iraq Reconstruction (SIGIR) audit reports identified the main results of the incapable security forces in Iraq:

- Over \$104.1 million was spent in an unsuccessful attempt to train Iraqi security forces to protect critical infrastructures.
- The United States had to adjust its priorities and reallocate over \$1.78 billion in IRRF reconstruction funds to provide for security and law enforcement programs.
- About \$560 million was wasted because construction efforts were sabotaged and had to be rebuilt and were delayed.
- Government officials were precluded from performing their quality control functions.
- Provincial Reconstruction Teams were often unable to have face-to-face contacts with local officials, a critical objective of the program.<sup>151</sup>

In order to maintain a prosperous economy, it is crucial to make a connection between today's urgent demands and long-term expectations. Without solving the current economic problems, future plans are not likely to create a better economy, and many efforts may become futile. In the Iraqi case, although the Coalition achieved some economic reconstruction in the short term, the CPA could not maintain its continuation in the long run, such as "restoring state-owned enterprises, creating sustainable jobs, and promoting private sector growth"<sup>152</sup>, and this caused stagnation and aggravation in the development process.<sup>153</sup>

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<sup>150</sup> Looney, "Impediment to Stability in Iraq: The Illusive Economic Dimension," 30.

<sup>151</sup> Office of the Special Inspector General for Iraq Reconstruction, *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 4, <http://www.sigir.mil/reports/pdf/audits/08-020.pdf> (accessed August 31, 2008).

<sup>152</sup> *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 4.

<sup>153</sup> Ibid.

An effective banking system is one of the main points for a better economy. However, to maintaining a secure environment, developments in oil revenue, and finding solutions for debt problems have great importance in the banking system.<sup>154</sup> Because of the insurgency and criminal groups and the growing informal economy, which negatively affect the oil sector, there are serious impediments to a stable and strong banking system in Iraq. Thus, there should be a good linkage between the Coalition and local Iraqi decision makers in that sense. However, it does not seem that there is good collaboration in Iraq between the CPA and the Iraqi delegates that could lead to a suitable agreement for Iraqi citizens.<sup>155</sup> This situation affects the social deterioration and well as the expectations of the Iraqi people for prosperity. It has been argued that, "Islamic banking, one of the most rapidly growing areas of finance in the Middle East, is not even mentioned in the voluminous documents and directives released by the CPA."<sup>156</sup> Therefore, this gap between the institutions caused uncertainty among the local Iraqi citizens in terms of viable reconstruction efforts. The lack of a strong and functional banking system affects foreign investors and entrepreneurs, and foreign banking companies in a skeptical manner, which in turn impedes the privatization and development steps of economic reconstruction.

One misperception made by the CPA was the amount of dependence on market forces, especially in an insecure area where turmoil is prevalent.<sup>157</sup> Actually, the CPA was expecting that market reforming and privatization of investments would support the rebuilding projects; however, the lack of security, and emerging criminal gangs and violence within a vague environment caused

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<sup>154</sup> Robert Looney, "Postwar Iraq's Financial System: Building from Scratch," *Middle East Policy*, Vol. XII, no.1, (Spring 2005): 147.

<sup>155</sup> Ibid.

<sup>156</sup> Ibid.

<sup>157</sup> Looney, "Impediment to Stability in Iraq: The Illusive Economic Dimension," 30.



diminishing rebuilding efforts.<sup>158</sup> This consequence reveals that when a project is focused on, the other factors, which may affect this project should be evaluated, such as environment, security, social structure, economic level, and local people's views. In this sense, the privatization of investments could be stalled until a reliable and stable atmosphere have occurred in Iraq.

In order to maintain high economic reconstruction efforts, it is crucial to decentralize the central government's power when engendering this reconstruction by local Iraqi people.<sup>159</sup> Because Iraq is trying to transfer to a stable environment from violence and turmoil, it would be plausible to decentralize the government to expedite the economic recovery. At this point, it is argued that, "...the CPA was unsuccessful in overcoming ministries' opposition securing funding for local authorities and Iraqi citizens to participate directly in the reconstruction process."<sup>160</sup>

One of the disappointing experiences regarding the open economy was the initiation of a neo-liberal approach by the CPA, which aimed to execute "free market reforms"<sup>161</sup> in order to increase the level of the economy in Iraq in the short term.<sup>162</sup> However, the post-conflict environment and uncertainties in Iraq did not match the neo-liberal approach. Because of the increasing insurgency and escalation among the tribal groups, privatization efforts for investment sectors and the recovery of economic initiatives have been impeded.<sup>163</sup> There are several key reasons why the neo-liberal strategy was not suitable for Iraq:

- Neo-liberal strategy restricts the bulk of the population from making decisions, so this creates a big gap among the institutions;

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<sup>158</sup> Looney, "Impediment to Stability in Iraq: The Illusive Economic Dimension," 30.

<sup>159</sup> Ibid.

<sup>160</sup> Ibid.

<sup>161</sup> Robert Looney, "Socio-Economic Strategies to Counter Extremism in Iraq," *Journal of South Asian and Middle East Studies*, Vol. XXIX, no. 2, (Winter 2006): 25.

<sup>162</sup> Ibid.

<sup>163</sup> "Socio-Economic Strategies to Counter Extremism in Iraq," 25.

- Although the neo-liberal strategy paves the way for lots of opportunities for the private sectors, in the Iraqi case, it does not seem likely to create prosperous results because of the prevalence of uncertainty in social and economic life, as well as the insurgency;
- Because of the fragile shape of the Iraqi economy after the conflict, a neo-liberal strategy does not fit this weak economic structure when an economic situation goes wrong, so before expected market reforms, strong institutions should be built and an affordable economic ground should be created;
- Because a neo-liberal strategy does not allow the central government to intervene in the Iraqi economy, this situation creates a highly uncertain environment within the increasingly unstable markets where the government is unable to handle the troubles and economic crises;
- One of the intentions of the reconstruction efforts was the dichotomization of the institutions connected to the previous regime, however, neo-liberal policies were incapable of executing institutional evolvement projects, so criminal gangs, insurgents and religious-based groups filled the resulting gaps;
- Finally new policies for a neo-liberal strategy paved the way for increasing extremism, the recruiting of young Iraqi people, and uncertainty; moreover, this uncertainty was engendered by “threats of mass privatization and high unemployment rates”<sup>164</sup>, and the government’s lack of response to economic reforms were exploited by radical groups.<sup>165</sup>

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<sup>164</sup> Looney, “Socio-Economic Strategies to Counter Extremism in Iraq,” 29.

<sup>165</sup> Ibid., 26-28.

It should be noted that time and money are crucial keys for the economic reconstruction process for any country. In the Iraqi case, it is apparent that funds allocated for reconstruction were sometimes wasted because of the inappropriate policies of the CPA.<sup>166</sup> The CPA has made mistakes regarding controlling allocated funds. In the Congress Report for Iraqi Reconstruction Assistance in August 2008 some solid examples were given:

A January 2005 SIGIR audit found that the CPA 'provided less than adequate controls' for \$8.8 billion of DFI resources it moved through Iraqi ministries. An April 2005 audit concluded that CPA managers of DFI funds distributed in the South-Central region of Iraq could not account for more than \$96.6 million in cash and receipts. An October 2005 audit found that South-Central personnel could not account for more than \$20.5 million in Rapid Regional Response Program funds and made \$2.6 million in excessive payments. In late 2005, several U.S. citizens were criminally charged with respect to the handling of these funds — and have since pled guilty. In February 2007, five more were indicted.<sup>167</sup>

These frustrating examples reveal that lots of funds created illicit activities, and the lack of trust became prevalent in the country. Mismanagement and wrong policies in reconstruction programs regarding U.S. funding exacerbated the current situation in Iraq, and increased the number of crimes.<sup>168</sup>

As noted in the previous chapter, the lack of adequate security in Iraq impeded many planned activities in the execution phase. In terms of producing reports for the news and having the outcomes of the current situation be in different provinces of Iraq, the media and related groups could not achieve what they had aimed for.<sup>169</sup> Therefore, local security measures in many provinces were weak, and mismanagement in security issues that handled the Coalition Forces caused those impediments; moreover, those precautions could not

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<sup>166</sup> Curt Tarnoff, "CRS Report for Congress Iraq: Reconstruction Assistance," *Congressional Research Service*, August 2008, 30, [http://assets.opencrs.com/rpts/RL31833\\_20080820.pdf](http://assets.opencrs.com/rpts/RL31833_20080820.pdf) (accessed September 30, 2008).

<sup>167</sup> *Ibid.*, 34-35.

<sup>168</sup> *Ibid.*, 31.

<sup>169</sup> Tarnoff, "CRS Report for Congress Iraq: Reconstruction Assistance," August 2008, 34.

alleviate the insurgency and turmoil. This atmosphere precluded successful assessments of the SIGIR in many ways. It was noted that, “the SIGIR conducted some assessments by aerial imagery because of the risk to its personnel; while investigating for its April 2008 report on the Nassriya Water Treatment Plant, on-site inspections were limited to 30 minutes each.”<sup>170</sup> Parallel to this, the Government Accountability Office (GAO) investigators could not come to Iraq when they were it was preparing water and sanitation program reports for 2005, because of the lack of a stable environment.<sup>171</sup>

In the August 2008 Congress Report, criticisms of the Iraqi Reconstruction were noted for the years between 2003 and 2006. In security issues, the main lesson learned was the CPA’s failure to figure out the main requirements of a secure environment, and its hasty decision to eliminate the Iraqi military forces at an inappropriate time.<sup>172</sup> As noted in the previous chapter, those wrong decisions could not have alleviated the increasing violence, and many of the Iraqi military members shifted to the illicit activities, which in turn proliferated the rate of the insurgency, and created uncertainty regarding the social trust. Moreover, the unemployment rate became high and people looked for alternative income sources, which increased the informal economy within five years. In addition, the lack of adequate security measures undermined many beneficial projects in the execution phase, increased the required funds because of long delays in those projects, which caused a shift of the allocated money from other projects, and damaged foreign investment with the indigenous participation that would have resulted in projects that are more successful.<sup>173</sup>

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<sup>170</sup> Tarnoff, “CRS Report for Congress Iraq: Reconstruction Assistance,” August 2008, 34.

<sup>171</sup> *Ibid.*, 35.

<sup>172</sup> Curt Tarnoff, “CRS Report for Congress Iraq: Reconstruction Assistance,” May 2008.

<sup>173</sup> *Ibid.*

The current rebuilding strategy has focused on “market reforms, infrastructure development and private foreign investment,”<sup>174</sup> instead of creating trust among the institutions, which would accelerate the downfall of social capital in Iraq. Thus, many funds for inappropriate investments have been squandered because they were easy targets for insurgents and criminal gangs.<sup>175</sup> In addition, the post-war strategy has not given satisfactory participation to the indigenous Iraqi people regarding building trust and improving social relations among the foreign and domestic markets.<sup>176</sup> Thus, the economic development process did not have the expected result and the local people are concerned about whether or not their future will be better. Without engendering social trust among the institutions, and building connections between foreign and local institutions, crucial changes in an economic realm cannot be obtained.

Finally, the economic development process has been greatly affected by increasing the informal economy in Iraq. As noted in the previous chapter, the main cause of the informal economy is uncontrolled corruption. Oil revenues have played a vast role in this sense, because people of different regions do not trust each other for a fair allocation of income from oil.<sup>177</sup> A good lesson from this is that a direct and fair distribution of oil revenues could diminish this problem regarding rebuilding trust networks among the different ethnic groups. However, the lack of control over the distribution of oil revenues and other economic activities have paved the way for the increasing informal economy in Iraq. Because the local people were skeptical about the prospect of their country in terms of their economic and social lives, they thought that the informal economy would be a good remedy for their future. In addition, uncontrolled corruption

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<sup>174</sup> Robert Looney, “Reconstruction and Peacebuilding Under Extreme Adversity: The Problem of Pervasive Corruption in Iraq,” *International Peacekeeping* (June 2008): 437.

<sup>175</sup> Ibid.

<sup>176</sup> Ibid.

<sup>177</sup> Ibid.

supported the informal economy where local security management could not be established by the Coalition Forces and the Iraqi Military personnel in a reciprocal manner.

## **B. STRATEGIES AT THE LOCAL LEVEL**

After the invasion of Iraq in 2003, the Coalition forces decided to implement economic reforms regarding reconstruction principles. However, it was difficult to execute those remedies where the environment was vague and uncertainty has been prevailing in every facet of economic structure. When May 2003 came, it was the end of active combat operations in Iraq, and the tangible economic reconstruction efforts began to be initiated by the U.S. Congress.<sup>178</sup> In this regard, the following funds were established in order to execute strategies at the local level and create a prosperous economy. But, Microfinance Institutions (MFI), The Commanders Emergency Response Programs (CERP), and The Provisional Reconstruction Team (PRT) played a vast role regarding the aforementioned three neglected issues—the informal economy, the insurgency, and damage in social capital—in all those funds. The following table epitomizes a general view of the allocated appropriation:

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<sup>178</sup> *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 1.

<b>Fund Name</b>	<b>Fund Acronym</b>	<b>Appropriation (Billions)</b>
Iraq Relief and Reconstruction Fund	IRRF	\$20.86
Iraq Security Force Fund	ISFF	\$17.94
Economic Support Fund	ESF	\$ 3.74
Commander's Emergency Response Program	CERP	\$ 3.49
Other Funding		\$ 4.43
<b>Total</b>		<b>\$50.46</b>

Table 3. Appropriated Funds<sup>179</sup>

### 1. Iraq Relief and Reconstruction Fund (IRRF)

For the initial reconstruction, the U.S Congress allocated \$3.34 billion,<sup>180</sup> and \$2.47 billion of this amount released under Public Law 108-11 “for necessary expenses for humanitarian assistance in and around Iraq and to carry out the purposes of the Foreign Assistance Act of 1961 for rehabilitation and reconstruction in Iraq,”<sup>181</sup> which was defined as the Iraq Relief and Reconstruction Fund (IRRF).<sup>182</sup> The purpose of this fund was to assist the planners of the Coalition Forces and the local Iraqi governance for upcoming “humanitarian crisis in the aftermath of the Operation of Iraqi Freedom.”<sup>183</sup> In order to get better results, \$18.439 billion were allocated for the same purposes

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<sup>179</sup> Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts, July 2008, 2.

<sup>180</sup> Ibid.

<sup>181</sup> Office of the Special Inspector General for Iraq Reconstruction, *Fact Sheet on the Roles and Responsibilities of U.S. Government Organizations Conducting IRRF-Funded Reconstruction Activities*, July 2007, 2, <http://www.sigir.mil/reports/pdf/audits/07-008.pdf> (accessed August 26, 2008).

<sup>182</sup> Ibid.

<sup>183</sup> Ibid.

under the same public law (108-11), which is defined as IRRF2.<sup>184</sup> Those funds include both construction projects, such as “security and law enforcement, justice, electricity, oil infrastructure, water resources and sanitation, transportation and telecommunication, roads, bridges and construction, healthcare, private sector development, education, democracy,<sup>185</sup> and on the other hand, include requirements such as “...equipment, supplies and training.”<sup>186</sup>

## 2. Iraq Security Force Fund

This fund was built in May 2005 in order to give permission to the Multi-National Security Transition Command-Iraq to supply financial support for improving Iraqi security forces’ development.<sup>187</sup> As shown in Table III, according to the SIGIR July 2008 report, \$17.94 billion were allocated to increase the level of Iraqi security forces. These forces included the Iraqi Army, Navy, and Air Force under the Ministry of Defense, and the Iraqi Police, the National Police, and the Border Enforcement under the Ministry of Interior.<sup>188</sup> Maybe not directly, but this fund can play an alternative role regarding the precautions for the insurgency and criminal gangs when Iraqi security forces become centralized and well trained.

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<sup>184</sup> Office of the Special Inspector General for Iraq Reconstruction, *Fact Sheet on the Roles and Responsibilities of U.S. Government Organizations Conducting IRRF-Funded Reconstruction Activities*, July 2007, 2, <http://www.sigir.mil/reports/pdf/audits/07-008.pdf> (accessed August 26, 2008).

<sup>185</sup> *Ibid.*, 3.

<sup>186</sup> *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 2.

<sup>187</sup> *Ibid.*

<sup>188</sup> United States Government Accountability Office (GAO), Report to Congressional Committees, *Stabilizing Iraq: DOD Cannot Ensure That U.S.-Funded Equipment Has Reached Iraqi Security Forces*, July 2007, 4, <http://www.gao.gov/new.items/d07711.pdf> (accessed October 21, 2008).



### **3. Economic Support Fund**

Actually, after the elections in 2005, the resentments among the institutions in Iraq were not alleviated because of their renewed positions in governmental structure.<sup>189</sup> Under the Foreign Assistance Act, the Economic Support Fund (ESF) was established.<sup>190</sup> This fund is required to strengthen the security level of Iraq and assist in Iraq's transition process to become a viable country.<sup>191</sup> The ESF program executes some "governance reforms at the local, provincial, and national-levels of government and strengthening Iraq's private sector economy."<sup>192</sup> In addition, this program focuses on maintaining stabilization among the important cities of Iraq regarding the prosperity of economy and engendering job opportunities.<sup>193</sup> Thus, relating to the problems in the previous chapter, this fund can be a beneficial remedy to diminish the informal economy and the insurgency. As shown in Table III, \$3.74 billion was allocated for this program. Especially in the strategic cities of Iraq, within this appropriation, local stability can expedite the improvement process and the insurgents and criminal gangs can be weakened.

### **4. Microfinance Institutions**

One of the crucial institutions playing a vast role in the economic development of Iraq is the establishment of Microfinance Institutions (MFI). Combined with the legacy of Saddam Hussein, the aftermath of the 2003 invasion in Iraq, the necessity of these foundations to support small enterprises became apparent. Began in 2003, the foundation of microfinance institutions

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<sup>189</sup> Kenneth Katzman, "Iraq: Reconciliation and Benchmarks," *CRS Report for Congress, Congressional Research Service-The Library of Congress*, August 2008, 3, <http://fpc.state.gov/documents/organization/108305.pdf> (accessed October 2, 2008).

<sup>190</sup> *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 2.

<sup>191</sup> USAID From The People, *Economic Support Fund*, 2, <http://www.usaid.gov/policy/budget/cbj2009/101425.pdf> (accessed October 2, 2008).

<sup>192</sup> *Ibid.*

<sup>193</sup> *Ibid.*

have successfully supplied leverage in terms of economic development.<sup>194</sup> Moreover, this support by microfinance institutions has been a remedy for impeding the proliferation of recruits for the insurgency and criminal gangs. Because the lack of job opportunities is a critical factor for young and discontent individuals to join those illegal groups, microfinance institutions increased this opportunity. Microfinance has been financially assisted and enlarged by the U.S. State Department within the Iraq Reconstruction Management Office, the United States Agency for International Department (USAID), and by the US/Multinational military.<sup>195</sup> It is difficult to create job opportunities where uncertainty, insecure environment and poverty are prevailing. Therefore, microfinance institutions can be seen as a kind of solution for short, medium, and maybe long term, to support the enhancement of the formal sector, and alleviate the lack of entrepreneurships and level of poverty.<sup>196</sup>

There are six MFIs in Iraq, which has thirty-one offices in sixteen provinces; three of those MFIs are international Non-Governmental Organizations (NGO) MFIs, and the rest of them are indigenous NGO MFIs<sup>197</sup>. Two of those International NGO MFIs have been granted by USAID under the Community Action Program (CAP), one International NGO MFI, and three Indigenous NGO MFIs have been founded by the “IZDIHAR Project,”<sup>198</sup> and USAID.<sup>199</sup>

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<sup>194</sup> “Status of the Microfinance Industry in Iraq,” *Iraq National Microfinance Summit*, November 13, 2006, <http://www.izdihar-iraq.com/resources/mfsummit/mfsummitindex2.html> (accessed September 21, 2008).

<sup>195</sup> “Status of the Microfinance Industry in Iraq.”

<sup>196</sup> *Ibid.*

<sup>197</sup> United States Agency-International Development, USAID From the American People-IRAQ, *Microfinance in Iraq*, February 2007, 3, [http://www.usaid.gov/iraq/contracts/pdf/Microfinance\\_in\\_Iraq-Feb07.pdf](http://www.usaid.gov/iraq/contracts/pdf/Microfinance_in_Iraq-Feb07.pdf) (October 21, 2008).

<sup>198</sup> “IZDIHAR is the Arabic word for prosperity. The project’s goal is to promote economic growth and prosperity for all Iraqis,” [http://www.izdihar-iraq.com/izdihar\\_means.htm](http://www.izdihar-iraq.com/izdihar_means.htm)

<sup>199</sup> “Status of the Microfinance Industry in Iraq.”

As a quick view, since the establishment of MFIs, 52,768 loans have been disbursed, at a value of \$109,471.162.<sup>200</sup> The number of outstanding loans is 19,019, and by value, it is \$26,765.351 in July 2007.<sup>201</sup> Actually, it is expected that MFIs support more small enterprises in the long run. Since these institutions supply a small amount of loans to small businesses, opportunity for people increases regarding building small-scale enterprises.<sup>202</sup> Thus, it can be easy to become widespread for MFIs via those opportunities among the Iraqi provinces, and increasing job opportunities even on a small-scale can reduce poverty, which in turn, decreases the informal economy and corruption. Many Iraqi citizens have been suffering from unemployment for more than five years. Moreover, the lack of an essential banking system, a viable economic regulation system, and the foreign investment directed U.S. decision-makers to create alternative job sectors. In this sense, MFIs seem to be a plausible remedy for this volatile environment where corruption is still a problem due to the lack of adequate security measures, and the informal economy, which contains a huge amount of the Iraqi economy.

The following table exemplifies the current status of MFIs since 2003:

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<sup>200</sup> Cliff Ruder, Laila Kuznezov, Tim Shumaker, "Rebuild Iraq by Iraqi Hands Conference," (lecture, United States Agency-International Development and IZDIHAR Project, Baghdad, July 23-25, 2007) [www.iraqihands.org/speeches/Micro%20Loans%20Presentation.ppt](http://www.iraqihands.org/speeches/Micro%20Loans%20Presentation.ppt) (accessed October 20, 2008).

<sup>201</sup> Ibid.

<sup>202</sup> Looney, "The Iraqi Economy II: Economic Progress at the Local Level," 35.

Province	City	MFI
Anbar	Fallujah	Al-Bashair
Babil	Hashmiya, Hilla	CHF
Baghdad	Baghdad (4)	ACDI/VOCA, CHF, Al-Bashair
Basra	Basra	CHF
Erbil	Erbil	ACDI/VOCA
Diyala	Baqubah	ACDI/VOCA
Karbala	Hussainiya, Karbala	CHF
Missan	Amarah, Gharbi, Majar	Relief Intl.
Muthanna	Semawa	CHF
Najaf	Abu Skheir, Herra, Najaf	CHF
Ninewa	Mosul	Ninewa Business Center
Quadissiyah	Dagharah, Diwaniya, Shafiya	CHF
Sulaymaniyah	Basiyan, Sulaymaniyah (2)	ACDI/VOCA, Relief Intl.
Tameem	Kirkuk (2)	ACDI/VOCA, Al-Aman
Thi-Qar	Nasiriyah	CHF
Wassit	Hay, Nu'mananiyah	Relief Intl.

Table 4. MFI Offices by Province<sup>203</sup>

## 5. The Commander's Emergency Response Program (CERP)

The Commander's Emergency Response Program was founded in May 2003, "to respond to urgent humanitarian, relief and reconstruction requirements within the commander's area of responsibility by executing programs that immediately assist indigenous population."<sup>204</sup> To support local development, and maintain a stable environment, this kind of program would be appropriate at the local level in Iraq. The aftermath of the invasion in 2003 made it necessary to implement some projects that can handle the environmental problems. In its initial phase, the funding for CERP created by the Coalitional Provision Authority (CPA), "using seized Iraqi assets and oil revenue from the Development Fund for

<sup>203</sup> *Microfinance in Iraq.*

<sup>204</sup> Office of the Special Inspector General for Iraq Reconstruction, *Commander's Emergency Response Program in Iraq Funds Many Large-Scale Projects*, January 2008, 1, <http://www.sigir.mil/reports/pdf/audits/08-006.pdf> (accessed October 10, 2008).

Iraq (DFI),”<sup>205</sup> and then from late 2003 to date, totaling \$3.5 billion in allocation funds appropriated by the United States.<sup>206</sup> Actually, those allocations are assumed to be a kind of alleviation of the current frustrating atmosphere in Iraq, for not only supplying urgent needs, but also for handling the corrupted areas and repairing damaged standards of living. More broadly, this program gave opportunity to U.S. military commanders to convince local Iraqi citizens of a prosperous economy, and to create a stable environment within the reconstruction projects.<sup>207</sup>

Looking at the last data from SIGIR July 2008 presented to Congress, CERP was allocated \$800 million under the Supplemental Appropriation Act.<sup>208</sup> In addition to the aforementioned humanitarian relief and reconstruction efforts since 2003, CERP supplies various job opportunities to the local Iraqi citizens, and the funds allocated for CERP projects are controlled by Multi-National Corps-Iraq (MNC-I) and executed at the Multi-National Division level.<sup>209</sup> Since its establishment, numerous regulations have been applied. For example, In July 2008, the Government of Iraq (GOI) focused on a new CERP program, namely I-CERP, allocating Iraqi funds, with the cooperation of CERP managers from the U.S., for the implementation of immediate reconstruction projects regarding ameliorating the social level of Iraqi citizens.<sup>210</sup>

The following table epitomizes the appropriated, obligated and expended amounts of CERP projects to date. Therefore, \$2.88 billion was allocated of the appropriated \$3.49 billion, and \$2.40 billion was expended to date.

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<sup>205</sup> Office of the Special Inspector General for Iraq Reconstruction, *Quarterly Report to the United States Congress*, April 2008, 75, [http://www.sigir.mil/reports/quarterlyreports/Apr08/pdf/Report\\_-\\_April\\_2008.pdf](http://www.sigir.mil/reports/quarterlyreports/Apr08/pdf/Report_-_April_2008.pdf) (accessed May 5, 2008).

<sup>206</sup> *Quarterly Report to the United States Congress*, July 30, 2008, 40.

<sup>207</sup> Tarnoff, “Iraq: Reconstruction Assistance,” August 2008, 26.

<sup>208</sup> *Quarterly Report to the United States Congress*, July 30, 2008.

<sup>209</sup> *Ibid.*, 16.

<sup>210</sup> *Ibid.*, 17.

U.S. SUPPORT FOR IRAQ RECONSTRUCTION (\$ BILLIONS)				
U.S. FUND	APPROPRIATED	ALLOCATED	OBLIGATED	EXPENDED
CERP FY 2004*	\$0.14	\$0.09	\$0.09	\$0.08
CERP FY 2005	0.72	0.70	0.70	0.66
CERP FY 2006	0.71	0.69	0.69	0.61
CERP FY 2007	0.75	0.74	0.74	0.64
CERP FY 2008	1.17	0.66	0.66	0.40
<b>CERP Total</b>	<b>\$3.49</b>	<b>\$2.88</b>	<b>\$2.88</b>	<b>\$2.40</b>

Table 5. U.S. Support for Iraqi Reconstruction (\$ billions)<sup>211</sup>

When these projects are chosen, it requires diligent adherence to focus on necessity and importance, because the immediate reactions at the local level play a vast role regarding the future reconstruction efforts. Therefore, the specifications for the chosen projects mandate that they are accomplished in a limited time, that local Iraqi citizens can find a job, that local Iraqi citizens will profit, and that they are impressive enough to win the hearts of the Iraqi people.<sup>212</sup> More broadly, there is a big range of CERP projects that serve many diverse areas of the reconstruction efforts including, “Water and sanitation, Food production and distribution, Agriculture, Electricity, Healthcare, Education, Telecommunications, Economic, financial, and management improvements, Transportation, Rule of law and governance, Irrigation, Civic cleanup activities, Civic support vehicles, Repair of civic and cultural facilities, Repair of damage, Condolence payments, Payment to individuals upon release from detention, Protective measures, Other urgent humanitarian or reconstruction projects, and Micro-Grants.”<sup>213</sup>

It is clear that CERP projects handle many different reconstruction purposes. Focusing on those projects, some remedies can be seen in terms of

<sup>211</sup> *Quarterly Report to the United States Congress*, July 30, 2008, 17.

<sup>212</sup> Looney, “The Iraqi Economy II: Economic Progress at the Local Level,” 41.

<sup>213</sup> *Commander’s Emergency Response Program in Iraq Funds Many Large-Scale Projects*, 2.

impeding the obstacles to economic development in Iraq, which was mentioned in the previous chapter, namely unemployment, internal migration, inflation, and in a broader sense, the informal economy, deterioration in social capital, and the insurgency. For example, agriculture, and irrigation projects are beneficial for increasing the employment rate, where this sector was neglected in Iraq during the years Saddam Hussein was in power. Thus, oil revenue dominated the main income of the central government. Electricity projects play a crucial role for increasing infrastructural development, which in turn, can be a remedy for unemployment. Education projects, especially, can be a future related strategy, which can alleviate the insurgency and crime rates that were caused mostly by regional discrepancies and biased ideas, as well as make future local decision-makers open-minded. Economic, financial, and management improvement projects can reorganize economic and financial regulations, and rebuild economic disparities, which can alleviate the informal economy that is so visible in Iraq today. Also, the same projects can increase the employment rate in Iraq. Repair of damaged projects focus on repairing buildings, and ameliorating the social environment, thus can be a good remedy to live in a beautiful environment for Iraqi citizens. Protective measures especially can be a precaution against the insurgency and criminal gangs. Because the infrastructure sites are salient targets for insurgents and criminal gangs, protection of those public and private facilities has crucial importance regarding the development process in Iraq. Micro-grant projects can give opportunities to small-scale enterprises, which plunged into economic recession because of the lack of security and increased poverty in Iraq.

Looking at the current status of the CERP projects, many of them have been accomplished, and those achievements are expected to be beneficial for the problems mentioned above. There are more than 2,400 CERP projects still in progress, and the following table epitomizes the major projects both completed and ongoing.

<b>MAJOR CERP RECONSTRUCTION PROJECTS (\$ MILLIONS)</b>				
<b>PROJECT NAME</b>	<b>TOTAL BUDGETED COST</b>	<b>STATUS</b>	<b>FORECAST/ACTUAL COMPLETION</b>	<b>PROVINCE</b>
Electrical Distribution In Muhalla 312	\$11.68	Ongoing	1/31/2009	Baghdad
Oil Security Project (Security Fencing)	\$9.92	Completed	7/9/2006	Basrah
Construct Kirkuk Municipal Landfill In Tameem	\$8.82	Completed	2/8/2008	Tameem
Dibbis Pump Station - Pumps	\$8.25	Completed	2/15/2008	Tameem
Zafarnia Paving, Sewers, Etc.	\$8.06	Completed	10/29/2006	Baghdad
Fallujah Sewer Pump Stations F1, F2	\$7.60	Ongoing	9/15/2008	Anbar
Strategic Crude Oil Repair	\$7.10	Completed	3/22/2008	Basrah
Baiji Oil Refinery Infrastructure Protection Materials	\$6.92	Ongoing	9/22/2008	Salah Al-Din
Electrical Distribution In Muhalla 310	\$6.57	Ongoing	9/9/2008	Baghdad
Rehabilitate Two BIAP Domestic Terminals	\$6.56	Ongoing	9/15/2008	Baghdad

Source: IRMS, CERP Excel Workbook, June 30, 2008.

Table 6. Major CERP Reconstruction Projects (\$ millions)<sup>214</sup>

## 6. Provincial Reconstruction Team (PRT)

In order to maintain security, increase the level of the economy, stabilize the political environment, reach each province's problems easily, and create solution propositions, a strategic approach was needed. It is no doubt that to work efficiently in conflict-prone areas regarding maintaining stability and security is extremely difficult. So, as defined in the Fact Sheet, Provincial Reconstruction Teams established by Condoleezza Rice in November 2005, and their intentions were to engender cooperation between civil-military institutions, and maintain a milieu that collaborates U.S. and coalition members and local and provincial Iraqi governance members in a reconciling manner.<sup>215</sup> In the inauguration of the first

<sup>214</sup> *Quarterly Report to the United States Congress*, July 2008, 43.

<sup>215</sup> U.S. Embassy-Baghdad-Public Affairs Section, *PRT (Provincial Reconstruction Teams) Fact Sheet*, 2008, [http://iraq.usembassy.gov/pr\\_01222008b.html](http://iraq.usembassy.gov/pr_01222008b.html) (accessed October 10, 2008).



PRT in November 2005, she said that, “these new entities would marry our economic, military, and political people in teams to help local and provincial governments get the job done.”<sup>216</sup> Those teams are dedicated to gathering military and civil efforts together, and providing a secure environment for civilians in each province.<sup>217</sup> The main mission of the PRTs is, “helping provincial governments with: developing a transparent and sustained capability to govern, promoting increased security and rule of law, promoting political and economic development and providing provincial administration necessary to meet the basic needs of the population.”<sup>218</sup> Therefore, it is apparent that the aftermath of the invasion in 2003, resulted in some regional problems, which increased especially after the overthrow of Saddam Hussein. Thus, to access each province’s problems and focus on their essential requirements, ad hoc remedies were needed at the decision-making level. In the Status of the PRT Program Extension Report, it was noted that, this program gave a hand to the coalition and U.S. forces to reach local Iraqi governments for purveying essential requirements and directing them in a reciprocal manner.<sup>219</sup> Under the concept of this program, the PRTs focus not only on the development of economic and political areas, but also take precautions against the insurgency and corruption with reconstruction efforts.

Looking at the shape of PRTs, they are divided into two different categories: Original PRTs and embedded PRTs.<sup>220</sup> According to the Measuring

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<sup>216</sup> Robert Perito, “Provincial Reconstruction Teams in Iraq,” *United States Institute of Peace*, March 2007, 1, <http://www.usip.org/pubs/specialreports/sr185.pdf> (accessed September 11, 2008).

<sup>217</sup> Robert Perito, “Provincial Reconstruction Teams in Iraq,” *United States Institute of Peace*, February 2007, [http://www.usip.org/pubs/usipeace\\_briefings/2007/0220\\_prt\\_iraq.html](http://www.usip.org/pubs/usipeace_briefings/2007/0220_prt_iraq.html) (accessed September 11, 2008).

<sup>218</sup> *PRT (Provincial Reconstruction Teams) Fact Sheet*, 2008.

<sup>219</sup> Office of the Special Inspector General for Iraq Reconstruction, *Status of the Provincial Reconstruction Team Program Expansion in Iraq*, July 2007, 1, <http://www.sigir.mil/reports/pdf/audits/07-014.pdf> (accessed October 07, 2008).

<sup>220</sup> Tarnoff, *Iraq: Reconstruction Assistance*, August 2008, 21.

Stability and Security in Iraq Report, there are twenty-seven PRTs in Iraq, and eleven of those teams are under the U.S forces, and three of those are under the Coalition.<sup>221</sup> In addition, “there are thirteen ePRTs embedded with Coalition forces that work on sub-provincial stability tasks in support of counterinsurgency operations.”<sup>222</sup> Their structures differ from the original PRTs in that, “they are embedded in Brigade Combat Teams with the Brigade Commander acting as leader.”<sup>223</sup> These ePRTs’ main roles are to work with the Iraqi government to create job opportunities, purvey essential needs, and make agreements among provincial, regional, tribal and municipal representatives.<sup>224</sup> In addition to this, there are four Provincial Support Teams (PSTs), and they are directed remotely from different bases in adjacent provinces.<sup>225</sup> They play a supportive role in terms of maintaining security and evaluating the provinces’ domestic problems in detail. According to the September 2008 report to Congress, three of those PSTs shifted to the original PRTs, and increased their activities and effectiveness in related provinces.<sup>226</sup>

Although all these different institutions under the roof of PRT work for specific purposes and dichotomize in organizational type, their common objective is “to expand the central Iraqi government’s authority to all areas of the country and improve the ability of provincial authorities to deliver essential services.”<sup>227</sup> The lack of provincial effectiveness and access to the core of the main problems fostered internal precautions for a better Iraq. Looking at the emphasized areas

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<sup>221</sup> Report to Congress, *Measuring Stability and Security in Iraq*, September 2008, 3, <http://www.defenselink.mil/news/d20080930iraq.pdf> (accessed September 30, 2008).

<sup>222</sup> Ibid.

<sup>223</sup> Tarnoff, *Iraq: Reconstruction Assistance*, August 2008, 21.

<sup>224</sup> Ibid., 22.

<sup>225</sup> *Measuring Stability and Security in Iraq*, September 2008.

<sup>226</sup> Ibid.

<sup>227</sup> Robert Perito, “Provincial Reconstruction Teams in Iraq,” *Special Report, United States Institute of Peace*, March 2008, 3, <http://www.usip.org/pubs/specialreports/sr185.pdf> (accessed September 21, 2008).

of the PRTs, five can be seen: “Governance, Rule of Law, Economic Development, Reconstruction, and Political Reconciliation.”<sup>228</sup> Each area focuses on required needs from different aspects, but they merge at the same point where a prosperous economy, secure environment and stabilized governance can be maintained.

In this respect, defining the tasks of each area will be beneficial in terms of comparing their effectiveness against the aforementioned neglected issues at the decision-making level—the informal economy, deterioration in social capital, and the insurgency. The task of governance is to help the provincial governments increase their ability to a certain level for defining, evaluating, organizing, and purveying the essential needs of their citizens.<sup>229</sup> This task includes citizens’ rights, their satisfaction in legitimacy, and effective ties among different governments. In this sense, those goals can be effective for alleviating the corruption and the insurgency. Because of the expected viable governmental precautions, control of corruption may easily be gained by developing the competency of provincial governments.

The main tasks of the rule of law are to help government increase the integrity of trust and convince the citizens that, “...the police, courts, prisons, lawyers, and other participants on law enforcement and judicial system function openly and equitably to protect and serve them.”<sup>230</sup> These implementations can alleviate the damaged relations among the institutions, which refers to “deterioration in social capital.” Alleviating crime rate, increasing social trust, impeding the insurgents’ attacks and punishing criminals objectively can all be carried out with these tasks.

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<sup>228</sup> Office of the Special Inspector General for Iraq Reconstruction, *Review of the Effectiveness of the Provincial Reconstruction Team Program in Iraq*, October 18, 2007, 7-8, <http://www.sigir.mil/reports/pdf/audits/07-015.pdf> (accessed October 7, 2008).

<sup>229</sup> Office of the Special Inspector General for Iraq Reconstruction, *Quarterly Report to the United States Congress*, October 30, 2008, 90, [http://www.sigir.mil/reports/quarterlyreports/Oct08/pdf/Report\\_-\\_October\\_2008.pdf](http://www.sigir.mil/reports/quarterlyreports/Oct08/pdf/Report_-_October_2008.pdf) (October 30, 2008).

<sup>230</sup> *Review of the Effectiveness of the Provincial Reconstruction Team Program in Iraq*, October 18, 2007, 6.

The objective of Economic Development is to assist the economic development programs and expedite economic activities and investments. Moreover, this program gives more attention to job creation opportunities at provincial level, and focuses on “agriculture/agribusiness, construction, retail/wholesale business, industrial/commercial enterprises, and banking/finance”<sup>231</sup> regarding the short and long term strategies for a better provincial development.<sup>232</sup> These policies can be a beneficial remedy for alleviating the informal economy, which especially increased because of the lack of formal job opportunities and an unsecure environment. In this regard, it can be easy to entice foreign entrepreneurs and investors to bring in more income for local Iraqi citizens.

Reconstruction efforts focus on the essential needs of Iraqi citizens in each province in terms of reconstruction services, identifying the solution propositions to the Iraqi Government, and increasing the capability of each province for coordinating civil construction.<sup>233</sup> Those efforts increase the developments of Iraqi citizens’ social life, thus maintaining a well-organized social life ameliorates the morality of people. Besides, those efforts enhance the ability of the U.S. and Coalition forces for building effective public services regarding “...clean water, sewer and sanitation, and electricity.”<sup>234</sup>

The objective of political reconciliation is to solve problems and alleviate escalation among conflicting parties by applying a reconciling conversation in a reciprocal manner, and follow the shared goals and purposes that refer to long-term stabilization.<sup>235</sup> More broadly, this program supports the close connection

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<sup>231</sup> *Review of the Effectiveness of the Provincial Reconstruction Team Program in Iraq*, October 18, 2007, 6.

<sup>232</sup> *Ibid.*

<sup>233</sup> *Ibid.*

<sup>234</sup> *Ibid.*

<sup>235</sup> *Quarterly Report to the United States Congress*, October 30, 2008.

among the differing institutions and groups such as “sectarian, tribal, religious, ethnic, civil society, military/police,”<sup>236</sup> to lessen escalation and turmoil, and to rebuild trust among those institutions.<sup>237</sup>

Finally, the following table epitomizes the funding allocated for PRTs as of July 2007. This table does not include the additional funding, which is purveyed by the agencies’ own allocations, such as personnel funding.

<b>PRT Funding Category</b> (\$ in millions)	<b>FY 2006 Supplemental Enacted</b>	<b>FY 2007 Supplemental Enacted</b>	<b>FY 2008 Budget Requested</b>	<b>Total</b>
<b>Operational Funding</b>	<b>\$230<sup>a</sup></b>	<b>\$ 414</b>	<b>\$679</b>	<b>\$1,323</b>
<b>Program Funding</b>				
• Provincial Reconstruction Development Council Projects <sup>b</sup>	315	720	160	1,195
• Local Governance Program <sup>c</sup>	155	90	98	343
<b>Program Subtotal</b>	<b>470</b>	<b>810</b>	<b>258<sup>d</sup></b>	<b>1,538</b>
<b>Grand Total</b>	<b>\$700</b>	<b>\$1,224</b>	<b>\$937</b>	<b>\$2,861</b>
Notes:				
<sup>a</sup> None of the operating funds from the FY 2006 supplemental (Public Law 109-234) were obligated or expended in FY 2006 and were carried forward into FY 2007.				
<sup>b</sup> The Economic Support Fund is used for local reconstruction projects coordinated by the PRTs through Iraqi Provincial Reconstruction Development Councils. The main thrust of this effort is to build capacity at the provincial level by teaching local officials how to prioritize projects and manage infrastructure development and sustainment.				
<sup>c</sup> Since 2003 USAID has supported, through its Local Governance Program (LGP), the establishment of local government structures to increase Iraqi capacity to deliver basic services. LGP supports the PRT Program by providing competency-based mentoring and technical assistance to local councils, committees, and departments.				
<sup>d</sup> Includes \$93 million in base agency funding and \$165 million in Global War on Terror (GWOT) funding. GWOT, also known as Title IX, has funds available for military and diplomatic operations overseas, especially in Iraq and Afghanistan. These operations may include a wide variety of activities, such as combating insurgents, civil affairs, capacity building, and infrastructure reconstruction.				

Table 7. PRT Program Funding<sup>238</sup>

<sup>236</sup> *Review of the Effectiveness of the Provincial Reconstruction Team Program in Iraq*, October 18, 2007.

<sup>237</sup> *Ibid.*

<sup>238</sup> *Status of the Provincial Reconstruction Team Program Expansion in Iraq*, July 2007.

### C. GENERAL STRATEGIC POINTS FOR THE FUTURE

Since the invasion of Iraq in 2003, many projects and plans have been prepared, and numerous efforts have been spent regarding a prosperous Iraqi economy. In this respect, achievement has been gained to some extent; however, the aftermath of the invasion reveals that there are lots of things to be done. What has been achieved as well as what went wrong, to date, should be scrutinized for future expectations. One of the crucial assessments by some observers indicates that<sup>239</sup>, in order to make predictions about the process of economic rebuilding, there is no “big picture,” due to the lack of adequate detail about the general national requirements such as “drinking water, schools, health care, electricity, employment.”<sup>240</sup>It is important to gather information to make a predictable assessment for future projects, which is also beneficial for evaluating the successful and unsuccessful sides of implemented projects to date.

One of the required emphases on the Iraqi economic situation is controlling corruption. In this sense, the Special Inspector for Iraqi Reconstruction recommends that anticorruption precautions should be evaluated in comparison to the global experiences that have been achieved by other countries.<sup>241</sup> In addition, there should be a study of the U.S. strategy’s ties with the Government of Iraq’s anticorruption strategy.<sup>242</sup> In this regard, eligible personnel should fill the critical departments where important decisions will be made on anticorruption policies.<sup>243</sup> The lack of staffing for these departments can result in squandering efforts and money that have been allocated for this issue. In addition, anticorruption efforts should be supported by adequate funding. It was argued

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<sup>239</sup> “Iraq: Reconstruction Assistance,” August 2008, 35.

<sup>240</sup> Ibid.

<sup>241</sup> Office of the Special Inspector General for Iraq Reconstruction, *Anticorruption Efforts in Iraq: U.S. and Iraq Take Actions But Much Remains To Be Done*, July 2008, 11, <http://www.sigir.mil/reports/pdf/audits/08-023.pdf> (accessed October 10, 2008).

<sup>242</sup> Ibid.

<sup>243</sup> Ibid., 2.

that the Embassy in Iraq does not have specifically allocated money for anticorruption efforts.<sup>244</sup> Thus, when needed, the lack of funding may cause some operations to fail to impede corruption activities.

Another important point that must be emphasized is the development level of security policies. It was recommended that until the Iraqi Government becomes capable of maintaining the security of main resources such as oil, water, electricity and gas, security plans should be developed with the Coalition and U.S. Forces in reciprocity.<sup>245</sup> This issue seems to require additional projects and funding, due to the ongoing insurgent attacks and activities of the criminal gangs. Because energy security plays a vast role in terms of the development process, especially in a post-conflict environment, there should be highly evaluated projects, which can be executed in high-risk areas. Moreover, extra funding may be needed for unexpected situations regarding security issues. In this sense, it was recommended to, “develop guidance on project risk for managers to assess the merits of funding a project faced with security threats.”<sup>246</sup>

To be successful at impeding terrorist activities and insurgent attacks, economic and social policies should be executed with enough funding support.<sup>247</sup> In this respect, to alleviate the current violence and uncertainty in Iraq, job creation projects should be supported by some projects such as CERP, Microfinance Institutions, and the Economic Support Fund. Then, social life can be ameliorated with increased job opportunities, and discontented youth can be convinced to some extent not to join an insurgent group.

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<sup>244</sup> Office of the Special Inspector General for Iraq Reconstruction, *Anticorruption Efforts in Iraq: U.S. and Iraq Take Actions But Much Remains To Be Done*, July 2008, 11, <http://www.sigir.mil/reports/pdf/audits/08-023.pdf> (accessed October 10, 2008). 3.

<sup>245</sup> *Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts*, July 2008, 17.

<sup>246</sup> *Ibid.*

<sup>247</sup> Looney, “Socio-Economic Strategies to Counter Extremism in Iraq,” 41.

To maintain economic stability, international assistance plays an important role for the future of Iraq. In this regard, one of the main objectives of the World Bank is “to help Iraq build efficient, inclusive, transparent, and accountable institutions as needed for stability, good governance, and sustainable economic prosperity.”<sup>248</sup> Thus, it is apparent that international assistance handles the situation in an overarching approach, and establishes economic institutions and supports them for prosperity. In this sense, the World Bank Report notes that international aid is nine times more beneficial in post-conflict regions, than in normal regions.<sup>249</sup> Because the main systems for maintaining basic living standards in a post-conflict country are mainly damaged, and to move ahead even an infinitesimal amount is extremely difficult, aid from outside expedites this process, and gives opportunity to the governmental and private sectors to build required institutions, and to invest money for future expectations. More broadly, it was recommended that to increase the effectiveness of aid, the amount should gradually be decreased in very small steps for the first few years, and increased around five years later.<sup>250</sup> In addition, the improvements in growth affect gained by international aid rely on proper policies, plausible decisions by government, and highly educated personnel in institutions in post-conflict countries.<sup>251</sup> In this respect, Iraq should evaluate its current position, and these key points should be implemented with the assistance of the U.S. and the Coalition forces.

When looking for solutions economic and social problems, it is crucial to evaluate the “...environmental elements, human, and non-natural renewable

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<sup>248</sup> Document of the World Bank, International Bank for Reconstruction and Development and International Development Association and International Finance Corporation, *Second Interim Strategy Note for The Republic of Iraq for the Period FY06-07*, August 23, 2005, 5, <http://siteresources.worldbank.org/IRFFI/64168382-1092419012421/21136784/SecondIraqInterimStrategyNote.pdf> (accessed August 10, 2008).

<sup>249</sup> *Ibid.*, 9.

<sup>250</sup> International Bank for Reconstruction and Development and International Development Association and International Finance Corporation, 9.

<sup>251</sup> *Ibid.*



resources..."<sup>252</sup>; however, it was argued that National Development Strategy has been unsuccessful focusing on the critical points that should be thought through carefully, like economic development.<sup>253</sup> In this respect, without building essential needs for the public, efforts toward economic growth will not be very effective. Thus, economic development projects should be implemented with the reconciliation of reconstruction needs in reciprocity.

As defined in the previous chapter, precautions that will be taken to impede the informal economy, rely on economic improvements in the formal sector. Thus, the solutions for scarcity and maintaining stability in the formal sector reforms will then diminish the informal economy.<sup>254</sup> For example, cooperation with the tribal groups will decrease the level of street vendors, and help diminish the informal economy, which in turn can alleviate the insurgent attacks.<sup>255</sup> Because the income from the informal economy cannot be controlled in detail, these efforts support the insurgency and criminal gangs. Thus, the more the informal economy increases, the more the insurgent groups find funding for their illicit activities. Therefore, the limitations on enhancement of the informal economy can result in a prosperous formal economy. These efforts should be conducted with discipline, and central government officials should stick with the rules of formal sector development. In this respect, it was argued that, lots of government officials have great interest in maintaining their profitable ties to the informal economy.<sup>256</sup> In addition, because of the uncontrolled corruption, price regulations in many fields will require much time to alleviate the effect of the informal economy. A typical consequence can be exemplified as, "...while gas prices are gradually rising as part of an International Monetary Fund, (IMF)

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<sup>252</sup> Al-Saadi, Iraq's National Vision, Economic Strategy, and Policies," 6.

<sup>253</sup> Ibid.

<sup>254</sup> Looney, "The Iraqi Impasse: Sustaining Economic Reconstruction During War-Time," 28.

<sup>255</sup> Ibid.

<sup>256</sup> Ibid., 29.

program, the impact on the shadow [informal] economy has been affected by the oil price differential between Iraq and its neighbors.”<sup>257</sup>

Looking at the critical points regarding the economic suggestions in the financial sector, two prominent factors are noticeable: “Iraq’s relationship with the international financial institutions, especially the IMF, and developments in the oil sector, especially with regard to oil production and the disbursement of revenues.”<sup>258</sup> On the financial side, the IMF pointed out the necessity of a price increase in petroleum productions, as well as a more flexible monetary policy, by enhancing the tools in order to handle liquidity conditions.<sup>259</sup> In addition, they focused on the “structural reforms with regard to tax administration, payments and settlements systems, state-owned enterprise reconstructing, and governance and transparency in the oil sector.”<sup>260</sup> However, it does not seem plausible for a post-conflict country to suddenly shift to a free market system and privatized sector. The lack of adequate job opportunities and security measures may transfer many unemployed Iraqis into the insurgent groups. It was argued that the recommendations of IMF, the World Bank and Paris Club put pressure on Iraq to reduce the state’s role in the economic area and rebuild the privatized sector.<sup>261</sup> However, when those policies are transferred, up to 33 percent of Iraqi employees who are working in 192 Iraqi state firms will be unemployed, and these jobless citizens will find that their best choice is to join an insurgent group, or look for alternative ways in the informal economy sector.<sup>262</sup>

In the financial arena, another suggestion is that, Iraq should gradually revoke its financial assistance for basic needs such as food and petroleum by-

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<sup>257</sup> Looney, “The Iraqi Impasse: Sustaining Economic Reconstruction During War-Time,” 28.

<sup>258</sup> Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” 31.

<sup>259</sup> *Ibid.*

<sup>260</sup> *Ibid.*

<sup>261</sup> *Ibid.*

<sup>262</sup> *Ibid.*

products.<sup>263</sup> This policy purveys many essential needs in very low prices to the Iraqi citizens. However, for an effective industrial sector development, it is necessary to diminish these subsidies. But, it should be remembered that, without a reliable “social security network,” it is extremely difficult for Iraqi citizens to live in an environment where basic subsidies are revoked gradually.<sup>264</sup> Thus, creating a strong social security system can slow the increase of the number of unemployed Iraqis.

The developments in the oil sector play significant and controversial roles in the Iraqi economy. After the overthrow of Saddam Hussein, conflict among the Kurds, Sunnis and Shiites increased dramatically. In an economic sense, oil revenue plays a vast role because it is the major income resource for the Iraqi citizens. However, the aftermath of the invasion in 2003 brought vague situations regarding the oil revenue, which should be solved to reach a stable economy and security in Iraq. In this regard, it is apparent that Sunnis have fears about not getting as much oil revenue as the Kurds in the north and the Shiites in the south, and plunging into economic recession and poverty.<sup>265</sup> Due to this uncertainty, it can be beneficial to allocate a huge amount of oil revenue directly to all Iraqi citizens.<sup>266</sup> This approach can alleviate the Sunni-based insurgent attacks, which endanger oil revenue, and give opportunities to the small-scale enterprises. Moreover, this direct disbursement can encourage the Iraqi citizens that there is hope for the future that could lead to a better standard of living.

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<sup>263</sup> Looney, “Impediments to Stability in Iraq: The Illusive Economic Dimension,” 32.

<sup>264</sup> Ibid.

<sup>265</sup> Ibid., 34-35.

<sup>266</sup> Ibid., 36.

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## IV. CONCLUSION

It has been more than five years since the Iraqi invasion and the point where the U.S stands is still uncertain. Begun with great expectations, the 2003 invasion brought a vague situation and has not yet reached many of its goals. Some achievements have been made, but there are more things to be done. It is not easy for the Iraqi government to rebuild a viable Iraq in the short term. Thus, the policy that the U.S. decision makers execute should be plausible, tangible, convincing and fair. Means and ends should merge at the same point. Otherwise, political power cannot be strengthened, and political accommodation may be extremely difficult between Iraq and the U.S.

Because the Iraqi economic situation is a legacy from the former Baath regime, managing its economy and transitioning to a prosperous level will not be easy. Therefore, in this thesis, the economic situation of Iraq was analyzed from the pre-invasion period forward. Then, beginning with the main problematic areas exacerbating the economic situation, Chapter II followed with three neglected issues—informal economy, insurgency and criminal gangs, and deterioration in social capital—by the U.S. government, which were emphasized in detail. Chapter III continued with what has been learned to date, and current policies executed at the local level, which include some remedies and solution propositions for the aforementioned three neglected issues. Then some key points for the future's strategies were explained in general.

The Baath regime exploited the oil revenues for many years while greatly ignoring other domestic income resources, such as infrastructure, agriculture and industry. Therefore, for many years, the country was tied to the oil revenue and the Iraqi government used this opportunity in every facet of life. The Saddam Hussein period, especially, was authoritarian, and social and political disparity remained concrete among Sunni, Shiite and Kurdish citizens. This discrimination throughout the country remained to date, thus the notion of a nation-state system has not been gained in this territory, since the 1920s.

Being dependent on the oil revenue impeded developments of the other sectors of economic structure. Holding this power in hand gave Saddam Hussein many opportunities to lead the citizens of Iraq as he decided. However, the other job sectors such as agriculture, industry and infrastructure could not develop as required, so employment was not enhanced. Most people were trying to find a job related to the oil sector. This monopolized approach became the main obstacle for domestic prosperity, thus an imbalance of income among the citizens became apparent. Also, tribal loyalties maintained its importance, so disunity among the provinces remained strong. Thus, the legacy of the Saddam regime brought catastrophic problems and unequal social life to the coalition and U.S. forces.

The effects of Saddam Hussein's legacy remains to date, and because of that, U.S. and coalition forces met various difficulties throughout the implementations. The overthrow of Saddam Hussein could not alleviate turmoil, but exacerbated the social and economic level of country. The post-conflict environment mixed with the escalation between Shiite, Sunni and Kurdish groups, thus the policies of the U.S. decision makers could not ameliorate social life to a certain extent. In this regard, many implementations have been executed, however, the increasing informal economy, the insurgency, and damage in social capital have not been considered seriously. Because of the informal economy, it was difficult to notice the real level of economic development, the main points that should be handled, and the level of unemployment. Because of the increasing insurgency, it was difficult to maintain a secure environment, build energy resources, and maintain security of high value public services. Moreover, this unstable milieu made it difficult to convince foreign entrepreneurs and investors. In this regard, U.S. decision makers have focused on solutions at the local level, and taken some precautions, such as establishing microfinance institutions, executing the Commander's Emergency Response Programs, and creating Provincial Reconstruction Teams. These strategies at the local level, have gained measureable success, but because

there is no certain decision for the future plans for Iraq, these implementations' results will be clear in the medium or long term.

As discussed in Chapter III, there are many recommended strategies for the future of Iraq. These recommendations will be shaped by the strategy of the new president of the U.S. There are three approaches in this sense: "unconditional engagement, unconditional disengagement, or conditional engagement."<sup>267</sup> The first one is a continuation of current policy, which includes support to the Iraqi government, whether they implement successful policies or not. However, because of the disappointing consequences of this strategy to date, this approach does not seem to be advocated at a high rate. The second one is rapid withdrawal of U.S. forces from Iraq. This option may be assumed to be the easiest and the cheapest one; however, what will be left behind in this country is an unaccomplished job, which can create a civil war and affect the national interests of the U.S. in the global world. Therefore, the last one seems the most plausible approach, pointing to gradually transferring governmental issues and security precautions to the Iraqi government. This shift requires a well-organized strategic plan and political reconciliation and principles of stability in this region. This controlled role change can increase the self-trust of Iraqi institutions, and ameliorate the morality of the Iraqi public. The role of the U.S. in this regard will be an observer of ongoing policies, and assisting when needed.

In this thesis, it became clear that the demographic shape of Iraq made it difficult to implement planned strategies and policies. Because three different groups have political, economic and social disunity, the remedies thought to be successful for a specific purpose may not work at the same level for all Iraqi citizens. Thus, that volatile environment requires initiative behaviors from the decision makers. Decisions and plans may be changed or updated according to upcoming events. This situation is related to the human factor. If eligible officers

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<sup>267</sup> Michele A. Flournoy, "Life After the Surge: Prospects for the Iraq and the U.S. Military," *Congressional Testimony, Center for a New American Security*, April 2, 2008, 9, [http://www.cnas.org/files/documents/publications/CNASTestimony\\_FlournoySFRC\\_April%202008.pdf](http://www.cnas.org/files/documents/publications/CNASTestimony_FlournoySFRC_April%202008.pdf) (April 5, 2008).

are not chosen at the strategic points, to evaluate and implement required changes cannot be made in a limited time. If cultural differences and environmental difficulties are considered, it is difficult to adapt feasible changes to the current situation, on time. Thus, it is important to figure out the view of the Iraqi people, who have witnessed terrible violence and turmoil for many years, about the purpose of the U.S. from time of the invasion. As mentioned above, it is crucial to convince the Iraqi people that the purpose of the invasion was for their benefit, for a stable and secure Iraq. Otherwise, time and money will continue to be squandered for some time. Convincing people can also alleviate the violence and strengthen the social ties among the indigenous citizens, the U.S. and the Coalition forces. Then it can be easy to diminish the ongoing insurgency, to increase job opportunities, and to build trust networks among the institutions and people. But, it should be remembered that, if the Iraqi people do not believe that executing strategies are beneficial for their country, but only for U.S. interests, rebuilding efforts will not result in the expected successes. So, here comes the importance of asymmetric warfare. The Iraqi people can easily join different extremist groups or criminal gangs, or they can join any kind of illicit operation such as smuggling or ransom. The lack of economic prosperity, drives people to illegal ways, especially where security is not well maintained. Therefore, using the tools of asymmetric warfare, it is plausible to ameliorate the social situation in Iraq, and take back those people from illicit activities. To use the tools of asymmetric warfare, the U.S. forces should give more education to their personnel to teach about the culture, belief, language, life style, and point of views of Iraqi people in various provinces. Then it can be easy to keep in touch with those people in order to walk on the same path with them. With these tools, it can be easy to alleviate the violence and bring stability.

Today, as we witnessed the election of a new president of the U.S., we know that the foreign policies of the new administration will reshape the ongoing strategies in Iraq. The expectations are that a controlled withdrawal will begin to be executed in the short and medium term. To comment on what might happen is



not possible now, but the economic effects of the new strategy will prove whether the changed policies have been working well or not.

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