

RECONSTRUCTING IRAQ

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TABLE OF CONTENTS

EXECUTIVE SUMMARY AND RECOMMENDATIONS	i
I. THE BALANCE SHEET	1
A. CONSUMPTION BUT LITTLE RECONSTRUCTION	1
B. THE IMPACT OF VIOLENCE.....	3
II. WHAT WENT WRONG?	4
A. RECONSTRUCTING WITHOUT A PLAN.....	4
B. RECONSTRUCTING WITH AN IDEOLOGY	6
C. CPA DYSFUNCTION	9
D. SHIFTING DEADLINES.....	10
E. REBUILDING FOR OR BY IRAQIS?	11
1. Consultation and capacity-building	11
2. The private sector	13
F. CHALLENGES AHEAD.....	15
III. THE PROBLEM OF UNEMPLOYMENT	16
A. EMPLOYMENT AND PUBLIC WORKS	16
B. JOB CREATION	18
IV. CORRUPTION AND LACK OF TRANSPARENCY	20
A. ALLEGATIONS AND PERCEPTIONS	20
B. ON FERTILE GROUND	21
C. SETTING A BAD EXAMPLE.....	22
D. TACKLING CORRUPTION	23
V. INTERNATIONAL ASSISTANCE	24
A. SECURITY, IRAQI SCEPTICISM AND DONOR COORDINATION	24
B. DEALING WITH SADDAM'S FINANCIAL LEGACY	26
VI. CONCLUSION	28
APPENDICES	
A. MAP OF IRAQ	29
B. ABOUT THE INTERNATIONAL CRISIS GROUP	30
C. ICG REPORTS AND BRIEFINGS ON THE MIDDLE EAST AND NORTH AFRICA.....	31
D. ICG BOARD MEMBERS	33



RECONSTRUCTING IRAQ

EXECUTIVE SUMMARY AND RECOMMENDATIONS

Amid political instability and violence, Iraq's economic problems have been viewed as secondary and unrelated. They are not. U.S. and Iraqi institutions have systematically lost and the insurgency gained momentum as living conditions failed to improve. Economic hardship and violence (political and criminal) feed on each other: heightened popular dissatisfaction and unemployment swell insurgent ranks and the growing insurgency further hampers development. Without genuine reconstruction and a sustained recovery plan, any political success will be short-lived. Coalition Provisional Authority (CPA) performance fell far short of expectations and needs and offers a fragile, dysfunctional legacy on which to build. The Interim Iraqi Government, its still-to-come elected successor, and the international community can ill afford to repeat its mistakes.

Lack of security has been important and will continue to hinder economic activity. Kidnappings, assassinations and travel restrictions discouraged reconstruction and investment and led many non-Iraqis to withdraw. Attacks on oil facilities further disrupted the economy. Assessments of what went wrong also must recognise the difficulties of rebuilding an economy ravaged by Baathist misrule, war, and sanctions.

But obstacles have not been of a security nature alone or wholly due to the Baathist legacy. The CPA made a hard job harder. For the most part, the occupation forces came without a plan. What strategy they had benefited from little if any Iraqi input, was heavily shaped by ideology and repeatedly subject to Washington's political deadlines. CPA plans for complete economic overhaul quickly encountered stiff opposition by Iraqis intent on their own long-term strategy; shifting course, the CPA took ad hoc decisions, leaving unresolved crucial policy questions for fear of triggering even greater discontent. Thus, it

was originally fixated on large-scale privatisation but, facing Iraqi hostility, neither privatised nor relinquished the objective. As a result, it failed to devise an alternative approach that might have revived ailing state companies so they could be used to find temporary jobs for the unemployed.

The 15 November 2003 turnaround accelerating the transfer of sovereignty led officials to readjust plans abruptly and emphasise projects they could complete, without regard to how they fitted an overall reconstruction strategy or whether they addressed Iraqis' immediate needs. U.S. bureaucratic infighting and high staff turnover and inexperience added to the obstacles. Inadequate transparency and accountability in the contracting process combined with real or alleged corruption has fed distrust of both occupation authorities and Iraqi institutions.

The point of listing failings is to learn from them. A sovereign Interim Government and eventually an elected one may be better positioned to correct missteps; more legitimate institutions may be better able to address everyday needs. But even if the process is smooth and viewed as credible by Iraqis -- a considerable "if" -- this will be a partial answer. Many issues that vexed the CPA remain. The Interim Government, for example, will be reluctant to make broad economic changes lest it be accused of usurping an elected government's prerogatives. As Lebanon's precedent shows, allocating power and positions along ethnic/sectarian lines risks encouraging a parallel apportionment of public jobs and resources, with corruption and malfeasance as by-products. Nor have the occupation authorities truly disappeared: the U.S. remains powerful and, importantly, controls most reconstruction funds.

The Interim Government's fundamental challenge will be to devise a coherent reconstruction strategy

that focuses on immediate material improvement and sets the stage for longer-term sound rebuilding while avoiding a socio-economic crisis and its attendant political implications. This means protecting and creating jobs; far greater involvement by Iraqis -- including civil society, local councils, trade unions and associations -- at the local level; and structural steps (such as decentralisation, and a strengthened, independent media and judiciary) to curtail corruption.

The international community's full and swift help is needed. Increased assistance will not suffice; aid institutions, particularly those carrying out reconstruction projects on behalf of the U.S. government, should reconsider their approach. Project-driven, externally designed aid is not the answer. Instead, the international community should work with Iraqi institutions to design a comprehensive economic development plan that seeks citizen input, emphasises decentralisation, job creation and alleviation of socio-economic distress, and includes a powerful transparency and anti-corruption component.

Giving Iraq a real chance to recover also requires a clean break with the financial legacy of the Baathist regime -- not full and total repudiation, but a significant write-off of debt and war reparations obligations through a smart combination of moratoriums, debt reduction, and preferential treatment of creditors in reconstruction projects.

RECOMMENDATIONS

To the Iraqi Interim Government and Future Elected Government:

1. Produce, in cooperation with the donor community, a comprehensive plan for reconstruction, including:
 - (a) a strategy for economic diversification that gradually steers the country away from its dependence on oil revenues;
 - (b) active support for the industrial and agricultural sectors; and
 - (c) postponed privatisation of state companies until market conditions and institution-building show considerable improvement.
2. Support and restructure state-owned companies, including by providing them with resources for repairs and investment.
3. Support Iraq's private sector by:

- (a) requiring foreign investors to help Iraqi firms, for example, by mandating contracting to them and hiring of Iraqi labour to the extent possible, as well as on-the-job training programs; and
 - (b) reviewing corporate taxes on foreign investment, raising them as Iraq's economic attractiveness increases.
4. Improve government transparency and accountability and ensure full access to economic and financial data, including by use of oil metering equipment to monitor oil revenues and by providing regular updates on revenues and expenditures of the Development Fund for Iraq.
 5. Address immediate socio-economic needs by:
 - (a) designing projects with a visible, direct impact and significant employment potential, such as street cleaning, garbage collection, sewage systems repair and local byroads repair;
 - (b) retraining former members of the Iraqi armed forces and employing them in state-owned enterprises;
 - (c) offering credit facilities for housing construction and repair;
 - (d) providing farmers with subsidised agricultural inputs; and
 - (e) generally consulting with Iraqis, in particular associations, labour unions, and groups representing the unemployed, on the design and implementation of projects.
 6. Give preferential treatment to Iraqi companies in the procurement of goods intended for the food rationing system.
 7. Initiate a debate on oil revenue management, using lessons learned from other oil-producing countries and Iraq's own past and, in particular, establish a special fund insulated from the national budget and day-to-day political decisions.
 8. Encourage foreign creditors and war reparations claimants to forego their demands in exchange for preferential status in reconstruction project procurement and contracting.

To the U.S. Government:

9. Improve the performance of U.S. agencies by recruiting staff with expertise in post-conflict

situations and encouraging them to serve in Iraq for longer than six months.

10. Increase Iraqi participation in U.S.-funded reconstruction projects by consulting with Iraqi decision-makers and civil society groups representing a range of interest groups, including women, at early planning stages, granting Iraqi state institutions implementation powers and better communicating reconstruction aims and plans.
11. Emphasise development of the private sector by ensuring that prime contractors subcontract to Iraqi companies to the extent possible and providing support to small and medium sized local companies.
12. Require prime contractors and subcontractors to employ Iraqi labour to the extent possible.

To the Donor Community:

13. Increase multilateral aid disbursement and immediately deposit funds pledged for reconstruction with the UN/World Bank Trust facility, attaching minimal earmarks and conditions.

14. Address corruption by:

- (a) granting the Iraqi Supreme Audit Board a seat on the International Monitoring and Advisory Board;
- (b) supporting independent Iraqi media to play a watchdog role; and
- (c) rigorously applying national anti-corruption legislation to foreign companies operating in Iraq.

To Iraq's Main Creditors and Official Claimants of War Reparations:

15. Agree to negotiate a major debt restructuring and reduction package, ensuring that any conditions regarding economic reforms are adapted to Iraq's fragile post-conflict conditions.
16. Forego most claims for war damages filed by corporations and governments, possibly in exchange for preferential status in state procurement and reconstruction project contracts.

Amman/Baghdad/Brussels, 2 September 2004

RECONSTRUCTING IRAQ

I. THE BALANCE SHEET

A. CONSUMPTION BUT LITTLE RECONSTRUCTION

According to numerous and varied indicators, Iraq's economic situation has improved substantially since the fall of the Baathist regime in April 2003. Karada, Baghdad's main shopping street, boasts a thriving market in expensive consumer items, some of which had never before been available. Rising salaries and incomes enabled many Iraqis to repurchase household items sold during the sanctions-era.¹ Significant sales of imported second-hand cars, air-conditioners, food items, television sets and satellite dishes bear witness to a growth in collective purchasing power, as at least some citizens were able to spend disposable income on items other than bare essentials. Mobile phone subscriptions, introduced in February 2004, have reached nearly 120,000 in Baghdad alone despite exorbitant fees.² In Basra, demand for mobile phone lines much exceeded expectations, triggering shortages from the day of the network launch.³ Hectic private building activity is noticeable throughout the capital, and real estate prices have risen five-fold in the last year.⁴ In the three northern governorates, long queues of trucks filled with consumer items wait at

the Khabur border.⁵ In Karbala and Najaf, scores of new hotels catering to Shiite pilgrims have opened.⁶

The Coalition Provisional Authority (CPA) can take some credit for this consumer-led growth. Its September 2003 decision to increase substantially public sector wages benefited at least 1 million employees and their families.⁷ Anti-inflationary policies helped stabilise the Iraqi dinar and control inflation at about 34 per cent for 2003 and slightly below 30 percent for the first two months of 2004.⁸ Defying predictions of a dinar collapse, the CPA successfully converted and unified the Iraqi currency.⁹

⁵ "This region has been sucking in white goods [such as washing machines and fridges]. We are talking about a consumer bonanza". ICG interviews, Erbil and Suleimaniyah, June 2004.

⁶ Immediately prior to the outbreak of fighting in these two cities in April 2004, local shopkeepers and real estate agents spoke of "unprecedented commercial activity". ICG interviews, Karbala and Najaf, March-April 2004.

⁷ The lowest monthly salaries were set at 69,000 ID (approximately \$46). A ministry's director general now earns about 1.5 million ID (approximately \$1,000). ICG interview with Fa'iq Abdul-Rasul, deputy minister of planning, Baghdad, 10 April 2004. Prior to 2003, salary levels were about one sixth of current levels. See Christopher Foote, William Block, Keith Crane and Simon Gray, "Economic Policy and Prospects in Iraq", Public Policy Discussion Paper, Federal Reserve Bank of Boston, 4 May 2004, p.3, at <http://www.bos.frb.org/economic/ppdp/index.htm>. Figures denominated in dollars (\$) in this report refer to U.S. dollars.

⁸ See Ministry of Planning, Central Unit for Statistics, "Mu'asharat al-Raqm al-Qiyasi li-as'ar al-Mustahlik li-sana 2003 fi al-Iraq", 2004, and "Nata'ij shahr shabat li-mustawa at-Tadahum", 2004. According to some estimates, inflation had reached 500 per cent in the mid-1990s. (Independent research on price indices was prohibited under the Ba'athist regime.) ICG interview with Amal Salash, Iraqi economist, Baghdad, 21 June 2004. However, the recent closure of Baghdad markets and the deteriorating security situation have led to increases in the price of basic food items. See *As-Sahab*, 20 August 2004; *Al-Zaman*, 19 August 2004.

⁹ ICG interviews with CPA officials, Baghdad, Erbil and

¹ ICG interviews, Baghdad and Basra, March-April 2004.

² See "First Quarter 2004 Financial Statement" of ORASCOM, an Egyptian telecommunications company, 1 June 2004, at <http://www.orascomtelecom.com>. In northern Iraq, mobile phone provider Asiaccell services 175,000 subscribers, up from 15,000 prior to Saddam's ouster. *USA Today*, 21 June 2004. Korek Telecom services a large number of subscribers in Erbil. *The Daily Star*, 7 June 2004.

³ ICG interview with mobile phone salesmen, Basra, April 2004.

⁴ ICG interviews with real estate agents, Baghdad, March 2004.

Yet, however welcome, consumption growth and relative price stability cannot suffice. They do not demonstrate the type of reconstruction required by an economy devastated by decades of mismanagement, war, sanctions and, more recently, widespread looting. Little major public construction work has occurred; factories by and large are deserted, and a number of industrial estates have become rubbish dumps. Nor has damaged infrastructure, including roads and bridges, been significantly repaired.¹⁰ Iraq only recently matched its pre-war power generation. It now slightly exceeds it but is still 20 per cent below the target that was set for June 2004.¹¹ Due in part to power cuts, in part to the April 2003 looting, water treatment facilities operate at levels below those prior to the conflict.¹²

"People may be generally better off, but there is no real construction going on except in oil and electricity, and even in these sectors progress has been slow", a senior Iraqi official observed.¹³ Most Iraqis apparently agree. According to a May 2004 poll, a majority of respondents believe that reconstruction has yet to begin.¹⁴ The mood at the "Destination Baghdad Expo" -- an Iraqi trade show held, after much delay, in Diyarbakir (Turkey) in late May 2004 -- was decidedly downbeat. "Don't expect any big business deals to be signed here", its organiser, Raad

'Umar, warned his audience of mainly Iraqi entrepreneurs. Many ultimately regretted the trip.¹⁵

Official U.S. data confirm that the effort has fallen far short of its goals. The Iraq Project and Contracting Office (PCO, formerly the Program Management Office -- PMO -- the body responsible for spending U.S. reconstruction funds) is running only 164 construction projects, less than 7 per cent of the 2,390 it has planned between now and 2008.¹⁶ Determining precisely how much U.S. agencies have actually spent in Iraq is a complex task, but it is clear that it is only a fraction -- roughly 10 per cent -- of the \$18.4 billion allocated for Iraq's reconstruction.¹⁷ Even if one adds resources made available by the U.S. government for small basic infrastructure projects that were carried out by the occupation forces,¹⁸ \$1.87 billion spent on reconstruction by the Iraqi Interim Governing Council and another \$3.8 billion budgeted for 2004,¹⁹ the total pales in comparison to the joint World Bank/UN estimated "immediate needs".²⁰ "It's like we have only managed to get one bulldozer into business in order to move the entire Kilimanjaro", acknowledged a CPA official.²¹ At the current pace and using the combined criteria and priorities set by the World Bank/UN and the CPA, it would take nearly ten years to rebuild and develop Iraq, not the four projected by these organisations.

Iraqis interviewed by ICG expressed puzzlement and anger. Most blamed the CPA, at least in part a reflection of inflated expectations. "The municipality of Baghdad may have spent more than ever before but the results are exactly zero", according to an Interim Governing Council member. "You can see

London, April-June 2004. On the currency reforms see Christopher Foote (et. al.), op. cit. pp.18-20.

¹⁰ USAID has completed repairs of two major bridges. See USAID, "Accomplishments Bridges and Railroads", updated 27 May 2004, at <http://www.usaid.gov/iraq/accomplishments/bridges.html>. See also Bechtel National, Inc., "Iraq Infrastructure Program: Assessment Report", June 2003.

¹¹ In July 2004, power generation reached 5,000 MW compared to a pre-conflict level of 4,400 MW. See USAID, "Accomplishments Electricity", updated 19 August 2004. The target level for 30 June, however, was 6,000 MW. <http://www.usaid.gov/iraq/accomplishments/electricity.html>.

¹² USAID, "Accomplishments Water and Sanitation", updated 7 June 2004, at <http://www.usaid.gov/iraq/accomplishments/watsan.htm%6C>.

¹³ ICG interview with Fa'iq Abdul-Rasul, deputy minister of planning, Baghdad, 10 April 2004. The same view was echoed by Basil Hussein, adviser to the ministry of planning, in ICG interview, Baghdad, 10 April 2004.

¹⁴ See *Al-Mashriq*, 4 May 2004. An Oxford International poll taken in February found a higher level of optimism. See Oxford Research International, "National Survey of Iraq", February 2004, at http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/15_03_04_iraqsurvey.pdf.

¹⁵ ICG interviews, Diyarbakir, 25-27 May 2004.

¹⁶ See PMO, "Pentagon Backgrounder", 24 May 2004, at http://www.rebuilding-iraq.net/pdf/pmo_update_brief_24_may_04.pdf.

¹⁷ Expenditures are as of 22 June 2004. See The White House, "Third Quarterly Report on Iraq", 2 July 2004.

¹⁸ See Office of Management and Budget, "Report to U.S. Congress Regarding Emergency Appropriations Act for Defence and for Reconstruction of Iraq and Afghanistan, 2nd 90-days report", 2004.

¹⁹ See Republic of Iraq, "2004 Budget", October 2003, and "Revision to 2004 Budget", March 2004.

²⁰ According to their assessment, Iraq will need \$17.5 billion to restore infrastructure and public services to the March 2003 levels; combined World Bank and CPA estimates put total needs in "reconstruction and development" for fourteen "priority sectors" and oil and security over the next four years at \$55.3 billion. World Bank, "Interim Strategy Note of the World Bank Group for Iraq", 14 January 2004.

²¹ ICG interview, northern Iraq, June 2004.

the dirt and garbage in the streets of Baghdad. It would be such a simple task to clean this all up, but it just doesn't happen".²² "I am at a loss to explain the lack of progress", confessed a Kurdish official in Sulaymaniyya. "They were able to bring thousands of tanks to Baghdad in three weeks, so didn't they have plenty of time by now to ship in a few power plants?"²³

B. THE IMPACT OF VIOLENCE

Violence both delayed reconstruction and heightened its cost. "The security problem is our main obstacle", an aid-worker at the British Department for International Development (DFID) said. "We are trying to get Iraqis to take over most of the reconstruction tasks because we can't even get out of the Green Zone [the U.S.-secured compound in Baghdad]. But this capacity building takes time, a lot of time".²⁴ The ripple effects of insecurity are legion: technical teams cannot do night shifts to repair power plants;²⁵ U.S. Agency for International Development (USAID) inspectors cannot perform needs assessments;²⁶ Iraqi officials must spend days away from their offices;²⁷ and insurance premiums are reported to have reached up to 30 per cent of a

company's payroll.²⁸ Sabotage and attacks also seriously hurt the oil industry, threatening Iraq's financial lifeline. Between June 2003 and August 2004, there have been nearly 100 attacks on pipelines, oil installations and personnel despite intense security measures.²⁹

The toll on foreign contractors has been heavy. At least 90 employees were abducted in recent months;³⁰ according to some estimates, 50 to 70 contractor employees were killed in April-May 2004, of whom some 34 worked for the U.S.-based Kellogg, Brown & Root.³¹ While many of these incidents were politically motivated, observers also evoked "a post-Soviet Chechnya scenario in which people settle business rivalries by taking advantage of chaos".³² As a result, foreign companies have been pulling out. "Capital is cowardly", complained an Iraqi entrepreneur. "With every new incident, it is taken out of circulation".³³ By early May 2004, roughly half of all foreign workers had departed.³⁴ All major contractors, including Bechtel, General Electric, Siemens, the Research Triangle Institute and several

²² ICG interview, Baghdad, 16 May 2004.

²³ ICG interview with Noshirwan Mustafa, senior PUK Politburo member, Suleimaniyeh, 3 June 2004. Iraqis also expressed irritation at the CPA's claims of success. "The only thing the CPA has done here [in Basra] is to build a business centre, and then they make a lot of noise about it. It's not a space shuttle going to the moon!" ICG interview with Zuhayr Kubba, Iraqi businessman, Basra, 5 April 2004.

²⁴ ICG interview with DFID official, London, May 2004. Saffin Dizay, a Kurdistan Democratic Party spokesperson, mentioned security problems as the foremost reason for reconstruction delays. "Before rebuilding can get off the ground we have to get the basics right. That means first and foremost improving security". ICG interview, Baghdad, 7 March 2004.

²⁵ ICG interview with official at Dora power plant, Baghdad, 27 February 2004.

²⁶ ICG interview with U.S. Agency for International Development (USAID) official, Baghdad, February 2004. CPA officials speak of a similar predicament. "[CPA] advisers often felt that they were navigating the Iraqi economy virtually blind." Christopher Foote (et. al.), op. cit., p.16.

²⁷ A deputy minister who insisted on proceeding with an interview in an otherwise deserted ministry of planning said, "my wife begged me to stay at home but if I do that I might as well have quit my job years ago. It's been war and trouble here for decades". ICG interview with Fa'iq Abdul-Rasul, Baghdad, 10 April 2004.

²⁸ See Naomi Klein, "Shameless in Iraq", *The Nation*, 12 July 2004. In addition, the cost of security arrangements can be prohibitive. A relatively small security entourage for two travelling foreign entrepreneurs currently approximates \$5,000 per day. Such expenses have forced contractors to increase bidding prices by up to 15 per cent. ICG interview with private security consultant, Diyarbakir, 29 May 2004.

²⁹ See Institute for the Analysis of Global Security, "Iraq Pipeline Watch", at <http://www.iags.org/iraqpipelinewatch.htm>. These figures are far from reliable as many incidents go unreported. Oil production is well below anticipated levels. The Brookings Institution, "Iraq's Oil Sector One Year after Liberalisation", 17 June 2004, at <http://brookings.edu/printme.wbs?page=/fp/saban/luftmemo20040617.htm>

³⁰ See *The Washington Post*, 30 June 2004.

³¹ Estimate by Stan Soloway, president of the U.S. Professional Services Council, cited in *Washington Technology*, 10 May 2004.

³² ICG interviews, Amman, 7-8 May 2004. A senior European aid worker in Iraq said it was no coincidence that kidnappings and assassinations of Russian and Finnish businessmen in that month coincided with "the major rebuilding contracts going up for grabs. Some are trying to frighten their rivals, to make sure they are not there when the bidding starts". In the Arab market of old Baghdad, hit-men were said to be freely advertising their services, including assassinations and kidnappings, against steadily falling prices. ICG interviews with Iraqi businessmen and shopkeepers at the Arab market, Baghdad, April-May 2004.

³³ ICG interview with Mahmud Muhammad Jiwad al-Wesh, vice chairman of the Baghdad Chamber of Commerce, Baghdad, 10 July 2004.

³⁴ See *The New York Times*, 8 May 2004.

Russian electricity companies, withdrew their foreign staff.

Nor has hostage-taking, armed robbery and killings spared Iraqi workers; indeed, it began months before the phenomenon was widely reported in the Western media. Again, motives appear to be part political, part financial: while Iraqis working for the CPA and foreign companies were targeted to send a clear message, in other instances kidnappings were resolved through ransom payments of up to \$100,000.³⁵

II. WHAT WENT WRONG?

Assessments of what went wrong must begin with the impact of violence and the inevitable difficulties of rebuilding an economy ravaged by decades of Baathist misrule and mismanagement, war, and sanctions. But the CPA committed serious and often stunning mistakes which carry important lessons for the current and future Iraqi governments as well as for post-conflict operations generally.

A. RECONSTRUCTING WITHOUT A PLAN

Reconstruction efforts were hobbled by the absence of post-war economic planning. This partly was dictated by extraneous events. U.S. officials had focused on and prepared for humanitarian disasters forecast by international organisations, including the UN, that failed to materialise. The looting in the early days of the occupation (itself, however, a by-product of poor security planning) was so widespread that, in the words of a CPA official, even "if there had been a clear plan, the extensive destruction would have made the original worthless".³⁶

The occupation itself produced political complications, most notably uncertainty and shifting timetables for the transfer of sovereignty and widespread Iraqi hostility to attempts by the occupiers or the local authorities they installed to make decisions liable to commit the country in the long-term. Suspicion that the U.S. was seeking unilaterally to impose its economic vision engendered opposition. Together, these factors inevitably damaged prospects for thoughtful long-term planning.

Even so, the U.S. administration appears to have discarded deliberately what planning did exist, the outcome of months of discussions between more than 200 Iraqi exiles and State Department officials.³⁷ The "Future of Iraq Project" contained recommendations covering "the economy and infrastructure", "public health and humanitarian needs" and "anti-corruption measures".³⁸ Whether its vision was the optimal one is a matter of some dispute;³⁹ what is not is that the

³⁵ ICG interviews with Iraqi businessmen, Baghdad, February-March 2004. A Canadian businessman of Iraqi origin, Naji al-Kuwaiti, told ICG that he was kidnapped shortly after arriving in Baghdad in February 2004. His kidnappers said they had no political motives and demanded a \$1 million ransom. They settled for \$100,000. His business partner in Iraq had been taken hostage earlier and released after paying \$30,000. Al-Kuwaiti had to put his home in Canada up for sale to pay back money his relatives lent for the ransom. ICG interview, Ontario, Canada, 10 May 2004.

³⁶ ICG interview, Baghdad, April 2004.

³⁷ See *The New York Times*, 19 October 2003.

³⁸ See U.S. State Department, "Duty to the Future: Free Iraqis Plan for a New Iraq", <http://usinfo.state.gov/products/pubs/dutyiraq>.

³⁹ See *The New York Times*, 19 October 2003.

project was virtually ignored by decision-makers once the war effort began. The Department of Defence prevented Tom Warrick, the group's coordinator, from playing a role;⁴⁰ and, while some Iraqi participants joined the new Iraqi Reconstruction and Development Council (IRDC),⁴¹ their advice also appears to have been ignored. "We were supposed to work in a 'partnership' [with the U.S.] but in reality we were delegated to a tertiary position", said one member who resigned in protest. "We were never given a formal role [in the reconstruction planning]. There were only private meetings with U.S. officials [in Baghdad] in which we could express some of our views".⁴² Such meetings gradually became rare, until the council stopped convening altogether.⁴³

With Paul Bremer's appointment at the head of the occupation authority, the renamed CPA developed a plan of sorts,⁴⁴ and, in June 2003, Bechtel conducted a needs assessment for infrastructure.⁴⁵ Still, it was hard to discern an effort to fit immediate reconstruction needs within an overall vision or policy framework covering structural reforms, sectoral development or poverty alleviation. Instead, the emphasis was on describing "the most important things that were destroyed and needed to be repaired and what could wait".⁴⁶

In October 2003, the World Bank and several UN agencies presented a joint assessment of reconstruction costs and needs. Although including useful data and some broadly-phrased policy advice, it did not offer a practical blueprint on how to rebuild the economy --

in part a reflection of the international community's awkward position vis-à-vis the occupation. In any event, most recommendations were overlooked by the CPA, which, contrary to the advice of the joint assessment, emphasised standard market reforms.⁴⁷

In December 2003, the Program Management Office (PMO) was given responsibility to oversee spending of \$18.4 billion allocated by the U.S. Congress. Again, however, there appears to have been no overall strategy but rather a list of "things broken that need to be fixed". "We are not economists, we are contractors", explained a PMO spokesperson.⁴⁸ PMO claimed that it cooperated closely with Iraqi ministry of planning officials, suggesting they were in charge of overall planning.⁴⁹ But that ministry had only a catalogue of projects without, apparently, an overarching strategy relating specific projects to economic goals.⁵⁰ Other U.S. agencies were unable to fill this vacuum; as an AID official put it, "the CPA and the PMO are doing the planning for reconstruction now. We are just implementing".⁵¹ Iraqis were surprised and disenchanted, and quite a number deeply suspicious, persuaded that the plan was not so much lacking as it was concealed, and that it aimed less at rebuilding Iraq than at usurping its oil resources.

Inadequate funding was both cause and consequence of improper planning. On the one hand, funds were

⁴⁰ See George Packer, "War After the War", *The New Yorker*, 21 March 2004.

⁴¹ The IRDC was set up "to restore Iraq's badly damaged infrastructure...at least to its pre-war state so that the country could be turned over to a transitional government". Isam al-Khafaji, "Broken Promise: Why I Quit Iraq", *The Guardian*, 18 July 2004.

⁴² ICG interview with Isam al-Khafaji, Uithoorn, The Netherlands, 17 June 2003.

⁴³ ICG interview with former IRDC member, Baghdad, 9 April 2004. The IRDC formally continued to exist, keeping most advisers on its payroll, until 30 June 2004.

⁴⁴ "Achieving the Vision to Restore Full Sovereignty to the Iraqi People" was prepared in July 2003 and revised after the 15 November 2003 agreement. It contains general guidelines as to what "realistically" could be achieved until the hand-over of sovereignty. A revised internal plan from December 2003, "Towards Transition in Iraq: Building Sustainability", a copy of which was obtained by ICG, was similarly short on detail.

⁴⁵ Bechtel, op. cit.

⁴⁶ ICG interview with USAID official in southern Iraq, April 2004.

⁴⁷ The case of agriculture is illustrative. According to the World Bank/UN joint assessment, "it will be necessary to maintain the agricultural input supplies [such as subsidised fertilisers and pesticides that were hitherto supplied by official farmers unions] to make sure that there is no reduction in the level of farm activities. Without these there is a distinct possibility of production failure and massive unemployment, besides a large increase in food imports requirement". United Nations/World Bank, "Joint Iraq Needs Assessment, Agriculture, Water and Food Security", October 2003. The CPA did not implement this recommendation.

⁴⁸ ICG interview with Steven Susens, PMO official, Baghdad, 29 February 2004. A senior Iraqi official complained that U.S. officials had "pulled together engineers lists without an overarching economic or strategic vision". ICG interview, Baghdad, 9 March 2004.

⁴⁹ "Working with the ministries and working with the governorates and others, we tried to find the right set of priorities to work on...It will be very fluid as we move forward". "CPA Briefing with Admiral David Nash", Baghdad, 19 January 2004.

⁵⁰ The plans presented aggregate needs on a ministry-by-ministry basis and sectoral overviews of no more than one page. ICG was given copies of the unpublished plans.

⁵¹ ICG interview in southern Iraq, April 2004.

lacking for the timely undertaking of important tasks, such as reviewing the needs of Iraqi farmers. "We had suggested [this assessment] in June 2003 but there was no money", a CPA official said.⁵² Iraqi surveyors finally were sent to the field a year later. On the other hand, with only partial understanding of the task at hand, U.S. officials could not adequately predict what resources would be needed. In its first request to Congress in April 2003, the Bush administration requested \$2.4 billion in reconstruction funds, and it waited several months before soliciting a supplementary appropriation. Reluctance to present a large bill that risked diluting support for the war effort almost certainly was at play, but so too was ignorance of Iraq's real needs. At the onset of the reconstruction effort, senior U.S. officials, including USAID director Andrew Natsios, placed price tags on Iraq's reconstruction that turned out to be a mere fraction of actual costs.⁵³

B. RECONSTRUCTING WITH AN IDEOLOGY

The occupation authorities were confronted with a legacy of heavy state control and restrictions on commercial activity. Iraq's economy was suffocating under heavy government regulation, subsidies, extensive state ownership and elaborate licensing procedures that hampered both domestic and foreign investment.⁵⁴ Much of the country's business potential was destroyed, turning private commercial activity into the preserve of the privileged few who had access to those in power and to lucrative state procurement contracts.

The CPA had a ready answer to the Baathists' state-centred approach, which one senior Iraqi official dubbed "market fundamentalism".⁵⁵ Bremer said:

[T]here is no substitute for a vibrant private sector. Markets allocate resources much more efficiently than politicians. So our strategic goal in the months ahead is to set in motion policies which will have the effect of reallocating

people and resources from state enterprises to the more productive private firms.⁵⁶

Market-oriented policies, he continued, would lower taxes, privatise state companies, end subsidies, impose fiscal discipline, and dismantle the regulatory regime. However, abstract principles soon collided with reality.

The CPA-led privatisation schemes were both unrealistic and ill-advised given Iraq's conditions. At stake were roughly 190 state-owned companies employing up to 650,000 people.⁵⁷ Aside from oil-related industries, virtually none was deemed viable; some were basically insolvent either due to depleted assets or to the wave of looting that followed the Baathist regime's fall.⁵⁸ Nor were potential buyers likely to be interested until security conditions improved.⁵⁹ Paradoxically, privatisation itself arguably would have fed insecurity, as it inevitably would have entailed the dismissal of thousands of workers, fuelling political unrest and further swelling the ranks of the unemployed.⁶⁰ The CPA's stated intention to embark on this course became intensely controversial, as Iraqis argued the U.S. would be overstepping its rights under international law.⁶¹ The CPA's counter-argument -- that, with each passing day, state-owned assets were depreciating --⁶² had little impact. In any

⁵⁶ "Address by L. Paul Bremer III, Chief Administrator in Iraq", Global Reconciliation Summit, Amman, 23 June 2003.

⁵⁷ For details on Iraq's state owned enterprises, see Iraq United Nations/World Bank Joint Needs Assessment, "State-Owned Enterprises", October 2003.

⁵⁸ To this day, Baghdad street markets offer an array of office furniture, engines, electrical equipment, air-conditioners and other assets stolen from Iraqi state companies.

⁵⁹ One CPA official remarked, "In hindsight it looks mad to have concentrated on such things as foreign investment and privatisation. But the situation now looks much worse than at that time". ICG interview, Baghdad, 30 May 2004.

⁶⁰ The Iraqi minister of industry, Hajim al-Hasani, estimated that only one third of the some 150,000 public sector workers are really needed. *As-Shira'*, 14 July 2004.

⁶¹ According to Peter Goldsmith, a legal adviser for the British government, who cited the restrictions placed on the authority of an occupying power by the 1949 Geneva Conventions and the 1907 Hague Regulations, "[t]he imposition of major structural economic reforms [such as privatisation] would not be authorized by international law". Goldsmith's advice, prepared in March 2003, was leaked to the British press. *The New Statesman*, 26 May 2003. For more on the legality of privatisation under occupation, see *The New York Times*, 10 January 2004.

⁶² "Soon the crown jewels of the state will end up being liquidated when the Iraqis will have to sell them off as scrap. They should prevent this and sell these assets now when they

⁵² ICG interview with CPA official, Basra, 31 March 2004.

⁵³ In April 2003, Natsios estimated costs for Iraq's reconstruction at \$1.7 billion. USAID later commented that this was "the best estimate available at the time, based on very limited information about the conditions inside Iraq". *The Washington Post*, 19 March 2004.

⁵⁴ A flirtation with economic liberalisation in the late 1980s was of brief duration. See *Middle East Report*, vol. 21, no. 3, May/June 1991; *Comparative Politics*, October 1994.

⁵⁵ ICG interview, Baghdad, 9 March 2004.

event, the debate could not be ignored by potential buyers who faced the very real risk that a future Iraqi government would not honour commitments made by occupation authorities.⁶³ The matter never was settled. On 15 November 2003, Bremer announced that the CPA would be disbanded no later than 30 June 2004. Given such a tight deadline, the CPA in effect shelved its privatisation plans.

Although it was not implemented, the CPA's privatisation policy harmed Iraq's economy. Unable to privatise but unwilling to relinquish that goal, the CPA failed to come up with an alternative approach that might have restructured and revived ailing state companies and exploited their remaining assets and labour.⁶⁴ Indeed, even after privatisation was off the table, it was busily drafting and to some extent implementing proposals that preserved its spirit: lease contracts to end state monopoly control and initiate build-operate-and-transfer (BOT) schemes.⁶⁵ Only some of these quasi-privatisation measures actually were carried out, but they helped define the CPA's agenda until June 2004.⁶⁶ Moreover, the CPA froze the accounts of some state-owned companies⁶⁷

still have some value". ICG interview with CPA official, Basra, 31 March 2004.

⁶³ Several Interim Governing Council members expressed unease with the privatisation plans. ICG interviews, Baghdad, March 2004.

⁶⁴ The CPA issued an instruction (Order 76) allowing for such restructuring and reorganisation at virtually the last minute, on 28 May 2004.

⁶⁵ Under BOT schemes, private companies are invited to rehabilitate public utilities or companies in return for the right to operate them for a fixed time period. Assets are subsequently to be returned to the state.

⁶⁶ Quasi-privatisation steps included a proposal to renew and expand a one-year private rehabilitation contract to manage the southern port of Umm Qasr (raising questions about the future of the Iraqi Port Authority and its more than 9,000 employees). ICG interview with USAID official in southern Iraq, April 2004; suspension of the exclusive rights of the Iraqi State Company for Water Transportation, CPA Order 51, 14 January 2004 (a move that could bankrupt the company and force its replacement by a private firm); granting Alia Transportation, a mixed state/private company, rights to operate a national airline, thereby doing away with the state-owned Iraqi Airways' monopoly. (Alia is owned 49 per cent by the Iraqi Transportation Ministry and 51 per cent by the Khawwam family.) The deal was not signed, however, and the CPA's inspector general began an investigation into alleged irregularities that continues. *Los Angeles Times*, 23 June 2004; Iraq Revenue Watch, "Controlling Iraq's Skies: The Secret Sell-off of Iraq's Air Industry", February 2004.

⁶⁷ ICG interview with senior Iraqi official in Baghdad, 9 March 2004.

and sold the inventory of others (principally those under the aegis of the ministry of trade) in order to replenish Iraq's budget.⁶⁸

These decisions led to severe liquidity shortages in several state-owned enterprises, including some that could have been put back in business, if only temporarily.⁶⁹ When coupled with the sweeping de-Baathification that deprived state companies of many of their most able managers and technicians,⁷⁰ the result was that even state industries with a relative comparative advantage (such as cement companies, which benefited from high international transport costs and heavy Iraqi demand) were unable to participate fully in the rebuilding process;⁷¹ instead, increased demand was met with mounting imports. In hindsight, some CPA officials acknowledged their approach might have been too inflexible. "The privatisation issue was kicked around like a football. I am not sure we didn't end up with the worst of two possible worlds", said one⁷² -- not enough privatisation to make a difference, just enough to disrupt the economy. As presented in a recent ministry of industry report, Iraq's state industries are in general disarray, with revenues less than the salaries paid to largely idle labourers.⁷³

The emphasis on privatisation also fed perception among Iraqis that the U.S. had a hidden agenda to get its hand on the country's resources, principally its oil, despite repeated denials by the CPA and Washington

⁶⁸ Ibid.

⁶⁹ An Iraq-based Jordanian business journalist echoed the question raised by many Iraqis: "Why didn't the CPA restructure these state companies first? Then Iraq would receive a much better price for them. They didn't do that because state-owned enterprises simply do not feature in their way of thinking". ICG interview with Khaled Oweiss, Baghdad, 1 March 2004.

⁷⁰ "Now state-owned enterprises are often run by engineers who have no management experience. As a result, management is generally passive and there is a lot of confusion over reporting lines". ICG interview with CPA official, Basra, 31 March 2004.

⁷¹ Some cement factories received CPA support (mostly via Iraqi government funds), for example, in Samawa and Mosul. In the north, Kurdish authorities kept several cement factories running but at capacities far below demand.

⁷² ICG interview, Baghdad, 30 May 2004.

⁷³ The Iraqi ministry of industry estimates that in the first five months of 2004, state factories generated \$73 million in revenues while salary payments exceeded \$85 million. *As-Shira'*, 14 July 2004.

that privatisation of the energy sector was in the cards.⁷⁴

A second pillar of the CPA's free-market effort was embodied in Order 39 of 19 September 2003, which overhauled Iraq's protectionist regime.⁷⁵ It allowed full foreign ownership and unrestricted foreign direct investment (FDI) in all economic sectors except oil and land, though in the latter case leases were permitted for up to 40 years. Order 39 also permitted unrestricted and untaxed profit remittance by foreign entities. The CPA explained, "foreign capital and expertise are essential for rebuilding the Iraqi economy and generating private sector growth, which will provide the jobs and higher incomes sought by all Iraqis".⁷⁶ The policy's principal architect, Peter McPherson, reportedly stated that Order 39 had turned Iraq into "the most liberal regime in the Middle East".⁷⁷

As with privatisation, the issue of foreign investment triggered local debate. Some businessmen -- and, indeed, a number of independent professionals and workers -- considered the policy overdue. If anything, they complained that foreign companies remained reluctant to enter Iraq,⁷⁸ and, notably in the Kurdish regions, that the new law did not go far enough.⁷⁹ Among others, however, objections were widespread. These were made on legal grounds (an occupying force has no right under international law to impose

such radical changes);⁸⁰ politico-economic grounds (the move was dangerous to Iraq's entrepreneurial class, given the private sector's already debilitated state, and yet another indication of a U.S. plan to promote its corporate interests);⁸¹ and more far-fetched conspiratorial grounds (it was paving the way for U.S.-Israeli hegemony).⁸²

Regardless of the Order's economic wisdom, the timing was highly debatable. Given ongoing violence and the absence of an effective legal framework, the prospect of foreign investment remains largely academic, with or without a more permissive legal environment. Some CPA officials, while not disputing the Order's economic rationale, warned against its potentially harmful political effect and questioned the wisdom of expending political capital to rush through an overhaul of the country's trade policies.⁸³

Iraqi businessmen and Western observers alike questioned the considerable effort invested in inaugurating a state-of-the-art stock exchange in Baghdad, asking how stocks could be traded and

⁷⁴ ICG interviews with Iraqi academics and businessmen, Basra and Diyarbakir, April-May 2004.

⁷⁵ The U.S. department of commerce prepared a detailed overview of Iraq's rigid pre-2003 trade regime. See http://www.export.gov/iraq/pdf/iraq_commercial_law_current.pdf.

⁷⁶ CPA, "Private Sector Development", at <http://www.cpa-iraq.org/>.

⁷⁷ ICG interview with CPA official, Baghdad, 30 May 2004.

⁷⁸ ICG interviews, Baghdad, Basra and Diyarbakir, March-May 2004. A senior member of the Iraqi Communist Party in Basra said: "Iraqi companies won't be able to do all the big reconstruction projects. So we need to encourage foreigners to come here, but in a way that will allow both of us to benefit".

⁷⁹ Both the Kurdistan Democratic Party and the Patriotic Union of Kurdistan have been considering laws granting foreign companies tax breaks of up to ten years, a custom duties waiver, discounts on land leases, free security guards and nominal fees for water and electricity. ICG interviews with official at the General Directorate of Trade, Erbil, and with Noshirwan Mustafa, PUK Politburo member, Suleimaniyah, 31 May and 3 June 2004. Replying to Iraqi critics of Order 39, Mustafa said: "These criticisms are fuelled by Baath culture and xenophobia".

⁸⁰ See *Le Monde Diplomatique*, May 2004; *Georgetown Law Journal*, vol. 93, no. 1, 2004. Echoing these legal objections, an adviser to the Supreme Council of the Islamic Revolution in Iraq (SCIRI) said: "With this law on foreign investment, they overstepped their authority as an occupying power. They should stay away from this and instead just manage the administration of the country and prepare the country for elections", ICG interview with Hussayin Adhab, Basra, 30 March 2004.

⁸¹ ICG interviews, Diyarbakir, 25-27 May 2004 and Erbil, 1 June 2004. Some Iraqi entrepreneurs claim that the "influx of cheap and basic commodities harmed Iraq's national industry". ICG interview with Mahmud Muhammad Jiwad al-Wesh. Vice Chairman of the Baghdad Chamber of Commerce, Baghdad, 10 July 2004. According to media reports, some Iraqi businessmen were forced to shut down factories due to "foreign goods invading the Iraqi market". *Al-Manar al-Yawm*, 4 July 2004; ICG interview with an adviser to an Interim Governing Council member, Baghdad, February 2004. Some Iraqi businessmen would have preferred a decree requiring foreign investors to seek an Iraqi partner. ICG interviews, Baghdad and Diyarbakir, March and May 2004. In response, CPA officials countered that the country could not afford to impose such conditions. ICG interviews, Baghdad, Basra and Salah ad-Din, March-June 2004.

⁸² ICG interview with Iraqi businessman in Diyarbakir, 27 May 2004.

⁸³ ICG interview in Baghdad, 30 May 2004. Pepsi-Cola is the only major U.S. company with sizable investments in Iraq. See Ariana Eunjung Cha and Jackie Spinner, "U.S. Companies Put Little Capital Into Iraq", *The Washington Post*, 15 May 2004.

contribute to national rebuilding in a climate of fear where rumours typically substituted for fact and corporate accounting principles were virtually non-existent.⁸⁴ Further examples of how the CPA appeared to elevate liberal economic principles over more immediate economic needs included establishing a sophisticated low-tax regime though Iraq is currently unable to collect its income tax⁸⁵ and adopting a law regulating patent rights despite the absence of a functioning legal regime.⁸⁶ As an Iraqi adviser to an Interim Governing Council member put it:

CPA policies suffered from ideological bias. Iraq is like a patient brought to a bunch of doctors high on theory. But what we need is a general practitioner who knows the history of the patient and prescribes a medicine that suits him.⁸⁷

C. CPA DYSFUNCTION

The CPA, which faced a daunting task that would have strained the capacity of even the best oiled-machinery, was further burdened by bureaucratic infighting and institutional confusion. Problems ranged from disorganisation ("there was no one system within the CPA. Everybody felt like he was working for a different boss. And if your boss disagreed with what you were doing, you simply went to another one");⁸⁸ to excessive red tape and observance of U.S. government standards ("they appointed people at the PMO whose sole job was to make sure that everybody sticks to the 1,200 pages or so of the Federal Acquisition Regulation for every single item purchased. Form prevailed over substance and things were not getting done");⁸⁹ to over-centralisation ("the CPA in Baghdad wants to be in control of everything. To Iraqis we are professing decentralisation but we are not backing our words

with action").⁹⁰ While in some cases the result was merely a contractual impediment, in others -- such as distributing salaries to state employees -- there were potentially ominous political consequences. "They are all waiting here [in Basra] for their money which has to come from the ministry of finance [then under CPA-control in effect]. There is money but there is no coordination, no real procedures".⁹¹

An additional obstacle was the high staff turnover, a function principally of dangerous security conditions: "Staff turnover was frightening. No one stayed longer than six months. As a result there was no institutional memory".⁹² While understandable given realities on the ground, relatively brief tenures at the CPA (generally three months) contributed to a focus on short-term projects.

Turf battles between the State Department and the Pentagon were a major problem, leading to delays in the disbursement of funds and to repeated changes in staff at the expense of experience and know-how. Differences in most instances were at least until very recently settled in favour of the Pentagon, which had far less developmental expertise, thus causing friction between officials it sent to Iraq and development specialists who had been on the ground for some time already. When it became clear that the PMO would be overseeing expenditures, the knowledge and relations with Iraqis build up over months by agencies such as USAID were largely disregarded. In the words of a USAID official, "they jumped in here and never heard of an NGO (non-governmental organisation)".⁹³ "The CPA came to be dominated by Pentagon staff" who lacked a "development perspective", lamented an official of the UK foreign aid agency, DFID.⁹⁴ Some Iraqis levelled far harsher judgment on the qualifications of U.S. advisers.⁹⁵

⁸⁴ ICG interviews in Baghdad and Diyarbakir, March and May 2004. See also *Az-Zaman*, 6 March 2004. The stock market reopened on 24 June 2004. Its elaborate legal framework was promulgated in CPA Order 74, 18 April 2004.

⁸⁵ ICG interviews, Baghdad and Diyarbakir, March and May 2004. Corporate and income tax ceilings were set at 15 per cent.

⁸⁶ See CPA Order 80, 26 April 2004.

⁸⁷ ICG interview, Baghdad, 1 March 2004

⁸⁸ ICG interview with former CPA official, London, 5 May 2004.

⁸⁹ ICG interview with foreign contractor, Diyarbakir, 27 May 2004.

⁹⁰ ICG interview with CPA official, Basra, 27 March 2004.

⁹¹ Ibid.

⁹² ICG interview with CPA official, Baghdad, 30 May 2004.

⁹³ ICG interview with U.S. official, southern Iraq, April 2004.

⁹⁴ ICG interview in London, 22 April 2004.

⁹⁵ Iraqis point to several questionable appointments, including a recent law school graduate reportedly without international experience put in charge of the Council for International Coordination (CIC), the Coalition's donor committee. A CIC member expressed frustration over its chairman, noting that most other non-U.S. members had been involved in post-conflict reconstruction in Bosnia, Rwanda and Cambodia. ICG interview, Baghdad, 26 February 2004. The CPA also appointed a 24-year-old with little if any financial background to revamp Baghdad's stock exchange. See *Wall Street Journal*,

Following the formal handover of sovereignty on 28 June 2004, the State Department appears to have gained a larger say in managing the reconstruction effort. With the opening of the U.S. embassy in Iraq, the reconstruction responsibilities of the CPA were given to the Iraq Reconstruction Management Office (IRMO), which will serve as a management staff for U.S. Ambassador Negroponte. IRMO will be headed by Ambassador William Taylor, who most recently served as the State Department's coordinator for Afghanistan. According to government officials, IRMO will be a temporary office of the embassy, meaning it will last for the next "few years" or "as long as the \$18.4 billion needs oversight and planning and spending".⁹⁶ Several implementing agencies will serve under it, including the U.S. Army's Project and Contracting Office (PCO), headed by Charles Hess, who most recently served as the director of the operations and response division of the U.S. Department of Homeland Security. The PCO will implement the majority of IRMO projects and also manage agencies involved in the reconstruction.

Whether this institutional change will end the wrangling between the two agencies -- and lead to clear State Department predominance -- remains to be seen.

D. SHIFTING DEADLINES

To the extent that the U.S. was guided by a strategic outlook, it was seriously hobbled by shifting timetables. The sudden announcement on 15 November 2003 that the CPA would be dissolved by the following July had the greatest impact: when "the CPA is not supposed to last very long, a real long-term strategy becomes impossible".⁹⁷ Faced with a quick deadline, CPA officials readjusted their plans, putting the emphasis on projects that could be completed in short order, without regard to how they fitted in an overall reconstruction strategy or whether they addressed real immediate needs. Attention shifted to high-visibility, but often low-impact, projects (constructing impressive business centres; auctioning Iraq's metal waste; equipping Karbala with

a "state of the art library with 500,000 titles, internet connection and DVDs"⁹⁸). "High level nonsense, Saddam-style" is how some Iraqis saw it.⁹⁹

Among the principal casualties were projects aimed at bolstering Iraq's institutional capacity and rationalising financial and monetary policies. For instance, USAID had asked the Research Triangle Institute (RTI) to overhaul local government structures and empower governorates and municipalities to begin running their own affairs. Once transfer of sovereignty was accelerated, the intended budgetary devolution was set aside, leading to a paradoxical situation in which RTI was "empowering" local municipality workers to carry out tasks for which they were not to receive any central funding in the foreseeable future.¹⁰⁰ An RTI employee observed: "Local governments now only have a budget for office supplies and their own salaries. We created a great myth. There is no local budget for the governorates".¹⁰¹ Likewise, after the 15 November agreement, "there was a complete withdrawal of the CPA from [financial and monetary] policies. The outcome is that we have no economic policy or strategic vision to speak of".¹⁰²

Diminished appetite for long-term development projects would not have been so harmful -- and indeed might even have helped -- had it been accompanied by increased emphasis on immediate, short-term socio-economic needs. It was not. Instead, long-term projects were hastily re-configured to yield immediate results rather than rethought with the aim of improving citizens' daily lives.

With this arbitrary 30 June date looming, our policies became destination-based. We developed a past-the-post-mentality, first because of 21 March when we had to show what we had achieved in one year's time and then 30 June [with the transfer of sovereignty]. So you get job-done stickers, which produce very good reports but are ultimately counterproductive. It

28 January 2004, and *The Washington Post*, 21 February 2004 and 23 May 2004. "We are ruled by teenagers", complained an Iraqi businessman. ICG interview, Basra, April 2004.

⁹⁶ "Briefing on the Transition from Coalition Provisional Authority to U.S. Mission, Baghdad, Iraq", Washington DC, 9 June 2004, at <http://www.state.gov/p/nea/rls/rm/33359.htm>.

⁹⁷ ICG interview with CPA official, Basra, 31 March 2004.

⁹⁸ ICG interview with CPA official, Karbala, 28 February 2004.

⁹⁹ ICG interview with Iraqi guard to Basra business centre, Basra, 4 April 2004.

¹⁰⁰ On 6 April 2004 the CPA issued Order Number 71 intended to bolster local government powers. However, the order failed to provide governorate councils with their own budgets for reconstruction and public services.

¹⁰¹ ICG interview with John Doane, Basra, 5 March 2004.

¹⁰² ICG interview with senior official, Iraqi Ministry of Trade, Baghdad, 9 March 2004.

doesn't produce the effects we hoped to achieve on Iraq's institutions.¹⁰³

The temptation to peg projects to short-term deadlines is likely to recur, first as the U.S. administration faces elections in November 2004 and then as Iraq braces for elections in January 2005. In both instances, it will be critical to avoid past mistakes, preserving those long-term projects that make sense from a development perspective, while implementing shorter-term initiatives in areas of urgent need, such as employment-generation and living conditions improvement.

E. REBUILDING FOR OR BY IRAQIS?

A main lesson from post-conflict efforts worldwide is the need to involve the local population in the rebuilding process. Unfortunately, there was little of this in Iraq. Instead, decisions appear to have been made by the occupation forces, at best in coordination with a small group of non-elected (and often formerly exiled) Iraqis. The cost of insufficient local involvement and consultation was several-fold: mistaken priorities, a disconnect between Iraqi aspirations and rebuilding efforts, and a lost opportunity to empower Iraqis, reform their institutions and, more generally, strengthen local capacity. In the words of a USAID official: "we didn't sufficiently involve Iraqis. We are here not just to do some physical rebuilding, but also to facilitate psychological and social repairs".¹⁰⁴

1. Consultation and capacity-building

From the outset, the CPA was inclined to impose its views, with only marginal local input. Leading Iraqi economists complained that they were never approached by the CPA or other U.S. agencies.

They are not consulting our academic institutions. Like the previous regime they don't see us as relevant to policymaking. In contrast, we have begun listening to them. We know that we have a lot of catching up to do. But they probably think that we were teaching socialist economics. Nothing is further from the truth. For decades we have taught standard economics, from Pareto to Keynes. That's the

big difference between us and the formerly communist countries in Eastern Europe.¹⁰⁵

An oil economist at Baghdad's Mustansariyya University claims repeatedly to have proposed sharing his research with the CPA adviser to the oil ministry, to no avail. "We have over 100 economic researchers here specialising in five different fields and not one of us was approached. All this knowledge and work is just being wasted".¹⁰⁶ An adviser at the Iraqi planning ministry echoed this: "Some of the best people with PhDs from all over the world are sitting at home doing nothing. No one thought of asking them for advice".¹⁰⁷ As further evidence, UN and European officials report that they were not asked for names of Iraqis with whom they had worked on electricity and sanitation projects in the 1990s.¹⁰⁸

The detrimental effects of insufficient consultation soon became clear. For example, Iraqis claimed that the selection of schools for urgent repair work reflected lack of local knowledge that could easily have been remedied through consultation since officials at the ministry of planning had detailed inventories of all Iraqi educational institutions.¹⁰⁹ Nor were local councils asked for their priorities in this regard.¹¹⁰

There were extenuating circumstances. In the wake of war, chaos in Iraq's public institutions and widespread absenteeism among officials and technocrats limited access to personnel and know-how. But the argument goes only so far. Even institutions established by the CPA, such as the Interim Governing Council, appear to have had very little say on basic economic decisions,¹¹¹

¹⁰⁵ ICG interview with Hajir Adnan, Iraqi economist, Baghdad, 6 March 2004.

¹⁰⁶ ICG interview with 'Ali Ubaydi, dean of economics and administration, Mustansariyya University, Baghdad, 6 March 2004.

¹⁰⁷ ICG interview, Baghdad, 10 April 2004.

¹⁰⁸ ICG interviews, Amman, April 2004.

¹⁰⁹ "We were there, carrying the inventories. But they failed to consult us". ICG interview with Iraqi planning director at the ministry of education, Baghdad, 9 March 2004; also ICG interviews, Baghdad and Basra, March-April 2004. Repair work was conducted by Bechtel, operating under a USAID contract. An Iraqi employee at Bechtel confirmed the ministry of education official's account. ICG interview, Baghdad, March 2004.

¹¹⁰ Ibid.

¹¹¹ ICG interview with Hamid Majid Musa, member of the Iraqi Interim Governing Council, Baghdad, 1 March 2004.

¹⁰³ ICG interview with CPA official, Basra, 31 March 2004.

¹⁰⁴ ICG interview, southern Iraq, April 2004.

not only privatisation,¹¹² but also financial and monetary policy.¹¹³ U.S. agencies, including the PMO, claimed they informed the Interim Governing Council about their projects, though they acknowledged that it had "no ability to push back on what we [were] doing".¹¹⁴

In an effort to remedy this, in January 2004 several Iraqi ministers and Interim Governing Council members formed a "higher body for economic policy" to establish a framework for reconstruction policy, including on regional integration, tariff and exchange rate policies and sectoral development.¹¹⁵ But the Council's own uncertain standing -- its weak domestic legitimacy, temporary nature, and junior status vis-à-vis the CPA -- undercut this endeavour. "There hasn't been much discussion about reconstruction because the Council is temporary. The details of the rebuilding projects were left to the CPA. We asked a few times for a greater role but we were turned down", a former member explained.¹¹⁶

The role of Iraqis in reconstruction was expanded, in principle, with the appointment of 25 ministers in September 2003 and, in December, of a planning ministry charged with coordinating overall donor activity and setting reconstruction priorities. Yet, CPA "coordinators" -- later renamed "advisers" -- effectively ran the ministries while Iraqis complained about a lack of genuine consultation.¹¹⁷ Senior ministry officials insisted they had little knowledge about how Iraq's oil revenues were being spent and managed. Whatever information they received came "when we asked for it. Nothing came voluntarily".¹¹⁸

U.S. officials make the strong case that Iraqi ministries lacked necessary institutional capacity either to take or implement well-informed decisions. As a senior official at the trade ministry explained, in September 2003 his offices were "a complete mess. It was an institution designed for a different world, for Mars".¹¹⁹ Most ministries lacked basic information, including how much staff was on the payrolls.¹²⁰ For a variety of reasons, Iraqis often failed to display initiative in seeking to be heard. Many, having dismissed the Interim Governing Council as a creature of the occupation, had strong reservations about dealing with it. Complaints about the CPA's inadequacy and lack of consultation with Iraqis on the one hand, and refusal to work with it and "its colonial council" on the other, often went in tandem.¹²¹ "We didn't ask them [the CPA and the PMO] anything. They should come to us. They are foreigners, not we. I am not going to kiss their feet".¹²² Suspicions carried over to international humanitarian organisations that benefited from CPA-funded reconstruction contracts.¹²³ It often took months before Iraqis were willing to interact with them.

Nor does Iraq currently possess the institutional or political instruments capable of formulating alternative policy proposals. It may boast some 135 political parties, but the number vastly overstates their influence or capacity.¹²⁴ None, so far, appears to have developed a clear economic program or agenda; a SCIRI representative acknowledged that it had no economic platform and, when asked, a representative from *al-Da'wa* could proffer only that it stood for "an Islamic economy".¹²⁵ While the Iraqi Communist Party traditionally has shown considerable interest in socio-economic issues, themes of its recent symposia

¹¹² ICG interview with former CPA official, London, May 2004. Interim Governing Council members were taken aback by Finance Minister Kayani's September 2003 privatisation announcement and issued a statement denying that they approved the measure. See Agence France-Presse, 26 September 2003.

¹¹³ ICG interview with adviser to Interim Governing Council member, Baghdad, 1 March 2004.

¹¹⁴ ICG interview with Steven Susens, PMO spokesperson, Baghdad, 29 February 2004.

¹¹⁵ ICG interviews with senior trade ministry official, Baghdad, 9 March 2004 and with adviser to Interim Governing Council member, Baghdad, 1 March 2004.

¹¹⁶ ICG interview with Hamid Majid Musa, Interim Governing Council member, Baghdad, 1 March 2004.

¹¹⁷ ICG interviews with Planning Ministry official and senior ministry officials and Iraqi observers, Baghdad, April-June 2004.

¹¹⁸ ICG interviews, Baghdad, March-April 2004. Similar problems have been recently reported. Referring to PCO

efforts to repair the sewage system, Abdul Latif Rashid, Iraq's Water Resources Minister, said: "I know some projects have been awarded, but what stage they are at and what progress has been made, I am not aware of". Reuters, 19 August 2004.

¹¹⁹ ICG interview, Baghdad, 9 March 2004.

¹²⁰ Ibid.

¹²¹ ICG interview with Humam Shama', Iraqi economist and consultant, Baghdad, 7 April 2004.

¹²² ICG interview with Jabaar al-Zaraayid Mansour and Zuheir Kubba, Basra Chamber of Commerce, Basra, 3 April 2004.

¹²³ ICG interview with foreign NGO aid-worker, Basra, 3 April 2004.

¹²⁴ The figure is from the Higher Preparatory Committee for a National Conference in Iraq, cited in *Al-Hayat*, 18 July 2004.

¹²⁵ ICG interviews with Sayyid Tahr Mater al-Hashimi, SCIRI, Basra, 30 March 2004, and Sayyid Ali Aref al-Musawi, *al-Da'wa*, Basra, 1 April 2004.

(including "Marxist theory after the cold war") are, at the very least, somewhat removed from ordinary Iraqis' day-to-day preoccupations.¹²⁶

A history of authoritarian and repressive rule presented another impediment, discouraging questioning of official decisions. "Assertiveness then was not appreciated and indeed could be very dangerous. We are not used to taking the initiative. We wait to be asked".¹²⁷ CPA officials were frustrated with apparent passivity even in the face of problems requiring immediate attention. Political activism does not come naturally either. Asked why he would not set up a news outlet or party sympathetic to his interests, an entrepreneur who railed against the business community's lack of representation admitted, "we never thought of that".¹²⁸

Still, the CPA aggravated rather than addressed these problems: first firing up to 30,000 high-ranking Baath party members from public administration jobs and then neglecting the vital task of capacity-building.¹²⁹ "Very little was done to empower the ministries", acknowledged a European official overseeing aid to Iraq.¹³⁰ Officials at the Iraqi planning ministry confirmed this.¹³¹ The formal transfer of sovereignty provides a new opportunity to give Iraqis a more substantial role in reconstruction. Certainly, the new government has more leeway in setting priorities and overseeing implementation of Iraqi-funded projects. But the real question involves U.S. assistance funds, still and for the foreseeable future the lion's share of all reconstruction.¹³² The U.S. insists on strict oversight; a CPA official explained, "PMO's money is from the U.S. So they set the priorities, and they don't necessarily have to work like a foreign donor who will have to go through the ministry of planning and

its needs assessment".¹³³ The challenge is to engage in actual consultation and achieve real Iraqi involvement.¹³⁴ As matters stand, the PCO risks duplicating the CPA's central mistake, which was to treat Iraqi participation and capacity-building as an afterthought, rather than an integral component of reconstruction.

2. The private sector

Iraqis complain that foreign rather than local contractors have been awarded the bulk of reconstruction activity. Citing the urgent need for progress, U.S.-funded projects were indeed channelled through 30 so-called prime foreign companies. But, recognising the importance of building Iraq's private sector, U.S. officials as well as prime contractors have been meant to subcontract as much as possible to local companies¹³⁵ and to provide them logistical support. One prime contractor, Bechtel, leased machinery and made partial advance payments to Iraqi companies that lacked sufficient start-up capital.¹³⁶

For all that, however, there is little doubt that the contracting process has favoured foreign outfits and that, in practice, prime contractors are not required to subcontract to Iraqi companies.¹³⁷ Indeed, neither CPA agencies nor prime contractors have clearly identified how much of the subcontracting ultimately

¹²⁶ ICG interview with Iraqi left-wing activist, Baghdad, 9 April 2004.

¹²⁷ ICG interview with Hajir Adnan, Iraqi economist, Baghdad, 6 March 2004.

¹²⁸ ICG interview with Jabaar al-Zaraayid Mansour and Zuheir Kubba, Basra Chamber of Commerce, Basra, 3 April 2004.

¹²⁹ ICG interviews with senior officials at the trade and planning ministries, Baghdad, April 2004.

¹³⁰ ICG interview with European official, Amman, 14 April 2004.

¹³¹ ICG interview with planning ministry official, Baghdad, 10 April 2004.

¹³² Compared to the \$10 billion budgeted by the PMO for 2004, Iraqi-funded reconstruction will be rather modest. The government budgeted only \$3.8 billion in 2004 for capital expenditures (reconstruction). See Republic of Iraq, "Revision to 2004 Budget", March 2004.

¹³³ ICG interview, Baghdad, March 2004. Describing its organisation chart, a PMO statement reads, "The top layer represents the 'ownership,' in other words, the people of the United States. After all, America is providing the capital necessary to undertake this project". PMO, "Program Management Office Concept of Operations", at <http://www.rebuilding-iraq.net>.

¹³⁴ A UK aid official told ICG that he and his colleagues had urged the PMO "to operate through the Iraqi institutions, not parallel to them". ICG interview with DFID official, London, 22 April 2004. The State Department reportedly holds a similar view and has been at logger heads with the Pentagon over this issue. See *The New York Times*, 27 July 2004.

¹³⁵ ICG e-mail exchange with Gregory Huger, Bechtel spokesperson, Baghdad, 21 March 2004. For a list of all main contractors in Iraq, see PMO at <http://www.rebuilding-iraq.net/pdf/contracts/> another_contract_in_place_constr_iraq.pdf and USAID at <http://www.usaid.gov/iraq/activities.html#contracts>.

¹³⁶ ICG interview with Gregory Huger, Bechtel spokesperson, Baghdad, 2 March 2004.

¹³⁷ ICG e-mail exchange with Gregory Huger, op. cit. According to recent reports, U.S. companies received the lion's share of Iraqi-funded reconstruction projects. Moreover, 85 per cent of the \$2.26 billion of Iraqi funds allocated by the CPA were channelled to U.S. companies. *The Washington Post*, 4 August 2004.

went to Iraqis. Available data is only partially revealing. For instance, Bechtel claims that "for about 70 per cent of our jobs Iraqi companies have been able to do the work".¹³⁸ But whereas a large number of Iraqi firms conducted small-scale jobs such as school repairs, foreign contractors typically have been given much larger (and more highly paid) tasks; both types of jobs are weighed equally in the balance sheet. As an Iraqi noted, "it's not about the number of contracts, but about the value of these contracts".¹³⁹ Asked to comment, Bechtel replied it does "not give out information on the value of subcontracts".¹⁴⁰

More generally, Iraqi businessmen question the rationale for granting prime contracts to foreign -- principally, U.S. -- corporations rather than investing in Iraq's future with, for example, joint ventures between foreign and indigenous entities.¹⁴¹ The argument that Iraqi companies lack the necessary technology and know-how, they claim, is incomplete; a number of jobs could have been carried out locally at much reduced costs.¹⁴² In the words of an Iraqi entrepreneur: "All this subcontracting is simply window-dressing to show the world that they are working with Iraqis. In reality, the reconstruction is left to U.S. companies. Iraqis can just do the petty, dirty jobs, like painting schools, while U.S. companies are making millions".¹⁴³ Another Iraqi businessman echoed this: "We need maximum opportunities for small and medium Iraqi enterprises that will be Iraq's backbone. By changing and revitalizing them, you will change Iraq".¹⁴⁴ Iraqis complain further that subcontracting is used by foreign companies to skim off profits while passing on the

bulk of the work to locals for a fraction of the contract price.¹⁴⁵ Ed Kubba, a member of the American-Iraqi Chamber of Commerce, asked, "if you take \$10 million from the U.S. government and sub the job out to Iraqi businesses for \$250,000, is that fair business practice, or is it corruption?"¹⁴⁶

A separate albeit related grievance is that the bidding process has favoured companies established by exiled Iraqis who could document a track record abroad; in contrast, indigenous Iraqis often lacked the requisite paper work.¹⁴⁷ Politics, Iraqis fear, is never far from the surface. "The U.S. has more confidence in Iraqi expatriates. They think that in every local Iraqi hides a Saddam".¹⁴⁸ For Iraqi businessmen, another obstacle is the lack of transparency; unable to understand why their offer was passed over, they both distrust the process and are unable to adjust their bids for future tenders.¹⁴⁹

To be sure, the Iraqi private sector faces formidable obstacles -- chronic electricity cuts, administrative chaos, a rudimentary banking system and little to no credit facilities.¹⁵⁰ As a result, it sometimes has difficulty to offer competitive prices or quality; this explains, for example, why food and other basic consumer goods purchased by the Ministry of Trade and then freely distributed under the rationing system have been almost entirely imported.¹⁵¹ However, a number of Iraqi officials and economists argue that if the goal is -- as it ought to be -- to encourage local business growth, U.S. and Iraqi procurement policies

¹³⁸ Ibid. Bechtel says it awarded 158 subcontracts out of a total of 229 to 119 different Iraqi companies. See <http://www.bechtel.com/iraq.htm>.

¹³⁹ ICG interview with Saad Bunnia, Iraqi businessman, Baghdad, 7 March 2004.

¹⁴⁰ ICG email exchange with Gregory Huger, op. cit.

¹⁴¹ ICG interview with Saad Bunnia, Iraqi businessman, Baghdad, 7 March 2004; ICG interviews with Iraqi businessmen at "Destination Baghdad Expo", Diyarbakir, 26-27 May 2004.

¹⁴² "They gave this British company [Barings] a multi-million dollar contract to build a business centre in Basra. What have they done that we couldn't have done? Repairing a building, installing some computers and putting some tables and chairs in a conference room, we could have done that at a fraction of the cost". ICG interview with Jabar al-Zarayid Mansur, Basra Chamber of Commerce, Basra, 3 April 2004.

¹⁴³ ICG interview with Saad al-Bunnia, Iraqi businessman, Baghdad, 7 March 2004.

¹⁴⁴ ICG interview with Iraqi businessman, Diyarbakir, 27 May 2004.

¹⁴⁵ "A U.S. company approached me and asked whether I could assemble and manage a team of Iraqi economists. Of course I could do that but they offered us only 20 per cent of the profit for a job that we could easily do ourselves". ICG interview with Humam Shama', Iraqi economist and consultant, Baghdad, 7 April 2004.

¹⁴⁶ Cited by Naomi Klein, *The Nation*, 5 January 2004.

¹⁴⁷ ICG interviews, Baghdad, February-March 2004.

¹⁴⁸ ICG interview with Saad Bunnia, Iraqi businessman, Baghdad, 7 March 2004.

¹⁴⁹ ICG interviews with Iraqi businessmen, Diyarbakir, 26-27 May 2004.

¹⁵⁰ The Iraqi State Industrial Bank recently began a modest credit scheme. *Al-Mu'tamar*, 1 August 2004.

¹⁵¹ ICG interview with senior official at the trade ministry, Baghdad, 7 April 2004. Muhammad Mustafa al-Jaburi, the current trade minister, argued against favouring local companies in the supply of food items. "Such government policies proved irresponsible [in the past] and resulted in the purchase of poor quality food stuffs at high prices". *Al-Mada*, 15 August 2004.

should be skewed in favour of local firms.¹⁵² In their view, "costs should also be assessed in terms of the losses suffered by private sector development".¹⁵³

F. CHALLENGES AHEAD

The occupation's unique circumstances and the burden it placed on the Iraqi institutions it established undoubtedly account for a number of existing problems. With the transfer of sovereignty to the new Interim Government and, further down the road, an elected one, some of these may subside; more legitimate and authentic institutions arguably will be better positioned to address citizens' everyday needs. But even a credible process that unfolds smoothly -- no easy objective to meet -- would only provide part of the answer. Many issues the CPA struggled with remain, and the occupation authorities have not truly disappeared: the U.S. importantly continues to control most reconstruction funds and is the largest donor.

A chief task for Iraq is to produce, in coordination with its partners and principally the U.S., a comprehensive reconstruction plan that harmonises various projects and incorporates them into a more coherent, long-term development vision.

Economic diversification. Although economic diversification and reduction of Iraq's oil dependency is unrealistic in the immediate future, it ought to be a guiding principle for project design. The industrial and agricultural sectors will require active support, even at the expense of conventional free market principles and wholesale privatisation.

Putting the brakes on privatisation. In the long run, and under improved circumstances, Iraq undoubtedly will need to privatise the vast state-owned sector inherited from the Baathist era. Yet, with high unemployment, weak institutions and imperfect market conditions associated with continuing security problems and fledgling economic foundations, hurried privatisation is likely to do more harm than good -- certainly more political harm than good. Acknowledging this and postponing the issue until

after elections -- as Iraq's new leaders seem prepared to do -- is not enough.¹⁵⁴ State-owned companies need to be restructured and, to that end, receive active financial and managerial support. The goals should be to use all available Iraqi assets for reconstruction, and to make these companies more dynamic and profitable before they are privatised, while at the same time working to establish a framework for competitive private enterprise in which smaller businesses will have a chance to flourish because the large companies, whether state-owned or eventually privatised, will not monopolise all advantages.

A careful free trade policy. Opening Iraq to foreign investment will equally be important to consolidate its economic recovery. This should not, however, be the overriding priority and is also not particularly feasible so long as security conditions are precarious and the basic institutional structures and legal regime are lacking. In the medium term, how to link foreign investment to policies for strengthening the local private sector needs to be thought through carefully. Iraq should encourage joint partnerships between local businesses and foreign investors -- for example by requiring the latter to give contracts to the former, to employ Iraqi labour to the fullest extent possible and provide on-the-job training when appropriate human resources do not exist locally. Given high anticipated profit margins in Iraq's oil-rich environment, the government should consider asking foreign companies to contribute to development, for instance through local reinvestment of revenues. Likewise, the low corporate tax rates on foreign investment should be reviewed and, when economic circumstances permit, increased to levels reconciling high incentives for foreign investment with the imperatives of generating additional state income and encouraging local entrepreneurship.

Building an institutional framework. Attracting international investment and bolstering the private sector requires strong institutions ensuring predictability in commercial transactions. In this respect, steps to ensure government transparency, full access to economic data, accountability, and establishing independent business courts and other mechanisms for arbitration are vital. A sound regulatory framework also will require legislation

¹⁵² ICG interviews with Nasir Da'ud Salam al-Halfi, deputy director of the Basra rationing bureau, Basra, 12 June 2004; with an adviser at the Ministry of Planning, Baghdad, 10 April 2004 and with Ghiyat Hamid Majid, Dean of the Agriculture College, Basra University, Basra, 28 March 2004.

¹⁵³ ICG interview with adviser at the ministry of planning, Baghdad, 10 April 2004.

¹⁵⁴ "Privatisation is a political and sovereign decision. There is an agreement that [this] decision must be made by an elected Iraqi government". Iraqi Industry Minister Hajim Al-Husayni cited in *Al-Quds*, 18 July 2004.

and institutions to counter monopolistic practices harmful to both investors and consumers.

Developing the private sector. This ought not be a side benefit of reconstruction but one of its core goals. Prime contractors should be contractually obligated, as much as possible, to subcontract to local companies. Authorities also should insist that major foreign contractors disclose the value of subcontracts awarded to local entities and seek, in coordination with donors, to improve the efficiency of such entities. Finally, procurement policies should be geared toward promoting local business, looking beyond strict cost and quality criteria.

All this will require a more elaborate perspective on reconstruction and development than currently exists. This is difficult to expect given the transitional nature of governing institutions and their lack of legitimacy, which inhibits sensible but controversial policies and militates against a coherent long-term economic plan. One way to address this problem is to focus simultaneously on immediate material improvements and job creation. Another is to increase substantially communication and consultation with and participation of Iraqi citizens. Much depends on the local level -- governorates, municipalities, districts -- and requires strengthening the representative and decision-making qualities of local institutions. Decentralisation, wide consultation at early project design stages and participation by relevant ministries and local civil society groups in implementation would maximise the effectiveness of reconstruction and enable a longer-term vision to form. All this requires resisting the twin legacies of Iraq's over-centralisation and the CPA's excessive U.S. ownership -- in other words, resisting the temptation of rebuilding Iraq without Iraqis. Lessons can be learned from some of the remaining foreign NGOs, who, for instance, have delegated responsibility for choosing priorities and selecting school repair contractors to local assemblies of teachers and parents.¹⁵⁵ It also will be the responsibility of Iraqis to insist on consultation and be prepared to participate in implementation.

¹⁵⁵ The NGO Save the Children adopted this approach in Basra. ICG interview with foreign aid worker, Basra, 30 March 2004.

III. THE PROBLEM OF UNEMPLOYMENT

In the early days of the occupation, it became an article of faith that success depended on persuading Iraqis that their everyday lives would experience significant material improvement; priority, therefore, had to be given to quick socio-economic gains. A year later, the balance sheet is distressingly disappointing. Although insecurity clearly tops the list of Iraqi preoccupations, failure to deliver tangible material progress has been a crucial factor in turning sentiment against the CPA and the Iraqi institutions it established. Virtually all opinion polls tell the same story: the most critical issues, after public safety and security, are "economic issues, unemployment and poverty", and, on this score, dissatisfaction is widespread.¹⁵⁶ In the absence of more effective steps, the Interim Government is unlikely to retain whatever legitimacy it currently enjoys.

A. EMPLOYMENT AND PUBLIC WORKS

The exact level of unemployment is controversial, with estimates ranging from 25 to 50 per cent of the workforce.¹⁵⁷ Regardless, Iraqis interviewed by ICG overwhelmingly mentioned unemployment as one of the most serious problems and believed that its persistence, together with insecurity, was the CPA's most glaring failure. In the words of a social activist, "unemployment is so huge that we can easily claim here at the Iraqi Union for the Unemployed that we enjoy the country's largest constituency -- for sure

¹⁵⁶ Iraq Centre for Research and Strategic Studies, "The results of the 7th public opinion poll in Iraq, Field Research: January 2004". See also the poll commissioned by the CPA, "Public Opinion in Iraq, First Poll Following Abu Ghraib Revelations", 14-23 May 2004.

¹⁵⁷ Various institutions use different methodologies and definitions. The CPA has mentioned a 25 per cent unemployment rate. See The Washington File, "Commerce Secretary Evans Urges U.S. Businesses To Deal with Iraq", at http://www.iraqcoalition.org/pressreleases/20040212_commerce.html. The Iraqi Ministry of Planning released a figure of 30 per cent. See Central Unit for Statistics, "Taqrir hawl nata'ij masah al-tashghil wa al-batala li-sana 2003", January 2004. The Iraqi Ministry of Social Affairs put the rate at 48 per cent. *Al-Mada*, 6 May 2004. According to a report by the Brookings Institution, it is somewhere between 28 and 45 per cent. See Brookings Institution, "Iraq Index", updated 16 July 2004, at <http://www.brookings.edu/fp/saban/iraq/index.pdf>.

larger than that of the CPA and the Interim Governing Council".¹⁵⁸

That the CPA inherited a host of structural and other problems is undeniable, but it quickly added to the list: the sweeping de-Baathification order and the army's disbandment are the two most widely cited missteps.¹⁵⁹ Loss of jobs meant loss of income, compensated, at best, by scant savings and irregular earnings by wives.¹⁶⁰ Widespread looting and the collapse of state institutions, particularly those specializing in agriculture, deprived tens of thousands of farmers of their means of subsistence, rendering them effectively jobless.¹⁶¹ The sale, at heavily subsidised prices, of fertilizers and pesticides also came to a halt with the fall of the Baathist regime.¹⁶² Lacking such necessary items, farmers saw plots turn into wastelands, while disease and severe salinity destroyed many of the crops they still managed to grow. A number of farmers sought alternative jobs in urban areas, where unemployment already was taking its toll.¹⁶³

Evidence suggests that neither the CPA nor Iraqi officials were aware of the gravity of the overall situation. An Iraqi municipal official in charge of reconstruction policy commented: "If farmers work hard, their production levels will recover. They can afford the new prices for fertilizers and pesticides".¹⁶⁴

¹⁵⁸ ICG interview with Qassim Hadi, Union for the Unemployed, Baghdad, 2 April 2004.

¹⁵⁹ A former Iraqi Airways pilot explained: "They told me you don't have a salary any more. You are a Baathist. Since then I have stayed at home and haven't earned a dinar. It's like begging. It's pure humiliation". ICG interview, Baghdad, 28 May 2004. See also ICG Middle East Report N°. 27, *Iraq's Transition: On A Knife Edge*, 27 April 2004; ICG Middle East Report N°. 20, *Iraq: Building A New Security Structure*, 23 December 2003. In May 2004, the CPA reversed itself; Bremer stated on Iraqi television that de-Baathification had been "applied unevenly and unjustly". *The Washington Post*, 4 May 2004. Approximately 12,000 Baathists subsequently were re-hired. .

¹⁶⁰ ICG interviews with ex-Baath members, Baghdad, May and July 2004.

¹⁶¹ Agriculture accounts for roughly 20 per cent of employment in Iraq. See United Nations/World Bank Joint Iraq Needs Assessment, "Agriculture, Water and Food Security", October 2003.

¹⁶² According to a CPA official, prices for fertilizers since the fall of the Baath regime have nearly tripled. ICG interview with CPA official, Basra, 31 March 2004. Farmers interviewed by ICG complained of a significant price increase. ICG interviews, north of Basra, 5 April 2004.

¹⁶³ ICG interviews, north Basra, 5 April 2004.

¹⁶⁴ ICG interview, Basra, 30 March 2004.

In December 2003, a U.S.-funded agricultural support scheme budgeted at \$40 million was cut back to \$5 million as new priorities were set.¹⁶⁵ What measures were taken -- such as purchasing fertilizers and then reselling them at subsidised prices, or establishing palm nurseries to boost date production -- were inadequate. In a farmer's words, "we need support in this transitional phase. Saddam's agricultural policy was a disaster, but parts of the old system should have been retained".¹⁶⁶

Further exacerbating the situation was the lack of attention to women's unemployment and their necessary integration into the workforce. Women comprise over 60 per cent of the population, but only 20 to 25 per cent of the work-force;¹⁶⁷ their unemployment rate is far higher than that for men. The CPA appears to have underestimated the economic, political and social importance of women's empowerment and involvement in reconstruction.¹⁶⁸

Iraqis also complain that, just as prime contractors rely excessively on foreign subcontractors, those subcontractors rely excessively on foreign -- chiefly Asian -- labour, viewed as more efficient and subject to less cumbersome vetting procedures.¹⁶⁹ Little data is available, and U.S. corporations in particular insist they have tried hard to hire local labour. But evidence suggests that in certain key areas such as construction and security the number of non-Iraqi workers is sizeable, perhaps in the tens of thousands.¹⁷⁰ A Turkish subcontractor building electricity poles, whose staff consisted almost entirely of Turkish workers, told ICG that it could not find qualified Iraqis,¹⁷¹ a claim hard to square with the number of unemployed engineers. Vetting appears to be a principal, albeit disputed, issue. "We don't want to overlook Iraqis, but we want to protect ourselves", Colonel Damon Walsh, head of the CPA procurement office, reportedly said. "From a force-

¹⁶⁵ ICG interview with USAID official, southern Iraq, 7 April 2004.

¹⁶⁶ ICG interview, north Basra, 31 March 2004.

¹⁶⁷ <http://www.parliament.the-stationery-office.co.uk/pa/cm200304/cmhansrd/cm040510>.

¹⁶⁸ "Building a New Iraq: The Role of Women in Reconstruction", Woodrow Wilson International Centre for Scholars and Women Waging Peace, 2004. See also World Bank MENA Region, 2004, "Gender and Development in the Middle East and North Africa".

¹⁶⁹ ICG interview with Qassim Hadi, Iraqi Union for the Unemployed, 2 April 2004.

¹⁷⁰ See *The New York Times*, 1 July 2004.

¹⁷¹ ICG interview, Basra, 3 April 2004.

protection standpoint, Iraqis are more vulnerable to bad guy influence".¹⁷² A senior Iraqi official at the Ministry of Trade replied, "The security argument doesn't fly. There is no reason not to hire an Iraqi to serve coffee in the canteen. Foreign labourers get hired because they are easier to handle, easier to instruct and because employers know whom to hire as they deal with the same recruitment agencies they use elsewhere".¹⁷³

Moreover, the CPA's emphasis on heavy infrastructure projects neither met Iraq's development needs nor provided a quick employment boost. Iraqis suggest alternative, less grandiose endeavours, such as recruiting former soldiers to work at state-owned companies, as means of generating short-term employment and rapidly bringing benefits to the people. Kurdish officials, with experience in managing Northern Iraq since 1991, make the same point.¹⁷⁴

In fairness, U.S. reconstruction has created some employment.¹⁷⁵ Notably, the U.S. initiated a number of quick, small-scale projects -- minor repairs of sewage systems, rubbish collection, refurbishing youth centres and mosques -- that relied principally on local labour and were designed to "win the hearts and minds" of ordinary Iraqis.¹⁷⁶ These were left to the U.S. military and its Commander's Emergency Response Program (CERP), which is designed "to enable military commanders to respond to urgent humanitarian relief and reconstruction requirements by carrying out programs that immediately assist the Iraqi people".¹⁷⁷ However, these activities were largely under-funded -- a mere \$140 million was budgeted -- and commanders struggled to uncover additional resources.¹⁷⁸ More broadly, U.S. and Iraqi

officials certainly were not oblivious to the need to create jobs but they often appeared to view unemployment principally as a by-product of market failure and therefore focused on establishing job centres and databanks rather than initiating large-scale, labour-generating projects.¹⁷⁹

B. JOB CREATION

That unemployment and violence (both political and criminal) go hand in hand has become painfully clear. "Unemployment is the main problem and main source of resentment. It's a vicious circle: Lack of security leads to lack of reconstruction, which leads to lack of jobs, which leads back to lack of security".¹⁸⁰ In both Falluja and Sadr City -- two of the main challenges for the occupation -- socio-economic problems played an important role in mobilising disgruntled young men. In Falluja, hostility to the U.S. grows easily among discontented, unskilled labourers who, day after day, wait for hours under the hot sun, seeking temporary employment at less than \$7 a day.¹⁸¹

The vast majority of followers of Muqtada al-Sadr, the radical Shiite cleric, also come from the Shiite urban underclass, twice dispossessed -- first under Saddam's regime and now under the new one.¹⁸² Many unemployed have reportedly joined the ranks of Sadr's Mahdi army,¹⁸³ whose principal recruiting grounds are poor, garbage-littered urban slums lacking paved roads, clean water and adequate sewage removal such as the neighbourhoods of al-Jumhuriyeh and al-Hayaniyeh in Basra and Sadr City

¹⁷² Cited in *Financial Times*, 14 October 2004.

¹⁷³ ICG interview, Baghdad, 9 March 2004.

¹⁷⁴ ICG interview with Nowshirwan Mustafa, PUK, Suleimaniyeh, 3 June 2004.

¹⁷⁵ According to the PCO, its projects in Iraq currently provide work for 114,621 Iraqis. See <http://www.rebuilding-iraq.net>.

¹⁷⁶ See Anthony H. Cordesman, "Iraq and Asymmetric Warfare: The U.S. vs. FRL/Islamist Duel", Centre for Strategic and International Studies, Washington D.C., 6 December 2003, at http://www.csis.org/features/031204_assymmetric.pdf.

¹⁷⁷ Office of Management and Budget, "Report to U.S. Congress Regarding Emergency Appropriations Act for Defence and for Reconstruction of Iraq and Afghanistan", 2nd 90-days report, 2004.

¹⁷⁸ Ibid. For additional funds, the CERP had to resort to Iraqi oil revenues and seized assets. See The White House, "Third Quarterly Report", op. cit.

¹⁷⁹ ICG interviews, Basra, 7 April 2003; ICG interview with ministry of social affairs official, Diyarbakir, 27 May 2004. "The ministry's task is not to create jobs", the official said, "but to act as an intermediary between employers and employees".

¹⁸⁰ ICG interview with Hajir Adnan, Baghdad, 6 March 2004. In a February 2004 poll, 96 per cent of respondents said that more employment would reduce violence. See Oxford Research International, "National Survey of Iraq", February 2004.

¹⁸¹ ICG interview with Husam Mahdi, resident of Falluja's al-Tharthar district, Baghdad, 30 April 2004.

¹⁸² See ICG Report, *Iraq's Transition*, op. cit., and ICG Middle East Briefing, *Iraq's Shiites Under Occupation*, 9 September 2003.

¹⁸³ In Basra, an activist with the Association for Graduates -- an organisation that staged numerous demonstrations demanding more jobs -- claimed that several people had left the Association to join the Mahdi army. ICG interview with Hussein Ali Khudr, Basra, 16 June 2004.

and al-Hurriyeh in Baghdad. Sheikh Ali al-Zaydi, Sadr's representative in Basra, confirmed that most of his followers were from the "labour classes". Resistance, he added, was fuelled by "unemployment and by the occupiers' phoney contracts that are just ink on paper. The British and the Americans just make false promises".¹⁸⁴ Unless the Interim Government seriously tackles this problem, it will be beset by the same security problems and lack of legitimacy that hampered its predecessor.

The failure to create jobs has had another effect: empowering militant parties that combine a political with a social or charitable function -- principally Islamist militant parties. "We give money to the families of the martyrs of the Mahdi army and to the poor and sick", said a Sadr representative.¹⁸⁵ This is all the more so since the CPA did little to encourage civil society or grassroots movements involved with the unemployed and with workers more generally. According to an International Confederation of Free Trade Unions fact-finding mission, U.S. officials in Iraq were largely unaware of the extent of trade unions, whose views were largely ignored when the new labour code was drafted.¹⁸⁶ The CPA further alienated Iraq's labour movement by enforcing a Saddam-era law (1987) banning unions from public enterprises.¹⁸⁷ The Iraqi Union for the Unemployed, established in mid-2003 and led by veteran labour activist Qassim Hadi (who organised strikes under the Baathist regime) echoes this charge. Although the Union came up with creative solutions to alleviate the hardships of the unemployed and encourage job creation, it never felt welcomed by the CPA.¹⁸⁸

¹⁸⁴ ICG interview, Basra, 27 June 2004.

¹⁸⁵ ICG interview with Ra'd al-Husseini, head of Shahid al-Sadr Bureau, al-Kharkh, Baghdad, 10 July 2004.

¹⁸⁶ See Owen Tudor, Trade Union Congress (TUC), "TUC Report of an ICFTU Fact-Finding Visit, Iraq: Unions and the Law", 4 April 2004, at <http://www.tuc.org.uk/international/tuc-7859-f0.cfm>, and John Howley, Education for Peace in Iraq Centre, "The Iraq Jobs Crisis", June 2004. <http://www.epic-usa.org/Default.aspx?tabid=262>.

¹⁸⁷ See "Foreign Policy in Focus", 29 July 2004.

¹⁸⁸ For example, the Union provides the unemployed with cards, which, when presented to electricians or doctors, can lead to a fee reduction or waiver. It also used its contacts with municipalities, humanitarian NGOs and private companies to provide thousands of temporary jobs. Hadi was incensed when the CPA responded to its appeals for help with the following letter: "We have noticed the rise of the Union and its constant request for the amount of \$100 per month [for the unemployed]. Frankly, this makes us doubt the sincerity of your association in looking for feasible and

Of late, U.S. and Iraqi decision-makers have emphasised the need for a change in reconstruction strategy. In the wake of the sovereignty hand-over and the transfer of greater authority to his department, Secretary of State Colin Powell pointed to job-creation as the priority, noting: "I'm sure that there is the opportunity to do a lot of reprogramming".¹⁸⁹ Such reprogramming is indeed vital, and should include:

- ❑ Requiring contractors to hire Iraqis: prime contractors and subcontractors should commit to maximising the employment of Iraqi labour, taking account of required vetting procedures.¹⁹⁰
- ❑ Focusing on visible, direct-impact public works projects: far more effort needs to be invested in public works programs that employ local labour, including street cleaning, garbage collection, sewage system repair and paving of local roads. Former soldiers who are unemployed should be offered retraining courses and be temporarily hired in the now largely defunct state-owned enterprises. Credit facilities should be extended to encourage private home re-building. Recent pledges by the Ministry of Housing and Construction to establish a small fund to this effect would, if honoured, be a step in the right direction.¹⁹¹ Similarly, a July 2004 USAID-funded project to collect Baghdad's garbage should be expanded beyond the capital.¹⁹²
- ❑ Supporting the agricultural sector: given its significant reservoir of surplus labour, agriculture should receive more support from both the Iraqi government and donors. While the goal should be gradual commercialisation and reduction of state intervention, subsidies should be temporarily reinstated to provide farmers with affordable inputs, such as fertilizers and pesticides.

rational solutions for the unemployment problem that Iraq is facing". ICG interview with Qassim Hadi, Baghdad, March 2004. Hadi provided ICG with a copy of the letter.

¹⁸⁹ The *Los Angeles Times*, 22 July 2004.

¹⁹⁰ The Iraqi Labour and Social Affairs Ministry recently asked the Cabinet to issue a decree requiring foreign companies to hire Iraqi workers. *Al-Bayan*, 17 August 2004.

¹⁹¹ *Al-Bayan*, 27 July 2004.

¹⁹² This \$12 million scheme is aimed at generating immediate improvement in living conditions and jobs. *The Washington Post*, 6 August 2004. The British aid agency DFID launched a similar \$29.7 million program in the south. See DFID, "Iraq Update", 23 July 2004.

- Fostering micro, small, and medium-sized enterprises: relatively small business will be vital to economic recovery and in particular to reducing unemployment. Support in the form of loans and technical assistance should be used to enhance the creation of new businesses and the growth of nascent enterprises. In this respect, the role of women in such enterprises should be given due account.

As with economic issues generally, premium should be placed on consultation with Iraqis, especially at the local level. A number of Iraqi associations and groups have emerged that seek to represent the interests of workers and the unemployed; investing in and consulting with them would be wise economics and smart politics.

IV. CORRUPTION AND LACK OF TRANSPARENCY

Within a year of Saddam's fall, complaints about corruption no longer targeted the Baathist regime alone; instead, and at times in equal measure, Iraq's new leaders and the occupation forces stood accused. Taking advantage of the post-war vacuum, scores of political parties and factions seized public buildings and settled in opulent villas vacated by the former regime's inner circles.¹⁹³ Hundreds if not thousands of SUVs that once served Saddam loyalists and members of the secret service are now used to drive party leaders. In some instances, seizure of state property could be understood, if not excused,¹⁹⁴ but in the eyes of many Iraqis, it cast a pall on the new elite even before they had begun to rule. "The political parties took everything they could get hold of. Cars, arms, storage depots full of sugar, coffee, you name it. State property was up for grabs".¹⁹⁵

A. ALLEGATIONS AND PERCEPTIONS

Iraqi businessmen routinely bemoan the need to resort to bribery when dealing with government operations as well as local and foreign reconstruction funds. Others see instances of corruption -- real or imaginary -- throughout the economy: inspectors from U.S. prime contractors are accused of turning a blind eye to shoddy or unfinished work in Iraqi schools¹⁹⁶ and customs officials and cargo handlers of malfeasance in Umm Qasr port;¹⁹⁷ director generals at various ministries are said to award contracts to friends and

¹⁹³ The head of Baghdad's City Council, Muhammad Baqir as-Suhayl, accused U.S. officers of having distributed properties to political parties, *Al-Mashriq*, 9 August 2004.

¹⁹⁴ For example, one official at the Kurdistan Democratic Party justified its seizure of the Baath Party's former headquarters in Baghdad with the claim that the former regime had destroyed KDP properties in the 1970s. ICG interview, Baghdad, 7 March 2004.

¹⁹⁵ ICG interview, Baghdad, 10 March 2004.

¹⁹⁶ ICG interviews with Iraqi contractors, Baghdad, April 2004. Bechtel confirmed these allegations but said bribery has been limited because inspectors are rotated to prevent repeated contact with the same contractors. ICG interview with Gregory Huger, Bechtel spokesperson, Baghdad, 5 March 2004.

¹⁹⁷ ICG interviews with Iraqi traders at the Basra Chamber of Commerce, Basra, 3 April 2004. Many of the 9,900 employees on the port authority's payroll are believed to be fictitious. ICG interview with USAID official, southern Iraq, April 2004.

relatives,¹⁹⁸ and so forth. Foreign company workers told ICG they had witnessed corruption "everywhere and on all sides".¹⁹⁹ In a March 2004 survey, 58 per cent of respondents said they had heard reports of corruption and 32 per cent were convinced the CPA was involved in it.²⁰⁰ Iraq's blossoming press has echoed these accusations, often mocking the lavish lifestyles of ministers and Interim Governing Council members and attributing them with ill-gotten gains.²⁰¹

Much of this must be taken with a healthy grain of salt. Corruption has become a convenient and ready-made explanation for all sorts of inefficiency: when Basra's refuse collection and sewage system remained in a state of disrepair, unsubstantiated rumours of corruption swiftly swirled around;²⁰² the near absence of public works in that city is seen as proof of malfeasance in the contracting process.²⁰³ The quick resort to corruption as an all-encompassing explanation is due, in part, to the lack of citizen participation, economic transparency and accountability. Given the weakness of the party-political system, such accusations also serve as useful substitutes for party programs or meaningful political debate.

Still, solid grounds exist for concluding that corruption is widespread. At the central Baghdad Ghazil market and the *suq* of old Basra, one can witness a booming trade in stolen medicines and medical equipment, apparently originating from the state's Kamadia warehouse.²⁰⁴ A senior Ministry of Trade official described large-scale corruption in the food and consumer goods rationing system at all

levels of procurement, storage and allocation.²⁰⁵ A CPA official claimed that some colleagues working on the rationing program were suspected of fraud.²⁰⁶

B. ON FERTILE GROUND

As other post-conflict situations show, corruption thrives on construction and public procurement projects, especially in the confusion and chaos of transition.²⁰⁷ One reason is that public institutions in such situations generally have little capacity to oversee expenditure and procurement. Iraq presents a uniquely ripe environment: the dismantling of virtually all institutions of the former regime and an extraordinary infusion of funds.

The legacy of the Baathist regime is particularly harmful. Under Saddam, political loyalty was purchased through the allocation of favours, the result being a shadow state in which normal bureaucratic procedures governed the unfortunate and underprivileged alone.²⁰⁸ With the imposition of sanctions in the 1990s, corruption and bribery took on yet another dimension, permeating every level of society. For public servants making as little as \$5 per month, petty bribery often was the sole means to feed a family. Although the precise ramifications of the scandal still must be established, the Oil-for-Food program appears to have intensified corruption among senior regime officials who dealt with foreign companies and politicians.²⁰⁹ Eradicating these habits

¹⁹⁸ ICG interview with Interim Governing Council member, Baghdad, 16 May 2004. See also *Al-Hayat*, 25 April 2004.

¹⁹⁹ ICG interviews with foreign contractors and private security company officials, Baghdad and Basra, March-April 2004.

²⁰⁰ *Al-Mashriq*, 4 May 2004.

²⁰¹ See, for example, *Al-Mu'tamar*, 13 March 2004. "Middlemen, thieves, and parasites surround newly appointed officials in certain ministries to create networks of fraud and theft....Construction, commerce, and licensing, as well as court services, are often denied until the responsible officials receive a bribe in money or in kind." *Al-Mu'tamar*, 1 August 2004. *Al-Mu'tamar* is the mouthpiece of Ahmad Chalabi's Iraqi National Congress, which itself has been at the centre of corruption charges.

²⁰² ICG interview with Iraqi entrepreneurs, Basra, April 2004.

²⁰³ *Ibid.*

²⁰⁴ "International donors have banded on the need to sort out Kamadia but the CPA focused on the hand-over and failed to address it". ICG interview with European aid official, Amman, 14 April 2004.

²⁰⁵ ICG interview, Baghdad, 9 March 2004.

²⁰⁶ ICG interview, Baghdad, 7 April 2004.

²⁰⁷ See Lebanese Transparency Association & UNDP, *Confronting the Vicious Circle: Corruption in Postwar Reconstruction*, (Beirut, forthcoming).

²⁰⁸ For details, see Charles Tripp, *A History of Iraq* (Cambridge, 2002).

²⁰⁹ The U.S. General Accounting Office estimated that the Baathist regime received \$4.4 billion in kickbacks during the seven years of the Oil-for-Food program. See GAO, "Observations on the Oil for Food Program and Iraq's Food Security", 16 June 2004. On 25 January 2004, the Iraqi newspaper *Al-Mada* published a controversial list of 270 firms and individuals alleged to have received bribes.. Iraqi officials told ICG that individual allegations still have to be substantiated and that the list of names could have been drawn up by the former regime in order to identify potential corruption targets. Moreover, they claimed that some oil coupons were handed out to settle arrears in payments to foreign companies dating back to the late 1980s. ICG interviews with finance ministry official, Baghdad, 10 April 2004 and Ibrahim Bahr al-Ulum, oil minister, Baghdad, 26 February 2004. In April 2004, the UN Security Council

will be neither easy nor quick. Iraqi businessmen point out that many ministry officials operate on a "business-as-usual-basis, asking for presents and privileges. It's the same culture as under Saddam: Red tape, favouritism and *wasta* (connections). Nothing has really changed."²¹⁰

A tradition of intrusive economic intervention by the former regime, in particular through state subsidies and state procurement of items for the ration system also provides fertile ground for current corruption. Black markets thrive on goods whose prices are kept artificially low and can be sold at a profit either locally or abroad.²¹¹ Politicians, ministry employees and customs personnel all face the same temptation to facilitate a deal in return for a share.²¹² Yet, as discussed, any abrupt break from these policies is likely to create disruption and hit the lower classes particularly hard; it also is likely to generate new opportunities for abuse. As witnessed in the former Soviet Union and other countries that hastily privatised, selling off state-owned enterprises without a free market, robust judiciary or transparent government results in widespread corruption.

Iraq's oil-dependence is yet another complicating factor. While few oil-producing countries have developed effective mechanisms against predatory practices, corruption in the management of oil revenues in Baathist Iraq reached exceptional levels. The situation has improved markedly but serious questions remain.²¹³ To date, transparency is still

charged Paul Volcker, the former head of the U.S. Federal Reserve Board, with overseeing an investigation into alleged irregularities and fraud in the Oil-for-Food Program. Volcker has said it will be another year before he will be in a position to report on his findings.

²¹⁰ ICG interview with Iraqi businessman, Diyarbakir, 26 May 2004. See also *Al-Mu'tamar*, 1 August 2004; *Al-Hadath*, 21 July 2004; and *Ad-Da'wa*, 21 July 2004.

²¹¹ Smuggling has been reduced by tighter border controls since April 2004, though it continues, for example at the northern border with Turkey. ICG interview with Peshmerga border guard, Habur, 5 June 2004. Iraqi press reports alleged that 47 illegal ports on the Shatt al-'Arab River bordering Iran are still used for smuggling. *Al-Mashriq*, 6 May 2004.

²¹² ICG interviews with Iraqi businessmen, Suleimaniyah and Basra, June and April 2004.

²¹³ Iraq's oil revenues were channelled to the UN-authorized Development Fund for Iraq and managed by the CPA's Program Review Board (PRB). Critics complain that the PRB was not transparent. For details, see Iraq Revenue Watch, "Auditors Find Poor Practices in Management of Iraqi Oil Revenues", June 2004. Following the handover of sovereignty and in accordance with UNSCR 1546 (8 June 2004), the PRB

has been dissolved. The Development Fund is now managed by the Iraqi Ministry of Finance and audited by the International Monitoring and Advisory Board (IAMB). In its first report, released on 15 July 2004, the IAMB referred to gross irregularities by CPA officials and chastised the U.S. for "lack of transparency," leaving the Iraqi accounts "open to fraudulent acts," and failure to hand over important information. See <http://www.iamb.info/dfiaudit.htm>.

hampered by the absence of oil metering equipment, contrary to standard international practice.²¹⁴ Nor has the Iraqi Interim Government provided regular updates of the Development Fund's revenues and expenditures. Moreover, little thought appears to have been given to the challenge of managing oil revenue in the future. Some ideas -- such as establishing a transparent and intensely audited fund independent from the national budget -- have been suggested. Such a fund would be insulated from daily cabinet or legislative squabbles, leave management and strategic planning to technocrats, and aim at equitable and sustainable development projects.²¹⁵ But a serious debate has yet to begin.

C. SETTING A BAD EXAMPLE

Critics of the U.S. effort focus on three levels: the selection of companies;²¹⁶ the "costs-plus" structure of contracts pursuant to which companies are fully reimbursed for costs incurred and given an additional percentage as guaranteed profit; and the individual practices of employees who allegedly accepted kickbacks from potential subcontractors.²¹⁷

Whether well founded or not, such allegations suggest the degree of Iraqi distrust of U.S. reconstruction efforts.

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²¹⁴ See <http://www.iamb.info/dfiaudit.htm>.

²¹⁵ History suggests some reasons to be sceptical, however. Albeit under different circumstances, an oil fund established in Iraq in the 1950s quickly fell in the hands of politicians who depleted its resources for patronage and corruption purposes. See Fahim Issa Qubain, *The Reconstruction of Iraq: 1950-1957* (New York, 1958).

²¹⁶ These concerns were reinforced by the secretive and closed nature of the contracting process, especially during the lead-up to the war, which froze out smaller and less-connected companies from the bidding process. The most notorious case has been that of Halliburton, which U.S. Vice President Cheney once led as chief executive officer (CEO).

²¹⁷ Translators in particular are said to have demanded 10 to 50 per cent of the subcontract value in return for facilitating access to the prime contractor. ICG interviews with foreign and Iraqi contractors, Baghdad, March 2004. See also Minnesota Public Radio, 23 April 2004 at <http://marketplace.publicradio.org/features/iraq/>.

What they have done is combine the worst of two worlds: Iraq's crooked business culture and the U.S. big business emphasis. The result is a money-driven frenzy at the expense of proper business standards. Everybody seems to have forgotten we are supposed to be building a new Iraq.²¹⁸

D. TACKLING CORRUPTION

Several anti-corruption initiatives have been initiated. A CPA decree protects whistleblowers;²¹⁹ the Iraq Business Centre set up a box in which complaints regarding bribery and other wrongdoing can be filed;²²⁰ judges have begun to look into alleged corruption by officials and businessmen;²²¹ and scores of judges and municipal officials have been dismissed for alleged bribery.²²² Large contractors such as Bechtel have introduced business ethics courses for their subcontractors and Iraqi government officials. Perhaps most important, the CPA established the Office of General Inspectors, backed by the Commission of Public Integrity (*lajna an-Nazaha al-'ama*) and the revived Supreme Audit Board, with one inspector attached to each Iraqi ministry.

But the story of this latter initiative says much about the obstacles any anti-corruption effort will face. Neither the Commission nor the audit board has done very much, and the now dissolved Interim Governing Council failed to agree on a candidate to chair it, leading CPA administrator Bremer to impose his choice only days before the CPA was dissolved.²²³ Moreover, the broad mandate -- it is empowered to

investigate instances of graft that preceded the fall of the Baathist regime -- risks saddling it with a massive and unworkable case-load.²²⁴ There also are fears that corruption investigations will be politicised. "The problem is how to prevent anti-corruption efforts from escalating into political score-settling".²²⁵

The magnitude of the problem is not likely to diminish. The vast infusion of reconstruction funds that is still to come will whet appetites. Moreover, "like any oil-rich country, the public sector in Iraq will bloat. All parties will behave as if they were running a welfare state".²²⁶ Despite general belief in Iraq that elections will help "because the electorate will vote any corrupt politician out of office",²²⁷ experience suggests otherwise. Relatively free elections in the Kurdish areas in 1992 did little to ameliorate the situation, and there are widespread reports of collusion between Kurdish political parties and business interests.²²⁸ The Lebanon precedent offers another warning: where power and positions are distributed along ethnic/sectarian lines -- a trend that, unfortunately, has been taking hold in Iraq²²⁹-- participatory politics can be a recipe for more rather than less corruption. Politicians scramble to divvy up public administration jobs and resources and distribute them to their constituencies (a process known in Lebanon as *muhasassa*, or apportionment).²³⁰

Banking on strengthened participatory politics alone is thus a hazardous gamble. Instead, more proactive measures are required. These include:

²¹⁸ ICG interview with Iraqi businessman, Diyarbakir, 26 May 2004.

²¹⁹ CPA Order 59, 1 June 2004.

²²⁰ See <http://www.iraqibusinesscenter.org/>.

²²¹ The Mosul Anti-Corruption board, established by the U.S. 101st Airborne Division in November 2003 and composed of sixteen local attorneys, is another example. See *The Leaf-Chronicle of Clarksville*, 13 December 2003.

²²² A Judicial Review Committee investigated all 860 judges and prosecutors for past corruption. About 180 were removed. See Report of the UN High Commissioner for Human Rights, "The Present Situation of Human Rights in Iraq", 4 June 2004.

²²³ ICG interview with Interim Governing Council member, Baghdad, 16 May 2004. Efforts to revive the Supreme Audit Board were set back with the assassination of its head, Ihsan Karim, on 1 July 2004. Earlier attempts to impose financial discipline were shaken by the arrest of the Ministry of Finance's chief anti-corruption watchman, Sabah Nuri, on charges of embezzling \$22 million during the country's otherwise successful currency exchange operation.

²²⁴ CPA Order 55, 27 January 2004.

²²⁵ ICG interview with Isam al-Khafaji, former IDRC member and currently affiliated with Iraq Revenue Watch, Baghdad, 9 April 2004.

²²⁶ ICG interview with Khaled Oweiss, Jordanian journalist, Baghdad, 1 March 2004.

²²⁷ ICG interview with Safwat Rashid, Kurdish human rights activist, Suleimaniyeh, 4 June 2004.

²²⁸ ICG interviews with Kurdish human rights activists and businessmen, Suleimaniyeh and Erbil, May-June 2004. "You have to pay everybody, left, right and centre. If you want a contract from the authorities you need to bribe them. Most contracts are awarded to people related to politicians". KDP Minister for Reconstruction Nazanin Waso categorically denied these allegations. ICG interview, Erbil, 31 May 2004.

²²⁹ See ICG Report, *Iraq's Transition*, op. cit., p.17.

²³⁰ See Reinoud Leenders, "Public Means to Private Ends: State Building and Power in Post-War Lebanon", in Eberhard Kienle (ed), *Politics from Above, Politics from Below: The Middle East in the Age of Economic Reform* (London, 2003). Some Iraqis have already expressed concern over the institutionalisation of *muhasassa*. See *Az-Zaman*, 26 February 2004.

- ❑ increased decentralisation of both governance and aid projects to give local beneficiaries a more direct stake in the awarding of contracts and encourage accountability;
- ❑ greater support for local media, encouraging it to be an independent watchdog;²³¹
- ❑ foreign governments' application of their domestic anti-corruption legislation to companies operating in Iraq;
- ❑ initiating public discussion on how to manage oil-revenues, taking into account lessons learned from other oil-producing countries and Iraq's past.²³² Serious consideration should be given to establishing a special fund insulated from the national budget, with management structures largely autonomous from daily political decision-making;
- ❑ installing oil metering equipment to monitor oil revenues and provide regular updates of revenues and expenditures of the Development Fund for Iraq; and
- ❑ granting the Iraqi Supreme Audit Board a seat on the International Monitoring and Advisory Board in order to familiarise it with international auditing practices and standards and to improve indigenous capacity.²³³

²³¹ Iraqis do not read many newspapers, and those who do say they do not trust them. See Iraq Centre for Research and Strategic Studies, "The Results of the Third Public Opinion Poll in Iraq", 23 October 2003. Some initiatives already exist to strengthen the media's role in holding politicians accountable. For example, the Institute for War and Peace Reporting (IWPR) supports a training program for Iraqi journalists. See http://www.iwpr.net/iraq_index1.html.

²³² Some general principles designed for oil revenue management could directly feed into such a debate. See <http://www.publishwhatyoupay.org/eiti/>.

²³³ In March 2004, the International Monitoring and Advisory Board (IAMB), which audits the Development Fund, decided to "examine ways to involve the Board of Supreme Audit more actively in its work". IAMB minutes, meeting of 17-18 March 2004. To date, a Supreme Audit official has attended IAMB meetings in a consultative capacity only.

V. INTERNATIONAL ASSISTANCE

A. SECURITY, IRAQI SCEPTICISM AND DONOR COORDINATION

Over the past year, the international community took important steps to facilitate reconstruction. The UN Security Council in effect froze Iraq's sovereign debt repayments until 31 December 2007²³⁴ and established an international audit oversight body for the Development Fund of Iraq.²³⁵ UNSCR 1546 also gives the UN a role in "the coordination and delivery of reconstruction, development and humanitarian assistance" in Iraq. The World Bank and UN agencies conducted an assessment mission toward the end of 2003, publishing an overview of Iraq's needs and have been training hundreds of Iraqi officials and aid workers. The international donors conference, held in Madrid on 23-24 October 2003, which led to pledges of \$13.4 billion in loans and grants, established the International Reconstruction Fund Facility for Iraq to coordinate reconstruction assistance. Finally, a number of UN agencies initiated programs to mitigate economic hardships, such as a job-creation project (the Iraq Reconstruction and Employment Program, set up by the UN Development Program, UNDP) and a project for small and medium-sized enterprises (set up by the International Financial Corporation, a sister organization of the World Bank).

Still, the scope of international involvement has been far less than anticipated or required. Security conditions are a principal explanation; in the wake of the 19 August 2003 bombing of the UN compound in Baghdad, its agencies and virtually all staff withdrew. Conditions provide scant hope for significant early return.²³⁶ As a result, it is hard to see how even the World Bank's interim strategy, designed to address immediate needs, will be implemented over the next several months. Its actions, so far, have been limited to training, financing new textbooks and establishing a micro-

²³⁴ UNSCR 1483.

²³⁵ UNSCR 1546.

²³⁶ "For the foreseeable future the United Nations will remain a high-value, high-impact target for attack in Iraq. United Nations agencies and programs will therefore continue to minimize administrative overheads and presence in Iraq by limiting their activities inside Iraq to the essential". "Report of the Secretary-General pursuant to paragraph 24 of resolution 1483 (2003) and paragraph 12 of resolution 1511 (2003)", 5 August 2004.

credit facility for widows.²³⁷ UN agencies similarly have adjusted their ambitions downward. The UNDP has only fifteen in-country Iraqi employees, most of whom work from home. Its job-creation project was significantly scaled back to encompass a mere handful of operations in southern Iraq.²³⁸

Problems encountered by the World Bank and the UN also appear to have dampened donor enthusiasm. Of the \$13.4 billion pledged in Madrid, donors have promised to transfer only \$1 billion to the UN/World Bank Trust Facility, and only \$741 million has been deposited.²³⁹ Important donors such as France and Germany have yet to transfer any aid aside from that provided by the EU. As a European aid official put it, given security conditions, "it's very difficult for donors to know where their money is going. It is unclear how the trust funds are going to work in these circumstances. So donors are holding back".²⁴⁰ Training programs also have suffered from fears of infiltration by insurgents.²⁴¹

There are additional obstacles. Some donors have attached conditions to their aid deemed unacceptable by the World Bank -- such as "not spending any money on U.S. contractors or insisting on visible projects".²⁴² The Bank's own lending -- potentially \$3 billion -- also faces impediments.²⁴³ Its internal regulations bar disbursement to Iraq so long as it has not cleared up its earlier debts. (Iraq owes the bank some \$99 million from loans dating back to the early 1970s.)²⁴⁴

The World Bank and UN have not escaped Iraqi complaints,²⁴⁵ which include slow and scarce

disbursement of funds; apparent lack of procurement guidelines to ensure that local companies are hired;²⁴⁶ allegedly excessive overhead costs for Trust Facility operations (claimed by some to reach 12 per cent),²⁴⁷ and focus on out-of-country training:

This remote control approach to construction isn't working. Training courses in Amman have become an impediment to ministries' work, as essential staff leave their positions. It also has become a source of political patronage with the lucky ones being sent for training as a kind of holiday. And when they return from intelligence technology training, they don't even find a computer at their ministries.²⁴⁸

Finally, lack of coordination between donors has hampered effective aid management.²⁴⁹ The proliferation of international actors (international institutions, individual states and, until most were forced to depart, NGOs) unwilling or unable to synchronise their efforts has been widely noted by Iraqi and foreign officials.²⁵⁰ Moreover, most aid will be provided bilaterally, not deposited with the Trust Fund; the Ministry of Planning -- charged with coordinating international assistance -- has already had difficulty coping with the ensuing burden. Political considerations have not been wholly absent either, as lingering anger at the U.S. impedes harmonisation with its priorities and programs. "As usual, multilateral

²³⁷ See <http://web.worldbank.org/wbsite/external/countries/menaext/iraqextn/0,menupk:313111~pagepk:141159~pipk:141110~thesitepk:313105,00.html>.

²³⁸ ICG interview with Boualem Aktuf and Roger Guarda, UNDP Iraq, Amman, 15 April 2004.

²³⁹ ICG e-mail exchange with Tufan Kolan, World Bank Trust Fund, 16 June 2004; ICG telephone interview with Bisrat Aklilu, UN Trust Fund, 27 July 2004. The Iraqi Ministry of Planning submitted a request for \$4 billion during a donors conference in Abu Dhabi in February 2004.

²⁴⁰ ICG interview with European aid official, Amman, 14 April 2004. In light of these challenges, some NGOs have begun working from the more secure northern governorates.

²⁴¹ ICG interview, Amman, 14 April 2004.

²⁴² ICG interview with foreign aid official, Amman, 14 April 2004.

²⁴³ World Bank, "Interim Strategy Note of the World Bank Group for Iraq", 14 January 2004.

²⁴⁴ ICG interview with World Bank official, Amman, 14 April 2004.

²⁴⁵ ICG interview with senior Iraqi official at the trade ministry, Baghdad, 9 March 2004.

²⁴⁶ ICG e-mail exchange with Fred Kranz, World Bank procurement officer, 12 March 2004.

²⁴⁷ ICG interview with senior official at the ministry of planning, Baghdad, 13 April 2004. The World Bank strongly denied this, claiming it charges an administrative fee of 0.4 per cent for technical assistance projects and 0.2 per cent for investment operations. ICG e-mail exchange with Tufan Kolan, 15-16 June 2004. The UN Trust Fund says it aims for a 7 per cent administrative and management fee. ICG telephone interview with Bisrat Aklilu, UN Trust Fund, 27 July 2004.

²⁴⁸ ICG interview with adviser to the ministry of planning, Baghdad, 10 April 2004.

²⁴⁹ Commenting on the lack of donor coordination, the CPA inspector general concluded: "no process was developed for tracking or coordinating internationally funded projects with other CPA reconstruction efforts. In addition, there was little guidance provided to the Iraq Ministries on maintaining adequate supporting documentation that describes the reconstruction efforts to be funded from donated funds". Office of the Inspector General, CPA, "Coordination of Donated Funds", 25 June 2004.

²⁵⁰ ICG interview with European aid official, Amman, 14 April 2004. As of June 2004, neither U.S. agencies nor the Ministry of Planning could specify the amount of bilateral aid. See GAO, "Report to Congressional Committees", op. cit., p.20.

aid is handicapped by turf battles, but here the problems are magnified by the political residue of the Iraq crisis".²⁵¹

B. DEALING WITH SADDAM'S FINANCIAL LEGACY

While security conditions clearly have restricted what the international community can do in terms of direct reconstruction projects, debt relief and war reparations are a different matter. By the latest unofficial count, Iraq has a \$137 billion debt, making it the world's most heavily indebted country on a per capita basis.²⁵² Unpaid reparations from the 1991 war (mainly to Kuwait and foreign oil companies) amount to another \$28 billion, and an additional \$98 billion in claims are still to be processed.²⁵³ This Baathist regime legacy is an extraordinary burden on the country's future.

Some steps have been taken to lighten the financial load. Between now and 2008, Iraq is exempted from repaying any of its debt; likewise, pursuant to UNSCR 1483, war reparations servicing has been temporarily reduced from 25 to 5 per cent of Iraq's oil revenues. That said, the servicing of war reparations still amounts to some \$709 million, exceeding expenditures on public sector wages and pensions and only slightly less than the total health budget.²⁵⁴ Moreover, reconstruction delays mean that the time required to put Iraq back on its feet is likely to exceed substantially the earlier anticipated four years so that the debt burden could still choke recovery.

Iraqis have repeatedly called on the international community to write off both debts and war reparations.²⁵⁵

Saddam's regime was judged to be unacceptable by the international community in 1991. How

can the Iraqi people be required to pay for the support countries gave in building up that regime? When Saddam executed people, he used to charge their families for the bullets used -- this is precisely what the creditor countries who financed Saddam are asking of Iraqis today.²⁵⁶

Officially, the Interim Government has asked for a 95 per cent debt write-off,²⁵⁷ considerably more than what Iraq's principal creditors -- Russia, France, Japan, Kuwait and Saudi Arabia -- seem prepared to accept.²⁵⁸ Even the U.S., which has welcomed Iraq's request,²⁵⁹ was said to have considered deducting several hundred million dollars from its assistance package to offset loans from the 1980s.²⁶⁰ The nineteen member states of the Paris Club of official creditors (which collectively are owed \$21 billion) agreed on "the desirability of prompt completion of restructuring of Iraq's debt" but have yet to specify how far they are prepared to go.²⁶¹ At the end of the day, some compromise will be required, presumably involving an additional moratorium on debt repayment and a trade-off between debt obligations

²⁵⁶ Muhammad Kamil, Iraqi Prospect Organisation, cited in Jubilee Iraq, "Paying For the Executioner's Bullets", at <http://www.jubileeiraq.org/iraqiviews.htm>.

²⁵⁷ Iraqi Finance Minister Adel Abdul Mahdi, cited in *Gulf News*, 14 July 2004.

²⁵⁸ A French government spokesperson said, "We don't think it's possible to cancel more than 50 per cent [of a total of \$3 billion], which already represents a considerable effort by the international community", Reuters, 22 June 2004. However, there are signs that France's position could be more flexible. See *Le Monde*, 30 June 2004.

²⁵⁹ In December 2003, the Bush administration appointed former Secretary of State James Baker as Special Envoy to help renegotiate and reduce Iraq's debts. Baker received promises of debt rescheduling and reductions, but no firm commitments. See *Middle East Report*, 2 March 2004, at <http://www.merip.org/mero/mero030204.html>. On 18 June 2004, the administration proposed legislation forgiving Iraq's debt to the U.S.

²⁶⁰ See Reuters, 24 June 2004.

²⁶¹ Paris Club, Press Release 10 July 2004. Invoking the "odious debt" theory -- under which debts incurred by an authoritarian regime as a means of sustaining its rule with the creditors' full knowledge ought not be passed on to the successor regime -- some have proposed that implementation of an international "Iraq debt tribunal" rule on which parts of the debt should be written off. See <http://www.jubileeiraq.org/tribunal.htm>. The "odious debt" doctrine originally was developed by Alexander Nahum Sack in the 1920s. See Patricia Adams, "Odious Debts: Loose Lending, Corruption And the Third World's Environmental Legacy", Probe International, 1991.

²⁵¹ ICG interview with foreign representative at the CIC, Baghdad, 26 February 2004.

²⁵² See Jubilee Iraq, "Saddam's Debts: Latest Estimates", at http://www.jubileeiraq.org/debt_today.htm.

²⁵³ See Jubilee Iraq, "Reparations, Compensation Claims", at <http://www.jubileeiraq.org/reparations.htm>. The UN Compensation Fund was established by UNSCR 687, 3 April 1991 to process claims and pay compensation to individuals, corporations and countries that suffered damages from Iraq's invasion of Kuwait.

²⁵⁴ See Republic of Iraq, "2004 Budget", October 2003 and "Revision to 2004 Budget", March 2004.

²⁵⁵ ICG interviews, Baghdad, Basra and Suleimaniyah, February-June 2004.

and reconstruction contract awards, thereby indirectly compensating countries that agree to forego significant portions of their debt. A similar logic ought to apply to war reparations: governments could compensate citizens who were victims of Baathist policies and whose applications are yet to be resolved (so-called "A-D claims") instead of placing this burden on the new Iraqi government; corporations and governments (so-called "E-F claims") could forego the bulk of their claims in exchange for preferential status in procurement and contracting for Iraq's reconstruction.

Creditors are likely to condition any debt rescheduling on implementation of a stringent reform package, as prescribed by the International Monetary Fund (IMF).²⁶² Iraqi officials expect the IMF "to be lenient" in its demands for reforms,²⁶³ and the Fund has signalled a willingness to take account of specific conditions, noting that it was not demanding its "normal conditionality but one that is especially designed for post-conflict situations. We will be working with Iraqis for them to be able to meet any conditionality".²⁶⁴ But precedent -- in particular precedent in post-conflict situations -- is hardly promising. The IMF has been widely criticised in such contexts for underestimating the social impact of its macro-economic reform prescriptions.²⁶⁵ Few Iraqis

doubt that immediate and large-scale privatisation, scrapping subsidies on fuel and food items, financial austerity and public salary reductions would have a catastrophic effect and reduce chances for a peaceful transition. Given the stakes, such measures should at a minimum be postponed until a freely elected, legitimate, and stable government is in place. Unconditional debt relief would be both unrealistic and undesirable. But in the present transitional phase, Iraq should be required to carry out only reforms geared to post-conflict recovery and aimed at minimising instability and social dislocation.

²⁶² ICG telephone interview with IMF official, 20 April 2004. See also Reuters, 10 June 2004. In a recent statement, the European Commission reiterated its position linking debt forgiveness and rescheduling to "economic policy conditionality". European Commission, "Communication from the Commission to The Council and The European Parliament, The EU and Iraq", 9 June 2004. The Paris Club traditionally demands an IMF reform package (including currency stabilisation measures, caps on government spending; lowering of trade barriers, privatisation of public enterprises, and reductions in the bureaucracy) in return for debt rescheduling. See IMF, "Guidelines on Conditionality", September 2002, at [www.imf.org/ External/np/pdr/cond/2002/eng/guid/092302.pdf](http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf). It is highly questionable whether Iraq would qualify for debt reduction under the IMF's Heavily Indebted Countries Initiative as eligibility is based in part on income level. ICG telephone interview with IMF official, 22 July 2004.

²⁶³ ICG interview with senior official at the planning ministry, Baghdad, 15 April 2004.

²⁶⁴ ICG telephone interview with IMF official, 20 April 2004.

²⁶⁵ Such criticism has been addressed in particular to IMF policies in Mozambique, Sri Lanka and the former Yugoslavia. See, respectively, Joseph Hanlon, *Peace Without Profit: How the IMF Blocks Rebuilding in Mozambique*, (Oxford, 1996); Centre for Economic and Policy Research, "The IMF-World Bank Plan for Sri Lanka: Will it Help or Hinder South Asian Success?", at www.cepr.net/Sri_Lanka.htm; and Milford Bateman, "Imposing Ideology as 'Best Practice': The

Problematic Role of the International Financial Institutions in the Reconstruction and Development of South-East Europe", 2004, available at www.ciaonet.com

VI. CONCLUSION

Iraq's transition to a stable, cohesive democracy is in jeopardy. The insurgency shows no sign of abating; Muqtada as-Sadr's movement is gaining status; and the legitimacy of the country's new institutions -- struggling to demonstrate independence while being wholly dependent on U.S. military support -- is under fire. Successful national elections by January 2005 could be a turning point, but even that prospect seems increasingly unsure in the absence of progress on the security front.

In these circumstances, the state of the economy may appear a secondary, unrelated issue. It is not. U.S. and Iraqi institutions have systematically lost ground and the insurgency gained momentum as material improvements failed to materialise. That is why, of course, insurgents have concentrated on economic targets and will continue to do so. But missteps by the occupation forces also have contributed mightily to this state of affairs, from ad hoc planning to misplaced priorities to shifting deadlines, excessive centralisation and bureaucratic infighting. What strategic planning has occurred has been ideologically driven and divorced from Iraqi realities.

Neither the Interim Iraqi Government, nor its elected successor, nor the international community can afford to repeat these mistakes. In fashioning economic policy, several requirements ought to be met:

Formulating a coherent, comprehensive reconstruction plan in coordination with the donor community. Current and future Iraqi governments should emphasise economic diversification to escape oil-dependency, in particular by supporting the industrial and agricultural sectors.

Emphasising job-protection, job-creation and immediate material improvement. Privatisation, free trade and active foreign investment are valid longer-term goals; in the shorter term, however, care must be taken to mitigate their negative impact on employment. Rapid, systematic privatisation of state-owned companies would lengthen unemployment rolls and promote crony capitalism without genuinely contributing to the national budget. Foreign investment should be encouraged, but investors should be required to hire Iraqi labour, provide on-the-job training and partner with local firms. At the same time, the government, the U.S. and the wider donor community should address immediate needs by

funding small-scale, labour-intensive, quick-impact projects, including street cleaning, garbage collection, sewage systems and local byroads repair.

Consulting with Iraqis in project design and implementation. Civil society members, associations, labour unions and groups representing the unemployed can play a critical role in devising economic projects and seeing them through in a manner that maximises benefits to Iraqis. For projects it funds, the U.S. should reverse past practice and consult Iraqi decision-makers and civil society groups at early planning stages.

Implementing firm steps against corruption. The credibility of Iraq's new institutions and of the U.S. reconstruction effort depend heavily on turning around the widespread perception of malfeasance. Several welcome measures have been adopted, but the Baathist legacy, allocation of power along ethnic and sectarian lines, expected vast infusion of funds and oil-dependency are all reasons for real concern. Structural measures -- including decentralisation, judicial independence, a media watchdog role and, critically, insulating oil revenues from political misuse -- are of vital importance.

In all this, of course, the international community has a central role to play. So long as the security environment remains as it is, greater on-the-ground involvement will be doubtful. But that leaves much it still can do: increasing aid disbursements, depositing them with the UN/World Bank Trust Facility rather than bilaterally; rigorously applying national anti-corruption laws to foreign companies operating in Iraq; and seriously addressing Iraq's debt and war reparations obligations.

Amman/Baghdad/Brussels, 2 September 2004

APPENDIX A
MAP OF IRAQ



APPENDIX B

ABOUT THE INTERNATIONAL CRISIS GROUP

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ICG's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, ICG produces regular analytical reports containing practical recommendations targeted at key international decision-takers. ICG also publishes *CrisisWatch*, a 12-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

ICG's reports and briefing papers are distributed widely by email and printed copy to officials in foreign ministries and international organisations and made generally available at the same time via the organisation's Internet site, www.icg.org. ICG works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The ICG Board – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring ICG reports and recommendations to the attention of senior policy-makers around the world. ICG is chaired by former Finnish President Martti Ahtisaari; and its President and Chief Executive since January 2000 has been former Australian Foreign Minister Gareth Evans.

ICG's international headquarters are in Brussels, with advocacy offices in Washington DC, New York, London and Moscow. The organisation currently operates nineteen field offices (in Amman, Belgrade, Bogotá, Cairo, Dakar, Dushanbe, Islamabad, Jakarta, Kabul, Nairobi, Osh, Port-au-Prince, Pretoria, Pristina, Quito, Sarajevo, Seoul, Skopje and Tbilisi) with analysts working in over 40 crisis-affected countries and territories across four continents. In Africa, those countries include Angola, Burundi, Côte d'Ivoire, Democratic Republic of the Congo, Eritrea, Ethiopia, Guinea, Liberia, Rwanda,

Sierra Leone, Somalia, Sudan, Uganda and Zimbabwe; in Asia, Afghanistan, Kashmir, Kazakhstan, Kyrgyzstan, Indonesia, Myanmar/Burma, Nepal, Pakistan, Tajikistan, Turkmenistan and Uzbekistan; in Europe, Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, Kosovo, Macedonia, Moldova, Montenegro and Serbia; in the Middle East, the whole region from North Africa to Iran; and in Latin America, Colombia and the Andean region.

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September 2004

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