

Iraq

Status Index (Democracy: 2.68 / Market economy: 2.89) 2.79		Management Index -	
HDI	-	Population	27.3 mn
GDP per capita (\$, PPP)	1,080 ^a	Population growth¹	2.9 %
Unemployment rate	-	Women in Parliament	-
UN Education Index	-	Poverty²	-
		Gini Index	-
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$1 a day (1990- 2003). ^a EUI estimate 2002.			

A. Executive summary

The transformation process in Iraq is a result of recent military defeat and occupation. Its outcome is far from certain. The transformation process was dominated by the occupation authorities and their allies - mainly brought in from the Iraqi diaspora community - and characterized by a lack of sufficient resources, poor planning and insufficient understanding of Iraqi society. The United States and its allies failed to secure sufficient legitimacy for the process, on both the international and the domestic level.

After an initial hand-off approach that contributed to the collapse of public institutions and widespread looting, arson and destruction, the occupation coalition established the Coalition Provisional Authority (CPA) and the Interim Governing Council (IGC) to govern Iraq through the transition period. This approach, which aimed to define the new institutional framework, including the drafting of a new constitution, was abandoned in autumn 2003. The formal transfer of sovereignty to an Iraqi body was scheduled for June 2004 based on a provisional constitution (the Transitional Administrative Law, TAL) that was agreed upon by members of the IGC in early March 2004. The steadfast insistence of Iraq's most important Shi'i cleric, Grand Ayatollah 'Ali al-Sistani, that democratic elections were the only possible instrument to bestow legitimacy on the constitutional process, led to the appointment of an interim government which assumed formal power on June 28, 2004, and the holding of elections in most areas of the country on January 30 of the following year.

As the administrative capacity of the state decreased dramatically in the aftermath of the invasion and the occupation forces lacked resources to substitute these, the supply of the most basic public goods, such as security (let alone the rule of law) could not be guaranteed against various local strongmen and militias which derived their authority from tribal or religious ties. The sweeping "de-Ba'athification" orders and the brief dissolution of the army following the invasion exacerbated the collapse of the country's institutions. Corruption, nepotism and embezzlement are reported to be rampant in the hastily reconstituted government

agencies. The CPA and IGC embarked on a number of reform projects to reshape the economic structure of Iraq, but implementation was hampered by the strained security situation, poor administrative capability and doubts about the legality of these regulations under occupation. Among the few successful reforms were the smooth introduction of a new currency and the establishment of an independent central bank.

B. History and characteristics of transformation

In the years of Iraq's monarchy (1921–1958), the limited-representative political system was dominated by large landowners and tribal shuyukh, who controlled parliament and rigidly opposed any sharing of power with the broader segments of society. Of the popular and reform-oriented parties, only the Communist Party managed to develop a broad mass base; as a result, army officers increasingly meddled in politics. Starting with the 1958 coup led by General 'Abd al-Karim Qasim, conspiracies among small groups of army officers became the most important instrument of political change. An authoritarian system took hold after the Ba'th Party, which was dominated by General Ahmed Hasan al-Bakr and his cousin Saddam Hussein, finally seized power in 1968.

Mobilizing tribal loyalties and employing massive physical force against its opponents, the regime also exploited the growing patronage power afforded to it by soaring oil export earnings. Saddam Hussein used his control over the party and its security apparatus to oust Hasan al-Bakr from the top government post in 1979 and subsequently assumed sole control of the country in his dual role as president and chairman of the Revolutionary Command Council (RCC). The nation's power structures, increasingly dominated by members of Saddam's clan and even his narrower family circle, proved remarkably resistant to external shocks—chief among them the bloody eight-year war with neighboring Iran (1980–1988), defeat by an international coalition in the 1990–1991 Gulf War and a comprehensive trade embargo imposed by the United Nations.

Iraq's economy is dominated by the oil sector, which historically has generated more than 95% of the country's export earnings and more than 60% of its GDP. With the nationalization of the Iraq Petroleum Company (IPC) in 1972 and the sharp rise in oil prices in the following year, the state reaped significant resources that strengthened its patronage power over selected population groups. A series of reforms completely restructured the agricultural sector, which before 1958 had featured large landholdings. However, the land confiscated by the state was distributed to new owners only very slowly. Here, too, the regime's patronage interests outweighed economic rationality. Over time, declining agricultural productivity forced Iraq to import more and more of its food.

The government had taken over broad segments of the private sector in 1964, but a lack of currency reserves and mounting foreign debt during the war against Iran

forced it to initiate substantial deregulation starting in 1987. As various sub-sectors of agriculture, industry and the service sector were opened to private investors under the watchful eye of the state, lucrative monopolies went primarily to profiteers close to the regime. After Iraq's 1990 invasion of Kuwait, the United Nations imposed a total embargo that isolated Iraq economically. In November 1996, that embargo was modified in the framework of the Oil for Food program, which allowed Iraq to export limited quantities of oil, then use most of the revenues to import food, medicine and other essential goods and distribute these to the population via a rationing system.

Effectively, a genuine transformation process started only with the military defeat of the regime of Saddam Hussein at the hands of an Anglo-American coalition in March-April 2003. In the wake of the terrorist attacks of 9-11, the U.S. administration took an increasingly bellicose attitude toward Iraq's alleged WMD program, motivated by a pre-emptive security strategy and a grand design for transforming the Middle East region. Despite mixed findings by the new UNMOVIC mission and its questionable basis under international law, American and British troops started attacking Iraq on March 20, 2003 and managed to capture Baghdad on April 9 after a speedy campaign with only occasionally fierce resistance.

After the fall of Baghdad, the remnants of Iraq's armed forces, including much of the elite Republican Guard, melted away and the occupation forces took much of the regime's Sunni Arab stronghold without a fight. The occupation forces and their civilian governing agency, the Coalition Provisional Authority, were legitimized by UNSC 1483 (2003) and moved on to create Iraqi institutions, the Interim Governing Council and a caretaker government. The CPA and IGC embarked on a number of reform projects to shape the new political, economic and social institutions of Iraq, but implementation was hampered by the strained security situation, poor administrative capability and doubts about their legality under occupation. Although the coalition forces made efforts to preserve Iraq's infrastructure and basic services during the war, looting and sabotage in its immediate aftermath led to the partial breakdown of the strained system.

The signing of the Baghdad agreement in November 2005 marked a major change of course resulting in the decoupling of constitutional and electoral processes. After the drafting of the Transitional Administrative Law (TAL), sovereign power was formally transferred to an Iraqi interim government on June 28, 2004. The interim government managed to gain recognition of most international and regional actors rather quickly, but faced the mounting insurgency that culminated in the bloody re-capture of Falluja by coalition troops.

In spite of the weakness of the central government and the lack of security in many areas, elections to a transitional parliamentary assembly were held as scheduled on January 30, 2005. In spite of the successful electoral exercise negotiations to form a new government between the victorious Shi'i coalition and

the Kurdish alliance took several weeks in the midst of an increasing shaky security environment.

C. Assessment

1. Democracy

1.1. Stateness

The demise of the regime of Saddam Hussein via Anglo-American military attack has dramatically weakened the ability of the central state to perform even the most basic function of statehood, the provision of security. The breakdown of much of the administrative bureaucracy, the dissolution of the armed forces and the ruling Ba'ath party in June 2003 coupled with widespread looting and sabotage created an atmosphere of anarchy in which crime and private militias blossomed and primordial religious and tribal networks substituted for public institutions. The occupation forces and the nascent institutions of the "new Iraq" proved only partially able to restore control, especially in the Sunni Triangle in the Sunni-dominated Northwest of the country. The situation is significantly different in the Kurdish areas in the North-East, which have enjoyed a very large degree of autonomy since the early 1990s. Here, a stable balance of power between the two main Kurdish factions has been maintained.

The prolonged weakness and the eventual breakdown of state institutions have brought to the fore various ethnic, religious, confessional and tribal identities. National identity therefore is contested and remains to be re-defined in a process of nation-building. This should, however, not disguise the fact that there is a strong, centripetal awareness of being Iraqi among large sectors of the population. This awareness is much less present the Kurdish minority. Ten years of autonomous status has significantly strengthened Kurdish national identity, manifested in symbols such as a Kurdish flag and army and the use of Kurdish language in the educational system and the media. While the Kurdish leadership has repeatedly announced its willingness to remain within a federally organized Iraq, popular desire for independent statehood was proven by a recent petition, reportedly signed by 1.4 million Kurds. In an unofficial referendum staged by Kurdish activists on Election Day, 1.9 million or 95% of those questioned supported independence.

The general lack of security and the breakdown of public services have strengthened both religious identity and the importance of religious institutions in many parts of the country. Religious authorities such as the Shi'i Grand Ayatollah al-Sistani or the Sunni Association of Muslim Scholars (*hiyat al-'ulama al-muslimin*) are playing an important role in the political process, a fact which should, however not be regarded necessarily as a indication of the establishment

of Iranian-style clerical domination. The Transitional Administrative Law (TAL) defines Islam as the official religion of the state and a source of legislation, declaring that no law may be enacted against the “universally agreed tenets of Islam”. A similar formulation is likely to be included in the permanent constitution, although operationalizing these principles into the political process remains to be determined.

Given the inability of the Iraqi government to provide to security in significant parts of the country, administrative structures are uneven and generally weak. Although the food distribution system was maintained throughout the period of observation, many administrative functions are reportedly performed by tribal, religious or other non-state networks.

1.2. Political participation

The Iraqi Governing Council (IGC) was appointed in July 2003 as a the predecessor of a Iraqi executive by the civil wing of occupation forces, the Coalition Provisional Authority (CPA), in consultation with the United Nations and in accordance with United Nations Security Council (UNSC) Resolution 1486. Although ICG was composed of 25 figures thought to be representative of various groups of Iraqi society, it was criticized for excluding certain sectors, favoring exiled politicians and reifying ethno-religious cleavages in Iraq society. In 2004, the ICG was replaced by a three-member presidency and an interim government appointed in consultation with UN Special Representative Lakhdar Brahimi, in accordance with UNSC Resolution 1546. On January 30, 2005, a transitional assembly was elected in the first free elections in Iraq since the 1950s. The elections, however, were partly distorted because, in several areas in the Sunni-dominated northwest, voters were intimidated by insurgents. In some cases, polling stations failed to open at all. The electoral campaigns were launched very late and most voters were largely unaware of the nature of their choice since the names of most candidates were published only shortly before Election Day for fear of reprisals. During the campaign, accusations of unfair campaign practices were occasionally raised including the prohibition of the use of religious symbols in campaigning and the utilization of state resources for campaign purposes. In those areas where voting took place it was generally free and fair. Several violations were reported in the northern part of the country.

The decisions of the IGC (which was not democratically elected) were subject to the veto of CPA head Paul Bremer, who also maintained full control over oil revenues which were transferred to the Development Fund for Iraq. In spite of the formal transfer of sovereignty the interim government’s room to maneuver remained small in terms of military and financial resources as well as domestic and international legitimacy. Given the lack of adequately trained and equipped security forces, the maintenance of law and order remained to a large degree the province of occupation coalition troops. The relationship between the interim

government and the occupation forces in the country was established somewhat vaguely in an exchange of letters between Prime Minister 'Allawi and U.S. Foreign Minister Powell, in accordance with UNSC Resolution 1546 which provided for partnership and coordination in security-related matters. The huge job of reconstruction has been financed mainly by international donors (the lion's share being provided by the United States), which are in a position to attach various conditions to their support.

Parties, interest groups and movements of all stripes have been blossoming since the fall of the Hussein regime. The CPA issued a decree providing for the legal framework of non-governmental organizations (Order Number 45) and political parties (Order Number 97) which gave considerable discretionary power to the Independent Electoral Commission of Iraq. However, as many of these groups were established by returning exiles, they often have rather shallow roots in society. A number of prominent public personalities associated with the occupation powers have been assassinated, the most prominent being the leader of the Supreme Council for the Islamic Revolution in Iraq, Ayatollah Muhammad Baqir al-Hakim, and the president of the ICG, Izz al-Din Salim. The Ba'th party was dissolved on the part of the occupation authorities and remains banned from political activity, although the sweeping "de-Ba'thification" of public institutions has been stopped and partly reversed.

After the fall of the Saddam Hussein's government and the corresponding end of its complete repression of independent and foreign media, hundreds of newspapers and other media have been flourishing. These outlets have been covering a broad range of opinions and catering to various constituencies, although many were criticized for being dependent on certain political actors and for poor professional quality. The freedom of press, however, was affected by the lack of the security and armed threats by various groups resulting in a number of journalists killed and many more wounded. The CPA prohibited media activity found guilty of incitement (including calls for armed resistance to occupation), threatening Iraq's neighbors and advocating the return of the Ba'th to power (Order Number 14). On this basis, a number of newspapers and television channels, including the Baghdad office of the popular Arab news channels Al-Jazeera and Al-Arabiya, were temporarily or permanently closed by the authorities. In a process haunted by various difficulties, the CPA established a new umbrella for public media (the Iraqi Media Network) and a regulatory framework. In Freedom House's Freedom of the Press 2004 Survey, Iraq ranks 142nd of 193 countries.

1.3. Rule of law

As the CPA dominated the decision-making process and maintained full budgetary control, there was no separation of powers during the occupation period. The interim government of Prime Minister 'Allawi presided over and

largely controlled a weak and toothless parliamentary assembly which, having little legitimacy and few prerogatives, was unable to balance the executive. The TAL, in effect since June 2004, provides for a federal and parliamentary system where the executive may be checked by a parliamentary vote of confidence. Iraq's three-member Presidency Council is to be elected with a two-thirds majority in parliament. The TAL recognizes the existing Regional Government of Kurdistan as a federal entity, maintains the existing distribution of revenues and allows every set of three provinces to form a new federal region in accordance with Article 53, Section C. The future shape of the Iraqi polity, including the division of powers between the central government and federal entities, will be defined in the drafting process for a permanent constitution steered by the new parliament elected on January 30, 2005.

The judicial system of Saddam Hussein's Iraq was characterized by corruption and shaped by political patronage. Having had very strong professional credentials in previous years, the judiciary was increasingly reduced to an instrument to maintain power at the disposal of the regime. Following the regime's demise, the general breakdown of institutional structure affected the judicial system as well as courthouses, which were frequently looted and organized crime was rampant. Religious courts based on Shariah law operated in various places. Tribal law – which was tolerated and even promoted by Hussein's weakened regime throughout the 1990s – is now applied, especially in rural areas. The interim government, in cooperation with the CPA, set out to gradually rebuild the judicial system, almost from the scratch, by establishing a judicial review committee to evaluate Iraqi judges. The committee, which was composed of three Iraqi judges and three American judges, was subject to criticism both because its formation and proceedings were unclear and because it included foreigners. The Council of Judges, which had been the country's highest independent judicial authority until its abolition by Saddam Hussein in 1979, was reconstituted in September 2003 (Order Number 35). In November 2004, martial law was declared with the exception of the comparatively quiet Kurdish region and subsequently prolonged into 2005, when the observation period for this report concluded. The TAL provides for the establishment of a Federal Supreme Court nominated by the Presidency Council upon recommendation of the Higher Juridical Council composed of the most senior judges. However, there remain strong doubts about the judiciary's implementation of the rule of law. A case which nurtured such suspicions – that is, that the judiciary was functioning as an instrument of political control – was the issuing of arrest warrants for Ahmad Chalabi and his nephew Salem in August 2004. Clearly, suspicion can be raised independently of the veracity of these charges.

Corruption and nepotism are reported to be rampant in many areas of public life. While some provincial governors and other officials have been dismissed for alleged corruption, due the institutional weakness of government, no comprehensive action has been taken. As such, it is clear that the problem

continues: the Minister of Interior, Faleh Al-Naqib, has reportedly appointed no fewer than 49 of his relatives to high-ranking jobs in the ministry.

In principle, civil rights are protected under the provisions of chapter 2 of the TAL which includes a charter of fundamental rights and a reference to international agreements. The CPA even established a Ministry for Human Rights to emphasize its commitment in this field. However, these provisions frequently do not match with current practice which seems to still fall in line with the approach of old security apparatus. According to Human Rights Watch, Iraqi security services are systematically using arbitrary arrest, prolonged pre-trial detention without judicial review, torture and ill-treatment and other instruments violating international human rights standards. Human rights violations are by no means limited to Iraqi institutions though. The well-documented abuse of detainees in the infamous Abu Ghraib prison on the part of U.S. troops damaged the credibility of the occupation forces significantly. An attempt by the IGC to mandate the application the Islamic Shariah law - which significantly disfavors women over men – in the infamous personal status law (Law Number. 137) was successfully challenged by women's rights groups. Various incidents of violence against the Christian minority occurred.

1.4. Stability of democratic institutions

Until the elections of January 2005, institutions had not been democratically legitimized and faced severe obstacles to effective functioning. Basic state functions such as security and reconstruction were dependent on the occupation forces and important international actors. Strong actors based on religious, tribal or other legitimacy, many boasting armed militias, also must be taken into account.

Given the volatility of the current situation, institutional stability is very weak. The ICG was perceived as rather dependent and ineffective by many and the fact that most of its members spent much of their time in office abroad did nothing to improve this image. A poll conducted by Oxford Research International in February 2004 indicated that the institution trusted most by Iraqis are religious leaders (70%) followed by the police and the new Iraqi army.

1.5. Political and social integration

Iraqi society has been largely atomized through decades of brutal repression which left only room for religious and tribal forms of autonomous organization. Polls indicate that an overwhelming majority of Iraqis are not yet mobilized and profoundly distrust political institutions. No single political leader was able to attract more than 10% of the population's support in these polls. Many parties are led by recently returned exiles and, as such, are rather weakly rooted in society.

The exceptions to this rule are the two Kurdish parties who have built a strong power base over the last decade in their autonomous statelets. With the support of Grand Ayatollah al-Sistani, Shi'i Islamist parties al-Da'wa and the Supreme Council for the Islamic Revolution in Iraq (SCIRI) scored a sweeping victory in the first parliamentary elections. Interim Premier 'Allawi skillfully used his executive position and his intensive American backing to prop up his own list, which did surprisingly well. The transformation plan which, as this report was being composed, foresaw two general elections and a referendum within barely a year, should eventually lead to a mobilization process.

The system of interest representation outside political parties is still weak. The depth of the roots of actors in society and their ability to function as transmission belts between government and society remains to be tested. Demonstrations by various constituencies have become a regular feature of public life. Occasionally these have led to violent clashes with the occupation forces. Some of the old syndicate-style professional associations have been reconstituted under the country's new leadership and a number of independent groups in different fields such as women's issues have sprung up. The General Federation of Workers' Trade Unions in Iraq (otherwise known as the "yellow union"), an umbrella organization set up by Saddam Hussein, was replaced by the Iraqi Federation of Trade Unions, founded in May 2003 and controlled by the Communist party and the 'Allawi's party, which claims to have set up 12 unions representing over 200,000 members in the transportation, printing, construction, oil, electricity, railways and food production industries. However, there are several competing unions, including the oil workers union in Basra and independent unions established by Kurds and Islamists.

Opinions on character of the future polity depend to some extent on the framing of questions. The largest poll conducted during the evaluation period (National Survey of Iraq by Oxford Research International) found that a majority of Iraqis favor a democratic system while. At the same time, however, a majority said that they favor a single strong Iraqi leader for the transition period. It is improvement to remember that such measures gives no precise specification of what, exactly, people mean when they speak about democracy, especially regarding issues such as the rights of the individual or minority protection.

Under the stark repression of the Hussein regime, social self-organization was virtually impossible outside the tightly controlled institutions of authoritarian corporatism and religious and tribal networks. After the demise of this regime civil society groups of all stripes emerged, many of them geared to community work or social rehabilitation. However, most are tiny and weak, and lack both organizational skills and adequate financial resources.

2. Market economy

2.1. Level of socioeconomic development

Through continuous investments during the 1970s and 1980s, Iraq had reached a relatively high level of development and created a relatively effective education and health care system. But after 1990, the considerable ravages of war and economic sanctions caused the Iraqi population's standard of living to plummet, a free-fall that was only halted with the introduction of the UN-administered Oil for Food program. Broad swaths of the urban middle class, most of which depended directly or indirectly on the public sector, were driven to ruin by the hyperinflation of the 1990s and the general decline of economic activity. As a result, Iraq's infrastructure and social services were in very poor condition and faced an abject lack of capital investment for an extended period of time. Parts of the population had no access to potable water and sewage treatment plants and electricity production covered only part of the demand. Seventy-four percent literacy among those 15 to 25 years of age is lower than that in the older age groups. This indicates the extreme degree of the educational system's deterioration.

The aftermath of the most recent war saw the near collapse of the infrastructure and the basic social services due to the combined impact of years of neglect and the widespread looting and sabotage. Driven by the large influx of aid funding, the process of reconstruction in various sectors has picked up since then, although this has failed, to meet overly-optimistic expectations of quick recovery. For example, in summer 2004, water treatment had reportedly reached only 65% of its pre-war capacity due to electricity shortages and looting. Although the supply of electricity has been steadily improving, it still falls short of growing demand and is therefore still being rationed. Health services are being refurbished, but do not yet fully match the needs of population. The system of public distribution of food and basic commodities originally established in the framework of the UN-administered Oil for Food program is being continued, as more than 60% of the Iraqi population depends on food rations for survival. In the traditionally-neglected provinces of the Kurdish autonomous zone, economic conditions have improved remarkably since the mid-1990s.

2.2. Organization of the market and competition

Iraq's economy has been ruined by twenty years of the Hussein regime's neglect and misallocation of resources. Historically, the dominance of the oil sector and the Ba'th Party's state-centered development ideology made the state the dominant actor in the Iraqi economy. Although private enterprises have become more important since the deregulation of the late 1980s, they depended on the state bureaucracy in many respects. Trade sanctions cut Iraq off from its trade relationships, caused a general decline in economic activity and triggered rampant

inflation. As the sole exporter, the state gained strength in comparison to a weak private sector, while the middle class, apart from a small group that profited from the sanctions, has all but disappeared.

During the occupation period the CPA and the IGC issued a number of potentially far-reaching regulations aimed at transforming Iraq into a market economy. In September 2003, a tax strategy (Order Number 37) was issued, declaring – with isolated exceptions – a tax holiday for 2003 and announcing that of individual and corporate tax rates would not exceed 15% in 2004, a move which would have put Iraq's tax rates among the lowest in the world.

In September 2003, a new foreign investment framework (Order Number 39) established generous conditions for foreign investment, including full ownership of businesses in all sectors (except natural resources), full repatriation of profits and equal legal standing with local companies. In reality, however, these proposals remain largely limited to blueprints and have not proceeded far beyond the planning stage because of constraints in security and implementation capacity.

The system of public food distribution has remained intact, while food, energy and certain inputs to the production of state-owned enterprises remain subject to price controls. At the time of this writing, it was not yet clear whether these regulations would remain in force after establishment and legitimization of an interim government through elections.

During the sanctions period, legal foreign trade was restricted to the UN-administered Oil for Food program and subject only to minimal market mechanisms. Parallel to the UN system, substantial amounts of formally illegal trade with neighboring countries has developed, especially in oil and diesel fuel. Most UN economic sanctions were lifted in May 2003 and the Oil for Food program was phased out. The CPA announced a holiday on all tariffs for imports through 2003. These measures, coupled with the rising salaries of many Iraqi officials, triggered a sharp rise in imports and a consumption boom, especially for used cars and electronic equipment. In April 2004, a 5% reconstruction levy on imports (except for food, clothing, medicine, books and humanitarian goods) was introduced. The Trade Bank of Iraq was created in December 2003. In February 2004, Iraq was granted an observer status at the WTO and in September of the same year it submitted a formal request for WTO membership.

Iraq's banking sector was very weak before the war and collapsed in its aftermath: Under the Hussein regime, the Iraqi government controlled all financial transactions; in addition to two large state banks (Al-Rafidain; once the largest bank in the Middle East, and Al-Rashid, which broke off from the former in 1988), a number of smaller public and private institutions operated. While a tiny stock exchange existed in Baghdad from 1992 until its closure during the recent war, but a true capital market has not developed. The economy was predominantly cash-based, while credit was largely based on cronyism. As a result, the financial

sector is underdeveloped and is characterized by ineffective institutions and a weak regulatory framework. It has little financial intermediation and transactions are limited to deposit-taking and infrequent loans. A new commercial banking law allows foreign banks to operate in Iraq or form joint-ventures with Iraqi banks. By January 2005, six foreign banks had been licensed, two of which had bought stakes in local Iraqi banks.

2.3. Currency and price stability

In October 2003, the CPA and the IGC introduced a new currency, the New Iraqi dinar (NID). The introduction of the new currency was complicated by the fact that, in the Kurdish Autonomous Region, an older version of the Iraqi dinar known as the “Swiss dinar” was in use, the exchange rate of which differed from the currency which had been used in the rest of the country. The NID has appreciated considerably since its introduction, from around 1,950 dinars per U.S. dollar in October 2003 to 1,460 dinars per U.S. dollar in October 2004. Inflation is estimated to have dropped from 50% in December 2003 to 28% in March 2004. While official data suggests that inflation averaged just over 2% in 2004 in spite of a large increase in money supply, these figures are disputed. A new central bank law announced in March 2004 establishes the independence of the new Central Bank of Iraq (CBI). The CBI, which is just beginning to develop its monetary instruments, is managed by a nine-member governing board and is prohibited from extending credit to the government.

In the 1980s the Iraqi regime resorted to international heavy borrowing to finance its long and costly war with Iran. When this option was no longer available due to Iraq’s international isolation in the 1990s, it resorted to printing currency, which, in turn triggered rampant inflation: the exchange rate between the Iraqi dinar to the U.S. dollar plummeted from 8 dinars per U.S. dollar in 1991 to 3,000 dinars per U.S. dollar in 2002. Today, Iraq ranks among the most heavily indebted countries in the world. In 2003, public spending was restricted to the wages of civil servants and the employees of publicly-owned companies as well as the distribution of basic goods. The IMF’s Iraq Debt Sustainability Analysis estimated Iraq’s total foreign debt at around \$121 billion, which includes a debt of \$42 billion to Paris Club creditors and \$64 billion to non-Paris Club creditors as well as \$15 billion of private debt. This account excludes an estimated \$30 billion of unpaid Gulf war reparations and about \$84 billion of unresolved claims from more than a dozen nations. These figures could be somewhat lower if part of the non-Paris club debt, mostly claimed by the GCC countries can be considered grants or loans on very favorable repayment terms. According to the terms of UNSC resolution 1483 Iraq’s oil revenues are immune from debt collection until end of 2007. The Paris Club announced in late 2004 that will write off 80% of its part of Iraq’s debt. After the elimination of an initial 30% tranche, the cancellation of the rest will be tied to the country’s successful implementation of an IMF economic restructuring program.

2.4. Private property

Under the Hussein regime, property ownership - while guaranteed in theory - was subject to the regime's control, made possible by the absence of an independent court system and the arbitrary use of violence by the security services. Under occupation, property laws have been enforced sporadically at best. The inability of the coalition forces to ensure security or prevent rioting, looting and sabotage has created a climate of insecurity; the industrial-scale armed gangs that have grown since the 1990s were able to operate with near-impunity. Being fraught with corruption, the court system is hardly operative. As such, the implementation of the court's rulings is extremely limited.

Iraq's key economic sectors (insurance, banking and large industrial and commercial enterprises) were all nationalized in 1964. The public sector continues to play an important economic role, with the central government and state-owned companies employing about 29% of the workforce. In September 2003, CPA advisor Tom Foley announced plans to sell some 150 of Iraq's 200-odd state owned enterprises, including cement and fertilizer plants, phosphate and sulphur mines, pharmaceutical factories and the country's national airline. However, no privatization measures have been implemented yet, partly because of doubts regarding legitimacy of such far-reaching measures under international law. Given the potentially large social costs involved, the CPA and the government shelved early plans to cut the salaries of the employees in state-owned companies at the end of 2004 and continue to keep them on the public payroll, even if many of them perform little or no useful service.

2.5. Welfare regime

The embargo and the associated curtailment of economic activity, along with inflation, posed insurmountable challenges to Iraq's social networks. For many Iraqis, inadequate support from the state led to a growing dependence on family and tribal solidarity, which in turn reinforced the effect of the Hussein regime's "tribalization" policies. The health care system, considered exemplary in the 1980s, cannot provide comprehensive care because of the shortage of medical supplies, lack of investment and the emigration of qualified personnel. The coverage and the quality of the health system have been improved by the rebuilding and refurbishing of dozens of hospitals and health clinics since 2003, although the lack of health personnel, medicine and adequate infrastructure remain acute. The high rates of inflation have undermined the pension system to the extent that the monthly pensions are almost worthless. Many families are heavily dependant on cash transfers of relatives living abroad. The most important welfare program remains the system of public distribution of food and basic commodities originally established in the framework of the UN-administered Oil for Food program is being continued, as more than 60% of the Iraqi population depends on food rations for survival.

Under the Hussein regime, the advancement of the status of women in public life corresponded to the “socialist” Ba’th ideology and has helped at least a small female educated elite to gain prominent positions. Since the 1990s, conservative tribal and religious tendencies within the state and society at large have increasingly restricted the rights of women. The UNDP reports that 64% of rural women above 15 years of age have not completed elementary education. While literacy gap between men and women has narrowed, this is a reflection of a decline in literacy among men rather than gains among women.

After the fall of the regime, many women feel that they are on the losing side. The strained security situation – which includes numerous cases of rape and abduction – considerably limits their freedom of movement. According to UNDP, the employment rate for women over 15 is only 10%. Furthermore, the growing strength of conservative Islamist groups has imposed an Islamic dress code on many and further eroded opportunities to work. The governing authorities have done little to stop this trend, although a decision by the Governing Council to apply Shariah law - which disfavors women – in personal status law, was subsequently reversed. The TAL was criticized for not giving explicit guarantees to women for equal rights in marriage, inheritance and conferring citizenship. On the political level, six out of 33 ministers in the interim government were women. In accordance with the TAL which requires that women account for no less than one quarter of the representatives in the new parliament, the elections have indeed greatly increased the political representation of women. Most electoral lists included female candidates on every third position throughout the list, thus achieving a percentage of over 30% female deputies.

2.6. Economic performance

Because of its undiversified export structure, Iraq’s macroeconomic development is heavily dependent on the oil market. In the aftermath of the war, the GDP dropped some 20% 2003, reflecting decreases in oil production as well as in non-oil economic activity. At the time this report was written, Iraq’s economy was estimated to have grown by 30% in 2004, driven mainly by international reconstruction aid. Iraq’s oil production, which stood at 2.5 million barrels per day (bpd) at the eve of the occupation, fell sharply in March 2003, to around 0.5 million bpd and was still hovering around 2 million bpd in November 2004, haunted by frequent attacks and sabotage on oil pipelines and facilities. Oil production constitutes more than 75% of Iraq’s total economic activity and is estimated to account for more than 98% of gross revenues.

Retail commercial activity has been booming through 2004 coupled with a modest revival of agricultural activity. Salaries for public employees have risen sharply, thereby reversing the relationship with private sector workers who used to earn much more in the past. Unemployment remains high, although the figures vary

widely, as much of the workforce is thought to be employed in the informal sector. UNDP gives 18.4% as unemployment rate, which seems to be rather low.

2.7. Sustainability

In the past, environmental concerns have played a subordinate role both in public policies and in society's awareness. As such increasing pollution of the Tigris and Euphrates rivers and their tributaries, as well as the salinization and erosion of agricultural land already poses significant cause for concern. Starting in the mid-1990s, the Hussein regime precipitated an ecological catastrophe of colossal proportions by draining the marshes and wetlands at Nasiriyya in the southern part of the country. The regime deliberately destroyed a unique natural biotope as well as an ancient civilization (the Marsh Arabs) in order to deprive deserters and insurgents a refuge in this difficult-to-access area. In theory environmental concerns play a role in the new government, and were institutionalized in the creation of ministry of environment. Some measures have been taken to reinvigorate the marshes, such as the breaking of dikes and the flooding of parched lands. Given the widespread insecurity, however, and the government's inability to cover basic needs, little action can be expected soon. For example, rough estimates are about 75% of the sewage is being dumped into the rivers.

Iraq's institutions for higher learning and advanced research have been seriously weakened by years of financial crisis and international isolation. The infrastructure for teaching and research does not fulfill modern standards and must be rebuilt during the coming years. Almost all of the country's 13 major universities and 40 other institutes and colleges were looted and ransacked in the early weeks of the occupation. The repression of the Hussein regime led to the emigration of an estimated 2,000 professors between 1995 and 2000 alone. The return of those willing to do so is endangered by the targeted killing of academics by terrorists which included the dean of Mosul University's faculty of law.

3. Management

3.1. Level of difficulty

Iraq's level of development, once ranked high among middle-income countries, has fallen rapidly since the early 1990s. The quality of the Iraqi labor force has been dramatically reduced by the international isolation, the mass emigration of skilled labor and the decline of the education system. The quality of Iraq's infrastructure, once among the best in the Middle East, has plummeted due to a lack of investment and the destruction caused by war.

Apart from the tentative and ultimately failed approach during of the monarchy until 1958 Iraq lacks any tradition of democratic governance. Civil society was

viable well into the 1960s, but faced increasing repression and ultimately violent destruction at the hands of the Ba’th party, leaving behind weak and atomized society. The economy’s rentier structure has tended to strengthen the authoritarian state and to hamper the development of autonomous social groups.

The governing system of Iraq has become increasingly tribalized, beginning with the Arif brothers in the 1960s. As such, ethnic and confessional conflicts have intensified and increasingly overlapped with socioeconomic differences. The period after the fall of the Hussein regime has witnessed a strengthening of ethnic and confessional identities across the country, fuelled by the breakdown of public institutions and their replacement with primordial networks. This development must be understood in the context of the Hussein regime’s retribalization policies, borne out of its weakness in the 1990s.

Profile of the Political System

Regime type:	<i>Autocracy</i>	Constraints to executive authority:	3
		Latest parliamentary election:	30.1.2005
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution.</p>			

3.2. Steering capability

During the period under discussion, the CPA and the IGC as well as the Iraqi Interim Government (IIG) were nominally committed to the goal of establishing a constitutional democracy and a market-based economy. The implementation of these goals, however, reflected poor planning, lack of sufficient resources, and lack of understanding of the realities of Iraqi society. More often than not, this process was driven by crisis management and short-term considerations. The United States and its allies failed to secure sufficient legitimacy for the process, on both international and domestic levels. Important actors in the international arena such as Russia, France and Germany, whose help was desperately needed in the first months of the occupation, had serious reservations about the war and the management of its aftermath. On the domestic level, crucial actors of the Sunni Arab community and the popular Sadr movement were not included in the process.

The CPA’s failure to issue a binding timetable for the withdrawal of the occupation forces also amounted to a failure to refute widespread conspiracy theories regarding the ultimate aims of the occupation. Most damaging of all, the occupation authorities were not accountable to any higher body, as investigations into prisoner abuse at Abu Ghraib – begun very late, in spite of substantial evidence – has proven. Indeed, the political process itself has been characterized

by at least three distinct approaches in quick succession. The initial approach, the Office for Reconstruction and Humanitarian Assistance (ORHA) managed by General Jay Garner's, was based on the assumption that the bureaucratic and military apparatus of Iraq would remain largely intact and the top layer of executives and military commanders could be quickly replaced with reliable figures brought in from the Iraqi exile community. Garner was quickly replaced by Paul Bremer and the CPA, which set out to manage the transition process more directly by remodeling the institutional structure.

The rising number of United States casualties and the coming American presidential elections convinced the CPA of the necessity to decouple the transfer of sovereignty from the constitutional process and to provide for a gradual American disengagement from Iraq. After the decision to transfer power, short-term considerations of occupation officials generally triumphed over long-term designs, producing a number of highly visible reconstruction projects to be completed by June 2004.

The ability of the governing agencies to implement reform policies was constrained by the weakness of public institutions and the lack of legitimacy. The strained security situation in many parts of the country made any meaningful attempt at institution-building on the local and regional level difficult. In addition, implementation was constrained by slow and cumbersome disbursement procedures. As a result, only a fraction of the \$18.4 billion allocated by the U.S. Congress for Iraq being actually spent. The failure to maintain public order, especially in the anarchic first weeks of the occupation, caused immense material and psychological damage. The hands-off approach of Garner and his team contributed to the near-total breakdown of order, when most public institutions simply ceased to operate, public services such as electricity and water no longer functioned, and, in the ensuing security vacuum, looting and sabotage wreaked widespread destruction on public facilities.

Bremer's plans for maintaining the occupation regime for up to two years to allow for a gradual process of institution-building – including the drafting of a constitution – met with resistance from Grand Ayatollah al-Sistani, who repeatedly stressed that only a constitution produced by a democratically elected assembly would be legitimate. Al-Sistani managed to mobilize public pressure to scrap U.S. plans for an indirect election of the interim government, insisting that elections should be held as early as possible. The CPA discontinued the organization of local elections on the lines of those which were held in a number of municipalities at the behest of local United States commanders, because it was feared that this would bring Islamists hostile to the United States to power and would raise premature expectations for national elections. Plans for an extensive restructuring of the Iraqi economy met stiff domestic and international resistance based on the assumption that structural changes of this magnitude under an occupation regime are contrary to international law.

The CPA has been capable of acting flexibly to a certain degree, but learning from past mistakes came at substantial cost, in a long and, at times, painful process. While the CPA changed course at least three times, it did this only after much damage had been inflicted and resources had been wasted, above all in terms of its own legitimacy. Despite these issues, CPA has repeatedly failed to give a more meaningful role to the United Nations. The United Nations was sidelined during the war and in its immediate aftermath and essentially fled the country in the wake of the bombing of its headquarters in August 2003. In the stalemate that emerged in early 2004 between the CPA and Grand Ayatollah al-Sistani, the United Nations was tasked with investigating the feasibility of elections, guiding the electoral process and appointing the interim government. In the end, however, UN Special Ambassador Brahimi was forced to accept selections for the most senior offices against his wishes.

3.3. Resource efficiency

After the near-complete breakdown of the public administration in April 2003 and the subsequent looting and destruction of most public facilities, the organizational resources of the state have only gradually been restored. As such, they are still compounded by various problems, the most pressing being, of course, the general lack of security.

The occupation coalition has failed to commit sufficient and adequately trained troops to restore law and order in many parts of the country. The recruitment and training of new Iraqi security forces other than the police has proceeded only slowly. At one point, a battalion of the newly formed army dissolved due to insufficient payment, while a second refused to fight the insurgents at Falluja. The dissolution of the army in May 2003 was grave mistake which was only partly reversed by a later decision to continue paying salary to individual soldiers and officers. Many believed it to be the only force that could have re-established security and had the residual reputation of being a national institution, although being commanded overwhelmingly by officers from the Sunni Arab elite of the regime. Indeed, the dissolution of the army also swelled the ranks of the unemployed (the army totaled 7% of Iraq's workforce and its salaries supported an estimated to 10% of the Iraqi population, assuming that every soldier supports a family of five) and created a broad reservoir of disgruntled and alienated individuals trained in the effective use of weapons, ready to be recruited by the mounting insurgency.

The breakdown of public services was exacerbated by the sweeping "de-Ba'athification" laws issued by the CPA in May 2003 (Order Number 1) which excluded indiscriminately many middle-level Ba'athists from professional life in crucial functions such as engineers, medical doctors or teachers. The de-Ba'athification commission led by Governing Council Member Ahmed Chalabi purged a total of 30,000 public employees before it was dissolved in June 2004.

This policy was subsequently reversed and ministries started to re-hire their purged employees. Salaries of most officials in public service were increased dramatically: according to the *Al-Hayat* newspaper, salaries increased by fifty or even hundred times.

UNSC 1483 established the Development Fund for Iraq (DFI) as the temporary deposit for Iraq's resources, managed by the CPA and monitored by the International Advisory and Monitoring Board (IAMB). The DFI was transferred to the Interim Government in June 2004, while the IAMB continues to operate. The Iraqi money spent through the DFI was hardly monitored until the IAMB issued its first report in May 2004, which found that weak controls over oil production as well as insufficient accounting procedures had led to smuggling and misallocation of resources. The occupation authorities were caught between quickly disbursing aid funds – and thereby risking embezzlement and corruption – and going through slow and thorough accounting procedures. According to the Special Inspector General for Iraq Reconstruction (SIGIR) as well as independent watchdog organizations, the CPA failed to establish adequate transparency with large sums being allotted to ministries without clear specification how the money would be used, thus opening the door widely for embezzlement and corruption. Most large reconstruction contracts paid for with Iraqi money were awarded in non-competitive procedures to American companies without proper oversight over adequate cost plans and delivery schedules. There were complaints that foreign companies worked at inflated costs for providing services that could have been performed by local enterprises at a fraction of the cost.

Corruption was widespread under Saddam Hussein, functioning both as an integral component of the informal government system and as an individual response to the dire economic situation, especially in the public sector. In the initial anarchy after the collapse of institutions members of the care-taker government were initially busy with reorganizing their ministries.

Coordination between ministries was largely absent and had to be established from scratch under difficult conditions and with poor communication devices. Some government ministries are reportedly seen as personal or party fiefdoms to serve as power bases for the unfolding political process. The very high level of corruption inherited from Saddam's regime seems to have continued, if not worsened, in the institutional vacuum that emerged during occupation. Various reports and evidence point to corruption being the norm rather than the exception, on all levels of government. In a particularly sensitive incident which was highly publicized in the international media, officials of the Ministry of Defense were caught shipping some \$300 million in cash to Lebanon in order to circumvent the accounting procedures meant to fight corruption. The same month, a U.S. defense contractor was killed shortly after alleging corruption within the Ministry of Defense.

3.4. Consensus-building

The normative framework established by the occupation authorities and the relevant UN resolutions have forced most relevant political actors to subscribe to aims of liberal democracy and market economy. However, taking the fluidity of the process into account, it can be suspected that there are differing interpretations of what these goals exactly mean. The real test of this will be whether these verbal commitments will be backed up by political action. Grand Ayatollah al-Sistani has used his tremendous influence to structure the sequence of the political process and support a religious Shi'i list in the elections. Aside from his well-known fundamental conviction that the clergy should not directly meddle in politics al-Sistani's intentions regarding the principles of the emerging political system and the content of the constitution unclear. He has only grudgingly accepted the TAL, and prevented its endorsement in UNSC 1546 believing that it grants too much power to minorities. The Islamist parties in their Shi'i or Sunni variations aim at including religious principles as a basis for the new polity established by the constitution; details thereof will come to the fore during the constitutional process.

The Kurdish parties have expressed that their future as a part of the Iraqi state is conditional upon the establishment of a decentralized federal system which would largely preserve the autonomous status the Kurdish region has enjoyed since the early 1990s. Large parts of the Sunni Arab minority – which makes up the main stronghold of the armed insurgency – participate only marginally in the political system and are only indirectly represented in public discourse. In addition, important choices in managing Iraq's transition to a market economy – such as the decision to draft a new investment code and the privatization plan announced in 2003 – were made without consulting with or securing sufficient support of the Iraqis. Such moves were thus perceived by many Iraqis as an imposition by a foreign occupier and deeply resented.

In the current fluid process of mobilizing a sullen population atomized by decades of quasi-totalitarian rule and establishing a new polity, it is far from clear which anti-democratic veto actors will ultimately emerge. In fact, the commitment to democracy of many actors could be questioned. The current political process has been threatened from the insurgency in the Sunni Triangle and the radical Shi'i Sadr movement. In the course of 2004, the insurgents managed to establish control of a number of urban centers in the Sunni-dominated northwest, a process which culminated in the bloody re-conquest of Falluja by U.S. troops in November 2004.

Although the reportedly high turnout in the elections has considerably weakened the insurgent's appeal as legitimate resistance force, the fears of the Sunni Arab minority remain virulent. The popular movement of the young firebrand cleric Muqtada Al-Sadr, son of the revered Grand Ayatollah Muhammad Sadiq al-Sadr who was assassinated by the Hussein regime, has refused to participate in the political process under occupation. Accordingly, its Mahdi militia staged an

armed rebellion against the occupation forces in August 2004, which, after much bloodshed and heavy casualties, was terminated through the intervention of Grand Ayatollah al-Sistani. At this report was written, there were encouraging signs that point to the creation of an inclusive formula which would enable the opposition to participate in the drafting of the permanent constitution.

The aftermath of war has strengthened ethnic and religious identities in Iraq. After the near-complete breakdown of public institutions, religious networks organized around mosques and tribal associations frequently provided desperately needed security and basic services. The fact that the Governing Council was deliberately composed to reflect the ethnic-confessional composition of Iraqi society has raised fears about the introduction of Lebanese-style confessionalism as the organizing principle of Iraqi politics. The unfolding of the political process has resulted in the proliferation of sectarian parties with only token representation from other groups: the strongest of these groups include the United Iraqi Coalition list endorsed by Ayatollah al-Sistani and the Kurdish parties. Few organizations are truly cross-cutting.

The history of increasing ethno-confessional polarization within the Iraqi political system and a propensity to use extraordinarily high levels of violence to settle conflicts would point to a rather low level of inter-group social capital. Nonetheless, the centripetal forces operating in Iraqi society and the long history of co-existence should not be underestimated. Indeed, intermarriage is not uncommon and many tribes have both Sunni and Shi'i branches. Attempts to spark a civil war between Sunnis and Shi'is undertaken by al-Tawhid wa al-Jihad, a terrorist group led by the Jordanian terrorist Abu Mus'ab al-Zarqawi have not succeeded. To the contrary, after the suicide bombing attack in the Shi'i Baghdad suburb of Kadhimiyya on the occasion of the 'Ashura holiday in March 2004 which killed dozens, inhabitants of the staunchly Arab Sunni quarter Adhamiyya offered help and donated blood for the victims.

While civil society organizations have flourished in many areas of public life since the fall of the Hussein regime, most are feeble and lack experience, as well as organizational and material resources. The CPA has accounted for this by issuing a legal framework for the operations of NGOs (Order Number 45). Although the CPA made efforts to address actors from civil society and to react to their demands, it failed to establish communication channels that would have allowed it to genuinely and systematically incorporate the views of civil society into decision-making. The CPA was perceived by many Iraqis as a complex and opaque institution isolated in the large green zone compound in Baghdad, having little contact with the daily problems of ordinary citizens. In some cases, there have been conflicts between the authorities or foreign contractors and union activists over employment and wage levels.

The sheer magnitude of the crimes committed on the watch of Saddam Hussein requires a careful process of coming to terms with the past in both legal and moral

terms. As does every transition process, Iraq faces a conflict between the popular desire and the moral necessity of punishing the perpetrators, and calls to forget the past in order to forge new national consensus. The legal determination of individual guilt is a complex and time-consuming process that requires universal and generally accepted standards, trained and experienced legal personnel, and careful preparation of evidence. The creation of an Iraqi Special Tribunal was announced in December 2003 (and confirmed in Article 48 A of the TAL) with a very broad mandate to cover crimes committed since the Ba'th takeover of power in 1968, including genocide, war crimes and crimes against humanity. Court proceedings started with a preliminary reading of charges against Saddam and 11 other top officials on July 1, 2004, and trials are to begin in spring 2005. The composition of the special tribunal has become politicized: Interim Prime Minister 'Allawi has moved to replace senior officials with his loyalists. International human rights agencies have voiced concerns over the fairness of this opening move and future proceedings, given the absence of defense lawyers and media representatives. Another criticism that was raised is the fact that, in contrast to other post conflict tribunals, the judges will be exclusively Iraqi. Given the poor state of the Iraqi judicial system, Iraqi judges and prosecutors may lack the necessary experience to deal with complex cases of crime, even providing for the participation of international advisors and observers.

The TAL encourages the Iraqi government to take all measures to remedy past injustices and includes potentially explosive provisions on the disputed city of Kirkuk (Article 58). In January 2004, the Iraq Property Claims Commission was established to deal with the property claims resulting from confiscation or seizure of property on the part of the Ba'th regime since 1968 (CPA regulation number 8, amended by regulation number 12). At the end of 2004, a reported 37,000 claims had been accepted, while 600 cases had been adjudicated.

3.5. International cooperation

The CPA and the IGC were endowed with international legitimacy through UNSC Resolutions 1483 and 1511. The interim government of Premier 'Allawi, legitimized through UNSC Resolution 1546, was recognized by all important international players, many of which emphasized the importance of establishing a popularly legitimized government by holding elections as soon as possible. The Iraqi government as well as various UN resolutions has called upon the international community to support the transformation process. The Joint Iraq Needs Assessment compiled by the United Nations and the World Bank estimated the costs of reconstruction through 2007 at \$55 billion. At a donor's conference held in Madrid in October 2003 pledges worth up to \$33 billion in loans and grants were made, more than half of which by United States.

The conference established the International Reconstruction Fund Facility for Iraq (IRFFI) as an alternative to the CPA-managed DFI, which was criticized for its

contracting procedures by potential donor countries. The IRFFI has two funds, one managed by the World Bank, the other by UNDP. However, only a fraction of the amount pledged in Madrid has actually disbursed, donor countries agreed at a meeting in Tokyo in October 2004 to speed up the disbursement of promised assistance. Because a number international assistance projects suffered from severe security constraints, including the assassinations and abductions of foreign aid workers, many were either discontinued or transferred to neighboring countries.

Iraq has been internationally isolated since the United Nations imposed sanctions in 1990. After two offensive wars within a decade (against Iran in 1980 and against Kuwait in 1990) the Hussein regime was considered aggressive and unpredictable, within the regional as well as in the broader international context. Recognizing the need to anchor the Iraqi government in a stable regional setting, the ICG and the interim government have attempted to establish good relations with all of Iraq's neighbors. As in the past, relations with Iran and Syria have proved the most difficult to cultivate. Both countries have been repeatedly accused by senior Iraqi officials of interfering into Iraq's domestic affairs and exploiting its porous borders to destabilize the country. Iraq's relationship with Turkey has been dominated by Turkish reservations about the Kurdish autonomy within a federal Iraq.

4. Trend of development

4.1. Democratic development

Since the fall of Saddam Hussein in April 2003, Iraq has embarked on an ambitious transformation process whose outcome is currently far from certain. The central government's power to govern has been almost fatally weakened through the collapse and subsequent looting of public institutions in the invasion's aftermath. Civil war and de facto partition of Iraq remain a dangerous possibility, although the prospect of a loose federal system, if ultimately successful, could achieve the reintegration of the Kurdish areas into a decentralized Iraqi state. The ICG and the interim government, although technically "representative" of Iraq's various communities, were flawed in many ways, but they paved the way for the remarkable elections of January 2005 which, in spite of all shortcomings, allowed for a degree of competition and choice.

4.2. Market economy development

Iraq's level of human development improved only slightly over the past four years. As there were no reliable figures until 2003, it is not listed in the UNHDR. The sharp decline in human development after the second Gulf war was arrested in the late 1990s with the introduction of the Oil for Food program and the inflow

of increasingly targeted aid from international organizations. The occupation period saw the temporary breakdown of parts of an already-strained social and educational system followed by the take-off of the reconstruction process financed by the influx of very large amounts of international aid.

The institutional framework for market economy in Iraq remains very weak and the overall situation of security vacuum and institutional breakdown is not conducive to establishing a regulated system of markets. Moreover, the far-reaching blueprints developed by the CPA met strong domestic and international resistance due to doubts about their legitimacy.

Iraq's economy has not witnessed a qualitative jump during the period under observation. Its GDP continues to depend heavily on its oil output and the price of oil on the world market. Before the war, the country's oil exports had dropped as a result of Iraq's unilateral suspension of production, conflicts over price levels and the uncertain political situation. After a temporary drop caused by the Anglo-American invasion, exports picked up again and neared pre-war levels in late 2004. Non-oil economic activity was characterized by a consumption boom of imported durables sparked by the rise in real wages, the termination of the UN sanctions regime and the temporary lowering of most tariffs.

Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	4.0	-6.0	-6.5	-21.8	37.5
Export growth in %		-31,3	-20,5	-28	245
Import growth in %		1,3	-30,6	-15,3	265
Inflation in % (CPI)	5.0	16.4	26.3	36.3	7.0
Investment in % of GDP					
Tax Revenue in % of GDP					
Unemployment in %					
Budget deficit in % of GDP					
Current account balance in billion \$	1.750	-1.770	-0.001	0.951	-1.940

Source: a. EUI Country Risk Service estimates

D Strategic perspective

The current year is decisive in determining the success of transformation in Iraq; establishing a broad national consensus is the first step. Clearly, the single most pressing problem in Iraq is the general lack of security and the rise of armed militias. Given the complex and dangerous environment in Iraq, and the lack of a truly multilateral framework, most countries are very reluctant to commit troops to the country, even under a UN command structure, and many of those on the ground face strong domestic pressure to withdraw. This problem can only be

addressed properly if capable Iraqi security forces are rebuilt and this is coupled with an inclusive political process that is perceived by the overwhelming majority of Iraqis as legitimate.

The interim parliament elected in the national elections on January 30, 2005 is supposed to supervise (until August 2005) the drafting of a new constitution, which will be put to a popular referendum. If the new constitution is adopted, new elections for a regular parliament are scheduled to be held in December. The post-election period is fraught with danger because of the ambitious transition schedule and the electoral boycott by a significant portion of the population. The week-long negotiation process leading up to the formation of the Ja'fari government has been everything but encouraging.

The most important task is to incorporate those groups that boycotted the elections—especially those representing the Sunni Arab minority—into the constitutional process. Following two failed attempts at drafting a constitution, the current effort must aim to ensure that a new social contract between various actors emerges. In summer 2003, the constitutional preparatory committee was halted by Grand Ayutallah al-Sistani who insisted that the drafting body be legitimized via elections. In early March 2003, the TAL agreed upon by the members of the GC deliberately elided certain crucial issues that were never properly discussed in public. Consequently, many Iraqis continue to perceive some of its provisions regarding federalism or minority rights as an imposition.

The successful establishment of a working democratic polity is by no means assured. However, there is a shaky balance of power between various groups that will prevent the return of a strong repressive central government in the foreseeable future.

Economic growth will be driven mainly by oil-sector activity and the inflow of reconstruction aid into non-oil sectors. Economic reform toward market principles succeed will only if decision-making authorities are perceived as legitimate and social costs are minimized. Neo-liberal shock therapies will swell the ranks of the unemployed and radical and therefore quickly undermine the success of transformation. Instead, careful steps toward reducing price controls and subsidies (especially in the sale of refined fuel products and electricity) should be taken. Reforming the social welfare system to cushion the effects of liberalization should be a priority. The future Iraqi government faces two key decisions regarding the oil sector: whether the oil sector should remain state-owned enterprise or be privatized, and whether the control and management of oil resources should be transferred to regional entities.