

BTI 2008 | Iraq Country Report

Status Index	1-10	3.23	# 117 of 125	
Democracy	1-10	3.20	# 111 of 125	↗
Market Economy	1-10	3.25	# 117 of 125	➔
Management Index	1-10	2.52	# 115 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

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Key Indicators

Population	mn.	28.1	HDI	-	GDP p.c.	\$	-
Pop. growth ¹	% p.a.	2.9	HDI rank of 177	-	Gini Index		-
Life expectancy	years	59	UN Education Index	-	Poverty ³	%	-
Urban population	%	66.9	Gender equality ²	-	Aid per capita	\$	166

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The United States have yet to achieve their stated goal for invading Iraq in 2003 – the establishment of a free and prosperous country. The administrative capacity of the Iraqi state, already weakened by three wars and a decade of sanctions, collapsed in the first weeks of the occupation and has not been adequately restructured. Both U.S. and Iraqi security forces have proven unable to provide acceptable levels of security or to combat crime. Ethno-confessional affiliation emerged as the main organizing principle in society and sectarian violence has brought the country to the edge of the yawning abyss of full-scale civil war. The constitutional process has been completed on schedule and Iraqis have successfully elected a permanent parliament, but ethno-confessional loyalties have driven the political process more than real policy choices.

Drafting a constitution has failed to create the broad national consensus required to establish a viable platform for reconciliation. A tight, rather unrealistic schedule did not allow for the broad consultation and negotiation that would have been necessary to create a sense of real ownership within prominent sections of the Iraqi population. The result was a document almost completely lacking in popular input or discussion; its deficiencies in form and content served to deepen, rather than heal, the rifts between the various communities.

The absence of consensus in key areas, and the general lack of capacity to implement policy choices, has prevented any major progress in restructuring the economy. In spite of some very large investments in infrastructure, since the invasion, the quality of services for average Iraqis has barely improved, and in some cases has even declined. The expensive and inefficient social security system with its indiscriminate subsidies to every household regardless of need has not been systematically overhauled. The privatization of the many state-owned enterprises has not proceeded beyond repeated declarations of intent. However, the parties in government have agreed on an

investment law and a draft oil law. Financial discipline is weak, and outdated equipment, insufficient training and the lack of proper accounting procedures have created an environment where corruption runs rampant.

History and Characteristics of Transformation

Beginning with the 1958 coup led by General ‘Abd al-Karim Qasim, conspiracies among army officers became the most important instrument catalyst of political change. In July 1968, army officers associated with the Ba‘th Party seized power over a course of two coups and began to implement a ruthless, authoritarian political system, dominated first by General Ahmad Hasan al-Bakr and later by his cousin Saddam Hussein. Saddam Hussein used his control of the party and its security apparatus to oust Hasan al-Bakr from the top government post in 1979 and assumed sole control of the country, both as president and as chairman of the party’s Revolutionary Command Council (RCC). The nation’s power structures, increasingly dominated by members of Saddam’s clan and even his immediate family circle, although widely unpopular, 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 the comprehensive trade embargo imposed by the United Nations between 1991 and 2003. The Iraqi economy is dominated by the oil sector, which historically has generated more than 95% of export earnings and more than 60% of GDP. With the nationalization of the long-established Iraq Petroleum Company (IPC) in 1972 and the sharp rise in world oil prices the following year, the state reaped significant returns that strengthened its ability to shower patronage on selected population groups. A series of reforms were designed to restructure the agricultural sector, which had been dominated by a small number of very large landlords, although the distribution of land “to those who worked it” went extremely slowly. Over time, declining agricultural productivity combined with substantial population growth increasingly forced Iraq to import food products. The government took over broad segments of the private sector in 1964, but a lack of currency reserves and mounting foreign debt during the war against Iran (after 1980) forced it to initiate substantial deregulation starting in 1987. After the invasion of Kuwait in 1990, the United Nations imposed an embargo that led to Iraq’s almost total economic isolation. In November 1996, the embargo was modified under the oil-for-food program that allowed Iraq to export limited quantities of oil and use most of the revenues to import food, medicine and other essential goods.

Genuine change started only with the overthrow of the regime of Saddam Hussein by an Anglo-American coalition in March – April 2003. In the wake of the terrorist attacks of 11 September 2001, the U.S. administration developed an increasingly bellicose attitude towards Iraq’s alleged WMD programs, and began to consider a pre-

emptive security strategy as part of a grand design for transforming the Middle East as a whole. Despite mixed findings by the new UNMOVIC mission and on a basis that was at best questionable under international law, American and British troops started to invade Iraq on 20 March 2003 and managed to capture Baghdad on April 9 after a speedy campaign that only occasionally encountered serious resistance. The military victory was both swift and decisive; the institutional structure of Iraq collapsed. The occupying power faced a task that it had not expected and for which it was not prepared: the rebuilding of much of the state apparatus. It established the Coalition Provisional Authority (CPA) to administrate the country for a transition period for which itself appointed an Iraqi Governing Council (GC) composed of 25 Iraqi members. As the GC proved increasingly inefficient, the CPA embarked on a number of reform projects to shape the new political, economic and social institutions of Iraq, but the strained security situation, the GC's poor administrative capacity, and Iraqi doubts about its legal status under occupation hampered the implementation of its initiatives.

Since the summer of 2003, the coalition and the nascent Iraqi institutions have faced an increasingly threatening insurgency based in the Sunni Arab heartland of western and central Iraq, directed first against the occupation forces but increasingly against government officials and institutions. In spite of various military operations, insurgents repeatedly took control of Sunni Arab cities such as Falluja or Ramadi and the Sunni Arab quarters of Baghdad. Fighting between insurgents and government forces became increasingly sectarian over the course of 2005. After intensive negotiations about the sequence of the political process, the Baghdad agreement of November 2003 permitted the GC to draft a provisional constitution, the Transitional Administrative Law (TAL). Sovereign power was nominally transferred to an Iraqi caretaker government on 28 June 2004. Based on the timetable provided for in the TAL, elections for an interim parliament were organized in January 2005, although most Sunni Arabs chose not to vote. This boycott led to the marginalization of the Sunnis in the drafting process for the new constitution, the final version of which was characterized by ambiguous and fragile compromises between Shi'i and Kurdish factions. The draft was finally adopted in a referendum in October 2005 in spite of adamant opposition from the Sunni Arab community.

Transformation Status

I. Democracy

1 | Stateness

The demise of the regime of Saddam Hussein dramatically weakened the ability of the central state to perform even the most basic function of statehood: to provide security. The breakdown of much of the administrative bureaucracy and the dissolution of the armed forces and of the ruling Ba'th party in June 2003, coupled with widespread looting and sabotage, created an atmosphere of anarchy that spawned crime and private militias as primordial religious and tribal networks began to replace public institutions. The Iraqi government has failed to establish a monopoly on the use of force and is dependent on foreign coalition troops. The insurgency has maintained a staggering volley of attacks against government institutions and, increasingly, civilians. The newly trained Iraq army reportedly has a very low readiness rate and lacks equipment and logistics; furthermore, the loyalty of many units remains questionable in circumstances of growing ethno-confessional conflict. Similarly, the Iraqi police have proved unable either to provide security or to combat crime. Armed militias continue to control many key areas and have infiltrated the national police, especially the notorious Wolf brigade of the Ministry of the Interior. In August 2006, a major operation combining U.S. and Iraqi forces aimed at establishing security in Baghdad was followed by a significant upsurge in violence in the autumn. In contrast, the Kurdish region is comparatively stable with only a few incidents being reported.

Monopoly on the use of force

National identity is vigorously contested and the social discourse and dynamics of the political process have become based increasingly on sectarian logic. Ethnic tensions have escalated into an undeclared ethno-confessional war; insurgents and militiamen have threatened and killed hundreds of civilians, especially in mixed neighborhoods. The autonomous status enjoyed by the three Kurdish provinces for more than ten years has significantly strengthened Kurdish national identity as manifested by such symbols as the Kurdish flag and army, as well as the use of Kurdish in the educational system and the media. While the Kurdish leadership

State identity

has repeatedly emphasized its intention to remain within a federal Iraq, a declaration signed reportedly by 1.4 million Kurds indicates widespread popular enthusiasm for a form of independent statehood. In an unofficial referendum staged by Kurdish activists in January 2005, 1.9 million or 95% of those questioned supported independence.

The new constitution adopted in the October 2005 referendum declares Islam to be the religion of the state and a fundamental source of legislation, although not the fundamental source, as demanded by many Islamists. This is complemented by a provision declaring that any law contradicting “the established provisions of Islam” is unconstitutional. Furthermore, the constitution includes a provision that requires the Federal Supreme Court to include a number of “experts in Islamic jurisprudence” in addition to civil judges. Although Iraq’s senior clergy has often played a quietist role, authorities such as the Shi’i Grand Ayatollah ‘Ali al-Sistani and the Sunni Association of Muslim Scholars (hayat al-‘ulama’ al-muslimin) have come to play important roles in the political process. The implementation of provisions of Islamic law (Shari’ah) varies greatly across Iraq. In the South and in some areas in Baghdad Shi’i militias and the police reportedly enforce the veiling of women and prohibit the sale of alcohol. In contrast, the two major Kurdish parties are basically secular, although the Kurdistan Islamic Union is gaining strength.

No interference of religious dogmas

Administrative structures are weak; the provision of public services is uneven at best, and in some areas it is nonexistent. Central government control does not extend beyond the Green Zone in Baghdad where most of the ministries are located. Regional and local institutions operate on an increasingly independent basis; for instance, the Ministry of the Interior has no control over the provincial police. There are no clear divisions of responsibility between various government agencies and no established lines of communication and control. Again, as a result of the sweeping implementation of de-Ba’thification in the first weeks of the occupation, many senior bureaucrats were fired or have left their positions, to be replaced with inexperienced staff whose only qualifications are their tribal or party loyalties.

Basic administration

2 | Political Participation

The year 2005 saw the election of an interim as well as a permanent government based on an ambitious schedule set out in the TAL. Both elections allowed for a degree of competitiveness unprecedented in post-1958 Iraq. Most of the Sunni Arabs (about 20 to 25% of the population) boycotted the January 2005 elections; they have tended to oppose the political process in general. As a result of this and the electoral system (devised by Shi’i politicians), Sunni Arabs were marginalized in the interim parliament and had very little leverage over the

Free and fair elections

constitutional process. To a large extent, voting was based on ethnic and confessional loyalties, marginalizing both nationalist and secular parties. The new constitution was adopted in the October 2005 referendum. On this occasion, Sunni Arabs participated in much greater numbers, but failed to achieve the two-thirds majority in three provinces required to block the document. The encouraging, if gradual, trend toward the inclusion of Sunni Arabs into the political process continued in the December 2005 election, which was held on the basis of a multi-district electoral system. Although generally free and fair, a number of irregularities marred the electoral process. An understanding reached with a number of resistance groups in December resulted in only a small number of attacks against polling stations and voters. However, lack of security in some areas during the January elections prevented the opening of polling stations, and insurgents intimidated both candidates and voters. Moreover, electoral campaigns took off very late and most voters were largely unaware of whom they were voting for, since most candidates' names were only published shortly before election day for fear of reprisals. In some areas, a free choice was prevented by the presence of militias intimidating or turning away voters. In the run-up to the December elections, there were complaints about fraudulent voter registration in the ethnically mixed Kirkuk province.

The United States evidently wields considerable informal political influence because of its military might. The Sunni insurgents and an increasing number of Shi'i militias operate without any government sanction. Two key Shi'i power brokers, 'Abd al-Aziz al-Hakim and Muqtada al-Sadr, who control most of the deputies on the United Iraqi Coalition list, do not hold public office. Religious leaders, such as the Shi'i marja'iyah or the Sunni Association of Muslim Scholars (hayat al-'ulama' al-muslimin) have tremendous influence among the population. No government can afford to ignore the wishes of the most important Shi'i cleric, Ayatollah al-Sistani, who has intervened decisively in the political process.

Effective power
to govern

The registration process for NGOs is cumbersome and there are indications that the government uses these procedures as an instrument to control the activities of opposition groups. In spring 2005, the responsibility for registering NGOs was transferred from the Ministry of Planning and Development Cooperation to the Ministry for Civil Society and new registration regulations were issued. The NGO assistance office threatened to outlaw a number of domestic and international NGOs if they refused to comply with the new regulations, but withdrew its demands after international pressure. The Ba'th party was dissolved by the CPA and remains officially banned. Officials in the Kurdish region have reportedly pressured NGOs to employ Kurds only.

Association /
assembly rights

Newspapers, television channels, radio stations and other outlets have flourished since the fall of the Saddam regime. Over a dozen television channels and more than 130 print publications have been established since 2003 without major

Freedom of
expression

government interference. However, most of the media has become closely linked to political parties and organized ethno-confessional groups that provide funding and other support. There are very few independent publications (a notable exception being the al-Zaman newspaper). The media has to be sensitive to the political environment, and the Iraqi government has at times attempted to exercise control. The pan-Arab news channels al-‘Arabiyya and al-Jazira have been subject to periodic reporting bans for allegedly inciting violence. The lack of security limits freedom of expression; many journalists complain about threats from insurgents as well as from U.S. soldiers and the various militias. For example, Atwar Bahjat, a well-known journalist on al-‘Arabiyya news channel, was murdered close to her hometown of Samarra’ in February 2006. Reportedly, insurgents or pro-government militias have threatened or attacked newspaper sellers and bookshops for selling the “wrong” publications. In Kurdistan, authorities have increased pressure on investigative or critical journalism. Journalists writing about corruption and cronyism involving government or party officials are charged with defamation. Journalists covering the riots at Halabja in March 2006 were reportedly harassed. In December 2005, the Kurdish journalist Kamal Sa’id Qadir was sentenced to 30 years in prison for “denigration of public institutions” and “defamation of the president,” but released in April 2006 after issuing an apology.

3 | Rule of Law

The constitution provides for a three-member presidential council with mostly (but not exclusively) ceremonial functions and a prime minister as the head of the executive branch of government. However, given the general weakness of the central government, the most important issue is the asymmetric division of powers between the center and the regions in the proposed federal system. During the drafting process, the prerogatives of the central government were significantly reduced, in particular in the last stages in which negotiations were shifted from the parliamentary constitutional committee to an unofficial leadership council. For example, the central government may not raise and collect taxes in the regions, once they are formed. As a result, the central government’s capabilities have been weakened to a point where it is doubtful whether it will be able to perform its constitutional functions. The management of the oil revenues and a number of other key responsibilities (such as electricity, education, or health) are to be shared between the central government and the regions with regional laws taking precedence over national laws.

With very few exceptions, the judiciary is not independent. Political and sectarian considerations frequently influence the appointment of judges. Since all previous judges were required to be Ba’th party members, the selective application of de-

Separation of
powers

Independent
judiciary

Ba'thification laws through the executive branch has ousted most of them. The judicial system operates very slowly and enforcement is weak. A large number of courts do not operate because of inadequate staff or resources, and many others are corrupt or act out of fear. Religious courts based on the Shari'ah reportedly operate in various places. Tribal law, originally made official during the British mandate but which had largely fallen out of use, had been revived and even promoted by the regime throughout the 1990s and is still being applied in some rural areas.

Corruption and nepotism are reported to be rampant in many areas of public life, although very few government officials have been indicted on charges of corruption. In 2005, a number of senior officials who served in the interim government headed by Iyad 'Allawi were indicted for embezzling government funds in contracts for the supply of military equipment. It was also well known that the CPA was notoriously lax in its accounting procedures.

Prosecution of
office abuse

Civil rights are formally protected by the constitution, but many of its stipulations are vaguely formulated and subject to legislation which is still pending. In practice, civil rights violations committed by Iraqi security agencies, the occupation forces and insurgent groups are commonplace. Iraqi security forces and the police have reportedly engaged in extralegal killings, abduction, illegal detention and torture. In November 2005, US forces raided a secret detention center operated by the Ministry of the Interior and found some 170 prisoners, many of whom had been ill-treated, malnourished and tortured. The multi-national forces have detained thousands (mostly Sunni Arabs) without charge or trial in at least four main detention centers. A substantial number of civilians have been killed in insurgent bombing attacks.

Civil rights

4 | Stability of Democratic Institutions

The country's democratic institutions are generally too weak to perform their functions adequately. The various coalition governments have been fragmented and they have lacked coherency in their approach to formulating and implementing policies. The formation of governments and cabinets consumed many weeks of precious time. At times, parliament has been paralyzed due to security constraints preventing the minimum number of parliamentarians from showing up. In Kurdistan, efficient administrative structures exist, although insufficient public services and bureaucratic incompetence have sparked protests. The regional parliament is politically weak and remains controlled by the two major parties, the Kurdish Democratic Party and the Patriotic Union of Kurdistan.

Performance of
democratic
institutions

Political actors support democratic institutions as long as they believe that their interests are served. Consequently, the concept of "democracy" is frequently subject to sectarian interpretation.

Commitment to
democratic
institutions

5 | Political and Social Integration

Iraqi society has been largely atomized through decades of brutal repression in which the only forms of autonomous organization were religious or tribal. As a result, most parties established after the fall of the regime are led by recently returned exiles and are thus rather weakly rooted in society. The lists competing successfully in the two national elections were usually heterogeneous coalitions of small groups and local notables united through sectarian affiliation and demand for power. The exceptions to this rule are the two Kurdish parties that have managed to build strong institutions and a broad power base in their autonomous statelets over the last decade. Parties are increasingly based on ethno-confessional loyalties as mobilizing forces, which appeal to their constituencies through sectarian symbols and discourse.

Party system

Interest groups of all stripes and shapes have been blossoming since the fall of the old regime. The government reports that 5,000 private organizations have been registered since 2003, including charities and human rights groups. It estimates that an additional 7,000 groups are working unofficially. However, many of these groups lack resources and have rather shallow roots in society. Some of the old syndicate-style professional associations have been reconstituted under new leadership and a number of independent groups in different fields, such as women's issues, have sprung up. However, civil society is increasingly tainted by sectarianism, thus reflecting the dominant social undercurrent in Iraq. Insurgent groups and militias have targeted a number of civil society representatives. Most prominently, the union leader and Communist Party politician Hadi Salih was tortured and killed by unknown assailants in Baghdad in January 2005.

Interest groups

Democracy – as an abstract notion – certainly enjoys the support of a majority of Iraqis. In a poll conducted in autumn 2005 by ABC news, 57% of the sample stated their support for a democratic political system, 28% preferred a single strong leader for life and 14% hoped for the establishment of an Islamic state. The police, religious leaders and the new Iraqi army enjoyed high support among Iraqis while trust in the occupation forces and in political parties is minimal. There are significant variations between the communities; for example, support for democracy is said to reach only 38% in Sunni Arab majority areas.

Consent to democratic norms

Under the repression of the Saddam regime, independent organizations were unable to function outside tightly controlled institutions of authoritarian corporatism and religious and tribal networks. After the demise of the regime, many civil society groups emerged, often geared toward community work or social rehabilitation. However, against a background of rising ethno-confessional tensions, civil society organizations tend to concentrate their operations within a certain community and there are increasingly few associations crossing the social

Associational activities

borders between the various ethno-confessional groups. The daily violence resulting in hundreds of innocent victims in sectarian revenge killings is rapidly destroying whatever had remained of inter-community social capital.

II. Market Economy

6 | Level of Socioeconomic Development

Broad swathes of the urban middle class, most of which consisted of state employees and thus depended directly or indirectly on the public sector, were driven to ruin by the hyperinflation of the 1990s and the general decline in economic activity as a result of economic sanctions and war. As a result, Iraq's infrastructure and social services were in a very poor state in 2003 and had been deprived of capital investment for a significant period. By many indicators of social development, Iraq has fallen well behind comparable middle-income countries in the region and around the world. Only 20% of the population has access to safe and stable drinking water and 15% to a stable electricity supply. Iraq's health care system has been unable to provide effective care, partly because of a shortage of qualified personnel such as doctors and nurses. Salaries for public sector employees have increased substantially in the post-2003 period. The average salary is now \$200 a month compared to an estimated \$10-15 before the fall of the regime. More recently, salaries for employees in the private sector have been rising as well. However, a quarter of the population is still estimated to be dependent on food rations. The World Bank estimates that every tenth Iraqi is living in absolute poverty and a further 12-15% is in danger of falling into poverty. Unemployment is estimated to be over 30%, while underemployment affects a further 20% of the workforce.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	18,970	12,602	-	-
Growth of GDP	%	-7.8	-41.3	46.5	-
Inflation (CPI)	%	-	-	-	-
Unemployment	%	-	28.1	26.8	-

		2002	2003	2004	2005
Foreign direct investment	% of GDP	-	-	-	-
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-	-	-	-
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
External debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	-	-	-	-
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	0.2	1.7	4.2	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Over twenty years of neglect and misallocation of resources has ruined Iraq's economy, and the middle class has all but disappeared. During the CPA's tenure in 2003 – 2004, a number of legal and institutional changes were enacted, such as the creation of a modern central bank, commercial banking and laws against money laundering. Most prices were liberalized, although existing subsidies on a number of key goods (accounting, by some estimates, for as much as half of the budget) such as food, fuels, electricity and agricultural input were maintained. A new foreign investment framework established generous conditions for foreign investments. Under regulations issued by the CPA, individual taxes are capped at 15% and companies are taxed at a flat rate of 15%. In September 2004, the government adopted a stabilization support program within the framework of the Emergency Post-Conflict Assistance mechanisms of the IMF that provided, among other things, for a reduction of fuel subsidies. In October 2006, parliament adopted a new investment law, under which national and regional commissions

Market-based
competition

for investment were to be formed with the task of deciding on applications for projects within 45 days.

After repeated delays, the government agreed on a draft law for the oil and gas sector in late February 2007. The draft allows the central government to distribute oil revenues to the provinces or regions based on population statistics. Regional oil companies are allowed to sign contracts with foreign companies, but a new central body (Federal Oil and Gas Council) would be in a position to “prevent” deals that do not meet certain standards.

Anti-monopoly
policy

After most U.N. sanctions were lifted in May 2003 and the oil-for-food program was phased out, the CPA announced a holiday on all tariffs on imports through 2003. These measures, coupled with the rising salaries of many Iraqi officials triggered a sharp rise in imports; subsequently, the Trade Bank of Iraq was created and in February 2004 Iraq was granted observer status at the WTO, and in December of the same year it presented a formal request for WTO membership. A national committee was established to flesh out the requirements for a WTO-compatible trade regime. A 5% reconstruction levy on imports (except for food, clothing, medicine, books and humanitarian goods) was introduced and responsibility for the customs administration was transferred to the Ministry of Finance and new staff selected. Although this initiative started customs operations at a number of entry points and clarified procedures, a serious lack of equipment and personnel remained. In November 2006, the European Union opened negotiations on a Free Trade and Cooperation Agreement with Iraq in Brussels.

Liberalization of
foreign trade

Iraq’s banking sector was very weak before the invasion and collapsed in its aftermath; the financial sector is underdeveloped and characterized by ineffective institutions and a weak regulatory framework. It has little financial intermediation and transactions are limited to deposit taking and infrequent loans. Interest rates were liberalized in March 2004, but very little credit is issued and interest rates play a very minor role in the allocation of capital. Real interest rates remain negative. A new commercial banking law issued by the CPA in September 2003 provided a comprehensive set of regulations for the banking sector. Private banks were given 17 months to accumulate a minimum capital of NID 10 billion and foreign banks were allowed to operate in Iraq or form joint ventures with Iraqi banks. Three foreign banks have been licensed, but operations have not yet started, evidently reflecting security concerns. HSBC and the National Bank of Kuwait are reportedly in the process of buying majority stakes in two Iraqi banks.

Banking system

8 | Currency and Price Stability

The introduction of the new currency in 2003, the new Iraqi dinar (NID) was complicated by the fact that an older version of the Iraqi dinar was in use in the Kurdish autonomous area, known as the “Swiss dinar” the exchange rate of which differed from the regular dinar. Public auctions open to all bidders are used to peg the dinar’s exchange rate to the U.S. dollar and as a result, there is little difference between official and unofficial rates. Economic transactions were increasingly re-monetarized, reflected in the rapid growth of base money. On the ground, two currencies are being used for daily transactions; the U.S. dollar is widely used as a second currency; many of the more expensive consumer goods are priced in dollars. In addition, the United States and other bilateral donors pay their contractors directly in dollars. The accumulation of foreign exchange reserves was rapid in 2003 – 2004 and stood at \$9 billion in 2005. The partial dollarization of the economy limits the impact of fiscal instruments. Inflationary pressures accumulated in 2005 – 2006 reflect rising wages in the public sector and a reduction in fuel subsidies, as well as the unstable security environment and the weakness of the dollar. According to the central bank, inflation stood at 46% on average (compared to 32% in 2004 – 2005) in the first half of 2006 with very large regional variations reported.

Anti-inflation /
forex policy

Iraq ranks among the most heavily indebted countries of the world. The IMF estimates that Iraq’s overall debt totaled \$119.8 billion in 2004. According to the terms of UNSC resolution 1483 (2003), Iraq’s oil revenues are immune from debt collection until the end of 2007. The Paris Club announced in November 2004 that it will immediately write off 30% of the debt stock, grant an additional 30% reduction conditional on the acceptance of an IMF stand-by agreement (which took place in December 2005) and a further 20% after an IMF Board review in the third year of the stand-by agreement (envisaged for December 2008). The remaining debt is rescheduled over 23 years, with an initial grace period of six years free of payment. A number of non-Paris Club countries have agreed to a debt relief of similar proportions. Private creditors have agreed to write off 90% of Iraq’s debt in 2006. An estimated \$30 billion of unpaid Gulf War reparations (Iraq is still obliged to transfer 5% of its oil export revenues) and about \$84 billion of unresolved claims are not included in this account.

Macrostability

9 | Private Property

Private property is not protected in Iraq. Under the old regime, property ownership – while guaranteed in theory – was subject to the regime’s control and to the arbitrary use of violence on the part of the security services in the absence of an independent court system. Since 2003, property laws have been enforced

Property rights

sporadically at best. In the aftermath of the fall of the regime, looting and sabotage created a climate of insecurity, and industrial-scale armed gangs that have flourished since the 1990s were able to operate with near impunity.

The National Development Strategy adopted by the Iraqi government in 2004 envisages the private sector as the main engine for economic growth and job creation in the country. However, until 2003 the private sector was largely engaged in black market transactions and smuggling as a result of the sanctions and the regime's patronage needs. The Iraqi Federation of Industries reported that only 4,000 of its 30,000 member companies were operating in 2004 – 2005. Iraqi companies have narrow production lines, weak management and information systems, poor product quality and very centralized structures. Some 200 state-owned companies (SOEs) have over 500,000 workers on their payrolls. Plans to privatize at least some SOEs are under consideration, although it is understood that leases and partnership with private companies would be preferred over complete sales. Investor interest is low, however, since the value of very few SOEs seems to exceed their fixed assets (buildings, land).

Private
enterprise

10 | Welfare Regime

The embargo and the associated curtailment of economic activity, along with inflation, posed almost 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 reinforced the effects of the old regime's retribalization policies. Considered exemplary in the 1980s, the health care system can no longer provide comprehensive care because of the shortage of medical supplies, lack of investment and the emigration of qualified personnel. The rebuilding or refurbishing of dozens of hospitals and health clinics since 2003 has improved coverage and the quality of the health system, although the lack of health personnel and medicines and various infrastructural failings remain acute problems. The high rates of inflation have undermined the pension system to the extent that the monthly pensions are almost worthless, and in any event, they are only collected by a small fraction of the population. Many families depend crucially on cash transfers from relatives in the diaspora. The only large-scale public safety system in Iraq is the food distribution system that was introduced in the 1990s to mitigate the impact of sanctions, but it is no longer effective. Pensions were introduced to Iraq as early as 1922, but the system covers only a small part of the population, and it has proven extraordinarily expensive. The CPA has introduced emergency payments of between \$53 and \$133 a month to compensate beneficiaries for the loss of value caused by inflation.

Social safety nets

Equality of opportunity is not guaranteed in Iraq. As sectarian tensions increase, benefits are increasingly distributed on the basis of sectarian affiliation. Quality of life is significantly higher in the Kurdish region, which enjoys relative stability. Incomes are reported to be significantly lower in several southern governorates. After the fall of the regime, many women feel that they are on the losing side. The strained security situation, which has led to numerous abuses and abductions, has considerably narrowed women's freedom of movement. Furthermore, the growing strength of conservative Islamist groups has imposed the Islamic dress code on women in areas under their control and dangerously eroded their opportunity to work.

Equal opportunity

11 | Economic Performance

Economic growth in Iraq has been weaker than expected. The IMF has reduced its estimate of GDP growth for 2006 from 10.4% to 4.0%, although double-digit growth is expected for 2007. Oil accounts for over 60% of GDP and for nearly all exports and budget revenues. Four years after the fall of Saddam Hussein, oil production remains below pre-invasion levels at an average of 2.1 million b/d, although revenues have increased as a result of very strong oil prices. This has allowed the government to keep the budget deficit at a moderate 4%. Production increases have been hampered by decades-long neglect of facilities, by extensive looting in the immediate aftermath of the war and by persistent sabotage by insurgents. Even the maintenance of current production levels would require annual investments of at least \$1 billion. Inflation has increased, partly because of higher energy costs and the reduction of subsidies. Non-oil economic activity is much stronger in the Kurdish provinces, where an agro-industrial base is emerging based on new investments in agricultural technology. The combined impact of the sanctions and the breakdown of state institutions in 2003 have created a huge informal economy ranging from street selling and flea markets to smuggling and kidnapping for ransom.

Output strength

12 | Sustainability

In the past, environmental standards played a subordinate role both in public policies and in social awareness. Increasing pollution of the Tigris and Euphrates rivers and their tributaries, as well as the salinization and erosion of agricultural land already represent significant ecological burdens. Since the fall of the Ba'athist regime, environmental concerns have been institutionalized in a Ministry of the Environment, but given the widespread insecurity and inability to cover basic needs of the population, little action should be expected soon. In December 2006, the World Bank and the Ministry of the Environment signed a \$5 million grant agreement, which aims to improve capacity building in the ministry.

Environmental policy

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 approach modern standards and will have to 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. Repression under Saddam led to the emigration of an estimated 2,000 professors between 1995 and 2000 alone. Since 2003, many university teachers have become the target of threats and physical attacks, prompting yet another exodus to the comparatively safe Kurdish region and foreign countries.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

Iraq's level of development, once high among middle-income countries, has fallen rapidly since the early 1990s. The quality of the Iraqi labor force has been dramatically affected by international isolation, the mass emigration of many qualified individuals and the decline of the educational system. The infrastructure, once among the best in the Middle East, is in a terrible state due to lack of investment and the destruction caused by three wars within two decades.

Structural
constraints

Apart from a tentative and ultimately inadequate experiment under the monarchy, Iraq lacks any tradition of democratic governance. Civil society was active well into the 1960s, but faced increasing repression and ultimately violent destruction at the hands of the Ba'th regime.

Civil society
traditions

Since 2003, ethnic and confessional identities have strengthened across the country, fuelled by the breakdown of public institutions, their mechanisms replaced by primordial networks.

Conflict intensity

II. Management Performance

14 | Steering Capability

Politicians routinely prioritize short-term individual or group benefit over the long-term goal to establish a stable and representative polity. A good example is the Supreme Council for the Islamic Revolution in Iraq (SCIRI) politician Bayan Jabr who used his tenure as Minister of the Interior to transform the Ministry into a party stronghold and pack the security services with loyalists from the party militia, the Badr Brigades. Criticism of Bayan Jabr's activities grew so strong that he had to be moved to the Ministry of Finance after the December elections where he reportedly blocked allocations to Sunni Arab neighborhoods

Prioritization

in Baghdad. The nominal head of the executive, the prime minister, proved too weak to impose a coherent agenda on the parties in government. Both incumbents, Ibrahim al-Ja'fari and Nuri al-Maliki, enjoyed only a comparatively weak popular base (their al-Da'wa party was systematically destroyed by Saddam's repressive apparatus) and became increasingly dependent on the radical grass roots movement nominally led by the self-styled "cleric" Muqtada al-Sadr. The result has been an uncoordinated set of policies driven by narrow sectarian interests sorely lacking any long-term policy perspective. The inability of the political class to agree at the very least on a shared vision has cemented the role of external actors, most importantly the United States, in defining the political agenda. The political process was structured by the ambitious schedule outlined in the TAL, which provided for elections for a transitional parliament, the writing of a constitution and its adoption in a referendum as well as elections for a permanent government, all within a year. By early 2006, the political process was more or less on schedule. However, a process intended to establish broad consensus on the structure of a new polity in fact deepened the rift among the various political groups.

The constitutional process has failed to create the broad national consensus required to establish a viable platform for reconciliation. A tight, rather unrealistic schedule did not allow for the broad consultation and negotiation that would have been necessary to create a sense of real ownership within prominent sections of the Iraqi population. The result was a document almost completely lacking in popular input or discussion, the deficiencies of which in form and content deepened, rather than healed, the rifts between the various communities. The most contentious issue proved to be the idea of federalism, which many Iraqis bitterly oppose, especially the Sunni Arab minority. Federalism was originally designed to accommodate the needs of the Kurdish minority, which has enjoyed autonomy from the central government for over a decade. Beyond that, however, the constitutional text provides for the establishment of new regions to be created from the existing provinces in the non-Kurdish parts of Iraq, the details of which are to be specified by a simple law. Indeed, the constitutional text allocates so much power to the regions that the future ability of the center to exercise its functions seems tenuous. The central government's prerogatives are limited to defense, foreign policy, fiscal and customs policy and some other fields (§107). It has, for example, no explicit power to raise taxes or to establish a federal police force. All powers not stipulated under the exclusive authority of the central government are devolved to the region, and in any conflict, the regional legislation has priority (§111).

The government has shown very limited flexibility in its policies. Policy changes, usually at the request of external actors, have been too limited and too late to be effective. The al-Maliki government's plan for national dialogue was

Implementation

Policy learning

intended as a major offer to integrate the mainstream groups of the insurgency into the political process. However, it failed to embark on serious negotiations because it never included a genuine offer on the part of the government to restructure the political system. Significant efforts were made to include the Sunni Arabs in the constitutional process. However, the mandate of the Sunni representatives co-opted into the constitutional committee remained weak and was frequently challenged. Indeed, negotiations shifted from the elected committee to a loosely defined leadership council that almost completely excluded the Sunni Arab minority. During the final stages negotiations were conducted in informal meetings between Shi'i and Kurdish leaders and representatives of the U.S. embassy, a group that was not representative and lacked accountability. During this period, profound changes were made to the original draft, resulting in a dramatic increase in the powers of the regions at the expense of the center.

15 | Resource Efficiency

After the near complete breakdown of public administration in April 2003 and the subsequent looting and destruction of most public facilities, the organizational resources of the state have been restored only gradually and are still compounded by various problems, the most pressing being, of course, the general lack of security. Lack of security has caused the diversion of a large part of reconstruction resources and severely diminished Iraq's oil revenues. Losses through attacks on pipelines and other oil facilities between June 2004 and January 2006 are estimated to have cost Iraq as much as \$11 billion in export revenues. An additional 5 – 10% of oil production is estimated to have been stolen and smuggled to neighboring countries. Financial discipline and efficient spending are absent in Iraq. Budget procedures have substantially eroded in the past two decades. Institutional weakness, insufficient communication and the absence of the necessary skills to handle the budget combine to make public spending opaque. The Ministry of Finance has little control of the budget, which is fragmented into several parallel spending plans. Spending reports have frequent gaps and are delayed by communication difficulties. Resources are wasted through the ineffective and bloated system of subsidies. According to the World Bank, the food distribution system (12-14%), the various fuel subsidies (25-30%), subsidies on electricity, other utilities and urban services (8-12%) and agricultural subsidies (8-10%) combined swallow up to 50% of GDP. Modern instruments of human resource management are largely absent from Iraq. Civil servants lack administrative skills, many departments are overstaffed and the division of functions is not clear.

Efficient use of
assets

Against the background of the increasing weakness and fragmentation of the central government and the abysmal security situation there is little policy coordination, even within the various ministries. No all-embracing financial framework defines the clear responsibilities for revenues and reserves between the ministries of finance, oil and planning. Similarly, the division of jurisdiction between government institutions at various levels is vague in the extreme. Regional and local institutions increasingly play a role as they review government spending plans and raise their own revenues. This process of uncontrolled decentralization results in a fuzzy patchwork of responsibilities.

Policy coordination

Corruption in Iraq is reportedly pervasive, although there is little non-anecdotal evidence. Iraq is ranked 160th in the 2006 Corruption Perception Index of Transparency International down from 137th in 2005. The very high level of corruption inherited from Saddam's regime seems to have worsened during the occupation and the institutional vacuum that emerged. The CPA attempted to stem the tide by (re-)establishing a number of control and public awareness institutions. The Commission of Public Integrity was charged with the criminal investigation of corruption cases and violations of code of conduct. The commission placed independent inspectors-general in every ministry, who were thus entitled (at least in theory) to audit records and activities and to investigate any official, including the minister. The (revived) Supreme Board of Audit was charged with improving the efficiency and credibility of the government and issuing regulations for financial disclosure and a code of conduct, as well as for implementing campaigns to raise public awareness. However, the impact of these institutions has been marginal given the institutional weakness and the lack of serious political will to address the issues effectively.

Anti-corruption
policy

16 | Consensus-Building

There is no broad consensus in Iraq on the shape of the polity which has been emerging since 2003. Ethno-confessional considerations increasingly influence positions on divisive issues. The Sunni Arab minority feels excluded and embattled and seems to have no integrative leadership. Initially, large parts of the community rejected the legitimacy of the political process since it was taking place "under the shadow of occupation." Thus, Sunni Arabs overwhelmingly boycotted the January 2005 elections and were only marginally represented in the first parliament. However, the huge turnout among Sunni Arabs in the constitutional referendum and the December elections indicated an encouraging trend towards prioritizing political participation over armed resistance. In the referendum, the Sunni Arabs rejected the draft, but failed to achieve the two-thirds majority in three provinces required by the Transitional Administrative Law to block the document.

Consensus on goals

The Kurdish parties define their future within Iraq on the condition of the establishment of a decentralized federal system, which would largely preserve the autonomous status the Kurdish region has enjoyed since the early 1990s. Although the majority of the Kurdish population favors independence, the leadership seems to have made a decision to remain within a united Iraq at least for the time being. However, secession remains a realistic exit option if basic Kurdish demands are not met. A key issue in this respect is the incorporation of territories into the region that they claim have a “historic” Kurdish majority, most importantly the oil-rich province of Kirkuk. The Kurdish insistence on a quick referendum in Kirkuk and other areas based on the “naturalization” of their population (meaning the return of Kurds expelled under the Ba’th regime, which is, of course, prone to manipulation) puts them in direct conflict with both Sunni and Shi’i Arabs. In spite of contesting the elections on a loosely united list, the Shi’is are deeply divided on the shape of the future political system since the two largest factions, the Supreme Council for the Islamic Revolution in Iraq (SCIRI) and the Sadr movement bitterly disagree over federalism.

Anti-democratic veto actors

The current political class in Iraq has not only failed to bridge ethnic and confessional cleavages that divide Iraqi society, but its incapacity and lack of authority has exacerbated tensions to a point where dozens are killed on a daily basis in vicious cycles of sectarian violence and counter-violence. Sectarian violence escalated to unprecedented levels after the bombing of the revered Shi’i shrine in Samarra’ by al-Qaeda terrorists in February 2006. After this attack, which was evidently intended to unleash civil war, an estimated 10 – 15 sectarian attacks were committed each day compared to less than one per day before. Against the background of growing sectarian hatred, mixed communities are increasingly being homogenized through a mix of voluntary migration and direct threats.

Cleavage / conflict management

Civil society is weak and remains largely excluded from the political process. The government is perceived by many Iraqis as a complex and opaque institution isolated in the Green Zone in Baghdad, having little contact with the daily problems of ordinary citizens. In spite of intensive efforts made by the United Nations and other donors to carve out a role for civil society groups in the constitutional process, negotiations were limited to a small group of party leaders, thus even excluding many members of the parliamentary constitutional committee.

Civil society participation

The Iraqi leadership has proved unable to reconcile a population increasingly divided along ethno-confessional lines and traumatized by decades of brutal repression. In December 2003, the creation of the Iraqi Special Tribunal was announced (confirmed in §48 of TAL) with a broad mandate to cover crimes committed since the Ba’th takeover in 1968. The trial against Saddam and 11 other top officials finally started in October 2005 and ended in July 2006 with

Reconciliation

the death sentence passed on Saddam and two others. Human rights organization like Amnesty International leveled the criticism that the trial did not adhere to acceptable international standards and was characterized by repeated political interference. The execution of Saddam took place hastily in an atmosphere of sectarian hatred.

17 | International Cooperation

Given the widespread dispute over the legality of the invasion, the international community as a whole has only engaged reluctantly in the reconstruction process. In fact, the United States refused to placate its critics and simply sidelined multilateral institutions at critical junctures. The United States has pledged some \$38 billion in aid to Iraq since 2003, part of which is distributed through the Iraqi Reconstruction and Relief Fund (IRRF). The international community has added another \$15 billion, amounting to one of the largest aid efforts ever. The United Nations and the World Bank established the International Reconstruction Fund Facility for Iraq (IRFFI) with two separate funds, reviewed on a biannual basis by meetings of the Donor Committee. The Strategic Review Board, an inter-ministerial body, approves or rejects reconstruction projects.

Effective use of support

Security constraints have severely limited the impact of international assistance programs as foreign aid workers are practically banned from entering the country and security and insurance costs swallow a substantial fraction of aid. The institutional weakness and fragmentation of the Iraqi government has compounded these problems. Some donors prefer to work directly with individual government institutions or other contractors to minimize communication problems and corruption.

Credibility

Iraq's relationship with its neighbors has been shaped by the desire to establish a stable regional environment and stop support for the insurgency that is infiltrating from neighboring countries. Official relations with Iran are close, based on the long-standing relations between many of Iraq's top Shi'i politicians and Tehran. Iran and Iraq have signed a number of bilateral agreements in various fields, including one on security cooperation. Furthermore, Iraq has recognized Iran's claim to compensation for damage sustained during the Iran-Iraq war. Driven by flourishing economic exchanges, relations with Turkey have improved after Turkey's concerns regarding the national aspirations of Iraq's Kurdish minority were at least temporarily allayed. The alleged role of top Ba'athists based in Damascus in supporting the insurgency has complicated relations with Syria, although diplomatic relations were restored in November 2006. Trade with neighboring countries has surged since 2003, most importantly with Turkey, Kuwait and Syria. Trade with Jordan has continued on its pre-war basis of cheap Iraqi oil supplies.

Regional cooperation

Strategic Outlook

It is hard to be optimistic about Iraq's future against the background of an unfolding sectarian war with an average of 3,000 civilian deaths a month. The situation has deteriorated to a point where only second best solutions are available. The Baker-Hamilton report issued by the U.S. Congress at the end of 2006 provided a sobering analysis of the huge problems Iraq is facing. It recommended the gradual withdrawal of U.S. forces between December 2006 and early 2008, placing more responsibility on the shoulders of the Iraqi government, and to embark on a serious dialogue with neighboring countries, most importantly Syria and Iran. President Bush, however, chose to ignore much of the report's advice and opted for a temporary troop increase in the capital and al-Anbar province to fight the insurgents, disarm the militias and attempt to put the Iraqi government in control. It is doubtful whether this strategy can succeed, and early reports indicate that insurgents and militia members are simply melting away (as they have done in the past) to return when coalition troops have withdrawn. Indeed, empowering the Iraqi government may be self-defeating since the government is as much a part of the problem as it is part of the solution. Establishing the broad national consensus so desperately needed to rebuild the administrative and coercive structures of the state would require a re-vamping of the political process on a much broader basis. It is only on the basis of strong and legitimate institutions that structural reforms of the economy (fair distribution of oil revenues, privatization of the most obviously wasteful SOEs, reductions of subsidies) can be envisaged. Even if Iraq's various communities are clearly drifting apart, there are many sectors that are preferably regulated on the federal level. Iraq's neighbors would have to be an integral part of a fresh approach given the growing regional dimension of sectarian escalation. It is, however, highly unlikely that such a radical approach will be adopted given the paramount interest of the dominant Shi'i and Kurdish parties in maintaining the powers they have so recently acquired. A key issue for the future shape of the country will be the implementation of the fuzzy concept of federalism. The current process of geographical reorganization coupled with fluid social identity ascriptions and the weakness of the center carries enormous risks. The creation of a huge Shi'i-dominated mega-region in southern and central Iraq composed of the nine provinces demanded by Supreme Council for the Islamic Revolution in Iraq (SCIRI) is a case in point. The referendum on the status of Kirkuk envisaged for late 2007 is bound to increase violence in the ethnically mixed area. The centrifugal dynamics of establishing ethnically more or less homogeneous regions with far-reaching competencies will, given the failure of the paralyzed central state to provide an attractive alternative, increase the danger that Iraq will be violently partitioned.