

Beyond Security: Stabilization, Governance, and Socioeconomic Challenges in Iraq

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DR. HARITH HASAN

Introduction

In November 2017, Iraqi Prime Minister Haider al-Abadi declared the defeat of the Islamic State of Iraq and al-Sham (ISIS) and the liberation of areas previously controlled by the terror group. During the conflict with ISS, most Iraqi officials, international and US policy makers and commentators focused on the country's security and military challenges. Finding political and legal frameworks to improve governance and make the government more inclusive, as well as preventing discrimination along ethnic and sectarian lines, are necessary to stabilize Iraq in the short- and mid-term. But to maintain peace, prevent further radicalization, and avoid the emergence of another insurgent group, it is important to address the economic and social challenges in Iraq in order to avert further turmoil and instability.

The Atlantic Council Iraq Initiative conducts research, publishes expert analysis, engages in public commentary and private consultations and convenes events on the most significant challenges faced by Iraq beyond its military confrontation with ISIS. The Iraq Initiative seeks to look past the current, narrow security lens to examine Iraq's potential to develop the drivers of any successful society: inclusive politics, economic development, and a vibrant civil society.

The May 2018 election, the results of which were contested by several groups, shows the fragility of Iraqi democracy and its institutions. The low turnout also indicates that there is increasing disillusionment with the system and with the idea of producing change through elections, especially in a context where established parties seem to have managed to reproduce their dominance by designing or manipulating the electoral process in their favor. The main risk here is the widening gap between ruling elites and public demands, which could lead to further radicalization in the street and de-legitimation of the fragile system of governance. Indeed, Iraq faced a similar challenge in the 1950s, and the failure of the monarchic government to deal with it led it to its demise



People show their ink-stained fingers after casting their votes at a polling station during the parliamentary election in Kirkuk, Iraq May 12, 2018. *REUTERS/Ako Rasheed /File Photo*

and the rise of revolutionary forces in a process that culminated in the ascendance of Saddam Hussein after the mid-1970s.

Iraq is going through a period of serious economic hardship, a demographic boom, and social mobility that could jeopardize an already fragile political situation. The Iraqi government is still largely dysfunctional, ranking high among the most corrupt states according to Transparency International.¹ The plummeting of oil prices in the last few years significantly reduced the government's income, 90 percent of which is based on oil revenues, forcing the executive branch to reduce public expenditures and request loans from foreign donors.

In 2016, the Iraqi government agreed with the International Monetary Fund (IMF) and the World Bank to implement measures for economic adjustment and financial reform. In turn, the government received several loans to reduce its budget deficit. Under the \$5.34 billion stand-by-agreement with the IMF,² Iraq agreed to pursue reforms aiming to restore fiscal balance, re-trench inefficient capital expenditure, and improve the country's credit rating. In coordination with the World Bank at a conference organized in Kuwait in February, the government announced sixty key projects for reconstruction with a total price tag of \$85 billion.³ Iraq was promised \$30 billion by donors, mostly as investments and credit facilities.⁴ The government will have

1 Transparency International, "Iraq: Overview of Corruption and Anti-Corruption," July 5, 2015, <https://knowledgehub.transparency.org/helpdesk/iraq-overview-of-corruption-and-anti-corruption>.

2 International Monetary Fund, "Iraq: Letter of Intent, Memorandum of Economic Financial Policies, and Technical Memorandum of Understanding," June 19, 2016, <http://www.imf.org/external/np/loi/2016/iraq/06192016.pdf>.

3 John Lee, "Kuwait International Conference for Reconstruction of Iraq," *Iraq Business News*, January 16, 2018, <http://www.iraq-businessnews.com/2018/01/16/more-details-on-iraqi-reconstruction-conference/>.

4 Maher Chmaytelli and Ahmed Hagagy, "Allies promise Iraq \$30 billion, falling short of Baghdad's appeal," Reuters, February 14, 2018, <https://www.reuters.com/article/us-mideast-crisis-iraq-reconstruction-ku/allies-promise-iraq-30-billion-falling-short-of-baghdads-appeal-idUSKCN1FYOTX>.



Residents demonstrate at Tahrir square in central Baghdad February 25, 2011. Thousands of Iraqis took to the streets on Friday to protest against corruption and a lack of basic services in an organized nationwide “Day of Rage” inspired by uprisings around the Arab world. The banner reads, “No for corruption, no for poverty, no for unemployment, no for terrorism, yes for the freedom and dignity.” *REUTERS/Thaier al-Sudani*

to take further steps to improve the investment environment and guarantee that money will go to the intended projects, rather than being squandered by inefficiency and corruption as was the case with many projects of services and infrastructural development that were funded by the United States or Iraqi government since 2003.⁵ This means applying more reforms in the public and financial sectors, as well as maintaining an acceptable degree of stability.

To implement effective economic reforms and improve governance, the structure of state institutions and their *modus operandi* must change. Iraq has a large public sector, both civil and military, which grew rapidly during the years of financial abundance, before the decline of oil prices in 2014. Jobs in the public sector be-

came a major tool of patronage for political parties in the federal government and in the Kurdistan Regional Government (KRG). Most appointments are not based on merit, but rather on nepotism and clientelism, thereby creating an inflated workforce that lacks the required professional skills to perform effectively.

In a rentier economy such as Iraq’s, the state continues to play the dominant role in the economic process and distribution of wealth. The private sector is weak, conducting most major business deals through questionable partnerships with political parties. The informal economy accounts for most private business, further complicating the objectives of economic diversification, fighting corruption, and spurring development.

5 Special Inspector General for Iraq Reconstruction, March 2013, http://psm.du.edu/media/documents/us_research_and_oversight/sigir/lessons_learned/us_sigir_final-report_learning-from-iraq.pdf.



Iraqi Shiite cleric Moqtada al-Sadr, who's bloc came first, looks at Iraqi Prime Minister Haider al-Abadi, who's political bloc came third in a May parliamentary election, during a news conference in Najaf, Iraq June 23, 2018. *REUTERS/Alaa al-Marjani*

The ongoing demographic growth, estimated between 2.60 and 3 percent annually,⁶ ratchets up pressure on the government and might intensify conflict over increasingly scarce resources. Protests against poor governance, poverty, lack of services, and corruption are common in Iraqi cities, including the Kurdistan region. If the state fails to implement major changes and restructuring to improve governance and meet popular demands, the largely peaceful protests might turn violent. In the mid- to long-term, Iraq might experience economic conditions similar to those witnessed in other resource-dependent countries when revenue shrinks without feasible substitution. The situation will become even more problematic for long-term stabilization if popular demand exceeds the government's ability to meet it.

Seeking to implement reforms, the government could face two contradicting pressures. One is from the IMF and other international monetary organizations that

require economic liberalization, public sector restructuring, and some austerity measures. The other would come from the street: demands for jobs and opposition to austerity measures. The state might opt to force some unpopular measures, which may augment its reliance on coercive measures to face any large wave of protests. Or, the ruling elite could decide to prioritize street demands, which might have negative consequences in the long run if systematic and planned reform is avoided. The May 2018 election, which resulted in the emergence of the Muqtada al-Sadr-backed coalition, indicates that his populist discourse, underlining the need to fight corruption and reduce poverty is attracting more support. This growing inclination toward reform and away from divisive identity politics, even if expressed in populist terms, should be taken into consideration in the formation of the new government.

To avoid the worst scenarios, Iraq needs to take advantage of the relative rise in oil prices and the lessening

6 Abdul Jabbar al-Atabi, "Iraq's population has grown to 37 million and growth is still high," *Elaph*, December 16, 2017, <http://elaph.com/Web/News/2017/12/1181801.html>.



Workers are seen at the Zubair oilfield in Basra, Iraq May 9, 2018. *REUTERS/Essam al-Sudani*

of the terrorist threat to institute reforms and improve governmental effectiveness. Reforming the government must be situated in a broader strategy to redefine its role in socioeconomic development. While this role should depart from the rentier authoritarianism common in Iraq and the region, it need not be solely defined by the simplistic neo-liberal formulas. Economic reforms must be sensitive to the urgent needs of the population and take into consideration the leading role played by the state in third world, resource-dependent countries such as Iraq. A combination of measured liberalization and developmental ideology can help devise a third alternative that is more suitable for Iraq's conditions.

This paper will identify major issues that are central for the reform of Iraq's political economy and governance.

Oil Prices And The Financial Crisis

Between 2007 and 2014, the rise of oil prices and the gradual increase of oil exports provided Iraq with relatively considerable resources and accelerated its economic growth. In 2013, when prices began to fall, the economy grew 7.6 percent, with a total of \$102 billion in revenue generated for the exportation of 2.39 million barrels a day (MBD). By comparison, oil revenue declined to only \$46 billion in 2017 despite an increase in exports which reached 3.80 MBD in 2017.⁷ In March 2018, the Iraqi parliament approved a new annual budget of \$88 billion, with an estimated deficit of \$10 billion.⁸ The budget indicated a relative success in reducing expenses and increasing non-oil revenue, but a failure to resolve key issues regarding long-term policies and economic reforms. The rise in oil prices might seem hopeful; however, there is a risk that it could lead

7 International Monetary Fund, "Iraq: 2017 Article IV Consultation and Second Review under the Three-Year Stand-by Arrangement and Requests for Waivers of Nonobservance and Applicability of Performance Criteria, and Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Iraq," 2017, p.13, <https://www.imf.org/-/media/Files/Publications/CR/2017/cr17251.ashx>.

8 Ahmed Aboulenein and Ahmed Rasheed, "Iraqi parliament approves budget, Kurdish lawmakers boycott vote," Reuters, March 3, 2018, <https://www.reuters.com/article/us-mideast-crisis-iraq-budget/iraqi-parliament-approves-budget-kurdish-lawmakers-boycott-vote-idUSKCNIGFOPP>.



A worker walks at the Zubair oilfield in Basra, Iraq May 9, 2018. *REUTERS/Essam al-Sudani*

the ruling groups to abandon serious reform and return to the unsustainable usual patterns of spending. IMF reports indicate that Iraq's record in the implementation of the standby agreement was mixed. While the government made good progress in the liberalization of currency exchange and public financial management, it is still lagging in meeting objectives such as decreasing the operational budget (which includes salaries, pensions, and subsidies), reducing the size of the public sector (estimated at five million employees in civil and military institutions), and developing the private sector.⁹

The attempts by the Iraqi government to achieve some of these objectives, however incomplete, faced resis-

tance from segments of the population such as state employees, parliament, and political parties. For example, when the government adopted a program to activate the collection of electricity dues by contracting a private company, protests erupted in several southern cities with some accusing the government of seeking to privatize the electricity sector and transfer its burden onto the citizens' shoulders.¹⁰ As a result, the government ordered changes to the program and announced reductions in tariffs.¹¹ This sector is almost fully subsidized by the government with only 10 percent of subsidies refunded through dues collection.¹²

9 International Monetary Fund, "Iraq: 2017 Article IV Consultation and Second Review under the Three-Year Stand-by Arrangement and Requests for Waivers of Nonobservance and Applicability of Performance Criteria, and Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Iraq," p. 9.

10 "Hundreds protest against privatization of electricity sector in Dhi Qar," *Baghdad Post*, November 20, 2017, <http://www.thebaghdadpost.com/en/story/19882/Hundreds-protest-against-privatization-of-electricity-sector-in-Dhi-Qar>.

11 Ali al-Hussaini, "Doubts about the success of the privatization of electricity in Iraq," *New Arab*, March 30, 2017, <https://www.alaraby.co.uk/economy/2017/3/30/قار-علي-حاجن-لوح-كوكش>

12 Rawabet Center for Research and Strategic Studies, "Al-Abadi: the privatization of electricity would protect the poor from electricity mafias," November 30, 2017, <http://rawabetcenter.com/archives/56283>.



Farmers scatter wheat seeds on a field in the Makhmur district, southeast of Mosul on January 8, 2015. *REUTERS/Azad Lashkari*

The Public Sector And The “Economy Of Subsidies”

Some economists see the inflated public sector in Iraq, including Kurdistan, as one key reason for the mismanagement of revenue, income inequality, and structural resistance to reform. According to Iraqi economist Ali Mirza, the public sector employed 62 percent of new employees between 2007 and 2014. Mirza estimates that the salaries and pensions of about five million current and former public-sector employees have consumed 47.5 percent of the 2016 governmental budget.¹³ According to Iraq’s Ministry of Planning, the public sector employs 40 percent of Iraq’s workforce.¹⁴

Iraq’s economy is an “economy of subsidies,” noted an Iraqi economist.¹⁵

According to Mudhir Muhammed Salih, an Iraqi economist and adviser to Prime Minister Haider al-Abadi, the problem is not only caused by crowdedness, inefficiency, and corruption in this sector, but also from socioeconomic inequality caused by the preferential treatment given to state employees. “The internal debt is used to pay salaries,” he said.¹⁶ According to economist Ahmed Bureihi Ali, Iraqi society was divided in the last decade into two categories: state employees who receive good financial compensation and enjoy a

13 Ali Mirza, “The Rentier Trap in Iraq: Comments and Recommendations,” Iraqi Economists Networks, 3, accessed on May 2, 2018, http://iraqieconomists.net/ar/wp-content/uploads/sites/2/2018/05/Merza_Rentier_Trap_In_Iraq_Journal_of_Strategic_Issues_number_6_2018.pdf.

14 The Central Body for Statistics, Ministry of Planning, “The State of Job Market in Iraq,” December 2011.

15 “Iraq’s Political Economy,” (workshop, Baghdad, Iraq, February 8, 2018). The workshop followed Chatham House rules and gathered a group of Iraqi officials and researchers.

16 Mudhir Salih, “Iraq’s Political Economy” (panel event, Baghdad, Iraq, February 7, 2018).



An Iraqi man works at a bakery in Baghdad on January 14, 2015. *REUTERS/Ahmed Saad*

relatively good standard of living, and those who do not have jobs in the public sector—in other words, the majority of Iraqis.¹⁷ The average income of public sector employees is \$8,000, \$3,000 higher than the per capita.¹⁸

Given the hardships that most state employees began to face in the last few years, this division might be overstated but it indicates the significant benefits of state employment when better options are lacking. The government took some measures to encourage its employees to leave the public sector by offering them severance packages that would last several years. However, these measures were not very successful given that good alternatives in the private sector are not available and very few public-sector employees are willing to give up the pension they will receive after

retirement.¹⁹ This problem is likely to grow given that the financial crisis forced the government to stop offering jobs to newcomers. Most university graduates in Iraq receive an education that prepares them to work in the public sector. If the current trends continue, the failure to provide jobs for fresh graduates along with the slow development of the private sector mean that unemployment in Iraq—currently estimated at 15 percent²⁰—will increase.

In Kurdistan, the problem is even more challenging because of the failure of the regional government to regularly pay the salaries of public employees as a result of the financial crisis. Twelve percent of Kurdistan's population works in the public sector, which is double what it should be according to the World Bank.²¹ The regional Ministry of Planning adopted a policy aiming to shift

17 Barik Schuber, "Dr, Ahmed Abrehi Ali, "The Iraq Economy and Prospects for the Near Future," *Iraqi Economist Network*, July 7, 2011, <http://iraqieconomists.net/ar/2011/07/07/او-يقتار على اداصنق اال ايل ع-ي هي ريب ادم ح ا د->

18 Salih, "Iraq's Political Economy."

19 Off-the-record meetings with two Iraqi officials, February 29, 2016; March 7, 2017. Maintaining the anonymity of officials was a prerequisite to discussion.

20 Trading Economics, "Iraq Unemployment Rate," <https://tradingeconomics.com/iraq/unemployment-rate>.

21 "Kurdistan's public sector is double what it should be," *Rudaw*, September 30, 2016, <http://www.rudaw.net/english/business/30092016>.

200,000 employees to the private sector.²² Additionally, securing the salaries of the region's public employees is one of the most contested issues with Baghdad. While the latter announced in March 2018 that it will pay these salaries,²³ there are disagreements between the two sides about the actual number of state employees and the right mechanism to secure their salaries.

The war against ISIS created justifications to increase military spending. About 25 percent of the 2018 budget was allocated to military and security institutions, mostly to pay the salaries of the estimated 1.3 million employees in the Army, federal and local police forces, Popular Mobilization Units, and anti-terrorism units.²⁴ The growth in military personnel was not only driven by the requirements of the war against ISIS, but also by the need to absorb the large number of unskilled job-seekers and to integrate paramilitary groups that otherwise could turn into a threat to the state. However, this increasing militarization could itself become a destabilizing factor due to the burden it has imposed on governmental spending and the potential rivalries between various military organs.

The discriminatory distribution of revenue will feed social tension. According to some statistics, 460,000 "martyr families" and former prisoners receive pensions in a largely politicized practice. The notion that people should be awarded salaries for their previous political choices, which ironically was common under Saddam Hussein regime, has created an unproductive segment of the population, receiving compensation.²⁵ As the oil rent declines, conflicts for scarce resources are likely to intensify, which could further destabilize the country. It is worth noting that, despite its obvious defects, the "economy of subsidies" has provided a relative degree of economic stability and directed part

of the oil revenue toward several sectors of the population. State employee salaries and pensions served as a tool of wealth distribution, with each employee providing for an estimated five family members. This raises the total number of those benefiting directly and indirectly from these salaries to at least twenty million. However, given the prevailing nepotism and clientelism, some families receive several salaries, while others do not receive any, according to an adviser of the Iraqi government.²⁶

The Private Sector and the Informal Economy

There is wide agreement that the government should undertake further measures to support the private sector, especially medium- and small-sized business, as a way to create jobs and expand the non-oil economy. Private sector activity accounts for 37 percent of Iraq's GDP and the government seeks to increase this percentage to 54 percent, according to the Prime Minister's economic adviser.²⁷ The key challenge is Iraq's dependence on oil and oil-related or funded contracts. Only 4 percent of the workforce operate in the oil sector, which provides for an estimated 50 percent of economic activity. In comparison, 16 percent work in the industrial sector, which provides only one percent of the GDP, and 20 percent work in agriculture to provide less than 8 percent.²⁸

Another serious challenge is the domination of the informal economy on the non-state-managed economic process. In addition to the black market, Salih estimated that almost 75 percent of private economic activity can be characterized as a grey market, where informal practices are dominant.²⁹ An estimated 62 percent of private enterprises are not officially registered to avoid

22 Ibid.

23 Utica Risk Services, "Inside Iraqi Politics," Issue No.174, March 26, 2018.

24 "Member of Parliamentary Finance Reveals the Proportion of Military Spending in the Budget of 2018," *Alghad Press*, March 28, 2018, <https://www.alghadpress.com/news/%D8%A7%D8%AE%D8%A8%D8%A7%D8%B1-%D8%A7%D9%84%D8%B9%D8%B1%D8%A7%D9%82-%D8%A7%D9%84%D8%B3%D9%8A%D8%A7%D8%B3%D9%8A%D8%A9/130648/%D8%B9%D8%B6%D9%88-%D8%A8%D8%A7%D9%84%D9%85%D8%A7%D9%84%D9%8A%D8%A9-%D8%A7%D9%84%D9%86%D9%8A%D8%A7%D8%A8%D9%8A%D8%A9-%D9%8A%D9%83%D8%B4%D9%81-%D9%86%D8%B3%D8%A8%D8%A9-%D8%A7%D9%84%D8%A5%D9%86%D9%81%D8%A7%D9%82-%D8%A7%D9%84%D8%B9%D8%B3%D9%83%D8%B1%D9%8A-%D9%81%D9%8A>.

25 "Iraq's Political Economy" (off-record workshop, Baghdad, Iraq, February 8, 2018).

26 Ibid.

27 Mudhir Salih, "Iraq's Political Economy" (panel event, Baghdad, Iraq, February 7, 2018).

28 Ibid.

29 Ibid.



Moayad stands in front of the market stall where he sells second-hand jeans in al-Nabi market in the east Mosul, Iraq, on January 11, 2018. *REUTERS/Raya Jalabi*

taxes.³⁰ This means there is a large economic sector that is not regulated or taxed, lacks minimum guarantees for its workers, is unstable, and is prone to illegal and even criminal activities. The formalization of the informal sector is a necessity to create a healthy environment for private economic activity, as argued by Salih.

Dealing with the informal economy will require the reform of the financial system, which in Iraq is primarily cash-based. Most households do not have bank accounts and the transfer of money between cities happens by the movement of physical cash or through money transfer companies.³¹ According to some esti-

mations, almost 70 percent of banknotes are saved in households, rather than banks.³² The banking system is also dominated by state-owned banks, leaving very narrow space for private banks to compete. Notably, the lack of competition is one reason that the bank system has been very slow in developing its methods and becoming a trusted channel for financial transactions and savings. For this reason, the IMF demanded that the government reform the banking system and encourage private investment in this sector. Recently, the government introduced electronic payment to state employees,³³ which could be the first step toward modernizing the banking system. This must be followed by

30 "Iraq's Political Economy."

31 Mark A. DeWeaver, *Inside Iraq's Cash Economy: Fully Reserved Banking in a Monetary Dystopia*, American University of Iraq Sulaimani, April 20, 2016, https://auis.edu.krd/iris/sites/default/files/IRIS%20Iraq%20Report%20IIR_Mark%20DeWeaver_Inside%20Iraq%E2%80%99s%20Cash%20Economy_2016_0.pdf.

32 "Iraq's Political Economy."

33 "Rasheed Bank Launches MasterCard Card with 'Unique Features,'" Searching 4 Dinar, March 23, 2108, <https://search4dinar.wordpress.com/2018/03/29/rasheed-bank-launches-mastercard-card-with-unique-features/>.



Supporters of Iraqi Shiite cleric Moqtada al-Sadr gather during a protest against corruption at Tahrir Square in Baghdad, Iraq August 4, 2017. *REUTERS/Wissm Al-Okili*

further measures to encourage private banks, attract savings that are frozen in households, and formalize the transactions of the informal sector.

Most economists agree that the Iraqi government needs to do more to support medium and small companies through loans and other incentives. In fact, the government has already adopted some of these measures but there are no guarantees that these loans will not be consumed by clientelist and corrupt conduct or governed by an efficient system of monitoring and performance measurement. Additionally, the weakness of the rule of law, the unfriendly legal and regulatory frameworks, the lack of security, and the obsolescence and vulnerability of infrastructure will continue to discourage economic activities in produc-

tive sectors rather than bolster the provision of services and importation.

In this respect, a considerable part of Iraq's foreign currency travels abroad to fund imports of almost everything, due to the decline of Iraqi agricultural and industrial products and their inability to compete on the global market. Today, the percentage of agriculture and industry in Iraq's GDP does not exceed 6 percent.³⁴ The agricultural sector is facing further problems because of increasing water shortages, mainly caused by water projects constructed in Turkey and Iran's decision that reduced the flow of water to Iraqi territory.³⁵ If this problem is not resolved, a further decline in agricultural production and new waves of migration from the countryside to the already congested and depleted urban

34 The Global Economy, "Iraq: GDP Share of Agriculture," https://www.theglobaleconomy.com/Iraq/Share_of_agriculture/.

35 Foreign Policy Concepts, "A Look at Iraq's Water Crisis and Geopolitics of Irrigation," January 7, 2018, <https://foreignpolicyconcepts.com/iraq-water-crisis-geopolitics-irrigation/>.

centers is expected. Clearly, this will be a destabilizing phenomenon, as demonstrated by the disputes and frequent security problems happening in the southern city of Basra as a result of tribal migration.³⁶

Corruption and Clientelism

Corruption and a sclerotic bureaucracy stand as key impediments toward economic reform and the growth of the private sector. In the last decade, the system of patronage has evolved and created entrenched interests, often in the form of clientelist and crony capitalist networks combining political forces, bureaucrats, and private entrepreneurs. The evolution of these networks was facilitated by two factors. First, the larger and most economically rewarding activity revolves around state contracts, state-sanctioned importation licenses, and the central bank's currency auction. It is rare that large-scale projects are not, in one way or another, influenced by decisions taken by the state's bureaucracy. Second, the system of power sharing that tends to distribute ministries and public institutions between political parties facilitates the evolution of fiefdoms within the state structure. Political parties, including those with armed wings, used these positions as tools for patronage that serve to sustain them financially. Each major political party formed what is often called an "economic committee," which was responsible for making arrangements for state contracts in their ministries to go to allied companies. Thirty-eight percent of registered companies are either dependent on state contracts or operate as economic extensions to political parties.³⁷

Najaf Public Airport, for example, is supervised by a committee consisting of the main parties represented in the provincial council. The committee is accused of working toward the distribution of the airport's income among these parties.³⁸ The use of security forces or militias to force private entrepreneurs to partner with—or transfer certain business to—the party controlling the respective "sector" is also very common. These prac-

tices demonstrate the difficulties in developing a private sector that is not influenced by political parties.

To deal with this challenge and respond to rising public demand, Iraqi Prime Minister Abadi promised to fight corruption more aggressively.³⁹ However, he could not yet deliver substantial results, given the political sensitivity of targeting senior politicians and the risk of being accused of using anti-corruption measures to gain political advantages. Corruption in Iraq is taking an increasingly sophisticated form. Its dissemination through complex networks within and outside state bureaucracy might limit the ability of the prime minister to achieve any substantial change in the short term. Moreover, because the prime minister will need to ally with some of the political forces that would be targeted by any genuine anti-corruption measures, he might opt to take the safer course of targeting lower ranking officials or cases that do not involve major parties. Understandably, Abadi has emphasized the rule of law as the fair approach to fight corruption in a depoliticized and impartial way. Nevertheless, establishing the rule of law is not any easier given that the Iraqi judiciary proved susceptible to corruption as well as threats and blackmail that are often carried out by political parties or paramilitary groups.⁴⁰ In cases related to organized crimes, such as human trafficking and drug smuggling, an informed official told the author that most illegal activities are in fact protected by influential paramilitary groups that get a share of the benefits.⁴¹ Another security official noted, on condition of anonymity, the rampant organized bribery systems at border control points and major internal checkpoints. He explained how a sophisticated network evolved by imposing informal taxation on imports, often through collaboration between official security forces and private groups, with some officials paying large sums for control over checkpoints. One such checkpoint on the road between Diyala and Baghdad was recently closed after a complaint by local officials that it was controlled by militias—in collaboration with corrupt security per-

36 Mustafa Saadoun, "Tribal disputes flare in southern Iraq over water scarcity," February 15, 2018: <http://www.al-monitor.com/pulse/originals/2018/02/water-security-iraq-tribal-conflicts.html#ixzz5GyPu93SY>.

37 "Iraq's Political Economy."

38 "Kurdistan's Public Sector Is Double What It Should Be," Rudaw, September 30, 2016, <http://www.rudaw.net/english/business/30092016>.

39 "Al-Abadi Vows to Fight Corruption Again, MP's Demand Action," *Al-Sharq Al-Awsat*, December 31, 2017, <https://aawsat.com/home/article/1128666/لاعفاء«عابنوبالاطي.بباونو-أددجمنيدسافلادجوتتي-يدابعلال>

40 Interviews with Iraqi citizens, Baghdad, March 2018. maintaining the anonymity of interviews was a prerequisite to discussion.; also see: GAN, "Iraq's corruption report," <https://www.business-anti-corruption.com/country-profiles/iraq/>.

41 Author interview with government official, who requested his identity be kept anonymous.

sonnel—and was used to blackmail crossing trucks and illegally force them to pay the militias.⁴²

Bribery and illegal taxation constrains the ability of the government to increase its non-oil income and diversify its resources. This is why the government is trying to improve its management of border controls that, if administered properly, could provide a considerable source of income through tariffs imposed on imports. Additionally, the government tried with relative success to develop its taxation system, focusing on sectors that are easier to monitor such as cellphone companies.

Sociodemographic Indicators

The gap between population growth—which entails a significant increase in demands for jobs and services—and the resources available to meet these demands is Iraq’s most pressing challenge. Although Iraq has not conducted demographic censuses since 1987, most calculations estimate a population today of 37 million. The number is expected to increase to 53 million by 2030, with an average annual growth of 2.75 percent. The fertility rates in Iraq continue to be among the highest in the world (4.27 percent between 2015 and 2020).⁴³ Almost 40 percent of the population is under fourteen years old, 20 percent is between the age of fourteen and twenty-four, and 33.7 percent is between the age of twenty-four and fifty-four.⁴⁴ The estimated rate of unemployment among the youth is 30 percent and this number is likely to increase in the coming years.⁴⁵

According to Iraqi scholar Adnan Yassin, as the percentage of people between fifteen and sixty-four years old reached 60 percent of the population, the country entered a critical period in its demographic evolution, called the “demographic window.” In this period that is expected to last ten-fifteen years more, the percentage of people able to work is about to reach its peak. If mobilized properly, this segment of society

could provide the required energy for reconstruction and development. To achieve this goal, the Iraqi government needs to have a holistic strategy to address the economic, social, and environmental vulnerabilities its citizens face. This could be done by incorporating both public and private efforts to generate innovation and diversification in the economy and use the young people’s talent to create job opportunities. In this respect, the International Labor Organization indicates the importance of investing in professional and entrepreneurship training, access to capital and local markets, and business start-ups. If such a strategy is not conceived and the state fails to recruit the available human resources, the rate of unemployment and underemployment could rise to levels threatening to political stability itself.

The national poverty line, which the World Bank established at 22.5 percent in 2014,⁴⁶ has been rising as a result of conflict, the decline of oil prices, displacement, drought in southern Iraq, and rapid demographic growth. In a study conducted in 2016 by the World Food Program, 2.1 percent of the population was identified as food insecure, and 22.5 percent live under the poverty line, with the highest rate recorded in southern cities (31.15 percent) and those that were in ISIS-held territories (41.2 percent).⁴⁷ The increasing poverty rate has led the Iraqi government to announce a new strategy for poverty reduction to be implemented between 2018 and 2022.⁴⁸ The strategy is framed in very general terms, focusing on delivering social subsidies to families living under the poverty line and incentivizing economic activity in the most needy areas, especially those damaged by the war.

The above statistics also reflect growing disparities among provinces, which would increase mobility between regions and cities. This unplanned mobility tends to intensify instability, especially by expanding the peripheral areas and adding more pressure on the

42 “Diyala Closes the Collection Yards in Al-Safra Customs Port,” *NRT*, <http://www.nrttv.com/Ar/Detail.aspx?Jimare=42947>.

43 Ali Abdul Amir, “The demographic indicators and socioeconomic development in Iraq” (paper presented at panel event on Iraq’s Political Economy, Baghdad, Iraq, March 7, 2018).

44 Ibid.

45 Ibid.

46 World Bank, *Iraq Country Poverty Brief*, October 2017, http://databank.worldbank.org/data/download/poverty/B2A3A7F5-706A-4522-AF99-5B1800FA3357/9FE8B43A-5EAE-4F36-8838-E9F58200CF49/60C691C8-EAD0-47BE-9C8A-B56D672A29F7/Global_POV_SP_CPB_IRQ.pdf.

47 World Food Programme, “Iraq: Comprehensive Food Security and Vulnerability Analysis,” 2016, <https://reliefweb.int/sites/reliefweb.int/files/resources/CFSVA%20Iraq%202016.pdf>.

48 Nasir al-Hassoun, “Iraq Launches Second Strategy to Lift a Third of the Population Out of Poverty,” *Al-Hayat*, February 28, 2018, <http://www.alhayat.com/Articles/27218075/ارقفلانمنالكسرلالحثلثلشلتنال-ةيناث-ايحييتارثساقولطيقارعل>

depleted infrastructure. Already, economically attractive cities such as Baghdad and Basra have seen an increase in migration and the expansion of shanty towns on the city's margins. The lack of resources to deal with this mobility often leads to the expansion of ungovernable margins and the spread of criminal groups and paramilitaries that either turn into radicalized factions or a threat to economic development and stabilization.

Re-Thinking The Role of the State

In the mid-twentieth century Iraq, like many other third world nations, the prevailing ideology viewed the state as the main agent of development and modernization. The centrally planned, socialist governments, such as the Baath regime, intensified their control over the economic process, helped by the 1970s growth of oil revenue.

After the US-led invasion that toppled Saddam Hussein in 2003, there was no serious debate regarding the state's role in the economic process. Instead, the coalition authority overestimated the importance of ethno-sectarian power sharing and other elements of identity politics. This led to an exaggerated focus on having officials representing various ethnic and religious groups rather than prioritizing meritocracy. Consequently, state institutions became crowded with inefficient people operating as representatives of their cultural groups, rather than personnel with a clear understanding of socioeconomic challenges. Further, Iraqi parties, mostly formed based on an ethnic or religious identity, perceived public institutions more as venues to expand their patronage than as tools of governance.

Apart from general clichés about the free market and the end of centralized planning, very little effort was made to understand how and whether economic liberalization should be conducted. It soon became clear that in an economy that is highly dependent on oil, the state would emerge again as the most powerful actor in the economic process. The combination of a rent-based economy with power sharing prevented the emergence of a new authoritarianism, but resulted in what some⁴⁹ identified as a kleptocratic regime in which considerable resources were wasted to fund

patronage networks of powerful groups. This not only furthered by the dysfunctionality of the state, but also created a private sector that is dependent on the extortion of resources from the state via clientelist networks formed in partnership with political actors.

With the lack of a well-defined economic system or clearly specified developmental objectives, Iraq's economy benefited those who had better access to the state's patronage and was unable to generate development with benefits that could be shared by the majority of the population. The main policy adopted to mitigate the socioeconomic consequences of this mismanagement was opening the public sector, including its civil and military organs, for new appointees, and maintaining or expanding the subsidiary system. This policy proved unsustainable after the plummeting of oil prices and the decline of the government's budget. To make things worse, the conflict and post-conflict challenges and the uninterrupted demographic growth meant that Iraq moved into a situation where resources are scarcer, but demands are greater.

Therefore, Iraq needs to reshape its economic strategy in a way that connects responses to the financial challenges with policies to address socioeconomic problems. While reforms to reduce public spending and budget deficits are inescapable, they must be balanced by a concrete developmental strategy. Unquestionably, Iraq needs to avoid a return to the authoritarian command of the economy, but this will take place not by dismantling the state, but by making it more effective. Reforms should target the system of patronage through which political parties have perpetuated kleptocratic methods in the management of resources. While reducing the public sector is necessary for a better management of resources, it should be gradual and accompanied by creating feasible substitutions. In the current setting, the Iraqi government rhetorically talks about supporting investment and encouraging competitiveness, whereas in reality it operates through a culture shaped by rent-dependency. Moving away from this culture will require developing a new understanding for the state's role, one that prioritizes that latter's part in planning development and sharing the implementation with the private sector, civil society organizations, and local communal authorities.

49 Luay al-Khateeb, "Corruption in Iraq: Where did all the money go?" *National Interest*, May 19, 2016, <http://nationalinterest.org/feature/corruption-iraq-where-did-all-the-money-go-16279>.

Policy Recommendations

1. After the liberation of areas controlled by ISIS, the Iraqi government, US government, and international partners must adopt a holistic approach to fight radicalization. Security methods are important, but they cannot deal with some of the root causes of radicalization and insurgency that are also influenced by socioeconomic conditions. **A new strategy of development must be adopted by the Iraqi government to deal with social and economic challenges such as the rise of unemployment, the decline of state resources, increasing inequality, poor governance and weak institutions, and rapid demographic growth.** The state must actively mitigate socioeconomic problems rather than being held captive to increasingly powerful clientelist networks and interest groups competing for resources.
2. A new development strategy must seek to deal with problems resulting from the rentier economy, which produced an import-oriented culture, limited internal productivity, created a large and inefficient public sector, led to social dependency on state subsidies, and produced a political elite empowered by oil rent rather than genuine social representation. Similarly, rapid economic liberalization that is not mitigated by policies to deal with income inequality and provide better governance will only deepen the crisis and augment the elite's authoritarian tendencies and the ability of informal actors to take on the state's functions, thereby generating further fragmentation. **A new development strategy should revive the state's leading role as the main agent of development, accompanied by a responsible and measured liberalization.**
3. For the state to redefine its role, major internal reform and restructuring must take place. This should include **measures to revive meritocracy, reduce incentives to work in the public sector, reduce the number of institutions, hand over some activities to civil society organizations, and partner with the private sector to manage others.** The ultimate goal is to improve institutions' performance and governance by prioritizing quality over quantity. The efficiency is not defined by the size of institutions but by their ability to deliver. International organizations can engage in more efforts for capacity building and the improvement of governance.
4. **Dealing with corruption should not be solely based on targeting individual cases, but be part of a systematic effort of reform that prioritizes the dismantling of patronage and clientelist networks and weakens the ability of informal actors to penetrate state institutions.** These are areas where international organizations can provide expertise, especially concerning efforts to develop and automate the banking system, reform anti-corruption institutions, and strengthen the rule of law and professionalization of the court system.
5. **Iraq needs to have a state family-planning policy. If demographic growth remains unchecked and indeed encouraged by present laws and regulations, it will be increasingly difficult to meet the population's growing social and economic demands.** This must be accompanied by a serious effort, backed by the US government, to develop human resources and train youth for a new type of economy that is dependent on creativity, initiative, and the skills to deal with new technologies.
6. **More investments should be directed toward renewable energy as a means of creating job opportunities, reducing dependence on fossil fuels, and diversifying Iraq's economy.** Additionally, Iraq needs to invest in irrigation and reforestation to improve agricultural productivity, reduce poverty through food security and job creation, and fight climate change. This must be accompanied by increasing diplomatic efforts with neighboring countries to tackle the water crisis as a supranational problem in the Middle East, necessitating a coordinated protection of water security for all populations. The US government and international partners can use their diplomatic outreach to support constructive solutions for this issue and prevent water conflicts in the future.
7. **The US government should have a more articulated economic policy in Iraq that situates economic reforms in the broader strategy of stabilization and peace building.** This means directing more US resources in Iraq toward encouraging reforms that create jobs, develop investments, and reduce corruption.

Dr. Harith Hasan is a nonresident senior fellow at the Council's Rafik Hariri Center for the Middle East. He is also a senior fellow at the Central European University

(CEU) in Budapest. He has written extensively for various English and Arabic publications and journals and is currently writing a book on Religious Authority and the State in post-Saddam Iraq. He was a member of the Atlantic Council's Future of Iraq Task Force and the CEU research team studying state, religion, and disintegration in the Middle East.

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Atlantic Council

1030 15th Street, NW, 12th Floor,
Washington, DC 20005

(202) 463-7226, www.AtlanticCouncil.org