

ORBIS

FPRI's Journal of World Affairs

Summer 2018, Volume 62, Number 3

STABILIZING THE FERTILE CRESCENT AFTER THE FALL OF THE CALIPHATE

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Immunizing Iraq Against al-Qaeda 3.0

May 2018

By Frank Gunter

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Abstract: Iraq still faces the same economic challenges that contributed to the rise of al-Qaeda and the Islamic State. And unless these challenges are resolved, the likelihood of future political stability is low. The extremely high level of unemployment and underemployment among Iraq's youth, combined with massive corruption, is contributing to widespread poverty and radicalization. The Iraqi government's efforts to deal with these challenges are hamstrung by the expectation that current low oil prices will continue for a decade or more. These obstacles will constrain state-led development efforts severely. Iraq needs to execute successfully anti-corruption and pro-youth employment strategies that draw on the experience of other states, but are crafted to meet Iraq's unique conditions.

This article is part of a special project conducted by the Foreign Policy Research Institute, titled: "After the Caliphate: Reassessing the Jihadi Threat and Stabilizing the Fertile Crescent," which includes a book, a thematic issue of Orbis: FPRI's Journal of World Affairs (Summer 2018), and a series of podcasts. Each element of the project can be found here: <https://www.fpri.org/research/after-the-caliphate-project/>.

The defeat of ISIS (al-Qaeda 2.0) at Mosul, Iraq and the insurgent group's loss of its "capital" of Raqqa, Syria in October 2017 has led many to wonder what will follow. Similar to the situation after the defeat of al-Qaeda in 2007, Iraq has returned to an uneasy peace. Violent civilian deaths, in this nation of 39 million persons, have fallen steadily from about 20,000 in 2014 to about 13,000 in 2017. And the favorable trend appears to be continuing in 2018. During the first three

months of 2018, 1,263 civilians died violent deaths, almost 70% fewer than in the same period of 2017.¹

Politically, the national elections of May 12 were sharply contested—a rarity in the region—although the election turnout was the lowest since the fall of Saddam. While it will take time for a final count, Muqtada al Sadr’s Alliance of Revolutionaries for Reform (Sa’irun) appears to have won a plurality, although not a majority, of the 329 seats in the Council of Representatives at the time of writing. He campaigned on fighting corruption domestically and opposing both Iranian and American influence internationally. Since Muqtada al Sadr did not run for a seat, he is ineligible under the current interpretation of the Constitution to become Prime Minister. However, since he controls the largest number of seats, he will probably have the deciding voice on whether the current Prime Minister, Haider al Abadi—whose Victory Alliance came in third—serves another term. While the complex negotiations to form the next government may take months, it is unlikely that the second-place vote getters—Hadi al Amiri’s Fatah Alliance—will have a major role in the next government because of its close association with Iran. The new government will have some good economic news since First Quarter 2018 oil prices are above estimates and there are other faint signs of recovery.

But, unless the country can meet its biggest challenge, peace in Iraq will be short lived. There were political, diplomatic, and military mistakes that led to the rise of ISIS—al-Qaeda 2.0—in 2013.² But even if these mistakes can be avoided, failure to deal with the problem of rapidly growing youth unemployment and underemployment will create a fertile environment for the rise of al-Qaeda 3.0.

Iraq is a young country; the median age is 20 years old. And while there is little recent reliable data on employment in Iraq, an estimated 80% of young male Iraqis of working age are unemployed or underemployed.³ And the number of unemployed is growing rapidly. Every year, almost 900,000 Iraqis become old enough to seek employment. Even after adjusting for retirements and the extremely low labor force participation by women—about 19%—the Iraq economy must create about 340,000 new jobs each year simply to keep the number of unemployed and underemployed from growing.

One major cause of the rise in youth unemployment and underemployment was the reduction in public sector employment brought about by the 2014 collapse in oil prices.⁴ Oil exports account for over 90% of Iraq’s total exports and government revenue. As shown in Figure 1, the volume of oil production and exports has increased steadily since 2005. However, the recent collapse in oil prices has more than offset the increase in export volume resulting in a 30% drop in the

¹ “Database,” Iraqbodycount, accessed April 14, 2018, www.iraqbodycount.org.

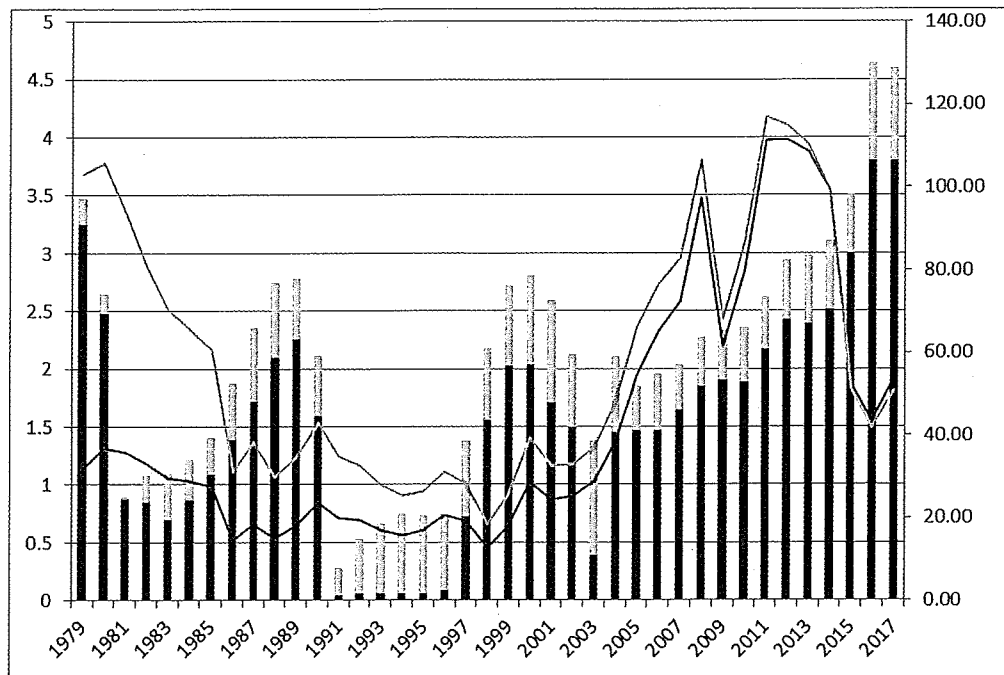
² Frank R. Gunter, “Once Fooled in Iraq,” *US News and World Report*, July 27, 2016, <https://www.usnews.com/opinion/articles/2016-07-27/next-president-cannot-repeat-obamas-mistake-in-iraq-with-the-islamic-state>.

³ Council of Statistics, “Unemployment,” (Government of Iraq, Iraq, 2009), Table 5.27.

⁴ “OPEC Basket Price,” *OPEC*, 2018, http://www.opec.org/opec_web/en/data_graphs/40.htm.

government's oil export revenues to about \$63 billion in 2017.⁵ This decrease in government revenue has had both a direct and indirect impact on the nation's employment. Since Saddam's regime, the Government of Iraq has served as an "employer of first resort," deliberately creating hundreds of thousands of jobs each year in the government bureaucracy to keep the pool of unemployed young people from growing. However, the loss in revenue from the fall in oil prices has stopped this practice; in February 2018, the Council of Representatives approved the 2018 budget with zero increased government employment.

Figure 1: Oil Prices, Production, and Exports



Sources: OPEC Website.

The left axis is in millions of barrels of oil per day, while the right axis is in dollars per barrel. The upper line is the inflation adjusted price of oil (Brent Blend). The lower part of each column is oil exports, while the upper part is domestic use of oil.

There is also a strong indirect effect to the rise in youth unemployment. As during the previous drop in oil prices in 2009, government capital expenditures—not current expenditures—are the budget shock absorber. As oil prices fell in 2015 and 2016, government current expenditures, primarily for salaries and pensions, actually *increased*, while government investment collapsed except for those related to oil

⁵ "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," *IMF*, Aug. 2017, 32, <http://www.imf.org/~media/Files/Publications/CR/2017/cr17251.ashx>.

production. Partially completed electricity, water, school, road, and housing projects were abandoned. Abandoning these projects not only led to an immediate loss of construction jobs, but also ensured a further deterioration of infrastructure.

Youth Unemployment and Political Instability

Will rising youth unemployment in Iraq lead to al-Qaeda 3.0? The relationship between political instability and youth unemployment is complex. In Paul Collier's seminal study of the causes of civil conflict, he points out several precursors of political instability that are applicable to Iraq.⁶ Among these precursors are heavy dependency on a primary commodity such as oil (oil accounts for 50%-66% of Iraq's GDP), population dispersion (Iraq's second and third largest cities—Mosul and Basra—are at geographic extremes), a history of previous civil conflict (the 2014-2017 fight against ISIS is the most recent), a large diaspora (brain drain from Iraq has been a serious problem since the 1980s), low education levels (14% of Iraqi males and 26% of females are illiterate), rapid population growth (Iraq's fertility rate of 4.0 children per female is one of the highest in the world⁷), economic decline (Iraq's predicted 2018 real GDP will be less than that of 2012⁸), and, finally, ethnic or religious diversity (as is well known, Iraq's population is divided among Arabs and Kurds, Sunni and Shi'a along with many smaller groups).

There is little that can be done about Iraq's history, population diffusion, or its ethnic and religious divisions. However, economic policy changes may increase the likelihood of political stability despite the historical headwind. Economic decline tends to increase the likelihood of civil conflict in at least three ways. First, the collapse of government revenues resulting from the decline in oil prices made it more difficult to pay for the war against ISIS. Not only were the Iraqi Security Forces often short of supplies and equipment, but also there were periods when soldiers and police received reduced or delayed salaries. Second, economic decline and the associated rise in unemployment and underemployment meant that young men could be recruited relatively cheaply by ISIS and related groups—the opportunity cost of being an insurgent was lower. Of course, this effect was partially offset by the fact that such men could also be recruited cheaply to fight for the government! Finally, economic decline leads to widespread pessimism and loss of confidence in the government, possibly increasing the willingness to accept an insurgent group's propaganda.

If this analysis is correct, then initiatives to reduce oil dependency while reversing economic decline should improve the odds of avoiding the rise of an al-

⁶ Paul Collier, "Economic Causes of Civil Conflict and Their Implications for Policy," in *Leasing the Dogs of War: Conflict Management in a Divided World*, eds. Chester A. Crocker, Fen Osler Hampson, and Pamela Aall, (Washington, D.C.: United States Institute of Peace, 2007), 197-218.

⁷ "Iraq: People and Society," *World Factbook, CIA*, 2018, accessed Apr. 14, 2018, <https://www.cia.gov/library/publications/resources/the-world-factbook/geos/iz.html>.

⁸ "Iraq: 2017 Article IV Consultation," 36.

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Qaeda 3.0. Unfortunately, since 2014, the Government of Iraq has avoided making the hard choices that such initiatives require.

Whistling Past the Graveyard in Baghdad

The initial reaction to the 2014 fall in oil prices was to assume that it was a temporary event similar to the oil price decline of 2009 that was reversed a year later. Rather than cut current expenditures, the government increased salaries and pensions for the bureaucracy as well as increased funding for security. As was mentioned above, part of this increase in current expenditures was paid for by reducing non-oil related capital expenditures. However, the government also began to run a large deficit in 2013 that reached almost 33% of total government expenditures—16% of GDP—in 2017!⁹ In view of the shallow domestic Iraqi financial markets, the sharp rise in government debt implied by this string of fiscal deficits required large-scale foreign borrowing and a substantial drawdown of the Central Bank's foreign reserves.

Table 1: Fiscal and Monetary Constraints

	Oil Exports Earnings	Total Gov. Debt	Foreign Reserves	CBI Auction Exchange Rate
2013	\$89.4 bn	\$73.1 bn	\$77.8 bn	1166 ID/\$
2014	\$84.3 bn	\$75.2 bn	\$66.7 bn	1166 ID/\$
2015	\$49.2 bn	\$98.0 bn	\$53.7 bn	1182 ID/\$
2016	\$43.8 bn	\$114.6 bn	\$45.2 bn	1182 ID/\$
2017	\$62.8 bn	\$122.9 bn	\$47.0 bn	1190 ID/\$
Issues	30% Below 2013	Rising Debt	Falling Foreign Reserves	Devaluation

As can be seen in Table 1, Iraq's total government debt rose 68% in four years to \$122.9 billion, of which about two-thirds is owed to foreigners.¹⁰ This debt rise has reversed substantially the favorable effects of the post-2003 debt forgiveness orchestrated by the U.S. government. In addition, much of the internal borrowing of the Iraqi government was from Iraqi banks who then resold the government debt to the country's central bank. In effect, the Central Bank of Iraq monetized the government's debt. However, Iraq is a dual currency economy—dinars and dollars—with a fixed exchange rate. Therefore, monetization of the debt led to a

⁹ "Iraq: Economy," *World Factbook, CIA*, 2018, accessed Apr. 14, 2018, <https://www.cia.gov/library/publications/resources/the-world-factbook/geos/iz.html>.

¹⁰ "Statement at the End of an IMF Mission," *IMF*, Mar. 17, 2017, <http://www.imf.org/en/News/Articles/2017/03/17/pr1787-statement-at-the-end-of-an-imf-mission-on-iraq>.

40% drop in the foreign reserves at the Central Bank of Iraq to an estimated \$47 billion at the end of 2017.

As expected, the combination of rapidly rising government debt and falling Central Bank foreign reserves has led to weakened confidence in the value of the Iraqi dinar. The official rate has declined about 2% from 1,166 dinars per dollar in 2014 to 1,190 dinars per dollar at the end of April 2018.¹¹ There is also a varying gap between the official and market exchange rates. Before the decrease in oil prices, the gap was about 2%. However, over the last four years, this gap has ranged from 3.5% to 9.9%. A fair evaluation is that Iraq has become a dual exchange rate economy with all of the inefficiencies that that implies. In addition, a dual exchange rate economy provides opportunities for corruption profits for persons or organizations that are able to buy dollars at the official rate and immediately resell them at the higher market exchange rate.

Running a large deficit financed by foreign borrowing and debt monetization by the Central Bank were recognized as temporary expedients by the decision-makers in Baghdad. There seems to have been the hope that the defeat of ISIS would reduce defense expenditures and lead to an increase in foreign investment to rebuild, while a return to \$100 per barrel or more oil prices would make more radical and painful policy initiatives unnecessary. While ISIS has been defeated, the expected increase in foreign aid and investment has not yet occurred partially for reasons discussed below. And the expectation of a return to \$100 per barrel oil is increasingly unlikely.

The next decade of oil prices will be determined—as always—by a combination of economic—demand and supply—and political factors. And, of course, any long-term prediction may be disrupted in the short-term by political disputes, especially among the states that border the Persian Gulf. However, in the long term, demand growth is slowing as three of the world's five largest oil importers—China, India, and South Korea—appear to be entering a period of real growth below their long-term trend.¹² This period of slower economic growth is expected to reduce the growth of their energy demand. In addition, the drive for increased efficiency and the shift to sustainable energy is reducing the energy use necessary for a given amount of economic growth. Finally, the United States, which was the world's largest oil importer as recently as 2016, may become a small net oil exporter within the next decade.

On the supply side, despite oil production trending down in Latin America, the Asia-Pacific, and Africa, the world's total oil supply has increased by about 8% over the last six years. This increase is a result of a 27% increase in oil production in the Middle East and a 50% increase in North America. Two countries are primarily responsible for the world's increase in oil production: Iraq had a 97% increase, while

¹¹ "Foreign Currency Selling Window," Central Bank of Iraq, (2018), accessed Apr. 28, 2018, https://cbi.iq/currency_auction.

¹² "Economic and Financial Indicators," *The Economist*, Apr. 21, 2018; and "World Development Indicators," *World Bank*, 2018, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

the United States had a 62% increase primarily from fracking.¹³ It is interesting to note that this increase in the world oil supply occurred while both Libya and Venezuela experienced substantial production reductions.

As a result of these long-term demand and supply trends, one can expect Brent Blend oil prices of roughly \$60 per barrel for the next decade. As can be seen in Figure 1, \$60 a barrel oil means a return to the inflation adjusted prices that occurred for almost two decades between 1986 and 2005. However, the revival of the dispute over nuclear research between Iran and the United States has once again raised concerns of a sharp drop in oil exports from the Persian Gulf states. In the third week of April 2018, oil prices reached \$75 per barrel. If conflict can be avoided and the dispute resolved, then oil prices should regress to their long-term price of about \$60 per barrel.

The implications for the Iraqi government are clear. Without a return to substantial real economic growth accompanied by a reduction in youth unemployment and underemployment, the potential for political instability, including the rise of al-Qaeda 3.0, is significant. The government is near the limits of foreign borrowing and dares not exhaust its foreign reserves. As a result, diversification from oil has changed from a desirable outcome to an existential necessity. Under the current harsh circumstances, Iraq must do what it was unwilling to do during the peace and high oil price “good times” of 2008-2012. Iraq must encourage private sector growth and employment.

Unemployment: Private Sector to the Rescue?

A vibrant private sector cannot only provide quality goods and services at more reasonable prices than government monopolies as well as increase employment, but also there is evidence that it can be a strong force for peace in Iraq.¹⁴ Private businesses are willing to cross ethnic, religious, or tribal borders in pursuit of mutually beneficial agreements.

However, there is a danger that the move towards a greater role for private sector employment could be destabilizing politically if the Iraqi government were to attempt to force private sector development by rapidly contracting public-sector employment in the Ministries or state-owned enterprises (SOE). These displaced former state employees probably would be outraged at the breaking of the “social contract” that a government job was for life. One way of mitigating this threat would be to follow China’s example. Preserve the jobs of current Ministry and SOE employees, but do not allow any expansion through new hiring. With the growth of the private sector, government employment gradually will become a smaller part of the labor force.

¹³ “OPEC Annual Statistical Bulletin,” *OPEC*, 2017, 32, http://www.opec.org/opec_web/static_files_project/media/downloads/publications/ASB2017_13062017.pdf.

¹⁴ John E. Katsos and Yass Alkafaji, “Business in War Zones: How Companies Promote Peace in Iraq,” *Journal of Business Ethics*, Vol. 139, No. 1, (Apr. 2017), 1-16.

Despite the necessity of increasing private sector employment in Iraq, such efforts continue to struggle. The two most serious barriers to the creation of a vibrant private sector and therefore an increase in employment in Iraq are ubiquitous corruption and regulatory hostility.

Like sand after a desert storm, corruption permeates every corner of Iraqi society. Corruption—the abuse of public benefit for private benefit—extends from the major governmental ministries in Baghdad to the food distribution centers in every small town.¹⁵ Iraqi researchers think that corruption has done more damage to the country's economic development and political stability than the al-Qaeda and ISIS insurgencies combined. According to Transparency International, Iraq is not the most corrupt country on earth—that dubious honor belongs to Somalia—but it ranks twelfth from the bottom. In fact, it has never ranked higher than twelfth since Saddam was overthrown.

The roots of corruption in Iraq are many. There is little that can be done about causes that are geographic, historical, or are deeply imbedded in the Iraqi culture. However, corruption also is motivated and facilitated by policies; some are recent and others date back to the Saddam era.¹⁶ By changing these policies, progress might be made in reducing corruption to levels that would permit employment growth in the private sector. Beginning with the first post-invasion *National Development Strategy* released in June 2005, the Government of Iraq developed a series of anti-corruption strategies, most recently in 2010. However, a fair evaluation is that the multiple anti-corruption strategies have failed. Assuming that Iraq is not *sui generis*, it should be possible to compare Iraq's anti-corruption strategy to those of other countries and identify possible causes of failure.

No country has succeeded in eradicating corruption although several countries have succeeded in reducing it to manageable levels. Since the causes of corruption differ among countries, it is not surprising that anti-corruption strategies differ as well. However, it can be argued that there are similarities among corrupt states that will provide useful insights not only into the causes of Iraq's corruption, but also facilitate the creation of a more appropriate anti-corruption strategy.

One important insight is that it is simplistic to view anti-corruption efforts as solely a law enforcement problem. Unless one is willing to tolerate a totalitarian state, arresting a succession of corrupt officials without changing the financial and other incentives that motivated their corruption will be an unending process. The few successful and many failed anti-corruption efforts around the world point to the need for a coordinated multi-faceted strategy—of which improved law enforcement

¹⁵ Corruption is the abuse of public power for private benefit. Corruption occurs if a government official has the power to grant or withhold something of value and—contrary to laws and publicized procedures—trades this something of value for a gift or reward. Corruption is a form of rent seeking. Among corrupt acts, bribery gets the most attention, but corruption can also include nepotism, official theft, fraud, certain patron-client relationships, or extortion.

¹⁶ Frank R. Gunter, *The Political Economy of Iraq: Restoring Balance in a Post-Conflict Society* (Northampton, MA: Edward Elgar Publishing, 2013), 46-66.

is one component—that is specifically crafted to meet the characteristics of each country.

It is challenging to find quality studies on countries that have most of the same characteristics as Iraq, including being a developing, post-conflict, natural resource-dependent country that is transitioning from socialism and is divided by religious/ethnic animosities. However, 2017 and 2015 studies by Transparency International¹⁷ as well as Jon S.T. Quah's 2013 work have identified at least five lessons for countries fighting corruption that would appear to be applicable to Iraq.¹⁸

1. Political Will and Good Governance are Needed for Effective Corruption Control

It is difficult to measure the political will to reduce corruption in Iraq. Iraqi politicians of all parties regularly speak against corruption and, periodically, there are well publicized arrests of senior government officials. However, the Iraqi public is cynical about these speeches and arrests believing that many of the latter are driven by political disputes, not extraordinary levels of corruption.

That this public cynicism about government anti-corruption efforts may be justified is illustrated by the August 2015 announcement of an anti-corruption program by Prime Minister Haider al-Abadi. While the Iraqi Parliament initially passed these reforms by a unanimous vote, less than three months later, the Parliament revoked the Prime Minister's mandate to implement his program. Instead, the Prime Minister only can implement this program after negotiating the approval of various political groups in the Parliament. Needless to say, progress in these reforms ground to a stop.¹⁹

One simple way that officials can demonstrate commitment to fighting corruption is by personally abiding by anti-corruption regulations such as accurately reporting personal financial assets. However, by the end of 2017, a substantial proportion of Iraqi officials covered by reporting regulations have failed to submit their reports. Reporting rates were high for the executive and judicial branches, but poor for the legislative branch. According to the Iraq Commission of Integrity, the worst offenders were members of the national legislature—only 36% submitted their

¹⁷ Marie Chêne, "Successful Anti-Corruption Reforms," *Transparency International*, Apr. 30, 2015,

https://www.transparency.org/whatwedo/answer/successful_anti_corruption_reforms; and Jackson Oldfield, "Overview of National Approaches to Anti-Corruption Packages,"

Transparency International, May 23, 2017.

¹⁸ Jon S.T. Quah, "Different Paths to Curbing Corruption: A Comparative Analysis," in *Different Paths to Curbing Corruption: Lessons from Denmark, Finland, Hong Kong, New Zealand, and Singapore* (Bingley, United Kingdom: Emerald Publishing, 2013), 219-255.

¹⁹ Jackson Oldfield, "Overview of National Approaches to Anti-Corruption Packages,"

Transparency International, May 23, 2017, 7,

https://www.transparency.org/files/content/corruptionqas/Anti_corruption_packages_2017.pdf.

financial statements—and the members of the provincial counsels (non-Kurdistan Regional Government (KRG))—50%. And audits of a small fraction of these reports have revealed that about 5% are very inaccurate.²⁰

With respect to improved governance, since 2003, the U.S. government, the International Monetary Fund, and several international NGOs have emphasized rationalizing governance mechanisms both to improve the operation of the Iraqi government and to reduce corruption. These initiatives include developing a professional civil service, a single integrated open budget in the place of the multiple secret budgets of the Saddam era, and moving from paper to electronic records. Results have been meager. Government employees have resisted procedural changes in part because increased efficiency may reduce the need for their jobs. However, even if these efforts at improving the quality of governance had succeeded, it probably would not have resulted in a substantial reduction in corruption. Improving governance may be necessary, but it is not sufficient.

2. Rely on a Single Anti-Corruption Agency (ACA) Instead of Many ACAs for Effective Corruption Control

Why have an independent ACA? In most corrupt countries including Iraq, the police and the courts are extremely corrupt. One survey showed that 35% of the Iraqi population had paid a bribe to a police officer within the last twelve months. And 22% had paid a bribe to a judge or member of the court.²¹ Other countries have found that when there is widespread corruption among the police and judiciary, making the national police forces responsible for rooting out corruption in the rest of the government almost always has failed. Usually, after the exposure of a particularly egregious case of police or court corruption, there will be calls to establish an independent ACA. However, a poor or badly managed ACA may prove ineffective or actually damage anti-corruption efforts.²²

There are multiple reasons why a country tends to make more progress against corruption with a single ACA. First, if there are multiple ACAs, then responsibility for fighting corruption is diffused. Incompetent or corrupt ACAs can attempt to shift the blame for lack of progress to another ACA. Second, several ACAs with overlapping areas of responsibility can lead to bureaucratic infighting that can lead to the spoiling of an anti-corruption investigations as one ACA withholds information from another. Attempts to prevent such overlap by delineating different areas of responsibility for each ACA intentionally or unintentionally can lead to gaps or “corruption free-fire zones,” where no ACA has statutory responsibility. Third, with multiple ACAs, there is a greater likelihood that one ACA will be “captured” by corrupt senior politicians and/or senior officials in the government. The captured

²⁰ Commission of Integrity, “Summary of Annual Report: 2017,” (Baghdad, Iraq: Republic of Iraq, 2018), http://nazaha.iq/en_body.asp?id=1778.

²¹ Transparency International, “Global Corruption Barometer: 2013, Iraq,” accessed April 27, 2018, <https://www.transparency.org/gcb2013/country?country=iraq>.

²² Patrick Meagher, “Anti-corruption Agencies: Rhetoric Versus Reality” *The Journal of Policy Reform*, Vol. 8, No. 1, (Mar. 2005), 69-103, <https://doi.org/10.1080/1384128042000328950>.

ACA then can be used to divert investigations of these senior officials. This is often the result when an ACA reports directly to the Prime Minister or Parliament. Fourth, a single ACA provides the public with a single unambiguous source of information on anti-corruption efforts as well as a single point of contact for reporting suspected corrupt acts. Countries with several ACAs often suffer from confusing or contradictory anti-corruption messaging that confuses the public. And multiple ACAs increase the likelihood that those citizens who muster the courage to report a corrupt official will report it to the wrong ACA resulting in either their statement being ignored or possibly released to the official involved. Finally, multiple ACAs compete for personnel and funding as anti-corruption resources are split multiple ways.

Iraq violates this guidance to have a single ACA. There are at least eight agencies with anti-corruption responsibilities in Iraq.²³ The Joint Anticorruption Council (JACC) was established in 2007 and is composed on senior government officials. The JACC focuses on policy issues and is perceived to have little impact.

The Federal Board of Supreme Audit (FBSA), founded in the same year as independent Iraq, performs audits of government organizations and oversees public contracts in order to expose fraud, waste, and abuse. When the FBSA uncovers violations, then it refers them to either the Commission of Public Integrity or the Inspector Generals. Performing these audits can be dangerous, and the FBSA at times has had to send auditors out of the country to protect them from physical attacks by thugs hired by persons at audited agencies. While progress has been made, the FBSA suffers from a shortage of quality staff and has been plagued by outdated technology. As a result, many of its audits are not completed and released in a timely manner and some fail to meet international standards.²⁴ There is a separate organization, the Kurdistan Board of Supreme Audit, with similar responsibilities in the KRG.

There are about thirty Inspector Generals (IG) who are supposed to unearth corruption within assigned ministries. This agency is generally considered to be the least effective of the major anti-corruption agencies. It is not simply that many of the IG are unqualified or corrupt themselves, rather each Ministry's IG reports to the Ministry Director—not to an independent organization. As a result, while the IGs have exposed low-level corruption, there have been very few cases where an IG has exposed corruption involving a Minister or one of his senior staff members.

The Iraqi ACA that is perceived as being most effective is the Commission of Integrity (CoI). It not only investigates cases of corruption, but also seeks to educate the public on transparency related issues. Unlike other Iraqi ACAs, the CoI publishes a quarterly report in Arabic and English providing data on investigations

²³ Coralie Pring "Iraq: Overview of Corruption and Anti-Corruption," *Transparency International*, Mar. 2015, 7-10,

https://www.transparency.org/whatwedo/answer/iraq_overview_of_corruption_and_anti_corruption1.

²⁴ Addulbasit Turki Saeed, "Rebuilding the Board of Audit in a Shattered Country" in *The Art of the Audit*, ed. Roel Janssen, (Amsterdam: Amsterdam University Press, 2016), 91-100.

and arrests as well as whether government officials are meeting their personal income/asset reporting requirements.²⁵ The CoI faces two serious challenges. First, the CoI, the Iraqi equivalent of the U.S. Federal Bureau of Investigation (FBI), has limited authority and must rely on the police to make most arrests. But the police are perceived to be very corrupt. There have been multiple cases where the police have either demanded bribes to release persons freed by the courts or accepted bribes to release persons that the courts have ordered to be held. As a result, a large proportion of senior Iraqi officials charged with corruption are tried in absentia since they successfully bribed authorities to leave the country. A second challenge is interference from the highest levels of the Iraqi government. One former Director of the CoI resigned because of such interference.

There are four other ACAs that are believed to be relatively ineffective. There is an Office of the Ombudsman that seems to be limited to publicizing corruption complaints. The Parliamentary Committee on Integrity is subject to substantial political pressure. The Central Bank of Iraq Monetary Laundering Reporting Office only has had limited success in reducing money laundering and the associated capital flight. Finally, the Financial Intelligence Unit launched in 2015 combines a very broad mandate with very limited power and resources.

As discussed above, Iraq's multiple ACAs diffuse responsibility and resources and therefore retard the fight against corruption. One possible solution would be to reduce anti-corruption efforts to three organizations. Because of their important institutional continuity and international roles, preserve an independent FBSA and Central Bank Monetary Laundering Reporting Office. Close the JACC and the Parliamentary Committee of Integrity as hopelessly compromised. Make all of the other ACAs part of the CoI with all of their budget and personnel decisions controlled by the CoI's Director. Carrying out such a change will require substantial restructuring of lines of responsibility. For example, IGs no longer would be assigned and report to their respective Ministries, but rather they would be assigned by and report to the CoI.

3. Importance of Cultural Values in Minimizing Corruption

Hong Kong and Singapore are among the few nations that have changed their peoples' attitudes towards corruption successfully within a fairly short period of time. Their experiences appear to show that if culture changing efforts are limited to billboards with anti-corruption messages and mandatory corruption classes for government employees, then such efforts will fail. As expected, changing the culture of corruption is extremely difficult. The few successes have utilized a top-to-bottom approach with careful coordination of different facets of the effort to create an anti-corruption culture.

There are several decisions that must precede the cultural initiatives in order that confusion doesn't weaken the effort. First, there must be a clear definition of corruption or rather the type or types of corruption that are targeted. Is the intent to reduce/eliminate grand corruption or state capture? An example would be when an

²⁵ Commission of Integrity, Republic of Iraq, *Summary of Annual Report: 2017*, (2018), 16-19.

oligarch uses political influence to gain wealth “legally.” Or should petty corruption be targeted as well? While state capture may do more damage to the national politics and economy of Iraq, Iraqi citizens may experience greater frustration at the daily demand for small bribes by a hoard of low-level officials. Second, should private corruption such as insider trading be included or only corrupt acts involving officials? Third, should there be a lower limit to acts of corruption that will be investigated? In a society with a long tradition of gift giving to persons in authority, should small bribes—a cup of tea for a policeman—be ignored or should the standard be an unambiguous “not one dinar?”

The final question to be answered before an effort to change the corruption culture is launched is especially controversial. Should there be an amnesty for corrupt acts that occurred before a certain date? On the one hand, an amnesty weakens the anti-corruption message by saying that the same act that would be prosecuted as a serious offense if it occurred in, say, 2018 would be forgiven and forgotten if it occurred earlier. However, in Iraq, it is a safe bet that almost every current Iraqi official has been engaged in corruption sometime in his or her career. Without an amnesty, there would be little official support for and maybe active opposition to anti-corruption enforcement. It should be noted that Hong Kong initially decided against an amnesty before adding one in order to gain police support for the anti-corruption effort.

Once the tough strategic decisions discussed above have been made about the scope of Iraq’s anti-corruption strategy, it will be important to have many influential individuals and groups openly support the effort. Which individuals and groups will have the most influence on public attitudes towards corruption will probably vary from place to place in Iraq. However, previous efforts in Iraq show that politicians and sports figures seem to have little credibility in the anti-corruption fight. On the other hand, religious leaders, writers, and—for some reason—soap opera stars seem to have a strong impact on the average Iraqi’s attitude towards corruption. The Iraqi government has made efforts to encourage religious leaders to add regularly an anti-corruption message to their Friday sermons.²⁶ It also may be possible to encourage writers and performers to add an anti-corruption element to their works on print, radio, and television.

Just as important is adding strong anti-corruption modules to school instruction starting in the first grades and continuing through secondary and tertiary education. The intent is not only to make corrupt acts unacceptable to the young, but also to encourage them to object to such acts by their parents and wider society. Combined with a well-designed anti-corruption media campaign, the support of well-regarded individuals/groups and integrating anti-corruption into education curricula gradually could change Iraq’s culture of corruption.

Among the Iraqi ACA, only the Commission of Integrity appears to be making a serious attempt to change the culture of corruption. It has begun distributing anti-corruption messages to Iraqi newspapers, television, and radio

²⁶ Commission of Integrity, Republic of Iraq, *Summary of Annual Report: 2017*, (2018), 24.

programs. In addition, anti-corruption material has been prepared for children in kindergarten, primary, and secondary schools.²⁷ However, these efforts are in their infancy, and there are no published studies of the effectiveness of these efforts or even the coverage—what percent of the Iraqi public is aware of these efforts.

4. Adequate Salaries are Necessary, but Insufficient for Effective Corruption Control

It long has been recognized that inadequate salaries for police and other government officials tend to lead to corruption.²⁸ However, the application of this general rule to Iraq may be counter-intuitive. In theory, raising the compensation of government employees will tend to discourage corruption.²⁹ Whether public sector compensation in Iraq is adequate is especially complicated. If one looks at average salaries alone, then the typical government employee is better compensated than a worker in the private sector. Combined with benefits, protection against dismissal, a less intense—some would say relaxed—pace of work, government employment is eagerly sought after. There are multiple applicants for each government service opening. However, once anyone has obtained a government position, the financial rewards for advancement in Iraq tend to be meager.

The existence of generous compensation for entry-level position combined with meager raises for seniority provides strong incentives for accepting bribes. New employees are often expected to “purchase” their entry into government employment by bribing senior officials. The payment usually is some combination of an initial bribe—possibly financed by borrowing—and a monthly cash “contribution” to one’s supervisor. Of course, each level of management is expected to make a “contribution” to the next most senior level of management. As a result, it is believed that the actual paycheck received by many senior members of the bureaucracy accounts for a small fraction of their compensation. Many seek bureaucratic advancement primarily to increase their ability to extract larger bribes.³⁰

In many cases, the newly hired government employee actually may not show up for work. Instead, a percentage of his or her salary will be paid to the supervisor so that the “employee” can stay home or work at another job—possibly another government job! These “ghost workers” or “ghost soldiers” are believed to exist in almost every Ministry and state-owned enterprise and may account for as much as 25% of total employment of some organizations. The Government of Iraq is struggling to complete a decade-long census of government workers in order to

²⁷ Ibid.

²⁸ Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform* (New York: Cambridge University Press, 1999); and Anne Krueger, “The Political Economy of the Rent Seeking Society,” *American Economic Review*, Vol. 64, No. 3, (1974), 291-302.

²⁹ Dilip Mookerjee and I.P.L. Png, “Corruptible Law Enforcers: How Should They be Compensated?” *Economic Journal*, Vol. 105, (1995), 145-59, <http://www.jstor.org/stable/2235324>.

³⁰ Frank R. Gunter, *The Political Economy of Iraq: Restoring Balance in a Post-Conflict Society* (Northampton, Massachusetts: Edward Elgar Publishing, 2013), 58-59.

eliminate the ghosts. But the census takers have had to deal with lack of cooperation, offers of bribes, and threats of violence from officials that benefit from the status quo.

What can be done about corruption encouraged by excessive government wages and benefits in Iraq? It is probably political suicide for the government to attempt to reduce public sector wages to the level of those in the small private sector with similar skills and responsibilities. A more politically realistic approach would be to hold the line on public sector wages and benefits and wait for inflation—about 2% in 2017—to reduce gradually the real value of government employment to levels competitive to those in the private sector.

5. Constant Vigilance is Needed for Sustained Success in Corruption Control

The final lesson is that the fight against corruption is never over. Especially if there are great financial incentives for corruption, each “generation” of government officials will find it difficult to resist the temptation. Since 2003, three successive Iraqi Ministers of Defense have been charged with corruption. Each took office promising to clean house, but the opportunities to amass \$100 million or more in illegal funds could not be resisted. In summary, if a society isn’t constantly fighting corruption in accordance with a well-planned strategy, then corruption will get worse. And every failed anti-corruption policy in Iraq since 2003 has led to increased public cynicism making eventual success more difficult.

The Missing Component: Reducing Economic Incentives for Corruption

A serious lacuna in Iraq’s current anti-corruption strategy is the absence of meaningful efforts to reduce the economic incentives for corruption. This is somewhat surprising because the first post-2003 National Development Strategy: 2005-2007 contained a substantial discussion of reducing government subsidies as part of the anti-corruption effort. However, reducing economic incentives for corruption disappeared from later five-year plans and was not included in either the Iraqi government anti-corruption plan of 2008 or the U.S. government-recommended anti-corruption strategy of 2009.

Iraq’s National Anti-Corruption Strategy 2010-2014³¹ contained a detailed action plan for combating corruption with 201 elements, while the Commission of Integrity’s 2018 *Anti-Corruption Roadmap*³² discusses 43 critical initiatives—however, there are only a few ambiguous references in either document to reducing economic

³¹ Joint Anti-Corruption Council, *The National Anti-Corruption Strategy: 2010-2014* (Republic of Iraq, Iraq, 2010), <http://www.track.unodc.org/LegalLibrary/LegalResources/Iraq/Authorities/National%20Anti-Corruption%20Strategy%202010-2014.pdf>.

³² Commission of Integrity, *Anti-Corruption Roadmap* (Baghdad, Commission of Integrity, 2018), http://nazaha.iq/pdf_up/1844/Anti-corruption%20Roadmap-2018.pdf.

incentives. In economic terms, Iraq's current anti-corruption strategy focuses primarily on reducing the supply of corrupt acts by government officials but with little attention paid to the demand for corrupt acts by the Iraqi public. Such an unbalanced strategy is doomed to fail. Investigating, prosecuting, convicting, and punishing corrupt officials has little long-term effect if the replacement officials face the same strong economic incentives to accept bribes. Currently, Iraq provides strong economic incentives for corruption in two overlapping areas: the Government of Iraq provides generous subsidies and has created a regulatory environment which stifles the non-energy private sector.

Iraq has an extensive system of subsidies and price controls. The International Monetary Fund estimates that direct subsidies of food, electricity, and fuels amounted to almost 9% of GDP.³³ Including indirect subsidies, the cost may reach 12% of Iraq's GDP. These generous subsidies result in low or zero official prices for food, electricity, fuels, water, medical care, etc. As a result, at the official price, the amount demanded of these goods or services are substantially greater than the amount supplied. In effect, Iraqi families are competing with each other to obtain these subsidized items. Each must try to persuade some government official to favor their family over another family in the distribution of scarce subsidized goods and services. Families may use political pull, tribal membership, or religious connections to persuade officials to favor their request for scarce items. However, the most common means of persuading an official to part with a subsidized good or service is to offer a bribe.

Changing the Regulatory Environment

Iraq's regulatory hostility towards the private sector not only encourages corruption, but also is itself a substantial barrier to increased employment. According to the World Bank, Iraq's business environment ranks 168th out of 190 countries surveyed.³⁴ As summarized in Table 2, legally operating a business is unnecessarily complex, expensive, and time consuming. Current regulations make it particularly difficult for private businesses to obtain credit or trade across international borders (Iraq is tied for the worst in the Middle East and North Africa (MENA) for both of these indicators), or resolve insolvency (Iraq is tied for the worst in the world). Not only does Iraq have a harsh regulatory environment, but also its relative standing has fallen since 2015. Out of the ten categories of business regulation monitored by the World Bank, Iraq's ranking has deteriorated substantially in six, remained roughly unchanged in two, and only improved with respect to dealing with construction permits and registering property.

³³ Koba Gvenetadze and Amgad Hegazy, "Iraq: Selected Issues," *IMF*, Aug. 2015, 15-29, <http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Iraq-Selected-Issues-43199>.

³⁴ World Bank "Doing Business 2018," (Oct. 2017), 168, <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf>.

Table 2: *Ease of Doing Business*

Category	Iraq 2017	Iraq 2015	Range of MENA Rankings
Ease of Doing Business	168 th	160 th	21 st to 186 th
Starting a Business	154 th	144 th	31 st to 169 th
Dealing with Construction Permits	93 rd	145 th	2 nd to 186 th
Getting Electricity	116 th	102 nd	1 st to 187 th
Registering Property	101 st	116 th	10 th to 187 th
Getting Credit	186 ^{th*}	180 th	20 th to 186 th
Protecting Minority Investors	124 th	114 th	10 th to 183 rd
Paying Taxes	129 th	57 th	1 st to 167 th
Trading Across Borders	179 th	178 th	41 st to 189 th
Enforcing Contracts	144 th	119 th	12 th to 175 th
Resolving Insolvency	168 ^{th**}	189 ^{th*}	63 rd to 168 th

Source: World Bank (2018) *Ease of Doing Business*

The need for relaxing regulatory hostility towards private business long has been recognized in Iraq. It was a major topic in all four post-invasion economic development plans. But little has been done for two overlapping reasons.

First, strict government regulation of private business is part of the government's DNA following four and a half decades of dominance by the Arab Socialist Ba'ath Party. The Ba'athist Party imposed complete government control of the private sector both because the party thought that doing so would increase economic efficiency—it was wrong—as well as a means to strengthen the dictatorship's control of the country.

Second, the government bureaucracy carefully maintains the existing rat's nest of regulations in order to motivate private businesses to pay bribes. For example, if a businessman is unable or unwilling to wait an average of 167 days to get government permission to build a warehouse, then he can speed up the process by paying several \$100 bills under the table. Also, research has shown that the impact of regulatory burden in motivating corrupt acts can be exacerbated if the regulations are implemented in a bureaucratic way.³⁵ This problem is especially severe in Iraq where almost every restructuring of a Ministry's organization increases the complexity of the bureaucratic process. One new Minister noted that for his Ministry to grant a relatively minor approval to a private firm required seventy-five signatures of various officials in the Ministry including his own signature—five times!

Some progress is being made. Over the last decade, Iraq has combined multiple registration procedures for starting a business, launched a new credit agency,

³⁵ Dinissa Duvanova, "Economic Regulation, Red Tape, and Bureaucratic Corruption in Post-Communist Economies," *World Development*, Vol. 59, (July 2014), <https://doi.org/10.1016/j.worlddev.2014.01.028>.

allowed simultaneous processing of building permits, and enforced tighter deadlines on electricity connections.³⁶ It should be noted that even if the Government of Iraq makes modest improvement in the country's regulations, its relative standing may decline. For example, if Iraq reduces the number of hours required to complete tax forms by 10%, but other countries reduce hours by 20%, then Iraq's ranking would deteriorate. Since Iraq is competing with other nations for foreign direct investment, rankings are more relevant than absolute measures.

Optimistically, it only will take another decade to complete a total overhaul of the country's commercial and labor codes. Unfortunately, Iraq cannot afford to wait another decade before freeing the private sector to create enough jobs for young men to slow the rise of al-Qaeda 3.0.

There are several options that could be adopted to speed up the process of rationalizing Iraq's incredibly complicated commercial code. First, instead of changing regulations one at a time, Iraq could adopt the best practices commercial code that has been developed by the World Bank. However, it is possible that the formal institutions and practices in this code are inconsistent with Islamic or Arabic cultures. Or the changes may conflict with informal institutions and practices that are widely accepted by the Iraqi people. If such inconsistencies exist, then imposing such a code regardless of its theoretical excellence probably will fail.

A second option would be for the Iraqi government rapidly to rationalize its regulations by substituting the existing commercial code of an Islamic Arab neighbor such as the United Arab Emirates (UAE). While far from perfect, the regulatory environment of the UAE is much friendlier to its private sector. For example, Iraq ranks 154th in the ease of establishing a new business since there are 9 procedures taking 27 days to complete at a cost equal to 43% of the average Iraqi's income. The Emirates rank 51st in establishing a new business with 5 procedures taking 9 days to complete at a cost of 13% of average Emirati income.³⁷

A third option that has received less attention is to establish a special economic zone (SEZ). A SEZ is a geographic area within a country where the rules of business are different from those that exist in the rest of the country.³⁸ Many developing nations have experimented with SEZs with two primary motivations. In some countries, SEZs are established primarily to encourage foreign direct investment in labor intensive production of goods for export. These SEZ often have been criticized as leading to not only the exploitation of labor, but also resulting in an industrial enclave that has little interaction with the rest of the country's economy. In others, such as the Shenzhen "miracle" SEZ in China, the primary motivation was to experiment with economic reforms before imposing these reforms nationwide.³⁹

³⁶ World Bank, *Reforming to Create Jobs: Economy Profile, Iraq* (Washington, D.C.: World Bank, 2018), 65.

³⁷ World Bank, *Doing Business*.

³⁸ Thomas Farole and Gokhan Akinci, eds., *Special Economic Zones: Progress, Emerging Challenges and Future Directions*, (Washington, D.C.: World Bank, 2011), 3.

³⁹ "Not So Special," *The Economist*, (Apr. 4, 2015), <https://www.economist.com/news/leaders/21647615-world-awash-free-trade-zones-and-their-offshoots-many-are-not-worth-effort-not>.

This latter type of SEZ might provide a viable transition route to a more rational regulatory environment in Iraq.

Most SEZs fail to achieve their stated goals. This failure often occurs when the government provides generous tax reductions, while failing to provide the physical and human infrastructure to connect the SEZ to the rest of the country. Also, it is difficult to achieve the necessary political oversight without permitting unnecessary bureaucratic interference. However, in view of the great uncertainty about the appropriate level of private sector regulation in Iraq, a SEZ might provide a useful laboratory to experiment with a different level of regulation. And if this experiment is successful, then the revised regulatory environment could be extended to the whole country.

A detailed SEZ proposal for Iraq is beyond the scope of this study. However, there are some general characteristics that should be considered. Because the government is already running a large fiscal deficit, building new infrastructure to support the SEZ is probably out of the picture. Therefore, the SEZ should be located where there are existing road, airport, electricity, and water infrastructure. Rather than develop a new commercial code, the SEZ might begin by adopting existing regulatory systems. For example, the SEZ might adopt the UAE commercial code and the U.S. labor code. To provide simultaneously political oversight by the elected Iraqi government while limiting excessive interference and corruption, the SEZ might be managed by a foreign company from—say, Germany or Switzerland—on a long-term contract with the Iraqi government.

But a SEZ is a means to an end—reducing the regulatory hostility towards the private sector. Currently, as a result of corruption and regulatory hostility, most small businessmen and women of Iraq are forced to keep their businesses in the underground or informal economy. As expected, operating in the informal economy is extremely inefficient, and yet such businesses employ an estimated 20% of the labor force. If they could be freed from the adverse conditions described above and allowed to operate openly, then one could expect rapid growth in the private sector accompanied by a rise in productive employment to help absorb the third of a million Iraqis looking for their first job each year. And an increasing proportion of young men engaged in productive activity should increase political stability and reduce the likelihood of the rise of an al-Qaeda 3.0.

Two Recommendations from an Outsider

If Iraq's recent past is an accurate guide to its future, then failure to create quality employment for the rapidly growing population of young Iraqis will be politically destabilizing. The growing army of Iraqi unemployed and underemployed young men is a prime recruiting group for various political, religious, tribal, criminal, and insurgent groups including a possible al-Qaeda 3.0. The period of low oil prices that began in 2014 is expected to continue for another decade making it impossible for the Government of Iraq to act in its traditional role of "employer of first resort." Therefore, rapid diversification from oil dependency is essential. However, the

growth of Iraq's private sector businesses and employment is severely limited by the effects of corruption and regulatory hostility. Other nations have had to deal with similar challenges, and there are valuable lessons learned that would appear to be applicable to Iraq for both reducing corruption and rationalizing business regulation.

There are two primary recommendations. First, the Government of Iraq must develop an integrated multi-faceted anti-corruption strategy and place the primary responsibility for its execution on a single well-funded anti-corruption agency. Second, the government does not have the decades that would be needed for a deliberate revision of the nation's commercial code that is currently extremely hostile to private businesses. The government should consider either adopting the existing code of one of its neighbors or establishing a special economic zone to experiment with an improved regulatory environment that can then be applied to the rest of Iraq. But the most important aspect is the need for urgency. Iraq only has a few years at most before a fiscal crunch and rising youth unemployment lead once again to political instability.

