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Liberate Iraq's Economy

By FRANK R. GUNTER

Bethlehem, Pa.

AFTER returning from the second of two tours in Iraq, I can attest to notable progress. Iraqi civilian casualties have dropped sharply, the result of both the United States surge and negotiations with Sunni groups. There has been political progress as well. Provincial elections were held this year and national elections are scheduled for early 2010.

The future of the Iraqi economy, however, remains bleak. Without fundamental change, unemployment and the accompanying instability will rise while the widespread corruption will worsen. The political and security gains made at such great cost in Iraqi and American blood and treasure will be imperiled.

Iraq not only has a severe shortage of jobs, it also has a growing number of job-seekers. As much as 51 percent of the Iraqi labor force is either unemployed or underemployed; the number is even higher for young workers. For three decades, the Iraqi government has been the primary source of employment. Almost half of the country's labor force is paid by the government from its revenues from petroleum exports. With the exception of agriculture, legitimate private-sector employment is small — by my calculations, about 6 percent of the labor force. Most of the remainder of the Iraqi labor force is either unemployed or working in the underground economy.

In 2008, the sharp rise in oil revenues and improved security led to an economic boom. The government created more than enough new public sector jobs to absorb the approximately 250,000 young people who enter the work force every year.

However, this economic surge was short-lived. After oil prices dropped by almost \$100 a barrel earlier this year, the government imposed a hiring freeze and unemployment began to rise.

Unfortunately, there is nowhere for these job-seekers to go. Iraq's private sector is unable to employ many of the jobless because the country has one of the most hostile business regulatory environments in the world. (Of the 183 countries ranked by the World Bank for the "ease of doing business," Iraq is 153rd.) In Iraq, it is hard to legally start a business, get credit or trade internationally. As a result, most private businesses either hide in the underground economy — with all of the associated inefficiencies — or accept the necessity of bribing an unending stream of government officials.

This is not sustainable. In 2010, the Iraqi government will hit the wall. A combination of low oil prices, exhausted cash reserves and the expense of paying for a bloated government sector will prevent the creation of public sector jobs. And the private sector, as it continues to struggle with excessive regulation and corruption, is unlikely to create more than a fraction of the needed employment. Rapid growth in the number of unemployed young men will likely follow — and these young men will be attractive recruits for political insurgents, fundamentalist terrorist groups and criminal gangs. Increased instability is almost certain.

There is another path. The potential for private sector job growth in Iraq is great. The country is blessed with a strong entrepreneurial tradition, a relatively well-educated labor force and a natural resource more valued in the Middle East than oil: water. Only Iraq and Turkey have sufficient water for large-scale agribusiness, and Iraq is surrounded by wealthy countries that need to import food. But to exploit these advantages, Iraq needs to make important changes. And it should start by rationalizing its commercial code.

The chief problems in Iraq's commercial code are its incredible complexity, long delays in processing requests for licenses and high cost. For example, registering a new business in Iraq costs almost \$2,800 compared to \$139 in Delaware. (However, a group of Iraqi businessmen assured me that if \$600 in cash was given to the right person, a license would be available immediately and no further fees would be required.)

The country could simply throw out its current commercial code and adopt a less restrictive, regionally acceptable one — like Saudi Arabia's. Or, more realistically, it could make its code more user-friendly by, say, allowing business owners to work with one ministry — as opposed to a dozen.

The government could take other steps, too. With the exception of tax collection and international trade regulations, responsibility for regulating private businesses could be taken from the Baghdad ministries and delegated to the country's 18 provinces. Encouraging the provinces to compete for private-sector jobs would lead to friendlier regulatory environments around the country — just as it has in the United States.

But whatever is decided, the government of Iraq is running out of time. It must either end its hostility toward private businesses — or accept that a sharply growing mass of unemployed will nullify the progress of the last three years.

Frank R. Gunter, an associate professor of economics at Lehigh University, was the senior civilian economics adviser to the Multinational Corps in Iraq from 2008 to 2009.