HAS A NEW POLITICAL ERA CHANGED IRAQI ECONOMY?

CHALLENGES FOR A LATE RENTIER STATE

Master of Arts in Law and Diplomacy Thesis

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ABSTRACT

This thesis has the objective of attempting to emphasize the need to establish new development channels for the Iraqi economy other than oil. This diversification can work to integrate all social segments of the population into a new post-conflict economy. I will argue that development of non-oil industries will encourage the private sector to become more involved in the development process of the country and also equip Iraq with social and political values of modern democracies.

In this regard, this work will provide a theoretical framework for discussing Iraq's socio-economic and political developments, and also elaborate on opportunities and constraints of a new economical approach in Iraq.

This thesis will examine the legacy of Iraq's long-term decline, offer potential explanations for the country's current situation, and suggest a future path of economic development that aims at diversification of economic activities and the development of non-oil industries that can move the country to a sustainable economic growth path.

KEYWORDS: Iraq, Iraqi Economy, Middle East, Oil, Rentier State, Ownership, Private Property,

I. INTRODUCTION

Since its emergence as a republic in 1920, the Iraqi state has been struggling to consolidate its power and centralize its authority over the diverse populace that falls under the rubric "the Iraqi people.[1]" Since the US invasion of 2003, the struggle for power has entered a new heightened period, and the Iraqi people have encountered the opportunity to control their own political and economic destiny. For years, economic sanctions, international isolation, and strict repressive policies had a huge impact on weakening the state. Ghani and Lockhart argue that, "a state is failing if it is not able to provide public goods to its citizens and suffers from weak governance, internal violence, social upheavals and economic and political instability" (Ghani and Lockhart 2008, 3). In this regard, Iraq has been dysfunctional because of its failure to deliver the core functions of a state and its prolonged political and economic instability.

However, most economic and political analysts maintain a high level of optimism regarding Iraq's future. With its substantial oil reserves, Iraq possesses the underlining means to spur considerable economic growth. Analysts argue the adaptation of proper political reforms and judicial allocation of oil income can help stimulate the modernization of key elements in the country (economy, health, education, etc.) and expansion the country's energy infrastructure. According to these analysts, the slow growth of Iraq's economy can be improved through more effective management of its large reserves of oil and natural gas.

This thesis intends to challenge this argument by arguing that an economy that totally relies on the revenue-generating ability of a single commodity is an ineffective long-term solution for integrating Iraq to world economy. Slow economic growth, which was been caused by an

[1] Arab Shi'ites are currently the majority in Iraq, comprising between 55 to 60% of the population; Kurdish (Sunni and Shia) are estimated to comprise 20% and Arab Sunnis 20% of the total population. Turkmen, Chaldeans, and Assyrian Christians are oter notable ethnic and religious groups in the country.

undiversified economy, has led to pervasive unemployment and a near-impotent middle class, threatening the future of the country. As the last elections in 2010 also showed, a continued stagnant economy will have the potential to trigger social and political upheaval in Iraq.

After the "Arab Spring" in the early months of 2011, it has become clear that a state's economic performance will determine the fate of Middle Eastern states. As the first Shia Arab state and second largest oil state in the world, Iraq has a significant place in regional and international politics. The strategic geographical location of Iraq also bolsters its importance as a key actor in international energy politics. After 2003, the US, Britain, China, Turkey, Japan, India and many other countries initiated strategies to align with Iraq in order to secure their petro-energy supplies and expressed their willingness to invest in the Iraqi energy sector. Iraq has the potential to meet the natural gas demands of the European Union (EU) as an alternative to Iran and Russia. In this context, it is clear that Iraq is a very important situation to analyze. It is also important to question why Iraq's economy has yet to attain stability and growth despite the intense development activities initiated after the 2003 invasion and overthrow of Saddam Hussein.

The reasons behind Iraq's stagnant economy and failed state are indeed complex. Nonetheless, the country's low economic performance can be explained in great part by rentier state theory and the theory of the "natural resource curse." The theory, in its broadest sense, defines rentier states as those countries that receive on a regular basis substantial amounts of external economic rent "from a single or very few natural resources" (Yates 1996, 11). Under this structure, rents are generated and accumulated through the exploitation of natural resources, and economic activity does not rely on investment, manufacturing and production activities. Since these rentier states depend on only one commodity, they are disproportionately vulnerable to changes in demand or changes in prices of that commodity.

Iraq can be considered a rentier state, as its economy heavily depends on one commodity – oil – as its chief export. This thesis will test the argument that the economic future of the Iraqi state will be greatly determined by whether it can escape its current rentier characteristic, which disproportionately relies on oil income. Dependency on a natural resource as the primary revenue hampers the development of the country since the vast amount of labor is not involved in the production process and the main non-petroleum industries in the economy have little incentive to further develop and increase their competitiveness at home or worldwide. I will further argue that, because of its rentier character traits, the Iraqi state still does not encourage private sector entrepreneurship.

In this context, I will seek out the ways in which Iraq can develop and an alternative to the rentier system and argue that by diversifying its economy the Iraqi government will help the overall recovery of the Iraqi state. I will posit that a strong emphasis on encouraging private ownership and a clear definition of property rights will strengthen the consolidation and growth of the Iraqi economy over time.

In order to test the validity of the hypothesis and contribute to a better understanding of the problem, this thesis will have four chapters. In the first chapter, I will elaborate on the theory of the rentier state and the natural resource "curse", and portray the relationship between abundant natural resources and slow economic growth. This chapter also will put a special emphasis on the relationships between rentier state and institutional development with special reference to the development of property rights.

In the second chapter, I will give a brief picture of Iraqi society and politics since its independence in 1920. It is unquestioned that the relationship between state and society will have a significant impact on how the structure of the economy is defined. The involvement of society in state decisions also will imply strong hints about development of the private activities in the economy.

In the third chapter, I will analyze the economic history of Iraq and question the impact of "natural resource curse" on Iraq's economic performance. After introducing the theory of rentier state and outlining the characteristics of political history and society, I will focus on the Iraqi economy and elaborate on the transitions and define the main actors.

In the last chapter, I will outline the challenges the Iraqi economy faces and try to define effective measures to improve and diversify the Iraqi economy. This chapter will explore a future path of economic development that aims at diversification of economic activities and the development non-oil industries that can move the country to a path of sustainable economic growth.

Overall, this thesis will concentrate on the need to establish new development channels in order to integrate diverse social segments of the population and to more evenly distribute the wealth. I will argue that development of non-oil industries will encourage the private sector to become more involved in the development process of the social and political values of modern democracies.

II. THEORETICAL BACKGROUND

After the discovery of oil in Iraq in 1927, the Iraqi economy has relied heavily on substantial oil revenues. Since then, the Iraqi economy has not developed diverse sources of agricultural and industrial production and has not concentrated its efforts on producing internationally competitive export commodities outside the realm of the petroleum industry. On top of this development, the enormous revenues generated from the oil industry were never efficiently and effectively re-invested in a diversification of Iraq's emerging civil society.

After the 2003 invasion, it became clear that the revenue from the oil production mainly benefitted the authoritarian Ba'ath regime and not Iraqi society at large and that the discovery of oil developed into more of a curse than a blessing for the country.

This chapter intends to provide a theoretical framework for the rentier economy and to demonstrate how the growth of an oil based economy stunted the political and social development of Iraq.

2.1. Rentier Economy

In accordance with the predictions of Karl (1997) and other scholars, over half a century massive oil revenues in Iraq became the only source for public investment, and the process created a culture of an inefficient employment in public services and other activities. This hindered the growth of the private sector and made it substantially harder for the Iraqi economy to diversify away from oil.

Iraq is quite rich in oil and gas deposits, yet it has a very low level of per capita income for most Iraqis. Perhaps most damaging to internal economic development was the impact of three devastating wars over the past thirty years. Like most oil producing countries, a large proportion of Iraq's income is not derived from the raw production done inside the economy, but from the sale of oil and gas. Thus any decline of oil prices is a major threat to Iraq's economic stability. This has a major impact on the non-oil economic sectors because it inhibits careful planning and increases mismanagement in a modern sense of an agricultural sector that is poorly protected by the Rule of Law where property rights are concerned. In this chapter I will outline the theoretical background concepts of the rentier state and discuss how this model hinders the development of private property, institutions and the associated wealth creation in rentier states.

The studies on the theory on rentier states have mainly focused on two dimensions. The first links natural resource abundance with a negative or slow economic growth and implies that the natural resource abundance, with "unearned wealth effect" is a major reason for poor economic development (Sachs & Warner, 1997: 2). The second contends there is a correlation between authoritarianism and rentierism, and the natural resource curse hinders the transition to democracy (Ross, 2001: 357). In this chapter, I will concentrate on economic side of the theory.

2.1.1. Definition

A rentier state is defined as a state that is highly dependent on the external rents produced by a particular economic sector, typically a low-value added industry based on a natural resource. The theory of rentier state was first introduced in Mahdavi's article (1970) the Republic Iran and the concept has then become a primary tool to understand Middle Eastern states in particular. The theory in its broadest sense defines rentier states as those countries that receive on a regular basis substantial amounts of external economic rent (Yates 1996, 11). In this structure, a rentier state is characterized by earning more than 40% of export income from the sale of natural resource. This incomes encourages one-crop economy.

To extend the definition, Beblawi described three characteristics that he should be in attendance in order for an economy to be characterized as being rentier: one, that rents are not the only kind of income collected in the country, but that the rents collected should be predominate, and make up a large share of the country's GDP; two, that the origin of the rent must be external to the economy (export income); and three, that a minority in the population must be engaged in the generation of the rent while the majority is involved in only the distribution or utilization of the rent (Beblawi 1987, 12)".

As Anderson defined, a 'rentier state' is one 'that [is] reliant not on [the] extraction of the domestic population's surplus production, but on externally generated revenues, or rents, such as those derived from oil (Anderson 1990, 61)."

From this perspective, in a rentier economy the income generated from the natural resource dominates and dictates the distribution of national income, and thus rentiers (the organizations and/or individuals) have a disproportionately significant political influence. Since the rent for the natural resource (commodity) contributes a high percentage of the rentier state's GDP, a rentier state generally lacks a productive outlook because it is subject to the whims of the international pricing of the commodity, not its own competitiveness.

Luciani contends that rentier state theory has three broad assumptions: one, economic realities determine total state resources; two, predominant production processes determine the political parameters of the state (the degree of centralization and tendency toward authoritarianism); and three, the nature of resources influences the basic rules of political life (Luciani 1990, 63).

The rentier characteristics of a state define its economic and political development. As Karl argues “the economies and politics of countries dependent on oil are rapidly and relentlessly shaped by the influx of petrodollars in a manner that sets them apart from other states (Karl 1999, 34)”.

2.1.2. Political Implications

In the literature, the rentier state has attracted criticism in political and economic arenas. Mahdavi describes rentier state as an institution with rich oil reserves that tends to become autonomous from their societies, unaccountable to their citizens and autocratic” (Mahdavi 1970) because the head of state and the government in these countries “own” (control) the natural resources and therefore do not necessarily need to levy taxes. [A]s long as the domestic economy is not tapped to raise further income through domestic taxation, the strengthening of the domestic economy is not reflected in the income of the state, and is therefore not a precondition for the existence and expansion of the state. …For rentier states that depend mainly on income from abroad, allocation is the main relationship that they have with their domestic economy; all others [i.e. extractive states] ride their domestic economies (Luciani 1990, 71-72).

In addition, when a rentier state does not tax its citizens, a key basis of representational democracy is absent, and therefore the rentier states can never become fully consolidated democracies. In contrast, these states quickly become authoritarian (Ross, 2001, 356-357). O’Donnell (1996, 38) describes a consolidated democracy as one where power is alternated between rivals, support for the political system is continued during economic hardship, rebels are defeated and punished, the regime remains stable in the face of restructuring of the party system, and an environment where their exists no significant political anti-system". One can therefore view these special traits of a rentier state as reasons why democracy and its associated vibrant economy are conspicuously absent the political economies of nations heavily dependent on raw material extractions. .

For Karl (1996), rentier states suffer from poor governance because state officials can use resource rents handle social and political difficulties rather than creating mechanisms to accommodate internal problems. He argues that fiscal reliance on petro-dollars as a political tool weakens the state and in the long run creates political instability. This political instability in oil producing states in the Middle East is indeed related to society's feeling that oil production by the state puts too much power in the hands of a few people who act mainly to defend the political elite rather than to serve the interests of the society.

Alahmad also argues that as the single owner and distributer of the revenues, the rentier state may "buy political consent through populist policies and patronage relations, which then may result in "creating a de-link between state and society and relieves the state from societal pressures, especially those that demand democratization (Alahmad 2007, 587)".

Most of the work on rentier economies goes on to link the abundance of natural resources to corruption and authoritarianism. According to many academics, the ruling elites in the rentier state utilize the natural resource income to control internal politics and to placate any negative effects on the stability at the state and society (Luciani, 1987: 7; Karl, 1997: 21–22). Yet the means to avert harmful societal effects are only effective in the short term, and problems rear up because the general population has little say in how or on what the natural resource rents are utilized. This is simply because the political systems in the vast majority of rentier economies are by no means democratic. In fact, many scholars point out that democracy has an extremely difficult time establishing a lasting foothold in rentier economies (Ross, 2001; Jensen and Wantechekon, 2004; Tsui, 2005).

The literature which links the renterism to autocracy has three explanations. Rose summarizes these as follows: First, because rentier governments accumulate sufficient revenues from the exports of gas and oil, they do not need to tax their population, and will tend to become less responsible towards the people and also the people will be less interested to demand accountability from the government (taxation effect). Second, oil wealth may prompt the governments to huge spending on state apparatus (military etc.) and patronage, which may create hidden pressure for democratization (spending effect). Third, the government with plenty of resources and as the only distributor of the wealth and prosperity will use its power to prevent the formation of social or political groups that are independent of the state and hence that may be inclined to demand political rights (group formation'' effect) (Ross 2001, 322-334).

According to Yates, in rentier states "income and wealth are seen as situational or accidental, rather than as the end result of a long process of systematic and organized production (Yates 1996, 22)". He contends that in a rentier state, "the lucrative government contracts are given to people or companies as an expression of gratitude and near-filial support rather than a reflection of economic rationale or merit (competitive advantages); in addition, civil servants see their principal duty as being government functionaries with significant power who are only available in their offices during working hours; businessmen, unable to compete in an economically rational sense, abandon their industry of choice and enter into real estate speculation or other special situations associated with a booming oil sector; in effect, the best and brightest will abandon business and seek out lucrative (as the corruption level is heighten) government employment" (Yates 1996, 22).

In rentier states, Yates argues, there is no incentive for a rentier class to promote democratic reforms as this class has a vested interest in continuation of the status quo" (Yates 1996, p. 35). And in order to maintain the status quo, rentier states generally invest on strengthening the state's coercive mechanisms: the army, police, and intelligence services. Karl also says rulers in rentier states have no incentive to adopt efficient and cautious policies and have "no reason to decentralize power to other stakeholders (Karl 1999, 37)". It can be argued that the rulers don't recognize the value of intense deployment of the factors of production to generate wealth.

2.1.3. Economic Implications

As stated earlier, there are three negative characteristics of a rentier economy and we'll add one more that is crucial to economic prosperity; the government is the main recipient of the external rent and this delivers a massive amount of power and influence to the ruling elite (Beblawi 1987, 51-52).

In the 1980s, the arguments defining natural resources as a curse and assuming a strong link between resource abundance and negative economic growth spread; some scholars call it "resource curse" (Sachs & Warner 1995), some others named it the "paradox of plenty" (Karl, 1997).

Sachs & Warner (1995) find that dependence on oil and mineral deposits as a primary form of national income reduces growth rates, and that the economies of the Gulf States contracted between 1970 and 1989, even though the price of oil skyrocketed (when adjusted for inflation). According to Ross (1999) the paradox of plenty occurs when "appreciation of a state's real exchange rate caused by the sharp rise in exports with a tendency of a booming resource sector to draw capital and labor away from a country's manufacturing and agricultural sectors, raising their production costs." He argues [selling the natural resource, this case oil, on the international market] is the only way for these countries to earn foreign currency (to buy the goods and services that economy doesn't produce itself and/or needs). In most cases, since the revenue generated by the exploitation of the natural resource is not accompanied by a sound monetary policy, these earnings cause the appreciation of the domestic currency. Currency appreciation (e.g. inflation) hampers the growth of domestic export business and conversely makes imports cheaper. Therefore, the manufacturing sector in the rentier state economy cannot progress since the international competitiveness of the export sectors of the economy declines and unfortunately imported products gradually dominate then replace domestic production (Ross 1999, 306).

Robinson and Verdier (2002) argue that public sector employment is a credible way of transferring rents to political supporters, and Keefer (2002) points out how this activity goes along with a clientelism that results from repeated face-to-face exchanges between the regime and its clients (Robinson and Tovrik 2005, 202).

Chaudhry argues that the rulers of the rentier states viewed the free market as politically dangerous, since 'a functioning market provides opportunities for mobility that undercut lineages and traditional rights of privileges, thus threatening the status quo. Market creates inequalities in wealth that may not match existing patterns of income distribution, status, power and entitlements; they dislocate groups in both the political and economic realms' (1994: 4).

Therefore, the greater economic implications for the rentier economy are high unemployment, high inflation, low wage growth, corrupted bureaucracy and poor accumulation of foreign social, human and physical capital. Real wages and real income typically cannot be improved by traditional methods available in more balanced economies (education, entrepreneurial activities, etc.), and as a result human capital is poorly developed in relation to other countries. In addition, GDP growth is a reflection of commodity prices and international demand for the natural resource, not the competitive abilities of the companies and labor force. The governments of rentier states allocate the limited monetary resources that would normally go to improving human capital and infrastructure to non-productive activities (military spending, benefits for certain elites, etc.), and this wasteful spending also results in a degraded standard of living for the citizens.

2.2. Rentierism, Institutions and Ownership

Another damaging result of rentierism is how key socio-political institutions essentially become feeble extensions of a state that fails to adequately protect the average citizen, establish and enforce crucial property rights and mete out the appropriate due process.

Democracy is no easy form of government to establish and then effectively maintain. Linz and Stepan (1996, 16) claim that there must be at least the following five conditions in place and acting properly for democracy to continue flourishing; one, that the necessary conditions have to be in place to encourage a free and lively civil society; two, there should be a dynamic and open political society; three, the state and all of its actors are not about the law; four, a functioning bureaucracy exits, and five, there is an institutionalized economic system.

Institutions are the cornerstone of the state's equal allotment of potential economic power to the citizens, and the main institution for equal allotment is the democratic process and the associated institutions that enable this governing style to work. It is clear that the natural resource rents on how that money is distributed allows the ruling elites to restrict or even avoid pressure for democratization. The elites in the "rentier state must still be politically responsive, yet not democratic, to a core set of societal needs and values. The state must balance repression and cooptation – a rentier does not have unlimited repressive ability, whatever its financial capacity – and especially, if it is to survive, a rentier state must be adaptable to the changes brought by globalization and must provide opportunity and employment through economic diversification" (Gray, 2010).

According to North, institutions that have humanly-devised constraints imposed on human interaction and consist of formal rules (rules, laws, constitutions, regulations), informal constraints (norms of behavior, conventions, and self imposed codes of conduct) and have the enforcement characteristics of both.

Institutions affect economic performance by determining transaction and production costs. North argues that if institutions are "the rules of the game", organizations are "the players." They come into existence with the engagement of groups of individuals (entrepreneurs). The constraints imposed by the institutional framework (together with the other constraints) define the opportunity set, and therefore the kind of organizations that will come into existence. The function of the organization will be to engage in productive activities and acquire skills for its players that will enhance its power in competition. It will be a process where organizations invest in acquiring skills and knowledge, and also to induce public investment in the kind of knowledge that they believe will enhance their survival prospects. It is because competition will force players on the market to engage in learning, acquiring skills to survive. North contends the degree of competition can change and vary, and that intense competition will provide more incentives to learn.

According to North, organizations will be willing to change only after assessing the perceived costs of altering the institutional framework. Time is a determining factor for the magnitude of transaction costs. He argues that only under the conditions of costless bargaining will players reach a deal without institutional arrangements. When it is costly to transact, then institutions matter; and oil production is costly to transact. North argues transaction costs are the costs of specifying what is being exchanged and of enforcing the consequent agreements. In his understanding, the firms/institutions exist in order to reduce transaction costs, and low-cost transacting in the markets is essential for productive economies. Competition also plays a critical role in reducing enforcement costs. He argues that creating economic institutions, undergirded by appropriate political institutions, is the only way to alter the benefit/cost ratios in favor of cooperation.

Most theoretical literature on rentierism agrees that the natural resource curse transforms politics and the economy through institutions (which are easily subject to corruption) and that rentier characteristics also hinder the development of the institutional capacity of states. Hartford and Klein argues that the most problematic impact of rentier state is seen in institutional development. Natural resource exports can damage institutions indirectly—"by removing incentives to reform, to improve infrastructure, or to even establish a well-functioning tax bureaucracy—as well as directly—by provoking a fight to control resource rents (Hartford and Klein, 2005)".

Torvik summarizes five different explanations behind the question why rentier states failed to rapidly develop modern economies. He concludes that since rentier states tend to overspend resource income, they have low saving rates. Second, he argues that because resource abundant countries do not need to have the consent of people, they mostly have a presidential system which implies "less rent extraction by politicians, a smaller public sector, and public spending targeted toward powerful minorities, rather than broad spending programs. Third, in these states institutional quality is poor, since the system mainly is based on natural resources that may encourage rent-seeking and non-productive activities, in turn creating negative externalities for the rest of the economy and ineffective or harmful institutions. In these countries, there is poor protection of property rights and corruption guided by institutions hinders the development of economy. Fourth, he asserts that the type of natural resource may affect the growth of economy and if the primary commodity is oil and institutions are ineffective and harmful, a stronger negative growth effect will be expected. Fifth, most of rentier states are among the countries that completed their industrialization very late and through technology transfer not organic development.

Mehlum, Moene and Torvik (2002) construct a model with two sectors: a "grabbing" sector and a "productive" sector and tries to explain the reasons behind the different economic experiences among rentier states. They say there may exist resource abundant countries with high economic growth and poor economic growth and assert that the main reason for these diverging experiences is the difference in the quality of institutions. More natural resources push total income down, when institutions are grabber-friendly, while more resources raise income when institutions are producer-friendly. While resource abundance can be a blessing for countries with good institutions, it is most certainly a curse for countries with [poor, ineffectual, inept and unfit] institutions. (Mehlum, Moene and Torvik 2006, 1-3, 17).

Karl attributes much place on the importance of oil wealth over institutional effectiveness. She argues that oil wealth molds institutions dramatically …especially if petroleum exploitation coincides with modern state-building. Karl contends, "where this historical coincidence occurs, petro-states become marked by especially skewed institutional capacities. The initial bargaining between foreign companies anxious to secure new sources from crude and local rulers eager to cement their own powerbase – whatever their mutual benefits – leaves a legacy of overly-centralized political power, strong networks of complicity between public and private sector actors, highly uneven mineral-based development subsidized by oil rents and the replacement of domestic tax revenues and other sources of earned income by petrodollars. In effect, this alters the frameworks for decision-making in a manner that further encourages and reinforces these initial [negative] patterns, producing a vicious cycle of negative development outcomes (Karl 1999, 34)".

While the exact definition of "institutional quality" is open to debate, most economists agree that it refers to the rules of the game, and that it is an important driver of economic development and growth (e.g. Easterly and Levine 2003, Rodrik et al. 2004). Regardless of how one defines the quality of an institution, rentier states uniformly have poorer institutions because the "state also need not concern itself with domestic bases of support, or legitimacy, either: the population is ‘bought off’, with democratic input sold to the state in exchange for a share of the rental wealth, and those who do not accept this ‘rentier bargain’ are subdued by the strong repressive apparatus purchased with rents (Gray, 2010). In rentier states, the absence of democratic processes and institutions is an outcome of rentierism (Crystal 1990; Luciani 1990; Sandbakken 2006), although there may be the scope for a fiscal crisis to create an impetus for political reform and democratization (Luciani 1994) On a more base level, rentier states don’t adequately provide the basic services for the citizens, embracing a culture where the misallocation of wealth, corruption (in for the form of graft payments for what would be considered expected operational behavior and activities in a Western economy), waste, and inefficiency through punishingly oppressive bureaucracies is the norm.

Askari notes that rentier states have suffered, from lack of adequate and effective institutions. He argues effective institutions may reduce the uncertainties and ambiguities, and enhances coordination in interaction by enhancing predictability. He asserts that the existence of effective institutions (which are materialized through constitutions, laws, and rules, written rules, codes, and agreements and commonly shared beliefs and social norms) secures a higher the degree of compliance, the more stable the social order and the lower the transaction costs in the society (Askari 2009, 413)

Individual property rights are critical for the development of a modern economy, and while many of the elites of rentier states have many of the benefits of the current modern age, the absence of effective and enforceable property rights prevents the general population from thoroughly embracing modern accoutrements. North says the quality of institutions is closely linked to existence polities, which enforce clear and efficient property rights. In his theory, economic growth is possible in the short run with autocratic regimes, but in the long run it is only possible with the development of the rule of law. Secure property rights are, after all, the foundation of market economies. Without them, markets cannot provide incentives for investment and innovation. Furthermore, several of the pathologies of the [rentier state and its elites], including asset stripping, political lobbying, and private enforcement, are all related to weak property rights (Barnes 2007, 48).

Barnes further goes on to point out that the essence of strong, transparent property rights is what fosters investment and economic growth, and yet "a central analytical problem, however, is identifying strong property rights independent of the outcomes they are supposed to cause. If, during one period, investment occurs and no major companies change hands by nefarious means, then the rules of ownership must have been strong and well enforced. If, by contrast, asset stripping takes place or a company falls to a politically connected rival, then property rights were not as sturdy as previously thought. That is, weak property rights may lead to asset stripping, yet it is the existence of asset stripping which indicates weak property rights (Barnes 2007, 49).

Rentierism deposits so much power in the hands of the elites that they fail to see the need to pressure the regime to update, reform or implement the necessary property rights that will stimulate growth, or empower the federal, state and local institutions that establish and enforce secure property rights, and this lack of faith in the institutions by the would-be business class undermines its morale and castrates its attempts to create individual wealth. The elites in a rentier state generate a certain large amount of non-productive economic activity as they seek to improve their standings vis-à-vis the elites of other countries, particularly other regional/neighboring rentier states, yet this fails to instill a continuous flow of economic activity because the intended market is so small (the rich can only buy so much materialistic items).

Coase contends that firms have contractual means of reducing transactions costs. "The firm" is created to rationalize production activities in favor of effective and efficient production. The decisions of firms are made through a rational process. In this regard, firms calculate the marginal costs and benefits of internalizing of goods and services. If the market is not efficient, firms have to internalize many functions into the firm. Then he focuses on the problem of social costs and asks how can societies solve the problem of high social costs (pollution, shortage of clean water, etc.). There is a social cost and missing market for solving the problems. He concludes the only solution is to create a market for efficient use of natural resources. This solution has two preconditions: 1) property rights should be clearly specified (a clear assignment of property issues) and 2) transaction costs should be low or ideally zero. He contends that if these two conditions are met and redistribution does not affect marginal values: The allocation of resources will be the same, regardless of the allocation of legal rights and the allocation will be efficient, so there is no problem of externality.

Through ineffective institutions, rentier economy hinders the development of property rights in an economy. In the rentier economy, the state is the single major determinant of property relations and controls the limits of competitive powers. As Ayyubi argues, enjoying unquestioning authority, the rentier state may have the power “to create new classes and/or to dismantle and reassemble existing ones (Ayyubi 1995, 228)”. Or they might delay the arrival of a new class.

In Hodler (2006), the economy is comprised of rival groups that allocate their endowments between a productive sector and a rent-appropriation sector. Unlike Robinson, Torvik and Verdier (2003), his institutional variable (property rights) is endogenous and depends on the level of rent-appropriation activity. However, in Hodler (2006), a necessary condition for natural resources to have any corrupting effect is for the country in question to be fractionalized by rival groups.

Acemoglu and Johnson (2003) suggest the primacy of political institutions. They contrast two sets of institutions: 'contractual institutions' (technologies for enforcing private contracts) vs 'property right institutions' (technologies for avoiding expropriation of private property by the government or other private parties). They show that 'property rights institutions' seem to be fundamental determinants of output and investment, while 'contractual institutions' are of secondary importance (Tabellini 2005, 287). They interpret this finding as suggesting that investors cannot really escape the threat of government expropriation, while private transactions can be structured to overcome the deficiencies of the judiciary.

In this regard, if combined with ill-defined or unclear property rights, imperfect or missing markets and weak institutions, rentier states may trigger the destruction of the economy by diverting economic resources away from more beneficial economic activities and hindering the diversification of the economy (Gylfason 2007; Auty, 2001; Gelb, 1988), and conversely plowing money into wasteful, non-economic expenditures (military, etc).

According to Gray, the impact of globalization and the need to respond to it has altered what it means to be a rentier state; rentierism's character and context have transformed to address a maturing state's economic and development imperatives, policies, population growth and employment pressures, and classical rentierism has become more sophisticated as the state has matured, and as new external threats emerge parallel to the rents that are created or sustained the existing state for so long. In this new era, globalization has forced rentier states to develop new political, social and economic responses (Gray 2010, 2-4).

In this regard, Gray underlines the need to redefine rentierism with respect to the impact of globalization. Globalization has had an enormous impact on the transformation of Iraq and other Middle Eastern countries. The intense development of technology, business and communication channels weakened national borders. This development has intensified social relations worldwide through new communication methods and transportation channels that have also gave birth to a new political and social environment in Middle East countries. New communication technologies (TV, the Internet and social media etc.) have increased the dissemination of information and ideas that have sparked questions regarding the validity of authoritarian regimes that lack transparency. The Arab Spring has been an outcome of this transformation.

These post-1980 changes have created new trans-national spaces that simultaneously accommodated the old and new social and cultural developments. These new global spaces produced new wealthy populations, but also created disadvantaged populations, vast criminal organizations and violent political movements.

Trade liberalization, the free flow of private capital, new communication channels across nation-state borders, characteristics of markets and commercial forces, education opportunities, population growth and extensive unemployment put new, incessant pressures on rentier states. According to Gray, there have been five characteristics of the late-stage rentier state:

First, it is non-democratic, but may allow some pluralism, and is always more responsive than classical rentier state theory would argue. He argues that late rentier states have moderated their approach to political pluralization and now they have acknowledged the need to appear open to change, responsive to the views and ambitions of society, and (moderately) consultative about the more important decisions that [society] takes (Gray 2010, 5).

Second, Gray contends that the new rentier states are open to globalization, not closed, but are still protectionist in many ways. He says that new rentier states are more open to the outcomes of globalization, which can be seen in their economic openness in recent years under the framework of integrating into the World Trade Organization (WTO); their openness to Western lifestyle, culture and tourism; their efforts to implement reforms in education and their cooperation with new media technologies. Even if it is still controlled, late rentier states are more open to embrace the developments of globalization (Gray 2010, 5).

Third, Gray notes that the new rentier states not only have an economic policy, they have a development policy too – but not a development model. He argues that Unlike rentier states of the past, the late-stage rentier actually has an economic and development policy. However, while the late-stage rentier state has development policies, it does not have a single, viable development model. Despite having undertaken some market reforms, it is by no stretch of the word neo-liberal and it tries to be a mix of the several development models: Islamist, neo-liberal, consistent with the post-Washington consensus, state capitalist, etc. (Gray 2010, 7).

Fourth, the new rentier state is state capitalist, whatever development policies it adopts. Gray says that new rentier states allow market-price mechanisms to operate, and the private sector to play a controlled role in the economy, but the state is a key actor in the economy and owner of the means of production. In other words, there are a business-friendly policies, but within a state capitalist framework – with the state controlling key firms and sectors, and it is informally influential in the upper levels across the private sector. Oil & gas companies and their assets are state-owned, but they function more professionally and efficiently than those in the past.

Fifth, the late rentier states are cognizant of long-term imperatives and threats. Gray argues that In order to mitigate the negative impacts of price declines in oil and prevent rent fluctuations, new rentier states have developed new tools for the long-term survival and (political) prosperity of the regime. A managed diversification and partial-marketization of some economic sectors, creating sovereign wealth funds (SWFs), etc.) (Gray 2010, 8).

Before analyzing economy of Iraq, the next chapter will briefly outline political history of the Iraqi state.

III. A BRIEF HISTORY OF IRAQ

The history of Southwest Asia covers the region's political growth and independence from colonialism to the nation-state era and eventually follows the region on the next path of development based on the power of global forces. Thus, this thesis argues that Iraq is a symbolic focal point of this transition, from national to global and its experience should be analyzed comprehensively and specifically detailing the elaborate complexity of the social, political and cultural structure of the country in a globalizing context.

After the collapse of Ottoman Empire in the waning days of WWI, Southwest Asia witnessed a series of major political and economic changes that reshaped the region. The disintegration of the notion of "Empire," the failure of Islamic polity, the redistricting of the region at the hands of the

British and French colonial powers, and the Ottomanist world-view paved the way for the quest for new ideological and political ideas for the Middle East.

For the Gulf states, the assumption of independence occurred after the end of World War l. Unfortunately, the national boundaries and institution did not emerge through internal developments, but through deemed-at-the-time benevolent actions by the Great Powers that emerged victorious after WWI. Since the very concept of national politics required a dramatic reorganization and re-education of Arab society, the institutionalization of the nation state produced and is still producing major political upheavals. As with the other states in the region, Iraq also experienced this tumultuous transition.

From 1534 to 1917, Ottoman Empire ruled over the territory that is now Iraq. Ottoman rule in Iraq was generally based on alliances with notable and prominent Sunni Muslim families. British involvement in India in the late eighteenth century increased the importance of Iraq, and by the middle of the nineteenth century Iraq had become a British sphere of interest (Wiley 1992, 14).

World War I brought profound changes to the region that would eventually become Iraq. As soon as the war began, the British invaded Iraq from the south. In 1920, at San Remo, Iraq was declared a British mandate. At the very beginning of the British rule, Iraqi Muslims steadfastly declared their refusal to be governed by a non-Muslim authority. In Karbala, Ayatollah al-Shirazi issued a fatwa declaring that to serve in the British administration was unlawful and "none but Muslims have any right to rule over Muslims" (Tripp 2000, 41; Braude 2003, 33). It is significant to point out that the initial resistance to the formal Iraqi state and its British-installed ruler was "symptomatic of the clergy's general inclination to stand on the side of 'Islam' against 'the infidels" (Sluglett 1993, 86). With its anti-imperialist character, the rebellion also "became enshrined in the Iraqi national mythology as the first symbol of the Iraqi rejection of foreign rule" (Cleveland 2004, 205).

Inspired by British sentiments and encouraged by ulama's fatwa, revolts against the British started and spread to all corners of Iraq. The British managed to regain the control in the region three months later at the end of October 1920. During the revolt, which lasted three months, Iraqi losses were over 6,000 casualties and the British lost around 500 lives (Tripp 2000, 44).

According to Tripp, there were four main reasons for the revolt: "the failure of the British to deliver on their wartime promises of self-determination; Shia dissent; the political-economic insecurities of tribal sheiks and former-Ottoman bureaucrats; and the overall lack of British troops on the ground, which allowed the revolt to gain momentum and spread" (Tripp 2000, 44).

Reconsidering the view of its direct role, the huge cost of the revolt spurred the British to form a more acceptable [to the Muslim population] form of government. This change in British thinking opened the way to establish an Arab government ruled by Faisal, the son of Sherif Hussain of Arabia. Additionally, the British tried to legitimize Faisal's rule by holding a national referendum in Iraq, in which 96 percent of the population supported his rule (Cleveland 2004, 207).

Although only democratic in appearance, the each Arab minister in the new cabinet had a British advisor and all members of new government were warned to recognize British rights in Iraq (Marr 1985, 34; Wiley 1992, 17).

In the first years of Faisal's reign, the secular Arab nationalist views, which were formulated by Sati al-Husri, started to dominate the Iraqi state ideology. As an ideological means for the state, government schools promoted a national identity based on common language rather than religion or race. Religious groups, largely Shias, under pressure of secular Arab nationalism, chose to keep the government school out of their areas and continued to follow the traditional religious education in their regions given by local Imams or Hodjas (Wiley 1992, 18).

The late 1940s and 1950s were a time of profound socioeconomic and political change for the Iraqi people. The global impact of World War II led to shortages and the economic condition of Iraq deteriorated. On the other hand, "rapid urbanization and the exposure to secular education and thus modern political ideas, contributed to a decline in the political power and spiritual influence of the Islamic schools, and of the clergy in forming the values of the community". (Cordesman and Hashim 1997, 97) As a result, communism found success and took a strong foothold in Iraq during the 1950s.

Aware of the approaching threat of communism, in the mid-1940s, the ulama began speaking out against communism. They declared that the rise of the communism was more of a threat to their legacy than the policies of the British-influenced government. As Cline pointed out, beyond the theological and philosophical differences with communism, the religious establishment in Iraq almost certainly claimed that the Iraq Communist Party (ICP) directly attacked their influence and power (Cline 2000, 47).

Centralization of the state provoked the first sign of rural and urban opposition. The British modernization of the army fueled anti-regime Arab Nationalism and urban unrest, and rapid urbanization and growing income disparities fuel massive social discontent.

In 1958, a military coup ignited a period of turmoil and upheaval in Iraq that changed its political system and social fabric. After 22 years of repeated efforts by Iraqi army officials to overthrow the Faisal monarchy by military coup, General Abd al-Karim Qasim finally succeeded and usurped power in 1958. As a result of the coup, the Arab Kingdom of 1921 establish by the British and governed by a Hashemite family was replaced by a "republic" under the rule of a military junta (Aziz 1993, 208) and Iraq entered a period of self-determined national politics in the Middle East.

With the success of the coup, old political groups started to seek a safe place within the new regime. Some were given a voice in the new regime. To increase his personal authority in Iraq, General Qasim used the Communists to eliminate his rivals in the ruling junta, who were loyal to the Arab nationalist movements (Aziz 1993, 208).

Qasim envisioned a new Iraq and devised [an ill-conceived plan of] micromanaging the country and transforming Iraqi future. According to Qasim, Iraq could achieve industrialization and prosperity in very short time. In Mosul in 1959, he declared his optimism: “Three or less years from today, the standard of [living for] the people will be great. From this country, goods will be exported to the neighbouring states. The country will be excellent from the aspects of building, education and health. We will have heavy factories and the farmer will be dignified and no one will remain without work… (Shwadran 1960, 31)” Under Qasim’s leadership, a land reform program was initiated, a housing system for the poor people was prepared and he focused on social reforms. During this period, oil revenues started to become the best single sources of state revenue, followed by agriculture. During the Qasim’s rule, the major industries of Iraq were planned to be nationalized (Braude 2003, 35).

Qasim was assassinated in 1963. The Iraqi National Ba'ath Pary under General Ahmed Hasan al-Bakr and Colonel Abdul Salam Arif stormed to power. Six months later, Arif led a coup. The Six Day war started and ended quickly and this was a huge defeat for Arab Nationalism.

Despite the autonomy of Iraqi state from society, there was no consolidation of state power till 1968, with the second Ba'athist coup. The new ruling elite of the country was the civil and military officers who replaced the monarchy, which used to have the support of the big tribal landlords. While the 1958 revolution had both an anti-imperialist and an anti-landlord character, the Ba'ath Party became a pan-Arab socialist party based on a genuine popular movement.

After its emergence as a powerful political actor in Iraq, the Ba'ath party dominated Iraw for four decades. Sluglett gives a comprehensive framework of this new phase as:

> "After 1968, the Iraqi state changed very fundamentally. It developed great coercive powers, and a degree of autonomy from the rest of society, underpinned as it was by massive oil revenues and an efficient and wide-ranging military, police and security apparatus. It became increasingly unwilling to tolerate independent centres of power, whether emanating from individuals within or outside the Ba'ath party, 'allied' political parties, national-ethnic independence movements, such as those sponsored by the Muslim Brotherhood (never particularly powerful in Iraq), or the Shi'i clergy" (Sluglett 1993, 86).

As underlined by Slugglett, "although Ba'athism is indeed secular in its outlook, the nationalist tradition from which it derives is essentially Sunni, in the sense that the idea of Arab unity necessarily implies unification with an overwhelmingly Sunni Arab world" (Sluglett 1993, 87)

During this era the world, like Iraq, was experiencing new developments. First of all, the new era amplified the importance of oil, since the surging post-WW2 industrial development of Western countries stimulated huge demand for oil, and also increased the strategic importance of the Middle East region. The major involvement of Western military and political powers in the region was fueled by the increasing dependence of the Western economies on oil. But Western political power the region was challenged by two development: an increasing competition in the region with Soviet Union and regional activities of OPEC, which in 1973 distabilized the world economy with the first oil shock.

During this period, in Iraqi national politics and throughout the globe, oil became a central preoccupation. In 1972, the Iraqi Petroleum Company was nationalized. Following the 1973-74 oil crisis, the oil revenues accounted for nearly two-thirds of Iraq's GDP, and for nearly 90 percent of state revenue. Thus, the political economy of Iraq became enslaved to oil-led development.

The influx of oil revenues after 1973 implied new job opportunities and prosperity in the larger cities, and the Iraqi people left the rural areas to take advantage of the prosperity in the urban areas. As Marr expressed, this rapid migration did not produce an effect of "urbanization as much as the ruralization of the cities (Marr 1985)."

Even though this influx of the rural population had serious consequences for political, social and economic life, political political activism was strictly controlled and largely suppressed by the regime (Munson 2006, 25). Since its independence, Iraq has gone through several forms of government, and violence (assassinations, coups, and invasions) ushered in each of these new forms of government, and each time a new regime assumed power it failed to actualize the lessons and ineffective experiences of the previous regime(s). Instead of seeking a wide social base and building up broad institutions to establish legitimacy in the eyes of the people, each new set of rulers used the government to dispense out patronage to narrow groups of supporters and used the military and security forces to oppress the general population. To compound matters and solidify the rule of the Ba'athist party and eventually Saddam Hussein's rule, the rise of oil revenues in the 1970s gave the government unparalleled resources to fund both the networks of patronage and the state's coercive levers (Munson 2006, 25).

Initially as the new leader of the Iraqi state, Saddam Hussein employed a more populist discourse. As Braude noted "he advertised his phone number to the public and encouraged Iraqis to call him with their problems. Saddam retained his popularity for several years into his rule, largely through state-owned television, which covered Saddam's random visits to Iraqi households to check on their welfare, sudden violent purges of "traitors" and "conspirators," and afternoons in the countryside helping poor farmers harvest their crops (Braude 2003, 35)".

Motivated by increased oil revenues and encouraged by the support of US, Iraq decided to attack Iran and started the longest war in the region had seen to date (only eclipsed by the US presence in Afghanistan). Following the military stand-off in the war with Iran in 1988, Iraq's government continued to increase the size of the Iraqi military establishment. However, the huge costs of the war with Iran – both in lives and in wealth – forced Saddam to look for financial relief from the rich Arab oil states.

When Kuwait refused to forgive a good portion of the Iraqi debt, Saddam invaded Kuwait on August 1990. Saddam occupied Kuwait and the occupation was short-lived thanks to Operation Desert Storm the American-led coalition of international forces that liberated Kuwait and forced Saddam's army, soundly defeated, back into Iraq. After the invasion, the relationship between Iraqi government and western countries changed completely, basically disintegrating. Western countries, particularly the US, who supported Iraq against the Iranian Islamic threat before the

Kuwaiti invasion, now turned against Saddam's regime and United Nations Security Council imposed severe economic sanctions on Iraq.

However, the eight-year war with Iran, the 1990-91 Gulf War, and the imposition of economic sanctions resulted in poor maintenance and outright neglect of oil industry and its infrastructure, and decreased oil revenues. The sharp reduction in oil revenues dramatically changed the support basis of the historically generous state welfare system of Iraq, and exacerbated Saddam Hussein's oppressive rule based on informal networks of patronage and the sadistic security apparatus. The state institutions, particularly the well-educated middle class of Iraqi society, became severely impoverished. The macroeconomic crisis gave way to widespread corruption and bribery since the civil servants' income evaporated.

The Gulf War reduced the power of Iraq's military, and following the uprising in 1991 in the South, the power of Saddam's regime started to weaken. The United Nations embargo that was imposed after the war also facilitated the decline of the regime. During the 1990s, the embargo sent Iraq's economy and society into a death spiral, by allowing only the exchange of oil for food and medicine. The new economic situation spread intense poverty and demoralizing hunger throughout the country. During this era, Saddam's regime attempt to try new diplomatic tools to reestablish political and economic relations with neighboring countries and far allies; these all failed (Braude 2003).

In the post-Gulf War period, Iraq also faced several challenges that included a rapidly increasing population, uneven distribution of key resources like water and oil, protracted armed conflicts and the necessary high military spending, rapid urbanization, and incorporation into a global economy.

Thanks to globalization, the Kurdish minorities in northwest Iraq contacted the Kurds in Syria, Turkey and Iran and they managed to gain the attention of international community and began to benefit from international relief efforts and investment. The Internet provided a ground for further dissemination of the Kurdish discontent and gave them the opportunity to announce their repressed situation to the world. Like the Kurds, the Shi'ites also developed new political mechanisms to get involved in Iraqi politics and employed global communication tools to enjoy more political power in Iraq.

After the US invasion of Iraq in 2003, the new order ended Sunni Ba'athist rule and paved the way for Shi'ite groups to take a strong, more dominate place in Iraqi politics. As Nasr pointed out, this triumph in Iraq also implies that there might be the emergence of the first Arab Shi'a state in the world. The election in the March 2010 galvanized the power of Nouri al Maliki's Shia Block even the government was formed after nine months of elections on November 25, 2010 when negotiations with opposition parties, especially former Prime Minister Ayad Allawi's al-Iraqiya bloc brought new elements into government. In this regard, needless to say, the political scene of Iraq now has different actors, and the political and social nature of the post-war Iraq is promising a completely new era.

In this new political environment, Iraq's economy is becoming more and more important. In the next section, an analysis of the Iraqi economy will be provided.

IV. IRAQI ECONOMY

4.1. Introduction

In 19th century, the Industrial Revolution spread throughout the world, and both the middle class and the industrial workforce increased in numbers. However, Southwest Asia did not experience the historical turning points that catapulted Europe out of the Middle Ages, including the Reformation, the Renaissance, the Enlightenment, the Industrial Revolution and democratic revolutions. There have been no bourgeoisie and labor classes in the Middle East in the Western sense.

In the Persian Gulf region, the arrival of nationalism took place after the end of World War I when many of these states were granted independence from the colonial powers. Consequently, in the region, the boundaries and institutions of nation states did not emerge through internal developments. Since national politics require a dramatic reorganization of society, the institutionalization of the nation state produced and is still producing major political upheavals. As with other states in the region, Iraq also experienced this transition.

Industrialization, which has transformed much of the world's economy, societies and politics, was either delayed or was effectively not experienced in Arab countries. Therefore, unlike Europe, Arab countries did not generate new interest groups (labor unions, trade groups, guilds, etc.) that have incentives in a growing economy According to Rivlin, the weakness of the industrialization process in Arab countries was in part because of government policies: "both in countries that espoused Arab socialism and in those that did not, governments have played, and continue to play, a dominant economic role. It is also reflected in the weakness of the private sector" (Rivlin 2009, 8).

According to Rivlin, the Arab economies share three interrelated features: a deep and prolonged employment crisis; very limited development of the manufacturing sector and a major role played by rental incomes. (Rivlin 2009, 9).

After gaining their independence after 1950s, most of Arab countries acquired an authoritarian politics and weak state institutions, both of which were embodied by massive increases in public sector activity and employment, especially in the civil service and army. By introducing something akin to the Soviet system, most of the countries in the region applied central planning model and nationalized economic assets to enhance their economies. These countries used public sector employment as a crucial means to maintain social stability and encourage political loyalty. Non-socialist countries in the region also considered the public sector to push economic development forward (Rivlin 2009, 20).

Since the beginning of the republic, like other countries in the region, the Iraqi government has been oversized and public sector employment has been high. The state has become the main employer and its bureaucracy, civil service and army provided employment for the country that suffers from large-scale unemployment. Even the liberalization wave of 1980s and changes in the country after 2003 could not substantially transform the picture.

From an economic standpoint, the Iraqi state has not been able to produce a working blend of private and public that will carry the country to prosperity. The agricultural reforms did not yield increased production and the volume and share of manufacturing remained very slow. Since Iraq has failed to industrialize, a manufacturing sector could not be established to provide the employment boom in the country the same way it did in western countries during the Industrial Revolution or in East Asia in the twentieth century.

In this chapter, I will analyze the transition of economic development of Iraq. The Iraqi economy can be divided into four eras: first, the economy under the constitutional monarchy from 1921 to 1958; second, the period following the military coup of 1958, in which military officers mainly controlled the direction of the country; third, the pan-Arab Socialist Ba'ath governments that started after 1968 and lasted till the military operation of 2003; and the fourth period implies the new economic era in Iraq after the overthrow of Saddam Hussein in 2003 and this determines the economic character of today.

4.2. Iraqi economy under constitutional monarchy from 1921 to 1958

Since the emergence of the Iraqi state in 1920, Iraq has been unable to succeed in gaining lasting political and economic stability. According to many scholars, most of Iraq's problems of have their origins in the first half of the twentieth century and the economic legacy of the monarchy period has left severe and entrenched constraints on Iraq's future development. As a hypothesis of this thesis, today, the main problem of Iraq's economy is its heavy reliance on oil revenues to fuel the state coffers, and the first seeds of this intrinsically weak form of establishing a national economy were sown at the end of this period.

Rivlin argues that there are four problems at the center of Iraq's developmentproblems; the polarization between social classes and ethnic groups (primarily those among the Shi'a, Sunni, and Kurds). Closely related to the above is the major political problem; the polarization of the rulers from the ruled, a characteristic that reached its widest and most horrific apogee under Saddam Hussein, and is currently manifested in the tensions between American occupational forces and many Iraqis. Third is the pattern of investment, which is the failure to invest in a diversified economy and to attract foreign investment in agriculture and industry. Fourth is the continued and even intensified reliance on oil as the major source of income (Rivlin 2009, 132).

According to Ozlu (2005) the legacies of previous governments in Iraq created plenty of obstacles to the development of the country: "Lack of proper hard infrastructure, low living standards, inefficient public sector, lack of a functioning private sector and the large international debt" are main outcomes of this legacy.

Following the opening of Suez Canal in 1869, the region that would become Iraq gained greater access to European markets, the territory of Iraq became more open to agricultural production and the tribal rulers began to sell their products to the Western markets (Metz 2003 139). At the end of the 19th century, pioneered by Western technicians, a few private investors and entrepreneurs appeared in Iraq to establish new industries. At the dawn of the 20th century, through the guidance of Western merchants, these Iraqis established small factories in different sectors, like textiles, cigarettes, construction materials and agricultural products (mostly dates, wool and licorice) (Langley 1961, 272).

The growth of Western interests in developing and exploiting Iraq's oil reverses interrupted the first signs of industrialization. As it owned and controlled the oil revenues, the government started to become main actor in exploiting a new petroleum dominated economy (Langley 1961, 272).

The history of oil in Iraq can be traced back to the end of the nineteenth century, but the commercial appearance of oil was in 1927. In 1925, Turkish Petroleum Company (later Iraq Petroleum Company – IPC) became the first company to be granted concession for the exploration and modern production of oil. Afterwards, two affiliates of the IPC – Moral Petroleum Company (MPC) and Basra Petroleum Company (MPC) – were granted concessions from the Iraq government. These concessions were valid for the totality lands of Iraq. British Petroleum, Shell Petroleum, Compaignie Francais des Petroles, Exxon and Mobil were IPC's partners. The concessions and the agreement with the IPC were significant milestones for the Iraqi economy, since they created the basis for the rentier conditions of today's Iraq.

According to Al Nasrawi, during this era, the rapid rise of oil development in the country was closely linked to the post-war situation in Europe. The demand for oil tremendously increased because post-war Europe was in desperate need for the components required for reconstruction, and internally Iraq's military expenditures increased (which tipped the balance of political power into the hands of the military leaders), agricultural mechanization was prioritized over other forms of industry, and motor vehicles became widespread (Al Nasrawi 1967, 5).

After Mo'sadaq nationalized the oil industry in Iran and the modification of the Saudi Arabian oil concessions (by signing a fifty-fifty profit-sharing agreements), Iraq was inspired to modify its agreements with the oil companies. In the old agreement, the royalties to the Iraqi government were mostly below 5%. However, after the negotiations with oil companies operating in Iraq a new Agreement was signed in 1952. According to the new Agreement, Iraqi government started to receive 50% of the profits resulting from the operations of oil companies. The new system increased Iraq's output and also provided for a higher per ton revenue. (The rise in demand for crude oil was also closely linked to the fact that United States became a net importer of oil in 1948). As a result, the average per ton revenue of Iraq reached $5.50 during 1950-1959 up from

$1.75 from 1934-36 and yearly income rose from $6 million in 1945 to $105 million in 1951 and $224 million in 1958 (Al Nasrawi 1967, 7).

In this period, the increasing oil revenues provided the incentive for the Iraqi government to craft new economic development plans. In order to manage and utilize the revenue from oil and to use it for development purposes, the Development Board was created in 1950. Very similar to the system of today, all the revenues from oil were credited to the Board's account with the Central Bank of Iraq. The Board was the first vehicle in Iraq history to adopt the policy of concentrating on oil revenues as the main source of investment. The Development Board defined development targets with an emphasis on agriculture, transportation and construction and produced four three-year plans from 1951 through 1961.

As Langley contended, after the establishment of the Development Board, governmental institutions became more directly involved with industry, and private entrepreneurs become more dependent on the government for assistance and sometimes needed the government to be the purchaser of their products. Financed by the oil revenues roads, bridges and other infrastructure projects were initiated, and other large capital investment projects were devised for agricultural, communication, transportation, and housing. Heavy public investment in agriculture helped to improve the irrigation system and the cultivatable area increased. The Development Board allocated large sums of money for irrigation projects, but massive agricultural development did not change the ownership of land, and consequently provided little benefit to the life of ordinary Iraqi people. On the contrary, the power of the tribal sheikhs increased, and the noble landowners discouraged investments in industrial development (Rivlin 2009, 134).

British rule and the establishment of the Mandate in 1922 did not change the landownership system, but what it did do was widened the economic and social gap between the landowners and peasants. In 1958, 3,400 landowners held 68 percent of the land and millions of peasants remained landless. The grants provided by the development programs under the Iraqi monarchy did not increase the productivity in the agricultural sector. On the contrary, it enhanced the power of the existing land tenure system and reinforced the inequitable distribution system. The number of landlords increased as tribal lands were appropriated, and the introduction of cash crops led to the indebtedness of the peasant. Landlords, who were also politicians, did not desire to change the status quo. *(*Rivlin 2009, 134; Langley 1961, 273*)*. This policy led to asymmetrical development and created conditions in the countryside where rural producers were excluded from profiting from new economic activities (Sluglett and Sluglett 1983, 502).

Although it allocated resources for capital projects and agricultural modernization, the Development Board did not give non-oil industrial development a priority and allocated only a small share of funds for manufacturing activities in general (Al-Nasrawi 1967, 35). Increasing government involvement and relative progress in transportation, education and agricultural sectors did not accelerate the general economic development of the country and did not create a wide industrial market. For example, in the 1955-1960 plan, out of 500 million Iraq Dinars of the budget, only 67 million ID was allocated for industry while agriculture, irrigation and transportation were allocated more than 300 million ID (Qubain 1958, 46-47). As a result, total expenditures under the plan remained skewed and low in terms, while the oil revenues were very close to the estimations of the plan. As Lange points out the Development Board only spent 57 percent of the planned amount during the period 1951-1958, and yet the realized revenue during that same period was very close to 93 percent of projected revenue (Lange 1964, 487). Until

WWII, the few industrialists who did emerge found the domestic market restricted, and none possessed sufficient funds or knowledge to develop Iraq's resources for a foreign market.

Unfortunately, the establishment and growth of industrial operations of considerable size was not sufficient to provide the necessary economic stimulus to foster continued economic growth, in essence the large companies weren't able to create the necessary reciprocal cycle of producers and consumers to make industrial activity viable. The activities of the Industrial Bank and the Development Board brought a number of these concerns into existence, but such actions by themselves could not lead to self-sustained economic development. After 1950, the Development Board had the means to push the economy forward but largely failed to do so. In the early years this was due, to a large extent, to over concentration on the technical aspects of flood control and irrigation, and a failure to see that agricultural engineering development would not necessarily bring about broad economic development. The Board's industrialization and housing programs did not clearly emerge until 1956. The establishment of chemical industries and the expansion of the market for private entrepreneurs through housing programs were sectors in which the industrial openings promised to be very profitable. The late evolution of these programs is undesirable, and their pursuit did not help Iraq become a country with a high and increasing level of real income, unless a substantial attack on the problems of raising agricultural productivity and rural incomes is also made (Langley 1961, 274).

Marr argues that the lack of attention to manufacturing activities and industry, the under emphasis on human resources and overemphasis on agriculture created a tension between the educated elite and the workers. He argued that this misallocation may have been a significant basis for the rising discontentment against monarchy and in turn provided political support to the military coup in 1958 (Marr 1985, 134).

By the mid-1950s, the myopic investments in generating projects began to foment controversy, and yet the large projects took four to five years to complete. And only then would these projects show benefit to the average Iraqis. The poorer strata of the population wanted to see immediate improvement of their situation in the villages, small towns and slums. The disparity between expectations, actions and results fostered growing discontent. Increased dependency of the economy on oil also caused a huge unemployment in the country. In 1956 the oil industry employed less than 1 percent of those actively engaged in economic activity, while it produced more than 39 percent of national income. Growing population and lack of employment due to lack of investment in labor-intensive sectors, such as heavy industry, created increasing numbers of unemployed Iraqis, and led these individuals to support the military coup.

The monarchy also consolidated and strengthened the feudal base of the economy by increasing the power of tribal sheikhs, and as a result, 79 percent of the population was employed in agricultural sectors by landowners with little commitment to modern economic development. The regime also did not develop development strategies for encouraging widespread manufacturing activities, rather it attempted to dominate all economic activities and this hampered the development of Iraqi private entrepreneurship. This excessive state control over the economy created economic stakes for the public officials whose primary responsibility was political and this created the tools and motives for the corruption in the bureaucracy.

Additionally, the monarchy's strengthening of the feudal base not only discouraged efficiency, but also prevented the formation of a large private sector, which is still only a minor part of Iraq's economy in 2011. Moreover, the Hashemite monarchy installed a strong central government with a large bureaucracy that was fallback on the practices of the Ottoman Empire in the sense that the state should neutralize the power of the rural sector of society. Under Iraqi conditions during and after the colonial period, this created conditions that encouraged corruption and neglected industrial development.

The economic report of IBRD on Iraq development in 1952 (the report prepared at the request of Iraqi government) summarized the situation as follows: "Today the people of Iraq for the most part suffer from dire poverty. Although a relatively small number of city merchants and landowners enjoy high incomes, the average standard of life is extremely low…" After emphasizing the fact, the report suggested that the Iraqi government use its oil revenues for providing means for a potentially rapid development of other sectors, to put the principal emphasis on developing industrial and agricultural development and most importantly to involve Iraqi people in the development of national economy. Report said that accomplishment of the targets of the plans required the united energies of the nation and economic development cannot be achieved through the sole functions of the Development Board. In this regard the report suggested that Iraqi government must arouse the interest and mobilize the enthusiastic cooperation of the Iraqi people, integrate them to the development process and create the tools for them to contribute to attaining the objectives of the government plans (IBRD 1952, 99).

Rony argues that prior to the 1958 revolution, development plans were regarded as lists of abstract and ineffective economic projects, unrelated to any overall economic planning, with an extra an emphasis on large-scale projects which would not have a major and rapid impact on the Iraqi economy and neglected directly productive projects (Rony 1978, 3).

Lord Salter’s 1955 report on the Development Board’s economic program largely summarizes the flaws of the program: first, there had been too great a focus on dams and water projects. Second, no coordinated planning had taken place regarding the use of the water in the reservoirs that were to be built. Third, insufficient effort and money had been allocated to development to insure quick and palpable results. The Board had failed to prioritize housing. More attention to this area would have produced quick and visible results to ordinary Iraqis. Also, the Board had done very little to improve Iraq’s agricultural sector. Fourth, the Board had ignored the human capital. Efforts should have been made to get endemic diseases under control. Public services, such as domestic water supply, needed improvement. Fifth, Salter also added a political dimension to his report by drawing attention to the danger of not allowing popular discontent to be expressed in Parliament (Salter 1955).

However, within the time, the government became the only actor to define the tools and targets for development, and the Iraqi people did not realize their own stake in the development programs. Langley argues that there are three stages of government’s role within the development of Iraq from 1920s to 1958 military coup. In the first stage, the government’s role was only limited to administrative actions, and industry was indirectly subsidized by means of certain taxation reliefs; in the second stage, oil revenues created a stronger government that began to indirectly participate in industry, through the Industrial Bank; and thirdly, after the establishment of the Development Board, the government became an active player in the economy, established certain plans and determined the direction of investments (Langley 1961, 273).

In conclusion, monarchy maintained and even strengthened the feudal economic base in the country, and this led to enhancing the economy's dependence on oil, neglected industrial development, fueled social inequality, failed to develop an effective public sector and created a fertile ground for corruption to spawn in bureaucracy. This also hampered the financial opportunities for entrepreneurialism and thus the creation of a private sector, and this left Iraqi people outside of policy-making processes (Alnasrawi 1994, 36-37).

All of this highlighted the central government's authority and caused the rising discontent against monarchy. A military coup eventually took place in July 1958 that had the support of the majority of Iraqis, partly thanks to the economic policies of the Monarchy. The coup did away with the British installed rulers. The coup came in the midst of the Development Board's fourth general program, and a new era of development planning in Iraq was ushered in.

4.3. The Military Coup of 1958

General Abd al-Karim Qasim, who led the coup d'etat of 1958, proclaimed the fully independent Republic of Iraq, terminated the country's ties with the West, and began a process of alignment with the Soviet Union. The new regime set out to introduce numerous changes to re-orient and broaden Iraq's economic priorities.

Alnasrawi argues that the new regime was determined to reformulate the failed economic priorities and development plans of the monarchy and completely altered the structure of development planning. New military rulers proclaimed that there were several reasons behind the failure of the old regime: first, there was no clear vision for the economic plans, and the members of the elite tended to plunder Iraq's resources and then transfer wealth exclusively to landowners, rent-seekers and foreign imperialist powers. According to Qasim's administration, the economy's dependency on foreign imperialism was intensified by the regime's ineffective development policy, which created a weak Iraq that could be only an effective trading partner. It became an importer foreign capital and goods, and an exporter of raw materials, particularly oil at low prices. Second, the economic policies were disorganized that they galvanized existing backwardness and imbalance. Under the monarchy, agriculture (with its feudal base) was the predominant sector and manufacturing was neglected to a level of near insignificance. The balance of payments and state budget showed deficits. Overall industrial output, worker productivity, income across the board and employment were low. These conditions led to serious inequality in the distribution of income, inflation, internal migration to the capital city and emigration out of the country all together. Third, the foreign policy of the monarchy isolated Iraq from other Arab countries and hampered any attempts at economic and political unity. Fourth, although revenues form oil could (and should) have been used in a manner that would have created an independent economy, the policies actually led to the deepening of the economy's dependent traits (Alnasrawi 1994, 36)

The 1958 intervention marked a new role of the state in the national economy and government's control over the economy that was aimed to protect domestic market through comprehensive restrictions on imported goods. These new policies encouraged the domestic market to consume locally manufactured goods and discouraged trade relations with Western countries, but what happened instead – because Qasim looked toward the Soviet Union, not the West, was a re-orientation of foreign trade toward barter trade with socialist countries (socialist countries did not produce competitive goods by in large, so this type of economic activity didn't increase the skills of Iraqi industry). In this regard, the new regime's plan was to reduce the negative trade balance with Western powers. It was going have drastic consequences.

However, the most radical projects the new regime instituted were related to agriculture. Qasim's regime abolished the tribal jurisdictions, whereby the legal basis for the feudal system in Iraq was attacked (Dann 1969, 57). Until 1958, the tribes were treated by a separate body of laws known as the Tribal Disputes Regulation, and administrated by the so-called Administrative Courts (Wahab 1964, 21).

Since the military coup was largely inspired by the discontent of peasants against landlords and in general against land tenure system in the country, the new rulers aimed to eliminate the power of landowners and tribal sheikhs by limiting the size and scope of privately owned land. At the time, 70 percent of the total population was dependent on agriculture, and a large portion of the workforce was experiencing partial or seasonal unemployment. The limited opportunities in countryside catalyzed the migration to urban areas.

In this regard, Agrarian Reform Law (Law 30 of 1958) was passed just after 3 months the military take-over. Since landlords and tribal sheikhs constituted a strong political force during the monarchical era, they posed a potential threat to the new regime. The 1958 Agrarian Reform Law was inspired by Egypt's agrarian law and limited the maximum amount of land an individual owner could possess to 625 acres of irrigated land or 1,250 acres of rain-fed land. The remaining portion of land would be expropriated and distributed among poor peasants over a five-year period. The law provided for the expropriation of 75 percent of all privately owned arable land. Peasants paid for the land and were required to join cooperatives, which were supposed to provide the inputs and services previously supplied by the landlord, such as seeds, credit, irrigation, storage, transport, and marketing facilities. The Iraqi peasants, so long just workers on the land, were unaccustomed to the level of responsibility required for successful land ownership and consequentially agricultural productivity dropped sharply following the implementation of Law 30; it has never fully recovered.

The reform did not have the desired effect, however, mainly due to the lack of the trained administrators required to oversee the expropriation and distribution process (Ghareeb 2004, 4) and land reform was never completed (Rony 1978, 113-114). The reform plan had difficulties, particularly in distribution of the land. As a result, in the second year of the Law, only 3% of the confiscated lands were actually distributed among the peasants. The failure of the government to effectively and efficiently redistribute the land caused conflicts in the countryside and led significant migration to the cities. In order to promote the life in rural areas, the government initiated programs, such as offering land and capital to the people that migrated back to the rural areas.

Since peasants couldn't be furnished with necessary qualifications, landlords were required to continue the management of the land and to supply necessary inputs to maintain agricultural production[2] The situation became more complicated due to the lack of funds, expertise to supply seed, credits and marketing services for customary products. Previous landowners reduced their production and tended to stop their activities as the hostilities against the land reform increased.

The inability of the cooperatives to play the role traditionally filled by the landlords also damaged productivity. After 1958, agriculture's share in the Iraqi GDP steadily declined, agricultural production declined sharply (Ghareeb 2004, 5). New agrarian systems also paved the way for heavy state intervention (Mahdi 2001, 321).

While these agrarian reforms did not take their full effect until 1963, they succeeded in raising the capital of the Industrial Bank and extending more protection to domestic industry. By 1979, the problem of landlessness largely had been overcome. In 1979, there were around 800.000 agricultural landholdings, while there were only 500.000 in 1971. Rivlin argues that as agriculture developed, the sector became more reliant on imports since it could not develop links with industry. Since marketing policies weren't formulated, the products were not sold abroad and the government became the only buyer for most of the products. He contends that price controls, the misallocation of investment, and mismanagement stymied agricultural production. The increasing oil revenues after 1970 provided large spending on the oil industry and pulled labor out of agriculture (Rivlin 2009, 139).

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[2] Between 1958 and 1963. 2.8 million acres of land were expropriated; however, only a third of the land was distributed to roughly 55'000 beneficiaries. The Ministry of Agrarian Reform thus became 'Iraq's largest landholder. Under Qasim, the ministry would lease sequestered land; an amendment to Law 30 during Arif regimes allowed landlords the continued use of sequestered land until the government was able to distribute it (Ghareeb, Edmund A. (2004). Historical Dictionary of Iraq. Scarecrow Press.p.4)

Despite the problems with the Agrarian Reform Law, Qasim focused on social projects to improve the economic situation of the people. He reduced the working hours for laborers and encouraged them to organize labor unions. The new regime also ordered industrial plants to provide housing and insurance for their workers. The regime also created new mechanisms to involve people into public policy decisions and encouraged the participation of the Iraqi people into the economic planning process through various organizations (Romero 2011).

Instead of the Development Board, Qasim created the Provisional Economic Plan (PEP), which increased the allocations for the industry, transportation and housing sectors. In 1962, the Detailed Economic Plan (DEP) was adopted. The DEP, for the first time in Iraqi history, established a target rate of economic growth, calculated the capital/output ratio and created an investment plan. The DEP also reallocated the budget revenues, in terms of sectors, and prioritized industrialization by allocating 30 percent of the total expenditures to industry. This allocation increased by 200 percent what was allocated to industry under the last plan of the monarchy before 1958. In this era, also Industrial Bank's capital was raised and new branches were opened in big cities (Alnasrawi 1967, 61). By this, the new regime aimed to build a strong industry that would be basis for creating equality in the society and elimination of class-related income differences due to the oil dependent nature of the economy. However, while industrial development received more attention in the planning stage, actual spending did not show any substantial change in the country. For example, while 43 percent of total expenditures allocated to the industry in 1964, actual spending was only 12.6 percent (Alnasrawi 1967, 83).

Alnasrawi analyzed the relationship between national income, oil sector and the rest of the economy for the period and concluded that the national income increased to ID 546.3 in 1964 from ID 158 million in 1950; the value added by the non-oil sector of the economy increased from ID 145.7 million in 1950 to ID 410 million in 1964; the value added by the oil sector increased from ID 12.3 million in 1950 to ID 136.3 million in 1964 (Alnasrawi 1967, 85).

The military rule of General Qasim also made serious attempts to develop greater control over the national oil sector. The new regime strove to reform the holdings of foreign-owned oil companies. The British-owned Iraq Petroleum Company had several branches throughout the country and occupied a significant role in the Iraqi economy, through the production of major oil revenues. After assuming power, Qasim focused on a guaranteed rate of oil production. He aimed to bring about gradual change in the relationship with the Iraq Petroleum Company to enable Iraq to have more power over national oil policies. In this regard, the government initiated negotiations with the oil companies for extension of Iraqi jurisdiction to the companies (Romero 2011).

The guiding principle for the Iraqi side in the negotiations with the Iraq Petroleum Company was Iraqization. The Iraqi objective was to increase Iraq's role in company activities and transfer of petroleum technologies. However, the new regime was also acutely concerned with national security and wasn't about to immediately nationalize the oil company; the aftermath would have be too chaotic, would have probably triggered an economic boycott by the British, which would have compelled the Iraq Petroleum Company to cease activities in Iraq, or worse—resulted in a Western invasion of the country. With the Suez Crisis in fresh memory (which gave Egypt control of the strategic waterway), IPC assured the new Iraqi government of its cooperation from early on. Baghdad thus stopped short of pursuing a forceful revolutionary policy towards the oil companies, but made clear it was going to change Iraq's relationship with the IPC. This ensured that the oil would flow wouldn't be interrupted and at the same time the government could actually demonstrate to the Iraqi public that it was increasing Iraqi control over the country's resources through negotiations.

Despite Qasim's apparent support of local industry, his populist agenda, (i.e., limits on the profits for consumer goods, cuts in prices and rents and land reforms), threatened the interests of commercial classes. In 1959, these fears were fueled after the imposition of higher income taxes on the wealthy, repealing tax immunity on agricultural land, the introduction of an inheritance tax, and legalization of the labor unions. Chaudry argues that these kind of populist reforms by the regime threatened business leaders, because they felt threatened by the new "government interest in expanding competition, protecting consumers and undercutting the long-standing monopolistic pacts that bound domestic commercial elites to the foreign corporations that thrived under colonial rule and after" (Chaudry 2001, 238).

The significant clashes between labor and management after 1958 implied a stage where the parties started to push a political struggle over who would define the structure of the domestic legal and economic systems (Chaudry 2001, 238).

As a result, discouraged by the socialist regime, private investors withheld investment and created shortages in basic commodities and this destabilized the regime, which was seen as being too close to the Communist Party. Chaudry claims that, "unlike the Gulf monarchies, the Iraqi state did not create a permanent class of private-sector clients. Economic insecurity and the rotation of economic contracts in construction were key means by which the once all-too-powerful bourgeoisie was kept under state control" (Chaudry 2001, 238).

On the other hand, new planning policies also could not create a stronger response from non-oil industries and they failed to achieve structural changes in the economy that Qasim desired. As Alnasrawi argued, this failure augmented the dependency of the development efforts and economic growth on the oil revenues (Alnasrawi 1967, 88).

A series of sectarian and regional differences caused considerable civil unrest throughout the first military era, and led to the 1963 coup by Generals Abd al-Salam Arif and Abd al-Rahman Arif. The new administration took a more moderate position on regional and international affairs, favored better relations with Western countries and other Middle Eastern countries, yet maintained close ties with the Soviet Union. The most striking change was the close relations with Egypt under then-President Gamal Abd al-Nasser and a stronger emphasis on Arab nationalization.

Along with the security concerns in Middle East, the new military regime under Arif increased the spending on modernizing the military. Like Qasim, Arif also was influenced by the socialist models and introduced a planned economy; Arif's administration even took the additional steps to increase the role and control of the public sector in the economy. In 1964, the new government nationalized all banks and at the same time nationalized the 27 largest privately-owned industrial firms. The new military regime largely maintained the land reform started under Qasim and intensified the measures to eliminate foreign influence in the economy, especially in the oil sector. The government also reorganized other companies, required profit sharing with workers, and participation by workers in management.

The new regime drafted a new Five Year Plan (FYP) in 1965 for the years 1965-1969. The economic objectives of the FYP were declared as follows: raise the standard of living, lessen the dependence on the oil sector, intensify investments in both agriculture and industry, equal distribution of planned investment throughout the country and expand employment opportunities. With a comprehensive set of targets and an outline of systematic reform policies in fiscal, monetary, trade and wage policies of Iraq, the FYP became the most sophisticated of all the plans that had been drafted after transition to development planning in Iraq. The FYP defined overall quantitative targets and determined clear objectives to evaluate the success of the plan.

Out of the FYP budget of $1.6 billion, 53 percent was allocated to agriculture and industry. Oil revenues were the source of 70 percent of the total budget. However, similar to previous plans, actual expenditures were far below the planned amount (55 percent). The actual spending for agriculture and industry was around 43%. The plan also failed to expand employment in the country. At the end of the plan period, the unemployment rate increased to 13.5 percent, from 3.1 percent in 1964. That means the number of unemployed people rose from 76,000 to 418,000 in five-year. Yet the GNP in the five-year plan period increased by 29 percent instead of the projected 45 percent. Meanwhile, the total increase in output was 31 percent instead of the planned 48 percent (Alnasrawi 2002, 46-47).

Assessing the performance of the FYP, Alnasrawi contended that at the end of the FYP, the oil sector remained the dominant sector in revenues and exports (while there was a decline in the oil dependency of the national economy from 22.8 percent of GNP in 1964 to 20.4 percent in 1969). On the other hand, the FYP created a foundation to introduce modern technologies to several sectors of the economy, such as manufacturing, power generation, transportation and communications. Despite the increase in population, average personal income, in real terms, increased by 12 percent over the five-year period. The military regime started to build the country's infrastructure, introduced modern technologies and adopted new policies to develop industrial sector in Iraq.

But the legitimacy of secular Arab nationalism marked by the success of Nassar in Egypt collapsed in the ignominious defeat of the Arab regimes by Israel in June 1967 at the Six Day War; and the military-centric Ba'ath political movement in Iraq also started to lose its credibility in Iraq. At the same time, the Kurdish insurgency continued to simmer. A year later, in July 1968, the Ba'ath Party overthrew the Arif regime.

4.4. Baath Period and Saddam Rule– From 1968 to 2003

After storming to power, the Ba'ath Party took control of Iraq in 1968 and lasted until the US invasion and occupation of 2003. The main ideology behind the Ba'ath Party was Arab nationalism and socialism, which was closely linked to the nationalist wave led by Nasser in Egypt.

As similar to the preceding military governments, Ba'ath government introduced central economic planning to rule over the revenues and enhanced the role of state in economic decisions. The government divided expenditures into three categories: a government operations budget, an investment budget and an annual import budget. Assessing the first years of the Ba'ath Party, Mertz argues that, "the responsibility of the state was not so much to allocate scarcer sources as to redistribute the wealth, and economic planning was concerned more with social welfare and subsidization than with economic efficiency (Metz 1990, 127)."

After following the objectives of previous development plan for two years, the Ba'ath leadership crafted a new economic plan and declared it in 1970. National Development Plan (NDP), which covered the period of 1970-1974. Despite the new regime's rhetoric of the socialist revolution and discourses on radical changes, the goals and the methods of the NDP to achieve these ends were very similar to the plans under previous military regimes.

Although the NDP declared its main objective as lessening dependence on the oil sector, it was the oil revenue that financed the development budget of the NDP. In the NDP, the total budget was \$5.8 billion, and \$4.7 billion of this was poured into economy through oil revenues. In the new plan, the allocation to the agricultural sector was 19 percent of total spending; industry was 20.2 percent; transport and communication was 11.4 percent and building and services was 14.6 percent. At the end of the plan period, actual spending became 61.6 percent of planned spending. Alnasrawi points out that although the plan was designated to go beyond previous macroeconomic indicators such as GDP, private and public consumption and foreign trade, it failed to reach its goals in production sectors except in the oil sector (Alnasrawi 1994, 66-70).

The Ba'athist NDP was in full force at a time when oil prices were increasing sharply following the conclusion of the Tehran price agreement of 1971, and the oil price explosion of 1973-74 led to the creation of OPEC. Cordesman and Hashim argue that during the 1970s, thanks to increasing oil revenues, Iraq had enough income "to fund both growth and Saddam Hussein's ambitions (Cordesman and Hashim 1997, 124)". Due to the increase in the oil prices, the share of oil in GNP increased from 26.4 percent in the beginning of the NDP to 60.4 percent by 1974. Iraq's export income rose from only \$484.7 million in 1970 to \$8.3 billion in 1975, and \$26.3 billion in 1980. By contrast, the roles of agriculture and manufacturing in the GNP declined to

6.9 percent and 5.2 percent respectively as of 1974. The oil revenues helped the Ba'athist socialist regime to maintain economic and political stability until the war with Iran, and the Iraqi government was able to pursue its socialist model without suffering from the trade off between solvency and pressing fiscal priorities, such as welfare benefits, infrastructure development and military modernization (Alnasrawi 1994, 70).

On the other hand, the rise of oil revenues gave the government unparalleled resources to fund both the networks of patronage and the coercive levers of state (Munson 2006, 25). These trends culminated with the brutal rule of the Ba'ath regime, which consolidated its power "through a mixture of rewards, coercion, and unprecedented use of internal security methods". As Munson argued, the Ba'athist regime received "the windfall of the post-1973 oil profits directly through the newly nationalized Iraqi Petroleum Company, allowing it to centralize power and wield patronage and violence like never before. (Munson 2006, 25)."

After 1974, the Ba'ath regime left the multi-year development planning and instead decided to introduce segmented annual plans, which required the approval of the Revolutionary Command Council (RCC). After the NDP, there were three annual investment programs for 1975, 76 and 77. At the end of the 1977 annual investment plan, RCC announced the adoption of a 1976-1980 NDP, but unlike the previous years it did not publish the details of the plan.

Despite the lack of economic data for the period, Alnasrawi found that in the Iraqi budget after 1975, there was a rapid increase in the allocation to the "other items", which increased from a mere ID 61 million in 1976 to ID 1,6 billion in 1980 (Alnasrawi 1994, 74). He comments that the majority of these allocations were spent on the military industrial complex.[3]

Before the Ba'ath regime seized power, there was little progress in the industrialization of Iraq. Although the share of industrial spending increased in the development plans under the military regime, industrialization could not effectively be achieved due to several factors such as mismanagement of the process, lack of skilled personnel and capital. The Ba'ath party declared its determination to put a priority on heavy industrialization and revive the manufacturing capacity of the country. In the first development plans of the Ba'ath Party (1970-1975 and 1976-1980), ID 5,199 billion ($17 billion) was allocated for the industrial sector, which was over 15 times the allocation for the period 1959-1969 (Cordesman and Hashim 1997, 128).

During the plan period of 1975-1980, the Iraqi government invested ID 4.4 billion ($14.15 million), and established new heavy industry plants, which are currently active in Iraq. Most of these industrial plants were in southern Iraq, and many of the plants were relatively efficient "turn key" plants supplied by the West. Some of these plants are: the Basra petrochemicals complex, the Khor al- Zubair iron & steel mill, and sulfur, urea, phosphate extraction and processing, and fertilizer industries (Cordesman and Hashim, 128)".

In 1979, Saddam Hussein introduced a liberalization and privatization program in agriculture. This involved reducing the number of agricultural collectives and cooperatives, relaxing the limits on an individual's land holding, and allowing private lessees to obtain usufruct rights from the state; more funds were made available to the private sector rather than to the public sector. Members of the urban middle class invested in agriculture on the basis of their connections with

[3] Even in 1974, the share of military spending was 53.3% of the GNP.

the regime. In spite of Saddam veering away from agriculture, vegetable and fruit production soared between 1979 and 1982, as did fodder production. In 1983, the introduction of law No. 35 led to the leasing of 6 million dunams (or 1.48 million acres) of land to the private sector, mainly to entrepreneurs rather than farming families. In the early 1980s, agriculture was feeling the effects of Iran-Iraq war as men were being conscripted to fight. This disrupted the presence of a reliable workforce. Their replacement by thousands of workers from Egypt then failed to boost output (Rivlin 2009, 140).

Despite partial liberalization[4] in some sectors, the heavy control policies of Ba'ath government hampered private sector development. The government's extensive central planning of the economy[5] and heavy control over agriculture, industrial production and foreign trade created a very narrow space for private sector in the economy, which was left only small industries, art and crafts, shops, and a small part of the service industry (Cordesman and Hashim, 124)".

Iraqi oil revenues increased from less than $1 billion in 1970 to $26 billion in 1980, and the rising oil prices and increases in oil production made Iraq one of the more prosperous countries in the region. In 1980, per capita income reached to $4,083, an amount that has yet to be re-attained after 8 years of economic reconstruction that started by CPA (Coalitional Provisional Authority) in 2003.

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[4] A variety of very large poultry, dairy and fishing enterprises were sold to t h e private sector outright. By 1989, 19 of t h e state's 29 poultry farms, six of the large poultry feed projects, six of t h e 10 large dairy farms, g three of the four large government fisheries, and subsidiary services, such as mills and bakeries, had been sold to private investor (Chaudhry 1991, 18)

[5] Chaudhry argues that direct entry of the state into the economy and the heavy control over economic activities in the market had a different political motive. This was mostly "a response to a recalcitrant and monopolistic private sector dominated by minorities or a small group of monopolists (Chaudhry 1991, 21)

However, the war with Iran reversed any progress Iraq had made, and impoverished the economy. The figures indicate macroeconomic development of Iraq along with the war. For example, Iraq's average per capita income dropped 70 percent from 1979 to 1988, from $8,162 to $2,108. Another related indicator is the GDP. Iraq’s GDP, Iraq which peaked at $53.9 billion in 1980 thanks to the oil booms of 1970s, had dropped by about one-half to $26.9 billion in 1989. It was mainly an outcome of the sharp decline in the oil production and oil revenues, which was $26.3 billion in 1980 but had declined to $11 billion in 1988 (Alnasrawi 2002, 103).

The financing of the war also forced the diversion of the country’s resources toward the defense industry. The mounting war expenditures absorbed Iraq’s oil income, created a huge foreign debt burden (grants, debts and loans from Gulf countries, mostly from Saudi Arabia and Kuwait) and interrupted crucial development planning. Iraq’s military spending, which was $57.9 billion during 1975-1979, increased to $140.2 billion during 1980-1984 and $126.5 billion between 1985-1989. Thus, military spending exceeded oil revenues and after 1980, while military spending averaged around $25 billion per year, average oil revenue remained constant at around $10 billion a year. In 1984, the share of military imports in total imports was 84 percent, while it was 16 percent in 1975 (Askari 2007, 275, 290).

Based on the estimation of Kamran Mofdi in 1990 (Mofdi 1990), Askari recalculated the total loss to Iraq was around $554.6 billion. Askari implies that the total damage to the Iraqi economy was more than 100% of total GDP from 1975 to 2000 and 157.5% of total oil revenues earned during those 25 years (Askari 2007, 299).

Kamran Mofdi argues that during the war, Iraq lost human and non-human capital, growth potential and real growth from rising inflation in the country. He argued that the war reoriented the Iraqi economy toward increased protectionism and import substation. In addition, due to increased spending on the military, the government did not invest on domestic development and the lack of production and declines in agricultural sector made Iraq more depending on imports than ever before (Mofid 1990, 6). Mofid contends that at the end of the war, Iraq has been turned out into "a military machine, with major consequences for the post-war period, as the readjustment to a more normal way of life may prove too difficult (Mofid 1990, 89)".

According to Alnasrawi, Iraq's failure to sustain the economic development during the war lies behind the unsuccessful Ba'athist industrial policy. He argues that the weak economic outlook of the Ba'ath Party became far more apparent during the Iran-Iraq War. He outlines the main weak points for the era, a lack of a consistent sense of priorities among key industrial programs; too much of focus on huge and impressive industrial projects, instead of on meaningful, simple projects. The new government didn't have a comprehensive understanding of the absorptive limitations of the economy and it failed to take into consideration the bottlenecks that would be created by the feeble transportation and port infrastructure when undertaking the creation of industrial infrastructure projects. Iraq had a pervasive state sector and bureaucracy, which stifled initiative and made state sector officials afraid of assuming authority and responsibility, and to compound matters there was widespread technical inefficiency and backwardness for the industrial sector employees; and the paucity of a middle-ranged technical cadre, which forced engineers to do low or mid-level work instead of showing their creativity and capacity in the process of design and production. The lack of understanding of modern technology, and hence an inability to deal with ordinary repairs and stoppages in operation of equipment and machinery, not to mention no quality control for products all created industrial output problems and inefficiencies. Another major mistake that the Ba'athists pushed a socialist agenda in industrial concerns that would have faired better in private hands (i.e. food cultivation and production and industrial manufacturing). This situation wasted capital and the talents of the technical and administrative cadre. The result was that Iraqi-produced industrial goods could not compete with foreign goods (Alnasrawi 1994, 64).

After the war, coupled with the legacies of previous administrations, the damages to the economy created an impoverished country with high inflation, rampant unemployment, a poor and decaying infrastructure, a heavy debt burden, low oil revenue, a weak private sector, declining output in industry and agriculture, low standard of living, and lack of funds for reconstruction.

The rising economic burdens of the war forced Iraq to adopt an austerity program of spending and prompted the government to reduce its expenditures. However, it did not take steps to control economic difficulties fueled by high inflation and declining oil revenues, which caused a further decline in living standards. The decline in oil revenues prompted Saddam Hussein to accuse Gulf countries of not cooperating (trimming back production) with Iraq to increase the price of oil. The increased oil production of the Gulf countries meant losses for the Iraqi economy, and Iraq decided to accumulate more oil revenue by acquiring the rich oil fields of southern neighbor Kuwait (Alnasrawi 2002, 64). Accusing Kuwait of drilling oil from Iraqi oil fields, Iraq invaded Kuwait in 1990.

The Iraqi occupation of Kuwait was a strategic and catastrophic blunder because it resulted in a major military defeat by the US-led coalition forces and ignited the first phase of sanctions against Iraq. During the war, United Nation Security Council adopted Resolution 661, which aimed at securing the withdrawal of Iraqi forces from Kuwait and restoring the authority and sovereignty of the Kuwaiti government. In 1991, UNSC imposed economic sanctions and banned all transactions with Iraq, and closed all international doors to Iraq; this was done to either force Saddam Hussein to take responsibility for his aggressive actions, reform his country's political system and perhaps even step down. Since the Iraqi economy was largely dependent on oil revenues and the rentier traits had depressed all other forms of industry, the Iraq economy could not find alternative ways to survive. The embargo also blocked Iraq from obtaining the inputs and capital goods essential for the effective operations of all economic sectors.

As a result, the national output sharply declined and what little industrial employment there was, dropped by 90%. The wars and embargo destroyed most of Iraq's infrastructure (as is wont to happen), including electricity facilities, transportation and telecommunication networks, oil facilities, iron and industrial plants, bridges and hospitals. After the war, the economy was characterized by extensive commodity shortages, loss of foreign exchange, accumulation of a devastating debt burden, loss of private sector output and ever-rising unemployment, not to mention the precipitous depreciation of the Iraqi dinar.

Economic indicators show the depth of Iraq's troubles; the enormous decline in productivity and the scarcity of goods, sent inflation on a stratospheric climb. The GDP, which was $4,083 per capita in 1980, had already dropped to $1,756 after the war with Iran, but it now declined to

$627 in 1991 and then to $643 in 1998. At the same time, Iraq's population nearly doubled; from 13 million in 1980 to 23.3 million in 2000. Within two years, the sanctions managed to shut off 90 percent of Iraq's imports and 97 percents of its exports (Alnasrawi 2002, 73)

Attacks and embargos brought a complete halt to oil production and exports and isolated the Iraqi economy from all kinds of international transactions. Zainy (2003) argues that the Gulf War catalyzed the collapse of the Iraqi economy. Iraq's GDP retreated from $53.9 billion in 1980 to only $7.2 billion in 1996, before recovering to $25.8 billion in 2000 as a result of the oil-for-food (OFF) program, and the continuation of oil exports after 1996. But despite this recovery, the oil sector remained severely depressed relative to its late 1970s peak.

According to Zainy, between 1990 and 2000, the loss of oil revenues for Iraq was around $170 billion. Additionally, he estimates Iraq's GDP losses during the same decade amounted to $380 billion. In order to underline the decline in the economy, Zainy argues that Iraq's GDP in the year 2000 was only 47 percent of what it had been in 1980 (Zainy 2003).

Along with its impacts on the economic and physical structure, the embargo also caused deep negative impacts for Iraq's human capital. After the war, the literacy programs, which were started late 1970s and reduced the literacy from 48 percent in 1978 to 20 percent in 1987, were ceased and educational facilities could not be funded. As a result, for the 15 – 25 age group, the illiteracy rate reached 55% for males and 59% for females. This is still the highest rate in the Arab region (Block, Crane, Foote, and Gray 2004, 49-50).

In 1995, Iraq agreed to the Oil-for-Food program, (UN Security Council Resolution 986 established the system), which opened limited channels for Iraq from 1996 to 2003 to sell oil to fund the importing of humanitarian needs under strict control of United Nations.

The OFF program shaped the economic picture of Iraq till 2003. Some scholars argue that the program paved the way for flourishing private activities. According to Merza, the OFF period created a hybrid of state-dominated and private activities, and new interest groups started to emerge. Merza argues in the new system, the state did not openly interfere with the private sector's activities, which was made possible "by the growing interests of the 'representatives' of the regime (Merza 2008, 2)"

On the other hand, according to many scholars, although relaxing the embargo mitigated the challenges of the Iraqi people in daily life (especially food through food-rationing system), it adversely affected private economic activity in a number of ways. First, the OFF was based on imports of allowed food products¸ the program discouraged and even hindered the domestic production, and therefore shrank the agricultural sector's share of GDP and reduced incentives for private economic activity in those same sectors. The OFF food imports made Iraq's trade dependence nearly complete for many basic foodstuff (Block, Crane, Foote, and Gray 2004, 53). Secondly, the system was providing the same food basket to every family and some households sold some portions of their allocation in the secondary market at a very cheap price. This also created huge disadvantages for local producers, since they could not compete with these low prices. (Block, Crane, Foote, and Gray 2004, 53). Finally, the program created certain food distribution agents (stores, bakeries) for each family and this also discouraged the entry of new retail firms into the market. The resumption of agricultural imports (under the OFF) has caused a decline of domestic production and probably shrank the sector's share of GDP once again.

According to Sassoon, the OFF program enhanced the central role of the Iraqi state by turning the "government into the sole allocator of the basic necessities for the population, thus increasing its power and ability to favor and enrich its political cronies (Sassoon 2010, 190)".

The sanctions strangled all economic activity in Iraq other than oil production. Since the only item that Iraq was allowed to export was oil, all other industries (agriculture in particular) were abandoned. By 28 May 2003, $28 billion worth of humanitarian supplies and equipment had been delivered to Iraq under the Oil-for-Food Program, including $1.6 billion worth of oil industry spare parts and equipment. An additional $10 billion worth of supplies were in the production and delivery pipeline.

During the sanctions period, Iraq was almost completely dependent on imports for basic foodstuffs and medicine. Although the Program was essential for maintaining the mere livelihood of an overwhelming majority of Iraqis, it could not prevent Iraq from being reduced to a low-income economy as of 2000.

4.5. The Economy under the Coalitional Provisional Authority

When the US-led coalition operation started in 2003, the Iraqi economy was in the midst of experiencing its worse days of decline since the Iran-Iraq War started in 1980.

Decades of heavy state control over all kinds of economic activity, successive wars and the subsequent economic sanctions basically destroyed the Iraqi economy. Iraq's modern development was completely suspended and all sectors suffered from negative growth;

dependency on oil revenues had increased, and despite slight declines, inflation was still very high, foreign debt and unemployment were hitting their peaks.

Table 1. Selected Indicators (1950-2002)

Year	Population (Million)	GDP ($ billion)	Per Capita GDP $
1950	5.2	3.4	654
1960	6.9	8.7	1261
1970	9.4	16.4	1745
1980	13.2	53.9	4083
1985	15.3	31.7	2071
1990	18.1	16.4	906
1992	19.1	11.9	623
1994	19.9	6.8	342
1996	21	7.2	343
1997	22.9	10.1	441
1998	23.6	10.4	443
1999	24.3	17.9	737
2000	25.1	25.8	1030
2001	25.7	18.9	735
2002	26.4	18.9	718

Source: World Bank, COSIT

After the war ended, the UN Security Council lifted sanctions in order to ignite the steps to develop, liberalize, and reform the Iraqi economy. The UN also guided the initial steps to restructure Iraq. In May 2003, the Coalitional Provisional Authority (CPA) was established as means to govern Iraq and promote the functioning of democracy and economy. The overall target of the CPA was announced to begin creating a new Iraq that based on a market economy. In this regard, the CPA outlined its priorities on the economy: privatization of state-owned enterprises (SOEs), including possibly the oil sector, setting up functioning governing institutions, issuing a modern foreign investment law, freeing external trade by lifting import tariffs and controls, reforming the central bank and the restructuring of the payments system.

The first step was to reestablish the oil flow network for the resumption of oil exports. In order to manage oil revenues a Development Fund[6] was created. In order to stabilize the currency (Dinar), the CPA reorganized the Central Bank of Iraq (CBI). The CPA also introduced new a currency (the new Dinar) on January 15, 2004. In cooperation with the CBI, the CPA took measures to stabilize the new currency through controlling interest rates and ensuring free circulation of the currency internationally. The policies helped create stability in the currency and also allowed the new Dinar to appreciate against the US dollar through June of 2004 (Dobbins, Jones, Runkle, and Mohandas 2009, 205).

In order to maintain liquidity, the CPA encouraged the Iraqi commercial banks to restart work within the country. Additionally, the CPA issued a new order for regulating banking activities that aimed at creating rules for a modern banking sector, defining capital requirements, and provided a new mechanism for dealing with troubled domestic banks. Although, the CPA strove to increase the numbers of commercial banks throughout Iraq, the new banks were not yet capable to provide commercial loans for supporting economic growth (Dobbins, Jones, Runkle, and Mohandas 2009, 205). In order to facilitate trade, the CPA established the Trade Bank of Iraq, which was projected to provide loans and letters of credit to Iraqi entrepreneurs and

[6] In May 2003, the CPA established the Development Fund of Iraq, DFI. Its accounts were deposited in the Federal Reserve of New York. Its revenues are consisted of: oil exports (95 percent after deducting 5 percent for the UN Compensation Fund), Oil for Food Programme's (OFFP) balances, Iraqi frozen assets in foreign countries, earned interest, and others. Its expenditures are composed of: transfers to the Iraqi Ministry of Finance, to finance the budget, letters of credit for the Iraqi ministries, projects managed by American institutions, debt service, and others. An International Advisory and Monitoring Board (IAMB) was established and charged with overseeing DFI revenues and spending, (SIGIR, 2008a)

facilitate international transactions that existing Iraqi banks could not manage. The Coalitional Provisional Authority also allowed and encouraged foreign banks to operate in Iraq.

The CPA set out to attract foreign investment to the country, since the authority considered foreign direct investment (FDI) as the most effective way to help finance Iraq's economic recovery and encourage the growth of local producers and the transfer technology to Iraq. In this regard, CPA Order 39 was issued in 2004. The purpose of the order was defined as in text as:

> "This Order promotes and safeguards the general welfare and interests of the Iraqi people by promoting foreign investment through the protection of the rights and property of foreign investors in Iraq and the regulation through transparent processes of matters relating to foreign investment in Iraq. This Order specifies the terms and procedures for making foreign investments and is intended to attract new foreign investment to Iraq (CPA Order, Section 2)."

According to the new order, foreign individuals or companies were allowed to own 100 percent of the share in an Iraqi business. The order also regulates that except certain sectors like oil and gas, insurance etc., foreign investors are to receive equal treatment with domestic investors.

Other than these programs, the CPA also spent money on activities to reconstruct Iraq's devastated infrastructure and provide the essential services to the Iraqi people (such as sewers, bridges, schools, etc.)

Crocker argues "the CPA undertook efforts in all these areas, but what made the CPA's efforts radical was its unusually early attention to reforming Iraq's financial sector and creating a business-friendly investment climate as well as the fact that it imposed significant legal reforms as an occupying power without the involvement of a legitimate Iraqi government" (Crocker 2004, 76).

However, the CPA also created adverse outcomes for the Iraqi economy and failed in certain tasks. First, the CPA put an extra emphasis on developing certain sectors to deliver the essential requirements such as oil, electricity, and potable water to the population and neglected long-term projects to improve agriculture and the industrial sectors.

Secondly, the CPA failed to implement its privatization projects. At the time the CPA came to power in Iraq, there were 189 state owned companies in the country. Most of these companies were operating at low capacity with rampant mismanagement, were overstaffed and had inefficient technological equipments. According to Merza, there are three reasons behind the failure to privatize: first, there were large number of state-owned enterprises, which the CPA inherited and it was technically very hard to manage the privatization process due to the lack of detailed information and the staff to carry out the task. Second, since companies employed most of the population (all those associated with the state-owned companies, workers, managers, customers and suppliers), the CPA feared that privatizing them would fuel unemployment and this may lead an increased in violence, especially after the dissolution of the army. The third was the strong political opposition to privatization of the oil sector (Merza 2008, 2). Looney also implies that the state is the biggest employer in Iraq, and the Iraqi people depend on a heavily subsidized system of inputs for its manufacturing industry and the inexpensive goods and services. Privatization caused the fear among the people of losing these advantages and facing higher inflation level with a lower living standard and now increases in wages that are linked to productivity (Looney 2004b, 94).

According to Sassoon, the failure of privatization was the unfortunate outcome of “the ambitious and unrealistic plans” of the CPA. The CPA perceived Iraq to be like postwar Germany or post-Communist Europe, and it believed a vibrant private sector could quickly succeeded and mostly referred to the experiences of Central and East European countries. However, Europe had a deep history of mercantilism, capitalism and a market economy prior to the hiccup of the Iron Curtain and/or WW2. The CPA’s strategic plan argued that: “The unique recent experience of the Central and East European countries from their transformations should be helpful in this regard (CPA 2003)”. However, this perception which portends problems along the lines of those experiences has been heavily criticized. Sassoon contends that because Iraq has had the legacy of 40 years of socialism, plans of privatization on such a scale would be like applying shock therapy to a feeble economy (Sassoon 2010, 191). Stiglitz also argues that shock therapy at the level of the macroeconomic reforms projected would not fix the economy, and he also claims “shock-therapy countries saw incomes plunge and poverty soar. Social indicators, such as life expectancy, mirrored the dismal GDP numbers.” He also notes that the unique economic conditions and ongoing occupation make “privatization particularly problematic. The low prices that the privatized assets are likely to fetch will create the sense of an illegitimate sell-off foisted on the country by the occupiers and their collaborators. Without legitimacy, any purchaser will worry about the security of his property rights, which will contribute to even lower prices. Furthermore, those buying privatized assets may then be reluctant to invest in them; instead, as happened elsewhere, their efforts may be directed more toward asset stripping than at wealth creation. (Stiglitz 2004)”

Third, due to de-Ba'athification efforts and policies, most of the senior officers and technicians in Iraq had fled or been arrested, and this led a huge vacuum in attempting to manage the economy. The CPA could not fill this vacuum and failed to employ an effective recruitment policy (Looney 2004b, 97).

Fourth, the measures taken by the CPA to reform the Iraqi financial sector caused serious allegations of corruption and the system was open to widespread abuse, since there were no anticorruption mechanisms in place, let alone enforced. Iraqis citizens and many NGOs believe that government ministries were withdrawing money for personal uses. This notion seriously reduced credibility and trust for CPA's intentions in reforming the Iraqi economy (Crocker 2004, 77: Looney 2004b, 92).

Another critique was directed toward the CPA's project management abilities. For most Iraqis, the reconstruction funds were not used for their explicit needs and they only financed the security-related needs of the elite, the profits for U.S. companies, CPA and Department of State administrative costs. Crocker also points out that the funds use to finance the CPA's economic strategy to rebuild infrastructure, and to revitalize the Iraqi economy were mostly used to provide contracts for US firms and contractors rather than Iraqis. Crocker argues that "reliance on large US contractors to perform reconstruction work in Iraq is not only far more expensive than hiring Iraqi companies, it also means that too small an amount of US reconstruction funds is being used to hire Iraqis [thus giving them experience], capitalize Iraq's economy, and build local capacity (Crocker 2004, 87)". This over-reliance and the fact that Iraqis were not adequately involved in the CPA's economic reconstruction efforts were primary reasons behind the CPA's failure to tackle Iraq's unemployment problem.

Ozlu notes that the CPA's failure to understand the outcomes of the reform process weakened its positive impacts on Iraqi economy. As a result, he argued that the policies of the CPA caused more unemployment and isolated Iraqi people from reform process and the development efforts. The reforms also did not support the creation of a civil society in Iraq. The fact that CPA reforms focused on radically restructuring the economy rather than adopting a people-centered concern caused the reforms to miss the point. What Iraq really needed was policies that aimed to increase the living standards of the poorest and the most desperate, not exclusively business oriented priorities that the Coalition Authority chose to focus on (Ozlu 2005, 22).

Overall, security problems, political instability and sectarian violence in Iraq hampered the economic efforts of the CPA by delaying the rebuilding efforts, increasing costs and discouraging foreign investment. The fact that the CPA was an occupying power and there was minimum Iraqi involvement in the formulation of its plans and priorities also limited the success of the efforts of the CPA (Crocker 2004, 75). Since the CPA was "provisional" and the rules of the CPA were subjected to approval of an elected Iraqi government in the future, the new economic sphere included several uncertainties for investors and entrepreneurs (Looney 2004b, 92). Analyzing economic growth in developing countries**,** Rodrik (2001) underlines the ineffectiveness of the "foreign programs". He argues "transitions to high economic growth are rarely sparked by blueprints imported from abroad". He contends that the initiating reforms for economic growth should be country-specific, and that come out of local knowledge and experimentation. These kinds of innovations are tailored to institutional realities" (Rodrik 2001, 1-2). However, the reform policies under the CPA could not create a peculiar context for Iraq.

V. NEW ERA: CAN IRAQ TRANSFORM THE ECONOMY?

On June 28, 2004, the CPA (the Coalitional Provisional Authority) transferred the management of the state and the economy to Iraqis and this opened a new chapter in Iraq's economic history.

5.1. The Transfer of Economy Management to Iraqis

After the CPA, Iraq's interim government undertook the herculean tasks of economic and political rebuilding efforts and aimed at creating institutions for a modern state and society. In the economic sphere, the new government focused on introducing fiscal and monetary policy tools to reinforce the capacity and capabilities of Iraq's financial institutions. In order to increase savings and investments, interest rates were liberalized and private banks were enhanced. New regulations were adopted to encourage foreign banks to operate in Iraq, and they were allowed to enter into joint ventures with private Iraqi banks. The structure of Central Bank of Iraq (CBI) was enhanced and its independent status was reinforced. New insurance laws were adopted. After achieving Paris Club debt forgiveness agreement in December 2004, the new government's fiscal burden on the budget was released. In order to ensure good governance, new mechanisms were established and the existing institutions were enhanced (the authority of the Board of Supreme Audit and ministerial inspector general offices were increased, the Commission on Public Integrity was established; and in order to fight against corruption in each ministry, inspectors general were installed into various positions). In order to liberalize the economy, government price controls were reduced and new regulations were introduced to regulate securities, foreign investment, public financial management, public procurement and central banking. To increase the integration of the economy with the world economy, Iraq started to introduce low tariffs and initiated accession talks with the World Trade Organization (WTO) in 2004.

After transfer the power to the Iraqi government, Iraq signed an Emergency Post Conflict Assistance (EPCA) agreement with the International Monetary Fund and submitted a memorandum in September 2004. The new government adopted a 'National Development Strategy (NDS) 2005-2007' in June 2005, and readopted a similar text for the period of 2007-2010. This document was declared as the "first National Development Strategy produced by a democratically elected government of Iraq" (Ministry of Planning and Development Cooperation 2005, vi). The document underlined the urgent need for an alternative strategy to fix the failures of the previous dictatorial regime, which mismanaged the country for 40 years (Ministry of Planning and Development Cooperation 2005, viii)[7]. The new vision of Iraq was announced: to become a prosperous, market-oriented regional economic powerhouse that is fully integrated into the global economy (Ministry of Planning and Development Cooperation 2005, viii)". The NDS also stated that this vision can only be achieved by a market-oriented economy that is open to the world, driven by the ingenuity and creativity of private enterprise, founded on the rule of law, and led by a federal, democratic, transparent and accountable government with some of the lowest human development indicators in the region. The aim of the NDS was declared as weaving "together macroeconomic and sectoral analyses and proposals into a consistent policy fabric that will bring substantial benefits to all regions in Iraqi society." In this regard, the NDS underlined the importance of the population's active participation in production activities and the creation of wealth formulating mechanisms to secure the involvement of all of Iraq's regions in the implementation of the NDS and in the development process.

[7] By stating that the country was mismanaged for 40 years, the new Iraqi government reveals that it differentiates the monarchy regime and military rule under Qasim from the Ba'ath experience. The NDS says "Iraq, once self sufficient in agriculture, with tremendous oil wealth, a vibrant private sector and an educated and skilled population has gone from being one of the most advanced nations in the Middle East to a country ((Ministry of Planning and Development Cooperation 2005, viii)".

The NDS also set out four pillars that would guide the strategic public actions for economic development in Iraq; first, strengthening the foundations of economic growth; second, revitalizing the private sector; third, improving the quality of life and; fourth, strengthening good governance and security (Ministry of Planning and Development Cooperation 2005, viii)".

In order to strengthen the foundations of economic growth and to ensure rising prosperity, the NDS argued three conditions should be met: stable macroeconomic environment, improving the performance of oil sector and a diversified economy.

For ensuring macroeconomic stability, the NDS contended that the government should focus on maintaining low inflation through monetary policy tools, preparing sound and transparent budgets, enhancing the control mechanisms on public expenditures, creating trustable mechanisms to ensure transparent and full accountability of oil revenues, alleviating the country's debt burden, following the reforms and policy recommendations under the IMF program, establishing mechanisms to provide financial and economic data, decentralizing the management of the economy and improving the banking system to increase the private savings in the country.

Second, the NDS discussed the ways and the means to improve the oil sector, which provided 63.3 percent of the GDP and 97 percent of the state budget revenues (as of 2005). According to the NDS, the oil sector's performance could be improved by improving the legal and regulatory framework in the sector to enable restructuring of the industry; taking the necessary steps to attract foreign oil and gas companies to invest in Iraq, and also promoting partnerships between Iraqi and foreign companies; creating independent national oil and gas companies; reducing the subsidies in the industry and investing in technical and administrative training to reinforce production capacity.

Third, the NDS argued that there was a need to bolster the performance of the non-oil industry and to create a diversified economy. The NDS implied that the reliance of only oil might create an adverse impact on the economy. First, it may cause “Dutch Disease”, which occurs when exploitation of oil de-industrializes the economy by triggering the appreciation of the currency and weakening the competitiveness of the domestic manufacturing. Second, the NDS argued that because the prices in the oil industry tended to be unstable, massive volatility in the oil markets had the potential to ruin Iraq’s economic growth. Hence, the Iraqi economy should open more space for non-oil industries, especially for agriculture, tourism and industry, which might mitigate the losses from oil price volatility. Third, the report pointed out that because the oil industry is capital intensive, it did not create jobs in the market and therefore, the rate of unemployment in Iraq is at its peak (Although new construction projects do employ large numbers of laborers, the activity is largely limited to the Northern Part of Iraq).

The second pillar of the NDS was revitalizing the private sector. The NDS emphasized that a vibrant private sector is the engine of economic growth, prosperity and job creation. In this context, the NDS argued that creating an attractive investment climate for both domestic and foreign entrepreneurs, and for different sectors, should be a priority.

The third pillar of the NDS was improving the quality of life. In this regard, the NDS prioritized the efforts to improve the life conditions of Iraqi people by creating access to water, electricity, sanitation, housing, etc.

The last pillar of the NDS was to enhance good governance and improve security conditions. The NDS notes that the access to "justice, security and human rights" was central to stability, and the lack of security has hampered economic activity and encouraged capital flight and proposed new mechanisms to ensure good governance and provide security.

Three successive Stand-By Arrangements (SBA) with the IMF (IMF, 2006, 2008, 2010) also reinforced the steps of National Development Strategy. The SBA documented its objectives as "the preservation of macroeconomic stability, and the adoption of policies and measures to ensure sustainable growth and poverty reduction." According to the IMF, cooperation with Iraq has two pillars. First, the IMF has helped the Iraqi authorities in their efforts to maintain macroeconomic stability as a key condition for economic growth and a generation of sustainable employment opportunities for Iraq's large labor force. Second, the IMF had and will continue to assist the Iraqi authorities in rebuilding essential economic institutions with its policy advice and technical expertise (IMF 2011)". The program also has intended to augment structural reform agenda of Iraqi government. This objective has had three key pillars: modernizing Iraq's public financial management system, developing the financial sector, and strengthening governance in the oil sector.

On October 1, 2010, the IMF completed the first review of Iraq's economic performance under the SBA with Iraq, and as of December 31, 2010, the total contribution of the IMF to the Iraqi economy reached to total of $1.67 billion (IMF 2011).

5.2. Economic Outcomes of the New Strategies

After the December 2005 parliamentary elections, the Maliki government has taken further steps to improve the economy. The second term of the Maliki government, which began on December 2010, has created the groundwork and necessary steps for augmenting the Iraqi economy.

Despite political uncertainty and security problems, the Iraqi government has succeeded in maintaining the reform process and has made some progress in developing the institutions needed to implement new economic strategies. The debt reduction agreement with the Paris Club, new Stand-By Arrangement with the IMF and pledges for $18.02 billion in foreign aid (as of December 2010) helped the government to sustain economic stability. In this context, I will briefly analyze the progress of the Iraqi economy and portray the implications and impacts of new era.

According to the IMF, Iraq's overall macroeconomic performance is strong. The Iraqi government has managed to maintain liberal economic principles along with a sound macroeconomic strategy.

Table 2: Selected Economic Indicators – (2005-2010)

Year	GDP (Billion $)	Growth (%)	Population (Million)	GDP Per Capita ($)	Inflation (%)	Exports FOB	Imports FOB
2005	31.3	3,3	28.4	1100	37,0	23,697	20,002
2006	45	6,2	29.2	1543	53,2	30,529	18,708
2007	56.9	1,5	29.9	1903	30,7	39,587	16,623
2008	86.5	9,5	30.7	2817	2,8	58,806	37,219
2009	65,8	4,2	31.4	2090	-2,8	40,857	35,768
2010*	80,3	7,3	31,4	2557	6	48,797	42,564

Sources: EIU Country Report Sept. 10, World Bank, IMF 2011, COSIT

In this context, economic growth was realized at 6.2, 1.5, 9.5, 4.2 and 7.3 percent from 2006 to 2010. The majority of this growth was financed by oil revenues. According to IMF projections, as a result of the increases in oil production in 2011, the real GDP growth in Iraq is estimated to be 12 percent in 2011. In Iraq the total GDP, in current prices, increased to $80.3 billion in 2010 from $31.3 billion in 2005 and expected to be $92.8 billion in 2011. The per capita GDP was $2,898 in 2010.

Regarding inflation, the Iraqi government has undertaken several measures since 2002. Persistent inflation emerged in Iraq during the 1970s, and after the two wars and the subsequent economic sanctions, hyperinflation became a major structural problem. After declining from 448 percent in 1994 to 5 percent in 2000, inflation accelerated to 20 percent in 2002. This trend was influenced by the supply limitations imposed by the UN sanctions. Sassoon implies that the negative impact of hyperinflation was that "people were forced to liquidate their assets, and huge disparities in income between the rich and poor were created. This was the beginning of the demise of the middle class" (Sassoon 2010, 196)

After the CPA, inflation stabilized at around 30 percent. However, after sharp rises in fuel and electricity prices, inflation again increased to 37 percent and 53 percent in 2005 and 2006. After transition to market economy and declining state control on prices, consumer prices started to increase sharply, following the rise in fuel prices (due mainly to insecurity, corruption and smuggling).

After 2006 the CBI took the lead and took successful steps to keep inflation under control through managing the exchange rate and keeping the interest rate policy positive in real terms. Since introducing the new Iraqi dinar, the Central Bank has utilized the exchange rate to manage inflationary rates. On the other hand, the gradual elimination of explicit and implicit fuel subsidies, the declines in government expenditures and securing oil revenues also helped keep inflation under the control. As a result, inflation, which was 37 percent in 2005, remained in the low single digits and was realized at 6 percent in 2010 (IMF World Report 2011) and 6.59 percent as of May 2011 (CBI 2011). The CBI's policy interest rate, which has been gradually reduced, was at 6 percent (valid from April 2010) and positive in real terms.

With low inflation, the exchange rate has been stable since the beginning of 2009. The dinar, which initially traded between 1,450 and 1,480 to the U.S. dollar, rose by 12 percent during 2006, reaching 1,295 dinars per dollar in January 2007. As of July 6, 2011, the exchange rate stood at 1,170 dinars to the dollar (Sassoon 2010, 197). The CBI's net foreign reserves reached to $50 billion at end-December 2010, up from $44 billion at end-2009 (CBI 2011).

However, the growth in non-oil real GDP is still very low and the share of tax revenues in GDP could not be increased. In 2009, tax revenues were only ID 1.4 trillion, while crude oil export revenues were ID 56.1 trillion. Government revenues for 2010 was projected ID 64.7 trillion and oil revenues still represent almost 90.5 percent of these revenues in 2010; however, non-oil revenues represent 9.1 percent (including customs, levies, taxes, transfers from oil related enterprises, fees and grants). According to 2011 projections, the share of oil in the budget will not be below 90 percent and tax revenues will be only 2.3 percent (IMF 2011, 8).

Government spending in Iraq reflects the broader picture of the economy. In 2010, only 25 percent of the expenditure was allocated for investments, while 55 percent of the budget was directed to salary, pension and transfers (IMF 2011, 16-17).

Cordesman argues that although the growth rate is high, it is still driven by earnings from oil exports and government spending. He says the economic growth is largely an outcome of massive amounts of foreign aid and wartime spending, and not from economic development. Especially for the first years of the Maliki government, he contends, resources have not been distributed in ways "that produce productive and lasting employment and investment; rather, they distort Iraq's economy and support subsidized and often 'dead end' jobs and projects (Cordesman 2010, 33-35)." In order to illustrate it, Cordesman implies that the government had to reduce its 2009 budget by 25 percent due to lower oil prices and declining aid expenditures.

Unemployment is another means to gauge Iraq's progress in the new era. Unemployment in Iraq has been increasing throughout 1990s as a result of declining economic activities due to the wars and embargos and is still a serious problem for the economy. Due to the high fertility rates after the 1980s, the annual population growth rate was 3.9 percent in the mid-1980s. Iraq's population was only 5.2 million in 1950; 13.2 million in 1980 when Saddam came to power; 17.8 million in 1990 when Iraq invaded Kuwait and economic sanctions against Iraq was initiated; 24 million in 2000, and in 2009 it is over 32.1 million. The population today is nearly three times higher than in 1980. However, GDP per capita in Iraq in 2010 was still almost half of the amount Iraq had in 1980.

According to Merza, after the war ended in 2003, several factors pushed unemployment even higher, mainly: "Violence, internal and external displacement; the low level of economic activity in general and public development expenditures, in particular; the disbanding of the army; physical segmentation of national and provincial markets (Merza 2008, 13)."

After the Iraqi government launched a new development plan, and as a result of reactivating the Iraqi economy, the unemployment rate fell from 28.1 percent in 2003 to 15.3 percent in 2008. Central Organization for Statistics in Iraq *(*COSIT*)* indicated that unemployment in Iraq fell to 15.34 percent in the 2008 from 17.5 percent in 2007. According to the study, while unemployment rates were low in Baghdad (11.7%), Erbil (13.2%), Kirkuk (12.6%) and Sulaimaniya (11.8%), they were high for Thi Qar (30.8%), al Muthanna (24.8%) and Ninevah (21.9%). Cordesman notes that although these numbers appear to be falling, they are still quite high. He also underlines the high unemployment rates among young population. Cordesman points out that the estimated unemployment rate for males aged 15 to 19 in 2008 remained high at 59 percent.[8] "The government needs to pay greater attention to providing either employment or education opportunities for this part of the population, as they are the greatest recruiting pool for insurgency movements" (Cordesman 2010, 33-34).

5.3. The Developments on Certain Sectors

Rivlin argues that the need for security and the ending internal conflicts are preconditions for economic progress. However, along with these efforts, the government should effectively channel increasing oil revenues to finance the development of the agriculture and industry. This is the only way for Iraq to reduce its overwhelming reliance on oil revenues, to diversify its economy and to create alternative sources of employment, income, and output (Rivlin 2006, 153). In this part, I will analyze the developments in certain sectors in Iraq.

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[8] DOD, Measuring Security and Stability in Iraq, October 2009 (issued November 2009).

5.3.1. Agriculture

The economic sanctions after 1991 prompted the Iraqi government to increase its emphasis on agricultural development and the government started to provide higher prices for the crops to Iraqi farmers. This had enlivened the sector for a limited time, which led to an impressive increase in agricultural GDP. However, after the OFF (Oil For Food Program) program started to be implemented, local farmers lost their position in the market and Iraq has become dominated by imports. After 1997, suffering from rapid population growth, the wars, poor governance, limited water resources and general stagnation in agricultural productivity, Iraq became completely dependent on imports to meet its food needs. By 2002, almost all agricultural products (wheat, rice, sugar, vegetable oil, and protein meals) were imported. Cordesman underlines that “Iraq, a country that exported food around the region, is now one of the world’s biggest rice and grain importers” (Cordesman 2010, 56-58).

Since the 2003, developmental progress in the agricultural sector has remained very limited. Only 8 percent of Iraq’s GDP comes from agriculture, although some the sector employed up to 20 percent of the nation’s work force.[9] Iraq’s self-sufficiency in food production dropped from 80 percent in the 1960s to less than 30 percent as of 2008 (Sassoon 2010, 198). It was mainly due to the legacy of past mismanagement, poor policy decisions and a neglected irrigation system along with the persistent effects of severe drought during 1999-2001.

[9] The share of agriculture in the GDP has declined sharply since the early 1950s, from 22% in 1953 to 7.5% in 1976. It is expected to dwindle further 5% during the 1976-1980 plan, whereas agriculture’s portion of the labor force is estimated to fall from 53% to 44% (Al Ameen 1981, 264).

Clearly, Iraq will be dependent on imports to fully meet domestic food demand for several years to come. The steps the Iraqi government has taken to revitalize agricultural development still could not achieve meaningful progress. The key areas in the agricultural sector that suffered a particularly sharp decline in output during the past few years include the production of dates, wheat and rice because of drought, insects, poor irrigation, red tape, salty water, and disease.

Sassoon argues that postwar looting damaged a variety of agricultural production centers, and agricultural policy continues to suffer from a lack of coordination between government ministries, and the sector faces similar issues to the rest of the economy, such as the under spending of allocated funds (40 percent), a lack of skilled personnel to run projects, corruption, and a lack of security (Sassoon 2010, 198). Iraq's service ministries spent only 11 percent of their allocated budget in 2008. For example, since 2003, Iraq has spent only 12 percent of a $17 billion investment budget for reconstruction in the oil, electricity and water sectors[10].

5.3.2. Manufacturing Sector

In the new era, the manufacturing sector has faced several challenges. During the early days of the Ba'athist period, the industrial sector was invested in, since it was considered an important element in the militarization of the economy. However, subsequent wars and sanctions caused heavy damage to industrial productivity and sector has deteriorated since 1980. Sassoon notes that during this period, while industrial workers constituted only 3 percent of the employed population, the military employed 23 percent of active work force (Sassoon 2010, 200).

[10] US Government Accountability Office Report to Congressional Committees "Key Issues for Congressional Oversight", March 2009

After 2003, the new management in the country inherited a key sector with damaged infrastructure, ineffective production methods and poor technical skills among the labor force and management. Part of the legacy afflicting the industrial sector is characterized by import substitution, which caused an increase in the country's reliance on imports (at the expense of precious foreign currency reserves). Most of the domestic industry was focused on military needs, light consumer industries and oil-related industries, such as petrochemicals and fertilizers.

Although the actors of the new era placed a strong emphasis on privatization and liberalization to revitalize the manufacturing sector, the domestic context in the country created several constraints on development efforts. As a legacy of the past era, the State-Owned Enterprises (SOEs) has created a heavy burden in the social and economic sphere for the government. These SOEs, established under the Ba'ath regime and controlled most sectors of industrial activity, still maintain a remarkable place in government spending (subsidies, free utilities) and have continued to employ hundreds of thousands of Iraqis, even though they have stopped their operations. More recently the SOEs have largely been managed by inexperienced new managers due to the de-Ba'athification policy, and therefore lacked the ability and incentives to become competitive internationally.

The Iraqi government determined that privatization was the key to success for SOEs and in 2008 the Iraqi Ministry of Industry and Minerals announced a new strategy to privatize the state-owned companies. The Ministry declared its intention to transfer the ownership to private companies and adopt a new national industrial development strategy that was led and formulated by the private sector. The Ministry announced the strategy as follows: "the investor shall implement the activities to rehabilitate and modify the factory in accordance with modern technology as well as manage and operate the factory, all at the investor's account against share of accomplished production, for a defined period" (MIM, 2008, 1-5). However, as of November 2009 only one joint venture existed between an Iraqi SOE and the private international investment consortiums (Cordesman 2010, 55-56). Among the reasons for failure in the sector were: unreliable power supply (fuel shortages, insufficient electricity supply), lack of skilled labour, heavily subsidized structure of the facilities and excessive number of work force[11], instable political and security situation; these represent only a small portion.

After eight years of the new Iraq, the manufacturing sector still depends largely on the exports of the oil industry to obtain key imported technology and other inputs. As a result, even today, the industry sector suffers from excessive dependence on state investment and is under heavy control of the government. Most of the tender procedures have been monitored and concluded by the government and state actors have exclusively made policy decisions of these companies. This failure to reduce the government patronage to the sector hampers the transformation of the sector and discourages foreign participation into the Iraqi market.

5.3.3. Investments and Trade

Cordesman argues that before Iraq initiated the efforts to diversify its manufacturing sector, it must focus on channeling government revenues to fund infrastructure projects essential for private business, and introducing and developing sound business practices in order to attract foreign investment (Cordesman 2010). However, as it is implied in the introductory chapter, ill-defined or unclear property rights continue to make the investment climate unfavorable and this has created a reluctant attitude of international companies to invest in the Iraqi economy.

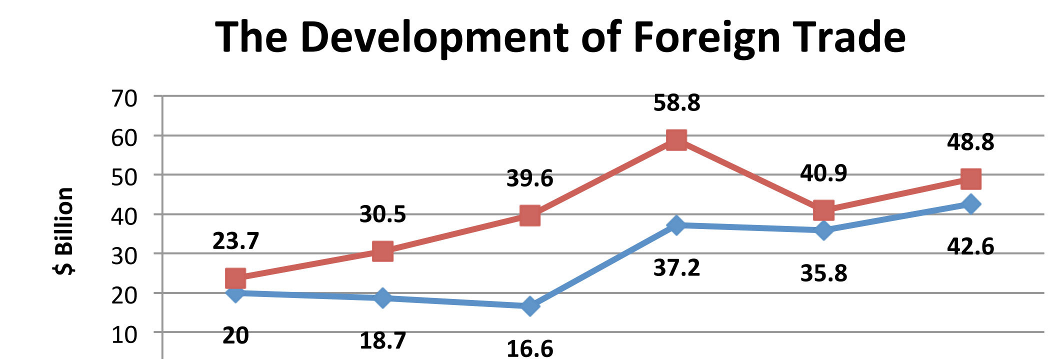
[11] There are an estimated 192 State- owned Enterprises (SOEs) that employ a combined 500,000 Iraqis. This labor forces support a significant portion of the population.

In this regard, the establishment of the National Investment Council of Iraq is one of the most significant achievements in new era. In 2006, the Iraqi government approved Investment Law No. 13, which defined the environment for attracting foreign investment to Iraq, and the government initiated a comprehensive strategy that includes tax incentives, investor guarantees, obligations of investors, and the creation of the National Investment Commission (NIC). The NIC has been established to serve as promoter, facilitator, monitor and policy advisor for investment into Iraq. The Council has established local investment commissions in every province, and has allocated certain amount of its budget for these commissions to fund their activities to attract investors. The organization serves as a gateway for investors to understand the Iraqi market and help them cope with the challenges they face in their investments. So there is some hope for increasing Iraq's exports and foreign investment.

Iraqi development in the telecommunications sector is also striking. Iraqi mobile telephone subscribers have steadily increased and reached 8.7 million in early 2007. By April 2009, there were 17.7 million cellular subscribers. A more dramatic change for the country has been the use of the Internet. During Saddam Hussein's regime, the Internet was virtually unknown among the population and, similar to cellular telephones, its access and use was restricted to government circles. Baghdad now has dozens of Internet cafes, and by April 2009 there were around 820,000 Internet subscribers (as compared with an estimate of just 4,500 subscribers prewar). Interestingly, importers and exporters have begun using the Internet to expand their businesses (Sassoon 2010, 201).

Another success in new era is the development of foreign trade. Iraq's foreign trade volume reached to $91 billion in 2010. Iraqi exports realized as $48.7 billion and the imports realized $42.5 billion. The main markets for Iraqi goods are USA, India, South Korea and Italy, and the primary sources for Iraqi imports are Turkey, Syria, Iran, United Arab Emirates and China.

Figure 1. The Development of Foreign Trade 2005-2010



	2005	2006	2007	2008	2009	2010
Imports	20	18.7	16.6	37.2	35.8	42.6
Exports	23.7	30.5	39.6	58.8	40.9	48.8

Source: Trademap

5.3.4. Oil Sector

In the new era, oil is still the core of the economy. Iraq has stated proven oil reserves of 115 billion barrels, and this is among the largest in the world. In 2010, the Iraq Oil Ministry, referring to new geological studies, announced that Iraq's proven oil reserves have increased by 25 percent to 143.1 billion. In terms of the size of proven reserves, Iraq remains in second place behind Saudi Arabia, and therefore holds a significant place in the political development and economic trend of the international oil market.

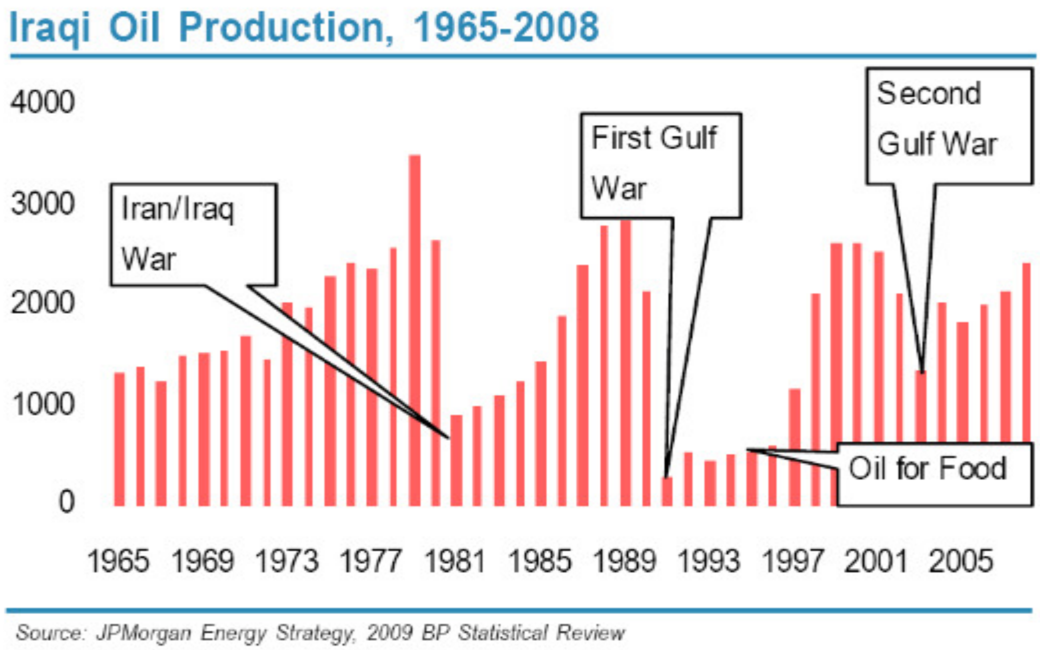
Table 3. Distribution of Oil Revenues

Distribution of Oil Reserves				
Operating Area	**Fields**	**Reserves (billion bbl)**	**2010 Production (1,000 bbl/d)**	**Potential Production (1,000 bbl/d)**
KRG	6	2	15	375
North Oil Company	32	21	770	1,300
Midlands Oil Company	27	13	10	680
Missan Oil Company	10	8	110	820
South Oil Company	25	69	1,455	10,050
Total	100	113	2,360	13,225

Source: EIA

However, the legacies of the wars and mismanagement in the country have blocked the benefits of oil industry to the Iraqi economy. When the CPA took over the administration in 2003, the infrastructure of the industry was in a very poor condition. While crude oil production reached to 3.48 million barrels per day in when Saddam took the power in 1979, it averaged 3.5 million bbl/d prior to Iraq's invasion of Kuwait in 1990 and it declined to an average of 0.68 million barrels per day aftermath of the Gulf War (from 1991 to 1996). After Iraq agreed to implement the OFF (Oil For Food) Program in 1997, crude oil production climbed to 2.81 million barrels per day in 2000 and declined to 2.13 million barrels per day in 2002 (OPEC, 2000; NDS 2005, 5).

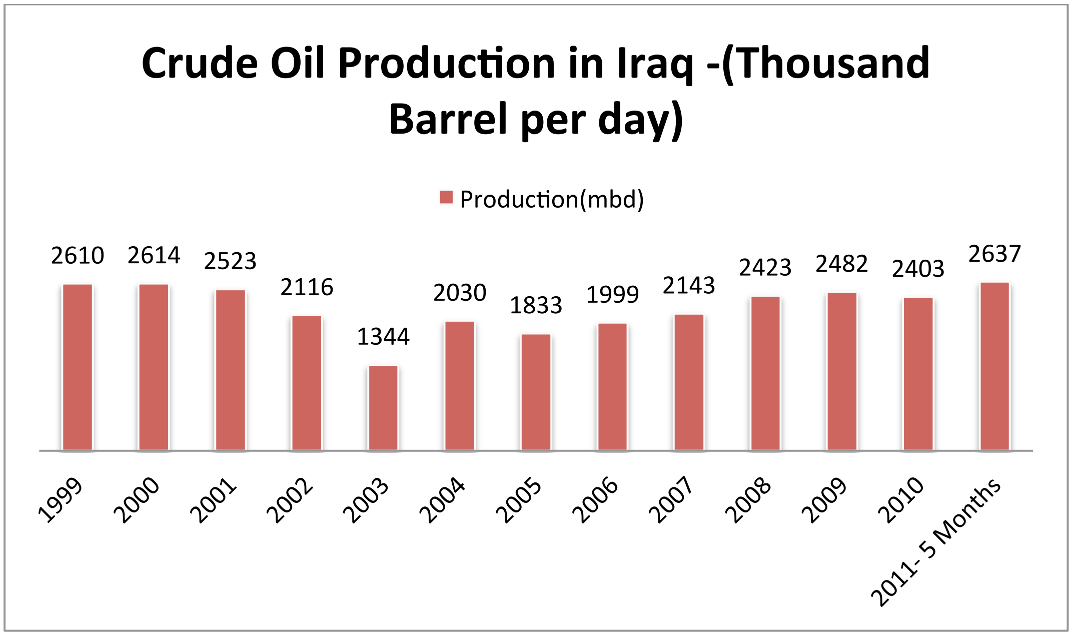
Figure 2. Oil Production - 1965-2008



Although, there have been several efforts to recover the oil industry from the aftermath of the wars and sanctions, which created underinvestment and damaged the infrastructure, the Iraqi government has yet to be able to boost and sustain its export capacity and fuel the production of oil. After 2003 and contrary to expectations, production dipped down below that of 2002.

After eight years of reconstruction, Iraq's production today is around 2.6 million barrels per day and current exports are 2.2 millions barrels per day during the first five months of 2011.

Figure 3. Oil Production (1999 – 2011)



Source: Ministry of Oil of Iraq

In 2009, out of 1.8 million bbl/d of crude oil of Iraq was exported via Iraq's Persian Gulf ports in the south and the Iraq-Turkey pipeline (Kirkuk-Yumurtalik) in the north. The main destinations for Iraqi oil exports were Asian countries, especially China, India, and South Korea.

Table 4. Oil Exports (1980-2010)

Crude Oil Exports of Iraq		
Year	**(Thousand Barrels per Day)**	**(Million US Dollars)**
1980	2482	26096
1981	872	10039
1988	2095	11315
1989	2260	14810
1990	1596	9933
1991	39	276
1998	1417.6	5832
1999	2130.9	12231
2000	2039.8	16864
2001	1710.2	14435
2002	1494.6	11473
2003	388.6	5224

2004	1450	17810
2005	1472.2	23648
2006	1467.8	30465
2007	1643	39433
2008	1855.2	56843
2009	1905.6	41852

Source: IMF Annual Statistical Yearbook, 2010

Although, the government announced its aim to increase its export capacity to 4.5-million bbl/d by the end of 2012, current production is well short of the government's projected target.

Many factors contribute to this failure. According to Sassoon, there are three main reasons: continuing violence and poor security, corruption and smuggling, and the lack of control of the oil in Kurdistan.

First, Sassoon argues that the attacks on oil facilities have hampered oil production. In 2006, the estimated cost to the country ranged from $5 billion to $8 billion per year. Second, Sassoon notes, corruption has impeded the development of Iraq's oil sector. He points out three factors behind the corruption: lack of a metering system of Iraq's oil exports; continued fuel subsidies, which have caused a huge difference between the prices of Iraqi products and those of neighbor countries; and the absence of proper control systems due to the collapse of the bureaucracy after 2003 (Sassoon 2010, 196). The third constraint for development of the oil industry, Sasoon contends, is the lack of control of the oil in the Kurdistan region. In Kurdish-populated northern Iraq, although security has been established through effective mechanisms, production and exports have been still limited due to disputes between the Kurdish Regional Government (KRG) and the Iraqi central government with regard to revenue sharing and the issuing of export licenses to foreign oil companies (Sassoon 2010, 196).

According to Jaffe, the failure to restructure the oil sector in Iraq has stemmed from two main factors: the lack of proper attention to reservoir management and inadequate maintenance of the pipelines and other infrastructure. Jaffe argues that there has been little to no development of new oil fields in Iraq since 2003, and the primary reason for this lack of investment has not been "lack of funds, but rather the politicization of the oil ministry, the absence and/or exodus of trained personnel, and poor or corrupt management in the oil sector. The deterioration of the security situation in key production areas has only compounded the problems" (Jaffe 2006). The figure below explains the weaknesses of infrastructural capacity.

Table 5. Oil Infrastructure

Oil Infrastructure				
Ports	**Upgrades**	**Status**	**Capacity (Thousand bbl/d)**	**Effective Capacity (Thousand bbl/d)**
Basra	developing plans to add at least 3.2 million bbl/d	operational	1,600	1,300
Khor al-Amaya		operational	700	200
Export Pipelines	**Route**	**Status**	**Capacity (Thousand bbl/d)**	**Effective Capacity (Thousand bbl/d)**
IPSA	Iraq-Saudi Arabia	closed	1,650	0
Iraq-Turkey	Kirkuk-Ceyhan	operational	1,600	1,000
Heavy Oil via Turkey	Majnoon-Turkey	proposed	1,500	0
Iraq-Syria	Haditha -Syria	proposed	1,250	0
Iraq-Turkey	Haditha-1T1A depot-Turkey	proposed	1,000	0
Iraq-Syria-Lebanon	Kirkuk-Banias-Tripoli	closed	700	0
Iraq-Jordan	Haditha-Aqaba	proposed	500	0
Internal Pipelines	**Route**	**Status**	**Capacity (Thousand bbl/d)**	**Effective Capacity (Thousand bbl/d)**
Strategic	Haditha-Rumaila-Basra	limited usage	800	200

Source: EIA

Jaffe also underlines the negative impacts of security and emphasizes that "sectarian and regional strife undermines the ability to operate facilities or the sector as a whole either efficiently or effectively" (Jaffe 2006, 5). He argues that since the capacity of Iraqi government to manage the sector has been eroded by these constraints, the reconstruction and maintenance of oil production could not be achieved. Until these obstacles are overcome, Iraq will have an extremely hard time going beyond its present production level and the projections of the government will remain are unrealistic. In addition, the agreements to develop the oil fields still do not produce promising outcomes.

VI. RENTIERISM AND IRAQ: AN ASSESSMENT OF THE CURRENT ECONOMIC SITUATION

The history of political economy in Iraq is basically the history of oil in the country. After 1950 oil became the main source of government revenue that has been used to fund investments in the country and this has retarded the development of other industries. Since the military rule of the 1950s, the government has used petroleum revenues to finance domestic political repression, military aggression and state-sanctioned looting. These revenues also financed the war with Iran and motivated the invasion of Kuwait. In this chapter, I will analyze the rentier characteristic of the Iraqi state by elaborating on the economic mindset of the state and society. In this regard, I will introduce the new faces of rentierism, which will provide a basis to understand Iraq and its current predicament.

In the last 40 years, the oil monoculture has created wealth and prosperity in the Middle East region. However, the rentier state system that evolved from the oil economies has neither provided the people with adequate prosperity nor empowered the masses to develop a more diversified economy. Noreng argues in the 1970s and 1980s, huge oil revenues started to distort the economy of Middle Eastern countries and led to political centralization. The rulers in these countries used oil revenues to delay or prevent political and economic reforms and to sustain their power over the people. Without a private sector, direct taxation and substantial reforms, the people in power in these countries could and do rule the state without needing the consent of the people; and they controlled the society and economy through a repressive state apparatus (Noreng 2004, 11).

According to Askari, there are three reasons why oil has harmed Middle Eastern economies. First, oil attracted outside powers to intervene in the political decisions of Middle Eastern countries and mostly the outside powers support autocratic rulers. Second, the oil rents led to corruption, since in rent-seeking economic activities money does not flow in a transparent way through the market, but relies on nonmarket, political means to maximize the returns. This flow of money creates government bureaucracies that institutionalize systemic corruption. Third, since the export of oil brings huge amounts of foreign earnings to the economy, imports became cheaper and domestic industries became less competitive in world markets. Thus, the production of non-oil goods will not create economic wealth for domestic market (Askari 2009, 414).

In the rentier economies of the Middle East, the central role of oil has created a capital-intensive mode of development where the economy under the control of public sector and private sector does not have the power to guide the direction of economic development. Through accumulating and distributing revenues, the state has become the distributor of privileges and transfers, instead of being a tax collector and/or redistributor (Noreng 2004, 11). In these economies, the absence of income and property taxes has blocked the development of market economy, and the state put no or little priority on the manufacturing sector, investments, foreign trade and entrepreneurship. The small private production has been also channeled to galvanize the survival of political power.

This political and economic environment has created a huge public sector with a powerful state apparatus, a national oil company and state-owned enterprises. Within this state, the private sector mainly has to operate very close to the state in order to maintain its interests and does not involve itself in large-scale industrial activities. Subsidies and transfers have been primary tools the state used to run the economy. The states failed to create commercial institutions (joint-stock companies, private enterprises etc.) that were capable of leading productive resources and produce transformations to keep the countries in the region globally competitive. This was interpreted an outcome of the superiority of traditional Islamic law in the region (Kuran 2011).[12] Since only the governments leads the development in the country, when the oil prices rise it provides the funds to finance government spending, yet when the price of oil declines, the subsequent reduction in oil revenues may block the supply of public services. In these economies, agriculture is largely characterized by low productivity, inefficient investments and heavy public support. In rentier states in the region, the military represents the power of the state apparatus and largely led the political or social changes. Therefore, most of the investments are channeled to finance the needs of the army. This situation galvanizes the strengths of military officials and military involvement in politics becomes a rule of political life. High military spending also prompts the governments to employ an intense nationalist discourse, to create internal and external threats with the aim of justifying the military expenditure and maintaining support of the nation during an economic or political crisis.

[12] Kuran argues that the Islamic law impeded the accumulation of private capital and also prevented the emergence of modern capital markets in the region. The region started to create institutions outside the purview of Islamic very late. According to him, the drawbacks of Islamic inheritance system, the persistent simplicity of Islamic partnerships and the absence of corporation hampered the development of modern economy in the region. He argues that while muslims were restricted from economic life due to Islamic concerns, non-muslim actors in the region benefited the privileges (Turan 2011) .

In Iraq, like in the vast majority of countries in the Middle East, a disproportionate amount of government revenue was funneled into the military. And in the end all the military spending was in vain as it led Saddam Hussein into two different wars, which were followed by international economic sanctions, caused the deterioration of the oil industry, depriving it of essential spare parts and new equipment. Thus, the primary objective of the coalition forces after the 2003 invasion was to focus on rebuilding the infrastructure, and to get oil and industrial production back on track. To better understand this sector, it might be worthwhile to focus on the main issues facing the oil industry.

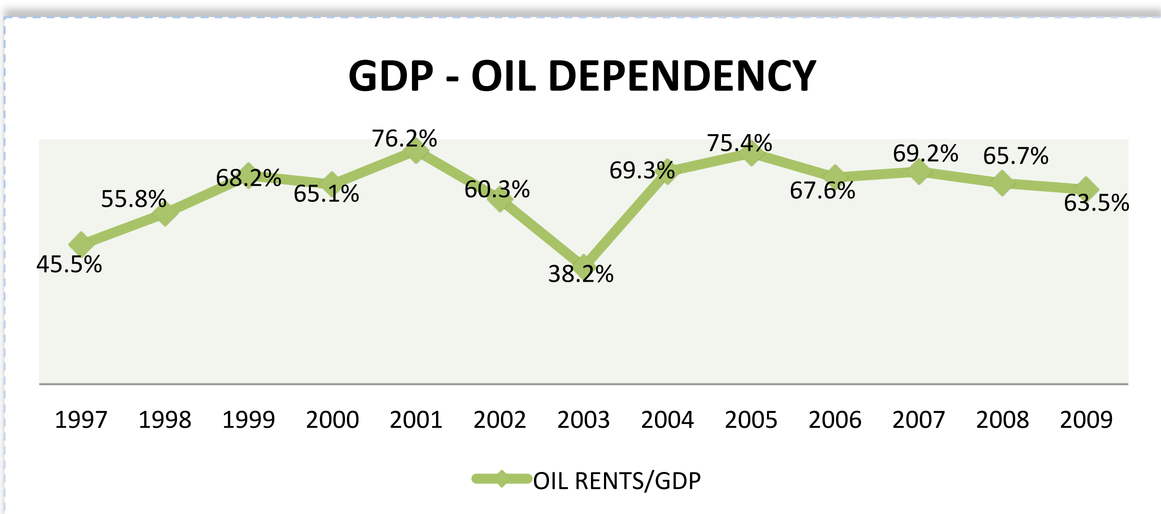
Most analysts point to the economic growth rates after 2003 and argue that the recovery of the Iraqi economy moved at a good pace after the 2003 invasion. However, the recovery for a state like Iraq seemed to be retarded since it is carrying the legacy of hegemonic control of the state over both the public and private sector for more than 50 years. Here, I will elaborate the codes of rentier economy in Iraq in this new era.

Zainy (2003) distinguishes between economic growth and economic development, in the context of Iraq and asserts that while economic growth simply reflects gross domestic product and per capita income, economic development is a far more complex notion, taking into account human resource development, structural changes in the economy (the extent of dependence on exports of primary production), alterations to production methods, and a variety of other social and political factors. Comparing these indicators with those of other OPEC member nations and several developed countries, Zainy concludes that Iraq was clearly not on the road to positive economic development.

Ever since the early 1950s, rising oil revenues, especially after 1973, have stimulated Iraq's economic development. Zainy examines the structure of the Iraqi economy before 2003 and notes that although the economy achieved a robust annual growth between 1960 and 1980, Iraq continued to be heavily skewed toward the extractive sector, dominated by crude oil extraction. This sector contributed 66 percent of GDP in 1960 and declined to only 62 percent in 1980. He asserted that this indicates a continued dependency on the primary production of oil and little diversification of the other sectors of the economy (Zainy 2003; Al Ameen 1981, 263).

The new era in Iraq provides a new frame to test Zainy's argument. In Iraq the dependence on oil revenues still remains prevalent even after eight years of efforts to reorganize the economic development, and Iraq is still an extremely vulnerable country to steep fluctuations in oil prices. As of 2009, 63.5 percent of Iraqi GDP came from oil, and this points to the fact that Iraq is more dependent on oil wealth now than it was 10 years ago. This dependence on oil revenues to sudden changes in oil prices became clear when Iraq's GDP growth dropped from 9.5 percent in 2008 to 4.3 percent in 2009.

Figure 4: Oil Dependency (The Share of Oil Rents in GDP)



The figure above illustrates this trend in GDP growth. The share of oil exports in total exports is more striking. After the war ended in 2003, exports have accounted for around 98 percent of total Iraqi exports. It reveals that the government in Iraq still has oil as its main revenue source and all budget allocations and future planning is based on oil revenues. This increases the vulnerability of the economy to oil price trends and is unreliable as a primary source of government revenue.

The situation in Iraq has produced several explanations on how to cope with the negative impacts of oil or how it can be used effectively. Birdsall and Subramanian (2004) analyzed three options to "save the oil-dependent countries" from their oil: privatizing oil resources, creating special oil funds that limit government discretion in spending the money, and transferring the proceeds from oil directly to the people." According to them, due to the poor institutional capacity of rentier states, privatizing the oil sector cannot produce fruitful outcomes. The second alternative for dealing with a country's oil wealth—the creation of special oil funds, also would not help since weak or unaccountable governments will run (and therefore mismanage) these funds. The third alternative for dealing with the curse of oil is distributing the oil wealth directly to the people. They argued for Iraq that this would be the most effective way, since this method minimizes the opportunities for corruption and misappropriation, as the windfall revenue stays out of the hands of public officials (Birdsall and Subramanian 2004, 85-87).

Looney also suggests one of three options or a combination of them: Privatization—completely separate the government from the oil sector; Disbursement—automatically allocate a fixed share of oil revenues for transfers to the population at large; and Transparency—if the government retains control of oil revenues, rules and procedures must be firmly established to assure full transparency and accountability as the oil revenues flow through the system (Looney 2006, 27).

Looney argues that a distribution fund that would break the direct link between oil and the government may enable Iraq to avoid the oil curse (Looney 2006, 43).

However, the current economic picture shows that Iraq still does not have the operational capability to redefine the role of oil revenues in the economy and still carries the structural problems from the previous eras. Sassoon argues that the current economic era has certain similarities to the Saddam/Ba'athist period. First, Iraq continues to be a rentier state that is dependent on oil revenues. Second, a lack of stability is prevalent in both periods, and in general a real vision for diversifying Iraq's economy away from oil is virtually nonexistent. Third, in the last 15 years of Saddam Hussein's rule, Iraq was essentially not a single economy, with Kurdistan and a number of other enclaves existing almost autonomously. In the first few years after the invasion, this became even more evident as the country had almost three economies with different sets of issues and potentials for growth: north, central, and south. Fourth, the middle class began to weaken dramatically after 1991, and a brain drain occurred soon after. Fifth, corruption was inherent during Saddam Hussein's era, but it has now become part and parcel of the economic management of the country (Sassoon 2010, 201).

The country's reliance on an oil-based economy has adversely affected both employment and private sector growth. Iraq's private sector faces challenges as modern business principles and practices are not widely observed in the business community. The main problem after 2003 is the lack of private involvement in the economy. Public sector and foundations together have covered the entire economy. As a legacy of the Saddam era, the rationing system has continued to provide food for most of the population, and the domestic market still does not have sufficient capabilities to meet the demands of the market. The absence of a competitive environment, lack of legal stability, absence of private sector institutions, a distorted market structure, legal barriers, and a lack of transparency still impede the development of the private sector. These factors also blocked the steps toward privatization. According to the World Bank Doing Business report, which presents quantitative indicators on business regulations and the protection of property rights throughout the world, Iraq is currently ranked 166 out of 183 economies in Ease of Doing Business (World Bank 2011, 2).

Table 5. Iraq's ranking in Doing Business 2011

Rank	Doing Business 2011
Ease of Doing Business	166
Starting a Business	174
Dealing with Construction Permits	102
Registering Property	96
Getting Credit	168
Protecting Investors	120
Paying Taxes	54
Trading Across Borders	179
Enforcing Contracts	141
Closing a Business	183

Source: World Bank

Rivlin suggests that the government in Iraq should transfer the leadership of the development to the private sector, and this encouragement of the private sector will limit the state's domination of the economy and increase the productivity in every field. This also will the help with the emergence of a strong middle class, a civil society, and will penetrate non-state activities (Rivlin 2006, 202).

Since the state controls the oil revenues, the stakes for government officials have continued to foster corruption in the country. Unregulated weak institutions and the legacy of the previous eras have solidified the ground for corruption, and a political environment in the new era has not developed a sustainable response to this problem. According to international surveys, as of 2010, Iraq is one of the most corrupted states in the world, ranking 175 out of 178 countries[13].

Gylfason asserts that there is a correlation between the presence of natural resources and poverty, corruption, inequalities and lack of human rights (Gylfason, 2004: 9-15). For Iraq, the outcomes of the dependence verified this correlation. Income distribution across the country appears to be heavily distorted and poverty is one of the most encountered situations. COSIT and the World Bank announced almost a quarter of the population – 23 percent or nearly 7 million people – live below the national poverty line (World Bank 2011, 15). Gini, a coefficient, which measures inequality in living standards, is .309 in Iraq. As a result, social inequalities exist in every type of civil service, such as health and education. Looney suggests that the increasing population along with high level of unemployment led to an increasing demand of social assistance (Looney, 2006, 36). The World Bank (2011, 70) indicates that as of 2008, almost all households (99.7%) in the country have had at least one ration card and the share of food rations in overall government budget was 8.6 percent. During the period of the survey, 79.1 percent of households received wheat flour rations during the previous month (World Bank 2011, 71).

The rationing system should be underlined since it is an important face of the rentier character of the new state in Iraq. The rationing system was established in 1995 to supply and distribute necessary food to the population after the economic sanctions against Iraq that stemmed from the invasion of Kuwait. The system was used by Saddam's regime to expand governmental authority over the Iraqi population. Due to harsh economic conditions, the rationing system was essential

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[13] Transparency International (2010) Corruption Perception Index (CPI)
http://www.transparency.org/policy_research/surveys_indices/cpi/2010

to the survival of the Iraqi population and also to the state itself, since it showed that the regime could save the people from starvation, which was caused by international forces (in official discourse “imperialism”). Over years the system became one of the principal instruments of the state to expand its role and to increase its authority over the people (Mazaheri 2010, 256-257).

In the new era, the rationing system still functioning under the management of the Ministry of Trade and has a very significant place in the lives of Iraqi people. Through the system, the Iraqi state continues to maintain its patronage over a large portion of population. The importance of the state for the poor population is at its peak. In addition, the system has made the government the only importer of foodstuffs and this impedes the opportunities for the private sector to trade food in the domestic market. The financial allocations for the ration card in the 2010 budget reached 3.5 trillion dinars (about $2.9 billion) and the 2009 allocations for the ration card reached four trillion dinars. In 2011, the Trade Ministry was allocated ID 4 trillion ($3.4 billion) only for the first 9 months. It implies that 8.5 percent of Iraq’s budget for 2011 is entirely allocated for importing food ration cards. It underlines that the share of the food rations in the government budget is greater than its allocation for education (6%) and health (3.4%). The World Bank Report on poverty in Iraq asserts that while the system has provided benefit to the poor people as a safety net, it is expensive, inefficient and fiscally risky. The system has been distorting incentives for agriculture producers and private food importers, and hampers production instead of to stimulate it (World Bank 2011, 72).

Despite recent improvements in certain areas, medical care throughout the country still needs more attention, especially outside the major cities, and in particular in the southern part of the country. While new facilities have been constructed in the big cities, the medical facilities in rural areas are still of poor condition. It is quite challenging to provide health care services especially in rural areas due to inadequate supply of electricity and water, insufficient numbers of medical personnel, inadequate infrastructure and old equipments. According to the World Bank, life expectancy in Iraq was 65 in 1990, up to 71 by 1996, but down to 68.2 in 2009. It is the lowest rate in Arab world after Yemen.

Table 6: Life expectancy at birth

Life expectancy at birth, total (years)							
Country Name	**1960**	**1970**	**1980**	**1990**	**2000**	**2005**	**2009**
Arab World	45.7	51.0	56.8	62.8	67.0	68.1	68.9
Bahrain	55.5	61.8	67.6	72.0	74.6	75.4	76.1
Iran, Islamic Rep.	48.2	53.9	58.7	64.6	69.1	70.7	71.7
Iraq	50.2	58.0	61.1	65.1	70.9	68.5	68.2
Kuwait	59.4	66.6	70.5	75.0	76.8	77.6	78.1
Qatar	52.9	60.8	66.7	69.8	73.6	75.3	76.1
Saudi Arabia	44.3	51.9	61.1	67.9	71.3	72.4	73.4
Syrian Arab Republic	49.3	55.5	63.1	68.2	72.3	73.6	74.4
Turkey	50.3	55.7	60.3	64.6	70.0	71.4	72.1
Yemen, Rep.	34.5	38.2	46.6	54.3	59.2	61.5	63.4

Source: World Bank

Gylfason argues that since revenues are derived from the rents, rentier states seem to have fewer incentives to invest in human capital (Gylfason (2004, 18). The history of lackluster investment in education in Iraq reflects this characteristic. Educational achievements are still retarded and the quality and availability of educational facilities is severely limited. According to the World Bank Survey, as of 2008, 80.9 percent of Iraqis older than 10 years are literate—88.4 percent of males and 73.6 percent of females. Primary school enrollment averages 84.8 percent among Iraqi 6–11 years of age, with the lowest rate (70.1%) among rural girls. Urban/rural and male/female gaps emerge by intermediate and secondary school. For example, of youth 15-to-17 years old, about 25.8 percent of urban boys and 25.1 percent of urban girls are enrolled in secondary school; however, the secondary enrollment rate fell to 14.5 percent for rural boys and just 7.2 percent for rural girls (World Bank 2007, 202-206). However, the most striking point in the World Bank survey is that among the Iraqi population the most shared reason for leaving or not being currently enrolled in school, especially among young population, is that "the family or person is not interested in attending educational activities" (World Bank 2007, 240). This shows that there is a strong need to reinforce the education strategy, and to put more emphasis on changing this perception with the people, rather than focusing only on the physical infrastructure of the education system. This is important because education has become a critical factor for continued economic growth and a major requirement to benefit from globalization.

As for political participation, Iraq has shown no appreciable progress, and political activity of the people is not encouraged or facilitated by the government. As a result, the turnout in Iraq's parliamentary election of 2010 was only 62 percent, which was down from the 75 percent who voted in the 2005 general elections. The World Bank survey reveals that social and political activity among the Iraqi population is very low and while 95.2 percent of males do not attend any political activities, 98.5 percent of females do not participate in political activities (World Bank 2007, 246). According to UNDP, Iraq's dependence on oil revenues still maintains a system of patronage, which leads to weak participation of civil society and lack of transparency in the use of resources (UN 2009, 10).

VII. CONCLUSION

This thesis was written to analyze the reasons behind the economic difficulties of the Iraqi state. It has argued that Iraq has large reserves of oil and natural gas, but it has failed to develop its economy and to create sustained economic growth even after the establishment of a new regime in 2003 and with support of the international community. My hypothesis was that the Iraqi economy has failed because its emphasis on oil undermined alternative development areas in the economy and created a rentier state, which has controlled the economy and hampered the development of the private sector.

To answer my research question, I first discussed the literature on the rentier state. Then, I elaborated on the political history of Iraq with its implications on society. In the fourth chapter, I analyzed the legacy of the Iraqi economy by focusing on different economic eras in its history and tried to find the roots of the present economic framework of the country. In the last chapter, I examined the current economic situation in the country and questioned if the rentier character of the state has been fixed or not. In that chapter, I also aimed to portray the main challenges that Iraq faces during the process of economic development and tried to grasp the impact of the "natural resource curse" on Iraq's economic performance, and measured the effectiveness of the current reforms after 2003. In conclusion, I have found that, even though the political face of Iraq has been renewed after the war of 2003, the state still continues to rely on the revenue-generating ability of oil and has not produced effective long-term solutions for integrating Iraq to world economy.

Since the 1970s, Iraq, relying on oil rents, has not established an open political structure that allows for active engagement with its citizens and society. Therefore, like other state structures in the Middle East, the Iraqi state was therefore largely separated from society. In the absence of effective state structures, this rentier state had the potential to turn into a failed state and eventually failed in 2003.

As I argued throughout this study, eight years after the fall of Saddam's regime, Iraq is still shaped by the legacy of the previous economic eras, which have been chiefly upheld and reinforced by the continuing importance and overreliance on oil revenues. Today's Iraq is still a rentier state whose roots can be directly traced back to the monarchy and the Ba'athist period. Like before, the Iraqi state survives primarily due to the rent obtained from the sale of oil that allowed it to fund government spending and to pay for fairly large military and security apparatus.

The new era has opened up several channels for private actors to establish more space for the Iraqi people to involve themselves in economic life and to derive income from these activities. (The National Investment Commission is an example of the institutional changes in new Iraq). However, the success of diversification efforts have been limited, and on a certain level rentier characteristics of the state have not been transformed.

In the new era, oil is still the primary source of government revenues, the share of oil in GDP and exports is steadily increasing, the privatization of state assets is not being achieved, and economic institutions and private property are not being developed throughout the national economy. During this time, Iraq largely missed the opportunity to become further integrated into the global economy, insofar as it failed to increase its non-oil exports and failed to attract significant foreign direct investment. This structure, which implies an economy that guarantees a steady flow of rent is considered sufficient to manage the economy, continues to be an impediment to the development of the rules of the market economy and to the rise of a middle class. In this sense, Iraq still follows a path travelled by other Arab resource-rich states, and this in turn will most likely have a negative impact on economic future of the country.

I concluded that in order to lift the oil curse from the Iraqi economy, the economy would need to become more diversified in order to significantly revitalizing the Iraqi economy. This may create a broader ground for economic growth and may mitigate the economic and political challenges of today. Along with creating viable alternatives for a diversified output, Iraq also needs to reduce the role of government in the private sector and in the economy in general, relax economic controls and create a new economic environment in which the private sector can thrive without pressure. This policy requires eliminating or at least reducing subsidies, effectively privatizing state enterprises, encouraging and facilitating private property and ownership, establishing a viable banking system, investing in the development of agriculture and manufacturing sectors, creating an effective tax system and concentrating to increase the share of the tax in government revenues and liberalizing barriers to trade. Oil is not the problem, but rather what humans do with wealth from the sale of petroleum products is what matters. In the case of Iraq, the problem has been the creation of institutions that will enable Iraq to move beyond an oil economy and profit from globalization.

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