After ISIS: Creating Strategic Stability in Iraq

Anthony H. Cordesman
Burke Chair in Strategy

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This study is being circulated as a working draft. Please send comments, corrections, and suggested additions or changes to acordesman@gmail.com

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The United States, its allies, and international organizations are just beginning to come to grips with the civil dimensions of "failed state" wars in Afghanistan, Iraq, Libya, Somalia, Syria, and Yemen. In each case, any meaningful form of "victory" requires far more than defeating the current extremist threat in military terms. The insurgent threat exists largely because of the deep divisions within the state, and the past and current failures of the government to deal with such internal divisions, and the chronic failure to meet the economic, security, and social needs of much of the nation's population.

In practical terms, these failures make the host government as much of a threat to each nation’s stability and future as are Islamic extremists. Regardless of the scale of any defeat of such extremists, the other internal tensions and divisions with each country also threaten to make any such “victory” a prelude to new forms of civil war, and/or an enduring failure to cope with security, stability, recovery, and development. They also require a different approach to stability operations and civil-military affairs.

Iraq provides a critical test case. It is the only one of America's "failed state" wars where the U.S. has a near-term prospect of winning both some form of military victory and of being able to implement some form of conflict resolution that can begin to deal with the other critical factors that have long made Iraq a "failed state." Defeating ISIS in Syria will not—by itself—solve its other failures and may well be the prelude to new forms of conflict. Libya remains a divided mess, and the wars against extremism in Somalia and Yemen are far from over.

Iraq also has unique opportunities. It does not face the same level of post-conflict challenges as Syria, Libya, Yemen, or Afghanistan. It has achieved substantial levels of development relative to other “failed states” in spite of nearly a half century of revolution, turmoil, and war, and has substantial petroleum income.

This does not mean, however, that the defeat of ISIS will bring stability, recovery, or successful national development. Iraq was still a “failed state” in virtually every respect before ISIS invaded and it is still largely a failed state. Ending ISIS's physical "caliphate" in Iraq will not end ISIS or the broader threat of terrorism and Islamist extremism. Finding a stable relationship between the central government and the Kurdish regional government presents a critical challenge, as does finding a stable relationship between Sunni and Shi'ite Arab and protecting minorities.

Unless Iraq's leaders can come together and govern more effectively, defeating ISIS may well be a prelude to continuing ethnic and sectarian crisis or civil war. While the war against ISIS has created some degree of cooperation, it is important to note that the ISIS invasion was enabled by massive misgovernment under former Prime Minister Nouri Maliki, and a steady rise in ethnic and sectarian violence—that had risen back to the 2008 levels of civil conflict by the time ISIS invaded Fallujah in January 2014. Significant tensions and risks of violence exist within the Kurdish, Sunni Arab, and Shi'ite factions. Iraq also is not able to choose its neighbors or its “friends.” Russia, Iran, Turkey, other Arab states, and the United States and its allies all have conflicting interests and compete for influence.

Moreover, many of the reasons why Iraq is a "failed state" are structural, and not just a matter of the impact of war and political differences. Iraq's politics and governance are corrupt and
dysfunctional at the working level from the central government down to local government. Its justice and political systems are weak, sometimes virtually non-existent at the local level, and often corrupt and ineffective. Iraq has critical economic problems at every level, and it has long been under acute population pressure in spite of the impact of its wars.

This complex mix of pressures makes creating any form of lasting stabilization, recovery, and movement towards development a massive challenge. It also makes it grossly unrealistic to assume that stability can be accomplished simply by political dialogue, or that recovery and development can take place by implementing some form, of nation-wide reforms that ignore regional, ethnic, and sectarian differences and the role of given factions and powerbrokers. Far too many recent U.S. and other outside efforts to bring stability to Iraq at the of the major fighting with ISIS ignore these realities, and do not address the full range of challenges that will to shape Iraq's "post-ISIS" future for at least the next half decade.

This analysis focuses on the depth and structural nature of these broader structural failures and challenges. It does not address the immediate problems in dealing with the political, sectarian, and ethnic divisions in Iraq; but it does focus on their deeper structural nature and how they interact with population pressure and the impact of key factors like poverty, unemployment, and the gross—state-centric—distortion of the nation's economy. It also focuses on the aspects of stability and Iraq’s status as a failed state that receive less attention than the risk of factional political conflict, but are equally important. These include failures in governance, economics, and demographics.

Accordingly, it draws on data from a wide range of sources—such as World Bank, IMF, CIA, UN, Transparency International, Institute for the Study of War, and IISS—to address the deeper critical challenges that Iraq must address over time if it is to achieve any degree of lasting strategic stability. In doing so, the analysis focus on six key sets of challenges:

- Impact of past divisions and conflicts,
- Ethnic and sectarian challenges,
- Human challenges,
- Governance Challenges,
- Economic Challenges, and
- Military and Security Challenges

The analysis concludes by noting that Iraq is still a country with vast opportunities, but the study outlines a host of critical challenges. Given Iraq’s recent history, such challenges are virtually inevitable, and it should be clear to any reader familiar with today’s Iraq that the ones outlined in this study only include the more serious problems and describe them using uncertain data and in broad terms.

Accordingly, one key step in meeting such challenges is to look beyond the immediate priority of finding some practical solution to Iraq's ethnic and sectarian divisions and to assess these challenges more accurately, along with possible solutions, and to establish clearer priorities and options for dealing with them. It is also clear that a proper diagnostic effort will require years of in-country efforts to analyze and quantify Iraq’s needs and create some kind of ongoing planning.
and management effort to deal with the changing interactions created by Iraq’s evolving problems and needs.

Such an effort can only begin, however, if Iraq's leaders look beyond their present sectarian and ethnic tensions, face the full nature of Iraq's problems, and find some way to work together. The first step is to take advantage of the defeat of ISIS's "caliphate," and find a common path to short term stability and the ability to work towards common goals. No outside effort, aid, or advice can deal with scale of the structural challenges outlined in this study unless Iraq's leaders take responsibility for their country and the broader consequences of their actions. The past and current mistakes of outside powers and factions may be all too real, but they are irrelevant. No one can successfully help an Iraq that does not help itself.

Iraq cannot succeed on its own. It will need outside technical and financial aid for years until its progress reaches a self-sustaining level. Outside states and institutions also have a potential common interest in helping Iraq, and some moral responsibility to do so, but only if Iraq's leaders can come together and show that such help will serve a clear purpose. It is critical, that Iraq’s leaders understand that they—and they alone—must assume responsibility for creating the necessary politics, leadership, and institutions that can ensure Iraq’s success. Iraq’s past tendency to try to export blame and responsibility will only end in another exercise in self-destructive behavior, regardless of the faults of outside states and institutions.

As events during 2003-2011 showed all too clearly, no outside power can help an Iraq that is not prepared and organized to actively meet the full range of challenges outlined in this report. The same lessons about a failure to assume responsibility have emerged again and again since World War II. The end result of exporting responsibility, and depending on outside aid efforts, may allow Iraq’s leaders to focus on their own or factional interests and dodge full responsibility for their actions. It will, however, end in failure, and create growing resentment and tension that may well divide the nation or lead to new forms of civil war.

The world must hold Iraq fully responsible for finding its own path in making the transition from war to security, stability, recovery, and development. This is particularly true because there is little sign of any outside willingness to try to rescue Iraq from itself. The United States, in particular, has already recognized that it cannot assume the burden of dealing with Iraq's complex human, governance, and economic transitions once ISIS is largely defeated in the field.
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The Need for Nation Building and Strategic Stability Operations

The United States, its allies, and international organizations are just beginning to come to grips with the civil dimensions of "failed state" wars in Afghanistan, Iraq, Libya, Somalia, Syria, and Yemen. In each case, any meaningful form of "victory" requires far more than defeating the current extremist threat in military terms. The insurgent threat exists largely because of the deep divisions within the state, and the past and current failures of the government to deal with such internal divisions, and the chronic failure to meet the economic, security, and social needs of much of the nation's population.

In practical terms, these failures make the host government as much of a threat to each nation’s stability and future as are Islamic extremists. Regardless of the scale of any defeat of such extremists, the other internal tensions and divisions within each country also threaten to make any such “victory” a prelude to new forms of civil war, and/or an enduring failure to cope with security, stability, recovery, and development. They also require a different approach to stability operations and civil-military affairs.

The Post-Conflict Need for Strategic Stability

In each case, the most immediate priorities will be to find some working political compromise that can hold the country together and to provide immediate humanitarian relief and short-term emergency recovery efforts. It is all too clear, however, that short-term stability operations and humanitarian efforts will fail to have lasting effects unless the deeper problems that make a state a "failed state" are addressed to the point where the vast majority of its people want to live with the result.

No “failed state conflict” would have reached anything like its intensity if there had not been critical political, governance, economic, and social problems before the insurgency began. As a result, post-conflict efforts must do far more than simply attempt to achieve recovery at pre-war levels. Meaningful stability efforts must address the key problems and divisions within a nation that led to successful insurgencies and the fracturing of that nation.

These efforts must create a working political structure and sharply raise the quality of governance. Stability, recovery, and development must build confidence and trust in the government and political system and address the competing needs of key factions, along with ethnic, sectarian, tribal, and regional groups.

They must address the deep economic failures that shaped the recent history of each “failed state” before the fighting began, and at least create enough economic hope for each major faction to be willing to work within the government. Similar improvements must take place in security, police activity, and the other elements of the rule of law, and corruption must be reduced to tolerable levels.

At the same time, such efforts must take full account of the demographic realities involved. In each case, the population has increased radically since 1950—usually by five to seven times. This put a massive strain on infrastructure, education, medical services, housing, and job creation long before the fighting began, and created a critical pre-war deficit that years of conflict have since made far worse.

An extremely young population could not find jobs or careers that met its expectations, and population growth sharply increased urbanization and put steadily rising pressure on already
limited water supplies and arable land—problems which years of war have left largely unaddressed. Government’s chose short-term employment and economic policies that created major barriers to growth and doing business, created major structural economic problems, and made most development plans unrealistic or sources of further problems.

**“Nation Building” or Continuing Self Destruction**

So far, much of the modern history of warfare is the product of a failure in achieving post-conflict stability in previous conflicts, and much of modern warfighting is the product of repeated struggles between factions or between a government and key elements of the people it should serve.

The United States has already attempted to deal with many of these failures in Iraq and Afghanistan. So far, it has largely failed. Whenever the United States has attempted to impose its own political, governance, and economic structures on very different cultures, peoples, and nation states—like Afghanistan, or Iraq between 2003 and 2011—it has failed to prevent their fracture lines from creating new tensions or conflicts. In the process, it has become all too clear that military forces alone cannot defeat an insurgency no matter how successful they are at a tactical level.

At the same time, efforts by outside civil bodies like the UN, IMF, World Bank, NGOs, and think tanks have been equally ineffective and equally unrealistic. Most have failed to fully address the failures in given states that led to civil wars and insurgencies. Any review of the public studies by such bodies reveals that they have suffered from most or all of the following defects—defects which make much of their content and conclusions little more than exercises in the theater of the absurd:

- The core diagnostics are heavily politicized and often seem designed to avoid direct criticism of the existing power structure and government—creating serious problems in “clientitis” on the part of countries seeking a security partner like the US or Russia, or that are unwilling to risk political confrontation like the UN, IMF, and World Bank.
- They assume a mythical future in which a nation’s government can pursue recovery and development in an abstract world without regard to its political and security realities.
- They do not address the factors that led to major popular unrest and instability before the conflict began.
- They treat the country as a unified nation when it has ethnic, sectarian, tribal, regional, and other internal differences that drive its problems with stability, security, and development.
- They focus on economics and humanitarian needs and largely ignore the scale of the problems in governance, practical politics, the impact of corruption, and the scale of the black economy and criminal activity like narcotics.
- They do not address the post-conflict need to fund large military forces, develop effective police, and create a functioning justice system and rule of law.
- They make roughly the same broad recommendations for each country—often reflecting the institutional focus and biases of the source of the study—without regard to whether such recommendations are feasible, meet the full range of a country’s needs, or have any serious chance of being implemented.
- They do not create realistic (or often any) picture of the phases of a successful effort or the time involved, and either ignore the cost and resources required or make “guesstimates” that lack a credible methodology.

In summary, outside efforts have failed to honestly address the fact that failed governments cannot or will not address a broad list of nation-wide reforms that were needed long before conflict began, and such reforms do not meet the needs of key factions. They do not address the real-world costs...
of post-conflict security and military forces, and do not provide realistic plans for stability, recovery and development.

Equally important, the United States, Russia, and other states that provide military support and aid have ignored the fact that no amount of security can provide post conflict stability, recovery, and development. It has long been clear that military force alone cannot win a victory in such wars, and it should now be clear that military victory alone cannot produce lasting stability.

Every "failed state" now involved in a “failed state” war will require sustained help in nation building over a period that will often approach or exceed a decade once the active fighting ends. It is all too true that such help will be pointless—or be little more than an endless humanitarian subsidy—if that state is incapable of helping itself. The history of post-conflict development has a grim consistency in showing that nations, governments, and factions must either take full responsibility for their own destiny or fail. Nations cannot be built from the outside using outside models. It is equally clear, however, that even the most competent effort to build an effective state that really services its people will need sustained outside aid or even the most successful warfighting security effort will end in a lost peace.

Dealing with Iraq as a "Failed State"

Iraq provides a critical test case. It is the only one of America's "failed state" wars where the U.S. has a near-term prospect of winning both some form of military victory and of being able to implement some form of conflict resolution that can begin to deal with the other critical factors that have long made Iraq a "failed state." Defeating ISIS in Syria will not—by itself—solve Iraq's other problems and may well be a prelude to new forms of conflict. Libya remains a divided mess, and the wars against extremism in Somalia and Yemen are far from over.

Iraq also offers unique opportunities. It does not face the same level of post-conflict challenges as Syria, Libya, Yemen, or Afghanistan. It has achieved substantial levels of development relative to other “failed states” in spite of nearly a half century of revolution, turmoil, and war, and it has substantial petroleum income. The other failed states—with the exception of Libya—are all among the world's poorest countries.

The impact of the fighting in Iraq has also been regional, rather than national. Most of the recent fighting against ISIS has been in the less populated areas of Western Iraq—although Mosul has been a notable exception—and Iraq still scores much higher on the overall human development rating issued by the UN than the other major conflict states. Iraq's global ranking is 121st out of 188 countries (medium human development) versus 149th for Syria (Low Human Development), 168th for Yemen, and 169th for Afghanistan.¹

“Terminating” Conflict in a Failed State

This does not mean, however, that the defeat of ISIS will bring stability, recovery, or successful national development. Iraq was still a “failed state” in virtually every respect before ISIS invaded and it is still largely a failed state. Ending ISIS's physical "caliphate" in Iraq will not end ISIS or the broader threat of terrorism and Islamist extremism. Finding a stable relationship between the central government and the Kurdish regional government presents a critical challenge as does finding a stable relationship between Sunni and Shi'ite Arabs and protecting minorities.

Unless Iraq's leaders can come together and govern more effectively, defeating ISIS may well be a prelude to continuing ethnic and sectarian crisis or civil war. While the war against ISIS has
created some degree of cooperation, it is important to note that the ISIS invasion was enabled by massive misgovernment under former Prime Minister Nouri Maliki. It was also due, in part, to a steady rise in ethnic and sectarian violence, which had risen back to the 2008 levels of civil conflict by the time ISIS invaded Fallujah in January 2014. Significant tensions and risks of violence exist within the Kurdish, Sunni Arab, and Shi'ite factions. Iraq also is not able to choose its neighbors or its “friends.” Russia, Iran, Turkey, other Arab states, and the United States and its allies all have conflicting interests and compete for influence.

Moreover, many of the reasons why Iraq is a failed state are structural, and not just a matter of current internal political differences. Iraq’s politics and governance are corrupt and dysfunctional at the working level from the central government down to the local government. Its justice and political systems are weak, sometimes virtually non-existent at the local level, and often corrupt and ineffective. Iraq has critical economic problems at every level, and it has long been under acute population pressure despite the impact of its wars.

This complex mix of pressures makes creating any form of lasting stabilization, recovery, and movement towards development a massive challenge. It also makes it grossly unrealistic to assume that stability can be accomplished simply by political dialogue, or that recovery and development can take place by implementing some form of nation-wide reforms that ignore regional, ethnic, and sectarian differences and the role of given factions and powerbrokers. Far too many recent U.S. and other outside efforts to bring stability to Iraq at the end of major fighting with ISIS ignore these realities, and do not address the full range of challenges that will shape Iraq’s "post-ISIS" future for at least the next half decade.

**Focusing on the “Structural” Causes of Failure**

This analysis focuses on the depth and structural nature of these broader structural failures and challenges. It does not address the immediate problems in dealing with the political, sectarian, and ethnic divisions in Iraq, but it does focus on their deeper structural nature and how they interact with population pressure and the impact of key factors like poverty, unemployment, and the gross—state-centric—distortion of the nation's economy. It also focuses on the aspects of stability and Iraq’s status as a failed state that receive less attention than the risk of factional political conflict, but are equally important. These include failures in governance, economics, and demographics.

There are serious limits to this analysis. In many cases, the data currently available are uncertain or dated, and many key data simply do not exist. Many of the economic and other data only cover Iraq as a nation—providing little or no insight into the exact nature of the regional, ethnic, sectarian, and other key differences that challenge future stability.

There is a key lesson here. As past experience in other conflict states—“failed” or not—has shown, recovery and stability require major data collection and analytic efforts in country. This is particularly true because there are no reliable models for estimating the impact of war in terms of the need to rebuild, the practical options for doing so, and their cost. Even less is known about dealing with the human dimension of prolonged conflict. Immediate humanitarian efforts are difficult enough, but building a new and stable social structure and society and coping with all of the longer-term human legacies of war is largely uncharted territory.

Many data are good enough, however, to serve as a clear warning that it is likely to take at least several years of internal Iraqi effort and outside support to put Iraq on the path towards some form
of stable recovery—and longer to reach the kind of broad development that benefits most of Iraq's people. Stability, recovery, and development will not occur at all unless Iraqis—and those outside Iraq—face the full range of challenges that Iraq must meet.

This study is also able to draw heavily on a pioneering World Bank study of Iraq entitled a Systematic Country Diagnostic Report on Iraq issued in February 2017. Unlike far too many UN, U.S., IMF, World Bank, and NGO studies this analysis does attempt to address Iraq's internal problems in depth. It does so with levels of objective criticism that highlight Iraq's failures and real world needs for the kind of stability, security, recovery, and development programs that can deal with the conflicting interests of its major sectarian, ethnic, regional, tribal, and other internal factions.

Many other sources have been used in creating this analysis, but the overwhelming majority sharply understate the nature of Iraq's problems. Like most studies of the problems in dealing with past conflict stability in other "failed states," they were too politically correct to honestly address the problems in given governments and societies, only provided limited diagnostics, and made recommendations for nationwide economic and governance reforms that had no practical chance of ever being implemented in the form they suggested.

They ignore the practical problems in politics and governance that created conflicts in the first place and will leave a given nation even more of a "failed state" when the fighting ends. If there is any consistent lesson from the history of "failed state" wars, it is that paving the road to hell with optimism and good intentions does nothing to produce real progress and usually does far more harm than good.

Any real-world approach to achieving stability in Iraq must recognize that it must focus on what can be done, rather than what should be done. The first priority must be to deal with immediate political realities, and this can pose a massive challenge to any effective effort. Iraq's short-term politics and internal dynamics are extremely volatile and unpredictable. It is still far too early to determine how the defeat of ISIS's physical "caliphate" in Iraq will affect the overall pattern of violent Islamist extremism that threatens Iraq, and the balance of power, tensions, and potential violence between key ethnic divisions like Arab and Kurd, and sectarian divisions between Sunni and Shi'ite. There are competing factions within each major faction—some of which have a long history of violence and in-fighting between groups within their own factions. Each faction has competing economic interests, and regional aspects as well.

At the same time, any systematic and enduring effort to move Iraq away from the status of a "failed state" requires that careful attention is given to the deeper and more consistent forces that divide Iraq at the human level. These forces also interact with the lasting structural problems in governance and the Iraqi economy, and all three sets of challenges will need to be dealt with over time. This is why a serious effort to achieve some lasting form of strategic stability can easily take a decade.

The Challenge of Past Divisions and Conflicts

No stability, recovery, and development effort can be successful unless it acknowledges the extent to which Iraq has been a nation in crisis during most of its existence. A long series of wars, living under sanctions, and other crises have combined to create major problems in the lives of ordinary Iraqis and reduced the quality of its human capital. Here, it is critical to understand that the
tendency to focus only on Iraq’s current war—while natural—seriously distorts the extent to which its current problems are the result of decades of conflict and crisis.

**The Prelude to Saddam**

Any short summary of these forces has to leave major gaps, but the broader forces at work remain clear. Iraq was formed after World War I by combining sectarian and ethnic groups in ways that led to major popular unrest against the British mandate, and that forced Arab and Kurd into a single state in a region which had never had stable or natural borders.

Britain only created a meaningful local government in 1921, after serious Iraqi popular resistance to British rule, limited revolt, and the exposure of serious tension between Arab Sunni, Arab Shi’ite, and Kurd. Britain imported a monarchy from the Hashemite family and empowered the Sunni minority as a way of helping to control Iraq’s Shi’ites and Kurds. Britain then granted independence in 1932, but kept forces in Iraq and kept control over the Iraqi National Oil Company—which had been created following the discovery of large-scale oil reserves in 1927.

The resulting resentment led Iraq’s prime minister, Rashid Ali, to ally himself with the Axis, demand that British forces leave in 1941, and invite Germany so send Luftwaffe forces. The British defeated Iraqi forces in a limited military campaign, and British and Iraqi forces also defeated the first major Kurdish uprising under Barzani in 1945, who fled to the Soviet Union.

Britain kept direct control of the country through 1945, and then exercised substantial power through Iraq’s young king, Faisal II and his ministers. The regime favored rural and “loyal” factions, and did little to develop the country in the years that followed. Iraqi oil revenues remained low and erratic and development remained slow. Britain also pressed Iraq to create and join the Baghdad Pact as a reaction to Nasser—which included Turkey, Britain, and Iran. Nasser reacted by launching a propaganda campaign against the Faisal regime, and a crisis occurred in 1958, after efforts to create a union between Iraq, Jordan, and Kuwait in response to the union between Egypt and Syria.

The Iraqi military had come to oppose the monarchy and it fell in a bloody coup on July 14, 1958. A series of military dictators followed, with substantial military purchases but limited economic progress. At times, nearly 90% of the budget was spent on military forces. The military leaders did not effectively suppress the Arab nationalist Baath Party, however, and it was able to take lasting power under Ahmad Hasan al-Bakr in 1968. Al-Bakr’s regime broke up the British monopoly control of the Iraq Petroleum Company (IPC), signed a contract with a French oil company called ERAP, and later nationalized the IPC. The 1973-1974 oil embargo following the October War marked the first time that Iraq was able to take real advantage of its export revenues under a government that did focus on development, and it triggered the first major rise in Iraq’s oil revenues—although the average global price of oil only changed from $3 to $12 a barrel.

**The Rise and Fall of Saddam**

Saddam Hussein rose to power during this period. Barzani had returned and again created a Kurdish effort to win independence in 1961. The fighting continued and the Ba’ath took power until Saddam Hussein—then Secretary General of the Baath—negotiated a compromise governance agreement in 1970. Hussein steadily gained in status and power, and negotiated the Algiers Accord over the Iraq-Iran border in 1975. He formally replaced Bakr in 1978, carrying out a broad and bloody purge of rivals in the Ba’ath and outside opposition in the process.
Saddam Hussein did carry out limited economic reform, improved housing, and encouraged measures like the creation of agricultural cooperatives. He also, however, indulged in a major arms race with Iran, created and funded a Baath-oriented Popular Army to counter the political threat from Iraq’s regular forces, and used major amounts of Iraq’s oil revenues to buy turnkey economic projects for its state-owned enterprises—efforts which were often terribly managed and had little productivity once Iraq took over. He also heavily subsidized Sunni areas in Iraq, and was careful to keep Sunni control over the military and security forces.

The fall of the Shah in 1979 first gave Iraq a new wave of oil revenues as prices rose because of the Shah’s fall. It then led Saddam to react to Iranian efforts to convert Iraq’s Shi’ites and to the seeming opportunity to seize some of Iran’s oil wealth by launching the Iran-Iraq War. The result was eight years of war where Iraq was eventually able to force Iran into a ceasefire in 1988 after the bloodiest war in the modern history of the Middle East.

By then, however, Iraq had been effectively bankrupted and was deeply indebted to Kuwait and Saudi Arabia. It also had helped create major anti-Saddam factions among Iraq’s Shi’ites, some of which actively opposed Saddam in Iraq’s eastern marshes while others fought for Iran from bases in Iran. A new effort by the Kurds to win independence had also triggered a major effort to relocate Sunnis into Kurdish areas, and a set of government anti-Kurdish offenses that made extensive use of poison gas.

Saddam reacted by invading and attempting to annex Kuwait—which had been the subject of Iraqi claims since the country’s formation. This triggered the first Gulf War in 1990-1991, which led to a catastrophic defeat of Iraq’s forces. It also brought about new internal political upheavals, some led by the Kurds and other by Iraqi Shi’ites. Saddam was able to put down the Shi’ite uprisings, although this led to further efforts to restructure the military and security forces to deal with Shi’ite opposition. The United States and other states, however, blocked him from occupying the Kurdish areas and a de facto Kurdish state was created under the Kurdish Regional Government (KRG).

The new fighting left Iraq even poorer than before and with major reparations for invading Kuwait. It also precipitated UN sanctions on Iraq to ensure payment and that Iraq give up its stocks of missiles and chemical, biological, and nuclear weapons. Those sanctions led to a series of military crises from 1992-2003, and left the Iraqi economy shattered during this period. The uncertainties surrounding Iraq’s compliance with the key UN resolutions was also a key factor leading to the U.S.-led invasion of Iraq in 2003. This invasion created still further economic pressures, as well as still further distortions of Iraq’s economy—including grossly inefficient state management of the agricultural sector.

**2003-2017**

The United States had made no meaningful preparations to ensure Iraq’s stability, recovery, and development after the success of the invasion—it sought to improvise them between 2003-2011. The end result was an awkward series of civil failures, although the U.S. was able to work with Iraqi forces to largely put down the remnants of Saddam’s forces, and defeat the wave of Sunni Islamist extremist threats during 2004-2011. It did not, however, succeed in reforming Iraq’s governance, reducing its corruption, or creating an effective rule of law. As becomes all too clear from the following analysis, the only major impact on Iraq’s development was the reduction of sanctions and a major increase in petroleum export revenues.
Efforts to create a post-Saddam system of politics and governance created an awkward layering of new institutions over old, half-implemented efforts at reform, and a political system which encouraged Sunni, Shi’ite, and Kurdish factions by relying on nationwide party lists, rather than actual representation by given area. Removing the cap from state control over the political system meant that competing Arab Shi’ite factions gained power, the Kurdish factions in KRG expanded their power and sought autonomy, and that the Arab Sunnis lost much of their power and influence.

The U.S. began to withdraw its forces in 2007, and completed this withdrawal in 2011. It was able to work with Sunni tribal forces in the West to largely defeat the Sunni Islamist extremist forces that had become a major threat after 2004, but it did not create effective Iraqi security forces. A close election kept Nouri al-Maliki in power, but created even more tension between Sunni and Shi’ite. Maliki prevented the U.S. from keeping a major train and assist program to help build Iraqi forces, and restricted the leadership of Iraq’s security forces to make them an instrument of personal power. Maliki’s actions created major tension with the Sunnis in Iraq’s West and created a level of hostility that helped empower the ISIS invasion in 2014. The end result was yet another divisive war, further major damage to Iraq’s economy, and a further deepening of ethnic and sectarian divisions.

Iraq’s present constitution relies largely on election from nationwide party lists that mean there is often no effective local representation, merely a series of competing factions that emphasize ethnic and sectarian differences, but also the divisions within them. The nation is too divided to produce a consensus on many issues, or even reasonable levels of compromise, and its awkward cross between a presidential and a parliamentary system—which has created an unstable line of authority—is linked to a massive lack of transparency and accountability. As the World Bank Diagnostic notes, 3

In March 2003, a military coalition led by the United States and Britain invaded Iraq, and a month later the coalition troops controlled the country. The Coalition Provisional Authority (CPA) dismantled the Baath Party and the Iraqi army, measures which have had a lasting impact. The Baath party was “disestablished,” and the four most senior levels of members within the Baath party were “removed from their positions and banned from future employment in the public sector.” It should be noted that, in Saddam Hussein’s Iraq, membership in the Baath party was the standard requirement for much state employment, and many joined the party in title only. Many of the state’s most competent administrators were fired overnight from an administration already severely weakened by two wars and more than a decade of sanctions, thus removing what was left of the state and its institutional memory. A number of key institutions were dissolved, including the army, navy, air force, and the Ministry of Defense. The sweeping de-Baathification policy left tens of thousands of public sector employees as well as security personnel unemployed, without pensions, and with no prospects of participating in state institutions in the future (World Bank, 2016). The widespread violence and looting that followed the dissolution of security forces lasted nearly a month and severely damaged the state’s administrative capacity; 17 of Baghdad’s 23 ministry buildings were completely gutted. Overall, the looting is estimated to have cost as much as US$12 billion, equal to one-third of Iraq’s annual GDP, creating a climate of citizen insecurity and criminal impunity (Dodge, 2014).

…De-Baathification, intended originally as a necessary vetting mechanism, quickly turned into a tool of political retribution and sectarianism. Opposition groups perceived the government as using state institutions in a sectarian manner to marginalize them. What had been an insurgency against US occupation mutated into an all-out civil war with sectarian rhetoric used to justify the killing of civilians and population transfers. The violence peaked in 2006 and 2007, with over 25,000 recorded civilian deaths in each of those years. Shia and Sunni militias, whether state-sanctioned or outside the control of government, operated with impunity; many militias continue to exist today. A military surge by coalition troops and agreements between the government and Sunni tribes succeeded in dramatically reducing the violence, and between 2009 and 2012 the average number of civilian deaths fell by over 80 percent. Violence has surged again since 2013 as Daesh campaigns have taken an increasing toll.
Following the overthrow of Saddam’s regime in 2003, Iraq’s main political blocs representing the country’s major identity groups (Shiites, Sunnis, and Kurds) informally agreed to a system of ethno-sectarian quotas, or muhasasat in Arabic, in the apportionment of high-level government positions to ensure each group’s representation in government. Under the muhasasat system, cabinet posts, along with the positions of prime minister and president, have been allocated in line with an ethno-sectarian formula that also takes into account the number of seats won by each group’s political parties in elections. Today, the quota system has permeated the rank and file bureaucracy, well beyond high-level positions.

Plans for a widespread reform of government were announced in August 2015 in response to popular anti-government protests over electricity shortages and corruption, including an initiative to replace cabinet ministers with technocrats. The plans encountered tough opposition as political parties would not agree to limit their own influence, resulting in an escalation of the political crisis (Oxford Analytica, 2016).

**Ethnic and Sectarian Challenges**

No study of Iraq’s stability, recovery, and development has value that does not acknowledge this legacy and that the most immediate and critical problem that Iraq must deal with after the defeat of ISIS is finding some solution to the competing interests of Sunni and Shi’ite and Arab and Kurd in ways that protect smaller factions.

Here, the current data on the size of each major faction are little more than sophisticated guesstimates, but many experts feel that the CIA is broadly correct in estimating that the following ethnic differences exist within a population that the CIA estimates at over 38 million: Arab 75%-80%, Kurdish 15%-20%, and Turkmen, Assyrian, Shabak, Yazidi, and other 5%. These problems are compounded in given areas by linguistic differences. While an Iraqi dialect of Arabic is dominant, Kurdish (official), Turkmen (a Turkish dialect), Syriac (Neo-Aramaic), and Armenian are all dominant in given regions.

Sectarian affiliation is also uncertain, but the CIA estimates the following percentages: Muslim (official) 99% (Shia 55-60%, Sunni 40%), Christian <.1%, Yazidi <.1%, Sabean Mandaean <.1%, Baha’i <.1%, Zoroastrian <.1%, Hindu <0.1%, Buddhist <0.1%, Jewish <0.1%, folk religion <0.1, unaffiliated 0.1%, other <0.1%. Decades of violence and tension, since the beginning of the Iran-Iraq War in 1980, have further polarized much of Iraq's population, forced major population movements and de facto segregation in some areas, and changed Iraq’s demographics.

Smaller minorities present particular problems. Some U.S. government working estimates indicate that well over 70% of Iraq’s smaller minorities have been forced out of the country since 2003. This is true of some larger minorities as well. The CIA states that, "while there has been voluntary relocation of many Christian families to northern Iraq, recent reporting indicates that the overall Christian population may have dropped by as much as 50 percent since the fall of the Saddam Hussein regime in 2003, with many fleeing to Syria, Jordan, and Lebanon (2010 est.)."

When it comes to Iraq’s challenges in terms of stability, security, recovery, and development, the World Bank Systematic Country Diagnostic Report differs somewhat in terms of numbers, and summarizes the current impact of ethnic and sectarian pressures as follows:  

...There are no reliable demographic numbers for Iraq. No full census has been held since 1987 as the 1997 census did not include the three Kurdish governorates...Nevertheless, according to government statistics from 2010, 97 percent of Iraq’s 35 million population is Muslim, with Shia Muslims constituting a 60 to 65 percent majority. Shia are predominantly Arab but also include approximately 2 million Turkmen, Faili Kurds, Shabak, and Circassians. Sunni Muslims constitute 32 to 37 percent of the population, comprising Arabs, Kurds, a small number of Turkmen, and Circassians. Kurds – mainly Sunni – constitute an estimated 15 to 20 percent of Iraq’s population.
Iraq previously had a thriving non-Muslim population. The pre-2003 Christian population may have been as high as 1.5 million, or 5 percent of the population, whereas estimates of the number of remaining Christians range from under 400,000 to 800,000. At least 14 Christian denominations continue to exist in Iraq, with the Chaldean Catholics being the largest group. An Ottoman census in 1917 counted 80,000 Jews in Baghdad out of 220,000 residents. In 1948, there were an estimated 150,000 Jews in all of Iraq. However, by 2008, the Iraqi Jewish population was thought to number fewer than 10 individuals (New York Times, 2008). The Yezidis, Shabak, Kakai, Mandaeans-Sabeans, and Bahai are other groups.

... The usual division of Iraq into three major groups associated with distinct territories – a Shia south, a Sunni center, and a Kurdish North – is also something of a misrepresentation. Iraq does not have neat ethnic dividing lines. Kurds dominate the North and Shia the South, yet neither is a homogenous group, and all groups have significant political and intra-sectarian divisions. While there has never been a census of Iraq that shows exactly how Sunnis, Shia, Kurds, and other groups are divided or where they are located, elections have made it clear that its cities and governorates all have significant minorities. Iraq’s various groups are highly intermixed across many regions, particularly in the larger cities like Baghdad, Basra, Mosul (at least until the Daesh takeover), Erbil, and Suleimaniya...Depending on which percentage cut-off is used, only one-third to one-half of Iraq’s provinces can be said to be demographically dominated by a single group (Vanzo, 2008).

**Kurdish Integration, Autonomy, or Independence**

Most experts agree that the end of the fighting with ISIS will create a higher level of tension over the future power and zone of control of the Kurdish Regional Government (KRG). The KRG occupied a substantial amount of territory during 2003-2011 that had not been under Kurdish control in the past. This expansion involved areas previously under Sunni Arab control, as well as Turcoman and other minority areas. Work by the Institute for the Study of War (ISW) in the northern portions of the map in Figure One shows that Kurdish fighters have gained substantially more territory in the fighting between 2014 and 2017.

The KRG announced on June 7, 2017 that it would hold a referendum on independence in September 2017. This means that the future of the Kurds—and of non-Kurds that live in or near the KRG—will be a critical problem following the defeat of ISIS in Mosul. Moreover, these ethnic issues will interact with sectarian issues because Syria has similar ethnic and sectarian divisions, the Iraqi Kurds have links to the Syrian Kurds, and the Syrian-Iraq border is largely unpopulated desert with good lines of communication and almost impossible to secure.
Who Has (and Keeps) Petroleum Resources

Far more is involved here than control of territory and Iraq’s cities, the previously described ethnic and sectarian issues interact with the distribution of Iraq’s petroleum resources and wealth. As the World Bank diagnostic notes:\(^8\)

Mineral wealth has been a key underlying factor in Iraq’s development since the 1950s. The world’s fourth largest oil exporter, Iraq also holds the world’s fifth largest proven reserves of petroleum. Yet oil wealth has not been successfully exploited as a platform for sustained and equitable development. Iraq is the world leader today in terms of dependence on oil, with the hydrocarbon sector accounting for 58 percent of the
country’s GDP, 99 percent of its exports, and more than 90 percent of central government revenue in 2015. Unlike some of its oil-rich neighbors, however, Iraq’s reliance on oil does not represent a viable source of broad-based economic development. The country’s large and rapidly growing population means that, even under optimistic scenarios for oil production, continued reliance on oil alone will not generate sufficient jobs to ensure the welfare of all Iraqis. Moreover, Iraq has been unable to generate productive spillovers from oil as the sector creates few jobs and has negligible links to the rest of the economy.

... Today’s Iraq is not only geographically diverse – dominated by the Tigris and Euphrates rivers, with mountains, plains, desert, marshes, and access to the sea – but is also demographically diverse. While Shia and Sunni Arabs and Kurds represent the country’s largest religious and ethnic groups, Iraq is home to numerous other communities, including Christians, Turkmens, Faili Kurds, Shabak, Circassians, and Yazidis among others. Iraq is also characterized by spatial diversity. Most relevant in today’s context, the country’s oil wealth is differentially distributed across the country. The bulk of proven reserves are located in the south, with most of the rest being in the north. The differential geographic distribution of oil resources has critical implications for any discussions about decentralization in Iraq. Poverty and welfare are geographically differentiated as well, and conflict has led to more pronounced spatial divergences not only in poverty but also in the delivery of services. These geographic inequalities have not been adequately addressed, which is why they persist.

... Poor governance has transformed Iraq’s strengths – oil wealth and diversity – into the twin liabilities of oil dependence and ethnic and sectarian fragmentation. Iraq’s institutions, which were not robust even in the 1970s, the decade of rapid economic growth and progress in many aspects of human development, have been severely debilitated by decades of wars, sanctions, and conflict. Despite its size, the state has in many cases not been able to effectively provide security, development, or the most basic services. Poor governance has contributed to undermining the state’s legitimacy, giving rise to a multitude of alternative groups seeking to capture resources and power. These have ranged from sectarian and ethnic militias to Daesh. Close links between political and militarized groups have exacerbated existing political divides along sectarian lines and further weakened governance. External intervention has brought sanctions and wars as well as massive humanitarian and development assistance.

... its oil wealth is differentially distributed across the country... The bulk of the country’s proven reserves are located in the south, with most of the remainder in the north – including 6 percent in the present Kurdistan region and 15 percent in Kirkuk. The Sunni-dominated west has no proven oil revenues (although it does possess gas). Oil wealth and its distribution is at the center of the dispute between the central government and the Kurdistan Regional Government (KRG). According to their existing agreement, the KRG was to export 550,000 bpd through Ceyhan, Turkey (250,000 bpd from its own fields and 300,000 bpd from federal fields) for the central government’s State Oil Marketing Organization (SOMO). In return, the central government would resume making agreed-upon budgetary transfers to the KRG. However, this agreement has not been fully implemented and, since June 2015, the central government has suspended the transfers and the KRG’s oil deliveries to SOMO have stopped. Because of the differential geographic distribution of oil resources, any decentralization or federalism reform would need to ensure a stable and equitable resolution to resource sharing to ensure that there were no “losers” who had little choice but to continue the conflict.

...The geographical impact of violent conflict over the past decades has also varied. Whereas the Kurdish region had been the most victimized before the 1990s, its de facto autonomy from 1991 onwards meant that it could meet its basic needs more effectively during the sanctions years. On the other hand, the southern provinces experienced a double negative impact – the destruction of wars compounded by a failed rebellion. Even after 2003, these spatial differences continued as a result of significant and persistent variations in the quality of service delivery across the country. With the level of security being uneven across the country, new differences between provinces emerged. In the South, while oil continued its self-contained, enclaved development, other sources of economic activity such as pilgrimages to holy sites in Karbala and Najaf, trade with Iran, and the Basra port came into play as growth drivers in some areas. The provinces north and west of Baghdad on the other hand, remain highly contested between sects, ethnicities, tribes, and insurgents (World Bank, 2014).
Human Challenges

There are no clear dividing lines between the current challenges that Iraq faces and must deal with as ISIS is largely defeated. They all interact. In broad terms, however, the challenges that make Iraq a “failed state” can be grouped into four major categories: human, governance, economic, and security. The ethnic and sectarian aspects of the human challenges have already been touched upon, but it is equally critical to understand that Iraq’s structural and long-term human challenges have another critically important cause.

Population Pressure

Demographics, population pressure, and the resulting changes in Iraq’s social structure and economy underlie and shape many of its current structural problems, although far too much analysis of Iraq—like much of the analysis of the Arab world—ignores or understates these forces.

While much of the political analysis of the current divisions within Iraq focuses on the resulting sectarian and ethnic tensions, these are only part of the forces driving Iraq’s status as a failed state. One of the strange aspects of far too many efforts to deal with the security, political, governance, and economic problems in the Arab world is that they ignore the sheer force of population growth, the extent to which population pressures have affected today’s problems and conflicts, and the extent to which any effort to achieve stability and development must take the level of future population growth into account.

Once again, there are no accurate figures based on a reliable census or an ability to predict future growth. It seems likely, however, that the trends shown in shown in Figure Two are broadly correct, and that the U.S. Census Bureau is right in estimating that Iraq’s population increased from some 5.2 million in 1950 to 13.2 million in 1980—at the beginning of the Iran-Iraq War. Its population was around 18.1 million in 1990, when Saddam Hussein invaded Kuwait, and over 25 million in 2003 when the U.S. invaded. It is now 39.2 million—more than seven times what it was in 1950. It is also clear that the war has not produced major cuts in the birth rate and that the Census Bureau may be correct in estimating that Iraq’s population will reach 53.4 million by 2030 and 76.5 million by 2050.
Figure Two: Iraq's Growing Population

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<td>3.2</td>
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<td>702</td>
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<td>(NA)</td>
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<td>(NA)</td>
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<td>(NA)</td>
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<td>(NA)</td>
<td>(NA)</td>
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<td>-46</td>
<td>-63</td>
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The “Youth Bulge”

These patterns of population growth ensure that Iraq’s population is very young, and that creating new jobs for a very young labor force is critical to stability—although the number of older and retired persons is also growing. The CIA estimates that the median age in Iraq is one of the youngest in the world (only 19.9 years), and that the average age of the population is distributed as follows: 10

- 0-14 years: 39.88% (male 7,766,832/female 7,445,633)
- 15-24 years: 19.07% (male 3,703,302/female 3,572,702)
- 25-54 years: 33.7% (male 6,499,345/female 6,354,506)
- 55-64 years: 3.96% (male 720,976/female 790,301)
- 65 years and over: 3.39% (male 574,521/female 717,907) (2016 est.)

There are no accurate figures for unemployment in Iraq and such data would be misleading in any case. As the later portions of this study show, Iraq has created many unproductive jobs in state-owned industries and government, and the pressure to survive has forced many Iraqis to take jobs that provide minimum incomes and where the net productivity is so low that they amount to disguised unemployment.

**Figure Three** provides what may be a good "guesstimate," and is almost certainly correct in putting the average level of youth unemployment above 30%. But—as is the case with many developing countries—employment is not a measure of popular satisfaction, of productivity, or even of the portion of the population that has found some form of work.

What is clear is that Iraq's kind of age distribution not only creates a massive continuing need for new jobs, it creates a dependency ratio of over 78%, and the need to support those who do not work places a major burden on the existing workforce. It also has forced rapid social change and made much of Iraq's population change its location and profession. Population pressure has interacted with the forces of war to push various ethnic and sectarian groups into very different alignments and economic and social circumstances.

Here, the World Bank issues an important warning—and one that tracks closely with youth attitudes in other "failed states,”12

Youth exclusion (lack of education, employment, trauma, discrimination, and neglect) coupled with mistrust of government authorities has fostered their radicalization and facilitated their recruitment by militias and violent groups. A recent Arab Youth Survey (Burson-Marsteller, 2016) has highlighted the connection between youth unemployment and the potential for radicalization. Almost a quarter (24 percent) of surveyed youths listed the lack of jobs and other opportunities as the main reason for some youths joining Daesh... In countries such as Iraq where Daesh has a significant presence, young people have worse perceptions of the economy and of sectarian conflict...

Militias and extremist groups may fill the void left by the government by offering marginalized youths a sense of identity and opportunities for upward socioeconomic mobility. Low incomes and unemployment reduce the opportunity costs of rebellion.6 Most Iraqi youths who have joined militias or Daesh have few economic prospects and have failed to complete primary or secondary education. As reported by the Iraq Crisis Group (ICG), young militants typically worked in precarious labor conditions and earned no more than ID 25,000 per week (US$21.4), making it almost impossible to afford even basic rent at ID 200,000 (around US$180)... In contrast, Daesh offers young combatants anywhere from US$400 to US$1,200 per month, in addition to the authority that youths gain within their communities... Youths joining extremist groups circumvent traditional community hierarchies and ascend to positions of power that would be unreachable for them in state institutions. Shia youths have also flocked to join militias for non-financial reasons following the fatwa issued by Iraq's Shia spiritual leader, Ali al-Sistani, which summoned them to volunteer in the defense of the country and their holy shrines. Therefore, while youths have an economic incentive to join sectarian or extremist groups, they also tend to find a sense of purpose as members of these organizations.
Additionally, a combination of population pressure and war have increasingly favored male education and employment in a society undergoing a great deal of stress. The World Bank concludes that these forces have had a major impact on gender equality, but an emphasis on human rights understates the problem. Denying women education and employment rights makes Iraq substantially less competitive and productive than if it can reform and modernize its economy, and creates its own source of social tensions. Nations pay a serious economic and material price for regressing backwards in liberalizing the role of women.\textsuperscript{13}
Figure Three: Youth Unemployment in Iraq: A "Guesstimate"

Hyperurbanization

Iraq still had many elements of a "traditional" society through the early 1960s and its population was probably some 75% rural vs. 25% urban. Today, Iraq is a very different place. War, a critical lack of water and arable land, and population growth have led to a level of hyperurbanization that has effectively reversed this situation. The CIA estimates that only 21% of the labor force is now in agriculture. It also estimates that urbanization has been growing at 3.0% per year, and has shifted to the point where urbanization will reach 75.5% in 2017. The CIA also estimates that the urban population data of five key cities has reached levels where cities that have far more modern urban needs and values will be critical to shaping Iraq's future stability: Baghdad (capital) 6.643 million; Mosul 1.694 million; Erbil 1.166 million; Basra 1.019 million; As Sulaymaniyah 1.004 million; and Najaf 889,000 (2015).

These shifts to a more modern urban life not only have changed the values and expectations of much of the population, they have combined with the impact of war to alter the distribution of given ethnic groups and sects—sometimes pushing them together in new ways and other times creating new patterns of local segregation for security reasons.

It creates a large number of young Iraqis seeking jobs, and puts intense social pressure on younger males and educated females to find jobs in a society where marriage still offers the principal path to an active social life and can be critical to social standing. These problems are made worse by a lack of merit-based hiring in Iraq's large State-Owned Enterprises (SOEs) and in its swollen state sector, and by the lack of reform in the agricultural sector which further limits job creation at a time when changes in regional rainfall, drought in some areas, draining marshes in the south, and growing Turkish and Iranian use of the water in the Tigris, Euphrates, and other riverine sources of water all add to the lack of jobs and opportunities.

This, in turn, puts intense pressure on the state to create jobs regardless of their productive output. It also puts heavy pressure on males to join the army and security services when these are the only ready source of employment, while job creation for the sake of jobs further encourages waste and corruption in every aspect of hiring and promotion.

Housing and Construction

This mix of population pressure and hyperurbanization will drive every future aspect of Iraq’s economy and development, and will have a major impact on the need for postwar reconstruction. Some largely consist of impacts on construction and infrastructure. For example, the World Bank Systematic Country Diagnostic Report notes that:

Iraq has a large and growing housing deficit following decades of sanctions, conflict, and substantial under-investment in new formal housing, which has been exacerbated by rapid population growth, ongoing urbanization, and large inflows of displaced people. The housing deficit continues to increase and is currently estimated by the Ministry of Construction and Housing to amount to at least 2 million units (Ministry of Construction and Housing, 2010). The quality of the existing housing stock is deteriorating as a result of the proliferation of substandard informal settlements.

The formation of new households is generating a demand for at least 200,000 units per year, even without accounting for displacement and conflict-related damage. The rapidly growing demand for housing has been fueled by population growth of 3.3 percent annually (between 2010 and 2015) and will likely further accelerate as the average household size continues to decrease (6.5 people per household in 2012, down from 7.6 in 1997). These factors will create the need for at least 3 to 3.5 million new units by 2020 if the current rate of housing construction stays the same. In addition, meeting the housing needs of IDPs and re-building the housing stock damaged by conflict will require further substantial investments.
The existing housing stock is of low quality, partly because substandard informal housing has been growing rapidly, with nearly 2.4 million people living in slums. Recent estimates (2014) indicate that 30 to 40 percent of the population lives in very poor housing conditions and that at least 10 percent of housing units are overcrowded and lack proper maintenance (World Bank, 2015h). Up to 90 percent of homes built in the last 30 years are self-constructed and likely to be informal. In Baghdad alone, more than 740,000 people were living in slums in 2013, most of whom had no access to water, sanitation, or other basic public services.

The situation is particularly severe in those governorates where many of the 3.2 million IDPs have sought shelter. The massive inflow of IDPs has created a huge demand for new units (more than 500,000 units), mainly in and around urban areas. Housing supply has not kept pace with demand, and this has put a severe strain on public services, creating created tensions between IDPs and their host communities. The return of IDPs to their homes is hindered by the growing number of housing units that have been damaged or destroyed in areas affected by the conflict with Daesh (World Bank, 2015i). A 2015 assessment led by the World Bank in conflict-affected areas found damaged housing units to account for as much as 26 percent of the housing stock in the most affected cities such as Ramadi.

Housing remains unaffordable for many Iraqi families, placing a significant burden on household budgets. The large inflow of IDPs and migrants to urban areas has put substantial pressure on the housing market. In 2012, low-and middle-income families spent over 35 percent of their monthly income on housing, utilities, and maintenance (CSO, 2012). Unable to afford housing, more than half of Iraq’s urban population (including the majority of the displaced) live in slum-like conditions (UN Iraq, 2016). On the supply side, weak institutional and coordination capacity, poor land management, centralized urban planning, and a weak housing construction industry have limited the housing supply in the country. Between one-fifth to one-quarter of Iraqi households rent, but very little formal rental stock is produced by the private sector (World Bank, 2014d).

**Human Capital**

Others involve human goals and values, and key aspects of human development. Once again, the World Bank’s *Systematic Country Diagnostic Report* provides a number of important insights: 17

Iraq’s institutions, which were not robust even in the 1970s, the decade of rapid economic growth and progress in many aspects of human development, have been severely debilitated by decades of wars, sanctions, and conflict. Despite its size, the state has in many cases not been able to effectively provide security, development, or the most basic services. Poor governance has contributed to undermining the state’s legitimacy, giving rise to a multitude of alternative groups seeking to capture resources and power. These have ranged from sectarian and ethnic militias to Daesh. Close links between political and militarized groups have exacerbated existing political divides along sectarian lines and further weakened governance. External intervention has brought sanctions and wars as well as massive humanitarian and development assistance.

Persistent poverty and arrested development are the symptoms of Iraq’s predicament. There has been no overall movement towards reductions in either poverty or income equality in Iraq since 2007. Headcount poverty as measured in 2014 has remained virtually unchanged at 22.5 percent. What limited gains in poverty reduction had been achieved up to 2012 had been reversed by 2014 as a result of a resurgence in violence and the worsening of the economic environment due to the collapse of oil prices. More than 4 million Iraqis have been displaced by the country’s various conflicts.

The loss of human capital over the past three decades in Iraq has been massive, a legacy of conflicts and continuing fragility. While the Iraqi education and health systems were ranked near the top of the MENA region in the late 1970s, they have fallen to near the bottom today. Achievements in increasing literacy and reducing gender disparities have been erased. Although some progress has been made in increasing primary enrollment and gender parity at the primary level and improving maternal health, much remains to be done in order for the country to progress towards sustained growth and poverty reduction. A huge vulnerable population exacerbates pressure on an already weak system, sharpens disparities of access between regions, and is poorly served by the education and health systems and by social safety nets.

... Wars, sanctions, and domestic strife have taken a heavy toll on the Iraqi population...Iraq’s per capita GDP is estimated to have dropped from US$3,500 in the early 1980s to about US$770 in 2001. Per capita GDP has climbed to $5,000 today, largely thanks to hydrocarbon revenues, but the cumulative impact of Iraq’s
troubled past and present continue to be acutely felt. The United Nations estimates that 10 million Iraqis (one-third of the population) need humanitarian aid of some form. Eight million Iraqis are poor, one-third of whom have fallen into poverty since 2014.

Iraq’s endowment of human capital has been steadily eroded as a result of decades of conflict. The sanctions that followed Iraq’s invasion of Kuwait halted the country’s development, obliterating the gains in welfare made in the 1970s. Health outcomes, for example, suffered a long-term deterioration. In the 1970s, Iraqi males enjoyed higher life expectancy than their counterparts in the Middle East and North Africa, but since 1980 (the beginning of the Iran-Iraq war), they have lagged behind. In 2011, Iraq’s infant mortality rate was the second highest in the region after Yemen. Iraqi primary school enrollment rates were near the top of the MENA region a generation ago but declined precipitously throughout the 1990s.... Although these enrollment rates have recovered, the lost decades have had a severe impact on Iraqis of all ages. The most prevalent level of education today is primary schooling or less, and 18 year olds in Iraq are as likely to have completed primary school as those aged 30 or older. Similarly, adult literacy rates are below the MENA average and well below the average for upper-middle-income countries.

The years of protracted violence have produced changes in family structure and a deterioration of child welfare. Women and children are the most heavily affected by the crisis, with 49 percent of IDPs being under the age of 18. There are an estimated 1.6 million widows, an increased number of female-headed households, and large numbers of orphans. Twenty percent of school-age children have dropped out of the education system in the last two years, including more than 2 million displaced children and children from host communities, partly due to the closure of 23 percent of schools during the 2015-2016 academic year. 10 The psychological impact of the violence on children is likely to have a lifelong impact. Children who have been forced to flee their homes due to violence often exhibit changes in behavior as a result of their experiences. According to an assessment in the Kurdistan region, behavior changes were reported in 76 percent of children. Grave violations of children’s rights are widespread, with one in five children being at serious risk of death, injury, sexual violence, or recruitment into armed groups. Violence against women and girls, particularly sexual violence, has been a widely used tactic of terror in the armed conflict. The conflict has increased the level of threat, both real and perceived, to women and girls, and families are increasingly seeing marriage as a way to protect women and girls and to increase household resources. Already high rates of forced and child marriage are increasing, and the once banned practice of temporary marriages for dowry is in resurgence. As of 2016, UNICEF monitoring data show that around 975,000 girls in Iraq were married before the age of 15, twice as many as in 1990.

... As displacement is protracted and people exhaust their income and assets, the need to provide them with assistance and access to basic services rises. The government’s capacity to meet these needs is very limited, and this situation has been compounded by severe resource constraints as a result of the drop in the price of oil. Nearly one-fifth of IDPs live in critical shelter arrangements, including unfinished or abandoned building, schools, religious sites, and informal settlements (IOM, 2016). Disease outbreaks, including cholera, are frequent. Within camps, only 50 percent of displaced children attend school; outside camps the numbers are worse, with only 30 percent of displaced children attending school. Nearly one-fifth of displaced families have lost key identity documents that are essential for access to education, medical, and social services as well as to Iraq’s main social safety net, the Public Distribution System (PDS). Returnees face all of these risks, compounded by security breakdown, a widespread militia presence, and the targeting of people of specific ethnicities (UNOCHA, 2015). The Iraqis who remain in the Daesh-controlled areas of Anbar, Ninewa, and Kirkuk are yet another group dealing with particularly arduous living conditions. Micro simulations suggest that this group has suffered some of the greatest adverse repercussions of the economic, social, and security disruptions (World Bank, 2015).

The World Bank also notes that: 18

- The 2006-7 civil war and more recently the Daesh insurgency have compounded the humanitarian crisis by creating a massive population of internally displaced persons (IDPs).
- The years of protracted violence have produced changes in family structure and a deterioration of child welfare
- As displacement is protracted and people exhaust their income and assets, the need to provide them with assistance and access to basic services rises.
• Massive economic and social dislocation and poor governance have also given rise to a web of organized crime, which sustains many of the parties involved in today’s conflicts.

**Current Pressures on Iraq’s Displaced Persons and Ethnic and Sectarian Challenge**

Figure one has shown that many of these effects have been concentrated in Arab Sunni and minority areas, and have been heavily driven by the recent fighting in the West, particularly in the heavily populated areas around Mosul. As of July 2017, the UN Office for the Coordination of Humanitarian Affairs (UNOCHA) estimated that,19

The surge in violence between armed groups and government forces has resulted to over 3 million internally displaced persons (IDPs) across Iraq and left more than 11 million in need of humanitarian assistance...Of the over 4.8 million people who had been displaced in Iraq since early 2014, about 3 million Iraqis remain displaced, living in 3,700 locations across the country. More than 1.8 million have returned to their homes since late 2014 to cities and districts retaken by Iraqi Security Forces. Most people have returned to Anbar, Salah-al Din, Ninewa and Diyala.

The humanitarian crisis in Iraq remains complex with multiple, unpredictable and volatile dynamics impacting civilians. The pace of displacement, and return, is one of the fastest on recent record. Since military operations began in Mosul in October 2016, about 780,000 people have been displaced from their homes, including over 600,000 people who have been forced to flee from the western neighborhoods of Mosul city alone. More than 322,000 people are currently sheltering in emergency sites and camps around Mosul while an estimated 288,000 people are staying with families, friends or being hosted by local communities. Humanitarian partners are working to expand camps and ensure people receive emergency supplies and are assisted as they move and settle in safer areas. Fighting also continues in other hotspots, including Telafar in Ninewa, Hawiga in Kirkuk and western Anbar with people fleeing violence in search of safety."

The war has displaced millions of Sunnis in the river cities in the West, particularly in cities which had received major subsidies under Saddam Hussein, but lost such support after the U.S.-led invasion in 2003. It is not clear how Iraq's post-ISIS War economy will adapt, but it is far from clear that natural economic forces will rebuild the economies of these Sunni river cities, and particularly the role Mosul played in Iraq's economy.

Displaced Sunni Arabs have faced problems and tensions in moving into Shi'ite areas and Kurdish controlled areas. This has been true even in Baghdad—which was the most mixed city in Iraq before 2003. There does not seem to have been any attempt at a sectarian census in Baghdad since 2009, but that census indicated a major shift had taken place in terms of sectarian segregation and dividing the city along sectarian lines.20 As a result, the extent to which postwar recovery will allow Sunnis and Arabs to mix, and bring economic recovery to Sunni areas in the West is a critical uncertainty in shaping Iraq's post-conflict stability, recovery, and development.

**The Public Sector as the Center of the Mismanagement of Human Resources**

Iraq has many well-educated and competent people, but a mixture of conflict, over-reliance on the state, and political manipulation of every aspect of government hiring and performance for the self-advantage of senior leaders and officials has created a national nightmare. The World Bank diagnostic tracks closely with previous work by the IMF and notes that, 21

Iraq’s public sector institutions have not been successful in equitably allocating resources across the country and its population because for decades they have been captured by sectarian interests and decimated by corruption. The politicization of state institutions and the pillaging of state resources have undermined the effective and equitable delivery of services, thus exacerbating the crisis of legitimacy, the challenges to state
authority, and, ultimately, the spiral of violence that we see in Iraq today. As noted in the 2011 World Development Report, weak institutions and a lack of legitimacy undermine states’ ability to provide basic security, justice, and economic opportunities for their citizens and can therefore be a key cause of conflict (World Bank, 2011a). This holds true in Iraq, where the fragility of key public institutions and processes is reflected most starkly in the chronically weakness of its civil service, public financial management, state-owned enterprises, public investment management, and judicial system.

...The public sector has been the predominant formal employer in the country since the beginning of the Republic, as, with few exceptions, private sector firms were and continue to be small and informal. De-Baathification and the exodus of tens of thousands of the most qualified employees due to conflict and violence intensified the disintegration of the public sector, which was already severely weakened by wars and sanctions in the 1980s and 1990s. Employment and promotion in the civil service have become increasingly non-meritocratic, and the sector has come to be viewed as a de facto social safety net. Iraqis queue for a secure job in the public sector, often for months or years, because of the job security, higher salaries, and benefits as well as one of the most generous pension systems in the world (World Bank, 2015c). However, this degree of employment generation by a large public sector is unsustainable. In the long term, sustainable jobs will only be created in an attractive investment climate and a predictable, low-cost business environment that enables the growth of a robust and productive private sector.

...In addition to undermining the quality of the civil service, the dramatic rise in clientelistic hiring since 2003 has contributed to a ballooning of public sector employment and of the wage bill. Between 2003 and 2015, the core public sector (i.e. excluding SOEs) expanded from 0.9 million to over 3 million employees, making it the country’s largest single employer, providing approximately 42 percent of all jobs in Iraq (Figure 50). Adding in SOE employees would bring total employment in the public sector to 3.5 million, close to one half of all of the jobs in the country. The core public sector wage bill, estimated at approximately US$30.5 billion (ID 36.1 trillion) in 2016, has become both the single largest and fastest-growing expense item in the government budget. Between 2004 and 2016, expenditure on core public sector wages and salaries expanded by almost 940 percent, while the share of the wage bill in the overall government budget grew six-fold from 7 to over 44 percent, representing 18 percent of GDP in 2016...This is extremely high by global standards, even when compared to oil exporters and other MENA countries.

...Because of a lack of effective human resource information systems and oversight in the relevant ministries, there has been a rampant use of favoritism in hiring and promotions. Audits have uncovered thousands of ghost workers and workers illegally receiving two salaries. While some agencies have tried to introduce competitive recruitment procedures, in many instances recruitment is used to further political and sectarian agendas. This dynamic is reflected in indices of meritocracy and favoritism in public sector hiring. In Iraq merit matters far less for promotion and social mobility than in OECD countries, in UMIC, and even in other MENA countries on average, while networks and favoritism matter far more...Meanwhile, the government’s strategy of using expanded hiring and generous ad hoc wage hikes to gain popular support in the context of an ailing economy has compounded the country’s problems over the medium and long term. Not only is the bloated public sector fiscally unsustainable, particularly in the wake of falling oil prices, but it has also provided workers with a disincentive to consider private sector employment, which is already depressed due its lower average wages, 44 job security, and benefits.

Salaries in the public sector are significantly higher than in the private sector for people with equivalent education levels. The gap increases with education level. Public sector employees who have completed a secondary school or higher earn salaries that are over 40 percent larger than they would in the private sector, while public sector workers with lower educational attainment earn salaries that are 20 percent higher than their private sector equivalents. Also, allowances and bonuses in the public sector are particularly large, complex, and frequently regressive and account for 60 percent of total personnel compensation costs (World Bank, 2015c).

...Repeated and ongoing conflict and fragility in Iraq have significantly constrained the options available to policymakers to solve the problems of the civil service in the near term. Although pay scale reforms and elimination of ghost workers would yield some much-needed fiscal savings and would signal a shake-up of the status quo, these measures would not by themselves significantly alter the character of the civil service in the short term. More extreme measures such as outright layoffs do not appear to be feasible because,
despite its distortionary effects, the public wage bill is essential to sustaining economic activity and maintaining social peace given the dearth of private sector jobs, thus giving the government little room to maneuver. In the medium term, a complete (gross) freeze on hiring is not optimal as some flexibility is needed to meet shifting public sector employment needs. However, reducing the net wage bill by attrition (in other words, filling only a small portion of the public sector positions vacated by the 60,000 to 80,000 employees who retire every year) (could represent a significant reduction in the wage bill each year. For this to be feasible, an agreement would need to be reached among Iraq's ministries who currently have loyalties to different ethnic and sectarian political stakeholders. Politicians need to stop using civil service jobs as distributive spoils and to turn the administration into a leaner, more professional machine focused on the effective provision of public services.

...The government has identified the civil service as a core area for reform. It has tried to trim the wage bill by pledging to implement a hiring freeze except for the security, health, and education sectors (which constitute more than 60 percent of total public sector employment). However, so far the ministries in question have refused to carry out the central government's orders. In 2015, the government also attempted to introduce a new salary scale that would cut the pay for highest grade civil servants, although this was partly rolled back in the face of public protests (World Bank, 2015c). The most promising initiative is the recent steps taken by ministries to introduce the biometric identification of employees and new direct deposit payroll systems as these have the potential to reduce numerous forms of payroll fraud, including a variety of "ghost" workers, double dippers, and absentee employees, which are estimated by the Federal Board of Supreme Audit (FBSA) to number in the tens of thousands. The FBSA is currently carrying out a comprehensive government-wide audit of wage and pension payrolls to identify these fraudulent payees.

There are two critical observations that need to be made about these problems: First, as Figure Four shows, they reflect a set of interests that affects a large part of Iraq's working and professional population. Second, they tie the problem deeply to Iraq's internal politics and political factions and do so at such a high cost that it will be very difficult for the government to buy its way out of the problem. Accordingly, it may be easier to address these problems in practice by acting slowly and focusing on corruption and better planning and budgeting.
Governance Challenges

The quality of Iraqi governance presents equal challenges. Iraq has long been rated by the World Bank as setting low standards in the efficiency and capability of every key element of government. Figure Five shows the World Bank rating of six key measures of Iraqi governance from 1996 to 2015. They have consistently been some of the worst ratings for any country in the world, especially for "Political Stability and the Absence of Violence."
They also are almost certainly all too fair in showing little improvement as a result of past U.S. aid efforts following the fall of Saddam Hussein. As many elements of the reporting on such U.S. efforts by the Special Inspector General for Iraqi Reconstruction (SIGIR) show, the U.S. never succeeded in achieving the key goals it set for the civil side of aid, and often grossly exaggerated its success and progress.

In contrast, the World Bank notes the degree to which the human, governance, and economic challenges in Iraq all still interact to create major problems for stability, recovery, and development.22

The rebuilding of state institutions that have been destroyed or severely weakened over decades of conflict and sanctions – and, in many cases, their creation – is one of the key challenges for Iraq. Iraq ranks unfavorably on many key indicators of good governance compared to the averages for other MENA countries, to upper-middle-income countries (UMIC), and OECD countries. Although little accurate and detailed data can be collected on the state of governance on the ground, existing indicators paint a picture of persistent governance challenges, as will be illustrated in this section.

The public sector’s institutional effectiveness and capacity is weak. In 2015, the Fragile States Index ranked Iraq as one of its high alert states, meaning that it lacks many of the basic administrative capacities required for effective governance. The latest Bertelsmann Transformation Index, World Governance Indicators, and Institutional Profile Database show Iraq performing poorly in relation to the OECD, UMIC, and MENA on standard measures of institutional capacity and effectiveness, including administrative capacity and efficiency and the capacity for implementation.

There have long been serious problems in basic administration, economic planning, budget planning and execution, in the functioning of the Iraqi parliament, and the willingness to accept responsibility. The World Bank Systematic Country Diagnostic notes that Iraqi governance still presents serious problems at every level. It also warns that these failures in governance have been driven by the ambitions of the leaders of each faction, the pursuit of factional interest and rivalries rather than a concern with national interests, and by critical failures in the weak and divided parliamentary system the U.S. helped establish after invading Iraq in 2003.23

... Efforts to tackle Iraq’s fundamental challenges and to appease competing interest groups have included the drafting of a new constitution, the holding of national and regional elections, and the approval of numerous laws. To date, these efforts have yielded only limited success in terms of resolving the country’s governance and security challenges. A key question facing Iraq today is whether a new governance structure can be peaceably built that has a better chance of distributing power and resources more equitably. A new social contract is needed, one which places a high value on the sustainability of social and political systems as well as on environmental and fiscal sustainability. Wealth analysis indicates that the country is not accumulating any wealth but is depleting it rapidly as oil wealth is consumed without the parallel creation of human or physical assets. The costs of environmental degradation, particularly the degradation of water resources, are huge, amounting to over 6 percent of GDP in some recent years.

...Efforts to resolve Iraq’s many development challenges are severely hampered by insecurity and poor governance. Economic decision-making today is dominated by short-term needs and rent-seeking. The government is prioritizing the rapid expansion of oil production in order to finance a bloated public sector and current spending needs – mainly wages – that are detached from any long-term diversification strategy. Fiscal institutions are weak and unequipped to deal with the complexities of an oil-dominated budget, which has made the Iraqi economy extremely vulnerable to a sudden decline in oil prices, as has been evident since 2014. Even though it has been unable to ensure the country’s security or to provide basic services, the public sector dominates the economy. It is by far the largest formal employer in the country, and its wage bill has become the single largest and fastest-growing expenditure item in the government budget. State-owned enterprises (SOEs) dominate the financial and non-financial sectors and enjoy significant privileges, thus crowding out private firms and impeding factor reallocation. Yet only one quarter of all SOEs are profitable. A substantial number are seriously decapitalized, inefficient, and in a state of physical degradation, and many appear to have a limited rationale for existing apart from providing public employment. The weak and
stagnant private sector is incapable of generating significant employment opportunities for the tens of thousands of young Iraqis who swell the ranks of the unemployed each year. Consultations with the private sector around this report noted that politically connected firms capture public sector contracts, further reducing the opportunities available to other entrepreneurs. Iraq has neglected its non-oil infrastructure, and poor quality services are aggravated by inadequate infrastructure and low levels of public investment. With few exceptions, the private sector is not yet in a position to play a major role in the non-oil economy.

... Decentralization is frequently discussed as a potential way to ensure political and social sustainability, to reduce Iraq’s ethnic and sectarian struggles, and to reverse the decline in service delivery and accountability. Absolute central control of resources no longer appears to be a viable alternative. Solutions that recognize differential conditions and capacities across Iraq – the semi-autonomous Kurdistan region is a case in point – may be a possibility. It is essential, however, to recognize that, while some are concerned about the government of Iraq being over-centralized, others are worried about fragmentation. Some have recommended the devolution of power to Shia and Sunni Arab, and Kurdish communities, but these proposals raise serious concerns. For example, Iraq’s oil reserves are concentrated geographically rather than being distributed evenly. Decentralization would make it difficult for the federal government to enforce the equitable distribution of wealth. Iraq’s three major communities are not as geographically contiguous as is often assumed, giving rise to potential discrimination or worse against large groups of minorities. Moreover, the premise of political legitimacy based on sectarian identity ignores many other cross-cutting identities such as tribe, class, or rural/urban dwellers. Strongly aligning Iraq’s political institutions with its sectarian identities is likely to entrench the zero-sum nature of the competition for resources and power that has already generated so much instability in the country (Fitzsimmons, 2008).

... Iraqis have witnessed a dramatic deterioration in most basic services. As a result, the poor and near poor are greatly in need of well-targeted and effective social protection programs, to weather the current highly volatile economic and social conditions.

...The poor management of Iraq’s immense oil wealth is one of the key constraints facing the country. The government has failed to equitably and sustainably exploit national resources to reduce poverty and ensure shared prosperity. Competition over the control of resources has exacerbated ethnic and sectarian divisions, with a consequent deterioration in governance, security, and state legitimacy. If the bulk of oil revenues continues to be allocated to public employment, wages, and transfers, this will perpetuate the current situation, which is characterized by short-term consumption, import dependence, a skewed labor market, and a crippled private sector. The role of the public sector, the prime beneficiary of mineral wealth today, needs to be redefined. Allocating more oil revenues to public capital investments would provide the broadest benefits in terms of diversification and economic transformation. However, Iraq has a poor record of public investment management (PIM) so it will be necessary to tackle this problem within the context of a medium-term fiscal framework, an explicit debt management strategy, and strengthened public financial management (PFM). To minimize losses due to poor PIM, a portion of oil revenues can be set aside in an overseas transitional saving fund while Iraq’s investment management and associated systems are strengthened. In parallel, hiring freezes can be implemented and civil service payroll audits should be conducted to identify ghost workers, absenteeism, and workers receiving more than one salary. While these measures will only be the first moves towards restructuring the public sector, implementing them would signal a change to existing clientelistic hiring practices that have greatly reduced the civil service’s capacity.

... The dominance of the public sector in the Iraqi economy has prevented the emergence of a vibrant private sector and the associated job creation necessary for enhancing the welfare of all Iraqis. A strong private sector is also a prerequisite for economic diversification and for sustainable growth. Yet outside the oil sector most non-oil private firms (beyond a few small and micro, informal, and service-oriented enterprises) have been crowded out by SOEs and by the maze of regulations that creates a hostile environment for market activity. SOE reform has been on the table for many years, but limited tangible progress has been achieved. In the medium term, it will be necessary, for the sake of fiscal transparency, to convert hidden subsidies into explicit budget expenditures; this may lead to increased public pressure for SOE reform. In the financial sector, a more level playing field between public and private banks will be required before the banking sector will be able to fulfill its role in financing the private sector. In the near term, internal restructuring of viable SOEs to improve their ability to carry out their mandates is likely to be a more politically and socially feasible strategy than closure or privatization.
... The consequences of failing to tackle Iraq’s weak governance, conflict, and fragility are not difficult to imagine. The country has unfortunately already witnessed some of them during the sectarian violence that racked the country between 2005 and 2007 and in the more recent rise of Daesh. Beyond the loss of life and displacement that a deterioration in governance and security would entail, the impact would affect all aspects of economy and society. What progress has been achieved in terms of the provision of social services and safety nets would be reversed, the losses in the accumulation of human capital would deepen, and hard-won advances in attracting investment would be undone. Trust among citizens and between citizens and the state would be further reduced. The slow process of constructing governance and the legitimacy of the state would receive a further blow. It is not clear that the institutional capital exists for Iraq to recover from more crises.
Figure Five: World Bank Governance Ratings for Iraq: 1996-2015

The inner, thicker blue line shows the selected country’s percentile rank on each of the six aggregate governance indicators. The outer, thinner red lines show the indicate margins of error.


http://info.worldbank.org/governance/wgi/#reports
The Curse of Corruption

It is critical to note that outside aid in governance per se is unlikely to have any more positive impact in the future than it has had in the past. Iraq’s most serious problems are not driven by a lack of talent or training, failure to adopt the most modern management and accounting systems, or flawed institutions. They go far deeper. One critical problem is corruption—which many Iraqis cite as the single deepest reason they distrust the government. Figure Four has already shown that the World Bank’s rating of Iraq’s corruption has been consistently dismal for several decades. Its latest Systematic County Diagnostic goes further:\textsuperscript{24}

identifies the three characteristics that underlie Iraq’s predicaments: its poor governance, dependence on oil wealth, and ethnic and regional diversity. It posits that the combination of oil wealth and ethnic and religious fragmentation has led to conflict, violence, and fragility due to long-standing governance problems and the inability of institutions to ensure an equitable allocation of resources among the country’s population and regions.

... The rebuilding of state institutions that have been destroyed or severely weakened over decades of conflict and sanctions – and, in many cases, their creation – is one of the key challenges for Iraq. Iraq ranks unfavorably on many key indicators of good governance compared to the averages for other MENA countries, to upper-middle-income countries (UMIC), and OECD countries. Although little accurate and detailed data can be collected on the state of governance on the ground, existing indicators paint a picture of persistent governance challenges, as will be illustrated in this section. The public sector’s institutional effectiveness and capacity is weak. In 2015, the Fragile States Index ranked Iraq as one of its high alert states, meaning that it lacks many of the basic administrative capacities required for effective governance. The latest Bertelsmann Transformation Index, World Governance Indicators, and Institutional Profile Database show Iraq performing poorly in relation to the OECD, UMIC, and MENA on standard measures of institutional capacity and effectiveness, including administrative capacity and efficiency and the capacity for implementation.

... Corruption is a key symptom of poor governance, and bureaucratic corruption, bribery, and nepotism are all major problems in Iraq. At the central government level, the combination of a weak yet resource-rich rentier state has allowed competing groups to capture state resources and contracts, decimate institutions, and undermine the development of a competitive private sector. The various power groups (such as sectarian and ethnic groups and militias) regard governance structures simply as means to capture rents and thus vie for control over them. When governance is weak at the state level, the leaders of non-state power groups derive their legitimacy from the degree to which they are able to capture resources and reallocate them to their constituencies. The informal sectarian quota system, which since 2003 has guided the distribution of ministerial positions as well as minor government posts, is a prime example of this and is one of the principal causes of the bloated public sector, which severely constrains government effectiveness and service delivery... The lack of confidence in public institutions that has arisen because of corruption is profound.

... The massive influx of reconstruction resources that followed the 2003 invasion and the previous decade of sanctions and deprivation overwhelmed the spending, management, and oversight capacities of the shattered Iraqi public sector. Underscoring the magnitude of the problem, recent polls have found that Iraqi citizens and business owners believe that corruption is the most important policy challenge facing the country, ahead of economic and even security concerns..., as well as the biggest constraint on business)... Also, corruption in Iraq often leads to or entails violence, which is not always characteristic of corruption elsewhere (Williams, 2009).

Ratings by Transparency International provide additional insights. Transparency International rated Iraq as the 10th most corrupt nation in the world out of the 176 countries it rated in 2016.\textsuperscript{25} Its country report is now several years out of date, but few Iraqis would argue that its summary of the character of Iraq’s government is not still correct: \textsuperscript{26}

After a difficult beginning marked by institutional instability, Iraq’s new regime has in recent years become increasingly aware of the enormous corruption challenges it faces. Massive embezzlement, procurement scams, money laundering, oil smuggling and widespread bureaucratic bribery have led the country to the
bottom of international corruption rankings, fueled political violence and hampered effective state building and service delivery.

Although the country’s anti-corruption initiatives and framework have expanded since 2005, they still fail to provide a strong and comprehensive integrity system. Political interference in anti-corruption bodies and politicization of corruption issues, weak civil society, insecurity, lack of resources and incomplete legal provisions severely limit the government’s capacity to efficiently curb soaring corruption. Ensuring the integrity of the management of Iraq’s massive and growing oil revenue will therefore be one of the country’s greatest challenges in the coming years.

... Since the overthrow of Saddam Hussein’s regime, Iraq has faced significant corruption challenges. The country continues to score among the worst countries on corruption and governance indicators. Corruption risks are exacerbated by the historical legacy of the previous authoritarian regime, lack of experience in the public administration, weak capacity to absorb the influx of aid money, sectarian issues and lack of political will for anti-corruption efforts. While Iraq has introduced a number of anti-corruption initiatives, these fail to provide a sufficiently strong integrity framework. Political interference, lack of political will, a weak civil society, a confusing penal code, and a lack of resources limit the effectiveness of anti-corruption measures. Corruption in the military and security services and oil smuggling has contributed to the major security challenge that the country now faces with the militant group Isis.

... Kurdistan Region of Iraq has faced years of war and genocide, but has developed a political system with regular elections, and an improving space for civil society and its engagement in governance...Levels of corruption in the country, while lower than in Iraq, are comparatively high compared to other countries in the region. Corruption challenges are rooted in the strong role that the two established political parties have in the political system, nepotism, a weak bureaucratic governance system and the task to ensure proper use of oil revenues.

While progress has been made on delivering the government’s 2009 ‘Good Governance and Transparency Strategy’ and the ‘Vision for 2020’, there is a desire to see more high-profile convictions for corruption cases. A challenging media environment remains a serious constraint on effective anti-corruption reform.

It is also important to note that corruption remains a critical problem in the military, the police, and the justice system. Iraq experienced serious problems in terms of gross corruption in the Ministry of Defense in mid-war in 2015-2016 and this has been the norm rather than the exception. Transparency International noted that, in the period before the ISIS invasion, corruption had a massive impact on Iraq’s overall economy, security efforts, and justice system, 27

...a study based on IMF & World Bank data conducted by Global Financial Integrity, an estimated US$ 65 billion in illicit funds left Iraq (about twice its 2005 GDP, or 56% of its 2011 GDP) between 2001 and 2010, suggesting massive fraud, corruption, tax evasion and money laundering. (Global Financial Integrity, 2012). An audit by Iraq’s Board of Supreme Audit gives an even higher figure, estimating in up to US$ 40 billion the flows of funds that could be leaving the country annually – through money laundering schemes that use the Central Bank’s activities - because of corruption (SIGIR, 2013).

... In the Global Corruption Barometer of 2011, 56% of respondents declared having paid a bribe in the 12 months preceding the survey. The Police, Customs and the Judiciary were the three institutions where the most bribes were paid.

... Other reports reveal that securing a public job, notably in the security forces, is often impossible without paying hundreds, or even thousands of US dollars. (The Independent, 2013)... Nepotism and clientelism are often reported to be common practices.

... While Iraq produces a number of budget documents for internal government use, such as the proposed and enacted budgets, as well as in-year and audit reports, most of them are not publicly released. In addition, no public consultation mechanisms are in place during the budgetary process, leaving ordinary citizens no opportunity for participation. This means that the government cannot be held accountable by the public neither for its decisions on the allocation of public resources nor for its actual spending, leaving significant space for arbitrary decision making...Procurement in Iraq has also been known in the past as a hot spot for corruption.
... ensuring that Iraq’s massive oil and gas income is used for the benefit of all Iraqis is probably one of the biggest anti-corruption challenges of the coming years. Two major corruption risks threaten the good use of hydrocarbon resources:

- **Oil smuggling.** There are converging reports denouncing oil smuggling on various scales, from local pipeline drilling to large-scale organized fraud. These illicit activities have been used to finance major political & religious groups and personalities, criminals, militias and other violent groups.

- **Oil revenue management** is another wider challenge for Iraq. Oil and gas, as extractives industries, are deemed to carry inherent high corruption risks due to the high volumes of revenue involved and the high incentives for rent seeking they provide...

... The ministries of defense and security have been regularly described to be amongst the public sectors which are most affected by corruption. Defense contracts and procurement have been repeatedly criticized as weak links, given the high number of corruption scandals that were uncovered...Furthermore, bribery has been reported in the hiring of new recruits for the security forces...

One also has to be careful about criticizing corruption when it has become a normal part of professional life, rather than an exception. Few who are actually working in the government feel secure enough not to take advantage of the opportunity, and the failure to join in destroys far more careers than it helps. Anti-corruption efforts become corrupt or are sidelined. Those that are charged are often political victims or scapegoats, and those who are charged that have real influence escape serious punishment and/or are recycled into new positions.

As has been the case in virtually every developing nation with high levels of corruption, anti-corruption measures have been largely punitive, and have not been tied to broader reforms in career management and stability, wages, and proper fiscal controls. They have had little positive effect, have become political weapons, and have sidelined or threatened those who tried to make them effective.

### Government Barriers to the Ease of Doing Business

The Iraqi government presents many other problems that have a major impact. One is a set of institutionalized problems in the ease of doing business. A separate World Bank effort has long assessed a wide range of indicators of the number of barriers a given government creates to doing business or creating new businesses. In 2016, Iraq’s performance was so bad that it ranked 165th out of 195 countries, and it was clear that Iraq was making no substantive progress in spite of years of talk about reform.28

Still another World Bank study provides a comparison of Iraq's performance by key parameters, and shows that its performance is dismal compared to that of its neighbors. These data are summarized in Figure Six.29
Figure Six: Iraq's Barriers to the Ease of Doing Business

How Iraq and comparator economies rank on the ease of doing business

Rankings on Doing Business topics - Iraq (Scale: Rank 190 center, Rank 1 outer edge)

Failing to Plan, Program, Budget, Account, Measure Effectiveness and Provide Transparency

Iraq has shown in case after case that its budget, reform, and development plans are more political than real, and most never survive the political process that review them. Iraq has long had chronic budget deficits and needs for outside loans—a need sharply reinforced by the more than 50% drop in oil prices and petroleum export revenues per barrel in 2014. Once again, it is hard to make a precise estimate because of the way Iraq treats its arms and military purchases, handles its loans, and reports on actual expenditures versus budget plans.

**Figure Seven** does, however, provide an illustration of the problem, and the impact of the sudden cut in oil revenues is clear. The CIA estimates that Iraq had a budget deficit of 14.7% in 2016—one of the highest in the world (212th out of 220). It estimates that Iraq's revenues were $52.43 billion, and its expenditures were $77.87 billion in 2016, and that its public debt increased from 63.9% of GDP in 2015 to 79% in 2016.30

Balancing its budget, however, is a far less serious problem than allocating the money properly, exerting adequate financial controls, and measuring the effectiveness of government spending. Once again, the World Bank warns that Iraq's problems in moving towards stability, recovery, and development face additional challenges. Its *Systematic Country Diagnostic* report notes that,

Effective public financial management (PFM) is a critical foundation for basic economic governance and for ensuring the performance, legitimacy, and accountability of the state. PFM interventions tend to focus on increasing aggregate fiscal discipline, allocating resources according to national priorities, and encouraging accountability in public spending. For fragile states, PFM reform can be an important part of state-building that is particularly significant when it is associated with efforts to increase transparency and accountability, to develop sustainable capacity and to support service delivery (Gill, 2015).

... In Iraq, enhancing PFM will be crucial for rebuilding the legitimacy of the state, in addition to ensuring accountability and efficiency in the management of public resources. Weaknesses in the PFM system increase the risk of waste, abuse, and corruption. The most recent comprehensive assessment of the Iraqi PFM system using the Public Expenditure and Financial Accountability (PEFA) methodology took place in 2007.45 It awarded Iraq the lowest possible score (D) on a large number of performance indicators, indicating that there was substantial scope for improvement.46

... In Iraq, however, as is the case in many fragile and conflict-affected countries, the formal channels by which public finance and procurement are managed mask the actual processes through which resources are raised and spent. These parallel processes are obscure and difficult to influence or change, especially as they shift power from the state to other actors, thus ensuring that formal PFM systems remain weak, unreliable, and corrupted. In Iraq, as elsewhere, the main challenge is often providing incentives to governing elites and other interests to support the legitimate formal system rather than the shadow arrangements (Porter et al, 2010). The difficulty in Iraq is that the volume of resources that can thus be seized—oil revenues, aid resources, and other state income—is vast, making it harder to develop the necessary incentives. More concerted global interdiction efforts—such as the Extractive Industries Transparency Initiative (EITI)—are needed to target illicit resource flows, particularly trans-border flows through money laundering, corruption, or criminal enterprises.

... Fragile states are particularly weak in the implementation phase of PFM, in other words, budget transparency and execution, including crucial downstream processes like cash management, procurement, payroll control, and internal control. This is also the case in Iraq (Porter et al, 2010). These transactions tend to involve multiple agencies and individuals acting at some remove from the center where it is possible to exercise considerable discretion with no supervision or control (Fukuyama, 2004). Focusing on improving these processes is more important than upstream processes such as budget preparation, multi-year frameworks, or program budgeting and is more likely to bear fruit in terms of improving results and accountability in government spending. Similarly, rather than passing laws and regulations at the center, it
may be more effective to strengthen central-local links through revenue sharing agreements with governorates and municipalities that are linked to performance and supported by strengthened PFM. In Iraq, it is likely to be necessary to strengthen PFM in the oil and security sectors and to move away from using cash-based transactions. While this is a highly contentious area, progress is possible. One of the first actions undertaken by the current government when it took office was to identify 50,000 ghost workers on the payrolls of the Ministries of Defense and of the Interior.

... Iraq’s PFM processes and systems are typical of fragile states with the same sorts of challenges in numerous areas. A key challenge for the government is to track spending across the various stages of the budget cycle. Line ministries and affiliated agencies often lack reliable data on the availability of funds and cannot commit expenditures in a timely fashion. Cash management is weak, and the government often has insufficient cash available to meet its financial obligations as they fall due. The IMF estimated that the accumulation of domestic arrears in Iraq was 2.5 percent of GDP at the end of April 2015, and while procedures for authorizing government purchase orders are designed *inter alia* to help to control arrears, they are not effective in the absence of a sound commitment control system. There are additional weaknesses in the government’s ability to allocate resources in accordance with its sectoral strategies...

**Figure Seven: Iraq's Uncertain Budget Deficits**

Economic Challenges

The previous analysis of Iraq's human and governance problems have shown all too clearly that neither can be separated from the other, and that both are closely tied to Iraq's economic problems. They have also shown that when petroleum revenues are steadily misused over a period of decades, they can do as much to bring poverty as wealth, and that systematic misrule can do almost as much damage to popular welfare as war.

These are not issues that the U.S. government has so far done an adequate job of addressing. Despite years of war, and massive flows of U.S. aid, the State Department and USAID have never provided a meaningful overall assessment of the Iraqi economy or anything like the civil side of an integrated civil-military plan to help Iraq move towards stability.

USAID has never produced a development plan of any kind, and both State and USAID often made grossly over-optimistic public estimates of Iraqi progress before 2011 and have made virtually no meaningful assessments since. As reporting by the Special Inspector General for Iraqi Reconstruction (SIGIR) and the Special Inspector General for Afghan Reconstruction (SIGAR) have shown, these same problems have affected the war in Afghanistan, and represent a key gap in the United States' ability to deal with serious counterinsurgency and the challenges posed by other failed state wars.

The CIA Overview of Iraq’s Economy

The CIA's public analysis of the Iraqi economy is anything but reassuring, and highlights the impact of the ethnic differences between Kurd and Arab:32

Iraq’s largely state-run economy is dominated by the oil sector, which provides more than 90% of government revenue and 80% of foreign exchange earnings. Oil exports in 2016 averaged 3.3 million barrels per day from southern Iraq, up from 2015. Moreover, the slow recovery of global oil prices improved export revenues throughout 2016, although monthly revenue remained below 2015 levels. Iraq's contracts with major oil companies have the potential to further expand oil exports and revenues, but Iraq will need to make significant upgrades to its oil processing, pipeline, and export infrastructure to enable these deals to reach their economic potential.

Iraqi oil exports from northern fields are hampered by fundamental disagreements between the Iraqi Government and autonomous Kurdistan Regional Government (KRG) in Iraq’s Kurdistan region (IKR) on the roles of federal and regional authorities in the development and export of natural resources. In 2007, the KRG passed an oil law to develop IKR oil and gas reserves independent of the federal government. The KRG has signed about 50 contracts with foreign energy companies to develop its reserves, some of which lie in territories whose status is in dispute between Baghdad and Erbil. Some of the companies have left or returned blocks, citing lack of commercial prospects. In 2014, the KRG began exporting its oil unilaterally through its own pipeline to Turkey, which Baghdad claims is illegal. In the absence of a national hydrocarbons law, the two sides have entered into four provisional oil- and revenue-sharing deals since 2009, all of which collapsed. In September 2016, the two sides began implementing a fifth ad hoc agreement to split oil exports from Baghdad-controlled fields in Kirkuk.

Iraq is making slow progress enacting laws and developing the institutions needed to implement economic policy, and political reforms are still needed to assuage investors' concerns regarding the uncertain business climate. The Government of Iraq is eager to attract additional foreign direct investment, but it faces a number of obstacles, including a tenuous political system and concerns about security and societal stability. Rampant corruption, outdated infrastructure, insufficient essential services, skilled labor shortages, and antiquated commercial laws stifle investment and continue to constrain growth of private, nonoil sectors. Under the Iraqi constitution, some competencies relevant to the overall investment climate are either shared by the federal government and the regions or are devolved entirely to local governments. Investment in the IKR operates within the framework of the Kurdistan Region Investment Law (Law 4 of 2006) and the Kurdistan Board of
Investment, which is designed to provide incentives to help economic development in areas under the authority of the KRG.

Inflation has remained under control since 2006. However, Iraqi leaders remain hard-pressed to translate macroeconomic gains into an improved standard of living for the Iraqi populace. Unemployment remains a problem throughout the country despite a bloated public sector. Encouraging private enterprise through deregulation would make it easier for Iraqi citizens and foreign investors to start new businesses. Rooting out corruption and implementing reforms - such as restructuring banks and developing the private sector - would be important steps in this direction.

The IMF Overview of Iraq's Economy

The IMF has found that Iraq has so far had mixed performance in meeting its broad international fiscal targets, but has reached staff level agreements with the Iraqi government. A review in March 2017 noted that, Iraq has been hard hit by the conflict with ISIS and the plunge in global oil prices since 2014. The government has responded to the fiscal and balance of payments crisis with a large but necessary fiscal adjustment supported by financial assistance from the international community. In 2016, real GDP growth was sustained at 11 percent supported by a large increase in oil output that benefitted from past oil investments. Nevertheless, the non-oil economy experienced an 8 percent contraction due to the conflict and the fiscal consolidation. In 2017, economic activity is expected to remain muted due to a 1.5 percent contraction in oil production under the agreement reached by the Organization for Petroleum Exporting Countries, and only a tepid recovery of the non-oil sector.

The plunge in oil prices has driven the decline of Iraq’s gross international reserves from $53.7 billion at end 2015 to the still comfortable level of $46.5 billion at the end of December, 2016. Fiscal pressures remain significant with the government deficit remaining at 12 percent of GDP in 2016, due to continuing weak oil prices and rising humanitarian and security spending. Total public debt increased from 32 to 64 percent of GDP during 2014-16. Credit growth decelerated and non-performing loans in state-owned and private banks increased significantly in 2016.

Medium term growth prospects remain modest driven by projected flat oil production and investments in the face of the revenue constraint and modest pickup in non-oil growth supported by the expected improvement in security and implementation of structural reform. Further reforms to create fiscal space for inclusive growth, strengthen the business environment, reduce corruption and repair the banking sector are needed to support private sector-led growth and diversification of the economy once post-ISIS reconstruction is underway. Risks remain high, arising primarily from uncertainty in the oil price outlook, security and political uncertainties, and administrative weaknesses.

The IMF, however, has not followed the World Bank's lead in conducting a detailed review of the internal human, governance, and economic problems in Iraq. It has focused largely on international financial stability, tended to make optimistic forecasts, and made recommendations for reform that tacitly assume a smooth end to conflict and broad and efficient Iraqi government implementation regardless of all of the competing forces that destabilize Iraq. The end result is that the projections shown in Figure Eight are of interest largely as an idealized best-case with limited prospect of ever becoming real.

It is also important to understand that any IMF (and CIA) increase in petroleum export income for 2016 needs to be kept in very careful perspective. A projection by the United Stated Energy Information Administration (EIA) shows that Iraqi export revenues peaked in 2012 at $91.2 billion in 2016 dollars. They dropped to $88.4 billion in 2013, $87.6 billion in 2014, $57.9 billion in 2015, and $53.5 billion in 2016. Similarly, the EIA estimates that Iraqi petroleum income per capita went from $2,767 in 2012 in 2016 dollars to $2,592 in 2013, $2,486 in 2014, $1,590 in 2015, and $1,423 in 2016—driven down by both the decline in world oil prices and the increase in Iraq’s population.
The total 2016 revenues were only 59% of Iraq’s peak, despite increases in the volume of Iraqi exports, and the revenues per capita were only 51%.36

**Figure Eight: Iraq — IMF Estimate of Recent Economic Developments and Outlook, 2013–21**

The World Bank Overview of Iraq's Economy

The previous analysis has already shown just how critical the links are between the human, governance, and economic challenges Iraq will face in seeking to create lasting security, stability, recovery, and development. World Bank reporting on the economic challenges, however, shows that there are serious additional challenges.

The World Bank summary outlook for the Iraqi economy issued in April 2017 raised several issues, although the summary of its economic data shown in Figure Nine indicates that the World Bank was less optimistic about a future rise in oil revenues than the IMF.37

Iraq has faced the ISIS war and a protracted reduction in oil prices since mid-2014. Strong oil production sustained growth, but the non-oil economy has contracted sharply. 10% of Iraqis remain displaced due to continuous unrest. A large international financing package supports the government’s reform effort. Following an OPEC agreement, oil production would decrease in 2017, but higher oil prices would improve fiscal and external balances. Non-oil activity would return to positive growth. Risks remain high.

Iraq’s economic outlook is expected to improve under the assumption of a more favorable security environment, and continued fiscal consolidation. The non-oil economy after three years of contraction is expected to rebound in 2017 due to improved security and higher non-oil investment spending. However, real GDP is expected to contract by 3 percent in 2017 due to a projected 6% reduction of oil production, as a result of the agreement to reduce oil production by 1.2 million barrels per day reached among OPEC members in November 2016.

...Lower production is expected to reduce oil export volume by 5% in 2017. Oil production and exports are projected to return to their 2016 level in 2018 and 2019. Iraq’s oil export prices are projected to average US$47.4 per barrel in 2017, compared to an average of US$35.6 in 2016. Higher oil prices would reduce the overall fiscal and current account deficits to 4.4% of GDP and 4.5% of GDP in 2017.

In 2016, overall growth is estimated to have reached 10% thanks to strong oil production. The security and oil shocks forced the government to rapidly reduce expenditure which negatively affected private sector consumption and investment. The non-oil economy contracted by 10% a year in 2015 and 2016. Inflation averaged 0.4% in 2016.

Once again, however, its Systematic Country Diagnostic covers a wider range of issues. These include the problem of oil wealth and the growth of poverty.

Oil "Wealth" versus Oil "Poverty"

One of the tragedies of what could be oil wealth is that most petroleum exporting states—including the vast majority of OPEC states have misused their petroleum export income to the point where they have done critical damage to their economies.38 The World Bank report described Iraq's "petroleum disease" as follows:39

Oil dominates Iraq’s economic and political framework. Iraq is the world’s fourth largest oil exporter (exporting about 3.7 million barrels per day of the estimated 4.2 million barrel per day that it produced in 2015), being responsible for 6 percent of today’s global oil exports and 9 percent of total global reserves. It also holds the world’s fifth largest proven reserves of petroleum, although Iraq remains greatly under-explored compared with other major oil producing countries. The cost of oil production in Iraq is one of the lowest in the world because of its relatively uncomplicated geology and its multiple, onshore super giant oilfields located close to coastal ports. Iraq is today also the country most dependent on oil in the world, with the hydrocarbon sector accounting for 58 percent of the country’s GDP, 99 percent of exports, and more than 90 percent of central government revenue in 2015 (Figure 3. Oil Exports as a Percentage of Total Exports, OPEC Members
16. The economic wreckage of wars and sanctions, combined with the dissolution of the country’s key institutions, meant that growing oil revenues in the post-2003 period reinforced the status quo rather than becoming an impetus for reform. The central government alone has expanded to 44 percent of GDP today, and the public sector is by far the largest formal sector employer. Public sector jobs were one of the few reliable instruments for distributing oil wealth that the post-2003 government had at its disposal, and public sector jobs as well as wages have continued to grow over the past 13 years. Likewise, the dominance of SOEs was strengthened as the state had no incentives to restructure them. Aside from their value as means of economic control, they provided jobs for many Iraqis. State dominance of the financial sector continued as the insolvency of the system made reform difficult, and banks expanded as their government business grew (World Bank, 2014).

Iraq’s current reliance on oil is not a viable source of broad-based economic development. Two key aspects underlie this. First, unlike its oil-rich neighbors in the Gulf Cooperation Council (GCC) – and even they have grave concerns about economic sustainability – Iraq has a significantly larger and rapidly growing population, estimated at 35.7 million today. 1 Even under optimistic scenarios for oil production, continuing to rely on oil alone would not generate sufficient jobs. Second, the current economic institutions in Iraq are unable to generate productive spillovers from oil sector growth or from government spending, particularly as there are no incentives for the private sector to invest in the economy. These constraints are exacerbated by limited government effectiveness and policy uncertainty as well as the legacy of conflict and violence (World Bank, 2012a). This raises the question of whether there are any prospects for diversifying the economy, which will be touched upon in Section IV. In the absence of greater security and changes in the role of the public sector, diversification is likely to remain elusive.

... Under the status quo, the economy will remain dominated by an oil-financed public sector, with its attendant shortcomings in terms of weak service delivery and its bloated civil service. Public sector spending as currently allocated and managed is not delivering the results that Iraqis expect (Figure 4). There is a significant tension between the enormous need for the state to improve the delivery of basic services and the overwhelming role that the state plays in the economy. And while the oil economy represents well over half of GDP, it produces only about 1 percent of total employment and has few links to non-oil activities. Rather, oil revenues have enabled the rapid expansion of the public sector

In addition to its impact on jobs, Iraq’s oil wealth has reduced the need for taxation and weakened the accountability link between citizens and the state. Compounding this, policy makers have not incorporated the implications of oil depletion and the need to save for the future, leading to a bias towards current consumption and subsidies, harming fiscal sustainability (World Bank, 2012a). Fuel and electricity subsidies in Iraq are estimated to amount to between 7 and 13 percent of GDP and are reflected in very low prices as seen in Figure 5 (IMF, 2015). The availability of oil rents reinforces the reluctance of the Iraqi government to foster the development of an autonomous private sector, transforming the private sector into an opportunity for political influence rather than as a potentially transformative force (World Bank, 2015a).

The World Bank also flags the fact that the ethnic and sectarian geography and division of Iraq's petroleum resources presents critical problems.

Iraq is spatially diverse in many ways, but most importantly its oil wealth is differentially distributed across the country...The bulk of the country’s proven reserves are located in the south, with most of the remainder in the north – including 6 percent in the present Kurdistan region and 15 percent in Kirkuk. The Sunni-dominated west has no proven oil revenues (although it does possess gas). Oil wealth and its distribution is at the center of the dispute between the central government and the Kurdistan Regional Government (KRG). According to their existing agreement, the KRG was to export 550,000 bpd through Ceyhan, Turkey (250,000 bpd from its own fields and 300,000 bpd from federal fields) for the central government’s State Oil Marketing Organization (SOMO). In return, the central government would resume making agreed-upon budgetary transfers to the KRG. However, this agreement has not been fully implemented and, since June 2015, the central government has suspended the transfers and the KRG’s oil deliveries to SOMO have stopped. Because of the differential geographic distribution of oil resources, any decentralization or federalism reform would need to ensure a stable and equitable resolution to resource sharing to ensure that there were no “losers” who had little choice but to continue the conflict.
If Iraq is to move towards stability and recovery, it must deal with the ethnic and sectarian challenges of developing and using its petroleum resources. If it is to move towards balanced development that meets the broad needs of its people, it must both deal with the critical burden imposed by its underproductive and costly SOEs described earlier and create a far more diversified economy. At present, most of its people suffer more from something closer to petroleum poverty than benefit from what could be called oil wealth.

**Broader Poverty Issues**

There is no simple way to characterize Iraqi poverty. Costs differ sharply between areas, and increasing urbanization and the impact of war means that many Iraqis now suffer from the equivalent of poverty even if their incomes appear to be above the poverty level. There also is no way to accurately count the number of people who have been effectively impoverished in the fighting since 2014, when the fighting against extremism began to have a far more serious impact on large elements of the population.

The World Bank also notes that the distribution of poverty has little to do with the presence of oil reserves and production. Poverty and welfare are geographically differentiated as well, and conflict has led to more pronounced spatial differences not only in poverty rates but in the delivery of services. There are three levels of administration in Iraq – governorates, districts, and sub-districts. Each of Iraq’s 18 governorates is subdivided into districts (gadhas) and sub-districts (nahiyas). For the purposes of this poverty analysis, the country can also be divided into five divisions consisting of governorates with approximately equal population sizes – Kurdistan, North, Baghdad, Central, and South. The sub-districts with the highest poverty rate are in the Southern governorates, despite their oil wealth. On the other hand, the sub-districts with the highest number of poor people are in urban centers with many residents (World Bank, 2015b). Access to and the quality of services, including water, electricity, education, and health, also vary widely across the country. These differences result in spatial differences in many human development indicators, including early marriage and motherhood, child stunting, and educational outcomes. The labor market is fragmented spatially as a result of violence and insecurity. While people are able to move to nearby governorates in order to increase returns to their human capital, moving across the country is much more difficult. People with similar characteristics can thus have different welfare levels depending on where in Iraq they live (World Bank, 2014).

When it comes to the assessment of poverty per se, the full World Bank analysis traces a complex pattern of issues which are hard to summarize. It is clear, however, that the problems involved interact with all of the other divisions in Iraqi society, and have been further complicated by the impact of the fighting, Iraq's problems in job creation, decades of inadequate economic development and reform, and the massive cut in petroleum revenues since 2014.

Persistent poverty is one of the symptoms of Iraq’s predicament. There has been no overall movement towards reductions in either poverty or income equality in Iraq since 2007; what gains were made in early years were lost to violence and conflict soon after. Certain groups, including IDPs, youths and girls and women, are particularly vulnerable in situations of conflict and poor governance. This chapter focuses on the evolution of poverty and inequality in Iraq and on some of the issues faced by excluded groups.

... Conflict combined with economic constraints in recent years have reversed the gains in poverty reduction that were attained between 2007 and 2012. Headcount poverty in Iraq had fallen to 18.9 percent by 2012. However, simulations suggest that this declining trend had been almost completely reversed by 2014, with headcount poverty estimated at 22.5 percent that year, close to the level recorded in 2007. These losses starkly illustrate how conflict and violence, as well as oil dependence, have increased poverty in Iraq. The significant regional differences in poverty dynamics and outcomes also reflect the differential impact of conflict and oil across Iraq and among its population.

... The modest declines in poverty in Iraq between 2007 and 2012 were driven by an increase in earnings
among the employed rather than by an expansion in employment or by higher public transfers. In particular, as will be discussed in other parts of this report, economic growth was not associated with job creation in the private sector where the majority of the poor work. Moreover, the oil sector, which represents almost half of Iraq’s GDP and almost all its exports, accounts for only 1 percent of employment in the country, and growth in the sector does not directly create new jobs. Even in other sectors, job creation has not been sufficient to absorb the growing workforce. The exception is the public sector where oil revenues have enabled a significant expansion in jobs but where relatively few of the poor are employed.

... Estimates indicate that multidimensional poverty (MPI) in Iraq – poor health and education outcomes and limited access to essential services – is at 35 percent, which is higher than consumption poverty. Both the MPI and consumption poverty measures suggest similar spatial patterns in poverty, with Kurdistan enjoying the lowest levels of poverty on both indicators, whereas the South suffers from the highest MPI and consumption poverty rates (Figure 17). The gaps between the two indicators do suggest, however, that increases in consumption do not always go hand in hand with improved welfare in human development aspects. Of the various factors that contribute to the MPI, a lack of sanitation, inadequate electricity, and poor nutrition are among the most prevalent deprivations in the country (Figure 18). Moreover, the vast majority of households suffer multiple deprivations in human development, with 63 percent of households suffering from two or three simultaneous deprivations, while 11 percent experience four or more (World Bank, 2014).

... Poverty reduction has been spatially uneven across Iraq, with a more rapid decline in rural areas than in urban areas albeit from higher initial levels. Between 2007 and 2012, the poverty rate in rural areas dropped from a high of 39 percent to 30.7 percent. There was a smaller fall in absolute terms (2.2 percentage points) in urban areas but a significant one relative to the baseline (a 14 percent decline). The poverty gap was also somewhat smaller in rural areas than in urban areas in 2012, suggesting that not only did poverty fall in rural areas but that the depth of poverty did as well.

... Poverty also varies across governorates. Dividing the country into three main regions, Baghdad, Kurdistan, and Rest of Iraq, Figure 19 indicates that a significant share of each region’s population is in the bottom 40 percent of the income distribution. Although the poor constitute a smaller proportion of the population of Kurdistan, they make up a larger proportion in the Rest of Iraq. The decline in poverty between 2007 and 2012 was concentrated almost exclusively in the central and northern governorates. The poverty rate in central governorates fell by 16 percentage points, while the rate in the northern governorates fell by nearly 9 percentage points. The change in other areas was modest. In Kurdistan, poverty levels were relatively low to start with at 4.3 percent, and poverty did not fall significantly in Baghdad, the most populous governorate in the country. In contrast to the overall improving trend nationally, in the southern governorates the poverty rate increased by 1.8 percentage points. Historically, poverty has been concentrated in the center and the south of the country (Table 4).

... The twin crises – namely the oil price declines and the Daesh insurgency – are estimated to have erased the reduction in poverty achieved between 2007 and 2012, raising the poverty headcount to 22.5 percent in 2014 and pushing an additional 3 million people into poverty. Poverty headcount rates are estimated to have increased by 7.5 percentage points between the non-crisis (business as usual, BaU) scenario and the crisis scenario. The twin crises are also estimated to have increased the poverty gap (by 3 percentage points) as well as causing the severity of poverty for the country as a whole to grow by 1.3 percentage points.

A reduction in employment and in income underlies the rise in poverty. Non-employment (which includes both the inactive and the unemployed) seems to have increased by over 800,000 compared to the non-crisis level as a result of the collapse of oil prices and the massive displacement resulting from the Daesh insurgency. Moreover, a shift of workers from more productive or higher earning jobs to less productive jobs with lower earnings (from the manufacturing and construction sector to the agriculture and services sectors) is estimated to have led to an average 20 percent decline in total household labor income in 2014 (or a 14 percent decline in total household income). The magnitude of these effects is higher in Daesh-affected regions and Kurdistan than in others. For instance, total income is estimated to have been nearly halved in Daesh-affected areas (Figure 23). The increase in unemployment rates, combined with the reduction in both labor and non-labor income, translates into lower per capita consumption. Simulation results show a 10 percent
reduction in average per capita consumption for Iraq as a whole. This is 4 percentage points lower than the estimated decline in total income, which seems reasonable given that households might have smoothed their consumption during difficult events and over time.

The World Bank also highlights the impact of the war on those displaced by the fighting since 2014 as a key factor in creating what it calls the "new poor:" 43

The per capita consumption of IDPs has shrunk by twice as much as that of the population at large. Per capita household consumption is estimated to have decreased by almost 22 percent as a result of the twin crises (Figure 28). The impact of the crises on total per capita income was even more severe (a reduction of 61.6 percent) assuming that households smoothed their consumption during the most difficult times. The reduction in consumption was driven mainly by a massive reduction in labor income of 62.5 percent as a consequence of job losses. The unemployment rate rose to 27 percent among this population, almost three times higher than the rate for the population as a whole.

... The lack of employment and the massive reduction in labor income reinforced by the loss of assets and services associated with having a proper dwelling implies a significant increase in the incidence of poverty among IDPs. Simulation results show that the headcount poverty rate for IDPs grew by 15 percentage points from 23 to 38 percent, twice the rate for the population as a whole. In other words, 4 out of 10 internal displaced individuals became poor as a consequence of the crises. Additionally, the poverty gap and its severity also increased by 5 and 2 percentage points for this population...

Overall, IDPs account for half a million of the total number of people who fell into poverty as a consequence of the twin crises...This represents almost 20 percent of the increase in the total number of poor (2.8 million poor). However, this effect varies significantly among regions. In Kurdistan, IDPs accounted for 62 percent of the increase in the number of poor, whereas in the South they only accounted for 2 percent. That being said, not all IDPs have become poor as consequence of the twin crises. Poor IDPs only comprise 6 percent of the estimated total number of 8 million poor people in Iraq following the twin crises, and only one-third of them have fallen into poverty as consequence of the crises.

A large number of displaced people will not be able to return to their homes because of destruction or continuing conflict. In addition, there appear to be de facto restrictions on the movement of IDPs (for example, of Sunni Arabs into the KRI and Baghdad and on their return to liberated areas), which may affect their ability to access critical services. It will be necessary to facilitate their integration within their host communities by eliminating unequal access to housing, employment, and basic services...Supporting housing reconstruction and repair in conflict-affected areas would strengthen social and political stability and enable IDPs to return to their original locations, as well as providing local employment opportunities and helping to develop local small- and medium-sized contractors. It would also spur demand in a number of complementary sectors, such as construction materials and related services...

Youth Economics

The World Bank analysis also highlights the combined impact of population growth, economic mismanagement, and long periods of war on Iraq's youth,44

... Over 3.4 million Iraqi youths are out of school, and fully 72 percent of women and 18 percent of men between the ages of 15 and 29 were neither in education nor in employment or training (UNDP, 2014). Among youths aged between 15 and 29 years old, 33.4 percent are illiterate or semi-illiterate, just one-third have completed primary school, 28 percent have finished middle or high school, and only 7 percent have completed post-secondary education. Despite low enrollment and graduation rates, education is an important goal for Iraqi youths, but economic factors often prevent them from continuing their education. Youth unemployment is high at 34.6 percent, 57.7 percent for females and 30.8 percent for males. Young people are underrepresented in government jobs, while the weakness and stagnation of the private sector prevents it from being an engine of employment for Iraqi youths.

...Iraq’s young people suffer disproportionately from exclusion and poor prospects, and rebuilding the legitimacy of the state will depend upon the productive incorporation of this group into society and the economy. About 50 percent of Iraq’s population is under 19 years old. One-third of those between the ages of 15 and 29 are illiterate or only semi-literate...Rehabilitating schools in conflict areas, where one in five...
schools has closed, would help to encourage some of the 3.5 million children of school age who are currently not in school to return to the classroom.

Schools are the best place to provide psycho-emotional support to conflict-affected children and youths, and education can play a pivotal role in promoting resilience among conflict-affected populations and eventually social cohesion. For girls in particular, particularly those in conflict zones, school attendance can combat illiteracy and exclusion, which are the key underlying reasons for the high adolescent birth rates for Iraqi girls. In consultations with stakeholders during the preparation of this SCD, many emphasized the importance of rewriting the education curriculum to combat sectarianism, reduce conflict, and build support for the basic concepts of human rights and civic engagement.

... Iraq fails to provide jobs for the thousands of young people entering the work force each year. Between 2006 and 2014, Iraq’s rate of youth unemployment never dropped below 28 percent, despite economic growth that averaged 6.3 percent annually. The benefits of growth did not accrue to young adults. Youths are underrepresented in government jobs, and the private sector is too weak to create enough employment to absorb the younger generation of Iraqis. In the near term, implementing much-needed local investment programs would create jobs at the local level. Yet as has been noted in this report, local administrations find it very difficult to implement investment programs because of their limited capacity and the lack of reliable resource flows from the central government, among many other constraints. Therefore, it is essential to resolve these constraints to greater local investment, and one way to do this might be to explore the feasibility of devolving some spending authority not only to governorates but to the districts or municipalities as they are directly involved in delivering local services.

... A recent Arab Youth Survey (Burson-Marsteller, 2016) has highlighted the connection between youth unemployment and the potential for radicalization. Almost a quarter (24 percent) of surveyed youths listed the lack of jobs and other opportunities as the main reason for some youths joining Daesh....In countries such as Iraq where Daesh has a significant presence, young people have worse perceptions of the economy and of sectarian conflict...Militias and extremist groups may fill the void left by the government by offering marginalized youths a sense of identity and opportunities for upward socioeconomic mobility. Low incomes and unemployment reduce the opportunity costs of rebellion.36 Most Iraqi youths who have joined militias or Daesh have few economic prospects and have failed to complete primary or secondary education.

As reported by the Iraq Crisis Group (ICG), young militants typically worked in precarious labor conditions and earned no more than ID 25,000 per week (US$21.4), making it almost impossible to afford even basic rent at ID 200,000 (around US$180).37 In contrast, Daesh offers young combatants anywhere from US$400 to US$1,200 per month, in addition to the authority that youths gain within their communities.38 Youths joining extremist groups circumvent traditional community hierarchies and ascend to positions of power that would be unreachable for them in state institutions. Shia youths have also flocked to join militias for non-financial reasons following the fatwa issued by Iraq’s Shia spiritual leader, Ali al-Sistani, which summoned them to volunteer in the defense of the country and their holy shrines. Therefore, while youths have an economic incentive to join sectarian or extremist groups, they also tend to find a sense of purpose as members of these organizations.

**Electricity, Fuel, and Water Subsidies**

The U.S. made the critical mistake early in its occupation of leaving major subsidies in areas like electricity, and fuel, and water without taking any measures to limit consumption. In doing so, however, it built on a model of past subsidies in many Arab states that was at best possible with much smaller populations and less sophisticated consumers. The full nature of current Iraqi subsidies is unclear, but the cost is massive and it prevents efficient use as well as efficient billing, revenue collection, and investment.

The World Bank estimates that “Fuel and electricity subsidies in Iraq are estimated to amount to between 7 and 13 percent of GDP.” This is a massive burden on Iraq’s economy, and it consumes a growing part of Iraq’s oil production and encourages earlier depletion of reserves.45 At the same
time, subsidies encourage under-investment in areas like electric power—a subject of deep popular resentment in Iraq. It also encourages other forms of waste. Iraq now flares some 60% of its gas production, while it imports some 50% of the fuel it needs for power generation. \(^{46}\)

**Sectoral Issues: Lack of Private Sector Development, Agriculture, and Water**

Iraq’s barriers to the private sector, and reliance on inefficient and unproductive SOEs create a set of problems that affects the majority of the working population. The CIA estimates that industry accounted for 45.1% of GDP in 2016, services accounted for 49.3%, and agriculture for only 5.7%. The labor force is more rural. The CIA estimate that Iraq’s labor force is 21.6% agriculture, 18.7 industry, and 59.8% services—although this estimate dates back to 2008.\(^{47}\)

The “land of two rivers” however, faces major challenges in agriculture as well as industry and services. Turkey, Syria, and Iran are all seeking to increase their water use and drought have been critical problems. At the same time, the World Bank notes that,\(^{48}\)

…the importance of agricultural employment in Iraq has been on the wane, and the role of the sector has been undergoing significant changes. In 2012, about 30 percent of Iraq’s rural poor in the labor force worked in agriculture, but only 12 percent of the heads of poor households worked in the sector. Interestingly, the composition of farm employment changed too – with the share of women in total farm employment increasing from about 36 percent in the early 1990s to 52 percent in 2012. It is important to discover whether this change is structural, but this will require more detailed analysis. If agricultural development can improve the allocation of resources within households, it will likely lead to better health and nutrition outcomes for children as well.

… The sector’s low productivity and growth rates in Iraq are attributable to a variety of factors including the government’s past policy of maintaining artificially low food prices through price and production controls and marketing restrictions. Nationwide subsidized food distribution through the PDS using imported food has had a negative impact on the local grain market with consequent depressing effects on producer prices and on agricultural sector investments. Government policies in the agricultural sector have been characterized by state control and subsidization of farm inputs (fertilizers, seeds, insecticides, farm equipment, and machinery) and of the prices of strategic crops. The most important crop, wheat, has been the most controlled and the most affected by the lack of open markets. In addition, years of insufficient maintenance and funding have degraded agricultural services and physical infrastructure, particularly the irrigation network. During the recent conflicts, extensive looting damaged a range of government and private agricultural production and service facilities in central and southern Iraq. Climate change is another threat.

... Problems in irrigation are severe. They range from widespread deterioration of irrigation infrastructure to the poor operation and maintenance of the systems, inefficient water use, soil salinity, weak institutional support, and the lack of a regulatory framework for the efficient use and pricing of irrigation water. Salinization is one of the most active land degradation phenomena in central and southern Iraq. The Food and Agriculture Organization estimates that approximately 60 percent of cultivated land has been seriously negatively affected by salinity, and 20 to 30 percent has been abandoned. Even on non-abandoned agricultural land, yields have declined by 30 to 60 percent as a consequence of salinization. The salinization of soil has the most negative impact on poor farmers and their livelihoods. The effects of climate change threaten further salinization. There will be more shortages of water resources in Iraq after Turkey and Syria develop their irrigation projects along the Euphrates, Especially as no international water use agreement has so far been signed by the three countries.

...Climate change threatens to exacerbate the effects of existing poor practices in agriculture. Deforestation, land degradation, overgrazing by livestock, war, and rapid urbanization all hasten desertification and land degradation. The implications of climate change and land degradation pose serious threats, primarily to food and water security. Climate change is already affecting the agriculture sector and is set to be an increasing threat...Significant investments in the sector are required to meet these challenges and to fulfill the sector’s
potential contributions to growth and diversification, food security, and employment generation. Yet there are no incentives in place to encourage private sector investment in food and agriculture.

… Unless there are changes in water management, Iraq may not have enough high quality fresh water to meet its development needs by as early as 2020 (T-Zero, 2015). Iraq currently has relatively abundant water compared to many other countries in the region - current annual, renewable freshwater availability of 2,200 cubic meters per capita compared to a regional average of 1,100 cubic meters. Yet rapid population growth is quickly reducing the gap between the demand for and the supply of water. Municipal and industrial demand for water has grown substantially, raising concerns about how to allocate water between competing uses.

… Declining water quantity and deteriorating quality have put almost 40 percent of historically irrigated agricultural areas out of production, while 70 percent of crop land is affected by high soil salinity, which significantly limits crop yields. The inadequate water supply also has a direct economic impact on the private sector. The Investment Climate Survey of 2012 noted that the average manufacturing firm in Iraq reported experiencing 17 water outages per month. To augment the public water supply, many firms rely on their own wells or commercial water providers, which adds to their costs.

… Iraq’s water sector has suffered from decades of conflict and sanctions that left its institutions weakened and that have resulted in under-investment and chronic deterioration of its infrastructure assets. Public spending on the water sector increased rapidly between 2007 and 2012 (World Bank, 2014b). Average annual public expenditure on water as a proportion of total federal spending in 2012 was almost 4 percent (from a low of 1.9 percent in 2007)—the equivalent of 1.8 percent of GDP…. the Iraqi water sector faces a significant investment gap… Most of the funds for the sector are provided by the government as consumers contribute very little even to the operation and maintenance of water services.

**Other Key Economic Issues**

The World Bank study raises a long list of additional economic issues affected by Iraq’s war, decades of Iraqi misgovernment, and Iraq’s population growth. These include the need for broad sectoral reform, including agriculture, major road and transport development, expanding the availability of the Internet, Iraq's growing water problems and the possible impact of climate change, the impact of combat and political pressure on the productive role of women, overemphasis on the state sector and SOEs, the failure to expand trade beyond the petroleum sector, aging and inadequate infrastructure, lack of direct foreign investment (DFI), growing environmental problems, problems in medical care, problems in the education system, the impact of a prolonged "brain drain," etc, etc.
**Figure Nine: World Bank Estimate of Iraq's Wartime Economy 2013-2019**

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<td>Non-oil GDP (in ID trillion)</td>
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<td>Iraq oil export prices (US$ pb)</td>
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<td>Consumer price inflation (percentage change: average)</td>
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**National Accounts**

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<td>Gross domestic investment</td>
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(In percent of GDP, unless otherwise indicated)

**Public Finance**

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<td>Government revenue and grants</td>
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<td>39.1</td>
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<td>Government oil revenue</td>
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<td>Government non-oil revenue</td>
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<td>Expenditure, of which:</td>
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<td>Overall fiscal balance (including grants)</td>
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<td>Non-primary fiscal balance (percent of non-GDP)</td>
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<td>-41.4</td>
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(In percent of GDP, unless otherwise indicated)

**Memorandum items**

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<td>Total government debt (in percent of GDP)</td>
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<td>32.6</td>
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<td>61.3</td>
<td>61.0</td>
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<td>25.2</td>
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(In percent, unless otherwise indicated)

**Monetary indicators**

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<td>Growth in reserve money</td>
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<tr>
<td>Growth in broad money</td>
<td>15.9</td>
<td>3.6</td>
<td>-9.0</td>
<td>5.1</td>
<td>3.0</td>
<td>8.5</td>
<td>9.2</td>
</tr>
</tbody>
</table>
| Policy interest rate (end of period) | 6.0 | 6.0 | 6.0 | ... | ... | ... | ...

(In percent of GDP, unless otherwise indicated)

**External sector**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account</td>
<td>1.1</td>
<td>2.7</td>
<td>-6.1</td>
<td>-6.8</td>
<td>-6.8</td>
<td>-6.2</td>
<td>-2.9</td>
</tr>
<tr>
<td>Trade balance</td>
<td>9.0</td>
<td>11.2</td>
<td>-0.1</td>
<td>-0.8</td>
<td>-0.4</td>
<td>1.0</td>
<td>-2.4</td>
</tr>
<tr>
<td>Exports of goods</td>
<td>38.3</td>
<td>40.6</td>
<td>31.3</td>
<td>28.3</td>
<td>30.1</td>
<td>30.5</td>
<td>29.7</td>
</tr>
<tr>
<td>Imports of goods</td>
<td>-38.4</td>
<td>-29.4</td>
<td>-31.5</td>
<td>-20.0</td>
<td>-30.5</td>
<td>-38.8</td>
<td>-37.3</td>
</tr>
<tr>
<td>Overall external balance</td>
<td>-1.3</td>
<td>-10.3</td>
<td>-7.1</td>
<td>-3.5</td>
<td>-2.3</td>
<td>-3.3</td>
<td>-0.3</td>
</tr>
<tr>
<td>Gross reserves (in US$ billion)</td>
<td>77.8</td>
<td>60.7</td>
<td>55.7</td>
<td>43.0</td>
<td>38.5</td>
<td>38.1</td>
<td>37.3</td>
</tr>
<tr>
<td>In months of imports of goods and services</td>
<td>10.8</td>
<td>10.9</td>
<td>9.6</td>
<td>6.7</td>
<td>5.9</td>
<td>5.8</td>
<td>5.6</td>
</tr>
</tbody>
</table>
| Exchange rate (dinar per US$: period average) | 11660.0 | 11660.0 | 11670.0 | ... | ... | ... | ...
| Financing gap (US$ billion) | 0.0 | 0.0 | 0.0 | 0.0 | 6.5 | 0.6 | 0.6 |

Sources: Iraqi authorities; and IMF and World Bank staff estimates and projections.

1/ Does not reflect KRG production during 2013 and 2014.
2/ Reflects KRG exports through State Organization for Marketing Oil (SOMO).
3/ Includes arrears.
4/ Positive means appreciation.

Military and Security Challenges

As was touched on at the start of this analysis, Iraq's political instability has been a serious issue since its founding and has become increasingly serious since the monarchy in 1958, and the violent coups that changed Iraq’s leadership. They became critical after Saddam Hussein consolidated power in 1979, Iraq fought the Iran-Iraq War for eight years between 1980 and 1988, Iraq invaded Kuwait and fought the Gulf War in 1990-1991, went through eleven years of sanctions, fought against the U.S. led invasion in 2003, then fought its first war against extremism in 2004-2011, and has now been fighting since 2014.

Recovery and development are not a matter of dealing with the war against ISIS, they are a matter of dealing with the cumulative effect of over a century of political crises, a series of wars that began in 1941, and almost constant economic stress. They also will not end with the defeat of ISIS’s physical caliphate. Iraq will need sufficient military forces to deter Iran and its other neighbors, and to prevent the rise of any new extremist forces, Sunni-Shi’ite conflicts, and Arab-Kurdish conflicts. It will need to create effective police forces for both paramilitary and civil roles, and it will need to create an effective justice system.

The Need for Security Forces

Iraq’s military forces have defeated ISIS only because of the support of the U.S.-coalition air forces, outside train and assist personnel, and special forces and other combat support. They still need years of development and must be expanded and modernized to be able to deter outside conventional and missile threats.

The World Bank diagnostic is the best analysis to date but—like all of the other work of its kind—it only addresses the civil dimension of the problem. It does not address the cost of Iraq's current wars, and future security needs, it only focuses on the civil impacts of the fighting. These present serious issues in terms of cost, and defining future needs: military, police, and justice system; and the interface between the Ministry of Defense, Ministry of Interior, and Ministry of Justice.

Funding the Military, Internal Security Forces, and Police

There is no clear way to predict Iraq’s future military and other security needs. The current war, however, has been anything but cheap. The International Institute for Strategic Studies (IISS) estimates that Iraq spent close to 12% of its GDP on war in 2016.49 This was equivalent to $21.2 billion out of a GDP of $165 billion in 2015 (12.8%), and $18.1 billion out of a GDP of $156 billion in 2015 (11.6%). To put this military spending burden in perspective, the U.S. spent well under 4% of its GDP, and most other NATO countries spend well under 2%.

A victory against ISIS will sharply reduce these warfighting costs, but Iraq will then have to rebuild key elements of the regular military forces it lost during 2003, and maintain security along its border with Syria—and potentially Turkey and Iran. It will also need to fund the security and counterterrorism forces of the Ministry of Interior.

Iraq will also have to create a new mix of military forces, police, and all the elements of an effective justice system that can deal with its present Kurdish, Arab Sunni, and Arab Shi’ite popular militias, smaller local militias and gangs, and organized crime. It will have to be large enough to represent all of Iraq’s factions, and be funded well enough to limit corruption. At least for some years, it also must be a critical source of both jobs and local security that make it clear that no one faction can
abuse the other and violent non-actors will be controlled and unable to threaten stability and security at even the local level.

**Rule of Law**

It will also have to create an effective Ministry of Justice and fund the reform of the rest of the justice systems. During 2003-2011, the U.S. and other outside efforts to reform the Iraqi justice system took a damaged system and thoroughly broke it—failing to reform the police, create an evidence vs. confessions-based system, and creating far greater levels of corruption. Here, the World Bank diagnostic study notes that, 50

... The administration of justice and the capacity of the legal profession have deteriorated after decades of dictatorship, conflict, and sanctions. Iraq is in last place in the MENA region and ranks in the bottom 10 percent worldwide on indices of the rule of law... The main reasons include the poor quality of legal education, years of domination of the justice sector by the executive branch, the country’s fragile security situation, and the politicization of law enforcement. Iraq’s judiciary still struggles to maintain its independence, poor security limits public access to court files and information, and judges routinely face political pressure and personal threats.

... The judiciary’s weak institutional and professional capacity has many implications for the quality of the criminal justice system, for doing business, and for access to legal aid for the vulnerable. Law enforcement, prosecution, criminal courts, and correction are all adversely affected. Iraq ranks number 122 (out of 189) in the Contract Enforcement Indicator of the Doing Business 2016 Report, largely due to the low quality of its judicial processes, the length of time taken to enforce a contract (520 days), and the high cost involved (28 percent of claim value). Finally, not only do poor security conditions hinder access to justice, but also many disadvantaged groups, including women and the poor, lack the legal aid that they require to access justice services.

**The Military-Civil Nature of Stability**

Put simply, any effective effort to study and/or create stability, recovery, and development must involve a clear effort to create security. Any study of Iraq’s post-ISIS conflict needs that focuses only on its civil dimension—but fails to address its needs for military, paramilitary and security forces and the other costs for any effective justice system—will ignore critical aspects of Iraq’s governance, human development and economy, and be unable to realistically come to grips with its ethnic and sectarian differences. This may be the current practice for stability studies, but the end result is analytic rubbish.

**Creating Effective Strategic Stability Operations**

Iraq is still a country with vast opportunities, but this study outlines a host of critical challenges. Given Iraq’s recent history, such challenges are virtually inevitable, and it should be clear to any reader familiar with today’s Iraq that the ones outlined in this study only include the more serious problems and describe them using uncertain data and in broad terms.

Accordingly, one key step in meeting such challenges is to look beyond the immediate priority of finding some practical solution to Iraq’s ethnic and sectarian divisions and to assess these challenges more accurately, along with possible solutions, and to establish clearer priorities and options for dealing with them. It is also clear that a proper diagnostic effort will require years of in-country effort to analyze and quantify Iraq’s needs and create some kind of ongoing planning and management effort to deal with the changing interactions created by Iraq’s evolving problems and needs.
Such an effort can only begin, however, if Iraq’s leaders look beyond their present sectarian and ethnic tensions, face the full nature of Iraq's problems, and find some way to work together. The first step is to take advantage of the defeat of ISIS’s "caliphate,” and find a common path to short-term stability and the ability to work towards common goals. No outside effort, aid, or advice can deal with the scale of the structural challenges outlined in this study unless Iraq's leaders take responsibility for their country and the broader consequences of their actions. The past and current mistakes of outside powers and factions may be all too real, but they are irrelevant. No one can successfully help an Iraq that does not help itself.

Iraq cannot succeed on its own. It will need outside technical and financial aid for years until its progress reaches a self-sustaining level. Outside states and institutions also have a potential common interest in helping Iraq, and some moral responsibility to do so, but only if Iraq’s leaders can come together and show that such help will serve a clear purpose. It is critical that Iraq’s leaders understand that they—and they alone—must assume responsibility for creating the necessary politics, leadership, and institutions that can ensure Iraq’s success. Iraq’s past tendency to try to export blame and responsibility will only end in another exercise in self-destructive behavior, regardless of the faults of outside states and institutions.

As events during 2003-2011 showed all too clearly, no outside power can help an Iraq that is not prepared and organized to actively meet the full range of challenges outlined in this report. The same lessons about a failure to assume responsibility have emerged again and again since World War II. The end result of exporting responsibility, and depending on outside aid efforts, may allow Iraq’s leaders to focus on their own or factional interests and dodge full responsibility for their actions. It will, however, end in failure, and create growing resentment and tension that may well divide the nation or lead to new forms of civil war.

The world must hold Iraq fully responsible for finding its own path in making the transition from war to security, stability, recovery, and development. This is particularly true because there is little sign of any outside willingness to try to rescue Iraq from itself. The United States, in particular, has already recognized that it cannot assume the burden of dealing with Iraq's complex human, governance, and economic transitions once ISIS is largely defeated in the field.

The costs and levels of effort will be too high for any single outside power to assume, and America's mistakes during 2003-2011 have already shown that too large a U.S. effort is self-defeating. It will fail to produce a strong and independent Iraq—the key strategic goal the United States should be seeking to achieve—and will almost inevitably provoke both major internal opposition in Iraq and opposition or challenges from outside power like Russia, Iran, and Turkey.

At the same time, all of the preceding analysis shows that there is little point in U.S. military intervention in failed state wars if outside states like the United States are not prepared to help nations like Iraq create effective plans and programs for post-conflict security, stability, recovery, and development. It also seems virtually certain that Iraq’s problems are so severe that it can only deal with them in ways that can produce an effective level of stability if it can supplement its revenues with outside aid.

As for international bodies like the UN, IMF, and World Bank—and various NGOs and think tanks—it should be clear that simply trying to “round up the usual suspects” and advance the usual parochial list of reforms tailored to institutional priorities and needs will do more harm than good. The same is true of dodging around key problems, understating challenges, and relying on good intentions and optimism. Failing to fully address Iraq's challenges, relying on institutional
mandates—rather than Iraq’s full range of needs—and trying to deal with key problems through a process of denial can only make things worse. Whether or not good intentions are the road to hell is debatable. Whether or not they are the road to failure is not.

If Iraq’s leaders do show that they can use such outside aid effectively, the answer may be to create some form of international body that will be located in Iraq and provide direct assistance in planning the necessary security, stability, recovery, and development program—doing so on a conditional basis, with full and open transparency as to Iraq’s problems and progress, and offer aid only where fiscal responsibility and measures of effectiveness are present and corruption is kept to an acceptable minimum.

The history of the UN raises critical questions as to whether it can ever be effective in missions that require effective management and criticism of a member state. Its history in dealing with Iraq’s oil sales between 1992-2003 was as filled with corruption as any Iraq effort. The IMF has a different mission, but one reason for highlighting the World Bank’s Systematic Country Diagnostic throughout this study has been to show that a World Bank in-country team might be effective—a possibility reinforced by the work of the World Bank team that did similar analysis in Afghanistan.

An international effort also might defuse the post-ISIS War competition between the U.S., Iran, Russia, Turkey, and other outside powers—all of which have a greater long-term strategic interest in a stable and independent Iraq than in an unstable client state. In practice, even bad, faltering compromises between outside powers might well be better than open competition and rivalry.

The challenges involved are certainly too great to offer any quick answers, rely on the traditional list of IMF and World Bank reforms, or assume that Iraq’s leaders are capable of enough unity and cooperation to move forward. The odds of creating even limited success are uncertain. The odds of creating an effective and efficient effort approach zero. Given the sheer scale of Iraq’s challenges, however, there is no alternative to trying. The alternative is not only failure, it is to set a precedent for all other “failed state” wars—one that can only lead to future conflicts and suffering.

6 World Bank, Iraq - Systematic Country Diagnostic (English), February 3, 2017, http://documents.worldbank.org/curated/en/542811487277729890/Iraq-Systematic-Country-Diagnostic. This study also states that, "Discussions about Iraq’s ethnic and religious diversity are often framed in terms of sectarian tensions among Iraq’s Shia and Sunni Arabs, and Kurds. However, sectarianism in Iraq is also easy to caricature and misunderstand or overstate. The current turmoil results less from a centuries-old feud among Sunnis, Shias, and Kurds than from a struggle to compete for power and resources in a post-2003 Iraq characterized by crippled institutions and power vacuums.” This reflect the views of many Iraqis who conveniently forget the fact that Iraqi Shi’ite rebels fought in the Marshes and for Iran throughout the Iran-Iraq War, the previous Arab-Kurdish conflicts, and extent to which the Saddam Hussein government favored Sunnis at the expense of Shi’ites.


This was a working study and evidently is not citable.


