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extreme adversity, The problem of pervasive  
corruption in Iraq

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## 10 Reconstruction and peacebuilding under extreme adversity

### The problem of pervasive corruption in Iraq

*Robert Looney*

*Uncontrolled levels of corruption in Iraq are fuelling the country's sectarian conflict and creating a political economy of violence. The political economy of this conflict is very much rooted in the alarming levels of corruption that we are dealing with. A lot of the money from many sectors of the economy is diverted to sustain the violence.*

(Barham Salih, Iraqi Deputy Prime Minister)<sup>1</sup>

There are two major obstacles to Iraq's economic recovery: the lingering violence and ongoing sectarian strife. Combating these problems has been further complicated by the large numbers of unemployed, easily available weaponry, a quickly widening gap between the rich and poor, and a largely impotent government. Pervasive violence and a deteriorating economy have created a vicious circle that has further undermined the government's ability to tackle the economy's four basic problems: the security of the oil supply; the high levels of unemployment; deficiencies in infrastructure; and the government's failure to introduce much-needed economic reforms. In turn, these four problems have contributed to the development of a large underground economy reinforced by pervasive corruption at all levels of government. With the reduction in violence in recent years the underground economy is evolving. However, because the shadow economy's size is largely controlled by the level of corruption, change is taking place in composition rather than absolute size.

In conflict countries, similar types of vicious circles are often set in motion through a process whereby negative developments are reinforced over time. These cycles will often continue in the same direction until an exogenous factor intervenes and stops or reverses the cycle. Research suggests that this is what is happening to the Iraqi economy in the post-Saddam period (Looney 2004, 2006a, 2006b). Any efforts to reconstruct and restore a functioning Iraqi economy will be constrained by the government's ability to set in motion a virtuous circle of economic expansion and improved security. In turn, this means constructing a strategy that positively addresses a number of interrelated factors including: (a) the growth and dynamics of the shadow or informal economy; (b) the

deterioration in social capital, and in particular the near absence of trust between the different regions, religious groups, tribes and even within local neighbourhoods; and (c) the evolving relationship between tribes, gangs and the insurgency.

As Deputy Prime Minister Barham Salih suggests (in the above epigraph), corruption is the common element that ties these diverse forces together, and the dynamic that drives the vicious circle of violence and economic stagnation that Iraq has experienced. Unfortunately, international media attention on corruption in Iraq has tended to focus exclusively on high-profile cases of fraud, waste and abuse by US contracting authorities and private foreign firms (GAO 2007), or the fallout from the Oil-for-Food programme of the 1990s. Without denying the importance of these forms of corruption, the analysis that follows is more focused on the future, in particular on the rampant and growing domestic Iraqi corruption that is draining the country's public finances, choking reconstruction efforts and undermining the fragile support for the new Iraqi state (*Oxford Analytica* 2007: 1).

As the following sections illustrate, the ongoing violence, lack of trust, and conflict, together with unique factors such as oil revenues and the presence of a serious criminal element, have combined to create an environment in which the extent and effects of corruption are even more pronounced than that observed by Mark Philp in his chapter (p. 000) in 'normal' post-conflict settings:

In post-conflict societies [corruption's] impact is potentially still more serious, since it can undercut the emergence of stable expectations and the processes by which they are legitimated; it can maintain or further exacerbate situations in which outcomes lack legitimacy, making it difficult for any serious form of authority to emerge; it can lead to the squandering of aid and external political will; and it can make the weak weaker, the poor poorer, and the vulnerable still less secure.

All of this has occurred in Iraq, perhaps even to an unprecedented degree – certainly to an extent not envisaged by even the most vocal critics of the invasion of Iraq and subsequent reconstruction efforts.

### Comparative measures of corruption

Unfortunately there are no definitive measures of corruption.<sup>2</sup> Instead several indices of the relative ranking of countries are available (Tables 10.1 and 10.2). In each case, Iraq ranks as one of the world's most corrupt countries. Even worse, there is little evidence that the already pervasive corruption that has gripped the country is declining.

The World Bank's Governance Indicators (Table 10.1) document Iraq's lack of effective governance not just in the area of corruption control, but

*Table 10.1* Iraq: measures of relative governance, 1996–2009 (in percentiles)

<i>Measures of governance</i>	2009	2008	2007	2006	2005	2004	2003	2002
Voice and accountability	13.7	10.6	9.6	11.1	9.3	4.8	5.3	0.5
Political stability	1.9	1.4	0.5	0.0	0.0	0.0	0.0	2.9
Government effectiveness	8.1	4.8	1.9	0.5	1.0	1.0	2.4	1.0
Regulatory quality	15.2	12.6	8.3	6.3	5.9	2.9	6.8	0.0
Rule of law	1.4	1.0	0.5	1.0	0.5	0.5	1.4	2.4
Control of corruption	4.8	2.4	2.4	1.5	3.9	1.9	12.1	1.0

Source: World Bank, *Worldwide Governance Indicators, 2009* (Washington: World Bank, 2010). Online, available at: <http://info.worldbank.org/governance/wgi/resources.htm>.

in other key areas of governance: voice and accountability, political stability/no violence, government effectiveness and the rule of law. The country consistently ranks in the bottom 5–10 per cent in each category.

Since the country's governance standards are so poor, making connections between corruption and the slow progress of reconstruction is difficult. Do reconstruction cost overruns stem from corruption or from government incompetence? Does the diversion of reconstruction funds stem from corruption or the absence of the rule of law? Do infrastructure projects fail to attract follow-on private investment due to corruption or the level of violence? Most likely, all these factors are interrelated, thus necessitating a comprehensive approach to combating the country's growing levels of corruption.

Transparency International's Corruption Perceptions Index (CPI) is a composite index that draws on multiple expert opinion surveys that poll perceptions of public sector corruption. It scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption. Again Iraq (Table 10.2) has one of the lowest scores. Unfortunately, rather than improving the

*Table 10.2* Iraq: Corruption Perception Index 2003–2010

<i>Year</i>	<i>Score</i>	<i>Rank</i>	<i>Total countries</i>
2003	2.2	113–117	133
2004	2.1	129–132	145
2005	2.2	137–143	158
2006	1.9	160	163
2007	1.5	178	179
2008	1.3	178	180
2009	1.5	176	180
2010	1.5	175	178

Source: Compiled from Transparency International CPI, various issues. Online, available at: [www.transparency.org/policy\\_research](http://www.transparency.org/policy_research).

1 situation, as depicted in the World Bank data, it appears to have stabilised  
 2 at very low levels in recent years. As of 2010, Iraq ranked 175 out of 178  
 3 countries.

### 4 **The pervasive nature of Iraqi corruption**

5 Underlying the figures and indexes are numerous accounts of corruption  
 6 cutting across all segments of Iraqi public and private life (*Oxford Analytica*  
 7 2007: 1). Following the establishment of the new Iraqi government, in late  
 8 2010, many of the key public ministries expected to play a lead role in the  
 9 country's reconstruction are staffed largely through political patronage  
 10 (*The Economist* 2011: 38). Despite efforts over the years, even rudimentary  
 11 systems of accountability, internal controls and the rule of law have been  
 12 lacking. For several years after the invasion, the Interior Ministry epitomised  
 13 this sad state of affairs: with different parts controlled by political  
 14 factions, it housed a myriad of competing police and intelligence agencies  
 15 that pursue various political or sectarian agendas. In the Oil Ministry, cor-  
 16 ruption at all levels has led to massive losses of revenue. The Oil Ministry  
 17 is aware of the situation and has endorsed the Extractive Industries Trans-  
 18 parency Initiative (EITI) and is seeking to become a full member. In the  
 19 Health Ministry, the dire shortage of medicines and drugs in Iraqi hospi-  
 20 tals is largely due to the organised theft that takes place at every point in  
 21 the supply chain. In the Defence Ministry, senior officials are under inves-  
 22 tigation following allegations that over US\$1 billion worth of military  
 23 equipment was paid for, but not delivered to army units.

24 In the justice system, the police and judges in many areas have reverted  
 25 to a system where families can only secure the release of their detained  
 26 relatives on payment of a bribe. It is now routine to hear reports of new  
 27 officers who have just graduated from the police academy selling their  
 28 handguns on the black market. Even worse, many in the police are linked  
 29 to, or are members of, assorted militias and criminal gangs – thus the dis-  
 30 tinction between the police, the political militias and criminal groups is  
 31 often marginal in the minds of Iraqis (*Oxford Analytica* 2010: 1). In the  
 32 southern provinces, insurgent gangs that attacked coalition forces more  
 33 often than not are indistinguishable from gangs of criminals or smugglers,  
 34 loosely affiliated with a Shia militia, mainly concerned with preventing the  
 35 closing down of lucrative smuggling routes.<sup>3</sup> With oil products still being  
 36 massively subsidised in Iraq, the smuggling trade is still booming (Looney  
 37 2005e).

38 Additional examples of widespread corruption, shoddy work and poor  
 39 management have been documented at length in a series of reports from  
 40 the US Government's Special Inspector-General for Iraq Reconstruction  
 41 (SIGIR), the Government Accountability Office (GAO), which is the inves-  
 42 tigative arm of Congress, and CorpWatch, a non-partisan, not-for-profit  
 43 monitoring organisation.  
 44  
 45

In his April 2007 report, Stuart Bowen, the head of SIGIR, noted that his agency sampled eight projects and found that seven of them had significant operational problems either because the expensive equipment that was purchased was never used or there were other problems such as plumbing and electrical failures, lack of proper maintenance and looting (SIGIR 2007).<sup>4</sup> What was particularly troubling was that this report was focused only on projects that the administration had touted as *successes*. In actuality, these successes, should have been described as failures.

- At Baghdad International Airport, where US\$11.8 million were spent on new electrical generators, US\$8.6 million worth of the project were no longer functioning shortly after completion of the project.
- In a maternity hospital in the northern city of Erbil, a newly built water purification system did not function; an expensive incinerator for medical waste was found padlocked; and medical waste – including syringes, used bandages and empty drug vials – was clogging the sewage system and probably contaminating the water system.
- At the same hospital, a newly installed system for distributing oxygen was ignored by the medical staff, who told inspectors they distrusted the sophisticated new equipment and had gone back to using tried-and-true oxygen tanks – which were stored unsafely throughout the building.
- Expensive generators went missing from the Iraqi Camp Ur military base, having been hauled off to another post. At the same camp, three modular buildings constructed at a cost of US\$1.8 million had been dismantled and removed with no explanation given.
- Barracks renovated for enlisted soldiers were already in disrepair, just a year after being handed over to the Iraqi Army.

These events contributed to the widespread concern over the ability of the various ministries to manage the reconstruction effort. How much of the difficulty can be attributed exclusively to corruption, however, is difficult to assess. Because the ministries suffer from shortages of skilled personnel and have budgets inadequate to cover maintenance, they have refused to assume responsibility for many projects.

SIGIR concluded that the Iraqi civil service is hampered by inadequately trained or unskilled staff. ‘Iraqi government institutions are undeveloped and confront significant challenges in staffing a competent, non-partisan civil service; effectively fighting corruption; using modern technology; and managing resources effectively’ (GAO 2007). Furthermore, political and sectarian loyalties have jeopardised the ministries’ abilities to provide basic services and build credibility among Iraqi citizens. In short, government ministries are being staffed with party cronies and their budgets are being used as sources of power for political parties.

SIGIR in particular noted that patronage in the ministries has led to staff instability, as key personnel are replaced when the government changes or a new minister is named. An ongoing fear in Iraq is that some Iraqi ministries, including the Ministries of Interior, Agriculture, Health, Transportation and Tourism, will revert to being led by ministers who are aligned with political parties such as the Sadrists who remain hostile to the international presence (*The Economist* 2011: 38). These ministers have used their positions to pursue partisan agendas that conflict with the goal of building a government that represents all ethnic groups.

In this environment SIGIR notes that: 'Corruption jeopardises future flows of needed international assistance and reportedly undermines the government's ability to make effective use of current reconstruction assistance.' Other factors contribute to the corruption problem: an ineffective banking system that leaves the government dependent on cash transactions, opaque and obsolete ministry procurement systems, and inadequately resourced accountability institutions such as the ministries' Inspector-Generals.

Aside from the lack of security, corruption is the biggest threat to progress in stabilising Iraq. SIGIR reports that Iraq has been losing US\$4 billion to corruption every year since the overthrow of Saddam Hussein. Paying bribes for services is now standard practice. As noted, corruption is particularly endemic in the oil sector, with the Ministry of Oil hit by smuggling rackets that have reduced state oil earnings. At least 10 per cent of refined fuels are sold on the black market and about 30 per cent of imported fuels are smuggled out of Iraq (Glanz and Worth 2006). Hundreds of criminal corruption cases remain open, involving billions of dollars. However the situation may improve because Iraq has signed and ratified the United Nations Convention against Corruption (UNCAC) and is beginning the process of evaluating changes that are required to come into compliance.

In addition, Iraq, at least on paper, has a strong set of institutions designed to address corruption issues:

- The Board of Supreme Audit dates back to the 1920s.
- The coalition installed Inspector-Generals in all Iraqi ministries and also created a Commission on Public Integrity to investigate the most serious cases of corruption (Coalition Provisional Authority 2004).
- Since April 2003, a large amount of international assistance has gone into providing these institutions (and the Iraqi courts and police) with training, equipment and technical advice.

Nonetheless, these anti-corruption institutions remain very weak and susceptible to political pressures, and it is common in today's Iraq to use charges of corruption to discredit officials who stand in the way of political objectives. The breadth and depth of corruption has infuriated Iraqi

citizens, who see politicians and officials growing rich while services decline. This also fed disillusionment with the United States, United Kingdom and coalition presence, and may have contributed to support for militias and insurgents. Corruption also alienates international donors, who see much of their investment in Iraq going to waste.

In order to address this issue, Iraq's key international partners have suggested a range of schemes that include training investigators, protecting judges and witnesses, and reforming procurement and financial processes to remove opportunities for fraud. However, without the political will of those at the top of the Iraqi government, such technical assistance will be of little use. The government's ability, let alone its determination to crack down on corruption, remains very much in doubt.

### **Corruption as an integral part of the economic dynamics of post-war Iraq**

While commendable, the attempts at combating corruption in Iraq are unlikely to be successful as long as many of the underlying factors remain unchanged. As noted above this means addressing three interrelated factors: (a) the growth and dynamics of the shadow or informal economy; (b) the deterioration in social capital; and (c) the evolving relationship between tribes, gangs and the insurgency.

#### ***The shadow economy***

The only part of the economy to have thrived under Saddam Hussein and in the post-2003 period of instability and insurgency is the country's informal economy. In fact, there is ample evidence that the country's informal economy has expanded considerably since Saddam's overthrow. In this regard, Iraq has followed a pattern seen in other parts of the world, where informal economies have tended to grow during periods of political, economic and social crisis. Preliminary analysis also suggests that a clear pattern exists whereby the relative size of a country's informal economy (as a share of gross national product) is related to its progress in opening up to the world economy (Looney 2005d, 2007). Countries that are relatively closed tend to have large informal economies, while those countries open to the pressures of globalisation have much smaller informal economies. Furthermore, the informal sector becomes significantly smaller as countries increase their control over corruption (Looney 2005d, 2005e).

As might have been expected, Iraq under Saddam was in a group of countries with the highest probability of possessing a large informal economy. With limited exposure to the world economy under the sanctions regime, Iraq's shadow or informal economy probably accounted for around 35 per cent of gross domestic product (GDP) in 2000 (Looney 2005b), with nearly 70 per cent of the labour force in employed in



1 informal activities. Since the fall of Saddam, Iraq's informal economy has  
 2 been fuelled by the ongoing crisis. Clearly, conflict and the insurgency  
 3 have taken a heavy toll on the formal economy. As private firms or public  
 4 enterprises are downsized or closed, newly unemployed workers often find  
 5 that their only choice is to seek work in the informal sector. Also, in  
 6 response to conflict-driven inflation or cutbacks in public services, house-  
 7 holds have often needed to supplement formal sector incomes with infor-  
 8 mal earnings. In some parts of the country continuing failure in attempts  
 9 to strengthen law and order has made it difficult to contain the expansion  
 10 of criminal activity, some of which continues to plague parts of the shadow  
 11 economy. For example, street vendors are now selling stolen merchandise.  
 12 In sum, corruption has been one of the key factors affecting the size of  
 13 Iraq's informal or shadow economy (Looney 2005a).<sup>5</sup>

14 Given increased levels of corruption, the insurgency and the uncer-  
 15 tainty surrounding political developments, we can expect large segments  
 16 of the population to continue to rely on survival relationships that were  
 17 characteristic of the 1990s sanctions period. This is confirmed daily with  
 18 the news coming out of Iraq describing economic mismanagement  
 19 (Al-Saadi 2004), vast black markets in gasoline (Noozz 2005), increased  
 20 crime and shortages of critical inputs (Murphy 2005). These developments  
 21 do not bode well and suggest that the current size of the informal  
 22 economy is considerably larger than the 35 per cent of GDP during the  
 23 late 1990s. Based on the on-going pervasiveness of corruption (statistically  
 24 the main link to the size of the shadow economy), a safe estimate, in light  
 25 of the decline in the insurgency, would put the informal economy at  
 26 around 50 per cent of gross national product (Looney 2005b, 2005d). It is  
 27 difficult to assess the impact of disbanding of the army and the anti-  
 28 Baathist campaign following Saddam's overthrow – this estimate may err  
 29 on the conservative side.

30 In addition to the factors noted above, the informal economy may be  
 31 growing simply because of the constraints limiting the expansion of formal  
 32 economic activity. Just as private capital formation is often critical to the  
 33 development of a thriving modern economy, social capital creation may  
 34 be just as essential in creating the shift to more formal activities. Iraq's  
 35 informal or shadow economy presents a number of obstacles to peace-  
 36 building. Most notably it facilitates an opaque environment that accom-  
 37 modates official corruption. There are solutions, but in the Iraqi context  
 38 they are difficult to implement. Specifically, recent research (Dreher *et al.*  
 39 2005) suggests that improvements in institutional quality reduces the  
 40 shadow economy directly and corruption both directly and indirectly  
 41 (through its effect on the shadow market). Unfortunately in Iraq's case,  
 42 the political accommodation of crime-based activities and their associated  
 43 financial gains significantly lessen the incentives for public officials to  
 44 initiate the institutional reforms needed to create a modern transparent  
 45 state (Looney 2005e: 6).

*The deterioration in social capital*

Perhaps the most detrimental effect of corruption on the peacebuilding process is its effect on the country's social capital. Social capital refers to networks of relationships that bind people together.<sup>6</sup> Social capitalists distinguish such relationships from physical capital and human capital (Scanlon 2003). In the context of Iraqi reconstruction and the establishment of a market economy, a key element of social capital centres on a particular component of social capital: the notion of trust. Corruption reduces trust at all levels thus making it nearly impossible for a formal economy to grow and displace the shadow economy.

Trust is such a critical factor in the development of modern economies because it enables contact with others and facilitates the exchange of goods and services. It fosters cooperation, and cooperation then breeds trust in a two-way interaction necessary for the creation of long-term generalised norms for cooperation. Social capital thus represents a set of resources rooted in networks of relationships possessing the power to facilitate economic progress. There are three types of relationships among parties to an economic transaction, giving rise to three different types of trust (Raiser no date):

*Ascribed trust:* This first type of relationship is found among kinship groups and family members. These relationships dominate economic transactions in subsistence economies and still characterise reproduction and the household economy (but also many small-scale crafts and trades).

*Process-based trust:* This type of relationship is between individuals that have known each other for a long time, but do not share loyalty to a specific group. Most business networks are characterised by this type of repeated relationship and the prevalence of what develops as a process-based trust.

*Extended trust:* This relationship is between individuals, who enter into a transaction with only limited information about the counterpart's specific attributes. For economic exchange to take place between these types of individuals, generalised or extended trust is needed. The importance of this third type of relationship and the correspondent economic transactions between largely anonymous individuals is a key element of a modern economic system.

This typology suggests that the building of extended trust is a key challenge for Iraq's development into a modern economy. It is also important to bear in mind the relationships between the various forms of trust. In particular, extended trust could not exist without the experience of reciprocity that is created through repeated interactions among family and other members of a societal or business community. Where process-based trust is absent, extended trust is unlikely to develop.

Corruption's role is to weaken trust at each stage, especially at the extended stage and to a somewhat lesser extent at the process stage. The

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1 net result is to retard the development of national and even regional  
 2 markets, thus making the attainment of any sort of normal efficiency  
 3 nearly impossible. In Iraq's case it is unlikely that extended trust in eco-  
 4 nomic exchanges could be sustained without third-party enforcement by  
 5 the state. Clearly, trust in government institutions will be a necessary pre-  
 6 requisite before Iraq can expect any type of significant expansion of the  
 7 formal economy. This is where the country's problems lie.

8 It is not just the current lack of incentives for policy makers to reform  
 9 the country's institutions; the situation inherited from the past would have  
 10 made reforms extremely difficult even under more favourable circum-  
 11 stances. The Ba'athist government had a profound effect on the nature of  
 12 formal and informal institutions in Iraq. Not only did Ba'athism hamper  
 13 the emergence of a market economy, but it corrupted the judicial and  
 14 legal institutions needed to create and nurture trust. The result was to  
 15 nearly eliminate extended trust, weaken process-based trust, and force  
 16 most transactions into networks that rely almost exclusively on ascribed  
 17 trust. Furthermore, the manner in which Ba'athist Iraq dealt with UN  
 18 sanctions was to abdicate authority over large swathes of public services to  
 19 local groups and militias which undermined many of the state institutions  
 20 that normally help create and maintain trust.<sup>7</sup>

21 In short, Iraqi values today are no longer those that were reported in  
 22 earlier accounts of the pre-Ba'athist period, which stressed the country's  
 23 vibrant entrepreneurial spirit. People's values have been affected by years  
 24 of repression under authoritarian top-down decision making. Several  
 25 decades of political and economic insecurity have caused doubt and dis-  
 26 trust to be deeply entrenched in the individual mind. They represent a  
 27 major constraint against drawing entrepreneurs and individuals out of the  
 28 safe, kinship-based informal economy.

29 One of the main criticisms of US policy in post-war Iraq has been a  
 30 rejection of the very state-centred approaches that were critical to the suc-  
 31 cessful reconstruction of post-war Japan and Germany. At the same time,  
 32 fundamental social reforms were also ruled out (Selden 2004). As might  
 33 be expected, with the post-invasion trauma, violence and the slow recovery  
 34 of the state as a social safety net, the process of restoring trust has been  
 35 slow. The economy remains largely divided into segments of mutually  
 36 exclusive networks divided along sectarian/ethnic lines.

### 38 *Ascribed trust networks*

39 The individual and business networks built on ascribed trust are by far the  
 40 largest in number in Iraq. These are usually confined to the local, infor-  
 41 mal economy. Most ascribed trust networks involve groups bound together  
 42 by family, tribal, or ethnic ties, which facilitates business based on verbal  
 43 contracts. Many of these networks have the potential to expand through  
 44 selective interaction with outsiders. However, such expansion will take  
 45

time in Iraq, especially under the current conditions of public corruption and great uncertainty over the enforceability of contracts.

In today's Iraq, many ascribed trust activities fall under what is commonly referred to as the coping economy – numerous economic interactions during armed conflict that provide benefits to the civilian population, particularly the poorest and most vulnerable. These functions are even more important to civilian livelihoods where the formal economy and traditional livelihoods have been destroyed or rendered difficult to sustain. The coping economy includes a wide range of activities including subsistence agriculture, petty trade and various household businesses such as catering and food processing.

Of the country's three main economic sectors – the public sector, the oil sector and the coping economy – it is reasonable to assume that a disproportionate share of the country's poor participate primarily in the coping economy. Data released by the Ministry of Labour and Social Affairs in 2004 indicates that in the aftermath of the war, about five million Iraqis were living below the poverty line, compared with 143,000 in 1993 (*Xinhua News Agency* 2004). While the data on poverty is crude and politically sensitive, a recent estimate from the Ministry of Planning suggests that 23 per cent of the population continues to live in poverty. The government's goal is to reduce this to 16 per cent by 2014 (Ministry of Planning and Development Cooperation 2009). Significantly, the ministry noted that more than one million Iraqi women aged 25 to 40 were unmarried, while divorce cases were increasing, as was child labour. It is reasonable to assume that this group of women is firmly entrenched in the coping economy. The plight of women in Iraq remains grim (UNB Connect 2010).

### *Process-based trust networks*

Second, there are the process-based trust networks that rely on existing ties between the previous members of the Ba'ath government and criminal groups that thrived during the sanctions period of the 1990s. Today, these activities have largely shifted into the criminal area. The emergence of pervasive criminality was readily apparent soon after the overthrow of Saddam Hussein. If anything, these problems have become increasingly severe. According to a UN report:

The emerging crime problem is subtler and scarier: theft, extortion, and drug- and arms-smuggling operations that have become more sophisticated, more clandestine, and more organised. In Baghdad, one team of thieves recently burned down a warehouse filled with the hot booty of another group. It was one mob sending a message to another.

(Fritz 2003)<sup>8</sup>

1 As in the case of the ascribed trust groups, the activities of these networks  
 2 have been affected by the insurgency. Process-based networks' activities have  
 3 often directly contributed to prolonging the insurgency in five ways. First,  
 4 they have contributed to the destruction or circumvention of the formal  
 5 economy and the growth of informal and black markets, thereby effectively  
 6 blurring the lines between the formal, informal and criminal sectors. Second,  
 7 such networks have engaged in pillage, predation and extortion; they have  
 8 used deliberate violence against civilians to extort ransoms and capture trade  
 9 networks and diaspora remittances. Third, these networks have led to greater  
 10 decentralisation, both in the means of coercion and in the means of produc-  
 11 tion and exchange, again blurring the lines between formal and informal  
 12 activities. Fourth, such networks have contributed to the licit or illicit exploi-  
 13 tation of lucrative natural resources. Finally, process-based trust networks  
 14 often rely on cross-border trading networks, regional kin and ethnic groups,  
 15 arms traffickers and mercenaries, as well as legally operating commercial  
 16 entities, each of which may have a vested interest in the continuation of con-  
 17 flict and instability. Many of the cross-border relationships cultivated by the  
 18 various smuggler/criminal groups in the 1990s are still in place and opera-  
 19 tional at the present time. Jonathan Goodhand observes that in many con-  
 20 flicts the shadow economy was already widespread before the outbreak of  
 21 conflict and is a facilitating factor for conflict, as it often contributes to  
 22 violent state collapse, or serves as a source of income to would-be-rebels.  
 23 Once conflict erupts, shadow economies are easily captured by combatants  
 24 and thus often become the basis for the combat economy (2004). This has  
 25 happened in Iraq, with kidnappings and smuggling providing significant  
 26 financial assistance to the insurgency (Salih 2004).

27 Western intelligence agencies are becoming increasingly worried about  
 28 this systematic strengthening of ties between terrorists and organised  
 29 crime. Stefan Maier of the German Institute for International and Security  
 30 Affairs confirmed that cooperation between the two camps was on the rise,  
 31 despite their different political and economic motives (*Deutsche Welle*  
 32 2004). As he observes:

33  
 34 Common ground between terrorists and organized criminal groups can  
 35 be found primarily in two areas. First, the two come together in money-  
 36 laundering activities: Terrorists often need to park their money tempo-  
 37 rarily with somebody else to cover up their tracks. Secondly, they need  
 38 weapons, and they usually get them straight from organized crime  
 39 (Struck 2005: A18)

40  
 41 'With the lack of security measures, disorganized crime became organ-  
 42 ized crime', said Hania Mufti, Baghdad director of Human Rights Watch,  
 43 'then, at some point, there was a merging between organized crime and  
 44 political crime' (Struck 2005: A18). In today's Iraq, terrorist groups use  
 45 many of the same channels for their activities that the Iraqi government

and associated criminal groups used in the 1980s and 1990s. In this regard, Iraq is an ideal environment for this type of activity. Decades of socialist and statist experiments of the Ba'ath Party regime, together with subsequent wars and the consequences of UN sanctions have left the Iraqi economy heavily damaged, distorted and exposed to administrative and political interference (Looney 2004). Within this context, terrorists, insurgents and organised crime elements have been able to thrive by exploiting various economic and institutional weaknesses.

### *Extended trust networks*

While extended trust networks may involve some reliance on kinship and family relationships, they are largely characterised by transactions between anonymous individuals. As noted, they are a key element in a modern economic system. Since the focus of the present analysis is on the informal economy, these networks will not be treated in detail other than to note that they are largely undeveloped outside the public sector and the national oil industry. Some banking arrangements are moving in this direction, albeit extremely slowly (Looney 2005c).

Clearly, for Iraq, the key challenge facing the economy is developing the conditions conducive to the creation and growth of extended trust networks. Conversely, the lack of supporting institutions has constrained most economic agents to informal activities characterised by family- and kinship-based ascribed trust.

Because the informal economy is largely the result of a convergence of powerful long-run demographic and economic forces, it will be a fixture for some time to come. At best, informal activities may evolve over the next several years with some progression from ascribed trust-based networks to process trust-based networks. If this transition is viewed as successful by Iraqi entrepreneurs and the government makes significant strides in the governance area, then the progression to extended trust-based networks becomes a distinct possibility, particularly if the security situation stabilises enough to support foreign direct investment.

However, a good case can be made that under current conditions, the development and evolution of organised networks may perpetuate and even expand the shadow economy through corruption and intimidation. Many of the organised networks today have evolved out of Ba'ath party efforts to limit traditional centres of tribal authority. In effect the Ba'ath party encouraged the growth and proliferation of informal associational links locally, as described below.

### **The evolution of local networks<sup>9</sup>**

Local-level kinship affiliation was increasingly encouraged as the effects of the 1980s war with Iran and the sanctions of the 1990s drained the power

1 of the central government. Particularly after the 1991 Gulf War, the  
2 central government was weakened to the point that it was unable to  
3 perform many of its traditional military, economic and security  
4 functions.<sup>10</sup>

5 The Ba'athist survival strategy during this period was for the party to  
6 serve as an umbrella for local tribal associations that would assist in provid-  
7 ing state capacity. By 1996, officially sanctioned 'tribes' were responsible  
8 not only for the maintenance of local law and order, but also collected  
9 taxes on behalf of the government, were appointed judicial powers, and  
10 applied customary tribal law within their territory. They received arms and  
11 ammunition, vehicles and logistical support as payment for services rendered  
12 to the party.

13 Local dominance of revived tribal networks was evident in 1998, follow-  
14 ing the eviction of the UN weapons inspectors, which resulted in US/UK  
15 air strikes against Iraq. At that time, heavily armed and equipped Sunni  
16 tribal units were positioned in and around Baghdad to control the restive  
17 urban population, a role formerly belonging to the Ba'ath Party militia.  
18 With time, the interests of the central government and local networks  
19 began to diverge. Clan-based groups controlled the highways around  
20 Baghdad. They increasingly turned to criminal activities, such as looting,  
21 smuggling and hijacking throughout most of al Anbar province. Con-  
22 ditions deteriorated to the extent that convoys were necessary even for  
23 basic travel in daylight to avoid raids by tribal guerrillas.

24 By 2000, policemen, judges and party officials were subject to violent  
25 tribal recriminations. Encounters between Iraqi soldiers and tribal irregu-  
26 lars, especially those based in al Anbar province escalated in frequency  
27 and scale. In this ever more lawless environment, tribal elements began to  
28 take over many of the local, informal street markets. These markets com-  
29 prised a sub-stratum of the informal Iraqi economy that, as discussed  
30 earlier, began to grow from the early 1980s as a result of chronic resource  
31 scarcities brought on by war, and were aggravated by unrest and a decade  
32 of sanctions. In addition, Saddam Hussein's selective distribution of scarce  
33 resources created some of the underlying group rivalries that exist today.  
34 By directing funds, rations, government positions, electricity, clean water,  
35 fuel and industrial investment toward specific villages in the western Sunni  
36 regions in exchange for service to the regime, and withholding resources  
37 to other villages as a punitive mechanism, a local-level competitive calculus  
38 developed that was perpetuated by Hussein as an instrument for rule.  
39 Because the state-level formal economy was dramatically curtailed by sanc-  
40 tions, this competition for resources further encouraged the growth of  
41 informal activities and employment.

42 The tendency of corrupt party and state institutions to favour key sup-  
43 porters in the distribution of goods and services encouraged those operat-  
44 ing in the informal (and formal) economy to rely on local level mediation  
45 by tribal groups. Because informal activity is based in large part on social

capital – the trusted familial and kinship ties noted above – local tribal groups played a central role in the expansion of the informal economy. By assessing fees for the settlement of disputes and collecting taxes on local production, local tribal groups also began to establish financial support systems free of state control.

Tribal groups were also increasingly involved in criminal-type activities, especially in the western border regions. Illicit criminal networks were initially based on the cross-border smuggling of animals, tea, alcohol and electronics. Later, these activities began to encompass the drug trade. Tribal-based organised criminal activities increased toward the end of Ba’athist rule with many party members becoming involved due to declining opportunities to acquire official resources. By early 2002, the entire route along the Euphrates River in al Anbar had essentially developed into a sanctuary for illicit traffickers and criminal entrepreneurs.

Resource scarcity and the stature of sub-tribal groups were both greatly enhanced at the local level following the removal of Saddam Hussein. The process began with the Coalition Provisional Authority’s early adoption of a neo-liberal economic programme which had the unintended effect of impeding the growth of regulatory and legal institutions. This institutional vacuum forced businesses and those entering the labour market to rely on the trusted kinship or extended family networks of the informal economy. Shortages of critical inputs such as electricity and fuel, and the dangers of transportation further encouraged informal entrepreneurs to rely on tribal and extended family associations for protection and support.

Endemic corruption and uncertainty further contributed to a dramatic increase in the informal sector following the 2003 invasion. As a result, approximately 80 per cent of the labour force is now engaged informally, accounting for nearly two-thirds of Iraq’s gross domestic product. In this regard, growth of the informal economy is particularly evident in certain areas west of the capital, where the destruction of the Sunni-oriented military establishment and related industries has contributed to a substantial contraction of formal employment.

Reinforcing these trends has been a dramatic rise in criminal activity dominated by local-level tribal elements, including emerging economic sectors based on the distribution of scarce resources, kidnapping, trafficking in petrol, narcotics, looted weaponry and the targeting of coalition forces. Where the Iraqi government lacks control or where there is not a substantial coalition presence, the shadow economy is rapidly displacing any legal or semi-legal structures that have managed to survive.

### **Conclusion: a possible way out of the vicious circle**

The integrated model sketched above suggests that any attempts to reduce corruption in Iraq needs to place the problem in a broader historical, social and economic context. Rather than focusing on trust-building and

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1 institutional reform, the current reconstruction strategy has emphasised  
2 market reforms, infrastructure development and private foreign invest-  
3 ment. It is not producing tangible economic gains and in fact has created  
4 an environment in which corruption flourishes.

5 As a result, the massive expenditures in infrastructure have not pro-  
6 duced the significant follow-on investment that Hirschman's unbalanced  
7 growth strategy might have anticipated (1958). Instead, infrastructure  
8 projects have been an easy target for the insurgents and a financial drain  
9 for the United States and the Iraqi government. The top-down nature of  
10 the post-war strategy is another reason for its limited impact. Rather than  
11 focusing on grassroots community development and trust building, there  
12 has only been limited Iraqi input and participation. Consequently many of  
13 the investments undertaken are not nearly as productive in the Iraqi  
14 context as they would have been if they were indigenously designed to  
15 respond to a tangible domestic demand enhanced by growing domestic  
16 markets. On the other hand, bureaucratic fear of the anti-corruption  
17 measures that are in effect has brought needed capital programmes to a  
18 halt.

19 The critical question is what can be done to break out of the current  
20 vicious circle of corruption, government inefficiency and pervasive unem-  
21 ployment trapping the Iraqi economy in a low growth path? Thomas Palley  
22 for instance has argued that the country's current needs are so pressing  
23 that a significant share of oil revenues should be disbursed to the popula-  
24 tion immediately (2003). His tentative figure was that 25 per cent of reve-  
25 nues be distributed.

26 The logical argument against disbursing a large share of oil revenues  
27 directly to the public is whether the country can afford such a  
28 programme.

29 A counter argument is that these projects have been a major source of  
30 corruption. Taking the money out of the hands of a corrupt political elite  
31 and giving it to the population is probably the most powerful anti-  
32 corruption policy available today (Gillies 2010b) – the policy of simply  
33 going after the 'bad guys' has clearly failed. In contrast, a distribution  
34 scheme would help undermine two key elements contributing to the coun-  
35 try's massive corruption problem – the shadow economy and deficient  
36 social capital. With regard to the latter, currently one of the main stum-  
37 bling blocks in uniting Iraq is the ongoing controversy over the distribu-  
38 tion of oil revenues with each region not trusting the others to agree to a  
39 'fair' allocation. The direct distribution of oil revenues would assist in  
40 overcoming this impediment while eliminating one of the major impedi-  
41 ments to improved trust. The process is summarised in Figure 10.1.

42 Such a policy would provide an incentive to ordinary Iraqis to protect  
43 the country's oil facilities by providing intelligence on insurgent groups  
44 attempting to disrupt the production and flow of oil (Johnson 2004). It  
45 might further help to quell the insurgency by allaying the fears of the

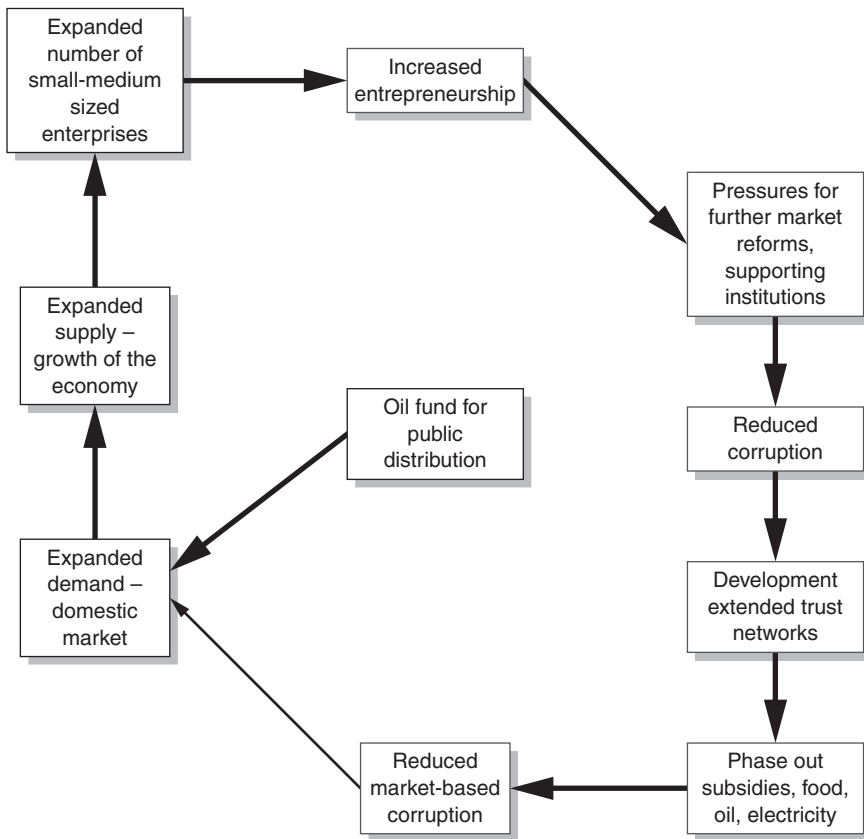


Figure 10.1 Iraq virtuous circle of demand-led private sector activity.

Sunnis that they will suffer financially from the fact that most oil reserves are in Shiite and Kurdish territories. Without an equitable distribution of oil revenues, the competition among various groups for oil money could turn ugly and even erupt into violent conflict in Iraq. Rifts over oil revenues already run deep, as Iraqi Kurds, Arabs and Turkmen struggle for control of oil-rich Kirkuk (Revenue Watch 2005).

Distributing oil revenues directly to the public could also contribute to the formalisation of a range of economic activities by creating an irrevocable personal identity under the law, and thus establishing the conditions for, inter alia, property rights and the registration for taxation; and could expand banking and credit access for small businesses. While not a panacea, the impact of such a policy is likely to contribute to reducing the impact of corruption and stabilising the economic environment in post-conflict Iraq. Unfortunately as of early 2011, the Iraqi government has

1 shown no interest in such a programme – the country’s new oil law that  
2 will government most aspects of the oil industry and is progressive in many  
3 key aspects surrounding the treatment of oil royalties, is completely silent  
4 on this issue (Lidstone 2009).  
5

6 **Notes**  
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- 8 1 Quoted by Negus (2006).  
9 2 See Philp, this volume for the conceptual difficulties in defining corruption in  
10 post-conflict settings. See also Jain (2001).  
11 3 As the storming of a police station in Basra by British forces in December 2006  
12 showed, parts of Basra’s police have been at the centre of the city’s criminal  
13 activity.  
14 4 This source is the basis of the summary of SIGIR findings reported in the para-  
15 graphs that follow.  
16 5 In an analysis of the size of informal economies across 146 countries corrup-  
17 tion was found to be statistically significant at the 95 per cent level.  
18 6 An overview of the literature on social capital can be found in Paldam (2000).  
19 The concept of social capital owes its origins to Robert Putnam (1993, 2000).  
20 7 See Braude (2003: ch. 4) for a detailed account of this process.  
21 8 For a full assessment of early post-Saddam crime in Iraq see UNODC (2003).  
22 9 This section draws heavily on Haussler (2005: 33–41).  
23 10 For this period see Braude (2003) and Glain (2004: ch. 5).  
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