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At Baghdad's Dawra power plant only one of four turbines function properly, April 2004.

PAOLO WOODS/AGENCY REGINA MARIA ANZENBERGER, VIENNA

# State Building in Reverse

## The Neo-Liberal "Reconstruction" of Iraq

**Khalid Mustafa Medani**

In June 2003, L. Paul Bremer, head of the now dissolved Coalition Provisional Authority (CPA), announced the broad outlines of the Bush administration's plan to rebuild Iraq along strict free market principles. "The removal of Saddam Hussein," Bremer helpfully explained, "offers Iraqis hope for a better economic future. For a free Iraq to thrive, its economy must be transformed—and this will require the wholesale reallocation of resources and people from state control to private enterprise, the promotion of free trade, and the mobilization of domestic and foreign capital."<sup>1</sup> Three months later, the CPA announced Order 39 permitting complete foreign ownership of Iraqi companies and assets (apart from natural resources), total overseas remittance of profits

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and some of the lowest taxes in the world. Iraq was officially "open for business."

Fifteen months after the US invasion, little of Bremer's "transformation" is evident to Iraqis, who continue to endure rampant unemployment, lengthy gas lines, sporadic violence and an uncertain political future. Nevertheless, the occupation has paid some big dividends—to the American companies that won a clean sweep of contracts to rebuild Iraq's physical infrastructure, health, education, transport and political systems.

Even prior to George W. Bush's unilateral invasion of Iraq, the US Agency for International Development began contracting the "reconstruction" of Iraq to various American firms, a process in which it was later joined by the Army Corps of Engineers and the State Department. After the fall of Saddam Hussein's regime, the US appointed American private-sector

executives to run the economy and attempt to impose free market policies on Baghdad. This reconstruction process has obstructed effective state and nation building in Iraq, vastly expanded the pool of the unemployed and undermined the already limited authority of the interim government.

It has also created a vacuum of legitimate power that is being filled with armed resistance groups organized around sect, region and mafia-like local protection rackets. The insurgency, fueled by unemployment, threatens to dismember the Iraqi nation and promote regional instability. Despite the June 28 handover of nominal political authority, moreover, Iraq's financial and political autonomy will be circumscribed for years to come. Through the newly renamed Iraq Projects and Contracting Office (PCO), the US Embassy in Baghdad will continue to administer the bulk of the \$18.4 billion allotted by Congress in 2004 for the "reconstruction" of Iraq.

## State Building in Reverse

The neo-conservative intellectuals and policymakers who pushed most vigorously for the Iraq war aimed to ensure the continued global dominance of the United States. In particular, they thought, occupation of a bridgehead in the oil-rich Persian Gulf would guard US interests against any potential challenge from the European Union, and, more importantly, China, whose resurgence as an economic and military power they regard as a serious threat. A corollary strategic objective was that, under US tutelage, "the new Iraq" would become a liberal democratic beacon to steer the Arab world away from Islamic fundamentalism, terrorism and authoritarianism. This goal, in turn, rested on the ambitious proposition that Iraq could be transformed into a prosperous, capitalistic state. While the neo-conservatives differ from neo-liberals in terms of geostrategic worldview, they overlap with neo-liberals in the belief that "free markets" contain the key to human wellbeing.

Historically, modern states have been built around centralized power, including a monopoly on military force, underpinned by the imperatives of tax extraction and administrative capacity. The neo-conservatives have rejected any approximation of this traditional model. In fact, as of yet they have shown little interest in establishing even the most limited prerequisites of successful state building: the establishment of locally generated enforceable property rights and efficient and autonomous legal institutions.

While US officials have suggested that the reconstruction of Iraq should follow the lines pioneered in Japan after World War II, in practice they have followed a markedly different policy. In Japan, US policymakers (inspired by New Deal principles) assigned the Japanese state a major role in setting priorities for the reconstruction of the country. Basic legal and regulatory structures were maintained, a strong labor movement was encouraged (at least in the initial phases of US occupation) and the incursion of foreign business interests was sharply limited.

In short, US authorities largely left the business of Japan's development to the Japanese. In Iraq, by contrast, the US has pursued an agenda of sweeping privatization and awarded lucrative reconstruction contracts to firms close to the Bush administration. As John Dower, the preeminent American historian of the US occupation of Japan, has noted: "Japan was spared the presence of carpetbaggers who might have tried to manipulate occupation policy to serve private interests. In oil-rich Iraq, foreign capital is poised to play a major political as well as economic role."<sup>2</sup>

US reconstruction in Iraq, with its hope of establishing American-style capitalism, has denied any significant role to the state or the public sector. The initial plan, now all but abandoned, was to liquidate insolvent Iraqi companies, and initiate a mass privatization program, which would distribute ownership vouchers to Iraqi citizens. This was the program implemented in Russia in the early 1990s, which resulted in large-scale corruption and the rise of monopolistic cartels.<sup>3</sup>

But even in its watered-down form, US reconstruction has effectively led to a pattern of "reverse state building," weakening bureaucratic capacity and legitimate military authority and, as a consequence, the capacity of the state to generate revenue from the private sector. The iconic acts of state building in reverse were Bremer's decrees that dissolved the army and information ministry and banned up to 30,000 Baath officials from government jobs, putting 400,000 Iraqis out of work. With unemployment running between 60 to 70 percent, these measures have led to crime and social unrest.

## "Economic Warfare"

One of the key problems of US policy in Iraq is that it has shunted aside local labor and business expertise. US sub-contractors are importing cheap migrant labor from South Asia, despite high unemployment and vociferous complaints from Iraqi contractors that they are being overlooked. Bechtel, which is handling a \$680 million reconstruction program for USAID, intends to spend upwards of \$300 million on Iraqi sub-contracts in many sectors, particularly construction, in which Iraqi firms are by most accounts highly capable of doing the work at competitive prices. One Iraqi construction manager, who routinely lines up for contracts in Baghdad, complained that "US contractors are importing labor and expatriating the benefits—where is the benefit for Iraq?" US officials say they "encourage" firms to employ Iraqis, but do not stipulate a minimum percentage of Iraqi employees. Many Iraqis fear the replication of the labor patterns of Arab Gulf states, whose economies are dependent on Arab and Asian migrants.

US officials cite security as the rationale for importing Asian workers, one of them saying: "From a protection standpoint, Iraqis are more vulnerable to a bad guy influence." The real reason may be simply that Asian labor is cheap. Kellogg Brown and Root (KBR) sub-contractors pay Asian workers an average salary of \$3 a day and grant leaves once every two years. KBR,



a subsidiary of Halliburton, which in 2001 won the contract to supply provisions to the military, said they look at Iraqis first but do not track employees by “ethnicity.” Not surprisingly, this state of affairs is clearly linked to the violence in several major cities, including Baghdad, where unemployment and resentment of foreign contractors are most severe.<sup>4</sup> The violence that various militant groups have meted out against foreign contractors in a variety of services and occupations can be understood in the context of competition in a severely constricted labor market.

To make matters worse for many Iraqis, the CPA announced it would enforce a 1987 law banning unions in public enterprises, where most Iraqis are employed. Bremer also added Order 1, banning pronouncements that “incite civil disorder, rioting or damage to property.” The phrase “civil disorder” encompasses organizing strikes. It has resulted in the detention of leaders of the Iraqi Federation of Trade Unions and the Iraqi Union of the Unemployed by US authorities several times. In Basra, there have been three general strikes, and in October 2003 conflict over reconstruction work resulted in a wildcat strike at an oil refinery south of Basra where KBR was given a no-bid contract.<sup>5</sup> Not surprisingly, over the last year there have been as many as 67 attacks on oil pipelines throughout the country.

Following the June 2004 handover, US officials have been forced to acknowledge that unemployment is an important cause of the violent insurgency in the country. In July, State Department officials began “reviewing” the \$18.4 billion set aside by Congress to see if funds could be reshuffled in a bid to create jobs more quickly.

In the meantime, US military commanders in zones where the insurgency is strong have resorted to what they call “economic warfare”—doling out cash to Iraqi men for minor “local rehabilitation and emergency welfare projects” through the Commanders Emergency Response Program. The stated goal of the payments is less to “rehabilitate” the countryside than to dissuade the locals from taking someone else’s money to mount attacks on US troops. “Nobody is going to ever be waving an American flag,” said one civil affairs officer. “But I just want them to be neutral, to stop planting explosives.”<sup>6</sup>

## The Spoils of War

Ironically, and in contrast to the Wild West image conveyed by the Commanders Emergency Response Program, Iraq has the best chance of any country in the Arab world to develop a vibrant economy. It not only has vast oil wealth and

Worker coaxes aging machinery into operation at a pumping station along a canal taking fresh water to Basra, March 2004.

DANA SMILLIE/POLARIS







In the absence of regulations, commercial billboards begin to transform the urban landscape of Baghdad, April 2004. PAOLO WOODS/AGENCY REGINA MARIA ANZENBERGER, VIENNA

a skilled labor force, but also many talented technocrats and scientists and (despite Saddam's best efforts) a significant manufacturing and agricultural base. Following the 1991 Gulf war, as is frequently rehearsed, the Iraqi government managed to restore services and infrastructure at an impressive pace. Key roads, bridges and telecommunications networks were rebuilt in a matter of months; electricity and water services were also partly repaired. US officials sound tired of hearing this refrain. Secretary of State Colin Powell told Iraqi leaders during his July 2004 visit to Baghdad: "We want to rebuild the infrastructure. We want to create jobs. We want to show the people the Iraqi people that this money is being used for their benefit and do it as quickly as we can. The terrorists will be defeated."<sup>7</sup>

But the credibility problems of the US-led "reconstruction" do not stem merely from its conspicuous lack of achievements to date. In direct contrast to neo-liberal nostrums about the virtues of market competition, Iraqi reconstruction has been a decidedly political and non-competitive affair. Although the range of reconstruction projects is diverse, the winning bidders are not. Whether in the initial round held by USAID before the war, or in the March 2004 round held by the PCO, the large contracts have exclusively gone to US-based corporations (some of

which then sub-contract to local firms). The deals aimed at rebuilding Iraq's oil, water and electricity infrastructure were given to American firms—such as Parsons, Fluor, Bechtel and Halliburton—not to Iraqi businessmen with firsthand experience rebuilding the country after the 1991 Gulf war. For US contractors, "reconstruction" has been a bonanza. In April 2004, the most notorious of the Iraq war profiteers, the oil services corporation Halliburton, announced that its Iraq contracts made up \$2.1 billion of the company's first-quarter revenues of \$5.5 billion. These contracts helped to offset the company's losses in its other operations.

US companies are also still contracted for work that, in the view of many Iraqis, properly belongs in the purview of the Iraqi interim authorities. In March 2003, the Research Triangle Institute of North Carolina was the sole bidder for a one-year, \$167.9 million deal to set up 108 local and provincial town councils. It retained this contract in 2004. Creative Associates International is another USAID contractor that, after the handover of "sovereignty," will still earn millions to increase the enrollment and "quality" of primary and secondary schools.

Privatization is everywhere a political process guided by domestic state elites and fraught with social conflict. But the present state of affairs in Iraq, characterized by the selective

# The Paris Club, the Washington Consensus and the Baghdad Cake

Justin Alexander

In October 2004, representatives from the G-8 and 11 other countries will meet without fanfare or press coverage in a quiet room in the French Finance Ministry. It is unlikely that their lunchtime dessert will actually be a cake decorated with the stripes and green stars of the Iraqi flag, but they will certainly be intent on grabbing as large a slice as they can of the metaphorical cake in their minds. The outcome of their meeting will have tremendous significance for 26 million Iraqis.

Formed in 1954 to protect the interests of powerful creditors against the risk of poor countries defaulting on debts, the Paris Club has become the muscle enforcing the neo-liberal economic policies known as “the Washington consensus.” Although the Paris Club coats its rulings in a honeyed language of debt “forgiveness” and development aid, its aim is to further the financial interests of its members. The Paris Club was deeply divided over the 2003 invasion of Iraq. In the 1980s, however, its members were of like mind as, jockeying for Cold War influence and fearing the Islamic Revolution in Iran, they financed the regime of Saddam Hussein with some \$21 billion of loans and export credits.

The loans helped to bankroll the Iran-Iraq war and the Anfal genocide and contributed to the 1990 economic crisis that spurred Saddam to invade Kuwait. For the next 13 years, when UN sanctions barred Iraq from trade and financial activities, the debts were forgotten. Then, a few days after the fall of Baghdad, as public buildings across the city were being looted and burned, the G-7 finance ministers held their annual meeting in the runup to the G-8 summit at Evian.

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distribution of private contracts, lacks even the pretense of the legitimacy of a national government supported by the majority of Iraqis. The corruption reported in the US reconstruction process is therefore more politically explosive than the homegrown corruption associated with privatization elsewhere in the Arab world. In addition to the overcharging and accounting irregularities attributed to Halliburton, the CPA itself misallocated Iraqi money. An audit compiled

Out of the blue, the issue of Saddam’s debt shot to the top of their agenda. Iraqi economists and activists raced to dig up details of the long-neglected debts and uncovered a shocking picture. The total amount of debt—including interest accumulated during the sanctions decade—was unclear, but plausible estimates put it around \$120-130 billion, ten times Iraq’s expected export earnings in 2004. There was even evidence that some loans had been directly related to the purchase of components and the construction of factories that produced the kind of chemical weapons used at Halabja in 1988.

Clearly, much of this enormous debt qualifies as “odious”—it was assumed by a dictatorial regime to finance activities that, often to the lenders’ knowledge, were against the interests of the Iraqi people. Numerous experts, including Nobel Prize-winning economist and former World Bank president Joseph Stiglitz, endorsed the formation of an international debt tribunal that would disqualify odious loans and enable fair negotiation between Iraq and legitimate creditors. But the Paris Club has refused to consider this approach. Instead, the cartel of creditors continues to insist on the status quo—recently rebranded as the Evian approach—whereby these hardly honest brokers decide how much an indebted country should repay and on what timetable. The repayment is linked to fulfillment of economic conditions laid down by the International Monetary Fund.

In December 2003, Republican heavyweight James Baker took on the role of special presidential envoy on Iraqi debt. In August, the Bush administration had sidelined a proposed Iraq Freedom from Debt Act in Congress, but Baker’s appointment suggested that at last the US was taking the issue seriously. When

by the CPA’s own inspector general found that the occupation authority paid as much as \$1.9 billion to US contractors from the Iraqi oil funds placed under its stewardship by UN Security Council Resolution 1483, when those contractors should have been paid with US taxpayer dollars as allocated by Congress.<sup>8</sup> Prior to its dissolution, the CPA allocated billions more dollars of Iraqi oil revenues to cover expenses and investments that are seemingly already covered by the \$18.4



Baker visited Iraq in 1989, he had pledged to secure an additional \$1 billion of US loans for the old regime. By March 2004, however, despite jetting off to almost a dozen countries, he had not yet visited Iraq to consult with the people he was claiming to represent.

Iraqis have made their views very clear. Perweez Mohammed of the Patriotic Union of Kurdistan says: "The creditors' cooperation enabled Saddam to preside over atrocities such as Halabja. Saddam never spent money for the benefit of the Iraqi people, just for himself and his followers." Thousands of Iraqis have signed the Jubilee Iraq petition calling for writing off Saddam's odious debt and dozens of them have played a key role in campaigning for this goal. Since the inception of the interim government on June 28, Iraqi officials have been speaking out with increasing confidence on the debt issue. The interim finance minister, Adil Abd al-Mahdi, told *Gulf News*: "We are asking for some major forgiveness, to wipe off at least 95 percent of the debt or 100 percent. We will have hard discussions with the IMF and the Paris Club in the coming months." Central Bank Governor Sinan al-Shabibi says he is seeking "the biggest reduction ever." This new assertiveness is a positive development, but Iraq will have a tough time facing down the Paris Club nevertheless.

The Paris Club discussed Iraq at its monthly meeting on June 11. One anonymous official told Reuters that the US was arguing for a 90 percent reduction, while Japan and Britain were talking about 80 percent, Russia 65 percent, and France and Germany 50 percent. These figures fit with numerous statements made by officials of the various nations over the last year. The implication is that the Club is likely to agree on a reduction of around 65–70 percent—and that is insufficient. With \$40 billion of debt left on the books (and possibly much more if non-Paris Club creditors such as Bulgaria refuse to accept comparable terms) and a conservative 5 percent interest rate, Iraq would be required to pay \$2 billion a year in interest alone, and more than double that when principal payments are included. Under even more conservative assumptions

supplemental passed by Congress.<sup>9</sup> The interim government, under regulations passed by the CPA, will likely be unable to cancel these outlays. Naturally, such abuses of power have exacerbated contempt for an occupation that also failed to provide job opportunities or security. In the void of legitimate government, militia groups have emerged to reclaim portions of Iraq from US occupation, and to defeat domestic rivals, as they fight to build states within the state.

(including just 3 percent interest), Iraqi economist Ali Merza predicts that, with anything less than 77 percent debt reduction, Iraq will face a serious balance of payments gap that will have to be financed with new loans from 2004–2014.

The Paris Club members have made it clear that they intend to get a deal signed and sealed in 2004. A statement at the EU-US summit in Ireland on June 25 reiterated the creditors' position: "Reduction should be provided in connection with an IMF program, and be sufficient to ensure sustainability taking into account the recent IMF analysis. We encourage governments within the Paris Club, and non-Paris Club creditors, to achieve that objective in 2004." The October Paris Club meeting is likely to be decisive.

The danger is that, once the Paris Club has reached a consensus, the US will twist the arm of the interim Iraqi government until it signs a sub-optimal agreement and also accepts the IMF structural adjustment package upon which gradual debt reduction will be conditioned. It would be understandable if the interim government decides to invest its energy in fighting more immediate battles. Nevertheless, giving in to the US and the Paris Club now could have very serious consequences as already insufficient resources for social spending are further depleted to finance debt repayment. Since April 2003, Iraq has paid \$1.45 billion in reparations to Kuwait and others, more than the combined health and education budgets prepared by the Ministry of Planning for 2004. With at least \$2 billion in debt service on top of continuing reparations payments, and with the social friction caused by IMF structural adjustment, it will be very hard to tackle the unemployment and devastated social services which are afflicting the Iraqi people and feeding crime, corruption and violence. The coming months are critical for informing the Iraqi people about the danger and supporting them in taking a strong stand—one which makes sense legally, morally, economically and politically—demanding a clean slate and, in particular, refusing to inherit any of the odious debt incurred by Saddam. ■

## Liberalization Then and Now

Perhaps a grimmer irony is that the Bush administration is replicating—at least in economic policy—the failed liberalization reforms implemented by Saddam Hussein in the late 1980s. Like other oil exporters, the Iraqi state suffered a fiscal crisis that coincided with the recession in the Gulf in that decade. As oil prices fell from \$28 per barrel in



An Iraqi woman inspects a line of Pepsi bottles at the Baghdad Soft Drink Company plant, January 2004.

FALEH KHEIBER/REUTERS/LANDOV

December 1985 to \$9 in July 1986, Iraq's external debt (see sidebar) rose to \$50 billion dollars.<sup>10</sup> Huge expenditures on military hardware and military industries for the 1980-1988 war with Iran further strained the public sector and signaled the demise of the state-controlled society.<sup>11</sup>

As a result of these internal and external pressures, Saddam Hussein announced plans to liberalize large chunks of the domestic economy on February 11, 1987. Though strategic oil and military industries always remained in state hands, the regime sold off state land, farms and factories to private investors, and dramatically altered the bureaucratic system. Government administrators were dismissed and encouraged to enter the industrial labor force. At the same time, deregulation of the labor market, including the abolition of the General Federation of Trade Unions, greatly affected individuals accustomed to decades of employment guarantees. The wage-earning classes in the formal economy experienced growing shortages and rising prices, as price controls were removed from most consumer goods. On the eve of the 1991 Gulf war, inflation was estimated at 45 percent. The combination of the diminished economic role of the state and the tripling of commodity prices had forced millions of families to seek

refuge in informal economic activity linked to rural-based clan and sectarian networks.<sup>12</sup>

Economic liberalization under Saddam's rule did not promote political liberalization or rebuild the state institutions. In great part, this was because it was designed to strengthen an already powerful and brutal regime. For example, those groups engaged in the burgeoning informal economy and currency speculation and who posed an economic threat to the regime were brutally murdered. The commitment to profit (and profiteering) was defined clearly by Saddam Hussein in June 1987: "From now on, the state should not embark on uneconomic activity. Any activity, in any field, which is supposed to have an economic return and does not make such a return, must be ignored.... It is a more sound economic view to lose the factory and ignore it, than to continue with a loss-making economic activity if it remains in action."<sup>13</sup> Hussein privatized the sectors of the economy that were losing money, namely agriculture and small industry. At the same time that these firms were auctioned off to private investors, the state was expanding the public sector in areas that seemed the most profitable and security-related, including the military and the oil industry.<sup>14</sup> In a pattern similar to the present state of affairs, those



industries and factories that were privatized were given to individuals with connections to the regime overseeing the “reforms,” altering the sectarian, ethnic and social power balances in the country.<sup>15</sup>

The rapid shift from Baathist populism to state capitalism and neo-liberal reforms failed to rescue Iraq from financial crisis. In 1991, Saddam Hussein invaded Kuwait, in part to extract much needed revenue.

The similarities between Saddam’s Iraq and the current situation are difficult to ignore. Under Saddam Hussein’s regime, the failure of economic liberalization to promote economic growth and political liberalization was due to the imbalance of power between the regime and civil society and the lack of credible institutions to regulate the transition. Under the present US occupation, American contractors operating in a regulatory vacuum have similarly earned windfall profits by making use of their connections to the Bush administration. In both cases, private entrepreneurs and contractors emerged as “winners” while the bulk of the population was forced to make their living in an increasingly informalized economy. Just as the last decade of Saddam’s regime saw the emergence of black market profiteers, smugglers and speculators who reaped great profits from the increasingly deregulated Iraqi economy, today Iraqis continue to rely on informal work.

## The Market Logic of Iraqi Violence

The neo-liberal reconstruction of Iraq, with its wholesale attack on the “state,” is the unexamined factor determining the organized violence in Iraq. The US invasion and occupation has given rise to a “state-building” process that is the reverse of the process by which modern states were built. In particular, the present pattern of corruption, clientelism and rent seeking has led to a simultaneous erosion of the tax revenue base and political legitimacy. The Iraqi state’s incapacity to collect taxes on private economic activity will continue the cycle of dependence on “external” sources through rents accruing from aid, oil exports and illicit, and largely informal, economic activities.

After the 1991 Gulf war, Iraq witnessed a notable struggle over the parallel economy, resulting in political and clan conflicts. At the time, the main contenders for control of trade and currency dealing were Uday Hussein, Saddam’s son, and his half-brother Barzan al-Tikriti. By 1994, after the dinar had sunk to 265 to the dollar, the government reversed policy and permitted Iraqis to deal legally in foreign exchange and to open foreign cash accounts in domestic banks—effectively institutionalizing the informal financial market. The cumulative effect of these developments was the further deterioration of the extractive and regulatory capacity of the state and further deterioration of the formal economy. The decision to allow foreign currency dealing in 1994 was followed by a wave of arrests and executions of currency dealers, which was apparently part of a bid by Uday to gain control of this lucrative sphere of economic activity.

This period laid part of the foundation for present patterns of violence. On the one hand, clan and family networks around the ruling group played a key role in monopolizing both “official” economic activity (construction, trade and transport) and the “parallel” economy (based on currency dealing, trade and smuggling on a regional scale) that developed in response to liberalization policies and sanctions-induced shortages. On the other hand, a growing informal economy associated with increased inequalities, unemployment and rural-urban migration continues to set the pattern for “privatized forms of violence”—organized crime and the substitution of “protection” for taxation, vigilantes, private security guards protecting oil facilities and the interests of international companies, and a variety of paramilitary groups associated with particular factions.

This is the real context for the current pattern of violence in Iraq. Absent formal bureaucratic and military institutions, in Iraq, as in other failed and collapsed states, violence substitutes for formal political mobilization. Under US occupation, however, violence is mainly directed against civil authorities and civilians and not the occupying army. The aim is similar to violence associated with state-building efforts elsewhere—to capture territory through political control rather than military success and to eliminate or expel foreign as well as domestic political rivals. That this violence is increasingly based on regional or religious identities is primarily because this offers a sense of security in a context where formal ideologies are absent, and unregulated markets require social regulation. The changing pattern of violence in Iraq is thus best understood as a manifestation of the erosion of the autonomy of the nation-state and the expansion of the contemporary informal economy under the impact of the Bush administration’s hard-core “free market” ideology. ■

## Endnotes

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- 14 *Ibid.*
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