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**THESIS**

**THE COST AND ECONOMIC CORRUPTION OF THE  
IRAQ WAR**

by

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December 2007

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**THE COST AND ECONOMIC CORRUPTION OF THE IRAQ WAR**

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Submitted in partial fulfillment of the  
requirements for the degree of

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## **ABSTRACT**

This research effort analyzes the cost of the current war in Iraq and the corruption that is siphoning funds away from the war effort through economic corruption by Iraqis and by United States citizens and American corporations, most notably Haliburton and its subsidiary Kellogg, Brown and Root. In order to help limit corruption and aid economic growth through its own resources, many economists to include Robert Looney have proposed the creation of an oil fund, similar to the one the state of Alaska uses where its citizens receive a direct distribution of funds from the state government. This analysis adds to that idea by looking at the types of corruption that is currently on going and the cultural and psychological reasons why Iraqis are joining terrorist and insurgent organizations. In doing so, the United States may be able better address the key the center of gravity of any insurgency, the population.

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# I. INTRODUCTION

## A. PURPOSE

The United States and 72 other countries and 20 international organizations pledged money to aid in Iraq's reconstruction in October, 2003 following the elimination of Saddam Hussein's regime. While the actual funding flows from many have been slow to materialize, there is no doubt that the United States' flow of money has been quick and with little obstruction until recently from Democrats in both the House of Representatives and the United States Senate. As the cost estimates for the Global War on Terror continue to increase, so has the concern of the American taxpayer as more and more of their money has been going towards the war instead of domestic issues such as healthcare, education, etc. American taxpayer concern has been further exacerbated by repeated findings of corruption and mishandling of funds by both United States and Iraqi personnel. As a result of such reports, Congress created the Special Inspector General for Iraq Reconstruction (SIGIR) in October, 2004 with the purpose to provide an outside review of policies and procedures during the Iraq Reconstruction as well as a check and balance to limit fraud, waste, and abuse.<sup>1</sup> The SIGIR was basically charged with ensuring that the American taxpayer's money is going to where it should be and spent in a reasonable manner within the scope of rebuilding Iraq to better secure American interests. In addition to the SIGIR identifying corruptive actions, the media has reported many instances of corruption from Americans and Iraqis that have reduced reconstruction progress. In the SIGIR's June 8, 2006 statement to Congress, he stated that "Corruption is another form of insurgency in Iraq. This second insurgency can be defeated only through the development of democratic values and systems, including the evolution of effective anticorruption institutions in Iraq."<sup>2</sup> So, how does the United States attempt to rid, or at least minimize, Iraq of corruption to ensure the billions of American dollars are spent appropriately? While the answer to this problem is certainly complex, this paper

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<sup>1</sup>Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, <http://www.sigir.mil/about/Default.aspx> accessed June 2007.

<sup>2</sup> Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, Statement Before the United States House Committee of International Relations, June 2006.

will not only attempt to analyze the corruption and its effects, provide possible solutions to help mitigate economic corruption, but will also include cultural intelligence into the equation so that the solutions may be acceptable within the Islamic culture and not strictly from Western ideology.

It will also address the short term necessity to immediately improve the average Iraqi's quality of life. It appears this is missing from the overall strategy which appears to be focused on the long-term vice the immediate need of winning over the population.

US officials largely measure progress in Iraq in terms of numbers: more than \$14 billion spent so far on reconstruction, or in terms of electricity, the numbers of kilowatt hours produced by Iraqi power plants. This year for the first time, US officials say that the number has surpassed prewar levels. The average Iraqi measures progress in numbers too: how many hours of electricity he gets each day before the lights go out. Right now that's roughly two for every five hours of blackout.<sup>3</sup>

While it is conceded that changing the number of hours of electricity every Iraqi receives will take time, there are things that the Coalition can do to help in the short term. As stated earlier, billions of dollars are pouring into Iraq, yet very little is seen by the average Iraqi. It is within the disbursement of funds, both short term and long term, which needs to be addressed. Looney has repeatedly argued that an oil fund is the appropriate avenue to pursue economic prosperity in Iraq as oil funds can work in the short term as well.<sup>4</sup> However, Looney also recommended that distributions be made in equal amounts to men and women that is in contrast to the clientalist market that has been established for generations. So, how can the Coalition do so in a manner that is not perceived as being imperialistic or contrary to Islamic culture? The first step is to limit the system of corruption that has plagued Iraq for decades.

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<sup>3</sup> Jamie Tarabay, "Despite Progress, Iraqis Still Face Daily Challenges," NPR, All Things Considered, December 20, 2005.

<sup>4</sup> Robert Looney, "Can Iraq Overcome the Oil Curse?" *World Economics*, Vol 7, No. 1. January-March 2006.

## B. IMPORTANCE

Mitigating corruption is a necessary condition to building trust between a government and its people. It is even more vital in a country like Iraq where the infrastructure has been destroyed and its people's way of life has been altered. To quote the Iraqi Oil Ministry's Inspector General, the effects of corruption result in "the rule of law being undermined through the violation of the provisions of laws and regulations, making them thus irrelevant."<sup>5</sup> And the long-term implication of irrelevant laws could lead to anarchy and, eventually, civil war. The corruption in Iraq has led to money and resources, especially oil, being sold on the black market, and then being used to purchase weapons to be used against the established government, its people, and against United States troops.

Furthermore, it is also vital that the United States limits corruption to ensure its taxpayers receive their expected return for investment. The United States has historically had a great system of checks and balances domestically to ensure that corruption is limited and the rule of law is adhered. However, the United States government allowed for a key piece of international legislature to pass that removed vital checks and balances and legal enforcement--United Nations Resolution 1483 that declared all of Iraq's oil and resource revenues were immune from legal proceedings.<sup>5</sup> This new loophole allowed for the Coalition Provisional Authority to award Iraqi funds without any competition to United States companies such as Kellogg, Brown, & Root, a well-known Haliburton subsidiary.<sup>6</sup> Without any competition or threat of legal action, the environment was ripe for fraud, waste, and abuse.

While it is important to analyze the costs and corruption, it is also important to provide possible solutions in a culturally appealing manner, assuming that the United

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<sup>5</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products, Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf> accessed June 2007.

<sup>5</sup> Open Society Institute, *Iraq in Transition: Post Conflict Challenges and Opportunities*, [http://www.soros.org/initiatives/washington/articles\\_publications/publications/iraq\\_20041112/iraq\\_Transition.pdf](http://www.soros.org/initiatives/washington/articles_publications/publications/iraq_20041112/iraq_Transition.pdf) accessed May 2007.

<sup>6</sup> Revenue Watch Report No. 7, September 2004, <http://www.iraqrevenuewatch.org/reports/092404.pdf> accessed May 2007.

Nations Resolution 1483 is no longer in effect. The military has attempted to kinetically win the Global War on Terror and take the fight to the enemy especially in Iraq, but the overall strategy has not focused on the key center of gravity in a counterinsurgency which is the populace. As a result, it is also important to look at non-kinetic means to win the hearts and minds of the people...or at least not create more enemies for the military to fight. Hence, it is critical for policy makers to make decisions and make statements that are both in line with moderate Muslims and rebuilding an American-friendly Iraq.

### **C. LITERATURE REVIEW**

The literature review will cover three different areas...the overall cost of the war, the major issues regarding the corruption on the both the American and Iraqi sides, and a look at proposed solutions to mitigate corruption and improve the Iraqi economy. Prior to looking at the economic corruption, it is important to analyze the overall cost of the war to the United States in order to keep things in perspective and to show the economic commitment the United States is making to aid Iraq's transition to democracy.

Despite William Nordhaus' self-proclamation that his estimates were flawed, his early analysis of the economic impact is surprisingly accurate in hindsight.<sup>8</sup> Nordhaus first analyzed the Iraq's oil production capabilities, explaining the strategic importance of Iraq's oil in the world economy and to the United States. Nordhaus stated that Iraq has roughly 10 percent of the world's known oil reserves that could satisfy the current United States import requirement for almost 100 years.<sup>9</sup> Drawing upon George L. Perry's 2001 work on an oil disruption on the United States economy, Nordhaus concluded that Perry was accurate in his estimates that an oil disruption could have a huge impact on domestic oil prices and change in real gross domestic product. Perry provided three case scenarios where crude oil prices ranged from 32 to 161 dollars per barrel. In his worse case scenario, Perry saw concluded that at 75 dollars per barrel, the average cost per gallon of gas would be 2.78 dollars, representing a 2.7 percent decrease in real gross domestic

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<sup>8</sup> William D. Nordhaus, *The Economic Consequences of a War With Iraq*, October 29, 2002, <http://www.econ.yale.edu/~nordhaus/iraq.pdf> accessed February 2007.

<sup>9</sup> Ibid.

product, corresponding to 282 billion dollars. Perry also assumed there would be widespread inflation that would trigger a recession. This portion of Perry's work has not proven to be true.

Nordhaus reviewed two government studies projecting the estimated costs of war in Iraq, and concluded their estimates were deficient as they did include costs for occupation, peacekeeping, democratization, nation building, post-occupation humanitarian assistance, oil supply impact, macroeconomic effects, and budgetary impacts. After broadly analyzing these areas, Nordhaus concluded that the economic costs could range between 121 billion and 1.6 trillion depending on occupation duration, etc. The 1.6 trillion dollar figure included a lengthy occupation, expensive nation building, and resistance to United States occupation...all of which have come to reality. What appeared to be unreasonable at the time has proven to be extremely accurate especially when it is compared to Joseph Stiglitz and Linda Bilmes more recent analysis.

After the war began, the world witnessed a spike in oil prices despite OPEC's increased oil production. This led Warwick McKibbin and Andrew Stoeckel to analyze the macroeconomic effects of higher oil prices on the global economy with an in-depth analysis of the United States and China in 2004.<sup>10</sup> Along similar lines, Coilin Nunan analyzed the fragility of the United States economy due to its large trade deficits and reliance on oil being only traded in dollars. He explored the possibility of OPEC changing its policy and requiring euros for oil purchases.<sup>11</sup>

As the Iraq War progressed and the death and injury tolls mounted, Scott Wallsten and Katrina Kosec analyzed the overall economic cost of the war to include the costs of the dead and injured as a lost opportunity cost to enhance the United States economic growth and a strain on the Veterans Administration in terms of future healthcare costs.<sup>7</sup> Nobel Prize winning economist Joseph Stiglitz and Linda Bilmes expanded on Wallsten and Kosec's work by separating the economic effects into three separate areas--budgetary

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<sup>10</sup> Warwick McKibbin and Andrew Stoeckel, *Oil Price Scenarios and the Global Economy*, 2004 [http://www.economicsscenarios.com/pdfredir\\_sample.asp?issueNo=9](http://www.economicsscenarios.com/pdfredir_sample.asp?issueNo=9) accessed March 2007.

<sup>11</sup> Coilin Nunan, *Oil, Currency, and the War in Iraq*, November, 2004 <http://www.feasta.org/documents/papers/oil1.htm> accessed February 2007.

<sup>7</sup> Scott Wallsten and Katrina Kosec, *The Economic Costs of the War in Iraq*, September, 2005 <http://www.aei-brookings.org/admin/authorpdfs/page.php?id=1188> accessed March 2007.

costs of the war, the economic cost, and the macroeconomic effect of the war in Iraq.<sup>8</sup> Perhaps to contradict the anti-war tone of Stiglitz and Bilmes, Steven Davis, Kevin Murphy, and Robert Topel addressed the economic effect from a 2003 decision-maker's reference to include the costs of a containment policy in Iraq.<sup>9</sup> In addition, there have been several articles that compare the Iraq War to other wars such as Vietnam, Korea, and the Cold War in terms of percentage of gross domestic product, showing a different perspective. For example, Matt Crenson reported that the Iraq War uses less than one percent of the nation's gross domestic product compared to 14 percent (Vietnam) and 9 percent (Korea).<sup>10</sup>

Transitioning from cost to corruption, the best information source regarding corruption in Iraq is the SIGIR who has released three reports regarding lessons learned concerning the reconstruction effort and corruption as previously mentioned.<sup>11</sup> Furthermore, David M. Walker, Comptroller General of the United States, provided testimony before the Subcommittee on Defense, Committee on Appropriations, House of Representatives where he articulated the lack of military commanders' understanding in using contractor support which inhibits contract oversight personnel to manage contracts, which leads to an environment where corruption can thrive. In addition, Walker pointed out that the security situation has led to problems with companies either leaving before the work is done correctly or leaving before the work is even finished. Within the Iraqi security forces, corruption is widespread as the forces have been infiltrated by militias and other who are loyal to parties other than the elected Iraqi government.<sup>12</sup> To illustrate this problem, the SIGIR mentioned throughout his reports that several sites that his team

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<sup>8</sup> Joseph Stiglitz and Linda Bilmes, *The Economic Costs of the Iraq War: An Appraisal Three Years After the Beginning of the Conflict*, January 2006, [http://www2.gsb.columbia.edu/faculty/jstiglitz/cost\\_of\\_war\\_in\\_iraq.pdf](http://www2.gsb.columbia.edu/faculty/jstiglitz/cost_of_war_in_iraq.pdf) accessed March 2007.

<sup>9</sup> Steven J. Davis, Kevin M. Murphy, and Robert H. Topel, *War in Iraq Versus Containment*, March, 2006 <http://www.nber.org/papers/w12092> accessed March 2007.

<sup>10</sup> Matt Crenson. "In Dollars, Iraq War's Cost is Nowhere Near a Record," *The Seattle Times*, 18 March 2007.

<sup>11</sup> Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction <http://www.sigir.mil> accessed June 2007.

<sup>12</sup> David M. Walker, Comptroller General of the United States, Testimony Before the Subcommittee on Defense, Committee on Appropriations, House of Representatives, April 2007.

wanted to audit were too dangerous for his team to visit. A report by Revenue Watch outlined how the Coalition Provisional Authority mismanaged both Iraqi and American funding during the onset of reconstruction. The report concluded that the personnel awarding contracts deviated from well-established procedures when dealing with American funds and did not adhere to any procedures when dealing with Iraqi funds.<sup>13</sup>

Inside Iraq, the Oil Minister Office of Inspector General has written two transparency reports describing the smuggling and corruption within the oil industry. The report included the three main factors of the smuggling were the huge price discrepancies between Iraqi oil and its neighboring countries, inadequate control and measurement instruments, and inadequate legal repercussions against offenders. In one example from the reports, 28 million dollars of oil were diverted and the accused were fined 4 million dollars for their actions.<sup>14</sup> Furthermore, Radi al Radhi, the head of the Iraqi Public Integrity Commission, released a statement through the Associated Press that his commission has investigated 2,600 corruption cases and estimated that Iraq has lost 8 million dollars in revenue due to that corruption. Al Radi also blamed the corruption on the Iraqi constitution where clause 136 B allows for Cabinet ministers to block investigations.<sup>15</sup> As a result of the corruption and lack of judicial oversight, much of the dollars being spent to Iraq is being siphoned away and not being used for its intended purposes.

One item that might aid in a solution is cultural intelligence. It is a relatively new catch phrase within military channels so little has been written concerning it in relation to Iraq reconstruction. However, in regards to Iraq in general, Lieutenant Colonel George W. Smith, Jr. concluded in his paper that the military needs to focus on the people and their history to better understand how to act in a post-hostilities area. He also concluded that the cultural intelligence preparation of the battlespace will not solve everything, a good balance is needed between it and traditional intelligence in order to counter the

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<sup>13</sup> Revenue Watch Report No. 7, September 2004, <http://www.iraqrevenuewatch.org/reports/092404.pdf> accessed May 2007.

<sup>14</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products, Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf> accessed June 4, 2007.

<sup>15</sup> Bassem Mroue and Qassim Abdul-Zahra, *Iraq Loses \$8 Billion Through Corruption*, April 4, 2007, <http://globalpolicy.igc.org/security/issues/iraq/reconstruct/2007/0404iraqloses.htm> accessed May 2007.

insurgents the United States are facing today.<sup>16</sup> Where traditional intelligence focuses on enemy action and counters to achieve military victory, cultural intelligence is learning about the people, how they live, how they think, etc., in order to understand how actions will be perceived from their perspective vice the American or Western frame of reference. The Rand Corporation published a paper that provided some overarching themes for American action to bridge the cultural intelligence gap and understanding of radical Islam, but did not look at Iraq reconstruction. However, the report did encourage the United States to expand economic opportunities for the youth, work with Moderate Muslim regimes, and to support civil Islam.<sup>17</sup> One important aspect to consider when dealing with Muslim countries and their culture is to look at how their markets have been structured for decades and perhaps centuries. Michael Mousseau addressed this item in his article, *Market Civilization and Its Clash with Terror*, where the clash of civilization occurs when free markets are established in areas where clientalist markets have been the standard for generations. Clientalist markets are built based on trust between people and based on relationships where free markets are based on an implied trust that the government will rectify any contractual misgivings through the judicial branch. Moreover, there is also an implied equality amongst a plaintiff and a defendant in court which is foreign to many Muslims.<sup>18</sup> This paper will attempt to apply these concepts within economic models to provide a possible solution to help win the key center of gravity...the people.

## **1 Major Questions and Argument**

The major question is what is a possible solution to the complex problem of using cultural intelligence to limit corruption, instilling a free market so the United States can help rebuild Iraq while being prudent with the American taxpayer's money? This paper

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<sup>16</sup> George W. Smith Jr., *Avoiding a Napoleonic Ulcer: Bridging the Gap of Cultural Intelligence (Or, Have We Focused on the Wrong Transformation?)*, <http://www.mcu.usmc.mil/mcwar/irp/document/CJCS%20Essay%20-%20Smith.pdf> accessed June 2007.

<sup>17</sup> Angel M. Rabasa et al., *The Muslim World After 9/11*. The Rand Corporation, 2004.

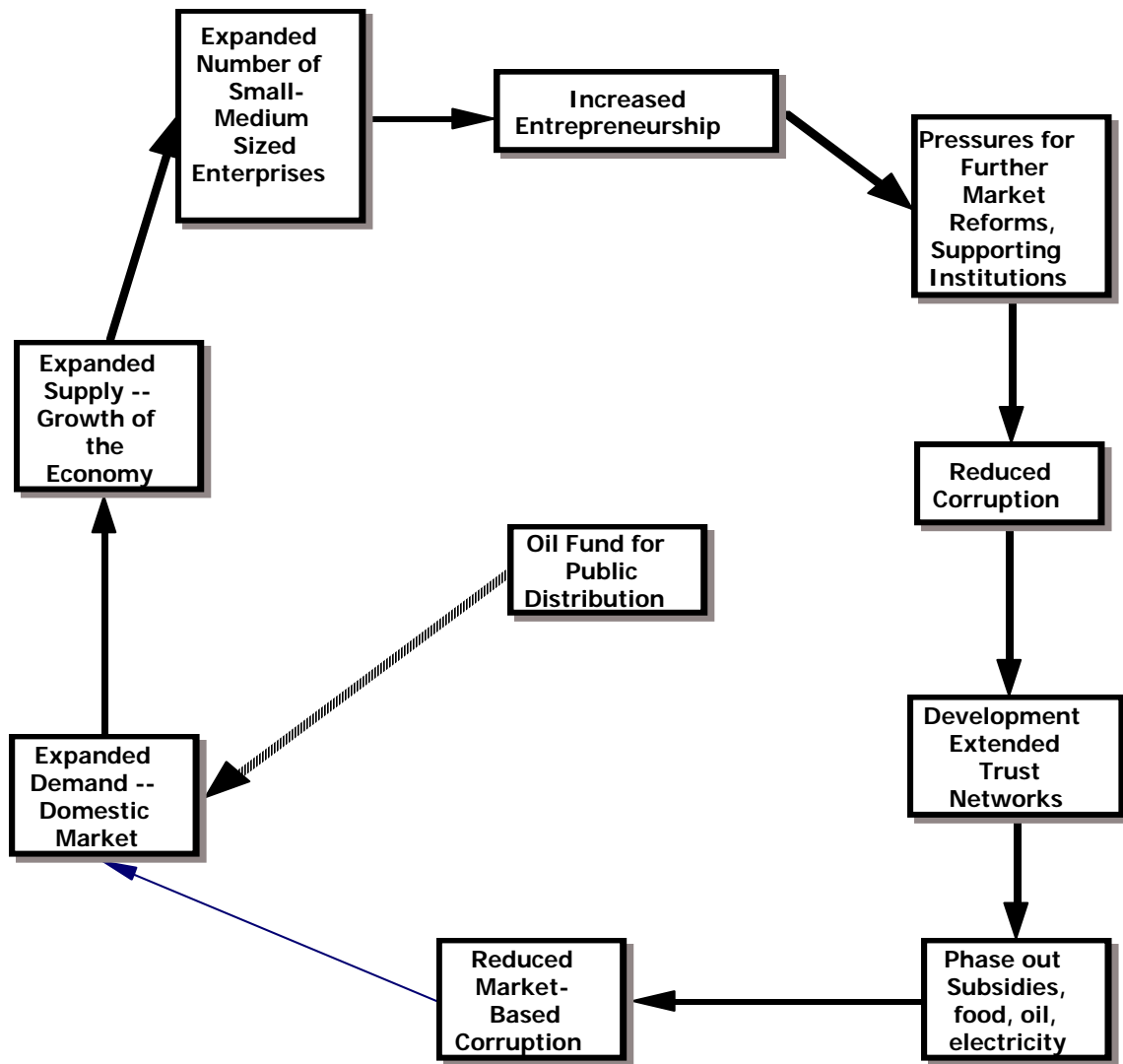
<sup>18</sup> Michael Mousseau, "Market Civilization and Its Clash with Terror," *International Security*, Winter 2002/03.



will argue that the first item to accomplish is to establish security within Iraq to secure its resource making capability...secure oil pipelines and its distribution systems. This includes strictly enforcing all contracts dealing with Iraq's oil making capabilities. In doing so, Iraq should be able to start taking more of the economic load for its reconstruction. Furthermore, the paper will expand on Dr. Robert Looney's article that concludes that an oil fund is needed to expand Iraq's economy which begins the following causal loop diagram (shown below)<sup>24</sup> that will eventually reduce corruption by addressing the cultural intelligence issues that Mousseau pointed out in his article.

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<sup>24</sup> Robert Looney, "Can Iraq Overcome the Oil Curse?" *World Economics*, Vol 7, No. 1. January-March 2006.



**Figure 1. Robert Looney’s Model for How an Oil Fund Can Help Curb Corruption**

The key point will be how to publicly distribute funds in a manner that will instill confidence within the government and persuade the population that democracy is in its best interest. If this can be accomplished, it will also improve the security situation as one requirement for any insurgency to succeed is the ability to blend into society and have safe-houses or sanctuaries in order to operate. Coalition and Iraqi Security Forces cannot be everywhere, but the population can serve as sentries. As a result, this paper will add to Looney’s causal loop diagram to show the connection between economics, cultural intelligence, and security.

The paper will also take a deeper look into why a terrorist or insurgent chooses violence as his tactic to achieve political satisfaction from a psychologist's point of view. It has been widely accepted that a relative deprivation is likely to be a necessary condition for an individual to resort to terrorist activities. The United States should aim to limit this relative deprivation and simultaneously implement Looney's model (with some additions). This can be accomplished by giving money directly to the Iraqis themselves to invigorate the economy just as President Bush did to rejuvenate a stagnant American economy in 2001. Moreover, the United States needs to focus on the same cash cow that is fueling the corruption...the oil pipeline and distribution process. With a high unemployment rate, it is possible to employ personnel as sentries with pay bonuses being tied to keeping pipelines free from corruptive activities. Once the oil pipeline has been secured, then Iraq needs to look to diversify its economic portfolio through free market enterprise that be accomplished with an aggressive government incentive program for small business creation.

#### **D. METHODOLOGY**

This paper will primarily use a case-study methodology. The situations and findings greatly vary between Iraqi and American corruption as well as established avenues of recourse against perpetrators. As a result, this paper will study each country's corruption independently as well as provide conclusions in regards to how to deal with the corruption. In addition, this analysis will provide a possible avenue for both countries to lead that will reduce corruption and help the Iraqi democracy.

The sources used for this analysis will mostly consist of articles from independent agencies, Congressional reports, and reports from the SIGIR. In addition, due to the media's widespread coverage of the war in Iraq, newspaper articles will also be used in order to show the different types of economic corruption that may include embezzlement, fraud, waste, abuse, theft of funds, etc.

This paper will first summarize the various estimates the war in Iraq is costing as calculated by leading economists as well as the government's estimates in the following chapter. In addition to the summary, some analysis is provided where the argument may be flawed. Once one understands the overall estimate of the war long term (economist

estimates range in duration but most include occupation in some manner through 2015), one can put into context the amount of corruption that is on going. Chapter III will articulate the various types of corruption that is being conducted by Iraqis while Chapter IV will present those corrupt actions performed by Americans, both independently and in conjunction with Iraqis. It should be noted that it is impossible to know all of the corruption that is on going as investigations are consistently on going. Moreover, no matter how transparent an organization or process is, some form of corruption is always present. Chapter V will show how including cultural intelligence into Looney's oil fund model could enhance the possibilities of American success and improve the United States ability to improve the population's quality of life.

## II. SUMMARY AND ANALYSIS OF THE COST OF THE WAR

Prior to looking at the corruption that is present within the reconstruction effort, one must look at the overall cost of the war in order to achieve a baseline in order to comprehend the magnitude of America's investment and effects of the corruption that is siphoning money away from the effort. By showing the estimates chronologically, one can see how the estimates have matured by taking more items in account, indicating that future, more detailed estimates could be, and most likely will be made as long as the United States has troops in Iraq. It should be noted that the overall cost of the war is an unknown as it is on-going and the United States could pull out of Iraq in the very near future or American forces could be present in Iraq for a considerable time period. If one is looking at precedent, both are possible scenarios as Americans are still stationed in Japan, Korea, and Germany, and have been for the past 50 to 60 years. In contrast, the American withdrawal from Vietnam was done quickly and without future presence. Hence, this chapter will chronologically review the works of the leading economist's analysis of the war and the estimates of how much the war will cost the American taxpayer. It will also provide some analysis that will show some issues that may be present with their work. In addition, it should be noted that this overall work is looking at corruption tied to Iraqi Reconstruction, but this baseline also incorporates Afghanistan as it is difficult to determine how much money is going to which theater. In some cases it is distinguishable, but in most cases it is not.

The first scholar to address the situation was William D. Nordhaus who looked at the history of cost estimates prior to going to war and analyzed the potential overall economic impact to the United States economy before the decision to invade Iraq was made.<sup>19</sup> Despite William Nordhaus' self-proclamation that his estimates were flawed, his early analysis of the economic impact is surprisingly accurate in hindsight.<sup>20</sup> Nordhaus first analyzed the Iraq's oil production capabilities, explaining the strategic importance of

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<sup>19</sup> William D. Nordhaus, *The Economic Consequences of a War With Iraq*, October 29, 2002, <http://www.econ.yale.edu/~nordhaus/iraq.pdf> accessed February 2007.

<sup>20</sup> Ibid. The entire section covering Nordhaus work is taken from this paper.

Iraq's oil in the world economy and to the United States. Nordhaus stated that Iraq has roughly 10 percent of the world's known oil reserves that could satisfy the current United States import requirement for almost 100 years.<sup>21</sup> Drawing upon George L. Perry's 2001 work on an oil disruption on the United States economy, Nordhaus concluded that Perry was accurate in his estimates that an oil disruption could have a huge impact to domestic oil prices and change in real gross domestic product. Perry provided three case scenarios where crude oil prices ranged from 32 to 161 dollars per barrel. In his worse case scenario, Perry concluded that at 75 dollars per barrel, the average cost per gallon of gas would be 2.78 dollars, representing a 2.7 percent decrease in real gross domestic product, corresponding to 282 billion dollars. Perry also assumed there would be widespread inflation that would trigger a recession. While Perry's worst-case scenario has come to fruition in terms of oil prices and the corresponding price of gasoline, the corresponding recession has not occurred.

Nordhaus reviewed two government studies projecting the estimated costs of war in Iraq, and concluded their estimates were deficient as they did include costs for occupation, peacekeeping, democratization, nation building, post-occupation humanitarian assistance, oil supply impact, macroeconomic effects, and budgetary impacts. After broadly analyzing these areas, Nordhaus concluded that the economic costs could range between 121 billion and 1.6 trillion depending on occupation duration, etc. The 1.6 trillion dollar figure included a lengthy occupation, expensive nation building, and resistance of United States occupation...all of which have come to reality. What appeared to be unreasonable at the time has proven to be extremely accurate especially when it is compared to Joseph Stiglitz and Linda Bilmes' more recent analysis that will be reviewed later in this chapter.

Following the initial major conflict and witnessing a sharp spike in oil prices, Warrick McKibbin and Andrew Stoeckel analyzed the effects of oil prices on the global economy as increased oil prices indirectly raise the price of the war.<sup>22</sup> They challenged

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<sup>21</sup> William D. Nordhaus, *The Economic Consequences of a War With Iraq*, October 29, 2002, <http://www.econ.yale.edu/~nordhaus/iraq.pdf> accessed February 2007.

<sup>22</sup> Warwick McKibbin and Andrew Stoeckel, *Oil Price Scenarios and the Global Economy*, 2004 [http://www.economicsscenarios.com/pdfredir\\_sample.asp?issueNo=9](http://www.economicsscenarios.com/pdfredir_sample.asp?issueNo=9) accessed March 2007. This portion of my paper comes from this work.

the finding of the International Energy Agency that a rise in oil prices would lead to increased unemployment and a deterioration of the oil importing countries' trade balance. While they compared a permanent versus temporary oil spike, this chapter will only address the permanent effects of the United States (and not China and Japan as it is not pertinent to this analysis) as their temporary spike of 2 years has now proven to be irrelevant. They concluded that demand for oil (and hence imports) would decrease as the global economy slows down. Further, United States exports would decline, but not to the magnitude of imports, indicating an improvement in the United States trade account. In addition, the increased price for oil forces substitution that spurns growth in other areas. Long term, consumption will remain low, but the country will diversify and eventually have gross domestic product growth long term. If one believes this argument, this would imply that OPEC would not want to raise oil prices too high as oil-importing countries will look for alternative energy sources. Oil exporting countries would lose money in the long term as demand will reduce creating a new equilibrium at a lower price. The United States is a classic example of this situation as President Bush has called for Americans to reduce their dependency on oil. This will decrease demand and should force oil prices down.

Expanding on the effects of the war on oil prices, Coilin Nunan challenged the economic prowess of the United States as not being as stable as most think. Furthermore, the Iraq War may exacerbate the problem. It is obvious today that the dollar is the world's currency. Foreign investors flock to buy the dollar as a stable investment as well as foreign governments purchase dollars in an effort to stabilize their own currencies. As a result, the United States can run huge trade deficits as foreigners purchase dollars in exchange for goods. It is almost a no interest loan and can only take place in a dollar-dominated hegemonic world. However, as Nunan articulated in his article that the European euro could challenge the United States for its hegemonic status that would bring the United States to an economic crisis.<sup>23</sup> His argument is based on the fact that oil is only sold in dollars and oil is required by all major industrialized countries to operate.

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<sup>23</sup> Coilin Nunan, *Oil, Currency, and the War in Iraq*, November, 2004  
<http://www.feasta.org/documents/papers/oil1.htm> accessed February 2007.

For example, let us assume that Great Britain wants to buy oil from any oil-producing country belonging to OPEC. Great Britain must first purchase dollars (or provide goods) and then make the oil purchase. The United States could print more dollars to give to Great Britain in exchange for goods. Nunan explored the consequences if OPEC changed its procedures and required euros as the only currency that could purchase oil. Now, the United States would have to purchase euros (by exporting goods rather than importing) in order to purchase oil. The United States economy would be turned upside down as it would have to begin trading at a trade surplus vice a trade deficit in order to prevent collapse. So how does the Iraq War affect this phenomenon?

Politically, the United States has alienated itself with many of the OPEC countries...Iran, Saudi Arabia, Syria and Venezuela are countries that do not look favorably on the United States. If these countries led a campaign to change OPEC's currency to euros, it could potentially devastate the United States economy. The United States is the largest consumer of oil and would either have to get oil from elsewhere (Alaska) or it would have to begin turning a trade surplus in order to start purchasing euros. Or it must have an oil producing nation that is friendly to the United States that will continue to sell its oil in dollars should OPEC move to euros...Iraq. Referring back to Nordhaus assessment of Iraq's oil producing capabilities, an allied Iraq would provide the United States a trading partner that could supply oil in dollars. The United States would not have to concern itself with enemies aligning to devastate the American economy. It begs the question if the war in Iraq was completely about oil and preserving the United States economy. While it is out of the scope of this paper, it is one to ponder. More importantly, Nunan's analysis shows the delicacy of the American economy and the absolute need for the United States to succeed in Iraq in order to ensure its global power.

Scott Wallsten and Katrina Kosec estimated the net present value of the Iraq War through 2015, attempting to calculate the total cost to the United States and Iraq (for the



purposes of this chapter, the cost to the United States will only be covered).<sup>24</sup> They were also the first to address the controversial issue of assigning a monetary figure to the loss of a life as well as the opportunity cost lost when mobilizing the National Guard and Reserves. Furthermore, they included the cost savings of the Iraq War as the United States no longer had to enforce the United Nations-mandated no-fly zones in northern and southern Iraq. (This work was originally completed by Davis, et al in 2003, which they updated in 2006 and is included later in this chapter.)

Wallsten and Kosec first analyzed the military and government expenditures to include transportation of moving troops, military hardware, combat pay, reconstruction, training and equipping Iraqi forces, and support for Coalition allies. Appropriately, Wallsten and Kosec did not calculate active duty normal pay as a cost as they are paid regardless nor do they include the economic effects of raising or lowering taxes or interest costs on any borrowed money...this is a financial decision on how to pay for the war, not an economic effect. However, they did include combat pay and the opportunity cost of mobilizing the National Guard and Reserve.

While it is conceded that there is an opportunity cost, it was a decision made over a decade previously and not one directly attributed to the Iraq War. When the United States military reduced its force structure in the 1990s, it adopted a Total Force Concept that increased the National Guard and Reserve responsibilities. This allowed for a smaller peacetime force (and less expensive), yet would allow the flexibility to be responsive to the nation's needs. Had the United States not decreased its active duty force in the early 1990s, the amount of National Guard and Reserve mobilizations would have been much less.

In order to calculate the value of the lives lost in the Iraqi War, Wallsten and Kosec looked at the Viscusi and Aldy work in 2003 that found the normal range is between 4 and 9 million dollars for a civilian life as most studies do not include military members due to their profession and propensity to engage in hostile activity (activities

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<sup>24</sup> Scott Wallsten and Katrina Kosec, *The Economic Costs of the War in Iraq*, September, 2005 <http://www.aei-brookings.org/admin/authorpdfs/page.php?id=1188> accessed March 2007. My overview of their analysis comes directly from this work. Any of my ideas or critique should be able to be identified through the written context.

and risks that are known prior to volunteering) is higher than a civilian. Wallsten and Kosec merely took the average of 6.5 million dollars per lost life. While this method seems rudimentary, Wallsten and Kosec attempted to determine the value of a military life. Their conclusions yielded a 6.1 million dollar per military member loss, but determined their calculations to be incomplete. However, due to its proximity to the 6.5 million dollar average that Viscusi and Aldy determined, Wallsten and Kosec felt comfortable using the 2003 figure. This 6.5 million dollar is key to their research as they continue to use this figure when determining the economic cost to the United States of the wounded by using a fractional amount of the fatal injury as charted below.

Type of injury	Coefficient to be multiplied by 6.5 million dollars
Fatal	1
Critical	.76
Severe	.19
Serious	.058
Moderate	.016
Minor	.002

**Table 1. Costs Associated to Injuries**

Hence, the maximum injury (death) will be calculated as an economic loss of 6.5 million dollars and as the injury is reduced in severity, the less economic loss is factored into the overall calculation. As a result of combining the cost of military operations, fatalities, wounded troops, and opportunity costs of National Guard and Reserve mobilizations, Wallsten and Kosec calculated that through August, 2005, the war had cost roughly 255 billion dollars. Under the assumptions that the death and injury rates would remain constant, a five percent discount rate, and the Congressional Budget Office's estimates for troop strength, the total net present value for the Iraq War for the United States calculated by Wallsten and Kosec was 603 billion dollars. Subtracting the cost savings of not enforcing the no-fly zones (calculated by Davis, et al in 2003 and using a five percent

discount rate from 2003 through 2015) of estimated at a net present value of 117 billion dollars results in an overall cost of going to war as roughly 586 billion dollars. Wallsten and Kosec noted in their conclusions that they failed to account for the macroeconomic effects and the notable spike in oil prices which Stiglitz and Bilmes addressed in their 2006 analysis.

Joseph Stiglitz and Linda Bilmes have been staunch critics of the effects the war on the United States economy, providing an in-depth analysis of the economic costs, building on the work of Wallsten and Kosec. Stiglitz is a Nobel Prize winning economist who also worked in the Clinton Administration. In their paper, *The Economic Costs of the Iraq War: An Appraisal Three Years After the Beginning of the Conflict*, they separated their analysis into three parts...the budgetary costs, economic costs and macroeconomic effects.

While analyzing the budgetary costs of the war they provided a conservative and moderate estimate that is provided as follows

	Conservative	Moderate
Spent to date	251	251
Future Spending on Operations	200	271
VA Costs	40	57
Cost for Brain Injuries	14	35
Veterans disability payments	37	122
Demobilization Costs	6	8
Increased defense spending	104	139
Interest on debt	98	386
Total	750	1,269

**Table 2. Budgetary Cost of the Iraq War (\$BN)**

Of course there are many assumptions that are made to derive each prediction aside from the spent to date that was taken from the Congressional Budget Office Report from February of 2005. We know this number will have ballooned to more than 600 billion

dollars after FY2007 has elapsed. (In the CBO testimony of Robert A. Sunshine, Assistant Director for Budget Analysis, *Estimated Costs of U.S. Operations in Iraq and Afghanistan and Other Activities Related to the War on Terrorism*, dated July 31, 2007, the FY2007 defense appropriations bill put the total cost spent to date at 604 billion dollars including diplomatic operations and the most recent troop surge.)<sup>25</sup>

The first assumption that is problematic is in the first block of Spent to Date...the inclusion of payments to Pakistan, Jordan, and Turkey as a cost to the war. Let's assume that the war had not occurred and the United States made those payments for purely diplomatic reasons in order to establish good will. Would that have been a cost to war? However, because the payments occurred simultaneously, Stiglitz and Bilmes included the payments in their assessment. As an example, let us look back at the North Korea situation in the early 1990s. The Clinton Administration provided more than 4 billion dollars in aid and energy relief to North Korea under the Agreed Framework agreement in order for North Korea to halt its nuclear ambitions. It was not tied to the United States Forces Korea budget nor was it attributed to a war. It was money spent establishing good will (and to prohibit nuclear proliferation). By providing money to Pakistan, Jordan, and Turkey, it has not only aided the United States military and the War on Terror, but in multiple other ways that may continue long after the United States withdrawal of troops from Iraq. For example, economic assistance to Turkey as they attempt to gain admittance to the European Union can only help United States-Turkey relations especially in regards to trade and globalization efforts, not to mention militarily as a strategic American ally. It is conceded that Pakistan and Jordan future alliance with the United States is unpredictable and the United States is hopeful that investment is not wasted as the funds for North Korea were in hindsight.

Under Future Spending on Operations, the difference between the two figures is in the conservative model, it is assumed that all troops will leave Iraq by 2010 and the moderate model has a small troop presence until 2015. It is my opinion that both of these assumptions are inaccurate. Furthermore, it is also wrong to necessarily tie long-term

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<sup>25</sup> CBO Testimony of Robert A. Sunshine, Assistant Director for Budget Analysis, before the Committee on the Budget U.S. House of Representatives, July 31, 2007.

future troop levels to the Iraq War. Looking back to World War II, the United States has kept open military bases in Germany, Japan, England, Portugal, and many other countries to ensure our security as a nation. The United States also has had thousands of troops on the Korean Peninsula since the Korean War in the early 1950s. In fact, in late May, 2007, President Bush stated he would like to see a similar presence in Iraq as the one that has remained in South Korea as the country developed its democracy.<sup>26</sup> While it is conceded that many bases were opened to counter the former Soviet Union, many have been closed since the Cold War's end. The remaining bases have remained as a strategic presence to maintain the United States and our allies' security. Is the budget of Osan Air Base, Republic of Korea still being tied to the Korean War or the budget of the large military presence (all four services) on Okinawa to World War II? No, it is eventually wrapped into the Department of Defense's normal budget. The amount of American or Coalition presence required in Iraq in the future is unknown, but both estimates provided in the paper are probably inaccurate as the United States will most likely have a military presence in some capacity for some time if history repeats itself.

Under Increased Defense Spending there is an underlying assumption that must be addressed...the Department of Defense was being appropriately budgeted prior to the war. In fact, the loss of intelligence, especially human intelligence, can be directly connected to the military force reduction after Persian Gulf War I. That loss of intelligence contributed to the ability of Al-Qaeda to attack the United States on September 11, 2001 and the eventual lack of evidence that originally warranted the attack of Iraq in March, 2003. Hence, it can be argued that the intelligence community has been undermanned and under-budgeted for years.

The paper also addressed "military" recruiting shortfalls as a problem and that sign up bonuses, higher pay and benefits, and advertising have been required. This is somewhat accurate, but not completely. Higher pay and benefits for military personnel has been needed for some time...enlisted troops in the Air Force have been (and some still are) on food stamps which is a key indicator that the pay was substandard and needed

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<sup>26</sup> Steve Holland, "Bush Envisions U.S. Presence in Iraq like S. Korea," May 30, 2007, Reuters, <http://www.reuters.com/article/politicsNews/idUSN3041621320070530?pageNumber=1> accessed November 2007.

to be fixed. The series of pay increases brought forth by the Bush Administration has aided the situation, but not completely. Furthermore, the Pararescue and Combat Controller career field was awarded extremely high bonuses for recruits that were able to complete the rigorous training and pilots also received large bonuses throughout the 1990s for retention purposes. Finally, the Air Force is currently attempting to reduce its forces and is forced to “fire” officers as they have not taken bonuses to leave voluntarily. The military has often offered high bonuses to keep tough-to-fill specialties and those careers with extensive training in the military. What is different today is that the Army is having difficulty achieving recruiting goals for ordinary infantry. However, it is important to remember that during the Vietnam War, the country resorted to a draft in order to fill the needs of the military. This has not happened, nor does it appear that will in the near future. The cost of drafting, training, feeding, etc. of men (and possibly women) would be extremely costly in comparison.

In regards to the National Guard and Reserves recruitment, the data is incomplete as many members of the regular Armed Forces choose to sign up with the Reserves or National Guard after leaving active duty status. In addition, with deployments in the Reserves and the National Guard equaling those of active duty, the incentive to leave active duty is not there, which has long allowed the National Guard and Reserves to easily meet or exceed its recruiting goals. However, the repercussions of more recruiters and more money spent in advertising are correct.

Finally, interest costs should not be tied to the war. As stated previously, interest costs are a financing decision, not an economic decision. How the Administration pays for a war is different than an economic cost. Had the Bush Administration raised taxes to fund the war, the interest costs would not have occurred.

The second part of the Stiglitz/Bilmes paper addressed costs of the war to the United States economy in terms of the opportunity costs lost of those members of the military who either lost their life or have been seriously wounded, citing and using Wallsten and Kosec’s work in terms of valuing the loss of life and the economic effects of the wounded troops’ ability to contribute to the economic growth of the United States.

The next comment from the second portion of the Stiglitz/Bilmes paper is in regards to their assessment of contractor fatalities. While they acknowledge that the some may argue that the wages of contractor personnel working in Iraq include a risk premium, I find it naïve to argue that there is not a risk premium included. Whether it is an electric grid specialist or a security guard, the pay must have been high to attract contractors to the job. For example, if one could be a security specialist in the United States and make the same money as a security specialist working in Iraq, why would any rational human choose Iraq? It is conceded that some may choose it out of patriotism, but the compensation would still have to be considerably higher.

Stiglitz and Bilmes also addressed the accelerated depreciation of military hardware. It is not contested that military hardware is consumed at a faster rate during combat than during peacetime. However, there are some items that should be addressed. For example, many units deployed with the M16A2 rifle that is in the process of being replaced by the M4. The wear and tear on the M16A2 is irrelevant as its replacement had been in the procurement cycle for years. Furthermore, there are many aircraft that are going through similar situations such as the F-15C being replaced by the F-22 and the Air Force's HH-60 helicopter fleet is in the process of being replaced. Moreover, those items that have been destroyed or no longer mission capable can be replaced by better, state-of-the-art equipment. This is an opportunity for the military to enhance its future combat capabilities as the marginal cost of purchasing a better replacement today will be less expensive than having to completely replace an entire inventory later.

The final portion of the Stiglitz and Bilmes paper analyzed the macroeconomic effect of the Iraq War. They conclude that the war has produced a less secure United States than before the invasion/occupation. This conclusion is problematic as there have not been any terrorist attacks on the United States since September 11, 2001, indicating the opposite is true. Their conclusions are based on the terrorist and insurgent activity located within Iraq. It can be argued that if the terrorists are fighting in Iraq, they are not planning an attack on American soil...hence, the United States is more secure. Some of the United States' policies were questioned by Stiglitz and Bilmes. For example, many of the 9-11 hijackers came to the United States on student visas. As a result harsher

stances on immigration and student visas have been implemented to ensure a repeat situation does not occur...this seems both logical and rational. With it does come an economic effect that limits the United States ability to harness foreign students ideas in science and technology. Many foreign students stay in the United States and make huge contributions to the economy. This loss is a direct result of increased security and its economic impact cannot be measured accurately.

Appropriately, Stiglitz and Bilmes show that the Iraq War can be blamed for the spike in oil prices. The futures markets prior to the Iraq War showed that oil prices would remain stable between 20 and 30 dollars per barrel. Assuming an efficient market, the price of futures takes into account all information that is known. As a result, the increased price of oil can be attributed to the Iraq War. In addition, there are some repercussions from the increased oil prices that can also be tied to the war. As a result of a large spike in oil prices, inflationary pressure is put on the economy, causing higher interest rates that can slow an economy...a monetarist view. However, those looking for a fiscal policy reaction did not receive one from the Bush Administration as taxes were cut and spending increased. Stiglitz and Blimes used a standard macro-economic “oil multiplier” of 1.5 for its conservative estimate of the war and a multiplier of 2 for its moderate estimate. (The paper did address the possibility that the multiplier should be much higher as assumed by the International Monetary Fund.) The multiplier is used to determine the loss in gross domestic product due to the increase in oil prices.

As a result of their analysis, Stiglitz and Bilmes estimate the total cost of the Iraq War as follows

Scenario	Budgetary Cost (Inc interest)	Cost with Economic Adjustments	Total Cost with Macroeconomic cost
Conservative	750	839	1026
Moderate	1269	1189	2239

**Table 3. Total Cost of the Iraq War (BN)**



The first column is directly from the previous table in this paper while the second column includes the costs to the United States economy that were documented in the second part of the Stiglitz/Bilmes paper and the final column includes the macroeconomic effects of the enhanced security and a rise in oil prices. Stiglitz and Bilmes concluded the projected cost of the war (with their assumptions) is between 1 and 2.2 trillion dollars. The final cost also incorporated the opportunity cost of the dollars that have already been spent had those dollars been invested into the United States economy, reaping a return on the investment. While I disagree with some of the assumptions made by Stiglitz and Bilmes (and in some cases they have underestimated), the most interesting item to note is Nordhaus's predicted upper bound was roughly 1.6 trillion dollars that falls squarely in line with Stiglitz and Bilmes analysis performed after three years of conflict and three years of data.

In contrast, Steven Davis, Kevin Murphy, and Robert Topel address the economic costs of the Iraq War from the prospective of the decision makers in 2003 vice the "Monday morning quarterback" perspective of Stiglitz and Bilmes. In addition, Davis et al compared the economic cost of the war to its alternative, containment.<sup>27</sup> Although indirectly, Davis et al addressed Stiglitz and Bilmes work in following manner. "The high cost of the Iraq intervention is sometimes seen as a compelling argument against the decision to forcibly overthrow the ruling order and install a new regime. This argument is deficient because it ignores the costs of alternative responses to the national security and humanitarian concerns presented by the pre-war Iraqi regime."<sup>28</sup> In order to show the costs of the alternative solution of containment, Davis et al proceed through six sections in their analysis that shall be briefly outlined.<sup>29</sup>

The baseline for the Davis et al argument stems from the testimony of General Tommy Franks who articulated the military force structure in place to enforce the United Nations-sanctioned no-fly zones. It should be noted that as the Central Command

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<sup>27</sup> Steven J. Davis, Kevin M. Murphy, and Robert H. Topel, *War in Iraq Versus Containment*, March, 2006, <http://www.nber.org/papers/w12092> accessed March 2007.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid. As I summarize their argument, the ideas and construct are those of Davis et al. If there is analysis on my part, the context should make it clear.

(CENTCOM) Commander, General Franks' authority included the execution of the southern no-fly zone, but the northern no-fly zone execution was performed under the command of the European Command (EUCOM) Commander. General Franks offered the following statement, "At any given time, some 30 naval vessels, 175 military aircraft, and between 17,000-25,000 soldiers, sailors, airmen, and Marines are in the CENTCOM AOR."<sup>30</sup> To account for EUCOM's aircraft assets devoted to the northern no-fly zone, Davis et al use 200 aircraft in their analysis. In addition, Davis et al further pinpointed the exact troop levels through the 2001 budget request that indicated a force-strength of 28,164 troops enforcing the no-fly zones.<sup>31</sup>

Davis et al calculated the personnel resources needed to enforce the containment policy by taking the 28,164 personnel and using the 226,000 dollars per person annually that the Congressional Budget Office calculated in 2002 by using data from the Bosnia-Kosovo experience in the 1990s. Despite showing the number to be conservative (especially now acknowledging the violence of Iraq in comparison to the post-war occupation in Bosnia and Kosovo), Davis et al determine the personnel costs at 6.4 million dollars per year. They then determine capital costs to be roughly 4.7 billion dollars per year and munitions expenditures to be .2 billion dollars for a total cost of 11.3 billion dollars. They perform a separate calculation under a simpler methodology concluding the total containment costs at 17.8 billion dollars per year. Since neither calculation appeared more accurate than the other, Davis et al used the simple average of 14.5 billion dollars per year as the baseline cost of containing Iraq under the auspices of the United Nations sanctions.

Accordingly, Davis et al provided a series of scenarios and probabilities of those scenarios as a method to calculate the costs of invading Iraq similar to how a decision maker would analyze the situation prior to committing forces ranging from very favorable outcomes to a drastic situation where after a long and costly occupation, a regime similar to the Hussein takes control of Iraq and the United States must resume its pre-war containment policy. In order to determine which strategy is preferable between

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<sup>30</sup> Testimony of General Tommy Franks to the U.S. Senate Committee on the Armed Services (2000).

<sup>31</sup> Steven J. Davis, Kevin M. Murphy, and Robert H. Topel, *War in Iraq Versus Containment*, March, 2006, <http://www.nber.org/papers/w12092> accessed March 2007.

war and containment, a valuation was performed by Davis et al with the following assumptions...war and containment are alternative cost investments that each produce a flow of future cash flows or benefits that have an economic value, both containment and war are equally effective of dealing with the crisis, and that at least one strategy has a positive net present value. Hence, Davis et al computed a net present value cost comparison to determine the optimum strategy. Their computations show the containment policy to cost between 297 and 400 billion dollars and the war option cost to range between 106 and 897 billion dollars. Therefore, with the underlying assumptions outlined earlier, the containment policy would be the best economic option.

Davis et al then explored the concept that containment does not perform the mission to an acceptable manner. In fact, several times between the two Iraq Wars, the United States was forced to provide evidence of a credible military threat in order achieve Iraq compliance with the United Nations sanctions. The authors point to Operation Desert Fox that involved more than 40,000 American troops, 300 aircraft, and 40 ships that still did not force Iraq into compliance as a specific example. A continued containment policy strategy would also have to account for repeated spikes in troop strength and small operations to ensure Iraqi compliance. Depending on the probability used in their equations of a required “show of force” (highly subjective based on the intelligence provided to a decision maker at the time), the cost of containment can quickly equate to the cost of war. In addition, Davis et al also engaged the possibility of fighting a limited war such as the Kuwaiti liberation in the early 1990s, if Hussein began slaughtering his own people as he had done in the past, or to deter or halt Hussein from manufacturing a nuclear weapon. Once again, adding in these uncertainties increased the price of containment in comparison to the cost of war.

Davis et al went on to address the possibility of pursuing containment and having to go to war at a later date. The underlying assumption is that a future war would be more expensive than a war fought today. They showed three scenarios where the cost of containment and then pursuing war is more expensive than an immediate regime change through the use of force. However, an unknown piece of this puzzle is international economic aid. I offer the possibility that many countries may help pay for a later war if

Hussein's resistance continued. While it is impossible to determine the actions of others in a political forum, it is a possibility that should be considered. It should be noted that Davis et al did not refute Stiglitz and Bilmes conclusions and price tag, only the alternatives may have been just as or more expensive.

Now that all of the major arguments have been briefly summarized, it is important to put the preceding argument into context. Two trillion dollars is a lot of money and the opportunity costs of using that money elsewhere is huge...what would 2 trillion dollars do for the United States education system, cancer research, or enhancing America's image by tackling world hunger? Furthermore, in an interview with Spiegel Online, Joseph Stiglitz even stated the United States can afford the war even at its 2 trillion dollar price tag, that is not the issue with him. His issue is that 2 trillion dollars is not being spent elsewhere such as education, foreign aid, etc. which could do more for peace and security vice a war.<sup>32</sup> According to Jerome Idaszak of Kiplinger, the 2007 budget for the war on terror is roughly 145 billion dollars, representing about 5 percent of the budget. This percentage pales in comparison to the 18 percent of the 1960's budget that went to pay for the Vietnam War and that does not include the massive expense of training and developing a military with draftees vice an all volunteer force. In addition, the 2007 defense budget of 607 billion dollars is about 20 percent of the total budget compared to almost 50 percent of the budget during the Vietnam era or more than 25 percent of the 1980's budget when the United States built up America's defense and defeated the former Soviet Union in the Cold War.<sup>33</sup> However, Idaszak does not take supplemental budget requests or bridge funding into account as the Congressional Budget Office and Stiglitz and Bilmes included, but even if they doubled the initial budget for war and approached 10 percent of the budget, it still would be drastically less percentage wise than the United States has spent on previous wars.

In light of the arguments presented above and the media's consistent targeting of the United States trade deficit as an American weakness, it is prudent to discuss the trade

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<sup>32</sup> Joseph Stiglitz, <http://www.spiegel.de/international/spiegel/0,1518409710,00.html> accessed March 2007.

<sup>33</sup> Jerome Idaszak. *War's Budget Bite Not as Big as It Used to Be*, <http://proquest.umi.com/pqdweb?> accessed February 2007.

deficit, its effects, and if the Iraq War has had any adverse effect. An analysis of the United States trade deficit by Deutsche Bank Research in late 2004 found the exact opposite...the ability of the United States to run trade deficits over an extended period is a sign of economic strength rather than weakness.<sup>34</sup> Their argument separated the external deficits into cyclical and structural. Cyclically, the United States is the only major industrial nation that still has population growth. Population growth leads to increased demand for goods and services that further increases demand for imports. In addition, the production growth of the United States is not duplicated anywhere in the world as the United States has led the technological revolution. The result is the United States economy has better growth potential than other countries. If other nations' growth catches or exceeds the United States' potential, those countries should import more American goods, decreasing the American trade deficit. However, the Deutsche Bank Research paper clearly stated that an American trade surplus is out of the question in the near term.

The structural deficits are also a reason for the trade imbalance. The United States income elasticity of imports is much higher than the foreign markets elasticity for American exports. This phenomenon is created by the ease of the United States free markets where imports can be easily accessed and sold at a competitive price. In fact, in some instances, foreign goods have such a competitive advantage that American corporations have stopped production of certain goods. American goods do not have the same capabilities in foreign markets.

So how does the United States finance such deficits repeatedly? It is due to the attractiveness of the United States markets in comparison to others. Foreign investors choose to invest their money in the United States markets rather than elsewhere. The United States has the ability to print more dollars and invest it overseas. The difference is that foreign investors basically provide their money at no cost to the United States where the United States makes money on their foreign investment. In fact, the paper articulated that this virtually no cost liability accounts for nearly 70 percent of the United

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<sup>34</sup> Deutsche Bank Research, Current Issues, October 1, 2004. [www.dbresearch.com](http://www.dbresearch.com) accessed November 2007. The argument presented in this paper is a summary of their analysis.

States debt. To put this into context, if someone could get a no-cost loan from a bank and invest it in the stock market making 13 percent (average return in the stock market is roughly 13 percent since 1929), he would be ignorant not to explore such a situation. The United States is basically doing the same thing on a grand scale.

So what effect does the trade deficit have to do with the Iraq War? While many countries have been outspoken against the American occupation, not one to my knowledge has boycotted American goods or not provided imports into the United States economy. The American domination on the global market and dollar hegemony has continued despite many countries distaste with the Iraq War. The question becomes what if the world gangs up on the United States and boycotts American exports and refuses to import their goods and services? Furthermore what if members of OPEC convert to the euro as Nunan hypothesized? It would likely be economic disaster for the United States, but it would also be economic disasters for many other countries that rely on the United States markets. As far as oil imports, such a scenario only emphasizes the need for the United States to succeed in Iraq to ensure an oil-exporting ally to enhance American security.

Now that the research has been presented, it is wise to summarize the latest estimates from the Congressional Budget Office.<sup>35</sup> The latest estimates by the Congressional Budget Office provide the estimated cost under two scenarios. The first scenario assumes that the United States will draw down its troop strength to 30,000 by 2010 and remain until at least 2017. Under those assumptions, the projected total cost is roughly 1.2 trillion dollars on the high end. Under the second scenario, the number troops is reduced to 75,000 by 2013 and then stabilized until 2017 which garners a total price tag of a little over 1.6 trillion dollars. Both projections include military operations, the training of indigenous security forces, diplomatic operations, and the cost of the medical care to returning troops that have been injured as a result of war. Neither estimate includes the latest initiative to increase the overall size of the Army and Marine

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<sup>35</sup> CBO Testimony of Robert A. Sunshine, Assistant Director for Budget Analysis, before the Committee on the Budget U.S. House of Representatives, July 31, 2007. This section of the chapter comes from this entirely.

Corps. Of course, the estimates would be much smaller if Congress no longer continues to fund the war, forcing an immediate withdrawal of troops.

The fact that the United States has extrapolated the costs out, figured the cost is roughly between 1.2 and 1.6 trillion dollars or more depending on which studies one believes to be most accurate, and is willing to pay that price is remarkable. Even more so, the American economic commitment is so substantial that it is crucial that the United States win the war in order to reap the return on investment of a free, democratic Iraq.

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### III. ECONOMIC CORRUPTION BY IRAQIS

Shortly after the United States invaded and quickly defeated Iraq in 2003, President George W. Bush stated in his Message to the Iraqi People, given April 10, 2003, “the regime of Saddam Hussein is being removed from power...and we will not stop until Saddam’s corrupt gang is gone...You deserve better than tyranny and corruption and torture chambers.”<sup>36</sup> According to the 2006 Transparency Corruption Perceptions Index, it does not appear that the United States is succeeding in ridding Iraq of corruption. Of the 163 countries the index rated, Iraq was less corrupt than only one other, Haiti.<sup>37</sup> While the United States has worked diligently to mitigate corruption with the creation of the Special Inspector General for Iraqi Reconstruction (SIGIR) as well establishing the need for transparency reports from the various cabinet ministers, it has obviously not met the President’s goal of transforming Iraq. “Iraq is a tribal society where the elite—maintaining decades-old practices—support and promote their own. That was true under Saddam. It is still true today.”<sup>38</sup> In order to find a possible solution set, one must not only analyze the existing corruption, but also look at Iraq’s economic and political history. This chapter will first review the history of corruption within Iraq, then review the existing corruption, concentrating on the oil sector as it accounts for nearly 70 percent of Iraq’s gross domestic product and more than 95 percent of the its government revenues.<sup>39</sup>

While many believe Iraq to be the birthplace of man and the location of the ancient Garden of Eden, modern-day Iraq was created in the 1920s by the British to exploit its commercial interests and contempt for “corrupt Oriental despotism.”

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<sup>36</sup> George W. Bush, President’s Message to the Iraqi People, April 10, 2003, <http://www.whitehouse.gov/news/releases/2003/04/20030410-2.html> accessed September 2007.

<sup>37</sup> Transparency International Corruptions Perceptions Index, <http://www.infoplease.com/ipa/A0781359.html> accessed September 2007.

<sup>38</sup> Bruno Silvestre, “Fighting Corruption in Iraq—An Uphill Battle,” <http://worldblog.msnbc.msn.com/archive/2007/03/09/85910.aspx> accessed September 2007.

<sup>39</sup> Iraq Study Group Report, <http://www.futureofthebook.org/iraqreport/3-economics> accessed September 2007.

Interestingly, the British entrusted their influence to a group of Sunni Arabs.<sup>40</sup> It may be this decision that separated Iraq from many of the other British colonial projects. Daniel Treisman found in his 2000 study, *The Causes of Corruption: A Cross-National Study*, that those countries with a history of British rule were much less corrupt than others; however, Treisman noted that Iraq was an exception to the rule. Treisman went on to question the 1999 study of La Porta et al. that argued that it was the corresponding common law legal system that was normally established within British colonies a reason for less corruption. Treisman stated that the legal culture was much more important vice the actual judicial system.<sup>41</sup> However, any type of British legal influence did not last in Iraq as the country went through several power struggles where any type of common law legal system was disbanded to ensure political control.

Competing political groups fought for control with a series of military coups culminating in the Ba'ath party gaining control in 1968 and putting Saddam Hussein in power. Due to the violent nature of the power struggles, the environment was conducive for corruption. The ruler would reward those close to him with wealth and would ensure the opposition was "controlled" and had little resources to resist. Moreover, during the successive coups, minority factions within the military would build their constituency through covert and corrupt means. Finally, the "controlled" group would resort to corruption in order to improve their quality of life. As a result, corruption became part of the culture or society by all members. The Ba'ath party was able to gain and keep control for nearly 35 years by "controlling" any opposition and because of the vast revenues the country received from oil in the 1970s that, coincidentally, nearly coincided with the Ba'athists accession of power. During the 1970s, annual economic growth in Iraq averaged 14 percent and Iraq became the second largest exporter of oil behind the Kingdom of Saudi Arabia.<sup>42</sup> (To put things into perspective, most economic experts are pleased if the United States is able to maintain economic growth at approximately three

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<sup>40</sup> Philippe Le Billon, "Corruption Reconstruction and Oil Governance in Iraq," *Third Quarter Quarterly*, Vol. 26, No. 4/5.

<sup>41</sup> Daniel Treisman, "The Causes of Corruption: A Cross-National Study," *Journal of Public Economics* 76.

<sup>42</sup> Philippe Le Billon, "Corruption Reconstruction and Oil Governance in Iraq," *Third Quarter Quarterly*, Vol. 26, No. 4/5.

percent.) Not only did Saddam Hussein reward his Ba'athist constituency with vast amounts of wealth, he also improved the average Iraqi's quality of life.<sup>43</sup> Furthermore, Iraq did not diversify its economic capabilities and solely relied on oil for its revenues, eventually falling victim to the "resource curse" in the following decade.

During the 1980s, Iraq's economy plummeted as a result of falling oil prices and its costly decision to wage war with Iran with its annual economic growth rate at negative six percent. After a poor political decision was made to invade neighboring Kuwait and the subsequent liberation, Iraq's economy took another blow as the United Nations imposed economic sanctions against Iraq. As a result, the per capita gross domestic product mirrored that of the 1940s economy vice that of the 1990s.<sup>44</sup> Moreover, Saddam Hussein, and the rest of Iraq for that matter, further increased the already-widespread corruption after the United Nations sanctions imposition, creating an informal economy that came to dominate the government's formal economy. Phillippe le Billon described the economy and corruption in the following manner

The control of smuggled goods and kickbacks from oil sales became the central economic focus of the regime and its formal tax handle on the oil sector drastically weakened. In continuity with the fiscal austerity measures of the 1980s the regime whittled down its politics of favouritism while strengthening its command of the rationing programme and the "illegal" economy on which the population depended. Increasingly nepotistic forms of corruption benefited 'Saddam's faithful'...Oil trafficking also allowed the regime to maintain political and economic channels of influence, both regionally and internationally. The situation with regard to corruption was more one of fragmented clientalism, with competing groups in Saddam Hussein's entourage controlling smuggling by clamping down on competing sanctions busters.<sup>45</sup>

This part of Iraqi history has enormous implications both economically and culturally. First and foremost, the "illegal" economy became a part of the culture as everyone depended upon it for their existence and quality of life. Moreover, the Ba'ath party

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<sup>43</sup> Phillippe Le Billon, "Corruption Reconstruction and Oil Governance in Iraq," *Third Quarter Quarterly*, Vol. 26, No. 4/5.

<sup>44</sup> A Alnaswari, *The Economy of Iraq: Oil, Wars, Destruction of Development and Prospects, 1950-2010*, Westport, CT: Greenwood Press, 1994.

<sup>45</sup> Phillippe Le Billon, "Corruption Reconstruction and Oil Governance in Iraq," *Third Quarter Quarterly*, Vol. 26, No. 4/5.

(Saddam's faithful), which the United States ousted from power in 2003, had already created the informal, illegal economy to include the covert logistics and contacts in order to avoid United Nations detection. Is it any wonder that the former members of the Ba'ath party resorted to smuggling and corruption once Hussein was removed from power? In fact, a conservative estimate of today's illegal economy in Iraq is valued at 65 percent of the gross national product.<sup>46</sup>

While the above paragraph describes the domestic corruption that had developed over the decades, le Billon also pointed out that the corruption was also tolerated internationally. The United Nations implemented a food for oil program to help alleviate some of the humanitarian hardships that resulted from the economic sanctions following the first Persian Gulf War. During the program's existence, Hussein was able to smuggle oil out of Iraq (mostly to Jordan and Turkey) with a financial return that is estimated at 5.7 to 13.6 billion dollars from 1997 to 2002. Moreover, le Billon claimed that the United States and Great Britain tolerated the oil smuggling, as the Clinton Administration did not want a political confrontation with any of the smuggling benefactors.<sup>47</sup> As one might expect, the logistics covert oil smuggling practices that were put in place during the food for oil program have come back to haunt the United States and Great Britain during reconstruction.

One final point of le Billon's description is the use of the term clientalism. In many ways, clientalism is the exact opposite of a free-market economy, which the United States is attempting to integrate in Iraq. The breaking apart of the clientalist market has some key repercussions that should be addressed when implementing free market reform. This is one of the items that will be addressed in chapter five of this analysis when looking at the cultural intelligence that should be added to Looney's model to aid the Iraqi economy.

Shifting from Iraq's history of corruption, let us now look at the current corruption that appears to still be widespread. While much of this analysis revolves

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<sup>46</sup> Dominik Zaum and Chirstine Cheng eds special issue of *International Peacekeeping on Corruption in Post-Conflict Peacebuilding*, forthcoming 2007.

<sup>47</sup> Philippe Le Billon, "Corruption Reconstruction and Oil Governance in Iraq," *Third Quarter Quarterly*, Vol. 26, No. 4/5.

heavily on the Iraq's Ministry of Oil Transparency reports to articulate both the scope and magnitude of the corruption, the fact that the Iraqi government is producing transparency reports should be considered a milestone for democratic principles and values. Opening up government agencies to ridicule and public disfavor is a huge step away from the covert actions of Saddam Hussein and the Ba'ath party. While it is unknown how many Iraqis actually read the reports, it is a step in the right direction. It should also be noted that the corruption documented in this analysis, or any review, is just what is known, as it is impossible to describe any covert corruption that has yet to be uncovered.

The Public Integrity Commission was stood up inside the Iraqi government with the mission to ensure that corruption was reduced. The commission, led by Radi Al-Radhi, has investigated about 2,600 cases of corruption from March 2004 to April 2007.<sup>48</sup> However, his work has been limited by his own constitution. Constitutional Clause 136 B allows for fellow Cabinet ministers to block investigations within their ministry. In 2005, Al-Radhi asked the judicial branch to change the clause, but the courts have not issued a ruling. This clause has enabled Cabinet ministers to block probes into their departments where an estimated 55 million dollars has been wasted or mismanaged. In addition, Al-Radhi stated that at least 8 billion dollars has been wasted or stolen from the government of which 2 billion dollars is directly tied to the Former Electricity Minister Ayhem al-Samaraie. Al-Samaraie, a dual citizen of both Iraq and the United States, was convicted, sentenced, and escaped from a Green Zone prison where he fled back to the United States.<sup>49</sup>

The impact of the corruption is not limited to economic issues...it is also enabling the insurgency and terrorist organizations. In February 2007, American and Iraqi forces arrested the Deputy Health Minister, Hakim al-Zamili. Al-Zamili organized a kickback scheme where equipment and services contracts were inflated. The extra money was then funneled back to Muqtada al-Sadr, a known Shiite cleric who has vociferously opposed the United States and the elected Iraqi government. While the amount of the kickbacks

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<sup>48</sup> Bassem Mroue and Qassim Abdul-Zahra, *Iraq Loses \$8 Billion Through Corruption*, Associated Press, April 4, 2007, <http://globalpolicy.igc.org/security/issues/iraq/reconstruct/2007/0404iraqloses.htm> accessed May 2007.

<sup>49</sup> Ibid.

and its use is unknown, it is estimated to be in the millions of dollars and used to help fund Sadr's militia that is fighting American forces. The al-Zamili example is just one of the daily problems plaguing the government ministries and its personnel. According to the United States Comptroller General of the United States, David M. Walker, "the Iraqi civil service remains hampered by inadequately trained or unskilled staff whose political and sectarian loyalties jeopardize the ministries' ability to provide basic services and build credibility among Iraqi citizens."<sup>50</sup>

Al-Radhi and his commission have been able to make some gains against corruption. They have been able to obtain arrest warrants against 15 former ministers on charges of corruption. However, of the more than 2,600 cases that have been investigated by the commission, only 17 percent have been moved to the Central Criminal Court, garnering 80 arrests and only 5 adjudications.<sup>51</sup> And their diligence has not been without sacrifice. The commission has lost roughly 20 members due to murder and the remaining members receive death threats routinely.<sup>52</sup> Obviously, the practice of corruption is deep seated and those officials authorizing or condoning the corruption do not have any bounds on preserving their freedom and/or livelihood.

Despite Al-Radhi and his commission's laudatory efforts, the Comptroller General of the United States cites United States government reports and World Bank reports that Iraq's accountability institutions and systems are one of three problematic areas in fighting corruption...the others are an ineffective banking system that forces the use of cash which is hard to trace, and nontransparent, obsolete procurement systems.<sup>53</sup> This combination has allowed for corruption to take place, a complete lack of

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<sup>50</sup> David M. Walker, United States Comptroller General of the United States, "Stabilizing and Rebuilding Iraq: Conditions in Iraq are Conducive to Fraud, Waste, and Abuse," GAO Report GAO-07-525T, April 23, 2007.

<sup>51</sup> Bruno Silvestre, "Fighting Corruption in Iraq—An Uphill Battle," <http://worldblog.msnbc.msn.com/archive/2007/03/09/85910.aspx> accessed September 2007.

<sup>52</sup> Bassem Mroue and Qassim Abdul-Zahra, *Iraq Loses \$8 Billion Through Corruption*, Associated Press, April 4, 2007, <http://globalpolicy.igc.org/security/issues/iraq/reconstruct/2007/0404iraqloses.htm> accessed May 2007.

<sup>53</sup> David M. Walker, United States Comptroller General of the United States, "Stabilizing and Rebuilding Iraq: Conditions in Iraq are Conducive to Fraud, Waste, and Abuse," GAO Report GAO-07-525T, April 23, 2007.

accountability, and the ability for anti-American groups to resort to its past practices of smuggling, theft, and sabotage with the goal of crippling the existing Iraqi government.

The Iraqi Office of the Oil Ministry defines the smuggling activity within Iraq in the following manner

Sending out a portion of the oil byproducts to neighboring countries through the southern ports and by illegal means; according to estimates, this represents 10% to 20% of the total imports value, which amount(ed) to 4.2 billion dollars in 2005.

Theft of crude oil and of local black oil from the transport pipelines or the warehouses, and smuggling them to neighboring countries or through the southern ports.

Diverting oil products to be delivered to public or private units or for other purposes, such as fishing boats, generators, factories, farms and bakeries, and selling them to smuggling networks.

Letting in a fraction of the products imported and offsetting the missing products with local products, or conniving to register the imports in full, or not delivering them to the warehouses in collusion with the inspection or receipt employees, or taking advantage of the small fines assessed against freighters in case some merchandise is missing.

Loading additional quantities of black oil exports in the Iraqi ports, by taking advantage of weak control and the measurement methods used.<sup>54</sup>

Before going any further, one must understand that the Iraqi government subsidizes a great deal of goods that dramatically reduces the official cost of the goods. In some instances, the official cost is only five percent of the real or market value.<sup>55</sup> Hence, there is an immediate arbitrage opportunity for smugglers. Smugglers can buy vast amount of goods at a fraction of the cost and sell it for up to 20 times that cost to smugglers that will sell the oil in neighboring countries, resulting in huge profits for all, except the Iraqi government and its populace as a whole. It is estimated that this “illegal,” secondary market produced revenues of one billion dollars. However, due to a lack of a central database measuring oil products and no precise measurement tools for

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<sup>54</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf>, accessed October 2007.

<sup>55</sup> Ibid.

accounting for the oil, this data is inaccurate and it could be much higher.<sup>56</sup> According to Wahid Khadduri of the al-Hayat business desk and an energy expert, the total loss of oil revenue to the Iraqi government is estimated at 18 billion dollars annually, and 5.5 billion dollars is contributed to the smuggling of crude oil.<sup>57</sup>

The largest reason for the arbitrage is the enormous difference between oil prices between Iraq and its neighboring countries. The following table, reproduced from the Oil Ministry’s report, depicts these huge differences.

Product	Iraqi Prices before Increase	Iraqi Prices after Increase	Syria	Jordan	Iran	Turkey	Kuwait	Saudi Arabia
Premium Gasoline	0.03	0.17	0.55	0.60	0.13	1.40	0.24	0.24
Regular Gasoline	0.01	0.11	0.50	0.38	0.10	0.78	0.21	0.08
Gas Oil	0.007	0.07	0.18	0.16	0.20	0.87	0.18	0.10
White Oil	0.007	0.02	0.19	0.16	0.20	---	0.18	0.12
Liquid Gas Cylinder	0.14	0.42	3.00	3.80	0.68	---	2.50	0.18

**Table 4. Differences of Oil Prices Between Iraq and Its Neighboring Countries**

The table also shows that the Iraqi government attempted to decrease the arbitrage opportunity by increasing prices, but the increase was not enough as the price differences

<sup>56</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf>, accessed October 2007.

<sup>57</sup> Walid Khadduri, *\$18 Billion—Iraq’s Annual Oil Losses*, <http://english.daralhayat.com/business/04-2006/Article-20060411-89398c8b-c0a8-10ed-0105-0034c1c49534/story.html> accessed October 2007.



are still quite high. Even after the price increase, the return on investment when smuggling to Turkey is still seven fold the initial cost of the goods. While arbitrage is possible with almost every country and every product, the primary reason Turkey is singled out is that the covert smuggling routes to Turkey (along with Jordan, but the return is not nearly as great) have been existence since the Oil for Food Program that was outlined previously. In addition, the porous Iraqi borders further exasperate the problem as it extremely easy to cross into its neighboring nations.

To outline exactly how the smuggling works, the Transparency Report outlines the following scenario. Oil is purchased at the official Iraqi price that is placed into a truck. The driver smuggling the truckload is paid 800 dollars to transport the oil to the smuggling outlet. The police along the route are paid 500 dollars to ensure safe passage. Once the smuggled oil has been sold on the other end, the smugglers profit for each truckload is 8,400 dollars!<sup>58</sup> Furthermore, due to the police corruption, the chance for being caught is drastically reduced as it is nearly an “inside job.”

The next major reason for smuggling and lack of transparency is that the country cannot accurately account for oil shipments throughout the distribution cycle. The counters, or measuring devices, at each point of the logistical flow are antiquated and in many cases obsolete. Moreover, because there is not a standard counter, measuring the product is inconsistent. This problem is increased by the violence and war that has plagued the country for the past 4 years.<sup>59</sup> Once again, the porous borders further add to the situation as many border points do not have any Iraqi authorities (or Iraqi officials with proper measuring devices) that can measure the oil exports. At those points that do have government officials, the “guards often regard bribes as a standard operating procedure.”<sup>60</sup> Finally, government trucks exporting oil can be vandalized or appropriated by smugglers as the security situation has degraded to near civil war. At the ports, Corpwatch has reported that smugglers have been able to divert billions of dollars of oil

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<sup>58</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf>, accessed October 2007.

<sup>59</sup> Ibid.

<sup>60</sup> Dominik Zaum and Chirstine Cheng eds special issue of *International Peacekeeping* on Corruption in Post-Conflict Peacebuilding, forthcoming 2007.

onto tankers because the metering system has not worked since the 2003 American invasion.<sup>61</sup> However, even if there were good measuring devices, customs officials at the border are often corrupt or incompetent, so that smugglers are not captured. And if they are captured, it has already been articulated that the inept judicial branch of the government does not hold corrupt violators accountable.

There are some extenuating circumstances that enable corruption and smuggling. There are more than 7,000 kilometers of oil pipeline that exist throughout Iraq that is impossible to secure against theft and vandalism. And since there is not an accurate method of measurement, any theft and vandalism is unlikely to be detected. Moreover, there is not one central authority that can monitor the entire industry. There are several different organizations that have some control of the distribution warehouses that supply domestic gasoline stations in an inefficient manner. While this may seem asinine to many Western businessmen, one must remember that the oil industry is a government-controlled industry. Hence, on an individualized, microcosmic scale, no one inside the system is being hurt by the corruption through lost profits. And, individuals identifying illegal or corrupt activities are not supported by an active judiciary, which is a necessary deterrent to limiting corruption.

To illustrate the point, the Transparency Report articulated a case where oil trucks smuggled gasoline, gas oil, and imported white oil from Basra to the central and southern governorates. While it would be naïve to assume that the government could account for the entire operation, it did find that 1,551 trucks did not reach their final destination, losing 56 million liters of oil at a price tag of 28 million dollars. The perpetrators were only fined 4 million dollars for their actions, resulting in a 24 million dollar profit.<sup>62</sup> This lack of justice not only fails to deter corruption, theft, and smuggling, but also decreases the public's trust and confidence in the government starting a vicious circle that perpetuates the clientelist markets that have existed for decades vice the free market reforms that the United States has espoused.

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<sup>61</sup> William Fisher, "Corruption, Shoddy Work, and Mismanagement Cripple Iraq Reconstruction," [http://www.truthout.org/docs\\_2006/050307J.shtml](http://www.truthout.org/docs_2006/050307J.shtml) accessed May 2007.

<sup>62</sup> Office of the Oil Ministry Inspector General, *Smuggling Crude Oil and Oil Products Second Transparency Report*, <http://www.iraqrevenuewatch.org/reports/052206.pdf>, accessed October 2007.

Moreover, the trust that must be developed within a democratic society lies with the people and the inherent trust that the populace puts into government institutions to ensure justice. The corruption, theft, and smuggling that have been described above directly undermine the current Iraqi government's authority and rule of law, creating problematic social and security issues. One area of grave concern is the widening gap between social classes as the smugglers and criminals become extremely wealthy at the detriment of those depending on the government for social programs. As social programs fall due to a lack of funding and quality of life is further hindered, the Iraqi government, and subsequently American presence and ideology, loses credibility and support. "The extent and depth of corruption has infuriated Iraqi citizens, who see politicians and officials growing rich while services decline. This has fed disillusionment with the US, UK and coalition presence, and may contribute to support for militias and insurgents. It also alienates international donors, who see much of their investment in Iraq going to waste."<sup>63</sup> The end result is that the populace is forced to revert to the survival techniques that dominated Iraq during the 1990s during the United Nations economic sanctions, further moving away from the free market and democratic values.

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<sup>63</sup> Dominik Zaum and Chirstine Cheng eds special issue of *International Peacekeeping on Corruption in Post-Conflict Peacebuilding*, forthcoming 2007.

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#### **IV. CORRUPTION BY AMERICANS AND AMERICAN CORPORATIONS**

Unlike the Iraqi corruption that is publicized mainly through government agencies such as Inspector General reports, much of the corruptive activities by Americans are being publicized by newspapers and outside organizations in addition to the Special Inspector General for Iraqi Reconstruction (SIGIR). This fact alone is a clear indication of the differences in culture and transparency of official activities between the United States and Iraq. Similar to Iraq that is at the bottom of Transparency International's latest Corruption Index, the corruptive actions of United States citizens and American corporations has lowered the United States' ranking amongst the 163 countries that were surveyed. Moreover, the United States was used an example of a country that had "noteworthy deterioration" as its rating slipped to 20.<sup>64</sup> In contrast to Iraq that is in a state of near civil war and influx, the United States has the judicial system and belief in the rule of law to adequately prosecute those attempting to take advantage of Iraq's turmoil. Hence, the actions to remedy the situation are already in place, however, the damage may have already been done in the eyes of Iraqi citizens who have witnessed the corruption from the country that is supposed to be "leading by example." While it is impossible to know exactly how much money has been lost due to corruption by Americans, this chapter will outline some of the different types of mistakes and corruption that the United States, its corporations, and its citizens made throughout the Iraqi occupation that has led to an environment where economic corruption has been able to thrive.

According to the latest report, dated October 30, 2007, the SIGIR has 52 current investigations, of which 30 are being prosecuted by the Department of Justice. In addition, to date, the SIGIR's inspections have resulted in 13 arrests, 5 convictions, 5 imprisonments, 2 indictments, more than 17 million dollars of court-ordered restitutions, forfeitures, and recoveries, and 57.8 million dollars saved or recovered through audits.<sup>65</sup>

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<sup>64</sup> Transparency International, <http://www.transparency.org> accessed October 2007.

<sup>65</sup> Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, <http://www.sigir.mil/reports/quarterlyreports/Oct07/Default.aspx> accessed November 2007.

It is also important to note that audits that correct practices also save future expenditures. While this may seem small when thinking of the estimated 2 trillion dollar figure that was reached in Chapter II of this analysis, 2 trillion dollars is through 2015, with the majority being spent on troops, equipment, and medical services, not reconstruction. In regards to reconstruction, Congress has appropriated more than 45 billion dollars as of October 30, 2007.<sup>66</sup> The SIGIR's latest report also identified a disturbing situation in regards to how certain pots of money are being spent, specifically the Iraq Security Forces Fund (ISFF) valued at almost 14 billion dollars (almost one-third of the total Congressional appropriations). Looking at the SIGIR's Iraq Reconstruction Information System (SIRIS) database for reconstruction, the SIGIR noticed that three of the top ten contracts in terms of monetary value (numbers 1, 4 and 8 in bold on the chart below that has been reproduced from the SIGIR's report) did not have a contractor identified. Moreover, notice those three contracts totaling more than 1.2 billion dollars have been obligated and expended.<sup>67</sup>

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<sup>66</sup> Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, <http://www.sigir.mil/reports/quarterlyreports/Oct07/Default.aspx> accessed November 2007.

<sup>67</sup> Ibid.

Name of Contract	Obligated (in millions)	Expended (in millions)
<b>Contract to DoS for INL Support</b>	\$696	\$696
Environmental Chemical Corporation	\$665	\$410
AECOM, Government Services, Inc	\$414	\$348
<b>Contract to DoS for INL Support</b>	\$386	\$386
Tetra International, LLC.	\$249	\$168
Toltest, Inc.	\$231	\$148
Iraqi Contractor – 5300	\$226	\$156
<b>Contract to DoD for DSCA</b>	\$224	\$224
Innovative Technical Solutions, Inc.	\$212	\$127
URS Group, Inc.	\$192	\$43

**Table 5. Top Ten ISFF Contractors**

While the report did not identify the situation as a weakness, it is apparent that it is extremely difficult for a third party such as the SIGIR to hold companies accountable and/or audit the execution of a contract when the identity of the contractor is not available. Furthermore, this type of inadequate oversight can make the environment ripe for fraud, waste, and abuse. This situation also begs the question, if the top contracts are not being adequately overseen, what is happening with the smaller contracts?

There have been many mistakes that have been made allowing for corruption to take place from the time period immediately following the invasion when the Coalition Provisional Authority (CPA) was in charge. Under the guise of the CPA, the United States had the opportunity to put sound practices in place that could have trickled down to the Iraqis as techniques to ensure transparency. However, the CPA did the exact opposite in its attempt to rapidly begin reconstruction. In doing so, not only did the CPA depart from standard accounting techniques, it also treated Iraqi funds with different accounting techniques than American money. This practice could only be taken as a negative by any Iraqi that became aware of the differing standards.

While it may have been well intentioned, the first error that occurred was the awarding of contracts based on a sole-source vice through competition. Competition not only ensures that the government is getting the best price, it also allows for companies from different countries to prosper from the reconstruction, most notably the Iraqis. Not only did the CPA choose to ignore tried and true procedures, it compounded the issue by predominantly selecting companies from the United States and Great Britain. Of the 1.5 billion dollars worth of contracts (where the contract totaled more than 5 million dollars) from Iraqi funds, American corporations received 74 percent, Great Britain firms garnered 11 percent, and Iraqi companies only 2 percent.<sup>68</sup> Whether the selection criteria for awarding those contracts was fair or not is irrelevant as the perception of had to be otherwise. Moreover, the Haliburton subsidiary of Kellogg, Brown, & Root (KBR) garnered 921 million dollars in contracts of the 1.5 billion (over 60 percent) offered through no-competition bids.<sup>69</sup> To make the perception of even more problematic for the United States, Haliburton was a former employer of Vice President Dick Cheney. Regardless of the situation, the perception of a corruptive selection process could not be avoided with data weighing so heavily towards the American firms and KBR specifically. Adding insult to injury, auditors subsequently uncovered that KBR overcharged the government for its services by 61 million dollars.<sup>70</sup> In a separate venture, it was uncovered that KBR overcharged the government of 400 million dollars for a contract to rebuild the Iraqi oil fields and the company may have skimmed 212 million dollars off the top of a 1.69 billion dollar contract.<sup>71</sup>

Also within the bidding process, the United States government allowed for “contract bundling.” A Transparency International report citing Iraq’s reconstruction is ripe for corruption and profiteering also “faulted the phenomenon of ‘contract bundling,’ which joins together two or more separate procurement requirements into a super-sized

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<sup>68</sup> Revenue Watch Report No. 7, September 2004, <http://www.iraqrevenuewatch.org/reports/092404.pdf> accessed May 2007.

<sup>69</sup> Ibid.

<sup>70</sup> Ibid.

<sup>71</sup> Ari Berman, “A Free Fraud Zone,” <http://www.thenation.com/blogs/outrage?bid=13&pid=2319> accessed November 2007.



contract, effectively disqualifying smaller companies because only the very largest contractors are able to compete.”<sup>72</sup> While this concept may seem reasonable to military contracting officers and politicians wanting reconstruction efforts to begin rapidly, it undermines the competitive bidding process that has been in place in the military for years. In addition, if contract bundling is allowed to become widespread or a norm, then the construct of the economic system becomes more of an oligopoly vice one where many firms are capable of competing for business.

The bidding process was not the only problem with the CPA and its handling of the reconstruction effort. In order to quickly start the reconstruction process, the CPA had 600 million dollars of cash for disbursement. The CPA Inspector General (CPA-IG) found that American funds had to be disbursed under the rules and procedures of the Department of Defense’s Financial Management Regulations (FMR) and Iraqi funds could have been disbursed in the same manner, but the CPA chose not to comply, citing flexibility as the main reason.<sup>73</sup> However, in its attempt to remain flexible, it allowed a slippery slope of falling standards. As a result, auditors found that disbursing officials at 14 of 15 locations did not keep a register of cleared receipts. The slippery slope extended to CPA officials not following its own rules where a 1.4 million dollar contract was verbally modified from ensuring transparency to performing accounting tasks.<sup>74</sup> Not only did this show a deliberate disregard for established procedures, but it also detracted from the original statement of work of the contract of providing transparency of the 600 million dollars that belonged to the Iraqi people. While it is unknown as to how much of the cash was wasted, stolen, or used in a manner inconsistent with its original intent, there is little doubt that the procedures, or lack of procedures, allowed for an environment where corruption could occur.

With such a large portion of the contracts going towards KBR, it would make statistical sense that much of the scandals have revolved around KBR. One type of

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<sup>72</sup> Emad McKay, “Corruption: Is Iraq Becoming the World’s Biggest Cash Cow?” <http://www.antiwar.com/ips/mekay.php?articleid=5255> accessed November 2007.

<sup>73</sup> Revenue Watch Report No. 7, September 2004, <http://www.iraqrevenuewatch.org/reports/092404.pdf> accessed May 2007.

<sup>74</sup> Ibid.

corruption that has been uncovered is that of overbilling KBR by its subcontractors. One case that depicts this type of corruptive action is that of Jeff Alex Mazon, a former employee of KBR, and Ali Hijazi, a managing partner of LaNouvelle, a Kuwaiti corporation. KBR did competitively bid the subcontract work, but Mazon tripled all the bids and then awarded the contract to LaNouvelle for 5.5 million dollars. LaNouvelle completed the work for 680,000 dollars, pocketed the rest of the profit minus the one million dollar check it paid Mazon.<sup>75</sup> Mazon has yet to stand trial and Hijazi has not been captured for the Kuwaiti government to prosecute.

While Mazon has yet to admit his wrongdoing, Philip Bloom, an American contractor agreed to a plea agreement for providing money, designer watches, and sex to Robert Stein, another American contractor through two senior United States Army officers in exchange for 8.6 million dollars of reconstruction contracts. The reconstruction projects were either never accomplished or done in an unacceptable manner. The plea agreement called for Bloom to pay a 3.6 million dollar fine and a forfeiture of 3.6 million dollars in assets as well as a lengthy prison sentence of up to 40 years.<sup>76</sup> In response to the plea agreement, the SIGIR stated that it “sends a message to Iraqis that US oversight will track down, arrest, and prosecute American citizens who committed crimes in Iraq involving Iraqi money.”<sup>77</sup> This quote sends the perfect message to the Iraqi populace. There is also a critical implication within the quote that has had, and will continue to have, a profound impact...how America handles corrupt practices is the example for the Iraqi judicial system to replicate, but must do so within its cultural norms and standards. It is naïve to think that Iraqis will change just by the United States providing an example, but allowing Americans to not be prosecuted in an appropriate manner sends a far worse message. In addition, it also begs that question that while this incident was found in an Australian newspaper, how many Iraqis, if any, are aware of the punishment?

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<sup>75</sup> Emad McKay, “Corruption: Is Iraq Becoming the World’s Biggest Cash Cow?” <http://www.antiwar.com/ips/mekay.php?articleid=5255> accessed November 2007.

<sup>76</sup> T. Christian Miller, “Sex and Money Bought Iraq Contracts,” *The Sydney Morning Herald*, April 20, 2006, <http://www.smh.com.au/news/world/sex-and-money-bought-iraq-contracts/2006/04/19/1145344153774.html> accessed November 2007.

<sup>77</sup> Ibid.

It may come to a surprise that senior Army officers were indicted for their part in the Bloom incident noted above, but it does not stop there. The *Los Angeles Times* obtained documents where United States Air Force Colonel Kimberly D. Olson, one of the first female pilots in the Air Force, used her position to ensure a South African security firm won a 3 million dollar contract, a company that Olson had started a branch for in the United States. While Olson did not receive a monetary fine or prison time, she was forced to resign her commission from the Air Force as a punishment.<sup>78</sup> Once again, there may have been absolutely no wrongdoing by the Colonel. In fact, both her boss, Brigadier General Jay Garner, and Paul Bremer defended Olson's actions as "doing her best in a chaotic situation" and that "an overzealous prosecution might impinge reconstruction efforts."<sup>79</sup> However, one cannot ignore the impact of perception. Even if Colonel Olson was completely innocent and the awarding of that contract was completely fair and void of corruption, then she should have dismissed herself from the decision-making process entirely just to ensure the perception of an equitable bidding and awarding process.

Another example of the corruption plaguing Iraq is that it seems the Iraqi culture of bribery is resonating to Americans rather than vice versa. An example of this phenomenon is the case of Glenn Allen Powell. While working for KBR, Powell recommended an Iraqi company as a subcontractor to refurbish four buildings. In exchange, Powell received 110,300 dollars in kickbacks. Powell eventually pled guilty and was sentenced to 15 months in prison and ordered to pay restitution of 91,000 dollars.<sup>80</sup> However, the good news about this story is that KBR discovered the kickback scheme, disclosed the information to authorities, and refunded the 110,300 dollars back to the United States government.

Yet another form of corruption that has taken hold in Iraq is that of unacceptable work being accomplished. More alarming is that despite inadequate performance, the

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<sup>78</sup> Tom Regan, "Iraq Corruption Probe to Expand," *The Christian Science Monitor*, April 20, 2006, <http://www.csmonitor.com/2006/0420/dailyUpdate.html> accessed November 2007.

<sup>79</sup> Ibid.

<sup>80</sup> Associated Press, "Ex-Halliburton Employee Gets Jail Sentence," November 19, 2005, <http://www.cbsnews.com/stories/2005/11/19/ap/business/mainD8DVB6FO6.shtml> accessed November 2007.

contract has been paid in full. One recent example is the 27 million dollar Mosul Dam project where a “catastrophic failure would result in significant loss of life.”<sup>81</sup> The SIGIR found that of the 21 American contracts that were designed to be short-term fixes, several of the contracts were unsuccessful due to inadequate construction performance, incomplete construction, or having the wrong parts delivered to repair the dam appropriately.<sup>82</sup> Unfortunately, the contracts have already been paid in full, leaving little incentive for the contractor to return unless ordered by the courts. It appears that the errors can be attributed to both the contractors for not performing in an appropriate manner, but also in a lack of proper oversight by either government or Army Corps of Engineer personnel. This is also the same conclusion as the SIGIR when it investigated Bechtel National, a large American contractor that was awarded part of a 1.8 billion dollar contract. The report found that fewer than half of the projects were completed and some objectives were reduced in scope or even canceled. The SIGIR found that only two individuals were hired to oversee 24 major projects, 150 subcontractors, and the government stipulated all invoices needed to be approved or disapproved within 10 days.<sup>83</sup> Moreover, Stephen Ellis, a Vice President of Taxpayers for Common Sense stated, “This isn’t so much an indictment against Bechtel as it is a criticism of the system.”<sup>84</sup> It is apparent that the lack of oversight has allowed for a situation where excellence is not demanded and inadequate work can be accomplished with little to no repercussions against the contractor.

Although removed by over three years, the effects of the initial corruption in conjunction with the Iraqi culture can be seen as recently as this past quarter with the largest bribery case in Iraq being uncovered. Major John Cockerham, his wife, and his sister have been charged with accepting bribes of more than 9.6 million dollars from Iraqi

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<sup>81</sup> British Broadcasting Company, “Iraqi Dam At Risk of Collapse,” October 30, 2007, <http://www.globalpolicy.org/security/issues/iraq/reconstruction/2007/1030damcollapse.htm> accessed November 2007.

<sup>82</sup> Ibid.

<sup>83</sup> British Broadcasting Company, “Iraqi Dam ‘At Risk of Collapse,’” October 30, 2007, <http://www.globalpolicy.org/security/issues/iraq/reconstruction/2007/1030damcollapse.htm> accessed November 2007.

<sup>84</sup> Ibid.

contractors.<sup>85</sup> Unlike the Powell case, the defendants have not pled guilty, so any sentence (assuming a guilty verdict) will not be lessened by plea agreements. While the trial is not scheduled to convene until April of 2008, it will be interesting to compare the verdict in a corruption case to that of its counterpart in Iraq.

While it is not a form of corruption, the perception of unfavorable treatment for whistle blowers can certainly lead to an increased perception of corruption. According to MSNBC, “the men and women who have stepped forward to report corruption in the massive effort to rebuild Iraq have been vilified, fired and demoted.”<sup>86</sup> The article goes on to tell the story of Donald Vance and Nathan Ertel who stated they were imprisoned and harshly interrogated for telling the FBI about guns, land mines, and rocket launchers that were being sold to Iraqi insurgents and American soldiers. The article also states that Bunnatine Greenhouse was subsequently demoted for blowing the whistle on KBR during Congressional testimony.<sup>87</sup> While the article only gives one side of the story, the problem is that when the government does not provide its side, the American people can only assume the story being told is true. As a result, the perception of corruption can only grow.

While it is impossible to know the extent of the corruption that has occurred in Iraq by Americans, it is obvious that the situation is not ideal to ensure that corruption is limited. In addition, the situation has also proven that all types of individuals, to include senior military officials, have been tempted or swayed to perform corrupt acts that have taken money away from the American taxpayer. While the numbers seem reasonably small when compared to the estimates of American investment, the effects of the corruption could go far beyond just dollars. Instead of showing the Iraqi people how democracy, capitalism, and rule of law are designed to work, the corruption has only shown America in a negative light, making the reconstruction even more difficult, and the price tag even higher.

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<sup>85</sup> Steven W. Bowen, Jr., <http://www.sigir.mil/reports/quarterlyreports/Oct07/Default.aspx> accessed November 2007.

<sup>86</sup> Associated Press, “Iraq Fraud Whistleblowers Vilified,” August 25, 2007, <http://www.msnbc.msn.com/id20430153/print/1/displaymode/1098/> accessed November 2007.

<sup>87</sup> Ibid.

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## V. ADDING CULTURAL INTELLIGENCE TO AN ECONOMIC SOLUTION

*[Corruption] can be defeated only through the development of democratic values and systems<sup>88</sup>*

*- Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction*

As the previous chapters have indicated, the corruption in Iraq by American companies and Iraqis is having a profound impact economically, preventing reconstruction efforts and wasting American dollars, Iraqi resources, and the country's transition to democracy. When providing an estimated 2 trillion dollars from the onset of the Global War on Terror through 2015, it is imperative that the United States attempts to rid Iraq of the corruption that is denying progress. The above quote from Stuart W. Bowen, Jr., is probably accurate as a long-term solution. However, the average Iraqi is not going to embrace democracy just because the United States tells them it is the best system. George W. Smith likened the current situation in Iraq to Napoleon's dealing with the Spaniards. Smith stated the "similarities may reflect the failure to understand the local populace within campaign planning...Thus, cultural intelligence preparation of the battlespace with a focus on the post-hostilities landscape is perhaps more important than traditional preparation of the battlespace."<sup>89</sup> Rather than mirror imaging or fusing Western ideology into Iraq, Americans need to better understand the Iraqi culture, and its recent past experience, so that the United States may be able to economically aid the democratic transition of Iraq.

The only way to gain the trust of the average Iraqi citizen is through a prolonged, continuous operation where each individual's standard of living and trust in the government has increased over time. The United States and its taxpaying population

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<sup>88</sup> Stuart W. Bowen, Jr., Special Inspector General for Iraq Reconstruction, [http://www.sigir.mil/reports/pdf/testimony/sigir\\_testimony\\_06-003t.pdf](http://www.sigir.mil/reports/pdf/testimony/sigir_testimony_06-003t.pdf) accessed October 2007.

<sup>89</sup> George W. Smith, Jr., "Avoiding a Napoleonic Ulcer: Bridging the Gap of Cultural Intelligence (Or, Have We Focused on the Wrong Transformation?)," <http://www.mcu.usmc.mil/mcwar/irp/documents/CJCS%20Essay%20-%20Smith.pdf> accessed August 2007.

need to comprehend the enormous task that is challenging Iraq and its people. By accepting democracy, Iraq will be changing its entire culture...and that will not change overnight, but could take years or decades. (Let us not forget that Vermont was looking to secede from the United States to Canada 7 years after the United States Constitution was ratified.) Hence, the United States needs to have patience in allowing the democratic, entrepreneurial spirit to take root and focus in the short term, on winning the key center of gravity in any insurgency, the people, by improving each individual's quality of life and attempting to attack the conditions that spark a turn to terror or joining an insurgency.

It is an important point in that when dealing with enemy contact in Iraq, there are two different foes. First, there are the terrorists that have come mostly from foreign countries joining the jihad in order to rid Iraq of infidels, non-Muslims on holy Islamic land. Second, there are Iraqis who are unhappy with the current government, the lack of security, their quality of life, and want the Americans to leave because their life is not any better now than it was 4 years ago. While the second group is the key center of gravity, it is my assertion that the reasons why an Iraqi would become an insurgent are the same reasons one may join a terrorist organization.

So why would an individual join the insurgency or a terrorist organization? Fathali M. Moghaddam of Georgetown University attempted to answer the question through a psychological approach. In his work, "The Staircase to Terrorism: A Psychological Exploration," Moghaddam uses a staircase analogy to describe how an individual transcends mentally from an average citizen to a terrorist.<sup>90</sup> The ground floor is where most individuals reside in their day-to-day lives and as long as there are options for individuals to voice their grievances, displeasure, or seek justice, individuals will not climb the first step of the staircase. Moreover, the key may be whether individuals perceive themselves to be deprived in some manner that cannot be rectified through legal means. In his book, *Understanding Terror Networks*, Marc Sageman also addressed this deprivation when analyzing known terrorists. Sageman noted that many terrorists he

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<sup>90</sup> Fathali Moghaddam, "The Staircase to Terrorism: A Psychological Exploration," *American Psychologist*, February-March 2005. The entire individual analysis of how a person ascends the staircase to terror is taken from this article.



studied were very well educated, but were either unemployed or underemployed, not using their advanced skills. Sageman concluded that this “relative deprivation” was probably a necessary condition for individuals to turn to joining a terror network.<sup>91</sup> This relative deprivation must be occurring in Iraq as the current unemployment rate is estimated to be between 25-40 percent according to the latest Brookings Institute report, released November 1, 2007.<sup>92</sup> If relative deprivation is a necessary condition for normal citizens to start looking at joining a terrorist organization or insurgency, then it would be prudent for the United States to curb this phenomenon as quickly as possible.

It is important to note that relative deprivation may or may not directly be tied to poverty. Studies show that there is no direct link between poverty and terror. Alan B. Krueger, a Bendheim Professor of Economics and Public Affairs at Princeton University, and Jitka Maleckova, an associate professor of Middle Eastern and African Studies at Charles University in Prague, concluded in their study that there is little connection between poverty, education, and terrorism.<sup>93</sup> As Sageman further points out, many of the leaders of al-Qaeda were multi-millionaires.<sup>94</sup> If poverty did indeed cause terror, the United States would see much more domestic terrorism in the inner cities and in neighborhoods such as Harlem or Watts. Rather, Moghaddam, concluded that it is the perception of fairness that is the most important factor in determining whether an individual will resort to extreme violence in an attempt to change the status quo and climb that first step in the staircase.<sup>95</sup>

The first floor of the staircase is filled with individuals that want to make a change and are looking for avenues to address their perceived inequalities. There must

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<sup>91</sup> Marc Sageman, *Understanding Terror Networks*, University of Pennsylvania Press, Philadelphia: 2004.

<sup>92</sup> Michael E. O’Hanlon and Jason H. Campbell, Brookings Institute, <http://www.brookings.edu/saban/~media/Files/Centers/Saban/Iraq%20Index/index.pdf> accessed November 2007.

<sup>93</sup> Alan B. Krueger and Jitka Maleckova, “Does Poverty Cause Terrorism?” *The New Republic*, June 24, 2002.

<sup>94</sup> Marc Sageman, *Understanding Terror Networks*, University of Pennsylvania Press, Philadelphia: 2004.

<sup>95</sup> Fathali Moghaddam, “The Staircase to Terrorism: A Psychological Exploration,” *American Psychologist*, February-March 2005.

be multiple ways for individuals to address their grievances and have the opportunity to either see results from the voicing of grievances or to hear the government's rationale for not reacting. It is within this realm of procedural justice that can have an exponential effect as this is where the fair person will critique the government's decision-making process. If the process is not viewed as fair, the anti-government/anti-American movement could gain momentum. It can be argued that Abu Ghraib caused an exponential recruiting effect against the United States, increasing anti-American sentiment in Iraq. Furthermore, in terms of corruption, the judicial problems discussed in Chapter III of this document further exasperate the perceived inequalities within Iraq. The inability of the Iraqi government to quickly and decisively deal with those inequalities can further fuel the insurgency and terrorism.

Also within the first floor of the staircase, Moghaddam described the need for a contextualized democracy. It is paramount that the United States realizes that not every democracy will look or behave like the one it uses. Islamic countries must be able to hold on to its cultural symbols and identity.<sup>96</sup> While this chapter so far has focused on the individual, it is also important for any proud nation to hold on to its roots and culture. Later in this chapter, the big picture effects of democratization will be analyzed.

According to Moghaddam, on the second floor is where people develop an us-versus-them attitude, displacing anger from their own government to out-groups, especially the United States.<sup>97</sup> However, in terms of Iraq and the insurgency, the Iraqi government and the United States are lumped into one category. Many view the current Iraqi administration as a puppet regime for Washington D.C., leaving the only choice to oppose the current administration as well as the United States. It appears that once an individual arrives at the second floor and begins displacing all anger towards the United States, there is nothing the United States can do to change their minds. A change may occur and these individuals may not develop into insurgents or terrorists, but the change must come from within the individual and cannot come from an external source,

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<sup>96</sup> Fathali Moghaddam, "The Staircase to Terrorism: A Psychological Exploration," *American Psychologist*, February-March 2005.

<sup>97</sup> Ibid.

especially the perceived enemy. While Moghaddam develops the staircase through five levels, this analysis will not as the United States should focus their efforts toward targeting those individuals on the ground and first floors.

While each Iraqi will evaluate the merits of democratization based on his or her quality of life, there are some implications of accepting democracy, following a rule of law, and setting aside decades and centuries of the clientalist society that has dominated many Islamic societies. The first is that there is an implied trust that must be present between the government and its people to ensure justice. The implied trust is based on each state's ability to enforce contractual agreements between individuals, businesses, or corporations to ensure the contract is fulfilled. As pointed out in Chapter III, the corruption in Iraq is absolutely killing this trust and keeping the populace from trusting its leadership. This implied trust is completely different than the trust required by clientalist economies to function (though a trust is required in these economic societies, it is amongst individuals, not business entities, etc.). As Michael Mousseau identified in his paper, *Market Civilization and Its Clash With Terror*, "in clientalist societies, cooperation occurs with the exchange of gifts, and trust is based on life-long friendships within in-groups."<sup>98</sup> The difference is not the idea of trust as trust is essential in any political-economic system, but with whom the trust is bestowed. In democracies based on free market economies, trust is granted to states by individuals, while in clientalist markets, trust is confined to individuals.

There are further implications between the differences in trust between clientalist and free market economies. When trust is given to the states, the state must also regulate infractions or violations that are normally accomplished via the judicial branch. Plaintiffs and defendants have equal representation in court where the state decides fault and the state enforces the ruling in some manner. There is an implied equality between plaintiffs and defendants. This contradicts the hierarchical society that exists in clientalist societies. Mousseau expanded on this idea by stating that market economies tend to believe more in science than faith-based knowledge. Furthermore, science is rooted with three fundamental premises (1) there are some facts that are universal in nature and

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<sup>98</sup> Michael Mousseau, "Market Civilization and Its Clash with Terror," *International Security*, Winter 2002/03.

cannot be disputed, (2) equality amongst individuals to challenge another's assertions of fact, and (3) truth is sought through tolerance and respect of each other's ideas.<sup>99</sup> This is very important because the overall goal of science is to find truth even if it directly contradicts religion. In contrast, clientalist economies are largely based on religious beliefs and culture. When science and religion conflict, those living in clientalist economies side with religion rather than science. The religious belief is so strong that nothing can override their religious beliefs that have been ingrained in their culture for centuries. Hence, the people tend to stay to themselves and develop as a group (no different than Amish societies in the United States). "As a result, developing countries tend to have political cultures characterized by intergroup conflict (deep in-group/out-group feelings), less respect for individual freedom, stronger religious beliefs, greater respect for loyalty and hierarchy than for the rule of law, and extensive informal patronage networks."<sup>100</sup> This is a complete contradiction to the liberal views the United States and those in the West espouse. However, when the United States attempts to democratize countries with clientalist markets like Iraq, they are undermining an entire way of life. Those in clientalist markets do not understand individual freedoms, science overriding religion, rule of law outweighing loyalty and hierarchy, and formal patronage through contracts rather than informal through friendship and kinship. This is the challenge that faces the United States on a grand scale in Iraq.

So what can the United States do in order to increase the average Iraqi's quality of life, ensure that the economic transition from a clientalist economy to a free market economy is completed, and that a democratic, prosperous Iraq is obtained? Primarily, the United States must realize that possible solution sets will most likely all be processes that must develop over time. The next issue, and perhaps the most important to ridding corruption at the national level, is establishing a judicial branch of government that upholds the law and produces verdicts that will deter citizens from breaking the law. Philosophically, deterrence is virtually impossible to prove by the very nature of its definition, unless someone publicly acknowledged a fear of reprisal or punishment, no

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<sup>99</sup> Michael Mousseau, "Market Civilization and Its Clash with Terror," *International Security*, Winter 2002/03.

<sup>100</sup> *Ibid.*

one could prove that deterrence worked. However, it is important that punishments fit the crime from the viewpoint of the average, fair-minded Iraqi citizen. As pointed out in Chapter III, this is not currently happening in Iraq where a 4 million dollar fine is the punishment for a 28 million dollar “theft.” In addition, it is imperative that the judicial branch is able to serve as the check and balance on the government. The Inspector General and judiciary must be authorized to investigate alleged misconduct against anyone. Hence, clause 136 B of the Iraqi Constitution that allows for Cabinet ministers to block investigations must be changed. While this establishment of a rule of law will be very difficult to implement and be ingrained into the culture, it is most likely a necessary condition for democracy to take hold long term.

In addition, the United States needs to exploit a strategy that targets the individual at the ground and first floor levels of the staircase of terrorism. These people are the key center of gravity and they are not yet committed to fighting the United States as those in the second floors and above. However, this cannot be done through military might nor done with a short-term focus.

A lesson from the history of terrorism is that this moral problem [terrorism] does not have a technical solution; this lesson is at odds with the contemporary tendency to try and find technological solutions to moral dilemmas. More sophisticated technology and increased military force will not end terrorism in the long-term. Over at least the last few decades, policies for ending terrorism have tended to be short-term, often driven by immediate political demands rather than by scientific understanding. The necessity of shifting to long-term policies is underscored by psychological research on populations most directly affected by the fight against terrorism, such as those in Afghanistan and Iraq.<sup>101</sup>

If the United States is to win in Iraq, it must look at long-term policies, void of domestic bureaucratic politics, and can be done best through sound economic support that bolsters quality of life in the short term which eventually sways the population against the insurgency in the middle term, and provides for a stable, democratic Iraq long term. This

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<sup>101</sup> Fathali Moghaddam, “The Staircase to Terrorism: A Psychological Exploration,” American Psychologist, February-March 2005.

is not anything new to the policy makers in Washington. In fact, it is only slightly different than the three-pronged approach released in November 2005 by the Bush Administration.<sup>102</sup>

Looking at Iraq's resources, the country has enormous potential to thrive economically. In addition to having the world's second largest oil reserve, it also has the ability to diversify its economic portfolio with livestock, agriculture, etc. as it has plenty of water for irrigation with the Tigris and Euphrates Rivers. The problem is that Iraq has fallen victim to the oil curse that has plagued many countries in the Middle East and Africa. Iraq had been a country where the entrepreneurial spirit was prevalent prior to Saddam Hussein's leadership. When oil skyrocketed in the 1970s, Iraq's leadership was content with not diversifying its economic portfolio. It put all its egg in one basket...oil.

As Robert Looney pointed out, relying on oil wealth as a sole source of government revenue has some damaging effects.<sup>103</sup> First and foremost is that the oil industry does not use many unskilled workers, which is evident today with Iraq's current unemployment rate. Moreover, the government has not had to establish a system of taxation where it relies on the people for its budget. Hence, the current Iraqi government is having problems raising capital to provide for its people and enhance its people's quality of life. In addition, an entire generation of its populace has not experienced a culture that spurred entrepreneurial activity.

Looney pointed out some different possible approaches that Iraq could use in order to capitalize on its resource wealth: privatization, disbursement, and transparency. Under privatization, the oil reserves in Iraq would be sold at an auction.<sup>104</sup> The Iraqi government would subsequently be able to tax the corporations operating in Iraq, providing revenue annually and forging a stronger state-society linkage. However, this would probably not be accepted by the Iraqi population as it would be viewed as the United States (or the West) invading Iraq to capture its oil reserves...the exact claim that al-

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<sup>102</sup> National Security Council, *National Strategy for Victory in Iraq*, Washington D.C., November 2005.

<sup>103</sup> Robert Looney, "Can Iraq Overcome the Oil Curse?" *World Economics*, Volume 7, No.1, January – March 2006.

<sup>104</sup> Ibid.

Qaeda has stated several times. Perhaps to put into a Western perspective, it would be similar to Honda or Toyota in the United States. Many Americans will only buy Ford or Chevrolet rather than Honda or Toyota because the prior are considered to be “American.” Yet, Toyota and Honda are made in America, only the after-tax profit is going to its corporation in Japan. This same phenomenon would occur in Iraq if the oil were privatized. Moreover, with American intentions in the region being questioned, it seems both culturally and politically wrong to follow this path.

Disbursement of oil revenue would allocate a fixed share directly to the public as a whole and appears the best way to enhance the average citizen’s quality of life. As Looney correctly pointed out, such a disbursement plan would definitely require full transparency on the government’s behalf.<sup>105</sup> (Once again, this is not something the Iraqi government is accustomed to providing as the Ba’ath Party’s regime had been extremely secretive. However, just as this analysis has used the Oil Ministry’s Inspector General transparency report, it is a document that is being generated and used today.) Looney cited Thomas I. Palley’s concept of using the Alaska oil disbursement fund in addition to a companion fund to be used by the local and regional government’s to ensure fair distribution.<sup>106</sup> The local and regional governments would then be able to use this money to improve their local municipalities, building trust between the people and its government. Palley also recommended that a disbursement should be done immediately to help the Iraqi citizens, which is right on target. This is only slightly different than the current Bush Administration’s refund checks in 2001 that was designed to spur a lagging American economy. By providing money to Iraqi citizens, it will provide each citizen with a boost in their quality of life, and produce a feeling of good will from the government to its people. In addition, the money that is then spent on goods and services enhances the overall economy that the government can subsequently tax.

One argument against the Alaska-style fund is that the Alaska fund worked because it was not in the middle of a war zone, but in the friendly confines of America where democracy and rule of law are adhered. There is no doubt there is a huge

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<sup>105</sup> Robert Looney, “Can Iraq Overcome the Oil Curse?” *World Economics*, Volume 7, No.1, January – March 2006.

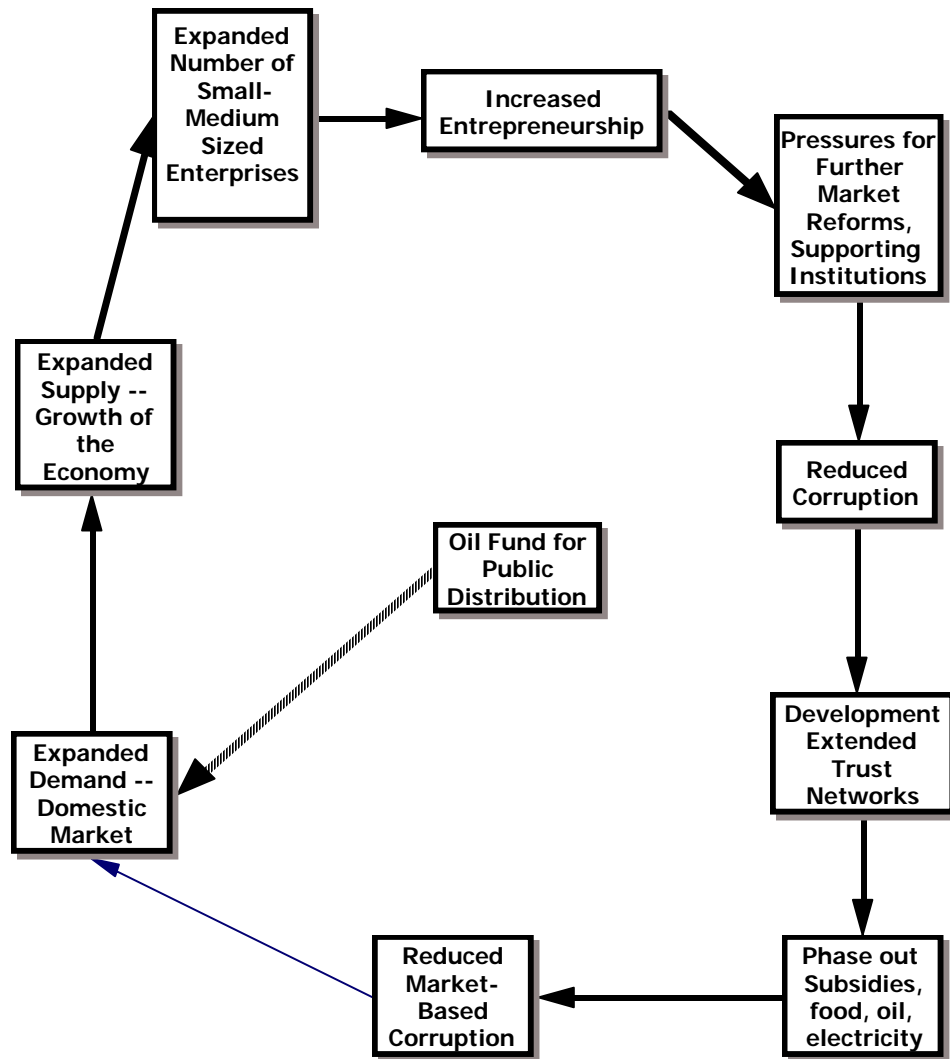
<sup>106</sup> *Ibid.*

difference and that securing the oil pipelines in Iraq is a much tougher task than securing the oil fields in Alaska. However, Iraq does have an estimated 25 to 40 percent unemployment rate that could be mobilized to help secure their resources. Of course, the question is how do you pay for it? The answer is simple economics. As shown in chapter 3, Iraq is currently selling oil well below market price. If Iraq allows supply and demand to dictate the price, it will generate possibly up to 5 times the revenue it is currently receiving through oil sales. This increase can pay for the security while reducing unemployment and also reducing the black market corruption that is a large part of the corruption. In addition, the government needs to reward its employees based on performance incentives...by placing accurate metering technology across the nation, employees securing the pipeline should be rewarded for not allowing theft or sabotage to the nation's most vital resource. The financial incentives should be at every level such that a vast amount of Iraqi citizens have a stake in the country's profitability. This would also lead many to turn insurgents, saboteurs and terrorists that currently reside within the population. With the population turning against the insurgency, the United States and the current Iraqi government may be able to win the battle over the key center of gravity.

The next part of the process needs to address relative deprivation and entrepreneurship. If 25 to 40 percent of the population is unemployed, it is a statistical certainty that not all are unskilled workers, meaning that many would be underutilized as a security sentry, possibly leading to a relative deprivation situation. Either through testing or through background checks, it would be wise for the United States to work politically with the Iraqi government to have some of the more educated or skilled workers to come to the United States to earn business degrees. Upon returning to Iraq, they would be able to set up viable businesses through government incentives (similar to the United States) in order to further spurn entrepreneurship. Referring back to the cultural intelligence landscape, Iraqis had been a society looking to expand its technology and economy until the Ba'ath Party took control. Hence, it is not unknown to the older generation, but it must be cultivated in the current work force by offering incentives,



education, and opportunity. Robert Looney’s virtuous circle of demand is shown below showing how an oil fund for public distribution can effectively reduce corruption.<sup>107</sup>

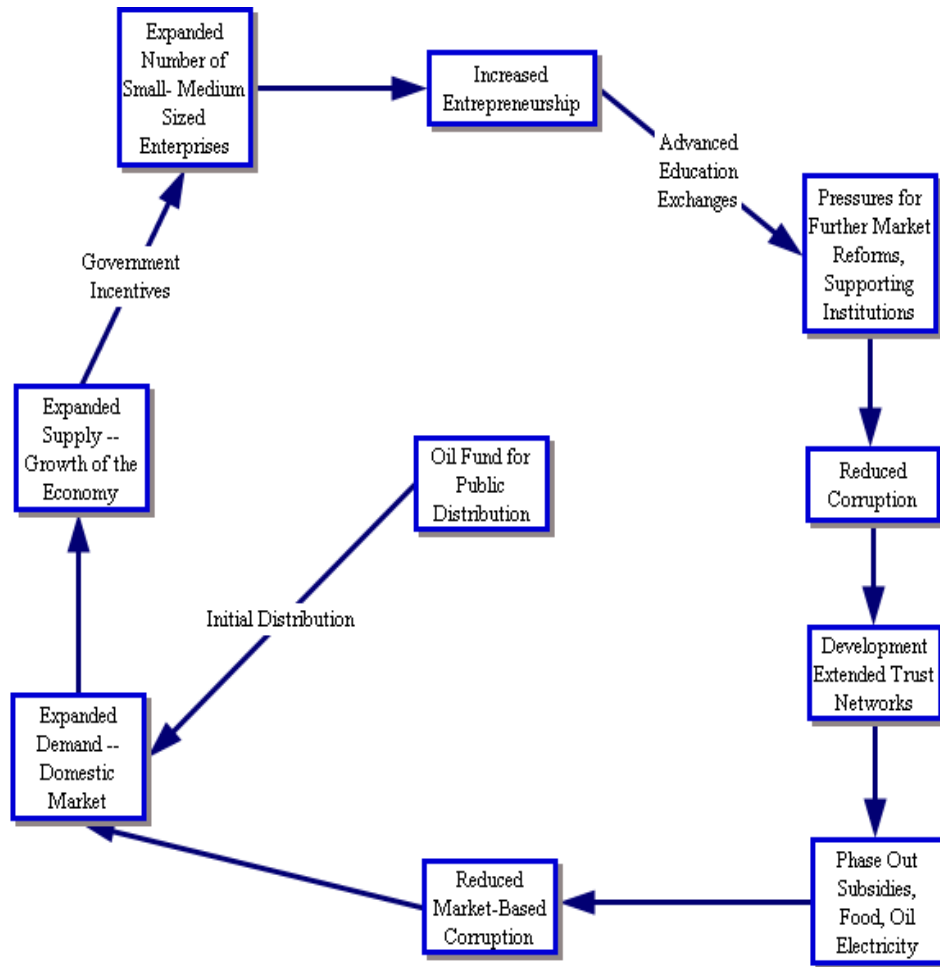


**Figure 2. Robert Looney’s Model for How an Oil Fund Can Help Curb Corruption**

By using cultural intelligence that has been presented in the document there should be additions where an initial return should be given immediately to allow the oil fund time to generate revenue, local municipalities to create plans for spending their revenue to enhance the quality of their citizen’s lives, and to train the unemployed on

<sup>107</sup> Robert Looney, “Can Iraq Overcome the Oil Curse?” *World Economics*, Volume 7, No.1, January – March 2006.

sentry duties. In addition, the entire plan must be advertised and marketed to the people. It is imperative the average citizen sees that the oil is theirs, so they will help protect the oil, and they will see direct compensation for their efforts. This would result in making additions to Looney's model so that it looks like the one below.



**Figure 3. Looney's Model With Additions**

One will notice that there are three additions to Looney's model. The first is an initial distribution provided directly to the public to help jumpstart the economy and to show goodwill towards the people until the oil fund can be established. In addition, this

money may be able to divert individuals in the first or second levels of Moghaddam's staircase from rising to the third level where they would join the insurgency or a terrorist organization. Provided the distribution is done evenly across the entire population, it could help alleviate any relative deprivation one group may feel toward the others, e.g., Sunni versus Shia or Sunni versus Kurds, or Shia versus Kurds. The second addition is to incorporate government aid as an incentive to help open small businesses and kick start the entrepreneurial spirit, and the third is to provide scholarships through either an exchange program with the United States, Great Britain, or perhaps a country such as Dubai that has embraced a free market economy for Iraqis to earn Masters of Business Administration that should help develop better market reforms and aid the transition process. All of these items target the people and should put more money in the people's pockets, raising their quality of life while stimulating free market reform and economic growth.

In conclusion, corruption and sound democratic values will not take hold in Iraq over night. The United States must be willing to see the process through as it will take years for the roots to formulate. However, it is important for the both the United States and the Iraqi government to begin fostering good will and focusing on improving each Iraqi's quality of life. Providing money, jobs, and ownership in the country's resource are all critical components to creating an environment that will forge a better state-society relationship that has been absent for decades. As the state-society relationship builds, the virtuous circle that has been spiraling downward can reverse course, hopefully leading to a prosperous, wealthy, democratic Iraq that is fulfilling its full potential.

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## VI. CONCLUSION

The cost of the war in Iraq is extremely high, though it is not something that will bankrupt the United States. It does come with a high opportunity cost of not spending roughly 2 trillion dollars elsewhere. With such a large financial investment, it is imperative that the United States achieves a return on its investment by ensuring that Iraq completes its transition to a democracy and becomes a solid ally of the United States in the Middle East. Directly opposing the democratic transition is an Iraqi culture that has been dominated by corruption and bribery for decades. It is precisely this cultural phenomenon of corruption that must be broken in order to ensure that rule of law becomes standard practice and for democracy to thrive.

Whether the United States likes it or not the Ba'ath Party and Saddam Hussein's regime is still having an effect on Iraq. The illegal systems and survival methods of the people are still being used today as the Iraqi government struggles to become an effective agency. The corruption is focused mainly on Iraq's cash cow...oil. The black market for crude oil is fueling an illegal market through porous borders with neighboring countries especially Turkey. The Iraqi subsidy for oil is allowing corruption to take place by not allowing the forces of supply and demand to determine appropriate gas prices, creating arbitrage possibilities. Furthermore, the judicial system is not providing sound punishments to deter perpetrators from attempting corrupt acts. As a result, billions of dollars are being taken away from the Iraqi government that could be used to improve the quality of life of its citizens. Moreover, instead of the American dream transcending upon Iraqis, it appears the Iraqi culture of corruption has strayed Americans from abiding by the law.

With the United States wanting to quickly rebuild Iraq, it abandoned sound contractual policies that have ensured success in the past. By not taking time to allow for a competitive process, the United States allowed a few companies to dominate the reconstruction process with Haliburton and its subsidiary KBR leading the way. Furthermore, with Vice President Dick Cheney's prior employment with Haliburton, the appearance of impropriety could not have been avoided. However, with repeated

instances of bribery and corruption in various methods that have been outlined previously, the perception of American corruption has skyrocketed. In addition, the CPA chose predominantly American and British firms for reconstruction contracts, leaving little of the spoils to go Iraqi companies that could employ its people. Instead, unemployment has stagnated between 25 to 40 percent, leaving the illegal economy and past corruptive practices as the only manner to survive for the population.

One possible solution to the problem was proposed by Looney is an oil fund similar to the Alaskan oil fund that provides money to Alaskan residents annually. The theory behind using an oil fund is that the revenue would spur economic growth by individuals using the increased cash flow to open businesses yielding a corresponding entrepreneurial spirit. Through the increase of cash flow from citizens, business and government, the quality of life of the population would increase through a developing tax system, and more services could be provided by the government. As the circle spirals upward, the government eventually wins the support of the populace...the key center of gravity in any insurgency. As the population sways in favor of the government, insurgents have fewer places to hide as the population becomes sentries for security forces.

The one major flaw with the Alaskan analogy is that the population of Alaska already abided by a rule of law that is missing in Iraq. Instead the opposite end of the spectrum is prevalent where some areas are near civil war. Hence, some awareness of the environment and cultural intelligence should be used to target the population in order to better facilitate an increase of quality of life of the average Iraqi. The United States attempted to improve quality of life by big picture construction projects such as electric power plants which have not produced a suitable solution. Now is the time where funds should be put into the hands of the Iraqis themselves to invigorate the economy just as President Bush did to rejuvenate a stagnant American economy in 2001. Moreover, the United States needs to focus on the same cash cow that is fueling the corruption...the oil pipeline and distribution process. With such a high unemployment rate, it is possible to employ personnel as sentries with pay bonuses being tied to keeping pipelines free from theft. Furthermore, government incentives should be made available for citizens to start

small businesses. In theory, the result should increase the quality of life of every Iraqi. It is also imperative that once the government starts seeing revenue from its oil production, it needs to ensure that the economy diversifies and can rid itself of the oil curse that has plagued Iraq and many other countries for decades.

By increasing the quality of life, there is a smaller probability that individuals will turn to the insurgency or terror. While poverty does not necessarily facilitate violence, it is believed that a relative deprivation is a necessary condition for an individual to resort to violence as a method to express disfavor with others. Understanding why many Iraqis are joining the insurgency should help facilitate American counters. Those counters need to focus on the population, not the enemy.

There are many areas where more research can be done this area. The first area is to see if American judicial activity is being adequately publicized by Iraqi newspapers. It is important that Iraqis see that corruption does not reap rewards in the United States. If it is being reported, how much of the population actually receives the information, and then is the news believed. Another area for research is what kinds of small businesses are needed in Iraq where immediate investment can prosper. Government incentives to start those types of businesses could also kick start economic growth. In addition, case studies of other Islamic countries such as Dubai could be researched to see how they transitioned from a clientalist market to a free market with little to no violence. A final area could be to research the opinions of first generation Iraqi-Americans as to possible solutions to help facilitate the democratic transition.

Corruption can be said to be the antithesis of democracy and a free market economy. Corruption can never be completely fixed. Democratic values and principles along with transparent reporting by the government and independent agencies limit corruption. The hardest part of the Iraqi transition is having the patience to allow economic changes to take hold and whether the American taxpayer will accept that it cannot be fixed quickly.

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