

Entrepreneurship, Corruption, And Economic Development In Post-conflict/Post-disaster States

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“The long-term guarantor of stability is not a tank round or a 500 pound bomb; it comes from development that is sustained and works for the people.”
General William Ward, Commander, U.S. Africa Command

Expeditionary economics: “Focuses on the role of indigenous entrepreneurship in spurring economic growth post-conflict or post-disaster.” (Kauffman 2010, p. 7)

In low-income post-conflict or post-disaster countries such as Iraq, Afghanistan, or Haiti: long-term political stability is threatened by a failure to create sufficient productive jobs. Consider the case of Iraq. Like many low-income countries, Iraq’s population is growing at a rapid rate. As a result, every year approximately 840,000 Iraqis become old enough to start working. Even after adjusting for jobs opening as a result of retirement as well as the relatively low rate of female labor force participation, any year in which there are less than a quarter of a million new jobs created will result in an increase in the pool of long-term unemployed. These unemployed – mostly uneducated, unskilled young men – are prime recruits for the various groups that seek to destabilize Iraq.

Not every job is a job

In many low-income post-conflict/post-disaster countries, officials attempt to reduce unemployment by an expanding government employment. This is generally a popular policy with the population since working for the government often provides better pay, more benefits, stronger job security, and a more relaxed work intensity than private sector jobs. Also, international advisors often support the rapid expansion of government employment since it provides a measurable means of reducing unemployment - especially among difficult to employ uneducated/untrained young men – and puts money in circulation. But does a rapid expansion of government jobs actually reduce political instability?

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It is often a misnomer to refer to the expansion of government employment as real job creation. A job implies an exchange. The worker provides something of value to his or her employer – his labor and human capital – and, in exchange, the employer provides something of value to the worker - a paycheck. Since this exchange is valuable to both parties, they develop a commonality of interests – a limited form of loyalty - since if the firm goes out of business then both the owner and the workers are worse off.

Contrast this to workers in government employment in low-income post-conflict/post-disaster countries. The loyalty of these workers is rarely to the government or to the public at large but rather to the particular political, religious, tribal, militia, or family member who arranged for their government paycheck. This is especially clear if the government job requires little labor or even attendance. In Iraq, it is estimated that as many as 25% workers at some government Ministries are “ghosts”. These ghost workers receive a regular paycheck without having to show up more than once a month. The combination of a government paycheck, little or no work, and an intense loyalty to whoever arranged this bounty is a recipe for instability. Political, religious, tribal, or militia leaders have a loyal force that is paid for by the government.

In addition to providing paid employment, a focus on creating private sector jobs tends to improve political stability for at least two reasons. First, with a few exceptions such as providing security services, private firms strongly support efforts to achieve political stability. Riots are bad for most businesses. While government employees generally continue to receive their paychecks even if their offices are looted, private sector employees know that if a mob or bunch of hooligans wrecks their shop then they are most likely out of a job. As a result, in Iraq, as in other countries suffering from political instability, it is not uncommon for employees to risk their lives to protect their place of employment during periods of disorder.

Second, motivated by profit, private firms tend to be more willing to ignore ethnic, religious, or tribal differences when they do business. While to an outsider, Sunnis and Shi'a or Arabs and Kurds appeared to be separated by hundreds of years of hostility; in fact, complex business relationships among these groups existed. The Sunni farmer sold his crop to a Shi'a merchant; the Kurdish merchant in Mosul arranged large shipments up the rivers with his Arab counter-part in Basra. These profit-motivated transactions create a degree of common interests and, sometimes, sympathy that can offset attempts by some leaders to benefit by inflaming political instability. In contrast, government ministries in Baghdad controlled by one ethnic or religious group can, with impunity, make it extremely difficult for members of other groups to obtain what they legally deserve. This leads to frustration and anger on the part of the excluded group. Political stability is better ensured with private sector jobs. But there is a continuing debate on the best means of encouraging private sector job growth.

Top-down vs. bottom-up job creation

Among the most oft cited military references on post-conflict economic development are: *Stability Operations Field Manual* (US Army FM 3-07, 2008), *Counterinsurgency Field*

Manual (US Army FM 3-24, USMC Warfighting Publication 3-33.5, 2006) and the seminal *Small Wars Manual* (USMC, 1940). While each of these works has great value, their recommendations for facilitating post-conflict economic development – with the partial exception of *Stability Operations* - generally concentrate on economic stabilization and rebuilding infrastructure.¹ These recommendations are consistent with Washington Consensus approach for bringing about an acceleration of economic growth through state driven “top-down” initiatives. While there might be some partial successes with the “top-down” approach in post-conflict/post-disaster countries, it is generally viewed as an expensive failure.² There are two primary reasons for its failure to deliver increased political stability. It does not focus on the creation of productive jobs and it treats corruption as primarily a law enforcement problem.³

Expeditionary economics is a “bottom-up” approach to increasing political stability by encouraging private sector job creation through productive entrepreneurship.⁴ This paper is intended to provide an overview of expeditionary economics in four parts. First, there will be a discussion of the relationship between economic growth, productive job creation, and political stability. Second, there will be an analysis of entrepreneurship and its impact on productive job creation in low-income, post-conflict/post-disaster countries. Third, the symbiotic relationship between political instability/conflict and corruption as well as the interplay between entrepreneurship, corruption and conflict will be discussed. The paper will end with some thoughts on possible tactical level actions to encourage entrepreneurship and fight corruption.

Economic Development and Political Instability

Samuel Huntington’s 1968 hypothesis⁵ of the relationships among modernization, economic development, and political stability has been described as the last great attempt to integrate the social, economic, and political causes of instability.⁶ There are more

¹ For example, see *Stability Operations Field Manual*, Sections 2-60 to 2-62.

² See Jeffrey Patterson (2010) “Towards a Post-Conflict Development Doctrine” in Kauffman Foundation *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics*, Kauffman Foundation: Kansas City, MO, p. 226.

³ See *Stability Operations Field Manual*, Section 3-53.

⁴ For detailed discussions of expeditionary economics, see Schramm, Carl (2010) “Expeditionary Economics” *Foreign Affairs*, May/June, pp. 89-99, and Peterson, Jeff and Mark Crow (2011) “Expeditionary Economics: Towards a Doctrine for Enabling Stabilization and Growth” presented at West Point conference on expeditionary economics, February.

⁵ Huntington, Samuel P. (1968) *Political Order in Changing Societies*, Yale University Press: New Haven, Connecticut, p. 41.

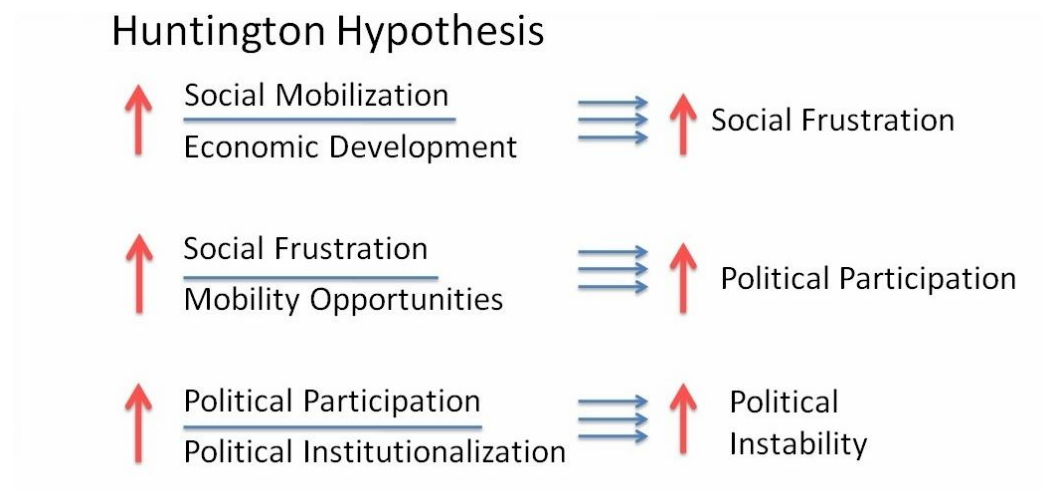
⁶ Fukuyama, Francis (2011) *Origins of Political Order*, Farrar, Straus and Giroux: New York, p. IX.

elaborate recent models of the relationships between economic and political change⁷ but Huntington's hypothesis provides a solid framework for examining the challenges facing low-income post-conflict/post-disaster countries.

Huntington attempted to explain an oft-observed phenomenon that: "Modernity breeds stability but modernization breeds instability." In other words, high-income countries generally experience less political instability or conflict. However, low-income countries that experience an acceleration of economic growth tend to experience *more* political instability or conflict. Huntington sought to explain this counter-intuitive result by looking at the rates of change of modernization, economic development, opportunities for mobility, and political institutions. His analysis is illustrated in Figure 1.

Urbanization, increases in literacy and education, and increased exposure to media lead to social mobilization. People in low-income countries begin to realize that there are more favorable ways of living. For example, on the village TV they see shows where people don't have to walk to work, aren't limited to farming with hand tools, and where sick children have access to medical care. This social mobilization leads to expanded aspirations. People begin to believe that progress is possible and they want a better life for themselves and their children.

Figure 1



Source: Huntington 1968, p. 55

Economic development increases a society's capacity to satisfy those aspirations. It doesn't have to be immediate or complete e.g. farmers may be aware that others have trucks but if they are able to buy motorbikes then this may partially satisfy their new-borne aspirations - at least for a while. However, if economic development lags too far behind in fulfilling the growing aspirations created by social mobilization then social frustration – a growing dissatisfaction with current circumstances – will increase.

⁷ See, for example, Daron Acemoglu and James Robinson (2006) "Paths of Economic and Political Development" in Barry Weingast and Donald Wittman (eds) *The Oxford Handbook of Political Economy*, Oxford University Press: New York, pp. 673-692.

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Social frustration can be dissipated if the society allows opportunities for mobility. This mobility can be geographic (people moving from one province to another or from rural areas to urban), occupational (moving to a higher-paying/higher-status job/profession), or international (migrating to another country – “brain drain”).

However, if social frustration grows faster than can be dissipated by mobility then people will want increased political participation in order to demand that the government either accelerate economic development or increase mobility. People will seek to either join existing political organizations or create new ones in order to give voice to their demands.

Demands for expanded political participation often collide with rigid or closed political institutions that are intended to protect the interests of those currently or previously in positions of power. Such institutions will limit incorporating new political participants in a meaningful way. This exclusion will provide fertile ground for political instability or, if the situation continues to deteriorate, conflict. This collision between demands for expanded political participation and closed political institutions is one of the major causes of the political instability that began in Egypt early in 2011 and has now spread to many nations in the Middle East and North Africa.

As Figure 1 illustrates, according to the Huntington hypothesis, there are three ways that a nation can forestall political instability or conflict: by accelerating economic development; by increasing opportunities for geographic, occupational or international mobility; or by increasing the flexibility of political institutions when confronted with new demands for political participation.

Entrepreneurship critically impacts the Huntington model in at two ways. First, entrepreneurship can lead to an acceleration of economic development. This will reduce social frustration, as faster economic development will allow more of the people’s aspirations to be met in a timely manner. Second, entrepreneurship can provide opportunities for increased mobility to large number of people. They have the opportunity of moving from being a waged worker to being self-employed. This mobility as a result of entrepreneurship will, at least partially, offset any increases in social frustration that do occur.

Entrepreneurship and Productive Job Creation

*Entrepreneurs are individuals who, in an uncertain environment, recognize opportunities that most fail to see and create ventures to profit by exploiting these opportunities.*⁸

⁸ Gunter, Frank R. (2011) “A Simple Model of Entrepreneurship Demand For Principles of Economics Courses”. In the seventh (2007) edition of Donald Kuratko and Richard Hodges’ textbook *Entrepreneurship: Theory, Process, Practice* defines an entrepreneur in a similar although more wordy form as: “An innovator or developer who

Despite the growing realization of the importance of entrepreneurship for economic development in both developing and developed countries, there is no consensus on the definition of entrepreneur or entrepreneurship.⁹ However, most of these definitions echo Mark Casson (1987) who emphasized that the entrepreneur specializes in “judgmental decisions”, decisions where there is no obviously correct answer *and* information is costly.¹⁰

When studying low-income post-conflict/post-disaster countries, it is important to use a definition that is broad enough that includes both of the major entrepreneurial “types”; arbitrage entrepreneurship and innovative entrepreneurship.¹¹ The proposed definition given at the top of this section meets these requirements. Most economic research occurs in high-income countries and focuses on the challenges facing innovative entrepreneurship – entrepreneurship that creates new products, processes, or markets. However, the less-studied arbitrage entrepreneurship is more relevant when attempting to increase employment in low-income countries especially in a post-conflict/post-disaster situation.

Such economies are constantly subject to shocks of various kinds. An act of war could destroy an electrical generation plant, a hurricane could devastate a crop just before harvest, human error could wreck a train in a tunnel, or an unexpected new government regulation could require the abandonment of a widely used fertilizer. These shocks lead to market shortages or overages, waste, and inefficiency - market disequilibria – and economic growth slows or ceases entirely.

However, these shocks also create opportunities for profitable arbitrage by buying low and selling high. For example – in response to the first shock listed above – an

recognizes and seizes opportunities; converts these opportunities into workable or marketable ideas; adds value through time, money, or skills; assumes the risk of the competitive market place to implement these ideas; and realizes the rewards...” For alternative definitions see Simon Parker (2009) *Entrepreneurship: Theory, Process, and Practice*, 7th edition, Mason OH: Thomson Higher Education.

⁹ It is interesting to note that in the Kauffman Foundation’s 2010 *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics*, only twelve of the twenty-one chapters even mention entrepreneurship. And it was often difficult to determine exactly what each author meant by the term. In fact, in two of these chapters, “entrepreneurial” appears to be used as a metaphor for “creative” or “innovative” thinking within government bureaucracies. This use of the term “entrepreneurial” is confusing at best.

¹⁰ Casson, Mark (1987) “Entrepreneur” in Eatwell, Milgate and Newman (eds) *New Palgrave Dictionary of Economics*, New York: MacMillan Press, Vol I, pp. 151-153.

¹¹ For a discussion of the differences between arbitrage (Kirznerian) entrepreneurship and innovative (Schumpeterian) entrepreneurship, see Baumol, William (2010) *The Microtheory of Innovative Entrepreneurship*, Princeton NJ: Princeton University Press, pp. 13-16.

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entrepreneur might use political influence (or bribes?) to import portable generators in order to sell black market electricity. In other words, arbitrage entrepreneurs - motivated by profit – reallocate existing resources using existing methods in existing markets. To the extent that these entrepreneurs are successful, shortages or overages will dissipate, waste will be reduced, and efficiency will increase resulting in accelerated economic growth and job creation.

In high-income countries, the process of arbitrage entrepreneurship is so fast and so efficient as to be almost invisible. There is widespread availability of information on various options. Also, transportation and commercial systems generally support rapid responses to changes in demand or supply. In fact, it is only in the governmental provision of private goods (e.g. garbage collection or elementary schools) that residents of most high-income countries ever perceive a shortage of arbitrage entrepreneurship!

But in low-income countries, the arbitrage entrepreneurship that is a critically necessary for accelerating economic growth is often lacking. While some cultures are more accepting of arbitrage entrepreneurship than others, the shortage of successful entrepreneurship is mostly a result of the high barriers to such efforts. The worst barrier is corruption. However, low education levels, difficulties in obtaining finance, a hostile regulatory environment for the private sector, and the perceived lack of security in a conflict/post-conflict/post-disaster societies also slow or prevent entrepreneurial activities.

Entrepreneurship, Corruption and Economic Development

*Corruption is abuse of public power for private benefit.*¹²

Bribery gets the most attention, but corruption can also include nepotism, official theft, fraud, certain patron-client relationships or extortion. This definition of corruption does *not* usually include abuses of private power such as insider trading.

One of the challenges of studying corruption in the Middle East is that the word “corruption” is both descriptive and pejorative. Many Middle Eastern societies have long cultural traditions of patron-client relationships, nepotism, or “gift giving” to officials. And members of these societies often object to describing such behavior as corruption. It is often argued that calling such cultural traditions corruption is a distortion - an attempt to apply Western standards to non-Western societies.

However, whether some forms of corruption are culturally accepted is a separate question from whether corruption has an adverse impact on economic development. While there has been extensive research on this issue, the results can be illustrated in a crude fashion

¹² Gunter, Frank R. (2008) “Corruption,” in *Encyclopedia of Social Problems*, Vol. 1, Vincent N. Parrillo (ed.). Thousand Oaks, CA: SAGE.

by looking at the relationship between countries' relative per-capita income (adjusted for cost of living) and measures of relative corruption. The relationship is negative. Regardless of culture or geographic location, *there are few corrupt rich countries and few honest poor ones*. Whether it is culturally accepted or not, corruption adversely affects economic development both at the microeconomic level – by discouraging entrepreneurship – and at the macroeconomic level – by making economic stabilization¹³ more difficult.

Corruption and conflict

There is a symbiotic relationship between corruption and conflict.¹⁴ Corruption is good for the anti-government forces in an insurgency. Corrupt activities, including black market sales of stolen goods, official theft, extortion and “ghost workers,” can provide funding for the insurgency.¹⁵ Organizations and ratlines that handle smuggled or stolen goods provide routes and safe houses for insurgents, their munitions, and other parts of the insurgents' logistical tail. Corruption also undermines the public's confidence in both its government and allies. Finally, corruption can result in diversion of government assets - from rations to weapons - into the black market. Corruption directly undermines the ability of U.S. forces to fight a counter-insurgency war.

And conflict is good for corruption. As the government absorbs an increased proportion of a nation's resources to fight the conflict, there will be widespread shortages and it is likely that price and wage controls will be imposed to prevent inflation. Both of these events provide strong incentives for the population to trade in the black market. The reality of insurgent attacks justifies bypassing procedures and provides a ready excuse for corruption related losses. Finally, fighting an insurgency increases the urgency of getting things done regardless of cost, which facilitates bribes and extortion. Since they are mutually reinforcing, corruption makes it more difficult to resolve a conflict while, the longer a conflict lasts, the more embedded corruption becomes in a society. Further complicating the relationship between conflict and corruption is that the former is sometimes favorable to entrepreneurship.

Conflict and Entrepreneurship

The relationship between conflict (or a disaster) and entrepreneurship is complex. June Reed, based on her extensive on-the-ground experience in Iraqi economic development,

¹³ Economic stabilization generally refers to reducing fluctuations in a nation's macro economy. An economy with fairly constant real output growth combined with low and stable inflation would be considered economically stable.

¹⁴ Gunter, Frank R. (2007) “Economic Development during Conflict: The Petraeus-Crocker Congressional Testimonies” *Strategic Insights*, Vol. VI, Issue 6, December 2007

¹⁵ Bahney, Benjamin; Howard J. Shatz; Carroll Ganier; Renny McPherson; and Barbara Sude (2010) *An Economic Analysis of the Financial Records of al-Qa'ida in Iraq*, Washington D.C.: Rand Corporation, p. 36.

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argues that effective expeditionary economics is a continuum with three phases.¹⁶ In the First Phase, even before the shooting stops, the focus must be on humanitarian assistance. The Second Phase concentrates on quickly providing employment for young men as a stopgap measure. Only the Third Phase is centered on entrepreneurial activity – seeking to accelerate economic development by facilitating private sector growth.

Unfortunately, there is a tendency for military and civilian decision makers to get “stuck” in the first two phases for at least four reasons. First, the concentration on humanitarian assistance and large-scale job projects for young men partly reflects the desperate need for essential services and quickly getting money circulating again in the economy. Second, military and civilian planners think that they can’t transfer “responsibility” for job creation and economic development because there is no one in authority in the private sector to accept the transfer. This reflects a bureaucratic mindset that says if the military or government doesn’t do something then it won’t be done. And, the civilian population often reinforces this mindset because they prefer to receive needed products and services free from the government rather than purchase them. For example, ask an Iraqi farmer what he will do if the government stops providing free seed and the most common answer is that he will stop farming. In reality, this is only partially true. Some farmers will abandon their land but many will seek the needed seed from non-governmental sources – from entrepreneurs.

Third, there is a tendency for military units to see economic development as a civilian responsibility and delay moving into the Third Phase until they can pass responsibility to the foreign or local civilian experts. However, such experts will probably be scarce until after violence has declined to low levels for a significant period of time. And delays in moving to the Third Phase in a timely manner can not only delay economic development but also, for the reasons discussed above, be politically destabilizing. Finally, many organizations would rather be able to report progress in meeting yesterday’s priorities than risk failure in achieving today’s! And few goals are more difficult to achieve than encouraging entrepreneurship in a post-conflict/post-disaster environment.

Conflict increases the transaction costs of entrepreneurship. Reductions in security make it more difficult for entrepreneurs to operate. Their suppliers or customers may be less willing to travel any distance to sell to or buy from the entrepreneur. It becomes more difficult to gather accurate market information concerning including prices and product shortages. It may become almost impossible to gain necessary licenses or approvals as government officials are either distracted, in hiding, or isolated by their security forces. Banks and other financial institutions hesitate to lend while informal financial sources tend to hoard their assets until the security situation clarifies. Governments may view any entrepreneurial profits during a period of violent political turmoil as being immoral and seek to confiscate them. All of the above are in addition to the possible direct impact on the entrepreneur. He or she may be drafted by the government or the insurgency, may experience theft or destruction of inventory or capital equipment.

¹⁶ Reed, June (2011) “Defining Expeditionary Economics” presented at West Point conference on expeditionary economics, February.

However, conflict might also provide profitable opportunities for arbitrage entrepreneurship. Even low levels of political instability can disrupt existing markets. For example, security issues might require diverting civilian shipments from traditional routes. The businesses of providing bodyguards and home/office security will expand rapidly. Both the government and any insurgency will try to rapidly expand their operations requiring increased purchases of supplies. Arbitrage entrepreneurs may thrive by meeting these demands. Periods of instability may also lead to a substantial reduction of government oversight over business – a regulatory holiday. Finally, trades that were traditionally dominated by a particular group may be opened to entrepreneurs from other ethnic, religious, political, gender, or cultural backgrounds. A prime historical example of the favorable impact of conflict on entrepreneurship would be the American Civil War that resulted in the foundation of some great entrepreneurial fortunes.

Whether the net effect of political instability or conflict on entrepreneurship is negative or positive will vary not only from country to country but also over time. As discussed in the *Stability Operations Field Manual* (2008, Section 1-90), while actual conflict discourages entrepreneurship, entrepreneurial opportunities tend to quickly emerge as soon as the shooting stops.

Corruption and Entrepreneurship

While the net impact of conflict on entrepreneurship is ambiguous, that of corruption is not. Corruption tends to weaken entrepreneurship in two ways. First, it increases the cost of being a business owner. He faces the choice of either continuously paying bribes to an unending queue of rapacious officials or structuring his enterprise so as to reduce its vulnerability to the actions of corrupt officials. The former option can be expensive. A survey of over 1,600 private businesses in Iraq revealed that one in five thought that bribes and other forms of corruption added 40% or more to their total costs of doing business!¹⁷ The alternative is for a business to operate in the underground or black market. In order to avoid coming to the attention of officials seeking bribes: businesses will stay small, avoid advertising, limit transactions only to family, tribal, or other trusted persons, and often produce their product or service so that equipment and inventory can be quickly hidden or moved. As expected, these avoidance tactics severely limit potential entrepreneurial activities.

The second means by which corruption adversely impacts entrepreneurship is by diverting potential entrepreneurs from productive to unproductive activities. Not all entrepreneurship is beneficial to an economy. William Baumol (1990) and Sameeksha Desai et al (2011) discuss the possibility that entrepreneurship can be unproductive, or even destructive.¹⁸ In fact, much corruption can be thought of as a form of unproductive

¹⁷ Center for International Private Enterprise (2007) *Iraq Business Owner Survey*, Table 27, p. 11.

¹⁸ Baumol, William (1990) “Entrepreneurship: Productive, Unproductive and Destructive”, *Journal of Political Economy*, Vol. 98, pp. 893-921. Desai, Sameeksha;

or destructive entrepreneurship e.g. rather than improve customer service to take market share from a competitor, an entrepreneur might instead bribe the police to arrest his competitor. And to the extent that officials can perform profitable corrupt acts with impunity, potential entrepreneurs may decide that they are better off becoming officials themselves and preying on anyone foolish enough to try to run a business.

The design of a nation's laws and institutions is critical in determining whether incentives motivate a potential entrepreneur to engage in activities that contribute to real economic growth, simply redistribute existing income, or actually destroy economic value. Whenever policy is changed, second-order (and third-order?) incentive implications must be considered. Otherwise, policy changes intended to reduce the impact of corruption on business may actually increase it. For example, in order to reduce the likelihood of the Iraqi government paying corrupt private sector vendors who failed to complete projects, procedures were changed to require the approval of several layers of the bureaucracy before a payment could be made. This created such long payment delays that vendors who had actually provided the contracted goods or services felt that it was necessary to pay bribes to speed up payment.

Figure 2:

Conflict, Corruption, Entrepreneurship, and Economic Development

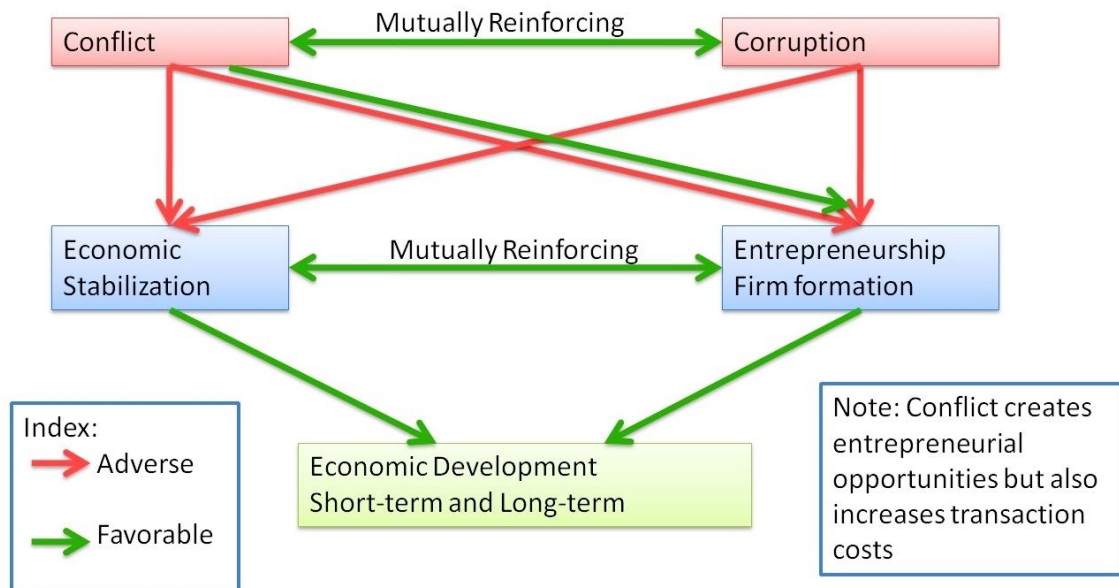


Figure 2 is intended to provide a simple illustration of the interrelationships among political instability/conflict, corruption, economic stabilization, entrepreneurship, and economic development. And, to the extent that acceleration in economic development can be achieved, it should – as illustrated in Figure 1 - reduce the likelihood of a future political instability. But what can be done at the tactical level to achieve this desirable outcome? This is the topic of the next section.

Encouraging Entrepreneurship and Discouraging Corruption at the Tactical Level of War

Characteristics of entrepreneurship in low-income post-conflict/post-disaster countries

As stated in the *Stability Operations Field Manual*¹⁹, "...host-nation enterprise creation is an essential activity." But encouraging enterprise-creation at the tactical level is complicated by the fact that in low-income post conflict/post disaster countries, entrepreneurship differs substantially from how it appears and operates in high-income countries. In high-income countries, the emphasis is on innovative (Schumpeterian) entrepreneurship that results in new processes, products, or markets. However, in low-income countries, the greatest need is for low-level arbitrage entrepreneurship that knits an economy together by buying and selling everything that people want. Only if the characteristics of arbitrage entrepreneurs in a given area are clearly understood can a successful tactical plan to encourage entrepreneurship be developed, coordinated, and executed.

Much entrepreneurial activity is invisible to an outsider or an official. This invisibility is partly a function of the lack of business information. Few small firms have websites or even a listed phone. In many low-income countries, credit or business registries are either non-existent or limited to relatively few well-established firms. In addition, political instability or conflict may force entrepreneurs to move to different areas where they are less known. But this invisibility is also partly a matter of entrepreneurial strategy to avoid criminal activity or exploitation by bribe-seeking officials.

If tactical units cannot pierce this veil of obscurity then the chances of success are small. They will be forced to engage in poorly targeted actions that, although expensive, will probably have little impact on job creating local entrepreneurial activities. An economic advisor in Iraq described attempting to jump-start local businesses without a clear knowledge of the local economy as: "Trying to build a bridge by dropping bricks from an helicopter." Another possible adverse outcome of a lack of knowledge of the local economy is that attention will be focused on one or a few local businesses that are known. Often, these businesses will endeavor to bring themselves to the attention of foreign forces, NGOs, etc. because they have discovered that there is more money to be made by participating in various development programs than in actually producing a

¹⁹ Section 3-61.

good or service. In Iraq, it was discovered that some firms had obtained funding multiple times for the exact same purpose from a succession of US military units.

What is needed is a substantial investment of command resources in a local economic intelligence preparation of the battlefield (Econ IPB) with an emphasis on the conditions for entrepreneurship and corruption. While an initial Econ IPB might be developed at higher headquarters, this product is unlikely to be detailed enough.²⁰ As noted by Lieutenant Colonels Blacker and Kim, there are many challenges to developing an Econ IPB in a conflict/post-conflict/post-disaster environment.²¹ Not only was it difficult to define appropriate metrics and gather reliable data about the economy but, surprisingly, it was extraordinarily difficult to obtain existing data and analysis from other U.S. government agencies. At the tactical level, the always-present lack of translators further complicates local Econ IPB development.

However, some units used, with success, the simple technique for gathering economic information that is associated with Benjamin Franklin. To judge economic development progress in Philadelphia, Franklin would periodically walk the same streets and note any changes in the outward appearance of every store, shop, or building that he passed. In Iraq, some units used detailed reports from regular patrols for this purpose. For example, a steady increase in the number of merchants and the variety of goods that are offered at a town's outdoor market provides some insight into the progress of the local economy, while observing which merchants are showing initiative in meeting changing customer demand helps identify potential entrepreneurs.

Arbitrage entrepreneurs in low-income post-conflict/post-disaster generally have a "bed post" distribution. A few high-income entrepreneurs engage in high volume activities possibly with many employees. These entrepreneurs tend to be closely associated with local political and military authorities for reasons both of self-protection and in order to use the authorities to suppress competition. At the other extreme, there are a large number of low-income, low-volume entrepreneurs who are often motivated by necessity not by opportunity. These necessity-driven entrepreneurs may operate at very low levels of economic activity e.g. sellers of single packs of cigarettes.

The failure rate of new entrepreneurial enterprises is very high – probably over 50%. As a result, especially in an environment marked by insecurity and political instability,

²⁰ See *Stability Operations Field Manual*, Sections 3-66 and D-48 to D-56; and *Counterinsurgency Field Manual*, Sections 6-33/34. Adopting a standardized Econ IPB format has substantial advantages especially when AOR changes are expected. In MNC-I in 2009, there was an attempt to standardize on an upgraded version of the Marine 1940 *Small Wars Manual* "Digest of Information" Section 13-11. See Appendix A for a copy of this upgraded Econ IPB format. Also, in 2009, Human Terrain Systems at Fort Leavenworth produced useful Econ IPB of each Iraq province that provided starting points for local economic intelligence efforts.

²¹ Blacker, Nancy and Charlie Kim (2010) "Measuring Economic Development in a COIN Environment" *Military Review*, November-December, pp. 11-18.

entrepreneurs attempt to diversify their activities. The same family may rent electricity to their neighbors from a private generator, do basic motor vehicle repairs, and deal in black-market fuel. It is likely that part or all of a loan or grant intended to encourage one type of activity, such as increased electrical generation, will be diverted to support other entrepreneurial endeavors that the family considers to be more advantageous.

Encouraging entrepreneurship to increase job creation

Many of the important changes needed to facilitate entrepreneurship must occur at the strategic level. For example, creating a more favorable regulatory environment will most likely require long-term expert assistance by the U.S. Mission and the major International Organizations. Progress in creating a more favorable regulatory environment is generally slow for two overlapping reasons. First, especially in a conflict situation, there is likely to be not only a shortage of civilian experts but also the capability of these experts to travel will probably be severely constrained for security reasons.²²

The second difficulty with making the necessary strategic level changes to encourage entrepreneurship while discouraging corruption is the belief - which is almost an obsession - that budget decisions are the most important driver of economic development. As a result, shifting funds from one "priority" area to another can absorb the attention of a whole organization for months. Partly this is the "street light" syndrome - budget expenditures can be easily presented in multi-color pie charts. However, budget adjustments often have little impact on real economic growth in a low-income post-conflict/post-disaster country.

Government budget expenditures are often used to offset perverse incentives. For example, many countries struggle to fund the replacement of relatively new equipment that was damaged by failure to perform basic maintenance. Without changing the incentives to favor timely maintenance, additional budget expenditures for replacement equipment is wasted. In addition, reflecting the self-interest of government officials, most national government expenditure ends up being spent in the immediate vicinity of the capital city - not in other urban areas or in the countryside.

While there are difficult strategic level policy challenges, there are actions at the tactical level that can strengthen local political stability by encouraging private sector job creation by domestic arbitrage entrepreneurs. Specifically, units can act in the areas of business micro-security, finance, education, and local sourcing.²³

Improving business micro-security refers to the difficult balancing of increased security for the local population with the need for sufficient freedom of movement for local

²² For a discussion of the difficulty of civilian expert staffing in Iraq see: Gunter, Frank R. (2007) "Economic Development during Conflict: The Petraeus-Crocker Congressional Testimonies" *Strategic Insights*, Vol. VI, Issue 6, December 2007

²³ See *Stability Operations Field Manual*, Sections 3-55/62 and 3-66.

businesses to operate. For example, to prevent VBIED²⁴, security forces raised dirt barriers around an Iraqi town except for a few entrances where vehicles were carefully searched. However, the half-day delays and expenses (bribes?) caused by these security measures made it very difficult for entrepreneurs in the town to receive shipments or even meet their customers. What is required is for local commanders to make an analysis of each area's unique micro-security challenge and, using risk-management techniques²⁵, develop a solution that balances security against facilitating job-creating businesses. In the case above, parking areas were established outside of the barrier on one side of the town's market and, on market days, multiple pedestrian entrances were opened so carts of vegetables, etc. could be quickly wheeled to the market. Of course, each town's business micro-security issues are different and will require creative resolution.

Limited finance is a serious constraint on the ability of entrepreneurs to expand since, because of they often lack acceptable collateral, small-scale entrepreneurs generally cannot access formal finance sources such as banks. As a result, needed finance comes from retained earnings, family, tribe, traditional moneylenders, suppliers, or from their customers. Finance from these sources can be extremely expensive. Creative use of CERP or other micro-grant/micro-loan programs can often provide needed finance for job-creating entrepreneurial activity.²⁶ However, these funds often have unrealistic legal restrictions that limit their usefulness for financing small businesses. Another approach is to provide local support for establishing micro-finance institutions. While the loans are generally small – an average of \$1,400 in Iraq – and the interest rates are high, these are often better terms than small entrepreneurs can receive from other lenders.²⁷

Unlike in high-income countries, many successful entrepreneurs in low-income countries have limited formal education. However, literacy and a basic knowledge of fundamental business procedures are important. In addition to reopening elementary schools as soon as possible, units might support after-hours literacy instruction for adults. With respect to business education, one approach is to tie consideration for any grants or loans to the successful completion of ten hours or so of instruction in basic accounting and management techniques. The material should be practical and tied as much as possible to the local business environment. For example, time spent on writing a formal business plan is probably wasted but a detailed discussion of the exact procedures for obtaining licenses can be valuable.

Vocational training is difficult to do well in a post-conflict/post-disaster situation. The temptation is to rapidly reopen vocational training schools. In fact, vocational training is often incorrectly viewed as an alternative to employment for young men. The temptation

²⁴ VBIED are vehicle borne improvised explosive devices.

²⁵ "Risk Management", *Staff Organization and Operations*, FM 101-5, Appendix J.

²⁶ *Stability Operations Field Manual*, Section 3-61.

²⁷ See Frank R. Gunter (2009) "Microfinance During Conflict: Iraq, 2003-2007" in Todd Watkins and Karen Hicks (eds) *Moving Beyond Storytelling: Emerging Research in Microfinance*, Emerald Publishing: Bingley UK, pp. 209-211.

to restart vocational training should be resisted until a detailed market survey has been completed concerning where the private sector jobs are. In many low-income countries, the education bureaucracy imposes a national curriculum on vocational training schools with little concern about whether their graduates are actually able to find employment. As a result, graduates often find that there is little local demand for their new skills and dissatisfaction increases. A better approach is to first determine which jobs have the greatest shortages. A successful vocational program in northern Iraq discovered that the greatest shortages were in plumbing, masonry, and hair dressing while, in Baghdad, the greatest demand was for basic computer skills and English. Only after the shortages have been identified, should the difficult process of obtaining qualified instructors begin.

Local sourcing is another option for encouraging the job creation by domestic entrepreneurs. The possibilities of obtaining logistical support from the local economy are limited only by the creativity of the unit. “Iraq First” and “Afghanistan First” programs encouraged such local sourcing for everything from long-distance truck transportation (Iraq’s ITN program) to printer paper. The most important considerations with local sourcing are three. First, units should be alert to the problem of creating shortages of essential goods or services.²⁸ If there is a drinking water shortage, then the unit should ship in its drinking water or, better yet, drill new wells or repair cisterns to increase the local water supply before tapping the local water market. Second, the wages and prices offered by the unit should be roughly consistent with those of the local economy to reduce unnecessary disruption. If a local mechanic closes his shop to drive a truck for the unit or the local doctor closes his clinic because he can earn more as a translator on base then there will be an adverse impact on the local economy. Third, there is the challenge of maintaining security. Some units have experimented with a “Yellow Zone” where local entrepreneurs, who do not have access to the base, can sell their goods or services to units in a semi-secure environment with basic mercantile infrastructure and access to necessary communication, power, and transportation assets.

Opposition to local sourcing can often be expected from U.S. and other nations’ contractors as well as from the host nation government. These entities often profit handsomely from providing the various goods and services required for a U.S. unit’s logistical support. As a result, they sometimes attempt to prevent or at least delay local sourcing by arguing strenuously against local sourcing within the command or by leaking to the U.S. media concerns of how local sourcing might compromise the safety of U.S. personnel. In some cases, it was rumored, that the national government sought to either block local sourcing through aggressive enforcement of existing although oft-ignored regulations or, at least, divert some of the earnings of local businesses into official pockets. Such corruption slows the expected employment gain from local sourcing.

*Corruption at the Tactical Level of War*²⁹

²⁸ *Stability Operations Field Manual*, Section 3-57.

²⁹ This section is based, in part, on “Post Invasion Corruption in Iraq”, in Frank R. Gunter

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Reducing corruption can be expected to have several benefits. Successful anti-corruption efforts will also weaken the insurgency by making it more difficult to obtain financing and logistical support. Also, as stated in the U.S. Army Stability Operations Field Manual (2008, Section 3-22): “Corruption and graft can hinder efforts to establish governance, restore rule of law, or institute economic recovery.” By increasing the risk and reducing the returns to corrupt acts, anti-corruption efforts should also motivate entrepreneurs to shift from unproductive or destructive activities to those that encourage economic development and the associated job creation.

As a result, some of the same strategic level policies that tend to encourage entrepreneurship also tend to discourage corruption. For example, reducing hostility towards private businesses by eliminating or radically simplifying regulations and other bureaucratic requirements will not only encourage entrepreneurship but also, by reducing the necessity of paying bribes, reduce corruption. It is also possible to undermine corruption at the tactical level but the first requirement is to determine who the corrupt individuals are and exactly how their corrupt acts are planned, coordinated, and executed.

It is sometimes fairly easy to uncover corrupt acts. Since illegal payments or “gift giving” to officials in low-income countries have been going on for decades or generations, it is often not considered something to be concealed. Local businesspersons and others will sometimes openly discuss which officials should be bribed and for what purposes. In addition, corrupt officials will sometimes attempt to use U.S. or other coalition forces to facilitate corrupt acts. For example, in the interest of restoring rule of law, local government officials may seek U.S. military support for closing an “illegal” market. However, the only thing really “illegal” about the market is that it failed to bribe the right officials. In other cases, corruption was uncovered because a junior officer or NCO thought that something just didn’t “smell” right. A degree of low-level detective work is sometimes then required to get the whole story. As an example, unit logisticians should regularly scrutinize black markets to check for stolen military equipment and supplies.³⁰

Unfortunately, the easy cases are the exception; most corruption in low-income countries is carefully concealed especially if it involves dealings with groups hostile to the government. Uncovering such corruption requires intensive intelligence work but the necessary resources are generally over-committed. Ensuring the security of friendly forces and supporting operations important to the mission generally will dominate the attention of collection assets – uncovering corruption is rarely a priority. In addition, even at the highest staff levels, it is rare to find an intelligence analyst who is trained in economics and can make even a rough judgment of the adverse impact of a corrupt act on economic development and associated job creation. Often a great deal of information on corruption is often inadvertently gathered as part of various intelligence efforts but it is

Political-Economy of Iraq, London: Edward Elgar Press, Chapter 4, (Expected 2012 publication).

³⁰ See *Counterinsurgency Field Manual*, Section 8-33 and 8-55.

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difficult to integrate this material to form a clear picture of corruption especially at the provincial or local levels. But at the end of the day, it is Commanders that set priorities for intelligence gathering and analysis. If they increase the importance of economic intelligence then assets will be reassigned. This, of course, raises the question of what should be done when evidence of corruption is uncovered.

As discussed above, widespread corruption has an adverse impact on economic growth especially by limiting entrepreneurship. This will slow job creation and, in the absence of increased mobility and political participation, lead to greater political instability. And yet, attempts to aggressively enforce anti-corruption policies in a low-income post-conflict/post disaster environment can adversely impact security and stability. The *Stability Operations Field Manual* discusses the difficulty of deciding whether to dismiss a corrupt official when such a dismissal may lead to a loss of influence.³¹ Some examples from Iraq further illustrate the tradeoff.

There was a local contractor that was developing a reputation for getting projects done on time and according to specifications. However, a U.S. unit discovered that one reason for the contractor's success was that he was making secret payoffs to local tribal leaders in return for promises not to interfere with his projects. Since quality contractors were scarce, the decision was made to do nothing but continue to monitor the situation. Should the decision be different if the secret payments were being made to a religious group that was hostile to the U.S.-led coalition? What if the payments were to an insurgent group that was attacking coalition forces?

A Mobile Training Team (MTT) was attached to an Iraqi unit that had an aggressive and reasonably competent commander. It was discovered that the Iraqi commander was profiting by selling some of his unit's supplies on the black market. If the Iraqi commander was replaced then it was likely that his successor would not be as aggressive or competent. If the MTT leader told the commander that his corruption had been discovered then it was possible that the commander would temporarily cease this particular scam, find and transfer (or kill?) whichever member of his staff he suspected of leaking this information to the MTT, and then return to business as usual. And yet if the MTT leader does nothing then it may appear that he approves of the corruption - reinforcing the culture of corruption in the Iraqi Army. Should the MTT leader's decision be different if the Iraqi commander was pocketing death benefits intended for the widows of his former soldiers? What if he was skimming his soldier's pay?

As these examples illustrate, dealing with corruption is often not as simple as the oft-cited "zero tolerance" legal advice of "document, report, and prosecute". A more realistic approach is to view corruption as a hazard - "an actual or potential condition that can cause mission degradation" - and therefore a proper subject for risk management.³² Identification of hazards must be followed by an assessment of their probability and severity. The assessment must include both the potential for mission degradation if the

³¹ *Stability Operations Field Manual*, 2008, Section 5-54.

³² "Risk Management", *Staff Organization and Operations*, FM 101-5, Appendix J.

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corrupt acts continue as well as possible adverse impacts of exposing or punishing the corrupt acts. For example, attempting to buy short-term political stability by ignoring a local official's corruption may increase long-term political instability by slowing economic development. Further complicating the assessing corruption as a hazard is the likelihood that any delay in exposing corrupt acts will be seen as U.S. acquiescence.

Once a corrupt act has been identified as a hazard and its risk assessed with respect both to probability (frequent to unlikely) and severity (catastrophic to negligible) then it is necessary to develop controls to eliminate or reduce the hazard resulting from a corrupt act. If there remains any residual risk then the commander alone decides whether or not to accept the level of residual risk. Of course, these assessments can be expected to change. A command may tolerate a level of corruption during an upsurge in violence that would be unacceptable when security is restored.

No country has ever succeeded in eradicating corruption. Progress is difficult and subject to unexpected reversals. However, the few successful anti-corruption strategies have a few characteristics in common. Strategies that concentrate on politicians giving a few speeches against corruption and the arrest of a few officials have failed. It is also necessary is to change the culture and economic incentives that motivate corruption. As they say in Internal Affairs: "If you get rid of the rotten apples without getting rid of the rotten apple barrel then you will have to do it all over again next year."

Exact causes for corruption differ substantially not only among countries but also among regions and professions within a single country. So guidance on tactical anti-corruption efforts must focus on some general concepts. The few successful anti-corruption programs have been multi-pronged with simultaneous efforts to:

1. Change the culture of corruption.
2. Reduce the economic incentives for corruption.
3. Improve governance.
4. Increase the likelihood that corrupt actors will be investigated, prosecuted, convicted, and punished.

The last two components of successful anti-corruption strategies – improving governance and more aggressive law enforcement – have received extensive treatment in the usual counterinsurgency references.³³ Therefore, the concentration will be on tactical efforts to change the culture of corruption and the economic incentives for corruption.

Anti-corruption should be assigned as an information engagement task as part of efforts to support advance host-nation governance as well as accelerate economic development.³⁴ While changing a culture of corruption sounds is a long-term process, some progress can be made by persuading respected members of the community to speak

³³ See *Stability Operations Field Manual*, Sections 3-21 to 3-30 and 3-50 to 3-53; *Counterinsurgency Field Manual*, Sections 6-9/10; and *Small Wars Manual*, Chapter XIII.

³⁴ *Stability Operations Field Manual*, Sections 3-73/74 and Figure 3-1.

out on the damage that corruption is doing to the society. Who these respected people are will differ from province to province and possibly from town to town. But they are unlikely to be politicians. In fact, focus groups in Iraq began to laugh when politicians (and soccer stars!) gave anti-corruption speeches. But the same groups listened respectfully when religious leaders and soap opera stars spoke on anti-corruption themes. The media has an important role to play in changing the culture of corruption although it faces difficult challenges. There is rarely a tradition of careful investigative reporting, it is often a popular theme to blame all corrupt acts on outsiders, criticism of government officials is often interpreted as disloyal, and it can be physically dangerous for a reporter to ask too many questions. However, units and media-oriented NGO can often provide protection and training to local reporters that will result in more professional reporting of corruption.

Reducing the economic incentives favoring corruption is critical to a successful anti-corruption policy. Often local government officials will conceal or deliberately misinterpret business regulations to increase the willingness of businesspersons to pay bribes to prevent official harassment. In her team's study of the environment for entrepreneurship in Iraq, Sameeksha Desai found that lack of accurate information on the regulatory environment was a significant barrier to potential entrepreneurs. At the tactical level, a unit may attempt to ensure that the basic information on various legal and regulatory requirements is made public.

Another way of reducing the economic incentives for corruption is to try to ensure that local government employees are not paid either too little or too much – either error leads to corruption. Of course, if government employees are paid too little then there is a strong incentive to seek to supplement their inadequate salaries through corruption.³⁵ On the other hand, if a particular official position pays too much then there is the risk that there will be an auction of the office with the position going to whoever offers the largest bribe.

However, the most important tactical level contribution towards a successful anti-corruption strategy is the personal example of U.S. military, U.S. civilian, and contractor personnel. Host nation military and government officials often envy the quality of life of their U.S. counterparts and their families. But there is also often an element of admiration for the effectiveness of the U.S. military and civilian forces - their ability to get things done. To the extent that this effectiveness is associated with a lack of corruption then there will be emulation. However, any corrupt actions by U.S. or other coalition personnel, whether military or civilian, can be expected to have a devastating impact on anti-corruption efforts. This adverse impact can only be mitigated by immediate severe sanctions. And these sanctions should probably be public. The local nationals are probably already aware of the corruption, to hide the sanctions to avoid embarrassing those in charge will make the situation worse.

³⁵ *Counterinsurgency Field Manual*, Sections 6-48, 6-97 and Table 6-3.

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The Leadership Challenge

Outside of cities and large towns, a U.S. military unit is often the dominant economic entity. This requires a difficult balancing of short-term measures to increase security against long-term activities to improve political stability by fighting corruption and encouraging local entrepreneurs to accelerate productive job creation. This security-development balance is especially difficult to achieve since substantial economic development will take the patient efforts of multiple rotations. Unfortunately, in Iraq, some commanders chose to abrogate their responsibility to facilitate job creation. They argued that only when the security environment was permissive, would it be time to work on economic development. Of course, if the lack of economic development in the face of rising aspirations leads to increased political instability then a “permissive environment” will become a chimera. *“It is difficult to think about draining the swamp when the alligators are attacking. But if you don’t drain the swamp, the alligator attacks will never end.”*