

CORRUPTION IN IRAQ: CONFLICT, COSTS AND CAUSES

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Abstract:

Corruption in Iraq is so great and pervasive that, during the height of insurgent violence, senior government officials considered corruption to be a greater threat to the future of Iraq than the insurgency. After discussing the scale of Iraqi corruption and the symbiotic relationship between corruption and the insurgency, the different costs of Iraqi are enumerated. The determinants of Iraqi corruption are then examined under two headings: long-term demographic, environmental or cultural causes and causes related to past or current policy decisions. The anti-corruption policies of the Iraqi and U.S. governments are described in detail. However, analysis shows that these policies are unlikely to succeed since they focus on improving rule of law and, to a lesser extent, changing the culture of corruption with little thought to changing the economic incentives that favor corruption. These economic incentives favoring corruption are especially strong in the large and intrusive government ministries.

Keywords: Iraq, corruption, bureaucracy, insurgency

CORRUPTION IN IRAQ: POOR DATA, QUESTIONABLE POLICIES

“Iraq has a history of massive corruption. The previous regime bankrupted the country through massive embezzlement of public funds for personal palaces and other conspicuous and wasteful consumption at the expense of the average citizen.” Iraq National Development Strategy, June 2005

1. Introduction:

Like sand after a desert storm, corruption permeates every corner of Iraq society. According to the 2008 Transparency International report, Iraq is not perceived as the most corrupt country on earth - that dubious honor belongs to Somalia - but Iraq is tied (with Myanmar) for second to last place. Corruption in Iraq extends from the ministries in Baghdad to police stations and food distribution centers in every small town. (For an excellent overview of the range and challenges of corruption in Iraq, see Looney 2008.) While academics may argue that small amounts of corruption act as a “lubricant” for government activities, the large scale of corruption in Iraq undermines private and public attempts to achieve a better life for the average Iraqi. The former Iraq Minister of Finance and the Governor of the Central Bank stated that the deleterious impact of corruption was worse than that of the insurgency. (Minister of Finance 2005) This is consistent with the Knack and Keefer study that showed that corruption has a greater adverse impact on economic growth than political violence. (1995, table 3)

Over the last two decades, there has been an explosion of research on corruption from a political-economic perspective. In view of the importance of corruption as a policy issue in Iraq, I intend to apply what has been learned about corruption as well as

explore factors unique to Iraq in an attempt to develop practical steps to mitigate this urgent problem.

1.1 Corruption Under Saddam

Corruption has a long history in Iraq or Mesopotamia as it was historically called. Some historians believe that, along with writing and the development of governments more inclusive than tribe, the first instances of both corruption and bureaucratic red-tape originated in the ancient cities of Mesopotamia. More recently, Saddam Hussein's regime (1979-2003) was considered one of the most corrupt in the world although the form of his corruption differed from that which currently plagues Iraq.

Under Saddam, corruption was controlled from the top in a classic case of "state capture". Under Ba'ath Arab Socialist Party control (1968-2003), almost all of the Iraqi economy was nationalized. Positions of power in the economy were assigned to members of Saddam's family and his loyal supporters. It was expected that this elite would receive a dominant share of the benefits from any economic activity. This pattern is consistent with that of most socialist developing countries. In fact, one researcher states: "...what is called socialism in much of the backward world is simply an elaborate mechanism for transferring rents to friends and close supporters of the dictator." (Tullock 2005, p. 29)

But corruption under Saddam's dictatorship differed in two fundamental ways from the corruption that exists during the current Iraqi transition to democracy. First, a large proportion of the bribes and other gains from corruption were captured by Saddam's family and his immediate ring of supporters. (Marr 2004, pp.208-209)

Relatively small amounts of the gains from corruption were captured by those at the base of the governmental pyramid. In contrast, current Iraqi corruption is more “democratic” with corrupt gains more widely distributed. In other words, under Saddam corruption was primarily of the “state capture” type while currently it is more “administrative corruption”.

Second, under Saddam corruption was more “honest”- honest in the ironic sense that one refers to an “honest judge” as one who - once bribed - stays bought. Since corruption under Saddam tended to be more structured, when bribes were paid to a public official, there was a high degree of confidence that the promised favor would be rendered. Current Iraqi corruption is more entrepreneurial. Government officials are engaged in sometimes cooperative, sometimes competitive efforts to extract the maximum rents from not only private citizens but also from other branches of the state bureaucracy. As a result, it is difficult to discover the proper person to bribe in order to obtain a specific favor and there is less confidence that that favor will be provided even if the bribe is paid. (This is a not-uncommon phenomenon. See Rose-Ackermann 1999, p. 32)

It is possible that, although Saddam, his family and supporters were able to capture a larger proportion of the nation’s economic income through their well organized corruption; current entrepreneurial corruption imposes a more serious burden because it increases uncertainty.

1.2 Extent of Current Iraqi Corruption:

For the purposes of this study, corruption is defined as the abuse of public power for private benefit. Corruption occurs if a government official has the power to grant or withhold something of value and – contrary to laws and publicized procedures – trades this something of value for a gift or reward. Corruption is a form of rent seeking. Among corrupt acts, bribery gets the most attention, but corruption can also include nepotism, official theft, fraud, certain patron-client relationships or extortion. (Gunter 2008) Private corruption, such as insider trading, is not considered in this study.

To maintain a reasonable size, this study focuses on corruption of Iraqi officials and institutions. Therefore it excludes the rapidly increasing number of studies on the corruption of international institutions such as the United Nations during the sanctions period as well as evidence of corrupt acts on the part of representatives of other nations, such as the United States, that have played major roles in Iraq's recent history.

Estimating the amount of corruption in Iraq is difficult for several reasons. First, this offense is often perceived as lacking a victim. Iraqi private citizens may find themselves excluded from business opportunities because of the length of time, expense or complex procedures required to pursue the opportunity legally. If, in order to speed up the bureaucratic process, citizens either offer bribes or agree to a public officials' demands then the citizens often see the officials as doing favors – not imposing burdens. Even if Iraqi bribe paying citizens feel victimized, they hesitate to report corruption for fear of retaliation or legal sanction. Second, conflict with a variety of insurgent groups following the 2003 invasion, increases both the opportunities for corruption and makes it easier to conceal it. This symbiotic relationship between corruption and the insurgency is discussed in greater detail below.

Because victims in Iraq rarely report the crime of corruption, almost all information on corruption is obtained from investigative reporting including publicized corruption investigations or surveys. In Iraq as elsewhere, publicized investigation reports tend to grossly underestimate actual levels of corruption because only a fraction of corruption cases are investigated and the results of some investigations are often not released to the public. Further complicating the analysis is the fact that decisions to institute corruption investigations in Iraq are partially political in nature. However, reported investigations reveal the scale of the corruption problem in Iraq.

That corruption extends to the top of the Government of Iraq was shown by the May 2009 questioning of the Minister of Trade by the Iraq Council of Representatives concerning suspicions of massive corruption in the Public Distribution System (food baskets). The MoT is paying for large quantities of high-quality imported wheat flour and yet families are receiving insufficient amounts of low-quality domestic flour. These accusations follow the August 12, 2006 announcement that the Minister of Electricity and several other senior officials were charged with accepting kickbacks for assigning contracts to non-existent companies as well as reports that Dr Ziad Al Qattan, general manager in the Ministry of Defense, engaged in \$400 million worth of fraudulent defense contracts with Poland. (Al Mendhar 2005)

The oil industry has been especially vulnerable to corruption. In 2005, the Iraqi Oil Ministry sacked 450 employees suspected of selling fuel on the black market while, in Basra, oil smuggling operations were in the open. One southern pipeline had more than twenty illegal taps to allow smugglers to fill up their tanker trucks at will. Even government gasoline station managers were openly selling fuel on the black market. (al-

Rubai'I Apr 20, 2005) It was estimated that hundreds of thousands of gallons of fuel per day were smuggled out of Iraq. The Minister of Finance stated that fuel smuggling cost at least \$6.9 billion a year. (Miller 2005)

Among the over thirty national ministries in Baghdad, the Ministry of the Interior (MoI) and the Ministry of Trade are considered to be the most corrupt. The MoI is responsible for the national police and therefore its corruption has widespread impact. Not only is there extensive corruption within the ministry exemplified by the not uncommon failure of police to receive all their monthly pay because their superiors have stolen a portion of it but also the corruption of the MoI undermines efforts to punish corrupt acts in other government organizations. It is widely believed that not only can an accused person or group bribe the investigating police officer to stall or “lose” an investigation but also that the police are willing, for an additional payment, to reveal the identities of anonymous witnesses or investigators to facilitate retaliation. Since the various Iraqi anti-corruption groups depend upon the MoI for support and security, its dishonesty makes ant-corruption investigations difficult and dangerous. One experienced Baghdad analyst referred to the MoI as an example of what would be called Racketeer Influenced and Corrupt Organization (RICO) in the U.S. A criminal group manipulates a public enterprise for purposes of engaging in, concealing, or benefiting from a pattern of racketeering activity. In Iraq, the crooks control the police.

While the corruption of the Ministry of Trade (MoT) doesn't have the systemic effects of the MoI, it exemplifies the situation at most of the other ministries. At the MoT, the same officials are responsible for writing policy, executing it and auditing the results. As a result, there is almost zero transparency and accountability. The open

corruption in the MoT eventually became too much for the government and ongoing investigations have already forced out three senior MoT officials. However, there is concern that the dismissals were simply for show since the Minister of Trade himself kept his position. (Rubin 2008)

2. How much does corruption in Iraq cost?

At the individual level, corrupt acts are inequitable. They allow some to avoid laws, regulations and practices that others must follow. Thus, corruption undermines the average Iraqi's confidence that success results from individual effort, rather than from bribery or political connections. Further exacerbating the impact of corruption in Iraq is the symbiotic relationship between corruption and the insurgency. In addition, there is a growing body of research that corruption tends to have an adverse impact on a country's economy.

Corruption is good for the insurgency. Terrorist groups in Iraq finance their operations, in part, with the proceeds from corruption. Some state factories including an oil refinery have been taken over by insurgent groups or by groups that are willing to pay the insurgent groups for security. Organizations and ratlines that handle smuggled or other black market goods provide terrorists with routes into and out of the country as well as safe houses for the terrorists, their weapons and IED makings. For example, once a border security guard or unit is bribed to allow thirty tankers of fuel a day to be smuggled across a border, it is a small matter that a box of anti-aircraft missiles will be stowed behind the driver's seat on the return trip. (Gunter 2007 and Looney 2006) Not only is corruption good for the insurgency but also the insurgency facilitates corruption because

it justifies bypassing accounting and regulatory procedures. It also increases the urgency of getting things done regardless of the cost and provides an acceptable excuse for corruption related losses.

Corruption also directly undermines coalition and Iraqi Security Forces (ISF) anti-insurgency efforts in Iraq. One of the key elements of a successful counter-insurgency endeavor is to immediately begin the restoration of essential services in order to build confidence and support for the government and counterinsurgent forces. (US Army 2006, p. 272; Gunter 2007.) From 2004 through 2007, massive corruption delayed or even prevented entirely the provision of food, electricity, water, medical care, etc. to the Iraqi population. Not only did officials divert needed goods and services into the domestic or international black markets but also the insurgency was able to obtain a portion of its logistical support by bribing or extorting public officials.

However, corruption among the Iraqi Security Forces (ISF, includes Iraqi army, police, border guards, etc.) appears even more widespread. In fact, there were persistent reports that an entire Border Forces Regiment sold itself to oil smugglers. (al-Rubai'I Apr 20, 2005) In 2008, each barrel smuggled abroad reduced GoI revenues by approximately \$60 which severely reduced the government revenues that could have been used for professionalizing the ISF and restoring essential services. This widespread belief in the corruption of the ISF undermined confidence in and support for counterinsurgency efforts.

In addition to its impact on the coalition's anti-insurgency campaign, corruption adversely affects the Iraqi economy. In fact, there are two economies in Iraq; an oil funded public sector economy (about 50% of Iraq's labor force – author's estimate) and a

non-oil funded economy with a large gray-market non-oil private component (about 32% with the remaining 18% of the labor force unemployed.). Both sectors are burdened by corruption although employees in the public sector often have the opportunity to accept bribes as well as pay them. The weak performance of the Iraqi economy is one factor in undermining support for the government among the Iraqi public. This reduces the Iraqi people's confidence in the future and their willingness to support the new government.

It should be noted that while many economists believe that corruption tends to reduce economic growth (Muaro 1995), others state that the results are not conclusive (Sevensson 2005). However, even a relatively crude analysis shows an adverse impact of corruption on economic development. When asked how much corruption added to the costs of doing business, a survey of 1,631 business owners in six Iraqi cities showed that 52% thought that corruption increased costs by more than 20%. (Margin of error of +/- 2.4%)

Table 1: How much do you think corruption adds to the costs of doing business?

	Total	Suly	Arbil	Kirkuk	Baghdad	Hilla	Basrah
Refused/Not sure	10%	9%	19%	26%	7%	4%	26%
0%	2%	4%	4%	-	1%	-	-
1%-10%	12%	18%	4%	10%	11%	4%	7%
11%-20%	24%	24%	13%	36%	24%	29%	19%
21%-30%	19%	17%	26%	14%	21%	27%	9%
31%-40%	13%	10%	14%	2%	15%	16%	14%
41% or more	20%	17%	20%	12%	22%	20%	26%

(Source: CIPE 2007 Iraq Business Owner Survey, p. 11)

In addition to increased costs for businesses, Iraqi markets for goods and services tend to be inefficient because of the uncertainty and risk associated with corrupt

activities. Firms deliberately stay inefficiently small and organize their activities in complex manners to avoid coming to the attention of those in authority who will seek payoffs. For example, advertising is by word of mouth since a newspaper advertisement or even a telephone listing may make one vulnerable to either the insurgents or corrupt bureaucrats.

The amount of directly unproductive economic activity – labor and resources used not to produce or trade but to “get around” artificial barriers to production and trade – is large. Since the Iraqi banking system rarely lends to firms in the informal economy, less efficient high-interest money lenders or more prosperous family members are asked to provide financing. Not only does corruption in Iraq lead to slower real growth but also it worsens the distribution of income. The poor in Iraq must pay bribes but rarely receive them.

The impact of corruption also leads to an expansion of the budget deficit, reduced services for the money spent and a waste of needed investment spending. Because of corruption, the Iraqi national government has to spend much to get little. At the provincial level, it is not uncommon for provincial governors to block any infrastructure investment that don't employ construction companies controlled by the governor's relatives and associates.

An estimated 10% - 25% of Iraqi government workers are “ghosts” who receive a paycheck but rarely show up for work. Instead, these “ghosts” give a portion of their pay to their supervisor to ignore their absence while the ghosts stay home or work at another government or private sector job. Other government workers use their government office, equipment, staff, etc. in private businesses. The completion of a census of all government

employees that would allow the identification of ghost workers has been delayed for over two years. (IMF 2008, p. 13) Census takers have been bribed, threatened and beaten in government offices to prevent them from providing an accurate list of government workers.

Finally, the widespread perception of corruption tends to discourage legitimate foreign entities from trading, lending or investing in Iraq. During a closed session at a November 2008 Baghdad conference intended to encourage foreign investment, representatives of several U.S. corporations unexpectedly raised corruption as a major barrier to increased foreign investment in Iraq. These remarks confirm the expectation that corruption costs will be a major part of a foreign firm's decision of which country to invest in. (Cheung 1996)

Corruption in Iraq is not static; in the absence of an effective anti-corruption drive, it tends to worsen over time. Corrupt officials are motivated to increase the inclusiveness and complexity of laws, maintain monopolies, and otherwise restrict legal, economic or social activities in order to be able to extract even larger bribes or favors in the future. Perhaps the most damaging aspect of corruption is that it increases the level of uncertainty and forces individuals and organizations to expend a great deal of effort in attempts to reduce this uncertainty. Investors have to worry not only about changing market conditions but also whether various unknown officials in Baghdad will seek to block their investment in order to extract additional bribes.

3. Why is Iraq corrupt?

3.1 Long-term determinates of corruption:

The determinants of corruption in Iraq can be divided into two general categories. Long-term demographic, environmental and cultural aspects may be important causes of corruption but are difficult to change. On the other hand, there may be economic or political incentives for corruption in Iraq that, optimistically, may be subject to short-term policy solutions. Dependency on a single natural resource, petroleum in the case of Iraq, doesn't fit neatly into either category and, somewhat arbitrarily, will be discussed under policy. There is an extensive literature on the long-term causes of corruption. In the table, five of these determinants are listed along with their applicability to Iraq.

Table 2: Long-term, institutional and environmental causes of corruption in Iraq

	References	Applicable to Iraq
Low levels of literacy	Glaeser et al (2004)	Yes – Literacy: 74%
Inhospitable climate	Acemoglu, Johnson and Robinson (2001)	Yes
History of French or socialist legal system	La Porta et al (1999) and Djankov et al (2002)	Yes - Socialist
Catholic or Muslim	Treisman (2000) and Landes (1998)	Yes - 97% Muslim
Cousin marriage		Yes – 33% or more

Low levels of literacy provide a fertile soil for corruption. (Glaeser et al 2004) An illiterate population is not only vulnerable to exploitation by low level government officials but also is unable to effectively monitor its government. While the quality of the data on literacy in Iraq is questionable, it is believed that about 84% of the male population is at least basically literate compared to 64% of Iraqi females. (US CIA 2008) While low by the standards of the industrial nations, literacy in Iraq is about average for countries in the Middle East and North Africa neighbors. (World Bank 2008, Table 2.13)

Acemoglu, Johnson and Robinson (2001) found a correlation between high mortality rates for Europeans during the colonial period and the type of institutions that were established in the colonized countries. Countries with climates friendly to Western Europeans tended to get better quality colonial administrators who tended to bring their families and stay for extended periods of time. Therefore, these countries tended to receive better quality administration as colonial administrators attempted to establish “neo-Europes” with institutions that protected private property and checked government power. Such institutions tended to constrain corruption.

However, countries with climates hostile to Europeans because of heat or disease tended to get lower quality administrators who left their families at home and lived in the colony as little as possible. There was a tendency for these administrators to have a short-term focus and establish “extractive” institutions in order to make as much as they could and get out while they still had their health. (Acemoglu, Johnson and Robinson 2001, p. 1370) This colonial influence on corruption was limited in Iraq. While commercial interests continued, the British mandate lasted only three decades from about 1918 (with the conquest of Mosul) to about 1948 (the treaty of Portsmouth and the violent uprising). (See Marr 2004, Chapters 2-4)

If during the colonial or post-colonial period, countries adopted French or Socialist legal systems then they tend to be more corrupt. (La Porta et al 1999) Napoleonic code or socialist legal systems tend to be extremely bureaucratic with complex regulations covering every aspect of life. Corruption becomes a way of life in such societies as a way of dealing with the bureaucracy. The Ba'ath Arab Socialist Party that dominated Iraq from 1968 through 2003 imposed an extensive bureaucratic socialism

on the country with most of the important economic decisions made by party members in the ministries in Baghdad.

Extremely controversial is the finding by Treisman (2000) and Landes (1998, chap. 24) that countries with large Catholic or Muslim populations tend to be more corrupt than Protestant ones. Possibly this is because Protestants tend to be more distrustful of any authority - including the state - and therefore more aggressively monitor it. Also, both Catholics and Muslims may place less emphasis on education. Of course, Iraq is almost 97% Muslim. Several analysts state that the significant losses sustained by religious parties in the January 2009 provincial elections were caused, in part, by the public's belief that doctrinal purity was more important to the leadership of these parties than either the administrative competence or honesty of the parties' officials. (Arraf 2009 and Economist January 22, 2009)

A demographic characteristic that may also be related to Iraqi corruption is cousin marriage. While the marriage of first and second cousins is not uncommon in Arab society, in Iraq it is estimated that about a third of all marriages are within this degree of consanguinity with the rate of cousin marriage rising to about 50% in rural areas. (Central Organization of Statistics and Information Technology 2005, Bobroff-Hajal 2006) In fact, Iraq may have one of the highest rates of cousin marriage in the world behind Pakistan and Nigeria. Such marriages tend to strengthen the influence of families and clans because not only do they multiply the relationships between any two members (your father-in-law is also your uncle) but also they reduce interactions between different clans. With wide-spread cousin marriage, it is clear why nepotism is not seen as an act of

corruption but rather as a positive virtue – caring for a member of your tight-knit family and clan.

3.2 Short-term determinates of corruption:

While a society can possibly break its ties to a French or socialist past, it is impossible (or at least difficult) to change a country' physical environment, history or culture. However, there are other determinants of corruption that are more of a function of policy error and therefore can potentially be improved in a reasonable period of time.

Table 3: Causes of corruption related to perverse policies

	References	Applicable to Iraq
Dominant natural resource	Ades and di Tella (1999) and Leite and Weidemann (1999)	Yes – petroleum is two-thirds of GDP
Lack of market competition	Ades and di Tella (1999) and Djankov et al (2002)	Yes
Weak free press	Brunetti, Aymo and Weder (2003)	Yes – 1979 to 2003 No – 2004 to present
Lack of political competition	Persson and Tabellini (2004)	Yes – 1979 to 2005 Partial – 2006 to 2008 No – 2009 to present
Large scale subsidies		Yes
Lack of legal sanctions		Yes
Inadequate Public Sector Salaries	Rose Ackerman (1999) and Krueger (1974)	Yes

3.2.1 Oil is the curse of Iraq

In Leite and Weidmann's 1999 study, it was shown that export dominance by a single natural resource such as petroleum tends to be associated with greater corruption (pp. 22 and 24). Natural resources tend to have high economic rents – a large gap between the cost of production and the export price. This results in large incentives for

corrupt behavior to capture these rents. (Rose-Ackermann 1999, p. 19) Oil accounts for almost 95% of its export revenues and over two-thirds of Iraq's GDP. In fact, Iraq's economy has the highest level of oil-dependence of any OPEC member (including Kuwait, Qatar and the UAE). (US CIA 2008)

In Iraq, the massive revenues from oil exports are controlled by the Baghdad ministries. And since the revenues from oil exports account for over 90% of total government revenues in Iraq, the ministries are not dependent on taxpayer-voters. The Baghdad ministries use the oil funds primarily to maintain the salary and benefits of their employees including both those who are directly employed by the Ministries as well as those employed by state owned enterprises (SOE) associated with many of the ministries. The perverse but predictable priorities of the ministries were dramatically revealed during the oil export revenue shortfall in the first half of 2006. Maintenance and capital expenditures were slashed while employment actually increased. The ministries and the associated SOE are, to a great extent, a welfare program providing generous salary and benefits in return for little work.

In addition, the independence that the Baghdad ministries enjoy as a result of oil export revenues, allows them to follow economic and social policies that block or undermine the economic liberalization goals set forth in the National Development Strategy (NDS 2005 and NDS 2007). The ministries were established by and, to a great extent, still retain the culture and goals of the Ba'ath Arab Socialist Party. They generally see their mission as managing the economy to constrain private sector competition for SOE.

3.2.2 Lack of market competition:

Lack of market competition is associated with corruption for at least two reasons. First, the possibility that the government may allow the creation or maintenance of monopolies tends to provide strong incentives for corruption. Individuals or groups would be willing to pay bribes or otherwise favor certain government officials in order to capture monopoly profits. Second, Iraqi firms will try to influence officials to reduce or eliminate competition from imports. (Ades and Di Tella 1999 and Djankov et al 2002)

Under Saddam, the economy was managed in classic socialist fashion. Detailed planning was done in Baghdad by dozens of ministries. These plans determined in exhaustive detail almost all economic activities from fertilizer consumption by farmers to setting the price for imported automobiles. Almost all of the manufacturing entities were combined into almost 200 State Owned Enterprises (SOE). Although these SOE were generally low-quality high-cost producers, they served at least three purposes. First, they reinforced Saddam's Ba'athist Party control of the political levers of power. Or to be more precise, political and economic power were joined. Second, control of the ministries and the SOE provided a means for Saddam to reward his supporters and, by exclusion, punish those who were less than enthusiastic. Finally, the SOE provided multiple opportunities for government officials to extract bribes and divert funding for their personal benefit.

Since 2003, there has been a radical liberalization of Iraq's international trade but no discernable progress in reducing the dominance of the SOE in the domestic economy. This dominance has been maintained both by continuing to provide large direct and

indirect subsidies as well as by discouraging the private business sector. The burdens placed on private businesses in Iraq are onerous even by regional standards.

This table adapted from the 2008 World Bank's Doing Business report, compares the bureaucratic burden of legally performing various common business transactions in Iraq to those of 180 other nations. The same data for other Middle Eastern countries and the USA are included for comparison purposes. Not only does Iraq possess one of the most hostile regulatory environments for private business in the world but also its relative position is deteriorating.

Table 4: Ease of doing business in Iraq, the Middle East and the USA

	Iraq 2008 Rank (2007 Rank)	Middle East Range	USA
Starting a business	175 (154)	22 to 134	6
Employing Workers	67(60)	24 to 147	1
Trading Across Borders	178 (175)	9 to 179	15
Closing a business	181 (178)	25 to 181	15

This table shows the challenges faced in 2008 by a private firm in Iraq. Legally starting a business, employing workers, foreign or domestic trade and going bankrupt are extremely complex and expensive processes. The bureaucratic complexities that tie businesses into knots are not random or unloved artifacts of earlier days. Government ministries continue to expend a great deal of influence to preserve these complex

procedures for a very simple reason. The more complex, illogical and time-consuming the procedures – the greater number and size of the bribes that can be extorted from businessmen. (Tanzi 1998 and Cheung 1996 p. 3)

3.2.3 Weak free press:

A free press reduces the potential for corruption both by increasing the likelihood that corrupt acts will be uncovered and providing a mechanism with which public opinion against corruption can be marshaled and expressed. (Brunetti and Weder 2003) Iraq has made a rapid transition from an extremely restrictive media environment before 2003 to a media free for all with a sharp rise in the number of media outlets. (Brookings Institution, January 2009, pp. 45) This increase in outlets was accompanied by increased variety of views and opinions. Stories about corruption are increasingly common. A few are careful investigative pieces but most make undocumented claims of responsibility and call for action. Based on a small sample of stories, letters to the editor and the call-ins to radio shows in the Arabic media, there appears to be little patience with the notion that corruption is part of Arab or Iraq culture. The more common view is outrage at corrupt government officials.

3.2.4 Lack of political competition:

Political competition serves a similar role as a free press in reducing the prevalence of corruption. (Persson and Tabellini 2004) From 1979 through 2004, Iraqis didn't have a realistic chance to express themselves politically but since then there have been four nationwide votes, most recently, provincial elections in January 2009. These

elections were important steps forward for democracy in Iraq (and in the Arab Middle East?) especially since few incumbents were retained by the provincial voters. News stories in both the Arabic and English language press emphasized that perceived corruption was an important determinant in the repudiation of the previously dominant parties. (See Black, 2009, Parker and Redha 2009; Crisis Group 2009, p. 27)

However, there is little worldwide experience of this sort of transition to help in predicting whether future elections will continue to focus on corruption. Studies of transitional political systems show that while democracy tends to reduce corruption, it is a long-term process. (Lambsdorff 2006, p. 10) In addition, it appears that some of the first-time Iraqi candidates are also troubled by corruption. The Inspector General of the Higher Education Ministry stated that as many as 4,000 of the almost 14,000 candidates in the January 2009 elections had forged university degrees. (Jawari 2009)

3.2.5 Large scale subsidies:

The greater the value of the good or service controlled by the government official, the greater the value and possibly number of bribes that he or she can extract. The existence of large government subsidies therefore leads to increased corruption since officials would possess something that they were supposed to distribute at below market prices, sell at market prices and pocket the difference.

Under Saddam, gasoline, kerosene, diesel and other fuels were almost free and the post-Saddam governments continued this policy although the size of the subsidy was reduced beginning in December 2005. For example, while the average price of premium gasoline in the Gulf in September 2005 was \$1.06 a gallon (28 cents/liter), in Iraq the

same fuel sold for 13 cents a gallon (3 cents/liter). This gap provided tremendous profits for corruption. If a single tanker truck of premium gasoline was diverted from the official market and its cargo sold in the Iraqi black market or smuggled to a neighboring country, a profit of \$6,000-\$7,000 was possible. A poorly paid customs official or border guard could easily double his annual income by accepting a cash bribe to turn a blind-eye to such diversions. Similar stories can be told about food subsidies. One survey showed that in some provinces almost 82% of the food rations (Public Distribution System) were illegally diverted between the seaports (most of the subsidized food is imported) and the village or town food distribution centers.

3.2.6 Lack of legal sanctions:

Of course, there are disincentives to accepting a bribe. In Iraq, although laws may call for severe punishment for bribery, the chances of being caught and convicted are near zero. In 2008, the GoI charged only 300 persons with corruption (out of a total of over 2.3 million government employees) and convicted 86. Not only is this believed to be only a small fraction of the corrupt but also the convicted were low level employees charged with selling fake passports. (US Department of State 2008) With subsidies providing large rewards for corruption and little likelihood of being punished, it is not surprising that corruption in Iraq is so pervasive.

3.2.7 Inadequate Public Sector Salaries

A more controversial possible cause of Iraqi corruption is that inadequate public sector salaries motivate (force?) government employees to seek and accept bribes. The

discussion about the adequacy of public sector compensation in Iraq is complicated. If one looks at average salaries alone then the typical government employee is better compensated than a worker in the private sector. Combined with benefits, protection against dismissal, a less intense - some would say relaxed – pace of work; government employment is eagerly sought after. There are multiple applicants for each government service opening.

However, once anyone has obtained a government position, the financial rewards for advancement in Iraq tend to be meager. For example, a senior enlisted member of the US Army would earn almost three times the pay of a Private even before adjusting for time in service raises. This is not true in the Iraqi Army, Iraqi Police or in almost all other Iraqi institutions. A senior enlisted member of the Iraqi Army earns only about 20% more than a Private.

The existence of generous compensation for entry-level position combined with meager raises for seniority provides strong incentives for bribes. New employees are expected to “purchase” their entry into government employment by bribing senior officials. (classic rent-seeking, see Krueger 1974.) The payment is usually some combination of an initial bribe – possibly financed by borrowing – and a monthly cash “contribution” to one’s bureaucratic supervisor. Of course, each level of management is expected to make a “contributions” to the next most senior level of management etc. As a result, it is believed that the actual paycheck received by many senior members of the bureaucracy accounts for a small fraction of their compensation. Many seek bureaucratic advancement primarily to increase their ability to extract larger bribes.

4. Reducing Corruption

Over the last fifty years, many countries have attempted to eradicate corruption in their economies. However, not only have there been no successful eradications of corruption but also most attempts to reduce it to tolerable levels have failed. Some of the failures were not surprising. Anti-corruption policies that are comprised entirely of exhortations to virtue and a spurt of well publicized investigations tend to have little long-term effect. In addition, various political factions will often usurp the anti-corruption campaign to settle scores with their opponents and, as a result, anti-corruption efforts collapse in mutual recriminations.

Pessimism is especially a realistic perspective when considering anti-corruption in Iraq. Looney (2008 pp. 429-435) argues that reducing Iraqi corruption will require dealing with the growth of the informal economy, the deterioration of social capital and the relationship among tribes, criminal gangs and the insurgency. But is this list too demanding?

Successful anti-corruption campaigns, such as Hong Kong's (Speville 1997), do take into account each country's cultural, social, political, historical and economic situation. These campaigns include institutional changes to reduce the economic incentives for corruption combined with improved governance, transparency and an aggressive effort to communicate the purpose and progress of the campaign to the public. Successful anti-corruption campaigns must have widespread support to enable them to move forward in the face of tenacious covert opposition. Finally, for lasting results, there must be a serious effort to change the culture of corruption. In summary, successful anti-

corruption campaigns tend to be complicated, difficult, politically risky and expensive.
(Rose-Ackerman 1999, chap. 1)

In view of the costs of a possibly ineffective Iraqi anti-corruption campaign, is the game worth the candle? In view of the other security, political and economic challenges facing the new Iraqi government, shouldn't it put aside an anti-corruption campaign until a certain degree of stability is achieved? There are two contrary arguments.

First, the current cost of corruption is probably unsustainable. Corruption finances the remaining insurgency. It slows economic growth and worsens income distribution. Corruption hurts Iraq's budget situation from both sides. Oil revenues and other government revenues are lower because of corruption while as much as one-third of government expenditures are diverted from their assigned purposes.

Second, in the absence of an aggressive anti-corruption campaign, corruption tends to worsen.

The government of Iraq has long been aware of the criticality of the corruption fight. In Iraq's original National Development Strategy for 2005-2007 (GoI, NDS June 2005), the last development goal concerned corruption: "Eradicate Corruption: Iraq has a history of massive corruption. The previous regime bankrupted the country through massive embezzlement of public funds for personal palaces and other conspicuous and wasteful consumption at the expense of the average citizen." This theme is continued in the revised National Development Strategy for 2007-2010 which states: "Corruption – the abuse of public office for private gain – is arguably the most critical component of governance in a natural resource rich country like Iraq." (GoI, NDS March 2007, pp. vi and 92)

Despite public statements of the importance of the anti-corruption effort in Iraq, the follow-through on these statements has been weak and confused. For example, in January 2008, the Prime Minister declared 2008: “The Year of Anti-Corruption” and published an eighteen point plan to fight corruption. However, by the end of the year only three or four of the points had been acted on and government spokesmen seemed unaware that that the original declaration had ever been made. The GoI did join the Extractive Industry Transparency Initiative and, in March 2008, sign the United Nations Convention Against Corruption (UNCAC) with its more than 160 provisions. However, the required implementing legislation for both of these agreements appears to be stalled. In Iraq’s defense, the UNCAC is a very complex document that combines broad coverage – corruption in the private sector is included (Article 12, pp. 14-15) – as well as strange lacunae (it lacks a specific definition of corruption!). (UN 2004) The UNCAC concentrates on improved governance and rule of law. (United Nations 2004) What is missing from the GoI and the UNCAC anti-corruption strategies is attacking corruption by directly changing the micro-economic incentives.

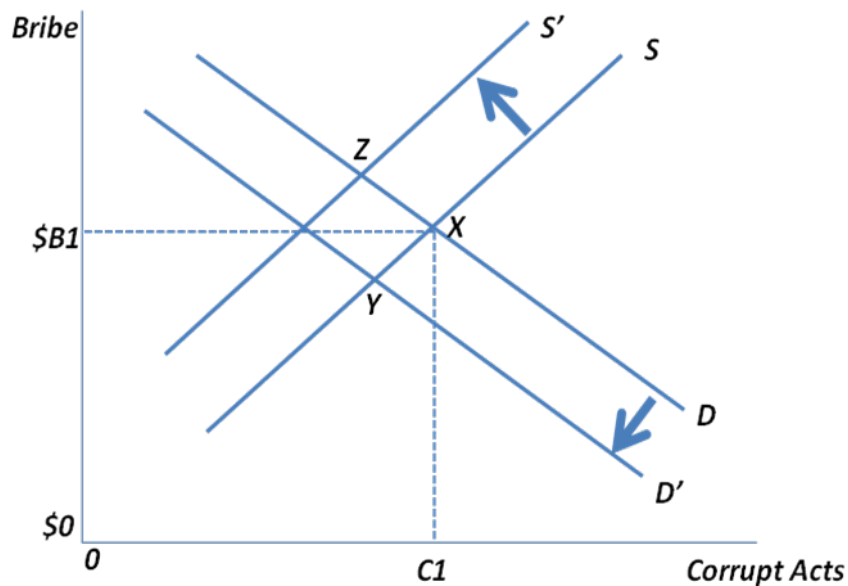
4.1 Microeconomics of anti-corruption

There is a market for corrupt acts and the size of the payment (bribe) tends to rise or fall until the amount of corrupt acts demanded is equal to the amount supplied. For example, officials control the necessary licenses to produce a product and, without corruption, it will require an extended period of time, such as six months, to obtain a license. Citizens will pay a bribe to speed up the licensing process if the bribe is not excessive compared to the net benefit that results from more rapid approval. And the

officials will be willing to accept a bribe if it is great enough compared to the net cost of speeding up the approval.

Viewed as an economic decision, the willingness of officials to accept or solicit bribes is a function not only of the size of the bribe but also of the consequences of being caught. The size of the bribe is related to the scale of the benefit sought by the bribe payer, whether the official must share the bribe with colleagues, and whether other officials might provide competition by offering to provide the same illegal benefit for a smaller bribe. The consequences of being caught accepting a bribe are a function of the likelihood of being discovered, investigated, prosecuted and convicted as well as the seriousness of the punishment if convicted. In the entrepreneurial corruption that is occurring in Iraq today, there are almost always multiple demanders of corrupt acts and often multiple suppliers.

Figure 1: Simple Market for Corrupt Acts



It is reasonable that the demand for corrupt acts by private citizens is inversely related to the size of the bribe – the greater the bribe (all else unchanged), the fewer citizens who are willing to pay for the corrupt act. In graphical terms, the demand curves (D and D') for corrupt acts slope down as in Figure 1. It is also reasonable to assume that the supply of corrupt acts is directly related to the size of the bribe – the greater the bribe, the more creativity and initiative officials are willing to exert in order to earn the bribe by performing the corrupt acts. Supply curves (S and S') slope up.

With initial demand for corrupt acts represented by the curve D and initial supply represented by curve S, the amount demanded of corrupt acts would equal the amount supplied of corrupt acts at point X – at a bribe of \$B1, there will be C1 corrupt acts provided. Of course, the total amount of bribes paid would be, at a minimum, no less than \$B1 times C1. The total amount of bribes would be greater if the official accepted bribes from several people before awarding the benefit to one.

Thinking of demand and supply in the market for corrupt acts reveals the usual asymmetry in the effects of shifts in demand and supply. An anti-corruption policy that leads to a decrease in the demand for corruption will lead to a decrease in both the quantity of corrupt acts and price (bribe). Graphically, the demand for corrupt acts would shift to D' with a new corruption equilibrium at point Y. In other words, both the number of bribes and the size of the average bribe will decrease and, therefore, the total amount paid in bribes will decrease. If the burden of the corruption is entirely represented by the total paid in bribes then a reduction in corruption demand reduces the total corruption burden.

However, an anti-corruption policy that leads to a shift in the supply of corruption will have an ambiguous impact on the total burden of corruption. If the net cost to an official of performing a corrupt act increases then this might be viewed as an upward (or leftward) shift of the supply of corrupt acts from S to S' in Figure 1. The equilibrium in this market for corrupt acts would shift to point Z . This would result in fewer corrupt acts (Z is to the left of X) but at a higher average bribe (Z is above X). Whether increasing the cost of performing a corrupt act (an upward shift of the supply of corrupt acts) actually leads to a decrease in total amount of bribes depends on the elasticity of demand for corrupt acts. If the demand for corrupt acts is inelastic, a successful “supply-side” anti-corruption policy may actually lead to an increase in the total corruption burden!

So an anti-corruption policy could reduce corruption in three ways. First, a policy may reduce the demand for corruption by reducing the net benefit to the bribe-payer. In our example, a revision of procedures may reduce either the wait for the necessary licenses (e.g. from six to one month) or by reducing the number of regulations or licenses required. Second, a policy may decrease the supply of corruption by increasing the net-cost to the official accepting the bribe. One method of increasing the net-cost would be to increase the likelihood of the official being investigated and punished for accepting a bribe. Finally, corruption may be reduced by increasing the transaction costs involved with the bribe transaction. This transaction cost involves the cost/difficulty of searching for someone to bribe (or pay a bribe), negotiating terms for the corrupt transaction and, if necessary enforcing the agreement.

Even well designed anti-corruption campaigns tend to stall. A common cause of failure is a weakening of political will brought about by a corruption “J” curve effect. A

“J” curve effect occurs when the announcement of a credible new anti-corruption campaign initially causes corruption to worsen. For example, towns on Iraq’s international border have profited from smuggling for generations by not being too greedy. Town officials may charge a bribe of \$B1 dollars to allow a truck to pass through the town and over the border. They don’t charge more than \$B1 because town officials know that the smugglers will stop using their town for transit. Instead, the smugglers will move to the next crossing north or south in search of a better deal. However, if the government credibly announces that all smuggling routes will be closed next week then the town officials will not be satisfied with \$B1 but will steal the entire cargo and the truck as well. Graphically, the credible announcement has shifted the Supply curve sharply to the left/up. Corrupt officials, who believe that they will lose opportunities for future bribes will seek to maximize their current corruption earnings. In early 2009, Iraq appears to be stuck in the J curve – the expectation of future anti-corruption initiatives has increased the size of current bribes.

And procedural changes to reduce corruption are not costless. Requiring the senior leadership of a ministry to approve all expenditures may reduce corruption but it will certainly increase bureaucratic delay. In Iraq, multiple bureaucratic checks and balances, that are intended to reduce corruption, can lead to half a year’s delay between when expenditure is approved by the national Council of Representatives and when the funds are actually available to be spent by a *beladiya* – a local office of the Ministry of Municipalities and Public Works. (Warden 2008)

In addition, corrupt officials may also attempt to “capture” a new anti-corruption campaign and turn it into just another means of extracting bribes from the guilty (or the

innocent). It is not clear whether the new government is willing to expend the political capital necessary to push through the curve. If it does summon the political will then gradually the perception of reduced corruption will increase public support for the effort. However, if the anti-corruption efforts falter then public cynicism will make any future attempt more difficult.

4.2 Moving from theory to practice in reducing economic incentives for corruption

One method of reducing the demand for corruption is to reduce the economic incentives to the bribe-payer. Economic incentives for corruption are not directly addressed in the National Development Strategy: 2007-2010. However, most of the components of an incentives strategy are listed under other headings including: reducing oil subsidies (p. 16), reducing agricultural subsidies (p. 41), reforming electrical pricing (p. 46), and privatizing SOE (p. 53). (NDS 2007) One economic initiative that could be expected to reduce the supply for corruption has dropped off the priority list. Reducing the subsidy for potable water was included in the NDS 2005 (p. 29) but is not included in the NDS 2007 (p. 72).

One of the few recent success stories in the fight against corruption in Iraq is the sharp reduction in direct fuel subsidies. The large gap between official and market prices provided a large rent to be captured by any corrupt official who could obtain fuel at the official price and divert it to the black market.

Yielding to pressure from the IMF and U.S. Embassy, the Government of Iraq began in 2005 to reduce fuel subsidies by gradually increasing official fuel prices. Over a three year period, direct subsidies were essentially eliminated for gasoline, diesel and

LPG although there remains a small direct subsidy for kerosene that is scheduled to be eliminated later in 2009. (IMF 2008, p. 12)

The successive increases in official fuel prices were accompanied by large scale protests. Political groups as well as national and international humanitarian groups opposed the increase because of the impact on the living standards of the poor, while many bureaucrats and others that profited from black market sale or smuggling of fuel opposed the increase because it reduced their black market profits. This unholy alliance sought the rollback of official fuel prices or at least a delay in meeting the remainder of the Government of Iraq's commitment to the IMF to close the gap between official and world fuel prices. However, after several delays, Prime Minister Nuri al-Maliki's government eliminated most of the remaining direct fuel subsidies in late-2007. At the same time, the Government of Iraq began planning for the legalization of the private importation of certain fuels into Iraq to be sold at market prices.

Another possible means of reducing the demand for corrupt acts would be to eliminate or simplify the incredibly complex and ambiguous regulatory environment for private businesses in Iraq. As discussed above, Iraq has one of the most hostile business regulatory environments in the world (152nd out of 181). Simply adopting the commercial code of Saudi Arabia would move Iraq to 16th place in the world (World Bank 2009 p. 3) and sharply reduce the willingness of Iraqi businesses to pay bribes.

The second prong of the anti-corruption strategy is better governance especially the investigation, prosecution and punishment of corruption. These efforts can be viewed as attempting to increase the cost to the bribe-taker of engaging in corrupt acts or increase

the transaction costs of engaging in a corrupt transaction (both can be represented as upward shifts in the supply curve of corrupt acts).

There are three national governmental organizations that are expected to play important roles in raising the costs of supplying corrupt acts. The Board of Supreme Audit is the Iraqi equivalent of the GAO. The Inspector Generals are a post-Saddam creation but these inspectors are not independent – they report to the head of their ministry. The final leg of the anti-corruption tripod is the Commission of Public Integrity (the Iraqi equivalent of the FBI).

All three organizations are slowly growing in size and proficiency but there have been few prosecutions for corruption so far. The Iraqi anti-corruption tripod currently suffer from four weaknesses: insufficient funding, lack of training, out of date equipment and facilities, and a serious lack of high-level political support. Combined with the difficulties of dealing with new procedures, these weaknesses have resulted in very low numbers of successful corruption investigations, prosecutions and convictions. In economic terms, there has been little success in raising the supply curve for corrupt acts.

The weaknesses of funding, training and modernization are gradually being overcome but little progress is being made with respect to the problem of the lack of high-level political support in the fight against corruption. Until May 2009, senior ministers, including Prime Minister Nuri al-Maliki, were able to block corruption investigations using Article 136B of the Criminal code. This Saddam era article, which was suspended under the CPA and then later restored, requires investigators to get the permission of the minister of an agency before it can take any case involving that agency to court. Judge Rahdi Hamza al-Radhi, the former head of the Commission of Public

Integrity who has the well deserved reputation of being both brave and honest, testified that the use of Art. 136B as well as repeated threats and acts of violence against corruption investigators have stalled most high-level anti-corruption investigations in Iraq. (Rahdi 2007) While use of Article 136B was suspended in May 2009, it is still part of the legal code and could be revived if the Prime Minister fears an investigation. (Al-Baghdadiya 2009)

Associated with the need for improved governance in the National Development Strategy was a call for "...establishing e-government to increase transparency and modernize governmental business processes." (2005, p. 36) E-government means that everything that the government does, from the prices and quantities of daily oil exports to trial testimony, will be accessible online almost immediately. It is hoped that e-government will lead to not only a better informed citizenry but also make government officials more careful about what they do (or at least what they report). Despite the logic of reducing corruption by improved governance and transparency, empirical evidence of its efficacy is still weak. According to Svensson: "...little evidence exists that devoting additional resources to the existing legal and financial monitoring institutions will reduce corruption." (2005)

4.3 Reducing cultural tolerance for corruption

The final prong of the anti-corruption plan is to reduce the cultural tolerance of corruption. Through increased media coverage and the efforts of NGO, it is hoped that corruption will cease to be perceived as "business as usual" and become increasingly seen as un-Iraqi. Despite surveys that show that religious leaders are the most credible

Iraqi authority figures when it comes to changing the climate of corruption, elected officials and bureaucrats still take the lead. For example, at a two day December 2008 “Day of Integrity” event, most of the time was devoted to speeches by politicians and academic papers. Probably more effective at changing public attitudes are some theatrical initiatives. In 2008, the GoI sponsored a series of plays with anti-corruption themes starring well-known Iraqi actors and actresses from the situation comedy “Mud House”. The performances were unexpectedly well attended and enthusiastically received but whether it is because of the message or the appearance of celebrities is not clear. (Pearson 2009)

4.4 The Iraqi elephant

While the current Government of Iraq anti-corruption plan is a vast improvement on its predecessor, it still ignores the elephant in the room. Under Saddam, the salient characteristic of the Iraqi economy was its centrally planned, large and intrusive state sector. All economic decisions including public spending were made in Baghdad by bloated governmental ministries. Most of the ministries continue to be incredibly inefficient and opposed to innovation. They impose severe bureaucratic delays and costs on the private sector. As long as their influence remains, incentives for corruption will remain strong.

One way to deal with this problem would have been to reduce the influence of the ministries over the national economy either by transferring their powers to provincial entities or trusting to the embryonic market economy. Competition between provinces or markets would act to reduce opportunities for corruption. There would be an increased

supply of corrupt acts leading to lower average bribes. While the Provincial Powers Law is intended to decentralize power in Iraq, curtailing the power of the ministries is apparently beyond the will and capability of the current Iraqi government. Instead, the Iraqi government and its international advisors have focused on increasing ministerial capacity to carry out their traditional responsibilities rather than shift these tasks to other entities or eliminating them entirely.

5. Conclusion

When corruption is discussed, the two most common remarks both by Iraqis are: corruption is devastating Iraq's society but corruption is an immutable part of Iraqi (sometimes Arab) "culture". The latter statement generally is taken to mean that nothing can be done to significantly reduce corruption – at best, one might be able to mitigate its adverse effects.

However, while some of the causes of corruption are long-term historical, environmental or cultural; others are the result of perverse policies. Changing these policies will be challenging. No country has successfully eradicated corruption but experience in other countries have shown that it can be reduced to manageable levels by an anti-corruption strategy that integrates improving rule of law, reducing the economic incentives for corruption and changing the public's attitude. However, in Iraq's case, such a strategy would be insufficient. Unless the perverse incentives of governmental employees can be changed or their ability to extract rents from the Iraqi society reduced, the anti-corruption strategy of the Government of Iraq will fail.

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