

Pay Role

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Articles & Testimony

Back in 2003, Senator Robert Byrd voiced a common view among liberals about reconstruction: that it would be expensive and that America would have to pay for it. "[B]efore the war," he said, "the president's policy advisers assured the American people that Iraq would largely be able to finance its own reconstruction through oil revenues, seized assets, and increased economic productivity.... It is the American taxpayer, not the Iraqi oil industry, that is being called upon to shoulder the financial burden of rebuilding Iraq." Ten days ago, however, the IMF released a report on Iraq's economic reconstruction that makes one thing plain: It was Bush's advisers who were right and Byrd who was wrong.

The IMF data show that about 90 percent of Iraq's investment expenditures (economists divide spending into investment and consumption) in 2004 came from Iraqi sources, with foreign aid financing the remaining 10 percent. Moreover, the IMF forecasts that over the years 2004 to 2010, 94 percent of Iraqi investment will come from its own resources. In other words, Iraq will be more or less paying its own way.

The report is polite about the massive U.S. expenditures in Iraq, but the message is clear: Little of the money is being used to rebuild Iraq. And that is because the foreign money is not really needed. In fact, Iraq has more funds available for investment than it can use. The Central Bank's foreign exchange assets went up by \$6.4 billion in 2004 (from under a billion dollars to \$7.3 billion). Iraq had such ample resources that it wasted amazing amounts on a massive subsidy program. According to the IMF, in 2004, fuel subsidies alone amounted to \$7.8 billion, equal to 30 percent of GDP. Add in the billions spent on food rations and subsidies to state enterprises, and the total subsidies were more than half of GDP. If Iraq wanted to invest more in reconstruction, there is an obvious way to raise the resources needed: The country could get started on an IMF plan to phase out those subsidies over a five year period instead of stalling (it has taken no action to date).

But the truth is that Iraq doesn't need the additional money -- at least not right now. Economic reconstruction is currently being held back mostly by the country's limited "absorptive capacity," to use economic development jargon. Iraq lacks the political structures to make decisions about what to build, where to build, and how to run facilities once construction is complete. More money does not solve these problems. No matter how much foreign aid is pledged, Iraq is simply not in a position to use more than the limit set by absorptive capacity. There is little merit in assessing Iraq's "needs," as the World Bank, United Nations, and Coalition Provisional Authority did in October 2003 for a donors' meeting, proposing a \$55 billion four-year program. The question is not what Iraq needs; it is what can Iraq actually handle. And the answer to that is not much. The Bank/U.N. study was criticized by U.S. officials at the time for forecasting that in the first year "only" \$5.2 billion would be spent in non-oil economic sectors (excluding security, religious, and other non-economic sectors). In fact, public investment in Iraq outside the oil sector in 2004 was \$4.2 billion -- even less than what the Bank/U.N. study predicted. (Full disclosure: I have worked for both the World Bank and IMF.)

Just as the Cassandras were wrong about Iraq needing massive foreign aid, so too they have been wrong about how the Iraqi economy is doing. The recent IMF report shows Iraq's economy grew 52 percent last year; because of the

horrific security situation, it will only grow 4 percent this year. That is not a bad growth record, and it is better than most countries emerging from war, such as Bosnia or Kosovo, much less ones still caught up in civil war. (If you want a real economic disaster, look at Somalia.) Reports about the desperate Iraqi economic situation reflect profound ignorance of how the poor of the world live. Compared to the United States, Iraq is in a very bad condition; but compared to most developing countries, it is merely in mediocre shape. Iraq is better off than many Arab countries. For instance, its GDP per person of \$1,050 is about the level of Syria or Palestine and well above Sudan and Yemen. Of course Iraq has massive economic problems, especially crushing unemployment which infuriates once-hopeful Iraqis, feeding anger at the government and sympathy for the insurgency. But most of those problems are inherent in a post-war situation when the government is weak and fragile; and there is little that foreign aid can do to reverse the situation.

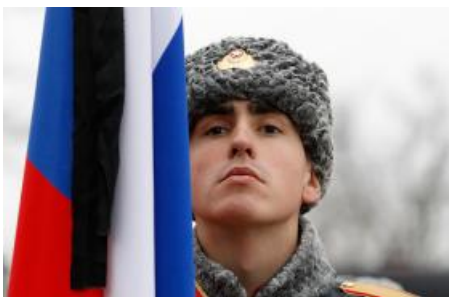
The main role now for the international community is not to flood Iraq with money but rather to help the government make sounder economic decisions. Encouraging Iraq's leaders to do away with wasteful and counterproductive subsidies would be a start. Thanks to these subsidies, electricity is virtually free and gasoline is 5 cents a gallon. (To give some context, it's 150 times more expensive in neighboring Turkey.) With prices so artificially low, no wonder these items are in short supply.

Iraq may not need much cash aid, but the world's powers should agree that the country can be freed of its \$114 billion in Saddam-era debt (a figure that does not include the tens of billions more owed in war compensation, under U.N. resolutions). The Paris Club of official creditors has offered to reduce Iraq's debt if it maintains IMF-approved economic policies, which could bring Iraq's debt down to \$31 billion in 2008. That would still be 60 percent of GDP. It would be appropriate for banks and Arab debtors to write off large parts of the odious loans they made to Saddam, and for Kuwait to forgive the war compensation it is due. A clean slate, not new money, is what Iraq's economy needs most from the outside world. Which isn't surprising -- unless you were listening to Senator Byrd.

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