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Working Paper

Resources and the political economy of state fragility in conflict states: Iraq and Somalia

WIDER Research Paper, No. 2008/35

Provided in Cooperation with:

United Nations University (UNU), World Institute for Development Economics Research (WIDER)

Suggested Citation: Dibeh, Ghassan (2008) : Resources and the political economy of state fragility in conflict states: Iraq and Somalia, WIDER Research Paper, No. 2008/35, ISBN 978-92-9230-081-4, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki

This Version is available at:

<https://hdl.handle.net/10419/45069>

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Economics Research

Research Paper No. 2008/35

Resources and the Political Economy of State Fragility in Conflict States

Iraq and Somalia

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April 2008

Abstract

This paper studies state failure and governance in two conflict-states in the Middle East: Iraq and Somalia. Iraq is currently undergoing a social experiment under which a new form of government is being constructed after the passage of autocratic rule. The government envisaged is a consociational democratic state designed a priori as a political mechanism for the redistribution of resources, mainly oil. Somalia represents a stateless society or anarchy. The paper argues that in resource-rich countries such as Iraq, the consociational project leads to an Olson-type rent-seeking confessional behaviour that hampers economic growth and development. The rent-seeking behaviour in Iraq is fuelling the insurgency that perceives the consociational system as a grabbing

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Keywords: fragile states, political economy, resources

JEL classification: D72, D74, N45, N55

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This is a revised version of a paper originally prepared for the UNU-WIDER conference on Fragile States–Fragile Groups, directed by Mark McGillivray and Wim Naudé. The conference was jointly organized by UNU-WIDER and UN-DESA, with a financial contribution from the Finnish Ministry for Foreign Affairs.

UNU-WIDER gratefully acknowledges the contributions to its project on Fragility and Development from the Australian Agency for International Development (AusAID), the Finnish Ministry for Foreign Affairs, and the UK Department for International Development—DFID. Programme contributions are also received from the governments of Denmark (Royal Ministry of Foreign Affairs), Norway (Royal Ministry of Foreign Affairs) and Sweden (Swedish International Development Cooperation Agency—Sida).

ISSN 1810-2611

ISBN 978-92-9230-081-4

attempt of the country's resources by other ethnic groups. However, state construction is possible since there is a positive economic effect of combining government and resources. In Somalia, on the other hand, the developments and the evolution of anarchy since state collapse in 1991 exemplify the result of prolonged conflict in a resource-poor state. The lack of resources, direct access of producers to resources and low productivity and weak redistributive potential of combining resources and government offer no material incentives to the various groups for resurrecting central authority.

Acronyms

CPA	Coalition Provisional Authority (of Iraq)
DFID	Department for International Development (UK)
GC	governing council
MENA	Middle East and North Africa

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Typescript prepared by Liisa Roponen at UNU-WIDER

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

1 Introduction

Fragile states and conflict-ridden states are highly interrelated in the countries of the Middle East and North Africa region (MENA). This symbiotic and structural relationship forms an interesting area of study for policymaking in countries that are not necessarily poor and hence fragile, but rather are potentially rich and fragile (such as Iraq). In other countries in the area, such as Somalia and Sudan, fragility is a complex outcome of both conflict and poverty. However, the common factor in most fragile MENA states is state failure and governance structures that perpetuate civil conflicts and form the nexus of postconflict reconstruction failures. According to classification by the UK Department for International Development (DFID), fragile states in the MENA region include Somalia, Sudan and Yemen. However, the *Foreign Policy* index of failed states classifies Lebanon, Egypt, Iraq, Sudan, Somalia, Saudi Arabia, Syria, Yemen and Iran as failed, with the degree of failure ranging from 'borderline' to 'in danger' to 'critical'. This broader classification system which takes into account political determinants of fragility explains the tendency of some countries to become fragile states. For example, Iraq and Lebanon, two countries with a relatively high GDP per capita, are fragile states on the brink of civil strife and conflict that could transform them into the more traditional fragile states as per the DFID classification.

The analysis in this paper assumes that there are two general types of fragile states: one type includes countries like Sudan, Somalia and Yemen which fall under the more traditional concept of poor fragile states intensified by ethnic and tribal conflict. In the case of Somalia, the country is a de facto failed state divided amongst tribal warlords. In Sudan, despite the latest peace agreement, the country is divided between the Arab Muslim north and the mainly Christian African south. The nexus of tribalism, ethnic conflict and poverty form the basis for state failure in Sudan and Somalia. In the case of Somalia, as we see later in the paper, the poor-resource attribute of the country makes it more amenable to chaos and anarchy. In the second type of state failure, on the other hand, state fragility is more related to the form of government established by potentially conflictive groups in a resource-rich economy (Iraq) or a middle-income state (Lebanon) with large financial wealth and debt-financed government expenditures. Through shared political space, the consensual or consociational democracy (since the independence in Lebanon and more recently in Iraq, following the US invasion) is supposed to mediate the demands of the different sects and religious communities for resources. The underlying fragility-producing dynamics in these states is the process of state reconstruction and the failure of governance structures to produce stable political systems that distribute resources amongst different communities. These instabilities can cause either low-intensity conflict (Lebanon) or high-intensity conflict (Iraq) or devastating civil wars (pre-1990 Lebanon or perhaps future Iraq).

The paper studies the political systems and economic development in two such conflict-states in the Middle East—Iraq and Somalia. Iraq is undergoing currently a social experiment during which a new form of government is being constructed after the passage of autocratic rule. Government is envisaged as a consociational democratic state, as it is designed a priori to serve as a political mechanism for the distribution of economic resources, mainly oil. Somalia, on the other hand, represents a stateless society bordering on complete anarchy. The incentives for power-sharing arrangements in Somalia are absent due to the lack of resources, the division of which various groups could potentially agree upon in any power-sharing arrangement. In this respect, Binningsbo (2005) shows in a theoretical and empirical study of postconflict societies

that consociational democracy as a power-sharing arrangement between different social groups increases the probability of stability and lasting peace in the postwar period. This paper argues, however, that the consociational system may lead to rent-seeking confessional behaviour that could undermine the efficiency of state-led or private-sector led economic development, particularly in postwar conflict societies rich in resources and with ethnic and religious divisions and, consequently, may lead to the prolongation of conflict or resurgence of political violence. The creation of a consociational democracy in Iraq in the post-invasion period has increased rent-seeking amongst the various ethnic and confessional groups and is fuelling the insurgency. The insurgency is attempting to improve its position within the consociational system that would eventually distribute the country's oil resources.

The paper concludes that in relatively well-off fragile states, economic growth and development can be hindered by Olson-type rent-seeking coalitions. In addition, war when followed by consociational political system can strengthen such coalitions (as happened in post-Saddam Iraq) rather than weaken them, as Olson had observed in the case of Germany after the Second World War (Eggertsson 1990). On the other hand, Somalia's evolution into anarchy after state collapse in 1991 is an example of the result of prolonged conflict in a resource-poor state. The development of what some called efficient anarchy (Leeson 2007) leads to a political-economic equilibrium where no group has an interest in forming a central authority.

The paper is divided as follows: section 2 discusses the various theories relating to resource availability, state structures and economic growth. A prototype model is then developed to model the relationship between resources and the demand for government. Section 3 surveys the economic development of Iraq until the first Gulf War in 1991. Section 4 discusses the postwar reconstruction process in Iraq against the backdrop of the country's economic decline during the decade of economic sanctions in the 1990s. The section examines Iraq's political reconstruction process in the post-Saddam period, given the relationship between oil resources and the political arrangements established. Section 5 applies the developed model to Somalia. Section 6 concludes.

2 A model of government and resources

Consociational democracy—in addition to being a system of distribution of political power between different ethnic or confessional groups as formulated by Lijphart (1969)—is also a mechanism for dividing state-controlled resources. In Iraq, for example, this type of democracy must provide a distributional mechanism for the country's oil resources.¹ However, the necessary condition for establishing and successfully applying such a system is the existence of a resource-threshold that permits the formation of a state. In the case of Somalia, this resource threshold is beyond reach, and resources in the economy do not permit the formation of a state nor, as a result, a constitutionally-based distributional system amongst the different group and tribes. The alternative to this type of state distributional system is the abolition of the state and the creation of an anarchistic stateless society that mediates the production and distribution

¹ The consociational system was successful in postwar Lebanon in distributing the proceeds of public debt and government expenditures, see Dibeh (2005).

of resources. The theory can be summarized as follows: In an ethnically divided or tribal society, a consociational democratic state will arise if resources, R , are larger than some threshold value R^* . This theory arises from the rent-seeking society theories of the origin of the state (Olson) in contrast to the social choice theory where the state arises if the cost of government, G , is less than the private gain from the establishment of the state, PG . In this respect, the social choice theory advanced by Leeson (2007) applies to small primitive but homogeneous populations such as small African tribes.

The relationship between resource abundance and negative economic growth outcomes has been explained by three different theories—Dutch disease effects, predatory state, and conflict theories (Olsson 2007). The role of resources in engendering democracy or conflict has been modelled theoretically and investigated empirically in a number of studies: Aslaksen and Torvik (2006) extend the resources-democracy-conflict literature by developing an extended model in which conflict and elections arise endogenously from the interaction of players in a dynamic game. They find that the probability of conflict rises as the ratio of resources to productivity of labour increases. This implies that poor (low productivity) but resource-abundant countries have high risk of ending in conflict rather than democracy. Collier and Hoeffler (2005), utilizing an electoral competition model, show that resource-richness endangers democratic rule.

In addition to the relationship between resources and government, two important related questions are discussed in the literature: the relationship between resources, and conflict and the relationship between resource abundance and economic outcomes. From their study of civil wars over 1960-99, Collier and Hoeffler (2001) present empirical evidence for the hypothesis that the driving factor behind civil wars is the opportunity for economic gain or 'greed', and that ethnic divisions were insignificant. This agrees with the central thesis of this paper that the political economy in post-Saddam Iraq is driven by expectations of resource gains from natural resources, whether achieved through outright conflict (if Iraq slips into civil war and subsequent breakup) or through consociational democracy which will provide the political space for their distributional arrangements. Torvik (2002) develops a theoretical model of natural resources and rent-seeking in which the abundance of natural resources triggers an increase in the number of economic agents moving away from productive activities into rent-seeking behaviour. Moreover, Collier and Hoeffler (2005) find a negative relationship between resource-rich democratic countries and economic growth with autocratic resource-rich countries outperforming democratic ones.

In contrast to the models that rely mainly on game-theoretic or electoral models, the following section develops a new political economy model of government and resources in the tradition of Findlay (1989) and McGuire and Olson (1996). The model sheds some light on the determinants of the size of government in a society with resources that can be used on their own (without government) to produce output. Findlay's (1989) seminal model introduces the role of government in society's production process as an externality that enhances the extraction of private production from private inputs. McGuire and Olson (1996) further develop a model of democracy and autocracy where output is a function of government or public goods needed by other resources (such as labour) for the production of output. In addition, literature on the optimal size of government has modelled government expenditures as input to the production function of society (Karras 1996). Tavits (2004) shows in an empirical study that government size is larger in consensus-type democracies than in majoritarian democracies due to the

increased role of the government in welfare provision in a cohesive society. Let the production function of the economy be defined as:

$$y = Af(R, G) + Bg(R) \quad (1)$$

where R = resources; G = government size or institutions or public goods needed in cooperation with R for production of output. The production function assumes that resources are used for domestic production as developed in a variant of Hotelling resource extraction model developed by Heal (2007). Furthermore, the production function assumes that the economy can produce goods using a resource-only $g(R)$ and a combined government-resource channel $f(R, G)$. The latter is a variant of the productive role of government model introduced by Findlay (1989). The government plays a productive role where a central government helps mobilize resources, protects property rights in these resources, enforces contracts and invests in resource maintenance. The production function has the property that under ‘anarchy’, $y(0, R) \geq 0$. Let there be two groups in society with the following payoff functions²

$$\Pi_1 = \lambda(y - \gamma G - \theta R) \quad (2)$$

$$\Pi_2 = (1 - \lambda)(y - \delta G - \theta R) \quad (3)$$

where λ = share of group 1, γ and δ cost of government to groups 1 and 2 respectively, and θ = resource price.

The maximization problem with respect to G is then given by the following:

$$\frac{\partial \Pi_1}{\partial G} = 0, \quad \frac{\partial \Pi_2}{\partial G} = 0 \quad (4)$$

which gives:

$$AR^\alpha \beta G^{\beta-1} - \gamma = 0 \quad (5)$$

$$AR^\alpha \beta G^{\beta-1} - \delta = 0 \quad (6)$$

Adding the two conditions we get:

$$AR^\alpha \beta G^{\beta-1} = \frac{\delta + \gamma}{2} \quad (7)$$

The maximization problem with respect to R is given by the following:

$$\frac{\partial \Pi_1}{\partial R} = 0, \quad \frac{\partial \Pi_2}{\partial R} = 0 \quad (8)$$

The first-order conditions (8) give:

² In contrast, the model in McGuire and Olson (1996) has the property $y(G)$ so that $y(0) = 0$.

$$A\alpha R^{\alpha-1}G^\beta + \alpha BR^{\alpha-1} - p = 0 \quad (9)$$

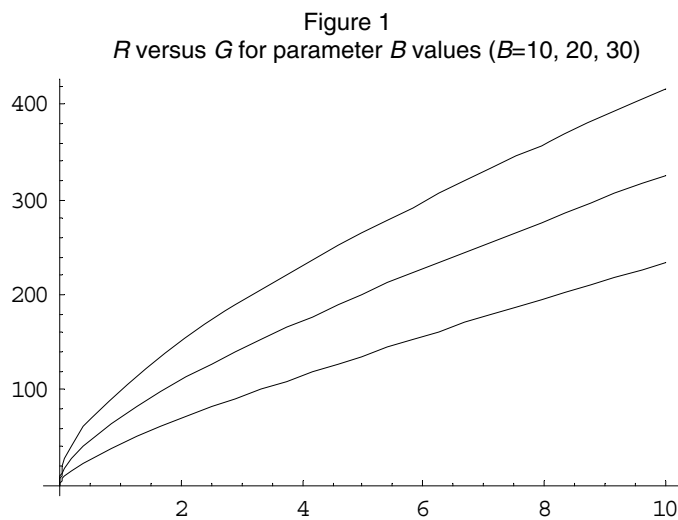
Dividing first-order conditions (7) and (9) and rearranging terms we get:

$$R = \frac{(\gamma + \delta)\alpha(B + AG^\beta)G^{1-\beta}}{pA\beta} \quad (10)$$

Relationship (10) defines the $\frac{R}{G}$ intensity as a function of the various parameters of the model. The important parameter effects are as follows:

- The higher β , the lower $\frac{R}{G}$. The higher β reflects the higher productivity and efficiency of the government, resulting in a larger government size or more effective institutions;
- The higher p , the lower $\frac{R}{G}$. The larger p reflects greater difficulty in extracting the resource, whether economic or otherwise. For example, an ethnic group attempting to secede (Kurds in Iraq or east region in Biafra) must take into account the possible resultant increase in p ;
- The higher B , the higher $\frac{R}{G}$. If total productivity of the resource without government is high, then this results in a relatively smaller government size. Even in resource-poor economies, if B is very high, G can become very insignificant, a scenario that can represent stateless societies. In resource-rich economies, such as the oil-rich countries, G can be very minimal *if G is unnecessary for the exploration, extraction and export of oil*;
- The higher α , the higher $\frac{R}{G}$. The higher the marginal productivity of resource, then this results in a relatively smaller government size.

Figure 1 shows a plot of R versus G for various values of the parameter B . The results show that for very large B and high resource availability then $G \rightarrow 0$.



Source: Author's simulation of (10) using MATHEMATICA.

3 The Iraqi economy before the invasion

The current state of Iraq as a deeply divided country with a non-functioning polity and economy is a phenomenon which was engendered by the economic crisis of the 1990s and intensified in the post-Saddam period. In this section, the Iraqi economy and its development in the period prior to the first Gulf War (1991) are studied. It is shown that the economic developments during 1960-80 did produce a fairly developed economy and a central developmental state. In this respect, economic progress in Iraq during that period can be measured according to the criteria outlined in the Rostovian stages of economic development (Rostow 1960). Moreover, Iraq satisfied the Rostovian preconditions for takeoff with regard to social overhead capital and reactive nationalism. Furthermore, the country satisfied the other takeoff prerequisites such as: (i) investment comprised 10 per cent of GDP; (ii) advanced petrochemical industry had been developed; (iii) the political climate was favourable to modernization; and (iv) a capital-output ratio of 4:1 had been reached and an abundance of loanable funds created.

The economy had been guided by five-year plans since the 1958 revolution that overthrew the monarchy and signalled the beginning of the republican era in the history of Iraq. In 1976, the five-year plans were abandoned and replaced with indicative planning on an annual basis. The government is the most important actor in the economy, as it owns most of the means of production, in addition to the lifeline of the economy, the oil sector. In 1980, the oil industry accounted for 67 per cent of the gross domestic product. Time-wise, the most important era in the Iraqi economy is the post-1973 period when, as a result of the Arab oil embargo and the subsequent rise in oil prices, oil revenue jumped from US\$1 billion in 1972 to US\$8.2 billion in 1975. This trend continued until 1980 when it was estimated that 'in the first nine months of 1980 (the war began on 22nd of September) oil export revenues were US\$25 billion or about US\$33 billion on an annual basis' (Kanovsky 1983: 5). This led to government expansion of its fiscal expenditures and investment programmes in an attempt to industrialize and diversify the structure of the economy that was becoming increasingly dependent on oil. Table 1 summarizes the investment programmes for the period 1970-78.

The objective was to allocate almost 70 per cent of oil revenues to investment programmes and in 1978, for example, 67 per cent of oil revenues were targeted to

Table 1
Investment programmes in Iraq, 1970-78

Year	1970-1	1973-4	1975	1977	1978
Total (millions of Iraqi dinar)	119	296	1591	2074	2121
Industry (%)	23.4	15.2	43.9	46.5	32.2
Agriculture (%)	23.4	21.9	20.1	12.9	23.4

Source: EIU (1986/87).

Table 2
National accounts—trends in GDP

Year	1979	1984	1985	1986	1987	1988
Nominal GDP, in billions of US\$	38.6	47.6	46.8	54.3	68.4	91.0
Real growth, in billions of US\$	23.5	-8.0	-9.7	-4.7	-1.9	5.0

Source: EIU (1989/90).

investment programmes. However, not all money allocated for these programmes was actually spent. Gross fixed capital formation, which reflects the efficiency of the government's implementation of the economic development plan, indicated tremendous growth rates from 1972 to 1976, followed by sluggish growth in 1976-81.

The developmental phase of the economy led, first, to the increasing importance of the oil sector, accounting for 67 per cent of GDP in 1980; and second, because of the huge oil revenues, increased public expenditures by the Iraqi government on social sectors such as education and health, as well as to industrialization and the military sector. Public employment became the source of national integration in Iraq. GDP per capita had increased to US\$2,312 in 1979, at the start of the Iran-Iraq war (Owen and Pamuk 1998).

During the post-boom industrialization drive of the 1970s to the war of the 1980s, the economy experienced upswings and downturns that left it both industrialized with comparatively huge financial resources, but also at the same time backward and indebted. The Iraqi economy suffered heavily from the Gulf War (1980-88); estimated costs of the conflict up to 1985 totalled US\$226 billion at the 1980 dollar-level. Furthermore, by the end of 1988, when the value of oil exports had dropped to 50 per cent of their 1980 level, Iraq had accumulated an estimated US\$60 billion in debts, costing around US\$3 billion per year in debt servicing (Crusoe 1989). In addition, according to the Bank for International Settlements (BIS), foreign exchange reserves accrued by the government during the 1970s expected to reach US\$25 billion in 1980 had dwindled to US\$800 million by the end of 1983 (Crusoe 1989). The war also created extreme distortions in agriculture, the labour market and capacity utilization—three major weaknesses of the pre-war economy. Closure of exporting facilities in the Persian Gulf caused Iraq's oil exports to decline considerably, dropping from 3.5 million barrels per day in 1979 to 2.6 million in 1988, and diminishing during 1984-85 to only 800,000-900,000 barrels. In 1987, fixed capital formation dropped to almost the pre-war era level. The Iraq-Iran war put an end to the growth in Iraqi GDP, which had averaged 27.9 per cent over the period 1968-78 (Khafaji 1983: 5).

In 1987, the economic climate began to change as a result of an increase in oil exporting capacity and higher oil prices. Expansion of the pipeline through Turkey increased oil export capacity by 500,000 barrels per day during the third quarter of 1987 and the pipeline flowing through Saudi Arabia increased it by an equal amount in September 1989. Furthermore, Iraq regained its traditional trade surplus position which had persistently experienced deficits during the years 1981-83 and 1986 (EIU 1986/87: 34; EIU 1989/90: 32).

4 Politics and economy in post-Saddam Iraq

We have shown that the Iraqi economy faced severe challenges at the end of the Iran-Iraq war. The decline in GDP per capita and the enormous foreign debt accumulated during the Iran-Iraq war (mainly to Arab countries) presented the most immediate problems. Arab advances to Iraq during this period have been estimated to have amounted to US\$80 billion (Owen and Pamuk 1998). The decline in oil prices to around US\$15-20 per barrel during this period prevented the Iraqi government from utilizing its oil exports—the traditional source of economic growth—to finance its way out of the

crisis. The policy of the government staggered until the Iraqi regime invaded Kuwait in an effort to find a solution to its debt crisis. The first Gulf War in 1991 was a milestone in Iraq's subsequent decline: economic sanctions and embargo imposed on the country from 1991 to 2003 devastated the economy. Capital accumulation faltered as the government lost control of its oil revenues under the UN oil-for-food programme. The government, strapped for cash, initiated inflationary financial measures to pay government wages, causing hyperinflation in the 1990s. By 2001, GDP per capita at market exchange rate was around US\$960 (Foote et al. 2004).

After the invasion, the Coalition Provisional Authority (CPA) led by Ambassador Paul Bremer assumed responsibility for economic policy. The basic thrust of the economic policy was the enactment of free market reforms with foreign investment law, reforms in the banking sector, import liberalization strategy and planned privatization of state enterprises as the main pillars (Looney 2004a). These reforms were to bring prosperity to Iraq, as it moved away from the statist economy to a free market one (Foote et al. 2004). However, four years after the invasion, the country has little to show in terms of economic progress, especially in the areas of public service such as electricity production and employment generation. These economic failures were intertwined with political and security developments. They should not, therefore, be perceived only at the economic level as traditional failure of neoliberal policies even though the incompatibility of such pro-market policies implemented in the Iraqi circumstances has been shown to be one of the main reasons for the failure of the postwar reconstruction programme (Looney 2006). In addition to the 'economic' failures of the neoliberal programme, developments in the post-Saddam governance structure, particularly the designs for the formation of a federal consociational democracy, led to growth-impeding political rent-seeking behaviour. The US invasion did not trigger economic growth and prosperity as anticipated, but created instead a political economy of (re)distribution, that breeds sectarian violence, insurgency and general economic collapse.

4.1 Governance and state construction

Many observers of Iraqi affairs have reached the conclusion that Iraq is at the crossroads between the establishment of a unified democratic state or disintegration and division across ethnic lines. According to Feldman (2006), the US occupation of Iraq will be historically judged as a major upheaval whether towards a failed state or a 'reasonably democratic' one.

Failure to achieve an ethnic division of power has led some observers, such as Downes (2006), to suggest that the solution could be a territorial division of Iraq into three states—Sunni, Shiite and Kurd, because power-sharing arrangements have failed to alleviate the mistrust among the groups. This was echoed in the *Iraq Study Group Report* issued in December 2006, i.e., the so-called Baker-Hamilton Report, which also warned of the dangers of regional breakup into three ethnic-based states.

Developments in the post-Saddam governance structure, especially the formation of a federal consociational democracy, were instrumental in creating this untenable political and ethnic-conflictive state. The neoconservative agenda for democracy in Iraq—envisaged as a beacon of good governance in the Middle East region—gave way to civil conflict, ethnic strife and corruption on an unprecedented scale. Instead of the clean

slate that neoconservatives assumed was being handed to them with the end of autocratic rule, the US occupation authorities turned Iraqi politics into a denominational political system that hampered state reconstruction and nation-building in the postwar period.

The problem of nation-building in Iraq was immediately faced by the CPA and Paul Bremmer, the US ‘governor’ of Iraq, and his actions during the first year of occupation sealed the fate of Iraqi political development in later years. According to a general consensus, the dismantling of the Iraqi army in May 2003, one month after the invasion, and the massive looting of Baghdad that occurred immediately after the invasion while US troops watched helplessly sent out signals to the population that the transition from autocratic rule was fraught with insecurity. According to Feldman (2006), the rise of denominational politics was a way to create ‘mutual protection associations’ in the face of chaos. Although it is true to some extent that the rise of denominational politics was spontaneous, the deliberate US design to create a multi-ethnic democracy was also instrumental in engendering this outcome. The nationalist development project of the Baath regime, although weakened by Saddam’s personal and tribal politics in the 1980s and more importantly in the 1990s, was replaced with a political system based on the division of power explicitly between the ethnic and religious communities of Iraq. The establishment of the governing council (GC) in 2003 by Ambassador Bremmer immediately after the invasion was based on ethnic representation,³ and laid the foundation for all subsequent governing bodies, appointed or elected, from parliament to government to be mirror-images of ethnic division. The GC was scrapped on 28 June 2004 when the CPA handed power to an interim government headed by secular Iyad Allawi: it was the start of the formal handover of power from the CPA to the Iraqis.

The pivotal point in the political construction of Iraq came in January 2005 when general elections were held due to pressure from Ayatollah Al-Sistani, the Shia highest religious authority in Najaf. US authorities reluctantly agreed after massive demonstrations by the Shiites at the urging of Sistani (Chomsky 2006). The elections brought a Shia majority to power and led to the defeat of the pro-US secular candidate, Iyad Allawi. They also paved the way for a constitution that institutionalized the confessional consociational democracy in Iraq. These political changes came in tandem with the intensified struggle over resources. The Iraqi economy had been dominated up to this point by international corporations involved in the US-led reconstruction effort. The new political system started preparing the ground for a confessional division of the reconstruction spoils and of the benefits from increased oil prices that produced windfall profits to the state-owned sector. This explains the intensification of the Sunni insurgency in the post-elections period up to present day. In parallel to what can be called a normal political process, there were increasing tensions regarding the status of the important oil-rich Kirkuk region and these were turning oil politics into a new impetus for violence between the Kurds and the Sunnis. Moreover, the creation of the semi-autonomous regions (for e.g., Basra in the south) that were forging economic ties

³ In a highly significant incident that attests to the role played by US authorities in enshrining denominational politics into Iraq’s new governance structure, Bremmer recalls in his memoirs that even the appointment of Communist Party general secretary to the GC was done on confessional grounds in appointing him as a learned representative of the Shi’a community rather than a representative of the Iraqi communist party (Bremmer 2006).

across the border with Iran added fears within the Sunni minority of economic marginalization.

The US plans for democratic progress in Iraq were diverted or controlled by pressure from Ayatollah Sistani. Sistani issued a series of *fatwas* from June 2003 onward. These *fatwas* stipulated that all constitutional and institutional formations be subjected a public referendum. Given the majority of the Shia, this meant all such measures were subjected to the will of the Shias. Cockburn (2006) cites the incident of an Iraqi calling the results of the January 2005 elections for the constitutional assembly—which the Sunnis boycotted—the ‘Sistani tsunami’. Cockburn (2006: 187) observes that in Iraq’s pivotal first democratic elections, the ‘Iraqis had voted almost wholly along ethnic sectarian lines’. Subsequently, the first elected government in postwar Iraq ushered in a new system of governance based on communal nature as a version of consociational democracy. But according to Anderson and Stansfield (2005), the effort was undermined by three negative aspects of the election: the marginalization of Sunni Arabs whose participation was estimated to be between 5-10 per cent; the dominance of Shiite religious parties in parliament, and the overrepresentation and empowerment of the Kurds.

In October 2005, the referendum for the Iraqi constitution—an important element in the confessional foundation of Iraqi polity in the post-Saddam period—was supported by the Shias and Kurds, and opposed by the Sunnis. The December 2005 parliament elections, although bringing a Sunni bloc to parliament, solidified the denominational political system of Iraq. Cockburn calls these events ‘a series of misleading milestones ... all the while the Iraqi state and society came even closer to dissolution’ (2006: 222).

The democratic system established through denominational politics and early elections lacked a fundamental element of democracy: there was no competition for the inter-ethnic representation or uncertainly over election outcomes (McGuire and Olson 1996; Przeworski 1991). This is one of the reasons for the failure of democratic rule and the ensuing violent conflict. Both the eruption of violence against occupation forces and inter-communal fighting that intensified after the 2005 elections and constitutional year have left more than 600,000 dead (Burnham et al. 2006). The Sunni insurgents have imposed huge losses on the society, given the current political structures that would offer them little gain in the event of success in nation-building.⁴

4.2 The geography and politics of oil

Oil played a pivotal role in the Iraqi economic and political development before the Gulf Wars in the provision of resources for state expenditures, as we have seen in section 3. Stansfield (2005) observes that oil was perceived as a spoil of war in the post-Saddam period. The location of oil juxtaposed on Iraq’s ethnic division based on three pre-independence *wilayat* (Mosul, Baghdad and Basra) gives control of Basra and the southern fields to the Shia, and the northern fields of Kirkuk are dominated by the Kurds but highly contested by the Sunni. This interrelationship of geography and oil is one of the main defining elements of post-Saddam Iraq: centralized control over oil

⁴ This type of behaviour in society is explained in McGuire and Olson (1996).

resources is eroding into a decentralized system embedded in the constitution adopted in October 2005 (Tsafos 2006). The constitution and the new hydrocarbon law proposal, however, were ambiguous on the extent of centralized versus decentralized mechanisms of oil production and distribution.

The consociational democracy currently being set up in Iraq is symbiotically related to the country's oil resources. In the post-invasion period, the development of the federal political system highlighted oil not only as a resource for national economic development or a source of contention between Iraq and colonial powers, as had been the case in the pre-nationalization phase, but as a resource contested by the different ethnic and religious groups for its revenue and 'rents'. Once the focus moved away from national economic development to distributional issues, the Kurds, Sunnis and Shias realized from the outset that controlling oil was equivalent to controlling the main source of state revenue. There have been many calls by Iraqi observers for an oil distributional system based on individual allotments. Birdsall and Subramanian (2004) propose that a substantial part of the oil revenues be distributed directly to Iraqi citizens in an effort to avoid transforming Iraq into another oil-rich country with the usual economic ills with respect to Dutch disease, lack of incentives for the development of political institutions, and economic reform. If implemented, such a proposal would provide non-sectarian channels of distribution for oil resources that complement their usage for postwar reconstruction. More importantly, the proposal could break the confessional shackles on economic growth imposed by the new confessional system. Looney (2006) supports such a system, albeit with more attention being given to the usage of oil resources for reconstruction through the financing of public investments and in generating aggregate demand in a typical Keynesian strategy. An interesting feature of the proposal is that it is in part seen as promoting counter-insurgency tactics because individual allotments could encourage the Iraqis to protect oil assets from sabotage attacks and could mute the Sunni complaints about possible unequal distribution of the proceeds. In this respect, Feldman (2006: 44) observes that 'the Sunni insurgency wanted to convince the Shia and the Kurds that oppressing them or simply denying them a full share of state resources would be very costly'.

Although the distribution of oil proceeds is seen as crucial to success in rebuilding civil society (Zubeida 2006), all proposals for political and economic reform, including those concerning oil funds, add to the current destabilizing and centrifugal elements in Iraq. The 'distributional' element is given considerable weight in these proposals.

The new oil law draft was introduced in a furtive manner. The draft, yet to be approved by parliament, calls for the establishment of a Federal Oil and Gas Council that would approve all oil-sector contracts. Juhasz and Jarrar (2007) note that many Iraqi oil experts have called the law as the 'Split Iraq Fund', as it paves the way for the three main ethnic groups/regions to claim their own oil production fields. However, the law is ambiguous enough to allow a strong central state to supersede measures by regional authorities. Hence, the application of the law will be an endogenous process depending on the power struggle among the central state, regions and ethnic groups. At present, the latter has the upper hand. The consociational democratic government, if fully functional and operational with the inclusion of the Sunnis in the process, will eventually be the central mediator of regional/ethnic distribution of oil.

5 A resource-poor economy: Somalia

Today, Somalia is considered to constitute a modern form of anarchy. The state collapsed in 1991 after the overthrow of Siad Barre, the last president of a unified Somalia. The country collapsed into a stateless existence, with Somaliland and Puntland as the two northern secessionist regions. This collapse outlasted US and international military intervention in the early 1990s. Over the past few years, an attempt at unification was made with ideological underpinnings led by the so-called Islamic Courts in an effort to extend central authority over most of Somalia. The efforts, however, were thwarted by an outright military intervention by Ethiopia in April 2007 which re-installed the provisional government. Despite such efforts at ‘unification’, the Somali state is far from escaping the trap of fragility, or worse, of failed state that has plagued the country for almost two decades.

The model presented in section 2 predicts that groups in a country like Somalia where resources are scarce, have little incentive to create central government. In the language of the model, Somalia has the following parameters and endowments: low R , low β , high B . Somalia’s main resources are pastoral production and crop farming, i.e., mainly agricultural resources.

The past record of Somalia’s central government since the socialist phase of the 1960s and 1970s shows that, due to a low resource base, the government was either reliant on foreign assistance (the Soviet Union at the time) or highly inefficient with respect to economic policy (in the post-socialist period starting from 1980). Collapse of the state in 1991 and eruption of a civil war that continues unabated have shown that the country’s various ethnic groups, tribes and regions have limited interest in restoring central authority. Many observers note that the Somali economy has actually fared better during this period than under centralized rule (Leeson 2006; Mubarak 1997; Powell, Ford and Nowrasteh 2006). For example, Powell, Ford and Nowrasteh (2006) show that Somalia, in comparison with 42 other Sub-Saharan African countries, has a comparable, if not better, level of progress in many economic and social welfare indicators. There has been economic progress despite the destruction of all public infrastructure such as electricity production, the spread of violence, and more importantly, the absence of central government or even a central bank.⁵ Many attribute this progress to the absence of the state or central authorities. For example, Mubarak (1997) shows that the collapse of the state led to regulations on urban commerce being lifted, and to the end of the negative effects of economic policies which had plagued Somalia in 1980-91. This allowed business in the cities to flourish, and pastoral and agricultural production to improve in rural areas. Currently Somalia is the biggest producer of cattle in the east African region (Powell, Ford and Nowrasteh 2006). Moreover, the relative calm and stability of the breakaway state, Somaliland, have allowed the economy in the north to experience a relatively strong revival.

Various theories have attempted to explain the continuing resilience of anarchy in Somalia. One explanation is attributed to the ambitions of the warlords for national domination (Mubarak 1997). As Menkhaus (1995) observes, the inability of one group or alliance of groups early in the civil war to dominate the national politics prevented

⁵ The central bank has been closed and stopped printing money after it was ransacked and destroyed in 1991 (Mubarak 1997).

the return to central authority. Another theory is based on the benefits of anarchy (Leeson 2006). Finally, Menkhaus (2003) points to the zero-sum nature of state revival. Although the Leeson's explanation may be plausible, it does not consider the benefits of anarchy in the context of missing national resources in Somalia that would produce the public goods (G) needed for state mobilization. In addition to the intrinsic benefits of anarchy, the model in this paper suggests that the benefits from central government in resource-poor Somalia would not create sufficiently greater material incentives for the warring factions to offset the huge costs of re-establishing central authorities after years of civil conflict. In Iraq, in contrast, conflicting groups have an intrinsic interest in establishing central authority because G is vital for the production and export of oil resources. Moreover, the experience of the breakaway region, Somaliland, in establishing a form of central authority shows that the poor resource-base is the main obstacle to the continuation of the experiment (Mubarak 1997). This also applies to the assumption that currently state formation would be a zero-sum game whereby some players benefit from state construction, while others, as a result, correspondingly lose. This theory would be plausible if the newly formed state can be used as a redistributionary mechanism between groups in a zero-sum setting. However, and since resources in Somalia are very scarce and are mainly pastoral and agricultural, their extraction by the state would actually lower the benefits to all, as has been witnessed during the socialist phase when the state supplanted the markets or even when Barre's government abandoned socialist policies for structural adjustment in the 1980s.

As the model in this paper shows, groups in direct control of resources weigh the high costs of establishing a central government in Somalia against the benefits of the existing stateless set-up. Anarchy in Somalia, according to Samatar (1993: 35), is a return to the pre-colonial era when traditional ties based on Islam and kinship had 'an economic counterpart: nomadism and peasant agriculture. All households had access to productive resources'. Samatar (1993) further argues that the *petit bourgeoisie* was a new class that benefited from state power in the post-colonial period until 1991. This supports the argument of this paper that in the presence of direct access to R (in the model represented by $y(0, R) \geq 0$), and due to the destruction of the *petit bourgeoisie* during the civil war, no group in Somalia has an interest in the resurrection of central state authority. This accounts for the fact that the recent attempts to unify Somalia originated from either a highly ideological group (the Islamic courts movement) or the Ethiopian military intervention that ousted the Islamic Courts from Mogadishu.

6 Conclusions

Although the long-run relationship between democracy and economic development is viewed by many observers as positive (e.g., Olson 1993), it is governed by the design of specific institutions that prevent rent-seeking or violent behaviour on the part of individuals or groups (McGuire and Olson 1996). The paper has shown that the level of resource availability plays a role in formulating the desire of groups for setting up state authority. In Iraq, the new government is being designed along the lines of a consociational democracy where all ethnic groups are represented through a government of national unity at least as of May 2006. According to our model, Iraq's abundance of resources and the high productivity of combining R and G make this attempt tenable. However, the denominational politics generated by ethnic representation fails to produce stability because 'conflict' over resources is compounded by geography, and is

thus usurping all plans for a stable consociational democracy. In Somalia, on the other hand, the lack of resources, the direct access of producers to resources and the low productivity and re-distributional potential of combining *R* and *G* do not provide the various groups with adequate material incentive for the resurrection of central authority.

The theoretical model and country experiences introduced a central question with regard to the relationship between state failure, governance and economic development in fragile multi-ethnic states. The failure to produce, either through inter-ethnic political or violent mediation and bargaining, a stable political and governance structure can have a negative impact on economic growth and development in the postconflict period. In Iraq, the destabilizing force generated by ethnic rivalry over the control of resources (the Shia in the south, Kurds in the north, the conflict over Kirkuk, Sunnis in central region without acknowledged reserves) is threatening to break apart the country. The Baker-Hamilton Report observes that the ‘Shia, Sunni and Kurdish leaders frequently fail to ... act in Iraq’s national interest ... The result is an even weaker central government than the constitution provides (2006: 13).

Formulation of a national economic development plan designed and implemented by a secular central government is necessary for transcending such divisions. Such a development plan need not resurrect autocracy in Iraq, nor introduce re-Baathification, even though it has been observed in the economic sphere that, at one time there was a tendency on the part of the bureaucracy to revamp Baathist economic policy (Looney 2004b). The Iraqi question can be solved through the establishment of an all-encompassing democracy, as McGuire and Olson (1996) theoretically discuss. Such a system would ensure the elimination of inefficiencies and the growth-impeding politics of interest groups. The establishment of a developmental state is imperative for Iraq’s economic progress, as is the necessity of secular national politics. In addition, integrating Iraq with the international economy necessitates the existence of a centripetal force, represented by strong central government, to counteract the centrifugal forces unleashed by the channels of economic exchange that have been established between the various ethnic groups and the global economy through state oil resources and foreign funds for postwar reconstruction.⁶ In the Somali case, although anarchy seems to be working, it is an unstable system, as indicated by the recent chain of events, starting with the Islamic courts takeover to the Ethiopian invasion. The establishment of an all-encompassing democracy can also be a solution to the seemingly intractable Somali question.

⁶ See a discussion on the theoretical relationship between globalization and national economic policy in Bhaduri (2002).

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