

Iraq: A Perspective from the Economic Analysis of Civil War

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Introduction

My expertise is partly on the economics of civil war and partly on the functioning of democracy in oil economies. Each of these seems broadly pertinent for Iraq currently. However, I must acknowledge from the start that I am not an expert on the Middle East and have not even been to Iraq. I usually avoid commenting on countries about which I know so little: country-specific knowledge is obviously essential for sound advice. The following comments should therefore be seen merely as pointers from the analysis of other situations. The extent to which such research is pertinent for Iraq must be assessed by those with expertise on Iraq.

Clearly, the March 2003 war in Iraq was not a civil war: it was an international war. On my reading of subsequent events, for the year following this brief international war there was a return to peace. Since around March 2004 the level of internal violence has increased to well beyond the threshold by which civil war is conventionally classified. Since the handover of sovereignty to an Iraqi government, in June 2004, it is probably reasonable to classify this violence as civil war, rather than international war, since it is increasingly directed at the Iraqi authorities, noticeably the police, and also civilians. So, I judge Iraq currently to be at civil war, rather than being post-conflict. Naturally, I hope that it will soon become post-conflict.

Based on this judgment, there are two pertinent economic literatures: that on how the duration of civil war might be shortened, and that on post-conflict recovery. I will take them in turn.

What do we know about the duration of civil war?

If we think of Iraq as having recently descended into civil war, what is the prognosis and what are the policy options? The prognosis, based on other civil wars, is not encouraging: most civil wars last a long time – typically around seven years - ten times as long as international wars. This indicates that civil wars are unusually hard to stop. Happily, there is some evidence that the chances of ending a civil war are somewhat higher in the first two years of the conflict – which is where Iraq now is. Occasionally, elections indeed end civil wars, as in Nicaragua. More commonly, however, they revive or even trigger them, as in Angola and Cote d'Ivoire. Usually, the group which most believes in the legitimacy of an electoral victory is the group which wins, and the group least inclined to accept it as legitimate is a rebel force that loses, or (perhaps anticipating such an outcome) refuses to participate. Electoral victory tends to reinforce the sense in the winning group that it has the right to power, and so reduces willingness to share power.

The normal strategy for ending a civil war involves a combination of sticks and carrots. The sticks are a squeeze on rebel finances, and military pressure. The carrots are some prospect of a share in power and its rewards. The most effective balance between sticks and carrots varies according to the situation. A former government of Colombia used nothing but carrot in an attempt to reach agreement with the large rebel group the FARC.

Indeed, it ceded a substantial area of the country to the FARC. This proved a complete failure: the FARC basically had no incentive to reach a settlement because it was doing so well out of the war. The government of Angola eventually used nothing but stick against the even more formidable rebel force, UNITA. It raised military spending to 20% of GDP, essentially spending its oil windfall on a military effort. This was entirely effective. As a result, Angola is at peace whereas Colombia is not, although it would be hard to argue that the former government was on any measure more democratic, competent, inclusive, or honest than the latter. Such experience should temper our natural inclination as concerned social scientists to advocate solutions based on strategies of government concession: sticks probably have a role. A further advantage of 'stick' is that a peace which is reached through military victory is far more durable than one reached through negotiation.

Economists studying civil war have puzzled over why, given that it is so costly, the parties cannot reach a mutually beneficial deal (Collier, Hoeffler and Soderbom, 2004). One solution to this puzzle is the time-consistency problem. This arises because peace gradually shifts military advantage to the government: it is difficult to maintain a rebel army intact if it does not fight. Hence, ex post, the government has an incentive to renege upon a deal which is mutually beneficial ex ante. This problem is compounded because internal conflicts lack the political technology of treaties and suchlike that are available to bind parties to an international conflict. A classic demonstration of this was the conflict between Eritrea and Ethiopia which was played out twice, once as a civil war and once as an international war. As a civil war it lasted more than thirty years; as an international war it lasted less than thirty days.

A second solution to the puzzle of the inability to reach a deal is that expectations about the prospects of military success might be systematically biased. Economists are rightly uncomfortable about systematic errors in expectations, but in the case of civil war there is a reasonable explanation which is entirely analogous to the 'winner's curse' in auction theory. Those potential rebel groups that under-estimate their prospects of military success tend not to rebel, whereas those that over-estimate their prospects are more likely to rebel: hence, actual rebel groups are systematically over-optimistic. It then takes time for expectations to adjust to reality. The difficulty with this explanation is that an implication is that the chance of a settlement in any year should rise as the conflict continues, whereas there is little sign of such a tendency. I therefore find the time-inconsistency explanation the more compelling. An implication is that there is an important role for the international community to guarantee the terms of an internal settlement, albeit that any such guarantee must be credible.

What do we know about Post Conflict Recovery in a New Oil Democracy?

Oil democracies are distinctive and this adds an important dimension to a post-conflict agenda. Globally, in terms of economic growth democracies usually outperform autocracies: but societies with large oil rents are an exception. Oil democracies typically perform badly: the oil rents tend to subvert the normal democratic processes, producing patronage politics. The best defense against this is to have exceptionally strong checks

and balances against political corruption. Empirically, checks and balances – such as a free press – significantly and distinctively raise the growth rate in oil democracies (Collier and Hoeffler, 2005a). Unfortunately, whereas the oil democracies are the societies most in need of checks and balances, they typically do not have them. The same process of political patronage that undermines the growth process also undermines checks and balances. A healthy democracy combines electoral competition with strong checks and balances, but the former is much easier to put in place than the latter. As an instant democracy, Iraq is in danger of following this pattern. Electoral competition is relatively easy to establish because the participants – the political parties – have an evident interest in attaining power. By contrast, political elites have little interest in establishing checks and balances since these would restrain their own power. One key early task in Iraq is therefore to move the political bargaining process on from who has power, to how power is restrained. It is easier to build checks and balances into the system before it becomes corrupted by patronage politics rather than once corrupt interests have become powerful.

More generally, economic policy in the post-conflict phase needs to be distinctive: it should not be simply development as usual. This is because the legacy of conflict implies distinctive objectives. One legacy is that there is a high risk of further violent conflict. The other is that the economy is severely damaged so that the proximate economic objective is recovery.

The high risks of conflict relapse are partly because the countries that have had a conflict have underlying and persistent characteristics (Collier and Hoeffler, 2004). In the case of Iraq the pertinent characteristics are large natural resource rents, long term economic decline, and ‘ethnic dominance’. Ethnic dominance refers to a situation in which the society is divided by ethnicity and religion with one group being numerically dominant, so that majority rule would not prevent the permanent exclusion of other groups.

However, post-conflict risks are also high because something happens during conflict that increases risk. Approximately, the high level of risk is equally due to these two factors – pre-conflict characteristics and the legacy of the conflict. It is imperative to bring down this initially high risk of further conflict, both as an objective in itself and because perceptions of high risk will be deeply damaging to economic recovery. Hence, economic policy needs to be designed in such a way that it contributes as much as possible to risk reduction.

The adverse economic legacy of civil war is sometimes obvious: capital – physical, human and social - gets destroyed. Some effects are more subtle. Government expenditure gets diverted away from economic services into the military. Private economic actors shift their capital abroad. The government resorts to debt accumulation in order to finance the need for military spending and more generally sacrifices future gains from good economic policies to snatch short term gains from policy deterioration. Because of increased uncertainty time horizons shorten, reducing the value of reputation. This, combined with the decline in policing, encourages opportunism and predation. In response to all these developments, people shift their economic activities into subsistence

or informality: activities which is less reliant upon other parts of the economy. Overall, the typical civil war reduces GDP relative to counterfactual by around 15% by the end of the conflict.

I now focus on what economic actions the post-conflict government and international actors – as donors and as security providers – can undertake to reduce the risk of repeat conflict and speed the economic recovery.

Priorities for the post-conflict government

Bringing down the risk of conflict – does military spending work?

During the conflict skills, organizations and investments build up that are only of use through violence. Peace is costly for these interests and so they will look for opportunities to revert to conflict. In practical terms, these interests have to be opposed by military force. Typically, post-conflict governments do exactly this by maintaining very high levels of military spending. However, this is found to be counter-productive (Collier and Hoeffler, 2005). Controlling for the obvious fact that in the presence of higher risk military spending is increased, high levels of spending in post-conflict situations actually increase the risk of further conflict. Note that this does not happen other than in post-conflict situations. That military spending is counterproductive may reflect the lack of trust and inability of the government to bind itself to the terms of a settlement - the 'time inconsistency' problem. As the peace is prolonged, rebel forces decline and so the government has a growing temptation to become more partisan. Knowing this, rebels have an incentive to preempt such behavior by returning to war. A government that wants to maintain peace therefore needs to signal its intentions not to become partisan. A sharp reduction in military spending – large enough to be irreversible – will provide such a signal. Conversely, the maintenance of high military spending is inadvertently a signal that the government means to rely upon repression. Hence, the most common policy error of post-conflict governments is to maintain military spending around conflict levels rather than making deep cuts.

Other than reducing military spending the most effective thing that a post-conflict government can do to reduce conflict risk is to accelerate economic recovery. Growth directly reduces conflict risk and also cumulatively raises income and diversifies the economy, both of which also reduce risk. The instruments that the government has to raise growth are a range of economic policies. These policies on average have no direct systematic effect on the risk of conflict, but indirectly lower risks by raising growth. How should these be deployed?

Raising the growth rate through policy reform

The inheritance from conflict is that overall economic policy and institutions are typically very poor. Further, growth during the post-conflict decade is much more sensitive to policy than in other circumstances. This is a key result of the econometric literature on post-conflict recovery (Collier and Hoeffler, 2004a). It can also be seen from the very

wide range of post-conflict growth outcomes – some countries recover rapidly, others continue to decline. So, economic policy is much more important in post-conflict settings than in other settings. Further, reform is relatively easy – typically, policies improve a lot during the decade and this suggests that the political obstacles to reform are unusually weak. Vested interests may be weakened by conflict, and in the aftermath of peace people expect change. They may also, however, have completely unrealistic short-term expectations of a ‘peace dividend’. The government needs to communicate a credible medium term vision of economic recovery, rather than promising instant yet undeliverable success.

Which policies are priorities? Some actions are obvious, for example, the reconstruction of damaged infrastructure. Other priorities are less obvious. For example, the retreat into subsistence and informality needs to be reversed and this reintegration may require marketing reforms. The rise of opportunistic behavior will need to be countered by a swift resolution of property rights, and by the establishment of a functioning system of commercial law to enforce contracts. The resolution of property rights may help to reverse capital flight. Typically, capital flight continues during the post-conflict decade, but in some cases governments have managed to attract substantial repatriation during the decade.

Among the broad categories of macro, structural and social policies, there is some evidence as to which should be priorities. Inclusive social expenditures are atypically important for growth in post-conflict settings, whereas macro policy is atypically less important. A possible reason for this relates to the signaling problem discussed above. High expenditures on social inclusion signal that the government does not intend to run a patronage system for its core support base, and so reinforce the signal given by a sharp reduction in military spending.

Locking-in Social Inclusion

How can a post-conflict society with large natural resource rents lock in to social inclusion?

One good way is likely to be fiscal decentralization, so that each social group feels confident of getting its share. This was the solution to the Nigerian civil war of 1967-70, and it has been successful even in the context of a society severely fractured both by ethnicity and religion: these tensions repeatedly flare up into communal violence, but have never scaled up into civil war.

Fiscal federalism may be particularly important in Iraq where the social divisions are even more problematic than Nigeria because of ‘ethnic dominance’ as discussed above. Where minority groups are geographically concentrated, as they are in Iraq, fiscal federalism offers a simple solution which can be incorporated into a new constitution and so subject to a degree of external guarantee.

A second way, which can be complementary, is to distribute part of the natural resource rents directly to households. Each household could be given equity in the national oil company, or the government could introduce a negative income tax the value of which depended upon oil revenues. A negative income tax offers greater scope for targeting benefits on the poor, but the distribution of equity has the advantage of being less easy to reverse and so is probably preferable given the overarching requirement of credibility.

International actors

International actors face the same two core possible areas for intervention – military provision and raising the growth rate. However, they have different instruments from the government – external military force and aid.

Risk reduction through external military force

Given that some military force is needed in post-conflict situations, but that force provided by the post-conflict government is counter-productive, there is an inescapable need for external military force. The function of such force should be both to suppress violent challenge to the government and to ensure that the government abides by the terms of a settlement, most notably, to the terms of the constitution.

UN forces operating under Chapter VI rules have not proved very successful. While countries are willing to supply forces under these terms, they are often not willing to see their troops exposed to significant levels of risk, and Chapter VI does not permit an adequate level of force to be deployed to discourage rebel groups. Sierra Leone provided a spectacular demonstration of this problem: the rebel RUF captured, with minimal force, 500 UN troops and confiscated their armaments.

To my mind the model for successful external intervention is the subsequent deployment of British troops in Sierra Leone under UN Chapter VII rules. British military intervention was at the request of the government and under the auspices of the UN. No one could seriously regard British intervention as being motivated by its national material interests: this could not be seen as colonialism Mark 2. The cost of the operation, over a four-year period, has been only around \$180m, and the pay-off has already been four years of secure peace in what was surely a very high risk situation. The costs of the typical civil war are around \$50bn, and the pay-off from a military intervention such as that of Britain in Sierra Leone is enormously greater than its cost (Collier and Hoeffler, 2004b). The Sierra Leone model is therefore worth taking seriously.

A contrasting military intervention, which has clearly gone badly wrong, is that of France in Cote d'Ivoire. France did not obtain prior approval from the UN for its military intervention; its presence is not welcomed by the government; and, regardless of its true motivation, it is not free from the perception that this is 'colonialism Mark 2'. Further, external force was used merely to separate the parties rather than to guarantee a settlement: each party reneged on the terms of an agreed settlement with impunity.

I leave it to others to judge whether an American military presence in a future post-conflict Iraq would be more closely analogous to Britain in Sierra Leone or to France in Cote d'Ivoire.

Accelerating growth through aid

Historically, aid has not been significantly higher taking the decade as a whole than if there were no conflict, although it is significantly higher in the first two or three years. Recent analysis of the effect of aid on growth in post-conflict situations finds that aid is super-effective in raising growth in post-conflict situations – about five times as effective as normal. However, this only applies during the middle of the decade. Hence, from the perspective of growth, aid should taper in during the first few years post-conflict, whereas actually it tapers out. During its present peak in the early post-conflict years, it is not particularly effective. Probably this is because although needs are great, capacities to spend aid effectively are very limited. Hence, the aid opportunity post-conflict is for bigger aid budgets overall, but better timed. Since politically the moment for committing to post-conflict aid is clearly around the time of the onset of peace, the right approach is probably to allow much greater flexibility in the timing of aid disbursements. Long lags between commitment and disbursement should become normal in post-conflict situations.

Unfortunately, the enhanced growth effect of aid is dependent upon the quality of policy, institutions and governance. That is, aid effectiveness is much more sensitive to these characteristics in post-conflict situations. Normally policies, institutions and governance improve quite rapidly during the decade. This reinforces the effect that aid should taper in rather than tapering out. It also provides a rationale for focusing international attention heavily upon improving these characteristics. Typically, considerable attention has been paid to political design in post-conflict situations, for example, in encouraging elections. While this may be desirable in itself, the evidence is that democracy per se does not reduce risks in post conflict situations. Indeed, changes in political arrangements, such as elections, appear actually to increase the risk of renewed conflict. The implication is not, of course, to forget about promoting democracy, but rather not to rely upon it as a quick fix for the problem of high risk. Greater attention needs to be paid to economic policies and institutions which are often not given much attention by the government itself.

Encouraging reform through international templates of economic governance

The enormous importance of good economic policies and institutions in post-conflict settings, and its previous neglect, suggest that it may be useful for the international community to establish 'templates' or models of reasonable practice in key areas such as the transparent management of the budget, and accountability to the domestic population for public expenditure. While donors are now rightly reluctant to insist upon ad hoc policy reforms, the existence of such internationally agreed templates would enable donors to coordinate around them, and would also assist governments in knowing what they should be aiming for.

Conclusion

Every civil war and post-conflict situation has important particularities, and Iraq is obviously distinctive because of the external military origin of the present conflict. However, I think that it may now be helpful to refocus. In April 2003 it may have been reasonable to see Iraq as being analogous to Germany and Japan in the aftermath of their external military defeats. As of now, Iraq may be more analogous to other societies at civil war. Indeed, it has three of the classic risk factors: large natural resource rents, ethnic dominance, and a long history of economic decline. If we see Iraq as having recently descended into civil war, getting to peace is unlikely to be simply a matter of elections. Further, the post-conflict economic agenda is somewhat different from the reconstruction agenda in postwar Germany and Japan. The key priority will probably not be infrastructure, but the building of credible institutions of social inclusion, and checks and balances that restrain the corrupt politics of patronage.

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