

# BTI 2010 | Iraq Country Report

<b>Status Index</b>	1-10	<b>3.95</b>	# 107 of 128	
Democracy	1-10	4.22	# 88 of 128	↗
Market Economy	1-10	3.68	# 116 of 128	➔
<b>Management Index</b>	1-10	<b>3.97</b>	# 99 of 128	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	29.5	HDI	-	GDP p.c.	\$	-
Pop. growth	% p.a.	-	HDI rank of 182	-	Gini Index		-
Life expectancy	years	67	UN Education Index	0.70	Poverty <sup>2</sup>	%	-
Urban population	%	-	Gender equality <sup>1</sup>	-	Aid per capita	\$	313.9

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

The last two years have witnessed a significant improvement in security in Iraq, a marked contrast to the state of anarchy and chaos of 2006. This is a consequence not only of the additional troops and improved strategy and tactics associated with the U.S. troop “surge,” but is tied as well to the ceasefire of the Sadr movement (and successful U.S.-Iraqi military operations against it), the “Awakening” of Iraqi Sunnis against al-Qaeda, and the growth in capabilities and confidence of the Iraqi Security Forces (ISF). Violence is currently at low levels not seen since the months immediately following the U.S. invasion in 2003.

Some political progress has occurred, even if slower and more uneven. Groups that previously resisted the new Iraqi political order have begun to take part in the political process, and will contest elections over the next year. This includes Sunni ex-insurgents and Shi'i followers of Muqtada al-Sadr. The parties in power – the Islamic Supreme Council of Iraq (ISCI), Prime Minister Maliki's Da'wa party and the two main Kurdish parties – have been reluctant to share power with emerging political actors. As the threat of political fragmentation and state collapse has receded, the risk of an increasingly repressive and authoritarian Iraqi regime has come to the fore.

The performance of the Iraqi government has improved over this period, largely because at the end of 2006 the central government effectively did not exist beyond the Green Zone and it had nowhere to go but up. The improvement in security has meant a return to basic functionality of government institutions and allowed reconstruction efforts to gain some traction. However, extremely high levels of corruption still plague Iraq. Non-security institutions remain weak and debilitated. The Iraqi leadership faces many structural constraints on governance, such as a massive brain drain, a high level of political division, and extreme poverty. Overall, however, the trend line is positive, and as the United States begins to draw down its military presence, Iraq is emerging as a dysfunctional but sovereign state.

## History and Characteristics of Transformation

Beginning with the 1958 coup led by General ‘Abd al-Karim Qasim, conspiracies among army officers became the most important catalyst for political change in Iraq. In July 1968, army officers associated with the Ba’th Party seized power over the course of two coups and began to implement a ruthless, authoritarian political system, dominated first by General Ahmad Hasan al-Bakr and later by his cousin Saddam Hussein. Saddam Hussein used his control of the party and its security apparatus to oust Hasan al-Bakr from the top government post in 1979 and assumed sole control of the country, both as president and as chairman of the party’s Revolutionary Command Council (RCC). The nation’s power structures, increasingly dominated by members of Saddam’s clan and even his immediate family circle, although widely unpopular, proved remarkably resistant to external shocks – chief among them the bloody eight-year war with neighboring Iran (1980 – 1988), the defeat by an international coalition in the 1991 Gulf War and the comprehensive trade embargo imposed by the United Nations between 1991 and 2003.

The Iraqi economy is dominated by the oil sector, which historically has generated more than 95% of export earnings and more than 60% of GDP. With the nationalization of the long-established Iraq Petroleum Company (IPC) in 1972 and the sharp rise in world oil prices the following year, the state reaped significant returns that strengthened its ability to shower patronage on selected population groups. A series of reforms were designed to restructure the agricultural sector, which had been dominated by a small number of very large landlords, although the distribution of land “to those who worked it” went extremely slowly. Over time, declining agricultural productivity combined with substantial population growth increasingly forced Iraq to import food products. The government had taken over broad segments of the private sector in 1964, but a lack of currency reserves and mounting foreign debt during the war against Iran (after 1980) forced it to initiate substantial deregulation starting in 1987. After the invasion of Kuwait in 1990, the United Nations imposed an embargo that led to Iraq’s almost total economic isolation. In November 1996, the embargo was modified under the oil-for-food program that allowed Iraq to export limited quantities of oil and use most of the revenues to import food, medicine and other essential goods.

Genuine change started only with the overthrow of the regime of Saddam Hussein by an Anglo-American coalition in March and April of 2003. In the wake of the terrorist attacks of September 11th, the U.S. administration developed an increasingly bellicose attitude towards Iraq’s alleged WMD programs, and began to consider a preemptive security strategy as part of a grand design for transforming the Middle East as a whole. Despite mixed findings by the new United Nations Monitoring, Verification and Inspection Commission (UNMOVIC) mission, and on a basis that was at best questionable under international law, American and British troops invaded Iraq on 20 March 2003, managing to capture Baghdad on April 9 after a speedy campaign that only occasionally encountered serious resistance. The military victory was both swift and decisive;

the institutional structure of Iraq collapsed. The occupying power faced a task that it had not expected and for which it was not prepared: the rebuilding of much of the state apparatus. It established the Coalition Provisional Authority (CPA) to administer the country for a transition period during which it appointed an Iraqi Governing Council (GC) composed of 25 Iraqi members. As the GC proved increasingly inefficient, the CPA embarked on a number of reform projects to shape the new political, economic and social institutions of Iraq, but the strained security situation, the GC's poor administrative capacity, and Iraqi doubts about its legal status under occupation hampered the implementation of these initiatives.

In the summer of 2003, the coalition and the nascent Iraqi institutions began to face an increasingly threatening insurgency based in the Sunni Arab heartland of western and central Iraq, directed first against the occupation forces but increasingly against government officials and institutions. Fighting between insurgents and government forces became more and more sectarian over the course of 2005. Elections for an interim parliament were organized in January 2005, although most Sunni Arabs chose not to vote. This boycott led to the marginalization of the Sunnis in the drafting process for the new constitution, the final version of which was characterized by ambiguous compromises between Shi'i and Kurdish factions. The draft was finally adopted in a referendum in October 2005 in spite of adamant opposition from the Sunni Arab community. In December 2005, Iraqis elected their first constitutional government and Sunnis participated, although the seating of that government, led by Shi'i Prime Minister Nuri al-Maliki, was not completed until April 2006.

In 2006, Iraq descended into chaos and a Sunni-Shi'i sectarian civil war, which was in large part precipitated by al-Qaeda's attack on the Askariya Shrine in Samarra in February. By the end of 2006, the central government was little more than a collection of militias, the constitutional order was widely viewed as illegitimate, and the climate of instability was so great that the state exerted little actual control over its territory. A series of events in 2007 and 2008 turned the tide: the U.S. "surge" policy of increased troop strength and the adoption of a viable counterinsurgency strategy, the "Awakening" of Iraq's Sunni Arab community, and a ceasefire order by the Mahdi Army, a populist militant group led by the Shi'i cleric Muqtada al-Sadr. In the period of stability resulting from these developments, the ISF grew rapidly in numbers and capability. Levels of violence have fallen off sharply and, as of January 2009, are at levels not seen since the period following the U.S. invasion in March 2003. The United States and Iraq signed a Status of Forces Agreement (SOFA), which went into effect on January 1, 2009, and transferred a substantial measure of sovereignty to the Iraqi government. However, important political fissures remain, particularly those between the central government in Baghdad and the largely autonomous Kurdistan Regional Government (KRG) over issues such as territorial claims and oil revenue distribution.

## Transformation Status

### I. Democracy

#### 1 | Stateness

The years 2007 and 2008 witnessed a dramatic expansion of the Iraqi state's control over its territory. In 2006, large portions of Baghdad and its suburbs, Basra, and other major cities, as well as huge swaths of the countryside, were under militia and guerilla control, and chaos reigned. The additional troops and improved tactics of the surge (including some Iraq-led operations in places such as Basra and Diyala in 2008), combined with the Sunni tribal Awakening and the Sadr Movement ceasefire, brought almost all of these areas under the joint control of the United States and Iraq. Since the enactment of the SOFA on 1 January 2009, near-total operational command has been transferred to Iraq.

Monopoly on the  
use of force

The Iraqi Army is still highly dependent on U.S. support – particularly in the areas of air and sea power, logistics, procurement, and intelligence – and the United States still has a large advisory presence embedded in most Iraqi divisions, so in that sense the state's monopoly on the use of force should be qualified. Small pockets of territory – for example in Ninewah and Diyala provinces – still fall outside state control, and in several areas state control is still tenuous. Al-Qaeda and other militants still operate, but their mobility has been greatly restricted and they have mostly lost the support of the Iraqi population. Attacks against U.S. forces, the Iraqi government and civilians are far below 2006 levels.

Despite improvement, infiltration of militias into the ISF, and the degree to which the ISF are loyal to the Iraqi state, still remain a concern. This is particularly the case at the provincial level. Many provincial police forces were formed by the incorporation of local militias with either insufficient or non-existent vetting procedures. These forces have proved loyal to the parties that have dominated national and provincial politics since 2003, and have therefore not actively challenged the state's monopoly of force, but any democratic transition of power at the provincial level could be problematic.

The Iraqi Army – in part due to its close partnership with the U.S. military – has greatly improved in cohesion, and many militia members and those with

questionable loyalty have been purged. Nonetheless, Prime Minister Maliki has reportedly been cultivating the loyalty of certain forces to himself personally through patronage and appointments, and similar efforts by other Iraqi actors are likely ongoing as well. Moreover, entire divisions of the Iraqi Army, as well as some police units in provinces like Diyala, Mosul and Kirkuk, are former peshmerga (Kurdish fighters), and their ultimate loyalty almost certainly lies with the Kurdistan Regional Government (KRG) in Arbil. This fact was illustrated in September 2008 when the Iraqi Army attempted to establish control of Diyala province and encountered resistance in Khanaqin district by local police, who would not yield to the Iraqi Army until given explicit permission by the KRG president.

The legitimacy of the state has grown in the eyes of the Iraqi population proportionally as violence has dropped. In 2006, the level of violence was so high, and the failure of the state to establish security or provide services so profound, that the continuation of Iraq's constitutional order was highly in doubt. Moreover, sectarian identity dominated Iraq's political discourse, and loyalty to sect, tribe, and militia often trumped loyalty to the state. Though these identities are still strong, the relative stability of the past two years and the perceived successes of the Iraqi Army – historically a bulwark of Iraqi national identity – have increased the popular feeling of patriotism and loyalty to the state in the Arab parts of Iraq. The signing of the SOFA on terms widely believed to be highly favorable to Iraq has also increased nationalist sentiment. There is a widespread belief that the current political and constitutional order, at least in its broadest contours, is here to stay. Citizenship is not denied to any group, although some minorities still face religious and ethnic persecution by militant groups, and, in some cases, by state security forces (although this is a question of rule of law rather than citizenship).

State identity

The Kurdish desire for autonomy has grown more problematic as the central government has emerged. Disagreements over oil revenue sharing, disputed territories, and the legal definition of KRG autonomy threaten an outbreak of violence between Kurdish and central government forces. However, the basis exists (especially given an effort by the United Nations and possibly other international actors) for a negotiated settlement acceptable to both sides. While many among the Kurdish public and some Kurdish leaders may desire Kurdish independence as a long-term aspiration, most realize that this goal is unrealistic in the short- and medium-term given the KRG's economic dependence on Baghdad, the growing capability of the Iraqi Army, and the high degree of hostility toward Kurdish independence from Iraq's Arab population and Iraq's neighbors, particularly Turkey.

On paper, Islam plays an important role in defining the Iraqi state's legitimacy and legal order, but in practice the state is still largely secular. In the first years of post-2003 Iraq, Islamic parties dominated the political debate. As a result, Iraq's

No interference of religious dogmas

constitution, ratified in October 2005, states that Islam is the official religion of the state and that “no law may be enacted that contradicts the established provisions of Islam.” The constitution also says that “experts in Islamic jurisprudence” will be among those who make up the Federal Supreme Court, although at the time of this writing, this body had not yet been created. However, Islam appears to be receding from Iraqi political discourse, at least for the moment. In Iraq’s January 2009 provincial elections, the first since 2005, even candidates with Islamist backgrounds, such as Prime Minister Nuri al-Maliki, ran on platforms highlighting the provision of essential services and law and order and downplayed religion. The Islamic Supreme Council of Iraq, a formerly dominant and strongly Islamist party (many of whose leaders are clerics) suffered significant losses. Moreover, Iraq’s civil and criminal court systems are not fundamentally different from the pre-2003 period, and have certainly not become more Islamic.

Basic administrative structures are very weak but have slowly grown stronger as security has improved over the past two years. Decades of war and sanctions, followed by the looting and chaos that accompanied the U.S. invasion, decimated the state apparatus. As Iraq was engulfed in civil war between 2005 and 2007, the central government effectively did not exist in many areas. Now it appears that the old state apparatus is gradually returning, albeit with a largely new administrative class, especially at the top, as many of the former bureaucrats were either purged from their positions or have left Iraq. Due to Iraqi and U.S. emphasis, security institutions are much stronger than essential service ministries, which still have yet to catch up even to their diminished pre-2003 capacity.

Basic  
administration

## 2 | Political Participation

Since 2005, Iraq’s rulers have been determined by general, free and fair elections, although the democratic system is still emerging and its long-term prospects are not clear. Iraq’s two general elections in 2005 and provincial elections in January 2009 were largely free and fair, despite some irregularities and low levels of election-related violence. Due to the improvement in security and to broader public acceptance of the electoral process, the 2009 elections were much more transparent and campaigning was much more open than in 2005. However, there are some constraints on the principle of equality: established parties –especially prime minister Nuri al-Maliki’s Da’wa Party – have built-in advantages, such as control of state resources, the loyalty of state security forces, and the power to structure and schedule elections to their advantage.

Free and fair  
elections

The effective power of Iraq’s elected rulers to govern is limited but increasing. Despite the establishment of the SOFA, the United States, due to its military advisory presence and financial and logistical support for the ISF, still yields a substantial veto power in some security matters. However, U.S. leverage is

Effective power to  
govern

gradually declining, and will continue to decrease as the U.S. presence is reduced. Ayatollah Sistani, the top Shi'a cleric in Iraq, does not publicly involve himself in political matters as he did in 2003 and 2004, but top leaders almost always visit him prior to announcing major decisions, either to get his blessing or at least present the appearance of having done so. The veto power of Muqtada al-Sadr has waned considerably over the past two years, as his movement has been dealt decisive military setbacks by U.S. forces and the Iraqi government.

At the moment, there are partial constraints – not consistent with democratic principles – on the freedom of association, but as a rule there are no prohibitions on civil society organizations in non-KRG Iraq. However, at the time of this writing, the Iraqi parliament was debating a law regulating the non-governmental sector which would inhibit the development of civic organizations, under which the state would be given extensive authority to intervene in the formation of NGOs and given a measure of fiscal oversight. The likely trajectory for Iraq is a restrictive regulatory framework resembling those in other countries of the region. In the KRG region, independent civil society barely exists, and almost all organizations described as NGOs are controlled by one of the two main political parties.

Association /  
assembly rights

The Iraqi government mostly does not interfere with the freedom of citizens, organizations or the media to express their opinions, except for a handful of brief occasions in which has refused to allow certain regional, non-Iraqi media outlets to operate, such as periodic crackdowns on Al-Jazeera. The post-2003 Iraqi media landscape has blossomed with a wide variety of new outlets, although due to limited funding the ones which survive tend to rely on support from political parties. Yet though the Iraqi media environment is much freer than that of most other countries in the Middle East, standards of professionalism fall far short of those in regional counterparts. Improved security has led to reduced attacks on journalists, who now move around more freely, and the quality of reporting has improved. The KRG remains far more authoritarian and restrictive in its treatment of the media than is the central government, and has continued to arrest and harass journalists critical of the ruling Kurdish parties. Curfews, checkpoints and general restrictions on movement still greatly inhibit public assembly, but mass rallies nonetheless occur.

Freedom of  
expression

### 3 | Rule of Law

The most important sense in which there is a working separation of powers in Iraq is in that Iraq's various ministries and security services are controlled by different political parties, which prohibits any single party from being too dominant. The parliament, at least on certain issues such as constitutional reform and hydrocarbon revenue distribution, has played a key role, mostly in the sense that Kurdish members of parliament have stonewalled attempts at greater centralization of Iraqi institutions. The provincial powers law, enacted in January 2009, vests increased

Separation of  
powers

power in provincial governments, which may diffuse power further. The KRG enjoys a high degree of legal autonomy, but is almost completely financially dependent on Baghdad.

The Iraqi judiciary is still fundamentally the same institution, in terms of professional standards, practices and legal framework, as it was under Saddam. However, many judges have been pushed out or assassinated, and replaced by loyalists to the current parties in power. In other cases – particularly in Ninewah, the most violent province remaining in Iraq – insurgents and other militants have infiltrated the courts, making the prosecution of terrorism and violent crime extremely difficult. Corruption in the judiciary is rampant, as is the case for all Iraqi government institutions. Civil courts, which were not as politicized as criminal courts under Saddam, and retain that status today, have a better reputation for transparency, independence and efficiency.

Independent  
judiciary

Generally speaking, officeholders can and often do exploit their offices for private gain as they see fit without fear of legal action. To the extent that corruption charges are made and individuals brought to trial (which is rare), the underlying causes are typically political and corruption is a pretext. The most egregious instances – including a scheme in the Iraqi Ministry of Defense led by Minister Hazem Sha'lan, which allegedly resulted in the embezzlement of at least \$1.3 billion in 2004 – appear to be in Iraq's past. The Iraqi people, based on polls and anecdotal evidence, consistently cite corruption as one of the worst problems plaguing Iraq. The provincial elections in January 2009 saw near-universal defeat for incumbents, which many observers viewed as punishment for corruption and the failure to provide services. Thus, if the democratic system continues to move forward, there is hope that officeholders will feel political pressure to rein in corruption.

Prosecution of  
office abuse

Civil rights are approved in principle by the Iraqi constitution, but in practice they have been routinely violated, particularly by ISF and U.S. forces as they have endeavored to establish control over the country. As security has improved over the past two years, these abuses have become less prominent, though there are still reports of ISF engaging in extralegal killings, mass illegal detentions, and torture. These activities have disproportionately targeted Iraq's Sunni Arab population. In a 2008 study, Human Rights Watch monitored Iraqi court proceedings and met with defendants and judges, and found that "the majority of defendants endured lengthy pretrial detention without judicial review, that they had ineffectual legal counsel, and the court frequently relied on the testimony of secret informants and confessions likely to have been extracted under duress." On the positive side, in early 2008, the Iraqi parliament did pass legislation requiring the release of prisoners with insufficient evidence to justify their continued detention. Moreover, the SOFA requires U.S. forces (and thus the ISF units with whom they are partnered) to acquire warrants for arrest and search and seizure, a development which is reportedly having a strengthening effect on the Iraqi system.

Civil rights

#### 4 | Stability of Democratic Institutions

Iraq's democratic institutions, particularly the Iraqi parliament, are slow, inefficient, and still largely incapable of performing adequately given their relative newness and the general climate of instability. Political friction results in even relatively simple matters – such as the appointment of a replacement for the speaker of parliament, Mahmud Mashhadani – dragging on for weeks. Many pieces of legislation required by the constitution and other essential laws – such as legislation creating an Iraqi supreme court, a media regulatory law, etc. – remain in limbo. However, the parliament has had some successes over the past two years, including important legislation on contentious issues such as de-Ba'athification.

Performance of democratic institutions

The most positive development in Iraq over the past two years has been the dramatic increase in the acceptance of democratic institutions and the political progress made by the relevant actors in society. In late 2006, wide swaths of the insurgency, the clergy, and the general public rejected the political process and the Iraqi government as illegitimate. The contrast between that period and January 2009 is night and day. Voices like those of nationalist insurgent leader Hareth al-Dhari, who formerly dominated the airwaves claiming the government was illegitimate, are rarely heard today. Nonetheless, specific institutions such as the court system – as distinct from the broader political process – are still seen as illegitimate in certain communities.

Commitment to democratic institutions

#### 5 | Political and Social Integration

In Arab Iraq, the party system is unstable with shallow roots in society; high fragmentation, extensive polarization and high volatility are the norm. Iraq's political system is quite new, and the recent public embrace of the political process combined with three sets of elections slated for 2009 has reshuffled the political deck. More than 500 parties and 14,400 candidates contested Iraq's January 2009 provincial elections, in which only 440 offices were at stake. This state of affairs allows a few big, organized parties to dominate the political system, while opposition interests tend to remain disaggregated. The KRG has essentially only two parties, as all ostensibly separate parties are either beholden to one of the two big parties or are highly restricted in their activities.

Party system

Despite the large number of interest groups that have been registered in Iraq, these groups cooperate infrequently and on the whole are poorly balanced. A large number of social interests remain unrepresented. There are some exceptions to this trend: For example, the interest groups representing Iraq's handicapped population (quite large in a country plagued by war for decades) have shown promise. Social and political organization in Iraq tends to be based not on common interests but on patronage networks and tribal and family ties.

Interest groups

Public consent to democratic norms cannot be properly assessed, as reliable data from opinion polls or similar sources are missing. It is hard to evaluate whether former U.S. President George W. Bush's rhetoric of "bringing democracy to Iraq" has positively or negatively affected the general perception of (Western) democratic values among Iraq's population.

Consent to democratic norms

Social self-organization in Iraq is rudimentary. Prior to Saddam, Iraq had a strong community of professional organizations that served as the backbone of civil society. However, under Saddam's increasingly totalitarian regime, non-governmental organizations' influence dwindled to nonexistence. Since 2003, civic organizations have flourished, but in capacity and coordination they remain weak. The violence of the past five years has had the effect of further dividing Iraqi society – both physically and politically – and eliminating what little social capital had accumulated.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Broad swathes of the urban middle class, most of which formerly consisted of state employees and thus depended directly or indirectly on the public sector, were driven to ruin by the hyperinflation of the 1990s and the general decline in economic activity as a result of economic sanctions and war. As a result, Iraq's infrastructure and social services were in a very poor state in 2003, and had been deprived of capital investment for a significant period. By many indicators of social development, Iraq has fallen well behind comparable middle-income countries in the region and around the world. According to a report from the Iraqi Central Office for Statistics and Information Technology (COSIT) with support of the World Bank, only 12.5% of the population connected to the public water supply (which in turn comprises roughly 80% of the total population) has access to safe and stable drinking water. The public electricity grid in Baghdad provides only five hours of power a day on average, though private generators provide another four hours. Iraq's health care system has been unable to provide effective care, partly because of a shortage of qualified personnel such as doctors and nurses.

Socioeconomic barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	-	-	-	-
Growth of GDP	%	46.5	-	-	-
Inflation (CPI)	%	-	-	-	-
Unemployment	%	26.8	-	-	-
Foreign direct investment	% of GDP	-	-	-	-
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-	-3335.4	2681.4	-
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
Total debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	-	-	-	-
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	4.1	3.1	2.7	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Iraq is focused on liberalizing its economy, encouraging competition, and attracting foreign investment. However, these efforts are still in their infancy and Iraq's economy remains largely centralized. Iraq's National Investment Commission has worked to bring foreign direct investment into Iraq with some success, but regulatory procedures remain murky and difficult to navigate. Many Iraqi businesses operate informally, without licensing or registration, due to the unfavorable regulatory environment. A 2008 World Bank report ranks Iraq at

Market-based  
competition

position 152 out of 181 countries surveyed for “ease of doing business.” There is a flat 5% reconstruction tax which is levied on all imports except those ordered by public institutions. In 2007, the Iraqi government reduced direct subsidies on fuel, although the overall level of subsidies on various goods remains high. The 2006 investment law opens Iraq to foreign investment, but implementation has been slow – investors continue to face many difficulties including security constraints, red tape and corruption. Government subsidies on numerous goods such as food, fuel and electricity further inhibit the emergence of market-based competition. The hydrocarbon sector dominates Iraq’s economy and is managed by the state: It accounts for approximately 66% of Iraq’s GDP, 95% of government revenues, and 45% of employment in Iraq.

The formation of economic monopolies and cartels is neither regulated nor impeded by Iraqi law. The state maintains effective monopolies in key areas such as the petrochemical industry.

Anti-monopoly  
policy

After most U.N. sanctions were lifted in May 2003 and the oil-for-food program was phased out, the CPA announced a holiday on all tariffs on imports through 2003. These measures, coupled with the rising salaries of many Iraqi officials, triggered a sharp rise in imports; subsequently, the CPA created the Trade Bank of Iraq and in February 2004 Iraq was granted observer status at the WTO. In December of the same year it presented a formal request for WTO membership. Today the holiday on import tariffs continues in Iraq. There is a 5% reconstruction tariff, set up by the CPA, charged against most imports. The Iraqi government has developed a tariff schedule for WTO negotiations but has not yet imposed tariffs other than the 5% duty. Protective tariffs could support domestic production, but might prove counterproductive in WTO negotiations.

Liberalization of  
foreign trade

Iraq’s banking system remains dominated by state-owned banks, and a real capital market has not yet emerged, though private banks have taken significant steps forward in the past two years. State-owned banks are mammoth institutions left over from the Saddam era and act as little more than payment offices for government pensions and salaries. State-owned banks have the largest network of branches spread throughout the country, but are not connected by a core banking system that facilitates electronic interbank communications. They are also burdened by Saddam-era debt, making them insolvent and unable to lend or develop correspondent banking relationships. They are also, with the exception of the Trade Bank of Iraq, subject to attachment risk and are almost universally unable to hold correspondent accounts outside of Iraq.

Banking system

Iraq’s private banks have begun to modernize and provide higher levels of customer service and better banking products over the past two years. The total assets of private banks have grown by 90% since 1 January 2007. Many of Iraq’s private banks are in process of implementing international banking standards in accordance

with the Basel Accords. Foreign ownership in Iraqi private banks is limited by legislation. Banks will be required to hold 50 billion Iraqi dinars in paid-in capital by summer 2009. As of 31 December 2008, only six majority foreign-owned banks were operating in Iraq. A lending culture is beginning to take hold, though banks remain conservative in their lending practices due to the lack of legal lending infrastructure. Private bank loan portfolios do not exceed aggregate capital. The lack of a regulatory framework for credit information, immovable property claims, bankruptcy, or deposit insurance hinders the future development of the banking system.

## 8 | Currency and Price Stability

The Central Bank of Iraq has managed to transform itself from a puppet of the former regime to an independent institution that is largely respected by the Iraqi government and international financial institutions. It sets monetary policy with little interference from the Iraqi government. The central bank has successfully deterred attempts by some government officials to use its reserves for government spending. As of 31 December 2008, year-on-year headline inflation was reported at 6.8% and core inflation was 11.7%, which is quite good compared to former standards. COSIT conducted a robust household budget survey for one year ending in 2008 with the support of the World Bank. A new consumer price index is expected to reflect the results of this survey in its weights.

Anti-inflation /  
forex policy

On 31 December 2008, Iraq completed its third IMF stand-by arrangement (SBA) securing the last 20% tranche of an overall 80% reduction in Paris Club debt. Non-Paris Club debt reduction is under negotiation. All non-Paris Club debt is expected to be settled according to terms equal to or better than the Paris Club agreement. The estimated total of external debt was over \$140 billion. Paris Club debt represented less than one-third of this total. In many instances, Iraq is replacing debt with bonds equivalent to the Paris Club terms. These bonds are traded in many international markets. Both Saudi Arabia and the United Arab Emirates have announced intentions to forgive part or all of Iraq's multi-billion debt; Kuwait has refused so far to consider any debt reduction.

Macrostability

## 9 | Private Property

Private property remains unprotected in Iraq. In addition to complicating business development, the lack of a regulatory framework for property claims negatively impacts lending in Iraq and banks' ability to execute against property accepted as collateral on loans. Returning refugees and internally displaced persons further complicate the situation, as such individuals return to find their homes occupied by others or severely damaged, with inconsistent avenues for recourse. Anecdotally,

Property rights

bankers have confided that real property collateral is often at risk from both insurgent and criminal activity, further diminishing its viability for protection of loans.

Small, medium-sized and state-owned enterprises all face serious challenges in Iraq. The harsh regulatory environment is a major deterrent to the creation of new small and medium-sized enterprises and, thus, new jobs. State-owned enterprises were once the primary industrial employers, but most are still not attractive to foreign investors.

Private enterprise

## 10 | Welfare Regime

The embargo and the associated curtailment of economic activity, along with inflation, posed almost insurmountable challenges to Iraq's social networks. For many Iraqis, inadequate support from the state led to a growing dependence on family and tribal solidarity, which reinforced the effects of the old regime's retribalization policies. Considered exemplary in the 1980s, the health care system can no longer provide comprehensive care because of the shortage of medical supplies, lack of investment and the emigration of qualified personnel. The rebuilding or refurbishing of dozens of hospitals and health clinics since 2003 has improved coverage and the quality of the health system, although the lack of health personnel medicines, as well as various infrastructural failings, remain acute problems. Many families depend crucially on cash transfers from relatives in the diaspora. The only large-scale public safety system in Iraq is the food distribution system that was introduced in the 1990s to mitigate the impact of sanctions, but it is no longer effective. Pensions were introduced in Iraq as early as 1922, but the system covers only a small part of the population, and has proven to be very expensive.

Social safety nets

Equality of opportunity is not guaranteed in Iraq. Nepotism and political patronage greatly limit access to jobs, a situation worsened by the public sector's dominance of the economy (30.4% of GDP in 2007). Quality of life is significantly higher in the Kurdish region, which enjoys relative stability. Incomes are reported to be significantly lower in several southern governorates. The strained security situation has considerably narrowed women's freedom of movement. Furthermore, the growing strength of conservative Islamist groups has imposed the Islamic dress code on women, and dangerously eroded their opportunity to work, in areas under these groups' control.

Equal opportunity

## 11 | Economic Performance

GDP per capita is estimated by the IMF to have grown 9% between 2007 and 2008, from \$2,109 to \$3,085. The IMF projects that GDP growth in the coming years will stagnate or decrease, due mainly to the drop in world oil prices and the ripple effect

Output strength

this will have on Iraq's economy. Unemployment remains a real concern in Iraq and is estimated to be as high as 18%. Iraq shaved billions off its 2009 national budget to reflect the drop in expected oil revenues. Many cuts occurred in capital expenditures, meaning decreased spending on reconstruction projects such as electrical plants, roads, sanitation plants and other essential services needed by Iraq's population. Because Iraq's economy is so dependent on oil, it can be expected that growth will be low or negative no matter what the merit of policies, regulatory frameworks and legislation that may be enacted.

## 12 | Sustainability

In the past, environmental standards played a subordinate role both in public policies and in social awareness. Increasing pollution of the Tigris and Euphrates rivers and their tributaries, as well as the salinization and erosion of agricultural land, already represent significant ecological burdens. Since the fall of the Ba'athist regime, environmental concerns have been institutionalized in an environmental ministry, but this has little budget and little actual impact. Given budgetary concerns following the late-2008 drop in oil prices, environmental concerns will likely assume a very low priority.

Environmental  
policy

Iraq's institutions for higher learning and advanced research have been seriously weakened by years of financial crisis and international isolation. The infrastructure for teaching and research falls short of modern standards and will have to be rebuilt during the coming years. Almost all of the country's 13 major universities and 40 other institutes and colleges were looted and ransacked in the early weeks of the occupation. Repression under Saddam led to the emigration of an estimated 2,000 professors between 1995 and 2000 alone. Since 2003, many university teachers have become the target of threats and physical attacks, prompting yet another exodus to the comparatively safe Kurdish region and foreign countries.

Education policy /  
R&D

## Transformation Management

### I. Level of Difficulty

The structural constraints on governance in Iraq are high. Iraq's governing institutions, especially those not related to security, are extremely weak, ridden with corruption, and often operated as private fiefdoms. Infrastructure, despite the vast sums of Iraqi and U.S. money that have been spent on reconstruction, remains inadequate, particularly in the most violent areas in Iraq such as the "Baghdad Belt" encompassing war-torn districts outside of Baghdad, including Mahmudiya, Arab Jubur, and Tarmiya. Iraq's once-thriving middle class has largely fled Iraq, both during the 1990s and the 2005 – 2007 civil war in Iraq. Societal division, though much reduced over the past two years, is multilayered, complex, and likely enduring. Regional dynamics – particularly transnational terrorism and competition between regional players such as the United States, Iran and Saudi Arabia – will continually pose an obstacle to Iraqi sovereignty and constrain the decision-making of Iraqi leaders. On the positive side, Iraq has massive oil resources that would be the envy of any country, and it has talented members of a diaspora that may return to Iraq if stability improves and the political climate allows.

Structural  
constraints

Traditions of civil society in Iraq are weak. Though perhaps from a biased perspective, many U.S. military and civilian personnel working in Iraq complain of a cultural lack of community initiative and self-assertion among Iraqis. Many believe that Iraq's long experience with totalitarian rule has bred a tendency in the Iraqi people to look to Baghdad for solutions to problems, with the top individual priority being to avoid standing out or posing any perceived challenge to the ruling authorities. To some degree this appears to be changing – as indicated, inter alia, by the active competition in Iraq's January 2009 provincial elections and the high number of newly registered NGOs – but the cultural tendency toward a strong central government in Baghdad and limited competition from independent organizations will likely persist.

Civil society  
traditions

The past two years have witnessed the end of the civil war in Iraq, but Iraqi society and state institutions remain deeply split and polarized along factional, communitarian, ethnic, religious and tribal lines. The trend line for the Arab parts of Iraq is positive. Though both Sunni and Shi'i political parties have fragmented considerably over the past two years, the realignment underway appears to be

Conflict intensity

increasingly on the basis of common interests rather than sectarian identity. For example, it is no longer the case, as it was in 2005, that there is effectively only one Shi'a party for which an Iraqi could vote. The Shi'i United Iraqi Alliance has fragmented, and now Prime Minister Maliki's Da'wa party, the ISCI, the Sadr Movement, and new parties led by Minister of the Interior Jawad al-Bolani and former Prime Minister Ibrahim al-Ja'fari all vie for votes. However, Arab-Kurd tensions persist and will likely intensify as Prime Minister Maliki's power grows and the central government in Baghdad becomes more assertive. The continuing violence in Ninewah province – where Arabs and Kurds vie for control over territory and resources – and the still unresolved conflict between Arabs, Kurds and Turkmens in oil-rich Kirkuk may foretell increased violence to come.

## II. Management Performance

### 14 | Steering Capability

The Iraqi political leadership is unable to act with a long-term perspective or in the country's prospective interests. The leadership relies on ad hoc measures, lacks guiding concepts, reaps the maximum short-term political benefit and shows no recognizable prioritization. Prime Minister Nuri al-Maliki's top strategic priority has been to stay in power at all costs. He has thus cultivated loyalties within the ISF, embraced and encouraged U.S. efforts to eliminate the Sadr Movement (a major rival to his power) and build up the ISF, and in December 2008 even arrested dozens of employees of the Ministry of the Interior, ostensibly to prevent a coup but likely to send a message to the current minister, Jawad Bolani, that use of the ministry to build up his own political party would not be tolerated beyond a certain point. Looking past the struggle to maintain and maximize their power, the broader political leadership – to include Da'wa, ISCI, the Kurdish parties, and the Sunni Iraqi Islamic Party – has focused on a single goal: stabilizing the country. In 2006, it was not clear that they had either the will or the capacity to do so. It was only by the United States taking the lead with the "surge" strategy and bringing the Iraqi leadership on board that they eventually gained the confidence to assert themselves, and by early summer had begun to take the initiative in military operations, as evinced by the Basra, Maysan, Sadr City and Diyala operations between March and August 2008.

Prioritization

The story on government reform for the past two years is quite positive, but this is primarily because it was needed so badly. The biggest success story is the ISF. The Iraqi National Police, a national gendarmerie run out of the Ministry of the Interior,

Implementation

used to be notorious for being the domain of Shi'i death squads. This force has now been largely purged of its most sectarian and criminal actors. The central government has been successful in reining in rogue militias among local police forces in the provinces by subordinating them, in the most volatile communities, to the command of Iraqi Army units. Of course, the helping hand and watchful eye of U.S. occupation forces have overseen and facilitated this reform process. Non-security ministries, particularly Health and Transportation, have also seen improvement. These ministries were formerly controlled by Sadrist ministers, and corruption, violent extortion, and incompetence in these all-important service ministries were the norm. The Sadrists have been removed and a modicum of functionality has returned. A range of other initiatives have been undertaken to reform the delivery of essential services such as water and electricity, with some success. Again, the U.S. civilian advisory presence, particularly in the form of the Provincial Reconstruction Teams (PRTs), has moved this along, but the will of the Iraqi government on these issues is apparent.

Given the constant flux of power in Iraq, innovation and flexibility on behalf of a number of political actors has been essential for survival. The best example is Nuri al-Maliki himself. He rose to power on the back of two sectarian Shi'i parties – the Sadr Movement and ISCI – while his Da'wa party lacked a base or any sort of substantial resources. Facing the prospect of the eclipse of his power in the medium term, he began building a coalition and used the power of patronage to establish a political base. He also changed his rhetoric substantially, projecting the image of a strongman, promoting a strong central government and taking on former allies such as the Kurds and ISCI for advocating policies that he claimed divided and weakened Iraq. Maliki also adjusted to the growing discontent with religiously based parties in Iraq. During the provincial elections, he effectively jettisoned the “Da'wa” label and formed a coalition called “The State of Law,” and put forth a tough law and order image that entirely avoided the use of religion in campaign materials.

Policy learning

## 15 | Resource Efficiency

The government's use of available economic and human resources has grown in efficiency over the past two years, but again this is largely due to the sorry state from which they began. The post-war era began with the near wholesale purging of top- and mid-level civil servants from their posts, both through the notorious de-Ba'thification program and other forms of intimidation, as well as the disbandment of the army. Nepotism and general favoritism have been pervasive. Nonetheless, in the past two years, the Iraqi government has grown more inclusive, particularly in the ISF. Many of Iraq's talented former officers have been returned to service. However, much of Iraq's former wealth of human resources now lies in the

Efficient use of assets

diaspora, both in the region (primarily Jordan and Syria) and in the West. Financial management, and in particular budgeting, planning and budget execution have improved, due in part to PRT and USAID focus in training and facilitating these processes. The main strategic failure in resource allocation has been the bloated budgets of the security apparatus, to the detriment of other government ministries. This prioritization, to some degree, was a necessary response to the need to establish central government authority, but many Iraqi and U.S. military observers have commented that the security forces are far too numerous. This imbalance will likely be far more pronounced in the future as Iraq becomes more stable and the need for ISF presence is correspondingly less, and the need to fund such a large security apparatus will be a burden on the state.

There are substantial differences in administrative capacity and efficiency between various ministries at the central government level. For example, the Ministry of Electricity has established a favorable reputation in dealing with contractors while the Ministry of Health, which was controlled by the Sadr Movement for many months, is infamous for being a rather awkward partner. In addition, administrative processes within the ministries are often complicated, and in many cases they lack routine procedures such as standard contracts. Tendering processes take usually a long time and are sometimes subject to political interference. Many provincial governments which receive funds for regional investment have proved to be unable to spend a considerable part of their resources, for lack of administrative capacity. In some cases, funds have been allocated to local contractors which have neither the experience nor the capacity to deliver on large projects.

For much of post-2003 Iraq, effective government coordination did not occur and “policy” beyond public officials’ pursuit of individual gain could scarcely be said to exist. However, as violence has subsided and the central government’s reach has been extended, this situation has improved. One of the main areas of success over the past two years has been improved coordination between provincial governments and central government ministries. In Iraq, provincial governments control most of the capital investment budgets, while operations and maintenance fall to the central government ministries. For some time, provincial governments made decisions without input from central government ministries, and thus stories abounded of provinces building hospitals or schools which ended up sitting idle because the ministries of Health or Education had not budgeted for their operations and maintenance. This process has been greatly rationalized in the past two years, with the U.S. PRTs playing a critical role in facilitating this coordination, and with the passage of a new Iraqi Provincial Powers Law which has helped clarify the roles of the various institutions.

Policy  
coordination

Corruption in Iraq is pervasive, and the problem is even getting worse. The very high level of corruption inherited from Saddam’s regime seems to have worsened during the occupation and the institutional vacuum that emerged, particularly as

Anti-corruption  
policy

vast amounts of reconstruction funds from the United States and the international community, released Iraqi funds, and oil revenues flooded the country. The CPA attempted to stem the tide by establishing a number of control and public awareness institutions. The Commission of Public Integrity was charged with the criminal investigation of corruption cases and violations of code of conduct. The commission placed independent inspectors-general in every ministry, who were entitled (at least in theory) to audit records and activities and to investigate any official, including the minister. The Supreme Board of Audit was charged with improving the efficiency and credibility of the government and issuing regulations for financial disclosure and a code of conduct, as well as for implementing campaigns to raise public awareness. However, the impact of these institutions has been marginal given the institutional weakness and the lack of serious political will to address the issues effectively.

## 16 | Consensus-Building

Only now that Iraq has emerged from civil war and the constitutional order is not immediately imperiled is it possible for the major political actors to begin considering common, long-term strategic aims. Democracy, at least as an abstract concept, and insofar as it means elections and representative government, is agreed on by nearly all political actors. However, some norms associated with democracy remain hotly contested, as is the case with women's liberty and freedom of expression. Economic policy is still motivated largely by crisis management, which results in a high degree of centralization and state management of key industries, particularly the oil ministry. State subsidies for a variety of goods, including food, fuel and electricity, continue to distort Iraq's economy. Debate about long-term economic vision is still a rarity in Iraqi political discourse, but, at least so far, pragmatism rather than ideology has been the guiding principle.

Consensus on goals

Now that the nationalist insurgency has been largely neutralized by U.S. and Iraqi efforts, and by the political calculation of Iraqi Sunnis to engage in politics, the only truly anti-democratic actor is al-Qaeda. Al-Qaeda continues to operate in cells and commit the occasional spectacular attack, but has almost completely lost the support of the population in Iraq, and does not meaningfully affect the political process. The only prospect for al-Qaeda to return to Iraq is in the event of return to civil strife between Iraq's political factions and the breakdown in general order, an environment in which al-Qaeda thrives.

Anti-democratic  
veto actors

In the past and to the present day, the Iraqi political leadership has often exacerbated existing cleavages in a way that has split society. The best example of this was in 2005, when ISCI (then known as the Supreme Council for the Islamic Revolution in Iraq, or SCIRI) organized the Shi'i United Iraqi Alliance, which ran on an explicitly Shi'i platform, further dividing Iraqi society for the sake of

Cleavage /  
conflict  
management

electoral expediency. A more current example is Prime Minister Nuri al-Maliki's antagonism toward the KRG, including the faceoff in Diyala province in the summer of 2008 and a series of blistering communiqués his office has directed toward the Kurds. The Kurdish drive for greater autonomy has caused resentment among Iraq's Arab population, and Maliki aimed to capitalize on this ethnic cleavage in order to burnish his nationalist credentials. Many Iraq scholars, including Rutgers University's Eric Davis, argue that societal cleavages are not inherently profound in Iraq, but are greatly exacerbated by "ethnic and sectarian entrepreneurs" who seek to capitalize on these divisions to further their own narrow political ambitions.

The Iraqi political leadership frequently ignores civil society actors and formulates its policy autonomously. This situation may be changing, as evinced by the heavy involvement of civil society organizations in the January 2009 provincial elections. These groups were involved in voter education and monitoring, and were supported by the state in their efforts. As many have interpreted these elections as a mandate for change, and as Iraqi politicians are clearly intent on appealing to the popular will at least in rhetoric, leading political actors may begin seeking cooperation and input from Iraqi civil society.

Civil society participation

The Iraqi leadership has proved unable to reconcile a population increasingly divided along ethno-confessional lines and traumatized by decades of brutal repression. In December 2003, the creation of the Iraqi Special Tribunal was announced (confirmed in §48 of the Transitional Administrative Law) with a broad mandate to cover crimes committed since the Ba'th takeover in 1968. The trial against Saddam and eleven other top officials finally started in October 2005 and ended in July 2006 with the death sentence passed on Saddam and two others. Human rights organizations such as Amnesty International were critical, arguing that the trial did not meet acceptable international standards and was characterized by repeated political interference. Saddam's execution took place hastily in an atmosphere of sectarian hatred. Since then, trials of lower level officials have continued, but with a much lower media profile.

Reconciliation

## 17 | International Cooperation

The United States has pledged some \$38 billion in aid to Iraq since 2003, part of which is distributed through the Iraqi Reconstruction and Relief Fund (IRRF). The international community has added another \$15 billion, amounting to one of the largest aid efforts ever. The U.S. military, as part of its counterinsurgency effort, has spent hundreds of millions of dollars in mostly quick-impact reconstruction efforts from a fund known as the Commanders' Emergency Response Program (CERP). Now that the United States is drawing down its presence, it is correspondingly downscaling its development aid, and CERP and IRRF monies

Effective use of support

have mostly disappeared. The PRTs, the United States' primary civilian assistance vehicle, have largely stopped funding large-scale reconstruction projects in favor of capacity-building goals, such as strengthening Iraqi institutions and processes to facilitate efficient spending of Iraqi funds on reconstruction and development. The United States has played a strong guiding role in this development effort, largely because it has been providing so much of the funding, and the Iraqi leadership has been mostly passive to this point. Now that the U.S. role is becoming largely advisory, it is unclear whether the Iraqi government will welcome its presence. Because Iraq's development needs are so great, and because of Iraq's political and institutional fragmentation, there is no single long-term development strategy. Rather, there is a great deal of redundancy and working at cross-purposes, but current fiscal constraints – on both the U.S. and Iraqi sides – will likely encourage discipline and focus. Apart from this, the successful negotiations over debt relief with the Paris Club countries have opened positive perspectives for Iraq's development, and discussions with the non-Paris club countries also seem to be on a good track.

More than five years after the downfall of Saddam Hussein – in a war and a subsequent occupation both of which were supported almost exclusively by the United States – attention is increasingly shifting to Iraq's neighbors and the wider international community. Given the outsized role of the United States since 2003, many external players avoided direct engagement, and failed to assume responsibility for promoting peace and stability in Iraq. But that dynamic is rapidly changing. With Iraq's elected government becoming more assertive on the regional and international stage, the beginnings of a regional diplomatic process (as of 2007), and the growing prospect of a U.S. redeployment, regional and international trends have become more important. The incentive structure for outside actors may be shifting rapidly. The Iraqi leadership is eager and willing to participate in regional and international organizations. The most promising and significant development in Iraq's international integration to date has been the International Compact with Iraq (ICI), a partnership agreement between the United Nations, the World Bank and the Iraqi government launched in 2007. According to the ICI mission statement, its "primary focus is to build a framework for Iraq's economic transformation and integration into the regional and global economy." With the January 2009 elections, which fulfilled almost all standards for being free and fair (at least measured against the difficult political, economic and social environment), trust in and the credibility of Iraq's government were further enhanced.

Credibility

Iraq's relationship with its neighbors has been shaped by the desire to establish a stable regional environment and stop support for an insurgency that has infiltrated from neighboring countries. Official relations with Iran are close, based on the longstanding relations between many of Iraq's top Shi'i politicians and Tehran. Iran and Iraq have signed a number of bilateral agreements in various fields, including

Regional  
cooperation

one on security cooperation. Furthermore, Iraq has recognized Iran's claim to compensation for damage sustained during the Iran-Iraq war. Driven by flourishing economic exchanges, relations with Turkey improved after Turkey's concerns regarding the national aspirations of Iraq's Kurdish minority were at least temporarily allayed. The alleged role of top Ba'athists based in Damascus in supporting the insurgency has complicated relations with Syria, although diplomatic relations were restored in November 2006. Trade with neighboring countries has surged since 2003, most importantly with Turkey, Kuwait and Syria. Trade with Jordan has continued on its pre-war basis, with Iraq providing cheap oil supplies.

## Strategic Outlook

The past two years have witnessed a dramatic improvement in security in Iraq. The Iraqi Security Forces (ISF) have improved in capacity and numbers. The Iraqi government appears to be assuming a greater degree of sovereignty, formalized by its signing of a Status of Forces Agreement (SOFA) with the United States that transferred substantial operational command on security matters to the Iraqi government and stipulated the withdrawal of all U.S. forces from Iraq by the end of 2011. There is great hope among Iraqis and the international community that these developments point toward the ultimate establishment of a basically stable and functioning Iraq which cooperates with international efforts to fight terrorism, and that the United States can scale down its presence in Iraq without triggering regional instability and state collapse.

However, deep political divisions remain in Iraq and the potential for a relapse into violence – or, alternatively, for the rise of narrowly based Shi'a authoritarian government – is very real. Although the Iraqi Sunni community has turned against al-Qaeda and toward political participation, the Iraqi government has so far been reluctant to incorporate it into state institutions. Elections in 2009 – both provincial and national – and the subsequent transfer of power will say much about how serious the ruling powers in Baghdad are about creating a truly inclusive political order. Moreover, tensions between Arabs and Kurds are escalating, and the potential for an outbreak of violence between the two sides is high. While many in the debate over Iraq focus on the extent and pace of U.S. withdrawal, Iraq's fate will largely depend on whether the Iraqi political leadership is able to overcome these manifold political obstacles. Moreover, as the United States exits Iraq, the country's fate will increasingly depend on how positively it engages with the international community, and how positively the international community engages with it.