

Aid, Conflict, and Growth: The Case of Iraq

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Doi:10.23918/icabep2018p5

Abstract

After decades of foreign aid consisting of capital transfers to developing countries and numerous empirical studies, the impact of foreign aid on growth remains questionable. The increasing recognition of short-comings in cross-country studies has created need for more attentive case studies. Post-conflict aid is of particular significance in determining whether external intervention can assist fragile states in their transition to stable democracies. Iraq presents a unique case study in understanding the impact of foreign aid on post-conflict countries. Its economic development, resources, and recent history compared to other reconstructions based on foreign interventions offers insights into how a military intervention followed by reconstructive assistance might take place in a country with an authoritarian history. This paper contributes to the aid, conflict, and growth literature using data from 2003 to 2013 in one of the world's highest recipients of aid over the first decade of the 21st century. The case study includes an OLS multiple regression using the statistics software SPSS, with the hypothesis that the presence of conflict decreases the positive impact of aid on growth. The findings suggest that conflict has a negative impact on growth. However, this study did not find statistically significant evidence suggesting that the presence of conflict decreases the positive impact of aid on growth.

“History will judge the war against Iraq not by the brilliance of its military execution, but by the effectiveness of its post-hostilities activities.”

~Jay Garner

“A Unified Mission Plan for Post-Hostilities Iraq”, 2006

“The United States is considering a model for post-war Iraq that resembles Japan after World War II, when Japan was occupied by an American-led military government. Another model... is the post-war occupation of Germany”

~Colin Powell, 2002

1. Introduction

The US reconstruction program in Iraq in 2003 was the second largest US reconstruction effort after WWII. The US allocated \$29.3 Billion for Western Germany and \$15.2 Billion for Japan from 1946-1952 (adjusted for inflation; real worth in 2005 dollars) (Serafino et al, 2006). The allocation for Iraq totalled \$61 billion by 2012 (SIGIR, 2013). However, the questions concerning the effectiveness of these efforts remain open amongst US policy makers and academics. Peace and stability were shortly established in both Germany and Japan after the war while Iraq, following a decade of democratic rule, is still a fragile state unable to provide neither security nor basic daily services for the population living there such as clean drinking water, proper sanitation, and an adequate electricity supply (Blunt, 2012).

The reconstruction of Iraq after the US invasion in 2003 presents a challenge to the understanding of the role of foreign aid that emerged after WWII (Barakat, 2005). Whilst the reconstruction in Japan and Germany was very successful, in Iraq it is agreed that the initial objectives of building a democratic government and achieving stability have not been achieved. This paper contributes to the aid policy literature, providing a specific case study that illustrates the impact of aid in relation to economic policies and institutional framework. The importance of assessing the US aid to Iraq lies in the fact that many other countries in the Middle East are currently experiencing changes under circumstances similar to those of Iraq. In Syria and elsewhere, the international community and the US have also shown willingness to intervene militarily and provide security, humanitarian, and technical assistance. It is therefore critical to have a better understanding of the consequences of such actions by reflecting on interventions in countries under similar circumstances.

The US-dominated Coalition Provisional Authority (CPA), which was in charge of the reconstruction projects in Iraq, failed to establish the primary conditions necessary for the transition to a functioning democracy (Le Billon, 2005). A number of inconsistent US policies were confronted by local and regional insurgencies. The reconstruction process was slow, costs always exceeded initial estimates, and priority was given to large infrastructure projects awarded to US companies. The absence of pronounced economic benefits and improvements in living standards for most Iraqis has resulted in resentment and increased political and economic violence. Oil, the key economic sector in the country, has been vulnerable to insurgent attacks (Le Billon, 2005). Oil is also a source of foreign policy distortions when it comes to the US strategic interests and motivations.

7,900 civilians were reported killed in Iraq between January and June 2015 (Hamourtziadou, 2015), whilst three and half million people are internally displaced (UNHCR, 2015). Iraq ranks as the 175th of 182 countries on the Corruption Index as compiled by Transparency International. The poverty rate is estimated to be thirty percent defined in terms of subsistence on incomes below \$1 a day (Crost, 2014). Unlike the Marshall Plan, which created a model for development economics, little theoretical and

empirical research has been conducted to assess the US led reconstruction in Iraq. Why was the US led state-building in Japan and Germany more successful than Iraq? Why did Iraq fail to establish robust and durable state institutions? My research topic was motivated by these questions and a desire to investigate the reasons for such failures.

I first examine the political economy of the country and its different stages of development throughout the 20th century in the second chapter named Country Background. The third chapter then reviews key growth theories with special attention paid to institutional quality and post-conflict aid studies. The fourth chapter presents my data and empirical analysis whilst the fifth chapter consists of the conclusion and policy recommendations.

2. Country Background

Rebuilding the economy is a precondition for creating a stable functioning democracy in Iraq. While Iraq's oil reserves are the second largest in world, second only to those of Saudi Arabia, Iraq suffers from wide-spread violence, a lack of proper infrastructure, poor living standards, inefficient government institutions, a limited private sector, and international debt (Ozlu, 2006). Its recent history suggests that like many other oil-dependent countries, oil wealth when accompanied with authoritarianism is susceptible to high levels of political corruption (Le Billon, 2005). These problems, coupled with confusion in the planning and implementation of aid programs, have contributed to the deterioration of the economy despite huge amounts of foreign aid that were allocated to the country since 2003 in reconstruction efforts. In order to gain a deeper understanding of the research problem to be dealt with, it is therefore important to shed light on important past and present key political and economic changes.

2.1 The Monarchy

Iraq was under the rule of the Ottoman Empire before the British occupation during WWI. Britain set up a colonial monarchy under the rule of King Faisal in 1921. It was given the status of a UK mandate by the League of Nations until 1932 when it gained independence as a kingdom, but was still under British colonial influence particularly regarding defence, trade, and foreign affairs established through bilateral treaties (Sanford and Weiss, 2003). Oil production in commercial quantities started officially in 1927 when the first concession for the production of oil was granted to the multinational Iraq Petroleum Company (IPC) and its partners British Petroleum, Shell Petroleum, Petroles Compagnie Française des Pétroles, Exxon and Mobil (Alnasrawi, 1994, P. 2). This period was crucial in building modern Iraqi economic and government institutions and shaping the Iraqi economy.

A new agreement in 1950 was established between the Iraqi government and the IPC on the basis of which the government was entitled to receive 50% of the profits from oil exports and 12.5% of the production that it could sell at any price (Ozlu, 2006). The increase in oil revenues and a \$12.8 million

loan from the World Bank were channelled towards achieving the goals set by the Development Board to invest in agriculture, transportation, communication, and construction (Ozlu, 2006). The outcome was below the Development Board's expectations and real expenditure on these sectors was significantly less than planned (Ozlu, 2006). The outcome of policies established during the monarchy policies created the foundation for the modern Iraqi economy and many contemporary problems are in fact legacies relating the monarchic rule. These problems include the heavy reliance on oil revenues and the establishment of a large central government. The private sector only plays a marginal role while a large bureaucracy had been strengthened with a wide scope for corruption and little attention paid to industrialisation and agriculture (Ozlu, 2006).

2.2 The Military Regimes

In 1958 a coup d'état by military officers led by General Abd al-Karim Qasim overthrew the monarchy and declared the Republic of Iraq. Unlike the monarchy, the new regime sought to terminate the country's ties with the West and strengthen ties with the Soviet Union. Changes to the economy were made so that the country was more socialist oriented, particularly as regards protectionist policies designed to strengthen domestic industries and to remove class related income differences (Langley, 1964). Two other military regimes later took over. Qasim was overthrown in 1963 by Colonel Abdul Salam Arif who was succeeded after his death by his brother Abdul Rahman Arif in 1966. They maintained similar economic policies to Qasim, but with a more moderate stance taken towards the West (Alnasrawi, 1994).

2.3 The Ba'ath Party

In 1968, the Ba'ath Party overthrew the military regime and established one party rule of which the most important element was the ideology of Arab Nationalism. Ahmed Hassan al-Bakr was the first Ba'ath President but Saddam Hussein took over in 1979 and maintained a dictatorship until the US invasion in 2003. Due to the large oil revenue, the government was able to keep its socialist model without having to struggle with spending on social welfare, infrastructure, and military modernisation until its military burden started to escalate when Iraq declared war on neighbouring Iran in 1980 (Metz, 1988). The economy has been hard to track since the 1970s and data on spending has not been frequently available for public use (Economist Intelligence Unit, 2003). Amongst the main reasons for Iraq's current heavy debt and deteriorated economy were the increase in military spending during the 1970s, the war on Iran during the 1980s, and the invasion of Kuwait in 1991 followed by eleven years of heavy economic sanctions (Sanford, 2003). The Iraqi governments in the twentieth century had always failed to respond to the demands of the Kurds and in containing the Shia as loyal citizens for Sunni dominated regimes centred in Baghdad.

2.4 The First Gulf War and the Sanctions

During his time in power, Saddam suppressed the Kurds in the north and the Shia in the south who sought foreign support to rebel against the regime. He used chemical weapons and aggressive means against them (Rathmell, 2005). Over the three decades of Saddam's rule, the country experienced two devastating wars and a decade of economic sanctions which ruined its economic base and caused stagnation. The first war was due to territorial disputes with Iran that escalated into an inclusive eight-year war (1980-88). In 1990, Iraq invaded its southern neighbouring country, Kuwait, but was driven out by US-led UN coalition forces in the first Gulf War of January-February 1991. Economic sanctions were put in place by the UN Security Council (UNSC) with the goal of the Iraq military disarming and initiating ceasefire with respect to the other countries in the region (CIA World Factbook, 2015). Saddam's political strategies and the suppression of opposition movements by the Kurds in the north and the Shia in the south were accompanied by severe economic conditions, which made sectarian and ethnic divisions more pronounced and triggered hatred and distrust amongst the people in a Hobbesian struggle for survival (Rathmell, 2005).

Despite the decline in wellbeing indicators by the time of economic sanctions, the international community constantly feared Saddam's intentions of starting war or using some form of force against other countries in the Middle East. There was always a fear that Saddam had helped Al-Qaeda after September 11th and that a military intervention was inevitable to help secure the region and spread democracy (Ozlu, 2006). The scope of damage to the society due to economic sanctions was evident, with obvious economic and social decline across many domains. The infant mortality rate had risen from 3.7% to 12% in seven years. The literacy rate had dropped from 80% to 58%. According to a report by UNICEF, the sanctions had reduced Iraq's GNP by 75%, resulting in lower levels than the GNP in 1950. Oil production also dropped to 0.6 million barrel per day (0.6 MPD) compared to 3.5MPD in 1979. Despite such damage to the economy, the sanctions did not loosen Saddam's grip on power (Sanford and Weiss, 2003).

A number of groups of UN verification inspectors had visited Iraq during the 1990s to ensure that weapons of mass destruction and long-range missiles had been scrapped. The Iraqi government refusal to consent to the UNSC resolutions led to the US-led invasion of Iraq in 2003 (the second Gulf War) with the aim of removing Saddam and his Ba'ath party from power. By 2003, the Iraqi economy was in a dire state. The sanctions placed on Iraq by the UN Resolution 661 froze all Iraqi financial assets abroad and banned all forms of trade except medical supplies and foodstuffs in humanitarian circumstances under the supervision of international organizations which meant the Iraqi economy was isolated from the global economy (Monten, 2013). Corruption and human rights abuses by Saddam's government provided the legitimacy required for the Bush Administration to forcefully change the regime in Iraq. Although weapons of mass destruction (WMD) were initially considered to be a serious

threat imposed by Saddam's government not only on the region but also on the world, such weapons were never found in Iraq (Rathmell, 2005).

2.5 The 2003 Invasion

The US led invasion took place and coalition forces remained in the country under a UNSC mandate until 2011 with a bilateral security agreement in place to help re-establish order and security, to provide military training, and to rebuild the economy and government institutions (CIA World Factbook, 2015). Following the 2003 invasion, the Office of Reconstruction and Humanitarian Assistance (ORHA) was responsible for occupation related activities. Later, it was replaced by the Coalition Provisional Authority (CPA) which expanded its domain of responsibilities to include governance roles. In the Future of Iraq Project, the working group on economy and infrastructure claims that, "We would rather roll up our sleeves and move heaven and earth to make a workable system of cooperative free enterprise triumph in Iraq in its hour of tremendous need" (US Department of State, 2002). The Future of Iraq Project was prepared by opposition figures and exiles in a series of discussions and debates in 2002 and early 2003 sponsored by the US Department of State, with the aim of deciding on how to reform Iraqi politics and government institutions after the invasion (Rathmell, 2005).

The most remarkable decisions made by the CPA were the following; first, to dismiss all government officials who ranked in the top four levels of Saddam's Baath Party and those who held positions in the highest three levels of each ministry; second, to disband the existing Iraqi military and establish a new army. These two decisions were made against the recommendations of CIA professionals and without consultation with the President and the cabinet. They were also fateful decisions in that they jeopardised the reconstruction process (Pfiffner, 2010). Hundreds of thousands of Iraqis found themselves unemployed and unable to support their families. The country's infrastructure had already been damaged by previous wars, and was poorly maintained during the sanctions when it became prone to looting and terrorist attacks. Militants and Ba'athists had weapons and were well trained to use them; indeed their anger on the US troops was fuelled by such decisions (Pfiffner, 2010).

2.6 Reconstruction Funds

The widespread violence made US Officials realise that rebuilding security in Iraq was critical to any other economic or political advances. The main focus of the reconstruction efforts and spending was therefore dedicated to training and arming the new Iraqi military and police forces designed to counter the insurgency and local terrorist groups. According to a report by Serafino, Tarnoff, and Nanto (2006), the US allocated \$28.9 billion from 2003 to 2006 for reconstruction assistance in Iraq. This amount is roughly equivalent to the US total assistance provided to Germany and double the amount provided to Japan (adjusted for inflation) after WWII. A question was raised by US Congressmen regarding the US aid effectiveness and allocation in Iraq. They also wondered why the US reconstruction efforts had

been more fruitful in Japan and Germany than they were in Iraq. The intention behind allocating huge amounts of aid, along with the foreign invasion and reconstruction effort, the largest after the Marshall Plan, was to establish a functioning democracy supported by free-market enterprise (Tarnoff, and Nanto, 2006). The final report by the Special Inspector General for the Iraq Reconstruction (SIGIR), published in 2013 revealed that the resources spent from 2003 to 2012 on the reconstruction efforts were as follows:

Table 1: Sources for Reconstruction Funds in Iraq

| | |
|---------------------------|---------------|
| United States | \$61 Billion |
| Other Foreign Governments | \$14 Billion |
| Iraq | \$138 Billion |
| Total | \$213 Billion |

Source: SIGIR Final Report to Congress 2013

2.7 An Oil Dependent Country

Oil plays a crucial role in the Iraqi political and economic framework. Its production, management, and ownership determine whether the country's economy can stand on its feet as a free market economy with a democratic regime (Ehrenberg, 2010). Oil makes more than 90% of the government revenue and 80% of the foreign exchange earnings (CIA World Factbook, 2015). Since the 2003 war, it was always the first target of insurgent operations as they were categorized by Ozlu (2006) into three groups. First, looters punctured pipelines in order to siphon oil and sell it on the black market to Syria, Iran, and Turkey. Second, saboteurs attacked pipelines and oilfields whose aims were to cripple the country's economy and increase instability and opposition to the US occupation. Third, tribes live around pipelines and receive a share of oil revenues in return for protecting these pipelines, so it is in their interest to keep the insecure environment and extend their security contracts with oil companies. Continuous attacks on oil assets caused a reduction in oil output and hindered the reconstruction process. For example, in 2005, attacks on oil cost approximately \$20 million per day and a total of \$6.5 billion throughout that year (Iraqi Ministry of Oil, 2006).

2.8 Corruption

Corruption was another major impediment to the success of the reconstruction efforts. Resource dependent countries are always prone to economic, political, and security risks relating to what economists call the 'resource curse'. This disease has started to infect the majority of the dependent countries since the 1970s onwards. Poor governance, slow growth, and high levels of corruption and in many cases authoritarianism are common symptoms present in many of the oil rich countries of the

Middle East (Le Billon, 2005). Huge amounts of resource revenues allow government officials to extract rent and expand their wealth from non-profitable activities.

Both oil revenues and reconstruction funds were blamed for creating more opportunities for political corruption particularly during transition. Corruption could also escalate hostilities amongst political parties who justified their corrupt actions in order to strengthen their hold on power (Le Billon, 2005). The CPA was accused of corruption and the misuse of resources. One of the major actions blamed for increasing corruption was the allocation of \$37 billion which was accumulated by the UN from the oil revenues during the sanctions period. The UN created the Development Fund for Iraq (DFI) and gave this fund to the CPA. The SIGIR's report in 2005 suggested that \$8.8 billion were distributed to Iraqi various ministries and cannot be properly accounted for. Bowen, the author of the report, stated that there were no adequate checks in place to ensure that the CPA was aware of how the DFI funds were spent (Scarborough, 2006).

2.9 Sectarian Division and Civil War

From 2003, Iraq has never been free from insurgent attacks on civilians and military troops. The attacks have targeted the US-coalition troops and civilians. The US has lost approximately 4,354 members of US forces in military attacks since the end of the combat operations in May 2003 (Katzman, 2009). Civilians were also vulnerable to terrorist attacks and violence that peaked during 2006 as insurgents bombed the Golden Mosque in Samarra, followed by a severe wave of Sunni-Shiite sectarian violence. These events marked a turning point in transforming the Sunni-led insurgency into a struggle for political and economic power in Iraq. The average number of civilian deaths was 100 per day in December 2006 including sectarian murders and had increased to 477 per day in June 2009 (Katzman, 2009). It is also estimated that two million Iraqis were either internally displaced or had fled the country by 2009 (Katzman, 2009). A safe and secure environment is a pre-condition for economic, social, and political development. The United Nations demonstrates the importance of peace and personal security as an essential ingredient for any aspect of human development in its fullest sense. The above figures regarding violence give some insight into how much the security situation in Iraq has deteriorated since the war in 2003.

2.10 Current Status

After more than a decade of US invasion and reconstruction efforts designed to bring economic prosperity and democratic rule, Iraq continues to suffer from worsening security triggered by internal and external insurgents. Oil prices have been decreasing rapidly on the world market. Despite three rounds of parliamentary elections and a constitutional government approved by the Council of Representatives (COR) in 2005 for the first time in half a century (CIA World Factbook). A survey conducted in 2014 by the Mercer consulting group named Baghdad the worst city to live in when

assessing the quality of life of 239 cities worldwide (Alarabiya, 2014). Since early 2014, the Iraqi army has been engaged in a military campaign against the Islamic State of Iraq and al-Sham (ISIS) which is believed to be a descendant of al-Qaeda. ISIS militants have gained control over one third of the country in the western and northern regions, including the second-largest city in Iraq, Mosul. The residents of these three provinces have fled to other cities in Iraq in particular to the semi-independent Kurdish Regional Government (KRG) in the north. President Obama has sent some 1,100 troops into Iraq and US aircrafts have conducted close to one hundred airstrikes (Keane and Pletka, 2014).

3. Literature Review

Official development assistance (ODA) hereafter ‘foreign aid’ refers to capital transfers in the form of grants and loans from bilateral and multilateral donors to developing countries (Moreira, 2005). An assessment of the effectiveness of foreign aid includes evaluating to what extent these loans and grants have achieved the main objective of foreign aid, which is the promotion of economic development and improvement of welfare in developing countries. The literature on aid effectiveness usually defines economic development as the economic growth in the country, most commonly measured in terms of GDP per capita as a reflection of the country’s living standards. After decades of foreign aid to developing countries, numerous studies have attempted to uncover the empirical relationship between aid and growth (Durberry, 1998). Micro-level studies support the view that foreign aid has a positive impact on growth whilst the macro-level studies, particularly cross-country regressions, demonstrate ambiguous results (Durberry, 1998). It is unfortunate that conflict and civil war were absent in the main growth models as stability was always taken for granted. Such an emphasis only started to attract attention amongst the third generation of those conducting empirical analysis when policy environment and economic institutions were introduced as major determinants for the success of aid programs.

3.1 The Relative Success of the Marshall Plan and the Gap Models

There is a long history describing the impact of aid on growth in developing countries. The literature on aid effectiveness started to rapidly expand after the relative success of the Marshall Plan in rebuilding Europe after WWII. The theoretical framework derived from the Marshall Plan was poor because the levels of investment were too low, which was due to low levels of domestic savings and a lack of foreign exchange in the war effected countries (McGillivray et al, 2005). The Marshall Plan resulted in a relative success which was followed by international initiatives who applied such an approach to poor countries worldwide so as to rescue their economies and help their markets grow.

The Marshall Plan was underpinned by the Harrod-Domar Model of growth. It was used to determine the required investment rate necessary to achieve a target growth rate. The model was called the two-gap model (Moreira, 2005). One limitation to economic growth in poor countries is their limited capacity to save due to their low income which generates the first gap. Import requirements exceed

exports earnings in these countries so they do not have enough foreign exchange to import goods and services crucial for investment and production. The shortage of foreign exchange accounts for the second gap (Moreira, 2005). Foreign aid inflows were expected to fill these two gaps in order to reach the target growth so the need for aid would disappear in a more prosperous world. The Harrod-Domar Model of growth generated a lot of optimism amongst economists regarding the effectiveness of aid. The prediction was simple; more savings go to more machinery, which results in high productivity which implies that more aid goes to investment and growth (McGillivray et al., 2005).

On the other hand, Solow surprised economists with his article in 1956 when he suggested that investment was not the key to long-term growth. The Solow model is an extension of the Harrod-Domar model. It assumes that growth is driven by technology, capital accumulation and labour. While the Harrod-Domar explains investment in capital as the main, if not the only, factor for increasing production, Solow thinks that this is the case only in the short-run because of diminishing returns to capital. Solow applies the same logic to labour because the return gained from the first few workers is much higher than the return gained from adding one more worker to a workforce of thousands of workers (Jones and Vollrath, 2013: 22).

In the Solow model, labour and capital accumulation stimulate growth only temporarily until the economy reaches the steady-state. In the case of the US, it was rather innovation and technology that kept the growth rate constant. Advances in technology were exogenous which means they resulted from noneconomic sources such as advances in science (Easterly, 2002: 52). Because of the high return to each additional unit of capital in the early stages of growth, poor countries will have higher rates of growth and higher returns to capital. This model offers one explanation for the rapid growth of Germany and Japan over the 1950-1960 period, despite the massive destruction of their stocks of capital after WWII. Foreign aid distributed on the basis of Harrod-Domar model, the Solow model, and the rapid recovery of European economies after WWII, did not achieve much success in the developing world. They assumed that with given amounts of aid, countries would grow at target growth rates and sustain their growth over time but surprisingly these levels of aid were achieved while the expected growth was not (Easterly, 2002: 42).

Hansen and Tarp (2000) published a survey that covers thirty years of cross country regressions with the aim of assessing the impact of aid on growth. They found that aid contributes to increasing investment and that it has a positive effect on growth when growth is determined by capital accumulation. This positive impact is independent of policy conditions. To account for the diversity of the sample countries' natural resources and cultural and socioeconomic characteristics, they capture the effect of aid through country specific effects in the regressions. They also include aid as an endogenous regressor (Hansen and Tarp, 2000). The conclusion is that aid impacts on growth via investment. Easterly (2002, P.42), who is a strong critic of foreign aid, uses the example of Zambia to show that

after receiving \$2 billion in aid to boost investment, the investment rate went down and growth was not achieved.

The micro-macro paradox in aid effectiveness was first suggested by Mosely (1986). Microeconomic analysis of aid financed projects showed positive results while the macro-economic data from regressions of aid and growth were disappointing. If this was the case, then the aggregate impact of aid was less than the impact of individual projects. Mosely therefore asked the following questions: “Is it true as the data suggest that aid projects are succeeding while aid as a whole is failing, if so how? Or do the data in fact deceive?” (Mosely, 1986: 22). Picciotto (2009) claimed that there is strong evidence for the existence of the paradox as one third of the World Bank projects show success at the micro level but the recipients’ macro evaluations are not affected.

Later research found that the problem was with the assumption that aid would be entirely saved which means that more aid goes to making more savings and more savings go towards generating more investment and growth (McGillivray et al., 2005). Devarajan and Swaroop (2000) relate this problem to aid fungibility. They define the term to mean that governments may receive foreign aid for projects that these governments would have financed in the absence of such aid. Aid relaxes the government’s budget constraint so the budget may be spent on unproductive activities such as defence and public consumption. They offer an explanation as for why aid may not cause a one-to-one corresponding increase in investment. Cassen (1994) summarizes the literature on aid effectiveness in saying: “Much of the literature on the macroeconomic effects of aid deals with relatively large groups of developing countries. Its results are ambiguous. The relationship between aid and growth is rather weak: it can be either positive or negative, depending on the country groupings and time period chosen.” This implies that there is no universal consensus concerning the impact of aid on growth and poverty reduction.

Reflecting on the findings of these previous models when considering our case study, Iraq, we can see that funds have been allocated in three areas; capital accumulation, governance, and security. The amount dedicated to the Iraq Relief and Reconstruction Fund (IRRF) was \$21 billion whilst the Security Forces Fund received \$5.7 billion up to 2006. 40% was aimed at restoring economic infrastructure which included airports, roads, railroads, seaports, electricity, water and sanitation facilities, telecommunications, and buildings (Serafino, 2006). 22% was allocated for democratisation, education, health, and developing the private sector. Unlike Japan and Germany where huge amounts were channelled toward food provision because of the severe humanitarian crisis after WWII, Iraq was in little need for food or emergency relief assistance. The major problem has been and appears to continue to be the insurgency and violence. The remaining 38% of the aid proportions was spent on training and provision of equipment to security forces (Serafino, 2006). Whilst in Germany and Japan, there was no resistance after the war, in Iraq, the insurgency and civil conflict has been a major challenge for the reconstruction efforts. Such problem was not addressed in the early aid effectiveness literature.

3.2 Aid Effectiveness is Contingent on the Policy Regime

There had always been a clear division between the ‘aid works’ and ‘aid does not work’ camps until the 1990s when the literature on aid was re-examined. The release of the World Bank publication: *Assessing Aid: What Works, What Doesn't and Why*, in 1998 and Burnside and Dollar's *Aid, Policies, and Growth* in 2000 constituted a turning point in the history of research on aid. It was a point where a grey area started to appear in the middle of ‘aid works’ and ‘aid does not work’ camps. The new perspective was that aid does work, but its success is contingent on the policy regime of the recipient country. Burnside and David Dollar (2000) used cross-sectional data to demonstrate that aid enhances growth in countries that have good policies and institutions. Their model of growth includes institutional and policy variables using a panel of fifty-six countries over six four-year intervals from 1970-1973 until 1990-1993. The policy variables are budget balance, inflation rate, and the trade openness dummy. An index of these three policies has been generated and they have been interacted with foreign aid. They find that aid alone is not a determinant of growth (the coefficient is not statistically significant), whilst the impact of aid on growth positively correlates with the level of policy (i.e. is contingent on the policy regime of the recipient). Hence the conclusion is that aid only works in environments with a decent level of policy.

The methodology of these authors and the empirical data they have used to draw such conclusions were revisited and re-examined by other economists such as the paper by Easterly, Levine, and Roodman (2003) in which they point out some methodological shortcomings in Burnside and Dollar's aid model. Collier and Dollar (2002) revisit Burnside and Dollar's results using different measures of policy, and a larger number of countries over a longer period of time in order to check the robustness of the results. They estimate the aid allocations that would maximize the reduction in poverty and compare it to actual allocations. Measuring policies through three macroeconomic indicators is limited since growth is also influenced by other policies. They prefer to use a much broader measure of the policy environment computed by the World Bank's Country Policy and Institutional Assessment (CPIA).

This measure has twenty different, equally weighted components covering macroeconomic issues, structural policies, public sector management and policies for social inclusion. Each of the twenty components is rated on a scale from one to six (with the best policy environment scoring at six). As concerns diminishing returns to aid, as earlier mentioned, the impact of aid on growth is non-linear, i.e. it increases until a certain threshold and starts to progressively decrease after this threshold. The decreasing returns on aid can be explained because of the limited absorptive capacity (ability to utilise aid effectively) of countries to take up large inflows of foreign capital. Their study confirms that the effectiveness of aid depends on the quality of policies enacted and on the amount of aid that countries receive. They estimate that with the regular allocation of aid, ten million people are lifted permanently out of poverty each year. With “poverty-efficient” allocation this could increase to nineteen million per

year. Sharma and Bhattarai (2013), on the other hand, trace the history of foreign aid in Nepal using time-series that cover data from 1965 to 2008 to show that aid contributes to growth in the presence of sound economic policy. They, however, do not have any statistical evidence to show that democratic governance and openness have an impact on aid.

In the case of the Iraqi policy regime, the US reconstruction agencies were mainly focused on building a democratic system with robust state institutions. This objective was clearly stated by Bush as follows:

“America has made and kept this kind of commitment before—in the peace that followed a world war. After defeating enemies, we did not leave behind occupying armies, we left constitutions and parliaments ... There was a time when many said that the cultures of Japan and Germany were incapable of sustaining democratic values. Well, they were wrong. Some say the same of Iraq today. They are mistaken.” (Bush, 2003).

Building a state refers to creating a self-sustaining democratic regime that can function after the withdrawal of foreign support (Brownlee 2007). Bush’s administration aimed at building an Iraqi state that could govern itself and defend itself without external reinforcement. There are three aspects to state-building: “the scope of state institutions, the strength of state institutions, and a state’s regime type” (Monten, 2013). The interventions made in Iraq designed to achieve state building by establishing political institutions that have democratic legitimacy, i.e. by changing the state’s mode of governance. In Japan, the US occupation maintained existing national institutions and directed resources towards a series of liberalizing reforms. In Iraq, the US decisions created a political and military vacuum by undermining scope and the strength of the previous Iraqi state institutions (Monten, 2013).

In contrast to Germany and Japan, which were industrialized economies, Iraq has been and continues to be a resource dependent country. Resource-dependent states are more vulnerable to corruption, conflict, and authoritarianism (Le Billon, 2005). Growth has been relatively slow in oil producing countries since the 1970s, and oil exporters tend to have higher rates of corruption as a result of elites’ control over large rents generated by oil exploitation. In 2014, Iraq ranked 170 out of 175 countries on Transparency International’s Iraq corruption index. Only Afghanistan, North Korea, South Sudan, Somalia and Sudan have lower scores than Iraq (Transparency International 2014). From 2003 to 2013 Iraq scored amongst the lowest ten percentile for control of corruption, rule of law, and political stability (World Bank, 2014).

| Year | Number of Sources | Governance Score -2.5 to +2.5 | Percentile Rank 0 to 100 | Standard Error |
|------|-------------------|-------------------------------|--------------------------|----------------|
| 2002 | 3 | -1.3 | 1.95 | 0.2 |

ISBN 978-0-9962570-9-1

| | | | | |
|-------------|---|-------|------|------|
| 2003 | 4 | -1.22 | 8.29 | 0.23 |
| 2004 | 4 | -1.56 | 1.46 | 0.23 |
| 2005 | 4 | -1.46 | 1.95 | 0.22 |
| 2006 | 4 | -1.56 | 1.46 | 0.24 |
| 2007 | 4 | -1.58 | 1.46 | 0.24 |
| 2008 | 7 | -1.57 | 1.46 | 0.23 |
| 2009 | 8 | -1.39 | 2.87 | 0.22 |
| 2010 | 9 | -1.31 | 4.29 | 0.2 |
| 2011 | 8 | -1.21 | 7.58 | 0.19 |
| 2012 | 9 | -1.24 | 7.66 | 0.17 |
| 2013 | 9 | -1.25 | 7.18 | 0.18 |
| 2014 | 9 | -1.34 | 5.77 | 0.18 |

 Table 2: **Control of Corruption in Iraq (2002-2014)**

Source: Kaufmann, Kraay, and Mastruzzi 2010; updated for 2015. The scale ranges from -2.5 to 2.5, where higher values correspond to less corruption.

3.3 The Strategic Interests of Donors and Foreign Policy

Issues concerning the allocation of aid and selectivity are a source of dispute amongst academics. Some argue that aid should be allocated on the basis of commercial and strategic interests whilst others claim that it should be distributed based on the altruism of the rich for the poor (Riddell, 2014). As Ehrenberg et al (2010) put it “It is in America’s interest to strengthen the hand of those who seek economic integration because this will probably lead to sustained and organized pressures for political liberalization.” Olofsgard and Berlin (2014) demonstrate that the dominance of political interests and foreign policy agenda in times of crisis can diminish the role of aid in fostering economic growth. Riddell (2014), on the other hand, illustrates that aid is always a political decision that can be informed or framed by both commercial and political interests. Both the Paris Declaration and the Millennium Development Goals (MDG) developed out of continuous forums and conferences held to improve aid allocation and implementation of aid projects. In both of these documents, the attention was not on how successful aid has been in generating growth. The discussions were mainly focused on reducing poverty as the main objective for aid allocation in the new millennium. There has been also a great emphasis on increasing the engagement of developing countries in foreign aid decisions (OECD, 2005).

Angeles, Azémar and Noorbakhsh (2008) address the question of aid selectivity in their empirical research that covers 104 aid recipients from 1984 to 2003. The paper sheds light on what determines how foreign is allocated. The motives they test are recipient country needs, the quality of the recipient country policies and institutions, and the geopolitical and commercial interests of the donors. They find that both developing countries' needs and democratic regimes play an important role in determining the

amounts of aid they receive. Multilateral aid seems to be targeted towards countries with responsible economic policies more than bilateral aid because inflation has a negative effect on it, while it has no effect on bilateral aid. They conclude that there has been an improvement in aid allocation based on poverty and a decrease in the prioritising of commercial interests (Angeles et al, 2008).

Oil has always been a driving source behind strategic interests, political disputes, and military conflicts in the Gulf region. The September 11th attacks generated big questions amongst policy makers regarding oil and US foreign policy towards the region. One side of the debate were the policy makers who opposed military interventions because they thought the war on terror was a cover for an imperialist oil grab in the region. Others justified the war by human rights abuses conducted by Saddam Hussein's government and the instability generated in Iraq and towards neighbouring countries. The US administration portrayed its intervention as necessary to ensure free access to oil on the world market by establishing democratic governance and free market enterprise (Le Billon, 2005). Collier and Dollar (2002) argue that aid can be employed for multiple objectives, such as; rebuilding post-conflict economies, meeting humanitarian needs, or to support the strategic or commercial interests of the donors. However, the most cited objective is poverty reduction.

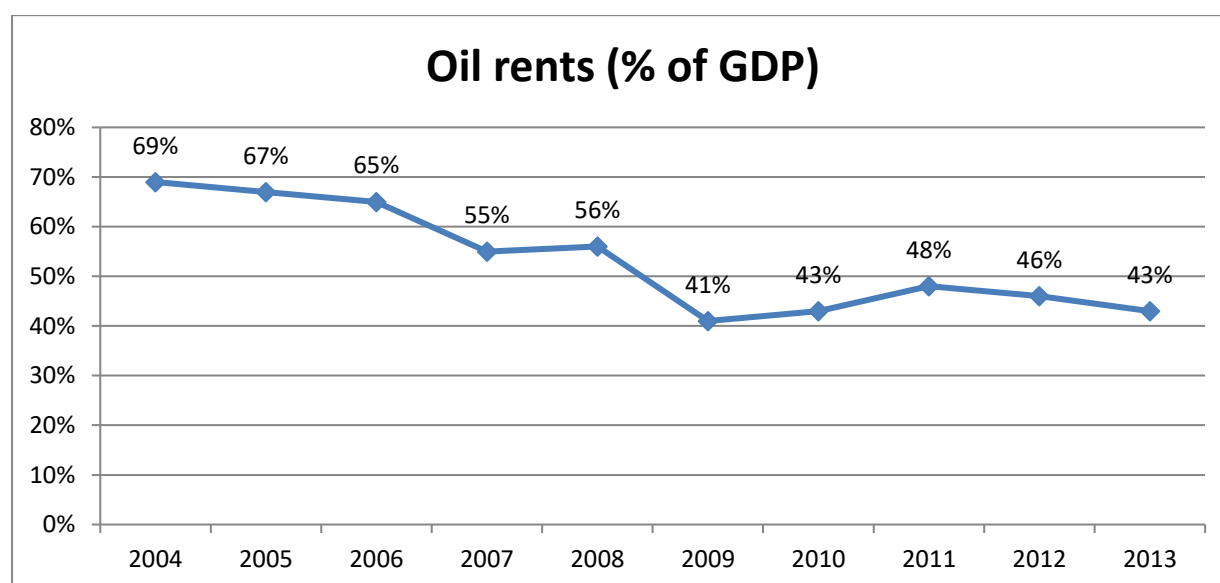


Figure 1: Oil Rents as a Percentage of Iraqi GDP

Source: Data from the World Bank Development Indicators

The main objective as concerns the invasion of Iraq and its reconstruction was related to the global war on terror in response to September 11th terrorist attacks and fighting Al-Qaeda in Afghanistan and Saddam who was a potential supporter of terrorist groups (Katzman, 2009). Barakat (2005) argues that Iraq was purposefully deconstructed in order to be rebuilt along the lines of the new principles of democratic rule and the free market. His generalized assumption for post-conflict reconstruction is that

it is never a purely technical matter and that there is always political agenda underpinning such efforts by the occupying powers. The implication of such an assumption is that reconstruction has to succeed in order to support the military strategy of the occupying powers.

3.4 Post Conflict Aid

Foreign Aid plays a crucial role in post-conflict periods particularly in the reconstruction process. Reconstruction refers to “the process of rebuilding degraded, damaged, or destroyed political, socioeconomic, and physical infrastructure of a country or territory to create the foundation for long term development” (Snodderly, 2011). There is no clear explanation as for how aid may reduce violence or escalate conflicts. Adison and McGillevray (2004) argue that aid is generally effective in promoting growth in recipient countries but that it is more effective in post-conflict countries. They suggest that countries in conflict and post-conflict periods tend to do very poorly in the assessments of their policy and institutional criteria; for this reason, they are penalized by the donors.

Countries that experience civil conflict attract aid and policy advice. A paper by Collier and Hoeffler (2004) covers 17 societies in their first decade of post-conflict economic recovery. They studied the absorptive capacity of these post-conflict economies to find that they are no greater than normal over the first three years but for the rest of the decade their capacity is almost double its normal level. For this reason, aid should be allocated during the first decade. They also look at the contribution of policy to growth, which is different in post conflict countries. They finally assess what particular policies are significantly important. They find that growth is more sensitive to policy in post-conflict countries (Collier and Hoeffler, 2004).

The post-war circumstances that countries experience after war are distinctive and the need to restore infrastructure and collapsed revenues make aid unusually productive in such contexts. At the same time, civil war may transform society, creating the possibility of a continuous high-corruption equilibrium existing with a weakened civil administration. Consequently, aid can be more or less effective in post-conflict societies (Collier and Hoeffler, 2004). Collier and Hoeffler (2004) account for possible influences relating to ethnic and religious composition of the society, as well as its geography and history such factors may provide donors with information about the level of risk these countries face but they do not alter the effects of aid and policy on conflict risk. There are direct and indirect ways in which aid and policy can affect the risk of conflict. They conclude that larger aid flows and improved policies over a period of five years can significantly reduce the risk of conflict.

Collier and Hoeffler (2004) use the policy ratings from the Country Policy and Institutional Assessment (CPIA) scores to see the effect of an improvement in the CPIA score (by one point sustained over five years) on the risk of conflict. The most evident indirect route by which policy affects the risk of conflict is through its effect on the rate of growth which reduces the risk of conflict significantly, when higher

levels of income are generated over five years of sustained growth. It affects the structure of the economy, stopping dependence on a primary commodity. Their conclusion is that after controlling for a range of economic, social, geographic, and historical variables, they find that neither aid nor policy have a direct impact on the risk of conflict. However, through their indirect effects on growth and the structure of income, increased aid and improvement in policy reduce the risk of conflict substantially.

Whilst Dollar and Burnside (2000) think that aid should be allocated on the basis of policy and institutional quality, Adison and McGillevray (2004) believe that such an approach will deprive the poorest people in conflict affected regions and it will not contribute to the prevention of violence. Their proposed alternative is to provide these countries with well-designed projects supporting peace building and reconstruction efforts. In their argument, they refer to the problem of project sustainability and recipient government ownership of such projects, but they do not clearly state how such concerns should be dealt with. Adison and McGillevray (2004) come up with the aid-policy-growth-poverty reduction-peace ($A \rightarrow P \rightarrow G \rightarrow P \rightarrow P$) story. It is a nice way of saying that good policy brings about three outcomes: growth, poverty reduction, and peace. As long as aid is conditional on good policy, aid is a potential source for these three good things. If this is true, then donors could achieve a lot through focusing on offering aid to conflict-affected countries than peaceful states.

4.1 Empirical Analysis

Civil war is bad for growth as it severely damages human and physical capital and disturbs the economy (Murdoch and Sandler, 2004). It is natural to believe that the longer and more intense a civil conflict is the more harm it causes to the economy. Bleaney and Dimico (2011) investigate the impact of the severity of civil war on growth using data enumerating annual casualties and the geographical magnitude of conflicts considered. They find that the economy may in fact grow faster than normal during the immediate post-conflict period because of the long-term loss of output during civil wars. They conclude that the negative effect of conflict on growth is most explicit in cases where fatalities exceed ten thousand annually or where more than half of the country is affected.

Based on the statistical model used by Bleaney and Dimico (2011), I will use the number of civilian fatalities as a measure of conflict in an Ordinary Least Squares linear regression model to examine the impact of conflict on the effectiveness of foreign aid on growth. As for the econometric model, Lensink and White (1999), and Burnside and Dollar (2000) conduct an endogeneity test of aid applying Durbin-Wu-Hausman (DWH) tests. The test reveals that ordinary least squares estimates and instrumental variable estimates in the growth regressions do not deviate significantly when aid is treated as an endogenous variable. Burnside and Dollar (2000) use the ordinary least squares and the 2OLS in their model. My hypothesis is that conflict decreases the positive effect of aid on growth using time series data from 2003 to 2013 that covers real per capita GDP growth rates, ODA per capita in current US\$, the number of annual civilian fatalities, an interaction term of ODA per capita receipts, and the number

of civilian deaths. I will control for corruption and oil rents. The justification used in covering this period is that before 2003, Iraq was under economic sanctions and had an authoritarian government that did not provide data on its economic performance for the international community. In addition, civil conflict and violence broke out after the fall of the old regime by the time of the US invasion in 2003.

4.2 Data and Measurement

Hansen and Tarp (2000), conducted a survey of empirical studies from the last thirty years in order to assess the effectiveness of foreign aid on growth in real GDP per capita. They found that aid increases aggregate savings, increases investment, and it has a positive impact on growth when growth is determined by capital accumulation. They also confirmed that the positive impact of aid on growth is not conditional on good policy. Studies by Hadjimichael et al. (1995), Durbarry et al. (1998), Lensink and White (1999), and Burnside and Dollar (2000) are all based on fairly standard cross-country growth regressions. In line with the above studies, I will use real GDP per capita growth rates from World Development Indicators as the dependent variable.

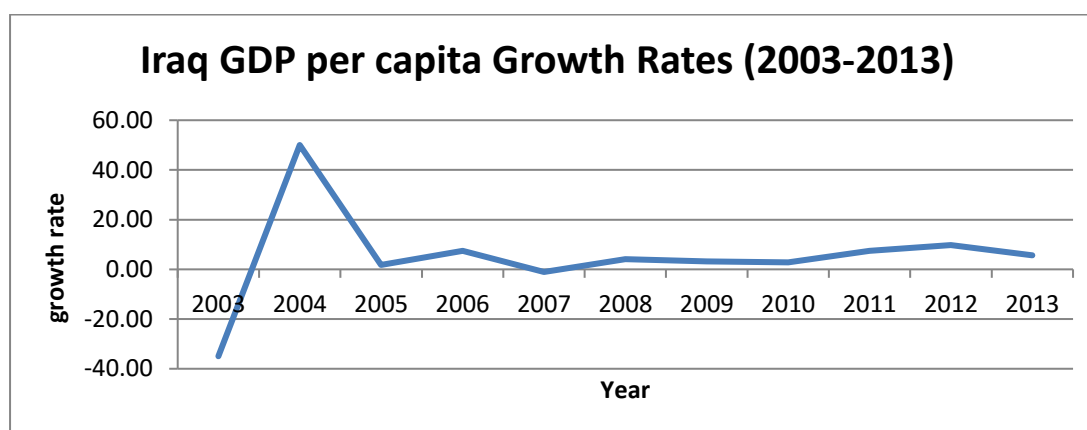


Figure 2: Iraq per capita Growth (2003-2013)

Source: Data from the World Development Indicators

Hansen and Tarp (2000) refer to problems pertaining to the Dutch disease and institutional distortions as channels through which economic policy hinders growth, using simple augmentations of popular cross-country growth regression from the last thirty years. They apply the ordinary least squares as well as the generalized method of moments to conclude the impact of aid on growth. They control for a number of policy effects using several policy and institutional variables which might affect growth. Aid in their model is measured as official development assistance, ODA, relative to GDP. They also control for budget surplus, inflation, and trade openness referring to Burnside and Dollar's (2000) model. Hansen and Tarp (2000) find strong signs of bias once the model is enlarged to take country specific effects into account. I will use net ODA per capita as a measure of aid receipts in Iraq because it is the closest measure I was able to find on the World Development Indicators data concerning Iraq.

Bleaney and Dimico (2011) use real per capita GDP growth with data charting the geographical extent of conflict and fatalities for each country provided by the Political Instability Task Force (PITE). They categorise the severity of conflicts into three groups; below 1,000 fatalities, between 1,000 and 10,000 fatalities, and above 10,000 fatalities per year. In Iraq, as we can see the table below, numbers were above 10,000 from 2003 to 2008 and above 1,000 from 2009 to 2013. They control for per capita GDP over the previous five-year period, population growth, investment rates, government consumption in relation to GDP. They also use the interaction term of post-conflict dummies multiplied by the share of ODA in terms of GDP and they separate bilateral and multilateral ODA.

Bleaney and Dimico (2011) also focus on the geographical extent of conflicts in each country in each year in a sample of 182 countries over the period from 1950-2004. Out of this sample of countries, 70 had experienced at least one civil war. Because this research intends to examine only one country, Iraq, we need to modify the model. The geographical extent of the conflict is spread all over the country where there are 18 governorates out of which only the three governorates in the North, that is the semi-autonomous Kurdistan Regional Government (KRG), are relatively stable. This implies that violence covers more than half the country by surface area.

The most well-known attempt to estimate the war dead with particular attention to civilians killed by violence was the Iraq Body Count (IBC). This database counts the numbers of individuals killed, as reported by the English-language media which limits its scope. The advantages of using media based casualty data are as follows. First, technology has allowed for the quick track of incidents and for the integration of information in the database. Incidents which take place in remote areas receive media coverage within 24 hours. The rapid production of these media reports makes them more efficient than monthly or yearly reports from official sources as the IBC updates its records frequently (Seybolt et al, 2013: 66). Surveys on the other hand, cannot be updated once the survey has ended. A survey's estimate is limited by the fact that its approach is merely static, which implies that surveys cannot be used to track trends unless similar surveys are repeated at multiple points over time. Periodic surveys are difficult to conduct in conflict affected regions because of the logistic difficulties associated with collecting data (Seybolt et al, 2013: 66). Based on the above reasoning, I will use the annual number of civilian deaths as reported in the IBC as a measure of the conflict in the econometric regression model.

Table 3: **Estimates of Civilians Killed in Violence (2003-2013)**

| year | Number of civilian fatalities |
|-------------|--------------------------------------|
| 2003 | 12,125 |
| 2004 | 11,736 |
| 2005 | 16,583 |

ISBN 978-0-9962570-9-1

| | |
|------|--------|
| 2006 | 29,451 |
| 2007 | 26,036 |
| 2008 | 10,271 |
| 2009 | 5,369 |
| 2010 | 4,167 |
| 2011 | 4,153 |
| 2012 | 4,622 |
| 2013 | 9,851 |

Source: Data from Iraq Body Count

4.3 Control Variables

Hansen and Tarp (2000), use the World Governance Indicators (WGI) to control for policy. They also control for budget surplus, inflation, and trade openness referring to Burnside and Dollar's (2000) model. I first attempted to control for the five indicators' scores from the World Governance Indicators; political stability (i.e. no violence), government effectiveness, regulatory quality, the rule of law, and control of corruption. I observed a warning on the SPSS when I first ran the regression using all the above indicators as control variables. When I checked for multicollinearity amongst the WGI components, I found they were highly correlated and I therefore chose to control for corruption as a representative score controlling for policy. I also use oil rents as a percentage of GDP as a control variable because it generates a huge share of GDP.

4.4 The Statistical Model

$$RGDP = \beta_0 + \beta_1 AID + \beta_2 (CONF * AID) + \beta_3 CONF + XB + \varepsilon$$

RGDP denotes growth in real GDP per capita. AID is the net ODA per capita in current US\$. CONF is the number of civilian deaths representing the severity of the conflict, CONF*AID is the interaction term. I chose to run a simple linear regression using the method of Ordinary Least Squares. Lensink and White (1999), and Burnside and Dollar (2000) ran an endogeneity test of aid applying the Durbin-Wu-Hausman (DWH) tests. They found that ordinary least squares estimates and instrumental variable estimates in the growth regressions do not deviate significantly when aid is treated as an endogenous variable.

Table 4: OLS Estimations

Dependent Variable: GDP Per Capita Growth Rate

| <u>Regressor</u> | <u>Model 1</u> | <u>Model 2</u> |
|------------------|----------------|----------------|
| Corruption | 0.072 | -0.488 |

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| | | |
|---|--------------|---------------|
| | 0.879 | 0.151 |
| Oil Rents | 0.627 | 1.159 |
| | 0.207 | 0.008 |
| Net ODA per Capita in Current US\$ | | -1.943 |
| | | 0.065 |
| Net ODA per capita*Civilian Deaths | | 1.724 |
| | | 0.179 |
| Civilian Deaths | | -1.405 |
| | | 0.054 |
| R Square | 0.329 | 0.891 |
| Sig. F Change | 0.203 | 0.020 |

Number of Observations: 66

Coefficients are in bold and the p-value is below

4.5 Results and Discussion

Table six contains the results from the regression of per capita GDP growth on corruption, oil rents, net ODA per capita, the interaction term of aid and conflict, and civilian deaths. When we statistically control for corruption and oil rents, R^2 changes from 0.329 to 0.891 which means that the variation in the two control variables explain 32.9% of the variance in GDP per capita growth rates and that the whole model explains 89% of the variance in GDP per capita growth and it is significant at the 5% level. Unexpectedly, I received a negative sign for the net ODA per capita; yet this was not statistically significant. The coefficient of the interaction term of ODA per capita multiplied by civilian deaths contradicts my hypothesis and shows a positive sign, which is also statistically insignificant. With regards to the civilian deaths, the coefficient is negative and it is statistically significant at the 5% level of significance. Barro (1989, 1991), Alesina et al. (1992), Easterly and Levine (1997), and Easterly (2001) all found a long-lasting negative impact of violence and instability on economic growth. One conclusion implied by the above model is that conflict has a negative impact on growth, a result consistent with the growth-conflict literature.

The regression as a whole is significant at the 5% significance level in explaining 89% of the variation in GDP per capita growth. The coefficient of the aid variable shows that aid has a negative marginal impact on growth, but we cannot consider this result to be relevant as it is not statistically significant.

The interaction term of aid and conflict tends to have a positive impact on growth but its p-value is greater than 0.05, which means it does not account for the variation in growth. The only two variables that demonstrate statistical significance and have a logical impact on growth are the oil rents (first control variable) and the conflict variable which is in our case the number of annual civilian deaths. This implies that the increase in oil rents affects growth positively and the escalation of conflict effects growth negatively.

4.6 Model Limitation

In this model, we have covered only sixty-six observations when examining the impact of conflict on aid effectiveness. This sample is relatively small for a multiple OLS linear regression of three independent variables and two control variables. The model could have been enlarged to include variables that represent human capital and institutional quality. A longer time interval could also offer deeper analysis. If this research is to be carried out in ten years from now, the data set would be of higher quality, as most empirical studies cover a data set from twenty to thirty years. One important element that could also add more relevance would be the inclusion of CPIA components as control variables or independent variables; however they are currently unavailable for Iraq in the World Development Indicators database.

5.1 Conclusion and Policy Recommendations

Foreign aid plays a very important role in conflict affected countries, particularly in those engaging in post-conflict reconstruction. In this research project, I have looked at the impact of civil war on the effectiveness of aid with particular attention paid to US strategic interests and policies in Iraq. The Marshall plan and the Iraq reconstruction both aimed to build democratic states with free market economies that could sustain themselves after the withdrawal of foreign military support. The US policy makers had images of the post-WWII reconstruction of Germany and Japan in mind when they were planning for the war in Iraq. Peace and stability were quickly achieved in post-WWII devastated economies, while in Iraq the war was followed by escalating violence and deteriorating economic and social conditions. The literature remains divided over the question of whether foreign military intervention may be an effective mechanism for building robust institutions in fragile states.

This paper has provided greater depth as concerns a critical aspect of foreign intervention followed by a huge aid program in a country where the objectives of intervention were not achieved. In the section named country background, I introduced the nature of Iraq's political economy in different stages of its economic development and stagnation. In the literature review, I looked at the evolution of the main growth theories with particular emphasis on donors' motivations and strategic interests in aid allocation and post-conflict aid studies.

In the empirical chapter, I applied an OLS linear regression to data set that covering the period from 2003 to 2013. The independent variable was GDP per capita growth and the explanatory variables were per capita ODA, number of annual civilian deaths, and an interaction term concerning aid and conflict. I also controlled for corruption and oil revenues as a percentage of GDP in the model. The hypothesis I wished to test was that “conflict decreases the positive effect of aid on growth”. The results did not reveal statistically significant evidence to support the hypothesis but the impact of conflict on growth was negative and statistically significant, with a significance level of 5%. The results from the empirical chapter are in agreement with the studies of Barro (1989, 1991), Alesina et al. (1992), Easterly and Levine (1997), and Easterly (2001) who find that conflict has an enduring negative impact on growth.

The US has been more successful in preserving state capacity than in building state capacity when it did not previously exist. In Japan, for instance, the US occupation preserved the Japanese national institutions and utilised the expertise of its officials in making a series of liberalising reforms. In Iraq, the US made decisions that created a security and political vacuum that could not be filled by the US military presence. These reasons may explain the failure of external intervention in overcoming these hard conditions no matter how large the reconstruction efforts were. Persistent state weakness can be a source of chronic instability, civil conflict, and economic stagnation. Without robust state institutions, a stable democracy cannot be established. The US failed to preserve the existing capacity of Iraqi state institutions and faced substantial barriers when attempting to rebuild those institutions (Monten, 2013).

After the US invasion, the Coalition Provisional Authority (CPA) continued to make decisions that dismantled and undermined the capacity of the Iraqi state. The first order by Bremer as executive of the CPA was the de-Ba’athification of the Iraqi government which meant the former Iraqi elites were eliminated from positions in top three layers of management in the Iraqi ministries. These officials represented the bulk of the previous regime’s political experience in the Iraqi state. The second order by the CPA was to disband the Iraqi military which included the Iraqi armed forces, the Ministry of Defence, and the Iraqi Intelligence Service, leaving the Iraqi government unable to preserve public order. The outcome of such policies was a total collapse of security in the aftermath of the invasion.

As Steve Browning, an army engineer and CPA official, reported to Bremer, “the purged Baathists were ‘the brains of the government...the ones with a lot of information and knowledge’, without whom the CPA would have ‘a major problem’ running the state ministries” (Chandrasekaran 2006: 71). These decisions had left large segments of the society alienated and unable to support themselves and their families. Instead of investing in them as an important source of human capital in the post-war reconstruction, they formed the major insurgent groups that contributed to further destruction and disorder generated from their anger at US made decisions (Pififfner, 2010). Sectarian division created another source that generated instability and upheaval. Ethnic and sectarian differences in a country previously ruled by a dictatorship are very likely to break into a bloody civil conflict. Establishing a

secure environment along with the necessary institutional and economic preparations must come before commencing reconstruction projects and building physical infrastructure in order to avoid such a scenario (Brown, 2005).

Local participation and ownership of reforms, such as from the Paris Declaration, indicates that more engagement on the side of the recipient makes aid more fruitful. A very important lesson from post-war reconstruction is that it is important to have a clear vision that allows for the participation of local people. Unfortunately, the planning and implementation of the reconstruction in Iraq was handled by foreign experts who had little if any practical knowledge of the local environment and the social and political structure. Professor Sultan Barakat, the founding Director of the Post-war Reconstruction and Development Unit (PRDU), states the issue as follows: “Post-war reconstruction begins in the hearts and minds of those who suffer the horrors of war and want to change societies so that there is no return to mass violence. For them planning for reconstruction often begins during conflict and is an essential part of negotiating their way towards peace.” (Barakat, 2010). The international community’s first concern when it comes to intervention always seems to be Western security and opportunistic self-interest rather than a coherent vision designed to reintegrate the affected societies into the world community. To avoid future similar disasters in current conflict affected societies there are important lessons from Iraq. It is essential to include the local population in the post-war reconstruction. If they are left behind, they may start to generate threats to their own societies and to the foreign contractors and military troops and jeopardise the reconstruction process.

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