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## CHAPTER 7

### ECONOMIC AND RECONSTRUCTION CONSIDERATIONS IN A FAILED STATE

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As the United States enters the 7th year of the Global War on Terrorism and continues its herculean efforts to rebuild the nations of Afghanistan and Iraq, it is evident that nation-building in failed states is of U.S. strategic importance for the foreseeable future. In December 2005, the President issued National Security Policy Directive (NSPD)-44 establishing the Department of State (DoS) as the lead agency for Stability, Security, Transition, and Reconstruction (SSTR) activities, and directed the Department of Defense (DoD) to integrate its SSTR contingency plans and operations with the DoS.<sup>1</sup> DoD subsequently published DoD Directive (DoDD) 3000.05, *Military Support for Stability, Security, Transition, and Reconstruction Operations*, which established stability operations as a core U.S. military mission comparable to combat operations. Further, it directed that U.S. military forces “shall be prepared to perform all tasks necessary” to establish order when civilians cannot do so.<sup>2</sup> The directive broadly states that stability operations include: help to rebuild institutions such as security forces, correctional facilities and judicial systems; revive/build the private sector, economic activity, and construction of necessary infrastructure; and, develop representative governmental institutions.<sup>3</sup> This chapter provides recommendations and prioritization of the many steps required to restore economic activity and rebuild related infrastructures and institutions.

First, nation-building and economic restoration require a coordinated international, U.S. interagency, and DoD joint approach. Formation of the Department of State’s new Office of the Coordinator for Reconstruction and Stabilization (S/CRS) and issuance of DoDD 3000.05 were good initial steps that hopefully will feed into larger international/United Nations (UN) efforts. The whole of the U.S. Government needs to jointly plan and exercise economic nation-building strategies and tasks in order to be prepared to execute them when called upon, and they need to capture lessons learned from previous nation-building efforts to improve future operations.

One lesson that continues to be relearned is the need for economic development at the early stages of nation-building. Often, once security has been reestablished, the priority has been to hold free elections as soon as possible. Unfortunately, rebuilding the economy is often delayed because it is considered a lower priority long-term issue. Although rebuilding an economy does take considerable time, it is a misguided approach to wait until later in the nation-building effort to begin rebuilding the economy because a stable economy and low unemployment are essential for security and stability, as evidenced in Iraq. In 2004, when Task Force Baghdad analyzed attacks in its area of operation, they found “a direct correlation existed among the level of local infrastructure, unemployment figures, and attacks on U.S. soldiers.”<sup>4</sup> Similarly, in the British counterinsurgency campaign in Malaysia (1948-60), the British counterinsurgency expert, Sir Robert Thompson, stated that three forces influenced the Malaysian population: nationalism; religion and culture;

and economic well-being. Of the three, he gave primacy to economic well-being, stating that “however powerful nationalist or religious forces may be, that of material well-being is as strong if not stronger.”<sup>5</sup> It appears that this lesson has been finally institutionalized in U.S. Army *Field Manual (FM) 3-24, Counterinsurgency*, where it states that “. . . lasting victory comes from a vibrant economy, political participation, and restored hope.”<sup>6</sup>

With this lesson hopefully firmly entrenched in the American psyche, the next question is how to go about rebuilding the economy of a failed state and in what priority tasks should be executed. There is no precise template that will work in every situation, but there are some universal principles that can be applied. The best way to approach this overwhelming challenge is to consider the tasks from a short-term and mid-/long-term perspective. In the short term, it is necessary to first reestablish security and provide humanitarian assistance. No economy can rebuild if the people are starving and there is no security. Lack of security in Iraq and Afghanistan continues to hamper economic revitalization of both these countries. Second, essential services, such as safe drinking water, health care, sanitation, garbage removal, and electricity, need to be provided as quickly as possible. Though directed at meeting the immediate needs of the populace and winning the hearts and minds in a counterinsurgency operation, these essential services are also critical to rebuilding the economy. Some of these services can be provided quickly and cheaply, (i.e., trash removal), while others such as electricity may require both immediate and long-term reconstruction solutions.

Closely linked to providing essential services and building on security is finding employment for the populace. After civil war or conflict, unemployment rates are usually very high, and as stated previously, high unemployment leads to instability as unemployed young males are quite susceptible to recruitment by an insurgency or are otherwise forced to turn to illegal and violent activities to provide for themselves and their families. In Iraq the workforce experienced great economic hardship, with the unemployment rate exceeding 50 percent after the war.<sup>7</sup> There is no doubt that these harsh conditions directly contributed to insurgent support and greater instability, which in turn slowed economic progress. There are three tools available to support short-term employment and restoration of essential services: the Commander’s Emergency Response Program (CERP), Provincial Reconstruction Teams (PRTs), and the formal contracting apparatus. CERP provides commanders in the field with a tool to rapidly execute small projects, which expedites local small scale humanitarian efforts and supports stabilization, builds rapport with the local populace, helps earn trust and confidence, and enhances the legitimacy of U.S. and coalition forces and the host nation.<sup>8</sup> Similarly, the widely publicized PRTs provide integrated teams of professionals to execute short- to mid-term projects to restore services, rebuild infrastructure, and employ the local populace. The idea is to create small teams comprised of military and civilian agencies that can provide security while conducting quick-impact projects that win the hearts and minds of the local people.<sup>9</sup> Finally, awarding government reconstruction and services contracts to local firms is also an effective way to employ locals and stimulate the economy. In Iraq, the Joint Contracting Command-Iraq/Afghanistan (JCC-I/A) established the “Iraq First” program which mandates that DoD contracts go to Iraqi businesses whenever possible.<sup>10</sup> In one 18-month period, some 3,900 Iraqi businesses received U.S. contracts at a *monthly* value of over \$100 million. These contracts ranged from construction, to material goods

production, to professional services across a variety of sectors. More importantly, this direct economic stimulus generated more than 100,000 Iraqi jobs.<sup>11</sup> Other methods to increase employment include cash-for-work programs, transitional assistance to farmers and micro-entrepreneurs, and vocational training programs.

Next in the economic rebuilding process are long-term initiatives such as establishing the rule of law, implementing a sound financial system, stimulating public and private investment, energizing industrial operations, rebuilding infrastructure, promoting entrepreneurs, developing human capital, rebuilding social institutions, and instituting sound trade and tax policies. But the phrase “long-term” is a bit of a misnomer because most of these initiatives need to begin as soon as possible and in small ways are initiated in the near- and mid-term. They are drivers or enablers of economic activity, and without them the economy will not flourish. Paul Collier, an Oxford University economist and leading expert on African economies, argues that external peacekeepers and economic growth have proven to be more critical than political reform in preventing a return to conflict.<sup>12</sup> Of these initiatives, establishing sound rule of law is probably the most critical and the most challenging. Moreover, the rule of law is not only essential to reviving an economy it is essential to reestablishing the legitimacy of the government and providing for the stability and security of the state. Therefore, reestablishing the rule of law should begin immediately in any nation-building effort.

The rule of law includes criminal law with an inherent criminal justice system, public law with accountability and transparency, and economic law to include property, contracts, and torts. Law must be supported by a competent police force with investigative and enforcement capability, an independent judicial system to adjudicate disputes and criminal and civil cases, and a penitentiary system. In regards to economic law, conditions are not likely to improve unless the legal building blocks for private economic activity are in place.<sup>13</sup> One important lesson in establishing the rule of law is to balance the existing law and customs/culture with a more modern and global legal framework. It requires good judgment and knowledge of various legal systems along with the local culture in order to select what to retain and what to discard in reestablishing a viable legal system that is locally accepted and provides for international economic integration.

Concurrent with reestablishing the rule of law is the imperative to establish a viable public and private financial banking sector. Viable financial services support not only private development but daily life and economic activity. One common approach to establishing financial services is the establishment or revitalization of a central bank. In Iraq, the Coalition Provisional Authority revived the insolvent Central Bank of Iraq and gave it authority similar to the U.S. Federal Reserve.<sup>14</sup> Steps should also be taken to establish and encourage private banking. For example, the expansion and growth of “electronic funds transfer (EFT)-capable private financial institutions are critical to stimulating sustained economic growth and moving from a cash-based society to a modern economy.”<sup>15</sup> In concert with establishing financial and banking systems, it is important to have a stable currency and a low rate of inflation. Many failing states make the mistake of printing money to finance war or fund peacetime reconstruction efforts, and the subsequent out of control inflation leads to the collapse of the economy and chaos. To stabilize the currency and curtail inflation requires the will to exercise fiscal control and sound monetary policy.

Related to financial services is the need for robust private and public investment to grow a struggling economy. Most failed states have limited resources for public investment, but those few that do should make funding available to private firms and individuals. One commonly-used approach is micro-loans. Micro-loans are just that, small dollar loans to individuals and small enterprises to encourage economic activity and business growth. This tool can build an economy from the ground up. In addition to public funding, steps to encourage private investment are also very beneficial. Of course, security and the rule of law are key to private investment and business growth, but post-conflict countries also need to focus on pragmatic, short-term actions to reduce obstacles to competition. These include reducing the costs and time required to register a business, removing or simplifying licensing requirements, removing export or import restrictions to allow more players in the market, and reducing the burden of regulations wherever possible.

Another important step for the revitalization of the economy and for encouraging entrepreneurial activity is to privatize public enterprises. Much caution should be given to privatization early in the nation-building process; otherwise the rich and corrupt may benefit to the detriment of the poor. In Iraq, the Ministry of Industry and Minerals issued a public solicitation to privatize 13 large state-owned factories, and on January 10, 2008, the Government of Iraq announced the first award of joint ventures to three Iraqi-European financial consortiums.<sup>16</sup> It is anticipated that 15,000 jobs will be created under the terms of these transactions. In addition to privatization and investment, it is also critical to restore idled industrial capacity in formerly industrialized states. Industrial activity feeds upon itself and restarting idle factories and industrial centers can jumpstart an economy and employ hundreds of thousands. Doing so requires an infusion of public and private funds and an environment conducive to trade. Grants are a useful tool in giving idle factories and centers the financial resources to restart operations.

One of the most expensive and time-consuming challenges to restoring an economy is building and repairing critical infrastructure. This includes but is not limited to roads, bridges, electrical capacity (both production and distribution), sanitation, water, and irrigation systems, communication networks, ports, airports, hospitals, clinics, schools, and everything else in between. The difficulty lies in funding and prioritizing the many infrastructure needs of failed states—in balancing overwhelming short-term demands with sensible long-term development. One approach is to look at which elements are the key enablers that will open economic growth and foster state stability to meet short-term needs while building for the future. In Iraq, for instance, due to poor communication infrastructure, it was decided to build a fiber optic communication backbone and network. This network was not only instrumental in meeting the need for immediate public communication, but it also aided the fledgling financial and banking institutions as well as other private sector business development.<sup>17</sup> Of course, the status and needs of infrastructure are different in each state, and each requires independent and careful analysis. Building or repairing roads is often the critically important construction priority in states that depend on the transportation of agricultural products for economic viability, but they can be built with an eye to future economic expansion. In a similar manner, electrical capacity is essential to both the well-being of the populace and economic activity in modernizing states and can be developed with both in mind. Trade-offs and tough



prioritization decisions are inevitable, but comprehensive analysis can create innovative synergies.

Sound economic and trade policies and institutions are important for long-term economic growth and must be encouraged. These include laws that favor industry, appropriate tariff and tax regulations, and honest as well as strong border control to regulate trade. In addition, states benefit enormously from fiscal discipline and sound monetary policy. In Iraq, since 2003, all tariffs on inbound goods have been suspended, essentially making Iraq a completely free open market for all international goods so as to encourage trade.<sup>18</sup>

Another difficult to grasp but essential element for economic prosperity is social capital. Social capital includes trust, public spirit, community participation and volunteerism, a sense of well-being, and optimism. Such elements serve as the grease in the machine of economic activity as well as the lubricant of a smoothly functional society. Ways to build social capital include establishing security and the rule of law, satisfactory delivery of basic public services, transparency in governance, and use of voluntary organizations.<sup>19</sup>

Last, but not least in rebuilding a nation and its economy, is improving human capital. This includes rebuilding educational and health care systems. Human capital is the most vital aspect of building long-term economic growth, and a vibrant educational system is the cornerstone of building human capital. Educational needs run the gamut from primary education and literacy, to trade and farming skills, to higher level and professional education. Education and health care lead to a quality workforce, a competitive economy, and a viable society in a globalized world order.

In the 21st century, nation-building is an essential strategic competency for the U.S. Government. The DoD is an instrumental player because of its role in security and its inherent capabilities. Revitalizing the economy is probably the most important element in rebuilding a failed state. The cornerstones of economic viability, as well as state stability, are security and the rule of law. Short-term priorities for rebuilding an economy include providing security and humanitarian relief, restoring essential services, and providing employment. In the mid- and long term, priorities include establishing the rule of law, implementing a sound financial system, stimulating public and private investment, energizing industrial operations, rebuilding infrastructure, promoting entrepreneurs, developing human capital, rebuilding social institutions and social capital, and implementing sound economic policies. Of course, every nation-building effort is different, and there is no template that can be universally applied. Each situation requires comprehensive analysis and sound judgment that focuses on the basics, establishes priorities, and makes informed trade-offs between short- and long-term objectives. The U.S. military must be prepared to participate in the essential economic and reconstruction activities on the ground and in the planning and strategy processes.

## ENDNOTES - CHAPTER 7

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