

The Economic Instrument of National Power and Military Operations: A FOCUS ON IRAQ

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Those who can win a war well can rarely make good peace.

—Sir Winston Churchill

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PHOTO: The \$1 billion NASDAK mall (800 shops) and office (400 units) complex in Erbil, Iraq, exemplifies the Iraqi Kurdistan Region's rapid development, fall 2006. (www.exporth.gov/iraq)

WITH ONE EXCEPTION—the post-World War II Marshall Plan for the reconstruction of Germany and Japan—Winston Churchill's statement was prophetic in describing American post-war experiences. It has proven particularly true of the current war with Iraq.

In its pursuit of national objectives, the U.S. uses diplomatic, informational, military, and economic (DIME) instruments of national power to influence other nations. The diplomacy component involves negotiating with other nations to settle differences. It is the job of statesmen, and it is most successful when supported by the other instruments of power. The information component comprises strategic communication, public diplomacy, and the collection, analysis, and dissemination of information about potential adversaries. The military component involves military activities ranging from peacekeeping, humanitarian assistance, and nation-building to large-scale combat operations. The economic component encompasses financial activities that run the gamut from providing foreign aid and market access to imposing trade sanctions.

In the past, when diplomacy and informational campaigns have failed to resolve a conflict, the U.S. has responded by imposing economic sanctions, and when these have failed, it has resorted to military options. Especially recently, the use of the military component of national power has been the subject of much discussion. Relatively little has been said, however, about how we have employed our economic power. This discussion is long overdue, for in our estimation, the economic arm has been ineffectively and even counterproductively employed in recent conflicts. Miscalculations or mistakes in its use have contributed greatly to the U.S.'s inability to terminate wars with a workable peace.

First, economic moves—usually sanctions—rarely, if ever, work as intended. They do not lead to concessions by the targeted government, and they do not stimulate citizens to seek their government's overthrow. In fact, sanctions usually cause the parties in conflict to harden their positions, and, by adding to the misery already imposed on people whose government the U.S. is attempting to influence, they portray the U.S. in a bad light. Both negative results have been evident in the cases of North Korea, Cuba, and post-Desert Storm Iraq.

Second, with the U.S. increasingly using the economic component coercively as a key part of its security strategy, it must begin to fund economic programs (e.g., foreign aid) much more robustly than it does at present. The economic objectives of our national security strategy and the funding needed to realize them must be more closely aligned.

Third, a nation considering war needs to make an honest, objective effort to assess how much the war and ensuing operations will cost. Politicians have historically lowballed war-cost estimates, even grossly, a tendency that stifles real preparation and invites eventual disillusionment. Neither of these augur well for a successful outcome. Additionally, as it assesses possible costs, a would-be combatant must be sure to take the effects of its pre-conflict economic moves, especially sanctions, into account. In particular, it must fully consider the implications such interventions will have for stability and reconstruction operations (SRO) should war (and victory) ensue. When sanctions precede war, nation-building can become a vastly more expensive and protracted proposition than it might have otherwise been.

Fourth, given the tremendous costs of SRO in the wake of sanctions and war, leaders should assume that they will need the financial assistance of international economic institutions and other nations. They need to lay the groundwork necessary to garner this assistance. The U.S. conspicuously did not do this prior to invading Iraq.

And fifth, only rarely has the U.S. employed all its components of national power in a synchronized, synergistic way when trying to influence other nations. Consequently, its actions have created voids that the military must fill.

Simply put, Washington must rethink how to best utilize the economic instrument of power in the contemporary global environment. Should it not do so, it risks eroding public and institutional support for America worldwide while creating domestic and international economic turmoil and exhausting the military.

Historical Perspective: The Last 60 Years

Since World II, America has frequently intervened in other nations' affairs to support its national-security interests. In places such as Korea, Cuba, and South Vietnam, the U.S. intervened to defuse regional conflicts and protect democracy. In other places—Somalia and Haiti come to mind—the U.S. participated in humanitarian operations by sending military forces and providing foreign aid to stabilize a struggling nation. In none of these interventions did the U.S. anticipate the economic implications of either the initial operation or of follow-on stabilization and reconstruction.

Korea. To prevent the spread of communism, the U.S. and its coalition partners fought the Chinese-backed Communist North Koreans to a stalemate in the early 1950s, which resulted in a cease-fire and multinational, multilateral sanctions against North Korea. The cease-fire has lasted for over 54 years, but the sanctions, a U.S. defense buildup, and military posturing by North Korea, South Korea, and the U.S. to prevent possible acts of war have cost all parties billions of dollars. This political and ideological war continues today, only now it is underlined by the nuclear weapons threat North Korea poses. When the North Korean Government eventually collapses, as many observers say it must, it will cost billions of dollars to establish a new functioning government and economy or to integrate North Korea into South Korea.

Cuba. For the past 45 years, the U.S. has imposed multilateral sanctions on Cuba in an effort to oust Fidel Castro and bring democracy to the nation. The effects of this ideological war have left Cuba marooned in the 1950s. Like Korea, it will cost billions to restructure a post-Castro Cuba as a democratic state with a vital, free-market economy—assuming that that is even possible.

South Vietnam. During the 1960s and 1970s, the U.S. military sent hundreds of thousands of its members to the Republic of South Vietnam to stop the spread of communism and preserve a democracy. The unpopular war helped create a large U.S. deficit and high inflation. As a result, nations that used the U.S. dollar as their currency reserve grew so apprehensive that the U.S. had to abandon the gold standard to circumvent a run on the dollar. By the end of the war, the U.S. had approximately 17 cents in gold reserves for every dollar in circulation.¹

Somalia. Secretary of State Condoleezza Rice has said, “When Americans begin a noble cause, we finish it.” Recent history, however, does not bear out her assertion.² The U.S. met with little success in Somalia during Operation Restore Hope, a mission meant to relieve famine and stabilize the country. U.S. forces withdrew without stabilizing the country, and Somalia is still embroiled in a conflict that pits clan against clan; Christian Ethiopians against Muslim Eritreans and radical Muslims; and Christians against radical Muslims with links to Al-Qaeda, Iran, and Syria. In many ways, the situation in Somalia and the Horn of Africa is worse than it was during the early 1990s.

Haiti. The U.S. has provided foreign aid and sent military forces to participate in humanitarian relief and stability operations in Haiti many times over the last 91 years, but it has never committed to Haiti's long-term economic and political stability. A 2003 Rand Corporation study concluded that U.S. aid to Haiti in the 1990s fell significantly short of making any meaningful difference.³ Haiti is now the poorest country in the Western Hemisphere, with an unemployment rate of 50 percent. According to the United Nations, 56 percent of Haitians are malnourished, 80 percent live below the poverty line (on less than \$2 a day), and 60 percent live in abject poverty. The annual inflation rate is over 20 percent in an economy that is shrinking at about 2 percent a year.⁴ Historically, much of the aid that nations and institutions pledge to Haiti never arrives because of concerns over political instability, crime, and corruption. This Catch-22 has had a devastating effect on the island nation.

After years of heated debate and failed legislation, the U.S. Congress finally passed several meaningful bills to promote economic growth within Haiti and Haitian trade with the U.S. The recently passed Haitian Hemispheric Opportunity Act, for example, allows particular items of Haitian apparel to enter the U.S. duty-free, even if the materials used to make the garments originated in a third country.⁵ Some believe the act will help revive the Haitian textile industry, create jobs and tax revenues to get government services functioning again, and help curb crime. Others worry, though, that trade legislation with Haiti will mean the loss of U.S. jobs. This concern is somewhat of an embarrassment when we compare the booming \$13 trillion U.S. economy with Haiti's dwindling \$4.3 billion economy.⁶ Furthermore, the U.S. Agency for International Development (USAID) says that for every dollar leaving the U.S. for Haiti, \$1.34 would return through trade.⁷

Since the end of the cold war, U.S. security strategy has increasingly emphasized foreign aid to fund humanitarian assistance and maintain or restore peace in failing nations. Nevertheless, the U.S. has most often responded to such problems with military force and limited State Department assistance—in effect, by applying short-term solutions to long-term geopolitical, cultural, and macroeconomic problems. It is evident that to increase global development and help stabilize weak, underdeveloped

countries, the U.S. must make more and better use of the economic instrument of power, and it must do so in conjunction with the other DIME components. The most urgent need is in Iraq, where economic assistance is clearly inadequate.

Goals for Foreign Aid

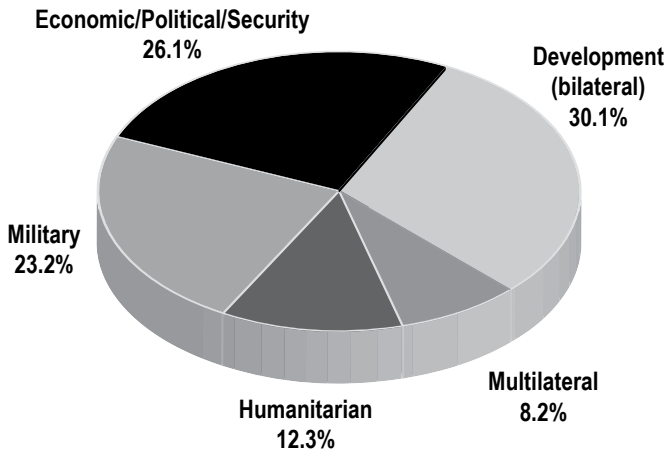
The 2002 National Security Strategy (NSS) cited global development as one of its three primary objectives, or pillars, the others being defense and diplomacy. In support of these strategic pillars, the U.S. embraced the foreign-aid goals of economic growth, agriculture and trade, global health and democracy, conflict prevention, and humanitarian assistance.⁸

More recently, in line with the NSS, a USAID white paper on American foreign aid identified five core operational goals of U.S. foreign assistance:

- Promote transformational development, especially in the areas of governance, institutional capacity, and economic restructuring.
- Strengthen fragile states.
- Provide humanitarian assistance.
- Support U.S. geostrategic interests, particularly in such countries as Iraq, Afghanistan, Pakistan, Jordan, Egypt, and Israel.
- Mitigate global and international ills, including HIV/AIDS.⁹

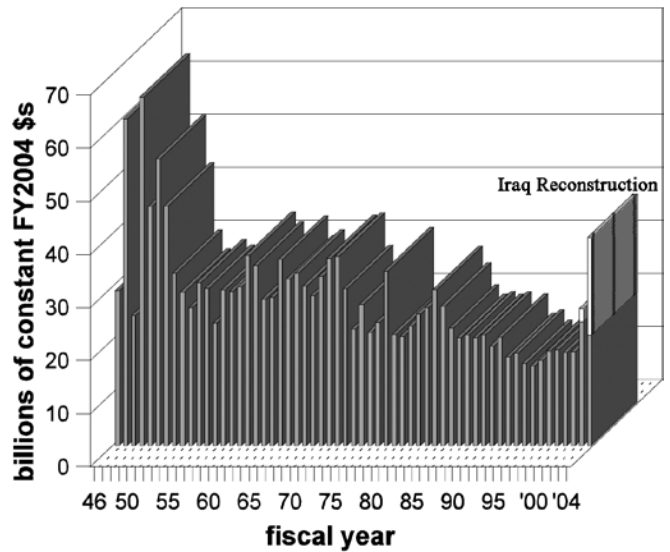
Despite the priority the NSS has assigned to foreign aid, the money for such aid has not been forthcoming. Figures 1 and 2 show the type and percent of foreign aid given for FY 2004 and the total annual U.S. foreign-aid contributions from 1946 to 2004. The figures include Iraq reconstruction costs, an amount that nearly equals all other foreign aid combined for FY 2004.¹⁰

Figure 3 depicts foreign aid as a percentage of the U.S. gross domestic product (GDP). Prior to the mid-1960s, foreign aid represented over 1 percent of the GDP (except during the Marshall Plan period, when it exceeded 2 percent).¹¹ Following the end of the Vietnam War, and for 20 years thereafter, foreign assistance as a percentage of the GDP ranged between 0.5 percent and 0.25 percent. This dropped to 0.16 percent, its lowest level ever, in fiscal years 1997, 1998, 2001, and 2002. Funds to support Iraq's reconstruction aside, U.S. foreign-aid expenditures continue to shrink as a part of GDP, which seems inconsistent considering the increased importance the 2002 NSS placed on global economic development.¹²



Sources: House and Senate Appropriations Committees and CRS calculations.

Figure 1. Aid program composition—FY 2004.



Sources: USAID, OMB, and CRS calculations.

Figure 2. U.S. Foreign Aid, FY 1946 to FY 2004.

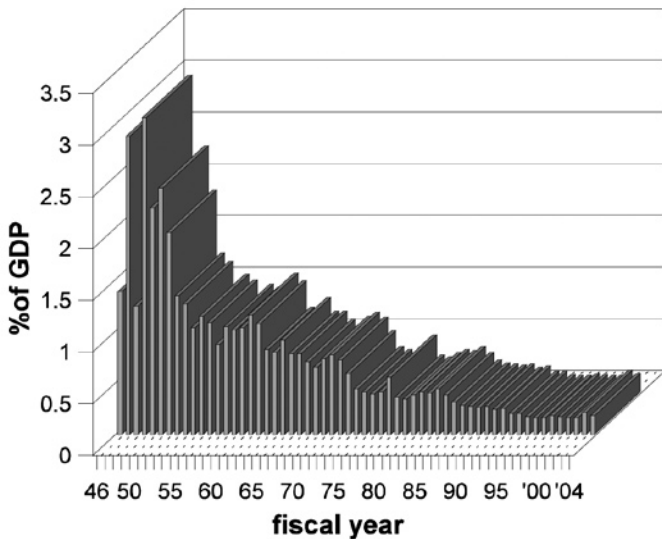
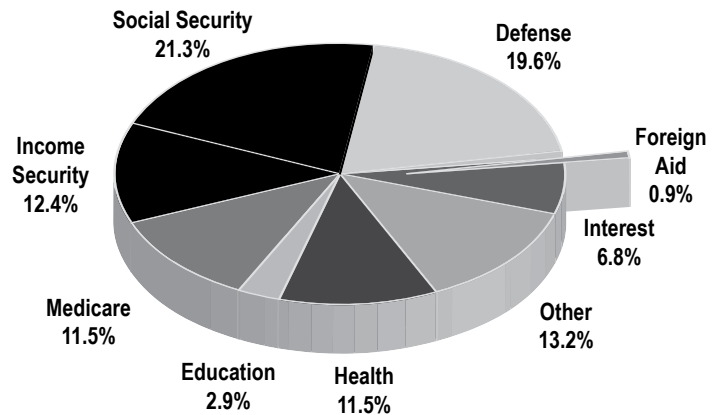


Figure 3. Foreign aid as a percent of GDP.



Sources: OMB

Figure 4. U.S. budget outlays, FY 2004.

Figure 4 shows U.S. budget outlays for FY 2004 by service area. Note that foreign aid consumes only 0.9 percent.¹³

The Economics of War

President Abraham Lincoln’s secretary of the treasury estimated that the direct cost of the Civil War to the North would be \$240 million, which was approximately 7 percent of the region’s annual GDP.¹⁴ Actual costs were some \$3.2 billion—13 times the original estimate. The U.S. grossly underestimated the cost of the Vietnam War as well. It anticipated the war lasting less than a year at a cost of approximately \$10 billion, but it went on for the better part of a decade and cost almost \$550

billion dollars (adjusted for inflation). In January 2003, U.S. Secretary of Defense Donald Rumsfeld predicted that the war with Iraq would cost “a number that’s something under \$50 billion.”¹⁵ The only other public estimate came from the Bush administration’s economist-in-residence, Larry Lindsey, who said the war would cost from \$100 to \$200 billion.¹⁶ Even the worst-case estimates by the Democratic staff of the House Budget Committee and the Congressional Budget Office (CBO) had the war and subsequent U.S. presence lasting less than a year at a cost between \$48 and \$60 billion.¹⁷

Aside from a CBO estimate that occupation forces would cost from \$1 to \$4 billion per month, initial official estimates failed to even consider the

IRAQ CIRCA 1999

With an estimated per capita income of \$237 [a year], Iraq, once one of the most developed countries in the Middle East, is now poorer than many countries in sub-Saharan Africa...Iraq's recurring annual budget needs for health, food and essential services, is \$12 to 15 billion. With the oil-for-food programs Iraq gets barely \$4 billion....With a total GDP of \$5.7 billion, Iraq's economy is worth about the same as four B-1 bombers. It is worth about half of Bill Gates' [net worth]....The entire Iraqi economy amounts to just two percent of the annual U.S. defense budget....

—Ali Abunimah²²

costs of a protracted war and postwar stability and reconstruction (e.g., occupation, peacekeeping, democratization, nation-building, post-occupation humanitarian assistance, and subsequent counterterrorism activities). Furthermore, they did not consider the federal budget's macroeconomic implications for the U.S. economy or the costs of persuading other nations to support the U.S. A 2002 study by Yale's William D. Nordhaus, which did include postwar costs for an extended U.S. occupation, reconstruction, and nation-building, projected the cost of the Iraq war (2002-2012) at \$1.6 trillion.¹⁸

Iraq's Economy: Prewar 2003

In the best situation, it is a monumental task to convert a state-owned economy into a privatized, healthy economy. Attempting to do so in a nation weakened by years of war and international economic sanctions, and without first fully understanding the economic and sectarian situation of that nation, would be folly—yet that is what the U.S. tried to do in Iraq.¹⁹

Because of the sanctions, the international community and international financial institutions were largely absent from Iraq. As a result, little reliable data existed with which to gauge the state of Iraq's economy prior to Saddam Hussein's removal. Consequently, the U.S. greatly underestimated the seriousness of the economic situation. Furthermore, the U.S. did not plan adequately to provide security, restore power and infrastructure, supply water, and

help create jobs—and the interagency community was ill-equipped and under-funded to do what was needed.²⁰ Had the planners considered Iraq's recent history, they might have been better prepared.

When Saddam Hussein seized power in 1979, Iraq's per capita GDP was at around \$9,000 a year (in 2002-2003 dollars). Since then, Iraq's economy has declined catastrophically. Iraq has accrued massive international debt and suffered chronic inflation, a staggering drop in its GDP, a drastic currency devaluation, and the loss of foreign investment. By 2003, its per capita GDP had plunged to around \$1,000.

The Iran-Iraq war in the 1980s destroyed a large part of Iraq's capital stock, reduced oil production and exports, and depleted the country's foreign assets and foreign-exchange reserves. Then the first Persian Gulf War destroyed about \$230 billion of Iraqi infrastructure. The multilateral sanctions that ensued from the war were the most severe ever collectively imposed on a nation.

As of 2003, Iraq owed international lenders about \$120 billion, including billions of U.S. dollars in Gulf War reparations claims. For example, the U.N. Compensation Commission, which oversees the payment of reparations, awarded \$21.5 billion in compensation to oil companies that lost profits and equipment during the Gulf War. Reparation claims consumed 5 percent of oil revenues under a payment plan devised through U.N. Security Council resolutions, but the UN's oil-for-food program did not permit imports of equipment vital to the oil sector until 1998. All told, war, sanctions, and reparations have cost Iraq the equivalent of 20 years of GDP in lost output, capital, and financial resources.²¹

Postwar Economic Realization and Internal Instability

A 2003 joint UN and World Bank report estimated that Iraq's key reconstruction needs through 2007 would cost \$55 billion. It also revealed that—

- Iraq had accumulated more foreign debt as a share of GDP than any other country, with roughly \$120 billion in debt owed to foreign governments and corporations.
- Banking was dysfunctional, with no credit facilities or effective payment systems.
- The agriculture sector was not a dependable source of food and income. The government imported

food rations and distributed them freely to all citizens, sapping the sector of its ability to compete.

- When sanctions were imposed on Iraq after the Gulf War, Iraq became a closed economy characterized by inefficient state-owned enterprises with no incentive to raise productivity.

- Only 5.5 million of Iraq's 25 million people had access to a safe, stable water supply, and Iraq's cities suffered from inadequate sewage systems.

- Iraq averaged 4,300 megawatts of peak electricity generation, enough to supply Baghdad with 12 to 24 hours of power a day, but only by diverting power from the rest of Iraq, which received 4 to 12 hours of power a day.

- Only select senior members of the Ba'ath Party had access to satellite television, cell phones, or the Internet.²⁴

Pledged support. At the 2003 International Donors' Conference for Iraq, 73 countries and 20 international organizations pledged a total of \$32 billion in aid for reconstruction, most of it courtesy of an \$18.6 billion U.S. pledge (increased to \$20.9 billion in 2005) to the Iraq Relief and Reconstruction Fund. The World Bank and the International Monetary Fund (IMF) pledged \$5.55 billion and 37 nations and organizations together pledged over \$8 billion. After the U.S., the largest pledges were made by Japan, the United Kingdom, the European Commission, and Canada. Vested and seized assets of the former regime, \$2.65 billion in all, also were earmarked for reconstruction.²⁵

Although these sums seem significant, the actual money has been slow to appear. Ongoing security problems that have given donors second thoughts, the need to get pledge money approved by political bodies, the fact that money pledged is typically spaced out over years anyway—all of these have undercut the positive effect donor money might have had on Iraq's reconstruction.

Debt. Seventeen of 18 Paris Club creditors have signed bilateral agreements to forgive 80 percent of Iraq's sovereign debt. They arranged debt-relief deals with commercial and other creditors for \$19.7 billion.²⁶ At the same time, though, Iraq has had to pay reparations (more than \$20 billion as of May 2006) for its Saddam-era depredations. The high cost of these penalties has strained Iraq's limited resources and handicapped attempts to rebuild the oil infrastructure, its main bill-payer.

Iraq is a country torn by profound ideological, religious and ethnic conflicts. Before democratization can even begin, the U.S. would have to assemble a power-sharing agreement among ethnic Kurds, Shiites, and Sunni Muslims... Washington would have to provide the political and, most importantly, military and security infrastructure necessary for holding a new government together. In short, the U.S. would have to become engaged in nation building on a scale that would dwarf any other such effort since the reconstruction of Germany and Japan after World War II. And it would have to stay engaged not just years, but decades, given the depth of change required to make Iraq into a democracy.

—Marina Ottaway, et al., 2002²³

Employment. Since 2003, economic changes instituted by the Coalition Provisional Authority (CPA), which were based on the neoliberal model that emphasizes privatizing government entities and cutting social spending, have neither increased domestic production or employment nor improved living standards.²⁷ Unemployment and underemployment remain at about 50 percent, comparable to figures noted before the Iraq war.²⁸ Iraq's structural economic problems have not eased, either. Except for trade and construction, industrial and agricultural activities are stagnant and private entrepreneurial initiatives are lacking.²⁹

Reconstruction. Economic reconstruction in post-conflict settings depends on security and law and order and can involve such factors as—

- Establishing a market-based financial system.
- Developing a legal and regulatory framework.
- Setting up functioning government institutions.
- Privatizing state-owned enterprises in phases.
- Rebuilding critical sectors of the economy.
- Creating jobs.
- Phasing out government subsidies in an orderly way.
- Normalizing relations with the outside world.
- Providing basic services such as health care, education, power, and water.³⁰

Prominent economists criticized U.S. goals for Iraq as too radical and warned of problems along the lines of those experienced in Eastern Europe and the former Soviet Union, which underwent the “shock therapy” of privatization and institutional reconstruction in the 1990s. Even so, the CPA stuck to its plans to rapidly privatize Iraq’s state-owned businesses and to open Iraq to foreign ownership and investment. A lack of economic opportunities and a reluctance to modify Iraq’s long-standing oil and food subsidies (the latter caused by the realization that more than 60 percent of Iraq’s population relies on the government for food) have since forced the U.S. to put on hold plans to privatize Iraqi enterprises and end the subsidies, but not before the CPA’s avowed policies complicated U.S. efforts to win over Iraqi hearts and minds. In this sense, misuse of the economic arm contributed to the ongoing violence instead of stanching it.³¹

Security. Political and security problems caused by the insurgency and sectarian violence have deterred risk-averse foreign investors, nations, and institutions from pledging financial assistance to Iraq. The CPA anticipated that 10 percent of the \$18.6 billion the U.S. Congress originally appropriated for Iraq’s reconstruction would fund security costs—the actual amount was about 25 percent.³² In 2006, inflation began to rise quite rapidly. Now annual inflation stands at 77 percent, largely because the ongoing violence has caused shortages of certain goods (especially gasoline) and slowed the growth of the non-oil sector.³³ Hundreds of sabotage attacks on Iraq’s oil infrastructure have caused the loss of tens of millions of dollars in oil revenue. Security of the infrastructure is particularly important because 98 percent of Iraq’s revenue is derived from oil.³⁴

Thousands of other attacks occur monthly against the government (the military, police, and infrastructure), average citizens, commercial businesses, and foreign workers. The Central Bank of Iraq granted several foreign banks licenses to operate in Iraq in 2004, but not even one has opened its doors there.³⁵ Despite a series of U.S. Government-sponsored trade conferences meant to entice American companies into the Iraqi market, few have done so. Most firms appear to be holding out for a more stable security and political environment before making major investments.³⁶

Sharing Ownership

The United States, its allies, and the UN have not offered an economic reconstruction plan that could unify factions in Iraq or initiate the broad sharing of ownership and economic power that might lead to prosperity and stability. In light of the increased role and importance the NSS places on economic development, it’s curious that the U.S. went to war having given so little consideration to the economic challenges it would face. No one—at least no one in charge—estimated the tremendous damage and concomitant costs for SRO caused by pre-war sanctions. No one foresaw the sectarian-terrorist-insurgent violence that would undermine security and so greatly complicate the promotion of economic reconstruction. No one assumed that other countries and international financial institutions would not want to do business in such a violent climate.

The general lack of economic planning and situational awareness, coupled with the subsequent adaptation of a neoliberal approach to economic development, resulted in the displacement of government employees and workers of state-owned industries and businesses. This situation further fueled terrorist and insurgency activities and resentment toward the U.S. presence in Iraq, and it increased security needs well beyond what was anticipated. It will take years to recover from the mounting costs associated with ongoing operations in Iraq. The war has cost the United States billions of dollars, caused a whopping national debt, and prevented opportunities to help other nations with foreign aid.

The war in Iraq continues to claim America’s scarce resources and attention, distracting the Nation from fighting the War on Terrorism in other troubling areas. Moreover, legacy cold war concerns still have significant economic implications that aren’t being addressed because of Iraq’s claim on U.S. attention and resources. The war also threatens U.S. relations with allies and international economic institutions, particularly those that did not fully support going to war but are now called on to help with postwar SRO and to write off significant debt owed them by the Iraqi Government.

What can the U.S. do in the future when it contemplates using its military and economic instruments of power to intervene in what it perceives to be just causes throughout the world? First, before

committing its military and its foreign aid dollars, the U.S. should seek commitments from other nations to help resolve conflicts, so that others can share ownership of the cause. Additionally, the U.S. and its allies must realize that to stimulate economic activity, security is paramount. Until a region has law and order, pledges for economic development may be withheld and interagency teams, international institutions that can promote development (such as the UN, the World Bank, and the IMF), entrepreneurs, foreign and private enterprises, and multinational corporations will not show up.

Furthermore, the U.S., along with its allies and international economic institutions, should conduct an economic analysis before military forces or foreign aid are committed. Doing so will ensure that the U.S. knows what it is dealing with. In particular, analysts should seek answers to the following questions: What is the goal of intervention? What

should the end-state look like? Can the intervention succeed? How long will it take to succeed? What are the costs associated with success (political, financial, and social)? Will intervention be supported by the international community (other nations, nongovernmental organizations and institutions, commercial banks, multinational corporations, and so on)? Is the intervention a sound economic investment relative to other needs and options throughout the world?

Finally, the U.S. needs to increase its foreign aid budget significantly, so that it is in line with the NSS's ambitious objectives. Future sustained funding should approximate 1.5 percent of the GDP, which would go a long way toward improving Iraq's and Afghanistan's future, preparing the U.S. to support a post-Castro Cuba, and adequately funding initiatives to secure peace and economic prosperity for nations such as impoverished Haiti. **MR**

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