

# RESTORING HOPE

## Economic Revitalization in Iraq Moves Forward

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*Counterinsurgents achieve the most meaningful success by gaining popular support and legitimacy for the host government, not by killing insurgents. Security plays an important role in setting the stage for other progress, but lasting victory comes from a vibrant economy, political participation, and restored hope.*

— U.S. Army Field Manual 3-24, Counterinsurgency<sup>1</sup>

**O**NE OF THE CRITICAL FACTORS in the counterinsurgency strategy that is demonstrating early but measured progress in increasing security in Iraq is the alignment and rapid application of economic development as security improves.

As discussed in the first part of this series on revitalization of the Iraqi economy, “A Cause for Hope” (*Military Review*, July/August 2007), the challenges in leveraging and applying American economic expertise, investment, and other stimuli to uplift the Iraqi economy have been numerous, ranging from policy to strategy to tactics.

Prior to 1991, Iraq was the most industrialized of the Arab states with a significant base of industrial operations across a wide range of sectors, and a highly skilled civilian workforce. From 1991-2003, industry in Iraq was strictly focused on internal production to meet domestic demand—United Nations sanctions prevented export of goods or international economic engagement, although some factories remained relatively modern through investments in equipment upgrades.

Following the collapse of the regime in 2003, the Iraqi workforce experienced great economic hardship with unemployment and underemployment exceeding 50 percent.<sup>2</sup> These conditions directly contributed to insurgent sympathy and economically motivated violence. The Task Force for Business and Stability Operations in Iraq (TFBSO) was established in 2006 by Deputy Secretary of Defense Gordon England to address the revitalization of the industrial economy in Iraq. What follows is a status report on this revitalization effort and the ongoing transition of the Iraqi industrial economy to a free-market state that is integrated with global financial, supply, and trade infrastructures.

### TFBSO and the Overall Economic Mission in Iraq

Underlying every strategic objective of the task force is a core principle based on the size and scope of the U.S. presence in Iraq. For calendar year 2007, Iraq had a gross domestic product estimated at \$55 billion.<sup>3</sup> The

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PHOTO: Quality assurance technician at the State Company for Drugs and Medical Supplies in Ninawah, Iraq. (courtesy of the author)

U.S. Department of Defense (DOD) current cost of sustaining operations in Iraq is approximately \$10 billion per month.<sup>4</sup> Most of this cost is dedicated to sustaining the presence of our uniformed service members and civilian workforce, covering not only the direct cost of military operations, but also everything from housing to food to security at the local level.

Considering U.S. government spending as a market has underpinned the TFBSO's economic development strategy in Iraq. Careful application of this spending with an eye on local economic development, while ensuring our forces are sustained with the best possible materiel support, has fundamentally changed the way DOD considers economic reconstruction and has led to the development of new approaches to post-conflict stabilization.

Economic reconstruction in Iraq has required an interagency operational concept that leverages the collective strengths of the various U.S. government entities in Iraq. The general framework illustrated in figure 1 represents the interagency operating model that has emerged for Iraqi economic development.

While the boundaries for the model are not firmly fixed, this general structure has informed collaboration and cooperation among involved U.S. government entities. With this basic structure defined and agreed upon, the TFBSO further defined its areas of focus.

## Framework for an Industrial Economy

From its inception, the Task Force for Business and Stability Operations has operated with a broad set of focus areas, each with a dedicated team of U.S. government and business leaders engaging in all areas of the country, and has been tightly aligned to Multi-National Force-Iraq (MNF-I) and its subordinate commands. While much of the public understanding of the task force has focused on enabling and automating direct contracting with Iraqi businesses and restarting idled large state-owned enterprises shut down since 2003, these two primary focus areas led to expanded emphases on economic development for each critical tier of a modern industrial economy.

A modern industrial economy must possess the following key elements:

- A fiber-optic communications backbone with corresponding local wireless access capability to enable automated transaction processing as well as broad-based access to information via the Internet.
- A banking sector and financial system infrastructure capable of automated financial management, from large-scale bank-to-bank financial transactions to personal financial transactions.
- Active industrial operations across sectors identified as competitively advantageous for economic or strategic reasons.
- Small-business and private-sector entrepreneurial activity to drive future employment.



\* U.S. Military Commander's Emergency Response Program Funds are applied primarily at the local level, with some investment in industrial capacity.

Figure 1. Interagency engagement model.

- Private-sector investment processes to encourage inflows of private capital to further stimulate business growth.

These key elements are addressed by the TFBSO operating model in figure 2.

## Review of Task Force Focus Areas

The progress and current status of the key economic elements in Iraq present an optimistic picture for the way ahead.

**Communications infrastructure.** To successfully integrate Iraqi industry with the global economy, a cost-competitive core fiber-optic communication backbone with robust connections to wire-line and wireless infrastructure is critical. In partnership with the MNF-I Communications and Information Services Command, the Defense Information Services Agency (DISA), and the U.S. Embassy Baghdad advisor for telecommunications, the TFBSO launched several initiatives to stimulate the creation of such a network infrastructure.

To incentivize public- and private-sector companies to build up Iraq's fiber-optic communications infrastructure, DOD leveraged its bandwidth

consumption for non-secure traffic. As of 2007, all non-secure DOD communications were being transmitted over satellite—the most costly means of broadband communication. Due to the lack of necessary low-cost terrestrial network infrastructure, and in the absence of alternatives, costly satellite-based Internet and telecommunications access has become common in Iraq. In partnership with DISA, TFBSO is working to contract with public and private telecommunications firms in Iraq to purchase bandwidth—encouraging these firms to build out communications networks. As these terrestrial networks are built out, private-sector businesses (banking, industrial transactions) can transfer from satellite communications onto them.

**Communications infrastructure status.** The first step in this critical effort has been establishing fiber-optic network capacity from Baghdad through Basra to Kuwait City, beginning to link to the global Internet backbone. This project, launched in January 2007, continues, although there have been delays resulting from circuit-testing failures within this first link managed by Iraq Telecommunications and Post Company (ITPC), the Iraqi state-run telecom enterprise. As this first circuit becomes active, subsequent

links north through Mosul and west through Al Qaim will be pursued, with necessary spurs to key industrial centers, including Irbil, Sulymania, and Najaf.

While these efforts to motivate construction of core terrestrial networks continued, the Government of Iraq (GOI) executed private-sector auctions for Global System for Mobile (GSM) cellular communications licenses at the national level during the summer of 2007. These license auctions, originally expected to generate no more than \$400 million in total revenue for the GOI, were an astounding financial success for Iraq. Three licenses generated \$3.6 billion in revenue to

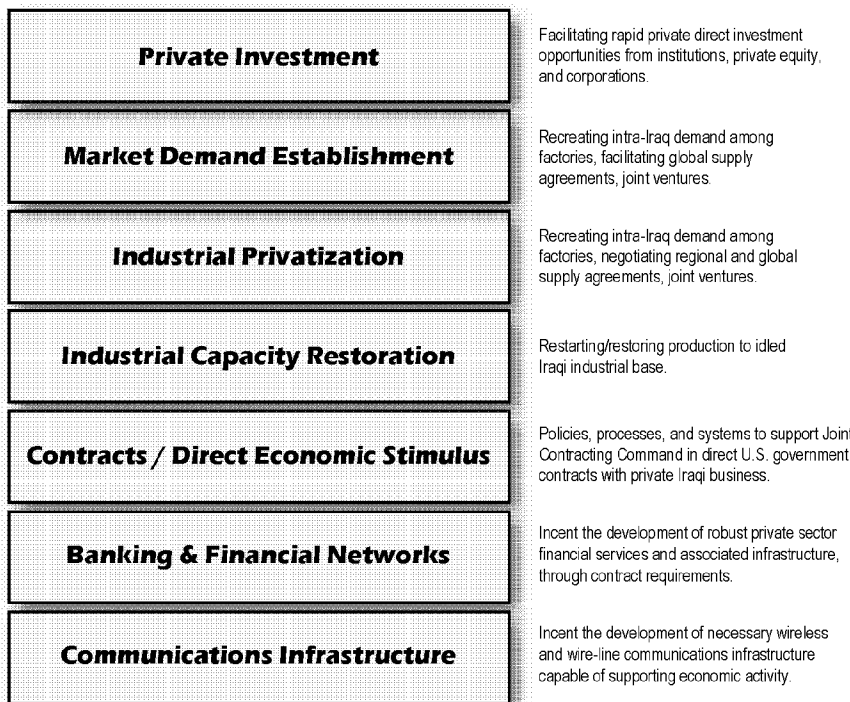


Figure 2. Task Force operating model.

the GOI from regional investors. These licenses have been awarded and network consolidation within Iraq is now underway. Modern mobile data services are being offered as a result of the investments in new infrastructure, and cell phone penetration in Iraq has increased by 50 percent since the summer of 2007, with over 12 million subscribers now active.

**Direct economic stimulus through contracting.** In support of the Joint Contracting Command Iraq/Afghanistan (JCC I/A) commander, Major General Darryl Scott, U.S. Air Force, the task force coordinated changes to policy unifying operational control of contracting in the Iraq area of operations under JCC I/A. Changes included fielding a system to automate contracting transactions in a way that was useful to Iraqi businesses as well as to the command resources working to ensure Iraqi firms were given access to DOD contracts. This new information system, the Joint Contingency Contracting System, was fielded in September 2006 and now operates with over 1,000 active users across the DOD contracting community in Iraq and Afghanistan. It provides a central database for Iraqi and Afghan companies, their capabilities, awards to date, and contract performance.

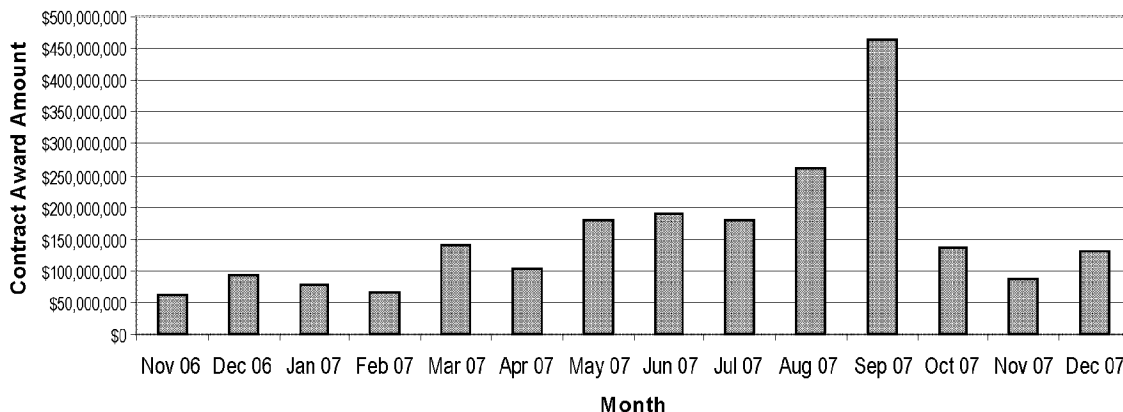
**Direct economic stimulus through contracting status.** The JCC I/A's "Iraqi First" program (which mandates that DOD contracts go to Iraqi businesses whenever possible) has been extremely effective. In the past 18 months, over 3,900 private Iraqi businesses have registered and received U.S. contracts at a monthly value in excess of \$100 million. These contracts range from construction to material goods to professional services across a variety of sectors.

This direct economic stimulus has generated more than 100,000 Iraqi jobs across the country. Figure 3 provides a graphic representation of the contract dollars awarded since the Iraqi First program was conceived and launched in the fall of 2006.

**Financial infrastructure and private banking.** A key issue in the development of a modern economy in Iraq has been the absence of a well-regulated, modern banking sector. Prior to 2003, Iraqi banking was dominated by a few large state-owned financial institutions that were closed to international financial flows due to United Nations sanctions. Despite negotiations since 2003 over debt settlements with creditor nations, these large state-owned banks are still not modernized because automating and linking them to global financial networks would enable their assets to be seized by creditor nations.

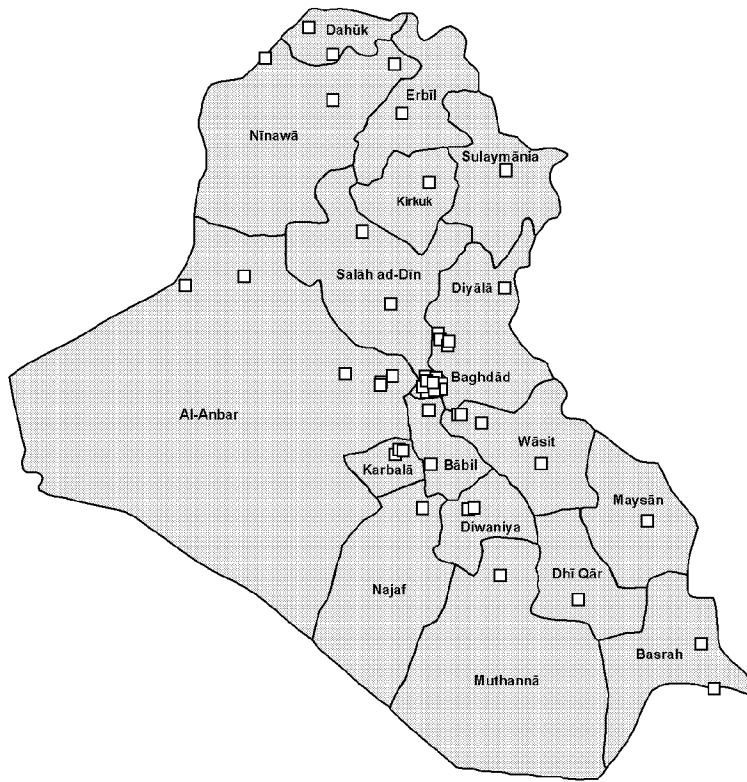
Over the past several years, however, a significant number of private bank branch offices have opened in Iraq, many with links to global financial networks via rooftop satellite access that enable electronic funds transfers (EFTs) (figure 4). The expansion and growth of these EFT-capable private financial institutions is critical to stimulating sustained economic development and to moving Iraq from a cash-based society to a modern economy.

**Financial infrastructure and private banking status.** Working in close partnership with the U.S. Department of the Treasury and JCC I/A, the TFBSO launched an effort in the fall of 2007 to stimulate and develop the private banking sector in Iraq. The effort includes building a consortium of Iraqi private banks. One of the consortium's



NOTE: Peak in September and subsequent drop in October and November aligns to fiscal year-end spending pattern for contract awards.

Figure 3. Host-nation contracting impact.

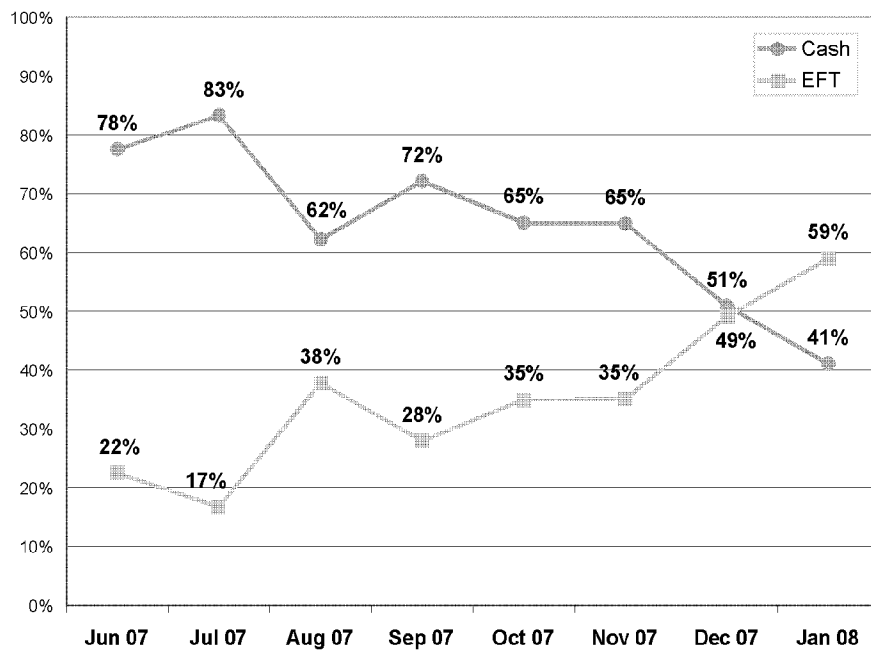


**Figure 4. Geographic distribution of private bank branches with EFT capability.**

objectives is to establish a core shared private financial infrastructure to efficiently process payment and financial-transfer transactions. The operating model for this shared service was defined and agreed to by the private banking consortium in January 2008. A key next objective is the establishment of a transaction regulatory body, the Iraqi Payments Association, accountable to the Central Bank of Iraq for oversight. The establishment of this body is planned for the summer of 2008.

To directly stimulate the rapid capitalization and expansion of private banking, and also to stimulate the migration away from a strictly cash-based economy toward EFT and management, steps were taken to again leverage DOD spending as a market incentive. Under policy that took effect in November 2007, and as a next step in the Iraqi First program, businesses in Iraq receiving new U.S. contracts are required to open accounts with one of the EFT-enabled private banks, from which they will receive all payment from DOD. The impact of this requirement has been immediate and measurable, as shown in figure 5.

As the graph indicates, by January 2008, almost 60 percent of payments to Iraqi firms were being executed electronically instead of via cash disbursement. The benefits of this transition include reduced payment cost and improved efficiency for DOD, the migration of over 3,000 private Iraqi enterprises to modern banking practices,



**Figure 5. EFT adoption rate.**

and the elimination of cash-based payment and its attendant risks of corruption and violent theft. Over \$100 million a month in DOD contracting actions are eligible for payment electronically. This flow of cash through private banks will improve their capitalization, enabling these critical financial institutions to begin their own private investment practices at the local level, further stimulating economic growth.

**Industrial revitalization.** As described in depth in “A Cause for Hope,” a primary area of emphasis for TFBSO was the restart of Iraq’s industrial base, largely idled or operating at a small percentage of capacity since 2003. Fielding a team of experienced business leaders, accountants, and consultants, TFBSO assessed major industrial sites across the country, as indicated in figure 6.

The restart effort struggled initially, in the absence of any appropriated funds for small capital investments in spare parts, training, or other requirements necessary to enable production in factories that had been idle for years. Between November 2006 and September 2007, 17 factories covering a variety of industrial sectors were restarted in Iraq. These operations were restarted by the direct application of demand via U.S. or Iraqi government contracts for goods or services, or through direct links to sources of demand inside Iraq. The infusion of \$50 million appropriated by Congress during the summer of 2007 accelerated the industrial revitalization effort significantly—enabling TFBSO to launch 48 projects in 30 additional factories or production lines across the country.



Figure 6. Assessed and impacted Iraqi factories.

**Industrial revitalization status.** As a result of these efforts, the task force has restarted or materially increased production at 29 factories across Iraq as of the date of this publication, with projects underway at 18 additional sites. Over 10,000 sustained jobs have resulted from these restarts, which also generate secondary and tertiary economic activity and employment at the local level—stimulating local suppliers, service providers, and other businesses.

Wherever possible, the task force has worked to again link factories together that once engaged in commercial transactions. As described in “A Cause for Hope,” these intra-Iraqi commercial relationships were a stabilizing element of Iraqi society. When investments in raw material, machinery, or other goods or services have been made to enable factories to restart, TFBSO has sourced these goods and services between and among Iraqi factories whenever possible. This sourcing helps align industrial revitalization to the overarching objective of political reconciliation.

The TFBSO has continued to help Iraq build industrial partnerships with international firms. A recent example of this engagement is illustrated by the international agriculture firm, Case New Holland Corporation, which partnered with TFBSO to restart tractor manufacturing operations at an idled factory in Babil province.<sup>5</sup>

**Industrial privatization and entrepreneurial activity.** The long-term intent of TFBSO economic efforts in Iraq remains Iraq’s transition to a vibrant free-market economy that is seamlessly linked to the global marketplace. TFBSO’s initial objective was to restart idled large state-owned factories, restoring employment and stimulating local economic activity. Working in support of the Iraqi Ministry of Industry and Minerals (MIM), the next step is to solicit bids from private investors for joint ventures or direct investment in operational state-owned enterprises. Such solicitations are first steps to long-term full privatization of these enterprises.

This is a transitional approach that is consistent with economic transition models successfully applied in other former command economies, especially in East Asia. As a method to introduce foreign investment and expertise from international businesses, this approach avoids large-scale

displacement of skilled workers and undermines insurgent sympathies. For a post-conflict economic development effort in an industrialized economy such as Iraq, in which terror networks prey upon local economic distress to generate support, this transitional approach also reduces the threat to our uniformed men and women.

**Industrial privatization and entrepreneurial status.** In February 2007, MIM issued a public solicitation for investors in 13 large state-owned factories in sectors ranging from construction materials to mineral processing to industrial operations. TFBSO accountants, consultants, and legal advisors have provided direct support to MIM in order to establish transparent, auditable financial review and assessment processes, and have actively supported each stage of review of bids submitted.

On 10 January 2008, the Government of Iraq announced the first awards of joint ventures to three Iraqi-European financial consortiums for large cement-manufacturing plants in Muthanna, Al Qaim, and Kirkuk. Averaging over \$100 million each in foreign direct investment, these proposals turn operational management of each cement factory over to the respective investor group while retaining ownership of the facility with the GOI. The investor will manage the facility, increasing the current average levels of 250,000 tons of cement per year to an average of 1.8 million tons per year, and receiving a majority percentage of profit over a 15 year period. Over 5,000 jobs will be created under the terms of these proposed transactions.

Given the security environment that has challenged Iraq over the past four years, these first joint ventures represent a highly desirable, and profitable, business model for both the investor and the GOI. The GOI gains world-class expertise in factory operation, as each consortium includes an international cement manufacturer, while the investor benefits because of the GOI’s stake in both security and development in the surrounding area over the period of the agreement.

These initial agreements, in final legal negotiation at the time of this publication, represent great progress for the Iraqi government and for TFBSO efforts to support revitalization of Iraqi industry as a step to private-sector development in Iraq. The notion of hundreds of millions of dollars in private foreign capital flowing into such places

as Muthanna, Al Qaim, and Kirkuk did not seem possible even a few months ago. Yet today, thanks to improvements in security that have taken place across the country under MNF-I leadership, foreign investment is starting to take place. TFBSO is hopeful that there will be additional announcements of joint ventures and new industrial starts over the coming months—further signs of normalcy taking hold in Iraq as security improves.

**Private investment.** In September 2007, following the Congressional hearings in which General David Petraeus, Commander, Multinational Force-Iraq, and Ambassador Ryan Crocker, U.S. Ambassador to Iraq, provided a review of status on post-surge security, political development, and economic stabilization in Iraq, there was a groundswell of interest from foreign investors regarding investment in Iraq.

This interest was unexpected. TFBSO had emphasized the importance of foreign investment and global corporate presence in Iraq from the inception of its effort, leveraging support from organizations, including the U.S. Chamber of Commerce and DOD's Defense Business Board, to solicit engagement from business in support of economic development in Iraq. These efforts resulted in business engagement with initial momentum, but new interest among U.S. corporations tapered off significantly in the late spring of 2007. The reasons cited at the time related to the decline in overall U.S. public opinion regarding the Iraq mission. TFBSO decreased its efforts to draw U.S. businesses to Iraq as a result of this decline in interest. However, to date 15 of the 29 American and international corporations that the TFBSO hosted in Iraq during the winter and spring of 2007 have transacted business or submitted proposals for new business that are still in review.

The emergence of interest in Iraq among investors after September appears to have resulted from a growing sense that there would be no sudden reduction or elimination of the U.S. presence, and that the surge strategy was bearing signs of progress in security. Investors began seeking information about the numerous secure areas of the country that were ready for new business development.

There is a pervasive sense among investors that Iraq has the potential for great prosperity, not only as a petroleum producing nation, but also as a diversi-

fied economy in a critical region of the world. While debates continue about necessary legal structure for Iraqi hydrocarbon sector development and associated revenue-sharing among sects and regions, there is great opportunity for investors seeking to enter the ground floor of all other industries—the point at which early investment in a developing region results in the greatest financial return.

To address this interest, TFBSO established a foreign direct investment team in October of 2007. This group, which includes experienced investment banking professionals, facilitates engagement of foreign investors in Iraq by identifying opportunities for immediate new business in partnership with the GOI. Primary initial investor interest is in new construction, specifically hotel, retail, and office space construction and property management. As a result of the lack of real estate development in Iraq over the past 18 years, there is a large need for hotel and office space development in anticipation of business expansion as petroleum companies engage in Iraq in coming years.

Initial areas of focus include the geographic areas and associated investment opportunities as shown in figure 7. These areas were selected based on their current security status, as well as direct input from the GOI at the national and provincial level.

**Private investment status.** TFBSO has already facilitated a proposal in final review and negotiation with the GOI for construction of a new, internationally branded hotel with retail space in the International Zone. Additional investment proposals are in process for hotel and office construction in Baghdad and Basra, as well as food processing, food services, and new industrial construction. Assuming security improvements are sustained and expanded over the next several months, there is reason for optimism that foreign investment will increase and that new, privately funded construction and business development will expand in the near future.

## Earlier Recommendations and Status

In the earlier report, "A Cause for Hope," three specific recommendations were made regarding revitalization of the Iraqi economy. One of these, the alignment of economic development to political reconciliation efforts, was described earlier and continues to be a part of the overall TFBSO strategy.



<b>Geographic Area</b>	<b>Initial Areas of Investor Interest</b>
Baghdad – International Zone, Abu Nawas, Haifa Street	Hotels, office and retail construction and management, food services, food processing, construction services.
Baghdad Airport	Hotels, office and retail, convention services.
Iskandariyah	Industrial assembly and fabrication, maintenance.
Najaf	Hotels and tourism infrastructure and services.
Karbala	Hotels and tourism infrastructure and services, agribusiness.
Basra (including Airport)	Hotels, office and retail, professional services, petrochemical sector support services.
Kurdistan Region	Broad-based investment across industrial sectors underway. Vibrant market economy emerging.

**Figure 7. Foreign direct investment priority areas and opportunities.**

A second recommendation focused on the need for standard international tariff and trade policies for Iraq. Since 2003, all tariffs on inbound goods have been suspended—essentially making Iraq a completely free open market for all international goods. This situation is unsound, especially for industries such as agriculture and food processing, which remain in a state of depressed output. As of the time of this report, the suspension of all tariffs remains in place.

The final recommendation involved the restoration of bank balances for state-owned factories seized in 2003. The cancellation of balances was a key step in shutting down state-owned factories, as it denied working capital necessary for purchase of raw material, maintenance, services, and new equipment. TFBSO took this recommendation forward in partnership with the GOI, then learned that the process to restore bank balances would be untenably slow, given the speed the industrial revitalization effort was attempting to achieve.

Instead of restoring bank accounts, the Ministry of Finance has applied an alternative strategy of allocating GOI budget to the Ministry of Industry and Minerals for the specific purpose of recapitalizing idled industrial facilities. Four-hundred million dollars has been budgeted in 2008 for the MIM, which exceeds the approximate value of the bank balances seized in 2003. The MIM is working with TFBSO to maximize the net effect of that budget.

To illustrate the significance of this decision by the GOI, the total capital budget in 2007 for the MIM was approximately \$30 million.

### **Next Steps**

The two initial focus areas for the task force, contracting support and industrial revitalization, are now targets of new strategic direction, designed to rapidly boost the growth of private business and the ability of large industrial enterprises to adapt their operations in support of broad Iraqi economic development objectives.

In the area of contracting and direct economic stimulus, the next step is an opportunity resident in the information JCC I/A collects on Iraqi businesses. Recall that over 3,900 private Iraqi businesses have been registered, have received contracts for goods or services, and are rated on their performance as a supplier to DOD. The Joint Contingency Contracting System now has 18 months of data, representing over a billion dollars in contracting actions, for these companies. This database represents a wealth of information helpful to future business development in Iraq. With the support of appropriate DOD general counsel and advice from international financial institutions and the Government of Iraq, TFBSO is working to identify appropriate mechanisms to enable private investors to invest in these Iraqi companies. TFBSO believes that these mostly small-to-mid-sized companies could eventually

form the backbone of one or more Iraqi growth funds, enabling individuals to invest in the future of Iraq. This would provide a channel of capital to entrepreneurial Iraqis, enabling more rapid growth and associated broad economic benefits.

In the area of industrial revitalization, the task force will apply standard business investment management practices to the process of allocating new funds to idled or low-production-rate Iraqi factories. Directors general (factory managers) of individual plants are being instructed in the preparation of business plans, marketing strategies, and capital investment plans. To receive new funding, these factories must submit their plans and strategies for review. Submissions will be combined with commander requirements for reemployment and stabilization in each area of operation within Iraq, and based on this combined criteria, funds will be granted. The disciplined process for executing any funds used to date will remain—but in the next phase we will use the funding to motivate factory managers to adopt standard international business practices. In fact, many factory managers are already adept at international business practices, and for these managers this process has proven relatively easy to adopt.

This investment-based approach will prepare the state-owned enterprises for the future they will encounter as they seek capital from private funding sources, and as privatization of these factories takes place over the coming years.

### Integrating the Overall Effort

TFBSO is working in partnership with MNF-I commands and the Government of Iraq to stimulate rapid establishment of the necessary elements of a modern industrial economy. A robust communications infrastructure enabling a transparent, modern, well-regulated banking sector capable of supporting vibrant small, medium, and large enterprises is the vision for the Iraqi economy set forth by the Iraqi

government. Security improvements have been significant, giving rise to cautious optimism and interest in investment by foreign private financial institutions and corporations. It is early, and much difficult work remains to make this vision a reality.

This is a critical time. The opportunity for the full application of economic development in support of counterinsurgency doctrine is now. The opportunity to support the Iraqi people in their desire for prosperity in a diverse, safe, and open society is now. The opportunity for international investment with an orientation to high risk and high return in a nation with great potential for long-term prosperity is now. Seizing these opportunities remains the challenge of the day. **MR**

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#### NOTES

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*The author wishes to acknowledge Lieutenant General Raymond Odierno for his unwavering vision and operational support for task force economic development efforts during his command of Multi-National Corps-Iraq, and Major General Darryl Scott, for his visionary leadership and partnership with the task force in all aspects of applying our contracts and associated business relationships as an instrument for economic development during his service as commander, Joint Contracting Command Iraq/Afghanistan.*