

The Washington Times

www.washingtontimes.com

Published April 9, 2003, p. A19

Coming battle to restore Iraq's economy

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As the military battle for Iraq comes to an end, a new battle is beginning - how to rebuild Iraq. On one side are those who believe that, by establishing the proper institutions and rules, the Iraqis will be able to rather quickly rebuild their own economy without placing a burden on U.S. taxpayers.

The other side, primarily led by the French and the Russians, will demand that the new government place its highest priority on paying back the tens of billions of dollars in loans they made to Saddam's government.

To repay these loans at close to face value to the French and Russians and other major lenders to Saddam's Iraq, would place such a burden on Iraq's revenue from oil sales, as to cripple any attempt to rebuild the economy.

The French engaged in this same stunt after the World War I, when they insisted on such a high level of reparations from the Germans that the German economy was unable to recover, which eventually caused the Germans to turn to Adolf Hitler.

Iraq has the world's second-largest proven reserves of oil. However, many of the existing production facilities are in a state of poor repair, and much of Iraq's potential is undeveloped. Oil experts believe it may take up to \$10 billion to bring the Iraqi oil production back to its 1990 level before the Gulf war.

This is a large sum, but not so large that it could not be provided by the private sector. More than 95 percent of Iraq's export income comes from oil, and, at the production levels of 1990, the Iraqi economy would be prospering and growing at a good rate if properly managed.

The bottom line is that Iraq needs relatively little foreign financial assistance, provided a proper economic structure is put in place with competent management, and that its oil revenues are not excessively siphoned away to pay loans that were made to Saddam's corrupt and despotic regime.

What should be done? Over the last several decades, more than a dozen countries, ranging from Chile to Poland, have gone through a transition from stagnant socialist to vibrant free-market democratic economies.

As a result of this collective experience, we now have a good understanding of what works and what doesn't. Uppermost is the establishment of the rule of law, an honest court system, and the protection of private property. Those formerly socialist countries that continued to have a corrupt and uncertain judicial system have had poor economic performance despite considerable economic reform.

If private property rights are not protected, few will invest. The U.S. and Britain should consider bringing retired judges to Iraq to update the civil code and oversee the establishment of a competent and honest judicial system. Fortunately, many Iraqis who left Iraq have been educated in U.S. and British law schools, and perhaps some of them can be encouraged to return to help establish a viable legal system.

Another pillar of economic reform is the creation of sound money. Iraq has suffered very high rates of inflation in recent years but, given the wealth of the country, a sound currency could be quickly created. One obvious solution is to establish a currency board where the new Iraqi currency would be fixed to the U.S. dollar, or the Euro, or perhaps partially to the price of oil. The International Monetary Fund has helped several transition countries establish successful currency boards, and this would be an appropriate role for them in Iraq.

The level of government spending in Iraq should be set by its net oil income minus whatever debt service is negotiated. Iraq does not now have a functioning tax system. At least for the immediate future, it should delay trying

to develop a tax system, other than the tax on oil. (Note, Iraq has a very low production cost relative to most other oil producers so, so long as it does not price its oil above the world price, it will be able to charge a very high tax on its oil exports - as it has been doing.)

Once the economy is revived and functioning normally, the government will have plenty of time to consider if other modest taxes are warranted. Some will advocate the imposition of tariffs on imports. Given the long history of smuggling in Iraq and its porous borders with several countries, tariffs would be almost impossible to enforce. Making the entire country a "free trade zone" would create the most economic benefits with the least costs.

The new Iraqi government should resist taking on more debt in the form of World Bank loans or loans from other multinational institutions. The World Bank has a history of funding dubious projects where the money is often stolen, while the citizens of the country are saddled with the debt. (When I was co-chairman of the Bulgarian economic transition project in 1990, we found the World Bank was undermining our efforts to privatize and demonopolize the economy. The Bank was giving loans to Bulgarian state-owned enterprises with the specific requirement that the government not allow competitive firms.)

Decontrolling prices and resisting all attempts to put in price controls is absolutely necessary to have a successful and speedy transition. Those transition economies that kept some price controls always experienced shortages and the rise of black markets. If the French and their allies are allowed to influence the economic transition, it is a good bet they will push for price controls, given their past behavior.

The French and their allies will attempt to saddle the U.S. taxpayer with the costs of Iraqi reconstruction, while they try to rape the wealth of the country as they did while in bed with Saddam. The U.S. and Britain should keep those who were in the "coalition of the unwilling" on the sidelines, as we help the Iraqis create the proper laws, regulations and institutions, which will enable them to pay for their own reconstruction.

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