

### **Can the Allies Win the Peace?**

From the military perspective the Iraq war has been an unqualified success. But the strategic goal -- to build a lasting market democracy in Iraq that can serve as an exemplar for the rest of the Middle East -- is equally important. Can the coalition achieve this goal?

In the recent weeks, attention has been diverted by the necessary, but mundane, task of restoring law and order. There is little doubt, however, that the coalition will eventually turn to its strategic objective. At that time, it will have to face up to the facts that the current distribution of economic power in Iraq is simply not conducive to democracy or markets, and that the natural tendency of an outside interim administration will be to make things worse.

Start first with the distribution of economic power. Years of dictatorship followed by sanctions have completely decimated the business and professional classes. Some studies estimate that over sixty percent of the Iraqis now depend on the government for their income. And that government will obtain the bulk of its revenues from oil in the foreseeable future. This situation, where an easily extractable, government-controlled natural resource accounts for such a large share of national output, can be bad for democracy. Consider what happened in Venezuela recently.

The government of Hugo Chavez was faced with a widespread opposition strike. Not only was the intent of the strike to show the degree of popular opposition to Chavez, it was also intended to starve the government of revenue. Without revenue, a government cannot stand, for it cannot pay the army or thugs who would keep it in power against popular opposition. Indeed, for a while it seemed as if the Chavez government would fall. But oil revived its fortunes. It does not take the support of a lot of people to extract oil. With the help of some loyal (and some foreign) engineers and with newly hired workers who replaced striking workers, the government kept oil flowing. Oil revenues provided the resources necessary to retain the loyalty of pivotal mercenary forces, who would otherwise have gone to the opposition if they saw little prospect of being paid. The strike is over now, and the Chavez government is taking action against the strike leaders.

Similarly, it was oil that allowed Saddam Hussein to stay in power so long. What is to prevent a successor regime from using the power flowing from oil to oppress the people of Iraq? The distribution of political power that democracy entails is stable only when it is accompanied by a widespread distribution of economic power. It is economic power that gives the citizenry the ability to keep a government from becoming arbitrary and tyrannical. Interestingly, these conditions under which democracies flourish are also conditions under which free markets prosper. When the people do not fear that a powerful rapacious government will expropriate their

wealth, and when market rules are not determined only by an elite that owes its success and loyalty to the government, opportunities percolate to everyone.

So how would one proceed to build the economic basis for a stable democracy in a post-war Iraq? Douglas MacArthur's partially successful policies in Japan after World War II offer some guidance. Japan was perhaps easier to transform in that it did not have an abundance of easily extractable natural resources. But land holdings were concentrated and industrial power was held by a few large industrial and financial combines called the Zaibatsus. MacArthur went after concentrated economic power under the assumption that large landholders and large firms typically became pawns of the government. The post-war land reforms did expand and widen the land-owning class, in the process fostering an agricultural revival, and making Japanese democracy more stable. But even though MacArthur started to break up the Zaibatsus, he did not have the necessary time to carry it out. The need for reliable suppliers during the Korean War forced the government to compromise with the Zaibatsus. This failure explains in part why the Japanese domestic market is still so uncompetitive even though Japanese democracy is vibrant.

There have been suggestions that Iraq's oil "problem" can be dealt with simply by distributing shares in the state oil company to the people (much as the people of Alaska get an oil dividend). But this is no solution for the government will still control oil revenues and determine the dividend the people get. Without adequate governance, as studies of the Alaskan experience demonstrate, the revenues will be wasted on grandiose government projects, corruption, or worse, rearmament, and the people will see little dividend. Also, even if the government-owned oil industry is broken up into smaller pieces and then privatized, perhaps even to foreigners, there is no guarantee that a future government cannot regain control.

The best hope for an enduring market democracy in countries like Iraq may lie in building countervailing economic power through their professional and entrepreneurial classes. There is certainly a sizeable such class in Iraq, decimated however by years of sanctions. A priority for any interim administration is to restore and improve educational and healthcare institutions so that these classes can recover the ground they have lost over the last decade.

A second priority will be to wean people from dependence on the government. The reconstruction process could revive the entrepreneurial classes, if small contractors and small businesses are given opportunities. The danger here, however, is that the interim administration may simply hand out contracts to those who are well connected in Washington or the rich westernized elite in Baghdad who make cozy with whichever government is in power. The creation of a business oligarchy that is totally dependent on the government, as the experience of Russia has shown, can make the prospect of a market democracy even more remote.

A better alternative is to distribute contracts more widely by opening up the bidding process and by ensuring more Iraqi businesses have the access to credit that will enable them to undertake projects. Clearly, many of the existing credit-granting institutions have become compromised and would simply lend to the cronies of the Baathist party or the old business elites if given a chance. The easiest fix is to allow entry for foreign financial institutions so that they can channel foreign capital into viable private ventures. New domestic financial institutions should also be encouraged. There are historical precedents for this. Louis Bonaparte broke the power of the Ancien Regime in France by encouraging the emergence of new financial institutions like the Credit Mobilier. Their lending created an independent entrepreneurial and professional class that eventually became a cornerstone of French democracy.

Clearly, all this will not happen overnight. A number of economic institutions have to be built or shored up. During this time the interim administration will have to undertake a delicate balancing act: Iraqis will have to be kept from exercising their democratic choice about how they will be ruled until the economic preconditions are in place for that choice to be genuinely free. At the same time, Iraqis have to be convinced that the interim administration has their best interests at heart, rather than simply the interests of American or British businesses. Success in this balancing act requires strong leadership, transparent policies, and good communication. In post-war Europe and Japan, the Allies succeeded in this difficult enterprise. It is time for them to rise to the challenge again.

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