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Legitimacy Risks and Peace-Building Opportunities: Scoping the Issues for Businesses in Post-War Iraq

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Introduction

The legitimacy of the military intervention in Iraq and of the conduct to date of the subsequent occupation has been the subject of vigorous debate. Earlier this July, a report commissioned by the US Secretary of Defense and undertaken by the Center for Strategic and International Studies (CSIS) indicated that the cooperation of the Iraqi people could be lost over the next year if they do not see progress on delivering, beyond the crucial issue of security, “opportunities for broad political involvement and economic opportunity.”¹

This debate has been paralleled, to the point of being transposed one with the other, by the debate regarding the role and conduct of international businesses in post-conflict Iraq. This connectedness is important on two counts. Firstly, business must earn legitimacy if it is to approach successfully the opportunities arising from the need to reconstruct Iraq. Secondly, business may lose legitimacy by association with the interim administration.

Legitimacy has long been considered essential to an organisation’s continued existence. Though intangible, like a brand, it amounts to a *de facto* licence to operate conferred on the firm by the stakeholders that it impacts or that can impact it². Legitimacy is earned when stakeholders are satisfied with the process by which companies are governed in terms of inclusivity, transparency and accountability. It is not a static resource but instead is built or eroded over time.

Iraq presents firms with unique legitimacy challenges, not least in terms of identifying the stakeholders who need to confer that legitimacy in a country where civil society has been repressed for decades. Drawing upon published research and the output of the workshop held at Chatham House on 26th June 2003 on Legitimacy Risks in Post-War Iraq, this paper examines these challenges against the current political context. It then goes on to identify the opportunities available to companies, singly and collectively, to nurture their legitimacy and concurrently to contribute to the making of the peace.

Why Does Legitimacy Matter to Business?

The governance processes that earn a firm legitimacy are a critical part of a firm’s overall approach to fulfilling its corporate social responsibility (CSR). It is not the place of this report to attempt to summarise the business case for CSR. Suffice to say there are indications that CSR practices lead to enhancements to the firm’s brand in the eyes of the consumer and the employee, the discovery of opportunities for innovation through dialogue with multiple stakeholders, and a reduction of reputational and operational risk.

The importance of legitimacy in a post-conflict situation

The costs to business of the ongoing effects of the conflict are both indirect - the breakdown in governance, trust and tolerance, and the undermining of environmental and economic capital - and direct, in terms of the higher cost of security and other forms of risk management, lost materials, capital, personnel, litigation, opportunity costs, and the damage to reputation. The Economist has described the risks faced by companies operating in conflict zones:

¹ *Iraq’s Post-Conflict Reconstruction – A Field Review and Recommendations*, CSIS, July 17, 2003

² *Reintroducing stakeholder dynamics* in Andrioff et al Eds., *Unfolding Stakeholder Thinking*, Greenleaf Publishing 2002, p.102

“Pipelines can be blown up by terrorists, contracts can be torn up by crooked partners. Fragile economies can collapse. And in recent years, firms doing business in countries with unpleasant governments have been pilloried by non-governmental organisations (NGOs), endangering the most priceless of assets, their good name.”³

An unstable environment also rebels against the substantial investment required over long periods of time by oil companies, and many such companies have postponed a decision to invest pending the establishment of a legitimate regime in Iraq. Sir Philip Watts, chairman of Royal Dutch/Shell, exemplified the stance when he stated at his company's recent results meeting:

“The safety of our people is paramount. There has to be proper security, legitimate authority and a legitimate process . . . by which we will be able to negotiate agreements that would be longstanding for decades. We wouldn't go into that situation unless these conditions were satisfied because we are a long-term business doing long-term projects and we need the framework in which we can make this sort of investment decision.”⁴

Indeed, the challenges facing any company entering Iraq at this time are sufficient to ensure that only those prepared to take a long-term view should venture in, and such a venture will be uniquely exposed should instability endure.

As the CSIS study infers, stability will not come while the regime is regarded as illegitimate. That illegitimacy extends to businesses coming into Iraq under the auspices of that regime and, in any event, to those businesses that pay insufficient regard to their stakeholders. Business can begin to break the cycle and earn its own legitimacy by attending to the processes by which it is governed and ensuring that these processes are inclusive, transparent and accountable to Iraqi stakeholders. In this way business can also help to confer legitimacy on the interim authority, creating a virtuous circle building towards the stability that business needs in order to operate profitably for the long term. Conversely, businesses that fail to engage adequately with stakeholders will merely undermine further the Iraqis' sense of involvement in their own future and so contribute to the downward spiral of instability.

A simple business case approach will not support all the actions necessary to tackle the risks associated with instability. Some actions will be required that are beyond the resources of a single company, or that, undertaken by a single company, do not generate an identifiable return, such as urging inclusivity and transparency in the process for awarding contracts, and taking steps to protect the environment or to eliminate corruption. Either collective action by business, or government action, will be needed to make this happen.

Legitimacy in the Context of Iraq

Iraq is a collection of peoples who share the connection of having been subject to the trauma of wars, dictatorship, sanctions and now occupation. It has been described as “a country of orphans and widows”. The challenges presented by this socio-psychological environment cannot be overestimated. True reconciliation remains for the moment a distant possibility. The situation has been aggravated by a failure on the part of the US administration to make use of their own Middle East expertise in

³ “Business in Difficult Places: Risky Return” The Economist, May 20 2000

⁴ Hoyos, Carola “Oil groups snub US on Iraq deals” Financial Times 24 July 2003

advance of the conflict to identify what would be required to effect speedy and effective nation-building in its aftermath.

The Evolving Political Order

The removal of Saddam Hussein and the process of dismantling the state institutions of the former regime have left a power vacuum. This vacuum has been filled through the unmanaged *de facto* devolution of power to a complex power network based on local ethnicities, tribes, religion, business networks, and organised crime. Within their respective spheres of influence, these all compete with the nascent central administration for control of business activities.

The integration of these communities represents a significant challenge to anyone wishing to reassert a central authority in Iraq. Anyone doing so would be greatly assisted by offering a system of governance that is viewed as generating greater legitimacy than the alternatives. They will also be assisted by demonstrating tangible reconstruction results quickly. These two requirements are not readily aligned.

The occupying powers have appointed an Iraqi Governing Council following extensive consultations. The UN Secretary General and his Special Envoy to Iraq support the representative nature of the Council, but the power of veto reserved by the head of the US civil administration in Iraq, coupled to appointment by the occupying powers, has meant that the Council is struggling to establish its legitimacy.⁵ The existence on the Council of former Iraqi exiles, whose own legitimacy is questioned by many inside Iraq and who remain the strongest voices of Iraqi support of the military intervention in Iraq, is not viewed as strengthening its position. It cannot help the political transition that the occupying powers are attempting at the same time to install a new national ideology, one that is trusting of the US.

Supporters of the old regime remain engaged in acts of violence and sabotage aimed at destabilising the new order. Security risks are such that the UK Foreign and Commonwealth Office is still advising that only essential personnel (which would extend to those engaged in reconstruction activity) should travel to Iraq.

Participation in the Iraqi Economy

The Iraqi economy is in a desperate state. Unemployment is high, swollen with the ranks of former Iraqi soldiers and Ba'athists removed from positions of influence, and will grow once the market for goods and services is opened up to competition. Job creation is a high priority for the interim administration although in that regard it is the informal economy that presents the greatest prospects. Until the economy begins to revive this unemployment will contribute to instability, but at the same time the economy is unlikely to be stimulated until there is stability.

The country's commercial infrastructure is not in a position to aid a quick recovery. Paralleling the poor state of law and order, the country lacks a just system of civil or criminal justice, giving rise to concerns about contract enforceability. The banking system has also been badly damaged. The flow of funds home from Iraqis overseas, estimated to amount in a normal year to between \$5bn and \$10bn, is at the moment being undermined by the restricted capacity of basic banking services such as

⁵ "Iraqi council gets mixed reaction", BBC News, 14 July, 2003

international money transfer. If western companies set up such services directly while the local providers are war-damaged, or enter into an Iraqi business buying spree, it could chime too readily with the existing sense that the war was undertaken to enable foreign powers to enter Iraq and acquire, in colonial style, the country's economic resources. The recent decision by President Bush to appoint an individual to make plans for the privatisation of Iraq's two hundred state-owned businesses raises concerns within this context.⁶

Crucially, oil production is at well below pre-Gulf War levels and the medium term strategy for the exploitation and ownership of Iraq's oil resources is as yet unclear. Unless there is a substantial measure of forgiveness in relation to the country's sizeable debt, oil production will merely service existing loans. The Paris Club is currently examining options. In the medium to long-term and after a slow recovery, the oil resource should ensure that Iraq will not be aid dependent. There is, however, a history in Iraq of the revenues generated from its oil resource giving rise to the macroeconomic imbalance known as the 'Dutch disease'. A dialogue is needed between oil companies and a legitimate Iraqi administration regarding the use and distribution of oil wealth, providing for appropriate management and transparency.

Two-Speed Reconstruction

The political situation in Iraq underscores the need for inclusivity, but legitimacy is also generated by evidence of progress in reconstruction. A two-speed approach to reconstruction appears to be the answer. On the one hand, the occupying powers must fund immediately, and demonstrate progress on, certain critical areas of reconstruction including the establishment, and empowerment, of an inclusive interim government, the provision of basic amenities like key roads and electricity, and the establishment of law and order. Beyond this and at the cost of speed, inclusivity should become paramount in the remainder of the reconstruction programme, both in order to build legitimacy and to make effective use of local knowledge. Inclusivity should underpin both the prioritisation of work and the allocation of reconstruction activity.

Building Business Legitimacy

Inclusivity

It should be clear that in a post-conflict society characterised by a fast changing environment, political complexity, unreliable information, conflicting interests, and a breakdown in social capital, engagement with people should be a core strand of the corporate way of life. The purpose of that engagement is to develop stakeholder dialogue processes that will nurture mutual understanding and trust, reveal problem areas as well as shared interests, and enable the setting of standards of behaviour appropriate to the communities being impacted by the firm's operations. As the situation is not a static one, this 'negotiated order' will evolve over time.⁷

Inclusivity is not without its pitfalls, particularly in a post-conflict situation. The principal risk concerns the identification of appropriate stakeholders with which to engage. The classic definition includes those that can affect as well as those that are affected by the firm's operations. This is pragmatic, especially given the absence of a global democracy through which to raise global issues

⁶ James Harding, "Bush picks friend to revive Iraqi businesses", Financial Times, 8 August 2003

⁷ Ibid, p.104

like environmental degradation, but perhaps there are stakeholders with the power to influence, who nevertheless have no legitimacy to bestow.

A foreign company, for example, wishes to enter a particular Iraqi community with a view to employing many of its people. The community expects, and the company desires, that the company's presence there will generate benefits to the community including improvements to its educational facilities. A wealthy foreign individual sets up and funds an NGO dedicated to improving educational facilities for Iraqi children and has much to say about the desired content of these facilities and the role to be played by companies in their provision. This NGO is well funded and can bring the pressure of publicity to bear on the company to a much greater degree than could the local community. Under what circumstances can that NGO represent itself as speaking for the affected stakeholder group? Should it be treated by the company as a stakeholder even if it does not pretend to be representative in any democratic sense of the word?

In a country in which civil society has been destroyed or else driven underground by an extended period of authoritarian rule, pragmatism must prevail. There will be many groups that approach a company with a view to influencing its conduct in Iraq, but rather than create a complex stakeholder engagement strategy that runs the risk of working with the wrong groups, the simplest approach may well be to begin by opening a formal dialogue with the firm's Iraqi employees and their families.

The process of engagement with the identified stakeholders carries its own risks. A company will often be too close to the issues to present itself as an unbiased facilitator. There may sometimes be a benefit to bringing in the services of a neutral third party to manage the process.

Transparency

Transparency conveys the ability of those affected by the exercise of power to know the mechanisms and processes by which that power is exercised. Those who exercise power should do so "visibly, predictably and understandably"⁸ if they are to build legitimacy.

Corruption, that is "the misuse of entrusted power for private gain"⁹, is the principal risk to transparency. For over 45 years, diverse Iraqi political movements have succeeded in focusing power and privilege in successive waves of elites and those receiving their patronage. This brand of corruption is ingrained. Although the senior Ba'athist figures have been removed from office, some of the old state institutions are still in place and companies are going to be dealing with many of the same people. Power over resources still rests largely with the old guard. It is not in the long-term interests of Iraqis that this remains the case and emergent stakeholder groups are advocating the democratisation of power and wealth.

This issue is particularly pertinent to the country's oil wealth. There could be a substantial risk to legitimacy were oil companies to allow themselves to be complicit in delivering the oil wealth into the hands of a small elite, rather than to a government that will apply the revenues transparently and accountably for the benefit of non-oil sectors.

⁸ From the Transparency International definition of 'transparency'.

⁹ From the Transparency International definition of 'corruption'

In tackling corruption, companies will have to choose whether to work through the representatives of the old guard, or to work around them and so help build the credibility of the institutions of the nascent new Iraqi state.

Accountability

Accountability amounts to a firm enabling its behaviour to be measured against its obligations, and to someone with legitimacy outside the firm making that assessment and ensuring that the firm takes responsibility for addressing any shortfall.

It is a significant enough challenge for business to monitor and report publicly on performance related to its corporate social responsibility. The added issue in Iraq, however, is the absence of a strong civil society following decades of repression. In order to generate legitimacy, business needs the independent scrutiny levelled by civil society institutions such as NGOs. If a business is being cross-examined by an NGO on a set of issues that have arisen, the business can be seen to have a healthy set of checks and balances on its behaviour and can be assumed to operate in fear of sanction from them.

If a firm feels it is being insufficiently scrutinised, or that a competitor is in danger of costing an entire sector its legitimacy, an investment might be needed in civil society capacity building.

Addressing Illegitimacy by Association

The businesses with the greatest chances of securing reconstruction work have been explicitly those rooted in the US or UK, and yet this was no civil war but a war initiated through the action of the US and UK governments. The legitimacy of businesses entering Iraq is thus affected by Iraqi cynicism regarding the motives for military intervention and by the legitimacy being earned or lost by the occupying powers post-conflict. They will have to distance themselves from the occupying powers by employing more inclusive, transparent and accountable practices than the occupying powers have so far demonstrated.

To reassert their claims to legitimacy over this noise, businesses must begin with the process for awarding contracts relating to work in Iraq. Many businesses have already demonstrated a desire for transparency and open competition in the tendering process in order to help instil legitimacy. In addition, and given the unique challenges to legitimacy detailed above, governments should ensure that contracts are not awarded to businesses with poor records in stakeholder engagement or where they have in other respects helped to bring capitalism into disrepute. This should be an ongoing criteria; the interim administration should come down hard on businesses that fall below expected standards of engagement or behaviour.

Meeting Expectations of Conduct

There has been a high level of NGO activity focused on setting out the substantive standards of behaviour that foreign businesses should address when entering Iraq. Although their appropriateness and prioritisation will need to be verified through engagement with Iraqi stakeholders, these sets of principles of conduct identify a useful set of questions for firms to raise in the engagement process. They are particularly useful guides on those issues for which achieving stakeholder representation is a challenge, such as, in the absence of a global system of governance, the degradation of the global environment.

Companies are expected, for example, to demonstrate respect for human rights by ensuring people are not arbitrarily displaced without compensation; not to profiteer by taking advantage of shortages of essential items in order to inflate prices; not to discriminate in the provision of basic services; to support the re-emergence of Iraqi businesses rather than to simply buy them at war-damaged prices; to demonstrate support for open civil society and a free press, including provision of practical support to their development; to guard against environmental degradation in and around facilities; to focus on diversity management in the workplace to alleviate ethnic tensions; to understand that this is a nation in the throws of recovery from trauma, and therefore to focus first on relief from suffering, and then on education and skills development.¹⁰

The substantive expectations of behaviour arrived at through stakeholder engagement should then be integrated into a firm's CSR management programme.

Conclusions

Companies entering Iraq will need considerable courage, and the stamina to hold and see through a long-term view. At the same time, businesses need to be conscious of their place within a complex system of influences, both with regard to the risks to the building of legitimacy, and with regard to the need to contribute to the broader building of peace.

A systems approach to legitimacy

This report has concentrated on the steps a business can take alone in order to establish its legitimacy based on inclusivity, transparency and accountability, but not all actions can be taken unilaterally. The different actors in a post-conflict situation, particular those actors associated with an occupying power, make up a system of legitimacy influences. Legitimacy building must therefore take place through multiple points of entry to that system including the actions of governments, the interim administration and NGOs, as well as business.

Collective action by business will be needed to exercise influence over the government actions that, through paying insufficient attention to inclusivity, transparency or accountability, currently risk exerting a negative influence over business' own legitimacy. Critical examples include the tendering process for reconstruction contracts and the content of and process for awarding oil infrastructure and service contracts. Such influence needs to be exerted publicly in order to underpin business' own claims to transparency, but where in order to avoid the risk of further destabilising the regime, private discourse with the administration is advisable, it becomes particularly important that the collective action involves a cross-sector partnership involving NGOs who can oversee the process and hold business accountable.

In this way, business may, for example, help to bring about the adoption of a business-wide approach to tackling corruption or to build greater legitimacy into the contract tendering process. The interim administration and, through the debt burden, the international financial institutions, are well placed to require would-be foreign participants in the Iraqi economy to demonstrate strong capabilities in inclusivity, transparency and accountability, so levelling the playing field for businesses with different degrees of home state pressure for responsible business practices.

¹⁰ See for example the framework provided in *The Business of Peace*, IBLF, 2000, and the principles for business articulated in *Iraq: On Whose Behalf?*, Amnesty International, 2003

Participation in third track diplomacy

Just as conflict and post-conflict risks have become disaggregated, so must be the response. It can no longer be the sole preserve of nation states to address and ameliorate the issues caused through conflict. Businesses act in close proximity to the people and they build myriad relationships that cut across the divides gouged through conflict. It is thus open to business, as to a whole range of actors, to act in its own best interests by contributing to the building of peace as a participant in a system of multi-track diplomacy¹¹, a framework for conflict prevention and peace-building that recognises the roles played by a range of actors including civil society, religious institutions and business, as well as government.

Through its own processes of engagement with stakeholders, business will be well positioned to identify substantive macro level issues – those relating to issues such as political governance, equality, poverty, justice, identity and ideology – that are of concern to its constituency. To participate in peace building, business needs to turn that learning into feedback to the interim administration, and work with civil society to hold the administration accountable for the extent to which it addresses through public policy the concerns raised. In this way business' engagement with the Iraqi people is linked into the governmental engagement track of a multi-track system.

Although peace-building produces the kind of stable environment that business needs, such activity will be hard to justify on an individual business case basis. For this reason it is perhaps best for such processes to be instituted by business sectors as a group or at the instigation of the interim administration.

Legitimacy risks aside, business, through its communication and relationship building activities, through its place as an integral part of social and political life, through the central place of economics in government policy-making and in the parameters of the conflict itself and its consequent influence over home state government policy, through its direct relationships with senior government figures in the host state, through the exploration of new modes of partnership with Iraqi business, as well as through the direct application of its resources to community development activity, has the opportunity to assist in building the peace. In all the complexity of post-conflict Iraq, business should not lose sight of the fact that the greatest risk management tool at its disposal is its contribution to the winning of the peace.

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¹¹ See the work of the Institute for Multi-Track Diplomacy, www.imtd.org, and the introduction to track three diplomacy (peacemaking through commerce) in *Multi-Track Diplomacy, A Systems Approach to Peace*, Drummond and McDonald, Kumarian Press, 1996, pp 52-59