

**STATEMENT OF STUART W. BOWEN, JR.
SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION**

BEFORE THE

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FOREIGN AFFAIRS' SUBCOMMITTEE ON
INTERNATIONAL RELATIONS, HUMAN RIGHTS, AND OVERSIGHT AND
THE SUBCOMMITTEE ON THE MIDDLE EAST AND SOUTH ASIA**

CAN IRAQ PAY FOR ITS OWN RECONSTRUCTION?

**Tuesday, March 27, 2007
Washington, D.C.**

Chairman Delahunt, Chairman Ackerman, Ranking Member Rohrabacher, Ranking Member Pence, Distinguished Members of the Committee, Ladies and Gentlemen. Thank you for this opportunity to address a very important question facing the U.S. reconstruction program in Iraq.

SIGIR's Mandate

The Special Inspector General for Iraq Reconstruction (SIGIR) has a well defined and narrow mandate to provide oversight of the U.S. efforts in the Iraq relief and reconstruction program. In addition to our duties to promote economy, efficiency and effectiveness, SIGIR provides Quarterly Reports to Congress, the Secretary of State and the Secretary of Defense that update the status of relief and reconstruction programs as well as SIGIR's oversight of these efforts. It is within the context of that second part of our mission that our organization gathers and analyzes a significant amount of data that provides insight into the question posed by this Committee. While SIGIR has no statutory authority to audit any entity of the Government of Iraq (GOI), we have, in the course of our work, interacted with the GOI, the various international organizations that assist the GOI, and the USG entities that engage with the GOI on these issues.

In addition, I have recently returned from my 15th trip to Iraq since I was appointed IG in January 2004. Over the course of those extended visits, I have established a dialog with many of the leaders and implementers of this effort and will provide this Committee with my best estimate of progress within the historical context of this complicated and challenging endeavor.

Reconstruction In Context

It is important to note that the term "reconstruction" needs to be examined within the context of this hearing and the ongoing efforts in Iraq. Reconstruction is commonly understood to describe the rebuilding of infrastructure in Iraq that has been degraded over

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

the last three decades by war, sanctions and mismanagement by the Saddam Hussein regime. However, much of the “reconstruction” efforts that have been undertaken over the last three years, with U.S., donor and Iraqi funds, actually include new construction, the rehabilitation of existing facilities, the purchase of supplies and equipment, and a number of non-construction expenditures that have been focused on programs such as democracy development and building the governance capacity of both central and provincial leaders.

There is an oft-quoted report published by the World Bank early in 2004 that estimates the total cost of “reconstruction” at \$60 billion. Over the past four years, the United States, foreign donors, and the revenues of the Iraqi government dedicated to “reconstruction” have totaled over \$100 billion, yet there is widespread recognition that much remains to be done to stabilize the infrastructure in Iraq. I have brought a chart that lays out the various sources of those funds – it is a chart that comes from our last quarterly report. In the past few weeks, the head of the U.S. Army Corps of Engineers, Gulf Regional Division, has been quoted as saying \$100 billion more is likely to be needed to get the country on its feet. Deputy Prime Minister Barham Saleh has stated publicly that it will take \$200 billion. These amounts are estimates of a long-term effort and are not benchmarked or calculated based on specific plans. To date, the most comprehensive approach for Iraq’s long-term economic development is contained in the International Compact. Still awaiting final approval, the compact lays out priorities that Iraq and the international community agree are necessary for Iraq’s long-term stability. But the very diversity in each of these estimates highlights an essential point – the amount of “reconstruction” said to be required has generally been driven by the amount of money available. An international development expert used the following analogy to describe the situation – the Iraqi government may want to buy a luxury sedan, but it can function just fine with an economy car. How much reconstruction is necessary to achieve a stable, democratic Iraq is likely to remain an open question. While the International Compact begins to lay that out, substantial planning and assessment of the state of Iraq’s current infrastructure is necessary before a figure can be agreed upon. Without the figure, it is difficult to provide a clear answer to the question, “Can Iraq pay for its own reconstruction?”

Capacity Development

A recent SIGIR audit addresses an important component of Iraq’s ability to manage and budget for its own reconstruction. SIGIR’s capacity development audit completed in January of this year focused on the U.S. efforts to support ministry capacity development. The audit found that U.S. government organizations have received \$125 million and requested another \$310 million for capacity development assistance through FY2008. The audit was, however, unable to estimate how much funding overall is necessary to achieve the stated goal of a self-sufficient Iraqi government. While some attempts have been made to measure the GOI ability to sustain itself, it remains extremely difficult to develop a credible measure of this capacity.

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

Our audit made several recommendations to U.S. implementing agencies:

1. Develop a baseline capacity assessment for all ministries,
2. Share information among USG agencies working on capacity development,
3. Develop a detailed plan for capacity development in concert with GOI including identifying outcomes,
4. Actively work with international donors to help plan, fund and execute improved capacity development, and
5. Assign clear responsibility for overall USG capacity development efforts to one USG official or organization¹.

Another SIGIR audit that touched on this question was requested by Senator John Warner and focused on Iraqi Ministry of Defense (MOD) and Ministry of Interior (MOI) capacity. It reviewed logistics, specifically focusing on U.S. efforts to support the Ministry of Defense and Ministry of Interior; however it did not directly address GOI components. That audit, published in October 2006, found that the Iraq Ministries of Interior and Defense are not capable, in the near term, of assuming responsibility for logistics support of the Iraqi army and local and national police forces. Much more needs to be done by MNF-I if it is to meet the goal of turning over this responsibility to the MOI and MOD by January 1, 2008. The sustainment of logistics is critical to the turnover of full responsibility for security to the GOI, and has been recognized by DoD as a primary focus of its efforts in 2007.²

The Iraqi Budget

The 2007 GOI budget is \$41.3 billion, which includes \$10.1 billion in capital investment. This \$10 billion is not a unique item in the budget dedicated to reconstruction efforts defined by the U.S. Rather, it is the tabulation of the routine capital investment items allotted to the various ministries – similar to the capital investment portion of any annual government budget. Of that amount, \$2.4 billion is slated to be given to the provincial governments for regional construction projects. A majority of the remaining capital funds are going to the MOI and MOD. The latest reports from Baghdad indicate that the Ministry of Finance has already begun the process of disbursing portions of that money to ministries and provinces to initiate projects.

The 2007 GOI budget is also a deficit budget, in that it requires \$7.7 billion in carry-over money from prior years (2005-6) to break even. The GOI allowed the surplus to build up for a variety of reasons, including the constant turnover of the government of Iraq, which made it difficult to sustain consensus on how the capital budget should be spent. Every time ministers have been replaced, the process for moving forward on capital expenditures has had to restart, and in many cases, interim ministers have focused on near-term priorities rather than longer horizon capital projects. In addition, international

¹ SIGIR 06-045 Status of Ministerial Capacity Development in Iraq, January 30, 2007

² SIGIR 06-032 Iraqi Security Forces: Review of Plans to Implement Logistics Capabilities, October 28, 2006

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

financial organizations such as the IMF have encouraged Iraq to keep some reserve to make up for its poor credit rating (and still considerable outstanding international debt which also tempered spending initiatives).

Another important achievement to note is the use of the Foreign Military Sales (FMS) program to facilitate expenditures of Iraqi funds on Iraqi security. At the end of 2006, knowing that the Ministries of Defense and Interior had outstanding funds that would have to be returned to the Ministry of Finance, DoD officials persuaded the GOI to move \$1.9 billion into an FMS³ account which resulted in a two-fold benefit: first, the money was effectively “spent” in 2006, and second, the Iraqi funds then became available to pay for much needed supplies and equipment for the army and police through a well-established U.S.-managed process.

While the GOI is moving forward in spending its \$41 billion 2007 budget, there are several factors that could negatively impact the effective expenditure of Iraqi’s own revenue for reconstruction efforts.

Limitations on Iraq’s Capacity to Manage its own Reconstruction

A major limitation in Iraq’s ability to finance more reconstruction can be traced to the Iraqi political process and the historical distribution of funds by a strong, centrally controlled Ministry of Finance (MOF). The Iraqis need to reach consensus on where, when, and how the budget is distributed. The question is contentious not only at the national level within the line ministries and within the Council of Representatives (COR), but also in the provinces where consensus is difficult and budgetary capability of local officials runs the gamut from experienced execution in the Kurdish regions, to nascent budgeting capacity in smaller provinces. There is also the question of the political will of the Iraqi government to make hard budget choices. Finally, there is an issue of what degree U.S. and other assistance has actually created a dependence on outside help to perform the task of government, and demotivated Iraqi officials. Thus, in the current environment in Iraq, it is very difficult to determine whether the Iraqi government is leaning on international donors for investments that it could fund and manage on its own and to what degree sectarian or political interests distort reconstruction budgeting decisions.

Budget Execution

Another key limitation is what has been labeled slow “budget execution”. Lack of understanding of complex GOI contracting regulations among Iraqi often inexperienced new officials is pervasive. There are, for example, complicating provisions that require all procurements above \$3 million (\$10 million in key agencies like electricity and oil) be

³ GAO 07-637T Preliminary Observations on Budget and Management Challenges of Iraq’s Security Ministries, March 22, 2007

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

approved by the High Contracting Commission, chaired by the Deputy Prime Minister, a process that some charge results in delays. There is an initiative in the GOI supported by the U.S. Embassy to develop a manual that will comprehensively cover contracting regulations within the GOI. At a day-long Budget Execution Conference on March 7, hosted by the Deputy Prime Minister and the Ministers of Finance and Planning, a CD with budget execution guidelines and contracting regulations was distributed to ministries to raise the level of understanding of a complex and otherwise opaque process. On March 8 and 9, the U.S. hosted a follow-on conference for Provincial Reconstruction Teams (PRTs) to disseminate and review the new GOI budget execution rules at the local level.

Meanwhile, the Ministry of Oil (MOO), the key revenue producing ministry, falls under the same general contracting rules as other ministries. The nature of the oil business and its importance to the economy suggests the need for more flexible contracting procedures including multi-year capital contracts, sole-source contracting for unique manufactured parts, and timely contracting to support urgent O&M needs. Such flexibility was allowed under Saddam Hussein's government, but the current GOI has yet to allow such flexibility for the MOO. The MOF cites the need for tight accountability in its refusal to allow for more flexible procedures. Given that the MOO produces over 94% of all Iraq's government revenue, this issue is of critical importance.

U.S. officials working closely with the Iraqi government believe budget execution will improve this year. The GOI has indicated that it intends to put a significant portion of its own revenue into infrastructure and capital projects at the central government and provincial levels. To spur officials to spend their capital budgets quickly, the GOI has declared that any ministry that does not spend 75% of the portion of its capital budget it has been allotted by June will forfeit the money for reapportionment by the Ministers of Finance and Planning.⁴

One of the reasons GOI officials have been slow to move on the capital budget in 2006 is that a permanent government was not formed until half-way through the calendar year. On the other hand, the GOI record of paying salaries and pensions is above 97%. So, the government is capable of spending effectively in certain categories. The slow execution of capital (12% through August 2006) and Operations and Maintenance (22% through August 2006) budgets is a likely a result of structural factors such as contracting procedures, the depth of capacity of the current Iraqi technocratic class, and lack of sufficient political will.

The U.S. Embassy and other donors are working to improve the capacity of the GOI to execute its budget at all levels – including improving contracting processes and training key officials at the Ministries and in the various governorates. The U.S. Budget Execution Initiative includes an interagency task force, established in October 2006, and chaired by the Deputy Chief of Mission. USAID's overall capacity development

⁴ Translation of Final Text of the Law of the Federal Budget for Iraq for 2007, February 10, 2007

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

program includes a budget execution component. Individual IRMO advisors are also working on budget execution in the ministries for which they are responsible.

Corruption

Extensive corruption is involved in the expenditure of GOI funds. Reports indicate that untold amounts of money that could be spent reconstructing the country are siphoned off the budget. The Commission on Public Integrity (CPI), the Iraqi version of the FBI, estimates that the loss is in excess of \$5 billion annually, although that figure is difficult to confirm. The Board of Supreme Audit (BSA), the most credible and long-standing (formed in 1927) Iraqi oversight organization akin to the GAO, also estimates significant losses. Its insight into GOI expenditure is probably the most comprehensive as it performs its oversight function within the GOI. Standing with the CPI and the BSA are the Iraqi inspectors general and their 2500 staff, situated in every ministry. The Coalition Provisional Authority (CPA) created this system three years ago and modeled it after the U.S. Inspector General system. Although the IGs have made some progress, they continue to struggle to gain traction as a viable government function.

While there has been some success by each of these entities in addressing corruption, each of them still has a long way to go in meeting their basic mandate. But tempering the positive aspects of the aggressive development of the three entities is something that could be labeled a “chilling effect” caused by the politicization of anti-corruption penalties. Some officials – both U.S. and Iraqi – have described reluctance on the part of some contracting officials in the GOI to execute contracts for fear that a political or personal rival would launch an accusation of improper acts. Under the current patchwork of laws and regulations, mere accusations can land a potentially innocent individual in jail for several months – a case supported by much anecdotal evidence. This has led to extensive debate over one particular corruption provision – Article 136b of the Iraqi Criminal Procedure Code. It provides ministers with the blanket authority to unilaterally overturn charges. In effect, this law provides Ministers with the power to issue “get out of jail free” cards. On the one hand, this provision can and does undercut efforts to prosecute real corruption. One report of the Anti-Corruption Working Group of the Iraq Reconstruction Management Office (IRMO) lists 48 cases involving 102 defendants during the period September 2006-February 2007 in which prosecution was stopped by Ministers using 136b. On the other hand, Article 136b also provides a check-and-balance for a nascent system that is itself subject to misuse.⁵

These and many other complex rule-of-law challenges are well known to Iraqi and U.S. officials and are part of the on-going efforts to assess and improve Iraq’s capability to address corruption.

⁵ Memorandum from Senior Consultant to CPI to the Anti-Corruption Working Group/IRMO Director, March 11, 2007

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

SIGIR has completed one audit and is currently starting a second that looks at USG efforts to support anti-corruption programs in Iraq. Progress is slow in coming, but there are hopeful signs. In the past few months, the IRMO has deployed senior advisors to each one of the three anti-corruption entities. In addition, there is a significant focus by both the GOI and the international community (including the U.S.) in building capacity through improved legislative authorities, expanded training programs, and the development of strengthened Iraqi support for anti-corruption initiatives.

The Way Forward

A key component in helping Iraq to prepare to shoulder more of its own reconstruction burden is the International Compact for Iraq. The draft compact document was negotiated between Iraq and the international donor community with the help of the United Nations. The compact document describes in some detail what reforms in the economic, political and social spheres Iraq is prepared to undertake in exchange for clearly articulated types of support and assistance from the international community. The U.N. hosted a meeting in New York on March 16 which moved the compact process forward, but the signing date, originally anticipated at the end of 2006, has slipped to Later this spring.

Another key to more effective budget execution is an automated Financial Management Information System (FMIS) system which is well underway. This project, which began in 2004, is being funded by both U.S. appropriations and the government of Iraq. The President of the BSA has expressed some concerns about the FMIS system to SIGIR, noting that there are still hurdles to overcome, but the process is ongoing. In fact, last week, we announced an audit to assess the management and implementation of this program.

Yet another key to Iraq's ability to finance its own reconstruction is passage of the Hydrocarbon Law and the companion laws necessary to stimulate investment in Iraq's Oil Industry. While further progress in the areas of security, operations and maintenance, and capital investment are required, the Hydrocarbon Law will provide the basic legal framework needed to attract long term foreign investment in the Oil Industry. The draft law is not expected to be voted on by the COR for some months, while remaining issues are considered. One problem is that the draft does not clearly address the overarching tensions between the national and regional authorities. Investors may be deterred by the absence of provisions that support contractual rights. Further, enactment of the law is dependent upon concurrent enactment of other legislation, the status of which is not yet clear. While there has been good progress, the end is not yet clearly in sight.

Iraq is also making progress in meeting its commitments to increase subsidies for fuels as required by the IMF Stand-By Agreement. By March, the price of gas will go up to \$0.30 per gallon (it was lower than \$0.10 per gallon three years ago). Price increases are key to reducing smuggling incentives and slowly correcting the economic distortions caused by heavily subsidized petroleum products.

FOR OFFICIAL USE ONLY
UNTIL RELEASED BY THE
HOUSE FOREIGN AFFAIRS SUBCOMMITTEES

Conclusion

This brief review of some of the key variables at play in determining whether Iraq will be able to fund its own reconstruction underscores the fact that it will take some time before Iraq has the resources – both technical and financial – to undertake a fast-paced reconstruction effort on its own. The difficult security situation and the increasing sectarianism within Iraqi society and its governing institutions only increase the challenge.

It is clear that without continuing U.S. and international support, the GOI will struggle to sustain existing levels of essential services and security. It is difficult to over-emphasize the degree to which security and stability are key to the Iraqi government's ability to promote economic growth and well-being and to increase the quality of life for its people. Security is also key to enabling the remaining international funds – a significant portion of the \$15 billion pledged over the last few years – to be expanded.

I thank the Committee for its interest in this important issue, and I look forward to further discussion.