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# REBUILDING IRAQ

## Stabilization, Reconstruction, and Financing Challenges

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International Affairs and Trade





Highlights of [GAO-06-428T](#), a testimony before the Committee on Foreign Relations, United States Senate

## Why GAO Did This Study

The United States, along with coalition partners and various international organizations, has undertaken a challenging and costly effort to stabilize and rebuild Iraq following multiple wars and decades of neglect by the former regime. This enormous effort is taking place in an unstable security environment, concurrent with Iraqi efforts to transition to its first permanent government. The United States' goal is to help the Iraqi government develop a democratic, stable, and prosperous country, at peace with itself and its neighbors, a partner in the war against terrorism, enjoying the benefits of a free society and a market economy.

In this testimony, GAO discusses the challenges (1) that the United States faces in its rebuilding and stabilization efforts and (2) that the Iraqi government faces in financing future requirements.

This statement is based on four reports GAO has issued to the Congress since July 2005 and recent trips to Iraq. Since July 2005, we have issued reports on (1) the status of funding and reconstruction efforts in Iraq, focusing on the progress achieved and challenges faced in rebuilding Iraq's infrastructure; (2) U.S. reconstruction efforts in the water and sanitation sector; (3) U.S. assistance for the January 2005 Iraqi elections; and (4) U.S. efforts to stabilize the security situation in Iraq (a classified report).

[www.gao.gov/cgi-bin/getrpt?GAO-06-428T](http://www.gao.gov/cgi-bin/getrpt?GAO-06-428T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Joseph Christoff at (202) 512-8979 or [christoffj@gao.gov](mailto:christoffj@gao.gov).

## REBUILDING IRAQ

### Stabilization, Reconstruction, and Financing Challenges

#### What GAO Found

The United States faces three key challenges in rebuilding and stabilizing Iraq. First, the security environment and the continuing strength of the insurgency have made it difficult for the United States to transfer security responsibilities to Iraqi forces and progressively draw down U.S. forces. The security situation in Iraq has deteriorated since June 2003, with significant increases in attacks against Iraqi and coalition forces. In addition, the security situation has affected the cost and schedule of rebuilding efforts. The State Department has reported that security costs represent 16 to 22 percent of the overall costs of major infrastructure projects. Second, inadequate performance data and measures make it difficult to determine the overall progress and impact of U.S. reconstruction efforts. The United States has set broad goals for providing essential services in Iraq, but limited performance measures present challenges in determining the overall impact of U.S. projects. Third, the U.S. reconstruction program has encountered difficulties with Iraq's inability to sustain new and rehabilitated infrastructure projects and to address basic maintenance needs in the water, sanitation, and electricity sectors. U.S. agencies are working to develop better performance data and plans for sustaining rehabilitated infrastructure.

As the new Iraqi government forms, it must plan to secure the financial resources it will need to continue the reconstruction and stabilization efforts begun by the United States and international community. Iraq will likely need more than the \$56 billion that the World Bank, United Nations, and CPA estimated it would require for reconstruction and stabilization efforts from 2004 to 2007. More severely degraded infrastructure, post-2003 conflict looting and sabotage, and additional security costs have added to the country's basic reconstruction needs. However, it is unclear how Iraq will finance these additional requirements. While the United States has borne the primary financial responsibility for rebuilding and stabilizing Iraq, its commitments are largely obligated and future commitments are not finalized. Further, U.S. appropriations were never intended to meet all Iraqi needs. In addition, international donors have mostly committed loans that the government of Iraq is just beginning to tap. Iraq's ability to financially contribute to its own rebuilding and stabilization efforts will depend on the new government's efforts to increase revenues obtained from crude oil exports, reduce energy and food subsidies, control government operating expenses, provide for a growing security force, and repay \$84 billion in external debt and war reparations.

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss U.S. efforts to rebuild and stabilize Iraq. The United States, along with its coalition partners and various international organizations, has undertaken a challenging and costly effort to stabilize and rebuild Iraq following multiple wars and decades of neglect by the former regime. This enormous effort is taking place in an unstable security environment, concurrent with Iraqi efforts to transition to its first permanent government. The United States' reconstruction assistance goal is to help the Iraqi government develop a democratic, stable, and prosperous country, at peace with itself and its neighbors, a partner in the war against terrorism, enjoying the benefits of a free society and a market economy.

My testimony today is based on the four reports that we have issued to the Congress since July 2005 and our recent trips to Iraq. Since July 2005, we have reported on (1) the status of funding and reconstruction efforts in Iraq, focusing on the progress we have achieved and the challenges we face in rebuilding Iraq's infrastructure; (2) U.S. reconstruction efforts in the water and sanitation sector; (3) U.S. assistance for the January 2005 Iraqi elections; and (4) U.S. efforts to stabilize the security situation in Iraq (a classified report). We continue to review U.S. efforts to train and equip Iraqi security forces, develop the oil and electricity sectors, reduce corruption, and enhance the capacity of Iraqi ministries.

Based on these four reports and recent audit work conducted in Iraq, I will discuss the challenges (1) that the United States faces in its rebuilding and stabilization efforts and (2) that the Iraqi government faces in financing future requirements.

This statement includes unclassified information only and is based on recent GAO reports. We conducted our reviews for these reports between September 2004 and October 2005 in accordance with generally accepted government auditing standards. In addition, we recently conducted audit work in Iraq in November 2005 and January 2006.

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## Summary

The United States faces three key challenges in rebuilding and stabilizing Iraq. First, the continuing strength of the insurgency has made it difficult for the multinational force to develop effective and loyal Iraqi security forces, transfer security responsibilities to them, and progressively draw down U.S. forces in Iraq. The security situation in Iraq has also affected rebuilding efforts. The security situation has deteriorated since June 2003,

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with significant increases in attacks against the coalition and coalition partners. Second, inadequate performance data and measures make it difficult to determine the overall progress and impact of U.S. reconstruction efforts. Although the United States has set broad goals for providing essential services in Iraq, limited performance measures present challenges in determining the overall impact of U.S. projects. Third, the U.S. reconstruction program has encountered difficulties with Iraq's inability to sustain new and rehabilitated infrastructure projects and to address maintenance needs in the water, sanitation, and electricity sectors. U.S. agencies are working to develop better performance data and plans for sustaining the rehabilitated infrastructure.

As the new Iraqi government forms, it must plan to secure the financial resources it will need to continue the reconstruction and stabilization efforts begun by the United States and international community. Iraq will likely need more than the \$56 billion that the World Bank, United Nations (UN), and the Coalition Provisional Authority (CPA) estimated it would require for reconstruction and stabilization efforts from 2004 through 2007. More severely degraded infrastructure, post-2003 conflict looting and sabotage, and additional security costs have added to the country's basic reconstruction needs. It is unclear how Iraq will finance these additional requirements. While the United States has carried the primary financial responsibility for rebuilding and stabilizing Iraq, its commitments are largely obligated and remaining commitments and future contributions are not finalized. Further, U.S. appropriations were never intended to meet all Iraqi needs. In addition, international donors have mostly committed loans for the reconstruction of Iraq that the government is just beginning to access. Iraq's ability to contribute financially to its own rebuilding and stabilization efforts will depend on the new government's efforts to increase revenues obtained from crude oil exports, reduce energy and food subsidies, control government operating expenses, provide for a growing security force, and repay \$84 billion in external debt and war reparations.

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## Background

From May 2003 through June 2004, the CPA, led by the United States and the United Kingdom, was the UN-recognized coalition authority responsible for the temporary governance of Iraq and for overseeing, directing, and coordinating the reconstruction effort. In May 2003, the CPA dissolved the military organizations of the former regime and began the process of creating or reestablishing new Iraqi security forces, including the police and a new Iraqi army. Over time, multinational force commanders assumed responsibility for recruiting and training some Iraqi

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defense and police forces in their areas of responsibility.<sup>1</sup> In May 2004, the President issued a National Security Presidential Directive, which stated that, after the transition of power to the Iraqi government, the Department of State (State), through its ambassador to Iraq, would be responsible for all U.S. activities in Iraq except for security and military operations. U.S. activities relating to security and military operations would be the responsibility of the Department of Defense (DOD). The Presidential Directive required the U.S. Central Command (CENTCOM) to direct all U.S. government efforts to organize, equip, and train Iraqi security forces. The Multi-National Security Transition Command-Iraq, which operates under Multi-National Force-Iraq (MNF-I), now leads coalition efforts to train, equip, and organize Iraqi security forces.

Other U.S. government agencies also play significant roles in the reconstruction effort. The U.S. Agency for International Development (USAID) is responsible for projects to restore Iraq's infrastructure, support healthcare and education initiatives, expand economic opportunities for Iraqis, and foster improved governance. The U.S. Army Corps of Engineers provides engineering and technical services to USAID, State, and military forces in Iraq. In December 2005, the responsibilities of the Project Contracting Office (PCO), a temporary organization responsible for program, project, asset, and financial management of construction and nonconstruction activities, were merged with those of the U.S. Army Corps of Engineers Gulf Region Division.

On June 28, 2004, the CPA transferred power to an interim sovereign Iraqi government, the CPA was officially dissolved, and Iraq's transitional period began. Under Iraq's transitional law,<sup>2</sup> the transitional period included the completion of a draft constitution in October 2005 and two subsequent elections—a referendum on the constitution and an election for a permanent government.<sup>3</sup> The Iraqi people approved the constitution on October 15, 2005, and voted for representatives to the Iraq Council of Representatives on December 15, 2005. As of February 3, 2006, the Independent Electoral Commission of Iraq had not certified the election results for representatives.

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<sup>1</sup>The CPA was responsible for police training at the Baghdad and Jordan academies. The Iraqi army units were trained by the Multi-National Security Transition Command-Iraq.

<sup>2</sup>Law of Administration for the State of Iraq for the Transitional Period, March 2004.

<sup>3</sup>See GAO, *Iraq's Transitional Law*, [GAO-04-746R](#) (Washington, D.C.: May 25, 2004), for more information on key events during Iraq's transitional period.

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Once certified, the representatives are to form a permanent government. According to U.S. officials and Iraqi constitutional experts, the new Iraqi government is likely to confront the same issues it confronted prior to the referendum—the power of the central government, control of Iraq’s natural resources, and the application of Islamic law. According to U.S. officials, once the Iraqi legislature commences work, it will form a committee that has 4 months to recommend amendments to the constitution. To take effect, these proposed amendments must be approved by the Iraqi legislature and then Iraqi citizens must vote on them in a referendum within 2 months.<sup>4</sup>

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## Security, Measurement, and Sustainability Challenges in Rebuilding and Stabilizing Iraq

The United States faces three key challenges in stabilizing and rebuilding Iraq. First, the unstable security environment and the continuing strength of the insurgency have made it difficult for the United States to transfer security responsibilities to Iraqi forces and to engage in rebuilding efforts. Second, inadequate performance data and measures make it difficult to determine the overall progress and impact of U.S. reconstruction efforts. Third, the U.S. reconstruction program has encountered difficulties with Iraq’s inability to sustain new and rehabilitated infrastructure projects and to address maintenance needs in the water, sanitation, and electricity sectors. U.S. agencies are working to develop better performance data and plans for sustaining rehabilitated infrastructure.

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## Strength of the Insurgency Has Made It Difficult to Transfer Security Responsibilities to Iraqi Forces and Engage in Rebuilding Efforts

Over the past 2½ years, significant increases in attacks against the coalition and coalition partners have made it difficult to transfer security responsibilities to Iraqi forces and to engage in rebuilding efforts in Iraq. The insurgency in Iraq intensified through October 2005 and has remained strong since then. Poor security conditions have delayed the transfer of security responsibilities to Iraqi forces and the drawdown of U.S. forces in Iraq. The unstable security environment has also affected the cost and schedule of rebuilding efforts and has led, in part, to project delays and increased costs for security services. Recently, the administration has taken actions to integrate military and civilian rebuilding and stabilization efforts.

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<sup>4</sup>The referendum is successful if it is approved by the majority of the voters and is not rejected by two-thirds of the voters in three or more governorates.

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Insurgency Has Intensified and Delayed the Transfer of Security Responsibilities

The insurgency intensified through October 2005 and has remained strong since then. As we reported in March 2005, the insurgency in Iraq—particularly the Sunni insurgency—grew in complexity, intensity, and lethality from June 2003 through early 2005.<sup>5</sup> According to a February 2006 testimony by the Director of National Intelligence, insurgents are using increasingly lethal improvised explosive devices and continue to adapt to coalition countermeasures.<sup>6</sup>

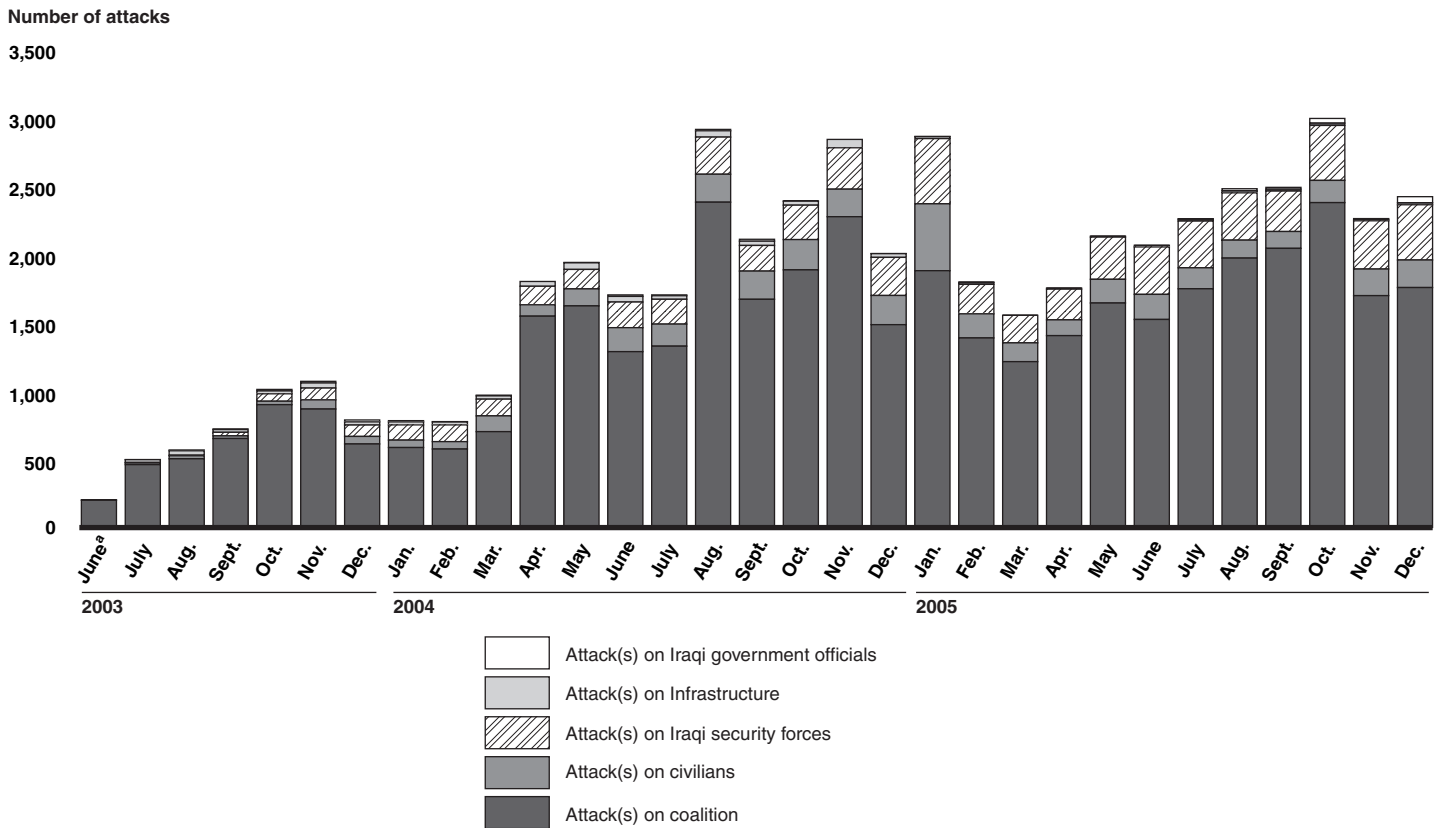
As shown in figure 1, enemy-initiated attacks against the coalition, its Iraqi partners, and infrastructure increased in number over time. The highest peak occurred during October 2005, around the time of Ramadan and the October referendum on Iraq's constitution. This followed earlier peaks in August and November 2004 and January 2005. According to a senior U.S. military officer, attack levels ebb and flow as the various insurgent groups—almost all of which are an intrinsic part of Iraq's population—rearm and attack again.

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<sup>5</sup>For more information on security trends and the makeup of the insurgency, see GAO, *Rebuilding Iraq: Preliminary Observations on Challenges in Transferring Security Responsibilities to Iraqi Military and Police*, [GAO-05-431T](#) (Washington, D.C.: Mar. 14, 2005).

<sup>6</sup>U.S. Senate, Senate Select Committee on National Intelligence, *Current and Projected National Security Threats to the United States*, Washington, D.C.: Feb. 2, 2006.

**Figure 1: Enemy-Initiated Attacks against the Coalition and Its Partners, by Category, June 2003 through December 2005**



Source: Multi-national Corps-Iraq, Multi-national Force-Iraq, February 2006.

<sup>a</sup>According to DIA officials, June 2003 data are incomplete.

As the administration has reported, insurgents share the goal of expelling the coalition from Iraq and destabilizing the Iraqi government to pursue their individual and, at times, conflicting goals.<sup>7</sup> Iraqi Sunnis make up the largest portion of the insurgency and present the most significant threat to stability in Iraq. In February 2006, the Director of National Intelligence reported that the Iraqi Sunnis' disaffection is likely to remain high in 2006, even if a broad, inclusive national government emerges. These insurgents continue to demonstrate the ability to recruit, supply, and attack coalition

<sup>7</sup>Department of Defense, *Report to Congress, Measuring Stability and Security in Iraq*, July 20, 2005. National Security Council, *National Strategy for Victory in Iraq*, November 2005.



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and Iraqi security forces. Their leaders continue to exploit Islamic themes, nationalism, and personal grievances to fuel opposition to the government and recruit more fighters. According to the Director, the most extreme Sunni jihadists, such as al-Qaeda in Iraq, will remain unreconciled and continue to attack Iraqi and coalition forces. The remainder of the insurgency consists of radical Shia groups, some of whom are supported by Iran, violent extremists, criminals, and, to a lesser degree, foreign fighters. According to the Director of National Intelligence, Iran provides guidance and training to select Iraqi Shia political groups and weapons and training to Shia militant groups to enable anticoalition attacks. Iran also has contributed to the increasing lethality of anticoalition attacks by enabling Shia militants to build improvised explosive devices with explosively formed projectiles, similar to those developed by Iran and Lebanese Hizballah.

The continuing strength of the insurgency has made it difficult for the multinational force to develop effective and loyal Iraqi security forces, transfer security responsibilities to them, and progressively draw down U.S. forces in Iraq.<sup>8</sup> The Secretary of Defense and MNF-I recently reported progress in developing Iraqi security forces, saying that these forces continue to grow in number, take on more responsibilities, and increase their lead in counterinsurgency operations in some parts of Iraq. For example, in December 2005 and January 2006, MNF-I reported that Iraqi army battalions and brigades had assumed control of battle space<sup>9</sup> in parts of Ninewa, Qadisiyah, Babil, and Wasit provinces. According to the Director for National Intelligence, Iraqi security forces are taking on more-demanding missions, making incremental progress toward operational independence, and becoming more capable of providing security. In the meantime, coalition forces continue to support and assist the majority of Iraqi security forces as they develop the capability to operate independently.

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<sup>8</sup>As we previously reported, the multinational force attempted to shift responsibilities to Iraqi security forces during spring 2004 but did not succeed. In response, resources available for developing Iraqi security forces were increased during fiscal years 2004 and 2005. In November 2003, the United States decided to maintain a force level of about 138,000 troops until at least the end of 2005, rather than drawing down to 105,000 troops by May 2004 as DOD had announced in November 2003. In December 2005, DOD announced a drawdown from 17 to 15 U.S. combat brigades, a decrease to about 131,000 U.S. military personnel, by spring 2006.

<sup>9</sup>Battle space can be defined as the physical space in which Iraqi security forces are conducting operations.

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Security Situation and  
Management Issues Have  
Affected Rebuilding Efforts

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However, recent reports have recognized limitations in the effectiveness of Iraqi security forces. For example, DOD's October 2005 report notes that Iraqi forces will not be able to operate independently for some time because they need logistical capabilities, ministry capacity, and command and control and intelligence structures.<sup>10</sup> In the November 2005 National Strategy for Victory in Iraq, the administration cited a number of challenges to developing effective Iraqi security forces, including the need to guard against infiltration by elements whose first loyalties are to institutions other than the Iraqi government and to address the militias and armed groups that are outside the formal security sector and government control. Moreover, according to the Director of National Intelligence's February 2006 report, Iraqi security forces are experiencing difficulty in managing ethnic and sectarian divisions among their units and personnel. GAO's classified report on Iraq's security situation provided further information and analysis on the challenges to developing Iraqi security forces and the conditions for the phased drawdown of U.S. and other coalition forces.<sup>11</sup>

The security situation in Iraq has affected the cost and schedule of reconstruction efforts. Security conditions have, in part, led to project delays and increased costs for security services. Although it is difficult to quantify the costs and delays resulting from poor security conditions, both agency and contractor officials acknowledged that security costs have diverted a considerable amount of reconstruction resources and have led to canceling or reducing the scope of some reconstruction projects. For example, in March 2005, USAID cancelled two task orders<sup>12</sup> related to power generation that totaled nearly \$15 million to help pay for the increased security costs incurred at another power generation project in southern Baghdad. In another example, work was suspended at a sewer repair project in central Iraq for 4 months in 2004 due to security concerns. In January 2006, State reported that direct and indirect security

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<sup>10</sup>Department of Defense, *Report to Congress, Measuring Stability and Security in Iraq*, October 2005.

<sup>11</sup>GAO, *DOD Reports Should Link Economic, Governance, and Security Indicators to Conditions for Stabilizing Iraq*, [GAO-06-152C](#) (Washington, D.C.: Oct. 2005).

<sup>12</sup>Task orders are placed against established contracts for the performance of tasks during the period of the contracts.

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costs represent 16 to 22 percent of the overall cost of major infrastructure reconstruction projects.<sup>13</sup>

In addition, the security environment in Iraq has led to severe restrictions on the movement of civilian staff around the country and reductions of a U.S. presence at reconstruction sites, according to U.S. agency officials and contractors. For example, the Project Contracting Office reported in February 2006, the number of attacks on convoys and casualties had increased from 20 convoys attacked and 11 casualties in October 2005 to 33 convoys attacked and 34 casualties in January 2006. In another example, work at a wastewater plant in central Iraq was halted for approximately 2 months in early 2005 because insurgent threats drove away subcontractors and made the work too hazardous to perform. In the assistance provided to support the electoral process, U.S.-funded grantees and contractors also faced security restrictions that hampered their movements and limited the scope of their work. For example, IFES<sup>14</sup> was not able to send its advisors to most of the governorate-level elections administration offices, which hampered training and operations at those facilities leading up to Iraq's Election Day on January 30, 2005.

While poor security conditions have slowed reconstruction and increased costs, a variety of management challenges also have adversely affected the implementation of the U.S. reconstruction program. In September 2005, we reported that management challenges such as low initial cost estimates and delays in funding and awarding task orders have led to the reduced scope of the water and sanitation program and delays in starting projects. In addition, U.S. agency and contractor officials have cited difficulties in initially defining project scope, schedule, and cost, as well as concerns with project execution, as further impeding progress and increasing program costs. These difficulties include lack of agreement among U.S. agencies, contractors, and Iraqi authorities; high staff turnover; an inflationary environment that makes it difficult to submit accurate pricing; unanticipated project site conditions; and uncertain ownership of project sites.

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<sup>13</sup>Department of State, *Report to Congress, Section 2207 Report on Iraq Relief and Reconstruction*, January 2006.

<sup>14</sup>IFES is a nonpartisan, nonprofit organization founded in 1987 that provides technical assistance concerning democracy and governance to transitional democracies. In 2004, USAID gave IFES a \$40 million grant to provide technical assistance to the Independent Electoral Commission of Iraq through the end of 2005 to help it administer elections.

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Recent Actions to Integrate  
Military and Civilian Rebuilding  
and Stabilization Efforts

Our ongoing work on Iraq's energy sectors and the management of design-build contracts will provide additional information on the issues that have affected the pace and costs of reconstruction.

The Administration has taken steps to develop a more comprehensive, integrated approach to combating the insurgency and stabilizing Iraq. The National Strategy for Victory in Iraq lays out an integrated political, military, and economic strategy that goes beyond offensive military operations and the development of Iraqi security forces in combating the insurgency. Specifically, it calls for cooperation with and support for local governmental institutions, the prompt dispersal of aid for quick and visible reconstruction, and central government authorities who pay attention to local needs.

Toward that end, U.S. agencies are developing tools for integrating political, economic, and security activities in the field. For example, USAID is developing the Focused Stabilization Strategic City Initiative that will fund social and economic stabilization activities in communities within 10 strategic cities. The program is intended to jump-start the development of effective local government service delivery by directing local energies from insurgency activities toward productive economic and social opportunities. The U.S. embassy in Baghdad and MNF-I are also developing provincial assistance teams<sup>15</sup> as a component of an integrated counterinsurgency strategy. These teams would consist of coalition military and civilian personnel who would assist Iraq's provincial governments with (1) developing a transparent and sustained capability to govern; (2) promoting increased security, rule of law, and political and economic development; and (3) providing the provincial administration necessary to meet the basic needs of the population. It is unclear whether these two efforts will become fully operational, as program documents have noted problems in providing funding and security for them.

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<sup>15</sup>As of late January 2006, these teams were called Provincial Reconstruction Teams, or PRTs. A U.S. embassy document, however, called for changing the name to Provincial Assistance Teams, or PATs, to reflect the main effort of the teams—capacity development and sustainability of the provincial government. Three provincial teams were operational as of mid-January 2006.

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Limited Performance Data and Measures and Inadequate Reporting Present Difficulties in Determining Progress and Impact of Rebuilding Effort

State has set broad goals for providing essential services, and the U.S. program has undertaken many rebuilding activities in Iraq. The U.S. program has made some progress in accomplishing rebuilding activities, such as rehabilitating some oil facilities to restart Iraq's oil production, increasing electrical generation capacity, restoring some water treatment plants, and building Iraqi health clinics. However, limited performance data and measures make it difficult to determine and report on the progress and impact of U.S. reconstruction. Although information is difficult to obtain in an unstable security environment, State reported that it is currently finalizing a set of metrics to track the impact of reconstruction efforts.

- In the water and sanitation sector, the Department of State has primarily reported on the numbers of projects completed and the expected capacity of reconstructed treatment plants. However, we found that the data are incomplete and do not provide information on the scope and cost of individual projects nor do they indicate how much clean water is reaching intended users as a result of these projects. Moreover, reporting only the number of projects completed or under way provides little information on how U.S. efforts are improving the amount and quality of water reaching Iraqi households or their access to sanitation services. Information on access to water and its quality is difficult to obtain without adequate security or water-metering facilities.
- Limitations in health sector measurements also make it difficult to relate the progress of U.S. activities to its overall effort to improve the quality and access of health care in Iraq. Department of State measurements of progress in the health sector primarily track the number of completed facilities, an indicator of increased access to health care. However, the data available do not indicate the adequacy of equipment levels, staffing levels, or quality of care provided to the Iraqi population. Monitoring the staffing, training, and equipment levels at health facilities may help gauge the effectiveness of the U.S. reconstruction program and its impact on the Iraqi people.
- In the electricity sector, U.S. agencies have primarily reported on generation measures such as levels of added or restored generation capacity and daily power generation of electricity; numbers of projects completed; and average daily hours of power. However, these data do not show whether (1) the power generated is uninterrupted for the period specified (e.g., average number of hours per day); (2) there are regional or geographic differences in the quantity of power generated; and (3) how much power is reaching intended users. Information on the distribution

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and access of electricity is difficult to obtain without adequate security or accurate metering capabilities.

Opinion surveys and additional outcome measures have the potential to gauge the impact of the U.S. reconstruction efforts on the lives of Iraqi people and their satisfaction with these sectors. A USAID survey in 2005 found that the Iraqi people were generally unhappy with the quality of their water supply, waste disposal, and electricity services but approved of the primary health care services they received. In September 2005, we recommended that the Secretary of State address this issue of measuring progress and impact in the water and sanitation sector. State agreed with our recommendation and stated in January 2006 that it is currently finalizing a set of standard methodologies and metrics for water and other sectors that could be used to track the impact of U.S. reconstruction efforts.

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### Iraq's Capacity to Operate and Maintain U.S.-Funded Projects Presents Sustainability Problems

The U.S. reconstruction program has encountered difficulties with Iraq's ability to sustain the new and rehabilitated infrastructure and address maintenance needs. In the water, sanitation, and electricity sectors, in particular, some projects have been completed but have sustained damage or become inoperable due to Iraq's problems in maintaining or properly operating them. State reported in January 2006 that several efforts were under way to improve Iraq's ability to sustain the infrastructure rebuilt by the United States.

- In the water and sanitation sector, U.S. agencies have identified limitations in Iraq's capacity to maintain and operate reconstructed facilities, including problems with staffing, unreliable power to run treatment plants, insufficient spare parts, and poor operations and maintenance procedures.<sup>16</sup> The U.S. embassy in Baghdad stated that it was moving from the previous model of building and turning over projects to Iraqi management toward a "build-train-turnover" system to protect the U.S. investment. However, these efforts are just beginning, and it is unclear whether the Iraqis will be able to maintain and operate completed projects and the more than \$1 billion in additional large-scale water and sanitation projects expected to be completed through 2008. In September 2005, we

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<sup>16</sup>See [GAO-06-179T](#) and GAO, *Rebuilding Iraq: U.S. Water and Sanitation Efforts Need Improved Measures for Assessing Impact and Sustained Resources for Maintaining Facilities*, [GAO-05-872](#) (Washington, D.C.: Sept. 2005), on limitations in the Iraqis' capacity to maintain and operate reconstructed facilities.

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recommended that the Secretary of State address the issue of sustainability in the water and sanitation sector. State agreed with our recommendation and stated that it is currently working with the Iraqi government to assess the additional resources needed to operate and maintain water and sanitation facilities that have been constructed or repaired by the United States.

- In the electricity sector, the Iraqis' capacity to operate and maintain the power plant infrastructure and equipment provided by the United States remains a challenge at both the plant and ministry levels. As a result, the infrastructure and equipment remain at risk of damage following their transfer to the Iraqis. In our interviews with Iraqi power plant officials from 13 locations throughout Iraq, the officials stated that their training did not adequately prepare them to operate and maintain the new U.S.-provided gas turbine engines. Due to limited access to natural gas, some Iraqi power plants are using low-grade oil to fuel their natural gas combustion engines. The use of oil-based fuels, without adequate equipment modification and fuel treatment, decreases the power output of the turbines by up to 50 percent, requires three times more maintenance, and could result in equipment failure and damage that significantly reduces the life of the equipment, according to U.S. and Iraqi power plant officials. U.S. officials have acknowledged that more needs to be done to train plant operators and ensure that advisory services are provided after the turnover date. In January 2006, State reported that it has developed a strategy with the Ministry of Electricity to focus on rehabilitation and sustainment of electricity assets.

Although agencies have incorporated some training programs and the development of operations and maintenance capacity into individual projects, problems with the turnover of completed projects, such as those in the water and sanitation and electricity sectors, have led to a greater interagency focus on improving project sustainability and building ministry capacity. In May 2005, an interagency working group including State, USAID, PCO, and the Army Corps of Engineers was formed to identify ways to address Iraq's capacity-development needs. The working group reported that a number of critical infrastructure facilities constructed or rehabilitated under U.S. funding have failed, will fail, or will operate in suboptimized conditions following handover to the Iraqis. To mitigate the potential for project failures, the working group recommended increasing the period of operational support for constructed facilities from 90 days to up to 1 year. In January 2006, State reported that it has several efforts under way focused on improving Iraq's ability to operate and maintain facilities over time. As part of our ongoing review of Iraq's energy sector, we will be assessing the extent to which the

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administration is providing funds to sustain the infrastructure facilities constructed or rehabilitated by the United States.

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## Iraq Faces Challenges in Financing Future Needs

As the new Iraqi government forms, it must plan to secure the financial resources it will need to continue the reconstruction and stabilization efforts begun by the United States and international community. Initial assessments in 2003 identified \$56 billion in reconstruction needs across a variety of sectors in Iraq. However, Iraq's needs are greater than originally anticipated due to severely degraded infrastructure, post-conflict looting and sabotage, and additional security costs. The United States has borne the primary financial responsibility for rebuilding and stabilizing Iraq; however, its commitments are largely obligated and remaining commitments and future contributions are not finalized. Further, U.S. appropriations were never intended to meet all Iraqi needs. International donors have provided a lesser amount of funding for reconstruction and development activities; however, most of the pledged amount is in the form of loans that Iraq has just begun to access. Finally, Iraq's ability to contribute financially to its additional rebuilding and stabilization needs is dependent upon the new government's efforts to increase revenues obtained from crude oil exports, reduce energy and food subsidies, control government operating expenses, provide for a growing security force, and repay external debt and war reparations.

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## Iraqi Needs May be Greater Than Originally Anticipated

Initial assessments of Iraq's needs through 2007 by the U.N., World Bank, and the CPA estimated that the reconstruction of Iraq would require about \$56 billion. The October 2003 joint UN/World Bank assessment identified \$36 billion, from 2004 through 2007, in immediate and medium-term needs in 14 priority sectors, including education, health, electricity, transportation, agriculture, and cross-cutting areas such as human rights and the environment. For example, the assessment estimated that Iraq would need about \$12 billion for rehabilitation and reconstruction, new investment, technical assistance, and security in the electricity sector. In addition, the assessment noted that the CPA estimated an additional \$20 billion would be needed from 2004 through 2007 to rebuild other critical sectors such as security and oil.

Iraq may need more funding than currently available to meet the demands of the country. The state of some Iraqi infrastructure was more severely degraded than U.S. officials originally anticipated or initial assessments indicated. The condition of the infrastructure was further exacerbated by post-2003 conflict looting and sabotage. For example, some electrical



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facilities and transmission lines were damaged, and equipment and materials needed to operate treatment and sewerage facilities were destroyed by the looting that followed the 2003 conflict. In addition, insurgents continue to target electrical transmission lines and towers as well as oil pipelines that provide needed fuel for electrical generation. In the oil sector, a June 2003 U.S. government assessment found that more than \$900 million would be needed to replace looted equipment at Iraqi oil facilities. These initial assessments assumed reconstruction would take place in a peace-time environment and did not include additional security costs.

Further, these initial assessments assumed that Iraqi government revenues and private sector financing would increasingly cover long-term reconstruction requirements. This was based on the assumption that the rate of growth in oil production and total Iraqi revenues would increase over the next several years. However, private sector financing and government revenues may not yet meet these needs. According to a January 2006 International Monetary Fund (IMF) report, private sector investment will account for 8 percent of total projected investment for 2006, down from 12 percent in 2005.<sup>17</sup> In the oil sector alone, Iraq will likely need an estimated \$30 billion over the next several years to reach and sustain an oil production capacity of 5 million barrels per day, according to industry experts and U.S. officials. For the electricity sector, Iraq projects that it will need \$20 billion through 2010 to boost electrical capacity, according to the Department of Energy's Energy Information Administration.

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## Future Contributions for Iraq Reconstruction May Be Limited

The United States is the primary contributor to rebuilding and stabilization efforts in Iraq. Since 2003, the United States has made available about \$30 billion for activities that have largely focused on infrastructure repair and training of Iraqi security forces. As priorities changed, the United States reallocated about \$5 billion of the \$18.4 billion fiscal year 2004 emergency supplemental among the various sectors, over time increasing security and justice funds while decreasing resources for the water and electricity sectors.<sup>18</sup> As of January 2006, of the \$30 billion appropriated, about \$23

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<sup>17</sup>International Monetary Fund, *Iraq: Request for Stand-By-Arrangement* (Washington, D.C., January 2006).

<sup>18</sup>See Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004, P.L. 108-106.

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billion had been obligated and about \$16 billion had been disbursed for activities that included infrastructure repair, training, and equipping of the security and law enforcement sector; infrastructure repair of the electricity, oil, and water and sanitation sectors; and CPA and U.S. administrative expenses. These appropriations were not intended to meet all of Iraq's needs.

The United States has obligated nearly 80 percent of its available funds. Although remaining commitments and future contributions have not been finalized, they are likely to target activities for building ministerial capacity, sustaining existing infrastructure investments, and training and equipping the Iraqi security forces, based on agency reporting. For example, in January 2006, State reported a new initiative to address Iraqi ministerial capacity development at 12 national ministries. According to State, Embassy Baghdad plans to undertake a comprehensive approach to provide training in modern techniques of civil service policies, requirements-based budget processes, information technology standards, and logistics management systems to Iraqi officials in key ministries.

International donors have provided a lesser amount of funding for reconstruction and development activities. According to State, donors have provided about \$2.7 billion in multilateral and bilateral grants—of the pledged \$13.6 billion—as of December 2005.<sup>19</sup> About \$1.3 billion has been deposited by donors into the two trust funds of the International Reconstruction Fund Facility for Iraq (IRFFI),<sup>20</sup> of which about \$900 million had been obligated and about \$400 million disbursed to individual projects, as of December 2005.<sup>21</sup> Donors also have provided bilateral assistance for Iraq reconstruction activities; however, complete information on this assistance is not readily available. Most of the pledged amount is in the form of loans that the Iraqis have recently begun to access. About \$10 billion, or 70 percent, of the \$13.6 billion pledged in support of Iraq reconstruction is in the form of loans, primarily from the

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<sup>19</sup>According to State information provided in October 2005, in addition to the \$13.6 billion, donors pledged an additional \$203 million for Iraq reconstruction at the IRFFI Donors' Committee meeting in Jordan in July 2005.

<sup>20</sup>The IRFFI was established in response to the June 24, 2003, UN technical meeting and the 2003 Madrid conference's calls for a mechanism to channel and coordinate donor resources for Iraq reconstruction and development activities. The IRFFI is composed of two trust funds, one run by the United Nations Development Group and the other by the World Bank Group.

<sup>21</sup>Data for the UN Iraq Trust Fund portion of the IRFFI are as of November 31, 2005.

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World Bank, the IMF, and Japan. In September 2004, the IMF provided a \$436 million emergency post-conflict assistance loan to facilitate Iraqi debt relief, and in December 2005, Iraq secured a \$685 million Stand-By Arrangement (SBA) with the IMF.<sup>22</sup> On November 29, 2005, the World Bank approved a \$100 million loan within a \$500 million program for concessional international development assistance.

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### Iraq Must Address Budget Constraints to Contribute to Future Rebuilding and Stabilization Efforts

Iraq's fiscal ability to contribute to its own rebuilding is constrained by the amount of revenues obtained from crude oil exports, continuing subsidies for food and energy, growing costs for government salaries and pensions, increased demands for an expanding security force, and war reparations and external debt.

Crude oil exports account for nearly 90 percent of the Iraqi government revenues in 2006, according to the IMF. Largely supporting Iraq's government operations and subsidies, crude oil export revenues are dependent upon export levels and market price. The Iraqi 2006 budget has projected that Iraq's crude oil export revenues will grow at an annual growth rate of 17 percent per year (based on an average production level of 2 million bpd in 2005 to 3.6 million bpd in 2010), estimating an average market price of about \$46 per barrel. Oil exports are projected to increase from 1.4 million bpd in 2005 to 1.7 million bpd in 2006, according to the IMF. Iraq's current crude oil export capacity is theoretically as high as 2.5 million bpd, according to the Energy Information Administration at the Department of Energy. However, Iraq's crude oil export levels have averaged 1.4 million bpd as of December 2005, in part due to attacks on the energy infrastructure and pipelines. In January 2006, crude oil export levels fell to an average of about 1.1 million bpd.<sup>23</sup>

Further, a combination of insurgent attacks on crude oil and product pipelines, dilapidated infrastructure, and poor operations and maintenance have hindered domestic refining and have required Iraq to import significant portions of liquefied petroleum gas, gasoline, kerosene, and

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<sup>22</sup>If Iraq needs balance-of-payment support, the IMF has agreed to provide \$685 million as part of the SBA.

<sup>23</sup>According to State Department monthly estimates from January 2005 to January 2006, crude oil production averages ranged from 1.71 to 2.17 million bpd and monthly crude oil export averages ranged from 1.05 to 1.61 million bpd.

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diesel. According to State, the Iraqi Oil Ministry estimates that the current average import cost of fuels is roughly \$500 million each month.

Current government subsidies constrain opportunities for growth and investment and have kept prices for food, oil, and electricity low. Before the war, at least 60 percent of Iraqis depended on monthly rations—known as the public distribution system (PDS)—provided by the UN Oil for Food program to meet household needs. The PDS continues to provide food subsidies to Iraqis. In addition, Iraqis pay below-market prices for refined fuels and, in the absence of effective meters, for electricity and water. Low prices have encouraged over-consumption and have fueled smuggling to neighboring countries. Food and energy subsidies account for about 18 percent of Iraq's projected gross domestic product (GDP) for 2006.

As part of its Stand-By Arrangement with the IMF, Iraq plans to reduce the government subsidy of petroleum products, which would free up oil revenues to fund additional needs and reduce smuggling. According to the IMF, by the end of 2006, the Iraqi government plans to complete a series of adjustments to bring fuel prices closer to those of other Gulf countries. However, it is unclear whether the Iraqi government will have the political commitment to continue to raise fuel prices.

Generous wage and pension benefits have added to budgetary pressures. Partly due to increases in these benefits, the Iraqi government's operating expenditures are projected to increase by over 24 percent from 2005 to 2006, according to the IMF. As a result, wages and pensions constitute about 21 percent of projected GDP for 2006. The IMF noted that it is important for the government to keep non-defense wages and pensions under firm control to contain the growth of civil service wages. As a first step, the Iraqi government plans to complete a census of all public service employees by June 2006.

Iraq plans to spend more resources on its own defense. Iraq's security-related spending is currently projected to be about \$5.3 billion in 2006, growing from 7 to about 13 percent of projected GDP. The amount reflects rising costs of security and the transfer of security responsibilities from the United States to Iraq.

The Iraqi government also owes over \$84 billion to victims of its invasion of Kuwait and international creditors. As of December 2005, Iraq owed

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about \$33 billion in unpaid awards resulting from its invasion and occupation of Kuwait. As directed by the UN, Iraq currently deposits 5 percent of its oil proceeds into a UN compensation fund.<sup>24</sup> Final payment of these awards could extend through 2020 depending on the growth of Iraq's oil proceeds. In addition, the IMF estimated that Iraq's external debt was about \$51 billion at the end of 2005.

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## Conclusion

For the past 2½ years, the United States has provided \$30 billion with the intent of developing capable Iraqi security forces, rebuilding a looted and worn infrastructure, and supporting democratic elections. However, the United States has confronted a lethal insurgency that has taken many lives and made rebuilding Iraq a costly and challenging endeavor. It is unclear when Iraqi security forces will be able to operate independently, thereby enabling the United States to reduce its military presence.

Similarly, it is unclear how U.S. efforts are helping Iraq obtain clean water, reliable electricity, or competent health care. Measuring the outcomes of U.S. efforts is important to ensure that the U.S. dollars spent are making a difference in the daily lives of the Iraqi people. In addition, the United States must ensure that the billions of dollars it has already invested in Iraq's infrastructure are not wasted. The Iraqis need additional training and preparation to operate and maintain the power plants, water and sewage treatment facilities, and health care centers the United States has rebuilt or restored. In response to our reports, State has begun to develop metrics for measuring progress and plans for sustaining the U.S.-built infrastructure. The administration's next budget will reveal its level of commitment to these challenges.

But the challenges are not exclusively those of the United States. The Iraqis face the challenge of forming a government that has the support of all ethnic and religious groups. They also face the challenge of addressing those constitutional issues left unresolved from the October referendum—power of the central government, control of Iraq's natural resources, and

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<sup>24</sup>The UN Security Council established the UN Compensation Commission in 1991 to process claims and pay compensation for damages and losses resulting from Iraq's invasion and occupation of Kuwait; along with the Oil for Food program, the commission received funding from Iraqi oil proceeds. In May 2003, UN Security Council Resolution 1483 directed that 5 percent of oil proceeds are to be deposited into the UN Compensation Fund account. As of January 2006, the commission had awarded \$52.5 billion to more than 1.5 million claimants and paid out about \$20 billion of this amount.

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the application of Islamic law. The new government also faces the equally difficult challenges of reducing subsidies, controlling public salaries and pensions, and sustaining the growing number of security forces. This will not be easy, but it is necessary for the Iraqi government to begin to contribute to its own rebuilding and stabilization efforts and to encourage investment by the international community and private sector.

We continue to review U.S. efforts to train and equip Iraqi security forces, develop the oil and electricity sectors, reduce corruption, and enhance the capacity of Iraqi ministries. Specifically, we will examine efforts to stabilize Iraq and develop its security forces, including the challenge of ensuring that Iraq can independently fund, sustain, and support its new security forces; assess issues related to the development of Iraq's energy sector, including the sectors' needs as well as challenges such as corruption; and examine capacity-building efforts in the Iraqi ministries.

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Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or the other Committee members may have.

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## Contact and Staff Acknowledgments:

For further information, please contact Joseph A. Christoff on (202) 512-8979. Individuals who made key contributions to this testimony were Monica Brym, Lynn Cothorn, Bruce Kutnick, Steve Lord, Sarah Lynch, Judy McCloskey, Micah McMillan, Tet Miyabara, Jose Pena III, Audrey Solis, and Alper Tunca.

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