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Future of Iraq

Alan P. Larson, Under Secretary for Economic, Business, and Agricultural Affairs

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Introduction

The liberation of Iraq was a triumph of American armed forces, working with coalition forces. The reconstruction of Iraq must be a triumph of the Iraqi people, working with the coalition and the international community. Our military victory was swift and decisive. The rebuilding of Iraq after decades of misgovernment will take longer. Most of this work will -- and rightly should -- fall to the citizens of Iraq. It is their country, and they must ultimately decide how it takes shape. The United States and other friends of the Iraqi people will be there to assist, and to advise. A free, democratic and prosperous Iraq will remove an island of hatred that long threatened its neighbors and the United States.

Update

The situation on the ground in Iraq remains tense. Gunfire, looting and the remnants of Saddam's regime continue to disrupt life in Baghdad and elsewhere. To ensure stability, American troops continue to be deployed throughout the country. In addition, we will stand up an Iraqi national civilian police force within existing structures. In Baghdad, there are already over 7,000 Iraqi police patrolling with U.S. military forces. Until the security situation calms down, it will be difficult for a genuine redevelopment of the Iraqi economy to gather momentum.

Many of the problems that had been widely anticipated did not materialize. We did not see mass hunger, widespread medical emergencies or floods of internally displaced persons. The military plans protected the oil fields from sabotage by Saddam in his final moments.

Looking to the future, there are many things upon which to build. Iraq has a large cadre of talented, dedicated technocrats anxious to return to work. And we have offers from many, many countries ready to provide technical assistance and to do business in Iraq.

We are beginning to see some bright spots. For example:

- water in Baghdad is back at 75% of pre-war levels;
- power is being gradually restored;
- mail delivery has begun around parts of the country;
- the Ministry of Health has been re-established and there is currently no major health crisis;
- primary schools re-opened May 4;
- oil production is increasing;
- the agricultural sector is reviving; and
- shops are open and the retail sector is increasingly active.

My colleagues and I can all tell you of the fine work our people have done on the ground in dangerous and difficult circumstances. Ambassador Bremer, General Garner and their teams have worked hard to bring order out of a chaotic situation. Ambassador Bremer is moving quickly to establish coalition authority in the country. State, USAID, Defense, Treasury, Justice and others have experts in the field looking at key reconstruction issues. Ambassador Bremer has made real progress in establishing communications with Washington, and in organizing his own resources to meet the

challenges ahead. We in Washington have also organized ourselves to be as helpful to Ambassador Bremer and his team as possible, as they progress from the current situation, where stability and provision of basic services are critical, to a time when we can address broader policy issues.

Some practical steps have already been achieved by the team in Baghdad. For example, an early goal of ours was to re-start economic activity by getting people back to work, and to employ the energy and talent of the Iraqi people in rebuilding the country. In order to get Iraqis untainted by strong links to the Ba'ath Party back to work, the Office of the Coalition Provisional Authority (OCPA), in consultation with Defense, Treasury, State and OMB, has begun making "emergency" salary payments to Iraqis in key sectors. These payments have brought port workers back to work at Umm Qasr, and key civil servants back to critical jobs at important ministries, for example the Ministry of Trade. And putting cash back into pockets means giving people money to spend on goods and services, which spurs economic activity.

UNSC Resolution 1483: A Framework for Reconstruction

President Bush has made clear his desire to work with the United Nations, other international organizations and other nations to rebuild Iraq. UN Security Council Resolution 1483 provides an important framework for economic development in Iraq. UNSCR 1483:

- Recognizes the United States and United Kingdom as the "Authority" and charges us with carrying out the responsibilities and obligations of this role for the welfare of the Iraqi people.
- Ends the economic sanctions in place for more than a decade, allowing trade and financial transactions with the world.
- Provides for a significant role for the United Nations in:
 - humanitarian and reconstruction assistance;
 - return of refugees;
 - restoring and establishing national and local institutions for representative governance;
 - formation of an Iraqi interim administration; and
 - coordination of humanitarian and reconstruction assistance by a Special Representative of the Secretary General (Mr. Sergio Vieira de Mello has been named to this position).
- Establishes a Development Fund for Iraq to be used to meet humanitarian needs, for reconstruction and repair of Iraq's infrastructure, and other purposes benefiting the Iraqi people. Specific requirements include:
 - receiving proceeds of all export sales of petroleum and natural gas from Iraq, along with remaining UN funds designated for Iraq, and frozen assets that had belonged to the Government of Iraq or designated senior officials, including Saddam Hussein;
 - disbursing money in a transparent manner, at the direction of the Coalition Authority, with expenditures to be audited by independent public accountants: the humanitarian needs of the Iraqi people; rebuilding the economy and infrastructure; continued disarmament; the costs of civilian administration; and for other purposes that benefit the people of Iraq; and
 - formation of an International Advisory and Monitoring Board, comprising representatives of the UN Secretary General, the IMF Managing Director, the Director General of the Arab Fund for Economic and Social Development and the World Bank President.
- Supports efforts by the Iraqi people to form a representative government based on equal rights and justice for all Iraqi citizens.
- Calls upon the international community and multilateral institutions to assist with the reconstruction and development of the Iraqi economy.
- Provides for a six-month winding-down of the Oil for Food Program (OFF), and removes restrictions on oil exports and sales.

The Job Ahead: Key Challenges of Reconstruction

We speak about the “reconstruction” of Iraq, but that word is misleading. We are looking not at reconstruction, but at construction, not at rebuilding, but at building. The Iraqi people must overcome the damage of 25 years of corrupt and vicious tyranny to build their society into a lively and historic center in the Middle East.

As a result of Saddam Hussein’s misrule, Iraq’s economy deteriorated significantly. GDP fell from almost \$180 billion in 1979 when Saddam took power to around \$50 billion in 2001. Twenty-five years ago per capita income was approximately \$17,000 – on a par with Italy – based on purchasing power. Today, per capita income is around \$2000, comparable to El Salvador. Moreover, the United Nations Development Programme’s Arab Development Report 2002 ranked Iraq in 110th place among 111 countries on its Alternative Human Development Index, which measures such things as life expectancy at birth, educational attainment and enjoyment of civil and political liberties.

Iraq’s economy today not only has shrunk, it is distorted in the way that the economies of Eastern Europe and the Soviet Union once were. Central control removed incentives for production. Overcoming the legacy of state planning and controlled prices will be arduous and time consuming.

There are many tasks ahead, including solving problems in the most critical sectors, properly managing the newly created Development Fund for Iraq, creating a healthy trade and investment climate and transitioning the country off the Oil for Food Program.

Tasks In Four Key Sectors

Oil

The oil sector did not do well in Saddam Hussein's Iraq. The infrastructure suffered from years of neglect, forcing Iraqi engineers to exercise ingenuity and find creative solutions to keep oil production levels as high as possible. The technologies applied to boosting production have in some cases damaged the oil fields. The lack of maintenance, equipment, and spare parts also affected the infrastructure throughout the production chain – from the wellhead to the gas-oil separation plants, to the power plants, to the pumping stations, to the refineries, and to the pipelines.

Since the liberation, Iraqi and U.S. engineers have been working around the clock to restore production so that Iraq will be able to meet domestic needs and begin earning revenues through exports. A lot of progress has been made already, but much more remains to be done. Because the oil sector is of such central importance and the issues it faces so complex, I will provide more details about it later in my testimony.

Food and Agriculture

The complexity of the task of reconstruction and reintroduction of market principles is well illustrated in the food and agriculture sector.

Under Saddam, agricultural productivity suffered from low investment, input shortages, poor agricultural and irrigation practices, droughts and soil salinity. Returning Iraqi agriculture to productivity and competitiveness is a major challenge we face.

Iraq has not been food-self sufficient, traditionally importing 60-70 percent of its caloric needs. Thus as we rebuild agricultural production to be competitive, we will also need to ensure that a vibrant trading environment exists.

The government rationing system provided a majority of Iraqis with food. Procurement and production of staples, like grains, were by the government. Neither production nor consumption reflected market prices.

Winding down the Oil for Food program does not mean the end of the need to feed Iraqis, most of whom have received virtually all their food through OFF. We are in the process of re-activating the food distribution system to do this. Operational responsibilities of buying, shipping, and distributing food and medicine will be transferred to us as the occupying power at the end of six months.

In the short run, we must continue food assistance for the Iraqi population dependent on it. In the longer term, we must move the Iraqi economy from the distortions of the Oil for Food program to a market-driven system with cash salaries so that people can begin to purchase their own food. When freed of government control, the agricultural sector is one of the most responsive to market forces.

Locally produced products, such as fruits and vegetables are now traded freely in open markets. Our challenge will be to extend this to grains, wheat and rice, which are the staples of the Iraqi diet.

USDA and AID have already begun to think through and implement steps needed to reintroduce competitiveness to Iraqi agriculture. For example, USAID and USDA have already designed and are putting in place a project to assist agricultural production and develop agricultural enterprise, credit availability and infrastructure. In the 1980's the United States was Iraq's largest supplier of agricultural products. We now look forward to rebuilding cooperation between Iraqi and U.S. agricultural sectors.

Transport

Critical to Iraq's reconstruction will be the transportation sector, which faces numerous challenges. On May 23, the port of Umm Qasr became the first reconstruction project transferred from military to civilian administration. The basic infrastructure is sound, but has not received proper maintenance for years. Rehabilitation priorities include the port administration buildings, new lighting, utilities, security fences, grain elevators, port dredging so that larger bulk grain vessels can offload near the grain elevators. The adjoining railroad system is also under review for repair to help move the large amount of cargo projected to arrive through the port. Major roadways have also sustained conflict-related damage and will need work.

In civil aviation, the aircraft of Iraqi Airways, the former national carrier, are parked outside Iraq and are not airworthy. Moreover, Baghdad International Airport has taxi lane craters, broken runway lights, unexploded ordinance, plumbing difficulties, and security access control problems. There is also no functioning civil aviation authority to oversee airport security, flight safety oversight, and the administration of civil services. Despite these obstacles, the Coalition Provisional Authority hopes to resume civil services before July to accelerate the flow of U.S. and foreign actors involved in reconstruction efforts. We foresee that with the improvement of Iraq's internal transport system, trade and investment relations with its neighbors will also improve.

USAID contractors Skylink, Bechtel and Global Securities are making preparations for the possible re-opening of Baghdad International Airport to limited commercial traffic by June 15. As part of an interim operation, Global Securities is to provide passenger and baggage screening security, Bechtel a temporary passenger terminal and Skylink airport management. Skylink has also been contracted to assess and make preparations for the re-opening of the Basra Airport. USAID contractor, Stevedoring Services of America, assumed operational responsibility for the deepwater port of Umm Qasr from the British military on May 23.

Telecommunications

Telecommunications remains a critical requirement for OCPA and the reconstruction effort. Prior to the conflict, Iraq had minimal telecommunications -- some three phones per 100 citizens. Although among the lowest levels in the world, even this low figure overstates phone penetration experienced by the average Iraqi since the ruling institutions -- Ba'ath Party, military and government offices -- controlled many of the phones. In addition, there was no wireless system, little Internet and few computers.

In prosecuting the war, command and control systems, and telecommunications centers, were targeted. The war and subsequent looting and fires destroyed some 50 percent of the telephone switches in Baghdad and severed all intercity and international links. Thus, even though about two-thirds of the 800,000 lines in Iraq remain serviceable; they can connect only with phones in their local exchanges.

As part of its efforts to provide security and operations for OCPA, DoD contracted with MCI for a small emergency wireless system for Baghdad, initially involving some 2,000 phones. The United Kingdom Ministry of Defense contracted through Vodafone for similar wireless coverage in the south.

The Department of State has been active in developing a policy response to address the larger telecommunications requirements. State leads an interagency Telecommunications Support Team to coordinate with and support the operations of OCPA's Joint Communications Advisory Board. The interagency team has endorsed a three-phase approach for telecommunications that addresses 1) emergency requirements, 2) telecommunications needs assessments, and 3) development of a broad policy framework for the telecommunications sector reconstruction and development.

The interagency team has also taken the lead in responding to specific telecommunications requests from OCPA,

including that from Ambassador Bremer for an emergency interim nationwide communications system for Iraq. With interagency agreement, State has recommended that USAID contract for the rapid restoration of critical emergency telecommunications facilities. This contract would provide a coherent, integrated management approach to emergency telecommunications that would link 21 cities and provide international connections. It would call for multiple technologies and not prejudge future decisions by service providers about technology. It would support supervisory control and data acquisition (SCADA) systems for other critical sectors -- power, water, refinery, transportation/airport, as well as support medical, fire, police and other emergency response operations. And, most importantly, it would provide these services within 30 days.

In other areas, members of the interagency team are developing a spectrum management plan and a framework for the telecommunications regulatory structure in Iraq that has as its goal a market based, private sector-led telecommunications sector.

Looking forward, there remain several requirements for getting a modern telecommunications system in Iraq. These include repair and building the wireline system, as well as a registration system leading to competitive licensing of wireless service providers so the Iraqi people can benefit from this important technology. We are working, as noted above, to establish the policy infrastructure for this action. It is difficult to speak with precision as to when these actions can be completed, but we hope within a matter of months.

As you can see from a very brief overview of key sectors, Iraq will need assistance to get up and running. Not long-term aid, but shorter-term aid until its economy can function well, and its citizens prosper.

Management of the Country's Finances – The Development Fund for Iraq

Security Council Resolution 1483 directs that oil proceeds be deposited in a Development Fund for Iraq and be used for the humanitarian needs of the Iraqi people, for rebuilding the economy and infrastructure, for continued disarmament, and for the costs of civilian administration. Ambassador Bremer already has created a senior-level Project Review Board, to be chaired by former USAID Director Peter McPherson, that would approve projects and allocate funding sources. This process of reviewing and approving expenditures will provide the basis for a national budget for Iraq; Treasury already has budget experts on the ground in Baghdad working on these issues. We also expect OCPA to design a transparent procurement mechanism for Development Fund expenditures that is consistent with USG procurement guides.

We have worked with other agencies to open accounts for the Development Fund for Iraq in both the Central Bank of Iraq and at the New York Federal Reserve Bank. The Development Fund for Iraq is now open for deposits of oil sale proceeds and other revenues, including transfers from the UN. State is also working closely with the Department of the Treasury to support the work of the International Advisory and Monitoring Board, which will bring representatives of the UN and international financial institutions together to approve auditors for the Development Fund for Iraq.

Creating a Healthy Climate for Trade and Investment

Removing economic and financial sanctions alone will not open trade. We must re-establish Iraq's trade with its neighbors and the world, and establish a healthy business climate for Iraqis and for domestic and foreign investment. Our team in the field has already made a preliminary identification of several key issues. These include:

- establishment of a new tariff schedule;
- removal of non-tariff barriers;
- encouragement of foreign investment through drafting of a more open investment code and loosening of restrictions of foreign ownership of private property;
- creation of an effective banking system, and other financial services;
- privatization of substantial means of production and development;
- adoption of effective copyright protections; and
- eventual entry into the WTO.

Mobilizing Resources for Iraq Reconstruction

UNSC Resolution 1483 lays a foundation for redevelopment of much of Iraq's economy and more work will need to be done over and above that. The American people and coalition allies paid the price in blood and treasure to liberate Iraq. The cost of redeveloping Iraq's economy should be shared by the Iraqi people, the international community and by the coalition.

I cannot give you a figure on how much it will cost to rebuild Iraq. This is a complicated question with a number of component parts. First, there is a need for funding of repairs and rehabilitation following this most recent conflict. Second, is the larger task of undoing the damage done by decades of Saddam Hussein's misrule – corruption, plunder and the distortions of central state planning. Third, the Iraqi people will need financing – public and private, domestic and foreign – to bring Iraq – isolated for decades – into the information-rich, technology-driven global economy.

As my comments on the oil, agriculture, transport and telecommunications sectors imply, it will be some time before we can even begin to estimate accurately all the forms of damage this country's economy has sustained. We are not talking about traditional long-term financial assistance. Iraq needs help to get its economy on a sound basis, develop a welcoming investment climate and integration into regional and international trade. The global community has asked the World Bank and UNDP to send a team of experts to Iraq soon to do a thorough assessment. The instability of the environment hampers our efforts currently, but to the extent we can, we stand ready to update you at any time on this important issue.

There are a number of resources that we plan on mobilizing to finance the rebuilding of Iraq.

Found and Vested Assets

First, existing Iraqi state assets and the ill-gotten gains of Saddam Hussein and his regime will be made available for the benefit of the Iraqi people.

After Saddam Hussein's invasion of Kuwait in 1990, the United States acted quickly and decisively to deprive the Iraqi regime of the means and materials to continue its regional aggression, further develop its weapons of mass destruction programs, and continue its repression of the Iraqi people. Consistent with UNSC Resolution 661, the United States blocked all Iraqi state assets legally within its control.

Today, the United States is using those assets for the benefit of the Iraqi people, as they build a new and better Iraq. The President vested \$1.7 billion in Iraqi government assets in the United States. The Secretary of the Treasury has already designated the Secretary of Defense with the authority to use over \$573.5 of these assets to meet the immediate humanitarian needs of the Iraqi people.

Since the President signed the March 20 Executive Order vesting Iraqi state assets in the United States, the State Department, in cooperation with our interagency partners, is confirming the status of assets declared frozen by foreign governments in 1991. We have reached out to more than 20 additional countries that also may have information regarding Iraqi state assets. With the unanimous passage of UNSCR 1483, we are also reminding countries of their obligation under the new resolution to make available any Iraqi state assets to the Development Fund for Iraq.

We have had, and continue to have, extensive bilateral and multilateral meetings with key jurisdictions. For example, the Administration took advantage of the IMF/World Bank meetings held in Washington in April to hold several important bilateral meetings to discuss the matter. Treasury and State officials have contacted their counterparts in key jurisdictions. My colleagues and I have stressed the need for all countries to search their financial institutions for ill-gotten gains of Saddam Hussein and his regime.

The Department of State is working closely with the Departments of the Treasury, Justice, Defense, and Homeland Security, as well as law enforcement and intelligence colleagues across the government, to identify additional assets and front companies that may be connected to Saddam Hussein or his fallen regime. Our efforts are leading to the identification of funds that can be made available for the benefit of the Iraqi people. To date more than \$1 billion in previously unfrozen assets outside Iraq have been identified.

Revenue From Petroleum Production

Oil sales are the biggest potential source of revenue for the new Iraq, as they were for the old, but this time Iraq's oil revenues will benefit the Iraqi people. A top priority is to bring the industry on line and to repair and rehabilitate the existing infrastructure. A highly qualified team is ready to take on this work. Thamir Ghadhban is the CEO of the Oil Ministry and is actively directing the process. He has a team of experienced and well-qualified Iraqi managers and engineers in place at the Oil Ministry, the State Oil Marketing Organization (SOMO), and the South and North Oil Companies, and they have technical support from the Army Corps of Engineers. Steps are being taken every day by Iraqis working with the Army Corps to assess the condition of wells, pipelines, pumping stations, gas-oil separation plants, power grids, and refineries, and to make repairs. As the security situation improves, the work will proceed at a

faster pace.

Iraq's entire oil infrastructure was shut down in the face of the American advance. The Iraqis and we have been working diligently since the international coalition liberated Iraq, to bring the sector back on line. Mr. Ghadhban announced on May 21 that Iraq was already producing 800,000 barrels of oil per day. While there are many variables that can affect success in meeting production goals, he also said that production could reach 1.4 or even 1.5 million barrels by June 15. On May 28, Mr. Ghadhban announced that the northern fields around Kirkuk have been producing 600,000 barrels per day since May 27 but are not expected to increase production above that level in the near term. In the south, the situation is not as far advanced, but again, progress is being made. He also said that, as of May 27, oil production in southern Iraq exceeded 200,000 barrels per day, so it seems that Iraq is well on its way to meeting Mr. Ghadhban's production goals.

As a point of comparison, Iraq produced between 2 and 3 million barrels per day in 2002. This is was down from 3.5 million barrels produced at Iraq's production peak in 1990. During 2002, Iraq exported an average of 1.7 million barrels per day.

Mr. Ghadhban also announced that the Basra refinery is -- or soon will be -- operating at full capacity -- 140,000 barrels per day. The plant is antiquated and the condition of the pipeline that runs to Baghdad is still being assessed. Iraq's two other major refineries at Baiji and Daura are also operating, but at below capacity, because of damage from looting, the continued lack of stable electrical power, and a shortage of heavy fuel storage.

Mr. Ghadhban has determined the first task is to ensure that Iraq is able to meet its own domestic needs for motor fuel and liquefied petroleum gas, which is used for cooking. Iraq's domestic needs for refined products require a production level of some 250,000 barrels of oil per day. But in creating gasoline, Iraq also generates considerable heavy fuel, which is largely exported. As Iraqi oil production reaches 1.3 - 1.5 million bpd, this would translate into roughly 1 million barrels of crude oil available for export every day, plus lesser quantities of refined product/heavy fuel.

SOMO has placed the first crude up for sale and is in the process of collecting and evaluating bids in expectation of oil liftings resuming in the next week, if not the next few days.

There is ample crude ready for export now through the port at Ceyhan in Turkey, with over nine million barrels of oil already in storage at the port, over eight million of which will be ready for export as soon as contracts can be drawn up and signed by SOMO.

The Mina al-Bakr oil terminal is operational. However, there are a number of problems that will need to be resolved in the south, not the least being the need to repair an industrial water plant needed for oil extraction, in order to raise production to pre-war levels of 1.2 million barrels per day.

In order to export these quantities, however, the legal framework of contracts, guarantees, payments, and credits will need to be finalized. SOMO has been working to draft a model contract. The head of SOMO, Mohammed al-Jibouri, has announced that the new contracts will be similar to those used under the Oil for Food program, but some important changes are envisioned: most importantly, contracts will be made transparently, unlike the past when Saddam Hussein sought kickbacks from purchasers.

Al-Jibouri plans to sign direct sales contracts with traders and refiners, cutting out the middlemen that facilitated the kickback schemes. SOMO will also drop the UN's retroactive pricing formula, moving instead to standard market pricing techniques.

The petroleum sector has seen virtually no new investment since 1991, and no new technology. Upgrades to protect the environment, to enhance efficiency, and to meet commercial and safety standards are badly needed, both upstream and downstream. There are a number of estimates that have been made regarding the probable costs associated with returning Iraq's oil production to previous levels. For example, Cambridge Energy Research Associates recently put a ballpark figure of \$3 billion over two years to reach 3.5 million bpd through an intensive program of rehabilitation and modernization. This would bring production back to pre-1990 levels.

In the meantime, Mr. Ghadhban has announced that in the short term Iraq would need not billions of dollars but "several hundred million dollars." Under a new Iraqi Government, Ghadhban has noted that, "We are going to open the doors for foreign investment but in accordance with a formula that safeguards the interest of the Iraqi people."

Oil Ministry officials hope to raise production to over 2 million barrels per day by the end of this year. This will require

more rehabilitation of the Rumaila fields and production chains in southern Iraq. Since the security situation is only slowly improving, it is difficult to project the likelihood of success or the likely costs associated with this work.

There obviously is considerable uncertainty surrounding these production and export projections. But we can still use these numbers as a rough basis for estimating potential revenue earnings from oil exports. In the next few days, as Iraq begins to sell oil from Ceyhan and the Gulf, we will have a better idea of the price Iraqi oil can fetch, compared to other blends on the market. Recently, European oil traders were tentatively pegging Kirkuk crude at a price of \$3.65 to \$3.85 per barrel lower than Brent, which is the standard against which all European crude is measured. Because of long-term damage to the fields, Kirkuk crude is higher in sulfur than it used to be. Europe's strict air quality standards will make the oil a hard sell there, which is reflected in the lower price.

If, for purposes of estimate, we say that a barrel of Iraqi crude sells for \$20, and if Iraq is able to bring exports up at a stable rate from 1 million bpd in mid-June to 2 million bpd at the end of the year, Iraq's gross earnings – before costs are deducted – would be in the range of \$5 billion for the second half of 2003. If Iraq is able to maintain stable production and export rates at 2 million bpd throughout 2004, it could earn, again in gross revenues, about \$14-15 billion. But potential earnings are subject to a host of factors both inside and outside the country, including the volatile nature of global oil markets and whether there is sufficient demand for Iraq's sour crude to keep the price at the projected range. The state of the global economy is also hard to predict, and this too will have an impact on potential earnings.

In looking toward the longer term, Iraq's oil ministry has begun to assess its rehabilitation requirements and evaluate existing service contracts against identified needs. Development contracts with Lukoil and China are being held in abeyance until a new Iraqi government is in place to determine their future. We would expect that the new government would also need new contracts to upgrade facilities – including refineries, gas-oil separation plants, power plants, pipelines and pumping stations, as well as to rehabilitate wells and open new fields to production.

Because Iraq has not had access to investments or new technology over the last decade, analysts say that the country may not be able to increase its production at existing fields even to pre-1990 levels, because standard operating procedures used over the past decade may have caused irreparable damage to the fields, especially in Kirkuk. The status of these fields will need to be assessed.

Over the long term, Iraq will want to acquire updated technology, and may want to open new fields (only 15 of the 73 known fields are in production now). It is possible that Iraq will also be looking into options for exploration in other regions.

Other parts of the oil sector infrastructure also need work. According to recent reports, the Mina al-Bakr export terminal in the Gulf has the potential to handle 1.6 million barrels per day, but we estimate that it cannot be safely run at levels much above 1.1 million. A second oil terminal, Khor al-Amaya, was destroyed in the first Gulf War and only partially repaired. It lies in a calmer area of the Gulf, however, and once rehabilitated will provide a useful alternative.

Many commentators are speculating about how much it would cost if Iraq should seek to raise production above historical levels. For example, experts at Deutsche Bank, PFC Energy Associates, and Energy Compass, have looked at not only sector rehabilitation, but also new field production. They have come up with large estimates of the financial cost of raising Iraqi oil production far above its historical peak.

But it will be up to the new Iraqi government to decide how far it wants to go and just where it wants to target Iraq's future production levels. Any large expansion of Iraqi production capacity would have to be accommodated by increased demand in the international oil market; such an increase in production capacity would, in all probability, need to be privately financed. The focus now is on rehabilitation and repair to help Iraq meet Mr. Ghadhban's more modest goal of 2 to 2.5 million barrels per day.

Finally, new laws and regulations will be needed to foster investment and facilitate foreign ventures in order to fund new development.

OPEC will hold its next meeting on June 11 in Doha. Mr. Ghadhban has indicated that Iraq has no plans to leave OPEC, which it helped establish, but he also has no plans to attend the June 11 meeting. Before the first Gulf War, Iraq was responsible for about 4 percent of world oil sales. Under UN sanctions, Iraq was exempt from OPEC quotas, and the other OPEC members, especially Saudi Arabia, adjusted production to compensate for Iraqi oil sales through the UN Oil for Food program and to maintain their target price of \$25 to \$28 per barrel.

Contributions From Other Countries

Despite the billions Iraq has in existing assets and expected oil revenues, resources will remain far below what will be needed for the next year or so to help the Iraqis achieve a stable economic base. We expect that other countries – both individually and through international organizations such as the United Nation – will make major contributions to this effort. Many countries have come forward with offers of assistance – either monetary or in-kind contributions. To date these have been offers nearing \$2 billion from third countries-- much of this pledged through the \$2.2 billion UN appeal. The EU alone has promised \$107 million. There have also been many pledges of in kind contributions -- from Albania's 70 peacekeeping troops to Jordan's field hospital to a medical team from Lithuania.

Even before the fighting stopped, the State Department, working closely with colleagues from DoD and Treasury, launched a series of quiet consultations with countries that share our interest in helping Iraq rebuild. These consultations confirmed that there is widespread recognition that repairing the damage of decades of misrule in Iraq is an international undertaking.

We now are working with the United Nations and the World Bank on a preparatory meeting on reconstruction that will involve a broad cross section of countries. The preparatory meeting will examine not only current needs, but also explore requirements in coming years. The preparatory meeting will be organized by the UNDP, the World Bank and the United States on June 24. One outcome of the meeting is likely to be a major donors conference in the fall. The meeting should also underline the urgency of undertaking a World Bank/UNDP needs assessment.

Debt Relief

In addition to the many costs Iraq faces to rebuild its economy, it will also have to deal with the weight of huge amounts of debt contracted by the previous regime. Treasury and State are working with other creditor countries on a long-run solution to Iraq's debt burden that is responsive to the full range of Iraq's creditors. Secretary Snow has urged the need for a comprehensive, multilateral debt treatment for Iraq. The issue was discussed at the spring World Bank/IMF meetings and in the G-7, where nations agreed on the need to engage the Paris Club, a group of creditor nations that meet regularly to provide debt relief to debtor countries.

At the April session of the Paris Club, State and Treasury and Paris Club colleagues discussed Iraq and began the process of debt data reconciliation. In their recent meeting at Deauville, G-8 Finance Ministers recognized that it would be unrealistic to expect Iraq to make payments on its debt at least through the end of 2004. Currently, Iraq is not making payments on its international debt. The G-8 also asked the IMF to assess Iraq's debt situation.

Private Sector Investment

In the end, the single largest contributor to Iraq's economic renewal will be the Iraqi people, their ingenuity and their determination to improve their lives, now that the burden of the Saddam regime has been lifted.

Ambassador Bremer has stressed that we must begin to create the conditions for a free market economy in Iraq now. Our biggest challenges will be creating a secure environment in which honest Iraqis can establish and run businesses, and the smooth transformation of a state-controlled economy into a free market. But the Iraqi people are talented and ambitious. And, despite decades of war, Iraq has a small private sector, which can be nurtured back to health.

We have been studying the legal and economic reforms needed to create a stable business environment in Iraq. Ambassador Bremer's team has been cataloging such reforms – which range from lifting tariffs to WTO accession to creation of a new legal framework. These and many other practical issues must be addressed before international trade activity with Iraq will resume and flourish.

In Washington, State's Assistant Secretary for Economic and Business Affairs has hosted a series of interagency meetings to look at key economic reconstruction issues for which Ambassador Bremer's team in Baghdad needs Washington guidance. Last week, the group conferred over necessary steps to revitalize business and commerce in Iraq following the lifting of economic sanctions. The group also examined action needed to successfully transition from the current centrally controlled food distribution system under the UN's Oil for Food program to a market-based food distribution system.

We have been drawing on the knowledge and expertise of our embassies in the region, and are also working to engage regional governments – the idea being to identify "best practices" and use regional reform models where appropriate.

One of the most important steps we can take is to help Iraq re-integrate with the broader regional economy. The upcoming June 21-23 special World Economic Forum event in Amman, Jordan, provides an excellent opportunity to begin this process, as Secretary Powell will undoubtedly underline during his discussions there. In addition, the international development institutions and the donor community will focus extensively on steps we can take to re-stimulate private economic activity in Iraq during June 24 donor's meeting at the United Nations.

Conclusion

The transformation that will take Iraqis from life under a ruler of unimaginable cruelty to a free and prosperous nation will take time. The American people have committed to help Iraqis make this transformation, but it will require much more work on our part. The long-term future of Iraq depends on the establishment of rule of law, representative government, and sustainable economic development. The United States, our coalition partners, the United Nations, and most importantly, the Iraqi people, must work together to finish the job, in order to guarantee peace and stability in the region, and safety for the American people.

The Administration welcomes the strong interest of the Congress in this issue and its strong support for the important task at hand. We look forward to working closely with the Congress in the months ahead.

[End]

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