

# Economic and Financial Reconstruction in Iraq

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As Prepared

Mr. Chairman, distinguished members of the Subcommittee, I appreciate the opportunity to testify on the economic and financial reconstruction of Iraq. There has been excellent progress since Under Secretary of State Larson appeared before this Committee on September 16.

## **INTRODUCTION**

The United States and its coalition partners are working with the Iraqis in a massive effort to revive their economy after decades of mismanagement, corruption, war and sanctions. We are boosting electricity generation and oil production and rebuilding Iraq's telecommunications and transportation network. We are helping Iraq develop a legal and regulatory system to encourage economic growth, attract foreign investment, and facilitate economic and technical assistance from foreign countries and international financial institutions. We are tracking down and returning assets of Saddam's regime to Iraq so that they will be used for the benefit of the Iraqi people.

## **INTERNATIONAL ASSISTANCE**

Under the leadership of Secretary Powell and Treasury Secretary Snow, the United States played a major role in organizing the highly successful Madrid Donors' Conference in October, which has cemented international support for Iraq's reconstruction. Representatives of 73 countries and 20 international organizations attended the meeting as well as members of the Iraqi Governing Council.

The official tally of the Conference's results, as compiled by the World Bank, showed final pledges of at least \$32 billion, including our own pledge of \$18.4 billion in grants from the FY 04 supplemental. The huge amount pledged in Madrid is by far the highest ever obtained at an international pledging Conference. Non-U.S. pledges of a minimum of \$13 billion will be a mixture of grants and loans to be disbursed during 2004-2007. Not included in the pledge numbers for other donors are offers of trade credits, in-kind assistance, and technical assistance (including training).

We are working hard to secure rapid and effective disbursement of funds pledged at Madrid, while ensuring good donor coordination. Many donors are now finalizing how they

will implement their pledges. In conjunction with the Conference, the World Bank and the United Nations Development Program have just established trust funds within an International Reconstruction Fund Facility for Iraq (IRFFI). Similar mechanisms have been used effectively for channeling foreign donations in post-conflict situations, including Kosovo, East Timor and Afghanistan. We expect that Japan, the European Union, Spain, Canada, Korea, Sweden, Australia, the UK and other donors will disburse at least part of their Madrid pledges through the Facility.

The United States will contribute \$10 million to the Facility from funds appropriated in the April 2003 supplemental. These funds will be equally divided between the World Bank and UNDP trust funds. The donation earns us a seat on the Facility's Donors' Committee so we can help guide and coordinate those trust funds within the overall assistance effort for Iraq.

The Iraqi Governing Council, working with the Coalition Provisional Authority (CPA), has established a mechanism to work with bilateral and multilateral donors to ensure that Iraqi priorities are fully reflected in donor activities. The new Ministry of Planning and Development Co-operation has the lead on donor coordination on the ground in cooperation with the Ministry of Finance and other Iraqi Ministries. Senior Iraqi officials, along with a U. S. Government team, will meet with other major donors in Abu Dhabi at the end of February to discuss the functioning of the trust funds and other aid coordination issues.

## **U.S. SUPPLEMENTAL FOR IRAQ RECONSTRUCTION**

Congress took a vital step forward in helping Iraq when it passed in November the President's request for a supplemental for Iraq's reconstruction. On January 5, the CPA, through the Office of Management and Budget, reported to Congress on how it plans to allocate the \$18.4 billion appropriated in the Supplemental for Iraq. The Administration will make quarterly reports to Congress on the status of the spending.

Working closely with Iraqi officials, especially in the Ministry of Planning and Development Co-operation and other Ministries, the CPA is in the process of allocating the reconstruction funds in accordance with Iraqi priorities.

For example, USAID in early January awarded Bechtel a \$1.8 billion contract for engineering, procurement and construction services for infrastructure projects, including electric power systems, municipal water and sanitation services, road networks and rail systems, public buildings, and ports and waterways. The Army Corps of Engineers also recently awarded, on the behalf of the CPA, contracts for oil sector repairs valued up to \$2 billion.

In total, \$8-9 billion are being allocated for infrastructure in areas such as telecommunications, power generation, sanitation, transportation, public buildings, and oil repairs. This includes the \$5 billion in Requests for Proposals announced by the CPA's Program Management Office (PMO) on January 7. These contracts are for construction and projects in key sectors that have an immediate impact in improving the lives of the Iraqi people such as power generation, water, sanitation, telecommunications, transportation,

and public buildings. The PMO anticipates awarding these contracts in March.

We anticipate that \$6 billion will be directed to non-construction projects, such as police training, military equipment, and democracy/governance activities. Four billion dollars will be held in reserve to spend as priorities change and unanticipated demands arise.

## **REFORM AND RECONSTRUCTION**

U.S. assistance is predicated on and directed toward reforming Iraq's society and economy. A new, prosperous, peaceful Iraq must be a democratic, free enterprise Iraq, fully integrated into the community of nations. The Governing Council and the CPA are working to establish a solid foundation on which future Iraqi governments can build. To establish a prosperous, dynamic, and competitive Iraqi economy, Iraqi and CPA officials are hard at work putting into place modern regimes for trade, investment, banking, tax, and corporate law.

- The CPA successfully introduced a unified, reliable new currency, the Iraqi dinar, between October and January, which is helping to promote commerce and unite the Iraqi economy.
- The Central Bank of Iraq will soon be independent. A Trade Bank of Iraq has been established.
- Iraq opened up to foreign investment, dropping all restrictions except those on industries associated with extraction and primary processing of natural resources, including oil, and the financial sector.
- The Central Bank of Iraq chose an initial set of three foreign banks as candidates for licenses to operate in Iraq (Hong Kong Shanghai Banking Corporation, National Bank of Kuwait, and Standard Chartered Bank from Great Britain). Others are under consideration.
- Iraq has slashed tariffs to 5%, with humanitarian and reconstruction goods being allowed to enter Iraq duty-free. Today the World Trade Organization welcomed and accepted Iraq's request to become an observer.

The International Finance Corporation, a part of the World Bank, is working with OPIC to establish a credit facility to encourage credit for small businesses, which will help generate needed employment opportunities for Iraqis and bolster the financial system. Full reform will take years, but by the time the Transitional Iraqi Administration assumes authority this summer, Iraq will be well embarked on reforms.

## **IMPROVEMENTS IN CRITICAL INFRASTRUCTURE**

There is good news on the economic infrastructure front as well. The restoration of essential services is gaining momentum. Power generation in Iraq is now back to pre-war levels (4,023 MW on February 5). While this is still below total demand of about 5,500 MW, we are making progress on expanding power transmission capability and improving distribution. We hope to reach our goal of 6,000 MW by summer, a level of generation that anticipates future economic growth, industrial production, and demand.

Hospitals and schools have re-opened. Potable water and medicines are more widely available than before. During the last several months, over 16,000 reconstruction projects across Iraq, from repairing schools and hospitals to rebuilding roads and bridges, have been completed.

This pump priming has generated thousands of new businesses all over the country, stimulating economic activity and providing employment. Inflation is low, judging from the strengthening exchange rate for the new Iraqi dinar. Iraq has started down the path to a responsible fiscal policy by producing balanced budgets for 2003 and 2004. The 2005 budget is now in preparation.

Our top priority is to create new jobs and improve lives through reconstruction projects since unemployment remains unacceptably high. Underemployment is a key challenge, too. We are prioritizing and accelerating work on projects funded by the Supplemental that can produce jobs and visible economic benefit to the largest number of Iraqis as quickly as possible. The CPA's micro, small and medium credit programs aim at stimulating private sector economic activity, development and employment by providing credit to viable small labor-intensive businesses.

## **OIL SECTOR**

The Iraqis are developing the framework and institutions to manage their oil sector, which has 112 billion proven barrels of reserves, the third largest in the world behind Saudi Arabia and Canada. This sector is important because production from Iraq's oil wealth provides about 95% of the country's export revenues and 95% of its government revenues.

After months of repairs by U.S. and Iraqi engineers, Iraqi oil production is now sustained at 2.2 to 2.3 million barrels a day (b/d); exports range from 1.5 to 1.7 million b/d. Continuing security problems in northern Iraq have prevented the reopening of the oil export pipeline to Ceyhan on the Turkish coast and reduced oil exports by at least 400,000 b/d. At present all oil exports are via the Persian Gulf. The Oil Ministry target is to produce 3.0 million b/d by the end of 2004, with exports of 2.2 million b/d. If exports are not badly interrupted, oil revenues could exceed \$1 billion per month.

It will be up to the Iraqis to determine their future role in OPEC, their invitation to foreign oil companies, and their overall oil policy. However, we hope to work with them to foster "best practices" in the sector.

## **OIL FOR FOOD TRANSITION**

About 60% of Iraq's 27 million people have been wholly dependent on food provided through a food ration system program largely supplied by goods imported under the United Nations' Oil for Food (OFF) program, which began operations in 1996. Every Iraqi is supplied a monthly ration of staples such as wheat, rice, dried milk, sugar, tea, and soap. This is distributed through a network of about 45,000 local grocers and other agents, with the food imported (with some local procurement) and supplied to the distribution network

through Iraq's Ministry of Trade.

The UN turned over administration of the OFF program to the CPA on November 21. This transition is going smoothly. The World Food Program (WFP) is helping the CPA manage the shipment and distribution of remaining OFF food contracts through June 2004. Over time, the Ministry of Trade will increasingly assume responsibility for the procurement and overall management of the food pipeline and prepare for a transition to a market-based system.

## **IRAQI DEBT**

One key to the successful reconstruction of Iraq is to secure a multilateral debt reduction arrangement that the new Iraqi government could ratify after the political transition. Of the approximately \$120 billion in Iraqi debt, roughly one third of it is held by Paris Club countries such as Japan, Germany, Russia, France and the U.S., about a third is with Gulf countries (mostly Saudi Arabia), and the rest is divided among non-Paris Club countries, the private sector, and International Financial Institutions.

In early December 2003, the President appointed former Secretary of State and Treasury Secretary James Baker as his Special Presidential Envoy on Iraqi Debt. During his meetings with leaders in Europe, Asia, and the Gulf over the past two months, Secretary Baker won commitments for at least "substantial debt reduction" for Iraq in 2004.

In addition, by sponsoring United Nations Security Council Resolution (UNSCR) 1483, the U. S. helped ease Iraq's yearly obligation to pay reparations to individuals and businesses from more than 35 countries who were victims of Saddam Hussein's 1990-91 aggression. Previously, Iraq was required to pay 25% of its oil export proceeds into a victims compensation fund. UNSCR 1483 pared that requirement to only 5%.

## **IRAQI ASSETS**

The United Nations Security Council has stressed Iraq's right to the return of assets plundered by Saddam Hussein and his associates, currently located in other countries, so they can be used at last for the benefit of the Iraqi people. The U.S. Government is facilitating the expeditious identification and transfer of those assets. The State and Treasury Departments are working together to encourage all UN Member States to comply with the requirement of UNSCR 1483 to freeze and transfer to the Development Fund for Iraq (DFI) all assets of the former Iraqi Government and its senior officials.

So far, countries in Europe, Asia, the Middle East and North Africa have transferred approximately \$650 million in such assets to the DFI. The U.S. has made \$1.9 billion in frozen Iraqi assets available for reconstruction and other purposes benefiting the Iraqi people. Moreover, roughly \$1.3 billion worth of assets have been found within Iraq.

The State Department and our embassies continue to approach governments around the world to identify, freeze, and transfer Iraqi assets. In particular, we have been focusing on

Lebanon, Syria, and Jordan and have had some success.

We are looking at how DFI provisions in UNSCR 1483 may need to be revised for the post-June 30 environment. The International Advisory and Monitoring Board (IAMB), which was formed pursuant to UNSCR 1483, is proceeding with its task of hiring an independent public accountant to audit the DFI and export oil sales. We expect the members of the IAMB to have their third meeting on February 12. The IAMB's role is to ensure transparency with respect to Iraq's oil revenues.

## **THE ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS**

We are strongly promoting IMF and World Bank engagement in Iraq. The U.S. and major partners such as the UK have urged the IMF and the World Bank to begin working with key Iraqi Ministries to build critical budget planning, revenue collection, and monetary policy and banking capacity. These activities aim at the resumption of international lending to Iraq as soon as possible after the transition on June 30.

The IMF and the World Bank have expertise and experience -- including in post-conflict situations -- as well as credibility. Their work will further internationalize support for Iraq, and these institutions are well placed to help Iraq formulate and implement sound economic, monetary, and fiscal policies.

## **CONCLUSION**

The State Department is part of an interagency, U.S.-Iraqi, and international team effort to mobilize the resources necessary to promote Iraq's economic and financial reconstruction. We are working extremely hard and harmoniously with colleagues at Treasury and USAID, who are present here today, as well as others at DOD, the NSC, the CPA, and Commerce to tackle the formidable challenge of returning Iraq to economic prosperity and allowing it, once again, to take its proper place as a productive member of the community of nations. We welcome Congress' continued strong support in this important task.

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