



REVENUE WATCH

BRIEFING NO. 7

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Iraqi Fire Sale: CPA Giving Away Oil Revenue Billions Before Transition

The Coalition Provisional Authority has launched a last-minute spending spree using Iraq's oil money shortly before it is due to be dissolved. In a little noticed move, the CPA is committing billions of dollars to hastily conceived projects on the eve of its completion deadline. The Program Review Board (PRB), which is the CPA's spending arm, will terminate operations on June 30 when political and financial autonomy is handed over to the recently appointed interim government.

In its latest available minutes, the Program Review Board on May 15 approved nearly \$2 billion in expenditures for a host of poorly planned projects.¹ It does not appear that all relevant ministries were consulted in the development of these funding requests. However, the new Iraqi government will have little choice but to honor the commitments. The resolution on Iraq passed by the UN Security Council on June 8 requires the new government to satisfy outstanding obligations against the Development Fund for Iraq, the main repository for Iraqi revenues.

The Development Fund for Iraq was established by United Nations Security Council Resolution 1483 to collect 95 percent of Iraq's oil revenues, repatriated funds previously held by Saddam Hussein, and transfers from the UN Oil-for-Food program, which ended in November 2003. Since its inception, the Development Fund for Iraq has received \$19.3 billion. As of June 9 it held \$10.1 billion.²

Appropriations from the Development Fund for Iraq are voted on by the Program Review Board, whose members are drawn from American, British, and Australian military and diplomatic staff, as well as one member each from the Iraqi Ministry of Finance and the Ministry of Planning.

No further board minutes have been made available since the May 15 meeting, leaving ambiguous what additional amounts the CPA has dispersed. But it is apparent that the lack of planning and the huge funds on tap for cash give-aways and other highly discretionary programs have paved the way for corruption and waste.

Among the expenditures approved by the Program Review Board on May 15 are \$180 million to the Iraq Property Claims Commission to “resolve real property issues resulting from the previous regime’s unjust expropriation of land;” \$25 million to compensate victims of Saddam Hussein; \$500 million for Iraqi security forces even though Congress allocated \$3.2 billion in 2004 for the same purpose; \$125 million for a revenue stabilization account; \$315 million for the electricity sector despite U.S. appropriations for the same sector; and \$460 million for oil sector reconstruction. (A full list of expenditures is in the appendix to this briefing.)

While few would object to the need for funding in these areas, Revenue Watch has concerns about how these appropriations are being made. Why were these appropriations not made when the 2004 budget for Iraq was adopted and subsequently revised in March? Why are such large amounts of discretionary cash being committed to programs prior to establishing mechanisms for implementing them? And why are these spending obligations being introduced at the last minute rather than allowing the in-coming government to make such decisions?

Many of these expenditures drew protest from a few board members—most often the British member of the Program Review Board, the Australian member, and the representative from the Council for International Coordination—but in each case they were outvoted.³

Iraq Property Claims: \$180 million

Duncan Gilchrist, of the Iraq Property Claims Commission, requested \$180 million to help settle claims over land or housing unjustly expropriated by Saddam Hussein, and to resettle individuals displaced from their homes by the original owners. When asked for information about how administration of such a large program would be handled, Gilchrist could neither provide details, nor offer any models of similar programs. Asked whether he had sought other funding, Gilchrist responded that immediate funding was needed.⁴ The lack of planning for how such a large cash give-away program will be administered does not bode well for its effectiveness.

Why funding is so urgent is unclear, given that funds to establish the Iraq Property Claims Commission were not even allocated until February 2004, and no other donors have identified property claims and resettlement as an urgent priority. It is also unclear why the Ministry of Displacement and Migration and the Ministry of Justice were not consulted on the request for this program. Yusuf Samiullah, the UK representative, and Neil Hawkins, the Council for International Coordination representative, expressed serious misgivings about the request.⁵ Samiullah urged that funding be provided only to establish a property claims mechanism.⁶ Only after such procedures existed should funding for compensations be approved. But Samiullah's motion was not seconded. Without a process for determining the validity of property claims, corruption and waste are likely.

Compensation for Hussein's Victims: \$25 million

Michael Ratney, the CPA Governance representative, requested and received \$25 million for a fund to compensate the families of victims of Saddam Hussein's human rights abuses. Yet, neither the Ministry on Human Rights nor the Ministry of Justice was consulted on the request.⁷ Again, the British representative Samiullah was alone in suggesting that it was premature to allocate funding for such an incipient initiative, asking instead to set up a task force to plan the process.⁸

Iraqi Security Forces: \$500 million

A similar lack of detail emerges in the request for \$500 million for Iraq's security services. This request comes on top of another \$500 million that was approved in April for highly discretionary spending for security needs. Asked why so much more money was necessary when the U.S. Congress had allocated \$3.2 billion for security and law enforcement in 2004, the CPA representative responded that there was "no limit to the amount one could spend on security." Several members expressed concern that the lack of specificity in the proposal allowed for too much leeway.⁹ Asked whether there had been any evaluation of the effectiveness of similar past spending, the CPA representative responded that this was "not simply a matter of value for money."¹⁰ The answers show little regard for transparency or accountability.

Revenue Stabilization: \$125 million

The Program Review Board also approved \$125 million to establish a revenue stabilization account that would function as a reserve for the Iraqi budget in 2005 should oil prices fall. Such stabilization accounts are often found in countries highly dependent on commodity exports, such as Norway, Chile, Mexico, Russia, and Oman. However, the success of such funds strongly depends on the governance mechanisms in place. Without tight controls, stabilization funds can turn into easily raided slush funds. There was no indication in the discussion that any plan existed for how this fund would be governed and managed. It is also uncertain why this stabilization fund is being created at the last minute rather than being introduced when the budget for 2004 was developed.

Electricity Infrastructure: \$315 million

The Program Review Board on May 15 also committed \$315 million in Development Fund money toward electricity infrastructure reconstruction. The allocation of Iraqi funds toward sectors already covered by U.S. reconstruction funding raises the question of whether any overlap exists. Under the \$18.4 billion appropriated by the U.S. Congress for reconstruction in the 2004 Iraq Supplemental, \$5.5 billion is allocated for rebuilding electricity infrastructure and services. As of March 2004, only \$428 million of these funds had actually been obligated.¹¹ The Program Review Board asked if outside funding sources—specifically international donors—had been considered for these projects. The CPA ministry of energy advisors said that no other sources were available.¹²

Neil Mules, the representative from Australia to the Program Review Board, also asked whether any of the proposed projects were covered by the U.S. Supplemental. The CPA energy advisors answered that none of the projects were funded in the U.S. Supplemental.¹³ Samiullah noted that all electricity projects have exceeded initial cost projections, and requested assurance that the CPA energy advisors' revised cost estimates were accurate.¹⁴ The CPA advisors said that these new estimates “reflected a higher degree of clarity than past estimates because a more extensive survey of equipment and requirements had been conducted and refined.”¹⁵ The key question is why Development Fund money, not the remaining \$5 billion in uncommitted U.S. electricity sector reconstruction funds, is being tapped to cover these projects.

Oil Sector Reconstruction: \$460 million

The Program Review Board on May 15 also obligated \$460 million in Development Fund money toward reconstructing Iraq's oil sector. This funding will entail \$201 million for downstream projects, \$255 million for upstream projects, and \$5 million for metering. Again the question of overlap with U.S. funding arises.¹⁶ Under the 2004 U.S. Supplemental, Iraq's oil sector is allocated \$1.7 billion in funding for infrastructure reconstruction.

As of March 2004, only \$443 million of these funds had been obligated for projects.¹⁷ A recent internal report by the Iraqi oil ministry allegedly reports that work has begun on only 119 out of 226 post-war oil reconstruction projects, most of which were awarded to Halliburton, Co.¹⁸ The report also claims that no oil reconstruction project has been finished and only half the work has been completed in 94 of those under way.¹⁹ A senior Iraqi official told Reuters news agency that these projects “were due to be completed between July last year and April [2004].”²⁰

Samiullah asked if any of the proposed oil reconstruction projects were funded by the U.S. Supplemental. The CPA ministry of oil advisors responded that there was “no duplication of projects.”²¹ Again, the question arises: Why isn't the \$1.2 billion in uncommitted U.S. supplemental funding for Iraq's oil sector being used for this purpose? Why are DFI funds being committed instead? Given the slow progress in oil reconstruction work on existing contracts, the CPA would do better to leave the decision-making process to the interim government, rather than rushing to commit further funds.

The CPA's 11th hour splurge will have serious consequences for the ability of the interim government and the subsequent elected government—which are meant to exercise autonomy—to choose how to spend their money. Moreover, the experience of other oil-rich countries has proven the necessity of putting in place the infrastructure and mechanisms to ensure that the money is well spent.²²

The CPA's drive to spend Iraq's money while it still has the chance remains a mystery. The current administration has refused to reveal its plans and rationale for crucial decisions regarding Iraq. The Program Review Board did not respond to requests for clarification. The reluctance of U.S. taxpayers and Congress to foot the bill for a reconstruction that they were told would pay for itself might be playing a role. After all, Deputy Defense Secretary Paul Wolfowitz told Congress in March 2003: "There's a lot of money to pay for this that doesn't have to be U.S. taxpayer money, and it starts with the assets of the Iraqi people.... We're dealing with a country that can really finance its own reconstruction, and relatively soon."²³

That promise has been broken. U.S. taxpayers have already paid over \$24 billion for Iraq's reconstruction (\$5.9 billion of the first \$74.7 billion Iraq Emergency War Time Supplemental Appropriations Act in 2003, and \$18.4 billion of the second \$87 billion Iraq Supplemental for 2004). The cost of restoring Iraqi infrastructure to its pre-1991 state and creating the basic conditions for democratic governance and a market-oriented economy is estimated to be \$55 billion from 2004-2007.²⁴

It is possible that the commitment of massive amounts of Iraq's oil revenues to reconstruction projects, no matter how poorly conceived, will be used to justify cutting back future U.S. funds for reconstruction. If so, there is little hope of seeing a transparent and publicly accountable government emerge in Iraq.

Appendix

Iraqi oil revenues committed in meeting of the Program Review Board on May 15, 2004

<i>Project</i>	<i>Amount approved (in \$US million)</i>
Iraq Property Claims Commission	180
Revenue Stabilization Account	125
Victim's Compensation Fund	25
Public Distribution System	200
Stand-up Iraqi Security Forces	500
Electricity Sector	315
Oil Infrastructure Rebuilding	460
Agriculture Reconstruction and Development for Iraq	65
State-Owned Enterprise Rehabilitation	50
Vocational Training	65
Total	1,985

Notes

1. The subsequent discussion of the appropriations is all drawn from the Program Review Board Minutes for May 15, 2004. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
2. http://www.iraqcoalition.org/budget/DFI_intro1.html
3. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
4. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
5. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
6. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
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8. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
9. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
10. http://www.iraqcoalition.org/budget/PRB/May15_PRB.html
11. For details on U.S. reconstruction funds allocated and obligated to date, see the Department of Defenses' March 30 report on Iraqi reconstruction funding, included as Appendix M to the CPA Inspector General's first report to Congress, at http://www.cpa-ig.org/pdf/appendix_m.pdf.
12. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
13. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
14. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
15. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
16. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
17. For details on U.S. reconstruction funds allocated and obligated to date, see the Department of Defenses' March 30 report on Iraqi reconstruction funding, included as Appendix M to the CPA Inspector General's first report to Congress, at http://www.cpa-ig.org/pdf/appendix_m.pdf.
18. Reuters, *Delays Hit U.S.-Funded Iraq Oil Projects*, June 14, 2004.
19. Ibid.
20. Ibid.
21. See May 15, 2004 PRB meeting minutes at http://www.iraqcoalition.org/budget/PRB/May15_PRB.html.
22. Alan Gelb and Associates, *Oil Windfalls: Blessing or Curse?* (A World Bank Publication: Oxford University Press) 1988.
23. House Committee on Appropriations Hearing on a Supplemental War Regulation, 3/27/03.
24. See Congressional Budget Office report, *Paying for Iraq's Reconstruction* (January 2004): <http://www.cbo.gov/showdoc.cfm?index=4983&sequence=1>.

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Anthony Richter, Director, Middle East Initiatives and Central Eurasia Project

Svetlana Tsalik, Director, Revenue Watch

Isam al Khafaji, Director, Iraq Revenue Watch

Julie McCarthy, Researcher

Iraq Revenue Watch monitors Iraq's oil industry to ensure that it is managed with the highest standards of transparency and that the benefits of national oil wealth flow to the people of Iraq. Iraq Revenue Watch complements existing Open Society Institute initiatives that monitor revenues produced by the extractive industries.

In many parts of the world, the lack of proper stewardship over oil resources has resulted in corruption, the continued impoverishment of populations, and abuses of political power. By prompting governments to tackle these problems early, the Open Society Institute hopes to help Iraq avoid this plight.

The Open Society Institute currently supports a recently launched initiative, Caspian Revenue Watch, which monitors the development of oil production in the Caspian basin. The goal is to promote transparency, accountability, and public oversight in the management of oil and natural gas revenues.

Iraq faces even greater challenges than the Caspian region. If Iraq is to become an open, democratic society it will need to develop transparent accountable institutions for ensuring honest management of oil revenues.

There is an urgent need for Iraq Revenue Watch given the current occupied status of the country. The Coalition Provisional Authority and the Iraqi Governing Council should establish rules that ensure complete transparency regarding Iraqi oil revenues. So doing will foster a stable, democratic Iraq, and will protect the Coalition Provisional Authority from charges of misappropriation during this period of trusteeship over Iraq's reconstruction.

The **Open Society Institute**, a private operating and grantmaking foundation based in New York City, implements a range of initiatives throughout the world to promote open society by shaping government policy and supporting education, media, public health, and human and women's rights, as well as social, legal, and economic reform.

For more information, contact:

Iraq Revenue Watch program

Open Society Institute

400 West 59th Street

New York, New York 10019

USA

E-mail: irw@sorosny.org

<http://www.iraqrevenuewatch.org/>

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