



Iraq's First Public Budget

On July 7th, Ambassador Paul Bremer announced to the Iraqi people and the world a national budget for Iraq for the remainder of 2003.¹ The adoption and publication of a budget is an important step for a country where budgets have traditionally been closely guarded state secrets and it was a crime to report on them.

As a country emerging from war with an occupying authority, Iraq surely faces significant challenges in developing a budget. Yet there are internationally recognized best practices for effective and transparent budgeting. These practices help ensure that there is proper accountability for revenue collected and funds spent, that the assumptions behind the budget and the risks inherent in these projections are spelled out, and that the budget proposals are accompanied by explanations sufficient to encourage public debate and involvement in the process. This brief summarizes the main points of Iraq's 2003 budget, and provides recommendations on how to make the budgetary process more transparent and participatory.

Budget Summary

On July 7th, Administrator of the Coalition Provisional Authority (CPA), Paul Bremer, announced the introduction of a new currency and release of the 2003 Budget, which was later posted on the CPA website in English and Arabic (www.cpa-iraq.org). Described by Bremer as an “emergency budget,” it allocates \$6.1 billion USD across a range of state responsibilities including electrical infrastructure, security and public health as well as ministerial and civil service costs.² It also anticipates a deficit of \$2.2 billion USD, which may grow larger if oil markets do not provide favorable returns over the next few months and if sabotage of pipelines continues.

Process of Budget Adoption

Each Iraqi Ministry and Kurd region was asked to prepare a budget with the help of the Coalition Senior Advisor and the Coalition Financial Advisor. The draft budget was reviewed by officials from the Iraqi Finance and Planning ministries, briefed to USAID and UN representatives, and approved by the Program Review Board, a board comprised of Coalition representatives and reporting to Paul Bremer. Although the budget documentation shows both the “proposed” and “approved” levels, it offers no explanation in those cases where the approved level is different than the proposed amount.

The Iraqi Governing Council, which began operating in July, may consider substantial amendments to the budget for 2003 and is authorized to play a full part in drawing up the 2004 national budget.³

Revenues

Oil rents of \$3.45 billion USD comprise 88% of expected revenues, with the remainder coming from state owned enterprises, taxes and fees. However, the reality of this revenue projection will rely heavily on the worldwide price of oil over the six-month period and the Iraqi oil industry recovering sufficiently to meet anticipated output, something that has been complicated by repeated sabotage attacks on pipelines. The Iraqi oil ministry is currently anticipating 1.5 million barrels per day (bpd) by the autumn rising to 2.8 million bpd by end Q1 2004.

The CPA has projected oil revenues of \$3.45 billion over the next six months at \$20 per barrel. “This would require exports of around 800,000 barrels per day. But oil flows out of the unsettled country remain a trickle - just 363,000 barrels per day compared with daily pre-war capacity of some 2 mln. barrels. Exports are even below last month’s figures, and well below the 1mln. target of Iraq’s oil officials.”⁴ Analysts remain skeptical about the feasibility of achieving the Iraqi oil ministry’s production plan, which, if true, could mean a larger deficit.⁵

Expenditures

The largest reported expenditures are for rebuilding the food social safety net (\$1.35 bln); restoring Iraqi oil through the Task Force RIO program, which is composed of representatives of the US Army Corps of Engineers, the CPA, and representatives of Kellogg Brown & Root/Halliburton (\$825 mln); \$400 million to co-fund a Bechtel contract with USAID; restructuring electricity provision (\$192 mln), police reform (\$150 mln) and military de-mobilization (\$60 mln), gas provision (\$135 mln), and currency reprinting (\$100 mln). Kurdish regions have been allocated \$366 million for spending to be determined by regional finance ministers.⁶

Several of the ministries will experience large staff changes. The Ministry of Housing and Construction will have a 90% staff increase. The Ministry of Interior will drop 10,000 police officers as it eliminates and restructures law enforcement units. The Iraqi Science Commission will increase its staff by 43% as it hires 1500 defense scientists to control nuclear sources. One of the largest ministries, the Ministry of Religious Affairs will maintain its current staff of over 10,000.

Information on personnel levels for a number of ministries was either incomplete or absent altogether. Further, none of the \$1.1 billion of personnel costs included in the budget were distributed to the individual departments, but rather were presented as a consolidated figure for the entire government. In general, given that the CPA anticipates major restructuring of civil service, it would have been preferable for the budget to have shown how these funds will be allocated across the line ministries.

There are a number of areas in the Iraqi budget that are in need of further clarification. For instance, the budget is broken out by ministry, with operating and capital expenditures for each. Yet, only \$2.6 billion of the budget is channeled through Iraqi Ministries. An additional \$3.49 billion is proposed as “other expenditures” such as food social safety net, electricity and police. It is not clear why these expenditures are not being channeled through the responsible ministries, and who will in fact be accountable for these funds. The budget summary notes that “over \$1 billion of capital expenditure to be funded off-budget,” raising questions about how transparency and accountability of off-budget funds will be ensured.

Some ministries provide extremely detailed information about spending plans. For example, the Ministry of Culture details spending even for a new store for the Iraqi Museum. Other departments include little detail about their expenditures. For example, the Ministry of Security Affairs sets aside \$120 million for capital expenditures without explaining what these will be used for. The Electricity Commission sets aside \$75 million for projects to be identified at a later date.

Recommendations

Providing a realistic budget for a country so recently emerging from war, with continued fighting, and in the absence of reliable information on past budgets is undoubtedly a daunting task. But because budget practices established in this early period will shape the path of future budgets, it is important to embed full transparency in the budget process as soon as possible.

The emergency budget is an important first step toward budget transparency in Iraq. However, further steps are needed to improve budget transparency. It will be important in future budgets to eliminate off-budget accounts or to ensure full reporting from such accounts. Greater transparency of state-owned enterprises and of expenditures that are outside the line ministries will be needed. A clear explanation of the broad strategic goals as well as the specific program goals within each ministry will be necessary to foster public debate and build consensus around budgets. Below we provide several recommendations to the Coalition Provisional Authority and to the Iraqi Governing Council on how to enhance the transparency and effectiveness of the budget.

- ▶ *Publish the minutes of the Program Review Board.* The Program Review Board, established by Ambassador Bremer is authorized to review budgets and make recommendations on funding requests. Final decisions on expenditures are made by Bremer.⁷ The Board has been meeting regularly and minutes of the meetings of this board are required to be made public.⁸ Yet, the minutes of the meeting to discuss the 2003 budget have not been disclosed. Nor have minutes of any other meetings of this Board been made available. Publishing the board meeting minutes would help fill in some of the narrative description missing in the 2003 budget. It might also explain some of the differences between the proposed and actual budget allocations.
- ▶ *Make the International Advisory and Monitoring Board more transparent.* Security Council Resolution 1483 notes the creation of an International Advisory and Monitoring Board (IAMB) to ensure that the Development Fund for Iraq is used in a transparent manner. To date, the draft terms of reference for the creation of this important body have not been made public, limiting opportunities for Iraqis and other observers to influence the formation of this important body.
- ▶ *Clarify the relationship between the Development Fund for Iraq and the budget.* UN Security Council Resolution 1483 notes the creation of the Development Fund for Iraq (DFI), which receives 95% of government proceeds from Iraqi oil sales. The DFI was established by Regulation No. 2 of the Coalition Provisional Authority.⁹ The 2003 budget notes that the Development Fund will provide \$1.2 billion for the budget. However, the relationship between the DFI and the budget is not made clear—the

budget anticipates oil revenues of \$3.45 billion—much greater than the amount in the DFI. Moreover, only the Provisional Authority Administrator may authorize spending from the DFI. However, as Iraq's governing council takes over the budgetary process in 2004, it is important that they gain authority over the DFI as well. Little information has been made public about the DFI. The Coalition Provisional Authority should include information on its web site about any transfer of assets into and out of the DFI and should clarify the relationship between the DFI and the budget.

- ▶ *Include a strategy document explaining budget priorities in 2004.* This should explain the main objectives of the budget, and how revenues and expenditures reflect those objectives. Clear explanations of budget priorities accompanying revenue and expenditure data are an important means of facilitating participation of civil society in the budget process and ultimately building a consensus on the use of national resources.
- ▶ *Provide narrative detail to explain major line items.* The 2003 budget includes a very short caption for each Ministry. In 2004, each Ministry should include a report on its 2003 activities, with an explanation of how its budget was spent. A detailed plan should be provided for its proposed 2004 expenditures, as well as statistical data, where available, justifying the socio-economic need, as well as an explanation of how those expenditures will meet the goals identified in the overall budget strategy. Where appropriate data is not yet available, plans should be made for collecting such data.
- ▶ *Include greater information on how deficits will be financed.* The 2003 budget leaves several questions about how the \$2.2 billion deficit will be financed, prompting concerns that Iraq will collateralize future oil production to repay new debt. The Iraqi Governing Council should add an amendment to the 2003 budget clarifying whether the sources of financing—vested assets, seized assets, Iraqi relief—are estimates, or actual amounts in these accounts. If these are estimates, it would be helpful to know the risks that may prevent these sources from materializing. More detail would be useful, and would be consistent with the budget's stated goal of ensuring "fiscal discipline in the use of budgetary resources in order to rebuild the confidence necessary for the international donor and investment community to support the country's efforts."
- ▶ *Provide greater data on state-owned enterprises.* Iraq has 192 state-owned enterprises (SOEs) in areas ranging from agriculture to oil to the military. Many of these will eventually be restructured and/or privatized. To minimize opportunities for corruption and ensure that the state gets a fair share for privatized assets, it is important to improve transparency of SOEs. The 2004 budget should include any available information about the income and assets of Iraqi SOEs.

- ▶ *Publish a report on the actual implementation of the 2003 budget.* Given that this is the first budget, it is likely that outcomes for 2003 will deviate in many cases from the budgeted amounts. Publication of actual budget information will allow observers to compare the 2004 budget to actual expenditures in 2003 to assess whether proposed expenditures are realistic and well-targeted. A comparison of actual to budgeted levels for 2003 is also necessary to highlight either areas of overspending or areas of under-spending where implementation has gone more slowly than anticipated. These data will be crucial for assessing the appropriateness of 2004 proposals.
- ▶ *Establish a procedure for budget auditing.* The budget establishes an important precedent in providing resources (\$400,000) for a supreme audit board. For 2004, the Governing Council and the Board of Supreme Audit should establish clear guidelines to ensure the auditor's independence, and to ensure that audit reports are conducted in a timely fashion and are made available to the public.
- ▶ *Provide opportunities for public comment on the draft 2004 budget.* While the urgent need to restore basic services may have left no time for allowing public comment on the draft budget, such opportunities should be provided in 2004. Once a draft budget has been produced in 2004, the Iraqi Governing Council should schedule public hearings.
- ▶ *Include scenarios for revenues under different oil outcomes.* Because of the high level of uncertainty surrounding Iraqi oil revenues due to sabotage and looting; unresolved claims of Iraqi debt; and the normal volatility of oil prices, the 2004 budget should include different revenue scenarios reflecting pessimistic, optimistic, and expected revenue projections.
- ▶ *Include more detail on personnel levels and expenditures in the 2004 budget.* Given the challenges associated with reforming the civil service, the budget should include more and complete information on personnel, both the numbers of employees in each ministry and the cost associated with these employees. Further, these personnel costs should be included in the budgets of each ministry (currently they are excluded) in order to improve management incentives and accountability of these funds.
- ▶ *Provide multi-year information.* The first budget had a very short-term focus, covering only six months. Future budgets should strive to include estimates of revenues and expenditures consistent with a medium-term framework. Such estimates are particularly important given the multi-year nature of plans for Iraq's reconstruction. A multi-year perspective is crucial for assessing the costs and trade-offs associated with competing projects. Further, recent reports suggest that cost of some of these reconstruction projects could be far higher than originally projected¹⁰; only a multi-year framework allows for assessing the impact of such re-estimates.

Notes

¹ <http://www.cpa-iraq.org/Budget2003.pdf>

² All amounts in this brief are in U.S. dollars.

³ Associated Press Newswire, Duties of Iraq's Governing Council, Sunday, July 13, 2003; <http://www.washingtonpost.com/wp-dyn/articles/A51112-2003Jul13.html>

⁴ "Pipe dreams of Iraqi oil." Guardian Unlimited. Sunday July 13, 2003. www.guardian.co.uk/Iraq/Story/0,2763,997069,00.html

⁵ Walid Khadduri, "Iraq Targets 2.8 mln. b/d Oil Production Level by April 2004—If Security Prevails," *Middle East Economic Survey*, 28 July 2003.

⁶ The \$366 million is a "gross" number excluding revenues. In Table 5 of the budget, funding for the Kurds is presented on a net basis, implying that the revenues are used to offset spending directly and are not included in the revenue totals. On a net basis, the total is \$300 million.

⁷ <http://www.defenselink.mil/dodgc/ia/docs/reviewboard.pdf>

⁸ <http://www.cpa-iraq.org/regulations/REG3.pdf>

⁹ <http://www.cpa-iraq.org/regulations/REG2.pdf>

¹⁰ Jackie Calmes, "Washington Wire," *The Wall Street Journal*, August 1, 2003. The article notes that Bechtel estimates that the cost of its work in Iraq could total \$16 billion, far exceeding the \$400 million in the current budget.

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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.

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