

FINANCIAL RECONSTRUCTION IN IRAQ

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
INTERNATIONAL TRADE AND FINANCE
OF THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED EIGHTH CONGRESS
FIRST AND SECOND SESSION
ON
ECONOMIC STABILTY, JOB CREATION, AND TRANSITION TO
INDEPENDENCE LEADING TO SELF-GOVERNMENT IN IRAQ

SEPTEMBER 16, NOVEMBER 4, 2003, AND FEBRUARY 11, 2004

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FINANCIAL RECONSTRUCTION IN IRAQ

TUESDAY, SEPTEMBER 16, 2003

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE AND FINANCE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 2:55 p.m., in room SD-538, Dirksen Senate Office Building, Senator Chuck Hagel (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Good afternoon, gentlemen. We apologize for starting late, but Senator Bayh and I have just saved the Republic by voting the right way. We concluded as we were coming over together that we collaborated in the interest of justice and democracy. So thank you for giving us a few extra minutes.

The development of Iraq's economy will be a significant factor in Iraq's transition to stability and democracy. Despite its potential, including the second largest oil reserves in the world, Iraq's economy has been devastated by more than three decades of corruption and mismanagement by Saddam Hussein's Government; more than a decade of international sanctions; three disastrous wars; and the looting that followed Iraq's liberation this year.

Financial reconstruction is critical to the future of Iraq. Without economic stability and the prospects for job creation and growth, the transition to independence and self-government in Iraq cannot and will not succeed. Our witnesses today will testify on the economic situation in Iraq, as well as the specific steps that the Bush Administration is taking to help rebuild Iraq's economy, Finance Ministry, Central Bank, banking system, and oil industry. The United States and its allies face a continuing security challenge in Iraq. Instability and rising violence have threatened the progress of Iraq's economic reconstruction.

The task in Iraq is daunting. The Bush Administration has estimated that Iraq's reconstruction will cost between \$50 and \$75 billion; \$20 billion of the Administration's forthcoming \$87 billion supplemental appropriations request will be specifically targeted for Iraq's reconstruction. Projected oil income from July 2003 through December 2004 is around \$14.3 billion. Iraq's oil revenues will not cover the budget for the Iraqi Government, which includes operating expenses of at least \$1 billion per month, let alone the costs of reconstruction.

Iraq faces an enormous debt and reparation burden. Current estimates are \$70 to \$120 billion in foreign debt, and approximately

\$116 billion in unpaid reparations claims pending against Iraq through the United Nations Compensation Commission. There are assessments underway to determine the exact amount of Iraq's debt. I look forward to learning from our witnesses what plans there are for working with international creditors to provide debt and reparations relief for Iraq.

America cannot meet Iraq's reconstruction and development needs without the help of the international community. The Administration has recognized the critical role that the international community must play in the reconstruction of Iraq. Secretary Powell and others have been working to seek a new UN resolution that will help facilitate the political transition to full Iraqi sovereignty. I also look forward to Under Secretary Larson's update on what we can expect from the International Donors' Conference in Madrid, Spain, October 23 and 24 of this year.

Rebuilding the financial sector in Iraq is a complex task. Setting up a trade-credit system is one of the first steps in a broader effort to help rebuild Iraq's financial system and allow Iraq to trade with the world. The CPA created the Trade Bank of Iraq on July 17 of this year to finance the import and export of goods to and from Iraq. The Trade Bank will also assist in the transition from the UN's Oil for Food Program when that program terminates in November of this year. The CPA has chosen a consortium of international banks, led by JP Morgan, to handle the operations of the Trade Bank. The Ex-Im Bank will play a key role in providing insurance for letters of credit issued by this Trade Bank.

The banking system itself must undergo significant reforms so that it can play its role in promoting economic growth and investment. Also, a legal framework for conducting transactions must be established to enable commencement of international trade and contracts.

A stable, unified currency is a key part of financial reconstruction. The CPA has announced that beginning October 15 of this year, the Central Bank will oversee a new Iraqi currency. New Iraqi dinars will replace both the "Saddam" dinars used in southern Iraq as well as the "Swiss" dinars used in the north. This new currency is an important step in the process to establish a stable, unified national currency.

An issue I would like our panelists to consider is how we can encourage the emergence of an Iraqi private sector, how we can draw this sector into our plans, and what are the best means to support small and medium enterprises in Iraq.

We have one panel of witnesses today to discuss all of these issues and more. First, we will hear from Under Secretary of State for Economics, Business, and Agricultural Affairs, Al Larson, who, by the way, has just returned from Cancun, Mexico, and, Mr. Secretary, we appreciate you making the effort to come before us today. Secretary Larson will describe the efforts to raise political support and funds for reconstruction in Iraq. We will then receive testimony from Under Secretary of the Treasury for International Affairs, John Taylor, who will give his assessment of the state of the Iraqi economy, as well as the economic situation on the ground in Iraq. Then, we will hear from the President and Chairman of the Ex-Im Bank, Philip Merrill, who will discuss Ex-Im's role in

the economic reconstruction of Iraq, including plans to work with the newly created Trade Bank of Iraq.

Gentlemen, we appreciate you being here, and at this time I would like to call upon my friend and colleague, the Ranking Minority Member of this Subcommittee, Senator Bayh.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Thank you very much, Chairman Hagel, both for your friendship and also for calling this hearing today. This issue before us is both important and timely. And thank you, gentlemen, in the midst of your busy schedules, for coming to share your thoughts with us.

I am struck, Chairman Hagel, by the fact that the last time this Subcommittee met to take testimony, it was on the subject, I believe, of Argentina and the profound economic and financial challenges facing that country. It is, however, my impression that that is largely a walk in the park compared to the challenges that we are facing in Iraq today, both the magnitude and the possible intractability of some of these challenges.

We are embarked upon nothing less than Nation building in its most profound sense. We are dealing with a society that cannot provide basic security for its citizens, some of the basic elements of even a rudimentary standard of living—water, electricity, things of that nature. Some basic elements, basic building blocks of an economic structure have not existed in the past, a central bank, for example, and some of the other things that the Chairman just mentioned that need to be put into place.

They face a crushing debt burden, no foreign investments, and a variety of other challenges, largely based upon the fact that they have oil and very little else to offer the rest of the world. So, I am going to look forward to hearing your thoughts.

I have four questions in the back of my mind. I may have a chance to pose some of them to you a little bit later.

First, what burden is it appropriate to ask the U.S. taxpayers to pay in this undertaking? We are willing to pay for the liberation and the war, but when it comes to economic and financial reconstruction, what burdens should we bear versus what burden is it appropriate to expect the Iraqi people to bear themselves at some future date, given the vast petroleum reserves that they will hopefully eventually have access to?

Second, what about debt cancellation? They face a crushing debt burden. What role, if any, are some of our allies willing to play, particularly with regard to some of the debts rung up by Saddam for arms purchases and other things used to subjugate the Iraqi people, unrelated to the Iraq-Iran war?

Third—Secretary Taylor, this may be your ballpark—what about ensuring that they put into place sound economic institutions and begin practicing sound macroeconomics so that our assistance does not just go down the drain but instead will be an investment that will give them a decent start toward a stable economy? As you know—and there is some parallel to the Argentine experience here—you invest in a system that is fundamentally flawed, you do not tend to get much return.

Finally, what is realistic to expect for their petroleum industry, both in terms of magnitude and timing? That obviously is going to be a big key here as they try and get back on their feet and transition to what hopefully will be an economy based on something more than just petroleum?

Gentlemen, thank you for your time. Again, Chairman Hagel, thank you for your foresight in calling this hearing. I look forward to working with you.

Senator HAGEL. Senator Bayh, thank you.
Secretary Larson.

**STATEMENT OF ALAN LARSON
UNDER SECRETARY FOR
ECONOMICS, BUSINESS, AND AGRICULTURAL AFFAIRS
U.S. DEPARTMENT OF STATE**

Mr. LARSON. Thank you very much, Mr. Chairman. I would like, if I could, to summarize the longer written statement that I will submit for the record.

Senator HAGEL. Each of your written statements will be included in the record.

Mr. LARSON. Mr. Chairman and Senator Bayh, we really appreciate the opportunity to testify on the overriding national priority of reconstruction in Iraq. The task of reconstruction is going to be a very challenging one and a costly one. At the same time, if we move decisively to mobilize the necessary resources and speed reconstruction, we will lower the long-run financial burden shouldered by the United States. In addition, a strong push for reconstruction now will reinforce efforts to establish an effective and internationally recognized Iraqi Government.

The task of reconstruction is going to be particularly challenging because of, as you said, Mr. Chairman, the years of neglect, mismanagement, and corruption of Saddam Hussein's regime. There is also a huge infrastructure deficit that impedes economic growth. You also will appreciate, Mr. Chairman, that the heavy-handed government controls that were practiced by Saddam Hussein's regime have distorted the economy, particularly in areas like food and agriculture, in ways reminiscent of the communist societies, and these distortions may be very difficult to unwind.

In spite of these challenges, we are seeing important signs of progress in rebuilding Iraq. We are working with the Iraqi people and have been making progress in meeting immediate needs, such as a dependable supply of food, reopening schools and hospitals, and rehabilitating water and electric power infrastructure. At the State Department, we have been particularly active in supporting the CPA and the Iraqi people in the analysis of issues related to oil, transportation, telecommunications, and the transition from the Oil for Food Program to a more market-based agricultural and food economy. My written testimony details the nature and the magnitude of the reconstruction challenges that we face in Iraq, including in some of the more important sectors.

For months, we have been working closely with international organizations, key donor governments, and the Coalition Provisional Authority to lay the groundwork for a reconstruction process with robust international participation and support. The Administration

reached out early on to the administrator of the United Nations Development Program and vice presidents of the World Bank to help launch meetings of some 30 donor countries in June of this year in New York at UN headquarters. This meeting resulted in the establishment of a core group of countries comprised of the European Union, Japan, the United Arab Emirates, and the United States. Since then, in both face-to-face meetings and weekly conference calls that have included the United Nations Development Program, the World Bank, the IMF, and the CPA, we have worked through some of the important issues of reconstruction.

For example, at the June 24 meeting, the countries there present commissioned assessments of the reconstruction needs from the United Nations, the World Bank, and the IMF. In conducting these 14 assessments, the international institutions have been working very closely with the CPA, as well as with the interim Iraqi Government.

Understanding that some donor countries might prefer to make contributions into a fund in which they have a voice in the governance, we set in motion preparations for a multidonor international trust fund. The World Bank is taking the lead in helping to design this fund, which is likely to be similar to the trust fund that supported reconstruction in Afghanistan.

As you said, Mr. Chairman, at the end of October, the international community will meet at a ministers'-level donors' conference in Madrid. At that time we expect to have a much clearer picture of the budget prospects in Iraq. We expect to have the final results of the United Nations, World Bank, and IMF needs assessments in these 14 sectors. We expect to have a model of the multilateral trust fund, as well as input from other countries on how it should operate. We expect as well to have the draft budget of the CPA for 2004, which will be fine-tuned in accordance with information that comes out of this donors' conference.

As a result of these multilateral efforts, we are seeing a converging of assessments about the magnitude and the nature of the reconstruction challenge in Iraq. In discussing the vital role of these international institutions, I would like, Mr. Chairman, to pause to pay tribute to the dedicated men and women of the United Nations, the World Bank, and the IMF who were killed or injured in the bombing of the UN headquarters in Iraq on August 19.

Linked with this work on the donor process has been the political work that the Secretary of State and the Administration have been pursuing through the Security Council of the United Nations. They have the UN Security Council resolutions, and basically the political framework that would give the maximum possible encouragement and support through the involvement of other donor countries and the international financial institutions.

As the realities of the reconstruction task come into sharper focus, the task can appear daunting. Fortunately, President Bush is leading by example. In his September 7 address, he set out for the American people the need for a large commitment of funds to finish the job that our troops have so ably and courageously begun. As you said, sir, he will be requesting \$20 billion for the reconstruction of Iraq, about a quarter of which will be devoted to secu-

rity-related reconstruction needs and the rest for the most urgent infrastructure needs.

We intend to make the same case as forcefully and as effectively as we can that our friends and allies need to be fully engaged in this effort. Congress' support for the President's request will strengthen the hand of the Administration in making the case for international participation that is commensurate with the importance and the urgency of this task.

As time proceeds, oil revenues in Iraq and private sector investment, both from within Iraq and outside of Iraq, can make increasing contributions to Iraq's development. My testimony says that export revenues for Iraqi oil could reach \$12 billion in 2004, which would roughly cover the recurrent costs of the government. It also says that in 2005 and we believe in 2006, those oil export proceeds could reach \$19 billion, which would mean that Iraqi resources could begin making a significant contribution to economic reconstruction.

We also believe that with the proper economic policies and a rehabilitated infrastructure, Iraq could attract considerable foreign investment. CPA, the Governing Council, and the Interim Cabinet are working hard to establish the appropriate investment and commercial rules and regulations that could make that type of private sector investment possible.

Mr. Chairman, we know that the President's request is a large one. We also believe that it is an urgent and essential one. During this hearing and in the weeks ahead, we want to do everything we possibly can to address all of the Congress' questions so that we can move forward as quickly as possible.

Thank you.

Senator HAGEL. Mr. Secretary, thank you.
Secretary Taylor.

**STATEMENT OF JOHN B. TAYLOR
UNDER SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. DEPARTMENT OF THE TREASURY**

Mr. TAYLOR. Thank you very much, Senator Hagel and Senator Bayh, for inviting me to testify on financial reconstruction in Iraq. This Committee is an excellent one for discussing trade and financial issues in Iraq, and it is also a pleasure for me to be here with Mr. Merrill and Mr. Larson. It demonstrates the great degree of government-wide work that is needed to get a job like this done.

The last time I testified on Iraq reconstruction was on June 4 at the Senate Foreign Relations Committee, and at that hearing I stressed two things which I would like to come back to in this testimony based on what has happened over the months of the summer.

The first was that the international community and the Iraqi people face an enormous task in the reconstruction of the economy. A quarter of a century of repression and economic mismanagement under Saddam Hussein, cut the size of the economy to a small fraction of what it was before his regime took over. In 1979, GDP in Iraq was \$128 billion. By 2001, it had declined to only \$40 billion.

The second thing I stressed was the importance of a strategy for financial reconstruction; that is, the contingency plans developed in

advance of the military conflict. I also stressed the tactics that were important on the ground to implement that strategy.

I think much has been accomplished in the financial area since the fall of Saddam's repressive regime, and many potential financial catastrophes have been avoided as well. In my view, it was the months of advance planning by the U.S. Government before Saddam's fall as well as the dedicated work of the Coalition Provisional Authority and the Iraqi people since his fall that are responsible for these accomplishments. Starting late last year, we began developing a strategy for financial reconstruction based on the information we had at the time. The strategy addressed such issues as payments to Iraqi workers and pensioners, the currency, the banking system, the international debt, the assessment of the reconstruction costs, and the international fundraising efforts. My written testimony reviews how that strategy is playing out, and I think it shows many successes.

An important part of our advance planning which I would like to emphasize here was the selection of some extraordinary people to participate in the effort. We began selecting experts back in January. The first wave of people were deployed to Kuwait in March and then into Baghdad in April. Early on, we decided that a financial coordinator is essential, and we are very grateful to Peter McPherson who serves in that position in Iraq.

My written testimony covers all of the six areas and addresses some of the questions that both of you raised in your opening remarks. I would be happy to come back to those in my question and answer period. But I would like to in my opening remarks here stress the strategy that was laid out for just one of the areas, and that was for paying workers and pensioners and for the currency.

It was clear that we had to have a strategy early on for paying workers and pensioners in Iraq after Saddam's fall. It was also clear that we had to work out a strategy well in advance of his fall. Keeping workers on a payroll with stable purchasing power would be essential to preventing severe hardship and economic collapse. But there are a lot of questions that we had to address: How many workers were there? How much should they be paid? What currency should we use to make the payments? Where would the funds come from? Would the payment system be sufficient to actually make the payments? What condition was it in? How could we prevent hyperinflation, sharp depreciation of the currency, which would further impoverish the Iraqi people?

Starting late last year, we developed a payment strategy. The payment strategy was approved interagency after a lot of good discussion and debate. The strategy in the end called for paying people in U.S. dollars on an interim basis. Using U.S. dollars, we could create stability and help prevent a collapse of the local currency, the dinar.

Finding a way to secure the funds for these payments was also a challenge. In the end, we decided that the best approach was to use Iraqi regime assets frozen back in 1990. Our estimates were there was about \$1.7 billion of such funds frozen in U.S. banks.

But in order to use those assets, we had to have them vested for the use of the Iraqi people. So a vesting strategy was worked out, reviewed, and approved by our legal experts. Under this plan, the

President would call for U.S. banks to transfer the assets to the Federal Reserve Bank of New York near the time the military conflict began.

To make such a strategy operational, of course, many tactical issues and contingencies had to be considered. This plan called for the military on the ground to issue public statements. These statements were worked out in advance by Defense and Treasury. The statements would say that the dinar would continue to be accepted as a means of payment after Saddam's fall. The plan also called for the first wave of financial advisers to go into the country and assess the payments mechanism to see if it was capable of making payments in dollars.

Another essential operational issue concerned the shipping of the currency to Iraq. We estimated that enough currency was in storage in the New York Fed's warehouse in East Rutherford, New Jersey. We determined that it was feasible to ship the currency by truck to Andrews' Air Force Base and then fly it to Kuwait for distribution into Iraq. Many tons of currency were involved because of the need for small denominations, \$1 or \$5 bills. On the ground, the military would assist in the actual shipment of the currency around the country. Financial experts would develop lists of people, eligible workers to be paid, and then make the actual payments. In some cases, the currency would be paid at the government ministries or the state-owned enterprises. In other cases, pensioners would come to the local banks to get the payments.

I am pleased to say that this strategy, along with all the tactical details I have described, has been carried out with great success. Back on March 20, at the start of the conflict, President Bush issued an order calling for the vesting of these frozen assets, and as planned, about \$1.7 billion was sent to the New York Fed. With these funds, the first shipments of currency were sent from the Fed's warehouse to Kuwait and then to Iraq. We were able to make emergency payments to dock workers, rail workers, power plant workers, and other essential workers essential for restoring basic services. We soon transitioned to a regular civil service salary structure and pension payments to over 2 million Iraqis.

Our financial experts in Baghdad considered this to be a major force for stability in the country as well as a significant spur to the economy. And throughout this period, I should add, there has been no collapse of the currency, no hyperinflation, and no serious glitch in the process.

This major and essential success in the financial reconstruction was due in large part to preconflict planning and to adjustments that were made as we implemented those plans. As I indicated, the payment strategy called for the use of U.S. dollars on an interim basis only. Our goal was for the Iraqi people to ultimately choose a new national currency to replace the Saddam dinar and the Swiss dinar. And we would provide them with the necessary financial and technical logistical assistance to do so. A stable unified currency is essential for a market economy, and, therefore, it was a key part of our financial reconstruction plans.

I am happy to say that this part of the financial reconstruction strategy is on track as well. This summer, after consulting with representatives from the central bank, the finance ministry, and

Iraqis all over the country, the CPA announced that a new currency would be issued starting in October. The new currency is now being produced and printed in facilities around the world, and it is on schedule. It will be shipped from printing facilities in England, Spain, Sri Lanka, and other countries, and it is on time.

A public education campaign is underway in Iraq to make sure the Iraqi people are well informed about the new currency and about the exchange itself. The new currency will be issued in more denominations than currently available, six rather than two. It will have built-in security features to enhance public confidence and reduce the risk of counterfeiting.

Mr. Chairman, let me conclude my opening remarks here with these examples of how the strategy is working. My written testimony documents similar progress in banking, in debt, in assessment of reconstruction costs, and preparations for international fundraising. We have made considerable progress over the summer months, and our activities will only intensify in the coming months. The challenges are formidable. We are on our way to creating great opportunities for the Iraqi people. President Bush's request for \$20.3 billion in supplemental funding for security and infrastructure is essential to this effort, as is the contribution from our friends and allies and from the international financial institutions.

Thank you, Mr. Chairman.

Senator HAGEL. Thank you, Secretary Taylor.

Chairman Merrill.

**STATEMENT OF PHILIP MERRILL
PRESIDENT AND CHAIRMAN
EXPORT-IMPORT BANK OF THE UNITED STATES**

Mr. MERRILL. Mr. Chairman, Senator Bayh, Members of the Subcommittee, I too am very pleased to be here with able colleagues to testify on the Bush Administration plan to rebuild Iraq and establish the foundation for a stable society. There are three pillars to this effort: physical security, political stability, and economic growth. I want to focus on the economic needs of Iraq and how to pay for them. In particular, I want to discuss the role the Bank is playing in this effort as it pursues its mission of supporting U.S. exports and the U.S. jobs they represent.

As you and my colleagues from the Departments of State and the Treasury have noted in your and their testimony, the cost estimates of what Iraq will need in future years for reconstruction are in the tens of billions of dollars. So, how will all this be financed? One source is, of course, U.S. funding. I think the President's speech demonstrates the high priority the Administration places on this effort.

Another source is donor support from other countries on which the Administration, as you have heard, is actively working.

But, of course, Iraq has its own resources. Iraq is a country with an educated people, a rich heritage, and significant natural resources, including tremendous oil reserves. The Administration expects Iraqi oil and other revenues and recovered assets to contribute to meeting Iraq's reconstruction needs. The U.S. economic contribution is designed to have an immediate and significant impact on the sectors critical to stability and growth. In this regard,

Ex-Im Bank is working on several initiatives to help Iraq move toward the utilization of its own resources for its own development with its own people.

While our mandate is to support U.S. exports and U.S. jobs, U.S. exports and trade in general are powerful tools of economic growth. Re-establishing Iraq's trade with its neighbors in the world is a key element in rebuilding Iraq's economy, and opening Ex-Im Bank's programs in Iraq will further this objective while fulfilling our mission to support U.S. exports and exporters.

Senator, you dealt in your testimony with our proposed \$500 million short-term credit facility, and so I am going to skip over it. It is in the written testimony. I am going to skip over that part here except to say that this is good for only up to 1 year, and part of the reason for that is that under the UN-funded oil mandate, Iraqi debt is excluded from creditors only for a relatively short period of time, through the end of 2007, I believe.

In any event, in the short term the Trade Bank will support Iraqi imports funded by the Development Fund of Iraq by current Iraqi oil revenues. This facility is also expected to serve as a model for other export credit agencies that are interested in providing similar support for the Trade Bank, making this a multilateral effort. I will come back to this. We expect that Ex-Im Bank's program in conjunction with the Trade Bank and similar programs initiated by other export credit agencies, will help jumpstart the flow of trade into Iraq.

But after we are done patting ourselves on the back, we cannot expect current Iraqi oil revenue to begin to generate the money needed now to ensure Iraq's success. Pay-as-you-go is simply not going to cut it.

So, other than the U.S. taxpayer and international donor contributions, where can the money come from?

One answer is foreign investment. Creating the right climate for foreign investment can provide dividends directly to the citizens of Iraq. This is no small effort. There is a historic reluctance on the part of Iraqis, and also most of the Muslim world to accept foreign investment, whether it is U.S. or anybody else's investment, so this is no small problem for Paul Bremer. For the economic stabilization of Iraq, however, prompt resolution of Iraq's external debt is absolutely a minimal requirement.

I think the important point to get across is that Iraq's potential oil revenues are enormous, on the order of tens of billions of dollars per year. Our numbers are consistent. These reserves can be tapped if the long-term investment to generate them is provided. This money needs to be invested on the conditions where the oil and gas business in Iraq will be conducted by and for the Iraqi people themselves and for their own benefit. But nobody is going to invest long term in Iraq if at the end of 3 years whatever they get is going to be seized by a plague of creditors in every country in the world, including, but by no means limited to, this one.

One could also envision an Iraqi authority that could securitize these revenues were the oil production there, in order to raise more money up front.

As one player in this area, we stand ready to respond. The business of Ex-Im Bank is to provide guarantees, insurance, and

project finance for projects as soon as conditions make such financing possible. That means somebody there that you can lend to, whatever you call it, DFI, Coalition Provisional Authority, or Provisional Government. We are willing to meet these challenges to the extent it benefits U.S. exporters and creates U.S. jobs. That is our job. But we fully expect the other export credit agencies to do the same thing for their exporters, again creating the circumstances for a significant multilateral effort.

There are 26 export credit agencies in the OECD and a number in other countries outside the OECD. The Bank also has a history I wish to call to your attention, of providing innovative financial solutions during times of political transition. It played a major role in the administration of the Marshall Plan. When Israel was being formed in 1948, Ex-Im Bank provided the initial provisional military administration with loans based on the idea that the future government would be supported by the United States and was therefore a good risk. Then Ex-Im Bank President and Chairman, William McChesney Martin said that Ex-Im Bank would have, "Reasonable assurance of repayment because the United States is going to support Israel in every reasonable way." The principle was the same. Also in the 1990's, the Bank used an oil and gas framework agreement for Russia so that investment in oil infrastructure was possible as the Soviet Union evolved into the CIS and then to Russia. I was at NATO at that point in time. Looking backward, it seems like everybody knew it was going to go from the Soviet Union to CIS to Russia. I can only tell you at the time the picture was a lot less clear. As these cases suggest, it would be sound policy for Ex-Im Bank and also for export credit agencies worldwide to support these efforts.

In closing, let me emphasize that Iraqis need to realize some economic value today in order to establish the physical security, political stability, and economic development their country needs, and to which the United States is fully committed. Time is of the essence, and it is less expensive to make them rich now than it is to pay to keep 140,000 U.S. soldiers there for an extended period of time.

I will be happy to answer any questions you may have, including the four that you posed.

Senator HAGEL. Chairman Merrill, thank you.

Again, to all three of you, we appreciate you taking the time to come up here, as well as your staffs to prepare you for the hearing.

Senator Bayh, if it is okay, we will go maybe just 7-minute rounds. That way we can share the time.

Secretary Larson, you mentioned, as you were taking us through, the donor conference structure possibilities. Would you define more clearly what the Administration is looking for in the ways of dollars from our allies at that donor conference?

Mr. LARSON. Mr. Chairman, it is a very fair question. I am going to give you a more general response than you probably are looking for. We believe that it is very important for other donors, as well as the international financial institutions to make a maximum effort to pay their share of a challenge that is an international challenge. It is not our challenge. It is something that we, the international community, and the Iraqis together, have to work on.

Part of the reason why I am not in a position to give you a figure today is that we are still in the process of refining the estimates that there will be for 2004 and 2005 on reconstruction costs and needs, and to have those in a form that they have really reconciled and dovetailed the estimates that are coming out of Baghdad from the Coalition Provisional Authority and the interim government, with those that are the results of these international needs assessments.

I can say that my sense is the assessments that are being refined in the international institutions end up being very close to our own when you look at the basic magnitudes and even some of the sectoral breakdowns. We are going to be pushing countries to make a large and a maximum effort, but we have not at this stage set a bar for a specific amount of a specific percentage, and we think that until we have a little more finality on the estimates, it is going to be difficult to go into capital and capital with a specific request for a specific amount. But I can tell you this: We intend to make this a very high priority for the entire Administration from the top on down.

Senator HAGEL. If the numbers that you and others in the Administration have put forward, numbers that were shared here today, are anywhere near correct, reconstruction costs of \$50 to \$75 billion. I think those are the Administration numbers. Some believe it will be over \$100 billion, but let us stay with your numbers. In the President's request that you have just discussed, that he will be bringing up here, \$20 billion is for reconstruction. In your numbers you have shared with us today, I believe you said could reach as far as oil sales in 2004, \$12 billion. Then you said, I believe, in 2005, 2006, we could see Iraqi oil flow generating \$19 billion. Is that what you said?

Mr. LARSON. Correct.

Senator HAGEL. So we have a pretty significant gap here as to where the rest of that money is coming from. Could you tell us a little bit about how the Administration is going to fill that gap and where that money is going to come from?

Mr. LARSON. Right. Again, as you said, Mr. Chairman, our estimate at this stage is for something on the order of \$57 to \$75 billion as the need to meet the reconstruction costs over a period of time. We want, with the \$20 billion that the President is requesting from the Congress, to meet those most urgent security-related and infrastructure-related costs, so that the things that really have to get done and get done fast are getting done. We want to get very major contributions from international donors, both bilateral donors as well as the international financial institutions. We believe that if Iraqi operating costs continue to be on the order of \$12 to maybe \$14 billion a year, that we are going to be seeing in 2005 some significant capability on the part of the Iraqi economy to generate some of the resources that are going to be needed, let us say something on the order of \$5 to \$6 billion a year.

I am being a little more specific than one realistically can about those out-year numbers, but to be responsive I am sharing with you our best estimates at this time for Iraqi oil receipts and how much of those receipts could be available to contribute to reconstruction.

Senator HAGEL. But that means based on your numbers there is not going to be very much available if, in fact, those numbers would play out, especially when you look at a universe of using your numbers again of a shortfall, a gap between \$30 and \$55 billion of unaccounted money here for the infrastructure of Iraq. Surely, again, adding up your numbers, which essentially are 2004 numbers, if you get \$12 billion out of that, that I suspect goes right back into the government operation, which Bremer has talked about.

So my question is: Where is the Administration looking to get an additional \$30 to \$55 billion for infrastructure cost, from our allies?

Mr. LARSON. We are looking to get that from our allies over time and from the Iraqi oil proceeds over time. As Secretary Taylor and others may be able to get into, there is a little bit more to be squeezed out of frozen and found assets, Iraqi assets, and we will want to make the most of that. There is a little bit to be squeezed out of the transfer of the Oil for Food Program. There is a little bit of that existing money that could be used to help contribute next year, but it is a very, very big lift for the international donor community.

The one point that I should say is that we do believe that foreign investment can contribute to meeting some of these reconstruction costs. Some of the reconstruction costs are in infrastructure areas and other areas where you can, under normal circumstances, attract foreign investment. It really points to what Chairman Merrill was saying about the importance of getting in place the environment and regime that can start attracting foreign investment as well. That means, among other things, moving fast on the things the governments have to do including security and infrastructure.

Senator HAGEL. Senator Bayh, if I may, I could follow up on this. Well, we will leave this point because obviously that \$30 to \$55 billion is hanging out there. It is not your fault, but there is no answer, or at least I have not heard an answer coming from the Administration how they are going to fill that, and you certainly have not given one today, and again, it is not your fault.

Let me go back to something you just said on oil production. You mentioned infrastructure. In order to get to where you think we might get to in next year, 2005 and 2006, in oil sales, what kind of additional infrastructure investment is going to be required to get there, private capital, public capital, any infrastructure requirements?

Mr. LARSON. In the 2005–2006 timeframe, there will be some requirements for rehabilitation, maintenance, upgrades, that I believe will be financed with public money, not private investment. Those numbers are being refined, but I would be prepared to guess that they would be on the order of a couple billion dollars and that that would be part of the needs, part of the reconstruction needs that we would consider urgent reconstruction needs that we would want to make sure are funded because they would help make sure that the stream of oil grows.

Senator HAGEL. Would you say that that \$2 billion that you have thrown out—and I know that is imprecise and you do not have all the pieces—would that be over a 2- or 3-year period of time that that would be required, 1 year?

Mr. LARSON. That would be over the next couple years to get oil production up to this level that we have forecast, and again, we have been a little bit conservative in projecting oil exports reaching 2 million barrels a day. Then on top of that is roughly 500,000 barrels a day of production that is devoted to domestic use.

But in light of the infrastructure requirements, in light of some of the challenges we faced on looting and sabotage, we have tried to go with a number that we think is realistic.

Senator HAGEL. Mr. Secretary, thank you.

Senator BAYH.

Senator BAYH. Thank you, Mr. Chairman.

Gentlemen, let me tell you what I hear when I go home, from my constituents since the Administration made its request. The principal question that I get is, Senator, why cannot Iraq pay for more of this themselves? We understand that we needed to foot the bill for liberating the country. It was unreasonable to expect them to pay for their own liberation. We continue to foot the bill for their security, both in terms of treasury and blood. That is a price we are willing to pay. But in terms of rebuilding their economy, is that not something that they should shoulder more of the burden of themselves? We are not dealing with a country like Afghanistan, with nothing to offer the rest of world. This is a country with hundreds of billions of dollars, or hundreds of billions of barrels of proven oil reserves. Our surplus is now gone and we are put in the position of having to borrow the money from the Chinese, the Japanese, and others. This is money our children and grandchildren will have to repay on behalf of a country that at some point, God willing, will be pumping out oil again, we will be buying it from them at a price, at least in part, set by—they may not be a member of OPEC, but at least affected by OPEC. How is this equitable?

Mr. TAYLOR. Senator, if I can take a stab at that. I think, first of all, the Iraqi people will be the ones that rebuild their economy. What we are suggesting here with this request of funds is a way to deal with many of the security issues, many of the infrastructure issues that have to be addressed so that we can provide for an economy where it can grow and where they can build it. Some of the funds that the President has asked for go to electric power reconstruction. That is obviously necessary for security and necessary for getting the country in a situation where we can withdraw.

Senator BAYH. Mr. Secretary, forgive me for interrupting. Let me put a little finer point on it. Is it not possible, since they do have very substantial assets in the country, although they cannot currently access them because of the state of their oil industry, is it not possible for them to securitize some of that, to take some ownership interest in some of the reserves to defray some of these costs?

Mr. TAYLOR. Ultimately, some of the support, for example, from the international financial institutions, will be in the form of loans, and we are actively engaged now with both the World Bank and the IMF, so that they can bet in the business of supporting them. Of course, you know both those institutions provide their resources largely in the form of loans. When they size up how much support to give, which we are hoping will be quite large, because as Senator Hagel indicated, there is quite a cost here, quite a gap. When we

talk to them about the importance of this, it is clearly the attractiveness ultimately of oil revenues and other sources of wealth in Iraq which will be there. So that is part of the strategy. But I do think the Iraqi people will be the ones that reconstruct their economy.

What we need to do is provide the security, the infrastructure, the electrical system that is at least back to some semblance of working again after the devastation that Saddam Hussein caused.

Senator BAYH. The sooner we can get the World Bank and the IMF involved, the better we will all be. I certainly would support that.

Let us transition then into the question of the legacy debt, which, Mr. Merrill, I think you mentioned was; "an absolutely minimal requirement" for starting to get some forward momentum here. What if anything have the largest debt holders indicated that they would be willing to do? I would like to speak just in general and specifically with regard to the Russians and our friends the French, who I understand hold a fair amount of this debt. Is it not fair for those who did not pay for the cost of liberation to not now help with the cost of peace by removing some of this debt burden?

Mr. TAYLOR. Let me address the question the following way. Early on after the conflicts began, we engaged with the other creditors, including the Russians and the French, and we began to lay out a strategy, if you like, to deal with this issue.

The first thing that was done was to agree that at least for a year and a half, so that we could start working on a budget, no one was going to expect any debt payments from Iraq, and that was a terrific advantage because you could put a big zero on that line item in the budget which would have debt service payments, and that has obviously affected the numbers that we are talking about right now.

The second thing was to agree to get estimates of how much debt there really was. So we sent some of our people, who went into Baghdad and looked through the books; we also had the IMF do a survey of non-Paris Club figures—

Senator BAYH. The figures I am looking at say it could be anywhere from \$42 to \$78 billion. That is a pretty wide range.

Mr. TAYLOR. The number is a little higher than that right now.

Senator BAYH. Is that right? Higher than the \$78 billion?

Mr. TAYLOR. Yes, probably higher than 70, yes. But we are still getting those data, and the next step will be to work out a way to reschedule, get a substantial reduction in the value of the debt, and that is what the plan is for the next year. And by the end of next year when the agreement now to defer the payments is currently scheduled, there will be a strategy put in place. I would say we have engaged quite a bit with those countries that are holding the debt, and I think in the end, it will work. I think negotiation is going to be tough, but you have laid out some of the reasons for it, and we will be making those arguments.

Senator BAYH. On a scale ranging from enthusiastic to tepid, how would you characterize their response today?

Mr. TAYLOR. It is mixed. Some are enthusiastic, some are tepid. But we are going to work this issue very hard, Senator. It is very important for our effort for the Iraqi people.

And I would say in general, if I could just comment on your general question about cooperation, we have noted in the financial area quite a bit of cooperation among governments, quite a bit of interest in humanitarian issues. And of course, the ultimate beginnings of reconstruction are very close to humanitarian. I, at least, with my colleagues in the financial area have noted quite a bit of interest in getting involved, trying to improve the situation in Iraq, and I hope that that continues as the UN Security Council resolutions are moved and we go ahead in the next few months. And of course it will be essential in the Donors' Conference period.

Senator BAYH. My time has just about expired, Mr. Chairman. If I could ask just one more question.

Senator HAGEL. Yes, go ahead.

Senator BAYH. It is also to you, Secretary Taylor, and it is related to the question I alluded to in my opening comments about the progress we are making toward establishing basic financial institutions like a central bank and treasury. In large part, our success will depend on the type of policies the Iraqi Government in the process of being established will choose to pursue in terms of fiscal policies, monetary policies, and all the rest. So we are making an investment on what comes, so to speak, here.

When I am asked at home what comfort can we give the American people that this new government will choose to pursue policies that will ensure that this investment is sustained and bears fruit as opposed to being a one-shot infusion that goes for naught?

Mr. TAYLOR. On the macroeconomic side, we got a budget as soon as we possibly could and are making sure that that budget is balanced and funded. This is the first time in many years there has even been budget data available from that country; the budget used to be a state secret, obviously not a good way to make sound policy. So there is good progress on the budget.

I mentioned the currency plans, which is an essential part of a sound monetary policy, so that is underway. There is a central bank governor who has been appointed by the Governing Council. There is a finance minister. Both of those people—

Senator BAYH. Are they solid individuals in your estimation?

Mr. TAYLOR. Solid individuals. They will be going to the IMF-World Bank meetings in Dubai, is our hope. So that is going well.

But also on the economic issues that are more microeconomic, which are also very important, Senator, we are hoping that there will be some good laws coming out soon with the CPA working with the Governing Council, laws on banking, laws on foreign investment, laws on taxes, et cetera. My understanding is that there is good discussion and progress going on; those are going to be really important for foreign investment. And we mentioned the Trade Bank as the beginning of a banking system for foreign trade. A lot of the branches of the two main banks, Rafidain and Rasheed Banks, were closed at the end of the major conflict; those have for the most part been reopened so people can do basic cash transactions, and we are now moving to get loans made from these banks, small business loans. The International Finance Corporation has agreed to begin to develop a small business loan program.

So there is a whole wide range of things like this that are so important for a market economy, and we are working on them.

Next, if I could just say one other thing, because I could go on with this, but one other thing—the Donors’ Conference that Secretary Larson referred to is going to have as part of it a whole special session, almost a whole day, on the private sector. To my knowledge, this is really the first time where a donors’ conference has devoted so much time—perhaps any time—to the private sector, because a lot of the funding has come in from investment, and we are encouraging that. So, I am actually very excited about that aspect of what we are doing. We are focusing on the private sector. Ambassador Bremer is emphasizing that, and we have a good team of individuals working on transforming the state-owned enterprises, too.

Senator BAYH. Gentlemen, thank you very much.

Thank you, Mr. Chairman.

Senator HAGEL. Senator Bayh, thank you.

Senator Carper.

COMMENTS OF SENATOR THOMAS R. CARPER

Senator CARPER. Let me just follow up on that last point—the willingness of the private sector to invest its own money and the level of violence and disruption that continues in the country. What is the relationship between those two?

Mr. TAYLOR. Well, there is certainly a serious concern of private investors with the security, as well as the things I mentioned, the banking laws and the foreign investment laws. Security is very important for those we talk to.

I have noticed myself so many people from the private sector anxious to get involved. One example of that is the amazing response we had to this Trade Bank proposal. Many, many banking consortia put in applications and bids for that project. So when the CPA made their choice, they had a lot to choose from, and I think you are going to see that. Now we are talking about having banks give some advice to these state-owned banks, and again, we have a lot of interest.

Once this Trade Bank is moving and you get other facilities, you are going to see some investments. If you are on the streets of Baghdad, you see a lot of private sector activity moving already—people selling refrigerators, kids’ toys, and satellite dishes.

Senator CARPER. Where do they get them?

Mr. TAYLOR. They get them from the border; some of it is coming up from Kuwait, some from Jordan, some from Turkey. And it is on the streets, they are selling it, and people are buying it. Some of those dollars we are paying are going to making people’s lives better directly.

Senator CARPER. I have been in and out of the hearing in some other meetings out in the anteroom, and I apologize that I was not able to listen to your testimony, except just in bits and pieces, nor to the questions.

So let me just ask all of you—it would be very helpful to me—if you would just take a minute or two apiece and say, if there is nothing else that I would take from this hearing, maybe a couple of the most important nuggets that you would have us take away from it.

Mr. LARSON. Well, thank you, Senator. I think, perhaps picking up on the spirit of your question to Secretary Taylor, we believe that the more rapidly we are able to move to address the fundamental security issues and reconstruction issues that inevitably have to be addressed by governments, including some of the basic infrastructure questions that the President would like to address with the supplemental reconstruction request that he is making, that the more quickly we can get to the point where there is an environment where the private sector investment that we would like to see in Iraq is taking place and is shouldering more of the responsibility for driving economic growth and reconstruction.

As has been pointed out, this is a country that does have resources, not only oil resources but human resources, but there is a big deficit, a deficit of infrastructure, the type of social deficit that comes from having had 30 years of miserable, oppressive governance.

What we are trying to do, working with other donors and international institutions like the United Nations, the World Bank, and the IMF, is to make a very aggressive push on the reconstruction process because we believe that will hasten the moment when political transfer of full responsibility can be made to the Iraqi Government and also hasten the day in which Iraqi development is being driven by Iraqis and by private investment, both from Iraq and outside of Iraq.

Senator CARPER. Thank you.

Mr. TAYLOR. Senator, I stressed two overall themes in my testimony. The first was that this job of reconstruction has been made so difficult because of the damage that Saddam Hussein caused to his country, with GDP falling from about \$128 billion to only \$40 billion during a 25-year period. So it is an immense task, but the rewards are tremendous, too, because people have so much to gain just to get back to where they were.

The second was that with respect to financial reconstruction, which I focused on, I tried to outline the sense that there has been—

Senator CARPER. Could I just interrupt? You said over a 25-year period, GDP fell from—

Mr. TAYLOR. One hundred twenty-eight billion in 1979 to \$40 billion in 2001.

Senator CARPER. And are those nominal dollars, or are those real dollars?

Mr. TAYLOR. Those are real dollars, adjusting for inflation, yes.

Senator CARPER. It took 25 years to fall from one level to \$40 billion. How long do you expect it is going to take them to get back up to where they were 25 years ago?

Mr. TAYLOR. That is a good question. A lot less time than it took to fall; a lot less time.

Senator CARPER. I interrupted you. Go ahead with your second point.

Mr. TAYLOR. The second thing was that the financial reconstruction has involved a strategy which was laid out before the conflict which we have stuck to, calling auditors where appropriate, on such issues as payments of salaries to Iraqi people on the ground, the workers, the teachers, as well as a new currency, and that as

we have proceeded in the months of this year and especially since the summer, we have made progress on that strategy on these financial matters, and I think we will continue in the months ahead.

Senator CARPER. Thank you.

Mr. Merrill.

Mr. MERRILL. Senator, I think the single, most important idea that I can leave with you rests on a set of conceptual numbers, and I emphasize the word "conceptual," not specific, because although we are all dealing from the same number sheet, there is the time value of money and so forth. We do not have a disagreement on numbers. I think the point we wish to get to is the point at which private capital will invest \$20 or \$30 billion in Iraq in order to produce in round terms—conceptual numbers, I emphasize again—\$20 or \$30 billion a year in oil revenue for them.

Now, to get there, it sounds simple—because—people pound the desk and say "Let us go into Iraq. We can produce oil. We can do this, we can do that"—American and foreign, Bulgarians, Rumanians, Czechs, Poles, and so forth. This issue is an optical issue of whether Iraq is receptive to Western investment, not only in oil but in general.

So our general idea, and idea I would like you to take away, and that Ambassador Bremer has emphasized, rightly, is that this has to be the Iraqis' own doing, with their oil, for their money, in their country. We can help them do that. The idea that I would like you to take away is how can we get the private oil and energy companies of the world who are anxious to invest in Iraq to put the \$20 or \$30 billion—whether that number is the exact number or not is not the point—into Iraq and therefore get what basically amounts to a 100 percent return for Iraq.

Let me add just one more number. Both secretaries here essentially said while you were out of the room that a couple of million barrels, 2 million barrels a day, produces about \$20 billion a year. The actual number was \$19 billion. Our numbers are approximately the same. But when you go up from 2 million to 5 to 6 million, you go from \$19 billion to a very, very large number. It is not a straight-line curve because it requires more investment, but in the end, at 5 or 6 million a year, you get a lot of money back, whether that money is \$30 billion a year, whether it is \$25 billion, whether it is \$40 billion—you can get all types of estimates.

I think the only way to close the gap that Senator Hagel just talked about and the gap that the Iraqis seek to close, is to find a way to create the political atmosphere so that that becomes a practical thing to do. That is the idea.

Senator CARPER. Mr. Merrill, thank you. Gentlemen, thank you all very, very much.

Thank you, Mr. Chairman.

Senator HAGEL. Senator Carper, thank you.

Gentlemen, if you would each address this question in your own respective areas of responsibility: How much progress are we making, and just give me some tangible examples of that progress, on moving Iraqis into responsible positions in the Trade Bank area, financial institutions—obviously, the central bank representative is first class, and everyone acknowledges that that was a terrific selection—but we hear from the Administration, we hear from the

Congress, and we hear from you that the objective here is to move the Iraqis into a position where they can govern themselves.

How fast are we doing that, are we doing it, and give me some examples of how the Governing Council or others are actually running or being prepared to run financial institutions and put together an economy and an infrastructure in Iraq.

Mr. Larson.

Mr. LARSON. The last time I had a chance to testify before you in June, we spoke a little bit about the oil numbers and the oil sector, and one of the things I said very forthrightly is my numbers are basically based on what Thamir Ghadban, the Iraqi CEO of the Iraqi oil industry, has been putting forward. A couple of weeks after that hearing, I had the chance to sit down with him in Jordan for a fairly detailed meeting about the way he was managing the oil sector and how he saw his task ahead. My assessment was that he was everything he was cracked up to be—a very skilled engineer, a very thoughtful person who understands both the engineering side and also the financial side of his business—and everything we have seen since June is bearing that out.

The Governing Council has now named Ibrahim El-Alum as the new minister for petroleum. He is also an oil engineer with international private sector experience.

We also know that the team below them is very competent, and they are basically running things in terms of the Iraqi oil sector—the rehabilitation, the maintenance, the production, and so forth.

The other comment I would make in response to your question is that when we went, at the beginning of this month, to Brussels for the most recent meeting of this Core Group, included in that meeting were both the CPA and an Iraqi official who is in the midst of the budget process, and it was interesting, I think, for other donors, who sometimes are under the impression that the CPA is running absolutely everything in Baghdad, to hear from this Iraqi gentleman how he was basically the guy who was the interface with all the ministries on their budget numbers. And just as OMB runs a process here where agencies make submissions and OMB says, “Wait a minute, this number looks inflated, that number looks inflated,” that was his role, working with the interim government, CPA, and the standing ministries to work through the numbers that are going into this 2004 budget that will be finalized later this fall.

Those are two specific examples, Mr. Chairman, that I think illustrate the point that Iraqis are really deeply involved in this process, and their role and authority is growing very rapidly.

Senator HAGEL. Thank you.

Mr. Taylor.

Mr. TAYLOR. In the financial area, there is increasing involvement. As you mentioned, the central bank governor, the finance minister, the two large banks, Rafidain and Rasheed, have many people who have been involved in those banks before who are still working there.

But I would say that one thing about the financial area is that there has been a lot of modernization around the world that has not reached Iraq because it was such a closed place and so little contact. In some senses, I think this is different than the oil sector.

What we have been trying to do is find ways to train, to give the opportunity for the Iraqis to learn more about modern financial systems. There has been a lot of cooperation in the region. The Bahrainians, the Jordanians, the Emirates are willing to provide training to people in the financial sector. We are encouraging them to do so.

With respect to issues like the budget, the finance ministry does have a budget process. We are encouraging a central treasury function for the people of Iraq to go through the same kind of calculations that our OMB does, as Mr. Larson was indicated.

And the other thing is with respect to the financial laws that are necessary, the Governing Council is engaged in that activity and discussions, and I believe that before too long, there will be some announcements of what their decisions are so you can provide this legal infrastructure for the economy, such as banking, tax, foreign investments, and things like that. And I see some progress there, but just to be candid, it takes time, and our involvement is very important, and I see a good professional engagement when I talk to the Iraqis and when I visit Baghdad.

Mr. LARSON. Senator, could I quickly comment on just one detail of what John Taylor said?

Senator HAGEL. Yes, go ahead.

Mr. LARSON. I did not mean to leave you with the impression that the technology base of the Iraqi oil industry is modern and up-to-date. In fact, I would say that what John said about the financial system is equally true, at least of the oil sector.

What I am really getting across is that over the years, this sector was neglected, and through ingenuity and improvisation rather than modern technology, the Iraqi engineers were able to keep it going, but one of the real challenges that we face now is that there comes a point when ingenuity and improvisation has to give way to more modern techniques and technology. There is a deficit there. It is just that the individuals who are dealing with these problems in Baghdad, in my view, are very, very highly skilled.

Mr. MERRILL. Mr. Chairman—

Senator HAGEL. If you will hold for a moment, Chairman Merrill, I want to ask Mr. Taylor a couple follow-up questions.

Mr. MERRILL. I apologize. I thought the question was coming to me.

Senator HAGEL. On decisionmaking, how many of these Iraqis are in decisionmaking positions?

Mr. TAYLOR. Well, a minister or a governor would be in a decisionmaking position. They are working with the Coalition. So for example, on this currency exchange, a lot of that involves the help and assistance of the people in the Coalition; in fact, we are helping with that here, even in Washington, to think about where the currency would be printed, how it is going to be shipped there. There will have to be assistance in terms of security around the country. There is quite a bit of that going on, but we want the central bank to be at the center of that.

The positions are clear, but as you know, decisionmaking is one where you have to have the information and the whole structure in place. So, I think it is going well, but it is something which we

are working with, and the Coalition is there, providing advice and making decisions, too.

Senator HAGEL. Do these individuals essentially report to Peter McPherson and his office—across the board, these financial—

Mr. TAYLOR. Yes. The chain of command is Peter McPherson to Ambassador Bremer. Ambassador Bremer is in charge of the Coalition, and he in turn reports to Secretary Rumsfeld.

Senator HAGEL. What is the status of McPherson? Is he coming back?

Mr. TAYLOR. Yes. He is going to be returning to his position as President of Michigan State University in October, and his replacement is going to be the former Finance Minister of Poland, Marek Belka. Marek Belka has been serving in Baghdad already as the coordinator of the fundraising effort, so he will be the one who will be taking over at that point, so the Polish involvement will take place in that way.

Senator HAGEL. Thank you.

Chairman Merrill, thank you.

Mr. MERRILL. Thank you, Mr. Chairman.

I simply wanted to note that the Trade Bank is already headed by a new Iraqi appointee and that the bank will eventually—meaning shortly, not eventually 6 years from now—be staffed by Iraqis. This process is in place. But based on the last round of conversations, I think I want to add two more points, one on modernization.

The Iraqi oil industry—I think Al Larson and I are on the same page—there is a huge question there of deferred maintenance, and it is not a small deal. If you will allow me to be what my people sitting behind me will say “slightly colorful”—they shudder when I say that—think of it this way. You have 100 1957 Chevies, and that is what is running the pipelines, the oil lines, the pumping stations, and all the rest of it. You know that if you plug a carburetor, a muffler, and an oil filter and do a valve job and so forth, you can get all 100 of those 1957 Chevies running. But you also know that half of them are going to break down in the next 6 months, even if you do not know which half. And that is the situation that the Iraqi oil industry is in at the moment.

There is a choice between what—I think Al Larson used the word “modernization”—and let us call it “plug them up maintenance.” Obviously, you have to do both if you want to get the thing running, but you want to modernize it. But one is much more expensive than the other, so when the great construction companies of the world come in to talk to us, some say modernize a little more, some say we can plug it up a little more. Ambassador Bremer’s view is that this is a factual question to be determined by Phil Carroll and the other people on the ground. But you should know that there is an issue there of modernization versus plugging up the 1957 Chevy, which I cannot determine as a matter of fact, sitting at this table, but it is an issue.

The second thing I would point out is that there is a tradeoff between time and representation. You and I are both entrepreneurs. There is a natural tendency to make things happen now. Ambassador Bremer is a “make it happen now” person. But representative governments in that country and in this country are about being representative, and in order to get the Iraqis to sign on to

the things that we want them to do and they should do for their own benefit, it means they have to move at a pace that may not be quite as rapid in economic terms as somebody like me would want them to move. This tradeoff of time versus political stability is a significant factor.

Senator HAGEL. Thank you.

Secretary Larson, Secretary Powell has been working with our friends, specifically the UN Security Council members, on crafting a resolution that would accommodate everyone's needs through the United Nations. A very significant part of that is what type of additional responsibility our allies would have in assisting with the reconstruction of Iraq—economic responsibility, political responsibility, certainly force structure security responsibility.

What can you tell us about those conversations, and what are we looking at in the way of expanding not just involvement, money and forces from allies, but what would we be asking them to do, and what would they want to do through an umbrella organization effort that would lay it out in a resolution?

Mr. LARSON. Mr. Chairman, as you said, the Secretary has been working very hard with the P-5 and Secretary General of the United Nations on a new Security Council resolution that would really provide more of a mandate, more of a authorization for international participation in the security task in Iraq as well as the task of reconstruction and, we would hope, really call on donors as well as the international financial institutions to play a maximum role in the task of reconstruction.

Those deliberations have reached a very, very intensive period, and I think over the days ahead, he will be working very, very hard to see if he can bring this to a successful resolution. There will be a number of people in New York next week as the General Assembly begins, so this will be an extremely active period for that.

Senator HAGEL. Excuse me. If I could pursue that for a moment, are we then willing to in fact engage, as I presume the Secretary is, on the basis that we are willing to share some decisionmaking responsibilities with our allies—economically, politically, and obviously security-wise.

Mr. LARSON. We are willing to share some decisionmaking responsibilities, and let me in the first instance focus on the economic side of things.

I referred earlier, but briefly, to the idea of a Multi-Donor Trust Fund. One of the reasons we have worked so hard on this is that it has become clear to us from comments of others that for many of them, if they are going to make major contributions to reconstruction, they would like to feel it is going into some type of system in which they have a voice, and there is a good track record of having trust funds that have their own governance structure where an international organization like the World Bank or the United Nations can provide the framework, the fiduciary role, the accountability about how funds are actually spent. And in contributing funds to such a task force, there can be agreement in advance about the types of uses to which those funds will be put.

If you are going to have that task force, you do want the priorities of it to dovetail with what is going on on the ground, and that is why the process that we have set out since spring has been de-

signed to reach a convergence of view about what these priorities are. So it is not an issue of control, but it is an issue of reaching a shared assessment of what are the most urgent priorities that have to be addressed and having those reflected in the mandate of a trust fund and have that be in synch with the budget priorities that are identified in the budget coming out of Baghdad.

That is just one example of where we already are in the process of encouraging our international partners to have a larger voice in thinking through what the priorities should be an being involved in a donor process where they will have a voice in governance.

Senator HAGEL. I would ask this next question of each of you. It may well be that this is more, Secretary Larson, in your area, but let us stay on that theme of decisionmaking and sharing responsibility, and in return for that, stepping up to responsibilities, stability, and security of Iraq in the interest of all nations. Certainly, to secure and to stabilize the Middle East is in the interest of all nations.

Contracts—there has been great speculation and conversation about sole-source, no-bid contracts. How does this play into decisionmaking, sharing with allies that would send money and troops? Would they be given the same opportunities to bid for contracts? Mr. Taylor, you may be very much a part of this as well as you, Chairman Merrill. Are we a legitimate marketplace? What percentages are we talking about? Any part of that universe that the three of you care to address is important because this is a big issue.

Also—and maybe, Mr. Taylor, you could give me this number—what presently is the percentage of sole-source, no-bid contracts that we are letting in Iraq?

Mr. Larson, we will start with you.

Mr. LARSON. Sure. In framing this answer, let me make clear that we have to talk about contracts with whose money. First, let me start with the Multi-Donor Task Force. The clear expectation here is that if this is housed in the World Bank or the United Nations, or if for various reasons we end up having two, one in each, contracts for using those funds would be based on the World Bank or the UN international standards, so they would be open to all legitimate competitive firms that could be certified as being capable of providing the services or the tasks that are being tendered. That much is clear.

Second, with respect to the money that is being spent out of the Development Fund for Iraq, that is, the fund into which the oil proceeds and other tax revenues are being used, the CPA put out contracting information in August. It is on their website. They did it after getting information on both U.S. contracting procedures as well as the contracting procedures of the United Nations and the World Bank. And we think that those arrangements also are very transparent. Again, they can be consulted by any company that wants to get on the Web and find out how to compete for contracts that might be funded with DFI money.

Third, there is the question of contracts funded with U.S. Government money. I am most familiar with the situation of USAID. In the early days, there were some contracts that were let on the basis of limited competition among prequalified bidders that were designed to make sure that we were able to move quickly in the

immediate post-war period to address some of these pressing infrastructure requirements.

On those contracts which we need to have an American be the lead contractor, we have been working hard to have—where appropriate—other countries' companies be subcontractors and to see if, where appropriate, as much of the work could be done by Iraqi companies and Iraqis as possible. And I know, going forward, the expectation is that these contracts would virtually always be on a full competition basis except in those cases where there might be an emergency need to move quickly and to resort to something that would be a more qualified competitive process.

Senator HAGEL. Thank you.

Mr. Taylor.

Mr. TAYLOR. That was a very comprehensive answer. I could not add anything to it at all.

With respect to your question on the exact percentage of sole-sourcing, I will have to get back to you on that, Senator.

Senator HAGEL. Thank you. Chairman Merrill, I will be right with you.

Let me pursue a couple of dynamics of this. Are we saying that the moneys coming out of the Fund now, those contracts paid for out of the Fund, are open to qualified bidders from around the world?

Mr. LARSON. That is right, and we are trying to do this in a way that we are getting best value for the money so that this work that needs to be done is done as efficiently and competitively as possible.

If I could just add, we understand that there has been a perception—in my view, an incorrect perception, but nevertheless a perception that has to be dealt with—that somehow, the contracting procedures have been operated in a way that is designed to give the business to American companies. I must say that I was shocked when I was in Europe during the war and was talking about how we needed to work with the Europeans to address the upcoming task of reconstruction, and virtually all the questions I got during an hour and a half question-and-answer period were based on the premise that our objective, or one of our major objectives, was to attract as much business as possible for American companies in the reconstruction process.

It is not correct, but we understand that is a perception that has been out there, and that is why we want to make sure that this Multi-Donor Trust Fund is operating under World Bank or UN contracting rules. We want to make sure that the DFI is operating under an absolutely transparent process so that bidders from around the world can find out how to compete for contracts that are being funded with Iraqi oil proceeds. And it is why we want to make sure that, subject to U.S. Government contracting guidelines, we are reaching out as much as possible, for example, with money that USAID is contracting for, to have participation from other countries' companies, albeit as subcontractors rather than prime contractors.

Senator HAGEL. Are we still letting sole-source, no-bid contracts?

Mr. LARSON. No. And again, the answer to that is that moving forward, it is our expectation that we would have in virtually all

cases a full competitive process, but just reserving the possibility that there could be instances where the urgency and the security requirements would call for moving in a more expedited basis. But we believe that is the exception, and it will not be the standard practice going forward.

Senator HAGEL. You noted if anyone is interested in participating, you mentioned a website. Let us take that down a little further into American small businesses. They would get the appropriate information through what—the Commerce Department, the State Department? Where would they go to participate or to find out about what might be available?

Mr. TAYLOR. USAID has a lot of information on their website about this. That is the first place I would go.

Senator HAGEL. Mr. Taylor, you will get back to the Committee on the percentage.

Mr. TAYLOR. On the percentage of sole-source, yes.

Senator HAGEL. Is there a percentage of international companies today that have won contracts that are working in various areas?

Mr. LARSON. Sir, I cannot give you percentages. I know that on contracts funded by USAID, there are a large number of foreign country companies who are working as subcontractors. I may be able with a little bit of research to put a number on that either in terms of the dollar value of their work or the percentage value. I certainly can undertake to do that.

On the Multi-Donor Trust Fund, of course, it is not up and running yet, so that is a prospective issue.

On the Development Fund for Iraq, that is really very much in the early days. The amounts of money that have flowed through that are still relatively minor, and I think it is too early to really have much of a baseline on it.

Senator HAGEL. Mr. Taylor, do you want to add anything to that?

Mr. TAYLOR. No.

Senator HAGEL. Thank you.

Chairman Merrill.

Mr. MERRILL. I just want to say that as we speak, our chief operating officer and a couple of our other senior Bank people are in Paris with other OECD export credit agencies explaining that the Trade Bank is open for all business, not limited to American business. Obviously, the business of the Export-Import Bank is to support American exporters, but it is our hope that this will serve as an example or as a role model for other export credit agencies around the world to deal with Iraq. All we seek is to deal on a level playing field. That is, I would happily have a couple of French or German contracts in the Trade Bank area, and as we go to small and medium enterprises, and even larger than \$500 million, we would want the same dynamics to take place there.

It comes back to this perception of whether our interest, Western, or the United States, in conducting this operation, was to take over Iraq and stay there or was it to take over Iraq and leave it to the Iraqis. And obviously, to us, it is the latter. When we talk to our counterparts around the world, you hear a lot of what Al Larson said, which is, "You want the contracts for yourselves."

I am certain—I guarantee you—that the Trade Bank will award contracts on the best bid basis.

Senator HAGEL. That is of course one of the purposes of hearings, so that you can enlighten, inform, and educate. I know, Chairman Merrill, that you look upon us as your friend and your ally up here, helping you make that case, but it is important that you do have forums and opportunities to explain the procedure.

Chairman Merrill, this may be a question for you. I was told—and I do not know this, and I am asking you or Mr. Taylor, I suppose, to clarify it—that we are allowing for 100 percent ownership as we transition business in Iraq for foreign investors and corporations. Clarify that if you can, because the question really comes to what role will the Iraqi people have to play, or what percentage ownership will be open or reserved for the Iraqi people versus taking all of the state-run industries, which was the case in almost every situation there as we know, and selling those off to the highest bidder without looking out for the interests of the Iraqi people. If you could clarify that, it would be helpful.

Mr. MERRILL. Yes, I can take a stab at it. This comes back to the question which is true around the world—India, to pick an example—of whether foreign investment must be done on a 51-percent-owned basis or on a 49-percent-owned basis. It makes a very big difference to a lot of investors on whether they can control the entity that they invest in.

That is a private business decision. It is not a governmental decision. I am not smart to know the answer to what commercial code the Iraqis will develop.

Senator HAGEL. So that is not going on now.

Mr. MERRILL. Oh, it is going on there. The discussions are going on, but how it is turning out, I do not know.

Senator HAGEL. Yes, but I mean turning over an industry, a previously state-run industry, to the highest bidder, a major company in Iraq.

Mr. MERRILL. No, I have no knowledge of that.

Senator HAGEL. Secretary Taylor.

Mr. TAYLOR. What is happening now is the Governing Council is considering these questions and will put the answer into the foreign investment law, the investment law that they are working on, and we have every expectation that that will be coming pretty soon; but it is not official yet, it is not done yet. But that is where that kind of issue will be addressed. And there may be a separate treatment for the formerly state-owned enterprises compared to other investments, but it goes back to one of your previous questions, Senator, of where the involvement of the Iraqi people is very evident and actually happening as we talk.

Senator HAGEL. The Governing Council will have the ultimate control over that to protect the interests of the Iraqi people.

Mr. TAYLOR. At this time, yes, while they are there.

Senator HAGEL. Well, let me go back—when you say “at this time,” what does that mean?

Mr. TAYLOR. What I mean is the future of the governance of Iraq is something that is still under discussion; it is something that the CPA is working on, and it is part of the discussions at the UN Security Council resolution. But right now, the Governing Council is very much involved in making a decision like this, but the evo-

lution of the governance in Iraq is something that is going to play out over the next months and years ahead.

Senator HAGEL. So the Governing Council right now would have maximum input into any decisions regarding what we have just been talking about—

Mr. TAYLOR. Yes, most certainly.

Senator HAGEL. —and obviously in the future, the future is the future.

Mr. TAYLOR. Some other group, or—

Senator HAGEL. I understand.

Mr. MERRILL. I think it is important to add one sentence here by way of example. I was in London a few weeks ago, and I met with two of the largest oil companies in the world, the presidents, and three of the 10 largest banks in the world, with substantial experience in funding oil and energy. In all five cases, the attitude was let us wait and see—we are interested, we have a watch on, we will assign somebody to keep an eye on it—but let us see what commercial code, so to speak, Iraq comes out with.

You have on the one hand a desire, yes, we want to be ready to invest, and on the other hand, let us not move until we find that there is room for private—where there is a framework where private capital in the Western sense can operate.

Mr. LARSON. Senator, can I add—

Senator HAGEL. Secretary Larson.

Mr. LARSON. —just a couple of footnotes to what John and Phil have said. As John said, the Governing Council, working with the CPA, has been working on this investment compact, and it is important to stress what a big job this is, both legally but also, I think, politically, because you are talking about an Iraqi Constitution that presently prohibits foreign investment in natural resources and other basic needs of production. You are talking about a companies law that prohibits investment in and establishment of companies that are owned by foreigners that are not residents of Arab states. And there is a whole list of things like this that, as John said, they are grappling with.

As Phil, I think, was underscoring, from the standpoint of foreign investors, they will want to see laws that address all of these issues in a way that provides for an appropriate investment environment; at the same time, they are going to want to have a sense of assurance that any new laws are going to stick. That is why I think this consultative process that John noted and that is going on now involving the Governing Council, with the CPA, is very important, because it is very important that what emerges from that both be good investment policy and also be something that is perceived as having staying power.

Now, I have said a little bit about the oil sector here. It is interesting to note that the new oil minister has been speaking out publicly about the benefits of privatization in the oil industry. When I testified back in June, I said this is a very, very delicate issue given the nationalism that is associated with petroleum. We need to really step back a little bit on something like this and let the Iraqis sort it through. It is encouraging that the Iraqi who has responsibility for the oil sector is in fact speaking out and contributing to a public discussion about the benefits of privatization.

So, I just wanted to stress both the legal challenge but also the political challenge of getting the investment framework that we all think would be good for Iraq.

Senator HAGEL. Thank you. I believe, Secretary Taylor, in your testimony, you gave a very good overall analysis which you did not get into at all in your verbal testimony, but I have read through your written testimony, and you addressed some of these issues in that we are concentrating on putting people back to work, pensioners, the focus that we need to get the vitality back into society, giving the people some sense of confidence for their future.

Do you know currently what the unemployment rate is in Iraq? And then I would ask the three of you to develop for me, if you can, some general theme in your three specific areas as to how we get the people of Iraq back to work.

Mr. TAYLOR. We have heard various estimates of unemployment rates in Iraq, but I cannot believe any of them. The data are very hard to come by. I know from surveying unemployment in other countries, it really depends on definitions. But it is high.

Also, I would say that you include the underemployment, because there are still workers in some state-owned enterprises who are really not producing much at all at this point. So that is something that—the lack of productivity is obviously a problem.

In terms of getting jobs created, as in every part of the world, the most important thing is small business. That is where jobs get created. So one of the things that is going to be important for that is the ability to get small business loans. The CPA has already authorized a plan where each of the major banks is supposed to be making 250 new small business loans in each slice of time, kind of a measure of performance.

I mentioned that we were going to have the IFC, the International Finance Corporation, provide a small business loan program. That is a very important part and I think just the ability for people to start businesses and employ people is going to be where that is going to come from.

The state-owned enterprises and the transformation of those into regular businesses is going to be important. There is a person in the CPA now who is focused on that, Mr. Foley, so that is another place to get those workers more effectively employed.

It is a whole wide range of things. I think the transition of the Oil for Food Program is also going to be a source of employment, because you are really transforming a system where all the food was coming from outside the country into one where a major fraction of the food is going to be coming from inside and distributed through regular distribution channels, retail stores, supermarkets. It is a great opportunity for people to get jobs, too.

Senator HAGEL. Thank you.

Secretary Larson.

Mr. LARSON. Thank you, Chairman.

In the very short run, one of the things Paul Bremer did was make sure that there was a little bit of money that was spent on public works, things like garbage collection. That is not sustainable employment, but it was something that I think he felt was very important to do to make sure that some basic services were provided

and there was some employment being provided to people who otherwise would not be actively involved in some useful activity.

I think as the reconstruction process moves forward, there is going to be tremendous opportunity for employment. One thing that we are trying to do is retrain thousands of police personnel so that they can take over more of the responsibility, providing the basic security.

As we move into a greater and greater emphasis on construction and rehabilitation, we know that there are many Iraqi firms who are already participating in contracting and working on roads and school repair, and as this process moves further and faster, there are going to be more and more opportunities for employment in the construction sector.

Finally, as John very rightly said, I think agriculture is potentially a promising sector for remunerative employment. It has been stunted by this system that had food distribution basically running on a ration card system, so it is going to need to be revitalized. That is important.

And finally, we have all stressed in various ways that the basic goal here is to get a self-sustaining economic growth process going that generates jobs through growth, and I think one of the more important things that we need to do to achieve that is to work on both the legal infrastructure and the physical infrastructure.

Senator HAGEL. Thank you.

Chairman Merrill.

Mr. MERRILL. I think you are asking the central question of today's hearing. I do not think it is a technical answer; I think only in part. It is a conceptual answer.

The first thing is that nobody has ever liberated, occupied, captured, whatever, a country before that came with a \$15 to \$20 billion a year in conceptual cashflow. I mean, countries have come for gold, for slaves, girls, or territory—all kinds of things—but not with cashflow.

First, we must try to get the cashflow going, which again comes back to long-term investment and getting the oil fields up and running as fast as you possibly can.

Second, we must decide what to do with some of that money. I have heard ideas, and I have expressed them myself, of paying dividends to the individual Iraqis like we do in Alaska, so that each family works for \$2 a day, a \$10-a-week payment per person. Two hundred thirty million dollars is not much compared to what we are spending just to occupy and stabilize militarily the security there. That money can be put to work buying things and starting things going.

Third, you have an educated population that has been held down for 20 or 30 years but which has an entrepreneurial base and is very secular. So the ticket is to get money into their hands. And I think my colleagues here have both touched on this with the banking system. And even if it is WPA-type projects that put money in their hands, if you have a banking system and you have people being put to work, even if they are put to work as policemen or sanitation workers, school teachers, whatever, that pay, the ongoing basic services of government, electrical workers and so forth,

that in itself will generate all kinds of new small businesses. So there is a technical issue.

Fourth, I would call it the WPA issue. One of the conceptual issues here is to put people back to work. We have a situation in which whatever number you want to use for the Iraqi army—nobody knows exactly what it is—I am going to pick 400,000 and hope that I am in the right ball park—they all went home. Well, we would have been delighted to guarantee them a payment for life to go home. Instead, they went home, and then we cancelled their salaries. So we have 400,000 angry people running around Iraq. Some of them, we do not want back, but they are better being paid than not being paid, and I imagine we will rework that. But the idea is the same—put people back to work if necessary in a WPA-type framework.

And fifth, I want to say something else on the time issue, and that is that we have to trade off the interests of Syria, Iran, and varying terrorists from wherever they come, whether they are called Al Qaeda or something else—their interest in our failure in Iraq was stimulated by the extent to which they smelled vulnerability.

The answer is do not give them vulnerability. Make things happen now. That is this time versus representation issue I referred to before. But I think that we have to make certain that the Iraqis feel that they have a stake in their society as quickly as possible.

Let me make one more point on this because I do think it is critical. Let me take the view that in these oil fields, in round terms, there were 1,000 pumping towers. During the war, 126 were destroyed. Since the war, 700 were destroyed by people seeking copper to melt down. Well, these are thought about in terms of being Saddam's oil fields, not their oil fields. We do not want them thinking about it being "our" oil fields, the way you think about insurance company money, rightly or wrongly, not being real money. The insurance company is going to pay for it. Well, okay, Saddam is going to pay for it, the United States is going to pay for it. We have to get them to the point where it is their money, their country, and their interest in the state. And that is not a problem for which I can give you a fighter pilot's checklist.

Senator HAGEL. Chairman Merrill, thank you. You mentioned the Alaska oil ownership plan. I was asked about that today in a nice little television show, and I said I do not know where the Administration is on that. I have heard that concept.

Mr. MERRILL. Nor do I.

Senator HAGEL. Do any of you want to comment on that? Have we looked at that possibility? Have we explored it? Where are we?

Mr. TAYLOR. Sure, there has been lots of discussion of those kinds of ideas, and again, this is something that is going to be the Iraqi people's decision, ultimately. My understanding is that one of the ideas that is most active in consideration at this point would be one where the pensions are financed through the oil revenues and that that would be made explicit to basically get at some of the issues that Phil Merrill is referring to, to create some sense of belonging or ownership to the resources in the country that the people would have.

That is one of the possibilities that has been discussed, but all these issues—and Al Larson mentioned some people talking about privatization—but whatever it is, I think it is important to have the Iraqi people be very much involved in this decision.

Senator HAGEL. Thank you.

Secretary Larson.

Mr. LARSON. I agree with what John said on this. I think there is great force behind the idea of some type of fund like this and showing that ultimately, this important resource belongs to the Iraqi people, it needs to be used for their benefit, and it is tied in some way to their benefit. Obviously, in the short run, there are many, many demands on those scarce oil export revenues, but I think it is very powerful idea; I think it is a very useful idea to have out there for the Governing Council, the interim government, and the new elected Iraqi Government to be able to consider.

Senator HAGEL. Gentlemen, thank you. You have all been very helpful, and I know we will hear back from you on some of the other questions, and we will talk with you again.

Is there any last-minute point that you want to make?

[No response.]

Senator HAGEL. I do appreciate you taking as much time as you have here this afternoon. This has been helpful to everyone.

So thank you, and much success. This is important work.

Mr. LARSON. Thank you.

Mr. TAYLOR. Thank you.

Mr. MERRILL. Thank you.

Senator HAGEL. The hearing is adjourned.

[Whereupon, at 4:50 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF ALAN LARSON
UNDER SECRETARY FOR ECONOMIC, BUSINESS, AND AGRICULTURAL AFFAIRS
U.S. DEPARTMENT OF THE STATE

SEPTEMBER 16, 2003

Chairman Hagel, Senator Bayh, and distinguished Members of the Subcommittee, thank you for the opportunity to testify on recent developments on the economic reconstruction of Iraq.

Since I appeared before Senator Hagel and other Senators on the Senate Foreign Relations Committee on June 4, there have been several major developments affecting Iraq's reconstruction.

On August 14, the UN passed Security Council Resolution 1500 to deal with two specific issues: The new Governing Council of Iraq and the United Nations Assistance Mission in that country. In its action, the Security Council made it clear that the international community would work with the Governing Council as a broadly representative partner with whom the United Nations and the international community can engage to support them in their efforts to build a better Iraq. The resolution also endorsed the Secretary General's recommendation to create a United Nations Assistance Mission for Iraq to better enable the United Nations to fulfill its important responsibilities under Resolution 1483. You may recall that UNSCR 1483 had facilitated the participation of the international community, including the international financial institutions, in Iraq's reconstruction.

On September 7, President Bush delivered a major speech to the Nation in which he announced that he would send a supplemental budget request to the Congress of \$87 billion, of which \$20 billion would be used to help secure Iraq's transition to self-government by establishing the conditions needed for economic investment and prosperity. After decades of misrule and corruption by the Saddam Hussein regime, the needs in Iraq are urgent and enormous. Based on initial estimates from the Coalition Provisional Authority (CPA) and the World Bank, we believe Iraq will need \$50-\$75 billion in the next few years to rebuild a viable economy and allow it to become a vital member of the world economy once again. The President's proposal envisages that roughly \$5 billion would be devoted to improving security by training border guards, civilian police, the new Iraqi army, and supporting a judicial and penal system. The remaining \$15 billion in the request would be used to repair crucial infrastructure that has suffered from many years of neglect and abuse as well as war damage. These would include medical and educational facilities, electricity, transportation and telecommunications networks, water and sanitation, and the oil industry. The reestablishment of safe, modern, reliable, and efficient services will have an immediate and positive impact on security and on sectors critical to stability and growth.

Since the President's speech, there has been concern expressed at the size of the task we are undertaking in Iraq, its difficulties, and how much it will cost. I won't deny those concerns. We are talking about a huge amount of money. But our strong engagement in Iraq's reconstruction will give that long-suffering Nation a chance that it has never had before—to become a decent and democratic society at the heart of the Middle East. President Bush was quite clear as to why this was in America's vital interest: "The Middle East will either become a place of progress and peace, or it will be an exporter of violence and terror that takes more lives in America and in other free Nations. The triumph of democracy and tolerance in Iraq . . . would be a grave setback for international terrorism." A free, democratic, and prosperous Iraq will remove an island of hatred that long threatened its neighbors and the United States. If we move hard and fast on Iraq's reconstruction now, it will ultimately lower the cost of this undertaking and hasten the day that our troops can come home. We cannot fail to meet this challenge.

Though Iraq will provide important resources for its reconstruction, its needs over the next few years far outweigh its current ability to meet those needs. The magnitude of the task is such that it cannot be done by the United States alone, either. We urge the international community join us and move quickly to invest substantial funds to ensure success. Thus, a third positive development has been our collaborative work over the last several months with other countries and the international community on how we together can help Iraqis fix their economy. We believe that other countries—both individually and through international organizations such as the United Nations—should make major contributions commensurate with the importance and urgency of the task. The UN, the World Bank, and the IMF are conducting needs assessments in various sectors in Iraq to help determine that country's future needs. This information will be used by the Iraq Reconstruction Donors Conference to be hosted by the Spanish Government in Madrid on October 23-24

where they will discuss pledges for the final quarter of 2003 and all of 2004. While some countries may prefer to make their reconstruction pledges directly to Iraq, we are working on establishing a Multi-Donor Trust Fund as another way for countries to provide reconstruction support to Iraq. This follows a similar model organized to facilitate Afghan assistance. I will talk more about our international outreach effort later in my testimony.

A fourth milestone has been the efforts that Ambassador Bremer, the CPA, and representative Iraqis are undertaking in a process to transfer political authority to Iraqi institutions and establish a process leading to the establishment of an internationally recognized representative government. As Secretary Powell said on September 8, "We have a common goal: To restore sovereignty to the Iraq people as fast as is possible, as fast as is practicable."

The first steps have already been taken. Early this summer we saw the creation of the principal organ of the interim Iraqi administration, the Governing Council, whose members have been drawn from a broad spectrum of Iraq's ethnic and sectarian groupings. The Governing Council has significant authorities, such as naming and overseeing interim ministers, formulating national budgets, and appointing Iraqi representatives to international organizations and bilateral missions. The Governing Council is assisting the CPA in developing policy on the full range of issues facing Iraq, including security, economic issues, and reconstruction.

Another step already taken was the creation of the Constitutional Preparatory Committee to make recommendations to the Governing Council on writing an Iraqi Constitution. Iraqis will write their country's Constitution, and it will be subject to approval of the Iraqi people.

The Iraqis are playing an ever-increasing role in making the decisions that affect their country. The Governing Council on September 1 selected the members of an Interim Cabinet, who are responsible for the day-to-day management of their respective ministries and who are working now on their 2004 budgets. The new Cabinet will have real responsibility.

We envisage several more steps to advance the objective that everyone shares: The establishment of an internationally recognized representative Government of Iraq. On September 15, the Constitutional Preparatory Commission will report to the Governing Council its recommendations on writing a Constitution. We anticipate a Constitutional Convention, which will draft a new Constitution that would be ratified by a vote of all adult Iraqis. The establishment of an elected Iraqi Government will follow. Once the new government is in place and prepared to assume full control, the coalition will depart. Iraqis are responsible for the timetable of these next steps. The coalition and international community will advise and assist them, and encourage them to proceed deliberatively.

Finally, the United States is in the midst of negotiations with the members of the Security Council on a new resolution that would reaffirm and outline the many areas where we see the United Nations playing a vital role in Iraq, including in reconstruction and humanitarian efforts. We also want the UN to work with the CPA, Ambassador Bremer, and the Governing Council to implement the political transition toward a representative government. A new resolution would give a broader mandate for the international community to come together over Iraq.

The Current Situation

Despite continuing paramilitary and terrorist activity, the situation on the ground throughout most of Iraq is improving. The bombing of UN headquarters in Baghdad on August 19 was tragic. We pay tribute to UN Envoy to Iraq, Sergio Vieira de Mello, and the other courageous and committed UN, World Bank, and IMF officials who were killed or wounded in that attack. Those who attacked the UN were attacking the hopes of the Iraqi people for a better future.

As Secretary Powell made clear last week, we take seriously the challenge that security poses and are taking actions. To augment the Coalition troops providing security, we are organizing an Iraqi national civilian police force within existing structures. About 46,000 Iraqi police have been rehired and most are patrolling with U.S. military forces. About 8,700 guards are on duty in the recently established Facilities Protection Services to guard fixed sites, such as banks, universities, or ministry facilities. But more needs to be done. The CPA has assessed that a minimum of 65,000 officers are necessary, a goal Ambassador Bremer hopes to reach by the end of 2004. We eventually hope to have strength of 17,000 guards in the Facilities Protection Services. Until the security situation stabilizes, it will be difficult for genuine development and transformation of the Iraqi economy to gather the necessary momentum.

Fortunately, there are many things upon which to build Iraq's future. Iraq has a large cadre of talented, dedicated technocrats anxious to return to work. And we

have offers from many countries ready to provide technical assistance and to do business in Iraq.

We are making real progress. Under the leadership of the CPA and the Governing Council:

- the food situation is stable and improving. Working with the UN, we arranged for the local purchase of this year's wheat and barley crop and restarted the public distribution system;
- all universities and most secondary schools are open;
- all major hospitals and 95 percent of local clinics are open;
- power generation is now over 75 percent of prewar levels;
- oil production (1.44 million barrels a day in August) and oil exports (709,000 barrels a day in August) are increasing;
- Iraq's civil service are being paid regularly, bringing money into the local economy;
- USAID partners is awarding Iraqi firms contracts worth millions of dollars;
- Iraqis have been hired to rebuild Iraqi municipal services and infrastructure;
- oil infrastructure, airports, ports, telecommunications networks, highway systems, electrical networks, and water and sewage systems are being repaired;
- an Iraq Central Bank has been created, and the banking system is operating once again;
- millions of dollars stolen by the Hussein regime has been returned by the coalition so that they can be used for the benefit of the Iraqi people.

The Job Ahead: Key Challenges of Reconstruction

My testimony speaks about the "reconstruction" of Iraq, but that word can be misleading. In one sense, we are looking not at reconstruction, but at construction, not at rebuilding, but at building. The Iraqi people must overcome the damage of almost 30 years of misrule and mismanagement by a corrupt and vicious tyrant to build their society into a democratic and prosperous center in the Middle East.

Under decades of Saddam Hussein's misrule, Iraq's economy deteriorated significantly. GDP fell from \$128 billion in purchasing power parity terms when Saddam took power in 1979 to around \$40 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 \$2,000. 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 has become distorted in the way that the economies of Eastern Europe and the Soviet Union once were. Central control removed incentives for rational production. Overcoming the legacy of state planning and controlled prices will be arduous and time consuming.

Tasks in Key Sectors

I would like to briefly describe the challenges Iraq faces in several key sectors.

Oil

The oil sector was stagnant 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 pipelines, to the pumping stations, and to the refineries.

Since the liberation, Iraqi and U.S. engineers have worked continuously to restore production so that Iraq will be able to meet domestic needs and begin earning revenues through exports. The Iraqi State Oil Marketing Organization (SOMO) has successfully sold crude at spot tenders and signed long-term export contracts.

Key future tasks include upgrades to oil facilities to protect the environment, to enhance efficiency, and to meet commercial and safety standards, both upstream and downstream.

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 Iraq rebuilds agricultural production to be competitive, it will also need to ensure that a vibrant trading environment exists.

The government procurement system provided most Iraqis with essential food and medicines. The government controlled procurement of and inputs to production of staples such as grains. Neither production nor consumption costs reflected market prices.

Winding down the UN-mandated Oil for Food (OFF) Program does not mean the end of the need to feed the Iraqi people, the majority of whom received virtually all their food through the public distribution system over the last 12 years. That system has been reactivated to meet the immediate needs of the population. Operational responsibility for buying, transporting, and distributing food and medicines will be transferred from the UN to the CPA on November 22 in accordance with UNSCR 1483. As of September 5, the UN in consultation with CPA has “prioritized” humanitarian and oil services contracts under the OFF program, valued at \$7 billion.

While the food distribution is continuing, consideration must be given to how best to move the Iraqi economy from a highly centralized, subsidized system to a market-driven system with cash salaries that better reflect productivity and people are free to make their own choices in the purchase of food and items.

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 freely traded in open markets. The challenge will be to expand this rapidly to grains such as wheat and rice, which are the staples of the Iraqi diet.

The U.S. Department of Agriculture and USAID 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. Key future tasks include rehabilitation of irrigation and drainage systems, food production facilities, and services for pest management and animal health; providing farm inputs such as seed, feed, and fertilizers; and public food distribution.

Transport

Critical to Iraq’s reconstruction will be the transportation sector, which faces numerous challenges. Basic transportation infrastructure is sound, but has not received proper maintenance for years. Rehabilitation priorities being carried out include port administration buildings, new lighting and fencing, utilities, security fences, grain elevators, silos, and port dredging to allow bulk cargo vessels access to grain elevators and deepwater berths at the port of Umm Qasr, which reopened to commercial traffic on June 17. Repair of the adjoining railroad system is underway to allow onward shipment of the large amount of cargo arriving through the port. Major roadways have also sustained conflict-related damage and are being repaired or rebuilt.

Baghdad International Airport has received repairs of its tarmac, runway lights, plumbing, communications, and security access control systems. The Coalition Provisional Authority is assuming civil aviation responsibility to oversee airport security and flight safety and the administration of civil air services. The repairs that have been completed at Baghdad International Airport have rendered it capable of hosting civilian air services since the beginning of August. In addition, rehabilitation has been undertaken on Basrah International Airport including airport striping, perimeter fence service, and land radio requirements. However, continuing security concerns have prevented these two airports from being reopened to commercial service for the time being.

CPA is coordinating with the State and Transportation Departments, the Federal Aviation Administration, Transportation Security Administration, other U.S. Government agencies, and with the International Civil Aviation Organization on procedures to initiate commercial aviation. CPA has completed solicitations for service for Baghdad and Basrah, and announced the carrier selections for Basra in order to expedite the initiation of commercial aviation once the security situation is adequate. We foresee that with the improvement of Iraq’s transport system, trade and investment relations with its neighbors will also improve. Key future tasks include rehabilitation of roads, bridges, airports, ports, railways, and public transport.

Telecommunications

Telecommunications remains a critical requirement for the reconstruction effort. Expanding telephone access is a key step to improving Iraqis’ lives and essential for the efficient functioning of basic services, including the electricity and oil indus-

tries and security. In prosecuting the conflict, command and control systems and telecommunications centers were targeted. The war destroyed almost 50 percent of the telephone switches in Baghdad, and severed many intercity and all international links. Thus, even though about three-quarters of the 1.1 million lines in country remained serviceable, many of them connected only with phones in their local exchanges.

At this time, telecommunications reconstruction is progressing steadily. There is telecommunications construction work underway on 12 switches, restoration of fiber connectivity between major cities, and the reestablishment of an international satellite telephone gateway. The completion of these projects will put Iraq at prewar levels of telecommunications. We have a target date of January 2004 for the completion of this work. The State Department and USAID have worked closely with CPA to expedite the telecommunication effort. CPA's selection process for the three regional wireless licenses is continuing due to the great volume of license applications. Granting of the licenses will ensure private sector participation in the telecommunications sector. Key future tasks include rehabilitation of switches, local access, international connectivity equipment, and the postal system.

Electricity

Restoring and expanding Iraq's electricity generation capacity and the power distribution grid is critical to Iraqi citizens' well-being, as well as to the rapid restoration of economic recovery, particularly in the oil sector. Despite sabotage and criminal activity, Iraqi electricity generation has been steadily improving and reached its highest point, 3,715 MW, on August 27, or roughly 84 percent of preconflict levels. CPA and USAID are working to repair power stations and transmission lines as part of a plan to increase power to 4,400 MW by September 30 and 6,000 MW before the summer of 2004. Iraq's Commission of Electricity (COE) has implemented a power sharing policy that provides a predictable "3 hours on, 3 hours off" power schedule throughout the country. Bechtel is providing technical personnel at key power stations to assist the COE and is converting units at the Bayji and Al Qudas power plants to burn crude oil until refined fuels are more widely available. USAID is replacing air conditioning systems and clogged heat exchangers at four southern power-generating stations and is purchasing new turbines for the Kirkuk power station. CPA and COE are analyzing maintenance and inspection schedules to reduce the potential for power outages during the fall and winter. Key future tasks include rehabilitation of generation, transmission, and distribution equipment and providing greater security to protect these facilities.

Water and Sewage

Iraq is blessed with abundant water resources, but saddled with decrepit and neglected infrastructure to assure clean water to citizens and industry. We are working hard to improve the situation. USAID support to water and sanitation projects has already benefited over 14.5 million Iraqis. We have repaired over 1,700 critical breaks in Baghdad's water network, increasing water flow by 200,000 cubic meters per day. USAID has begun to expand Baghdad's Saba Nissan water plant, which will add 225,000 cubic meters of water a day by May 2004. We have rehabilitated 70 of Baghdad's 90 nonfunctioning wastewater-pumping stations and begun restoring Iraq's largest wastewater treatment facility, the Rustimiyah plant, which is southeast of Baghdad. USAID is dredging Basrah's Sweet Water Canal and partly completed restoration of the Safwan water pumping station in Khor az Zubayr, benefiting 40,000 people. USAID is also working to rehabilitate the An Najaf and Al Hillah sewage treatment plants, which serve 194,000 Iraqis. USAID has provided funds for the purchase of 100 MW generators for Baghdad's water system, thereby ensuring continuous water supply. Existing USAID projects will implement plans to increase potable water flow to east Baghdad by 45 percent, helping 2.5 million people and restore sewage treatment plants and the Baghdad pump station, serving over 5.5 million Iraqis. Key future tasks include the repair and rehabilitation of water pumping stations, wastewater treatment plants, and associated distribution systems.

Health

While there has been no health crisis thanks to the efforts of USAID and other agencies, building Iraq's health infrastructure remains a high priority. USAID has rehabilitated delivery rooms in hospitals and primary care centers serving 300,000 residents in Basra. Three million sachets of oral rehydration salts are being distributed to children with diarrhea. With USAID funding, UNICEF has provided more than 100,000 pregnant and nursing mothers and malnourished children under 5 years old with supplementary rations of high protein biscuits and 1.4 million children have been vaccinated to date during monthly vaccination days. USAID has re-

habilitated delivery rooms in hospitals and primary care centers service 300,000 residents in Basrah and 500,000 in Nassirya. More than 60 primary health clinics are being renovated and over 6,000 re-equipped to provide life saving health services at a local level throughout Iraq. We will also train thousands of health care providers in the most important life saving techniques. We will continue to rehabilitate hospitals, public health centers, and delivery rooms in the Baghdad area and nationwide. In addition, a hospital burn ward, and dentistry and allergy/asthma centers in Basrah, Mosul, and Kirkuk are being repaired. USAID and Iraq's Health Ministry are developing a health strategy for the country that has been supported by all health donors in Iraq. Key future tasks include the rehabilitation and construction of hospitals and health clinics.

Education

Iraq's children are among its greatest resources for a better future. Their education has been severely disrupted during and after the recent conflict. A top priority is to get the education system up and running again as soon as possible. USAID inventoried all of Iraq's 3,900 secondary schools in permissive areas and is on target to equip and open all secondary schools by the opening of school in early October. UNICEF accessed 1,000 primary schools in Iraq. With USAID funding, UNESCO has completed revision of 45 math and science textbooks. USAID has ordered student/school kits for 1.5 million students and 3,900 schools, including furniture and teaching materials. USAID also provided supplies for final exams to At Tamim Directorate of Public Education, Technical Institute of Kirkuk, Technical College of Kirkuk, Kirkuk University, and Basra University. We are working with Ministry of Education (MOE) to create a plan for the national exam process, including an exam schedule and security requirements. USAID also conducted a competition for U.S. universities to partner with Iraqi universities under a \$20 million grant program. USAID will rehabilitate at least 1,000 primary and secondary schools before the start of the new school year in early October. UNESCO will print and distribute 5 million math and science textbooks during the month of October. Key future tasks include the rehabilitation and construction of school facilities.

Paying for Reconstruction

Experts from the CPA, Iraqis in various ministries, and the international organizations are fine-tuning detailed estimates for Iraqi needs in preparation for the Madrid Donors Conference in late October. The analysis that has been accomplished thus far is that they will be substantial, as high as \$50-\$75 billion over the next several years. The Iraqi people and the broad international community must now share this cost of redeveloping Iraq's economy with the Coalition.

CPA issued a 2003 budget for Iraq on July 7 of \$6.1 billion, a huge step in a country where budgets historically were closely guarded state secrets and it had been a crime to reveal them. The Governing Council, in close consultation with individual Iraqi ministries and budget experts from the U.S. Government are coordinating work on a budget for 2004. This budget should be ready in advance of the October Iraqi Donors Conference in Madrid in order to help international donors identify funding priorities.

There are several primary sources of revenue for Iraqi reconstruction: Revenue of the Iraqi Government, including from oil sales; unfrozen Iraqi assets; funds from the Oil-for-Food program; contributions from the United States, including \$20 billion request the President is making to the Congress; and contributions from foreign governments and international organizations.

Iraq: Revenue from Petroleum Production and Other Local Revenue

Iraq itself will bear an important share of the cost of reconstruction as its oil proceeds are used for the first time in 30 years for the benefit of the Iraqi people. UN Security Council Resolution 1483 directs that 95 percent of all oil export proceeds be deposited in the Development Fund for Iraq to be used for the humanitarian needs of the Iraqi people, for rebuilding the economy and infrastructure, for continued disarmament, for the costs of civilian administration, and for other purposes benefiting the people of Iraq. (The other 5 percent are applied to a special account for the United Nations Compensation Commission.)

To ensure transparency Ambassador Bremer has created a senior-level Project Review Board to approve projects and allocate funding sources and has issued procurement rules consistent with U.S. Government rules. Moreover, U.S. Government agencies are working with CPA to initiate the International Advisory and Monitoring Board (IAMB), created under UNSCR 1483. The IAMB, composed of representatives of the UN, the Arab Fund for Social and Economic Development, and international financial institutions, will ensure transparency with respect to expend-

itures from the Development Fund for Iraq and to verify that its export sales are consistent with prevailing international best market practices.

Oil sales are far and away 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 online and to repair and rehabilitate the existing infrastructure. A highly qualified team has taken on this work. The Governing Council has named Ibrahim al-Uloum the new Minister for Petroleum. Al-Uloum is an oil engineer with international private sector experience. Thamir Ghadhban, a highly dedicated and competent career Oil Ministry executive, remains in place as CEO. Iraq has in place a team of experienced and well-qualified Iraqi managers and engineers at the Oil Ministry, the State Oil Marketing Organization (SOMO), and the South and North Oil Companies; they have technical support from the Army Corps of Engineers. Steps are being taken every day by Iraqis, working with the U.S. Army, to assess the condition of wells, pipelines, pumping stations, gas-oil separation plants, associated power grids, and refineries, and to make repairs.

In July, SOMO signed Iraq's first term contracts since the war, for exports of Basra Light oil from Iraq's southern fields. Iraq's Mina al-Bakr oil terminal is operational and SOMO is successfully exporting oil from it. SOMO recently reported that oil exports averaged about 700,000 barrels a day in August.

There obviously is considerable uncertainty surrounding all production and export projections for Iraq. Raising oil production will require more rehabilitation of fields and production chains. Since the security situation is improving slowly, it is difficult to project the likelihood of success or the likely costs associated with this work. Estimates of future oil production vary considerably. Domestic needs are expected to stay in the 500,000–600,000 barrels a day range. The following chart provides mid-range estimates of oil export levels and revenue for the next 2 years:

Estimated Oil Exports and Revenue

	2004	2005
Exports	1.5 million b/d	2 million b/d
Revenues	\$12 million	\$19 million

Assets of the Former Iraqi Regime

In addition to oil, existing Iraqi state assets and the assets acquired by Saddam Hussein and other senior officials of his regime are to be used for the benefit of the Iraqi people to reconstruct the country.

After Saddam Hussein's invasion of Kuwait in 1990, the United States acted to deprive the Iraqi regime of the means and materials to continue its regional aggression and to further develop its weapons of mass destruction programs. Consistent with UNSC Resolution 661, the United States blocked all Iraqi state assets within its jurisdiction, for example, in the United States, or held by U.S. persons wherever located.

The President has vested \$1.7 billion in Iraqi Government assets in the United States, almost all of which have been transferred to the CPA to meet the immediate humanitarian needs of the Iraqi people. These funds have been used to pay Iraqis' salaries and pensions, as well as for humanitarian projects such as replacing hospital generators.

The State Department and other government agencies have also reached out to many countries that have frozen Iraqi state assets. Under UNSCR 1483, countries have an obligation to freeze without delay and immediately transfer Iraqi state assets to the Development Fund for Iraq. Japan, for instance, turned over \$98 million in frozen assets to the Development Fund for Iraq on August 29.

We continue to have extensive bilateral and multilateral discussions with key countries, with Treasury and State officials contacting their counterparts. We have stressed the need for all countries to search their financial institutions for the assets of Saddam Hussein and his senior leadership, as well as their family members, in both face-to-face meetings and in messages delivered by our embassies overseas. Our efforts are leading to the identification of funds. Over \$1 billion has already been frozen. We are urging that these funds be transferred to the Development Fund for Iraq so that they are used for the benefit of the Iraqi people.

Mobilizing Resources from the International Community

In my opening remarks, I referred to our ongoing work with the international community on Iraqi reconstruction. Many countries have already 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 humanitarian “flash” appeal. 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. Much more will be needed.

We moved immediately after the end of Operation Iraqi Freedom to start the work of coordinating and increasing donor efforts in Iraq. Technical consultations among key donors held at the United Nations on June 24 in New York confirmed that there was widespread recognition that repairing the damage of decades of misrule in Iraq must be an international undertaking. These consultations led to the formation of a Core Group consisting of the EU (Presidency and the European Commission), Japan, the United Arab Emirates, and the United States along with the cooperation of the United Nations Development Group, World Bank, IMF, and CPA. The Core group is charged with laying the groundwork for an international donors’ conference, to be hosted by Spain on October 23–24 in Madrid, and provides regular briefings on progress to over 50 other countries that are also interested in the success of Iraq reconstruction. At that meeting, we will be looking for foreign pledges for Iraqi reconstruction commensurate with the importance and urgency of the task for the remainder of 2003 and all of 2004.

The governments represented at the June 24 meeting in New York asked the World Bank, the IMF, and the UN to undertake a series of needs assessments in Iraq. In response, the World Bank is doing sectoral studies on education, economic management, investment climate, banking, transportation, and telecommunications; the International Monetary Fund led a study on the macroeconomic situation and the overall budget requirements that would be faced by Iraq and the United Nations Development Group led tasks forces on health, agriculture, mine action, water supply, electricity, housing, and institutional capacity building. The fourteen needs assessments are designed to ensure that the best experts available internationally take a look at the situation in Iraq. They have gone into Iraq to assess the situation, identify needs, begin to put a price tag, begin to establish priorities.

The results of these assessments are being fed into the 2004 budget process, being undertaken by the Coalition, working with the interim Iraqi cabinet and the new Iraqi ministries. Both the international organizations, as well as the authorities in Baghdad, agree that the budget should be the coherent planning tool that guides not only how operating funds are spent, but also what reconstruction priorities should be. We are aiming to get a fusion of what reconstruction needs are between the budget being prepared in Baghdad, on the one hand, and the results of the needs assessments being done by the international organizations, on the other.

The Core Group and other donors are also consulting with the World Bank and UN to develop ideas for a multidonor trust fund into which donors could make contributions. A technical meeting on the multidonor trust fund was held in Washington in late August, and that work is moving forward.

Running in parallel with the Core Group process are meetings of the Liaison Group at the UN, which is the larger group of countries that first met in New York in June. About 60 countries as well as several international organizations are members of the Liaison Group. On September 5, this Group met in New York to learn about the results of the Brussels and to invite their input to the issues discussed, including the governance structure of the trust fund, and the process of refining of the World Bank, IMF, and UN assessments. The Group generally made sure that everyone that is likely to participate in the donor’s conference is having a voice in its organization.

Private Sector

Iraq’s financing needs for the coming months will need to come principally from international donors. However, in the longer run Iraq’s development will depend on expanding trade and investment and the growth of the private sector. Iraq’s reestablishment of trading ties to its neighbors and beyond will generate employment opportunities, diversify and increase exports, raise revenues, and facilitate regional reintegration of its economy. The State, Treasury, and Commerce Departments, the Office of the U.S. Trade Representative, the Ex-Im Bank, OPIC, and other agencies are working with CPA and the Iraqis on measures to establish an environment that is conducive to business, including:

- establishment of a new, open trade regime;
- encouragement of foreign investment through a more open investment regime and loosening of restrictions against foreign and domestic ownership of private property;
- creation of an effective banking system, and other financial services;

- transformation of substantial means of production and development currently in the hands of the state;
- replacing existing currencies with a single new currency;
- establishing credit facilities for small businesses;
- reviewing and revising commercial laws and regulations to support a market-driven economic framework.

To help facilitate trade, the CPA is creating the Trade Bank of Iraq, which was announced in July 2003 and will be established soon. President Merrill of the Ex-Im Bank is here today to discuss the Trade Bank during his testimony. Finally, OPIC and the Trade Development Administration are taking steps that would permit them to operate in Iraq in support of U.S. investors in Iraq.

Mr. Chairman, you can see from my summary of the economic reconstruction of Iraq that this is an issue that is getting the highest priority within the U.S. Government. It is an immensely complicated effort involving not only the United States, but also the whole international community and major international institutions, including the United Nations, the World Bank, and the IMF. I have outlined the considerable progress we have made over recent months, but the formidable challenge of restoring Iraq to economic vitality will continue to require major resources from the United States and the international community as well as from the Iraqis themselves. The task will take years to complete. It is an effort that we cannot afford to lose. We welcome the strong support of Congress as we confront this challenge.

PREPARED STATEMENT OF JOHN B. TAYLOR

UNDER SECRETARY FOR INTERNATIONAL AFFAIRS

U.S. DEPARTMENT OF THE TREASURY

SEPTEMBER 16, 2003

Chairman Hagel, Ranking Member Bayh, other Members of the Subcommittee, thank you for inviting me to testify on the financial reconstruction of Iraq. Given the importance of trade and finance for Iraq's reconstruction, this Subcommittee is an ideal forum for this discussion. And the presence of my colleagues, Under Secretary Larson and Chairman Merrill, further underscores the importance of active government-wide participation in the reconstruction effort.

When I last testified on this subject, on June 4 before the Senate Committee on Foreign Relations, I stressed that "the international community and the Iraqi people face an enormous task in the reconstruction of the Iraqi economy. A quarter century of repression and economic mismanagement under Saddam Hussein cut the size of the economy to only a small fraction of what it was before his regime took over. In 1979 GDP in Iraq was \$128 billion . . . by 2001 it had declined to \$40 billion." I also stressed the *strategy* of financial reconstruction—the contingency plans developed in advance of the military conflict—and the *tactics* followed on the ground since the conflict began. I would like to stress these same issues in my testimony today, with emphasis on the additional information we have obtained on the state of the Iraqi economy and on what has happened on the ground during the summer months.

Much has been accomplished in the financial area since the fall of Saddam Hussein's repressive regime, and many potential financial catastrophes have been avoided. In my view, months of advance planning by the United States government before Saddam's fall as well as the dedicated work of the Coalition Provisional Authority and the Iraqi people since Saddam's fall are responsible for these accomplishments.

Starting late last year, we began developing a strategy for financial reconstruction based on the information we had at the time. The strategy addressed such issues as (1) payments to Iraqi workers and pensioners, (2) the currency, (3) the banking system, (4) Iraq's international debt, (5) an assessment of reconstruction costs, and (6) the international fundraising efforts. I want to review how that strategy is playing out today. But before doing so I must emphasize that an important part of our advance planning has been the selection of people to participate in the financial reconstruction effort. We began selecting financial experts in January; the first wave of people was deployed to Kuwait in March and to Baghdad in April. Early on we decided that a financial coordinator was essential and we are very grateful to Peter McPherson who took leave from the Presidency of Michigan State University and has served most ably in this position, advising Ambassador Bremer and the rest of the Coalition Provisional Authority.

A Strategy for Paying Workers and Pensioners

It was clear that we had to have a strategy for paying Iraqi workers and pensioners after the fall of Saddam Hussein, and thus we crafted a strategy well in advance of his fall. Keeping workers on the payroll with stable purchasing power would be essential to prevent severe hardship and economic collapse. But how many workers were there and how much should they be paid? What currency should be used to make the payments? Where would the funds come from? Would the payments system be in good enough condition after the conflict to actually make payments? How could we prevent hyperinflation and a sharp depreciation of the currency, which would further impoverish people? After all, one of the reasons for the terrible economic performance under Saddam was that he resorted to the printing press to finance his spending, causing high inflation and a drop in the dinar to about 1/5,000th of its former value.

Starting late last year, we developed such a payments strategy, which was approved interagency after much valuable discussion and debate about alternative strategies. The strategy called for paying workers and pensioners in U.S. dollars on an interim basis. This was not dollarizing the economy, because the strategy called for the continued use of local currencies—such as the Saddam dinar in the center and south and the Swiss dinar in the north—and their eventual replacement by a new national currency, as described below. Using U.S. dollars on an interim basis would create stability and would help prevent a collapse of the dinar.

Finding a way to secure the funds to make these payments in advance of the conflict proved to be a challenge. After much discussion and debate, we decided that the best approach was to use Iraqi regime assets that were frozen at U.S. commercial banks back in 1990 at the time of the first Gulf War. In order to use the assets for this purpose, they had to be “vested” for the use of the Iraqi people. Our estimates were that there was about \$1.7 billion that could be vested in the United States and that this amount would probably be sufficient to last until a new currency could be issued in Iraq. A vesting strategy was worked out and approved by interagency legal experts. Under this plan the President would call for the vesting of the assets in the Federal Reserve Bank of New York near the time that the military conflict began.

To make such a strategy operational, many tactical issues and contingencies had to be considered. For example, the plan called for the military on the ground to issue public statements—worked out with the Departments of Defense and Treasury—that the dinar would continue to be accepted as a means of payment after the fall of the Saddam regime. The plan also called for the first wave of financial advisers into Baghdad to assess the payments system’s capability for making dollar payments.

Another essential operational issue concerned the actual shipping of the currency to Iraq, and a plan for making the payments to workers and pensioners on the ground had to be developed. We estimated that enough currency in the right denominations was in storage in the New York Fed’s warehouse in East Rutherford, New Jersey, and we determined that it was feasible to ship the currency by tractor trailer to Andrews Air Force Base, load it on military aircraft, and fly it to Camp Arifjan in Kuwait for the last leg into Iraq. Many tons of currency were involved because of the need for small denominations: one-dollar or five-dollar bills. On the ground, the military would assist in the actual shipment of the currency around the country. Financial experts would develop lists of eligible workers and pensioners who would be paid. The currency would be distributed to Iraqis who would then actually make the payments. In some cases, the currency would be paid at the state-owned enterprises or government ministries. In other cases, pensioners would come to local banks to receive payments.

I am pleased to say that this strategy along with all its tactical details has been carried out with great success. On March 20, at the start of the conflict, President Bush issued an order calling for the vesting of the frozen assets. As a result, approximately \$1.7 billion was vested in the New York Fed. With these funds at the New York Fed, the first shipment of currency from the Fed’s East Rutherford, New Jersey warehouse to Camp Arifjan was made on April 13. Even as major combat operations were winding down, a mechanism for shipment of cash and distribution of emergency payments was established and began to function. Thanks to this system, we were able to make monthly emergency payments to dock workers, rail workers, power plant workers, and others essential to restoring basic services. We soon transitioned to regular civil service salary and pension payments to over 2 million Iraqis.

Despite tremendous logistical challenges, the system of payments has worked well. Our financial experts in Baghdad consider this to be a major force for stability in the country, as well as a significant spur to economic growth. As of this date all

but \$64 million of the vested assets has been shipped to Iraq where they have been used principally to support salary and pension payments to the Iraqi people. The Department of Defense's logistical support has been crucial in this enormous undertaking.

Throughout this period there has been no collapse of the currency, no hyperinflation, and no serious glitch in the payments process itself. In sum, this major and essential success in the reconstruction was due in large part to preconflict planning and to adjustments that were made as we implemented the plan and learned from experience.

A New Unified Currency for Iraq

As I indicated, the payments strategy called for the use of U.S. dollars on an interim basis only. Our goal was for the Iraqi people to choose a new national currency to replace the Saddam dinar and the Swiss dinar, and to provide the necessary financial and logistical assistance to do so. A stable, unified currency is an essential part of a market economy and therefore one of the key parts of financial reconstruction.

I am happy to say that this part of the financial reconstruction strategy is on track as well. Last July 7, after consulting with representatives from the Central Bank, the finance ministry, and other interested Iraqis in the north and the south, the Coalition Provisional Authority announced that a new currency would be issued starting in October. The new currency would replace the old currencies at fixed rates that were also announced. Hence, the Coalition Provisional Authority and Iraqi officials in the Central Bank and the finance ministry are about to begin one of the most important parts of the financial reconstruction to date: Issuing a new currency to replace the Iraqi currencies that are now circulating. The new currency is a key component in the effort to establish a stable financial system.

The new currency bears the designs of the old Iraqi, or Swiss, dinar and is being produced at printing facilities around the world on schedule. There will be six denominations to replace the current two denominations. About 2,200 tons of currency will be shipped from printing facilities in England, Spain, and other countries. A sufficient supply of new notes will be available when they are introduced.

The exchange period will begin on October 15 and last until January 15. A public education campaign is underway in Iraq to ensure that the Iraqi people are well informed about the new currency and are prepared for the currency exchange. The new currency will improve the ease of transactions, since it will be issued in more denominations than currently available, and will have built-in security features that will enhance public confidence by making the notes more difficult to counterfeit.

Restoring and Revitalizing the Banking Sector

We knew well before hostilities began that strengthening and modernizing Iraq's financial sector would be central to achieving overall economic reconstruction, and that a thorough on-the-ground assessment of Iraq's financial sector would be needed as soon as conditions allowed. Thanks to extensive prewar planning, Treasury was able to position advisors in Iraq's finance ministry, Central Bank, and two main commercial banks even as hostilities were winding down.

The challenges they faced to perform seemingly simple tasks, such as schedule a meeting with Iraqi bankers, were enormous due to security concerns, the lack of working phones or faxes, and language barriers. Despite these difficulties, I am pleased to report some major successes. One of the most important is the reopening of most of the branches of Iraq's two large state-owned banks—Rafidain and Rasheed—which enabled cash-strapped Iraqi families to gain access to their savings. Opening these branches was no small feat. Many of the banks' branches were damaged and we were fearful of a bank run once the banks reopened. Due to careful planning, individual Iraqis now have access to their deposits and there were no bank runs.

The initial assessments conducted by our advisors have provided much insight into the operations of Rafidain and Rasheed banks. As our preplanning analyses indicated, these banks did not function independently of the former regime. We now know that these banks were not permitted to make loans based on commercial viability and a borrower's ability to repay, but instead on the ability of the borrower to fulfill a Ba'athist party political objective. The Coalition Provisional Authority, with the support of Treasury, is hard at work reviewing ideas for restructuring the two major state-owned banks.

Analyses of Iraq's private banks are almost complete. While these banks are small in relation to the two large state-owned banks, they will play a role in Iraq's future. We know that remittances through these banks are starting to occur. Remittances by Iraqis overseas will soon form a large pool of resources in Iraq that will finance

investment and consumption. According to some estimates, about 4 million Iraqis live abroad, and in recent years they have transferred over \$1 billion per year to relatives in Iraq.

In addition to strengthening specific banks, the financial system more broadly—including the relevant laws and regulations—will require significant work to ensure that an efficient and effective system for financial intermediation is achieved. In consultation with the International Monetary Fund, we are working with the Iraqi Governing Council, other Iraqi officials, and the Iraq Bankers' Association on a revision of Iraq's Central Bank law and commercial banking law. Creating a sound supervisory and regulatory regime is also critical to establishing a strong financial system. We have reached out to countries in the region, including Jordan, Bahrain, and the UAE, who have offered to provide technical training to Central Bank and commercial bank employees.

As work proceeds on these broad objectives, some initial bank lending has started, with the focus on loans directed toward Iraqi small- and medium-sized enterprises. Additionally, the Treasury has approached the International Finance Corporation, the private sector arm of the World Bank, about setting up a facility in Iraq to provide loans to micro-, small-, and medium-sized businesses. This would be a multilateral facility modeled after other highly successful programs in Russia, Central Asia, and Southeast Europe.

One major initiative that is now getting off the ground is the creation of the Trade Bank of Iraq. This Iraqi-staffed institution will facilitate imports to and exports from Iraq by putting in place the people and systems needed for the country to trade more efficiently and on a larger scale with the rest of the world. Currently, trade is taking place at the retail level. In Baghdad's markets one can find consumer goods—from refrigerators to satellite disks—imported from neighboring countries. But in order for Iraq's reconstruction to move forward as quickly as possible, and for private sector activity to take off, there needs to be an efficient system for importing a broad range of capital goods and services. Our goal is for Iraqi banks to provide trade finance services. But as the process of strengthening Iraqi banks goes forward, there is an immediate need to do this. The Trade Bank of Iraq is intended to fill that gap.

Following a competitive bidding process, the CPA is negotiating a contract with a consortium of international banks which will facilitate the operations of the Trade Bank. Additionally, the Trade Bank will be the entity by which Export Credit Agencies around the world support trade with Iraq. There is precedent in creating institutions such as the Trade Bank in post-war Japan and Germany. Those institutions evolved and took on functions akin to export-import banks, although how the Trade Bank evolves will be up to the Iraqi people.

Iraq's International Debt

Early on we recognized that dealing with Iraq's substantial foreign debt problem would be crucial to the country's medium-term economic health. We therefore developed a strategy to resolve this problem.

First, using the financial information we had, we ensured that Iraq would not have to service its debt following the end of the war and during the critical reconstruction phase. Demands for repayment would have greatly reduced the resources available to a new Iraqi Government. Therefore, we secured recognition from the G7 that Iraq would not service its external debt at least through the end of 2004. Subsequently, the Paris Club group of official creditors stated their expectation that Iraq would not make payments over this time period.

Next, we sought to obtain the best possible data on Iraq's foreign debt and its economic condition. Without any reliable data, it would be difficult to reach an international consensus on a debt strategy. We began collecting data by sending several technical assistance advisors to Iraq to review the government's debt records once the war ended. At the same time, we worked intensively through the Paris Club and the International Monetary Fund to obtain data from creditors.

We have made significant progress. The latest available information indicates that Iraq's external debt amounts to at least \$70 billion and is probably closer to \$100 to \$120 billion. Paris Club members report that they are owed roughly \$40 billion—\$21 billion in principal and roughly an equivalent amount in late interest. The IMF has polled non-Paris Club governments and, as of September 10, reports creditor claims of \$28 billion in principal and interest. Since 20 governments have yet to respond to the IMF poll, this figure is likely to increase.

With better data in hand, we can now proceed with our strategy and work out a long-term solution to Iraq's debt problem. We will continue to work with other creditors toward the goal of achieving a substantial restructuring of Iraq's debt that will permit the Iraqi Government to channel resources into reconstruction activities.

Assessment of Reconstruction Costs and International Fundraising Efforts

We also knew at the outset that one of the major priorities following the conflict would be to produce a comprehensive assessment of reconstruction costs in Iraq. We recognized that we could not focus solely on the costs of repairing the damage inflicted during the short conflict. Saddam Hussein's total disregard for the welfare of his population likely meant that the needs of the Iraqi people—and the cost of reversing decades of economic decline—would be substantial.

Because of the extent of Iraq's isolation from the international community, we had little reliable information regarding the extent to which critical investments had been neglected. We were concerned that the absence of economic data and other information would make the job of producing a timely needs assessment especially challenging. We engaged early with our fellow shareholders and with senior officials from the World Bank and the IMF to create a process for making a needs assessment as soon as the environment was permissible. As a result of these discussions, these institutions acted quickly to develop the scope of the assessment, divide up responsibility for different sectors, and recruit the necessary staff.

We expect that the cost for reconstruction will be in the range of \$50 to \$75 billion. This estimate covers critical infrastructure needs in electricity, public works, transport, telecommunications, health, education, and agricultural sectors, among others. But it excludes the annual expenses that have been identified by the Coalition Provisional Authority to cover the government operating budget.

Clearly, this is a cost that will need to be shared widely, and underscores the importance of a major donor effort for Iraq. In June, we established a "Core Group" of donors, consisting of Japan, the EC, and the United Arab Emirates, to consult regularly with the UN, World Bank, IMF, and CPA, on the planning and preparation for the donor conference. The members of this group are engaging intensively with other potential donors to urge them to pledge generously at the donor meeting in Madrid on October 24. We believe our own substantial contribution of \$20 billion—as reflected in the President's forthcoming supplemental request—will be critical to leveraging support from other governments.

In addition, we are encouraging the international financial institutions to commit their own resources to the people of Iraq. As you are aware, the IMF and World Bank recalled their staff following the bombing of UN headquarters where they were also housed. However, these institutions remain actively engaged on Iraq, and are continuing to work with CPA and Iraqi officials, providing technical assistance and finalizing the needs assessment. The World Bank—in conjunction with the UN—is also completing the design of a multidonor trust fund that would pool bilateral donations and make them available for priority needs identified by these agencies in their needs assessments. In addition to these vital contributions, we have made good progress in our discussions with the IMF and the World Bank on identifying the type and amounts of resources that could be made available to the Iraqi people once the conditions for lending are in place.

In a related exercise, we are reaching out to Export Credit Agencies (ECA's) around the world, encouraging them to follow the U.S. Ex-Im Bank's efforts to support investments in Iraq by insuring repayments. Many other governments have responded positively to this effort, including Japan and the United Kingdom. Through credit facilities such as the one proposed by Ex-Im Bank, credit agencies will be able to provide short-term export credits worth several billion dollars. Initiatives like this will be very important for supporting trade, facilitating commercial activity, and spurring growth in Iraq.

Countries other than the United States have been identifying and freezing assets of the Hussein regime in accordance with UN Security Council Resolution 1483. Over \$1 billion of such assets has been identified and frozen. We are working hard to encourage countries that have frozen assets to transfer those funds to the Development Fund for Iraq (DFI), where they will assist in the reconstruction of the country. We have already had some success in these efforts, including a transfer of approximately \$98 million to the DFI announced by Japan on August 29.

Conclusion

Achieving a stable and productive economy is central to our goal of a unified and prosperous Iraq. We have made considerable progress on financial reconstruction over the last several months, thanks to extensive advance planning and the work of many dedicated professionals from the United States, Coalition partners, and Iraq. Our activities will only intensify in the coming months. While the challenges are formidable, we are well on the way to establishing a vibrant economy that creates opportunities for all Iraqis to achieve a better future for themselves and their children.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR HAGEL
FROM ALAN PARSON**

Q.1. How many sole-source noncompetitive contracts are there? What is the exact percentage of these contracts?

A.1. To the limited extent to which the Department of State has access to comprehensive details related to contracting for the reconstruction of Iraq, we offer the following information on sole-source noncompetitive contracts being awarded by the U.S. Agency for International Development (USAID) and the Department of Defense (DOD):

- As of September 12, 2003, USAID had awarded nine reconstruction contracts. Of these, one was a sole-source contract to International Resources Group (IRG) valued at USD 18.3 million of current programming. Out of the USD 1.55 billion in USAID contracts funded thus far, this sole-source contract award represents 1.2 percent of the total.
- DOD has awarded one reconstruction contract that was not competed. The Army Corps of Engineers awarded one sole-source contract to Kellogg, Brown, and Root. The total contract award is not to exceed USD 7 billion. DOD has awarded 1.6 billion in contracts to Kellogg, Brown, and Root through September 12, 2003.

The General Accounting Office (GAO) has produced two reports on Iraq reconstruction contracting—one through July 31, 2003 and the other through September 30, 2003.

Q.2. What are the numbers of foreign contract and subcontracts awarded?

A.2. According to publicly available information and the Department of State's best efforts to obtain additional information from other agencies, the Department offers the following information:

- The United States Agency for International Development (USAID) has awarded all of its prime contracts (9) to U.S. firms. As of September 19, 2003 Bechtel, one of USAID's prime contractors, had awarded 133 subcontracts with the majority (98) going to Iraqi firms.
- The Department of Defense requires Kellogg, Brown, and Root (KBR) to competitively bid the subcontracts for each individual order placed against its overall contract. We are unable to prove an exact determination of the number of foreign subcontractors working with KBR but there are many, including a number of small Iraqi subcontractors.
- USAID and the Department of Defense as the contracting agencies may be able to provide more complete data.

FINANCIAL RECONSTRUCTION IN IRAQ

TUESDAY, NOVEMBER 4, 2003

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE AND FINANCE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 2:33 p.m., in room SD-538, Dirksen Senate Office Building, Senator Chuck Hagel (Chairman of the Subcommittee) presiding.

OPENING COMMENTS OF SENATOR CHUCK HAGEL

Senator HAGEL. Good afternoon. I think the order of business is for Senator Stabenow to introduce Mr. McPherson, but in her absence, I have conferred with the Vice Chairman of the Subcommittee, Senator Bayh, and we have concluded, in the interest of time—oh, she is here. We just about threw you overboard here, Senator Stabenow. But allowing you an opportunity to make the presentation, if you would like to sit there or down in front, either way you want to do it.

Senator STABENOW. Well, I would be happy to sit down front.

Senator HAGEL. We will keep all these Michiganders together.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman. I appreciate very much you giving me an opportunity to introduce a distinguished constituent of mine. Peter, welcome. Good to see you.

I am not a Member of the Subcommittee, but, of course, Mr. Chairman, as a Member of the Banking Committee and, most importantly, as a Michiganiaan, I wanted to be here today to introduce Peter McPherson.

As you know, he is the President of Michigan State University, my alma mater, which is one of the many reasons that I am pleased that he is here today. But he has a long history of leadership in the financial services industry as well as in public service and in education.

Over his impressive career, he has served as Deputy Secretary in the Department of the Treasury, Administrator of the U.S. Agency for International Development, a leader at the Overseas Private Investment Corporation, and as a Special Assistant to President Gerald Ford.

Mr. McPherson has been President of Michigan State University since 1993. As head of MSU, he oversees an institution of nearly 4,500 faculty and approximately 45,000 students. Under his leadership, the Spartans have continued their impressive track record as

a wonderful institution, well respected for both innovative teaching and impressive research.

When I heard that Peter had been called upon back in April to serve as the Financial Coordinator for the Iraq reconstruction, I knew that we were in good hands. I knew the Administration had picked an excellent person for that position.

During his time in Iraq, he has worked closely with Iraqis rebuilding their Finance Ministry, their central bank, their entire financial services system, and I know that we are anxious to hear from him today about his perspectives. I know that he came back to Michigan State, and we are glad to have him back. I also know he could have spent many more months there doing the things that need to be done to rebuild Iraq. But we are just pleased that he was willing to step away from his duties to go to Iraq and that he is here to share his experiences with us today.

Thank you.

Mr. MCPHERSON. Thank you, Senator.

Senator HAGEL. Senator Stabenow, thank you. You certainly are welcome to stay for a while, or whatever your schedule calls for.

Senator STABENOW. Thank you.

Senator HAGEL. But we appreciate very much your introduction of Peter McPherson.

This is the second hearing that this Subcommittee has held on financial and economic reconstruction in Iraq. Under Secretary of State Alan Larson, Under Secretary of Treasury John Taylor, and Ex-Im Bank Chairman Phil Merrill discussed U.S. efforts to bring stability and growth to Iraq's economy.

Today we will hear from M. Peter McPherson, who has just been introduced, and as has been noted, is a former Deputy Secretary of the Treasury, current President of Michigan State University, and former Director of Economic Development for the Coalition Provisional Authority in Iraq; as well as Mr. Mark Malloch Brown, current Administrator for the United Nations Development Programme. We welcome you both. We appreciate very much each of you making an effort to be here. Mr. Brown, especially in your case where it is not often we have representatives of the United Nations to come before any committee of Congress. So we very much appreciate your being here. The Committee will be interested in your insights, observations, and analysis of Iraq's economic development based on your experience.

America must continue to lead the international effort to support the economic and financial reconstruction in Iraq. This effort is directly connected to our interest in transferring authority as soon as possible to an Iraqi Government that is capable of governing and is viewed as legitimate in the eyes of the Iraqi people.

Post-Saddam Iraq has the potential to be a model for economic development in the Arab world and throughout the Middle East. For success in Iraq, Iraqis must believe that their economic future will be brighter, that there will be jobs, opportunities, growth, and economic security. And they must see a quantifiable improvement in their lives.

There has been substantial economic progress in Iraq over the past 6 months. A trade bank has been established and a new Iraqi

currency is in circulation. Iraq is also in the process of establishing new and more transparent banking and investment systems.

But time is not on our side. There are major challenges ahead before Iraq can realize its potential. Iraq faces reconstruction costs of at least \$56 billion over the next few years, according to the assessments of the CPA, the United Nations, and the World Bank, an international debt estimated between \$97 and \$124 billion; as well as approximately \$96 billion in war reparation claims against Iraq to be resolved through the United Nations Compensation Commission; and an unemployment rate of around 60 percent.

Iraq's economic potential has been set back by more than three decades of mismanagement and corruption by Saddam Hussein's regime, and as a result of Saddam's disastrous policies and decisions, Iraq experienced three wars and more than 12 years of international sanctions. The looting and destruction that followed Iraq's liberation intensified the problems. While Iraq has an educated and professional middle class and the second largest proven oil reserves in the world, Iraq's economy faces many obstacles and challenges.

Iraq's oil revenues alone will not be able to meet the demands of governance, reconstruction, and debt servicing over the next few years. At best, Iraqi oil revenues might be able to cover the recurring costs of running the Iraqi Government, but probably not much more than that over the next few years. We, therefore, should not expect that Iraqi oil revenues will be available for reconstruction or debt repayment anytime soon.

The United States has committed \$18.6 billion in grants to help rebuild Iraq. Pledges from the international donors in Madrid last month include between \$3 and \$4 billion in grants and as much as \$14 billion in loans and credits. The infusion of approximately \$22 billion in grants will have a significant impact on Iraq's economy. But there is still a long way to go.

Providing debt relief must be another urgent priority in Iraq, and cannot be disconnected from reconstruction initiatives. A substantial debt and reparations burden will hinder Iraq's economic development, no matter how much oil Iraq has in the ground.

The Iraqi people should not be burdened with debt incurred by Saddam Hussein's regime. Iraq needs significant debt relief as soon as possible. But Iraq's debt must be renegotiated through international institutions such as the United Nations, the World Bank, and the Paris Club.

Inside Iraq, we must support macroeconomic policies that expand opportunities in education and, most importantly, increase jobs. Iraqi politics cannot stabilize with more than half of Iraq's workforce unemployed. We must work with our Iraqi and international partners to strengthen and expand the Iraqi private sector and those industries that offer the best comparative advantage. The oil sector in Iraq is capital intensive, not labor intensive, and provides jobs for less than 1 percent of Iraq's population. We need to look beyond oil to provide jobs and opportunities for all Iraqis.

Iraq's economic and political development will depend upon an improvement in security in Iraq. If security in Iraq continues to deteriorate, and the problems spread outside the so-called "Sunni triangle," economic development will be very difficult. Security in Iraq

is not the subject of today's hearing, but it is critical to any prospect for economic stability and growth.

We very much appreciate both of your testimony, your observations today, and we look forward to your testimony.

I would now ask the Ranking Minority Member of the Subcommittee, Senator Bayh from Indiana, if he would like to add his comments.

Senator Bayh.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Thank you very much, Mr. Chairman. I want to compliment you for conducting this hearing today following the one that we previously held. It is vitally important to securing the reconstruction efforts of Iraq, and through that eventually securing the peace. So, I thank you for focusing us on this topic.

Also, gentlemen, thank you for your time. We know there are other things that you could be doing, so we are grateful to you for joining us.

Mr. McPherson, I would just like to say I hope you enjoyed your experience in Indianapolis a few years ago when the Spartans won the NCAA Basketball Championship. From our point of view, if it cannot be an Indiana school, it may as well be a neighbor.

Mr. MCPHERSON. You were a great host, Senator.

Senator BAYH. Well, I am glad you think so. I had the privilege of being seated next to the Spartan cheering section, and my hearing is still recovering. We are happy to have you anytime, and we appreciate your presence today, as well as you, Mr. Brown, as well.

I am going to be particularly interested to obviously hear statements, but then focus some questions on the status of our debt relief efforts. As my colleague mentioned, the amount of outstanding debt is unsustainable for the Iraqi economy when you include not only the ordinary loans but these war reparations, things of that nature. I would like to know what our strategy is for going about convincing other countries to either relieve some of this debt or to have the newly constituted Iraqi Government repudiate some of it. We had an example not long ago of Argentina deciding that their internationally held debt was unsustainable, and they have taken steps unilaterally to deal with that. I would like to know what our strategy is for trying to alleviate the Iraqi situation as well so they can make a fresh start of it and get on.

I would be interested, as Senator Hagel mentioned, the Madrid Conference that generated some additional support for the reconstruction efforts. I noted with interest that at a time when the Administration was vigorously opposing having part, a relatively small fraction of the U.S. assistance, be provided in the form of loans, they nevertheless were applauding the international effort, two-thirds of which was constituted as loans. I am interested to know why, according to the Administration, it is apparently all right for the rest of the world to be repaid, but the American taxpayer is not to be repaid. I am looking for a little consistency here, and perhaps you can help to provide it today.

Also, what do we intend to do with regard to sustainable macroeconomic policy, both fiscal and monetary? Vitally important. I mentioned Argentina before. All the U.S. assistance in the world

and from other nations will go for naught if they do not have sustainable fiscal and monetary policies. What leverage do we have to try and convince the new Iraqi authorities to take not the path of least resistance but the difficult course of providing sound fiscal and monetary policies for themselves in the longer-run and not just curry temporary favor with the crowd by pursuing policies that are not sustainable in the long-run?

Finally, I would be interested to know if you concur with the cost estimate for reconstruction over the next 4 to 5 years that Senator Hagel mentioned of \$55 to \$56 billion. Is that, in your estimate, an accurate assessment? Or if it is not, how would you go about assessing the cost of reconstruction?

Again, thank you for your presence. We look forward to hearing from you. And I again thank the Chairman.

Senator HAGEL. Senator Bayh, thank you.

Senator Stabenow, would you like to add any comments?

Senator STABENOW. No, thank you.

Senator HAGEL. Well, thank you again, and I would add I have known Peter McPherson for not quite 30 years, but close to that. He is one of the genuine public servants of our time, and, again, we appreciate the time that he invested in helping this country once again over the last few months. We look forward to his words as well as Mr. Malloch Brown's words after we hear from Mr. McPherson.

Mr. McPherson, please begin your testimony. You both can either paraphrase it, work from notes, or read it. We will assure you that your full testimony will be included in the record.

**STATEMENT OF M. PETER McPHERSON
FORMER DIRECTOR OF ECONOMIC DEVELOPMENT
COALITION PROVISIONAL AUTHORITY IN IRAQ
PRESIDENT, MICHIGAN STATE UNIVERSITY**

Mr. McPHERSON. Thank you very much, Senator, and, Senator Stabenow, thank you for your comments. It is good to see you and have your long support for Michigan State and other matters. We appreciate it.

I am particularly happy to be here with my old colleague Mark Malloch Brown. We have worked together on a number of things, and he and his organization were so important in putting together the needs assessment as we ran up to the donor conference in Madrid. Senator, I know this is in no way a passing interest of yours to really look at the economic side of what is happening in Iraq, and I think it is important. It is much appreciated.

Security certainly is a critical component of our long-term success there. I do think, though, that what has been achieved in areas such as health and education and the economy begins to put in fairly stark relief what Iraq can be if we deal with the security matter. It is no longer just theory and possibilities. We can see what can be in what we can have when the job is done.

We are beginning to put in place the foundation for a revolutionized economy. The new economy will challenge the whole region, where the economic policies frequently have not been as sound, and market forces have not played nearly as important a role.

The situations is pretty messy. It is a very imperfect world. But in my judgment, the progress is real.

In June, we began to pay the government employees—there are 1.3 million of them—and about 1 million pensioners. It was a real accomplishment to get this all done, because as we started off, we did not even have the names of the people. The government ministries were not open. And in many cases, we actually could not work out of those ministries. We finally found together individual employees that had taken lists home, or we patched lists together here and there, and over a few weeks we put together a list of all the government employees. We then got some key people in the Ministry of Finance who had worked on this before. I came to respect a couple men particularly. Through their honesty and their 24-hour work at this, they signed off on the integrity of lists all over the country.

Senators, to get \$100-million-plus in value distributed all over the country in June, was something of which I am still proud of. There was never a major theft, never a major problem that was not solved.

One part of this that has almost never been mentioned is that we paid that first payroll in the Saddam dinar. There was some discussion about that because Saddam's picture was on the old currency. The decision was made that to pay in the old currency in part to tell the country that we were not going to let their currency, the value that they had in that currency, just drop through the floor. Everybody remembered what happened in Germany after World War I where the currency essentially came to have no value. We would have destroyed whatever value was left in the hands of the people if we had done so. The Saddam dinar fluctuated in the months since, but it has maintained its value within a range. It is a success hardly spoken of, and I think it was quite key for progress.

In fact, on July 7, the decision was announced to create a new currency. There was lots of discussion about that. At the time there was much back and forth, but the Iraqi businessmen and others were clamoring to do something, and after the fact, everyone has been really very satisfied that we did. In all but the North of Iraq, there were only two denominations of the currency, one worth about a dime, the other about \$5. Think if we had to operate in our country, or any country, with only a dime and a \$5 bill, the new currency was. We began to print it. On October 15, the swap begin through January 15. There is a couple billion dollars equivalent being moved into the country. You swap during these 3 months or all you have left are souvenirs. Actually, this is going very smoothly. I talked to my replacement this morning just to confirm. There have been bumps, of course, but overall things have gone very well.

Something we did helped. The central bank pushed hard to urge people to put money in the banks prior to the swap and have that money automatically swapped and so people did not have to stand in line to get it done. But once more, billions of dollars moved around the country at over 200 sites. That has been quite a feat.

We put together a 2003 budget. We announced that on July 7 at first. We could not find the prewar budget, because it was a state

secret under the old regime. We found it a few weeks after we had put together the new budget. The 2004 is now in place along with the supplemental budget.

When we arrived the banks were all closed. Frankly, virtually nothing was open. The two big banks, Rafideen and Rashid, have now opened. At most of their branches, checks are being cashed. Eighty sites, through a satellite, now connect the banking system and the central bank are so that we can get information about what is happening around the country. That has been a significant achievement.

You mentioned the trade bank a moment ago. When the Oil for Food Program ends we would not have had in place any trade credit facility. Unless something is done some of the private banks will be doing some work, but Rafideen and Rashid are not yet in a position to do that work. So the trade credit facility, so-called trade bank, is an important tool.

One of the first things that countries need as a step out of financial extremis, is trade credit. And so this facility, which should go out of existence in a couple years, is meant to be a short-term measure, not to replace the regular banking system.

Now, as time went on, the Iraqis played a steadily bigger role in things. When we got there, they had a very limited role, but the ministries began to operate, the central bank, the Ministry of Finance, and by August there was an enormous involvement by Iraqis in making some key decisions. This included sweeping economic reforms, changes that were announced by the Finance Minister in Dubai at the World Bank-IMF meetings. Those changes make the Iraqi economy, under the law of Iraq, the most open economy in the region—and, frankly, one of the more open economies in the world.

What it provides is an across-the-board tariff at 5 percent with a few exceptions that go down to zero. It provides a maximum personal income tax of 15 percent and corporate rate at 15 percent. It allows foreign investment of 100 percent, foreign corporations treated as national corporations, full repatriation of profits and so forth.

The investment provisions were strongly urged by the World Bank that pointed out how little foreign investment the Middle East is getting. In fact, in 2002, the last annual figures, the Middle East received only \$4 billion of foreign investment. All of Sub-Saharan Africa, generally thought not to attract a little of foreign investment, attracted \$7 billion and Latin America about \$44 billion.

The World Bank said you must open up this economy. The Iraqis were saying, “We need jobs. And how do we create an edge? We do not want to be just the same as everybody else, but how can we be something special?” Well, the sweeping economic reforms certainly put that into place.

By the way, I neglected to mention a moment ago, part of those reforms was allowing foreign banks in to enter the country and to compete with the state banks, the two big state banks. There is a lot of interest already being displayed by some Middle East.

The process of adopting these reforms is instructive. The Governing Council, the 25-person, now 24-person-member Governing Council appointed by Bremer, is representative in terms of religion

and geography of the country. I can tell you from lots of dealing with these people, they are strong people. They stand up and tell you what they think, and they have an economic subcommittee of 10 people, many of the very strong, forceful people on the Governing Council. I was Ambassador Bremer's representative to work over these issues with that subcommittee, and we spent three long meetings working on the matter. They very much made it their own. They were working on drafts, they took out things, they put things in. There were lots of discussions. And the speech that the Finance Minister made in Dubai at the World Bank meeting was, in my judgment, an Iraqi speech.

It is premature to speculate on how democracy will work in Iraq, of course, but after seeing how these religious groups, the individuals, and groups could work together, I really believe that, if they are given the time and the opportunity, these people can find some common ground.

It is important to keep on focusing on the fact that democratic processes and market forces are mutually supportive, perhaps even necessary in Iraq. The democratic process should foster individual freedom and economic opportunity. Market forces can create widely held resources that give the means for people to avoid arbitrary and exploitive government.

More certainly needs to be done. There needs to be more credit available. That is why the foreign banks can be helpful. There needs to be more loans by the big domestic banks, and the 17 private banks. Iraq needs a competition law to prevent undue concentration. They need a bankruptcy law. They need a number of legal infrastructure changes, and I think those probably will be done.

They also need to continue to cut back on the subsidies. This is one of the more messy things that you do in economic restructuring because there is this balance between disruption of individuals' lives versus the need to cut back on the subsidies. This is not one decision. It will be hundreds of decisions as time goes on.

The point is, though, that World Bank has done a particularly exhaustive job and this conclude that subsidies need to cut back early so that the private sector can have room to grow. The sooner you do that, the earlier you get growth.

One or two quick last comments as to the supplemental which has just been voted here in the Senate, there is no question that the infrastructure is necessary. And as you pointed out in your excellent statement, Senator, the oil money, the \$13 to \$15 billion for next year will basically cover operating expenses of the government. The supplemental looks to deal with extraordinary requirements. And they absolutely are requirements. The expenditures will not only go a long way toward addressing these requirements, but also will create economic activity during a bridge period before growth occurs. We cannot expect substantial real growth soon. There is no evidence that early real growth that occurs in situations like this. The economic activity bridge is very important.

Overall, Senator, I come back to the point I began with, that we can see today, because of what we have been able to achieve, that what can be. There is a clearer outline, a clearer view of what can be. Certainly, we need the security issues dealt with. But even in

this unstable, uncertain condition, schools are open, health care is delivered, currency is there, and so on.

I believe that this is a historical time. The opportunity is there, and if we can stick to it, we achieve something that a generation from now will be regarded as enormously significant for the region and the world.

Thank you.

Senator HAGEL. Mr. McPherson, thank you very much.

Mr. Malloch Brown.

**STATEMENT OF MARK MALLOCH BROWN
ADMINISTRATOR, UNITED NATIONS
DEVELOPMENT PROGRAMME**

Mr. MALLOCH BROWN. Thank you very much first, Mr. Senator, for the invitation to address this hearing today, and let me just congratulate Peter McPherson for the extraordinary job he has done in Iraq, along with his colleagues in the CPA. I actually think this should be required duty for every university president because they come back and recognize running a university is not such a bad job after all.

But let me start, if I could, with a very obvious point but one which someone such as myself, who worked very hard to try and support the United States and others to make the Madrid Conference a success, believes in profoundly. I should perhaps add, so does my colleague Julia Taft, who is with me and known to you, Senator, I think, from her previous stint at the State Department. But it is something that, nevertheless, I feel I have to say here, which is that all of us in the United Nations profoundly want to see the United States succeed in Iraq. We certainly want to see that for the well-being of the people of Iraq, as it remains the only way to establish a successful, sustainable democracy in the country, that this venture that the United States leads is seen through to a successful conclusion.

But also, those of us in the leadership of the UN feel equally profoundly that the United States must succeed in Iraq for the health of the overall international system, not just for the fight against terrorism, vital though that is, but for broader confidence and faith in the international order of which we are all part.

And in that context, coming out of Madrid, I equally firmly want to say that we in UNDP—but I speak more broadly for the UN when I say this—want to step up our operations in Iraq in support of the reconstruction and rehabilitation of that country, that the reports in the media of our departure are wrong, a bit like the character who reads his obituary in that morning's newspaper and complains he is still very much alive. We strongly believe this about our operations in Iraq.

It is the case that last week in Baghdad, following in August the attack on our own headquarters, two events forced us to call our international staff out for brief consultations. One was the bombing of the Red Cross Headquarters in Iraq, of the International Committee Red Cross and the Federation of Red Cross offices, which, by the way, demonstrated that the attack on the UN had not been because we play a political role in Iraq, as many had suggested,

but because anybody who seeks to bring help and assistance to the Iraqi people at this time is a potential target for these groups.

We did have last week for us, a very troubling independent report on the security arrangements that we had in Iraq since the end of the conflict there, which cast doubt on our own internal procedures for managing risk adequately, and we wanted our people to come out and have frank conversations with us about whether or not we have adequate security arrangements in place.

But the point is we want those conversations because we are going to stay in Iraq and we are going to stay carrying out our mission and taking the risks that we recognize are inherent in that mission.

Let me say that there is a role for the UN in three areas, what you might call the political, humanitarian, and the development and reconstruction. Let me quickly touch on each.

First, the political, has always been in a sense the difficult one for us because the CPA is tasked with the ultimate responsibility for the political evolution of Iraqi political life, the move via elections and a constitution to a sovereign government. We can support that with advice on elections. We can support Iraqis in constitution writing. But there is nothing in the most recent Security Council Resolution 1511 which changes our fundamental view that this is the responsibility of the CPA and we must support them in it, but we are not the prime actors.

Second, on the humanitarian, we have been carrying out, particularly through my colleagues in the World Food Programme, a huge feeding operation. The Iraq that Peter McPherson has described, an Iraq of subsidies not incomes, is one where at least 60 percent of Iraqis were wholly dependent on food rations and all Iraqis to some extent dependent on food rations. Nevertheless, this subsidy-based economy cannot and must not last. Mr. McPherson is entirely right. We have to press for a transformation of the economy where subsidies go down and incomes go up. And we need to get there as quickly as possible. And then the basic wealth of this country, which 25 years ago had a per capita income of \$3,600, a per capita income that has fallen now to only about \$600, won't need a major humanitarian operation. Humanitarian support is a consequence of years of accumulated economic mismanagement, not because the country is poor.

But that then leads us to the third area, which is where I think the major critical intervention of the UN must take place in the coming months and years, and that is in the development/reconstruction area, where obviously to reverse that situation of mismanagement imposing poverty on a naturally rich country needs to be addressed. And my own view is that the conference in Madrid has laid the basic framework for that.

Let me, therefore, start with the \$56 billion, Senator, and is that a realistic assessment of needs. I was at pains in Madrid to remind the other sponsors, organizers, and attendees at the conference that \$56 billion was not what we or, the United States, felt was needed in grant assistance. It was, rather, what Iraq would spend over the next 4 years on the nonrecurrent capital investment in the reconstruction of the country. In other words, oil income would pay for the recurrent expenditures, as you made clear, but the capital

expenditures could amount to as much as \$56 billion over the next 4 years.

But it is certainly my view that only a portion of that will come in grant assistance, that as the years pass by, the country will be able to access loans, it will be able to attract foreign direct investment, and its own tax base will grow, therefore, giving it other sources of paying for this.

The need for grant finance is up front, and it is particularly in the year 2004 when it will not be able to access loans because, first, there will still not be an Iraqi Sovereign Government able to access loans from the capital market, or even possibly from the World Bank and the IMF, although that is a point of some debate.

Second, it will have difficulty in attracting foreign direct investment into the oil sector, let alone other sectors of the economy, on any very great scale.

And, third, and critical to those first two goals, it will have enormous difficulty restructuring its debt before there is a Sovereign Iraqi Government.

So, for my mind, there have always been two phases to the next few years. There is the immediate phase where the Governing Council, under the CPA, can manage in a relatively short-term way and introduce major early steps toward liberalizing the economy, but is unable to do the big irreversible steps of restructuring, such as privatizing assets or restructuring debt, until it has transitioned into a sovereign government. Once it does so, it will be able to access, as I say, foreign direct investment, loans, other sources of capital, and not be solely dependent on grants.

Our view is that of the \$56 billion, a significant portion is grants, but much of that is front-ended into the first year or so, which brings me to the question—whether or not we should be angry with the non-U.S. donors for providing such a large proportion of their funds in loans rather than grants.

Let me say I made the case in Madrid that, while for the 4-year period that we were looking at in this funding, 2004 was grants but 2005 to 2007 would have a significant loan portion as well as grant finance in it. I went on to argue that I strongly supported the Administration in its proposal that the \$20 billion be in the form of grants. This is not, Mr. Senator, some European double standard, despite my accent. It is actually because the United States had first promised to put its money up front to, in a sense, be financing this early period when loans are not so practical. But also, I think it goes with the whole nature of the U.S. role, that the already difficult relations between the United States and many segments of Iraqi public opinion would be further complicated if suddenly what appeared to be a grant became a tied loan. And I think it would have all kinds of consequences to make the political situation harder to manage for the United States in the immediate short- and medium-term.

Ultimately, therefore, on the \$56 billion, let me, therefore, again conclude that by saying that, yes, I think it is what will be spent in Iraq over the next 4 years in the same way, if you look back over your shoulder and said how much was spent in many Eastern European countries, Poland or Hungary, for example, over the early years after 1989. Looking back, this amount was spent. But it cer-

tainly was not all spent out of grant finance from the United States or its European allies. As an estimate of spending, it is realistic. As an estimate of grant resources over the next few years, I think it is misleading.

Having said that, let me just very quickly make two further points. One, how in this security situation will the UN carry out our role of supporting Iraq in its reconstruction? We are very lucky. We have 4,000 national staff operating in the country, many of them highly skilled. They have been the human capital of our operation there for many years. We started development operations in Iraq 40 years ago, and we have been running humanitarian operations for the last 20 years. So we have not only a very experienced staff, but also an extraordinary network of National partners now playing leading roles at the technical level in National ministries, and also in the municipalities and in the emerging civil society. So we feel we have ways of mobilizing Iraqi partners to work with us, and, of course, with the CPA.

Two, we believe that we can do this with a light international presence. We have to be very prudent with the number of international staff we have there. We have to recognize that every person we put there is an individual at risk in this current security situation. So we will be careful about those we put there, and we will make sure we have adequate security arrangements to manage the risk for those who are there. And we will extensively support them with back-up operations from Amman, Jordan; Larnaca, Cyprus; and from Kuwait City. This is the model that we had to use during the Taliban years in Afghanistan, where we had a small international presence in Kabul, but supported it from Islamabad; or that we use today for Somalia where the majority of our operations are not in Mogadishu but in Nairobi, Kenya. It is not ideal. It is not the way one wants to work. But we have to manage this vis-à-vis the risk of kidnapping and armed attack.

Let me finally just suggest two longer-term lessons from all of this. The first is obviously American public opinion has been shocked by the \$87 billion figure, and perhaps within that, for the \$20 billion for reconstruction. It is a very high sticker price, and I think many people have been dismayed by it. It is worth, though, putting it in context. Iraq, it is estimated, needs to spend \$56 billion over the next 4 years. If that indeed had been grant money, which many in the media read it to be, that would be more than we spent in grant money for Africa over the last 4 years, where we spent as a global community, not just the United States but all donors combined, about \$50 billion. Africa is a region with 25 times the population of Iraq. Does that mean we are spending too much in Iraq or too little in Africa? And it may not surprise you that I would argue we are spending too little in Africa.

We believe we could achieve the Millennium Development Goals around the world of halving poverty, getting every boy and girl into school globally, if the United States contributed \$25 billion a year. In other words, a little bit more than Iraq for the whole world as a contribution to a \$75 billion annual spend by all donors toward achieving those goals.

Maybe we should be expecting the next President, in his State of the Union address in 2005, be it President Bush or a Democratic

successor, to be calling for \$25 billion for the rest of the world to achieve the Millennium Development Goals because, as I say, it is not that we think the Iraq figure is big. We think the rest of the world is small.

Let me make one other final observation, which is that I think this operation, the extraordinary leadership of Mr. Bremer, Peter McPherson, and others in the CPA, has perhaps demonstrated to them, as I think it has to us outside, that we need a standing international capacity for peace building at times like this. It is easier, whether you are France in Cote d'Ivoire or the United States in Iraq, to be able to rely on multilateral partners to undertake many of these tasks, everything from demobilization to early justice systems and constitutions, to delivering basic services such as health care or education. Throughout these sets of tasks, a neutral multilateral partner is a much easier way to deliver it than through the same power force to provide the military arrangement in such a situation.

Why not through the leadership of the United States, for what we are learning here in Iraq, support the creation of this stand-by multilateral capacity, probably centered on the UN and the World Bank, to be able to provide this support not just on a case-by-case basis, but whenever an Iraq or a Cote d'Ivoire or a Liberia or an East Timor emerges, that we have the money and the resources to step in and the lessons learned and the experience to do it right each time.

Thank you very much.

Senator HAGEL. Mr. Malloch Brown, thank you.

Senator Bayh, why don't I begin the questions, and we will go back and forth, maybe 7 minutes each, and that way they won't get bored with either one of us too much.

Senator BAYH. Let's hope.

Senator HAGEL. Let's hope.

Mr. McPherson, you mentioned the CPA decisionmaking process and the critical nature of that. In your testimony, you went into some detail as to how it affected what you were doing and how you were part of that. And you mentioned the Governing Council, and you noted the diversity of the council, among other observations.

Tell us in your opinion how much authority is actually being exercised by the Governing Council in the economic sector. What, in fact, are they doing? Are they monthly taking on more and more responsibility for the economy decisionmaking?

Mr. MCPHERSON. I am certain that the economic reform package would not have gone forth if they had not agreed. And they not only agreed, but there were significant components of it which they either modified or they put in.

The cabinet members, for example, the Minister of Finance, and the central bank president, were their decisions. Bremer approved them, acted upon them, but they were names initiated by them. They weren't names initiated by the CPA.

As to the trade bank, it is very clear to me they are making the critical decisions in the final stages. And my colleague George Wolf said to me today, "Peter, their role continues to accelerate in the weeks after."

The Governing Council feels to me like a legislative body with the CPA being an executive body. It is not quite that way because the Council have initiated, for example, the names for the central bank and the Finance Minister, so it is a hybrid. My work with the Council felt like, when I was in the Administration in the Reagan years, coming here with some smallish group of a committee and working out some key issues.

Senator HAGEL. So as the Finance Minister's role becomes more apparent in decisionmaking as the banking structure starts to develop with leadership in each bank, those decisionmaking elements will be transferred, and I assume much of this is being placed in the acceleration of that decisionmaking by the Iraqis themselves.

Mr. MCPHERSON. Absolutely. In my AID days, I worked all over the world, and in a few countries I felt they waited for you to tell them what to do or at least to tell them what you thought. By the time I left Iraq, I did not feel that at all. There are, of course, intelligent people all over the world, but in Iraq there are many very educated people, and in some cases quite sophisticated. They are more and more assertive. I see this to be an advantage.

Senator HAGEL. What industries or economic sectors would you point out that represent the best possibilities for jobs, opportunities, exports in the near-term for Iraq, other than oil?

Mr. MCPHERSON. I think that has to shake out. I have thought a lot about that. Agriculture has to play a role, though there are major reforms that are going to be necessary there. I believe that a whole range of manufacturing industries certainly can evolve.

Those that have a petroleum component to it would be natural, though petroleum subsidies must be cut back.

There is no reason why there should not be more refineries in the country rather than exporting most of the crude oil. The refineries in the country now are for domestic consumption.

Senator HAGEL. Thank you.

Mr. Malloch Brown, you noted the Madrid conference, which was a very critical point in this long journey to put Iraq back on its feet, and your involvement was critical to the success of that conference. Tell us what we do now to process, to move forward on collecting on the commitments, on those billions of dollars. What has to be done? And how do you do that?

Mr. MALLOCH BROWN. Well, I think they fall into two or perhaps even three categories. The one is the United States, which I do not think the United States needs any advice from me. It is anxious to get that money out into the field and get spending against the priorities that the CPA has established with the Iraqis.

The second two components are the grant monies committed by donors, a lot of which will go through a multilateral trust fund, part of which is managed by my organization, UNDP, on behalf of the UN, and part by the World Bank. And ours will tend to address the quicker, faster disbursing items identified in the needs assessment. The Bank's will be more aimed at the longer-term, slightly bigger projects. Both, however, will require some quick work with the Iraqis to determine first priorities.

The third component is the lending program, which, as I say, I think you know, there will be a lot of planning for it and perhaps some early mixed grant-loans. The World Bank has so-called blend

monies which are part grant, part loans, which may start this coming year. But the majority of the loans which are from the World Bank and the IMF, the only other big loan provider at this stage is Japan, and I should add, some export loans from the Gulf. But all of those may take a little bit longer to come online.

The key final challenge is just to link the spending priorities of this multilateral effort with the United States' priorities, to make sure that we are not falling over each other, that the thing is done in close coordination and that we have set up or proposed, at least, a basic coordination structure so that we can see what the United States is spending out of the so-called development fund and supplement it rather than repeat it in terms of the use of this multilateral fund.

Senator HAGEL. Thank you.

Senator Bayh.

Senator BAYH. Thank you, gentlemen. I am sorry I had to step out to take a phone call during your testimony.

Let me begin by something I mentioned in my own opening comments about debt relief on the part of the other nations. Either one of you, I would be interested in your views, Mr. Malloch Brown, perhaps beginning with you. I was deeply disappointed to see that coming out of Madrid, other than the \$231 million, I think, from the European Union, which is fairly *de minimis*, the French were good for nothing, the Germans were good for nothing, the Russians were good for nothing. Having played no role in liberating the Iraqi people, in good conscience the least they can do is to relieve the debts that they extended to the regime of Saddam Hussein to prop up his dictatorship.

When do you expect that they will do that?

Mr. MALLOCH BROWN. I think, Senator, there was actually a clear strategic decision by the organizers of the Conference to make sure that did not mutate into being a debt relief conference, because there was a fear that then there wouldn't be the fresh, up-front cash needed for the immediate needs of the people.

Senator BAYH. How much fresh, up-front cash was there, not including the loans?

Mr. MALLOCH BROWN. There was about \$3.5 billion of up-front cash for this coming—most of it concentrated in the next year, 2004.

Senator BAYH. The strategic decision does not seem to have worked terribly well if it only generated \$3.5 billion.

Mr. MALLOCH BROWN. Well, it depends what we think Iraq can spend in 2004. My own view is that the United States by saying it is going to spend perhaps half of its \$20 billion in 2004, combined with this \$3.6 billion, which, you are quite right, is much less than the usual burden-sharing proportion where you would expect something like a 3:1 ratio. Nevertheless, that is probably as much as Iraq can absorb next year.

Senator BAYH. When do you expect the debt relief decisions to be addressed? And what result do you think we can anticipate?

Mr. MALLOCH BROWN. First there is the debt moratorium until the end of 2004, and the earlier Security Council resolution said no debt relief—I mean, no debt payments to any debtors until we can get this sorted out. The French have made it clear that the Paris

Club, which is the basic forum for this type of debt meeting, should now, you know, come together quickly and start working through this debt. And they were at pains to come and see me at Madrid, and I imagine they went to see the United States as well, to say, look, you know, we plan to help on the debt side, and I think all the debtors seemed to be in the same room on this. So, I think the next stage debt relief, in other words.

Senator BAYH. How much of a haircut do you expect that they could be willing to take?

Mr. MALLOCH BROWN. They should take a big one. Everybody should take a big one. When you are talking debt of something between \$120 and \$200 billion, depending how you count it and how you treat reparations, against a GDP per year at the moment estimated by the IMF at \$15 billion, you have got a debt ratio overhand 10 times the size of GDP. There is no other country in the world which comes close.

Senator BAYH. How do we define "big?" It is my understanding the Argentines are insisting upon a 75- to 90-percent haircut?

Mr. MALLOCH BROWN. Let me just say, I mean, there are two things about big. First, is it a haircut or the head severed off from the body? And there is a critical point of difference here because, you know, the IMF and others are very worried that there not be such an odious debt solution which says all of this debt should be wiped off because of the manner in which it was incurred—dictator spending it on things which did not benefit the people.

The fear is that if you went that route, where does it stop? Which country could not at some point in its history claim the same things?

There is a view that you have to try and do this within the normal debt parameters; in other words, it is relief but it does not treat Iraq as completely *sui generis*, because very quickly you would have countries, whether, say President Mobutu of Zaire, others who could come back and make a similar argument about their debt.

Senator BAYH. Let me ask a couple of questions about that. As I understand it, is it their point of view that the Provisional Authority is not the sovereign—I think you alluded to this—sovereign entity capable of taking on debt? Is that their position?

Mr. MALLOCH BROWN. It is not that it cannot take on debt. It is not clear that it can restructure debt for the future because a future debt restructuring is something that successor governments have to respect. In other words, if you say, instead of paying 100 percent, you are going to agree to pay 20 percent, but you are going to pay that 20 percent, and it is very important that the Iraqi authority, which enters into that commitment can commit its successes.

And there is a view that you cannot do that until you have an Iraqi Sovereign Government, just as it would be hard for the CPA to offer an oil concession of 10 or 20 years to an oil company because could it bind its successors to honor that concession?

Senator BAYH. Could Saddam Hussein bind his successors? Was he the duly constituted Sovereign Government of Iraq? Who was he elected by?

Mr. MALLOCH BROWN. I am afraid he was because, and I think it is a tragedy that he was allowed to stay in office for as long as he did, but the fact is that the countries of Africa are being made to repay debt which was incurred by dictators over many years. Either we decide that democracy is the basis of legitimate debt and any debt incurred by a Communist Government, a military dictator, is therefore eligible to be written off.

Many of us in the development community would love to go that route, but I think you should just pause and think of the consequences to the international financial system of a situation where a Government which incurs debt, that its successors are not bound to be responsible for that debt. It would undermine the whole premise of the international borrowing system.

Senator BAYH. I am not sure I agree with that, but I understand your point of view.

Mr. MCPHERSON. Let me get into this. This is a subject which I have thought about for years. My first job at Bank of America after I left the U.S. Treasury was, in fact, to run their bad debt portfolio, then largely Latin American.

I think you can get largely where you wish to go within conventional procedures. I really do. I believe that there needs to be very, very substantial debt reduction by the international creditor community for Iraq. I have talked to Ambassador Bremer about this numerous times probably and he agrees.

I believe you do not want to repudiate the debt because it is going to make it harder to borrow after that under international creditor conventions.

Senator BAYH. I have exceeded my time, and I do not want to intrude on the Chairman's time. Mr. McPherson, correct me if I am wrong, did Argentina not walk away from its sovereign debt?

Mr. MCPHERSON. But let us see how much credit and at what cost they are going to get in the future.

Senator BAYH. And within 48 hours was rewarded by a new agreement with the International Monetary Fund?

Mr. MCPHERSON. They have not gone to the international creditor community yet, though. It is a stigma to repudiate debt. If you, thereafter go to the bond or the bank market, the stigma will be hard to overcome.

Senator, you do have to take your position to get substantial debt reduction.

Senator BAYH. I missed your—

Mr. MCPHERSON. —you do not have to take the position to repudiate debt in order to have restructured debt that is very deep.

Senator BAYH. I understand your point, but it seems to me you do business with murderous dictators, you run the risk of a future democracy choosing to repudiate the debt.

Mr. MCPHERSON. Well, my hope is the international community will understand—

Senator BAYH. That is a risk, as a creditor, you assume.

Mr. MCPHERSON. My hope is the international community will now recognize that this debt is what it is, and there should be huge reduction to it within normal procedures. I think that is very possible.

And by the way, I believe, now, I speak as an individual today, not as a representative of the U.S. Government, but I think the reparations should be largely or wholly forgiven.

The Kuwaitis and the other people in the region, but the Kuwaitis particularly, need to understand that as a tiny country next to this huge country that the last thing they want to do is to try to insist upon payment when, in fact, they have got generations ahead of them, as neighbors. The Kuwaitis have done more than they have been given credit for. They have not been dramatic enough about it. It is my view forgiving those reparations would be a historical and important step, and I hope they do it.

Senator BAYH. I agree with that strongly. I would just conclude by saying we have stepped forward here trying to do the right thing. What the Iraqi people need is a fresh start. The reason for my line of inquiry is I think we should do whatever we can to try and alleviate as much of this debt burden as humanly possible, to allow them to get on with the future development of the country, rather than paying for the sins of the past, and it is going to be difficult.

Mr. MCPHERSON. And the Russians need to provide deep debt reduction.

Senator BAYH. I agree with that, I am not holding my breath, but I hope to share your optimism, Mr. McPherson.

And thank you, gentlemen, both of you.

Mr. Chairman, I apologize for running on here.

Senator HAGEL. Senator Bayh, thank you.

Staying on the debt issue for a moment, what range of debt reduction do you think is possible? I would like to hear from both of you.

Mr. MALLOCH BROWN. Well, perhaps, I would just say, because I must say I find myself in a completely unaccustomed position having to defend debt because I am completely with you, Senator Bayh. In fact, I am going to get a medal of sound financial—

[Laughter.]

Because all of my instincts are on your side for a massive write-down, but just to give you a sense what I think can be achieved under best current practice, under the HIPC initiative for poor countries, the governing principle is that a poor country can afford to service a debt which is something like one-and-a-half times its GDP. The current debt of Iraq is 10 to 15 times its GDP. So, for me, if I was advising the Iraqi negotiators, my starting point would be to reduce the annual service and to reduce the volume to something close to that HIPC level. So we are talking a real hair cut.

And I think if you cannot get there, then, frankly, countries which incurred their portion of the credit, I mean, became creditors because they were supporting Saddam Hussein during the particularly gruesome periods of his rule are going to find themselves subject to probably unilateral write-off because I do not think they will have the sympathy of the international community. Some of those countries are not themselves likely to be major extenders of future credit, so it would not necessarily, have the punitive effect that Peter refers to in the case of Argentina.

So, I think there will be a huge pressure for rapid, dramatic debt reduction, even under conventional procedures.

Senator HAGEL. Thank you.

Peter.

Mr. MCPHERSON. Someone was telling me the other day that the Iraqi secondary debt market was about 21 cents on the dollar of debt and interest, and I said I would not buy it.

There will be a lot of push-and-shove between here and there, but I think the parallel we should think about on this is Versailles, 1919. France particularly at Versailles, insisted upon huge reparations, a big burden on Germany. It was not the only reason Hitler came to power, but it certainly helped him.

And the Kuwaitis with their reparations and the world community needs to see, okay, it is impossible to pay debt the next few years in any large amount. The usual inclination of bankers, and I have been a banker, will be to say, "All right so you are not paying a few years, let's push it off and pay later."

But, if we are having Iraqis pay for Saddam 25 years from now in a big way, that is a geopolitical mistake. We did not go into Iraq to make money. We did it for a whole set of reasons, and we need to come out of this with an Iraq that has something of a democracy, a stable economy, including a debt structure which is realistic and which the people will see as realistic. I would not buy debt at 21 cents on the dollar.

Senator HAGEL. Thank you. Would you describe the intent and what you think will be the short-term impact of the 100-percent foreign ownership law that the governing council approved recently.

Mr. MCPHERSON. I think there is some regional interest, for example, some regional banks. If, in fact, as the security situation gets under control, there will be great global interest. There were companies from all over the world that were inquiring about Iraq even before the law, but it will take foreign investment, especially investment outside the region, will take a little time. It always does. By the way, the tax and tariff measures involved here are very important as well.

Senator HAGEL. Thank you.

The tax-tariff measure issues you just mentioned, and you mentioned during your testimony, the 15-percent flat tax—

Mr. MCPHERSON. Actually, the top marginal rate is 15 percent. So, below that, including some people of low incomes that will not pay income taxes. The details are to be worked out. However, the law now provides that the top marginal tax rate will be no more than 15 percent.

As it is not only what rate you pay that is on the books, but also the compliance. The prior rate was like 45 percent. Most did not say that. It is important that you have a rate low enough so most people do pay, and I think 15 percent will work, as well as in my judgment it is important for growth.

Senator HAGEL. What structurally, institutionally is being put in place in order to assure that compliance?

Mr. MCPHERSON. The Ministry of Finance is responsible for tax collection. There is a unit within the Ministry, not separate. The whole tax code is being reworked, and the compliance and collection structure being restructured. There is a huge push to get this done because a new tax rate is effective January 1, 2004.

Senator HAGEL. Thank you.

Mr. Brown, you mentioned some of the past experiences you have had, the United Nations has had, that we are applying to Iraq reconstruction and economic growth development. Each is different, we all understand that, each situation. What lessons would you note that we have learned as we are working our way along in Iraq from donor projects in Afghanistan, East Timor, and Bosnia? Is there anything we can draw from those experiences and apply to Iraq?

Mr. MALLOCH BROWN. Of course, in Afghanistan, a big complaint was, and remains, that there is not an adequate international security force to keep the peace across the country. Whatever the difficulties the United States is having, it is enormously important that there is that nationwide coalition force keeping the peace. It is hard to imagine how much more difficult the situation would be if it was not there. I think what is often criticized is nevertheless a basic of peace-building, that the peace is kept, even if it is proving difficult in the case of Iraq.

I also think it is fair to say—it has been much commented on in the press—that the general experience of peace-building is it is very imprudent to demobilize the army of the defeated power without a strategy for reintegrating it effectively into civilian life and without a strategy for jobs and well-being for soldiers and their families in the interim.

Another lesson that I think we are learning is the enormous importance of a clear political time table, which everybody understands, every Iraqi, whatever their political position, the international community, the CPA, the governing council, that there is a clear blueprint with a timeline on the process to be followed.

Constantly, the name Mountbatten rings in the back of my mind because when Mountbatten was sent to India at the end of the second World War, he made one quick snap decision: Let us do this quickly. It will only get worse the longer we take.

I think, as I watch events in Iraq, I would urge my friends in the United States to really think about how this process can be accelerated as rapidly as possible, obviously, without a loss of control because the quicker you have Iraqis empowered to make decisions for Iraqis, the quicker there is the potentially stable base for easing the political violence which is so difficult at the moment.

Senator HAGEL. Thank you.

Peter, would you want to comment on any of this?

Mr. MCPHERSON. Well, I would not want to engage too extensively with my British colleague on Mountbatten's decision in 1949, but I am not sure everybody would agree with this being a good case study on making quick decisions on new governments in India and Pakistan.

No, I am fine. Thank you.

Senator HAGEL. Now, remember, Peter, you do not represent a government. You speak for yourself, so that gives you some latitude here.

The Arab countries' assistance to Iraq, I do not know what measurement or standard we went into the Madrid Conference with regarding the Arab Nations as to what we expected or a range of expectations, but I suspect there was some sense of disappointment

around that we did not see more financial commitment from the Arab countries.

Are you aware of any specific effort the United Nations is undertaking to try to engage other Arab Nations to get them more directly involved in helping reconstruct Iraq?

Mr. MALLOCH BROWN. First, I think you are right. I think there was disappointment that there was not more funds pledged from the region at Madrid, Senator.

Second, my late colleague, Sergio Vieira de Mello, probably one of the most significant contributions he made as the Secretary General's Special Representative in Iraq, was to try and get the region involved. He had just, at the time of his assassination, completed a round of meetings with visits to the regional capitals, both looking for their financial support, but frankly even more their political endorsement of the political process in Iraq, recognition of the Governing Council, the participation of the Governing Council in regional political meetings, all of which are the other side of the coin of financial contributions to reconstruction, and I think he felt that that was moving forward, and I think the United States has tried to keep that momentum subsequently. But there is no escaping the deep ambivalence and skepticism in the region toward what is happening in Iraq.

Senator HAGEL. Thank you.

Peter, do you want to add anything to that?

Mr. MCPHERSON. I think that what is happening in Iraq is likely to have a dramatic impact on the whole region if we are even half-way successful because what we are saying is that we need a democratic process, we need market forces, we need open economies. And my hope is that we will continue and that there will be more and more help from the other countries.

I certainly felt that there was a willingness to keep, for example, in talking to regional central banks for help for our central bank.

By the way, let me get back to the debt for a moment. I absolutely disagree with the idea that the current governmental structure cannot negotiate the sovereign debt. In fact, we cannot take that because it will be excuses to the Russians, French, and these others that they do not have to do debt now. Debt negotiations has to be done reasonably quick. I disagree with the legal position, and I think it is very important for us to say, look, this has to be done now, and we need to move on.

There will be some creditors that will try to claim that they cannot negotiate with this government before there is an election. I, frankly, think any government that does that is hypocritical and does not really want to negotiate.

Senator HAGEL. Well, does that not also apply to loans? I mean, who are you going to sign a loan agreement with?

Mr. MCPHERSON. Yes, countries are going to provide loans. They are going to send loans. There was this huge debate about what the CPA could do. Some people said the CPA should not do the currency. Well, we had to do the currency. Every time we turned around, there was somebody, for example, the French or would say, a proposed action was beyond the authority of the occupying power.

It really does seem odd that Saddam can do anything and find it internationally acceptable, including decide what to buy with the

Oil for Food Program, and the CPA in its best efforts to get things done, would be criticized for taking steps like the currency.

Senator HAGEL. Mr. Brown, do you want to add anything?

Mr. MALLOCH BROWN. Look, the last thing I want to do is pick a fight with Peter on this because I do not want to do anything to disempower the current reform movements in Iraq, and I completely agree with him that we have got to push with economic change now and a lot cannot wait.

The issue on debt is that we do have a moratorium until the end of next year. It gives us time to do it and to allow an Iraqi Government to do it. As we have repeatedly made clear, we think that, like in Afghanistan, you can have a sovereign government before elections. It is the CPA which believes that elections must come first and then a sovereign government. We think that a representative Iraqi body could emerge based on the governing council well before that time which could exercise full sovereignty and complete a debt restructuring.

But, as I say, we have a point of view based on international law, and we know we disagree with the United States on this, but—

Mr. MCPHERSON. But it is really important, Mark, there is a legitimate debate, as to what the CPA can do under the law. But as I say, I always found it a little really odd that Saddam was recognized and some thought his actions to be legitimate sovereign actions, even if they were illegitimate at their very core, and the CPA gets criticized for taking needed steps. I know you are a person, and Julia Taft who is behind us here, worked so very hard to get this needs assessment done. However, I do not think we should let anybody off the hook on prompt negotiations of debt fast.

We wanted to get by the Donor Conference, before we had serious debt negotiations, and now we should move, in my judgment. The longer this goes on, the tougher it is going to be. If we did not have serious negotiations for a year, it will be tougher to get the debt reduction necessary. The calendar is not on the side of the deep reductions required. I believe that.

Mr. MALLOCH BROWN. I mean, there is no doubt that Peter is right, that with debt reduction, the sooner you do it, the better. Strike while the iron is hot.

We are trying to, ourselves, be as flexible as possible. I mean, I think the practical line in the sand is that it is very hard for an occupying power to do things which tie the hands of its sovereign successors indefinitely. The currency arguably did not do that. You could even, in a way, argue that debt restructuring does not because it frees you of future obligations rather than increasing them. So maybe we will find a way around even this, but at the end of the day, you cannot pretend there is not a line there in the sand. You can shuffle it around a bit, move it a bit, but fundamentally a lot of Iraq's international economic relations, its ability to leverage its wealth with new loans and new foreign direct investment, rests on a sovereign government.

And I think the United States equally needs to hear that pressure. If France needs to hear that it needs to do a good debt deal and soon, the United States needs to hear that the sooner there is a Sovereign Government in Iraq, the easier a lot of this is going to become.

Senator HAGEL. Well, I think we have gotten the point.

[Laughter.]

Thank you very much.

I am not going to keep either of you here much longer, but—

Mr. MCPHERSON. It is a good thing we are such good friends.

[Laughter.]

Senator HAGEL. This, actually, you remember your old days up here, Peter, when you used to testify, this actually is rather timid and serene compared to some of it.

The U.N. Oil for Food Program, where are we with all of that?

Mr. MCPHERSON. The Oil for Food Program ends, has ended, in the sense no more money is going into it. The oil proceeds are going into the new account. There is still a substantial amount of goods purchased from the old program and they are in arriving. The old program is a vast structure, and I do not know all the details.

A very important part of the Oil for Food Program was the delivery of food, some 60 percent of the people depending almost totally for their food on program. There is enough food purchased in the pipeline to go through this spring.

The Trade Bank was set up to pick up the slack for new purchases out of the new oil money.

The Oil for Food Program is beyond the scope of this hearing, but a good audit would be appropriate.

Senator HAGEL. I heard your comment.

Mr. Malloch Brown.

Mr. MALLOCH BROWN. Well, Peter is being, knowing his views on this program, very gracious. But let me just say that this is a program which was micromanaged by one man and one committee. The one man was Saddam Hussein, who was only restricted in the areas of the country he controlled, by the fact that we had to ensure that what he ordered was actually delivered, but the price he paid for goods and the countries from which he procured them were his decisions to make.

The approval of the lists of goods he could procure and the detailed management of the program was in the hands of a committee at the UN, a committee at the Security Council, called the 661 Committee, of which the United States was an extremely active participant.

And I think the whole program was a reflection of a lousy, terrible moment in international affairs, where a clean-cut decision would have led to Saddam Hussein's much earlier removal from power, either by the hands of the Iraqi people or of the international community.

But absent that and a lot of cynicism surrounding it, the program reflects an effort to square the circle of how on earth you sought to put some control over the procurement activities of a corrupt leader who was still in power, and it was undoubtedly not the perfect solution. But I think for all of us it was the best effort we could make under impossible circumstances.

Mr. MCPHERSON. I wish the United Nations, several years ago, had said, enough is enough. We are not going to stand for this any more. I mean, the United Nations, good people, worked hard at it—a committee of, what, 15 people. The British and the United States were, by far, the most concerned.

If historical lessons are here, one of them is that the UN should have said we are not going to be part of such situation as this became.

Mr. MALLOCH BROWN. Yes. I think it is just worth saying, it is not 15 people, it is 15 governments of Security Council members which approved every contract. My own view is the governments should have said, enough is enough. This system does not work.

Mr. MCPHERSON. The United States and the United Kingdom did, vigorously again, and again, and again. It is a matter that, sitting over there and being in the middle of this, I became interested in it. We are where we are, and it is good for everybody money is now going to the new fund.

Senator HAGEL. Well, gentlemen, that is a good, constructive way to end the hearing.

Julia Taft, nice to see you. Thank you for your good work. We appreciate always what you are doing for our country.

Unless you have additional comments, we are grateful, as always, and we may call upon you again soon.

Mr. MCPHERSON. Keep probing.

Senator HAGEL. This hearing is adjourned.

[Whereupon, at 4:05 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF M. PETER McPHERSON

FORMER DIRECTOR OF ECONOMIC DEVELOPMENT
 COALITION PROVISIONAL AUTHORITY IN IRAQ
 PRESIDENT, MICHIGAN STATE UNIVERSITY

NOVEMBER 4, 2003

I recently came back from about 5 months in Iraq, serving as CPA Administrator Bremer's Economic Adviser. Security certainly is critical for longer-term success for Iraq. The progress with the economy as well with schools healthcare and other areas puts in stark relief what is at stake. The people of Iraq and the region can have a country that really works.

A foundation for a revolutionized economy is being put in place in Iraq. This new economy will challenge the economic policies and the politics of the whole region. From first-hand observation, I know it is an imperfect world there, often messy, but progress is real. Americans will see it over time, once the terrorists are held at bay.

You can see and feel progress from month to month. These stories of progress have been swept off the front page by coverage of the violence against democracy and reform. They represent significant building blocks for a country that works for all people of Iraq.

In June, we started paying 1.3 million government employees. This was a real accomplishment considering that our first steps were to find out who the employees were and then to deliver the cash all over the country. In July, another milestone was reached when a new Iraqi currency was announced. The swap of the old for the new started throughout the country on October 15. The 2003 and 2004 budget was developed for the national government, put together by a CPA team and Iraqis. They started out with almost no budget information, no surprise since Saddam's budget prewar was a state secret.

Banks were all closed just a few months ago, but now almost all are open. Checks are being cashed and some small loans are being extended. Shops on the street are busy. Electricity production is at prewar levels and oil production is up substantially. A few weeks ago, sweeping economic reforms unlike any in the Middle East were announced by the finance minister.

Iraq wants jobs. The Iraqis concluded that an open economy would, in time, bring the investment to help create the jobs. The World Bank told Iraqis that in 2002, the Middle East attracted only \$4 billion in foreign investment as opposed to \$7 billion in Sub-Saharan Africa and approximately \$42 billion in Latin America.

However, Iraq cannot borrow its way into prosperity. It needs investment. The plan is to provide an edge in the global and domestic competition for investment. A new law allows for foreign investment up to 100 percent of foreign ownership, full repatriation of investment and profits, national treatment and no screening committee. Six foreign banks can come into the country and take deposits immediately. There will be a fast track admission for two of these banks, looking to early and substantial loans by those banks. Several banks are showing interest.

The top bracket for individual and corporate taxes will be 15 percent. Low rates will make it possible to collect the taxes and will encourage investment. Tariffs are to be at a flat rate of 5 percent, with the exception of food, medicine, and a few other items with tariffs at zero.

These proposals were approved by the Governing Council, a very diverse and independent minded group. As Bremer's representative to the Economic Committee of the Governing Council, I worked closely with this group on various drafts of economic policy proposals for hours at a time. The meetings had the collaborative and democratic feel of an executive session of a legislative committee.

It is premature to speculate on how democracy will work in Iraq. However, from seeing the process of agreeing to economic reform, I see great potential. Religious groups and individuals can work together if they are given enough time and opportunity. A democratic process and market forces are mutually supportive perhaps both are necessary in Iraq. A democratic process should foster individual freedom and economic opportunity. Market forces can create widely held resources that give the means to avoid an arbitrary and exploitative government.

More certainly needs to be done. More credit needs to be made available through local and foreign banks, including to Iraqis who will need assistance to compete with or be part of foreign investments. Iraq needs a competition law to prevent undue concentration of economic power and several other legal changes are necessary.

Also there is a need to continue to cut back on subsidies to government-owned companies and give the private sector room to grow. The World Bank has carefully studied post-war and post-communist transition economies. Those studies make it clear that the sooner subsidies are reduced the quicker an economic recovery.

In any case, historic progress can be made on these matters. However, it will take time. Studies show that substantial economic growth occurs in post-transition economies over extended time periods. We can expect difficulty for a while in Iraq. There will be controversy. It is in the nature of change. A strong safety net for the poor, of course, must continue to be in place during this period of change.

The supplemental appropriations bill before Congress is important. It includes \$15 billion for infrastructure. The infrastructure was nearly destroyed by lack of maintenance for a generation, the war itself, and the looting afterward. The infrastructure is critical for the economic recovery. For example, more electricity is central to economic production. Construction of the infrastructure and other needed expenditures will help spur economic activity. This activity will help to sustain political will in the country and allow time for the economic changes required to bring about economic growth that benefits the Iraqi people.

Change will not be easy, but the impact of an open economy, paired with some type of democratic process in Iraq, will change the lives of the Iraqi people and impact the whole region.

PREPARED STATEMENT OF MARK MALLOCH BROWN
ADMINISTRATOR, UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP)

NOVEMBER 4, 2003

Mr. chairman, excellencies, honored guests, as Secretary-General Kofi Annan observed yesterday, we are gathered here for a proud purpose: To help the people of Iraq build the democratic and prosperous nation that has been denied to them through years of brutal dictatorship.

The Needs Assessment, prepared under the leadership of the United Nations and the World Bank, tells the story of a country brought down from a per capita income of \$3,600 25 years ago, to less than \$600 today; from a per student education expenditure of \$620 to \$47. In short, a nation whose collapse is written in its social indicators as well as in the violence on some of its streets.

How do we help its people put their country back together again? As we have gathered here, the media headlines have screamed an answer: "Give them \$56 billion over the next 4 years," together with a preemptive verdict on our Conference. "Bet you won't raise that much!"

This is a sum that happens to be rather more than the world gave sub-Saharan Africa over the last 4 years, a region with a population some 25 times bigger than Iraq's.

Why \$56 billion? Because it is the combined sum of the UN/World Bank Needs Assessment and the additional sectors, notably oil and security, covered by a Coalition Provisional Authority (CPA).

And yes, there is no doubt that Iraq needs a capital injection of this scale. But we made it clear in the Needs Assessment, and "the Assessment notes that the \$36 billion (in addition to the \$20 billion that was assessed separately by the CPA) is not the same as the financing gap; that is, not all of the identified needs may require external donor assistance. It is expected that, over time, investment will be increasingly covered by Iraqi Government revenues or private sector financing, thereby diminishing the needs for donor support."

Let me spell out clearly what, at least this author, meant by those words: First, in 2004, Iraq and its Governing Council will be totally dependent on donor grant financing for almost everything above its day-to-day costs, which will be met from oil revenue. We estimated for our sectors, not the CPA's, that \$9 billion would ideally be needed for the first year, but warned that a realistic implementation rate, given the insecurity and our more general post-conflict experience, was that perhaps only \$5 billion of that could actually be implemented in 2004. So the grant finance needs for 2004, particularly when the CPA sectors are added in, are considerable, but not beyond the reach of this Conference.

Second, after 2004, for the years 2005-2007, the financing mix must change, as a grant finance effort alone would surely be an unsustainable distortion of aid flows from poor countries and other crises.

I think we could meet both of these benchmarks today, a strong grant package for 2004; and the elements of a mixed financing model thereafter. If there had been a Madrid Conference in 1989 for Eastern Europe and a UN/World Bank Needs Assessment, the participants would have had sticker shock. But with hindsight, the transition was carried out by the markets. If the political track of Iraqi Sovereign Government is aggressively pursued in 2004, we can indeed look to a more creative

financing package for 2005–2007. Then imagine what full progress toward Iraqi Sovereign Government by the end of 2004 would allow. In our Iraqi colleagues here with us we have seen the promise of the new leadership.

- Iraq could enter into negotiations with the Paris Club and other creditors to renegotiate the debt overhang, which at more than four time GDP, stifles, even concessional, lending.
- Liberalization of the economy including the disposal of state assets.
- A new foreign investment framework, particularly for the oil sector, that will be respected and honoured by future governments.
- An easing of the internal tensions that feed the instability and violence that are impeding reconstruction and deterring foreign investment.
- Above all Iraq, as the Iraqi delegation today has already been so effectively doing, would take full leadership and ownership of the development and reconstruction effort.

Together, these steps by an Iraqi Government enjoying full domestic and international legitimacy can convert Iraq quickly from a land of subsidies and state control to one of rising incomes and market opportunity. In doing so, it will herald in the kind of mix of financing that transformed the countries that emerged in 1989 from behind the Berlin Wall. Yes, grant finance counted, but even more, technical assistance and capacity building to adjust to a modern market economy and a global economy beyond; and a growing flow of initially concessional finance increasingly supplemented by foreign direct investment portfolio, and bond flows as well as domestic savings. That is not aid alone. It is Iraq's future. And we have to reach for it boldly and urgently together.

By promoting loans as part of the solution I do not want to be misunderstood. I am aware that in the capital of the most generous donor today, the United States, a debate has raged about grants versus loans to Iraq. Let me side with the Administration that has insisted its assistance be grants. For the United States, to convert its generosity to a tied loan would surely risk terrible resentment and opposition in Iraq in today's circumstances.

The economic transformation that Iraq now faces will be dislocating and very painful for many groups. We must therefore be ready.

- Through UNICEF, WHO, the World Bank and others, we must assist in maintaining and improving basic services and target support to vulnerable groups.
- Unless the security sector is effectively addressed, any reconstruction programme is jeopardized.
- The governance technical assistance and capacity building that UNDP and others specialize in is vital, we believe, to creating the honest, transparent policy and institutional environment in which the new economics and politics of Iraq can flourish.
- The multidonor facility with a common governance structure and two fund windows, a UN and a World Bank one, offers donors real options for spending in coordinated, but segregated mechanisms, parallel to the Development Fund for Iraq. We see our UN window providing flexible, fast implementation arrangements to meet the grant needs for 2004, as well as longer-term technical assistance requirements.

Through the UN system, our experienced international and 4,000 Iraqi national staff, and our 20 years of partnership with Iraqi national and municipal officials and civil society leaders, we believe we can innovate implementation arrangements which will be effective even in today's difficult security environment.

We all have hopes for Iraq. Many of my UN colleagues were at the Canal Hotel discussing this Needs Assessment when the office was bombed on August 19. So for us in the UN, this is a particularly precious piece of work; but so is our relationship with Iraq. We have known you through war and sanctions, through tragedy on both our sides, to the hope of peace and liberation. From the ashes of the Canal Hotel, we dream of helping you build a new Iraq.

Thank you.

FINANCIAL RECONSTRUCTION IN IRAQ

WEDNESDAY, FEBRUARY 11, 2004

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE AND FINANCE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 1:03 p.m., in room SD-538, Dirksen Senate Office Building, Senator Chuck Hagel (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Good afternoon. This is the third hearing on Economic and Financial Reconstruction in Iraq that we have held in this Subcommittee since last September.

The transition to a stable and democratic Iraq will greatly depend on economic development and job creation. The economic track in Iraq cannot be considered in a vacuum. Iraq's economic reconstruction is directly linked to both security inside Iraq and to the political transition to a new and sovereign Iraqi Government.

The economic reconstruction of Iraq presents a historic opportunity to help chart a new course in Iraq and the greater Middle East. America has invested precious lives, resources, and credibility in Iraq. The long-term strategic interests of America and our international and regional allies depend on getting it right in Iraq.

There is good news in Iraq's economy. Schools and hospitals are reopening, and visitors report increasing economic activity in Baghdad and other Iraqi cities. Iraq's oil sector and infrastructure are beginning to stabilize. And Iraq's public and private banking sectors are being rebuilt. In March, three major foreign banks will begin operating in Iraq. *The New York Times*, on Sunday, February 8, cited a report by The Economist Intelligence Unit which predicted that Iraq's GDP could grow by 25 percent this year, the result of American spending on reconstruction, the recovery of Iraq's oil industry, and increased trade.

However, despite Iraq's potential Iraq's economic reconstruction and stability are far from assured. The assessments last fall of the United Nations/World Bank and the Coalition Provisional Authority estimated capital investment needs for Iraq of \$55.3 billion over the next 4 years. Of that amount, the World Bank identified \$17.5 billion in "immediate" reconstruction needs for 2004. To help meet these needs, the Bush Administration plans to spend \$12.7 billion on Iraq's reconstruction this year.

A report last month by the Congressional Budget Office, "Paying for Iraq's Reconstruction," concluded that projected Iraqi revenues

alone will probably not be sufficient to cover capital investment and reconstruction through 2007. Iraqi oil revenues are likely to cover only recurring Iraqi Government costs, with little remaining for the capital investment required in the UN/World Bank and CPA assessments. The world community, led by the United States, has pledged between \$32 and \$36 billion toward Iraq's reconstruction over the next 4 years.

Iraq's economy will also depend on substantial relief from debt and reparations. This is an absolute priority for our international diplomacy on Iraq. Iraq's debt, not including unresolved or unpaid reparations from the Gulf War, is estimate at \$125 billion. Iraq's budget, and Iraq's international creditworthiness, will be crippled if Iraq's creditors do not agree on substantial debt relief. I am encouraged that former Secretary of State James Baker has undertaken this critical diplomatic mission, and I am optimistic about his progress so far.

The financial and economic reconstruction of Iraq will depend on the development of transparent and accountable institutions of economic governance. The CPA should support concrete steps by Iraq to build strong and transparent regulatory and oversight institutions to assure that Iraq's potential is not again squandered by corruption and mismanagement.

Iraq's economic potential will ultimately be realized by empowering Iraqis. The CPA has budgeted \$184 million for private sector development. But in yesterday's *Washington Post*, Ms. Rend Rahim Francke, the Iraqi Governing Council's Ambassador-designate to the United States, said that the CPA is not doing enough to employ Iraqis. She added that, "jobs for Iraq will create stability and peace . . . and curb terrorism."

The contracting and subcontracting process in Iraq must empower and employ Iraqis. America must set an example with transparent rules and procedures. The Middle East has seen enough deal brokers and "middle men" looking for a piece of the action. The contracting process cannot, in Ms. Francke's words, be "shrouded in mystery."

The Committee looks forward to the testimony of today's witnesses: John Taylor, Under Secretary of the Treasury for International Affairs. Secretary Taylor, welcome. You have been on a fast pace and have come from a meeting, I understand, at the White House, and we appreciate your efforts to be here.

Also included in our witnesses today, E. Anthony Wayne, Assistant Secretary of State for Economic and Business Affairs. Tony, welcome again. And Mr. Gordon West, Acting Assistant Administrator, Bureau for Asia and Near East, U.S. Agency for International Development. Mr. West, welcome.

We are grateful that each of you are here and look forward to your testimony.

Secretary Taylor.

**STATEMENT OF JOHN B. TAYLOR
UNDER SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. DEPARTMENT OF THE TREASURY**

Mr. TAYLOR. Thank you very much, Chairman Hagel, for inviting me back to your Committee to testify about the financial and eco-

conomic reconstruction issues in Iraq. I last testified here in September of last year, and I am happy to say that, coming back, there is much significant progress on the financial front since then, and I welcome the opportunity to be here to report on some of this progress.

Just this last weekend, during the G-7 finance ministers' meeting in Florida, we had an opportunity to hear from the Governor of the Central Bank of Iraq, from the Finance Minister of Iraq, Minister Gailani, about their reform priorities. Both these officials told Secretary Snow, who chaired the meeting, Alan Greenspan, and the other ministers and central bank governors of the G-7 about their plans for sound, market-oriented reforms that will underpin private sector-led growth in Iraq.

In fact, they are already taking actions on these statements. The Iraq Central Bank Governor recently announced several major actions, including the selection of three foreign banks to come in and do business in Iraq; a plan to remove all interest rate controls in the financial sector to free up the financial sector; and the announcement of a new central bank law which will soon be passed through the Governing Council.

My written testimony provides substantially more detail about these important actions, and in these opening remarks I would like to touch on some other important accomplishments during the last few months.

One of the most important accomplishments in our view is the successful introduction of a new currency in Iraq. When I last spoke here in September, I laid out a strategy and some tactics for replacing the old Saddam dinar. At that time, the currency exchange was just about to begin. In fact, it began on October 15, 2003 and finished on January 15, 2004. I am happy to report that this plan was implemented, finished last month right on time, and was an enormous success.

I must say, printing and delivering currency of this magnitude in a short period of time was a huge feat. It required coordination. It required international cooperation in complex logistical efforts. For example, the amount of currency consisted of 27 747 planeloads of currency, printed in seven different locations around the world, including Sri Lanka and Malta, sent in to Baghdad, distributed to 250 exchange sites around the country. Millions of Iraqis came and exchanged those old Saddam dinars and their old Swiss dinars for this brand-new currency.

The Iraqis have not only exchanged their old money for the new, but they have also wholeheartedly embraced the new currency. The notes are much more difficult to counterfeit. There are six denominations rather than the measly two. And, importantly, the value of the currency has increased since its introduction. Now the challenge is to operate a monetary policy to manage this new currency and to provide a stable monetary foundation for the economy.

The Trade Bank of Iraq is another important accomplishment since I testified here in September. As you know, Mr. Chairman, we sent a group of Treasury experts into Iraq last April, soon after the major conflict ended and Saddam fell, to assess the financial situation. They reported on a financial system which had very limited capabilities. For that reason, we decided early on to set up a

Trade Bank in Iraq in order to facilitate imports and exports of urgently needed goods to support Iraq's reconstruction.

When I reported on this initiative in September, it was just under way, so I am happy to report today that the Bank opened on December 4 of last year. It is now fully operational. To date, the Trade Bank has issued over 200 letters of credit worth \$190 million to facilitate the import of important goods into Iraq.

I would like to mention the international debt, which you raised in your introductory remarks, Mr. Chairman. Last September, the G-7 finance ministers committed to resolve this issue by the end of 2004. But we have made significant progress since then. And as you indicated, the indication of the high priority on this issue in the Administration is that President Bush asked former Secretary of State and Treasury James Baker to serve as a special envoy to work with the world's governments at the highest levels and to seek the restructuring of Iraq's official debt.

Over the past 2 months, Secretary Baker has successfully secured commitments from leaders throughout Western Europe, Asia, and the Gulf States to provide at least substantial debt reduction for Iraq this year. Final agreement on the amount and the terms of this reduction will be negotiated between the Iraqi Government and its creditors through the Paris Club during the course of this year.

We are also continuing our efforts to get the best possible data on how much debt Iraq owes. Our estimates now put the total at about \$120 billion, but more information needs to come in.

I would like to also update you on the efforts to mobilize international financial support that has occurred since last September. As you know, last October, Secretary Powell and Secretary Snow led a U.S. delegation to an Iraqi Donors' Conference in Madrid. Seventy-three countries participated in this effort. We succeeded in accumulating \$32 billion of pledges, including the important \$18.4 billion commitment from the United States.

The World Bank had pledged to provide between \$3 billion and \$5 billion of its resources over a 4-year period, and already the World Bank's private sector arm, the IFC, has approved the establishment of a small business loan facility in Iraq. And we are hopeful this facility will be operational by midyear.

The IMF is also laying the groundwork to provide financial support for Iraq. At the Madrid Donors' Conference, the IMF announced that total assistance could range from \$2.5 to \$4.25 billion over a 3-year period. Iraqi finance officials met here in Washington this week with IMF staff subsequent to the meeting with the finance ministers and central bank governors of the G-7 in Florida.

Finally, I am pleased to report that our efforts to persuade governments to transfer assets of the former Iraqi regime back to Iraq, to the Iraqi people, have yielded results. To date, more than 10 countries have transferred approximately \$650 million in such assets back to Iraq, to the Development Fund for Iraq, and we are continuing to press other governments to do the same, especially Iraq's neighbors, so they can move quickly to find, freeze, and ultimately transfer those assets back to the Iraqi people.

In closing, I would like to stress that, despite a difficult security situation, challenging working conditions, and limited capacity, the

Iraqis are beginning to overcome the terribly grim economic legacy of Saddam Hussein. I cannot give enough praise and credit to the dedication of individuals in our Government and in the coalition governments, including Olin Wethington, who is now coordinating economic issues at the CPA, I cannot give them enough credit for the important work they have done to make all this possible.

Thank you, Mr. Chairman.

Senator HAGEL. Mr. Secretary, thank you.

Secretary Wayne.

**STATEMENT OF EARL ANTHONY WAYNE
ASSISTANT SECRETARY, BUREAU OF ECONOMIC AND
BUSINESS AFFAIRS
U.S. DEPARTMENT OF STATE**

Mr. WAYNE., Chairman Hagel, Senator Miller, thank you very much. It is a pleasure to be here today, and I thank you very much for holding this series of hearings on what is, in fact, one of the very important pillars of our efforts in Iraq: To support their economic and financial reconstruction.

Not surprisingly, you will hear a bit of overlap in some of the topics we talk about because we really are working as a very tight economic team here—between AID, State, Treasury, CPA, the CPA backup, and DOD—as we work to really accomplish all these goals on a daily basis. This is a team effort, and not only in the U.S. Government. We are really working with a host of international partners and, of course, the Iraqis to revive their economy, to overcome the legacy of decades of mismanagement, corruption, war, and sanctions. It is a big task, but there has been, as Under Secretary Taylor said, very significant progress since he and my boss, Under Secretary Larson, had the pleasure of being here in September before this Committee.

We are doing a great deal to facilitate additional assistance from foreign countries, from international institutions, and from the United States to help Iraqis as they start on this new path to build their future.

The United States did play a very major role in organizing the highly successful Donors' Conference in Madrid last October. The result of that meeting, with pledges of at least \$32 billion over the next 4 years, I am told, is the largest tally ever achieved in such a donor gathering.

We are now working very hard to secure the rapid and effective disbursement of the funds that were pledged in Madrid, while ensuring that we have good coordination with the donors and with the Iraqis. This means a very intensive process of interaction between Iraqi officials, the Minister of Finance, the Minister of Planning, with CPA, with the Core Donors, with the World Bank, the UN, and the IMF.

We are working now to organize a gathering of key donors in Abu Dhabi for the end of February, where we would discuss the operation of two trust funds that have just recently been established by the UN and the World Bank. These could serve as a means for some of the donors who choose that way, to make their money available to Iraq. We will also discuss other aid coordination issues.

Of course, as Under Secretary Taylor mentioned, a vital step forward in this was the action of Congress, last November, to approve the President's request for \$18.4 billion in supplemental monies for Iraq's reconstruction. Working closely with Iraqi officials, and especially the Ministry of Planning and Development Cooperation, the Coalition Provisional Authority is in the process of allocating the reconstruction funds in accordance with Iraqi priorities. The Iraqis and the CPA have set up several mechanisms to promote this process and to assure that there is good on-the-ground coordination among ministries and with international donors. And as you know, sir, from previous donor efforts, it is very important to make sure that there is an effective use of the money.

The U.S. assistance is predicated on and directed toward reforming Iraq's economy. We all agree, I think, that a new, prosperous, and peaceful Iraq needs to be one that is democratic, that has a free enterprise basis, that is fully integrated into the community of nations. And we are working hard to help develop the legal and regulatory system that will encourage that kind of integration and encourage the kind of economic growth that we want and to attract foreign investment. And this includes putting in place modern regimes for trade, for investment, for banking, for tax and corporate law.

There is good news, as I am sure my colleague Mr. West will tell you, on the infrastructure front also. We are boosting electricity generation. Oil production is up. Rebuilding of the Iraqi telecommunications and transport network is under way. Hospitals and schools have reopened. Potable water and medicines are more widely available than before. Inflation is low, judging from the strengthening exchange rate that Under Secretary Taylor mentioned for the new Iraqi dinar.

Iraq really has started well down the path to a responsible fiscal policy by producing balanced budgets, and Iraqi oil production is now sustained at about 2.2 to 2.3 million barrels a day, with exports ranging from 1.5 to 1.7 million barrels a day.

Our top priority, as you mentioned, Senator, in your introductory remarks, is to create new jobs, to improve lives through the spending of the money that we have on reconstruction projects, because unemployment remains unacceptably high, and underemployment is a key challenge, too. The United States is prioritizing and accelerating work on projects funded by the supplemental that can produce jobs and visible economic benefit to the largest number of Iraqis possible.

About 60 percent of Iraq's 27 million people, I think as you know, Senator, have been wholly dependent on food provided through the food ration system, which was largely supplied by goods imported under the United Nations Oil for Food Program.

The United Nations turned over administration of the OFF program to the CPA on November 21, and I am pleased to note here that that transition is going smoothly. The World Food Program has agreed to work with CPA and the Iraqi Ministry of Trade to manage the shipment and the distribution of the remaining OFF contracts through June 2004. But Iraqi officials are assuming increasing responsibility for managing the system and preparing the way for a transition to a market-based system.

One of the keys to successful reconstruction of Iraq, as Under Secretary Taylor mentioned, is to secure a multilateral debt reduction agreement that the new Iraqi Government could ratify after the political transition. As Under Secretary Taylor mentioned, we estimate that debt right now at about \$120 billion.

After Secretary Baker was appointed by President Bush as his special envoy for Iraqi debt, he has had very successful meetings in Europe, in Asia, and the Gulf over the past 2 months, and he has won commitments for at least substantial debt reduction for Iraq in 2004.

We will continue to pursue this issue energetically because it is, as you mentioned, Senator, essential to help assure that Iraq's economic rebuilding takes place as rapidly as possible.

We are also working hard and working very closely with our colleagues in Treasury to track down and secure the return of assets that were disbursed by the regime of Saddam Hussein so that they can be used for the benefit of the Iraqi people. So far, from Europe, Asia, the Middle East, and North Africa, we have had transfers of about \$650 million in such assets that have gone into the Development Fund for Iraq. As you remember, Senators, we transferred about \$1.9 billion in frozen Iraqi assets that were in the United States. And there has been found in Iraq, about \$1.3 billion worth of assets. We need to, and we will, keep up a vigorous effort here to find and return additional assets.

Also, as Under Secretary Taylor mentioned, we very much are promoting the active involvement of the World Bank and the IMF in this process. They have already been working intensely with key Iraqi ministers and ministries on critical budget planning, on revenue collection, on monetary policy, and, very importantly, on building capacity. These activities aim at the resumption of international lending to Iraq as soon as possible after the transition on June 30, as well as building up the basic ability of Iraqi ministries to more effectively manage the economy and the international assistance that is being made available.

I am also very pleased today to report that the 146-member World Trade Organization has just this morning in Geneva accepted Iraq's request to become an observer. As an observer at the WTO, Iraq can now really start engaging again and learning how the international trade system works. It can start to more effectively begin preparations for its own eventual accession. And it will be able to avail itself of trade-related technical assistance. This is another important signpost on the way to Iraq reintegrating into the international community in ways that will help Iraq build prosperity.

Just to conclude on the note that the State Department is one part of really a global team. It is an interagency team, it is a United States-Iraqi team, it is an international team that is really working together to mobilize the resources necessary for Iraq to rebuild itself to start on a new path of prosperity. We are working very hard and very closely with our colleagues in Washington, in Baghdad, and in capitals around the world on a regular basis to pursue this policy, and we very much welcome Congress's continued strong support in this task.

Thank you very much, sir.

Senator HAGEL. Secretary Wayne, thank you.
Mr. West.

**STATEMENT OF GORDON WEST
ACTING ASSISTANT ADMINISTRATOR
BUREAU FOR ASIA AND THE NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT**

Mr. WEST. Chairman Hagel, Senator Miller, I thank you for this opportunity to testify before the Subcommittee concerning USAID's role in the reconstruction of Iraq, particularly concerning our role in economic reform and growth programs. We have some detail in my prepared statement that I ask be put in the record.

Senator HAGEL. Your complete statement will be included in the record.

Mr. WEST. USAID, in September, October, before the war in Iraq, began a planning process for what might be a reconstruction and rehabilitation program. We had divided priorities based on what we perceived in those days in the areas of infrastructure, education and health, economic growth, and governance. Based on those observations, we developed initial scopes of work for two contracts—one in the area of economic growth, one in the area of agriculture.

As we developed our relationships with Office of Reconstruction and Humanitarian Assistance in the early days, we vetted out a contract basically under the direction of the Department of the Treasury, who was the lead in that area at that time, and eventually awarded in July a contract to Bearing Point. This was funded under the supplemental one. It had a ceiling of \$80 million.

At that point, we actually were doing a transition as the CPA had taken over from ORHA, and we developed what basically is a work order construct where, rather than a typical USAID mission construct, we really were responding to the niches and the requirements of CPA on how to implement policies and implementation programs in the economic growth area.

In that respect, Treasury still had a very key role in that it has many senior advisors in the CPA itself. As noted by Assistant Secretary Wayne, we also have a very active coordination mechanism back in Washington where we participate at least twice weekly in very intensive dialogue. You will see that there are many areas where we are involved in programs where there is a lead, whether it is bank reform, implementation of job creation programs, the Oil for Food, and many of the programs. But basically we are trying to respond to the implementation needs of the CPA.

In the area of agriculture, we eventually awarded a contract to Development Alternatives, Incorporated. That was awarded in approximately October.

Under the economic reform program, we have done a considerable amount of work with the banking sector, building the technical infrastructure of state-owned banks, developing a financial sector regulatory framework and helping with the implementation of that framework, working on an interbank payment system, helping establish a currency auction system, and building the statistical capacity of the central bank and the Central Statistics Office.

In the fiscal area, we have worked on budget planning software installation and staff training, working on a budget classification system, and on a financial management information system that also relates to the ability for World Bank, IMF, and other donors to begin operations come this summer.

We are also involved in coordination with Treasury on tax administration planning, legislative efforts, and training in the tax area.

In the area of private sector development, one of the major programs that Bearing Point is involved in is a bank training program. We are actively involved with both the two main state banks and with six private banks in a bank training program that really involves a broad area of their total operations, but specifically is focused on bank lending that will directly feed into job creation programs.

We oversee currently \$21 million in microfinance programs that are done under CPA grants to NGO's, and Bearing Point works on bankruptcy, labor, consumer protection, securities, and competition laws.

We also have worked together with the Ministry of Public Works on a job creation program, which is really a public works program for temporary jobs for up to 100,000 people.

We have been very active in the area of utility regulation. Bearing Point plays a key role in developing plans for the electricity regulation over a 10-year period. We are also looking at how that relates to the more immediate needs of getting electricity up to maximum amounts by this summer, when the hot season comes.

We are also getting ready to initiate work in telecommunications regulatory work, and as that comes out, to develop an umbrella regulatory utility framework for the country.

We have also been able to respond through the contracts to not just the economic reform and private sector groups. There are other groups active in the CPA who need this type of assistance. Some examples are the Oil for Food Program, where we have helped to staff and manage the central and now northern offices of the transition. We have assisted with an oil and gas study to give the country options on the type of regulatory framework and programs that they wish to have in the future in the oil and gas sectors.

We are working in trade capacity building related to future needs for the WTO. And as noted, outside of this area in particular, we are, so far at least, the lead implementing agency in the infrastructure sector, which is a clear and very important component of economic growth. We are the lead in electricity, in water, in roads and bridges, as well as ports. We will be seeing a transition, however, over to the PMO in terms of infrastructure. We currently have a bridge contract, and PMO will begin to take on the heavy lifting in the infrastructure.

Within agriculture, we have a small contract that really is looking at developing a strategy for CPA for immediate needs on agriculture inputs that meets the needs currently and looking at a more long- or medium-term, 3- to 5-year strategy of how to get stability and growth in the agriculture sector. We have been involved in immediate needs of the wheat crop, restoration of the date plantations. We work with prevention of foot-and-mouth disease and

getting vaccinations in veterinarian centers up and on their feet. We are also beginning on a rural credit program that focuses on farm families. In addition, we have been part of the planning and now initial implementation in the marshlands in the south of Iraq and restoration and reestablishment of basic services in the marshland areas.

These programs come to a close roughly July of this year. We are working with the CPA now on what are the follow-on generation of programs that may be implemented under USAID. The one area it seems of agreement right now is work on what would be a vocational and skills training program to be implemented under a host of centers throughout the country to promote job creation.

Thank you, Mr. Chairman.

Senator HAGEL. Mr. West, thank you.

Senator Miller, if it is agreeable with you, we will just bounce back and forth, maybe 7 minutes at a time, and it gives us enough time to develop some of these questions.

Senator MILLER. Sure.

Senator HAGEL. Thank you again, each of you, for appearing.

Mr. West, to pick up on a couple of your comments, in particular agriculture, I noted in your written testimony, then what you said here, let me quote just a moment from your written testimony: "Agriculture can absorb a substantial amount of labor and provide world jobs which are particularly important when they keep young men employed in the villages," and then you developed that theme. Of course, that also goes back to a couple of points that Secretaries Taylor and Wayne made about underemployment and unemployment.

My question is: What are we doing specifically to promote Iraqi agriculture exports, support rural development programs, jobs, and in particular how are you doing that if you do not have any budget for it? Because I do not believe the President's budget included any authority, any request, any line item request for specific agriculture programs in Iraq? Thank you.

Mr. WEST. First, I would just note that although there is no line item specifically, there are a variety of programs, the largest being the water in irrigation sector, which have a major and direct impact on the future of agriculture. We also note there is a large amount of infrastructure which includes rural infrastructure including reliable electricity which has largely heretofore focused on Baghdad in particular, whereas irrigation pumps, et cetera were very much under utilized or not utilized at all because of the lack of electricity in the rural areas. So a lot that is going on under the infrastructure sector is key to the future of agriculture.

Second, there are areas in terms of finance and other areas of private sector which are applicable, and we are focusing on rural economies. For instance, the SME credit programs and the job creation programs are being carried out in all governance, many of which are rural governance, and are targeted on both market towns and agriculture families.

Under the first supplemental we did have the initial funding for the agriculture contract that I mentioned. You are correct, there was not a line item in the second supplemental for agriculture. There are currently discussions, but at least as of right now, we are

not able to fully fund the contract which is awarded under the first supplemental, and there is discussion under way of whether there are other means or ways to continue in agriculture.

As it is noted from the second supplemental budget, there are just a large number of issues and priorities facing the CPA, and we are one of the many trying to seek resources for future programs.

Senator HAGEL. I understand your limitations regarding resources, but it is a little puzzling to have you come before this Committee and highlight as you have agricultural, rural economy and development, but you do not have any money to implement the programs.

Mr. WEST. We have initial funding. We are working very closely with the Ministry of Agriculture. Australia and other countries are involved. We believe we still can have a key policy and directional role in this sector, even to the extent we do not have large sums of money. Presently, we have approximately \$10 million worth of funding in that contract. Small as it may be, compared to the total budget in Iraq, in many countries that would be a reasonable agriculture program and we think we are having some impact. Thank you.

Senator HAGEL. Certainly it is not your fault you do not have the resources, but this is not any regular country. We have 130,000 American troops. We have over 500 dead, and \$18.5 billion in supplemental appropriations from this Congress last year, so this is not just your run-of-the-mill country. We have a little more investment than that in it. I am not sure if it is CPA not understanding the priorities, or what would you attribute to the lack of resources for agriculture and development especially since you have noted it in your testimony, that it is important, not just for jobs, but for stability.

Mr. WEST. Basically, I believe the priorities have really focused on infrastructure, governance issues, and again, there are many, many competing demands. I really cannot speak for the CPA further than that.

Senator HAGEL. Thank you.

I noted in my statement, and I am sure you saw the piece in *The Washington Post* yesterday that I referred to, that was a rather lengthy article quoting the Iraqi Ambassador Designate, Ms. Francke, about her displeasure with the contracting process, lack of Iraqi participation, job development. Would you care to respond to that? Is there a problem?

Mr. WEST. To me?

Senator HAGEL. Yes. And I am going to ask each of you the question, but, Mr. West, if you would answer the question as best you can. Is there a problem? Is Ambassador Designate Francke right?

Mr. WEST. Concerning Iraqi participation first, I might say that we have guidance under all our contracts for a strong preference for both the involvement and the training and the development of Iraqi subcontractors. As an instance, under the Bechtel infrastructure contract we have over 100 Iraqi subcontractors with over 35,000 employees working on programs. Through our grantees such as RTI, Community Action Program Grants, OFTA grants, and others, we clearly are involving both local groups in terms of job creation and subgrants and subcontracts to Iraqi firms. The same goes

in health and education. I believe it is having a substantial impact on the development of the capacity of local institutions and businesses to perform.

In terms of transparency in the contracting process, we have committed to the Administration and Congress to proceed with full and open competition on all contracts under the supplemental to funding. We are well along in that process. We have had one request for an exception in the area of governance related to election assistance, but other than that, we are already fully unfolding contracts that we believe represent the U.S. Government well.

Senator HAGEL. Do you think Ambassador Designate Francke just does not understand all that, or do you think she has a legitimate point?

Mr. WEST. There are a host of contracts. We are one of many agencies. We awarded contracts under the first supplemental under what was termed limited competition because of the time constraints. As I noted, we are now moved into full and open competition. It is clearly an admonition that all of the elements of the CPA, ourselves included, know we need to pay attention with and it is sound advice and it is being listened to.

Senator HAGEL. Do you know if that story yesterday attracted the attention of senior policymakers in Iraq?

Mr. WEST. I cannot—

Senator HAGEL. I mean it is rather significant to have the Ambassador Designate of Iraq given an interview and say what she did. At least it hit me that way.

Mr. WEST. Clearly, it would be great if we could do a lot more with Iraq institutions. Having seen firsthand the situation on the ground and the limitations to get out in many of the rural areas, there is always more that could be done, and particularly in terms of involving Iraqi firms, and we hope as we learn and proceed, and particularly as the Iraq ministries get much and much more involved on a daily basis, that more can be done in the future and will be done.

Senator HAGEL. Thank you.

Senator Miller.

STATEMENT OF SENATOR ZELL MILLER

Senator MILLER. Thank you, Mr. Chairman.

Thank you for being with us, and for your testimony and for the job that you do. You have a gigantic job. I was in Iraq recently, and it is mind boggling. It is overwhelming, the work that has to be done and needs to be done. I am not here to complicate things, but to better understand what you are doing and your thinking for it.

It may seem minor in the big scheme of things, but I can assure you that to those of us who represent farmers and ranchers, it is not. Increasingly I am concerned with the CPA policy of permitting nations that are not members of the Coalition to bid on Iraq food tenders administered by the World Food Program. It seems to me that the CPA policy on food tenders should be consistent with the reconstruction policy, and restrict contracts to the countries that made the sacrifices and have invested in the coalition effort to free Iraq. Can you explain to the Subcommittee why the CPA may be

purchasing food from countries that did not participate in coalition activities?

Mr. WAYNE. Senator, let me take a first cut at that. I am not familiar with the procedures right now for food tender policies. I can commit to ask and look into that. I know that as part of the transition of replacing the OFF program, we and CPA have taken over that process. So maybe I could just commit to getting an answer for you and being back in touch.

Senator MILLER. I would appreciate it if you would.

In your testimony you talked about, as you said, the administration of the Oil for Food Program will be turned over to the Coalition Provisional Authority on November 21, 2003.

Mr. WAYNE. Right.

Senator MILLER. You state the Minister of Trade will increasingly assume responsibility for the management of the food pipeline and transition to a market-based system. That is what I am trying to get some elaboration upon. Is that what you are going to get back with me on?

Mr. WAYNE. I can talk to you a bit about what we are doing and the mechanics of doing that, but I honestly do not know the specifics for the tendering process. I know there was a UN tendering process which, by the rules, was I believe open to a very wide range of nations, and there are still contracts being fulfilled under that process, which I think was open for bidding from most anybody around the world. But I do not know for sure the details, Senator, so I do not want to mislead you on that part of it.

What we are trying to do generally in the transition process is to make sure that there are not any gaps that happen in the food and medicine distribution during this period of transition, and I think we have done a very good job in handing over from UN administration to CPA and Iraqi administration. Then, at the same time as we are moving forward and making sure there are no gaps coming up, we are trying to ensure that the Iraqis are fully trained to take over all the aspects of this process, international and domestic, to make sure that it continues on effectively, after June 30. Then we went to think through what are the right ways to transition from this ration system to a market-based system. You claim, in fact, to reduce the number of people and the groups that have to get special care, and you enlarge the role of the market in that process. So, the market will play a larger and larger role in Iraq's supply of agricultural goods, which will also increase the incentives inside Iraq for agricultural production and return them to their strengths in certain areas. Traditionally, they did produce a number of products for export and they have the potential to do that again. But they did not produce enough to feed the whole country in all areas. So, we will be transitioning over.

Senator, I would have to take back and get back to you on the specifics of what the procurement policy is right now.

Senator MILLER. It is my understanding that there is going to be—and correct me if I am wrong—that there is going to be a \$600 million purchase for buffer stocks right away. Do you know if that is right or wrong?

Mr. WAYNE. Sorry, I do not, sir.

Senator MILLER. Does Iraq have enough food to last until June 2004, and if not, how are the food purchases going to be handled until then?

Mr. WAYNE. My understanding is that there is—that in the planning pipeline that is being foreseen, there is assurance that that pipeline will continue to meet all the needs, and that there may in fact be needs for additional purchases, and probably will, and that is part of the job which the team, that USAID and others are helping to staff out in Baghdad, are doing. They are now managing that, working with the Iraqi Ministry of Trade, looking at the food needs, the medicine needs, the OFF contracts that exist and what new contracts have to be let.

But I do not, sir, very honestly, have the specifics of the purchases upcoming. I will be happy to take that and add that as part of what we get back to you with, sir.

Senator MILLER. I would appreciate it. I have to sum up, so let me just say that I think maintaining a policy of allowing noncoalition nations to bid on World Food Program food tenders for Iraq, can be justified, and I think that it should be changed immediately. I just do not understand that line of thinking.

Thank you.

Senator HAGEL. Senator Miller, thank you.

Secretary Wayne, you noted in your testimony under the oil sector section that—if I can just read a line here. “The 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 barrels per day. At present, all oil exports are via the Persian Gulf.”

Could you give us a bit of a status on security for the oil pipeline in the north, what projections are as to when it might be secured to the point where we can see oil flowing to Ceyhan, and any other thoughts that you have on the estimates that CPA is looking at right now. I noted your dollar number down here. You say could exceed one billion per month, and you talk about the possibility of 3 million barrels a day.

Mr. WAYNE. Yes, Senator. Oil production and exports have been steadily increasing as I noted in my testimony, and they now have reached the 2002 levels. But it is not secret that sabotage has hampered the efforts to boost production. As I said, currently there are about 2.3 million barrels a day produced. Exports are about 1.6 million a day. The target that the Iraqis have set for themselves is to reach a production of about 3 million barrels a day by the end of 2004, and then exports, if they meet that target, would be about 2.2 to 2.4 million barrels a day.

But you are correct that right now all of the oil is going out via the Mina al Basra port on the Persian Gulf. There is work under way to expand export capacity by using an additional terminal nearby that has not been operational, called Khor al-Amaya, and there has been work under way on the Northern Pipeline. A rapid pipeline repair team is being organized and is expected to be ready to go in the next 2 months, which would help to move toward being ready there. If that line is reopened again, you would have an additional export capacity of 1.1 million barrels a day, so that would significantly increase the long-term export capacity.

Exactly when and how that will be reopened, however, I am far from an expert to tell you that, sir because it has to be based on the actual security in that area. But I do know they have been learning from other experiences around the world, probably including Colombia, where there have been pipelines that have been exposed to sabotage, and trying to put together the response team that would be effective in response to that threat, as well as all that you read about the daily sacrifices people are undertaking to try to bring the security situation under better control.

Senator HAGEL. Thank you. Once a sovereign government is in place in Iraq—and I would be interested in Secretary Taylor's comments on this as well—do you think it would be in the best interest of Iraq to join OPEC?

Mr. WAYNE. I think that is a decision really that the Iraqi authorities need to take, and I would not want to be in the position of dictating to them that decision. Iraq has previously been a member of OPEC. They have now, in the interim, have been attending the meetings again. I think I really want to leave it that they have to take that decision.

As you know, however, we believe in principle that it should be the market that determines the effective price of oil, that is really the mechanism for matching supply and demand, and that, of course, is based on our whole approach to market economies.

Senator HAGEL. Thank you.

Secretary Taylor.

Mr. TAYLOR. Certainly is going to be a decision for the Iraqi people, and the idea of having production determined by a group is not as attractive as production determined in the markets. But that is going to be their decision, and we are going to be helping them work in the markets, work to produce more, understanding the implications for their own economy at different levels of production. But that is going to be their decision, sir.

Senator HAGEL. Thank you. Secretary Taylor, would you—and you noted this in your testimony—give us an update on the Madrid Conference pledges. Are we on target on the timetables set at the Conference? Are our allies forthcoming with the resources they have pledged? Are they behind schedule? If they are, what are we doing to address that issue?

Mr. TAYLOR. We are actually working in a way which I think is really unprecedented in following up from a donors conference, in bringing the key donors together, continuing to discuss the implementation, the disbursement of funds. Phone calls are regular with the key donors, and in fact the meeting was taking place as Assistant Secretary Wayne said in the Middle East to make sure they were moving ahead on the disbursements.

With respect to the World Bank and the IMF, which of course are big components of that donors' conference, \$3 to \$5 billion from the World Bank and up to \$4.25 billion from the IMF. They are actively engaged in getting things ready so they can start disbursing as soon as the transition occurs on July 1. Even, as I mentioned, the IFC, the private sector arm of the World Bank, is moving ahead with a small business loan program. The World Bank has a whole strategy in place about how to work on programs and projects so they can begin as soon as possible. Then finally, the

IMF is working with the Iraqis now to develop a program which could disburse, in the first part of the period at the transition.

So it is going well, and we are going to keep working it hard. I think there is an understanding that the pledges can fall behind if we are not on top of it working with the other donors to watch that. It is one thing to pledge, it is one thing to disburse. I must say, even on top of the disbursements, it is actually getting specific results done. We would like to have certain numbers of schools built, a certain number of hospitals repaired, et cetera, and so to focus on these visible, measurable on-the-ground results is where we are moving on this, and I am pleased with the way things are moving at this point, sir.

Senator HAGEL. You believe that the commitments made, the pledges made, have been forthcoming, are on target, and that is not an issue?

Mr. TAYLOR. It is an issue in the sense we need to watch it carefully, but now things are on track and we are going to continue to monitor it carefully. But it is an issue. It is an important issue for us to keep track of, and I appreciate your question about it.

Senator HAGEL. Mr. Secretary, back to your comments regarding the World Bank and IMF and their pledges. You mentioned the date of June 30 obviously as a key date for many reasons if we are to hold to that date. Would you review for this Committee what conditions must be in place for the IMF and World Bank to make loans, to come forward with their commitments and pledges? For example, does significant debt reduction have to have been accomplished? Obviously, a sovereign government has to be in place, but I mean I am particularly interested in are there stipulations on the debt issue, so substantial debt reduction have to have been agreed to or taken place or factored in before the IMF and World Bank will come forward with their assistance?

Mr. TAYLOR. With respect to the IMF, it is necessary to have the IMF program in place as part of the agreement to do the debt reduction, so it is more of a simultaneous occurrence than a sequenced one. What we are hoping is that the IMF program can be in place and ready to go soon after July 1, and that provides the structure for the debt relief. The reason is that the IMF program is the quantitative way to describe what level of debt reduction is needed for the debt to be sustainable again in Iraq so Iraq is not in a position where it is burdened by these heavy debt payments. So the IMF program is part of that.

Likewise, the World Bank, they can begin disbursing with the recognition that there is a process in place to deal with the debt. But I would characterize it, Senator, as a more simultaneous thing where you have the debt reduction process in place, you have the IMF program, which is very much something we are working on now, and then finally the World Bank itself moving ahead.

Senator HAGEL. I know you have done a significant amount of work on the debt relief issue, and as we have noted and certainly you know, Secretary Baker has been asked to take on a significant part of that responsibility. Can you give us an update on where we are and how effective those meetings that the Secretary has had over the last 2 months have been? Maybe a timetable on where we go next, when debt relief is actually going to be worked out, worked

through? Anything that you can do to enlarge on our understanding of that issue, we appreciate it.

Mr. TAYLOR. Sure. Secretary Baker has reported that his travels to Europe, Asia, and the Gulf have resulted in statements by these governments that represent at least substantial debt reduction, that is, commitments to at least substantial debt reduction. That is number one.

Number two, the governments already have committed to resolving this issue this year, so that is a commitment that the key governments have made, the key players in this whole process.

Now, what remains to be done with those commitments for at least substantial reduction, is to get the IMF to do a debt sustainability analysis so we have a measure of how much debt relief there should be. That is going to play out during the year.

Now, we have the important marker of the end of the year. We also have the important marker that the transition is to take place July 1. So what we are doing is trying to sequence what will eventually become the more detailed calculations of what the percentage amounts are and how they take place and when over the course of the year. Those are some of the specifics that have happened already and some of the things that we think will happen.

Senator HAGEL. So there are ongoing meetings working toward what you have just described?

Mr. TAYLOR. Yes, there are. Just some more color on that, we are working with the Iraqis in Baghdad to make sure that the estimates of the debt are correct too. We have got estimates from external sources. The Paris Club and the IMF did surveys of what governments said that the Iraqis owed them, and we are also checking those against the Iraqis' records, double check and making sure nothing is missing or that the numbers are correct by having a team work through the records in Baghdad now. We sent Treasury experts to work with the Iraqis to go over those documents. That is the microdetailed level that is happening simultaneously with what Secretary Baker is doing at the highest levels.

Senator HAGEL. You are satisfied with the progress of that effort?

Mr. TAYLOR. Yes, I am, and it is something that has been—we thought about it very early after Saddam fell. It was one of the first examples I think of the G-7 pulling together and saying: We have to deal with this, and that included in that case both France and Germany saying we need to deal with this issue. So it is coming along, and it seems to me pretty much on track, sir.

Senator HAGEL. What about the war reparation claims?

Mr. TAYLOR. Those are being handled through a process at the UN. They agreed, as one of the resolutions, to limit the amount to 5 percent of revenues. That is a maximum 5 percent of oil revenues. But now the claims are being handled as part of the UN and we are letting that play out at this point. There may be some additional work that needs to be done at that point, but that is now on a separate track from the debt relief.

Senator HAGEL. Is that part of Secretary Baker's portfolio?

Mr. TAYLOR. To my knowledge, Secretary Baker is not dealing explicitly with that part of it.

Senator HAGEL. Thank you.

Secretary Wayne, in your opinion, would a greater UN role in Iraq or even a UN resolution, another UN resolution, make it easier to get more international support in Iraq?

Mr. WAYNE. Senator, I would say that on the economic reconstruction side there has been already established since before Madrid a very important UN role in that they have been one of our main partners in planning for the donor conference and the post-Conference effort. I think, as you know, Secretary General Annan has a team right now in Baghdad working to come up with ideas for how the transition might proceed.

So, I would say that a UN role is important to help us move forward on the economic side. We look forward really to building on that. One of the things that came out of Madrid was a UN trust fund and a World Bank trust fund where donors who did not have a big enough aid program of their own to actually go into Iraq, or who chose, they said not to go into Iraq and set up an aid program, could use these trust fund facilities. We have used them effectively, as you know, sir, in East Timor, in Afghanistan, and elsewhere to help channel reconstruction funds.

So, to go back and also answer one of your earlier questions about other donors, one of the things that has just recently happened is that the UN and the World Bank have finished their proposals for their trust funds. They have now come up with proposals for how to spend that money if you put it in the trust fund, and they are now just going out to the donors and saying, "okay, if you like the structure and you like what you see as projects." They have been working with the Iraqis on this—"please now put some of your money forward." So only now are we getting to the point where a number of the Madrid pledges will really be tested, and we will be urging people to actually come forward and start putting money of the table.

Coincident with this, in Iraq and Baghdad there has been a process going on to revisit the initial list of projects prepared by the Iraqi ministers and ministries that they worked with CPA on, to really take another look at those, to prioritize them, to sort out the ones that we are going to focus on with our funds, and then to make available to the other donors and to the UN and the World Bank, projects that the Iraqis believe are top priorities. That is, right now, an intense process that is going on in Baghdad with the Ministry of Planning, working with the Ministry of Finance, and then with all the ministries and CPA, to come up with that priority list.

There is a structure that has been established that involves the Governing Council, the CPA, the key ministers in approving that priority list of projects. So again, that list of projects will then be available for the donors other than the United States to look and the Iraqis can say, "okay, here is the opportunity to put your money on the table."

In all of that, the UN, and in all of these phone calls that we have been having internationally, the UNDP, UN Development Programme has been a key player and a very constructive player in all of that.

Senator HAGEL. Thank you. Following on with what you just said, partly what you just described is a transitional process lead-

ing to hopefully a sovereign Iraqi Government or at least some semblance of one June 30 so that economic decisions, policy decisions, other decisions will be handed off as you are working through this process; is that correct?

Mr. WAYNE. That is correct. Along with Under Secretary Taylor, I had the pleasure to meet with the Central Bank Governor and the Minister of Finance this week when they were in Washington, and 2 weeks ago with the Minister of Planning and Development Cooperation who was here. All of them, in fact, see their roles as now expanding and as a full partner in decisionmaking on the projects, on the way money should be spent.

There has been something that is called the Iraqi Strategic Review Board that has been set up to actually look at strategic spending. It has two members appointed by the Governing Council, the Minister of Development and Cooperation, and the Minister of Finance and a CPA representative who will be Marek Belka of Poland, former Finance Minister of Poland who is working in the CPA on the economic side. They will look at all of the proposals that come together to bless them, the Iraqi proposals, to assure coherence between how we are going to spend money, what the other projects are, and then to try to effectively draw in the other international money that is available.

Indeed, as you say, Senator, this is viewed as a transitioning to the interim government or the transitional government starting July 1.

Senator HAGEL. Thank you. I want to get Secretary Taylor's comments on this as well, but I want to ask another question in regard to this. Does this give you any concern that unintentionally we are placing a great amount of power, centralized power in the ministry planning, in a command economy and the things that we want to get away from?

Mr. WAYNE. I would say no, because at the same time what we are doing is working, and not only us but also the World Bank and others, working to build the capacity of the several line ministries to understand what that role needs to be in a noncommand economy situation. Here really what we are doing is creating an effective interagency process, because you do need interagency coordination and you do need to merge the considerations of the budget into the considerations of how you are spending the development money that might be coming in.

So we, the CPA, the World Bank, and other institutions are going to be putting a lot of effort in the months ahead into helping the Iraqis learn the effective way to do this, and at the same time to have a free market emerge and a democratic system emerge.

Senator HAGEL. Thank you.
Secretary Taylor.

Mr. TAYLOR. Mr. Chairman, on the question of the transition, we focused mainly on the central bank and the ministry of finance areas that have been our focus, at least from the Treasury, and have worked quite extensively with the central bank governor. As I mentioned, we asked him to come to Florida to meet with all the central bank governors of the G-7. It was quite a historic thing, if you can think about it. Here is a man just recently chosen to run the central bank of a country that is just starting out being grilled

by the top central bankers in the world such as Chairman Greenspan, really doing extraordinarily well and providing what he wants to do, asking tough questions about the currency, his own currency, for example. So, I think it is coming along very well.

We have people working with them closely and I am going to be going to Iraq next week to look for myself, making sure from my perspective at least that the monetary policy operation is working well. The fact that the currency exchange worked so remarkably well is a good sign but we want to make sure that the policy is actually operating as well too. They have deregulated the interest rates; as of March 1 there will be no controls on interest rates. That, I think, will help bank lending and the use of the financial system more efficiently.

But it is something that I would think that we are not going to simply just disappear with respect to this advice giving and helping them on July 1. They certainly hope we are not. We have got a good relationship.

I could just say again, maybe a little more color, this last Sunday night, the person who is our economic coordinator had the minister and the governor to his house here in the DC area, invited all of the Treasury people who have been working with them. You could just see the remarkable degree of friendliness and wanting to work together. It is a very positive sign, I think of what is going to happen after the transition. But we keep working on that.

Senator HAGEL. What is the status of the central bank law, which if I understand it, grants independence to private banks as well as other things?

Mr. TAYLOR. It is a good law. It does grant central bank independence to the Central Bank of Iraq so they do not get into the business of printing money to finance the deficit. It has got some good strategies with respect to focusing on price stability, and recognizing the importance of financial market stability. It is a good law. It has been widely discussed in the international community and people have had lots of comments on it. The central bank governor and his staff are happy with it. There is just one last step, and that is for the Governing Council to approve it. It has already been approved by their financial committee, if you like, of the Governing Council, but very soon we hope it will actually go through and be finished in the Governing Council.

Senator HAGEL. Is there some difficulty within the Governing Council as to why they have not approved it yet?

Mr. TAYLOR. I do not believe so, it is just these things take time. As far as I know, it could happen any day, but I do not want to make any predictions of these kinds of things. But it is a good law. We have heard nothing but favorable things coming from the Governing Council now, so for all I know it could simply be that they did not have a quorum on the day they met to deal with this. But we hope it is soon.

Senator HAGEL. That has not inhibited the progress of private banks looking at wanting to move into Iraq?

Mr. TAYLOR. No, in fact I do not believe it has had any impact because there is also the banking law which was passed earlier with respect to foreign bank entry and the rules of foreign investment. In that regard, there was a decision made just in the last

week to allow three foreign banks to come in and do business *de novo*, 100 percent, if they want, of ownership, into Iraq. They chose three banks, Standard Chartered, National Bank of Kuwait, and HSBC. There were many, many other banks who applied. A lot of interest.

This is actually one of the major foreign investment activities that are happening right now. I must admit it is very pleasing to see such interest from the banking community. In the trade bank of Iraq that I mentioned earlier, there was a lot of interest in that.

So, I think in terms of the bank law itself, it is not inhibiting any activity at this point. Of course, it is always important to have a good central bank law for monetary independence and keeping inflation low. As far as we know, things are stable in the economy.

I could just add briefly about this, we need better data in the economy. You were asking questions about the employment and unemployment. There just are not good statistics. Even the inflation statistics are quite poor. So those are high priorities. It is hard to run a central bank if you do not have good inflation data, good employment data, or good production data, so that is a high priority for us working with the central bank.

Senator HAGEL. Thank you. A question for each of you. In your opinions, where do you believe the most significant potential prospects lie in Iraq for exports, employment over the next few years? Obviously, the oil sector is probably foremost. Mr. West and I had an exchange regarding agriculture. But in the opinions of the three of you, where do you think some of the greatest potential rests for their economy, exports, jobs, development?

Mr. TAYLOR. For jobs in the country it is going to be the reconstruction is the biggest part coming forth. We have some data that even just our civil affairs teams, CJTF-7 report that they have already created 394,000 jobs. We know that our payment of \$1.7 billion in cash to people early on created a lot of economic activity. The small business loan program is going to generate jobs.

I believe the conversion of the Oil for Food program to a market-based system is really the key to reviving agriculture in Iraq, because basically when the Oil for Food program was established domestic agriculture production just basically plummeted. So when that becomes replaced by production largely in Iraq and they have the capabilities that will be a great boon. And of course, there are lots of opportunities in some old businesses that Iraq used to be in; the date plantations around the south. There is perhaps an opportunity—that used to be a great export for Iraq in the past.

I think it is very promising that they have agreed to have very low tariffs, 5 percent maximum tariff. It is very much of a free trade, open trade perspective.

Then maybe just one last thing on this. With respect for the fact that we do not have a lot of data, I think it is hard to pay too much attention to anecdotes that people have. That is the only thing you can base things on, but the impressions of one person, they are just one thing.

Just for example, the finance minister who we had many meetings and discussions with in the last 5 days, he is a former Iraqi businessman. That is what he was doing, running a business. He put his business aside to become the finance minister, so, he is a

natural person to ask about how things are going. He is very positive about what is happening in the private business sector, and did not comment about contracting so much, just about the activity that is happening in the economy.

To me that is reassuring, but again, you cannot pay attention to any one thing. It is a cumulation of evidence and we just need to get more and more evidence like that. But that offsets, I think to some extent, the views you were getting and asking Mr. Wayne about that you got from *The Washington Post*. So other kind of anecdotal information is important.

Senator HAGEL. Thank you.

Secretary Wayne.

Mr. WAYNE. I would agree with Under Secretary Taylor both in reconstruction and then in the SME area, small and medium enterprises, there is a great deal of potential to create jobs. As we do see this transition to a market economy, both in the food and medicines area, and potentially under a new Iraqi Government in other sectors, I think there is a lot of potential if we look at those smaller business opportunities. As we know in the United States, that is a big job creator.

In the longer-term, also not only the low tariff level but also the very forthcoming foreign direct investment policy that has been established will, I think, start attracting more and more interest. There are already, as you may have seen from the many different conferences that are held, many businesses that are interested in going into and working in Iraq as soon as they feel that it is the right thing to do. I think that will be a big job creator also.

In the various sectors—in addition to dates—barley, wheat, cotton, and rice are areas apparently where Iraq was very productive previously before Iraq went into this rationing system that really undercut all the production. Poultry and livestock apparently also they could export a bit to their neighbors.

In the natural resources, in addition to oil, sulfur and phosphates are potential exports. And then, they did have a large chemical and fertilizer industry. As we remember, some of it was misused at some point, but there is a potential there again that they could export in some of those areas.

Senator HAGEL. Thank you.

Mr. West.

Mr. WEST. No general disagreement with what has been said. I think basically the jobs are going to be created where the money is. First will, obviously, be oil and gas. Second, real estate is substantially undervalued throughout the country and I think real estate and the construction industry will be the second largest source of new funding. Third, I think agriculture will be a boom area.

I might just add to what was earlier said in agriculture, unlike some of the traditional countries we work in, there really were some major structural and, frankly, intentional constraints. The lifting of those constraints, export controls, the fact that Saddam really tried to suppress the south and the Shi'a population and really cut off their incomes, the lifting of those constraints, a lot will happen without any outside assistance just by the changing of oil for food export controls, access to irrigation, water.

The last area really is related to oil for food but it is not the agriculture sector. There are \$6 billion to \$8 billion worth of important that were coming through this UN system, and the small and large trading houses are already starting to boom. As that transitions out I think the trade business in Iraq will continue to expand.

Senator HAGEL. Thank you.

Secretary Taylor, what is the status of the law allowing 100 percent foreign ownership in various companies in Iraq?

Mr. TAYLOR. That was a law that was promulgated back in September, and it is still there. The only examples I know where it specifically has been taken up is in the banking area, which I mentioned, those three banks. But that is the law that they put through. I remember the finance minister presenting that at the international conference in Dubai in September.

Senator HAGEL. But other than the banking industry you do not see much evidence of that law being taken advantage of?

Mr. TAYLOR. It is better to say I do not know rather than I do not think it is there. I do know that there is just a lot of interest in foreign investment, but I do not know if actually it is taking place. I do not have any specific evidence.

At that Madrid Conference there was actually, I think for the first time at one of these donor conferences, a whole day for the private sector to come through and see what opportunities there were. We tended to emphasize the foreign investment opportunities in Iraq. Of course, there is a lot on the oil side.

This is not really so much foreign investment, but in order to produce this currency we had to get a firm to print the currency. They printed the currency and that was a very successful operation. But I just do not have good information except for the sectors that I am focusing on which is the financial sector.

Senator HAGEL. Thank you. One additional status question. What is the status of the proposal that had been floated regarding a flat tax in Iraq?

Mr. TAYLOR. The proposal was again made back in September and it was something that was worked through—more than a proposal. It was a part of the policy for the tax system. It was a maximum 15 percent rate, not simply that all the rates had to be 15, but the maximum was 15. In principle it could be graduated from 7 to 15 percent, but the maximum was 15 percent. They also had a maximum tariff rate of 5 percent as part of that.

Neither the 5 nor the 15 percent has been implemented explicitly in the law yet, because that requires that tax forms be set up and a system of payment.

With respect to the customs, there is the most progress is on that front. They are training the customs officials, they are getting the computers ready to go at the main ports of entry. My expectation is that could be put into place in the spring. It is a high priority for us because if they can begin to generate their own revenues it will be a way that the American taxpayers have to worry less about that, and the donor community worries less about it. So it is a high priority. Customs is the first thing and then after that the income tax on both individuals and firms. It is mainly an implementation issue right now.

Senator HAGEL. Thank you.

Gentlemen, any of you wish to make any further comments? Secretary Wayne?

Mr. WAYNE. I just might add one other area where there has been direct foreign investment, and I was reminded because there was an article in *USA Today* about the mobile cell phone system. As you know, there were three licenses given out to three different consortia. They have a responsibility to build a system in their own area and then they can expand and compete nationally. I would just note that the system in Baghdad is now up and running for the first time. There were, again, plenty of bidders for that system also.

I think there will be a great deal of interest as the opportunities open and as we move forward.

Senator HAGEL. These are 100 percent private licenses?

Mr. WAYNE. They are licenses. They are not Iraqi Government owned. I think, and I will have to check on this, there may be as part of some of the consortium, there may be national telephone companies from other countries. But I know several of them have Iraqi partners and at least one of them has two foreign partners working together with others in it too.

Senator HAGEL. Gentlemen, you have been generous with your time, and you have been very helpful to this Committee. We appreciate what you have contributed today and also the good work of you and your colleagues throughout the year. Thank you very much.

The hearing is adjourned.

[Whereupon, at 2:32 p.m., the hearing was adjourned.]

[Prepared statements and response to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR CHUCK HAGEL

This is the third hearing on Economic and Financial Reconstruction in Iraq that we have held in this Subcommittee since last September.

The transition to a stable and democratic Iraq will greatly depend on economic development and job creation. The economic track in Iraq cannot be considered in a vacuum. Iraq's economic reconstruction is directly linked to both security inside Iraq and to the political transition to a new and sovereign Iraqi Government.

The economic reconstruction of Iraq presents a historic opportunity to help chart a new course in Iraq and the Middle East. America has invested precious lives, resources, and credibility in Iraq. The long-term strategic interests of America and our international and regional allies depend on our getting in right in Iraq.

There is some good news in Iraq's economy. Schools and hospitals are reopening, and visitors report increasing economic activity in Baghdad and other Iraqi cities. Iraq's oil sector and infrastructure are beginning to stabilize. And Iraq's public and private banking sectors are being rebuilt. In March, three major foreign banks will begin operating in Iraq. *The New York Times*, on Sunday, February 8, cited a report by *The Economist* Intelligence Unit which predicted that Iraq's GDP could grow by 25 percent this year, the result of American spending on reconstruction, the recovery of Iraq's oil industry, and increased trade.

However, despite Iraq's potential, Iraq's economic reconstruction and stability are far from assured. The assessments last fall of the United Nations (UN)/World Bank and the Coalition Provisional Authority (CPA) estimated capital investment needs for Iraq of \$55.3 billion over the next 4 years. Of that amount, the World Bank identified \$17.5 billion in "immediate" reconstruction needs for 2004. To help meet these needs, the Bush Administration plans to spend \$12.7 billion on Iraqi reconstruction this year.

A report last month by the Congressional Budget Office, *Paying for Iraq's Reconstruction*, concluded that projected Iraqi revenues alone will probably not be sufficient to cover capital investment and reconstruction through 2007. Iraqi oil revenues are likely to only cover recurring Iraqi Government costs, with little remaining for capital investment required in the UN/World Bank and CPA assessments. The world community, led by the United States, has pledged between \$32 and \$36 billion toward Iraq's reconstruction over the next 4 years.

Iraq's economy will also depend on substantial relief from debt and reparations. This is an absolute priority for our international diplomacy on Iraq. Iraq's debt, not including unresolved or unpaid reparations claims from the Gulf War, is estimated at \$125 billion. Iraq's budget, and Iraq's international credit worthiness, will be crippled if Iraq's creditors do not agree on substantial debt relief. I am encouraged that former Secretary of State James Baker has undertaken this critical diplomatic mission, and I am optimistic about his progress so far.

The financial and economic reconstruction of Iraq will also depend on the development of transparent and accountable institutions of economic governance. The CPA should support concrete steps by Iraq to build strong and transparent regulatory and oversight institutions to assure that Iraq's potential is not again squandered by corruption and mismanagement.

Iraq's economic potential will ultimately be realized by empowered Iraqis. The CPA has budgeted \$184 million for private sector development. But in yesterday's *Washington Post*, Ms. Rend Rahim Francke, the Iraqi Governing Council's Ambassadors-designate to the United States, said that the CPA is not doing enough to employ Iraqis. She added that, "jobs for Iraq will create stability and peace . . . and curb terrorism."

The contracting and subcontracting process in Iraq must empower and employ Iraqis. America must set an example with transparent rules and procedures. The Middle East has seen enough deal brokers and "middle men" looking for a piece of the action. The contracting process cannot, in Ms. Francke's words, be "shrouded in mystery."

I look forward to the testimony of today's witnesses: John Taylor, Under Secretary of the Treasury for International Affairs; E. Anthony Wayne, Assistant Secretary of State for Economic and Business Affairs; and Mr. Gordon West, Acting Assistant Administrator, Bureau for Asia and Near East, U.S. Agency for International Development.

PREPARED STATEMENT OF JOHN B. TAYLOR

UNDER SECRETARY FOR INTERNATIONAL AFFAIRS

U.S. DEPARTMENT OF THE TREASURY

FEBRUARY 11, 2004

Introduction

Chairman Hagel, Ranking Member Bayh, and other Members of the Subcommittee, thank you for inviting me back to testify on the financial reconstruction of Iraq. There have been many significant, positive developments since I last testified in September, and I welcome the opportunity to discuss them with you today.

Just this weekend, during the G-7 finance ministers' meeting in Boca Raton, we had an opportunity to hear from Iraq's Central Bank Governor, Sinan Shabibi, and Finance Minister, Kamel Gailani, about their reform priorities. Both officials participated in a session with the G-7 ministers, and took the opportunity to underscore their commitment to moving ahead with sound, market-oriented reforms that will underpin private sector-led growth.

They also stressed that their vision of a new Iraqi economy shares the following key principles: Openness and transparency of Iraq's institutions; the creation of strong incentives for private sector development; close economic and financial integration with the international community; implementation of international standards and best practices; and a social safety net that addresses the needs of all Iraqis.

These officials are already taking meaningful actions to back up their statements. For example, Iraq's Central Bank Governor recently announced three major actions that will have far-reaching consequences for the development of Iraq's financial sector: The selection of three foreign banks to receive a license to operate in Iraq; a plan to liberalize interest rates by March 1; and passage, soon, of a new Central Bank law.

Today, I would like to tell you more about these developments, as well as update you on the progress that has been made on currency reform, reducing Iraq's international debt burden, and mobilizing international support to meet Iraq's reconstruction needs.

Currency Reform

I would like to begin by highlighting one of the most important accomplishments in the financial sector—the successful introduction of a new currency in Iraq. When I last spoke before this Committee, I laid out our strategy for replacing the old national currencies—the Swiss dinar and the Saddam dinar—with a new, unified national currency. I am happy to report that this plan was successfully implemented as scheduled between October 15 and January 15.

Printing and delivering this currency on time was an enormous feat—the equivalent of 27 747 plane loads of currency were delivered to Iraq and distributed to the public through approximately 240 exchange sites, mostly bank branches, under a significant security threat.

By all accounts, the Iraqis have wholeheartedly embraced their new dinars. Not only are the new notes much more difficult to counterfeit—a chronic problem under the old currency regime—but also the Iraqis now have six denominations available, up from only two. And the value of the currency has steadily increased since its introduction. Now the challenge is to manage this new currency in such a way as to provide a stable monetary foundation for a healthy financial system and vigorous reconstruction.

Restoring and Revitalizing the Banking Sector

Another area where meaningful progress has been made is in the banking sector. In my last testimony, I reported that Treasury advisers were assessing the conditions of Iraq's state-owned and private banks. Since then, we have learned that Rasheed and Rafidain banks—the two large state-owned banks which controlled over 85 percent of banking assets—are at best marginally capitalized, and have loan portfolios with a high concentration of non-performing loans. Compounding these problems is the lack of comprehensive, modern accounting standards and systems. We also discovered that although these two banks have an extensive network of more than 360 branches throughout the country, each branch has operated largely as an independent unit. As a result, Iraq lacks centralized management and an integrated system for making and clearing payments.

An evaluation of the private banks uncovered significant problems as well. It turns out the 17 private banks in Iraq served predominantly to take deposits rather than finance investments, and that the largest of these private banks had only \$1

million in capital. Finally, our evaluation of Iraq's legal regime showed that Iraq lacked a competent supervisory or effective regulatory structure to oversee the financial sector.

Despite this bleak assessment, the Iraqi bankers we engaged with from the private and public sectors—as well as key finance officials—shared an eagerness to adopt the reforms necessary to develop a modern, efficient financial sector. Though they lack technology, resources and experience, after only a few months, significant progress has already been made toward this goal.

First, the Iraqis are moving towards the establishment of a modern legal and regulatory framework for the financial sector. For example, working with experts from central banks and other governments and the International Monetary Fund, we helped Iraq to prepare a modern banking law and a new central bank law, both based on international best practices. The banking law was enacted in late September and contains many provisions designed to support the development of a strong, robust banking sector, including higher minimum capital requirements (10 billion dinars, or more than \$6 million), and more rigorous standards for bank licensing and for bank governance.

We expect the central bank law to be adopted soon by the Iraqi Governing Council. It will not only confirm the independence of the Central Bank established by a July 7 CPA order, but will also prevent the Central Bank from engaging in inflationary financing of the government. Indeed, it establishes price stability as the primary macroeconomic objective of monetary policy.

Second, the Central Bank Governor announced that interest rates on all domestic financial instruments—loans, deposits, and securities—will be fully liberalized by March 1. This measure is an important step in the direction of creating a modern, efficient financial sector, because it will enable lenders and borrowers to make their own decisions rather than having them determined by fiat and top-down directives issued by the Central Bank.

And third, the Iraqis have taken significant steps to reinvigorate private banks in Iraq. Under Saddam's regime, private banks fared poorly—they controlled less than 8 percent of total banking assets, used antiquated technology, and offered very limited services. Despite their weaknesses, Iraq's private bank managers have been eager to develop their capacity to operate as modern, commercial bankers. As provided under the new banking law, these banks can now provide new services to their clients. Already, ten banks are receiving international payments and remittances, and issuing letters of credit. With 143 functioning branches, international payments and remittances are now estimated at more than \$5 million per day into Iraq. This influx of funds will play a major role in financing investment and consumption.

While some of the existing private banks are expected to develop into fully functioning financial institutions, Iraqi authorities decided that it would be important for foreign banks to operate in Iraq because of the experience, technology, and resources they can offer. The new bank law permits up to six foreign banks to enter the Iraqi market over the next 4 years. This is in sharp contrast to the previous regime, which permitted only Arab banks to enter Iraq's market.

Following a request for applications issued in November, Iraq received fifteen applications for a foreign bank license. On January 31, the Central Bank Governor announced the three finalists for the first set of licenses to be awarded—Hong Kong Shanghai Banking Corporation, the National Bank of Kuwait, and Standard Chartered Bank from the United Kingdom. The Central Bank anticipates that all three will be granted a license by mid-March. Already, the National Bank of Kuwait has announced its intent to purchase 85 percent of one of the existing private banks.

Next on the agenda is reform of the state-owned banks. Substantial and sustained restructuring of management, organization, personnel and systems is needed to make these banks competitive. The Iraqi authorities are now working with Treasury advisers to develop a strategy for dealing with the state-owned banks so they can operate profitably and provide a wide array of financial services to the Iraqi economy. In the meantime, we are working with the Iraqis to ensure that the state-owned banks can provide basic services, such as taking deposits, clearing checks, and making loans to support business activity. For the quarter ending November 30, 2003, Iraq's two large state-owned commercial banks, Rafidain and Rasheed, extended loans totaling about \$6 million, primarily to small and medium enterprises.

Trade Bank of Iraq

Given the limited capacity of the Iraqi banking system, we also went forward with a plan to open a trade bank in order to facilitate the imports and exports urgently needed to support Iraq's reconstruction and the transition from the UN's Oil for Food program. When I reported on this initiative last September, the CPA had com-

pleted a competitive bidding process for management of the bank, and negotiations for its establishment were underway. The Bank opened on December 4, 2003, and is now fully operational. To date, the Trade Bank of Iraq has issued over 200 letters of credit worth \$190 million for most ministries and several state-owned enterprises. In addition, sixteen export credit agencies have signed an agreement with the CPA and the trade bank under which they will provide guarantees and short-term credit lines valued at \$2.4 billion.

Iraq's International Debt

I want to turn now to the issue of Iraq's substantial foreign debt problem. Last September, the G-7 finance ministers committed to making their best efforts to resolve this issue by the end of 2004. We have made significant progress towards this goal.

As an indication of the priority we place on this issue, the President asked former Secretary of the Treasury and of State James Baker to serve as his Special Presidential Envoy to work with the world's governments at the highest levels in seeking to restructure Iraq's official debt burden. Over the past two months, Secretary Baker successfully secured commitments from leaders throughout Western Europe, Asia, and the Gulf States to provide at least substantial debt reduction for Iraq in 2004. Final agreement on the amount and terms of this reduction will be negotiated between Iraq and its creditors, including through the Paris Club.

We are also continuing our efforts to obtain the best possible data on how much debt Iraq owes. Current estimates put Iraq's external debt burden around \$120 billion. Paris Club members are owed roughly \$40 billion—\$21 billion in principal and roughly an equivalent amount in late interest. Non-Paris Club governments, chiefly the Gulf States, and private creditors hold the rest.

To further the data gathering effort, the Iraqi Government recently issued a request for proposals from accounting firms and financial organizations to assist in the process of gathering and reconciling data on Iraq's external debt. With this data in hand, all parties will be better able to reach a resolution on reducing Iraq's unsustainable debt burden.

Assessment of Reconstruction Costs and International Fundraising Efforts

Before concluding, I would like to update you on our efforts to mobilize international financial support for the reconstruction and recovery of Iraq. In October, Secretaries Snow and Powell led the U.S. delegation to the Iraq donors' conference in Madrid. Seventy-three countries participated in this conference, which succeeded in raising over \$32 billion, including the \$18.4 billion commitment from the United States.

Donors also called on the World Bank and United Nations to establish a vehicle to channel their resources and help coordinate assistance for reconstruction and development activities. Working with key donors, CPA and the Iraqi authorities, the World Bank, and the United Nations established two trust funds within an International Reconstruction Facility for Iraq (IRFF). We plan to contribute \$10 million to the Facility, which will be equally divided between the World Bank and UNDP trust funds. The World Bank has met several times with Iraqi authorities to identify priority programs and projects under this Facility, and hopes to begin disbursements by July 2004.

In addition, the World Bank has pledged to provide between \$3 and \$5 billion of its own resources over a 4-year period. In consultation with Iraqi authorities, the World Bank will prepare a lending program in support of Iraq's economic development with particular attention to health, education, and the creation of a strong social safety-net.

The World Bank's sister agency, the IFC, has already approved the establishment of a Small Business Finance Facility in Iraq. This Facility will be funded by resources from the IFC, as well as bilateral donors, the Overseas Private Investment Corporation, and private banks, to provide credit to micro and small businesses on a transparent, commercial, and sustainable basis. We are hopeful that this facility will be operational by mid-year.

The International Monetary Fund (IMF) is also laying the groundwork to provide financial support for Iraq. At the Madrid donor conference, the IMF announced that total assistance could range from \$2.5 billion to \$4.25 billion over a 3-year period. Iraqi finance officials met with Managing Director Kohler in Boca Raton over the weekend before traveling to Washington for additional meetings with IMF staff. The purpose of these meetings was to initiate discussions on a policy framework that could become the basis for a funded program later this year.

Frozen Assets

Finally, I am pleased to report that our efforts to persuade governments to transfer assets of the former Iraqi regime back to Iraq have yielded results. To date, more than ten countries have transferred approximately \$650 million in such assets to the Development Fund for Iraq. We are continuing to press other governments—especially Iraq's neighbors—to move quickly to find, freeze, and transfer Iraqi assets so they can be put to use for the benefit of the Iraqi people.

Conclusion

In closing, I would like to stress that despite a difficult security situation, challenging working conditions and limited capacity, the Iraqis are beginning to overcome the grim legacy of Saddam Hussein's regime. With the strong support of the international community, Iraq is making tangible progress towards the establishment of an open, robust market economy that will offer its citizens a promising and prosperous future.

PREPARED STATEMENT OF EARL ANTHONY WAYNE

ASSISTANT SECRETARY FOR ECONOMIC AND BUSINESS AFFAIRS

U.S. DEPARTMENT OF STATE

FEBRUARY 11, 2004

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 they will be used for the benefit of the Iraqi people.

International Assistance

Under the leadership of Secretary of State 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 fiscal year 2004 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 United Kingdom, 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 Cooperation 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 Cooperation 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 to \$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 percent, 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 the 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 percent of the country's export revenues and 95 percent of its government revenues. After months of repairs by United States 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 percent 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 United States, 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 2

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 United States 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 1990–1991 aggression. Previously, Iraq was required to pay 25 percent of its oil export proceeds into a victims compensation fund. UNSCR 1483 pared that requirement to only 5 percent.

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 United States 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 United States and major partners such as the United Kingdom 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, United States-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 thers 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.

PREPARED STATEMENT OF GORDON WEST

ACTING ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA AND THE NEAR EAST
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

FEBRUARY 11, 2004

Introduction

Through the provision of expert policy and technical assistance the Agency for International Development (USAID) is helping to promote U.S. foreign policy goals in the reconstruction of Iraq. USAID activities in Iraq are fully coordinated with the Coalition Provisional Authority and its Administrator, Ambassador Paul Bremer.

Currently, USAID has 16 direct hire staff, 54 contract staff, and 60 Iraqi staff in Iraq. Ten of our expatriates are located in regional offices outside of Baghdad. Contractors and grantees funded by USAID have an additional 700 expatriate and 3,000 Iraqi staff, and have a presence in every province.

Overview

USAID began its reconstruction activities in January 2003 under the Office of Reconstruction and Humanitarian Assistance (ORHA), the predecessor agency to the Coalition Provisional Authority. The first phase of USAID programs aimed to repair the most essential infrastructure and restore the most important social and governmental functions. These efforts are to be completed in June 2004 and are on schedule to achieve their planned objectives.

With the advent of the Coalition Provisional Authority in July 2003, USAID prepared a 2-year program to extend the reconstruction program beyond post-conflict triage. USAID is presently working in four areas of concentration:

- Infrastructure repair: Primarily electricity, water, and transportation sectors (including capital-intensive major projects and community-based small projects).
- Education and health: Primary and secondary schools, university partnerships, primary health care, and reduction of childhood deaths.
- Governance: Introduction of viable, legitimated provincial and city governments that represent their constituents, promotion of a vibrant civil society, support the political transition at the national level.
- Economic growth: Macroeconomics, government finance, banking, private sector development, trade, rural economics, and food security.

During the 6 months immediately following the war, USAID strongly supported public health activities and emergency food delivery to avoid a potential humanitarian disaster. For example, USAID assisted the World Food Program to deliver 516,000 tons of grain to ensure that the population was fed, and enough medical supplies and equipment for 1 million persons.

USAID was tasked by the Administration to manage \$2.4 billion of the April 2003 supplemental appropriation. USAID is currently coordinating with CPA on planning activities it will manage with the fiscal year 2004 supplemental. Presently, the CPA has directed \$1.7 billion of these new resources to USAID. USAID is coordinating closely with CPA on how to implement these funds and on the issue of whether USAID will receive and manage further funds from the fiscal year 2004 supplemental.

USAID has eleven contracts for reconstruction through April, but will be scaling back to nine contracts over the summer. (The airport and seaport management contracts will not be renewed, as Iraqi ministries take over operation of the ports.) We have grants to the United Nations (UNICEF, WHO, UNESCO, and WFP), to five U.S. universities, and nine international non-governmental organizations. As conditions improve in Iraq, CPA, and USAID would like to see a greater number of non-governmental organizations become active with U.S. funding. Through USAID contractors and grantees, USAID have provided financial support to over 600 Iraqi nongovernmental organizations.

Economic Development in Post Conflict Situations

As the lead development agency for the United States, USAID has considerable practical and policy experience in dealing with post-conflict situations. In Iraq, we are applying the economic reform lessons learned in the early 1990's from the former Soviet Union and Eastern Europe. One example of this direct application was a conference held in Baghdad in October, which brought together Eastern European economic leaders, who had a hand in their countries' transition to market economies, with Iraqi economic leaders.

Reform programs in conflict areas require special handling, and USAID brings years of experience from numerous countries: El Salvador, southern Mexico, Guatemala, Colombia, Peru, Bolivia, Angola, Sudan, Congo, Afghanistan, Philippines, Nepal, West Bank, Sri Lanka, Bosnia, and Kosovo.

There are five common themes in all these experiences:

- *Avoid a humanitarian disaster.* The United States has done that.
- *Reactivate food production and markets.* We are assisting the Ministry of Trade to maintain the public ration distribution system, smoothing the importation of food, and working with the Ministry of Agriculture on grain and other food production. Private food markets are functioning.
- *Involve the private sector early on.* Economic growth is good for the poor, and agricultural growth is even better for them.

- *Link economic development with democratic governance.* Good economic governance boosts economic growth. We are reforming the legal and regulatory framework and promoting a transparent tax system.
- *Transparency in government finance and procurements.* Successful introduction of democracy will require the confidence in the probity of public officials and faith in the equity of public investment.

Macroeconomics

At the Central Bank of Iraq, USAID in coordination with Treasury advisers and CPA staff has helped reinforce the independence of this key financial institution. To unify the national currency and reissue banknotes, the Central Bank used a model developed by USAID in Afghanistan. USAID experts managed the logistics of the banknote exchange, helped set up daily currency auctions to maintain control of the exchange rate, and are training the bank staff. At the Central Statistics Office, USAID-financed experts are creating a consumer price index for inflation measurement, setting up national income accounts, and gathering employment information. All these activities assist in enabling the International Monetary Fund to promptly re-engage in Iraq, which will ultimately benefit Iraqi reconstruction.

Government Finance and Procurement

Working with the Ministry of Finance, USAID is putting a financial management information system in place to allow tracking of public funds through the national ministries. This system is also a condition for assistance from the IMF and the World Bank. USAID-financed experts are assisting the Ministry of Finance and provincial authorities to prepare and roll up executive branch budgets that are consistent with the Governing Council's priorities. Our experts are working with the Iraqis on an equitable tax policy—presently a tax called the Reconstruction Levy—as well as options for a variety of income and use taxes and customs duties. We want the tax system to be transparent to the public, so that tax cheats will be identified more easily.

The Ministry of Finance is being prepared to share national revenue with governorates and municipalities. USAID is also financing the introduction of international accounting standards, reliable property inventories, and a public procurement law.

Banking

Iraqi banks have little recent experience with modern practices in financial systems. To help commercial banks function more efficiently, USAID-financed experts are developing a mechanism for interbank funds transfers. The state-owned banks are receiving improved systems in accounting, cash flow management, interest accrual, and computerization. USAID coordinates its work in the banking sector with technical assistance provided by the Treasury.

Private Sector Development

Together with other Federal agencies, USAID is assisting the CPA, the Governing Council, Ministries, and business groups to establish a legal and regulatory framework for the new Iraqi economy. This framework includes a commercial code, a labor law, and foreign and domestic company registration. Leasing, contracts, insurance, and mediation laws also are planned.

For electricity, USAID is helping the Ministry of Electricity estimate growth in demand, costs of providing service, and possible user tariffs to finance electricity. In addition, we are advising on accounting, internal controls, billing, and staffing. Iraqi banks are not structured to successfully lend to private enterprise. To finance private businesses, USAID has begun a substantial reform of bank lending processes, staff training, and lending policy aimed at micro-, small-, and medium-sized enterprises. USAID partners manage two microenterprise loan programs that have made over 2,000 loans.

To deal with state-owned enterprises, CPA tasked USAID experts to assess the financial and commercial viability of numerous enterprises. CPA is still considering when and if to restructure these enterprises. USAID also provided analyses of best practices implemented by national oil and refining companies around the world—including several in the Gulf Region—to assist the Iraqi Oil Ministry in evaluation the present structure of its petroleum sector.

Trade and Competitiveness

Among the lessons from other post-conflict countries is the need to avoid dependence on a single export commodity. While oil will continue to dominate export earnings, Iraq can become competitive in at least two agricultural crops. Northern Iraq produces high quality durum wheat, poorly suited for bread but excellent for noo-

dles, that in the past has been exported to Turkey and Iran. Southern Iraq has 16 million date palms. USAID is assisting the Ministry of Agriculture to increase the quality and quantity of the bahri date, which is the most valuable.

Food security

Iraq needs a sustainable way of ensuring that its people have secure access to affordable food. Presently, the Iraqi Public Distribution System, managed by the Ministry of Trade, attempts to feed the entire nation. To visualize the complexity of this task, imagine the U.S. Department of Agriculture issuing ration cards, and then providing subsidized food, to everyone in the United States. As many as 10 million Iraqis do not depend on the basket of publicly supplied foods.

Reform of the food subsidy will have political ramifications. For instance, continued importation and distribution of subsidized grains will continue to stunt rural employment and drive down rural incomes. A stable, financially sustainable safety net ought to remain under the truly needy, and could incorporate a substantial role for private sector purchases in lieu of 100 percent government procurement. It is important for Iraqis begin discussion of alternatives to an open-ended subsidy during the transitional administration, to avoid the perpetuation of a costly entitlement program.

Agriculture and the Rural Economy

Agriculture can absorb a substantial amount of labor, while increasing food production and incomes for the poor at the same time. Rural jobs are particularly important when they help keep young men employed in the villages. There, they remain under the moderating influence of family, mullahs, and others. When unemployed young men migrate to cities in search of work, these influences are lost and the youth can gravitate towards gangs and militant groups. Stimulating the rural economy will stem this urban migration and keep men in the rural areas. USAID's agriculture program aims to improve farm production, support business development, and rehabilitate irrigation systems.

Title to land and water define the property rights in rural Iraq. A family's investment in house and production depend on clear land title. Irrigation water lies under the control of Ministries that own the pumps and village elders that control distribution. Poorly maintained irrigation systems concentrate natural salts in agricultural soils, rendering them too saline for cultivation. The October 2004 goals for USAID's agricultural assistance include increased grain and horticultural crop production, vaccination of dairy cattle for hoof-and-mouth disease, 1,000 loans to small agricultural businesses, and a 25 percent increase in irrigated land through repaired equipment.

Conclusion

USAID is helping Iraqi Ministries apply the lessons of numerous post-conflict states to the Iraqi economy. Timely but judicious reforms can be expected to generate jobs, both in cities and on farms. These reforms underlie the conditions that attract donor and private investment as well as providing the conditions for a private sector to flourish. Transformation of the Iraqi economy will be one of the lasting benefits of the post-war reconstruction.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR HAGEL
FROM EARL ANTHONY WAYNE**

Q.1. What is the CPA's policy on food tenders administered by the World Food Program? Can non-members of the Iraq coalition bid on contracts?

A.1. WFP food tenders are done under WFP tendering rules and are open to international competition.

All companies on WFP's Registered Vendors List are invited to bid on contracts. (The list is based on performance.) In addition, all rice vendors on USDA's Registered Vendors List are invited to bid on rice contracts.

CPA and WFP are working closely to ensure that United States suppliers can fully participate in procurement competitions.

Q.2. Does Iraq have enough food to last until June 2004? If not, how are the food purchases going to be handled until then?

A.2. The CPA, the Iraqi Ministry of Trade (MOT), and the World Food Program (WFP) are working together to ensure that the food pipeline for the Iraqi people will continue to be filled.

Pursuant to an agreement signed in January, the WFP is procuring urgently needed new commodities and is working with the CPA and the MOT to complete the delivery of outstanding Oil for Food (OFF) contracts. The MOT is scheduled to take over all new procurement from WFP as of April 1.

The CPA's plan includes building 3 months of buffer stocks by the time of the transition to Iraqi management of the food Public Distribution System in July. Changes in contract specifications, problems in coordination between MOT and CPA, and delays in the release of funds for procurement, however, initially hampered WFP's ability to build those buffer stocks. These problems appear to have been resolved.

The WFP and the CPA are also engaged in capacity building for the MOT in order that the Ministry can adequately carry on its new responsibilities for procuring and distributing food to the Iraqi people.