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Can Iraq Pay for Its Own Reconstruction

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Chairman Delahunt, Chairman Ackerman, Congressman Rohrabacher, Congressman Pence, members of the subcommittees, ladies and gentlemen: Thank you for the opportunity to appear before you today to discuss Iraq's ability to manage and pay for its own reconstruction. I appreciate your raising this question, as a critical dimension of the President's New Way Forward is that the Iraqis take responsibility for their future. The Government of Iraq must, with our help, take the lead in articulating and achieving the political, security and economic goals that are essential to success.

I would like to talk to you today about the economic track of reconstruction in Iraq and how the Iraqis are increasingly taking responsibility for their own reconstruction, their country, and their future. I will outline what the Iraqis have done and are poised to do, and what the US is doing to help the Iraqis build their capacity. It is vital that we support Iraq during this time of transition so that Iraq develops the ability to manage and sustain its own reconstruction.

Iraqi Efforts

There are tangible signs that the Iraqis are committed to taking the lead on reconstruction and doing their part to advance economic reform. The passage by Iraq's Council of Representatives of key economic legislation such as a national investment law and a fuel import liberalization law, Iraq's pursuit of accession to the World Trade Organization, Iraq's beginning debt negotiations with Saudi Arabia, and Iraq's attempts to tackle the insidious problem of corruption, all signal that the Iraqis are serious about economic reform. Admittedly, these laws still need implementing regulations. It is a work in progress.

In addition, the Government of Iraq has made serious progress on the vital hydrocarbons framework law. The Council

of Ministers approved a draft of the law on February 26, and when a draft Revenue Sharing Law is also approved by the Council of Ministers, the two will be submitted as a package to the Council of Representatives.

In conjunction with Deputy Under Secretary of Defense Paul Brinkley, the Iraqis are aiming to boost legitimate economic activity in Iraq. This strategy has three components: (1) facilitate Iraqi and DOD procurement of Iraqi-made goods, (2) promote connections between U.S. and Iraqi businesses, and (3) identify Iraqi state-owned enterprises (SOEs) that have the potential for revitalization and privatization. Revitalization of promising SOEs may then lead to positive spin-offs in the Iraqi private sector, which has in the past grown around the presence of SOEs. There is also potential for long-term privatization. The GOI has identified some initial funding for SOEs to resume production and increase employment. The State Department actively supports this initiative.

Budget Execution

Among the most pressing economic challenges holding Iraq back from its true potential, apart from the ongoing violence, is Iraq's continuing inability to fully spend its capital investment and reconstruction budget. The Government of Iraq has substantial financial resources available - the result of unspent funds that have been rolled over from the 2006 capital budget, along with higher than anticipated oil revenues. While those resources provide the Iraqi Government a golden opportunity, Iraq must develop the full means to put that money to use, not only with respect to medium-term and longer-term capital investment, but also with respect to short-term efforts in which money must be spent rapidly, as is the case with post-combat stabilization in areas such as Baghdad and Anbar Province. At present, the Iraqis have only limited capacity to execute all of these investments, particularly the short-term efforts necessary to support the new security strategy.

The Iraqis have responded by making budget execution a high priority in 2007. The Government of Iraq is committed to spending \$10 billion in its 2007 budget on capital investment and reconstruction. Spending these moneys should provide services - from bridges and water projects to schools - for all of the Iraqi people. It should help create jobs and further national reconciliation.

To this end, the Government of Iraq has formed a Budget Execution Task Force, led by Deputy Prime Minister Barham Salih, Finance Minister Bayan Jabr and Planning Minister Ali Baban. In coordination with Ambassador Tim Carney and a team of experts from the U.S. Department of the Treasury, the Iraqi joint task force held a conference in early March at which officials from Iraq's spending ministries and Iraqi provincial governments discussed Iraq's new budget regulations and dispelled concerns about corruption allegations that, in part, stymied Iraqi spending in 2006.

Last week Deputy Prime Minister Salih hired a director to monitor Budget Execution. The Ministry of Finance also has made early efforts to jumpstart spending by ordering 10 percent of capital budgets to be released following passage of the 2007 Budget in February and creating powerful incentives for ministries to execute their capital budgets or risk losing the funds.

We remain cautiously optimistic that Iraqi resolve, combined with the technical assistance from the donor community, will result in better Iraqi budget execution in 2007.

International Compact

Recent developments with the International Compact with Iraq provide clear signs of Iraq increasing its responsibility for its own economic reconstruction. The Compact provides a framework for Iraq to achieve economic self-sufficiency in the medium term, including detailed timelines and benchmarks for goals covering Iraq's main economic objectives. The reforms in the Compact will lay the foundation for a strong private sector capable of attracting investment capital from within and outside Iraq. To support Iraq in these efforts, the international community will provide Iraq with debt relief and financial and technical assistance. This technical assistance is particularly crucial, since this is what is needed to build managerial and administrative capacity in the ministries and provincial governments for them to carry out reconstruction.

The International Compact was approved by Iraq's Council of Ministers on November 26, 2006. The Compact documents were finalized and presented to the international community on March 16, 2007 in New York. Iraq is ready for the next step, which is the convening of an international conference later this spring to formally sign and adopt the Compact.

U.S. Efforts

As Iraqis take the lead in economic reform, the United States has shifted its focus from large infrastructure projects to capacity development and technical assistance programs that increase the ability of Iraqis to manage their own reconstruction. This will allow the Government of Iraq to better plan and execute its capital budget - particularly in the critical oil sector - to increase production of essential services in vital areas such as electricity and water, and to improve governance at the national and provincial levels.

Ambassador Tim Carney

To lead our efforts in this area, Secretary Rice appointed Ambassador Tim Carney as the Coordinator for Economic Transition in Iraq. On the ground in Baghdad only since February, Ambassador Carney has already forged a partnership with the Iraqis that has begun to show progress.

Ambassador Carney has been accepted by Iraqi authorities as a partner in realizing their budget execution goals. He works with Deputy Prime Minister Salih and the Ministers of Finance and Planning to synchronize efforts and ensure that U.S. assistance meets Iraqi government needs. Following an Iraqi government conference on March 7 to train officials on budget execution procedures, Ambassador Carney opened a conference for our Provincial Reconstruction Teams (PRTs) to ensure that our PRTs understand the fiscal procedures for which the provincial governments-which have limited experience with budget management-would need support. Ambassador Carney is also coordinating a broad U. S. Government effort to encourage the Government of Iraq to advance its own stalled budget execution reforms, such as raising the ceiling under which an Iraqi spending agency can issue a contract without prior approval of the Ministerial High Contracting Committee.

National Capacity Development Program

To effectively manage the country's reconstruction efforts, Iraq's mid- and senior-level managers need ongoing training to polish their skills in the core functions of public administration, as well as specialized, technical assistance specific to their areas of operation. Thus, our National Capacity Development (NCD) program is taking a two-pronged approach in building the capacity of Iraq's cadre of public administrators. We are assisting the Iraqis in developing a standardized curriculum to teach core capabilities, in such areas as personnel management and administration,

strategic planning/policy development, leadership/communications, and information technology. In addition, the NCD program is placing Public Management Advisors in the ten key ministries to provide ongoing technical assistance to improve the day-to-day operations within each ministry.

This three-year, \$165 million program will help foster the start of a more professional Iraqi civil service through an institutionalized, sustainable training system that will promote modern management through Iraq's public institutions. The program will provide short-term support for key Iraqi government priorities, help Iraqis carry out medium-term activities to improve and standardize public administration, and help invigorate Iraqi government training centers to provide sustainable human resource development. To address Iraq's need for a government that promotes transparency, integrity, and accountability, the NCD program includes standardized auditing and procurement reform and other vital governance measures. It will help Iraqis establish capacity in priority ministries to directly assist in the execution of key service functions and conduct on-the-job training.

Provincial Reconstruction Teams (PRTs)

At the center of our efforts to build capacity is the expansion of our Provincial Reconstruction Teams (PRTs). While we will continue to work closely with the central government in Baghdad, we are extending and expanding our reach beyond the International Zone to help local communities and leaders transition to self-sufficiency.

We are doubling the number of PRTs from 10 to 20, and adding more than 300 new personnel to the current 290 or so personnel already on the ground. The first phase of PRT expansion is soon to be complete, as the ten new interagency PRT core teams, 40 people in total, will arrive in Iraq by March 31. The State Department has assigned ten senior-level Team Leaders for these new PRTs. Each Team Leader will be joined by a senior USAID development advisor, as well as a civil affairs officer and a bilingual, bicultural advisor from the Department of Defense. The ten new PRTs will be embedded in Brigade Combat Teams to increase support for our counter-insurgency strategy.

One key objective of PRTs will be to build local capacity. Through both civilian and military resources, including foreign assistance and the Commanders' Emergency Response Program (CERP), PRTs will foster Iraqi self-sufficiency where we have made security gains. In the next two phases of our PRT expansion, we will add specialized technical personnel to both new and existing PRTs. Based upon ground-up evaluations, we are recruiting city planners, rule of law experts, and agri-business development experts, among others, to meet provincial and local needs.

PRTs will support local moderate Iraqi leaders through targeted assistance designed to develop provincial capacity to govern effectively. PRTs will continue to play a leading role in coordinating U.S. programs funded by the Congress, including Iraqi Provincial Reconstruction Development Councils (PRDC) and USAID's local governance, community stabilization, economic development and community action programs. We intend to complete all three phases of our PRT expansion by the end of the calendar year. This will depend, however, both on the level of funding appropriated in the FY 2007 supplemental and circumstances on the ground.

Funding

Of total funding in FY 2006, both Base and Supplemental, we have obligated \$1.4 billion (or 97%) for programs to advance our policy objectives in Iraq. Of this funding, more than \$500 million is allocated to support programs coordinated by the PRTs to build the capacity of local and provincial governments to provide services for the Iraqi people.

We have requested \$2.34 billion in Emergency Supplemental funds for FY 2007 and \$1.37 billion for FY 2008. The question naturally arises as to why we need to provide assistance if Iraq's oil provides significant revenue. The answer is straightforward: Our assistance is necessary to accelerate the capacity of the Iraqi government to become self-sufficient. As described earlier, experience has shown that the Iraqis currently have significant limitations in their ability to spend their budget. While the ultimate goal is to get them to execute their budget as quickly as possible, we have to recognize reality. The reality in Iraq is that the Government of Iraq has limited institutional history of how to manage all aspects of the needed reconstruction and capital spending projects, including, but by no means exclusively, short-term projects in support of Iraq's own security.

We have increasingly shifted reconstruction contracts to Iraqi firms to inject revenue into the local Iraqi economy and build Iraqi capacity to meet Iraq's needs. Initially only 5 percent of 15,241 USG-funded contracts was awarded to Iraqi contractors. In the last six months, an average 80 percent of actions have been on contracts awarded Iraqi firms, thereby infusing local firms with capital and developing their economic ability to meet local needs.

The Supplemental and budgetary funds are essential to helping the Iraqis untangle their own bureaucratic gridlock and allowing them to manage and spend their own resources. Our assistance during this transitional year is critical to help the current Iraqi government develop the skills to manage their country's reconstruction. Delaying funding of these programs or applying conditions on this funding would undermine our ability to support our military. Without funding for our PRT expansion and programs to support economic development and assistance to moderate Iraqi leaders, we risk not achieving the unity of effort, military and civilian, needed to be successful.

Defining Success

The coming year in Iraq is an important one of transition that will be filled with challenges. As the Iraqis continue to make progress and increasingly assume responsibility for the stabilization and economic development of their country, our commitment to them must remain strong. The Government of Iraq should continue to foster positive relationships with its neighbors. National unity must begin to replace sectarian violence. The President's New Way Forward in Iraq seeks to empower Iraqis at the national, provincial and local levels to take the necessary steps, both politically and economically, to fulfill their commitments and realize our mutual goal of a stable, federal, democratic Iraq, at peace with its neighbors and an ally in the war on terror - an Iraq that is able to manage and pay for its own reconstruction. Thank you very much. I look forward to your questions and ideas.

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