

Final for Delivery

Remarks by

Ambassador Charles Ries

Minister for Economic Affairs and Coordinator for Economic Transition

U.S. Embassy Baghdad

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INTRODUCTION

Thank you for asking me to join you today. I am delighted to be back in London, where I spent four busy years at the American Embassy on Grosvenor Square. It is a special honor to speak at the London School of Economics, among the foremost centers of thought and learning on the economic challenges of our day. This evening, I plan to outline our work in support of Iraq's own efforts to build a growing economy, a topic that I think you'll agree is not only of economic, but also strategic, importance.

My functional title at Embassy Baghdad is “Coordinator for Economic Transition in Iraq”. We are focused on **transition** because as the President pointed out last week in his State of the Union message last week “... after decades of dictatorship and the pain of sectarian violence, reconciliation is taking place – and the Iraqi people are taking control of their future.” Moving to a sound economy is a key part of this transition, which we and the Iraqi government agree should be a process led by Iraqis, with the support of the international community.

DEFINING THE CONTOURS OF TRANSITION

Iraq is undergoing not only a transition from conflict to post-conflict environment, but also from decades of a cumbersome state-run economy to a market economy. From the early 1970's, Iraq's economy became increasingly statist as the previous regime used oil wealth to expand its control over the lives of its citizens. During the 1980s, development was constrained by the disastrous war with Iran and the debt Iraq incurred to fight it. Iraq became a true command economy as Saddam used economic might to reward his supporters and crush his enemies. One example: Saddam built a power grid across Iraq designed to serve Baghdad alone. It will take years to adapt and reinforce that grid, and build the new generating capacity needed to serve all Iraqis.

State control of the economy continued to increase in the 1990s. In response to sanctions imposed after the 1990 invasion of Kuwait, Iraq launched a huge import substitution program, building inefficient state-run industries. And the "Oil for Food" program created the Public Distribution System -- supplying a wide range of food items and fuel to most of Iraq's citizens. This program remains, to this day, the largest single expenditure in the Federal budget.

Coalition forces that ousted Saddam Hussein found an Iraqi economy staggered by mismanagement, and years of conflict with the international community. Critical infrastructure lay in ruins, or collapsed as key technicians fled. Years of neglect took their toll. Unemployment resulted from the insolvency of state-run factories and the demobilization of the Iraqi military. Isolated from the world for years and saddled with crippling foreign debts, there was practically no trade and no investment. Iraqis had fallen behind in every area of economic development.

OUR GOAL

Against this troubled backdrop, we are working with our Iraqi and Coalition partners to move forward. Our goal: a self-sustaining, successful economy managed **for** the Iraqi people, **by** the Iraqi people. That means it will be up to the

Iraqis to decide how best to balance the role of the state and the private sector in the economy.

Iraq's government is planning for a more dynamic economy led by private sector development and growth, an economy playing an active part in the region and in the international system. Their vision is supported and endorsed by the international community in the International Compact with Iraq, which aims “To build a secure, unified, federal and democratic nation, founded on the principles of freedom and equality, and providing peace and prosperity for its people.” Our task is to help Iraq set the stage, to develop the skills and build the institutions it needs to shape its economic development.

IRAQ’S FIVE ECONOMIC DEVELOPMENT CHALLENGES

Many challenges confront us as we do so. Security is, for many investors, of paramount importance. It is the focus of both Iraqi and coalition efforts; it is the reason for the U.S. surge in troop strength last year. And the surge is working. Iraqis are coming together to reclaim control of their neighborhoods and institutions. It is gradual, but the process is underway.

But Iraq faces five key challenges as it moves forward to build the successful economy that its people deserve.

Government Responsiveness

The first is to enable the Iraqi government to respond to the needs of its citizens.

The Iraqi people should see that they have a functioning government that can identify and respond to their needs. How will they judge its performance? One way is by seeing their government formulate, pass, and spend its budget.

Effective budget execution and delivery of services is the key to bolstering the Iraqi people's faith in their government. Resources exist – the Government of Iraq's budget has doubled from \$20 billion in 2004 to \$41 billion in 2007, largely as a result of dramatically higher oil export prices. As the government improves its budget execution rates more citizens are sharing the benefits of Iraq's oil wealth.

Another way to judge performance is by seeing that budgets and services reach the people beyond Baghdad. Provincial and municipal issues are best understood and resolved locally, not from afar in Baghdad. For that reason, the Iraqi Parliament right now is debating a provincial powers law to continue devolving power -- and resources -- to local governments across Iraq. Doing so requires better communication between the levels of government, to ensure Iraqis throughout the

country share equally in the benefits of a growing economy. Beginning with modest provincial budgets initiated in the 2005 budget year, central government direct transfers to the provinces have grown to over \$2 billion in 2007, with further growth proposed in the budget for 2008. Many were initially skeptical about this program, as provinces had never managed direct transfers from the central government's budget. But with our help, spending rates have accelerated, contracting has become more professionalized, and the provinces are beginning to meet local needs.

Finally, Iraqis know that a responsive government must be accountable for its actions. Corruption remains pervasive in Iraq, squandering valuable resources and creating mistrust. The Iraqi government took an important step when it hosted an anti-corruption conference on January 4. The United Nations is planning a similar effort in Iraq this March. We at the Embassy are increasing our support of the Iraqi government's strategy on this critical issue.

Harnessing Iraq's Energy Resources

The second major challenge is effective use of Iraq's energy resources, both for export or as fuel for industry. Iraq has a great advantage over most transitioning states. Its vast oil wealth is providing vital revenue, and can become the center of

a vibrant industrial economy. But oil and gas in the ground is only prospective wealth. The Iraqis must develop ways to exploit more effectively these resources.

Among the essential, interconnected steps to do so are:

- Final agreement on a hydrocarbon framework law, which will pave the way for development of more of Iraq's energy resources for the benefit of the Iraqi people;
- Expansion and upgrading of refineries in Iraq, which will ensure fuel supplies to power broad economic growth;
- Allocation of fuel for electrical generation, and in particular the capture of millions of cubic feet of natural gas, that will light Iraqi homes and power factories that can employ tens of thousands;
- And increased exports, both of oil and of natural gas, which will generate expanded revenues and forge stronger international ties, linking Iraq into the regional and international economy.

Attracting Investors

The third major challenge for Iraq is attracting investment. That means attracting foreign investment and encouraging Iraqis to invest in their own country. The main obstacle is Iraq's dysfunctional banking system. The major state-owned banks currently serve as little more than cash transfer mechanisms; private banks are growing, but remain too small to provide any significant loan capital for economic development. Banking sector reforms need to be expanded and accelerated to provide a stable regulatory environment for new lending and additional services, such as mobile banking.

Attracting investment also means ensuring transparency. Investors – domestic and foreign -- look for transparency, predictability, and enforceability. They need to know what the rules are; they need to know how the rules work; and how they can get fair redress if the rules are broken. Iraq's Investment Law largely provides that framework. The appointment of a National Investment Commissioner and the publication of implementing regulations for the law will be another important step to convince investors of Iraq's potential for solid returns.

Investors want to see what they are getting into and they want to meet their potential business partners. In Iraq, that can be a challenge. A new business hotel at the Baghdad International Airport, complete with security, has been built and

will provide business travelers with a secure and convenient location to meet Iraqis and negotiate deals face to face. Additionally, several groups are interested in building international class hotels in downtown Baghdad.

Finally, in a global economy, investors need to know that their products will be able to compete fairly. Iraq currently offers no tariff protection but only collects a five percent reconstruction levy. It has no anti-dumping legislation, a weak system of intellectual property rights protections, and a dysfunctional customs administration. Joining the World Trade Organization will help Iraq resolve many of these issues. It recently submitted a draft legislative package to the WTO as part of the application process.

Employment and Economic Reconciliation

The fourth economic challenge Iraq faces today is unemployment and underemployment. Officially unemployment is eighteen percent, but underemployment is much higher -- perhaps as high as forty to fifty percent. Jobless Iraqis feel that they have little stake in the future of the country; underemployed Iraqis are frustrated that they cannot contribute more. As Iraq makes progress on governance, energy policy and investment issues, employment will rise. In the meantime, we also need to provide some short-term relief.

We have a variety of programs designed to do just that.

One is the Concerned Local Citizens or CLCs, sometimes referred to as the “Awakening”. It is not an employment program. It was originally an effort to encourage and support local Iraqis who step up to provide security for economic infrastructure in their communities. These individuals have been a key part of the success of the security surge. Having given them a stake in securing the future of their homes and communities, we are now working with the Iraqi government to provide them with opportunities for employment.

Our Community Stabilization Program provides jobs, essential services, vocational training and micro-grants, particularly in recently stabilized areas. A pilot Civilian Service Corps program launched by U.S. forces will provide jobs and vocational training to Iraqis who band together to undertake reconstruction and infrastructure development projects in their neighborhoods. A task force led by Deputy Under Secretary of Defense Paul Brinkley has worked with the Minister of Industry and Minerals to revive some of Iraq's state owned enterprises and put people back to work. Additionally, the Ministry of Industry and Minerals recently concluded three production sharing joint ventures with international companies for cement

factories in Iraq. These deals provide a framework for future deals, and demonstrate that Iraq is open for business.

Agriculture

The fifth major challenge is reviving Iraq's agricultural sector. The land of the two great rivers, the Tigris and the Euphrates, can and should again have the most advanced farming sector in the region. Iraq's old Stalinist, centrally planned model that replaced market signals crushed farmers and decimated productivity. The current Public Distribution System, in which the Iraqi government inefficiently procures and distributes a basket of food items to all Iraqi citizens, regardless of need, further distorts the agricultural sector. A new system is needed to empower farmers to respond to market forces. A sound policy would encourage agribusiness at all levels, from tractor manufacturing and seed distribution to the food processing and distribution systems. It would be supported by regulatory mechanisms to ensure that consumers can buy wholesome food. Such a policy would allow Iraq to take its place as a major supplier in regional agricultural markets.

WHAT ARE WE DOING?

These five challenges – ensuring government responsiveness, harnessing Iraq's energy resources, attracting investors, promoting employment and reviving Iraq's agricultural sector -- are our highest priorities. So what are we doing to address them?

We are moving beyond the "bricks and mortar" type of reconstruction projects we began with in 2003 and 2004. It is time for us to get out of the way and let the Iraqis take responsibility for building their future. Budget mathematics make this not just a goal, but a fact. The government of Iraq's budget for 2006 and 2007 together allocated \$6 billion for the Ministry of Oil and \$2.3 for the Ministry of Electricity, amounts far in excess of what donors could provide. The budget for 2008 will provide for similar magnitudes in capital spending allocations. Our work in Iraq is changing from spending our own resources to helping the Iraqis spend their resources as productively as possible. That is our long-term goal.

During this transition, we are giving our Iraqi partners some short-term support, so they can maximize their own effectiveness. In areas where fighting has recently ceased, the CLCs and Community Stabilization programs ensure that Iraqis see and feel the tangible benefits of a democratic and stable Iraq. These programs are closely coordinated with the military brigades operating in those areas, many of

which include embedded civilian Provincial Reconstruction Teams. They work directly with local citizens and leaders to identify the most pressing needs and find resources to address them – whether from Iraqi, Coalition, or other sources.

At the national and provincial levels, we are fully engaged in helping Iraqis strengthen the capacity of ministries and government leaders to carry out their duties. That means ensuring officials have the skills and tools needed to do their job, whether it's operating a water treatment plant or contracting for a new power plant. It also means building up the government's ability to operate efficiently -- improving its ability to recruit and train staff, to develop budgets, and to use technology efficiently. All are essential to building capacity. All are essential to ensure that our short term successes are sustainable in an economy managed by Iraqis, for Iraqis.

In many of these tasks we are joined by international partners, both within the framework of the Coalition and increasingly through other multilateral initiatives. Most important is the International Compact with Iraq. In the Compact, the Government of Iraq lays out its most important priorities for development, and the international community pledges its support for the reforms needed to achieve

those goals. A Compact secretariat will provide the mechanism to match requirements with donor resources.

HOW ARE WE DOING? BETTER THAN YOU THINK

While it's easy to point to the myriad challenges and problems that lie ahead, it's important to take a clear-eyed look at what we have achieved. The economy of Iraq is growing. How fast is hard to say because of data problems and lags. The IMF however acknowledges that real GDP growth in 2007 was likely much higher than the 1.3 percent that the available midyear 2007 figures show. And on present trends, the IMF projects 7 percent growth for 2008, which seems about right to me. In fact, with the support of the IMF, Iraq has made great strides in achieving fiscal and monetary stability. The dinar is growing stronger, and inflation -- which approached 65 percent last year at this time -- has dropped to under 5 percent. This should allow the Central Bank to reduce interest rates, a move that should support lending and encourage investment.

One of the economic echoes of the security surge has been an increase of 9.1% in new businesses registered nationwide during 2007 (compared to the previous year). Over 30,000 private sector companies have registered since 2003. Over 100,000

micro-loans have been made across Iraq. These microloans are seeing a virtual 100% repayment rate, a testament to the strength of the informal private sector. Iraqi merchants are meeting the demand for goods and services and reviving markets in cities and towns throughout the country. We are also seeing growth and development by middle market companies. Our middle market loan program is fully committed and performing well. We would have more customers if we had the funds. But this task too will be increasingly Iraqi-led.

In the energy sector, electrical production continues to grow; new production records were set during the second half of last year. During the critical Iraqi summer peak period, production output in 2007 outpaced 2006 by about 20%. And the cumulative increase in MWH output for the period September through mid-November 2007 over the same period in 2006 exceeded 1 million MWH. Nonetheless, electricity demand has multiplied since the fall of Saddam and outpaces even this increased supply. The Ministry of Electricity estimates that demand has grown over 70% since 2004 – the effect of Iraqis purchasing air conditioners, refrigerators, and other consumer products. Such investments in consumer durables are a reflection of consumer confidence in their future in Iraq. Another measure of progress in electricity is the fact that the number of unplanned

outages has dropped dramatically as the Ministry of Electricity grows more skilled at performing preventative maintenance.

And in the oil sector, production and exports also continue to grow, as the Ministry of Oil slowly rehabilitates its facilities and as Iraqi security forces improve their ability to protect pipelines and other vital infrastructure. During the last quarter of 2007, oil production averaged nearly 2.4 million barrels per day and oil exports averaged 1.9 million barrels a day. With high world oil prices, this has made a substantial contribution to Iraq's budget: oil export sales topped 41 billion dollars for 2007.

The government's ability to renovate and build has improved. In 2006, the Iraqis were able to spend only about 22 percent of the ministry and provincial capital budget allocations. While modernization of the government of Iraq's accounting makes direct comparisons between 2006 and 2007 difficult, initial data from the Ministry of Finance suggest that, when published, final 2007 financial data will show that 2007 capital budget execution rates were more than double 2006 rates. This shows that the Iraqi government is increasingly able to use Iraqi resources to meet Iraqi needs.

CONCLUSION

Iraq is on an upward economic, as well as security, trajectory. Sometimes it is by fits and starts, but real progress is being made. The progress which we see on the ground in Baghdad and across the country is real. It is, I would argue, much better than may be generally understood.

That said, the situation remains very fragile, and will require continued support by the international community to encourage the kind of economic and governance reforms Iraq needs to continue on this upward path.

Many challenges lie ahead. The future of Kirkuk, Iraq's relationship with Iran and with other neighbors and partners, and the sustained effort required to finish a determined insurgency are some of the questions that Iraq must address to guarantee its stability and prosperity. But the fact that Iraq has made the economic progress I've outlined here gives us reason for hope and will underpin the political and security process.

Much remains to be done, and many political bridges remain to be built. But the political will of the vast majority of Iraqis to build a better future is strong and

growing. With their determination, and with international support, Iraq will succeed.

Thank you very much.