



B-71 Cannon House Office Building
Washington, DC 20515
Representative Paul D. Ryan, *Ranking Republican*

REPUBLICAN CAUCUS

THE COMMITTEE ON THE BUDGET

Phone: (202)-226-7270
Fax: (202)-226-7174
Augustine T. Smythe, *Republican Staff Director*

IRAQ'S BUDGET SURPLUS

WITNESSES

First Panel

JOSEPH A. CHRISTOFF
Director, International Affairs and Trade
U.S. Government Accountability Office

Second Panel

CHRISTOPHER M. BLANCHARD
Analyst, Middle East Affairs
Congressional Research Service

FREDERICK W. KAGAN, Ph.D.
Resident Fellow
American Enterprise Institute

LAWRENCE J. KORB, Ph.D.
Senior Fellow
Center for American Progress

9:30 a.m.
Tuesday 16 September 2008
Room 210 Cannon House Office Building

CONTENTS

Hearing Purpose and Strategy	Page 1
Background	Page 2
Iraq Funding	Page 2
Success of the Surge	Page 3
Expected Testimony	Page 4
Views of Mr. Christoff	Page 4
Views of Mr. Blanchard	Page 5
Views of Dr. Kagan	Page 6
Views of Dr. Korb	Page 7
Suggested Questions	Page 9
Questions for Mr. Christoff	Page 9
Questions for Mr. Blanchard	Page 11
Questions for Dr. Kagan	Page 11
Questions for Dr. Korb	Page 12

HEARING PURPOSE AND STRATEGY

THE DEMOCRATS' TACTIC

- **Oppose the President's Iraq Strategy.** This hearing will continue the Democratic Majority's criticism of the conduct of operations in Iraq, as part of a strategy to build support for withdrawal. Because they were wrong about the troop surge launched in January 2007, which has now proved successful, they are shifting to an argument that Iraq is flush with money while the U.S. economy is struggling.
- **The Purported Iraqi Budget Surplus.** The Democrats also will use the hearing to note that the Iraqis generate oil revenue in excess of what their government is spending on reconstruction and stabilization, but will ignore that these conditions result from improving conditions, and that Iraq lacks the internal capabilities to actually spend the projected surplus.

THE REPUBLICAN FOCUS

- **Avoid Defensiveness.** Republicans should cite the good news in this report: it shows another example of the success of the surge, which has provided conditions in which Iraq can generate oil revenue. The U.S. has made gains in Iraq to the point where its no longer the lead story on the nightly news or headline news on the front page.
- **Acknowledge the Potential of Iraq's Oil Revenues.** The Government Accountability Office [GAO] projects that Iraqi oil exports will generate approximately \$70 billion in revenue in 2008. Unfortunately, due to a lack of trained budget and procurement personnel, Iraq's government is not yet in a position to effectively execute a budget. Republicans should argue, however, that now is not the time to withdraw U.S. support for reconstruction and stabilization. Given the amount of resources and the sacrifice of U.S. life expended in Iraq, withdrawing U.S. support prematurely would squander the gains made there.
- **Point Out Improved Prospects for the Future.** Finally, Republicans will want to contend that as the security environment improves – made possible by the success of the surge – Iraq will be able to improve its oil infrastructure, enhance its government's ability to budget and procure, and wean itself from U.S. assistance.

BACKGROUND

IRAQ FUNDING

- Since the terrorist attacks 7 years ago, the U.S. has appropriated more than \$500 billion on the Iraq front of the Global War on Terrorism in Iraq. Overall spending on the Global War in that period is nearing \$800 billion.
- Since 2003, the U.S. has appropriated roughly \$48 billion for stabilization and reconstruction efforts in Iraq. These funds have been used to develop Iraq's security forces, enhance Iraq's capacity to govern, and rebuild Iraq's oil and utilities infrastructure.
- Since 2005, Iraq has spent \$3.9 billion in four domestic sectors: Security, Oil, Water Resources, and Electricity, estimates the Government Accountability Office [GAO]. Over a slightly longer period (since 2003), the U.S. has spent \$23.2 billion in those sectors. Interestingly, Iraq allocated \$28 billion for these sectors, but – due to a shortage of trained budget and procurement staff, nonexistent to weak budgeting and procurement systems, and ongoing violence – Iraq has been unable to execute, or actually spend, those funds.
- GAO includes “security” funding in its totals. The \$22.5 billion allocated by the United States for security is to help rebuild the Iraqi security forces. When these funds are removed, it turns out that the infrastructure and economic development spending – while substantial at \$20 billion over 5 years – is nowhere near the \$48 billion the report otherwise suggests.
- The argument that Iraqis should fund more of their own reconstruction is valid; and in fact Iraq has been increasing the amount of funds budgeted for capital expenses by roughly 30 percent each year. But greater progress is impeded mainly because the Iraqis' budget and procurement systems are still immature, and they do not yet have the trained personnel to execute their budgets without incurring a tremendous amount of waste. In addition, until recently sectarian violence has been an obstacle to developing Iraqi government capacity.
- To improve Iraqi budget reporting, transparency, and accountability, the U.S. government is working with the Iraqis to reestablish the Iraq Financial Information System. This system was established in 2003, but could not be implemented at the time and was postponed. Now that conditions are supportive, the system should be operational in all 250 Iraq reporting units by early 2009.

SUCCESS OF THE SURGE

- When the President announced the U.S. troop surge in Iraq, (on 10 January 2007) many criticized the plan to deploy an additional five brigades to Iraq, and the House passed a resolution (H.Con Res 63), on a party line vote, explicitly stating its disapproval. Today, however, it is widely acknowledged that the surge has succeeded.
 - A year ago, in September 2007, General Petraeus reported that the objectives of the surge were being met and that ethno-sectarian violence in the country had been drastically reduced.
 - Even Senator Obama, an opponent of the Iraq war, said on 4 September: “[I]t [the surge] has succeeded beyond our wildest dreams”
- With this success, it is now appropriate to focus on how the Iraqis can begin to take further responsibility for their future. Some argue that the Iraqis should be doing more. But before the violence was curbed, it would have been impractical to expect the Iraqis to manage and execute their own budget; and given the amount of corruption that was prevalent, and taking advantage of the violence, misspent funds would have in all likelihood fallen into the wrong hands.
- Some will argue that the U.S. is spending too much on Iraqi reconstruction. They will contend that Iraq is running a budget surplus while the U.S. is sustaining very large budget deficits. Although this is true, the U.S. should be careful not to squander the hard-won gains in Iraq. Iraq is very close to being able to stand on its own and use that surplus to fund its domestic reconstruction.
- The U.S. provides foreign assistance based upon its strategic interests. The success of Iraq’s fledgling government is a strategic goal. The relative wealth of a country – while a consideration – should not be the sole consideration in determining whether aid is warranted. For instance, the U.S. provides economic aid to the many governments worldwide regardless of whether their budgets are in surplus or deficit.

EXPECTED TESTIMONY

VIEWS OF MR. CHRISTOFF

- The main points of Mr. Christoff's analysis for GAO, which he will describe in his testimony, include the following:
 - From 2005 through 2007, the Iraqi government generated an estimated \$96 billion in cumulative revenue, of which crude oil export sales accounted for about \$90.2 billion, or 94 percent. For 2008, the GAO estimates that Iraq could generate between \$73.5 billion and \$86.2 billion in total revenue, with oil exports accounting for between \$66.5 billion to \$79.2 billion. Projected 2008 oil revenue could be more than twice the average annual amount Iraq generated from 2005 through 2007. These projections are based on actual sales through June 2008 and projections for July to December that assume an average export price from \$96.88 to \$125.29 per barrel, and oil export volumes of 1.89 to 2.01 million barrels per day.
 - From 2005 through 2007, the Iraqi government spent an estimated \$67 billion on operating and investment activities. Ninety percent was spent on operating expenses, such as salaries and goods and services, and the remaining 10 percent on investments, such as structures and vehicles. The Iraqi government spent only 1 percent of total expenditures to maintain Iraq – and the U.S. funded investments such as buildings, water and electricity installations, and weapons.
 - While total expenditures grew from 2005 through 2007, Iraq was unable to spend all its budgeted funds. In 2007, Iraq spent 80 percent of its \$29 billion operating budget, and 28 percent of its \$12-billion investment budget. For 2008, GAO estimates Iraq could spend between \$35.3 billion and \$35.9 billion of its \$49.9-billion budget.
 - As of 31 December 2007, the Iraqi government had accumulated financial deposits of \$29.4 billion, held in the Development Fund for Iraq and central government deposits at the Central Bank of Iraq and Iraq's commercial banks. This balance is the result, in part, of an estimated cumulative budget surplus of about \$29 billion from 2005 through 2007. For 2008, GAO estimates a budget surplus of between \$38.2 billion to \$50.3 billion. If spent, a proposed Iraqi budget supplemental of \$22 billion could reduce this projected surplus.
 - Since fiscal year 2003, the United States appropriated about \$48 billion for stabilization and reconstruction efforts in Iraq; it had obligated about \$42 billion of that amount as of June 2008. U.S. agencies spent about \$23.2 billion on the

critical security, oil, electricity, and water sectors. From 2005 through April 2008, Iraq spent about \$3.9 billion on these sectors.

- U.S. government, coalition, and international officials have identified a number of factors that have affected the Iraqi government's ability to spend more of its revenue on capital investments. These factors included the shortage of trained staff; weak procurement and budgeting systems; and violence and sectarian strife. The U. S. has funded activities to help build the capacity of key civilian and security ministries to improve Iraq's ability to execute its capital project budget.

VIEWS OF MR. BLANCHARD

- Mr. Blanchard describes the existing structure of Iraq's oil revenue accounting and the movement of funds as dictated by the United Nations, as follows:
 - Ninety-five percent of the oil revenue generated goes into the Development Fund for Iraq [DFI] and is transferred to the Ministry of Finance. The other 5 percent is used to repay the victims of the 1990 Iraqi invasion and occupation of Kuwait. The International Advisory and Monitoring Board [IAMB] calculates it will take Iraq 17 years to fully repay those victims.
 - At present, Iraq's steady oil export levels and a relative decline in world oil prices from recent highs have moved revenue projections closer to the more pessimistic assumptions outlined in the GAO report. The GAO's lower estimate for Iraq's 2008 budget surplus assumed Iraq would export an average of 1.89 million barrels per day and that the average price received would be \$96.88 per barrel. As of 10 September 2008, the U.S. State Department reported that Iraq's Basra Light Crude was priced at \$100.15 per barrel and that Iraq was exporting 1.93 million barrels of oil per day. Coupled with Iraq's recently adopted Supplemental Budget of \$22 billion, these market trends suggest that Iraq's 2008 budget surplus may remain well below the upper limit projected in the August 2008 GAO report, pending the result of expenditures through the rest of 2008.
- He will also say that while reports about Iraq's current and projected budget surplus have raised questions in Congress about the relative overall size of Iraqi and U.S. expenditures, shortcomings in Iraqi revenue management practices and capabilities also have contributed to the accumulation of surpluses.
 - U.S. and international auditors have not expressed doubt about the Iraqi government's *ability to afford* taking on more of the costs of its reconstruction and security sector development, if oil production expands and export conditions remain favorable.
 - Those auditors and observers have expressed doubts about the Iraqi government's *ability to expend available funds at a sufficient rate or level of efficiency* to maintain the complex, long-term, and large-scale programs required.

IEWS OF DR. KAGAN

- Dr. Kagan will make the following points:
 - On 16 September, General Odierno will succeed General Petraeus as commander of U.S. and coalition forces in Iraq. The surge strategy Petraeus and Odierno developed and executed in 2007 achieved its objectives: reducing violence in Iraq enough to allow political processes to restart, economic development to move forward, and reconciliation to begin. Violence has remained at historic lows even after the withdrawal of all surge forces and the handover of many areas to Iraqi control. Accordingly, President Bush has approved the withdrawal of 8,000 additional troops by February 2009.
 - The Iraqi government has accomplished almost all of the legislative benchmarks set by the U.S. Congress and the Bush administration. More important, it is gaining wider legitimacy among the population. The attention of Iraqis across the country is focused on the upcoming provincial elections, which will be a pivotal moment in Iraq's development.
 - An understandable desire to seize on the reduction in violence to justify hasty force reductions and premature transfer of authority to Iraqis puts the hard-won gains of 2007-08 at risk. The President's announcement of new troop withdrawals has come before it is known when Iraq's provincial elections will occur.
 - The notion, popular in some American political discussions, that withdrawing U.S. forces increases U.S. leverage is nonsensical. The presence of 140,000 American troops on the ground in Iraq requires the Iraqi leadership to pay attention to America's suggestions in a way that nothing else can. Every brigade that leaves reduces leverage just when it is needed most.
 - Discussions in the American media about whether AQI is "really" al Qaeda are puerile. AQI's leadership, largely foreign, is part of the global al Qaeda network operating in support of Osama bin Laden. Bin Laden and his lieutenants in Pakistan and around the world send support (including foreign fighters) to Iraq and closely follow the situation there, as their repeated public pronouncements show no less than their actions. Al Qaeda's central leadership is not prepared to lose in Iraq, and has been seeking ways to regain lost ground.
 - If the U.S. remains firm in its commitment, success in Iraq is very likely. The AQI and Shiite militias do not have the capacity to drive Iraq off course – unless both the U.S. and the Iraqi government make a number of serious mistakes.
 - The most serious error would be to withdraw American forces too rapidly. That would strengthen the resolve of both al Qaeda and Iran to persevere in their efforts to disrupt the young Iraqi state and weaken the resolve of those Iraqis, particularly in the Iraqi Security Forces, who are betting their lives on continued American assistance.

-
-
- The blunt fact is this: in Iraq, al Qaeda is on the ropes, and the Shiite militias are badly off-balance; now is exactly the time to continue the pressure to keep them from regaining their equilibrium. It need not, and probably will not, require large numbers of American casualties to keep this pressure on. But it will require a considerable number of American troops through 2009.
 - Recent suggestions in Washington that reductions could begin sooner or proceed more rapidly are premature. The current force levels will be needed through the Iraqi provincial elections later this year, and consideration of force reductions makes sense only after those elections are over and the incoming commander in Iraq, General Odierno, has evaluated the new situation.
 - For too long, the U.S. has allowed domestic political considerations to reduce our leverage and weaken American bargaining position, and the U.S. has refused to recognize the critical role the presence of American combat forces plays. When America provides combat forces to maintain internal or external security in a foreign state, it acquires the right to bargain hard for what it thinks is best for the common interest, even when the host state's government does not agree. The U.S. has engaged in such hard bargaining in South Korea and in Europe, and it is a normal part of alliance relationships. The U.S. must bargain harder in Iraq, and gain the tools and leverage needed to succeed.

VIEWS OF DR. KORB

- Dr. Korb will contend that to capitalize on gains made in Iraq, the United States must use a withdrawal timetable as leverage to force political change in Iraq while pushing Iraq's competing powers to recalculate their self-interest in light of the withdrawal.
- He will say there is still significant disagreement and confusion about how long a withdrawal would take. Despite the assertions of those who wish to remain in Iraq indefinitely, a massive yet safe and orderly redeployment of U.S. forces, essential equipment, and support personnel is within the capabilities of the U.S. military, and could be achieved efficiently and safely over 8 to 10 months. In fact, if the U.S. military had to withdraw to Kuwait as quickly as possible, it could get out of Iraq within 3 months by conducting an "invasion in reverse."
- Such an exit, however, would sacrifice a significant amount of sensitive equipment and create an instant political and security vacuum similar to that created by Saddam Hussein's overthrow. While feasible, that is not a preferred course.
- He will also argue that a phased redeployment of U.S. forces has at least three advantages.
 - First, a withdrawal is a conventional operation that plays to the strengths of the U.S. military. The Army's institutional and operational strengths rest on both advanced logistics and maneuver tactics, strengths crucial to a redeployment.

-
-
- Second, a phased redeployment does not leave a sudden and immediate power vacuum in the country. By putting the Iraqi government and its neighbors on notice that they, not the United States, will be responsible for the consequences of Iraq's internal stability, the U.S. would give all players an incentive to start doing just that.
 - Third, a phased redeployment would enhance security for U.S. forces.

SUGGESTED QUESTIONS

QUESTIONS FOR MR. CHRISTOFF

- What really grabbed headlines when you released this report is that Iraq is generating oil revenues, and that revenues generated in 2008 could be more than double the average annual amount Iraq generated from 2005 through 2007. Isn't this a strong indication that the security conditions in Iraq have been improving, and that Iraq is making strides towards financial independence?
- On Page 17 of your report, Table 5 (see below) shows that the U.S. has allocated \$22.5 billion for "Security." Could you explain what that entails.

Table 5 of Mr. Christoff's GAO Report:
Comparison of Iraq and U.S. Allocations and Spending for Selected Sectors
(in billions of U.S. dollars)

	Government of Iraq		U.S. Government	
	Allocated	Spent	Allocated	Spent
	2005-08	2005-April 2008	FY 2003-June 2008	FY 2003-June 2008
Security	12.3	2.9	22.5	13.7
Oil	10.5	0.3	2.7	2.5
Water Resources	1.0	0.4	2.9	2.2
Electricity	4.2	0.4	5.3	4.8
Total	28.0	3.9	33.4	23.2

- Is this "Security" funding included in the total of \$48 billion that you calculate the US has appropriated for stabilization and reconstruction efforts?
- From your expertise and knowledge of Iraq, do you think Iraq is capable of rebuilding its own security forces without US assistance?
- Would Iraq be able to generate oil revenue without establishing security forces?
- Is the establishment of security forces critical to the success of Iraq's ability to govern itself?
- From a budgetary perspective, which costs more: the deployment of US troops to maintain security or the establishment of an indigenous security force?

- In looking at Table 5 again, because the spending is not broken out in individual years, it is difficult to tell whether the Iraqis are making progress or allocating more resources now than they were three years ago.
 - Is there a trend that shows that as the security position improves, the Iraqis are allocating more funds towards reconstruction?
 - For instance, how much did the Iraqis budget last year (2007) and how much did they budget this year (2008) for non-security reconstruction?
- Even if the budget surplus you predict does exist at the end of 2008, do you think that the Iraqis are now capable of executing a budget that fully finances their reconstruction? If the US were to leave today or were to stop funding reconstruction, what would be the result?
- In looking at Table 4 on Page 15, titled “Estimated Total Revenues, Expenditures, and Surplus, 2005 through 2008,” you show Iraq with an estimated budget surplus of anywhere from \$38 billion to \$50 billion, but you note Iraq is considering a supplemental of \$22 billion. Is the supplemental amount included in your estimates of a surplus?
- In looking further at Table 4, you roll up the years 2005 through 2007 and show the revenue and expenditure lines as “estimates.” You estimate that Iraq had a budget surplus of somewhere around \$29 billion over those years. Why are these numbers still treated as estimates when surely the books must be closed on 2005, 2006, and 2007?

Table 4 of Mr. Christoff’s GAO Report:
Estimated Total Revenues, Expenditures, and Surplus, 2005 through 2008, Under Different Scenarios
 (in billions of U.S. dollars)

	2005-07	2008	2008	2008	2008	2008	2008
Scenario		1	2	3	4	5	6
Estimated Total Revenue	96.0	73.5	75.7	80.2	82.8	83.3	86.2
Estimated Total Expenditures	67.0	35.5	35.4	35.6	35.8	35.8	35.9
Estimated Budget Surplus	29.0	38.2	40.3	44.6	47.1	47.6	50.3

- Do you know what the deficit was for the U.S. government in 2007? Until last Tuesday, when CBO released its latest update, I thought I did, but they adjusted it again even though 2007 is a year behind us. Interestingly, CBO’s estimate is not only different from what it was in March, it is different than OMB’s late July Mid-Session Review. My point is that even in this country, with all its sophisticated accounting methodologies and systems, we have a tough time knowing exactly where we stand financially. I can only imagine how difficult it is to keep track of Iraq’s budget. It does, however, make me take any estimate about surpluses or deficits with a grain of salt.

Tell us about your methodology for gathering data and making these estimates and tell us how accurate you believe them to be.

-
-
- What are your assumptions for the future of oil revenue in Iraq? We have already passed an initial supplemental for 2009, but as we look towards next spring and another supplemental, should we expect higher revenues for 2009 than you have projected for 2008?

QUESTIONS FOR MR. BLANCHARD

- The press has widely reported that Iraq will have a large surplus in 2008.
 - Do you think Iraq will have a budget surplus in 2008? If so, how big do you think it will be?
 - Is that surplus a result of Iraq consciously deciding not to spend its oil revenues, or more the result of an inadequate capability to finance its reconstruction?
- Can you describe how the oil revenues are collected, what happens to them, and who is ultimately responsible for them?
- Have improved security conditions on the ground in Iraq resulted in the generation of higher oil revenues, or is the increase all attributable to the rise in oil prices?
- When Iraq is able to pump and distribute its oil at capacity, will it generate enough revenue to fund its government?
 - Do you have any estimate as to when that will happen?
 - Do you have any estimate as to how long before Iraq's financial management systems are robust enough to allow that to happen?

QUESTIONS FOR DR. KAGAN

- As an expert on this war, what is your reaction to this GAO report? Are conditions on the ground improving such that Iraq is nearing the point where it can stand on its own two feet?
- Can you explain what you mean when you say that the US will lose leverage if it begins to withdraw troops?
- Even with the budget surplus that GAO predicts may exist at the end of 2008, do you think that the Iraqis are now capable of executing a budget that fully finances their reconstruction? If the U.S. were to leave today or were to stop funding reconstruction, what would be the result?
- How do we build on our gains and ensure future success in Iraq? Conversely, what - in your opinion - would be detrimental to meeting our objectives in Iraq?

-
-
- For the past several years, there has been a major debate over whether to establish a “timeline” for “redeploying” U.S. troops.
 - What are the advantages and disadvantages of such an approach?
 - Is there an alternative approach that would be preferable?

QUESTIONS FOR DR. KORB

- Would the phased withdrawal you encourage, on an 8- to 10-month timeline, create any kind of vacuum for the insurgents in Iraq to use to their advantage?
- You argue that a “phased” redeployment would not leave a sudden and immediate power vacuum in Iraq. But suppose in the middle of such a redeployment, conditions suddenly changed in an unfavorable direction.
 - Would it then be unwise to continue on the pre-determined timeline notwithstanding those changing conditions?
 - Isn't that precisely the risk of focusing on a timeline rather than emphasizing improved real conditions on the ground to justify redeployments?