



Oil Revenue Accountability in Iraq: Breaking the Resource Curse

Svetlana Tsalik, director of the Open Society Institute's Revenue Watch program, told the U.S. Institute of Peace on January 22 that Iraq's oil revenues are likely to become a source of instability if they are not managed in a transparent manner by a government that the Iraqi people see as legitimate.

Tsalik, who has done extensive studies on oil revenue and transparency issues, described the current management of Iraq's oil revenues as marked by confusion and having virtually no oversight. She said all oil revenue spending decisions are made by the U.S. installed Coalition Provisional Administration's (CPA) Program Review Board, which is composed almost entirely of CPA appointees. The Board's one Iraqi member, Iraq's Finance Minister Kamel al-Keilani has attended only two of the Board's twice weekly meetings, according to Board minutes. Meanwhile, the Board has spent over 2 billion dollars without any audits or oversight mechanisms in place.

In addition to highlighting the current lack of transparency and accountability in Iraq, Tsalik pointed out that these problems are likely to be exacerbated by a combination of economic and political challenges known as the "resource curse."

The resource curse is a paradox faced by resource-rich countries like Iraq where the natural resource wealth that should propel development actually results in slower economic growth, increased poverty, higher levels of corruption, worse governance, and greater potential for violent conflict. One reason that so many countries suffer from the resource curse is because natural resource revenues discourage good governance and the absence of good governance permits poor fiscal policy.

“The challenge of avoiding the resource curse in Iraq will be doubly difficult,” Tsalik said. “Even oil-rich places that look good today, like Norway and Alaska, struggled for years with inflation, unemployment, and erratic boom-bust cycles.”

Tsalik noted that in an oil-based economy like Iraq’s, the resource curse can weaken the non-oil sector of the economy as foreign currency for oil floods in and makes domestic goods more expensive than those produced abroad. Without proper planning, oil-based economies create non-labor intensive industries that generate only a small number of jobs that require high skills and training. In developing countries, these jobs are often filled by foreigners. Meanwhile, other sectors of the economy wither and overall unemployment increases. Finally, because oil prices are unsteady, any medium to long-term budget planning will be extremely difficult for an Iraqi economy based largely on oil.

Beyond these economic effects, Tsalik explained that the resource curse can also create or reinforce significant political problems. Having natural resources exclusively in the hands of undemocratic governments gives unaccountable leaders enormous power. Such governments do not have to compete in elections and are not accountable for choices about taxation, spending policies, and use of oil revenues. And, as Saddam-era Iraq and Saudi Arabia demonstrate, unaccountable governments can use their control of oil revenues to buy off influential groups to preserve and entrench their rule. Tsalik added that the lack of good governance in oil-rich states like Iraq enables government to keep oil revenue information secret and pursue poor fiscal policies that provide little public benefit.

Tsalik then examined the potential problems of the resource curse given Iraq’s history and its current situation.

She said Iraq does not have a tradition of fiscal transparency or accountability. During Saddam’s long rule, government budgets were a state secret and any disclosure was punished with either imprisonment or death.

Under tight UN sanctions and Saddam’s reign, corruption flourished and continues to thrive after his fall. Iraq’s Oil Ministry recently estimated that 25 percent of Iraqi oil meant for domestic consumption is smuggled out of the country.

The unemployment rate in Iraq continues to range from 60 to 70 percent. Narrow, oil-based development policies will do little to alleviate this massive joblessness. Most Iraqis who do have jobs work at one of 192 state-owned enterprises. Tsalik said that many of these businesses are likely to be privatized or restructured soon, thus further increasing unemployment.

The International Advisory and Monitoring Board (IAMB) mandated by the UN in May, and comprised of representatives from the UN, the IMF, the World Bank, and the Arab Development Fund, finally has started to operate after months of wrangling with the CPA over how much monitoring and enforcement power it should have. Yet Tsalik said it remains to be seen whether the IAMB will have the authority and the resources to be effective. Moreover, it is unclear what institution will continue the IAMB's watchdog function once it is dissolved with the establishment of an internationally recognized government in Iraq.

In order to meet these challenges, Tsalik made several recommendations.

The first priority, she said, is to establish a government that is recognized by the Iraqi people as legitimate and not an American puppet. Iraq's economic recovery will require a total overhaul of the economy, and a break with Saddam's patronage system that rewarded loyal families with lucrative contracts at public expense. These reforms will only be possible with a government that Iraqis consider to be their own and working in their interests.

A second priority identified by Tsalik was to avoid rushing economic reform. Ambassador Bremer has proposed the most liberal trade regime in the Middle East for Iraq, with provisions that far exceed anything found even in the United States. Bremer's plan would allow 100 percent foreign ownership of Iraqi state-owned enterprises, except in the oil sector; suspend tariffs and duties for imports and exports; permit unrestricted repatriation of profits and assets—a policy believed to have contributed to the crises in Southeast Asia and Argentina; and a flat tax rate of 15 percent—a goal long sought by conservatives in the United States. According to Tsalik, such an approach runs the risk of a Russia-style privatization in which property moves into private hands before a system of corporate governance and law exists, and creates incentives for asset stripping, not investing to build asset value. Moreover, in a rushed Iraqi privatization, the buyers most likely to have the resources to purchase state assets are those who prospered handsomely under Saddam Hussein's regime.

A third priority should be to bring transparency to Iraq's rebuilding process. Procedures must be introduced to ensure that Iraqis are getting good value and an equal chance at employment in the reconstruction of their country. Tsalik said that many Iraq reconstruction contracts are going to well-connected Western and regional companies, while unemployed Iraqis experienced in rebuilding their war-torn country could do the job at a fraction of the cost. She pointed out that even Ambassador Bremer admitted in testimony to the U.S. Congress that Iraqi construction costs are about a tenth of those of U.S. companies. The CPA should announce the winners of tenders as well as provide the names of companies that have bid. It should also ensure that Iraqis are represented on all committees to evaluate tenders.

Finally, Tsalik said that the idea of establishing an Alaska-style public dividend fund based on oil revenues is gaining popularity in Iraq. Revenue Watch has produced an oil funds book with 10 case studies including the Alaska Permanent Fund. According to Tsalik, this research has shown that dividend style funds are most appropriate when there are large oil resources and a small population, strong fiscal transparency, effective corruption controls, and an efficient civil service.

For Tsalik, such a dividend fund in Iraq is premature for two reasons. First, it is likely to be a long time before Iraq's oil resources generate enough revenue to start paying dividends to citizens. According to the 2004 Iraqi budget, Iraq's oil revenues are not even enough to sustain the government's operating costs, let alone fund the country's costly reconstruction. Iraq's budget for 2004 is estimated to close with a \$600 million deficit. Second, distributing dividends to every eligible Iraqi requires a trustworthy civil service. Tsalik felt that Iraq's tattered civil service and the country's current, extreme levels of corruption could not guarantee that dividend payments get to the designated recipients.

Tsalik urged those involved in the rebuilding of Iraq, particularly the United States and the CPA, to consider these recommendations. She concluded that effective oil revenue tracking, transparent budgeting, and independent auditing to monitor fiscal accountability can play a critical role in helping Iraq overcome its current problems and those posed by the resource curse.

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Iraq Revenue Watch monitors Iraq's oil industry to ensure that it is managed with the highest standards of transparency and that the benefits of national oil wealth flow to the people of Iraq. Iraq Revenue Watch complements existing Open Society Institute initiatives that monitor revenues produced by the extractive industries.

In many parts of the world, the lack of proper stewardship over oil resources has resulted in corruption, the continued impoverishment of populations, and abuses of political power. By prompting governments to tackle these problems early, the Open Society Institute hopes to help Iraq avoid this plight.

The Open Society Institute currently supports a recently launched initiative, Caspian Revenue Watch, which monitors the development of oil production in the Caspian basin. The goal is to promote transparency, accountability, and public oversight in the management of oil and natural gas revenues.

Iraq faces even greater challenges than the Caspian region. If Iraq is to become an open, democratic society it will need to develop transparent accountable institutions for ensuring honest management of oil revenues.

There is an urgent need for Iraq Revenue Watch given the current occupied status of the country. The Coalition Provisional Authority and the Iraqi Governing Council should establish rules that ensure complete transparency regarding Iraqi oil revenues. So doing will foster a stable, democratic Iraq, and will protect the Coalition Provisional Authority from charges of misappropriation during this period of trusteeship over Iraq's reconstruction.

The **Open Society Institute**, a private operating and grantmaking foundation based in New York City, implements a range of initiatives throughout the world to promote open society by shaping government policy and supporting education, media, public health, and human and women's rights, as well as social, legal, and economic reform.

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