Restarting the Economy in Iraq

by Dave Oliver
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Settling In.

On April 12, 2003, Lieutenant General Jay Garner (US Army, retired) arrived in Baghdad to begin the reconstruction of Iraq. Ambassador L. Paul (Jerry) Bremer succeeded Jay as Administrator a month later. I arrived in Iraq the first week in June and left the last day of October. I served the Coalition as the Director for Management and Budget, and the Iraqi government, as well as the Administrator, as the Senior Advisor to the Iraqi Minister of Finance.

Several weeks before I arrived, Peter McPherson, the President of Michigan State University, had been ensconced as the Director of Economic Policy. Economic policy and money need to be bedfellows, and fortunately, Peter and I quickly became good friends. Because of our personal and professional relationship, Peter and I worked every economic problem together, and normally jointly presented alternatives and recommendations to the Administrator.

Peter provided our team the international economic knowledge, as well as a unique personal ability to get well outside "the box" in looking at a problem. I was a wheel horse in implementing several of his ideas, managed the budget and worried about Iraq and Coalition issues that involved money.

Peter's special efforts were focused on –

> Maintaining the value of the Iraqi currency,
> Accomplishing sweeping economic reform to transition Iraq to a market economy, and
> Installing a modern banking system that would facilitate a new economy.

I endeavored to put these policies in place and jump-start the economy.

He and I reported directly to the Administrator, as did a half-dozen other Directors. Ambassador Pat Kennedy served as Chief of Staff for the 600 of us, a number which would climb to above a thousand in those six months. Ambassador Clay McManoway was the Administrator's senior counselor. They both were the Administrator's closest confidants, advised him on nearly all issues, and were of great help to me in thinking through the myriad of economic and practical problems.

After initially relocating daily to follow the few working computers, Peter and I settled in with our staffs of experts on the second floor of the south wing in Saddam's over-decorated Republican Palace, declaring squatters rights on a former suite of two bedrooms and a sitting room. As soldiers and civilians sleeping in the Palace moved to the reopened Al Rasheed hotel in June, we shoved additional desks and chairs into a kitchen, as well as a bedroom and its sitting room.

It will probably be difficult for historians to document why particular decisions were made during this hectic period. Peter and I discussed issues extensively, but I fear neither of us documented much more than the succinct decision papers we provided Administrator Bremer to consider. There was neither the time nor the staff to spend time on files and documentation. All of us were working Iraq's economic issues on "Baghdad Time" -- seven days a week, from 6:30AM to often well after midnight. In order to at least partially correct that documentary oversight, this article lays out the economic situation we found during the first six months of the Coalition's occupation of Iraq, our intentions, successes, and some of the early consequences of our actions.

The Task.

Iraq is potentially a very rich country, about the size and population of California. The land lies in the breadbasket of the Middle East, athwart the historical floodplain created by the north to south passage of the Tigris and Euphrates Rivers. An extensive water aquifer burbles shallowly beneath these two famous rivers. Significantly, the Tigris also crisscrosses two developed oil fields – the visible representation of what some suspect is the greatest oil reservoir in the world.

The raw materials and human capital in Iraq could well produce a rich, powerful country. Iraq can be a strong contributor to world peace and stability. However, we feared this would not happen without dramatic economic and political change. The political change had started with the Coalition's disposition of Saddam. The economic change would be slow in coming without additional help from the Coalition.

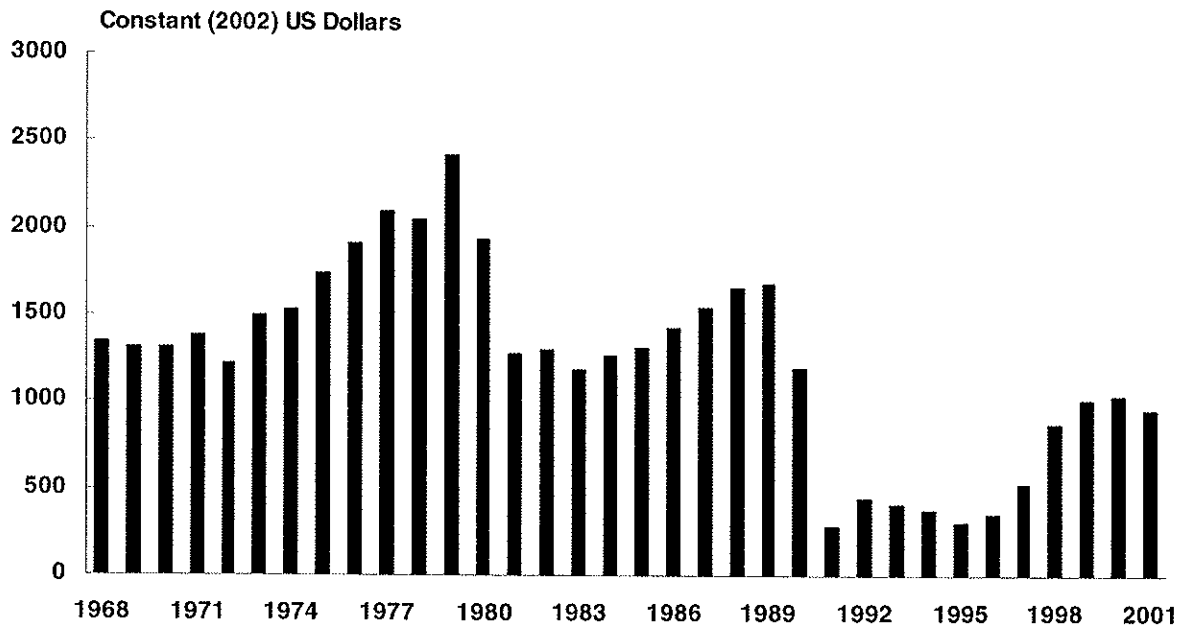
The challenge for this Moslem country is its geography and history. Strong potential enemies surround Iraq, and, although the Iraqis note these are the same lands that comprised the powerful Sumerian culture six thousand years ago -- Noah, Hammurabi and Nebuchadnezzar are long dead.

The current state of Iraq was cobbled together after World War I from areas traditionally occupied by the Shiites, Sunnis, Kurds and Turkomans. Iraq may be old in history, but it is very young in national identity. Life and death conflict between the factions is recent history for all Iraqis.

The economic situation in Iraq posed another barrier to success. When Saddam took power twenty-plus years ago, the Iraqi Gross Domestic Product was about the same per individual as other modern nations. However, this favorable position was destroyed by

the Baath Party's wars with Iran, Kuwait and the Kurds, nationalization of industries, and the basic management and economic flaws in the centrally-run economy Sadaam installed. When we arrived, the Gross Domestic Product per individual in Iraq was the same as in the Congo, a loss of forty years for the Iraqi people.

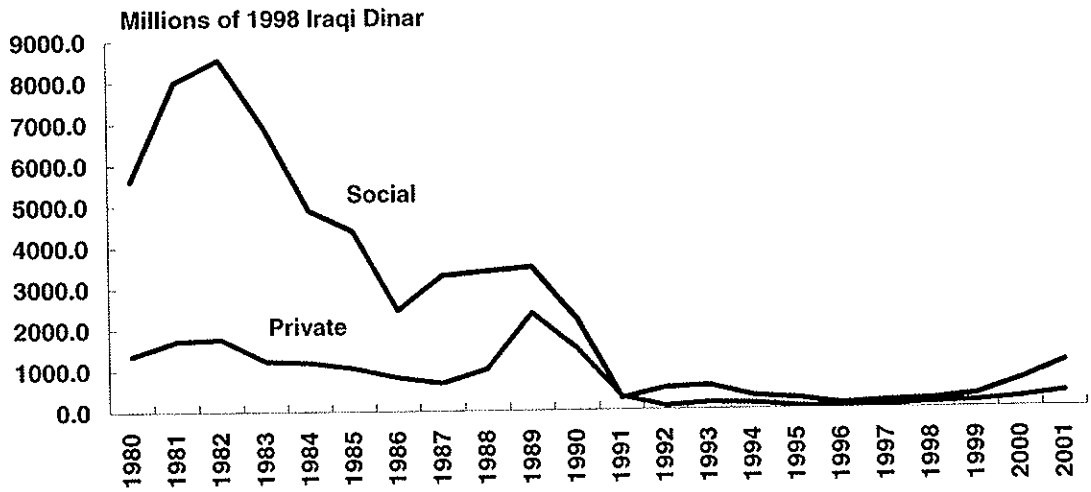
Iraqi per capita GDP: 1968-2001 ($US 2002)



Source: Ministry of Planning, CPA estimates.

The wars with Iran, Kuwait, and the Kurds also wasted every dollar of the substantial currency reserves that existed when Saddam took office in 1979. Additionally, subsequent international borrowing put Iraq in such debt that the current entire Iraqi Gross Domestic Product is insufficient to cover the interest on these loans. During the nineties, capital formation in Iraq by both the "social" or nationalized industries, as well as by the private sector, collapsed.

Gross Capital Formation in Iraq: 1980-2001



Source:
Ministry of Planning

When the Coalition arrived, Iraq was among the poorest of states. A college graduate schoolteacher earned $8/month, a bank manager $40/month and the Minister of Oil (excluding graft) took home less than $20,000 a year.

Our purpose was to assist the Iraqis in their goal of developing a country that was democratic, secular, and operated on a market-based economy. They and we believed that a market-based economy was essential to the long-term viability of their society. The middle-aged Iraqis we talked to remembered when their country was rich and growing, and agreed the fall of Saddam was their opportunity to make this critical economic change.

To start toward a transitional economy – one that would move from a centrally controlled situation to a market-based environment – would require Coalition assistance. It would require transitioning the 192 subsidized, inefficient, state-run companies, none with the slightest concern about a bottom line, to businesses that could compete in the Arab and world marketplace. Once the Iraqis achieved this, we believed their superior education and entrepreneurial spirit, assisted by the free flow of capital and their natural resources, would power them to economic success.

There, however, was a catch – the World Bank had documented the 24 Eastern European countries that had attempted a transition to a market-based economy after the collapse of the Soviet Union. Each had experienced a severe depression. There was an inevitable time lag after the old inefficient businesses collapsed before vibrant micro and small businesses grew in their place. Most of these depressions were worse than that which the United States experienced in the thirties. Less than a quarter of the transitioning economies (Romania, Poland, Albania, Hungary and Slovenia) recovered within a span of less than ten years.

In addition, as I will discuss, Iraq did not have the same preconditions that enabled these five relatively quick successes.

We recognized from the beginning that if the Coalition left before we achieved this transition, we would have lost the greatest prospect in the last fifty years to influence the Middle East, and the best opportunity since the Cold War to improve the long-term chances for world peace.

Equally as important, leaving Iraq without success would also severely damage the United States' influence around the world, as well as that of the key Allies (Brits, Aussies, Spanish, Italians and Poles), who were standing with us in the Coalition.

We studied, we thought, we talked and we consulted experts. Neither Peter McPherson nor I ever took a day off.

Establishing Stability.

When the Coalition team drove their Suburban SUVs North from Kuwait City to join Jay Garner, they found that widespread looting had destroyed nearly every Government building, as well as seriously damaging the oil fields and the electrical power distribution. Everything in Baghdad, Basra and elsewhere (except for the Kurdish Governates) which could be pried loose was missing, including desks, toilets, piping or wiring. The denuded husks had been torched to their concrete and marble shells.

There also was the enervating heat. The hot months of the early summer were upon us and there was no power for air conditioning. In the afternoons, as the thick concrete Baghdad walls absorbed the sun's rays from the cloudless blue sky, temperatures rose well above a hundred degrees, and remained there until the wee hours of the mornings.

There was less physical danger at this time than would later develop, but the requirement existed outside the "Green Zone" to wear Kevlar helmets and flak jackets (absent the essential ceramic plate inserts which would stop a bullet, which were unavailable to most of the civilians, as well as a fifth of the Coalition military).

The Green Zone was a "protected" area of about four square miles near the middle of Baghdad. "The Zone" surrounded Saddam's Republican Palace and the living trailers we had installed behind it, the Al Rasheed Hotel where many of the Coalition would live after the hotel reopened in early June, the Convention center, some residential areas and other palaces. The Green Zone is an upscale area. It includes the modern one-story building in which we would establish the Governing Council as well as the adjacent large center in which we planned to hold the Constitutional Convention.

The heat and the difficulty of the task weighed heavily on some, who looked for reasons to leave Iraq. We lost several valuable people, and more decided not to join us. The majority of the Coalition simply worked even longer hours.

One of the first orders of business was to coordinate the Iraqi Ministries' search for temporary facilities and to supply the minimal administrative necessities, such as desks and pens, so the Iraqis could again begin running their country.

Ministerial responsibilities for the twenty-odd Government organizations which would be retained (i.e. some hopelessly Baathist Ministries, such as War and Information, were abolished) had been assigned before the Coalition arrived in Kuwait. Coalition team members immediately spread out across Baghdad to locate their responsible civil servants (most of whom had either gone to their homes or fled Baghdad for the surrounding countryside in mid-March, shortly before the "decapitation attack"). The Coalition's initial goals were to establish personal relationships with the non-Baath senior civil servants, and to assist these senior officials in finding temporary facilities for their Ministries.

The Coalition men and women also were anxious to recover any records that existed, so the conditions in country could be compared with what the various Coalition intelligence agencies had estimated. Establishing the ground truth was recognized as important, and, in many cases, would prove surprising. Restarting Iraq would prove to be a harder task than anyone had imagined.

The successful safeguarding of records and vital data was one of the first indications of the true professionalism of the Iraqi civil servants. Although the top three tiers of nearly every Ministry were senior Baathists and either in hiding or told not to return, individuals in the next layers had preserved many of the records of the country, often hiding files and disks in their homes during the hostilities. The Coalition translator teams went to work, but it would be several weeks before an accurate picture of Iraq would emerge from the previously secret and redacted documents.

The Iraqis were helpful. In fact, they were usually bravely eager to assist. We had not yet captured Saddam or his sons, and there are more AK-47s in Iraq than ice cream cones on Coney Island in August. Officials known to be talking with us eventually sported at least one bullet hole in their cars. Several were killed. Nevertheless, most civil servants disregarded their own safety and were helpfully forthcoming. They wanted Saddam gone forever, and they were willing to risk their lives for a better Iraq. These true patriots saw the Coalition as a means to their goal.

Many Iraqis were astonishingly brave. This was especially true if one paid close attention to conversational pauses and body language. Poignant pauses or a slight flicker of an eyelid often indicated the questioner was not precisely on point. There was something important to learn, and the person questioned would honestly answer, but the question had to be precise. The answerer wished to help but was equally anxious to avoid a "quisling" label. We had to be attentive and alert. Many long conversations were a sophisticated version of the old game that starts with the clue of "animal, mineral or vegetable?"

Given that reluctance, senior Iraqis were in significant danger. Some in the Coalition wanted to publicize the support of these Iraqis and have appropriate native bureaucrats standing side-by-side with Coalition officials for all policy and change announcements. I was convinced that even good change has its detractors, and detractors in Iraq possess both AK-47s and access to explosives.

Therefore, I established the policy that I would order all changes and actions I desired the Finance and Planning Ministries to undertake. I vetted these orders with those Iraqis whose judgment I valued, but my final guidance was both written and directive. As I explained to Iraqi senior officials, their country needed them alive, and, while it was relatively calm now, I suspected that eventually there would be targeted violence against those assisting the Coalition. My goal was to make change happen, while offering my own body as the target of any dissatisfaction. I wore a flak jacket and was guarded by Coalition soldiers. Someday I was going home to America. They were going to continue to live in Iraq.

None of the officials for whom I felt responsible was assassinated.

There were other daunting barriers to rapid improvement. Working in temporary facilities only accentuated the backwardness of the Iraqi bureaucracy. The only item on the desk of the Director of Accounts, the key operating individual in the Finance Ministry, the one man with control over every dollar spent in Iraq, was a thick pad of carbon paper. No telephone. No computer.

Previously people came to see the Director General of Accounts, pled their case for disbursements over about $40, and he subsequently wrote out his decisions and orders in longhand. Even when the phones had worked, the system was that carbon copies of his orders had always been delivered to the other Ministries in Baghdad by couriers in cars. Now their cars had also been stolen or looted. The entire Government was at a halt.

Electrical power was another difficult problem to solve. The country now had 300MW, less than a tenth of the pre-war usage and much less than the (later established) 6000MW necessary to provide 24-hour power to the factories, businesses and homes in Iraq.

Within a couple of weeks, our bodies had physically adjusted to the pervasive heat, but the lack of lighting and power for our computers was a severe shortcoming. In addition, the Coalition was suffering in Iraqi minds and the newly freed press. The Iraqis could recall a quick comparison. Saddam had restored electricity within a month after the Allies attacked Iraq a decade ago.

We finally achieved the pre-war level of electricity in September, but, once we evened distribution around the country (previously Saddam had deliberately undersupplied the Shiites in the south), we were still only generating power sufficient to provide each Iraqi home light and air conditioning three hours out of every six. We also did not have sufficient power for essential industries. Several of the concrete companies, key to the reconstruction effort in Iraq, remained dark.

The Coalition's failure to match Saddam's management performance not only physically hindered our work, but was also a highly visible public demonstration of Coalition inadequacy. It would become evident that the Coalition was spread thin and we had an insufficient number of experienced managers assigned. We were too few in number and the talents of our experienced people excessively biased towards theory. The national electrical crisis was also our first indication that the Coalition did not have sufficient funds to accomplish our task.

Until the Kellogg, Brown and Root contractors could establish sufficient portable generators for the Palace (which finally occurred during the Fourth of July weekend), and string an internet connection along the six meter high corridors, communications between Coalition members, even in the Palace, were, at best, intermittent. Communications within the City of Baghdad, even with our satellite mobile phones, were not reliable when I departed at the end of October.

The more immediate problem for the Coalition in May was getting money in people's hands and out on the streets. There was no danger of starvation, but the great majority of people did not have funds for more discretionary purchases. In March, before the war, Saddam had directed early distribution of three months of Food Baskets (a United Nations program in which each Iraqi was provided imported food paid for from supervised oil export sales). Everyone had something to eat, but payment of government employees and pensioners (over a third of the Iraqi families) had stopped. The 1.1 million pensioners had not been paid in several months, and civil servants in the Kurdish region had not been remunerated since January.

The Coalition settled into the Palace located just north of the 14th of July Bridge over the Tigris. On our end of the bridge was a traffic circle that looped around a large bronze statue of an Iraqi soldier, rifle help triumphantly aloft, one foot on what looked suspiciously like a British soldier. The bridge commemorated the coup against the British-installed monarchy in 1958.

It was a good location for the Coalition. Every time we passed through the deserted four traffic lanes circling the statue, it reminded us of the transitory nature of any occupation.

In the Palace, Coalition members replaced shattered windows with cardboard and swept sand from the floors of their new sleeping quarters and offices as they made the first critical decision – to stabilize and use the existing Saddam Dinar.

Whether or not (and how to) sustain the value of the old currency was a major issue, and like all key decisions, neither completely black nor white. We could not immediately replace the existing 3300 tons of currency, and if the Saddam Dinar became worthless, as had the German Mark after World War I, citizen's savings would plummet in value. Starvation and unrest would inevitably follow the consequential severe inflation. On the other hand, we suspected former Baathist sympathizers had rooms full of old currency

secreted away in their homes. Would they use those funds to mount support against the Coalition?

The practical concern for the average citizen outweighed our ideological hated of the Baathists. We would stabilize the Saddam Dinar.

But, how was this to happen, when Saddam had pillaged the Central Bank of its reserves?

Three decisions were key:

We would pay the 2.4 million civil servants and pensioners' salaries with Saddam Dinar, while announcing that future monthly payments would be in US dollars. Both would be interchangeable as soon as we opened the banks (and both currencies quickly were interchangeable on the streets, where the moneychangers continued their normal business).

We would wait to lift the price controls Saddam had established, which fixed prices in Dinar, and

We would take care not to induce inflation. We would meet most of our fiscal needs with the solid US dollar – resisting the impulse to ramp up the printing presses to produce 10,000 dinar notes, and carefully holding salaries to a level consistent with the existing economy.

US dollars were immediately available to the Coalition from the Iraqi assets that had been frozen in New York banks after the 1991 war ($1.7B we called "vested" assets), plus Central Bank Reserves (looted by Saddam) that had been found by Coalition troops in the Palace (nearly $900M we termed "seized").[1] Having made a decision, we watched the "street rate" of moneylender conversion anxiously, as we turned to the first key decision – what should we pay the civil servants and pensioners?

Salary Payments and Scales.

The existing Iraqi civil service pay scale was a terrible jumble of basic pay and as many as thirteen special bonuses. Most of the pay was based on "bonuses," which were

[1] We dispersed this money in a disciplined manner visible and transparent to the International Community and our critics. The Administrator established a Program Review Board, which reviewed every proposed disbursement. Members of the Board included the Ambassadors from each of the Coalition members, US AID and others, including the Iraqi acting Finance Minister (who was always invited, but infrequently attended, probably to avoid a collaborator label). Peter chaired the Board for the first two months and then turned over the chairmanship to me. We were supported by a staff run by Sherri Kraham, who did all the coordination of requests and kept the records.

The records were all public (www.cpa-iraq.org), but we found many people interested in them did not want to travel to Iraq, so in August we began placing Board deliberations and decisions on the World Wide Internet, only omitting dollar amounts if a contract was still in the "bidding" process.

dependent primarily on non-performance-related items such as an individual's relative seniority in the Baath party.

The most extreme case I saw was a man whose monthly salary was only 50 dinar (assume 1500 dinar to the U.S. dollar, so he was making a base pay of less than 10 cents a month). One shouldn't feel too sorry for him, his monthly bonuses were 250,000 dinar (more than the total monthly pay of the individual running the entire Oil Ministry, a Ministry we expected to eventually produce more than $20B (US) revenue a year for Iraq).

We couldn't unravel the salary bonus system in the short time before we anticipated Iraqis might take to the streets, and we were appalled at some of the pay rates (for example, college graduate teachers were only paid between $8 and $28/month). At the same time, we recognized the existing low wage scales[2] would be a great incentive to foreign capital looking for locations to invest. We did not want to start paying Coalition-level wages, and thus destroy the important business economic advantage the Iraqis currently possessed.

This latter consideration also demonstrated our approach to Iraq's economy. It was the same as a physician -- first, do not harm. Not only was a Coalition-level wage scale inappropriate, we knew, when we left, the Iraqi budget would not be able to afford such compensation.

It was decided that rough justice could be done if the pre-war eight-tier civil service Iraqi pay scale were collapsed into four tiers, with the bottom tier paid 100,000 dinar, the next 200,000, then 300,000 and 400,000. This was within our resources, and would put sixty percent of the people in the lowest tier, thirty percent in the next tier, and ten percent in the upper two tiers.

Through great effort by Tony McDonald, on loan from the Australian Treasury, and David Nummy (U.S. Treasury), armed caravans were distributing cash nationwide to pensioners within three weeks. About half of the Government employees were paid within six weeks, and we had everyone paid by mid-July (last were the schoolteachers and previous members of the Iraqi Army and the Kurdish Peshmerga.) Jacob Nell of the British Treasury took over this program and made the monthly cash payment of $170M seem routine.

We were deliberately overpaying the lower grades. Cash was in the hands of at least a good portion of the workforce, and the streets were quiet. Unfortunately, we were underpaying the senior civil servants we needed to get the government and economy running again, which would soon lead to a pressing need for additional salary reform.

The extraordinary effort to get money into the hands of citizens, combined with the lifting of import restrictions, was an immediate success. By late June, we could see the results in the buzz of the marketplaces and the (rapidly disappearing and replenished)

[2] A taxi driver made $3-$4 a week, a day laborer less than a dollar a day, and a bank manager $40/month.

mountains of air conditioners, refrigerators and satellite dishes on the sidewalks in front of the small shops. The immediate cash crisis was solved, and the Dinar/Dollar exchange rate remained relatively stable on the streets.

Jacob Nell, one of the mainstays of our financial team -- a brilliant young man who was equally comfortable thinking about macroeconomics as he was working twenty-plus-hours a day executing the budget – would be seriously injured in the October rocket attack on the Al Rasheed Hotel. Jacob was successfully stabilized in the Green Zone and medically evacuated to his family in Cambridge, England.

The inequitable salaries quickly produced some tension. The Coalition was especially relying on two groups to perform, and we were underpaying both. The first underpaid group was the senior managers, who were largely willing to wait for the promise of equity, but the second were the oil company employees, essential in getting the oil fields back in production. In the one-product-economy Saddam's disastrous economic policies had developed for Iraq, the oil workers were accustomed to being specially pampered, and not reluctant to express their displeasure.

We recognized we needed an immediate comprehensive solution and formed two groups – one of the Ministry Advisors and the second of appropriate senior Iraqis -- to begin devising a new permanent salary structure. Our discussions were long. I espoused three principles:

First, the salary scale was to be based on performance, not education, and be free from bonuses. The previous salary scale had been built on the individual's level of education achieved rather than performance. Some Iraqis clearly did not believe me when I said that, in the United States, the chief executive's secretary nearly always made more than a beginning employee who arrived carrying only his PhD robe.

The policy of paying people based on their education level, rather than performance, had produced a previous salary scale that was incompatible with a market-based economy, and we spent many hours explaining this to both the Iraqis and the Coalition Senior Advisors (who too frequently became uncritical advocates for their Ministries). In the end, the American and Iraqi representatives of the Iraqi Ministries of Education, Higher Education and Justice, whose civil servants would be negatively affected by a performance based salary scale, never fully agreed with this principle. As elsewhere, personal self-interest drives a great deal of thinking in Iraq. Fortunately, there were fourteen votes in each group, and the majority acted responsibly.

Secondly, I wanted the military to be part of the national government employee wage scale. I did not want military pay disconnected from civil service pay as it is in the United States. I had watched what happens during cycles in which the military is held in low esteem (e.g., post-Vietnam War), and military pay drops so low it dissuades good people from staying or joining. At the moment, the average Iraqi hated the military -- Saddam had used the Army to involve Iraq in three disastrous wars. Left to themselves, the Iraqis would pay soldiers nothing. (Previously recruits had been paid only a dollar a

year, plus room and board). Nevertheless, the new Iraq would eventually need a professional military – both to deter aggression from their neighbors -- and to ensure respect for civilian authority.

There was also another reason for this policy of specifically including the military in any new salary scale. While the Ministry of War had been abolished and the Iraqi Army disbanded, the Coalition Military commanders were currently busily overpaying everyone they employed, and advocating excessive pay for the New Iraqi Army they were recruiting.

The military's reasoning was simple. Task Force 7 (our military) commanders, reported not to the Administrator (Ambassador Bremer), but to the military four-star in Tampa Bay, Florida. The military commanders were understandably focused on preventing military casualties. Because of the divided chain of command, they were not responsible for the long-term economic success of Iraq, and thus had no reason to consider the impact that paying people too much would have both on unemployment and the inability of Iraq to compete in the world marketplace.

The military commanders were worrying about finding Saddam and keeping the peace. They were not trying to evaluate whether the Iraqis could still use ancient production facilities profitably, as long as the wages remained low, and how best in the long run to attract foreign capital to build new jobs in Iraq.

I had several difficult conversations with the senior military commanders. Once adequately explained, they understood, in principle, the economic reasons for keeping pay equitable, but not excessive. Colonel Greg Gardner, Walt Slocombe's senior military aide (Walt was the Senior Advisor for Iraqi National Security), was of great help. Greg was instrumental in negotiating with the Coalition parties to develop a wage scale which included all military and law enforcement (e.g., police, border patrol, customs, etc.) forces, and was completely integrated into the national system of grades and steps.

My third principle was that the new salary scale had to be economically affordable. This was shorthand for insisting the new scale not fuel inflation. The low end had to start somewhat below what we were currently paying -- and the top end could not reflect the living standards of rich Kuwait, to which the Iraqis longingly looked -- but had to reflect the realities of today's Iraq.

In mid June, I asked Washington, London and Canberra for some salary experts to evaluate the work that was being done and to help bring the process to an answer. Even although the violence level was low at this time (only a few people a week were being killed), the Governments were relying on volunteers to fill civilian needs in Iraq and their subsequent silence was disappointing. I had told the Iraqis that we would have a new salary scale announced by August 15, and that promise was one of the key factors keeping the oil and electrical ministries working without significant protest.

I firmly believe that you have to drive yourself to produce results as they are needed. In Iraq, there were overriding practical reasons why fiscal items such as the 2003 Budget, the new salary schedule and the 2004 Budget needed to be completed by certain dates. In these cases, I established and published aggressive dates by which the work would be accomplished. Rather than be professionally embarrassed, we delivered. The dates made us focus, and also ensured we did not dither about unknowables.

Finally, the Pentagon's Ray DuBois identified a couple of private firms who specialized in compensation that he could employ to help me. I called them. One said that they would need a yearlong study to do the work. That was clearly unsatisfactory. Time had passed while I searched for experts. I needed results in two weeks.

My second telephone call was the most rewarding I ever made in Iraq. Pete Smith, a worldwide expert in compensation, who had run his own large compensation-consulting firm, said he would drop everything and pay his own expenses to get to Iraq to help. He did. Pete was merely professionally extraordinary. He produced, with the help of Linda Oliver and Colonel Rich Reynolds, my military aide, a balanced salary schedule for Iraq.

When briefed, Administrator Bremer decided that the plan should include a "save pay" provision for those overpaid by our four-tier scale. He then presented the modified arrangement to the Iraqi Governing Council on 15 August. The new scale would go into effect as soon as the Ministries reclassified their employees. The announcement immediately assuaged the Iraqi groups most concerned about their pay, and facilitated aggressive recruiting of military, law enforcement and guard forces.

Our military forces were still unsure that the lowest pay rates were adequate, but two incidents served to make me personably comfortable with our lowest rate. The first was that 94% of the soldiers in the first New Iraqi Army recruiting class returned from their post-introductory training period leave. The second was a riot caused because an Iraqi official was requesting $150 cash bribes to award $50/month jobs.

Although I have arranged this economic discussion in categories, rather than time or event-sequencing decisions, it should be recognized that Peter and my teams were working all sorts of problems at the same time. In this case, Administrator Bremer had just appointed the Iraqi Governing Council and we were preparing (and negotiating) their budget. To lower the Council Members' initial salary expectations (which were unpolitically high), we agreed to tie their salaries to the civil servant salary scale. Their rate was to be a third higher than that of the highest civil servant grade.

I sensed from our negotiations that the lowest salary the Governing Council would accept was $2000/month. This corresponded well with some of the off-the-record conversations I had with senior ministers in which they discussed how much they had previously been paid, both over and under the table. We established the top civil service scale accordingly.

When I was searching fruitlessly for someone in any Government to help Pete Smith, Linda Oliver, a senior career civil servant from the Pentagon, insisted, over my objections, on coming to Iraq for three weeks. I needed her. She was experienced in personnel management, smart and an invaluable addition to the team. Nevertheless, I did not enjoy watching someone I love go out in Baghdad each day in a Kevlar helmet and flak jacket. I was very relieved when her temporary assignment was over.

One final note about salaries. The Iraqi economy was changing so fast that private sector employment was tenuous. Government employees, however, could rely upon receiving a paycheck. Soon we were hearing reports of managers being physically threatened in order to force them to employ excess people. We also heard of payrolls growing without an obvious change in requirements.

I took the precaution of seizing the authority to hire and promote government employees in Iraq. It was unfair to ask an Iraqi to expose his family to danger over the obtuse principle that government should remain lean and as inexpensive as possible. Again, until a popular Iraqi political authority was in power, I believed that a Coalition member should be the one physically at risk for potentially unpopular decisions.

Banks.

Iraq under Saddam was a cash economy. It may have been because people were fearful Saddam would track any deposits. It may have been because none of the banks paid interest on deposits. Whatever the cause, it made economic recovery difficult. I had never appreciated all a banking system facilitates until we were forced to live without one.

Very few Iraqis had bank accounts and the Iraqi banks were decidedly not user-friendly. There were two major bank "systems" in Iraq – Rafidain and Rasheed -- with more than 340 branches between the two. Because none of the branches were electronically connected, there were actually 340 individual banks (four other specialty banks and seventeen small private commercial banks completed the spectrum). No branch would honor the checks of another branch, and the head honcho of the Central Bank personally had to approve any transfer of funds across the border of Iraq. The banks were merely vaults for deposits of funds, and probably reported all transactions to Baath authorities. Very few Iraqis had ever been in a bank. The public used the moneychangers and moneylenders in the street.

In addition, Saddam had looted the Central Bank in Baghdad of at least a billion dollars before he fled. We had also used Dinar in the banks to make the initial civil servant and pensioner payments. As a result, we feared the banking system was legally bankrupt.

From the first days, we had a large competent team of experts, with experience at the US Treasury or Bank of England, working hard every day trying to establish the financial

condition of the banks – did the vaults contain enough dinars to cover what depositors might well demand? We were trying to get the bank branches at least open so that businessmen had a place to deposit their receipts overnight.

Once the doors were open, we intended to build on that success, dramatically expand the customer base, and have the banks start providing loans and truly serving the communities. However, to take the first step, we had to have some feel for whether the banks had enough cash to cover their deposits. It would obviously set us back if we opened the banks and then had to close them because there were insufficient dinars in the vaults. Nevertheless, until the banks were open, we were daily inviting street robbery and violence.

We were delayed several times in getting a determination of how much money was in the vaults when various Coalition military officers took it upon themselves to go into a bank and demand payment for a debt a particular local citizen had convinced them was equitable. The military was just trying to keep peace and quiet on the streets and did not realize they were disrupting a major economic effort underfoot.[3] To make this basic dichotomy of purpose worse, communications between the Coalition military and civilian "sides" were poor.

Walt Slocombe and I were the only two Senior Advisors who understood working with the military well. We thus were the only two to make the basic, yet essential, arrangements for the Pentagon to provide us with senior military aides to foster better civilian/military interconnectivity.

While the bank team was accumulating data, we declared that all accounts for Government entities were zero, and that all inter-governmental debt was null and void. This policy also applied to the 192 nationalized companies, employing nearly half a million Iraqis. They now had no more debt. They also had no liquid assets. (We did not cancel the Treasury bills Rasheed and Rafidain had on deposit with the Central Bank.)

There were several reasons for, and a couple of exceptions to, this policy. The exceptions were the accounts of the Oil and Electrical Ministries. We needed these Ministries to perform as soon as possible – the Oil to restart the oil fields -- and the Electrical Commission to work night and day to get the power system back functioning. Early on, General Garner issued orders keeping the bank accounts of the Oil and Electricity Ministries open and available to those particular Ministries for use. We took the precaution of noting the operating balances in each of the accounts thus affected. None was more than a few million dollars.

The reasons to freeze all the other Governmental accounts were several. First, Iraq was bankrupt, and early fiscal recognition of that fact would facilitate recovery. Secondly, we were unsure of the validity of the inter-government transactions that had taken place in the weeks before the liberation. We knew that some government companies had been

[3] Chris Foote, who came to Iraq from his job a chief economist on the Council of Economic Advisors, and would proceed next to the Boston Federal Reserve, was one of our most brilliant advisors.

forced to buy unneeded product from others (a five years supply of cotton in one instance), and we were unsure what else may have happened under the "cover of paper" in the pre-war environment.

We decided to stop the music and ask all the players to find a chair. We directed nationalized businesses to establish plans and seek legitimate loans for the operating capital they needed to operate. By freezing all accounts, we would also save as many assets as possible for the refinancing of viable companies. Otherwise, there was nothing to prevent companies with no future (the ones with destroyed facilities or those already known [e.g., the Sugar Company] to be economic disasters), from wasting irreplaceable Iraqi cash assets. In the meantime, the Coalition paid all nationalized company employee salaries at the four-tier rate.

This freeze also had the effect of reducing the demands on the banks so they were temporarily liquid, if not necessary solvent.

Peter McPherson drove this key decision, and it was another example of his innovative approach to the situation we found in Iraq. Peter believed that the situation was one of "hopeless entanglement," a bankruptcy term Walt Slocombe contributed to our lexicon. There was a great deal of opposition to freezing the accounts within the Coalition advisory team. Peter addressed this division of opinion in several long meetings, of which one was particularly memorable. We all gathered in the common room between Peter and my offices.

Peter started by stating the situation and his plans as I have outlined above. Then he asked for comments as we went around the room. Each senior advisor outlined their professional opinions. As all spoke, they enunciated new reasons why such a policy was both theoretically and practically flawed. Many of the advisors were against freezing existing government bank accounts, and several were passionate. The meeting lasted for over an hour. Finally, Peter summed up the comments, "What I hear you saying is that…" and then, ignoring their conventional wisdom, he repeated, word for word, his original exposition!

I had listened quietly to the whole proceedings. I agreed with Peter, but felt that someone should point out his summation was definitely <u>not</u> what the group had said. Peter only chuckled, "But that's what I heard."

Several days later, I thought of a way to accomplish his goals. Peter concurred and Administrator Bremer approved. The hopeless entanglement was resolved.

An additional important fiscal measure Peter directed was in making the Central Bank independent of the Finance Ministry. This follows the practice of all market-based countries, and is intended to ensure the Central Bank is free to establish, independent of the Government, fiscally responsible short and long-term monetary policy. Thus, for example, the Iraqi Finance Ministry could not order the Central Bank to print money to

meet a deficit, the exact situation that had resulted in runaway inflation in Iraq during the early nineties.

Another important decision Peter and I made (as in all economic decisions, with Administrator Bremer's agreement and encouragement) was to let the dinar exchange rate "float." Rather than using Iraq's and the Coalition's limited resources to establish several billions of dollars as reserves in the Central Bank, we reasoned that Iraqis would view their currency as having the "full faith and confidence" of the US Federal Reserve behind it. (We didn't ask the Federal Reserve – we weren't interested in learning if they agreed with our use of their prestige). After some wavering, the dinar/dollar exchange rate steadied, and the Coalition had billions more to invest in reconstruction.

Peter's success with the Banks was extraordinary. His[4] team opened the Baghdad banks in late July. Private citizens and private companies were authorized full access to their accounts. The banks were back "functioning" in Iraq quicker than ever even contemplated in Afghanistan and other similar situations. There was no run on the banks. Now the banking team could work to make improvements that would add value to the Iraqi banking system.

Unfortunately, even though the banks were quickly "open for business," none of the nationalized companies had ever written a business plan. Instead, they had merely requested subsidies each year from their Ministry. In the cases where the individual Ministry could not, or would not, cover their losses, the Finance Ministry had done so, directing the Rafidain Bank to issue the necessary sums (with some inevitable deductions for the private accounts of the senior Baath members) as grants or pre-forgiven loans.

The Company executives, who had operated with subsidies for years, and invariably had no accounting or finance expertise on their staffs, were lost. Their "home" Ministries (each Ministry had previously been responsible for ten to fifty companies) were of little help. Although all the senior executives were smart, educated individuals, the United Nations' sanctions had effectively cut them off from the rest of the world' business experience for more than a decade.

Not only were they three or four business-knowledge cycles behind, the executives had functioned for decades in a pure centrally controlled economy. No matter what their

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[4] The bank advisory team worked for Peter, but the Banks were physically owned and directed by the Finance Ministry (and me, as the Senior Advisor). This was a potentially terrible management situation. As just one example, if the Bank Advisors did not agree with a policy Peter was pushing them to implement, I could rely on them to, late at night, when Peter was busy elsewhere, sidle into my office to try to get me to override his direction, of course without telling me of Peter's involvement. Our management arrangement only survived because Peter and I had become fast friends and made no decisions without consulting the other.

After awhile, both staffs recognized it was impossible to bureaucratically drive a wedge between us. Each was also answerable to either of us, depending on what Peter or I needed at the moment. Peter and I were joined at the hip, or at least at the cerebellum. I have never been on a team where I had a better personal and professional working relationship with an individual. This instant bonding was particularly noteworthy given the rapid pace of policy decisions and the life and death stress of the situation.

plant produced, they were accustomed to being considered a necessary portion of the Iraqi economy. With the sanctions, their particular plants had to function or Iraq didn't have the product. The Iraqi Government paid the costs incurred. There had been no incentives for the executives even to consider alternative ways of doing business or methods for controlling costs.

In August we addressed price controls. We released all nationalized Iraqi businesses (except the Oil and Electricity Companies) from bureaucratic and market price controls – only keeping a restriction that prices of a product could only rise 25% per quarter, to protect us against unforeseen market interrelationships – and then tasked the Iraqi business leaders to plan for a future without subsidies.

Coalition members worked with company leaders for weeks trying to develop reasonable business plans. When those plans were presented to the Rafidain and Rasheed management, the latter were equally mystified. In the past, the bankers had only followed orders from the Finance Ministry as who to and how much money to loan. They had never done any loan or risk evaluation. The process of getting the viable businesses up and running was slow.

Meanwhile, we were improving the bank services little by little. Larry Blume[5] (US Treasury) had purchased a simple satellite link and electronically connected the five central bank branches and over seventy branches of the Rafidain and Rasheed. They could thus start to perform same-day data exchanges and balancing across the city. In October, this system would support salary payments and the currency exchange.

We also stood up the dinar check clearing system and introduced dollar check clearing. The latter significantly reduced the requirement for every contractor working in Iraq to make multi-million dollar payments in cash.

With the assistance of some major international banks, we had also begun working on establishing a Trade Bank, so that Iraqis could reliably import and export goods. We encouraged the Central Bank to liberalize foreign exchange controls, so that private banks could start offering cross-border services (payments for imports, remittances from relatives abroad, etc.). Rasheed and Rafidain, as state-owned banks could not offer these services. Due to Iraq's extraordinary high international debt, any state assets which ventured abroad were likely to be seized by creditors.

On July 7, we announced that all the Iraqi Saddam dinars had to be exchanged for new money between the October 15th and January 15th. After mid-January, Saddam dinars would be worthless. During the exchange, we would get every Iraqi in a bank, many for the first time, by the simple strategy of using the banks as the only exchange locations for the new money (the banks were encouraged to consider this added work as a business opportunity to attract new accounts). The currency exchange plan was announced with

[5] Larry would demonstrate his broad leadership capabilities by later stepping in and running the critical public information preparations for the October currency conversion.

great fanfare. Now all we had to do was deliver on this monumental logistical and security task.

Printing presses in England and Spain (the Spanish had donated their services) were rolling, turning out the new currency that would replace the Saddam dinar and its two awkward denominations (250 and 10,000 dinar) with six different new bills. Bill Block from US Treasury conceived, analyzed, negotiated and shepherded this entire effort. We launched the currency replacement on October 15th. The new currency would prove to be a popular, economic and logistical success, with the countrywide distribution managed by Hugh Tant, a retired Army Brigadier General, assisted by Jacob Nell, Simon Gray (Bank of England) and John Rooney, our Scottish secret weapon.

Budgeting.

We published the first public budget for Iraq in twenty-four years on July 6th. Our goals for this initial budget were simple. We wanted to provide an immediate input of money to empower the civil servants to get the Government and Industry working again. We also wanted to involve the Iraqis hands-on in a professional budget development process, and, we needed to use the budget formulation and review process to start determining the impact of the numerous subsidies.

Understanding the costs and ramifications of the existing subsidy system was essential before we considered making changes.

Some of the subsidies were obvious. Pre-war, about 400,000 barrels of Basra light crude (market value of ten million US dollars) had been diverted each day into derivative petroleum products and provided to (privileged) Iraqis as subsidized goods. The subsidy (and bad economics) was enormous. Benzene (gas) was sold for 20 dinar a liter (4 cents/gallon). As a result, old inefficient cars crowded the donkeys on the streets, the latter pulling wooden carts carrying natural gas, at a thousandth the market cost, to businesses.

This was an easy subsidy to compute. Three hundred and sixty-five times ten million dollars a day is a subsidy of $4B a year (nearly twice what the oil fields would produce in 2003, and 20% of the full rate production of all the Iraqi oilfields) with no checks or evaluations on how the resource is used. There was no supply and demand equation in effect. There were just demand forces, which quickly, at the smallest supply disruption, produced long queues at the benzene stations.

Electricity was another obvious subsidy causing Iraqi market distortion. Power was provided at about 1/5th a cent per kilowatt, while the production cost was at least forty times that. Previously, Saddam had controlled the demand by shutting electricity off from his enemies, thus limiting both their standard of living as well as their economic development. We were currently resorting to rolling blackouts, a la California a few years ago, to even out the social and economic disruption, and allow people to plan, but

this was obviously only a temporary practical patch. Fortunately, homes and businesses were individually metered. Unfortunately, the deteriorating security situation, and an unaggressive Iraqi Electricity Commission, deterred collection of even these minimal normal revenues.

There were also not-so-obvious subsidies. Doing the initial budget, it became evident there were at least seven official exchange rates in use pre-war. As an example, while the street rate was about 1500 dinar per dollar, the Oil Ministry, when computing the tax due on their foreign oil sales, had been preferentially permitted to use a rate of one dinar per 3.4 dollars -- a rate 5000 times actual -- to the detriment of the Government!

The budget review process provided enough insights into the subsidies to realize that any perfunctory review was insufficient. By the end of June, we were only prepared to provide a budget that continued essential operations and made affordable repairs to the looting damage. We estimated that we would receive $3.4B in oil revenues for the rest of the year (soon to be downgraded to the $2B range as the dilapidated condition of the oil field equipment became evident and sabotage incidents continued to plague us). With the seized and vested money available, we could afford a budget of about $6B for the latter half of 2003.

Tony McDonald[6] and I had discovered two critical facts during the budget review. Issuing the budget would teach us a third.

Our first discovery was how the United Nations Oil for Food program had operated within Iraq. The second was that no one alive (and not on the run) in Iraq had any idea what moneys were required (or where the revenues would come from) to operate Iraq.

The hard lesson we learned was what happens in the absence of a political authority.

The Oil for Food program provided more than food to Iraq. Since 1997, under United Nations supervision, Iraqi oil was sold and the moneys used to buy items not subject to sanction. Everyone knew that fact, and many recognized that suppliers often paid a bribe. Our best information was that each Oil for Food contract involved a payment of ten percent of the contract's value to a member of Saddam's family or inner circle. What was unknown outside Iraq was what happened to the goods once they were imported, and the impact of those arrangements on the national budget.

Essentially, Oil for Food products, once imported, were consigned to the Trade, Agriculture or Health Ministries. Through a documentary sleight of hand, these goods were assessed a cost of zero by the Finance Ministry. The appropriate ministry then sold the goods at a fraction of their costs, and booked the entire sale as "profit."

There was a law that established how these profits were to be distributed. Forty percent of the "profits" went to the Finance Ministry, twenty percent went into "bonuses" for the

[6] Tony is a brilliant macroeconomist from Australian Treasury. He was my Deputy Director of the Office of Management and Budget.

senior people in the administering ministry, and most of the rest was retained as "capital" by the same ministry.

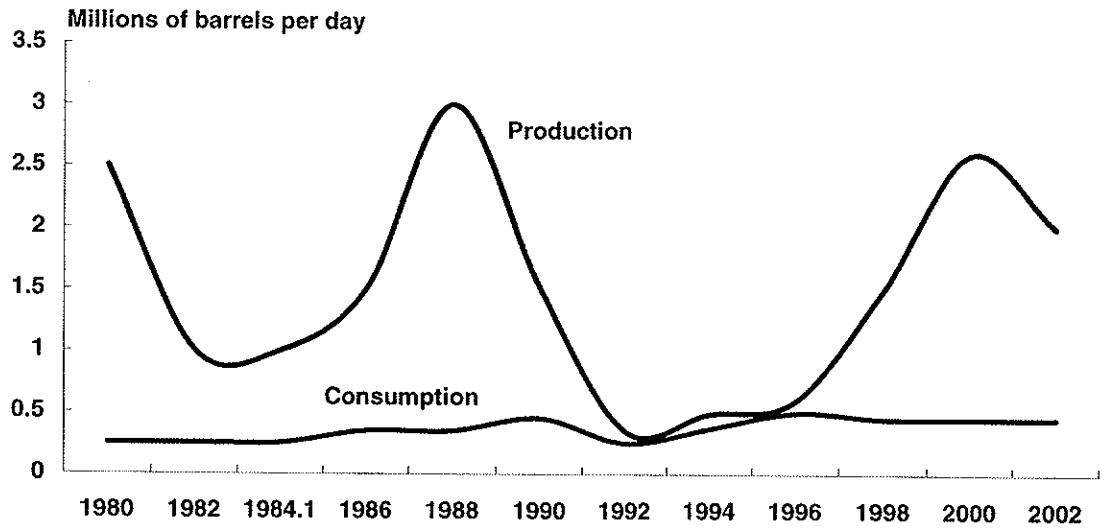
As one might expect, there were also a great number of "fees" involved at each step in the process, and the senior Baath Ministers of these favored organizations raked off untold millions. Our estimates were that this system produced less than $10B of annual economic value for the $15B of Iraqi oil that had been pumped and sold each year.

Our estimates were the only thing we had. UN Resolution 1483 specified that the Oil for Food program was to terminate on November 21, 2003. There were no central records at the UN or in Iraq by which we could accurately determine the key products would have to continue to be provided to the Iraqi economy. In addition, the only Government records (after subtracting funds which had been budgeted for the military and unnecessary public projects such as building more palaces) totaled only $1.3B. This was clearly wrong. The Iraqis had been spending at least $12B US a year.

Our estimates led to a sober realization. If all went better in the oil fields, and the price of oil stayed near its recent high (i.e., didn't drop by 70%, as it had done two years ago), Iraq would barely have enough money next year to pay civil servant salaries and ministry operating expenses. The Iraqis would also need government funds to buy the essential products the Oil for Food program had previously provided.

This prognosis assumed that we eliminated all graft and drove out the waste by placing all purchases on a competitive, rather than negotiated, basis. We were also counting on reaching a level of sustained oil production that Iraq had previously only achieved during infrequent periods of peak output. This would be difficult to achieve, as shown below.

Iraq Oil Production and Consumption: 1980-2002E



So how were we to get sufficient funds to assist Iraq in transitioning its economy from centrally controlled to market-driven? We would also need money if the Administrator choose to compensate the citizens when the oil, electrical and food subsidies are

eliminated. If cash were not so provided, we believed the consequential social disruption might well be more than this fragile young nation could absorb.

We discussed the best way for the Coalition to assist this process with the individuals on the International Monetary Fund and World Bank teams who were in Iraq conducting independent assessments. They were bright, experienced people who had seen many transitioning economies, and offered their assistance in thinking through the macroeconomics. Scott Brown from the IMF was particularly helpful in coordinating between the UN and the Coalition. He ignored the ideological rumblings that randomly emanated from both sides in New York and Washington, and focused on helping.

Scott would be of invaluable assistance until he was severely injured in the mid-August bombing of the United Nations building in Baghdad. He had been at the site of our weekly meeting. We were fortunately delayed in attending.

In June we had been struck by a UN study showing that all countries undertaking the transition to a market economy suffered significant periods of economic depression. Those countries that possessed the political will to persist were eventually much stronger economically, but some of the depressions had lingered for many years.

A notable exception was Poland, which had deliberately quickly collapsed their old industries. Poland had subsequently recovered from their depression in only two years. We discussed this with the staff of the World Bank (which produced the transition report we often referenced), as well as the International Monetary Fund individuals in country. One advantage of discussing the report with the authors is we could further question them on items particularly relevant to Iraq, as well as on what they had observed but not written down. We also questioned our own invaluable asset -- Marek Belka -- who had been the Deputy Finance Minister in Poland, and was currently serving as the Chairman of the Council for International Coordination for the Coalition.

Marek pointed out that there were two essential differences between the situation Poland faced and that which currently existed in Iraq. First, there was no security problem in Poland that hindered external capital investment.

Secondly, a good infrastructure (e.g. electrical power, potable water, telephones, etc.) existed in Poland to support the rapid development of micro and small businesses. We knew these types of businesses were particularly key. Attracting foreign capital was important, but micro and small businesses were essential for rapidly providing alternative jobs to those in the non-competitive nationalized industries that could be expected to fail.

Marek did not mention the third key difference in Iraq. All of the other countries that had decided to shift to a market-based economy had a political leadership in place when Communism collapsed. That leadership believed in the necessity of the change and were willing to lead their people to a new paradigm.

Iraq currently had no political leadership. In fact, some were concerned that any Iraqi political leader who achieved popular following might well differentiate himself by running on an anti-Coalition platform, now that neither Saddam nor the Baath party were threats. The Coalition was currently in charge, and many politicians around the world successfully achieve office by running against whoever is in power.

The Coalition could do little about this last factor. All we could do was assist the Iraqis in getting all the other economic cards in place so that a successful transition could be possible.

One card in the deck that was definitely defaced was the infrastructure. By July, it had become evident that the infrastructure in Iraq was much more fragile than had been predicted, or any of us had suspected. We were struggling to counter the continuing sabotage in the oil fields and the electrical grid, but the Coalition, the Iraqis and our contractors were also struggling even harder to overcome old, tired, and inadequate equipment.

After the UN sanctions took effect following Saddam's invasion of Iran in 1990, Iraq had done no periodic maintenance on any of the infrastructure. Due to fouled steam generating surfaces, many electrical generating plants could operate at no more than 20 percent of design power. In addition, only thirty percent of the irrigation pumps worked, and hundreds of millions of dollars intended for sewage plant repair had been diverted.

Iraq was literally falling apart. Our invasion seemed to have occurred just as the condition of the entire infrastructure teetered on the edge of the cliff of disaster. It appeared the looting was the last straw. Iraqis were no longer being tortured, and hundreds of thousands of government workers were now being paid a livable wage, but Iraq's infrastructure and living conditions were worse than before the war. We estimated it would take billions of dollars and at least a year before the average Iraqi could see the difference. The infrastructure had to be fixed if Iraqi entrepreneurs were to have a realistic chance. Where would we get the money?

And, by the way, how was our 2003 budget, which we had worked so hard to produce, doing in restarting the Iraqi economy? Not very well. Gary Brown (provided by U.S. Treasury) and Justin Tyson (another exceptional individual from Her Majesty's Government) were struggling to convince the Iraqi Ministries to spend the money the budget had allocated them. There was reconstruction work crying to be done. However, the Iraqi civil servants weren't getting money down to the people who needed it. Consequently, few of the public projects we had funded were underway and disappointingly few Iraqis were back at work. We worked to overcome each obstacle we found, making field trips to the sources of problems to ascertain ground truth. Every log we heaved out-of-the-way rolled aside only to reveal a new bureaucratic impediment.

We decided that I had made a fundamental error. My premise was that, given the funds, the professional Iraqi civil servants would take the initiative to get the country moving. I had met many of the remaining senior officials, and was convinced of their honesty and

professionalism. I also knew that the budget we had produced was only an approximation, and local officials would have to modify it to solve problems we in Baghdad had not anticipated. Thus, we had deliberately used Iraqi procedures and existing processes in developing the Budget, as well as in the distribution of money.

However, I underestimated the stifling effects of two decades of Saddam's rule. I should have realized that many of the bureaucrats with initiative had either been killed or discouraged. After several weeks of disappointment, we changed our plan in August and sent the 2003 budget moneys directly to the local Iraqi spending unit, asking our Coalition team members in the Regions and Governates to help prioritize the money locally. This began working better, but the Iraqis were still not executing the budget at the pace we had hoped, and the billions available were having little impact on the local economies.

It was not until Tony McDonald, Linda and I took a trip to the two Kurdish Governates in the North that we fully realized the core problem. In the North, where the Kurds had been protected from Saddam for twelve years by airplanes enforcing the UN sanctions, and two political parties were firmly in power, the economy was alive, construction was booming and unemployment was so low the politicians were worried about obtaining more labor. Here, established political authorities were aggressively using their budget for their needs. We had no such supporting establishment in the other Governates.

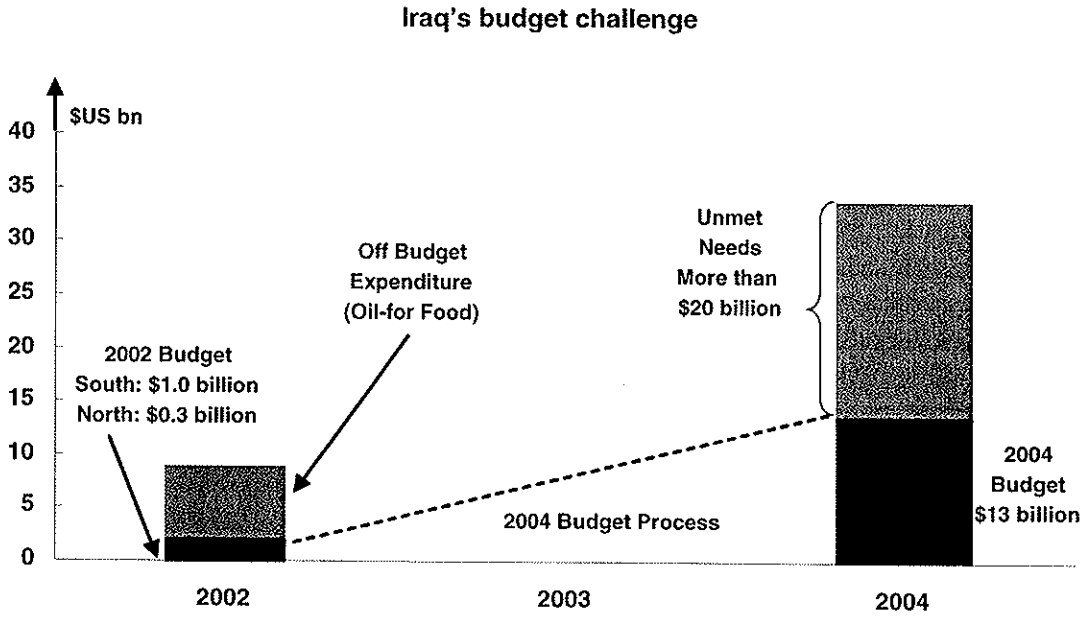
When the Governing Council subsequently appointed interim Ministers for the South, we saw an immediate change in the pace of budget execution. These new Iraqis might not have broad political support, but they were Iraqis of some constituted authority, who had responsibility for making progress and were answerable to a Governing Council that was beginning to think of itself in political terms. Budget execution immediately and noticeably improved, surging in those areas with particularly strong Ministers. (Equally noticeable were delays as individual bureaucrats, with either histories or sympathies the new Minister did not appreciate, were replaced, and new individuals learned on the job.)

Budget execution improved, it was time to focus on how Iraq was to get sufficient funds to reconstruct and transition.

We had become convinced that Iraq was unique. Iraq needed to reestablish both security and the infrastructure before we would have the economic conditions precedent to a transitional economy. Our months in Iraq (along with the assessments UN teams were compiling) had been sufficient to establish the extent of the infrastructure needs. We needed to get the oil fields producing, the electrical grid reestablished, potable water to more than 50% of the Iraqis, sewage services to more than 5%, etc.

The Coalition had asked the Senior Advisors and the Iraqis to compile a list of their immediate needs. We knew that the financial needs over the next few years were on the order of $70B to $100B, but what did they require next year, in calendar year 2004? Their requests totaled more than $35B. We couldn't imagine how we could ever achieve that number, so we judgmentally reviewed that list and eliminated less essential items.

No matter how we pared the list, we needed $20B more than we had available, or Iraqi reconstruction and transition would stall.



Source. Iraq 2004 Budget.

There were two possible sources of funds. The International Community holds a "Donors Conference" when countries go through the sort of disaster from which Iraq was emerging. That conference was scheduled for late October in Madrid. The UN had been conducting a needs assessment of Iraq, as had been the Coalition, for some weeks. Could the Donors Conference provide the needed funds? Would they?

Even if they did, there were three problems with Donor Conference money – quantity, quality and timing.

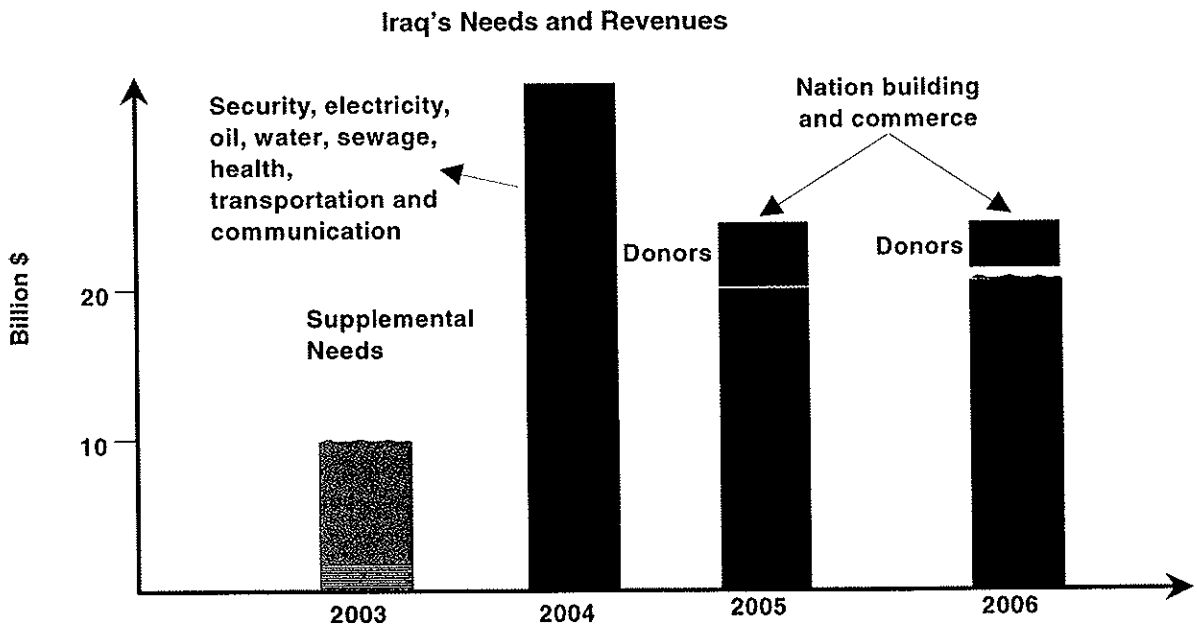
The quantity problem was simple. It was no big secret that the United States Government and much of the International Community had some serious disagreements over the way the Coalition had approached regime change in Iraq. With this background, even considering that the US would attempt to ensure its closest friends understood this donor's conference was "special," how much could we seriously expect to raise?

The "quality" issue was related. Nations that donated funds might well expect to control the problem(s) those funds addressed. If they were to choose to direct those funds to a problem that was not in our "critical path" to transition success (such as supporting Iraqi Olympic teams or rebuilding the Universities), then, while the funds would make Iraq a better place, they would not address our identified immediate needs.

Our short-term needs also gave us a timing issue. Some of the Donors would likely "buy" a position inside Iraq to improve the economic position of their national companies. They would want to ensure that presence existed over several years, to give their companies an opportunity to gain an economic foothold in Iraq. That was in the Donor nation's interests. Iraq, however, needed an immediate influx of money in order to accelerate its transition to economic growth.

In addition, there were timing problems of getting Parliamentary approval of the pledges the diplomats would make. As a result, much of the money pledged at the Conference would actually not become available for Iraq until 2005 to 2007.

We decided that the best course was to ask the American Congress for help in 2004, and rely on the Donors Conference, as well as the reestablished Iraqi oil industry, for the subsequent two years. We predicted that the non-oil domestic economy would not show recovery until 2008. We developed a graph to show the plan. The shaded area in the 2003 column shows our estimate of the off-budget items which were not documented, and the bottom portion of the 2004 to 2006 columns show the oil and tax revenues which we expected in each year.



Source. Iraq 2004 Budget.

The Iraqis and we recognized we needed to produce the 2004 budget well in advance of the October's Donors Conference, in order that donors could see Iraq practicing honest, balanced and transparent budgeting. We also were documenting all needs, in each economic sector and in every village. We intended to put all this information on the

Internet, as we had the 2003 budget and our other fiscal decisions, so everyone could see and judge the situation.

The 2004 budget process was well underway. For the first time since 1979, the Iraqis held budget hearings, in which the Finance Minister publicly questioned each Minister about the requirements that Minister had presented, and made decisions that cut requests as necessary to conform to the gross revenues he expected in 2004.

Taxes.

In developing those expected revenues, the Iraqi Finance Minister, Peter McPherson and many others worked to make the necessary key decisions on custom duties and taxes.

The World Bank was insistent that a custom duty of zero would be viewed by the international community as demonstrative of an unwillingness by Iraq to tax itself for reconstruction. They cautioned that disregarding this advice might well negatively impact the Madrid donor's conference.

We strongly preferred keeping Iraq's borders free of all customs duties, so as not to encourage inefficient Iraqi industries to seek destructive protective duties. We had already heard the owners and/or managers of uneconomical Iraqi companies (and most were grossly inefficient) grousing about the need for protective duties. We had long conversations with the Governing Council representatives about how protective duties were simply the equivalent of imposing taxes on all the Iraqi people, and the mere existence of duties prevented capital from being efficiently reapplied to make more Iraqi jobs.

Everyone we talked to nodded agreement, just as everyone in the United States nods, but we feared that if the "zero barrier" were breached in the customs tax arena, Iraq, just as the United States, might suffer continual pressure to slide into protectionism. Our Treasury Department leadership, Secretary Snow and the Deputy Secretary, John Taylor, believed setting the customs tax at zero was important.

Peter McPherson particularly argued this issue long and hard.[7] The problem was not the Iraqis, but the International Monetary Fund. They wanted a ten percent duty, and unlike several items we had discussed with them, were adamant, on this one. Since the IMF was going to be one of the presenters at the donors' conference, and could well set the tone for the entire discussion, we made a political compromise and agreed to a flat 5% "reconstruction customs duty." The duty would sunset after two years.

[7] The US Treasury was tremendously supportive of both Peter and my efforts in Iraq. Peter talked to Secretary Snow at least weekly (and made several other late night calls to Chairman Alan Greenspan of the Federal Reserve). We took their suggestions seriously, and they, to their great credit, relied upon our judgment as to whether those suggestions were right for Iraq.

We also set individual and corporate tax rates at no more than 15%, effective 1 January 2004. There were different considerations involved in each.

Iraq had a tax collection system, but it was not routinely deducted from wages, and the individual tax rates were so high that tax evasion had become a national game. Most Iraqis, who were well aware of the potential of their oil fields, did not believe it was necessary for individuals to pay any taxes. We discussed this for many hours with key members of the Governing Council's Budget Committee. The Coalition's position was that a tax on individuals was a necessary antecedent to the Iraqi citizen feeling involved in national fiscal decisions. In the end, we reached consensus on a low tax rate -- which other countries with histories of similar tax evasion problems had found resulted in more tax being collected.

A key meeting on this decision took place in the Administrator's office, in which Ambassador Bremer asked Peter McPherson, "Why a rate of 15%?

Peter's simple reply, "Russia has 13%, and there was a lot of McPherson wrapped up in that number," avoided a multi-hour discussion of international tax theory.

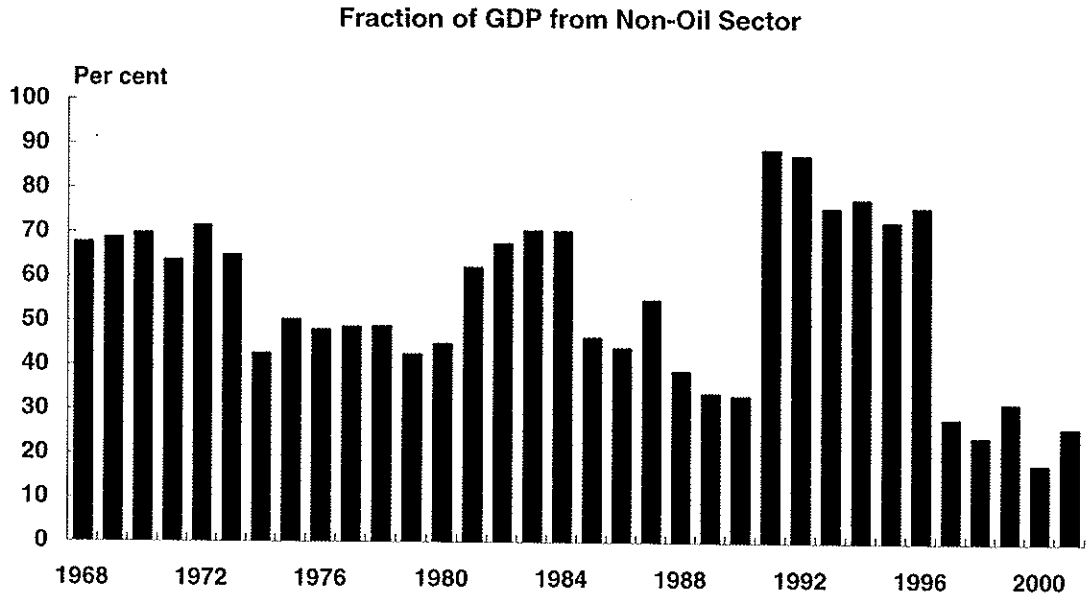
Previously the Iraqi Corporate tax rate was 25%, with the proceeds used to buy Iraqi property. The rents from the properties were then used to fund the retirement plan for private companies. The theory seemed good, but the properties were all underperforming (most were in rent controlled areas in Baghdad) and the consequent retirement pay was only $5/month. We intended to bring all the Iraqi retirees under a universal retirement system, and we wanted to set corporate taxes at a rate that would encourage development and investment. Concurrently, we needed to quickly establish a corporate tax rate so that company executives considering investment in Iraq could accurately estimate future returns and return on investment.

As another critical facet in providing some certainty for future companies contemplating capital investments in Iraq, Peter McPherson (after literally weeks of discussions) obtained Iraqi Governing Council agreement on capital investment parameters – foreign companies would be permitted to buy into any sector in Iraq (except oil, which was reserved for Iraqis). This was true in most countries. The news here was that the companies could exercise operational control of their investments (i.e. they would not be restricted to minority percentage positions, a consideration which stops most firms from investing outside their home territory). In addition, foreign investors would subsequently be permitted to remove earned profits from Iraq.

Some who did not understand Iraq criticized this move as opening Iraq to foreign exploitation. Those critics did not sit in the same meetings we had with Iraqis. Most senior Iraqis believed that any Iraqis who had profited in business under Saddam had only done so by doing Saddam's bidding. These private individuals might or might not be Baathists (and the only restrictions the Governing Council had set on the Baathists were that they not be part of the Government), but the antecedents of their funds were

popularly suspect. There was not enough "clean" money in Iraq, so the Iraqis established a set of rules that encouraged investments from sources outside the country.

The long-range goal was for Iraq to develop an economy in which oil revenues were not the big dog on the block. Before the last regime, the Iraqi private economy (including proceeds from the agriculture breadbasket) had been robust, and generated most of Iraq's GDP. We needed a rate that would reverse the trend shown in the graph below (the high percentages in '91 to '96 are a period of no oil exports).



Source. International Monetary Fund calculations.

Coincidentally, the Iraqis settled on 15% for the corporate tax rate.

In mid-September, at the annual meeting of the Board of Governors of the World Bank Group and the International Monetary Fund in Dubai, the Iraqis announced their Economic Reform Package, including the new tax and foreign investment policies. Observers noted these policies made Iraq the most open economy in the Middle East, even superior to Jordan and Israel. The Iraqis (with Peter McPherson's essential help) had positioned themselves to attract the foreign capital necessary for long-term growth. Now, if we could only get through the next year.

Reconstruction Funds.

After we compiled the extent of the Iraqi needs in August and September, Dan Devlin (another exceptional Aussie) assisted the Iraqis in preparing the 2004 budget, while Paul Hough (an outstanding American Colonel) and I worked on a request to the US Congress for supplemental appropriations, and Tony McDonald supervised preparing documentation for the October's Donors Conference in Madrid. By working all three

"money documents" at the same time, we ensured that we carefully examined the entire picture of Iraq for the next three years.

After a great deal of work by the entire Coalition team,[8] the US Congress provided nearly $19B US dollars, and the Donors Conference another $14B. With these pledges, and Iraq's expected future revenues, we believed the Iraqis had sufficient funds to succeed.

In September, while I was in Washington carrying Administrator Bremer's bag as he made our case for the Supplemental with Congress, the Coalition experienced its first attack on the Al Rasheed Hotel. A rocket penetrated into Sande Layton's room, but did not explode. Sande is a Navy civil servant who had volunteered to help me in Iraq. Her husband, Dan, was already present -- running the Iraq mine-clearing program. Sande was, like the rest of the team, innovative and hard working. She was not hurt in the attack. I assigned her more work so she had less time to worry about what might have happened.

Three weeks later, a second rocket attack on the Al Rasheed nearly killed Jacob Nell.

Subsidies.

Funding secured, we turned again to addressing the four major subsidy areas:

Monetizing the Food Basket,
Rationalizing the Nationalized Industries,
Bringing oil derivative products to border prices, and
Proper pricing of electricity.

Food Basket. The Food Basket program was a UN attempt to keep the Kuwait war sanctions from inadvertently starving the populace. The sanctions had been very successful in frustrating Saddam's program to develop weapons of mass destruction. However, the sanctions had not even touched the root cause of Iraqi's internal problem – Saddam and his family – who had continued stealing as much as ever. With foreign trade forbidden in the early nineties, and Saddam still stealing the same as before, the common Iraqi was economically driven to his or her knees.

The Food Basket program monthly provided each Iraqi man, woman and child with sufficient imported food for its basic nutritional needs. A Washington "think tank" had computed the cost for providing that basket at around $13, while another group had computed the value of the basket to the Iraqis as $6. The difference of seven dollars was due to the additional costs of UN supervision, the use of all imported items, and the waste involved in centrally planning and distributing the food. The unnecessary economic cost

[8] Tom Korologos, the Coalition's own "101st Senator," did the great majority of Capitol Hill heavy lifting to get the President's Supplemental request successfully through the Congress.

to Iraq from this was $1.5B a year, more than ten percent of their expected total revenues for 2004.

The key word in the previous paragraph for the Iraqis was "imported." Since all the food was imported, the previously vital Iraqi agriculture sector had been economically destroyed. Although it would present a potential disruption, the Iraqis we talked to wanted their agriculture sector restored. They were unanimous in wanting the food basket monetized.

The Coalition agreed. Monetizing the food basket would also build many, many small businesses, which would develop to transport and sell food to the public. The only issue was timing. We didn't want to be solving the monetization logistics and social problem at the same time we were trying to change out all the country's currency. In addition, there were numerous termination problems that had to be worked out, such as exactly how we were going to pay the people, and whether local markets would be ready to provide sufficient choices and quantity. A team was established to work the details and Administrator Bremer announced monetization would be accomplished during 2004.

Rationalization of Nationalized Industries. This was largely an evaluation and timing problem. As I earlier discussed, the nationalized industries were inefficient and the managers lacked basic modern business skills and tools. Nevertheless, we determined many companies could survive largely intact, and more could be successfully rationalized under a different business model.

Assisting the industries was a difficult task, as each company had different needs and futures. A team was formed to assist the Iraqis with that evaluation, and the Iraqis were provided millions of dollars of Coalition funds to hire their own expert consultants.

By the time we put together the 2004 Budget, we realized that some of the nationalized companies actually were doing inherently governmental work (e.g., controlling Iraqi commercial airspace). These divisions were folded into the appropriate Ministry during the budget process.

We also had provided some direct subsidies to the nationalized industries in the 2003 Budget. With these funds, plus the loans they obtained from the revitalized banking system, many companies opened their doors for operation. We set aside additional money in the 2004 Iraqi Budget for job retraining and unemployment compensation that would be necessary when security and infrastructure conditions were adjudged right to make the next transitional steps.

Oil Product and Electricity Pricing. The largest and economically most distorting subsidies in Iraq were those in the power industries. Not only did the existing prices remove the stabilizing effect of supply and demand and encourage Iraqis to make uneconomical choices in both their home and business investments, they also were a security issue. The low price of gas in Iraq, relative to that in the nations on their borders, established a very profitable incentive for smuggling.

Fixing this problem also offered the clear opportunity to put some of the revenues from the Iraqi oil industry directly into the hands of the Iraqi populace, either as a compensating cash payment or through alternative services, such as education or retirement plans. There were several models available in the world (Alaskan, Norwegian, etc.). The Iraqis and we discussed the options for best control of oil revenues, as well as whether the oil industry should be privatized, subject to an international board of directors, or left as a state-owned enterprise.

We were aware of the danger the oil industry posed to Iraq's future, for while there is underground wealth sufficient to propel Iraq to international power, no country which did not already have a solid existing constitutional government has managed to adapt to the economic temptations that accompanies oil riches.

Again, timing (we needed to get the oil fields producing before we had the assets to do any of the plans which were under consideration) was important. In addition, I counseled against moving too fast in making a decision as to how to alter the oil industry ownership. I was concerned that any quick decision would be viewed by the world community (and many Iraqis) as justifying the false proposition that the Coalition had only become involved in Iraq for the oil. I also felt we needed to give the new Iraqi Ministry management time to drive out the remaining graft.

The Coalition at this point had already turned down several opportunities to discuss future oil field development. Development of new fields would cost in excess of ten billion dollars and would require several years. Administrator Bremer, Peter and I all told the Governing Council that new oil development decisions would not solve their current economic problems and were best left to the future Iraqi political establishment they were all working hard to establish.

Military/Civilian Coordination.

Problems in this area affected the economic team and Iraq. The organization of the Coalition and the Military was awkward and used few of the existing best practices. There thus were continual communication breakdowns between our military and civilian groups. Some of the problems were inevitable, because of the different objectives, but more were self-inflicted.

Administrator Bremer, reported to the Secretary of Defense, and then to the President. The Coalition military commander, Lieutenant General Ric Sanchez, reported thorough the U.S. Central Command Commander to the Secretary of Defense. Thus, the two key men on the ground in Iraq had different immediate bosses. The Administrator and the Military Commander were quickly physically collocated a few feet from each other in the Palace, met with each other several times daily, and had a good personal relationship. However, I am convinced there should have been one person fully responsible for

everything happening in Iraq – General Sanchez should have reported directly to the Administrator.

There has to be only one person with the button of responsibility, and in a democracy, that person is a civilian.

I don't believe it would have necessarily changed their relationship, but it would have significantly affected the coordination of everyone who worked for them in the country, and forced better management.

It has to be recognized that the civilian members of the Coalition and their Military counterparts have different roles, which are often complementary, but are basically in conflict in Iraq.

The military was there to win the conflict, find Saddam and then keep the peace. The Coalition was there to assist the Iraqis in developing a democratic, secular government powered by a market-based economy. After the war, the Military was focused on rooting out the remaining bad guys and keeping the population quiet.

However, the Coalition was focused on change. Changes to the status quo inevitably make someone unhappy. Unhappy people will consider options for making their views known. Remaining quiet is only one of many options.

In the Pentagon, where the same differences in viewpoint often exist, a best practice has developed of having a senior Military Aide, well trusted by the military, serve in the immediate offices of all the senior civilians appointed by the President. These officers are assigned to provide the civilian with the military view of problems that arise. The same officers serve as effective communication channels between the civilians and the military. These officers were not routinely assigned in Iraq, even to the Directors and Senior Advisors who were making things happen twenty hours a day.

As an aside, these assistants have to be both senior (O-5 and O-6) regular Army, Marine Corps, Navy or Air Force for this to work. Junior officers or civil affairs officers cannot do the job required. They did not do the job in Iraq.

The civilians in the Coalition generally had no knowledge of military organization, and thus no idea of which parts of the military might either assist them or need to know what they were planning. The civilians didn't know whom to call. Senior military officers do know.

Do you think an Australian businessman, who has volunteered to help the Coalition, and is occupying an independent policy-making position in Iraq, has any idea who in the (largely) American military might be interested in the fact that he is about to stop the distribution of urea (a fertilizer the Iraqis were overusing (because it was free) on the their non-irrigated croplands)? Stopping distribution of urea might well cause

demonstrations counter to the interests of military. Not stopping distribution would result in lower crop yields, which would negatively impact Iraq's economy.

A military commander might see nothing wrong with going in a bank with his gun to get money for what seemed to him on the spot as not only very valid reasons, but also the righting of a previous injustice, especially if he believed this action might stop what he thought was potentially a demonstration. Of course, he thus might prevent the reopening of the banks, and result in six Iraqis being killed during the next week during armed robberies. This action is hard to fault if the military commander does not know the bigger picture.

Militaries also organize and communicate very effectively. That is the core of their job. They need to make the logistic trains run on time and be able to focus power on the right spot at the right moment. Civilians in government tend to focus on the power of ideas. They have a great deal of specific expertise, because that is their own core capability. Civilians tend not to be as interested in rigid organizations and do poorly communicating reliably.

There were 147,000 military personnel in Iraq, and less than a thousand Coalition civilians. The civilians were quickly driving governmental, economic and physical change. The military was trying to maintain quiet. There were inadequate mechanisms set up to coordinate these potentially disruptive goals.

Let me give you two examples. Administrator Bremer and Gene Stakhiv, the Senior Advisor for Irrigation, flew off one day, accompanied by a helicopter full of reporters to report a good news story. Gene was employing 100,000 Iraqis cleaning the irrigation ditches. Not only did this provide jobs, it increased the water available to agriculture. In addition, Gene's Ministry personnel were learning how to take initiative and make this new program work -- recruiting personnel, keeping the records, doing the payments, etc. The Iraqis were being paid $2.50 a day (above the normal manual labor rate), and when the jobs ended, they could take their shovels, wheelbarrows, etc. home. If they individually possessed such initiative, they automatically had tools to start up their own micro-business. It was a good story. Gene was one of those officials who did not have a senior military assistant.

As the helicopters neared the pay site, a Marine unit with responsibility for the area saw the Administrator would land near a large crowd of unruly Iraqis, so the Marines dispersed the Iraqis at gunpoint. Of course, the large crowd had been around the pay station, so now there was no "good story" for the photographers, but instead only an angry crowd shaking their fists.

Was the crowd unruly? Yes. The Ministry had failed to arrange for the proper size currency, and was trying to pay people with twenty-dollar bills for two days work. Once the Iraqis had waited in line and had their names checked against the work log, then four workers proceeded to the local moneylender to get it changed, each holding a corner of the bill.

The local Marine commander assessed the situation. He had access to five-dollar bills, and knew how to organize. His men assembled the crowd into orderly lines and paid them all in a few hours.

Unfortunately, he ignored the work log, and paid everyone in line. The nearby town heard the Americans were handing out money and many came to see what was going on. The commander paid everyone who got in line. He solved the problem according to his goals. Of course, we had wasted money and not exactly sent the larger message of a fair pay for an honest day's work.

The military commander dammed the civilians as poor organizers and managers. The Ministry thought the commander was an interfering, overbearing sod. No lessons were learned or corrective actions taken until I sent my Military Aide, Colonel Rich Reynolds, to resolve the situation.

Second example. There were four banks in Baghdad in which we stored large cash shipments received from the United States. Each had several hundred million in its vaults (as opposed to a normal Iraqi bank float of forty or fifty thousand dollars). These banks were guarded by military troops, as the Coalition could ill afford to lose this quantity of money.

While eating in the common mess in the Palace, for months I heard scraps of indignation from the civilians in charge of the banks about the military's lackadaisical attitude toward bank security. At least once a week, one key bank was left unguarded. Finally, during a meeting in which a civilian was cursing the military, and the junior "civil affairs" military officers assigned to the group were all nodding their heads, agreeing with the vitriol, I interrupted. I have spent a great deal of time working with each of the Coalition's military forces. I know they are definitely professional.

I took the complainer by the hand and went off in search of a General. Overnight we resolved the problem. The military was using grid coordinates of Baghdad to determine what needed guarding. Military units were being rotated between assignments weekly. Once a week, one bank was found unguarded. It did not take a rocket scientist to determine what was going on -- one of the key banks was designated with incorrect coordinates. Once a week, the new Army unit was setting up its armor around an empty warehouse. We never did bother to determine who had made the original error. It was sufficiently illuminating that the Coalition military and civilians viewed each other as belonging to the "other side."

Why had this error persisted for months? Because there was not a senior military aide assigned to the senior Coalition advisor in charge of the banks and financial systems (or the person responsible for trade, or the one responsible for regional coordination and development, etc). Thus, there was no effective communication system between the few hundred civilian Coalition members in charge of the country, and the hundred thousand

military on the ground, and there were two completely different chains of command operating in Iraq, with ineffective intra-chain communications.

This problem was not resolved when I left.

Planning Differently. Since my return to the United States, I am often asked what I would have done differently if I had been involved in the planning for Iraq. Probably nothing.

I was not involved in any way with the planning, but the professionals who were assembled for the Coalition Economic teams were good ones who knew a great deal about Iraq, and were experts in economic theory and practice. However, I believe we were all surprised by many of the conditions we found in Iraq.

"Nevertheless," friends insist, "what would you do differently, given your experience and 20-20 hindsight?"

Given those key caveats, let me suggest the following:

Funding. I know from experience that any time the United States employs military forces overseas to project the National Interest, the added cost to our Nation is between $3B and $4B a month. You can build the numbers up by adding the cost of Meals Ready to Eat, gasoline and bullets, or you can do the figures parametrically from the top down, the results are the same. Those costs are in addition to the $400B it will cost to run the Defense Department next year.

The United States is a rich country, with a Gross National Product around ten-and-a-half trillion dollars. Given this, if the United States has decided to use our military to enter an area and do "nation-building," should we not plan to give the Administrator, whom we are tasking with success for that plan, sufficient funds to be successful? I would recommend a minimum of six months of the cost of the military deployment, or in this case, at least $20B, to start.

It should be recognized that in the chaos of establishing a presence in a foreign environment, it will be some time before anyone can "know" how much money is needed. Cash is a blunt instrument that can quickly solve or begin to address a multitude of problems. If you have underestimated your needs, you lose valuable time getting additional money approved. In our case, we lost at least 16 weeks from the point it became obvious that we did not have enough money to address the security and infrastructure problems before we received additional money, and that was with the Administration and Congress bending over backward to assist us.

(I know it may not have appeared so to the readers of morning newspapers outside the Washington Beltway, but I participated in the conversations with senior Administration

officials and Members of Congress. Given all the issues involved, they all moved at a lighting pace for the American democracy.)

With the money we found in the Palace, the Iraqi funds which had been frozen in New York and elsewhere, the money appropriated by Congress, plus the oil revenues we could project, we had about $6B to do "nation-building" in Iraqin 2003. This sum was insufficient to attack the surprising conditions we found. I was continually stealing nickels from one important project to fund something else which had become of more immediate priority. One of the discriminators the United States brings to a party is money. We did not bring enough money to Iraq.

Talent. The Coalition nations have millions of the most talented individuals in the world. We needed, and did not have, several thousand of them. Our partners sent some of their best and brightest. The United States did not proportionally provide. There were all sorts of reasons that sending enough good people to Iraq was difficult, from simply the lack of places to sleep, to the difficulty in getting people to put their lives on hold to do a demonstrably dangerous job. Those involved in staffing the Coalition found every one of these obstacles.

We simply did not have sufficient people for the task. There was no time to maintain a record of what was occurring – it was difficult enough in my Directorate to maintain even the semblance of a correspondence chronological file. The volunteers that did come to Iraq performed heroically, but people frequently rotated through every four to eight weeks, and, when they departed, too often took their invaluable knowledge with them.

Since most problems involve or can be solved by money, the Office of Management and Budget was frequently where new people went for help. My staff frequently shifted desks – no one wanted to be the person nearest the entrance to our office -- for fear of getting yet another issue added to his already overflowing plate. It was only the good intentions and extraordinary performance of the few that kept Iraq's economic recovery moving.

I tried and failed even to make a dent in this problem. As I write this, there are only two experienced people in the Coalition's budget and finance directorate – trying to do the job of hundreds.

I will note one example, from many, of the deleterious impact of the lack of sufficient experienced talent. The electrical infrastructure was a disaster in Iraq. As I have previously noted, it was also an area in which the Coalition was broadly unfavorably compared with Saddam. Fixing this problem required an experienced and sophisticated management team. The Senior Coalition Advisor to the Iraqi Electricity Commission was a good person and an engineer. He was, however, relatively junior (a GS-15 for those who are familiar with American Civil Service scales), and had only one assistant.

When this Senior Advisor took personal leave, he was replaced by a 27-year-old individual, also a good person, with no management or engineering experience, who had

refinanced his flat in London, and, financially flush with 80,000£, decided he wanted to see what was going on in Iraq. The young man had flown to Amman, Jordan and taken a taxi to Baghdad to see if he could be of any help. When he, a breathing member of one of the Coalition partners, appeared at the gates of the Palace, he was pressed into service. Two weeks later, he was trying to run the entire Iraqi electrical grid recovery effort for the Coalition, his clothes still in a hotel room in Amman.

The United States military brings overwhelming force and capability to a military problem. The United States can also bring any situation money, talent and technology. When the United States plans to attend a function, it should bring all the attributes that garnered the invitation.

Summary. I believe it unimportant how or why the Coalition got to Iraq. We all were there, and the national interests of important States were intimately involved in success. In addition, whatever the chances for complete victory, the opportunity to assist the Iraqis in developing a democratic, secular country, with a market-based economy, which would vault them into becoming a stabilizing world power, was too important to spare any effort. The economic sector teams worked day and night with that dream.

We accomplished a great deal before we handed responsibility off to Poland's Marek Belka, America's Rodney Bent, and Australia's Tony McDonald. Government employees were being reliably paid with a new, viable, currency, and there was a fair national salary schedule in effect. The Iraqis were operating with a public budget, the budget for the following year was already published, and there were funds available to reconstruct Iraq over the next four years.

An independent Central Bank had been established, as well as a Trade Bank.[9] The commercial banks were open, providing both loans and interest on deposits, and serving as facilitators and a stimulus for Iraq's economic development. Census efforts were underway to determine the actual impact of changing economic policies. We had planned Iraq's disengagement and recovery from the Oil for Food program, and were well along to eliminating the disastrous system of subsidies.

Stabilizing new custom and tax rates were in place designed to attract new Iraqi and foreign investment.

In six months, we had accomplished more than any of us ever thought possible. History and graduate students will have to resolve whether the Iraqis' and our efforts were successful.

[9] An extraordinary achievement by Rick Bloom, a banker's banker, whom Peter had known at the Bank of America.