



SPECIAL REPORT

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ABOUT THE REPORT

This report, sponsored by the Center for Conflict Management at the U.S. Institute of Peace (USIP), examines coalition efforts to strengthen the Iraqi government, provide essential services and infrastructure, and counter the insurgency by building Iraq's budgetary system. The budgetary process provides Iraq with a significant source of political and institutional stability in the midst of ongoing political tension and violence. These recommendations are consistent with USIP's findings that effective systems of public finance contribute significantly to the success of postconflict stabilization efforts.

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James D. Savage

Iraq's Budget as a Source of Political Stability

Summary

- Good budgeting that promotes democratic governance and effective administration requires a transparent and inclusive process that is responsive and accountable to elected public officials. In this sense, Iraq is no different from any other state.
- Under Saddam Hussein, Iraq's budget remained a state secret, and the government divided budget formulation responsibilities between its Ministry of Finance and Ministry of Planning. The U.S.-led coalition that invaded Iraq discovered a budgetary process that reflected Ottoman, British, and Baathist origins.
- Coalition officials worked successfully with Iraqis to pay civil servants and pensioners in the months following the invasion and later drafted Iraq's 2003 and 2004 budgets. Criticized as rudimentary and incomplete, these were the first publicly accessible budgets available since the 1990 Gulf War.
- The coalition's most important, lasting contribution came in the form of Coalition Provisional Authority (CPA) Order 95, which outlined a new budgetary process. The order called for parliamentary approval of the budget and enhanced the powers of the Finance Ministry, returning it to the coordinating role it had played during the British Mandate; set a timetable for formulating and approving the budget; promoted budgetary transparency; and initiated a rudimentary system of fiscal federalism.
- In 2007, the seventeenth of eighteen U.S. benchmarks that evaluated Iraqi progress called for the Iraqis to boost their budget allocations and spending of investment funds.
- To promote Iraqi budgeting, the coalition initiated various capacity-building programs that proved to be of mixed success. The seventeenth benchmark's focus on Iraqi investment spending became the metric for evaluating many of these programs.
- Iraqis took ownership of the CPA budgeting process and have used it to formulate their budgets since 2005.
- Iraqi budgeting suffers from delays in budget formulation and approval, deficiencies in transparency and accountability, effective budget execution, and endemic corruption.

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Introduction

Budgeting is a critical state function. Effective budgeting enables a state to plan, prioritize, allocate resources, manage the bureaucracy, restrain corruption, and set fiscal policy. A functional, politically legitimate budgeting process may also serve as a dispute resolution mechanism that offers a source of political and institutional stability through which claimants for public funds can reach nonviolent agreements on the division of these resources. Consequently, scholars and practitioners studying postconflict, statebuilding, failed states, and peacekeeping situations are paying increasing attention to the importance of developing reliable, transparent, and accountable budgetary institutions that are responsive to and promote democratic politics.

Public budgeting can be viewed as the “linchpin of the state.”¹ Budgeting, in this regard, consists of both the “upstream” formulation and political approval of the budget and the “downstream” administrative management and spending. The rules that govern the budgetary system—including those on the execution of the budget’s funding proposals throughout the downstream procurement, contracting, payment, and auditing processes—are understood to reflect the state’s capacity to function. Weak budgetary processes and institutions contribute to fiscal malfeasance, corruption, and state failure in providing public services. Consequently, donors frequently fund their programs off-budget, that is, outside the regular government budgetary and bureaucratic apparatus.² It has been suggested, however, that one of the five rules for effective reconstruction includes channeling assistance support through a beneficiary government’s national budget. Independent donor funding creates fragmented development strategies.³ Similarly, assistance efforts that rely on parallel funding systems through donor off-budget spending are said to undermine government accountability and lead to uncoordinated spending programs.⁴ Thus, although the conditions that confront statebuilders in failed-state, postconflict situations frequently create disincentives for allocating funds through on-budget government institutions, a central goal of statebuilding and the promotion of good governance should nevertheless be the development of effective public budgeting.

The American-led coalition’s statebuilding efforts in Iraq exemplify the challenges and significance of building budgetary capacity under harsh, violent postconflict conditions. The U.S. Department of the Treasury’s efforts focused on the humanitarian and stabilization needs of paying civil servants and pensioners and converting the currency. The U.S. Agency for International Development (USAID) created contracts for the long-term reconstruction and developmental need to strengthen Iraqi budgetary practices. The scope of what was required to bring Iraq’s budgetary institutions into some degree of compliance with international best practices led the CPA to reconstruct the government’s budgetary rules, institutions, and processes. The importance of the Iraqi government’s ability to formulate and adopt a budget and then spend its money was reflected in the establishment of the seventeenth benchmark in 2007, which set a target for spending Iraq’s budget to provide essential services as part of a broader counterinsurgency strategy and reducing Iraqi donor dependency.

Nonetheless, the coalition encountered numerous obstacles in building Iraqi budgeting capacity. Coalition officials, for example, knew little about Iraq’s existing budgetary institutions and procedures; postinvasion looting and ongoing sectarian violence plagued reconstruction efforts; and Iraq’s bureaucracy suffered from a chronic lack of capacity in formulating, managing, and executing its investment budgets. Coalition capacity-building programs created to address these deficiencies were too frequently inconsistent in purpose, poorly coordinated, hampered by bureaucratic stove piping, and insensitive to Iraqi preferences. Despite the deficiencies, Iraq took ownership of the CPA’s budgetary process

in 2005, successfully formulated and adopted their budgets and slowly improved their rate of investment expenditures, often in the face of rapid turnover in governments, continued violence, sectarian differences, corruption, dramatic variations in oil prices, and administrative incapacity.

This report examines the significant events that encompass the coalition's efforts to reconstruct Iraq's budgetary institutions, beginning with pre-invasion planning, continuing through the CPA, and concluding after the transfer of power to the Iraqis in 2004. The Iraqis took ownership of the CPA's rules and used them to formulate, adopt, and execute their budgets. The budget process has become a dispute resolution mechanism that provides a critical source of institutional and political stability to Iraq.

Iraq's Budgetary System

The budgeting process the coalition discovered in Iraq and would attempt to reconstruct reflected the layering of successive institutions, procedures, and rules created by the Ottomans, the British Mandate, and Baathists. Ottoman public financial management for the provinces that now constitute Iraq largely consisted of a highly fragmented tax collection that maximized the extraction of revenues to fund the empire. During the British Mandate, ratified in 1923 and concluded in 1948, the then-new Iraqi government operated under a parliamentary system that established Iraq's first finance ministry in 1921 as well as a finance committee to provide budgetary oversight. Saddam Hussein later added a planning ministry that reflected the Soviet Union's influence in Iraq during the Cold War. As a 1990 budgetary law declared, "The consolidated budget for the socialist sector is a planning budget."⁵ The creation of this ministry contributed to inefficient budgeting by dividing the formulation and management of the government's operational and capital investment programs between the two ministries. The weakened Ministry of Finance largely became staffed by accountants, and the Ministry of Planning personnel developed more sophisticated planning, statistical, and economic capabilities. Saddam's budgets were unpublished state secrets, and budgetary decisions were made in a top-down, compartmentalized fashion that strengthened Saddam's power and excluded meaningful legislative deliberation and the participation of credible provincial governments.

The American-led coalition that invaded Iraq in March 2003 was unaware of much of this institutional history. The coalition did not understand, for example, the functions of the Ministry of Planning and its contribution to Iraq's budgetary process by developing the government's capital budget. Nevertheless, coalition officials recognized before the invasion the importance of Iraq's key budgetary and financial management activities and struggled to make them work during the occupation. The U.S. Treasury's prewar stabilization planning identified the need to pay civil servants and pensioners their salaries and benefits. Yet on entering Baghdad, Treasury's team from its Office of Technical Assistance (OTA) discovered that the Ministry of Finance, many of its records, rudimentary computers, and communications equipment had been looted and destroyed.⁶

Because of Saddam's compartmentalization, Iraq lacked a unified budget that identified total government revenues and expenditures. The budget instead consisted of a host of programs and their separated budgets. Ministerial spending was dispensed from Iraq's Rasheed and Rafidain banks rather than a central treasury. Much of the ministry's top leadership proved to be of little help in making budgetary decisions. The coalition arrested Saddam's minister of finance and deputy prime minister, Hikmat Mizban Ibrahim al-Azzawi, who had been assigned the eight of diamonds in the deck of most-wanted Iraqi playing cards. Despite the breakdown in security, some ministry staff were able to hide critical payment records during the looting. This enabled OTA personnel to work successfully with Iraqi officials to

ensure that these civil servant salary and pension payments were made during the short-lived Office of Reconstruction and Humanitarian Assistance and in the early days of the CPA.

Making the 2003 and 2004 Iraqi Budgets

As vital as these payments were, Iraq still required a regular budget. After the coalition deposed al-Azzawi, the CPA assigned the task of formulating a budget to former Navy admiral David R. Oliver Jr. Aided by a handful of Australian and United Kingdom treasury staff, Oliver drafted the 2003 and 2004 Iraqi budgets under extraordinarily difficult circumstances. Making a budget normally requires the participation of line ministries working with a central finance ministry. In a parliamentary system, for example, the Ministry of Finance ensures that the prime minister's priorities are reflected in budgets of the various line ministries before the government's budget is presented to Parliament for approval.

Oliver confronted the challenge of working with a finance ministry largely unaccustomed to coordinating the government's budget, an unexpected planning ministry that controlled the capital budget, and diminished leadership and technical capacity throughout the ministries resulting from postinvasion looting and the CPA's de-Baathification order. The order, however, proved to have little effect on Finance Ministry personnel: coalition officials identified and removed only one active Baathist among the ministry's director generals. The 2003 budget subsequently emerged from a hasty effort at budget formulation that incorporated admittedly questionable estimates for both revenues and expenditures.

These early, basic budgets primarily provided for operational expenses such as salary payments; minimal allocations of 4 and 10 percent of these budgets respectively went for investments. Meanwhile, the CPA's Program Review Board (PRB) distributed funds from the UN's Development Fund for Iraq (DFI) for investment purposes. External auditors subjected the PRB and the CPA's administration of the DFI to intense criticism for the lack of transparency and accountability in the management of these funds and for the lack of participation by Iraqi officials in the decision-making process. Nonetheless, the 2003 and 2004 budgets were the first Iraqi budgets publicly accessible since before the 1990 Gulf War.

Bureaucratic Differences Among Agencies

Despite the success of the salary payments and early budgets, the coalition's early efforts were marked by bureaucratic turf issues dating to the prewar planning period and to the relationship between the CPA and the agencies in Iraq. As noted, the U.S. Treasury planned for and successfully implemented stabilization efforts to pay civil servants and pensioners, as well as convert Iraq's currency. USAID also engaged in planning for the reconstruction of Iraq's budgetary process and issued contracts to private firms to conduct this effort. Neither Treasury nor USAID, however, included the other agency in its internal planning process or allowed a role for the other agency in its assistance activities. Long-standing bureaucratic differences and rivalries affected the relationship between the agencies both before and after the March 2003 invasion.

For its part, as part of its prewar planning and immediate on-the-ground presence, USAID issued its economic governance contract in 2003, which called for the firm BearingPoint to reconstruct and be involved in virtually every aspect of Iraq's fiscal and budgetary institutions and policymaking. USAID's intentions, however, were overruled in Iraq by the CPA, whose leadership determined that it was inappropriate for such a significant task to be left to contractors who reported to USAID. As a result, the CPA's team, led by David Oliver, drafted the 2003 and 2004 Iraq budgets, not BearingPoint. After taking control of the coalition's relationship with the ministries in formulating the Iraqi budgets, the CPA drafted the framework for a new Iraqi budgetary process.

CPA Order 95, Financial Management, and Public Debt Law

The CPA's most significant, positive, and long-lasting influence on Iraqi budgeting stemmed from its Order 95, the Financial Management and Public Debt Law, which codified a new system of governance for Iraq's budgetary process. The order promoted democratic governance by requiring parliamentary approval of the budget. It also enhanced the powers of the Ministry of Finance, returning it to the coordinating role it played during the British Mandate; set a timetable for formulating and approving the budget; encouraged budgetary transparency; and initiated a rudimentary system of fiscal federalism. To prevent a shutdown of the government, the order included a critical provision that authorized the Finance Ministry to release operating funds on a monthly basis at the previous year's level, even in the absence of a formally approved budget. At the same time, the law required the government to pass a new budget to fund current and start-up investment projects. Although bitterly disliked by coalition authorities because of its connection to a Soviet-type economy, the Ministry of Planning retained its responsibilities for developing an investment budget. Beginning in 2005, the Iraqi government used this process to formulate and approve its budgets.

The Seventeenth Benchmark

As violence in Iraq spiked in late 2006 and into 2007, the coalition's strategy for countering the insurgency and reconstructing the Iraqi state centered not only on a surge in coalition military forces but also on rebuilding Iraq's ability to budget. American political and military leaders embraced the idea that making progress in reconstruction and service provision contributed to the government's legitimacy, strengthened popular support, and undermined the insurgency. General Raymond T. Odierno, the commanding general of U.S. military forces, declared,

The Iraqi government has to be able to deliver consistent services. Electricity is probably the most important. They're working toward this, but if they don't do this the citizens over time will potentially start to move against the government if they have to wait too much longer for services.⁷

The very act of making and executing credible capital budgets would encourage Iraqi ownership and participation in provincial and municipal government.

An indicator of the coalition's concern is found in the seventeenth benchmark, one of eighteen established by the U.S. Congress in 2007 that measured Iraqi and American progress in Iraq. The seventeenth was the only one that actually applied to the day-to-day administration of government in Iraq. The measure called for "allocating and spending \$10 billion in Iraqi revenues for reconstruction projects, including delivery of essential services, on an equitable basis." Allocating referred to success in preparing and adopting a budget; spending referenced the ability to execute a budget's spending requirements. Preparing and adopting the budget demonstrated the Iraqi's technical ability to formulate a credible budget document, engage in democratic deliberation, and overcome its political divisions to adopt a budget.

Spending the budget's allocated funds became the overriding metric for assessing progress in constructing capital projects, providing basic services, and evaluating the coalition's statebuilding ministerial and provincial capacity-development programs. On this scale, the Iraqi government performed poorly, as reflected in the budget execution rate for 2006 that rested at just 22 percent. Spending these investment funds proved a great challenge. Violence and sabotage endangered workers, destroyed construction sites, and delayed the completion of projects. The deteriorating security environment led to the exodus of

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thousands of trained civil servants and other professionals, thus adding to the loss of civil servants previously removed from the bureaucracy due to de-Baathification.

Coalition Capacity-Building Programs

To help the Iraqis meet the targets set in the seventeenth benchmark, the coalition attempted to build Iraqi administrative and budgetary capacity through USAID's economic governance, local governance, *Tatweer*, legislative strengthening programs, and the Defense Department's Task Force on Business and Stability Operations. The World Bank and the International Monetary Fund (IMF) made separate efforts to encourage improvements in Iraq's budgetary institutions. USAID awarded its economic governance contract to the firm BearingPoint to advise the Iraqi government on economic policy, build up the technical skills of Iraqi Finance Ministry and Central Bank officials, and install a financial management information system. USAID's local governance contract awarded to the firm RTI promoted democratic self-governance in the new provincial and local governments. In 2006, in a radical departure in Iraqi budgeting, the budget law authorized these governments to participate in the budget process by proposing capital projects. The *Tatweer* contract awarded to Management Systems International (MSI) aimed at training Iraqis in the basics of public administration, including budget formulation and execution, to the ministries and four provincial governments. The legislative strengthening program, managed by the firm AECOM Technology Corporation, concentrated on building the budgetary formulation and oversight capacity of Iraq's Council of Representatives. Through the firm Grant Thornton, the Task Force on Business and Stability Operations focused on developing contract and procurement skills in the ministries, principally the Ministry of Planning. Iraqi acceptance and stakeholding in these programs varied widely among the ministries.

Pushback and Resistance at the Ministry of Finance

The Ministry of Finance proved exceptionally resistant to coalition contractors, as suggested by USAID's attempt to bring Iraq's budgetary record keeping up to the standards of international best practices. USAID's economic governance contract with BearingPoint called on the firm to install what would be called the Iraq Financial Management Information System (IFMIS) throughout the ministries, the goal of which was to connect all levels of government into a computerized network. Installing IFMIS provided the cornerstone for rebuilding Iraq's fiscal administration. This system would replace the bureaucracy's pencil and paper ledgers and promote efficient budget formulation, transparency in bookkeeping, and accountability in the use of public funds. For its part, Iraq's government agreed to install IFMIS as part of a broad set of financial management reforms it would undertake in response to repeated coalition demands, as a signatory to the International Compact with Iraq, and as a condition for receiving IMF donor assistance.

Nonetheless, BearingPoint alienated the Ministry of Finance and failed to develop an effective working relationship, and the ministry's successful pushback prevented the firm from completing its task. The ministry's leadership, as well as much of Iraq's bureaucracy, was comfortable with its paper and pencil ledger system. Having an authorizing signature on a document insulated the bearer from taking the responsibility and the blame if the order proved politically dangerous or some sort of malfeasance occurred. The imposition of this new system, which the BearingPoint contractors simply assumed would best serve the Iraqis, introduced change without benefit.

In 2007, a BearingPoint team was kidnapped in front of the ministry under suspicious circumstances, suggesting that Iraqi officials could have provided information to the kidnappers about the contractors' travel schedule. The kidnapping and the ministry's dangerous location in Sadr City deterred BearingPoint and other firms from visiting the ministry's facili-

ties through the remainder of their contracts. The original *Tatweer* program, for example, called for MSI to work with eleven ministries, including the Ministry of Finance, to build the administrative capacity of Iraq's bureaucracy. The Defense Department contractor Grant Thornton expected to work with the Finance Ministry to improve coordination with the Planning Ministry in developing a more effective procurement process. In both cases, opposition by the ministry's leadership and the fear of what happened to the BearingPoint team led these other contractors to avoid the Ministry of Finance.

Endemic Coordination Problem

In addition to Iraqi pushback, coalition agencies and their contractors experienced ongoing coordination challenges in their capacity-building programs. Coordination problems began with the prewar planning process when the U.S. Treasury and USAID developed their separate plans to address Iraq's public financial management issues. USAID, for example, wrote its economic governance contract without coordinating with the Treasury. When the two agencies entered Iraq, they acted separately in engaging the Iraqi ministries. USAID, however, was quickly excluded by the CPA from budgeting and most public financial management matters at the ministerial level, though not at the provincial level. Information silos emerged between contractors working for different agencies and even for the same agency, primarily due to unwillingness to share training information for proprietary reasons. Provincial reconstruction team (PRT) leaders complained that some USAID contractors charged with developing provincial budgeting systems failed to coordinate with their teams.⁸ The USAID inspector general reported that USAID neglected to provide PRT contractors with adequate guidance and oversight.⁹ Different agencies engaged in uncoordinated reconstruction projects that created long-term budgetary obligations for the Iraqis. The U.S. departments of State and Treasury created various coordinating bodies among agencies and contractors engaged in budgetary advising and capacity-building programs, such as the Public Financial Management Action Group, but coordination problems persisted throughout the coalition's presence in Iraq.

Evaluating Success

The seventeenth benchmark served a number of purposes, but it produced certain perverse incentives in measuring success. On the positive side, it focused the Iraqi government's attention on investing in the infrastructure and services urgently needed by the populace. It also reflected the growing demand in the United States for the Iraqis to pay for their country's reconstruction from their own resources. Doing so would aid both the Americans and the Iraqis, because the cost of the war would decrease for the United States and the Iraqis would be weaned from donor dependency. By investing in its oil facilities and boosting petroleum production, Iraq would generate increased revenues and budgetary independence.

The use of benchmarks could also be counterproductive. As Ambassador Ryan Crocker observed, benchmark values had limits: "You could get all the benchmarks and fail in Iraq, or you could get a few of them and actually get success. These are too precise and discrete of measures to really capture the enormous magnitude of a nation finding its feet or not."¹⁰ Because of the seventeenth benchmark, budget execution and rates of investment spending, also known as burn rates, became the metric for measuring Iraqi budgetary success and the success of the coalition capacity-building programs. Consequently, this use of spending rates induced creativity in their calculation and employment by all parties involved.

The Finance and Planning ministries, for example, calculated their rates differently. Where the Finance Ministry rates more accurately reflected actual, current spending, those of the Planning Ministry reflected commitments to spend over the life span of building capi-

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tal projects. Spending levels often accelerate during the construction of a capital project, because the first years of planning, contracting, and procuring for a project typically involve lower spending rates than the actual construction of the project. The Ministry of Planning therefore typically released data showing higher spending rates, though most of the actual spending had yet to occur, thus suggesting the effectiveness of its capital investment programs. At the same time, the rates released by provincial and local governments indicated extraordinary, if not questionable, levels of bureaucratic efficiency for such newly created administrative entities.

Whereas national levels of budget execution stood at 28 percent of the investment budget spent in 2007, 40 percent in 2008, 61 percent in 2009, and 62 percent in 2010, a number of provincial governments reported more than 100 percent of their investment budgets spent in a given year. In many cases, getting the Iraqis to spend their budgets proved more important than either how effectively they spent the funds or the sustainability of their investments. The pressure to spend may have contributed to the skimming of contracts, the use of substandard construction materials, and the failure of construction projects to meet contract specifications.

Meanwhile, some coalition agencies and contractors involved in capacity development pointed to the Ministry of Planning's rates as indicators of the success of their advising and training sessions. Without a more considered and detailed evaluation criterion than national budget execution rates, assessing the actual contribution of these capacity-building programs and learning lessons from them remains problematic.

Iraqis Take Command of Budgeting

Although the Iraqis did not always welcome the coalition's budgetary capacity-building efforts, they did take ownership of Order 95 and have used it as a legal framework for developing their budgets since 2005. According to former finance minister Ali Allawi,

The most important economic and financial reform that the CPA introduced was the promulgation of the Finance Management Law. This was a profound and far-sighted piece of legislation that set the framework for writing balanced budgets, with public accountability for all government expenditures. The law played a vital part in establishing the parameters of budget preparation.¹¹

The Iraqis were able to secure lasting ownership of the budget early on for two critical reasons. First, Order 95 and the Financial Management Law gave rise to new stakeholders in the budgetary process—among them the Council of Representatives, provincial and local governments, and emerging civil society groups—who had a vested interest in making procedures more transparent and accountable. In addition to its responsibility under the constitution and the budget process for approving the budget, the Council of Representatives is increasingly active in overseeing how the ministries use their allocations. Second, the CPA, for the most part, layered new rules and procedures on existing Iraqi institutions, making them more palatable to Iraqis. Although Order 95 identified the sequencing of the budgetary process and defined the responsibilities of various ministries, it did not, for example, penetrate deeper into how the ministries developed their budget proposals. Although many coalition officials regarded the Ministry of Planning as a relic of the Cold War and centrally planned economies, the ministry was never abolished. David Oliver and the CPA team that wrote the 2003 and 2004 budgets and Order 95 intentionally relied on the existing relationships between ministries rather than imposing, say, American budgetary practices. Order 95 revitalized the Ministry of Finance but kept the ministerial system intact, giving the ministers meaningful participation in budget formulation. CPA officials, for example, brought ministry leaders together to offer their priorities for the 2004 budget.

The Iraqis succeeded in passing a budget each year despite such formidable obstacles as the escalation of violence in 2005 and 2006.

Relying on the framework of Order 95, the Iraqis succeeded in passing a budget each year despite such formidable obstacles as the escalation of violence in 2005 and 2006, the coalition's demand that Iraqis engage in massive investment spending for complex large-scale capital projects in 2006 and 2007, the wild oil revenue fluctuations of 2008 through 2010, and sectarian differences that delayed the election of Parliament in 2011. The three-year cycle of oil revenue boom, bust, and rebound produced volatile swings in the budget's spending allocations and deficits. This fiscal instability severely tested the government's ability to manage a fiscal crisis in the face of growing demands from budgetary claimants for more resources. The government's reliance on the budgetary process to manage this crisis further embedded and layered these rules onto Iraq's political institutions.

During this period, the Iraqis experienced several transitions in government and the sometimes rapid and disruptive turnover of finance ministers: seven individuals served as acting finance minister or finance minister between 2003 and 2011. The Ministry of Finance suffered serious damage from two huge explosions, one in August 2009 and one in December 2009, that destroyed records and delayed the drafting of the 2010 budget. Perhaps most challenging, in 2011 the Iraqis finally approved a budget despite a nine-month absence of parliamentary government.

Budget Execution Challenge

The Iraqis proved that they could formulate and adopt a budget under highly stressful conditions, but the great challenge of effectively executing their budgets remains. Following mass protests in Egypt and Tunisia in February 2011, tens of thousands of angry Iraqis took to the streets, protesting the poor provision of essential public services, corruption in government, and a staggering unemployment rate of some 25 percent. Iraqis still lacked the basic infrastructure to meet their demands for adequate electricity, potable water, and the production of food stuffs. In one instance, Iraqis attacked government buildings and officials in the city of Kut, and on February 25, the so-called Day of Rage, twenty-three Iraqis were killed in demonstrations across the country. These protests pointed to the great deficiencies in Iraqi budget execution and to the broader debate over allocating investment funds.

Although by 2010 the Ministry of Finance reported that 62 percent of the investment budget had been spent, Iraq's government struggled in this still-violent postconflict environment to build the administrative capacity to absorb the substantial growth in the budget. Between 2004—the last of the CPA-drafted budgets—and 2011, Iraq's total budget grew by 223 percent, its operational allocation by 161 percent, and the investment budget allocation by a remarkable 692 percent. This flow of investment funds strained its ability to spend the funds promptly, efficiently, and transparently. In addition, the Iraqis confronted the task of absorbing the large infrastructure projects built by the coalition and sustaining all of these projects with appropriate operations and maintenance funding.

To redress some of these deficiencies, the Council of Representatives included provisions in the 2011 budget to discipline ministries that failed to execute their budgets. Article 11 instructed the Ministry of Finance, working with the Ministry of Planning, to redirect funding from any ministry or provincial government that did not execute 25 percent of its budget within six months. The Finance Ministry then would report to the Parliament explaining why this failure occurred. Finally, the budget law authorized the Parliament to withdraw its "confidence from the minister or head of the entity" if that governmental unit failed "to execute 75 percent of the investment allocations assigned to his ministry or department from the federal public budget."

The budgetary process and the government's ability to execute the budget, therefore, require continued improvement. The budget needs to be formulated and approved on a timely basis. Delays in adoption set back the budget execution process, because ministries are unable to spend and commit their allocations sometimes as late as two or three months into the fiscal year. Budgetary documents are often opaque and incomplete, in that figures are inaccurate or missing. Budget execution rates may be increasing, but these simple statistics do not speak to the quality, timeliness, and sustainability of the investments being funded. Investment budgets are predominantly focused on physical capital spending, principally on infrastructure spending to boost the oil industry, whereas human capital investments in education and health are relatively underfunded.¹² Corruption remains endemic, which undermines the quality and effectiveness of the investment spending that does occur. These budgetary needs are ongoing and constant.

Budgeting and Stability

Consideration of the 2012 budget began normally enough, but political divisions in Iraq quickly challenged the government's ability to ratify the budget. First, the process began with the Finance Ministry somewhat tardily submitting its initial budget to the cabinet for review in November. Taking into account the World Bank and IMF's recommendations for increasing investment spending while reducing the deficit, the ministry proposed a budget of Iraqi dinar (IQD) 133.6 trillion (\$112 billion) and a deficit of IQD 23.9 trillion (\$20 billion). Finding even this to be excessive, the Council of Ministers approved a revised version in December calling for IQD 117 trillion (\$98.4 billion) in spending, a 20 percent increase over 2011, and a deficit of IQD 14 trillion (\$12 billion). The deficit would be financed from existing balances in the DFI. The council set the investment allocation at IQD 37 trillion, 35 percent of total spending, versus 29 percent in 2011. The council reduced the expected price of a barrel of oil in the Finance Ministry's draft of \$90 to a more conservative \$85. The parliamentary Financial Committee and Economy and Investment Committee later urged that the price of oil be reestimated and raised to the global price of more than \$100 per barrel. In an attempt to promote greater transparency, the committees also urged the Ministry of Finance to release final accounts for the 2011 budget. Meanwhile, provincial governments and other claimants called for additional funding for their interests in the budget. All of this reflected what had become the normal ebb and flow of the budget process.

Then sectarian tensions and escalating violence threatened to unravel Iraq's power sharing agreement and end any further consideration of the budget. On December 19, 2011, Prime Minister al-Maliki ordered the arrest of Vice President Tariq al-Hashimi, a Sunni, and in January an attempt was made to assassinate Finance Minister Rafe al-Essawi, another Sunni. Despite the assassination attempt, Amin Hadi, a member of the Finance Committee, declared that Parliament would act on the budget. "The adoption of the budget will not require political consensus, and this issue is far from the disputes and outstanding issues, and it is settled between the political parties," said Hadi, adding that "the Finance Minister Rafe al-Essawi called the House of Representatives to speed up approving the budget in 2012. There are no objections from the Iraqiya List, in this regard."¹³ Remarkably, in spite of the hostility between al-Maliki's State of Law bloc and the opposing Iraqiya bloc, the parliament did indeed approve the budget on February 23. Then on July 5, the Council of Ministers approved a IQD 10.875 trillion (\$9.35 billion) supplemental budget, given the government's growing revenues stemming from higher world oil prices.

In the midst of this bitterness, budgeting in Iraq offers both a challenge and a source of hope. The budgetary process may provide the country with a foundation for political and institutional stability. From an administrative perspective, Order 95 fortunately permits the

continued funding of Iraq's operational activities. From a political perspective, all factions in Iraq depend on the budget and the resources it allocates. There may indeed be a coincidence of interests such that Iraqis have come to rely on the budget process as a mechanism for compromising on some of the deep divisions that plague the country.

Policy Lessons

Some attempts have been made to learn from the coalition's efforts in budgetary statebuilding in Iraq. In 2005, the U.S. Department of Defense issued its Directive 3000.05, *Military Support to Stabilization, Security, Transition, and Reconstruction Operating Concept*, which stated that stabilization and reconstruction activities should reconstitute critical ministries and promote local and national economic recovery.¹⁴ In 2009, the U.S. Institute of Peace and the U.S. Army Peacekeeping and Stability Operations Institute jointly released the *Guiding Principles for Stabilization and Reconstruction*, which provides a more precise and detailed list of recommendations for stabilization and reconstruction, including an outline for rebuilding a public financial management system.¹⁵ These generic recommendations include building a transparent and accountable budgeting process, strengthening budget execution capabilities through technical assistance and training in government ministries, and fighting corruption with a strong procurement mechanism. In addition to these technical recommendations, the particular experiences of the coalition in Iraq suggest additional lessons that focus attention on the context of budgetary statebuilding in a conflict, postconflict environment.

Planning for postconflict intervention in support of public budgeting and finance can play a significant role in the success of statebuilding efforts. Much has been made of the lack of coherent, comprehensive, and coordinated prewar planning in the invasion of Iraq. These concerns also apply to the planning for how the coalition would address Iraq's budgetary institutions. The lack of both intelligence and agency cooperation hindered planning. The United States, for example, lacked information about the Iraqi Ministry of Planning and failed to take into account its role in developing the capital budget. Bureaucratic differences and rivalries inhibited the U.S. Treasury and USAID from developing a comprehensive plan for reconstructing Iraq's budgetary and financial management system.

Gaining beneficiary ownership, stakeholding, and buy-in are necessary for almost all aspects of successful peacekeeping, foreign assistance, and postconflict interventions. The failure to take Iraqi preferences seriously and conduct a thorough needs assessment directly contributed to the coalition's inability to introduce its financial management information system. The effectiveness of other budgetary capacity-building programs also suffered from Iraqi pushback due to the lack of ownership and buy-in.

Spending levels, or burn rates, are often dubious measures of success. The focus on spending tends to drive out concerns for quality, sustainability, and accountability in the use of public funds. Corruption, patronage, and rentierism are promoted because the drive to spend funds as quickly as possible encourages faulty contract and procurement processes. These problems are multiplied when postconflict stabilization and reconstruction efforts do not emphasize building financial control, auditing, and workable financial management information systems.

Coordination problems are endemic in peacekeeping, postconflict, and statebuilding operations and must be addressed throughout these activities. Coordination problems plague multination, multiagency, and multidonor peacekeeping and postconflict operations, and Iraq has proved no different than any other country in crisis. Coalition agencies and their contractors encountered ongoing coordination challenges in their capacity-building programs. Information silos emerged, even between contractors working for the same

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agency. Different agencies engaged in uncoordinated reconstruction projects that created long-term budgetary obligations for the Iraqis. The U.S. departments of State and Treasury created various coordinating bodies among agencies and contractors engaged in budgetary advising and capacity-building programs, but coordination problems persisted throughout the coalition's presence in Iraq.

Making changes in rules can bring about significant institutional change. Arguably, the coalition's most important and long-lasting change in Iraq's budgetary institutions came with the imposition of CPA Order 95 and its outlining of the broad rules for the budgetary process. The Iraqis did take ownership of this rule and used it to formulate and adopt their budgets. The value of such rules is that they can be effective if they are highly visible, salient, enforceable, and serve a large array of interests. These rules may be more consequential and long-lived than short-term capacity-building programs.

Notes

1. Ashraf Ghani and Clare Lockhart, *Fixing Failed States: A Framework for Rebuilding a Fractured World* (New York: Oxford University Press, 2008), 135. Also see Ashraf Ghani, Clare Lockhart, Nargis Nehan, and Baqer Massoud, "The Budget as the Lynchpin of the State: Lessons from Afghanistan," in James K. Boyce and Madalene O'Donnell, eds., *Peace and the Public Purse: Economic Policies for Postwar Statebuilding* (Boulder, CO: Lynne Rienner, 2007). The importance of budgeting in the case of Iraq is developed further in James D. Savage, *Reconstructing Iraq's Budgetary Institutions: Coalition Statebuilding After Saddam* (New York: Cambridge University Press, 2013).
2. The argument for off-budget spending is made in William Easterly, *The White Man's Burden*, (New York: Penguin Books, 2006), chap. 4, and Paul Collier, *The Bottom Billion* (New York: Oxford University Press, 2007), 102–3. Collier claims that large amounts of financial assistance run through government budgets may actually act as an inducement for inciting coups, as rebels seek to control government funds (105).
3. The argument for on-budget spending is made in Graciana del Castillo, *Rebuilding War-Torn States* (New York: Oxford University Press, 2008). Also see Graciana del Castillo, "The Economics of Peace: Five Rules for Effective Reconstruction," Special Report 286 (Washington, DC: U.S. Institute of Peace, September 2011).
4. Michael Carnahan and Clare Lockhart, "Peacebuilding and Public Finance," in Charles T. Call, *Building States to Build Peace* (Boulder, CO: Lynne Rienner, 2008), 73–102.
5. "First Amendment to the Unified Law of the General State Budget," no. 107 of 1985, law no. 48 of 1990, Al-Waqaia Al-Aiaqiya no. 332 (August 13, 1990): 378–81.
6. On Treasury and OTA in Iraq, see Jeremiah S. Pam, "The Treasury Approach to State-Building and Institution-Strengthening Assistance: Experience in Iraq and Broader Implications," Special Report 216 (Washington, DC: U.S. Institute of Peace, October 2008).
7. Jim Michaels, "Gen. Odierno: Iraqi Government Must Improve Services," *USA Today*, September 29, 2008. http://usatoday30.usatoday.com/news/world/iraq/2008-09-29-odierno_N.htm.
8. Rusty Barber and Sam Parker, "Evaluating Iraq's Provincial Reconstruction Teams While Drawdown Looms: A USIP Trip Report" (Washington, DC: U.S. Institute of Peace, December 2008).
9. USAID Office of Inspector General, "Audit of USAID/Iraq's Local Governance Program II Activities," Audit Report No. E-267-09-003-P, Baghdad, May 31, 2009.
10. Interview with Ryan Crocker, U.S. ambassador to Iraq, September 24, 2010.
11. Ali Allawi, *The Occupation of Iraq: Winning the War, Losing the Peace* (New Haven, CT: Yale University Press, 2007), 194.
12. On the need for a larger share of the investment budget directed at human capital, see Kamal al-Basri, *Iraq Federal Budget 2006–2010 and Economic Challenges* (Baghdad: Iraqi Institute for Economic Reform, 2010).
13. SHAFFAQ.com, "Finance Committee Confirms that the Political Crisis Has No Impact on Passing the 2012 Budget," January 4, 2012, www.iraqupdates.com/p_articles.php/refid/E2F-04-01-2012/article/105831.
14. U.S. Department of Defense, "Military Support to Stabilization, Security, Transition, and Reconstruction Operations Joint Operating Concept," version 2.0 (Washington, DC, December 2006), 44.
15. Beth Cole and Emily Hsu, *Guiding Principles for Stabilization and Reconstruction* (Washington, DC: U.S. Institute of Peace and the U.S. Army Peacekeeping and Stability Operations Institute, 2009).

