

Falling revenues threaten rebuilding and stability in Iraq

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*American soldiers on a recent patrol with Iraqi forces in Mahmudivya. Iraqi troops are increasing their responsibilities, but Iraq may have trouble paying them.
Jehad Nga for The New York Times*

In few nations around the globe are the consequences of the financial crisis as potentially sobering as they are in Iraq. Both oil revenues and American financial support have plummeted just as the country has the chance to take advantage of its increasing stability to improve basic services and upgrade its ruined infrastructure.

Now, projects are being put off as Iraq struggles to pay for huge raises granted to government employees as well as the salaries and equipment for hundreds of thousands of new Iraqi security troops.

Last summer, with oil prices above \$100 a barrel, Iraq was so flush with cash that many in the United States were arguing that a country so rich should be paying for its own reconstruction and possibly even reimbursing American taxpayers.

Six months later, the question is whether a decline in Iraqi government revenues, which depend almost entirely on oil, could threaten the relative security and stability won here at the cost of so much American treasure and life. Indeed, political pressure is rising here, as more Iraqis demand precisely the services, like better electricity, water and education, that could now come more slowly.

A stable Iraqi economy and an adequately prepared Iraqi military are crucial if American combat troops are to withdraw by August 2010, as aides to President Obama suggested this week. And illustrating just how closely the two countries are still intertwined, a faltering Iraq could also complicate Mr. Obama's plan to lower the American deficit with billions in savings that would come from such a withdrawal.

As the Iraqi Parliament debates a proposed \$62.8 billion budget this week, senior American and Iraqi officials say that Iraq can prevent an immediate crisis by drawing on the very source

that attracted such intense criticism in the United States: the billions of dollars in oil revenues that Iraq was unable to spend on its reconstruction projects.

That money, which Iraq's central bank and senior Obama administration officials say comes to roughly \$35 billion, is sitting in various bank accounts, including one at the Federal Reserve Bank in New York.

To help plug the gap, Iraq is planning to withdraw about \$20 billion in a single year. But that will not be enough, government officials say, to save reconstruction projects crucial to improving gravely inadequate services.

The provision of electricity is still far short of meeting demand, and the government is still struggling to provide clean water. Iraqi officials insist that Iraq could have revenue sources besides oil, like agriculture and industry, but developing them requires investments. Oil production itself has recently dropped in certain key fields, requiring a major injection of government money.

In the past, money for projects has been allocated but not spent. Now it is drying up altogether.

"It's a mathematical issue," Raed Fahemi, the minister of science and technology, said at a conference on Wednesday dedicated to finding alternatives to oil money. "We are staying up all night trying to ensure that there are required funds for projects currently under way. The issue comes with the future projects."

The reason capital projects are being put off is that the reserve funds in the banks were originally intended to be spent as part of the capital budget, not to meet shortfalls in Iraq's day-to-day operating costs, which now take up four-fifths of the proposed 2009 budget. And unless oil prices increase or Iraq finds new sources of revenue, its piggy bank at the Fed will last only so long.

"It's a disaster," said Ismail Shukir Haruty, a member of Parliament's financial committee. "What are we going to do in 2009, 2010, 2011?"

In many ways, the financial crisis, with the resulting drop in oil prices, could not have come at a worse time. The government gave its employees substantial raises last year. Wages now take up about 35 percent of the budget.

And in a critical move as the United States takes less and less responsibility for security, the number of soldiers, police officers and other security personnel has soared to 609,000, from 250,000 two years ago, when oil prices were on the rise, according to the Pentagon.

"There are some critical expenditures, like paying the military and the police and making sure that's being done very, very well," said Rick Barton, co-director of the post-conflict reconstruction project at the Center for Strategic and International Studies in Washington. "You can't afford any slippage at this time."

Still, a senior administration official said the United States was confident that the cumulative oil surpluses would allow it to weather the immediate storm. "The overall trend is still moving in a reasonable direction even if they're not able to do quite as much as anticipated," the official said.

Identifying the roots of the crisis here is much simpler than it is in many places in the world. In Iraq, there is not much of a credit market to dry up nor are there mortgages to default on. Oil accounts for roughly 90 percent of government revenue. When oil prices drop, as they have

to below \$40 a barrel from a high last summer of nearly \$150, there are few other options for collecting revenue.

Finance and Oil Ministry officials in Iraq maintain that oil prices will rise again by the end of the year. After years of conservative budgeting, the proposed 2009 budget is based on an optimistic projection that oil will be selling at \$50 a barrel, and that Iraq will be exporting two million barrels a day, about 100,000 barrels more than Iraq exported per day in January.

Critics of the budget say that the projections are unrealistically rosy and that the deficit will be even larger than the one planned.

The timing is particularly bad for the new leaders who emerged from January's provincial council elections. Many blamed incumbents for failing to deliver services and improvements, but they will have to make good on their promises with much less money.

"Reasonable people will understand, but the common people will not accept it," said Baqir al-Shaalan, who won in the southern Iraqi province of Diwaniya on promises of a refurbished irrigation system, new housing and government jobs for unemployed youths. "They will tell us: 'You've been justifying the lack of services with the security situation. Now the security situation has improved.' "

Then again, the provincial councils have such a dismal record of spending the money they have been allocated that, American officials say, they could actually spend more money this year even if their budgets are more austere.

There is a bright side: the crisis could finally force the Iraqi government to build up its agricultural and industrial sectors, and create a thriving private sector. Some Iraqi officials have been pushing for these moves for years.

"If the Iraqi government knew about the big depression, it would have done a lot of things differently," Mr. Haruty, the lawmaker, said. "Same as the American government, I think."

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