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General Keane and Ambassador Charlie Ries

Economic Update

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N204, Embassy Annex, International Zone, Baghdad

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Abstract

The IDF in March-April impacted people and raised stress levels. Economic growth is uneven quarter to quarter, but high overall. The oil minister has tried to make deals, but it has been very difficult. The Iraqis need western investment and partners. Things are going well, and the Iraqis are more confident. The American supplemental budget is down, and that is going to militarize our efforts.

Discussion

R: is Ambassador Charley Ries.

JS is b 6

K is General Keane

Kagan is Fred Kagan

(b)(3), (b)(6)

R: Back in March and April, people were only getting 3 or 4 hours of sleep a night because of the incoming. Some of us moved over into the New Embassy Compound and slept soundly in that absolutely secure building. It was an ideal place to sleep. Initially, the IDF was very accurate, but it decreased over time. Coming back over here, people were snappish because they weren't getting enough sleep.

K: How are we doing?

R: Pretty good. We've collected numbers for the CASB tomorrow. The economy is growing, approximately 8 to 9% growth annually, although the quarterly numbers are lousy and inconsistent. In the first quarter of '08, the economy grew by 3%, for 12% annual rate. We've seen a very sharp spike in private bank outstanding loans, which is the secret to long-term growth. The Brinkley Group and Carleton Investors have been here looking at possibilities. We've seen diplomatic progress with Turkey and the UAE. We could have done service contracts had it not been for the New York Times story.¹

K: Has that stopped?

¹ In June, NYT ran a story on a Temporary Services Agreement the Gol signed with six majors seeking help on improving production. There is considerable risk involved and speed was essential, so it was a no-bid process. The Times played it up as proof of a blood-for-oil war, and that fed Iraqi populism and nationalism, which killed the deal and precluded any production assistance anytime soon.

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R: Sharistani, the Iraqi Oil Minister, was determined to go forward, but the NYT called it a sweetheart deal and pressure from Tawafuq and the Kurds then froze it. He then went in search of a long-term deal. He may still go with Total, since an Exxon-Mobil deal looks bad.

Kagan: But Exxon-Mobil is Venezuelan!

R: Oh well. The MoO approached Shell to capture natural gas in the south. They lack the capital and the technology they need for the field. The cabinet forced Sharistani to pull back. Cabinet politics make all of this very difficult.

Kagan: Were these sweetheart deals?

Shell thought not. Iraq poses a lot of risks for oil firms.

[b 6]: Yesterday, Total pulled out of Iran because the risk of missile launches elevated the risk of its project there.

R: The hydrocarbon thing has been ugly the last two years. The good news is the Minister of Oil, Sharistani, has a huge nationalist reputation. He supports foreign investment in Iraq. [b 6] could not do the same thing.

Kagan: Why can't Iraqis capitalize the investment deal?

They can, but they need help procuring the equipment and the necessary technology. The oil boom means all the equipment and expertise they need is fully employed elsewhere, and Houston does not want to deal with them because the Iraqis don't know how to tender the necessary offers, how to write the proposals. The Minister of Oil needs a major partner to shepherd him through the process. Then the issue of payment came up. The big oils want payment in barrels of oil—a share of production—and the Minister of Oil was ready to do that, but others opposed the idea.

R: We supported the Temporary Service Agreement and the Production Sharing Agreement, but Sharistani offered a weak explanation for why to give up on it.

K: What about other foreign investment?

We've had an investment in a cement plant, in power plants, and in real estate. Gulf investors have shown interest. There has been a sea change in last six months with investors coming through, looking for opportunities. The areas in which Iraq is interesting are energy intensive: minerals, glass, phosphate. Agriculture looks okay over the long term. They'll never be much in manufacturing. A small tariff would be okay.

Keane: Thanks to improving security.

R: That is facilitating the investment. Violence is so much lower.

Keane: There is great resiliency here.

R: On terrorism, I consider it is the Israeli effect. The Iraqis have adapted to the reality of terrorism and violence; they carry on. Politically, it is the Putin effect. PMM is no longer facing an existential threat to governance.

Keane: We are victims of our success. A general just told me he is on his 3rd tour, and he just had an Iraqi general tell him no for the first time. How much of the economic growth depends on our spending?

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R: The growth is not that dependent on us. The approved budget is \$49 billion, and the supplemental is \$21 billion. Budget execution is a challenge, but it is below the capital execution. They are financing big ticket things.

K: How are they improving budget execution?

b 6 The provincial execution is different. They run behind on resources. We've had no real blowups in the provincial budgets. The numbers on the Ministry of Oil are opaque.

R: On the MoE, the minister is nervous about acting without authorization. In January, they bought \$450 million in generators from GE. They've also bought from Hundai and Siemens. Now they have to install them. But he is nervous about hiring foreigners. He still has a statist mentality. He thinks in terms of only being allocated X amount of fuel, so it is hard for him think of getting more generators because he can't imagine getting more fuel. There are thousands of projects underway. The Iraqis are increasing spending about 30% a year. Even more significant is the fact that the technocrats went to Jordan, leaving the Iraqis have to struggle with the loss of skilled talent.

K: How much are we spending in Iraq versus what the Iraqis are spending?

R: We spend 1 ½ billion this year on Iraqi projects. The Iraqis are spending about \$37 billion this year. We will get the specific numbers to you.

Kagan: I need numbers to argue. I didn't know this. I didn't know the Iraqis were spending so much more than we were, and the numbers help me make the case [for continued US support of the operation].

b 6 I have to note that we are suffering a self-inflicted wound because there are two accounting systems in place. There are the IMF numbers. There is a capital account series, which is the legacy. It has execution rates of 60 to 70%, but the data series are not comparable.²

K: There is a sense [back in the states] that the Gol is not doing much.

R: The need is just so huge, but people are working all over on these problems.

(b)(3), (b)(6) There are large swaths of the country where the Gol has not been and is not spending money.

K: In Sunni areas, they say money is all going to the south, but when we go south, it is all extremely deprived.

R: The situation is not good, it is just better, and security helps that. The Army Corps of Engineers has 100+ active projects. They consider just 3% delayed due to security problems. Last September, that number was 20% or higher.

JS: the financial system here is creaky. We're making real strides in electronic funds transfers. It is difficult.

(b)(3), (b)(6) What about the [American] supplemental?

R: It was reduced. They took out things for infrastructure security, like the Pipeline Exclusion Zone. We requested \$700 million and got 0. On many things, we got much less than requested from the

² The accounting issue is very interesting and worth exploring. My notes are not adequate to explain it fully. I understood that the two separate accounting systems, IMF and ?, produce different numbers, and the generates great confusion. It will require more thorough investigation.

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Congressional appropriation, but they did fund all the PRTs. The congressional democrats went after the president in this cut. The result is the operation is turning more military and less civilian.

JS: When Joint Contracting Command started . . . [now?] it keeps 50% of all its expenditures in country, through the Iraqi First program.

R: Back in the summer of 2007, the NYT did a story on the market's view of the surge. It weighed things in terms of Iraqi bonds. The bonds had lost ground, so they NYT considered the surge a failure. Since then, Iraqi bonds have done extremely well, but the NYT is ignoring the rebound.

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