

**THE CENTER FOR  
STRATEGIC AND INTERNATIONAL STUDIES**

**ECONOMIC GROWTH IN IRAQ**

**FEATURING:**

**FRANK LAVIN,  
UNDERSECRETARY OF COMMERCE**

**INTRODUCTION:**

**DR. JOHN HAMRE,  
CSIS PRESIDENT AND CEO**

**THURSDAY, MARCH 1, 2007**

*Transcript by:  
Federal News Service  
Washington, D.C.*

JOHN HAMRE: Ladies and gentlemen, good morning. I'm delighted everybody could join us; I'm very, very pleased to have you here.

I'm very pleased to welcome back Frank Lavin. Frank is – he has been on sabbatical from CSIS – let me just put it that way. We were fortunate to have Frank as an – affiliated with us as an advisor, and of course, during the last six years he has been active in government. He was our ambassador in Singapore for a good time, came back, and of course is now the undersecretary at Commerce, and is doing a splendid job.

This is – you know, Frank's portfolio is pretty large, and economic growth, economic development in Iraq might be a small part of his portfolio if you look at it strictly in terms of economics. But we can't look at it in those terms. If you – when the president announced his strategy – and everybody is preoccupied with the surge, you know, of troops into the region, that actually is only a minor part of what it is going to take to succeed. That is strictly trying to get the violence down. The real foundational element of this strategy is to get the economy going so people are invested in a peaceful future in Iraq; not in this violence that is overwhelming the country. So what we're here now today for is frankly to hear Frank articulate the outlines of what really is the foundation of what has to be the success of our policy in Iraq.

And Frank, I'm grateful that someone with your experience and knowledge, capability, and credibility in Washington is willing to come today to be with us and actually take the lead on this.

So let me turn it to you, Frank. We're delighted you are here. Thank you for coming.

FRANK LAVIN: Thank you, John. Thanks a lot. Thanks, John, very much for those kind words. Thanks, everybody, for coming this morning. I see all sorts of good friends in the audience – Bill Taylor; as always, my advisor, peer at CSIS who helped me get off on the right foot. Good to see you again.

I want to chat about our recent mission to Iraq, some of the things we did there, how we tried to engage Iraq – the private sector and Iraq government, some of the points we made, talked about, what we saw in the current situation and the next steps – how the Iraq government responded and where we think we're going from here.

I just got back from Iraq eight days ago – a week ago Wednesday from what was my second trip – first trip last summer into Baghdad, and second trip took a small group into Erbil for about three day – each of which had essentially an economic/commercial focus.

We had two specific projects – what I want to do in just a minute is share with you the presentation we shared with the Iraq government and other people in the private

sector in Iraq, but before I get there I want to talk about two of the specific initiatives we are launching in Iraq. One is a business dialogue, which we have with other countries around the world, but this was to -- the inception of the U.S.-Iraq Business Dialogue, which, as the name suggests, is a B2B mechanism where we have private-sector participants on each side. But the point of the B2B mechanism is to feed into a G2G mechanism, so the chair on each side – the minister of commerce and the secretary of commerce in Iraq and U.S. But day-to-day work, so to speak, is done on a B2B basis. And what this allows is for business leadership on each side to consult on business operating environment issues, impediments to opening up businesses, expanding businesses, availability of credit, labor laws, trade regulations, other elements that just might affect day-to-day business operating environment. And some of these are at a policy level; a lot of them are sub-policy.

So we had the initial meeting of this group, and indeed, we got a draft circulation of what their initial recommendations, initial discussion points are, and these are everything from ease of visas to investment law, and I'll touch on that latter point a little later.

So one of our goals in Erbil eight days ago was to launch this U.S.-Iraq Business Dialogue. The second goal was another initiative we have at the Commerce Department called Iraq Gateways Initiative, which is simply to encourage companies that are looking at Iraq – are looking at doing business in Iraq to think about particular locales that might be more fruitful environments for starting a business. In this case, it's the Kurdistan region.

So we talked about business environment in the Kurdistan region itself, and then the gateway idea of saying if you were to get established in this region, how then would you migrate across the rest of the country, how could you service your customer base and undertake your business operations in this kind of environment, even if you had a good presence in the Kurdistan region. So those were two specific initiatives we launched in the course of the visit, and then beyond that you could say maybe the most useful part to my mind of the discussion was the policy engagement with Iraq government leadership where we wanted to sit down and review with them what saw as some of the policy challenges in Iraq.

And if you could, I'll just take a few minutes and walk through this – not to read every point. Let me just Steve to heat up that machine and just share this with you. (Pause.) There's a certain sense of drama, I think, as it appears. (Laughter.)

This is a point of fact when we came through Iraq, and at the end of it there are probably some modifications that I would make in this presentation – some minor ones. But just for the sake of sharing with you what we shared with Iraqi government leadership, this is exactly the same presentation. So, we told them that we had at least three main goals in mind of looking at this environment and looking at reforms and then looking specifically what kind of promotional activity we could undertake with U.S. business community. Go ahead, Steve.

And the economic assessment really starts – yeah, go ahead – it starts – the economic assessment really starts with security. I mean, we’ve just kind of put that front and center, even though we’re really in Iraq to talk about economic issues, financial issues, commercial issues – any discussion, I think, in Iraq has to begin with a very candid discussion of the security challenge in Iraq. And indeed, if we had to say what’s probably the single greatest impediment to business development in Iraq at the moment, it’s not going to be the conventional set of economic policy issues, but it’s going to be the security matter. So, we kicked off the discussion with that point.

But then we said having said that, let’s just take off this security prism for a second and put on an economic hat and just talk about Iraq the way we talk about any economic analysis around the world, Japan or France or Brazil, and let’s look at some of the things that are going on.

There has been an economic transition underway post- Saddam Hussein. Some of it’s slow paced, but some sectors and some activities moving quite rapidly. I think anything on a small scale tends to move very rapidly, and particularly the IT sector, ICT sector, tended to move quite rapidly and there’s been very vibrant developments in both of those areas. Go ahead.

There have been other bits of good news. I think probably an underreported story is a very stable currency, so at least trade and normal economic decision-making can be facilitated. Exports have gone up. A lot of that simply represents the spike in the price of oil last year, but nonetheless, that’s a positive trend. Go ahead. Also as a result, we see GDP and GDP per capita moving the same way. These are World Bank figures.

So, on a sort of macroeconomic basis, there’s been some good news in the picture. But we said, having discussed the security situation, having discussed some sort of macroeconomic good news, there are some severe challenges, and many of these we can describe properly as legacy challenges – that just because you remove the leadership doesn’t mean you’ve changed the system.

And, in many respects, what we have, I think, in Iraq economy is a second-world system, an Eastern-European type model, a state-dominated economy, where after years of massive state intervention, we’ve got a residue of issues that the system of government ministries that play a direct role in the economy where they’re probably not equipped to do so; a very underdeveloped private sector; a lack of the legal infrastructure for business start-ups; lack of the connectivity for business start-ups. So there are just a range of issues that are going to take a while to come to terms with.

These also suggest that what some of the issues to our mind that Iraq needs to think about tactically – getting market forces back to work in the economy; coming to terms with some of the pervasive state intervention and distortions in the economy; allowing a national banking sector to play a role in fostering access to credit and business expansion; coming to terms with housing and real estate process so that people can get

title, can sell land, can acquire, people can monetize assets so you'll have an entire asset class serve as a spur to the economy; and corruption is a vital task as well.

And let me just try to go through each one of these with a few ideas. One of our points was we think that the 5 percent tariff is probably not useful, that at the moment, Iraq is almost a textbook example of a single-factor economy, a single-product economy. And there's certainly scope for other industry and products to develop in Iraq, but for the near term, it's going to be overwhelmingly dominated by the petroleum sector. So, the idea that a tariff wall is helpful to Iraq's economy I think doesn't have a lot of merit to it. And it also feeds corruption and inflation.

So, one of our points was think about that tariff holiday. And we said, look at some of the average tariffs in the region; you're saying, I think you're pricing yourself out of the market. Even if your tariffs are roughly in line with your neighbors, because there's a risk premium in Iraq, you're pricing yourself out of the market. So, one way to compensate for that risk premium is to have a tariff holiday.

We talked about tax holiday, too. We said, well, where does tax revenue get you? How important is tax revenue for your fiscal well-being? And we'll show you in a second. We said tax revenue is almost completely irrelevant to your fiscal well-being. You don't need tax revenue to fund the activities of your government. So, what you put in is a market distortion that you might not need. Again, you're not sure how well you're competing with your neighbors.

I think the next – is the next one the pie chart? Yeah. We looked at '06 budget revenue. There's essentially one source of revenue. Not surprising. And we said if you look at the marginal benefit of these other sources of revenue, it strongly suggests looking for ways to enhance that 93 percent and just simply eliminate the others, just in the interest of economic growth and economic efficiency. It suggests that Iraq is going to be better off.

We talked about the state-owned enterprises. Saddam Hussein had a massive apparatus – 192 companies, some 500,000 Iraqis – and, as you know, that can substantially understate sort of the socioeconomic role of these companies, given an extended family system. Some of these are now out of business; some of them are still functioning. But our point is that Iraq's got to come to terms with this. But I'd also put an important caveat in this presentation, which is this: Iraqi people have suffered enormously in recent decades and there's still a fair amount of turmoil in Iraq as we speak, so I think any attempt to come to terms with this challenge has to bear all of that in mind. In other words, I think it would be misguided for anyone to suggest what we simply need to do is take a sharp knife to this and we're going to shut down anything that's not making money and, just in the interest of economic rationalism, we're going to treat Iraq's state-owned enterprises the way we might treat a state-owned enterprise in the United States or developed nations. So, I think we have to be thoughtful about this.

But regardless of what our appetite is for going down this path, I think we can all agree that these companies – I think it's on the next slide – these companies have to perform to the extent possible according to market incentives. Their pricing has to be in line with market pricing. Their input costs have to reflect market prices. There should be published accounts. There should be profit and loss statements. There should be quarterly numbers that are published. If we're subsidizing them – the Iraqi government subsidizes them – we should at least understand the cost of the subsidy and then we should understand what's the plan. How are we going to move toward market-oriented businesses?

And some of these, there's going to be some good news. Certainly not a majority, but some will be good news where you say, look, it might be a matter of profit-sharing if the company's performing. So don't view this all as bad news and don't view this as an exercise in pain. But we do want companies to perform increasingly according to market principles. And simply taking on outside investors might be part of the solution.

Public distribution system. If you're not aware of this, Iraq has the most comprehensive food distribution system in the world, of any country, where 100 percent of its citizens are entitled to a monthly allotment of food. And it is a physical delivery. It is not a coupon, it is not monetized. It is a basket of food products that is delivered to every single household every single month. It absorbs an enormous amount of government resources, and, well, you can see other problems of it as well.

And so we've had some thoughts on the public distribution system. One is that simply allowing the private sector to play a role could reduce the need for PDS. So to the extent possible, allowing modern farmer, retailing, wholesaling distribution systems to come into place reduces the need. And another key point up there is at some point I think Iraq leadership has to think about needs testing, targeting this program only for the needy, but there is certainly a segment of the population in Iraq that does not have a day-to-day need, although there's a substantial percentage that does have a day-to-day need. So anything that can be done to focus this kind of program on those who actually need it is going to provide for better management, reduce the scope for corruption or mismanagement, and also just reduce that drain on the budget as well.

Banking sector was another key area where we saw there was scope for improvement. There's essentially an absence of normal credit facilities for business in Iraq. And again, it's largely, I think, a Saddam legacy. The banks played a very different role in that kind of society than we envisioned banks playing in our society. We came up with some recommendations just to modernize the sector to allow companies to access the credit facilities to expand.

By the way – Steve, just tell me if I've got this right – but we've got soft copies of this available. People want copies of this. So we can just email copies as well. Steve, raise your hand for a second. See Steve – hi. See Steve afterwards and he'll email you a copy if you want a soft copy. If you want a hard copy he's got them here.

Are we done?

JONATHAN: (Off mike.)

MR. LAVIN: All right, we're just about done.

Housing. Housing is both a human need and an asset class, and we want a farmer who wants to expand to be able to acquire new land. We want a farmer who wants to sell to be able to sell, and maybe his kids can go to college or he can set up a shop or go work in a factory if that's what he wants to do. But if people don't have clear title to their land and if the system of transfer isn't regularized, then what we have is an asset class that can't function in financial markets. So we want to both take care of people who have housing needs and we also want to respect the fact that for a lot of people, that's their life savings and they want to do something with it. So land registration was a big part of this.

Corruption. Corruption is hard to measure, and it might even be harder to combat, but at least on an anecdotal basis it is one of the more frequently voiced complaints. It might be the single most common complaint articulated after security. And again, I think the ultimate solution is long-term, but we had at least some initial points. We just simply – if you reduce the scope of government decision-making, you reduce the scope of corruption. And if you take that tariff out of the border, the border crossings are tariff free, then there is no ability for a customs official to monkey around with any kind of customs assessment. If you put registration procedures on the Internet and allow people to, in real time, submit their applications and get it processed in real time, again, that just reduces the scope for corruption. If you simply reduce the number of business registration requirements, it reduces the scope for corruption. So it wasn't so much an ultimate solution, but as a way of at least containing and shrinking the problem to take some of these points on board.

That summarized our discussion with Iraq government leadership, and we had this discussion I think several times in the course of our time there. You know, I think I'd say this: I've got a lot – we've met now Iraq government leaders. The people we deal with are typically the industry minister and the trade minister, and we've met them now several times in Iraq and in Washington, and I have a lot of respect for them. I think they're – they've got a challenging assignment.

Without putting words in their mouth, I think they'd say most people in the Iraq government would more or less agree with those points, although they certainly might weight them differently or emphasize different elements or have a different time horizon than we've got, but there's not a broad disagreement on these central points. A lot of it has to do with what will the market bear, what's the political system going to allow in the near term, and what other competing interests are there that Iraq has to take care of.

Let me close out – and I can go to questions – with three key points that we registered as very important short-term goals. Some of these are longer-term goals, but we wanted to leave our Iraqi hosts with three points to keep in mind that I think have to

be viewed with some sense of urgency to help economic development. One were the investment regulations, that they passed investment law but they have not promulgated the implementing regulations. And by the way, that's both a Baghdad issue as well as an Erbil issue because the Kurdistan region has its own investment code as well.

So one was investment regulations. The second point, on which I'm glad to say there's been some movement since our departure, was a hydrocarbon law, and as you saw in the press reports, the – it's been approved by the Council of Ministers, and is going to be parliament.

And I certainly can't say that our trip played a role in that, but it was nice to see that of all of the sectors of the United States industry that might have an appetite for involvement in Iraq, I think most people would put the energy sector at the top, A, because there is a market need there, but, B, because this is an industry that is more comfortable than other sectors in working in very challenging environments. So get the hydrocarbon law fixed, and you're going to see, in my view, response from U.S. industry.

And the third point was focus on marquis (?) investments for the near term, short term, meaning the next six, 12, 18 months. Don't focus as much on the terms of the deal, if you will, but focus on just making a deal happen, getting any serious investment take place at all because you're trying to overcome a multi-decade-long legacy of economic mismanagement, and a more current challenge of security. So you have got a severe marketing challenge, and just to allow a transaction to take place would be enormously helpful. So the precise terms of the deal are going to be less important over the long run than the fact that a marquis (?) investment took place.

And there are some U.S. companies that we are aware of that we have been talking with that are keenly interested in getting to Iraq, and whatever can be done to help that process along in the near term I think will be enormously helpful to just setting a better tone for the investment climate and business operating climate in Iraq. So those were our three final points we left with the mission. I'd be very happy to take on the basis of these points. Thank you for your attention.

(Applause.)

JONATHAN: Thank you very much. We have some time. We have about a half-hour for questions. I would ask three things: one, that when the microphone comes to you, you identify yourself, second that because we have a lot of people in just a little time that everybody only ask one question. And the third thing is that you ask your question in the form of a question, which is not to make a long statement, and it with, what do you think. (Laughter.) So actually ask the undersecretary a question.

So is there a question over there in the corner?



Q: I'm Dana Marshall with Hunton & Williams. And thank you, Frank, for that very good briefing. Jonathan has kind of cut me down. I was going to make a few observations but I will – (laughter) –

JONATHAN: It's working already.

Q: It's working already. I wanted to first of all to say somebody was involved with this from the beginning that when the big war ended, your comments regarding the state-owned enterprises, I think that is very important what you said. I think that pragmatism is going to be very important, and I think it will reach the goals that we all share. The question I had was regarding the oil distribution and sharing process. I don't mean so much among the provinces, but the idea that I think the president himself came up with at the State of the Union about a sharing system, where somehow the individual Iraqis would get direct benefits in some way, which would certainly help across the board on everything. I wonder if you could sort of let us know where that stands and how you are going to kind of mesh U.S. business interests with that new money that they may be having.

MR. LAVIN: Yeah, well, I only – I did touch on that indirectly if you think for a second on the fiscal discussion because when we talk about the enormous amount of money that the state-owned enterprises absorbed, and we talked about the enormous amount of money that this national comprehensive public distribution absorbs, what it really means it despite that incredible wealth, despite the fact that 93 percent of all government services are paid for, there is not necessarily a lot to show for all of that at the end of the year because of these two central government programs.

So the point is, the more you can trim back some of these to put them on more of a market footing, the more you're willing to free up funds. But we did not have specific fiscal discussions to say let's look at your – let's look at where your money is going and where it ought to go. And there other folks in the U.S. government who have senior advisors at the education ministry and elsewhere in the government that work on higher education in Iraq and how do we help farmers in Iraq, and so forth. We are really trying to focus on our area of expertise and simply look at the commercial sector, and that spills into some broader economic policy, but we did not directly get into that area, Dana.

JONATHAN: Right there in the blue shirt.

Q: I'm Brian Katulis with the Center for American Progress. Thank you for your presentation.

I was curious, in your assessment of the Iraq business environment, did you find much involvement from local – regional actors, like Iran and Turkey? When I was in Iraq, in 2003, I was struck by the large numbers of Turkish and Iranian businessmen who were in my hotel. To what extent are they shaping and influencing the economic dynamics and the business environment.

MR. LAVIN: Of course we were – this time we were in the Kurdish region, and so I don't think I can give you necessarily a fair national snapshot. But certainly in that region, there is a pretty palpable Turkish presence in – branded consumer products might be the most obvious, where it has Turkish names, Turkish alphabet brands, and so forth in the shops. But it's pretty pervasive. It's not surprising it's just a truck ride down the border. It also suggests there is opportunities for U.S. firms to distribute their goods as well perhaps from Turkey.

I couldn't give you any figures on what role Turkey plays in the economy, what role Iran plays there. You can go downtown Erbil and – I mean, there are certainly Ford cars and General Motors cars on the streets. Tata – the one car dealership I went to was the Tata dealership, the Indian distributorship. But one of the frustrating challenges of this kind of discussion is – there can sometimes be some decent national level statistics. They are very rarely sub-national level statistics because – we had a number of discussions in the building about how was the Kurdistan region economy performing, and there is no – we couldn't find any statistical basis. I suggest anecdotally – my guess is it is – Erbil city of a million people is growing at over 5 percent. I mean, it's just visible from the construction sites, the housing developments, the new retail establishment. There is a lot going on in Erbil. But there is no data we could find on that, so it's hard to give you a better answer on that.

Q: Jennifer Brinkerhoff from George Washington University. And I just wanted to build on the last point that you made about marquis investments. And I wondered if you could speak a little to what role corporate social responsibility would play in this picture, and subsequently perhaps, what role the Department of Commerce will play in ensuring that while we are at once encouraging them not to focus on the details that we don't also land on the deals that are really not good for them.

MR. LAVIN: Sure. You know, at the end of the day for business transaction or investment to work, both sides have to be satisfied. You sometimes an sort of force or push, but if there is not an underlying business logic where both sides believe in it, are grateful it took place, be careful of that being a hall of factory. That might be what you were suggesting.

But my point to the Iraqi side was simply, look, there is usually a range of outcomes that you would be satisfied with. Think of an everyday transaction we undertake where we say the actual price that we purchased something at – we might be willing to pay a little more a little less than we did, and we would still probably be satisfied.

My point was that Iraq's focus at this moment I don't think should be, let's spend the next six months in negotiations on a project to get 2-percent better pricing on it, when in fact, It would do much more good for its economy and its people just to have that transaction start tomorrow, that develop start tomorrow because of the signal to market that would come from that. And they have got, as I mentioned, a severe marketing challenge.

So what they need are some scores on the board. They just need to bat some runners in. As good news picks up, then you can be – you are in a better negotiating position, and you can push a little more on pricing. And maybe you do care about that last percent a little bit more. But my only point to them was, if you're negotiating down between that last hundred dollars and a hotel project, my friends, what you need is a major international hotel project. And that last \$100, I would leave that money on the table and get the hotel going in terms of the jobs it will create the signal that will come out of that. So that was the key point to them. Don't over-negotiate, and you don't let best be the enemy of good.

JONATHAN: The gentleman right here on the aisle. (Inaudible.)

Q: Colonel Datoff (ph), Foreign Policy Association. Could you please talk about the contracts recently allotted to the Iraqi companies on construction, on construction contracts as compared to the foreign companies?

MR. LAVIN: I'm afraid I don't have any information as to what Iraqi company might have gotten a contract or didn't get a contract or what happened. I'm afraid I can't comment. I'm sorry.

Q: (Inaudible) – apply to you as well.

Q: John Sullivan with the Center for International Private Enterprise – CIPE. I was just wondering – I noticed you had commercialization on your list of things to do with those – (inaudible) – enterprises, and I understand and sympathize with the point you can't throw 500,000 people out on the street.

MR. LAVIN: Yeah.

Q: Is there any thought being given to how you improve the governance of these companies?

MR. LAVIN: Yeah.

Q: Get them – we have a huge amount of material on – (inaudible). We'd be happy to help out.

MR. LAVIN: Yeah, and by the way, CIPE has got a guy on our bill we met with, and I think you've got a good team going there. Part of it was simply accountability and transparency. I mean, part of it is these companies, to their defense – I mean, a lot of them are not well managed, but to their defense, they've never been in a system where performance was required, and it was a, frankly, closer to a Soviet model than anything else.

So you're talking to people who have been in a factory where inputs came in and outputs went out and there was never a pricing mechanism, there was never industrial engineering, there was never a normal quality control, there was certainly never any marketing involved with this, and now we're saying, my friends, you've got to perform.

So part of what we're suggesting is simply getting those numbers out there, some transparency. At least it lets people know how well they're doing. So at least getting the input prices at market level makes the subsidy transparent. So maybe for the near term or extended period of time, the subsidy is what the political environment calls for, but at least everybody understands what that subsidy is, and then we can start having discussion about, well, can we reduce that subsidy through any way? Can we get sales up in any kind of way?

So the first step is at least let's get a scorecard out there and understand how all these companies perform and get these numbers published, and I think we're still grappling with all of that data.

JONATHAN: First the gentleman in the front row and then we'll go to the back. Right here.

Q: Leonard Oberlander. In the political and cultural context, do you have an intuitive or subjective view of how the individuals who are the corporate executives in Iraq and who are the consumers and the investors, from a human point of view, value their money and see the risk that they're taking in terms of how you're, quote, "playing this game"?

MR. LAVIN: Yeah. It's very hard to evaluate. That's a great question. I can tell you this: There's at least one optimistic side, but I think the security situation clouds a lot of decision-making, so it's hard to fully discern an answer.

But on an optimistic basis, what you can see vividly is that on the SME basis, on the small-shop basis, there strikes me in Iraq to be as healthy and vital and entrepreneurial culture as in any other society, that, you know, folks run restaurants, folks repair bikes, folks are doing things with metal or doing some simple fabrication or construction work and they have no problem at all hanging a shingle outside their house and saying, you know, I was always good at carpentry so I guess I'm a carpenter, and I'm going to find some business and I'm going to earn a living. And there's a natural entrepreneurial bent in at least a large strata of the population that you'd see in any other healthy society, and that's very encouraging.

There are going to be constraints on that such as access to credit or training personnel, or sometimes even electricity, so some of the natural growth that might take place, you don't see. When you get to places in Iraq where there's not a pressing security issue, such as the Kurdistan region, you see an enormous amount of economic vibrancy. I mean, you know, your single-greatest – a friend was saying to me over there, the single-greatest risk we've got in Erbil was a traffic accident. I mean, it's a bustling city with a

range of shops you'll see anyplace on the planet and a phone book you can look through and find anything you need done. And people have no problem at all getting their business going and setting up and expanding and their life is moving along very smartly in Arbil.

JONATHAN: All the way in the back there?

Q: I'm Robert Sheretta of International Investor. You mentioned in your presentation that it is largely a cash economy and that it's difficult to sometimes gather statistics. So our question is, how can we measure the performance of this program going forward? How frequently will you issue reports? Will you rely on data that your agency is trying to gather, or will you rely on Iraqi government statistics?

And finally, given your role that you have responsibility for a number of nations, will this program pull any resources from other programs having to do with other nations in the area?

MR. LAVIN: Sure. On the final point, we set up an Iraq task force in the Commerce Department commensurate with the fall of Saddam Hussein. I don't think there are any new resources there but we've had a small team – I think there are four or five people – that work on Iraq issues, and they've been there four or five years. So this is evolution of program or people who have been in place.

I think what we're looking for is success in terms of the U.S. role in that economy. We do have, I think, reasonable statistics. One is export volume, which doesn't capture everything, but you can measure it. And exports have been bubbling up. U.S. exports to Iraq last year were \$1.5 billion, and that's – by the way, this is not sales to U.S. military in Iraq, this is not U.S. contractors for the U.S. government in Iraq; these are across the border transactions to sell into Iraq. So it's not a bad number, and when you break that down quarter to quarter and month to month, you see a very nice trajectory that, you know – there is increased performance on that.

Now, you could say, well, they've got oil money. No doubt that's what's underwriting a lot of this is they do have cash, but on the other hand, you know, take good news where you can find it. So they've got some bad news because of the security situation; they've got some good news because they've got some oil wells. So here we are.

I think another very important measurement we'll look at is what I alluded to in my remarks, which is let's look at the number of U.S. companies that are looking at investments or more formal activity on the ground, and that you just track case by case. And I think when the implementing regulations for the hydrocarbon law is passed is going to be – will be getting to the market test of this. That might be in a few weeks, it might be later this year, but I think we're getting to the finish line where, at least for the energy sector, that's the majors, but also all of the suppliers, and there are a lot of specialty firms that follow behind the majors, can finally take a good look at Iraq and say

there's pressing needs for the kind of technical expertise that U.S. firms can bring to that sector, and there's a appetite from some of the people we've talked to on the U.S. side, and now they're able to get in there.

So we might get a more of a market test, if you will, of your point by the end of this year.

JONATHAN: Right here in the front row.

Q: I'm Bob Hershey (sp). I'm a consultant. You mentioned the Internet. What's currently being done on the Internet there?

MR. LAVIN: Well, my mission on the Internet was simply – there was such a spike in Internet hookups since the fall of Saddam. It was a very tightly regulated – I think the total number of Internet hookups in Iraq under Saddam Hussein was a nominal number. It was only for the nomenklatura. You might know that. It was something like 1,000.

JONATHAN: One-thousand.

MR. LAVIN: Yeah, nationally. So it was a prize. By now I think there's something like 200,000 hookups. So it certainly doesn't have the density it's going to have in a more developed market. On the other hand, 200,000 is not a bad number. And this is a hopeful sign. I mean, it shows that there is a desire for connectivity, that there's some kind of IT capabilities in that country, and that we can feed on that. We've seen even sharper rises in phone hook-ups, I think something like 7 million cell phones. So in some sectors you see stronger growth than others.

It's also worth noting in those sectors, the providing companies don't have to have a heavy footprint, so not surprisingly, when you have a security situation, the sectors that tend to do better are those that don't require a massive operation. We can still provide services. It's sort of a sporadic footprint.

JONATHAN: (Inaudible) – back on the right.

Q: Hello, my name is Michael Stanisich. I'm with the International Solutions Group. We're actually a team member on the Iraq Middle Management Development Fund. And my question –

MR. LAVIN: Is Steve Ladik (sp) with your group?

Q: Yes.

MR. LAVIN: Yeah, I bumped into Steve at the Erbil airport.

Q: Exactly.

MR. LAVIN: Yeah.

Q: And we've been operating there since 2004.

MR. LAVIN: Great.

Q: And my question pertains primarily –

MR. LAVIN: Don't get him mad by –

Q: Sorry.

MR. LAVIN: – making a statement and not asking a question.

Q: All right, it's coming.

MR. LAVIN: He's going to come after you.

Q: Primarily related to the banking sector, at what point, in your opinion, do you see the Iraqis having the capacity to provide this component that's currently provided by outsiders? And secondly, the property issue, commercially – I know for individuals or residents it's not been solved whatsoever since 2003. There is still – (inaudible). But what's your sense in terms of the commercial sector in regards to foreign direct investment?

MR. LAVIN: So your first question is on banking – what's the Iraqi capacity to deal with this? I've got to tell you, I think Iraqis are as capable as anybody on this planet. I think they're very highly trained as a strong engineering tradition. It's not a problem, are the Iraqis capable? The challenge, if you ask me – a little bit back to the Eastern Europe, the Central Europe transition – you see this time and time again, you see it very clear with the banking sector: Are you better off just setting up a greenfield operation or are you better off trying to get an old state-directed enterprise that was really never performed according to the way we'd like to see it performed. You give them time to get that improved to a point, and which is the faster route.

And you see that very clear with the state banks. The state banks didn't play the role that they play in most other societies as an allocator of credit, as a way of pricing risk, as a way of spurring economic growth. They never played that role. They were simply a repository for funds, and you could put some savings there, you could take them out. So they never had a credit function. They also never had a national function where – they were never nationally integrated. So you can do something in one part of the country and do it again in a different part and it all fits together, so that the Pepsi bottler in Iraq can say, look, here is what I need to take place from my different bottling plants on a regular basis in terms of availability of funds or credit or loans for trucks or whatever. They say there is no – there's nobody in Iraq who can do that right now.

You've got to have a series of different discussions with a series of different banks about what we would say are very rudimentary business decisions.

So that is a huge challenge about how do you get these guys to perform the way a normal bank would perform? I would say you try to do both. You just get as – encourage foreign banks to come in, and they've got some foreign banks in again back to Turkish banks in the north you saw, and you also say, we've got to start helping these big state banks perform increasingly along market lines so they can play a constructive role in the economy, and see how far you can go.

What was your other question? Sorry, you had something else about banks.

Q: It had to do with – (inaudible).

MR. LAVIN: My suggestion to the housing minister, one of the persons we met with, Minister Diza'l, was, look, this is a tough order. Can you just pick a few cities and make this a model? Just pick a few midsize that demonstrate what happens. So people have titled their land. There's a registry. It's computerized. It's online. A transaction can take place and you solve problems. So start fixing things. And it might be a five- or 10-year process, I don't know, but can you start? And let's pick a few. Let's get an IT system in there, let's get professionals in there, the surveyors in there, and let's start this process, because I think we're freezing a lot of normal economic activity when people don't have clear title to their land. So we've got to be able to provide that. She did like that idea and she said, I'm going to pick seven. So we'll see where she goes with that.

JONATHAN: In the third row here.

Q: (Inaudible) – of International Petroleum Enterprises. You correctly pointed out the role of oil on the government revenues and so on, but it has not always been this way. Iraq of course is probably the richest country as far as water resources is concerned in the region, and also tourism. These are two other areas of interest that you didn't even talk about.

The regional cooperation that you also didn't talk about in your discussion – early discussion until the question and answer session is another area – I mean, those guys – Turkey, Syria, Jordan, and to some extent Iran, has been dealing with Iraq for thousands of years. They don't have these kinds of Western restrictions and laws and regulations, so they can probably do a better job.

On the Kurdistan –

JONATHAN: Is there a question hiding in here?

Q: Yes. I'll get to it in a second, but Kurdistan, you know, the situation is very fragile, and to support one side because of the opportunities that exist I think is going to widen the gap and it's going to create problems.



And another thing, you were too optimistic on the hydrocarbons law. There are a number of countries in the region that, you know, the government is pushing for changes but the parliaments and others are not allowing this. The question is, what –

JONATHAN: Could we get to the question please?

Q: Yes, the question is, what do you think the – how can we actually look at the whole thing, then make a policy decision on the situation in Iraq?

JONATHAN: Thank you very much.

Q: Thank you.

JONATHAN: The question is, how can we look more broadly at the regional environment to do the kinds of things you're talking about doing domestically in Iraq?

MR. LAVIN: Right. Yeah, fair point, and I'm sensitive to what you alluded to a moment ago, which is, look, it's reasonable to expect that all the different parts of Iraq are going to present a different security situation and therefore be more or less inviting to economic activity. We want to always make sure that our policy, which from day one is one Iraq, unified Iraq – federal system, fair enough, but one government, one country, that that remains intact. And you're absolutely right, that is central to our policy.

I have to say this: Every minister we met in the Kurdistan regional government respected that point. We did not get a hint or whiff of any other view except that within the constitutional construct of Iraq, we at the regional level, have certain rights and privileges, and here is what we want to do. So it was nice to see sort of a level of maturity in those discussions.

I'd say, look, we always respect the unity of the country. That's central to our policy. At the same point, from my perspective, on a commercial basis, we would pursue the same policy in Iraq or China or Mexico, which is differentiation. Every single company is going to have a different view of the market. If you're involved in port services and that's what you do, you're going to be in Basra. If you're involved in energy services, you're going to be in the oilfields. If you're in branded retail products, you might very well say the Kurdistan region is the best place to go because I can distribute, I can compete against the Turkish consumer products and get my products in there. So, depending on what your line of business is, you're going to see that market differently. So, we respect the principle of differentiation as well. But that's a commercial principle, that's not a political point.

We just encourage U.S. companies, take a look at Iraq; take a look at Iraq. You understand your business, you can think through the risk factors, we'll work with you in a discussion on this, but we just want you to take a look at the country and see what opportunities are there.

JONATHAN: (Off mike) – the gentleman in the blue shirt in the back.

Q: Don Gross from Stonebridge International. Like one of the other questioners, I very much appreciated your thoughtful and pragmatic approach to the question of reforming SOEs. But my question is, you know, how do you operationalize that? I think you gave one example where you said merely having a scorecard, creating greater transparency is a very good first step. And I wondered, since the economic priorities have a heavy focus on market reform, how do you balance your pragmatism with that policy goal?

MR. LAVIN: Excellent. By the way, I think we're still in that first-step phase where let's just get everybody to perform but understand how well they're performing and how close to market reality they're performing. And then the tougher question in sort of phase two is, how do we improve performance to the point where they're at market levels and who can make that transition and maybe who can't? And that has political sensitivities because of the employment base and so forth about that.

I'll tell you, from my part of it – this is a really a question for the Iraqis – from my part, I would say don't be dogmatic about it. Life is trade-offs. And the near-term goal might want to focus on just maintaining a level of employment. The longer-term goal almost certainly has to do with having these companies stand on their own two feet. But my advice to people who are specifically charged with SOE management is let's be flexible about it. Let's understand the cost and benefit of what we're doing and proceed on that basis rather than proceed sort of on a pure philosophical basis about what an ultimate good might be several years hence. And I think we'll be having more of those discussions as we go along.

MR. HAMRE: I want to thank Secretary Lavin for a very thoughtful and informative presentation. I want to thank you for your courtesy and attention and we look forward to seeing you again soon.

(Applause.)

(END)