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Observations on the Oil for Food Program

Statement of Joseph A. Christoff, Director
International Affairs and Trade

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Highlights

Highlights of GAO-04-651T, a testimony before the Committee on Foreign Relations

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Observations on the Oil for Food Program

Why GAO Did This Study

The Oil for Food program was established by the United Nations and Iraq in 1996 to address concerns about the humanitarian situation after international sanctions were imposed in 1990. The program allowed the Iraqi government to use the proceeds of its oil sales to pay for food, medicine, and infrastructure maintenance. The program appears to have helped the Iraqi people. From 1996 through 2001, the average daily food intake increased from 1,300 to 2,300 calories. From 1997-2002, Iraq sold more than $67 billion of oil through the program and issued $38 billion in letters of credit to purchase commodities.

GAO (1) reports on its estimates of the revenue diverted from the program, (2) provides preliminary observations on the program's administration, (3) describes some challenges in its transfer to the CPA, and (4) discusses the challenges Iraq faces as it assumes program responsibility.

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To view the full product, including the scope and methodology, click on the link above. For more information, contact Joseph Christoff at (202) 512-8979 or christoffj@gao.gov.

What GAO Found

GAO estimates that from 1997- 2002, the former Iraqi regime attained $10.1 billion in illegal revenues from the Oil for Food program, including $5.7 billion in oil smuggled out of Iraq and $4.4 billion through surcharges on oil sales and illicit commissions from suppliers exporting goods to Iraq. This estimate includes oil revenue and contract amounts for 2002, updated letters of credit from prior years, and newer estimates of illicit commissions from commodity suppliers.

Both the U.N. Secretary General, through the Office of the Iraq Program (OIP) and the Security Council, through its sanctions committee for Iraq, were responsible for overseeing the Oil for Food Program. However, the Iraq government negotiated contracts directly with purchasers of Iraqi oil and suppliers of commodities, which may have been one important factor that allowed Iraq to levy illegal surcharges and commissions. While OIP was responsible for examining Iraqi contracts for price and value, it is unclear how it performed this function. The sanctions committee was responsible for monitoring oil smuggling, screening contracts for items that could have military uses, and approving oil and commodity contracts. While the sanctions committee responded to illegal surcharges on oil, it is unclear what actions it took to respond to illicit commissions on commodity contracts.

OIP transferred 3,059 Oil for Food contracts—with pending shipments valued at $6.2 billion—to the CPA on November 22, 2003. However, the CPA stated that it has not received all the original contracts, amendments, and letters of credit it needs to manage the program. These problems, along with inadequate CPA staffing during the transfer, hampered the efforts of CPA's Oil for Food coordination center in Baghdad to ensure continued delivery of commodities. Poor planning, coordination, and the security environment in Iraq continue to affect the execution of these contracts.

Inadequate oversight and corruption in the Oil for Food program raise concerns about the Iraqi government's ability to import and distribute Oil for Food commodities and manage at least $32 billion in expected donor reconstruction funds. The CPA has taken steps, such as appointing inspectors general, to build internal control and accountability measures at Iraq's ministries. The CPA and the World Food Program (WFP) are also training ministry staff to help them assume responsibility for Oil for Food contracts in July 2004. The new government will have to balance the reform of its costly food subsidy program with the need to maintain food stability and protect the poorest populations.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss GAO's review of the United Nations (U.N.) Oil for Food program.

In 1996, the United Nations and Iraq established the Oil for Food program to address growing concerns about the humanitarian situation after international sanctions were imposed in 1990. The program allowed the Iraqi government to use the proceeds of its oil sales to pay for food, medicine, and infrastructure maintenance. From 1997 through 2002, Iraq sold more than $67 billion in oil through the program and issued $38 billion in letters of credit to purchase commodities.[1]

Today, we will present our findings and observations on the operation of the Oil for Food program and its transfer to the Coalition Provisional Authority (CPA). Specifically, we will (1) report on our estimates of the revenue diverted from the program by the former Iraqi regime; (2) provide some preliminary observations on the administration of the program; (3) describe the challenges the CPA faced when it assumed responsibility for the program; and (4) discuss the challenges Iraq faces as it assumes responsibility for the program.

To address these objectives, we reviewed documents and statements from (1) the United Nations on its management and oversight responsibilities for the Oil for Food program; (2) the CPA, the Departments of Defense and State, and the United Nations and its World Food Program (WFP) on the transfer of the program to the CPA and its implementation; and (3) from the World Bank and Iraq's 2004 budget regarding the effect of food subsidies on the Iraqi economy. We met with U.N. officials immediately following the transfer of the program to the CPA in November 2003 and with numerous U.S. officials representing the CPA, the Departments of Defense and State, and the U.S. Agency for International Development to discuss the program's transfer and ongoing management by the CPA. Our review is ongoing because we have not yet received all the CPA and Iraqi ministry documentation that we have requested from the CPA and the Department of State. We have also requested certain U.N. documents, including internal audits, to determine the use of Oil for Food funds prior to the transfer to the CPA and the current disposition of funds. We assessed the reliability of the data on the number of contracts reviewed for

[1]All references to Oil for Food estimates are in 2003 constant U.S. dollars.

priority by the United Nations, the CPA, and Iraqi ministries and those transferred to the CPA November 2003 by corroborating OIP information with CPA data. We were unable to assess the reliability of the dollar amounts of contracts reviewed and pending shipment because we did not have access to the information that would have allowed us to confirm the dollar amounts reviewed and transferred.

We conducted our review from November 2003 through April 2004 in accordance with generally accepted government auditing standards.

Summary

- From 1997 through 2002, we estimate that the former Iraqi regime acquired $10.1 billion in illegal revenues related to the Oil for Food program—$5.7 billion in oil smuggled out of Iraq and $4.4 billion in surcharges on oil sales and illicit charges from suppliers exporting goods to Iraq. This estimate is higher than our May 2002 estimate of $6.6 billion because it includes (1) oil revenue and contract amounts for 2002, (2) updated letters of credit from prior years, and (3) newer estimates of illicit commissions from commodity suppliers.

- Both the U.N. Secretary General, through the Office of the Iraq Program (OIP) and the Security Council, through its sanctions committee for Iraq, were responsible for overseeing the Oil for Food Program. However, the Iraq government negotiated contracts directly with purchasers of Iraqi oil and suppliers of commodities, which may have been one important factor in allowing Iraq to levy illegal surcharges and commissions. While OIP was responsible for examining Iraqi contracts for price and value, it is unclear how it performed this function. The sanctions committee was responsible for monitoring oil smuggling, screening contracts for items that could have military uses, and approving oil and commodity contracts. While the sanctions committee responded to illegal surcharges on oil, it is unclear what actions it took to respond to illicit commissions on commodity contracts.

- OIP turned over responsibility for 3,059 Oil for Food contracts—with pending shipments valued at $6.2 billion—to the CPA on November 22, 2003. However, the information the United Nations supplied to the CPA on the renegotiated contracts contained database errors and did not include all contracts, amendments, and letters of credit associated with the 3,000 contracts. These problems, along with inadequate CPA staffing at the time of the transfer, hampered efforts by the CPA's Oil for Food coordination center in Baghdad to ensure that commodities continued to be delivered. Also, the execution of these contracts

continues to be affected by poor planning, coordination, and security.

- The history of inadequate oversight and corruption in the Oil for Food program raises concerns about the Iraqi government's ability to manage the remaining Oil for Food commodities and about $32 billion in expected donor reconstruction funds. The CPA has taken steps, such as appointing inspectors general, to build internal controls and accountability measures in Iraq's ministries. The CPA and the World Food Program (WFP) are also training ministry staff on procurement and distribution functions to help them fully assume responsibility for remaining contracts and a continued food distribution system in July 2004. In addition, the new government will have to balance the need to reform a costly food subsidy program with the need to maintain food stability and protect the poorest populations.

Background

In August 1990, Iraq invaded Kuwait, and the United Nations imposed sanctions against Iraq. Security Council Resolution 661 of 1990 prohibited all nations from buying and selling Iraqi commodities, except for food and medicine. Security Council Resolution 661 also prohibited all nations from exporting weapons or military equipment to Iraq and established a sanctions committee to monitor compliance and progress in implementing the sanctions. The members of the sanctions committee were members of the Security Council. Subsequent Security Council resolutions specifically prohibited nations from exporting to Iraq items that could be used to build chemical, biological, or nuclear weapons. In 1991, the Security Council offered to let Iraq sell oil under a U.N. program to meet its peoples' basic needs. The Iraqi government rejected the offer, and over the next 5 years, the United Nations reported food shortages and a general deterioration in social services.

In December 1996, the United Nations and Iraq agreed on the Oil for Food program, which permitted Iraq to sell up to $1 billion worth of oil every 90 days to pay for food, medicine, and humanitarian goods. Subsequent U.N. resolutions increased the amount of oil that could be sold and expanded the humanitarian goods that could be imported. In 1999, the Security Council removed all restrictions on the amount of oil Iraq could sell to purchase civilian goods. The United Nations and the Security Council monitored and screened contracts that the Iraqi government signed with commodity suppliers and oil purchasers, and Iraq's oil revenue was placed in a U.N.-controlled escrow account. In May 2003, U.N. resolution 1483 requested the U.N. Secretary General to transfer the Oil for Food program to the CPA by November 2003.

Despite concerns that sanctions may have worsened the humanitarian situation, the Oil for Food program appears to have helped the Iraqi people. According to the United Nations, the average daily food intake increased from around 1,275 calories per person per day in 1996 to about 2,229 calories at the end of 2001. In February 2002, the United Nations reported that the Oil for Food program had considerable success in several sectors such as agriculture, food, health, and nutrition by arresting the decline in living conditions and improving the nutritional status of the average Iraqi citizen.

The Public Distribution System run by Iraq's Ministry of Trade is the food portion of the Oil for Food program. The system distributes a monthly "food basket" that normally consists of a dozen items[2] to all Iraqis. About 60 percent of Iraqis rely on this basket as their main source of food.

Former Iraqi Regime Diverted an Estimated $10.1 Billion from the Oil for Food Program

We estimate that, from 1997 through 2002, the former Iraqi regime acquired $10.1 billion in illegal revenues related to the Oil for Food program—$5.7 billion through oil smuggling and $4.4 billion through surcharges against oil sales and illicit commissions from commodity suppliers. This estimate is higher than the $6.6 billion in illegal revenues we reported in May 2002.[3] We updated our estimate to include (1) oil revenue and contract amounts for 2002, (2) updated letters of credit from prior years, and (3) newer estimates of illicit commissions from commodity suppliers.

Oil was smuggled out through several routes, according to U.S. government officials and oil industry experts. Oil entered Syria by pipeline, crossed the borders of Jordan and Turkey by truck, and was smuggled through the Persian Gulf by ship. In addition to revenues from oil smuggling, the Iraqi government levied surcharges against oil purchasers and commissions against commodity suppliers participating in the Oil for Food program. According to some Security Council members,

[2] Wheat flour, rice, vegetable ghee (semifluid clarified butter used for cooking), pulses (edible seeds of various leguminous crops, such as peas, beans, or lentils), sugar, tea, salt, milk, infant formula, weaning cereal, soap, and detergent.

[3] U.S. General Accounting Office, *Weapons of Mass Destruction: U.N. Confronts Significant Challenges in implementing Sanctions Against Iraq*, GAO-02-625 (Washington, D.C.: May 23, 2002).

the surcharge was up to 50 cents per barrel of oil and the commission was 5 to 15 percent of the commodity contract.

In our 2002 report, we estimated that the Iraqi regime received a 5-percent illicit commission on commodity contracts. However, a September 2003 Department of Defense review found that at least 48 percent of 759 Oil for Food contracts that it reviewed were overpriced by an average of 21 percent.[4] Defense officials found 5 contracts that included "after-sales service charges" of between 10 and 20 percent. In addition, interviews by U.S. investigators with high-ranking Iraq regime officials, including the former oil and finance ministers, confirmed that the former regime received a 10-percent commission from commodity suppliers.

United Nations and Security Council Had Responsibility for Oversight of Program, but Iraq Contracted Directly with Purchasers and Suppliers

Both OIP and the sanctions committee were responsible for overseeing the Oil for Food Program. However, the Iraqi government negotiated contracts directly with purchasers of Iraqi oil and suppliers of commodities. While OIP was to examine each contract for price and value, it is unclear how it performed this function. The sanctions committee was responsible for monitoring oil smuggling, screening contracts for items that could have military uses, and approving oil and commodity contracts. The sanctions committee responded to illegal surcharges on oil, but it is unclear what actions it took to respond to commissions on commodity contracts.

Iraq Negotiated Directly with Oil Purchasers and Suppliers

U.N. Security Council resolutions and procedures recognized the sovereignty of Iraq and gave the Iraqi government authority to negotiate contracts and decide on contractors. Security Council resolution 986 of 1995 authorized states to import petroleum products from Iraq, subject to the Iraqi government's endorsement of transactions. Resolution 986 also stated that each export of goods would be at the request of the government of Iraq. Security Council procedures for implementing resolution 986 further stated that the Iraqi government or the United Nations Inter-Agency Humanitarian Program would contract directly with suppliers and conclude the appropriate contractual arrangements. Iraqi

[4]The Defense Contract Audit Agency and the Defense Contract Management Agency, *Report on the Pricing Evaluation of Contracts Awarded under the Iraq Oil for Food Program* (Washington, D.C.: Sept. 12, 2003).

control over contract negotiations may have been one important factor in allowing Iraq to levy illegal surcharges and commissions. Appendix I contains a chronology of major events related to sanctions against Iraq and the administration of the Oil for Food program.

OIP Was Responsible for Key Oversight Aspects of the Program

OIP administered the Oil for Food program from December 1996 to November 2003. As provided in Security Council resolution 986 of 1995 and a memorandum of understanding between the United Nations and the Iraqi government, OIP was responsible for monitoring the sale of Iraq's oil, monitoring Iraq's purchase of commodities and the delivery of goods, and accounting for the program's finances. The United Nations received 3 percent of Iraq's oil export proceeds for its administrative and operational costs, which included the cost of U.N. weapons inspections.

The sanctions committee's procedures for implementing resolution 986 stated that U.N. independent inspection agents were responsible for monitoring the quality and quantity of oil being shipped and were authorized to stop shipments if they found irregularities. To do this, OIP employed 14 contract workers to monitor Iraqi oil sales at 3 exit points in Iraq. However, the Iraqi government bypassed the official exit points by smuggling oil through an illegal Syrian pipeline and by trucks through Jordan and Turkey. According to OIP, member states were responsible for ensuring that their nationals and corporations complied with the sanctions.

OIP was also responsible for monitoring Iraq's purchase of commodities and the delivery of goods. Security Council Resolution 986, paragraph 8a(ii) required Iraq to submit a plan, approved by the Secretary General, to ensure equitable distribution of Iraq's commodity purchases. The initial distribution plans focused on food and medicines while subsequent plans were expansive and covered 24 economic sectors, including electricity, oil, and telecommunications.

The sanction committee's procedures for implementing Security Council resolution 986 stated that experts in the Secretariat were to examine each proposed Iraqi commodity contract, in particular the details of price and value, and to determine whether the contract items were on the distribution plan. It is unclear whether the office performed this function. OIP officials told the Defense Contract Audit Agency they performed very limited, if any, pricing review. They stated that no U.N. resolution tasked them with assessing the price reasonableness of the contracts and no contracts were rejected solely on the basis of price.

The sanction committee's procedures for implementing resolution 986 state that independent inspection agents will confirm the arrival of supplies in Iraq. OIP deployed about 78 U.N. contract monitors to verify shipments and authenticate the supplies for payment. OIP employees were able to visually inspect 7 to 10 percent of the approved deliveries.

Security Council resolution 986 also requested the Secretary General to establish an escrow account for the Oil for Food Program, and to appoint independent and certified public accountants to audit the account. In this regard, the Secretary General established an escrow account at BNP Paribas into which Iraqi oil revenues were deposited and letters of credit were issued to suppliers having approved contracts. The U.N. Board of Audit, a body of external public auditors, audited the account. According to OIP, there were also numerous internal audits of the program. We are trying to obtain these audits.

The Sanctions Committee Had a Key Role in Enforcing Sanctions and Approving Contracts

The sanctions committee was responsible for three key elements of the Oil for Food Program: (1) monitoring implementation of the sanctions, (2) screening contracts to prevent the purchase of items that could have military uses, and (3) approving Iraq's oil and commodity contracts.

U.N. Security Council resolution 661 of 1990 directs all states to prevent Iraq from exporting petroleum products into their territories. Paragraph 6 of Resolution 661 establishes a sanctions committee to report to the Security Council on states' compliance with the sanctions and recommend actions regarding effective implementation. As early as June 1996, the Maritime Interception Force, a naval force of coalition partners including the United States and Great Britain, informed the sanctions committee that oil was being smuggled out of Iraq through Iranian territorial waters. In December 1996, Iran acknowledged the smuggling and reported that it had taken action. In October 1997, the sanctions committee was again informed about smuggling through Iranian waters. According to multiple sources, oil smuggling also occurred through Jordan, Turkey, Syria, and the Gulf. Smuggling was a major source of illicit revenue for the former Iraqi regime through 2002. It is unclear what recommended actions the sanctions committee made to the Security Council to address the continued smuggling.

A primary function of the members of the sanctions committee was to review and approve contracts for items that could be used for military purposes. For example, the United States conducted the most thorough review; about 60 U.S. government technical experts assessed each item in a contract to determine its potential military application. According to U.N. Secretariat data in 2002, the United States was responsible for about 90 percent of the holds placed on goods to be exported to Iraq. As of April 2002, about $5.1 billion of worth of goods were being held for shipment to Iraq.

Under Security Council resolution 986 of 1995, paragraphs 1 and 8, the sanctions committee was responsible for approving Iraq's oil contracts, particularly to ensure that the contract price is fair, and for approving most of Iraq's commodity contracts.[5] In March 2001, the United States informed the Security Council about allegations that Iraqi government officials were receiving illegal surcharges on oil contracts and illicit commissions on commodity contracts.[6] According to OIP officials, the Security Council took action on the allegations of surcharges in 2001 by implementing retroactive pricing for oil contracts.[7] However, it is unclear what actions the sanctions committee took to respond to illicit commissions on commodity contracts. At that time, there was increasing concern about the humanitarian situation in Iraq and pressure on the United States to expedite its review process.

CPA's Administration of the Oil for Food Program

In November 2003, the United Nations transferred to the CPA responsibility for 3,059 Oil for Food contracts totaling about $6.2 billion and decided not to transfer a remaining 2,199 contracts for a variety of reasons. U.N. agencies had renegotiated most of the contracts turned over to the CPA with the suppliers to remove illicit charges and amend delivery and location terms. However, the information the United Nations supplied to the CPA on the renegotiated contracts contained database errors and did not include all contracts, amendments, and letters of credit associated with the 3,000 contracts. These data problems, coupled with inadequate

[5] Under fast-track procedures established by Security Council resolution 1383 of 1999, OIP could approve contracts that contained only humanitarian goods.

[6] The sanctions committee received reports from the independent oil experts appointed by the Secretary General to determine whether there was fraud or deception in the oil contracting process.

[7] Under retroactive pricing, the Security Council did not approve a price per barrel until the oil was delivered to the refinery. The Iraq government signed contracts with suppliers without knowing the price it would have to pay until delivery. This allowed a fair market price to be set.

staffing at the CPA, hampered the ability of the CPA's Oil for Food coordination center to ensure that suppliers complied with commodity deliveries. In addition, poor planning and coordination are affecting the execution of food contracts.

Program Transferred to the CPA in November 2003

On November 22, 2003, OIP transferred 3,059 contracts worth about $6.2 billion in pending commodity shipments to the CPA, according to OIP. Prior to the transfer, U.N. agencies had renegotiated the contracts with the suppliers to remove "after-sales service fees"—based on information provided by the CPA and Iraqi ministries—and to change delivery dates and locations. These fees were either calculated separately or were part of the unit price of the goods. At the time of the transfer, all but 251 contracts had been renegotiated with the suppliers. The Defense Contract Management Agency is renegotiating the remaining contracts for the CPA to remove additional fees averaging 10 percent. The criteria for renegotiating contracts and the amount of the reductions were based on information from the CPA in Baghdad and the ministries that originally negotiated the contracts.

An additional 2,199 contracts worth almost $2 billion were not transferred as a result of a review by U.N. agencies, the CPA, and the Iraqi ministries that negotiated the contracts. For example:

- The review did not recommend continuing 762 contracts, worth almost $1.2 billion, because it determined that the commodities associated with the contracts were no longer needed.
- Another 728 contracts, worth about $750 million, had been classified as priority contracts, but were not transferred to the CPA for several reasons. About half—351 contracts—were not transferred because suppliers were concerned about the adequacy of security within Iraq or could not reach agreement on price reductions or specification changes. Another 180 contracts were considered fully delivered. Another 136 suppliers had either declared bankruptcy, did not exist, or did not respond to U.N. requests. It is unclear why the remaining 61 contracts were removed from the priority list; the OIP document lists them as "other."
- Suppliers did not want to ship the outstanding small balances for an additional 709 contracts totaling about $28 million.

The largest portion of the $6.2 billion in Oil for Food contracts pending shipment in November 2003—about 23 percent—was designated for food procurement. An additional 9 percent was for food handling and transport. The oil infrastructure, power, and agriculture sectors also benefited from the remaining contracts. Nearly one half of the renegotiated contracts were with suppliers in Russia, Jordan, Turkey, the United Arab Emirates, and France.

Inadequate Information and Staffing Affected Transfer and Implementation of Contracts

According to CPA officials and documents, the incomplete and unreliable contract information the CPA received from the United Nations has hindered CPA's ability to execute and accurately report on the remaining contracts. U.N. resolution 1483 requested the Secretary General, through OIP, to transfer to the CPA all relevant documentation on Oil for Food contracts.[8] When we met with OIP officials on November 24, 2003, they stated that they had transferred all contract information to the CPA.

CPA officials and documents report that the CPA has not received complete information, including copies of all contracts. The CPA received several compact disks in November and January that were to contain detailed contract and delivery data, but the information was incomplete. The CPA received few source documents such as the original contracts, amendments, and letters of credit needed to identify the status of commodities, prepare shipment schedules, and contact suppliers. In addition, the CPA received little information on letters of credit that had expired or were cancelled. Funds for the Oil for Food program are obligated by letters of credit to the bank holding the U.N. escrow account. When these commitments are cancelled, the remaining funds are available for transfer to the Development Fund for Iraq. Without this information, the CPA cannot determine the disposition of Oil for Food funds and whether the proper amounts were deposited into the Development Fund for Iraq.[9]

In addition, the CPA received an OIP contract database but found it unreliable. For example, CPA staff found mathematical and currency errors in the calculation of contract cost. The inadequate data and documentation have made it difficult for CPA to prepare accurate reports on the status of inbound goods and closeouts of completed contracts.

[8] U.N. Resolution 1483, ¶16(f) (May 2003).

[9] As of March 31, 2004, the United Nations had transferred $7.6 billion in Oil for Food funds to the Development Fund for Iraq.

According to a Department of Defense contracting official, some contractors have not received payment for goods delivered in Iraq because the CPA had no record of their contracts.

In November 2003, the CPA established a coordination center in Baghdad to oversee the receipt and delivery of Oil for Food commodities. The CPA authorized 48 coalition positions, to be assisted by Iraqis from various ministries. However, according to several U.S. and U.N. officials, the CPA had insufficient staff to manage the program and high staff turnover. As of mid-December 2003, the center had 19 coalition staff, including 18 staff whose tours ended in January 2004. U.S. and WFP officials stated that the staff assigned at the time of the transfer lacked experience in managing and monitoring the import and distribution of goods. A former CPA official stated that the Oil for Food program had been thrust upon an already overburdened and understaffed CPA. As a result, 251 contracts had not been renegotiated prior to the time of the transfer and the CPA asked the Defense Contract Management Agency to continue the renegotiation process. A November 2003 WFP report placed part of the blame in food shortfalls during the fall of 2003 on OIP delays in releasing guidelines for the contract prioritization and renegotiation process. A September 2003 U.N. report also noted that the transfer process in the northern governates was slowing due to an insufficient number of CPA counterparts to work with U.N. staff on transition issues.

The center's capacity improved in March 2004 when its coalition staff totaled 37. By April 2004, the coordination center had 16 coalition staff. Up to 40 Iraqi ministry staff are currently working on Oil for Food contracts. As of April 1, the coordination center's seven ministry advisors have begun working with staff at their respective ministries as the first step in moving control of the program to the Iraqi government.

Inadequate Planning, Coordination, and Security Affect the Management of Food Contracts

According to U.S. officials and documents, CPA's failed plans to privatize the food distribution system and delayed negotiations with WFP to administer the system resulted in diminished stocks of food commodities and localized shortages. Before the transfer of the Oil for Food program, the CPA administrator proposed to eliminate Iraq's food distribution system and to provide former recipients with cash payments. He asserted that the system was expensive and depressed the agricultural sector, and the Ministry of Trade began drawing down existing inventories of food. In December 2003, as the security environment worsened, the CPA administrator reversed his decision to reform the food ration system and left the decision to the provisional Iraqi government.

In January 2004, CPA negotiated a memorandum of understanding (MOU) with WFP and the Ministry of Trade that committed WFP to procuring a 3-month emergency food stock by March 31, 2004 and providing technical support to the CPA and Ministry of Trade. Delays in signing the MOU were due to disagreements about the procurement of emergency food stocks, contract delivery terms, and the terms of WFP's involvement. No additional food was procured during the negotiations, and food stocks diminished and localized shortages occurred in February and March 2004. The CPA and WFP addressed these problems with emergency procurements from nearby countries.

An April WFP report projected a continued supply of food items through May 2004 except for a 12-percent shortage in milk. Only 55 percent of required domestic wheat has been procured for July 2004 and no domestic wheat has been procured for August. Under the terms of MOU, WFP's commitment to procuring food stock ended March 31, 2004. The Ministry of Trade assumed responsibility for food procurement on April 1, 2004.

According to a U.S. official, coordination between WFP and the Ministry of Trade has been deteriorating. The Ministry has not provided WFP with complete and timely information on monthly food allocation plans, weekly stock reports, or information on cargo arrivals, as the MOU required. WFP staff reported that the Ministry's data are subject to sudden, large, and unexplained stock adjustments, thereby making it difficult to plan deliveries.

The security environment in Iraq has also affected planning for the transfer and movement of Oil for Food goods in fall 2003. The transfer occurred during a period of deteriorating security conditions and growing violence in Iraq. A September 2003 U.N. report found that the evacuation of U.N. personnel from Baghdad affected the timetable and procedures for the transfer of the Oil for Food program to the CPA and contributed to delays in the contract prioritization and renegotiation processes. Most WFP staff remained in Amman and other regional offices and continued to manage the Oil for Food program from those locations. The August bombing of the U.N. Baghdad headquarters also resulted in the temporary suspension of the border inspection process and shipments of humanitarian supplies and equipment. A March 2004 CPA report also noted that stability of the food supply would be affected if security conditions worsened.

CPA and Transitional Government Face Challenges in Preventing Corruption and Reforming the Food Distribution System

The history of inadequate oversight and corruption in the Oil for Food program raises questions about the Iraqi government's ability to manage the import and distribution of Oil for Food commodities and the billions in international assistance expected to flow into the country. In addition, the food distribution system created a dependency on food subsidies that disrupted private food markets. The government will have to decide whether to continue, reform, or eliminate the current system.

Addressing Corruption

The CPA and Iraqi ministries must address corruption in the Oil for Food program to help ensure that the remaining contracts are managed with transparent and accountable controls. Building these internal control and accountability measures into the operations of Iraqi ministries will also help safeguard the $18.4 billion in fiscal year 2004 U.S. reconstruction funds and at least $13.8 billion pledged by other countries.

To address these concerns and oversee government operations, the CPA administrator announced the appointment of inspectors general for 21 of Iraq's 25 national ministries on March 30, 2004. At the same time, the CPA announced the establishment of two independent agencies to work with the inspectors general—the Commission on Public Integrity and a Board of Supreme Audit. Finally, the United States will spend about $1.63 billion on governance-related activities in Iraq, which will include building a transparent financial management system in Iraq's ministries.

CPA's coordination center continues to provide on-the-job training for ministry staff who will assume responsibility for Oil for Food contracts after July 2004. Coalition personnel have provided Iraqi staff with guidance on working with suppliers in a fair and open manner and determining when changes to letters of credit are appropriate. In addition, according to center staff, coalition and Iraqi staff signed a code of conduct, which outlined proper job behavior. Among other provisions, the code of conduct prohibited kickbacks and secret commissions from suppliers. The center also developed a code of conduct for suppliers. In addition, the center has begun identifying the steps needed for the transition of full authority to the Iraqi ministries. These steps include transferring contract-related documents, contacting suppliers, and providing authority to amend contracts. In addition, the January 2004 MOU agreement commits WFP to training ministry staff in the procurement and transport functions currently conducted by WFP. Training is taking place at WFP headquarters in Rome, Italy.

Reforming the Food Distribution System

After the CPA transfers responsibility for the food distribution system to the Iraqi provisional government in July 2004, the government will have to decide whether to continue, reform, or eliminate the current system. Documents from the Ministries of Trade and Finance indicate that the annual cost of maintaining the system is as high as $5 billion, or about 25 percent of total government expenditures. In 2005 and 2006, expenditures for food will be almost as much as all expenditures for capital projects. According to a September 2003 joint U.N. and World Bank needs assessment of Iraq,[10] the food subsidy, given out as a monthly ration to the entire population, staved off mass starvation during the time of the sanctions, but at the same time it disrupted the market for food grains produced locally. The agricultural sector had little incentive to produce crops in the absence of a promising market. However, the Iraqi government may find it politically difficult to scale back the food distribution system with 60 percent of the population relying on monthly rations as their primary source of nutrition. WFP is completing a vulnerability assessment that Iraq could use to make future decisions on food security programs and better target food items to those most in need.

Mr. Chairman and Members of the Committee, this concludes my prepared statement. I will be happy to answer any questions you may have.

Contacts and Acknowledgments

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[10] United Nations/World Bank, *Joint Iraq Needs Assessment: Agriculture, Water Resources, and Food Security* (New York: October 2003).

Appendix I: Timeline of Major Events Related to Sanctions Against Iraq and the Administration of the Oil for Food Program

Date	Event/Action	Summary
Aug. 2, 1990	U.N. Security Council Resolution 660	Iraqi forces invaded Kuwait. Resolution 660 condemned the invasion and demanded immediate withdrawal from Kuwait.
Aug. 6, 1990	U.N. Security Council Resolution 661	Imposed economic sanctions against the Republic of Iraq. The resolution called for member states to prevent all commodity imports from Iraq and exports to Iraq, with the exception of supplies intended strictly for medical purposes and, in humanitarian circumstances, foodstuffs.
Aug. 6, 1990	Operation Desert Shield	President Bush ordered the deployment of thousands of U.S. forces to Saudi Arabia.
Nov. 5, 1990	U.S. legislation	Public Law 101-513 prohibited the import of products from Iraq into the United States and export of U.S. products to Iraq.
Jan. 12, 1991	U.S. legislation	Iraq War Powers Resolution authorized the president to use “all necessary means” to compel Iraq to withdraw military forces from Kuwait.
Jan. 16, 1991	Operation Desert Storm	Operation Desert Storm was launched: Coalition operation was targeted to force Iraq to withdraw from Kuwait.
Feb. 28, 1991	Gulf War cease-fire	Iraq announced acceptance of all relevant U.N. Security Council resolutions.
Apr. 3, 1991	U.N. Security Council Resolution 687 (Cease-Fire Resolution)	Mandated that Iraq must respect the sovereignty of Kuwait and declare and destroy all ballistic missiles with a range of more than 150 kilometers as well as all weapons of mass destruction and production facilities.
Jun. 17, 1991	Creation of U.N. Special Commission	The U.N. Special Commission (UNSCOM) was charged with monitoring Iraqi disarmament as mandated by U.N. resolutions and to assist the International Atomic Energy Agency in nuclear monitoring efforts.
Aug. 15, 1991	U.N. Security Council Resolution 706	Proposed the creation of an Oil for Food program and authorized an escrow account to be established by the Secretary General. Iraq rejected the terms of this resolution.
Sep. 19, 1991	U.N. Security Council Resolution 712	Second attempt to create an Oil for Food program. Iraq rejected the terms of this resolution.
Oct. 2, 1992	U.N. Security Council Resolution 778	Authorized transferring money produced by any Iraqi oil transaction on or after August 6, 1990, which had been deposited into the escrow account, to the states or accounts concerned as long as the oil exports took place or until sanctions were lifted.
Apr. 14, 1995	U.N. Security Council Resolution 986	Allowed Iraq to sell $1 billion worth of oil every 90 days. Proceeds were to be used to procure foodstuffs, medicine, and material and supplies for essential civilian needs. Resolution 986 was supplemented by several U.N. resolutions over the next 7 years that extended the Oil for Food program for different periods of time and increased the amount of exported oil and imported humanitarian goods.
Mar. 27, 1996	U.N. Security Council Resolution 1051	Established the export and import monitoring system for Iraq.
May 20, 1996	Government of Iraq and the United Nations	Signed a memorandum of understanding allowing Iraq’s export of oil to pay for food, medicine, and essential civilian supplies.
Jun. 17, 1996	United States	Based on information provided by the Multinational Interception Force (MIF), communicated concerns about alleged smuggling of Iraqi petroleum products through Iranian territorial waters in violation of resolution 661 to the Security Council sanctions committee.

Date	Event/Action	Summary
Jul. 9, 1996	U.N. Security Council Sanctions Committee	Committee members asked the United States for more factual information about smuggling allegations, including the final destination and the nationality of the vessels involved.
Aug. 28, 1996	U.S. delegation to the U.N. Security Council Sanctions Committee	Provided briefing on the Iraqi oil smuggling allegations to the sanctions committee.
Dec. 3, 1996	Islamic Republic of Iran Permanent Representative to the United Nations	Acknowledged that some vessels carrying illegal goods and oil to and from Iraq had been using the Iranian flag and territorial waters without authorization and that Iranian authorities had confiscated forged documents and manifests. Representative agreed to provide the results of the investigations to the sanctions committee once they were available.
Dec. 10, 1996	Iraq and the United Nations	Phase I of the Oil for Food program began.
Jun. 4, 1997	U.N. Security Council Resolution 1111	Extended the term of resolution 986 another 180 days (phase II).
Sep. 12, 1997	U.N. Security Council Resolution 1129	Authorized special provision to allow Iraq to sell petroleum in a more favorable time frame.
Oct. 8, 1997	Representatives of the United Kingdom of Great Britain and Northern Ireland to the United Nations	Brought the issue of Iraqi smuggling petroleum products through Iranian territorial waters to the attention of the U.N. Security Council sanctions committee.
Nov. 18, 1997	Coordinator of the Multinational Interception Force (MIF)	Reported to the U.N. Security Council sanctions committee that since February 1997 there had been a dramatic increase in the number of ships smuggling petroleum from Iraq inside Iranian territorial waters.
Dec. 4, 1997	U.N. Security Council Resolution 1143	Extended the Oil for Food program another 180 days (phase III).
Feb. 20, 1998	U.N. Security Council Resolution 1153	Raised Iraq's export ceiling of oil to about $5.3 billion per 6-month phase (phase IV).
Mar. 25, 1998	U.N. Security Council Resolution 1158	Permitted Iraq to export additional oil in the 90 days from March 5, 1998, to compensate for delayed resumption of oil production and reduced oil price.
Jun. 19, 1998	U.N. Security Council Resolution 1175	Authorized Iraq to buy $300 million worth of oil spare parts to reach the export ceiling of about $5.3 billion.
Aug. 14, 1998	U.S. legislation	Public Law 105-235, a joint resolution finding Iraq in unacceptable and material breach of its international obligations.
Oct. 31, 1998	U.S. legislation: Iraq Liberation Act	Public Law 105-338 §4 authorized the president to provide assistance to Iraqi democratic opposition organizations.
Oct. 31, 1998	Iraqi termination of U.N. Special Commission (UNSCOM) Activity	Iraq announced it would terminate all forms of interaction with UNSCOM and that it would halt all UNSCOM activity inside Iraq.
Nov. 24, 1998	U.N. Security Council Resolution 1210	Renewed the Oil for Food program for 6 months beyond November 26 at the higher levels established by resolution 1153. The resolution included additional oil spare parts (phase V).
Dec. 16, 1998	Operation Desert Fox	Following Iraq's recurrent blocking of U.N. weapons inspectors, President Clinton ordered 4 days of air strikes against military and security targets in Iraq that contribute to Iraq's ability to produce, store, and maintain weapons of mass destruction and potential delivery systems.

Date	Event/Action	Summary
Mar. 3, 1999	President Clinton Report to Congress	President Clinton provided the status of efforts to obtain Iraq's compliance with U.N. Security Council resolutions. He discussed the MIF report of oil smuggling out of Iraq and smuggling of other prohibited items into Iraq.
May 21, 1999	U.N. Security Council Resolution 1242	Renewed the Oil for Food program another 6 months (phase VI).
Oct. 4, 1999	U.N. Security Council Resolution 1266	Permitted Iraq to export an additional amount of $3.04 billion of oil to make up for revenue deficits in phases IV and V.
Nov. 19, 1999	U.N. Security Council Resolution 1275	Extended phase VI of the Oil for Food program for 2 weeks until December 4, 1999.
Dec. 3, 1999	U.N. Security Council Resolution 1280	Extended phase VI of the Oil for Food program for 1 week until December 11, 1999.
Dec. 10, 1999	U.N. Security Council Resolution 1281	Renewed the Oil for Food program another 6 months (phase VII).
Dec. 17, 1999	U.N. Security Council Resolution 1284	Abolished Iraq's export ceiling to purchase civilian goods. Eased restrictions on the flow of civilian goods to Iraq and streamlined the approval process for some oil industry spare parts. Also established the United Nations Monitoring, Verification and Inspection Commission (UNMOVIC).
Mar. 31, 2000	U.N. Security Council Resolution 1293	Increased oil spare parts allocation from $300 million to $600 million under phases VI and VII.
Jun. 8, 2000	U.N. Security Council Resolution 1302	Renewed the Oil for Food program another 180 days until December 5, 2000 (phase VIII).
Dec. 5, 2000	U.N. Security Council Resolution 1330	Extended the Oil for Food program another 180 days (phase IX).
Mar. 8, 2001	Deputy U.S. Representative to the United Nations Remarks to the Security Council	Ambassador Cunningham acknowledged Iraq's illegal re-export of humanitarian supplies, oil smuggling, establishment of front companies, and payment of kickbacks to manipulate and gain from Oil for Food contracts. Also acknowledged that the United States had put holds on hundreds of Oil for Food contracts that posed dual-use concerns.
Mar. 8, 2001	Acting U.S. Representative to the United Nations Remarks to the Security Council	Ambassador Cunningham addressed questions regarding allegations of surcharges on oil and smuggling. Acknowledged that oil industry representatives and other Security Council members provided the United States anecdotal information about Iraqi surcharges on oil sales. Also acknowledged companies claiming they were asked to pay commissions on contracts.
Jun. 1, 2001	U.N. Security Council Resolution 1352	Extended the terms of resolution 1330 (phase IX) another 30 days.
Jul. 3, 2001	U.N. Security Council Resolution 1360	Renewed the Oil for Food program an additional 150 days until November 30, 2001 (phase X).
Nov. 29, 2001	U.N. Security Council Resolution 1382	The resolution stipulated that a new Goods Review List would be adopted and that relevant procedures would be subject to refinement. Renewed the Oil for Food program another 180 days (phase XI).
May 14, 2002	U.N. Security Council Resolution 1409	UNMOVIC reviewed export contracts to ensure that they contain no items on a designated list of dual-use items known as the Goods Review List. The resolution also extended the program another 180 days (phase XII).
Nov. 6, 2002	U.N. Security Council Sanctions Committee	MIF reported that there had been a significant reduction in illegal oil exports from Iraq by sea over the past year but noted oil smuggling was continuing.

Date	Event/Action	Summary
Nov. 25, 2002	U.N. Security Council Resolution 1443	Extended phase XII of the Oil for Food program another 9 days.
Dec. 4, 2002	U.N. Security Council Resolution 1447	Renewed the Oil for Food program another 180 days until June 3, 2003 (phase XIII).
Dec. 30, 2002	U.N. Security Council Resolution 1454	Approved changes to the list of goods subject to review and the sanctions committee.
Mar. 12, 2003	U.N. Security Council Sanctions Committee	Chairman reported on a number of alleged sanctions violations noted by letters from several countries and the media from February to November 2002. Alleged incidents involved Syria, India, Liberia, Jordan, Belarus, Switzerland, Lebanon, Ukraine, and the United Arab Emirates.
Mar. 19, 2003	Operation Iraqi Freedom	Operation Iraqi Freedom is launched. Coalition operation led by the United States initiated hostilities in Iraq.
Mar. 28, 2003	U.N. Security Council Resolution 1472	Adjusted the Oil for Food program and gave the Secretary General authority for 45 days to facilitate the delivery and receipt of goods contracted by the Government of Iraq for the humanitarian needs of its people.
Apr. 16, 2003	U.S. legislation	Public Law 108-11 §1503 authorized the President to suspend the application of any provision of the Iraq Sanctions Act of 1990.
Apr. 24, 2003	U.N. Security Council Resolution 1476	Extended provision of resolution 1472 until June 3, 2003.
May 1, 2003	Operation Iraqi Freedom	End of major combat operations and beginning of post-war rebuilding efforts.
May 22, 2003	U.N. Security Council Resolution 1483	Lifted civilian sanctions on Iraq and provided for the end of the Oil for Food program within 6 months, transferring responsibility for the administration of any remaining program activities to the Coalition Provisional Authority (CPA).
Nov. 21, 2003	U.N. Secretary General	Transferred administration of the Oil for Food program to the CPA.
Mar.19, 2004	U.N. Secretary General	Responded to allegations of fraud by U.N. officials that were involved in the administration of the Oil for Food program.
Mar. 25, 2004	U.N. Secretary General	Proposed that a special investigation be conducted by an independent panel.

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