

**Statement by Ambassador Patrick F. Kennedy
United States Representative for United Nations Management and Reform
on the UN Oil-For-Food Program
before the House Committee on Government Reform Subcommittee on
National Security, Emerging Threats, and International Relations
April 21, 2004**

Mr. Chairman, distinguished members of the Committee,

I welcome and thank you for the opportunity to appear before you today to discuss the UN Oil-for-Food (OFF) program and recent allegations of possible mismanagement and abuse with regard to the implementation of that program.

At the outset, I want to make perfectly clear that we appreciate and share your concerns. We will do what we can to ensure that all such allegations are investigated and addressed, most importantly for the benefit of the Iraqi people. I can assure you of Secretary Powell's strong personal interest and concern regarding this issue. Following recent specific allegations of corruption by UN officials, we were immediately instructed by Secretary Powell to convey our concerns to UN Secretary-General Annan. The Secretary-General has on his own initiative launched an investigation that is intended to be independent, transparent and comprehensive. As you know, we joined our fellow Security Council members on March 31 in welcoming this expanded investigation and pledging our full cooperation through a formal letter to the Secretary-General.

We must not forget that, corporate and official allegations aside, it is the Iraqi people who would have been most hurt by any wrongdoing. It is for them most of all that we must take this responsibility very seriously, and we will urge all UN member states to do the same so any and all wrongdoing is uncovered and addressed.

Mr. Chairman,

I think it may be helpful to you to have some background on the Oil-for-Food program and the Iraq sanctions regime.

The United Nations Oil-for-Food (OFF) program was authorized by Security Council Resolution 986 in April 1995 and became operational in December 1996.

The Security Council had imposed comprehensive multilateral sanctions on Iraq in August 1990 (UNSCR 661) to convince Saddam Hussein to withdraw from Kuwait without the use of force. Sanctions on Iraq continued after the Gulf War and were thought by many in the international community to impose extreme hardship on the Iraqi people. The Oil-for-Food program was created to alleviate those hardships. It allowed the import of humanitarian goods using the proceeds from controlled Iraqi oil sales while maintaining sanctions on imports other than food and medicine. The objective was to continue constraining Saddam Hussein's ability to use oil revenue to build a military arsenal.

The Oil-for-Food program represented the largest humanitarian relief operation ever launched by the international community. Iraqi oil exports totaled \$64.2 billion over the life of the program. The proceeds funded \$46 billion worth of humanitarian contracts for Iraq, and \$16 billion for the UN Compensation Commission (UNCC), as well as administrative costs for the Office of the Iraq Program (OIP), the UN Monitoring, Verification, and Inspection Commission (UNMOVIC), and the UN Special Commission (UNSCOM) totaling \$2.65 billion. Of the \$46 billion funding for humanitarian contracts, more than \$31 billion in humanitarian supplies was delivered to Iraq from March 1997 until November 21, 2003. An additional \$8.2 billion in prioritized supplies ordered under the program is scheduled to arrive in the coming months. To date, \$8.1 billion in surplus funds have been transferred from the UN escrow account to the Development Fund for Iraq (DFI), monies that have been extremely useful in the implementation of various programs for the people of Iraq.

The United States Government supported the program's general objective of creating a system to address the humanitarian needs of the Iraqi civilian population while maintaining strict sanctions enforcement of items that Saddam Hussein could use to re-arm or reconstitute his WMD program. We believe the system the Council devised by and large met those objectives. However, the rules and procedures governing implementation of the program were the product of negotiation among the fifteen members of the Security Council and between the UN and the former Iraqi regime. The United States was able to set basic parameters and monitor the functioning of the program through our participation in Security Council discussions and as a member of the Iraq Sanctions Committee, also known as the "661 Committee," named for the Security Council resolution that created it. However, we were not in a position to exercise exclusive control over the process. Although the flow of humanitarian and civilian goods to Iraq was a matter of strong interest to the U.S. government, it should be emphasized that an even greater preoccupation throughout the period of sanctions was to

ensure that no items be permitted for import which could in any way contribute to Iraq's WMD programs or capabilities. Thus, at USUN we concentrated our efforts on this aspect of the sanctions.

It is important to note that no U.S. Government funds, including those that might have been drawn from UN assessments, were involved in the establishment and functioning of the program. With the exception of voluntary funds provided by the United States for the UN Guards Contingency in Northern Iraq (UNGCI), whose task was to protect humanitarian personnel working there, all expenses associated with management and implementation of the program were drawn from Iraqi oil revenue that was deposited into a UN escrow account established under Resolution 986 (1995).

The sanctions regime and the OFF program constituted the most comprehensive and intrusive regime ever imposed by the Security Council, short of a complete embargo. At the insistence of many other Security Council members, the program permitted the Government of Iraq to control the sale of oil and the selection and negotiation of contracts with suppliers of humanitarian items destined for Iraq. The United Nations and its UN Office of the Iraq Program (OIP), which managed implementation of the program, were not a party to the contracts. The contracts were concluded exclusively between the Iraqi government and individual suppliers. These Council members insisted that Iraq's national sovereignty and territorial integrity, and thus the right to execute contracts, be enshrined in the language of Resolution 986 (1995). The 661 Committee reviewed the contracts that had been concluded between the Iraqi government and contractors to ensure that no items could be used for military purposes.

Much of what the U.S. Government could and could not achieve with regard to monitoring the program and implementation of the sanctions was directly related to the political situation surrounding the contentious issue of Iraq in the Security Council and in the 661 Committee. U.S. efforts to keep the comprehensive sanctions regime in place repeatedly were challenged by Council members who complained about the humanitarian impact of sanctions on the Iraqi people, and whose national firms would derive economic benefit from the lifting of sanctions. Indeed, starting in the mid-'90s and continuing into 2001, these pressures to lift sanctions grew.

Recent press reports allege there was corruption and abuse in the implementation of the program, allegations which fall into four general categories:

- direct oil smuggling by the former Iraqi regime;
- manipulation of pricing on Iraqi oil exports;
- kickbacks on OFF humanitarian contracts; and
- possible abuse by UN personnel.

At the heart of this were the determined efforts by Saddam Hussein to obtain funds illicitly and his repeated efforts to hide sanctions-busting activities.

Mr. Chairman,

We know there was abuse and fraud in the implementation of the OFF program. Where we could identify it, we and our UK partners stopped it. What we did not have before the fall of Saddam's regime was documentation and witnesses who were willing to step forward to provide evidence of corruption. Documentation is now becoming available in the wake of the Saddam Hussein regime's demise, and witnesses are also now coming forward who may be able to shed light more precisely on how the previous Government of Iraq and its supporters evaded sanctions, and on instances of corruption that may have existed in implementing the Oil-for-Food program.

The Secretary-General of the United Nations has initiated the process for conducting an independent high-level inquiry into the allegations of corruption and abuse in the administration and management of the OFF program. This inquiry will look into the allegations of fraud and corruption by UN personnel, contractors, and entities that entered into contracts with the UN or with Iraq under the program. Separately, the Iraqi Board of Supreme Audit, with assistance from the CPA, has launched its own investigation in Baghdad into allegations of misconduct concerning the OFF program. The United States will fully support these efforts.

Oil smuggling

It was commonly understood that the Saddam regime engaged in multiple, complex efforts to evade the sanctions imposed by the Security Council. In fact, the Saddam Government orchestrated the largest share of non-compliance with the Council's demands through outright oil smuggling and the procurement of unauthorized goods completely outside the context of the OFF program.

While it is assumed that Saddam engaged in oil smuggling throughout the life of the sanctions regime on Iraq, reports suggest that oil smuggling efforts intensified from 2000 onward, reaching a peak annual level of \$2 billion in 2002, mostly through the Persian Gulf and Syria. While it is not possible to confirm the General

Accounting Office's March 2004 estimate of \$5.7 billion in illegal oil smuggling revenue for the period 1997 through 2002, this figure appears realistic given the magnitude of the problem in 2002 alone. Saddam and his fellow ruling authorities then used these funds to acquire desired items in circumvention of Council oversight and review.

The Multinational Maritime Interception Force (MIF) operating in the Persian Gulf enjoyed success from 2000-2001 in significantly reducing the number of small vessels operating out of Shatt al-Arab that were smuggling Iraqi oil along Iran's southern coast. An equally noteworthy source of oil smuggling prior to the 2003 Iraq war was the illegal flow of oil through Iraq's pipeline with Syria, which restarted operations in late November 2000. The United States, in coordination with the UK, repeatedly raised concerns over such blatant non-compliance, only to be told by Syrian representatives that the Iraq-Syria pipeline was "being tested," but was not operational.

Oil surcharge

Evidence that the Iraqis were attempting to impose excessive price premiums on oil exports to exploit differences between oil prices approved by the 661 Committee and subsequent fluctuations in global oil prices surfaced as early as the fall of 2000, when the UN oil overseers informed the 661 Committee of instances in which the GOI was requesting imposition of an additional fee on the sale of Iraqi crude.

Members of the 661 Committee, led by the U.S. and UK, agreed to a statement issued by the Committee Chairman on December 15, 2000, making clear that additional fees above the oil selling price approved by the 661 Committee were not acceptable, and that all revenue derived from the sale of Iraqi oil was to be deposited in the authorized UN escrow account. Despite circulation of this message to all companies approved to lift Iraqi oil, evidence of the illicit surcharge continued through the spring of 2001. In April 2001 the United States and the United Kingdom first blocked 661 Committee approval of the price of Iraqi oil. The U.S., working in close coordination with the UK delegation in New York, raised the issue of excessive oil price premiums in a series of more than 40 formal and informal 661 Committee and Security Council meetings. An early instance was in December 2000. The U.S. and UK initially sought in April 2001 to limit the time that oil prices approved by the Committee at the beginning of each month would remain valid, from 30 days, which had been the practice up to that point, to 15 days. The U.S. and UK also requested weekly updates from the UN oil

overseers on the status of oil price premiums, which revealed that the Iraqis continued to seek imposition of additional, unauthorized fees on oil shipments ranging from 5 cents to 50 cents per barrel. We were unable to secure agreement to deal with this ploy.

Bolstered by such reports from the UN oil overseers, U.S. and UK experts made creative use of the consensus rule governing decisions in the 661 Committee, and began to withhold support until the end of each month for oil prices submitted by the Iraqi State Oil Marketing Organization (SOMO) prior to the beginning of that month. This retroactive price analysis permitted U.S. and UK experts the opportunity to assess oil prices sought by SOMO compared to the actual market price of comparable crude oils to determine if SOMO's prices reflected "fair market value" -- a requirement under Resolution 986 (1995). Beginning in October 2001 the U.S. and UK regularly employed the retroactive oil pricing mechanism to evaluate SOMO's suggested prices until the suspension of the OFF program in March 2003.

Certain 661 Committee members strongly resisted U.S. and UK efforts to deviate from the previously standard 30-day, pro-active oil pricing scheme. Some Council members alleged that imposition of retroactive oil pricing caused a decline in the total volume of Iraqi crude oil exports, thereby reducing available funds to finance procurement of additional humanitarian supplies to benefit the Iraqi civilian population. However, the retroactive oil pricing we imposed had its intended effect: by the spring of 2002, the UN oil overseers reported that oil price premiums had been reduced from as much as 50 cents per barrel to an accepted industry variation of 3 to 5 cents per barrel. This significant reduction in price premiums made it economically unfeasible for oil traders to pay a kickback and still make a profit. Thus for at least the final 18 months of the program we were able to save the people of Iraq significant sums of money in illegal oil surcharges.

Kickbacks on humanitarian contracts

Allegations of kickbacks related to OFF humanitarian contracts began to surface in late 2000. No documentary evidence was produced at the time to support these allegations.

U.S. and UK experts raised this issue with 661 Committee experts and OIP representatives during late 2000 and early 2001 and formally submitted proposals to address this issue during a 661 Committee meeting in March 2001. Our

proposals received no support: members claimed that absent receipt of evidence indicating that such kickbacks existed, no action could be taken.

In a few instances a supplier accidentally left surcharge language in a contract, and in every such case we blocked the contract. As a general rule, though we often suspected contract overpricing during the latter years of the program, we were hampered by the lack of substantiated evidence -- evidence that is now becoming available and which we are intent on pursuing.

The most important measures taken to address this issue occurred after the U.S., through CPA, was informed of the kickback by Iraqi ministry representatives in Baghdad. With the fall of the Hussein regime in the spring of 2003, and with the subsequent authorities granted to CPA under UNSC Resolution 1483, CPA officials (including sanctions experts from USUN staff), in coordination with UN officials and the Iraqis, took steps to eliminate surcharges in existing Oil-for-Food contracts meant evidently for kickbacks.

The CPA and the Iraqis not only identified priority contracts in the OFF pipeline, but also requested the UN agencies to negotiate a reduction in the overall contract value at an average rate of 10 percent for those contracts that the Iraqis identified as containing the kickback. It is estimated that this process saved the Iraqis approximately \$600 million -- money that is being returned to the Development Fund for Iraq.

The efforts by the CPA and the Iraqis to uncover the scale and intricacy of the hidden network created by Saddam Hussein to siphon funds from OFF have produced the first public acknowledgement by Iraqis that a systemic kickback system for OFF contracts actually existed. As more information comes to light and is evaluated, especially documentary evidence, we hope that the true scope and extent of this system and associated corruption and wrongdoing can be established.

Allegations against UN personnel

During the life of the OFF program, to the best of my knowledge the United States Government was not aware of allegations of abuse, fraud, or corruption against those UN officials responsible for management and implementation of OFF. It was with the appearance of press reports in January 2004 about abuse of the OFF program that allegations of corruption by UN Office of the Iraq Program (OIP) Executive Director Benon Sevan and possibly other UN officials were made. Thereafter the UN OIOS -- the UN's Inspector general -- approached us at USUN

to request any substantiating information or evidence from the CPA and the Iraq Governing Council.

The Independent Inquiry initiated by the Secretary-General is being complemented by an Iraqi Board of Supreme Audit investigation. The provision of documentation and the forthrightness of Iraqis who previously managed the Oil-for-Food matters will be essential to determine the full scope of the problem. We have informed the Secretary-General that the United States Government endorses and fully supports these investigations and will assist in whatever way we can.

U.S. initiatives: special briefings

In addition to efforts to eliminate or counter surcharges, kickbacks, smuggling or sanctions-busting activities, the United States also took initiatives to provide members of the 661 Committee and the Council information and evidence of violations by the former regime through various briefings. To counter charges that the U.S. was responsible for the continued suffering of Iraqi children, the United States briefed Council members in 2000 on the various ways the Saddam regime was diverting funds to benefit Iraq's elite, including through the use of diverted funds to build and furnish Saddam's palaces. The U.S. again briefed Council ambassadors in the spring of 2002 on Saddam Hussein's non-compliance with UN Security Council resolutions, and Saddam's attempts to procure WMD-related materials. In March 2002 a U.S. interagency team briefed the 661 Committee on the former regime's diversion of trucks.

Starting in 1996, U.S. Commanders of the Multinational Maritime Interception Force (MIF) in the Gulf briefed the Committee each year on the MIF's activities in combating the illegal smuggling of Iraqi crude. Most recently, MIF Commanders Vice Admiral Moore in 2001 and Vice Admiral Keating in 2002 briefed the 661 Committee and highlighted the continued attempts by Saddam Hussein to circumvent sanctions by illegally exporting oil and illicitly importing materials into Iraq through the unauthorized use of ferry services from neighboring states.

Status of investigations

The independent high-level inquiry initiated by the Secretary-General will shortly get underway. The Terms of Reference have been written and provided to Security Council members for their information. The inquiry is designed to investigate allegations of fraud and corruption in the administration and management of the

OFF program, including those against UN personnel, contractors and entities that entered into contracts with the UN or with Iraq under the program.

We and other Security Council members have welcomed the Secretary-General's initiative, and called for international cooperation. The formal appointment of the independent inquiry Panel will be a welcomed first step in addressing the allegations against the UN and the OFF program. The U.S. and CPA have pledged their support and assistance for the UN investigation. Members of the Council have requested they be provided original copies of the complete final report. Both the summary and the final report on the findings of this Panel will be made public.

In Baghdad, the CPA is assisting the Iraqi Board of Supreme Audit to launch a Baghdad-based investigation into the allegations of corruption regarding OFF. CPA Administrator Bremer issued a directive to the CPA and all Iraqi Ministries in early March instructing all Ministry officials to identify and secure relevant OFF documents. Representatives of the Iraqi Board of Supreme Audit have met with CPA and Iraqi Ministry officials to ensure cooperation and transparency in this process.

Mr. Chairman,

The UN Oil-for-Food program was established to address the humanitarian needs of the people of Iraq in the face of callous disregard by Saddam Hussein for their welfare. Failure to do so would have prompted an accelerated deterioration in international support for the sanctions regime. We met with fairly good success in limiting Saddam's access to prohibited items under the program, and in exercising control over most of the revenue derived from the export of Iraqi oil. However, this program was abused by Saddam Hussein in nefarious and clever ways. The inquiries now being launched will, we hope, identify those who may have conspired with him, and perhaps assist in recouping lost funds for the Iraqi people.

Mr. Chairman, again I thank you for the opportunity to provide this information on the Oil-for-Food program, and would close by emphasizing that you have my fullest support and that of my staff in your efforts to determine the extent and involvement of wrongdoing associated with the program.

