CASE STUDY: REBUILDING IRAQ

In his recent report on government procurement fraud, U.S. Representative Henry Waxman identified three major contracting events since 2001: Iraq reconstruction, Hurricane Katrina, and the Department of Homeland Security ("Dollars, Not Sense," House Government Reform Committee, www.democrats.reform.house.gov/Documents/20060620140127-02294.pdf). The rebuilding of Iraq and the Hurricane Katrina–related rebuilding efforts have led to cases of fraud committed in various phases of the procurement process by private companies and individuals. In fact, many observers have noted similarities between the rebuilding of the Gulf Coast and the experience in Iraq. This discussion focuses on Iraq reconstruction and government procurement fraud.

The Scale of the Problem

In a quarterly audit, Stuart Bowen, Special Inspector General for Iraq Reconstruction, stated: "The Iraqi government estimates that corruption costs the country at least $4 billion a year" (Yochi J. Dreazen, "Audit of Iraq Reconstruction Finds Corruption Worsening," *Wall Street Journal*, Aug. 2, 2006). Another reporter found that "there are 70 corruption investigations underway in Iraq, of which 23 involve allegations of contract fraud, overcharging, product substitution, or false claims. Fifty cases arose from whistleblowers under the False Claims Act" (Carl Osgood, "Cheney's Halliburton Paradigm for Fraud," *Executive Intelligence Review*, July 2006).

Furthermore, Dreazen reported that Iraq's anticorruption agency had opened 1,400 criminal cases, alleging the theft of $5 billion by Iraqi officials, including a former defense minister accused of stealing or misspending more than $1 billion. According to a spokesperson from the Department of Defense (DOD)'s criminal investigations area, its office expected a "rise in referrals of potential fraud or corruption cases [in Iraq]" (Dawn Kopecki, "When Outsourcing Turns Outrageous," *BusinessWeek*, July 31, 2006). Meanwhile, the GAO reported in July 2006 that the DOD had "recovered about $2 billion since 2001 from all outside contractors and government procurement officials accused of dishonesty or mismanagement, but the GAO didn't isolate those working in Iraq."

The U.S. Department of Justice (DOJ) announced on February 7, 2007, that a federal indictment had been unsealed charging five people with rigging bids on contracts and stealing millions of dollars from the Coalition Provisional Authority, which had been created by the United States and the United Kingdom to rebuild Iraq. More than $3.6 million is estimated to have been lost from the fraud, with more than $2 million recovered. At a February 7, 2007, press conference announcing the charges, Deputy Attorney General Paul J. McNulty said, "This indictment is part of the first major investigation being prosecuted by the Department of Justice to root out corruption and fraud in the awarding of Iraq reconstruction contracts."

A 2007 hearing of the House Committee on Oversight and Government Reform indicated that the DCAA director was to testify that there are more than $10 billion in questioned and unsupported costs relating to the Iraq reconstruction and military support contracts. This estimate is a result of a review of $57 billion of Iraq contract spending, with another estimated $300 billion of contracts remaining to be audited.

The Role of Halliburton

The single fastest-growing federal contractor between 2000 and 2005, Halliburton, is often mentioned in connection with the Iraq rebuilding effort and the obstacles it has encountered. From the Waxman report: "In 2000, Halliburton was the 20th largest federal contractor, receiving $763 million in federal contracts. By 2005, Halliburton became the 6th largest federal contractor, receiving nearly $6 billion in federal contracts." Indeed, in 2001, Halliburton's subsidiary Kellogg, Brown & Root (KBR) received the largest cost-type contract: the Logistics Civil Augmentation Program (LOGCAP), valued at $16.4 billion, to provide food, shelter, and other support services to U.S. troops in Iraq, Afghanistan, and other locations (Jeremy Kahn, "Will Halliburton Clean Up? The Company That Dick Cheney Once Ran Stands To Make Millions Rebuilding Iraq," *Fortune*, April 14, 2003). Waxman's report noted that Halliburton earned more than $5 billion on this contract.

Kopecki reported that, by July 2006, the Army ended its 10-year multibillion-dollar contract with KBR to supply food, water, shelter, and other basic needs to U.S. troops. At that point, the Pentagon had paid KBR $15 billion since 2001, and planned to divide the contract between four contractors, but KBR was to be permitted to bid for a portion of the contract. KBR came under scrutiny when DOD auditors indicated "$1.2 billion in 'excessive,' 'duplicative,' or otherwise questionable charges." KBR officials called its costs reasonable, considering that the work was done under "extraordinarily hostile conditions." KBR also said it had resolved most of the audit disputes with the Army.

DCAA government auditors found several problems with the work conducted by Halliburton under the LOGCAP contract. As noted in Waxman's report:

> After identifying 'significant unsupported costs' and 'numerous, systemic issues' with Halliburton's 'inadequate proposals,' DCAA recommended on three occasions that the Army begin withholding a portion of contractor payments until Halliburton corrected the deficiencies as federal law requires. In total, DCAA identified over $1.1 billion in questioned and unsupported costs under this contract.

Still, according to Kopecki, "a recent study by the nonpartisan Congressional Budget Office concluded that in 2004 the U.S. reduced its costs by one-third for feeding and housing troops by paying one contractor to do the work—a savings of nearly $3 billion. Such findings point to the conclusion that even with a lot of fraud and waste, outsourcing may still pay off."

Waxman's report noted another contract awarded to Halliburton (called RIO, it was to restore and operate Iraq's oil infrastructure) that was approved in March 2003 for KBR in a no-bid process: "Halliburton charged approximately $2.4 billion under the RIO contract, split generally between oil infrastructure projects and fuel importation."

According to one press account (Paula Dwyer and Frederik Balfour, "Iraq Deals: Who Got What—and Why; How the Big Contracts To Rebuild the Nation Were Awarded," *BusinessWeek*, May 5, 2003), selecting Halliburton was: "an emergency process that did not involve competitive bidding. The Army Corps of Engineers similarly awarded a contract to extinguish oil-well fires to KBR because it had the expertise and specialized resources. KBR helped douse approximately 300 oil fires in Kuwait after the first Gulf War in 1991."

USAID, the principal U.S. agency that extends assistance to countries recovering from disasters and engaging in democratic reforms, reported that competition for rebuilding Iraq was limited due to the timeframe. It took just 63 days to complete a process that usually takes six months. USAID Administrator Andrew S. Natsios said that, "For political and humanitarian reasons, the Iraq project couldn't wait … We wanted it all in place so we could begin construction immediately" (Dwyer and Balfour, 2003).

The Aftermath

Many skeptics have criticized Halliburton for inflating costs, and DOD auditors have concurred. Waxman's report noted that, in audits of the 10 task orders under the RIO contract, DCAA identified $219 million in questioned costs and $60 million in unsupported costs. DCAA auditors found exceptions in most aspects of Halliburton's work, including excessive charges to import fuel into Iraq from Kuwait and unnecessary retroactive payments to its Turkish fuel subcontractors. Since March 2005, multiple Halliburton officials have been indicted or convicted of corruption-related charges involving contracts in Iraq.

Some critics have likened Halliburton's sale of KBR and planned move of its headquarters to the United Arab Emirates (UAE) to fleeing the scene of the crime (Jim Donahue, "Halliburton Bails Out of Iraq, KBR and Now America," www.halliburtonwatch.org, March 12, 2007). Halliburton moved to the UAE at a time when it is being investigated in the United States for bribery, bid-rigging, defrauding the military, and illegally profiting in Iraq. Although Halliburton remains incorporated in the United States, Donahue noted that moving its corporate headquarters to the UAE makes it easier to avoid accountability from federal investigators and to avoid U.S. taxes. Furthermore, the United States has no extradition treaty with the UAE.