

IRAQ RECONSTRUCTION: ENGAGING USA AND OTHER KEY DONORS

At the Madrid Conference in October 2005, 37 bilateral donors, the European Community, the World Bank and the IMF pledged a total of \$32 billion for Iraq's reconstruction. A significant proportion of this money remains unspent, for a variety of reasons. Some donors spread their funding over several years; some offered soft loans which could not be activated until Iraq's external debt problem had been resolved; some have been waiting for an elected government before opening a substantive dialogue; and many have experienced difficulties in implementing reconstruction projects in Iraq's security environment. One or two donors are simply backsliding.

2. To press for improved donor performance, **Annex A** identifies 16 countries for priority lobbying by the UK and summarises the action proposed. The forthcoming Brussels International Conference and Donor Committee meeting in Amman offer key opportunities.

USA

3. The USA is committed to as rapid as possible disbursement of its funds. While we have limited influence over US policy, and are not questioning its current thrust, we should pursue dialogue with the US in three main areas:

- continuing efforts to join up US work in southern Iraq with ours, including through DFID's technical teams in Basra;
- encouraging the USA to engage effectively in the new donor coordination processes being developed in Baghdad; and
- working with the USA on encouraging other donors and multilateral agencies to contribute more effectively to the reconstruction process.

4. The key immediate messages for the USA are that we should work together to:

- a. press the Iraqi Government to negotiate an IMF Programme before the end of 2005 so that it qualifies for the second tranche of Paris Club debt reduction;
- b. encourage the Japanese and World Bank to focus in a coordinated way on funding the power sector – using up to \$3.5 billion in Japanese soft loans and a Bank IDA programme;
- c. press the World Bank to establish a presence in Baghdad;
- d. press Gulf States, particularly Kuwait and Saudi Arabia, to deliver debt deals comparable to the Paris Club's November 2004 deal; and
- e. put pressure on those donors which appear to be backsliding on their Madrid commitments –

Other Bilateral Donors

5. Recent discussions with the **Japanese** have focused on their plans for spending \$3.5 billion of soft loans pledged at Madrid. We are encouraging Japan to allocate the bulk of this money to the power sector, working closely with the World Bank which we also want to focus on power. The Japanese have recently agreed to allocate the remaining \$100m of their \$1.5 billion grant funds to building a 60MW power station in southern Iraq.

6. We are exploring with **Australia** and **Denmark** the possibility of cofinancing DFID projects in southern Iraq, which would enable them to use DFID expertise and life-support facilities in implementing their own assistance. **Canada** may be interested in similar arrangements, which DFID is also pursuing.

7.

8. The Gulf States made large pledges at Madrid: over \$1.3 billion between **Kuwait, Qatar, Saudi Arabia** and **UAE**. Arab funding channels are less

transparent than those of OECD donors, but it appears that much of this money has yet to be spent. The reasons appear to include a wish to negotiate with the ITG rather than its predecessors, and to see Iraq's debt issues resolved before providing soft loans. We are working to support the USA in pressing Gulf States to write-off 100% of Iraq's debts. The UK itself will follow the Paris Club's 80% write-off.

9. Other non-traditional donors making important pledges at Madrid were **China, Republic of Korea and Turkey**. Their spending allocations are unlikely to be influenced significantly by UK lobbying. We should however keep up pressure generally for quick disbursement – preferably in key areas of infrastructure such as power and water – and good coordination with other donors. We will at the same time explore any opportunities for cooperation on the ground.

10. **France and Germany** remain the two main missing donors although France has taken a constructive approach on donor coordination and the Brussels Conference, and Germany has been contributing to the police training effort (outside Iraq). We should use preparations for the Conference to explore areas in which a high level approach might unlock funding.

11. **Annex B** identifies 19 smaller donors, or potential donors. Many, but not all, have made progress in spending, often through multilateral channels including the World Bank and UN Trust Funds. The transaction costs of cofinancing with such donors are likely to be high, as would having them engage bilaterally with the Iraqis. Action should therefore be confined to encouraging those which have not disbursed their pledges to do so through those multilateral channels which are showing themselves to be effective.

Multilaterals

12. The key multilaterals in the long term are the **World Bank and IMF**. An early approach to Wolfowitz is a priority in order to follow up on the PM's and International Development Secretary's correspondence earlier this year with

Wolfensohn. The main issues are the lack of a presence by either organisation in Baghdad, the Paris Club deal's requirement for Iraq to negotiate an IMF Programme by end-2005, and the urgent need for the Bank to find ways of implementing projects on the ground in Iraq – if necessary by reprioritising its portfolio in consultation with the ITG. Meanwhile, DFID is working with the Bank to follow up on its agreement in principle to channel up to \$20m of unallocated trust fund money through our southern Iraq infrastructure project. We are also providing two consultants to work for the Bank at a strategic level in the Iraqi Ministry of Electricity.

13. Implementation of reconstruction projects by **UN agencies** has picked up recently, and the SRSG's team in the UN Assistance Mission for Iraq (UNAMI) is taking a tough line with those agencies which have been underperforming. DFID is continuing to press for further improvements to Trust Fund operations and is supporting UNAMI's efforts to manage UN processes more effectively. The UN is also now playing a valuable role in supporting Iraqi-led donor coordination in Iraq. The Trust Funds remain an important means by which donors without a presence in Iraq can channel their finance towards meeting Iraqi government priorities. We are therefore keen to promote their use in areas where they show that they can work effectively.

14. DFID is in regular contact with the **European Commission** on EC aid to Iraq. The bulk of EC funding is channelled through the Trust Funds – on which the Commission generally shares DFID's analysis. The bulk of the €200m 2005 allocation is likely to go to UN agencies which have shown themselves to be capable of working on the ground in Iraq. The Commission is well aware of our view that it should open a permanent office in Baghdad as soon as possible, and meanwhile is making use of HMG life support and security facilities for its increasingly frequent visits to Baghdad.

MENAD, DFID

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Annex A: IRAQ RECONSTRUCTION: MAIN BILATERAL DONORS, MAY 2005

	Total Pledges	Madrid Pledge	IRFFI	Other	Estimated Balance	Comments and Action
<u>Key partners</u>						
Australia	90	46	18	39	32	Working-level discussions underway on possible co-financing in S Iraq: Australians interested in principle.
Canada	222	188	60	8.6	119	Canadians keep to cooperate; good working-level relations; DFID pursuing co-financing possibilities.
Denmark	85	27	5	6	74	Working-level discussions underway on possible co-financing in S Iraq: Danes interested in principle.
Italy	236	236	12		224	Italian planning unclear: follow-up needed at senior official level (DFID/FCO) in Rome, followed if necessary by Ministerial contacts.
Japan	5,000	5,000	500	900	3,600	Continuing working-level discussions on allocation of \$3.5bn soft loans, including joining up Japanese and World Bank on power sector.
Spain	300	220	20	23	177	Spanish planning unclear: follow-up needed at senior official level (DFID/FCO) in Madrid, followed if necessary by Ministerial contacts.
USA	21,000	18,600	10	7,000	14,000	Continuing discussions at all levels; US intentions for remaining allocations clear; important to draw US into effective donor coordination.
<u>Gulf States</u>						
Kuwait	500	500	10.0		490	Most funding has not been allocated pending the formation of the TNG and the capacity of the Iraqis to take up concessional loans from eg the Kuwait and Saudi development funds. Need now to press in capitals for early spending, as well as for quick resolution of outstanding debt – especially from Kuwait and Saudi Arabia. Scope for US lobbying support. Cofinancing prospects unlikely.
Qatar	100	100	5.0		95	
Saudi Arabia	500	500	0		500	
UAE	215	215	0	32.4	182.6	
<u>Others</u>						
China	25	25	0		25	We are unlikely to have significant influence over timing and direction of spending. But we need to keep up general pressure for early disbursement, and see if there are any avenues for further cooperation. Action in capitals.
Korea	260	200	10.0		190	
Turkey	50	50	1.2		48.8	
<u>Potential Donors</u>						
France		none	0		N/A	Political decision needed on any significant contribution.
Germany	150	none	0		N/A	Assistance mainly to police training; political decision needed on any significant reconstruction finance.

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Annex B: IRAQ RECONSTRUCTION: SMALLER DONORS, MAY 2005

	Total Pledges	Madrid Pledge	IRFFI	Other	Estimated Balance	Comments
Austria	5.5	5.5	0	1.7	3.8	Funding to UNHCR and hospitals; encourage use of multilateral channels.
Belgium	5.9	5.9	1.2	4.3	0.4	Belgium has contributed to UN agencies and ICRC.
Czech Rep.	14.7	14.7	0	2.3	12.4	Encourage use of multilateral channels
Finland	5.9	5.9	6.5		0	Funding through IRFFI.
Greece	3.6	3.5	3.7		0	Funding committed to IRFFI and demining.
Hungary	1.2	1.2	0		1.2	Funding promised for technical assistance and training.
Iceland	2	2.5	1.5		1	Funding committed to IRFFI and prosthetic project.
India	10	10.0	5.0		5	Funding through IRFFI.
Iran	5	5.0			5	Promised funding through IRFFI.
Ireland	3.5	3.5	1.2	1.1	1.2	Funding committed to IRFFI and supporting Marsh Arabs.
Luxembourg	2.4	2.4	1.2	0.2	1	Funding through IRFFI and Caritas Luxembourg.
Netherlands	9.4	9.4	12.9	6	0	Funding through IRFFI.
New Zealand	3.4	3.4	0.9	3.8	0	Funding through IRFFI and bilateral projects.
Norway	33	12.9	9.2	0.6	3.1	IRFFI, humanitarian assistance and private sector development.
Oman	3	3.0	0		3	Funding through IRFFI.
Pakistan	2.5	2.5	0	0.6	1.9	Health and humanitarian assistance.
Portugal	0	0				Encourage a multilateral contribution
Sweden	55	33.0	12.6	18	2.4	Allocated to support democracy, human rights and infrastructure.
Switzerland	0	0				Encourage a multilateral contribution