JIC Assessment, 15 February 2006

IRAQ'S DEVELOPMENT: EXPECTATIONS AND DELIVERY IN 2006

This paper was discussed and approved by the JIC at their meeting on 15 February 2006.

Key Judgements

I. Iraqi public opinion is divided about whether Iraq is heading in the right direction: Sunni Arabs are overwhelmingly negative; the Shia and Kurds are mostly positive. Most Iraqis express confidence that the country will recover. The new government will largely be judged on their ability to deliver security, fuel, electricity and jobs – and a timeline for MNF withdrawal. In the next 12 months there will be little progress on the first four issues.

II. The security situation (general lawlessness, the insurgency, and growing sectarian violence) is the greatest immediate obstacle to economic recovery.

III. The new government will be no more competent or united than its predecessor, at least initially. The Iraqi civil service at all levels lacks the ability to deliver; building its capacity will be a long process. […]

IV. Economic reform and growth are key to meeting Iraqi expectations. The new Iraqi government will be under international pressure to revitalise the oil sector and push ahead with economic reforms – particularly subsidy reduction. But they will be cautious of a backlash which might prompt further localised public disorder and violence.

V. The oil sector is crucial, providing some 90% of income. Oil production and exports remain well below pre-2003 levels; exports should improve slightly in 2006 compared with last year. Electricity output is only meeting 45% of demand: there is no prospect of significant improvement in 2006.

VI. International pressure will provide an incentive for reform, but there is no 'international solution' to improving the levels of services in Iraq. Bilateral and multilateral donors will continue to play a supporting role, but the scale of Iraq's fiscal difficulties means that ultimately a solution can only come from within Iraq itself.

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At the request of the Senior Officials Group on Iraq, we draw together opinion polls of Iraqis' expectations for their new government, and assess the extent to which they will be met during 2006. Detailed examinations of the ISF and security prospects are contained in other JIC assessments.

What do Iraqis want?

1. Our understanding of Iraqi public opinion is limited. A number of opinion polls provide some insights, but surveys are constrained in Iraq by the poor security situation, particularly in Sunni areas. Subject to that caveat, polling from December 2005 indicates that Iraqis want their new government to focus on, in order of priority: building infrastructure; economic development; securing Multinational Force (MNF) withdrawal; and fighting government corruption (see annex A). Opinion is divided about whether Iraq is heading in the right direction. A number of polls conducted in late 2005 and early 2006 show striking regional variation. In central and western provinces (mainly Sunni Arab), an overwhelming majority felt the country was heading in the wrong direction, and felt the government had performed poorly. In mainly Kurdish and Shia areas attitudes were more positive: 80% said the government had performed very well or quite well. However, irrespective of views on government performance, in another December poll almost all respondents across Iraq expressed dissatisfaction with the availability of market goods, school reconstruction, infrastructure development, and employment prospects. Of those who felt Iraq was heading in the wrong direction, the security situation was most often cited.

2. However there were also many upbeat responses, which may be attributable to national pride as much as to current reality: in a BBC poll, two thirds of respondents expressed confidence in the Army and Police, and 50% claimed they felt safe. There was overwhelming support (74%) for a democratic system of government, although 75% also wanted a single strong leader in the short-term. Iraqis claim to trust their own institutions more than outsiders: in the BBC poll only 30% said they trusted the UN; the Coalition scored less than 20% - and 87% across Iraq would like their new government to set a timeline for MNF withdrawal.

Security

3. The security situation is the greatest immediate obstacle to economic recovery. Lawlessness is now entrenched in many major cities across Iraq. Iraqi security forces (ISF) are primarily focussed on counter-insurgency operations rather than improving law and order. Even police units in relatively benign areas conduct very little normal police work, and some officers are involved in extortion and blackmail. We judge that police ability or willingness to tackle ordinary crime is unlikely to improve significantly during 2006. We have previously judged that a significant insurgency in Sunni Arab areas will persist beyond 2006. As long as the insurgency remains strong, reconstruction in these areas will be very difficult – in itself fuelling further discontent. Sectarian violence is a growing problem.

Will the new government be up to the task?

4. The Transitional Government achieved little in delivering public services and was unable to agree on a strategy for tackling infrastructure requirements. The new government will not be any more competent or united, at least initially. The new Prime Minister, whoever he is, will have to develop policy within a more complex political landscape, now including Sunni Arab groups and the unpredictable Sadrists. Some Ministers from the last administration will be retained; others will have little or no experience of government. Once formed, there will be a protracted period of settling in. Any "national unity" government is likely to be fragile and prone to reflect the more factionalised Council of Representatives. The tendency of new Ministers to replace the top tier of officials in their Ministries with friends, family, or tribal members will add to the difficulties.

5. The Iraqi civil service lacks the capacity to deliver at all levels. Some ministries (eg Oil) were unable to spend their 2005 budget allocation. Although there are talented individuals, institutional capacity was effectively destroyed under Saddam's dictatorship and in the aftermath of his overthrow: de-Baathification, which removed many experienced bureaucrats, has been particularly damaging. Building up civil service capacity in both Baghdad and the provinces will be a long process, which we judge will not achieve significant results during 2006 even with substantial international support. Endemic corruption is a significant brake on economic development, pervading the highest levels of government, but also reaching into provincial and local levels.

6. Provincial elections and the constitution review are likely to be particularly divisive if they are pursued as planned in 2006. Provincial administrations have even less capacity and less adequate funding than the centre, although local government (and the economy) is more established in the more secure Kurdish region. […]

The economy

7. Economic reform and growth will be key to delivering Iraqi expectations. The value of Iraq's economy halved between 1999 and the end of 2003 as a result of sanctions, declining oil revenues, and deteriorating infrastructure. From this low base, the economy grew rapidly in the immediate aftermath of the 2003 conflict, and per capita GDP has risen by over 10% since 2004. Inflation has also been kept under control. But, at 3.7%, GDP growth in 2005 was lower than is usual in post-conflict economies.

8. A budget for 2006 has been approved, with revenue estimated at $30bn – a deficit of $3.7bn. The transitional government signed an agreement with the IMF allowing access to $685m of loans, and provision for the cancellation of $30bn of debt with the Paris Club creditors. In return, the Iraqi Government has signed up to an ambitious economic reform programme, although it remains to be seen whether the new government will be willing or able to comply with all the IMF requirements.

9. The new government will be under international pressure to revitalise the oil sector and push ahead with economic reforms, but they will be cautious, especially with provincial elections expected in the coming months. Some of the measures required by the IMF will stir public discontent. Reducing domestic fuel and food subsidies (57% of 2005 government expenditure) will be central to funding long-term reconstruction

and economic reform, but will increase prices. The trebling of fuel prices in some provinces at the end of 2005 led to small-scale street protests. Most Iraqis in a survey in late 2005 said they would protest peacefully against further price rises, although in Babil, a Shia province, some claimed they would accept modest price rises if this lead to better public services. Ultimately, we judge that during 2006 Iraqis are not likely to engage in widespread violent mass protests in response to economic reforms.

Electricity and oil: slow progress from a low base

10. Although near the top of the public's list of concerns, there will be no early progress in improving energy supplies. Most of Iraq's infrastructure is decades old, suffered years of under-investment, and is in a fragile state. Insurgent and criminal attacks will remain a major problem. The 12,000 miles of pipelines and power lines are difficult to protect: attacks on the key Bayji to Baghdad power line are frequent, and have blacked out most of Iraq on several occasions. Security and maintenance personnel (foreign and Iraqi) are increasingly unwilling to continue working – they are constantly targeted by insurgents, and unreliably paid by the Iraqi government.

11. Current electricity production meets only about 45% of demand. There are only 9 hours of power per day on average (only 5 hours in Baghdad). Substantial capital investment is required (estimated at $10bn over the next 10 years); the Ministry of Electricity's capital budget is inadequate, at $766 million for 2006. Some extra output capacity should be added this year, but with poor security and maintenance, we judge that there is no prospect of significant improvement in output in 2006, and only slow progress over the next 3 years. Demand will continue to rise faster than new output capacity. External supplies (eg from Iran) can not make up the difference; the weak Iraqi infrastructure is the limiting factor.

12. Iraq's oil industry is crucial to future economic development, providing over 90% of government revenues. A fall in oil prices would have a major impact, although a significant price reduction is highly unlikely this year. Oil production and exports currently remain well below pre-2003 levels (see annex B), although exports should improve slightly during the year compared with last year. One International Energy Agency analysis predicts that even with a stable security environment it could take until the end of the decade for Iraq to reach its previous peak output of 3 million barrels per day. Iraq also suffers from a lack of refining capacity, and consequently depends on imported petroleum. Intelligence confirms that the government has had trouble paying for imports from Turkish, Kuwaiti, and UAE oil companies.

What happens if Iraqis' expectations are not met?

13. Most of the serious economic problems are not new – many are the legacy of the Saddam era, and Iraqis have proven resilience. Most Iraqis express a confidence that the country will recover. But the new Iraqi government, increasingly wishing to distance itself from the Coalition, will have to shoulder the burden of heightened expectations, which will have to be carefully managed. The government will largely be judged on its ability to deliver key services: the provision of fuel, electricity and jobs.

14. Security and economic recovery are inextricably linked. However in the next 12 months there will be little progress on any of the issues common to most Iraqis, which may result in further localised public disorder and violence. If in the longer-term the economy fails to grow significantly, consistently failing to

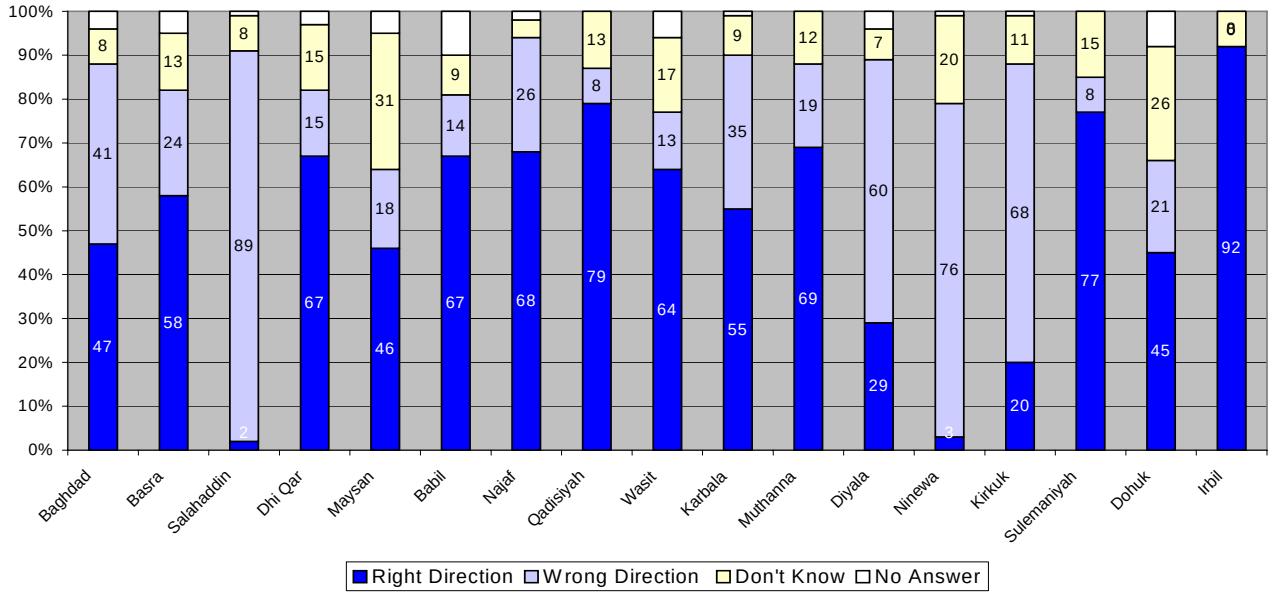
meet public expectations, protests are likely to become more widespread. Perceived sectarian favouritism in the allocation of reconstruction resources, or further serious disputes over federalism and the control of natural resources, could damage the government's chances of surviving a full term.

International Assistance

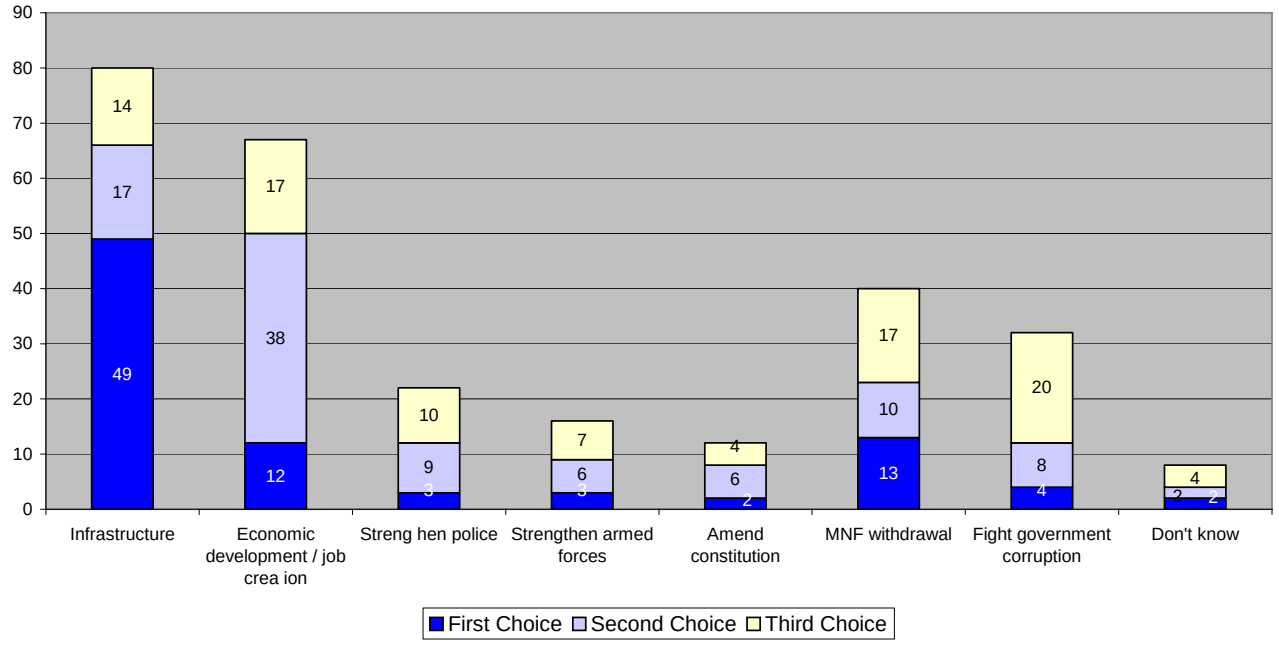
15. While international pressure (eg from the IMF/Paris Club) will provide an incentive for reform, there is no 'international solution' to improving the levels of services in Iraq. Investment in physical construction alone will not deliver benefits unless it is supported by a long-term maintenance regime and trained staff. The Iraqi government needs to adopt a strategy to increase growth and invest in services and infrastructure. Bilateral and multilateral donors will continue to play a supporting role, for example by helping strengthen the budget process or by providing technical advice. But the scale of Iraq's fiscal difficulties means that ultimately a solution can only come from within Iraq itself.

Annex A – IRI opinion poll, 7 December 2005

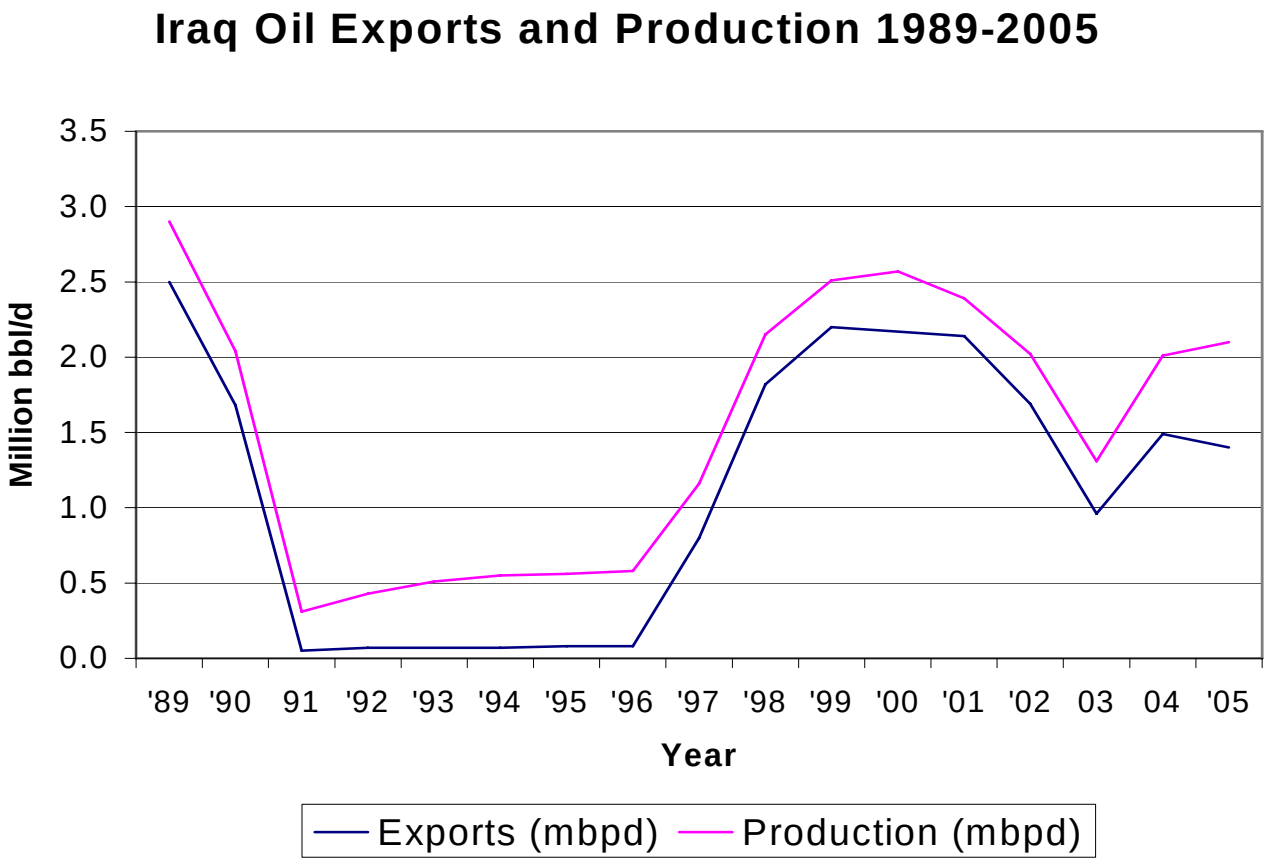
Do you feel that Iraqi is generally heading in the right direction or the wrong direction?



What do you want the party or coalition that you vote for to make its highest priority during 2006?



Annex B


Iraq Oil Exports and Production 1989-2005
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Million bbl/d
'89
'90
91
'92
'93
'94
'95
'96
'97
'98
'99
'00
'01
'02
03
04
'05
Year
Exports (mbpd)
Production (mbpd)