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INFO IMMEDIATE BRITISH OFFICE BAGHDAD, CABINET OFFICE, CPA BASRA
INFO IMMEDIATE DFID, HM TREASURY, IBRD WASHINGTON, UKDEL IMF
INFO IMMEDIATE UKMIS NEW YORK, WASHINGTON

CABINET OFFICE FOR PS/NO 10

SUBJECT: IRAQI ECONOMY: DOES EXPENDITURE NEED UNBLOCKING?

SUMMARY

1. For now the answer is probably no - given absorptive capacity and security conditions. Money is coming through via DFI: a new "seven cities" programme is to be launched for trouble spots. Further disbursements will rise as PMO implement projects under the Supplemental. An immediate acceleration of disbursements risks wasting funds on ill-prepared projects and straining the budget by introducing running costs for which there is insufficient provision. Donor money will need to supplement the capital expenditure line in the budget for some years. Creating employment will over time improve security, but there is not always a direct correlation between areas of highest unemployment and insurgency rates.

DETAIL

2. DFID/HMT have been asked whether unblocking funding streams would improve the security situation. We understand that a view from IRAQREP would be welcome.

3. A disaffected, unemployed Tikriti can be bought for a few dollars to launch an attack on a member of the Coalition. It has passed no one by that project planning, fund disbursement and employment generation might help direct the Tikriti's efforts to more productive ends. There was a physical cashflow problem in the first quarter of 2004 which meant that even monthly salaries were being delayed. Those have been largely unblocked.

4. The 2004 Budget is now in place. It is designed to meet running/consumption costs rather than capital investment (which account for only USD2.5bn out of a total budget of USD17bn). Plans are being brought forward on how to spend the extra USD2.5bn recently made available through the DFI. The Program Review Board approved USD500mn of proposals this week. This included a "seven cities" initiative to inject funding into areas which pose significant security problems. It will disburse up to USD10mn in quick time (with up to a further USD20mn subsequently) in each of

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Baghdad, Fallujah, Ramadi, Tikrit, Baquba, Mosul and Samarah, with the aim of creating new employment. A new but refreshing condition of approval was that a robust monitoring and evaluation programme should accompany fund disbursement. DFID and USAID met CJTF7 commanders on 30 April to give guidance on how this could be done effectively.

5. In the immediate term, therefore, disbursing significant extra funds into projects is not the key issue. Indeed, to do so risks exacerbating a growing concern about inadequate quality control of proposals which can lead to wastage of resources and corruption. More thought must also be given to how to meet the additional running costs which will be created by capital/project expenditure and for which no budgetary provision is currently made.

6. There are mixed views in CPA about whether the training programmes it has promoted have fostered the skills which are most required (manual and technical) rather than those which sound most modern (IT literacy). Work is in hand to review whether the balance is right and, if not, how that might be addressed.

7. Using a CJTF-7 standard definition of "significant acts" against Coalition forces, CPA statistical analysis does not show a correlation between areas of highest unemployment and violence. Promoting employment in and directing projects to specific trouble spots will not produce immediate results. Longer-term, effective distribution of funding is therefore required.

8. That longer-term strategy will be delivered by the US Supplemental funding and other donor contributions (there will not be adequate capital investment in Iraqi Budgets for some time to come). It remains important that the appropriations process of disbursing committed funding maintains its momentum so that project managers can prepare the way for the contractors to begin work, allow the benefits to feed in to the local economy and improve essential services. Security conditions will inevitably delay implementation - but there is no point constructing a transmission line only for it to be blown up. PMO still speak of disbursing the Supplemental over the next four years, with up to 2000 individual projects running concurrently. That looks unrealistic. More important is to establish clear priorities for sequencing the projects to provide maximum benefit.

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ECPOL	0
ISLAMIC MEDIA	0
MENARG	0
PROTOCOL D//PALACE	0
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