

**IRAQ: RECONSTRUCTION UPDATE***8<sup>th</sup> February 2007***Summary**

- Iraq is enjoying an oil windfall and surging revenues. However, by October 2006 it had spent less than 14% of its planned \$8.2bn investment in public services.
- Security, lack of planning, and a dysfunctional budget process are to blame.
- GoI wants to set up a new council for reconstruction. The US is trying to boost short-term spending by throwing in extra capacity. The best solution is to get the line ministries planning and delivering services.
- Iraqis are showing greater leadership on economic elements of the Baghdad Security Plan.
- World Bank due to open its office in Baghdad and is well positioned to become GoI's partner of choice as the Coalition scales back in 2007.
- New push to communicate the UK's progress in Basra.

**Iraq's oil windfall**

1. With oil prices topping \$60 per barrel in 2006 and Iraq exporting up to 1.7 million barrels per day (mbpd), the Government is cash rich. Revenues in 2007 are estimated to reach \$37.6bn, rising at about \$1bn a month.
2. There is universal agreement that Iraq must boost public investment to lift oil production, provide electricity, and generate jobs. However, Iraq has been unable to spend its vast wealth. We estimate that in the nine months to October 2006, it had spent just 14% of the \$8.2bn allocated to public investment.
3. In some areas the picture is even bleaker. For example, by October the Ministry of Oil had spent just 1% of the \$3.5bn allocated in 2006. Likewise, in December 2006 the Ministry of Finance finally released the money it had promised the regions, and although they are allowed to carry it forward they now have a further \$2.7bn to spend in 2007. This chronic under spending has given the Government an estimated budgetary surplus of at least \$10bn.

**Why has the Government failed to invest?**

4. There are several reasons for the Government's failure to invest in public services. First, poor security remains the single biggest impediment to improved Iraqi planning and implementation of large scale public projects. Moreover, line ministries have failed to produce systematic and comprehensive investment plans, and the Prime Minister has not demanded them. Thus efforts to date remain ad hoc and the allocations in Iraq's budget are largely meaningless.

*we must get this sorted out*

5. Second, the Government's budget process is dysfunctional. The Ministry of Finance is responsible for disbursing and accounting for funds, whilst the Ministry of Planning reviews plans and makes allocations. This division of labour has created paralysis and mutual distrust.

#### **GoI's response**

6. The Iraqi government's response is to attempt to reorganise the machinery of government. The Council of Ministers has recently discussed legislation to set up a new National Council for Reconstruction and Development. It is envisaged that the Council, chaired by the PM, will implement major investment projects as set out in an annual plan, advise on development priorities in each province, and engage with the private sector in project implementation. It will have its own budget drawn primarily from unspent investment funds.
7. This proposal could be considered a throwback to the central-planning approach that Iraq used in the 1970s. Whilst the current system is dysfunctional, it is unclear how this new approach will solve or supplant existing problems. Setting up a new institution in charge of investment risks putting additional pressure on already weak institutions, centralising power, and increasing opportunities for corruption and politicisation. On the other hand, if the Council acts in an oversight role, it may help to galvanise line ministries to spend more effectively.

#### **Turning Iraqi money into effective public services**

8. In reality, there are few quick fixes to improving services in Iraq. The US is setting up a "Budget Execution Cell" in the Deputy PM Barham Salih's Office to address these shortcomings. This might produce some short-term results (mainly an increase in spend), but without clear investment plans for services, Iraqis are unlikely to see great improvements. Moreover, this model is unsustainable because Deputy PM Barham's office lacks sufficient competent staff to implement any recommendations. Furthermore, it will distract the Deputy PM from more strategic issues like the International Compact and the contentious hydrocarbons law.
9. Spending money more quickly is only part of the answer. Accounting for it and making sure that it translates into improved services is equally, if not more, important. We have consistently lobbied the Government to devise coherent investment plans for critical sectors (electricity, oil, water) and focus its efforts on making the line ministries function more effectively.
10. By proposing a new reconstruction council, the Government has recognised that something must be done. However, we worry that this prescription will distract attention from the hard work of improving the

*Can't we provide the answer?*

way Iraq manages public expenditure. The most effective solution is to merge the Ministries of Finance and Planning and integrate the budgeting and planning functions. We have proposed that the Government, with World Bank assistance, conduct a quick review of Iraqi public finances that also addresses institutional problems. We must help the Government realise that the bigger prize is to make what they have work better.

**Shock therapy: getting a grip of the electricity sector**

11. There is one glimmer of hope amidst the investment gloom. The Ministry of Electricity has been given \$1.3bn to spend in 2007, and has 500 MW of capacity coming online in the next few months. It has also announced \$900m of new projects, although these are unlikely to produce tangible results until late 2007. We judge it unlikely that Iraq will meet its summer production target of 6,500 MW (which it promised last year and failed to deliver).
12. The poor security environment is complicating the Government's efforts. Attacks, sabotage or repairs continue to make electricity transmission a major challenge. At present, eleven of Iraq's 400 kV lines (the very large transmission lines) are down, seven because of sabotage, two because of high winds, and two for "unknown" reasons. Six of these have been closed for almost 200 days. Lines that are repaired are frequently attacked again. Insurgents now also target repair workers.
13. Getting the right fuel (natural gas or diesel) to the power stations is difficult. The Ministry calculates that at any given time 1,000 MW is lost due to a lack of diesel. The Ministry's staff, including engineers at the rate of 50-60 a month, are also leaving due to intimidation and threats of violence. This further weakens an already fragile Ministry.
14. Nevertheless, despite all these difficulties, the Ministry is starting to get a grip of the electricity challenge and its initial response is encouraging. The Ministry of Electricity has requested expert advice from DFID and the World Bank to work up an investment plan to help them restructure the sector. We have responded positively and are currently finalising the details.

**Economic elements of the revised Baghdad Security Plan**

15. Quick impact projects and work creation schemes are an integral part of the refreshed Baghdad Security Plan. The US has previously tried this but in the past has been unable to sustain the benefits due to the lack of buy in from local officials. This time the US is pushing for much greater Iraqi leadership (including the use of Iraqi funds) to address that deficit.
16. The Iraqis have set up a range of committees to coordinate and synchronise the security, political and economic elements of the Plan.

Deputy PMs Barham Salih and Salaam Zawba'i will chair the economic and services committees respectively. The US has set up a coordination structure which mirrors the Iraqi committees. We expect the US and the Iraqis to discuss and approve priority projects in different Baghdad districts.

17. This is likely to have a short-term immediate impact and produce visible improvements for local residents. However, given the scale of the challenge and chronic lack of public investment, the Government must quickly produce plans for new infrastructure investment rather than simply plugging the gaps.

**World Bank engagement: building momentum**

18. Momentum is building behind the World Bank's engagement in Baghdad. The World Bank's Managing Director, Juan Jose Daboub, will formally open the World Bank's office next week during his visit to Baghdad. It now has three full-time staff members supported by DFID and protected under the HMG security umbrella. They are engaging on a range of strategic economic issues such as budget execution and the hydrocarbons law. It also aims to boost its pipeline of loans to the energy sector.
19. We are unlikely to see a step change in the Government's engagement with the World Bank in the short-term given GoI's focus on the Baghdad Security Plan. However, as the Coalition scales back during 2007, the World Bank is likely to become the Government's partner of choice. Thus, supporting the World Bank's presence and engagement in Baghdad remains a core part of HMG's strategy.

**Communicating progress in Basra**

20. To complement the UK's forthcoming statement on transition in mid-February, the PRT is organising for a delegation of Basra Provincial Council officials to visit Baghdad in the next few weeks. At Deputy PM Barham Salih's request they will discuss the implementation of their provincial development plan and put forward new initiatives for central government funding. PM Maliki's office will then host a joint UK-Iraqi press conference with the Basra delegation to communicate Basra's progress and outline how the UK-led PRT and other donors (UK, Japan, Denmark, US) have supported them to date.

DFID, 8<sup>th</sup> February 2007

## KURDISH REGION

**Facts**

Population: 6,988,656

Ethnic mix: Predominantly Sunni Kurd. Also Sunni Arab and Turkoman.

Main industries:  
Manufacturing and trade employ 40% of people, agriculture employs only 6%. Despite Duhouk being Iraq's least populated province, it provides 11% of Iraq's armed forces.

**Economic**

Economy: In 2004, per capita income in Kurdistan was 25% higher than for the rest of Iraq.

Whilst exports from Kurdistan's oil fields only resumed in mid-2006, Kurdistan is home to Iraq's first new oil well since the war (drilled in 2006). Oil production is hindered by attacks on the pipeline between the Kirkuk oil fields to the Bahi refinery, but a new pipeline is being constructed. Exporting oil is difficult because one of the two export pipelines to Turkey is completely non-operational while the other remains in poor condition.

All of Mosul's economic sectors are suffering due to poor security and Mosul faces unemployment and lack loans available to fund medium and small projects. Mosul has only one bank branch for every 29,000 people (about average for Iraqi cities).

Employment: Unemployment levels were lower than the Iraqi average in 2004; 41% of adults were in the labour force.

**Reconstruction effort / services**

Provincial Reconstruction Teams and Funding: Kirkuk has one PRT with a 2007 budget of \$13.9m. Kirkuk's Provincial Council has recently allocated its entire 2006 budget to 542 projects. Whilst project completion and quality remain challenges, this is a significant accomplishment given it did not receive the remaining 60% of funds until December 2006. Delay in \$37 million of Government funds reaching Ninewa has created distrust amongst local officials but the Iraqi PM has recently assured the funds will be released.

US funding for cities in Kurdistan:

Mosul	125 completed projects worth \$95m	51 projects underway worth \$56m
Kirkuk	54 completed projects worth \$174m	11 projects underway worth \$209m

Electricity supply: Available electricity falls well short of what is needed to sustain Kurdistan's economy. About 80% of Mosul's 1.75m people have electricity connected to their homes and receive about 10 hours power a day. The homes of most of Kirkuk's 750,000 residents receive 5-7 hours power a day.

Other services: The biggest problem for citizens is the lack of kerosene and LPG. Recent fuel shortages (particularly in Ninewa) have been caused by occasional closures of the Turkish border and payment disputes with Turkey.

53% of homes are connected to sewers (the highest proportion outside of Baghdad), but Kirkuk has no sewage system. 70% of people have piped drinking water. In December, Iraqi provincial health teams vaccinated 150,000 children.

Assessment base: UNDP, UN Living Conditions Survey 2004, PRT Assessments, UNHCR / IOM for Humanitarian, GRD Bi-Weekly Strategic Cities Report



## CENTRAL IRAQ

Anbar, Salah ad Din, Diyala, Al Qadisiyah

**Facts**Population: 4,778,301Ethnic mix: Predominantly Sunni Arab, with some Sunni Kurds in Diyala, and Shia Arabs in southern Anbar and southern Diyala.Main industries: Agriculture is the biggest sector (employing 24% of the population), followed by trade (17%) and manufacturing (14%). Anbar is mostly desert.**Economic**Economy: Funds from donors and the Government for reconstruction in Anbar have been delayed by the lack of a functioning banking system (their state-owned bank was robbed last summer). Some 62% of families have no access to fuel due to its unavailability or high cost.Employment: Central Iraq had higher than average employment figures in 2004. Salah ad Din in particular (the most stable governorate in the region) had the lowest unemployment out of all Iraqi governorates (45% of people were in the labour force in 2004).**Reconstruction effort / services**Provincial Reconstruction Teams and Funding: Anbar (\$8.9m) currently has one PRT. The US proposes to add two more. Although Anbar's PRT has identified many projects, security has prevented them being implemented. The Government has \$71 million to spend in Anbar, of which \$29 million has been allocated to projects. Apparently the Council has let many contracts but the impact is unclear. Diyala's PRT (\$8.9m) is very limited with moderate reporting. The security situation has also stopped the Provincial Council from meeting. The PRT is funding media to counteract insurgents' propaganda.

US funding for cities in central Iraq:

Fallujah	25 completed projects worth \$30m	49 projects underway worth \$52m
Ramadi	44 completed projects worth \$60m	25 projects underway worth \$103m
Samarra	38 completed projects worth \$30m	10 projects underway worth \$8m.

Electricity Supply

Most of Samarra's population (200,000) have power at least 12 hours a day. About 80% of the homes of Fallujah's 200,000 residents are connected to electricity lines, and they receive around 4-6 hours of power per day. Most of Baqubah's 500,000 residents have power for 6-12 hours per day (Iranian power augments local power).

Other services: Only 8% of Anbar's homes are connected to sewers (the lowest proportion in Iraq). About 90% of Baqubah's homes are connected to the water mains and 65% to sewage lines. Approximately 80% of homes in Fallujah are connected to the water distribution system, but there is no sewage system. Samarra has no operating water department to maintain the city's main water plant – currently operating at about 20% capacity. There is no sewage system in Samarra.

Before 2003 Ramadi has a population of 446,000 – violence has reduced this to around 100,000. 60% of Ramadi's homes are connected to water lines. Many Ramadi streets have deep standing water because of broken water mains and a high water table. Once complete, a US funded bridge will be closed immediately to prevent insurgents getting further arms across the river to downtown Ramadi. A new health clinic had to be imploded because insurgents had buried dangerous items under the building.

Assessment base: UN households survey, PRT assessments, PDMIN Report Jan 07; IOM

## JTHERN-CENTRAL IRAQ

Wasit, Diwaniyah, Karbala, Babil, Najaf

**Facts**Population: 4,230,470

Ethnic mix: Najaf has a mixed Shia Arab/Sunni Arab population. The rest of the region is predominantly Shia Arab.

Main economy:

Najaf is home to Iraq's second largest business, the Imam Ali Foundation. Najaf has an industrial base including state-owned industries in rubber pipes and garments. Hilla connects Baghdad and southern Iraq. It trades in food, livestock and agricultural products. Outside Najaf, agriculture is the biggest employer (22%).

**Economic**

Economic situation and poverty: Mean incomes in Hilla are 14 % higher than in Baghdad and 29% higher than in Najaf.

Employment: Unemployment was lower in south-central Iraq than the national average in 2004, with the exception of Najaf, where 60% of the adult population were not in the labour force (despite the many jobs generated by the pilgrimage industry).

**Reconstruction effort / Services**

Provincial Reconstruction Teams: Najaf doesn't yet have a fully fledged PRT but there is a proposal to reintroduce Coalition forces, and establish a full PRT. Babil Provincial Council is now responsible for all rapid reconstruction funds and development funds. PIC in Babil is planned for April 2007

US funded projects:

North Babil:	130 completed projects worth \$15m	24 projects underway worth \$57m
Najaf:	123 completed projects worth \$11.2m	60 projects underway worth \$67m

Electricity supply: About 90% of the homes of Najaf's 482,000 people are connected to electricity. They receive power for 6-8 hours a day. About 80% of North Babil's 320,000 people receive about 7.6 hours of power per day.

Other services: Najaf has better waste collection, roads, water supply and sewers than other Iraqi cities. Najaf has been especially damaged by violence (one in ten homes affected by military action). 30% of Najafi's homes are connected to drinking water and 40% have sewage lines connected. Najaf's infrastructure is insufficient to meet demand from pilgrims. The British architects Llewelyn Davies Yeang have been appointed to prepare a Masterplan for the future development of Najaf.

Throughout south-central Iraq, 14% of homes are connected to sewers and 76% have piped drinking water (although only 25% of homes are connected to water distribution lines in North Babil).

Inequality in secondary and tertiary education is particularly marked in Najaf (less than 30% of tertiary students are girls). Najaf and Wasit have some of the highest rates of malnutrition in Iraq (around 33% in 2005), but Karbala has one of the lowest rates (17%).

Over the past few weeks, the ICRC has improved the water and sanitation infrastructure of 21 primary health care centres in the region.

Assessment base: Taheri, 2004, IOM. UN Household survey 2004, UN Habitat, PRT Assessments.

## JTH-EASTERN IRAQ

Maysan, Dhi Qar, Muthanna, Basra

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## Facts

Population: 4,588,092

Ethnic mix: Muthanna and south western Basra have a mixed Shia Arab/Sunni Arab population. The rest of the region is predominantly Shia Arab.

Main industries:

Basra governorate has the greatest oil wealth in Iraq. Trade is the biggest employer (19%) closely followed by agriculture (18%, but only 4% in Basra). Agriculture is important to the economy of Dhi Qar's largest city, Nassiriya. Nassiriya manufactures aluminium, electric cables, textiles and blankets.

**Economic**

Economic situation and poverty: 2003's economic boom has slowed down as deteriorating security has reduced consumer and investor confidence. Growth has mainly been in subsistence agriculture, oil, small trading, services (e.g. car maintenance) and services to the construction industry (tailing off with a reduction in foreign aid). Failure to implement laws to accommodate outside investors has impeded investment in local oil and banking sectors. Basra has 13% of Iraq's small enterprises (6062), mostly in the industrial sector, employing 10,213 workers. This number is falling with the difficulty of getting bank loans, real estate guarantees and information about markets and goods. Eight foreign banks have set up subsidiaries in Basra, but the economy remains largely cash based.

Fruit and vegetables grow well in southern Iraq, although agriculture, particularly dates, has suffered from collapsed irrigation systems and water pollution. Food is wasted because it is difficult and expensive to transport, and high trade barriers to Kuwait make it impossible to export food (the PRT in Basra are working to lower these barriers).

A fire in the Khor Al Amaya oil terminal left Basra oil terminal as the only reliable export terminal in Iraq, whose failure would result in economic collapse. Umm Qasr port (Iraq's only deepwater ocean port) and Khawr Az Zubayr together receive at least three ships a day and could accommodate double this.

Employment: In 2004, unemployment was similar to the Iraqi average for Basra and Maysan but very high for Muthanna and Dhi Qar (where 66% of the adult population were not part of the labour force). Recent estimates suggest around 45% of people in Basra are unemployed (or in the black economy). Increasing unemployment is due to lack of economic growth, lack of funds for the private sector and an under-trained and under educated workforce.

**Reconstruction effort / Services**

Numbers and budgets of PRTs: The Italians run a PRT in Dhi Qar (\$8.9m) whilst the UK runs a PRT in Basra (\$40m). The Iraqi Government has provided \$400m to southern Iraq to spend on reconstruction (expected to double in 2007). Basra Provincial Council has approved over 300 projects to deliver essential services. Delays in receiving funds from central government are causing problems, particularly in Dhi Qar, who had to allocate 60% of its \$147m budget between mid-November and 31 December. In Basra, the US has funded 140 completed projects worth \$398m and has 216 worth \$707m underway.

Electricity: Basra and Nassiriya have one of the best electricity supplies in Iraq (10 hours per day).

Other services: Only 21% of homes in Basra receive piped drinking water (lowest in Iraq) and 33% are connected to sewers. In summer 2006 work began to extend Basra's sewage system to a further 500,000 people. Basra has the worst maintained roads in the country. In 2006, 60% of the Marshlands in Basra, Maysan and Dhi Qar had been re-flooded.

Assessment base: ICLA, 2004, UN living conditions survey, Rassam 2006.

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## BAGHDAD

**Facts**

Population: 6.6 million - one quarter of the country's population.

Ethnic mix: Whilst predominately in a Sunni region, Baghdad is a mix of various communities: Arabs, Kurds, Turkmen, Christian, Assyrians and particularly Sunni and Shia Muslims.

Main industries: Trade employs 22% of people, followed by manufacturing (17%) then agriculture (6%).

**Economic**

Economic situation and poverty: About 35 per cent of Baghdad's workers are estimated to be living in poverty. Household incomes are below the national average.

Employment: Baghdad has higher unemployment than most other Iraqi cities. In 2004, 40% of adults were in the labour force.

**Reconstruction effort / Services**Numbers and budgets of PRTs:

There is currently 1 PRT in Baghdad (with 7 Brigade Combat Teams), and proposals to add 5 more. The Municipality received 60% of its budget in December, which they must spend by April 2007.

The US has funded 473 completed projects worth \$1.68 billion in Baghdad, and has another 158 projects worth \$85.7m underway.

Electricity supply: About 75% of homes and business are connected to electricity lines and they receive about 4.6 hours of power a day.

Other services: Reasonable water supply. The main supplier of potable water to Baghdad has been refurbished, but is one of the few water facilities to have been attacked because of its high profile as the main source of Baghdad's drinking water. The city has sewers but waste management is a problem. 79% of homes are connected to sewers (highest in Iraq) and 97% receive piped drinking water. The availability of fuel has improved recently but queues are the norm.

Attacks and 'pipe tapping' against refined oil lines have contributed to recent fuel shortages.

A national blood transfusion centre has been established in Baghdad.

Assessment base: UN Households survey, 2004. PRT assessments. UN Habitat.