

Annex B: Implications of and Modalities for the 'Development Fund for Iraq'

Summary

UN Resolution 1483 (UN SCR 1483) creating the Development Fund for Iraq (DFI) raises two important issues for the UK:

1. UK role and responsibilities as a Coalition member. UNSCR 1483 formally recognises the US and UK as occupying powers and makes clear we ('the Authority') are jointly responsible for the management of Iraq. On the economic side, this responsibility includes directing the disbursement of funds from the DFI. In effect, the Coalition is recognised to be in control of Iraq's resources (oil and unfrozen assets) until an internationally recognised, representative government is established in Iraq. This raises questions of how we manage that (shared) control with the US. How will we influence decisions on spending? What reporting lines will there be? etc. Importantly, these structures need to be decided *quickly*: the DFI will have significant resources immediately and spending decisions could start being made in the next couple of weeks.
2. Ensuring that the DFI outlined by the resolution meets UK objectives and commitments in practice - in terms of transparency, accountability and oversight in the management of Iraq's resources. The UNSCR is very high-level and does not outline much of the detail necessary to operationalise this structure. Hence there is a role for the UK in developing modalities that meet our objectives. In addition, where there is resolution language committing the Coalition to use the resources of the DFI 'in a transparent manner' and to ensure that oil sales are 'made consistent with international best practice', how do we ensure that structures are out in place to meet these commitments?

This paper sets out some thoughts on these two issues. The attached annex (A) outlines some draft UK terms of reference for the DFI and for the Advisory Board and some principles that could form the basis of our engagement with the US on these issues.

The UNSCR and the Development Fund for Iraq

Para 12 of UNSCR 1483 'notes the establishment of a Development Fund for Iraq (DFI)'. This and the two subsequent paragraphs set out some aspects of this structure such that:

- The DFI will be held in the Central Bank of Iraq<sup>1</sup>
- It will be audited by 'independent public accountants'
- An International Advisory and Monitoring Board will be created, which the independent public accountants will be approved by and to whom they will report. The Advisory Board members shall include duly qualified representatives of the Secretary General, the Managing Director of the IMF,

<sup>1</sup> This may not be practically possible immediately and the US is also considering other options such as holding the funds in the Bank for International Settlements (BIS).

the Director General of the Arab Fund for Social and Economic Development and the President of the World Bank

- Funds in the DFI will be 'disbursed at the direction of the Authority' (ie coalition), 'in consultation with the Iraqi interim administration'
- Funds shall be used 'in a transparent manner to meet the humanitarian needs of the Iraqi people, for the economic reconstruction and repair of Iraq's infrastructure, for the continued disarmament of Iraq, and for the costs of Iraqi civilian administration and for other purposes benefiting the people of Iraq'
- The sources of finance for the DFI will be:
  1. Revenues held in escrow accounts under the OFF programme: \$1bn immediately from unencumbered funds and 'all surplus funds' (ie after deducting UN costs etc) to be transferred 'at the earliest possible time'
  2. Oil revenues: 95% of proceeds from export sales of petroleum, petroleum products and natural gas<sup>2</sup>
  3. Frozen assets: all 'funds or other financial assets or economic resources' of the previous government of Iraq, Iraqi state bodies or members of the Saddam regime currently held and/or frozen outside Iraq
- The DFI shall enjoy the privileges and immunities equivalent to those enjoyed by the United Nations

This framework is shown diagrammatically in the attached annex (B).

#### Timing

The US have already created the DFI and opened an account in its name at the Federal Reserve Bank of New York. The \$1bn from the UN Escrow accounts has been transferred to this account. Frozen assets and the first oil revenues could also be deposited quickly -- so the DFI could begin disbursements immediately. The US plan to transfer this account to the Central bank of Iraq as soon as possible.

The US has also written to the Managing Directors of the UN, World Bank and IMF immediately, requesting that they designate a representative to serve on the Advisory Board. The World Bank held a discussion of their role on the Advisory Board at during a Bank Board meeting on 28<sup>th</sup> May. The US Treasury plans to hold a meeting for these representatives in Washington DC in the next few weeks.

#### Implications and Modalities of the DFI

The UNSCR 1483 raises two sets of issues for the UK.

##### *1. UK Roles and Responsibilities as a Coalition Member*

UN SCR 1483 makes clear that the UK Government (as a member of the Coalition) will be jointly responsible for disbursing revenues from the DFI. The Resolution also notes that other States that are not occupying powers may work under the Authority --

---

<sup>2</sup> 5% goes to the UN Compensation Fund

# DECLASSIFIED

so it does not preclude us from engaging with other members of the military coalition or other international partners. But, from a legal perspective, the US and the UK are jointly responsible for controlling Iraqi resources. UNSCR 1483 raises a set of questions over our relationship with the US – as we are, in effect, becoming the temporary government of Iraq in terms of managing resources. For example:

- Do the US have an early estimate of the total amount available to the DFI? (ie \$1bn plus frozen assets) and of the likely early revenue stream from oil over the next few months?
- How will decisions be made over the allocation of resources from the DFI? Based on what priorities?
- If this is to be done by ORHA, how and how often will ORHA report to Coalition governments?
- What mechanisms will there be for resolving disagreements among coalition partners over spending or letting of contracts?
- Which department in the UK will have oversight responsibility for these resources? (HMT? DFID? FCO?)

Since the resources in the Fund do not originate from UK taxpayers, the standard legal and reporting requirements, for example to Parliament, do not apply. However, there may still be a political and moral rationale for ensuring that Parliament is informed through some mechanism(s) as to the decisions being taken by the Authority and hence, implicitly, the UK Government.

However, UNSCR 1483 does 'encourage' the Authority to 'inform the Council at regular intervals of their efforts under this resolution'. In addition, it mandates the UN Security Council to 'review the implementation of this resolution within twelve months of its adoption and to consider further steps that might be necessary'. Further, the UN Secretary General is requested to report to the Security Council at regular intervals on the 'work of the International Monitoring and Advisory Board'. Hence, the UN Security Council will provide some form of oversight function and there is an opportunity to press for regular information flows to the Council by the Authority and the Advisory Board.

In addition, the creation of the DFI and UNSCR 1483 more generally raises once again the important legitimacy issue concerning economic policymaking under the Authority. The Attorney General has been asked to provide an opinion on the legal basis provided by UNSCR 1483 for the Coalition to take, in particular, economic decisions that go beyond those allowed under Occupation Law. There is a clear linkage between economic policymaking and the DFI since most economic policy decisions will have a spending element. If this opinion is that Occupation Law continues to constrain such economic decisions, there could be important practical implications over which spending decisions we deem to have a legal basis.

These issues are for us to settle within the Authority (ie with the US) and not a wider group of countries. However, UNSCR 1483 does provide a role for other countries if they wish to work under the Authority so there is scope for engaging other countries if we wish to. In addition, there are principles such as transparency that we will need to press the US Administration very hard on if we are to retain credibility with the wider international community. It is important to note that these decisions need to be made

# DECLASSIFIED

*quickly*: the DFI has significant resources immediately (\$1bn from the OFF escrow accounts, plus unfrozen assets) and will start receiving inflows of oil revenue very shortly. Hence, spending decisions could start being made in the next couple of weeks.

## *2. Ensuring that the DFI meets UK objectives and commitments in practice*

While the UN Resolution text sets out the parameters of the Fund and the management of oil revenues once sanctions are lifted, it is very high-level and does not outline much of the detail necessary to operationalise this structure. This is partly intentional since the US Administration have made clear that they wish the members of the Advisory Board to consult on their roles and approve a position they themselves are comfortable with. However, the model is also vague on some of the key questions, which potentially leaves significant room for shaping the final outcome to meet UK objectives.

The main questions raised by the model are

1. Line Management: Who technically establishes the DFI? In practical terms, what is the line of reporting for the accountants and the Advisory Board? (The UN Resolution simply notes the establishment of the Fund so it is not explicitly the UN. Similarly the Coalition controls spending but what is the role of the Advisory and Monitoring Board?).
2. Transparency – ex ante and ex post: The resolution provides some mechanisms for ex post transparency through the auditing role but even here there are questions, such as: how often will the accountants audit the IDF? Will they publish their reports? In addition, best practice would demand some form of ex ante transparency in economic policymaking through the publication of forecasts, budgets etc. This raises questions such as: How will the resolution requirement to ‘use funds in a transparent manner’ be operationalised? Will the Coalition publish a budget? If so, how often? Who will review it? What additional checks, if any, are needed to guard against corruption?
3. Prioritisation: How will competing spending demands be managed? How will political (ethnic etc) interests be managed? Decisions would traditionally be based on a needs assessment undertaken by the IFIs but how will this work in the interim? Can an IFI needs assessment still play a role?
4. Regional/Federal Structures. Prioritisation of spending decisions will need to be consistent with any political moves to a federal structure. How will this be achieved? Will regions have some control over their own budgets? Their own revenue sources? How will the Kurdish regions existing institutional structure be managed?
5. Relationship to other sources of finance: How will *donor finance* (eg in a Donor Trust Fund) be managed in the context of the DFI? What is the linkage to *domestic* sales of oil? Will they be subsidised? What happens to any domestic revenue?

## US Thinking

Early indications suggest that US thinking is not unified on the management and procedures for the DFI. Contacts with the US Treasury suggest that they have similar concerns to us over transparency, the need for sensible budgeting frameworks, a unified account etc. However, the DOD and thinking in ORHA seems to envisage a very light touch of transparency and limited budgetary control. For example, the role for the Advisory Board could simply involve appointing the independent auditors as this is the only formal role given to the Advisory Board in the UN Resolution. While this does not preclude the IMF and World Bank undertaking their more usual monitoring and surveillance roles separately (as discussed above), it does present a very weak form of transparency over Iraqi oil revenue directly and provides no 'checks' with any teeth if the DFI revenues are spent unwisely (eg on bad projects, too slowly, duplicating work by NGOS and donors etc), if there is corruption and/or political influence over contracts funded by the DFI (eg money is seen to be distributed unevenly across Iraq or among different ethnic groups), or the funds are spent on projects that go well beyond the legal mandate provided by the UN Resolution.

In the DOD/ORHA view, the main role for monitoring falls to the auditor who would ensure that the domestic and international sales of petroleum and derivatives are 'in line with prevailing international market practice' and the revenues are deposited in the DFI. He/she would also ensure that funds disbursed from the account are recorded accurately and disbursed for the purposes set out in the UN resolution. However, these purposes are very broad (eg 'humanitarian needs of the Iraqi people' or 'other purposes benefiting the Iraqi people') so it is not clear how effective such monitoring will be.

The DOD/ORHA view also seems to envisage keeping the DFI completely separate from donor financing. However, this poses questions of coordination and potential problems of duplication and transparency.

We are not fully sighted on US thinking in terms of how spending decisions and reporting lines will operate within the Coalition.

## Wider Questions

At present, the UNSCR is not specifically time-limited. However, it does state that the oil revenues will be deposited in the DFI 'until such time as an internationally recognised representative government of Iraq is properly constituted'. This is likely to be some way off but it does mean that we would not expect the Coalition to continue controlling Iraqi revenues indefinitely. It is therefore possible to view the IDF as the very beginning of an Iraqi government budget or Treasury Department – with the Coalition in control on a temporary basis and, once the political situation allows, control being handed over to an Iraqi administration. This raises some slightly broader but very relevant questions relating to the efficient use of Iraqi resources.

1. Surveillance and monitoring. The IFIs (especially the IMF) have a huge amount of experience and expertise in providing surveillance of economies,



Restricted - Revised Draft

# DECLASSIFIED

particularly in the area of fiscal frameworks and budgeting. This extends much further than membership of an ad hoc advisory board as currently envisaged. As the IFIs become more fully engaged in Iraq, how will they take on their more traditional surveillance roles? Possibilities include:

2. Technical Assistance. The decision to undertake significant De-Ba'athification of the Iraqi civil service combined with the significant amount of reform required to put the Iraqi economy and public sector onto a sound footing ensures a heavy demand for technical assistance, which itself can be an important mechanism for influencing policy outcomes. Again, the IFIs (including the regional development banks) have significant expertise in this area and their early engagement would prove invaluable. Options here include:
  - DFID has provisionally agreed to (help) fund the IMF's technical assistance to Iraq, likely to be around US\$2 million over the first year - with similar contributions (possibly declining) over year two (and possibly three.)
3. Links to wider Iraqi public finances. Will other sources of Iraqi revenue be folded into the same Fund as and when they begin to come on stream? (eg tariff revenues, tax receipts?). Will there be a unified Treasury Account?
4. Role, if any, for the UK region and or federal structures? While there is not a formal UK sector, the UK military is providing security in the Southern region around Basra and the UK secondees to ORHA are concentrated in the administration of this region. If budgets are allocated on a regional basis (which may be practical for some projects and/or sectors), this raises a question of the financial management of the UK-dominated region.

DECLASSIFIED