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Ext:

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To: Martin Dinham

Back To Office Report: Iraq 13-18 June

1. I am grateful to everyone in the DFID offices in Baghdad and Basra for organising a rewarding visit for me on 13-18 June. The visit was routine, timed to follow closely on the arrival of in Basra. A number of management issues have been dealt with in separate emails.
2. DFID staff in Basra and Baghdad again impressed me with their dedication and high levels of performance. Skills in delivery, strategic thinking, problem solving, and close working with other government departments were particularly noticeable. Lindy Cameron and have both assumed leadership roles within their donor communities. Staff morale is high despite the difficult circumstances.

Situation Report (see also recent Iraq Weekly Reports)

3. Gol Capacity. The capacity of the new government remains very weak. This is true of Interior, Finance, Planning, the Office of the Prime Minister, and the Council of Ministers. Yet the last two weeks have brought some promising movement.
 - Most ministries have now appointed Directors General, and a regular meeting of DGs has been initiated.
 - After many months of delay, the Ministry of Finance finally set up the Macroeconomic and Fiscal Policy Department – with an office, computers, and a dozen staff in place.
 - The Government Communications Directorate is finally becoming more active and open to change. A recent strategy workshop signalled a step up in the pace of reform and capacity building.

These developments result mainly from some new faces in power and ministers agreeing to get on with work. The structural capacity of ministries remains exceedingly weak: in most cases only a handful of key individuals are making all the decisions and doing all the implementing.

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Nearly all decisions come up to the minister for decision, and often, action.

4. Donor coordination. Again, the last week has shown some promise:
 - a. The UN convened a donor coordination meeting on 16 June to prepare for the Brussels conference. The meeting was chaired in Baghdad, with a video link to Amman. Some 20 agencies and donors were represented, including USAID (for the first time). Although IRMO and the military reconstruction sectors were not represented, the meeting marked a real consolidation of a new donor coordination structure. The UN now also chairs the meetings of the Southern Iraq Reconstruction and Coordination Group, although DFID continues to provide the secretariat functions. The next step will be securing stronger Iraqi presence and leadership in both meetings.
 - b. The GoI has now settled on the Minister of Planning, Barham Saleh, as the donor coordination focal point. The Minister of Finance will be involved in budgetary issues, and will be the focal point for loans but not strategic programming. This was announced on the 16th, following a series of meetings between SRSG Qazi and the Prime Minister, Minister of Finance, and Minister of Planning.
5. Lieutenant General Brims hosted a dinner the night before a donor conference on the proposed Provincial Support Teams and Provincial Reconstruction and Development Committees (in brief, this is a US attempt to use the Afghanistan PRT model in Iraq). The meal was convened as a formal seminar, with Brims in the chair and speakers identified in advance. The topic was the prospects for Iraq over the next 12-24 months. Two key points emerged: a) the strong divergence of views among different US players – there is clearly no US consensus on the medium term strategy; and b) the strong advice of General Brims to DFID – that from 2006 our programme should focus on governance, which will be a key constraint on effective withdrawal of international forces (I suspect that MND(SE) may not agree with this view given their emphasis on infrastructure).
6. Constitutional drafting. Good meeting with Fink Haysom, leading the UN team supporting the drafting process. Iraqi Government agreed the Sunni representation on the constitutional drafting commission so work can get underway. Pressure to adhere to deadlines is coming from the Iraqi Government as much as international actors – Iraqis see political payoff of quick delivery. Haysom rightly worried about the long-term consequences of a hasty drafting and consultation process, but is supporting creative approaches to quick delivery.
7. Macroeconomic issues. There is a significant gap between the premises of the 2005 budget and actual practice. Domestic fuel price increases, even if implemented immediately, will not raise the projected \$1.5bn. In

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the face of an impending fiscal crisis, the Ministry of Finance has not been willing to prioritise. Nor has it managed the expectations of the International Monetary Fund, but instead continues to make unrealistic promises.

Strategic Issues

8. Aid Volumes. Meeting with USAID revealed that total US aid is likely to be much lower next year. Will decline from present package of \$18.4 bn over two years to somewhere around \$1bn next year. Current range being discussed is \$0.36bn to \$1.4bn. Similarly, Japanese grants are now exhausted, and the DFID programme will decline next year. The UN and World Bank programmes are likely to show fairly modest increases. It is possible that further pledges will be made in Brussels, and some key players (e.g. Spain, Italy, Arab donors) have still not delivered on their Madrid pledges. But even in the most optimistic scenario, there will be a dramatic decline in aid levels due to the changing US position. This rapid decline in projected aid raises three strategic issues:
 - a. Security: What impact will declining aid have on security? Most Iraqis have not felt a 'peace dividend' in their income or delivery of state services. Public expectations of continued donor support are high.
 - b. Aid allocation: Research by Collier and others shows that aid during or immediately after a conflict tends to be wasted. Aid in post-conflict environments is most effective 4-7 years after the conflict ends. This is of course precisely the time when donors tend to reduce their funding levels as political priorities change. The international donor community is in danger of repeating this sub-optimal aid allocation pattern in Iraq.
 - c. Iraq as a Middle Income Country. The projected decline in DFID's funding for Iraq is based on the premise that it is a middle income country with adequate resources for its own development. It is not clear if this holds true as long as security is poor and increased oil revenues therefore difficult to obtain.
9. Funding for security. The recurrent and capital costs for the Iraq Security Forces are predicted to be \$4bn - \$6bn in 2006. More precise estimates will be sent to the MOD from theatre in the next few weeks. This cost is on the same order as the present budget for the entire Government of Iraq. Much of the cost will be for new equipment, but recurrent salary costs are likely to account for more than 50% of the figure. No provision has been made for this in the 2006 budget. Nor has the budget provided for the \$250m required to cover the pensions of recently retired security staff. Unless the international community is able to cover these security costs in full, the Iraqi budget is likely to be distorted with cuts to social programmes in order to cover high priority security costs.

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10. Possible Iraq declaration on the Extractive Industries Transparency Initiative. In a discussion with HMA and DHM it emerged that one possible strategic priority for the UK in 2005 is to persuade the Gol to sign up to the EITI. This would have five main attractions:

- i. Ja'afari and others are looking to do something tangible to address corruption; a public statement acceding to the EITI would send a strong signal to the international community and could be played for domestic political support.
- ii. States with large oil revenues are more vulnerable to conflict and authoritarian rule; transparency of income and expenditure can ameliorate this risk, and is thus a high priority for Iraq's long term stability – and the UK's strategic interests.
- iii. Once a declaration to sign up the EITI is made, the Gol would be locked into a process that would bring technical assistance to support transparency reforms over a period of several years. Yet no immediate action would be required by this very weak government.
- iv. There is a window of opportunity over the next 3 months – while this government is new and before vested interests have their claws too deeply into the oil cash. Once a declaration of adherence is made, political embarrassment would prevent backing out of it. External scrutiny would increase.
- v. The EITI is a British-led initiative, and a declaration would demonstrate the UK's comparative advantage and ability to add value.

Programme Issues

11. World Bank co-financing. team along with Peter Fernandes Cardy have made significant progress toward securing an estimated \$18m-\$25m in co-financing from the World Bank on infrastructure in the South. Following World Bank guidelines, the Iraqis with support have identified five proposals for financial support. Bids should be submitted to the Trust Fund in the next few weeks. If the bids are approved, the Bank funding will be channelled through the Iraq Infrastructure Support Programme based in the DFID office in Basra. The IISP team will implement the work with TAT support. We will need to ensure that the Basra office financial systems are robust enough to handle these additional funds [Action: from Internal Audit has agreed to visit Basra the last week in July].
12. Slimmed down programmes. The DFID Iraq team has done an excellent job in implementing the programme cuts agreed under the leadership of and the programme teams. From the amount of activity on

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the ground, it does not seem that much underspend is likely, so we will need to ensure that financial constraints are watched closely as the financial year goes on.

13. Future DFID programme. The shape of the DFID programme after March 2006 is not clear. This is particularly true for the South, where we have front-loaded our infrastructure and Governorates Capacity Building Programmes in order to achieve high impact in 2005. A process to review options for 2006-7 will be needed over the summer **[Action: Michael, Lindy, and to sketch out preliminary thoughts for consultation]**.
14. Progress on specific programmes. I spoke with the teams implementing the Technical Advice on Infrastructure, Governorates Capacity Building project, the Economic Reform project, the Emergency Public Administration project, and the Ministry of Interior programme. The Mol project is still in its infancy, but the others seem to be producing impressive results, with management and policy issues being addressed effectively.

Management Issues

15. Team Working. Lindy Cameron continues to lead the Basra and Baghdad offices to work together as a single team. This has shown real benefits, particularly where both offices are subject to staffing restrictions. A combined in-day planned for 12 June was delayed due to a sandstorm.
16. Information sharing from London. The London half of the Iraq programme needs to do more to share information, particularly on Whitehall and international developments. **[Action: to establish a new email group for Iraq Whitehall issues]**.
17. Staff Security. I am pleased to report that the DFID staff in both Baghdad and Basra continue to adhere to prescribed security procedures and good security practice despite derisory comments from some other British personnel. The nature of the security threat is changing, with a much lower incidence of indirect fire and a higher threat of kidnapping or complex attacks. It will be important to avoid complacency in the next six months.
18. Staff Appointed in Country. Many of the staff appointed in country face increased personal security risks due to their employment with DFID. Some SAIC in Basra were unclear if they are allowed to stagger their arrival and departure times. I emphasised that unpredictable travel times (and routes) are not only allowed, but also regarded as an obligation as a part of good security practice. Lindy agreed to send a letter to all staff reiterating the point **[Action: Lindy Cameron]**.

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19. Staff rotation. We will need to manage arrival and departure times carefully in the final quarter of 2005 in order to avoid gaps in staffing.

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