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Reference

FROM:

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CC: PS/PUSS
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To: 1. Martin Dinham
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IRAQ: INTERIM COUNTRY ASSISTANCE PLAN: ANNUAL REVIEW

Issue

The Secretary of State is invited to endorse the annual review of the Iraq Interim Country Assistance Plan (ICAP).

Recommendation

2. I recommend that the Secretary of State endorses the annual review, attached at Flag A.

Timing

3. Routine.

Publicity and Parliamentary Handling.

4. I recommend that copies of the review are placed in the Libraries of the House, accompanied by a short Parliamentary Statement. A draft statement is at Flag B. The review should also be placed on the DFID Website.

Information

5. The ICAP was published in February 2004 and was expected to remain in place for two years. It contains a commitment for a substantial review after one year. Like the ICAP, this would normally be made publicly available.

Information not for pro-active disclosure

6. Events pre-empted a pro-active review of the ICAP. The Prime Minister wrote to the Secretary of State on 26 October 2004 about the need to accelerate the pace of reconstruction and to increase the impact of our bilateral programme in the short term. Following this, Suma Chakrabarti visited Baghdad and Basra with Jim Drummond in early December to review DFID programmes and assess priorities for 2005. Subsequently in December 2004 the Secretary of State endorsed as priorities for 2005 that we should:

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- use our influence internationally and expertise in Baghdad to keep the current IMF programme and debt deal on track, working for agreement of a Stand By Agreement in 2005 to address major constraints on Iraq's economic success.
- ensure that reforms at the centre of government are sustained and expanded to key ministries as security allows.
- continue support for civil society.
- not expect to run bilateral programmes in sector ministries such as health or education, because security will not permit a significant increase in staff in Baghdad.
- review in March whether to make a further contribution to the Trust Fund (done – answer no).
- retain the south as a priority for bilateral reconstruction, expanding the Southern Iraq Employment and Services Programme to continue job creation through at least the first half of 2005 and stepping up substantially the infrastructure element to, say £50 million in 2005/6.
- continue to help the Iraqi Government on Fallujah and similar cases, ensure we have post-conflict expertise on close call, and respond to appeals from international organisations and NGOs. We should decide on the ICRC appeal in January (done), but only do bilateral post-conflict work in the south if needed.
- support the elections and constitution-making process.
- encourage HMG to focus on the quality, not just numbers, of Iraqi Security Forces, lead the HMG reform effort in the MoI and consider whether there are other ways we can add value on SSR.
- press at high level for the UN and World Bank to get staff into Iraq and facilitate security for them.
- use our influence and experience to get the Iraqis and donors focused on an Iraqi-led reconstruction strategy.
- work closely with the US, but recognise the limits on our influence on their strategic decisions.
- And that staff security should remain a top priority.

7. Earlier this year the Prime Minister agreed an HMG strategy for 2005 covering the political process, security, international outreach and reconstruction. This strategy was produced by the Cabinet Office in quick time, but includes most of the items we suggested. It is in line with the priorities agreed by the Secretary of State. The focus now is on delivery.

8. Subsequently, the DFID programme was faced with unexpected and significant funding constraints. We have a smaller than expected aid framework for 2005/06 (£65 million reduced from £86 million). And the FCO, which manages our security contracts in Iraq, announced in March a sudden increase in those costs. We are negotiating on DFID's fair share. As a result of these funding constraints we have re-prioritised across the programme. The resulting work-plan (at Flag C) maintains the shape and priorities of the programme agreed by the Secretary of State in December. The programme remains almost entirely bilateral. There are no further allocations in view to the UN or World Bank. The work-plan covers four main areas of work –

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- Quick impact activities on power, water, fuels, jobs (£24 million)
- A £40 million infrastructure programme: 75% on power, the rest on water. Impact on ground by spring 2005.
- Building capacity – in the centre of government, on economic reform, and in the southern governorates.
- Support to civil society, including helping participation in the political process.

Advice

9. The planned drawdown of UK forces might affect our ability to deliver in the southern governorates. We are in close touch with the MOD and FCO in London and with the military Basra and need to keep our activities under constant review.

10. A major constraint to DFID's programme, not highlighted in the ICAP review, is the limited capacity of Iraqi government institutions to drive forward reform and reconstruction. This is exacerbated by the short political horizons inherent in the Transitional Administrative Law (TAL), which militate against far-reaching reform. Corruption is also becoming increasingly apparent and might become the main constraint on reconstruction and development if security were to improve significantly.

Middle East and North Africa Department

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DFID: IRAQ COUNTRY ASSISTANCE PLAN REVIEW 2004/5

Introduction

1. DFID's "Interim" Country Assistance Plan was published in February 2004, at a time when the Coalition Provisional Authority was administering Iraq and the security environment was improving.

2. The Plan has 3 strategic objectives:

- Promoting rapid, sustainable, equitable economic growth;
- Encouraging effective and accountable governance; and
- Promoting social and political cohesion and stability.

And involves working at three levels:

- 1) Internationally to improve aid effectiveness;
- 2) Nationally to support policies and reforms and strengthen capacity; and
- 3) In southern Iraq to reduce poverty and restore links with the centre.

Iraq: current context

3. The **political process**, laid out in the Transitional Administrative Law (TAL) and UNSCR 1546, is on track. The Coalition Provisional Authority handed over to an appointed Iraqi Interim Government (IIG) in June 2004. Elections to a new Transitional National Assembly in January 2005 were a success. This was followed by the negotiation among the Iraqi parties of a new Transitional National Government (TNG) to administer Iraq while a new constitution is agreed. The new Government and National Assembly began work in May 2005. The next political challenge is the constitutional drafting process leading to a referendum scheduled for October 2005 and elections under a new constitution in December 2005.

4. The Iraq **economy** is doing well, driven by high oil price but also, and despite the difficult security environment, the vibrant response of the domestic economy. Growth was estimated to be 50% in 2004, and is expected to be 17% in 2005. The agreement in late 2004 of an Emergency Post Conflict Agreement (EPCA) and a **debt-reduction** agreement with Paris Club creditors was another major step forward. At the Madrid Conference in October 2003, 37 bilateral donors, the European Community, the World Bank and the IMF pledged a total of \$32 billion for Iraq's reconstruction up to the end of 2007. A significant proportion of these funds remains unspent.

5. Key **risks** identified in the ICAP were realised in 2004/05. In particular the **security situation** deteriorated significantly in April 2004 with uprisings by both Sunni and Shia militant forces. Since then the security environment has been characterised by periods of improvement and other periods of deteriorations, notably in August (Shia 'Sadrist' uprising); November (coinciding with Ramadan and military action in Fallujah); and January 2005 (elections). Security affects reconstruction and development by limiting movement and agencies' ability to design, implement and monitor projects. It also adds substantially to costs of working in Iraq. Projected costs for security and life-support for UK staff and advisers working in Iraq in 2005/06 are in excess of £500,000 per person-year.

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6. Linked to the downturn in security over the last year there have been substantial **delays to reconstruction**. Water supplies and waste-water treatment are now slightly better than before the conflict and progress has been made in the rehabilitation of education and health facilities and government buildings. However, despite substantial investment in repairs, total electricity supply has frequently been even lower than before the conflict, due to the age and dilapidation of the infrastructure, maintenance requirements, breakdowns and sabotage. This is exacerbated by rising demand, driven by the buoyant economy. Substantive improvements are required to begin to meet Iraqi expectations on reconstruction. Electricity supply and jobs are consistently identified as major concerns in Iraqi opinion polls. Lack of progress on reconstruction feeds discontent and affects security, completing a vicious circle.

7. The **US** is the largest donor and has disbursed about a third of its \$20 billion plus commitment. Its Projects and Contracting Office (PCO) has reviewed its programme to enable quicker and improved delivery and with a focus on Iraqi security, but with fewer longer-term projects. The UN and World Bank have around \$1 billion available through contributions to multilateral trust funds. The **UN** made a substantial contribution to the elections, but still has very few international staff in Iraq working on reconstruction and implementation of its other programmes has been variable. However, since the beginning of 2005, the UN has been delivering more quickly through Iraqi staff and institutions. The **World Bank** has achieved little so far, disbursing 6% of the money deposited in its trust fund. Negotiations for up to \$5 billion in World Bank soft loans (IDA) and an **IMF** Stand-By Arrangement (SBA) worth up to \$4.25 billion are beginning with the TNG. All of **Japan's** \$1.5 billion grant funding is committed and much of it disbursed; the Japanese are considering how to allocate their \$3.5 billion soft loan pledge. The **European Community** has now allocated over €400 million for Iraq reconstruction (in addition to €100 million in humanitarian assistance in 2003) mostly channelled through the multilateral trust funds. Other donors made smaller pledges and operate mostly by providing assistance such as training outside Iraq or through contributions to the Trust Funds.

8. The **UK's** overall commitment to Iraq's reconstruction amounts to £544 million over April 2003–March 2006, of which **DFID** is providing £422.5m. Of this DFID has committed £391 million to specific projects, and disbursed £270 million. Other UK reconstruction funding is being provided by the MOD, through Quick Impact Projects and through the joint FCO, MOD and DFID-funded Global Conflict Prevention Pool (GCPP).

Key challenges for reconstruction and development in 2005/06:

9. The difficult **security** situation affects the lives of all Iraqis. It impacts on the delivery of reconstruction, inhibits the economy and discourages inward investment. Increased security costs have reduced DFID's flexibility to initiate new programmes. Our planning assumption is that security will continue to constrain what we and other donors can do. However, we also assume that we will be able to work on the ground in the south so long as UK

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forces are present. It is expected that multinational security forces will gradually hand over full responsibility for security to Iraqi security forces during 2005/06. We will need to monitor the security situation and the safety of DFID staff and advisers carefully, shaping our approach accordingly.

10. The **political process**, while essential for progress on stability, presents its own challenges. The TNG has a popular mandate but, like the IIG, has only a short life, which might affect its ability to implement major reforms. While short-term stabilisation and some improvements can be made through repair and rehabilitation, a sustained impact, e.g. on fuel and electricity, will require new investment, which will be difficult to achieve without reform of subsidies and tariffs.

11. The involvement of **other donors** in Iraq remains limited. New donor finance will become available during 2005 and 2006, such as loans from Japan, the World Bank and possibly Arab countries that pledged over \$1.3 billion at Madrid. But these will not be sufficient to provide the major investments needed in Iraq over the next five years. Private finance and commercial loans will be required, but this is unlikely to be forthcoming until greater stability has been achieved and economic reforms put in place.

Examples of DFID impacts in 2004/05

Infrastructure rehabilitation projects managed by DFID repaired power lines from Hartha power station to parts of Basra city and employed thousands of Iraqis in repairing key parts of southern Iraq's infrastructure. After the handover of sovereignty on 28 June 2004 DFID ensured that \$63 million worth of projects in the south of Iraq and initiated by the Coalition Provisional Authority were completed.

In Baghdad, DFID's support for **Public Administration** has helped to set up new institutions and systems at the centre of the Iraqi government. We are also helping the Iraqi government improve public expenditure management.

DFID technical assistance to the **Ministry of Finance** contributed to the 2005 budget process and helped support Iraq's successful negotiations with the IMF on Emergency Post-Conflict Assistance (EPCA) and the agreement on debt reduction with Paris Club creditors.

DFID support to the **justice sector** has trained 216 Iraqi judges, lawyers and prosecutors in human rights, international humanitarian law, and independence of the judiciary.

DFID assistance for the successful January 2005 **elections** included support for the Independent Electoral Commission of Iraq and work through Iraqi civil society to encourage broad public participation. DFID has also provided training for journalists, editors and media managers on humanitarian and independent reporting.

DFID's **Civil Society Fund** is helping Iraqi civil society develop sustainable links with international partners. Projects include capacity-building partnerships between international and Iraqi NGOs and trade union link-ups.

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12. It is essential that Iraq retains its hard-won **macro-economic stability** and stays on track with its commitments under the Emergency Post-Conflict Agreement with the IMF. These include making first steps to reduce fuel subsidies, which will have to be achieved during 2005, but carry their own risks to stability. Iraq also needs to negotiate a Stand-By Arrangement with the IMF by the end of 2005 to secure the Paris Club debt deal and release new international financing. As well as keeping the Paris Club deal on track, Iraq needs to secure agreement on parallel debt reduction measures by non-Paris Club creditors. The provision of macro-economic advice is constrained by the absence of World Bank or IMF staff in Iraq.

DFID approach

13. DFID's work programme has evolved to take account of the difficult security situation and the absence of some traditional donors. The objectives and approach set out in our ICAP remain valid.

1. We will promote broader and **effective international support** for Iraq. The focus will be on encouraging:

- existing donors to deliver on their Madrid pledges and new donors to offer their support;
- effective Iraqi leadership of reconstruction and promoting effective donor co-ordination mechanisms to support this;
- the International Financial Institutions and UN to improve delivery;
- other donors to pool financing to reduce transaction costs and maximise impact, either through effective multilateral trust funds or by co-financing our own programmes.

We do not intend to make further contributions to the multilateral trust funds until there is evidence that they can be as effective on the ground as our bilateral projects.

2. We will continue and deepen work at a **national level**, to build Iraqi capacity and encouraging greater Iraqi leadership of reconstruction, flexible and responding to emerging priorities. We will work to:

- support the institutions at the centre of government, which can play a key role in driving forward effective reconstruction and development;
- help the Ministry of Interior provide better support to the policing effort, through the joint FCO, MOD and DFID-funded Global Conflict Prevention Pool;
- provide economic advice, to help promote economic recovery, keep the Paris Club debt agreement on track and negotiate an IMF Stand-By Arrangement; and
- support the constitutional process and elections at the end of 2005 through initiatives to support political participation.

3. High levels of poverty persist in **the south**, despite its lying above Iraq's richest hydrocarbon resources. The reconstruction benefits expected as US funding and the multilateral trust funds began to deliver and as Iraq's own resources began to flow have not yet been fully realised. The presence of UK forces helps to shape a security environment in the

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south that enables DFID and other donors to work in a way that would not be possible elsewhere in Iraq. DFID will work bilaterally in the south through projects and programmes to deliver benefits to the Iraqi people. We will expand and accelerate our programme of assistance during 2005, specifically to:

- improve infrastructure: for which a total of £55 million has been allocated during 2005/06 to provide immediate and medium-term improvements in power supplies, water and sanitation and fuel supply. We will specifically seek co-financing from other donors for this work. We will also provide technical support, in collaboration with the World Bank, to help the Iraqi authorities in Baghdad develop an effective plan for development of Iraq's power sector and to bring in other donors.
- build capacity: of provincial structures in the four southern governorates, helping them to co-ordinate reconstruction and to re-establish links with Baghdad; and
- create jobs: through public works programmes in the south extended until summer 2005.

Annex: Monitoring the impact of DFID-supported activities on the reconstruction effort in Iraq

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Strategic Objective: to promote sustainable and equitable growth

Planned Change by March 2006	Annual Change indicators(2004/05)	DFID Activities (2004/05)	Assessment of progress at June 2005
Private Sector led growth and sustainable increase in trade and investment.	<p>Relevant enabling legislation agreed and approved by Transitional Assembly.</p> <p>Investment and trade strategy agreed by the transitional government.</p>	<p>Growth barriers study completed and used by Transitional Government to inform policy thinking.</p> <p>Support to Ministries of Finance and Planning and Development Co-operation leading to improved reconstruction management.</p>	<p>The economy recovered from low post-conflict levels with 50% growth in 2004 and an estimated 17% in 2005. Support provided under DFID's Economic Reform Programme (ERP) contributed to the development of a coherent macroeconomic reform programme in line with IMF and World Bank recommendations. IMF Emergency Post Conflict Assistance and a Paris Club debt deal have been agreed.</p> <p>DFID projects are advising on the implementation of macro-economic reform measures, with particular focus on public financial management.</p> <p>Countrywide survey of Small and Medium Enterprises will be completed in June 2005.</p>
Improved Economic Development in the south.	<p>Transitional Government agrees sound economic development strategies, which include the particular needs of the south.</p> <p>Increasing public satisfaction with employment amongst poor and vulnerable groups in Southern Iraq</p>	<p>Southern Iraq support strategy leading to significant job creation and enterprise development opportunities.</p>	<p>The Iraqi Interim Government adopted a National Development Strategy in late 2004, but this has not yet been developed into a strategic national and regional economic development plan.</p> <p>DFID's Southern Iraq Employment and Services Project (SIESP) contracted 117 projects and created 1.6 million work days by April 2005.</p> <p>DFID's Governorates Capacity Building Project (GCBP) is supporting private sector development in Basra Governorate, including: advice on banking services; helping develop business associations and information centres; training in small business development; and courses for women entrepreneurs.</p>
Sustained improvements in Iraqi infrastructure support and services.	<p>Power, fuel and water supplies exceed pre-conflict levels on a sustained basis</p>	<p>IRFFI support being disbursed effectively.</p> <p>Essential infrastructure project continues to impact positively on services and quality of life in south, particularly poor and vulnerable groups.</p>	<p>Water supplies have improved since pre-conflict; fuel supply infrastructure has improved but pricing reform is urgently required; power supplies have frequently been below 2002 levels and reliability is poor despite considerable investment.</p> <p>UN agencies are now implementing projects under the Multilateral Fund e.g in: health, education, electricity, port dredging, refugee returns and employment (in the south as well as elsewhere). World Bank implementation has been slower: DFID is urging the Bank to overcome the obstacles to progress, including through possible joint-funding with DFID projects.</p> <p>DFID infrastructure projects have benefited over 5 million in southern Iraq through improvements in: water supplies (quantity, quality and coverage); electricity supply, power back up for key installations such as hospitals, government offices and schools; distribution systems for domestic fuels; solid waste removal, sewerage and sanitation systems, and the capacity to manage oil spills to avoid polluting water courses.</p>

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Strategic Objective: Supporting and encouraging effective and accountable governance

Planned Change by March 2006	Annual Change Indicators (2004/05)	DFID Activities (2004/04)	Assessment of Progress at June 2005
Representative and inclusive political institutions and mechanisms established.	Peaceful transition process. Transitional Assembly elected and Transitional Government operational on 1 July 2004. New constitution agreed by March 2005.	Political participation fund and media projects supporting open and inclusive democratic debate and is increasing public access to information on key electoral and constitutional issues.	An Interim Government was appointed in June 2004, and Transitional Government in May 2005. Negotiations are underway to table a draft constitution by 15 August and hold a referendum on it in October. DFID's Political Participation Fund provided £1.2m in grants for activities in support of the January elections. DFID also funded media training by the Institute of War and Peace Reporting.
Improved public administration.	Public administration reform strategy agreed by Transitional Government and being implemented. Government carrying out its basic functions and ensuring provision of basic services for all. Increasing public satisfaction with government performance.	Public administration reform support team enjoys good working relations with key government personnel and contributing positively to major reform issues and policy decisions. Support to establish civilian oversight of military agreed and making positive impact on institutional development of Ministry of Defence.	The first elected government was appointed in May 2005: public administration reform is slow and a secondary priority to the constitutional negotiations; public service delivery is improving slowly. DFID's Emergency Public Administration programme (EPAP) has provided practical advice on establishing centre of government institutions and public financial management; and is helping develop policy-making capacity amongst Ministers and senior officials. DFID's Governorates Capacity Building Project (GCBP) is providing policy and management advice to local government in southern Iraq, focusing on service delivery in power, water and public works. The UK MOD is supporting the development of its Iraqi counterpart.
Improved independence, performance and reputation of judiciary and other key justice institutions.	Judiciary functioning satisfactorily and public confidence in system growing. Transitional Government and judiciary taking steps to introduce and enforce modern human rights legislation. Backlog of court casework steadily reducing.	Justice sector support is raising awareness of human rights issues, making a positive impact on ways of working and fostering a sound human rights dialogue in Iraq and with international community.	Evidence of the performance of the judicial system is not readily available. Human rights issues are being taken into account in the constitution negotiations. Training and human rights awareness programmes have been provided for judges through DFID and joint FCO/DFID/MOD Global Conflict Prevention Pool (GCPP) projects. A DFID project financed through the GCPP is supporting the strengthening of the Iraqi Ministry of the Interior. The GCPP is also supporting prison reform in southern Iraq.
Strengthened economic policies and public financial management systems.	Key economic restructuring policies agreed, take account of social dimensions (eg SOE, PDS) and have adequate poverty focus. Key financial management systems (budgeting, payroll, procurement, accounting) meeting priority needs of government. Improved technical and management capacity within Ministry of	Economic policy team working well with Transitional Government and advice is contributing to development of sound and pro-poor policies. Public administration reform team inputs leading to modernisation plan for core public financial management systems and statistics function.	Key reform decisions have not yet been taken by the Iraqi Government. The newly appointed Finance Minister has expressed a commitment to address these issues in 2005 and 2006. DFID's Economic Reform Programme (ERP) has provided advice to the Finance Ministry on fuel subsidy reform, and to the Ministry of Industry and Minerals on state owned enterprise reform. ERP and EPAP are advising on strategic planning and budget preparation issues.

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Planned Change by March 2006	Annual Change Indicators (2004/05)	DFID Activities (2004/04)	Assessment of Progress at June 2005
	Finance.		
An effective media.	<p>Appropriate media regulatory framework agreed and established.</p> <p>Media contributing actively and responsibly to constitutional debate.</p> <p>Freedom of speech and right to information issues being considered constructively by Transitional Government and media.</p>	Media support making positive impact on quality of print journalism, on increasing media service provision in south and government policy thinking on access to information issues.	<p>The national legislative framework for the media has been improved, but not yet enforced.</p> <p>Media training, including that provided by the Institute of War and Peace Reporting, has improved the quality of print journalism.</p> <p>Al-Mirbad independent radio and TV station, funded by DFID through the BBC World Service Trust, began broadcasting to southern Iraq in June 2005.</p>

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Strategic Objective: Promoting Social and Political Cohesion and Stability

Planned Change by March 2006	Annual Change Indicators (2004/5)	DFID Activities (2004/5)	Assessment of Progress at June 2005
Maximum participation and representation in the political process	<p>High level of citizen interest and voter turnout for all elections</p> <p>Transitional Assembly representative and functioning responsibly</p> <p>Inclusive constitutional process</p>	<p>Political participation fund and media projects supporting open and inclusive debate on key political and rights issues</p>	<p>Participation in the January 2005 elections was high in parts of Iraq, but very low in less secure regions, resulting in the under-representation of Sunni Arabs. The Transitional Assembly began work in May 2004 and will function as a constitutional assembly as well as legislative body.</p> <p>DFID's Political Participation Fund (PPF) financed 24 projects amounting to £1.2m between December 2004 and March 2005. These covered policy debates and strengthening the capacity of civil society organisations (CSOs) – including women's organisations, voter education and Iraqi election observers.</p> <p>The PPF is now focusing on supporting participation in the constitution drafting process by people in less secure areas, minority groups in the north, and women and poor people in the south.</p> <p>DFID provided finance and practical support for UN and EU contributions to election assistance.</p>
Government Policies and institutions support gender equality and rights issues	<p>Transitional Administrative Law and new constitution enshrine women's rights</p> <p>Inter ministerial government committee takes forward gender issues</p> <p>Iraqi Women's National Council established and active</p>	<p>Policy support is raising awareness of gender issues widely and contributing to development and implementation of major policy reforms</p> <p>Support to Iraqi Women's Higher Council agreed and making positive impact on its institutional development</p>	<p>The female proportion of the Transitional Assembly exceed the 25% required by the Transitional Administrative Law. However the new Cabinet has a much lower proportion of women.</p> <p>The Iraqi Women's National Council was not formed: the Ministry for Women took on its anticipated role instead.</p> <p>DFID's Civil Society Fund (CSF) has financed links between senior Iraqi women politicians and the UK National Women's Council. Both the PPF and CSF are promoting gender rights through training workshops, conferences and support to the development of NGOs. The Governorates Capacity Building Project is funding an initiative to support women entrepreneurs in southern Iraq.</p>
A vibrant civil society which is engaging effectively with government and communities	<p>Appropriate NGO policy agreed</p> <p>Active NGO networks</p> <p>Local level partnerships between civil society and government growing</p>	<p>Civil Society strengthening project promoting new ideas and ways of working particularly at community level</p>	<p>More than 2500 Iraqi NGOs are registered with the Iraqi government, and a diverse range of NGO networks has developed. No regulations have been introduced to control the activities of NGOs.</p> <p>DFID's CSF has funded nine partnerships between nascent Iraqi CSOs and international NGOs, many of which are focused on engaging with government and helping it become more responsive to local needs.</p> <p>DFID's Governorates Capacity Building project in southern Iraq has promoted dialogue between local government and CSOs. The joint FCO/DFID/MOD Global Conflict Prevention Pool has also provided support for Iraqi CSOs.</p>

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