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**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL FINANCE CORPORATION**

**INTERIM STRATEGY NOTE
FOR
THE REPUBLIC OF IRAQ
FOR THE PERIOD MID FY09-FY11**

February 19, 2009

**Iraq Country Management Unit
Middle East and North Africa Region**

**The International Finance Corporation
Middle East and North Africa Region**

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**Currency Equivalents
(As of January 29, 2009)
US\$1.00 = 1100 Iraqi Dinars**

**Government Fiscal Year
January 1 to December 31**

ACRONYMS AND ABBREVIATIONS

AAA	Analytic and Advisory Activities	IHSES	Iraq Household Socio Economic Survey
ABP	Annual Business Planning	IMF	International Monetary Fund
BSA	Board of Supreme Audit	IRRF	Iraq Relief and Reconstruction Fund
CAG	Community Action Group	IRFFI	International Reconstruction Fund Facility for Iraq
CAS	Country Assistance Strategy	ISBFF	Iraq Small Business Financing Fund
CBI	Central Bank of Iraq	ISN	Interim Strategy Note
CDD	Community Driven Development	ITF	Iraq Trust Fund
CFAA	Country Financial Accountability Assessment	IZ	International Zone
COFE	Council of Financial Experts	KRG	Kurdistan Regional Government
COI	Commission of Integrity	MENA	Middle East and North Africa
CoR	Council of Representatives	MIC	Middle Income Country
COSIT	Central Organization for Statistics and Information Technology	MIGA	Multilateral Investment Guarantee Agency
CPA	Coalition Provisional Authority	NBP	National Board of Pensions
CPPR	Country Portfolio Performance Review	NDS	National Development Strategy
CSA	Country Social Analysis	NGO	Non-Governmental Organization
CSDI	Consultative Service Delivery Initiative	PCF	Post Conflict Fund
DA	Designated Accounts	PEIA	Public Expenditure and Institutional Assessment
DFI	Development Fund for Iraq	PEP	Private Enterprise Partnership
DFID	Department for International Development	PER	Public Expenditure Review
EC	European Commission	PFM	Public Financial Management
EITI	Extractive Industries Transparency Initiative	PMT	Project Management Team
ESW	Economic Sector Work	PPF	Project Preparation Facility
FMA	Fiduciary Monitoring Agent	PPP	Public Private Partnership
FY	Fiscal Year	PSD	Private Sector Development
GDP	Gross Domestic Product	PRT	Provincial Reconstruction Team
GoI	Government of Iraq	PSIA	Poverty and Social Impact Analysis
IAMB	International Monitoring and Advisory Board	SME	Small-Medium Enterprise
IBRD	International Bank for Reconstruction and Development	SOE	State Owned Enterprise
ICA	Investment Climate Assessment	SOFA	Status of Forces Agreement
ICI	International Compact with Iraq	SPBF	State and Peace Building Fund
ID	Iraqi Dinar	SPSS	Statistical Program for the Social Sciences
IDA	International Development Association	SSN	Social Safety Net
IEG	Independent Evaluation Group	TA	Technical Assistance
IFC	International Finance Corporation	UN	United Nations
IFMIS	Iraq Financial Management Information System	UNDP	United Nations Development Program
		USAID	United States Agency for International Development
		USG	United States Government

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INTERIM STRATEGY NOTE FOR IRAQ (FY09-FY11)
EXECUTIVE SUMMARY

- i. **Recent positive developments suggest that Iraq has made important progress towards political and economic stabilization, although the situation remains fragile and reversible.** Recent months have seen a sharp decline in incidents of violence, especially in the Baghdad area, and a corresponding decrease in the rate of internal displacement of the population. This reflects improved security as well as successful initial steps towards political reconciliation. Macroeconomic performance has also improved although growth has been volatile.
- ii. **The Government has been demonstrating its commitment to reform and reconstruction, indicating that continued engagement with Iraq may produce further concrete results.** The Government has succeeded in sharply reducing inflation and containing recurrent spending, while increasing capital expenditures to accelerate the recovery process. In addition, the machinery of government is slowly reviving as Iraq emerges from conflict. A more proactive and confident government is likely to devote more attention to the economy. Finally, high oil prices and – to a lesser extent – an increase in production produced an estimated US\$70 billion of revenues in 2008, although a deterioration in Iraq's fiscal balance is expected during part of the ISN period in view of the recent declining trend in oil prices.
- iii. **However, results from past and ongoing reform efforts remain far from meeting the needs and expectations of the Iraqi people.** Unemployment remains extremely high and access to basic services severely limited. Electricity supply is unreliable and is far exceeded by demand; access to clean water and sanitation is the lowest in the Region. Recent improvements in access to education and health services have not yet translated into significant welfare gains on the part of the people of Iraq.
- iv. **Iraq is resource rich and has benefited from a substantial increase in oil revenues over the past few years. At the same time, it is still subject to conflict, insecurity, political instability and revenue volatility.** As a conflict-affected, IBRD-eligible middle-income country, the main challenge for Iraq – in addition to security and political stability – is to mobilize and effectively use its own vast resources to improve the welfare of the Iraqi people and to rebuild its infrastructure in a sustainable manner through market-based reforms. The main role for the international community, including the World Bank Group, is therefore to help Iraq use its own resources more effectively and to support the creation of a healthy business climate.
- v. **Working in Iraq has been challenging for the Bank Group and other donors.** As in other fragile environments, while some notable successes have been achieved, the effectiveness of assistance has been hampered by issues related to both the country's operating environment and the approach followed by the donors. Operating environment issues – which also affect the Government's ability to execute its own investment budget – include: the fragile political and security situation; the unstable policy and institutional environment; the Government's weakened institutional capacity, and weaknesses in Iraq's banking system. Issues related to the approach of the Bank to Iraq include the

selectivity of assistance as well as business processes and fiduciary arrangements which have been unfamiliar to Iraqi counterparts and are challenging for Ministries with limited capacity.

vi. **The design of this third Interim Strategy Note benefited from a stocktaking of the Bank Group's engagement with Iraq to date.** The goal of the stocktaking exercise was to identify the key bottlenecks for the implementation of the previous ISNs and to extract lessons for this ISN. This exercise informed the design of this ISN: (i) the continuing centrality of institution building; (ii) the critical importance of interest and engagement on the part of ministries and implementing agencies; (iii) the need for increased selectivity in terms of the ability to identify and seize opportunities as they arise to achieve concrete results; (iv) the need to focus on reform efforts that do not overtax Iraq's existing capacity and that more clearly reflect the country's current political and security situation; and (v) the need for increased flexibility in the design and programming of Bank assistance and for experimentation with alternative implementation arrangements for the Bank's assistance program for Iraq.

vii. **The ISN also benefited from extensive consultations with the Government of Iraq, the donor community, and other stakeholders, including representatives from private sector and civil society organizations.** These consultations were helpful in identifying the country priorities, defining promising engagement arrangements to maximize Bank assistance results, and highlighting the centrality of donor coordination. Some of the main priority areas identified during the consultations include: (i) public financial management; (ii) banking sector reform; (iii) support to planning processes and strategy design (not only at the central level, but also at the sectoral and provincial levels); (iv) private sector development; and (v) energy and services.

viii. **Given Iraq's difficult operating environment and the uncertainties that lie ahead, an ISN is the appropriate strategy vehicle at this point in time. This ISN is also proposed for a longer time horizon – from mid-FY09 through FY11 – than the typical ISN.** This interim strategy contains lessons and principles of engagement. The work program beyond FY09 would be kept up to date through Annual Business Planning, jointly with the Iraqi Government to ensure it meets the evolving needs of the Government as well as evolving opportunities for engagement.

ix. **The central guiding principle of this ISN is that Iraq is well-endowed with natural and financial resources, and that the main role for the World Bank in this context is to help Iraq use its resources more effectively and transparently and to lay the ground work for an increased role for the private sector.** This principle impacts both the form and the content of the proposed work program for the next two years. However, it needs to be tempered by recent developments in the global economy and their impact on Iraq's projected oil revenues for the next few years and its increasing need for external financing in the short-to-medium term. Hence, this ISN anticipates IBRD financial support as requested by the Iraqi authorities.

x. **Regarding the *form* of the assistance, the main instruments of Bank Group support under this ISN include:** (i) operational support to accelerate implementation of the current portfolio, totaling about US\$1 billion; (ii) advisory services in selected sectors and areas; (iii) IBRD financial support in priority sectors to be selected on the basis of funding needs and implementation capacity; (iv) IFC investment and advisory services products; and (v) MIGA's political risk guarantee products. Under this ISN, an IBRD envelope of US\$500 million can be committed for investments projects over FY09-11. The Bank is currently administering 15 active grants funded from the Iraq Trust Fund, totaling US\$481.6 million to provide textbooks, schools, health clinics, improved social safety nets, water supply and sanitation, irrigation and drainage, and a comprehensive household survey. The ongoing IDA portfolio consists of five projects, worth US\$508.5 million, in the areas of education, roads, electricity, and water supply. IFC will support PSD through prioritized investments and advisory services in key sectors. The Bank's Analytical and Advisory Activities (AAA) program will support the Government in its efforts to enhance its ability to effectively use its oil revenues to the benefit of the Iraqi people. Key analytical work undertaken since re-engagement in 2003 includes a Study on Subnational Public Financial Management (2007), a joint IFC/IBRD Construction Industry Study (2008), a Country Economic Memorandum (2006), a Pension Reform Study (2005), a Report on Iraq's Public Distribution System (2005), an Investment Climate Report (2004), and a Study on State-owned Enterprise Reform (2004). The Government has also expressed interest in borrowing from IBRD as the need arises, increasing IFC support, and getting MIGA guarantees that could leverage private financing. Other instruments include the State and Peace Building Fund, and possibly, Treasury services.

xi. **With respect to the *content* of the assistance, activities under this ISN will fall under one or more of three thematic areas of engagement:** (i) *continuing to support ongoing reconstruction and socio-economic recovery*; (ii) *improving governance and the management of public resources, including human, natural and financial*; and (iii) *supporting policies and institutions that promote broad-based, private-sector-led growth*, with the goal of revitalizing the private sector and facilitating job creation. IFC and MIGA will play a key role particularly (but not exclusively) with respect to the third thematic area. New activities under the ISN will be chosen on the basis of criteria for selectivity reflecting opportunities to achieve concrete results on the ground.

xii. **The three thematic areas are closely linked with the key goals of the International Compact with Iraq.** The first ISN theme responds to the goals of the International Compact with Iraq (ICI) which are related to Iraq's reconstruction and recovery efforts, including strengthening the energy sector and developing a stable, competitive and sustainable agriculture. The second ISN theme responds to the ICI goals of improving public financial management as well as strengthening institutions and improving governance. The third ISN theme responds to the ICI goals of implementing economic reform to create an enabling environment for private investments as a driver for broad-based growth.

xiii. **To achieve tangible results in a relatively short term, the Bank Group will place a renewed emphasis on *how* this ISN will be implemented.** Building on lessons

learned from the implementation of the previous Interim Strategy Notes, the various consultations held, and other relevant country experiences, this ISN will aim to: (a) enhance the effectiveness of institution building and analytical and advisory activities; (b) strengthen the implementation of the current portfolio; (c) introduce more flexibility in the Bank Group's programming and ability to experiment with alternative implementation arrangements; and (d) foster donor coordination. For planning purposes, this ISN is based on the assumption that progress in the security situation over the next two to three years would continue to be slow and incremental, with a risk of reversal.

xiv. **Risks.** There are high risks to the World Bank Group's program in Iraq. The most important risk pertains to the political and security situation, which remains fragile, as does the country's operating environment. To mitigate this risk, the strategy emphasizes flexibility, and the Bank will adjust its activities as appropriate. Given the current limitations on mobility within the country, maintaining a vibrant dialogue with counterparts on issues of policy reform as well as implementation, and ensuring adherence to core fiduciary and safeguard requirements will remain challenging. These risks are substantial despite the Bank's mitigating measures, which include capacity building, local oversight capacity, and prudent financial management procedures.

I. INTRODUCTION

1. **This Interim Strategy Note (ISN) for Iraq outlines the World Bank Group's work program for the next two and a half years.** It draws on lessons learned from the implementation of the first and second ISNs and reflects Iraq's evolving and fluid political, security, and socio-economic situation. The design of this ISN benefited from extensive consultations with the Government of Iraq, the donor community, and other stakeholders, including representatives from private sector and civil society organizations.
2. **As the second ISN covered the period FY06-07, there is a need for an updated strategic framework to guide the Bank Group engagement in Iraq.** Iraq's improving but still fragile situation is not yet conducive to a full CAS. Therefore, an ISN remains the most appropriate instrument of engagement while Iraq is still transitioning to a more stable political, social and security situation. This ISN will cover the remainder of FY09 through FY11. From a corporate perspective, this ISN for Iraq will be closely linked with four of the six strategic themes for the Bank Group: (i) post-conflict and fragile states; (ii) middle-income countries; (iii) the Arab World Initiative; and (iv) knowledge and learning.
3. **The central guiding principle of this ISN is that Iraq is well-endowed with financial resources, and that the main role for the World Bank Group in this context is to help Iraq use its resources more effectively and transparently, and to lay the ground work for an increased role for the private sector.** This principle impacts both the form and the content of the proposed World Bank Group's work program for the next two and a half years.
4. **This document is organized as follows.** Section II outlines the country context for this ISN. Section III describes Iraq's reconstruction and development program and the international response to it. Section IV takes stock of and draws lessons from the implementation of the previous ISNs. Section V discusses the objectives and scope of this ISN. Section VI addresses key implementation issues. Section VII discusses the risks to which this ISN is subject to as well as associated risk mitigation measures. Section VIII outlines benchmarks for further engagement.

II. COUNTRY CONTEXT

A. Political Context

5. **Iraq is an oil-rich country.** Its economy is highly dependent on the oil sector and therefore subject to significant world oil price volatility and risks. The share of oil GDP has averaged 61 percent over the past four years. Crude oil exports represent 98 percent of total exports and oil revenues make up 96 percent of total budget revenue (excluding grants).
6. **Iraq is going through a complex political and economic transition compounded by a difficult security situation.** It is shedding its legacy of a centrally planned economy and adjusting to politically difficult economic reforms implemented from 2003 to 2008. Iraq is also shifting from one political system to another: from a unified, non-democratic central government to a democratic, decentralized and possibly to

a federal state. Iraq's political landscape remained in flux from 2004 to 2007 and sometimes stalled government operations. In addition, a fragile security situation hampered reconstruction and development efforts.

7. **The focus on security and the political process (three elections in one year; drafting of a constitution in a few months) captivated most of the attention of the emerging new leadership** (see Box 1). Iraq experienced a violent conflict of considerable intensity from 2003 until the end of 2007. Moreover, since 2003, Iraq has seen four different administrations (See Figure 1). After a year of administration under the Coalition Provisional Authority (CPA), sovereignty was handed over to an appointed Iraqi government on June 28, 2004. The first post-2003 election was held on January 30, 2005, for a 275-seat Transitional National Assembly which formed the Iraq Transitional Government¹. Following the approval, through a popular referendum, of the draft constitution in October 2005, elections for a four-year government were held in December 2005. Each province contributed a predetermined number of seats to a Council of Representatives (CoR). Voters chose lists representing their confessional affiliation and/or regions, and Shiite and Kurdish parties emerged dominant. The CoR was inaugurated on March 16, 2006. A 37-member cabinet led by Prime Minister Maliki was voted on May 20, 2006.

Box 1: Iraq: Changes in Leadership: Main Characteristics

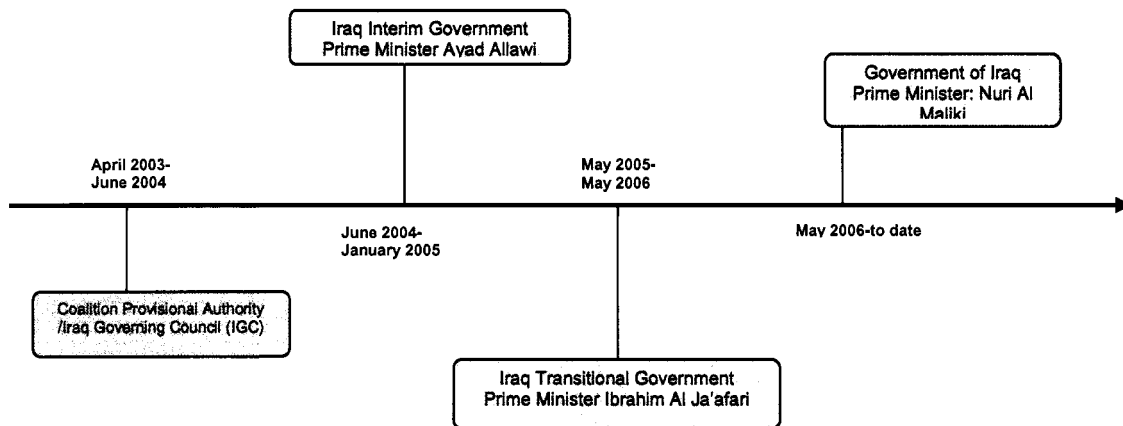
Political transition in Iraq has brought to the fore a new set of leaders. Since 2003, Iraq has seen four different administrations. A March 2006 Special Report drafted by the United States Institute of Peace² examining the new Iraqi leadership found that:

- Iraq's new leadership is educated (47 percent hold doctoral degrees or their equivalent) and the majority is middle aged (average age 54).
- A high percentage of the new leaders are former exiles with years of opposition to the Ba'ath regime and were unfamiliar with today's Iraq. With some exceptions, most held no real experience in government.
- There are virtually no hold-over from the Ba'ath era. The "de-Baathification" program implemented by the CPA (CPA order 1) resulted in the removal of 30,000 Iraqis at the four top levels of the Ba'ath Party and barred any of these top level officials from holding public office. This fundamental change contributed to insufficient carryover in leadership experience.
- Ministers have changed posts frequently. It was thus difficult to build institutions or develop expertise in managing their departments. In addition, this time constraint did not allow leaders to develop ties with the lower levels of the administration.

¹ The election also formed four-year term provincial councils in all 18 provinces (41 seats per council; 51 for Baghdad), and a Kurdistan regional assembly (111 seats) under the "Transitional Administrative Law" (TAL, enacted March 8, 2004).

²This box draws largely from USIP's *Special Report 160: Who are Iraq's new leaders? What do they want?* March 2006.

Figure 1



8. **Violence and political wrangling in Iraq delayed implementation of reconstruction and economic development priorities.** Although Iraq's security situation has improved significantly over the year, it has had significant impact on the economy and the politics in Iraq since 2006. Incessant violence forced thousands of people to leave their homes every month presenting Iraq and the international community with a large scale humanitarian crisis. Delivery of basic public services was also severely limited. The economy suffered directly from conflict with constrained real GDP growth in 2006 and 2007 and below-target oil production. Continued conflict and the unsettled political situation impacted ownership and implementation of the post-conflict reconstruction agenda. Ongoing violence also hampered private and public investment. In addition, between 2007 and 2008, the 37-member cabinet did not function at its full capability. In early 2007, withdrawal of 17 cabinet members belonging to various political parties impeded government operations. Key legislation such as the passing of the budget was delayed over the past three years. Furthermore, negotiations over a Hydrocarbons Law and provincial elections were difficult and continuously stalled.

9. **Despite these challenges, progress was made on a number of legislative benchmarks supported by an improvement in the security situation.** In 2008, the CoR approved a Justice and Accountability Law (formerly called de-Baathification law) and an Amnesty law which should grant amnesty to thousands of political detainees, both key demands. Along with these key legislative benchmarks adopted, political parties that boycotted the government rejoined the cabinet in July. Another key piece of legislation, the provincial elections law, was adopted on September 24, 2008. Provincial elections took place³ on January 31, 2009 except in Kirkuk. The legislation mandates a parliamentary committee to review the Kirkuk issue and make recommendations on resolving it by March 2009. Provincial elections are perceived for many as a pivotal step to promoting national reconciliation by giving voice to constituencies that boycotted the vote in January 2005.

³ These elections were originally planned for October 1, 2008. They were delayed due to disagreement over the status of the oil-rich city of Kirkuk and other disputed internal boundaries.

10. **Important challenges remain for the reconciliation process in Iraq.** Chief among those are: (a) the type of federal system to be adopted in Iraq; (b) the degree of devolution of powers to the regions; (c) the status of Kirkuk and other disputed internal boundaries; (d) the modalities and mechanisms of oil revenue management, particularly in view of (a)-(c) above⁴; (d) the nature of the political system, particularly with respect to the potential for further sectarian polarization; and (e) Iraq's place in the broader geopolitical context, in light of the Status of Forces Agreement, and its evolving relationships with neighboring countries.

B. Implementation of Economic Reforms: 2003-2008

11. **In the early post-war years, attempts were made to implement reforms similar to the “shock therapy” programs of the mid-90s in some transition economies of Eastern Europe.** The main thrust of the reforms revolved around the assumption that market-friendly reforms and the creation of appropriate legal and regulatory arrangements to facilitate private investment would lead to reconstruction and growth. Reforms were oriented towards creating an attractive investment climate for foreign investors and a new economy. Foreign investors would be allowed 100 percent ownership of Iraqi assets, repatriation of profits and equal legal standing with local firms, except in the oil production and refining sectors. Foreign banks were permitted to establish operations and purchase equity shares in existing Iraqi financial institutions. Income and corporate taxes were capped at 15 percent. Tariffs were reduced to a universal 5 percent with none on food, drugs, books and other humanitarian imports. Iraq's State-Owned Enterprises, except for those in the oil sector, were to be privatized.

12. **Some of these reform efforts were premature for Iraq and lacked domestic ownership, often leading to disappointing results.** Only relatively few of the policy reforms implemented in Iraq in the early postwar years were tailored to the local context. These reforms were at times ill-informed and revealed a lack of appreciation of local context and needs. This disconnect was exacerbated by the massive brain drain that occurred during the period. Local capacity was unavailable and sometimes inadequate. The Iraqi economy, particularly in the wake of the 1991 Gulf War, had suffered from high inflation, capital consumption and rapidly falling living standards. Iraq's institutions were also shaped by 30 years of authoritarian legacy, decades of sanctions, war and dictatorship where rent seeking and patronage reigned and oil provided the state with a tool to garner public compliance. The state provided Iraqis with free services and utilities such as gas, electricity and water. Most prices were controlled, many consumer goods and foodstuffs rationed, and the money and banking system was developed to finance the state apparatus.

13. **Nonetheless, significant progress was achieved during the past few years with the support of the international financial organizations.** Under the monitoring of three consecutive IMF programs, the Government succeeded in drastically improving macroeconomic performance. Growth is projected to increase from 1.5 percent (2007) to

⁴ Contention on the Hydrocarbon Law revolves around the extent of foreign participation in the oil sector. Some favor a regional sharing of responsibilities while others prefer a national oil investment and production framework which would allow oversight of foreign investment.

9.8 percent (2008). Authorities managed to curb inflationary pressures and reduce dollarization of the economy. The Government's record demonstrates its commitment to fiscal sustainability and sound macroeconomic policies. As such, direct budgetary fuel subsidies were eliminated by 2008 except for a small subsidy on kerosene, which will be abolished in 2009. With the support of the IMF and the World Bank, progress in strengthening budget management and banking sector reform is underway⁵. With support from the IMF, the Government also executed a debt restructuring program with all Paris Club creditors which should be completed by December 2008. Non- Paris Club restructuring is still on-going. However, a trade-off remains between curbing spending to maintain financial discipline with the need for public sector investments and job creation.

C. Recent Economic Developments and Prospects

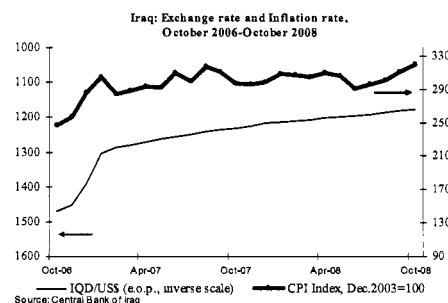
14. **As a direct result of conflict, real GDP growth between 2003 and 2007 has been fragile and volatile.** After reaching 46 percent in 2004, real GDP growth marked a slowdown between 2005 and 2007, moderating to 1.5 percent in 2007. Economic activity in 2008 benefited from an increase in oil production and exports, reaching record highs since 2004. Oil output has been consistently averaging 2.5 mbpd in Q3/2008. After missing its yearly production target since 2005, Iraq's oil sector was above target for most of 2008. The rise in production is due to rising output from the North and secured oil-related facilities and personnel. Real GDP growth is estimated to have risen to almost 10 percent in 2008. Non-oil activity appears to have regained some momentum in 2008 although lack of data continues to hamper accurate reporting of this sector. Non-oil activity has suffered from years of embargo and ill-conceived policies. The informal economy has expanded significantly since the 1990s and especially after 2003.

Figure 2 Economic growth



15. **The monetary and exchange rate policy stance has helped contain inflation and reduce dollarization in the economy.** Between 2003 and 2007 capital inflows, supply bottlenecks and conflict had accelerated inflation. Consumer price inflation jumped to 65 percent in 2006. By end-2007, inflation was brought down to 5 percent. Inflation has been capped with a fiscal and monetary policy mix. Since November 2006, the CBI had allowed a gradual appreciation of the ID against the dollar and raised its policy interest rate to 20 percent as of January 2007. Between end-2007 and July 2008, the CBI lowered its policy rate in three steps from 20 percent to 16 percent. The CBI policy interest rate has been reduced to 15 percent as of November 3, 2008. As inflationary pressures get contained, further easing of monetary policy through the policy interest rate would be

Figure 3



⁵ Annex III provides a summary of the main achievements of Iraq's reform process.

conducive to better functioning of the banking sector. Accumulation of gross international reserves reached US\$40 billion at end July 2008 (equivalent to about 11 months of imports of goods and services).

16. **Iraq's fiscal position remained strong while oil prices were on the rise.** Fiscal surpluses were achieved for four consecutive years. Rising oil revenues and a low rate of execution of the capital budget strengthened the fiscal position. The balance in the Development Fund for Iraq (DFI) reached US\$23.5 billion by end September 2008, an 85 percent increase from end-2007. Direct budgetary fuel subsidies were eliminated in 2008 except for a small subsidy on kerosene. These had amounted to 13 percent of GDP in 2004⁶. The overall budget surplus reached 13.5 percent of GDP in 2007. Rising output in 2008 has allowed the CoR to boost this year's budget in a supplementary spending bill approved earlier in August. The supplementary budget includes significant increases in current and capital spending in priority sectors while preserving fiscal sustainability. The inflationary impact of this fiscal stimulus is expected to be modest. A preliminary overall surplus for 2008 is estimated at about 8 percent despite the recent downturn in world oil prices and the supplementary budget. In addition, capital spending has increased two-fold from 2007 levels but is still below budget.

17. **Iraq's current account is estimated to have reached a surplus of 17.3 percent of GDP in 2007.** Due largely to the predominance of oil exports, the current account balance is expected to reach 15 percent of GDP in 2008. The overall balance of payments is projected to deteriorate in 2009 as oil prices retreat and aid flows decline.

18. **Iraq's debt restructuring has made substantive progress.** With the third and last stage of Paris Club debt reduction that went into effect in December 2008, Iraq has restructured its external debt with all of its eighteen Paris Club creditors. Debt agreements have also been concluded with 11 non-Paris Club creditors. Negotiations are ongoing with the remainder. In July, the United Arab Emirates announced full cancellation of Iraq's outstanding debt. Most of Iraq's commercial debt was successfully renegotiated over 2004-2006, leaving Iraq with an outstanding debt of US\$5.2 billion by end-2007 (down from US\$21.9 billion). The old debt was swapped (with an 80 percent discount) into a 20-year bond. By end-2007, Iraq's total external debt amounted to US\$103 billion, or about 165 percent of GDP. The debt-to-GDP ratio could be reduced to a third of that figure in 2009 if agreements with all non Paris Club creditors were completed along terms similar to the 2004 agreement with Paris club creditors.⁷ Based on the Paris Club Agreement, Iraq will start making repayments on the remainder of the debt stock by 2011. However, the recent slump in world oil prices has increased Iraq's external vulnerability given the country's dependence on oil exports.

19. **GDP growth of about 8 percent is projected for 2009.** This assumes continued progress in the security situation and a sustained increase of oil production and exports. Assuming the former, non-oil sector activity is expected to pick up further in 2009, and

⁶ However, indirect subsidies are expected to increase to 6.5 percent of GDP in 2008 due to higher international oil prices.

⁷ The largest bilateral creditors (mostly Gulf countries) have yet to negotiate agreements on terms comparable to the Paris Club.

inflation is projected to be contained at 10 percent. A zero current account balance is projected for 2009. Provided a continuing rise in oil export volumes and upturn in oil prices, the current account balance is expected to improve by 2010. Refer to Table 1 below.

Table 1. GDP Estimates and Projections

	2006	2007	2008p	2009p	2010p	2011p
Nominal GDP (in US\$ billion)	49.5	62.4	93.8	83.5	94.8	108.1
of which non-oil GDP (percent of GDP)	42.5	43.4	35.8	47.3	45.1	43.1
Real GDP growth (in percent)	6.2	1.5	9.8	7.7	7.2	7.3
Per capita GDP (US\$)	1,720	2,109	3,085	2,673	2,957	3,292
Consumer Price inflation (percentage change, e.o.p)	64.8	4.7	12.0	10.0	8.0	7.0
Iraqi oil export Price (US\$ per barrel)	55.6	63.0	93.3	62.5	68.5	72.8
Oil production (in mbpd)	2.0	2.1	2.4	2.5	2.7	2.9

Source: Central Bank of Iraq, World Bank and IMF staff estimates and projections (p: projections).
Nominal GDP for 2009 takes into account the effect of falling oil export prices.

20. **While the direct impact of the global financial crisis on the economy remains limited, the indirect impact through declining oil prices may be significant.** Iraq's banking sector is underdeveloped and centered on the domestic market. Levels of direct foreign investment and private capital flows are very low. However, the financial crisis has set off a global recession. Crude oil prices fell 25.8 percent in November 2008, averaging US\$54.0/bbl, and fell to a low of US\$40/bbl in early December 2008—down more than US\$100/bbl or 72 percent since peaking in early July. Oil prices are not expected to recover to early 2008 levels in the immediate future. Due to this recent fall in prices, the Government revised the initial 2009 spending budget twice with a lower oil export price (currently US\$50).

21. **As a result, the 2009 budget projects a fiscal deficit, reflecting declining oil prices.** It envisages cuts in recurrent spending and adjusting investment to implementation capacity. It still provides for an increase in capital spending compared to expected 2008 outturns and a rise in security spending. A deficit of about 17 percent is projected. Financing of the fiscal balance will come from the draw down of resources in the Development Fund for Iraq (DFI). The Government announced that public spending would be reduced in a supplementary budget if oil export revenues are substantially lower than budgeted. The Iraqi authorities remain committed to fiscal sustainability and, assuming a gradual recovery in oil prices, a surplus should be envisaged by 2012.

22. **Despite notable achievements in putting macroeconomic policies on a sustainable path, the medium-term economic outlook for Iraq is subject to considerable risks.** Reversal of the current security situation or increased political instability could lower economic growth and amplify inflationary pressures as well as stall the structural reform agenda. Moreover, the slump in world oil prices is posing a serious risk to Iraq's fiscal and external accounts. The global recession could be particularly severe

and prolonged. Lower than projected oil export prices for the next two years could translate into more economic and political volatility in the medium term, indicating a potentially increasing need for external financing.

23. **While some reform efforts are showing positive results, they have yet to trickle down to the Iraqi population.** Violence and conflict have created an unparalleled movement of population in Iraq, the largest in the Middle East since 1948. An estimated total of over 2.5 million are internally displaced and over 1.5 million are refugees⁸. Unemployment remains high and access to basic services continues to be severely limited. Electricity supply is unreliable and far exceeded by demand; access to clean water and sanitation is among the lowest in the Region; and recent improvements in access to education and health services have not yet translated into significant welfare gains on the part of the people of Iraq.

III. IRAQ'S RECONSTRUCTION AND DEVELOPMENT PROGRAM AND THE INTERNATIONAL RESPONSE

24. **The Government's reconstruction and reform program has been spelled out in the National Development Strategy (NDS) and the International Compact with Iraq (ICI).** In addition, drawing on newly available information on poverty from the recently completed Iraq Household Socio-Economic Survey (IHES), Iraq's High Committee on Poverty Reduction has initiated work on a Poverty Reduction Strategy for Iraq.

25. **The NDS, presented in July 2005 by the Iraqi Transitional Government, covered the period 2005 – 2007.** The NDS was structured around four pillars for sustainable development, which remain relevant to Iraq's present conditions: (i) strengthening the foundations of economic growth; (ii) revitalizing the private sector as the engine of growth and job creation; and (iii) improving the quality of life; and strengthening good governance and improving security.

26. **The International Compact with Iraq (ICI) was launched on May 3, 2007 by Prime Minister Nouri al-Maliki and UN Secretary General Ban Ki-Moon.** The ICI is an initiative of the Government of Iraq for a new partnership with the international community. As such, the ICI is the platform for Iraq's cooperation with the international donor community. The primary focus of the ICI is "to build a framework for Iraq's economic transformation and integration into the regional and global economy".

27. **The ICI concentrates on four reform and investment areas as well as in two sectors:** (i) public resource management; (ii) governance and institutions; (iii) economic reforms; (iv) social sector reform; (v) energy; and (vi) agriculture. The first annual review conference of the ICI was held on May 29, 2008 in Stockholm. The review examined the achievements and noted the progress made by the Iraqi government in meeting the Compact benchmarks during 2007-2008.

⁸This includes an estimated 1.2 million who were internally displaced before February 2006 and 500,000 refugees before 2006. *IOM Emergency Needs Assessments, Post February Displacement in Iraq*, November 2008.

28. **The international community has committed in excess of US\$29.2 billion of financial assistance to Iraq between June 2003 and June 2008.** A significant proportion of this assistance was provided through the US Government Iraq Relief and Reconstruction Fund (IRRF) as grants. Other significant contributions include those of Japan and the European Commission and the multi-donor International Reconstruction Fund Facility for Iraq (IRFFI) comprising contributions from 25 donor nations. The majority of international financial assistance has been aimed at reconstruction and development of essential services infrastructure (water, electricity, health, education), with further infrastructure grants to the oil, security and transportation sectors, primarily by the US Government. More recently, international assistance has increasingly become focused on policy advice, capacity development and technical assistance to unlock Iraq's own significant financial resources for economic development, and to develop private sector engagement in Iraq.

IV. THE WORLD BANK GROUP ENGAGEMENT WITH IRAQ: STOCKTAKING AND LESSONS LEARNED

A. The World Bank's Engagement with Iraq

29. **Iraq has a long history of engagement with the Bank Group.** Iraq was a founding member of the World Bank and IFC, and received six loans from the International Bank for Reconstruction and Development (IBRD) between 1950 and 1973 for agriculture, education, flood control, telecommunications, and transport. The last loan closed in 1979. The World Bank Group re-engaged with Iraq in the summer of 2003 when it prepared a needs assessment together with the United Nations (UN). The UN-World Bank Joint Needs Assessment was the basis for the October 2003 International Conference on Iraq in Madrid. The International Reconstruction Fund Facility for Iraq (IRFFI) was endorsed at the Madrid Conference, in response to international requests for donors to channel their resources and coordinate their support for reconstruction and development activities in Iraq. In close consultation with Iraqi authorities and donors, the World Bank and UN created the structure, governance, and modalities of IRFFI. The IRFFI structure is designed to ensure that activities financed by the Facility are aligned with Iraq's priorities. IRFFI encompasses two trust funds: the World Bank Iraq Trust Fund (ITF) administered by the World Bank, and the UN Development Group Trust Fund (UNDG Trust Fund) administered by the United Nations Development Program (UNDP) on behalf of itself and participating UN organizations. The World Bank Board of Executive Directors approved the World Bank to act as Administrator of the ITF in January 2004.⁹

30. **World Bank Group support to Iraq since 2003 has been framed around two Interim Strategy Notes.** The first ISN (FY04-05) for Iraq was presented to the Board of Executive Directors in January 2004. It built on the Bank's work in 2003, including the preparation of Watching Briefs in key sectors as well as on the joint Needs Assessment undertaken in collaboration with the UN. It was designed to rely on the Bank's Iraq Trust

⁹ The ITF finances 18 grants (US\$481.6m). There are 4 new projects in the pipeline for a total planned allocation of US\$37m. The ITF is comprised of the following countries: Australia, Canada, EC, Finland, Iceland, India, Japan, Korea, Kuwait, Netherlands, Norway, Qatar, Spain, Sweden, Turkey, UK, and USA. The largest donor is the EC (US\$179.7m), followed by Japan (US\$130.6m) and UK (US\$71.4m).

Fund to finance emergency projects. Activities under the first ISN were organized under three tracks: (i) Build Iraqi institutional capacity; (ii) prepare and start implementing emergency operations to address urgent needs; and (iii) lay the groundwork for Iraq's medium-term reconstruction and development program.

31. **The second ISN (FY06-07) was discussed by the Board of Executive Directors in September 2005.** It provided the framework for up to US\$500 million from IDA as well as additional resources from the Iraq Trust Fund. Under the overall umbrella of institution building, the second ISN was organized around four pillars: (i) restore basic service delivery; (ii) enable private sector development; (iii) strengthen social safety nets; and (iv) improve public sector governance.

32. **The Bank has approved since 2003 a total of US\$990.1 million in financing for Iraq:** US\$481.6 million in grants from the World Bank Iraq Trust Fund and US\$508.5 million in soft loans from IDA. Both the first and second ISNs envisaged possible IBRD support (in the order of US\$500 million), which did not materialize in view of Iraq's limited absorptive capacity.

33. **Since the inception of IFC's work in Iraq in 2003, the Corporation has undertaken a range of investment and technical assistance activities.** The primary focus of the program has been to support for the financial sector, the construction sector, and SMEs. IFC committed US\$115 million in 3 projects since 2003. IFC has 10 percent stake in Credit Bank (US\$5 million), provided US\$12 million loan to Iraq National Bank (INB) to support SME lending, and committed US\$99 million to support the construction of the first private cement company in Suleimanya, Kurdistan.¹⁰

34. **The Iraq Small Business and Finance Facility (ISBFF) was approved by the IFC Board in December 2003, and has been operational since mid-2004.** The facility has funding of US\$83 million, comprising an investment component of US\$68 million (from UK, US and IFC) to provide funding to local financial institutions for on-lending to micro and SMEs and a technical assistance component of US\$15 million (from Japan and Spain) to create capacity on the ground for MSME financing. Iraq National Bank (INB) was the first bank to be selected under the Facility.

35. **Numerous capacity building activities and knowledge products covering different sectors have been delivered since 2003.** Analytical work includes a Study on Sub-national Public Financial Management (2007), a Country Economic Memorandum (2006), a Pension Reform Study (2005), a Report on Iraq's Public Distribution System (2005), an Investment Climate Report (2004), and Study on State-owned Enterprise Reform (2004). More recently, sector strategies have been completed or initiated with Bank support, including in the water, education and electricity sectors (see Annex V).

36. **Through PEP-MENA, IFC's advisory services since 2003 included:** (i) training to around 250 Iraqi bankers (ii) completing SME advisory to INB in collaboration with

¹⁰ Due to sponsor issues, project related developments, and security circumstances, both INB and the cement project have been cancelled in 2008.

Rabobank of Holland, (iii) supporting, together with World Bank and UN-Habitat the development of a local land development strategy and the construction industry sector; (iv) successfully implementing its SME management training program, Business Edge; and (v) organizing a conference to discuss the development of the country's cement sector, which brought together key investors, government leaders, donors, and the private sector.

37. **Since the security situation has limited World Bank Group staff from freely traveling to and around Iraq, the World Bank Group employs special measures to supervise project implementation and mitigate risks for its program in Iraq.** Iraqi staff and consultants, backed by staff in Amman, Beirut, and Washington, monitor project progress and support the Project Management Teams (PMTs) on a daily basis. While task teams typically conduct semi-annual project supervision missions, task teams supervise projects in Iraq 3-4 times per year. These supervision missions have usually been conducted at the Interim Office for Iraq in Amman and sometimes in Beirut. This arrangement has facilitated the gathering of large teams with numerous counterparts as well as consultations that require a commitment of several days at a time (see Box 2).

Box 2: How the World Bank Group Works in Iraq

Iraqi Staff/Consultants throughout Iraq. The World Bank has had a continuous presence in Iraq since mid-2004, employing several professional-level Iraqis. Several national staff and consultants work out of their homes (using satellite phone and email connections) and in the executing agencies to support the implementation of projects. Their access to the former "Green Zone" was constrained due to security risks and complex clearance procedures at check points to enter that Zone. In the KRG, however, staff and consultants were able to function normally, attending meetings and visiting project sites as needed.

International Staff in Baghdad. International staff based in a secured area in Baghdad focus on overall policy dialogue and donor coordination and are playing an increasing role in portfolio oversight. From mid-2004 to mid-2007, the UK's Department for International Development (DFID) facilitated an expatriate consultant based in the former "Green Zone" to serve as a liaison for the World Bank with the Iraqi Government and donors. In 2007, that role was expanded to that of a Country Manager for Iraq. The World Bank hired a new Country Manager and a new public sector specialist both located in Baghdad as of the last quarter of 2008. In addition, a DfID-funded private sector development specialist and a senior operations officer are being recruited to further strengthen the Country Office's capabilities. Bank staff in Baghdad are supported by a projects assistant and support staff. IFC staff visited Iraq to conduct field appraisal of one project.

Interim Office for Iraq in Amman. The Amman Office was established in 2003, after the bombing of the UN headquarters in Baghdad, which also housed the Bank's office, which killed one Bank consultant and injured several staff. The Amman Office provides key logistical support for Bank staff and consultants located in Iraq and for visiting missions, including support for staff travel, security, and medical emergencies, in addition to administrative support to the Iraq program, it also provides a cost-effective and secure venue to hold meetings and workshops that require large teams to work closely over several days, as is required for appraisal, negotiations, and supervision missions.

The IFC Jordan Office in Amman. The office is responsible for covering IFC's programs in Jordan and Iraq and is co-located with the World Bank's Interim Office for Iraq. The office allowed for improved communication with Iraqi government counterparts and the private sector community. Many major Iraqi businessmen and private sector companies are located in Jordan. It has also allowed for better coordination with the donor community, and improved coordination with the World Bank.

Fiduciary Monitoring Agent (FMA). The Bank employs an Iraqi firm in Baghdad, to help ensure that funds are disbursed only for the purposes intended and according to applicable World Bank procedures. The FMA employs about two dozen Iraqi staff, predominantly professional engineers and accountants, who visit project sites and ministries on a daily basis. The FMA reports its findings to the World Bank task team and the Project Management Teams in the implementing agencies.

Videoconferencing (VC) Facilities. In 2004, the World Bank installed four video-conferencing facilities in Baghdad (located in the Convention Center in the former Green Zone, Ministry of Planning, Ministry of Finance, and Central Bank of Iraq). The VC hub at the convention center was dismantled without warning in mid-2006 by Iraqi officials. The World Bank procured and installed portable VC equipment in the World Bank office.

38. **The World Bank also engages a local Iraqi firm as a Fiduciary Monitoring Agent (FMA) to help supervise project implementation.** The FMA assists PMTs in building their capacity in project management, visits project sites and supports the PMTs to monitor the physical implementation of projects and the implementing agency's compliance with the required procurement and financial management procedures. The FMA reports issues to the World Bank's task teams as they arise, to ensure the teams can follow up on any implementation concerns. The FMA's monthly reports describe and document the physical progress of projects, report key findings, and make recommendations for follow-up actions to be carried out by the PMT and World Bank task team. Reports include digital photos, which provide evidence of the delivery of goods, and assess the quality and progress of the work of contractors. Staff of the FMA also participated in supervision missions, working closely with the task team and PMT to improve project implementation. The FMA performance is evaluated each year by the Bank.

B. Lessons Learned from the Implementation of the First and Second ISNs.

39. **The design of this Interim Strategy Note benefited from a stocktaking of the Bank Group engagement with Iraq over the past five years.** The goal of the stocktaking exercise was to identify the key bottlenecks for the implementation of the previous ISNs and extract lessons for this ISN.

40. **Achieving results in the Bank's program and implementation experience are linked.** Difficulties in the operating environment have led to delays in many projects reaching their development objectives yet, although some emergency reconstruction projects have yielded results. Some projects – such as the ITF-funded Textbook Provision, Household Survey, and Community Infrastructure projects – have been successful while other projects are encountering implementation delays as a result of a number of factors, which can be classified in two categories: (i) issues related to Iraq's operating environment; and (ii) Bank-related issues. Implementation issues are further addressed in Section VI, while Box 3 summarizes some of the key achievements so far associated with Bank-supported projects.

41. **Operating environment issues** comprise security; the policy and institutional environment; counterpart engagement; and weaknesses in the banking system.

- *Lack of security* affects Bank Group activities in a number of ways: (i) the safety of Iraqi officials and Iraqi Bank staff is at constant risk; (ii) Bank Group staff's ability to visit Iraq is constrained and when possible limited to secured areas in Baghdad or with high levels of security arrangements or Kurdistan, offering very limited direct interaction with high officials; (iii) most project supervision missions and interactions with Iraqi counterparts are held outside the country; and (iv) IFC's ability to conduct its required field appraisal of projects is significantly hampered. Security concerns have affected the willingness of international contractors and consultants to bid for projects in

Iraq, and have contributed to work stoppages and long delays in many instances.

- *Iraq's policy and institutional environment* has not been conducive to a smooth implementation of the Bank Group's assistance program. Main bottlenecks include: (i) weakened capacity of ministries and implementing agencies as a result of the large-scale departure of talented professional staff; (ii) likewise, pre-existing private capacity to a large extent eroded by the exodus of skilled professionals; (iii) lack of familiarity with World Bank procedures and approaches to project management; (iv) a decision-making process hampered by an atmosphere of uncertainty and by a history of overly centralized processes; (v) lengthy procedural delays and inability or unwillingness to delegate functions within ministries; and (vi) frequent changes in leadership leading to turnover in government counterparts at all levels. Furthermore, private sector development activities by IBRD and IFC are further constrained by incomplete legal and regulatory frameworks, weak enabling environment for businesses, limited financial capacity of project sponsors, insufficient understanding of the requirements of project finance, and unavailability of financial statements and feasibility studies of projects.
- *Counterpart engagement* has been uneven across ministries and implementing agencies. In addition, lack of qualified human resources combined with frequent changes in ministry staff slow implementation and often setback progress.
- *Weaknesses in the banking system* have contributed to delays in payments to local contractors, becoming a major impediment to project implementation.

Box 3. World Bank: Examples of Assistance Results (As of December 2008)

- Financed the printing and distribution of more than 82 million textbooks, averaging approximately 11 textbooks per pupil, and exceeding the original objective of distributing 69 million books.
- Rehabilitated 133 schools and constructed 46 schools.
- Rehabilitated 8 hospital emergency units, 6 of which have been officially handed over to MOH, supplied essential equipment and drugs, trained 48 doctors and 60 nurses in Advanced Trauma Life Support and trained 22 doctors in Emergency Preparedness and Response.
- Completed 22 labor-intensive rural water supply subprojects in 14 governorates.
- Completed the first nationwide household income and expenditure survey since 1998, covering 17,000 households. Results will help Iraq establish a poverty line and make data-based policy decisions.
- Conducted 22 workshops for 600 Iraqi officials to provide essential project implementation tools and help Iraqi officials develop professional networks with regional neighbors.
- Carried out more than 60 workshops for over 1,200 Iraqi officials in economic management, public sector management and social safety nets.

42. **Bank-related issues** refer to the focus of Bank assistance; and Bank processes and fiduciary arrangements.

- Bank assistance to Iraq has largely responded to the country's multiple reconstruction needs as identified in the 2003 Joint Needs Assessment carried out jointly with the United Nations (and later reiterated by the National Development

Strategy). The downside of this approach is that the Bank's assistance program *may not have been sufficiently selective, being to some extent driven by the highly charged and visible international focus on Iraq at the time*. While the Bank did not want to put 'all its eggs in one basket', the Bank has been involved – both in terms of financial support and AAA – in virtually every sector in Iraq without sufficiently clear engagement criteria. Implementation, as discussed further in Section VI proved difficult. As already identified in ISN2, the Bank could have better managed expectations and assumptions as results were lower than expectations given the weakened institutional capacity, and what ended up being a worsened security situation over the implementation period. A greater sense of pragmatism and adaptation to the Iraqi context would have enhanced the impact of the Bank's assistance efforts.

- While procurement and disbursement procedures were adapted to Iraq's circumstances, *the Project Management Teams still find Bank processes and fiduciary arrangements challenging*, as highlighted during the consultation process. To respond, the Bank provides regular training on Bank procedures, such as financial management and procurement. The Bank also uses its most flexible procedures for emergency situations and addresses implementation issues as they arise, as well as through the CPPR mechanism.

43. Therefore, the **key lessons** for this ISN from past experience are: (i) for planning purposes, it should be assumed that progress in the security situation over the next two to three years would continue to be slow and incremental, with a significant risk of reversal due to the outstanding sensitive political issues yet to be addressed; (ii) despite the mixed results obtained thus far in terms of institution building in Iraq, it continues to be an imperative for the Bank's engagement with Iraq, and its delivery should be customized to the varied needs encountered and to the Bank's own ability to meet those needs; (iii) interest and engagement on the part of ministries and implementing agencies should be a criterion for Bank support; (iv) more selectivity is needed in terms of the ability to identify and seize opportunities as they arise to achieve concrete results; (v) the design of new investment projects, analytical products, and institution-building activities should support reform efforts that do not overtax Iraq's existing capacity and that more clearly reflect the country's current political and security situation; and (vi) additional flexibility is needed in the design and programming of Bank assistance, in the scope for experimentation with alternative implementation arrangements, and in the way IFC conducts its field appraisal of projects.

V. THE WORLD BANK'S ASSISTANCE STRATEGY UNDER THE INTERIM STRATEGY NOTE (FY09-FY11)

44. **Iraq's unsettled political and security situation calls for an ISN that is flexible in both design and implementation arrangements.** Flexibility in design means that this ISN will not be overly specific about individual activities, but it will rather contain a broad menu of options to: (i) respond in a demand-driven way to Iraq's evolving needs and priorities, while taking into account the Bank's comparative advantages; and (ii) seize opportunities as they arise to achieve concrete results. Flexibility in implementation means

that the Bank Group will explore ways to increase the effectiveness of its activities and engage with, parliamentarians, civil society and the private sector. This includes experimenting with other implementation and monitoring arrangements such as third party execution, and direct transfers to NGOs, as discussed in Section VI.

45. Given Iraq's difficult operating environment and the uncertainties that lie ahead, an ISN is the appropriate strategy vehicle at this point in time. The period for this ISN is two and a half years, to be updated to a full Country Assistance Strategy broadly in line with the benchmarks for further engagement spelled out in Section VIII. The work program beyond FY09 would be kept up to date through Annual Business Planning, jointly with the Iraqi Government to ensure it meets the evolving needs of the Government, as well as evolving opportunities for actual institutional and policy improvements. This would be complemented by periodic briefings to the Board on the status of the program.

46. Reflecting these realities, and broadly consistent with the goals of the NDS and the ICI, this ISN will focus on three thematic areas of engagement:

- Theme 1: Continuing to support ongoing reconstruction and socio-economic recovery efforts. Activities under this theme will support Government policies and public investments that will help restore and modernize Iraq's physical and human capital.
- Theme 2: Improving governance and the management of public resources, including human, natural and financial. Activities under this theme aim to strengthen the institutional context wherein Government policies and public investments take place.
- Theme 3: Supporting policies and institutions that promote broad-based, private-sector-led growth. Activities under this theme will support the transition to a more private-sector-oriented development process over the medium to long-term.

This definition of objectives will allow the Bank Group to focus its assistance in areas where it has a comparative advantage and where there is strong demand from and engagement by the Iraqi counterparts, while at the same time building to the extent possible on work already initiated under the previous ISNs. The achievement of these objectives will be supported by both analytical/advisory activities (AAA) and financial assistance, both through the ongoing portfolio, as well as new IBRD and IFC commitments.

47. The three thematic areas of engagement ("themes") are mutually reinforcing and, if successfully implemented, can help create a virtuous cycle of development. For example, a stronger public financial management (PFM) system (theme two) should accelerate the implementation and increase the success rate of public investments (theme one), while improving the business environment wherein the private sector can flourish (theme three). At the same time, a thriving private sector (theme three) can strengthen the demand and add pressure for continuing institutional reform (theme two) and for more growth-oriented public investments (theme one).

48. **The three themes are closely linked with the key goals of the International Compact with Iraq (ICI).** The ISN theme of supporting ongoing reconstruction and socio-economic recovery efforts responds to the ICI goals of strengthening the energy sector and developing a stable, competitive and sustainable agriculture. The ISN theme of improving the management of public resources responds to the ICI goals of improving public financial management as well as strengthening institutions and improving governance. The ISN theme of supporting policies and institutions that promote broad-based, private-sector-led growth responds to the ICI goals of implementing economic reform to create an enabling environment for private investments as a driver for broad-based growth.

49. **The design of the ISN was informed by consultations held with the Iraqi authorities, the donor community and other stakeholders, including representatives from labor unions, women's organizations, and private sector as well as parliamentarians.** A key conclusion of the consultations with the Iraqi authorities was that the assistance to Iraq under the ISN should focus on areas of Bank comparative advantage, while aligning with the most pressing priorities of the country leading to sustained growth. They include: (i) public financial management; (ii) banking sector reform; (iii) support to planning processes and strategy design (not only at the central level, but also at the sectoral and provincial levels); (iv) SMEs development, and (v) energy and services (covering most of the Bank's current portfolio in Iraq). The authorities also emphasized the need for (a) greater sectoral focus (with priority given to energy and agriculture, but also including municipalities and water); (b) a more comprehensive approach to capacity building (emphasis on institution building – including organizational issues, systems, processes and policies – rather than just training individuals); and (iii) strengthened donor coordination. Many of these broad conclusions were echoed by the other stakeholders. Similarly, the donors singled out institution building support as the mainstay of the Bank's work in Iraq. In this context, most donors agreed that public financial management and private sector development should be at the forefront of the Bank Group assistance, and that the Bank's AAA and IFC advisory services work should also support the design of sector strategies.

50. **IBRD's work program in Iraq under this ISN will mainly include ongoing operations and advisory activities.** A key goal of this ISN is to increase the development effectiveness of the Bank's current assistance program in Iraq. This issue is tackled in detail in subsection VI.B below.

51. **New activities under this ISN will be decided on the basis of clear criteria for selectivity – not in terms of the sector cut, but identifying and seizing opportunities as they arise to achieve concrete results.** Opportunities for engagement would not only be sought beyond the project level but also at the sector and national levels. Success in specific projects or sectors could trigger “demonstration effects” that could spread to other areas in a virtuous cycle. Utmost efforts will be made to producing high quality work in line with a demanding MIC client and making use of the Bank's role as a knowledge Bank, with top expertise, and access to worldwide best practice while taking into account Iraq's special circumstances.

52. The proposed selectivity criteria are as follows:

- Support the Government's goals as stated in the ICI and the NDS as well as the objectives of this ISN. Particular attention will be given to activities supporting capacity strengthening of government institutions and better use of Iraq's own resources.
- Respond to the assistance needs of, and demand from, the Government of Iraq, and fully take into account Iraq's specific socio-economic circumstances.
- Support reforms and/or sectors for which champions have been identified in the relevant Government ministries or agencies and the private sector and that are committed to engage with the Bank Group and the donor community more broadly.
- Reflect the Bank Group comparative advantages vis-à-vis other donor agencies.
- A close working relationship with other donors is necessary as well as a clear division of labor such as what has emerged with Public Financial Management.
- With regard to the ongoing portfolio, projects going particularly well will be considered for continuation or deepening. Projects that are experiencing delays and not delivering results will be considered for restructuring or dropping.

53. **The proposed themes should be seen as a useful organizing framework, and not as a straightjacket.** First, some activities may contribute to more than one theme; they do not necessarily "belong" to any one theme, although their focus and contribution may be more strongly linked with a particular ISN objective. Second, one of the Bank's comparative advantages is its ability to undertake multi-sectoral or cross-sectoral work, which by design would straddle more than one ISN theme. Third, activities under all themes can potentially contribute to generating both short-term and longer-term results.

54. **Under the proposed themes, the Bank Group would also provide support to activities which have a regional dimension.** For example, under Theme III, the Bank has also initiated work on regional trade logistics and facilitation involving Iraq, Jordan, Lebanon and Syria, in addition to discussions which are underway on a specific Iraq-Jordan border crossing project. IFC could also play a key role in mobilizing South-South capital flows for investment in Iraq.

55. **While activities launched in FY09 are clearly identified and underway, the program for the outer years will be decided in consultation with the Government on a yearly basis.** Activities for FY10-11 will be confirmed through an Annual Business Planning (ABP) exercise conducted jointly with the Government of Iraq. This approach should ensure that the activities and services provided by the Bank are relevant to the country needs and enhance ownership. However, on its side the Bank must ensure that its work in Iraq serves the institution's broader goals and meets institutional standards. The ABP process is further discussed in subsection VI.C. At the same time, some potential activities for the outer years have been identified during the consultation process as part of

a “menu” of options for Bank assistance. A summary list of the identified and potential activities launched over the course of FY09 is provided in Table 2. This list is not meant to be exhaustive.

Table 2. Ongoing or Planned FY09-Launched Activities¹¹

Overarching Objective: To help Iraq use its resources more effectively and transparently		
Theme 1. Continuing to support ongoing reconstruction and socio-economic recovery efforts	Theme 2. Improving the management of public resources, including human, natural and financial	Theme 3. Supporting policies and institutions that promote longer-term broad-based, private-sector-led growth
Financial Assistance		
Education Sector Reform Project (ITF, US\$3m)	Public Financial Management Reform Project (ITF, US\$18m)	Supplemental Financing for the Emergency Private Sector Development Project (ITF, US\$10m)
Community-Driven Activities Scaling-Up (SBPF)	Pension Reform Project (ITF, US\$6m)	Bank Restructuring Project (ITF, US\$10m)
AAA/TA		
Poverty Assessment	Fiscal Federalism and Decentralization	Private Sector Development Policy Notes and TA
Food Safety Net TA	Kurdistan Civil Service Reform Note/TA	Investment Climate Assessment
Social Safety Net Implementation Support TA.	TA for Economic and Social Sector Strategies and Priority Investment Programs	
	EITI	
IFC (Investments and Advisory Services) and MIGA – FY09-FY11 Activities		
		<p>Supporting financing of projects in key sectors. Mobilizing additional financial resources.</p> <p>Support with PPP initiatives and SOE reforms.</p> <p>Development of the financial sector and banking capacity building and restructuring.</p> <p>SME access to finance.</p> <p>Improving Business Enabling Environment and Industry-Specific Policy Reforms.</p> <p>Supporting investment through MIGA's guarantee product.</p>

¹¹ The table does not show operations and advisory activities launched before FY09 (shown in Annex V) nor potential activities to be launched in the outer years (FY10-11).

A. Theme I: Continuing to Support Ongoing Reconstruction and Socio-Economic Recovery Efforts

56. **The Bank's portfolio provides support to reconstruction, socio-economic recovery and restoration of basic services in a wide range of sectors.** Many of the results to be achieved during the ISN period will be through the ongoing Bank- and ITF-financed portfolio (see discussion on Monitoring Framework, subsection VI.E). Most of these activities fall under this theme, and include projects in health, education, water, environment, community-driven development scaling up and other basic infrastructure sectors. These areas are in line with the National Development Strategy to strengthen the foundations of economic growth, improve quality of life and strengthen service delivery at the community level. A priority for this ISN will be to ensure that the current program is being implemented rapidly and well (see discussion in subsection VI.B).

57. **Ongoing or planned FY09-launched activities under this theme include:**

- *Expanding government-citizen consultative development initiatives and providing local basic services.* The Bank Group will explore with the authorities the opportunity for piloting and/or expanding community-driven development-type activities at the national and regional levels. This would benefit from (i) data collected during the two-year Country Social Analysis (CSA); (ii) subsequent field research findings; and (iii) the lessons-learned from the current Bank-funded pilot in the Kurdish north (see Box 4).
- Financial support through an ITF-financed *Education Sector Reform Project*. The project will meet the sector needs identified by the government in (i) Development of a National Education Strategy; (ii) Institutional Strengthening of the Ministries of Education (Baghdad and KRG); (iii) Institutional Strengthening for Higher Education and Scientific Research; and (iv) Capacity Building for Vocational Training and Education.
- Preparation of a *Poverty Assessment*. Based on the recently-completed Iraq Household Socio-Economic Survey, the assessment will describe and analyze the poverty situation in Iraq and provide inputs to the preparation of Iraq's first Poverty Reduction Strategy. The household survey contains gender-disaggregated data, allowing also for the analysis of the gender dimension of poverty and inequality in Iraq.
- Support to the implementation of Iraq's Social Safety Net (SSN) Law (currently in draft) through a *Social Safety Net Implementation Support TA*. The Law is currently under deliberation at the Council of Ministers, and expected to be passed soon. This work will support the transition from universal subsidies to targeted safety nets which will be efficient, equitable, and provide adequate protection to the poor and vulnerable. This is expected to be programmatic and to continue through FY10.

Box 4. Community Service Delivery Initiative (CSDI)

A consultative service delivery project has been piloted in Sulaimaniya governorate within Iraq with funding from the Post-Conflict Fund (US\$1 million). The purpose of project is two-fold: 1) to further the state of the Bank's knowledge on sustainable, consultative decision-making in Iraq, while at the same time providing tangible improvements in service delivery, and 2) to inaugurate a long term, sustainable and transparent utilization of the country's resources.

Nine months into implementation the project is delivering solid results. Since January 2008 eight community action groups (CAGs) have been established and introduced to the CSDI within Sulaymaniya governorate. The CAGs are created in community-wide meetings using public nominations followed by elections. Each CAG numbers eight to thirteen persons, including women and youth representatives. Within a relatively short period of time the CAGs have accomplished much in terms of training and joint project planning with government officials.

CAG members collect project ideas from provincial and local authorities, civic actors, and informal social and neighborhood networks. The projects selected tend to be within the areas of water, electricity, youth and women.

Several of the CAGs had already started planning for more projects, in addition to the CSDI supported project in cooperation with district and local municipalities and the Provincial Council. CAGs had succeeded in raising funds from other sources than the CSDI program. These sources included government sources, the private sector and/or individual community members.

The CSDI program is well perceived by all engaged parties, including the implementing agency, the local communities and the district and local municipalities.

Creating sustainable CAGs will require time as the CAGs will need support over an extended period of time to ensure that the methodology and structures are durable.

58. Possible additional activities under this theme would aim to strengthen Bank support to Iraq's reconstruction and recovery process, ultimately helping to strengthen the country's physical and human capital. First, a broader *Community Service Delivery Project* would provide a test of local service delivery mechanisms using a CDD approach which could be jointly financed by the Iraq Government and IBRD resources. Second, a *Water Resources Management and Infrastructure Rehabilitation Program*, currently under preparation with Bank assistance, could benefit from technical and financial support from the Bank if requested by the Government. Third, possible future activities in the *electricity sector* could include Partial Risk Guarantees for private investments in generation; technical assistance for implementation of an electricity sector structuring and organization strategy; and new lending in IBRD terms to support development of new generation plants. Fourth, the Ministry of Health has expressed interest in Bank-supported *technical assistance on health systems/policies and financing*. Fifth, a *Poverty and Social Impact Analysis (PSIA)* could be carried out to gauge the welfare impact of recent economic reforms, particularly regarding petroleum price subsidies. Finally, analytical work on *Gender and Conflict*, focusing on labor markets and poverty, could be carried out on the basis of gender-disaggregated data from the Household Survey.

59. A critical element in ensuring success in the implementation of Theme I is delivering on the current portfolio, particularly as a significant component of Bank assistance under Theme I consists of existing projects.

B. Theme II: Improving Governance and the Management of Public Resources, Including Human, Natural and Financial

60. **Activities under Theme II will focus on helping the Iraqi Government to develop the institutions, systems and processes needed to manage public services efficiently, effectively, transparently and accountably.** An important component of this will be strengthening the management of Iraq's public resources. They will also support the efforts of the Iraqi government to fight corruption, formulate consistent and realistic national and sectoral plans and strategies, successfully implement its public investment program, and strengthen its social protection system. Particular attention will be given under this objective to enhancing institutional capacity of Iraq's public sector. These efforts are expected to generate results over the medium to long term.

61. Ongoing or planned FY09-launched activities under this theme include:

- Financial assistance through the ITF-financed *Public Financial Management (PFM) Reform project*. This project aims to improve allocation, execution, transparency and accountability in the mobilization and use of all public resources. Cross-cutting reform of the PFM will be addressed by the reform of the national system, by strengthening budget formulation, execution and control, improving public financial reporting, strengthening public procurement and developing capacity in PFM, both at the central and the governorate levels.
- Programmatic assistance through a *Fiscal Federalism and Decentralization AAA*. The objective of this programmatic AAA is to examine various aspects of intergovernmental management of Iraq's petroleum value chain, including the current and suggested expenditure assignments as the basis for revenue distribution and management. It will provide short briefing notes and policy advice to the Iraqi Constitutional Review Committee and other policy makers in Iraq to familiarize them with international experiences and good practice in fiscal federalism, including revenue assignment and revenue sharing as they draft new laws and amend their Constitution.
- Preparation of an *Iraq Kurdistan Civil Service Reform Note*. The note will undertake a systemic assessment and evaluation of the capacity of the civil service in the KRG, identify a set of reform priorities, and propose a realistic set of reforms which could be undertaken to address the identified shortcomings and make progress towards achieving intermediate outcomes. This will support the KRG Government's efforts in the development of a comprehensive diagnostic of the public administration, contribute to the formulation of a public sector reform strategy, and continue policy dialogue with the government.
- Support for pension reform through an ITF-financed *Pension Reform Implementation Support TA*. This is a continuation of work already started and will support implementation of the recently enacted Unified Pension Law. This is expected to be programmatic and to continue through FY10.

62. **The selection of additional activities under this theme will reflect a policy of “strategic opportunism”.** It will place public financial management (including public procurement) at its heart supplemented by other potential interventions that focus on specific entry points and issues that emerge over time where there is potential for traction. These would target civil service reform, legal and judicial reform and anti-corruption. The strategy is based on an analysis of donor activity as well as consideration of the Bank’s comparative advantage and in-country operating capability.

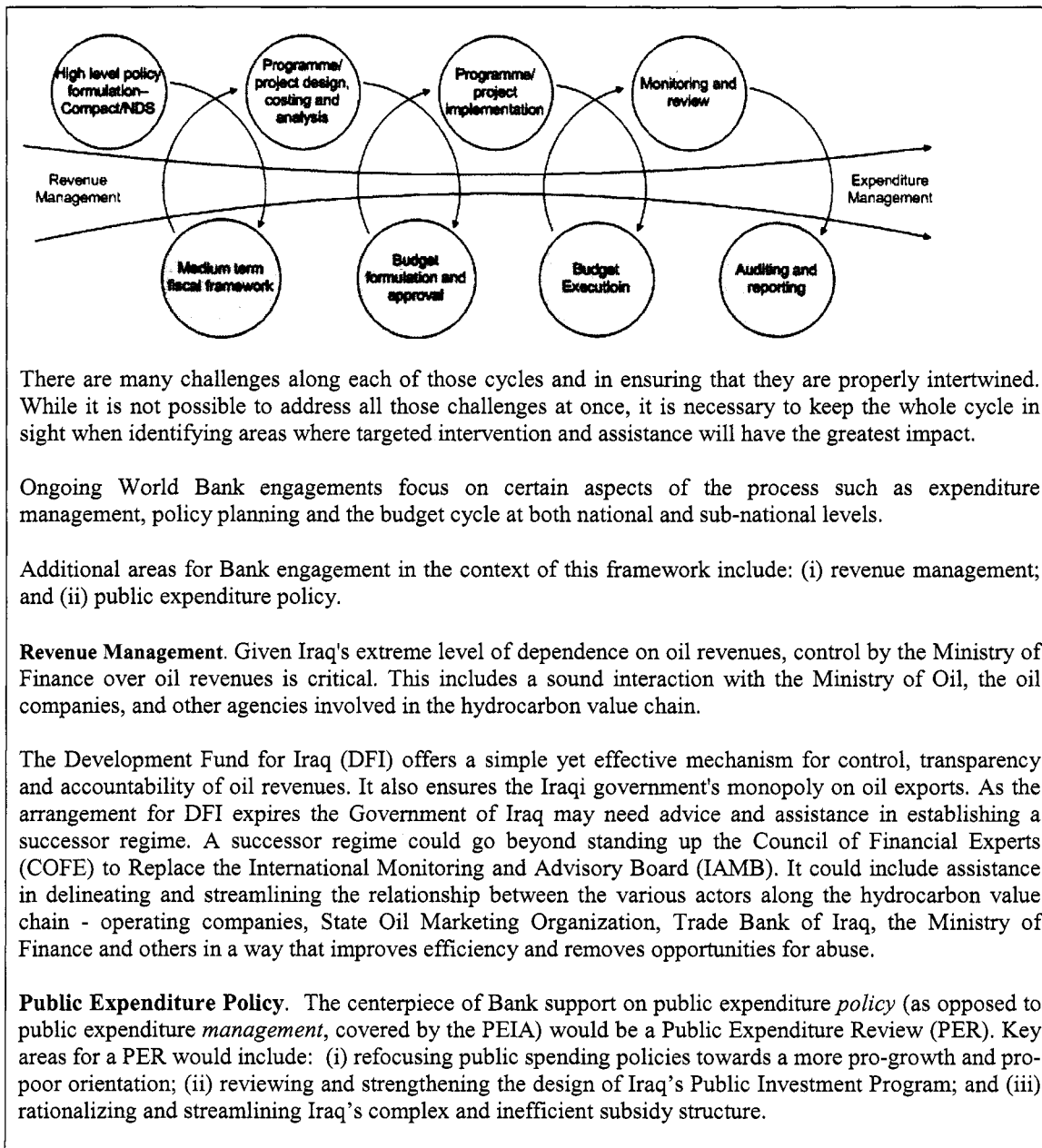
63. **Public financial management will continue to feature prominently in the Bank’s governance work. Apart from the PFM reform project mentioned earlier, it is likely that the Iraq program will focus on a number of other key areas.** First, the Bank will also continue to support the Extractive Industries Transparency Initiative (EITI) to help the Government’s efforts to translate its vast resources into benefits for the Iraqi people. Iraq has announced its intention to sign up to the EITI, and the Bank will provide support on request. Second, an understanding of Iraq’s PFM framework would not be complete without an *assessment of revenue controls and collection*, including the oil sector financial flows that feed into the Development Fund for Iraq and ultimately the State Budget. Third, the Bank could provide technical assistance to *help clarify and streamline relations between the various oversight and control agencies (such as the Board of Supreme Audit)*, introducing greater transparency (including working with Parliament and the public) and improving qualitative evaluation methodologies including performance audits. Fourth, a *Public Expenditure Review* - building on the Public Expenditure and Institutional Assessment - could help the Government strengthen its ability to conduct pro-growth public expenditure policy, including at the sectoral level, where linkages with line ministries’ service delivery capacity could be further explored. Fifth, for selected sectors, the Bank could provide assistance in the *design of sectoral strategies and priority investment programs* to better inform the national budget process. Finally, the Bank could support *institutional assessments* to help inform institution building activities for selected ministries and governmental agencies (see discussion in subsection VI.A). A framework for PFM support is outlined in Box 5.

Box 5. A Framework for Public Financial Management Support

The main challenge facing the Government of Iraq today is how to transform oil wealth into public goods and services and create the conditions for a diversified, sustainable economy. Given the context of conflict and state weakness the transformation needs not only to be efficient and sustainable but also equitable.

The budget is the framework within which this transformation takes place. The budget reflects the government’s policy priorities and its ability to deliver services. The budget process could be notionally divided into two interwoven cycles - a policy cycle and a financial cycle (see chart).

The first includes policy design, planning, implementation, evaluation and review. The second includes financial planning, budget design, approval and execution, auditing and reporting. Revenue and expenditure management tools ensure transparency, efficiency and control throughout the system.



64. In the justice sector, possible areas for Bank-supported TA would include:

- **Contract Enforcement** to help develop programs aimed at improving effective resolution of business disputes. This includes alternate dispute resolution mechanisms (ADR) within the overall framework of improving investment climate for foreign and local businesses.
- **Court Administration** through complementing efforts by other partners including the U.S Government by providing technical expertise in areas such as budgeting,

administrative and financial management, and procurement for the Higher Judicial Council.

- **Legal Aid Services for the Vulnerable** through supporting the establishment of legal aid schemes for the most vulnerable groups including widows, orphans, the unemployed and displaced citizens. These services, which could be provided by government or non-governmental organizations, or by a combination of the two, would help these groups enforce and protect some of their most essential socioeconomic rights – for example property, health and education rights.

65. **The actual choice of additional activities under Theme II will require the application of the appropriate selectivity criteria discussed above.** Possible additional areas include: (i) an indirect approach to anti-corruption support, seeking to strengthen the institutional arrangements for public accountability and transparency; and (ii) civil service reform, an area with hitherto limited Bank engagement due to the difficulty of finding a suitable counterpart in Baghdad.¹² As with other activities under the ISN, in order to be undertaken, support in these additional areas would require the full backing and ownership of the Government. The authorities have emphasized public financial management, revenue management, public expenditure policy, fiscal federalism and support to the formulation of sectoral strategies as the main areas for Bank engagement under Theme II.

C. Theme III: Supporting Policies and Institutions that Promote Broad-Based, Private-Sector Led Growth

66. **Activities under Theme III would support an enabling policy environment for private sector investment, employment generation, and financial sector development in Iraq.** By virtue of its dependence on oil, the Iraqi economy is dominated by the public sector. Iraq's currently weak environment for private-sector-led growth is illustrated by the fact that it ranks low at 152 out of 181 countries in Doing Business 2009. Iraq faces a multitude of challenges as it seeks to mobilize oil rents to serve economic diversification and private sector growth. Many of these challenges are common to other economies in the MENA region: Missing or incomplete reforms, policy uncertainty, and an uneven playing field for investors may all adversely shape the private sector's expectations of returns and risks, depressing investment demand.¹³

67. **The security situation and a damaged or outdated infrastructure are key Iraq-specific factors deterring private-sector-led growth.** Should recent security gains prove lasting, and further improvements in infrastructure as well as in the investment climate are achieved, foreign and local investors are likely to be attracted to Iraq's energy, telecommunications, construction/real estate and other key sectors. The Bank Group, including IFC and MIGA, can play a central role in implementing private sector-support activities that prepare the ground for sustained private-sector-led growth in Iraq. However,

¹² There are other active donors in the civil service reform field, including the United Nations, Canada, Korea, the United Kingdom and, especially the United States.

¹³ World Bank (2008). *From Privilege to Competition: Policies and Institutions to Unlock Private-Led Growth in the Middle-East and North Africa*. MENA Region Flagship Report.

given the longer-term nature of this theme, only limited results would be sought in this ISN period.

68. **Bank assistance is proposed to follow three parallel tracks: (i) supporting an enabling environment for private sector investment drawing on IBRD and IFC advisory services; (ii) supporting the restructuring of non-oil State-owned enterprises (SOE), and (iii) supporting PSD through prioritized IFC investments in key sectors.** This three-track approach reflects the main policy priorities for private sector-led growth identified by the Iraqi authorities and representatives of the private sector during the ISN consultations. Financial support will also be provided drawing on the wide range of World Bank Group instruments.

69. **The Bank Group will also support policies that would have a positive direct or an indirect impact on Iraq's business environment.** This track would comprise policies that directly promote private sector development, SME development, as well as complementary macroeconomic and structural policies that indirectly contribute to increasing the role of the private sector in driving non-oil growth in Iraq.

70. **Ongoing or planned FY09-launched activities under the first track include:**

- Financial assistance through the ITF-financed *Bank Restructuring Project*.¹⁴ This project will support the restructuring of the two main state-owned commercial banks and streamlining their role and activities in the financial sector—in parallel with ongoing efforts to strengthen the banking sector regulatory and supervisory framework in line with international standards—and would foster more efficient financial intermediation in the medium-term. The project would thus help in re-establishing the country's financial system, which is necessary for the revival of the private sector and economic recovery.
- Financial assistance through the ITF-financed *Emergency Private Sector Development Additional Financing*. This additional financing will continue to support the original project goal of providing capacity building to help lay the foundation for increased investment and growth.
- Continuing advisory assistance through *Private Sector Development Policy Notes*, focusing primarily on issues related to business environment, institutions for private sector and SME development, as well as trade logistics (cross border).

71. **Further analytical and advisory support under the first track would help frame the reform agenda for private sector development in Iraq going forward.** An Investment Climate Assessment (ICA) could play a key role in that regard. While there is a substantial amount of written work on PSD issues in Iraq, it appears that a strategic, consolidated piece of analytical work clearly setting out the main priorities is not available.

¹⁴ This project will support the financial and operational restructuring of two state-owned banks, Rafidain and Rasheed. However, its ultimate goal is to support private-sector-led growth through improved financial services and increased access to finance.

An ICA's value would come mostly from its pulling together all available information on PSD in Iraq as well as complementing the insights generated by the Doing Business reports. Some of the main PSD issues already identified during the consultation process include (i) capacity building for the Investment Commission as well as the provincial-level Investment Promotion Agencies; (ii) general capacity building for the private sector, including the development of the advisory, accounting, audit, export and other business services that firms (including reformed SOEs) will increasingly need from the private sector; (iii) improving the legal and regulatory framework to strengthen the business environment; and (iv) taking stock and providing advisory support with respect to industrial parks and border zones. A matching grant program, oriented towards export promotion, might also be an attractive option to channel inexpensive finance to small and medium enterprises. The collaboration between the Bank and IFC to implement this track is crucial to its success.

72. In addition to support directly geared towards improving the business environment, the Bank Group would also support complementary policies that can foster broad-based, private-sector-led growth and counterbalance “Dutch Disease” effects. These policies could be spelled out in a *Country Economic Memorandum*, which would help the Government review its overall policy framework (including macroeconomic policies) from the point of view of facilitating broad-based, private-sector-led growth and reducing the adverse impact of oil wealth on other sectors. It would also provide inputs for an update of the ICI and the NDS as well as for the Government’s next Five-Year Plan. Additional support for the *improvement of national socio-economic statistics* would also help inform policymaking and provide critical information for potential investors.

73. The second track – support to restructuring non-oil SOEs – is also essential for the transition towards a more private sector-oriented growth process. The sector as a whole represents an unsustainable drain on public resources. However, the hundreds of state owned enterprises scattered across Iraq not only provide employment for tens of thousands of people, they also represent the accumulation of decades of investment, human and financial. While many are idle, some provide critical goods and services including, medicine, financial services and construction materials. The key to effective restructuring of state owned enterprises is for the state to act as a good corporate owner seeking greater efficiency in the delivery of goods and services and maximum return on investment. This approach is necessary to address two of the main challenges posed by SOEs, their drain on public coffers and unfair competition with the private sector.

74. The third track will involve IFC support for viable projects in the private sector. As the situation stabilizes, IFC anticipates strong demand for funding of projects in infrastructure, tourism, agribusiness, and manufacturing industries. IFC will continue to support the financial sector and enhance SMEs access to finance as well as supporting microfinance activities. IFC has been in continuous contact with Iraqi and foreign businesses and project sponsors exploring opportunities in the country and many are poised and ready once the environment improves. IFC could also play a key role in mobilizing South-South capital flows for investment in Iraq. The MIGA guarantee product is also available to support viable and eligible private sector investments.

75. **During the ISN consultation process, the Iraqi authorities expressed interest in Bank Group assistance to SOE restructuring.** Some of the key policy issues that could be addressed under this assistance include: (i) separation of policy making and regulatory functions from the ownership and operations; (ii) establishment of corporate governance and finance structures that ensures independent operation on commercial terms; (iii) design of a regulatory framework that ensure smooth transition of those enterprises to commercial operation, maintains a level playing field for all actors regardless of ownership, and promotes private public partnership (PPPs); and (iv) reorientation of public investment in SOEs towards preparing them for independent operation under market conditions, rather than providing them with an open-ended subsidy. Likewise, IFC's range of advisory services' products can be selectively mobilized to help with this objective.

76. **Critical to the implementation of these three tracks under Theme III is the role of IFC.** IFC will continue, security permitting, to ramp up activities and branch out to include new initiatives. IFC believes that the private sector in Iraq has tremendous potential under stable circumstances. Together with the Bank, IFC intends to be a partner with Iraq in its transition to a market-driven economy and from an oil-based, single commodity dependency to a more diversified, productive, job creating economy.

77. **Iraq's membership in MIGA is very recent, and MIGA's activities in Iraq will follow a demand-driven orientation.** MIGA's program will be aligned with the ongoing or planned Bank and IFC activities. Private investors have already shown interest in partnering with MIGA for investments in Iraq.

78. **The Bank Group would also be available to provide on-demand support to the oil and gas sector beyond revenue management issues.** The Bank has played a limited role in the oil and gas sector, essentially maintaining a watching brief. It has also undertaken the preparation of three studies including: (i) Fiscal System for a National Oil Company in Iraq; (ii) Federal Aspects of Petroleum Regulation and Management in Iraq; and (iii) the Impact of Fiscal Parameters on Oil Revenue Volatility. Any further assistance would respond to specific Government requests and build on the results of the existing studies. Establishment of the legal framework for the hydrocarbons sector would facilitate foreign investment in that sector.

VI. IMPLEMENTING THE ISN

79. **Each of the two previous Bank strategies for Iraq responded to the context and circumstances of the time, and the present ISN also aims to be context-specific.** Given the current situation and lessons learned based on implementation experience to date, this ISN proposes to continue some efforts and activities that have worked well or are now starting to yield results while proposing some new ideas to move forward in the Bank's engagement with Iraq. These are summarized in Box 6.

80. **While strengthening public resource management and helping develop the private sector are medium-to-long term objectives, the ISN will also focus on achieving tangible results in a relatively short term.** To deliver tangible results more

quickly and effectively, close attention will be paid on *how* this ISN will be implemented. This is the object of this Section.

Box 6. What are we doing differently through this Strategy?

- Now that conditions are relatively more conducive, working more closely with Government on design and implementation of this strategy.
- Strengthening Bank presence in Iraq and empowering the Baghdad office (portfolio management, policy dialogue and assistance in priority areas: PFM, PSD agenda). PFM specialist now based in Baghdad; PSD specialist to be based in Baghdad, supported through DFID. Country Manager to cover portfolio implementation locally, plus recruiting a portfolio assistant in Baghdad.
- Introducing more flexibility through Annual Business Planning jointly with Government to focus on priorities with “champions” and compliant with selection criteria.
- Introducing selection parameters for future activities. (Para 49).
- Incorporating the “how to” as an integral part of the ISN.
- Implementation challenges have been continually identified and addressed following reengagement with Iraq. This regular analysis and efforts to unblock bottlenecks will be continued and special efforts made to draw in corporate level support as part of the CPPR process and when otherwise needed.
- Expanded the use of the FMA for IDA projects as well as ITF.
- Looking at institution building in a new way, with concrete proposals, and placing greater emphasis on this within the strategy. Previously, this approach was through many workshops and institutional capacity building through PMT model. While these will be continued, this ISN also proposes an institutional assessment of key ministries; and working with Government on strategies to transfer knowledge.
- Building on PEIA and other good examples, working with other donors jointly on AAA and projects, such as PFM and Banking.
- Proposing to expand use of designated accounts, implicated accepting a higher level of fiduciary risk.
- A special focus on private sector development and increased engagement of IFC and new engagement of MIGA.
- Revitalizing donor coordination efforts in Baghdad.

81. The Bank will engage in a number of actions in order to strengthen its effectiveness in Iraq. They include: (i) enhancing the effectiveness of institution building and analytical and advisory activities; (ii) strengthening the implementation of the current portfolio; (iii) introducing more flexibility in the Bank’s implementation arrangements and business processes, including through Annual Business Planning; and (iv) fostering donor coordination.

A. Enhancing the Effectiveness of Institution Building and Analytical and Advisory Activities

82. A key stabilizing factor for Iraq is to build public confidence in government institutions. The challenge is two-pronged: First, to improve Iraq’s allocation and management of its resources and revenue; and second, to ensure the effective delivery of critical services and infrastructure to its communities. Addressing these challenges requires building effective institutions and systems for service delivery and job creation at the local and national levels.

83. **A great deal of capacity building, technical assistance and training activities has been delivered with support from the donors, including from the Bank Group under the first and second ISNs.** Despite the many efforts to build institutional capacity in Iraq, the actual impact on the ground – while difficult to assess accurately – seems to have been limited, except in some specific cases (e.g., procurement and financial management; statistical capacity). Some of these efforts did not fully address the chief capacity issue in Iraq, which is not so much at the individual level but rather relates to the Government’s ability to effectively design and implement plans, strategies, and the state budget. The main drawbacks of previous capacity building efforts include: (i) insufficient attention has been paid to the need to build or strengthen the basic core functions of governmental institutions; and (ii) excessive emphasis has been placed on training for second or even third-generation policy reform issues.¹⁵

84. **Institution building efforts going forward should fully take into account Iraq’s particular circumstances.** This means that institution building efforts would need to factor in: (i) the existing capacity in Iraq as well as existing government systems, by finding ways to reinvigorate the strong elements or enhance the weaker elements of what is already available; and (ii) the difficult operating environment and the security situation in Iraq.

85. **Taking advantage of recent security improvements, this ISN will strive to implement a more comprehensive and tailored approach to institution building.** While AAA and IFC advisory services will continue to be a vehicle for policy dialogue at the national and sectoral levels, *the bulk of institution building activities under this ISN will focus on strengthening the core functions of key ministries and governmental organizations, with the ultimate goal of improving their service delivery capacity.* The main principles for the proposed approach to institution building in Iraq under this ISN are:

- Bank Group support will be *demand-driven*, responding to Government requests and priorities. It will be more finely tuned to specific and varied needs across ministries and other government agencies, while taking into account the beneficiaries’ capacity and the Bank’s own comparative advantages.
- Bank Group support will be *selective*, seizing opportunities as they arise and focusing on those ministries and agencies with strong, demonstrated demand and engagement as well as high potential development impact and cross-sectoral synergies.
- Bank Group support will be delivered in two broad stages: First, the Bank will assist the relevant ministry or agency in conducting an *institutional assessment*, on the basis of which an *action plan for institution building* would be devised. Second, the Bank will assist in the implementation of the resulting action plan.
- Bank Group assistance will be implemented in close collaboration with other donor-supported capacity building efforts in Iraq.

¹⁵ It is conceivable that some of the training may have facilitated further “brain drain”, with officials leaving their jobs for other opportunities in the wake of receiving donor-supported training.

86. **The proposed institutional assessments would provide a comprehensive review of the existing capacity as well as reform needs of selected Government institutions, including at the provincial or governorate level.** These assessments would cover the selected institutions' mandate; overall policy and strategic framework; organizational structure; business systems and processes; human resources; and monitoring & evaluation systems. A key element of such assessments is the link between capacity development and outputs/results of Ministry's activities. As noted above, the assessments would culminate in specific action plans for institution building, the implementation of which could be assisted by the Bank.

87. **Ultimately, this proposed approach for institution building aims to:** (i) ensure that Iraqi public institutions and agencies are involved in the institution-building process in its entirety; (ii) strengthen the necessary systems, processes, and human resources underpinning such institutions and agencies; and (iii) encouraging the Iraqi leadership to focus first and foremost on building institutional capacity in a comprehensive and sustainable manner. While the specific institutions for which this approach could be piloted would be identified in collaboration with the Government of Iraq, the principles outlined above would help identify possible entry points for engagement on institution building. Possible early beneficiaries of this proposed approach could include: the Council of Ministers Secretariat, the Ministry of Finance; the Ministry of Planning and Development Cooperation, the Prime Minister's Advisory Council; ministries in charge of the delivery of a key public services; or selected governorates.

88. **Support to institution building in Iraq under the ISN will draw on the findings of a recent evaluation¹⁶ by the Independent Evaluation Group (IEG) of the effectiveness of Economic and Sector Work (ESW) and technical assistance.** Among the main factors enhancing effectiveness of ESW and TA identified in the IEG evaluation, the following are particularly pertinent to Iraq: (i) government receptivity to the proposed ESW/TA; (ii) close collaboration with the client country, from inception to the design of recommendations; (iii) sustained follow-up beyond one-off dissemination; and (iv) better and rapid translation of reports into national languages. Several of these factors were present in the delivery of Bank TA to Iraq's Central Organization for Statistics and Information Technology (COSIT) under the Household Survey project and are also envisaged for the upcoming Pension Reform TA (see Box 7).

¹⁶ Independent Evaluation Group (2008). *The World Bank's Economic and Sector Work and Technical Assistance, FY00-06*, discussed by CODE on July 9, 2008.

Box 7. Examples of World Bank Institution Building Support: Statistics and Pension Reform

A. Statistics

Over the past few years, much progress was made in strengthening COSIT's capacity.

A generation ago, Iraq was a regional leader in many areas including statistics. However, the years of sanctions and a repressive regime stifled statistical capacity in Iraq, which was also severely hampered by the post-2003 conflict.

The Bank has been working very closely with COSIT under the Household Survey project, which has literally provided thousands of person days of training. The Bank worked very closely with COSIT in the development of the IHSES and encouraged it to try many innovative approaches. These included field-based data entry allowing early detection of problems and an opportunity to correct them, use of smart data entry software to detect possible errors, and use of remote access software to compensate for mobility problems. Since then, COSIT has applied the techniques thus learned on other surveys.

Most importantly, COSIT has improved in its ability to make use of the data it collects. Through the Household Survey project, COSIT has begun to interact systematically with policy makers -- letting policy makers define the kind of information needed. COSIT established a Data Analysis Unit comprised of a group of young, qualified staff who are now trained in SPSS and Stata and are increasingly called upon by policy-makers from the various ministries to provide analysis using IHSES data and their enhanced analytical skills. COSIT still has a long way to go. Macroeconomic data, for example, continues to be relatively weak. Nevertheless, COSIT actually seems stronger than many statistical agencies in the region in terms of its staff's willingness to share data and eagerness to learn.

B. Pension Reform

The Pension Reform Implementation Support Technical Assistant project incorporates key features that illustrate the ISN proposed approach to institution building. The project aims to build the capacity of the National Board of Pensions (NBP) to implement the provisions of the Unified Pension Law, enacted in December 2007. Some of the main features include: (i) the centrality of institutional building, through development of NBP guidelines, regulations, and human resource development activities; (ii) while the World Bank will provide key technical assistance inputs, the Government is committing to provide financial support to key investment areas; (iii) the World Bank team will also provide technical assistance support to elaborate the capital investment requirements for the NBP; (iv) the project will finance full-time Baghdad-based national staff, who will provide on-the-ground support for the work; (v) periodic (at least three times per year) reviews will be undertaken by the World Bank team responsible for implementation, to ensure flexibility in adapting to changing circumstances; and (vi) support to Government for donor coordination in the area of pension reform.

89. **The Bank would also consider experimenting with alternative institution building approaches for selected ministries.** One possibility is a Senior Executive Advisors' program, which would consist of support to the Government in bringing Iraqi professionals on a performance-based, renewable contract basis to help conduct institutional assessments as well as to design and implement the action plan. This approach would initially be implemented on a pilot basis, providing initial lessons for possible expansion or mainstreaming. Another possibility is to organize a World Bank fellowship program which would provide ongoing mentoring and support to qualified young Iraqi professionals who could assist ministry departments in the hands-on

implementation of the technical elements of the reform process. In some cases, a combination of these two options will be considered.

B. Strengthening the Implementation of the Current Portfolio

90. **This ISN starts with US\$928.8 million worth of active projects in the portfolio.** As of December 2008, ITF projects are 75 percent contracted and 45 percent spent. IDA projects have been more recently made effective (end 2007)¹⁷ and virtually undisbursed, with about 10 percent contracted. This will give the Bank the opportunity to contribute to development results in a broad range of sectors, and most of the results at the end of this ISN period will be from the existing portfolio. A central theme for this ISN is to *maximize the effectiveness of the existing projects*. The current implementation model for Bank-supported projects is based on project management teams (PMTs) established by the Government ministries. The PMT model, with its emphasis on country execution and on embedding implementation capacity within ministries, is a distinctive feature of the Bank's engagement with Iraq. The Bank's approach of working through the Government rather than external implementing agencies for project execution helps strengthen the institutional capacity of key governmental institutions. However, it also affects the pace of implementation. There is a trade-off between timely disbursements on one side, and sustainability, institution building, and building fiduciary safeguards on the other.

91. **While security has improved since 2007, the operating environment remains extremely difficult, delaying project implementation.** Security issues affect portfolio implementation through a number of channels: (i) discouraging contractors from bidding for contracts; (ii) delaying the delivery of goods, the progress of civil works, and the inspection of project sites; and (iii) preventing staff access to ministry offices and to project sites. To some extent, these risks are mitigated by the Iraqi execution of projects and the engagement of local contractors. The broad geographical coverage of the projects, with subprojects often located in 9 to 18 governorates, also reduces the impact of localized instability.

92. **The World Bank and Government held Country Portfolio Performance Reviews (CPPR) in 2006 and 2007 to identify issues that hamper project implementation, and to reach agreement on actions to be taken to address weaknesses and improve project performance.** The main factors hampering project implementation identified during the 2007 CPPR exercise include:

- Frequent changes in PMT staff, leading to overall diminished project management and fiduciary capacity;
- Lengthy procedural and approval delays within line ministries;
- Uneven collaboration between the Bank and line ministries;
- Volatile security conditions;
- A lack of liquidity in project accounts;

¹⁷ IDA projects were all initially delayed due to time it took Government to determine the legal process to ratify and make international loans effective.

- Inefficient domestic banking system, causing delays in Iraqi Dinar payments; and
- Currency fluctuations and price escalations.

93. **Several measures were taken to address these issues.**

- The Government appointed a senior staff member within the Ministry of Finance to oversee the implementation of the World Bank program and facilitate actions to improve implementation. This working relationship now needs to be developed.
- One project (Water Supply, Sanitation and Urban Development) was restructured in February 2008 and the Bank and Government have agreed on restructuring plans for two projects (Disabilities and Baghdad Water Supply and Sanitation). Options for restructuring the Third Emergency Education project is under discussion with the authorities. Additional financing was provided to projects that have been performing well; or negatively impacted by exchange rate fluctuations.
- The Bank initiated actions to improve local currency payments by: (i) processing withdrawal applications for Iraq on a priority basis; (ii) closely monitoring the flow of funds through the entire chain of intermediary banks; (iii) providing training and support on payment instructions; (iv) requesting commercial banking partners to establish a more effective network of correspondent banks within Iraq. Despite improvements, some projects continue to suffer from liquidity problems and an inefficient banking system.
- The World Bank is also piloting Designated Accounts (DA) in Iraq to advance project funds rather than the Bank making direct payments to individual contractors. DAs are typically used for projects in which there are no significant concerns about the recipient's ability to properly safeguard and account for the funds. Since the control environment in Iraq is considered to be relatively weak, additional mitigating measures were put in place to manage incremental fiduciary risk. World Bank management approved the use of a DA for two projects is currently evaluating their use.
- The World Bank holds financial management and disbursement workshops and meetings to review World Bank guidelines and fiduciary requirements, analyze disbursement and financial management problems faced in the projects, anticorruption, introduce the designated account concept and its associated controls, and provide an opportunity for participants to analyze and address specific issues that affect project implementation.

94. **Although the Iraq portfolio continues to face implementation delays, these measures have led to some significant improvements, and there are signs that portfolio implementation is picking up.** As of December 2008, the number of problem projects in the portfolio has been reduced from 71 percent in FY07 to 50 percent in FY08 and at the time of writing, stands at 47 percent in FY09. As of the second quarter of FY09, the disbursement ratio is already at the same level as what it was for the whole year of FY08. And the pace of commitments and disbursements, particularly for ITF projects, has substantially picked up since 2007.

95. **The Government and Bank will continue to engage in a constructive dialogue to decide on the appropriate course of action to expedite project implementation.** It will also continue to rely on the CPPR mechanism to monitor portfolio-wide performance. Other instruments include a focused implementation support mission as part of the CPPR, quarterly portfolio status monitoring, and case by case project review to address potential or actual problem projects, for example, project restructuring or cancellation if problems are too deeply entrenched to be solved within a reasonable amount of time. This dialogue will involve all relevant levels in the Iraqi Government, from implementers to decision-makers. Corporate level support within the Bank will be sought as needed to help unblock the particular bottlenecks of the Iraq work context, such as accepting a higher level of risk with appropriate mitigating measures (such as the designated account pilot).

96. **Given the security situation and the difficulties for the Bank teams to undertake field visits in Iraq, a full Country Financial Accountability Assessment (CFAA) has not been possible.** An internal report entitled Financial Management Accountability Assessment based on a desk review¹⁸ of available reports and assessment issued by the IMF, the Bank and other donors, was prepared to inform the Bank project preparation and design. Although the Government of Iraq, along with the Bank and other donors, has embarked on a number of activities to strengthen the PFM system, the current levels of fiduciary risks are very high and will remain as such for some time, until these PFM activities and reforms yield results in the medium term. A number of other reports undertaken by the Bank and the other agencies have confirmed the above assessment and led to considering Iraq as one of the “high risk-weak control environment countries” that require special attention. As such, the Bank is putting in place several mitigating measures (see Annex VII).

97. **At the country and sector levels, the Bank would also continue the dialogue with the Government in the area of expenditure controls,** through the following mechanisms:

- *At the sector level,* the institutional assessments to be carried out with selected government institutions could also look at ways to enhance FM procedures and processes and strengthen the internal audit function.
- *At the country level,* the Bank would continue with the dialogue with the Board of Supreme Audit, seeking ways to strengthen its capacity in playing their role as the external auditor of the government accounts. The Bank could also review the roles and work of government oversight agencies in charge of expenditure controls and internal audit.

¹⁸ “Financial Management Accountability Assessment”.

98. **The Bank will continue to rely on the PMT model as the basic mechanism for project implementation in most cases.** Discussions with the authorities during the ISN consultations put forward recommendations to improve PMTs, based on successful PMT models (see Box 8). During the ISN period, the Bank may also explore further the possibility of supporting the establishment of a semi-independent implementation agency, staffed with highly qualified Iraqi professionals.

Box 8. Recommendations on the PMT Model

- Use consistent job descriptions
- Enhance authority (decision-making) of PMT director
- Raise thresholds for contract/payment approval by PMT.
- Key responsibilities in PMT should be filled by full-time dedicated staff to project implementation
- Consider providing incentives to PMT staff
- PMT must be fully integrated within ministry departments (physical & managerial)
- PMT director to report project progress and implementation issues to minister
- Ensure project has needed liquidity
- Optionally engage procurement agent, depending on needs of particular ministry
- Provide additional training

C. Introducing More Flexibility in Implementation Arrangements and Business Processes

99. **Until January 2009, Baghdad's security landscape consisted of a "red" and "green" zone, which greatly constrained Bank staff's ability to operate in-country as well the line ministries' ability to move around Baghdad.** Currently, Bank Group staff are limited to working in secured areas in Baghdad or in KRG. Since most line ministries located outside the former international zone and their staff cannot always safely move throughout Baghdad, World Bank Group interaction with counterparts and private sector in Iraq is severely constrained. With the Status of Forces Agreement (SOFA), the Iraqi authorities now have full responsibility over the former International Zone. At this stage, it is still uncertain what impact this will have on Bank staff or counterpart mobility in or around Baghdad. The Bank will continue to rely on a number of implementation arrangements established under the previous ISNs. First, Bank task teams will engage local consultants to help PMTs implement projects. Second, the Bank will continue to engage a Fiduciary Monitoring Agency (FMA) to help task teams monitor physical implementation and PMT compliance with Bank procedures. Third, sector missions will continue to get support from the Amman-based Interim Office for Iraq. Finally, the Bank's Country Office in Baghdad will continue to be responsible for high-level policy dialogue with the Iraqi authorities and donors in Baghdad. In addition, the Country Office will be responsible for portfolio management. In order to enhance day-to-day support to portfolio implementation, the Bank is exploring the possibility of recruiting additional locally-hired professional Iraqis to liaise with the Government and PMTs who have greater mobility. International Bank Group staff travel to Iraq will be increasingly considered but will depend on security conditions, business needs and cost-effectiveness.

100. **The Bank's policy on *Rapid Response to Crises and Emergencies* – OP/BP 8.00, for which Iraq is eligible – allows for additional flexibility.** In addition to streamlined processing procedures, OP/BP 8.00 allows for the application of additional flexibility in support of project implementation in a number of ways: (i) the possibility for limited

recourse to Bank execution when counterpart capacity does not exist; (ii) increased financial flexibility through increased US\$5 million limit on Project Preparation Facility (PPF) financing; (iii) the possibility to finance up to 40 percent of total grant/credit amount to retroactive financing; (iv) the possibility to finance against a positive list of goods (and not just imports); (v) flexibility on eligibility of expenditures; and (vi) the application of flexible procurement procedures. However, it is likely that for some operations (e.g. particularly high fiduciary risk or those that are complex with a longer term gestation period) it will be more appropriate to go through the regular appraisal process, outside the OP/BP 8.00 framework, thus benefiting from additional peer reviews and providing for more *ex ante* risk mitigation and control measures, including on safeguards.

101. Further flexibility will need to be introduced in the implementation arrangements and business processes in order to increase the Bank's responsiveness to the fluid situation on the ground in Iraq. Key elements of this added flexibility would include: (i) Annual Business Planning (ABP) with the Government to determine each year's work program; (ii) setting aside funds in contingency to be able to rapidly respond to Government requests as they arise; (iii) an expanded use of designated accounts, if the pilots are deemed successful; and (iv) a focused effort to tap the Bank's top available expertise in order to respond quickly to Iraq's evolving needs.

D. Fostering Donor Coordination

102. **In recent years, the global aid architecture has become increasingly complex, with a growing proliferation of aid channels and a significant degree of fragmentation of assistance.** The very complexity of the aid architecture may reduce the effectiveness of assistance by increasing transaction costs of aid for donors and recipients alike.¹⁹ The Paris Declaration on Aid Effectiveness – of which Iraq is a signatory – is an important step towards strengthening donor harmonization and alignment with recipient country development programs, as well as in reducing aid-related transaction costs.

103. **Donor coordination in Iraq could be strengthened.** Donor-financed capital investments are often not reflected in Iraq's national budget; investments are therefore often made without consideration of associated recurrent costs to the national budget; and the efficiency of the international community's assistance is weakened by uncoordinated parallel work activities. Donor coordination issues include conflicting goals and procedures as well as divergent approaches to development. Preliminary evidence suggests that considerable transaction costs may hamper the effectiveness of foreign aid to Iraq.²⁰ Although the National Development Strategy outlined the mechanisms by which it would undertake donor coordination, these are yet to be successfully implemented. Sector working groups established under the NDS have now all but ceased to function. However, the Baghdad Coordinating Group, a meeting between Government and heads of development agencies, does continue to convene occasionally in relation to the International Compact for Iraq.

¹⁹ IDA (2007). *Aid Architecture: An Overview of the Main Trends in Official Development Assistance Flows*. Paper presented to the IDA15 Replenishment discussions, February.

²⁰ Kanayan, S. (2007). "Proliferation and Fragmentation of Donor Aid to Iraq". Iraq's Ministry of Planning and Development Cooperation.

104. **The International Compact with Iraq offers an opportunity for enhanced Government leadership in the donor coordination process.** Donor coordination will become less of a constraint as Iraq assumes this role by signaling its own needs and priorities. The Government of Iraq has established an ICI Secretariat, and sector working groups for economic and social development, public resource management, energy and agriculture. Whilst these working groups are currently internal to the Iraq Government and their function is slowly evolving, it is the Government's intention that their mandate be expanded to include donor coordination in these focal areas. Furthermore, the Iraqi Government has recently endorsed the Paris Declaration on Aid Effectiveness, thereby facilitating a partnership with the donor community to harmonize legislation, institutional procedures, regulations and practices in line with Paris Declaration principles.

105. **The political and security contexts have prevented the Bank from playing a stronger coordinating role in Iraq.** This may change as the Iraqi authorities – emerging from conflict – increase their focus on economic development. Within the context of Iraq's leadership in donor coordination, and the UN's strong local presence, the Bank will be part of the effort to support and strengthen local donor coordination.

106. **While Government leadership is crucial to ensure that donor assistance are coordinated and aligned with national priorities, the Bank can contribute to this process in a number of ways.** First, the Bank can together with other donors to map donor activity in key sectors or themes in Iraq. Box 9 provides an example of such mapping in the crucial area of governance. Second, the Bank can conduct joint work with other donors in the delivery of specific assistance to Iraq, as illustrated by the collaboration with DFID in the support to the design of Iraq's PFM reform action plan. Third, the Bank can co-organize – together with the UN agencies – regular donor meetings in Baghdad. Finally, the Bank can support and actively participate in the sector working groups organized under the ICI.

E. Monitoring Framework

107. **While neither the first or second ISN contained a monitoring framework, this ISN proposes to indicate program performance against a set of indicators aimed at reflecting key outcomes of the Bank assistance program in each important development area.** Given the challenges faced in Iraq, these indicators have been kept simple and realistic. The indicators, presented in Annex I, reflect Iraq's current situation and the timeframe of this ISN.

108. **It is important to highlight the time dimension in the process of monitoring and evaluating results from the Bank Group assistance to Iraq.** Many of the results expected to be achieved over the next two and a half years are expected to come from the current portfolio. On the other hand, much of the work being initiated by this ISN, focusing on PFM, private-sector-led growth and institution building, is expected to bear fruit over the medium to long-term.

Box 9. Review of Donor Activity in Governance

Notwithstanding the difficulties of tracing all the development assistance that has been provided in the area of governance, it is clear that several donors have paid considerable attention to this important area of reform. As with other issues, the most prominent donor has been the United States, which has engaged heavily across all key governance issues. Other active donors have included the United Kingdom (principally through its development assistance agency, the Department for International Development (DFID)), the United Nations through a number of its agencies, especially the United Nations Development Program (UNDP), the European Commission, Japan, Canada, Sweden and Korea. Much of this assistance has been channeled through the ITF.

Public Financial Management: The wide-ranging US assistance has included assistance to the General Administration for Taxes, provision of advisory and training services on a variety of issues including budget management (formulation and implementation), government accounting, financial controls, internal and external audit and procurement and the Iraq Financial Management Information System (IFMIS). The support has been provided through a number of USG departments and agencies including State, Treasury, Defense and USAID. The UK has been a strong supporter of economic and financial management reform for several years, with a team of resident PFM specialists and economists being based in Baghdad. These specialists have worked closely with their Bank and US colleagues in a number of key areas including training events and workshops. The UNDP has supported Iraq's supreme audit institution, the Board of Supreme Audit in its strategic planning and human resource management, and the Ministry of Planning.

Anti-Corruption: The United Nations has taken the lead in terms of organizing and hosting a number of high-profile conferences of key GoI ministers and officials. These events have been supported by a broad range of governance programs. The United States has tried a variety of ways of supporting anti-corruption efforts, including working with the Inspectors General and the Commission of Integrity (COI). Sweden has provided funding through the International Reconstruction Fund Facility for Iraq (IRFFI) for several general good governance and democracy programs. The Bank has brought together high-level officials from the COI, BSA and Inspectors General, together with the Chief Justice and other senior legal officials to discuss international approaches to fighting corruption including asset retrieval and better ways of working together.

Legal and Judicial Reform: The US continues to be the main donor supporter of legal and judicial reform, having provided large amounts of assistance to the justice sector. This has included the rehabilitation of courts, the restoration of critical services at the Ministry of Justice, support to the Iraq Property Claims Association and a number of conferences on legal matters. It currently has a major rule of law program in operation. The UN has also operated various rule of law and human rights programs, and is updating and launching an Iraqi legal database, while Sweden has supported the education of Iraqi judges, lawyers and prosecutors.

Civil Service Reform: Although there is not yet any coherent Government program of civil service reform, donors have been supporting institutional development at the federal, regional, governorate and local levels. These initiatives have taken place both inside and outside Iraq with support from a large group of owners, including the Us, UK, UNDP, Sweden, Canada, Korea, Japan and, indirectly, the EC through Trust Fund arrangements.

Decentralization: Decentralization has received substantial assistance from the UK and, especially, the US. The latter has operated a large Local Governance Program funded by USAID which has worked closely in two phases with Iraqis in all 18 governorates typically through Provincial Reconstruction Teams (PRTs), to promote diverse and representative citizen participation in provincial, municipal, and district government. Similarly, the UK financed a major Governorates Capacity Building Program.

109. The proposed indicators are organized according to the three themes of this ISN and were designed to reflect both new and ongoing Bank operations in Iraq, which are expected to influence development outcomes during this ISN period. Progress against these indicators will be assessed on an ongoing basis, through regular

consultations with the Iraqi authorities, the donor community, and key domestic stakeholders.

F. Resources to Iraq

110. World Bank Group support available for Iraq under this ISN includes the ongoing portfolio, new advisory services and technical assistance, and the resources outlined below. The Government has indicated interest in IBRD borrowing. Given the recent deterioration in Iraq's fiscal situation brought about by declining oil prices, financial support from IBRD would help the Government implement much-needed public investments. World Bank Group resources – including IBRD, IFC and MIGA – could leverage other sources of financing – including Iraq's own revenues, donor grants, and financial institutions – to support high-impact development activities and well-targeted capacity building.

111. Clear progress has been made since the last ISN towards the restoration of Iraq's creditworthiness. Under this ISN, an envelope of US\$500 million can be committed for investments projects over FY09-11. The current situation is that Iraq's income per capita is well above the IDA operational cut-off and Iraq does not have access to IDA 15 resources. Iraq has witnessed gains in all the major components of creditworthiness, although to varying degrees with the most significant advances made in the past twelve to eighteen months. Furthermore, these achievements have included the overall improvement in security and political conditions. These two factors, in turn, have facilitated the passage of critical legislative reforms, the satisfactory completion of successive IMF programs, an eventual increase in oil production and exports, and a series of generous debt reduction deals with many Paris Club, non-Paris Club and commercial creditors. Yet, Iraq's overall creditworthiness for non-concessional borrowing remains limited, in large part because of the fragility of the recent progress. Looking forward, a further improvement in creditworthiness will depend on greater stabilization of the security situation, a strengthening of the domestic political consensus around lasting compromises, and an easing of regional political tensions.²¹

112. This ISN will tap the following additional financing sources:

- *Co-Financing or Parallel Financing Arrangements.* The Bank will work with the Iraqi authorities to identify public investment projects where co-financing or parallel financing arrangements with the Iraqi Government could be set up.
- *Iraq Trust Fund.* The limited resources that remain in the Iraq Trust Fund (ITF) will be used during the first year of this ISN period to support activities such as a PFM reform project, a Bank Restructuring project, a Pension Reform project, an Education Sector Reform project, and additional financing for the Emergency Private Sector Development project.
- *IFC and MIGA Support.* Private sector-support activities under this ISN will benefit from IFC's financial products and services as well as from MIGA

²¹ Annex VI presents a more detailed discussion of Iraq's creditworthiness for IBRD financing.

guarantees. IFC and MIGA activities could also be complemented by IBRD guarantees. IFC can also mobilize additional funding for private sector investments through its syndication (B-loan) program.

- *State and Peace Building Fund (SPBF)*. Resources from the newly-created SPBF will be used to support institution building activities; the scaling-up of community-driven activities initiated under the Post-Conflict Fund (PCF); and innovative approaches to delivering basic services.

VII. RISKS AND MITIGATION

113. **As was the case for the previous ISNs, this ISN is subject to substantial risks.** The risks to the Bank program in Iraq can be grouped in three categories: (i) political and security-related risks; (ii) economic performance-related risks; (iii) fiduciary risks; and (iv) risks that project-related implementation issues pose to the achievement of development results.

114. **A first critical risk is that the ability of the Bank Group to engage with Iraq becomes constrained by a reversal of recent, hard-won security gains.** Related to that, a deterioration in the political environment either in Iraq or in the Region would also affect the Bank's ability to implement its assistance program. As such, engagement with Iraq can follow an *adaptive approach to political and security issues*. Under this approach, staffing in the Baghdad office, the frequency of missions to Iraq, and the launching and implementation of specific activities would be tailored to the evolving political and security situation on the ground. In addition, the continuing reliance on the Interim Iraq IBRD Office in Amman would be an important tool for business continuity should the political and security situation take an unexpected turn for the worse.

115. **A second critical risk is that Iraq's economic performance worsens in view of the impact of the current global financial crisis, making it more difficult to implement much-needed reforms.** As discussed before, the main channel of impact of the crisis on the Iraqi economy would be through oil prices, export volumes and fiscal revenues. This risk could take the form of a higher (if temporary) fiscal deficit, renewed inflation, and a worsening current account. The change in the external and domestic economic environment could make it harder for the Iraqi Government to implement sensitive reforms such as the elimination of fuel price subsidies or the phasing out of the Public Distribution System. To help mitigate these risks, the Bank Group will continue to work with the Iraqi Government in supporting the implementation of critical economic reforms – including helping address oil revenue volatility issues – through policy dialogue, analytical/advisory work, and financial support through operations such as the PFM Reform and the Bank Restructuring projects.

116. **A third critical risk is that weaknesses in Iraq's institutional environment increase the exposure of the Bank's portfolio to fiduciary problems.** To mitigate these risks, the Bank has adopted specific measures to reduce fiduciary risks, mitigate weaknesses in the control systems of Iraqi agencies, and compensate for a difficult operating environment, which limits travel throughout Iraq. They include: a more

systematic approach to institution building based on ministry- or agency-specific institutional assessments and action plans; strengthening of the Bank Baghdad Country Office; continuing use of a Fiduciary Monitoring Agent to supervise project implementation; and support to Iraq's action plan to improve public financial management, both through the PFM Reform project and forthcoming analytical and advisory work. Rules and controls used in Bank-supported operations in Iraq are outlined in Annex VI. In addition, fiduciary risk issues are being addressed through the Bank's work with the control bodies in Iraq. The Bank has provided two ITF-financed workshops for the top management of Iraq's Board of Supreme Audit (BSA), dealing primarily with the application of risk-based external auditing. Representatives of the Inspectors General have also participated in Bank workshops. The overall control environment within Iraq raises important fiduciary concerns, which are addressed through the proposed mitigation measures.

117. **A fourth critical risk is the risk that the Bank's current portfolio does not achieve its intended development impact due to project implementation issues.** While some issues, such as security, are beyond the Bank's control, portfolio risk will be mitigated through the measures discussed above. The need to ensure that concrete development results are achieved calls for a balanced approach toward fiduciary and reputational risks on the part of the Bank.

VIII. BENCHMARKS FOR FURTHER ENGAGEMENT

118. **The main benchmark for further engagement by the World Bank is a sustained improvement in the security situation.** Other benchmarks, which will be monitored, are:

- **Political and institutional stability.** Continued consolidation of political and institutional stability as demonstrated by events and as appraised by the international community.
- **Results achieved and improved portfolio performance.** Bank support would be expected to continue or increase on demand commensurate with the extent to which Bank supported activities are achieving results as well as improvements in portfolio performance.
- **Commitment by relevant Government agencies to respective projects.** Demonstrated commitment through successful project implementation can pave the way for further engagement in the respective areas or sectors. On the other hand, should projects stall for an excessive amount of time or not have traction with the involved Ministry, cancellation or not engaging in those areas would be considered, even if it is a priority sector.
- **Consolidation of a new National Strategy.** As a MIC, Iraq does not need a Poverty Reduction Strategy as a platform for Bank assistance, although one is being developed. A full fledged updated national strategy, which provides prioritized and reasonably costed objectives for recovery and national development,

as jointly appraised by Fund and Bank staff, would provide a basis to align the Bank's program.

119. **These benchmarks constitute a broad indicative framework on the basis of which further engagement – including the move to a full Country Assistance (or Partnership) Strategy – could be considered.** In the event of a deterioration in the security situation, lack of progress in project implementation, or very limited engagement by counterpart institutions, the World Bank Group would adjust its operations as needed. In practice, this would mean revising implementation schedules and planned activities, or in the case of severe obstacles, a partial suspension of activities. Nevertheless, the World Bank Group would remain committed to staying engaged in Iraq over the long-term, even in the event that activities would need to be scaled down.

ANNEX I. MONITORING FRAMEWORK FOR IRAQ

Overarching Goal: To help Iraq use its resources more effectively and transparently.

ISN Thematic Areas of Engagement	Outputs the WBG expects to influence [by June 2011]
Theme 1. Continuing to support ongoing reconstruction and socio-economic recovery efforts	<ul style="list-style-type: none"> • Output 1 (Electricity): Increased generation capacity of targeted plants for rehabilitation as measured by: (a) Dokan hydropower plant capacity increased from 65% to at least 80%; (b) Derbandikhan hydropower plant capacity increased from 60% to a minimum of 75%. (c) Restoration of original capacity (400 MW) of Units 2 and 3 at Hartha Plant). • Output 2 (Education): Alleviation of school building hazards and overcrowding in primary and secondary schools as measured by: (a) Rehabilitation of at least 100 schools; (b) Construction of at least 80 new schools. • Output 3 (Water): Restore basic water supply, sanitation and urban services as measured by: (a) 20 million cubic meters (MCM) per year of additional water made available; (b) Construction of 400 km of water pipeline in targeted areas. • Output 4 (Roads): Improved capacity both at the State Commission for Roads and Bridges and KRG- General Directorate for Roads and Bridges as measured by the Emergency Roads Rehabilitation Project including: (a) Development of road asset management tools and their effective use; and (b) Increase in Percentage of population in targeted villages with access to an all-weather road. • Output 5 (Community Infrastructure): Undertaking measures to address urgent rural water needs, as determined by: targeting improvement to about 111,000 hectares of targeted irrigated areas.
Theme 2. Improving the management of public resources, including human, natural and financial	<ul style="list-style-type: none"> • Output 6 (PFM): Improve the implementation of the budget as measured by (a) Improved reporting framework in place, leading to 30% reduction in unused, outstanding balances in Spending Units (baseline ID 9.5 trillion at end-2007 (12 percent of GDP); (b) Improved budget preparation as measured by completing at least one sector strategy in a pilot sector.

	<ul style="list-style-type: none"> • Output 7 (EITI): Supporting improvements in transparency of oil revenue flows through the validation of Iraq's EITI candidacy. This requires meeting the four EITI validation criteria, which include: (a) Government issuing unequivocal public statement of its intention to implement EITI; (b) Government committing to work with civil society and companies on EITI implementation; (c) Government appointing a senior individual to lead on EITI implementation; and (d) Publishing, and making widely available, a costed Country Work Plan containing measurable targets, a timetable for implementation and an assessment of capacity constraints (government, private sector and civil society). • Output 8 (Pensions): (a) The public pension scheme maintains adequate benefits, and is financially sustainable in the long-term, as assessed by actuarial evaluation; (b) A database of contributors and beneficiaries, based on individual records, is fully populated, operational and regularly maintained. • Output 9: (Institution Building): Completion of an institutional needs assessment in two pilot ministries.
Theme 3. Supporting policies and institutions that promote longer-term broad-based, private-sector-led growth	<ul style="list-style-type: none"> • Output 11 (State-owned banks): Satisfactory implementation of the banking reform strategy action plan as measured by the Banking Sector Reform Project including: (a) Improved quality of banking regulations; and (b) Improved corporate performance of the two state-owned banks Rafidain and Rasheed. • Output 12 (Telecom): Improve telecommunications network as measured by: National Telecommunications Network rehabilitated, providing modern digital links between Baghdad and cities in 13 districts and benefiting government, businesses and individuals. • Output 13 (PSD): Improve export capacity of private sector companies as measured by: 100 firms assisted to prepare export plans and access new sources of financing. • Output 14 (Public-private partnership): Improve PPP framework to attract private participation in key projects.

ANNEX II. DONOR ASSISTANCE MATRIX MAPPED TO ICI PILLARS²²

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08	2009-10
ICI Compact Pillar: 4.1 Public Resource Management (PRM)						
4.1.1 Oil Revenues: Establish a transparent single petroleum account and an equitable petroleum revenue sharing framework.					WB Policy Papers: - Fiscal System for a Natl Oil Co. in Iraq. -Federal Aspects of Petroleum Regulation & Mgt in Iraq. -Private Sector Participation in Iraq Electricity Generation. -Oil and Gas Sector reforms.	WB Support to EITI
4.1.2 Public Financial Management (PFM): Align PFM and procurement system with sound international practice.			WB-ITF	US\$18m	WB Policy Papers: - Improving Mgt of Public Distribution System (including training) -Sub-National PFM (including workshops). -Decentralized PFM -WB Fiscal Sustainability Note. -WB Public Expenditure & Institutional Assessment (PEIA) -PFM training in KRG.	
	DFID	US\$4m	DFID	US\$10m		
	USAID ²³	US\$26.2m	USAID	US\$6m		
	US Embassy	US\$36.5m				

²² Table indicates information received from donors as of November 2008 and may not reflect all donor activities in Iraq.

²³ All USG financing is based on a fiscal year running from October through September.

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08 "	2009-10
ICI Compact Pillar:						
4.2 Strengthening Institutions and Improving Governance						
4.2.1 Engaging with Civil Society: Building a consensus on economic reforms through dialogue and engagement with civil society.	USAID	US\$136.3m	USAID	US\$163.2m		
	US Embassy	US\$5m				
4.2.2 Good Governance and Anti-Corruption: Develop a legal framework and build institutional capacity to deter corruption at all levels of government.	WB-ITF	US\$7m				
	Japan	US\$23m				
	USAID	US\$145m	USAID	US\$106.5m		
	US Embassy	US\$281.7m	US Embassy	US\$150m		
4.2.3 Civil Service Reform: Establish a civil service corps on the principles of professionalism, integrity and non-partisanship.					-WB Kurdistan Civil Service Note.	
					- Data Analysis Training.	
					-Household Survey Local Supervisor Training.	
					-Inter-Ministerial Poverty Committee Workshop.	
					-Living Standards Measurement Survey Course.	
	DFID	US\$19.5m	DFID	US\$8m	-Utility Reform Training.	
	Japan	US\$4m				
	USAID	US\$4.6m	USAID	US\$4.6m		

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08	2009-10
ICI Compact Pillar: 4.3 Economic Reform						
4.3.1 Reforming Subsidies: The government shall work to phase out inefficient and inequitable universal subsidy programs while ensuring the protection of the vulnerable.	USAID	US\$5.2m	USAID	US\$0.6m	WB	WB
	US Embassy	US\$10.5m				
4.3.2 Private Sector Development and Investment Promotion: Create an enabling environment for private investment and job creation.	WB-ITF	US\$65m			WB/IFC Review of Build-Own-Operate Contracts	IFC ICA
	WB-IDA	US\$135m	DFID Japan	US\$18m 42,500m Yen (Loan)		
	USAID	US\$18.4m	USAID	US\$18.4m		
	US Embassy	US\$9.65m				
4.3.3 Financial Sector Restructuring: Promote public savings and investment and continue reforming the Financial Sector.			WB-ITF	US\$10m	-WB FM & Disbursement Workshop for Project Financial Officers. -Local Budgeting & FM Training. -Independent External Auditors Workshop. -Audit and Accountability Workshop with Board of Supreme Audit. -WB/IFC TA to Iraq's Financial Sector.	
	USAID	US\$14.3m	USAID	US\$1.7m		
4.3.4 Regional and International Economic Integration: Reintegrate Iraq into					WB	WB
	USAID	US\$2.8m	USAID	US\$2.8m		

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08	2009-10
the regional and global economy and deepen international cooperation on the basis of mutual benefit and common interest.						
ICI Compact Pillar:						
4.4 Human Development and Security						
4.4.1 Delivering Basic Services: Achieve significant progress in meeting the 2015 UN Millennium Development Goals.	WB-ITF	US\$9.1m				
	DFID	US\$40m	DFID	US\$6m		
	US Embassy	US\$492m	US Embassy	US\$140m		
4.4.1.2 Employment: Build human capital necessary to sustain growth, reduce unemployment by one half and double labor force participation for women in the economy.	USAID	US\$379m	USAID	US\$132.5m		
	US Embassy	US\$0.8m				
4.4.1.3 Education: Achieve significant progress towards: i. Full primary completion by 2015 ii. Gender parity in education by 2015 iii. Improve adult literacy by 25% Increase education budget to 5% of GDP.	WB-ITF	US\$66m	WB-ITF	US\$3m		
	WB-IDA	US\$100m				
4.4.1.4 Health: Improve health and nutrition of all Iraqis as a cornerstone of welfare and economic development.	WB-ITF	US\$33.7m				
	Japan	US\$77.35m				
	US Embassy	US\$3m				

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08	2009-10
4.4.1.5 Environment, Water & Sanitation, and Housing: Preserve Iraq's environment and ensure careful exploitation of its natural resources for the benefit of all citizens, improve access to housing by 15%, and improve access to water and sanitation by 1/3.	WB-ITF	US\$175m- Water US\$5m- Envir.			-WB Training on Envir & Soc Safeguard Policies -WB Housing Construction & Finance Policy Paper.	
	WB-IDA	US\$109.5m				
	WB-PHRD					
			Japan	2,800m Yen (Loan)		
4.4.1.6 Gender: Reduce gender discrimination, increase participation of women in public life and labor market, increase women's participation at the decision making level and their involvement in the democratic process, and protect women from violence and mobilize their potential to promote peace.	USAID	US\$4m	USAID	US\$4m		
					WB Policy Paper: -Women in the Economy: Microfinance for Women in Iraq.	
4.4.2 Social Sector Reform and Integration of Vulnerable Populations: Protect the poor and vulnerable groups from the fallout of change and reintegrate them into society, community and economy. Address the needs of IDPs, refugees and returnees while also enabling them to realize their potential as contributing members of the economic community.	WB-ITF	US\$8m- Social Protection US\$19.5m- Disabilities	WB-ITF	US\$6.2m	- Soc Protection TA Workshop. -Pension TA Workshop. -WB workshops to develop a PRS. -WB Poverty Assessment.	
	Japan	US\$21.7m				
	USAID	US\$37.2m	USAID	US\$76.1m		
	US Embassy	US\$216m	US Embassy	US\$200m		

ICI Goals	Ongoing (Active) Commitments Until December 31, 2008		New Commitments Expected between January 1, 2009- December 31, 2010		Analytic/Advisory Work	
	Sponsor	Amount Committed (Actuals and Expected)	Sponsor	Expected Commitments (Planned)	2007-08	2009-10
ICI Compact Pillar: 4.5 Energy (Oil, Gas, Electricity)						
4.5.1 Oil and Gas: Promulgation of a hydrocarbon law and improved oil and gas investment project execution.			Japan	4,100m Yen (Loan)		
	USAID	US\$6.1m	USAID	US\$6.1m		
4.5.2 Electricity: An aligned institutional and legal framework supporting efficient rehabilitation of the power sector.	WB- IDA	US\$164m			WB Workshop on Private Participation in Energy	
	WB-ITF	US\$6m				
			Japan	27,100m Yen (Loan)		
	USAID	US\$6m	USAID	US\$6m		
	US Embassy	US\$12m				
ICI Compact Pillar: 4.6 Agriculture and Water Management Strategy						
4.6. Agriculture and Water Management Strategy: To support the development of the agriculture sector to achieve food security, generate employment, diversify the economy and preserve the countryside and to create an enabling environment for a market oriented agricultural sector.	WB-ITF	US\$46m				-WB Capacity Bldg TA & Training for the Water Sector.
			Japan	4,800m Yen (Loan)		4,700m Yen (Loan) after 2010: Irrigation sector loan.
	USAID	US\$44.3m	USAID	US\$75.2m		
	US Embassy	US\$9.2m				
	USDA				US\$12.2m	US\$8.4m

ANNEX III. MAIN ACHIEVEMENTS OF IRAQ'S REFORM EFFORTS

Public Finance, Resource and Debt Management

- The final review of the second IMF SBA took place in October 2008 and was completed in December 2008. Completion of this review triggered the third and final stage of Iraq's Paris Club debt reduction agreement, for a total debt reduction of 80 percent in NPV terms.
- Year on year inflation was reduced to 5 percent by end-2007, compared with 65 percent end-2006. The government continues to tackle inflation using the policy tools at its disposal.
- Investment budget spending reached 55 percent of allocation in 2007.
- There has been significant progress made on increasing transparency of allocations to sub-national governments; the 2007 budget law, for the first time in Iraq's history enshrined rule based allocations to the provinces and regions.
- In regulating oil revenues and their distribution, the government has established a committee of financial experts to:
 - i. Ensure tight monitoring of Iraqi oil revenue;
 - ii. Monitor the performance of external auditors;
 - iii. Follow-up on DFI audits and;
 - iv. Monitor government spending.
- The Ministry of Oil (MoO) now publishes a monthly report on their website and in a national newspaper, comprised of details on Iraq's oil exports. It also now advertises the methodology for crude oil sale contracting and details of the pricing mechanism.
- The Ministry of Finance (MoF) organized a number of workshops concerning economic reform and transparency with attendees from MoO, MoPDC and CBI.
- The system of oil measurement throughout all fields and facilities has been revised by MoO and the process of installing metering began in 2007.
- By July 2008, bilateral agreements with all 18 Paris Club member countries, and agreements with 11 Non-Paris Club creditors on terms comparable to Paris Club have been signed. About 97% of private sector debt has been settled.
- The Ministry of Agriculture is reducing subsidies on agricultural products reform of the land tenure system is under consideration. Rent on state-owned land has also been reduced by 50%.
- A budget classification system was implemented based on the IMF's Government Finance Statistics (GFS) and UN's classification of Function of Governments (COFOG)
- A unit has been established within the Prime Minister's office to oversee the administrative reform agenda and address issues such as the size and structure of government and human resource policy.
- Financing to private entrepreneurs as well as SMEs has been improved, and concessionary financing has become available from both state-owned banks.
- The Government of Iraq passed a law prohibiting regions and provinces from erecting barriers impeding the free flow of goods within Iraq.

Transparency & Anti-Corruption

- The Joint Board for Combating Administrative Corruption was established by the Presidential Order under the chairmanship of the Secretary General Council of Ministers to ensure efficiency, integrity, and transparency in the implementation of the Governments economic and social policies and to enable coordination among anti-corruption bodies represented on the Board.
- The Government launched a national initiative geared at combating administrative corruption in a conference held by the Prime Minister in January 2008.
- An International Anti-Corruption Conference was held in Baghdad on 17-18 March 2008 which culminated in the Baghdad Declaration on Corruption.

- The Government ratified and implemented the UN Convention on Anti-Corruption in April 2008 (UNCAC).
- The Government has committed to join the Extractive Industries Transparency Initiative (EITI) and has written to EITI to express this commitment.

Social and Human Development

- A categorical targeting based social safety net (SSN) has been established to facilitate subsidy reform; it consists of cash benefits (US\$100 per household), microfinance opportunities, and employment services. One million households are registered in this program, with 850,000 families currently receiving payment. This system has been automated in Baghdad by the Ministry of Labor and Social Affairs (MoLSA) and will be automated in several other locations.
- In 2007 MoLSA provided vocational training to 8,500 Iraqis, the majority of which were in governorates outside of Baghdad.
- A US\$100 minimum wage per month has been implemented in the public sector.
- In 2007 the Government established the Department of non-formal education and the budget for education was increased from 3% of GDP in 2006 to 5% in 2008.
- At the end of 2007 a public education and consultation program to ensure public support for subsidy reform was developed.
- Child allowance has been expanded, conditional upon primary school attendance of children in low-income families included under the SSN program.
- The Iraq Housing Fund has been restructured to include support for refugees, internally displaced persons (IDPs) and other disadvantaged social categories. Loans have also been disbursed to approximately 10,000 poor and low income government-employee households.
- A Commission for Women's Affairs was established within the office of the Prime Minister and an annual budget has been allocated to this end.

ANNEX IV: SUMMARY OF ITF AND IDA FINANCED PROJECTS

December 31, 2008

Project	Grant Amount (US\$ m)	Implementing Agency	Signing/ Effectiveness Date	Project Objective and Description:
ITF				
First Capacity Building	2.5	World Bank	2/14/04	Build the capacity of the Iraqi authorities to enable them to define, prioritize, and implement development projects.
Second Capacity Building	7.0	World Bank	12/6/04	Build on the First Capacity Building project to help authorities introduce reforms to lead to a diversified and market-driven economy.
Textbook Provision	38.8	Ministry of Education	5/15/04	Provide 69 million textbooks to improve learning conditions in primary and secondary schools throughout Iraq. Build institutional capacity of the ministry.
School Rehabilitation and Construction	60.0	Ministry of Education	10/14/04	Alleviate school building hazards and overcrowding in primary and secondary schools through construction of new schools and the major rehabilitation of existing schools.
Marshland School Construction	6.0	Ministry of Education	10/12/06	Construct about 30 new schools in the marshlands area of Basra, Nasiriyah and Missan, emphasizing local stakeholder involvement.
Water Supply, Sanitation, and Urban Reconstruction	110.0	Ministry of Municipalities and Public Works	12/8/04	Restore basic water supply and sanitation services and urban services in the poorest areas of the country, choosing subprojects that will have high impact.
Baghdad Water Supply	65.0	Mayoralty of Baghdad	12/8/04	Restore basic water supply and sanitation services for Baghdad and provide capacity building to the Mayoralty of Baghdad.
Community Infrastructure Rehabilitation	20.0	Ministry of Water Resources	12/18/04	Undertake a flexible program of labor-intensive civil works, generating near-term employment while improving rural irrigation, drainage, and water supply.
Community Infrastructure Rehabilitation (Additional Financing)	26.0	Ministry of Water Resources	07/01/08	Expand the impact of the Community Infrastructure Rehabilitation Project, by rehabilitating additional sites, enhancing community participation, and strengthening the regional directorates of the ministry.
Health Rehabilitation	25.0	Ministry of Health	12/4/04	Improve emergency services in 10 hospitals (to ensure at least one well-equipped emergency unit per governorate), and provide 12 hospitals with basic medical equipment and pharmaceuticals.

Project	Grant Amount (US\$ m)	Implementing Agency	Signing/ Effectiveness Date	Project Objective and Description:
Disabilities	19.5	Ministry of Health	11/23/05	Improve services to the disabled by helping Iraq develop a comprehensive policy and legal framework for disabilities, strengthen Government-NGO partnerships, and reconstruct 11 rehabilitation centers.
Regional Emergency Health Response	8.7	Ministry of Health of Kurdistan Regional Government	07/01/08	To assist the KRG establish rapid, coordinated and effective emergency response services to health emergencies.
Private Sector Development	65.0	Ministry of Planning and Ministry of Telecommunication	12/6/04	Lay the foundation for the development of the private and financial sectors by installing essential communications infrastructure and addressing selected priorities in institution building.
Electricity Reconstruction	6.0	Ministry of Electricity	4/4/07	Finance technical assistance to upgrade technical skills in operations, maintenance and of power utilities, in coordination with the US\$ 124 million IDA project that aims to restore the base load generation capacity of the Hartha power station.
Environment Management Project	5.0	Ministry of Environment	12/20/06	Strengthen key institutional and regulatory functions of the ministry to enable it to undertake policy analysis, formulate regulations, monitor environmental quality, promote environmental awareness, and conduct technical studies.
Household Survey and Policies for Poverty Reduction	5.5	Ministry of Planning and KRG	7/24/06	Finance a comprehensive household income and expenditure survey and data analysis, to enable the Government to establish a poverty line, target social assistance to the neediest, and make informed policy decisions.
	3.6	World Bank	5/31/06	Provide the technical support needed for Iraq to undertake modern data collection and analysis for the companion ITF grant implemented by the Ministry of Planning Center of Statistics and the KRG Statistics Unit.
Social Protection	8.0	Ministry of Labor and Social Affairs	6/6/2006	Assist Iraq to implement modern management and information systems to improve the delivery of social safety nets, and enhance the impact of its social safety net and pensions programs.
Total	481.6			

IDA				
Third Emergency Education	100.0	Ministry of Education	10/15/2007	Alleviate school overcrowding through the construction of 82 new schools in 15 governorates, benefiting 57,000. The construction program will be supplemented by technical assistance to lay the groundwork for comprehensive education reform
Emergency Road Rehabilitation	135.0	Ministry of Construction	10/15/2007	Assist in the rehabilitation of highways and village access roads in central and southern Iraq. Three floating bridges will also be replaced with permanent structures.
Dokan and Derbandikhan Hydropower	40.0	Kurdistan Regional Government- Ministry of Electricity	10/30/2007	Part of Iraq's overall electricity Master plan and will provide electricity primarily in the Kurdistan region but also nationally through its connection to the national grid. An estimated 490,000 households will benefit directly as well as a number of industries.
Emergency Electricity	124.0	Ministry of Electricity	12/17/2007	Aims to restore the baseload generating capacity of the Hartha power plant and build capacity at the Ministry of Electricity.
Emergency Water Supply	109.5	Ministry of Water Resources	10/15/2008	Improve the quantity and quality of water availability in 4 selected high priority governorates through rehabilitation and upgrading of water supply and distribution infrastructure. Engage with the government on developing a sustainable policy framework for the water sector.
Total	508.5			
Grand Total	990.1			

ANNEX V: LIST OF ANALYTICAL AND ADVISORY ACTIVITIES

1. Policy Papers

Title	Delivery to Client
<i>Energy</i>	
Oil and Gas Sector Reform - Background Paper	Jun. 2004
The Fiscal System for a National Oil Company in Iraq	Mar. 2007
Federal Aspects of Petroleum Regulation and Management in Iraq	Mar. 2007
Private Sector Participation in Iraq Electricity Generation	May 2007
Oil and Gas Sector Policy Note	Feb. 2008
<i>Finance</i>	
Financial Sector Notes	Apr. 2005
Housing Construction and Finance	Feb. 2007
Women in the Economy: Microfinance for Women in Iraq	Oct. 2007
<i>Private Sector Development</i>	
Building a Sustainable Investment Climate in Iraq	May 2005
<i>Project Management</i>	
Financial Management	Apr. 2005
Operational Procurement Review	Jun. 2005
Master Implementation Manual	Oct. 2005
<i>Public Administration</i>	
The Role of Civil Service Commissions in the Management of the Public Sector – Lessons for Iraq	Mar. 2005
Iraq's Evolving Inter-Governmental Structures: Implication for Local Service Delivery	May 2005
State-Owned Enterprise Reform	May 2005
Iraq Country Economic Memorandum (also in Arabic)	May 2005
Food Security and Safety Nets in Iraq (Reform of the Public Distribution System)	Jun. 2005
Leveraging WTO accession to Design a Strategy of Economic Reforms for New Iraq	Jun. 2005
Briefing Book for the Government of Iraq (in 2 volumes)	May/Jul. 2006
Improving the Management of the Public Distribution System (Food Rationing)	Sep. 2007
<i>Public Financial Management</i>	
Public Financial Management (jointly with IMF)	May 2005
Payroll Issues Report (separate from PFM Report)	May 2005
Iraq Payroll Policy Note (Public Sector Management)	Apr. 2006
Fiscal Sustainability Note	Mar. 2007
Sub-National Public Financial Management	Nov. 2007
Public Expenditure and Institutional Assessment	Jun. 2008
<i>Social Sector</i>	
Social Protection Policy (executive summary available in Arabic)	May 2005
Pension System Reform	Jun. 2006
Country Social Analysis	Jun. 2008
<i>Water</i>	
Iraq Water Resources Assistance Strategy	Jun. 2006

2. Technical Assistance and Training Programs

Title	Date Held
<i>Education</i>	
Governance, Financing and Reform in Higher Education in a Post Conflict Environment	Jun. 2004
National Education Strategy Workshop (jointly with UNESCO and UNICEF)	Feb. 2008
<i>Energy</i>	
Oil and Gas Sector (jointly with IMF)	Jan. 2005
Oil and Gas in Federal Structures (jointly with UNAMI)	Apr. 2006
Oil Training Course (jointly with USTDA)	Apr. 2006
Workshop on Private Participation in the Electricity Sector	May 6 & 7, 2007
<i>Finance</i>	
Payment System (jointly with IMF)	Jul. 2004
Banking Supervision and Regulation (jointly with IMF)	Jul. 2004
Micro-Finance Conference and Policy Dialogue	Dec. 2005
DL Sessions in Micro-Finance for Women	Apr. 2006
Housing Finance	May 2006
<i>Health</i>	
National Health Accounts Capacity Building Workshop	May 2004
Seminar on Needs-Based Master Planning / Facility-Based Health Systems Planning	May 2004
WBI Flagship Course on Health Systems Development and Sustainable Financing	Jun. 2004
Health Financing Workshop	Nov. 2004
Study Tour to Bosnia – War Victims Rehabilitation Project *	Sep. 2006
<i>Private Sector Development</i>	
Investment Climate – Trade Facilitation, Legal Systems	Apr./May 2004
State-Owned Enterprise Privatization Strategy	Dec. 2004
Investment Promotion (Dublin) *	Jun. 2005
Training Workshop for the Iraqi Business Community on Procurement *	Nov. 2006
<i>Project Management</i>	
Environment and Social Safeguard Policies *	Mar./Apr. 2004/ Mar. 2007
Project Management: Procurement and Financial Management (ongoing) *	2004-2008
Procurement and Financial Management *	Apr. 2005
Workshop on Master Implementation Manual, comprising project management, procurement and financial management *	Jan. 2006
Training Workshop on Public Procurement *	Jul. 2006
Financial Management and Disbursement Workshop for Project Financial Officers *	Jun./Sep./Oct. 2007
National Procurement Technical Assistance (ongoing) *	Dec. 2007
Training in Public Procurement Reform *	Jan. 2008
<i>Public Administration</i>	
State-Owned Enterprises	Apr./May 2004
Macroeconomics in Transition Countries (Granada, Spain)	Jul./Aug. 2004
Infrastructure Regulations *	Jul./Aug. 2004
Formulation of the National Development Strategy	Sep. 2004
Statistical Capacity Needs Assessment Workshop *	Dec. 2004
Iraqi Labor Markets (ILO-led, Bank Staff participation)	Dec. 2004
Regional Capacity Building Program in Gender and Economic Policy, Statistics	May 2005
Sector Reform, Restructuring, Public Private Partnerships, and Economic Regulation	May 2005

Title	Date Held
International Trade Statistics	Jul. 2005
Modern Methods in Survey Fieldwork *	Jan. 2006
Budget and Planning Capacity for the Judiciary *	Mar. 2006
Iraq's Federalism (jointly with UNAMI)	Apr. 2006
Anti-Corruption *	Jul. 2006
Emergency Preparedness Training *	Aug. 2006
Policy Dialogue on Constitutionalism *	Nov. 2006
Improving the Management of the Public Distribution System – Food Rationing *	Mar./Jun./Sep. 2007
Utility Reform	May 2007
Macroeconomic Modeling and Forecasting *	Mar. 2007
Capacity Building of the Iraq Higher Judicial Council *	Sep. 2007
How to Develop a PRSP *	Apr. 2008
Study Tour for the Iraqi Constitutional Review Committee *	Jun. 2007
Rule of Law Workshop *	Jul. 2008
Needs Assessment Workshop for the Committee for the Enhancement of Statistics *	Dec. 2004
Multi-Topic Household Survey Core Course *	Jan./Apr. 2005
Sampling Core Course *	Feb. 2005
Household Surveys *	Mar./Sep. 2005
Iraq Household Socio-Economic Survey (IHSES) Workshops *	Apr./Jun./Jul. 2006/ Jan./May 2007
General Data Dissemination System Workshop (jointly with IMF) *	May 2005
Advanced Topics in Household Survey Design *	Jun. 2005
Data Management *	Jun. 2005
Data Analysis Training 2 and 3 *	May/Sep. 2007
Customizing Survey Instruments to Local Conditions – Pre-Testing Questionnaire Instruments *	Sep. 2005
Designing Smart Data Entry Programs *	Oct. 2005
Household Survey Local Supervisor Training 1 and 2 *	Jun./Jul. 2007
Inter-Ministerial Poverty Committee Workshop *	Sep. 2007
Living Standards Measurement Survey Course *	Jan. 2008
Public Financial Management	
Fiscal Federalism (jointly with IMF) *	Dec. 2004
Public Financial Management (jointly with IMF) *	Feb. 2005
Payroll Reform	Jun. 2005
Fiscal Federalism in Iraq (jointly with UNAMI) *	May 2006
Local Budgeting and Financial Management *	Aug. 2007
Sub-National Public Financial Management Workshops *	Feb./May 2007
Independent External Auditors Workshop	Jun. 2007
Audit and Accountability Workshop with Board of Supreme Audit *	Aug. 2007
Workshop on Fiscal Federalism and Local Service Delivery *	May 2007
Workshop on Government Accounting *	Nov. 2008
Social Sector	
Pensions – Improving Administration *	May 2005
Social Protection Core Course *	Nov. 2004
Pensions Workshop *	Dec. 2004
Labor Markets and Social Safety Nets *	Jan. 2005
Social Protection Strategy *	Oct. 2005
Pension Reform (jointly with IMF) *	Aug. 2006
Conference on Economic Growth and Protecting the Vulnerable *	Jun. 2007
Pension Policy Technical Assistance Workshop *	Apr. 2008
Urban	
Roads Network Planning and Management (Birmingham)	Apr./May 2004

Title	Date Held
Urban Management, Resettlement and Reconciliation in post-war Lebanon	May/June, 2004
Comprehensive City Development Planning *	June/July, 2006
<i>Telecommunications</i>	
Telecommunications Sector Reform *	Mar. 2004
Telecommunications Policy *	June, 2007
Telecom Technical Assistance *	Mar. 2008
<i>Water</i>	
Water and Sanitation Study Tour *	June, 2005
Iraq Water Resources Assistance Strategy Workshop *	May 2006

* ITF-funded activities.

ANNEX VI. IRAQ'S CREDITWORTHINESS FOR IBRD LENDING

Creditworthiness for IBRD lending is assessed by evaluating the sovereign's ability and willingness to repay the IBRD on time and in full over the foreseeable future. The major components of this assessment include an evaluation of: political and security risks, macroeconomic risks with a particular emphasis on fiscal balances, balance of payment risks and monetary challenges, financial sector risks, structural economic strengths and weaknesses and external debt sustainability.

At the time of the second ISN in the Fall of 2005, Iraq was assessed to be only marginally credit worthy for IBRD lending. Risks were identified to be exceptionally high in all major components of creditworthiness. Yet, the ISN agreed that if the available ITF and IDA resources were fully committed under the second ISN and if critical progress towards IBRD creditworthiness was achieved, a continuum of IBRD resources of up to US\$500 million could be provided. In the event, IDA and ITF resources were sufficient to finance the Bank's program in Iraq during the ISN implementation period, and IBRD lending was not contemplated.

Clear progress has been made since the last ISN towards the restoration of Iraq's creditworthiness. Under this ISN, an envelope of US\$500 million can be committed for investments projects over FY09-11. The current situation is that Iraq's income per capita is well above the IDA operational cut-off and Iraq does not have access to IDA 15 resources Iraq has witnessed gains in all the major components of creditworthiness, although to varying degrees with the most significant advances made in the past twelve to eighteen months. These achievements have included the overall improvement in security and political conditions. These two factors, in turn, have facilitated the passage of critical legislative reforms, the satisfactory completion of successive IMF programs, an eventual increase in oil production and exports, and a series of generous debt reduction deals with many Paris Club, non-Paris Club and commercial creditors.

Yet, Iraq's overall creditworthiness for non concessional borrowing remains limited, in large part because of the fragility of the recent progress. First, with regard to security and politics, new shocks and reversals are likely, and it may take years before stability is fully entrenched. Second, Iraq's economy remains extremely dependent on its hydrocarbons sector, which is very exposed to price and volume shocks. Third, structural reforms are only in their infancy. Finally, several GCC countries have yet to enter into formal negotiations on Iraq's debt obligations and would need to effectively conclude very generous debt reduction deals in line with the Paris Club arrangement. Overall, numerous risks cloud Iraq's medium and long-term capacity, and possibly willingness, to honor current and future financial obligations. Looking forward, **a further improvement in creditworthiness will depend on greater stabilization of the security situation, a strengthening of the domestic political consensus around lasting compromises, and an easing of regional political tensions.**

ANNEX VII: FIDUCIARY CONTROLS FOR PROJECTS FINANCED THROUGH THE WORLD BANK

During Project Preparation:

- The implementing agency establishes a project management team (PMT) staffed by qualified employees from the recipient agency and assisted as needed by consultants. The Bank and implementing agency agree on detailed terms of reference for PMT staff and a matrix of roles and responsibilities.
- The PMT includes a qualified and experienced accountant, financial officer, and procurement specialist, and the Bank trains and supports the PMT in modern procurement, financial management, and project management techniques.
- The Bank and implementing agency define a clear flow of funds and information.
- The PMT is required to maintain accounting and financial monitoring systems for the project, and retain project records and supporting documents for review by Bank staff or their delegates and the appointed auditor.

During Project Implementation:

- A project-launch workshop takes place at the start of each project, to ensure the PMT is prepared for project implementation.
- The Bank applies low thresholds for prior Bank review of contracts.
- Bank procurement and financial management staff in Baghdad, Amman, and Beirut actively support PMTs and review procurement documents. Together with the Bank task team, they ensure on-the-job training and support are available to PMT staff throughout the life of the project.
- Task teams conduct frequent project supervision missions, four times per year. Due to the security and logistical constraints of travel for both Bank and PMT staff, supervision missions are usually conducted at the Interim Office for Iraq in Amman. Bank teams conduct workshops with PMT staff to address project-specific procurement and financial management issues and to simultaneously build PMT capacity during each supervision mission.
- The Bank typically disburses through direct payment to contractors and suppliers. To help overcome deficiencies in the domestic banking system that have caused severe delays in local currency payments to small contractors, the Bank is piloting the use of a “designated account” in two ITF-financed projects. (A designated account is a revolving account, which is provided an advance from the trust fund.) Full documentation is required for both disbursement methods.
- Bank task teams employ Iraqi consultants outside the former International Zone, who work from their homes and the ministries, to help supervise project implementation, visiting project sites and supporting the PMT responsible for project implementation on a constant basis.
- The Bank also engages a local firm of about 24 professional consultants as a Fiduciary Monitoring Agent (FMA), to help monitor the physical implementation of projects, and the implementing agency’s compliance with procurement and financial management requirements. The FMA reports issues to the Bank as they arise, to ensure the teams

can follow up on any implementation concerns. The FMA also provides monthly reports that document the physical progress of projects, report findings, and make recommendations for follow-up actions. Reports include digital photos, which provide evidence of the delivery of goods, as well as the quality and progress of the work of contractors.

- Each project is subject to an external audit that is carried out by an independent auditor who is acceptable to the Bank and has international experience, in accordance with terms of reference acceptable to the Bank. The Bank monitors compliance with the audit requirement for each project.
- The ITF is also subject to annual external audits by the Bank's auditor. Audit reports for 2005, 2006, and 2007, which were unqualified, have been provided to donors together with management letters.
- All Bank-administered trust funds are subject to the single audit process that enables senior Bank management to assert that funds entrusted to the Bank are administered under an appropriate control framework. Task teams confirm that trust fund disbursements have been made in accordance with the terms of trust fund agreements and that effective internal control systems have been maintained by the business unit responsible for the trust fund.
- The Bank completed an internal audit of its Iraq program in June 2008. The audit focused on management's handling of the special risks inherent in Iraq, and the effectiveness of key financial and administrative controls. While the study recommended closer management of staff turnover, and increased oversight of expenditures, and procurement and disbursement processes, the audit also noted several good practices, including the use of an FMA and local consultants to assist with supervision, the on-going provision of training to PMTs, and the careful management of travel and the budget.
- The donors to IRFFI commissioned an independent review of the projects financed by the Bank and UN Iraq Trust Funds. Preliminary results noted that, despite extreme security conditions: (i) most projects showed a meaningful impact and were making progress toward their development objectives; and (ii) some projects are strengthening Government capacity and contributing to medium-term service delivery. For Bank projects, the quality of project monitoring was judged to be robust and the quality of project reporting was rated good. The review did not encounter evidence of systematic corruption, and noted that the level of transparency was good.

Despite such efforts, there remains a high residual risk of operating in Iraq.

ANNEX VIII. INTERIM STRATEGY NOTE CONSULTATIONS WITH STAKEHOLDERS

1. The World Bank Group held a series of consultations, between June and December 2008, to obtain feedback on the proposed third Interim Strategy Note (ISN) for Iraq for FY09-11. IFC, with whom the Bank is preparing the strategy, played an active role in some of these consultations. The purpose of this exercise was: (i) to better understand the perspectives of the Iraqi government and other stakeholders on the World Bank's ongoing and future engagement as well as the strategic priorities for the country moving forward, and how the Bank can best support them; and (ii) to share the draft ISN to ensure that it accounts for these strategic priorities and is fully aligned with the Iraqi National Development Strategy (NDS) and the International Compact for Iraq (ICI). The consultations were rich and presentations and summaries of the discussions were provided separately at these sessions. This summary provides an overview of some key messages that were raised.
2. June 7, 2008- Poverty Reduction Strategy Higher Committee (PRS), Amman: The PRS Committee has multi-sectoral representation and is comprised of a number of senior Iraqi officials and Parliamentarians. The objective was to discuss main priorities for Bank engagement in Iraq.
3. July 3, 2008- Iraqi authorities and the donor community, Baghdad: The mission consulted with senior representatives from the Deputy Prime Minister's office, the Ministry of Finance, Ministry of Planning and Development Cooperation, and other line ministries, as well as representatives from a number of donor agencies.

Some key messages on Bank engagement from these discussions include:

- (i) Leverage comparative advantage in public financial management and banking sector reform;
 - (ii) Build institutional capacity and provide technical assistance and training; and
 - (iii) Bring the donor community together and coordinate activities vis-à-vis a stronger presence in Iraq.
4. October 20, 2008- PRS Committee, Beirut: The PRS Higher Committee was consulted a second time for the purpose of sharing the draft ISN and obtaining comments.

Issues raised on Bank engagement include:

- (i) Need to encourage increased private-sector led growth (including privatization);
 - (ii) Improve donor coordination in Iraq; and
 - (iii) Build capacity of ministries to conduct financial management, procurement, and project oversight.
5. November 4, 2008- IRFFI Executive Committee, Baghdad: Consultations on the draft ISN was held with donors within the framework of the Iraq Partners Forum. The meeting was attended by representatives of over 17 partners, some in Baghdad and others in Amman through video-conference. These included Denmark, Germany, Greece, Italy, Japan, Norway, Spain, United Kingdom, United States, European Commission, UNAMI, UNDP and other UN specialized agencies. Donors welcomed the draft and praised the Bank's initiative to consult with them early on this document.

The main discussion points include:

- (i) Support of the main thrust of the ISN and its strategic focus on public sector capacity building, public financial management, and private sector development.
 - (ii) Appreciation of the implementation model of Bank assistance programs, which emphasizes Iraqi ownership, develops project management capabilities, and strengthens beneficiary institutions and ministries.
 - (iii) Concern on role and impact of having separate project implementation units and the risks of losing capacities and knowledge if those mechanisms are not fully integrated into government structures.
 - (iv) Request for further clarifications on the scope of the proposed work program on private sector development.
6. November 23-24, 2008- Government of Iraq (GoI), Beirut: Consultations with Government officials were held to share the revised draft ISN and obtain feedback on the proposed strategic directions. Several line ministries representing a variety of sectors as well as other government institutions such as the Board of Supreme Audit (BSA), ISRB, and ICI Secretariat, as well as representatives from the Kurdistan Regional Government (KRG) were in attendance. In order to further discuss approach and related WBG support, four working groups were held on the following topics: Policies for Institution Building, Public Resource Management, Portfolio Implementation, and Private Sector Development. The Government welcomed the opportunity to comment on the draft ISN and stressed the need to improve implementation of the current portfolio.

On the draft ISN, participants mentioned the following elements:

- (i) Include possibility of IBRD borrowing;
 - (ii) IFC should be more involved in investment in Iraq particularly supporting SMEs access to finance.
 - (iii) Support development of sector strategies;
 - (iv) Concern that the Bank will be moving toward Technical Assistance and away from Financing.
7. December 3, 2008- Iraqi Civil Society and Private Sector, Amman: The World Bank Group met with representatives from NGOs, the private sector, trade unions and parliamentarians. The purpose of this consultation was to present and discuss the draft ISN and to engage Iraqi Civil Society in obtaining feedback and establishing priorities.

The following main points were discussed:

- (i) Bank should support increased private sector-led growth and development;
- (ii) IFC and World Bank requested to advise the GoI on how to refine the existing monetary policy to encourage private sector development as the then prevailing 20% interest rate created disincentives for investment.
- (iii) IFC requested to help strengthen Iraqi private banks; and
- (iv) NGOs requested that cooperation with Civil Society Organizations, especially NGOs, be added to the main points of the draft ISN, and to be built into the capacity building projects.

8. Throughout the various consultations the central points of **consensus** among stakeholders included:
- (i) Crucial role of private-sector led growth in propelling Iraq towards a free market economy;
 - (ii) Critical role of donor coordination in promoting ownership and ensuring harmonization of activities;
 - (iii) Significance of increased flexibility in the draft ISN;
 - (iv) Engagement in Public Resource Management (including integration of donor resources into the government budget);
 - (v) Security permitting, strengthen the Bank's physical presence in Iraq.

The main points of **debate** included:

- (vi) While the political and security situation has improved considerably in Iraq, the situation continues to evolve and political challenges continue to exist.
- (vii) The public sector is encouraging donors to assist the private sector by improving access to financing and establishing a sound regulatory framework. It is equally important for the Government of Iraq to engage the private sector in the fiscal reform process, identify obstacles to private sector development and, in doing so, creating a business-friendly environment.

ANNEX IX. IRAQ AT A GLANCE

Iraq at a glance

January 26, 2009

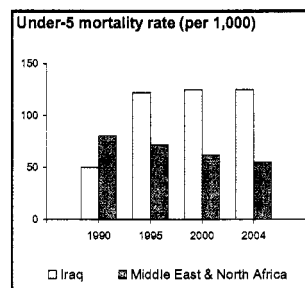
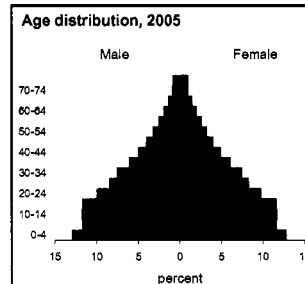
Key Development Indicators^a

(2007)

	Iraq	M. East & North Africa	Lower middle income
Population, mid-year (millions) ¹	29.6	313	3,437
Surface area (thousand sq. km)	438	8,778	35,510
Population growth (%)	2.8	1.7	1.0
Urban population (% of total population)	67	57	42
GNI (Atlas method, US\$ billions) ²	58.6	876	6,485
GNI per capita (Atlas method, US\$)	1,982	2,794	1,887
GNI per capita (PPP, international \$)	..	7,413	4,544
GDP growth (%)	2.8	5.8	9.7
GDP per capita growth (%)	0.0	4.0	8.6

(most recent estimate, 2000–2005)

Poverty headcount ratio at \$1 a day (PPP, %)	..	5	..
Poverty headcount ratio at \$2 a day (PPP, %)	..	19	..
Life expectancy at birth (years)	61	70	69
Infant mortality (per 1,000 live births)	82	34	41
Child malnutrition (% of children under 5)	16	..	25
Adult literacy, male (% of ages 15 and older)	84	83	93
Adult literacy, female (% of ages 15 and older)	64	63	85
Gross primary enrollment, male (% of age group)	108	108	112
Gross primary enrollment, female (% of age group)	89	103	109
Access to an improved water source (% of population)	61	89	88
Access to improved sanitation facilities (% of population)	79	75	54

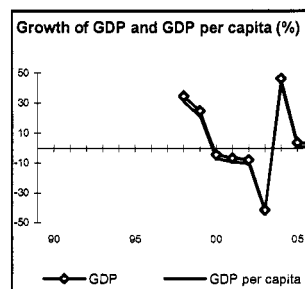


Net Aid Flows

	1990	2000	2006	2007
(US\$ millions)				
ODA and official aid ³	63	101	6,178	2,305
Top 3 donors (in 2005):				
United States ⁴	336	0	..	..
Japan	-20	0	..	..
United Kingdom	54	14	..	..
Aid (% of GNI)	0.1	..	12.5	3.9
Aid per capita (US\$)	3	4	221	78

Long-Term Economic Trends

Consumer prices (annual % change)	..	5.0	64.8	4.7
GDP implicit deflator (annual % change) ⁵	..	47.4	48.6	24.7
Exchange rate (annual average, local per US\$)	0.3	1,930.0	1,467.4	1,254.9
Terms of trade index (2000 = 100)	..	..	..	..



Population, mid-year (millions)	18.5	25.1	27.9	29.6
GDP (US\$ millions)	48,657	25,763	49,529	62,383
			(% of GDP)	
Agriculture	..	5.4	8.6	..
Industry	..	84.4	70.1	..
Manufacturing	..	0.9	1.7	..
Services	..	10.3	21.3	..
Household final consumption expenditure	..	..	37.4	41.9
General gov't final consumption expenditure	..	..	38.4	30.5
Gross capital formation	..	..	18.0	..
Exports of goods	..	..	57.4	59.5
Imports of goods	..	..	41.2	41.4
Gross national savings	..	..	27.1	22.9

1980–90 1990–2000 2000–05
(average annual growth %)

Population, mid-year (millions)	18.5	25.1	27.9	29.6
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			(% of GDP)	
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Note: Figures in italics are for years other than those specified. .. indicates data are not available.

(a) 2006 indicators for Middle East and North Africa and Lower middle income countries 1. Staff estimates 2. GNI is calculated as sum of GDP and net income on annual exchange rate and differs from the atlas method. 3. ODA and official aid are total official receipts for the year 2007. 4. GDP deflator in U.S. dollar terms. 5. Gross savings are gross national savings derived from GNI minus gross domestic consumption plus net transfers.

Middle East and North Africa, Social and Economic Development Group (MNSD).

Balance of Payments and Trade	2000	2007
<i>(US\$ millions)</i>		
Total merchandise exports (fob)	20,603	37,835
Total merchandise imports (cif)	13,384	20,628
Net trade in goods ¹	..	17,207
Workers' remittances and compensation of employees (receipts)	..	..
Current account balance as a % of GDP	..	10,794
	..	17.3
Reserves, including gold	..	31,455

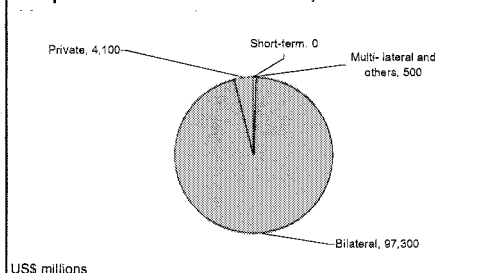
Central Government Finance

<i>(% of GDP)</i>		
Revenue ²	..	71.3
Tax revenue	..	1.6
Expense ³	..	45.9
Cash surplus/deficit ⁴	..	9.8
Highest marginal tax rate (%)		
Individual	..	15
Corporate	..	15

External Debt and Resource Flows

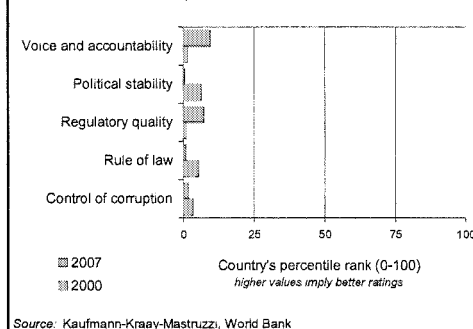
<i>(US\$ millions)</i>		
Total debt outstanding and disbursed	..	101,900
Total debt service	..	700
HIPC and MDRI debt relief (expected; flow)	..	..
Total debt (% of GDP)	..	163.3
Total debt service (% of exports)	..	1.9
Foreign direct investment (net inflows)	..	964
Portfolio equity (net inflows)	..	0

Composition of total external debt, 2007



Private Sector Development	2000	2008
Time required to start a business (days)	..	77
Cost to start a business (% of GNI per capita)	..	150.7
Time required to register property (days)	..	8
Ranked as a major constraint to business (% of managers surveyed who agreed)		
n.a.
n.a.
Stock market capitalization (% of GDP)
Bank branches (per 100,000 people)	..	2

Governance indicators, 2000 and 2007



Technology and Infrastructure	2000	2007
Paved roads (% of total)	84.3	..
Fixed line and mobile phone ⁵ subscribers (per 1,000 people)	27	57
High technology exports (% of manufactured exports)	..	0

Environment

Agricultural land (% of land area)	22	23
Forest area (% of land area, 2000 and 2005)	1.9	1.9
Nationally protected areas (% of land area)	..	0.001
Freshwater resources per capita (cu. meters)	..	2,800
Freshwater withdrawal (% of internal resources)	..	150.0
CO2 emissions per capita (mt)	3.0	2.7
GDP per unit of energy use (2000 PPP \$ per kg of oil equivalent)	..	..
Energy use per capita (kg of oil equivalent)	1,038	1,099

World Bank Group portfolio	2000	2006
<i>(US\$ millions)</i>		
IBRD		
Total debt outstanding and disbursed	101	0
Disbursements	..	0
Principal repayments	..	0
Interest payments	..	0
IDA		
Total debt outstanding and disbursed	..	0
Disbursements	..	0
Total debt service	..	0
IFC (fiscal year)		
Total disbursed and outstanding portfolio of which IFC own account	..	100
Disbursements for IFC own account	..	..
Portfolio sales, prepayments and repayments for IFC own account	..	..
MIGA		
Gross exposure	..	0
New guarantees	..	0

Note: Figures in *italics* are for years other than those specified. 2007 data are preliminary estimates.

January 26, 2009

.. indicates data are not available. – indicates observation is not applicable.

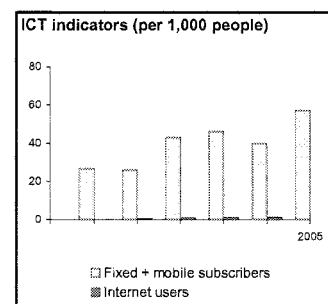
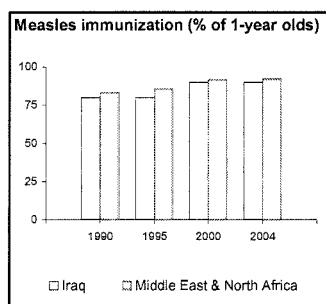
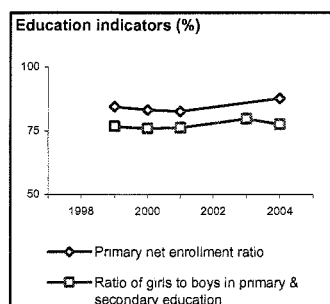
1. net trade is derived by offsetting imports of goods against exports of goods due to limited data on Exports and Imports of services 2. Revenue excluding current grants. 3. These are recurrent expenditures and do not include capital expenditures which amount to 12.4 percent of GDP in 2007. 4. Excluding grants. 5. Iraq's National Communications & Media Commission estimates mobile-phone subscribers at 4 million end-2006. Middle East and North Africa, Social and Economic Development Group (MNSD).

Millennium Development Goals

Iraq

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Iraq			
	1990	1995	2000	2007
Goal 1: halve the rates for \$1 a day poverty and malnutrition				
Poverty headcount ratio at \$1 a day (PPP, % of population)	..	..	..	..
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
Share of income or consumption to the poorest quintile (%)	..	..	..	..
Prevalence of malnutrition (% of children under 5)	..	..	12.9	7.7
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	94	..	83	89
Primary completion rate (% of relevant age group)	58	59	53	75
Secondary school enrollment (gross, %)	44	..	36	45
Youth literacy rate (% of people ages 15-24)	..	..	85	..
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	78	..	76	78
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	..	21	..
Proportion of seats held by women in national parliament (%) ¹	11	..	6	26
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	53	48	48	46
Infant mortality rate (per 1,000 live births)	42	38	38	37
Measles immunization (proportion of one-year olds immunized, %)	75	80	85	80
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	300
Births attended by skilled health staff (% of total)	54	..	72	89
	14	..	44	50
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	..	..	..	..
Contraceptive prevalence (% of women ages 15-49)	..	..	..	0.2
Incidence of tuberculosis (per 100,000 people)	56	56	56	56
Tuberculosis cases detected under DOTS (%)	..	..	51	40
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	83	82	80	77
Access to improved sanitation facilities (% of population)	..	71	72	76
Forest area (% of total land area)	1.8	..	1.9	1.9
Nationally protected areas (% of total land area)	..	..	..	0.0
CO2 emissions (metric tons per capita)	2.6	3.4	2.9	3.0
GDP per unit of energy use (constant 2000 PPP \$ per kg of oil equivalent)	..	..	..	..
Goal 8: develop a global partnership for development				
Fixed line and mobile phone subscribers (per 1,000 people)	3.8	3.0	2.7	3.8
Internet users (per 1,000 people)	0.0	0.0	0.0	48.3
Personal computers (per 1,000 people)	0.0	..	0.0	0.2
Youth unemployment (% of total labor force ages 15-24)	..	..	0.8	..



Note: Figures in *italics* are for years other than those specified. .. indicates data are not available.
1. 2006 data

January 26, 2009

Middle East and North Africa, Social and Economic Development Group (MNSD).

ANNEX X. KEY STATISTICAL INFORMATION

Iraq: Key Macroeconomic Indicators				
	2005	2006	2007	2008
Economic growth and prices				
Nominal GDP (US\$ million)	31,380	49,457	62,383	93,817
of which Non-oil GDP (% of GDP)	37.8	42.5	43.4	35.8
Real GDP (% change)	-0.7	6.2	1.5	9.8
of which Non-oil GDP (% change)	12	7.5	-2.0	5.0
GDP per capita (US dollars)	1,124	1,720	2,108	3,085
Oil production (million bpd)	1.8	2.1	2.2	2.4
Oil exports (million bpd)	1.4	1.5	1.6	1.8
Consumer Price Index (% change)	31.6	64.8	4.7	6.8
National Accounts				
		<i>(percent of GDP)</i>		
Gross domestic investment	23.4	18.4	16.1	21.1
Of which public	19.8	17.0	11.9	17.3
Gross domestic consumption	78.8	71.0	63.0	61.8
Of which general government	60.1	38.4	34.0	33.4
Gross national savings	32.0	32.0	33.4	36.2
Of which public	26.5	28.1	25.5	24.6
Fiscal and oil sector accounts				
		<i>(percent of GDP)</i>		
Revenues and grants	107.4	80.4	75.0	77.5
of which Oil revenues	76.7	65.2	67.6	70.9
Foreign grants	27.9	12.5	3.7	1.6
Expenditures	96.5	69.4	61.5	69.8
Operating expenditures	100.8	52.4	49.0	52.3
o.w. Salaries and pensions	20.4	15.2	16.4	18.5
o.w. Security related expenditure	6.9	5.7	8.7	11.7
Capital expenditures	19.8	17.0	11.9	17.3
Overall fiscal balance (including grants)	6.5	11.0	13.5	7.8
Balance of Payments				
		<i>(percent of GDP, unless otherwise indicated)</i>		
Current account balance	8.6	13.6	17.3	15.1
Trade balance	16.1	20.9	27.6	22.6
Merchandise exports	73.6	60.5	60.6	66.1
of which oil (in percent of total exports)	97.0	97.5	97.7	98.8
Merchandise imports	57.5	39.5	33.1	-43.5
Income and services (net)	-32.5	-17.7	-12.0	-8.6
Transfers	25.0	10.3	1.7	1.1
Financial Account	-7.0	1.4	1.3	0.5
Foreign direct investment	1.6	0.2	1.5	2.3
Overall external balance	6.1	16.3	17.2	15.6
Financing	-7.3	-16.2	-18.3	-16.4
Central Bank reserves (increase -)	-13.0	-16.2	-18.3	-16.4
Net change in arrears (decrease -)	-51.0	-31.3	-0.1	-70.1
Debt forgiveness	53.0	29.7	0.0	70.1
External Public Debt ⁽¹⁾				
Estimated Debt Stock (US\$ billion)	109.3	97.9	101.9	40.4
in percent of GDP	348	198	163	43
Memorandum Items				
Population (millions, mid-year)	27.9	28.7	29.6	30.4
Oil prices (US\$ per barrel)	43.9	55.6	63.0	93.3
Gross Reserves (US\$ billion)	12.0	20.0	31.5	46.8
Gross reserves in months of imports	5.5	9.3	8.0	11.6
Exchange rate, ID per US\$1 (period average)	1467	1459	1255	1193

Notes: 2007 data are preliminary estimates; (...) not available.

(1) Debt data assume full application of the first (2004) and second (2005) tranches of the Paris Club debt rescheduling agreement by the dates stipulated by the Paris Club, and of comparable treatment by other creditors, but not the third tranche of debt relief. The figure assumes debt reduction comparable to the 2004 Paris Club agreement for creditors with whom a debt agreement has been signed. Debt reduction is assumed to take place at end - 2008 for the remainder of non Paris Club creditors.

Sources: IMF and World Bank staff estimates, COSIT. Trade: UN Comtrade reported by partner countries. OII: International Energy Agency.

ANNEX XI. KEY EXPOSURE INDICATORS

Indicator (CY)	Actual				Estimate		Projected		
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total debt outstanding and disbursed (TDO) (US\$m) ^a	142,400	122,700	109,300	97,900	101,900	31,800	33,200	34,700	34,400
Net disbursements (US\$m) ^a	..	436.0	0.0	0.0	-450.9	60.9	544.6	899.8	1445.2
Total debt service (TDS) (US\$m) ^a	..	200	200	1,200	700	900	600	700	3,400
Debt and debt service indicators (%)									
TDO/XGS ^b	..	690.0	465.9	323.4	262.1	51.3	96.4	80.7	67.6
TDO/GDP	..	476.3	348.3	197.9	163.3	33.9	39.8	36.6	31.8
TDS/XGS	..	1.1	0.9	4.0	1.8	1.5	1.7	1.6	6.7
Concessional/TDO ^c	..	0.0	0.0	0.0	0.0	0.2	1.5	0.4	0.7
IBRD exposure indicators (%)									
IBRD DS/public DS	..	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Preferred creditor DS/public DS (%) ^d	..	0.5	7.8	1.8	67.9	0.0	1.0	2.6	1.0
IBRD DS/XGS	..	0	0	0	0	0	0.002	0.0024	0.0054
IBRD TDO (US\$m) ^e	..	0	0	0	0	0	11	59.0	154.0
Of which present value of guarantees (US\$m)	..								
Share of IBRD portfolio (%)	..	0	0	0	0	0	0	0	0.1
IDA TDO (US\$m) ^f	9.7	50.5	88.1	101.0

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital. Net disbursements are Gross disbursements minus principal payments
Iraq's debt reconciliation process is still ongoing. Estimates of the debt stock may differ from other publications and may include unreconciled data.

The third tranche of the Paris Club agreement was triggered by the completion of the second and last review of the IMF SBA in December 2008. The third tranche of debt reduction from Paris Club creditors is estimated at approximately US\$ 8 billion.

Estimates and projections assume debt reduction comparable to the 2004 Paris Club agreement for creditors with whom an agreement has been signed. For the remaining non-Paris Club creditors, debt reduction is assumed to be effective by end-2008. All debt to private creditors is assumed to be settled by end-2009.

Debt service is actual amount paid, including repayment of arrears to Turkey

Total debt data is provided by the IMF staff report.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Bilateral debt is treated as concessional up to 2009. Beyond 2009 bilateral debt is assumed to be non-concessional.

d. Preferred creditors here are defined as all multilaterals including IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

Public Debt Service is equivalent to Total Debt service for Iraq.

Estimates and projections assumes no disbursement under the current precautionary IMF Stand By Agreement.

The Program will end in March 2009.

e. Includes present value of guarantees.

ANNEX XII. IFC PROGRAM SUMMARY

Iraq: IFC Investment Operations Program

	2006	2007	2008	2009
<u>Commitments (US\$m)</u>				
Gross	98.30	2.40		
Net**	98.30	2.40		
<u>Net Commitments by Sector</u>				
General Manufacturing & Services	98.30			
Financial Markets		2.40		
Total	100	100	0	0
<u>Net Commitments by Investment Instrument (%)</u>				
Equity	8.44	100		
Loan	91.56			
Quasi equity***				
Total	100	100	0	0

** IFC's Own Account only

*** Quasi Equity includes both loan and equity types

ANNEX XIII. STATEMENT OF IFC'S HELD AND DISBURSED PORTFOLIO

Iraq **Committed and Disbursed Outstanding Investment Portfolio** **As of 01/31/2009** **(In USD Millions)**

<u>FY Approval</u>	<u>Company</u>	<u>Committed</u>					<u>Disbursed Outstanding</u>				
		<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>	<u>Loan</u>	<u>Equity</u>	<u>**Quasi Equity</u>	<u>*GT/RM</u>	<u>Partici pant</u>
2005/07	Nbk iraq	0	4.29		0	0	0	4.25		0	0
Total Portfolio:		0	4.29		0	0	0	4.25		0	0

* Denotes Guarantee and Risk Management Products.

** Quasi Equity includes both loan and equity types.