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INTERIM STRATEGY NOTE
OF THE
WORLD BANK GROUP
FOR
IRAQ

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ABBREVIATIONS AND ACRONYMS

bpd	Barrels per day
CPA	Coalition Provisional Authority
ESW	Economic and Sector Work
FAO	Food and Agriculture Organization
FY	Fiscal Year
G7	Group of Seven Industrialized Countries
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IMS	Investment Market Services (MIGA)
ITF	Iraq Trust Fund (World Bank)
IMF	International Monetary Fund
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MoP	Memorandum of the President
MoPDC	Ministry of Planning and Development Cooperation
NGO	Non-Governmental Organization
OP	Operational Policy
PEP-ME	Private Enterprise Partnership for the Middle East
PSD	Private Sector Development
SBFF	Small Business Financing Facility (IFC)
SOE	State-Owned Enterprise
TSS	Transitional Support Strategy
UN	United Nations
UNDG	United Nations Development Group
UNDP	United Nations Development Program
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
US	United States
WBI	World Bank Institute
WHO	World Health Organization

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IRAQ INTERIM STRATEGY NOTE OF THE WORLD BANK GROUP

I. INTRODUCTION

1. Iraq, a founding member of the International Bank for Reconstruction and Development (IBRD), received six loans from the IBRD between 1950 and 1973 for agriculture, education, flood control, telecommunications, and transport. The last loan closed in 1979; and Iraq has been in non-accrual status since 1990. In early 2003, the Bank began rebuilding its knowledge base on Iraq. In June 2003, shortly after major combat ended, the Bank and the United Nations (UN) initiated a Joint Needs Assessment, with the participation of the International Monetary Fund (IMF). Despite the tragic bombing of the UN compound in Baghdad on August 19, 2003, the Bank and UN completed on schedule the Needs Assessment, which provided the basis for an International Donors' Conference for Iraq in Madrid on October 23-24, 2003. In addition, the Bank has worked closely with the UN to establish a multi-donor trust fund facility for Iraq. A Memorandum of the President (MoP) requesting the approval of the Executive Directors for the Bank to act as administrator of the World Bank Iraq Trust Fund is submitted together with this Interim Strategy Note.

2. **This Interim Strategy, which builds on the Bank's previous work in Iraq during 2003, outlines the World Bank Group's work program for Iraq for the next six to nine months.** It draws on the Bank's experience with post-conflict countries and countries in transition from a centrally-planned economy to a market-based economy. The Interim Strategy focuses on actions the World Bank Group will take during the current interim period when conditions for a broader Bank program have not yet been met. The strategy also provides an indication of a future lending program; and it aims to ensure that the Bank is prepared to provide its full range of services, including lending, when it becomes possible. Within nine months, if conditions permit, Bank management will submit a Transitional Support Strategy to the Board.

II. COUNTRY CONTEXT

A. Political and Economic Background

3. **Turbulence and conflict have been part of Iraq's political landscape since it emerged as a modern state after World War I.** Iraq was established in 1921 out of three provinces (Mosul, Baghdad, and Basra) of the Ottoman Empire. A British-backed Hashemite monarchy ruled until 1958, when it was toppled by a military coup. A second military coup took place in 1963, and a third in 1968, when the Baath Party took over. Saddam Hussein took power in 1979.

4. **Despite successive military coups, large oil reserves enabled Iraq to attain the status of a middle-income country in the 1970s.** After oil prices began rising in 1973, Iraq's oil income grew from US\$1 billion in 1972 to about US\$8 billion in 1975. By 1979, Iraq was the Gulf's second largest oil producer, with proven oil reserves of 112 billion barrels, ranking it second behind Saudi Arabia. Iraq's wealth helped the country develop good infrastructure and well-performing education and healthcare systems, widely regarded as the best in the Middle East until the 1980s. Oil revenues also allowed the regime to build

and wield enormous power through allocating the dividends of this wealth and by further increasing the role of the state in the economy.

5. **Over the last 23 years, war and repression have traumatized Iraq's population and dissipated the country's economic and social gains.** War with Iran began in 1980, one year after Saddam Hussein assumed power. The war lasted eight years, diverting resources to the military at the expense of public infrastructure and social services and resulting in colossal human and material costs. By the war's end, Iraq had accumulated high external debt and faced an economic crisis. Iraq invaded Kuwait in August 1990; and was expelled by US-led coalition forces within six months during a Gulf War that further damaged Iraq's infrastructure. In April 1991, a UN Security Council resolution formally ended the Gulf War and imposed a multi-faceted sanctions regime. Iraq's defeat in Kuwait helped spur large-scale uprisings in the south and the north in 1991, both crushed by the regime, followed by mass executions.

6. **Iraq's centralized command economy has also stifled growth and development.** The state has dominated industry, agriculture, finance, and trade; and prices have played little role in resource allocation. Lack of resources and years of politicization have debilitated basic infrastructure and the education and healthcare systems. The state has also neglected and mismanaged the environment, resulting in degradation that imperils health and livelihoods.

7. **International sanctions imposed in 1991 further crippled Iraq's economy,** causing further hardship for most Iraqis. Conditions eased somewhat under a UN Oil-For-Food (OFF) Program that began in December 1996, allowing Iraq to sell oil to finance the purchase of food and medicine, and expanding over the years to include other imports. The international sanctions and the closed political system isolated Iraq from global trends and innovations.

8. **Despite the country's rich resource endowment, Iraq's human development indicators are now among the lowest in the region.** Income per capita, which rose to over US\$3,600 in the early 1980s following sharp rises in the real price of oil, is estimated to have fallen to the range of US\$770-1,020 by 2001, with continued decline thereafter. Although there is a severe paucity of good data (see para. 9), available statistics indicate that Iraq has veered away from the Millennium Development Goals (MDGs) (see Box 1).

B. Macroeconomic Framework and Prospects

9. **Reliable statistics are scant and economic information remains limited** (see Annex 1, Iraq at a Glance). War, economic sanctions, and political directives to suppress data reduced the capacity of Iraq's statistical agencies to collect and publish reliable data. Most national statistics published since 1991 have not included the north of Iraq; and there are no records of the trade and other transactions carried out in violation of UN sanctions. The recent war and subsequent looting damaged or destroyed many government offices—and the databases and documents within them. Consequently, economic estimates and projections will need to be revised as better data become available. It will be important to build modern systems for data collection and dissemination in order to provide reliable information on a regular basis to Iraq's policymakers.

Box 1: Iraq's Status vis-à-vis the Millennium Development Goals

Lack of data makes it difficult to evaluate Iraq's position towards achieving the MDGs by 2015. However, the data available indicate that Iraq's situation has in many cases deteriorated since 1990; and Iraq fares poorly when compared to other countries in the region. This preliminary assessment of Iraq's status vis-à-vis the MDGs will be revised as more data become available. Within the international system the UN leads the monitoring of progress towards MDG targets and indicators.

Eradicate extreme poverty and hunger. An estimated 60 percent of the population is dependent on the food ration system and the percentage of the population without the minimum level of dietary energy consumption increased from 7 percent in 1990 to 27 percent in 2001 (compared to 6 percent in Jordan and 33 percent in Yemen).

Achieve universal primary education. In 1980, Iraq had achieved near universal primary school enrollment. Over the last two decades, primary school enrollment fell to 93 percent, while secondary school enrollment dropped from 47 percent to 38 percent. The attendance rate dropped more dramatically: about one quarter of primary school age children do not attend school. Nonattendance is higher among girls and in rural areas.

Promote gender equality and empower women. In 1985, Iraq's ratio of girls to boys in primary and secondary education was comparable to the Middle East and North Africa regional average of 72 percent. While the region's ratio improved steadily to reach 95 percent in 2000, Iraq's ratio only increased to 76 percent. The ratio of young literate females to males (% of ages 15-24) is about 50 percent, compared to 60 percent in Yemen and 100 percent in Jordan. The gender distortion is greater in rural areas.

Reduce child mortality. Infant mortality rates decreased from 80 per 1,000 live births in 1979 to 40 in 1989. In the same period, under-five mortality rates fell from 120 to 60. Since 1990, however, some health indicators (particularly in the center and south of Iraq) reached levels comparable to sub-Saharan Africa. Under-five mortality has increased to 133 in 2001 (compared to 33 in Jordan and 107 in Yemen) and is twice as high in the south and center of the country as it is in the north. Infant mortality has increased to 107 per 1,000 live births, compared to 105 in sub-Saharan Africa.

Reduce maternal mortality. Maternal mortality rates are extremely high at about 300/100,000 live births compared to 41 in Jordan and 350 in Yemen. Sixtyfive percent of births occur outside of health institutions and the proportion of women delivering without trained assistance went up to 30 percent in urban areas and 40 percent in rural areas.

Combat HIV/AIDS, malaria, and other diseases. The reported incidence of tuberculosis is markedly higher than in neighboring countries. Cholera and malaria are endemic in parts of the country. The incidence of the most important vaccine-preventable disease, measles, has declined since vaccine coverage improved in the late 1990s, but the disease is still the third most common cause of death in under-five children in the north. There are 230 reported HIV/AIDS cases, mainly due to infected blood products imported from Europe. Although the registered number of cases of HIV/AIDS is relatively low, all risk factors are present for increased rates of transmission.

Ensure environmental sustainability. Prior to 1991, safe potable water was accessible by over 95 percent and 75 percent of the urban and rural populations respectively. By 2000, water service coverage had dropped to 92 percent and 46 percent of the urban and rural populations.

10. **Preliminary estimates indicate that Iraq's gross domestic product (GDP) declined by about 4 percent in 2002 and a further 31 percent in 2003**, amounting to an estimated US\$13-17 billion in 2003, or US\$480-630 per capita. GDP is projected to increase by about 33 percent in 2004, bringing it to US\$17-22 billion, or US\$620-810 per capita. (See Table 1.) Although the absence of data hampers analysis, it is clear that unemployment is high and there is severe poverty and vulnerability stemming from decades of economic decline combined with the consequences of the recent war. Traditional social structures and the informal economy offer some coping mechanisms.

Table 1: GDP Estimates and Projections

	2001	2002	2003	2004
Population (million)	24.8	25.5	26.3	27.1
Nominal GDP Growth Rate (%)	-12	-4	-31	33
GDP Annual Total (US\$ billion)	19 – 25	18 – 24	13 – 17	17 – 22
Per Capita GDP (US\$)	770 – 1,020	720 – 960	480 – 630	620 – 810

Source: Iraqi Central Statistics Office, IMF, UN/World Bank Watching Briefs

11. **Significant economic reforms have taken place in the post-war period.** Reforms include: the liberalization of all prices, with the significant exception of energy and some food items; the simplification of taxes; the abolition of licensing requirements for trade; and the abolition of tariffs and the decision to place a 5 percent reconstruction levy on all imports starting in 2004. Iraq's ministries were involved in drawing up the budgets for 2003 and 2004. In addition, the central bank has been accorded statutory independence and given an anti-inflation mandate as its central responsibility; a currency reform is nearly completed; and a new trade bank is established.

12. **Real GDP growth in 2004 depends mainly on restoring and expanding oil production,** as well as reestablishing security and basic utilities. Oil output, which is estimated at more than half of GDP, is expected to increase from the current level of about 2.2 million barrels per day (bpd), of which 1.5 million bpd is exported, to 2.7 million bpd by the end of 2004, of which 2.3 million bpd would be exported, corresponding to US\$12 billion in oil revenues for 2004.¹ Non-oil GDP is expected to recover somewhat to below the 2002 level as a result of the reconstruction efforts and private investment. Sanctions, war, post-war looting, and especially the collapse of state-controlled inputs and outputs, have affected the activities of state-owned enterprises (SOEs). SOE activities will be further affected by decisions on closure, restructuring, or privatization.²

13. **Oil revenues and other Iraqi assets are expected to fully fund 2004 recurrent expenditures** amounting to US\$12.1 billion and modest investment expenditures of US\$1.4 billion. In addition, ongoing contracts initiated under the OFF Program of about US\$7.8 billion are financing a range of public sector imports.³ All additional reconstruction needs in 2004 will require donor funding. Inflation in 2004 is likely to be under control due to a policy of no recourse to domestic financing by the Government and a central bank whose main mandate is now to preserve price stability. Nevertheless, keeping inflation low will be a challenge given the significant amounts of foreign inflows to be used in the reconstruction effort and pending policy decisions on price liberalization.

¹ Five percent of oil revenues go to the Kuwait Compensation Fund and the remaining flow into the Development Fund for Iraq.

² Although the number of SOEs at 192 is modest compared to other transition countries, they employ about 500,000 people and control key points of the economy.

³ In accordance with UN Resolution 1483 (May 2003), the OFF Program terminated on November 21, 2003, and most operational responsibilities including the food ration system were transferred to the CPA.

14. **Sustainable medium-term growth hinges on key economic policy decisions to create a market economy that encourages investment and efficient resource use.** Price liberalization is needed to eliminate untargeted subsidies that heavily burden the budget, disproportionately benefit the wealthy, and cause major market distortions. Fuel prices are only about one-tenth the level of Gulf countries, resulting in wastage, smuggling, and shortages; and the distribution of a nearly free food basket to all households, a legacy of the OFF Program, undermines agriculture. An open economy and an enabling environment for private investment are essential for growth. Iraq also needs to establish a sound regulatory framework, and to reform and privatize SOEs and banks. These reforms need to be carefully paced and sequenced, accompanied by safety net measures to protect vulnerable groups.

15. **Restructuring Iraq's external debt is necessary for restoring the country's debt sustainability, creditworthiness, and access to new financing.** Preliminary estimates of total external liabilities, including already awarded compensation claims, range from US\$121-152 billion, which is clearly unsustainable at six to nine times the projected GDP for 2004. The Paris Club, whose creditors hold about US\$40 billion of claims, has announced that it does not expect any payment on debt before the end of 2004, and members have agreed to make their best effort to complete the restructuring of Iraq's debt before the end of 2004. They have also agreed that, in the context of the Evian approach, Iraq's debt restructuring would be discussed on the basis of an IMF debt sustainability analysis, which requires a comprehensive view of overall debt. IMF staff are in the process of collecting data on the claims of non-Paris Club creditors and are awaiting responses from a number of key creditors. The IMF plans to prepare a preliminary debt sustainability analysis in early 2004 based on the data collected so far. Generous debt relief from non-Paris Club creditors will be equally important to attain viable debt ratios and contribute to the restoration of Iraq's creditworthiness.

C. Recent Developments

16. **Following the recent war, Iraq's political environment is uncertain and still evolving.** In April 2003, the occupying coalition forces created the Office of Reconstruction and Humanitarian Assistance, which was superseded in May 2003 by the Coalition Provisional Authority (CPA). In July 2003, the CPA appointed a 25-member Iraq Interim Governing Council to serve as an interim body involved in major decisions.⁴ The Governing Council appointed interim ministers to lead Iraq's ministries. However, there was slow progress in launching the constitutional process; and security in the country grew worse from August to November 2003.

17. **The CPA and the Governing Council have approved a plan for a transition to a provisional Iraqi government by June 2004.** Under the current plan, approved in mid-November 2003, caucuses in Iraq's eighteen provinces would select a transitional assembly, which would then elect an executive branch, select ministers, and serve as a legislative body. The new transitional administration would assume full responsibility for governing Iraq by June 30, 2004. (See Annex 2 for a detailed description of the current political transition plan.) The assembly would draft a new constitution to lead to a fully elected government by the end

⁴ Resolution 1511 (October 16, 2003) characterizes the Governing Council, the interim Iraqi administration, as embodying the sovereignty of Iraq; and it notes that the CPA, exercising temporarily the authority and obligations of an occupying power, is vested with executive, legislative, and judicial authority.

of 2005. However, some of the features of the plan—especially the use of caucuses to select the transitional assembly—are still under debate in Iraq. At the time this strategy was written, the CPA, Governing Council, and key Iraqi leaders are considering various compromises to broaden political support for the plan.

18. **The interim administration has indicated that it does not expect to take major or sensitive policy decisions over the next six months, pending the establishment of a provisional government.** Therefore, decisions to increase fuel prices, monetize food subsidies, and restructure and privatize SOEs are likely to be postponed. However, it will be important to lay the groundwork for reforms.

III. INTERNATIONAL RESPONSE

19. **The Group of Seven Industrialized Countries (G7) was quick to recognize the need for a multilateral effort to help rebuild and develop Iraq and for World Bank and IMF assistance in these efforts,** as expressed in the statement by G7 finance ministers and central bank governors on April 12, 2003. UN Security Council Resolution 1483 (May 22, 2003) noted the G7's statement. On June 24, 2003, the UN hosted technical consultations in New York to discuss Iraq's reconstruction. The meeting resulted in the creation of a Liaison Group, composed of some 50 states, and a Core Group.⁵ Meeting participants also asked the Core Group to coordinate the preparation of a Donors' Conference, and asked the World Bank and UN to assess Iraq's needs and to design a multi-donor trust fund for Iraq.

A. Needs Assessment

20. **The Bank accessed the Post-Conflict Fund in early 2003 to finance a series of Watching Briefs** covering power, water, health, education, social protection, and economic monitoring, as well as a workshop on post-war economic and social reconstruction. These were done jointly with UN counterparts, and involved consultants from various countries. They provided the groundwork for the subsequent Needs Assessment.

21. **The World Bank and the United Nations Development Group (UNDG) worked closely together to produce a Needs Assessment, under considerable time and logistical constraints.** The IMF contributed a macroeconomic assessment. The Needs Assessment covers fourteen sectors and three cross-cutting themes and identifies investment needs and priorities for the short (2004) and medium (2005-2007) terms.⁶ The Bank led or participated in eleven of the fourteen assessments, and drew from experiences with similar joint UN-Bank assessment exercises in other countries, such as Rwanda, East Timor, and Afghanistan. The August 19, 2003, bombing of the UN headquarters in Baghdad and the subsequent evacuation interrupted ongoing and planned consultations in Iraq with officials and civil society stakeholders. The Assessment was finalized following consultations with Iraqi

⁵ The original Iraq Core Group consisted of the CPA; European Union (Commission and Presidency); IMF; Japan; Spain; United Arab Emirates; United Nations; United States; and World Bank. Following the decision to hold the Donors' Conference in Madrid, Spain was invited to join the group. There is currently a proposal for the Core Group's expansion.

⁶ The sectors are: education; health; employment creation; water and sanitation; transport and telecommunications; electricity; housing and land management; urban management; agriculture, water resources, and food security; finance; state-owned industries; investment climate; mine action; and government institutions. The cross-cutting themes are: gender, environment, and human rights.

officials and others in Dubai and Amman in September 2003. The Needs Assessment is summarized below (paras. 22-29).

22. As highlighted in the Needs Assessment, Iraq faces monumental reconstruction and development challenges. In addition to a complicated political transition (see para. 17), Iraq needs to rebuild social cohesion and implement an economic transition from a centrally-planned economy to a diversified market-based economy. Iraq's political, social, and economic challenges are intertwined. Human security and social stability are preconditions for sustainable development; while improving security requires progress in the political process. Beyond security, the Needs Assessment suggests that priorities for Iraq's reconstruction include: (i) strengthening institutions of sovereign, transparent, and good government; (ii) restoring critical infrastructure and core human services; and (iii) supporting an economic and social transition that provides both growth and social protection.

23. It is vital to build efficient and inclusive public institutions for Iraq's long-term political stability and economic growth, following decades of autocratic rule that undermined Iraq's institutions by creating parallel party structures. Increasing transparency and accountability at all levels will strengthen institutions. Decentralizing decision making on the basis of subsidiarity will improve the effectiveness of institutions; and community-based approaches will help build institutions from the bottom up.

24. Years of conflict and deferred maintenance have degraded Iraq's infrastructure. Many Iraqis have little or no access to essential basic services or must rely on costly alternatives for electricity and water services. Infrastructure rehabilitation will improve service quality and also enhance Iraq's economic competitiveness. Some investments are needed urgently to enable the importation and distribution of strategic commodities and construction inputs necessary for the overall reconstruction effort. In addition to the immediate need to restore and improve basic service delivery, policy and institutional issues related to infrastructure service delivery should be addressed early on to rationalize and realign regulatory oversight and delivery mechanisms across the sectors.

25. As the Needs Assessment points out, Iraq's education and healthcare systems, once among the best in the region, are now among the worst, owing to politicalization and misdirection of resources. Priorities for both education and healthcare are to rehabilitate physical infrastructure, update equipment, and begin the process of reform in order to restore indicators to the levels of the early 1980s. In education, the priority is to rehabilitate schools damaged by conflict and neglect, relieve classroom congestion, bring out-of-school children back into the classroom, and thereafter improve the quality and modernize the system by upgrading teachers' qualifications and updating the curriculum and instruction methods. In the health sector, the challenge is to restore basic services in the short term and to initiate long-term transformation of the current centralized system into a decentralized and sustainable model based on primary care, prevention, partnership, and evidence-based policy.

26. Given the right support and policy environment, Iraq's agriculture sector could contribute significantly to economic growth and job creation. Today, however, over half of the country's total food requirement is imported and a majority of the population is dependent on food rations. Moreover, Iraq is heavily dependent on external water resources that are generally not subject to cross-border agreements and now faces decreased water inflows and increased salinity, which negatively affect agriculture, drinking water, and the ecological balance in marshland areas. The strategic goals for agriculture in Iraq should be efficient and stable growth, increased food security, and high rates of rural employment.

Given the high dependence rates on the food ration system, great care must be taken to ensure continued household access to food.

27. **A main challenge will be to support sustainable job creation outside of the oil sector**, through policies that create an enabling environment for the private sector and that foster domestic and foreign investment. To this end, it will be critical to build a sound legal and regulatory framework, establish a viable banking system, apply hard budget constraints to public enterprises, and foster a trade regime that is liberal yet sustainable.

28. **It is particularly important to mitigate the temporary adverse effect of reforms on the poor and vulnerable.** The safety net measures to be put in place should also benefit demobilized soldiers and former state-enterprise workers. Over the medium term, Iraq needs to develop a fiscally sustainable social protection system, including a well-targeted cash assistance program and a social insurance system for health, unemployment, and pensions.

29. **An estimated US\$55 billion is needed for reconstruction and development over the next four years.** This comprises US\$35.8 billion estimated by the Bank and the UN for the fourteen sectors,⁷ and US\$19.4 billion estimated separately by the CPA for areas outside the fourteen sectors, including security and oil. This figure does not represent the financing gap, because, over time, Iraq's investment needs are expected to be increasingly covered by Iraqi government revenues or private-sector financing.

30. **The Needs Assessment provides an initial framework for channeling resources to urgent needs, but it is imperative to move towards an Iraqi-led process.** The Assessment has also encouraged partnerships at the outset and cemented good Bank-UN working relationships, including at the sectoral/technical level. However, success in addressing the needs set forth in the Assessment depends on a country-owned reconstruction and development process, ideally articulated in a national reconstruction and development strategy formulated by an Iraqi government with the participation of its population, and anchored by a long-term vision shared by the Iraqi people. The very process of formulating such a strategy—although challenging—could have multiple benefits, including building social cohesion and improving the transparency of public policy making. A country-owned strategy linked to a medium-term expenditure framework would contribute to a more transparent budget process and improve the effectiveness of public expenditures. A country-owned development strategy would also provide a comprehensive framework for donor coordination and partnership (see para. 54)

B. International Donors' Conference for Iraq

31. **In a well-attended conference, donors came together on October 23-24, 2003, in Madrid to discuss the Needs Assessment and make pledges.** Donors pledged about US\$32 billion, including US\$18.6 billion from the United States (US), and conservatively taking the Bank and IMF range of assistance at the low end (US\$3.0 billion and US\$2.5 billion respectively). Conference participants expressed broad support for the Needs Assessment.

⁷ This figure covers physical reconstruction, technical assistance, and training needs, plus additional operational and maintenance costs associated with new investments across the fourteen sectors.

C. International Reconstruction Fund Facility for Iraq

32. **The World Bank and the UN have designed an International Reconstruction Fund Facility for Iraq** to ensure swift, flexible, and coordinated donor financing for priority investments consistent with the Needs Assessment. The Facility consists of two trust funds—a World Bank Iraq Trust Fund (ITF) and a UNDG Iraq Trust Fund—each with its own characteristics, within a structure that ensures close coordination. A Facility Donor Committee, which will meet on a semi-annual basis, will endorse overall priorities, provide strategic guidance to the two trust funds, review progress, and ensure reporting to all donors.⁸ A Facility Coordination Committee, comprising representatives from the Bank and UNDG and the IMF as an observer, will meet at least monthly to review and coordinate the overall program of activities to be financed by both trust funds to ensure conformity with Facility objectives, Iraqi priorities, and other programs funded from the national budget and bilateral donors. A Joint Secretariat staffed by Bank and UNDG representatives will be responsible for informational, administrative, and secretarial functions. It will be based in Baghdad when conditions permit. In sectors where the World Bank and UNDG trust funds will each provide support, there will be a division of responsibility based on each institution's comparative advantage, and coordination will be facilitated by the close working relationships established at the technical level during the preparation of the Joint Needs Assessment. A MoP requesting approval for the Bank to administer the World Bank ITF is submitted to the Board together with this Interim Strategy Note and provides more detailed information on the coordination between the two trust funds.

33. **The Bank's Iraq Trust Fund will emphasize Iraqi ownership and building Iraqi institutional capacity.** Under the ITF, potential recipients submit project or program proposals for approval to the Ministry of Planning and Development Cooperation, which will work closely with the Ministry of Finance to ensure that proposals conform to Iraq's overall budget framework. Proposals are then submitted to the Facility Coordination Committee, which determines the eligibility of each proposal to receive financing. The Bank will apply emergency procedures under OP 8.50 and simplified project design. The Bank will engage a qualified and experienced independent firm to continually monitor procurement, disbursement, and financial reporting related to the activities financed from the ITF.

IV. THE BANK'S INTERIM STRATEGY

34. **This strategy aims to support Iraq's reconstruction and development to the extent possible during the current interim period.** Resolution of the legal status of Iraq's government is required for the Bank to provide its full range of services; and the security situation in Iraq prevents the Bank from sending staff to the country at this time. Satisfactory resolution of the above issues, as well as the settlement of Iraq's arrears to the Bank, are prerequisites for IDA and/or IBRD lending to Iraq (see Box 2). However, resources from the ITF are expected to become available in early 2004 (see para. 48). For planning purposes, the Bank is currently working under the assumption that it may not be possible for staff to travel safely into Iraq through the period covered by this strategy. However, the Bank is building flexibility into its strategy to act rapidly if the situation improves.

⁸ The Donor Committee will comprise donors whose paid-in contribution or binding commitment to either or both trust funds amount to a minimum of US\$10 million.

Box 2: Threshold Issues

Deploying the full range of Bank resources to Iraq depends on resolving a number of **threshold issues**.

Security. In order to carry out their functions under their respective Articles of Agreement, IBRD and IDA must be able to send staff to safely visit the territory of a member country on a regular basis for purposes of project identification, preparation, appraisal, and supervision. This is a key factor for the IBRD/IDA to consider in deciding whether to proceed with a project in an area that is subject to hostilities or emerging from conflict. IBRD/IDA must be satisfied that staff may safely carry out their duties and comply with the relevant requirements set forth in Bank policies with respect to the identification, preparation, appraisal, and supervision of projects.

Dealing with a de facto government. In the absence of a de jure government and in considering whether to extend new loans or grants to a country with a de facto government, Bank policy (OP 7.30) allows a certain time to pass to weigh:

- (i) whether the new loan or grant would expose the Bank to additional legal or political risks associated with the country's financial obligations and obligations to carry out the project;
- (ii) whether the government is in effective control of the country and enjoys a reasonable degree of stability and public acceptance;
- (iii) whether the government generally recognizes the country's past international obligations, in particular any past obligations to the Bank;
- (iv) the number of countries (particularly neighboring) that have recognized the government or dealt with it as the government of the country; and
- (v) the position of other international organizations toward the government.

Arrears. Arrears to the IBRD and IMF are relatively small (US\$100 million and US\$81 million respectively, as of January 5, 2004), so clearance should not be overly difficult. According to recent information, Iraqi authorities and the CPA plan to set aside money in the revised 2004 budget to clear arrears to the IBRD and IMF.

35. **Given the evolving situation in Iraq, the Bank will focus on an incremental approach based on the Needs Assessment and on what practically can be done.** The Bank Group's interim work program represents a range of potential interventions that will be pursued to the extent allowed by the evolving situation. To this end, the Bank's immediate objectives will be to:

- (i) ***Build Iraqi institutional capacity***, especially to establish mechanisms of transparency and accountability urgently needed for implementing the large amounts of external funding needed for Iraq's reconstruction.
- (ii) ***To the extent possible under the circumstances, prepare and start implementing emergency operations to address urgent needs:***
 - Generate employment / kick-start economic activity; and
 - Restore essential infrastructure and services.
- (iii) ***Lay the groundwork for Iraq's medium-term reconstruction and development program*** and begin assisting in the transition from central planning to market economics, through policy advice and analytical work.

The Bank Group's interim work program for January-October 2004 is discussed below and summarized in Table 2.

36. **The Bank's proposed work program has been discussed and agreed with key Iraqi ministers**—the only avenue for consultation under the circumstances. Broader consultation is not possible at this time. However, the Bank has strived to identify activities that are likely to hold broad support. To this end, the work program derives from the Needs Assessment and focuses on "the basics." The Bank expects to formulate a more

comprehensive program—to be articulated in a Transitional Support Strategy—if the expected political transition scheduled for mid-2004 satisfies the Bank’s requirements for extending Bank resources to Iraq (see Box 2 and para. 49).

37. The Bank’s comparative advantage is to build Iraqi institutional capacity by implementing operations using Iraqi institutions and by emphasizing Iraqi ownership, sector-wide approaches, and coherent expenditure frameworks. In contrast, many other external partners channel assistance to particular projects through private contractors, external agencies, or non-governmental organizations. Another important comparative advantage is to ensure consideration of international experience and best practice. During the interim period, lessons from world-wide experience will be emphasized while building institutional capacity, designing emergency operations, and providing policy advice. The Bank will support Iraq in building a comprehensive framework for sector-wide approaches and close partnerships, which will help the Bank develop an increasingly selective work program during the period beyond the Interim Strategy.

A. Build Institutional Capacity

38. Following years of authoritarian rule and sanctions, building Iraqi capacity is a priority during this interim period and beyond. Despite Iraq’s relatively strong human capital, it has been isolated from global innovations and best practices, and there is no experience in implementing externally-financed projects. The Bank’s Middle East and North Africa Region and the World Bank Institute (WBI) have already supported visits of a group of Iraqi women leaders and activists to Washington, D.C., and Amman, culminating in specific plans for further capacity building (see Box 3). Additional training will be organized in the coming months, using Iraq Trust Fund (ITF) resources and Bank budget. A multi-sectoral institutional capacity building project is expected to be the first activity to be financed from the ITF. It will address immediate training needs, while laying the foundation for a comprehensive public sector reform program.

39. The Bank will give special emphasis to procurement, financial management, monitoring and evaluation, and environmental and social safeguards, areas that are critical for operations by the Bank and other international partners, and for the country’s own fiduciary responsibilities. Training for line ministry staff and others in procurement, financial management, and monitoring for results will be linked to preparation of public procurement and financial accountability reviews. Capacity building in environmental and social impact analysis will aim to strengthen the expertise of in-country specialists and institutions, and eventually to institutionalize environmental and social assessment and monitoring in Iraqi ministries.

40. Capacity building in key policy areas will benefit line ministries, helping them to make the urgent policy choices needed to put Iraq back on the track to meet MDG goals and to build strategic and technical skills. Sectors will include education, health, and social protection.

41. After decades of disruptions, the private sector also needs capacity building at all levels, from establishing a sound legal and regulatory framework to building the skills of private entrepreneurs, especially for micro, small, and medium-sized businesses. There is also much to be done to build capacity of the financial sector to be a catalyst for private sector development. There is a need to build a reliable payments system and strengthen bank supervision; and the two large state-owned banks and the small private sector banks need

support to develop management information systems, set credit policies, and train staff. The Bank, IFC, and IMF will closely coordinate their support to build central bank, financial sector, and private sector capacity (see also para. 42 for capacity building within specific IFC operations).

B. Prepare and Implement Operations to Address Urgent Needs

42. **The Interim Strategy focuses on creating jobs and jumpstarting economic activity, which are among the top priorities in Iraq.** The Executive Directors approved on December 18, 2003, two International Finance Corporation (IFC) operations that are designed to help revive Iraq's economic activity. The Iraq Small Business Finance Facility (SBFF), which draws on successful experiences in other post-conflict environments, will include up to US\$170 million for financing for micro and small businesses, and up to US\$30 million for capacity building for participating financial institutions. Support for micro and small businesses is an appropriate early step in a post-conflict situation because these businesses are resilient and nimble, adapting quickly to new circumstances. IFC support is expected to accelerate the development of this potentially vibrant sector. The Private Enterprise Partnership for the Middle East (PEP-ME) will provide technical assistance and advisory services for improving the overall business and regulatory environment and addressing other private sector needs. The PEP-ME, which provides for a broad range of PSD support, will allow for a flexible response to needs on the ground. Both SBFF and PEP-ME are intended to support the expansion of the private sector, leading to job creation. In the longer term, the IFC hopes to expand its activities and investments more broadly in both the financial and real sectors. For example, IFC would be interested in the possibility of investing in equity in a commercial bank.

Box 3: Capacity Building: Gender and Reconstruction

The World Bank Institute and the Bank's Middle East and North Africa Region, with funding from the Bank-Netherlands Partnership Program Capacity Building Trust Fund, organized a two-day workshop on Gender and Reconstruction in November 2003 for a group of thirty Iraqi women leaders, representing all regions of Iraq and many different professions. The workshop aimed to give the participants a broad perspective on the Bank and its operations. It was part of a larger program made possible through collaboration with the Woodrow Wilson Center and the Women Waging Peace organization.

The workshop represented "best practice" in mainstreaming gender in the Bank's work program at the outset. It provided an opportunity to hold detailed discussions with the women on a variety of topics and sectors, benefiting not only from their gender perspective but also from their professional expertise.

The workshop also catalyzed additional capacity building activities. At the end of the two days, the participants developed an action plan for capacity building and began planning the first item in the action plan: a workshop to take place the following month in Amman.

Both men and women community leaders attended the workshop in Amman on December 7-8, 2003. It focused on how to design and implement community-driven development (CDD) activities, emphasizing fiduciary aspects and monitoring and evaluation. As a result of the discussions, the participants developed a proposal for a pilot project to be carried out in four areas of Iraq representing different development needs—in the north, center, south-center, and south of Iraq. The proposed pilot project, which could become part of a larger CDD operation, would seek to improve social and economic infrastructure according to local priorities and build local capacity.

The workshops and contacts made with participants are resulting in an increasing number of requests for additional training. The Bank is actively following up these requests.

43. **The Multilateral Investment Guarantee Agency (MIGA) is exploring various avenues for supporting the flow of foreign direct investment (FDI) into Iraq**, which is an expressed priority of the interim Iraqi administration, although Iraq is not currently a member of MIGA. In particular, MIGA's Investment Marketing Services Department (IMS) will support Iraqi efforts to develop its investment promotion function by providing access to all of IMS's on-line support resources, such as the FDI Promotion Center, a new online knowledge-sharing resource containing a reference library of tools, best practices, investor research sources, presentational aids, software reviews, case studies, templates, open source software, and other resources. IMS will also explore other mechanisms for supporting Iraqi efforts, including help in developing terms of reference for further work in this area. The specifics of the assistance will be explored in the coming weeks with the Ministry of Planning and Development Cooperation. In addition, MIGA could potentially play an important role in providing investment guarantees for investors and lenders involved in making direct investments in Iraq, covering the risk of expropriation, currency transfer restriction and inconvertibility, war and civil disturbance, and breach of contract. If considered a priority by the interim Iraqi administration and donors, MIGA could consider establishing and administering a donor-funded Guarantee Facility for Iraq (similar to the ones established for Bosnia and Herzegovina and the West Bank and Gaza) to increase the capacity that is available from MIGA and other sources for investment insurance.

44. **The Bank will also aim to generate employment through community-based activities.** In particular, an emergency community-based rural infrastructure project will finance labor-intensive infrastructure rehabilitation based on community-identified needs. The Bank's overall program will employ community-driven techniques as much as practical to build local capacity, increase social cohesion, and maximize impact on the ground.

45. **Restoring basic infrastructure and services is another top priority in Iraq.** An emergency infrastructure reconstruction project will enable the Ministries of Electricity, Housing and Construction, Municipalities and Public Works, and Communications and Transport to draw down funds for urgent infrastructure investments based on pre-determined eligibility criteria. It will generate employment both directly and indirectly by helping ease infrastructure bottlenecks. In the education sector, an emergency education project will include urgent repair and rehabilitation of schools and supply of materials and equipment in order to expand access and improve the efficiency and quality of education.

C. Lay the Groundwork for a Medium-Term Program

46. **In addition to immediate needs, it will be important to address some key policy and institutional issues in the near term.** There is a need to build the base of knowledge on Iraq and to lay the groundwork for sustainable growth and poverty reduction. The Interim Strategy therefore includes building blocks of analytical work to support the transition to a liberal and diversified market economy and to develop a social protection system. The Bank will start with core diagnostic work, including procurement, financial management, and social analysis. Beyond this, the Bank will focus on areas likely to be important in the near term, such as poverty and safety nets; incentive framework for a market economy; energy pricing; policy advice for restructuring SOEs; the financial sector and investment climate; and assistance in developing sustainable health sector policies. In addition, the Bank will initiate work on such areas as external debt management; prioritization of public spending; macroeconomic implications of the oil sector, including oil revenue management; a country environmental assessment, including a rapid emergency environmental strategy; and sector strategies for agricultural and rural development, education, and water.

Table 2: Proposed Operations – January – October 2004

Trust Fund Operations	US\$ million*
Multi-Sector Institutional Capacity Building	5-10
Emergency Education	100
Emergency Community-Based Rural Infrastructure	100
Emergency Infrastructure Reconstruction	200-400
Core Diagnostic	
Procurement and Financial Accountability Reviews	
Core Economic Monitoring	
Social Development Analysis	
Other Economic and Sector Work (ESW) and Policy Advice	
Poverty and Safety Nets	
Incentive Framework for a Market Economy	
Energy Pricing	
Policy Advice for SOE Restructuring, Investment Climate, and Financial Sector	
TA for Health Policy, Health Finance, and Public Health	
ESW to be Initiated (to be completed after September 2004)	
Priorities in Public Spending	
Oil Sector – Macroeconomic Implications	
External Debt Management	
Country Environmental Assessment	
Health Sector Master Plan – Phase 1	
Strategy Development for the Education Sector	
Agricultural and Rural Development Policy Framework	
Country Water Assistance Strategy	
* Project amounts during the interim period are contingent on the availability of trust fund resources. If necessary, for example, the emergency infrastructure reconstruction project could be phased.	

D. Resources to Iraq

47. As discussed with the Executive Directors prior to the Madrid conference, the Bank is expected to make available to Iraq a total lending envelope of US\$3.0-5.0 billion over five fiscal years, a period consistent with the Needs Assessment. The lending envelope includes US\$500 million from IDA and US\$500 million from IBRD over fiscal years 2004 and 2005, conditional on the resolution of threshold issues.⁹ Given Iraq's substantial natural and human resources and economic prospects, IBRD, IFC, and MIGA would be the main sources of World Bank Group support to Iraq over the medium term. Iraq's creditworthiness for IBRD lending is predicated on an optimistic scenario of improvements in political stability and security, rapid economic recovery (including in the oil sector), and generous debt relief. In the event political, economic, and financial conditions in Iraq do not improve sufficiently and Iraq's creditworthiness remains limited, the lending envelope would be adjusted accordingly so as to limit the financial risks that IBRD would take in Iraq to a reasonable and fair amount.

⁹ IDA Deputies also endorsed this approach at the IDA 13 Mid-Term Review on November 5-6, 2003, provided that the threshold conditions are met. IDA Deputies agreed that "the normal rules governing IDA support and lending should be applied to Iraq."

48. **During FY04, the Interim Strategy will mainly rely on the Iraq Trust Fund to finance projects, and on Bank budget for economic and sector work and policy advice.** We expect the first agreements with ITF donors to be signed soon after the ITF documentation is discussed by the Board in January 2004, which will enable an early start for some activities, such as capacity building. It is not yet possible to know the level of resources that will be channeled through the ITF. The four proposed projects will be financed from the ITF to the extent that ITF resources are available. Projects could also be financed by a combination of ITF and IDA/IBRD resources, once the threshold conditions are met.

49. **Conditions permitting, the Bank will present a Transitional Support Strategy (TSS) to the Board following the political transition scheduled for mid-2004,** in line with OP 2.30.¹⁰ The TSS will outline a proposed program for Bank involvement in FY05. In addition to continuing capacity building and emergency operations, the TSS is likely to focus on: (i) strengthening institutions, emphasizing efficiency, transparency, and accountability; (ii) enabling private sector development; (iii) assisting in the transition from a centrally-planned economy to a market-based economy and diversifying the economy away from dependence on the oil sector; and (iv) building systems for social protection. The TSS would also support Iraqi efforts to formulate a national reconstruction and development strategy, which would be the basis for future Bank assistance.

E. Implementation Arrangements

50. **To facilitate work in the coming months, the Bank is establishing a small office for Iraq activities in Amman.** This decision follows extensive discussion between senior Bank management, country mission staff, and the Bank's security team. Through its presence in Amman, the Bank aims to liaise closely with Iraqi administration officials, who frequently visit Amman, and continue to work closely with the UN, which will also have a presence in Amman. The Bank is designing the temporary office to be flexible and poised to relocate to Baghdad as soon as the situation permits. The Bank has taken steps to hire a core team of Iraqi staff, so that the office will be fully functional once it is moved to Baghdad. The IFC will also make use of the Bank's office in Amman for the initial phases of its program for Iraq. The Bank will also leverage other existing resources in the region, utilizing the infrastructure and training facilities in the Bank's Beirut office and institutes throughout the region for building Iraqi capacity.

51. **A videoconferencing facility in Baghdad, accessible by all ministries, will be operational in early 2004,** barring unforeseen technical difficulties. In addition, to facilitate communication, the Bank is providing broadband email access to the Ministry of Planning and Development Cooperation.

52. **The Bank will adopt innovative project preparation and implementation techniques,** and the Bank is drawing upon the experience of specialists who have implemented projects in Iraq over the last six months. The Bank will design interventions to be as simple as possible, given the highly challenging circumstances, and will place emphasis

¹⁰ According to OP 2.30, a TSS is initiated when: (i) active conflict has diminished sufficiently for Bank staff to be able to travel to the area for the purpose of identifying and supervising Bank-supported activities, and for the country to prepare and carry out any such activities effectively and achieve their objectives; (ii) there is a reasonable expectation of continued stability or of a sustainable formal cease-fire; (iii) there is an effective counterpart for the Bank; and (iv) there is evidence of strong international cooperation and the potential for a well-defined role for the Bank.

on piloting activities to minimize risk and learn from experience. The Bank is hiring Iraqi consultants, and will make use of videoconferencing and meetings outside of Iraq. The Bank will give immediate attention to identifying mechanisms for ensuring that fiduciary requirements are adequately met, which is a particular area of risk (see para. 63). The Bank will draft a general implementation manual, including fiduciary requirements, which will be subsequently tailored to each project. Some of the concrete activities planned for the next few months are shown in Box 4.

Box 4: Specific Activities Planned for Early 2004

January 2004

- **Education.** The Bank sponsors a visit by the Minister of Education and eight senior officials, including a member of the Governing Council, to Bank headquarters for a five-day workshop to: (i) discuss lessons from other countries; (ii) further the policy dialogue; (iii) advance preparation of an Emergency Education Project; and (iv) agree on specific training courses to begin in February 2004. Since November 2003, ministry and Bank staff have held weekly conference calls to discuss policy issues and project preparation.
- **Planning.** Minister of Planning and Development Cooperation (MoPDC) visits Bank headquarters to discuss the details of implementing the Bank's interim work program.
- **Infrastructure.** Bank staff hold technical meetings in Amman with the Ministries of Planning and Development Cooperation; Municipalities and Public Works; Electricity; and Transport. Meetings include detailed discussions between Bank and ministerial staff on training needs in procurement and financial management.
- **Health.** Bank staff organize a four-day high-level policy seminar in Amman for the Minister of Health and key advisors. The agenda includes: review of the National Health Plan prepared by the ministry and CPA; introduction to master planning; introduction to national health accounts; and discussion on health financing issues.
- The Bank's *videoconferencing facility* in Baghdad becomes operational.
- The Bank establishes a *temporary office* for Iraq activities in Amman.
- The *World Bank Iraq Trust Fund* becomes operational.

February 2004

- **Fiduciary areas.** On the basis of discussions with the MoPDC and line ministries in January, the Bank organizes training in procurement and financial management.
- **Finance and Private Sector Development.** Bank staff hold meetings in Amman with the Ministries of Finance; Planning and Development Cooperation; Industry; and Trade and Telecommunications to discuss the work program and implementation in the areas of finance, SOEs, investment climate, and telecommunications reform.

March 2004

- **Environment.** Bank staff organize a safeguard compliance capacity building workshop in Amman for about 40 persons from the Ministry of Environment and other line ministries to familiarize participants on the Bank's environment and social assessment systems.
- **Health.** Bank staff organize a two-week training activity for senior Ministry of Health staff, to be conducted in Beirut or Amman, on health policies, planning, management, and financing.
- **Gender.** Bank staff help organize a second workshop in March or April 2004 based on the capacity building action plan developed by Iraqi participants at the November 2003 gender and reconstruction workshop (see Box 3).

53. **There are enormous uncertainties that make it impossible to predict all potential hurdles to implementing the interim work program.** The situation in Iraq poses an unprecedented work environment for the Bank. In addition, there are large gaps in the Bank's information given the inability to travel to the country since August 19, 2003, and the difficulties in traveling within the country during the months prior to that time. At the minimum, the Bank will strive during this interim period to lay the framework for a more comprehensive program once conditions permit, while attempting to address emergency needs to the extent allowed by the current circumstances.

F. Donor Coordination / Partnerships

54. **Given the magnitude of Iraq's challenges and the large number of external partners expected to provide support to the country, it is important to build towards a comprehensive development framework-type process,** whereby Iraq leads the coordination of external partners and a country-owned national development strategy provides a common framework for external assistance (see para. 30). During the interim period, sectoral meetings led by the line minister and attended by all external partners interested in the sector could help move the sectoral dialogue toward a sector-wide approach.

55. **The CPA recently established arrangements for an Iraqi-led development coordination mechanism.** A new Ministry of Planning and Development Corporation (MoPDC) is based on the former Ministry of Planning. An Iraqi Strategic Review Board, comprising the Minister for Planning and Development Cooperation, Minister of Finance, two appointees of the Governing Council, and the CPA's Director of Economic Policy, will provide overall policy guidance and approval for reconstruction activities. The MoPDC will follow up on donor pledges; recommend sectoral allocations and funding sources to the Strategic Review Board; establish guidelines for developmental activity among the ministries; and monitor implementation. The Council for International Cooperation, which has 23 members and has served as the main point of contact between donors and the CPA since July 2003, will be placed under the chairmanship of the MoPDC.

56. **The International Reconstruction Fund Facility for Iraq will also assist donor coordination.** The MoPDC will be the interlocutor with the Facility, ensuring consistency with Iraq's donor coordination mechanism (see para. 32). Most external partners providing financing to Iraq will be represented on the Facility Donor Committee, which will meet every six months. The UN/World Bank Facility Coordination Committee will meet at least once a month, and the minutes of the meetings will be sent to all members of the Donor Committee. Also, the UNDP/World Bank Joint Secretariat, to be based in Baghdad when conditions permit, will be a focal point to respond to inquiries by donors.

57. **The Facility will also help ensure continued close coordination between the UN and the Bank,** which will necessarily work hand-in-hand in the Facility Coordination Committee and the Joint Secretariat. The Facility's coordination mechanisms will result in an unprecedented sharing of information at project preparation stage, which should eliminate duplication. The UN is establishing an office in Cyprus, with a presence in Amman, which will enable close communication with the Bank's temporary office in Amman. A Bank representative attended a UN Strategic Planning Workshop held in Amman in December

2003, which proposed ten clusters for UN involvement.¹¹ To provide the framework for moving forward, the UN is now preparing a Strategic Plan, to be completed in early 2004.

58. **The Bank and the IMF are also continuing to collaborate closely.** In December 2003, the Bank and IMF discussed their respective proposed work programs with key Iraqi ministers during joint meetings organized in Amman. The IMF is taking the lead in coordinating technical assistance efforts in its areas of responsibility, including fiscal policy, tax policy and administration, central bank organization, and the macroeconomic statistics framework. Areas of common Bank-IMF responsibilities include public expenditure management, accounting procedures and financial reporting, external debt management, bank regulation and supervision, and the payments system. The Bank will be taking the lead in structural policy areas, including poverty, monitoring, food policy, energy subsidies, SOEs, restructuring of commercial banks, social safety net, and trade policy.

59. **Details of bilateral assistance to Iraq should become clearer in 2004.** At the time of the Madrid Donors' Conference in October 2003, many donors were not yet able to provide details on the timing or mode of their assistance. Financing from the US, the single largest donor, includes USAID funding for reconstruction; Department of Defense/US Army Corps of Engineers expenditures on oil sector infrastructure repairs; the Spring 2003 appropriation by the US Congress to the CPA; and, most recently, the US Congress authorization of US\$18.6 billion.¹² The US has recently established a Program Management Office within the CPA to be responsible for financial, contractual, and program management of the US\$18.6 billion. The Bank is maintaining close contacts with the US and other bilaterals to coordinate assistance to the extent possible at this stage.

60. **Given the evolving situation regarding donor financing, the Bank's program purposefully builds in flexibility.** For example, the emergency infrastructure reconstruction project will establish a funding facility for subprojects that meet pre-determined eligibility criteria in a range of sectors, allowing funds to flow where financing is needed. Similarly, the emergency community-based rural infrastructure project will be demand-driven according to community priorities.

V. RISKS AND MITIGATION

61. **The Interim Strategy is subject to substantial risks, given the uncertain and evolving situation in Iraq.** The range of potential interventions presented in the interim work program are based on a scenario whereby conditions do not deteriorate and may incrementally improve. If such a scenario is not the case, the range of potential interventions will narrow. For this reason, the strategy focuses on maintaining flexibility during the next six to nine months, permitting the Bank to do all that is possible according to the

¹¹ The ten clusters and agency task managers are: (i) education and culture (UNICEF); (ii) health (WHO); (iii) water and sanitation (UNICEF); (iv) infrastructure and housing (tbd); (v) agriculture, water resources, and environment (FAO); (vi) food security (WFP); (vii) mine action (UNDP); (viii) internally displaced persons and refugees (UNHCR); (ix) governance and civil society (UNDP); (x) poverty reduction and human development (UNDP). The clusters are part of a rolling strategy allowing disaggregation or consolidation of the clusters as required in the coming six months.

¹² The US\$18.6 billion includes the following estimated program amounts: (i) electricity (US\$5.56 billion); (ii) public works and water (US\$4.332 billion); (iii) security, justice, and safety (US\$4.56 billion); (iv) transportation and telecommunications (US\$0.5 billion); (v) buildings, housing, and health sectors (US\$1.43 billion); and (vi) oil infrastructure (US\$1.89 billion).

circumstances, while carefully monitoring the situation and preparing to scale-up assistance when conditions permit. In the event circumstances in Iraq do not lend themselves to the preparation of a TSS within six to nine months, Bank management would provide the Board within that timeframe with an Update to the Interim Strategy Note.

62. Lack of security poses the principal risk to implementing the Interim Strategy and to economic recovery, as evidenced by the bombing of the UN headquarters in Baghdad and subsequent assaults on domestic political and religious leaders, domestic security forces, international diplomatic corps, and international aid representatives. The Bank mitigates the security risk by avoiding travel to Iraq at this time, engaging Iraqi consultants, establishing a small office for Iraqi activities in Amman, and using videoconferencing facilities. If security or instability deteriorates to the point where it would be difficult to sustain a dialogue with the interim administration, employ local consultants, and start-up activities in Iraq, it would be necessary to scale back the proposed work program. In such a situation, the Bank would focus on policy advice and building Iraqi capacity, through videoconferences and training outside of Iraq, to lay the groundwork for a future more comprehensive Bank program of support. If security improves so that Bank staff can travel safely to Iraq, the Bank will be poised to establish an office in Baghdad and scale up its assistance.

63. Ensuring core fiduciary requirements will be challenging under the circumstances and could take longer than planned. The inability to travel to Iraq at this time precludes the Bank's normal program and fiduciary oversight processes. The Bank is striving to mitigate fiduciary risks and possible delays resulting from fiduciary concerns by focusing on capacity building and contracting appropriately qualified and independent local oversight capacity. Nevertheless, risks are likely to remain high even in comparison to other post-conflict situations.

64. The political transition to a provisional government could be a source of instability. The political transition is an important opportunity for Iraq to establish a democratic pluralistic society, but the transition will be complicated and challenging. A provisional government without legitimacy could result in continuing or increasing violence. In the absence of a de jure government in Iraq, the provision of Bank financial resources will be subject to meeting the de facto government requirements set out in OP 7.30 (see Box 2).

65. Insufficient country ownership or inadequate pacing or sequencing of reforms could contribute to social and political instability. Iraq's fragility dictates that careful consideration be given to the social and poverty impact of all proposed reforms. Reforms that would potentially increase unemployment or poverty in the short term need to be structured to minimize the adverse impact on the poor and accompanied by measures to protect vulnerable groups. Failure to do so could undermine efforts to improve security and stability. The strategy includes policy advice and analytical work that aims to ensure that reforms are appropriately sequenced and accompanied by safety net measures.

66. Institutional weaknesses could hamper the absorption of international assistance and the reform process. Although Iraq has been endowed with strong human resources, the country's current institutional capacity is not yet well known. The Interim Strategy emphasizes the need to build institutional capacity.

67. Careful coordination among international partners will be crucial for avoiding duplication and confusion. The establishment of an Iraqi-led coordination mechanism and the International Reconstruction Fund Facility for Iraq should help in this regard. The Bank

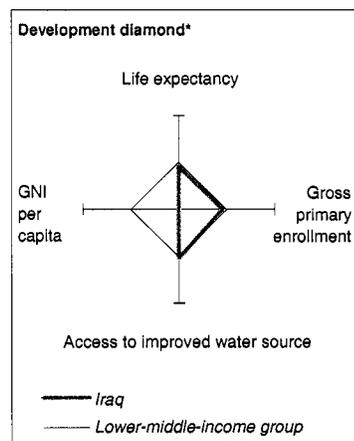
will also strive to help Iraq develop a county-owned national reconstruction and development strategy and to move in the direction of sector-wide approaches.

68. **In the period beyond the Interim Strategy, economic recovery and sustainability depends also on restructuring Iraq's large external debt.** The magnitude of Iraq's future debt servicing obligations will remain uncertain until creditors' claims and intentions are clarified, which is expected to take place during 2004. In addition to generous debt relief, improving Iraq's creditworthiness hinges on substantial improvements in the political and social situation and in economic prospects, especially in the oil sector. The Bank will analyze creditworthiness in the context of preparing the TSS.

Iraq at a glance

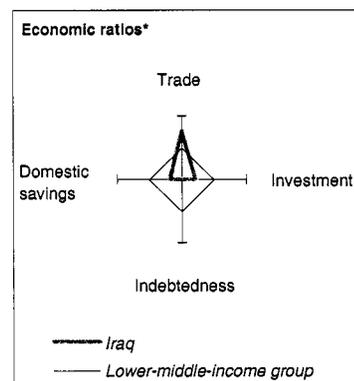
Annex 1

POVERTY and SOCIAL	Iraq	M. East & North Africa	Lower-middle-income
2002			
Population, mid-year (millions)	24.3	306	2,411
GNI per capita (Atlas method, US\$)	..	2,070	1,390
GNI (Atlas method, US\$ billions)	..	670	3,352
Average annual growth, 1996-02			
Population (%)	2.2	1.9	1.0
Labor force (%)	2.9	2.9	1.2
Most recent estimate (latest year available, 1996-02)			
Poverty (% of population below national poverty line)	..	..	..
Urban population (% of total population)	68	58	49
Life expectancy at birth (years)	63	69	69
Infant mortality (per 1,000 live births)	107	37	30
Child malnutrition (% of children under 5)	..	..	11
Access to an improved water source (% of population)	85	88	81
Illiteracy (% of population age 15+)	60	35	13
Gross primary enrollment (% of school-age population)	102	95	111
Male	111	98	111
Female	91	90	110



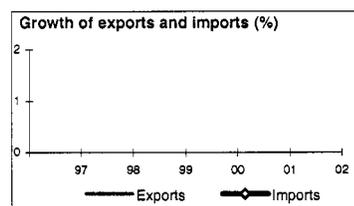
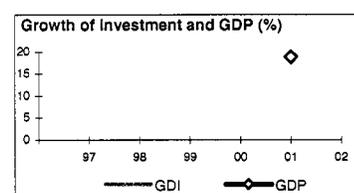
KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1982	1992	2001	2002
GDP (US\$ billions)	..	4.7	25.4	26.1
Gross domestic investment/GDP	..	14.6	..	..
Exports of goods and services/GDP	27.3	13.0	43.5	51.0
Gross domestic savings/GDP	..	14.8	..	..
Gross national savings/GDP	..	14.8	..	..
Current account balance/GDP	..	0.1	4.1	8.9
Interest payments/GDP	..	0.0	..	..
Total debt/GDP	..	448.2	382.8	402.3
Total debt service/exports	..	..	..	..
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..
	1982-92	1992-02	2001	2002
(average annual growth)				
GDP	-17.1	..	18.9	..
GDP per capita	-19.7	..	16.5	..
Exports of goods and services	-15.8	..	..	..



STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(% of GDP)				
Agriculture	..	36.6	7.5	..
Industry	..	..	78.5	..
Manufacturing	..	..	1.4	..
Services	..	..	14.0	..
Private consumption	..	69.7	..	..
General government consumption	..	15.5	..	..
Imports of goods and services	57.5	12.9	20.4	30.7
	1982-92	1992-02	2001	2002
(average annual growth)				
Agriculture	..	..	26.0	..
Industry	..	..	24.9	..
Manufacturing	..	..	0.0	..
Services	..	..	-17.2	..
Private consumption	..	..	..	..
General government consumption	..	..	..	..
Gross domestic investment	..	..	..	..
Imports of goods and services	8.1	..	..	..

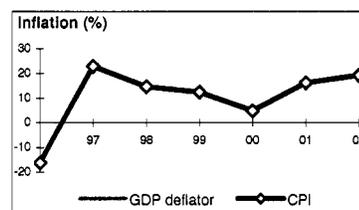


Note: 2002 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

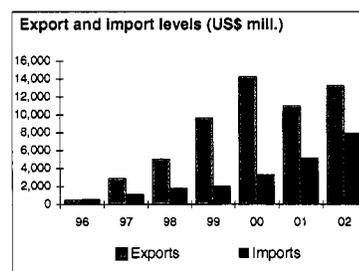
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices				
(% change)				
Consumer prices	..	83.6	16.4	19.3
Implicit GDP deflator	30.6	127.2	4.8	..
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	6.2	2.3	..
Current budget balance	..	-38.9	-0.5	..
Overall surplus/deficit	..	-48.5	-1.1	..



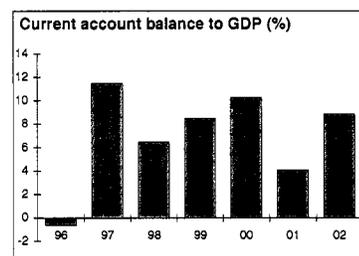
TRADE

	1982	1992	2001	2002
(US\$ millions)				
Total exports (fob)	10,033	609	11,041	13,300
Petroleum and petroleum products	9,900	583	10,963	..
Gas, natural and manufactured	0	6	17	..
Manufactures	48	5	13	..
Total imports (cif)	21,134	603	5,190	8,000
Food	1,824	350	520	..
Fuel and energy	132	0	1	..
Capital goods	12,319	16	3,150	..
Export price index (1995=100)	9	88	84	..
Import price index (1995=100)	111	86	88	..
Terms of trade (1995=100)	8	103	95	..



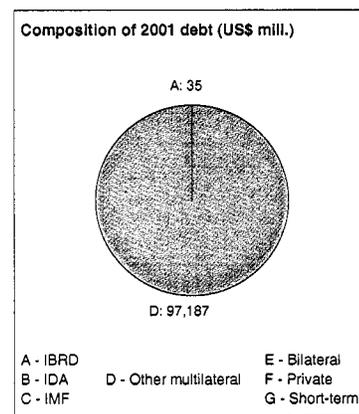
BALANCE of PAYMENTS

	1982	1992	2001	2002
(US\$ millions)				
Exports of goods and services	10,033	609	11,041	13,300
Imports of goods and services	21,134	603	5,190	8,000
Resource balance	-11,101	6	5,851	5,300
Net income	..	..	..	..
Net current transfers	..	..	..	..
Current account balance	-11,101	6	1,031	2,314
Financing items (net)	11,058	-6	..	..
Changes in net reserves	43	0	..	..
Memo:				
Reserves including gold (US\$ millions)	..	..	..	23,000
Conversion rate (DEC, local/US\$)	#REF!	12.3	1,950.0	1,775.2



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
(US\$ millions)				
Total debt outstanding and disbursed	5,971	20,917	97,222	105,000
IBRD	76	48	35	40
IDA	0	0	..	..
Total debt service	1,546	1,801	..	..
IBRD	0	0	..	..
IDA	0	0	..	..
Composition of net resource flows				
Official grants	..	..	..	..
Official creditors	-866	800	..	..
Private creditors	1,600	-1,600	..	..
Foreign direct investment	..	..	..	..
Portfolio equity	..	..	..	..
World Bank program				
Commitments	0	0	..	..
Disbursements	0	0	..	..
Principal repayments	0	0	..	..
Net flows	0	0	..	..
Interest payments	0	0	..	..
Net transfers	0	0	..	..



Annex 2: Current Agreement on Iraq's Political Process

On November 15, 2003, the Governing Council and the Coalition Provisional Authority (CPA) approved an Agreement on Political Process, a road map for a transition to a sovereign Iraqi government by June 2004. Under the plan, caucuses in Iraq's 18 provinces will select a transitional assembly, which would then elect an executive branch, appoint ministers, and serve as a legislative body. The new transitional administration would assume full responsibility for governing Iraq by June 30, 2004. The assembly would draft a new constitution to lead to a fully elected government by the end of 2005.

Fundamental Law. The Governing Council, in consultation with the CPA, will draft a Fundamental Law, with basic principles of openness and transparency, to formally set forth the scope and structure of the sovereign Iraqi transitional administration. The Law will specify the bodies of the national structure and spell out the detailed process for selecting individuals for these bodies. The Law will include basic rights, such as freedom of speech and religion; equal rights for all Iraqis; a federal arrangement for Iraq; and an independent judiciary. Both the Governing Council and CPA will approve the Fundamental Law by the end of February 2004. The Governing Council will have no formal role in selecting members of the assembly. Individual members of the Government Council will, however, be eligible to serve in the transitional assembly, if elected according to the agreed process.

Security. By the end of March 2004, the Governing Council and the CPA will approve bilateral agreements on security arrangements, covering the status of the Coalition forces in Iraq.

Process for Forming a Transitional National Assembly. In each governorate, an Organizing Committee of Iraqis will be formed, under a process to be supervised by the CPA. The Organizing Committee will include five individuals appointed by the Governing Council, five appointed by the Provincial Council, and one appointed by the local council of the five largest cities within the governorate. The purpose of the Organizing Council will be to convene a Governorate Selection Caucus of notables from around the governorate. To do so, it will solicit nominations from political parties, provincial-local councils, professional and civic associations, university faculties, and tribal and religious groups. Nominees must meet the criteria for candidates in the Fundamental Law. An 11/15 majority of the Organizing Committee must approve each nominee for the Governorate Section Caucus. Each Governorate Selection Caucus will elect representatives to represent the governorate in the new transitional assembly based on the governorate's percentage of Iraq's population.

Following the selection of members of the transitional assembly, it will meet to elect an executive branch and appoint ministers. By June 30, 2004, the new transitional administration will be recognized by the CPA, and will assume full sovereign powers for governing Iraq. The CPA will dissolve, as will the Governing Council.

Process for Adoption of Permanent Constitution. The constitutional process and timeline will be included in the Fundamental Law. The Iraqi people will directly elect—no later than March 15, 2005—a constitutional convention to prepare a permanent constitution for Iraq. A draft of the constitution will be circulated for public comment and debate. A final draft of the constitution will be presented to the public, which will vote to ratify the constitution in a popular referendum. Elections for a new Iraqi government will take place by December 31, 2005, at which point the Fundamental Law will expire and a new government will take power.

MAP SECTION

