

THE IRAQI STRATEGIC REVIEW BOARD

**NATIONAL DEVELOPMENT STRATEGY**

2005 – 2007

**The Ministerial Committee on  
The National Development Strategy  
September 2004**

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**PREFACE**

The United Nations/World Bank Joint Iraq Needs Assessment of October 2003 estimated the cost of investments need for the reconstruction of Iraq in the range of \$36 billion (1,000 million) through 2007, excluding certain significant sectors in which donors were not expected participate, such as security and police and oil, which were estimated to require another \$19 billion. Available internal resources can finance roughly half of the stated amount in the budget for the years 2005 - 2007. However the needs are greater than what Iraq can provide for itself.

In this strategy, the Iraqi Government expounds social and economic reforms for the reconstruction of Iraq, development of its economy, and the advancement of its people. It hopes that the donor countries, especially the major industrial countries, will comply with their stated financial intentions to assist in the reconstruction of Iraq in accordance with Madrid Donors' Conference resolutions. It also hopes that the upcoming Tokyo donors committee meeting will be the appropriate forum to advance the timetable for fulfilling these intentions, especially through provision of additional resources of the International Reconstruction Fund Facility for Iraq, which will soon have disbursed its resources. Covering the gap in resources also requires calling upon friendly and brotherly countries which did not participate in Madrid Conference to contribute effectively to the efforts of assisting Iraq in its reconstruction.

The Iraqi government recognizes the generosity of the donor countries which are assisting in the reconstruction and development of Iraq. These countries are contributing to this cause not only out of their calculations of national interest, but also out of a spirit of benevolence. The Iraqi government wishes to extend its appreciation and gratitude for their efforts. This strategy should demonstrate the seriousness of Iraq's intent to reform Iraq and resolve to build a more progressive and modern society that will consolidate the gains made possible through these donations. In this context, we would like to extend our deep appreciation and thanks for all those who have contributed, in various forms, to the elaboration and formulation of this document. Special thanks should go the Japanese government, the representatives of World Bank and United Nation agencies for their important comments and suggestions to make this strategy more responsive to the Iraqi needs as well as the requirements of International Donors Community.

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Baghdad, Iraq  
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## **INTRODUCTION**

Iraq is distinguished by the great balance between its area, population and natural resources. It occupies an important geographical location. In addition, the characteristics of the Iraqi economy offer competitive advantages and hidden development abilities compared to other promising economies in the region.

However, misguided economic policies and the three wars the previous Iraqi regime dragged Iraq into have wrought terrible damage on Iraq's society and economy. Sanctions; the loss of the country's financial resources and of the lives of hundred of thousands of its people; out-migration, excessive inflation; and a deterioration of infrastructure due to negligence and extensive use for more than 20 years, especially during the 1990s, are all consequences of the disastrous leadership in power at the time. Per capita income has fallen to very low levels, unemployment has increased, poverty has expanded, basic services have deteriorated, and with them social indicators in areas such as health and education. The situation grew more severe due to the huge damage to infrastructure after the last war from looting, burning of public property and lack of security. Dangerous environmental problems that threaten public health have also developed.

In the light of this dangerous and worsening reality, rebuilding programs and economic reform face major challenges. Lack of progress in executing these programs, slower than expected economic progress and increased insecurity have contributed to a state of frustration among the population which, if continued, could threaten the chances of success for these programs.

Overcoming these challenges requires preparation and execution of a medium-term program in order to meet urgent needs. It also requires a general structure of medium-term economic, political and social policies within a strategic and holistic vision on economic, social and political development in the long run. While striving to balance these three elements, in particular this vision opts for restructuring the national economy and expanding its productive capacity through investment in a free market setting, liberalizing prices and free trade.

These objectives can only be accomplished in a context of improved security. While this represents a major challenge that the IRAQI GOVERNMENT will exert all its efforts to achieve, efforts to restore security are not treated explicitly in this document. Rather, an improving security situation is assumed. Another significant risk that could constrain execution of the strategy would be financial. A shortfall in oil revenue whether from price or volume would seriously affect Iraq's ability to carry out fully the strategy. A significant lag or shortfall of donations below expectations could also have a strong impact.

The success of the strategy will also require vigorous private sector participation. To facilitate this participation, the state's institutions must be renewed; key processes modernized according to international standards; decision making decentralized close to the people; transparency and accountability enhanced.

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This document is the first strategy prepared for this purpose. It represents the first statement of the Iraqi Interim Government's policies for national development. The document was prepared through an extensive series of workshops drawing together sector experts from various Iraqi Ministries, the private sector and academia. This participatory approach should enhance governance, accountability and transparency. An inter-ministerial committee was established to prepare the first draft, with members from ten Ministries drawing from their official programs as well as from discussions held under the committee's auspices. A draft of this document was submitted to the World Bank and United Nations Development Group for comment, and was discussed with these two organizations over a series of meetings in Amman in early September 2004 to incorporate their comments. The strategy was approved by the Iraqi Strategic Review Board and by the Iraqi Government's Council of Ministers as the program for reconstruction and reform of the Iraqi economy for the next three years.

## **1. LEGACY OF THE PAST**

As a combination of its unique factor endowment, but primarily as a result of the economic policies and mismanagement imposed by the previous regime over the last three decades, political repression, internal conflicts, wars and sanctions, the Iraqi economy today faces a number of serious challenges. The most significant developmental obstacles include:

- a. The oil sector dominates Iraq's economy: comprising 74% of GDP. Iraq depends solely on oil exports for finance of investment and consumption expenditures, for government revenues—of which oil export proceeds exceed 93%—and for 98% of foreign currency earnings.
- b. Centralized decision making and intrusion of the state into economic life have distorted the pricing structure so that prices do not reflect the real value of the product or service. Supply and demand are consequently distorted and inefficiencies and wastage result.
- c. The public sector is over represented in the economy, leading to inefficiency and decreased growth. Many SOEs are currently dormant. The weakness of the private sector has limited its role in economic development, increasing the lack of diversification.
- d. Social inequities are widespread in a broad range of fields covering health, education, public services, social services to low-income groups, the disabled, internally displaced persons, refugees, single-parent households, and other vulnerable groups, across geographic areas.
- e. With over 50% of the population under 24 years of age, youth is alienated due to violence and limited access to education, training, and career prospects.
- f. Widespread unemployment, ranging to about 50%, and absolute poverty where more than 60% of the population depends on the government's rationed food basket. Unemployment has led to an increase in demands for social assistance.
- g. Poor governance practices are common, including widespread nepotism in public appointments and corruption among public servants. The lack of accountability and

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transparency in managing state resources has abetted corruption and increased its corrosive effect on growth and efficiency.

- h. Iraq's decades long isolation has resulted in the digital divide, outdated institutions, administrative systems and know-how. Technological stagnation and the use of outmoded production methods have weakened the economy as a whole.
- i. Public sector institutions have witnessed serious looting, theft and destruction. Archeological sites suffered from extensive looting and vandalism, illegal traffic in artifacts has led to an invaluable loss of scientific information and mining of Iraqi cultural identity.
- j. Another legacy of the past was the total dependence on monetary expansion to finance the deficit in the budget, which led to average inflation of 50% annually during the 1990s, a decrease in the purchasing power for those on fixed incomes, and depreciation of the Iraqi Dinar from .3125 ID/\$ to 2000 ID/\$.
- k. The traditional family unit and the community have remained the core of Iraqi society, ensuring solidarity and social cohesion against all odds. However, conflict and inequality have eroded the social fabric of communities and families throughout the past three decades.
- l. Iraq retains its strong sense of identity in the nation-state and within the region. It is a culture entrenched in history and heritage with strong sense of accomplishment.
- m. In Iraq, social capital establishes an important relation between incomes and human capability to withstand shocks. Iraqis have witnessed a depletion of social capital which led to social deprivation in most sectors of society.
- n. Civic participation and recognition of human rights were denied during the previous regime. They remain poorly understood and lack ancillary support structures.

## **2. ACHIEVEMENTS SINCE APRIL 2003**

Despite the significant security challenges faced, much progress has been made in several economic, social, and political areas since the end of the previous regime. The following represents some of the major achievements over this period:

**Economic:** Real GDP increased by 60.2% from 2003 to 2004 from roughly \$12 billion to \$19.4 billion (in 2003 dollars). Per capita GDP increased from \$440 to \$693. Significant developments include:

- a. **Improvements in the legal framework:** A significant body of economic legislation was put in place including new laws on corporations, banking, securities, foreign investment, public financial management, public procurement and Central Banking.
- b. **Fiscal affairs:** Customs duties were reduced and simplified. A new flatter, more progressive income tax scheme was introduced. Salaries and pensions of government workers were increased three to ten-fold, from previous levels which were below subsistence level. The

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budget was balanced for the first time in two decades. Promoting the financial system by instituting an auction for Treasury bills. A more equitable distribution of resources throughout Iraq's governorates was achieved.

- c. Monetary affairs: A new currency was introduced and its exchange rate was stabilized through foreign exchange auctions. Interest rates were liberalized. The capital base of private banks was increased. Foreign banks were allowed to open branches and to joint venture with private Iraqi banks. The Central Bank was made independent. Monetization of government deficit was ceased. Inflation has decreased from an average of 40-50% annually to roughly 2-3% in 2004.
- d. Oil sector: Major rehabilitation of the oil infrastructure has led to an increase in the production capacity to 2.8 million bpd, of which 2.1 million can be exported under normal conditions, however, presently Iraq is exporting in the range of 1.7 million bpd. The oil sector is to be restructured by combining the three national oil companies into one national oil company.
- e. Telecommunications: Telecommunications have improved from the very limited and insular situation under the previous regime. Satellite television penetration extends to a majority of the population. Mobile telephone networks are now operating in major urban centers. Fixed-line telephone networks have been increased and expanded.
- f. Electricity and Water: Electrical generation has increased from 3,500 MW to 5,400 MW, above pre-war levels but significantly below demand. Potable water distribution has been increased.

### Social:

- a. New Ministries have been established to reflect important new social groups and concerns: Human Rights, Displacement and Migration, Environment, and Youth In addition, Ministers of State for Women's Issues and Provinces have been established. The Ministry of Culture and in particular its State Board of Antiquities and Heritage has been restructured and are fully functioning.
- b. Non Governmental Organizations (NGOs) have been fully supported (over 2,000 have been established) to enhance governance, community participation and the culture of dialogue, as well as providing valuable social services.
- c. Iraq has taken on a target of ensuring 25% participation of women in decision making structures—including the National Assembly and the Council of Ministers.
- d. The Commission on Public Integrity has been established, along with Inspectors General in each Ministry, as part of a comprehensive approach to combat corruption.
- e. Over 1,000 schools have been rehabilitated.

**Political:** Within the space of one year, Iraq has set itself on the path away from a totalitarian system and towards a free and democratic society.

- a. On June 28, 2004 the Coalition Provisional Authority ceased to exist and the Iraqi Interim Government assumed full sovereignty in Iraq. Moreover this government fully represents the

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multi-ethnic, -cultural, and -religious character of Iraq, with broad participation of groups from across the legitimate political spectrum.

- b. A Transitional Administrative Law was adopted to provide for effective government in Iraq until adoption of a constitution and subsequent elections in 2005.
- c. A UN team is already in Baghdad to assist the Independent Electoral Commission of Iraq in the preparation of free and fair elections in 2005.
- d. Numerous political parties have been established.
- e. Significant decentralization has been written into the state management law.
- f. Freedom of speech and press has been established. All media have been made independent of the state. More than 100 independent newspapers are published.

### **3. MACRO-FISCAL FRAMEWORK**

Initial figures regarding the implementation of this year's state budget indicates a wide range of achievements concerning the following:

- a. Inflation is low and under control.
- b. The exchange rate of the Iraqi Dinar is stable.
- c. Salaries of state-employed officials and retirees have been substantially increased after years of erosion due to inflation.
- d. Crude oil production capacity was restored to previous levels.
- e. Tariffs were reduced and access to imported goods broadly increased.
- f. Taxes on income and profits were reduced to discourage tax evasion and broaden the general tax base.

The 2005 budget aims to achieve the following priorities:

- a. Building capacity in ministries, offices and state-owned companies at all levels of government to enable provision of basic services to the public in the best of manner and at all government employment levels.
- b. Development of plans and mechanisms for the preparation of state-level budgets according to select priorities aimed at promoting the role of the state in economic development.
- c. Achieving a balanced budget to avoid loans and to reduce the burden of loans service.
- d. Distribution of resources between current and investment expenditures to maintain a balance between the provision of basic services and achieving economic growth.

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- e. Emphasis on improvements in security, national defense, electricity and basic infrastructure, employment, the environment and human rights.
- f. Generation of employment and creation of new jobs in specific sectors such as health and education.
- g. Diversification of the Iraqi economy and the creation of export capacities.
- h. Enabling the private sector to play a leading role in the reconstruction and development of the Iraqi economy through institution building and regulatory improvements, including the development and improvement of the financial and banking sectors and the creation of new employment opportunities.
- i. Development of human resources through the allocation of government resources aimed at quantitative and qualitative improvement of Iraqis through the provision of social, health and educational services and training facilities.
- j. Reducing unemployment levels through
  - the creation of new government employment opportunities;
  - reemployment of those who lost their jobs for political reasons
  - redirecting the employment of those working in disbanded state enterprises to other government offices in need of new employment,
  - and the creation of new employment opportunities for new graduates from medical, health and education institutions.

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**2005 Preliminary Budget,  
Expected Revenues And Expenditures For The Years 2006-2007**

In millions of U.S. dollars

<b>Revenues</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Expenditures</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
Oil revenue	18113	24317	25716	Salaries and retirements	3733	3733	3733
Taxes & customs	262	743	865	Goods & services	5085	4785	4034
Income from State enterprise	860	966	1012	Cost of oil extraction and refining	2160	2522	2704
				<b>Subsidies</b>	<b>9450</b>	<b>9744</b>	<b>10134</b>
				-Provision coupon, social safety net	4000	4084	4170
				-Subsidies to state enterprises	1020	850	700
Other revenues	257	320	414	-Others	4430	4810	5264
				Internal & external debt service	100	6661	6727
				War damages compensations	856	1039	1027
Total revenue	19492	26346	28007	Total current expenditures	21384	28483	28358
				Investment projects	9087	10548	10152
Grants and assistance	4253	5430	4208	of which, from foreign assistance	4007	6025	5119
Total revenues	23745	31777	32216	Total expenditures	30471	39031	38510
Deficit (w/o grants)	-(10979)	-(12685)	-(10503)				
Deficit (with grants)	-(6726)	-(7255)	-(6295)				

**Revenues:** The revenues of the budget during the three coming years are estimated at \$ 73.8 billion, with a yearly average of \$ 24.6 billion dollars, constituting nearly 97.9% of expected GDP during the next three years. 84.2% of revenues are derived from oil exports, taxes, and revenues from state owned enterprises, with 15.8% from donors. Here are the principle assumptions:

Oil export proceeds

Annual proceeds of crude oil exports and oil products range between \$18.1 and 25.7 billion for the period of 2005 – 2007. These proceeds form 92.3% of the total revenue of the budget (excluding external donations). These estimates are based on production rate of 2.35 million barrel per day (bpd) and an export rate of 1.8 million barrels per day (bpd) at an average price of

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\$26 per barrel. This is the average price designated by OPEC. During 2006, Iraq will increase its oil production to 2.7 million bpd, 2.15 bpd to be exported. As for the year 2007, the rate of production is expected to increase to 3.5 bpd, and exports to increase to 2.8 bpd.

These estimates are obviously based on conservative production level and price assumptions, for the years 2005 and 2006 considering that today's prices exceed double the price used in the estimates. Expected oil prices for 2005 indicate that these prices will probably decrease to \$30 per barrel. However, it is important to maintain a conservative set of assumptions for both production and export levels, given the security situation. Over the past year and a half, oil pipelines and production facilities have encountered deliberate sabotage and vandalism which led to the suspension and/or decrease in the quantity of exports for days and sometimes over a week. It is important to factor in this risk, as unexpected reductions in the exported oil quantities may offset any higher prices.

### Refining Capacity

Iraqi refining capacity is approximately 550,000 bpd. All these refineries are state owned. Currently, crude is sold to the refineries for 300 Dinars (roughly \$0.2) per barrel. Regardless, refineries and oil distributors are experiencing great losses, as a result of the very low prices of refined products set by the state: roughly \$.01 per liter of regular gasoline and \$.025 per liter of improved gasoline.

The state is currently not collecting any revenues from the preparation of crude oil for refineries. This foregone revenue comes to approximately \$5.2 billion annually. Imports of gasoline resulting from the shortage of refinery capacity are projected to cost Iraq \$2.4 billion for the year 2005. Therefore, the total budget cost arising from limited refinery capacity is around \$8 billion yearly, more than 40% of the state's total revenue.

For this reason, rehabilitation and increasing refinery capacity should take first priority during 2005 to reduce the budgetary cost. Increasing price gradually is important based on the improvement of economic activity, and purchasing power of citizens which is considered an issue of great concern for the coming two years. In general, the revenues which are achieved due to the amendment of oil products' prices during the coming three years is expected to be used to cover the losses of refineries, finance the maintenance operations, and modernize and expand the production capacity in order to cover the deficit from the demand in local markets.

The plan for refinery modernization appeared to be to first upgrade the existing refineries by, among other measures, adding more conversion capacity, and then to expand overall capacity. One estimate for this program is \$1 billion for upgrading the three existing refineries and \$2.75 billion for new refinery construction. Alternatively, Iraqi and foreign private sector investment, would be expected to create new refining capacity.

### Taxes and Customs and other Revenues

Despite the reduction in personal income and corporate profits taxes and customs, the expansion of the tax base by canceling the exception of employees' income and business profits, is expected to increase tax revenues during the coming year, in addition to the fact that the government's trend is to reduce depend on oil revenues by forcing new taxes such as the value added tax and another on sales, and increase it on luxury items. In addition, the development and

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implementation of the private sector and the revival of economic activity will lead to an increase in tax revenues. It is estimated that this will contribute up to 2.5% of budget revenues over the three year strategy period.

Revenues from state enterprises

Government enterprises in the banking, financial, construction and oil refining sectors are suffering from a host of problems and are not expected to perform well during 2004 or 2005, excepting the oil refining sector which should realize a profit in 2005. However, during 2007 the banking and financial sector together with oil refining sectors are expected to realize over \$1 billion which forms at least 3.6% total government revenues in 2007.

**Expenditures**

Current Expenditures

Employees salaries and pensions form around 12.3% of the total budget for 2005. Aside from a slight increase resulting from the restoration of pension payments to some state personnel dismissed during 2003, these expenditures will not increase in the following three years.

This limited portion of the budget for salaries and pensions implies that public sector employment will make only a marginal contribution to easing unemployment. As reconstruction accelerates, it should reduce unemployment. Government expenditures on goods and services form 16.7% of the total budget. These expenditures will be frozen at their current level despite expectation to increase the prices of goods and services purchased by the government. The National Strategy aims at reducing the weight of subsidies in state current expenditure from around 48.3% to 35.7%. Subsidies beside the food ration also include the costs of electricity and imports of refined oil products as well as subsidies to government enterprises, the agricultural sector, imported drugs, local governorate administrations and other emergency costs (though it does not represent the full economic costs as it does not include the implicit costs of subsidized energy).

The budget foresees reducing support gradually over the coming three years. At the same time, a comprehensive social security system benefiting vulnerable groups will be put in place. Financing for this system will be made possible through proceeds from gradually rationalizing energy pricing while wages and living standards are increasing. There will also be initiatives to restrict the benefits of the food ration system to targeted groups as opposed to the comprehensive system now in place. Further study, and perhaps pilot projects, will be carried out to identify the level of vulnerability and alternative options to the current food distribution system.

Foreign Debts

The IMF estimates Iraqi external public debt at \$125 billion of which around one third (\$42 billion) is owed to Paris Club creditors, with Japan, Russia, France, Germany and the U.S. being the largest creditors. The remainder is owed mostly to Arab governments, along with China and some Eastern European governments. Only 12 percent of the debt, mostly short-term, is owed to

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commercial creditors. The IMF prepared a detailed debt sustainability analysis for Paris Club discussion. This study concludes that Iraq's external debt burden is highly unsustainable and that reduction of it by anything less than 95% would still leave a financing gap.

The budget also includes war damages enforced on Iraq after the first Gulf War, constituting, according to a UN Security Council Resolution, 5% of the revenues from oil exports. Iraq is committed to fulfilling its UN obligations, which inevitably impact its budget and capacity to service other external debts.

Investment Expenditures

The legacy of the last twenty years in Iraq cannot be rectified without allocation of huge resources for investment in reconstruction projects. Therefore, an amount of \$29.8 billion has been budgeted for the period of 2005-2007, to be financed roughly equally from the resources of Iraq and from grants and preferential long-term loans from donor countries. Investment projects in the budget form around 28% of total expenditures, during the coming three years 14% of it financed through aid from donor countries. This high level of investment in the national budget will constitute roughly 33% of expected GDP, and should help produce a growth rate of 12 percent annually over the next three years. It is important to note, however, that the \$29.8 billion of budgeted investment does not cover all of Iraq's priority investment needs, when one also considers the needs in the areas not covered by the United Nations/World Bank needs assessment. The target for donor financing would appear to be within reach, especially as friendly countries and international organizations in October 2003, realizing the magnitude of the required investment and Iraq's inability to bear the costs, pledged to grant Iraq grants and loans under preferential conditions for an estimated \$32 billion dollars, of which \$18.4 billion are from the US grant alone.

#### **4. ECONOMIC REFORM POLICIES**

The coming three years are considered a transitional phase and as such short-term strategies should be seen in the light of long term strategic objectives for social advancement and economic reform.

However, to facilitate economic and social reform Iraq needs a transformation of public administration focusing on the regulatory framework and the management, rather than the provision of services. The country now has a unique opportunity to empower the private sector, enhance the role of the financial and banking systems, strengthen institutions of governance, and improve the effectiveness and efficiency of public institutions. Good governance for human development requires fostering fair, accountable institutions that protect human rights and basic freedoms, as well as establishing and implementing appropriate regulatory frameworks for economic activity and the rule of law.

Iraq's economic reform strategy is based on the public sector promoting the free market to achieve growth, while managing the social impact to ensure equity. It is summarized as follows:

**a. Enhance The Role Of The Private Sector**

The private sector will perform a critical role in Iraq's sustainable reconstruction and development process through the initial reconstruction effort. The government must establish a regulatory environment that can accommodate the private provision of infrastructure, thus allowing for the provision of essential infrastructure in a fiscally sustainable manner. The government must also ensure basic public services and utilities. Well-functioning and efficiently-priced infrastructure will enable private sector growth.

The private sector is seen as the primary engine of economic diversification in Iraq. Realizing this vision will require institutional and legal changes to create the proper atmosphere. For the private sector to flourish security must be established, the rule of law strengthened, an efficient payments system and a diversified financial sector developed. All quantitative and qualitative restrictions and sanctions which hinder geographical movement among different economic sectors must be removed.

A "one stop" approach to investment facilitation is being considered, which should prove beneficial in facilitating investment and reducing initial costs of setting up and doing business in Iraq. The government will seek to streamline the process of licensing new business.

**b. Develop Human Resources**

The state must use its considerable financial resources to play a vital role in developing human resources as an investment in the present as well as the future. Social services such as health, education and vocational training must be enhanced. Vulnerable groups in Iraqi society expanded due to war and sanctions, with their resultant destruction and poverty. A comprehensive social aid network to protect these vulnerable groups must be put in place.

**c. Promote The Capacity Of Governmental Institutions And Enhance Their Performance**

The key challenge for public sector reform in Iraq is to strike a balance between emergency management and more long-term work.

The strategy is aimed at shrinking the size of government in comparison to the rest of the economy decreasing it over the next three years. Government, however, will continue to play a dominant role in economic activity over this period, and will play a key role as provider of public goods thereafter. Great attention must be given to promote the administrative capacity. The structure of government will be reconsidered, with the intent to eliminate government departments that compete with the private sector in economic and service activities and to reduce the overall size of the government. The state will come to rely on the private sector for some purposes, rather than attempting to internalize these functions by enlarging its departments.

An immediate need is for Iraqi institutions to strengthen systems of accountability. This will both improve the efficient use of Iraqi resources and facilitate the flow of donor funds. This is particularly important to allow Iraq to absorb a large degree of donor assistance using its own existing administrative and implementation structures without creating parallel systems. The government is also called upon to provide services to the citizens in a transparent, respectful, efficient and dedicated manner, free of corruption. This will require improved management to

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increase the efficiency of most government departments, and attracting and training competent young people.

A general civil service reform framework must be considered including all aspects of human resource management, but focused on fiscal sustainability and ensuring a transitional process that does not create social unrest. Additional accountability institutions and anti-corruption initiatives are required, as is a system for setting priorities in public spending, a degree of fiscal decentralization, improved public procurement and stronger financial management.

**d. Reducing Subsidies**

The government heavily subsidizes both consumers and producers in Iraq, directly or indirectly. Direct subsidies in the consolidated Iraqi budget include the food basket and the import of refined oil products, while the indirect ones include the discounted prices of crude oil supply to refineries, electricity, water, and agricultural inputs. Taken together, direct and indirect subsidies may consume a major part of the government revenues. Direct subsidies constitute more than I.D. 9.9 billion, its share in GDP is estimated more than 31%. The overall strategy on subsidies calls for targeting vulnerable groups instead of providing them to the population at large and aims at increasing economic efficiency.

Food: In 1996, under the UN's Oil for Food Program, Iraq's food ration system was expanded to provide the population a basket of basic food items needed to sustain existence. These items included rice, flour, sugar, tea, cooking oil, pulses milk powder and iodized salt. Increases in population and prices have driven up the cost of the program, which now stands at approximately \$4.6 billion per year. An estimated 60% of the Iraqi people are now dependent on the food ration system.

The high current level of unemployment and the fragile internal security situation necessitate a gradual reduction of the existing distortions resulting from this subsidized system. The government aims to identify and remove from the food ration system certain segments of the population who are not identified as food insecure. The Food Security Analysis Study along with the National Census, scheduled for October 2004, and the planned creation of a social security number for each citizen thereafter may help provide the data necessary for wider application of this policy. This action might save up to 25% of the total costs of the food ration system over the next two years.

Oil products: Prices of refined oil products in Iraq are fixed at very low levels to alleviate the financial burden on consumers. Oil products are heavily subsidized. Crude oil is supplied to refineries at a price of 300 ID per barrel (about 21 cents) compared to current spot market benchmark price of more than \$40 per barrel. The quantity supplied to those refineries ranges from 500,000 to 550,000 bpd. According to the price per barrel assumed in the 2005 budget projections, \$22 per barrel, foregone revenues ranges between \$4.7 and \$5.2 billion. Added to this must be the cost of imports (\$2.4 billion) which are sold to the consumer at the price of 20 ID per liter (about 1 cent) while the government imports at market price. Total subsidies are in the range of \$7.1 billion to \$7.6 billion yearly.

The government is studying a gradual increase in domestic prices of oil products as per capita income increases. A decision should be taken in early 2005 to adjust these prices to bring them gradually into line with prevailing prices in neighboring countries.

Electricity and Water: Electricity and water prices are fixed by the government and are also heavily subsidized, especially household consumption. Approximately 47% of electricity production goes to households. Implicit subsidies for the consumer in the electricity sector are estimated at \$4 billion due to fuel prices charged to generators below opportunity costs, as well as depreciation for equipment not being taken into account in pricing. Water, on the other hand, is provided well below the cost of providing it to the consumer. Adjustments must be made in pricing of electricity and water consistent with increases in per capita income.

**e. SOE Reform**

The Iraqi government owns an estimated 192 State Owned Enterprises (SOEs) that employ a combined 500,000 Iraqis. This workforce supports a significant portion of the population. Following the hostilities of April 2003, many of these firms suffered from looting and destruction. Most of the SOEs are currently idle. They can be classified into three categories:

- Category I: Companies that are a financial burden on the state. These firms should be liquidated or merged into integrated, economically-viable institutions.
- Category II: Companies for which additional information is needed to determine whether to liquidate or privatize them.
- Category III: Industrial companies dependent on local raw materials and increasing demand for their products, such as fertilizers, cement, and petrochemicals. Their privatization can be achieved through a new authority linked directly to the Council of Ministers, to which the ownership of such companies will be transferred. The authority should be empowered to pre-qualify, liquidate, sell or enter into partnerships with strategic partners under a comprehensive, transparent reform program over a specific time frame, announced in advance.

The new interim government has established a Commission under the Council of Ministers to study options for reform and privatization of SOEs. The reform process should minimize the negative social impact of discharging a large number of employees. Therefore, SOE reform must be synchronized with the reconstruction campaign, which will draw down the level of unemployment. However, this should not prevent the initiation of the assessment process for individual entities.

**f. Liberalization Of External Trade**

The liberalization of external trade aims at integrating the Iraqi economy with the global economy, removing distortions in the local prices of commodities and services, increasing competitiveness, and enhancing performance efficiency of the Iraqi economy. This process was initiated immediately after the fall of the previous regime. Restrictions on trade were cancelled and imports were subjected to a uniform custom tax of 5%. Food and medicine were exempted. The liberalization of trade will help Iraq's current efforts to join the WTO.

A national committee already has been established to design a rules-based, transparent and stable foreign trade regime, and domestic regulations and policies which are WTO compatible. The process of joining the WTO and the international commitments arising from it will act as a

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“lock-in mechanism” and guide for domestic economic reforms. The committee will also assess the social and economic impact of Iraq’s WTO accession and determine remedial measures.

**g. Foreign Investment**

Iraq has a sound legal framework for the formation and registration of foreign-, Iraqi-, and jointly-owned companies under the investment law of 19 September 2003. Foreign, legal, and natural persons have the right to be an investor or partner in, or a founder of, companies in Iraq by virtue of company law number 21 of 1997, as amended. Further objectives in the area of foreign investment include:

- a. Continue to remove all kinds of restrictions on foreign investors and to encourage the flow of direct or indirect foreign investment in all sectors (except strategic areas) in a manner that ensures the flow of foreign capital, modern technology and management expertise.
- b. Encourage partnerships between foreign and Iraqi investors in the Iraqi private sector.
- c. Simplify the procedures for foreign investors through a single-window approach for all proceedings related to foreign investors that would draw together all Iraqi government officials concerned in one place.
- d. Create a specialized authority to provide facilities to investors and offer investment opportunities in the country.
- e. Conclude foreign investment agreements with developed and developing countries, and to ratify investment guaranty agreements with groups such as the MIGA and the U.S. OPIC.

**h. Regional Development**

The regional development strategy aims at reducing the dual territorial development in Iraq reflected in the clear economic and social differences between the various Iraqi governorates on one hand, and between urban and rural areas on the other hand.

The strategy also seeks to utilize the relative advantages in the various regions and to consolidate the development efforts. In addition, the strategy intends to promote development, as well as administrative and regulatory capabilities of the various governorates, local departments and municipalities, and to guarantee efficiency and equality in development throughout Iraq.

**5. SOCIAL ADVANCEMENT PROGRAMS**

Social reform and development are complex and long term processes, and require coordination and concerted efforts across institutions at all levels. In this context, the strategy recognizes the need for a combination of both general and targeted social investments as well as for taking affirmative action in favor of disadvantaged groups including the disabled.

**a. Job Creation**

Iraq faces the challenge of very high unemployment, exacerbated by refugee returns and movement of internally displaced persons (IDPs). During the past year, the persistent high rate of unemployment was due to the slowdown of economic activity. The high rate of unemployment may have contributed seriously to Iraq's insecurity over this period. As a temporary measure until the reconstruction process accelerates and begins to draw down the unemployment rate, a short-term employment policy with different schemes has been worked out during this year and could be enhanced in the coming years. It is composed of the following elements:

- a. Make-work schemes. These programs provide income and employment generation for a limited duration. The primary objective of these measures is to transfer cash in a rapid and efficient manner through useful activities with low start up and overhead costs. Examples include employing security guards, cleaning and painting. These programs could be expanded through labor intensive reconstruction and rehabilitation of schools, agriculture, and irrigation works which can create thousands of jobs.
- b. Development of Skills. There is a need to develop a strategy for sustainable job opportunities, especially for vulnerable groups. Programs to provide marketable skills for more permanent jobs through training institutions are available now at the Ministry of Education and Ministry of Labor and Social Affairs. Rehabilitation of these training centers and widening the scope of their training skills may contribute to upgrading the skills of the semi-educated Iraqi unemployed labor forces. Educational assistance to help students who formerly left the education system return to complete their studies is also an important skills building program. The Ministry of Labor and Social Affairs has enhanced the scheme of training through wage subsidies. The Ministry of Culture will also initiate training and capacity building in the protection of cultural heritage through public and private education. Given Iraq's enormous cultural heritage, job creation in this area should be substantial. Related government entities, such as the police and non-government sectors such as the tourism industry will take part in specific training to fill the future needs in the cultural tourism sector, where the Ministry will aim to offer professional hospitality to the visiting public.
- c. Micro-finance programs aimed at small scale investment and helping vulnerable groups to meet their emergency needs and build assets should also create private sector employment. These programs should be designed to strengthen the capacity of the financial and banking sector to establish sustainable micro-finance windows.
- d. The government must consider establishing financial facilities for community integration of returned refugees and IDPs that would help create employment opportunities for them.
- e. Also under study are financial windows to support local councils and civic organizations to train youth in monitoring, accounting, procurement, and administration.

**b. Human Rights and the Rule of Law**

The challenge for Iraq is to establish a democratic system, based on the principles of human rights, the rule of law and good governance. This principles shape an enabling environment for

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Iraqi people and institutions to interact in a participatory and transparent manner. The government has made significant advances by actively promoting freedom of speech and public dialogue. This is in recognition that human rights link directly to the safeguarding and advance of human freedoms, as it applies to the cultural diverse populations of Iraq. The government must embrace the principles of non discrimination due to race, color, gender, language, religion, political opinion, national or social origin, or wealth.

The government adheres to the international covenants of human rights and the rule of law. Accordingly, a new Ministry of Human Right has been established to reflect modern Iraqi society and concerns. The Ministry is mandated to develop policies, programs and interventions at the national and community levels. Linkages are established and will be strengthened with NGOs and international bodies, including the United Nations.

### **c. Civil Society**

Currently in Iraq there is a healthy expansion of NGOs, community based organizations and media channels that are advocating greater public awareness and dialogue. The strategy seeks to promote the role of the civil society to act independently, to cooperate with authorities or to exert pressure on them and call them to account. Civil society organizations can make an enormous contribution to the prudent management of Iraqi society. They should be free to build their capacity to do so. Civil society must receive sufficient support to perform the following roles:

1. Activate participation of youth, women, and marginalized groups in service and development activities and social programs.
2. Establish a culture of dialogue and cooperation, and promote the concept of voluntary work in a manner that enhances citizenship.
3. Participate in implementing development projects and social services with both public and private sectors.

### **d. Gender**

Iraq is witnessing significant transformations towards women's advancement in various fields and changing methods to address women's issues. Promoting women's conditions is considered a factor of economic and social change, and women's rights form an integral part of human rights. However, the achievements of Iraqi women have been eroded, resulting in increased poverty, discrimination, and decreasing opportunities for civic participation.

Accordingly, to enhance the status of woman and enable the practice of women's rights as an active and influential element in the society, the strategy of social advancement must include measures to integrate woman in the development process, ensure equality of opportunities between genders and create appropriate atmosphere to remove impediments to the practice of women's rights.

## **6. SECTOR DEVELOPMENT PROGRAMS**

Oil and gas, the financial sector, electricity, water and sanitation, transportation and communications, education and health, housing, environmental protection, water resources and agriculture, and the industrial sector: all these areas continue to suffer from tremendous infrastructural, technical and regulatory problems. They are not meeting the needs of the people even at minimum required levels. Therefore, continued emergency interventions for securing basic social services would be welcome from the international donor community.

### **a. Oil and Gas**

Iraq has some of the largest estimated oil and gas reserves in the world. The cost of production is also among the lowest in the world because the fields are on shore, very large, and have a relatively simple geological structure. The Ministry of Oil has prepared medium and long term plans to increase the country's oil production capacity to reach or surpass 6 million bpd. The target for the year 2007 is 3.5 million bpd. Estimated costs to maintain and increase production are in the range of \$4 billion. Iraq's oil sector plan also targets an increase in gas production and inviting large foreign companies to participate in developing the oil and gas fields in shared production contracts.

Restructuring the oil sector and merging the national oil companies into one conglomerate is already under way. The Ministry of Oil plans to establish open, transparent, and fair policies, practices, and treatments to attract foreign investors. The government in the foreseeable future will continue to play the most active role in this sector through the established national oil company. However, private firms, foreign or domestic, can be hired for rehabilitation or production. Much of the future investment in both upstream and downstream operations is expected to come from the private sector, foreign and domestic.

One avenue worth exploring would be investing in capture of natural gas, which is currently flared. This would provide a low cost fuel for electricity generation and have a strong positive environmental impact.

### **b. Financial Sector**

Banking is the principle component of the financial system in Iraq. Other than the sale of government debt instruments, capital markets are virtually non-existent. The stock exchange began operations in July 2004 and has a very small capitalization. State owned and private insurance companies are very weak. The banking system has very low credit facilities and a weak payments system. In addition to the Central Bank, it consists of 24 licensed banks, including 6 public and 18 private commercial and investment banks. In aggregate, the banking sector has only \$2 billion in assets: the banks are marginal in the economy as providers of liquidity. The Central Bank of Iraq supervises the banking. Overall supervision is very poor and needs significant improvement in capacity building, organization, technology, and in providing operational manuals, regulations, and a legal framework.

During the past year, an independent Central Bank law, a new Securities Law and a new banking law were all adopted. Significant change in the structure of the financial and banking sector is expected to occur during the period covered by the strategy. Foreign banks are allowed to open branches and to joint venture with private Iraqi banks. Interest rates have been completely

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liberalized, new currency notes have been issued and the exchange rate has been stabilized through frequent foreign exchange auctions by the Central Bank. The immediate and medium-term priorities can be identified as follows:

- a. Restructuring the state owned banks, including updating technology and providing technical assistance, and capacity building.
- b. Creating an effective operating structure for the Central Bank to provide services and supervision of the banking system.
- c. Upgrading and modernizing the country's non-cash payments system, including inter-bank clearing and settlement services.
- d. Establishing up to date electronic settlement facilities at the Central Bank and its regional branches.
- e. Restructuring the Central Bank in view of the state management law.
- f. Addressing the status of state owned banks and insurance companies to encourage the process of consolidation and privatization.

**c. Electricity**

Historically, electricity and fuel prices have been kept extremely low and the national budget has had to entirely fund the expansion of the system. Electricity tariffs were fixed at a level to cover the operation costs. However, since March 2003 billing and revenues collection for electricity services has ceased. Ensuring adequate fuel supplies for the power sector has proven to be a major challenge during the last two years.

The medium term objective for the coming three years is to return the power system to a reliable and efficiently run system, similar to pre-1991, with a generating capacity of about 7,000 MW. This will require additional power generation of about 2,700 MW. In order to achieve the target investment is needed to continue the rehabilitation and augmentation of current work. The estimated cost this objective could be approximately \$3 billion. The recent shift of some US assistance into other areas makes it important for other donors to assist in this sector. The following measures are planned to support this goal:

- a. Reconstruct the electric power network, increase power generation to the levels that guarantee continuous supply to satisfy consumer demand with minimum interruptions.
- b. Update the electric power distribution networks to meet the objective above.
- c. Develop a timetable on short and long term bases to qualify and train executive and supervisory staff for the sector to upgrade its efficiency.
- d. A combination of more rational pricing, significant investment, and improved efficiency should eliminate the existing gap between electrical supply and demand. The private sector may be the main source of new investment.

**d. Water and Sanitation**

Until 1991 the water and sanitation systems in Iraq were operating efficiently, utilizing then-current technology. Safe potable water was accessible to 95% of urban and 75% of rural inhabitants. 218 conventional water treatment plants were operating in the country and 1,191 compact water treatment plants were also in operation. Sanitation services covered 75% of urban communities and 50% of rural ones. Recent studies show that many water and sewage treatment plants were provided at an “acceptable” level. Of the 177 water treatment plants only 34 were classified as “good.” Sewage collection and treatment service in Baghdad is provided to only 80% of the population and only 9% of urban populations outside of Baghdad, while rural areas in the north of Iraq do not have piped sewage systems. Again, the recent shift of some US assistance into other areas makes it important for other donors to assist in this sector.

Sanitation is thus becoming a serious environmental and health problem. According to current reports, none of the sewage treatment plans are operational and raw sewage has been discharged into rivers and waterways. Deteriorating sewer pipes are contaminating the potable water network and underground water, further adding to the health and environmental problems. It is estimated that 50% of wastewater generated in Iraq is being discharged into the rivers and waterways. Baghdad contributes as much as 75% of that discharge.

This year, the administration is working hard to restore the standards that existed before 2003. Their activities include water tankering, especially to the southern cities. Water quality monitoring has been established throughout the country. Procurements for water treatment chemicals and garbage collection are being provided. Institutional arrangements have been initiated. The objective for the next three years in this sector can be summarized as follows:

- a. Provide financial and technical support to water, sewage, and solid waste sectors to achieve pre-2003 levels by the end of this year, including increasing access to potable water by urban areas by 15% and that of rural areas by 20%; reducing water losses by 10%; raising sanitation coverage by 10% in urban areas; developing city master plans for water and sanitation service in the major cities; building capacity and enhancing management systems.
- b. Build Al Rasafa plant for potable water in Baghdad and providing safe potable water to the city of Basrah. Provide sewage services to newly built areas in Baghdad and Basrah.
- c. Continue the efforts to reconstruct and establish new sanitation plants in urban and rural areas to ensure full coverage of all regions of Iraq, and to reduce the inequality between urban and rural areas.
- d. Improve water quality and upgrade the water distribution networks.
- e. Develop a timetable on short and long term bases to qualify and train executive and supervisory staff for the water and sewerage projects, and to establish high level training centers for this purpose.
- f. Provide adequate crude water resources for all regions of Iraq.
- g. Maintain and improve the efficiency of existing pumping stations and sewerage networks, while achieving the required environmental standards for processed water prior to pumping to drainage points.

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- h. Develop a timetable for the implementation of a number of new projects in all governorates in order to increase the scope of sewerage service coverage.
- i. Acquire specialized machinery used in cleaning and clearing sewerage networks.
- j. Reconsider the subsidy policies of the sector and develop a timetable for the gradual increase of the prices of drinking water supply, taking into account the pricing differences between the various social categories, regions and consumption.

### **e.      **Transportation and Communications****

Iraq's transport sector comprises 40,690 kilometers of roads, two international and three major domestic airports, six cargo ports, two oil terminals, and 2,456 kilometers of rail lines. Roads accommodate about 70% of all traffic in Iraq. Existing facilities of telecommunications, post offices, and internet infrastructure are very underdeveloped. The transportation and communication networks in all governorates of Iraq must be expanded and internal, regional and international connections enhanced. The sector needs significant resources and policy changes in order to rise to regional standards. Iraq can "leapfrog" over rivals in this sector by adopting the latest technology and adopting a favorable business environment through adopting proper policy and regulatory frameworks. The following actions are intended:

#### Communications:

- a. Rebuilding and expanding the existing switching and local access. Undertake civil works in order to reach fixed line telephone service teledensity of 3.3 million customers by 2007.
- b. Establishing a modern and integrated national long distance backbone network with international connectivity.
- c. Reconstruct the postal system including rehabilitation of post facilities and the existing buildings to bring Iraq in line with other countries in the region.

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Transport:

- d. Continue ongoing dredging activities in and around Umm Qasr port.
- e. Remove wrecks in Shatt al Arab and Umm Qasr ports in the most environmentally sound manner possible.
- f. Develop a master plan to increase efficiency and optimize the institutional arrangement for ports and inland waterways.
- g. Explore the potential for developing a bus rapid transit system and dedicated bus lines.
- h. Rehabilitation of key railway stations and refurbishing rolling stock and maintenance equipment.
- i. Modernize railway training center in order to maintain the skills of railway staff.
- j. Prepare a railways strategy to assess the merits of restructuring the present system to permit greater private sector participation in the delivery of services.
- k. Develop airports and civil aviation strategy coupled with a master plan which should include plans for rationalization of facilities and future institutional arrangements with the possibility of outsourcing airport management to private operators.
- l. Develop programs for the privatization of some activities in the sector, particularly in the field of communications, and land, sea, and air transportation.
- m. Retrain supervisory and operational staff, particularly in the area of previously suspended activities such as aviation and maritime.

**f. Education**

The educational and health systems in Iraq were widely regarded as among the best in the Middle East until 1980. Since then lack of resources, politicization of the educational system, and emigration of doctors and teachers have made Iraq's health and educational systems below the standards of all Middle Eastern countries. To restore the high standards of the of 1980s is the heart of the reconstruction efforts in the coming three years. The private sector will be encouraged to take part and play an important role in both education and health. Private primary and secondary schools may be established and private investment in building professional capacities and upgrading medical technology will be sought. Action is already underway this year to attain this objective. Among other measures, the following are priorities:

- a. Physical rehabilitation and reconstruction of primary and secondary schools.
- b. Ensuring minimal quality standards of teaching and learning through strengthening the basic training.
- c. Providing adequate supplies of material, equipment and furniture to schools.
- d. Developing a new curriculum, educational priorities and mechanisms for change.

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- e. Within a national vision, modernize the outdated education system including the concept of teachers professional development, teaching methodologies, linking between vocational, technical education, higher education and labor markets.
- f. Professional development of educational staff, especially university professors.

**g. Health**

Based on the analysis of the current health situation our immediate needs and strategies include five areas for action:

a. Meeting urgent needs during 2005 to:

- Meet shortages in medicines and other critical supplies, rehabilitate hospitals and secure the blood transportation system.
- Upgrade emergency services including obstetric care.
- Increase immunization coverage, disease surveillance system, communicable disease control activities and food safety measures.
- Establish an efficient information system and improve communications.
- Re-organize the pharmaceutical sector.
- Conduct an in-depth review of primary care and coordinate with other sectors regarding safe water and sanitation.
- Develop human resources to meet urgent organizational and coordination issues.
- Strengthening management.

b. Management: Use modern management techniques to restructure the health sector to:

- Respond to new challenges.
- Identify and develop new leadership with an enhanced role for women.
- Review the Public Health Law and update health legislation.
- Institutionalize work ethics based on transparency, openness, equality, participation and fighting corruption.
- Capacity building in planning, management, procurement, budgeting and finance.
- Institute evidence-based decision-making, performance appraisal, monitoring and evaluation.

c. Planning: Draw up a four year plan for reconstruction of the health sector with emphasis on:

- Reviewing reconstruction requirements and prioritizing urgent projects.
- Developing standards for rehabilitation and new construction.

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- Capacity building in project management and implementation.
  - Encouraging private sector participation on projects construction.
  - Improving maintenance of medical equipment.
  - Strengthening coordination with partners.
- d. Training and capacity building: Special emphasis will be placed on four areas, namely; public health and related branches like health planning, economics, financing, and other areas, clinical skills and professional health professional education (basics, post-graduate, continuing) and strengthening nursing education as well as promoting capacity in epidemiological and health system research.
- e. Resource Mobilization: Current expenditure on health, as a proportion of GDP, is considerably lower than neighboring countries like Jordan and Lebanon and should therefore increase. At the same time, much of the planned rehabilitation of the physical infrastructure of the health sector will depend on donor funding. Thus, our strategy should focus on effective action to mobilize funds at the national, regional, and international levels to increase commitment to the health sector strengthen donor partnerships and coordination and to encourage partnership with non-governmental organizations and communities. Action is needed to improve information on current status and needs and on public relations.

**h. Culture**

Iraq's cultural heritage has suffered tremendously over the past few decades. Tangible heritage-- such as archeological and historical sites--are complimented with a rich tradition of arts and crafts throughout the country. This intangible heritage has often been oppressed, while its tangible counterpart has, even very recently, suffered from looting, pillaging and vandalism. The enormous assets still provide an important resource that should produce significant employment in protection, conservation and tourism helping the Iraqi nation in its social and economic recovery process. Protection and promotion of Iraq's cultural heritage requires private sector involvement. Taken together the opportunities related to Iraq's heritage could provide insurance for durable and sustainable management of cultural sites, preventing any more losses of our tangible heritage and helping deeply rooted traditions such as music, poetry and dance to flourish.

The following are the main lines of action for Iraq's cultural strategy:

- a. Ensure institutional reform through education and technical education, capacity building and training in cultural policies and the safeguarding of cultural heritage.
- b. Review, enforce and strengthen legislation on culture heritage and provide human resources and capacity building to law enforcement agents in the field of cultural heritage protection.
- c. Strengthen the protection, conservation and rehabilitation of tangible and intangible heritage through its safeguarding and promotion.
- d. Establish an Iraqi culture tourism policy allowing private sector involvement and investment.

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- e. Development of tourism related education and training facilities and programs.
- f. Review the needs of cultural sites and supporting infrastructure, including strategies for local community development, management, tourism and entertainment.
- g. Development of micro-industries at various sites (arts & crafts).
- h. Analyze and avoid degradation and threats to the cultural sites.

**i. Youth Policy**

People under 24 years of age represent over 50% of the population of Iraq. They have witnessed wars and conflicts since their birth. As this segment of the population is the future of Iraq, it is essential that any development strategy takes into account their needs both economic and social as well as cultural.

Youth need training in all aspects of modern life including technology, languages, new fields of science and arts in order to prepare them for meaningful employment. They need to have internalized good citizenship, team building, leadership, conflict resolution and other aspects of social interaction. They also need to look towards peaceful and participatory ways of conducting business and everyday life

Programmes And actions to be implemented in cooperation with the UN may include:

- A national strategy to elaborate a national youth policy and strategy and link them to specific programmes in the above areas to address the various issues that are likely to improve the life and prospects of Iraqi youth.
- Exposures to other experiences in the world have always played a major role in the development of the human resource base of Iraq. A programme of scholarships that benefit the most promising students and civil servants in the fields identified as priority by the government will be considered in order to develop and enrich As well as compensate the losses the country has witnessed through the brain drain and assassinations.
- Employment strategy to enhance employment opportunities at decent wages through enterprise development, agricultural development, housing and construction and small and medium enterprise.
- ? Establishment of a human development center that will address the issues of poverty assessments, surveys, mapping, monitoring and link them to employment strategies and social safety nets including the gradual phasing out of the public distribution system and some subsidies.

**j. Urban Management and Housing**

Iraq is suffering from a huge housing shortage. The best estimates indicate that there is a shortage of about 1.5 million housing units including those that need to be rebuilt due to war

damage, long neglect or under-utilization of land. This problem varies from one governorate to another.

The quality of housing has deteriorated chiefly because of overcrowding and the lack of maintenance during the past two decades. About 30-35% of the housing units are below minimum acceptable standards, especially in major cities. The Ministry of Reconstruction and Housing has already begun to take many initiatives. It is taking a comprehensive view of housing and urban development strategies. It has established a fund with initial capital of \$200 million to provide small loans ranging from \$5,000 to \$12,000 to assist low-income groups and IDPs in building their housing units on lots to be sold to them at nominal sums by the government. There are also different housing schemes already under study for government employees through the state bank that may augment their savings to build their housing. Special attention is being paid to affordable housing for the vulnerable groups and improving slums to bring them up to minimal acceptable conditions.

A master housing sector plan is being developed, which should assist Iraq to precisely address the housing needs on the basis of approved, reasonable housing criteria. The housing policy would help strike the right balance between the roles of the public and private sector in housing construction. All housing finance options are being explored with the objective of making housing available to the all classes of society including the weak and the deprived. Housing must be addressed as an investment activity and not only as a necessary social cost. This requires a wider role for the private financial sector, construction sector and investors. In addition, a comprehensive urban development master plan should be elaborated at national, regional, and municipal levels - that includes the private sector and civil society - to address broader urban planning requirements.

#### **k. Environmental Management**

The environment in Iraq is suffering from major problems. There is the water, air, and radiation pollution. Furthermore, the countrywide Explosives Remnants of War (ERW), situation, including Depleted Uranium, impact as many as 16 million people and creates a major threat to the environment as well as reconstruction and development activities. Environmental protection is a new function for the Iraqi government, the responsibility of a new Ministry of the Environment.

The strategy in this area aims to:

- a. Explore options to introduce emissions standards and phase out old vehicles.
- b. Conduct a comprehensive assessment of environmental of water, air and soil conditions in Iraq, identifying sources and extent of contamination, and needed remedies.
- c. Assess the current legal and regulatory framework for the environment including international treaties, and the requirements for improving environment protection in Iraq. This would include environmental impact assessments of any new reconstruction and development activity.
- d. Promote the financial, human, and technical capacity of the Ministry of the Environment, to facilitate building an effective environment surveillance and control system including environmental emergencies such as fires and oil/chemical spills.

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- e. Promote the development of an efficient National Mines Removal Action Authority to take control of the ERW situation.
- f. Protect the natural balance through expanding forests and natural conservations projects and maintain environmental systems.
- g. Establish national facilities for waste management including hazardous, medical and radioactive waste.

### **l. Water Resources**

There is an increasing demand for water resources due to population growth and economic development on one hand, and reduction in the amount of water available and a deterioration in quality as a result of intensive use of water resources in the neighboring countries. This situation necessarily requires the adoption of a master plan for this vital resource, including rationalization of all water consumption in all sectors. The basic priorities in the area of water resources are:

Actions at the regional and international levels with respect to Tigris and Euphrates water division:

- a. The Tigris and Euphrates are made up of one river basin, requiring an agreement between Iraq, Syria, Turkey, and Iran for a fair and reasonable division of water in terms of quality and quantity through compliance with the bases of fair and reasonable division of water and utilization under international laws and practices. During the lifetime of this strategy, Iraq will work with its neighbors to revive the Technical Committee meetings suspended since 1982.
- b. Renovate existing irrigation and cultivation projects according to a priority schedule based on the significance of the project and on the availability of resources over the next two years.
- c. Proceed with the implementation of committed projects in the area of dams, general water reserves and minor dams.
- d. Direct research towards upgrading field irrigation and apply research findings on pilot projects that could be the starting point to disseminate the findings to agricultural water users.
- e. Utilize artesian water sources for all purposes including agriculture and drinking water supply. This will require investment in equipment for drilling and machinery needed to increase the capacity of artesian well drilling capacity. It will also entail additional hydro-geological studies to monitor the quality and quantity of water in the various water basins.
- f. Provide continuous maintenance for irrigation canals and nurseries, requiring equipment and financial resources to cover such activities including regulators and shutters, etc.
- g. Renovate pumping stations. A total of 1008 pumps distributed over 254 stations and most of them are old are distributed throughout Iraq. These stations need to be renovated according to a pre-set schedule taking into account the availability of parts.

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- h. Renovate the water surveillance network along the Tigris and Euphrates Rivers and establish an advanced communication network to pass field information to decision makers in order to ensure fair distribution of financial allocations and maintain an acceptable quality of water.
- i. Continue study and design work in accordance with field information with the objective of developing implementation programs for the various water projects as well as adopting the operation and maintenance guide at the Irrigation Projects department.
- j. Restore the supply of water to the Ahwar (Marsh) regions in accordance with studies to be prepared and availability of water. This includes the construction of a number of facilities, canals, dams and outlets.
- k. Organize capacity building training courses in and outside the country, in addition to participating in conferences, seminars and workshops outside Iraq and expanding educational programs towards the rationalization of water usage for irrigation purposes.

### **m. Agriculture**

Agriculture currently provides a share of GDP less than half of its twenty percent share of employment. It supports a rural population of more than 7 million people. Over the last 15 years, agricultural production dropped by an average of 1.1% per year. Per capita agricultural production declined by about 3.9% annually. Productivity of the main cereal crops—wheat, barley and rice—has fallen drastically. All of these developments are a result of previous policies, especially the government's keeping food prices artificially low through control of prices, production and marketing.

Moreover, agriculture is heavily dependent on external water resources, not subject to cross-border agreements. Declining water inflow and resulting deterioration of water quality has negatively affected not only the agricultural sector, but also drinking water and the ecological balance.

Presently, the government has taken the first steps towards freeing the prices of fertilizers, insecticides, wheat, barley, and rice. It has also directed the Ministry of Trade to purchase food basket inputs, especially wheat and rice from local farmers at international prices. This is expected to increase agricultural production. The government has begun to develop agricultural policies and institutional reform that will provide the basis for food security in the medium-term, including capacity building of the private sector, phasing out subsidies, reshaping water resource management and rehabilitation of agro-industry. The following are the main prioritized actions to be taken in this sector:

- a. Increasing production and productivity through providing improved seeds, fertilizers and scientific exploitation of them.
- b. Expanding the scope of development and research programs, starting leading projects and expanding supplementary agricultural services such as veterinary services, fighting horticulture pesticides and agricultural counseling services.
- c. Introducing agricultural reforms, particularly reducing supplies provided through the government to the agricultural sector.

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- d. Rehabilitating the infrastructure of the agricultural sector particularly silos storing capacity.
- e. Building and enforcing technical and administrative capacity through training and rehabilitation.
- f. Protecting animal assets including poultry and fish from deterioration by protecting them from smuggling and brutal slaughter. Improving hereditary breeds through hybridization, providing artificial fertilization requirements and improving veterinary services.
- g. Protecting the agricultural environment from the diseases of imported plants and animals through enforcing the abilities in the field of agricultural and animal quarantine.
- h. Maintaining natural grazing lands, protecting plant cover, organizing graze process and utilizing flowing artesian water.
- i. Considering and implementing complementary policies that can enhance the impact an poverty of macroeconomic and adjustment policies namely : agricultural and rural development through rural infrastructure, finance of agricultural development and credit to SMES.,

### **n. Industrial Sector**

After a period of rapid expansion in the manufacturing industry sector up to 1980, a long period of stagnation and technological obsolescence started due to protracted wars and sanctions. The result is a small and weak manufacturing sector that contributes no more than ten percent to GDP, but employs no more than 4% of the labor force. The sector depends exclusively on exports of the oil sector to secure its imported technology as well as other required inputs. The sector has suffered from excessive dependence on state investment, inward-looking industrial strategies, and active discouragement of foreign participation. Based on the relatively large and expanding local markets, the country's rich hydrocarbon resources as well as a variety of other suitable industrial inputs could be utilized to create a rapid, private sector-led (and export-oriented) industrial expansion. To facilitate this process the following measures are planned:

- a. Achieving a significant increase in the annual production of industrial enterprises in comparison with 2002.
- b. Finding the appropriate financing and investment to resume operations of State Owned Enterprises (SOEs) whose physical plant has been damaged where there is an economic advantage from their operations.
- c. Stopping SOEs whose physical plant has been damaged where there is no economic advantage from keeping them in operation and facilitating the redistribution of assets to more productive uses elsewhere.
- d. Expanding the activities of geological survey in northern areas and starting metal exploring activities.
- e. Establishment of industrial zones and complexes for the purpose of industrial integration and the encouragement of the joint ventures.
- f. Strengthening standardization and quality assurance services.

- g. Encouraging the establishment of Small and Medium Scale Enterprises (SME) projects and developing appropriate financing mechanism for such projects.

## **7. CHALLENGES AND OBSTACLES**

The challenges that currently face the Iraqi economy are a result of three decades of war and sanctions that impacted all economic, social and security aspects in Iraq. These challenges cannot deter Iraq from following through on its development program, but they must be recognized as risks to be factored into planning. Among the most important of such challenges are:

### **a. Lack of Security and Stability**

A wave of violence, looting, kidnapping, upheavals, and legal disorganization currently prevails in Iraq, particularly outside the Kurdish region. In spite of the efforts of the Iraqi police and national guard, with the support of American and other multi-national forces, instability continues. The huge quantity of Explosive Remnants of War aggravates the situation. Insecurity has had many negative repercussions. Production and investment have been impeded, unemployment aggravated, oil exports interrupted. Government resources have been diverted from other more productive uses and the pace of governmental departments resuming service delivery has been slowed. Donor countries have been delayed in proceeding with reconstruction activities and found the costs of securing their projects much higher than expected. A large number of professionals, businessmen, and investors have emigrated to foreign countries.

Restoring internal security must be the first priority of the government. Without success in this area, Iraq cannot hope for significant improvements that will repair the legacy of the past.

### **b. Poverty, Vulnerability, and Unemployment**

To address the issue of poverty the government has undertaken steps to acquire the necessary poverty related data and information to help develop appropriate poverty alleviation strategies and policies.

There are several interventions underway:

- a) A United Nations sponsored Food Security Study (published in September 2004) and Living Conditions Survey that has been completed with the support of the Ministry of Planning and Development Cooperation's Central Statistical Office. The results and final analysis should be provided to the government in November 2004.
- b) The Ministry of Planning and Development Cooperation's State Organization for Statistics and Information Technology (SOSIT) is preparing for the census that will be conducted in October 2004.
- c) NCSIT, in collaboration with the World Bank, is planning to carry out a Household Expenditure Survey in 2005.

- d) An UN-World Bank food market study identifying the commercial market capacity has also been completed.

These interventions should provide the government with a good poverty data base, making possible a national definition for poverty. This would allow identification and mapping of the poverty distribution at the governorate level, assisting in the development of appropriate poverty alleviation measures to be put in place by mid 2006. The Ministry of Labor and Social Affairs will be the focal point for poverty-related issues. Since poverty is a high priority, cross-cutting issue, poverty focal points will be identified in each Ministry and related NGOs. Proper training in follow-up on poverty related work and data collection (including Millennium Development Goals indicators) will be provided to them.

Short-term interventions to alleviate basic poverty needs are in place. Presently, a group of experts have been recruited by the Ministry of Labor and Social Affairs to comprehensively assess the services and support provided to vulnerable groups, to recommend immediate interventions needed. These interventions should include the condition of children, infant and maternal mortality, and targeted actions to address malnutrition in infants and children under five.

**c. Technological Divide**

As stated, war, sanctions and economic mismanagement had led to serious economic decline in Iraq: infrastructure has eroded, investment declined below depreciation, and per capita income fell from \$ 3500 to less than \$ 800 per annum. Isolation has created a considerable technological divide between Iraq and the rest of the world. Without the most modern technology and methods at their disposal, Iraqis experience reduced productivity and low efficiency. The shortage of governmental resources and weakness of the private sector have also contributed to the deterioration of scientific research centers in Iraq.

**d. Limited Financial Resources**

The requirements for Iraq's reconstruction and development are very large. Available finance at present and in the foreseeable future appears insufficient, particularly if compared with the amount of Iraq's debt and compensation for war damages. Iraq's resources will not be sufficient to meet the requirements of its reconstruction and development in the near future, unless the international community provides the appropriate support to help Iraq erase the legacy of the past.

**e. Corruption**

The previous regime's highly centralized system and the lack of accountability and transparency in managing state resources have contributed to the prevalence of administrative corruption in Iraq. Current political and security circumstances and weak capacity of control authorities have allowed this problem to persist. Corruption adversely affects overall economic management, progress on political and economic reforms, and on reconstruction. Corruption must be fought by all possible means, particularly through transparent management of state resources. This clearly requires developing and improving regulations that enable disposal of public funds in a prudent manner. Also needed are improved legal accountability for bribery, corruption and

embezzlement of public funds. Building and developing potential of control systems such as the Financial Control Department, Inspectors General and Commission on Public Integrity.

## **8. ROLE OF EXTERNAL FINANCING**

There are four groups involved in managing Iraq's reconstruction process: the Ministry of Planning and Development Cooperation, the International Reconstruction Fund Facility for Iraq, the donor countries and the beneficiary Iraqi Ministries. To mobilize foreign and domestic resources, to optimize the distribution of such resources according to Iraq's social and economic priorities, and to expedite the implementation of reconstruction projects, coordination between these four groups should be improved and made more transparent.

### **Iraqi Structures**

In order to coordinate effectively with donor countries and to organize the relationship between Iraq and the International Reconstruction Fund Facility for Iraq, Iraq has established a fairly complex mechanism for donor coordination. The mechanism included three components:

#### **a. Iraqi Strategic Review Board**

The ISRB was established in 25 December 2003. It is a five member board, chaired by the Minister of Planning and Development Cooperation and including the Iraqi Minister of Finance, a rotating donor representative, and two other members (currently from the private sector). The main functions of the ISRB are:

1. Draft a plan to approve projects and reconstruction activities in Iraq in relation to projects financed by the United Nations and World Bank Funds in addition to bilateral agreements with donor countries.
2. Study priority of reconstruction needs in Iraq in general and their balanced distribution between geographical regions in Iraq.

#### **b. Ministry of Planning and Development Cooperation**

The Ministry keeps track of financing sources for projects in the various sectors and coordinates with other Iraqi Ministries in the areas of projects, development activities, monitoring of project implementation, and identification of pitfalls in the various sectors, through the Program Monitoring Office (PMO). In cooperation with the Ministry of Finance, the Ministry makes recommendations to the ISRB with regard to the priorities of the various sectors. In addition, the two Ministries work together to differentiate between investment projects for which international financing is sought and the investment plans incorporated in the national budget.

The Iraqi Strategic Review Board and the Ministry of Planning and Development Cooperation also seek to coordinate reconstruction and rehabilitation demands throughout the regions and governorates through a systematic consultation process. This allows the Iraqi authorities to provide a comprehensive assessment of short- and medium-term priorities, and to tailor the reform program accordingly.

**IRAQ'S NATIONAL DEVELOPMENT STRATEGY**  
IRAQI STRATEGIC REVIEW BOARD

In this regard, representatives of the Ministry of Planning and Development Cooperation undertook a series of consultations with the northern governorates in April 2004 to develop a mechanism to incorporate the capital budget requirements of the three governorates, as well as to agree on common criteria for selection and inclusion of priority projects within a comprehensive envelope.

**c. Council for International Coordination**

Founded in 17 June 2003, the Council is a key point of communications between donor countries and the Iraqi government, facilitating the participation of the international community in Iraq reconstruction process. The Council presently consists of: Australia, Bahrain, Bulgaria, Canada, Czech Republic, Denmark, France, Germany, Italy, Japan, Jordan, Korea, the Netherlands, the Philippines, Poland, Portugal, Romania, Singapore, Slovakia, Spain, Turkey, Ukraine, UAE, UK, and USA.

International Trust Funds

In light of decisions during the Madrid Donors' Conference of 23-24 October 2003, the International Reconstruction Fund Facility for Iraq was established as a channel to finance reconstruction projects. The facility consists of the World Bank Iraq International Reconstruction Fund (WBIRF) managed by the World Bank, and the United Nations Fund (UNIRF) managed by UNDP on behalf of all UN agencies.

In addition to the two international funds, several other channels of cooperation with Iraq exist. Several countries and the European Union have active bilateral aid programs. Iraq is working to regularize its status with the World Bank and the IMF.