

THE WORLD BANK IRAQ TRUST FUND

REPORT TO DONORS

March 30 – September 30, 2004

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ABBREVIATIONS AND ACRONYMS

EC	European Commission
EOI	Expressions of Interest
EU	European Union
G-7	Group of Seven Industrialized Countries
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Assistance
IFC	International Finance Corporation
IMF	International Monetary Fund
IRFFI	International Reconstruction Fund Facility for Iraq
ISRB	Iraqi Strategic Review Board
ITF	Iraq Trust Fund (World Bank)
PEP-MENA	The Private Enterprise Partnership for the Middle East and North Africa
PIU	Project Implementation Unit
PMT	Project Management Team
SBFF	Small Business Financing Facility
TAL	Transitional Administration Law
UN	United Nations
UNDG	United Nations Development Group
UNDP	United Nations Development Program
US	United States

DEFINITIONS

A “**pledge**” is an indication of intent to mobilize funds for which an approximate sum or contribution is specified.

A “**donor commitment**” is a pledge that has been expressed in a specific sum and formalized by an Administration Agreement between the donor and the World Bank as Administrator of the World Bank Iraq Trust Fund.

An “**allocation**” refers to a notional set aside by the World Bank for a discrete activity under preparation.

An “**approved project**” is a project for which a Grant Agreement has been negotiated and signed with the Recipient.

A “**project commitment**” is an amount for which contracts have been tendered, signed, or completed.

A “**disbursement**” is the actual transfer of an amount pursuant to a project commitment, for expenditures made or to be made in compensation for works, goods, and services.

INTRODUCTION

As Administrator of the World Bank Iraq Trust Fund (ITF), the World Bank has agreed to furnish to the contributing donors, on a semi-annual basis, a report describing the operations of the ITF during the preceding six months, including contributions, disbursements, and implementation progress.

The World Bank has prepared this first World Bank Iraq Trust Fund Report to Donors for the IRFFI Donor Committee Meeting in Tokyo on October 13-14, 2004. This Report covers the period March 30, 2004 (the effectiveness date of the ITF) to September 30, 2004.

A second Report to Donors, to be prepared in early 2005, will cover the period to December 31, 2004. Subsequently, World Bank Iraq Trust Fund Reports to Donors will be prepared on a semi-annual calendar year basis.

I. BACKGROUND AND COUNTRY CONTEXT

A. The International Reconstruction Fund Facility for Iraq

1. **Mandate.** At their meeting on April 12, 2003, the Group of Seven Industrialized Countries' (G-7) Finance Ministers and Central Bank Governors recognized the need for a multilateral effort to rebuild and develop Iraq. United Nations (UN) Security Council Resolution 1483 (May 22, 2003) noted the statement of the G7 and called for the international financial institutions to assist the people of Iraq in reconstruction and to facilitate assistance by the broader donor community. In response, on June 24, 2003, the UN hosted a meeting of some 50 states which, collectively, became known as the Liaison Group. The Liaison Group, in turn, requested a small number of major donors, known as the Core Group, to convene a Donors' Conference. The Liaison Group also asked the World Bank and the UN to assess Iraq's reconstruction needs, and to design a multi-donor trust fund to coalesce donor support around Iraq's priority reconstruction needs.

2. **Joint Needs Assessment.** The World Bank and the UN, with support from Iraqi national officials and the International Monetary Fund (IMF), conducted a Needs Assessment during the period June through August 2003. The Needs Assessment was finalized following consultations in Dubai and Madrid with the Core Group, representatives of Iraq's Governing Council, Iraqi sector ministries, and the Coalition Provisional Authority. The final document was presented at the Donors' Conference in Madrid on October 23-24, 2003, where it was endorsed by the donors present and representatives of the Iraqi Governing Council.

3. **The Design of IRFFI.** In parallel with the Needs Assessment, the Bank and the UNDG designed the International Reconstruction Fund Facility for Iraq (IRFFI). The IRFFI aims to help donors channel their resources and coordinate their support for reconstruction and development activities in Iraq in line with the priorities identified in the Needs Assessment and validated by Iraqi authorities. The World Bank and UN designed the structure, governance, and modalities of the IRFFI in close consultation with the Core Group, other donors, and Iraqi national authorities over the period August through December 2003 at meetings held in Washington, D.C., Brussels, New York, Dubai, Madrid, and Amman.

4. The IRFFI encompasses two trust funds: the World Bank Iraq Trust Fund (ITF) administered by the World Bank, and the UN Development Group Trust Fund (UNDG Trust Fund) administered by the United Nations Development Program (UNDP) on behalf of itself and participating UN organizations. The IRFFI is designed to ensure close cooperation and avoid duplication through a common governance structure, including a joint Donor Committee, a UN/World Bank Facility Coordination Committee, and a joint Secretariat.

B. The World Bank Iraq Trust Fund

5. **Eligible Sectors.** The ITF finances eligible operations in all sectors and cross-cutting themes identified in the Needs Assessment, with the exception of mine action, and with particular emphasis on areas where the World Bank has comparative advantage. The ITF does not finance humanitarian relief, peacekeepers, or other security, military, or political interventions.

6. **Recipients.** Recipients of grants from the ITF need to meet the World Bank's eligibility criteria, including financial viability. Recipient entities responsible for implementing activities financed from the ITF can be inside or outside Iraq, and include:

Iraqi ministries, governorates and municipalities, private entities, NGOs, UN agencies, or international financial institutions.

7. **Emphasis on Iraqi Ownership.** The ITF emphasizes Iraqi ownership and building Iraqi institutional capacity (see Box 1: The World Bank Iraq Trust Fund – Key Principles). Under the ITF, potential recipients, in consultation with World Bank staff, submit project proposals for approval to the Iraqi Strategic Review Board (ISRB), which determines whether proposals are consistent with priority needs. Following ISRB approval, the World Bank proceeds to appraise the project. For satisfactorily appraised operations, the Bank, as the ITF Administrator, and the recipient negotiate and sign a Grant Agreement which spells out the terms and conditions under which funds will be made available to the recipient entity. The Grant Agreement governs the actual use and disbursement of funds. It specifies measurable indicators to monitor implementation progress. It also contains detailed financial management, procurement, monitoring, and other fiduciary arrangements to ensure that funds are used for eligible expenditures.

8. **ITF Effectiveness.** On January 29, 2004, the World Bank Board of Executive Directors approved the World Bank to act as Administrator of the ITF. The ITF became effective upon receipt of the first deposit, on March 30, 2004.

Box 1: The World Bank Iraq Trust Fund – Key Principles

The World Bank Iraq Trust Fund operates under the following **principles**:

Iraqi leadership and priorities: The ITF finances projects that are considered to be high priority by the Iraqi Strategic Review Board.

Iraqi participation in project design and preparation: Iraqi teams are fully involved through the project processing cycle.

Iraqi implementation: Investment projects are implemented by Iraqi authorities using Iraq's own institutions.

Iraqi-led donor coordination: To ensure coordination and guard against duplication in funding, the Iraqi Strategic Review Board plays a central role in the project processing cycle.

Iraqi monitoring of project commitments and disbursements: The World Bank informs the Recipient, the Ministry of Planning and Development Cooperation, and the Ministry of Finance of project allocations and disbursements to guard against extra-budgetary financing.

C. The Interim Strategy of the World Bank Group

9. On January 29, 2004, the World Bank's Board of Executive Directors discussed the World Bank's Interim Strategy Note, which provides the framework for World Bank activities in Iraq, including those financed by the ITF. The Interim Strategy focuses on an incremental approach based on the Needs Assessment and on what can be done practically.

10. **Interim Strategy Objectives.** The work program identified in the Interim Strategy initiates activities on three tracks:

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

11. **ITF-Financed Projects.** The Interim Strategy relies on the ITF to finance projects.¹ Since March 30, 2004, one project (First Capacity Building, US\$3.6 million) has been completed and a second project (Emergency Textbook Provision, US\$40 million) is underway. Seven additional emergency operations amounting to about US\$317 million are at various stages of appraisal and approval. As a result, nearly all the funds currently on deposit in the ITF have been allocated. (For a short description of each project, see Part II: Status of the World Bank Iraq Trust Fund. Also, Project Information Documents have been distributed separately.)

12. **Economic and Sector Work.** The World Bank, through its own budget, is also laying the groundwork for Iraq's medium-term program through economic and sector work. To fully exploit cross-sectoral synergies, the economic and sector work program has been clustered into three themes: (i) economic reform and transition; (ii) poverty, safety nets and social development; and (iii) public sector management. In close collaboration with counterpart ministries, the World Bank is finalizing a number of short policy notes focusing on key reforms, including investment climate and state-owned enterprise reform, trade reform, telecommunication sector reform, financial sector reform, oil and gas sector reform, and social protection and safety net issues. This work is informing the policy agenda of the Interim Iraqi Government.

13. **Interim National Development Strategy for Iraq.** More recently, the World Bank has provided policy advice and inputs to the Prime Minister's Higher Economic Committee in drafting an interim National Development Strategy (NDS) for Iraq. The NDS seeks to

¹ As of the transfer of authority to an Interim Iraqi Government on June 28, 2004, Iraq has a de jure government that can access Bank resources, pending clearance of arrears (about US\$100 million, which is included in Iraq's 2004 budget). As of this writing, the Interim Iraqi Government has not formally requested to access IDA/IBRD.

provide an overall vision for the Iraqi economy, identify sector needs, and place external finance requirements within a multi-year fiscal context.

14. **The International Finance Corporation.** The International Finance Corporation (IFC) continues to make progress in implementing its two initiatives that were approved by the World Bank's Board of Executive Directors in December 2003. Under the Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA), IFC has finalized a Financial Sector Review of private Iraqi banks, which identifies gaps and needs in banking institutions. IFC has identified bank training as one of the immediate priorities for the financial sector in Iraq. In June 2004, PEP-MENA conducted a three-day training session in Amman, attended by 48 Iraqi bankers from 19 banks. A more intensive, five-month training session was launched in September 2004. This training session, which aims at upgrading managerial and technical capacity of the financial sector, introduces state-of-the-art practices in risk management, retail banking, accounting and finance, asset liability management, foreign trade, bank performance monitoring, credit appraisal, and financial analysis.

15. For the Small Business Financing Facility (SBFF), IFC has identified the first participating financial institution to upgrade its financial statements to international standards, and will then provide loan financing for on-lending to micro and small businesses. There are some delays, however, in providing investments and technical assistance due to legal issues and security concerns. IFC is also considering equity investments in the banking sector and would like to stress the importance of maintaining a coherent set of banking laws and regulations. IFC has appointed a Head of Mission for Iraq, who is co-located with the World Bank Head of Mission in Amman.

D. Current Methods of Working in Iraq

16. Iraq is a founding member of the International Bank for Reconstruction and Development (IBRD). The Government of Iraq received six IBRD loans between 1950 and 1973. For over twenty years, however, no World Bank missions visited Iraq. The last loan closed in 1979, and Iraq has been in non-accrual status since 1990.

17. In early 2003, the World Bank began rebuilding its knowledge base on Iraq by initiating "watching briefs" covering all key economic sectors. World Bank staff visited Iraq in May 2003, following UN Security Council Resolution 1483, which called for a multilateral effort to rebuild Iraq. The World Bank worked intensively in Iraq during the summer of 2003 to prepare the UN-World Bank Needs Assessment. World Bank staff, along with UN and IMF staff, evacuated Iraq on August 20, 2003, following the deadly attack on UN Headquarters in Baghdad.

18. Given the security situation, the World Bank's Interim Strategy, for planning purposes, assumes that it will not be possible for World Bank staff to travel safely into Iraq through the period covered by the strategy. The World Bank has found ways to work in the current situation and to maintain frequent contact with Iraqi officials:

- (i) The World Bank's **Interim Iraq Office in Amman** is playing a key role in facilitating and hosting meetings and workshops with Iraqi officials and coordination with the UN. The IFC is co-located with the World Bank. The Interim Office, which includes Iraqi staff, is poised to relocate to Baghdad once that becomes possible.

- (ii) The World Bank **videoconferencing facilities** in Baghdad's conference center (Green Zone), the Ministry of Planning, and the Central Bank are used constantly, and will soon extend to the Ministry of Finance.
- (iii) The World Bank also has **Iraqi staff and consultants in Baghdad**—including a senior economist, a procurement specialist, and advisors on health, private sector development, and the financial sector.

E. Information Dissemination

19. **World Bank/UNDG Website for IRFFI.** A joint website (www.irffi.org) is scheduled to be available for public access during the week of October 11, 2004. The unique aspect of the site is that it is jointly managed and updated by World Bank and UNDP staff, using World Bank servers. A webmaster serves as the focal point for information posting from both institutions, with the assignment rotated every six months between the Bank and the UNDP.

II. STATUS OF THE WORLD BANK IRAQ TRUST FUND

(as of September 30, 2004)

A. Overview

20. Seventeen donors have pledged about US\$398 million to the World Bank Iraq Trust Fund (ITF). Donor commitments to the ITF (formalized through signed Administration Agreements) stand at US\$386 million. Thirteen donors have deposited US\$371 million in the ITF account (including the related holding account). Nearly all of the funds deposited have been allocated to operations that are either under implementation or preparation. One project (First Capacity Building Project) has been implemented and closed.

B. Pledges, Commitments, and Deposits

21. **Pledges.** Seventeen donors have pledged about US\$398 million to the ITF. Pledges, commitments, and deposits by donor are shown in Table 1.

22. **Commitments.** Fourteen donors have signed Administration Agreements for commitments totaling US\$386 million. The first Administration Agreement was dated February 26, 2004. Five Administration Agreements are dated in March 2004, and ten Administration Agreements are dated from April to September 2004. Sixteen Administration Agreements have been signed in total; two donors each signed two Administration Agreements.

Table 1: ITF Pledges, Commitments, and Deposits

Donors	Pledges in Donor Currency	Pledges (US\$ million)	Commitments (US\$ million)	Deposits (US\$ million)
Australia	AUD 14.0	10.2	10.2	10.2
Canada	CAD 30.0	22.3	22.3	22.3
EC	EUR 83.0	102.5	102.5	102.5
Finland	EUR 2.0	2.5		
Iceland	USD 1.0	1.0	1.0	1.0
India	USD 5.0	5.0	2.5	2.5
Japan	USD 130.0	130.0	130.0	130.0
Korea	USD 3.0	3.0	3.0	
Kuwait	USD 5.0	5.0	5.0	5.0
Netherlands	EUR 5.0	6.2	6.2	6.2
Norway	NOK 15.0	2.2	2.2	2.2
Qatar	USD 5.0	5.0	5.0	2.5
Spain	USD 20.0	20.0	20.0	10.0
Sweden	SEK 40.0	5.4		
Turkey	USD 1.0	1.0		
United Kingdom	GBP 40.0	71.4	71.4	71.4
United States	USD 5.0	5.0	5.0	5.0
Total		397.7	386.3	370.8

23. **Deposits.** Thirteen donors have made deposits amounting to US\$371 million in the ITF account (including the related holding account). The first three deposits (US\$1 million and US\$5 million to the ITF account and US\$90 million to the related holding account) were received on March 30, 2004, thereby activating the ITF. Commitments, deposits, and allocations to projects by month are shown in Table 2. Cumulative commitments, deposits, and allocations to projects by month are shown in Table 3.

C. Allocations

24. To move forward with project preparation as quickly as possible, the ITF allocates funds to projects based on donor commitments. Because the ITF operations on a “cash” basis, in the event a project is in the final stage of preparation but funds are not yet deposited in the ITF account or the funds on deposit are specified for a different sector, the project cannot be finalized and the Grant Agreement cannot be signed. Tables 2 and 3 show allocations to projects in comparison to donor commitments and deposits. Chart 1 presents a time-line graph of donors commitments and allocations to projects. Allocations per sector are shown in Table 4.

25. **Time lags for donor commitments and deposits.** Following the first IRFFI Donor Committee meeting in Abu Dhabi in February 2004, it took, on average, 75 days to sign an Administration Agreement. It took, on average, a further 27 days to deposit the funds into the ITF account.

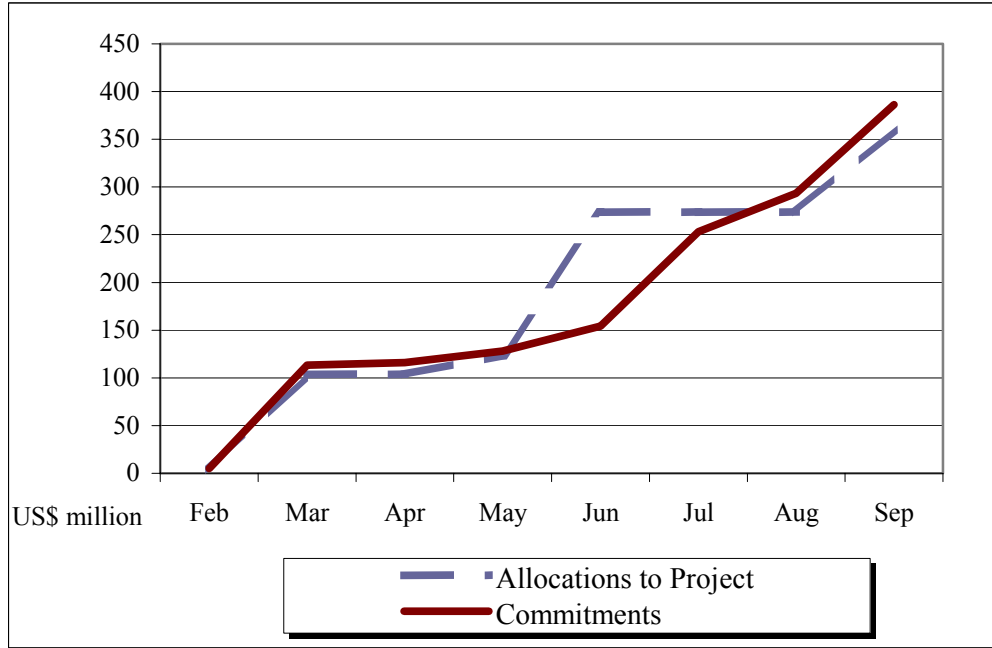
**Table 2: Monthly Commitments and Deposits
(US\$ million)**

	Feb.	March	April	May	June	July	August	Sept.	Total
Commitments	5.0	108.4	2.5	12.2	26.2	99.0	40.0	93.0	386.3
Deposits into ITF or Holding Account		96.0	107.4	5.0	103.7	8.7		50.0	370.8
Allocation to Projects	3.6	100.0		20.0	150.0			87.0	360.6

**Table 3: Monthly Commitments and Deposits (Cumulative)
(US\$ million)**

	Feb.	March	April	May	June	July	August	Sept.
Commitments	5.0	113.4	115.9	128.1	154.0	253.3	293.2	386.3
Deposits into ITF or Holding Account		96.0	203.4	208.4	312.1	320.8	320.8	370.8
Allocation to Projects	3.6	103.6	103.6	123.6	273.6	273.6	273.6	360.6

Chart 1: Donor Commitments versus Allocations to Projects



D. Sectoral Preferences

26. Only 34 percent of pledges and 35 percent of deposits are not tied to sectoral preferences. Nine donors have deposited US\$127 million in the ITF account without indicating a sectoral preference. Three donors have deposited in the ITF account and related holding account US\$234 million (65 percent of deposits) indicating a sectoral preference. Sectoral preferences are shown in Chart 2 and Table 4.

Chart 2: Sectoral Distribution of Donor Deposits by Amount (in percent)

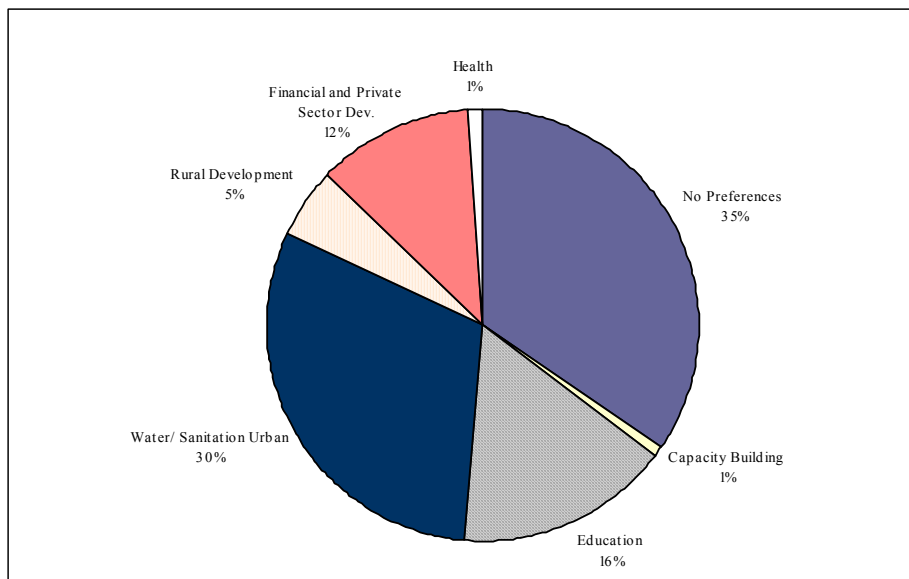


Table 4: Donor Deposits by Sectoral Preference
(US\$ million)

	No Preference	Capacity Building	Education	Water/ Sanitation Urban	Rural Develop.	Health	Financial / Private Sector	Total
Australia	10.2							10.2
Canada	22.3							22.3
EC		7.3	49.5	25.7	20.0			102.5
Iceland						1.0		1.0
India	2.5							2.5
Japan*				90.0			40.0	130.0
Kuwait	5.0							5.0
Netherlands	6.2							6.2
Norway	2.2							2.2
Qatar	2.5							2.5
Spain**				4.0		3.0	3.0	10.0
United Kingdom	71.4							71.4
United States	5.0							5.0
Total	127.2	7.3	49.5	119.7	20.0	4.0	43.0	370.8
Allocations to Projects		10.6	100.0	150.0	20.0	25.0	55.0	360.6

* US\$90 million is deposited in the ITF holding account.

** Amounts shown per sector are notional. Spain did not specify distribution between the three sectors.

E. Implementation Status

27. One project (First Capacity Building, US\$3.6 million) has been completed and another project (Emergency Textbook Provision, US\$40 million) is being implemented. Seven additional emergency operations amounting to US\$317 million are to be approved by year end.

Completed:

First Capacity Building Program (US\$3.6 million)

- Funded by EC Rapid Response Mechanism (first donor commitment to the ITF).
- Implemented from February-August 2004 (retroactive clause to February 9, 2004).
- Financed over 20 seminars and workshops that trained about 600 Iraqi officials from 19 ministries, the Central Bank, universities, and the private sector.
- Focused on key topics for Iraq's reconstruction – project management, financial management, procurement, environmental/social safeguards, macroeconomic reform, private and financial sector development, and specific topics in the education, health, and infrastructure sectors.

Underway:Emergency Textbook Provision Project (US\$40 million)

- Implemented by the Ministry of Education beginning in mid-May 2004.
- Financing the printing and distribution of 69 million textbooks (600 titles) for 6 million students in Iraq's primary and secondary schools (12 grades) in all 18 governorates for the 2004/05 school year.
- The Ministry of Education has signed over US\$27 million in textbook printing contracts.
- The Ministry of Education is delivering textbooks to schools at this time, and most deliveries will be completed by the end of October 2004, a substantial improvement over textbook deliveries in 2003.

Under Preparation (seven operations amounting to US\$317 million):Emergency Community Infrastructure Project (US\$20 million)

- Will finance labor-intensive water supply, sanitation, and irrigation rehabilitation in rural areas throughout Iraq using a flexible programmatic approach and increasing community involvement.
- Individual subprojects to range up to US\$1 million.
- Negotiations are completed. The project will be approved (Grant Agreement signed) in October 2004.

Emergency School Construction and Rehabilitation Project (US\$60 million)

- Redesigned at the request of the new Minister of Education.
- Will finance construction of new buildings for about 110 existing primary and secondary schools in unsafe or overcrowded facilities, and major rehabilitation of about 140 schools.
- Reappraisal completed in September 2004. Negotiations and approval will take place in October 2004.

Second Capacity Building Project (US\$7 million)

- A follow-up to the successful First Capacity Building Project to support the authorities in tackling medium-term policies.
- To be approved in October 2004.

Emergency Baghdad Water and Sanitation Project (US\$60 million)

- Will finance rehabilitation of water supply and sanitation infrastructure throughout Baghdad, including a large portion of sewerage system rehabilitation and extension (US\$32 million) in Sadr City.
- Complements US investments in Baghdad water treatment facilities.
- Appraisal is completed. To be negotiated/approved by November 2004.

Emergency Water Supply and Sanitation and Urban Development Project (US\$90 million)

- Finances water supply and sanitation rehabilitation in nine governorates; and urban reconstruction (roads, sidewalks, community centers, etc.) in the poorest areas of four governorates.
- Appraisal is completed. To be negotiated/approved by November 2004.

Emergency Health and Rehabilitation Project (US\$25 million)

- Aims to improve quality emergency services in selected health facilities.
- Will finance rehabilitation of priority emergency services, including emergency obstetric care, in 10 selected hospitals. Rehabilitated hospitals will also receive basic medical and laboratory equipment and a 3-6 month supply of up to 30 essential emergency medicines.
- To be appraised in October 2004 and negotiated/approved by November 2004.

First Private Sector Development Project (US\$55 million)

- Aims to fill critical gaps to improve the investment climate and develop the private sector.
- Finances part of the telecommunications backbone (US\$40 million) and related infrastructure needed for a payment system. Also develops and strengthens the institutional framework for private sector development (investment promotion, export promotion, and small and medium enterprise reform agencies); and provides direct support (through pilot funds) for private sector opportunities.
- Appraisal is scheduled for October 2004, and negotiations and approval are expected by December 2004.

F. Implementation and Fiduciary Arrangements

28. ITF-funded operations are implemented by Recipients, which are in most cases Iraqi ministries. The World Bank, as the ITF Administrator, will supervise ITF-funded operations in accordance with the World Bank's applicable policies and procedures. The strategy of the World Bank in Iraq is to put in place implementation arrangements that rely to the maximum extent possible on Iraq's own institutions. At the same time, the World Bank is working with ministries to strengthen their controls and putting into place measures to provide additional assurances, such as Monitoring Agents.

29. **Project Management Teams.** In many emergency and conflict-affected environments, the World Bank and other donors rely on ring-fenced Project Implementation Units (PIUs). Experience elsewhere, however, has indicated that use of PIUs can undermine long-term sustainability and institution building. In Iraq, the World Bank is striving to avoid the institutional disincentives caused by enclave PIUs through use of dedicated ministry staff and consultants constituting a flexible project management team (PMT). PMT staff are civil servants paid by the ministry using the regular pay scale. The World Bank provides intensive training to PMT staff before and during project approval in all aspects of project management, including procurement and financial management. PMTs are thus designed to provide the skills needed for effective project implementation, yet be flexible and easily reintegrated into the ministry's institutional structure.

30. **Monitoring Agent.** While staff travel to Iraq is restricted, the World Bank will employ two experienced firms as monitoring agents to help ensure that ITF funds are used only for the purposes intended and according to applicable Bank procedures.

31. In May 2004, the World Bank issued a request for Expressions of Interest (EoI) for the Monitoring Agent assignment. Of the twelve responses, no firm offered the required qualifications in both procurement and management, and environmental and social safeguards. The World Bank, therefore, split the assignment into two contracts—a Project Management Monitoring Agent and a Safeguards Monitoring Agent—and reissued the

request for EoIs. The responses for the second round have been received. A request for proposals will be issued following evaluation of the responses.

32. The Project Management Monitoring Agent will be responsible for monitoring the full cycle of financial management requirements and procurement transactions under each project covered by an ITF Grant Agreement; support initiatives to strengthen fiduciary capabilities of implementing agencies; and support the World Bank in conducting its reviews and audits.

33. The Safeguards Monitoring Agent will be responsible for ensuring that the environmental and social safeguard procedures designed for Iraq are applied; assist in the design and implementation of safeguard procedures; and conduct post-reviews of selected subprojects.

G. Disbursements

34. ITF grant proceeds are disbursed in accordance with the appropriate policies and procedures of the World Bank. As part of the compensating controls, disbursements in Iraq at this stage are made primarily by direct payment by the World Bank to the contractors, consultants, and vendors. Small payments (e.g, below US\$10,000) are made through payments by the Recipient from its own resources. These payments made from the Recipient's own resources are reimbursed, on a periodical basis, by the World Bank upon presentation of proof of payment and a signed withdrawal application. Main financial counterparts in project management teams are receiving intensive training in World Bank disbursement procedures.

35. During the period covered by this Report, ITF project disbursements amount to US\$2.1 million for payments associated with the First Capacity Building Project. Additional payments for the First Capacity Building Project may be made for invoices received within four months after the project's closing date of August 9, 2004. In many cases, such as the Emergency Textbook Provision Project, disbursements are made after the goods and services are rendered. The Ministry of Education has signed over US\$27 million in textbook printing contracts under the Emergency Textbook Provision Project.

H. The World Bank's Cost Recovery and Investment Income

36. The World Bank recovers the cost of its administration and management support to the ITF under two categories:

- (i) An administrative fee that helps recover the cost of central services provided by the trust fund accounting, legal, and other support units. The fee is set at 0.4% for technical assistance projects and 0.2% for investment operations. The administrative fee is deducted upon the signing of each Grant Agreement.
- (ii) Actual full cost of other support, which covers eligible expenditures for the following:
 - World Bank staff and consultants involved in activities that are solely for carrying out the World Bank's responsibilities under the ITF. The activities include: project analysis, appraisal, supervision, including procurement, financial management, safeguards, and other project specific activities.

- The ITF management team at headquarters and 50% of the cost of the joint World Bank/UN Secretariat.
- Costs of contracts for the Monitoring Agents and for independent review of their performance.

37. During the period covered by this Report, the Bank's cost recovery was US\$937,000, of which US\$99,000 was the administrative fee (the latter for the First Capacity Building Project and Emergency Textbook Provision Project). The services delivered against this amount include the preparation and negotiation of Administration Agreements, setting up of trust fund operations, management of the fund, and the work of World Bank project teams on nine operations. The amount represents 0.26% of the US\$361 million allocated to projects under implementation or preparation. Cost recovery by project and type of expenditure is shown in Table 5.

38. Cost recovery may increase in subsequent reporting periods due to: (i) staff costs associated with the seven projects that are in the final stages of intensive preparation; and (ii) administrative fees for the seven operations under preparation, which will be deducted upfront when Grant Agreements are signed.

39. **Investment Income.** The World Bank invests donor deposits pending their disbursement. Investment income earned on these funds is deposited into the account to be used for the purposes of the ITF. The investment income earned on ITF deposits during the reporting period is US\$1,272,279.86.

Table 5: Cost Recovery by Project and Type of Expenditure
(US\$)

	TF053167	TF053196	TF053541	TF053542	TF053544	TF053543	TF053552	
	Main Trust Fund	Capacity Building I	Emergency Textbook Provision	School Rehabilitation	Infrastructure Rehabilitation	Community Infrastructure	ITF Administration	Total
Staff Costs		13,435	67,825	105,829	132,481	87,254	133,368	540,192
Consultants			7,000	24,572	20,350	2,205	35,393	89,520
Travel		26,009	19,475	68,110	46,725	18,888	26,239	205,446
Communications			112	1,425			261	1,798
Training Logistics								-
Admin. Fee	99,600							99,600
Other							1,215	1,215
Total	99,600	39,444	94,412	199,936	199,556	108,347	196,476	937,771

Note: Due to a lag time in posting expenditures, figures for the final month (September) are subject to change.

I. Use of Future Deposits

40. Of the US\$398 million in donor pledges and US\$386 million in donor commitments, there remain US\$27 million in outstanding pledges and US\$16 million in outstanding commitments. During the IRFFI Donor Committee Meeting in Doha in May 2004, donors agreed to deposit all outstanding commitments to IRFFI by the end of December 2005. Following on their receipt, the World Bank will use the additional funds to supplement current ITF-financed projects under preparation, especially the Emergency Health and Rehabilitation Project, the Emergency Baghdad Water and Sanitation Project, and the Emergency Water Supply and Sanitation and Urban Development Project, where Iraqi requests exceed the amounts available in the ITF.

41. In order for the ITF to continue channeling donor funds to Iraqi priority projects, additional funds are needed. The World Bank plans to use a two-pronged strategy for use of additional funds: (i) deepen involvement in the sectors where ITF-funded operations have a good implementation track record and are showing results; and (ii) commence operations in a few additional priority sectors where the World Bank has a comparative advantage and where there is a strong dialogue with Iraqi counterparts, such as electricity.

III. COMMENTS AND OBSERVATIONS

42. The ITF has been effective for a relatively short period of time. However, there are a few comments and observations that can be made from experience to date, as well as from experience in other conflict-affected environments:

- (i) **Increase Iraqi Leadership and Ownership.** Given the magnitude of Iraq's challenges and the large number of external partners providing and expected to provide support to the country, it is important to build towards a comprehensive development framework-type process, whereby Iraq leads the coordination of external partners and a country-owned national development strategy provides a common framework for external assistance. Iraq's interim National Development Strategy is an excellent first step in this direction.
- (ii) **Initiate Iraqi-Led Sectoral Meetings.** During the interim period, sectoral meetings led by the line minister and attended by all external partners interested in the sector could help move the sectoral dialogue toward a sector-wide approach.
- (iii) **Support a Comprehensive Budget Framework.** It is important for the Iraqi authorities to begin to reflect all donor-financed capital expenditures in the Government's budget. This allows for transparency in spending, and supports the development of a multi-year budget framework that allows the authorities to plan effectively for future recurrent expenditures.
- (iv) **Implement Operations Using Iraq's own Institutions.** Iraqi ownership of the reconstruction process is essential for both stability and sustainable development. Reliance on Iraqi institutions to implement projects could initially be slower than direct contracting or outsourcing to parallel institutions, but it is likely to be more effective by building both ownership and institutional capacity.
- (v) **Agree on Common Terminology for Donor Assistance.** Aid effectiveness and transparency could increase if donors would agree on common definitions for terms used frequently in relation to donor assistance, such as pledges, commitments, allocations, and disbursements. An important first step would be to harmonize the language used by the World Bank and UNDP within the framework of the IRFFI.
- (vi) **Maintain Flexibility.** Iraq will continue to undergo political and economic transitions for the next few years. The environment necessitates a flexible approach to donor preferences that allows Iraqi authorities and international institutions to redirect funds in a balanced way to areas of emerging needs.