

## **World Bank Iraq Trust Fund**

Update to IRFFI Donor Committee  
Naples, Italy – February 18, 2009

### **Public Finance Management Project**

#### **I. BACKGROUND/KEY DEVELOPMENT ISSUES**

1. Numerous studies prepared by the Bank, the IMF, US Agency for International Development (USAID), UK Department for International Development (DFID), and others, indicate that poor financial management leads to poor budget execution, and delays the pace and impact of reconstruction activities. The Government of Iraq (GOI) has made some progress in reforming public expenditure policy and management, which has had a positive impact on capital budget execution rates in 2008 compared to 2007. Despite these gains, the GOI continues to face problems in implementing the capital budget as intended, while current expenditure has risen rapidly. In order to further its growth and development, the GOI will need to make progress on key fiscal and institutional challenges.

2. The *budget preparation* process in Iraq is weak. Line ministries are not provided with a ceiling within which to prepare the budget, leading to considerable time being spent on negotiating the budget between the line ministries and the central ministries. The strategic prioritization of the budget is hampered by the lack of multi-year costed strategies in the line ministries. There is no well defined process for vetting new capital spending, and the technical capacity of staff to evaluate and approve projects has eroded, leading to poor project selection. Decisions on capital and recurrent spending appear to be largely disconnected.

3. *Capital budget execution* also remains weak. While budget execution rates have been improving, they still remain fairly low due to a wide variety of factors, including the ineffective upstream budget preparation process outlined above. In addition, a lack of institutional capacity in the line ministries leads to poor project preparation, and ineffective coordination between project teams and administrative staff. Budget execution is also delayed by: (i) weak project implementation plans; (ii) site preparation problems and land disputes; (iii) unavailability of qualified contractors; (iv) a slow payment process; and (v) outdated cash budgeting system. In addition, the security situation impedes project implementation in some locations.

4. The *cash management system* needs to be modernized. Currently, Iraq uses a cash-based payments system which provides authority to make cash payments over one fiscal year only, precluding the ability to make multi-year commitments.

5. The *control environment* needs to be strengthened. Reporting is incomplete and while the new chart of accounts has been defined, it is not yet uniformly used at all levels of government, leading to a weak control environment. Independent audits of all GOI budget accounts for any recent financial year have either not been undertaken, or have not been made available.

#### **II. STRATEGIC CONTEXT/DONOR COORDINATION**

6. The proposed project is consistent with Iraq's National Development Strategy, and the GOI has demonstrated its commitment to improving public sector governance by putting public finance management (PFM) issues at the heart of the socio-economic pillar of the International Compact for Iraq. The World Bank's program in Iraq is committed to helping Iraq use its

resources more efficiently and transparently. The Interim Strategy Note (ISN) for Iraq for FY09-11 recognizes the crucial importance of supporting policies and institutions that improve the management of public resources and create a more efficient PFM system to promote longer-term, broad-based, economic growth.

7. The Bank is working closely with the Ministries of Finance, Planning and Development Cooperation, Education and Health at the central and regional level, as well as provincial level. A number of donors have been supporting specific PFM issues (e.g. IMF, UN, UK, US). Donors have largely invested in providing advisors to build capacity in various line ministries on implementing the existing regulations to improve the pace of budget execution. However, the effectiveness of this support could be improved with stronger coordination. The proposed project provides one mechanism that should help Iraq address PFM issues in a systematic fashion, and improve coordination among donors.

### **III. RATIONALE FOR BANK INVOLVEMENT**

8. The World Bank has extensive experience in providing guidance on good practices in PFM reform, worldwide, and with Iraq's neighbors. The World Bank has had substantial involvement over the last three years in assisting the GOI evaluate the current PFM systems, through several analytical studies. The project responds to a GOI request for World Bank assistance in implementing key reforms identified through these analyses.

### **IV. PROPOSED PROJECT DEVELOPMENT OBJECTIVE**

9. The project aims to support the GOI implement more effective, accountable and transparent PFM by strengthening: (i) budget formulation, execution and control; (ii) public financial reporting; (iii) public procurement; and (iv) institutional capacity in PFM. Cross-cutting PFM reforms will be implemented in the national system and extended or adjusted to the sub-national system, where appropriate.

### **V. PROJECT DESCRIPTION**

10. The project will build on several analytical reports, including the Subnational Public Financial Management Report and the Public Expenditure and Institutional Assessment, both of which were undertaken in close cooperation with the GOI authorities. The project, valued at US\$18 million) will include the following components:

- i) Strengthen Budget Preparation and Expenditure Programming;
- ii) Strengthen Public Sector Procurement;
- iii) Strengthen Budget Execution and Implementation; and
- iv) Conduct Training and Capacity Development.

11. The project will finance international and local technical assistance, limited goods, and significant training and capacity building for staff of the Ministry of Finance (MOF), other line ministries, and provincial and local authorities. The project will implement a dedicated Project Implementation Unit (PIU) within the MOF. The Central and KRG MOPDC, and line Ministries selected for direct assistance, will establish smaller Project Implementation Teams to handle day-to-day project-related tasks.

12. In addition to the activities implemented by the MOF, totaling US\$16 million, the World Bank will establish a smaller complementary grant of US\$2 million to provide technical

assistance, including formal training, on-the-job training, and just-in-time advisory services by World Bank staff and international consultants. The technical assistance grant will be executed by the World Bank at the request of the MOF to help ensure speedy implementation of the project.

13. The project will be the first stage in a multi-year strategy for budget reform. The GOI is consolidating its reform strategy with an action plan to specify the reforms that will be undertaken at each stage.

#### **VI. STATUS OF PROJECT AND TIMELINE FOR APPROVAL**

14. The project has been prepared and appraised in close collaboration with the MOF. Negotiations are expected to be held at end-February 2009, with project approval in March 2009.