



THE WORLD BANK

**The World Bank in Iraq:
Iraqi Ownership for Sustainability**

Faris Hadad-Zervos

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The findings, interpretations, and conclusions expressed herein are those of the author and do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent.



**Iraq Country Unit, Middle East Department
Middle East and North Africa Region
The World Bank**

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Abbreviations and Acronyms

AACA	Afghanistan Aid Coordination Agency
BiH	Bosnia and Herzegovina
CDR	Council for Development and Reconstruction
CFAR	Country Financial Accountability Report
CPA	Coalition Provisional Authority
CPAR	Country Procurement Assessment Report
CIC	Council for International Coordination
DAC	Development Assistance Committee (OECD)
DFI	Development Fund for Iraq
ESSAF	Environmental Social Screening and Accounting Framework
ESW	Economic and sector work
FY	Fiscal Year
GDP	Gross domestic product
IAMB	Iraqi Advisory and Monitoring Board
IBRD	International Bank for Reconstruction and Development
ICB	International competitive bidding
IDA	International Development Association
IFC	International Finance Corporation
IIG	Iraqi Interim Government
ITF	Iraq Trust Fund (World Bank)
ITG	Iraqi Transitional Government
IMF	International Monetary Fund
IRFFI	International Reconstruction Fund Facility for Iraq
ISBFF	Iraq Small Business Fund Facility
ISRB	Iraqi Strategic Review Board
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
MIGA	Multilateral Investment Guarantee Agency
MIM	Master Implementation Manual
MoPDC	Ministry of Planning and Development Cooperation
NCB	National competitive bidding
NDS	National Development Strategy
NID	New Iraqi dinar
OECD	Organisation for Economic Co-operation and Development
OP	Operational Policy
PECDAR	Palestinian Economic Council for Development & Reconstruction
PEP-MENA	Private Enterprise Partnership for the Middle East and North Africa
PER	Public Expenditure Review
PIC	Peace Implementation Council
PIU	Project Implementation Unit
PMT	Project management team
SBFF	Small Business Financing Facility (IFC)
TAL	Transitional Administrative Law
UN	United Nations
UNDG	United Nations Development Group
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNTAET	UN Transitional Administration for East Timor

1. Introduction

1. Iraq's reconstruction and development takes the World Bank to its core mission, while also presenting challenges without recent precedent. Iraq is a unique country with abundant natural resources; a once skilled, educated, and relatively prosperous society; a significant diaspora population; and an advanced infrastructure that has been destroyed by a complex mix of war, sabotage, and neglect. Both the natural and social resources have been disrupted by a long history of conflict and economic decline.

2. The country faces the twin challenges mentioned above, as well as a third one: the transition from an oil-based to a diversified economy. Ample resources, even oil, are not enough to assure sustainable development. Natural resource endowment can be a source of prosperity for some countries, but a catalyst for poor governance and conflict in others. This places the goal of institutional development at the heart of Iraq's reconstruction program.

3. This combination of post-conflict reconstruction and a need for long-term institution building reaches back to the World Bank's origins to rebuild the economies of Europe and Asia after World War II, and forward to its current collaborative approach to sustainable development. Post-conflict reconstruction is at the heart of the World Bank's mission, dating from the creation of the International Bank for Reconstruction and Development (IBRD) after World War II. That mission has since evolved into poverty reduction, including financial and policy assistance to developing countries. Over the past 15 years, there has been an increasing focus on institutional capacity building to sustain reconstruction and advance the transition to development. A 2003 World Bank study showed that developing countries with poor policies and institutions are 15 times more likely to suffer from conflict than the richest countries. It follows that reconstruction is first and foremost an institutional issue.

4. Since 1990, the World Bank has substantially increased its assistance to conflict-affected countries, recognizing that, in addition to physical reconstruction, the World Bank and other donors should support the development of institutions and help build capacity for sustainable development—the capacity to develop and implement reconstruction programs, adopt transparent macroeconomic policies, govern well, generate growth and employment, maintain social safety nets, and provide access to social services. In other words, in many of countries, post-conflict reconstruction has meant not only a transition from conflict to peace, but also a transition from a planned to a market-based economy, with a critical role for government as an enabler of social and economic progress.

5. While the Bank's current focus in Iraq is on reconstruction and essential services, the near term offers a chance to lay the groundwork for credible institutions of social inclusion, in addition to supporting sustainable reconstruction and reform. This will also allow Iraq, a country with ample natural and human capital, to look past the immediate needs of post-conflict reconstruction to an eventual return as a middle-income country that managed its own affairs and contributed assistance to other countries.

6. This paper examines the experiences of the World Bank Group in other countries, and explores its work in Iraq in light of its mandate and areas of impact. It outlines the objectives the Bank Group has sought to meet and the procedures used to adapt to the Iraqi context, while focusing on transparency, inclusiveness, and sustainability.

7. In carrying out its work in Iraq, the Bank returns to its core mandate while employing its many new areas of expertise. This goes beyond short term needs, into supporting the Iraqis in owning, absorbing, and managing the reconstruction and reform program over the long term. This view has governed the choice of projects, the process by which they have been implemented, and the tradeoff between speed and long-term impact.

8. Such a lengthy effort will take some time to evaluate. The Iraq experience will contribute greatly to the World Bank's own mandate and processes. It is a relationship that has been long and deep, that has lapsed, and that is now renewed in one the most challenging endeavors the World Bank has ever undertaken.

2. The Iraqi Setting and the World Bank Program

2.1 Background on Iraq's Political and Economic Situation

9. Despite having the world's second-largest oil reserves and considerable gas reserves, ample water, and a tradition of attention to health and education, Iraq is a country where all development indicators are dismal. There is a perilous mixture of low indicators, heavy dependence on oil, and large numbers of unemployed youth.

10. It has not always been this way. Iraq has had a long tradition of strong public and private institutions, a capable cadre of civil servants, and a sound basic legal infrastructure. However, years of conflict, mismanagement, and sanctions have isolated the country from international experiences and practices, both technologically and in most areas of governance.

11. Economically, after hitting a low of US\$12 billion as a result of the conflict in 2003, GDP recovered in 2004 to almost US\$26 billion, and income per capita to about US\$940. This is below the 2000 level, which itself was quite low from two decades of debilitating wars and international sanctions. Even if growth continues into 2005 as projected, GDP per capita will be just a quarter of what Iraq enjoyed 25 years ago.

12. Almost 25 percent of the population remains highly dependent on food rations. Formal safety nets cover less than 5 percent of population and the rest are vulnerable to imminent financial crisis. Non-communicable diseases, usually prevalent in developed countries, are at the same level as incidents of communicable diseases from poor quality of water and sanitation. And, according to a recent World Food Program survey (UNWFP 2004), more than one-quarter of Iraq's children suffer from chronic malnutrition.

13. While recent employment surveys suggest that unemployment is about 30 percent, it is estimated that total unemployment and underemployment stand at 50 percent. Unemployment among young urban men is twice as high, while women's labor participation is very low even by the MENA standards. In the absence of comprehensive debt reduction, Iraq's external debt is over three times its GDP.

14. The main engine of recovery is the oil sector, which accounts for about 70 percent of GDP and over 98 percent of exports and Government revenues. Another engine is private spending, which had risen because of increases in civil servants' salaries and remittances from abroad. The extent of this spending is apparent in the rise in private sector imports. But security concerns have slowed investment and raised the cost of doing business in Iraq. In addition, the security situation has undermined the Government's ability to raise non-oil revenues, which remain at roughly 2 percent of the total.¹

¹ Anecdotal evidence suggests that 20–30 percent or more of international contracts go toward the cost of private security firms protecting contractors, suppliers, and consultants. This does not include insurance-related costs.

15. The security situation has therefore had a large impact on Iraq's economic recovery and on its capacity to move away from dependence on external donor resources. It has also slowed the pace of international participation in the reconstruction process, technical assistance, and capacity building. The past year has seen an exodus of international aid organizations and diplomatic missions. Iraqi staff of international organizations have also become targets for threats and attacks.

2.2 Early Reform Efforts

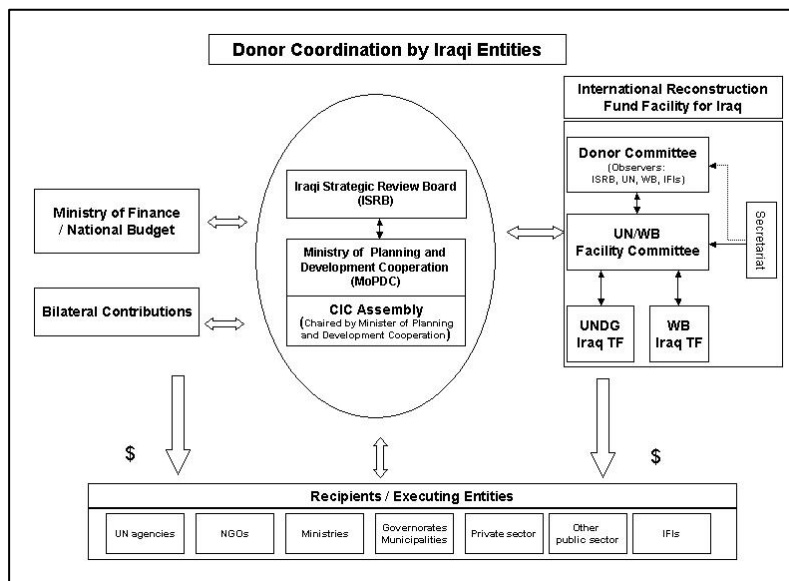
16. Notwithstanding these constraints, in early 2003 the Coalition Provisional Authority (CPA) and the Governing Council took steps to spur Iraq's recovery and coordinate the flow of aid and the overall reconstruction effort. (See Annex 1 for more information about the current Iraqi Government.)

17. Early attempts were also made to coordinate aid and the overall reconstruction effort. CPA regulation no. 7 of December 2003 set out a framework for donor coordination, including bilateral and multilateral aid, and established the Iraqi Strategic Review Board (ISRB). The ISRB, a committee consisting of the minister of planning and development cooperation, the minister of finance, a representative of the CPA,² and two ISRB secretariat members, acts as a focal point for coordinating donor activities, including loans, grants, guarantees, and technical assistance.³ While the reconstruction programs are to receive prior ISRB clearance to prevent duplication, the relevant sector ministries are charged with direct coordination in the implementation of these programs. The Council for International Coordination (CIC), chaired by the Ministry of Planning and Development Coordination MoPDC), was set up to provide advice and support to the minister on coordination issues. It includes donors and other key partners involved in the reconstruction of Iraq (figure 2.1).

² After the Americans transferred power to the Iraqi Government on June 28, 2004, the CPA representation was changed to a rotating donor representation.

³ For a list of regulations, see <http://www.iraqcoalition.org/regulations/index.html#Regulations>.

Figure 2.1: Early Coordination Mechanisms



2.3 Iraq’s New Governments and Their Economic Steps

18. The CPA was succeeded by the Iraqi Interim Government (IIG), which took important steps in 2004 to strengthen ownership of the policy-setting process and to address institutional weaknesses. Interministerial committees were created to tackle economic reform, oil policy, reconstruction, privatization, and reorganization of the Iraqi stock exchange, among others.

19. In October 2004, the IIG drafted a medium-term National Development Strategy (NDS)⁴ to outline a vision for Iraq anchored in market-focused reforms, economic diversification, and strong social safety nets. The NDS stresses sustained employment and growth through improved security, an effective reconstruction program, and market reforms. The strategy highlights the importance of capacity building to allow the Iraqi Government ownership of the reconstruction and reform agenda (Annex 1).

20. During the preparation of this report, a new cabinet was approved by the Iraqi Transitional National Assembly, formed after Iraq’s successful elections in January 2005. While the new Government is currently organizing itself, there have already been efforts to develop policies for strong and transparent institutions and sound financial management. A Cabinet Committee for Economic Development and Finance has been established, consisting of the ministers of finance, planning and development cooperation, oil, trade, electricity, and the central bank. A Reconstruction Coordination Committee has also been established, incorporating the ministries of finance and planning, among others.

⁴ The National Development Strategy (NDS) was developed by an interministerial committee led by the Ministry of Planning and Development Cooperation. It can be accessed at www.irffi.org.

2.4 The World Bank and Iraq: Renewed Contact with a Founding Member

21. Iraq was a founding member of the World Bank, and received six IBRD loans between 1950 and 1973. The last loan closed in 1979, and Iraq had not been making payments on its outstanding loans since 1990. In early 2003, the Bank and the United Nations Development Group (UNDG) initiated a joint needs assessment, with the participation of the International Monetary Fund (IMF). This provided the basis for an international donors' conference for Iraq in Madrid on October 23–24, 2003. In Madrid, the World Bank and UNDG presented the International Reconstruction Fund Facility for Iraq (IRFFI), to help donors channel their resources quickly and coordinate their support for reconstruction in Iraq.

22. Prior to the handover of administrative powers to the IIG in June 2003, and the clearance of about \$108 million in payments owed to the World Bank in December 2004, the Iraq Trust Fund (ITF) represented the only source of financing for the World Bank.

23. Since then, and in response to a formal request in December 2004 by the IIG, the World Bank committed US\$500 in International Development Association (IDA) credits between FY2005 and FY2006 (Annex 3).

24. All work carried out by the World Bank Group, be it through trust fund or IDA resources, is governed by an Interim Strategy. In January 2004, the Bank's Board of Directors discussed the first Interim Strategy, which covered programs financed by the IRFFI. That strategy focused on: (i) capacity building for more than 600 civil servants responsible for implementation of donor-financed reconstruction, including procurement, financial management, and environmental and social safeguards; (ii) emergency reconstruction projects implemented by the recipient ministries, and (iii) policy advice and capacity building on a number of topics, including subsidy reforms, public finance, pensions and social safety nets, restructuring of state-owned-enterprises, the investment climate, trade policy, and telecommunications.

25. Between March and December 2004, the Bank approved and launched nine emergency projects at a total value of about US\$366 million, covering health, education, water and sanitation, rural infrastructure, communication, and private sector development (box 2.1).

Box 2.1: Projects Financed by the Iraq Trust Fund

The World Bank's Interim Strategy relies on the Iraq Trust Fund (ITF) to finance projects. One project (First Capacity Building) is completed and another eight are underway, amounting to about US\$367 million in assistance.

First Capacity Building Project (US\$3.6 million, completed). Some 600 Iraqi officials were trained through 22 seminars/activities.

Emergency Textbook Provision Project (US\$40 million). Underway since mid-May 2004, the project finances the printing and distribution of 69 million textbooks for 6 million students in Iraq's primary and secondary schools in all 18 governorates for the 2004/05 school year.

Emergency School Construction Rehabilitation Project (US\$60 million). Underway since October 2004, the project finances *construction of new buildings for about 110 existing primary and secondary schools in unsafe or overcrowded facilities, and major rehabilitation of about 140 schools.*

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, the project focuses on economic management, public sector management, and social safety nets, three of the six pillars of Iraq's first National Development Strategy.

Emergency Baghdad Water and Sanitation Project (US\$65 million). The project finances *rehabilitation of water supply and sanitation infrastructure throughout Baghdad*, including rehabilitation and extension of the sewerage system in Sadr City, one of the poorest areas of Greater Baghdad, and preparation of a comprehensive city development plan for Baghdad.

Emergency Water Supply and Sanitation and Urban Development Project (US\$90 million). The project finances *water supply and sanitation rehabilitation in nine governorates and urban reconstruction (roads, sidewalks, community centers, etc.) in the poorest areas of three governorates.*

Emergency Health and Rehabilitation Project (US\$25 million). The project finances *rehabilitation of priority emergency services, including emergency obstetric care, in 12 selected hospitals.* It also provides hospitals with basic medical and laboratory equipment and a 3–6 month supply of essential emergency medicines.

First Private Sector Development Project (US\$55 million). The project finances *part of a high-capacity national telecommunications network (US\$43 million) and related infrastructure to connect key parts of the Central Bank's payments and settlements system.* It 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 to private firms to access finance and foreign markets.

Emergency Community Infrastructure Project (US\$20 million). The project will finance *labor-intensive water supply, sanitation, and irrigation rehabilitation in rural areas* throughout Iraq using a flexible programmatic approach and increasing community involvement.

26. In June 2005, the Bank prepared a new Interim Strategy for 2005–06, covering both IDA and additional trust fund resources. Based on consultations with the Iraqi authorities, and building on the experiences in Iraq to date, the strategy focuses on basics, emphasizing simplicity and flexibility. It uses financing and technical assistance to

leverage existing programs in which the Bank has invested heavily to enhance the Iraqi capacity to continue to implement them and enter into new sectors. That emphasis is based on the view that given the enormous financial needs in each sector, the Bank can, through its procedures and its focus on implementation by the recipient of assistance, put in place a system that can be leveraged by other donors. Also, the Bank's entry into these sectors would create a platform to advance dialogue on policy reforms.

2.4 Sustainable Reconstruction through Reliance on Iraqi Institutions

27. The methods used by the World Bank in Iraq are different from the traditional forms of reconstruction assistance. The first difference relates to adjusting to Iraq's evolving situation the World Bank's way of doing business throughout the world, with its emphasis on financial assistance accompanied by the qualitative transfer of knowledge, and working with the recipient country's procedures, resources, and, where appropriate, systems. The second relates to the uniquely difficult security and logistics circumstances in Iraq, which require the Bank to adapt and remain flexible.

28. To meet both the immediate and long-term needs in Iraq, assistance must strike a balance between speed and sustainability. The Bank's methods reflect the need for Iraqi institutions to absorb and manage large amounts of aid, while at the same time tailoring the system to deliver quick results in a difficult security situation and an evolving legal and institutional environment.

29. The Bank's approach is consistent with its experience in other post-conflict countries, among them Afghanistan, Bosnia-Herzegovina, Ethiopia, and the West Bank and Gaza. There, the Bank's reconstruction efforts put a premium on early but selective engagement, flexible design and implementation, early capacity building, reliance on recipient execution, coordination with other partners, and close monitoring and evaluation.

30. The Iraqi Government's own experience supports this view. In March 2005, the Iraqi Ministry of Planning and Development Cooperation issued to the Interim Cabinet a report on the Outcomes and Experiences of the Reconstruction Program in 2004 (MPDC 2005). The report provides a summary of commitments and expenditures for reconstruction by ministries, donors, and multilateral institutions. It also assesses the performance of aid and identifies obstacles to implementation of reconstruction projects. Among those obstacles are the security environment, on the one hand, and donors' hesitance to rely on Iraqi institutions to determine priorities and implement projects.

31. The remainder of the paper will highlight the processes put in place by the World Bank to build capacity and increase reliance on Iraqi-led implementation, while tailoring that process to ensure that the fiduciary requirements of donors and the Bank are not compromised. That goal was met through a judicious mix of existing structures in Iraq, new procedures and temporary structures, and outside technical support.

3. Models of Reconstruction: Moving toward Country Ownership

3.1 The Bank's Approach: Country Ownership and Implementation

32. Reliance on a country's institutions to receive and distribute aid is a general concept that embraces a wide range of examples, from complete dependence on a country's rules and regulations, to "ring-fenced" aid management and implementation structures that operate independently from a country's budget and institutions. Experience has shown that practical and effective aid delivery usually lies somewhere in the middle of the spectrum, particularly in countries emerging from years of conflict and institutional decay.

33. The World Bank is required by its articles of agreement and operational policies to ensure the appropriate use of its resources. Like other development institutions, it has sometimes imposed requirements that insulate the projects it funds from problematic government systems by creating special project implementation units (PIUs). In post-conflict reconstruction, this ring-fencing of programs and projects through PIUs was used to move funding and implementation quickly, without hindrance from an ineffective bureaucracy.

34. While ring-fencing continues to be relevant in some cases, there is also a common view among the development community that country ownership and sustainability can be strengthened if a reconstruction program works directly with the existing institutions of the recipient. While this needs a longer start-up time to rebuild existing local capacity, it can (i) lower costs by avoiding the need for the recipient to build and maintain parallel structures to satisfy donor requirements; and (ii) provide a natural focal point for donors to harmonize their processes.⁵

3.2 The Development Community, Aid Coordination, and Harmonization

35. During the 1990s, work by the United Nations Development Programme (UNDP), the Organisation for Economic Co-operation and Development (OECD), the World Bank, and others led to the common view that aid is most effective if donors align their requirements and objectives, which is best done by relying on local institutions. The overall approach, no less relevant in Iraq, is to influence change without bypassing domestic systems and accountabilities. Along with building local capacity, it provides a common and country-led basis for assistance, which reduces external, donor-driven demands on the country.

⁵ For detailed information on the harmonization initiative, see www.aidharmonization.org.

36. One example is Ethiopia. Although more than 40 bilateral and multilateral donors were in the country, the flow of aid remained roughly half of the African average. The authorities attributed this to fragmented priorities by donors; misalignment between donor flows and government planning and budget cycles; use of separate systems for donor assistance; and huge demands on local capacity to satisfy multiple donor requirements. As a result, the average age of a project was around four years, with one-third taking five to nine years.

37. The Monterrey Conference on Financing for Development in March 2002 stressed the role of partnerships among donors and developing countries to reach the Millennium Development Goals⁶ and the need to harmonize procedures to lower costs and make delivery more flexible and more responsive to local development needs.

38. In February 2003, a High-Level Forum on Harmonization in Rome brought together more than 40 multilateral and bilateral development institutions, aid agencies, and government officials to discuss ways to enhance aid. To improve aid effectiveness and meet the goals, the Rome Declaration on Harmonization (2003) emphasized the need to align donor policies and procedures, and to coordinate them with recipient countries.⁷

39. On March 2, 2005, the Bank joined 91 countries and 25 international organizations in approving the Paris Declaration on Aid Effectiveness, which builds on substantive work since the Rome Declaration. The Paris Declaration commits aid institutions, donors, and developing countries to a series of steps to enhance aid. These include: (i) recipients taking the lead in their development strategies; (ii) donors harmonizing their work and basing their programs on recipients' national development strategies, institutions, and procedures; and (iii) donors and recipients focusing on building capacity and ensuring aid effectiveness. Moreover, the Paris Declaration commits donors to providing more predictable (multiyear) aid flows for better planning and greater transparency.⁸

40. While these ideas are not new, the recent forums have developed good practices among the various institutions, including the OECD's Development Assistance Committee (DAC), the United Nations, the World Bank, and other donors (box 3.1 and OECD 2004). They also put in place a set of precedents for coordination among donors.

⁶ In September 2000, the member states of the United Nations unanimously adopted the Millennium Declaration and the Millennium Development Goals setting targets for 2015. For more information, see www.developmentgoals.org.

⁷ See also OECD 2003.

⁸ Second High-Level Forum on Joint Progress Toward Enhanced Aid Effectiveness: Harmonization, Alignment, and Managing for Results, Paris, February 28–March 2, 2005.

3.3 Adapting the Ideal: How Much Reliance on Iraqi Institutions?

Within the Bank, efforts are underway to find ways to increase, to the extent possible, the use of existing procedures and implementation capacity in countries where the Bank judges these to be acceptable.⁹ To determine whether a country's procedures meet the requirements, a set of thorough assessments is required. Going beyond the country's laws, regulations, and procedures, these assessments examine implementation practices, achievements, and the capacity of a country's central ministries (such as the Supreme Audit Board in Iraq) and line ministries. They also assess the overall risk environment. At each step, the national rules and practices are compared to international norms. Where there are material differences, attempts are made to determine whether there are minimum standards that can be adopted. For example, the OECD Guidelines summarized in box 3.1 include a set of procurement standards and performance indicators.

Box 3.1: OECD Findings and Guidelines for Harmonization

The Development Assistance Committee (DAC) of the OECD seeks to increase the volume of resources to developing countries, and to improve their effectiveness. Taking into account the Monterrey Conference in March 2002, and the Rome Conference on Harmonization in February 2003, the DAC has compiled and assessed areas where aid can be enhanced and harmonized among donors.

In collaboration with some recipients^a, a DAC Task Force (set up in December 2000) began studying donor practices that strengthen country ownership and lower recipients' costs. A survey of some recipient countries showed that the biggest burden on governments was the use of donor-driven priorities and systems, followed by cumbersome donor procedures, uncoordinated donor practices, excessive demands on time, delays in disbursements, lack of information, and finally the demands outstripping national capacity. The same survey found that the priorities for recipients are to simplify procedures and systems, harmonize procedures, align procedures on partner systems, share information, untie aid, respect national priorities, strengthen local capacity, and use a coordination structure, among others.

The study also found areas where common procedures were developed and successfully used. Some examples include Cambodia, with a system of joint implementation and financial management procedures, portfolio reviews, and quality indicators between the World Bank and the Asian Development Bank; and Vietnam, where the Government issued a decree on the use and management of aid that set common procedures and clarified the responsibilities of Vietnamese agencies. The World Bank and Asian Development Bank also used harmonized procurement, financial management, and environmental and social safeguards.

a. These countries are: Bangladesh, Bolivia, Cambodia, Egypt, Senegal, Guatemala, Kenya, Kyrgyz Republic, Mali, Morocco, Mozambique, Pacific Forum, Romania, Tanzania, Uganda and Vietnam.

Source: OECD 2003.

41. These assessments are made using existing diagnostic tools, such as the Bank's Country Procurement Assessment Report (CPAR) and the Country Financial Accountability Assessment (CFAA). The CPAR examines a country's procurement practices and consistency with international policies, and identifies major issues affecting

⁹ On September 14, 2004, the World Bank's Board of Directors endorsed a strategy to increase use of in-country systems in World Bank operations.

public procurement. The CFAA diagnoses public financial management and accountability arrangements, and identifies weaknesses in the system. The CPAR and CFAA also define the role of national institutions, such as the procurement departments within each ministry, and the Iraqi Supreme Audit Board, in auditing donor-supported organizations.

42. CPARs and CFAAs form the basis for the project-specific procurement and financial-management assessments that Bank teams carry out in the preparation of each project. Results of the CPAR and CFAA feed into the design of projects to ensure compliance with the Bank's procurement and financial management policies. In view of the security situation, Bank teams have not been able to visit Iraq to carry out a full-fledged CPAR or CFAA. However, in June 2004 they prepared an Operations Procurement Review and a Financial Management System Review for Iraq. While less comprehensive and deep, these two analyses have offered valuable information to guide Bank procedures until a full study can be carried out.

43. Other diagnostic tools needed to form a complete picture of a country's systems include the Public Expenditure Review (PER), which focuses on the country's fiscal position and expenditure policies, and the Environmental and Social Screening and Accounting Framework (ESSAF), which reviews a country's ability to monitor and control the environmental and social impact of projects and programs.¹⁰

44. In addition to providing the Bank with a clear picture of the strengths and weaknesses of a country's systems, these diagnostic tools are designed to be used by other donors, so as to avoid multiple diagnoses and excess burdens on the recipient.

45. Ultimately, these tools are only one part of the picture. While one can develop minimum standards and procedures, the final structure of an assistance program is a "softer" expert judgment, which takes into account many factors including the overall environment, the capacity to carry out a full assessment, and the ability of Bank staff to visit the country and supervise projects. A system on paper may be fundamentally different in practice.

46. At the end of the day, the use of existing institutions remains a broad concept. In most countries, the solution is neither complete consistency with the Bank's procedures, nor complete acceptance of the country's procedures, but a balance of both. In Iraq, the objective is to rely as much as possible on the local institutions, while safeguarding transparency and accountability.

¹⁰ Other tools include the Fiscal Transparency Review of the IMF, the Country Assessment in Accountability and Transparency of the UNDP, and the Ex Ante Assessment of Country Financial Management of the European Union. In some cases, the World Bank and other agencies undertake a common assessment (such as the CFAA in Bangladesh, done by the World Bank and UNDP).

47. There is a strong potential for reliance on the Iraqi authorities to implement the reconstruction program, and for harmonization of procedures among donors. And there are successful precedents. In Bolivia, for example, the Inter-American Development Bank, the Netherlands, Sweden, and the World Bank use the same monitoring and reporting procedures and carry out joint field visits.¹¹ In Iraq, this will be critical in the short-term to reduce security and administrative costs to donors and to lessen the burden on Iraqi officials.

3.4 Ownership vs. Quick-Results: Project Implementation Units (PIUs)

48. A key part of the discussion on country ownership relates to PIUs, which have been set up in many countries receiving aid. PIUs come in many forms and go by many names. Often, these terms are used interchangeably; the same term can mean different things in different countries.¹²

49. On one end of the spectrum, where there is an established capacity within government, there are no PIUs at all, and the government simply absorbs the project into its existing ministries. An example is Jordan, where a strong cadre of civil servants has allowed some ministries to build implementation capacity internally for donor-financed projects. At the other extreme, where there is no capacity to implement reconstruction or development programs, an autonomous unit is established for project management and implementation, augmenting the government's structures. Two cases are Lebanon after the civil war and the West Bank and Gaza after the formation of the Palestinian Authority. In both cases, because the capacity for reconstruction was either depleted or nonexistent, ring-fenced institutions outside the ministries were created to manage and implement the programs (box 3.2). In other places, government institutions were functional enough to allow PIUs to focus on regulating the flow of traffic and providing selected implementation services upon the request of the ministries.

50. While PIU structures vary, in many countries they are associated with a strong degree of autonomy, special management arrangements, independent staff and reporting, pay and employment outside the civil service, and parallel financial management and procurement systems. PIUs can also function within or alongside a particular ministry or department.

51. So, at the early stages of different countries' reconstruction programs, an assessment is made of the capacity of the government to implement the programs, and the tradeoffs between expediency and long-term capacity. The final structure depends on: (i) the costs and benefits of insulating the project from political forces; (ii) the impact of each option on the ability of the project to employ qualified personnel; and (iii) issues of accountability, institutional development, and sustainability.

¹¹ Some anecdotal evidence suggests that in some countries as many as 800 donor-funded activities are begun each year. Some countries host more than 1,000 donor missions and prepare over 2,400 progress reports.

¹² Variants include project management teams (PMTs), project coordination units (PCUs), project management units (PMUs), special management units (SMUs) and technical implementation units (TIUs).

52. Where PIUs are set up, they help organize staff to cover fundamental tasks, such as the release of funds, coordination with other agencies, procurement, financial reporting, and monitoring and supervision. PIUs also ensure that these tasks are carried out in line with donor standards and guidelines. PIUs are thus able to act quickly where the existing institutions are weak or insufficient. But evidence suggests that their impact on the broader public sector over the long term is less positive.

53. A study of 100 World Bank projects in the Latin America and Caribbean Region (Boyce and Haddad 2001) concluded that PIUs compromised the likely sustainability of results without providing a significant impact on project outcomes. Another study on the Eastern Europe and Central Asia Region (World Bank 2004c) produced similar findings. In Africa, evidence suggests that PIUs often did more harm than good, depriving line ministries of resources and project experience (WDR 2004).

54. Conversely, in countries where ministries have some basic capacity to implement projects, and where projects focused on using the existing institutions, the results were more sustainable. China, with an enormous aid program, executes its projects through civil servants in the existing ministries. Other East Asian countries have done so as well (WDR 2004).

3.5 The Pros of PIUs

55. Some of the benefits of PIUs include the following:

- In countries where capacity is weak and large quantities of aid are needed, PIUs can facilitate disbursement, help ensure direct monitoring and accountability for donors, and facilitate aid management.
- They can help protect against mismanagement and ensure the timely flow of funds.
- They can help to strengthen the skills of local staff for future projects.
- They can act as a valuable link between the donor and the recipient.
- They can provide continuity for donors, who can also benefit from having repeater projects with the same implementing agency.

56. A number of examples support this. In Lebanon, benefits generated by PIUs led to the creation of the Council for Development and Reconstruction (CDR). In the Palestinian Territories, they led to the creation of the Palestinian Economic Council for Development and Reconstruction (PECDAR). Both institutions are outside of any ministry, report directly to the country's leadership, and manage and execute reconstruction projects autonomously. In Yemen, PIUs were created within the ministries, but with a great deal of financial and operational autonomy. These PIUs also bypassed the government's civil service salary structure, which was too low to attract the right talent. In all these cases, the aid program was able to move quickly, and the donors' reporting requirements were met with greater ease.

3.6 The Cons of PIUs

57. But experience shows that PIUs also have disadvantages, including the following:

- PIUs can weaken central and line ministries and agencies by bypassing government structures and contributing to their fragmentation.
- They can set up parallel systems of reporting and financial management which proliferate and make it difficult to streamline and integrate business processes.
- They tend to perpetuate themselves and can become “super ministries.”
- They can be expensive, consuming a large portion of the project funds.
- They can lead to a brain drain within the public sector, as the most competent staff are drawn to the higher salaries. They can also lead to pay anomalies that make broader civil service reform more difficult and complicate the reabsorption of PIU staff into the ministries.

58. Ironically, both CDR and PECДАР became “super ministries” whose work, while critical and often effective, did not translate into sustainable capacity within the other ministries. Often, financial resources were not accessible to the ministries, and the PIU priorities competed with those of the government. In Yemen, the PIUs were financed under World Bank, GTZ, and other donors, causing friction between PIU staff and civil servants. Ownership of projects was not always clear, duplication of efforts was common, and implementation capacity was limited to a few staff. This is of course not unique to the Middle East region. In Afghanistan, the Afghanistan Aid Coordination Agency (AACA) often undertook direct prioritization and execution of reconstruction projects, with little involvement by the line ministries. In Kenya, a World Bank agricultural project created a ring-fenced structure that paid local staff between 12 and 24 times the salary of a senior economist in the civil service, resulting in a mismatch in terms of incentives and responsibilities (World Bank 2004c).

59. However, there is no standard answer as to whether or not a PIU is needed. There are several cases where PIUs were effective in delivering projects quickly. The decision must be made on a case-by-case basis, taking into account the characteristics of each country. The ideal is to use existing government structures (ministries, departments), but often this is not immediately possible. It is important to recognize the tension between the need to move quickly and the need for ownership and leadership by the recipient government in executing the country’s reconstruction program.

3.7 The Bank’s Alternative to PIUs: Ministry Project Management Teams (PMTs)

60. Iraq, a country with a substantial human-resource base and income potential, is undergoing a severe short-term gap in financing and executing a vast reconstruction program. Taking this into account, the goal then becomes two-fold; meeting immediate needs while not compromising the longer-term recovery of institutions. Moreover, the fact that the Bank’s activities were financed through the Iraq Trust Fund should not be overlooked. The need to safeguard the donors’ contributions has governed the use of

funds in Bank projects, placing equal emphasis on both speed and appropriateness of procedures.

61. Earlier studies by the World Bank and UNDP suggest that PIUs should be used selectively in exceptional circumstances, and when there is no alternative. Where PIUs must be used, there should be an exit strategy to phase them out and integrate them into the existing government institutions.¹³ This was done in Jordan with a number of World Bank projects. PIUs should not operate in isolation, but should be integrated into the relevant ministry, and not distort salary structures and incentives. Their policies and procedures should be harmonized with standard government practices.

62. The World Bank's approach in Iraq—the use of Project Management Teams (PMTs) comprised of existing Ministry staff—is consistent with these findings. It is based on the view that when a project is implemented by an Iraqi Ministry, or when the PMT does not operate separately from the Ministry, the project can benefit from the existing civil servants. Key bureaucrats can be involved on a daily basis, which facilitates administration. At the close of the project, its accomplishments may be easier to sustain compared to those achieved under a ring-fenced structure.

63. The Bank's experience from almost two years of recent involvement in Iraq suggests that, while ministry staff is over-extended due to demands by multiple donors, their qualifications and institutional experience allow them to successfully implement donor projects. However, years of isolation has required initial training in various aspects of implementation, as well as the ability to recruit consultants to supplement the PMTs in areas where they are weak.

64. Therefore, the PMT structure reflects a balance between the need to move quickly, and the benefit of relying on existing structures within the Iraqi institutions. The PMT is a practical solution that seeks to speed up implementation without circumventing the current systems and staff in place.

65. Most importantly, the PMT allows the Bank to bring in more than money. By building capacity, the Iraqi institutions will be able to absorb more aid. Ultimately, the institutional impact of World Bank financing will allow other donors to leverage the work and provide country-led assistance where it is needed most. (See Annex 2 for some case studies of implementation arrangements.)

¹³ For example, an education action project in the West Bank and Gaza involves a project coordination unit that was set up in 1999. It will be phased out as the integral systems and practices are made part of the ministry's normal functions.

4. Adapting Post-Conflict Reconstruction Experience to Iraqi Needs

4.1 Implementation of World Bank-financed Projects in Iraq

66. The Bank's role in post-conflict reconstruction over the past decade has provided a wealth of experience for the needs of Iraq. Guided by Operational Policy (OP) 2.30–Development Cooperation and Conflict, the Bank's efforts focus on early but selective engagement, flexible design and implementation, early capacity building, coordination with donors, and close monitoring and evaluation. Rehabilitation is coupled with policy advice to assist the Government in laying the groundwork for sector restructuring.

67. In line with these lessons, the Bank's strategy in Iraq has been flexible to permit a quick response to a changing security environment. The Bank's operations in Iraq rely on:

- (i) A small number of full-time senior Iraqi staff and consultants in Baghdad.
- (ii) The recruitment of consultancy firms to assist the Bank teams in project appraisal and supervision within Iraq.
- (iii) The recruitment of a Monitoring Agent to monitor procurement and expenditures related to the activities financed from the World Bank Iraq Trust Fund.
- (iv) A network of videoconference facilities set up in the International Zone, the Ministry of Planning, the Central Bank, and the Ministry of Finance¹⁴.
- (v) An Interim Iraq Office in Amman to facilitate contacts with key Iraqi officials and coordination with other international partners. The Interim Office in Amman is staffed by Iraqis and is poised to relocate to Baghdad as soon as security permits.

68. But the critical part of the Bank's approach in Iraq relates to the way projects are implemented. In the case of Bank-financed programs, whether through the Iraq Trust Fund or the Bank's own resources (IDA or IBRD), each project is implemented by the relevant sector ministry or agency (e.g., Ministry of Health, Baghdad Municipality, etc.) along Bank Project Cycle guidelines. (Box 4.1 and Figure 4.1 highlight the World Bank's procedures in all countries where it relies on local institutions to implement projects. The Bank's responsibilities are confined to appraisal of projects identified by the authorities, and then supervision once implementation begins.)

¹⁴ The World Bank's videoconferencing network has been made available to other agencies, including UNESCO which has used the infrastructure to set up a facility in the Ministry of Education.

Box 4.1: The World Bank Project Cycle

Under regular Bank operations, each project goes through several stages before implementation. In the case of emergency operations, such as those for Iraq, the processing steps are accelerated to ensure rapid delivery of funds to the country. The steps used for Iraqi projects (both Trust Fund and IDA financed) are as follows:

Project Identification (Recipient): The project is identified by the Iraqi authorities and endorsed as a project concept by the Iraqi Strategic Review Board (ISRB). The ISRB enters the project into its database, and identified the World Bank as a funding agency to avoid overlaps with other donors. Discussions start on the institutional arrangements, including the set-up of the PMT, within the Recipient Ministry.

Project Preparation (Recipient): The implementing agency prepares the project documentation with the advice and support of the Bank. At this point, the Project Management Team (PMT) would have received an initial training program in procurement, financial management, and social and environmental safeguards.

Appraisal (WB): Bank staff appraise the project by assessing the capacity of the implementing agency; the project's technical soundness; financial and economic viability; and environmental and social aspects. The Bank prepares the draft Grant Agreement (or Credit Agreement for IDA financing) and the project report, referred to as the Technical Annex. Further training is provided.

At this point, the Ministry of Finance (Loan and Grant Department) would have been brought in the loop to assure awareness of the project for inclusion in the budget. Usually, a line item is created under the Recipient Ministry's section in the budget. In the case of IDA credits or other loans that require repayment, the MOF created a "commitment" item.

Negotiations and Grant Agreement Signing (Recipient and WB): Iraqi representatives review the Grant/Credit Agreement and the Technical Annex and start project negotiations to agree on the final shape of the project and the relevant provisions for use of the funds. The final Grant/Credit Agreement and the Technical Annex reflect the agreement of both parties. In addition to the Recipient Ministry, the Ministry of Finance, and the Ministry of Planning and Development Cooperation, are invited to attend.

The provisions of the Grant/Credit are binding on both parties unless revised by agreement of both parties. These provisions are summarized in each Project Technical Annex.

At this point, the Ministry of Finance records the Credit/Loan as a commitment in the budget, to allow for proper accounting and planning of recurrent expenditures. Trust Fund projects are also recorded to ensure a consolidated and clear budget.

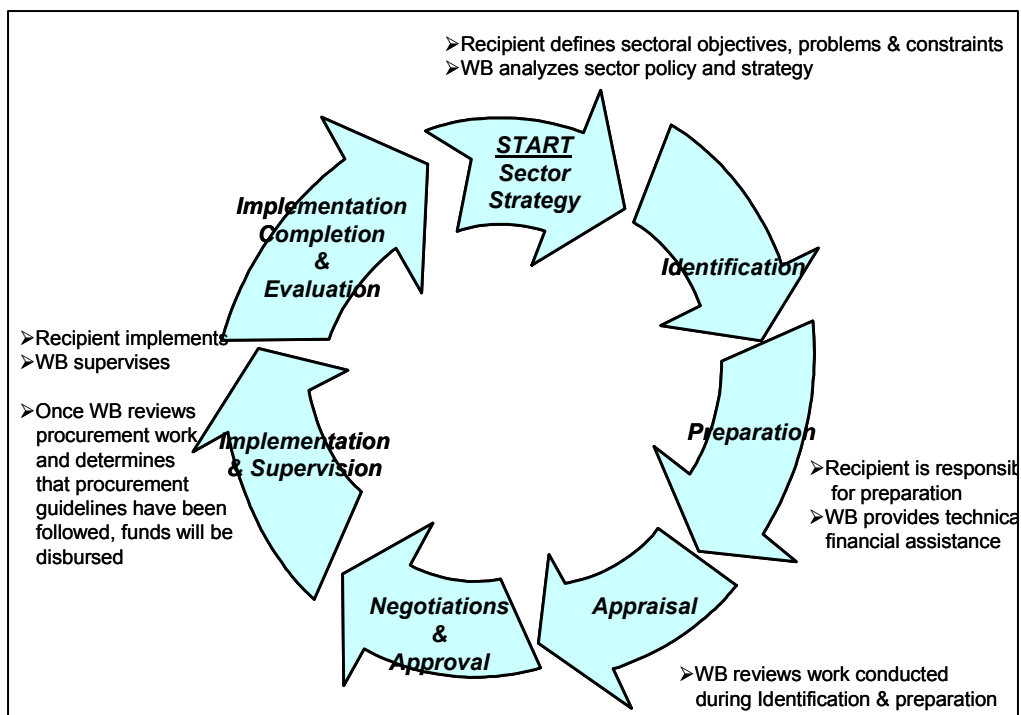
Implementation (Recipient): Following Grant Agreement signing, the implementing agency starts carrying out the activities for the project and the Bank disburses funds for eligible expenditures. They are available to each implementing entity since signing of the Grant/Credit Agreement so disbursements can be made for eligible expenditures for goods, works and services.

Supervision (WB): Bank staff review progress of project implementation and share their observations with the relevant Iraqi authorities and management of the Bank.

Project Closing (Recipient and WB): Upon completion of project implementation, the project is closed. Any unused funds are cancelled and an Implementation Completion Report is prepared to evaluate the performance of both the recipient and the Bank.

69. In Iraq, the implementing Ministry is the Grant/Credit recipient. While the overall allocations are agreed upon with the Ministries of Finance, and Planning and Development Cooperation to ensure coherence with national priorities and integration into the budget, the financial resources will be managed by the sector ministry. This is done within the framework of the sector ministry's financial management system and additional World Bank's procurement and financial management procedures. The Grant/Credit funds will be made available to the ministry, which will enter into contractual agreements with suppliers of goods, construction companies, contractors, consultants and/or vendors for the rehabilitation and construction financed under each project.

Figure 4.1: The World Bank Project Cycle



4.2 The PMTs in Iraq

70. Management of the implementation process is done through a Project Management Team (PMT) in each Ministry, reporting directly to the Minister, with experienced staff seconded on a full-time basis from existing technical and financial units. To date, there are active PMTs implementing World Bank-financed projects in the Ministries of Municipalities and Public Works, Health, Education, Trade, Planning and Development Cooperation, Water Resources, Environment, in Baghdad Municipality and in the Iraqi Telecommunications and Postal Commission. PMTs are being assembled in the Ministries of Power, Transport, Agriculture and Higher Education.

71. Each PMT is responsible for planning and coordinating all project activities, financial management (accounting and disbursements), procurement of works, goods and consulting services (and related contract management) from the private sector, and monitoring and evaluation.

72. The PMT coordinates its daily activities with the different ministry departments, and with the directorates in the various governorates. On average, each PMT includes a director, one or two procurement specialists, a number of project engineers, a financial management specialist, an environmental safeguard specialist, an administrative assistant, a quality assurance staff and a legal advisor. PMTs are employed and paid by the implementing entity at regular salary levels, thereby avoiding the disadvantages of stand-alone PIUs that can erode civil service institutional capacity over the medium and long term.

73. The key staff of each PMT have attended the training courses and workshops organized by the World Bank, UN agencies and some bilateral donors. Further training is provided during the preparation and appraisal of a project. Upon the signing of a Grant or Credit Agreement, a substantive project launch is held with each PMT to provide further training in project-specific management, procurement and financial management.

74. In early 2005, Crown Agents, a firm recruited by the World Bank, prepared a Master Implementation Manual (MIM), in English and Arabic, which provides a comprehensive set of standards and procedures for PMTs to ensure compliance with the requirements for project management, procurement and financial management.¹⁵

75. However, to ensure that the recipient is able to meet the requirements set out in the Grant/Credit Agreement, the Bank encourages each PMT to recruit, through the grant or credit, local or international consultants to assist with final designs, tender documents, tendering, financial management and supervision of works. These consultants assist in completing the project briefs and in carrying-out initial analysis and due diligence on all the proposed components.

76. Given the security environment in Iraq, and until Bank staff can travel to the country, the supervision of projects is carried out through individual consultants hired by the Bank, and through independent firms engaged as Monitoring Agents for ITF-financed projects. Monitoring Agents monitor financial management requirements and procurement transactions under each ITF-financed project, support the Bank in strengthening the fiduciary capacities of PMTs, support compliance with the Bank's environmental and social safeguards, and conduct reviews and inspections as agreed with the Bank.

¹⁵ Once finalized, the Master Implementation Manual will be available on www.irffi.org.

4.3 Procurement Under World Bank-Financed Projects

77. In 1997, the Bank modified its procurement strategy to increase its development impact, increase recipient accountability, and make it more cost-effective. To do this, the Bank has: a) raised the threshold for Bank prior review of procurement contracts signed by the recipient, and increased reliance on post-contract review; and b) focused on the recipients' capacity to procure at both the project and the national levels, using National Competitive Bidding procedures.

78. Procurement for all projects are carried out in accordance with the World Bank's "Guidelines: Procurement under IBRD Loans and IDA Credits"; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" of May 2004. These are spelled out in the provisions in each Grant/Credit Agreement. The PMTs use the World Bank's standard bidding documents for all procurement of goods and services, and Requests for Proposals for consultant services.

79. The World Bank's guidelines allow for International, as well as National, Competitive Bidding for projects in Iraq. However, to the extent possible and where local suppliers and consultants are available, the Bank encourages National Competitive Bidding in all of the projects it finances in order to encourage local firms to participate.¹⁶

80. Based on existing information on procurement in Iraq, and given that a full CPAR has not yet been conducted due to travel constraints, the Bank judges the overall risk to be high. The risks include:

- (i) The volatile security situation.
- (ii) The lack of adequate laws, regulations and modern standard documentation under the former regime.
- (iii) The lack of familiarity with Bank procurement guidelines and international procurement practices.
- (iv) The inability of Bank procurement staff to directly supervise the project in Iraq.
- (v) Delays in implementing due to limited Iraqi government experience in planning, preparation of terms of reference, preparation of tender documents, and technical and financial evaluation of bids.

¹⁶ International firms are not excluded under national competitive bidding, but are required to bid within Iraq. Similarly, national firms are not excluded under international competitive bidding, but are required to compete with outside firms for contracts advertised in the international press. According to Bank guidelines, PMTs are to ensure wide dissemination of contract opportunities (both for national or international competitive bidding procedures) for projects through general procurement notices published in *United Nations Development Business*, as well as in local Iraqi newspapers.

81. To mitigate this risk, the Bank has introduced a standard procurement assessment questionnaire to quantify the relevant ministry's capacity in procurement. Based on the findings of the questionnaire, as well as the overall Operations Procurement Review carried out in June, it adopts several measures, including: (i) training the PMT procurement staff and requiring a procurement monitoring system; and (ii) recruiting a specialized international firm to assist the PMT on procurement and project management issues; (iii) appointing a local World Bank Procurement Officer in Iraq; and (iv) where appropriate, a physical inspection system.

82. The Master Implementation Manual (MIM) describes, step-by-step, the World Bank procurement procedures that will be applied for all projects. Also, the Procurement Plan (PP) in each Project Technical Annex (attached to the Grant/Credit Agreement) specifies the procurement or consultant selection methods. The Procurement Plans for each project are updated at least annually, or as needed for project implementation. The Bank reviews bid evaluations by the PMTs to ensure a transparent, competitive process, and consistency with agreed procedures.

83. The Bank's experience in Iraq to date has shown that PMTs would benefit from hiring an international procurement consultant with a presence in Iraq. While the PMT exists as part of a ministry, it is not always easy to draw on the resources of the ministry to support the large processing challenges. And in some cases, that sense of urgency in the PMT's work does not necessarily extend to the rest of the Ministry. These issues are not unique to Iraq, as organizational development takes time in any country.

84. The recruitment of an international procurement consultant has been complicated by the reluctance of most experienced procurement firms to establish a large presence in Iraq for the moment. The PMTs have adopted several measures to deal with this. In the case of the Emergency Infrastructure Projects, the Terms of Reference for consultancy firms providing engineering services have included procurement support activities. In the case of the Emergency Education Projects, a full-time procurement consultant was recruited to support the PMTs.

85. However, the best option is to recruit a procurement firm to work alongside the PMT, building skills and institutional capacity as needed. Despite an initial reluctance by PMTs to involve "outsiders" in such a sensitive matter as procurement, and the cost implications, the Ministries have accepted the need for outside help to speed up the work.

4.4 Disbursement Under World Bank-Financed Projects

86. Disbursement, as defined under Bank-financed projects, is the transfer of funds pursuant to a project commitment, for expenditures made or to be made in compensation for works, goods, and services. Like in many other countries, disbursement in Iraq takes place after the successful provision of goods and services. So, they tend to occur later on in the project cycle.

87. The Bank is bound by its Articles of Agreement to ensure that the proceeds of any grant/credit/loan are used only for the purposes intended, with due attention to considerations of economy and efficiency and without regard to political or other non-economic considerations.

88. Disbursements for projects financed by IBRD Loans and IDA Credits are governed by disbursement policies and procedures agreed to by all member countries. The disbursement methods for Trust Fund-financed projects are the same.

89. Although procurement and project management are carried out by the PMTs, the Bank makes disbursements primarily by direct payment to contractors, consultants, and vendors. Once authorized by the PMT through submission of a Withdrawal Application and supporting documents, the Bank makes direct payments in New Iraqi Dinars (NID) or any major currency into the account of the contractor in any commercial bank inside or outside of Iraq that can receive funds through the international banking system. Currently, direct payments for projects in Iraq are received by the contractor/consultant within four to five days after the Bank receives a valid Withdrawal Application.

90. Once a direct payment is made, the Bank's Disbursement Unit informs the PMT and copies the Loans and Grants Department of the Ministry of Finance to ensure that the payment is reflected in their records. In the case of IDA credits, the Ministry of Finance is notified in order to monitor the project's flow of funds, as this represents a commitment in the Iraqi budget.

91. The Recipient Ministry makes payments below the threshold of US\$10,000, using its own resources. The Bank then reimburses, on a periodic basis, the Recipient upon presentation of proof of payment and a signed Withdrawal Application. The PMT and the financial counterparts from the Ministry receive intensive training in the Bank's disbursement procedures.

92. This method allows the Bank, and the donors depositing funds into the Iraq Trust Fund (ITF), to abide by their requirements for tracking the funds. It also benefits the Iraqi institutions by encouraging more participation by local and international firms. In the case of Iraq, firms have been able to benefit from the direct payment method by avoiding buying short-term trade insurance to cover the payment risk.

93. Direct payments, together with reimbursement to the government, have been used by the World Bank since the reconstruction of Germany and Japan after the second world war, and were also the methods used for the first World Bank loans to Iraq in the 1950s.

94. In addition to Direct Payments, the Recipient may request the Bank to enter into special commitments in writing, to pay a third party for expenditures to be financed out of the grant/credit proceeds under terms and conditions agreed between the Bank and the Government. This is done through guarantee letters of credit that a PMT establishes to pay for imports of goods or equipment for projects. The World Bank's guarantee reduces the financial transaction cost to the PMT.

95. To date, the direct disbursement methods used by the Bank in Iraq have been effective. However, the PMTs faced some difficulties early on in making available financial resources to honor payments below \$10,000. This was because the Ministry of Finance was not able to advance funds to the Ministry without creating a line item in the budget. This was resolved in the case of the Trust Fund projects by the line ministry using its own resources. In the case of IDA-financed projects, the Ministry of Finance has agreed to advance these funds as these projects are reflected in the Government's budget directly.

96. At the time of this report, total Iraq Trust Fund disbursements stand at about US\$24 million, comprising about \$20 million for projects and about \$4 million for the Bank's costs for project processing, supervision, and administrative fees. Recipient-executed projects account for \$17 million in disbursement; and capacity building projects executed by the Bank account for about \$3 million. Procurement is underway for over \$80 million in contracts.

97. This is consistent with the rate of disbursements in other countries, despite the perceived effects of the security situation on Bank operations in Iraq. The Iraq Trust Fund and IDA resources do not finance quick-disbursing Government budget recurrent expenditures, as do many other multi-donor trust funds (e.g., Afghanistan). They also do not finance humanitarian aid, which is usually quick disbursing. Also, disbursements are a lag indicator of implementation progress; contractors are paid once work is completed. Experience so far indicates that contractors in Iraq choose not to receive an advance payment, typically 20 percent of the contract value, in order to avoid the costs of obtaining a bid security. Therefore, disbursements can sometimes lag behind work completion.

98. For example, as part of the Emergency Textbook Printing Project, 69 million textbooks valued at \$30 million have been delivered to primary and secondary schools under the Emergency Textbook Provision Project and are already in use by students, yet only about half of the total contract value has been disbursed due to the Ministry of Education's strict quality control procedures.

4.5 Ensuring Transparent Financial Reporting

99. As mentioned earlier, the unique security situation in Iraq has led the Bank to rate the financial management risk to be high. Some of the risk factors include:

- (i) The security situation renders on-site Bank work virtually impossible in the short-term.
- (ii) The Bank's limited knowledge of the Government's financial systems, controls, and procedures.
- (iii) The limited knowledge of the implementing agencies about the Bank policies and procedures.
- (iv) The lack of complete financial coordination, which may result in double payments for the same goods and services.

100. Notwithstanding, the Bank and PMT have agreed on Financial Management procedures that use the current systems of the ministries,¹⁷ with minor revisions to accommodate the requirements of the Bank. While each PMT continues to comply with the ministry's controls, it works closely with the Bank teams to tackle the remaining risks during project preparation, with close monitoring and supervision during implementation.

101. In addition, the Recipient and the Bank have partially mitigated the risks by putting in place additional controls, including: (a) the need for PMT verification before payments are made; and (b) the PMT's recruitment of financial staff from within the ministry, who may be supported by outside financial consultants, as needed.

102. The Bank also requires each PMT to maintain its records and accounts, and to prepare financial statements to separately reflect its operations. The Bank has recommended the use of simple accounting software to generate timely reports, including the required Quarterly Financial Monitoring Reports (FMRs) for project management and reporting purposes.¹⁸ This simple software could be easily customized based on every ministry's needs, and still meet the requirements of the Bank and other donors.

103. The Grant/Credit Agreements also commit the recipients to have the accounts, records, and financial statements audited each fiscal year by a qualified auditor acceptable to the Bank. These audits are conducted in line with International Audit Standards, and encompass all project activities. In addition to this, the Bank is finalizing plans to support the Iraqi Supreme Audit Board to perform its verification of project activities.

¹⁷ These systems include the ministry's approval authority, recording and reporting procedures, and audit requirements. They also include the normal role of the ministry's Finance Department in each of the projects.

¹⁸ Presently, the MOF and the Bank are discussing a more systematic way to reflect the grant/credit funds in the government budget and provide a role for the Iraqi Supreme Audit Board.

104. In addition to meeting the needs of the Bank, these procedures can encourage the linking of donor aid to the budget. This will allow the Ministry of Finance to monitor donor-financed expenditures and remaining balances, whether in Iraq or offshore. There are also practical implications for each project. As the Government enforces its June 2004 Financial Management Law, the Ministry of Finance will not be able to make advances for a specific project without an appropriation for a project in the budget. It will therefore become critical for projects to be reflected in the national budget, as this will be the only way for the ministries to pre-finance project preparations.

105. The procedures will also allow the Supreme Audit Board to audit such transactions as part of the Government's consolidated financial accounts. In February 2005, a Joint IMF-Bank mission met with the Iraqi authorities in Amman, where recommendations were made to strengthen the Government's Public Financial Management System, and operationalize the Financial Management Law.¹⁹ These include steps toward a medium-term budget framework, transparent accounting and reporting, a Financial Management Information System, civil service reform and enhanced cash management, among others.

106. The IMF and the Bank, in collaboration with UNDP, will also provide assistance to the Supreme Audit Board to carry out external auditing. The Bank has also provided advice to the Ministry of Finance as it seeks to strengthen internal audits in the ministries, as required by the new Financial Management Law.²⁰

107. Substantial training has been provided to the PMTs on this issue. Most recently, a Capacity Building Workshop on Procurement and FM was held in April 2005 in Amman. This included representatives from the ministries of Education, Higher Education, Health, Planning and Development Coordination, Telecommunication, Finance- Kurdistan Region, Water resources and the Iraqi Telecommunications and Post Company. In addition, the Bank has provided intensive training to the financial officers of all PMTs throughout the project cycle, and during the various Project Launches carried out in Amman.

4.6 Evaluating the Environmental and Social Impacts of Reconstruction

108. All World Bank-financed projects in Iraq must abide by an Environmental and Social Screening Assessment Framework (ESSAF). Prepared by the Bank for Iraq in early 2004, the ESSAF provides policies and guidelines to be integrated at the initial phase of Bank-financed operations. This is consistent with the procedures used by the Bank elsewhere.

¹⁹ The public financial management system in Iraq remains in need of reforms in several areas. However, the financial management law and the central bank law have laid a sound framework for reforms, including the consolidation of the recurrent and capital budgets for the whole of Iraq, including the northern governorates.

²⁰ In addition to the internal audit requirements in this law, a recent initiative put in place an inspector general in each ministry. The IMF and World Bank recommended greater clarity between the roles of the inspector general and internal auditors.

109. The framework ensures compliance with the Bank's safeguard policies under the current conditions in Iraq. While the Bank's procedures usually allow for corrective measures to be built into either the same emergency project, or in a future project, environmental and social requirements in Iraq are met in every emergency project and are not postponed. The objective of the ESSAF is to ensure that activities under the proposed reconstruction operations address the following issues:

- Protect human health;
- Prevent or compensate any loss of livelihood;
- Minimize environmental degradation as a result of either individual subprojects or their cumulative effects;
- Minimize impacts on cultural property; and
- Enhance positive environmental and social outcomes.

110. Recognizing the emergency nature of projects in Iraq, and the need for immediate assistance, the ESSAF seeks to ensure due diligence, avoid causing harm or increasing social tensions, and ensure consistent treatment of social and environmental issues throughout all Bank-related projects. The ESSAF also assists the PMTs in screening all the subprojects for their likely social and environmental impacts, identifying preparation requirements and prioritizing the investments.

111. ESSAF guidelines are incorporated into each project, and the procedures are reflected in each Technical Annex to a project Grant/Credit Agreement. They are disclosed by the Borrower before appraisal. All subprojects must be screened by the PMT according to a checklist, and an ESSAF *code of practice* is included in every work contract and in every contract for the purchase and installation of equipment. Where there is a likely environmental or social impact from a project, the PMTs must prepare specific mitigating measures which are incorporated, as appropriate, in the contracts that are signed with the private sector.

112. Several training programs were provided to the PMTs on environmental impacts and on corrective measures. This will allow both the PMT and the Ministry of Environment, to address any issues that arise during implementation.²¹

113. The Monitoring Agent, recruited for ITF-financed projects, will ensure that the guidelines of the ESSAF are met and mitigation measures undertaken. This is in addition to the normal supervision work carried out by the Bank Teams.

²¹ The technical annexes for each of the projects is available at www.irffi.org.

5. Lessons Learned and the Way Forward

114. The World Bank's work in Iraq has benefited from a wealth of experience in other post-conflict countries. At the same time, the Iraqi Program has provided experiences that can benefit other country programs. Clearly, although each country setting is different, there are similarities that can be adapted in other countries.

115. In April 2005, the Bank carried out an independent review of its existing portfolio of projects. The goal was to assess the quality of the portfolio and identify issues that could help inform the supervision of current projects and the design of future ones.

116. The review concluded that the Bank is balancing well its commitment to its client with concern for due diligence and the safety of its staff and consultants. Given the way in which the Bank operates, its response was speedy and focused; it processed and approved nine projects valued at almost \$370 million in the fourteen months between the Madrid Conference in October 2003 and the end of 2004.

117. The projects focused on simple and visible activities affecting the lives of individual Iraqis—water, schools, textbooks, hospitals, communications. Each project was properly sequenced, starting with a needs assessment followed by capacity building projects to support the new Project Management Teams within ministries. Given the poor security environment, the Bank used innovative methods, including the establishment an office in Amman and adopting “remote” measures such as third-party oversight and direct payments to contractors and suppliers that help ensure due diligence.

118. At the same time, shortcomings were identified, including a lack of realism in the timeframes for project completion, which were overly influenced by the end-date of the IRFFI in December 2007. Related to this, the Bank should have managed the expectations of both donors and the client as to what can reasonably be done in a relatively short time frame, given the Bank's methods and the absorptive capacity of Iraqi institutions. After a hiatus of more than 25 years, Iraq is effectively a new client for the Bank. Most projects in Iraq are less than six months old, while Emergency Projects Bank-wide usually start disbursing after seven months. Other shortcomings include weak harmonization among donors and the sparse use of performance indicators for the projects.

119. While many principles have been drawn from Iraq, and while the Bank and other institutions are learning more each day, a set of lessons have been identified:

- ***Designing simple projects was key***, at least during the political transition and until the Iraqi institutions are able to absorb more aid and work cross-sectorally. Since June 2004, the Iraqi Interim Government has made progress in setting up cross-sectoral committees on oil policy, private sector participation, and economic reform, among others. But this has not yet translated into joint technical teams to work with the donors on such areas as gas and power; power and water; health, water supply, and

sanitation; etc. Also, the logistics and security problems in Iraq make it difficult to coordinate with one ministry at a time, let alone multiple ministries.

- ***Projects have worked best when they incorporated reconstruction and policy work.*** Bank-financed projects have moved on twin tracks, with a major thrust on supporting physical reconstruction, while at the same time building the capacity for the transition from emergency recovery to sustainable development. This is due to the Iraqi awareness that the years of isolation have left the country behind in international experience and practices, and the recognition that this is a golden opportunity to leap-frog in terms of new technologies and sector structures. The Bank-financed rehabilitation of the wireless telecommunications backbone under the Emergency Private Sector Development Project is a case in point.
- ***Sequencing of the Bank's intervention has been critical.*** As in other countries, the Bank focused on early but selective engagement, flexibility in design and implementation, and an initial heavy dose of training and capacity building. This initial emphasis on training of 600 civil servants enabled the ministries to access modern practices of procurement, financial management, and social and environmental safeguards, and move quickly to implement reconstruction projects—whether financed by the World Bank or other donors. For example, the Ministry of Education is exploring the use of Bank procedures to procure textbook printing services for the coming school year. This is in view of the speedy procedures used under the Bank-financed Emergency Textbook project, which also yielded a cost savings of around \$5 million due to use of competitive procurement methods and the involvement of local contractors.
- ***The International Reconstruction Fund Facility for Iraq structure has shown that resource pooling is important for effective reconstruction, and reducing costs to each donor.*** In Iraq, donor priorities often governed their bilateral assistance. Often, these priorities were either inconsistent with Iraqi priorities, or involved ministries with weak implementation capacity. Some ministries were the subject of excessive attention by donors, while others were ignored. Many Iraqi ministries continue to complain from “donor fatigue” as civil servants often have to repeat the same discussions with different donors at different times. In this regard, pooling funds allowed the donors to reduce the demands on the recipient, as well as their own costs. Given the security problems, the IRFFI has allowed the donors to avoid the costs of sending large numbers of staff to Iraq.
- ***Donor coordination must take place at the sector level also.*** It was commonplace in the early period of the reconstruction program for donors to separately engage a ministry to develop different policies for a sector. Recently, the Iraqis and the donors began to set up donor coordination groups for each sector. This was initiated in March 2005 by the Ministry of Electricity, which assembled a Power Sector Working Group chaired by the Ministry, and including representatives from the World Bank, UNDP, DFID, Japan, Sweden, Canada, EC, USAID and Program Coordination Office at the US Embassy in Baghdad. The Working Group set up a communication

mechanism, and agreed to meet quarterly to share each other's work program, and to coordinate assistance. It is too early to judge the impact of these Groups. But to date, there is a consensus among the Electricity Working Group that the flow of information has improved significantly.

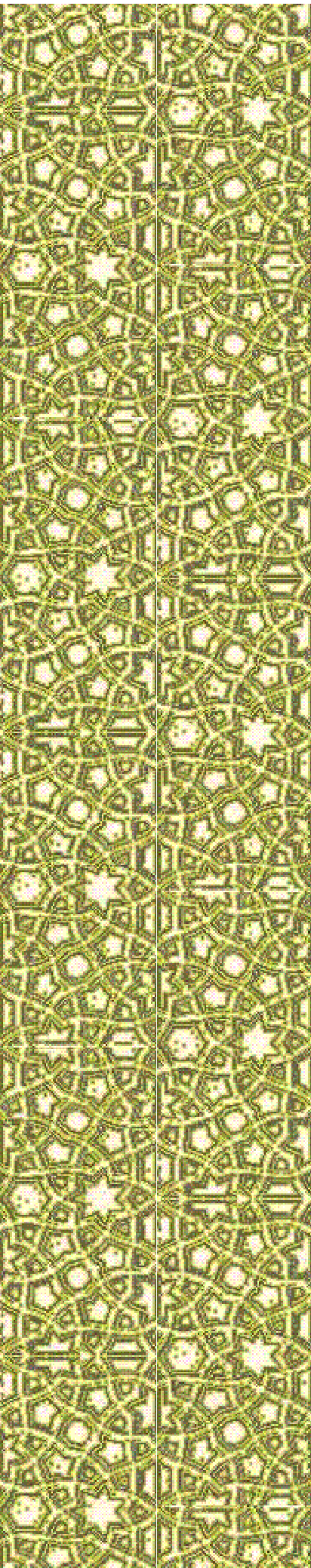
- ***Sector coordination was most successful when the Iraqi Ministry led early in developing a sector strategy, and providing discipline to donors.*** The Health and Education strategies, developed by each of the ministries in early 2004, are good examples of sector coordination. At the time of this paper, the Ministry of Municipalities and Public Works was finalizing a Strategic Program for the Sustainable Delivery Basic Services in Iraq, which sets out short-, medium- (5–10 years) and long-term (10–20 years) priorities in water, sewerage, and municipal services.
- ***Expectations on the pace of disbursements should be set early on.*** A key concern of the Iraqi authorities and the donors has been the pace of disbursements in these first two years. This is amplified by Iraqi frustration with the delays in providing pre-2003 levels of power, water, etc. There is also an initial push by donors to front-load aid flows, which puts pressure to disburse large amounts of funds early on. Clearly, the security situation has delayed most reconstruction. While there is an obvious need to move quickly, experience elsewhere calls for patience to allow local institutions to recover. World Bank studies show that, even under normal conditions, absorptive capacity usually increases in the 4th year after conflict, and tapers off on the 10th year. In the final analysis, the success of a reconstruction program reflects not only the velocity of funds, but their medium and long-term impacts. Bank projects do not finance quick-disbursing recurrent Government budget expenditures or humanitarian aid. Also, disbursements are a lag indicator of implementation progress: disbursements are made once work is completed.
- ***The costs of bypassing Iraqi institutions to execute projects outweigh the short-term benefits.*** In evaluating the performance of the reconstruction program, the Ministry of Planning and Development Cooperation stressed the need to involve local institutions to reduce the high costs of international consultants, and the delays from security-related evacuations. The Bank's experiences to date support this, whereby the Ministry of Education has determined that school rehabilitations managed by the ministry under Bank-financing cost less per unit than those implemented by donors.²² For the Bank, the cost of project administration in Iraq is not far from that of other countries, given the usual reliance on the recipient. However, it is critical for the Iraqi institutions to develop a track record in using aid. The low disbursement of the 2004 capital budgets by most ministries shows that absorptive capacity is still relatively weak. So expectations have to be managed in every regard.

²² This is based on anecdotal evidence from the Ministry of Education. Under the current World Bank-financed Emergency School Rehabilitation Project, the average total cost of a comprehensive reconstruction of a school by an Iraqi contractor is around US\$ 240,000. This includes complete rehabilitation and extensions to an existing facility.

Table 5.1: Average Project Completion Costs (Actuals Only)

	Number of Projects	Total Cost	Average Cost
in US\$'000			
Iraq	7	2,232	319
Afghanistan	4	1,153	288
Kosovo	5	1,593	319
Timor Leste	5	1,769	354
Egypt	5	2,219	444
Iran	6	1,888	315

- ***Projects moved quickest where Iraqi ministries received professional support for pre-feasibility studies at an early stage of preparation.*** Ideally, professional assistance should also be provided to prepare final designs and bidding documents, to ensure quick implementation. Accurate feasibility studies during project preparation also allow for accurate cost estimates and realistic price contingencies.
- ***Focusing on practical implementation arrangements at an early stage of project preparation has proven useful.*** The Project Management Team (PMT) concept has been effective and is being considered by other donors. But it is important to get high level support and the PMT appointed as early as possible, ideally during project preparation. The PMT must have enough authority to move quickly, along with strong support by the Minister to be able to move confidently. In some cases, PMTs expressed reservations in moving ahead with projects for fear of a conflict with the existing procedures in a ministry, and risks of corruption accusations and scandals. In this regard, high-level support and an emphasis on clear procedures have provided the confidence to move ahead.
- ***The Iraqi authorities and donors should agree on a system to integrate aid into the budget.*** This will help the Ministry of Finance to link investment decisions to recurrent expenditures, ensuring that current assistance does not affect the country's liquidity. The Iraqi authorities have provided, in their National Strategy, a multiyear budget (2005–07) which addresses this to an extent. Donors can facilitate further progress by ensuring that their procedures incorporate both the Ministry of Finance and Ministry of Planning and Development Cooperation. Both ministries have begun to tackle this issue through the new Reconstruction Committee.
- ***While the Bank continues to encourage Iraqi participation in all contracts, there are areas in need of the experience of international firms.*** The recent attacks have pushed up the costs of consultants and contractors. To counter this, allocations to projects must factor in some of this risk. However, recent experiences with two emergency infrastructure projects show a continued willingness by international firms to operate in Iraq. In a recent tender for an engineering consultancy, eighteen of the twenty bidders were international. This reflects an increased dependence by international firms on Iraqi partners, which has allowed them to stay in the market while at the same time building Iraqi private sector capacity. This has also led to noticeably lower security costs for foreign firms that have relied on an Iraqi partner.



ANNEXES

ANNEX 1

Background on the Iraqi Government

A1.1. The Iraqi Interim Government

On June 28th, 2004, the CPA handed authority to an Interim Iraqi Government (IIG), consistent with UN Security Council Resolution 1546. This was followed in August 15-18 by a UN-led process whereby a 1,000-member National Conference appointed of a 100-member National Council to assist the Interim Government with legislation and preparations for the January 30th, 2005 elections, as outlined in the Transitional Administrative Law (TAL).

Since its inception, the IIG has taken important steps to strengthen ownership of the policy formulation process, and to address institutional weaknesses. Several inter-ministerial committees were created to tackle Economic Reform, Oil Policy, Reconstruction, Privatization, and the Reorganization of the Iraqi Stock Exchange, among others.

In October 2004, the IIG drafted a medium-term National Development Strategy (NDS)²³ to outline a vision for Iraq anchored in market-focused reforms, economic diversification, and strong social safety nets. The Strategy also sought to provide a basis for additional reconstruction funding, and to enhance the matching of existing funds to an Iraqi national development agenda and Iraqi needs.

A1.2. The Iraqi Transitional Government

On January 30th, Iraq held its first set of elections as planned. In Iraq and fourteen other countries, Iraqis voted for a 275-member Transitional National Assembly, a Kurdistan Regional Assembly, and Municipal Councils. The Transitional National Assembly will form an Iraqi Transitional Government (ITG) replacing the IIG, and draw up a new constitution ahead of a referendum in October of 2005. If approved, the Constitution will serve as a framework for elections for a permanent Government.²⁴

At the time of this report, elections had taken place with over 8 million voters participating despite precarious security. The election results were compiled, and the Transitional National Assembly convened to confer on a new Iraqi Transitional Government. On April 4th, the Assembly elected a speaker, and, by two-thirds majority vote on April 6th, a President and two Vice Presidents. The new President was sworn in on April 7th, after which he announced the appointment of Prime Minister Ibrahim Al-

²³ The National Development Strategy (NDS) was developed through an inter-ministerial committee led by the Ministry of Planning and Development Cooperation, and can be accessed at www.irffi.org.

²⁴ The National Assembly will approve the nomination of a President and two deputies by a 2/3 majority. The President and deputies are to unanimously approve the nomination of a Prime Minister, who will then form a cabinet. The Cabinet will then revert back to the national assembly for a majority approval.

Jaafari. On May 8th, a final cabinet roster was approved by the Assembly after the resolution of a number of remaining ministry positions.

A1.3. The Iraqi Reconstruction and Reform Agenda

The Joint World Bank-UN Needs Assessment presented at the Madrid Donors' Conference in October 2003 estimated Iraq's reconstruction needs at around US\$36 billion for 2004-2007²⁵. In addition to restoring critical infrastructure, the Needs Assessment highlighted two parallel priorities: strengthening institutions of sovereign, transparent, and good government, and supporting a transition that provides both growth and social protection.

Since May 2003, efforts are underway to tackle medium-term issues and set Iraq on a course of reform. In addition to the initiatives mentioned earlier, the IIG has placed a high priority on the renegotiation of Iraq's external debt, which stands at six times its 2004 GDP. Debt relief, including the Paris Club debt reduction program, is linked to Iraq's performance under an International Monetary Fund-supported program (Emergency Post Conflict Assistance), which was approved on September 28th, 2004.

Under the IMF program, IIG committed to a series of measures that include rationalization of spending, raising of non-oil revenues, transparency and consolidation of public finances, and other institutional reform in support of transparency and sustainability.

These reforms tie into the overall agenda of the Iraqi authorities, and are articulated in the National Development Strategy, which stresses sustained employment and growth through improved security, an effective reconstruction program, and market reforms. The Strategy highlights the importance of capacity building to allow the Iraqi Government ownership of the reconstruction and reform agenda:

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

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

Additional accountability institutions and anti-corruption initiatives are required, as is a system for setting priorities in public spending, a degree of

²⁵ This did not include the oil sector and security, which were estimated by the CPA to be US\$20 billion for the same period.

fiscal decentralization, improved public procurement and stronger financial management."²⁶

The National Development Strategy also lays a basis for sectoral reconstruction and reform strategies, some of which have already been prepared by the sector ministries.²⁷ In addition to providing a framework of short- and medium-term needs, the sector strategies would:

- (i) Guide the donors on the boundaries of their programs.
- (ii) Set technology standards for donors to ensure consistency.
- (iii) Carve out a role for the private sector in the provision of services.
- (iv) Help the ministries to coordinate and monitor the multiple sources and forms of donor assistance that are currently in place in Iraq.

At the time of this report, the new post-elections cabinet has begun efforts to operationalize the NDA and develop policies for strong and transparent institutions, and sound financial management. A Cabinet Committee for Economic Development and Finance has been established, consisting of the Ministers of Finance, Planning and Development Cooperation, Oil, Trade, Electricity, and the Central Bank. A Reconstruction Coordination Committee has also been established, incorporating the Ministries of Finance and Planning, among others.

²⁶ Iraq National Development Strategy, October 2004.

²⁷ Education, higher education, and health are some examples.

ANNEX 2

Case Studies of Implementation Arrangements

West Bank and Gaza: In the aftermath of the 1993 Oslo Accords, there were no Palestinian Government Institutions to implement a reconstruction program. There was a need for an agency that could support aid management and project implementation. The quality of Human Resources in WBG was high and did not pose a constraint, but the concern was how to put in place a capacity to fulfill these purposes without pre-empting the development of regular institutions of Government. PECDAR was created to: (i) regulate and coordinate the flow of assistance, on a semi-permanent basis; (ii) implement projects directly, in the first phase, and then serve as implementation services provider for a regular Palestinian Government; and (iii) incubate the core of sectoral ministries, until they are developed. It was expected that the agency's function and staff would eventually be spun off to regular organs of government, and the agency would be dissolved by the end of 1996. It is currently still in place.

Bosnia and Herzegovina (BiH): Given the unique circumstances in BiH, and the decentralization following the 1995 Dayton Peace accords, donors sought a decentralized reconstruction approach, while trying to foster more coordination among the various regions and municipalities. The overall reconstruction program was guided by the Peace Implementation Council (PIC), consisting of the parties to the Dayton agreement, and the Office of the High Representative of the UN. Aid coordination was led by the World Bank and European Union. Given the multiple donors and agendas, a set of sectoral priorities (projects) were developed, and eleven sector task forces were created, each chaired by a different lead donor. Each sector program was managed by a Project Implementation Unit (PIU) working in the relevant BiH agency. While there was an initial consideration of creating a stand-alone structure, it was decided to develop PIUs within ministries to build local capacity. However, not all donor assistance went through the PIUs, and the structure did not lead to a harmonized implementation program. Given BiH's political architecture, there were essentially three parallel aid administration and implementation systems, with three separate budget and cash management systems. However, an aid management unit was formed in the state Ministry of Foreign Affairs, which provided a reasonably well-functioning aid database, and liaised with two similar units in the other regional governments.

The lack of effective coordination among donors did not allow the BiH authorities to take full advantage of the aid program or build capacity for sustainable reconstruction and reform. However, the BiH experience showcases the benefits of involving NGOs, which were successful from the start. Also, there is evidence of substantial capacity building in some sectors through the PIUs, who were staffed by locals. There is consensus that these positive results have depended greatly on the stable security environment facing donors and local administrators.

East Timor: After the entry of the UN authorized multi-national force in late 1999, the Indonesian Assembly declared void the 1978 annexation of East Timor, paving the way for the establishment of the UN Transitional Administration for East Timor (UNTAET), responsible for all administration (Kosovo had a similar arrangement). Unlike Palestine or Iraq, East Timor did not possess a strong core capital of human resources to manage the reconstruction program, and physical infrastructure had not been as developed as in others. However, East Timor provided enough security to enable the UN to administer the territory while supporting the creation of local administrations. But implementation continued to be in the hands of the aid agencies. As no Government was in place in the early days, the UNTAET was in charge of aid management. This was eventually devolved to a growing Timorese capacity, and gained additional coherence once the new Government developed a National Development Plan. Although the initial WB Needs Assessment presented a unified budget, the actual process was somewhat fragmented by a number of numerous sources of aid, including: the WB and ADB-managed Trust Fund for East Timor; the UN administered Trust Fund which covered recurrent costs; the efforts of UNTAET; projects financed by individual UN agencies; and projects financed by the bilateral donors.

Afghanistan: In the aftermath of the military conflict and the fall of the Taliban regime in November 2002, Afghanistan was left with a severely destroyed infrastructure, and a political and social aversion to any centralized control. However, Afghanistan's long tradition of commerce and entrepreneurship, and its focus on strong local governance, implied a substantial human capital at the local level. In fact, while the Taliban regime had almost obliterated any remaining institutional capacity at the central level, there remained a strong governance infrastructure at the village level, which underpinned the reconstruction program.

What remained of the central government institutions were brought to bear, along with small cadre of dedicated staff and some adequate formal procedures, to govern the country. However, there remained a gap in aid management and project implementation. The Afghanistan Aid Coordination Authority (AACA) was created by decree in March 2002 to coordinate aid, and implement projects. The AACA, an autonomous agency, was created to manage the transition to more form capable formal institutions, and was intended to dissolve after 2004. The AACA often competed with the Ministry of Finance, dealing directly with the line ministries. In June 2002, the Head of the AACA also became the Minister of Finance, which was expected to increase donor coordination, and integration of aid assistance into the budget framework. However, the AACA's continued direct selection and prioritization of projects did not allow the line ministries to develop fully. However, given the recent reconstruction history in Afghanistan, the verdict on the institutional setup is yet to be determined. The mandate of the AACA is being devolved to the Ministries of Finance and Economy.

Lebanon: The country's civil war in 1975-90 severely battered its physical and institutional infrastructure. The Council for Development and Reconstruction (CDR) was created in the late 1970s to undertake emergency projects quickly, and mitigate the governmental fragmentation that occurred. A virtually autonomous agency reporting directly to the Prime Minister, CDR had its own staff, salary structure, and reporting requirements. It was responsible for project design, and carried out directly all donor-related procurement, financial management, and environmental/social safeguards. CDR often undertook dialogue with the donors on aid packages and strategies. While this allowed for quicker results in reconstruction during and after the civil war, there was little infusion of capacity into the line ministries with which CDR often competed. Also, a growing bureaucracy within CDR began to constrain the flow of aid, and implementation, within various sectors.

CDR has recently begun reorganizing, and adopted a new structure with six defined departments, intended to enhance efficiency and clarify roles. Its new strategy includes a Monitoring and Evaluation Framework, a staff training/retraining program, the hiring of consultants while new managers and staff gained experience, and a comprehensive Management Information System. However, there remains a need for CDR to enhance coordination with other agencies. A recent Bank assessment recommended that the CDR, the Central Bank, and the Ministry of Finance establish a mechanism to ensure that key systems being put in place are compatible with each other. The WB team also found CDR management to be highly centralized under the President and the Board of Directors. Almost all procurement decisions have to be deferred to CDR management, taking up to six months for prequalification of contractors or short-listing of consultants.

ANNEX 3

The World Bank Program

A3.1 The World Bank and Iraq: Renewed Contact with a Founding Member

Iraq was a founding member of the World Bank, and received six IBRD loans between 1950 and 1973 for agriculture, education, flood control, telecommunications, and transport. The last loan closed in 1979, and Iraq had not been making payments on its outstanding loans since 1990. Until May 2003, no Bank missions had visited the country in over twenty years. Iraq was in non-accrual status until December 2004, when the Iraqi authorities paid arrears of about US \$108 million to the World Bank.

In early 2003, the Bank began rebuilding its knowledge base on Iraq. In June 2003, the Bank and the United Nations Development Group (UNDG) initiated a Joint Needs Assessment, with the participation of the International Monetary Fund (IMF).²⁸ The World Bank staff, along with UN and IMF staff, evacuated Iraq in August 2003, following the deadly attack on UN Headquarters in Baghdad. The World Bank now operates out of an Interim Iraq Office in Jordan, with a small local contingent in Iraq.

The Needs Assessment provided the basis for an International Donors' Conference for Iraq in Madrid on October 23–24, 2003,²⁹ in which the Bank indicated a possible range of lending of US\$3.0-5.0 billion over five years, including up to US\$500 million in IDA funds, once “threshold issues” are resolved, including security, the legal status of Iraq's government, and payment of arrears to the Bank. 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. In December 2004, Iraq paid its arrears to IBRD. Security, the third threshold issue, remains precarious, but the Bank has found innovative ways of operating in Iraq, relying on local staff and consultants, a wide communications network, and a satellite office in Amman.

In parallel with the Needs Assessment, the World Bank and UNGD presented the International Reconstruction Fund Facility for Iraq (IRFFI), to help donors channel their resources quickly and coordinate their support for reconstruction and development in Iraq. The IRFFI also allowed donors to pool their aid, and lower the transactions costs and demands for the Iraqi counterparts.

²⁸ The IMF and World Bank have worked closely on the reform program in Iraq. They have conducted a number of joint missions and organized policy workshops and training courses, covering public financial management, oil revenue management, intergovernmental finance, investment climate, payment system, banking supervision, social safety nets, and the like. Both are in broad agreement on the core reform program in Iraq, namely: (i) reinforcing public governance and institutions, including management of oil revenues; (ii) ensuring coherent and well-sequenced market-focused reforms; (iii) strengthening social safety nets; and (iv) improving the delivery of essential services, including education and health.

²⁹ The World Bank/UNDG Needs Assessment covers fourteen sectors and three cross-cutting themes and identifies investment needs and priorities for the 2004–07. The Bank led or participated in eleven of the fourteen assessments, and drew from experiences with similar joint UN-Bank assessment exercises in other countries, such as Rwanda, Timor Leste, and Afghanistan.

Within the IRFFI structure, separate World Bank and UNDG trust fund windows were developed, each with procedures consistent with the institution's mandate and operational policies. To date, donors have pledged around US\$1 billion to the IRFFI. Of that amount, seventeen donors have pledged about US\$400 million, and deposited US\$392 million, to the Iraq Trust Fund (ITF), the World Bank window.

Prior to the handover of administrative powers to the Interim Iraq Government in June 2003, and the subsequent clearance of arrears to the World Bank in December 2004, the ITF represented the only source of financing for the World Bank. An Interim Strategy, prepared in January 2004 by the World Bank in consultation with the Interim Government, provided a framework for ITF-financed assistance during the interim period when conditions for a broader Bank program had not yet been met.³⁰

A3.2. The World Bank's 2004 Interim Strategy for Iraq

On January 29, 2004, the World Bank's Board of Executive Directors discussed a first Interim Strategy Note (ISN) of the World Bank Group for Iraq and authorized the Bank to act as Administrator of the World Bank Iraq Trust Fund (ITF) within the International Reconstruction Fund Facility for Iraq. Over the past sixteen months, the Bank has worked within the framework of the first ISN, focusing on building Iraqi institutional capacity, preparing and starting to implement emergency operations, and laying the groundwork for Iraq's medium-term reconstruction and development program. Between March and December 2004, the Bank approved and launched nine emergency projects at a total value of about US\$366 million, thereby committing nearly all donor deposits in the ITF:

The Interim Strategy was shaped by the need for the country to undergo the transitions mentioned earlier. It focused on:

- (i) Building Iraqi capacity.
- (ii) Emergency operations to generate employment and restore essential infrastructure and services.
- (iii) Laying the foundation for the medium-term program, through studies and policy advice.

³⁰ Security Council Resolution 1483 of May 22, 2003 led to the establishment of the International Advisory and Monitoring Board (IAMB), which began operations in December 2003. The IAMB acts as an audit oversight body for the Development Fund for Iraq (DFI), also created under SCR 1483 to receive Iraqi oil proceeds, balances from the UN Oil-for-Food Program and frozen Iraqi funds. Until June 28, 2004 disbursements from the DFI were directed by the CPA in consultation with the Iraqi authorities. The mandate of the IAMB was extended under SCR 1546, and resources in the DFI are now controlled by the Iraqi authorities. The IAMB initially consisted of the Arab Fund for Economic and Social Development, the International Monetary Fund, the United Nations, and the World Bank. A fifth member was later designated by the Interim Government of Iraq. For more information on the IAMB, and access to the audit reports, please visit www.iamb.info.

In addition to including a component for policy reform assistance and capacity building within each of the urgent reconstruction projects (see Box 2.1 in Chapter 2), the Interim Strategy focused on building Iraqi capacity which is critical for reconstruction³¹. A First Capacity Building Project provided training to over 600 Iraqi civil servants to support Iraqi-implemented reconstruction projects, focusing on good international practices of project management, procurement, financial management and environmental and social safeguards.

In November 2004, a Second Capacity Building Project carried this forward, and began providing additional training related to economic reform; poverty and social safety nets; public sector and microfinance, among others.

The Bank has also, through its own budget and in coordination with partners such as the IMF, carried out various economic and sector analyses, and provided the Interim Government policy advice in:

- (i) Economic reform and transition
- (ii) Poverty, safety nets, and social development;
- (iii) Public sector reform and governance.³²

Specific Bank inputs are provided in the form of just-in-time policy notes on key reform areas and sectors, such as subsidy reforms, public finance, pension system and social safety nets, SOE restructuring and investment climate, trade policy and trade facilitation, and telecommunications. The World Bank is working with the World Food Program on the food market issues. Work is under way on social safety nets, state bank restructuring, agriculture reform, intergovernmental finance and civil service reform. In collaboration with the UN, the Bank has also provided policy advice and inputs to the Prime Minister's Higher Economic Committee in drafting the National Development Strategy.

A recently completed Country Economic Memorandum (CEM) provides an integrated analysis of the Iraqi economy for the Second ISN. Entitled *Rebuilding Iraq: Economic Reform and Transition*, the CEM drew on sectoral studies of Iraq's economy and policy discussions with Iraqi officials over 2003–05. To create jobs, restore basic services, and protect the vulnerable, the CEM identifies three main policy instruments:

- (i) Reforming incentive systems and supporting institutions to generate faster and more efficient growth in private sector jobs
- (ii) Establishing strong formal safety nets to protect the poor and vulnerable as prices are freed.

³¹ For example, the Emergency Education project has a component on institutional development restructuring and curriculum reform. The Baghdad Emergency Infrastructure Rehabilitation project has a component to develop a master plan for the city.

³² Four World Bank Policy Notes, covering the investment regime, state-owned enterprises, trade reform and food grain markets were released at Second IRFFI Donor Committee Meeting in Tokyo, in October 2004. Five more Policy Notes are under preparation.

- (iii) Strengthening accountable and transparent management of public resources, particularly oil.

The Bank is working closely with the Fund on the reform program in Iraq. The two institutions have conducted a number of joint missions and organized policy workshops and training courses for Iraqi civil servants and academics, covering public financial management, oil revenue management, intergovernmental finance, investment climate, payment system, banking supervision, social safety nets, and the like. There are no major differences of views between the two institutions on policy issues. The staffs are in broad agreement on the core reform program in Iraq, namely:

- (i) Reinforcing public governance and institutions, including management of oil revenues.
- (ii) Ensuring coherent and well-sequenced market-focused reforms
- (iii) Strengthening social safety nets.
- (iv) Improving the delivery of essential services, including education and health.

Since the summer of 2003, the International Finance Corporation (IFC), the private sector arm of the World Bank Group, has advanced its program to strengthen the private sector through financial and technical support. Through a specialized trust fund for Iraq, and its own resources, the IFC has led a parallel effort to: (i) build the capacity of private banks to support an emerging private sector; and (ii) inject funds and expertise into banks to provide funds to small and medium enterprises (Box A.3.1).

Box A.3.1: The International Finance Corporation

Since the inception of IFC's work in Iraq in 2003, the Corporation has undertaken a range of activities. The program consists of investment as well as technical assistance. The primary focus of this initial effort has been on support for the financial sector and SMEs. Development of the financial sector is essential to the expansion of the Iraqi private sector.

On the investment side, IFC has recently signed an agreement to acquire a minority stake in Credit Bank of Iraq, in partnership with the National Bank of Kuwait (NBK), which was among the first three international financial institutions to receive a full domestic banking license from the Iraqi Central Bank. IFC and the NBK plan to increase the capital of Credit Bank of Iraq in stages to put it in a strong position within the domestic financial market. IFC expects this investment to have a strong demonstration effect and pave the way for other international banks to invest in and transfer knowledge to the Iraqi market.

Another investment has been approved to support the financing of the SME sector in Iraq. The Iraq Small Business Financing Facility (SBFF) combines investment and technical assistance. Partially funded by donors and partly funded by IFC, the SBFF will provide financing, including a first loss component, and technical partners to the nascent local banking sector. The first participating bank has been identified, a joint venture partner bank has invested to increase the bank's capital and an agreement with a technical assistance provider is about to be signed. Following challenges in registering the shares of the joint venture partner and delays caused by security concerns, the first commitment is expected this fiscal year.

IFC has also been active in technical assistance in Iraq through the Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA). PEP-MENA launched a five month bank training program in September 2004, where 250 Iraqi bankers, representing 19 private and state owned banks, were trained on different banking disciplines: credit risk management, asset liability management, foreign exchange risk, strategic planning, marketing and retail financial products, international accounting standards, and credit appraisal and financial analysis. At the conclusion of the five month program, PEP-MENA held a two day seminar for Iraqi senior executive bankers in Amman, Jordan in January, 2005. The objective of the seminar was to discuss strategic options for the development of the Iraqi banking sector going forward. It also provided valuable input regarding future technical assistance needs.

The IFC Iraq program is now carried out from the newly-established IFC office in Amman, co-located with the Bank's Iraq Interim office in Amman.

The New Interim Strategy and IDA Assistance

In response to a formal request in December 2004 by the Interim Government, the World Bank will extend US\$500 in International Development Association (IDA) credits between FY2005 and FY2006 (See Box A.3.2 on IDA credits). In June 2005, a second Interim Strategy was prepared, in consultation with the Iraqi Transitional Government.³³

The Strategy builds on the Bank's experience to date in Iraq, and provides a framework for IDA lending and additional ITF financing over the next 24 months. Given the continued uncertain situation in Iraq, the strategy focuses on "the basics" and stresses simplicity and flexibility. Given Iraq's dependence on its oil wealth, and given that the Bank's financial resources for Iraq are relatively modest compared with those of other major donors and with Iraq's own budget, the Bank's most important contribution would

³³ During the Madrid Conference in October 2003, the World Bank pledged US\$3–5 billion in IDA and IBRD loans between 2004–07, with a first tranche of \$500 in IDA loans.

be to help Iraq develop institutional frameworks, policies, and systems that allow for more effective use of all donor funds and of Iraq's own financial resources.

This is based on the view that given the enormous financial needs in each sector, the Bank can, through its procedures and focus on recipient-implementation, put in place a modus operandi that can be leveraged by other donors. Also, the Bank's entry into these sectors would serve as a foothold to further dialogue on policy reforms.

Box A.3.2: World Bank Loans and Credits

IDA Credits. Terms for IDA credits are concessionary—0 percent interest, 0.5 percent commitment fee on the un-disbursed amount of the credit, and 0.75 percent service fee on the principal amount withdrawn and outstanding. Commitment and service fees are payable on the semiannual payment dates specified in the Development Credit Agreement. For IDA-eligible countries whose gross national income per capita is above the operational cutoff for IDA eligibility (currently \$895), credits are repayable over 20 years, with principal repayment at the rate of 10 percent per year from the 11th to the 20th year. Under these terms, IDA credits are approximately equivalent to 40 percent grant on a present value basis. Iraq has been grant IDA status on a temporary basis.

IBRD Loans. IBRD members that are creditworthy for IBRD lending, and who are servicing their existing debt obligations to the IBRD, are eligible for new loans on IBRD terms. The availability of IBRD loans to Iraq, if eventually requested, will depend on a positive political/security scenario, rapid economic recovery (including the oil sector), and generous debt relief or restructuring. IBRD currently offers two types of financial products for new loan commitments: Fixed-Spread Loans and Variable-Spread Loans. IBRD financial products typically offer grace periods and final maturities that are longer than what is offered by commercial institutions. In addition, they are priced so that they pass on to IBRD borrowers IBRD's low funding cost.

In addition to focusing on existing sectors where the Bank is involved, new programs have been introduced as a result of substantive dialogue with each Ministry, and training of staff is underway in procurement, financial management, and safeguards. These include power, higher education, environment and transport.

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