

DRAFT OUTLINE

‘To build a secure, unified, federal and democratic nation, founded on the principles of freedom and equality, and providing peace and prosperity for its people’

The International Compact with Iraq

**A Shared Vision
A Mutual Commitment**



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1 EXECUTIVE SUMMARY

The International Compact with Iraq (ICI) is an initiative of the Government of Iraq for a new partnership with the international community. Its purpose is to achieve a National Vision for Iraq which aims to consolidate peace and pursue political, economic and social development over the next five years.

The primary focus will be to build a framework of mutual commitments which will lead to Iraq's economic transformation and integration into the regional and global economy. It is recognized that good governance and resolution of security and political challenges are pre-requisites for progress in all other areas, including economic revival and normalization.

This document is an outline of the evolving ICI Document which will be developed through a process of consultation, and agreed at the ICI Event in November 2006. Within the structure envisaged of the final ICI document, this outline broadly describes the Government's key priorities and socio-economic reform directions.

The centrepiece of the final ICI document will be an agreement on mutual commitments by the Government of Iraq and the international community based upon an agreed medium term fiscal framework. Sections 6 and 9 of this outline document give indications of the nature of commitments expected to be agreed in the final ICI document. It is these sections in particular, and the initial directions that they convey, that the government of Iraq will seek to have endorsed by the Compact Preparatory Group in Abu Dhabi on September 10, 2006.

Compact Scope

- Political and Security Context
- Enhancing the National Development Strategy
- National Economic Integration
- Regional and Global Integration
- Public Resource Management
- Good Governance and Anti- Corruption
- Economic Reforms
- Private Sector Development
- Social Policy Reforms
- Human Development
- Energy Sector
- Agricultural Sector
- Medium-Term Fiscal Framework Based on the Needs of Iraq as Identified in the National Development Strategy
- Significant Investment Projects
- Mutual Commitments

2 THE COMPACT RESOLUTION

The official “Compact” or agreement between the Government of Iraq and the International Community

To be developed in consultation with the Preparatory Group through a consultative process over the period to November '06.

3 OBJECTIVE OF THE INTERNATIONAL COMPACT WITH IRAQ

Compact Objectives

- Iraq's Economic Transformation and Integration into Regional and Global Economies
- To achieve a National Vision for Iraq
 - Consolidate peace and political unity and the vision of a united federal democracy
 - Establish a path to economic reconstruction, integrated national economy and self-sufficiency over five years
- Advance goals of Iraq's National Development Strategy
- Reinforce stability and security
- Mutually reinforcing commitments
 - Iraqi resolve to critical reforms
 - International commitments for support
- Recognizing fundamental needs
 - Good governance
 - Resolving the political and security challenges
- Benefits to the Iraqi People – Towards Peace and Prosperity
- Benefits to the Government of Iraq – Support and Enhanced Legitimacy
- Benefits to the International Community – Peace and Stability, a New Partner

4 THE SHARED VISION FOR IRAQ: STRIVING FOR PEACE AND PROSPERITY

The compact will support the achievement Iraq's vision for its future:

‘A secure, unified, federal and democratic nation, founded on the principles of freedom and equality, and providing peace and prosperity for its people’

This section will elaborate Iraq's vision for its future development and discuss the three pillars that will support the achievement of this vision: Political, Security and Economic transformation.

5 REALIZING THE VISION

5.1 The Political and Security Context

Political Environment

Goal: *A united, democratic and federal Iraq, at peace with itself and integrated in its region and the world.*

Iraqi Commitments:

As outlined in the program of the national unity government and its national reconciliation initiative

- Implement the National Reconciliation Plan, which includes:
 - Rejecting violence in all forms,
 - Creating a rational political discourse
 - Protecting human rights and prosecuting those who violate them
 - Addressing the issue of militias
 - Building state institutions – effective, transparent, accountable, non-partisan
 - Combating corruption
 - Confidence building measures such as: Amnesty; De-Baathification; Detainee Releases
- Constitutional review and electoral legislation
- A just solution to the status of Kirkuk through agreement which takes account of the views of all communities and in accordance with the Constitution
- Strengthen rule of law and the criminal justice system
- Continued progress on legal reform

Security Environment

Goal: *The Compact will advance Iraq's commitment to achieving security and stability by:*

- Building the capabilities of Iraqi Security Forces
 - Joint Committee for Achieving Iraqi Security Self Sufficiency
 - Specific plans to assume greater responsibility
- Developing a credible, comprehensive and properly-costed demobilization, disarmament and reintegration program for militias and other armed groups
- Working with neighbors and international partners to protect Iraq's sovereignty and secure its borders.

5.2 The National Development Strategy

National Development Strategy

- Sets the objectives, strategies and priorities for achieving the shared vision for Iraq
 - Objectives
 - Creating and Enabling Environment for Private Sector Development, Investment and Growth
 - Managing public resources to promote unity and fiscal sustainability
 - Promoting Human Development and Reducing Poverty
 - Strategies
 - Public resource management and Institutional Strengthening
 - Economic Reform
 - Social Sector Reform
 - International Cooperation
 - Public Investment Priorities – the Sectors
 - Energy – Oil & Gas, Electricity
 - Essential Infrastructure
 - Agriculture

5.3 Enhancing the National Development Strategy

Enhancing the National Development Strategy

- **Data:** Improve the analytical underpinnings (needs and resources). Robust determination of needs. Realistic targets.
- **Planning:** Coordination at all levels. Broad participation to improve planning, avoid overlap and competition and ensure buy-in
- **Budgeting:** Reform and investment plans and costing to feed into the budgetary processes at all levels within an integrated federal fiscal framework. No projects outside the NDS and Budget
- **Execution.** Ensuring timely disbursement on the basis of approved plans. Devolve execution as close as possible to the point of delivery. Capacity building at the executing levels
- **Monitoring Review:** Data collection and analysis to provide feedback on the state of execution into the NDS to inform the process of review and future planning

National Integration

- Gradual roadmap for transition from national to area based, regional and provincial planning within integrated NDS framework
- Capacity building at sub-national levels – planning, execution and monitoring
- Transition ministries to policy development, setting, coordination, analysis, and regulation
- Synchronize with the development of fiscal federalism framework
- Synchronize with legislation delineating the roles and responsibilities at various levels of government

Regional and Global Integration

- Normalize relations with neighbors
 - Settle outstanding issues
 - Restructuring debts and other obligations
 - Participate in regional organizations
 - E.g., MENA-FATF
 - Develop relations with leading Chambers of Commerce and business organizations in the region
 - Private Sector-to-Private Sector affiliations and contacts
- Participate in global institutions
 - Deepen relations with WB, UN, others
 - Aim to join the WTO
 - Establish relations with leading NGOs
 - E.g., Transparency International

6 REFORM AND INVESTMENT COMMITMENTS

In the context of the Government of Iraq's security and political strategies and the National Development Strategy, this section will outline key reform processes, commitments to reform and investment actions, and benchmarks for monitoring performance against these commitments.

The nature of GoI commitments

- Towards a medium term reform process
- Specific reform actions with intrinsic value and to drive further future reform through the Consultative Group process
- Investment actions

These will form the basis for joint monitoring indicators (Benchmarks)

These commitments will focus on three key policy areas:

- Public Resource Management and Institutional Strengthening
- Economic Reform
- Social Sector Reform

and three key sectors:

- Energy (Oil, Gas and Electricity)
- Agriculture
- Significant Investment Projects

6.1 Public Resource Management and Institutional Strengthening

Public Resource Management

Goal: *Maximise the benefit from oil wealth to the people of Iraq in all the regions and provinces by establishing an efficient, equitable, transparent and accountable system for the management of oil and other revenues. Use the oil wealth to promote national unity and diversified sustainable development.*

- Oil and other revenues
 - Create a focal point for all oil and other revenues and the mechanisms to support this
 - Iraqi Audit and Monitoring Board
 - Ensuring transparency and accountability, (IAMB successor)
 - Publish oil output, exports and revenues
 - Revenue sharing framework
 - Ensuring equity, sustainability and fiscal integrity

Public Finance Management

- Establish a program for Public Expenditure Reviews
 - Method to set spending priorities, assess changes in assumptions, assess actual spending versus plans and allocations
- Establish a consolidated budget and a single Treasury account
- Implement effective Financial Management and Information System (FMIS)
- Establish benchmarks and take measures to improve budget execution (including contracting and procurement reform) across all ministries and provinces and all titles of the budget
- Transparency of public accounts
 - Publicize government budgets and data related to production and sales of oil and use of revenues
- Publish regular audits of government finances performed by qualified independent auditors
- Introducing a Medium Term Perspective
- Reforming Institutional Arrangements
- Fiscal Federalism

Good Governance / Anti-Corruption

Goal: *Develop a legal framework and build institutional capacity to deter corruption at all levels of government*

■ Notional Benchmarks:

- Reforming and improving the capacity of government under the rule of law at all levels
- Develop anticorruption plans for institutions with substantial revenue and expenditure assignments
- Strengthen and implement the public income and asset disclosure law
- Launch a public education campaign on anticorruption
- Strengthen capacity for internal audit for Inspector Generals
- Ratify the UN Convention Against Corruption
- Establish a unit to recover assets that are the proceeds of corrupt dealings
 - Introduce legislation as necessary to authorize asset seizure and forfeiture

Civil Service Reform

- Human Resource Policy
- Rationalise Payroll
- Build Capacity
- Delineate Competencies
- Merit Based System

6.2 Economic Reform

Reforming Subsidies

Goal: Phase out inefficient, large scale subsidy programs while ensuring delivery of services to the poorest

- **Transition from universal subsidies to targeted benefits**
Ensuring efficiency and equity; Protecting the vulnerable; Conducting public education and consultation; Promoting economic diversification
- **Fuel Subsidies**
Phase out according to SBA in tandem with Social Safety Net development and other compensation mechanisms
- **PDS**
Improve efficiency and integrity; Rationalise and introduce targeting

Private Sector Development, Investment and SOEs

Goal: *Create an enabling environment for private investment and job creation*

- **Notional Benchmarks:**
 - Pass and implement the new Investment Law
 - Develop and implement a plan for reform of major state-owned banks
 - Adopt a public procurement law
 - Streamline procedures for business creation
 - Consider strategies for restructuring, commercializing and/or and privatizing SOEs
 - Find private sector-based solutions to stimulate housing development (e.g., mortgage loan guarantee system)
 - Improve availability of private sector financing

Financial Sector Reform

- Restructure and rationalise State Owned Banks
- Create an enabling environment for private banks
- Provide credit guarantees, concessionary financing and other support for SME financing and Micro-Credit Schemes
- Continue progress towards developing Electronic Payment Systems

6.3 Social Sector Reform

Social Safety Net

Goal: *Taking care of the poor and vulnerable*

- Notional Benchmarks:
 - Develop an integrated strategy for social policy reform
 - Maintain social safety net budget in real terms
 - Not just cash benefits
 - Education, development of marketable skills, job orientation
 - Means-tested; effective delivery system
 - Taking account of phase-out / reductions of other subsidies
 - Fuel price increases / fuel import liberalization
 - Reforming Public Distribution System
 - Reform pensions ensuring equity, sustainability and transparency

Human Development

Goal: *Protect citizens, improve their wellbeing and productivity and mobilize Iraq's human capital as the key ingredient for sustainable development. Human development is one of the main goals of the Compact and will be one of the main benchmarks for evaluating the effectiveness of the entire process.*

- Iraq's National Development Strategy (NDS) sets out strategic priorities for Iraq's development towards achieving the MDGs including:
 - Reduce poverty
 - Improve access to clean water and sanitation;
 - Improve the quality and access to medical care;
 - Increase affordable housing; and
 - Invest in human capital
 - Schools, universities, vocational training
 - Adult literacy programs, actions to reduce school drop-out rate.
 - Developing institutional capacity a key theme
- The International community will support Iraq through programs to increase Iraqi central and local government capacity to develop these programs.
 - Consistent with other agreements, e.g., IMF SBA
 - Supported by Social Sector Working Group

6.4 Energy (Oil, Gas and Electricity)

Energy Sector

Goal: *Develop an energy sector that promotes national unity and prosperity, meets Iraq's energy needs and maximizes the benefit of Iraq's hydrocarbons for all Iraqis.*

- Integrated energy policy: Energy Sector Master Plan, Energy Balance
- *Oil and gas reform*
 - Hydrocarbon legal and regulatory framework (Petroleum Law) to:
 - Clarify mandates between the national and sub-national level
 - Enable the development of national strategy, policy and regulation
 - Support national infrastructure and marketing
 - Create diversified operations
 - Restructure and commercialize operators and liberalise downstream
 - Promote foreign investment and private sector development
 - Establish hydrocarbon fiscal regime
 - Improve monitoring and control
- *Oil and Gas Investment*
 - Meet Demand for Petroleum Products by 2008
 - Increase Crude Output to 3.5mbpd by 2010
 - Prioritise Natural Gas Development

Energy Sector

- *Electricity reform*
 - Least Cost Development Plan
 - Financing strategy (public and private)
 - Regulatory framework delineating policy, regulation and operations
 - Tariff policy balancing commercial viability and protection for the vulnerable
 - Managing demand
- *Electricity investment*
 - Meet demand with 10% reserve by 2015

6.5 Agriculture

Agriculture Sector

Goal: *Support the development of the agriculture sector to achieve food security, generate employment, diversify the economy and preserve cultural heritage*

- Notional Benchmarks:
 - Build planning and financial management skills, marketing analysis, and credit management for farmers and downstream agribusinesses
 - Revise Iraq's agricultural policies to develop markets that encourage enterprise and the right choice of crops
 - Undertake land and water-use planning to offer incentives to reduce the misuse of soil and water (e.g., changes in land tenure, water rights, field crop subsidies, irrigation)
 - Adopt an institutional and policy framework that encourages private sector initiative and investment

7 MEDIUM TERM OUTLOOK

Medium-Term Fiscal Framework

Goal: *To ensure that the needs identified in Iraq's National Development Strategy and reflected in its Medium-Term Fiscal Framework are fully met by the resources available to Iraq, including revenues, grants and official and foreign direct investment*

- The Iraq Compact will include a Medium-Term Fiscal Framework that:
 - Incorporates Iraq's major investment priorities and development goals, consistent with the National Development Strategy
 - Incorporates base line with prudential and optimistic scenarios, taking account of different projections of oil prices and production levels
 - Recognizes the full costs of Iraq's security forces and anti-terrorism efforts
 - Quantifies needs for external support
 - Recognizes the potential for official and foreign direct investment
 - Is consistent with the Iraq's Stand-By Arrangement with the IMF
 - Forms the basis for mutual commitments under the Compact

Risks in the Fiscal Outlook

- Security/Political Risks
 - Increases costs, hinders execution, constrains financing
- Political Risks
 - Uncertain sovereign risk effects investment
 - Other events competing for attention, e.g., Lebanon
- Financial Risks
 - Oil prices; failure to resolve outstanding debt issues
- Economic risks
 - Inflation; crowding out (public sector expansion); failure to reclaim regional status as 'knowledge nation'
- Institutional and Fiduciary
 - Lack of capacity needed to achieve results
 - Potential for resource misallocation, waste, abuse
 - Lack of transparency, accountability

8 Significant Investment Projects

Significant Investment Projects

Goal: To Enhance Iraq's Capacity to Carry out Significant Investment Projects in Priority Areas

- Explore ways to streamline and expedite planning, design and execution of significant investment projects through, for example, the establishment of a special reconstruction board
 - Emphasis on fast-tracking implementation of projects of national significance including major water and transport infrastructure
 - Promoting economic growth and diversification
 - Removing administrative bottlenecks and enhancing contracting and execution capacity
 - Ensuring efficiency, equity, transparency and accountability
 - Preserving fiscal integrity and sustainability
 - Ensuring consistency with the National Development Strategy

9 Mutual Commitments

Based on the medium term fiscal framework and its expression of Iraq's reform and investment needs, this section will outline the commitments and support required from the international community.

Mutual Commitments

- The Government of Iraq and the international community will:
 - Commit to "partnership principles" to improve the effectiveness of assistance
 - Improve aid effectiveness
 - Provide support through a range of mechanisms:
 - Technical assistance
 - Capacity building
 - Grants and loans
 - Restructuring debts and other obligations
 - Loan guarantees
 - International agreements
 - Assistance with regional and international initiatives
 - Agree on coordination and monitoring mechanisms
 - Elaboration of IRFFI's role in supporting the Compact

Example Joint Monitoring Indicators Matrix

Indicators	Actions Needed	Responsible Government Ministry	Commitments and Resources	
			Government	International Community
1. Desired outcome / high level government goal				
1.1 Program / sector / theme				
Indicator 1	Action 1 Action 2 Action 3	Ministry 1 Ministry 2 Ministry 3	Government Commitments (e.g., counterpart funds, policy elaborations)	International Community Commitments (e.g., financial, technical, other)
Indicator 2	Action 1 Action 2 Action 3	Ministry 1 Ministry 2 Ministry 3	Government Commitments (e.g., counterpart funds, policy elaborations)	International Community Commitments (e.g., financial, technical, other)

10 IMPLEMENTING THE COMPACT

This Section will detail how the agreements reached through the Compact process will be implemented. A Consultative Group Process will be adopted to coordinate and monitor performance against benchmarks, and to develop more comprehensive reform programs that can be undertaken over the medium term.