

## Executive Summary

Section 2207 of the Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004 (Public Law 108-106), requires the Secretary of State to submit a quarterly report to Congress outlining the current conditions for programs and initiatives supported by the specific appropriations dedicated to the Iraq Relief and Reconstruction Fund (IRRF). The Office of Management and Budget (OMB) submitted the first three quarterly reports to Congress, with the last OMB submission occurring July 2, 2004. Subsequent reports have been submitted by the Department of State, beginning October 5, 2004.

### *Completing IRRF Projects*

Over the last quarter, the IRRF obligations have continued at a steady pace, reaching over \$16.7 billion obligated as of June 30, 91% of the total \$18.4 billion. As detailed in Appendix I, many IRRF projects are ending this quarter or next.

- The Al Fathah oil crossing pipeline was completed. When a related 40-inch pipeline is completed, this project will significantly increase Iraq's capacity to export oil through Turkey. Several other oil projects were completed, including 11 Gas Oil Separation Plants (GOSPs) which add 300,000 barrels/day in oil production capacity, projects to increase LPG production and the rehabilitation of a loading arm for Iraq's marine oil terminal, which will significantly increase Iraq's oil export capacity.
- The Consolidated Fiber Network was completed, which when integrated with the finished SCADA system, will establish reliable communication between Ministry of Electricity generation and transmission sites. This project will form the backbone of a SCADA system, due to be complete in April 2007, which will significantly improve the reliability of Iraq's electricity transmission system, improving service to customers and reducing operational breakdowns. A project to increase electricity distribution in Baghdad was also completed.
- The IRRF education program wrapped up, which trained 60,000 teachers, provided 8.7 million textbooks, opened 84 model schools and provided 525,000 education kits, as well as setting up an Education Management Information System (EMIS) to enable the Education Ministry to track and plan Iraq's long-term educational development.
- The Advanced First Responders Network was completed, improving emergency communications among police entities in 15 Iraqi cities. Rehabilitation of the national Civil Defense Headquarters was also completed, providing a modern facility for Iraq's firefighting and rescue services that will allow them to improve response time and service.
- Border forts and Iraqi Armed Forces facilities were completed, as were projects to provide Iraqi Armed Forces with communications equipment and vehicles.

- A major sewage project in Basra was completed, as were 24 of the 25 rural well projects. The village road program is now 92% complete.
- Assistance was provided to the Iraqi Government in drafting a new securities law and an investor roadmap to provide a comprehensive guide for businesses interested in opportunities in Iraq. IRRF projects continue to support a number of projects to improve Iraq's investment climate, including the commercial law institutional reform program, which has seen 18 of 80 draft laws adopted already by the Council of Representatives. Another 23 draft laws have been completed and are awaiting GOI approval, while 39 are still being drafted. These laws cover a wide range of issues, including telecommunications, tax reform, budget processes, banking, investment, insurance and oil.

For the remaining projects, the U.S. implementers are on track to fully obligate the remainder of the IRRF program by September 30, 2006 and are focusing the remaining funds on completing projects still underway and providing the new government with funding support. The focus continues to be on small, local projects that build credibility and capacity through direct contracting with Iraqi firms and extensive training for operations and maintenance. We continue to adapt the programs based on lessons learned in a dynamic and fluid environment.

### ***New Government Formation***

On May 20, 2006, Iraq's Council of Representatives approved a government of national unity, Iraq's first government under its new constitution. The new government, led by Prime Minister Nuri al-Maliki and President Jalal Talabani, represents the final phase of the transition from an American-led authority to an interim government, transitional government and now a freely-elected, representative unity government under the Iraqi Constitution. Prime Minister Maliki has moved to establish and energize a government of national unity and action by approving a Baghdad security plan, a summer electricity action plan, a plan for National Reconciliation and a plan to conclude an International Compact. The new government also implemented fuel price increases in June that bring those prices closer to regional averages and will reduce the cost to its budget, a key aspect of its reform agreement with the International Monetary Fund. These plans will bring visible and lasting change to the Iraqi people. Moreover, the Prime Minister has begun public outreach by traveling throughout Iraq to underscore his connection with Iraqis and emphasize his personal commitment to addressing Iraq's challenges.

Throughout the government formation process and into the new administration, the United States remained actively and constantly engaged in supporting the desire of Iraqis for the formation of an inclusive, national unity government that serves the interests of all Iraqis. As part of our strategy, we have actively engaged the new Ministers in designing programs that provide for the security and the essential services needed by the citizens of an emerging democracy. The U.S. mission continues to ensure that reconstruction projects and programs funded with U.S. funds will reinforce the Prime Minister's priorities.

The Iraq Relief and Reconstruction Fund has been essential to providing a foundation upon which the newly formed Government of Iraq (GOI) can build its capacity to provide services to Iraqi citizens and to govern effectively. During the second quarter, a number of IRRF infrastructure projects were completed. We expect to complete most large infrastructure projects by the end of the year, after which only a few high-profile projects, such as the Nasiriyah water supply project, will still be under construction. As the IRRF projects are completed, we are emphasizing the critical importance of the Iraqi Government and Iraqi people assuming ownership of the projects, to include responsibility for their maintenance and operation.

Since March 2006 the United States has collaborated with the Ministry of Finance to transfer IRRF-funded assets to the Government of Iraq, enabling the Ministry of Finance and the receiving operating ministry to plan and budget for sustainable operations. Through this process, the U.S. is assisting the Asset Recognition and Transfer Operations Group (ARTOG) develop a Capital Asset Registry, which will help the GOI leverage the value of their current assets to obtain further external financing to support additional infrastructure needs. Asset Recognition and Transfer (ART) represents the final stage in the IRRF implementation process and requires an active engagement on the part of the new Government of Iraq. We expect ART will continue into 2007.

### ***Capacity Development***

As the Council of Representatives and Ministers take their seats in the new Iraqi government, the U.S. has engaged to assist with building ministerial capacity. To complement the longer-term nature of the National Capacity Development (NCD) initiative, the U.S. is providing immediate support to the incoming government through Ministry Advisory Teams (MATs) to strengthen its capacity to effectively and efficiently deliver goods and services to the Iraqi people.

The MATs, which include Iraqi ministry, U.S. government, and donor nation representatives, are working to assist key ministries identify strategies and programs to develop the internal capacity needed to support improved and sustainable service delivery. Iraqi ministries are becoming more active in addressing and prioritizing their needs through the MAT process, which has established credible working relationships and received support from the Prime Minister. Through the MAT process, the Ministry of Finance was able to identify critical needs and sponsor a budget retreat to train Iraqi officials from all ministries and provincial treasuries on budget preparation and execution processes. The retreat was led by Iraqis with U.S. and UK support and participation. The NCD initiative will then conduct further capacity development activities identified by the MAT that build upon the budget training. These activities will include supporting procurement and contracting reform and introducing inventory and supply management systems to combat corruption.

The United States will continue to assist long-term ministry capacity development through the NCD initiative by focusing on Iraqi training institutions, such as the National Training Center, to build sustainable Iraqi-owned training and certification programs that

will continue well beyond U.S. assistance programs and allow other donors additional mechanisms to contribute support.

### ***Provincial Reconstruction Teams (PRTs) Expanding***

Developing effective national and provincial governance in Iraq is a key component of Iraqi self-reliance and defeating the insurgency. The new Constitution devolves more responsibility to the governorates (provinces). Provincial Reconstruction Teams (PRTs) provide a crucial link between national capacity-development efforts and provincial governments. Five PRTs are currently operational, including PRT Tamim (Kirkuk), PRT Ninewa (Mosul), PRT Babil (Hillah), PRT Baghdad, and PRT Anbar (Ramadi). Recruiting for additional PRTs is underway; as many as eight would be U.S.-led, with the others led by Coalition partners or Iraqis. The UK is leading a PRT in Basrah, as is Italy in Nasiriyah and other partners are considering leading or supporting roles. These Coalition-led PRTs follow a functional structure similar to those led by the United States.

The coalition PRTs are led and staffed by coalition partners with support from U.S. personnel. We continue to seek involvement from other coalition and international partners in the PRT program. In addition to the U.S. and coalition-led PRTs, we intend to establish PRTs in Maysan, Muthanna, Dohuk, Karbala and Sulaymaniyah with a local Iraqi staff supported by a U.S. or international staff remotely located.

PRTs build on the successful establishment of the Iraqi-led Provincial Reconstruction Development Committees (PRDCs) in each of the governorates. In keeping with the National Capacity Development initiative, PRTs work with the PRDCs and Provincial Councils to develop provincial capacity to provide for the needs of their citizens and effectively administer the provincial government.

### ***IRRF Reallocations During the Quarter***

Two Congressional Notifications (CNs) regarding the reallocation of a total of \$133.6 million in IRRF funds were submitted to Congress during the last quarter. These CNs increased funding for programs such as Electricity Generation and Nationwide Hospital and Clinic Improvements. This quarterly report will serve as notification of another \$59.75 million as follows:

- \$27.7 million to be taken out of Distribution Network Infrastructure and put into Generation.
- \$12.8 million to be taken out of Transmission and put into Generation.
- A total of \$10.4 million to be taken out of Water Conservation (\$2.2 million), Irrigation and Drainage (\$0.2 million), Major Irrigation Projects (\$3.5 million), Dam Repair (\$4 million) and Umm Qasr/Basrah Water Supply (\$0.5 million) and put into Sewerage.

- \$8.6 million to be taken out of Major Irrigation Projects to be put into Potable Water.
- \$250,000 to be taken out of Business Skills Training and put into Micro, Small and Medium Enterprises.

In addition, this report now reflects \$5 million transferred in from the Economic Support Fund, as required in P.L. 109-234, for the Marla Ruzicka Iraqi War Victims Fund.

### ***Challenges***

In the second quarter of 2006, IRRF-funded reconstruction continued to face security challenges on the ground, reducing the positive impact of projects on the delivery of services to the Iraqi people. Most notably, work in the oil and electricity sectors has been delayed by attacks on the physical infrastructure and intimidation of workers and their families. Dramatic increases in demand, driven by the liberalization of trade and increased income of Iraqis, but unchecked by the implementation of market-based pricing, also continue to challenge efforts to improve basic services.

These challenges require a combined U.S. and Iraqi effort over the short- and long-term. Over the short-term, the GOI in coordination with the U.S. Mission and MNF-I began executing an Energy Action Plan to overcome challenges in the energy sector by mid-summer. In the last three months, an intensive, combined effort focused on improving the maintenance of electrical generation facilities, the availability of fuels for electrical generation and the establishment of infrastructure security response mechanisms.

Oil export volumes rebounded from the first quarter's average of under 1.3 million barrels per day (mbd) to an average of 1.56 mbd in the second quarter, and 1.6 mbd for June, close to the Energy Action Plan average goals for the summer. Moreover, higher world oil prices have kept oil revenues very close to Iraqi budget projections. In addition, the GOI has undertaken active measures to execute the Energy Action Plan, by approving letters of credit for fuel imports, mobilizing contractors to operate electricity plants and implementing operations and maintenance training at key power stations. In the longer-term, the U.S. and the new government have focused on capacity building and training to ensure proper maintenance and management. Coupled with this training, the U.S. has also assisted the new government in fuel reform, including reducing subsidies and drafting legislation to liberalize fuel imports, which will reduce the burden on the Iraqi budget and improve Iraq's ability to reinvest funds into reconstruction efforts.

### ***Health Sector***

The U.S. has recognized the need to continually improve good business practices and sound accounting in all its projects. Under this principle, the three task orders for construction of Primary Health Centers (PHCs) were terminated for convenience last quarter due to depletion of available funds resulting from delays and other issues of contractor performance. The PHCs are in the process of being completed through direct contracting with local Iraqi firms, for which additional IRRF funds were notified and are being used. Despite reconstruction challenges, the Ministry of Health opened two PHCs

on May 25, and they were well received by the Iraqi neighborhoods where they are located. The IRRF funds reallocation will allow us to contract directly with local Iraqi firms to complete the remaining PHCs. The U.S. continues to work with the Ministry of Health to ensure sustainment for the PHCs over the long-term.

During this period, the U.S. terminated for convenience the contracts to renovate eight hospitals, which were over budget and significantly behind schedule. The contracts were subsequently re-awarded to local Iraqi firms. Using a bridge contracting mechanism, there was no work interruption, and the Iraqi contractors are working to complete the projects within budget and make up a substantial portion of schedule delays. These proactive mitigating actions by IRMO and the Army Corps of Engineers/PCO demonstrate sound business practices, and reflect awareness of past challenges to deliver projects within allocated budgets.

Responding to similar challenges, a U.S. team arrived in Iraq in early June to conduct a comprehensive assessment of the Basrah Children's Hospital (BCH) project and provide recommendations for moving the project forward. The U.S. is negotiating with the design-build contractor of BCH to implement a contractor phase-out plan as a result of significant schedule delays and cost-overruns. The contractor phase-out plan would include provision for the contractor's demobilization costs and preserving work that has been completed at the construction site until the best way forward to complete the project is determined.

### ***International Donor Assistance***

In addition to managing the implementation of IRRF projects, the U.S. has continued to partner with international donors to support reconstruction and capacity development efforts in Iraq. In May, the World Bank (WB) announced that it would send a country director and possibly five internationally-recruited staff to establish a full-time presence in Iraq. The Bank's presence in Iraq will enable rapid execution of much needed WB programs and funds. WB presence will also send a strong message to the international community about engaging with the new Iraqi Government. The European Community (EC) has also indicated it will expand its office in Baghdad during the summer of 2006. Japan has finalized \$650 million in soft loans to Iraq, targeted for port development, irrigation sector assistance, and the Al-Mussaib Thermal Power Plant rehabilitation. These loans are the first to be concluded under Japan's \$3.5 billion soft-loan program, focused on mid-term reconstruction needs.

The Iraqi Prime Minister has announced his intent to pursue an international compact, loosely modeled on the Afghan Compact, to address Iraq's development needs and strengthen international support. Under this initiative, Iraq will make specific commitments to undertake reforms along a timeline. In return, Iraq's international partners will respond by making commitments to support Iraq's needs. At Iraq's request, the UN will play a lead role in helping Iraq formulate this important document, as will the World Bank. Senior UN officials have already met with Iraqi leaders to discuss preparations to launch this important international initiative.

### ***Conclusion***

The United States is working closely with the new Iraqi government and remains committed to assisting the people of Iraq. Through the last phase of the IRRF program, the United States is focused on building capacity of the central, regional and local Iraqi governments. The United States and the GOI believe that through the National Capacity Development initiative, Ministerial Advisory Teams, and Provincial Reconstruction Teams, along with the continued focus on smaller, high-impact projects, government responsibility and independent leadership will be strengthened, increasing its capability to deliver essential services and provide economic opportunities to Iraq's citizens. IRRF monies provide this critical support through programs and projects that strengthen capacity, promote stability and enable reconstruction in Iraq.