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from : Secretary-General of the European Commission,
signed by Ms Patricia BUGNOT, Director

date of receipt : 6 October 2003

to : Mr Javier SOLANA, Secretary-General/High Representative

Subject: **Communication from the Commission to the Council and the
European Parliament
– The Madrid Conference on Reconstruction in Iraq – 24 October 2003**

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 1.10.2003
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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT**

**The Madrid Conference on Reconstruction in Iraq
24 October 2003**

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

The Madrid Conference on Reconstruction in Iraq 24 October 2003

1. INTRODUCTION

At the Thessaloniki European Council on 19-20 June 2003, the European Union reiterated its commitment to the development of a prosperous and stable Iraq and concluded that it “*stands ready to participate in the reconstruction of Iraq within the framework of UNSC Resolution 1483*”. The July GAERC confirmed that the EU is ready to participate in reconstruction and to play an important role in multilateral efforts with a view to a Donors’ Conference for Iraq. The Thessaloniki European Council invited the Commission to submit proposals for an EU contribution to the multilateral effort to assist Iraq’s transition. The present Communication responds to this invitation.

Under the auspices of the United Nations, a preliminary conference was held in New York on 24 June 2003. This meeting decided that donors would be asked to contribute to meeting Iraq’s needs for assistance for rehabilitation and reconstruction in the coming 12-15 months. The Spanish Government has agreed to host an international conference on 23 and 24 October 2003 which will launch the multilateral effort to support the rehabilitation and reconstruction of Iraq and seek indicative pledges from donors for the period until the end of 2004.

The present Communication aims to take full account of the developing situation in Iraq, particularly with regard to security and steps towards political transition. This is all the more urgent in the light of recent violence which has tragically claimed the lives of Iraqis and members of the international community, including UN Special Representative Sergio Vieira de Mello. Iraq now has a unique opportunity to transform itself from an authoritarian regime and command economy to a representative, democratic political system that promotes respect for human rights and fundamental freedoms and a functioning market economy. This objective deserves the full support of the European Union and the international community as a whole.

This Communication sets out the basis for a common approach for the participation of the European Union in the Madrid Conference, as well as making proposals for the Community’s contribution to rehabilitation and reconstruction in Iraq until the end of 2004. It will be necessary subsequently for the European Union to develop a comprehensive medium-term strategy for its relations with Iraq in the light of developments during this period including political, social, economic and trade policy issues.

2. THE CONTEXT FOR THE MADRID CONFERENCE

Security Environment

The attack on UN headquarters on 19 August 2003, the bombing of the mosque in Najaf, the targeting of international humanitarian organisations and the daily toll of casualties and

fatalities among coalition soldiers have led to a scaling down of operations by international organisations and NGOs. A large number of NGOs have withdrawn their international staff from the country, scaled back operations outside the capital, and increased protection for local staff. The United Nations has reduced its international staff by more than two thirds.

A general increase in criminality has restricted the scope for movement around Baghdad and beyond – both for international operators and the Iraqi population. Acts of sabotage against infrastructure, particularly the electricity transmission lines and oil and water pipelines, are undermining efforts to restore the delivery of basic utilities and re-start production. As explained below, a significant improvement in security environment is needed to permit reconstruction work to go ahead.

Political and Legal Framework

United Nations Security Council Resolution (UNSCR) 1483, adopted on 22 May 2003, established the international framework for the administration of Iraq. Under the terms of Resolution 1483 the Security Council takes note that the Coalition Provisional Authority assumes specific authorities, responsibilities and obligations under applicable international law as “Occupying Powers”. This encompasses, *inter alia*, compliance with the Geneva Convention of 1949 and the Hague Regulations of 1907. The United Nations – through the Office of its Special Representative – was given a significant role in co-ordinating humanitarian and reconstruction assistance and, together with the Coalition Provisional Authority, in restoring representative government in Iraq. UN Security Council Resolution 1500, adopted on 15 August, welcomed the establishment of an Iraqi Governing Council as an important step towards the hand over of sovereignty to a representative Iraqi government. UNSCR 1500 also established the United Nations Assistance Mission for Iraq (UNAMI), tasked with implementing the mandate accorded to the United Nations in UNSCR 1483.

UNSCR 1483 refers to the future establishment of an internationally recognised, representative government by the people of Iraq which will assume the responsibilities of the Coalition Provisional Authority. Until such a time, the Iraqi people shall, with the help of the Coalition Provisional Authority and working with the United Nations Special Representative, form an Iraqi interim administration as a transitional administration run by Iraqis. On 21 July 2003, the European Union welcomed the establishment of the Iraqi Governing Council as a first step in this process. On 1 September 2003, the Governing Council appointed 25 Interim Ministers who took office on 2 September 2003.

On 13 August 2003, the Iraqi Governing Council appointed the 25 members of a Preparatory Committee charged with agreeing on a process for drafting a new Iraqi constitution. This Committee is due to report back on 15 September with its recommendations. The aim is for a draft Constitution to be put forward for adoption by a popular referendum, paving the way for elections for a Iraqi government and the transfer of sovereignty.

Economic Situation

Iraq is not a resource-poor country. It has the second largest proven oil reserves in the world and the lowest oil production costs in the region. It is, however, suffering from over two decades of economic degradation, a tightly controlled command economy, and the impact of successive conflicts and associated sanctions. Between 1990 and 2001, for example, Iraq’s position in the United Nations Human Development Index slipped from 76 to 127 and Gross Domestic Product declined by at least two-thirds to around US\$750-1000 per capita.

The Iraqi economy has a number of fundamental strengths. An abundant supply of arable land and water resources could contribute to the revival of the agricultural sector. High investment in education until the 1990s has created a skilled labour force. One hundred thousand small businesses already exist from which to expand Iraq's private sector. In the medium-term Iraq ought to be able to exploit this potential in order to diversify its economy and develop alternative sources of revenue.

Iraq's immediate economic prospects are heavily dependent on its capacity to expand production in the oil sector in 2003-4. Substantial investment and improved security conditions are required if oil production is to be expanded from 1.3 million barrels per day (mbd) in August 2003 to the 2.5-3.0 mbd the Coalition Provisional Authority hopes to achieve by the end of 2004. In the coming 12 – 15 months, oil revenues will not be sufficient to cover the costs of Iraq's rehabilitation and reconstruction¹.

Moreover, action is needed in a number of areas to set Iraq's economy on a sustainable medium term path. For instance, the massive external financial obligations (debt and compensation claims) accumulated by the previous regime should be addressed and economic management should be improved, including through market-oriented reforms and the introduction of an effective social safety net.

Framework for Reconstruction

UNSCR 1483 created a Development Fund for Iraq (DFI)², funded from Iraqi resources, mainly oil revenues, and through the repatriation of frozen assets and the remaining funds from the Oil For Food programme, administered by the United Nations³. The decline in Iraq's oil production capacity and a lack of alternative sources of state revenue place severe constraints on Iraq's capacity to finance rehabilitation and reconstruction activities in 2003-2004 from the DFI. With Iraq's resources devoted to covering recurrent administration and investment costs of the state, external assistance will be required to meet the cost of investment in reconstruction.

In this context, the United Nations hosted technical consultations in New York on 24 June 2003 and a Liaison Group, composed of some 50 states, and a Core Group were established to consider the international contribution to reconstruction in Iraq. The Core Group was asked to co-ordinate the preparation of a Donors Conference⁴. It agreed that the United Nations and the World Bank should organise needs assessment missions leading up to a Donor's Conference in October 2003.

¹ A detailed assessment of the Iraqi economy and its prospects is under preparation by the UN, IMF and World Bank in the context of the needs assessment process. A synthesis report will be issued before the Madrid Conference.

² As the governing authority, the Coalition Provisional Authority is responsible for disbursements from the DFI. An International Advisory and Monitoring Board, composed of the IMF, World Bank, Arab Fund for Social and Economic Development and the UN, is responsible for auditing the way in which DFI funds are spent.

³ The United Nations is due to transfer responsibilities for the Oil for Food Programme to the Coalition Provisional Authority on 21 November 2003.

⁴ Initial participants in the Core Group were EU (Commission and Presidency), US, Japan, UAE, UN Development Group, World Bank, IMF and Coalition Provisional Authority. Following the decision to hold the Donors' Conference in Madrid, Spain was invited to join the group.

On 16 July 2003, the Coalition Provisional Authority, in conjunction with the Iraqi Ministries of Finance and Planning, circulated a budget covering July – December 2003. This budget focused on the restoration of basic services, restructuring the banking system, state owned enterprises and agriculture and expanding security and justice activities. For 2004, the United Nations and the World Bank led needs assessment, in which Commission experts have been involved, will identify sector priorities for reconstruction.

In parallel, the Coalition Provisional Authority is producing a draft national budget for Iraq for 2004 which will show expected levels of revenue, in particular from oil sales, and expenditure for both the operating costs of the Iraqi administration and investment needs for reconstruction. These two exercises are being co-ordinated to ensure that potential donors are presented with an integrated set of priorities for rehabilitation and reconstruction at the Madrid Conference.

3. THE EUROPEAN UNION'S POSITION AT THE MADRID DONORS CONFERENCE AND BEYOND

Three broad conditions need to be satisfied if the European Union and its Member States are to make an effective contribution to the reconstruction of Iraq at Madrid and beyond:

- **The need for an improvement in the security situation**

The security environment in Iraq needs to be improved to permit effective and rapid reconstruction work to go ahead. As the occupying power, the Coalition Provisional Authority is responsible for providing the conditions which will enable the delivery and implementation of international assistance. This requires more effective action by the military, better adapted to present circumstances, and further efforts to expand and improve civilian policing. Some donors have expressed an interest in providing assistance for non-military security, such as police training, as well as independent protection for international organisations operating in Iraq.

The European Union should continue to underline the need for the Coalition Provisional Authority to make further efforts to improve the security environment in Iraq. These issues will need to be taken up in the agenda for the Madrid Conference.

- **A clear commitment to the establishment of a sovereign Iraqi government**

The United Nations Secretary General has emphasised that “the importance for the Iraqi people of moving quickly towards their own government cannot be overstated”⁵. Tangible progress and a clear timetable for the transfer of power and sovereignty to the Iraqi people are needed if they are to gain a sense of participation in and responsibility for rebuilding their country. In this context, Iraqi Ministerial and civil society representatives should be encouraged to participate fully in the Madrid Conference, presenting their views on needs and priorities for the reconstruction process. The European Union should continue to emphasise the importance of transition to an internationally recognised and representative Iraqi government and the central role of the UN in facilitating this process.

⁵ SG Report pursuant to para 24 of UNSCR 1483 (S/2003/715 of 17/7/03) Para 23

The Iraqi people need to see a credible process leading to a new constitution and elections. Developing the institutions of democracy and fostering an independent and strong civil society capable of voicing its concerns are essential to achieve pluralistic and representative government. Ensuring more active participation of women in public life and a free media are two important dimensions of this. Work is needed to promote reconciliation, by addressing past violations of human rights and by establishing a properly functioning judiciary capable of assuring the rule of law. The European Union should support the efforts of the United Nations to assist the establishment of national and local institutions for representative governance, promote the protection of human rights, judicial and legal reform.

- **The creation of a transparent and operational multilateral framework for reconstruction**

A coherent budgetary framework is essential to ensure a transparent and efficient reconstruction programme. The World Bank and United Nations-led needs assessment missions are helping to define a common set of priorities for donors, the Iraqi Provisional Government and the Coalition Provisional Authority for 2003-4. As the Coalition Provisional Authority hands over more responsibility to the Iraqi Interim Authority, dialogue should progressively become one between donors and the Iraqi authorities.

Donors wish to channel their contributions to reconstruction independently of the Coalition Provisional Authority and the DFI. With this end in view, the World Bank and UN are currently developing a Multi-Donor Trust Fund for Iraq. The Commission intends to channel the main part of the Community contribution through such a fund, while allowing for flexibility to support actions implemented by UN bodies and NGOs, especially in the early phases of reconstruction. A mechanism is also needed to ensure proper liaison and dialogue between the international community, the Iraqi authorities and the Coalition Provisional Authority on budget expenditure priorities and the reconstruction strategy. Transparent and non-discriminatory procedures are needed, in particular concerning public procurement, in the management of both the Development Fund for Iraq and the Trust Fund.

A further important factor in the success of the European Union's efforts is the:

- **Involvement of Iraq's Neighbours**

Successful transition in Iraq and regional stability will also depend on co-operative relations between Iraq and its neighbours, notably Turkey, Jordan, Syria, GCC states and Iran.

The European Union should support and promote the involvement of Iraq's neighbours in Iraq's reconstruction, at Madrid and beyond.

4. FINANCIAL IMPLICATIONS FOR THE EUROPEAN UNION

The commitment of the European Union to Iraq is not new. Since 1992, through its Humanitarian Aid Office (ECHO), the Community has been the largest external source of humanitarian aid for Iraq after the United Nations-administered Oil For Food programme. In March 2003, a total of €100 million was earmarked for humanitarian aid to Iraq. Of this, €69.5 million⁶ has already been committed for humanitarian interventions in areas such as

⁶ As of 30 September 2003

health, water and sanitation, de-mining and to support co-ordination amongst humanitarian actors in Iraq.

The European Union has expressed its desire to make a significant contribution to rehabilitation and reconstruction. It is well placed to assist in this process, drawing on its experience in post-conflict countries and economic transition. In order to achieve maximum impact, the contributions of the European Union as such and of the Member States need to be closely co-ordinated. We should therefore aim at making a combined pledge at the Madrid Conference. To facilitate co-ordination, the Commission has established a clearinghouse mechanism to collect and distribute information about reconstruction activities.

The Needs Assessment process, led by the UN and World Bank, has examined Iraq's short and medium-term needs and priorities for reconstruction in 14 sectors to be addressed via the Multi Donor Trust Fund for Iraq⁷. Commission officials participated in missions on the macroeconomic framework, health, education, employment creation and local governance.

Priorities for Community assistance will build on the work of ECHO and include support in areas such as institutional and capacity-building, particularly in the area of macroeconomic management including trade policy, creating a social safety net, health, water and sanitation, education, employment, the strengthening of civil society and the protection and promotion of human rights and democracy.

On this basis, and taking into account the resources available under Heading 4 of the Community budget, the Commission will propose to the budgetary authority that €200 million be made available for Iraq until the end of 2004. Since urgent reconstruction needs in Iraq go beyond the resources available from the Community budget, and as a number of Member States have indicated their willingness to contribute to these efforts, the Commission proposes that, at the Madrid Conference, a common pledge is made on behalf of the European Union and its Member States.

5. CONCLUSIONS

In the context of preparations for the Madrid Conference, the European Commission invites the Council to:

- Reiterate the European Union's support for the development of a prosperous, stable and sovereign Iraq.
- Underline the important role of the UN, in line with the relevant UNSC resolutions, in the process leading to the establishment of an internationally recognised representative government in Iraq and in mobilising the necessary support from the international community for Iraq's reconstruction.

⁷ Needs assessment missions considered the following sectors: health, education, water resources, agriculture, irrigation and food security, humanitarian mine action, water supply and sanitation, macro-economic policy, economic management, including public sector management, trade, price liberalisation, safety nets, investment climate and state owned enterprises, banking and finance, transport and communication, electricity, livelihoods, employment generation and reintegration, labour and social welfare, housing, including urban development and property restitution, local governance capacity building, civil society, rule of law and media. In addition to the sector analysis, each team was also requested to assess needs in the areas of gender and the role of women, human rights, environment and capacity building as cross-cutting issues.

- Confirm that, to be effective, support from the EU and its Member States for reconstruction in Iraq requires an improvement in the security situation, a clear commitment by the parties concerned to create the conditions for the establishment of a sovereign Iraqi government, and the setting up of a transparent multilateral framework to channel support from the international community for reconstruction. These conditions will determine the participation of the EU in the reconstruction process beyond the Madrid Conference.
- Note the importance of promoting Iraq's integration in its regional environment and reiterate the European Union's call on Iraq's neighbours to support stability in Iraq and in the region.
- Note that work is underway to set up an independent Multi-Donor Trust Fund for Iraq which should be managed by the UN and World Bank to address priorities identified by the UN, World Bank and IMF in the framework of Iraq's overall reconstruction needs.
- Note that this implies a need for close co-ordination between donors and the relevant authorities in Iraq.
- Confirm the importance of transparent and non-discriminatory procedures, in particular concerning public procurement, in the management of both the Development Fund for Iraq and the Multi-Donor Trust Fund.
- Note that support from the European Union and its Member States may also be directed to UN bodies and NGOs which are operational in Iraq.
- Invite the Commission to ensure the necessary co-ordination with a view to the announcement of an overall pledge by the European Union and its Member States for reconstruction in Iraq in 2003 and 2004 at the Madrid Conference.
- Endorse the Commission's proposal that the European Union announce at Madrid an indicative pledge. This pledge will be made up of €200 million at this stage for 2003-4 from the EU budget, plus the contributions of Member States.
- Note that in parallel to the work on reconstruction, the European Union will continue its active and substantial involvement in humanitarian relief.
- Invite the Commission to report as necessary on preparations for the Madrid conference and its follow up.

ANNEX

FINANCIAL STATEMENT				
				DATE: [23.09.2003]
1. BUDGET HEADINGS:				
<p><u>A) 2003 financing</u> B7-432 (19 08 06 under ABB structure) "Other operations in favour of Middle East developing countries".</p> <p><u>B) 2004 financing</u> New budget article 19 08 07 "Aid for rehabilitation and reconstruction of Iraq".</p>				
2. TITLE:				
[New Article proposed for 2004: <i>19 08 07 "Aid for rehabilitation and reconstruction of Iraq"</i>]				
3. LEGAL BASIS:				
<p>Council Regulation (EEC) No 443/92 of 25 February 1992 on financial and technical assistance to and economic cooperation with developing countries in Asia and Latin America (OJ L 52, 27.2.1992, p. 1). (Attached to 19 08 06, ex B7-432)</p> <p>Council Regulation (EC) No 2258/96 of 22 November 1996 on rehabilitation and reconstruction operations in developing countries (OJ L 306, 28.11.1996, p. 1). (Attached to 19 08 05, ex B7-431)</p> <p>"Under the new line, in 2004, both legal bases will be applied. For 2003, the projects will be implemented under budget article B7-432 (ALA Regulation) ".</p>				
4. AIMS:				
[Community contribution to rehabilitation and reconstruction of Iraq over the coming 14 months]				
5. FINANCIAL IMPLICATIONS		12 MONTH PERIOD	CURRENT FINANCIAL YEAR [2003]	FOLLOWING FINANCIAL YEAR [2004]
		(EUR million)	(EUR million)	(EUR million)
5.0 EXPENDITURE		[-]	[40] ⁽⁸⁾	[160](1)
-CHARGED TO THE EC BUDGET (REFUNDS/INTERVENTIONS)				
-NATIONAL AUTHORITIES				
-OTHER				
5.1 REVENUE		[-]	[-]	[-]
-OWN RESOURCES OF THE EC (LEVIES/CUSTOMS DUTIES)				
-NATIONAL				
5.0.1 ESTIMATED EXPENDITURE		[2005]	[2006]	[2007]
		[-]	[-]	[-]
5.1.1 ESTIMATED REVENUE		[2005]	[2006]	[2007]
		[-]	[-]	[-]
5.2 METHOD OF CALCULATION:				
6.0 CAN THE PROJECT BE FINANCED FROM APPROPRIATIONS ENTERED IN THE RELEVANT CHAPTER OF THE CURRENT BUDGET?				
NO				
6.1 CAN THE PROJECT BE FINANCED BY TRANSFER BETWEEN CHAPTERS OF THE CURRENT BUDGET?				
YES in 2003 and NO in 2004				

⁸ In 2003, only € 29 Million on article 19 08 06 (B7-432) for Iraq. Remaining funds on RRM and EIDHR articles (€ 11 Million). In 2004, € 160 Million on the new Iraq article 19 08 07 (B7-433).

6.2	WILL A SUPPLEMENTARY BUDGET BE NECESSARY?	NO
6.3	WILL APPROPRIATIONS NEED TO BE ENTERED IN FUTURE BUDGETS?	YES
OBSERVATIONS: [See clarifications below]		

1. BUDGET HEADING

Considering the importance of such pledge, the Commission is proposing to create a new budget line dedicated to fund the rehabilitation and reconstruction in Iraq. This will allow to respect the policy expressed by the Budget Authority, in particular the European Parliament, as regards transparency when the Community is contributing to the financing of reconstruction action (Afghanistan, Kosovo, East Timor).

- The following nomenclature and title is proposed through an amending letter to the 2004 PDB: *Article 19 08 07 “Aid for rehabilitation and reconstruction of Iraq”*

6.0 CAN THE PROJECT BE FINANCED FROM APPROPRIATIONS ENTERED IN THE RELEVANT CHAPTER OF THE CURRENT BUDGET? NO

The 2003 financial contribution of € 40 Million is provided as follows:

I. Existing instruments (€ 11 Million)

- Up to € 8 million from 19 02 05 “Rapid Reaction Mechanism”⁽⁹⁾. Commitments from the RRM line. No transfer of funds needed.
- € 3 million from 19 04 “EIHRD”. Projects committed from the EIHRD. No transfer of funds needed.

II. Reserve and excess of funds in Heading 4 (€ 29 Million)

- € 6,4 million from B0-4011, item B7-6600 “KEDO”⁽¹⁰⁾.

⁹ As of 28.08.2003, € 8 Mio unprogrammed in 2003. Intervention would depend on the priority sector identified by the Commission.

¹⁰ With regard to the proposed use of the part of the budget reserved for Kedo, the following observation has to be made:

The Council, on the proposal of the EP, has decided to put the EU's 2003 contribution to Kedo (apart from a small part to be used for Kedo's administrative costs) in reserve. This was done under the terms of the Accession Agreement as the DPRK didn't respect anymore its nuclear non-proliferation obligations. In spite of this non-respect Kedo has continued up to today the construction of two nuclear light water reactors in the DPRK (LWR project). However a consensus is now emerging amongst the 4 Kedo Members to suspend these construction activities for probably a year. The extra costs resulting from such a suspension have been estimated by Kedo's secretariat to amount to \$102 million. The decision to suspend will have to be taken by Kedo's Executive Board. No date for a meeting has been set yet. No agreement exists yet on who will pay for the additional costs. Kedo's existing financing mechanism doesn't foresee the payment of such additional costs. The EU has no financial liability beyond its financial contribution. It has taken the view that suspension of the LWR project would remain within the realm of that project and thus leave untouched the financial commitments made by the Japanese and South Korean Governments. The US shares this position. However Japan and South Korea consider that all 4 Members should finance the extra costs. The issue can only be finalized through a decision of the Executive Board. It is also still not known whether the Council, possibly for political reasons, may wish to contribute to the suspension costs as they are a logical consequence of the non-proliferation difficulties. Therefore the proposed use of the part of the budget reserved for Kedo (€ 6,5 million) would create the risk, remote as it may be, that at a later and for the time being unknown moment, no money would be available for the payment of an existing EU financial obligation.

- € 2,5 million from B0-4011, item B7-8000 “International fisheries agreements”.
- € 20,1 million from available funds in Heading 4.

These credits of € 29 million in CA will be transferred to the budget line B7-432 “Other operations in favour of Middle East developing countries” through a specific budgetary authority transfer. The corresponding PA will be also transferred to cover the first disbursements of the 2003 commitment.

The 2004 contribution of € 160 million:

I. New additional funds

- € 86 million from the Preliminary Draft Budget margin in Heading 4. Amending Letter to increase the Preliminary Draft Budget (PDB) 2004 needed.
- € 74 million from the funds available under the Flexibility Instrument. Amending Letter to increase the Preliminary draft Budget (PDB) 2004 needed.

The status of the humanitarian assistance provided through ECHO in 2003 for Iraq is that ECHO has programmed € 100 million in 2003, of which € 69,5 million has already been decided by the Commission and pre-committed. ECHO has as of 5.9.2003 signed contracts for the amount of € 57,3 million. The remaining fund to be committed and contracted amounts to € 30,5 million. Financial decisions are expected to be presented to the Humanitarian Committee during October 2003.
