INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/248

IRAQ

July 2019

2019 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR IRAQ

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Iraq, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 19, 2019 consideration of the staff report that concluded the Article IV consultation with Iraq.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 19, 2019, following discussions that ended on May 2, 2019, with the officials of Iraq on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 3, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Iraq.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

Press Release No. 19/301
FOR IMMEDIATE RELEASE
July 26, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with Iraq

On July 19, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Iraq.

An improved security situation and the recovery in oil prices have improved near-term vulnerabilities. Large fiscal and current account surpluses—around 8 and 6 percent of GDP, respectively—were recorded in 2018, allowing the government to retire domestic debt and accumulate fiscal buffers. Gross international reserves reached $65 billion by end-2018.

However, post-war reconstruction and economic recovery have been slow. Non-oil GDP rose by only 0.8 percent year-on-year in 2018 in a context of weak execution of reconstruction and other public investment. Overall GDP contracted by around 0.6 percent as oil production was cut to comply with the OPEC+ agreement.

The 2019 budget implies a sizable fiscal loosening that will reverse the recent reduction in vulnerabilities. Current spending is expected to increase by 27 percent year-on-year, in part due to a higher public sector wage bill, while revenues will be dampened by the abolition of non-oil taxes. As a result, the budget is projected to shift to a deficit of 4 percent of GDP in 2019, and reserves are projected to decline.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The fiscal and external positions are expected to continue to deteriorate over the medium term absent policy changes—with reserves falling below adequate levels and fiscal buffers eroded. Although the level of public debt will remain sustainable, gross fiscal financing needs will increase. Non-oil GDP growth is projected to reach 5½ in 2019 but subside over the medium term.

In a context of highly volatile oil prices, the major risk to the outlook is a fall in oil prices which would lower exports and budgetary revenues, leading to an even sharper decline in reserves or higher public debt. Geopolitical tensions, the potential for social unrest in a context of weak public services and lack of progress in combatting corruption pose further risks.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They were encouraged by the recent strengthening of Iraq's economy but recognized that the country continues to face daunting challenges. Social conditions remain harsh, post-war reconstruction progress is slow, development needs are large, and institutional weaknesses are significant. Volatile oil prices and a difficult regional and geopolitical environment pose additional difficulties. Directors encouraged the authorities to seize the opportunity presented by the improved security situation and higher oil prices to implement policies and structural reforms aimed at ensuring macroeconomic and financial stability, tackling long-standing social problems, and promoting sustainable and inclusive growth.

Directors emphasized that building a robust fiscal framework is essential to maintain fiscal and macroeconomic stability and strengthen buffers. They encouraged the authorities to adopt a risk- and rules-based approach to fiscal policy as part of broader reforms to manage oil revenue more effectively, reduce tendencies for procyclicality, and shift to a more growth-friendly composition of expenditure. Directors supported scaling up reconstruction and development expenditure gradually in line with improving absorptive capacity. They underscored the need to strengthen public financial management to ensure public spending is appropriately monitored

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

and to reduce vulnerabilities to corruption. In this context, Directors welcomed the newly adopted General Financial Management Law and encouraged its full implementation.

Directors emphasized that gradual fiscal adjustment, including containing current primary spending and boosting non-oil revenues is essential for maintaining fiscal and debt sustainability. They recommended that spending measures should give priority to containing the growth in wage bill and lowering subsidies to the electricity sector. Directors emphasized that the poorest and the most vulnerable must be protected from the adjustment process.

Directors underscored that an overhaul of the banking sector is necessary to maintain financial stability. They encouraged the authorities to restructure the large state-owned banks, enhance their supervision, and implement other reforms to increase financial intermediation. Directors highlighted the benefits of increasing financial inclusion, especially for the SME sector, which has a large potential to absorb entrants to the labor market.

Directors agreed that building public institutions and enhancing governance is key for success, and highlighted the scope for Fund capacity development to support these efforts. They welcomed progress in developing an anti-corruption framework and called for further modifications to the legal regime for combatting corruption coupled with stronger coordination between the relevant government agencies, while continuing to strengthen the framework for Anti-money laundering and combatting the financing of terrorism (AML/CFT). Directors also recommended strengthening Public Investment Management framework to ensure that spending is well directed and that donor funds targeting reconstruction are put to the most efficient use.

Directors looked forward to continued close engagement between the authorities and the Fund in the context of post program monitoring.

Iraq: Selected Economic and Financial Indicators, 2015–24 (Percent of GDP, except were indicated)										
					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic growth and prices										
Real GDP (percentage change)	2.5	15.2	-2.5	-0.6	4.6	5.3	2.6	2.3	2.1	2.1
Non-oil real GDP (percentage change)	-14.4	1.3	-0.6	0.8	5.4	5.0	4.1	3.4	2.7	2.7
GDP deflator (percentage change)	-26.1	-13.4	14.6	15.4	-4.5	2.3	2.6	2.8	3.1	3.3
GDP per capita (US$)	5,047	4,843	5,263	5,882	5,728	6,017	6,172	6,326	6,486	6,666
GDP (in ID trillion)	207.2	206.7	231.0	265.0	264.8	285.4	300.4	315.9	332.3	350.4
Non-oil GDP (in ID trillion)	137.3	138.3	140.8	145.6	158.1	173.2	188.1	202.8	217.1	232.6
GDP (in US$ billion)	177.7	175.2	195.5	224.2	224.1	241.5	254.1	267.3	281.1	296.5
Oil production (mbpd)	3.72	4.63	4.47	4.41	4.59	4.84	4.93	5.01	5.10	5.18
Oil exports (mbpd)	3.35	3.79	3.80	3.86	4.03	4.25	4.33	4.40	4.47	4.55
Iraq oil export prices (US$ pb) 1/	45.9	35.6	48.7	65.2	56.0	55.8	54.9	54.4	54.4	54.8
Consumer price inflation (percentage change; end of period)	2.3	-1.5	0.2	-0.1	2.0	2.0	2.0	2.0	2.0	2.0
Consumer price inflation (percentage change; average)	1.4	0.5	0.1	0.4	0.8	2.0	2.0	2.0	2.0	2.0
National Accounts										
Gross domestic investment	24.9	20.8	16.7	12.9	18.8	16.7	16.0	15.6	15.6	15.4
Of which: public	15.6	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
Gross domestic consumption	81.2	87.0	80.8	79.1	84.5	85.4	86.8	87.9	88.6	89.6
Of which: public	22.6	22.6	21.8	21.2	26.5	26.3	26.4	26.2	26.2	26.3
Gross national savings	18.4	12.5	18.6	19.8	13.6	12.5	11.7	11.1	10.3	9.4
Of which: public	3.1	-2.0	7.0	13.4	6.5	5.2	4.1	3.2	1.8	0.8
Saving - Investment balance	-6.5	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
Public Finance										
Government revenue and grants	30.6	26.8	33.0	39.8	40.5	39.6	37.9	36.5	35.5	34.6
Government oil revenue	27.8	22.9	28.9	36.7	37.2	36.3	34.5	33.1	32.0	31.0
Government non-oil revenue	2.8	4.0	4.2	3.1	3.3	3.3	3.4	3.4	3.5	3.5
Expenditure, of which:	43.4	40.7	34.6	32.0	44.6	43.1	41.2	40.5	40.5	40.5
Current expenditure	27.8	29.3	26.4	26.7	33.9	34.7	33.6	33.5	33.7	33.9
Capital expenditure	15.6	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
Overall fiscal balance (including grants)	-12.8	-13.9	-1.6	7.9	-4.1	-3.5	-3.3	-4.0	-5.0	-5.9
Non-oil primary fiscal balance, accrual basis (percent of non-oil GDP)	-46.5	-43.3	-39.4	-42.4	-56.9	-52.1	-49.2	-47.1	-46.2	-45.3
Adjusted Non-oil primary fiscal balance, accrual basis (excl. KRG, percent of non-oil GDP) 2/	-44.7	-43.3	-39.4	-40.5	-50.1	-46.0	-43.6	-41.8	-41.0	-40.2
Adjusted non-oil primary expenditure (excl. KRG, percent of non-oil GDP) 3/	48.9	49.2	46.3	46.2	55.6	51.5	49.1	47.2	46.3	45.5
Adjusted non-oil primary expenditure (excl. KRG, annual real growth, percent) 3/	-24.7	0.9	-4.5	2.8	29.9	-0.6	1.4	1.6	3.1	3.2
Memorandum items										
Total government debt (in percent of GDP) 4/	56.2	64.2	58.9	49.3	51.4	50.5	50.6	51.5	53.6	56.4

Total government debt (in US$ billion) 4/	99.9	112.5	115.2	110.4	115.3	121.9	128.5	137.5	150.7	167.3
External government debt (in percent of GDP)	37.2	37.1	35.6	30.6	32.2	31.5	30.5	28.4	26.8	24.9
External government debt (in US$ billion)	66.1	65.0	69.5	68.7	72.2	76.2	77.6	75.8	75.3	73.8
Monetary indicators										
Growth in reserve money	-12.0	9.2	-4.4	6.7	2.5	5.4	4.7	4.9	5.1	4.6
Growth in broad money	-9.1	7.1	2.6	2.7	2.5	6.2	5.4	6.0	5.9	5.3
External sector										
Current account	-6.5	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
Trade balance	-0.1	-1.7	7.6	13.4	3.5	4.1	3.2	2.0	1.3	0.5
Exports of goods	31.8	28.6	34.8	41.2	37.0	36.2	34.4	33.1	32.0	31.2
Imports of goods	-31.9	-30.3	-27.1	-27.8	-33.5	-32.0	-31.2	-31.1	-30.8	-30.7
Overall external balance	-6.7	-3.7	2.5	6.3	-2.5	-1.1	-1.6	-3.5	-3.8	-4.7
Gross reserves (in US$ billion)	54.1	45.5	49.4	64.7	57.2	53.5	48.5	38.8	28.2	14.3
Total GIR (in months of imports of goods and services)	9.3	7.8	7.3	8.0	6.8	6.2	5.5	4.2	2.9	1.4
Exchange rate (dinar per US$; period average)	1,166	1,180	1,182	1,182	1,182	1,182	1,182	1,182	1,182	1,182
Real effective exchange rate (percent change, end of period) 5/	6.5	1.8	-5.1	4.9	…	…	…	…	…	…

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Negative price differential of about $3.6 per barrel compared to the average petroleum spot price (average of Brent, West Texas and Dubai oil prices) in 2018-23.

2/ Adjusted to exclude (i) full year estimates of federal government transfers to the Kurdistan Regional Government, and (ii) non-oil tax revenues from the KRG to the federal government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

3/ Adjusted to exclude full year estimate of federal government transfers to the Kurdistan Regional Government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

4/ Includes arrears. The debt stock includes legacy arrears to non-Paris Club creditors on which the authorities have requested (but not yet obtained) Paris-Club comparable relief. Implementing comparable terms will substantially reduce debt (e.g. by 15 percent of GDP in 2017).

5/ Positive means appreciation.

INTERNATIONAL MONETARY FUND

IRAQ

July 3, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING

KEY ISSUES

Context. Forty years of upheaval has eroded physical and human capital and weakened public institutions. Social conditions remain harsh following the war with ISIS, with slow progress at reconstruction, weak public services and a lack of job opportunities. The recent rebound in oil prices helped deliver a large budget surplus and healthy build-up in reserves in 2018, but post-war recovery has been sluggish. The SDR 3.8 billion ($5.3 billion) Stand-by Arrangement approved in 2016 expires in July.

Outlook and risks. In the absence of policy changes, a widening budget deficit will divert resources away from essential investment to rebuild the country and improve public services, while eroding reserves and posing risks to medium-term sustainability. Expenditure rigidities and limited fiscal buffers imply a significant vulnerability to oil price shocks in a context of volatile prices.

Policy Recommendations

- **Fiscal policy framework**. Fiscal policy should be anchored on scaling up capital spending and building fiscal buffers within a risk- and rules-based fiscal framework. Expenditure ceilings should be established, supported by phased measures to lower current spending and boost non-oil revenue. A steady build-up of fiscal buffers will help the authorities reduce pro-cyclicality and protect investment in the event of oil price and other shocks.
- **Reorienting public expenditure**. Structural measures to curb the sharp rise in the public-sector wage bill will help create fiscal space for essential investment. Electricity reforms will entail significant capital spending in the near term, but should enable the authorities to tackle power outages and eventually reduce budget subsidies. Public investment practices require significant reforms. The authorities should review the adequacy and efficiency of social spending to help ensure that poor and vulnerable groups are protected throughout such reforms.
- **Financial sector**. Bank supervision should refocus on the two largest and troubled state-owned banks, which need to be audited and restructured prior to recapitalization over the medium term. Such reforms, along with efforts to promote financial inclusion could help tackle access to credit and promote private-sector job creation. Strengthened enforcement of the AML/CFT regime would support the integrity of the financial system.
- **Combatting corruption**. A multi-pronged strategy is required involving strengthening the legal framework, developing national anti-corruption policies, and fostering closer co-ordination between the involved agencies. An effective AML/CFT regime can complement enforcement efforts.

Approved By
Taline Koranchelian and Kristina Kostial

Discussions were held in Amman (Jordan) during April 25–May 2, 2019. The staff team comprised Gavin Gray (head), Gazi Shbaikat (advance team lead), Kareem Ismail (Resident Representative for Iraq), Salim Dehmej (all MCD), Seyed Reza Yousefi (FAD), Chady El Khoury and Kathleen Kao (LEG), and Diva Singh (SPR). Maya Choueiri (Senior Advisor, OED) participated in the discussions. The mission met with Dr. Fuad Hussein, Deputy Prime Minister for Economic Affairs, Dr. Ali Mohsen Ismail Al-Allaq, Acting Governor of the Central Bank of Iraq, and staff from government ministries and the Central Bank of Iraq. Laila Azoor, Alexander de Keyserling, Cecilia Pineda, and Jawed Sakhi assisted from headquarters in the preparation of the report.

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TABLES

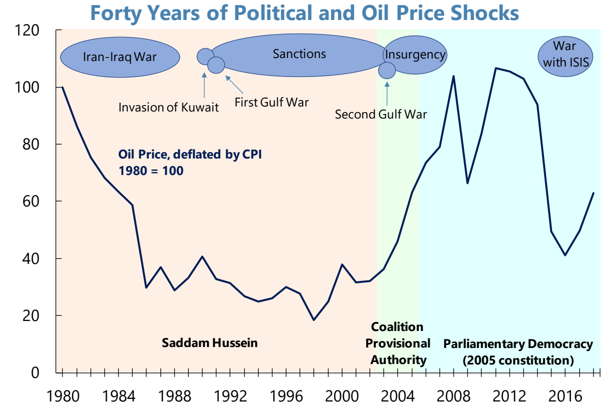
ANNEXES

BACKGROUND: IMPROVED POLICY ENVIRONMENT BUT MEDIUM-TERM RISKS ON THE RISE

A. Context

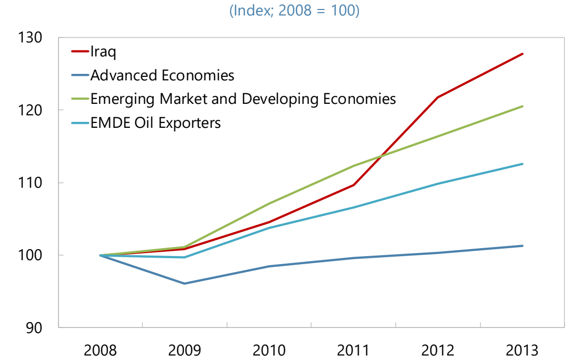
1. **Despite its vast oil wealth, Iraq has major development needs and significant institutional weaknesses**. It possesses the world's fourth largest oil reserves, which are projected to last over 100 years at current production rates (Figure 1). Slow progress at channeling these resources into human and physical capital reflects decades of political upheaval and armed conflict as well as the resulting weakness of public institutions; weak governance and corruption are widely acknowledged elements of the problem.[1] An exodus of skilled workers amidst poor security conditions since the second gulf war in 2003 has eroded human capital, while the more recent conflict with ISIS led to 100,000 deaths, five million internally displaced people and an estimated $46 billion of damage to infrastructure and property.[2] As a result, Iraq's development needs include large infrastructure gaps, poor basic services, subpar health and education outcomes, and widespread poverty; GDP has barely grown in per capita terms over the past five years.

Forty Years of Political and Oil Price Shocks



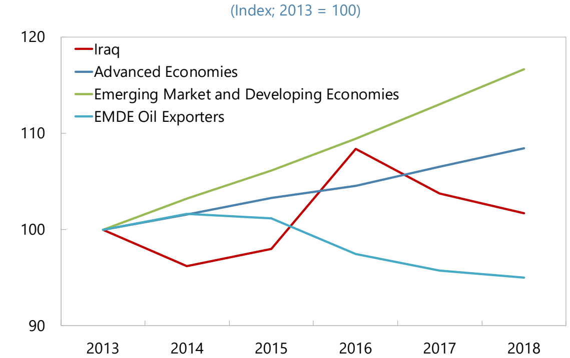
Sources: World Economic Outlook; and IMF staff calculations.

GDP Per Capita
(Index; 2008 = 100)



Sources: World Economic Outlook; and IMF staff calculations.

GDP Per Capita
(Index; 2013 = 100)



Sources: World Economic Outlook; and IMF staff calculations.

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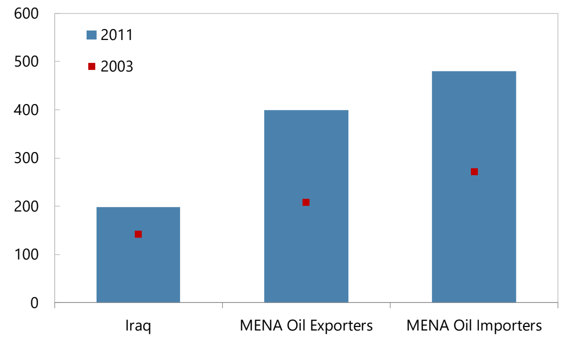
[1] Prime Minister Adil Abdul-Mahdi has compared the impact of corruption on Iraqi society to that of the ISIS terrorist group (http://www.rudaw.net/arabic/middleeast/iraq/3112201812).

[2] See Iraq: Reconstruction and Investment.

2. Weak fiscal policy frameworks, which are ill equipped to cope with oil price shocks, have contributed to these outcomes. The authorities have generally saved little during oil price booms, instead ramping up current spending—particularly the civil service payroll and other items that are hard to cut—leaving them with limited buffers when oil prices dipped, and necessitating sharp cuts in investment and the accumulation of arrears. Such procyclical patterns coupled with poor public financial management and inefficient public procurement have hindered investment in infrastructure, especially electricity,[3] undermining both core public services and the overall business environment.

Capital Stock
(Index 1980 = 100)



Source: Penn World Tables.

3. The Fund provided a $5.3 billion SBA in 2016 and significant capacity development (see Annex I) to support the authorities' response to the twin shocks of ISIS and the collapse in oil prices. The main achievements under the SBA were the preservation of the pegged exchange rate, a large fiscal consolidation (albeit mainly through capital expenditure cuts), a reduction in external arrears, and progress on AML/CFT. However, a number of structural fiscal measures were reversed or not enacted, and there has been limited progress at restructuring public banks or strengthening public institutions, while the authorities' response to Fund advice in the context of the last Article IV has been mixed (see Annex II). The SBA went off track after the second review in August 2017, and expires in July 2019.

4. An improved security situation and the windfall from higher oil prices offer an opportunity to rebuild the country and tackle longstanding social problems. The government faces a wide range of socio-economic challenges, including repairing infrastructure and other property destroyed in the war, as well as improving the provision of electricity, water supply and other public services. A young and fast-growing population is exerting strains on public institutions, while job opportunities for the estimated 800,000 annual entrants to the labor market are limited.

5. The obstacles to progress are formidable. Geopolitical strains are a distraction, with the re-imposition of U.S. sanctions on Iran complicating energy reforms. [4] Weak governance and corruption have impeded public institutions and discouraged private-sector investment and job creation. More positively, relations between Baghdad and the Kurdistan Regional Government (KRG) have improved over the past year.

[3] Despite ample oil reserves, electricity supply has averaged only 17 hours per day in recent years, which is a key weakness of the business environment.

[4] Around a third of electricity supply comes either directly from Iran, or from Iraqi plants reliant on Iranian gas.

B. Recent Developments: Slow Post-War Recovery

6. **Post-war reconstruction and economic recovery have been slow.** The large-scale reconstruction effort that was expected in liberated areas has not yet materialized, with capital spending in these areas totaling just ID 100 billion ($85 million) in 2018, or less than 0.5 percent of the estimated damage. Non-oil GDP rose by only 0.8 percent year-on-year in 2018 on account of weak execution of public investment (including reconstruction) and power outages, while overall GDP contracted by around 0.6 percent as oil production was cut to comply with the OPEC+ agreement. Inflation was flat over the year as a whole (Tables 1–2).

7. **The fiscal and external positions improved significantly in 2018 due to the rebound in oil prices and underexecution of the capital budget (Tables 3–5).**

- A large fiscal surplus—around 8 percent of GDP—was recorded in 2018 due to larger than expected oil revenues and a significant underexecution of the capital budget. However, the underlying fiscal position barely improved as non-oil revenue collection declined significantly (due to weak compliance) and current spending expanded by 5 percentage points of non-oil GDP.

- The government retired some domestic debt, including unwinding ID 1 trillion (about $0.9 billion) of indirect monetary financing, and accumulated fiscal buffers (about $17 billion). Public debt fell to 49 percent of GDP at end-2018 (Table 1).

- Higher oil prices and the modest improvement in the underlying fiscal position also led to a large current account surplus in 2018 (5¾ percent of GDP). Gross international reserves reached $65 billion by end-December, outstripping standard reserve adequacy metrics.

- The spread between official and market FX rates has narrowed to below 2 percent in recent months, from 6.25 percent at end-2017, as the comfortable reserve position has allowed the CBI to satisfy banks' FX demand.

8. **Iraq's external position in 2018 was substantially stronger than suggested by desirable policies and fundamentals (see Annex III).** The sizable surplus realized in 2018 was 10 percent of GDP higher than staff's current account norm of a 4½ percent of GDP *deficit*, developed from a model tailored to resource-rich countries such as Iraq with large investment needs. The real effective exchange rate (REER) appreciated by 4.9 percent year on year in 2018, continuing a gradual trend since 2013 due mostly to movements in the nominal effective exchange rate (NEER).

9. **Bank balance sheets remain weak, and private-sector credit is growing but from a very low base.** Two large public banks—Rafidain and Rasheed (R&R)—are burdened by legacy assets as well as loans to SOEs, while NPLs are high at a number of private banks. R&R's capital is below statutory levels, while private banks are losing money due to the compression of spreads in

the FX market, and could face capital constraints. The private-sector credit stock was only 9 percent of GDP at end-2018, up 9 percent year on year.

10. Parliament adopted a new General Financial Management Law (GFML) in May 2019 that strengthens the legal framework for public financial management.[5] The law defines general government for the first time, establishes the need for a medium-term fiscal framework and enshrines fiscal transparency requirements. It also limits parliament's capacity to amend the budget, as well as the scope for spending to be authorized outside budget processes. A number of gaps remain, including regarding guarantees and a treasury single account, that will need to be addressed by secondary legislation and/or decisions by the council of ministers. Newly introduced elements of fiscal federalism could erode non-oil revenue.

C. Outlook and Risks: Vulnerabilities on the Rise Again

11. The 2019 budget implies a large fiscal loosening that will reverse the recent reduction in vulnerabilities. Current spending is projected to rise by 27 percent year on year in the budget due to large increases in the public-sector wage bill, transfers, good and services, as well as allocations to KRG. Staff baseline projections assume that the wage bill will exceed budget provisions, due to weak PFM controls, and total more than 17 percent of GDP—the equivalent of 47 percent of oil revenues—whereas the budgeted ramp-up in capital spending will likely not fully materialize due to absorption constraints. The abolition of non-oil taxes will dampen revenues. As a result, the budget is projected to shift from a surplus of close to 8 percent in 2018 to a deficit of 4 percent of GDP in 2019, and reserves are projected to decline in 2019.

12. In the absence of policy changes, the fiscal position will deteriorate over the medium term as oil prices subside and current expenditure persists at an elevated level (Tables 1–9). Sizable fiscal and external deficits will be recorded—both reaching around 6 percent of GDP by 2024—with reserves falling steadily to well below adequate levels and fiscal buffers eroded. Public debt will increase but remains sustainable, although financing needs will increase and remain above the high-risk threshold (see Annex IV). The government will likely need to rely on financing that crowds out the private sector or depletes reserves, and will be unable to fulfill more than a quarter of reconstruction needs over the medium term.

13. Growth is projected to pick up in 2019-20 but taper off over the medium term. Non-oil GDP growth is projected to reach 5½ in 2019—due to better rainfall, a rebound in electricity production[6] and significantly looser fiscal policy—with some carryover in 2020. Oil GDP growth will also increase in 2019-20 based on current trends and assuming that the OPEC+ agreement expires, and export capacity improves . However, these transitory factors will unwind and the authorities will likely be unable to sustain capital spending, while borrowing by the public sector will crowd out

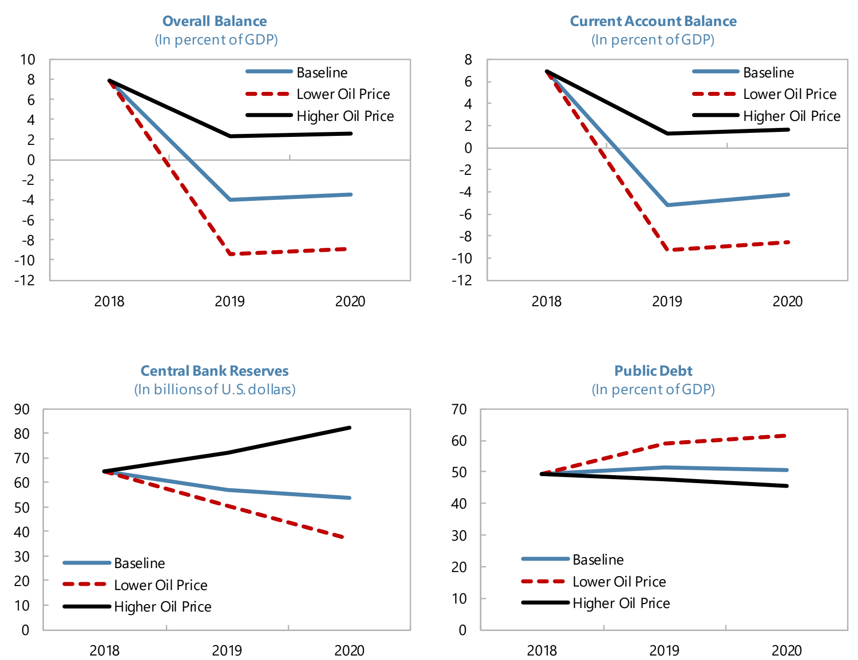
[5] The law was drafted with support from FAD TA, and its approval by government was a structural benchmark at the First Review of the SBA.

[6] In mid-May, peak electricity production was around 25 percent higher than a year earlier as new generating capacity has come onstream.

private credit. Growth will therefore decline significantly from 2021 onward, falling below both population growth and a level required to absorb labor market entrants.

14. There are significant downside risks to the outlook, and in a context of highly volatile oil prices, the major external risk is a fall in oil prices (see Annex V). A shock to oil prices (or volumes) would lower exports and budgetary revenues, leading to an even sharper decline in reserves or higher public debt. Every $1 per barrel decline in oil prices lowers annual oil revenue by 0.6 percent of GDP, thus even modest swings in oil prices could have a material impact, and recent increases in current spending make it harder to adjust. In illustrative scenarios, based on prices ± $10 around staff's baseline assumptions, if the authorities responded to a negative shock by cutting capital spending to an absolute minimum level, current expenditure could be maintained at the 2019 level only through significant external borrowing and some accumulation of arrears. Under this shock, reserves would decline from $65 billion at end-2018 to $37 billion by end-2020, with public debt reaching 61 percent of GDP (10 percentage points above baseline). On the flip-side, absent policy discipline, a rebound in oil prices, while improving the external and fiscal positions, could blunt incentives for reform and divert spending away from priority investment.

Iraq: Oil Price Scenario Analysis 2018–20



Source: IMF staff calculations.

15. Geopolitical developments and regional risks especially tension between the U.S. and Iran could have significant implications for Iraq. Potential economic spillovers arise from Iraq's heavy reliance on electricity and gas imports from Iran, which will require careful management in the context of U.S. sanctions. Regional factors and the risk of a resumption of terrorism could also have political and security spillovers with macrocritical effects.

16. Domestic risks remain significant. The effectiveness of the government could be undermined by popular protests absent faster progress at improving public services or rebuilding ISIS-liberated areas. Long-term growth prospects could be undermined if the authorities fail to address absorptive capacity and investment does not pick up, or if the already weak governance and the quality of public institutions were to deteriorate further. The fiscal costs of restructuring and recapitalizing R&R also pose a non-negligible medium-term risk.

Authorities' Views

17. The authorities had a more positive view than staff on the outlook. They considered medium-term vulnerabilities to be more contained given a more supportive outlook for oil prices and ample buffers. The authorities also viewed risks to be overall on the upside from potentially higher oil prices if market concerns on supply shortages were to re-emerge due to U.S. sanctions on Iran. While cognizant of the challenge posed by the sanctions given dependence on energy imports from Iran, they viewed the current situation as an opportunity to rebalance trade relations with neighboring countries and promote domestic production. That said, the authorities were concerned with the risk that current geopolitical tensions could escalate and potentially jeopardize regional security.

ECONOMIC POLICIES TO SUPPORT SUSTAINABILITY AND PROMOTE INCLUSIVE GROWTH

18. Discussions focused on the required changes in policy settings and structural reforms to restore medium-term sustainability and help lay the foundations for inclusive growth. In light of the significant social needs following the end of the war with ISIS, staff encouraged the authorities to strengthen policy frameworks and build fiscal institutions to manage oil revenue more effectively, and presented an adjustment scenario that would help secure macroeconomic stability while ensuring sufficient resources for investment. Staff also emphasized how recalibrating public expenditure coupled with reforms to promote financial inclusion can address weaknesses in the business environment and over time promote private-sector led employment and growth, while the authorities will need to review the adequacy and efficiency of social spending in light of social and demographic strains. Capacity development from the Fund and development partners can help the authorities implement such reforms, with the Fund's contribution based on a medium-term engagement strategy adapted to Iraq's circumstances (see Annex I).

19. Staff's advice is tailored to Iraq's circumstances as a resource-rich developing country with weak institutions.[7] As exhaustibility of oil reserves is not an immediate concern and investment needs are large, Iraq should also use its energy revenues to rebuild physical and human capital. However, investment inefficiencies and limited absorptive capacity imply that

[7] See Macroeconomic Policy Frameworks for Resource Rich Developing Countries (IMF, 2012) and Current Account Norms in Natural Resource Rich and Capital Scarce Economies (Araujo and others, 2013).

investment should be scaled up gradually. A model balancing these considerations and tailored to Iraq's circumstances implies that it would be optimal for Iraq to run current account deficits of 2.5–4.5 percent at the behest of higher investment over the medium term (see Annex III, Box 1).[8] The same considerations have a bearing on fiscal policy frameworks, which should create space for such investment, while dampening procyclicality and reducing vulnerabilities to oil price fluctuations.

20. Rebuilding public institutions will be essential for success, including by reducing vulnerabilities to corruption, and could deliver a significant impetus to long-term growth (see Annex VI). On the fiscal front, improving tax and custom administration has large potential to generate non-oil revenue, while strengthening public financial management would help ensure that public money is appropriately spent, including for capital expenditure projects. Financial sector stability would be enhanced by restructuring public banks and strengthening bank supervision and frameworks for AML/CFT. Moreover, steps to strengthen the rule of law will be essential to encourage private-sector investment. Staff assesses that a comprehensive package of governance reforms that reduces fiscal leakages and enhances private investment would add 10–20 percent to output over 10 years (see Box 1).

A. Building a Robust Fiscal Framework to Manage Oil Wealth

21. Staff encouraged the authorities to adopt a risk- and rules-based approach to fiscal policy as part of broader fiscal reforms to manage oil revenue more effectively. This approach entails building fiscal buffers to mitigate the impact of oil price shocks on spending, and moving to a multi-year fiscal and budget framework based on robust budget processes and reinforced by fiscal rules. Staff analysis shows that expenditure rules, if well designed and backed by political commitments, can help Iraq reduce tendencies for procyclicality, shift to a more growth-friendly composition of expenditure, and encourage complementary public financial management reforms.[9]

22. Committing to a fiscal rule in the form of a ceiling on current primary spending of the central government would support efforts to create space for scaled up public investment. Excluding capital expenditure from the expenditure ceiling would help ensure adequate space to rebuild the country after the war and close infrastructure gaps. It would also prevent the buildup of fiscal risks during oil price booms—by capping wages and other outlays that are difficult to reverse during shocks. This would support medium-term planning, dampen pro-cyclicality and support the authorities' social objectives. Line ministries would be expected to commit to these ceilings as part of the budget preparation process and develop medium-term plans on this basis. Staff emphasized that the ceiling on current spending should be supported by measures to strengthen public expenditure management to ensure efficiency of capital spending, and prevent spending from being reclassified to circumvent the rule.

[8] Looking much further ahead, once the capital stock has been rebuilt and inter-generational equity considerations grow in importance, fiscal policy can be anchored on long-term considerations and Iraq would be expected to run current account surpluses to accumulate assets for future generations, in line with the permanent income hypothesis (PIH).

[9] See accompanying Selected Issues Paper, "A Risk and Rules-based Approach to Fiscal Policy."

Box 1. Quantifying the Macroeconomic Benefits of Improved Governance[1]

The macroeconomic implications of improved governance can be assessed using the Debt, Investment, Growth and Natural Resources (DIGNAR) model developed by Melina and others (2016). This general equilibrium model estimates the impact of three types of governance reforms on output, private investment, private consumption and debt: (i) a reduction in bribes and other distortions that discourage private firms from investing and expanding; (ii) an improvement in public investment spending efficiency that facilitates an increase in the public capital stock; and (iii) an improvement in tax revenue mobilization that reduces evasion and widens the tax base.

The model is calibrated to capture the main features of the Iraqi economy. Iraq's main macroeconomic aggregates are set to their 2010–18 averages, and the initial level of private investment is set at its observed value of 8½ percent of GDP. For public investment efficiency, 26.9 percent is taken as the starting point based on the lower bound of estimated investment inefficiencies for the MENA region by Pritchett (2000). Given data limitations, consumption tax and personal income tax collection efficiencies are set at a starting point equivalent to the first quartile of the Emerging Market Economies' (EMEs) distribution, which are 35 percent and 4 percent respectively.

The model simulates two reform scenarios over ten years: An optimistic scenario where each indicator improves enough to advance Iraq to the next quartile of the EMEs' distribution; and a moderate scenario, where the improvement is half that of the optimistic. The optimistic scenario implies that: (i) the ratio of private investment to GDP increases to 16 percent, the second quartile (median) of the EMEs' distribution; (ii) public investment efficiency rises to 48 percent, the first quartile of the EMEs' distribution; and (iii) the government's efficiency in collecting consumption and personal income taxes rises to 55 percent and 8 percent, respectively, the median for EMEs.[2]

The simulations imply that a comprehensive reform package improving all three governance channels could add about 2 percentage points to growth each year and reduce public debt significantly over 10 years. The model assesses the impact of reforming each aspect of governance on its own (keeping the other two unchanged), as well as the combined impact of reforming all three elements simultaneously (Table 1, Figure 1). Focusing on the combined impact, the optimistic scenario shows private investment doubling in real terms over 10 years, while output and private consumption each increase by about 20 percent. These results translate into additional annual growth of 2 percent. In addition, public debt falls by 32 percent of GDP over 10 years, allowing the tax rate to fall given the fiscal reaction function, which further stimulates private demand. The moderate scenario delivers still significant results, with 1 percent of additional annual growth and a one-fifth reduction in public debt-to-GDP over ten years. Overall, the largest contribution to the improvement in macroeconomic conditions stems from removing the distortions affecting private firms` decisions to invest. Improving public investment efficiency also has a non negligible impact on all variables, while enhancing the efficiency of tax collection has a significant impact on debt, highlighting the benefits of a comprehensive reform package. Thus, reducing distortions and inefficiencies, caused at least in part by weak governance, would entail large positive macro-fiscal benefits for Iraq.

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[1] Prepared by Giovanni Melina and Alessandro Cantelmo (RES).

[2] For the moderate scenario: (i) private investment-to-GDP rises to 12 percent; (ii) public investment efficiency rises to 37.5 percent; and (iii) consumption tax and personal income tax collection efficiency rise to 45 percent and 6 percent, respectively.

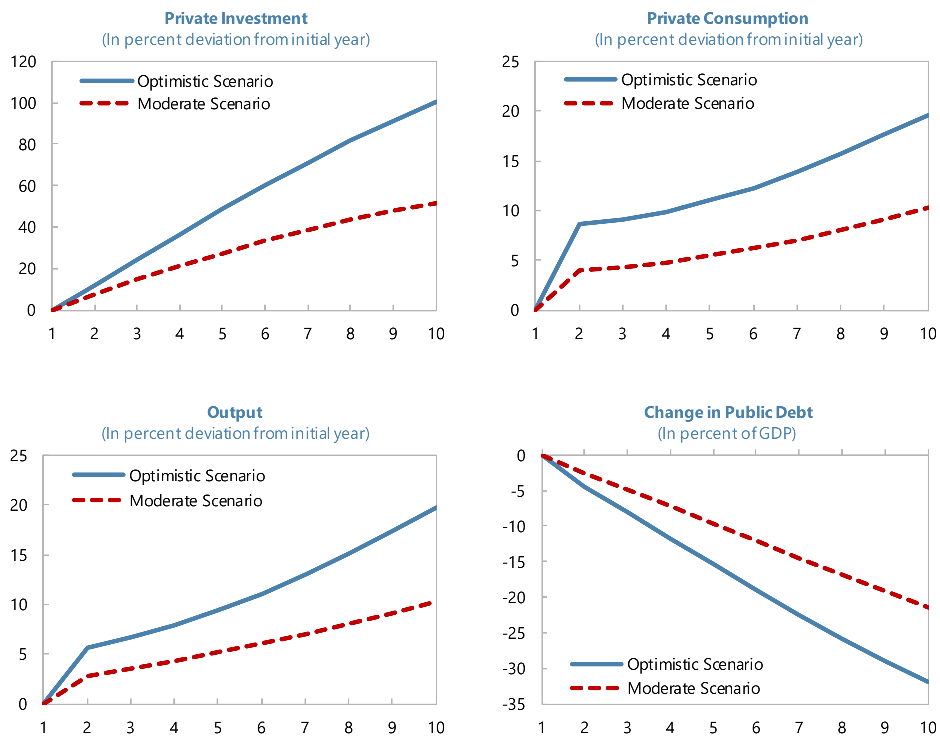
Box 1. Quantifying the Macroeconomic Benefits of Improved Governance (concluded)

10-Years' Effects of Improving Governance

	Firms' Distortion		Public Investment Efficiency		Revenue Mobilization		All Areas of Governance	
	Optimistic Scenario	Moderate Scenario	Optimistic Scenario	Moderate Scenario	Optimistic Scenario	Moderate Scenario	Optimistic Scenario	Moderate Scenario
Private Investment	94.8	49	3.67	1.64	0.53	0.39	100.5	51.6
Private Consumption	11.7	6.72	4.44	2.22	1.04	0.47	19.6	10.2
Output	14.9	8.02	2.91	1.42	0.53	0.24	19.7	10.2
Change in Public Debt	-20.7	-13.1	-9.61	-4.70	-11.9	-7.11	-32.1	-21.5

Note: Private investment, private consumption and output are in percentage deviations from the initial year. The change in public debt is expressed in percent of GDP.

Effects of Reforms in All Areas of Governance



Source: IMF staff estimates and calculations.

23. In line with this approach, staff presented a macroeconomic framework involving a gradual fiscal adjustment to restore and maintain sustainable fiscal and external positions. A phased adjustment of 11 percent of non-oil GDP is proposed over the medium term. A ceiling on current primary spending, based on annual nominal growth of 2 percent during 2020–24, is calibrated in line with this target. Spending measures focusing on containing the growth in the wage bill (¶28) and lowering subsidies to the electricity sector (¶30) would deliver most of the adjustment needed in current spending. The proposed adjustment would help keep public debt on a declining path and maintain reserves at adequate levels. The current account would remain in deficit over the medium term in this scenario, but at a level consistent with the current account norm.

Selected Indicators: Baseline

(In percent of GDP; except where indicated)

				Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total revenue	26.8	33.0	39.8	40.5	39.6	37.9	36.5	35.5	34.6
of which non-oil	4.0	4.2	3.1	3.3	3.3	3.4	3.4	3.5	3.5
Total expenditure	40.7	34.6	32.0	44.6	43.1	41.2	40.5	40.5	40.5
of which current	29.3	26.4	26.7	33.9	34.7	33.6	33.5	33.7	33.9
of which wage bill	15.6	14.5	14.2	17.4	17.4	17.5	17.4	17.5	17.6
of which capital	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
of which non-oil	4.3	2.8	1.4	5.1	3.0	2.3	1.9	1.9	1.8
Overall deficit	-13.9	-1.6	7.9	-4.1	-3.5	-3.3	-4.0	-5.0	-5.9
Public debt	64.2	58.9	49.3	51.4	50.5	50.6	51.5	53.6	56.4
Current account	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
International reserves (in billions of U.S. dollars)	45.5	49.4	64.7	57.2	53.5	48.5	38.8	28.2	14.3
International reserves (in percent of ARA)	173.6	174.4	208.4	186.6	165.9	146.1	112.2	80.7	39.7
Memorandum Items									
Fiscal buffer (in trillions of Iraqi Dinars)	4.0	7.2	20.0	12.4	10.4	8.4	6.4	5.4	4.4
Non-oil primary balance (in percent of non-oil GDP)	-42.4	-42.4	-41.8	-51.7	-46.0	-43.6	-41.8	-41.0	-40.2
Primary current spending (excluding payment to Kuwait)									
Annual nominal growth (in percent change)	5.0	-0.9	13.4	28.5	6.6	5.3	4.6	5.2	5.5
In percent of non-oil GDP	42.8	41.6	45.7	54.0	52.6	51.0	49.5	48.6	47.9
Nominal GDP (in trillions of Iraqi Dinars)	207	231	265	265	285	300	316	332	350
Real GDP Growth (in percent change)	15.2	-2.5	-0.6	4.6	5.3	2.6	2.3	2.1	2.1

Sources: Iraqi authorities; and IMF staff calculations.

Selected Indicators: Adjustment Scenario

(In percent of GDP; except where indicated)

				Projections					
	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total revenue	26.8	33.0	39.8	40.6	39.8	38.0	36.6	35.6	34.6
of which non-oil	4.0	4.2	3.1	3.4	3.5	3.8	4.2	4.8	5.3
Total expenditure	40.7	34.6	32.0	43.6	42.6	40.3	38.9	37.7	36.0
of which current	29.3	26.4	26.7	33.9	33.3	31.1	29.8	28.4	27.1
of which wage bill	15.6	14.5	14.2	17.4	16.3	15.6	15.0	14.2	13.4
of which capital	11.5	8.3	5.3	9.7	9.2	9.2	9.1	9.3	9.0
of which non-oil	4.3	2.8	1.4	4.1	3.8	4.0	4.1	4.6	4.5
Overall deficit	-13.9	-1.6	7.9	-3.1	-2.7	-2.2	-2.3	-2.1	-1.5
Public debt	64.2	58.9	49.3	51.1	50.4	50.2	49.8	49.9	49.2
Current account	-8.3	1.8	6.9	-4.7	-3.4	-3.6	-3.6	-3.1	-3.1
International reserves (in billions of U.S. dollars)	45.5	49.4	64.7	59.4	60.1	60.7	61.5	65.6	70.2
International reserves (in percent of ARA)	173.6	174.4	208.4	193.7	186.2	182.5	176.2	184.5	189.5
Memorandum Items									
Fiscal buffer (in trillions of Iraqi Dinars)	4.0	7.2	20.0	14.0	15.0	16.0	17.5	22.5	28.0
Non-oil primary balance (in percent of non-oil GDP)	-42.4	-42.4	-41.8	-50.1	-44.5	-41.2	-37.6	-34.3	-30.9
Primary current spending (excluding payment to Kuwait)									
Annual nominal growth (in percent change)	5.0	-0.9	13.4	28.5	2.0	2.0	2.0	2.0	2.0
In percent of non-oil GDP	42.8	41.6	45.7	54.0	50.4	46.8	43.4	40.2	37.2
Nominal GDP (in trillions of Iraqi Dinars)	207	231	265	265	285	302	322	345	371
Real GDP Growth (in percent change) 1/	15.2	-2.5	-0.6	4.6	5.3	3.0	3.1	3.2	3.3

1/ Staff uses multiplier analysis to estimate the impact of capital spending on non-oil GDP growth, based on empirical studies on the MENAP oil exporters (see Cerisola and others 2015). In view of Iraq's limited absorption capacity, staff assumes that the multipliers operate with a lag. Staff proposal to under-execute capital expenditure will likely have no impact on growth given the large increase planned in the 2019 budget and scope to rationalize lower priority projects.

Sources: Iraqi authorities; and IMF staff calculations.

24. The proposed adjustment and financing mix would aim to achieve the following fiscal policy objectives:

- ***Fiscal buffer***. An appropriate target would be the equivalent to one-year revenue loss from a permanent oil price shock (equivalent to one standard deviation of historical forecast errors), and is estimated at 17 percent of non-oil GDP. While a larger buffer target would mitigate oil risks further, it would reduce the space for essential spending. Staff suggested making gradual progress towards this target by increasing the fiscal buffer (cash balances of the government at the CBI) from ID 20 trillion in 2018 to ID 28 trillion by 2024 (11 percent of non-oil GDP). The buffer could be built faster to reach the desired target (or targeting more than a year of oil revenue loss) if oil prices are higher than expected or capital expenditure is under-executed, whereas if an oil price shock materializes the buffer could be used to protect capital spending.

- ***Capital spending***. The adjustment would create space for about $22 billion of capital spending over the baseline, close to a quarter of the aggregate reconstruction cost estimated by the World Bank. Staff suggests a gradual ramp up of capital spending allocations—to 4.5 percent of GDP by 2024—as it will take time to implement the structural and institutional reforms required to improve absorptive capacity (see ¶31).

- ***Financing mix***. Staff suggests a financing mix that would help build the buffer, while largely eliminating central bank financing to support foreign reserves and avoid overheating. To this end, disbursement of pledged donor financing to support higher capital spending should be expedited,[10] while domestic financing should rely more on domestic banks, which have room to retain some T-bills—departing from the triangular operations in which all T-bills purchased by banks were rediscounted at the central bank.

25. Expanding non-oil revenues would create further fiscal space to help achieve the above objectives and lower vulnerabilities to oil price shocks. Revenues from sales taxes adopted as part of the 2018 budget fell short of expectations because of a lack of compliance procedures, and most of these measures were cancelled in the 2019 budget. The way forward should involve developing a standalone tax bill to reintroduce well-articulated measures and clear penalties, and ensuring adequate resourcing of the large taxpayers' office.

26. Prioritizing capital spending in 2019 will help advance the adjustment process. Given the long lead time for the preparation and approval of projects, and weaknesses in procurement procedures, the capital expenditure budget cannot be executed this year without efficiency losses, calling for careful identification and focus on key projects to ensure their completion, while delaying

[10] Donors pledged around $30 billion to support the reconstruction of Iraq at a donors' conference in Kuwait in February 2018 organized by the World Bank. Disbursements seem to have been limited so far—with external project financing from all sources totaling less than $1 billion in 2018. Factors behind the delays include the time taken to form a government after the May 2018 parliamentary election, as well as the documentation requirements and project procedures established by donors.

lower priority projects. In this regard, a decision to transfer unexecuted capital spending to spending units' trust funds will weaken budgetary controls.

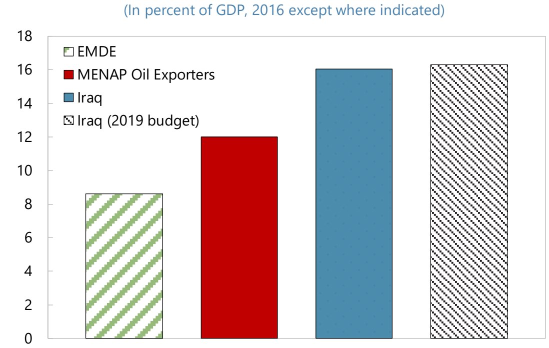
Authorities' Views

27. The authorities were unconvinced of the urgent need to modify fiscal policy settings. They cited higher oil prices as well as their track record of underexecuting the budget as likely sources for budgetary savings in the near term. The authorities also viewed reining in current spending as undesirable politically and socially at this stage, and signaled their intention for another expansionary budget in 2020. That said, they agreed on the need for reforms over the medium term, particularly on non-oil revenue mobilization, subsidies, and civil service. The authorities agreed on the benefits of adopting fiscal rules, and expressed interest in integrating them into their medium-term fiscal strategy.

B. Reallocating Public Expenditure to Promote Inclusive Growth

28. Well-structured measures are essential to contain the rapid growth in the public wage bill, and deliver a large and sustainable reduction over time. The wage bill, already one of the highest in the world, is subject to further pressures in the coming years due to the large and rising number of labor market entrants as well as pressures to convert tens of thousands of contractual and daily workers in the public sector into regular employment.[11] Staff proposes a mixture of short-term measures to avert a further large increase in the wage bill in 2020, as the authorities work on more durable measures that will pay off over time (see Annex VII).

Public Sector Wage Bill
(In percent of GDP, 2016 except where indicated)



Sources: World Economic Outlook; and IMF staff calculations.

- To dampen spending pressures in the short run, the authorities could focus on compensation measures such as capping allowances, bonuses and other non-base wage payments, as well as using natural attrition to avert a further increase in the size of the payroll.
- Structural measures will be essential to achieve durable savings over the medium term, based on a functional workforce review as well as deeper civil service reform once new HR management and information systems are in place. Biometric systems and other technological solutions will support these reforms, while also generating savings by eliminating ghost workers and double dippers.

[11] A number of provisions are exerting pressure on the wage bill in a context of weak PFM controls. Allowing certain ministries to convert contractual workers into full-time staff (e.g. Ministry of Electricity) and offer wage increases (e.g. Ministry of Health), has sparked demands from other ministries for similar treatment. The cabinet has allowed ministries to convert daily wage earners into contractuals. Recruitment of those dismissed on political grounds or due to security concerns, families of martyrs, and those returning from the liberated areas, and wage increases to doctors, nurses, and engineers have exerted further upward pressure on wage spending.

29. The electricity sector is a major drag on public resources. It incurs a large operational deficit covered through direct budgetary transfers, borrowing from the Ministry of Oil (MoO) and arrears to Iran. The sector also receives oil and gas products from the MoO at below market prices: it paid 1.8 percent of GDP in 2018 for these inputs, compared with 3.8 percent of GDP if they were valued at market prices.

Summary Budget and Financing of the Electricity Sector, 2018

(In percent of GDP)

Tariff Collection	0.4
Expenditures	2.6
Deficit	-2.3
Total Financing	2.3
Transfer from Ministry of Finance	1.2
Project financing and suppliers credit	0.3
Debt to Ministry of Oil	0.8
Payment of old arrears to Iran (- means payment)	-0.1
Accumulation of new arrears to Iran	0.3
End of year balance (- means surplus)	-0.2

Sources: Iraqi authorities; and IMF staff calculations.

30. Ambitious reforms in the electricity sector can deliver budgetary savings while also achieving the government's goal of providing a more stable electricity supply. The authorities will need to address the main factors behind large budget costs including modest tariff rates, chronic non-payment of electricity bills, poor maintenance and over-reliance on expensive generation sources together with significant losses materializing in the generation and distribution process. Cross-liabilities between the Ministries of Electricity, Oil, and Finance totaled nearly 5 percent of GDP by end-2018, and should be settled. Curtailing gas flaring to capture more domestic natural gas is essential, and will require significant capital expenditure. The allocation of contracts in 2019 to rehabilitate moth-balled plants and improve generation capacity is a welcome development, and the authorities should continue to explore technological solutions to increase revenue collection. It would be important to ensure that the poorest and most vulnerable are protected throughout the reform process.[12]

Cost of Electricity Generation, 2018

(In percent of GDP)

	Providing Ministry	MoE Rate	If Priced at International Prices
Imported Electricity from Iran	MoF [budget transfer]	0.1	0.1
Purchased Electricity from IPPs	MoF [budget transfer]	0.3	0.3
Imported Gas from Iran	MoF [budget transfer]	0.6	0.6
Dry Gas from BGC	MoO [debt]	0.2	0.4
Imported Gas Oil	MoO [debt]	0.2	0.2
Fuel Gas	MoO [debt]	0.3	0.6
Crude Oil	MoO [debt]	0.1	1.6
Total Support from Ministries		**1.8**	**3.8**

Sources: Iraqi authorities; and IMF staff calculations.

Note: As reported by the authorities, MoE debt stock rose from ID 9.3 trillion to ID 12.7 trillion in 2018, implying a flow of ID 3.4 trillion. This is higher than the ID 2.1 trillion of debt to MoO implied by this table.

31. Improvements in public investment management would help strengthen absorption capacity and ensure that resources are well spent. Efforts to prioritize capital spending in the context of medium-term fiscal/expenditure frameworks and based on cost-benefit analysis would be enhanced by improving pre-investment studies, deepening quantitative analysis underpinning feasibility studies, introducing independent reviews of appraisals and curbing political interference in prioritization decisions. Given the time it may take to tackle these weaknesses, some investment projects may need to be rephased. As absorptive capacity improves, the authorities should streamline procedures for the approval of public projects, while maintaining adequate safeguards in place, and strengthen capacity to comply with the terms and conditions of donor financing. Such

[12] Reforms to improve the reliability of electricity supply could lead to a substantial reduction in the effective price paid by Iraqi households by lessening their need for expensive back-up supplies. (see https://www.iea.org/publications/iraqenergyoutlook/)

reforms would help improve the execution of allocated capital expenditure, making the budget a better predictor of actual outcomes.

32. Public financial management (PFM) reforms are essential to ensure public spending is appropriately monitored, and can help reduce vulnerabilities to corruption (see Annex VI). These include:

- Implementing the newly adopted GFML, including by adopting decrees or secondary legislation. Key gaps should be addressed, including strengthening and firmly institutionalizing rules for the vetting and monitoring of guarantees, and capacity development from the Fund and other partners can support these efforts.

- Accelerating progress on implementing IFMIS, a World Bank-led project to replace the current paper-based systems with more robust systems that are essential to establish a modern PFM system.

- Establishing commitment controls and reinforcing monitoring of arrears to help ensure a robust mechanism to prevent a recurrence of arrears in the event of future shocks.

- Strengthening cash management through regular sweeping of spending units' cash balances as a step towards the longer-term goal of establishing a Treasury Single Account (TSA).

Authorities' Views

33. The authorities viewed staff's proposals on public-sector wages as desirable and feasible over the medium-term but politically difficult in the near term. They highlighted the social pressures to increase employment in the public sector to address unemployment, achieve justice for some groups that were affected by past consolidation including militia forces that helped defeat ISIS, and meet current legal requirements to absorb graduates of certain specializations. The authorities thought some of the proposed measures, such as freezing allowances and bonuses, could be taken starting in 2021 while more structural measures should be introduced over the medium term as part of a broader review of public sector functions and size. They highlighted the recently enacted civil service law as a starting point for the reform agenda in this area.

34. The authorities broadly agreed with staff's assessment and policy recommendations regarding electricity. They emphasized the priority given to the sector and the need to look into subsidies as part of a comprehensive review of the budget. The high cost reflects structural factors that will require time to address, including a multi-year agreement to import Iranian gas at prices currently above international levels. They also acknowledged the need to address debt between ministries and will reactivate work by a committee formed to address these cross liabilities.

C. Enhancing Financial Stability and Financial Intermediation

35. An overhaul of the banking sector is essential to maintain financial stability and to transform the sector into an effective vehicle for intermediation that also supports inclusive growth. The two largest banks—Rafidain and Rasheed (R&R)—have portfolios heavily weighted towards public-sector assets, some of which are not being serviced, which limit their capacity to lend until they are restructured and recapitalized. A number of private banks are struggling with sharply reduced FX trading incomes while working out NPLs that emerged during the 2014–16 crisis. These weaknesses coupled with shortcomings in the financial architecture and legal framework help explain why lack of access to credit is a material weakness of the business environment.

36. The long-delayed restructuring of the public banks is beginning, and well-structured plans are required to bring it to a successful conclusion. R&R have contracted suppliers for core banking systems, and segregated legacy assets and liabilities into 'bridge branches'. The Bureau of Supreme Audit (BSA) is working on finalizing their accounts for 2014 and subsequent years. Once the core banking systems are fully operational,[13] the two banks should be audited to international standards, which would allow their capital needs to be assessed accurately. In the interim, and to prevent a further deterioration in their financial conditions, the authorities should strengthen governance and oversight over the two banks and develop long-term strategies for their future, while abstaining from piecemeal capital injections. All these steps would require coordinated government action in light of the potential fiscal implications of bank restructuring.

37. Strengthening banking supervision, with an increased focus on risks in the public banks, is essential to support stability during this transitional phase. Building on steps to improve the prudential framework, staff encouraged the authorities to commission a targeted quality review of the public banks' main assets, especially loans to SOEs that are government guaranteed (and therefore zero risk weighted), yet are not being fully serviced. Such a review would help guide supervisory efforts, lower the risks of a further deterioration in the public banks' balance sheets, and facilitate the transfer of assets to the core banking system. To reduce risks in the private banks, staff encouraged caution in licensing new banks, and urged the authorities to strengthen frameworks for handling troubled banks.

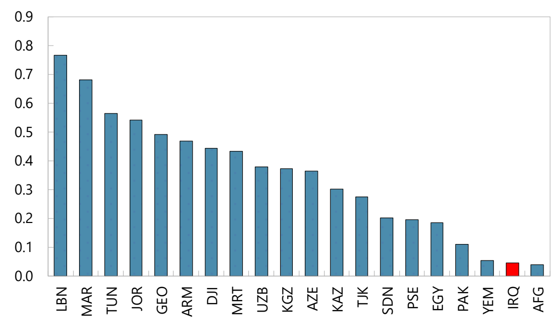
38. Tackling weaknesses in the banks coupled with wider structural reforms can help the authorities realize their goals of promoting financial development and inclusion.[14] Work is underway to strengthen payment systems and encourage salary payments directly into bank accounts. Fintech can help banks strengthen risk management and channel additional financial resources, and in view of the extensive wireless coverage, there is considerable potential to improve financial inclusion by developing mobile banking. Improving credit information and strengthening legal procedures could also encourage banks to relax collateral requirements and facilitate access to

[13] International experience suggests that it could take two to three years for the systems to be fully operational. In light of the work already done, the Iraqi authorities consider that the systems could be fully operational in 2020.

[14] See the Selected Issues Paper 'Iraq: Financial Development and Inclusion'.

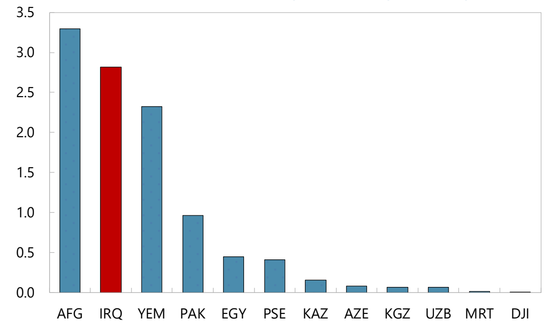
credit. Plans are underway to develop a deposit insurance scheme, which would help level the playing field across the banking sector, but requires effective bank supervision to limit risks. In helping to boost the currently very low level of SME financial inclusion, such measures can add a significant impetus to growth and employment.

SME Financial Inclusion Index
(On a 0 to 1 scale)



Source: IMF Departmental Paper.

Growth Benefits of Closing SME FI Gaps
(Increase in real GDP; in percentage points over global average)



Source: IMF Departmental Paper.

39. **Building on improvements to the legal and institutional framework for AML/CFT, staff emphasized the importance of effective implementation in this area (see Annex VI).** In 2018, the Financial Action Task Force (FATF) removed Iraq from its list of jurisdictions with strategic deficiencies in recognition of the new AML/CFT law adopted in 2015, which brought the legal framework into line with international standards, and other reforms including the establishment of institutions to implement the law. However, the country continues to face significant money laundering and terrorist financing (ML/TF) risks from the informal economy and the cross-border movement of cash. Supervision of financial institutions is not yet sufficiently effective to safeguard the financial system against illicit flows and criminal activity.

40. **The authorities have made some progress in implementing the recommendations of the 2016 safeguards assessment of the CBI.** Amendments to the law on the Central Bank of Iraq to strengthen CBI governance have been enacted, and the revised audit committee charter now prohibits CBI executive representation on the committee. However, progress in strengthening the capacity of internal audit and financial reporting has been slow.

Authorities' Views

41. **The authorities agreed on the need to address weak banks.** They agreed on the scope for greater coordination between the Ministry of Finance, CBI, and BSA in restructuring R&R. They considered the progress on procuring core banking systems for the two banks as an important first step. The authorities concurred that the financial system is currently overbanked. They expect the number of private banks to decline as non-profitable banks merge with others or exit the system. They expressed the need for continued strengthening of their capacity on banking supervision and resolution with Fund support.

42. **The authorities also agreed on the importance of strengthening financial development and inclusion.** They saw the main impediments as a cash-based culture that narrows the funding

base, and pervasive non-repayment of credit due to sluggish legal processes and weak enforcement. They cited progress through recent measures to encourage deposits including paying public salaries through the banking system, and passing the law establishing a deposit insurance company. The authorities also highlighted the credit bureau system at the CBI, which they plan to eventually transfer to the private sector. The CBI considered the weak credit to the private sector to be mainly due to weak demand and the limited capacity in the private sector to prepare financial statements and viability studies. They cited limited uptake on the CBI's ID1 trillion initiative to finance SMEs and the difficulty in finding bankable projects.

D. Anti-Corruption

43. Iraq has begun developing an anti-corruption framework, and there is scope for it to be strengthened. A Commission on Integrity (COI) was set up in 2011 with the tasks of corruption prevention and enforcement, and it has investigated several high-profile corruption cases. Legislation to criminalize illicit enrichment, trading in influence, embezzlement, and all forms of bribery has been drafted but not yet enacted. Public officials convicted of corruption are currently not barred from holding office. Staff emphasized the importance of tackling these gaps in the legal and institutional framework.

44. There is also considerable scope to improve co-ordination and streamline institutional structures. A number of public agencies are involved in anti-corruption efforts, but working largely in isolation and sharing information to a limited degree. The High Council for Combatting Corruption, which was established this year, should work closely with the parliamentary Integrity Committee to promote coherent anti-corruption laws and policies. The agencies involved in enforcement should co-ordinate to avoid duplication of tasks. E-governance can support these efforts by simplifying procedures and limiting opportunities for discretion.

45. Iraq has developed a system of asset declarations, and staff highlighted reforms that would strengthen its effectiveness. A large number of public officials are currently required to disclose their assets, but failures to submit disclosures go largely unpunished due to limitations on the COI's powers. Asset declarations are not adequately verified, nor shared with relevant public authorities. Staff emphasized that the system should be focused on public officials most at risk of corruption, with sufficient resources allocated for digitalizing and verifying submissions. Clear penalties should be established and enforced for officials who do not submit declarations. Over time, asset declarations should be published.

Authorities' Views

46. The authorities agreed that combatting corruption is a priority. In doing so, they are focusing on strengthening public institutions. At the same time, they see a need to streamline the anti-corruption framework to make it more effective and less onerous for economic activity. They consider reforms aimed at government digitization as key towards limiting the scope for corruption. They also cited their continued progress on AML/CFT with the help of international partners as an important means for cracking down on the transfer of illicit gains.

E. Future Fund Engagement

47. Iraq meets the criteria for initiating post-program monitoring (PPM). Its outstanding obligations to the Fund are expected to remain above the SDR 1.5 billion threshold until April 2020. Moreover, there are no circumstances that would indicate that PPM is not warranted.

STAFF APPRAISAL

48. The end of the war and higher oil prices have given the government an opportunity to rebuild the country and tackle social issues, but the challenges it is facing are formidable. Major capital investments are required to repair war damage, improve electricity and other public services and cope with the strains from a young and fast-growing population. But strong spending pressures across the board and the continuation of the current procyclical fiscal expansion will increase the country's exposure to oil price shocks, erode reserves and could frustrate the government's chances of achieving these goals. Public institutions will find it hard to prioritize competing demands in a way that consistently promotes inclusive growth.

49. In a context of elevated oil price volatility, maintaining medium-term sustainability while addressing social objectives will require changes in policy settings and structural reforms, including with respect to governance. Fiscal policy should be anchored on scaling up capital spending and building fiscal buffers within a sustainable framework. The restructuring of the financial sector should be accelerated. Taking firm steps to strengthen governance is essential to enable public institutions to deliver on the government's social objectives and lower risks of corruption. Governance reforms are also key to improving the business environment, and can provide a significant impetus to long-term growth. Capacity development from the IMF and development partners can support these efforts.

50. Staff recommends adopting a more risk- and rules-based approach to fiscal policy. Containing current spending and boosting non-oil revenue will create space for investment, while lowering the deficit, keeping public debt on a declining path and building fiscal buffers. This would help avoid pro-cyclicality and lower Iraq's vulnerability to oil price shocks. The authorities should strengthen public financial management frameworks, and adopt necessary decisions and secondary legislation to implement the recently adopted general financial management law, in particular with regards to the vetting and monitoring of guarantees.

51. To achieve this, staff also encourages the authorities to commit to medium-term ceilings on current spending, supported by well-structured and carefully sequenced measures. The focus should be on the wage bill, given its existing size and heavy pressure to add staff to the payroll. Measures in the short term to cap allowances and bonuses would give the authorities space to develop structural measures including through civil service reform. Significant reforms are also required to reduce the operational deficit in the electricity sector while expanding supply. The authorities should review the adequacy and efficiency of social spending to help ensure that poor and vulnerable groups are protected throughout such reforms to current expenditure.

52. Restructuring of the public banks coupled with enhanced bank supervision is essential to preserve financial stability. The key next step is to install core banking systems in the two large public banks, which is a pre-requisite for these banks to be audited, restructured and eventually recapitalized. Steadfast supervision would help prevent a further deterioration in their balance sheets during this process, and to monitor vulnerabilities among private banks.

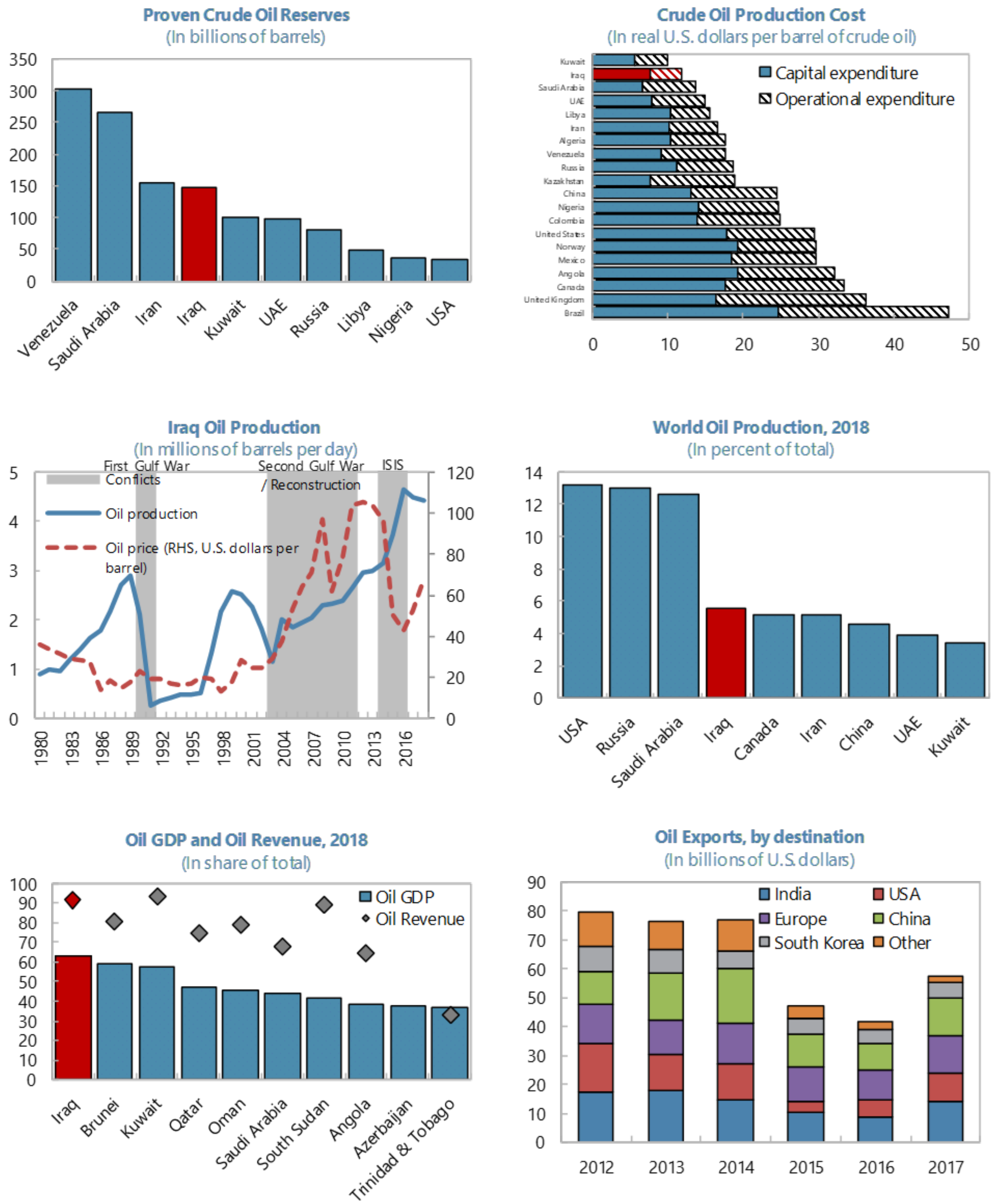
53. Successful restructuring of the banks coupled with structural reforms can help the authorities address long-standing problems with financial inclusion, including access to credit. Improving credit information and strengthening legal procedures would encourage banks to relax collateral requirements and facilitate access to credit. The planned deposit insurance scheme would also help level the playing field across the banking sector, but effective supervision is essential to limit risks. By strengthening SME financial inclusion, such efforts can have a significant impact on growth and employment.

54. Combatting corruption requires modifications to the legal framework and closer co-ordination between public agencies. A sound legal regime criminalizing all corruption offences and setting out effective sanctions will be necessary; public officials convicted of corruption should be prohibited from holding office. The authorities should also develop coherent national anti-corruption policies, based on a deeper understanding of the risks, and relevant agencies should coordinate more closely, with enhanced information exchanges. The system of asset declarations should be progressively strengthened by targeting the officials most exposed to corruption, sanctioning failures to submit declarations, digitalizing declarations and moving eventually to publication of asset declarations.

55. Bolstering AML/CFT implementation would help enhance the integrity of the financial system and support anti-corruption efforts. The Central Bank of Iraq (CBI) should implement risk-based AML/CFT supervision of banks and exchange houses to improve compliance with preventive measures, including those related to politically exposed persons and beneficial ownership. Such efforts would help identify proceeds of corruption and ease pressure on correspondent banking relationships. The CBI should also step up efforts to implement outstanding safeguards recommendations.

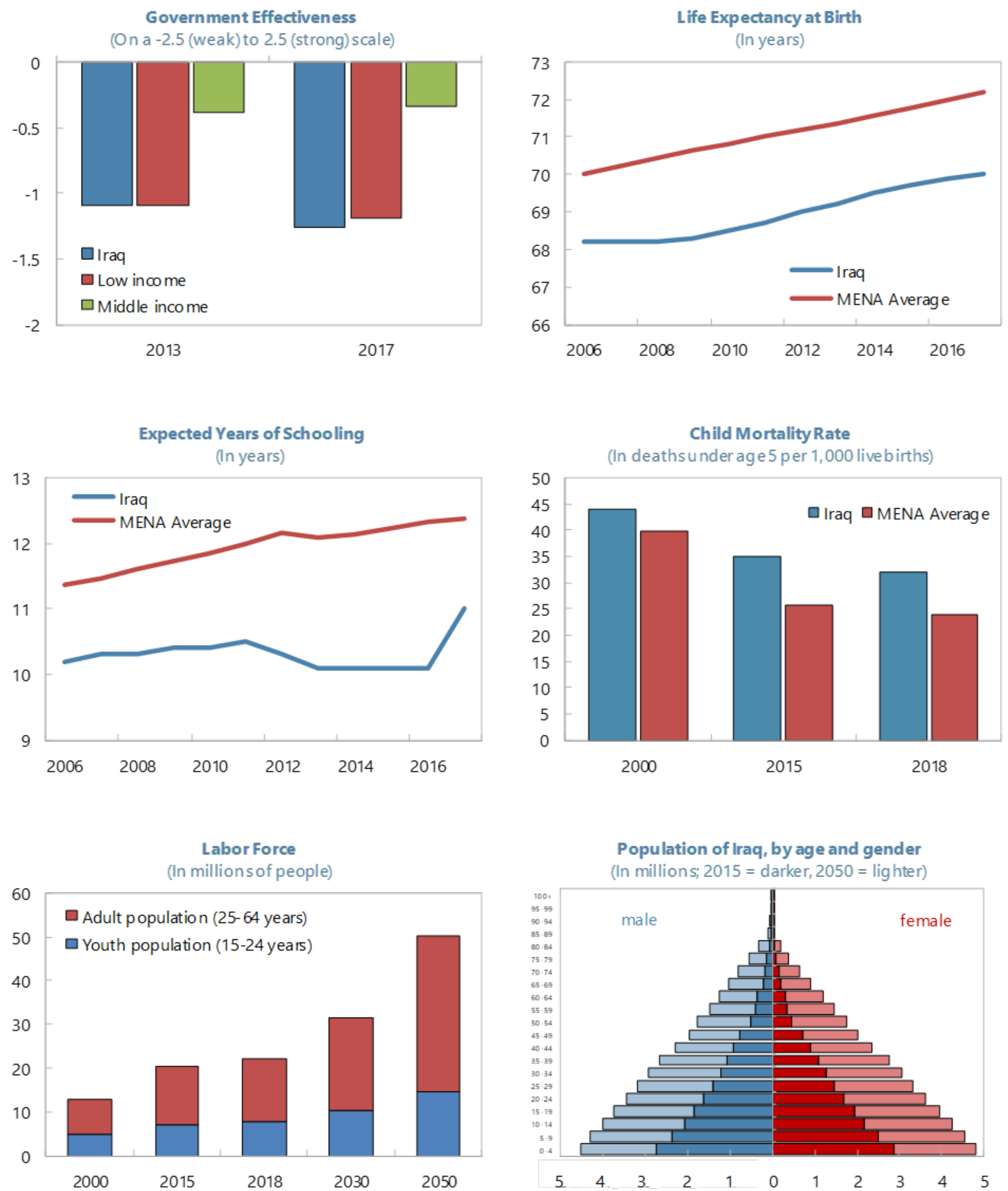
56. The Managing Director recommends the initiation of post-program monitoring. The first PPM Board discussion is envisaged before end-2019. It is further proposed that the Article IV consultation cycle revert to the 12-month cycle.

Figure 1. Iraq: An Oil Dependent Economy, 1980–2018



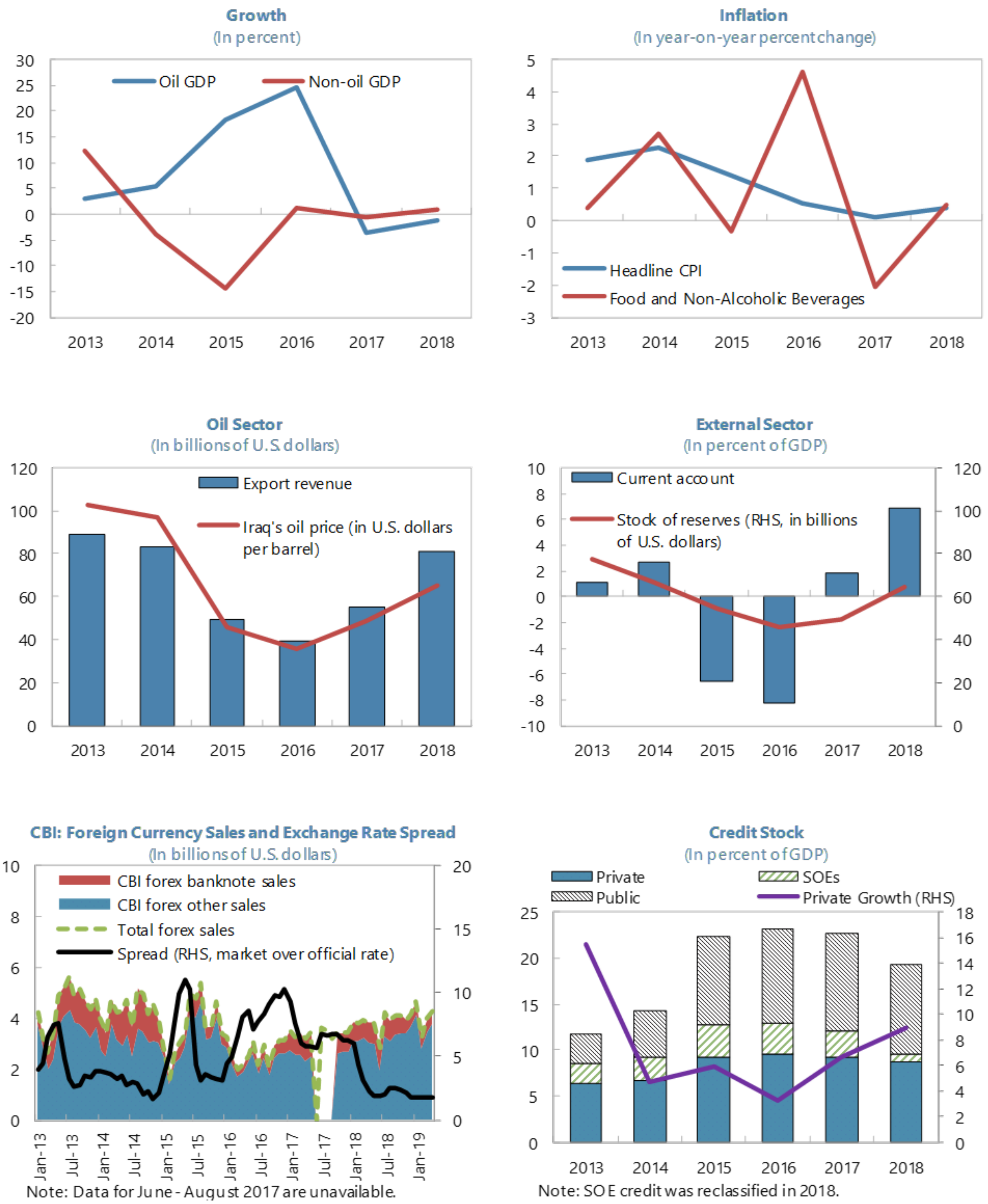
Sources: OPEC; Rystad Energy; World Bank; U.S. Energy Information Administration; World Economic Outlook; BACI International Trade database; and IMF staff calculations.

Figure 2. Iraq: Social Indicators, 2000–50



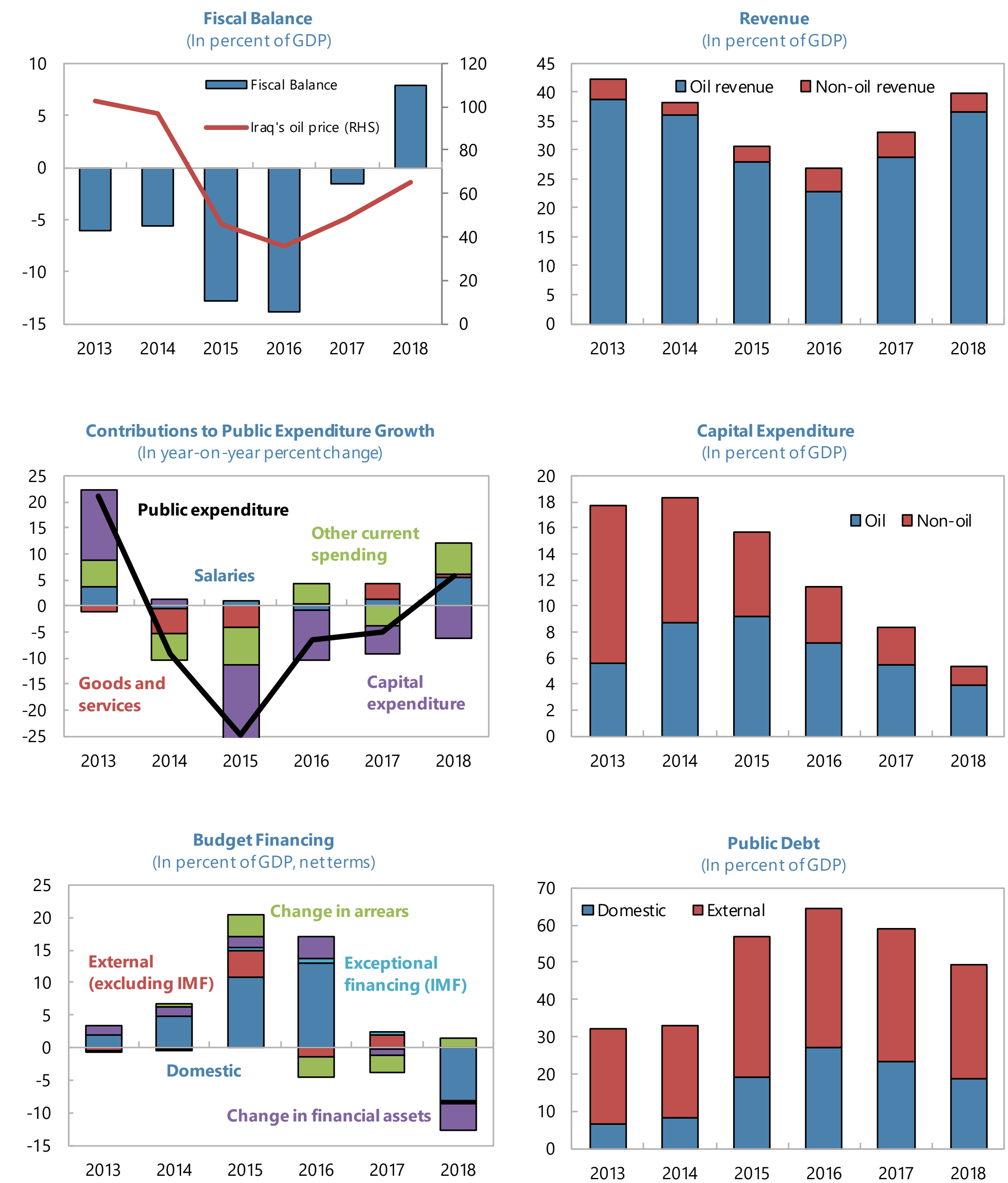
Sources: Worldwide Governance Indicators; Human Development Indicators; UN World Population Prospects (2017); and IMF staff calculations.

Figure 3. Iraq: Recent Economic Developments, 2013–19



Sources: Iraqi authorities; and IMF staff estimates and calculations.

Figure 4. Iraq: Fiscal and Debt, 2013–18



Sources: Iraqi authorities; World Economic Outlook; and IMF staff calculations.

Table 1. Iraq: Selected Economic and Financial Indicators, 2015–24

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic growth and prices										
Real GDP (percentage change)	2.5	15.2	-2.5	-0.6	4.6	5.3	2.6	2.3	2.1	2.1
Non-oil real GDP (percentage change)	-14.4	1.3	-0.6	0.8	5.4	5.0	4.1	3.4	2.7	2.7
GDP deflator (percentage change)	-26.1	-13.4	14.6	15.4	-4.5	2.3	2.6	2.8	3.1	3.3
GDP per capita (US$)	5,047	4,843	5,263	5,882	5,728	6,017	6,172	6,326	6,486	6,666
GDP (in ID trillion)	207.2	206.7	231.0	265.0	264.8	285.4	300.4	315.9	332.3	350.4
Non-oil GDP (in ID trillion)	137.3	138.3	140.8	145.6	158.1	173.2	188.1	202.8	217.1	232.6
GDP (in US$ billion)	177.7	175.2	195.5	224.2	224.1	241.5	254.1	267.3	281.1	296.5
Oil production (mbpd)	3.72	4.63	4.47	4.41	4.59	4.84	4.93	5.01	5.10	5.18
Oil exports (mbpd)	3.35	3.79	3.80	3.86	4.03	4.25	4.33	4.40	4.47	4.55
Iraq oil export prices (US$ pb) 1/	45.9	35.6	48.7	65.2	56.0	55.8	54.9	54.4	54.4	54.8
Consumer price inflation (percentage change; end of period)	2.3	-1.5	0.2	-0.1	2.0	2.0	2.0	2.0	2.0	2.0
Consumer price inflation (percentage change; average)	1.4	0.5	0.1	0.4	0.8	2.0	2.0	2.0	2.0	2.0
National Accounts										
Gross domestic investment	24.9	20.8	16.7	12.9	18.8	16.7	16.0	15.6	15.6	15.4
Of which: public	15.6	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
Gross domestic consumption	81.2	87.0	80.8	79.1	84.5	85.4	86.8	87.9	88.6	89.6
Of which: public	22.6	22.6	21.8	21.2	26.5	26.3	26.4	26.2	26.2	26.3
Gross national savings	18.4	12.5	18.6	19.8	13.6	12.5	11.7	11.1	10.3	9.4
Of which: public	3.1	-2.0	7.0	13.4	6.5	5.2	4.1	3.2	1.8	0.8
Saving - Investment balance	-6.5	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
Public Finance										
Government revenue and grants	30.6	26.8	33.0	39.8	40.5	39.6	37.9	36.5	35.5	34.6
Government oil revenue	27.8	22.9	28.9	36.7	37.2	36.3	34.5	33.1	32.0	31.0
Government non-oil revenue	2.8	4.0	4.2	3.1	3.3	3.3	3.4	3.4	3.5	3.5
Expenditure, of which:	43.4	40.7	34.6	32.0	44.6	43.1	41.2	40.5	40.5	40.5
Current expenditure	27.8	29.3	26.4	26.7	33.9	34.7	33.6	33.5	33.7	33.9
Capital expenditure	15.6	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
Overall fiscal balance (including grants)	-12.8	-13.9	-1.6	7.9	-4.1	-3.5	-3.3	-4.0	-5.0	-5.9
Non-oil primary fiscal balance, accrual basis (percent of non-oil GDP)	-46.5	-43.3	-39.4	-42.4	-56.9	-52.1	-49.2	-47.1	-46.2	-45.3
Adjusted Non-oil primary fiscal balance, accrual basis (excl. KRG, percent of non-oil GDP) 2/	-44.7	-43.3	-39.4	-40.5	-50.1	-46.0	-43.6	-41.8	-41.0	-40.2
Adjusted non-oil primary expenditure (excl. KRG, percent of non-oil GDP) 3/	48.9	49.2	46.3	46.2	55.6	51.5	49.1	47.2	46.3	45.5
Adjusted non-oil primary expenditure (excl. KRG, annual real growth, percent) 3/	-24.7	0.9	-4.5	2.8	29.9	-0.6	1.4	1.6	3.1	3.2
Memorandum items										
Total government debt (in percent of GDP) 4/	56.2	64.2	58.9	49.3	51.4	50.5	50.6	51.5	53.6	56.4
Total government debt (in US$ billion) 4/	99.9	112.5	115.2	110.4	115.3	121.9	128.5	137.5	150.7	167.3
External government debt (in percent of GDP)	37.2	37.1	35.6	30.6	32.2	31.5	30.5	28.4	26.8	24.9
External government debt (in US$ billion)	66.1	65.0	69.5	68.7	72.2	76.2	77.6	75.8	75.3	73.8
Monetary indicators										
Growth in reserve money	-12.0	9.2	-4.4	6.7	2.5	5.4	4.7	4.9	5.1	4.6
Growth in broad money	-9.1	7.1	2.6	2.7	2.5	6.2	5.4	6.0	5.9	5.3
External sector										
Current account	-6.5	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
Trade balance	-0.1	-1.7	7.6	13.4	3.5	4.1	3.2	2.0	1.3	0.5
Exports of goods	31.8	28.6	34.8	41.2	37.0	36.2	34.4	33.1	32.0	31.2
Imports of goods	-31.9	-30.3	-27.1	-27.8	-33.5	-32.0	-31.2	-31.1	-30.8	-30.7
Overall external balance	-6.7	-3.7	2.5	6.3	-2.5	-1.1	-1.6	-3.5	-3.8	-4.7
Gross reserves (in US$ billion)	54.1	45.5	49.4	64.7	57.2	53.5	48.5	38.8	28.2	14.3
Total GIR (in months of imports of goods and services)	9.3	7.8	7.3	8.0	6.8	6.2	5.5	4.2	2.9	1.4
Exchange rate (dinar per US$; period average)	1,166	1,180	1,182	1,182	1,182	1,182	1,182	1,182	1,182	1,182
Real effective exchange rate (percent change, end of period) 5/	6.5	1.8	-5.1	4.9	…	…	…	…	…	…

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Negative price differential of about $3.6 per barrel compared to the average petroleum spot price (average of Brent, West Texas and Dubai oil prices) in 2018-23.

2/ Adjusted to exclude (i) full year estimates of federal government transfers to the Kurdistan Regional Government, and (ii) non oil tax revenues from the KRG to the federal government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

3/ Adjusted to exclude full year estimate of federal government transfers to the Kurdistan Regional Government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

4/ Includes arrears. The debt stock includes legacy arrears to non-Paris Club creditors on which the authorities have requested (but not yet obtained) Paris-Club comparable relief. Implementing comparable terms will substantially reduce debt (e.g. by 15 percent of GDP in 2017).

5/ Positive means appreciation.

Table 2. Iraq: Central Government Fiscal Accounts, 2015–24

(In trillions of Iraqi dinars, unless otherwise indicated)

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenues and grants	63.5	55.5	76.3	105.6	107.3	113.1	113.9	115.3	117.9	121.1
Revenues	63.5	55.5	76.3	105.6	107.3	113.1	113.9	115.3	117.9	121.1
Oil	57.7	47.2	66.7	97.3	98.5	103.6	103.7	104.4	106.3	108.7
Crude oil export revenues	57.2	46.6	65.2	96.1	97.3	102.4	102.5	103.2	105.1	107.5
Transfers from oil-related public enterprises	0.5	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Tax on oil company profits	0.0	0.3	1.2	0.8	0.7	0.8	0.8	0.8	0.8	0.8
Non-oil	5.8	8.3	9.6	8.3	8.8	9.5	10.2	10.9	11.6	12.4
Tax revenues	1.4	5.2	6.7	4.9	5.2	5.5	5.8	6.2	6.6	7.0
Direct taxes	1.1	3.7	3.9	2.6	2.5	2.7	2.9	3.1	3.3	3.5
Indirect taxes	0.4	1.5	2.9	2.3	2.7	2.8	3.0	3.1	3.3	3.5
Non-tax revenues	4.4	3.0	2.9	3.4	3.7	4.0	4.3	4.7	5.0	5.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	90.0	84.2	80.1	84.7	118.0	123.1	123.7	128.0	134.6	141.8
Current expenditures	57.6	60.5	60.9	70.7	89.9	99.0	101.0	105.9	111.9	118.8
Salary and pension	42.2	41.6	42.9	48.3	57.8	61.6	64.6	67.5	70.9	74.7
Salary	33.1	32.3	33.4	37.7	46.0	49.7	52.4	55.1	58.2	61.7
Pension	9.0	9.3	9.5	10.6	11.7	12.0	12.2	12.5	12.7	13.0
Goods and services	4.7	5.0	7.5	8.0	12.4	13.5	14.6	15.3	16.3	17.4
Transfers	9.5	12.5	8.2	10.2	15.2	15.9	16.7	17.5	18.3	19.2
Interest payments	1.3	1.4	2.3	3.7	3.0	4.9	5.1	5.6	6.4	7.5
War reparations 1/	0.0	0.0	0.0	0.4	1.5	3.1	0.0	0.0	0.0	0.0
Investment expenditures	32.4	23.7	19.2	14.0	28.1	24.1	22.6	22.2	22.7	23.0
Non-oil investment expenditures	13.3	9.0	6.5	3.6	13.4	8.6	6.9	6.1	6.4	6.4
Oil investment expenditures	19.1	14.7	12.6	10.5	14.7	15.5	15.8	16.0	16.3	16.6
Fiscal balance	-26.6	-28.7	-3.7	20.9	-10.7	-10.0	-9.8	-12.7	-16.7	-20.7
Statistical discrepancy	0.0	-0.3	0.2	0.0	…	…	…	…	…	…
Financing	26.6	29.0	3.5	-20.9	10.7	10.0	9.8	12.7	16.7	20.7
External financing	4.2	2.4	4.0	1.2	3.0	4.7	1.6	-2.4	-0.5	-1.9
Budget Loans	2.8	3.5	4.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
International Financial Institutions	2.8	3.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	0.0	0.3	0.6	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Eurobond	0.0	0.0	2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project Loans	0.3	2.3	2.2	1.1	6.0	5.5	3.8	2.2	1.0	0.6
Donor funds for reconstruction	0.0	0.0	0.0	0.0	1.2	3.9	4.3	4.7	5.9	5.9
Amortization	-1.6	-1.1	-1.0	-1.7	-2.8	-4.9	-6.5	-9.3	-7.5	-8.5
Assets held abroad	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR Holding	2.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-4.8	-0.3	0.6	0.0	0.0	0.2	0.1	0.1	0.1	0.1
Arrears	5.3	-2.0	-1.9	1.5	-1.3	0.0	0.0	0.0	0.0	0.0
Domestic financing	22.3	26.7	-0.5	-22.1	7.8	5.3	8.2	15.1	17.2	22.6
Bank financing	24.0	21.9	0.3	-21.6	8.9	5.3	8.2	15.1	17.2	22.6
CBI	10.1	16.7	1.2	-19.1	8.9	4.3	5.9	11.4	12.5	16.4
Loans	6.4	14.3	2.4	-1.5	1.3	2.3	3.9	9.4	11.5	15.4
Deposits	3.7	2.4	-1.2	-17.6	7.6	2.0	2.0	2.0	1.0	1.0
Commercial banks	13.9	5.2	-0.8	-2.5	0.0	1.0	2.3	3.7	4.7	6.2
Loans	7.9	0.6	0.0	-2.5	0.0	1.0	2.3	3.7	4.7	6.2
Deposits	6.0	4.6	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-bank financing	0.0	2.0	1.5	1.2	0.2	0.0	0.0	0.0	0.0	0.0
Net sale of government financial assets	0.8	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-0.1	1.8	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears	3.7	0.7	-3.0	-1.7	-1.3	0.0	0.0	0.0	0.0	0.0
Financing gap 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Non-oil primary expenditure, accrual basis	69.7	68.1	65.1	70.1	98.9	99.7	102.8	106.4	111.9	117.7
Adjusted non-oil primary expenditure, accrual basis (excluding KRG) 3/	67.1	68.1	65.1	67.2	88.0	89.2	92.2	95.6	100.5	105.8
Adjusted non-oil primary expenditure, accrual (annual real growth, percent) 3/	-24.7	0.9	-4.5	2.8	29.9	-0.6	1.4	1.6	3.1	3.2
Domestic inflation (in percent)	1.4	0.5	0.1	0.4	0.8	2.0	2.0	2.0	2.0	2.0
Non-oil primary fiscal balance, accrual basis	-63.9	-59.9	-55.5	-61.8	-90.0	-90.2	-92.6	-95.6	-100.3	-105.4
Adjusted non-oil primary fiscal balance, accrual basis (excluding KRG) 4/	-61.3	-59.9	-55.5	-58.9	-79.2	-79.7	-82.1	-84.8	-88.9	-93.5
Non-oil primary fiscal balance, cash basis 5/	-59.3	-58.7	-59.7	-63.7	-92.7	-90.2	-92.6	-95.6	-100.3	-105.4
Adjusted non-oil primary fiscal balance, cash basis (excluding KRG) 4,5/	-56.8	-58.7	-59.7	-60.8	-81.8	-79.7	-82.1	-84.8	-88.9	-93.5

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Five percent of oil exports as mandated by U.N. Security Council Resolution 1483 to finance war reparations to Kuwait.

2/ Includes unidentified financing only.

3/ Adjusted to exclude full year estimates of federal government transfers to the Kurdistan Regional Government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

4/ Adjusted to exclude (i) full year estimates of federal government transfers to the Kurdistan Regional Government, and (ii) non oil tax revenues from the KRG to the federal government.

5/ The non-oil primary fiscal balance on cash basis adjusts the non-oil primary balance measured on accrual basis by subtracting the spending financed by arrears' accumulation during that period, and adding the repayment of arrears from previous years.

Table 3. Iraq: Central Government Fiscal Accounts, 2015–24

(In percent of GDP)

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenues and grants	30.6	26.8	33.0	39.8	40.5	39.6	37.9	36.5	35.5	34.6
Revenues	30.6	26.8	33.0	39.8	40.5	39.6	37.9	36.5	35.5	34.6
Oil	27.8	22.9	28.9	36.7	37.2	36.3	34.5	33.1	32.0	31.0
Crude oil export revenues	27.6	22.5	28.2	36.2	36.8	35.9	34.1	32.7	31.6	30.7
Transfers from oil-related public enterprises	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Tax on oil company profits	0.0	0.1	0.5	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Non-oil	2.8	4.0	4.2	3.1	3.3	3.3	3.4	3.4	3.5	3.5
Tax revenues	0.7	2.5	2.9	1.8	2.0	1.9	1.9	2.0	2.0	2.0
Direct taxes	0.5	1.8	1.7	1.0	0.9	0.9	1.0	1.0	1.0	1.0
Indirect taxes	0.2	0.7	1.2	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Non-tax revenues	2.1	1.5	1.3	1.3	1.4	1.4	1.4	1.5	1.5	1.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	43.4	40.7	34.6	32.0	44.6	43.1	41.2	40.5	40.5	40.5
Current expenditures	27.8	29.3	26.4	26.7	33.9	34.7	33.6	33.5	33.7	33.9
Salary and pension	20.4	20.1	18.6	18.2	21.8	21.6	21.5	21.4	21.3	21.3
Salary	16.0	15.6	14.5	14.2	17.4	17.4	17.5	17.4	17.5	17.6
Pension	4.4	4.5	4.1	4.0	4.4	4.2	4.1	3.9	3.8	3.7
Goods and services	2.3	2.4	3.3	3.0	4.7	4.7	4.8	4.8	4.9	5.0
Transfers	4.6	6.0	3.5	3.8	5.8	5.6	5.6	5.5	5.5	5.5
Interest payments	0.6	0.7	1.0	1.4	1.1	1.7	1.7	1.8	1.9	2.1
War reparations 1/	0.0	0.0	0.0	0.2	0.6	1.1	0.0	0.0	0.0	0.0
Investment expenditures	15.6	11.5	8.3	5.3	10.6	8.4	7.5	7.0	6.8	6.6
Non-oil investment expenditures	6.4	4.3	2.8	1.4	5.1	3.0	2.3	1.9	1.9	1.8
Oil investment expenditures	9.2	7.1	5.5	3.9	5.5	5.4	5.2	5.1	4.9	4.7
Fiscal balance	-12.8	-13.9	-1.6	7.9	-4.1	-3.5	-3.3	-4.0	-5.0	-5.9
Statistical discrepancy	0.0	-0.1	0.1	0.0	...	...	...	...	...	...
Financing	12.8	14.0	1.5	-7.9	4.1	3.5	3.3	4.0	5.0	5.9
External financing	2.0	1.1	1.8	0.4	1.1	1.6	0.5	-0.7	-0.2	-0.6
Budget Loans	1.4	1.7	1.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
International Financial Institutions	1.4	1.6	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	0.0	0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Eurobond	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project Loans	0.1	1.1	1.0	0.4	2.3	1.9	1.2	0.7	0.3	0.2
Donor funds for reconstruction	0.0	0.0	0.0	0.0	0.4	1.4	1.4	1.5	1.8	1.7
Amortization	-0.8	-0.5	-0.4	-0.6	-1.1	-1.7	-2.2	-3.0	-2.3	-2.4
Assets held abroad	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR Holding	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-2.3	-0.2	0.3	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Arrears	2.5	-1.0	-0.8	0.6	-0.5	0.0	0.0	0.0	0.0	0.0
Domestic financing	10.8	12.9	-0.2	-8.3	2.9	1.9	2.7	4.8	5.2	6.5
Bank financing	11.6	10.6	0.1	-8.1	3.4	1.9	2.7	4.8	5.2	6.5
CBI	4.9	8.1	0.5	-7.2	3.4	1.5	2.0	3.6	3.8	4.7
Loans	3.1	6.9	1.0	-0.6	0.5	0.8	1.3	3.0	3.5	4.4
Deposits	1.8	1.2	-0.5	-6.6	2.9	0.7	0.7	0.6	0.3	0.3
Commercial banks	6.7	2.5	-0.4	-1.0	0.0	0.4	0.8	1.2	1.4	1.8
Loans	3.8	0.3	0.0	-1.0	0.0	0.4	0.8	1.2	1.4	1.8
Deposits	2.9	2.2	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-bank financing	0.0	1.0	0.7	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Net sale of government financial assets	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-0.1	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears	1.8	0.3	-1.3	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0
Financing gap 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP to compute ratios	207.2	206.7	231.0	265.0	264.8	285.4	300.4	315.9	332.3	350.4
Memorandum items										
Non-oil primary expenditure, accrual basis (percent of GDP)	33.6	33.0	28.2	26.4	37.3	34.9	34.2	33.7	33.7	33.6
Adjusted non-oil primary expenditure, accrual basis (excl. KRG, percent of GDP) 3/	32.4	33.0	28.2	25.4	33.2	31.3	30.7	30.3	30.3	30.2
Non-oil primary fiscal balance, accrual basis (percent of GDP)	-30.8	-29.0	-24.0	-23.3	-34.0	-31.6	-30.8	-30.3	-30.2	-30.1
Adjusted non-oil primary fiscal balance, accrual basis (excl. KRG, percent of GDP) 4/	-29.6	-29.0	-24.0	-22.2	-29.9	-27.9	-27.3	-26.8	-26.8	-26.7
Non-oil primary fiscal balance, cash basis (percent of GDP) 5/	-28.6	-28.4	-25.8	-24.0	-35.0	-31.6	-30.8	-30.3	-30.2	-30.1
Adjusted Non-oil primary fiscal balance, cash basis (excluding KRG, percent of GDP) 4,5/	-27.4	-28.4	-25.8	-22.9	-30.9	-27.9	-27.3	-26.8	-26.8	-26.7

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Five percent of oil exports as mandated by U.N. Security Council Resolution 1483 to finance war reparations to Kuwait.

2/ Includes unidentified financing only.

3/ Adjusted to exclude full year estimates of federal government transfers to the Kurdistan Regional Government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

4/ Adjusted to exclude (i) full year estimates of federal government transfers to the Kurdistan Regional Government, and (ii) non oil tax revenues from the KRG to the federal government.

5/ The non-oil primary fiscal balance on cash basis adjusts the non-oil primary balance measured on accrual basis by subtracting the spending financed by arrears' accumulation during that period, and adding the repayment of arrears from previous years.

Table 4. Iraq: Central Government Fiscal Accounts, 2015–24

(In percent of non-oil GDP)

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenues and grants	46.2	40.1	54.2	72.5	67.9	65.3	60.6	56.9	54.3	52.1
Revenues	46.2	40.1	54.2	72.5	67.9	65.3	60.6	56.9	54.3	52.1
Oil	42.0	34.2	47.4	66.8	62.3	59.8	55.1	51.5	48.9	46.7
Crude oil export revenues	41.6	33.7	46.3	66.0	61.5	59.2	54.5	50.9	48.4	46.2
Transfers from oil-related public enterprises	0.3	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Tax on oil company profits	0.0	0.2	0.8	0.6	0.5	0.4	0.4	0.4	0.4	0.3
Non-oil	4.2	6.0	6.8	5.7	5.6	5.5	5.4	5.4	5.3	5.3
Tax revenues	1.1	3.8	4.8	3.3	3.3	3.2	3.1	3.1	3.0	3.0
Direct taxes	0.8	2.7	2.7	1.8	1.6	1.5	1.5	1.5	1.5	1.5
Indirect taxes	0.3	1.1	2.0	1.6	1.7	1.6	1.6	1.5	1.5	1.5
Non-tax revenues	3.2	2.2	2.1	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	65.5	60.9	56.9	58.2	74.6	71.1	65.8	63.1	62.0	61.0
Current expenditures	42.0	43.8	43.3	48.5	56.8	57.2	53.7	52.2	51.5	51.1
Salary and pension	30.7	30.1	30.5	33.2	36.5	35.6	34.4	33.3	32.6	32.1
Salary	24.1	23.4	23.8	25.9	29.1	28.7	27.9	27.2	26.8	26.5
Pension	6.6	6.7	6.8	7.2	7.4	6.9	6.5	6.1	5.9	5.6
Goods and services	3.4	3.6	5.3	5.5	7.9	7.8	7.7	7.6	7.5	7.5
Transfers	6.9	9.0	5.8	7.0	9.6	9.2	8.9	8.6	8.4	8.3
Interest payments	1.0	1.0	1.6	2.6	1.9	2.8	2.7	2.7	2.9	3.2
War reparations 1/	0.0	0.0	0.0	0.3	0.9	1.8	0.0	0.0	0.0	0.0
Investment expenditures	23.6	17.1	13.6	9.6	17.8	13.9	12.0	10.9	10.4	9.9
Non-oil investment expenditures	9.7	6.5	4.6	2.5	8.5	5.0	3.7	3.0	2.9	2.8
Oil investment expenditures	13.9	10.6	9.0	7.2	9.3	9.0	8.4	7.9	7.5	7.1
Fiscal balance	-19.3	-20.8	-2.7	14.4	-6.8	-5.8	-5.2	-6.3	-7.7	-8.9
Statistical discrepancy	0.0	-0.2	0.1	0.0	...	...	...	...	...	...
Financing	19.3	21.0	2.5	-14.4	6.8	5.8	5.2	6.3	7.7	8.9
External financing	3.1	1.7	2.9	0.8	1.9	2.7	0.8	-1.2	-0.2	-0.8
Budget Loans	2.1	2.5	2.9	0.2	0.0	0.0	0.0	0.0	0.0	0.0
International Financial Institutions	2.1	2.3	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	0.0	0.2	0.4	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Eurobond	0.0	0.0	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project Loans	0.2	1.7	1.6	0.7	3.8	3.2	2.0	1.1	0.5	0.3
Donor funds for reconstruction	0.0	0.0	0.0	0.0	0.7	2.3	2.3	2.3	2.7	2.5
Amortization	-1.1	-0.8	-0.7	-1.2	-1.8	-2.9	-3.5	-4.6	-3.5	-3.7
Assets held abroad	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR Holding	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-3.5	-0.2	0.4	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Arrears	3.8	-1.5	-1.3	1.0	-0.8	0.0	0.0	0.0	0.0	0.0
Domestic financing	16.3	19.3	-0.4	-15.2	4.9	3.1	4.4	7.4	7.9	9.7
Bank financing	17.5	15.8	0.2	-14.8	5.6	3.1	4.4	7.4	7.9	9.7
CBI	7.3	12.1	0.8	-13.1	5.6	2.5	3.1	5.6	5.8	7.1
Loans	4.6	10.3	1.7	-1.0	0.8	1.3	2.1	4.6	5.3	6.6
Deposits	2.7	1.8	-0.8	-12.1	4.8	1.2	1.1	1.0	0.5	0.4
Commercial banks	10.2	3.7	-0.6	-1.7	0.0	0.6	1.2	1.8	2.2	2.7
Loans	5.8	0.4	0.0	-1.7	0.0	0.6	1.2	1.8	2.2	2.7
Deposits	4.4	3.3	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-bank financing	0.0	1.5	1.1	0.8	0.1	0.0	0.0	0.0	0.0	0.0
Net sale of government financial assets	0.6	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Account payables	-0.1	1.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Arrears	2.7	0.5	-2.1	-1.2	-0.8	0.0	0.0	0.0	0.0	0.0
Financing gap 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
Non-oil primary expenditure, accrual basis (percent of non-oil GDP)	50.7	49.2	46.3	48.1	62.5	57.5	54.7	52.5	51.5	50.6
Adjusted non-oil primary expenditure, accrual basis (excl. KRG, percent of non-oil GDP) 3/	48.9	49.2	46.3	46.2	55.6	51.5	49.1	47.2	46.3	45.5
Non-oil primary fiscal balance, accrual basis (percent of non-oil GDP)	-46.5	-43.3	-39.4	-42.4	-56.9	-52.1	-49.2	-47.1	-46.2	-45.3
Adjusted non-oil primary fiscal balance, accrual basis (excl. KRG, percent of non-oil GDP) 4/	-44.7	-43.3	-39.4	-40.5	-50.1	-46.0	-43.6	-41.8	-41.0	-40.2
Non-oil primary fiscal balance, cash basis (percent of non-oil GDP) 5	-43.2	-42.4	-42.4	-43.7	-58.6	-52.1	-49.2	-47.1	-46.2	-45.3
Adjusted Non-oil primary fiscal balance, cash basis (excl. KRG, percent of non-oil GDP) 4,5/	-41.3	-42.4	-42.4	-41.8	-51.7	-46.0	-43.6	-41.8	-41.0	-40.2
Non-oil GDP (ID trillion)	137.3	138.3	140.8	145.6	158.1	173.2	188.1	202.8	217.1	232.6

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Five percent of oil exports as mandated by U.N. Security Council Resolution 1483 to finance war reparations to Kuwait.

2/ Includes unidentified financing only.

3/ Adjusted to exclude full year estimates of federal government transfers to the Kurdistan Regional Government. In 2014 and 2015, actual transfers were made for only 2 and 5 months, respectively.

4/ Adjusted to exclude (i) full year estimates of federal government transfers to the Kurdistan Regional Government, and (ii) non oil tax revenues from the KRG to the federal government.

5/ The non-oil primary fiscal balance on cash basis adjusts the non-oil primary balance measured on accrual basis by subtracting the spending financed by arrears' accumulation during that period, and adding the repayment of arrears from previous years.

Table 5. Iraq: Balance of Payments, 2015–24
(In billions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018	Projections 2019	2020	2021	2022	2023	2024
Trade balance	-0.2	-3.0	14.9	30.1	7.8	10.0	8.1	5.4	3.6	1.5
(In percent of GDP)	-0.1	-1.7	7.6	13.4	3.5	4.1	3.2	2.0	1.3	0.5
Exports	56.5	50.0	68.0	92.4	82.9	87.3	87.5	88.4	90.1	92.4
Crude oil	56.1	49.7	67.6	91.9	82.3	86.7	86.7	87.4	88.9	90.9
Other exports	0.4	0.4	0.4	0.5	0.6	0.6	0.8	1.0	1.2	1.5
Imports	-56.7	-53.1	-53.1	-62.3	-75.1	-77.3	-79.4	-83.0	-86.5	-90.9
Private sector imports	-41.6	-38.3	-38.7	-41.0	-46.8	-47.6	-48.7	-50.6	-53.4	-56.1
Government imports	-15.1	-14.8	-14.4	-21.3	-28.3	-29.7	-30.7	-32.4	-33.1	-34.8
Services, net	-10.7	-10.7	-10.2	-12.1	-15.1	-15.0	-15.2	-14.9	-15.3	-16.2
Receipts	6.3	6.2	6.5	6.3	7.0	8.2	8.3	8.8	9.0	9.2
Payments	-16.9	-16.9	-16.7	-18.4	-22.1	-23.2	-23.6	-23.8	-24.3	-25.4
Income, net	-1.3	-1.3	-2.2	-2.9	-2.3	-2.6	-2.9	-3.0	-3.2	-3.4
Transfers, net	0.5	0.6	1.0	0.3	-2.0	-2.6	-0.8	0.4	0.0	0.4
Private, net	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Official, net	0.1	0.2	0.6	-0.1	-2.4	-3.0	-1.3	0.0	-0.4	0.0
Current account	-11.6	-14.5	3.6	15.5	-11.6	-10.2	-10.8	-12.2	-14.8	-17.7
(in percent of GDP)	-6.5	-8.3	1.8	6.9	-5.2	-4.2	-4.3	-4.6	-5.3	-6.0
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	8.3	9.2	7.1	-1.0	5.9	7.6	6.7	2.8	4.1	3.8
Direct and portfolio investment (net)	2.8	1.8	1.8	1.0	1.0	1.4	2.5	2.5	2.5	2.5
Other capital, net	5.5	7.4	5.4	-2.0	4.9	6.2	4.2	0.3	1.6	1.3
Official, net	-4.5	4.1	5.5	0.9	5.6	5.0	2.3	-1.7	-0.5	-1.7
Assets	-6.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	1.6	4.1	5.5	0.9	5.6	5.0	2.3	-1.7	-0.5	-1.7
Disbursements 1/	2.7	4.9	6.7	2.2	7.3	8.0	6.8	5.8	5.9	5.5
Amortization	-1.1	-0.9	-1.2	-1.3	-1.7	-3.0	-4.6	-7.6	-6.4	-7.2
Private, net	10.0	3.4	-0.2	-2.9	-0.7	1.2	2.0	2.0	2.1	3.0
Errors and omissions	-8.7	-1.3	-5.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-12.0	-6.6	5.0	14.2	-5.7	-2.6	-4.1	-9.4	-10.7	-13.9
(in percent of GDP)	-6.7	-3.7	2.5	6.3	-2.5	-1.1	-1.6	-3.5	-3.8	-4.7
Financing	12.0	6.6	-5.0	-14.2	5.7	2.6	4.1	9.4	10.7	13.9
Development Fund for Iraq (increase -) 2/	-1.7	0.6	-1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross International Reserves (increase -)	13.9	8.0	-2.9	-15.3	7.5	3.7	5.0	9.7	10.6	13.9
Fund credit (repayment)	-0.6	-0.1	0.0	-0.2	-0.7	-1.2	-1.0	-0.3	0.0	0.0
Change in arrears (negative = decrease)	4.5	-1.7	-1.6	1.3	-1.1	0.0	0.0	0.0	0.0	0.0
Change in payables (negative = decrease)	-4.1	-0.3	0.5	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Financing gap (increase -) 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items										
GIR (end of period)	54.1	45.5	49.4	64.7	57.2	53.5	48.5	38.8	28.2	14.3
Total GIR (in months of imports of goods and services)	9.3	7.8	7.3	8.0	6.8	6.2	5.5	4.2	2.9	1.4
GDP	177.7	175.2	195.5	224.2	224.1	241.5	254.1	267.3	281.1	296.5
Of which: Non-oil GDP	117.8	117.2	119.1	123.2	133.8	146.5	159.1	171.6	183.7	196.8

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Includes prospective disbursements from the IMF, WB and other donors in 2016–19.

2/ Reflects the transfer of the Development Fund for Iraq from the Federal Reserve Bank of New York to the CBI in May 2014.

3/ Includes unidentified financing only.

Table 6. Iraq: Monetary Survey, 2015–24

(In billions of Iraq dinars, unless otherwise indicated)

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Net foreign assets	75,163	60,600	63,892	86,266	75,276	72,370	67,570	56,486	43,930	27,540
Of which: CBI	60,725	49,550	52,864	71,212	63,267	60,352	55,543	44,451	31,886	15,488
Net domestic assets	9,208	29,726	28,818	8,977	22,346	31,324	41,762	59,386	78,751	101,686
Domestic claims	17,322	36,444	39,018	16,428	27,246	34,824	45,462	62,886	82,451	107,536
Net claims on general government	-8,119	11,125	13,173	-6,662	2,221	7,522	15,735	30,838	48,036	70,652
Claims on general government	28,627	41,490	44,385	44,353	45,636	48,937	55,150	68,253	84,451	106,066
less: Liabilities to general government	-36,746	-30,365	-31,212	-51,015	-43,415	-41,415	-39,415	-37,415	-36,415	-35,415
Claims on other sectors	25,441	25,318	25,844	23,090	25,024	27,302	29,727	32,047	34,414	36,884
Other Item Net (OIN)	-8,114	-6,718	-10,199	-7,451	-4,900	-3,500	-3,700	-3,500	-3,700	-5,850
Broad money	84,370	90,326	92,710	95,243	97,622	103,695	109,332	115,872	122,680	129,226
Currency outside banks	34,855	42,075	40,343	40,498	41,653	44,073	46,290	48,733	51,403	53,945
Transferable deposits	34,758	33,449	36,643	37,331	38,165	40,656	42,988	45,783	48,604	51,334
Other deposits	14,757	14,802	15,724	17,414	17,803	18,966	20,053	21,357	22,673	23,946
Memorandum items										
Broad money (percentage growth)	-9.1	7.1	2.6	2.7	2.5	6.2	5.4	6.0	5.9	5.3
Broad money (in percent of GDP)	40.7	43.7	40.1	41.2	36.9	36.3	36.4	36.7	36.9	36.9
M2 velocity (based on non-oil GDP)	1.6	1.5	1.5	1.5	1.6	1.7	1.7	1.8	1.8	1.8
Credit to the economy (percentage growth)	4.8	-0.5	2.1	-10.7	8.4	9.1	8.9	7.8	7.4	7.2
Credit to the economy (in percent of GDP)	12.3	12.2	11.2	8.7	9.4	9.6	9.9	10.1	10.4	10.5
Credit to the private sector (percentage growth)	5.9	3.2	6.7	9.0	8.4	9.1	8.9	7.8	7.4	7.2
Credit to the private sector (in percent of GDP)	9.3	9.6	9.2	8.7	9.3	9.2	9.3	9.3	9.4	9.5

Sources: Iraqi authorities; and Fund staff estimates and projections.

Table 7. Iraq: Central Bank Balance Sheet, 2015–24

(In billions of Iraqi dinars, unless otherwise indicated)

					Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Net foreign assets	60,725	49,550	52,864	71,212	63,267	60,352	55,543	44,451	31,886	15,488
Foreign assets	64,285	54,219	58,862	76,966	68,082	63,733	57,769	46,308	33,743	17,344
Official reserve assets	63,830	53,774	58,389	76,502	67,618	63,269	57,305	45,844	33,279	16,880
Gold	3,626	3,957	4,433	4,689	5,064	5,469	5,907	6,379	6,890	7,441
Other	59,809	49,149	53,460	71,328	62,069	57,315	50,914	38,980	25,905	8,955
SDR holdings and reserve position in the Fund	395	482	497	484	484	484	484	484	484	484
Other foreign assets	455	446	472	464	464	464	464	464	464	464
Foreign liabilities	-3,416	-4,669	-5,939	-5,645	-4,815	-3,381	-2,226	-1,856	-1,857	-1,856
Net domestic assets	5,194	19,166	14,664	-1,180	8,549	15,374	23,721	38,710	55,534	75,945
Domestic assets	3,062	16,910	14,367	-94	7,959	10,826	15,584	26,618	39,116	55,531
Net claims on general government	3,040	16,281	12,909	-1,863	6,191	9,057	13,815	24,849	37,347	53,762
Loans to central government	2,466	2,466	2,271	2,016	1,186	-249	-1,404	-1,773	-1,773	-1,773
Holdings of discounted treasury bills	6,329	17,771	17,741	16,394	17,677	19,978	23,891	33,294	44,792	60,208
Domestic currency deposits	-1,523	-455	-2,478	-5,315	-3,035	-2,435	-1,835	-1,235	-935	-635
Foreign currency deposits	-4,232	-3,500	-4,625	-14,957	-9,637	-8,237	-6,837	-5,437	-4,737	-4,037
Monetary policy instruments 1/	-1,120	-3,199	-1,500	-1,052	623	4,582	8,171	12,126	16,452	20,448
Other items net	3,260	5,455	2,831	-34	-34	-34	-34	-34	-34	-34
Reserve money	62,914	68,716	65,690	70,066	71,815	75,726	79,264	83,161	87,420	91,433
Currency in circulation	38,585	45,232	44,237	47,169	48,161	50,525	52,624	54,915	57,459	59,825
Bank reserves	24,329	23,485	21,453	22,896	23,654	25,201	26,640	28,247	29,961	31,607
Other liquid liabilities	0	0	0	0	...	...	...	...	...	...
Memorandum items										
Reserve money (annual growth, in percent)	-12.0	9.2	-4.4	6.7	2.5	5.4	4.7	4.9	5.1	4.6
Currency in circulation (annual growth, in percent)	-3.3	17.2	-2.2	6.6	2.1	4.9	4.2	4.4	4.6	4.1
Gross foreign exchange assets (in millions of U.S. dollars) 2/	54,093	45,494	49,399	64,722	57,206	53,527	48,481	38,785	28,155	14,281

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ This mainly represents the ID standing overnight facilities, US$ deposits of commercial banks, domestic currency deposits, and CBI bills.

2/ Starting 2014 reflects the balances of the Development Fund of Iraq were moved from the Federal Reserve Bank of New York to the CBI as a $ account ($ balances from oil revenues) in May 2014. Starting Q3 2015, SDRs and reserve position in the Fund are excluded from the definition per instruction from the Central Bank of Iraq. SDR and reserve position and all transactions with the Fund were reported on balance sheet in June 2016 temporarily and the issue is under review.

Table 8. Iraq: Indicators of Fund Credit, 2016–24

(In millions of SDRs, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
Disbursements of Fund credit (SBA and RFI)	910	584	0	0	0	0	0	0	0
SBA, 2009	0	0	0	0	0	0	0	0	0
In percent of IMF quota (old)	0	0	0	0	0	0	0	0	0
RFI, 2015	0	0	0	0	0	0	0	0	0
In percent of IMF quota (old)	0	0	0	0	0	0	0	0	0
SBA, 2016	910	584	0	0	0	0	0	0	0
In percent of IMF quota (current)	55	35	0	0	0	0	0	0	0
Repurchases and Charges (SBA, RFI and SDR charges)	53	35	166	559	905	716	234	12	12
SBA, 2009	37	0	0	0	0	0	0	0	0
Repurchases under the SBA 1/	37	0	0	0	0	0	0	0	0
RFI, 2015	0	0	111	446	334	0	0	0	0
Repurchases under the RFI 1/	0	0	111	446	334	0	0	0	0
SBA, 2016	0	0	0	57	528	690	219	0	0
Repurchases under the SBA 1/	0	0	0	57	528	690	219	0	0
In percent of IMF quota (current)	0	0	0	3	32	41	13	0	0
Total charges and interest	16	30	45	44	30	13	2	0	0
SDR charges and assessments	1	5	10	12	12	12	12	12	12
Total obligations, in percent of:									
Exports of goods and services	0	0	0	1	2	1	0	0	0
External public debt	0	0	0	1	2	1	0	0	0
Gross reserves	0	0	0	1	2	2	1	0	0
GDP	0	0	0	0	1	0	0	0	0
IMF Quota (old)	4	3	14	47	76	60	20	1	1
IMF Quota (current)	3	2	10	34	54	43	14	1	1
Outstanding Fund credit (SBA and RFI)	1801	2386	2274	1772	909	219	0	0	0
SBA, 2009	0	0	0	0	0	0	0	0	0
RFI, 2015	891	891	780	334	0	0	0	0	0
SBA, 2016	910	1,494	1,494	1,437	909	219	0	0	0
Total outstanding Fund credit, in percent of									
Exports of goods and services	3	4	4	4	2	0	0	0	0
External public debt	4	5	5	3	2	0	0	0	0
Gross reserves	6	7	5	4	2	1	0	0	0
GDP	1	2	1	1	1	0	0	0	0
IMF Quota (old)	152	201	191	149	77	18	0	0	0
IMF Quota (current)	108	143	137	106	55	13	0	0	0

Sources: IMF staff estimates and projections.

1/ The SBA and RFI repurchases are based on scheduled debt service obligations.

Table 9. Iraq: Inclusive Growth Indicators

	Indicator	EMDE Average
Growth		
GDP per capita growth (percent; 2015-17 average)	-6.7	1.4
Gross Fixed Capital Formation (percent of GDP; 2015-17 average)	20.8	24.1
Poverty and Inequality		
Poverty headcount ratio at $3.20/day (percent of population; 2012)	17.9	32.9
Multidimensional poverty (percent of population)	14.7	31.2
Prevalence of stunting (% of children under 5, 2011)	22.6	22.7
GINI Index (2012)	29.5	39.6
Child mortality (per 1,000, 2016)	31.2	36.6
Human Development and Access to Services		
Human Development Index (2017)	0.6	0.6
Life expectancy at birth (years, 2016)	69.9	69.5
Access to electricity (% of population, 2016)	100.0	78.4
Net school enrollment, secondary, total (% population, 2007)	44.8	63.1
Individuals using internet (% population, 2016)	21.2	40.8
Literacy rate (% population, 2013)	43.7	79.1
Government		
Spending on social safety net (percent of GDP, 2018)	2.6	1.6
Social safety net coverage in poorest quintile (% population, 2012)	86.1	42.3
Government expenditure on education, total (% GDP, 2012)	3.9	4.6
Health expenditure, domestic general government (% of GDP, 2015)	0.8	2.9
Access to Finance		
Account at a financial institution (% age 15+, 2017)	20.3	43.0
Domestic credit to private sector (% GDP, 2015)	9.2	39.8
Loans to SMEs (% of GDP, 2016)	1.0	7.8

	Indicator	EMDE Average
Labor Markets (ILO estimates)		
Unemployment rate (% of total labor force, 2018)	7.9	7.5
Female unemployment rate (% of female labor force, 2018)	12.3	9.6
Youth unemployment rate (% of total labor force ages 15-24, 2018)	16.6	16.5
Labor force participation (% of total population ages 15+, 2018)	42.5	63.0
Female labor force participation (% of female population ages 15+, 2018)	12.4	51.0
Youth labor force participation (% of population ages 15-24, 2018)	29.6	43.5
Business Environment 1/		
Ease of Doing Business (DTF, 2019)	44.7	56.2
Registering Property (DTF, 2019)	57.7	57.4
Enforcing Contracts (DTF, 2019)	48.0	52.4
Paying Taxes (DTF, 2019)	63.6	63.8
Governance 1/		
Government Effectiveness (WGI, 2017)	-1.3	-0.5
Regulatory Quality (WGI, 2017)	-1.2	-0.4
Rule of Law (WGI, 2017)	-1.6	-0.4
Control of Corruption (WGI, 2017)	-1.4	-0.3
Corruption Perceptions Index (2017)	18.0	36.2
Gender Equity and Inclusion		
Account at a financial institution (female vs male, %, 2014)	51.1	79.6
Female employment to population ratio (%, 2017)	16.5	46.8
Literacy rate (female vs male, %, 2013)	71.6	86.1
Net school enrollment, secondary (female vs male, %, 2007)	74.7	97.3
Female seats in Parliament (share of total seats, 2018)	26.0	19.5

Better than EMDE Average (green)   **Worse than EMDE Average** (pink)

Sources: IMF World Economic Outlook, World Bank, World Economic Forum, International Labour Organization, Transparency International, UNDP, Oxfam International.
1 / Indicators use official sources and surveys to summarize perceptions of the quality of governance and business environments.

Annex I. Capacity Development Strategy

The Fund and other development partners have provided significant capacity development in recent years, especially in the context of the SBA. In light of the government's objectives and the challenges facing Iraqi authorities, major priorities for Fund Capacity Development (CD) over the medium term are likely to include public financial management, revenue administration, bank supervision and statistics.

Overview of Capacity Development Efforts

1. CD activities in recent years have aimed at helping the authorities deliver on policy commitments under the 2016–19 SBA while also responding to their specific requests:

- Reflecting commitments to address weaknesses in public financial management, the Fund has provided extensive technical assistance to help control arrears, establish commitment controls and take steps towards the establishment of a treasury single account (TSA). The Fund has also provided advice on Iraq's PFM law.
- Similar, program commitments to diversify revenue sources have been supported by advice to develop and strengthen indirect taxation.
- In the financial sector, technical assistance has been directed to strengthening prudential regulation, bank supervision and the AML/CFT framework.

2. Much of the Fund's TA has had a training component. However, the authorities have made more limited use of Fund training online or at the Center for Economics and Finance (CEF) training center.

3. The Fund has worked closely with development partners in the delivery and implementation of TA. World Bank staff have joined Fund TA missions, such as to develop a chart of accounts, which is a critical pre-requisite for the World Bank-led IFMIS project. Other partners, such as JICA, have financed support for debt management, while resident advisors funded by other partners have helped support practical implementation.

Priorities for IMF Technical Assistance and Training

4. The government's strategy of rebuilding the country will require significant capacity building effort alongside a reorientation of the budget towards capital spending. Maintaining fiscal discipline in a context of rising expenditure will involve a continued focus on budget execution and control, including to ensure that off-budget spending and guarantees are adequately monitored, and steps to strengthen non-oil revenue. Thus, the main priorities for Fund fiscal TA are likely to include public financial management, revenue administration, and over time public investment management. Capacity development to support bank supervision should continue.

5. Improvements to statistics would support policy-making in Iraq. The Central Statistics Organization (CSO) faces resource and technical expertise constraints, with progress hampered by weaknesses in interagency data sharing and issues surrounding data collection responsibilities. Capacity development should focus in the near term on real sector and external sector statistics.

Annex II. Response to Past Fund Policy Advice

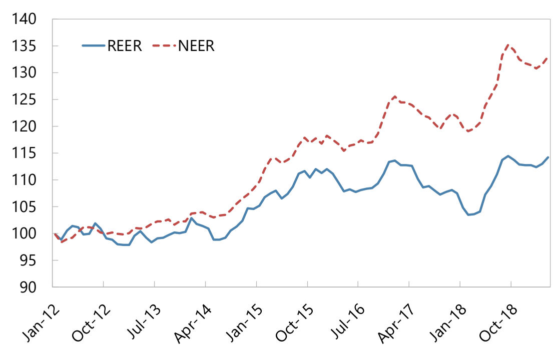
Key Recommendations	Authorities' Response
Fiscal. Find fiscal space needs to enhance human capital and rebuild the physical capital of the country. Tackle the low level of non-oil tax revenue and very high level of public consumption to help create the fiscal room to finance growth-enhancing investment.	**Fiscal**. Limited progress at building fiscal space or controlling public consumption; current spending was increased sharply in 2018 and 2019. The authorities introduced new non-oil taxes in 2018, but initial revenues were limited, and a number of measures have been revoked.
Financial stability. Bolster supervision. Move forward with plans to restructure the state-owned banks. Strengthen the legal framework of the Central Bank. Eliminate an exchange restriction and an MCP.	**Financial stability**. Steps have been taken to strengthen supervision. The authorities have segregated some legacy assets of the state-owned banks to bridge branches, but a comprehensive restructuring plan has yet to be implemented. All previously identified exchange restrictions have been eliminated.
Governance. Accelerate implementation of AML/CFT and anti-corruption measures.	**Governance**. Iraq was removed from FATF monitoring in 2018, signaling progress at AML/CFT implementation. A new High Council on Combatting Corruption was created in 2019, but a significant step-up in anti-corruption enforcement has yet to materialize.
Structural reforms. Implement reforms to improve the investment climate, diversify the economy, and achieve sustainable growth.	**Structural reforms**. Limited progress.
Public financial management. Complete a regular inventory and pay down any arrears. Strengthen expenditure commitment and cash management to prevent the accumulation of new arrears. Address weaknesses in administrative capacity and data provision. Implement the budget-sharing agreement between the Federal and Kurdistan Regional governments.	**Public financial management**. The authorities have generally kept arrears under control, although there has been limited progress at developing commitment controls or strengthening cash management. Budget transfers to KRG were progressively restored during 2018, and have been included in the 2019 budget. A new PFM law was adopted in May 2019.

Annex III. External Sector Assessment

Staff assesses the external position in 2018 to be substantially stronger than suggested by fundamentals and desirable policy settings. However, this is expected to reverse in 2019, with the current account (CA) weakening significantly, reserves falling, and the REER moving into overvalued territory. Ensuring external stability in the medium term will critically hinge on fiscal adjustment, to bring the CA and REER back into line with fundamentals, and maintain reserve adequacy.

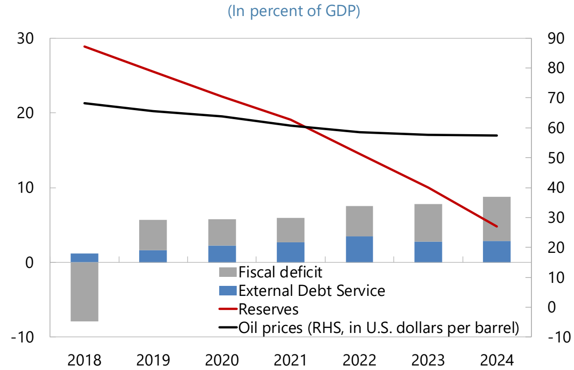
1. From a surplus in 2018, Iraq's CA balance is expected to worsen significantly in 2019 and average a deficit of 5 percent of GDP over the medium term. In 2017, Iraq's CA registered a surplus of 1.8 percent of GDP, from a deficit of -8¼ percent of GDP in 2016, on the back of higher oil prices and fiscal consolidation under the program, while oil export volumes remained flat year on year. In 2018, preliminary estimates suggest that the surplus increased to 6.9 percent of GDP driven by a large increase in oil prices (by USD 16 year on year), with a minor increase in oil export volumes also contributing. Looking forward, the expected decline in oil prices in 2019 (by USD 9 year on year) together with fiscal loosening are projected to dramatically reverse the CA surplus this year to a deficit of 5¼ percent of GDP, despite a projected increase in oil export volumes of 4 percent year on year. Thereafter, the CA balance is expected to remain in deficit through the medium term, averaging –5 percent of GDP, with a gradual increase projected for oil export volumes while prices will remain roughly flat. The real effective exchange rate (REER) appreciated by 4¾ percent year on year in 2018, continuing a trend seen since 2013 (the REER has appreciated by 12½ percent in the past five years) mostly due to movements in the nominal effective exchange rate (NEER) dampened by inflation differentials.[1]

Real and Nominal Effective Exchange Rate
(Index: 2012 = 100)



Source: IMF Information Notice System (INS).

Financing Needs, Oil Prices and Reserves
(In percent of GDP)



Sources: World Economic Outlook; and IMF staff estimates.

[1] The NEER saw a larger appreciation of 8¼ percent in 2018, in line with its sharper five-year trend (29 percent appreciation). The appreciation of the NEER over this period, including a spike in September 2018, largely reflects depreciations of the currencies of Iraq's key trading partners against the U.S. dollar, to which the Iraqi dinar is pegged.

2. Iraq's international reserves, while adequate in 2018, are expected to decline precipitously to levels well below conventional and IMF adequacy metrics over the medium term, given weak oil price prospects and rising financing needs. After increasing to $64.7 billion (29 percent of GDP) in 2018, reserves are expected to fall over the medium term to $14 billion (4¾ percent of GDP) in 2024. Oil prices are expected to decrease marginally from 2019–24, providing no contribution to reserve accumulation, while higher financing needs from the growing fiscal deficit and rising external debt service (from 1¼ percent of GDP in 2018 to almost 3 percent of GDP in 2024) will serve as a drain. Reserves will dip below the IMF's augmented reserve adequacy metric for oil exporters (which adds a buffer to hedge against lower than projected oil prices) in 2019, and by 2023 they will fall to a level well below all IMF and traditional adequacy metrics.

Reserve Adequacy Indicators, 2017–24

			Projections					
	2017	2018	2019	2020	2021	2022	2023	2024
Reserves in USD billion	49.4	64.7	57.2	53.5	48.5	38.8	28.2	14.3
Reserves in months of imports of goods and services	7.3	8.0	6.8	6.2	5.5	4.2	2.9	1.4
Reserves in percent of external debt service coming due	2,005	1,867	1,045	780	522	501	364	166
Reserves in percent of reserve money	88.9	109.2	94.2	83.5	72.3	55.1	38.1	18.5
Reserves in percent of broad money	63.0	80.3	69.3	61.0	52.4	39.6	27.1	13.1
Reserves in percent of the IMF RA metric 1/	174	208	187	166	146	112	81	40
Reserves in percent of the augmented IMF RA metric 1,2/	113	111	98	81	68	54	38	19

Sources: Iraq authorities; and Fund staff estimates and projections.
1/ Reserves within 100–150 percent of the Reserve Adequacy (RA) metric are considered adequate.
2/ The augmented RA metric adds a buffer to account for the possibility of lower than projected oil prices.

3. Staff believes that the non-regression-based Investment Needs model is the most appropriate model for assessing Iraq's CA at this juncture. Staff explored three different approaches for estimating a CA norm against which to assess Iraq's projected CA balance:

- ***The Investment Needs model* (see Box 1)**, which proposes that resource-rich developing countries with scarce capital stocks and high investment needs should use part of their resource wealth to finance investment. CA norms derived with this model tend to be lower than those of other approaches but are highly sensitive to the calibration of investment inefficiencies, which reduce optimal investment levels and therefore increase the norm. In the case of Iraq, investment needs are significant, but inefficiencies are also assessed to be severe.

- ***The Consumption Allocation model***, another non-regression based approach, assumes that exhaustible resource exporters should smooth the consumption of resource revenues in order to satisfy inter-generational equity considerations. While this may gain relevance for Iraq in the longer-term, staff believe it is not appropriate for shaping immediate or medium-term policies given the ample energy reserves and significant investment needs.

- Finally, ***the EBA-lite CA model***, a regression-based approach, which does not fully account for the characteristics of oil-exporters, resulting in high residuals and a poor fit for such countries.[2]

4. The Investment Needs model indicates that Iraq's CA in 2018 was stronger than warranted by fundamentals and desirable policy settings. The Investment Needs and EBA-lite CA models deliver cyclically-adjusted norms well below Iraq's projected cyclically-adjusted CA balance of 5¾ percent of GDP in 2018, while the Consumption Allocation

[2] The volatility of oil prices also makes it difficult to estimate the cyclical component.

model provides a higher norm. Staff focuses on the Investment Needs model, which yields a CA norm of –4½ percent of GDP, implying a CA gap of 10 percent. The CA gap can be entirely explained by the fiscal balance in 2018, estimated to be a surplus of 8 percent of GDP, and the implicit "fiscal gap", which can be obtained by comparing the 2018 fiscal balance to the medium-term fiscal objective: a debt-stabilizing overall balance of –2½ percent of GDP. The 2018 fiscal surplus, in turn, is largely due to higher oil prices. As a cross-check, and given the sensitivity of Iraq's current account and fiscal balances to highly volatile oil prices, staff also estimated an "underlying" current account series, holding oil prices constant at a long-run average (Figure 3). As expected, the results of the underlying series would greatly reduce the CA gap in 2018.[3] Based on the CA gap, staff estimates the REER to be about 20 percent undervalued in 2018. While standard policy advice in the context of a stronger than warranted CA might be to loosen policies, policymakers in Iraq face multiple objectives and the binding constraints lie in the areas of reserve adequacy and debt sustainability. Moreover, based on current projections, the CA gap is expected to close and reverse in 2019 and beyond with a significant worsening of the CA.

Current Account Norm, 2018

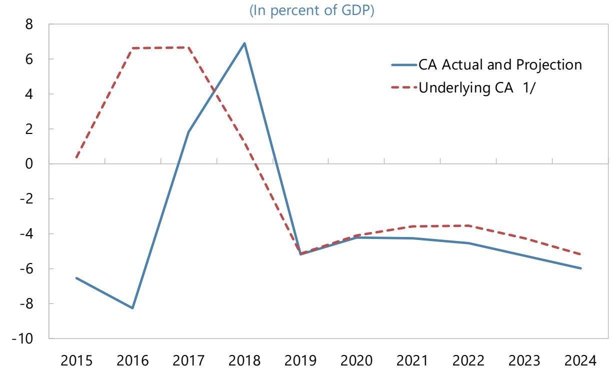
(In percent of GDP)

	EBA-lite CA	Investment Needs	Consumption Allocation
Current account (CA) results			
CA projection 1/ 2/	5.7	5.7	5.7
CA norm 1/	-1.9	-4.5	7.1
CA gap	7.6	10.2	-1.4

Source: IMF staff estimates.
1/ Cyclically-adjusted.
2/ Cyclical adjustment is -1.2 percent of GDP.

Current Account: Actual versus Underlying

(In percent of GDP)



1/ Setting WEO and Iraqi oil prices to 1999-2018 average of US$60 and US$56.
Sources: Iraqi authorities; and IMF staff calculations and projections.

5. **The Iraqi dinar peg with the U.S. dollar remains an appropriate nominal anchor for macroeconomic policies.** The misalignment of the REER is expected to over-correct and move into slightly overvalued territory in 2019 as the CA weakens against its norm. Fiscal adjustment will be crucial to bring the CA back into line with fundamentals, preserve reserves, and ensure external stability over the medium term. In the longer-run, structural policies to improve competitiveness and achieve export diversification would also help support Iraq's external position.

[3] The underlying CA in 2018 is estimated at 1.2 percent of GDP, suggesting a CA gap of 5¾ percent of GDP against the Investment Needs norm of –4.5 percent of GDP.

Box 1. The Investment Needs Model for Natural Resource-Rich Developing Countries

Countries that are rich in exhaustible natural resources experience windfalls that can be consumed, saved or invested—with each of these options having a disparate impact on macroeconomic outcomes and external stability. Empirical studies indicate that most resource-rich developing and advanced countries save much of their windfalls in an attempt to smooth consumption and ensure intergenerational equity, in line with the permanent income hypothesis (Friedman, 1957), and therefore tend to run current account surpluses.[1]

However, drawing on a separate stream of development thinking,[2] Araujo and others (2013) question whether resource-rich developing countries (RRDCs) with large investment needs and external borrowing constraints should save as much as their advanced economy peers, or instead use these windfalls for investment in much needed physical and human capital. They develop a neoclassical small open economy model that aims at assessing the optimal external balance and savings/investment decisions in response to windfalls in RRDCs. The model explicitly incorporates the role of investment given capital scarcity in these countries but also captures pervasive frictions in RRDCs, such as investment inefficiencies, absorptive capacity constraints, and external borrowing constraints. Investment inefficiencies are modeled as impediments that prevent a dollar of investment translating into a dollar of productive capital, thereby lowering the optimal level of investment. Absorptive capacity constraints are adjustment costs that arise when the speed of investment negatively impacts project selection, management and execution, thereby necessitating a slower pace of investment. Finally, imperfect capital mobility and borrowing constraints are modeled through a country risk premium that can be relaxed as natural resource endowments lower the premium.

The results of the model suggest that the optimal external balance and savings/investment decisions for windfalls in RRDCs depend heavily on the degree of investment frictions. Facing borrowing constraints, but *absent* investment frictions, the model indicates that RRDCs should mostly convert windfalls into private and public capital rather than save them in the form of foreign assets. This would imply lower current account balances or even deficits. Furthermore, if resource wealth reduces RRDCs' risk premia thereby relaxing their borrowing constraint, this can facilitate further private and public investment, implying still lower current account balances. However, the presence of investment inefficiencies and absorptive capacity constraints in RRDCs modulates these results, making it optimal to delay or decelerate capital accumulation depending on the degree of the frictions, implying higher current account balances than otherwise would be the case.

On the whole, the model delivers optimal current account balances and savings levels for RRDCs that are significantly lower than those implied by conventional approaches such as the permanent income hypothesis, but the extent of these varies depending on the presence and severity of investment frictions.

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[1] See Berns and Carvalho (2009) and Bayoumi and Thomas (2009).

[2] See Collier and others (2010) and van der Ploeg and Venables (2011).

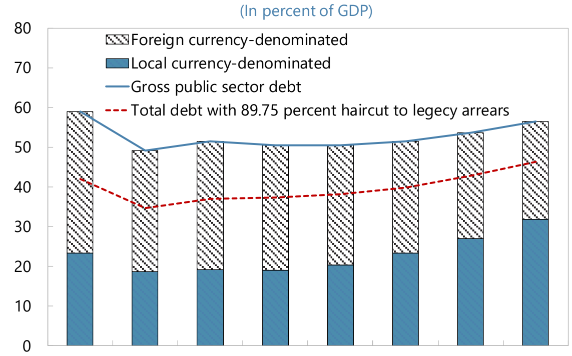
Annex IV. Public and External Debt Sustainability Analysis

Iraq's public debt will rise steadily over the medium term, reaching 56 percent of GDP, in tandem with widening fiscal deficits. Staff assesses that Iraq does not face major solvency risks, notwithstanding its limited debt carrying capacity. However, liquidity risks are high with financing needs consistently exceeding the high-risk threshold over the medium term, reflecting sizable amortization of external debt and short-term debt rollover. Public debt is subject to significant risks and particularly sensitive to adverse real growth and real interest rate shocks. A mitigating factor is that about a third of domestic debt comprises short-term debt held by the central bank.[1]

Public Debt Sustainability Analysis

1. **Public debt is projected to increase in the medium-term from 49 percent of GDP in 2018 to 56 percent in 2024.**[2] Following a period of fiscal consolidation under the SBA that helped reduce public debt in 2017–18, Iraq's overall fiscal position is projected to deteriorate over the medium term, shifting from a surplus of 7.9 percent of GDP in 2018 to deficits approaching 6 percent by 2024. This reflects lower oil revenue—oil prices are projected to be about $10 lower in 2019–24 on average than the 2018 level—and rising government expenditure by close to 10 percent annually on average over the medium term. The government has limited fiscal buffers (ID 20 trillion as of end 2018) to cover the rising deficits (the aggregate sum of deficits over the medium term is ID 80 trillion). Staff assumes that the government will use about ID 15 trillion of this buffer, with the remainder financed through borrowing. There are arrears on the order of ID 2.3 trillion (less than 1 percent of GDP), which have arisen partly for technical reasons, comprising ID 1.3 trillion arrears to an Iranian SOE for electricity and gas purchases, and around ID 1 trillion to International Oil Companies. As a result, public debt is projected to increase in nominal terms by over ID 67 trillion (or 52 percent) over 2019–24. The 32 percent growth in nominal GDP will mitigate the impact of the large increase in nominal debt on the debt-to-GDP ratio over the medium term.

Total Public Debt-to-GDP, 2017–24
(In percent of GDP)



Source: IMF staff calculations.

2. **Guarantees and other contingent liabilities are significant.** Debt and service guarantees, mostly in the electricity sector, were estimated to exceed 20 percent of GDP in 2017.[3] There are also

[1] The main assumptions underpinning the DSA are presented in the lower panel of Figure 1 and are based on staff's medium-term macroeconomic framework.

[2] Applying an 80 percent haircut to the $40 billion of non-Paris Club arrears (comparable to the Paris Club treatment) would reduce headline public debt from 49 percent of GDP in 2018 to 34 percent of GDP.

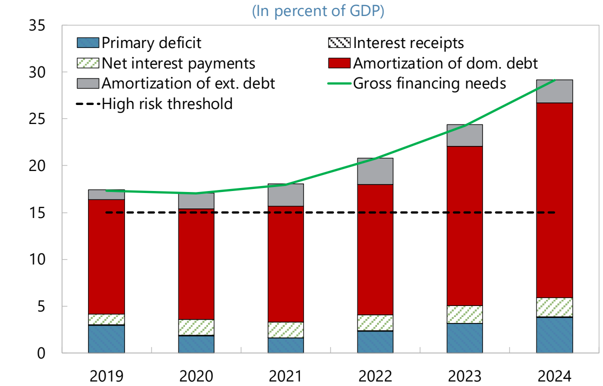
[3] In 2017, the Debt Directorate of the Ministry of Finance completed a survey of guarantees issued by the central government. At end-June 2017, the stock of guarantees related to foreign currency service payments and debt

contingent liabilities in the banking sector relating to potential recapitalization of the two largest public banks, which cannot be accurately measured prior to an international audit.

3. A significant part of Iraq's debt comprises legacy arrears that have yet to be restructured. The full face value of $40 billion of external arrears to non-Paris club creditors accumulated before 2003 is included in the stock of external debt, as they have yet to be settled in line with the 2004 Paris Club agreement terms.[4] The DSA also maintains the conservative assumption that these arrears will not be settled during the projection period. If they were to be restructured on Paris Club terms, the debt-to-GDP ratio would fall from 51 to 37 percent of GDP in 2019, and from 56 to 46 percent in 2024.

4. Gross financing needs (GFN) will increase significantly, and remain above the high-risk threshold over the medium term. The GFN is projected to rise sharply, remaining substantially above the high-risk threshold of 15 percent of GDP over 2019–24. Financing needs are rising due to widening deficits and a shift in the structure of debt toward shorter maturities, mostly T-bills either purchased by state-owned banks and discounted at the Central Bank of Iraq or purchased and retained by banks. At the same time, the longer maturity debt (mostly external) is declining as sizable external principal payments fall due starting 2019 (reaching over ID 8 trillion in 2024).

Gross Financing Needs (GFN), 2019–24
(In percent of GDP)



Source: IMF staff calculations.

5. The compositional shift towards domestic and short-term debt will continue over the medium term. Domestic borrowing will rise over the medium-term, mostly through the issuance of T-bills to banks either directly or through triangular operations at the central bank. On external debt, staff assumes Iraq will continue to rely on medium-to long-term external financing, but net external borrowing is projected to be negative given large amortization payments. As a result, domestic debt rises from 37 percent of total debt in 2018 to 56 percent of total debt by 2024. The share of short-term debt will also increase, especially for the new debt of which the share of T-bills will increase from 22 percent in 2018 to close to 60 percent by 2024.

6. The large financing needs coupled with an elevated level of public debt will constrain options to rebuild the country and address difficult social conditions, underscoring the need for fiscal adjustment. Post-conflict reconstruction and recovery needs are estimated at $88 billion, a small fraction of which is covered in expenditure over the medium term given current oil revenue projections. To ramp up capital spending significantly without endangering debt sustainability, the authorities would need to better control current spending and raise additional non-oil revenue. The government should also aim at building fiscal buffers to avoid excessive recourse to domestic and

amounted to $21.7 billion (12 percent of GDP) comprising $19.4 billion for service payments to independent power producers (IPPs) and $2.3 billion for debt.

[4] 89.75 percent reduction of the net present value (NPV) of the legacy arrears.

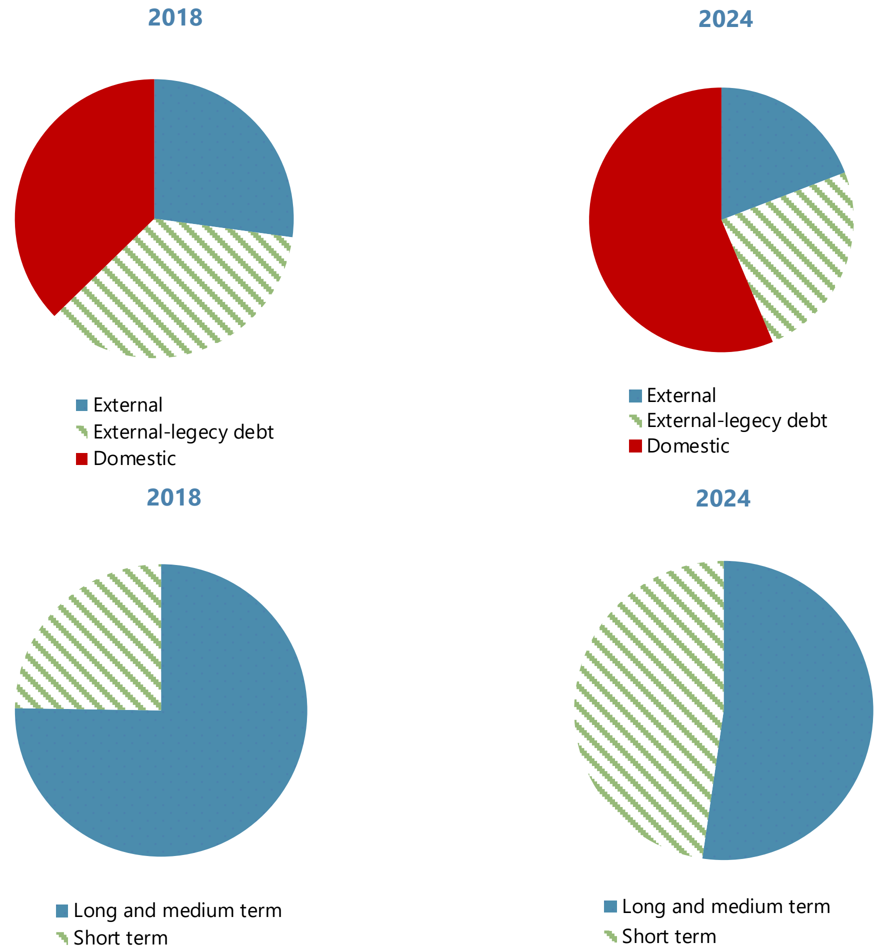
external borrowing if the oil price declines. Staff proposed adjustment path would help reduce debt to below 50 percent and financing needs to 15.7 percent of GDP (main document, ¶21).

7. Stress tests confirm that Iraq's total debt is particularly vulnerable to growth and real interest rate shocks.

- **Growth shock:** If projected real GDP rates are lowered by one standard deviation (implying lower real growth by 5.6 percentage points) in 2020 and 2021, the debt ratio would jump by 16 percentage points by 2021, and increase gradually to 77 percent of GDP by 2024.
- **Primary balance shock:** This scenario assumes a worsening of the primary balance by 3.8 percentage points of GDP in 2020 and 2021. The larger deficit would lead to higher debt which will reach 65 percent of GDP by 2024.
- **Real interest rate shock:** A one-time, permanent real interest rate increase of 10 percentage points in 2019 would make the debt ratio reach 73 percent of GDP in 2024.[5]
- **Real exchange rate shock:** A one-time real depreciation of 30 percent in 2018 would increase total public debt to 65 percent of GDP by 2024.
- **Combined shock:** A combination of these shocks would increase debt to 103 percent of GDP by 2024.

[5] The DSA methodology for generating interest rate shocks is based on GDP deflators rather than CPI inflation. As this standard approach implies an excessively large shock in the case of Iraq, due to the large weight of oil prices in the GDP deflator, we consider a moderate 10 percent real rate shock.

Figure 1. Iraq: Public Debt Composition, 2018–24



Source: IMF staff estimates and calculations.

Figure 1. Iraq: Public Debt Sustainability Analysis—Baseline Scenario

(In percent of GDP unless otherwise indicated)

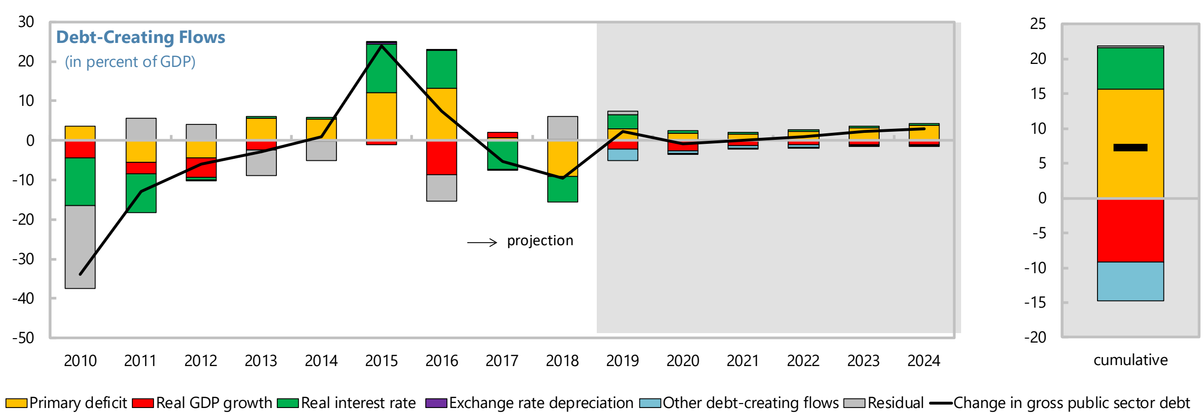
Debt, Economic and Market Indicators 1/

	Actual			Projections					
	2008-2016 2/	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	53.0	58.9	49.3	51.4	50.5	50.6	51.5	53.6	56.4
Public gross financing needs	5.7	1.2	-7.9	17.4	17.1	18.0	20.8	24.3	29.1
Real GDP growth (in percent)	7.3	-2.5	-0.6	4.6	5.3	2.6	2.3	2.1	2.1
Inflation (GDP deflator, in percent)	1.6	14.6	15.4	-4.5	2.3	2.6	2.8	3.1	3.3
Nominal GDP growth (in percent)	9.1	11.8	14.7	-0.1	7.8	5.2	5.2	5.2	5.5
Effective interest rate (in percent) 3/	1.1	1.7	2.7	2.5	3.7	3.7	3.7	4.0	4.3

As of January 25, 2019		
Sovereign Spreads		373
5Y CDS (bp)		424
Ratings	Foreign	Local
Moody's	Caa1	Caa1
S&Ps	B-	B-
Fitch	B-	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	-3.3	-5.4	-9.7	2.2	-1.0	0.1	0.9	2.2	2.8	7.2	-0.9
Identified debt-creating flows	0.8	-5.1	-15.4	1.3	-0.8	0.2	1.0	2.3	2.9	6.9	
Primary deficit	4.3	0.6	-9.2	3.0	1.8	1.6	2.3	3.1	3.8	15.7	
Primary (noninterest) revenue and grants	39.7	33.0	39.8	40.5	39.6	37.9	36.4	35.4	34.5	224.3	
Primary (noninterest) expenditure	44.1	33.7	30.5	43.4	41.4	39.5	38.8	38.6	38.3	240.0	
Automatic debt dynamics 4/	-3.5	-5.8	-6.1	1.3	-1.9	-0.7	-0.7	-0.6	-0.6	-3.3	
Interest rate/growth differential 5/	-3.5	-5.8	-6.1	1.3	-1.9	-0.7	-0.7	-0.6	-0.6	-3.3	
Of which: real interest rate	0.0	-7.2	-6.4	3.5	0.6	0.5	0.4	0.4	0.5	6.0	
Of which: real GDP growth	-3.5	1.4	0.3	-2.3	-2.5	-1.2	-1.1	-1.0	-1.1	-9.2	
Exchange rate depreciation 6/	0.1	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows 7/	0.0	0.0	0.0	-2.9	-0.7	-0.7	-0.6	-0.3	-0.3	-5.5	
Other flows (+ reduces financing needs) (negative)	0.0	0.0	0.0	-2.9	-0.7	-0.7	-0.6	-0.3	-0.3	-5.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 8/	-4.1	-0.3	5.7	0.8	-0.2	-0.1	-0.1	-0.1	-0.1	0.2	



Source: IMF staff calculations.

1/ Public sector is defined as central government and includes public guarantees, defined as Public debt guarantee .

2/ Based on available data.

3/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4/ Derived as $[r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi)$ times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as -g.

6/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

7/ Other flows consist of drawdown of government deposits in the banking system.

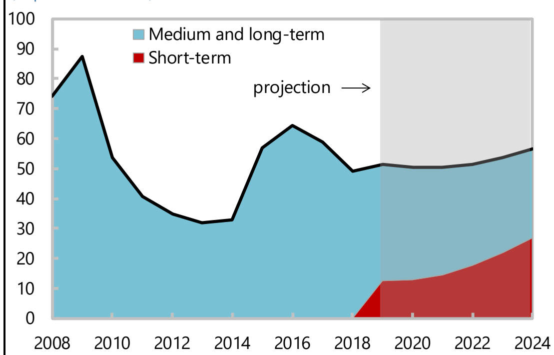
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

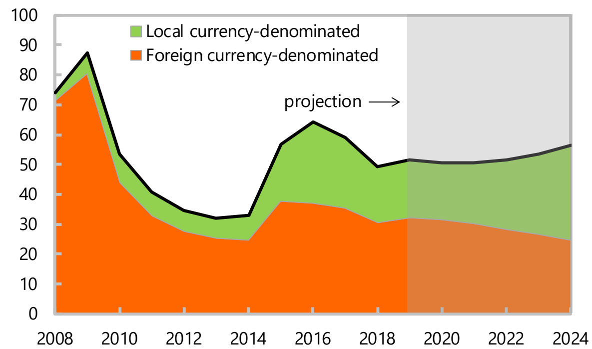
Figure 2. Iraq: Public Debt Sustainability Analysis—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



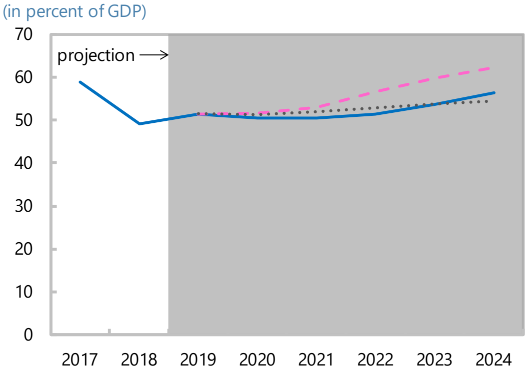
By Currency
(in percent of GDP)



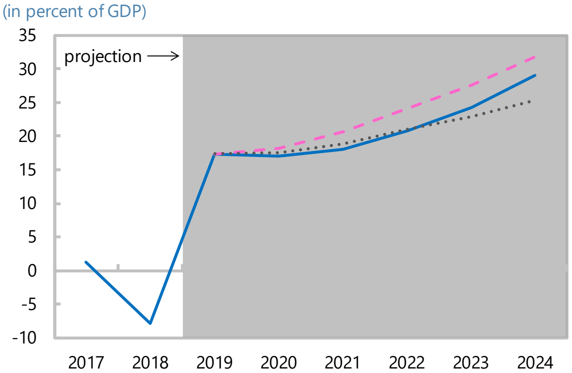
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

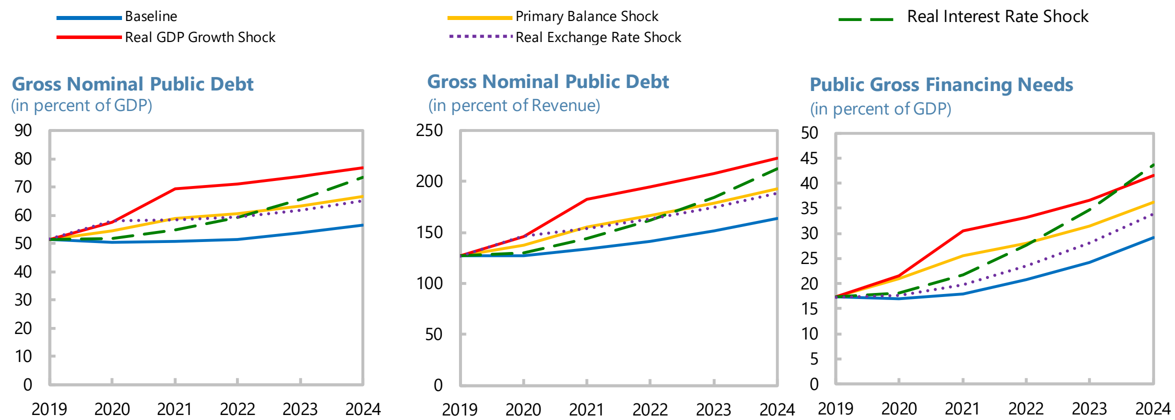
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	5.3	2.6	2.3	2.1	2.1
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary Balance	-3.0	-1.8	-1.6	-2.3	-3.1	-3.8
Effective interest rate	2.5	3.7	3.7	3.7	4.0	4.3
Constant Primary Balance Scenario						
Real GDP growth	4.6	5.3	2.6	2.3	2.1	2.1
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary Balance	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Effective interest rate	2.5	3.7	4.5	4.7	4.9	5.0

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	5.7	5.7	5.7	5.7	5.7
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary Balance	-3.0	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	2.5	3.7	3.9	3.9	3.9	3.9

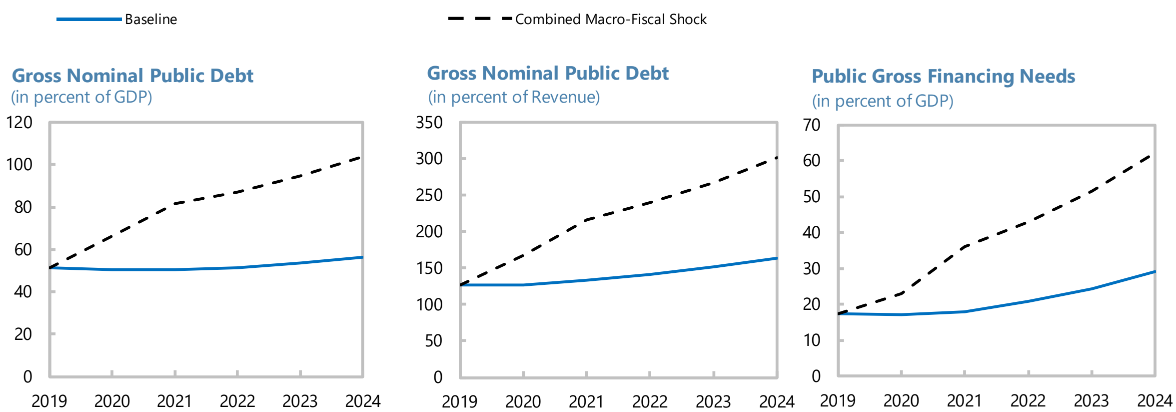
Source: IMF staff calculations.

Figure 3. Iraq: Public Sector Debt Sustainability Analysis (DSA)—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	5.3	2.6	2.3	2.1	2.1
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary balance	-3.0	-5.7	-5.5	-2.3	-3.1	-3.8
Effective interest rate	2.5	3.7	5.0	5.4	5.1	5.3
Real Interest Rate Shock						
Real GDP growth	4.6	5.3	2.6	2.3	2.1	2.1
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary balance	-3.0	-1.8	-1.6	-2.3	-3.1	-3.8
Effective interest rate	2.5	6.1	10.0	10.8	11.9	12.7
Combined Shock						
Real GDP growth	4.6	-0.9	-3.6	2.3	2.1	2.1
Inflation	-4.5	0.8	1.0	2.8	3.1	3.3
Primary balance	-3.0	-5.7	-8.1	-2.3	-3.1	-3.8
Effective interest rate	2.5	4.1	9.6	10.5	11.3	11.9

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	4.6	-0.9	-3.6	2.3	2.1	2.1
Inflation	-4.5	0.8	1.0	2.8	3.1	3.3
Primary balance	-3.0	-5.1	-8.1	-2.3	-3.1	-3.8
Effective interest rate	2.5	3.7	4.9	5.7	5.2	5.3
Real Exchange Rate Shock						
Real GDP growth	4.6	5.3	2.6	2.3	2.1	2.1
Inflation	-4.5	2.3	2.6	2.8	3.1	3.3
Primary balance	-3.0	-1.8	-1.6	-2.3	-3.1	-3.8
Effective interest rate	2.5	4.1	4.2	4.4	4.8	5.1

Source: IMF staff calculations.

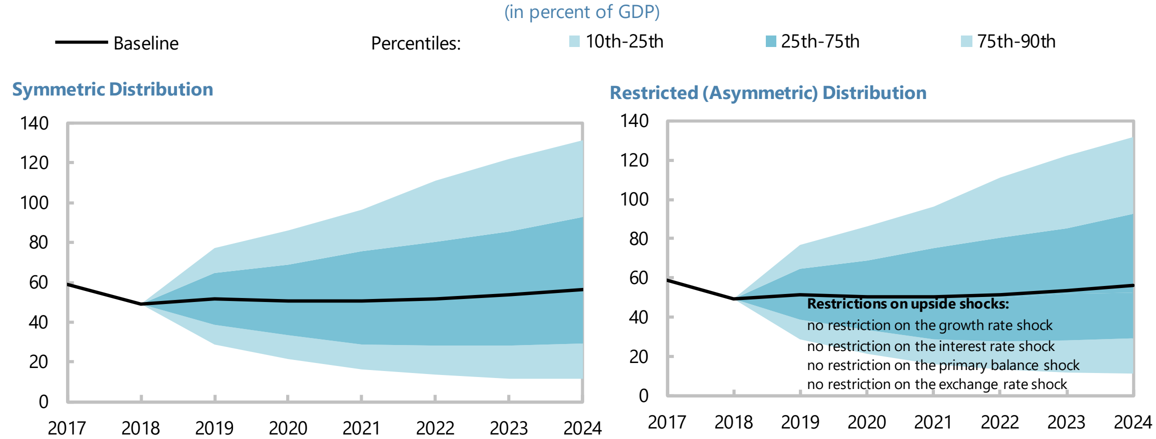
Figure 4. Iraq: Public Sector Debt Sustainability Analysis(DSA)—Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

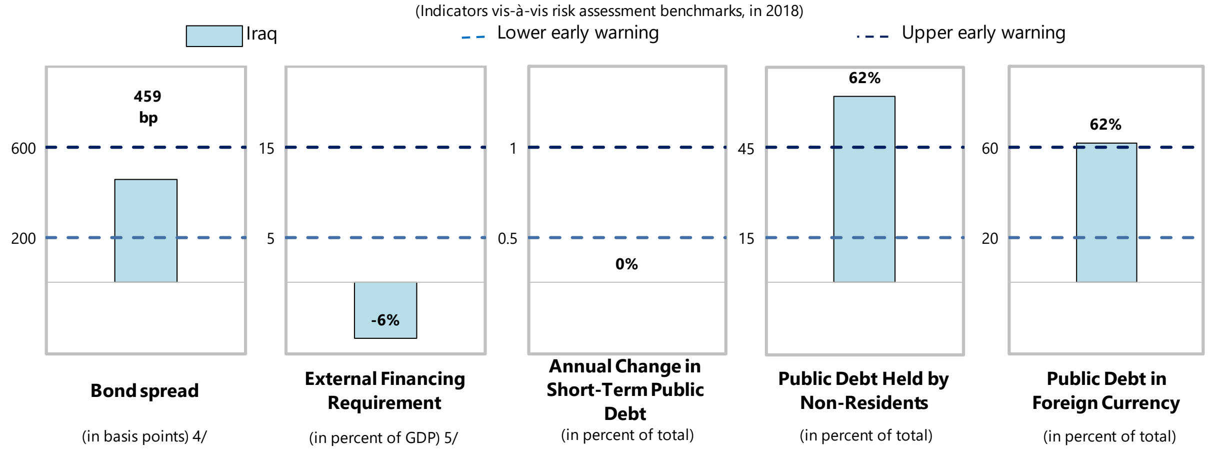
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff calculations.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

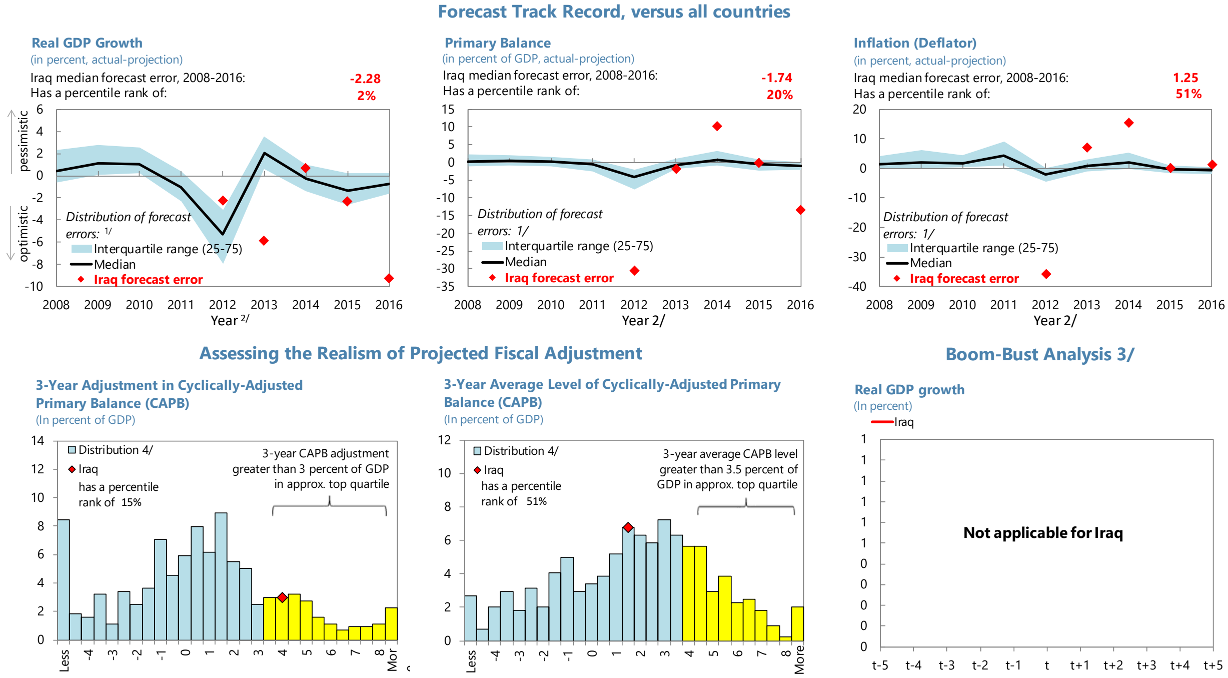
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG (bp), an average over the last 3 months, 27-Oct-18 through 25-Jan-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 5. Iraq: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Source : IMF staff calculations.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Iraq, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Table 1. Iraq: External Debt Sustainability Framework, 2015–24

(In percent of GDP; unless otherwise indicated)

	2014	2015	2016	2017	10-Year Historical Average	10-Year Standard Deviation	Projections 2018	2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	24.8	37.2	37.1	35.6			**30.6**	**32.2**	**31.5**	**30.5**	**28.4**	**26.8**	**24.9**	**-5.5**
Change in external debt	-0.5	12.4	-0.1	-1.5			-5.0	1.6	-0.7	-1.0	-2.2	-1.6	-1.9	
Identified external debt-creating flows (4+8+9)	-4.3	12.9	7.8	-6.6			-11.9	3.3	2.1	2.5	3.0	3.8	4.6	
Current account deficit, excluding interest payments	-2.9	6.2	7.9	-2.2			-7.3	4.7	3.7	3.7	4.0	4.8	5.5	
Deficit in balance of goods and services	-4.4	6.1	7.8	-2.4			-8.0	3.3	2.1	2.8	3.6	4.1	5.0	
Exports	41.3	35.3	32.1	38.1			44.0	40.1	39.5	37.7	36.4	35.3	34.3	
Imports	36.9	41.4	40.0	35.7			36.0	43.4	41.6	40.5	40.0	39.4	39.2	
Net non-debt creating capital inflows (negative)	-1.7	-1.6	-1.0	-0.9			-0.4	-0.5	-0.6	-1.0	-0.9	-0.9	-0.8	
Automatic debt dynamics 1/	0.3	8.2	0.9	-3.4			-4.1	-0.9	-1.1	-0.3	-0.2	-0.1	-0.1	
Contribution from nominal interest rate	0.3	0.3	0.3	0.4			0.4	0.5	0.5	0.5	0.5	0.5	0.5	
Contribution from real GDP growth	-0.2	-0.8	-5.7	0.8			0.2	-1.4	-1.6	-0.8	-0.7	-0.6	-0.5	
Contribution from price and exchange rate changes 2/	0.2	8.8	6.3	-4.7			-4.7	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.8	-0.5	-7.9	5.1			6.9	-1.7	-2.7	-3.5	-5.1	-5.4	-6.5	
External debt-to-exports ratio (in percent)	59.9	105.3	115.4	93.3			69.6	80.3	79.8	81.0	78.0	76.0	72.6	
Gross external financing need (in billions of US dollars) 4/	-4.5	13.0	15.4	-2.4			-14.0	14.0	14.3	16.4	20.1	21.2	24.9	
in percent of GDP	-1.9	7.3	8.8	-1.2			-6.2	6.2	5.9	6.4	7.5	7.5	8.4	
Scenario with key variables at their historical averages 5/							**30.6**	**23.8**	**18.6**	**13.1**	**6.4**	**0.0**	**0.0**	**-1.3**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	0.7	2.5	15.2	-2.5	5.4	5.9	-0.6	4.6	5.3	2.6	2.3	2.1	2.1	
GDP deflator in US dollars (change in percent)	-0.7	-26.1	-14.4	14.5	1.5	16.8	15.4	-4.5	2.3	2.6	2.8	3.1	3.3	
Nominal external interest rate (in percent)	1.0	0.9	0.9	1.3	0.9	0.4	1.4	1.6	1.8	1.8	1.8	1.8	1.8	
Growth of exports (US dollar terms, in percent)	4.3	-35.3	-10.3	32.4	8.7	30.2	32.5	-8.9	6.2	0.3	1.5	1.9	2.6	
Growth of imports (US dollar terms, in percent)	2.5	-15.1	-5.0	-0.3	6.1	14.6	15.7	20.5	3.4	2.4	3.7	3.7	5.1	
Current account balance, excluding interest payments	2.9	-6.2	-7.9	2.2	0.7	7.1	7.3	-4.7	-3.7	-3.7	-4.0	-4.8	-5.5	
Net non-debt creating capital inflows	1.7	1.6	1.0	0.9	1.3	0.6	0.4	0.5	0.6	1.0	0.9	0.9	0.8	

Sources: IMF; country desk data; and staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

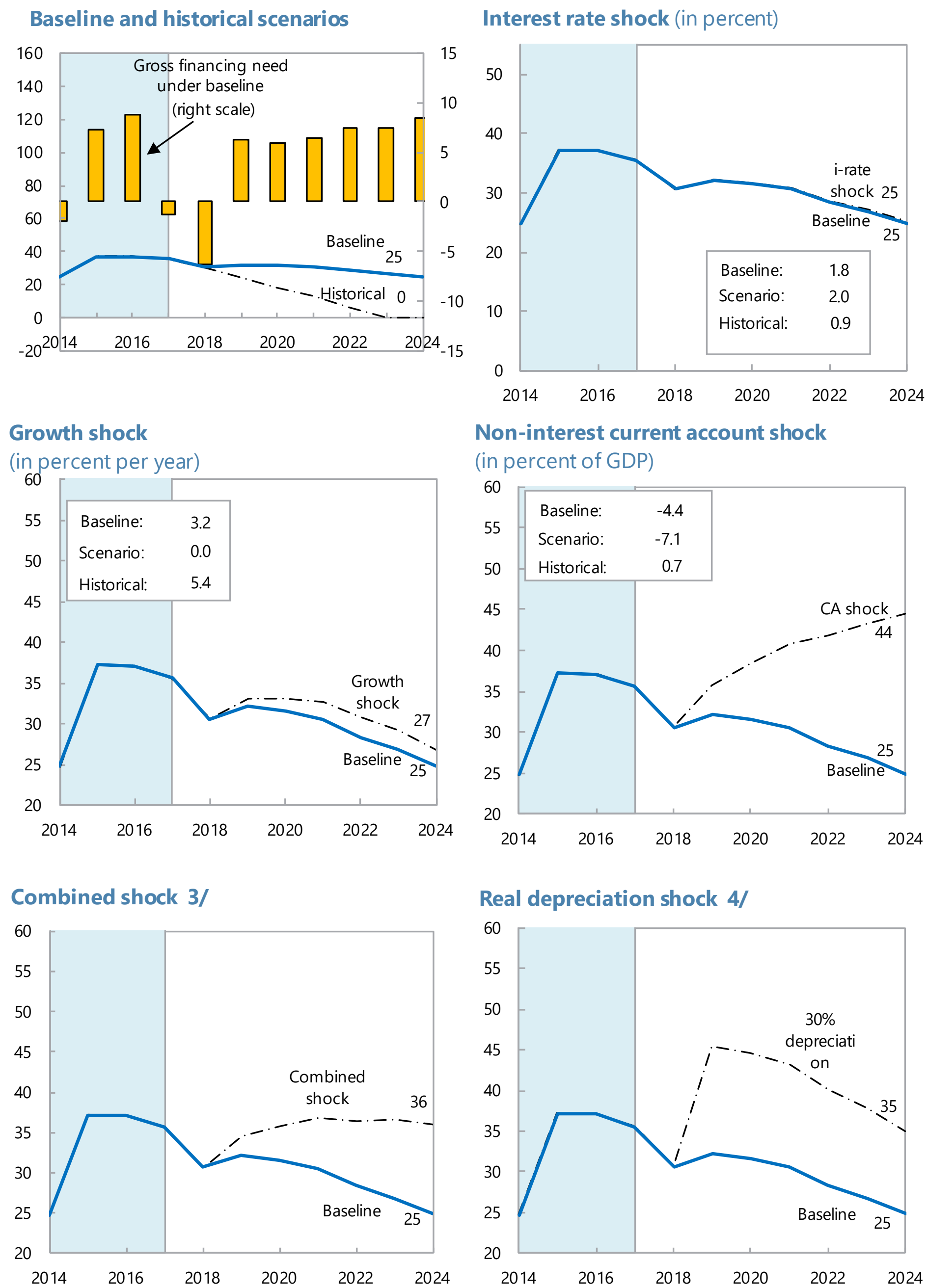
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 6. Iraq: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Source: IMF; country desk data; and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2019.

Annex V. Risk Assessment Matrix[1]

(Potential Deviations from Baseline)

Source of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Measures to Dampen the Impact of Shocks
Potential External Shocks			
Large swings in oil prices. Uncertainty surrounding supply and demand shocks translates into elevated price volatility.	**Medium** Short to Medium Term	**High**. Iraq's heavy reliance on oil implies that even modest price swings would undermine growth (via reduced public spending) or erode fiscal sustainability (higher deficits, or accumulation of arrears), and also put pressure on CBI reserves leading to increased vulnerabilities. Price volatility also complicates economic management, and adversely affects investment in the energy sector.	Build fiscal space, diversify revenue away from oil, and improve the composition and efficiency of public spending. Diversify the economy, encourage the emergence of the private sector and develop human capital.
Spillovers from geopolitical tensions. The reimposition of U.S. sanctions on Iran could adversely affect Iraq in light of significant economic links through energy (electricity and gas), trade and tourism.	**High** Short to Medium Term	**High.** Increased geopolitical tensions could undermine growth through confidence effects, as well as financial and energy channels. Vulnerabilities in the financial sector arising from ML/TF risks are subject to greater scrutiny, implying increased risks to correspondent banking relationships (CBRs). Iraq's access to U.S. dollar funding could also be affected. If waivers on U.S. sanctions were not renewed, Iraq could face difficulties in sourcing and paying for electricity and gas imports, with a sharp adverse impact on domestic electricity supply.	*Financial Sector*. Continue implementing AML/CFT measures to avoid gray-listing and negative impact on CBR. *Energy*. Existing initiatives to diversify energy sources, in particular by better exploiting domestic gas resources, would help lower Iraq's vulnerability to disruptions in energy imports.
Sharp tightening of global financial conditions. Tighter financial conditions could be triggered by a sharper-than-expected increase in interest rates or other risks.	**Medium** Short to Medium Term	**Medium**. Notwithstanding Iraq's limited exposure to global markets, tighter global conditions would exert upward pressure on debt service and risk premia, and could make it harder for Iraq to tap international financial markets (issuing new debt or rolling-over existing liabilities). It could also lead to a tightening of domestic monetary conditions, given the U.S. dollar peg, with some impact on growth.	Implement fiscal consolidation to maintain debt sustainability.

[1] Based on the Global Risk Assessment Matrix (February 2019). The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within one year and three years, respectively.

Source of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Measures to Dampen the Impact of Shocks
Potential Domestic Shocks			
Political instability and rising popular discontent amid poor policy implementation and political fragmentation. Social dissatisfaction, related to weak public services, lack of job opportunities and high perception of corruption, is already elevated.	**High** Short to Medium Term	**High.** Political stability would be undermined by a resumption of popular protests or a spike in internal tensions (intra and inter-communal). Such events would hinder the implementation of structural reforms, and compel the government to realign spending away from longer-term priorities towards items that buy social peace.	Reach a consensus on the priorities and scope of reforms. Secure resources for capital spending and reconstruction (fiscal space) through fiscal consolidation. Implement Public Financial Management and other governance-linked reforms and tighten anti-corruption measures.
Resurgence of terrorism.	**Low** Short Term	**High.** A renewed conflict with ISIS or other terrorist groups could threaten Iraq's stability, result in further severe damage to infrastructure, undermine country risk perceptions, weaken the business environment and discourage foreign investment.	Build fiscal space to enable a reallocation of spending (including higher military spending if needed) while maintaining debt sustainability.

Annex VI. Governance

CONTEXT

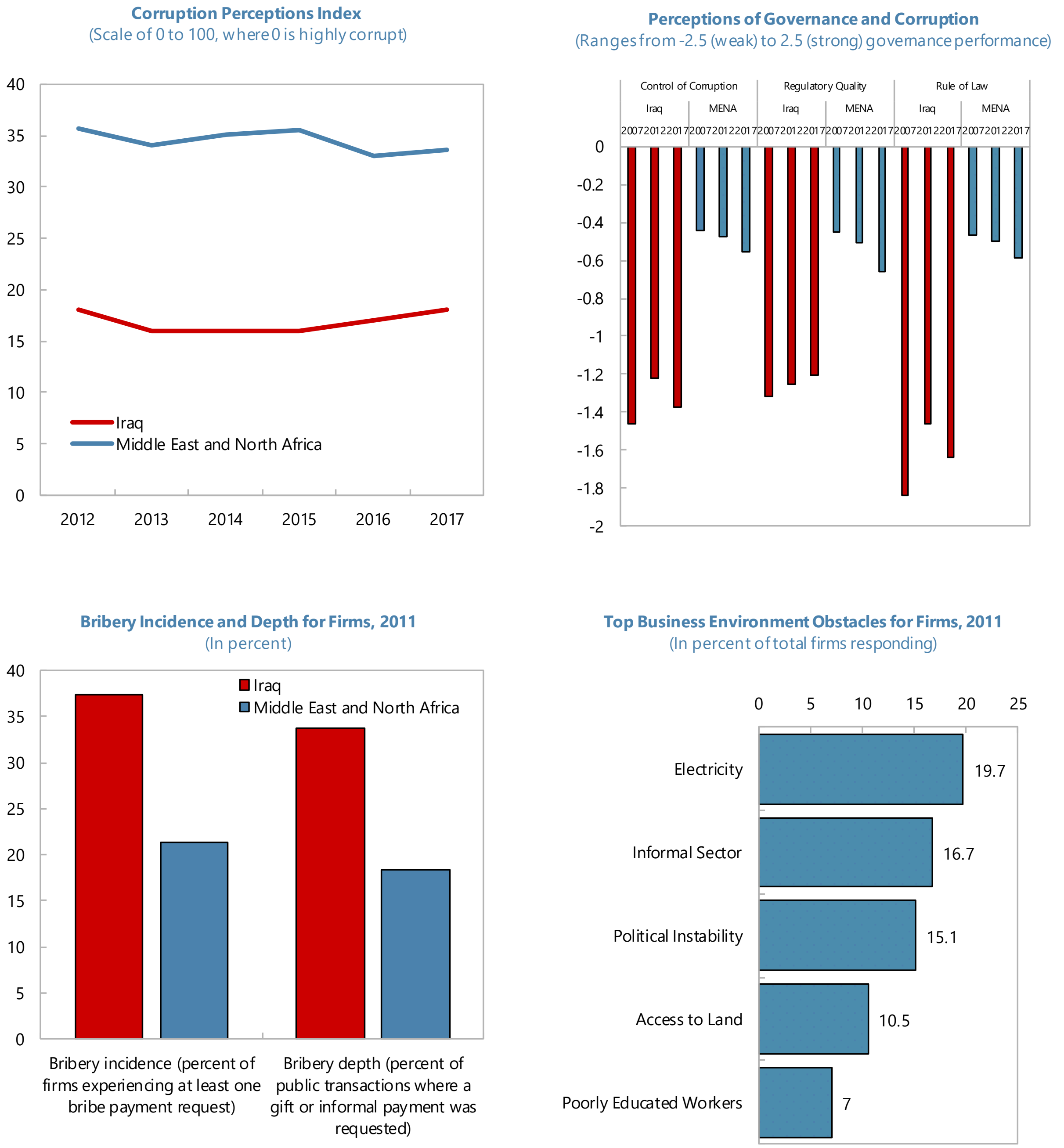
1. Iraq suffers from widespread governance weaknesses, with significant risks of corruption:

- ***Fiscal***. There are tangible weaknesses in public financial management—including control of the public wage bill, public investment management, procurement and overall expenditure transparency—as well as in revenue and customs administration, and the governance and oversight of SOEs, which heighten vulnerability to corruption.
- ***Legal/institutional***. Weaknesses, particularly regarding enforcement of the rule of law and transparency, likely present obstacles to private sector development. Anti-corruption institutions have been established, and would need to be strengthened together with anti-corruption legislation in order to become more effective. Steps have been taken to strengthen AML/CFT (reflected in Iraq's removal from FATF monitoring in 2018) but stronger implementation of the AML/CFT regime is needed to support governance efforts and preserve the integrity and stability of the financial sector.
- ***Regulatory and business environment***. Iraq ranked 171 out of 190 countries in the World Bank's 2019 Doing Business Report, with weaknesses across the board and particularly acute problems in the areas of getting credit, trading across borders, resolving insolvency and starting businesses.
- ***Corruption.*** Iraq scores poorly relative to the MENA average in both the Worldwide Governance Indicators (WGI) and Transparency International's corruption perceptions index (Figure 1). Respondents to the World Bank's Enterprise Survey also reported widespread bribery.

2. These weaknesses, in turn, undermine macroeconomic outcomes through a number of channels. Bribery and weak regulatory and legal institutions hamper private investment, while weak fiscal institutions lead to leakages and can reduce the effectiveness of public investment. Addressing such weaknesses would promote better macroeconomic outcomes through fewer fiscal leakages and increased investment (see main document, Box 1).

3. This remainder of this annex assesses public financial management, anti-corruption policies and AML/CFT, and provides recommendations in each area.

Figure 1. Iraq: Corruption and Governance Indicators, 2007–17



Sources: Transparency International; Worldwide Governance Indicators; and World Bank Enterprise Survey, 2011.
Note: There are uncertainties around point estimates from Transparency International and the Worldwide Governance Indicators. Scores are normalized and measure relative performance.

Public Financial Management

4. In recent years Iraq's public financial management framework has performed poorly in terms of helping ensure fiscal discipline, strategic allocation of resources, and efficient service delivery. A weak legal framework has enabled spending to be approved through legislation outside the budget, while the absence of commitment controls allowed the emergence of arrears when revenues collapsed.

A. The Legal Framework

5. Parliament adopted a new General Financial Management Law (GFML) in May 2019 that strengthens the legal framework for public financial management.[1] The law defines general government for the first time, establishes the need for a medium-term fiscal framework and enshrines fiscal transparency requirements. It also limits parliament's capacity to amend the budget, and the scope for legislation approving spending to occur outside budget processes. Newly introduced elements of fiscal federalism could erode non-oil revenue.

Recommendations

6. The new law has left a number of gaps that need to be addressed by secondary legislation or decrees. These are required in particular with regards to the control and management of guarantees, commitment controls, and in-budget adjustments. Moreover, the authorities should develop an implementation plan for the new law.

B. Arrears and Commitment Controls

7. The emergence of arrears in 2015–16 underscored the consequences of weak commitment controls. Then, as now, the country lacked legal and procedural frameworks to limit spending units' authority to enter into and execute commitments. There were also no rules establishing liability for assuming commitments without government approval based on the budget law. The absence of a commitment control system (CCS) implies insufficient reconciliation to prevent expenditures from being committed in excess of available financial resources. This could result in line ministries executing their entire annual original budget allocation, which the MOF will subsequently not be able to cover due to insufficient revenues.

8. Multi-year commitments present a particularly difficult problem since they should be viewed as mandatory expenditures, constraining the government's capacity to assume discretionary or new mandatory commitments. In the absence of reliable information on existing commitments, and in light of possible ministerial and other decisions creating commitments without regard to the approved budget law, such constraints are difficult to incorporate into the budgeting process.

[1] The law was drafted with support from FAD TA, and its approval by government was a structural benchmark at the First Review of the SBA.

Recommendations

9. Implementation of a commitment control system would support effective budget execution. A comprehensive CCS would facilitate the necessary reconciliation between the approved budget, the available cash resources, and the actions of the SUs to achieve their objectives. Earlier FAD and METAC missions have provided extensive TA on implementing a simple CCS with adequate reporting that could be further enhanced when IFMIS is implemented. Such improvements would strengthen expenditure control with the goal of avoiding arrears.

C. Cash Management

10. The lack of centralized cash management makes it hard to assess the budget's financing needs and thus complicate public debt management. Spending units manage their accounts at state-owned banks without centrally controlling their spending, and also regularly carries over balances between fiscal years and rationalize both their spending and calls for budget allocations. Savings therefore accrue to spending units rather than the budget, and if poor financial management results in arrears, they are eventually covered by the budget. Such weaknesses in controls erode central government's capacity to manage fiscal resources.

11. These practices obscure the monitoring of budget execution. What appear to be seasonal patterns of underspending and overspending, respectively, in the first and second half of the fiscal year simply reflect that spending units often rely on accumulated "reserves" before calling their budget appropriations. Thus, while the MOF knows what the SUs are supposed spend their allocations on, it has limited information or effective control over actual execution.

Recommendations

12. These weaknesses could be best rectified by fully establishing a treasury single account that would release funds against spending items sanctioned by law. This will require significant institutional changes, including the restructuring of the two dominant public banks. In the interim, the authorities could establish a system of regularly swiping SU balances, and require spending units to request financing in line with legally or contractually verified obligations. This would increase transparency and strengthen the finance ministry's control over resources.

D. Anti-Corruption

13. Iraq has over time established legal and institutional frameworks to combat corruption. The country is a party to the United Nations Convention against Corruption (UNCAC) and the League of Arab States Convention on Commercial Arbitration. A Commission on Integrity (COI) was set up in 2011 with the task of corruption prevention and enforcement, including investigating corruption cases, proposing legislation, and overseeing financial disclosures. In 2019, the Prime Minister established a High Council for Combatting Corruption, which along with the Parliamentary Integrity Committee, has the task of developing national policies and strategies to tackle corruption.

14. In the context of this framework, a number of public bodies are involved in combatting corruption, albeit with overlapping functions that can create inefficiencies and potential gaps. The bodies involved, apart from the COI, include the Offices of the Inspectors General (IGOs), the BSA and the Ministry of Planning. Despite similar mandates, limited coordination has led to redundancies in some functions (e.g., audits of the same body or project by multiple agencies) and gaps in others.[2]

15. Organizational bottlenecks and lack of capacity impede enforcement against corruption offences. Although the COI has investigated several high-profile cases, prosecution and conviction rates seem low relative to the risks faced by the country. One contributing factor is that all corruption investigations need to be channeled through an investigative judge, of which there are only two in Baghdad and one in each province.

16. Moreover, the linkages between corruption and money laundering are not reflected in enforcement activities. Although corruption is recognized as a significant source of illicit flows—particularly in vulnerable sector such as real estate—the authorities do not seem to be actively pursuing proceeds of corruption, with limited co-ordination between authorities responsible for AML/CFT and those detecting and investigating corruption. Likewise, national committees shaping policies for AML/CFT and anti-corruption do not appear to co-operate.

17. Iraq has had an asset disclosure system for public officials in place since 2011, which has yet to be used effectively to support prevention or enforcement efforts. Only around 10 staff in the COI with limited resources are tasked with verifying approximately 25,000 asset declarations submitted manually. Further, a failure to file entails an administrative penalty for which Ministers and Parliamentarians enjoy immunity, and filing rates among certain categories of public officials are low.[3] Asset declarations have neither been published nor made available to relevant public authorities. As a result, the disclosure regime has neither been useful in facilitating the detection or investigation of corruption or financial crime, nor effective in supporting AML/CFT compliance.

18. Legal provisions granting amnesty may foster a culture of impunity. The General Amnesty Law allows officials who repays embezzled funds to be freed from culpability, and over 1,000 officials were granted amnesty in the first quarter of 2018 through this route. The funds repaid by officials receiving amnesty have generally fallen far short of the amounts involved.

Recommendations

19. Improvements to the legal framework would facilitate anti-corruption efforts. The Penal Code should be amended to criminalize illicit enrichment, trading in influence, embezzlement, and all forms of bribery. The legal framework also needs to be aligned with international norms on asset disclosures, access to information, conflicts of interest, and protection of whistleblowers and

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[2] For instance, COI does not conduct investigations in the oil and gas sector, which it considers falls under the purview of the IGO.

[3] In 2018, only around 17 percent of Parliamentarians, 59 percent of Ministers, 20 percent of governors, and 47 percent of provincial leaders had submitted asset declarations.

witnesses. Public officials convicted of corruption should be prohibited from holding office. Finally, the General Amnesty Law should be amended so it no longer applies to corruption offences.

20. The High Council and the Parliamentary Integrity Committee should co-ordinate to promote coherent anti-corruption laws and policies. Developing a shared understanding of corruption risks at the national level would help guide mitigating strategies and policies. The High Council should coordinate with parliamentarians to ensure that legislation reflects national priorities, and its membership should be expanded to include all stakeholders along the enforcement chain. Anti-corruption policies should be aligned with AML/CFT priorities.

21. Likewise, the institutional structure for combatting corruption needs to be streamlined and clarified. Agencies should coordinate to avoid duplication of tasks, and to improve accountability.

22. The asset declaration regime can be enhanced. The focus should be narrowed to the range of public officials most at risk of corruption and sufficient resources should be dedicated to digitalizing and verifying asset declarations. Information in asset declarations should be shared with relevant authorities. Clear penalties should be established and enforced for failure to submit declarations. Over time, asset declaration requirements could be extended to family members and the declarations themselves could be published.

23. The governance and autonomy of the COI and IGO should be strengthened. Priorities include strengthening the COI's operational and financial autonomy, clarifying eligibility criteria for staff appointments (e.g., disqualification for past corruption offences), and establishing clear rules for staff dismissal, as well as legal protections for COI officials. Such safeguards should be instituted before the COI's investigative powers are strengthened. The COI should also devote adequate resources to areas particularly vulnerable to corruption (e.g., extractive industry, procurement, verification of financial disclosures). Similarly, giving IGOs greater independence from their line ministries would help ensure that corruption cases are pursued.

24. E-governance efforts should be continued to simplify government procedures and limit opportunities for discretion. Digitalizing registries and databases (such as for property and real estate transactions) would improve access to information and facilitate cooperation among relevant authorities. Digitalization would also facilitate the detection of corruption and financial crime.

25. Building on recent progress, there is also scope for greater transparency on oil and gas sector contracts. The Ministry of Oil (MoO) has developed a policy on the disclosure of oil and gas contracts, which remains to be implemented pending the adoption of the law on access to information.

E. AML/CFT

26. Iraq has strengthened its AML/CFT regime since the Middle East and North Africa Financial Action Task Force (MENAFATF) assessment in 2012.[4] A new AML/CFT Law, adopted in

[4] See Mutual Evaluation Report of Iraq, FATF (November 2012).

2015, brought the legal framework into line with international standards, and established a national AML/CFT Council as well as the AML Bureau, the country's financial intelligence unit. The Central Bank of Iraq (CBI) has issued instructions to banks on customer due diligence, including a risk-based approach and measures for higher risk customers, such as politically exposed persons (PEPs). The Council of Ministers also established procedures to freeze terrorist assets in line with United Nations Security Council resolutions. The FATF recognized these steps by removing Iraq from its list of jurisdictions with strategic deficiencies in 2018.

27. The country nevertheless remains exposed to significant money laundering and terrorist financing (ML/TF) risks. The economy is primarily cash-based, and a large share of financial transactions occur through unlicensed exchange houses or other informal channels. The proceeds of domestic corruption and terrorist-related flows pose significant vulnerabilities, including via cash smuggling. There are risks of shell companies linked to unlicensed exchange operators attempting to obtain dollars at FX auctions. Individual agencies are aware of these risks to varying degrees, and the authorities are beginning work on a national assessment of ML/TF risks.

28. Enforcement of money laundering offences and confiscation of criminal proceeds remains weak. Few cases have been disseminated by the AML Bureau for investigation. Prosecution and convictions are rarely secured, and the tracing and confiscating criminal proceeds is not actively pursued.

29. Gaps in supervision coupled with poor controls by banks have also created opportunities for financial crime. Some 15 staff in CBI's supervisory departments are responsible for supervising over 70 banks and 2,000 licensed exchange houses, while the supervision of securities and insurance from an AML/CFT perspective has yet to begin. Moreover, a lack of oversight over the real estate sector makes it particularly attractive for laundering the proceeds of corruption.

30. Financial institutions generally do not appear to be taking a risk-based approach in their internal control systems. As was the case at the time of the 2012 FATF assessment, Iraqi banks seem to be applying AML/CFT measures primarily on a rules-based approach. Reporting of suspicious transactions by banks remains low, with no reports so far relating to PEPs or real estate transactions.

31. Cross-border cash transfers can also pose ML/TF risks. Any movements in cash exceeding $10,000 must by law be declared, and the customs service has been instructed to treat amounts exceeding $20,000 as suspicious, report them to the AML Bureau, and, if necessary, seize suspicious amounts. However, funds can be seized only at a few checkpoints, and with strict limits on how long they can be held.

Recommendations

32. There is considerable scope for AML/CFT measures to complement efforts to combat corruption. The authorities need to develop national AML/CFT priorities and risk mitigation strategies, based on a national assessment of ML/TF risks. AML/CFT tools should be systematically leveraged to identify and recover proceeds of corruption. Preventive measures, such as those requiring enhanced due diligence for PEPs and identification of beneficial owners, combined with transaction monitoring and customer due diligence, can help detect proceeds of corruption.

33. Greater cooperation and information sharing would help the authorities focus AML/CFT measures on tackling the proceeds of corruption. Information is decentralized, with few databases in electronic form or linked together, resulting in significant delays in the transmission of and access to information. This is a key impediment to effective detection and enforcement of money laundering and corruption offences. Law enforcement, the AML Bureau, and the CBI should therefore strengthen and formalize inter-agency cooperation, while the AML Bureau and the COI should coordinate more frequently.

34. Building on progress so far, efforts to strengthen supervisory capacity should continue. The CBI is piloting a risk-based supervision model with a view to full implementation in 2020, with rollout first to banks and subsequently to other financial institutions. Towards this end, the CBI needs to develop ML/TF risk profiles for banks and conduct AML/CFT inspections based on its risk-profiling. It should also finalize specific criteria that will be used to risk-profile banks and implement its new on-site procedures. These procedures should focus on assessing the risk understanding of reporting entities, the implementation of preventive measures (particularly relating to customer due diligence), and the reporting of suspicious transactions. Supervisors should remind banks of the importance of verifying beneficial ownership of companies seeking to obtain FX through auctions. These steps will have significant resource implications for the CBI.

35. Targeted efforts to reduce the size of the informal financial sector would help lower vulnerabilities to illicit flows. This would entail bringing entities acting in the informal sector into the regulatory fold (i.e., licensed and supervised) or shutting them down, including through more effective enforcement actions against non-compliant entities.

36. The governance and operational capabilities of the AML Bureau should be strengthened. The AML Law describes its mandate, powers, and responsibilities, but does not detail governance and reporting lines, or the process for selecting and dismissing staff, which could be clarified by a Council of Ministers decision. The Bureau's resources also need to be enhanced.

37. Systems should be put in place to monitor the transportation of cash and bearer negotiable instruments. Developing an inter-agency network comprising the Customs Authority, the CBI, and the AML Bureau would help coordinate such efforts.

Annex VII. International Experience with Public Wage Bill Management

1. The public sector is the largest employer in Iraq with a rising wage bill, reaching 17.4 percent of GDP and accounting for over a third of central government budget in 2019. That would place Iraq among the top ten countries worldwide in terms of the size of the public-sector wage bill. Multiple factors have driven the increase including political pressure to find jobs for the large number of young people entering the labor market, facilitated by weaknesses in public financial management and a lack of centralized control.

2. International experience suggests that effective management of the wage spending requires fiscal planning, strengthening institutions, and structural reforms to accompany short-term consolidation efforts. A study of 20 country-experiences in wage bill rationalization demonstrates that short-term wage and employment measures can provide temporary fiscal relief.[1] However, structural and institutional reforms that focus on improving the management processes in wages and employment have had long standing and sustained impacts, although they are more difficult to implement. Among compensation and employment measures, most countries have relied on across-the-board wage freezes and attrition-based employment reductions while a smaller group of countries have implemented structural measures such as reforming compensation, targeted employment reductions, public sector restructuring or steps to strengthen payroll management.

Short- and Long-Term Wage and Employment Policy Options for Iraq

	Wage measures	Employment measures
Short-term measures	• **Ad hoc wage adjustment**, e.g., wage freeze, capping allowances	• **Attrition-based employment reduction and elimination of vacant positions**
Structural measures	• **Streamlining bonuses and allowances**	• **Targeted employment reduction**, e.g., separation incentives/packages
	• **Structural pay policy reform**, e.g., introducing performance related pay	• **Public sector restructuring**, e.g., functional workforce review
		• **Strengthening payroll management**, e.g., eliminating ghost workers, centralizing HR management and technological solutions

3. Ad-hoc measures, such as wage and employment freezes or temporary caps on allowances, can deliver short-term gains. The Iraqi authorities implemented such short-term measures under the SBA, which have either provided only temporary relief or have been reversed. This is line with international experience that while such measures could be effective in the near term, they tend to unravel over the medium term and adversely affect service delivery if not accompanied by appropriate structural reforms.

4. Structural compensation and employment measures are therefore essential to deliver long-term savings. On the compensation front, allowances should be streamlined, a unified wage scale should be adopted, and once administrative capacity is strengthened, wages should be better aligned with job requirements and performance levels. In addition, the public sector wage premium should be reviewed to ensure that public sector is not creating skill shortages in the private sector. On the employment side, public sector employment could be reduced through separations or targeted retirements.

[1] See Managing Government Compensation and Employment - Institutions, Policies, and Reform Challenges (IMF. 2016)

5. Institutional reforms would support the effectiveness and sustainability of such structural reforms. Payroll management should be strengthened by conducting a census of government employees, centralizing human resource management, and identifying ghost workers and double-dippers. Furthermore, technological solutions such as installation of biometric systems, and a functional workforce review followed by possible downsizing or mergers of government units based on their functions, could deliver efficiency gains.

6. Given low capacity, wage bill management and civil service reforms should become centralized under the Ministry of Finance or another central authority. As Iraq develops higher capacity and improves governance systems, such delegations could be made to the line ministries and agencies under a set of standards guided by the central government. Until then, a central human resource management unit should champion the reforms and make decisions on hiring, promotion, and termination rules. In addition, enhancing data availability on government wages and employment, and flow of information between the central government and the Kurdistan Regional Government are crucial to undertake a comprehensive assessment and monitoring of the wage bill and public employment processes.

INTERNATIONAL MONETARY FUND

IRAQ

July 3, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND PROPOSAL FOR POST-PROGRAM MONITORING—INFORMATIONAL ANNEX

Prepared By | Middle East and Central Asia Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 31, 2019)

Membership Status: Joined December 27, 1945; Article XIV

General Resources Account

	SDR Million	Percent of Quota
Quota	1,663.80	100.00
Fund Holdings of Currency	3,425.13	205.86
Reserve Tranche Position	289.95	17.43

SDR Department

	SDR Million	Percent of Allocation
Net Cumulative Allocation	1,134.50	100.00
Holdings	2.64	0.23

Outstanding Purchases and Loans

	SDR Million	Percent of Quota
Stand-By Arrangements	1,494.20	89.81
Emergency Assistance[1]	557.06	33.48

[1] Emergency Assistance may include Emergency Assistance for Natural Disasters (ENDA), Emergency Post-Conflict Assistance (EPCA), and Rapid Financing Instrument (RFI).

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jul 07, 2016	Jul 06, 2019	3,831.00	1,494.20
Stand-By	Feb 24, 2010	Feb 23, 2013	2,376.80	1,069.56
Stand-By	Dec 19, 2007	Mar 18, 2009	475.36	0.00

Overdue Obligations and Projected Payment to the Fund (as of June 14, 2019)
(SDR Million; based on existing use of resources and present holdings of SDRs)[1]

	Forthcoming				
	2019	**2020**	**2021**	**2022**	**2023**
Principal	279.70	862.26	690.23	219.08	
Charges/Interest	27.33	42.39	25.74	14.79	12.35
Total	**307.03**	**904.65**	**715.95**	**233.86**	**12.35**

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Safeguards Assessments

The most recent safeguards assessment of the Central Bank of Iraq (CBI) was completed in April 2016. It concluded that the CBI continues to face capacity constraints in its operations, as well as a difficult security situation on the ground. In line with the IMF safeguards assessment's recommendations the Governing Council of the CBI approved a new charter for the Audit Committee prohibiting CBI executive representation on the committee. Also, the Parliament has approved amendments to the Law on the Central Bank of Iraq to strengthen CBI governance and the internal control framework. However, progress in strengthening the capacity of internal audit and financial reporting has been slow.

Exchange Arrangement

Iraq's de jure and de facto exchange rate arrangements are classified as a conventional peg arrangement. The Central Bank Law gives the Board of the Central Bank of Iraq (CBI) the authority to formulate exchange rate policy. Effective January 2, 2017, the cash and transfer exchange rate was set at ID 1,184 plus ID 6 (fees) per U.S. dollar. Effective May 24, 2018, the official exchange rate was set at ID 1,190 per U.S. dollar including the Central Bank commission (ID 1,182 plus ID 8 (fees)) according to the closing prices of the daily bulletin of gold & main currencies published on the CBI website (www.cbi.iq).

The CBI provides foreign exchange at the official exchange rate for permissible transactions through its daily auctions (allocations), establishing a peg. However, because certain transactions are excluded from access to the CBI auctions, many transactions take place at parallel market exchange rates. The CBI publishes the daily volume of the auction allocation on its website.

Iraq continues to avail itself of the transitional arrangements under Article XIV, Section 2 but no longer maintains any exchange restrictions or multiple currency practices subject to Article XIV, Section 2, and currently maintains one multiple currency practice (MCP) subject to Fund approval under Article VIII, Section 3.[1]

[1] The authorities have imposed a requirement that, to access the CBI foreign exchange window, a purchaser must have at least one bank account that has been opened for a minimum of six months. This requirement does not apply for access to foreign exchange from other sources, including purchases of foreign exchange from commercial banks' own resources. Staff will monitor the implementation of this requirement to ascertain whether any undue burdens on access to foreign exchange for current international transactions emerge from its application in practice.

The MCP arises from the lack of a mechanism to ensure that the exchange rate at the CBI foreign exchange window and the market rates (retail exchange rates of commercial banks and exchange bureaus for the sale of foreign currency from sources other than the CBI foreign exchange window) do not deviate from each other by more than 2 percent.

A previously identified exchange restriction arising from an Iraqi balance owed to Jordan under an inoperative bilateral payment agreement has been eliminated.

Article IV Consultation

Upon the approval of the 36-month Stand-By Arrangement on July 7, 2016, Iraq was placed on the 24-month consultation cycle. The last Article IV consultation was concluded on August 1, 2017, along with the Second Review under the Three-Year Stand-by Arrangement. The staff report (IMF Country Report No. 17/251) was published on August 9, 2017, and is available on the internet.

Resident Representative

Mr. Kareem Ismail has been the resident representative for Iraq, based in Amman, since June 2018.

Technical Assistance, 2014–19

Department	Date	Purpose
FAD	March 2014	Budget classification (METAC)
	June 2015	Status of public financial management reforms (METAC)
	November 2015	Public financial management law, budget execution, and program-based budgeting
	March 2016	Public financial management law
	February 2017	Revenue administration: tax policy
	February 2017	PFM: commitment controls, cash management, treasury single account (METAC)
	March 2017	Advice on a modern LTO/ Tax administration
	July 2017	Seminar on Commitment Control System
	January 2018	Assist in the Development of an IT System
	February 2018	Commitment controls, cash management and TSA
	March 2018	Improved Integration of Asset and Liability Management Framework
	April 2018	Follow up on establishment and functioning of large taxpayer office
	July 2018	Follow-up on Treasury Single Account and Cash Flow Management Unit (METAC)

Department	Date	Purpose
	July 2018	Budget Classification and Chart of Accounts (METAC)
	August 2018	Implementation Plan for New Sales Taxes (METAC)
	March 2019	Budget Classification and Chart of Accounts (METAC)
LEG	May 2015	Desk review of the draft AML/CFT Law
	June 2015	Article VIII acceptance
	September 2015	Desk review of the draft AML/CFT Law
	January 2016	Anti-money laundering activities
	March 2016	Cross-border financial flows
	June 2016	AML/CFT: review of the framework to implement targeted financial sanctions
	December 2016	UNODC Seminar on Strengthening the legal regime against terrorism in Iraq
	December 2016	Program TA in Central Bank Law
	December 2017	Review of AML/CFT law and integration of internal comments
	January 2018	Review of the "AML/CFT Regulations for Dealers in Precious Metals and Stones"
	January 2018	Review of the "Process for Implementing Targeted Financial Sanctions"
MCM	March 2014	Assessment of banking needs (METAC)
	April 2014	Central bank reserve management
	May 2015	Asset management
	November 2015	Banking supervision (METAC)
	November 2015	Prudential regulations: review and assessment (METAC)
	March 2016	Seminar on foreign exchange regimes and controls (Joint LEG/MCM)
	September 2016	Reserve management workshop
	November 2016	Regulations on capital adequacy and liquidity (METAC)
	March 2017	Regulations on credit risk (METAC)
	March 2017	Banking supervision: upgrade CBI prudential regulations (METAC)
	April 2017	Banking supervision (METAC)
	June 2017	Improving Regulatory Framework (METAC)
	February 2018	Improving Regulatory Framework – Follow-up (METAC)

Department	Date	Purpose
	September 2018	Regulatory Framework of Internal Audit (METAC)
	November 2018	Training on dealing with weak banks (METAC)
	November 2018	Forecasting and Policy Analysis System (FPAS)
STA	December 2014	Balance of payments statistics (METAC)
	March 2015	Government finance statistics (ArabStat)
	May 2015	Government finance statistics
	November 2015	Consumer price index (METAC)
	January 2016	National accounts statistics (METAC)
	March 2016	Government finance statistics
	March 2016	External sector statistics
	April 2016	Financial stability indicators
	January 2017	National accounts (METAC)
	January 2017	External sector statistics (METAC)
	February 2017	Price statistics (METAC)
	August 2017	National accounts (METAC)
	April 2018	External sector statistics (METAC)
	August 2018	National accounts (METAC)
	October 2018	Price statistics (METAC-EDDI2)
	December 2018	Government Finance Statistics
	December 2018	FSI: Financial Soundness Indicators

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=IQ

STATISTICAL ISSUES

(As of May 31, 2019)

I. Assessment of Data Adequacy for Surveillance

General

Data provision to the Fund has serious shortcomings that significantly hamper surveillance. Data availability also continues to impair policy-making in Iraq. The Central Statistics Organization (CSO) lacks adequate technical expertise and resources to address the requirements for a modern statistical system. Both the CSO and the Central Bank of Iraq (CBI) face challenges with interagency data sharing as well as issues surrounding data collection responsibilities.

National Accounts

The CSO compiles annual and quarterly GDP at current and constant (2007) prices from the production approach, and in current prices from the expenditure approach. The national accounts mainly follow the 1968 System of National Accounts (SNA). The lack of regular, reliable and comprehensive source data for some industries and for GDP by expenditure undermine the quality of the national accounts. Volume estimates of GDP suffer from shortcomings, and delays in source data affect the timeliness of the annual estimates. Reduced regional coverage of source data due to the conflicts in four provinces has further weakened the GDP measures. Ongoing TA from METAC is helping the CSO to introduce 2012 as a new base/benchmark year, and to implement core concepts and definitions of the 2008 SNA and to improve the compilation methodology and coverage of GDP. Access to administrative data could be a very significant data input for national accounts estimates, but this would require strong ministerial support and proactive collaboration with other government institutions.

Price Statistics

The CSO compiles and disseminates a monthly CPI for all-Iraq (including Kurdistan) and for each governorate. The index was rebased in 2016, based on the 2012 Household Social and Economic Survey. However, the CPI covers only the urban areas in all governorates and there are insufficient resources to expand coverage. Starting June 2014 official data on CPI do not include the four conflict-affected governorates. A quarterly PPI for manufacturing is also compiled on a 2012 base. An upcoming STA TA mission will provide advice on further improvements to the CSO's price statistics.

Government Finance Statistics

Despite the difficult security situation, which has a direct impact on data compilation and analysis, the provision of fiscal data for program monitoring purposes has been satisfactory. Infrequent submission delays occur, and coverage of Kurdistan remains sketchy. However, the authorities are taking measures to address these shortcomings.

STA GFS TA missions have proposed a work plan aimed at improving the frequency and timeliness of fiscal reporting data and setting a migration plan to improve fiscal statistics based on the Government Finance Statistics Manual 2014 (GFSM 2014). The missions have also assisted in setting up a reporting tool on quarterly and monthly statements of government operations for budgetary central government. Iraq resumed reporting government finance statistics for publication in the Government Finance Statistics Yearbook (GFSY) but the time lag remains long.

Monetary and Financial Statistics

The CBI reports monetary statistics for the central bank and other depository corporations (ODCs) for publication in the IMF's *International Financial Statistics (IFS)*, using the standardized report forms (SRFs). However, the quality and timeliness of the data continue to be hampered by the lack of staff capacity, particularly at the commercial bank level and source data quality. With technical assistance from a monetary and financial statistics mission in December 2017, the updated SRF 1SR for the central bank is now broadly in line with the *Monetary and Financial Statistics Manual and Compilation Guide* (*MFSMCG*). The publication of SRF data in *IFS* has been resumed. However, more efforts are required to improve the compilation of the SRF 2SR for ODCs as the current source data lack the required breakdowns. Source data improvement will also address the inconsistencies between financial soundness indicators for deposit takers and the SRF 2SR for ODCs. As part of efforts to improve data quality, the CBI plans to use a more detailed form to collect data from commercial banks. According to the CBI, some foreign-owned companies operating in Iraq are classified as nonresidents—a deviation from international standards regarding the application of the residence concept. In addition, monetary statistics do not cover bank operations in Kurdistan Region due to problems with data collection. Iraq reports some data and indicators of the Financial Access Survey (FAS), including the two indicators adopted by the UN to monitor Target 8.10.1 of the Sustainable Development Goals (SDGs). There is room for improvement in reporting to the FAS, especially for series on use of financial services (depositors, deposit accounts, borrowers, and loan accounts).

Financial Sector Surveillance

Following a mission on financial soundness indicators (FSIs) in April 2016, the CBI has compiled the 12 core FSIs and 7 of the 13 additional FSIs for state banks and a similar set of FSIs for private banks with quarterly frequency. The last FSI mission in December 2018 assisted in compiling the sectoral FSIs, covering the entire banking sector, merging the FSIs for the state-owned and private banks, and prepared metadata. The dissemination of the sectoral FSIs and metadata on the IMF's FSI website awaits the CBI's approval.

External Sector Statistics

Balance of Payments and IIP Statistics

The CBI compiles and reports annual as well as quarterly balance of payments data in the format of the IMF's *Balance of Payments Manual, sixth edition* (*BPM6*) to the IMF. The CBI also compiles and disseminates an annual international investment position (IIP) statement. The latest TA mission on external sector statistics (ESS) was conducted in April 2018. Despite some progress in reducing net errors and omissions (NEOs), they remain high and persistently negative, suggesting capital flight. STA will continue assisting the CBI in improving data reliability by addressing the most probable sources of the large NEOs, including the recording of oil sector transactions, cross-border trade with Kurdistan, arrears, and in-kind payments for external borrowing. International reserves are compiled consistent with international methodologies and published in the IFS since end-2006.

External Trade Statistics

External trade data have serious problems of timeliness and are of poor quality, given the absence of reliable customs data. A new customs form for imports is available but is not being used at the customs border due to the security situation and the lack of Customs Department resources at the border outlets. The compilation of external trade statistics has been hampered by a lack of interinstitutional coordination among key data providers.

Coverage of private sector imports is constrained by a lack of data sources. Only goods that are paid for through the Iraqi banking system are captured. Thus, goods that are imported under external payments arrangements (for example, imports for direct investment projects by international oil companies) are not recorded in the balance of payments. The coverage of the external trade statistics excludes Kurdistan, and no estimates for smuggling are made.

Export data from the oil sector are received from the Balance of Payments Statistics Division at the CBI. The data on non-oil exports, which amount to the equivalent of 3–5 percent of total exports, are derived from information on the customs export form. Non-oil export data are provided to the CBI monthly for crosschecking purposes.

Transactions related to oil exploration, extraction, and development payments to international oil companies have recently been included in the balance of payments.

II. Data Standards and Quality

Iraq has been participating in e-GDDS since 2009, but has not yet launched a National Summary Data Page for the dissemination of key macroeconomic statistics. The metadata, some of which have been updated in early 2016, for key macroeconomic indicators are available on the country page on the IMF's Dissemination Standards Bulletin Board.

Iraq: Table of Common Indicators Required for Surveillance
(As of May 16, 2019)

	Date of Latest Observation (For all dates in table dd/mm/yy)	**Date Received**	**Frequency of Data**[7]	**Frequency of Reporting**[7]	**Frequency of Publication**[7]
Exchange rates	01/2019	03/07/2019	M	M	M
International reserve assets and reserve liabilities of the monetary authorities[1]	12/2018	03/2019	M	M	M, 4–6-week lag
Reserve/Base money	12/2018	03/2019	M	M	M, 4–6-week lag
Broad money	12/2018	03/2019	M	M	M, 4–6-week lag
Central bank balance sheet	12/2018	03/2019	M	M	M, 4–6-week lag
Consolidated balance sheet of the banking system	12/2018	03/2019	M	M	Q, 4–6-week lag
Interest rates[2]	01/2017	02/03/2017	M	M	M, 4–6-week lag
Consumer price index	03/2019	04/2019	M	M	M, 3-week lag
Revenue, expenditure, balance and composition of financing[3]—general government[4]	06/2016	09/2016	M	M	N/A
Revenue, expenditure, balance and composition of financing[3]—central government	06/2016	09/2016	M	M	N/A
Stocks of central government and central government-guaranteed debt[5]	12/2015	03/2016	N/A	N/A	N/A
External current account balance	Q4/2018	04/2019	Q	Q	Q,
Exports and imports of goods and services	Q4/2018	04/2019	Q	Q	Q,
GDP/GNP	03/2016	04/2016	Q	Q	Q,
Gross external debt	12/2015	03/2016	N/A	N/A	N/A
International investment position[6]	12/2014	12/06/2016	Q	Q	Q,

[1]Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2]Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3]Foreign, domestic bank, and domestic non-bank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Including currency and maturity composition.
[6]Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7]Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Hazem Beblawi, Executive Director for Iraq and Ms. Maya Choueiri, Senior Adviser to the Executive Director
July 19, 2019

1. On behalf of the Iraqi authorities, we would like to thank staff for their constructive engagement, as well as the valuable capacity development provided to Iraq in support of its policy and reform efforts.

Recent Developments

2. Since the last Article IV discussion for Iraq, several elements contributed to improved political and economic conditions in the country: The formation of a new government, the recapture of territories previously held by ISIS, and a gradual recovery in oil prices. Millions of people displaced by the war against ISIS returned home, and negotiations around trade agreements with neighboring countries have progressed. Nonetheless, hundreds of thousands remain internally displaced and reconstruction efforts are delayed by many factors, including implementation capacity.

3. The economy is gradually recovering following the deep economic strains of the last four years. Growth is expected to be robust in 2019, reversing the contraction seen in the past two years, thanks to a notable improvement in security conditions and higher oil prices. The non-oil economy is projected to grow at more than 5 percent, due to better rainfall, a rebound in electricity production, and the fiscal stimulus. Inflation remained low in 2018 and the fiscal balance turned to a large surplus of about 8 percent. Higher oil prices have also supported a steady increase in international reserves to US$65 billion, helping to rebuild solid buffers to external shocks and retire domestic debt, including unwinding about US$1 billion of indirect monetary financing. Growth and the positive fiscal balance contributed to reducing public debt-to-GDP by about ten percentage points in 2018 and the government has adopted a framework to control the issuance of guarantees, in cooperation with the Fund. Higher oil prices and the improvement in the underlying fiscal position also contributed to a marked improvement in the external position, as reflected in the large current account surplus (about 7 percent of GDP). At the same time, the spread between official and market foreign exchange rates has narrowed to below 2 percent in recent months.

4. The authorities are fully aware that Iraq is facing the challenge of maintaining economic stability, while ensuring durable peace and inclusive growth. This entails rebuilding much needed infrastructure, addressing the legacy of conflict, ensuring the provision of services and job opportunities for all Iraqis, particularly the youth, and modernizing the economy. To address these challenges, the newly formed Government of Iraq has launched an ambitious reform and reconstruction agenda, outlined in the Recovery, Reconstruction, and Development Program and National Development Plan. In February 2018, in Kuwait, the international community committed to supporting Iraq's reconstruction

and development and pledged US$30 billion in the form of loans and guarantees at the International Conference for the Reconstruction of Iraq. A small portion of the needed reconstruction effort has, however, taken place to date, mainly due to limited absorptive and implementation capacity, as well as slow disbursement of pledged donor financing due to the heavy documentation requirements and project procedures.

Fiscal Policies and Reforms

5. The authorities are faced with pressures to increase employment in the public sector to address unemployment, achieve justice for some groups that were affected by past fiscal consolidation efforts including militia forces that helped defeat ISIS, and meet legal requirements to absorb graduates of certain specializations. Accordingly, tightening the fiscal stance in the short run is politically and socially difficult. Nonetheless, the authorities fully agree on the need for reforms over the medium term, particularly in the areas of non-oil revenues, subsidies, and civil service. Parliament recently adopted a new civil service law as part of their effort to conduct a comprehensive review of the public sector functions and size. The reform of the electricity sector ranks high on the authorities' agenda and priority has been given to increasing generation capacity to address power outages. Work in this area has resulted in increased electricity generation by about 25 percent in mid-May relative to the year before. Work to settle electricity-related cross-liabilities is ongoing. The authorities acknowledge that important challenges in the electricity sector remain, as outlined in paragraph 30 of the staff report.

6. The authorities also concur with staff on the need to adopt a risk- and rules-based approach to fiscal policy as part of broader fiscal reforms to manage oil revenue more effectively, and they appreciate staff's analytical work on the subject. In this connection, Parliament adopted a new General Financial Management Law in May 2019 that strengthens the legal framework for public financial management. The law defines general government for the first time, establishes the need for a medium-term fiscal framework and enshrines fiscal transparency requirements. It also limits parliament's capacity to amend the budget, as well as the scope for spending to be authorized outside budget processes.

7. Public financial management (PFM) reforms continue to rank high on the authorities' agenda. They have adopted tight procedures for the approval of government guarantees, kept arrears under control, and enacted a new PFM law in May 2019. They are also designing and implementing a commitment control system for budget execution to avoid the emergence of new arrears. Moreover, budget transfers to the Kurdistan Regional Government were progressively restored during 2018 and have been included in the 2019 budget. The Ministry of Finance is planning to implement an Integrated Financial Management Information System with the support of the World Bank, for which the adoption of an updated budget classification and a chart of accounts is a prerequisite. Work in these areas is progressing, with the support of Fund technical assistance.

Monetary, Exchange Rate, and Financial Sector Policies and Reforms

8. The authorities remain committed to the peg to the U.S. dollar as it continues to provide a key nominal anchor to the economy.

9. The authorities are taking measures to enhance the stability of the banking sector. The two largest state-owned banks, Rasheed and Rafidain, are being restructured. The authorities have made progress in procuring suppliers for core banking systems and have segregated legacy assets and liabilities into “bridge branches.” The Bureau of Supreme Audit is working on finalizing their accounts for 2014 and subsequent years. Once the core banking systems are fully operational, the authorities intend to have the two banks audited to international standards, which would allow their capital needs to be assessed accurately.

10. At the same time, the Central Bank of Iraq (CBI) is pursuing its efforts to strengthen the regulatory framework and improve prudential regulations in banking supervision to align them with Basel II Committee on Banking Supervision standards and guidelines. In this connection, supervisory guidelines on bank internal audit and compliance functions were prepared in the fall, with Fund technical assistance. Work is progressing on early identification of bank risks and the way to deal with weak banks, including early intervention of supervisors, corrective actions and their enforcement, banking crisis management and the supervisor’s role, as well as techniques for liquidating unviable banks. The CBI also intends to develop a deposit insurance scheme, which would help level the playing field across the banking sector. To promote financial development and inclusion, the CBI is working on strengthening payment systems and encouraging deposits, including public salary payments directly into bank accounts.

11. In June 2018, the Financial Action Task Force (FATF) welcomed Iraq’s significant progress in improving its AML/CFT regime and noted that “Iraq has established the legal and regulatory framework to meet the commitments in its action plan regarding the strategic deficiencies that the FATF identified in October 2013.” FATF thus considered that Iraq was no longer subject to the FATF’s monitoring process under its ongoing global AML/CFT compliance process. The authorities will continue to work to strengthen the AML/CFT framework. They consider that continued progress on AML/CFT will also help them address the transfer of illicit gains.

12. Good progress has been made in implementing the recommendations of the 2016 safeguards assessment of the CBI. Amendments to the Law on the Central Bank of Iraq to strengthen CBI governance have been enacted, and the revised audit committee charter now prohibits CBI executive representation on the committee. Work is ongoing on strengthening the capacity of internal audit and financial reporting.

Anti-Corruption Reforms

13. The government is prioritizing anti-corruption efforts, with a focus on strengthening public institutions. A new High Council on Combatting Corruption, chaired by the Prime Minister, was established in February 2019. A Commission on Integrity was established in 2011 with the tasks of corruption prevention and enforcement, and it has investigated several high-profile corruption cases. Legislation to criminalize illicit enrichment, trading in influence, embezzlement, and all forms of bribery has been drafted. Iraq has also developed a system of asset declarations, and a large number of public officials are currently required to disclose their assets. The authorities agree with staff that streamlining the anti-corruption framework would make it more effective and less onerous for economic activity.

Conclusion

14. Notwithstanding an improvement in security conditions and oil prices, Iraq faces the serious challenge of maintaining economic stability, while ensuring durable peace and inclusive growth. The Iraqi authorities very much value the Fund's policy advice in addressing its economic challenges, and they would welcome a Post-Program Monitoring engagement. Continued Fund capacity development would be essential in the period ahead. The authorities have been calling on the Fund to resume visits to Baghdad, similar to the practice of other international institutions. They welcome the recent lowering of the Fund's security rating for Baghdad to a medium level of residual risk and look forward to welcoming Fund staff again.