

Policies and Economic and Social Trends in Iraq: 2003-2007

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Contents

I. Introduction, 1

- (I-1) The economy before 2003, 1
- (I-2) The fall of the regime, 2003, 2

II. The elements of economic policy set, 3

III. Implementation of the elements/benchmarks of economic policy, 4

IV. Economic and social trends: the influence of economic policies, 6

- (IV-1) Economic growth, 6
 - (IV-1-1) Sectoral and overall growth, 6
 - (IV-1-2) Energy, 8
- (IV-2) Inflation, 8
 - (IV-2-1) Before and after 2003, 8
 - (IV-2-2) Fuel prices and inflation in 2007 and 2008, 9
 - (IV-2-3) Tools of economic policy and inflation, 10
- (IV-3) Poverty, the ration system and population displacement, 12
- (IV-4) Unemployment, 13
- (IV-5) Crude oil and oil laws, 14
- (IV-6) Privatization, 18
- (IV-7) WTO membership, 19
- (IV-8) External Debt, 20
- (IV-9) Corruption, 22

V. Conclusions, 24

References, 25

Tables

- Table (1) Summary of Economic Policy Programme (Macro Policies According to Type), 29
- Table (2) Implementation of Economic Policies, Timeline 2005-2008, 31
- Table (3) Iraq: GDP by Sectors, 32
- Table (4) Index Numbers of Production Quantity in Manufacturing, 33
- Table (5) Index Numbers of Production Quantity in Agriculture, 33
- Table (6) Inflation and Market Rate of Exchange, 34
- Table (7) Consumer Price Index: *Fuel and other Constituents*, 35
- Table (8) Average Monthly Fuel Consumption, 36
- Table (9) Fuel Price Indices of Open/parallel, Official and Average Markets between June 2006 and April 2008, 36
- Table (10) State-Owned Establishments for Privatization, 37
- Table (11) Iraq: Crude Oil Production and Exports, 38
- Table (A1-1) Policy Set, 39
- Table (A2-1) Iraq: Income and Expenditure, July 2005, 43

Appendices

- Appendix 1: Policies in the COMPACT Agreement, 39
- Appendix 2: Poverty, *July 2005 and December 2007*, 42
- Appendix 3: Unemployment Rate 2005, 44
- Appendix 4: Comments on the Draft of Oil and Gas Law, 45

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Abstract

Economic and social policy set as a unified and coordinated package had been formulated within agreements between the Iraqi government and the United Nations, World Bank and the IMF; mainly through the *International Compact with Iraq* and *Standby* arrangements. A host of policies/measures, institutional changes and benchmarks, included in these agreements, had been implemented/met during the period 2003-2007/2008. Analyses and figures, in this paper, on such variables as economic growth, inflation, employment, poverty, etc. have indicated weakening trends, signifying, inter alia, low effectiveness of the elements/tools of economic policy and institutions in influencing developments in these essential variables. Policy effectiveness has been greatly reduced by instability, terrorist attacks and corruption. Signs of political reconciliation, lower violence and public investment recovery in the first half of 2008, however, could contribute to more stability, better economic/social trends and improved policy effectiveness.

I. Introduction

(I-1) The economy before 2003

When the old regime fell in April 2003 the economic system was mainly dominated by the public sector operating within UN-sanctioned economy; mainly:

1. Oil for food programme, OFFP, and universal ration system (Public Distribution System, PDS).
2. Highly constrained revenues from oil (which was limited to set levels of oil production by OFFP).
3. Mushrooming open/parallel markets in currency and goods. Official rate of exchange of 3 \$ for one Dinar (ID), was confined to OFFP and some official transactions. Otherwise, the open/parallel rate was applied in all other transactions, which stood at an average of ID1957 for one \$ in 2002.
4. The open/parallel markets interacted with the 'official' market through leaks from the OFFP, be it re-sales of rations or official corruption.
5. Semi-official smuggling of crude oil and oil products.
6. During 1991-1995, lack of oil revenues forced the government to print money in order to finance the budget. Prices spiraled. Annual inflation averaged 237% during the period 1990-1995. Afterwards, monetary policy became more conservative.
7. Economic policy was, in general, a hybrid of administrative measures and 'free market' attitude. For instance, the annual imports' budget set a ceiling on public sector's imports. In the private sector, however, importation was more or less free.
8. While non-oil GDP was stagnant or declining during the period 1991-1996 it started to grow after the implementation of the OFFP. Between 2000 and 2002 it grew by 5.2% annually (Table 3).¹

¹In 1991, non-oil GDP was about 53% of its value in 1989 (in 1980 prices), Central Statistical Organization (1994), *Annual Abstract of Statistics 1993*, Baghdad.

During the period 1991-2002 the private sector enhanced its activities through two channels:

- i. Import and export activities through Jordan, the Gulf, Iran, Syria and Turkey. An important part of trade had gone through channels that had not been necessarily subject to UN inspection.
- ii. The government, through the OFFP and smuggling of oil, had entrusted its 'representatives' within the private sector to carry out public dealings.

(I-2) The fall of the regime, 2003

With the existing hybrid of state-dominated and private activities, both under UN sanctions, the economic system was functioning so far as the state did not overtly interfere with the private sector's activities, which was made possible by the growing interests of the 'representatives' of the regime².

After the collapse of the regime, the looting that ensued, burning of documents, etc., had dealt the administrative structure an enduring damage. Mr. Garner (through the newly established ORHA) was given the task of activating a working system in public administration and the economy. In May 2003 Mr. Garner was replaced by Mr. Bremer, who headed the newly formed Coalition Provisional Authority, CPA. The CPA's economic team was intent on transforming Iraq into a model of market-based economy³, mainly; privatization of state-owned enterprises (SOEs), including possibly the oil sector, issuing a modern foreign investment law, freeing external trade by waiving out import tariffs and controls, reforming the central bank and the restructuring of the payment system, the establishment of the Development Fund of Iraq⁴, etc.

Apart from privatization, the other elements were, largely, initiated or carried through, including the introduction of a new currency. The privatization project was postponed for the following reasons:

- i. The large number of the public enterprises involved, on the one hand, and lack of information and staff to carry out the task, on the other.
- ii. Fear that another spate of unemployment, after the dissolution of the army, could increase violence and retributions. (For i and ii see Chandrasekaran, 2006).
- iii. Political opposition to privatization of the oil sector.

² The summary execution of 'merchants' in Baghdad in 1992, however, is an example indicating possible dangers of involving in economic activity or clashing with established vested interests.

³ "After months of ... discussions, USAID and [US] Treasury officials came up with an ambitious plan for economic transformation. The plan was detailed in a confidential, 101-page document titled 'Moving the Iraqi Economy from Recovery to Sustainable Growth'... The goal was to lay 'the groundwork for a market-oriented private economic recovery'. The plan envisioned the sale of state-owned enterprises through a 'broad-based mass privatization program', the establishment of a 'world-class exchange' for trading stocks and a 'comprehensive income tax system consistent with current international practice'", Chandrasekaran (2006, 115).

⁴ The Development Fund of Iraq, DFI, was established in May 2003. Its accounts were kept in the Federal Reserve of New York. Its revenues are composed of: petroleum exports (95 percent after deducting 5 percent for the UN Compensation Fund), Oil for Food Programme's (OFFP) balances, Iraqi frozen assets in foreign countries, earned interest, and others. Its expenditures are composed of: transfers to the Iraqi Ministry of Finance, to finance the budget, letters of credit for the Iraqi ministries, projects managed by American institutions, debt service, and others, (SIGIR, 2008a).

II. The elements of economic policy set

In a macro economic assessment an IMF report (IMF, 2003) pointed out to the main elements of economic strategy/policy course to be followed in Iraq, a line which have been repeated and new elements added in subsequent statements, documents, accords, agreements, Iraqi and foreign; mainly:

1. Implementing a potential reform agenda for a market-based economy.
2. Open the economy to trade and foreign investment.
3. Liberalize prices.
4. A reform strategy for SOEs, including privatization.
5. Removal of domestic oil price subsidies (to be phased out in stages to avoid undue social disruption and a gradual, carefully monitored transition from the in-kind social safety net under the OFFP/ration system, PDS, to a cash-transfer system).
6. For Iraq to achieve sustainable debt service payments in the future, it will need generous restructuring of its external debt.
7. The primary objective for monetary policy should be to maintain broad price stability.
8. A flexible exchange rate regime to be followed after achieving stability for the Iraqi Dinar through a peg system (to the US\$).⁵
9. The Central Bank of Iraq (CBI) also needs to take steps to improve its banking supervision capacity to ensure that the banking sector plays its key role in the economy.
10. Domestic banks will need to be strengthened at the same time as the financial system is opened to foreign investment.

A memorandum submitted to the IMF by the Iraqi government in September 2004 (IMF, 2004), and a '*National Development Strategy 2005-2007*' drafted in June 2005 by the Ministry of Planning (Ministry of Planning and Development Cooperation, 2005), have taken up similar elements for this course of economic policy. Two successive Stand-by arrangements with the IMF (IMF, 2006, 2008) had, further, taken up similar elements of economic policy. Economic, social, institutional and political elements have, however, been expanded and articulated, in great details, in the *International Compact with Iraq*, COMPACT. The COMPACT is an accord between Iraq and the international community through the UN (launched in Sharm Al-Shiekh, June 2006); see Government of Iraq, United Nations, World Bank (2006a, 2006b, 2006c).

Table (1) summarizes the main (macroeconomic) policy set according to type (i.e. fiscal, monetary, trade, employment, etc.) from the wider policy set contained in the COMPACT's and IMF Standby's documents. Appendix 1, lists policy elements/benchmarks of the COMPACT Agreement (in different classification than Table 1). Benchmarks in the two agreements are found to be compatible (Merza, 2007b). The documents, on which Table (A1-1) in Appendix 1 is prepared, contain more detailed benchmarks and timelines.

Economic and social policy set as a unified and coordinated package, therefore, had been formulated through agreements between the Iraqi government and such international organizations as the United Nations, World Bank and the IMF (mainly; the *COMPACT* and *Standby* arrangements). The documents referred to above, therefore, seem to be the de facto economic programme of the government.

⁵ 'By the third quarter of 2007 Iraq was following a de facto exchange rate regime of a crawling peg to the U.S. dollar', IMF (2008, 1).

Monetary, fiscal, trade and other economic and social policies have been translated in these documents into benchmarks and timelines.

Following a well-defined programme largely imparts two advantages:

- i. It lends a unifying and effective framework for follow-up, monitoring and appraisal of policies.
- ii. It encompasses elements of wide range of policies and institutional changes. With the transition from a previously outdated practices and institutions, such a programme could become an element of stability during the transition period.

Yet, concentrating only on these elements, measures and benchmarks raises the risk of leaving or diluting such fundamental issues as:

1. The employment issue, which is of vital importance to the alleviation of the now prevalent poverty and insecurity.
2. The diversification issue and the role of government/public-sector to support diversification activities. It is worth noting that the '*National Development Strategy 2005-2007*' has stated that diversification should be a main objective to rid the country of the one-sided dependence on oil (P. 4). Furthermore, it has indicated that industry, agriculture, services including tourism and export-oriented activities are the main vehicle to fulfil this objective (P.35). Apart from creating a growth oriented environment by policies similar to those listed in Table (1) and Appendix 1, however, no specific direct measures are set for the government to contribute to this policy, in this document. Diversification policy has largely been left; it seems, to the initiatives of the private sector.

III. Implementation of the elements/benchmarks of economic policy

The implementation of the policies and benchmarks can be tracked in many such documents as the Central Bank of Iraq's economic reports, the COMPACT's progress reports (e.g. Government of Iraq, 2007 and Government of Iraq and United Nations, 2007), reports on IMF's Article IV consultation and Stand-by Arrangements with Iraq, (e. g. IMF, 2005, 2006, 2008) and STIGIR's reports (e.g. STIGIR, 2007, 2008a, 2008b).

The implementation of the policy set or 'economic programme'⁶ has been influenced by such factors as security situation/terrorist attacks, the overlapping and lately clashing federal/regional spheres of authority, political differences among the main political factions, the low competence of the administrative and institutional system, exodus of qualified personnel⁷, corruption and entrenched interests opposing institutional and policy changes, etc. On the other hand, policy and institutional changes of far-reaching consequences pertaining to changes in monetary, fiscal, trade, legal frameworks are taking place, this time motivated by the follow-up of the IMF and some countries through the COMPACT. Furthermore, the WTO's fact finding process that has been going on since 2005 would motivate further changes

⁶ The term 'policy set' or 'economic programme' is used her to describe the collection of policies, benchmarks and timelines that have been listed in the documents of the COMPACT and IMF's Standby Agreements, see Tables (1), (2) and Appendix 1.

⁷ Deteriorating living conditions have resulted in the emigration of professionals and skilled labour. UNHCR estimates that about 2.0-2.2 million have fled the country, UNHCR (2008, 2).

(see IV-7 below).⁸ These pressures/efforts are resulting in changes that would not have been possible, otherwise.

In the light of these factors, we can summarize the implementation of the economic programme by referring to Table (2), which itself summarizes the implemented and to-be implemented elements of the policy set:

1. It is clear from the table that the central/federal government has been faster than the regions (except for Kurdistan) in implementing measures and benchmarks. Among the latter benchmarks; monetary, trade and fiscal policies were implemented faster than those required by the oil industry or those related to central/regional coordination. For instance, institutional changes in the Central Bank, CBI, were earnestly carried out starting in May 2003. Concurrently, trade liberalization occurred faster than changes related to the budget. Improvement in the balance of payments compilation, according to international standards, preceded those in the Budget (in applying IMF's Government Finance System Manual, GFSM2001). On the other hand, installation of oil metering in Basrah was only started in 2007 in spite of continuous calls to do so much earlier. Entrenched vested interests in Basrah (corruption and smuggling) combined with violence must have played important role in the lack of effective monitoring, (see also IV-5 below).
2. Changes have not been progressing in a balanced or steady manner or carried through regularly. Table (2) indicates that most implemented measures need to be followed through and enforced. For instance, the financial management systems need to be strengthened, including the auditing of the DFI's expenditures and revenues (when the International Advisory Monitoring Board's role expires at the end of 2008), full development of the payment system (credit cards, financial transfers, etc.), the streamlining of the tax system, strengthening of the financial intermediation, etc.
3. The crude oil sector is still in need of faster rehabilitation and development of its infrastructure, production capacity and of its regulatory and institutional framework. Low investment, corruption, recurring terrorist attacks, slow rehabilitation, absence of regulatory framework including dispute over draft oil laws are delaying the development of this sector. During the last nine months, however, production has been increasing steadily, (see IV-5, below).
4. The debt problem is taking a pattern that has become well established. Contrary to initial expectations the non-Paris club creditors, led mainly by the Gulf countries are resisting call for Paris-Club-type reductions.⁹ See IV-8 below.
5. It is worth noting that apart from expected increase in employment from construction activities consequent on the execution of public investment in 2008, what remains to be implemented of reforms and institutional changes in 2008- (Table 2) seems to have no immediate results in increasing employment, see (IV-1) – (IV-4) below.

⁸ Many of these changes and measures may turn up to be controversial in their consequences on employment, poverty and income distribution. These measures need to be proactively discussed and in-place guarantees established.

⁹ For instance, in spite of good-will statements in Kuwait's meeting of the foreign ministers of Iraq's neighbouring countries during 21-22 April 2008, no concrete results had emerged.

IV. Economic and social trends: the influence of economic policies

There are two approaches to appraise and evaluate economic policies:

1. The implementation of the elements of the policy set or economic programme (section III above).
2. Possible influences of implemented measures/benchmarks and policies on such general economic and social trends as, economic growth, inflation, employment, poverty, trade, external debt, etc. (i.e. outcomes).

With the dearth of data, of their coverage and even credibility, on the one hand, and difficult security situation, on the other, the second approach is difficult to undertake. However, it is important to try that approach because undertaking the first only, risks a situation whereby the *policy set* itself becomes the yardstick for success or failure rather than the outcomes sought from its implementation. Therefore, after touching on the implementation of measures and benchmarks that were put or to be put in place in the last section let us touch, in the subsequent sections, on the following economic and social variables:

- (1) Economic growth.
- (2) Inflation.
- (3) Poverty, the ration system and population displacement.
- (4) Unemployment.
- (5) Crude oil and oil laws.
- (6) Privatization.
- (7) WTO membership.
- (8) External Debt.
- (9) Corruption.

(IV-1) Economic growth

(IV-1-1) Sectoral and overall growth

In the year 2006, the value added (measured in 1988 prices) in all economic sectors were below their 2002 level except for social services and dwelling. The situation in 2007 was not better, save for the growth in oil output in the second half of 2007.

The overall decline in GDP in 2003 amounted to 33%, shared between oil (37%) and non-oil activities (28%). Construction and Electricity (and water) were hardest hit (76% and 60% respectively) followed by transport and trade (about 43-46%). Agriculture and manufacturing suffered equally hard (29% each). Only social services kept its level¹⁰, Table (3). The main factors that contributed to this outcome are mainly:

1. Looting and low level of security, after the collapse.

¹⁰ It is not clear how could the value added of the social (mainly civil) services, measured in constant prices, have increased in 2003. With the disbandment of the army, the number working in the civil service has decreased markedly, implying a drastic fall in the value added of this sector (in constant prices). The increase in salaries in the civil service and payments to the disbanded army cannot be taken as 'quantitative' increase in the value added. First, the increase in salaries is an increase in the 'price' of the service rather than the services themselves. Historically, the statistical authority in Iraq has erroneously used the consumer price index (CPI) as a price deflator in this sector, which may have also been used this time, hence the high growth. Secondly, if the payments to the disbanded army were included in the value added of this sector then this does not accord with UN SNA system because these payments represent 'social transfers' rather than value added components. Furthermore, all those who worked or subcontracted with the CPA are not considered part of the civil service; rather they are analogous, in SNA, to those working for a foreign company inside Iraq.

2. The unclear and in many cases inconsistent course of action by the CPA (Chandrasekaran, 2006, Ch. 6).
3. The absence of effective public administration and governance.

The years 2004 and 2005 witnessed some stability in the administrative structure of 'economic management', be it the CPA or the Interim government. Although the insurgency was growing during 2004 and 2005 agriculture picked up in 2005 by about 14% growth. In 2006, however, production stagnated despite a sizable growth in fisheries (Table 5). Manufacturing output, on the other hand, plunged further in 2004, mainly due to ineffective and even discouraging policies by the CPA.¹¹ In 2005, it continued its plunge (Table 4).¹² In 2006, and despite worsening security situation, industrial production grew by 10%, led mainly by metallic industry (130%), wood and paper (77%), and non-metallic and tobacco (about 40% each). Even oil refining made a 13% growth. In 2007, however, indications point at stagnation or a mild decline (Table 4).

It is not clear how the opening of the domestic markets to imports (through very low tariffs) had contributed to the decline in industrial production after 2003. Apart from food stuffs all manufacturing subsectors had undergone, on average, sharp decline. Industrial output in 2002 was 66% its level in 1988. In the third quarter of 2007 it was 39% its level in 1988 (Table 4). It seems that the decline during 2003-2007 is more to do with the general instability and violence and less with the sharp decline in import tariffs, and hence the opening of domestic markets.

Construction projects by government, local governments, the US Army, the aid agencies, etc. led to a revival in 2004 and 2005 in the construction sector, only to plummet sharply in 2006 (after the explosions in the Samaraa shrines). Transport and telecommunications had also made good growth during 2004-2006 mainly due to the growth in such activities as mobile telephony and other telecommunications. Transport, however, was governed by the security situation, which restrained its growth. Social services, mainly civil service, were the exception with continuous growth, averaging 14.1% annually between 2002 and 2006 (see footnote 10, however).

Starting from a low level of economic activity in 2003, the mini construction boom of 2004 and 2005, together with high growth in most non-oil sectors, resulted in relatively high growth in non-oil output in the years 2004 and 2005 by 8% and 15%, respectively. In spite of drastic fall in construction, growth of non-oil output continued in 2006 (8%), mainly due to social services, dwelling and manufacturing. It was, however, less than its level in 2002.

Apart from actual figures indicating positive growth in crude oil production (Table 11) and stagnation/decline in manufacturing output (Table 4), figures for other sectors for 2007 are not generally available. Extrapolation, though, indicates zero growth in non-oil output (Table 3). For 2008, expectations for high non-oil growth are mainly driven by such indicators as improvement in the security

¹¹ The CPA's decision to relieve all public enterprises of their banking debt has led to relieving losing enterprises of their obligations while punishing potentially viable enterprises by denying them their bank deposits, Chandrasekaran (2006, 120-121)

¹² Growth rates of value added in agriculture and manufacturing are generally in line with growth rates in the quantity of production in these two sectors, respectively, for the years 2002-2004. For 2005, however, they diverge. Compare table (3) with tables (4) and (5).

situation, high investment allocations in 2008's budget, high oil revenues for 2008 and signs of better political climate and national reconciliation.

(IV-1-2) Energy

Shortages in energy (oil products and electric power) had played a pivotal role in retarding economic activity. To compensate for inadequate generation and transmission, the mushrooming of private power generation (generators serving small areas or single houses) and installation of small gas turbine stations, coupled with exceptional rise in number of vehicles, increased demand, tangibly, for light and middle distillates. The latter are limited in the refinery yield, leading to recurring supply crises that were only relieved through imports. Power cuts affected the refineries, in turn, with recurrent stoppage in refining operations. Through such measures as raising oil products' prices, guarding pipelines and increasing supplies during the second half of 2007 and first half of 2008, shortages in fuel supplies and distribution eased. Electricity situation remains critical, though.

Since 2003 power generation in Iraq has lagged way behind demand. In June 2007 peak output averaged 25.6 MW/h compared to an estimated demand of 48.3 MW/h. On average residents received electric power for 10.9 hours a day, ranging from 8.1 for Baghdad to 11.8 for the rest of the country. Wide variations from the average within different areas in Baghdad and the governorates are common. The \$4.6 billion allocated/expended since 2003 was mainly spent on repair and rehabilitation of existing capacities and installation of small gas turbine stations. No major station had been installed, yet. In addition to recurring insurgent attacks and fuel shortages, bad management, poor maintenance and monitoring of the grid cause the power system to experience frequency drops that result in breakers tripping and blackouts. Regional manipulation of the power grids has also affected the transmission of power from the large plants in northern and southern Iraq to Baghdad.¹³

(IV-2) Inflation

(IV-2-1) Before and after 2003

After declining from 448% in 1994 to 5% in 2000, inflation accelerated to 20% in 2002. The main factors that influenced inflation before 2003 are:

- i. Supply limitations imposed by the UN sanctions on imports that had also constrained utilization of domestic production capacity.
- ii. The expansionary policy of the 1991-1994 of money printing that led to the entrenchment of inflationary pressures in the economy.
- iii. The inflationary expectations that heightened towards the end of 2002 when it became clear that the war is eminent.

After 2003, inflation accelerated further. It averaged around 36% annually for the period 2002-2007 compared to 13.6% for 1997-2002 (1997 was the first year for implementation of the oil for food programme, OFFP). In 2003 the rate stood at 37% to go down to 23% in 2004 then to accelerate to 48% in 2006 and 36% in 2007, Table (6).

The main factors that affected the rate of inflation during 2003-2007 were:

¹³ This paragraph draws on material in SIGIR (2007, 67-76). Subsequent SIGIR's reports do not expand on supply and demand for electric power.

1. Supply shortages (shocks) due mainly to insecurity, corruption and smuggling. The decline in most sectors' output as indicated in Table (3) signifies the domestic constraints on supply.
2. Lower capacity and flexibility on the part of the administrative system to identify problems and take corrective measures. For instance, in spite of persistent calls and need for additional generation/production capacities in electricity and oil refining, no timely actions were taken (e.g. the indecision to build refineries in Karbala and Nasria, SIGIR, 2007, 18).
3. The weakness of the distribution fleets of the ministry of trade, due mainly to looting and subsequent neglect.
4. Recurring terrorist attacks on the power grid and crude oil/products' pipelines.
5. Interference of vested interests in the supply chains.¹⁴

In the period June 2007-April 2008, inflation fell sharply to about 0 percent (Tables 6 and 7). This was, however, due largely to a transient factor, as shown in the following section.

(IV-2-2) Fuel prices and inflation in 2007 and 2008

In the second half of 2007 and first four months of 2008 prices started to moderate. Between June 2007 and April 2008 the monthly rate of change of the consumer price index was 0%, (Table 7). The main cause was a sharp decline in the prices of fuel and light (-4%, monthly). During the same period, however, *non-fuel-transport* price index (i.e. consumer price index excluding fuel, light and transport) representing 'core' inflation, increased by a monthly rate of 1.6%. Inflation is still entrenched in the economy. It is, therefore, pertinent to explore the causes of the overall decline in inflation during June 2007-April 2008 in order to figure out a transient cause of zero monthly inflation in this period.

Between June 2006 and June 2007 official prices of oil products were raised by an average of 133 percent. For the single products the change ranged from 100% for kerosene to 220% for Diesel (Table 7). Concurrently, a sharp rise in fuel and light price index (the average of official and open/parallel prices) of about 188% occurred in the same period. However, between June 2007 and April 2008 this index declined by an annualized rate of about 39% (4% monthly), Table 7. How could that happen, i.e. how could a sharp rise that exceeds official price rise, between June 2006 and June 2007, and a sharp decline with no official price decline, between June 2007 and April 2008, happen in fuel and light price index?

Evidence suggests that the main causing factors that led to these outcomes i.e. rise and then fall in fuel prices between June 2006 and April 2008, are more to do with the open/parallel market:

- i. The open/parallel market has become an important supplier of oil products (be it in the quantity supplied or its share in the consumer's budget). Partial evidence suggests that the domain (i.e. quantity traded and also the share in the consumer's budget) of the open/parallel market has widened appreciably between June 2006 and June 2007. At the time when official prices increased by an average of 133 percent between June 2006 and June 2007 the open/parallel prices increased

¹⁴ IGO (2008, 19), cites examples of such interferences; e.g. diverting the routes of oil products' trucks.

somewhere close to 240 percent (Table 9)¹⁵. This rise had, we believe, caused the share of the open/parallel market in the consumer's fuel budget to surge to more than 52% (Table 8).

ii. Developments, which resulted in the fall of fuel prices between June 2007 and April 2008, were as follows:

(ii-1) According to the Oil Inspector General 2007's report, consumption of such products as gasoline, kerosene, gasoil/diesel and LPG had declined consistently between 2005 and 2007.¹⁶ This was due mainly to lower smuggling (IGO, 2008, 1) and the influence of income effect of higher fuel prices. On the other hand the low economic activity in 2007 could not have increased demand to compensate for the downward effect of lower smuggling and higher prices.

(ii-2) We estimate that prices in the open/parallel market have come down by some 55% between June 2007 and April 2008 (Table 9). Direct observation in Iraq also suggests that important fall in open/parallel prices had taken place (personal contacts) during the period June 2007-April 2008, yet they are still higher than the official prices.

(ii-3) Together with the high share of the open/parallel market, in average consumer's budget (52 percent+), this fall must have been the main cause for the fall in fuel and light price index by 33% (Table 9) between June 2007 and April 2008.¹⁷

(IV-2-3) Tools of economic policy and inflation

Three or more tools of economic policy have interacted since 2003 to contribute to/or influence inflationary trends during the period 2006-April 2008:

The elimination of explicit and (part of the) implicit fuel subsidies:

The raising of official prices of all oil products in 2006 and 2007 were meant to achieve two objectives; first to eliminate subsidies in the budget and second to combat smuggling of oil products to neighbouring countries (which itself reduces subsidies). The raising of fuel prices has contributed to the lowering of direct and indirect (implied) subsidies as evidenced by the fall in fuel imports by the government (IGO 2008, 20-23)¹⁸. However, as price differentials still exist between domestic and (rising) international prices, implicit subsidies continue. Nevertheless,

¹⁵ It seems that the increase of official prices in June 2007 was only narrowing an already widening gap between the open/parallel and official prices.

¹⁶ Compare this with figures from OPEC (2007), which indicate that Iraq's consumption of total refined products had slightly increased between 2005 and 2006.

¹⁷ The share of quantities in total consumption of fuel products provided by the open/parallel market, in 2005, ranged from 23% for gasoline, 37% for diesel, 49% for kerosene to 85% for LPG. Evaluating officially supplied quantities by official prices (as of June 2006) and open/parallel market supplied quantities by what we consider the floor of open/parallel market prices (taken to be the new official prices in June 2007) results in a share of official supplies equals to 48% and for open/parallel supplies of 52 percent, for average monthly household's consumption of fuel products, Table (8). This share of the open/parallel market is considered a minimum because prices in the open/parallel market, although declined sharply after the raising of official prices in June 2007, they continue above new official prices. For instance, the IGO (2008, 26) mentions that although the new kerosene price has been raised (in June 2007) to ID 150 per Liter, some sellers continue to charge ID200.

¹⁸ In the first quarter of 2008 imports of refined products started to increase, it seems, due to production disruptions in Doura (Baghdad), Beiji and Basrah refineries, SIGIR (2008b, 116).

by April 2008, the objectives of reducing budget deficit and combating smuggling and leaks to the open/parallel market have largely been met.

As for the burden of higher fuel prices on the consumer, the impact depends on the size of change in fuel prices and the weight of fuel and light in the consumer's budget. Table (7) indicates that the price index of fuel and light had risen from 1 time in June 2006 to 2.9 times in June 2007 then declined to 1.9 times in April 2008 (still almost twice its level in June 2006). These figures suggest that higher fuel prices must have had a tangible impact on the budget of average consumer during the period June 2006- April 2008 and still does, despite the recent fall. This is reinforced by the fact that the consumer was paying much higher prices than the official fuel prices even before June 2007 and that the weight of fuel in his/her budget must have increased over time¹⁹.

Monetary tightening:

According to the IMF (IMF January 2008) falling from an annual rate of 29 percent in 2006 to 20 percent in 2007 to 13.2 percent in the first four months of 2008, lower core (i.e. non-fuel-transport) inflation (Table 6), was due to:

- (i) Appreciating rate of exchange.
- (ii) Tightening monetary policy through higher interest rate and higher required banks' reserves with the Central Bank, CBI (CBI's primary interest rate rose from 7 percent in 2005 to 16 percent in 2006 to 20% in 2007, IMF, 2008, 26).
- (iii) Controlling current government spending.

How had tightening of monetary policy contributed to lower inflation in Iraq between June 2007 and April 2008? By checking demand, theory suggests, higher interest rate reduces pressures on prices.²⁰ For Iraq, it seems that the IMF envisages that the effectiveness of tighter monetary policy (i.e. high interest rate) was achieved directly by affecting demand for goods and services and/or (with the appreciation of the ID against the US\$) through de-Dollarization.

In response to the rise in the interest rate (together with the appreciation of the ID), it seems that holdings of Dinar balances had increased between 2006 and 2007 (de-Dollarization?). This can be seen from a 33 percent increase in reserve money and doubling of ID demand and time deposits between 2006 and 2007 (IMF 2008, 29-30) at the time when US\$ time deposits had experienced a fall of 28 percent, between December 2006 and December 2007, (CBI, 2008, 18).

As for reducing or checking demand on goods and services the evidence is not clear. Compared to 2006, it could well be argued that demand was largely low during 2007 because of other factors than monetary policy. Public expenditures (through the budget) declined sharply from ID38.9 trillion in 2006 to ID24.0 trillion in 2007 (SIGIR, 2008a, 123). That was mainly due to lower public investment and lower subsidies (largely lower imports of fuel), in turn the result of administrative

¹⁹ The weight used presently for fuel and light in the consumer price index is that of 1993; 2.1 percent. With the increase in the relative price of fuel in the open/parallel market, since 1993, the share of fuel in the consumer's budget must have increased accordingly.

²⁰ Because of higher cost of borrowing, higher interest rate is supposed to check demand for loans and hence for goods and services (consumer durables/housing and investment), thus reducing economic activity (weaker demand-pull). Higher interest rate also means lower shares' prices and, through the 'wealth-effect', lower demand for goods and services. Lower economic activity, in turn, implies lower demand for labour. This puts a lid on wage increases and hence checks inflation through the cost side (weaker cost-push). Furthermore, higher interest rate may also lead to lower inflationary expectations.

low capacity in planning and execution of projects and insecurity. As for private demand it is more likely that the security situation and the state of uncertainty, which resulted in lack of viable investment opportunities, have held back economic activity more than higher interest rate. Two categories of private demand have been at play. The first category includes that largely operating in cash-based economy. This category is hardly sensitive to interest rate changes. As for the second; mainly those keeping deposits in banks, it is true that interest rates were high enough for them to keep money there. It can be argued, however, that high bank deposits are mainly due to lack of viable investment opportunities (apart from speculating in real estates) as much as high interest rate.

Therefore, whereas the first and third causes, cited by the IMF for lower 'core' inflation, seem reasonable the influence of the monetary policy is in need of better evidence.²¹

(IV-3) Poverty, the ration system and population displacement

By 2003/2004 about 90-95 percent of Iraqis were receiving food rations; '*the rations provided around 1,904-2,000 calories per person a day*', Ministry of Planning and UNDP (2005, 63). This is close to the required minimum of 1,940-2,100 calories/person/day intake (which defines the poverty or hunger line), implying (with additional consumption) that by 2003/2004, population at or below poverty line in Iraq could have been around 5-10 percent. In September 2004, however, it was reported that 25 percent of Iraqi families were still highly dependent on the monthly food rations (public distribution system, PDS) and that poverty is closer to 11 percent and would potentially widen, (WFP and COSIT, 2004, 32).

Based on a survey conducted in July 2005, which covered 22,050 households (0.55 percent of all households) from 98 districts (qadha) all over Iraq, another WFP and COSIT report indicated rising trend in poverty. It emerged that 15.4 percent of Iraqis were *food insecure* (i.e. consuming *poor* or *borderline* intake of food), WFP and COSIT (2006, 61-63)²² and Appendix 2. This figure approximates the percentage of population living in extreme poverty (which is 15 percent, living below \$0.5 person/day, according to the same report, P. 2) in mid-2005; up from 11 percent in 2003/2004. The report also calculates what would happen if the ration system (PDS) is discontinued, i.e. if entitlement or access were denied. The report shows that if the PDS stops then the percentage of those pushed to levels of consumption at or below the borderline would rise sharply from 15.4 percent to 47 percent, (WFP and COSIT 2006, 61-63) corresponding to the possibility of rising poverty to 47 percent of all population. This scenario of possible discontinuation, narrowing down of the ration's contents, or limiting access to the PDS, points at the major cause of rising poverty that has developed since 2005.

COSIT is reported to have estimated that about 40 percent of Iraqis were living under income of one \$ a day²³, i.e. in poverty, by December 2007, (IMF,

²¹ After slowing down during the last quarter of 2007 and first quarter of 2008, core inflation has picked-up in April 2008 (Table 6), which was, however, almost exclusively caused by the rise in food prices (largely due to world food price rise); calculations on monthly price data from COSIT (2008a).

²² In WFP and COSIT's survey 'food insecure' and 'in poverty' are almost used interchangeably, (WFP and COSIT, 2006, 26).

²³ In poverty estimations, 'one\$/person' is measured in Purchasing Power Parity (PPP)'s rate of exchange, which is usually different from the official rate. See for instance, UNDP (2007, tables 3 and 4) and the UN's International Comparison Programme at

2008, 17), see also Appendix 2. This possible drastic change, since 2003/2004-2005, suggests that the ration system has deteriorated in coverage and contents, which in turn was the main reason for rising poverty incidence. Many households do not receive their rations regularly or not at all. This has already been reported for the internally displaced, ‘*Many displaced people do not register for rations*’, UNHCR (2007, 10). The number of internally displaced, IDPs, amounted to 2 million (plus another 2 million abroad) in March 2007 (UNHCR: 2007, 2), rising to 2.47 million in December 2007 and to 2.77 million in April 2008²⁴.

Dwindling access to the ration system and reduction of the ration’s contents, on the one hand, and population displacement, a result of sectarian infighting and insecurity, on the other, therefore, have resulted in sharp increase in poverty. With continuing high unemployment and displacement higher poverty would feed into more instability and violence. The preservation/rehabilitation of the contents of the ration system and access to it, therefore, has become an urgent matter.

(IV-4) Unemployment

Unemployment in Iraq had been high throughout the 1990s. This had motivated/forced continuous stream of movement abroad and emigration to other countries. After 2003 many factors contributed to push unemployment even higher, mainly:

1. Violence, internal and external displacement.
2. The low level of economic activity in general and public development expenditures, in particular.
3. The disbanding of the army.
4. Physical segmentation of national and provincial markets.

These very factors have also made it difficult to measure unemployment in such circumstances. That is why estimates vary widely. The delay in the holding of censuses for population and public employees has complicated the task further.

The survey by WFP and COSIT (2006), referred to above, came up with a figure for unemployment rate in the region of 47 percent of population (in the age bracket 16-60)²⁵ in 2005. This rate is derived by dividing all persons not working by those in the age group 16-60 years. The standard definition of unemployment, however, divides the number of those *seeking employment, at the going wage rate* (but are not employed) by *labour force* UNDP (2007, 371) and O’Higgins (1997)²⁶. Labour force is equal to the number of population in age group 16-60 minus

<http://www.worldbank.org/DATA/ICP>. It seems, however, that COSIT (and WFP and COSIT, 2006) had used the actual rather than the PPP rate of exchange.

²⁴ ‘it is estimated that over 2.77 million people are currently displaced inside the country. Of these, 1.2 million were displaced before 2006 and more than 1.5 million were displaced in 2006 and 2007. Most of the post-2006 IDPs come from Baghdad and Diyala. Less than 1 percent has been displaced in 2008. The large difference between the current and last IDP count on 31 December 2007 – an increase of around 300,000 individuals – is largely due to the improved entry of IDP data in the central Ministry of Displacement and Migration’s (MoDM) database’, UNHCR (2008).

²⁵ This rate is a weighted average of the unemployment rate of the head of the household (26 percent) and the unemployment rate of the other members of the household (58.6 percent) in an average household of 6.5 persons. The weights are 1 and 5.5, respectively.

²⁶ According to the ILO definition, “the unemployed are defined as those people who have not worked more than one hour during the short reference period but who are available for and actively seeking work”, O’Higgins (1997, 1).

housewives, students, pensioners and those who are not actively seeking employment. Using the data in this survey and other pieces of information, we corrected WFP and COSIT's figure to reach an employment rate, according to standard definition, of 25 percent in 2005 (Appendix 3). We think, however, that actual unemployment rate in 2005 could have been above this figure. The corrected figure is arrived at by using, inter alia, a participation rate, in the labour force, of 41 percent in 2005 (COSIT, 2007, Table 15/10). Compared to other countries this rate is low.²⁷ This is due to the fact that had it not for the security situation some of those considered out of the labour force (the not-actively-seeking-employment) would have entered the labour force; e.g. housewives and the older ages below 60.

In March 2007, UNHCR indicated that '*Fifty percent of the working population is unemployed*', (UNHCR, 2007, 1). UNHCR does not elaborate. Compared to mid 2005, however, unemployment must have increased to levels much higher than the 25 percent mentioned above. The waves of internal displacement in 2006 and 2007, referred to above, must have added to the reserve of the unemployed. In the light of this, UNHCR's figure for 2007 does not seem exaggerated.

(IV-5) Crude oil and oil laws

After reaching a high of 3.48 mbd in 1979 (OPEC, 2000), crude oil production and production capacity had undergone continuous decline. Production reached a low of 0.68 mbd during 1992-1996 (OPEC, 2000). After the Oil for Food Programme (OFFP) was implemented in 1997, oil production started to climb from 0.74 mbd in 1996 gradually to 2.81 mbd in 2000 before declining to 2.13 mbd in 2002. After 2003 and contrary to expectations production had dipped down below that of 2002. It only recovered to that level in the fourth quarter of 2007 as is shown in table (T-1).

Table (T-1) Crude Oil Production, mbd

	1998-2001	2002	2003 (H2)	2004	2005	2006	2007	2007 (Q4)	2008 (Q1)
Southern Fields			1.34	1.69	1.61	1.75	1.75	1.78	1.76
Northern Field			0.41	0.42	0.30	0.28	0.30	0.50	0.50
Total	2.58	2.13	1.75	2.11	1.91	2.03	2.05	2.28	2.26

Source: Ministry of Oil (2008), SIGIR (2008a, 109), Table (11).

Note: Figures from SIGIR (2008a) for 2004-2007 are modified downward to accord with figures in Table (11) and Ministry of Oil (2008).

Many factors contributed to this decline during 2003-2007, mainly the damage inflicted on oil fields by looting, terrorist attacks (largely on the pipelines transporting oil from the northern fields) and inability of the central government to initiate major development work especially in the south.

Since late 1970s, the Ministry of Oil was intent on raising production capacity from 3.5 mbd to 6-8 mbd. The programme was shelved after the outbreak of Iran-Iraq war and afterwards, only to be resurrected after 2003.

²⁷ In 2005/2006 average participation rates in the world were as follows: World 65.7%, Developed Economies 60.3%, East Asia, 74.8%, North Africa 50.7%, Middle East 56.2%, see ILO, *Participation in the world of work (KILM 1)*,

<http://www.ilo.org/public/english/employment/strat/kilm/download/kilm01.pdf>, Accessed 9 May 2008.

To meet outstanding obligations, on the one hand, and fund needed investment in a wide front of social, infrastructure and productive sectors, on the other, the expansion of oil production capacity and exports have become urgent. Resurrection of the national oil company is deemed to be an important means to realize this objective. Moreover, it is also considered necessary to draft and enact a set of oil laws to better regulate the industry. This was also shared by sponsors of aid and international organizations. It was even enshrined in such agreements as the *International Compact with Iraq* and the *Standby Arrangements* (see Appendix 1 and IMF, 2006, 2008).

A draft of Oil and Gas Law was prepared in February (Council of Ministers, 2007) and amended in July 2007 (Advisory Board of the State, 2007). The draft has not been passed by the Council of Representatives, yet. In April/May 2008, it was officially announced that February's version will be reverted to and would be submitted to the Council of Representatives instead of that of July (Iraqia TV channel interview with Al-Shahristani, Minister of Oil, 6 May 2008). The following, therefore, are comments on February's version with references made to that of July.

Since its publication in February 2007, the draft of the Oil and Gas Law was and is being subjected to wide economic and political comments. The economic and technical comments divide into three major lines, two of which stem from a premise that a resurrected national oil company is capable of rehabilitating and expanding production capacity to six or more million barrels daily, mbd, without the need for foreign production-sharing or concession agreements. Foreign assistance should be solicited, instead, in the form of service agreements or contracts:

1. Production-sharing or concession agreements, according to this view, would reduce the financial surplus available to Iraq from oil production/export because of unspecified income tax levied on net income, low royalty charged, inflated cost and/or faster depletion by the operators (Muttitt, 2005).
2. Present producing and developed oilfields are adequate for the increase in production capacity to the required levels. Further development or exploration in new fields would only increase production and hasten depletion unnecessarily. Furthermore, control would become harder, thus reducing the role of the government and undermines OPEC (Shafiq 2007, and Zainy 2008a, 2008b).
3. Other detailed comments on the articles and stipulations of the law (see Appendix 4).

The main tents of the first two views rest on the claim that a resurrected national oil company is capable of carrying out the needed rehabilitation and development in the next ten years. Moreover, due to low operating and investment costs, characteristic of the oil industry in Iraq and the near certainty of oil discoveries in new areas, financial requirements are not prohibitively large; the proponents of these views contend.

Supporters of these serious comments about the law, however, have not tackled adequately such fundamental issues as:

- a. Most studies and reports on which claims are made are now dated. They were largely carried out in 1970s and early 1980s; no recent study has been cited or made public.

- b. Technical and technological capabilities and know-how of most personnel in the industry had not, for long, been upgraded. Moreover, most of those who left the industry and the country had not been substituted for, adequately.
- c. Technological advances in the oil industry had not been implemented in Iraq for a long time.
- d. The industry's infrastructure had undergone continuing degradation/destruction/looting since the beginning of the 1980s; the conditions of which have not been satisfactorily surveyed and/or publicly made available.
- e. Financial requirements for rehabilitation and expansion of production capacity have not been contemplated in enough details to find out whether Iraq, with its current and future obligations, can afford the task without the help of international established companies.

It remains, therefore, a practical matter to decide whether to go it alone (by a resurrected national oil company assisted by foreign-service agreements or contracts). This can be done by showing the detailed requirements to rehabilitate and expand the production capacity of the industry and its infrastructure including: funding, staffing, infrastructure, technology and marketing. Only then it becomes possible to draw conclusions about the need for production sharing agreements or otherwise.

Concurrently, a parallel course can be followed:

1. Steps need to be taken to set up the national oil company,²⁸ which together with the Oil Ministry shall work for the rehabilitation and expansion of production capacity, assisted by service agreements with foreign oil companies.
2. The draft law of oil and gas can be revised along the following lines:
 - i. To specify the rates of income tax, other taxes, bonuses, etc. and royalty (which was set at 12.5 per cent of production, at export price, in July 2007's version of the draft) at levels not below those in the MENA region.
 - ii. To strengthen the coordinating and approval roles of the Federal Council of Oil and Gas versus the Oil Ministry and the regions in oil contracting.
 - iii. To strengthen the inspection capabilities and practices of the Ministry of Oil in order to effectively monitor and enforce implementation of sound standards by operators, concerning their technical and costing practices in their fields of operation.
 - iv. To make arbitration and dispute settlements the prerogative of the Iraqi judicial system.
 - v. Other possible revisions in line with observations in Appendix 4.

Complicating factors have heightened uncertainty in the oil industry since the publication of the (federal) Draft Law. First, the Kurdish region is reported to

²⁸ The draft Law of Oil and Gas stipulates the setting up of a national oil company and entrusting it (Article 6 in February's version of the Law, Article 13 in July's version) exclusively with the management, operation and investment in the presently producing (Annex 1 of the Draft Law) and discovered but not developed (Annex 2 of the Draft Law) areas.

have entered into oil agreements, since late 2005, without counseling the federal Ministry of Oil, thus contravening the Constitution (Article 109) and the Draft Law (Article 10, C in February's version; Article 18, Second in July's version). Secondly, the Oil and Gas Law of the Kurdistan Region (Law 22, 2007) which was passed in August/September 2007 by the Kurdistan parliament contains articles that could increase dispute with the federal authorities. As required by the federal constitution, Article 18 (Second) of the Kurdistan Law reads *'to cooperate with the Federal Government in formulating strategic policies to develop the petroleum resources of the Region'*. Other clauses of the Kurdistan law, however (mainly Article 2, Second and Article 24, First), effectively give the region the right to enter into oil agreements without seeking the approval of the federal government as obligated by the Constitution. Article 2 (Second) of the Kurdistan Law, for instant, reads, *'Pursuant to Article 115 and paragraphs (1) and (2) of Article 121 of the Federal Constitution, no federal legislation, and no agreement, contract, memorandum of understanding or other federal instrument that relates to Petroleum Operations shall have application except with the express agreement of the relevant authority of the Region'*.^{29 30}

Another law was drafted, 'Draft Law of Financial Resources' and approved by the Council of Ministers and the Presidency Office on June 20, 2007. Article 1 reads *'in accordance with the provisions of Article 61 (First) and Article 73 (Third) of the Constitution, ... to establish the Financial Resources Fund for collecting total federal financial resources'* and *'to verify fair distribution between Regions and Governorates not organized in a region in accordance with the Constitution'*. Financial resources include all revenues related to the production of oil and gas, international aids and grants as well as all federal revenues (Article 2). This law has not yet been passed by the Council of Representatives³¹. Furthermore, draft laws have been prepared for the reorganization of the Ministry of Oil and the resurrection of a national oil company in accordance with the stipulations of the Draft Law of Oil and Gas.

Continuing disputes over draft oil laws heighten uncertainty and could adversely affect the development of this vital sector.

²⁹ Articles 115 and 121 of the federal Constitution referred to in this quotation deal with the right of governorates to organize themselves in federal regions rather than to coordination between regions and the federal authorities. On the other hand, Article 24 (First) of the Kurdistan law reads *'The Minister [of oil in Kurdistan] may, after obtaining the approval of the Regional Council, conclude a Petroleum Contract for exploration and development in respect of a specified area, with a Person or a group of Persons...'*.

³⁰ The Kurdistan law is, in general, more lenient in its terms than the federal law. For instance, it specifies a 10% royalty (Article 37, First, 5); it allows high cost recovery percentage (45% of a portion of) production, (Article 37, First, 6) and offers possibility of exemption from taxation (Article 40, Second). It also stipulates that operators only pay regional taxes (Article 40, Third), see, Kurdistan Region – Iraq, Presidency of the Region (2007).

³¹ In December 2007 a law was passed and enacted (Law number 64, 2007), which allows the building of private refineries (owned totally by locals or foreigners). Each region has to coordinate on this matter with the Ministry of Oil. Moreover, the refiners get crude oil from the Ministry of Oil at international prices (at a discount of 1 percent).

(IV-6) Privatization

Following the formation of the CPA, privatization had figured out prominently within the context of Iraq becoming a market-oriented economy with most production and services owned and run by the private sector (section I-2 above). Many Iraqi politicians and economists concurred with the drive towards economic reforms and liberalization, one way or the other. Others disagreed. The looting and physical damage inflicted on many state-owned establishments (SOEs), after the fall of the regime in 2003, caused manufacturing production to fall way below its 2002 level, in all sub-sectors as referred to in section (IV-1).

The Iraqi Ministry of Industry and Minerals, MIM, has recently formulated a 'strategy' which includes a scheme to restart, reform and transfer the ownership of SOEs in the short term and at the same time formulate a long-term view of 'comprehensive policy framework for national industrial development led by private sector' (MIM, 2008, 1). To overcome administrative difficulties and lack of adequate staffing and expertise in the privatization section of the Ministry, MIM has started a programme to rehabilitate, operate and manage its SOEs in a *production-sharing-type* agreements with willing 'investors'. In these agreements *'the investor shall implement the activities to rehabilitate and modify the factory in accordance with modern technology as well as manage and operate the factory, all at the investor's account against share of accomplished production, for a defined period.'*, (MIM, 2008, 5)³². This is considered a necessary practical step on the way to full privatization. The list of state-owned establishments advertised for such possible agreements comprises 42 SOEs (including the plants of each establishment in different governorates) in the following industries:

Table (T-2) SOEs for Privatization

Industry	Number of Employees	Evaluation of Fixed Assets
	'000	US\$ Million
Engineering & Metal	42.4	44.6
Textiles and Cloths	29.9	4.1
Construction Industries	28.8	105.7
Chemicals and Petrochemicals	20.4	55.3
Food, Tobacco and Drugs	10.4	17.2
Industrial Services and Information	2.5	32.5
Total	131.4	259.5

Source: Aggregated from Table (10).

Total employment (on payroll list) in these establishments amounts to 131 thousand. Evaluation of fixed assets amounts to about \$260 million, as of January 2008. Six establishments (e.g., Southern Cement Co., State Industrial Co. for Design, Southern Fertilizer State Co, etc.) make about 74 percent of the total value of fixed assets (MIM, 2008, 6-104) of the 42 establishments.

It is not clear how could investors (locals or foreigners) be attracted to such agreements given the difficult security situation, segmented labour markets, and the dire conditions of many establishments. One obvious consequence of such agreements, if they materialize, is the laying off of workers which would add to the

³² It seems that this scheme does not stipulate the change of ownership or sharing in the existing value of fixed assets of the SOEs

already swollen number of unemployment. However, this may prove necessary, given that many of those establishments are either not fully operating or heavily subsidized. This step may help differentiate those establishments which are viable from those that better be liquidated. The process, however, may take long time. In more stable countries it took much longer than first anticipated, and still ongoing (Egypt, Brazil).

As for privatization in utilities, services, etc., the political and security situation seems not ready to sanction or commence it, for the time being.

(IV-7) WTO membership

Iraq applied for WTO membership and was accepted as an observer (in December 2004), a term usually used for a status during which time the applying country starts by providing the WTO Secretariat with details about its trade regime, then enters into bilateral/plurilateral/multilateral market access negotiations, undertakes sector-specific commitments (on services), etc.

‘Iraq submitted a memorandum on the foreign trade regime in September 2005, followed by replies to questions raised by members in November 2006. In 2007 and first quarter of 2008, it has provided members with a legislative action plan which shows the state of play of the ongoing legal reforms. Iraq also provided information on its sanitary and phytosanitary (SPS) measures, technical barriers to trade (TBT) and the trade-related aspects of intellectual property rights (TRIPS) as well as information on its domestic support and export subsidies in agriculture. Members requested more information on Iraq’s pricing policy, investment rules, import licenses, customs law, state-trading enterprises, regulations on tariffs, free zones and telecom licenses’, (http://www.wto.org/english/thewto_e/acc_e/a1_iraq_e.htm, Accessed 4 April 2008). The process of fact finding is still going on, and it seems would take some time before negotiations start.

Iraq’s accession to membership is still a subject of discussion between Iraqi economists and political groups. Two opposing views abound:

1. First view; for the foreseeable future, membership is not beneficial to Iraq, for the following reasons:
 - i. Iraq has only one important good for export, crude oil. Although technically within the domain of WTO rules (UNCTAD, 2000), unlike manufacturing or even other primary goods it does not face barriers in entering the markets of WTO members. In the present tight supply condition of crude oil in the international market, which is generally anticipated to prevail in the future, this may continue for a long time.
 - ii. Although the WTO rules are mainly trade-related and do not stipulate adoption of all market-based policies and institutions, political pressures (through the different levels of accession negotiations) and the threat to delay accession could force applying countries to contemplate wider opening and institutional changes than required by the WTO rules.
 - iii. Opening of Iraqi markets to outside competition would destroy what is an already non-competitive manufacturing, and to some extent services sectors.
 - iv. Such social policies as subsidies and subsidized staples (the pillar of the ration system) and energy will be the subject of pressure by other countries. For people long suffering from deprivation and need, such pressure would add to the already fragile social and political situation.

2. Second view; Iraq is in need to catch up with the world in polices, institutions and economic performance. Membership could contribute positively to this:
 - i. Being a rentier state dominated by a rentier culture, mainly dependence on the state and complacency in developing alternatives, Iraq would hardly carry out needed serious changes in policies and institutions without pressure.
 - ii. If Iraq stays outside the WTO, it will hardly be able to develop sustainable diversification lines (including manufacturing) in the same way as was possible, before; i.e. through import substitution industries and protected markets. Export-oriented activities (goods and services) need open markets. As 182 of the 192 countries of the world are either members (151) or on their way to join (31)³³, Iraq could not find adequate markets outside the WTO.
 - iii. Social assistance in the form of cash transfers are allowed in WTO rules. Moreover, compared to subsidies they are not as distortionary. The ration system can, however, continue until such times when economic progress and improvement in social conditions allow an alternative.
 - iv. It is possible to use developing countries arguments (mainly those advanced in the Doha round, but regrettably stalled later) to get exemptions and delays of implementation of some WTO rules for some time.

The weighing of advantages and disadvantages indicates that the main issue is not membership or otherwise, rather it is how to get into WTO with minimal adverse effects (economic and social). This can be achieved through a transparent, informed, democratic and continually evaluated process of membership accession carried out by capable teams of economists, lawyers and specialists in international law, technology, trade etc.

(IV-8) External Debt³⁴

The structure of Iraq's external debt can be classified as follows:

- (1) Official debt: debt obtained through guarantees by creditor countries:
 - Paris-Club (official) debt³⁵.
 - Other official debt
 - Gulf debt (Saudi Arabia, Kuwait, Qatar, UAE).
 - Non-Gulf debt³⁶.
- (2) Commercial debt; debt owed to private creditors, mainly credit for financing imports.
- (3) Multilateral debt (IMF and the like).

Before the Paris Club agreement in 2004 total debt was estimated (by the IMF) at about \$ 133 billion including debt to Paris Club of \$42.6 billion (Table T-3, below). Apart from the Gulf debt, all other types bear interest, which had accumulated a great deal since 1990. Accumulated interest seems to parallel the principal in size for non-Gulf debt. For instance, at the time of the Paris-Club agreement, capitalized (i.e. accumulated) interest made about 43 percent of Paris-Club's debt (Merza, 2007b).

³³ Nine of the 13 members of OPEC are members in WTO and 4 are on their way to join.

³⁴ This section draws on Merza (2007b) with updated figures and revised arguments.

³⁵ Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Korea, Russia, Spain, Sweden, Switzerland, UK, USA.

³⁶ Bulgaria, China, Czech Republic, Hungary, India, Jordan, Morocco, Poland, Romania, Serbia, South Africa, Turkey, and others.

Calls for external debt reduction arose right after the fall of the old regime. The calls stemmed from the following considerations:

- i. *The odious debt argument.* Many writers (e.g., Adams 2004, CISDL 2003) used the odious debt argument to demand the writing-off of most Iraq's outstanding debt, especially those held by public creditors. According to the '*international doctrine of odious debt ...debts not used in the public interest are not legally enforceable*', Adam (2004, 1). These writers contend that most of the debt incurred during the period 1980-2003 was used by the old regime to support wars, quelling legitimate uprisings or in persecuting opposition groups. Most of the creditors were aware of the regimes' practices. Therefore, the Iraqi people should not be accounted to repay such debt. Detractors, however, argue that some of the debt incurred was to finance ordinary imports that served the population in terms of food, medicine and other necessities; therefore, such debt need to be repaid back.
- ii. *The nature of the Gulf's debt;* an argument has been made that most of this debt was in fact grants. It has also been reported that in its memorandum to the UN Security Council in May 1991, about the size of Iraq's external debt, the government of Iraq indicated that most of what is considered debt owed to the Gulf countries was grants rather than loans (Jiyad, 2001).
- iii. The imposition of war reparations (compensations), themselves consequences of the regime's adventures, makes the burden of debt even harder.
- iv. With long years in war, destructions and UN sanctions the infrastructure and even the social fabric have deteriorated to a point that expected resources will not be enough to sustain the pre 2003 standards of living, let alone those of the 1980s, Merza (2004, 2007a).

Bolstered by these considerations and an assessment, by the United Nations and World Bank, of Iraq's financial requirements for reconstruction (UN/World Bank, 2003), the Interim Government of Iraq demanded, in September 2004, the writing off of almost all Iraq's debt, '*Iraq will need substantial debt reduction (in the neighborhood of 90% to 95%) to reach external and fiscal viability*', (IMF 2004). The creditors found it expedient, however, to call for the majority of debt to be forgiven, *but only subject to conditions and performance benchmarks to be fulfilled or met by the Iraq government.* This was included in the Paris Club agreement: '*On November 21, 2004, the Paris Club agreed to a reduction of Iraq's outstanding debt ... in three stages: 30 percent debt reduction upon the signing of the agreement, combined with interest deferral on the outstanding balance; 30 percent additional debt reduction upon approval of an upper credit tranche arrangement with the IMF (end-2005), and a further 20 percent debt reduction following completion of the IMF's Executive Board's final review of three years of one (or more) upper credit tranche arrangement(s). The agreement also entails a rescheduling of the remaining debt stock with repayments of the debt stock starting in July 2011 and ending in January 2038...*', IMF (2005, 50). It was hoped that this scheme would apply not only to Paris-Club debt but to all official non-Paris Club and commercial debt.

Although optimistic statements are plentiful, including a reported official agreement to reschedule the Russian debt of \$11.7 billion (in April 2008), as of June 2008 the initial hopes that debt would be reduced by 80 percent (more precisely, 60

percent during 2004-2007) across the board have not materialized in full, yet. With the reported Russian consent of debt reduction, all Paris Club members seem to be committed to the 80 percent reduction (by end-2008). Saudi Arabia, China and Kuwait have reportedly agreed to 80 percent reduction, but no concrete agreements have materialized yet.

Commercial debt reduction had been carried out relatively smoothly (Allawi, 2007). About US\$18.4 billion was exchanged for cash payments (\$0.38 billion) and national bonds (\$2.88 billion) implying an 82.3 percent reduction. The agreement was negotiated directly between the Iraqi Ministry of Finance and the creditors and finalized in April 2006. By July 2006, the exchanged debt increased from \$18.4 to \$19.7 billion, Merza (2007b). By May 2008, further settlements of some commercial debt are still pending (http://www.eyidro.com/User_Add.asp, Accessed 15 June 2008).

In sum, in addition to outstanding unpaid war reparations of about \$29 billion (<http://www2.unog.ch/uncc/status.htm>, Accessed 15 May 2008), outstanding external debt at the end of 2007 stood at about \$101 billion; i.e. total obligations of \$130 billion. At the end of 2008 and after the 20% reduction in (original) Paris-Club (including Russian) debt, outstanding debt would be somewhere between \$36 billion and \$89 billion, depending on how would non-Paris Club official creditors carry out their promises of reduction (Table T-3 below). Outstanding unpaid war reparations, at the end of 2008, would stand at \$25- \$26 billion (after paying about \$3.5 billion in reparations in 2008).

Table (T-3) Iraq: External Debt, \$ Billion

	Outstanding Debt before Reduction 2004	Two-Stage Paris-Club Reduction for Paris Club (excluding Russia) Plus Private Debt Actual Settlements			2008, Projection	
		2004	2005	2007	Only Paris-Club Reduction	Across the board Paris-Club-Type Reduction
Paris Club official creditors	42.6	33.0	25.5	27.0	13.0	13.0
Non-Paris Club official creditors	68.8	68.8	68.8	70.0	70.7	17.4
<i>Saudi Arabia</i>	39.2	39.2	39.2	39.2	39.2	7.8
<i>Kuwait, UAE and Qatar</i>	10.7	10.7	10.7	10.7	10.7	2.1
<i>China</i>	8.0	8.0	8.4	8.9	9.2	2.8
<i>Others</i>	10.8	10.8	10.4	11.0	11.4	4.6
Private creditors	20.7	20.7	19.5	3.0	3.1	3.1
Multilateral creditors and others	0.9	1.2	1.8	1.4	2.3	2.3
Total Outstanding Debt	133.0	123.7	115.6	101.4	88.9	35.8

Source: An update of *Estimate 1* in table (T2) in Merza (2007b) using revised figures for 2004 and 2007 and Multilateral debt in 2008 in IMF (2008, 41).

(IV-9) Corruption

Corruption has grown in Iraq noticeably; mainly in the public sector and related activities. In Transparency International's *Corruption Perception Index*, Iraq's rating has consistently declined from 2.2 (out of 10) in 2003 to 1.9 in 2006 and 2007. Corruption can be identified in four major areas; crude oil and oil products, public contracts, public trading organizations and government services and employment.

(IV-9-1) Crude oil and oil products

A report by the ministry of oil (IGO, 2006) identified seven ways or channels in smuggling and profiteering from oil in 2005; five for oil products and two for crude oil:

- i. Theft of crude and fuel oil from pipes and storages.
- ii. Overloading of crude and fuel oil in loading terminals (absence of metering and/or ineffective monitoring).
- iii. Supplying incomplete imports of oil products.
- iv. Smuggling oil products to neighbouring countries.
- v. Diverting oil products (from public entities) to the open/parallel market.

The report estimates the value of smuggled/leaked oil products for three channels, out of which we estimate a 'rent' for smugglers in the order of \$1.43 billion. We further estimate that weakness in metering might have led to smuggling of about 90 mbd of crude oil (\$1.61 billion for the whole of 2005). Together with an estimate of \$0.51 billion of imported oil products usurped before entering Iraq, then a total of about \$3.55 billion could have been the rent generated to smugglers and profiteers (from 5 out of 7-channel smuggling/profiteering) in 2005, Merza (2007a).

The raising of domestic prices of oil products in June 2007 has reduced smuggling of oil products to neighbouring countries (IGO, 2008, 18). A programme to install metering systems during 2007-2009 would contribute to more effective monitoring³⁷. Furthermore, the latest military campaign in Basrah seems to have an effect in checking smuggling activities. Its longer term result is yet to be seen, depending on how effective that campaign and its follow up would combat and eliminate gangs and vested interests involved in smuggling and illegal trading of crude oil and products. A stronger role for the central government in monitoring and controlling production of crude oil and oil product is a prerequisite to stop the squandering of this vital resource.

(IV-9-2) Public contracts

Non-competitive cost-plus contracting, involving the pre-selection of single, usually foreign, contractor was prevalent in 2003/2004 (IAMB, 2005). This has led to overpricing and waste. In general, corruption in this field also shows in commissions paid to public servants, inflated prices and fictitious contracts. A number of high ranking officials were indicted for corruption by the Iraqi Transparency Commission. Provincial corruption has been growing in this area to parallel that in the centre.

(IV-9-3) Public trading organizations³⁸

The government imports and distributes food, medicine and arms in large quantities and values. Quantities have been leaking to the open/parallel markets, usually performed and managed by organized crime and gangs.

³⁷ The Ministry of Oil has started to install metering systems in 2007, to be completed in 2009. However, 'the new meters are still not being used for custody transfer...The South Oil Company, SOC must operate and maintain the meters according to [international] standards before customers will agree to use them for custody transfer', SIGIR (2008b, 117). In a Council of Representatives' hearing on June 7, 2008, the Oil Minister had indicated that in Basrah's loading terminals of crude oil the metering system is internationally certified and already fully operative.

³⁸ Paragraphs (IV-9-3)-(IV-9-4) draw on material in, Iraq Centre for Research and Studies (2008) *Problem of Transparency in Iraq*, March, A Mimeograph, Beirut, Lebanon.

(IV-9-4) Government services and employment

Public administration has become fraught with corruption. An environment has prevailed in which government services and even appointments in public service are provided in return for kickbacks and pre-agreed payments.

Implemented measures are so far proving ineffective to stall the growing domain of corruption.

V. Conclusions

- i. Policies within the *International Compact with Iraq* and the *Standby Arrangements* have formed the 'policy set' or 'economic programme' of the government for the period 2004-2008 and will continue through to 2012.
- ii. Implementation of the 'policy set' indicates reasonable record especially in legislation and institutional changes in monetary, trade, fiscal policies and data collection and classification. This would be beneficial in facilitating investment and economic activity once security is maintained and reconstruction gets underway. Other elements, mainly those related to oil, resources sharing, corruption, governance, political reconciliation and administration, are still in need of further invigoration.
- iii. The record on such vital social and economic trends as economic growth, inflation, employment, poverty, corruption, oil sector development, is not encouraging. First there is no clear influence of policy tools on outcomes concerning these variables. Second, apart from low level of economic activity, serious economic growth and employment have neither been activated through public investment nor taken-up seriously by vigorous private initiatives.
- iv. Low performance in wide ranging issues tackled in this paper can be attributed to instability, violence, political wrangling, weakness of central authority, and slow process of decision-making on the part of political parties. The public administrative structure has undergone continuous degradation, the result of political favouritism and corruption. Together with insurgency and terrorist attacks these factors have entwined to delay the implementation and effectiveness of economic policies. Furthermore, they are impeding the monitoring, follow-up and evaluation of these policies.
- v. Although most price subsidies are economically distortionary and lead to resource misallocation, the ration system should be preserved for its vital importance for social peace and combating poverty. In the insecure environment of today rehabilitating the system and insuring access (including for the internally displaced) is of paramount importance. The ration system should continue until such time when security were fully restored and economic activity increased; only then, other forms of safety nets to be contemplated.
- vi. The present scale of corruption could seriously threaten the development process and effectiveness of public administration. Therefore, in addition to military campaigns against organized crime and armed gangs and other measures, the Transparency Commission needs to be strengthened and protected against administrative and political influence.
- vii. The exodus of professionals abroad, is constraining the ability of the administrative/education/health system and the economy to carry on with required policy changes and revived economic development.

- viii. Signs of political reconciliation and lower violence in the second half of 2008, however, could contribute to more stability. Political agreements and social peace, it seems, can provide a starting point to initiate organizational and economic revival that has long been overdue, to fight corruption and start sustainable development processes.
- ix. Allocations for investment in 2008's budget (ID 16.0 trillion; SIGIR, 2008a, 18) exceed those in 2007 (12.7 trillion). Indications suggest that spending and execution would be higher³⁹. Given a more stable situation, this would help fuel economic activity and increase employment, therefore dampens one important cause of violence.
- x. Kurdistan is still outside the domain of official data collection and compilation in national accounting, price statistics and monetary surveys. Inclusion of Kurdistan region in data reporting on all levels, therefore, remains a task that would take a sovereign proportion (for the unity of the country).

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³⁹ For instance, in a Counsel of Representatives' hearing on June 7, 2008, the Oil Minister mentioned that the Ministry has already spent 49 percent (more than \$1 billion) of its investment budget allocations for 2008.

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Tables

Tables in the text, mainly summary tables, are numbered with an attached letter T, e.g. (T-then the number of the table). In the detailed tables that follow (1 to 11) they are labeled with numbers only. In appendices 1 and 2, tables are numbered with an attached letter A, e.g. (A-then the number of the table).

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Table (1)

Summary of Economic Policy Programme (*Macro Policies According to Type*)

Fiscal Policy and Related Issues	Monetary and Exchange Rate Policy	Banking Sector Reform	Trade Policies and External Debt
Align Public Financial Management and procurement system with sound international practice.	Implementation of payment system regulations.	Promote public savings and investment and to create an environment for investment and growth the Government shall continue its effort at reforming the financial sector:	Reintegrate Iraq into the regional and global economy and deepen international cooperation on the basis of mutual benefit and common interest:
Operationalize and enhanced planning, monitoring and evaluation framework.	Commencement of operation of Real Time Gross Settlement system (RTGS) linking headquarters of commercial banks to the Central Bank, CBI.		
Establish a credible, integrated and comprehensive budget that delivers reliable and predictable resources to budget holders.		1. Undertake specific measure to restructuring state-owned banks.	1. Conclude negotiations on outstanding debts and reparations.
Develop a framework for intergovernmental fiscal relations to ensure efficiency, transparency and equity while maintaining national fiscal integrity.	Full capitalization of CBI to the stipulated ID 100 billion, based on the 2005 audited financial statements and taking into account the restructuring of outstanding claims on the central government that are on the December 31, 2005 balance sheet of the CBI.	2. Undertake specific measures to promote private banking.	2. Ratify signed agreements and treaties, undertake specific measures including legislation to implement ratified treaties. Negotiate and sign new ones.
<i>Subsidies</i> : the Government shall work to phase out inefficient and inequitable universal subsidy programs while ensuring the protection of the vulnerable: (1) Eliminate direct budget subsidies on fuel products by Prior Action: nationwide increase of official domestic price of petroleum products, (2) Streamline the social safety net. In addition to enhanced monitoring and improved procurement procedures, limiting the rations in the <i>Public Distribution System</i> , and to further limit eligibility of well-off families.			
Promulgation of a hydrocarbon law and improved oil and gas investment project execution.	Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.		
Establish and implement a petroleum revenue-sharing framework.			

Poverty	Employment	Public and Private Sector	Corruption
Reduce the number of families living under US\$ 0.50/day/individual by one third.	Build human capital necessary to sustain growth. Reduce unemployment by one half and double labor force participation for women:	Create an enabling environment for private investment and job creation:	Establish and implement mechanisms to ensure transparency of petroleum sector flows.
Protect the poor and vulnerable groups from the fallout of change and reintegrate them into society, community, and economy. Address the needs of the internally displaced, IDPs, refugees and returnees while also enabling them to realize their potential as contributing members of the economic community:	1. Undertake specific measures to promote continuous education for competitive skills and equal opportunities in the labour market.	1. Undertake specific measures to design and implement private sector development policies.	Develop a legal framework and build institutional capacity to deter corruption at all levels of government:
1. Undertake specific measure to strengthen the targeted safety net.	2. Undertake specific measures to strengthen social partners' role in expanding employment.	2. Remove key Private sector development constraints.	1. Implement specific measures to strengthen the judiciary.
2. Strengthen financial viability of the pension system.			2. Adopt and implement legislation, regulations and procedures and strengthening legal and institutional framework for anti-corruption.
3. Design and implement a reform strategy for the pension system.	3. Enact and implement legislation to encourage job creation while protecting livelihoods of the labour force, particularly vulnerable groups.		3. Begin recovering ill gotten assets.
4. Undertake specific measures to promote social inclusion of the internally displaced persons, IDPs, refugees, returnees and other vulnerable groups.			4. Carry out public awareness campaigns on anticorruption.

Sources: Summarized and reclassified from Table (A1-1) in Appendix 1 and IMF (2006, 2008).

Table (2)**Implementation of Economic Policies, Timeline 2005-2008**

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20-Jun-08

Implemented: 2003-2007	To-be implemented: 2008 -
(1) All <i>quantitative performance criteria</i> under the IMF's Standby Agreement, SBA, (see Table A1-1 in Appendix 1) through June 2007 were met, but one structural performance criterion remains (census of public service employees).	(1) To further reduce fuel shortages, including by supporting private sector fuel imports.
(2) Installation of a metering system in the Basra oil-export terminal was fulfilled.	(2) The government is committed to ensure that the <i>Committee of Financial Experts</i> , will fully take over the tasks of the <i>International Auditing and Monitoring Board</i> , IAMB, as an audit oversight body for the DFI.
(3) Progress has been made with <i>structural reforms, in SBA</i> (see Table A1-1 in Appendix 1), despite the lack of security and capacity constraints:	(3) To accelerate structural fiscal reforms, notably in public financial management, mainly:
	(i) To step up efforts to develop, with Fund technical assistance, a realistic action plan to modernize public financial management, <i>Financial Management Information System</i> , FMIS.
(i) Prices of domestic fuel products were increased significantly and direct budgetary subsidies were eliminated in 2007.	(ii) To streamline the tax system in order to broaden the tax base and improve incentives for economic activity.
	(iii) Steps to streamline the social safety net. In addition to enhanced monitoring and improved procurement, the authorities are considering to limit the rations in the PDS, to further limit eligibility of the well-off and expand the coverage of the new cash-based Social Safety Net. (iv) To carry out census of public service employees.
(ii) Legislation and administrative regulations were enacted to allow importation of fuel products by the private sector, which has begun in 2007, including in the south.	(4) To significantly strengthen financial intermediation in Iraq, it is crucial to:
(iii) Amendments to the new pension law were passed by the Council of Representatives in October 2007.	(i) Move ahead with developing and implementing restructuring programs for Rafidain and Rasheed banks, based on the results of their audits.
	(ii) The government to adhere to its commitment to refrain from providing government guarantees on bank loans.
(iv) As part of its efforts to modernize public financial management, the government has brought the chart of accounts and budget classification in line with the IMF's <i>Government Finance Statistics Manual</i> , GFSM 2001, within a cash accounting framework.	(iii) Efforts to strengthen banking supervision and expand coverage of the payment system should be stepped up.
(v) The CBI has begun to address weaknesses in its accounting and reporting framework.	(iv) The CBI should continue to strengthen its accounting, auditing, and reporting systems.
(vi) The payment system is being modernized, and an up-to-date real-time gross settlement system and an automatic clearing house are operational.	(5) To push ahead with reforms in the oil sector, notably in light of the need to strengthen governance and fight corruption:
	(i) To expand metering to all upstream and downstream oil sector activities as soon as possible.
	(ii) To develop a periodic price adjustment mechanism to allow prices to change in line with costs.
(vii) Preparations for the restructuring of the two largest state-owned banks (Rafidain and Rasheed) are underway.	(iii) To establish a new legislative framework for the hydrocarbon sector.
(4) Bilateral agreements have been signed with all Paris Club creditors, except Russia. Progress has been much slower with non-Paris Club creditors, where Iraq has announced agreements with ten creditor countries.	(6) External Debt:
	(i) To conclude debt agreements with the remaining private creditors.
(5) Data provision is improving, but weaknesses remain.	(ii) Debt issues relating to non-Paris Club creditors and Russia still not resolved.
	(7) Further improve the accuracy, coverage, and timeliness of:
	(i) Macroeconomic statistics, notably of data on the real sector.
	(ii) Public finance, and the balance of payments.
	(iii) To update the weights of the CPI.
	(iv) Continue efforts to extend the coverage of statistics to the Kurdish region.

Sources: IMF(2006, 2008), and Table A1-1 in Appendix 1.

Note: This table does not include the complete set of implemented or to be implemented policies.

Table (3) Iraq: GDP by Sectors

Iraq\ACIS_16_17July_2008_\11Tables.xls

	GDP at 1988 Prices, Million I.D.								Rates of Growth, %							
	2000	2001	2002	2003	2004	2005	2006 Actual/Pro jection	2007 Actual/Pro jection	2001	2002	2003	2004	2005	2006	2007	2002- 2006
Agriculture, Forestry, Hunting & Fishery	4,589	4,644	5,433	3,850	3,785	4,320	4,337		1.2	17.0	-29.1	-1.7	14.1	0.4		-5.5
Mining and Quarrying	25,900	25,701	22,123	13,930	19,057	17,967	19,078		-0.8	-13.9	-37.0	36.8	-5.7	6.2		-3.6
<i>Crude oil</i>	25,878	25,676	22,099	13,917	19,035	17,942	19,053	19,253	-0.8	-13.9	-37.0	36.8	-5.7	6.2	1.1	-3.6
<i>Other Kinds of mining</i>	23	25	24	13	22	25	25		10.1	-4.4	-46.0	72.1	13.5	0.0		1.3
Manufacturing Industry	1,748	1,909	1,740	1,244	895	956	1,056	1,043	9.2	-8.9	-28.5	-28.0	6.8	10.5	-1.3	-11.7
Electricity and Water	378	435	504	200	424	451	392		15.1	16.0	-60.3	111.8	6.4	-13.2		-6.1
Building and Construction	433	887	1,078	258	494	1,187	247		104.9	21.5	-76.0	91.2	140.2	-79.2		-30.8
Transport, communication & storage	2,427	2,277	2,368	1,260	1,602	1,812	1,946		-6.2	4.0	-46.8	27.2	13.1	7.4		-4.8
Wholesale and Retail Trade, Hotels & others	1,770	2,309	1,862	1,056	1,334	1,295	1,397		30.4	-19.4	-43.3	26.3	-2.9	7.9		-6.9
Finance, insurance, real estate and business services	1,116	1,154	1,189	1,120	1,201	1,259	1,348		3.4	3.0	-5.8	7.3	4.8	7.1		3.2
<i>Banking and insurance</i>	170	180	187	89	140	167	115		6.2	3.6	-52.5	57.8	19.2	-31.3		-11.5
<i>Ownership of dwellings</i>	946	974	1,002	1,031	1,061	1,092	1,233		2.9	2.9	2.9	2.9	2.9	12.9		5.3
Social and personal services	4,144	4,176	4,209	4,242	4,501	5,149	7,123		0.8	0.8	0.8	6.1	14.4	38.4		
<i>Social services</i>	3,822	3,845	3,868	3,891	4,140	4,777			0.6	0.6	0.6	6.4	15.4			
<i>Personal service</i>	322	331	341	351	361	371			2.9	2.9	2.9	2.9	2.9			
Total activities	42,506	43,492	40,506	27,161	33,293	34,396	36,924	37,099	2.3	-6.9	-32.9	22.6	3.3	7.4	0.5	-2.3
<i>Oil</i>	25,878	25,676	22,099	13,917	19,035	17,942	19,053	19,253	-0.8	-13.9	-37.0	36.8	-5.7	6.2	1.1	-3.6
<i>Non Oil</i>	16,628	17,816	18,407	13,244	14,259	16,454	17,846	17,846	7.1	3.3	-28.0	7.7	15.4	8.5	0.0	-0.8
Less imputed banks service charges	148	157	161	170	108	128	171	163	6.2	2.4	6.0	-36.8	19.2	33.0	-4.4	1.5
Gross domestic product at factor cost	42,358	43,335	40,345	26,990	33,186	34,268	36,754	36,936	2.3	-6.9	-33.1	23.0	3.3	7.3	0.5	-2.3

Sources:

2001-2005: COSIT (2007).

2006-2007: growth of value added in crude oil : growth of quantity produced (Table 11) used as approximation for value added growth in constant prices.

Non-Oil Growth:

2006: Based on the first half of the year, actual figures in current prices (COSIT, 2007) and Tables (4) - (5).

2007: Table (4) and a rate of growth for non-oil sector of 0% from IMF (2008, 27).

Table (4) Index Numbers of Production Quantity in Manufacturing**1988=100**

Iraq\IACIS_16_17July_2008_11Tables.xls

	Foodstuffs	Tobacco and Beverages	Textiles and Shoes	Wood & Paper	Oil & Chemical Industries	Non - Metallic Industries	Basic Metallic Industries	General Index
<i>Weight</i>	81	172	137	55	338	112	105	1000
2001	88.9	37.5	77.6	104.2	88.5	46.4	69.7	72.4
2002	83.9	33.1	71.6	96.9	82.2	35.1	65.5	66.2
2003	80.1	17.3	55.6	27.6	65.2	38.3	8.8	45.9
2004	99.9	2.6	142.1	5.1	16.5	20.5	3.8	36.6
2005	97.7	9.8	78.5	6.2	28.1	50.4	3.0	36.2
2006	101.1	13.6	68.8	11.0	31.8	70.7	6.9	40.0
Q2 2007	95.2	14.6	71.0	17.6	28.0	58.5	4.2	37.4
Q3 2007	102.7	14.9	71.7	17.4	30.1	59.7	4.4	39.0
Annual Rates of Growth, %								
2001	51.7	16.1	26.0	9.2	1.4	-16.5	17.5	9.4
2002	-5.6	-11.7	-7.7	-7.0	-7.1	-24.4	-6.0	-8.6
2003	-4.5	-47.7	-22.3	-71.5	-20.7	9.1	-86.6	-30.8
2004	24.7	-85.0	155.6	-81.5	-74.7	-46.5	-56.8	-20.3
2005	-2.2	276.9	-44.8	21.6	70.3	145.9	-21.1	-1.1
2006	3.5	38.8	-12.4	77.4	13.2	40.3	130.0	10.5
Q₂2006-Q₂2007	-5.8	7.4	3.2	60.0	-11.9	-17.3	-39.1	-6.4
2001-2002	-5.6	-11.7	-7.7	-7.0	-7.1	-24.4	-6.0	-8.6
2002-2006	4.8	-19.9	-1.0	-42.0	-21.1	19.1	-43.0	-11.9

Source: COSIT (2008b).

Table (5) Index Numbers of Production Quantity in Agriculture**1988=100**

	Plant Production	Livestock Production	Fisheries	General Index
2001	145.5	100.8	86.9	133.5
2002	181.6	115.8	151.9	165.5
2003	136.1	105.3	71.9	127.2
2004	129.1	109.6	61.5	122.8
2005	141.5	95.9	116.0	130.1
2006	139.6	95.8	180.2	130.6
Annual Rates of Growth, %				
2002	24.8	14.9	74.8	24.0
2003	-25.1	-9.1	-52.7	-23.1
2004	-5.1	4.1	-14.5	-3.5
2005	9.6	-12.5	88.6	5.9
2006	-1.3	-0.1	55.3	0.4
2001-2002	24.8	14.9	74.8	24.0
2002-2006	-6.4	-4.6	4.4	-5.7

Source: COSIT, Annual Statistics Bulletin 2005-2006,

http://www.iraqcosit.org/pdf/2008/consumer_agr1.pdf

Accessed 27 May 2008.

Table (6) Inflation and Market Rate of Exchange

Iraq\IACIS_16_17July_2008_11Tables.xls

	Consumer Price Index				Rate of Exchange	
	Average of all items		Excluding Fuel, Light and Transport		Iraqi Dinars for one US\$	Annual Rate of Change, %
	1993=100	Annual Rate of Change, %	1993=100	Annual Rate of Change, %		
1994	549	448.5	549		458	518.9
1995	2673	387.3	2695	391.2	1674	265.5
1996	2242	-16.1	2221	-17.6	1170	-30.1
1997	2759	23.1	2701	21.6	1471	25.7
1998	3167	14.8	3090	14.4	1620	10.1
1999	3565	12.6	3370	9.0	1972	21.7
2000	3743	5.0	3553	5.4	1930	-2.1
2001	4355	16.4	4202	18.2	1929	-0.1
2002	5219	19.8	5134	22.2	1957	1.5
2003	7174	37.5	6277	22.3	1936	-1.1
2004	8816	22.9	8378	33.5	1453	-24.9
2005	12074	37.0	10959	30.8	1469	1.1
2006	17820	47.6	14139	29.0	1467	-0.1
2007	24256	36.1	16959	20.0	1253	-14.6
2008						
Jan	24,980	1.3	18,492	10.8	1,214	-0.2
Feb	24,841	8.1	18,773	13.8	1,210	-0.3
March	24,577	5.6	18,993	12.1	1,208	-0.2
April	25,028	5.5	19,799	15.9	1,203	-0.4
May					1,200	-0.3
1994-1997		71.3		70.1		47.5
1997-2002		13.6		13.7		5.9
2002-2007		36.0		27.0		-8.5
Jun 07-Apr0 8		-0.1		21.0		-5.0

Sources:

COSIT (2007, 2008a).

Central Bank of Iraq, CBI (2004, 2007).

IMF, IFS (2008).

Note: for June 2007-April 2008 the rate of change is annualized.

Table (7) Consumer Price Index: Fuel and other constituents

Iraq\IACIS_16_17July_2008_11Tables.xls

21-Jun-08

	<i>Food stuffs</i>	<i>Fuel and light</i>	<i>Rent</i>	<i>Other Items</i>	General Price index	Non-fuel-transport Price Index
<i>Weights</i>	63.2	2.1	11.5	23.2	100	
June 2006	6,978	125,906	65,886	10,873	17,154	14,200
June 2007	7,994	363,207	80,615	13,347	25,046	16,894
April 2008	9,765	241,607	93,522	13,051	25,028	19,799
Monthly Rate of Change, %						
<i>June 2006- June 2007</i>	1.1	9.2	1.7	1.7	3.2	1.5
<i>June 2007- April 2008</i>	2.0	-4.0	1.5	-0.2	0.0	1.6
Annual Rate of Change, %						
<i>June 2006- June 2007</i>	14.5	188.5	22.4	22.8	46.0	19.0
<i>June 2007- April 2008</i>	27.1	-38.7	19.5	-2.7	-0.1	21.0

Sources, COSIT (2007, 2008a).

Note: for June 2007-April 2008 the rate of change is annualized.

Official Fuel Prices

	LPG, ID for 12 kg, the rest ID for a Liter.				Price Index
	<i>LPG</i>	<i>Regular Gasoline</i>	<i>Kerosene</i>	<i>Diesel</i>	
<i>June 2006 Weights</i>	2	89	5	4	
June 2006	1,000	175	75	125	100
June 2007	3,000	400	150	400	233
April 2008	3,000	400	150	400	233
Monthly Rate of Change, %					
<i>June 2006- June 2007</i>	9.6	7.1	5.9	10.2	7.3
<i>June 2007- April 2008</i>	0.0	0.0	0.0	0.0	
Annual Rate of Change, %					
<i>June 2006- June 2007</i>	200.0	128.6	100.0	220.0	132.6
<i>June 2007- April 2008</i>	0.0	0.0	0.0	0.0	0.0

Sources:

June 2006-June 2007 , IMF (2008, 35)

April 2008 , no change had taken place on official prices between June 2007 and April 2008.

Note: The price index of the four products in this table is the average of the price **indices** (each formed by dividing the price of a product by its price in June 2006) of the four products weighted by the shares of these products in the fuel budget of average household in June 2006. Shares are calculated from the 'official' line in the panel titled 'Average household's monthly spending on fuel products, June 2006 ', in Table (8). The individual price indices of the four products are not shown in the above table.

Table (8) Average Monthly Fuel Consumption

Iraq/IACIS_16_17July_2008_11Tables.xls

	Gasoline	Diesel	Kerosene	LPG	
Quantities consumed monthly by average household, 2005					
	Liter	Liter	Liter	12kg-Cylinder	
Official	107.4	7.4	13.1	0.4	
Open/Parallel	31.5	4.3	12.6	2.2	
Total	138.9	11.7	25.7	2.6	
Quantity share in average household's consumption , %					
Official	77.3	63.2	51	14.9	
Open/Parallel	22.7	36.8	49	85.1	
Total	100.0	100.0	100.0	100.0	
Prices, ID Per :					
	ID/Liter	ID/Liter	ID/Liter	ID/12kg-cylinder	
Official Price in June 2006	175	125	75	1000	
Official Price in June 2007 (considered to be the minimum open/parallel price in June 2006)	400	400	150	3000	
Average household's monthly spending on fuel products, June 2006, 1000 ID					Total
Official	18.8	0.9	1.0	0.4	21.1
Open/Parallel	12.6	1.7	1.9	6.6	22.8
Total	31.4	2.6	2.9	7.0	43.9
Value shares (minimum for the open/parallel) in average household's budget, June 2006, %					Average
Official	59.9	35.0	34.2	5.7	48.1
Open/Parallel	40.1	65.0	65.8	94.3	51.9
Total	100.0	100.0	100.0	100.0	100.0

Sources: calculated on the basis of figures from: COSIT (2007), section on *Living Conditions Survey 2005*, and IMF (2008, 35).

Table (9) Fuel Price Indices of Open/parallel, Official and Average Markets between June 2006 and April 2008

Iraq/IACIS_16_17July_2008_11Tables.xls

21-Jun-08

	Shares (weights)	1993=100	June 2006 = 100	Rate of Change %
Jun 2006				
Fuel and Light Price Index	100.0	125,906	100	
Price Index in Official Market	48.1		100	
Price Index in Open/Parallel Market	51.9		100	
Jun 2007				
Fuel and Light Price Index		363,207	288	188
Price Index in Official Market			233	133
Price Index in Open/Parallel Market			340	240
April 2008				
Fuel and Light Price Index		241,607	192	-33
Price Index in Official Market			233	0
Price Index in Open/Parallel Market			154	-55

Notes:

(I) Rates of change are for the period shown, i.e. annual: June 06-June07 and for ten months: June 07-Apr 08.

(II) Figures in this table are calculated as follows:

1. The figures of the Fuel & Light index are taken from COSIT, <http://www.iraqcosit.org/pdf/2008/consumer6.pdf>, Accessed 22 May 2008, 1993=100.

2. The basis is then changed from 1993 to June 2006, i.e. June 2006=100.

3. In order to construct two indices one for the official market and the other for open/parallel market the Fuel and Light index P_t is assumed to be a weighted average of these two indices, P_{1t} and P_{2t} , respectively. The weights are the shares of the official (β_1) and open/parallel (β_2) markets in the consumer budget, respectively, i.e.:

$$P_t = \beta_1 P_{1t} + \beta_2 P_{2t}$$

4. Starting from 100 in 2006, the rate of change of official price index between June 2006 and June 2007 is calculated as the change in the average official price of the four fuel products consumed by average household from the official market (in Table 8) between these dates, see Table (7).

5. After getting the rate of change of official price index, the value of the index in June 2006 (100) is multiplied by (1+this rate of change) to give the official price index in June 2007. As official prices had not changed between June 2007 and April 2008 this is also the official price index in April 2008.

6. Having gotten these two price indices the open/parallel price index is calculated using the above equation as follows:
 $P_{2t} = [P_t - \beta_1 P_{1t}] / \beta_2$

(III) Shares of the consumption from official and open/parallel markets in average

1. The quantities of four fuel products (gasoline, diesel, kerosene and LPG) consumed by average household from the official and the open/parallel are from Table (8).

2. The price set of the official market for these products in June 2006 are official prices as of June 2006. The price set of the open/parallel market for these products in June 2006 are approximated by official prices after the rise in June 2007 (as a matter of fact they are taken to be the minimum of these price).

3. Calculations of the shares, using these data, resulted in the following figures as detailed in Table (8):

$$\beta_1: \text{Share of fuel monthly budget from official} \quad 48.1\%$$

$$\beta_2: \text{Share of fuel monthly budget from open/parallel} \quad 51.9\%$$

Table (10) State-Owned Establishments for Privatization

Iraq\IACIS_16_17July_2008_11Tables.xls

		Employees	Evaluation of Fixed Assets	
		Number	Million ID	Million US\$
	Engineering , Metal, Electric & non-Electric	42,414	54,093	44.6
1	State Co for Mechanical Industries/SCMI	5,944	938	0.8
2	State Co for Automotive Industries/SCAI	3,958	678	0.6
3	State Co for Electrical Industries/SCEI	4,792	1,061	0.9
4	State Co for Iron and Steel/SCIS	6,507	1,405	1.2
5	Diyala Electrical Industries	3,421	21,993	18.1
6	Nassr State Co for Mechanical Industries	4,037	6,447	5.3
7	Al Faris State Co	1,695	2,185	1.8
8	Heavy Equipment State Co (HEESCO)	2,703	615	0.5
9	Al Sumood State Co for Steel Industries	1,982	1,071	0.9
10	UR State Co for Engineering Industry	5,075	1,500	1.2
11	Al-Shaheed State Co	1,732		
12	Light Industries Co	302	11,200	9.2
13	National Co for Metal Industries & Bicycles	266	5,000	4.1
	Textiles and Cloths	29,861	5,034	4.1
1	State Co for Cotton Industries	4,297		
2	Wasit State Co for Textile Industries	5,489	1,000	0.8
3	State Co for Leather Industries (SCLI)	4,887	614	0.5
4	State Co for Woolen Textiles	5,731	1,013	0.8
5	State Co for Textile Industries - Hilla	9,457	2,407	2.0
6	State Co for Ready to Wear Industries			
	Construction Industries	25,778	128,380	105.7
1	Iraqi Cement State Co	4,766	14,512	12.0
2	Southern Cement State Co	8,676	109,369	90.1
3	State Co for Glass and Ceramics Industry	3,219		
4	State Co for Refractory's	810	1,399	1.2
5	State Co for Construction Industries	8,307	3,100	2.6
	Chemicals and Petrochemicals	20,432	67,131	55.3
1	Basra Petrochemical	4,455	14,392	11.9
2	Southern Fertilizer State Co	1,669	35,657	29.4
3	State Co for Fertilizer	1,651	2,919	2.4
4	Al Mishraq Sulfur Industry Co	1,533	597	0.5
5	State Co. for Battery Manufacturing.	2,505	679	0.6
6	State Co for Paper Industries	5,088	1,563	1.3
7	Al-Sawary State Co for Chemicals	1,052	1,137	0.9
8	Al Furat State Co for Chemical industries	2,333	2,594	2.1
9	National Co for Chemicals & Plastic	146	7,593	6.3
	Food, Tobacco and Drugs	10,353	20,934	17.2
1	State Co for Medicines Samarra			
2	State Co for Vegetable oils	5,230	5,486	4.5
3	State Co for Sugar Industry	2,322	2,257	1.9
4	State Co for Tobacco and Cigarettes	2,801	13,191	10.9
5	Baghdad Al-Salam Co for Food			
	Industrial Services and Information Industries	2,543	39,500	32.5
1	State Co for Industrial Design and Consultation (SIDCO)	932	37,250	30.7
2	General Systems Co (GSC)	1,004	650	0.5
3	State Co for Information Systems	107	100	0.1
4	Electronic Industries Co	500	1,500	1.2
42	Overall	131,381	315,071	259.5

Source: MIM (2008, 6-10).

Table (11) Iraq: Crude Oil Production and Exports

Iraq\ACIS_16_17July_2008_11Tables.xls

	Production (million b/d)			Export Price	Value of Crude Oil Exports <small>(2) × (4) × Days/1000</small> (5) Billion \$
	Domestic Consumption of Crude Oil (1)	Exports (2)	Total (3)		
2002	0.54	1.49	2.13	22.8	12.5
2003	0.48	0.89	1.38	28.4	9.3
2004	0.50	1.53	2.11	31.4	17.5
2005	0.51	1.40	1.91	45.7	23.3
2006	0.53	1.50	2.03	55.7	30.4
2007	0.42	1.63	2.05	66.8	39.8
2008 First Half	0.44	1.94	2.38	101.3	35.8

Sources:

1. Ministry of Oil (2008).
2. OPEC (2000, 2007).

_____ : *Monthly Oil Market Report*, January - December 2003, 2004, 2005, 2006, 2007, -June 2008, OPEC's website, <http://www.opec.org/home/>.

Notes:

(i) Oil production should equal exports plus domestic consumption (refineries' and power stations' throughput) plus change in stocks of crude oil. In the above table discrepancy between production (column 3), on the one hand, and sum of the columns (1) and (2), on the other, for 2004, is not explained in the sources of data.

(ii) For the years 2004-2007, SIGIR (2008a, 109) provides higher figures for oil production (by an average of 6.2 percent) than those in column (3) of this table.

Appendix 1

Policies in the COMPACT Agreement

Table (A1-1) Policy Set

International Compact with Iraq 2007-2012
72 Benchmarks: <i>13 political and 59 other benchmarks for 2007 and 2008 - 2012 (including 400 actions and commitments). 55 benchmarks repeated for 2007 and 2008-2012 and 4 new for 2008-2012.</i>
Legislative Program
An inclusive constitutional review. (3.1.2)
De-Ba'athification Committee will be restructured and divested of its political aspects. (3.3.11)
The, Government of Iraq, GOI will set a date for governorate and municipal elections for early to mid 2007. (3.1.2)
National Reconciliation and Dialogue Program
Proposed law and a series of confidence-building measures for a Disarmament, Demobilization, and Re-Integration (DDR) program, including an amnesty program consistent with accepted norms of transitional justice and appropriate to the Iraqi context. (3.2.3)
Create political agreement and the legislative framework necessary for the disbanding of militias, including legislation to control the possession and proliferation of weapons (3.2.3)
Conduct outreach programs to ensure support and implementation of the Baghdad and Basrah security plans. (3.2.1)
The effective enforcement of state authority will require de-politicized, impartial, accountable, transparent, and professional security forces, including the military and police. The government recognizes the important and urgent need to translate these principles into practical programs in the organization and operations of its security forces. (3.2.1)
The government will work with international partners to develop well-trained, disciplined, and capable Iraqi security forces that fully understand and respect human rights and the rule of law. (3.2.1)
As a priority of the GOI, a Disarmament, Demobilization, and Re-Integration (DDR) program, aimed at the dissolution and re-integration of militias. (3.2.3)
Developing and sustaining, Internal Security Forces, ISF to targeted and authorized strengths and capabilities with the aim of achieving self-sufficiency. (3.2.1)
The GOI will continue its efforts to expand the range of participation for groups interested in the [National Reconciliation] initiative, regardless of their ideological or political orientation, [including] establishment of inclusive, legitimate, and sustainable political institutions. (3.1)
The effective enforcement of state authority will require de-politicized, impartial, accountable, transparent, and professional security forces, including the military and police. The government recognizes the important and urgent need to translate these principles into practical programs in the organization and operations of its security forces. (3.2.1)
Section 4.1: Public Resource Management (PRM)
Goals: Maximize the benefit from public resources to the people of Iraq in all the regions and provinces by establishing an efficient, equitable, transparent and accountable system for the management of oil revenues and other resources. Use public resources to promote national unity and diversified sustainable development.
Section 4.1.1: Oil Revenues
Goal: Establish a transparent single petroleum account and an equitable petroleum revenue sharing framework.
1. Establish and implement a petroleum revenue sharing framework.
2. Establish and implement mechanisms to ensure transparency of petroleum sector flows.
Section 4.1.2: Public Financial Management (PFM)
Goal: Align Public Financial Management and procurement system with sound international practice.
A: Planning, Coordination, Monitoring and Evaluation.
Goal: Operationalize an enhanced planning, monitoring and evaluation framework.
1. Effective functioning of an enhanced sector-wide and cross-cutting consultation and coordination framework.
B: Budget and Budget Execution
Goal: Establish a credible, integrated and comprehensive budget that delivers reliable and predictable resources to budget holders.
1. Develop and implement legislation and build institutions to improve Public Financial Management
2. Achieve an integrated and comprehensive budget and increase strategic content.
3. Establish and implement procedures and regulations to improve budget reliability and accountability.
4. Undertake specific measures to improve budget execution and effectiveness. Achieve over 90% budget execution.
C: Procurement
Goal: Align public procurement legislation and institutions with sound international practice
1. Pass and implement legislation and regulations; build and operationalize institutions for public procurement.
2. Build capacity to comply with the new framework for public procurement.
D: Intergovernmental fiscal relations
Goal: Develop a framework for intergovernmental fiscal relations to ensure efficiency, transparency and equity while maintaining national fiscal integrity
1. Increase transparency of allocations.
2. Set criteria for budget requests.
3. Decide on and implement oversight process for transfers.

International Compact with Iraq 2007-2012

72 Benchmarks: 13 political and 59 other benchmarks for 2007 and 2008 - 2012 (including 400 actions and commitments). 55 benchmarks repeated for 2007 and 2008-2012 and 4 new for 2008-2012.

4. Clarify expenditure assignment.

Section 4.2: Strengthening Institutions and Improving Governance

Section 4.2.1. Engaging with Civil Society

Goal: Building consensus on economic reforms through dialogue and engagement with civil society. Mobilize Iraq's Social Capital in the process of development

1. Adopt and carry out policies to stimulate civil society engagement in reforms.

2. Adopt and implement comprehensive transparency policies and legislation.

Section 4.2.2 - Good Governance and Anti-Corruption

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

1. Implement specific measures to strengthen the judiciary.

2. Adopt and implement legislation, regulations and procedures and strengthening legal and institutional framework for anti-corruption.

3. Begin recovering ill gotten assets.

4. Carry out public awareness campaigns on anticorruption.

Section 4.2.3 - Civil Service Reform

Goal: Establish a civil service corps on the principles of professionalism, integrity and non-partisanship

1. Adopt and implement policies, legislation, regulations, procedures and build institutions of public service management.

2. Carry out specific actions to improve human resources management practices.

Section 4.3 – Economic Reform

Goals: Create an enabling environment for investment, public and private, domestic and foreign, as a driver for sustainable and diversified economic growth. Create the conditions for maximizing the benefits from foreign aid and investment and integration into the global economy

Section 4.3.1 - Reforming Subsidies

Goal: The Government shall work to phase out inefficient and inequitable universal subsidy programs while ensuring the protection of the vulnerable

1. Phase out universal subsidies (see also 3.1, 4.5 and 4.6.1).

Section 4.3.2 - Private Sector Development and Investment promotion

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

1. Undertake specific measures to design and implement private sector development policies.

2. Design and implement policies including legislation and institutions for the restructuring or SOE's.

3. Remove key Private sector development constraints.

Section 4.3.3. – Financial Sector Restructuring

Goal: Promote public savings and investment and to create an environment for investment and growth the Government shall continue its effort at reforming the Financial Sector

1. Undertake specific measure to restructuring State Owned Banks.

2. Undertake specific measures to promote private banking.

Section 4.3.4 - Regional and International Economic Integration

Goal: Reintegrate Iraq into the regional and global economy and deepen international cooperation on the basis of mutual benefit and common interest

1. Conclude negotiations on outstanding debts and reparations.

2. Ratify signed agreements and treaties, undertake specific measures including legislation to implement ratified treaties. Negotiate and sign new ones.

4.4 Human Development and Human Security

Goal: Protect the citizens, improve their wellbeing and productivity and mobilize Iraq's human capital as the key ingredient for sustainable development (human security and development are keys to achieving social peace, a cornerstone of national unity and economic development)

4.4.1.1 Eradicate Extreme Poverty and Promote Area Based Development

Goal: Reduce the number of families living under US\$ 0.50/day/individual by one third

1. Enact and implement policies and operationalize institution aimed at expanding active social protection measures to reduce poverty and to promote inclusion.

4.4.1.2. Employment

Goals: Build human capital necessary to sustain growth. Reduce unemployment by one half and double labor force participation for women

1. Undertake specific measures to promote continuous education for competitive skills and equal opportunities in the labor market.

2. Undertake specific measures to strengthen social partners' role in expanding employment.

3. Enact and implement legislation to encourage job creation while protecting livelihoods of the labor force, particularly vulnerable groups.

4.4.1.3. Education

Goals: Invest in people and their abilities to ensure optimal contribution to the economy. Achieve significant progress towards: i) full primary completion by 2015; ii) gender parity in education by 2015, iii) Improve adult literacy by 25%, iv) increase ed. budget to 5% GDP

1. Achieve universal access to basic education.

2. Carry out specific activities to promote adult literacy and skills training, early childhood development and life skills training.

4.4.1.4 Health

Goal: Improve health and nutrition of all Iraqis as a cornerstone of welfare and economic development

International Compact with Iraq 2007-2012

72 Benchmarks: 13 political and 59 other benchmarks for 2007 and 2008 - 2012 (including 400 actions and commitments). 55 benchmarks repeated for 2007 and 2008-2012 and 4 new for 2008-2012.

1. Undertake specific measures to improve access to the Primary Health Care system (PHC) and focus on prevention and healthy life style.
2. Improve administration and emergency management in the health care system.

4.4.1.5 Environment, Water & Sanitation, Housing

Goals: Preserve Iraq's environment and ensure careful exploitation of its natural resources for the benefit of all citizens, Improve access to housing by 15% , improve access to water and sanitation by one third

1. Improve institutional capacity to administer environment and natural resources conservation programs.
2. Undertake specific measures to ensure universal access to services (water, sanitation, housing, etc.).

4.4.1.6 Gender

Goals: Reduce gender discrimination, increase participation of women in public life and labor market. Increase women's participation in politics at decision making levels and their involvement in the democratization process. Protect women from violence and mobilize their potential to promote peace

1. Develop and implement legislation and institutional framework to develop social partnership and access for women to public life and to all of society's resources.

4.4.2 Social Sector Reform and Integration of Vulnerable Populations

Goals: Protect the poor and vulnerable groups from the fallout of change and reintegrate them into society, community, and economy. Address the needs of IDPs, refugees and returnees while also enabling them to realize their potential as contributing members of the economic community.

1. Undertake specific measure to strengthen the targeted safety net.
2. Strengthen financial viability of the pension system.
3. Design and implement a reform strategy for the pension system.
4. Undertake specific measures to promote social inclusion of the IDPs, refugees, returnees and other vulnerable groups.

Section 4.5. Energy (Oil, Gas and Electricity):

Goal: To develop an energy sector that meets Iraq's energy needs and maximizes the benefits of Iraq's hydrocarbons for all Iraqis

Oil and Gas

Goal: Promulgation of a hydrocarbon law and improved oil and gas investment project execution

1. Pass and implement a Hydrocarbon Law and Fiscal Regime.
2. Carry out investments.
3. Undertake specific measures to improve monitoring and execution.

Electricity

Goal: An aligned institutional and legal framework supporting efficient rehabilitation of the power sector

1. Pass and implement legislation and undertake measures to align the sector's institutional and legal framework with good practice.
2. Implement an adequately funded sector rehabilitation strategy.

Section 4.6. Agriculture and Water Management Strategy

Goals: To support the development of the agriculture sector to achieve food security, generate employment, diversify the economy and preserve the countryside. Create an enabling environment for a market oriented agricultural sector.

1. Undertake specific measures to rationalize and transition the Public Distribution system to targeting in a way that is integrated with agricultural policies (see also 4.3.1 and 4.4.2)
2. Undertake specific measures to liberalize agricultural market.
3. Replace market distorting input subsidy with market friendly price subsidy.
4. Increase access to agriculture credit through financial market reforms.
5. Undertake specific measures to develop an integrated land and water development policy.
6. Negotiate trans-boundary water agreements with neighboring countries.

Commitment will ensure that legislation, regulation, systems, and processes are in place that will allow efficient and effective disbursement of budget resources. (5.3)

Sources:

1. Government of Iraq, United Nations, World Bank (2006a), (2006b), (2006c).
2. Government of Iraq (2007).

Appendix 2

Poverty July 2005 and December 2007

I. July 2005, 15 percent of population living in poverty

By first defining a poverty line (in steps 1 and 2 below); percentage of people living in poverty is calculated in step 3, according to WFP and COSIT (2006), as follows:

1. Ration Market Price: average market price of the monthly ration in July 2005:
\$15.0 person/month (WFP and COSIT, 2006, 2).

2. Poverty Line (July 05) = Food Insecurity Line = Ration Market Price in July 05
= \$15.0 Person/Month,
= \$0.5 Person/Day.

Equivalent to (using exchange rate of ID 1472 for one \$, July 2005):

ID22,146 /Person Month,

ID714 /Person/Day.

3. From Table (A1-1) below, shaded line, it is clear that people spending less than \$15 a month on food are 14.9 percent of population.

4. Thus the food insecure = 14.9% of population which is very close to the 15% living in poverty mentioned in WFP and COSIT (2006, 2).

II. December 2007, 40 percent of population living in poverty

COSIT is reported to have estimated that 40 percent of people were living in poverty by December 2007 (IMF, 2008, 17). It seems that COSIT has calculated this figure according to the following steps:

1. Food price increase between July 2005 and December 2007 = **77.4%**.¹

2. Poverty Line Dec 07 = Food Insecurity Line = Ration Market Price in Dec 07
(Ration Market Price in July 05 × 177.4%) = *ID22,146 × 177.4%*

= ID39,288 Person/Month

*ID1,267 Person/Day (ID714 ×
177.4%)*

¹ Food Price Index in July 2005 was 4,740 (1993=100). In December 2007 an interpolated food price index (between September 2007 and January 2008) amounts to 8,408. Figures are downloaded from COSIT website, http://www.iraqcosit.org/sections2005_ar.shtm, <http://www.iraqcosit.org/pdf/2008/consumer6.pdf>, Accessed 18 November 2007 and 22 May, 2008, respectively. Exchange rates for July 2005 and December 2007 are from Iraq's page in IMF's IFS online, <http://www.imfstatistics.org/imf/ifsbrowser.aspx?branch=ROOT>.

3. The equivalent cost of the ration, in December 2007, in US\$ would be (using exchange rate of ID1217, December 2007):

\$32.3 Person/Month (ID39,288/1217=\$32.3)

\$1.0 Person/Day (ID1267/1217=\$1.0)

4. It seems that COSIT uses this updated poverty line to derive its estimate of 40 percent living below \$1/person/day in December 2007 (IMF, 2008, 17). Comparable table (to Table A1-1) from which COSIT derives its estimation of 40 percent is not made available.

Table (A2-1) Iraq: Income and Expenditure, July 2005

Average monthly income (\$/capita/month)	41.2
Average monthly expenditure (\$/capita/month)	34.6
Average monthly expenditure in \$/capita/month (reported by items)	48.5
Food expenditure (\$/capita/month)	20.3
In-kind food expenditure (\$/capita/month)	2.7
Non-food expenditure (\$/capita/month)	10.6
In-kind non-food expenditure (\$/capita/month)	14.9
% Household (\$/capita/month) with:	
Income<19	18
19<=Income<27	17.2
27<=Income<38	21.7
38<=Income<55	20.9
Income=>55	22.2
Expenditure<15	14.9
15<=Expenditure<23	22.8
23<=Expenditure<30	16.6
30<=Expenditure<42	19.4
Expenditure=>42	26.3
% Households reported:	
Regular wage as main income source	54.5
Private business as main income source	40.1
Others as main income source	5.4
% of main income sources out of total income	91.7
% Households reported:	
Regular wage as second income source	7.9
Private business as second income source	12.9
Others as second income source	5.8
% of second income sources out of total income	8
PDS value (PDS Market Price/(Income + PDS Market Price))	31%

Source, WFP and COSIT (2006, 74-78).

Appendix 3

Unemployment Rate 2005

1. According to WFP and COSIT (2006, 42, 76), unemployment rates in July 2005 were as follows:

26 percent of the heads of households are unemployed.

58.6 percent of household members (16 to 60 years old) are unemployed, of which:

47.3 percent are unemployed and not looking for a job.

7.4 percent are unemployed and looking for a job.

3.9 percent are pensioners and not working.

Iraq's population as of July, 2005 (only 16 governorates out of 18): 26,028,467.

2. These rates are not calculated according to standard definition of unemployment.
3. In order to get the number of the unemployed right, according to the standard definition or formula, (e.g. UNDP, 2007, 371) then the number of the unemployed and not looking for jobs and the number of pensioners are to be deducted. In this case the unemployed that are seeking employment can be calculated as follows (noting that average size of the household is 6.5).

$$(26\% \times 1 + 7.4\% \times 5.5) / 6.5 = 10.3\%$$

4. But 10.3% is still not the proper definition of unemployment rate because the denominator still includes all people in the age group 16-60 rather than labour supply (which is equal to age group 16-60 minus students, housewives, pensioners and those not actively seeking employment).
5. To correct for this, one has to deduct (students, housewives, pensioners and those not actively seeking employment) from the numerator and denominator.
6. This can be done, equivalently, by:
 - (i) Calculating or obtaining estimate for the participation rate in the labour force, α . The participation rate for Iraq in 2005 was 41 percent, COSIT (2007, Table 15/10).
 - (ii) Dividing the rate of employment as calculated above (10.3 percent) by the participation rate $\alpha = 41$ percent.

7. The correct unemployment rate is thus: $u = 10.3\% / \alpha = 10.3\% / 41\% = 25$ percent.

Summary:

- (I) According to WFP and COSIT report unemployment rate (v):

$$v = [26\% \times 1 + (58.6\% - 7.4\%) \times 5.5] / 6.5 = 47.3 \text{ percent.}$$

Persons not working for all reasons / Age groups 16-60.

- (II) The unemployment rate (u) according to standard definition/formula:

$$u = 25 \text{ percent.}$$

Persons seeking employment but do not find it / labour supply,

Labour supply = Age group 15/16-60 minus students, housewives, pensioners and those not actively seeking employment.

Appendix 4

Comments on the Draft of Oil and Gas Law

Exploration and Production Licenses

1. The Draft of Oil and Gas Law of February 2007 (*Council of Ministers, 2007*) defines an oil license in a way that accepts such agreements as service contracts, production sharing and concessions. Licenses are offered for up to 35 years (Article 13).
2. There is no obligation in the Draft Law for the state to enter into partnership with the licensee (in areas not allocated to the National Oil Company, NOC), Article 12. The question arises is why should not the NOC enter into partnership in all agreements, such that its share in the venture could be met from its future share in profits (as the probability of success is very high in Iraq)²?
3. Licenses are subject to royalty payment, on the one hand, and such taxes as income, local, municipal, ownership transfer and real estate revenue taxes. One-time payments include contract-signing and production bonuses, (Article 33). Apart from the royalty (which was not specified in February's version but set at 12.5% of production at export prices in July's version, *Advisory Board of the State, 2007*) other rates are not specified. As concerned the income tax two points arise:
 - i. Income tax, being the most important of all taxes, needs either be specified in the Draft Law or in other tax laws in order to minimize discretion³. The rate should not be less than those prevailing in comparable countries in the MENA region; in terms of oil reserves and production/investment costs.
 - ii. Income is not well specified in the law. This offers the licensee a leeway to exaggerate cost⁴.
4. The negotiations between the Ministry of Oil and the licensees or between the regions and the licensees (Article 9, item A) need to be streamlined, as coordination is almost absent between the centre and the regions, during the contracting process. Although the final approval for exploration and production agreements rest with the Federal Council of Oil and Gas, the Draft Law has constrained the Council in ways that may lead to inefficiencies:
 - i. The binding of the Council by a 120-day ceiling for approval of contracts submitted by the Ministry of Oil or regions (Article 10, Para D, 3) might pressure the Council to take hasty decisions.
 - ii. The statement '*in the formation of the Council of Oil and Gas essential components of Iraqi society to be taken into consideration*' (Article 5, Para C), although aiming at wider participation, could deny the Council of much needed economic, technical and law capabilities, on the one hand, and burden it with political wrangling, on the other.

National Oil Company, NOC

The treatment of the national oil company in the law raises some questions:

² In some MENA countries the participation of the state in production sharing agreements ranges from 50% to 80%.

³ Compare this with a specific rate of 65% levied on net income in some MENA countries.

⁴ Compare this with a precise specification of a barrel's income to be equal to export price minus cost; such that the cost (including royalty) is specified beforehand, depending on the exploration prospect and expected investment and operating costs.

- i. To win an exploration license (in areas outside those allocated to NOC) the company needs to compete with other bidders (Article 6, Para 3⁵).
- ii. Article 12, Para D stipulates that the Republic of Iraq has the right to have a share in the contracts (it is not clear, though, which body decides for the state, is it the Council of Ministers or NOC). NOC, however, is made to represent the state in such partnerships (Article 5, Para C, First).
- iii. NOC has to deliver its crude oil to Oil Marketing Company at production cost plus 'reasonable' profit (Article 5, Para C, First).
- iv. NOC has the right to set-up operating companies with other companies or owning shares (stocks) in others inside Iraq, and it can do the same outside Iraq contingent on the approval of the Council of Ministers (Article 5, Para C, Fifth).

These stipulations raise the following points:

- a. In the light of (i) and (iii) above, how could NOC generate enough surplus to finance its investment inside or outside the country?
- b. For NOC to be competitive it needs a high degree of independence. How independent could NOC be in the light of (iv) above? Independence could further be compromised by the unclear delineation of powers and domains of the Council of Ministers, Federal Council of Oil and Gas, Ministry of Oil and NOC.

Obligations of the Licensees

1. Article (14) is not clear about the monitoring of the execution and enforcement of obligations by the license holders in such matters as exploration, production, production metering, reinjection of gas, gas flaring, actual cost components, unsustainable lifting, fast depletion, etc. this article needs to be revised.
2. Article 30 states that '*the responsible body may set up an independent body for inspection*'. This seems optional. Article 30 ought to be obligatory and the license holder to bear the cost of inspection.

Dispute settlement

In case of disputes between the state and foreign companies Article 41, Para D, is not specific about the body to settle them; settlement can either be enforced by Iraqi courts or through international arbitration⁶.

Definition of Iraqi person

An Iraqi person is defined, in the Draft Law, to be a citizen or a company established inside Iraq such that Iraqi persons or Iraqi companies/institutions own more than 50 percent of shares in this company (Article 4 Para 17). It is not clear why this definition is used in the Draft Law. It could have been meant in the end to offer a foreigner the same treatment as that of an Iraqi.⁷

⁵ The Draft of Oil and Gas Law gives NOC the sole right to undertake:

1. Managing and operating existing producing areas (Annex 1). Furthermore, Southern and Northern oil companies to answer to NOC.
2. Developing, managing and operating discovered but undeveloped fields (Annex 2).

⁶ In July's revision this has been changed but it remains hung between national judicial system and international arbitration. Article 45 of July's revision reads '*If solution is not arrived at, the dispute goes to arbitration or judicial authorities as agreed in the contract*'.

⁷ It can be shown that through a series of sharing arrangements with local subsidiaries, a company (together with these subsidiaries) can be defined as an Iraqi person even if it is predominantly owned by non-Iraqis.