

Iraq Economic Monitor

From War to Reconstruction and Economic Recovery



With a Special Focus on Energy Subsidy Reform

Spring 2018

Middle East and North Africa Region



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PREFACE

The *Iraq Economic Monitor* provides an update on key economic developments and policies over the previous six months and presents findings from recent World Bank work on Iraq, placing them in a longer-term and global context and assessing the implications of these developments and other changes in policy regarding the outlook for Iraq. Its coverage ranges from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Iraq.

The *Iraq Economic Monitor* is a product of the World Bank's Macroeconomics, Trade & Investment Global Practice. It was prepared by Luca Bandiera (Senior Economist) and Ashwaq Maseeh (Research Analyst) under the general guidance of Kevin Carey

(Practice Manager). The Special Focus is authored by Bledi Celiku (Economist) under the general guidance of Luca Bandiera. Muna Abeid Salim (Senior Program Assistant) provided outstanding administrative support.

The findings, interpretations, and conclusions expressed in this Monitor are those of World Bank staff and do not necessarily reflect the views of the Executive Board of the World Bank or the governments they represent. For information about the World Bank and its activities in Iraq, please visit www.worldbank.org/en/country/iraq (English) or www.worldbank.org/ar/country/iraq (Arabic). For questions and comments on the content of this publication, please contact Luca Bandiera (lbandiera@worldbank.org), Ashwaq Maseeh (amaseeh@worldbank.org), Bledi Celiku (bceliku@worldbank.org), or Kevin Carey (kcarey@worldbank.org).

LIST OF KEY ABBREVIATIONS USED

AML/CFT	Anti-Money Laundering and Combating of Terrorism Financing	ID	Iraqi Dinar
Bpd	Barrel per day	IEA	International Energy Agency
BOP	Balance of Payments	IDPs	Internal Displaced Persons
CBI	Central Bank of Iraq	ILO	International Labor Organization
CGE	Computable General Equilibrium	IMF	International Monetary Fund
CPI	Consumer Price Index	IOCs	International Oil Companies
CSO	Central Statistical Organization	IPP	Independent Power Producers
DB	Doing Business	ISIS	Islamic State of Iraq and Syria
DNA	Damage and Needs Assessment	JICA	Japan International Cooperation Agency
DPF	Development Policy Financing	KRG	Kurdistan Regional Government
EMDEs	Emerging Market Developing Economies	MENA	Middle East North Africa Region
EODP	Emergency Operation for Development Project	OPEC	Organization of Petroleum Exporting Countries
ESMAP	Energy Sector Management Assistance Program	PDS	Public Distribution System
ESSRP	Emergency Social Stabilization and Resilience Project	PMT	Proxy-Means Testing
ESR	Electricity Subsidy Reform	PPP	Public Private Partnerships
FATF	Financial Action Task Force	RPP	Revenue Protection Program
FDI	Foreign Direct Investment	SBA	Stand-By Arrangement
FFES	Funding Facility for Extended Stabilization	SFD	Social Fund for Development
FFIS	Funding Facility for Immediate Stabilization	SOEs	State Own Enterprises
GCC	Gulf Council Countries	SOMO	Iraqi State Organization for Marketing Oil
Gol	Government of Iraq	SPC	Social Protection Commission
GDP	Gross Domestic Product	TBI	Trade Bank of Iraq
GW	Giga Watt	TSP	Transmission Service Provider
ICA	Investment Climate Assessment	UNDP	United Nations Development Program
ICPI	International Corruption Perception Index	UNOCHA	United Nation Office for the Coordination of Humanitarian Affairs
		WB	World Bank
		WDI	World Development Indicators
		WGI	World Wide Governance Indicators

EXECUTIVE SUMMARY

Iraq is slowly emerging from the deep economic strains of the last three years, but progress in addressing the legacy of the war against ISIS and the accumulated development deficit from decades of conflict needs to be accelerated.

The improvement in oil prices since mid-2017 and expenditure restraint have been conducive to better outcomes on fiscal and external balances. The reconstruction needs and economic consequences of the war against ISIS need to be placed in the overall fiscal and growth context of Iraq, both to assess the implications of reconstruction for growth and the budget, and to highlight the importance of the structural reform agenda in complementing and accelerating the recovery from conflict.

Following the complete liberation from ISIS of all Iraq territory in December 2017, the Government of Iraq (GoI) is putting in place a comprehensive reconstruction package linking immediate stabilization to a long-term vision.

On December 9, 2017, following more than three years of intense fighting, the Government of Iraq (GoI) announced the complete liberation of all Iraqi territories from ISIS. By end-September 2017, the Government forces supported by the U.S.-led coalition and other regional allies liberated Mosul, the second largest city, followed by other cities along the North-West border with Syria. The GoI, with the support of the international community, deployed efforts to address humanitarian needs,

promote stabilization, and initiate a recovery and reconstruction process. Kuwait hosted a donor reconstruction and recovery conference in February 2018 to identify short- and medium-term financing needs for Iraq. The GoI's reconstruction and development framework presented at the conference addresses recovery needs and priorities according to five key pillars: governance, national reconciliation and peacebuilding, social and human development, infrastructure, and economic development.

The conflict with ISIS and widespread insecurity have created a major humanitarian and economic crisis. Since 2014, the war against ISIS claimed the lives of over 67,000 Iraqi civilians. The war has caused massive displacement, trauma, and rapid increase in poverty with the internal displacement of over three million people across Iraq. Recent estimates suggest that more than 8.7 million Iraqis (22.5 percent of the population) are currently considered in need of some form of humanitarian assistance. The conflict with ISIS and widespread insecurity have also caused the destruction of infrastructure and assets in ISIS-controlled areas, trade routes have been cut off or severely curtailed, and investor and consumer confidence has dwindled. Agricultural production has declined by 40 percent, undermining the country's food sufficiency, and hundreds of thousands of people have been forced to migrate to urban areas for jobs and support. Hundreds of thousands of people, especially women and youth, have been brutalized by

violence, and subjected to exploitation, harassment, and intimidation.

The recent Iraq Damage and Needs Assessment (DNA) on the seven directly affected governorates estimates the overall damages to be US\$45.7 billion and reconstruction and recovery needs to total US\$88.2 billion. Economic losses due to conflict have been enormous and failure to address reconstruction needs would further reduce people's welfare. Iraq's conflict, accompanied by an oil price shock, has caused a three-year recession of non-oil GDP. The impact of the oil price decline has considerably worsened the fiscal situation, the external sector, and the medium-term growth potential. By 2017, the cumulative real losses due to the conflict to non-oil GDP stood at ID124 trillion (US\$ 107 billion), equivalent to 72 percent of the 2013 GDP and 142 percent of 2013 non-oil GDP, assuming the non-oil economy would have continued to grow at the pre-conflict rate of 8 percent.

Poverty has risen sharply. Poverty, which had seen a decline from 22.4 percent in 2007 to 18.9 percent in 2012, has risen sharply due to declining oil revenues and the war against ISIS. The poverty rate in 2014 was estimated at 22.5 percent for the whole country, pushing an additional three million people into poverty in 2015. The poverty rate doubled to 41.2 percent in ISIS-occupied areas, with a sharp increase in poverty levels in the Kurdistan Region of Iraq from 3.5 percent to 12.5 percent, due to the inflow of 1.4 million internally displaced persons (IDPs) and over 241,000 refugees from Syria. Women have been particularly affected by increased insecurity, which imposed restrictions on movement that affected access to education, health, and jobs. Already in 2012, one fifth of the Iraqi population was spending less than the amount required to meet their minimum nutritional requirements and cover their basic non-food needs. Jobs were not providing a pathway out of poverty as 70 percent of the poor are in households with employed heads. The country has one of the lowest employment-to-population ratios in the region, even among men, and the 2014 crisis has led to an estimated reduction in employment by 800,000 jobs. The Public Distribution System (PDS) suffers from severe inefficiencies but remains the primary safety

net for the poor. The Gol is implementing an ambitious reform to improve targeting of social spending, following the introduction of a proxy means testing (PMT) system to identify the poor. The Gol committed to adopt a unified database of eligible households based on the PMT system across all different social protection schemes.

While defeating ISIS marks a positive step, Iraq continues to face many political and

sectarian challenges. Political and social tensions remain along ethnic and sectarian lines. The federal government periodically faces large popular protests, organized by political factions, against corruption and poor service delivery. Over the last 24 months, the government has faced several demonstrations, the last one in early February 2018, and some turned violent in Baghdad. Despite military success, the Federal Government faces political tensions. Since September 2016, the Prime Minister is acting Minister of Finance after the minister was removed from office due to a vote of no-confidence in the Iraqi Parliament and no consensus has emerged on a replacement. The next federal parliamentary election and the overdue provincial elections have been set for May 12th, 2018.

Political trust between Baghdad and Erbil remains low. The Kurdistan Regional Government (KRG) held a referendum on independence on September 25, 2017, which was considered illegitimate by the Federal Government. Since mid-October 2017, the Federal Government has quickly re-gained control of all disputed areas between the Federal Government and KRG, including Kirkuk, an oil rich area. As a result, KRG has lost half of its oil revenue. The federal budget proposes to reduce transfers to KRG from ID12 trillion in 2017 to ID6.7 trillion in 2018 and requires KRG to transfer the entirety of its remaining oil export receipts to the federal government. Disagreement on the budget has dominated political developments since early 2018.

The ISIS war and the protracted reduction in oil prices have resulted in a 21.6 percent contraction of the non-oil economy since 2014, with non-oil growth estimated to have returned to positive in 2017. Because of increased oil production and exports, overall GDP growth remained positive in

the 2015–2016 period. But overall growth is estimated to have contracted by 0.8 percent in 2017 due to a 3.5 percent reduction in oil production, to comply with OPEC+ agreement to cut oil production until end-2018 and further reduction of oil production in the area of Kirkuk in the last quarter of 2017, following the transfer of its control from KRG to the federal government. Non-oil growth has been negative since 2014, but improved security situation and the initial reconstruction effort is estimated to have sustained non-oil growth at 4.4 percent in 2017, driven by construction and services, and pick-up in private consumption and investments. The pegged exchange rate and subdued demand have kept inflation low around 0.1 percent in 2017.

The fiscal deficit is estimated to have narrowed to 2.2 percent of GDP in 2017, due to higher oil prices, and measures to control expenditure on wages, pensions and transfers. Fiscal balances deteriorated in the 2014–2016 period due to low oil prices, higher security spending, humanitarian outlays and weak controls. In 2017, the fiscal balance improved mainly due to a 43 percent increase of oil revenue despite production cuts, driven by higher oil prices. The 2017 supplementary budget, adopted on July 28, 2017, increased non-oil taxes with the introduction of a flat 3.8 percent withholding tax on wages and the adoption of a tax on internet services. Nominal expenditure on salaries and pensions were kept close to their 2016 level, and current expenditure and domestically financed investments were reduced. The 2017 budget included a larger envelope to pay domestic and external arrears, a key measure to increase private sector confidence. The Gol has also committed to strengthen procedures to avoid further accumulation of arrears in 2018. The Gol is prioritizing investment expenditure for reconstruction in areas liberated from ISIS and for increasing electricity production.

Thanks to better fiscal outturn, the Gol stopped the rapid increase of public debt. The Gol also adopted sound management practices to control the large stock of government-issued guarantees. From 2014 to 2016, short-term domestic debt increased from 7 to 27 percent of GDP and external debt increased by 12 percentage points of GDP. Thanks to fiscal consolidation and higher

oil prices, total public debt is estimated to have declined to 58 percent of GDP in 2017. In 2017, the government was also successful in reducing the stock of guarantees from US\$36.5 billion to US\$25.7 billion, thanks to improved management practices, and limited their issuance within a ceiling established in the annual budget law.

In 2017, the current account deficit is estimated to have returned to a surplus equal to 0.7 percent of GDP. Low oil prices widened the current account deficit to 8.6 percent of GDP in 2016. The strong reserve accumulation in 2010–2013 smoothed the impact of the fiscal policy adjustment required to maintain external sustainability. Foreign reserves financed most of the balance of payment deficit, declining from US\$77.8 billion at end-2013 (or 10 months of imports) to US\$48.1 billion at end-2017 (or 7 months of imports).

The Gol's reform program is supported by a large financing package from the international community, and, thanks to satisfactory performance, the Gol has also tapped the sovereign bond market in 2017. The financing provided has so far avoided a much deeper economic and social crisis that could have been triggered by the large fiscal shock, that would excessively hurt the poor and further delay the economic recovery and reconstruction of Iraq. The financing package from the international community includes a US\$5.34 billion Stand-By Arrangement (SBA) with the IMF; a US\$1.44 billion budget support operation approved by the World Bank on December 2016, including US\$444 million guarantees provided to the Bank by the United Kingdom (US\$372 million) and Canada (US\$72 million); US\$270 million in parallel financing provided by JICA, US\$450 million provided by France; and a US\$1 billion bond issued in January 2017, guaranteed by the U.S. government. In August 2017, following the successful conclusion of the second review of the IMF program, the government issued a US\$1 billion bond maturing in 2023, its first independent issuance since 2006.

Iraq's growth outlook is expected to improve thanks to a more favorable security environment and gradual pick up of investment for reconstruction, but absent structural reforms,

higher growth would be short-lived. Overall GDP growth is projected to return positive in 2018 despite the extension of the OPEC+ agreement till end-2018. Oil production will grow by 2.2 percent in 2018 as the oil production in Kirkuk resumes. Oil production is expected to return to pre-2017 levels in 2019, after the expiration of the OPEC agreement. From 2020, oil production is projected to increase only marginally, reducing overall growth, as Gol cannot afford to significantly increase investments in the oil sector. Non-oil economic growth is expected to benefit from increased investment for reconstruction, but absent structural reforms including to public finance management, service delivery, business environment, and the financial sector, higher non-oil growth would be short-lived. Under a no-reconstruction scenario, non-oil growth is projected to reach 3 percent in 2018 and then is conservatively projected to recover to about half its pre-2014 average growth to 4 percent, as recurrent violence and remaining insecurity could delay investment and post-conflict recovery. In 2018, a step up of government investment, with a large import component, is expected to stimulate growth over the projection period in agriculture, manufacturing, construction, transport and supporting services. Private sector activity is subsequently projected to pick up, as public investments decreases. Under a reconstruction scenario, non-oil growth could spike to above 6 percent in 2018–19, but it is expected to taper down once the scale effect of higher investments is factored in.

Projected fiscal surpluses should be seen in the context of continued oil price volatility, the need to rebuild severely depleted buffers, and finance investment for reconstruction. This fiscal outcome is the result of the resolve of the Gol to create fiscal space to finance reconstruction and recovery, while at the same time reconstitute international reserves and protect social expenditure. The fiscal outcome in 2018 and over the medium term would depend on the financing that will be identified following the reconstruction conference hosted by the

Kuwait's government in February 2018, the capacity to attract interest from the private sector and the pace of implementation of the reconstruction plan.

Risks to the outlook arise from oil prices volatility, failure to improve the security environment, and failure to implement the expected large fiscal adjustment to contain current expenditure and prioritize investment for reconstruction and development. While oil prices are expected to remain higher than their lowest level reached in 2016, they would remain on average 50 percent lower than in 2014 and their level over the projection period remains highly uncertain according to volatility indices. The external debt remains highly vulnerable to a reduction in oil prices or a real exchange rate depreciation. Iraq could yet again face a fiscal crisis if conflict and violence re-ignite because of setbacks in the recent successes against ISIS or increased tensions with KRG.

The outlook is also subject to significant social and political risks. Lingered political tensions, weak administrative capacity and widespread corruption continue to pose a downside risk and could further limit the government's reform effort and its capacity to implement investment for reconstruction. Escalating political tensions and the probability of terrorist attacks ahead of the parliamentary and provincial elections in mid-May 2018 add further political risk in the short-term. Following the parliamentary elections, difficult political negotiations could prevent the formation of a new government and bring to a halt executive and legislative activities needed to implement the expected fiscal adjustment while at the same time provide public services and start reconstruction. Deteriorating relations between the federal government and the KRG could weaken oil exports, slow the recovery of the non-oil economy, and discourage donor support for post-ISIS reconstruction. The large reform agenda, including the unification of the public and private pension systems could give rise to social tensions and impact implementation of reforms.

ملخص تنفيذي

من أشكال المساعدة الإنسانية. كما أحدث الصراع مع التنظيم وغياب الأمن على نطاقٍ واسعٍ تدميراً للبنية التحتية والموجودات في المناطق التي سيطر عليها التنظيم، وأحدثت قطعاً أو نقصاً كبيراً في الطرق التجارية، وبالتالي تضاءلت ثقة المستثمر والمستهلك. وتراجع الإنتاج الزراعي بنسبة 40 بالمائة، وهو ما أضرَّ في وفرة الغذاء في البلاد، كما أجبر مئات الآلاف من الناس على الهجرة الى مناطق حضرية بحثاً عن الوظائف والمعونة. وتعرضَ مئات الآلاف من الناس، خصوصاً من بين النساء والشباب، لأعمال عنفٍ وحشيةٍ أخضعتهم للاستغلال والمضايقات والترويع.

يُقدَّر تقييم الأضرار والاحتياجات (DNA) في العراق الذي وُضع مؤخراً، والذي أُجري على المحافظات السبعة التي تأثرت بشكلٍ مباشرٍ، قيمة الأضرار الكلية بما يصل الى 45.7 مليار دولار أميركي واحتياجات إعادة الإعمار بقيمة كلية تصل الى 88.2 مليار دولار. فالخسائر الاقتصادية التي نجمت عن الصراع كانت هائلة وعدم التصدي لاحتياجات إعادة الإعمار من شأنه أن يُنقص رفاهية الناس أكثر. حيث تسبب الصراع في العراق، مصحوباً بصدمةٍ في أسعار النفط، بحدوث كسادٍ لثلاث سنواتٍ في الناتج الإجمالي المحلي غير النفطي. إن تأثير انخفاض أسعار النفط قد زاد من الحالة المالية سوءاً وأضرَّ بالقطاع الخاص وبقابلية النمو على المدى المتوسط. وبحلول عام 2017، وصلت قيمة الخسائر الإجمالية في الناتج الإجمالي المحلي غير النفطي والناتجة عن الصراع الى 124 ترليون دينار عراقي (107 مليار دولار أميركي)، وهو ما يعادل 72 بالمائة من الناتج الإجمالي المحلي لعام 2013 و142 بالمائة من الناتج الإجمالي المحلي غير النفطي لعام 2013، على فرض أنَّ الاقتصاد غير النفطي كان سيستمر في النمو بنفس معدل ما قبل الصراع وهو 8 بالمائة.

معدل الفقر ارتفع بشكلٍ حادٍ. لقد ارتفع معدل الفقر، الذي شهد انخفاضاً من 22.4 بالمائة في عام 2007 الى 18.9 بالمائة في عام 2012، بشكلٍ حادٍ بسبب تراجع عائدات النفط والحرب على تنظيم داعش. حيث قُدِّر معدل الفقر في عام 2014 بـ 22.5 بالمائة في عموم البلاد، وهو ما يعني الدفع بثلاثة ملايين شخصٍ إضافيٍ الى دائرة الفقر في عام 2015. كما ارتفع معدل الفقر بمقدار الضعف ووصل الى 41.2 بالمائة في المناطق التي احتلها تنظيم داعش، مع زيادةٍ كبيرةٍ في مستويات الفقر في إقليم كردستان العراق التي ارتفعت من 3.5 بالمائة الى 12.5 بالمائة، بسبب تدفق 1.4 مليون نازح داخلي (IDPs) وما يزيد على 241,000 لاجئٍ من سوريا. وقد تأثرت النساء بشكلٍ خاصٍ بغياب الأمن المتزايد، والذي فرض عليهن قيوداً في الحركة للوصول الى التعليم والصحة والوظائف. فخمس سكان العراق،

إنَّ العراق أخذَ بالخروج ببطءٍ من الضغوطات الاقتصادية العميقة التي لازمتها في السنوات الثلاث الأخيرة، لكنَّ التقدُّم الحاصل في التعامل مع تركة الحرب على تنظيم داعش والعجز التنموي المتراكم الناتج عن سنواتٍ من الصراع يجب أن يمضي بوتيرةٍ أسرع. فقد عاد التحسن الحاصل في أسعار النفط منذ منتصف عام 2017 وضغط النفقات بنتائج أفضل على الميزانيات المالية والخارجية. ويجب أن توضع احتياجات إعادة الإعمار والتبعات الاقتصادية للحرب ضد داعش ضمن السياق المالي وسياسي النمو العام في العراق، وذلك من أجل تقييم تأثيرات عملية إعادة الإعمار على النمو والموازنة، مع تسليط الضوء في الوقت نفسه على أهمية برنامج الإصلاح الهيكلي في إتمام التعافي من الصراع وتعجيله.

بعد التحرير الكامل لجميع الأراضي العراقية من تنظيم داعش في كانون الأول 2017، تضع الحكومة العراقية حزمةً من برامج إعادة الإعمار التي تربط بين عملية تحقيق الاستقرار المباشر والرؤية المستقبلية بعيدة المدى. ففي 9 كانون الأول من عام 2017، وبعد أكثر من ثلاثة أعوام من القتال المحتدم، أعلنت الحكومة العراقية التحرير الكامل لجميع الأراضي العراقية من سيطرة تنظيم داعش. فمع نهاية شهر أيلول من نفس العام، حررت القوات الحكومية، مدعومةً بالتحالف الذي تقوده الولايات المتحدة وحلفاء إقليميون آخرون، مدينة الموصل، ثاني أكبر المدن العراقية، لتتبعها مدناً أخرى على طول الحدود الشمالية الغربية مع سوريا. ثم قامت الحكومة العراقية، بدعمٍ من المجتمع الدولي، بحشد الجهود للتصدي لاحتياجات الإنسانية وتعزيز الاستقرار والبدء بعملية تعافٍ وإعادة إعمار. فاستضافت الكويت مؤمراً للمانحين لإعادة الإعمار والتعافي في شباط 2018 لتحديد احتياجات العراق للتمويل على المدى القصير والمتوسط. ويتطرق إطار إعادة الإعمار والتنمية الذي قدمته الحكومة العراقية في المؤتمر الى احتياجات التعافي وأولوياته وفق أركانٍ رئيسيةٍ خمس: الحوكمة والمصالحة الوطنية وإقامة السلام والتنمية الاجتماعية والبشرية والبنية التحتية والتنمية الاقتصادية.

لقد أحدث الصراع مع تنظيم داعش وغياب الأمن على نطاقٍ واسعٍ أزمةً إنسانيةً واقتصاديةً كبيرةً. فمنذ عام 2014، تسببت الحرب على داعش بفقدان حياة ما يزيد على 67,000 مدنيٍ عراقي. كما نتجت عنها حركة نزوحٍ واسعةٍ وأذىً نفسياً وارتفاعاً سريعاً في معدل الفقر رافقه النزوح الداخلي لما يربو على الثلاثة ملايين فردٍ في عموم العراق. وتشير التقديرات الأخيرة الى أنَّ هناك ما يزيد على 8.7 مليون عراقي (22.5 بالمائة من مجموع السكان) يُنظر إليهم حالياً على أنهم بحاجةٍ لشكلٍ

الأجنبية على تمويل معظم العجز في ميزان المدفوعات، الذي انخفض من 77.8 مليار دولار في نهاية عام 2013 (أو 10 أشهر من الواردات) إلى 48.1 مليار دولار في نهاية عام 2017 (أو 7 أشهر من الواردات).

يأتي برنامج الإصلاح الحكومي العراقي مدعوماً بحزمة تمويل كبيرة من المجتمع الدولي، وبفضل الأداء المرضي، فقد توجهت الحكومة العراقية إلى الانتفاع من سوق السندات السيادية في عام 2017. لقد ساعد التمويل الذي تم تقديمه للحكومة لحد الآن في تجنب احتمالية أن تُحدث الصدمة المالية الكبيرة أزمةً اقتصادية واجتماعية أعمق بكثير كان من شأنها أن تلحق الضرر البالغ بالفقراء وتتسبب بالمزيد من التأخير في التعافي الاقتصادي وعملية إعادة الإعمار في العراق. وتشمل حزمة التمويل المقدمة من المجتمع الدولي اتفاقية استصدار ائتماني بقيمة 5.34 مليار دولار أميركي مع صندوق النقد الدولي؛ وعملية دعم للموازنة بقيمة 1.44 مليار دولار أميركي وافق عليها البنك الدولي في كانون الأول 2016، بما في ذلك ضمانات بقيمة 444 مليون دولار للبنك قدمتها المملكة المتحدة (372 مليون دولار) وكندا (72 مليون دولار)؛ ومبلغ 270 مليون دولار أميركي بشكل تمويل موازي قدمتها الوكالة اليابانية للتعاون الدولي (JICA)، ومبلغ 450 مليون دولار أميركي قدمتها فرنسا؛ وسندات بقيمة 1 مليار دولار أميركي أصدرت في كانون الثاني 2017، مضمونة من قبل الحكومة الأميركية. وفي آب 2017، وبعد إنهاء المراجعة الثانية لبرنامج صندوق النقد الدولي بنجاح، أصدرت الحكومة سندات بقيمة 1 مليار دولار أميركي باستحقاق في عام 2023، وهو الإصدار المستقل الأول منذ عام 2006.

تُشير التوقعات إلى أن النمو المستقبلي للعراق سيتحسن بفضل وضعٍ أمنيٍّ أكثر ملاءمةً وتزايداً تدريجياً في الاستثمار من أجل إعادة الإعمار، ولكن في ظل غياب الإصلاحات الهيكلية، لن يكون عمر المعدل الأعلى للنمو طويلاً. من المتوقع أن يعود النمو العام في الناتج الإجمالي المحلي إلى الأرقام الإيجابية في عام 2018 بالرغم من قيام منظمة أوبك بتمديد اتفاقية خفض الإنتاج حتى نهاية عام 2018. فالإنتاج النفطي سينمو بمعدل 2.2 بالمائة في عام 2018 مع استثناء عملية إنتاج النفط في كركوك. ويُتوقع أن يعود إنتاج النفط في عام 2019 إلى مستويات ما قبل عام 2017، بعد انتهاء اتفاقية منظمة أوبك. وبدءاً بعام 2020، تشير التوقعات إلى زيادة إنتاج النفط بشكل هامشي فقط، وهو ما يخفف من النمو العام، حيث أن الحكومة العراقية لا تستطيع أن تتحمل تكاليف زيادة الإنتاج بشكل كبير في قطاع النفط. كما يُتوقع أن يعود الاستثمار المتزايد في مجال إعادة الإعمار بالفائدة على النمو الاقتصادي غير النفطي، لكن في ظل غياب الإصلاحات الهيكلية بما فيها تلك المتعلقة بالإدارة المالية في القطاع العام، وتقديم الخدمات، وبيئة النشاط التجاري، والقطاع المالي، لن يكون عُمر المستوى الأعلى من النمو غير النفطي طويلاً. وتشير التوقعات إلى أن النمو غير النفطي، في ظل السيناريو الذي لا يشتمل على إعادة الإعمار، سيصل إلى 3 بالمائة في عام 2018 ثم بنظرٍ تنطوي على التحفظ يُتوقع أن يستعيد ما يقارب نصف معدل النمو الذي كان قبل عام 2014 ليصل إلى 4 بالمائة، حيث أن حوادث العنف المتكررة وما تبقى من حالات فقدان الأمن من شأنها أن تؤخر الاستثمار والتعافي بعد الصراع. وفي عام 2018، يُتوقع أن تعمل زيادة الاستثمار الحكومي، مع وجود مكونٍ كبيرٍ للاستيراد، على تحفيز النمو خلال الفترة المعنية في قطاعات الزراعة والتصنيع والبناء والنقل والخدمات الساندة. كما يُتوقع أن يرتفع

تبعاً لهذا نشاط القطاع الخاص، مع تراجع الاستثمارات في القطاع العام. وفي ظل السيناريو الذي ينطوي على إعادة الإعمار، من الممكن أن يقفز النمو غير النفطي إلى ما يربو على 6 بالمائة في الفترة 2018-2019، لكنه يُتوقع له أن يتناقص حال دخول عامل الأثر الذي يُحدثه تغير الأسعار والمرتبب بالاستثمارات الأعلى.

يجب أن يُنظر إلى الفوائض المالية المتوقعة ضمن سياق التذبذب المتواصل في أسعار النفط، والحاجة لإعادة بناء المخزون المالي المستنزف بشكلٍ حادٍ، وتهيئة الاستثمار اللازم لإعادة الإعمار. إن هذه الحصيلة المالية هي نتاج عزم الحكومة العراقية على الإذخار لخلق فضاءٍ ماليٍّ لتمويل عمليات إعادة الإعمار والتعافي، وفي الوقت نفسه إعادة تشكيل احتياطيّاتٍ دوليةٍ وحماية الإنفاق الاجتماعي. وستعتمد الحصيلة المالية في عام 2018 وعلى طول المدى المتوسط على التمويل الذي سيتم تحديده بعد مؤتمر إعادة الإعمار الذي استضافته حكومة الكويت في شباط 2018، وعلى القدرة على جذب اهتمام القطاع الخاص وعلى سرعة تنفيذ خطة إعادة الإعمار.

تأتي المخاطر التي تكتنف النظرة المستقبلية من تذبذب أسعار النفط، وعدم القدرة على تحسين بيئة الأمن، وعدم القدرة على تنفيذ التغيير المالي الكبير المتوقع لاحتواء الانفاق الجاري وإيلاء الأولوية للاستثمار من أجل إعادة الإعمار والتنمية. ففي الوقت الذي يُتوقع أن تظل فيه أسعار النفط أعلى من المستوى الأدنى الذي وصلت إليه في عام 2016، إلا أنها ستبقى في المعدل أقل بنسبة 50 بالمائة مما كانت عليه في عام 2014 كما أن مستوى هذه الأسعار خلال الفترة المعنية يظل غير مؤكدٍ إلى حدٍ كبيرٍ حسب مؤشرات تقلب الأسعار. كما يظل الدين الخارجي إلى حدٍ كبيرٍ رهينة انخفاضٍ في أسعار النفط أو تخفيضٍ حقيقيٍّ في سعر الصرف. ويمكن أن يشهد العراق مرةً ثانيةً أزمةً ماليةً إذا ما تأجج الصراع والعنف مرةً ثانيةً بسبب نكساتٍ في النجاحات التي تحققت مؤخراً ضد تنظيم داعش أو توتراتٍ متصاعدةٍ مع حكومة إقليم كردستان.

تظل النظرة المستقبلية أيضاً أسيرة المخاطر الاجتماعية والسياسية الكبيرة. ما تزال التوترات السياسية التي تأتي الزوال والقدرة الإدارية الضعيفة والفساد المستشري تمثل خطراً سلبياً ومن الممكن أن تزيد من تحجيم جهود الإصلاح الحكومي وقدرتها على تنفيذ الاستثمار من أجل إعادة الإعمار. كما تضيف التوترات السياسية المتصاعدة واحتمالية حدوث هجماتٍ إرهابيةٍ تسبق الانتخابات البرلمانية وانتخابات مجالس المحافظات التي سيتم تنظيمها أواسط شهر أيار 2018 مزيداً من المخاطر السياسية على المدى القصير. وبعد الانتخابات البرلمانية، من الممكن أن تحول المفاوضات السياسية الصعبة دون تشكيل حكومةٍ جديدةٍ وهذا من شأنه أن يُحدث توقفاً في النشاطات التنفيذية والتشريعية الضرورية لتنفيذ التصحيح المالي المتوقع مع العمل في الوقت نفسه على توفير الخدمات العامة والبدء بإعادة الإعمار. كما أن العلاقات المتدهورة بين الحكومة الفدرالية وحكومة إقليم كردستان من شأنها أن تُضعف صادرات النفط، وتُبطئ تعافي الاقتصاد غير النفطي، وتُثبّت دعم الدول المانحة اللازم لعملية إعادة الإعمار ما بعد داعش. كما أن أجندة الإصلاحات الكبيرة، بما فيها توحيد نظامي التقاعد للقطاعين العام والخاص من شأنها أن تُحدث توتراتٍ اجتماعيةٍ وتؤثر على تنفيذ الإصلاحات.

حكومة إقليم كردستان الى الحكومة الفدرالية. والنمو غير النفطي ظل سلبياً منذ عام 2014، لكنّ التقديرات تشير الى أنّ الوضع الأمنيّ المتحسن وجهود إعادة الإعمار الأولية قد أحدثت استدامةً في النمو غير النفطي عند معدل 4.4 بالمائة في عام 2017، مدفوعاً بقطاعي البناء والخدمات، والارتفاع في استهلاك واستثمار القطاع الخاص. وأبقى سعر الصرف المدعوم والطلب الفاتر على التضخم منخفضاً عند 0.1 بالمائة في عام 2017.

تشير التقديرات الى أنّ العجز المالي قد تحسّن ليصل الى 2.2 بالمائة من الناتج الإجمالي المحلي في عام 2017، بسبب أسعار النفط الأعلى، ووجود إجراءات للسيطرة على الإنفاق على رواتب الموظفين ومعاشات المتقاعدين والتحويلات. لقد تدهورت الموازنات المالية في الفترة 2014-2016 بسبب أسعار النفط المنخفضة وإنفاق أعلى على الأمن ومصاريق تتعلق بالحاجات الإنسانية إضافةً الى وسائل السيطرة الضعيفة. وفي عام 2017، تحسنت الموازنة المالية بالدرجة الرئيسية بسبب ارتفاع نسبة 43 بالمائة في عائدات النفط على الرغم من عمليات خفض في الإنتاج، مدفوعةً بأسعار النفط الأعلى. كما زادت الموازنة التكميلية لعام 2017، والتي تمت الموافقة عليها في 28 تموز، 2017، من الضرائب غير النفطية بإدخال ضريبة استقطاع ثابتة بمعدل 3.8 بالمائة من الرواتب والموافقة على فرض ضريبة على خدمات الإنترنت. وبقيت المصروفات الإسمية على رواتب الموظفين ومعاشات المتقاعدين قريبةً من مستوياتها في عام 2016، كما تم تخفيض المصروفات الجارية والاستثمارات الممولة محلياً. حيث تضمنت موازنة عام 2017 باباً أكبر لدفع المتأخرات المحلية والخارجية، وهو إجراء مهمّ لتعزيز ثقة القطاع الخاص. كما التزمت الحكومة العراقية أيضاً بتعزيز الإجراءات التي من شأنها أن تُجنّب البلاد مزيداً من التراكم للمتأخرات في عام 2018. وتولي الحكومة العراقية الأولية للمصروفات الاستثمارية المتعلقة بإعادة الإعمار في المناطق المحررة من تنظيم داعش وزيادة إنتاج الكهرباء.

بفضل العائد المالي الأفضل، أوقفت الحكومة العراقية الزيادة السريعة في الدين العام. كما تبنت الحكومة العراقية أيضاً ممارسات إدارة سليمة للسيطرة على العدد الكبير من الضمانات الصادرة عن الحكومة. فمنذ عام 2014 وحتى عام 2016، ارتفع الدين الداخلي قصير الأمد من 7 الى 27 بالمائة من الناتج الإجمالي المحلي وارتفع الدين الخارجي بمقدار 12 نقطة مئوية من الناتج الإجمالي المحلي. وبفضل ضبط أوضاع المالية العامة وأسعار النفط الأعلى، تشير التقديرات الى انخفاض الدين العام الكلي الى 58 بالمائة من الناتج الإجمالي المحلي في عام 2017. ونجحت الحكومة أيضاً في عام 2017 في خفض مجموع الضمانات من 36.5 مليار دولار أميركي الى 25.7 مليار دولار أميركي، بفضل ممارسات الإدارة المحسنة، وجعلت إصدار هذه الضمانات مقتصرًا على سقفٍ يحدده قانون الموازنة السنوية.

في عام 2017، أشارت التقديرات الى تحول عجز الحساب الجاري الى فائض يساوي 0.7 بالمائة من الناتج الإجمالي المحلي. لقد وسّعت أسعار النفط المتدنية عجز الحساب الجاري الى 8.6 بالمائة من الناتج الإجمالي المحلي في عام 2016. وكان للاحتياطي المتراكم القوي للفترة 2010-2013 فائدةً في التخفيف من أثر تعديل السياسة المالية المطلوب للإبقاء على الديمومة الخارجية. كما ساعدت الاحتياطيّات من العملة

سلفاً في عام 2012، كان ينفق أقل من المبلغ المطلوب للإيفاء بالحد الأدنى من متطلبات التغذية اللازمة لهم والمطلوب لتغطية احتياجاتهم الأساسية غير الغذائية. فالوظائف لم تكن توفر مخرجاً من الفقر حيث أنّ 70 بالمائة من الفقراء موجودون في بيوتٍ تسكنها أسرٌ أربابها موظفون. والبلاد تملك واحداً من المعدلات الأدنى في المنطقة لعدد الموظفين الى عدد السكان، حتى بين الرجال، وأزمة عام 2014 أدت الى إنخفاضٍ في التوظيف يُقدّر بـ 800,000 وظيفة. ونظام الحصة التموينية (PDS) يعاني من نقوصٍ حادةٍ لكنّه يظل شبكة الأمان الأساسية للفقراء. الحكومة العراقية تقوم بتنفيذ حزمة إصلاحاتٍ طموحةٍ لتحسين عملية الانفاق الاجتماعي المُستهدف، بعد إدخال نظام الاختبار بالوسائل غير المباشرة (PMT) لتحديد الفقراء، وهي مُلتزمةٌ بتبني قاعدة بياناتٍ موحدةٍ للأسر المُستحقة على أساس النظام هذا في عموم برامج الحماية الاجتماعية المختلفة.

في الوقت الذي تمثل فيه هزيمة تنظيم داعش خطوةً إيجابيةً، يظل العراق يواجه العديد من التحديات السياسية والطائفية. فالتوترات السياسية والاجتماعية ما تزال موجودةً على طول الحدود الإثنية والطائفية. والحكومة الفدرالية تواجه بين الحين والآخر مظاهراتٍ شعبيةٍ كبيرةٍ، تُنظمها أحزابٌ سياسيةٌ، ضد الفساد وسوء الخدمات. فخلال الأشهر الـ 24 المنصرمة، واجهت الحكومة عدداً من المظاهرات آخرها في مطلع شباط 2018، وبعضها تحول الى العنف في بغداد. فالرغم من النجاح العسكري، تواجه الحكومة الفدرالية توتراتٍ سياسيةٍ. منذ أيلول 2016، يقوم رئيس الوزراء بدور وزير المالية وكالهُ بعد أن أعفي الوزير من منصبه إثر تصويتٍ بسحب الثقة عنه أثار الجدل في البرلمان العراقي ولم يتشكل إجماعٌ على بديلٍ يحل محله. وقد حُدد الثاني عشر من أيار، 2018، موعداً للانتخابات الفدرالية القادمة ومعها انتخابات مجالس المحافظات التي فات مواعدها.

الثقة السياسية بين بغداد وأربيل ما تزال مُتدنيةً بشكلٍ يندر بالخطر. فحكومة إقليم كردستان (KRG) نظّمت استفتاءً حول الاستقلال في 25 أيلول، 2017، والذي اعتبرته الحكومة الفدرالية غير شرعي. ومنذ أواسط تشرين الأول 2017، استعادت الحكومة الفدرالية سريعاً السيطرة على جميع المناطق المتنازع عليها بين الحكومة الفدرالية وحكومة الإقليم، بما فيها كركوك، الغنية بالنفط. ونتيجةً لهذا، فقدت حكومة الإقليم نصف عائداتها من النفط. والموازنة الفدرالية المقترحة تخفض المبالغ المحولة الى حكومة الإقليم من 12 ترليون دينار في عام 2017 الى 6.7 ترليون دينار في عام 2018 وتفرض على حكومة الإقليم أن ينقل كل عائداته من صادرات النفط المتبقية الى الحكومة الفدرالية. وطغى الخلاف الدائر حول الموازنة على المشهد السياسي منذ مطلع عام 2018.

نتج عن حرب داعش والانخفاض المطول في أسعار النفط تقلصٌ مقداره 21.6 بالمائة في الاقتصاد غير النفطي منذ عام 2014، بينما تشير التقديرات الى أنّ النمو غير النفطي قد عاد ليصبح إيجابياً في عام 2017. بسبب الإنتاج المتزايد للنفط وصادراته، ظل النمو الكلي للناتج الإجمالي المحلي إيجابياً في الفترة 2015-2016. لكنّ التقديرات تشير الى أنّ النمو الكلي قد تقلص بمقدار 0.8 بالمائة في عام 2017 بسبب انخفاضٍ مقداره 3.5 بالمائة في إنتاج النفط، التزاماً باتفاق منظمة أوبك بخفض إنتاج النفط حتى نهاية عام 2018 ليصاحبه انخفاضٌ آخر في إنتاج النفط في منطقة كركوك في الربع الأخير من عام 2017، بعد انتقال السيطرة عليها من

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Political and Social Context

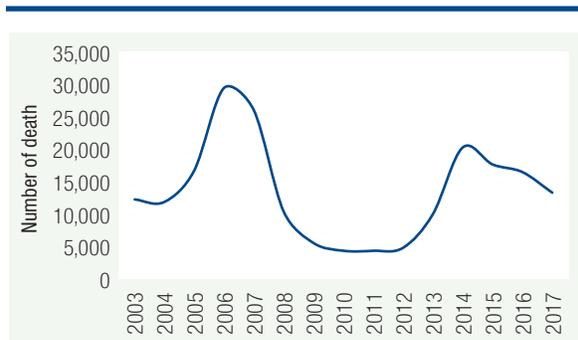
Iraq declared complete victory in the war against ISIS on December 9, 2017, more than three years after militants overrun and captured one-third of the country and imposed a violent and austere rule over millions of Iraqis. The insecurity since 2014 has led to the death of thousands and created a major humanitarian crisis with over 3 million Internally Displaced Persons (IDPs), and 8.7 million people in need of humanitarian assistance. Poverty has risen sharply, further intensifying the loss of human capital over the past three decades. Political trust between the Gol and KRG remains low, after the latter held a referendum on independence in September 2017. In anticipation of the reconstruction conference held in Kuwait in February 2018, the government of Iraq has put in place a comprehensive reconstruction and development framework linking immediate stabilization and a long-term vision.

Following the complete liberation from ISIS of all Iraq territory in December 2017, the Gol is putting in place a comprehensive reconstruction package linking immediate stabilization to a long-term vision. On December 9, 2017, after more

than three-years of fighting, the Gol announced the complete liberation of all Iraqi territories from ISIS. By end-September 2017, the Government forces supported by the U.S.-led coalition and other regional allies liberated Mosul, the second largest city, followed by other cities along the North-West border with Syria. The Gol, with support of the international community, deployed efforts to address humanitarian needs, promote stabilization, and initiate a recovery and reconstruction process.¹ Kuwait hosted the International Conference for the Reconstruction of Iraq in February 2018 to identify short- and medium-term financing needs for Iraq. The Gol's reconstruction and development framework presented at the conference addresses recovery needs and priorities according to five key pillars: governance, national reconciliation

¹ For example, in May 2015, the Gol, in cooperation with the United Nations Development Program (UNDP), launched the Funding Facility for Immediate Stabilization (FFIS), which was later extended as Funding Facility for Extended Stabilization (FFES) in September 2016. The FFES has undertaken more than 1,200 projects in 23 cities across five governorates aimed at reviving infrastructure and public services.

FIGURE 1 • Casualty Figures Have Been Decreasing after 2014



Source: Iraq Body Count, 2017.

and peacebuilding, social and human development, infrastructure, and economic development.

The conflict with ISIS and widespread insecurity have created a major humanitarian and economic crisis. Since 2014, the war against ISIS claimed the lives of over 67,000 Iraqi civilians (Figure 1).² The war has caused massive displacement, trauma, and rapid increase in poverty. The armed conflict with ISIS has led to the internal displacement of over three million people across Iraq. Recent estimates suggest that more than 8.7 million Iraqis (22.5 percent of the population) are currently considered in need of some form of humanitarian assistance.³ Hundreds of thousands of people, especially women and youth, have been brutalized by violence, and subjected to exploitation, harassment, and intimidation. The conflict with ISIS and widespread insecurity have also caused the destruction of infrastructure and assets in ISIS-controlled areas, trade routes have been cut off or severely curtailed, and investor and consumer confidence has dwindled. Agricultural production has declined by 40 percent, undermining the country's food sufficiency, and hundreds of thousands of people have been forced to migrate to urban areas for jobs and support.

While defeating ISIS marks a positive step, Iraq continues to face many political and sectarian challenges. Political and social tensions remain along ethnic and sectarian lines. The federal government periodically faces large popular protests, organized by political factions, against corruption and poor service delivery. Over the last 24 months,

the government has faced several demonstrations, of which some turned violent in Baghdad. The latest large demonstration took place in Baghdad in early February 2018. Despite military success, the Federal Government faces political tensions. Since September 2016, the Prime Minister is acting Minister of Finance after the minister was removed from office due to a vote of no-confidence in the Iraqi Parliament and no consensus has emerged on a replacement. The next federal parliamentary election and the overdue provincial elections have been set for May 12th, 2018.

Output and Demand

The ISIS war and low oil prices have severely impacted Iraq's non-oil economy since 2014, but it is estimated to have returned to positive growth in 2017, driven by improved security, construction and services, and pick-up in private consumption and investment. Overall GDP growth remains highly sensitive to performance of the oil sector. Overall GDP expanded in 2015 and 2016, due to increased oil production and exports, but it is estimated to have turned negative at 0.8 percent in 2017, due to a 3.5 reduction in oil production.

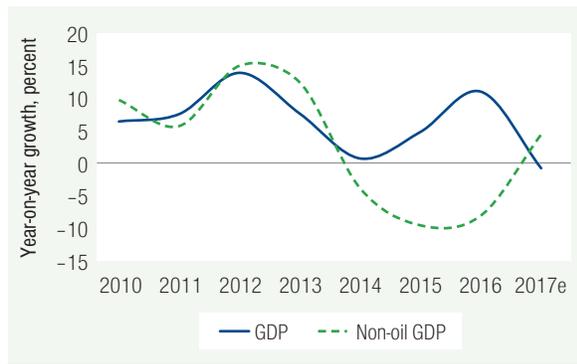
Economic Growth

The ISIS war and the protracted reduction in oil prices have resulted in a 21.6 percent contraction of the non-oil economy since mid-2014, with non-oil growth estimated to have returned positive in 2017. GDP growth is highly dependent on performance of oil production and revenues. Because of increased oil production and exports, overall GDP growth remained positive in the 2015–2016 period. But overall growth is estimated to have contracted by 0.8 percent in 2017 due to a 3.5 percent reduction in oil production, to comply with OPEC+ agreement to cut oil production until end-2018 and further reduction of oil production in Kirkuk in the last quarter of 2017, following the transfer of its control from KRG to the federal government. Non-oil growth has been negative since 2014, but improved

² Also confirmed by the Iraq's Ministry of Health in July 2017.

³ OCHA Iraq Humanitarian Bulletin, February 2018.

FIGURE 2 • Improved Security and Initial Reconstruction Effort IIs Estimated to Have Sustained Non-Oil Growth in 2017



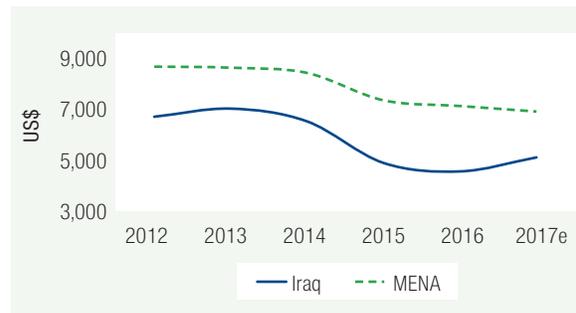
Sources: IMF; and World Bank estimates.

security situation and the initial reconstruction effort have sustained non-oil growth at 4.4 percent in 2017, driven by construction and services, and pick-up in private consumption and investments (Figure 2). The economic disruption resulting from the two crises has caused a marked contraction in nominal GDP, with GDP per capita declined from US\$6,517 in 2014 to an estimated US\$ 5,088 in 2017 albeit at higher level compared to 2016 (Figure 3).

The recent Iraq Damage and Needs Assessment (DNA) on the seven directly affected governorates estimate the overall damages to be US\$45.7 billion and reconstruction and recovery needs to total US\$88.2 billion. Economic losses due to conflict have been enormous and failure to address reconstruction needs would further reduce people’s welfare. Iraq’s conflict, accompanied by an oil price shock, has caused a three-year recession of non-oil GDP. The impact of the oil price decline has considerably worsened the fiscal situation, the external sector, and the medium-term growth potential. By 2017, the cumulative real losses due to the conflict to non-oil GDP stood at ID124 trillion (US\$107 billion), equivalent to 72 percent of the 2013 GDP and 142 percent of 2013 non-oil GDP, assuming the non-oil economy would have continued to grow at the pre-conflict rate of 8 percent.

The contraction in non-oil economy has impacted various sectors, but better security would improve the performance of non-oil industry

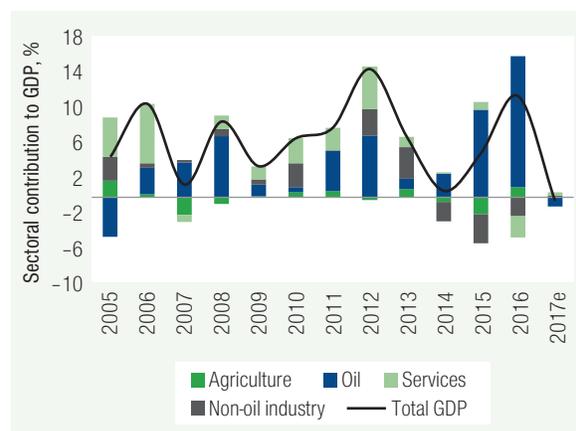
FIGURE 3 • After a Marked Contraction, GDP Per Capita Is Estimated to Have Improved in 2017



Sources: IMF; and World Bank WDI.

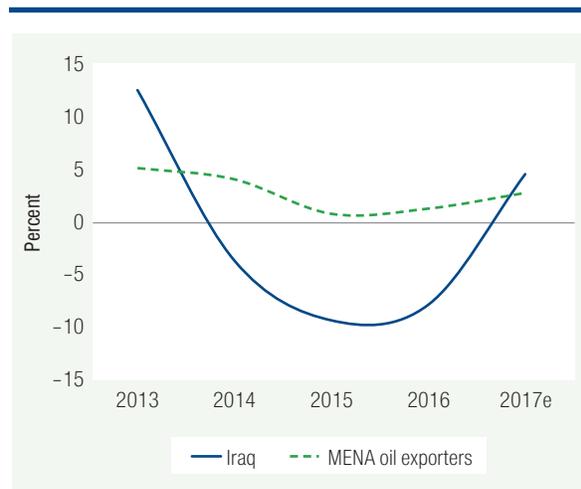
and services. The impact of the conflict and limited government spending has had a profound impact on the already weak and under-developed non-oil economy. Available data from Iraqi authorities shows that the non-oil industry was the hardest-hit sector, especially the construction sector, which contracted by over 40 percent in 2016, and contributed to -2.3 percentage points to overall growth. Disruption of routes, trade routes, personal and social services have also led to about 6 percent contraction in the services sector, shrinking the overall growth to an additional -2.3 percentage points (Figure 4). However,

FIGURE 4 • A Better Security and Initial Construction Are Estimated to Have Improved the Economic Contribution of Non-Oil Sectors in 2017



Sources: Iraqi authorities; and WB staff estimate.

FIGURE 5 • Iraq’s Non-Oil GDP Growth Has Exceeded that in MENA Oil Exporters in 2017

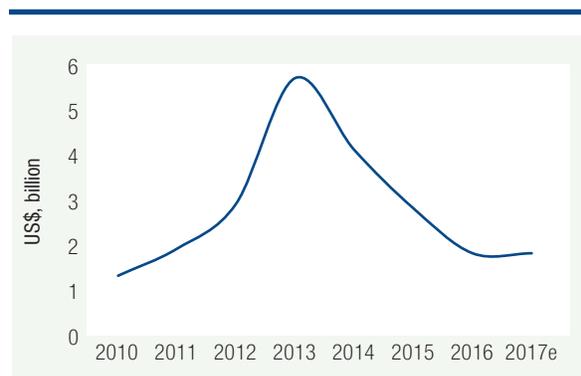


Sources: Iraqi authorities; and IMF REO, Oct 2017.

a better security situation and the benefits of the initial reconstruction effort are estimated to have increased the growth rate of non-oil industry and services to 1.0 and 6 percent in 2017. Non-oil growth in 2017 has exceeded that in MENA oil exporters group for the first time since 2014 (Figure 5).

On the demand side, private consumption and investment have picked-up in 2017 after a sharp reduction in 2014–16. A 63 percent fall in oil prices between 2014 and 2016 forced the Gol to rapidly reduce expenditure, with most of the

FIGURE 7 • Foreign Direct Investment Plummets Due to Insecurity and Poor Business Environment



Sources: IMF; and World Bank estimates.

FIGURE 6 • Non-Oil Investment Was Sharply Under-Executed



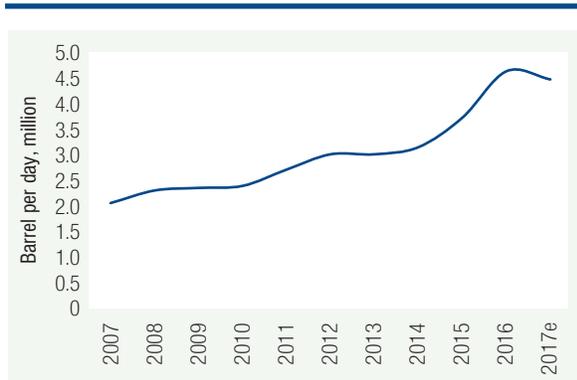
Sources: IMF; and World Bank estimates.

adjustment falling on non-oil investment expenditure, which negatively affected private sector consumption and investment. The Gol prioritized social and military expenditure, payments of wages and pensions to protect social stability, debt service and oil-related investment, but sharply under-executed non-oil capital investment. Thus, expenditures on oil investment increased from 48 percent in 2014 to about 66 percent of total investment expenditures in 2017, while non-oil investment expenditure declined from 52 percent to 34 percent of total investment expenditures in the same period (Figure 6). Because of insecurity and poor business environment, FDI declined from US\$4.1 billion (2.4 percent of GDP) in 2014 to US\$1.8 billion (1 percent of GDP) in 2017 (Figure 7). Private consumption and investment have slightly picked-up in 2017 following the end of the conflict that affected supply of goods and household spending.

Oil Sector

Iraq’s hydrocarbon sector has continued to be the primary driver of growth, but further expansion will depend on higher oil investments. Iraq has the fifth largest proven crude oil reserves in the world with 141.4 billion barrels. With the rapid increase in production in 2015 and 2016, the country is now the world’s third largest and OPEC’s second largest oil exporter. With 130 trillion cubic feet of proven reserves, Iraq’s largely untapped natural gas reserves

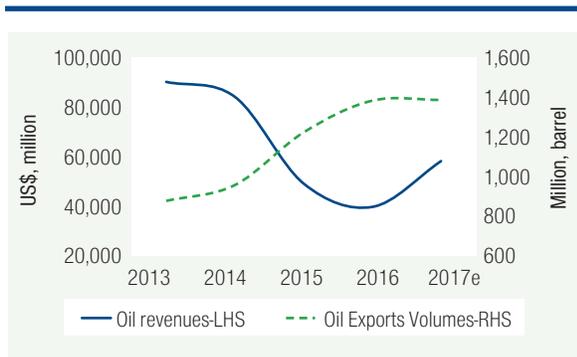
FIGURE 8 • Oil Production Is Estimated to Have Declined by 3.5 Percent in 2017, but to Remain the Primary Driver of the Growth



Sources: CSO; and IMF.

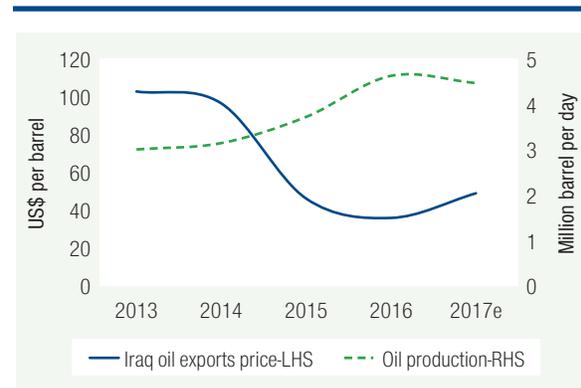
are the twelfth largest in the world. Iraq is also the world's fourth-largest natural gas-flaring country in 2014, behind Russia, Iran, and Venezuela. More than half of its gross natural gas production was flared in 2017. The country is taking steps to reduce flaring and instead use its natural gas resources more for power generation and for reinjection into wells to enhance oil recovery. The oil sector dominates the economy, even by regional standards. Despite volatile security conditions, oil production has tripled since 2003. The sector accounts for over 65 percent of GDP, 90 percent of central government revenue, and nearly 100 percent of the country's exports.

FIGURE 10 • Oil Revenue Is Estimated to Have Increased in 2017 Sustained by Higher Oil Prices



Source: Iraq Ministry of Oil.

FIGURE 9 • Oil Prices Are Estimated to Have Increased in 2017



Source: Iraq Ministry of Oil.

Conflict had only a limited impact on oil production, since the southern oil fields account for over 90 percent of production. Iraq's crude oil production⁴ averaged 4.6 million bpd in 2016, 900,000 bpd more than the production level in 2015. KRG accounted for 490,000 bpd or 11 percent of total 2016 oil production. In 2017, oil production estimated to have declined by 3.5 percent, to implement the OPEC+ agreement to cut oil production until end-2018 to increase international oil prices, and the reduction of oil production in Kirkuk in the last quarter of 2017, following the transfer of its control from the KRG to the federal government (Figure 8). Major obstacles to further expansion of oil production plans include lack of insufficient water supply and gas injection, and cumbersome bureaucratic procedures.

Despite the good performance in production and exports volumes, the fall of oil prices drastically reduced Iraq's oil revenue. Iraq's oil prices decreased from an annual average of US\$96.5 per barrel in 2014 to US\$35.6 in 2016, before increasing to an average of US\$48.7 in 2017 (Figure 9). Oil revenues decreased to US\$40 billion in 2016 (a 53 percent reduction) compared to 2014 and increased to almost US\$59 billion in 2017, a 46 percent increase compared to 2016 (Figure 10).

Following the GoI move to extend its authority in all disputed areas, KRG oil export volumes and

⁴ Including production in KRG,

revenues are estimated to have dropped by 55 percent in the last quarter of 2017. Since mid-2014, KRG has controlled the oil production area of Kirkuk, which defended from an attempted ISIS take-over. Production from Kirkuk contributed 250,000 bpd to KRG exports. Gross oil production from the territory of KRG amounts 310,00 bpd, of which 40,000 destined to local refineries. The federal government take-over of Kirkuk dropped KRG oil exports from an average of 520,000 bpd to 270,000 bpd. Furthermore, according to the KRG, the gross revenue generated from these exports and refining activities would amount to US\$420 million per month, but the oil revenue net of payments to international oil companies, debt service and payments for the use of the pipeline would amount to only US\$230 million per month to finance budget expenditure.

Access to Services

Iraq's current security and fiscal constraints have affected the Government's ability to provide basic public services, but the government will implement a number of projects supported by the World Bank to improve service delivery.

The fiscal, security, and humanitarian crises, hindered the government's ability to deliver the services needed for poverty reduction, social inclusion and economic development. Despite the large public expenditure in Iraq, access to even basic services (health, education, electricity, and transport) has been deficient, and the ISIS war further undermined service delivery. According to UNOCHA, as of February 2018 there are 2.6 million IDPs and 8.7 million people in need of targeted humanitarian assistance. Basic infrastructure has either been destroyed or is in a debilitated state, with cities like Mosul and Tal Afar facing over 70 percent destruction. Since July 2015, the World Bank is supporting the reconstruction efforts with the Emergency Operation for Development Project (EODP). In October 2017, the World Bank approved a US\$400 million additional financing to the project (US\$350 million) approved back in July 2015, to focus not only on the basic infrastructure but also on health and education, with a special attention to the needs of the marginalized

youth and women in those areas affected by ISIS. In February 2018, the World Bank approved the Iraq's Social Fund for Development (SFD) project financed with US\$300 million, to improve the living conditions of over 1.5 million poor households in Iraq by increasing access to basic services and creating employment opportunities. This was followed in April 2018 by the approval of the Emergency Social Stabilization and Resilience Project (ESSRP), financed with US\$200 million to increase livelihood opportunities, access to psychosocial services, and expand the provision of social safety nets.

Chronic shortages in the delivery of public services, especially electricity supply, have had a negative impact on households and private sector development. Already before the conflict, 73 percent of Iraqi firms identified lack of sufficient electricity supply as a "very severe obstacle" to productivity, and the most significant issue affecting private sector development and job creation.⁵ Technical losses, poor collection and tariffs below costs have made energy production a costly and increasing liability for the government. The deficit of the electricity sector is estimated to reach 5.2 percent of GDP in 2017.⁶ The economic cost of Iraq's severe electricity shortages is estimated to have exceed US\$22 billion annually in the 2013 Iraq Integrated National Energy Strategy (INES). Years of neglect have led to a dilapidated grid infrastructure with low operational efficiency and a broken business model unable to generate adequate revenue to sustain itself nor to offer value to its consumers. The 2014 World Bank poverty assessment⁷ shows that Iraqi households and consumers receive an average of 14.6 hours of electricity per day, of which only 7.6 hours per day is provided by electricity grid. Furthermore, Iraq's distribution system, outside KRG, has deteriorated owing to poor design, lack of maintenance, and electricity theft, resulting in large distribution losses, low voltage level, and frequent disconnections. The World's Bank Doing Business

⁵ Iraq Investment Climate Assessment (ICA) 2012 Survey (World Bank, 2012).

⁶ See IMF Staff Report, August 2017.

⁷ The Unfulfilled Promise of Oil and Growth: Poverty, Inclusion and Welfare in Iraq, 2007–2012, The World Bank 2014.

2018 report ranks Iraq poorly in terms of reliability of supply and transparency of tariff index. On a scale of 0 to 8, where higher values indicate greater reliability of electricity supply and greater transparency of tariffs, Iraq scores the lowest (0), compared to the average of 4.2 for the MENA region.

The Gol is committed to reform and restructure the electricity sector, with the support of the World Bank. As a result, the Gol increased tariffs fourfold effective January 2016 from an average of US\$1.7/KWh to US\$8.0/KWh. In October 2016, it adopted a strategy to reduce operational losses and increase tariff collection. However, with protests from key commercial consumer groups, the cabinet decided to lower the commercial and industrial tariffs effective January 2017, resulting in an overall average tariff reduction of 25 percent to about US\$6.0/KWh. In the medium-term, electricity sales revenue collections are expected to increase from about US\$780 million in 2015 to over US\$1.14 billion by end-2018. The new Electricity Law No. (53) of 2017 issued in March 2017 provides for the first time the legal framework for the sector's reform and governance. The World Bank is providing technical assistance to support the Government implement the MoE roadmap towards cost recovery, operational efficiency, and implementing a strategy for subsidy reform.

Poverty, Equity and Vulnerabilities

Poverty remains prevalent, exacerbated by the conflict, violence and the collapse in oil revenues, and the social safety net suffers from severe inefficiencies and gaps, but the Gol is embarking on a comprehensive reform that is improve targeting of the poor and vulnerable.

Poverty has risen sharply. Before the conflict, and despite Iraq experienced high economic growth driven by rapidly increasing oil revenue, poverty remained high and welfare improvements were particularly slow for the poor. Already in 2012, one fifth of the Iraqi population was spending less than the amount required to meet their minimum nutritional requirements and cover their basic non-food needs. Jobs were not providing a pathway out of poverty as 70 percent of the poor were

in households with employed heads. Poverty, which had seen a decline between 2007 and 2012, has risen sharply due to declining oil revenues and the war against ISIS. The poverty rate in 2014 was estimated at 22.5 percent for the whole country, pushing an additional three million people into poverty. Poverty rate doubled to 41.2 percent in ISIS-occupied areas, with a sharp increase in the Kurdistan Region of Iraq, from 3.5 percent to 12.5 percent, due to the inflow of 1.4 million internally displaced persons (IDPs) and over 241,000 refugees.⁸ The security crisis is estimated to have created more than 3.4 million internally displaced persons, half a million of which are estimated to have fell into poverty since the beginning of the conflict.

In February 2018, the Gol launched a second Poverty Reduction Strategy (PRS2) 2018–2022.

The new strategy,⁹ which aims to reduce Iraq's poverty by a quarter by 2022—to no more than 17 percent—is the result of a consultative and participatory process between all concerned ministries in Iraq and clearly identifies priorities to improving access to basic services to the poor, particularly to the most vulnerable including women and children, as well as providing sustainable social protection mechanisms. The new strategy also focuses on the needs of the returnees and IDPs in the recently liberated areas. Furthermore, the new strategy promotes income generation from projects in agriculture, that will particularly focus on rural women. This Strategy complements and aligns with the Iraq's on-going strategies and plans, including the Sustainable Development Goals, the Iraq's Vision 2030, Social Protection Strategic Roadmap, and the National Development Plan 2018–22.

Social protection is dominated by the inefficient and poorly-targeted Public Distribution System (PDS).¹⁰ The authorities, as agreed under the

⁸ Losing the Gains of the Past: The Welfare and the Distributional Impacts of the Twin Crises of 2014 in Iraq. World Bank, June 2015.

⁹ The first PRS-1 finalized in 2009 and adopted by the Parliament in 2010, has reached the end of its initially-envisaged implementation period in early 2016.

¹⁰ Under the PDS, the government procures local and imported food that is distributed to all families irrespective of income.

IMF SBA, will protect social spending which is expected to remain at around 22 percent of non-oil expenditure, in line with 2015–2017.¹¹ The PDS provides a minimum amount of caloric consumption to the entire population. It reached 99.4 percent of the poor and accounted for 64 percent of total caloric consumption for the bottom 40 percent of households in 2012. This program is large—the 2017 budget allocated ID 1.7 trillion, or 3 percent of the current primary budget expenditure—but it is untargeted, covering also 95 percent of the non-poor and suffers from significant inefficiencies in procurement, distribution, and management.

With the assistance of the World Bank, the Government is introducing a better targeted and cash-based social safety net program. To implement the Social Protection Law (11/2014), the Gol has adopted a proxy means testing (PMT) formula to identify the poor. The Gol committed to adopt in 2018 a unified database of eligible households based on the PMT system across all different social protection schemes. Other safety net programs are not yet poverty targeted and cover a small share of the poor. Through these reforms, the coverage ratio of the poor is expected to increase from 11 percent in 2015 to at least 50 percent by end-2018.

The Gol is also embarking on a comprehensive reform of its social protection system. In 2016, the Gol has introduced to the Council of Representative (CoR) a new draft Social Insurance Law, which expands the coverage and fairness of the pension system and improve its sustainability. Iraq's pension system is fragmented, unequal, costly and unsustainable. Public pension spending in Iraq, at around 4 percent of GDP, is high by international standards.¹² Despite such a high cost, the system suffers from large coverage gaps and provides overly generous benefits. Pensions, reach less than 20 percent of the poor, while about 85 percent of pension recipients belong to non-poor households. Only about 48 percent of the total labor force is currently contributing to and covered by the pension system. Most covered employees are in the public sector, while less than 3 percent of the private sector employees are covered. Revising pension parameters would not only reduce the fiscal cost of the public-sector pension scheme but would also improve the system's equity characteristics. In addition, the new pension system would harmonize the public and private systems and

make the pension portable, removing a disincentive for seeking employment in the private sector.

With initial financing provided by the World Bank, the Gol is improving service delivery at the community level, through the implementation of the Iraq's Social Fund for Development program (SFD).

With a US\$300 million loan from the World Bank approved in February 2018, the SFD program aims to provide technical assistance and capacity building for sustainable and inclusive development of local communities, support and empower them to improve their livelihoods and access to basic services, and increase short-term employment opportunity in communities affected by conflict. The program would also include a specific allocation to support women entrepreneurship with special financing for women-led projects. The SFD is expected to scale-up across all of Iraq, including KRG, over a period of five years, using a phased approach, with resource allocation based on population and poverty headcount figures in the governorates. Resource allocation will also include an allowance for IDPs, with 10 percent of total resources divided between governorates proportional to the number of IDPs they are hosting.

Labor Markets and Employment

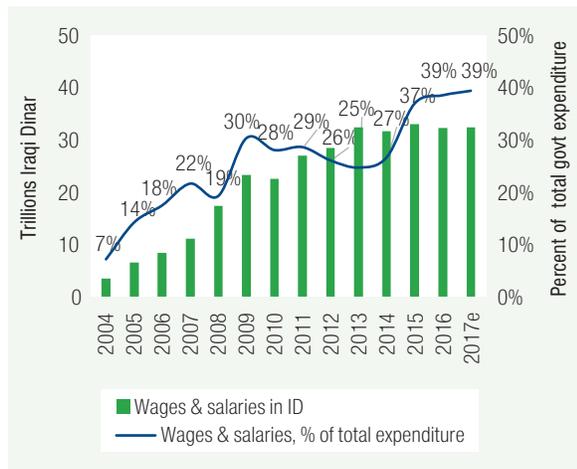
The public sector is predominant employer in Iraq, and unemployment remains high, especially between women and youth.

The public sector is the predominant employer in Iraq and the role of the formal private sector is marginal. Public sector expansion has created wide distortions and limited job opportunities in other sectors. Although more than 750,000 new jobs were created between 2007 and 2012, these were not enough to absorb all new participants in the labor market, and

¹¹ Defined as budgetary allocations to health, education, and transfers in support of the PDS, the social safety net, the internally displaced and refugees.

¹² The OECD average of 23 countries is 1.8 percent of GDP; Iraq's spending also exceeds the OECD's most expensive pension system, namely, that of Greece at 3.7 percent of GDP.

FIGURE 11 • The Wage Bill Continues to Be the Largest and Fastest Growing Expense in the Government Budget



Sources: IMF; and World Bank estimates.

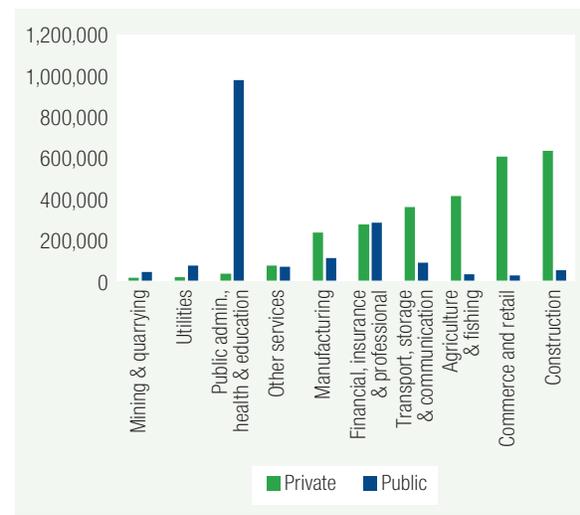
four-fifths of these new jobs were generated by the public sector. Increasing oil revenues have enabled the rapid expansion of public sector employment. From 2004 to 2014, public sector employment more than tripled from 0.9 to 3 million employees. Over the same period, the government wage bill ballooned from 7 to 27 percent of the budget. In 2017, the wage bill is estimated to increase to ID32.5 trillion or 40 percent of government budget (Figure 11). Iraq is an outlier in terms of the wage bill (as a share of GDP) in MENA among oil exporting countries (Figure 12).

FIGURE 12 • Iraq Is an Outlier in Terms of the Wage Bill



Sources: IMF; and World Bank estimates.

FIGURE 13 • Jobs by Sectors, Public and Private



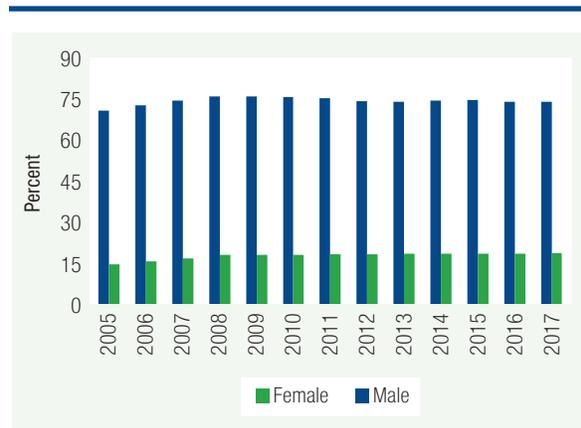
Source: Iraq Household Socio-Economic Survey 2012.

With support of the IMF and the World Bank, the Gol is taking steps to control and reduce the wage bill. This sharp rise in the wage expenditures was driven largely by unchecked politically backed recruitment and by fraudulent payroll practices, including the proliferation of “ghost” workers (not legally employed), and “double dippers” (illegally drawing multiple salaries), collection of salaries by chronic absentees and outright theft of payroll cash. Under the IMF SBA, Gol committed to reduce the number of employees through natural attrition.¹³ With support from the World Bank, the Gol has also introduced expenditure control measures, including a transition to electronic payment of salaries and biometric verification of civil servants’ attendance.

Potential for private sector jobs is in construction, retail services, tourism, transport and logistic and agri-business (Figure 13). Employment in small and medium enterprises (SMEs) is concentrated in construction, commerce (retail and

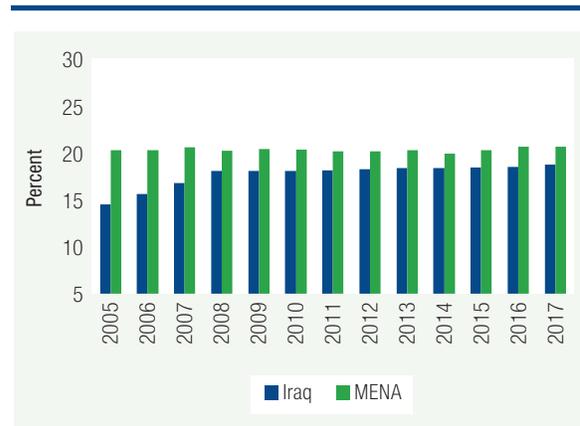
¹³ The natural attrition strategy entails (1) freezing employment in all sectors except three priority sectors (education, health, and defense), and (2) hiring only one new employee for every five retiring employees in the three priority sectors.

FIGURE 14 • Labor Force Participation for Men Highly Exceeds that for Women



Source: World Bank, WDI.

FIGURE 15 • Women Participation in Labor Force Is Below the Already Low Rates for that in MENA



Source: World Bank, WDI.

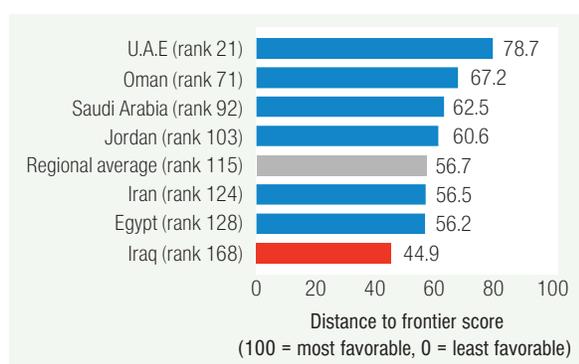
wholesale trade), transport and communications. Construction is the single largest employment sector in the private sector and one of the largest sectors for jobs in the entire economy. Because of reconstruction activities, the sector has also large potential to grow Tourism, whose main driver is religious tourism, generated US\$4 billion in export earnings in 2015 and is the largest non-oil exports. Transportation, freight, and logistics remain dominated by the state but growth of SMEs is increasing. Agriculture more broadly provides about 20 percent of employment and contributes 4 percent of GDP. Its potential has been severely diminished by conflict and insecurity. It represents a large employer for women. While accounting for more than 65 percent of GDP and 90 percent of government revenue, the oil sector currently employs only 1 percent of the total labor force.

Unemployment is high and labor force participation remains exceedingly low, especially for women and youth and in the areas affected by conflict. Unemployment was officially estimated at 11 percent in 2011, although actual levels, particularly among youth, were significantly higher. Jobs were not providing a pathway out of poverty even before the crisis. Iraq has one of the lowest employment-to-total population ratios in the region, even among men, and the 2014 crisis has led to an estimated reduction in employment by 800,000 jobs. The WB estimates that there were 2.5 million unemployed Iraqis including

IDPs in 2016, and the national unemployment could have reached 15 percent in 2017. Youths are underrepresented in government jobs, and limited growth of the private sector has not generated significant employment opportunities, especially for young Iraqis. From 2005 to 2014, Iraq's youth unemployment (ages 15–24) never dropped below 32 percent, despite economic growth that averaged over 6 percent during that period, with youth employment estimated to have increased over 33 percent since then.¹⁴ In the period 2005–2017, only an average of 17 percent of Iraqi women of working age participate in the labor force—below the already low rates of female labor force participation in MENA region of 21 percent (Figure 14)—and compared to 74 percent of that for men (Figure 15). The unemployment rate for young females is double that of males. In 2017, about 56 percent of young females were unemployed compared to 29 percent for young males. The labor force lacks basic skills because of years of war and sanctions and massive emigration since 2003. The sector of employment for households is also a strong determinant of poverty, with 70 percent of poor household heads working in agriculture, construction, utilities, transport or non-employed.

¹⁴ World Bank, World Development Indicators (WDI) based on modeled ILO estimate.

FIGURE 16 • Unfavorable Business Environment Remains a Significant Deterrent to Foreign Investment, but Reforms on the Way



Source: World Bank, Doing Business 2018.

Business Environment and Private Sector Development

Poor business environment and corruption keep Iraq at the bottom of global rankings for doing business, but recent reforms will pave the way for more progress going forward.

An unfavorable business environment remains a significant deterrent to foreign investment.

Overall, Iraq ranked at 168 out of 190 economies in the 2018 Doing Business;¹⁵ significantly behind other countries in the region (Figure 16). The 2018 Doing Business finds that during 2016 and 2017, Iraq has implemented substantive changes in the local regulatory framework in two main areas: starting a business and getting credit. In fact, starting a business in Iraq has become easier by combining multiple registration procedures and reducing the time to register a company. Entrepreneurs are no longer required to register separately with the tax authority. The time required to register a company has declined thanks to increased resources at the registry, an improved online registration system. As a result, Iraq's rank in the ease of doing business improved by 11 points from 165 to 154, but still below that for MENA region (113). Iraq has also improved access to credit information by launching a new credit registry managed by the Central Bank of Iraq.¹⁶ Iraq performed poorly on several of the other areas that

FIGURE 17 • The Quality of Iraqi Governance Remains Critical



Source: World Bank Worldwide Governance Indicators.

Doing Business measures, including, trading across borders (179), resolving insolvency (168), enforcing contracts (144), and getting electricity (133). Difficulties with corruption, customs regulations, cumbersome visa procedures, unreliable dispute resolution mechanisms, electricity shortages, and lack access to finance are common complaints from businesses. The WB is providing support to Gol in improving performance in areas covered by the Doing Business report namely: resolving insolvency, enforcing contracts, getting credit, protecting minority investors, and in reforming the business registration scheme at the national level in Baghdad and the subnational level in KRG.

Corruption and poor governance remain critical issues. The country is persistently ranked around or below the tenth percentile globally based on indicators of government effectiveness, rule of law, and control of corruption (Figure 17). Iraq's performance was particularly poor in the indicators

¹⁵ In 2017 Doing Business report, Iraq ranked 165 out of 190 economies, however, these rankings are not comparable because of the introduction of some methodology refinement and data revisions that impact how countries rank.

¹⁶ As of January 1, 2017, the registry listed 234,967 consumers and 4,877 commercial borrowers with information on their borrowing history within the past five years.

for stability and absence of violence, rule of law, and control of corruption. It is also ranked 169 out of 180 countries in the latest Transparency International Corruption Perception Index 2017, with only Syria, Yemen, and Libya scoring worse within MENA region. Social unrest has continued periodically due to low quality and availability of basic public services and perception of widespread corruption. In 2016, Iraqi parliament questioned and dismissed the Minister of Trade, Defense and Finance on corruption allegations. In early January 2018, the Government successfully pursued extraditions of high level officials accused of corruption from neighboring countries. Payroll corruption, including collection of salaries by “ghost employees”, chronic absentees and skimming of salaries, is rife, and hiring and disciplinary decisions are affected by nepotism and bribery. Efficient public procurement processes are often undermined by bribery and kickbacks. Difficulties with corruption and unreliable dispute resolution mechanisms remain common complaints from companies operating in Iraq. Weak public administration, lack of experienced staff, high insecurity, and weak oversight of government spending provide incentives and opportunities for corruption.¹⁷ Investors in KRG face many of the same challenges as investors elsewhere in Iraq, but a business-friendly investment law and more stable security situation are generally more attractive to foreign businesses. However, the ISIS offensive, low oil prices, and suspended budget transfers from the federal government have reduced foreign investment in KRG as well. The Iraqi government led by the Prime Minister Al-Abadi has committed to a road map, including reducing obstacles to business, tackling corruption, and promoting foreign investments. The WB-DPF operation is aligned with the government objectives and the demand of citizens for improving governance, transparency, and reducing corruption through increased expenditure rationalization.

Fundamental constraints remain behind the very limited capacity and incentives of the private sector. Iraq’s private sector is not yet able to generate the investment and enterprise growth that is needed to create employment and reduce Iraq’s high level of dependence on oil revenue and public sector employment. Multiple constraints stifle investment

and continue to limit growth of private, non-oil sectors, including poor security and infrastructure, rampant corruption, skilled labor shortages, and antiquated commercial laws. Many private businesses are small and informal; mainly operating in retail and trade, construction and transportation services.

Firms identified access to electricity as the most severe obstacle to private sector development, but the track record to address this constraint remains unconvincing. Before the conflict, 73 percent of Iraqi firms identified the lack of sufficient electricity supply as a “very severe obstacle” to productivity, and the most significant issue affecting private sector development and job creation.¹⁸ To promote a shift towards more diversified private sector-led development, the Gol has prioritized improving the doing business and investment environment, and has adopted a strategy to increase electricity supply and reliability through corporatization of the sector and the adoption of a tariff setting policy to eliminate subsidies in five years (see special chapter on electricity tariffs). However following protests against higher tariffs and a lack of an improvement in the supply of the service, in January 2018, the CoM approved a new tariff structure that reduced electricity tariffs by 16 percent.

Public Finance

Following the rapid deterioration in the period 2014–16, the fiscal deficit is estimated to have improved in 2017 due to higher oil prices and measures to increase non-oil revenues and fiscal adjustment. To finance past deficits, the Iraqi government has increased domestic and external public debt, which doubled from 30 to 60 percent of GDP from 2014 to 2016. Public debt is estimated to have declined in 2017 and to remain sustainable over the medium-term provided the Gol continues its fiscal adjustment. The Gol has also improved debt

¹⁷ Transparency International, Coralie Pring, U4 Expert Answer, Anti-Corruption Resource Center 2015.

¹⁸ Iraq Investment Climate Assessment (ICA) 2012 Survey (World Bank, 2012).

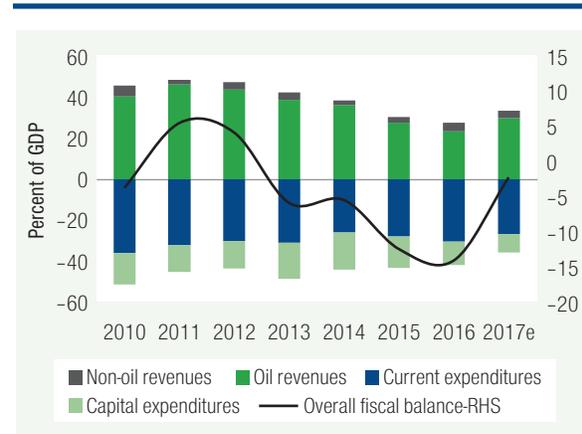
management capacity, with the adoption of pre-announced monthly domestic debt auctions and a new framework to assess risks of government-issued guarantees.

Lower oil receipts have considerably widened the budget deficit in 2015 and 2016.

With no other relevant source of revenue, Gol's budget deficit increased from 5.4 percent of GDP in 2014 to 14 percent of GDP in 2016, despite a reduction of primary expenditure by almost 23 percent in real terms over the period 2015–16 (Figure 18). Rapid fiscal deterioration resulted from a sharp reduction in oil prices, which decreased from an annual average of US\$96.5 per barrel in 2014 to US\$45.9 in 2015 and US\$35.6 in 2016. The limited financing available forced the Government to make some adjustments to contain the deficit in both 2015 and 2016. On the revenue side, these focused on ensuring increased volumes of oil exports (e.g., through oil infrastructure—pipelines, storage facilities, maintenance—optimization). On the expenditure side, the Government prioritized security spending, payments of wages, pensions, debt service and oil-related investments and sharply under-executed non-oil capital investment (Figure 19). Domestic and external arrears also accumulated to US\$11 billion at end-2016.

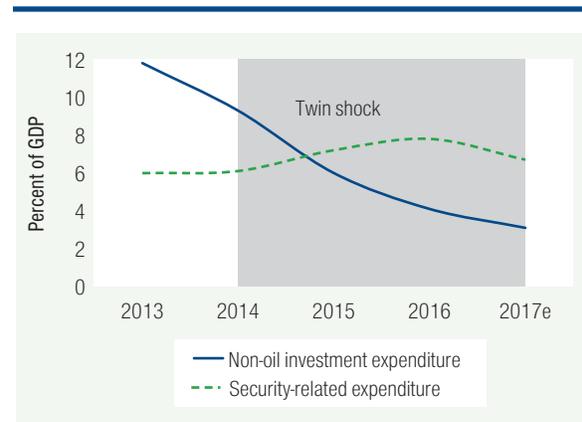
In 2017, the fiscal deficit is estimated to have improved to 2.2 percent of GDP thanks to higher oil prices, measures to increase non-oil revenue, and cap expenditure on wages, pensions and transfers. There was a 43 percent increase of oil revenue despite production cuts, driven by higher oil prices. To keep the fiscal consolidation on track and protect social spending, the 2017 supplementary budget, adopted on July 28, 2017, increased non-oil taxes with the introduction of a flat 3.8 percent withholding tax on wages and the adoption of a tax on internet services. Nominal expenditure on salaries and pensions were kept at their 2016 level, and current expenditure and domestically financed investments were reduced. The 2017 budget included a larger envelope to pay domestic and external arrears, a key measure to increase private sector confidence. The Gol has also committed to strengthen procedures to avoid further accumulation of arrears in 2018. The Gol is prioritizing investment expenditure for

FIGURE 18 • Following Large Deterioration, Higher Oil Prices and Continuation of Fiscal Adjustment, Fiscal Deficit Is Estimated to Have Improved in 2017



Sources: IMF; and World Bank estimates.

FIGURE 19 • Improved Security in 2017 Is Estimated to Have Contained a Large Fall in the Share of Non-Oil Investment to GDP, while the Share of the Security Spending Declined



Sources: IMF; and World Bank estimates.

reconstruction in areas liberated from ISIS, and increasing electricity production.

The 2018 budget is expected to result in a small surplus, but it represents a setback in Gol attempts to reduce dependency on oil revenue.

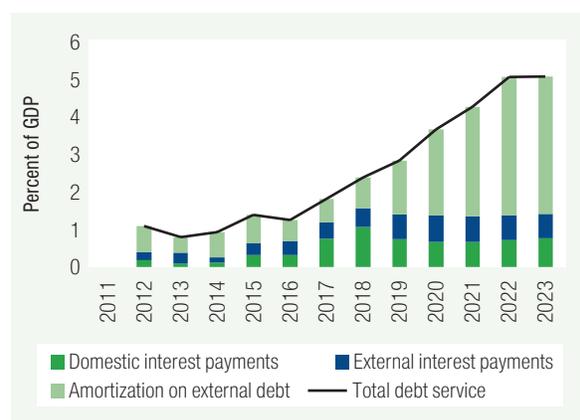
Oil revenue in 2018 is prudently budgeted at an export price of US\$46 per barrel. At this level, the overall fiscal deficit would remain contained at 1.7 percent of GDP.

FIGURE 20 • Large Borrowing and Debt Guarantees Increased Iraq’s Public Debt-to-GDP Ratio



Sources: Ministry of Finance and World Bank estimates.

FIGURE 21 • Large Borrowing is Projected to Increase Total Debt Service



Sources: Ministry of Finance and World Bank estimates.

However, with export oil prices expected to average above US\$56 per barrel in 2018, the fiscal balance is expected to reach a surplus of 2.7 percent of GDP. The approve budget does not include investment financing for reconstruction. Therefore, the budget surplus in 2018 should be considered as government savings to continue to re-build buffers and provide financing for reconstruction after the amount of foreign financing has been clearly identified.

The Gol’s reform program has been supported by a large financing package from

the international community, and, thanks to satisfactory performance, the Gol has also tapped the sovereign bond market in 2017. The financing provides has so far avoided that the large fiscal shock could trigger a much deeper economic and social crisis that would excessively hurt the poor and further delay the economic recovery and reconstruction of Iraq. The financing package from the international community includes a US\$5.34 billion Stand-By Arrangement (SBA) with the IMF; a US\$1.444 billion budget support operation approved by the World Bank on December 2016, including US\$444 million guarantees provided to the Bank by the United Kingdom (US\$372 million) and Canada (US\$72 million); US\$270 million in parallel financing provided by JICA, US\$450 million provided by France; and a US\$1 billion bond issued in January 2017, guaranteed by the U.S. government. In August 2017, following the successful conclusion of the second review of the IMF program, the government issued a US\$1 billion bond maturing in 2023, its first independent issuance since 2006.

Since the onset of the crisis, public debt doubled from 32 percent of GDP in 2014 to 64 percent of GDP in 2016, but this pace has since been halted. Over the same period, domestic debt increased from 7 to 27 percent of GDP and external debt increased by 12 percentage points of GDP. Thanks to fiscal consolidation and higher oil prices, total public debt is estimated to decline to 58 percent of GDP in 2017 (Figure 20). Large borrowing at commercial terms, including through the issuance of Eurobonds is projected to rapidly increase total debt service, which would reach 5 percent of GDP by 2023 (Figure 21). In 2017, the government was able to reduce the stock of guarantees from US\$36.5 billion to US\$25.7 billion, thanks to improved management practices, and limited their issuance within a ceiling established in the annual budget law.

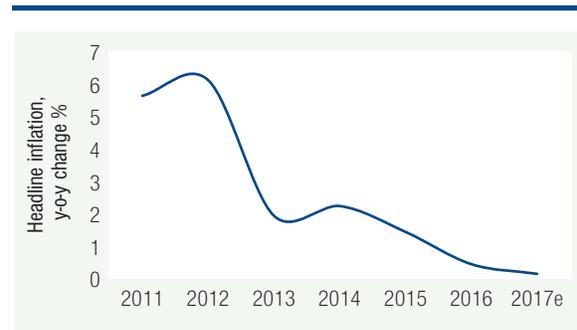
The KRG is implementing measures of fiscal austerity to contain expenditure and improve non-oil revenue. Since mid-2014, the inflow of 1.4 million IDPs and 241,000 Syrian refugees to KRG have increased needs to deliver services. Oil revenue, which represents 90 percent of total KRG fiscal revenue, decreased from US\$8.3 billion in 2014 to US\$5.5 billion in 2016, because of lower oil prices. In 2016 the KRG

announced new measures to withhold a significant percentage of government salaries, pensions and stipends—excluding Peshmerga and other security forces. In 2016, these delayed payments provided a temporary fiscal saving of ID 531 billion (US\$455 million). In addition, the KRG took an action to reduce operating costs. The Government has also moved to increase non-oil revenues by raising fees, penalties, water charges and electricity tariffs for industrial consumers; as well as by slashing petroleum product subsidies. As a result, fiscal deficit decreased by 80 percent from 2014 to 2016—from ID 7.7 trillion in 2014 to an estimated ID 1.6 trillion in 2016, but spending pressures remain high to accommodate the need of IDPs and refugees. Debt and arrears on payments of the Government payroll have mounted since 2014. Public debt increased from less than US\$1 billion in 2012 to US\$18 billion in 2015. Arrears amounting to US\$8 billion at end-2015 have accumulated on wage payments to public employees and payments to oil-producing companies.

Failure to reach an agreement on budget transfers could increase vulnerability in KRG.

Previous agreements were only implemented two months in 2014 and five months in 2015 and halted entirely in 2016 and 2017.¹⁹ Since mid-October 2017, the Federal Government has quickly regained control of all areas disputed between the Federal Government and KRG, including Kirkuk, an oil rich area. As a result, KRG has lost half of its oil revenue. The 2018 federal budget proposes to reduce transfers to KRG from ID12 trillion in 2017 to ID6.7 trillion in 2018 and requires KRG to transfer the entirety of its remaining oil export receipts, assumed to amount to 250,000 barrels per day, to the federal government. This lower level of transfers could result insufficient to pay salaries in KRG to the civil servants and the military. Since early 2018, demonstration demanding payment of salaries have become frequent in the area. The Federal Government and KRG are continuing to work to reach an agreement to ensure payment of salaries. In January and March 2018, the Federal Government has made transfer to pay salaries of the Ministry of Health and Education, following audits to verify of the number of employees and the amount of salaries.

FIGURE 22 • Inflation Remains Low Thanks to Pegged Exchange Rate and Subdued Demand



Source: Iraq CSO.

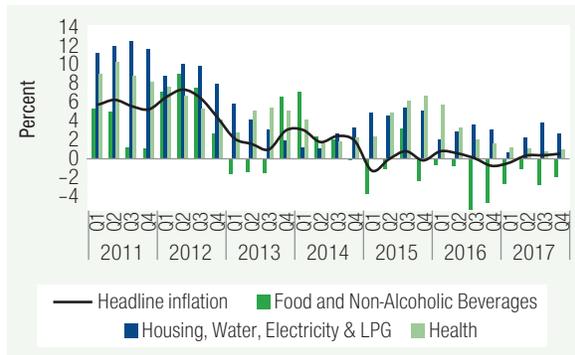
Inflation, Money and Banking

The pegged exchange rate and subdued demand contributed to maintain inflation very low. Banking system is underdeveloped, dominated by inefficient State-Owned Banks, with little credit to the private sector. The Central Bank of Iraq is continuing reforms to improve supervision of banks, and simplify access to the foreign exchange auctions.

Inflation remains very low. The pegged exchange rate and subdued demand have kept inflation low at around 0.1 percent in 2017 (Figure 22). The disruption in trade and food supply moderately boosted food inflation in the third quarter of 2015, to an average rate of 3 percent, but food prices have decreased since, reaching -2 percent in the fourth quarter of 2017 (Figure 23). Official statistics don't include the conflict-affected provinces, where inflation could be higher due to shortages in fuel and goods. Prices have also increased in the KRG governorates that host many IDPs and Syrian refugees, and where food and basic commodities cost more than in other governorates.

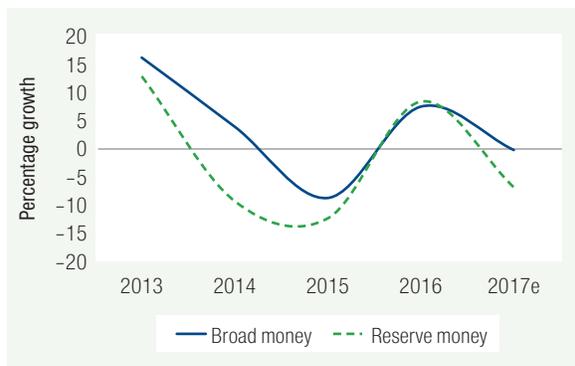
¹⁹ The budget sharing agreement reached in 2014 required that KRG transfers revenue from exports of 500,000 barrel per day of oil extracted in KRG territory and in areas controlled by KRG and the federal government makes transfers to the KRG equivalent to 17 percent of non-sovereign spending in the federal budget.

FIGURE 23 • The Disruption of Trade and Food Supply Boosted Food Inflation the 2nd Quarter 2015, but Remained Low since Then



Sources: Iraq CSO.

FIGURE 24 • Monetary Aggregates Are Estimated to Have Declined in 2017



Sources: IMF, and World Bank estimates.

Broad money and reserve money declined in 2017. Because of fiscal consolidation, increase in availability of foreign financing, and continued government borrowing from banks, reserve and broad money have increased in 2016. In 2017, the broad money has remained almost unchanged compared to 2016. Reserve money have contracted 7.1 percent y-on-y (Figure 24), as CBI reduced the reserve requirement ratio on time and saving deposits from 15 to 10 percent in March 2017 to support banks' liquidity.

The banking system in Iraq is underdeveloped, dominated by inefficient State-Owned Banks and

extends little credit to the private sector. As of September 2017, there were 70 banks operating in Iraq, including 7 state-owned banks (SOBs), 44 Iraqi private banks, and 19 foreign banks. The SOBs account for the bulk of assets and credits, particularly three of them, Rafidain Bank, Rasheed Bank and Trade Bank of Iraq (TBI). Both Rasheed Bank and Rafidain Bank are believed to be capital deficient. Since the crisis, SOBs have provided soft loans, amounting to about ID9.8 trillion (or US\$8.3 billion), to insolvent SOEs to allow them to pay salaries. The government is committed to restructure Rasheed Bank and Rafidain Bank. The first audits on their latest financial statements per international standards since 2006 have been finalized and submitted to the CBI and Ministry of Finance in end-September 2017. Results of the audits are heavily qualified and inconclusive, as the auditor was not able to obtain sufficient appropriate evidence to form an audit opinion. Private banks are small and they are mostly active in currency exchanges and wire transfers. In 2017, total credit to the economy was 12 percent of GDP, the lowest level in the Middle East and North Africa (MENA). Access to finance is very low in Iraq with only 11 percent of adults having a bank account, suggesting that there is a substantial unmet demand for financial services. In addition, men are more than twice as likely to have a bank account than women. The share of non-performing loans to total loans is high for both public and private commercial banks at 10 percent and 24 percent respectively at end-2016 and expected to have increased in 2017, reflecting the low business confidence, and reduced private sector activity.

The CBI is working toward eliminating exchange rate distortions. The fixed exchange rate regime has worked well in a highly volatile situation helping maintaining prices stable in the areas non-occupied by ISIS. The real and nominal effective exchange rates for Iraq appreciated by about 8 percent in 2016. This is a continuation of the real appreciation trend that the Iraqi Dinar has experienced since 2013 and mirrors the appreciation of the U.S. dollar to which the Iraqi dinar is pegged. To protect reserves, the CBI has enforced limits on transfer of investment proceeds and in 2016 reduced its foreign exchange sales on the official market. As a result, the spread between official and parallel market exchange rate has widened from

3 percent at end-2015 to 9 percent in January 2016. Under the IMF SBA program, and to boost investors' confidence, the CBI has committed to remove restrictions to the repatriation of investment proceeds as well as remove weekly limits to purchases on foreign exchange by commercial banks and citizens. Thus, streamlined procedures for access to the CBI foreign exchange window have contributed to a reduction of the spread between the official and parallel exchange rates from 10 percent in December 2016 to 6 percent in December 2017 as the Central Bank of Iraq (CBI) streamlined the documentation requirements for access to its foreign exchange window.

The Central Bank of Iraq (CBI) is continuing its reforms and tightening supervision of the banking sector while at the same time simplifying access to its foreign exchange window. The CBI is placing special emphasis to its mandate on Combating Financing of Terrorism (CFT) and Anti-Money Laundering (AML) regulations. The risk of money laundering and terrorist financing has increased during the ISIS war. Physical assets of some banks and their clients have been destroyed. The government issued a new AML/CFT Law in October 2015, which kept Iraq off the Financial Action Task Force's (FATF) black list. In 2016 and 2017, the CBI has issued regulations to comply with the AML/CFT

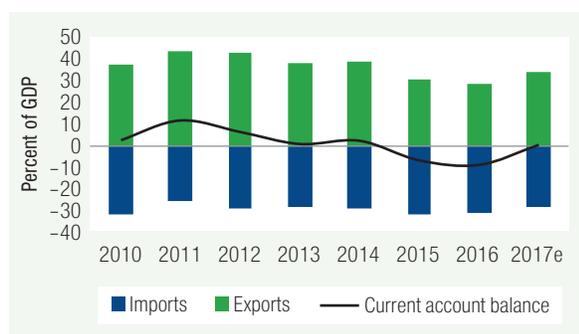
law for banks, foreign exchange bureaus, insurance companies and other actors. In February 2018, the FATF has issues a very supportive statement of the reforms implemented and has planned a verification mission in May 2018, following which Iraq is expected to be removed from the FATF watch list. Without undermining anti-money laundering regulations, the CBI has also implemented several measures to simplify access to its foreign exchange window.

External Position

Higher oil prices have helped the current account to return to a surplus in 2017, but foreign reserves continued to decline.

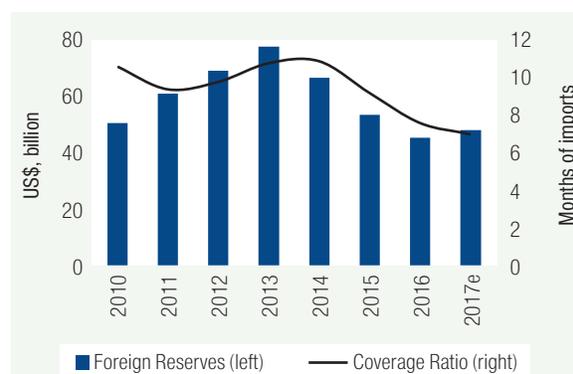
In 2017, the current account deficit is estimated to have returned to a surplus of 0.7 percent of GDP. Low oil prices widened the current account deficit to 8.6 percent of GDP in 2016 (Figure 25). The strong reserve accumulation in 2010–2013 smoothed the impact of the fiscal policy adjustment required to maintain external sustainability. Foreign reserves financed most of the balance of payment deficit, declining from US\$77.8 billion at end-2013 (or 10 months of imports) to US\$48.1 billion at end-2017 (or 7 months of imports) (Figure 26).

FIGURE 25 • Current Account Balance Is Estimated to Have Returned to a Surplus of 0.7 Percent of GDP in 2017



Sources: Iraqi authorities; IMF; and world Bank estimates.

FIGURE 26 • International Reserves Have Been Falling to Finance the Current Account Deficit



Sources: Iraqi authorities; IMF; and world Bank estimates.

ECONOMIC OUTLOOK AND RISKS

Economic Outlook

Iraq's overall growth outlook is expected to improve due to increasing oil production, a more favorable security environment, gradual pick up of investments for reconstruction and economic recovery and a more benign global and regional outlook. Overall growth expected to return positive at 2.5 percent in 2018 and to further accelerate to 4.1 percent in 2019 and to average around 2 percent in the medium-term. Oil demand is expected to be sustained by strong global growth in 2018 (Box 2). Non-oil growth is projected to reach 3 percent in 2018 and then is conservatively projected to recover to about half its pre-2014 average growth to 4 percent as recurrent violence and remaining insecurity would delay investment and post-conflict recovery. Average inflation is expected to remain at 2 percent over the projection period, assuming maintenance of the exchange rate peg. Projections do not factor in possible higher investment for reconstruction. At a reconstruction conference hosted by Kuwait in February 2018, the Gol obtained pledges amounting to US\$30 billion to finance reconstruction activities, but it still has to formulate an investment plan for

the medium-term, which would be consistent with the financing received and domestically-financed investment.

The macroeconomic outlook is based on conservative assumptions regarding oil production. Oil production is expected to remain strong at around 4.8–4.9 mbpd for 2019–21, if Gol and KRG reach an agreement to continue to share the KRG-controlled pipeline. Oil production is expected to grow by 2.2 percent in 2018 despite the extension of the OPEC+ agreement until end-2018.²⁰ Oil production will be sustained thanks to the resumption of production in Kirkuk's province, where it was halted following the re-occupation of the province by the Federal forces in mid-October 2017. Oil production is expected to return to pre-2017 levels in 2019, after the expiration of terms of the current OPEC+ agreement. It is then projected to continue to

²⁰ This outlook does not yet factor in that OPEC countries and other non-OPEC oil-exporting countries could agree to further extend the production cap to end-2019, as proposed in March 2018 by Saudi Arabia and Russia.

increase by 1 percent per year as Gol cannot afford to significantly increase investments in the oil sector.

Under a reconstruction scenario, non-oil growth could spike to above 6 percent in 2018-19, but it is expected to taper off once the scale effect of higher investments is factored in

(Box 1). Under this scenario, a step up of government investment, with a large import component, is expected to stimulate growth over the projection period in agriculture, manufacturing, construction, transport and supporting services. Elevated levels of forced displacement and remaining insecurity could

BOX 1 • Reconstruction: Only a Limited Boost, Especially if Delayed

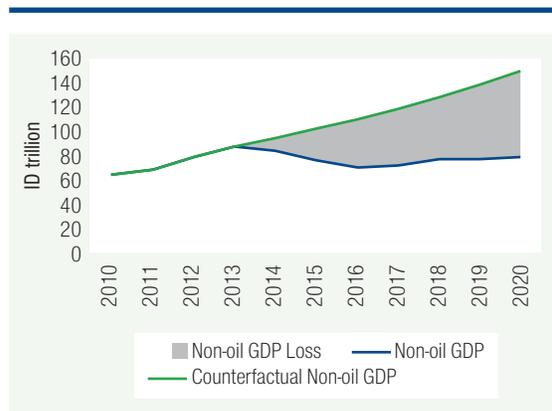
Iraq's conflict has caused a three-year recession of non-oil GDP. By 2017 the cumulative real losses to non-oil GDP stood at 72 percent of 2013 GDP (Figure B1) and 142 percent of 2013 non-oil GDP, assuming the non-oil economy would have continued to grow at the pre-conflict rate of 8 percent. The conflict has only marginally affected oil production, which has continued to grow.

The reconstruction would only partly offset the economic and social losses suffered by Iraq. Estimates of the growth effects of a credible path of public and private investments indicates how fast the reconstruction would bring non-oil GDP to its pre-conflict 2013 level. A reconstruction path to pre-conflict level of non-oil GDP would include higher public and private investment. Post-conflict total gross capital formation grows gradually as a share of GDP and in a back loaded fashion, which is consistent with the absence of a prolonged post-conflict boom, following a short-lived immediate recovery.^a Investments in infrastructure tend to ramp up and peak 6 years after the end of a conflict.^b Past levels of FDI inflows indicate that Iraq can attract large amounts of foreign capital that can provide the country with access to capital, skills, technology, and international business networks not available domestically. Since 2004, Iraq had experienced a tenfold increase in FDI inflows, which stood at over \$5 billion in 2013.^c Most FDIs were directed to the oil sector, and provided financing also for construction and agriculture.

Thanks to higher growth, the non-oil economy will reach 2013 levels by 2019 if both higher public and private investments are realized. It will take one year longer if there is no scale up of private investment (Figure B2). Compared to the baseline macroeconomic outlook, the reconstruction scenario assumes that from 2019 Gol will be able to gradually increase non-oil public investment by US\$10 billion.^d This is a conservative estimate that would result into a reconstruction phase longer than 10 years. It is assumed that public investment for reconstruction is entirely externally financed, at terms comparable to those of the current Iraq's external public debt portfolio and with a magnitude adequate to an initially limited absorption capacity and consistent with debt sustainability.^e Increased security and public investment would also contribute to the return of private investment to the pre-conflict level of US\$5 billion a year by 2019.

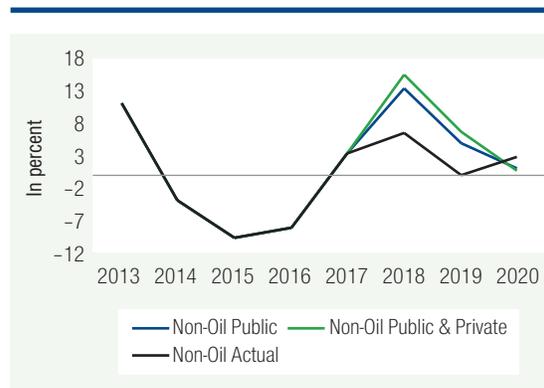
Further delays in the reconstruction would continue to increase the cost of the conflict for the people of Iraq. However, investment alone would not be sufficient for Iraq to achieve higher non-oil growth if structural reforms would not result in higher productivity of the Iraq economy. The recovery would also take longer if the reconstruction fails to crowd in the private sector.

FIGURE B1 • Non-Oil GDP Losses



Source: World Bank staff estimates.

FIGURE B2 • Non-Oil GDP



Source: World Bank staff estimates.

^a United Nations and World Bank (2017); Schwartz, Hahn, and Bannon (2004).

^b Schwartz, Hahn, and Bannon (2004).

^c An amount similar to that of significantly larger economies such as Egypt and Nigeria and the second largest as a share of GDP among OPEC countries.

^d A level consistent with the investment needs indicated by the Gol. In 2018 a US\$5 billion increase in non-oil public investment is assumed compared to the baseline.

^e Under this scenario public debt would continue to increase and peak in 2020 at 61.8 percent of GDP, compared to the baseline.

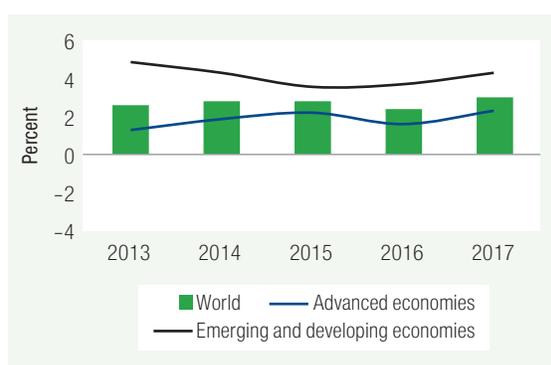
BOX 2 • Global and Regional Economic Outlook

Global Economy. The global economy is experiencing a cyclical recovery, reflecting a rebound in investment, manufacturing activity, and trade. In January 2018, the World Bank estimated the global growth to have picked up from 2.4 percent in 2016 to 3 percent in 2017, above the June forecast of 2.7 percent (Figure B3). Growth in Advanced Economies strengthened in 2017, reaching an estimated 2.3 percent and helped by a recovery in capital spending and exports. In the United States, growth picked up in 2017 to an estimated 2.3 percent, supported by strengthening private investment. The recovery reflected a diminished drag from capacity adjustment in the energy sector, rising profits, a weakening dollar, and robust external demand. In the Euro Area, growth gained substantial momentum in 2017, reaching an estimated 2.4 percent with broad-based improvements across member countries spurred by policy stimulus and strengthening global demand. In Japan, growth picked up in 2017 to an estimated 1.7 percent. Domestic demand firmed, supported by a gradual recovery in consumer spending and investments, as well as the implementation of a fiscal stimulus package. In China, growth is estimated to have reached 6.8 percent in 2017 reflecting continued fiscal support and the effects of reforms, as well as a stronger-than-expected recovery of exports and a slight positive contribution from net trade. EMDEs growth accelerated in 2017 to 4.3 percent, reflecting a recovery in commodity exporters amid continued robust activity in commodity importers. Growth in commodity exporters EMDEs is estimated to have accelerated in 2017 to a still subdued rate of 1.8 percent as various large economies (e.g., Argentina, Brazil, Nigeria, Russia) emerged from recession. Meanwhile, growth in commodity importers EMDEs remained robust at an estimated 6 percent in 2017, in part reflecting a continued strong contribution from India, firming global and domestic demand, following a stronger-than-expected cyclical upturn in 2017. A further pickup investment growth in major economies could strengthen the recovery, with positive spillover effects for trading partners. While global growth is forecast to edge up to 3.1 percent in 2018, risks remain predominantly on the downside, especially over the medium term. With interest rates and financial market volatility at exceptionally low levels, the outlook is vulnerable to sudden changes in market sentiment or unexpected policy shifts that could lead to financial instability. Also, increased trade protectionism and rising geopolitical tensions could weigh on sentiment and disrupt the recovery.

Regional Economy

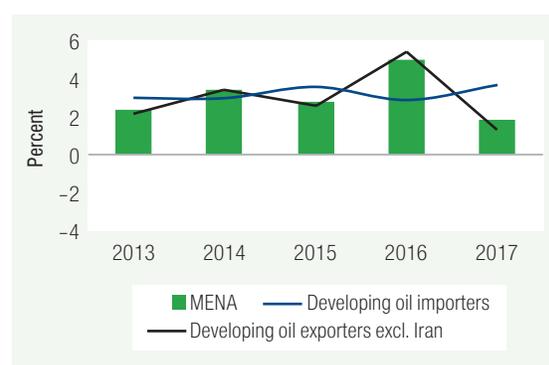
Growth in the Middle East and North Africa (MENA) region is estimated to have declined markedly to 1.8 percent in 2017 from 5.0 percent in the previous year (Figure B4), contributed by hydrocarbon-sector-led growth decelerations among regional oil exporters. In contrast, growth in oil importers in 2017 has strengthened to 3.7 percent from the previous year, supported by reforms and improved competitiveness. Growth in both groups of economies continue to face headwinds from fiscal consolidation plans and geopolitical tensions. Growth among the oil exporters was affected by OPEC oil production cuts and fiscal consolidation. Besides the effect of a slowdown in its oil sector following an exceptionally high 2016 surge, activity in the Islamic Republic of Iran was dampened by weak foreign investor confidence associated with geopolitical tensions (including new sanctions and hardened nuclear-deal stance by the United States). Algeria and Iraq's growth are also estimated to have decelerated in response to fiscal consolidation, moderating hydrocarbon sector growth, and weak non-oil activity. Lower growth among the Gulf Cooperation Council (GCC) members mainly reflects lower oil output from production cuts. Among the region's oil importers, growth improved in 2017, as a result of reforms and improved competitiveness. Egypt experienced strong industrial production, investment, and exports, supported by the effects of the exchange rate devaluation on competitiveness. In Morocco, a strong rebound in agricultural production in the first three quarters of 2017 from severe droughts in the previous year further supported the economy's recovery. Tunisia has experienced gradual recoveries in agricultural and manufacturing sectors. Regional growth is projected to increase steadily after 2017, to 3.0 percent in 2018 and 3.2 percent by 2020, reflecting accelerations among both oil exporters and importers. The risks to the outlook, while varying between oil exporters and importers, are generally to the downside. The regional outlook faces four main risks: amplification of geopolitical tensions, weak momentum in oil prices, obstacles to reform progress.

FIGURE B3 • Global Growth Has Picked Up to 3 Percent in 2017, Mainly Reflecting a Rebound in Investment, Manufacturing and Trade



Source: World Bank, Global Economic Prospects, January 2018.

FIGURE B4 • Growth in MENA Region Is Estimated to Have Declined Markedly to 1.8 Percent in 2017, Reflecting the Deceleration among Oil Exporters



Source: World Bank, Global Economic Prospects, January 2018.

Note: The World Bank's MENA aggregate includes 16 economies, and is grouped into three sub regions: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE comprise the Gulf Cooperation Council (GCC); all are oil exporters. Other oil exporters in the region are Algeria, the Iran, and Iraq. Oil importers in the region are Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza. Syria Yemen, and, as of this publication of *Global Economic Prospects*, Libya, are excluded from regional growth aggregates due to data limitations.

limit private consumption and investment initially, but are expected to then increase also thanks to a projected increase of credit to the private sector albeit from a very low level.²¹

Projected budget surpluses in 2018–21 should be seen in the context of savings to finance identified reconstruction needs and rebuild severely depleted buffers.

The economic and social losses suffered by Iraq in the last three years add already to ¼ of GDP in terms of missed development opportunities. The overall reconstruction and recovery needs are estimated at ID 104.2 trillion (US\$88.2 billion), with ID 27 trillion (US\$22.9 billion) needed in 2018–19 short term, and ID 77.2 trillion (US\$65.3 billion) needed for the medium term.²² The 2018 budget expenditure and balance do not reflect the level of investment that the government could finance (either thanks to identified external financing or use of saved reserves) to reconstruct the areas liberated from ISIS including Mosul. The government could adopt a 2018 supplementary budget, following the reconstruction conference in Kuwait and the parliamentary elections to fully reflect the investment and other activities to finance the reconstruction.

Domestic financing is transitioning to market-based instruments.

In 2018, the domestic gross borrowing needs are projected to be covered mainly through the issuance of Treasury bills, most of which will be refinanced by commercial banks at the discount window of the CBI. As the capacity of the public debt management office improves and the domestic market is developed, the GoI will resort to an increasing share of market-based short-term instruments, gradually discontinuing automatic refinancing of T-bills falling due, and longer-term bonds, including Islamic financing bonds. The borrowing plan for 2018 increases the share of market-based domestic debt instruments from 8.6 percent in 2017 to above 10 percent in 2018.

The current account deficit is projected to remain moderate thanks to higher oil prices, increase in oil exports and fiscal consolidation.

The government commitment to contain expenditures but continue oil-related investments is key to reduce the current account balance over the projection period, ensure direct financing will flow to Iraq from

international oil companies (IOCs), and reconstitute international reserves to a level considered appropriate to reinforce the exchange rate peg.²³

Risks

Downward risks to the outlook remain many.

These include oil prices volatility, failure to improve the security environment, and failure to implement the expected large fiscal adjustment to contain current expenditure and prioritize investment for reconstruction and development. While oil prices over the projection period are expected to remain 40 percent higher than their lowest level reached in 2016, they are expected to remain on average 50 percent lower than in 2014. In addition, their level over the projection period remains highly uncertain according to volatility indices. Fiscal and external debt sustainability remain highly vulnerable to a reduction in oil prices or a real exchange rate depreciation. Iraq could yet again face a fiscal crisis if conflict and violence re-ignite because of setbacks in the recent successes against ISIS or increased tensions with KRG. As in the recent past, any setbacks in the recent success against ISIS could renew pressures on Iraq's twin deficits and require a combination of further fiscal adjustment, additional external financing, depletion of international reserves and accumulation of mainly short-term domestic debt, inconsistent with the exchange rate peg and macroeconomic stability. Failure to achieve fiscal consolidation could

²¹ Credit to the economy grew by 4 percent year-over-year during the first five months of 2017 and is projected to increase to average 14 percent in 2018–20. See IMF — Article IV Consultations and Second Review under the Three-Year SBA, August 2017.

²² See: Iraq Damage and Needs Assessment of Seven Directly Affected Governorates (2018).

²³ Under the current outlook for oil prices, production and exports, International reserves are projected to increase from 7.0 months of imports in end-2017 to 8.9 months of imports in 2021. While high compared to traditional metrics, Iraq's reserve adequacy needs to factor in the inherent volatility of oil exports.

delay investment for the reconstruction and continue to increase the cost of the conflict for the people of Iraq. The recovery would also take longer if the reconstruction fails to crowd in the private sector. On the upside, any further increase in the export price of Iraq's oil would generate additional resources for reconstruction.²⁴

The outlook is also subject to significant social and political risks. Escalating political tensions and the probability of terrorist attacks ahead of the parliamentary elections to be held in mid-May 2018 add further political risk in the short-term. Lingering political tensions, weak administrative capacity and widespread corruption continue to pose a downside risk and could further limit the government's reform effort and its capacity to implement investment for reconstruction. Following the parliamentary elections, difficult political negotiations could prevent the

timely formation of a new government and bring to a halt executive and legislative activities needed to implement the expected fiscal adjustment while at the same time provide public services and start reconstruction. Deteriorating relations between the federal government and the KRG could weaken oil exports, slow the recovery of the non-oil economy, and discourage donor support for post-ISIS reconstruction. The large reform agenda, including the unification of the public and private pension systems could give rise to social tensions and impact implementation of reforms.

²⁴ An increase of US\$1 in the annual average of Iraq's oil export prices results in US\$1.4–1.5 billion higher oil exports and oil revenue.

SPECIAL FOCUS: ENERGY SUBSIDY REFORM IN IRAQ²⁵

The Time is Now

Introduction: Economic Rationale of Energy Subsidy Reforms

Developing countries need more and cleaner energy to overcome poverty and to set them on strong growth paths. At the heart of the debate about the future of global energy is how to expand supplies and access to energy for the world's poor in ways that meet the needs of both the current generations and all future generations. Energy subsidies can be large within a country context and are found in virtually every country.²⁶ Justifications for their use vary from social welfare protection, job creation, the encouragement of new sources of energy supply, and economic development to energy security.

Energy subsidies, however, are expensive, lead to overuse of fossil fuels, deter private sector investment by making new forms of renewable energy uncompetitive, and undermine climate change mitigation efforts. These subsidies compete for limited resources that could otherwise be suitable to deliver essential services to the poor, widen the scope for rent seeking and may contribute to misallocation of resources towards energy-intensive sectors. Global

subsidies for fossil fuels totaled US\$325 billion in 2015—more than double the value of subsidies for renewables.²⁷ Approximately 13 percent of global CO₂ emissions are linked to the use of subsidized fossil fuels. More importantly, subsidies are not properly targeted and often fail to help the poor.

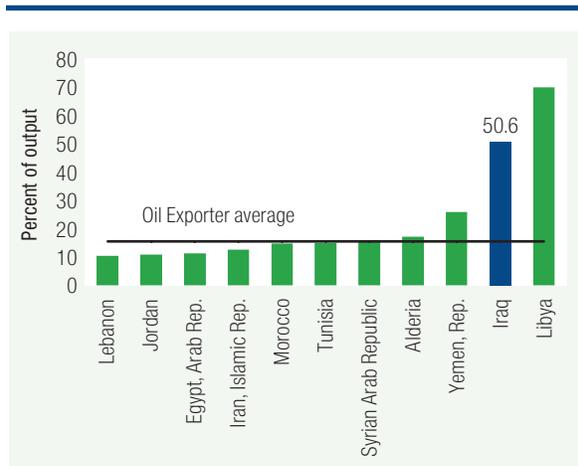
Energy subsidies are popular, easy to introduce, but difficult to dismantle, even though there is ample evidence that generalized subsidies are inefficient and inequitable. This is more so with subsidies for goods that are purchased by a large segment of the population, such as food, fuel, and electricity. The most visible subsidies are price subsidies, measured as the difference between end-user prices paid and price levels that would have prevailed in a competitive, deregulated market. These “price gaps” are often financed in part or wholly by

²⁵ This section is based on sector inputs provided by Paul Baringanire, Senior Energy Specialist.

²⁶ World Bank (2010): Subsidies in the Energy Sector. An Overview.

²⁷ Energy Sector Management Assistance Program (ESMAP).

FIGURE 27 • Electric Power Transmission and Distribution Losses, Latest Available Indicator



Source: World Development Indicators.

the government, reducing resources available for other government programs. If a growing budgetary burden is what typically drives a price subsidy reform, it is however, easier to reduce energy subsidies at a time when input prices are lower and as a result also subsidies levels fall.

Fuel subsidies have been part of the social contract in the MENA region but recent economic and political developments suggest a new social contract is needed. The development model followed broadly by the region is one where the state provides free health and education for all, subsidizes food and fuels and the public sector is the main formal sector employer. As a result, citizen engagement and voice has been limited and the quality of public service has been lacking.²⁸ Falling oil prices resulted in a high fiscal burden for governments and made maintaining the same level of subsidies very difficult. Public-sector employment also slowed down at the same time when young people's expectations and aspirations have been increasing. A new social contract must involve elements where the state promotes competition and the private sector takes a larger role in the economy and subsidies are replaced with targeted cash transfers that favor the poor. Certainly, these changes don't apply the same to all countries, and the case of electricity subsidies for Iraq is discussed below.

FIGURE 28 • Electricity Generated, Billed, and Collected



Source: Ministry of Electricity, 2015 Operating Statistics.

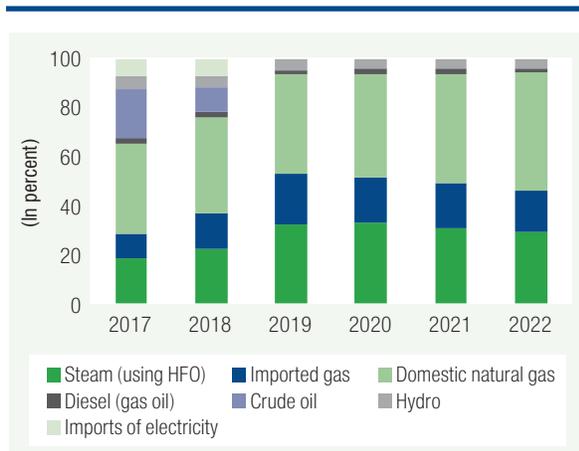
Rationale for Reform in Iraq

Iraq's electricity sector suffers from a series of simultaneous and compounding challenges, which makes it unable to generate adequate revenue to sustain itself or to improve services for consumers. Years of neglect have led to a dilapidated grid infrastructure with low operational efficiency and high levels of losses, where over 50 percent of electricity generated is lost in transmission and distribution (Figure 27) and an additional 20 percent lost because of poor revenue collection. Actual electricity paid is less than 30 percent of production, but covers only about 10 percent of the cost of production because tariffs are non-cost-reflective (Figure 28). The sector depends on government direct budgetary support, implicit fuel subsidies and guarantees to undertake capital investments and finance its operational expenditure.

Iraq has made significant progress in restoring its power generation from a peak demand supply of about 5GW in 2005 to 14GW in 2016, but continues to face challenges, including a high demand growth of over 10 percent per annum. Even with the high growth of generation capacity and investments, the grid supply is only available, on average, about 15 hours per day. New highly efficient generating units (mainly gas turbines) have been installed, but their ability to

²⁸ Devarajan & Mottaghi (2015).

FIGURE 29 • Planned Energy Generation Mix- 2017/22



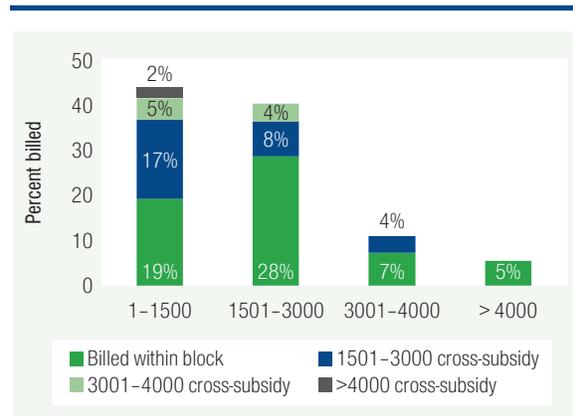
Source: Ministry of Electricity.

operate is often affected by lack of fuel supply and other inputs (e.g. water).

The cost of producing electricity is high in Iraq and shifting to gas-based generation is key to reduce the cost of production. In 2017, the portion of low-cost natural gas-based generation is expected to have increased to about 47 percent of the total installed capacity (Figure 29). However, more than 50 percent of the fuel used to produce electricity still consists of gasoline, crude oil and heavy fuel oil which are both more expensive and less efficient.

Electricity consumption is not only heavily subsidized, but subsidies accrue to the largest consumers. All households benefit from subsidies, which favor large consumers of electricity (Figure 30). For example, 44 percent of the total amount billed in Iraq in 2016 is billed at prices applicable for the 1–500 KWh block. However, of that 44 percent, only 19 percent (less than half) is billed to consumers which consume within that level. The rest is billed to those households that consume more than 1500 KWh, but that, for the first 1500 KWh, benefit from the subsidized rate of ID 10 per KWh. Large consumers continue to benefit from these intra-block cross-subsidies also at the second block (1501–3000 KWh) which is billed at ID 35 KWh. This tariff block consists 40 percent of total billing, but about a third of that amount is collected from households that consumer

FIGURE 30 • Intra Block Billing, Higher Consumers Benefiting from Lower Block Subsidy



Source: Ministry of Electricity.

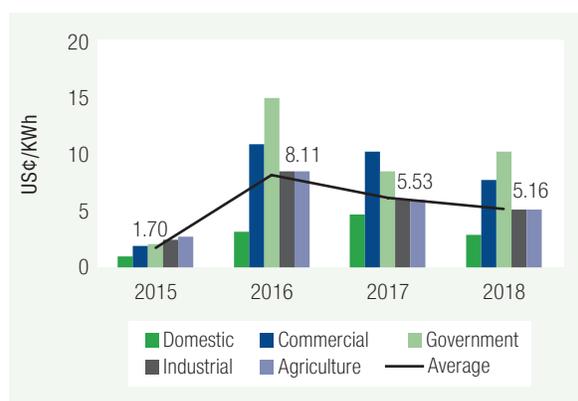
more than 3000KWh. As a result, subsidies are untargeted among the domestic consumer block categories and efficient and rational use of electricity is not promoted as a result.

As the sector operates at a loss, investments require large government guarantees, that if called, would further increase the already high level of public debt. At end-June 2017, the government had issued guarantees on foreign currency debt for an amount of US\$2.7 billion (1.3 percent of GDP) and guarantees for service payment in foreign currency for an amount of US\$19.4 billion (11.3 percent of GDP). If called, these service guarantees could over time increase the public debt which in end-2017 has reached 58 percent of GDP.

Reform Progress

Since late 2015, the Gol has started to reform and restructure the sector, to gradually bring it up to international industry standards. The Gol has initiated actions to improve the sector's commercial performance and sustainability by increasing tariffs nearly fourfold effective January 2016. In October 2016 the MoE adopted a strategy to reduce operational losses, increase tariff collection and improve electricity availability. This includes the introduction of private

FIGURE 31 • Iraq Electricity Tariffs - 2015/18

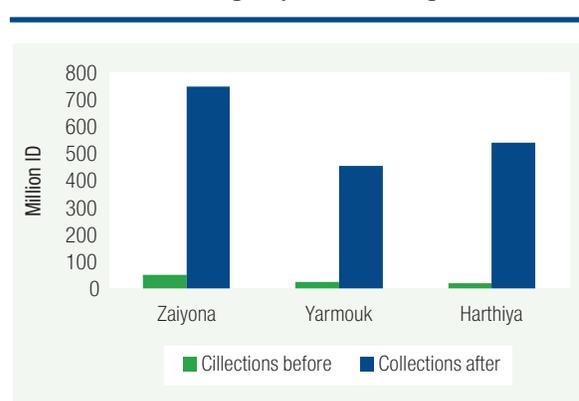


Source: Ministry of Electricity.

sector revenue collections services starting with pilot contracts in the Baghdad area. A new Electricity Law²⁹ was issued in March 2017, which provides, for the first time, the legal framework for the sector’s reforms and governance to: (i) introduce private sector participation in the generation and distribution functions, and (ii) decentralize management of electricity services.

Results in recent past has been mixed but promising regarding increased sector revenues from electricity sales. The Gol increased tariffs on average by fourfold effective January 2016 from the average of US\$1.7/KWh to US\$8.0/KWh. However, unable to improve the quality of service and facing protests from hoteliers in the holy sites of Karbala and Najaf tariffs have been reduced by 30 percent in 2017 and again by 16 percent in 2018 (Figure 31). The 2018 modest average decrease in tariffs is buttressed by an increase in the Government category tariff rate which increases both the underlying implicit government subsidy and the sector exposure to the “circular debt” (non-payments from the government affiliated institutions). The revenue contract management services are yielding positive initial results. The experience from the first pilot areas of Zaiyoni, Yarmouk and Harthiya (Baghdad) are impressive with the initial revenue collection from one single billing cycle,³⁰ far exceeding the total annual amount collected under normal MoE collection procedures (Figure 32). In addition, a reduction in the electricity demand in these areas seems to imply that

FIGURE 32 • Contracts for Revenue Collection Average Cycle of Billing



Source: Ministry of Electricity.

consumers are adjusting their consumption to their ability to pay for electricity services underscoring the impact of price signaling effect.

The tariff structure adopted in January 2018, simplified the number of tariffs (Table 1), but did not remove subsidies for large electricity residential consumers. The newly approved tariff structure is simpler since it only includes 4 tariff blocks instead of 7. However, the intra-block subsidization has been increased compared to previous tariffs. For example, a household that consumes 3500 KWh per month will pay 10ID/kWh for the first 1500KWh, 35ID/KWh for the next 1500 KWh and 80 ID/KWh for the remaining 500 KWh. With this current structure, all households are subsidized at the same rate for the same level of consumption, regardless of their total consumption.

Government’s Reform Plan

The Gol has committed to continue the reform process to achieve fiscal sustainability in a five-year period. This will include implementing a new roadmap by the MoE towards cost recovery and operations efficiency comprising of: (i) the MoE policy

²⁹ The Electricity Law No. (53) of 2017.

³⁰ One billing cycle is equivalent to 3 months.

TABLE 1 • Current vs. Alternative Tariff Structure

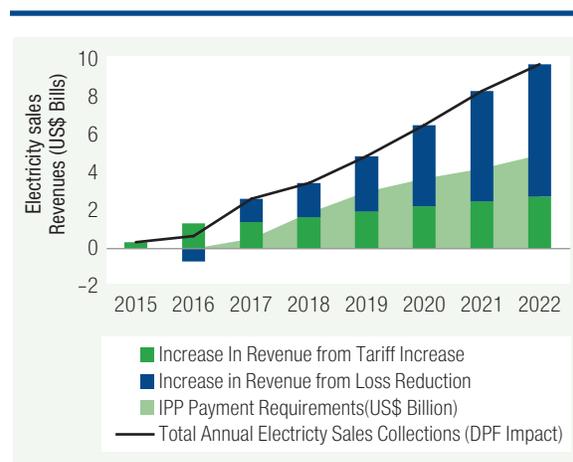
Residential type	Tariff structure in 2017	Approved Tariff Structure 2018	2017 Tariff – Highest invoice amount (ID per month)	Alternative Tariff Structure (block tariffs and removing subsidies for high level consumers) – Highest invoice amount (ID per month)
1-500	10	10	20,000	15,000
501-1000	10			
1001-1500	20			
1501-2000	40	35	120,000	105,000
2001-3000	80			
3001-4000	120	80	240,000	320,000
4001-5000	200	120	440,000	600,000

Source: Ministry of Electricity.

to corporatize the departments of electricity production, transmission, distribution and maintenance and (ii) a tariff rationalization policy that enables the MoE to implement a new electricity tariff structure to achieve the five-year fiscal stabilization plan.

The targets for the performance improvements are captured in the five-year fiscal stabilization plan implemented by MoE. This includes actions to improve revenue collections, through the ongoing revenue management services contracts and implementation of a Revenue Protection Program (RPP) initially targeting the high value customers (industry and commercial consumer categories) who are about 0.5 percent of the total number of electricity consumers (about 15,000 of the total 3.0 million consumers) but the value of their energy billed constitute about 35 percent of the total billing. This, coupled with government agencies (who constitute about 45 percent of the value of the total energy billed) paying regularly their electricity bills, is expected to lead to a net cumulative increase in electricity sales revenue collections of about US\$ 9.6 billion from 2017 to 2022 (Figure 33). The increase in revenue collection is mainly generated thanks to loss reduction. If ring fenced, the higher electricity revenue would be able to cover the required annual Independent Power Producers' (IPP)³¹ repayment obligations and thus reduce the risk of increased public debt arising out of the guarantees issued to IPPs. The increase in revenue collections is complemented by

FIGURE 33 • Effects of Increase in Tariffs and Loss Reduction Policy



Source: Ministry of Electricity.

reduced cost of electricity generation (gas-to-power) to about IQD72/KWh. The MoE expects to have a positive cash flow by 2022.

The MoE's tariff rationalization policy requires full elimination of intra-block subsidies among household consumers categories. The alternative tariff structure (Table 1, last column),

³¹ IPP capacity is expected to increase to about 20GW equivalent to about 40 percent of the country's total planned installed capacity by 2022.

would keep the same tariff blocks, but for example would bill households consuming 3500 KWh at ID 80 for the entire amount of electricity consumed. This alternative structure aims to maintain the average tariff at IQD72/KWh, the same level of subsidies but differentiated by consumption block and provide incentives for a more efficient energy consumption at the household level.

Additional undertakings to enhance sector performance include the adoption of a corporatization policy. It defines a new industry and enterprise governance structure and a platform for commercialization of the distribution, generation and transmission businesses making them more accountable for performance, including cost reductions, efficiency and customer service improvements. The sector corporatization policy authorizes the MoE to: (i) convert the Electricity Directorates responsible for generation and distribution into joint-stock company incorporated under the Companies Law; (ii) establish a Transmission Service Provider (TSP) responsible for the wheeling of electricity over the high voltage network and system/market operator; (iii) establish a Holding Company; and (iv) declare the Holding Company and its subsidiaries as self-financed, effective January 2020.

The corporatized companies, in accordance with Iraqi laws, will no longer be eligible for direct budget allocations and thus result in reduced subsidies to the sector. The new sector structure will instead empower the new companies to enter into private sector partnerships, either immediately through outsourcing of services such as bill collection and revenue cycle management, or in the form of Public Private Partnerships (PPP) and/or eventual privatization. The corporatization of the sector is expected to provide:

- i. *Clarity of roles and responsibilities:* Government's policy, regulatory and ownership roles will be clearly separated institutionally and functionally by removing from the MoE electricity operations and regulatory roles, which would retain policy functions;
- ii. *Autonomy of operations.* The corporate institutional arrangements will provide an

environment where utilities can run as efficient, ring-fenced businesses, albeit within the policy frameworks established by the MoE; and

- iii. *Transparency and accountability-* the setup of the regulator's office, initially focusing on setting-up industry performance benchmarks complemented by performance management contracts are expected to increase accountability from the various sector management with regard to system performance indicators and bench marks. Transparency of information on performance through publication of comprehensive annual reports and separate financial statements of the sector, performance against key performance indicators in the performance contract, or benchmarked data from comparative utilities will encourage operations efficiency.

Impact of Subsidy Reform on the Economy

Removing electricity subsidies would have no overall negative effects on the economy and on the poor. Static simulations on the impact of a fourfold increase in the electricity tariffs suggest that the subsidy reform would result in an overall increase in GDP thanks to a very large increase in investment. If the GoI would implement a subsidy reform for the full energy sector, it would protect the poorest if savings from the reform were used to offset the impact of price increases for the poor and the reform would still result in a budgetary surplus.

A Computable General Equilibrium (CGE) model was used to assess the impact of a fourfold increase in the electricity tariffs, thereby effectively removing the electricity subsidies. The CGE model uses 2012-based complete set of national accounts data, a social accounting matrix and electricity input and tariff data.³² Budget and national accounts and electricity data are then updated to 2015. The CGE model is then used to assess the impact of an

³² This is the most recent year with a complete set of data.

average fourfold increase in tariffs (or 312.8 percent increase), consistent with the tariff increase adopted in early 2016. The effects of electricity tariff increases were examined in a simulation for four key aspects of Iraq's economic performance: i) government revenues; ii) consumer price indices (CPIs); iii) real consumption by household types; and iv) economic growth by sector.

At 2012 prices, electricity was 91.1 percent subsidized. The total unsubsidized value of domestic electricity supply was ID 7,493.8 billion, which included:

- i. Energy input costs amounting to ID3,940.5 billion, including crude oil, gasoline, diesel and fuel oil;³³
- ii. Imported electricity at a cost of ID 1,897.4 billion;³⁴
- iii. Other input costs amounting to ID1,656.0 billion, including labour and capital, intermediate inputs and the costs associated with transmission and distribution.³⁵

The aggregate subsidy is reflected in the amount received from consumers through electricity bill collection. The aggregate revenues for domestic electricity consumption, equivalent to the subsidized value, was ID665.5 billion ID or approximately 8.9 percent of the unsubsidized costs, (i.e., the subsidy rate was 91.1 percent).

A subsidy reform would increase overall prices because of the increased cost of electricity, decrease demand for power and other goods and services from households in response to higher prices and reduce power generation initially in response to the reduced demand. Also, investment and production would shift to goods and services that are less electricity intensive, the extent of these adjustments depending on underlying price and substitution elasticities; The reduction in the demand for goods and services would reduce the demand for labor and lower employment would lead to reduced incomes; The composition of international trade will tend to change because the relative price of electricity between Iraq and the rest of the world has changed, resulting in greater shares of imports

of relatively energy intensive goods and services increases and reduced exports of these types of goods; Finally, the government's fiscal balance would improve thanks to the reduction of subsidies. Eventually, markets adjust to the modified relative prices as do imports and exports.

In a static simulation scenario,³⁶ increased electricity tariffs would reduce the subsidy for electricity consumption by 88.8 percent, and reduce the fiscal deficit by 0.1 percent of GDP in 2016. As a major user of electricity, a significant portion of the increased payments for power would amount to an internal transfer within the government itself which would increase revenues. As a result of higher prices, government consumption increases as well. The net result is positive³⁷ and is translated in a decrease of the deficit by 0.1 percent of GDP. Higher electricity prices would also increase CPI inflation by 3.0 percent, driven by a total increase in the price index for electricity of 219.9 percent. Price indices will increase relatively more for building and construction (3.8 percent); water (3.2 percent); and agriculture, hunting, forestry and fishing (2.2 percent), all of which employ significant numbers of people. All households³⁸ would face a reduction in real consumption as a result of the increased electricity costs. The burden would be shared more or less equally between richer and poorer households,

³³ Measured at international prices, quantity data are from the IEA.

³⁴ Data obtained from BOP.

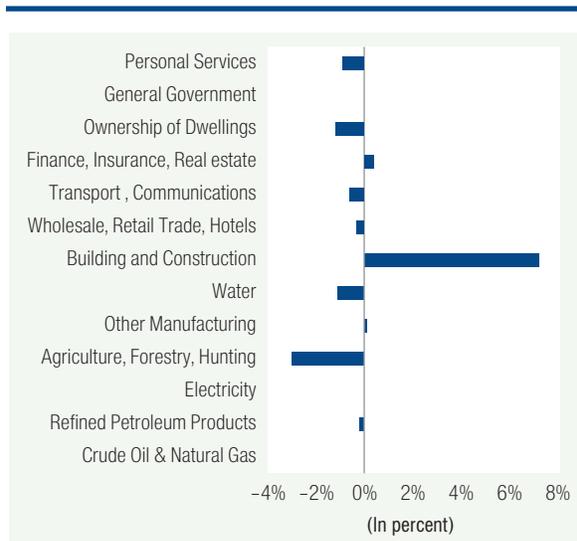
³⁵ Data are from CSO.

³⁶ In the static exercise only 2015 (current period of analysis) and impact on next period, 2016, are assessed. It does not consider dynamic changes that may take place over time as a result of the changes in power tariff rates. Nor does it account for the growth and evolution of the economy over the period analyzed/period of impact.

³⁷ Revenues would increase more than expenditure.

³⁸ To assess the possible distributional consequences of changes in power subsidies, the Iraqi CGE model includes ten groups of households, five income quintiles of rural households and five quintiles of urban households.

FIGURE 34 • Change in GDP (Fixed Prices) by Sectors



Source: "Iraq: Assessment of the Economic Impact of Energy Subsidy Reduction," P. Griffin, 2017.

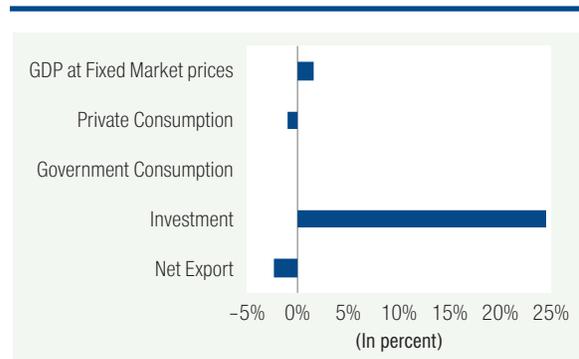
with reductions ranging between -2.0 percent and -1.6 percent.

Energy subsidy reform would be beneficial to investment sectors, except for more power intensive sectors. Building and construction would benefit the most boosted partly by higher public investment as a result of higher revenues (Figure 34). This would be especially relevant now, at a time where Iraq is undergoing a big reconstruction effort after the conflict ended. The only other sectors that would gain are finance, insurance, real estate and business and other manufacturing, and by only a small amount. The agriculture, forestry, hunting and fishing sector would be the largest loser, falling by almost 3 percent possibly because of a reallocation of labor from agriculture to more productive sectors.

The subsidy reform would result in an overall increase in real GDP of 1.6 percent. It would result in an overall reduction in private consumption of 0.9 percent, a very large increase in Investment of 24.6 percent, and a decline in net exports of 2.3 percent as imports increase because of the large increase in investment activity (Figure 35).

To account for the natural evolution of the economy and its growth over time, the Iraq CGE

FIGURE 35 • Change in National Accounts at Fixed Prices



Source: "Iraq: Assessment of the Economic Impact of Energy Subsidy Reduction," P. Griffin, 2017.

incorporates also dynamic effects. Simulations to estimate the impact of the elimination of electricity subsidies were conducted for the period 2017 through 2025. To establish the baseline over this period, against which the electricity subsidy reform (ESR) was assessed, assumptions included: i) government consumption increases of 1.5 percent annually in real terms through 2025; ii) transfers to households remain constant at 2016 levels; and iii) the current account balance was fixed at -0.5 percent of GDP. Dynamic CGE simulations for the ESR adopts the baseline assumptions plus i) a 50 percent reduction in electricity subsidy rates in 2017; and ii) remaining electricity subsidies removed in 2018.

After electricity subsidy reforms are introduced, the average growth rate increases to 1.4 percent in 2017 and to 1.5 percent thereafter when the full energy subsidy reforms are included. The baseline average annual real GDP growth for this period is 1.3 percent (Table 2). This includes the relatively slow growth of oil GDP, which averages 0.5 percent. The impact of the reconstruction on GDP growth has not been incorporated in these simulations. Thanks to the impact of electricity subsidies, non-oil GDP average annual growth would increase by an additional 0.2 percent a year in comparison to the baseline (2.6 percent). Underlying the increased growth resulting from subsidy reforms are assumptions that the growth of government consumption and the current account deficit remain constant. Economic growth

TABLE 2 • Dynamic Analysis: Average Growth of National Accounts in Real Terms (2017-2025)

National Accounts (fixed prices)	Base Line	Electricity Subsidy Elimination
Pct. Change	Period Avg	Period Avg
GDP at Factor Prices	1.3%	1.4%
Oil GDP at Factor Prices	0.5%	0.5%
Non-Oil GDP at Factor Prices	2.6%	2.8%
GDP at Market Prices	1.4%	1.4%
Consumption	1.9%	1.9%
Private	2.2%	2.1%
Government	1.5%	1.5%
Investment	3.6%	4.4%
Exports	0.6%	0.7%
Less Imports	1.5%	1.5%

Source: "Iraq: Assessment of the Economic Impact of Energy Subsidy Reduction," P. Griffin, 2017.

in this context is stimulated by increased investment which grows on average 4.4 percent, or 0.8 percent higher than baseline. Private consumption would grow less rapidly, as resources would shift from private consumption to investment in the non-oil sectors. Average growth rates for private consumption would be 1.3 percent in comparison to 2.2 percent in the baseline scenario. CPI would grow on average at 1.8 percent, an increase of 0.2 percent compared to baseline results.

Impact on Poverty

The full impact on households of the reform of electricity supplies and pension reforms is expected to be negligible in the short term and lead to an increase in poverty by 0.1 percent in the long term.

The microsimulation analysis conducted to gauge the effect of electricity subsidy reform on household consumption and welfare using results from the CGE analysis concludes that the direct and indirect effect of residential tariffs on household welfare is minimal because electricity comprises only a small share of total household expenditure (approximately 2.4 percent) and the price increase does not affect users who consume below the lifeline tariff, as it is the case for the poor. The knock-on welfare impact of non-residential tariffs

on consumers through general increase in prices is also expected to be mild because electricity constitutes a relatively small share of inputs in the production process for most sectors. Moreover, poor households that spend relatively larger share of expenditure on food will be largely insulated from electricity price increase as the production of food is less electricity-intensive than non-food items. The CGE simulations assume that implicit (i.e. no collection and fuel subsidies) and explicit (i.e. tariffs below costs) are gradually eliminated by 2022 according to the MoE roadmap.

Implementing a subsidy reform for the full energy sector would protect the poorest if savings derived from the subsidy reform are used to offset the impact of commodity price increases for the poor. The CGE simulations also assess the impacts of the combined removal of electricity and crude oil and gas subsidies and calculate the required compensation to the bottom 40 percent of the income distribution to fully offset the impact of the subsidy reform. A combined subsidy reform would decrease consumption even more in the following years, increase investment more sharply, and results in a budgetary surplus of 11.9 percent of GDP. This surplus compares to an estimated transfer to the bottom 40 percent of the income distribution of 2.2 percent of GDP to offset the subsidy removal.

The proposed improvement in revenue collection is unlikely to materially adversely commercial viability of productive enterprises.

The government reforms are expected to result in an improvement of revenue collection and an increase in the supply of electricity through the grid from the current average of 14.6 hours per day to 20 hours per day in the next year. For productive enterprises, given the unpredictability and paucity in supply from the public grid, and the higher costs associated with private substitutes such as generators, these entities may be able to lower costs while increasing output and productivity. Updated CGE simulations confirm that more power and better revenue collection would result in higher government revenue and investment, with positive impact on economic activity.

Conclusion

Reform of electricity subsidies would come at the appropriate time if enacted now. Oil prices are still relatively low and projected to stay around these levels. In addition, the Gol now has the legal framework to allow for reforms to take place. CGE simulations show that the overall benefits of the subsidy reform outweigh the negative impact to the poorest 40 percent of the income distribution as this cohort can be fully compensated for the reduction of the subsidy amount. Last but not least, simulations also show that subsidy reform would increase government revenue and investment, to a large extent in the building and construction sector—making this a very timely reform to boost the reconstruction effort.

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APPENDIX: SELECTED DATA ON IRAQ

TABLE 3 • Selected Macroeconomic Indicators

	2014	2015	2016	2017	2018	2019	2020	2021
Economic growth and prices								
Real GDP (percentage change)	0.7	4.8	11.0	-0.8	2.5	4.1	1.9	2.1
Non-oil real GDP (percentage change)	-3.9	-9.6	-8.1	4.4	3.0	3.1	3.4	3.9
GDP deflator (percentage change)	-0.7	-26.9	-12.9	16.2	6.5	0.3	2.2	3.1
GDP per capita (US\$)	6,517	4,869	4,533	5,088	5,415	5,512	5,597	5,741
GDP (in ID trillion)	273.6	209.7	202.7	233.7	255.1	266.3	277.4	291.9
Non-oil GDP (in ID trillion)	149.5	139.8	134.1	143.4	154.0	165.6	178.6	193.5
GDP (in US\$ billion)	234.7	179.8	171.7	197.7	215.8	225.3	234.7	246.9
Oil production (mbpd)	3.1	3.7	4.6	4.5	4.6	4.8	4.8	4.9
Oil exports (mbpd)	2.62	3.35	3.79	3.80	3.89	4.08	4.10	4.12
Iraq oil export prices (US\$ pb)	96.5	45.9	35.6	48.7	53.3	50.8	49.3	48.6
Consumer price inflation (percentage change; end of period)	1.6	2.3	-1.0	0.4	2.0	2.0	2.0	2.0
Consumer price inflation (percentage change; average)	2.2	1.4	0.4	0.1	2.0	2.0	2.0	2.0
(In percent of GDP)								
National Accounts								
Gross domestic investment	25.7	24.4	20.6	17.4	17.9	17.4	16.9	16.5
Of which: public	18.0	15.1	11.4	8.9	9.6	8.9	8.2	7.5
Gross domestic consumption	69.9	81.6	87.5	81.3	81.7	81.9	82.7	83.5
Of which: public	18.3	22.3	23.0	20.8	22.3	21.3	20.3	19.2
Gross national savings	28.3	18.0	12.0	18.1	17.7	17.3	15.6	15.5
Of which: public	13.0	3.0	-2.1	7.2	11.2	11.6	10.0	10.3
Saving - Investment balance	2.6	-6.5	-8.6	0.7	-0.2	-0.1	-1.3	-1.0

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TABLE 3 • Selected Macroeconomic Indicators (continued)

	2014	2015	2016	2017	2018	2019	2020	2021
(In percent of GDP, unless otherwise indicated)								
Public Finance								
Government revenue and grants	38.2	30.3	27.4	33.1	39.2	38.0	36.2	34.5
Government oil revenue	36.0	27.5	23.2	28.8	34.1	32.8	30.8	29.0
Government non-oil revenue	2.1	2.8	4.1	3.5	4.4	4.6	4.8	5.0
Expenditure, of which:	43.5	42.6	41.3	35.2	38.3	36.4	34.8	32.2
Current expenditure	25.5	27.5	29.9	26.3	28.7	27.4	26.6	24.7
Capital expenditure	18.0	15.1	11.4	8.9	9.6	8.9	8.2	7.5
Overall fiscal balance (including grants)	-5.4	-12.3	-13.9	-2.2	0.9	1.7	1.4	2.3
Non-oil primary fiscal balance, accrual basis (percent of non-oil GDP)	-56.1	-45.1	-44.2	-40.2	-44.4	-39.7	-35.4	-31.3
Adjusted Non-oil primary fiscal balance, accrual basis (excl. KRG, percent of non-oil GDP)	-54.4	-43.3	-44.2	-40.2	-38.8	-34.7	-30.9	-27.3
Adjusted non-oil primary expenditure (excl. KRG, percent of non-oil GDP)	58.3	47.5	50.4	45.9	45.5	41.4	37.7	34.2
Adjusted non-oil primary expenditure (excl. KRG, annual real growth, percent)	-9.2	-24.9	1.3	-2.6	4.3	-4.0	-3.8	-3.5
Memorandum items:								
Total government debt (in percent of GDP)	32.0	55.1	64.4	57.8	55.2	53.5	50.7	46.9
Total government debt (in US\$ billion)	75.2	98.0	110.4	114.3	119.2	120.6	119.0	115.8
External government debt (in percent of GDP)	24.8	36.7	37.2	34.5	34.9	34.3	32.0	28.9
External government debt (in US\$ billion)	58.1	66.1	63.9	68.3	75.3	77.4	75.2	71.3
(In percent, unless otherwise indicated)								
Monetary indicators								
Growth in reserve money	-9.6	-12.6	8.1	-7.1	1.2	2.5	3.3	2.0
Growth in broad money	3.6	-9.0	7.2	-0.5	3.8	3.8	4.3	4.8
Policy interest rate (end of period)	6.0	6.0	4.0	–	–	–	–	–
(In percent of GDP, unless otherwise indicated)								
External sector								
Current account	2.6	-6.5	-8.6	0.7	-0.2	-0.1	-1.3	-1.0
Trade balance	10.9	-0.1	-1.8	6.6	6.5	6.2	5.3	4.7
Exports of goods	39.6	31.4	29.1	34.4	35.3	33.8	31.7	29.9
Imports of goods	-28.7	-31.5	-31.0	-27.8	-28.8	-27.6	-26.5	-25.2
Overall external balance	-10.0	-7.1	-3.6	2.6	3.8	2.6	0.6	0.7
Gross reserves (in US\$ billion)	66.7	53.7	45.4	48.1	55.9	60.8	61.1	61.2
In months of imports of goods and services	10.9	9.2	7.6	7.0	8.2	8.9	8.9	8.9
Exchange rate (dinar per US\$; period average)	1166.0	1166.0	1180.0	1182.0	1182.0	1182.0	1182.0	1182.0
Real effective exchange rate (percent change, end of period)	4.7	7.0	5.9	-0.6	–	–	–	–
Financing gap (US\$ billion)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Iraqi authorities; IMF; and World Bank staff estimates and projections.

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Systematic Country Diagnostic	3/2/2017	Report
Programmatic Development Policy Financing	1/12/2016	Report
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1818 H Street, NW

Washington, DC 20433