

# Breaking Out of Fragility

A Country Economic Memorandum for  
Diversification and Growth in Iraq



INTERNATIONAL DEVELOPMENT IN FOCUS

# **Breaking Out of Fragility**

**A Country Economic  
Memorandum for  
Diversification and  
Growth in Iraq**

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# Abbreviations

AEO	authorized economic operators
CEM	Country Economic Memorandum
EITI	Extractive Industries Transparency Initiative
FAO	Food and Agriculture Organization
GDP	gross domestic product
IDP	internally displaced person
IGCC	Iraqi General Commission of Customs
ISIS	Islamic State of Iraq and the Levant
KRG	Kurdistan Regional Government
MENA	Middle East and North Africa
MOA	Ministry of Agriculture, Iraq
NDI	National Democratic Institute
NTFC	National Trade Facilitation Committee
PDS	Public Distribution System
PMFs	Popular Mobilization Forces
SITC	Standard International Trade Classification
SOE	state-owned enterprise
TFA	trade facilitation agreement
TFP	total factor productivity
UMICs	upper-middle-income countries
UN	United Nations
WTO	World Trade Organization



# Overview

Iraq is at a crossroads. Almost two decades after the 2003 war, the country remains caught in a fragility trap, facing increasing political instability, growing social unrest, and a deepening state-citizen divide. Amid a multitude of crises (including an oil price shock, the COVID-19 pandemic, and recent protests) as well as a culmination of poor economic policies, a lack of reforms, and an inability to tackle corruption, Iraq is having its worst annual gross domestic product (GDP) growth performance in 2020 since the fall of the Saddam regime.<sup>1</sup> Instability, a lack of jobs, corruption, and poor service delivery remain among the most important risks to the country's long-term growth.

With every crisis comes an opportunity to reform. However, Iraq's path to reform will be challenging and uncertain. Given current oil prices and the persistent drop in global demand for oil because of the COVID-19 pandemic, the country will have a tough time addressing the needs of its people in the short term. It can, however, embark on a long but much-needed path toward structural transformation and reform, one that could leave its economy less dependent on oil and more driven by private sector activity. The widespread protests since October 2019, which have called into the question the country's current political economy, illustrate that such path for reform can no longer be avoided. Nevertheless, as this report shows, this path will demand persistence, and Iraq will face much uncertainty as it tries to address its long-lasting challenges and change the status quo.

This report highlights *what* Iraq can do to sustain future growth, but it also shows *why* the country has not yet managed to achieve high levels of diversified growth alongside peace, stability, and a better standard of living for its people. Iraq's high levels of fragility and conflict, reinforced by high oil dependency, hinder the country's prospects for economic reform and growth. The report also suggests strategic pathways by which Iraq can break free from this fragility trap, in which peace and stability can create the conditions for people to fulfill their aspirations, find private sector jobs, and thrive. In this context, the report's four chapters provide (a) an understanding of Iraq's underlying fragility and political economy challenges and their implications for a diversified growth model, (b) an analysis of Iraq's growth characteristics and the country's potential for and benefits from economic diversification, (c) a trade diagnostic and assessment of Iraq's potential for

trade and regional integration to create growth and stability, and (d) a review of Iraq's agriculture sector, from primary agriculture to agrifood systems, and its potential to support economic diversification, growth, and stability.

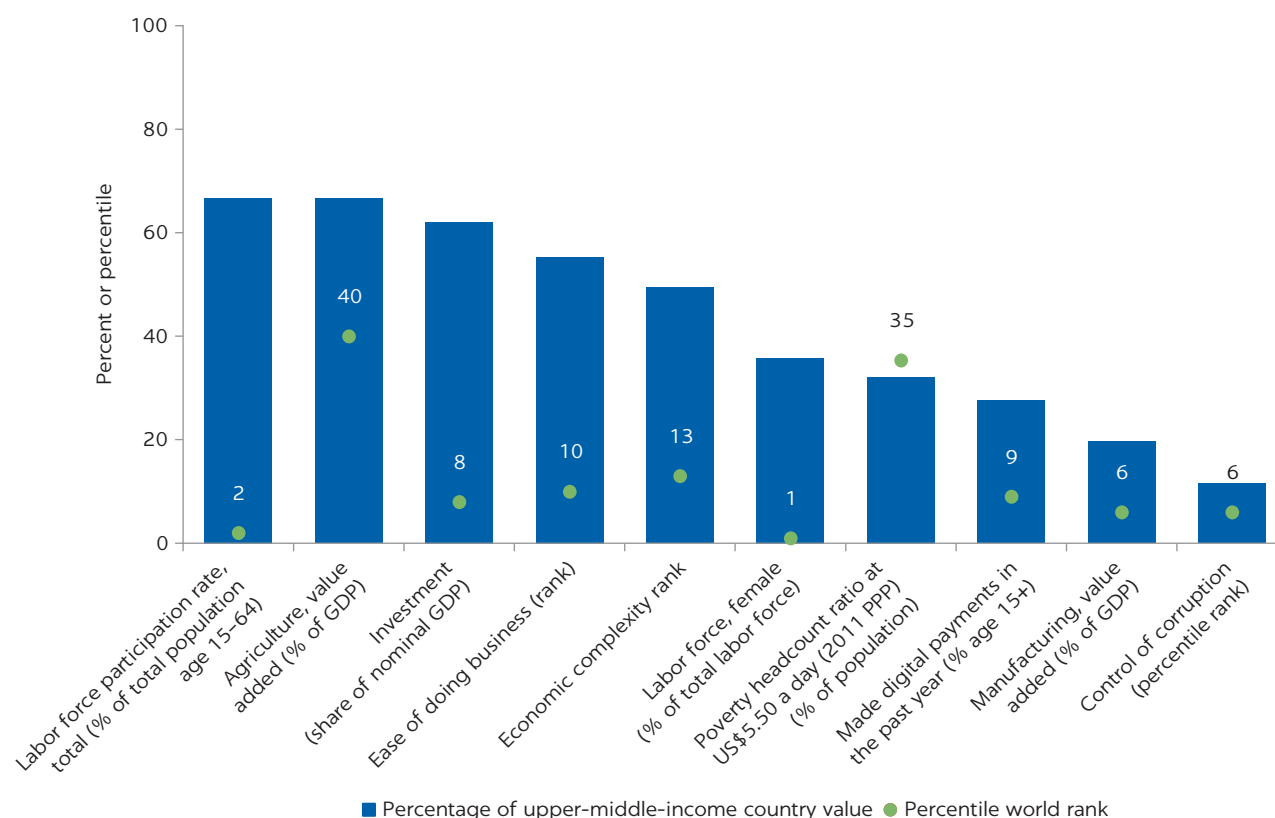
## WHY REFORMS HAVE NOT PRODUCED SUSTAINED GROWTH AND BETTER LIVING STANDARDS FOR IRAQIS

### Iraq lags upper-middle-income countries on most socioeconomic indicators

Although oil wealth has allowed Iraq to obtain upper-middle-income status, in many ways its institutions and socioeconomic outcomes more closely resemble those of a low-income, fragile country. The Iraqi education system once ranked near the top of the Middle East and North Africa (MENA) region, but it now sits near the bottom. Iraq's rate of participation in the economy is also low, and the country has one of the lowest female labor force participation rates in the world, low levels of human and physical capital, and deteriorating business conditions (figure O.1). Iraq also has one of the highest poverty rates among upper-middle-income countries (UMICs).<sup>2</sup> Without key reforms in these areas, the country

FIGURE O.1

Iraq resembles a low-income, fragile country on many socioeconomic dimensions



Source: World Bank, World Development Indicators.

Note: PPP = purchasing power parity. For the ease of doing business rank, economic complexity rank, and poverty rate, percentile world ranks are inverted (100 - actual percentile) to make them comparable with indicators such as the participation rate for which higher-percentile scores are better than lower-percentile scores. Iraq's US\$5.50/day poverty rate is 57.3 percent, the third-worst among upper-middle-income countries.

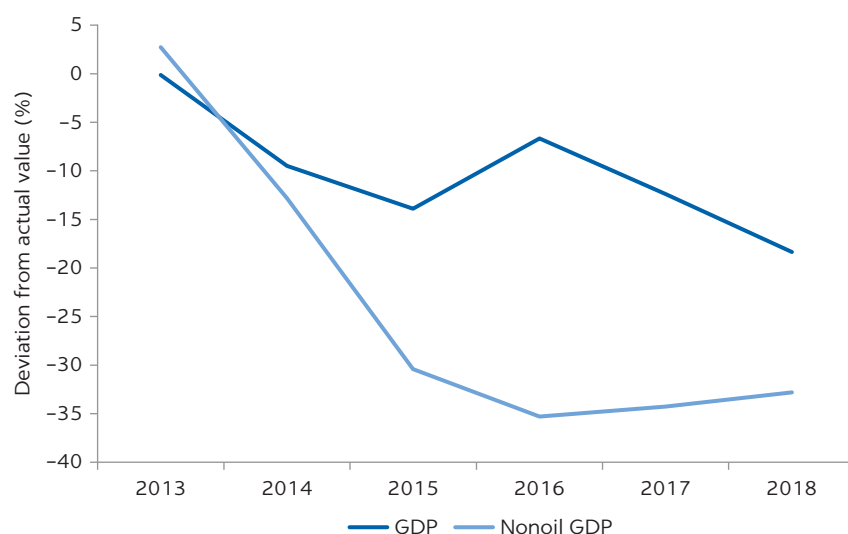
will find it increasingly difficult to grow sustainably and equitably and to sustain its standard of living.

### Repeated conflicts in an inherently volatile oil economy have not delivered sustainable prosperity

Iraq's recent conflicts have had significant economic and social costs. The country's per capita GDP is about 18–21 percent lower in 2018 than it would have been if not for the conflict beginning in 2014. In particular, although Iraq's oil GDP grew steadily during the conflict, the country's nonoil GDP is estimated to be about 33 percent lower in 2018 than it would have been without the conflict (figure O.2) and has fallen below its peers (figure O.3). Iraq's national poverty headcount is estimated to be almost 7 percent higher

**FIGURE O.2**

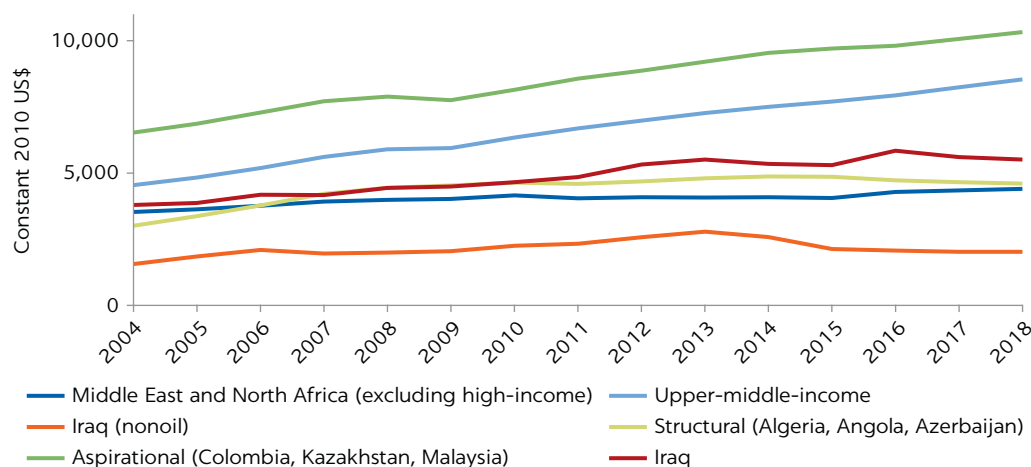
**Iraq has suffered staggering GDP losses because of ISIS**



Source: World Bank staff estimates using the synthetic control method.  
Note: GDP = gross domestic product; ISIS = Islamic State of Iraq and the Levant.

**FIGURE O.3**

**Iraq's GDP is falling behind those of its peers**



Source: World Bank, World Development Indicators.

than it would otherwise have been. Although some of this weakness reflects the 2014 oil price shock and the conflict with the Islamic State of Iraq and the Levant (ISIS), it also reflects losses in productivity and competitiveness in the real economy that have put nonoil GDP on a declining trend.

### **Iraq has missed opportunities to reform despite thorough diagnostics**

Previous studies, including the World Bank's previous two Country Economic Memorandums (CEMs), in 2006 and 2012, have emphasized similar areas for reform as this report, but Iraq has made no visible progress in most of those areas to date. The two earlier reports noted that in order to improve its living standards, Iraq needed to transition (a) from conflict to rehabilitation, (b) from state dominance to market orientation, (c) from oil dependence to diversification, and (d) from isolation to better global and regional integration. The 2006 CEM called for generating growth and employment in the private sector, protecting the poor and vulnerable with strong safety nets and sustainable pensions, and improving public management and accountability, especially for oil revenues. It also noted that although the state had a role to play in postconflict reconstruction, it also had to step back to allow Iraq's private sector to flourish. The 2012 CEM recommended "three pillars to promote diversification: private sector development, integration of nonoil public spending with diversification objectives, and strengthened linkages of the wider economy to the energy sector."

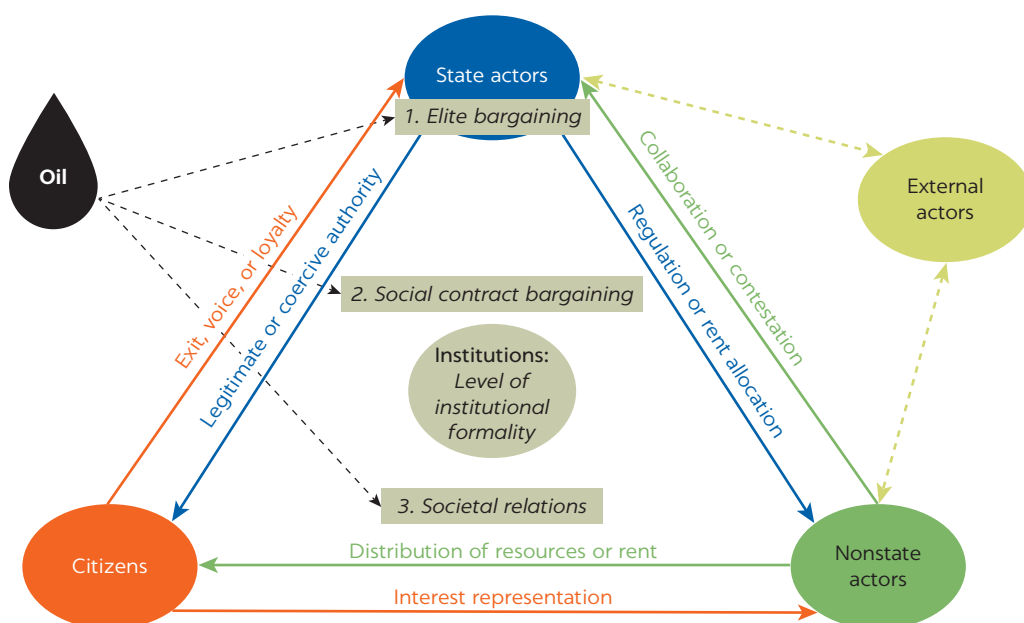
These earlier recommendations remain valid. Moreover, the state still needs to provide security, rebuild infrastructure, and improve service delivery following yet another conflict; while the country's nonoil economy still struggles to grow amid heavy government regulation, an uncertain business environment, and an unstable political climate. With little progress made on these recommendations, the country's situation has markedly worsened in most socioeconomic aspects. This observation calls for a thorough analysis of the underlying fragility constraints on development in Iraq and of the political economy of the country's decision-making and economic reforms, their intricacies and what sets them in motion.

### **Understanding development in Iraq requires a close analysis of its political system and the nature of its social contract**

Contestation between political elites ("elite bargaining"), relations between the Iraqi state and society ("social contract bargaining"), and the relationships between social groups ("social cohesion") are critical to understanding the political economy of Iraq. At various times in Iraq's recent history, the aforementioned contestation has turned violent. Conflict has erupted mainly over competition for power and resources, and Iraq's elites have instrumentalized ethno-sectarian divisions between groups in their pursuit of power. High levels of external interference reinforce these fault lines and turn Iraq into an arena for wider geopolitical contestation (figure O.4). However, contestation in the country is increasingly shifting toward popular grievances over poor delivery of services, state corruption, and the lack of economic opportunities, as Iraq's most recent protests illustrate. In addition, oil dependence is a powerful driver of fragility in Iraq and has reinforced contestation at all levels, fueling elite competition and undermining the state's accountability to citizens.

**FIGURE O.4**

**Contestation between elites, the state, and society and social groups is at the center of the social contract in Iraq**



Source: Adapted from World Bank 2019.

### **Iraq's political settlement consists of elite contestation over power and resources**

Iraq's current political settlement, which rests on rent-sharing and power-sharing by political parties, has led to elite capture, widespread clientelism and patronage, and political paralysis. The post-2003 political system in Iraq grew out of an elite pact built on ethnic and sectarian identities. In its early years, the process of de-Ba'athification and the dissolution of the Saddam-era army led to an erosion of the country's existing bureaucratic infrastructure and displaced the senior civil service that had run it. As time went on, the process of elite politics shifted from sectarian and ethnic power-sharing to political party-based power-sharing and polarization, in which contestation and negotiation take place over control of the formal bureaucracy. Politicizing appointment for key bureaucratic posts became a fundamental component of how political parties extended their patronage networks to strengthen their legitimacy, power, and wealth (Dodge 2019). Furthermore, the increasing fragmentation of Iraq's political landscape has led to political instability and paralysis and fueled fragility.

### **Iraq's oil wealth (or curse) has affected the politics of resource management**

Iraq's reliance on oil has had a major impact on the country's political settlement and economic outcomes. Over the past decade, despite fluctuations in oil prices, Iraq's hydrocarbon sector has accounted for almost all of the country's export value, 90 percent of government revenues, and more than 57 percent of GDP. Iraq's oil wealth has eroded the country's international competitiveness by fueling the gradual appreciation of its real exchange rate. Dependence on oil wealth

has also reduced Iraq's incentive to generate other forms of government revenue, such as tax revenue (Devarajan, Raballand, and Le 2012). This, in turn, has reduced the need for state-society bargaining, which is at the heart of successful state-building processes. As a result, Iraq's administrative capacity has declined and its institutions have grown unresponsive.

Ongoing disputes over oil resource control in Iraq are inextricably linked to unsettled debates about the country's federal system, which has also hampered the adoption of a revenue-sharing law. Intergovernmental relationships are inevitably challenging in resource-rich economies, where resources are unevenly distributed, rents are pooled and managed from the center, and producing regions do not always benefit from rent dividends (Ahmad 2020). Additionally, ongoing disputes over resource control in disputed territories (including the Kirkuk governorate) impair their recovery from the ISIS conflict. Resource control is also an arena of contestation between the federal government and other oil-producing provinces, such as the Basrah governorate (Isakhan and Mulherin 2018).

Political instability, oil rents, and high government discount rates in Iraq lead to short-term rent maximization and an incentive system in which decision-makers highly discount future payments and prefer present rewards. The political instability caused by Iraq's increasing political fragmentation and alienation undermines the credibility of the government's long-term commitments. It also breeds a strong sense of insecurity within the ruling elite, which is reflected in their preference for the political status quo (Mansour 2020). For the sake of this status quo, the ruling elite has observed some level of fiscal prudence in recent years, but the Iraqi government has yet to invest in fiscal stabilization mechanisms or long-term reforms. Focusing on short-term rent maximization leads governments to discount future revenue (including oil tax revenue, which is more challenging to collect than royalties) at a significant cost to the economy (World Bank 2012).

### **State-society contestation has emerged as a new fault line**

The social contract between Iraq's ruling elite and the people has failed to meet social demands, fueling growing discontent. The country's increasing political fragmentation has exacerbated this power struggle and the elite's concern for the status quo, widening the divide between the ruling elite and its constituencies. As a result, grievances have accumulated, particularly among Iraq's youth, and social unrest has spread, culminating in the 2019 protests.<sup>3</sup> Protesters' demands include improvements to public services, such as education and electricity and water provision, and jobs, which the Iraqi government has until now sought to provide mainly by expanding public sector employment. However, as oil revenues decrease and the Iraqi population grows, this model, and its consequent expansion of the state's wage bill, are no longer sustainable.

Iraq's rapidly changing demographics suggest that the country's political equilibrium will become even more fragile in the coming years. Iraq's youth unemployment rate is 36 percent (World Bank 2018), a particularly serious problem given that the country has one of the youngest populations in the world. Moreover, almost all Iraqi youth (95 percent) believe that personal connections, or *wasta*, shape one's employment opportunities—the highest share in the region (according to the Arab Barometer Wave 5 survey).

Regional disparities within Iraq point to yet more risk factors for conflict and instability. A wide literature considers between-group inequality to be a

contributing factor to the onset of conflict. Iraq contains several regional and religious disparities, in terms of both poverty and service delivery indicators. Most Iraqis (64 percent) say the country is divided as opposed to unified (NDI 2019). Issues of cohesion and social trust are particularly salient in areas liberated from ISIS and in disputed territories where internal displacement remains high. The country's south has consistently had the highest poverty rates, and the Kurdistan region the lowest; however, the regions most affected by the recent conflict (the Kurdistan region and the north) saw increases in poverty compared with 2012.

### **From a wealth accounting approach, Iraq's vast oil wealth hides a growing gap in human capital between it and peer countries**

Rather than focusing on what a country produces and sells, one can focus instead on how it goes about producing it (Gill et al. 2014; Lange, Wodon, and Carey 2018). Reliance on a broader and more productive portfolio of assets ultimately determines a country's ability to grow sustainably. Wealth creation in Iraq is overwhelmingly driven by oil, unlike in its peers, which derive their wealth from human capital.<sup>4</sup> Iraq's wealth grew by 133 percent in the 2005–14 period, one of the highest rates among both resource-rich countries and resource-rich fragile countries (see chapter 2). However, compared with other upper-middle-income countries and selected peers, Iraq's wealth was driven far more by depletion of its oil reserves than by improving the country's stock of human capital (as measured by the size and quality of its labor force). In fact, over the past few decades, Iraq has witnessed a significant decline in health and education outcomes.

### **Development in Iraq's private and nonoil sectors is held back by a range of regulatory and political factors**

Iraq's anticompetitive environment is a bottleneck for both firm-level productivity and the overall development of the country's private sector. Iraq's performance in the Doing Business Rankings has fallen markedly in recent years, especially in the “getting electricity” and “paying taxes” categories. Iraq's performance in the Logistics Performance Index also deteriorated between 2014 and 2018; the country fell further behind not only its developmental peers but also other countries in the region. Relative to its structural and aspirational peers, Iraq has a much riskier business environment, with greater prevalence of cronyism and, especially, unfair competitive practices. The results of this environment can be seen when evaluating the time and cost to trade across Iraq's borders. Although the country has few regulatory restrictions on cross-border trade, the cost of and time needed for complying with import and export rules are much higher in Iraq than in both Iraq's peers and neighboring countries.

## **WHAT CAN BE DONE TO SUSTAIN FUTURE GROWTH?**

This report outlines key pathways for Iraq to achieve sustainable growth after closely considering the country's complex political economy and the limitations thus associated with those pathways (see annex table O.A.1). It makes specific

technical recommendations for each reform area and suggests how to create a virtuous cycle of growth and stability that goes beyond the recommendations. However, in countries such as Iraq that have undergone a vicious cycle of violence and fragility, coordinated policies from a broad coalition of actors are critical to maintaining such “peaceful pathways” (United Nations and World Bank 2018) and kickstarting this virtuous cycle. In the meantime, and over a shorter horizon, reforms that require less demanding government interventions can be initiated while the state and its formal institutions are strengthened.

### **Iraq’s priority should be to refocus the country’s political settlement on development and restore the authority of formal state institutions over nonstate actors**

A stable elite bargain is an important but not sufficient prerequisite for peace. Only if Iraq’s elite bargain is oriented toward growth and development will the country’s citizens fully enjoy peace dividends, and only then are they likely to grant public institutions and the ruling elite the legitimacy necessary for governing. Iraq also needs to restore the authority of formal state institutions over non-state armed groups, not only to stabilize the political settlement but also to help reduce informal and front-loaded rent extraction, which currently deprives the government of much of its potential fiscal space.

Although institutional reform is a slow-moving and gradual process that can take years, it requires reform coalitions among both ruling elites and citizens of all social groups. There may be opportunities in the short term to build new platforms or mechanisms for dialogue and consensus building that can bring together Iraq’s various political and social actors, including protesters, civil society, the private sector, and religious authorities. Progress in Iraq will remain elusive unless elite incentives shift and the country assumes a new, shared political vision that acknowledges that it needs to shift from its current clientelist and patronage-based model toward a system that delivers the benefits of development to its people.

### **Iraq needs to strengthen the management and allocation of its oil wealth and public resources**

The short-term rent maximization induced by Iraq’s current political settlement is leading to growth in the production and export of oil irrespective of, and even at the expense of, maximizing revenue generation over time (including from nonoil products). It is also skewing rent allocation toward recurrent expenditures to the detriment of productive investment.

Transitioning from a distributive to a developmental model of fiscal federalism will be critical to the success of such reforms. Iraq’s contested federalism hampers revenue generation by inducing revenue capture at the source by nonstate actors affiliated with dissenting authorities and by slowing down the devolution of fiscal resources, thus limiting the institutional capacity of provincial and local governments. Intergovernmental disputes also prevent the stabilization of the legal and institutional framework of Iraq’s federal system and impede policy and program implementation and service delivery. As long as federalism is construed as a zero-sum game, in which a gain by one tier of government must mean a loss by another, and rent-sharing is seen as the only or the main objective

of fiscal federalism, ongoing disputes and debates may remain unsettled, and Iraq may struggle to escape from its rent-seeking trap.

**Restoring the social contract, building confidence between citizens and the government, and addressing grievances will be key**

Iraq needs to strengthen its existing accountability institutions so that they can effectively respond to public concerns about corruption. These institutions need to focus on mitigating the risk of corruption and enhancing government performance. They should aim to improve citizens' actual experiences of corruption, red tape, arbitrariness, abuse of authority, and other problems when availing themselves of public services and interacting with public officials. Petty corruption and bureaucratic harassment hurt citizens as much as grand corruption, and they could be addressed through delivery mechanisms such as e-service delivery and online grievance-redress mechanisms. Public perception of corruption can also be improved by measures that signal the willingness of political leaders to make amends, such as the public disclosure of the asset, income, and financial declarations of government officials.

Iraq could also strengthen citizen engagement and government accountability in the delivery of priority services and infrastructure. First, Iraq would need to ensure that federal investments are prioritized by their importance to citizens in the relevant region. Second, the state could recognize that the way services are delivered and how fair they are perceived to be matter at least as much to state legitimacy as who delivers them and how effective they are. Prioritizing investments identified as citizens' top priorities and embedding within them mechanisms to support accountability, participation, and grievance-redress could help improve the relationship between Iraqi citizens and the state.

Establishing a fiscal contract between the government and citizens is another part of the equation. One way Iraq could do so is to transfer part of the country's oil revenue directly to citizens through uniform and universal cash transfers and then introduce the direct taxation of distributed revenues (Devarajan, Raballand, and Le 2012).<sup>5</sup> Taxation fosters social demand for government accountability that oil revenues do not, because "they go directly from the extractive company—usually a multinational—to the government, without passing through the citizens" (Devarajan et al. 2013). Given that the federal government of Iraq currently spends much of its budget on wages, pensions, social allowances, and tariff subsidies, the effectiveness of public expenditures for restoring the social contract should also be reviewed. The government could also consider introducing local taxation to help establish a fiscal contract.

Responding to youth demand for jobs and addressing medium-term demographic pressures is important to reduce the risk of instability and avoid downward pressure on incomes. As highlighted above, Iraq needs to cater to a growing number of young job seekers, and thus it needs to shift from a public sector-centric employment model to a private sector-centric one. This shift will require a change in mind-set among the country's youth, who currently expect jobs in the public sector. Despite this challenge, important pathways for job expansion are available to Iraq, especially in construction, agriculture, and small and medium enterprises (World Bank 2018). But in order to perform those jobs,

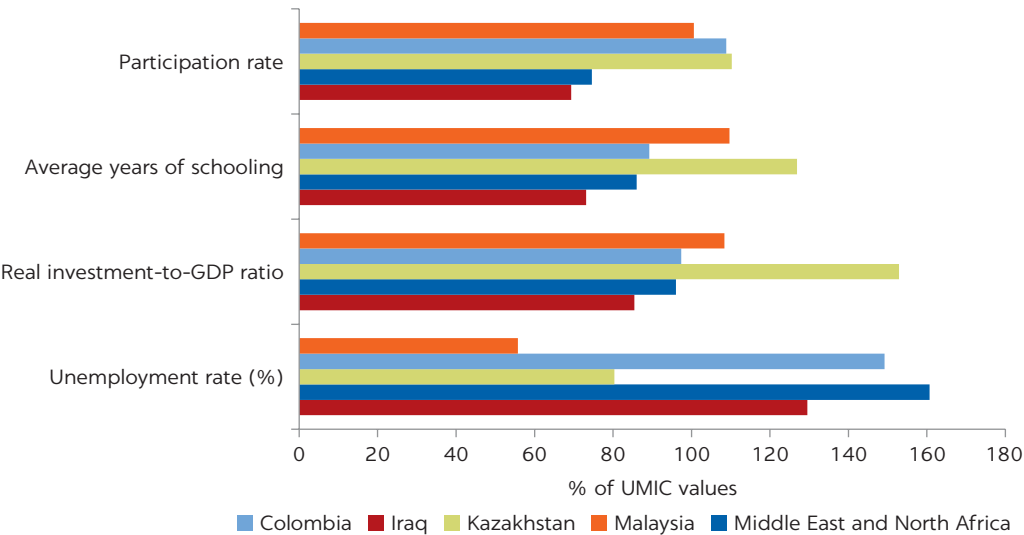
Iraq’s youth will need more education, skills development, and efforts to strengthen female labor force participation.<sup>6</sup>

Tackling socioeconomic inequalities, which can fuel group-based grievances and increase gender inequality, will also be key to addressing Iraq’s structural vulnerability to violent conflict. A concerted effort will need to be made to ensure that resources are distributed equitably across groups and that perceived or real inequalities in access to welfare, basic services, and employment opportunities are addressed. Finally, Iraq will need to reach remote and underserved communities in order to ameliorate their condition and help build up their human capital. Particular attention should be paid to Iraq’s disputed territories (e.g., Nineveh, Kirkuk, and Diyala), to areas where nonstate actors provide security or other services, and to areas where attacks by ISIS and other terrorist groups are on the rise.

**Iraq has lost some opportunities, but plenty of potential lies ahead**

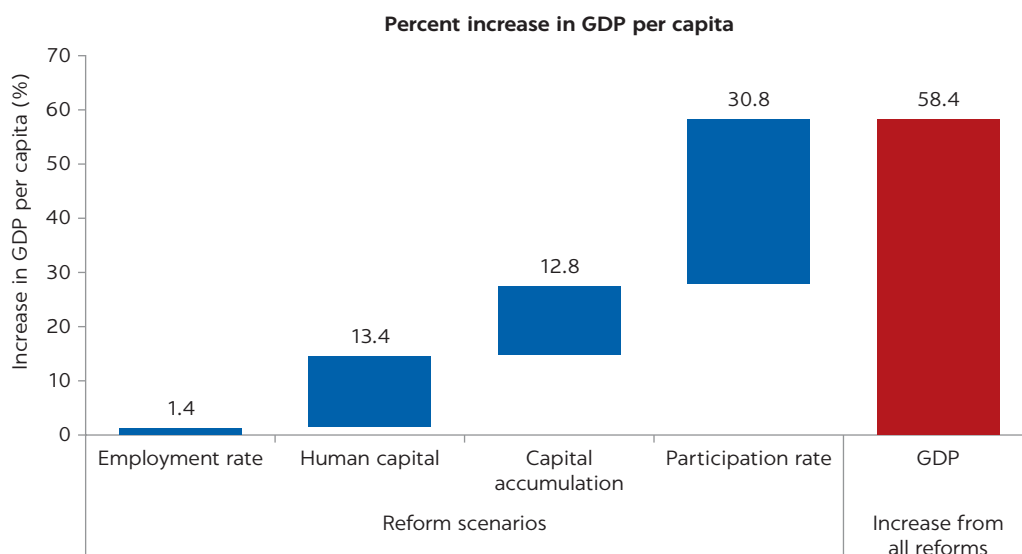
Iraq’s GDP per capita could be up to 60 percent higher if it had the same levels of labor force participation, investment, human capital, and productivity as other upper-middle-income countries.<sup>7</sup> At the moment, Iraq lags behind its aspirational peers on all of these indicators, particularly the labor force participation rate (especially among women) (figure O.5). Raising Iraq’s participation rate to the UMIC average would alone increase Iraq’s GDP per capita by almost 31 percent (figure O.6).<sup>8</sup> Raising the investment rate and the quality of the labor force would each also raise GDP by about 13 percent. However, to achieve these outcomes, Iraq would need to implement reforms with payoffs farther in the future than its ruling elites have yet shown interest in.

**FIGURE O.5**  
**Iraq lags UMIC and MENA countries in key GDP inputs**



Source: World Bank estimates using World Development Indicator data.  
Note: GDP = gross domestic product; MENA = Middle East and North Africa;  
UMIC = upper-middle-income country.

FIGURE O.6

**Iraq has much potential to improve its GDP per capita**

Source: World Bank calculations.

**Iraq's diversification and growth strategy needs to focus on diversifying its asset portfolio by investing in its people, its capital stock, and its institutions**

Iraq may not be able to rely on oil revenues to maintain its standard of living in the future. Although Iraq has the world's fifth-largest proven oil reserves, it is estimated that these reserves will last only 80–85 more years, assuming there is no fall in the global demand for oil. In case demand slows down, as it has during the COVID-19 crisis and may continue to do because of technological improvements or climate change considerations, Iraq's shift to an economy less reliant on oil may need to happen much faster. At that point, Iraq's nonoil economy must become able to sustain the country's middle-income level.

With the end of the ISIS conflict, Iraq can invest in infrastructure to support diversified development. Iraq's investment rate is below that of the country's regional and income peers, and a large share of the country's investment is dedicated to the oil economy. In recent years, the share of government spending devoted to any sort of investment has fallen as well, from 41 percent in 2014 to about 17 percent in 2018. To help its nonoil economy grow in the postcrisis period, Iraq would need to rebuild its capital stock by investing in productivity-enhancing infrastructure and critical services. This category includes the infrastructure needed to develop trade corridors and more efficient border crossing posts (see chapter 3) and infrastructure linked to water provision and rural development, which would benefit the agriculture sector (see chapter 4). Without these investments, operational costs for businesses will rise and service delivery will continue to be of poor quality.

A renewed focus on improving human capital is also needed. Although this change would include shifting some of Iraq's recurrent spending toward improving education and health outcomes,<sup>9</sup> it is also about taking a new

approach that places Iraq's people at the forefront of the social contract and enables them to be productive economic agents. Promoting private sector activity, with a renewed focus on the digital economy, will also help enable Iraqis to achieve their potential.

### **Injecting more competition and contestability into Iraq's economy could have powerful effects**

Iraq's economy requires a dose of competition to shake up its large public sector and politically connected private sector, promote the private nonoil economy, and help increase efficiency. Competition and contestability are essential to creating economic opportunity. Allowing firms to compete against each other on a level playing field can help raise household incomes (by reducing prices and incentivizing technological progress), drive economic growth, and reduce inequality. And for competition to work, there must be contestability; in other words, it must be easy for firms to exit and enter markets as opportunities arise.

Another measure that could increase competition in Iraq's economy is to privatize some of the country's many state-owned enterprises (SOEs). Previous attempts at privatizing SOEs were reversed—the state ended up renationalizing most of the companies—but such changes could be attempted again.

### **Iraq has much latent potential to resume or increase exports of products it once produced and to promote regional trade**

Iraq has much potential to improve its product diversification, given that it has proven capable of exporting many products in the past. Until fairly recently, Iraq exported a wide variety of products, and under the right conditions, including a return of domestic security, those exports could return. Food and live animals, chemical products, and machinery and transportation equipment are among the goods for which Iraq has latent export potential (as detailed in chapter 3).

Although Iraq's geography gives it the potential to be a regional transit hub, its performance at logistics and border management is weaker than any of its neighbors', turning it instead into a regional bottleneck. Trade facilitation is thus an urgent priority for Iraq. The country's outdated legal and regulatory framework for customs should be revised to align more closely with international best practices. Institutional and integrity reforms for border management should be prioritized and should complement the country's broader initiative to develop a comprehensive anticorruption framework using a whole-of-government approach. Also, implementing automated trade systems could enhance risk management and reduce the number of paper documents required to trade.

Reforms of trade policy and trade facilitation, by reducing trade costs, will promote export diversification and trade with Iraq's neighbors, which will in turn promote regional peace and stability. Iraq traditionally exported nonoil products to the broader Middle East and North Africa region. Given the difficulty Iraq faces in establishing formal trade agreements in the region, practical measures to promote actual trade on the ground are more likely to bear fruit. Increasing the region's integration by promoting trade in goods and services is a win-win strategy that could shift the political economies of Iraq and its neighbors.

## **Diversifying Iraq's agrifood sector could do much to boost stability and prosperity**

Rebuilding agriculture is an important strategy for postconflict reconstruction. As in most conflicts, large numbers of Iraq's rural civilians have been displaced, and their agricultural livelihoods disrupted, by the struggle against ISIS. Fortunately, agriculture is well suited to absorb demobilized combatants, improve food security, and enhance livelihoods (Birner, Cohen, and Ilukor 2011). There is also increasing evidence that when implemented appropriately, well-timed food security related interventions can build resilience to conflict by providing coping and recovery mechanisms and by supporting sustainable development more broadly (FAO 2016). Furthermore, the development of Iraq's agrifood sector could present an opportunity to develop new ways of working.

Iraq's agrifood sector has already established agriculture value chains that allow for high value addition. The country's immediate priority is to identify and invest in interventions that will increase the efficiency, competitiveness, and sustainability of existing value chains, especially those that have thus far received little government support. Three value chains in particular show high potential to expand employment and boost economic growth: poultry, tomatoes, and date palms. These subsectors could benefit from greater investment from the private sector, rapid adoption of innovation and technology, improvements in competitiveness, and growth in employment, both on farms and along their value chains. In addition, these subsectors would offer much-needed stabilization in governorates that have suffered from prolonged conflict, including Basrah, Babylon, Najaf, Anbar, and Salahaddin. These value chains have shown potential in the past (as described in chapter 4), are directed at both internal and external markets, and can become mutually supportive and stimulate the development of a range of ancillary services. This change will further improve Iraq's competitiveness. Consequently, investment in these value chains could expand employment well beyond them.

A new vision for Iraq's food system is required in order to reap those transformational benefits. Immediate actions include (a) forming a cross-ministerial committee on the future of food in Iraq; (b) institutionalizing improved food system planning between the ministry of agriculture and the ministries of finance, planning, and trade; and (c) undertaking a national audit of the current food system to assess whether it will continue to be fit for purpose in. This audit should start a high-level debate on the future of food in Iraq, including the future of reforms of price supports, trade, and subsidies.

Boosting competitiveness in Iraq's agriculture sector will help maximize opportunities for investment, growth, and job creation. For example, Iraq's Public Distribution System (PDS) currently supplies food to all inhabitants regardless of income level or regional conditions. Iraq could identify areas where welfare levels are sufficient and food markets function well and help transition segments of the population in those areas to market substitutes. To further boost competition, the private sector, especially small and medium enterprises, can be encouraged to further invest in developing value chains where the government is dominant and where potential is high for expansion in domestic and export markets, such as the date palm sector.

Iraq's digital economy could also play a significant role in revitalizing the agriculture sector and its related services and in catering to the country's young population. A starting point could be linking financing to mobile payment systems, which would leapfrog brick-and-mortar banking and support financial risk management. The enhanced cash management that arises from phone banking, including automatic bill payment, would not only optimize the use of cash, and thereby profitability, but also create a trail of credit data on smaller and remote borrowers that could help build credit-scoring approaches for them, which thus far are entirely missing in Iraq. Such approaches would help not only banks but also other risk management providers, such as insurance companies. Good scoring would also reward more creditworthy farmers with greater access to finance.

Despite Iraq's existing sociopolitical and economic environment, three encouraging messages emerge from this report:

- First, there is a peace dividend in Iraq. Iraq's per capita GDP was about one-fifth lower in 2018 than it would have been if not for the conflict beginning in 2014, and nonoil GDP was one-third lower. Thus, maintaining peace can by itself be a strong driver of growth. However, Iraq's reliance on oil has had a strong-enough negative impact on the country's political settlement and economic outcomes to obscure this dividend. The country's political parties use oil wealth to reward their patrons rather than to address the needs of the people. Oil wealth has also eroded the country's economic competitiveness, reduced the need for taxation, weakened the accountability link between citizens and the state, and fueled corruption. Amid political instability and elite contestation, the incentive system for Iraq's decision-makers is biased toward seeking present rewards rather than making long-term reforms.
- Second, Iraq has latent export potential for a variety of goods that, if tapped, could diversify the country's economy, raise living standards, and boost economic resilience. Under the right conditions, including a return of domestic security, improved trade policy could also bring about better prices and quality for Iraqi consumers. This policy would include reforming the country's trade institutions and regulations, which are no longer optimal for present conditions, such as its import-licensing regime and two separate customs territories, which should be unified under a single tariff schedule. Furthermore, Iraq has the geographical position to be a regional hub for logistics, but its performance lags that of its peers by so much that it is instead a regional bottleneck. Trade facilitation measures are thus an urgent priority.
- Third, Iraqi agriculture could be revived to serve as a pillar of a more diversified and private sector-led economy. Agricultural production, food processing, and supporting services all have large potential to expand and create jobs. Also, Iraq's agriculture value chains have not been subject to the same level of government control or governance challenges as those of other commodities. As it rebuilds itself, Iraq's agrifood sector can develop new ways of working, building on both its historical experiences and modern technologies to maximize its competitive potential. Doing so will take time, and thus the short-termist models used in rent extraction may not apply.

## ANNEX O.A: PATHWAYS FOR IRAQ TO ACHIEVE SUSTAINABLE GROWTH

**TABLE O.A.1** Key pathways to sustainable growth

PRIORITY OBJECTIVES	MEDIUM-TERM PRIORITIES	LONG-TERM PRIORITIES AND SHIFTS
<b><i>Refocus the political settlement on the development agenda and restore the authority of formal state institutions over nonstate actors</i></b>		
<b>Pivot toward a more development-oriented political settlement</b>	<ul style="list-style-type: none"> <li>• Build leadership coalitions for reform and develop mechanisms for strategic citizen engagement and national dialogue.</li> <li>• Reform of electoral law and electoral commission to facilitate the participation of all Iraqis in the democratic process, increase the integrity of the process, and boost the inclusiveness of representation.</li> </ul>	<ul style="list-style-type: none"> <li>• Build a new elite consensus and political vision around the need to reduce oil dependency and provide developmental benefits to people.</li> <li>• Shift the topic of electoral competition to programs geared toward collective welfare enhancement.</li> </ul>
<b>Restore the authority of formal state institutions over nonstate actors</b>	<ul style="list-style-type: none"> <li>• Send confidence-building signals to restore state authority over nonstate actors (e.g., border control and security actors).</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the integration and accountability of security actors and strengthen security sector governance.</li> <li>• Restructure the oversight and regulatory institutions, and boost their capacity and independence with an objective to enhance accountability, transparency, and competition.</li> </ul>
<b><i>Strengthen the management and allocation of oil wealth and public resources</i></b>		
<b>Strengthen the governance framework for the oil and gas sectors</b>	<ul style="list-style-type: none"> <li>• Increase transparency in the oil sector, including with regard to contract disclosure.</li> <li>• Strengthen external auditing of oil revenue in order to validate EITI data.</li> <li>• Enact a complete policy and legal framework for formula-based revenue sharing (as per article 112 of the Iraqi constitution).</li> </ul>	<ul style="list-style-type: none"> <li>• Operationalize the provisions of the 2019 public financial management law on the investment of oil and gas revenue surpluses.</li> <li>• Strengthen oversight and accountability of SOEs in the oil and gas sectors.</li> <li>• Review licensing policies in order to maximize oil rent in the long term.</li> <li>• Introduce oil revenue forecasting and modeling in order to better respond to price volatility.</li> </ul>
<b>Transition from distributive to developmental fiscal federalism</b>	<ul style="list-style-type: none"> <li>• Promote renewed dialogue on the merits, challenges, and opportunities of federalism.</li> <li>• Settle resource control disputes by clarifying resource assignment across the tiers of government.</li> </ul>	<ul style="list-style-type: none"> <li>• Adopt and implement developmental fiscal federalism.</li> </ul>
<b><i>Restore the social contract by building confidence between groups and in government institutions and address grievances</i></b>		
<b>Strengthen accountability institutions and respond to public concerns about corruption</b>	<ul style="list-style-type: none"> <li>• Publicly disclose asset, income, and financial interest declarations by public officials (starting with cabinet members).</li> <li>• Introduce a legal framework on the right to information.</li> <li>• Introduce mechanisms for citizen feedback on public policies and programs (including responses to emergency situations).</li> </ul>	<ul style="list-style-type: none"> <li>• Pass legislation on whistleblower protection, conflicts of interest, and political immunity.</li> <li>• Undertake forensic institutional reviews of the government entities and programs that are most vulnerable to corruption.</li> </ul>
<b>Strengthen the responsive delivery and accountability of priority services and infrastructure</b>	<ul style="list-style-type: none"> <li>• Prioritize service delivery and infrastructure investments (e.g., water, electricity, and housing) according to citizen priorities.</li> <li>• Embed mechanisms in these programs to support accountability, participation, and grievance redress in the delivery of services.</li> </ul>	<ul style="list-style-type: none"> <li>• Adopt public service standards.</li> <li>• Extend the reach of state institutions where government presence is weak or contested by other actors.</li> </ul>
<b>Establish a fiscal contract between the government and citizens</b>	<ul style="list-style-type: none"> <li>• Restore the tax base, strengthen tax enforcement, and allow lower tiers of government to raise local taxes.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the legal and institutional framework for taxation.</li> </ul>
<b>Respond to youth demand for jobs and address demographic pressures</b>	<ul style="list-style-type: none"> <li>• Identify pathways for job creation, especially in construction, agriculture and related industries and services, and small and medium enterprises.</li> <li>• Assess and invest in job-relevant skills development programs for youth and women.</li> </ul>	<ul style="list-style-type: none"> <li>• Address cross-cutting impediments to the development of the private sector, including bottlenecks in the business environment, lack of depth in the financial sector, and lack of competition.</li> </ul>

*continued*

TABLE O.A.1, *continued*

PRIORITY OBJECTIVES	MEDIUM-TERM PRIORITIES	LONG-TERM PRIORITIES AND SHIFTS
<b>Tackle socioeconomic inequalities that can fuel group-based grievances and reduce gender inequality</b>	<ul style="list-style-type: none"> <li>Study group-based grievances and begin to address inequalities through spatial approaches.</li> </ul>	<ul style="list-style-type: none"> <li>Institutionalize mechanisms for more equitable resource sharing (see the row on distributive federalism) and inclusion of vulnerable and marginalized communities.</li> </ul>
<b><i>Diversify Iraq's asset portfolio by investing in people, the capital stock, and institutions</i></b>		
<b>Raise the labor force participation rate</b>	<ul style="list-style-type: none"> <li>Reduce bottlenecks to labor market participation, especially for women.</li> </ul>	<ul style="list-style-type: none"> <li>Increase the labor force participation rate for women.</li> </ul>
<b>Increase nonoil investment as a direct means of diversification</b>	<ul style="list-style-type: none"> <li>Implement the Financial Management Information System and build capacity for budget planning.</li> <li>Revisit public investment management to improve the effectiveness of capital expenditures.</li> <li>Prioritize investment in infrastructure, especially in areas liberated from ISIS.</li> <li>Prioritize investment in human capital through the education system.</li> </ul>	<ul style="list-style-type: none"> <li>Increase the nonoil investment rate.</li> <li>Bring the overall nonoil investment rate—including public, domestic, and foreign direct investment—up to par with regional and income peers.</li> <li>Increase educational attainment and the quality of the learning attained.</li> </ul>
<b><i>Promote trade as a vehicle for growth</i></b>		
<b>Increase opportunities for trade by reducing distortionary costs, delays, and uncertainty at the border</b>	<ul style="list-style-type: none"> <li>Modernize customs and improve border infrastructure.</li> <li>Adopt modern risk management techniques and trade automation.</li> <li>Increase the transparency of import licensing and the associated allocation of foreign exchange for imports.</li> </ul>	<ul style="list-style-type: none"> <li>Reduce internal and external fragility, conflict, and violence in order to support the diversification of nonoil exports.</li> </ul>
<b>Increase opportunities for trade by boosting revenues and reducing rent-seeking</b>	<ul style="list-style-type: none"> <li>Increase the integrity and professionalism of customs.</li> <li>Reduce administrative fragmentation at the border.</li> </ul>	<ul style="list-style-type: none"> <li>Unify the customs territory of Iraq so that procedures and tariffs in the Kurdistan region and in the rest of the country are the same and customs revenues are shared.</li> </ul>
<b><i>Support diversification along agricultural value chains, from primary agriculture to agrifood</i></b>		
<b>Refocus food policy toward employment, sustainability, and economic diversification</b>	<ul style="list-style-type: none"> <li>Invest in strengthening institutional and human capacity for policy research, analysis, and development in Iraq's food system.</li> <li>Develop processes and forums to enable consultation with key food-system stakeholders.</li> </ul>	<ul style="list-style-type: none"> <li>Establish a revised policy framework with pillars focused on green growth, inclusive employment, private sector development and competitiveness, and innovation and digitalization.</li> </ul>
<b>Maximize the impact of high-value production systems and value chains</b>	<ul style="list-style-type: none"> <li>Using demand-driven models to assess opportunities for aggregating supply chains and building strong links between producers and buyers or processors.</li> <li>Enable competitiveness through private investment, increased access to technologies (especially climate technologies), improved services, and regulatory reform.</li> </ul>	<ul style="list-style-type: none"> <li>Increase inclusive employment, competitiveness, and environmentally sustainable practices on and off farms.</li> <li>Increase agrifood-related manufacturing, processing, and service provision.</li> </ul>
<b>Invest in digital solutions and opportunities</b>	<ul style="list-style-type: none"> <li>Invest in expanding the digital economy, prioritizing rural areas.</li> <li>Enable the expansion of business models that will give farmers, processors, and service providers (especially women and youth) increased access to finance using digital technology.</li> </ul>	<ul style="list-style-type: none"> <li>Increase access to finance for rural women and youth working in the agrifood sector.</li> </ul>

Source: World Bank.

Note: EITI = Extractive Industries Transparency Initiative; ISIS = Islamic State of Iraq and the Levant; SOE = state-owned enterprise.

## NOTES

1. Iraq's GDP growth is projected to be -9.7 percent in 2020 (World Bank 2020).
2. Using the \$5.50 (purchasing power parity) per person per day poverty line the World Bank recommends for UMICs, Iraq's poverty rate is 57.3 percent, below only Botswana's (60.4 percent) and Turkmenistan's (92.5 percent).
3. In opinion polls, Iraqis identify the lack of employment opportunities and corruption as the two most important issues to be addressed by the government, followed by security and public service provision (NDI 2019).
4. Lange, Wodon, and Carey (2018) provide estimates of a nation's wealth and its decomposition into three types of capital (natural, produced, and human) plus net foreign assets (see chapter 2).
5. There is evidence that direct transfers are the most effective at preventing conflict (Cordella and Onder 2020).
6. Current estimates show that "fewer than one in ten adult women with intermediate or lower levels of education participates in the labor market." Additionally, women participating in the labor market are more likely to be unemployed than men. Among Iraqi youth, young women were more than twice as likely to be unemployed as their male counterparts: about 65 percent of young women were unemployed, compared with 32 percent of young men.
7. If Iraq were to catch up to MENA averages on these key economic indicators, its per capita GDP would be 25 percent higher.
8. By decomposing GDP into its supply-side inputs (physical capital, the participation rate, and human capital), we can understand what will be possible once Iraq invests in these areas.
9. An upcoming Human Development public expenditure review will delve into more details.

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# 1 Iraq's Fragility and Its Implications for Diversified Growth

Iraq is on the brink of catastrophe. Almost two decades after the Iraq war began, the country remains caught in a fragility trap and faces increasing political instability and fragmentation, geopolitical risks, growing social unrest, and a deepening divide between the state and its citizens. The impact of the COVID-19 crisis and the crash in oil prices compound Iraq's preexisting fragilities and could lead to economic meltdown and a new cycle of violence and conflict—or they could provide an opportunity to fundamentally realign the government's priorities, advance much-needed reforms, and tackle the deep structural issues that hold back progress in Iraq.

Iraq's power-sharing system has resulted in widespread corruption and patronage and has reinforced competition over oil rents while giving few incentives to build accountable institutions, diversify economically, or deliver benefits to the Iraqi population. The failure to equitably share the benefits of oil wealth and provide employment opportunities and basic services to all Iraqis has fueled grievances and widened spatial inequalities. In combination with a young population seeking jobs, and amid decreasing opportunities for public-sector employment and high levels of frustration and alienation from the political elite, the country faces significant risks.

This chapter highlights how Iraq's high level of fragility and conflict (reinforced by its high oil dependency) hinders the country's prospects for economic reform and growth. It argues that without (a) understanding how Iraq's fragility and political economy shape economic reform and development and (b) addressing these factors as part of a wider strategy and reform agenda, the best technical solutions are likely to fail or be derailed by continued political instability and social unrest—or, worse, a new outbreak of violent conflict if structural issues and risk factors are left unaddressed.

The chapter is structured in four sections. Following an introduction to the framework applied for analyzing fragility and conflict in Iraq, the first section discusses the nature of competition and contestation between Iraq's political elites; the second section describes the nexus between Iraq's oil reliance, fragility, and conflict and how oil revenues shape the management of public resources;

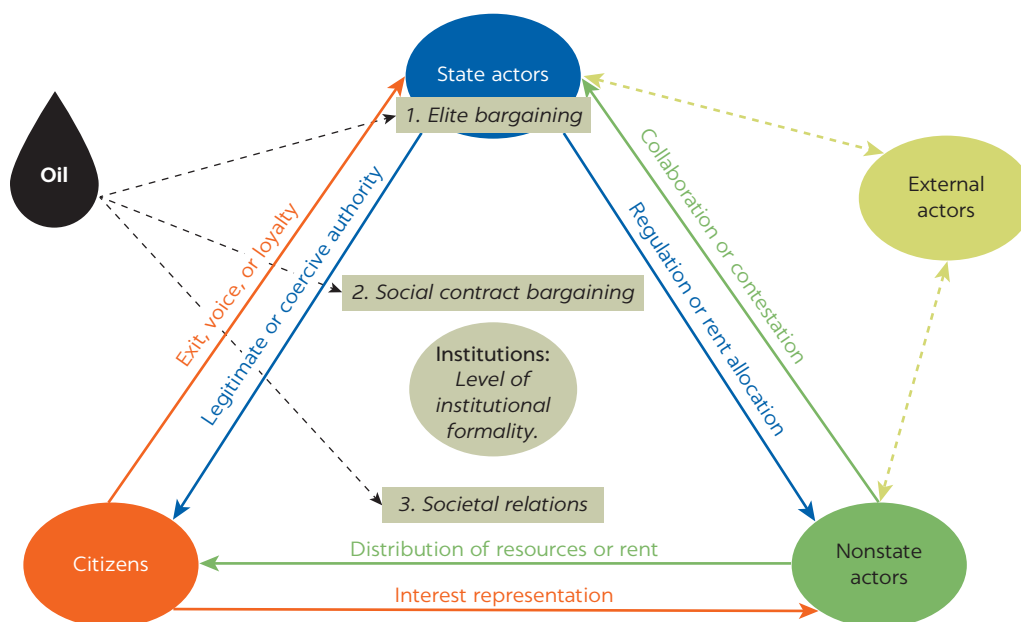
the third section shows how contestation between the state and Iraqi society has emerged as a new fault line in the country; and the fourth section examines Iraq's societal divides and horizontal inequalities. The chapter concludes with initial considerations for pathways out of fragility.

## A FRAMEWORK FOR ANALYZING FRAGILITY AND CONFLICT IN IRAQ

Understanding fragility, violence, and limited development in Iraq requires a close analysis of the country's political system, the nature of the social contract, and the social divisions in Iraqi society. This chapter proposes a framework that takes competition and contestation between political elites ("elite bargaining"), relations between the Iraqi state and society ("social contract bargaining"), and relationships between social groups ("social cohesion") as its starting points for analysis. At various times in Iraq's recent history, this contestation has turned violent. Conflict has erupted mainly over competition for power and resources, and elites have exploited ethno-sectarian divisions between groups. However, contestation is shifting toward popular grievances over poor delivery of services, state corruption, and the lack of economic opportunities, as illustrated by Iraq's most recent protests. High levels of external interference reinforce these fault lines and turn Iraq into an arena for wider geopolitical tensions and contestation. Figure 1.1 provides an overview of the framework adopted for this chapter of the Country Economic Memorandum (CEM).

Oil dependence acts as a powerful driver of fragility in Iraq and has reinforced contestation at all levels, fueling elite competition, undermining

**FIGURE 1.1**  
Framework for analyzing fragility, contestation, and conflict in Iraq



Source: Adapted from World Bank 2019.

accountability to citizens, and increasing the risk of conflict. Iraq's dependence on oil income not only fundamentally affects the structure of the Iraqi economy but also plays a critical role in shaping the state, notably its political settlement and the relationship between it and its citizens. Weak governance and poor resource management undermine the potential of Iraq's vast oil wealth, contributing to a vicious cycle in which oil rent-sharing reinforces fragility and increases political instability. Elite contestation over oil rents is also a source of conflict, and the capture and smuggling of oil can finance an armed insurgency, as was seen with the Islamic State of Iraq and the Levant (ISIS). Oil price shocks and the slowdown in global demand caused by the COVID-19 crisis, along with an ever-growing young population, underline the unsustainability of the current model, which seeks to respond to demand for jobs and services with patronage-based distribution of public sector jobs and social benefits. There are thus other strong reasons (beyond the economic imperative) for Iraq to diversify its economy and break out of its fragility trap.

External actors and their competing agendas have reinforced Iraq's fragile political system and threatened the country's sovereignty. Iraq's oil wealth and location have traditionally made it prone to foreign interference, and many regional and international geopolitical tensions play out in Iraq (World Bank 2017c). The geopolitical rivalry between external actors, especially the US and Iran, is an underlying point of tension that manifests across security, political, economic, and social lines in Iraq. In domestic politics, it creates a significant fault line among the ruling elite and aggravates public distrust in government by spurring people's resentment of foreign interference. One of the most prominent external actors shaping Iraq's politics today, Iran, has used its sectarian ties, deep economic and political relationships with local elites and parties, and security partnerships with paramilitary groups to solidify its presence in Iraq. Following the US invasion in 2003, extraordinarily high levels of international aid have been provided or pledged for Iraq's reconstruction efforts, but the impact of this aid has been limited at best, and the aid has been prone to elite capture (Matsunaga 2019).

## **IRAQ'S POLITICAL SETTLEMENT: ELITE CONTESTATION OVER POWER AND RESOURCES**

Understanding Iraq's political settlement and how it has evolved in recent years is fundamental to understanding the country's prospects for peace, growth, and development. A wide body of work argues that stable and inclusive elite bargains are a prerequisite to containing violence.<sup>1</sup> The work by Douglas North et al. (2007, 2012) on limited access orders provides a useful entry point to describe the functioning of Iraq's political system and public sector and how they ultimately impact the country's prospects for stability and development.<sup>2</sup> Iraq can be characterized as a "fragile limited access order," in which (a) authority is fragmented and the potential for violence shapes the control and distribution of rents and resources; (b) different groups control the state and its institutions; and (c) patronage and clientelism (largely from oil) are the main ways to obtain support, leading to the underprovision of public goods that enhance collective welfare. This arrangement excludes most Iraqis from services, public goods, and institutions, and it has led to a growing disconnect between the incentives of elites and of citizens.

### **Iraq's political system: From sectarian power sharing to party fractionalization**

The post-2003 political system in Iraq was built on ethnic and sectarian identities that eventually came to fuel conflict and fragility. This political system, established in the aftermath of the US invasion, was grounded in a power-sharing agreement between different ethno-sectarian parties and was meant to restore peace and stability to the country. Under this system, key political positions are allocated to specific ethnic or sectarian communities: the prime minister's office to the Shia, the presidency to the Kurds, and the speaker of parliament to the Sunnis.<sup>3</sup> In addition, each bloc is allocated control over certain ministries and their respective budgets. However, the identity-based nature of this system exacerbated both intercommunal tensions and competition among parties from different communities over wealth and power, and it did not prevent the civil war of 2004–08. The domination of the political system by sect-centric Shia political elites and their Kurdish and Sunni allies, along with the centralization of power and neglect of and hostility toward the predominantly Sunni areas in northwestern Iraq, also contributed to the ISIS insurgency in 2014–17.

Throughout the years, the process of elite politics has shifted from sectarian and ethnic power sharing toward political party-based power sharing and polarization. As the allocation of political positions and ministries based on sectarian and ethnic identities became more institutionalized and less contested, competition between elites and parties within the same identity bloc over these “allocated” positions increased (Haddad 2019). Intracommunal group competition thus created an additional layer of contestation beyond sectarian divisions, and this competition has at times turned violent, as demonstrated by the conflict among Shia parties in 2008 and more recent clashes in southern Iraq.<sup>4</sup>

The shift of power-sharing struggles from between sects to within them has led to a splintering of Iraq's political parties and a growing disenchantment by the electorate with them. Since 2005, the number of registered parties has doubled and the number of parties within the main party coalitions has tripled, while the highest percentage of votes won by one single coalition has shrunk by more than 60 percent (to 16 percent), and voter participation has dropped to less than 45 percent (Mansour and van den Toorn 2018). The country reached a particular impasse in 2018, after the national elections returned highly fragmented and inconclusive results.<sup>5</sup> Key cabinet and bureaucratic positions ended up split between competing parties, further weakening the prime minister's executive powers (Mansour 2019). Rather than representing the political diversity of Iraq, the political system reflects a fragmented power-sharing agreement between the country's elites and their respective parties that often results in stalled decision-making, as witnessed in the protracted process of forming a new government in late 2019 and early 2020 following the resignation of Prime Minister Abdul Mahdi.

The fragmented nature of Iraq's political settlement and uncertainty over the stability of the government hinders the country's prospects for growth. First, the constant (re-)negotiation of the distribution of resources, and the fact that political exchanges take place in informal environments where the ability to enforce agreements is weak, makes political elites more risk averse (World Bank 2012a). This uncertainty also makes it harder for decision-makers to assess the implications of policies or legislative actions that have broad impacts or far-reaching distributional consequences for their constituencies (e.g., tax or

pension reforms). And second, complex reforms are likely to require more time to elaborate to the many actors in this fragmented system and to win a consensus among them, increasing the likelihood that the reforms will take longer than one minister's term in office. This environment, combined with the country's significant oil rents, shifts elite incentives to privilege short-term rent distribution over public-service delivery and long-term productive investment (as later sections of this chapter discuss).<sup>6</sup>

## Federalism and center-periphery relations

Iraq's federalism was initially construed as part of the aforementioned power-sharing agreement, but it remains one of the main arenas of contestation. Grounded in the 2005 constitution, the country's federal structure attempts to decentralize power by granting regions sovereignty and narrowly limiting the exclusive jurisdiction of the federal government (for example, even security is constitutionally declared a concurrent responsibility of the federal, regional, and provincial authorities). However, federalism in Iraq has not appeased secessionist aspirations, as the 2017 independence referendum in Kurdistan demonstrated, nor has it solved persistent territorial disputes over multiethnic regions (such as constitutionally declared "disputed" territories like the provinces of Kirkuk and Diyala). The current setup has also failed to resolve conflicting claims on resource control between the federal government and lower tiers of government, as is discussed in the following section.

Despite the federal structure established in the 2005 constitution, Iraq's institutional and legal framework for decentralization remains incomplete, and the federal government continues to resist devolving power and resources to lower tiers of government. In 2018, the latest amendments to the Decentralization Act reversed the devolution of responsibility for health and education (Al-Mawlawi 2019a). Revenue generation by lower tiers of government is not encouraged by the federal government (Al-Mawlawi 2019a; Fleet 2019), and fiscal transfers to governorates and the Kurdistan Regional Government (KRG) are disbursed unevenly, erratically, and partially. The parliament's recent move to suspend provincial councils until new elections, in response to mass protests in October 2019 over "gross dereliction of duties," further undermined the legitimacy of these councils and, indirectly, the governors whom the councils elect.

## Elite bargaining: Control over state institutions and resources

The contestation and negotiation between political parties over control of Iraq's formal bureaucracy has resulted in elite capture of state institutions. The process of de-Ba'athification in 2003 and the dissolving of the Iraqi army eroded the country's existing bureaucratic infrastructure and displaced the elites that had run it and the tens of thousands of workers it had employed. In the aftermath, many senior positions, down to the level of director general (*al-darajat al-khassa*)<sup>7</sup> within the country's new bureaucracy, were filled by political appointees of the country's main parties. In turn, politicizing the appointment of key bureaucratic posts became a fundamental piece of how the parties extended their patronage networks to strengthen their legitimacy, power, and wealth (Dodge 2019). Parties also awarded public contracts to their delegates, paid at higher salaries than was standard for the respective positions, in what was known as the *wikala* (proxy) system.

This politicization of the Iraqi civil service has blurred the lines of accountability and shifted power from formal state institutions to political actors. The heightened role political parties play in appointing candidates for senior bureaucratic positions, along with the *wikala* system, creates a conflict of interest: appointees prioritize and report to the parties behind their nomination before their respective ministers or official superiors (Mansour 2020). This conflict of interest often undermines the authority of ministers over their departments and obfuscates the formal hierarchies within the ministries. And senior officials allied with political parties have more influence than their nonaffiliated counterparts (al-Shadeedi and van Veen 2020), which creates a structural incentive for greater alignment with political parties.

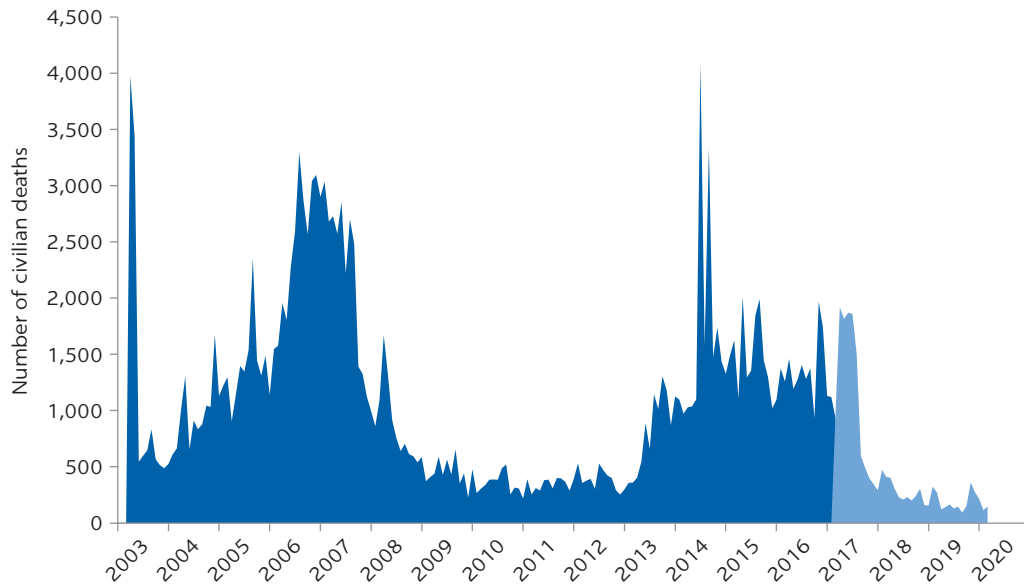
As described by Dodge et al. (2018), the bargains under this political settlement flow in three ways: “First, the dominant parties use government payrolls to reward political loyalty. Second, they use government contracts to enrich business people close to their leaderships. Third, money is simply stolen from the ministerial budgets for both personal gain and party use.” These effects are particularly visible during elections and in times of crisis, when the elites use promises of public sector jobs to win votes or to appease dissent. Many of these mass job appointments are based not on merit but on patronage by the elite.<sup>8</sup> The political elites also use pensions and social allowances in similar ways to reward their constituencies. As a result, the number of public sector employees has increased significantly, and the security services in particular have seen significant expansions in public spending (see the following section). Likewise, spending on recurrent costs has crowded out capital investments.

Beyond this rent-sharing, Iraq’s political elites also engage in contestation over rent generation. State and nonstate actors compete for revenue at its source (e.g., by taking control of oil fields, refineries, or border crossings), raising taxes informally (e.g., through checkpoints by militia or security forces or by insurgents in areas under their control), smuggling oil products out of the country, or smuggling other goods into it.

### **Fragmented authority, security, and violence**

State authority in Iraq is fragmented, and a complex array of political parties, militias, armed groups, and extremist groups share the capacity for violence. Over the past 15 years, the elite contestation described earlier has led to the proliferation of these groups. Violent actors have included Sunni, Shia, and Kurdish groups, including the various groups under the Popular Mobilization Forces (PMFs). The PMFs, which emerged in the fight against ISIS, consist of dozens of militias (some of which had existed prior to ISIS’s capture of Mosul) that fall under divided leadership. In 2016, under the so-called *Hashd* law, the PMFs became officially integrated into the country’s security forces. However, the law left some contentious ambiguities, framing the PMFs both as part of the country’s security forces and as independent groups. Notable actors within the PMFs maintain strong ties with local elites or external backers, indicating another arena in which Iraq’s elites compete with one another at the expense of the country’s institutions.

Since 2003, security in Iraq has steadily improved, and today, following several cycles of large-scale military conflict (as illustrated in figure 1.2), violence has decreased. Since the defeat of ISIS in 2017, Iraqis’ perceptions of security and

**FIGURE 1.2****Number of civilian deaths from conflict, 2003–20**

Source: Iraq Body Count.

Note: Light blue bars (from March 2017 onward) denote preliminary data.

of the Iraqi army have improved. According to a survey by the National Democratic Institute (NDI) in 2019, 72 percent of Iraqis perceived the country's security as improving, one of the highest percentages recorded by the NDI since 2010. The same survey shows that the army and the country's security forces also have relatively high levels of public support compared with other public institutions.<sup>9</sup>

Iraq's sovereignty and the state's monopoly on violence are weakened by outside actors and the risk of proxy conflict. Outside interference has been a constant challenge since 2003. Iraq has experienced particular tension between its neighbor Iran and the US-led coalition based in Iraq. In 2020, relations between the two hit their nadir following a US strike that killed Iranian General Qassem Soleimani and a key leader of the PMFs, Abu Mahdi al-Muhandis. The increase in violence following this event and the rise in political tensions between US- and Iranian-backed political figures in Iraq risk further destabilizing the country's security and its political settlement.

However, over the past few years, contestation between citizens and their leaders has overshadowed large-scale political conflict, as is discussed later in this chapter. Today, the most imminent conflict in Iraq is between demonstrators and the state's coercive apparatus, which since October 2019 has killed hundreds and injured tens of thousands.

There have also been several other conflicts, many at the community or local level, in post-2003 Iraq (Mansour 2020). Displacement as a result of military conflict has created tensions between communities competing for land and livelihoods in recently liberated areas (Abdel-Razek and Puttick 2016). Moreover, ISIS and similar Salafi-jihadi groups have not been eliminated; they continue to mount underground insurgencies, often attacking checkpoints and local state

officials and institutions. In a heavily armed society, conflict in Iraq also at times involves militias, political parties, or tribal groups settling scores through targeted assassinations. And gender norms in Iraq have led to consistent gender-based violence and conflict against woman (Al Ali and Pratt 2011).

## **OIL WEALTH, GOVERNANCE, AND RESOURCE MANAGEMENT**

### **Oil wealth and oil dependency as a fragility driver and development constraint**

Iraq is the most oil-dependent country in the world, as is further explored in chapter 2, and its reliance on oil has had a major impact on its political settlement and economy and has acted as a driver of fragility and conflict. Iraq is the world's sixth-largest oil producer and the world's third-largest oil exporter. In 2019, it exported about 4 million barrels of oil per day of the estimated 4.7 million barrels per day it produced. Over the past decade (2010–19), and despite fluctuations in oil prices, Iraq's hydrocarbon sector has accounted for more than 95 percent of the country's export values, 90 percent of governmental revenues, and 57 percent of gross domestic product (GDP) in real terms.

The quality of governance and institutions is critical for determining whether a resource-rich country can reap the benefits of its natural wealth. Work on the resource curse shows that resource wealth has a positive effect on growth in countries with good institutions and a negative effect on growth in those with poor institutions (box 1.1). However, the quality of institutions is itself influenced by the presence of natural resources. Collier and Venables (2010) have argued

#### **BOX 1.1**

### **The “resource curse” and the resource-conflict association**

Although extractives like oil are usually sources of wealth, the “resource curse” literature reveals that they have an inhibitory effect on economic growth and the quality of institutions in their country of origin (van der Ploeg 2011). A number of studies (e.g., Hodler 2006) have argued that ethnic or political fractionalization, fueled by competition for rents, plays a critical role in degrading institutional quality, making it a key driver behind the “resource curse.” Exploring the link between fractionalization, resource wealth, and income, Bjorvatn, Farzanegan, and Schneider (2012, 1314) conclude that “when the level of fractionalization is high, indicating a weak government, oil revenues appear to be fully wasted: Above a critical level of fractionalization, there is no significant, positive effect of oil revenues on income.”

In addition to adding stress on economic growth and institutional quality, rents generated by extractives have also been associated with fueling or engendering conflict and prolonging internal wars (Basedau and Lay 2009). Investigations into the relationship between extractives and conflict suggest four types of influence such rents can have toward conflict: (a) becoming a source of contestation and competition between elites, (b) providing elites and political rivals with incentives to use force and seek armaments, (c) offering financial support for armament and military mobilization, and (d) producing or deepening existing inequalities and subsequent grievances between segments of society (see United Nations and World Bank 2018).

that natural resources negatively impact the quality of governance in a country while at the same time playing a more important role in resource-rich countries than in other countries in determining a country's development trajectory. This link creates a mutually reinforcing relationship that can start a vicious circle: "if governance quality is above a certain level, then natural resources can lead to further improvement, while below the threshold, further deterioration may occur" (Collier and Venables 2010).

In Iraq, oil wealth has both fueled contestation between elites over control of natural resource rents (and thus of offices) and contributed to financing of the ISIS insurgency. Having the state be the main collector and distributor of rents raises the incentive for elites and political parties to secure access to the government and thereby control key institutions. This incentive has also contributed to the fractionalization of Iraq's political parties and pushed them to compete for voters on the basis of their patronage networks (paid off with resource rents) rather than programs. These networks have not included the wider population, only a narrow segment that has become clients of individual leaders (Mansour 2020). Oil revenue has also allowed political parties to maintain power bases outside of formal state structures by employing their own militias and armed groups (Mansour 2020). During the 2014–17 conflict, ISIS's capture of oil fields and trading points played an important role in financing the insurgency in its early stages, even though oil generation at those fields declined substantially over time and was replaced as the group's key revenue source by extortion and taxation (see box 1.2).

Iraq's oil wealth has also diminished the need for taxation, weakening the accountability link between citizens and the state, and has fueled corruption. Dependence on oil wealth reduces the incentive for a state to generate other forms of revenue, such as taxation (Devarajan, Raballand, and Le 2012). This, in turn, reduces the need for state-society bargaining over how the state should respond to citizens' expectations and priorities, which are at the heart of successful state-building processes. The result can be a decline in administrative

#### BOX 1.2

### Oil as a source of financing for ISIS

Following the expansion of the Islamic State of Iraq and the Levant (ISIS)'s military activities and controlled territory in 2014, the group captured oil production fields and trading points across Iraq and the Syrian Arab Republic. In 2014, according to the US Department of Treasury and Bloomberg, oil was estimated to be the group's largest revenue stream, bringing them about US\$40 million per month, compared with \$3.7 million from theft and \$2.0 million from taxation. Although the initial wealth the group gained from selling oil on the informal market cannot be underestimated, it appears that oil production on ISIS-controlled fields depreciated with time.

Using satellite imagery to measure oil production at ISIS-controlled sites across Iraq and Syria, Do et al. (2017) found that oil production dropped from approximately 56,000 barrels per day (bpd) in July through December of 2014 to an average of 35,000 bpd in 2015 before sinking to approximately 16,000 bpd in 2016. This decline reflected the group's inability to effectively manage these assets for lack of equipment and technical capacity. Other reports highlight the role of bombing campaigns against ISIS oilfields, which pressed the group to rely more on other financial resources like tax collection and extortion (Levallois, Cousseran, and Kerrello 2017).

capacity and the responsiveness of institutions. Instead of investing in public services and providing economic opportunities, the Iraqi government uses oil wealth to provide public sector employment, subsidies on energy, and welfare to its patrons.

The unrealized potential of Iraq's vast oil wealth to increase opportunities for all and to contribute to development has generated widespread frustration and reinforced grievances. As highlighted in *Pathways for Peace* (United Nations and World Bank 2018), "The capture of resources by elites . . . is a major source of grievance. Diverting revenues from resources can fuel tensions, especially when combined with corruption and mismanagement or where revenues benefit only certain groups and exclude others." The inability of the Iraqi state to respond to its people's priorities, expectations, and aspirations, along with the limits of the patronage-based model in securing popular support, has led to increasing frustration and a breakdown of the social contract, as manifested in recent social unrest (see the following section).

Given Iraq's reliance on oil revenue for rent-based patronage, oil price shocks can have a major impact on the country's stability. Negative oil price shocks can force the government to make unexpected fiscal adjustments, cut consumption subsidies, or reduce the civil service wage bill—all expenses that are instrumental for Iraq's rentier-state model, which is already under stress. Increases in social unrest are likely to result. Similarly, when shocks arise, patronage patterns and political networks may be disrupted, creating yet more instability. As Le Billon (2003) argues, it is not corruption per se that increases conflict risk, but rather changes in the pattern of corruption, especially in countries where corruption is high to begin with.

### **The politics of resource management**

Iraq's power-sharing arrangement and overreliance on oil revenue have given the country a political elite unwilling to diversify the economy and an inert state bureaucracy. The availability of resource rents can delay the reform or change of dysfunctional policies. As Collier and Venables (2010) explain, "Normally, if a government embarks upon an economic strategy which destroys the economy, change will eventually be forced upon it by the decline of revenue. However, resource rents are robust and thus may weaken the impetus for decisive reform." In addition, Iraq's pluralistic power-sharing agreement further encourages elites to not challenge the status quo or embark on reforms that might increase the risk of violence and thus reduce rents for everyone. The availability of oil rents also reinforces the reluctance of the Iraqi government to foster the development of an autonomous private sector, consigning the private sector to be an arena for political influence rather than a potentially transformative force in the country's economy.

The political settlement in Iraq negatively impacts resource management in terms of both rent generation and rent distribution. As a result, (a) resource control remains contested and hampers oil rent and nonoil revenue generation, (b) political instability leads elites to privilege short-term rent maximization and to maintain the status quo, (c) rent allocation crowds out productive investment, and (d) accountability for both rent generation and rent distribution remains weak. Table 1.1 provides an overview of the impact of Iraq's political settlement and political economy on various elements of the country's resource management value chain.

**TABLE 1.1** The political economy and resource management nexus in Iraq

RESOURCE MANAGEMENT VALUE CHAIN	OIL SECTOR ORGANIZATION, REGULATION, AND OVERSIGHT	REVENUE COLLECTION	REVENUE MANAGEMENT	REVENUE DISTRIBUTION	DEVELOPMENT OUTCOME
Political economy challenges	<ul style="list-style-type: none"> <li>• Incomplete and inconsistent regulatory framework</li> <li>• Limited financial oversight of SOEs and international oil companies</li> </ul>	<ul style="list-style-type: none"> <li>• Informal taxation</li> <li>• Rent capture by nonstate actors at the source</li> <li>• Weak revenue auditing</li> <li>• Lack of validation of data publicly released under EITI</li> </ul>	<ul style="list-style-type: none"> <li>• Lack of accountability for oil and gas revenue account</li> <li>• Short-term rent maximization</li> <li>• Soft rules for fiscal stabilization</li> </ul>	<ul style="list-style-type: none"> <li>• Strong preference for wage and pension bill over capital expenses</li> <li>• Lack of policy framework for revenue sharing</li> <li>• Contested fiscal federalism</li> <li>• Low and uneven disbursement of fiscal transfers</li> </ul>	<ul style="list-style-type: none"> <li>• Volatile fiscal space</li> <li>• Unmitigated resource dependence for lack of revenue diversification</li> <li>• Fiscal unsustainability of wage and pension bills</li> <li>• Decreasing and procyclical public investment</li> </ul>

Source: World Bank 2012a.

Note: EITI = Extractive Industries Transparency Initiative; SOE = state-owned enterprise.

### Contested resource control

Ongoing disputes over resource control have led to legal uncertainty in Iraq's oil sector and have hampered the development of oil production and revenue generation. First and foremost, the sector's legal framework remains incomplete. The provisions of the 2005 constitution on oil resource control (articles 111 and 112) are ambiguous, and their meaning has been contested by stakeholders. Divergences have proved irreconcilable so far and have not yet been clarified through secondary legislation. A national hydrocarbon law and other legal documents, including a revenue-sharing law and a law for the establishment of a national oil company, were drafted in 2007 and submitted to the Council of Representatives but have not yet been adopted. As a result, significant legal and political risks weigh on private investors in Iraq's oil sector, which hinders foreign investment in the sector.

In the absence of a national legal framework for oil, the KRG passed its own legislation in 2007 and independently entered into production-sharing contracts with international oil companies. However, the Iraqi federal government is contesting the sovereignty of the KRG in this matter and has blacklisted those oil companies. After the referendum on the independence of Kurdistan, the federal government occupied disputed territories, and in October 2017, Iraqi security forces took control of the Kirkuk oil fields. Since then, exports from Kirkuk through the Kirkuk-Ceylan pipeline have dropped by more than half (Scholl 2018). The federal government is also legally contesting the right of the KRG to independently export oil to Turkey, and it is trying to establish a new pipeline between the Kirkuk oil fields and Turkey that would bypass Kurdistan. Those disputes are significant enough to potentially hold back Iraq from reaching its target of increasing its oil production to 6 million barrels per day by 2030.<sup>10</sup>

Iraq's disputes over oil resource control are inextricably linked to unsettled debates about the country's federalism, which also hamper the adoption of a revenue-sharing law (box 1.3). Intergovernmental relationships are inevitably challenging in resource-rich economies, where resources are unevenly

## BOX 1.3

**Fiscal federalism in Iraq**

Deemed asymmetric, federalism in Iraq is in effect strikingly unbalanced. Although the only region established so far, the Kurdistan Region of Iraq, is granted full sovereignty by the 2005 constitution except in narrowly defined areas where the federal government holds exclusive authority, neither the constitution nor decentralization laws effectively frame the devolution of power to the country's provinces, let alone to their subdivisions (districts and subdistricts). In effect, the only significant responsibility devolved to the provinces is the preparation of provincial development plans and the design and implementation of capital projects (World Bank 2016). Since 2015, decentralization laws have introduced only limited and tentative devolution of capacity through the transfer to governorates of a few federal ministries and some devolution of power to provinces. These measures fall well short of “grant[ing] broad administrative and financial authorities” to the provinces “to enable them to manage their affairs in accordance with the principle of decentralized administration,” as per the Iraqi constitution. The lower tiers of government—i.e., districts and subdistricts—consist only of territorial subdivisions of provinces and have yet to be institutionalized as local governments (so-called municipalities in Iraq are only local branches of the federal ministry of municipalities) or to ensure effective service delivery.

In Iraq, the constitution vests the federal government with the responsibility to distribute oil and gas revenues “in a way that ensures balanced development in different areas of the country” by “specifying an allotment for a specified period for the damaged regions which were unjustly deprived of them by the former regime, and the regions that were

damaged afterwards” (article 122). The government has yet to legislate on oil revenue sharing as part of a legal package for the oil and gas sectors. The only legal frameworks for fiscal transfers are appropriation laws and the recently enacted Public Financial Management Law, which mandates only the retrocession by the federal government to governorates of (a) half of the federal taxes and fees (except custom duties) collected in the governorate by centrally funded agencies, (b) a share of the revenues generated by international trade, known as “petrodollars,” and (c) local revenues raised by provincial councils.

Although the 2005 constitution grants Iraq's regions and provinces financial autonomy (article 122), the newly enacted Public Financial Management Law seems to vest the federal government with exclusive authority over spending. It states that the general federal budget consists of the budget of the central government as well as “the expenditure and revenue of the region and governorates.” In fact, all fiscal transfers are routed through the federal budget and disbursed by the federal government. Furthermore, public spending has been centralized in the past few years, and revenue authority has become even more concentrated (World Bank 2016). All revenues are pooled and redistributed by the central government, which means that lower tiers of government lack incentives to mobilize resources, which in turn induces the capture of revenue at the source. This effect has been seen for oil revenue (when nonstate or shadow-state actors take control of oil fields or refineries) as well as for nonoil tax revenue (when these actors take control of border crossings or revenue-generating state-owned enterprises). Local taxation, including of oil production (NRGI and UNDP 2016), could help align local and federal incentives (Ahmad 2020).

distributed, rents are pooled and managed from the center, and producing regions often do not benefit from their rent dividends (Ahmad 2020). Struggles over resource control in Iraq's disputed territories (including the Kirkuk governorate) have impeded the country's recovery. Also, the Basrah governorate recently filed a legal case against the federal government's contracting with international companies to capture flared associated gas in Basrah without letting the governorate in on the deal (Isakhan and Mulherin 2018).

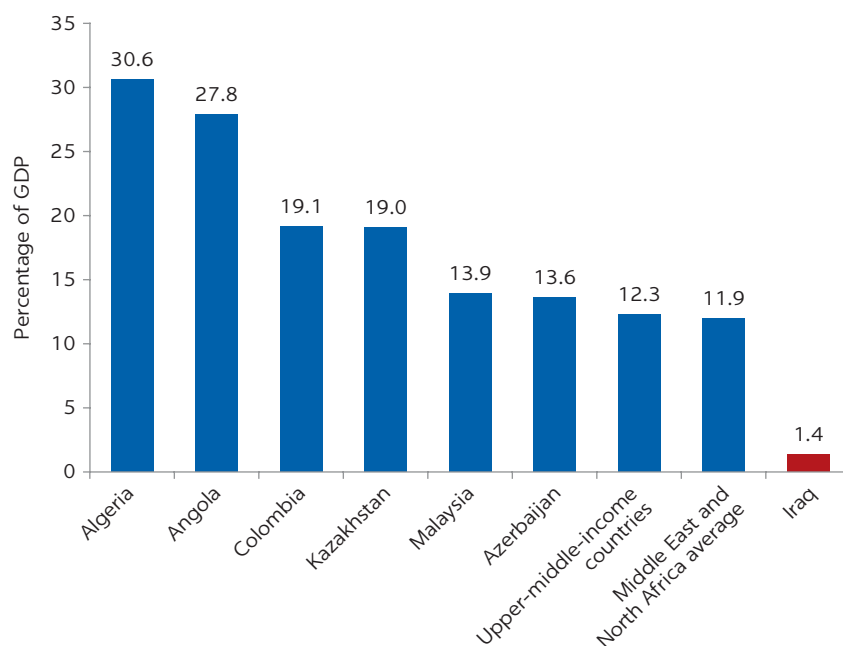
Iraq's overreliance on oil rents is reflected in its extremely low nonoil tax revenue-to-GDP ratio. According to the International Monetary Fund, "Iraq has one of the most undiversified revenue base of oil exporters in the MENA [Middle East and North Africa] region" (IMF 2019b, 4). This ratio has lately dropped even further (from 8.4 percent in 2015 to 1.5 percent in 2019) as a result of tax exemptions (including the allowances granted to government employees, which amount to between 35 and 150 percent of their basic salaries) (figure 1.3). The country's income tax base is also narrowed by exemptions granted to state-owned enterprises (SOEs) from the corporate income tax and to pensions from the personal income tax. The state collects hardly any indirect taxes. Tax collection is further limited by tax competition from nonstate actors (such as security forces capturing tax revenue at border crossings and checkpoints) and the central government's reluctance to decentralize revenue mobilization. Iraq's efficiency of consumption and personal income tax collection, at 35 percent and 4 percent, respectively, is quite low, compared with an average of 55 percent and 8 percent across emerging market economies (IMF 2019a).

### Short-term rent maximization

As discussed earlier, prevailing political settlement in Iraq leads to short-term rent maximization. For the sake of the status quo, the ruling elite has observed some level of fiscal prudence. For example, the oil price benchmark agreed on by the executive and legislative branches for budget preparation and execution purposes has generally been well below actual average export prices since 2011, and thus more than US\$70 billion of gross oil revenue has accrued to the

FIGURE 1.3

**Nonoil tax revenue as percentage of GDP in Iraq and comparators, average, 2010–19**



Source: World Bank calculations.

petroleum revenue account held by the central bank beyond what accrued to the budget under appropriation laws (Kannan and Gordy 2020). However, the government has yet to invest in fiscal stabilization mechanisms. Furthermore, focusing on short-term rent maximization leads governments to discount future revenue (including oil tax revenues, which are more challenging to collect than royalties), at a significant cost to the economy (World Bank 2012a).

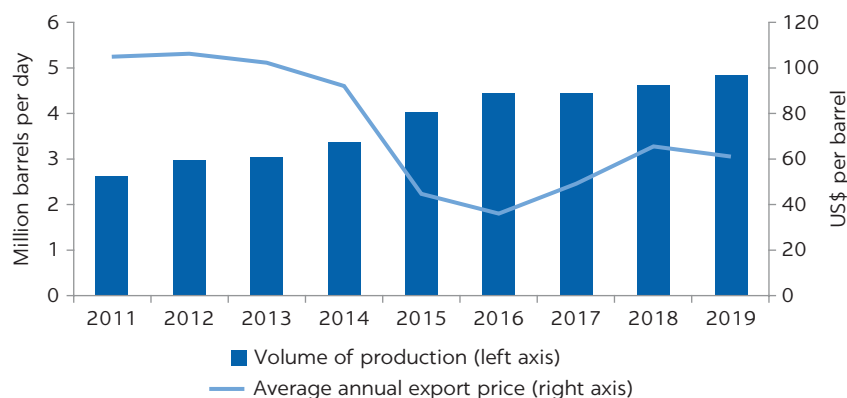
The tools for long-term rent maximization in Iraq are missing. As stressed in the 2012 CEM, given the magnitude of Iraq's public spending, it is critical that "spending allocations get effectively translated into productive assets," in other words, that the Iraqi government invest in investing (World Bank 2012b, vii). The 2012 CEM also noted that a sovereign wealth fund can help with economic diversification and reduce the costs of external shocks, including oil price volatility. A sovereign wealth fund, if adequately structured and managed following best international practices (including the investment of revenues from nonrenewable resources into other future income-generating assets), could indeed help the Iraqi government invest in longer-term stability (Kannan and Gordy 2020). However, it is uncertain whether Iraq's political elite could agree on the role of a sovereign wealth fund, let alone the rationale for a fiscal stabilization mechanism, under their present dire fiscal constraints.

Oil revenue modeling would also significantly improve the management of oil production to optimize oil export revenue. At the moment, oil production and export volumes from Iraq remain unrelated to market prices, and oil exports have increased regularly since 2003 irrespective of price volatility. This inattention to market conditions could result in significant revenue shortfalls (Kannan and Gordy 2020), especially when oil prices drop on international markets (figure 1.4).

### Revenue allocation

Pervasive political patronage distorts fiscal resource allocation in Iraq by inflating the wage bill at the expense of public investment. Since 2004, Iraq's wage and pension bill has increased from 10 percent to 51 percent of budget expenditures and from 12 percent to 15.6 percent of GDP.<sup>11</sup>

**FIGURE 1.4**  
**Iraq's oil export volumes and revenues, 2011–19**

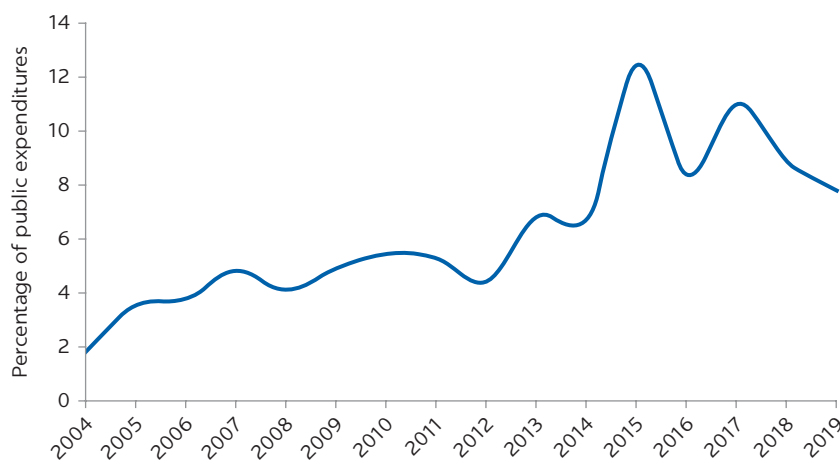


Source: Iraq Ministry of Oil.

This growth resulted from both increases in the number of government employees (from 1.2 million to more than 3 million) and salary increases, to the effect that the wage bill has been nearly multiplied by 10 and the premium on wages in the public sector compared with the private sector has reached 300 to 400 percent (Al-Mawlawi 2019b). The sector and spatial distribution of the civil service leaves critical services such as health (with only 10 percent of the total) and certain parts of the country (the south and north) underserved (UNODC 2012). In contrast, security personnel represent more than 40 percent of total federal government employees. The recent absorption of militias (PMFs) into the state security forces and the recruitment of large numbers of graduates into ministries and SOEs should continue to increase the wage bill.

Political patronage is also reflected in the prioritization of employee compensation in the security sector. Since 2003, military expenditures have increased from less than 2 percent of public expenditures to 7.8 percent in 2019 (after a peak of more than 12 percent in 2015 because of the fight against ISIS) and from 1.7 percent to 3.5 percent of GDP in 2019 (with a peak of 5.4 percent in 2015) (figure 1.5). However, the incorporation of the PMFs' 120,000 authorized personnel into the military and the allocation of US\$2.16 billion (an increase of 20 percent from 2018) to the PMFs in the 2019 defense budget may be deemed the fiscal price of bringing these nonstate security actors under state authority. The 2019 appropriation process also reflects the prioritization of military expenditures and employee compensation by the legislative branch of the government as a result of party politics: after the appropriation bill's review by the Council of Representatives, funds allocated to security forces increased by 15 percent, those allocated to employee compensation increased by 20 percent, and those allocated to the PMFs incorporated into the security forces increased by 25 percent (Al-Mawlawi 2020).

**FIGURE 1.5**  
**Iraq's military expenditures as percentage of public expenditures, 2004–19**



Source: Stockholm International Peace Research Institute, Military Expenditure Database.

The appropriation process for the budget allocated to the Reconstruction Fund for Areas Affected by Terrorist Operations, in charge of coordinating reconstruction programs in areas affected by the ISIS insurgency, also reflects the preference of the political elite for employee compensation. Between the initial draft appropriation bill submitted by the Ministry of Finance to the Cabinet and the final appropriation act, the share devoted to employee compensation was multiplied by nearly ten, whereas the share of capital expenses decreased by about one-third (Al-Mawlawi 2020).

The influence of political parties over Iraq's formal institutions also impedes and distorts budget implementation. Saleem and Skelton (2019) argue that the implementation of infrastructure projects is subject to multiple processes and procedures handled by various public entities, such as the "transfer of promised government funds from Baghdad, the flow of supplies through ports and across borders, visas for experts and employees, and numerous governmental approvals for contracted companies" (Saleem and Skelton 2019, 32), thus making the process particularly vulnerable to unnecessary bureaucracy and blockages. This fragmentation of authority inevitably lowers the execution rate of capital expenditure (to only 56.5 percent in 2018), even when the oil price rises above the benchmark used for budget preparation. It has also impeded or delayed the implementation of reconstruction programs, which in turn has undermined the rekindling of the social contract between the government and citizens in areas affected by the ISIS insurgency.

### **Transparency and accountability**

Despite recent progress, opacity prevails in both rent generation and rent distribution in Iraq. Despite significant progress toward fiscal transparency under the Extractive Industries Transparency Initiative (EITI), publicly available information on Iraq's oil revenue remains limited and lacks validation. After exhibiting progress deemed "meaningful" by the EITI secretariat, Iraq, whose membership to the EITI was suspended in 2017, was reinstated as a compliant country in 2019. To remain thus, Iraq still needs to meet another 12 conditions, deemed to reflect significant progress, by mid-2021. Financial information on the country's oil and gas revenue account will have to be audited and publicly disclosed, as required by the 2019 Financial Management law. However, Iraq's auditor general is ill equipped to validate the oil revenue data publicly released under the EITI (including data from SOEs and international oil companies) and the flow of funds through the oil and gas revenue account.

Weak accountability mechanisms and institutions also impair Iraq's capacity to optimize its oil rent. The state needs to strengthen its financial oversight of the oil sector in order to mitigate information asymmetries and rebalance the negotiations between it and the private operators it contracts with (under production service agreements at the federal level and under production-sharing agreements in Kurdistan). The fiscal crunch caused by the current health crisis has drawn particular attention to cost pricing (because production costs are paid to oil and gas companies out of the oil and gas revenue account) and the need to strengthen the auditor general's capacity for cost auditing.

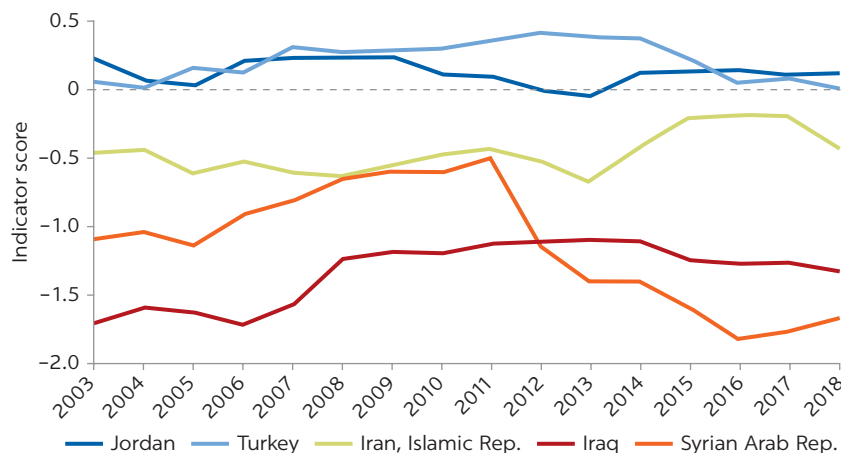
## STATE-SOCIETY RELATIONS: BREAKDOWN OF TRUST AND SOCIAL PROTESTS

The social contract between Iraq's ruling elite and its people has failed to meet social demands and has fueled growing discontent. As mentioned earlier in this chapter, Iraq's post-2003 elite bargain rests on oil rent-sharing through power sharing, and the country's increasing political fragmentation has exacerbated power struggles and the elite's concern for the status quo. Instead of ensuring the representation of all Iraqis through an inclusive power-sharing arrangement, the political settlement has widened the divide between the ruling elite and its constituencies across the country. As a result, grievances have accumulated, particularly among the country's youth, and social unrest has spread over the past few years, culminating in the 2019 protests.

Iraq's elites and political parties have until recently aimed to gain support primarily by mobilizing sectarian and ethnic identities, but this strategy seems to have lost its appeal. Whereas Iraq's elite in the early post-2003 period appealed to democracy and anti-Saddam or anti-Ba'ath narratives to gain popularity, over time they increasingly employed ethnicity- and sect-centric narratives.<sup>12</sup> However, as has also become apparent during the recent protest movement, Iraqis are losing support for such appeals. From March 2014 to April 2018, according to NDI polling, 32 percent more Iraqis claimed they would prefer to support a party that represented multiple ethnicities and sects than claimed otherwise. In response, political parties and elites have recently shifted their messaging to civic, reform, and anticorruption narratives (Mansour 2020), but in light of poor government performance, public support for these leaders has steadily declined.

According to expert opinion, Iraq's government effectiveness has not improved over the past 10 years (figure 1.6), and public trust in the government's capacity to address the country's challenges has significantly deteriorated.<sup>13</sup> Since 2003, Iraq has not made significant progress on any of the World Bank's Worldwide Governance Indicators, and Iraq now ranks in the 10th percentile

**FIGURE 1.6**  
Government effectiveness in Iraq and selected regional countries, 2003–18



Source: Worldwide Governance Indicators (WGI) for 2020.

Note: The six aggregate WGI indicators that make up the index values shown range from -2.5 to 2.5, with higher values corresponding to better governance.

globally (as of the 2020 data set). Overall trust in key national institutions (figure 1.7), in the legislative branch of the government, and in lower tiers of government has deteriorated since 2013 and has fueled political alienation. In particular, public trust in the government's capacity to "improve the situation in Iraq" significantly dropped among Shia Iraqis, the regime's main constituency, from 59 percent in 2012 to 40 percent in 2018 (Dagher and Kaltenthaler 2019). A Gallup World Poll even found that in 2018, trust in the Iraqi government had dropped significantly lower among Shias (18 percent, compared with 62 percent in 2010) than it was among Sunnis (30 percent) (Klapper et al. 2020).

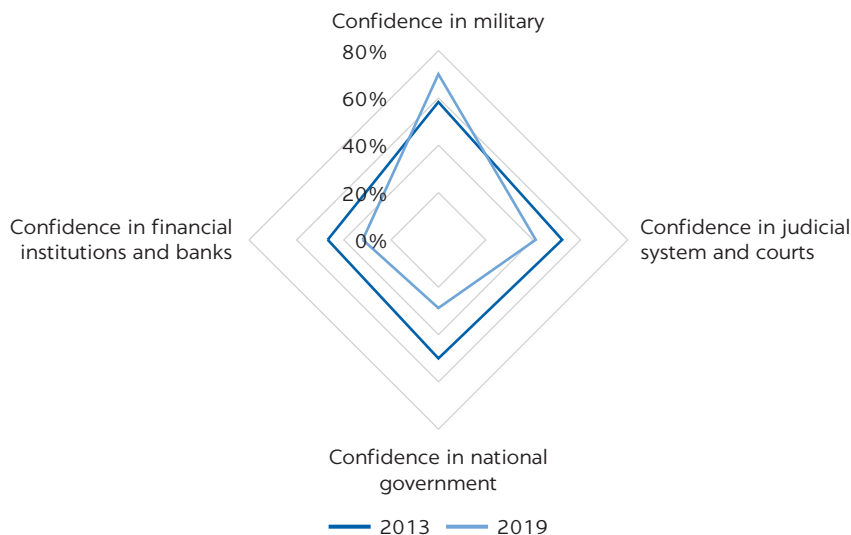
At the core of the breakdown of the social contract in Iraq lie grievances over corruption, weak accountability, lack of employment opportunities, and inadequate service delivery. Opinion polls indicate that Iraqis identify the lack of employment opportunities and corruption as the most important issues to be addressed, followed by security and public services (figure 1.8). In terms of service delivery, better education (23 percent) and improvements in electrical and water services (22 percent) are of higher priority than public infrastructure like roads and bridges (16 percent) and health care (10 percent). However, this perception may change in light of the COVID-19 outbreak.

### Corruption and accountability

Corruption has become one of the main factors in Iraq's public grievances, and it fuels distrust in the state and the political system. It has fast become a concern of Iraqi citizens, far above security and close to unemployment. For youth, particularly young men, it has become the main concern. An increasing majority of citizens believe that corruption is worsening in Iraq (83 percent in 2019).<sup>14</sup> Only a small minority believes that the government is effectively fighting corruption,

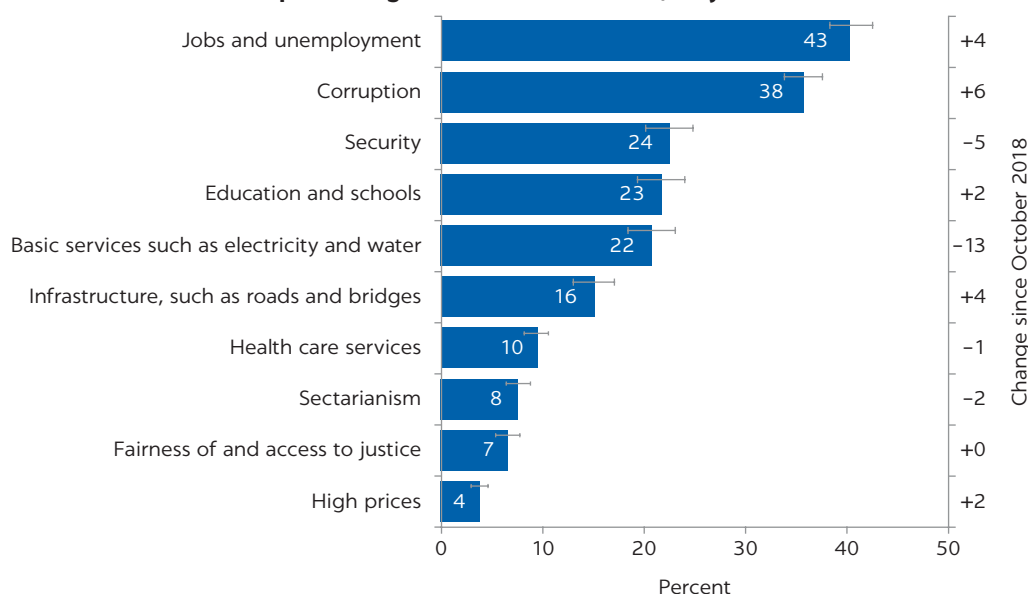
**FIGURE 1.7**

#### Confidence in Iraqi national institutions, 2013 and 2019



Source: Gallup World Poll, 2019.

Note: Figure shows percentage of adult respondents who say they have confidence in Iraqi national institutions.

**FIGURE 1.8****Main issues citizens expect the government to address, July 2019**

Source: NDI 2019.

and a lack of trust in law enforcement agencies dissuades public servants and citizens from reporting cases of corruption (UNODC 2012). Citizens are most concerned about corruption among senior government officials, illustrating the political elite's loss of legitimacy. The public also closely associates corruption and instability: "in a 2017 [national] survey, respondents expressed the view that corruption had been a greater driver of the emergence of ISIS than had sectarian tension," and during protests in 2015, demonstrators shouted the slogans "Corruption equals ISIS" and "Corrupt leaders are the same as terrorists" (Mansour 2017, 14).

Despite recent progress, Iraq's accountability institutions and mechanisms remain weak, and their efforts to tackle corruption have been regularly thwarted by political interference. Iraq's legal and institutional anticorruption framework was deemed robust enough by peer reviewers of Iraq's implementation of the United Nations (UN) Convention against Corruption (which the government ratified in 2008). Progress has been made recently to improve the government's accountability, including Iraq's signing on to the EITI and reinstatement as a compliant country in 2019 and its removal from the Organisation for Economic Co-operation and Development Financial Action Task Force's watchlist of "jurisdictions with strategic deficiencies" in preventing money laundering and the financing of terrorism. But political interference in accountability institutions is widespread in Iraq, and in 2019, the parliament dismantled the inspector general's offices that had been set up across ministries in 2003.<sup>15</sup> Iraq also still lacks critical fiscal accountability systems such as an integrated financial management information system and a centralized personnel and payroll management information system. Internal auditing has been sidelined; no budget audit report has been publicly released since 2014; and the 2017 Public Expenditure and Financial Accounting assessment concluded that overall, "most aspects of the PFM [public financial management] system are

functioning at a barely satisfactory level—one that will make it difficult for GOI [the government of Iraq] to attain its fiscal and budgetary objectives” (World Bank 2017a, vi).

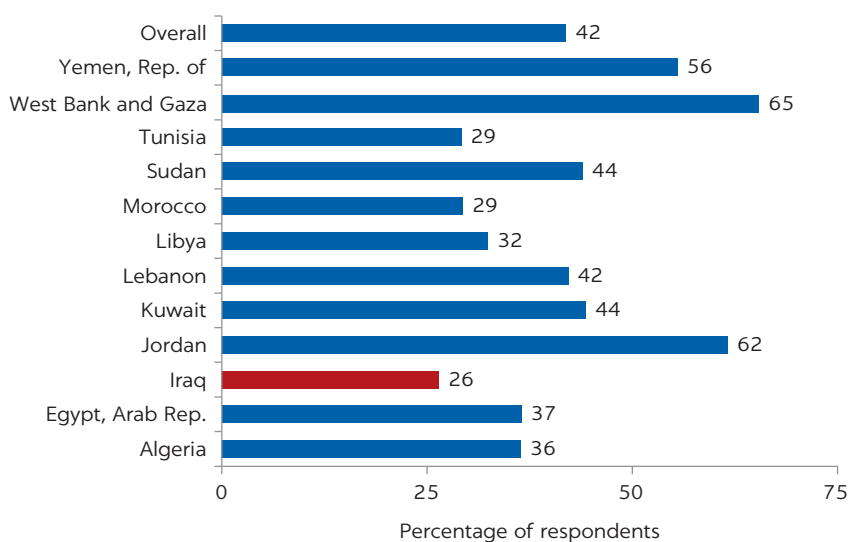
Iraq is also ranked among the least fiscally transparent countries, including in the MENA region, with a score of 9 out of 100 on the Open Budget Index. Fiscal opacity fuels distrust both within elite circles and among people toward the government: during the 2019 mass protests, demonstrators demanded that the government account for missing oil revenue. Since 2014, senior public officials have been legally required to disclose their income, assets, and financial interests—not publicly, but to the Commission of Integrity, which does not have the capacity to enforce compliance or to detect and prosecute conflicts of interest or illicit enrichment. The politicization of corruption allegations paralyzes public action and disqualifies the ruling elite as a whole in the eyes of the public (Abdullah 2019).

### Service delivery

Over the past several decades, Iraqis have witnessed a significant deterioration in human capital and in most basic services, ranging from health and education to electricity, water, and sanitation. Although the Iraqi education and health systems were ranked near the top of the MENA region in the late 1970s, they have fallen to near the bottom today (World Bank 2017c). Iraq’s low Human Capital Index score suggests large inefficiencies in the quality and delivery of services that promote human capital development.<sup>16</sup> Public services have been impacted by limited public investment, destruction of human capital and infrastructure by conflict, and corruption. These effects have wiped out previous achievements in increasing literacy and reducing gender disparities. In recent years, progress has been made in a number of areas, such as increasing enrollment rates at the primary school level and decreasing under-five mortality. Overall, however, the quality of Iraq’s health and education services remains poor.

Basic government services previously taken for granted in Iraq, such as water and electricity, have faltered. The supply of safe drinking water has become a concern, especially in the south of the country, where the government’s failure to address water scarcity drove civil unrest in 2018 and sickened more than 118,000 people (Human Rights Watch 2019). Electricity is unevenly supplied and prone to cutoffs during the heat of the Iraqi summer. Iraqi citizens expect electricity to be provided for free by the state, stemming from a legacy of subsidies that predates 2003 (Allawi 2007). Despite significant progress in 2019 in expanding the electricity supply by increasing generation to an average of 16 gigawatts (GW) (up from 12 GW in 2018) and boosting peak generation by nearly 20 percent, Iraq’s power generation remains well below the total demand of 26 GW, and power delivery is frequently interrupted by problems linked to transmission, distribution, and bill collection (World Bank 2020).<sup>17</sup>

Although 2019 saw an increasing number of Iraqis who believed that service delivery was improving, a large majority continue to be dissatisfied on this count. According to the most recent Arab Barometer survey (wave V), few Iraqis are satisfied with their country’s education system (26 percent) or health care system (33 percent). When compared with other economies across the Arab region, Iraq ranks lowest in terms of satisfaction with its education system (figure 1.9). Iraqis are also concerned about corruption, and more than half of Iraqis declare that it is necessary to pay a bribe to obtain better education or

**FIGURE 1.9****Satisfaction with the education system in Arab economies, 2018**

Source: Arab Barometer wave V data set.

Note: Figure shows percentage of adult respondents who say they are satisfied or very satisfied.

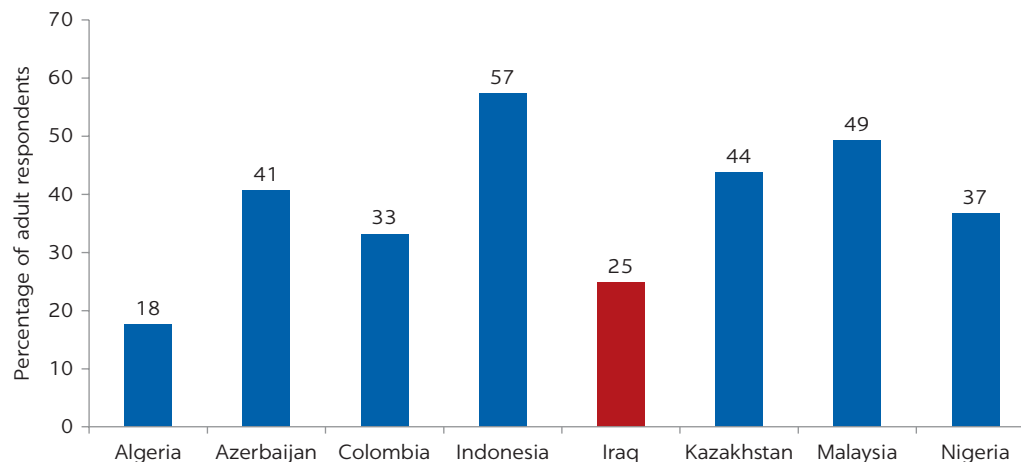
health services (a percentage higher than the regional average but lower than in Lebanon or Egypt).<sup>18</sup>

## Job creation

Job creation is among the main concerns of the Iraqi people, and perception of poor government performance in this regard is a major driver of public dissatisfaction and the current protests. At least 2.5 million Iraqis, mainly youth, are currently unemployed and in need of jobs. Youth unemployment in Iraq is 36 percent, compared with the national unemployment rate of 16 percent (World Bank 2018). The crisis of youth unemployment in Iraq cannot be understated, given that the country has one of the youngest populations in the world (see the following section). Opinion polls indicate that most Iraqis (more than 80 percent) believe that job opportunities are getting scarcer (NDI 2019), more than in most other oil-rich economies (figure 1.10). Notably, youth satisfaction with the government's performance at creating job opportunities, at 6 percent, is one of the lowest in the region (Raz 2019). Almost all Iraqi youth (95 percent) believe that personal connections, or *wasta*, shape one's employment opportunities—the highest rate in the region (Raz 2019). Public concern about the government's capacity to address this demand for jobs may be aggravated by a general feeling that one's "situation can only improve with government assistance or salaries," expressed by 70 percent of respondents (NDI 2019).

Iraq's failure to diversify its economy away from the dominant, capital-intensive oil sector has meant that few economic opportunities have been created in nonoil and labor-intensive sectors. Instead, the government's dominant approach to creating jobs has been to expand the public sector. However, youth are seriously underrepresented in the civil service—in 2011, those age 18–29 made up 37.7 of the general labor force but only 15.3 percent of civil servants—although with significant variations (e.g., much less so in Kurdistan and for

FIGURE 1.10

**Perception of whether it is currently a good time to find a job, 2019**

Source: Gallup World Poll, 2019.

Note: Figure shows percentage of adult respondents who say that it is currently a good time to find a job.

young women) (UNODC 2012). Furthermore, this model of responding to dissatisfaction with job prospects (including the October 2019 protests) is no longer viable, not only because it stifles the prospects for creating employment in the private sector but also because the sheer demand for jobs over the next decade cannot be met through public sector employment. Moreover, the Iraqi government's reliance on oil wealth renders this strategy high-risk: a reduction of public service jobs by 50 percent would cause a need for 7 million new employment opportunities.

The particularly low levels of trust among Iraqi youth in the government's performance on job creation, along with widespread concern over corruption and a general sense of exclusion from the political system, contributes to a significant alienation of youth. This alienation has led many youths to take part in recent protests despite the violent response to them. Alienation also increases the risk that some segments of this population will become radicalized and that tensions will rise between communities whose members fear or suspect that employment is distributed to preferred groups. Iraq's demography puts additional pressure on this situation: about 700,000 young Iraqis enter the job market each year, and the country's demand for jobs will at least double in the next 13 years. The combination of high levels of youth unemployment, strong projected demand for new jobs, and vulnerability to oil price shocks calls for a new approach.

### **Protests, coercion, and violence**

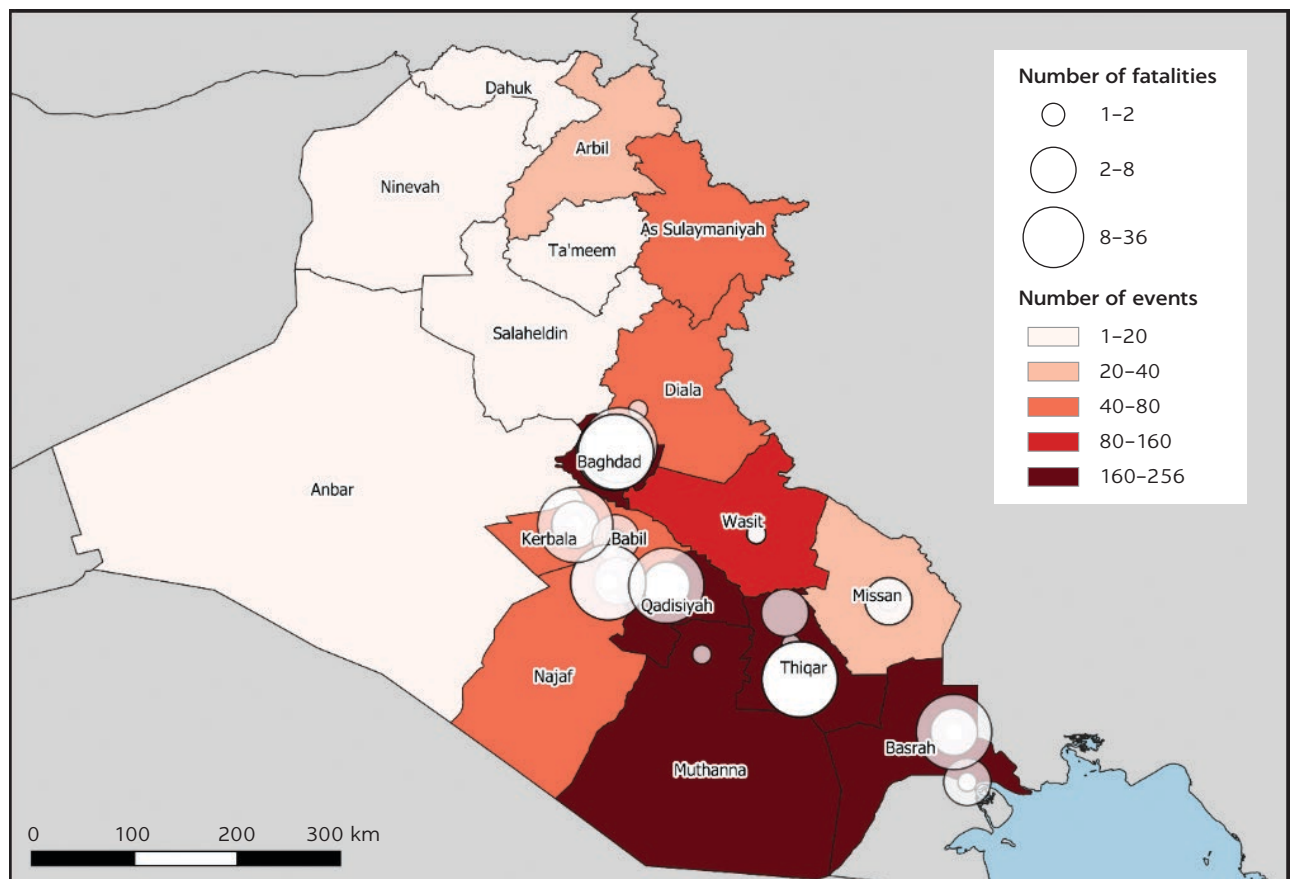
Over the past 10 years, successive waves of social mobilization in Iraq have culminated in protracted antigovernment demonstrations, ongoing since October 2019, that reflect growing discontent within the regime's main constituency. Whereas previous waves of social protests in 2011, 2012–13, and 2015 spread across the country—including the northern and western governorates of Anbar, Nineveh, Salahaddin, and Sulaimaniya—the past two waves of protests, in 2018

and 2019–20, essentially mobilized the Shia community in Baghdad and southern parts of the country, such as Basrah, Najaf, Kerbala, Diwaniyah, Amarah, and Nassiriyah (map 1.1). This shift also highlights the revival of issue politics as opposed to identity politics (Haddad 2019; Jabar 2018). “Rather than identity issues, Iraqi mobilization [in 2019] is animated today by the demand for a peace dividend, political representation, economic opportunity, functioning services, and the elusive promise of a better life” (Haddad 2019, 51).

The protests that emerged in October 2019 also differ from previous protest movements in their grassroots nature, their composition, and their demands. Unlike past protests, which were more connected to political parties, Iraq's most recent protests are no longer elite-driven. Demonstrators are mobilized locally, “mostly by youth organized in coordination committees, with each local context generating [a] different socio-political coalition driving the protests” (Costantini 2020, 15). Although these forms of local mobilization do not necessarily translate into a national movement, the demonstrators are widely supported by the broader public.<sup>19</sup> The protesters also represent a much younger portion of the population than in previous events, and many of them do not have permanent employment (Mansour 2020). Women have also played a significant role in the demonstrations and held feminist rallies in early 2020 that stressed their role in the movement.

MAP 1.1

**Protests and riots, September 2019–April 2020**



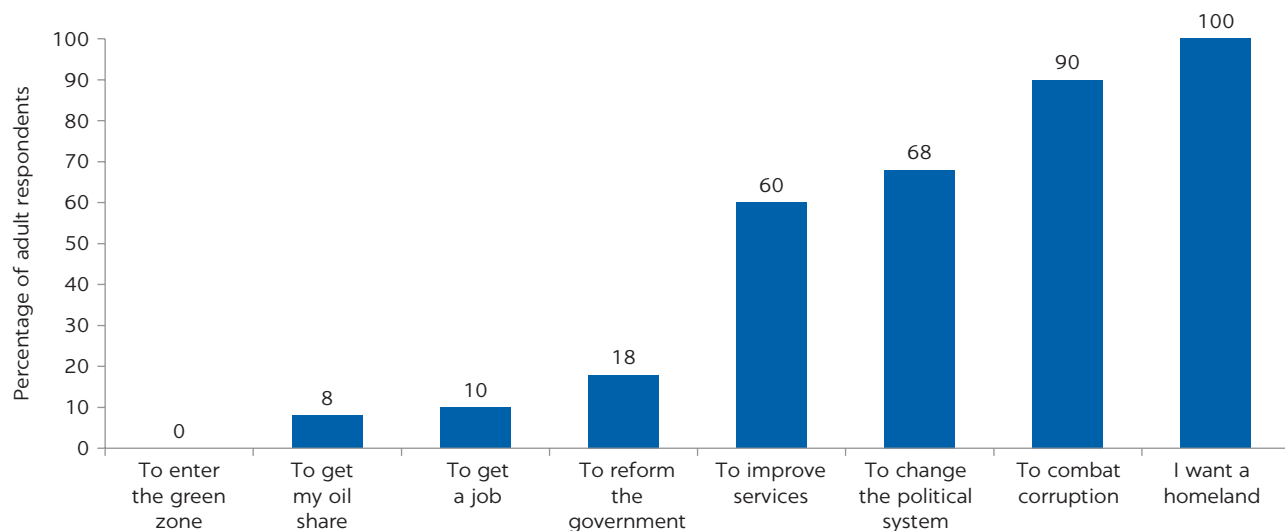
Source: ACLED data set.

Moreover, the protesters' demands have shifted from those of previous social movements. According to surveys of demonstrators in Baghdad and southern Iraq, the main demands have moved from tangible socioeconomic benefits (service delivery and jobs) to fundamental reforms of governance and the political system—in other words, to putting an end to elite capture and restoring citizens' agency in the country's destiny (Mansour 2020) (figure 1.11). Opinion polls find that citizens do not believe in the fairness of the 2018 elections and that a vast and growing majority, across both gender (94 percent of women and 79 percent of men in 2018) and religious and ethnic groups, feel their voice is not heard by the government. Disillusionment with politics is especially common among youth: only 21 percent of Iraqi youth express interest in politics (Raz 2019). In sum, Iraq's current social mobilization calls into question the effectiveness of the country's political settlement and the prevailing social contract built on sectarian ideology and rewarding patrons.

The protests have been met by a combination of promises for reform, redistributive short-term measures, and coercive responses, but public authorities have failed to respond to the underlying social demands. Since the protests broke out in October 2019, hundreds of protesters have been killed and more than 25,000 have been injured.<sup>20</sup> According to the Iraqi High Commission for Human Rights, 2,800 people were detained between October 2019 and March 2020, and cases have been reported of abductions, use of excessive force, and assassinations. The reliance on violence and coercion by the state and security actors fueled the early stages of the protest movement and risks further destabilizing state-society relations throughout the south and center of Iraq. It is also a key driver of violence: empirical studies have shown a link between repression and violent conflict.<sup>21</sup> The coerced suppression of protests in Sunni areas in northwestern Iraq starting in 2011 not only increased citizen disenfranchisement and rejection of the political system but also may have contributed to the rise of ISIS.

**FIGURE 1.11**

**Motivation for participating in the current (2019) protests**



Source: Mansour 2020.

## SOCIAL COHESION AND HORIZONTAL INEQUALITIES

### Social cohesion and exclusion of vulnerable groups

Communal divides between Sunnis, Shias, and Kurds in Iraq have decreased in recent years, but the country's social cohesion remains weak and will continue to shape fragility and the risk of violence (and thus the prospect for growth) for the foreseeable future. A majority of Iraqis (64 percent) say the country is divided as opposed to unified (NDI 2019). It is therefore important to understand Iraq's societal fault lines, patterns of exclusion, and group-based grievances. Polling shows that Iraqis identify themselves foremost as Iraqis, rather than by other identity markers such as sect or tribe, and that relations between social groups are perceived to be improving. Today, Iraqis see the division between citizens and the state and those between political parties as the main fault lines in the country. However, Iraq still ranks among the countries where "social hostilities" between religious groups are highest (Pew Research Center 2019), and levels of interpersonal trust stand at only 10 percent (Arab Barometer 2019).<sup>22</sup> This hostility provides fertile ground for the instrumentalization and mobilization of sectarian identities (and associated grievances) by political parties or armed groups.

Issues of cohesion and social trust are particularly salient in areas of Iraq liberated from ISIS and in disputed territories where internal displacement remains high. As of April 2020, there are still an estimated 1.39 million internally displaced persons (IDPs) in Iraq, with a majority concentrated in four governorates.<sup>23</sup> In both the KRG and the north of the country, IDPs constitute a substantial share of the population. A pervasive issue in liberated areas is the stigmatization of individuals suspected of having supported ISIS or being related to someone in ISIS.<sup>24</sup> These people form a large part of the population of IDP camps, and some of them report being denied services in camps as a result of their perceived affiliation and being unable to obtain security clearances or important civil documents. Many IDPs, fearing further stigmatization and possible recriminations, therefore do not return to their communities of origin. This exclusion raises concern over IDP camps as potential incubators for radicalized youth and sites for recruitment into extremist groups.

Gender inequalities and the systemic exclusion of women and girls, exacerbated by conflict and fragility, also undermine Iraq's social cohesion and produce gendered vulnerabilities. Aside from the particular vulnerabilities experienced by women and girls in conflict zones, gendered inequalities are pervasive in all of Iraq: women and girls face disproportionate barriers in the workplace, at home, in society, and in politics. Consequently, economic opportunities for Iraqi women are limited, especially in comparison with those of men.<sup>25</sup> These divisions are replicated in education: Iraqi women experience notable differences in adult illiteracy rates (24 percent of adult women, compared with 11 percent of adult men) and participation in primary, secondary, and tertiary education (female enrollment rates are 19, 32, and 15 percent, respectively) (World Bank 2017c). Greater inclusion of women in public policy decision-making across sectors is needed to resolve these structural inequalities. Finally, important spatial differences and horizontal inequalities remain across Iraq's territory and present a considerable structural risk of violence and instability. Horizontal inequalities refer to differences in access and opportunity across

social groups on the basis of identities such as region, religion, or ethnicity.<sup>26</sup> Real and perceived inequalities can create grievances, especially when socioeconomic and political problems combine and accumulate. However, group-based inequalities alone do not generate violence—it takes collective mobilization around those grievances or perceived injustices.

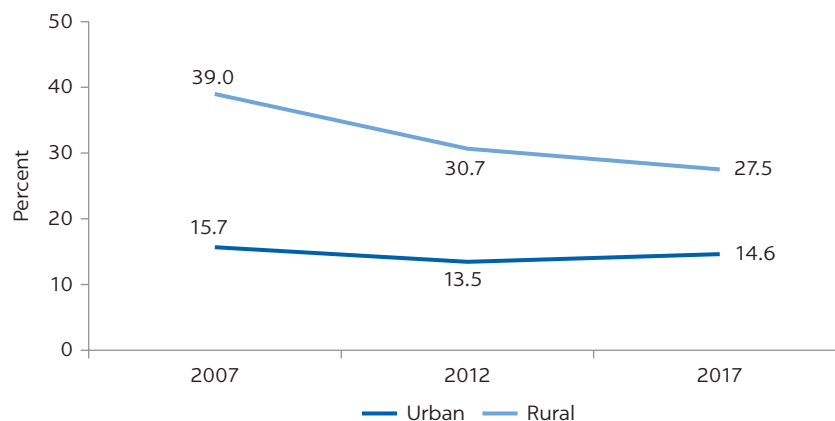
## Poverty

The decade from 2007 to 2017 saw various effects on horizontal inequality in Iraq with respect to monetary poverty.<sup>27</sup> The urban-rural gap closed significantly over the decade (figure 1.12). In 2007, the rural poverty rate was 39 percent, 23 percentage points higher than the urban poverty rate. However, by 2017, the gap had closed to 13 percentage points, with urban poverty stagnant at 14.6 percent (partly because of the 2014 conflict) and rural poverty down to 27.5 percent. In contrast, the regional and ethno-religious gap remains significant: the distribution of poverty is now split between the historically poor Shia south and the newly poor Sunni north, on one hand, and the relatively less poor Shia center and Sunni Kurdish areas, on the other (figure 1.13). Moreover, the higher poverty rates in the Sunni north are driven largely by another group disparity, that between the displaced and the nondisplaced. The poverty rate for IDPs in both the Kurdistan Region of Iraq and the Sunni north—regions that account for the vast majority of the displaced—is about 2.5 times higher than the rate for non-IDPs, and in the north, about half of all IDPs live in poverty.

## Nonmonetary measures of household welfare

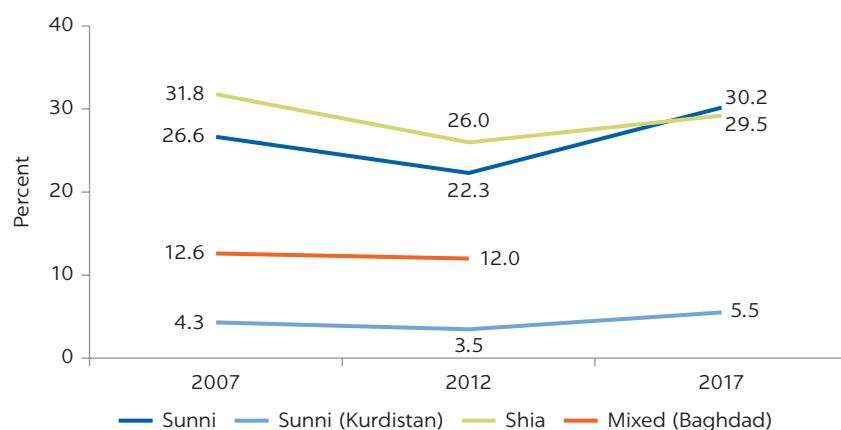
Trends in between-group inequalities in nonmonetary poverty do not always follow the same pattern as trends in monetary poverty.<sup>28</sup> Although the monetary poverty gap between urban and rural areas has been closing sharply, the urban-rural gap in nonmonetary measures has remained relatively stable. Figure 1.14 shows the deviation from the national mean for various regional and ethno-religious groupings across several dimensions of

**FIGURE 1.12**  
**Urban and rural poverty rates, 2007–17**



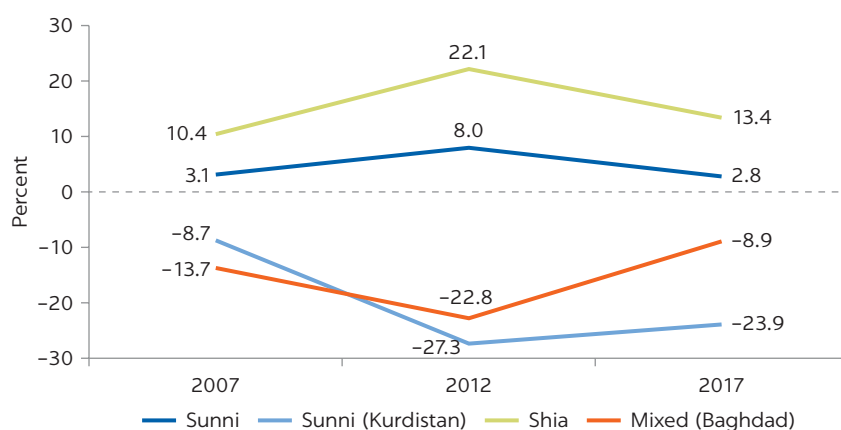
Sources: Iraq Household Socioeconomic Survey 2007, 2012; SWIFT (Rapid Welfare Monitoring Survey [Iraq]) 2017; World Bank calculations.

Note: Data for Baghdad are not available in 2017 because of the sample size.

**FIGURE 1.13****Regional and religious poverty rates, 2007–17**

Sources: Iraq Household Socioeconomic Survey 2007, 2012; SWIFT (Rapid Welfare Monitoring Survey [Iraq]) 2017; World Bank calculations.

Note: Data for Baghdad in 2017 are not available because of the sample size. The gap between Sunni and Shia areas has closed since the 2014 crisis, although more because the conflict increased poverty in Sunni areas than because poverty declined in Shia areas. Poverty in Kurdish areas has remained far lower than in Sunni or Shia areas despite an uptick caused by the conflict.

**FIGURE 1.14****Average deviation from mean national nonmonetary deprivation by regional/religious group, 2007–17**

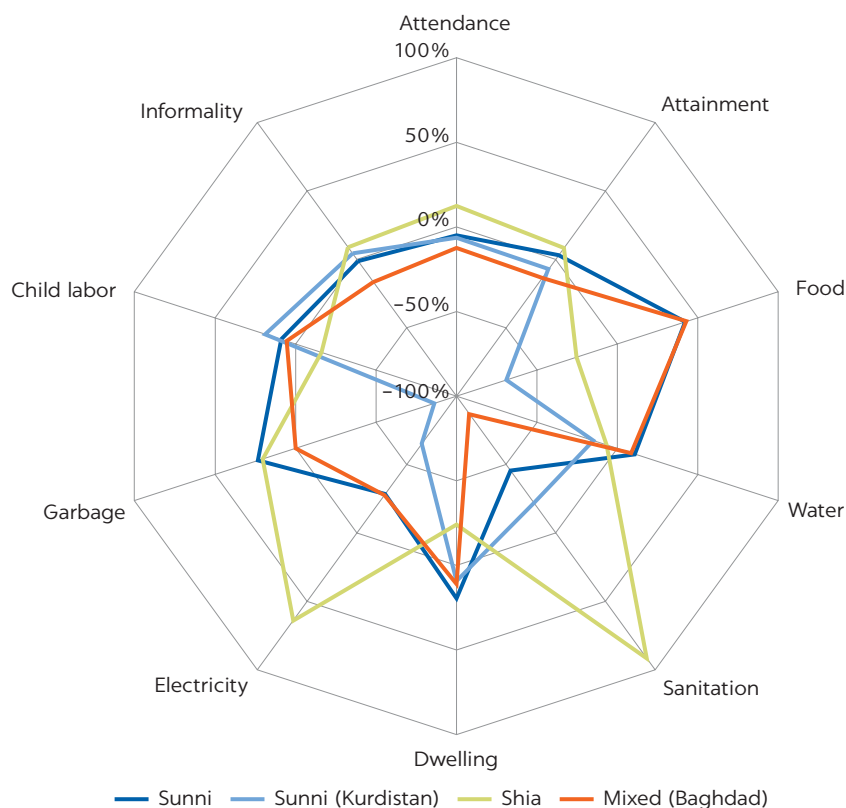
Sources: Iraq Household Socioeconomic Survey 2007, 2012; SWIFT (Rapid Welfare Monitoring Survey [Iraq]) 2017; World Bank calculations.

nonmonetary poverty.<sup>29</sup> This measure can be interpreted as how much higher or lower, in terms of percentages, a group's mean deprivation is than the national mean. For the past decade, Shia governorates have been significantly more deprived along nonmonetary dimensions of household welfare than any other regional or ethno-religious grouping.<sup>30</sup> In particular, the region's electricity deprivation has been 64 percent worse than the national average, and the sanitation deprivation has been 91 percent worse; all other regional and ethno-religious groups perform significantly better than average on those two dimensions (figure 1.15).

However, these regional and ethno-religious divides mask significant spatial disparities across governorates (including intra-ethno-religious disparities)

**FIGURE 1.15**

**Deviation from mean national nonmonetary deprivation, by indicator and by regional/religious group, 2017**



Sources: Iraq Household Socioeconomic Survey 2007, 2012; SWIFT (Rapid Welfare Monitoring Survey [Iraq]) 2017; World Bank calculations.

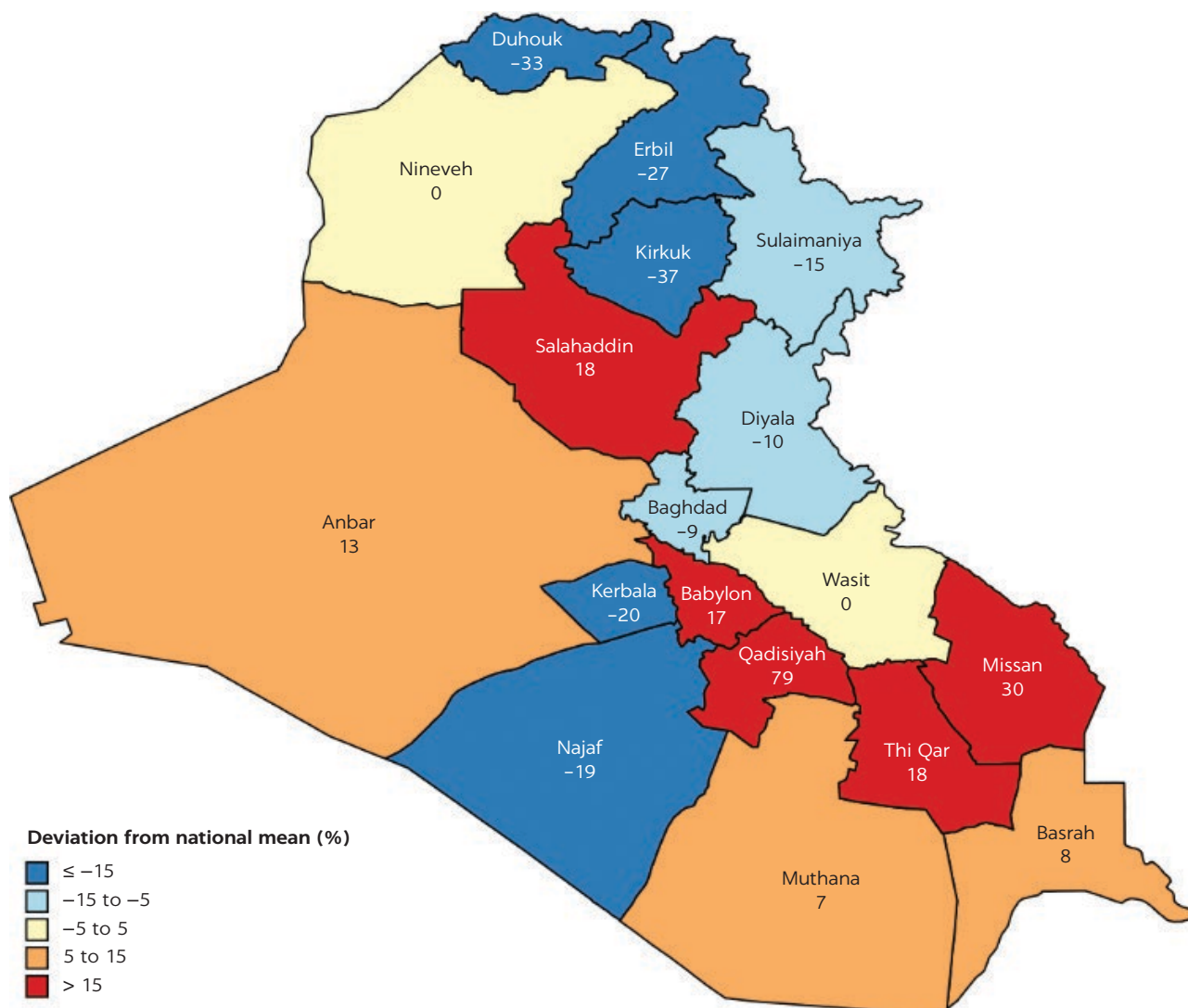
(map 1.2). Although all Kurdish governorates have consistently outperformed the national average, the paths of Sunni governorates have diverged. Kirkuk and Diyala, among the northern governorates least affected by the ISIS crisis, were significantly less deprived in 2017 than the national average (37 percent and 10 percent lower, respectively), whereas Anbar and Salahaddin were significantly worse than average and deteriorating (13 percent and 18 percent higher, respectively) and Nineveh had recovered to the national average. The Shia areas show the greatest intragroup variation. There is a relatively clear divide between the Shia south governorates (Qadisiyah, Muthana, Thi Qar, Missan, and Basrah), all of which are more deprived than the national average, and the Shia center.

### Perceived inequality and group-based grievances

Data limitations make it difficult to examine Iraq's perceived inequalities across various dimensions, but perception data highlights that satisfaction with basic services is significantly lower in Shia areas than elsewhere. In Basrah, an NDI poll found that in 2018, 90 percent of respondents expressed concern over a lack of clean drinking water (NDI 2018). Throughout central and southern Iraq, two-thirds of respondents expressed the same concern. People from Kurdish and Sunni areas are about 25 percentage points more likely than those from Shia

MAP 1.2

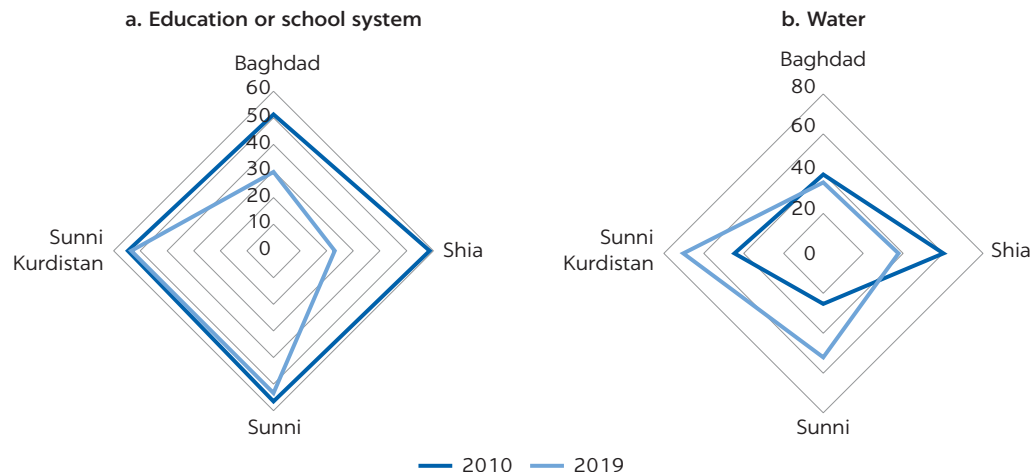
## Spatial disparities in nonmonetary welfare across governorates, 2017



Source: World Bank calculations.

areas to be satisfied with the quality of water services. There are other religious and ethnic variations in satisfaction with basic services as well (figure 1.16). Perceptions of local health services have improved among adults living in Baghdad and in Sunni areas. In contrast, the share of adults in Kurdish areas satisfied with the quality of health care dropped by 10 percentage points from 2010 to 2019; in Shia areas, the share dropped by 21 percentage points. This striking decline in satisfaction among Shia citizens reflects an increase in frustration among the government's main constituency and a gap between what the Shia population is getting and what it feels it should, especially considering that Iraq's oil reserves are located largely in the Shia south. This discrepancy is one of the reasons protests broke out in 2018 and 2019.

In liberated areas, frustration is growing with the slow and insufficient pace of reconstruction efforts, and insecurity and high levels of vulnerability persist.

**FIGURE 1.16****Satisfaction with the quality of city or local services, 2010 and 2019**

Source: Gallup World Poll, 2019.

Note: Figure shows percentage of adult respondents who say they are satisfied or very satisfied.

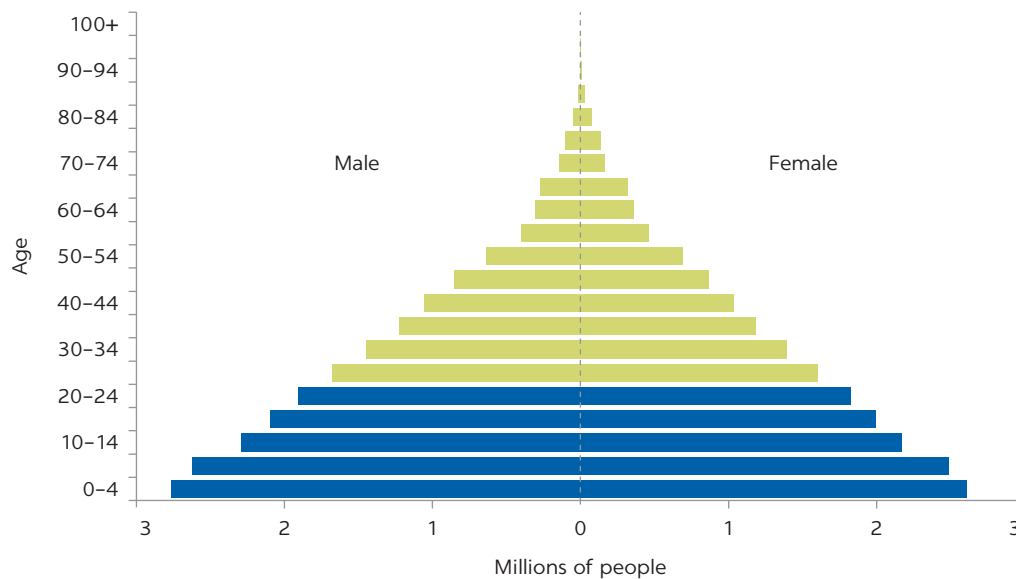
Although satisfaction with service delivery has increased among Sunni communities, likely reflecting a more optimistic outlook following their liberation from ISIS in 2017, the public mood regarding the government's efforts to reconstruct the affected areas is more negative. The inability of the central and local governments to significantly advance reconstruction, the continued presence of IDPs, and the threat of ISIS sleeper cells and regular attacks in the region are of particular concern. There is also a sense that the international community is focusing most of its efforts on rebuilding Anbar and central Mosul City, leaving Kirkuk, Diyala, and the wider (and mainly disputed) areas of Nineveh province neglected (Halawa 2020). Finally, the presence (and growth) of the PMU militias that defeated ISIS has left many residents feeling repressed by Shia leaders. In parts of these regions, the Sunni-Shia conflict threatens to erupt again.

The presence of strong spatial inequalities and associated grievances in Iraq not only threatens development but also poses a structural risk of conflict. As mentioned, the presence of socioeconomic inequalities does not necessarily generate conflict risk; but when they are combined with political exclusion and inequities and mobilized by political elites or extremist groups, they can lead to armed conflict. Iraq's current political settlement is inclusive of all political parties and all main social groups, meaning that popular grievances are channeled and manifested in mobilization against the state rather than in conflict between social groups. Nevertheless, the fragile and fractionalized nature of the political settlement, the unequal spatial distribution of oil reserves, the proliferation of security actors (including their presence in liberated areas), high levels of external involvement, and low levels of social cohesion make it imperative to tackle these inequalities both to help prevent conflict and to strengthen Iraq's social contract.<sup>31</sup>

### Demography and youth exclusion as a driver of instability and conflict

Iraq has one of the highest shares of youth in the world. Forty-nine percent of the population is below the age of 19, and 58 percent is below the age of 25 (figure 1.17).<sup>32</sup>

**FIGURE 1.17**  
**Population pyramid, 2019**



Source: World Bank, World Development Indicators.

Note: Age 0–24 = 22.7 million people, 58 percent of the total population.

Both figures are strikingly high compared with the MENA region. Although Iraq's population growth rate has decreased in recent years, it is still well above the MENA average: the region's population grew by 1.7 percent in 2018, but the Iraqi population grew by 2.3 percent. Similarly, Iraq's fertility rate is 3.7 children per woman, far higher than the regional average of 2.8 (according to the World Development Indicators). The UN projects that on its current trajectory, the population of Iraq will grow from its current level of 40 million to 108 million by 2100. The share of youth (age 15–24) in Iraq's adult working-age population ("the youth bulge") stands at 32 percent.

Iraq's demographic trajectory, with its high fertility rate and increasing age dependency ratio, puts a strain on the country's future economic growth. Countries with a high proportion of children, and thus a higher age dependency ratio, need to shelter a greater number of people per working-age adult, potentially overwhelming available resources (Bloom, Canning, and Sevilla 2001). Large youth populations put huge pressure on education systems, thus creating vulnerabilities (United Nations and World Bank 2018). Similarly, rising levels of educational attainment by youth in comparison to older generations raise youth aspirations and put additional pressure on the government (Devarajan and Ianchovichina 2018). And failing to create jobs, particularly by investing in more labor-intensive industries, as these children grow up will result in soaring unemployment rates and depressing economic prospects. Given Iraq's almost complete dependence on the capital-intensive oil industry and the country's weak private sector, Iraq needs to bring about a demographic transition. Hamilton (2020a) demonstrates that Iraq's slow demographic transition relative to the MENA region threatens the country's per capita economic growth.<sup>33</sup>

Recent empirical analysis finds that the degree to which youth are included in economic, social, and political life is the key determinant of whether a youth

bulge represents a structural risk of conflict (Paasonen and Urdal 2017)—in other words, whether young people participate in violence or join armed groups. In addition, Farzanegan and Witthuhn (2017) establish a statistically significant joint negative effect of corruption and youth bulges on political stability. They conclude that as the share of the youth population (age 15–24) in the adult population (age 15 and older) rises above 20 percent, high levels of corruption become a significant factor predicting internal conflict. Thus, Iraq’s atypical demographic profile, on top of youth exclusion and high levels of corruption, increases the country’s risk of instability and conflict.

## **PATHWAYS OUT OF FRAGILITY AND IMPLICATIONS FOR REFORM AND DEVELOPMENT**

On the basis of this chapter’s analysis of Iraq’s fragility and political economy challenges, the following overall priorities have been deemed critical to helping Iraq strengthen peace and stability and promote growth and development: (a) refocusing the political settlement on the development agenda and restoring the authority of formal state institutions over nonstate actors, (b) strengthening the management and allocation of oil wealth and public resources by shifting from short-term to longer-term rent maximization, and (c) restoring the social contract by building confidence in state institutions and addressing popular grievances. Table 1.2 provides an overview of recommended objectives, distinguishing between short-term priorities and medium-term, more aspirational priorities that will likely require a higher level of governance and a more conducive political environment to achieve. Shifting toward a more development-oriented political settlement and improving state authority are fundamental prerequisites for making progress in other areas. It will also be important to coordinate the measures taken in order to create a virtuous cycle of reforms; starting with confidence-building measures can signal a shift in approach upon which further progress can build.

### **Refocusing the political settlement on development and restoring the authority of state institutions**

A stable elite-bargain is an important but not sufficient prerequisite for peace in Iraq. Only if the elite bargain is oriented toward growth and development will a country’s citizens fully enjoy its peace dividends and grant public institutions and the ruling elite the legitimacy necessary for governing. Iraq thus needs to shift from “clientelist pluralism” to “programmatic pluralism.” The more political parties and internal factions compete on the basis of policy options instead of clientelism and patronage, the more likely it is that the system will produce public goods (World Bank 2012a). This change requires a shift in elite behavior and a new political bargain grounded in the recognition that Iraq’s current development model (relying on oil-rent sharing) is not sustainable and risks further undermining long-term outcomes and stability. In addition, institutional reforms will be needed to “lock in” credible commitments by political elites and increase the predictability of political exchanges (World Bank 2017b). Priority measures include (a) strengthening the accountability of revenue collection agencies (such as the tax and customs administrations and the state oil marketing organization) and broaden the

**TABLE 1.2 Pathways out of fragility: Short- and long-term priorities and shifts**

PRIORITY OBJECTIVES	SHORT-TERM PRIORITIES	LONG-TERM PRIORITIES AND SHIFTS
<b>Refocusing the political settlement on the development agenda and restoring the authority of formal state institutions over nonstate actors</b>		
Pivoting toward a more development-oriented political settlement	<ul style="list-style-type: none"> <li>• Build leadership coalitions for reform and develop mechanisms for strategic citizen engagement and national dialogue</li> </ul>	<ul style="list-style-type: none"> <li>• Establish a new elite consensus and political vision around the need to reduce oil dependency and provide developmental benefits to the people</li> <li>• Focus electoral competition on developing programs geared toward collective welfare enhancement</li> </ul>
Restoring the authority of formal state institutions over nonstate actors	<ul style="list-style-type: none"> <li>• Send confidence-building signals in order to restore state authority over nonstate actors (e.g., border control posts, security actors)</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the integration of security actors with the formal military, increase their accountability, and strengthen security sector governance</li> </ul>
<b>Strengthening the management and allocation of oil wealth and public resources</b>		
Strengthening the governance framework of the oil and gas sector	<ul style="list-style-type: none"> <li>• Increase transparency, including contract disclosure, in the oil industry</li> <li>• Strengthen external auditing of oil revenue in order to validate EITI data</li> <li>• Complete policy and legal frameworks for formula-based revenue sharing (as per article 112 of the constitution)</li> </ul>	<ul style="list-style-type: none"> <li>• Operationalize the provisions of the 2019 public financial management law on the investment of oil and gas revenue surpluses</li> <li>• Strengthen oversight of SOEs in the oil and gas sector and increase their accountability</li> <li>• Review a licensing policy to maximize oil rent in the long term</li> <li>• Introduce oil revenue forecasting and modeling to better respond to price volatility</li> </ul>
Increasing investment in productive assets (including infrastructure) to maximize their development impact	<ul style="list-style-type: none"> <li>• Strengthen public investment management (with a focus on preparation and implementation)</li> <li>• Secure financing for public investment, including by promoting enclave public investment capacity (e.g., re-source-for-infrastructure deals)</li> <li>• Enhance the competitiveness of procurement</li> </ul>	<ul style="list-style-type: none"> <li>• Introduce a centralized project preparation and screening process ahead of budgetization that is based on standardized appraisal methodology, project portfolio management, and ex post evaluation</li> </ul>
Transitioning from distributive to developmental fiscal federalism	<ul style="list-style-type: none"> <li>• Promote renewed dialogue on the merits, challenges, and opportunities of federalism</li> <li>• Settle resource control disputes by clarifying assignment across tiers of government</li> </ul>	<ul style="list-style-type: none"> <li>• Adopt and implement developmental fiscal federalism</li> </ul>
<b>Restoring the social contract by building confidence between groups and in government institutions and by addressing grievances</b>		
Strengthening accountability institutions and responding to public concerns about corruption	<ul style="list-style-type: none"> <li>• Publicly disclose asset, income, and financial interest declarations by public officials (starting with cabinet members)</li> <li>• Introduce a legal framework on rights to information</li> <li>• Introduce a mechanism for citizen feedback on public policy and programs (including responses to emergency situations)</li> </ul>	<ul style="list-style-type: none"> <li>• Pass legislation on whistleblower protection, conflicts of interest, and political immunity</li> <li>• Undertake forensic institutional reviews of the government entities and programs most vulnerable to corruption</li> </ul>

*continued*

TABLE 1.2, *continued*

PRIORITY OBJECTIVES	SHORT-TERM PRIORITIES	LONG-TERM PRIORITIES AND SHIFTS
Strengthening responsive delivery of and accountability for priority services and infrastructure	<ul style="list-style-type: none"> <li>• Prioritize service delivery and infrastructure investments on the basis of citizen priorities and grievances (e.g., water and electricity, housing)</li> <li>• Embed mechanisms to support accountability, participation, and grievance redress into the delivery of services</li> </ul>	<ul style="list-style-type: none"> <li>• Adopt public service standards</li> <li>• Extend the reach of state institutions where their presence is weak and contested by other actors</li> </ul>
Establishing a fiscal contract between the government and citizens	<ul style="list-style-type: none"> <li>• Restore the tax base, strengthen tax enforcement, and allow lower tiers of government to levy local taxes</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthen the legal and institutional framework for taxation</li> </ul>
Responding to youth demand for jobs and addressing demographic pressures	<ul style="list-style-type: none"> <li>• Identify pathways for job expansion, especially in construction, agriculture, and small and medium enterprises</li> <li>• Assess and invest in job-relevant skills development for youth and women</li> </ul>	<ul style="list-style-type: none"> <li>• Promote the shift from public sector employment to private sector employment</li> </ul>
Tackling socioeconomic inequalities that can fuel group-based grievances and reducing gender inequality	<ul style="list-style-type: none"> <li>• Send confidence-building signals to promote inclusion, reconciliation, and gender equality</li> <li>• Understand group-based grievances and begin to address inequalities through spatial approaches</li> </ul>	<ul style="list-style-type: none"> <li>• Institutionalize mechanisms for more equitable resource sharing (see the row about distributive federalism) and inclusion of vulnerable and marginalized communities</li> </ul>

Source: World Bank.

Note: EITI = Extractive Industries Transparency Initiative; SOE = state-owned enterprise.

state's fiscal space and diversify its revenue sources; (b) clarifying intergovernmental relations through the assignment of functions, resources, and capacity; and (c) strengthening the authority and independence of accountability institutions such as the auditor general, the judiciary (including over administrative justice), the central bank, and the anticorruption agency.

Iraq also needs to restore the authority of formal state institutions over nonstate armed groups. This measure will not only strengthen state sovereignty, improve security, and stabilize the political settlement; it will also help reduce informal rent extraction and the capture of revenue through informal taxation, illegal trade, and usurpation of custom duties, which deprive the government of a significant part of its potential revenue and fiscal space. In light of the plurality of Iraq's security architecture, a single unified coercive authority is unlikely to emerge in the short to medium terms (Aziz and van Veen 2019). However, measures to strengthen the links between various security actors, assign them roles and responsibilities, and reinforce security sector governance will nevertheless have to be taken. Such measures should aim to reduce the autonomy of security actors, strengthen the army's professionalism, and ensure civilian oversight of it.

Experience and evidence from countries that have successfully navigated similar transitions suggest that strong and programmatic leadership and coalitions of a range of actors are critical to maintaining "peaceful pathways" (United Nations and World Bank 2018). Institutional reform is a gradual process that may take years, and change requires reform-oriented coalitions among both ruling elites and citizens across social groups. There may be opportunities in the short term to build new platforms or mechanisms for dialogue and consensus building that bring together a range of Iraq's political and social actors, including protesters, civil society, the private sector, and religious authorities. Inclusive coalitions can take many forms: in Tunisia, for example, the civil-society Quartet

coalition brokered a national dialogue between the government and the opposition that resulted in a road map to new elections. But whatever happens, progress in Iraq will remain elusive unless there is a shift in elite incentives and a new shared political vision for Iraq (at least among a critical mass of key actors) that acknowledges that the current clientelist and patronage-based model is no longer viable and that the country needs to shift toward a system that delivers developmental benefits to the people.

### **Strengthening the management and allocation of oil wealth and public resources**

For the Iraqi government to maximize its oil rent generation over the long term, it should paradoxically reduce its dependency on oil revenues, if only because such dependency weakens its leverage on markets and its bargaining power with private investors, producers, and trading companies. Long-term rent maximization should also help mitigate oil price volatility, which, in turn, would help stabilize Iraq's economy.

Strengthening the governance framework for the oil and gas sector is critical to this shift toward long-term rent maximization. Priorities include (a) increasing transparency in the oil sector, including around contract disclosure, which “reduces information asymmetries between governments and investors, helps bolster credibility and predictability over time, and usually improves the deals that governments can make” (World Bank 2012a, 107); (b) increasing government capacity for revenue forecasting and auditing, which is indispensable to enforcing rent-sharing agreements between the government and private operators “because revenue administrations often have insufficient capacity, [and] multinational corporations in the extractive industries typically self-assess their tax liabilities, which are, for the most part, not subjected to audit and instead simply accepted by government” (World Bank 2012a, ); and (c) strengthening the oversight of SOEs in the oil and gas sector and improving their financial and operational accountability. This last change is critical to sustainable rent maximization through the state petroleum revenue account, and it will entail strengthening cash management under the Treasury Single Account, which should cover all revenue-generating and -spending public entities (including national oil companies and lower tiers of government), and harmonizing accounting standards (Ahmad 2020).

Investing the oil rents in productive assets (including infrastructure) will maximize their development impact and help the country weather external shocks, including oil price volatility. “A better public capital stock is one of the most promising avenues for transforming resource rents into sustainable development riches.” (World Bank 2012a, 211). And investments in Iraq's capital stock will also help compensate for oil and gas resource depletion and mitigate spatial disparities. This calls for both better strategic prioritization of public investment, on the basis of a centralized screening process and standardized project appraisal methodology, and a financing strategy to broaden the fiscal space earmarked for public investment (by capping recurrent expenditures) and shelter public investment from economic contractions by leveraging innovative financial mechanisms.

Fiscal federalism in Iraq is still contested, and it lacks legal, institutional, and policy frameworks. Ongoing disputes over resource control and revenue sharing between the federal government and lower tiers of government have impeded the effectiveness of policy and program implementation as well as service

delivery. Contested federalism hampers revenue generation by inducing revenue capture at source by nonstate actors and by slowing down the devolution of fiscal resources and institutional capacity. Intergovernmental disputes also prevent the stabilization of the legal and institutional framework of the federal configuration. As long as federalism is construed as a zero-sum game in which the gain of one tier of government must be the loss of another, and as long as rent sharing is seen as the only or the main objective of fiscal federalism, ongoing disputes and debates will likely remain unsettled, and Iraq may struggle to escape from its present rent-seeking trap. A renewed dialogue on the merits, challenges, and opportunities of federalism for state building and nation building in Iraq is needed, and conflicting views among the political leadership will need to be reconciled. Box 1.4 sets out three overall objectives to guide this policy dialogue and decision-making.

### **Building confidence between ethno-religious groups and in government and addressing grievances**

Breaking out of the current dynamic of dissatisfaction, social protests, coercive responses, and weakening government legitimacy will require Iraq's government to adopt both short-term confidence-building measures that signal a break

#### **BOX 1.4**

### **Toward developmental fiscal federalism**

The assignment of functions, resources, and capacity among the levels of government in Iraq are yet to be determined and will need to be aligned. Districts and subdistricts, which at the moment are only province subdivisions, should be legally established as local governments, or a lower tier of the national government. The assignment of responsibilities to governorates and their subdivisions needs to be legally established by law. The devolution of resources (including through the assignment of authority to mobilize revenue) also needs to be established in legal documents other than appropriation laws to make the practice stable and more enforceable. Capacity needs to be further devolved to lower tiers of government (beyond the narrowly limited provisions of existing decentralization laws) and to be commensurate to their assigned responsibilities.

Resource allocation needs to strike the right balance between fiscal equalization and derivation. At present, Iraq's fiscal transfers are far too scarce to meet any fiscal equalization or derivation objectives. But in order to effectively pursue such objectives, Iraq will need a formula for revenue allocation across the

different tiers of government. Establishing such a formula calls for both strong buy-in by political leadership at the governorate level and effective oversight. For example, in Nigeria, a lack of trust between the different tiers of government and the inability to effectively verify the allocation formula's criteria induce its gaming (through the misreporting of criteria, the capture of revenue at the source, etc.) to the point of significant distortion.

Spending authority should be devolved to the lower tiers of government wherever feasible, and decentralized revenue generation should be incentivized. Federalism should be not only distributive (i.e., distributing revenue) but also productive (i.e., generating revenue), and achieving this goal will require adequate assignment of revenue generation responsibility across the tiers of government. At the moment, Iraq's lower tiers generate hardly any of their own revenue and are penalized by a reduction in their fiscal transfers from the federal government when they do (Fleet 2019), plus their legal authority to generate local revenue is contested by the federal government (Al-Mawlawi 2019a).

with the past and structural measures that address citizen demands and deep-seated grievances. Restoring the public's trust in government is critical to the government's effectiveness, because most public policies and programs require social consent, if not active participation (e.g., voluntary compliance with health crisis-prevention practices such as social distancing).

The top two priorities for Iraq in this regard are strengthening existing accountability institutions to effectively discharge their mandates and responding to public concerns about corruption. For the latter, disciplining corrupt officials is not enough, and it may even confirm the perception that the whole government is corrupt. Accountability institutions need to focus on mitigating corruption risks and enhancing government performance; they also need to capture and address citizens' feedback on perceived corruption and misuse of funds in public policies and programs. The goal should be to improve citizens' actual experiences with corruption, red tape, arbitrariness, abuse of authority, and other problems when accessing services and interacting with public officials. Petty corruption and bureaucratic harassment hurt citizens as much as grand corruption, and they could be addressed through programs such as e-service delivery and online grievance redress mechanisms. Public perceptions of corruption can also be reduced through measures that signal the willingness of political leadership to amend their wrongs, such as the public disclosure of the assets, incomes, and financial declarations of government officials.

Strengthening citizen engagement and government accountability in the delivery of priority services and infrastructure will also be important. The Iraqi government must ensure that investments are prioritized according to their importance to citizens in the affected region. For example, in the south of Iraq, water and electricity top the list of citizens' concerns, whereas in areas liberated from ISIS, the top priorities are housing and reconstruction of critical infrastructure. This prioritization may also include extending the reach of state institutions into areas where their presence is weak and contested by other actors. Also, the way services are delivered and their perceived fairness matter at least as much to the state's legitimacy as who delivers them and how good they are. Embedding mechanisms to support accountability, participation, and grievance redress within service delivery could help improve the relationship between Iraqi citizens and their state. The government should also strengthen its communication approaches and its engagement with citizens to ensure that their feedback improves state functions and services.

Establishing a fiscal contract between the government and citizens is another important part of the equation. Taxation is one of the most foundational elements of the fiscal contract, because it fosters social demand for fiscal accountability—a missing link in oil-rich economies, where the main source of revenue, oil rents, “go directly from the extractive company—usually a multinational—to the government, without passing through the citizens” (Devarajan et al. 2013, 1). However, the willingness of taxpayers to comply with taxes, or their tax morale, depends on the government's responsiveness to their expectations regarding fiscal resource allocation and on government officials' integrity (Sjoberg et al. 2019). Accordingly, to strike a fiscal contract with its citizens, the government of Iraq needs to first enact the reforms described above. It will also need to prevent the capture of customs revenue by nonstate actors, such as politically affiliated militias, both at border crossings and through informal tolls. The sequencing of public spending reforms (notably subsidy reforms) matters to their acceptability; for example, in 2010, the government of Iran

successfully introduced a universal cash transfer before cutting energy subsidies (Guillaume, Zyteck, and Farzin 2011). Box 1.5 provides options for strengthening tax revenue mobilization, including by allowing local taxation.

Over the medium term, Iraq must respond to youth demand for jobs and address demographic pressures in order to reduce the risk of instability and avoid downward pressure on incomes. To accommodate its growing number of young job seekers, Iraq must shift from creating jobs in the public sector to supporting their creation in the private sector. This shift will also require a change in mind-set among Iraqi youth, who expect jobs in the public sector. There are important pathways for job expansion, especially in construction (given Iraq's need to rebuild its war-battered infrastructure), agriculture (to feed its growing population), and small and medium enterprises (World Bank 2018). But to fill those jobs, youth will need higher-quality education than they currently receive. Special attention needs to be paid to strengthening female labor force participation. And Iraq could also address the problem by catching up with other MENA countries in lowering its fertility rates.

Finally, tackling socioeconomic inequalities, which can fuel group-based grievances, and reducing gender inequality will be key to addressing Iraq's structural vulnerability to conflict. A concerted effort will need to be made to

#### BOX 1.5

### Diversifying revenue through tax revenue mobilization

In the short run, the government of Iraq should restore its tax base, strengthen tax enforcement, and allow lower tiers of government to raise local taxes. The government should revisit the exemptions it grants to the personal income tax, including for allowances to government employees, pensions, and other monetized benefits (including cash transfers). It should also revisit its exemption of SOEs in the competitive sector (i.e., those it does not burden with public service obligations or price or tariff controls) from the corporate income tax. Tax assignment and revenue allocation across the tiers of government should be consistent with the responsibility each tier is given and should allow lower tiers of government to raise their own resources. Some taxes, such as property taxes, lend themselves best to decentralized taxation (Ahmad 2020). Taxes for services—such as those levied on traders in exchange for the provision of market facilities or on properties in exchange for their betterment through the provision of network and municipal services (water supply, waste management, roads, and electricity)—could help build local fiscal contracts by promoting trade, consumption, and investment

(Ahmad 2020; Ahmad, Brosio, and Pöschl 2014). Under specific conditions, the transfer part of the country's oil revenue directly to citizens through uniform, universal cash transfers should be considered. The state could then introduce the direct taxation of distributed revenues so as to bolster public scrutiny of expenditures (Devarajan, Raballand, and Le 2012).

In the long run, the government of Iraq should strengthen the country's legal and institutional framework for taxation in order to steady the tax policy framework. At the moment, significant tax policy decisions are formalized only by appropriations laws; in other words, they are subject to reversion every year. There is no clearly established and legally binding tax assignment between the tiers of government, which is a disincentive for decentralized revenue mobilization because all revenues are to be pooled by the federal government before being redistributed to lower tiers. Accordingly, sustained efforts to diversify the government's revenue and broaden its fiscal space need to be bolstered by revising tax laws and assigning taxation authority and tax revenue across the various tiers of government.

ensure that the distribution of resources is equitable across groups and that perceived or real inequalities in access to welfare, basic services, or employment opportunities are addressed. The government will also need to reach remote and underserved communities to ameliorate their conditions and increase their human capital. This effort is particularly important in the disputed territories (including Nineveh, Kirkuk, and Diyala), in areas where nonstate actors provide security or other services, and in areas where attacks by ISIS and other terrorist groups are on the rise. Exclusion from education has great potential to fuel grievances, and preventing it is central to preventing violent conflict. And, as previously mentioned, developing the population's skills will also be instrumental for the jobs agenda.

## NOTES

1. The importance of understanding the link between peace and elite bargains or political settlements has been discussed in various reports, including *World Development Report (WDR)* 2011, *WDR* 2017, and United Nations and World Bank (2018).
2. North et al. (2007, 2013) contend that all societies must solve the problem of violence, and they distinguish between two ways in which societies do so. Under the limited access order, the likelihood of violence is reduced by granting political elites privileged control over parts of the economy, with each getting some share of the rents. Because outbreaks of violence tend to disrupt or reduce the generation of rents, elite factions have incentives to reach informal bargains (the elite bargain) to share resources and opportunities and to refrain from violence. However, the unstable nature of these elite coalitions creates pervasive uncertainty about outcomes and prevents individuals and organizations from credibly committing to observe rules in many possible circumstances.
3. Unlike in Lebanon, where the sectarian allocation of key positions is enshrined in the constitution, Iraq never formalized these quotas. The de-Ba'athification process after 2003, which led to an erosion of state bureaucracy, played an important role in incentivizing competitions within ethno-sectarian identities over national ones, because elites wanted to monopolize "representation" of their respective communities.
4. For example, the clashes between the League of the Righteous (Asaib ahl al-Haq) and the Peace Brigades (Saraya al-Salam).
5. The difference between the two leading Shia lists was narrow, resulting in a long string of political negotiations to avoid a violent breakdown of relations. Both lists were given equal representation within the formation process of the government. Importantly, a compromise candidate for the premiership, who did not belong to either list or have his own political base, was selected.
6. For an empirical analysis of the link between Iraq's political settlement and economic decision-making, see Hamilton (2020b), who shows that as more elite groups are included, the quality of decision-making (measured in terms of selected governance indicators) declines and rents and corruption increase.
7. The civil service in Iraq is organized into 10 grades, plus an additional "private grade" for senior positions such as senior advisers, deputy ministers, and directors general.
8. For a detailed account of nepotism and patronage in the Iraqi public sector, see Al-Mawlawi 2019b.
9. More than 7 in 10 Iraqis declare that they trust security forces, while "less than 4 in 10 say they trust the justice system, district and provincial councils, the Iraqi Council of Representatives, and the Iraqi government" (NDI 2019, 39).
10. This level of production was forecast by the International Energy Agency and targeted by the government of Iraq.
11. Figures according to World Bank estimates.
12. Some leaders also relied on anti-Americanism, particularly during the insurgency and civil war period and, more recently, in the context of growing US-Iran tensions, including after the assassination of General Soleimani.

13. Effectiveness was measured as “perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.”
14. The highest score recorded by NDI on this question was 88 percent in 2013, on the eve of the ISIS insurgency (NDI 2019).
15. These offices were dissolved on the pretext that they were ineffective and prone to corruption, but interviews conducted for this chapter suggest that political blocs in the parliament were motivated by a collective desire to weaken accountability within ministries.
16. Iraq ranked second-last in the region on the World Bank’s 2018 Human Capital Index.
17. Central Bank of Iraq and the Middle East Economic Survey (MEES).
18. These data came from the Arab Barometer wave V data set, available at [https://www.arabbarometer.org/surveys/arab-barometer-wave-v/#data\\_sets](https://www.arabbarometer.org/surveys/arab-barometer-wave-v/#data_sets).
19. Opinion polls conducted by the IIACSS (Independent Institute of Administration and Civil Society Studies, a market research company) confirm public support for the protesters (76 percent of respondents declared support for them in 2018, and up to 80 percent in the southern part of the country) and thus refute the argument that active minorities are at odds with the silent majority in Iraq (Dagher 2019).
20. For more information, see the ACLED data set at <https://acleddata.com>.
21. A wide literature has analyzed the link between political repression and protest behavior (Chenoweth, Perkoski, and Kang 2017). Repression can have either a positive or a negative effect on protest behavior, by either increasing protests by intensifying the motivation behind it or decreasing protests by raising the cost of participating. As highlighted by Nygård et al. (2019, 24), “where political repression prevails, governance breakdown also becomes more likely. As the state invests its resources in repressive policies and actions, fewer resources are available to provide goods and service to the population. Additionally, repressive behavior likely also excludes large parts of the population from goods and service provision. Consequently, both the perception of goods and service provision and the de facto delivery of such services suffer in repressive systems.”
22. The social hostilities index developed by the Pew Research Center measures hostilities related to (a) religious norms, (b) interreligious tension and violence, (c) religious violence by organized groups, and (d) individual and social-group harassment.
23. For more information on Iraq’s IDPs and returning people, see <http://iraqdtm.iom.int>.
24. The stigmatization of so-called “ISIS families” has especially affected women and children (Hagedorn 2020).
25. Current estimates show that “fewer than one in ten adult women with intermediate or lower levels of education participates in the labor market” (World Bank 2018, 5). Additionally, women participating in the labor market are more likely to be unemployed than are men. Among Iraqi youth, young women were more than twice as likely to be unemployed as their male counterparts: about 65 percent of young women are unemployed compared with 32 percent of young men.
26. A considerable literature discusses the link between conflict and (horizontal) inequality, and the topic is central to the discussions on conflict prevention in United Nations and World Bank (2018). For a detailed discussion of the literature and its empirical approaches, see Bahgat et al. (2017).
27. Nationally, poverty in Iraq slowly fell as violence gradually declined from its peak in 2006. However, the ISIS and oil price crises of 2014 caused poverty to reach an estimated 22.5 percent in 2014 before falling again to 20.0 percent in 2017 as recovery began (World Bank 2019).
28. For the methodology on nonmonetary welfare measures and definitions of the indicators used in this analysis, refer to the CEM background paper by Wai-Poi, Temgoua, and Phadera (forthcoming).
29. For any particular dimension, a group’s deviation from the mean is the group’s mean deprivation minus the national mean divided by the national mean. Thus, a negative value means that the group has less deprivation than the national mean, and dividing the difference by the national mean normalizes the size of the group difference and allows comparison across dimensions with very different mean levels of deprivation.
30. Although Shia areas are the best performing in 2017 on some dimensions of nonmonetary poverty, notably on owning their own home (24 percent better than average; all other

regions are worse than average), child labor (16 percent better than average; all other regions are worse than average) and food security (25 percent better than average; only Kurdish areas perform better), they performed worse than the national average on most other dimensions.

31. Abu-Bader and Ianchovichina (2019, 1) find that “religious polarization is positively and significantly associated with conflict in the presence of non-neutral and non-humanitarian external military interventions in the Middle East and North Africa region . . . This type of intervention intensifies religious polarization through its effect on alienation, increasing the risk of high-intensity conflict.”
32. See the UN population data set at <https://population.un.org/wpp/DataQuery/>.
33. Hamilton (2020a) shows that slight changes to Iraq's population momentum can have a significant effect on the country's spending per capita. A shift from the median to the high population projection between 2020 and 2024 results in a cumulative decrease in per capita expenditures equivalent to 0.72 percent of GDP.

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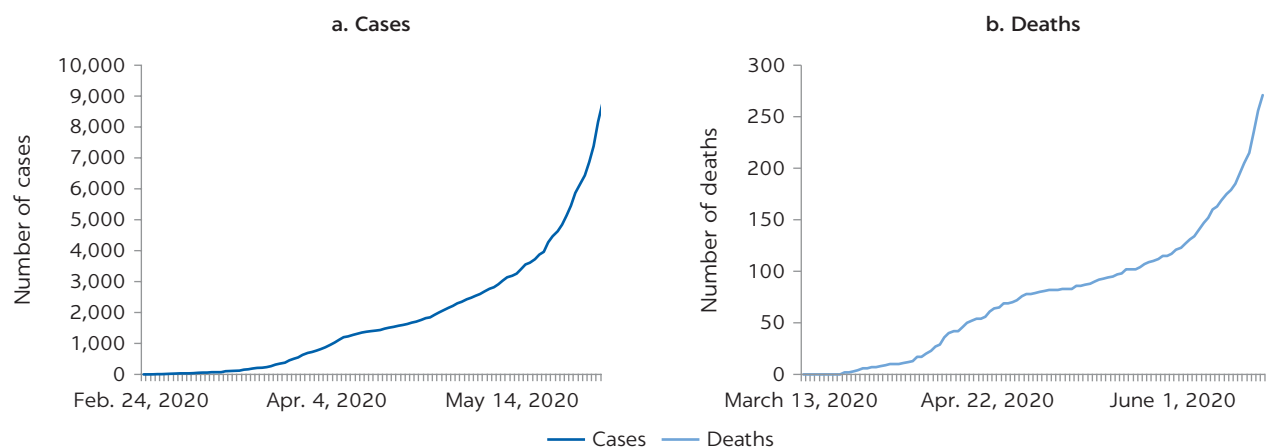
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## 2 Past and Future Drivers of Growth

Iraq today faces a litany of challenges, particularly the COVID-19 pandemic and low oil prices (figure 2.1). As outlined in chapter 1, the political economy of Iraq is held together by oil rents. Iraq's government requires an oil price of at least US\$60 per barrel to break even. Given the fall in oil prices and rigidities in the government's spending, the current forecast for Iraq's budget deficit in 2020 is more than 20 percent of gross domestic product (GDP) (figure 2.2). In addition to these challenges, a set of political, economic, and security issues linked to diversification, education, and productivity are holding back Iraq's long-term prosperity. In light of these numerous challenges, the outlook for Iraq's medium- to long-term growth is very uncertain. This chapter outlines how Iraq arrived at its present situation, the country's characteristics that are holding back development, and what it can do to move forward and spur sustainable growth.

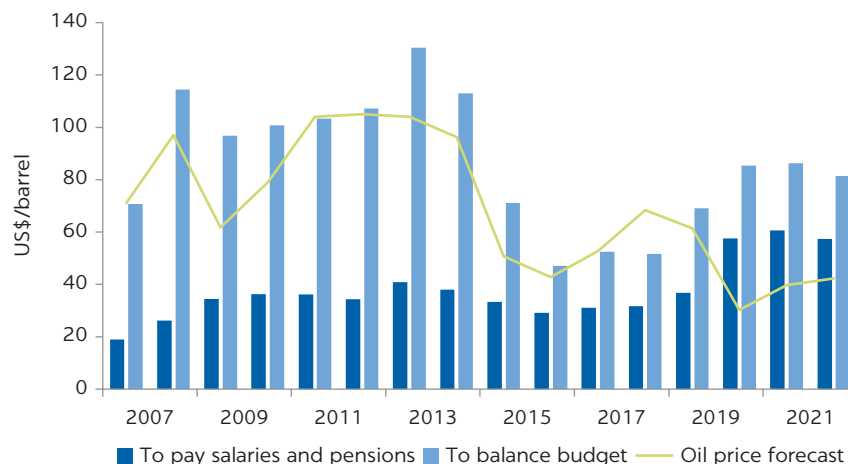
**FIGURE 2.1**  
**COVID-19 pandemic in Iraq**



Source: Johns Hopkins University CSSE, as of June 5, 2020.

Note: This data set is available at [https://github.com/CSSEGISandData/COVID-19/tree/master/csse\\_covid\\_19\\_data/csse\\_covid\\_19\\_time\\_series](https://github.com/CSSEGISandData/COVID-19/tree/master/csse_covid_19_data/csse_covid_19_time_series).

FIGURE 2.2

**Break-even oil prices, 2007–21**

Source: World Bank data.

**HOW HAS IRAQ ARRIVED AT THIS POINT?****Repeated conflicts and sectarian tensions in an inherently volatile oil economy have prevented sustainable prosperity**

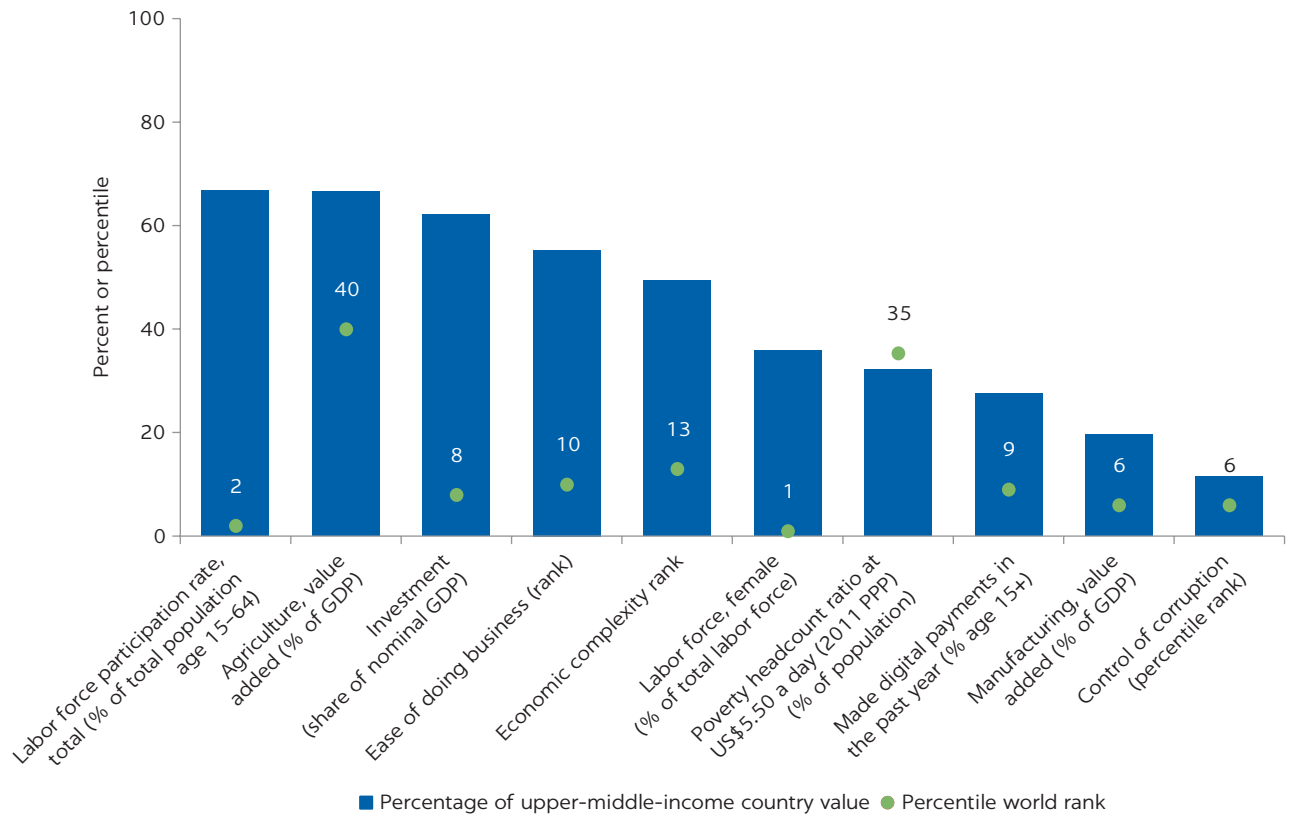
Although Iraq's oil wealth has allowed it to obtain upper-middle-income status, in many ways Iraq more closely resembles a low-income, fragile country. It has one of the lowest female labor force participation rates in the world, low levels of human and physical capital, and deteriorating business conditions (figure 2.3). Without improving its scores on these key indicators, Iraq will find it increasingly difficult to grow sustainably and equitably.

Oil wealth has helped sustain a fragile political economy in Iraq. Instead of improving service delivery and public infrastructure, oil revenues have been used to expand public sector employment and transfers. Furthermore, a reliance on oil rents means the Iraqi government is less dependent on the nonoil economy and the demands of the general public. Growth in the nonoil economy is divorced from growth in the oil economy, except through the patronage network.<sup>1</sup> The ease with which oil income is generated and redistributed to maintain networks of power weakens the government's drive to pursue growth-enhancing reforms.

The recent conflicts in Iraq have had a significant economic and social cost. Iraq's per capita GDP was 18–21 percent lower in 2018 than it would have been without the conflict that began in 2014. Excluding Iraq's oil sector, which grew steadily during the conflict and somewhat masked its impact, Iraq's GDP was about 33 percent lower than it would have been (figure 2.4; see also annex 2.A). As discussed in chapter 1, Iraq's many conflicts over the years have also caused a severe loss of human capital (figure 2.5). Children in Iraq can now expect to complete only 6.9 years of schooling by age 18, well below the median for the Middle East and North Africa (MENA) region—and when adjusted for quality of learning, this amount is equivalent to only 4 years. The rate of participation in the economy is also low, with only about 42 percent of the working-age population engaged in the labor market. This rate is well below the median for upper-middle-income countries (UMICs) (57 percent) and for MENA countries (46 percent). And in 2017, Iraq's Human Capital Index was also lower than what would be predicted for its income level.

**FIGURE 2.3**

**Iraq's deficit compared with those of upper-middle-income countries on key economic indicators**

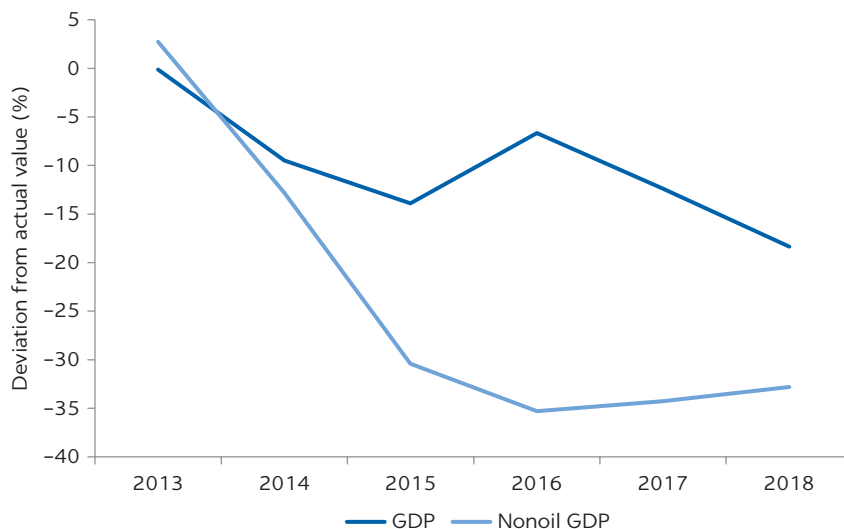


Source: World Bank, World Development Indicators.

Note: PPP = purchasing power parity. For the ease of doing business rank, economic complexity rank, and poverty rate, percentile world ranks are inverted (100 - actual percentile) to make them comparable with indicators such as the participation rate for which higher-percentile scores are better than lower-percentile scores. Iraq's US\$5.50/day poverty rate is 57.3 percent, the third-worst among upper-middle-income countries.

**FIGURE 2.4**

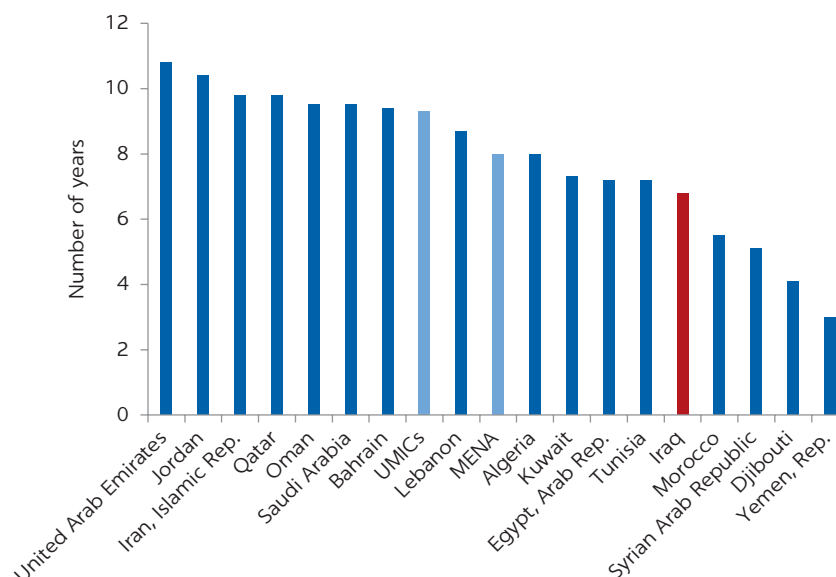
**Iraq's GDP per capita, actual and counterfactual, 2013-18**



Source: World Bank estimates.

FIGURE 2.5

### Average years of schooling, Iraq and other Middle Eastern and North African countries



Source: World Development Indicators.

Note: MENA = Middle East and North Africa; UMICs = upper-middle-income countries.

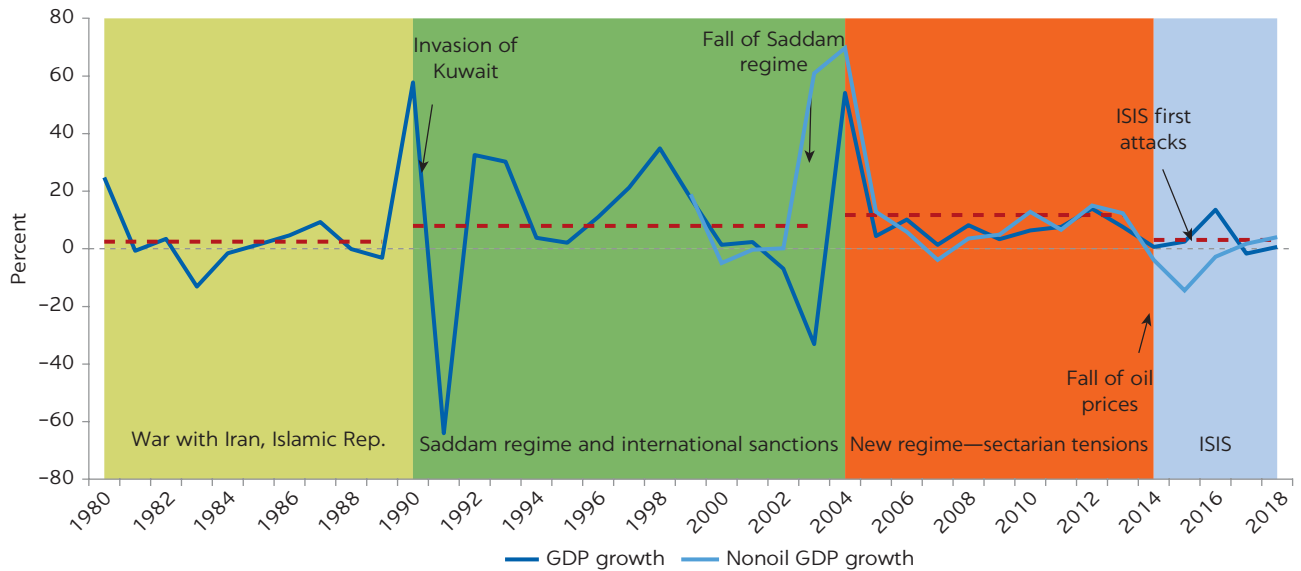
## PAST DRIVERS OF GROWTH (OR THE LACK THEREOF)

### Iraq's economic growth has been relatively robust but has masked significant volatility and weakness in the nonoil sector

Iraq's growth path over the past four decades can be decomposed into four main periods characterized by conflict, political instability, and oil price volatility (figure 2.6). These periods include the conflict with Iran (pre-1990), the Saddam regime and international sanctions period (1990–2003), the new regime starting in 2004 (2004–14), and the Islamic State of Iraq and the Levant (ISIS) attacks alongside the oil price collapse (2014–18). This study, and more specifically the analysis presented in this chapter, focuses mainly on the past two periods, starting in 2004.

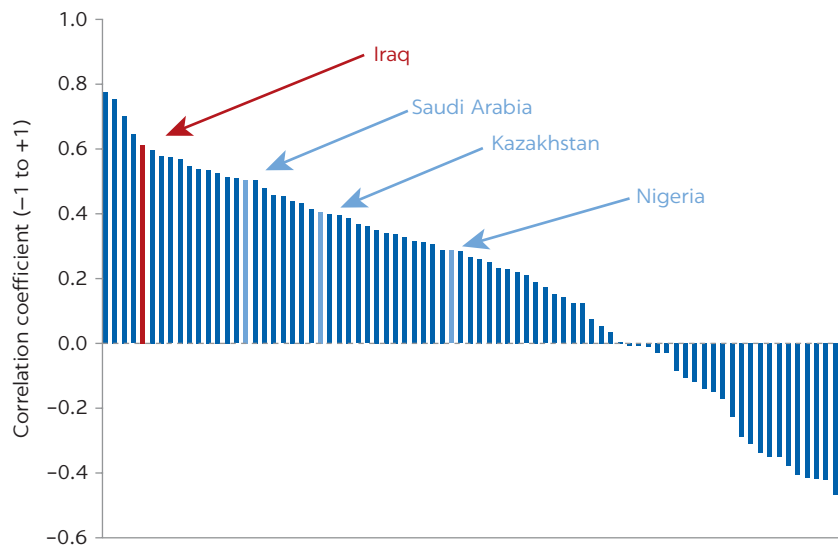
Iraq's GDP growth remains very volatile, reflecting oil peaks and conflict episodes that have reduced the country's potential output over time. The country's growth volatility rose by 80 percent in the 2014–18 period compared to 2005–13. Over the period 2006–18, the standard deviation of output growth in Iraq was about 70 percent higher than the median value for other resource-exporting countries; nonoil GDP growth was almost 175 percent more volatile. Output volatility concerns economists because it is closely associated with other bad conditions for development.<sup>2</sup>

The rigid and procyclical stance of Iraq's budget has enhanced the volatility of the country's economy. Among oil-producing countries, Iraq has one of the most procyclical budgets (figure 2.7). The budget includes a high level of rigid expenditures, particularly wages and transfers, and relies almost completely on oil revenues to fund them. This mix has been particularly problematic in recent years as oil prices have fallen. Although Iraq's fiscal balance averaged 1.1 percent of GDP over the period 2004–13, it fell to –2 percent of GDP in the period 2014–18. These averages, however, mask extreme volatility; the budget balance swung

**FIGURE 2.6****Decades of political instability and oil price volatility, 1980–2018**

Source: World Development Indicators.

Note: ISIS = Islamic State of Iraq and the Levant.

**FIGURE 2.7****Correlation of oil prices and government expenditures in oil-producing countries**

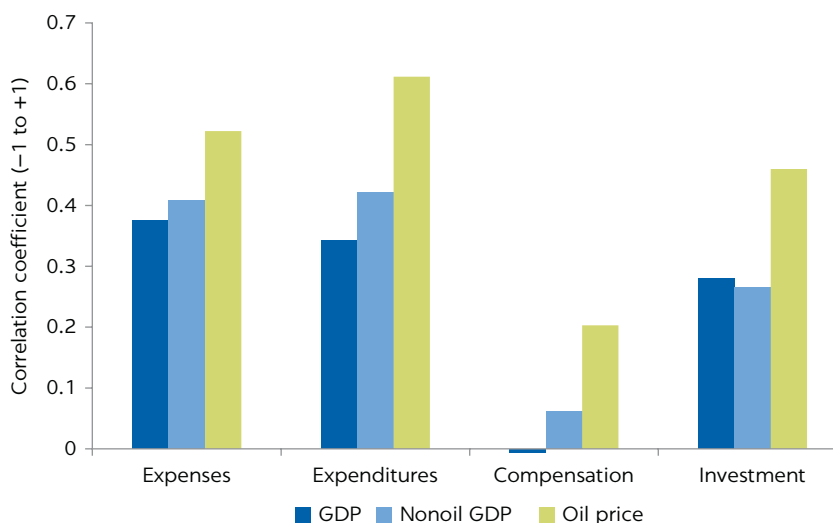
Source: World Development Indicators.

between -12.8 percent of GDP in 2015 and +11.2 percent in 2018. With the recent fall in oil prices, the 2020 budget balance is forecast to be -29.6 percent of GDP. The budget's rigidity, particularly where salaries are concerned, means that spending that could enhance Iraq's productivity must be cut when oil prices fall (as reflected in the relatively high correlation of investment spending to oil prices shown in figure 2.8). Spending has also been poorly targeted and ineffective at creating jobs or addressing inequality.

Because of its recent slow economic growth, Iraq is falling behind the GDP per capita of its peer countries.<sup>3</sup> Despite high population growth, Iraq's overall

**FIGURE 2.8**

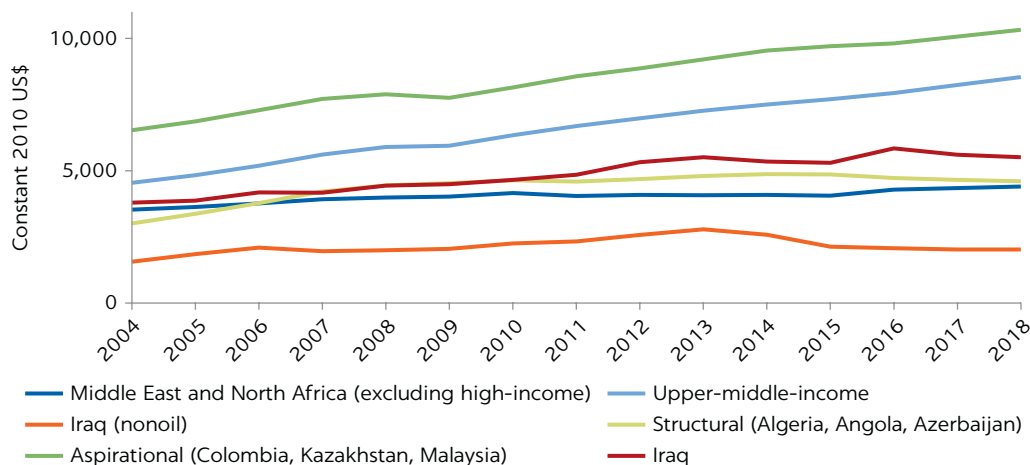
**Correlation of government spending to GDP, nonoil GDP, and the price of oil**



Source: World Development Indicators.

**FIGURE 2.9**

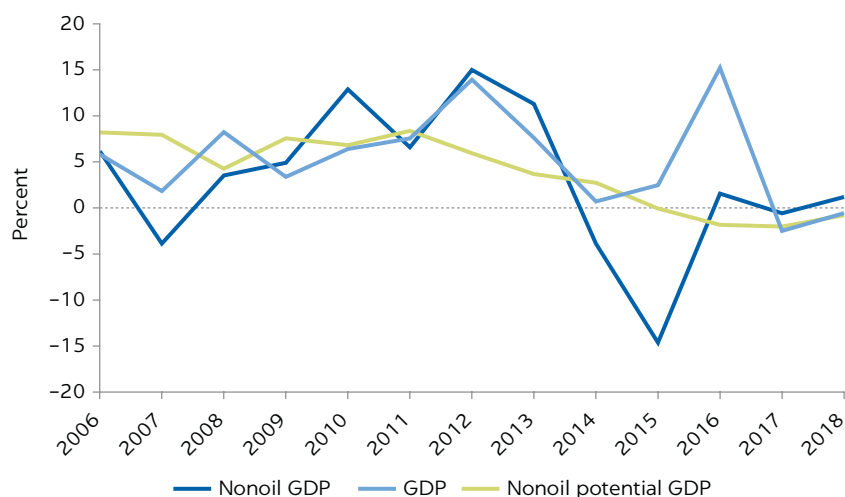
**GDP per capita, 2004–18**



Source: World Development Indicators.

per capita GDP grew at a robust 2.8 percent per year in the 2004–13 period, but growth dropped to only 0.6 percent in the 2014–18 period because of the oil crisis and political instability. In contrast, GDP per capita in upper-middle-income countries grew, on average, by 4.5 percent and 3.0 percent per year in the same periods (figure 2.9). As noted earlier, the growth of Iraq’s nonoil GDP has been particularly weak since 2013. Although some of the weakness in Iraq’s GDP growth reflects the 2014 oil price shock and the conflict with ISIS, the rest reflects a weakening of potential nonoil GDP, driven mainly by weakening total factor productivity (TFP) growth (figure 2.10). (See annex 2.B for details.)

FIGURE 2.10

**Nonoil GDP, potential and actual, 2006–18**

Source: World Bank estimates.

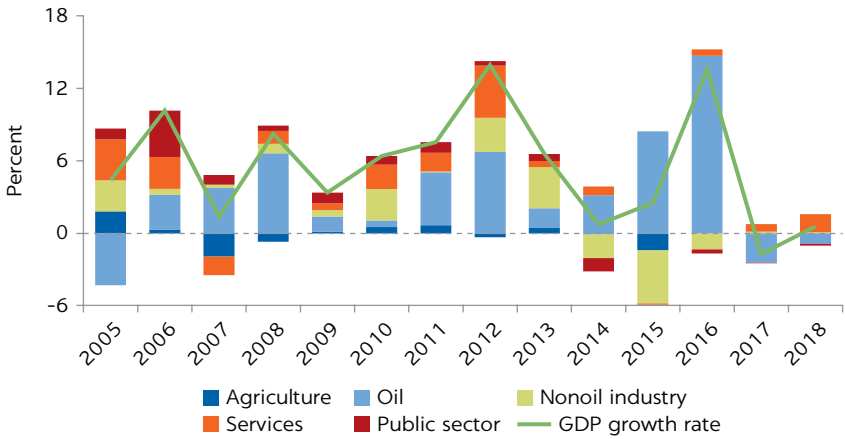
**Oil continues to dominate growth in Iraq, and productivity remains weak**

The main drivers of growth in Iraq have been oil production, investment, and population growth, not productivity. A supply-side growth decomposition of Iraq's GDP reveals that the oil sector has been its main driver since 2005 (figure 2.11). Decomposing GDP growth further into productivity and the factors of production, we can see that growth was driven by capital and labor inputs rather than productivity (figure 2.12). If we restrict the analysis to Iraq's nonoil economy, productivity's performance since 2013 is even worse: TFP fell by more than 5 percentage points. On the demand side, growth has been driven by oil exports and private consumption, with some contribution from investments linked to the oil sector.

Oil has become an even more important source of Iraq's economic growth since the most recent conflict began in 2014. The crisis severely curtailed the nonoil economy; almost all the growth in real GDP from 2014 to 2016 was driven by oil production. Nonoil sectors have been very weak over the past four years, particularly the service sector. The small amount of growth that occurred in that sector was led by retail trade and transportation and communications, nontradable sectors, which reflects the symptoms of Dutch disease. Looking more closely at the subsectors of Iraq's economy, both construction and agriculture have been hit hard by the instability, and agriculture's share of GDP fell by half after 2014. The public sector still represents a large share of the country's GDP, though smaller than before.

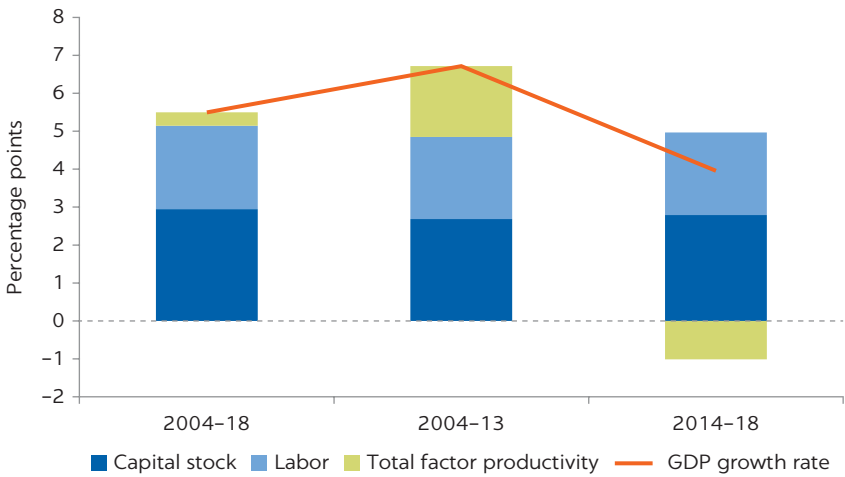
The oil sector also drove Iraq's growth in labor productivity, the main source of growth in value added per capita. Other potential drivers of growth, such as demographics and labor market variables like employment and participation rates, have been stable over the past decade (figure 2.13). Therefore, swings in GDP per capita reflect swings in labor productivity. At the aggregate level, any

**FIGURE 2.11**  
**GDP components, growth rates, 2005–18**



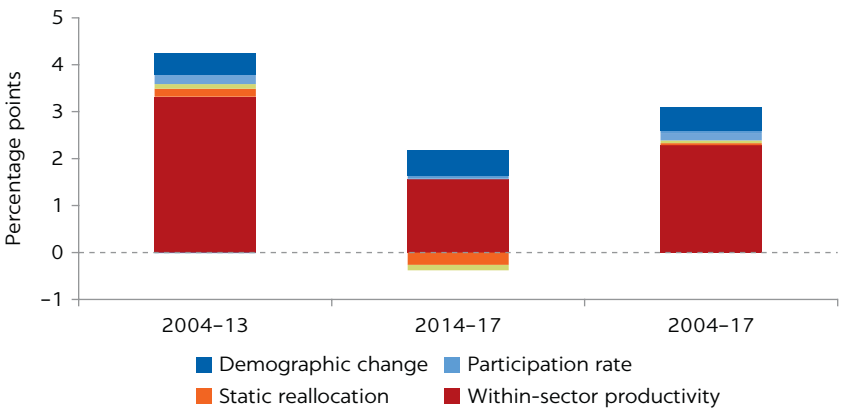
Source: World Development Indicators.

**FIGURE 2.12**  
**GDP growth decomposition, 2004–18**



Source: World Bank estimates using the Growth Expenditure Tool and data from World Development Indicators.

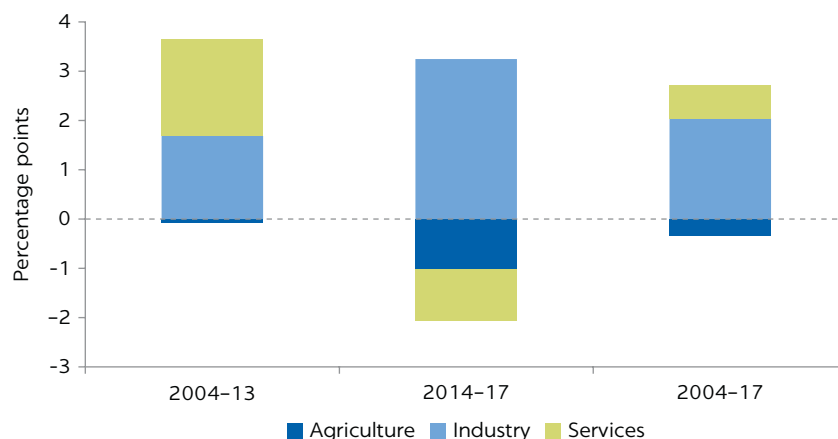
**FIGURE 2.13**  
**Growth decomposition of value added per capita, 2004–17**



Source: World Bank estimates using Job Tool and data from World Development Indicators.

FIGURE 2.14

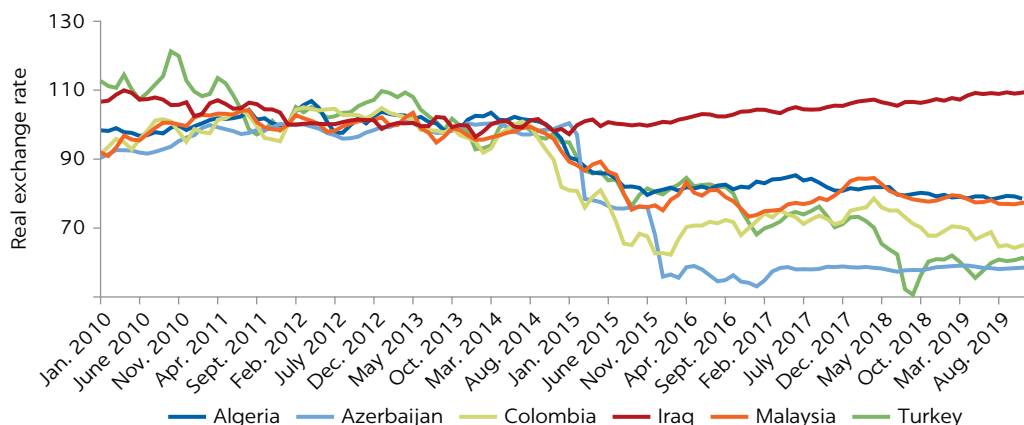
## Growth decomposition of value added per capita by sector, 2004–17



Source: World Bank estimates using Job Tool and data from World Development Indicators.

FIGURE 2.15

## Real exchange rates of Iraq and selected peers, 2010–19



Source: Data from the International Monetary Fund's International Financial Statistics database.

Note: January 2012 = 100.

movement in oil production translates into a large change in the overall productivity of labor. Examining the various sectors' contributions to value added per capita (figure 2.14), we see that most of the recent growth comes from the oil sector. If we subtract its numbers from the aggregate statistics, especially in recent years, the growth rate of value added per capita becomes much weaker, sometimes even negative.

The oil sector's dominance has considerably reduced the external competitiveness of the Iraqi economy by amplifying the Dutch disease phenomenon. Over recent years, Iraq's real exchange rate has appreciated while its structural and aspirational peers' exchange rates have depreciated (figure 2.15), which means that Iraq's tradable and more productive sectors have become more expensive compared to those of other countries and have hence lost competitiveness. This effect forms yet another roadblock to diversifying Iraq's export base away from oil (in addition to the bureaucratic and conflict-related challenges already faced by Iraqi exporters, which will be discussed in chapter 3). For example, as mentioned

in chapter 4, the increasing real exchange rate makes it difficult for Iraq’s agricultural exports to expand and compete in the region or more widely.

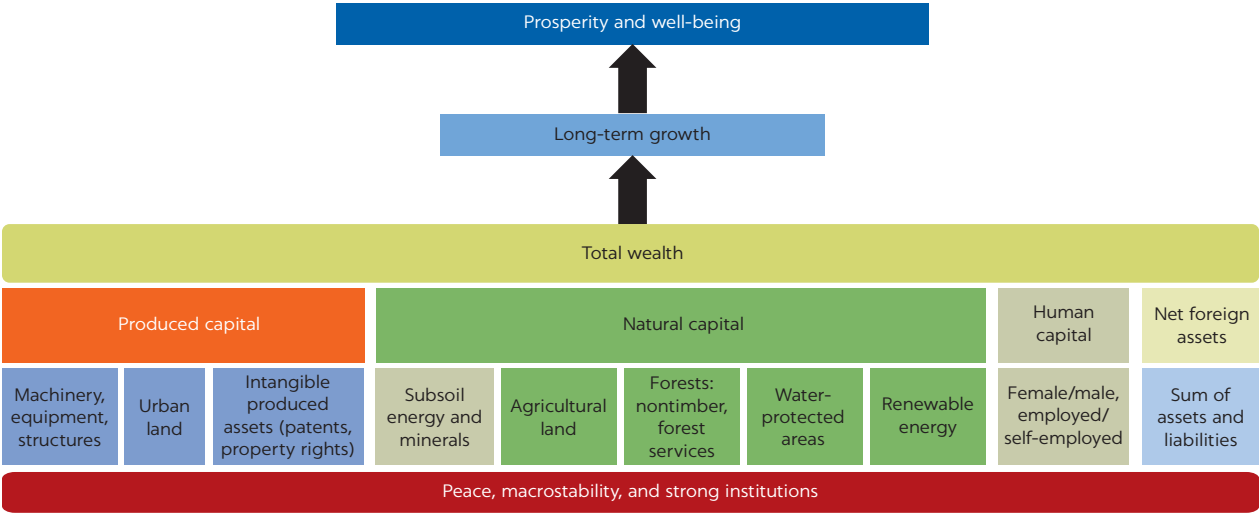
**Wealth creation in Iraq is overwhelmingly driven by oil; in contrast, its peers derive their wealth from human capital**

Lange, Wodon, and Carey (2018) provide estimates of a country’s wealth and its decomposition into three types of capital—natural, produced, and human capital—plus net foreign assets (figure 2.16). In the standards of national accounts, total wealth includes the following assets:

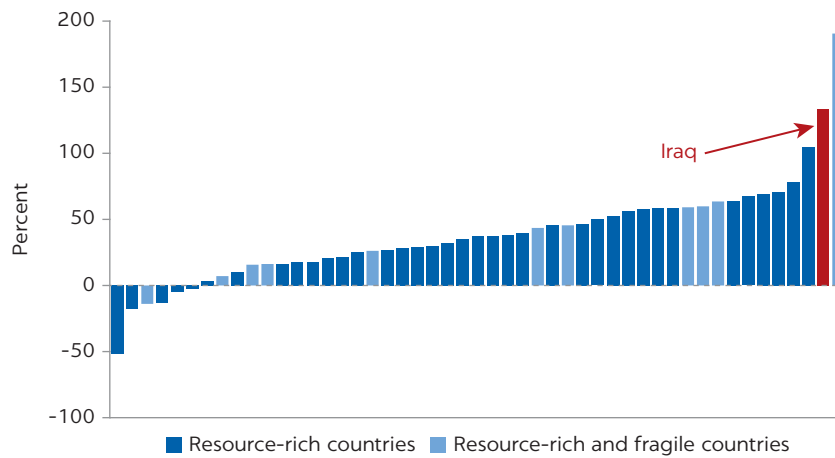
- Produced capital, which includes factories, machinery, equipment, transport vessels, physical infrastructure, buildings, and intangible assets such as patents and property rights.
- Natural capital, such as oil.
- Human capital, which constitutes the country’s people, their productive life expectancy, and their skills and capabilities. Human capital is a broad concept, and it goes beyond educational attainment, also capturing entrepreneurial spirit and the ability to innovate.
- Net foreign assets, the total net value of a country’s foreign assets and liabilities held by public and private entities.

Iraq’s oil wealth constitutes a substantial share of its total natural capital, generating an income that represents a significant share of the country’s GDP. Iraq’s per capita wealth grew rapidly until the most recent conflicts. In the period from 2005 to 2014, Iraq’s wealth grew by 133 percent, one of the highest rates among resource-rich countries and among resource-rich, fragile countries (figure 2.17). However, Iraq’s growth in wealth was driven mainly by the depletion of its oil reserves, in contrast to the growth of other upper-middle-income countries and selected peers, which came primarily from improving their stocks of human capital (figure 2.18).

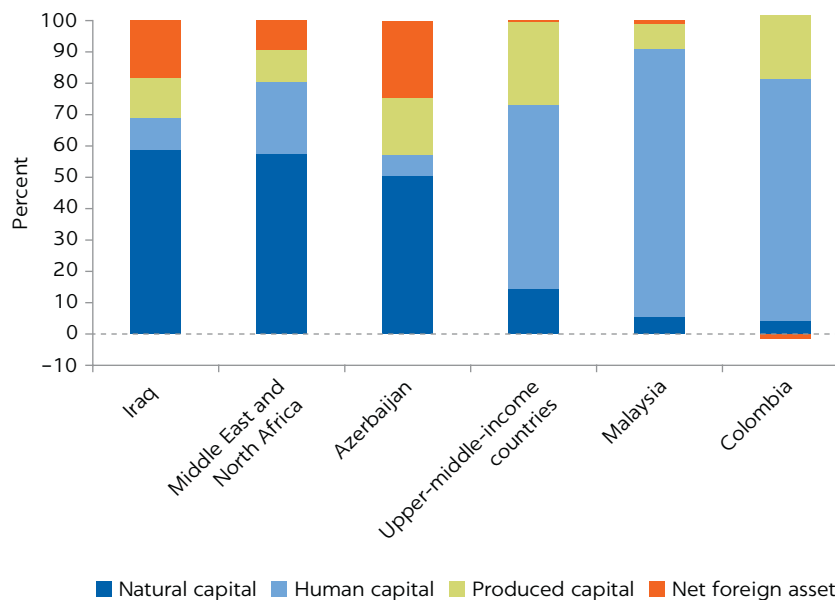
**FIGURE 2.16**  
**Macrostability, peace, and strong institutions must underlie prosperity and well-being in Iraq**



Source: Adapted from Lange, Wodon, and Carey 2018.

**FIGURE 2.17****Growth in per capita wealth, 2005–14**

Source: Lange, Wodon, and Carey 2018.

**FIGURE 2.18****Contribution to growth in per capita wealth by type of capital, 2005–14**

Source: Lange, Wodon, and Carey 2018.

**Development in Iraq's private sector and nonoil sector is held back by a range of regulatory and political factors**

Iraq's anticompetitive environment is a bottleneck for firm-level productivity and private sector development overall. Compared with its structural and aspirational peers, Iraq has a much riskier business environment that is more prone to cronyism and, especially, unfair competitive practices. The effects of this environment can be seen in the time and cost of trading across Iraq's

borders. Although there are few regulatory restrictions on such trade, the resources and time spent on import and export compliance are much higher in Iraq than in both its peers and neighboring countries, as is discussed in chapter 3. For instance, the importation of goods into Iraq is controlled and dominated by a series of state-owned companies run by the country's Ministry of Trade. This ministry controls the importation of food, construction materials, heavy machinery, spare parts, and other goods. The ministry also restricts the size and quantity of a range of imported goods.

Iraq's weak customs administration represents another serious nontariff barrier to trade with the country. Iraqi customs authorities and related systems are chaotic and vary among different border crossing points. The time spent at the border is therefore very long and volatile. Many customs procedures are paper-based, and some parts of the customs agencies work only half days. Corruption is also an issue, especially for important customs tasks such as valuation.

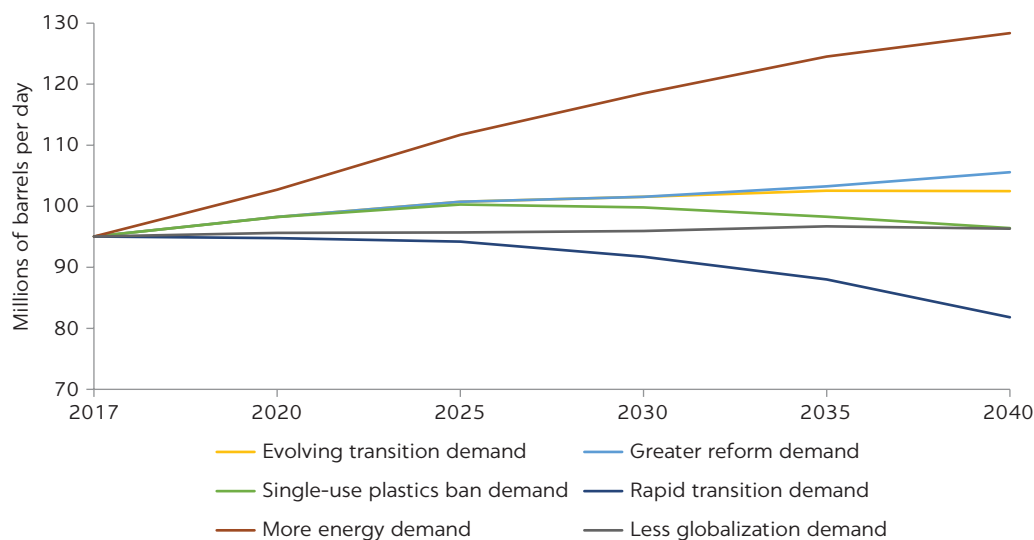
In addition, the quality of logistics in Iraq has deteriorated in recent years. Iraq's performance in the Doing Business Rankings has fallen markedly, especially regarding the "getting electricity" and "paying taxes" indicators.

## THE WAY FORWARD: HOW IRAQ CAN MAINTAIN ITS UPPER-MIDDLE-INCOME STATUS

Iraq may not be able to rely on oil to maintain its standard of living in the future. Although Iraq has the world's fifth-largest proven oil reserves, it is estimated that its reserves will last only 80 to 85 more years. And if global demand for oil slows because of technological improvements or climate change considerations, the shift to an economy not reliant on oil may need to happen much faster. Current forecasts of global oil demand by 2040 vary by as much as 50 million barrels per day, or about one-half of current global oil demand (figure 2.19).

FIGURE 2.19

Range of uncertainty about future oil demand, 2017–40



Source: BP 2019.

At that point, Iraq's nonoil economy must be able to sustain the country's upper-middle-income level.

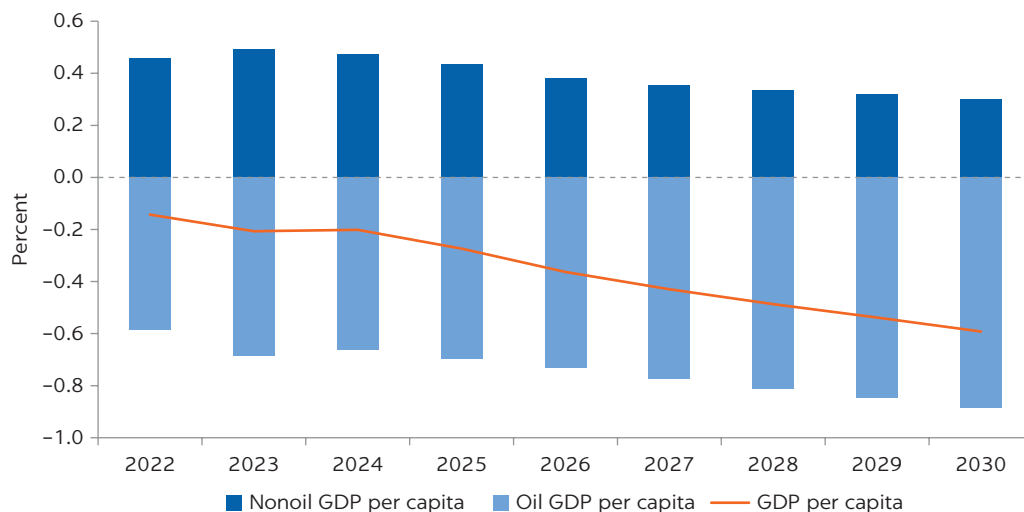
As discussed earlier in this section, decomposing Iraq's GDP per capita growth into the contributions from oil and nonoil sectors shows the challenge Iraq faces to its future growth. Examining longer-term projections (to avoid issues of short-term cyclical fluctuations), the growth of GDP per capita in Iraq is projected to be negative in the near to medium terms (figure 2.20). Two factors are driving this result. The first is a slowdown in nonoil GDP growth, because Iraq's TFP growth is assumed to converge to its historical average of about 0.1 percent per year. The second is that growth in oil production is also projected to decline, from about 1.5 percent per year in 2022 to only 0.9 percent in 2030. Furthermore, these projections do not incorporate the uncertain outlook for global oil demand. Additional declines in demand caused by technological shifts or climate change policies will further weaken Iraq's growth outlook.

Given the uncertain outlook for both oil production and productivity, Iraq can increase its GDP per capita through improvements in investment and its labor force. GDP can be decomposed into several key inputs, including physical capital, the labor force participation rate, and human capital.<sup>4</sup> We compare Iraq's values for some of these key indicators against the regional MENA average, the UMIC average, and the values of relevant peers (figure 2.21). For this analysis, we assume that population and productivity are unchanged in each of the following scenarios.

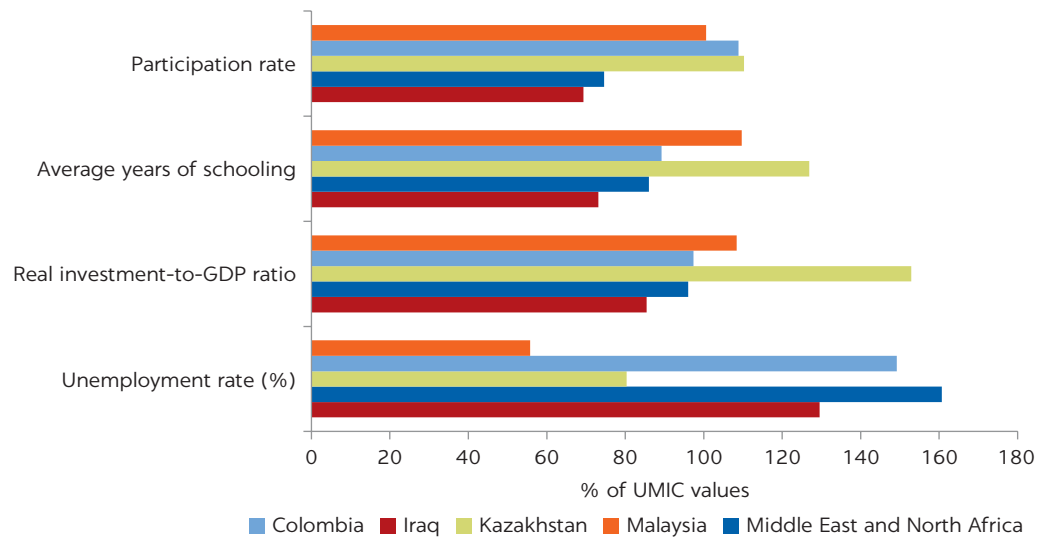
Reaching UMIC averages on these key indicators would markedly raise Iraq's GDP per capita. Raising Iraq's participation rate to the UMIC average would alone increase the country's GDP per capita by almost 31 percent. However, Iraq's male participation rate already ranks around the median for all countries, slightly above the average level for upper-middle-income countries. This improvement would thus require a large increase in the female labor force participation rate, which ranks third-lowest among countries with data (above only war-torn Yemen and the Syrian Arab Republic) and has barely risen since 1990 (from a low of 8 percent to the current level of 12 percent). Much would have to change for Iraq to substantially improve at this indicator.

**FIGURE 2.20**

**Projections for Iraq's GDP per capita, 2022–30**

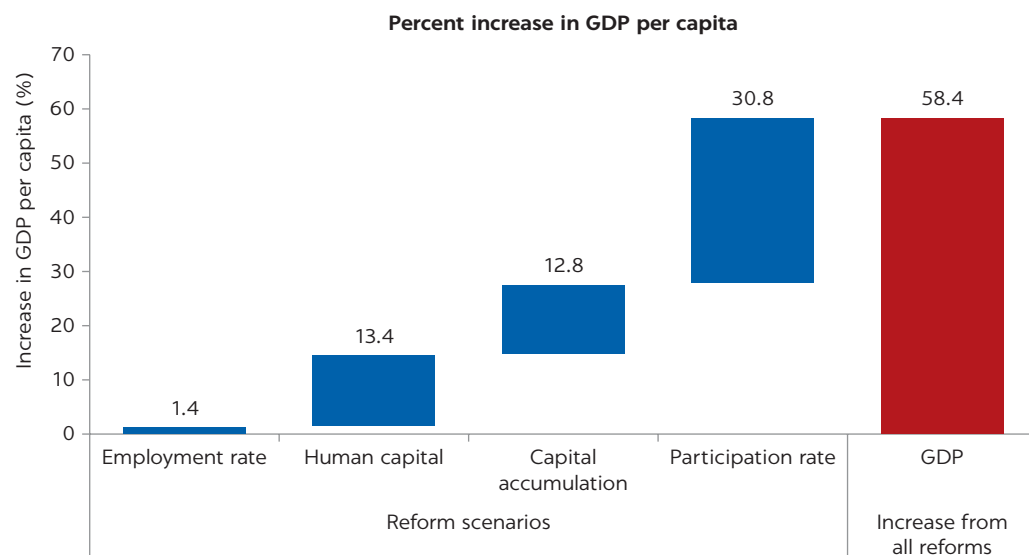


Source: World Bank calculations.

**FIGURE 2.21****Key supply-side inputs, Iraq compared with selected peers**

Source: World Bank estimates using World Development Indicator data.

Note: GDP = gross domestic product; UMIC = upper-middle-income country.

**FIGURE 2.22****Reform scenarios in Iraq**

Source: World Bank calculations.

In January 2019, the Iraqi government committed to raising the female participation rate by 5 percentage points by 2025. However, even if this goal is achieved, Iraq's female participation rate would improve only to the sixth-lowest among all countries. Additionally, Iraq's oil sector is both male dominated and not very labor intensive. This means that employment opportunities for women are highly concentrated in the public sector. Given the outlook for oil prices and Iraq's current budget position, it will be difficult to significantly increase female public sector employment.

Raising Iraq's investment rate and the quality of the country's labor force to the UMIC averages would also raise Iraq's GDP per capita by about 13 percent each (figure 2.22).

To achieve these outcomes, Iraq would need to implement reforms with payoffs in the medium term. As discussed in chapter 1, Iraq's political equilibrium is designed to favor the very short term. There is no mechanism by which these revenues can be saved or used for productivity-enhancing measures, such as improving the educational system or upgrading public infrastructure. To overcome this deficit, Iraq needs to build public institutions, raise citizen awareness of and engagement with economic issues, and build mechanisms for government accountability.

The previous two Iraq Country Economic Memorandums (CEMs) proposed a range of measures and reforms that Iraq could take to improve its economy. However, Iraq's lack of progress on these reforms is evident, and the country's situation has markedly deteriorated in most if not all socio-economic aspects. Compared with long-run growth forecasts from around the time of the 2006 CEM, Iraq's GDP is about one-third smaller than projected (see annex 2.D). Failure to implement the political and economic reforms proposed in this report could result in a similar decline in the coming decades.

### For Iraq to maintain its UMIC status in a sustainable way, it must diversify its national asset portfolio

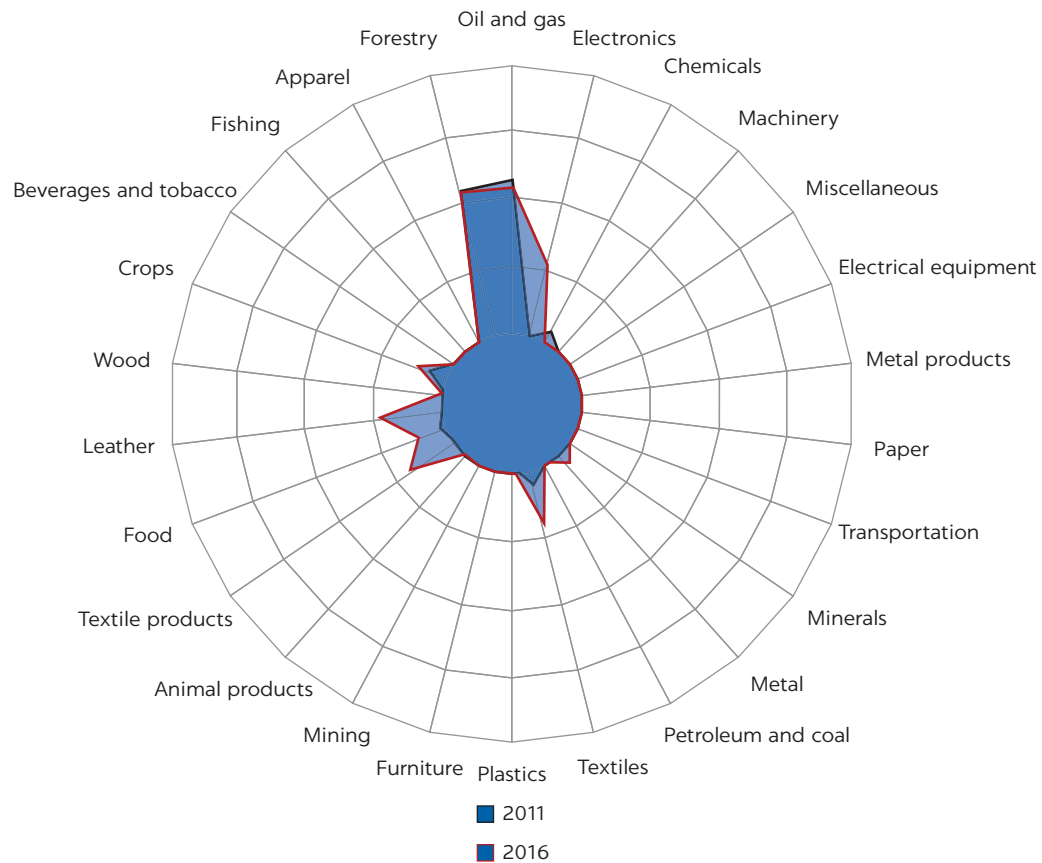
Iraq's export basket has become more concentrated over time, reflecting the country's deteriorating capabilities—namely, its physical inputs, human capital, technology, and governance. The country is also far from its peers in terms of economic complexity, and it is only comparable to Angola from the group of structural and aspirational peer countries selected for the CEM (figure 2.23).

**FIGURE 2.23**  
**Growth and fitness trajectory, 2004–15**



Source: World Bank calculations using World Bank Economic Fitness database.

Note: Data show 2004–15 values for Iraq and comparator countries (for example, IRQ4 = Iraq economic fitness ranking in 2004). AGO = Angola; AZE = Azerbaijan; COL = Colombia; DZA = Algeria; IRQ = Iraq; KAZ = Kazakhstan; MYS = Malaysia.

**FIGURE 2.24****Normalized sector fitness rank, 2011 and 2016**

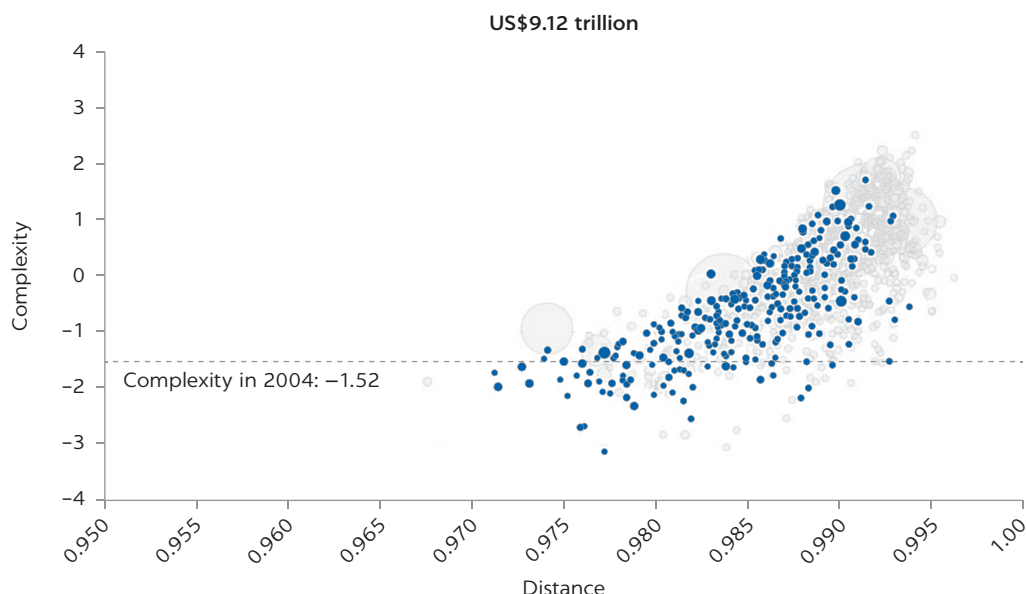
Source: World Bank calculations.

Aside from extractives, Iraq's productive capabilities remain concentrated in low-complexity industries such as leather, textiles, food, and crops. But despite their low complexity, new opportunities exist for Iraq in these sectors: they have seen improvement in their economic fitness over time and can act as a catalyst for diversification (figure 2.24).

With Iraq's diverse resource base and large rural population (11.3 million people), the country's agriculture sector can make a significant contribution to diversifying the economy and strengthening the private sector, as is further discussed in chapter 4. Agriculture is one of the largest nonoil sectors of Iraq's economy (composing 5 percent of total GDP), is the country's largest source of employment (employing approximately 20 percent of workers), and is dominated by private producers and market agents. During the short period of relative stability from 2008 to 2014, Iraq's agricultural GDP grew by 40 percent in real terms, and the industry had much diversification potential (figure 2.25). Although the sector regressed after 2014, in response to the dual crises caused by ISIS and falling oil prices, Iraq's improved political stability and increased support from the international community have created an opportunity for further growth in agriculture.

FIGURE 2.25

## Iraq's diversification feasibility chart, 2004



Source: Atlas of Economic Complexity.

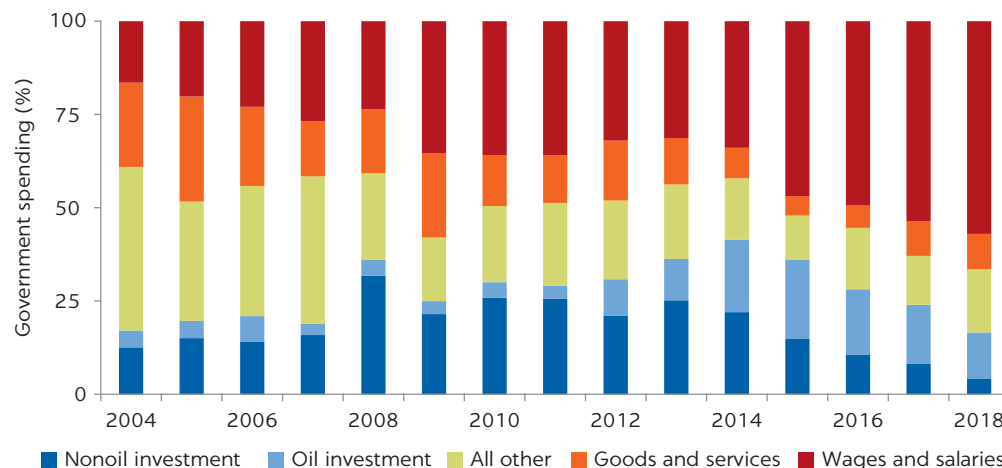
Note: The feasibility graph displays a country's opportunities for diversification on the basis of what it currently exports. The agriculture sector, represented by blue circles, displayed the most potential, and it was also the most feasible in 2004.

However, Iraq's capacity to produce tradable merchandise, even for its own domestic economy, has deteriorated over time. The share of agriculture and manufacturing in the country's GDP, which in recent decades had approached 30 percent, has now declined to less than 6 percent. In earlier decades, Iraq's production of nonoil merchandise followed a pattern consistent with Dutch disease: agriculture and manufacturing would decline as the price of oil rose and expand again as the price of oil fell. However, this pattern was broken sometime in the 1990s, and when oil prices fell sharply beginning in 2013, the production of tradable goods did not recover (though this is at least in part because of the ISIS conflict).

With the end of the ISIS conflict, Iraq can invest in infrastructure to support diversified development. Iraq's investment rate is below those of regional and income peers. Importantly, a large share of government investment in Iraq is dedicated to the oil economy, and this share has only increased with the recent fall in nonoil investment (to 74 percent in 2018, compared with about 12 percent in 2008 and 26 percent in 2004). The share of government spending on investment has also fallen in recent years. In 2014, investment spending was about 41 percent of government spending, but it fell to about 17 percent in 2018 (figure 2.26). To help the nonoil economy grow in the postcrisis period, Iraq can invest in productivity-enhancing infrastructure and critical services. Without these reforms, operational costs for businesses will rise and service delivery will continue to be poor.

However, Iraq's ability to invest in public infrastructure will be constrained by the country's fiscal position. As global oil demand falls in the coming years and decades, Iraq will require sizable fiscal consolidation. This change will involve many concurrent steps, such as raising nonoil revenues and reducing

FIGURE 2.26

**Government spending in Iraq, 2004–18**

Sources: World Bank Development Indicators; IMF 2019b.

government expenditures (Mirzoev et al. 2020). One part of this adjustment might be the establishment of fiscal rules, such as a ceiling on the current primary spending of the central government, which has been proposed by the International Monetary Fund (IMF 2019a). Such a rule would constrain spending on salaries and subsidies while creating space for investment. Furthermore, Iraq will have to increasingly rely on private sources for investment in infrastructure. Tackling corruption, improving the business environment, and reforming the financial sector will be key to attracting foreign direct investment, especially in nonoil sectors, and mobilizing domestic savings into investment.

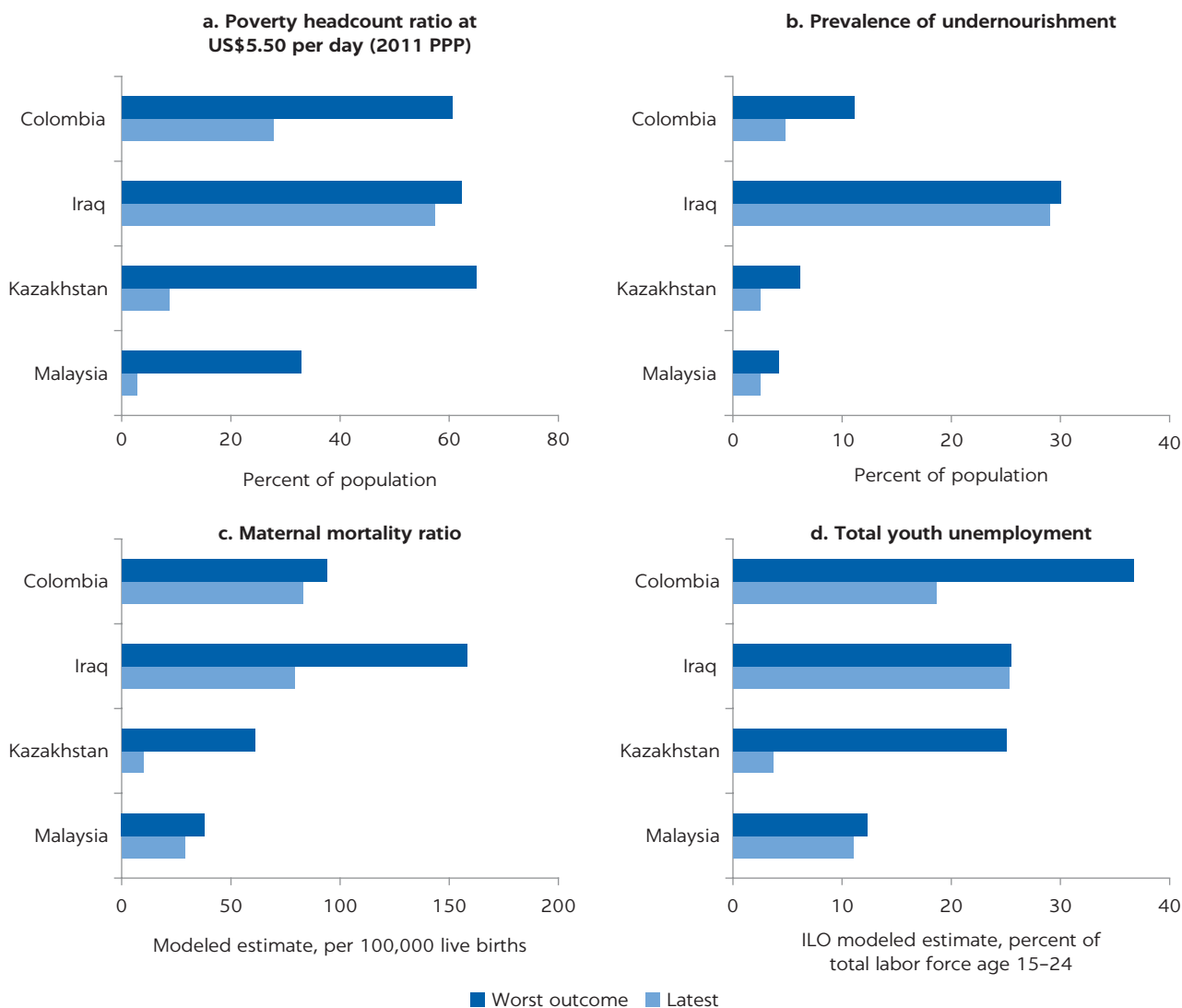
Iraq's aspirational peers show both the country's postoil potential and the long road ahead. As shown earlier in this chapter, Iraq's economy could be much larger if it had similar levels of participation, investment, and productivity to its peers. Furthermore, the benefits of economic diversification are not only economic but also social. Figure 2.27 shows the values of several Sustainable Development Goal measures for Iraq and its aspirational peers: both the worst outcome recorded for each country and the country's current status. For example, Kazakhstan's poverty headcount (at a poverty rate of US\$5.50 per day) was once 64.9 percent but is now only 8.6 percent. To obtain outcomes in line with other (more diversified) UMICs, Iraq must travel a great distance—but not an impossible one.

### **Improving governance and security are crucial for economic success**

For Iraq to diversify away from oil, it will need to improve its governance and the quality of its institutions (figure 2.28). As described in chapter 1, the country's current system relies on using Iraq's oil wealth and demographic divisions to maintain power for elites through patronage. This system has weakened citizens' faith in their government and left them no way to hold it accountable for its failure to provide needed public goods. Furthermore, the government's weak response to public demands for accountability continually undermines its legitimacy.

FIGURE 2.27

## Social indicators in Iraq and aspirational peers



Source: World Development Indicators.

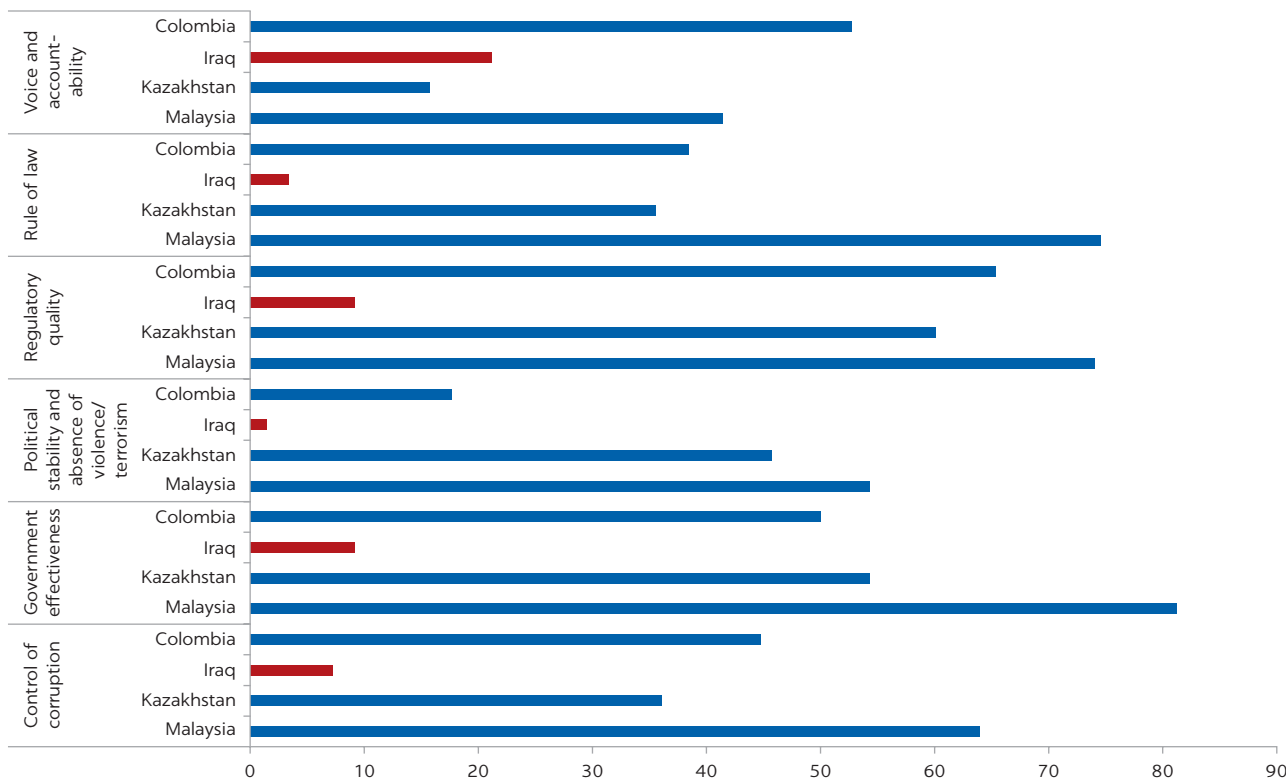
Note: ILO = International Labour Organization; PPP = purchasing power parity.

In order to raise income levels, all countries must improve their governance, but resource-rich economies must do so earlier in their development so that their resource wealth can be put to positive use. The examples of Chile and the República Bolivariana de Venezuela are salient. Since the 1980s, Chile managed to formalize rules for managing its resource revenues, freeing fiscal space for spending on infrastructure and social services. In contrast, the República Bolivariana de Venezuela used its resource revenues to expand public sector employment. In 1983, Chile's GDP per capita was only three-quarters of the República Bolivariana de Venezuela's. It is now more than 1.5 times as large (Gill et al. 2014).

In addition to not providing basic goods and services, the Iraqi government has also failed to enable job creation in the private sector. The ease of collecting oil revenues has reduced the government's urgency and desire to foster private

FIGURE 2.28

## Worldwide governance indicators, Iraq and aspirational peers



Source: Worldwide Governance Indicators, <https://info.worldbank.org/governance/wgi/>.

sector development. As such, Iraq's existing private sector is seen as an opportunity to exert political influence instead of a force for inclusive growth.

A key symptom of Iraq's weak governance and fragility is the extent of corruption, bribery, and nepotism in its government. The hiring of unqualified personnel through nepotism and political favoritism has weakened the technical capacity and discipline of the civil service and raised expenditures on salaries, crowding out funding for services (as explained in chapter 1).

The prevalence of corruption and governance failures has left Iraqis distrustful of and unhappy with their government, as shown by the Gallup World Poll<sup>5</sup> and Arab Barometer<sup>6</sup> surveys. In a country beset by conflicts (internal and external), frustration with perceived corruption, lack of security, and economic instability can be key to determining accountability and confidence in the state. Certain populations, especially those that have been traditionally marginalized, have a greater likelihood of being excluded from public services and economic opportunities.

In summary, Iraq's various governance and corruption issues show why previous reform efforts have failed. Unless Iraq's weak institutions and governance are embedded in the design of any reform, even the best technical efforts are unlikely to succeed.

Iraq's central bank shows the possibility of a well-functioning institution in Iraq. The Central Bank of Iraq (CBI) was established in 1947, and its role as an independent regulator and supervisor was formalized under the Central Bank of Iraq Law of 2004. Its main objectives are to maintain domestic price stability and promote a competitive and stable financial system. The CBI has managed to

partially deliver on one of its key mandates, ensuring price stability. Median inflation in Iraq for the past 10 years has been kept at about 1.1 percent (year-on-year) while core inflation has been 1.4 percent (year-on-year), and the US dollar peg to the Iraqi dinar was effectively maintained in spite of the country's challenging macrofiscal and sociopolitical environments. The CBI is also working to improve the regulatory and supervisory framework for its licensed entities, with technical assistance and support from the World Bank and the International Monetary Fund (IMF) to align and update its laws and regulations with international standards, to build on its supervisory powers, develop human capital, and invest in information technology infrastructure and capacities to ensure effective supervision and oversight.

### **Increasing competition could revitalize Iraq's economy**

To bring about future prosperity, Iraq needs to invigorate its private nonoil economy. One approach to doing so would be to inject more competition into the economy, improving efficiency and reducing informality. Competition (firms competing against each other) and contestability (the ease of entry of new firms into the market) are essential to creating economic opportunity. Increasing competition can also help raise household incomes by reducing prices and incentivizing technological progress. Thus, competition can not only help drive economic growth but also help reduce inequality. And for competition to work, there must be contestability in Iraq's markets: it must be easy for firms to exit and enter markets as opportunities arise.

However, Iraq's economy remains highly centralized and heavily dependent on state-owned enterprises (SOEs). These SOEs have a complicated and largely opaque impact on government finances.<sup>2</sup> In addition to commercial objectives, some SOEs pursue public good—promoting investments in infrastructure, health, and education. SOEs are also used to achieve political and social objectives such as employment generation, income distribution, and control over natural resources and other strategic sectors, often at the expense of productivity and profit. The presence of SOEs complicates the competitive nature of most markets in Iraq. When an SOE is involved in a market, firms may face different sets of rules, depending on whether they are public or private, or connected or not to the ruling elites.

Previous attempts at privatizing Iraq's SOEs failed; the state renationalized most of the privatized companies. Iraq's strong position in the oil economy, its prohibition of non-Arab foreign investors, and the United Nations (UN) embargo on the country have left the SOE sector starved of assets and lacking raw materials. Compounding this already difficult situation is Iraq's state of conflict and fragility since 2003. The destruction of many factories, the poor business environment (*de facto* and *de jure*), and insufficient investment continue to hamper growth among both private and state-owned nonoil enterprises and to stifle company performance.

Because well-functioning markets cannot be taken for granted, good antitrust legislation and enforcement are essential in any economy. Establishing these institutions is particularly challenging in Iraq, with its weak governance and accountability. The lack of them places a big burden on the Iraqi economy while substantially benefiting political and economic oligarchs. Although Iraq does have a competition policy, it does not have any competition authority to enforce the policy. Both the independence and the accompanying accountability instruments of the Iraqi competition authority should be significantly strengthened.

## CONCLUSION

With the recent fall in oil prices and the COVID-19 outbreak, Iraq must overcome an incredible set of challenges to maintain its current level of prosperity. Even in normal circumstances, countries often find it difficult to diversify their national asset portfolios away from natural resources; Iraq, however, must do so in a very fragile and unstable political and social environment.

For any of its reforms to be successful, Iraq must first establish peace and stability in the country. Without this base to build upon, even the best technical advice and solutions will likely fail or even worsen social tensions and conflict. Iraq suffers from two sources of fragility: the political settlement between its factions and the way the state and society interact (as described in chapter 1). This fragility has left Iraq muddling through a string of crises and conflicts. Without a change in this dynamic, the root cause of both ISIS and citizen disillusionment, Iraq will be unable to pursue a path to growth in the short to medium terms.

Upon a foundation of peace and stability, Iraq must work to diversify its economy away from oil. The Iraqi government can help this process in several ways. First, it can prioritize investment spending on infrastructure to support the nonoil economy. Second, it can improve the competitive environment by allowing genuine competition and easing entry into different markets. And third, it can improve the quality of its institutions and public services, which would reduce corruption and improve the overall business climate.

In a nonoil economy, Iraq's prosperity will be driven by the quality of its workforce. Over recent decades, amid the relative ease of pursuing oil wealth and continuous conflict and sectarian tension, Iraq's human capital has deteriorated. Iraq must invest in its education system, improving not only the level of educational attainment but also the quality of the learning attained. In particular, it must invest in the education attainment of women, who lag men in areas such as literacy.

Iraq's future well-being will be shaped by its youth and its women. Iraq's growing youth population has the potential to drive the nonoil economy forward. However, as mentioned in chapter 1, the country's current political and economic structure will struggle to produce the high-quality jobs that this cohort will demand. Additionally, Iraq has the potential to tap a huge pool of female workers. With one of the world's lowest female labor participation rates, Iraq can dramatically increase per capita incomes by engaging more of its women in the labor force.

As revealed in this chapter, if Iraq could more closely resemble a more traditional upper-middle-income country, it could dramatically increase the welfare of its population. Although Iraq has relatively high income per capita, by all other metrics it more closely resembles a fragile, low-income country. By investing in its institutions, its infrastructure, and its people, Iraq could not only increase its income per capita by several orders of magnitude but also improve its social and environmental outcomes. However, if Iraq passes up this opportunity to reform, it faces a future of stagnant or falling living standards.

## ANNEX 2.A: COUNTERFACTUAL GDP CALCULATIONS

The synthetic control method (SCM) was developed by Abadie and Gardeazabal (2003) and Abadie, Diamond, and Hainmueller (2010). This approach avoids the arbitrary selection of a control group by relying on a combination of comparator countries that best approximate the characteristics of the country that is exposed to the shock being studied. A combination of comparator countries is likely to produce a better control or comparison group for the exposed country than would any single country.

By checking the preshock differences between the outcome variable for Iraq and the synthetic Iraq we generate as a control, we can judge the quality of our control group. We can then create counterfactual outcomes for Iraq, controlling for the effect of recent conflicts, by identifying the comparator countries that best predict the historical development of Iraq prior to the conflicts. This process produces a set of weights for each country (most end up being 0, because the corresponding countries are not relevant), and these weights are used to construct a synthetic Iraq series that is based on the actual outcomes for the comparator countries during the period of the conflict.

### Specification and data

The following variables were included in our SCM analysis: oil rents, rule of law, the average inflation rate, and GDP per capita. The analysis relies on a cross-country panel data set for the period between 2005 and 2018. Our outcome of interest is real GDP per capita, but we also employ the technique to observe the effects on population growth. Our data were sourced from the World Bank's World Development Indicator database. Our specification is a common one for cross-country growth simulations and was most recently used by the IMF in an SCM estimation of reform effects (Adhikari and Alm 2016).

### Detailed methodology

We first create a synthetic version of Iraq by constructing a weighted sum of other countries with similar characteristics and outcomes as Iraq. We define  $Z_1$  as a vector of variables for Iraq and  $Y_1$  as the same vector but for the other countries in our sample. We calculate the matrix of weights  $W$  so as to minimize the following formula:

$$(Z_1 - Y_1 W)' V (Z_1 - Y_1 W).$$

$V$  is a diagonal matrix, the values of which reflect the relative importance of the different growth predictors.

After minimizing the above formula, we can calculate the counterfactual Iraq's GDP per capita according to the formula

$$X_1^* = X_0 W^*,$$

where  $X_1^*$  is the counterfactual real GDP per capita for Iraq and  $X_0$  is the matrix of real GDP per capita for the control countries.

The countries with the largest weights, in descending order, are Turkmenistan, Chad, the Democratic Republic of Congo, and the United Arab Emirates.

## ANNEX 2.B: POTENTIAL GDP CALCULATION

Productivity contributed negatively to economic growth in Iraq in recent years, and under a no-reform scenario, potential growth will remain sluggish. This annex models potential GDP for Iraq, especially for the nonoil economy. Economy-wide potential output is described with a simple Cobb-Douglas production function. A standard function includes capital stock, employment, and a residual (the growth in GDP unexplained by observed increases in factor inputs, often labeled as TFP).

This model uses nonoil potential GDP to calculate a nonoil output gap in its estimates. We assume that the price dynamics within Iraq are influenced directly by nonoil factors of production, given that most of the country's oil is exported. Oil affects prices indirectly, only inasmuch as it affects wealth and government spending of oil revenues. Nonoil potential GDP is expressed using TFP, structural employment, and the capital stock:

$$Y_{noil,t} = A_t N_t^\alpha K_t^{1-\alpha},$$

where  $A$  is trend TFP;  $N$  is structural employment, or  $[(1 - U_t^*) \times LFPR \times LF^{1564}]$ ;  $U_t^*$  is the natural rate of unemployment (usually determined using the equilibrium solution to labor demand and labor supply);  $LFPR$  is the labor force participation rate;  $LF^{1564}$  is the working-age population; and  $K$  is the capital stock (calculated using the perpetual inventory method). The share of labor,  $\alpha$ , is set to 0.7, a standard assumption (see Burns et al. 2014). We use this simplifying assumption because of the difficulty of obtaining the share of labor income in Iraq's nonoil GDP.

Alternatively, one can express economy-wide potential GDP as nonoil potential GDP plus oil gross value added (GVA), where oil GVA is assumed to be produced at its potential:

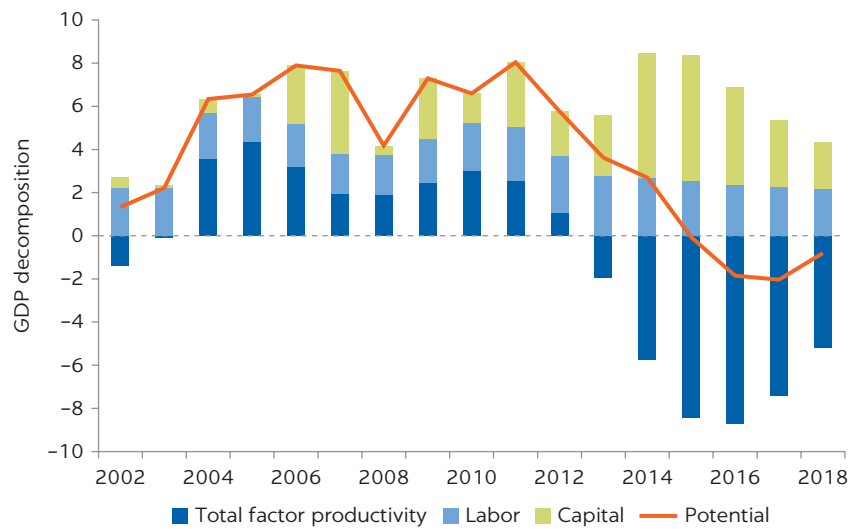
$$Y_t = Y_{noil,t} + O_t.$$

For long-run trends and policies associated with structural change, it is useful to decompose potential GDP instead of actual GDP. The raw TFP calculations from actual GDP show significant variations from year to year. This variation is caused partly by noise in measuring GDP and partly by missing important variations in the factor inputs (e.g., when employment is measured using labor force surveys). Furthermore, policies affect both cyclical and structural variants of output, whereas the focus here is on the long run.

Figure 2.B.1 summarizes potential GDP and its decomposition into input factors for the 2002–18 period. TFP contributed negatively to growth in recent years, because the conflict with ISIS has significantly damaged the nonoil economy. Although investment growth has been strong in recent years, it has been focused more on expanding oil production and output than on improving infrastructure and other productive capital for the nonoil sector (as can be seen in the difference between nonoil and total potential GDP growth shown in figure 2.B.2).

**FIGURE 2.B.1**

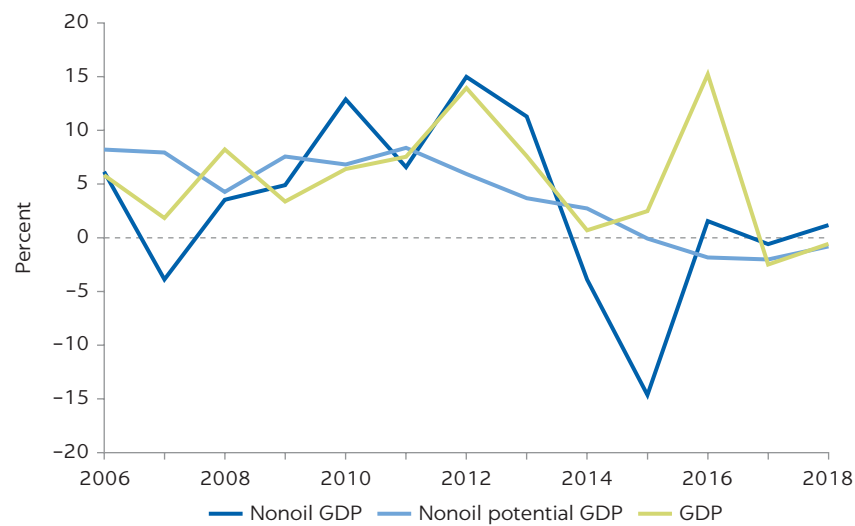
**Potential GDP decomposition, 2002–18**



Source: World Bank calculations.

**FIGURE 2.B.2**

**GDP and potential GDP growth path, 2006–18**



Source: World Bank calculations.

## ANNEX 2.C: SELECTING IRAQ'S PEERS

To understand a country's progression along its development path and bring to light its relative performance, opportunities, and obstacles, it is crucial to place its outcomes in the proper context. Typically, when analysts want to understand how a country is performing, they compare it with its neighbors or other countries in the region, as if geographical proximity were the defining characteristic of comparability. Instead, we determine Iraq's binding issues and combine them in a data-led approach to identify structural peers across the globe that can provide a more appropriate benchmark. In addition to Iraq's structural peers, we also identify aspirational peers—countries that possess similar structural conditions to Iraq but have evolved and performed better than it, which offers us an entry point for asking how these peers managed to do so. Using these comparators, along with other standard or custom comparator groups (commodity exporters, island states, small states, low-income states, etc.), we can place every development outcome of a country in a context that can help build evidence-based stories.

For the 2020 Iraq CEM, we used the World Bank's Find My Friends Excel tool. This tool helps identify statistical similarities between countries across the globe, making it easy to compare the macroeconomic, fiscal, debt, and human development outcomes of a country with the relevant comparators. The tool instantly identifies where a country is an outlier and allows the user to build customized charts with many types of benchmarks.

The structural peers we chose for Iraq were countries that had similar characteristics to Iraq in 2017–18 and satisfied the following criteria: they were (a) commodity exporters, (b) not landlocked, (c) had a population above 10 million, (d) suffered from armed conflict with civilian casualties, and (e) scored below the world average on governance effectiveness indicators.

Iraq's aspirational peers were countries that had similar structural characteristics to Iraq in the early 2000s but since then had grown significantly faster in per capita terms and had managed to diversify more.

## ANNEX 2.D: 2006 IRAQ COUNTRY ECONOMIC MEMORANDUM (CEM)

The Iraq CEM of 2006 shared many themes and recommendations with the current version. The report noted that to improve its living standards, Iraq needed to make three transitions:

- 1) From conflict to rehabilitation;
- 2) From state dominance to market orientation; and
- 3) From oil dependence to diversification.

The lack of progress on these three fronts is evident in the performance of the Iraqi economy since that report. Compared to long-run growth forecasts from around the time of the 2006 CEM, Iraq's GDP is about one-third smaller than was projected (figure 2.D.1).

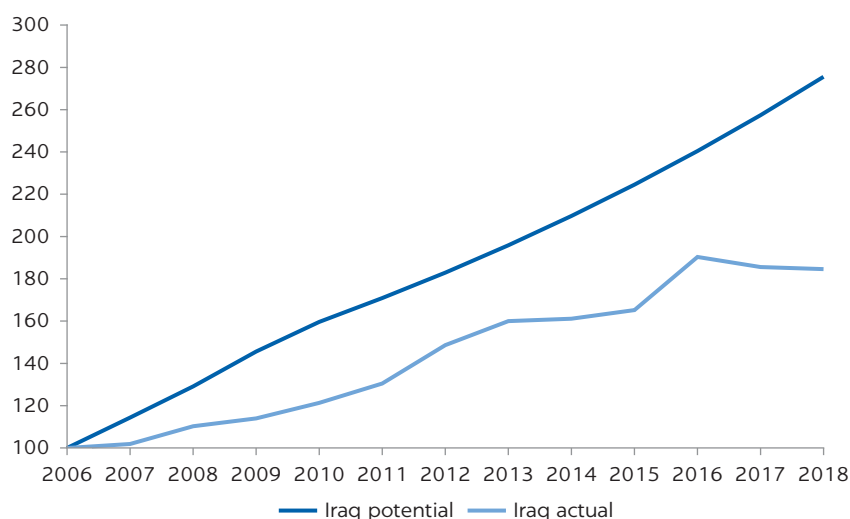
The 2006 CEM report called for three main policy approaches to support the three transitions:

- a) Generating growth and employment in the private sector,
- b) Protecting the poor and vulnerable with strong safety nets and sustainable pensions, and
- c) Improving public management and accountability.

The report noted that although the state had a role to play in reconstruction in a postconflict environment, it was important for the state to step back and allow the private sector to flourish. Iraq finds itself in a similar predicament today. Following yet another conflict, the state is needed to provide security and rebuild public infrastructure. However, Iraq's nonoil private economy still struggles to grow amid heavy government regulation, an uncertain business environment, and an unstable political climate.

FIGURE 2.D.1

**Iraq's GDP: projected growth versus actual, 2006–18**



Sources: World Bank and International Monetary Fund (IMF) data.

Note: The 2006 actual and potential GDP has been normalized to 100, IMF growth forecasts for 2012–18 are assumed to equal the last forecast value of 7 percent in 2011.

## NOTES

1. See the section on Iraq's political settlement in chapter 1.
2. A substantial literature shows that high volatility is associated with lower growth and lower investment in human capital (Krebs, Krishna, and Maloney 2005; Perry 2009).
3. For details on how these peer countries were selected, see annex 2.C.
4. Output is defined as  $Y = A[(1-u)PR \times P \times H]^\alpha K^{1-\alpha}$ , where  $A$  is total factor productivity,  $u$  is the unemployment rate,  $PR$  is the participation rate,  $P$  is the population,  $H$  is the level of human capital (proxied by average years of schooling), and  $K$  is the capital stock.
5. See details here: <https://news.gallup.com/poll/165404/world-poll-methodology.aspx>.
6. See details here: <https://www.arabbarometer.org/waves/arab-barometer-wave-v/>.
7. A deeper dive into issues concerning SOEs can be found in Government of Iraq 2016.

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## 3 Trade as a Vehicle for Growth

Iraq's exports are among the least diversified in the world. Oil dominates Iraq's export structure, as mentioned in chapter 1, accounting for more than 95 percent of total exports. Crude petroleum is still the country's most important exported item, and its share of Iraq's exports has increased over the past 15 years. The benefits of export diversification for expanding the economy, raising living standards, and mitigating risk and volatility are not presently available to Iraq.

However, in the relatively recent past, Iraq exported a wide variety of products. Under the right conditions, including a return of domestic security, these exports could return. Food and live animals, chemical products, and machinery and transportation equipment are among the goods for which Iraq has latent export potential.

Iraq's current trade policy and institutions were formed under a variety of circumstances related to past conflicts and are no longer suited for present conditions. The heavy regulation of imports, and the foreign exchange required to purchase them, dates to the period when Iraq was under strict international sanctions and could not export oil; and the overall system is easily subject to abuse and manipulation. Furthermore, the existence of two separate customs territories in Iraq, dividing a land territory internally, is unique in the world and exacerbates internal tensions associated with the confessional division of political powers. Reforming the import licensing regime and unifying the Iraqi customs territory under a single tariff schedule with low dispersion could go a long way toward improving Iraq's economic performance.

Although Iraq's geography gives it the potential to be a regional trade hub, its performance on logistics and border management is weaker than any of its neighbors, turning it into a regional bottleneck. Trade facilitation is an urgent priority. The country's outdated legal and regulatory framework for customs should be revised to align more closely with international best practices. Institutional and integrity reforms of Iraq's border management should be prioritized and should complement the broader initiative to develop a comprehensive anticorruption framework using a whole-of-government approach. Also, implementing an automated trade system could enhance risk management and reduce the number of paper documents required to trade.

Reforms in trade policy and trade facilitation, by reducing trade costs, will promote export diversification and trade with Iraq's neighbors, which will in

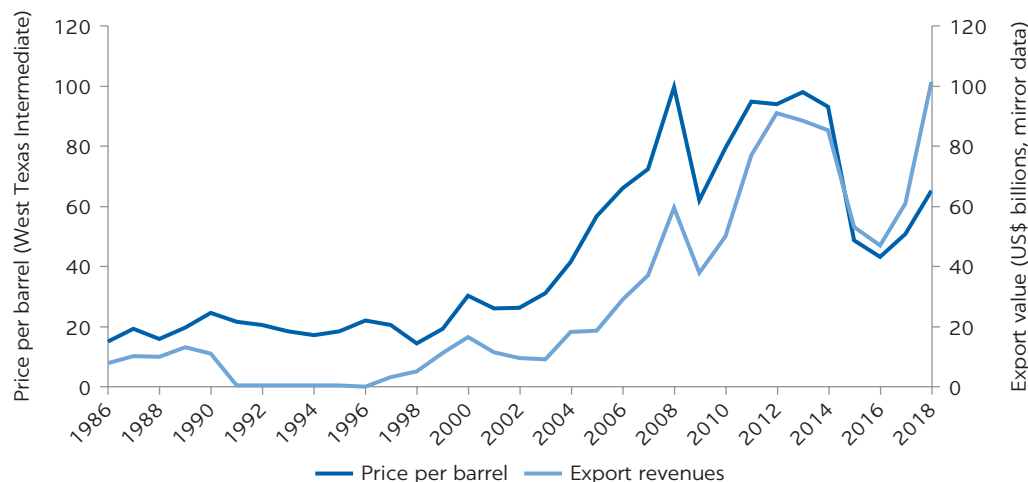
turn promote regional peace and stability. Iraq's nonoil exports traditionally have gone to the broader Middle East and North Africa (MENA) region. Given the difficulty Iraq faces in establishing formal trade agreements in the region, practical measures to promote actual trade on the ground are more likely to bear fruit.

## EXPORT DIVERSIFICATION AND ECONOMIC GROWTH

Countries with strong export performance are more likely to experience economic growth and rising living standards. A wide range of studies has documented the association of export performance with economic growth, typically finding that a 1-percentage-point increase in exports is associated with about a 0.2-percentage-point increase in economic growth (Lewer and Van den Berg 2003). However, countries that specialize in a single product, such as Iraq, often struggle to maintain steadily increasing exports. Such countries' export performance depends on the price of their favored product, which is set in world markets and is beyond the countries' control. Figure 3.1 shows the high degree of correlation between the world price of oil and Iraq's export revenues over an extended period. For short periods of time, drops in the price of oil can be overcome by pumping more oil. But as new extraction technologies increase the global oil supply and the pricing discipline that major producing countries exhibited in past decades increasingly breaks down, Iraq's ability to increase its export revenue will become increasingly uncertain.

One benefit of export diversification is limiting risk. In the same way that a stock investor holds a diversified portfolio to insure against any one stock losing value, a country with a diversified export basket can more easily maintain steady revenue if the price of one of the commodities drops. But the benefits of diversification go beyond that. It is widely believed that productivity gains arise from the learning-by-doing processes associated with diversified exporting. Firms that act as suppliers in global value chains—of parts, components, and

**FIGURE 3.1**  
**Iraq's export revenues and the world oil price, 1986–2018**



Sources: United Nations Comtrade data; statista.com.

other intermediate goods that are then further processed in other countries—may learn from their customers about new technologies and possibilities. As a result, the firms acquire a wide range of capabilities that can be applied to the production of other goods (Hausmann and Klinger 2006). This knowledge spills over to the rest of the economy. Thus, a relationship can be found between increasing export *diversification* and economic growth (Al-Marhubi 2000; Newfarmer, Shaw, and Walkenhorst 2009) separate from the relationship between accelerating exports and economic growth.

Agricultural exports exemplify this pattern of increasing competitiveness through knowledge spillovers. Producers that successfully export one type of crop overseas learn techniques of production, storage, and transportation that can enhance their export performance for other types of agricultural goods (see chapter 4). In Latin America, this happened when Chile transitioned from a mining-based economy to an exporter of fruit, flowers, and wine (Gutierrez de Piñeres and Ferrantino 1997). Colombia diversified in a similar way after being highly specialized in coffee (Gutierrez de Piñeres and Ferrantino 1999). Malaysia, Thailand, and Uganda also experienced episodes of accelerated economic growth led by export diversification (Hesse 2009). This pattern of increasing competitiveness through diversification also applies to manufacturing.

A successful program of trade diversification can also contribute to export diversification by lowering the cost, time, and uncertainty of exporting, which in turn can reduce economic volatility and promote economic growth. A country can only export products that it can produce with sufficient productivity to overcome the trade costs associated with exporting. Thus, any policy that reduces those costs, from improving border procedures to relaxing policy restrictions on exporting to promoting exports, is likely to enhance export diversification (Dennis and Shepherd 2011).

This chapter (a) undertakes a diagnostic of Iraq's export structure, identifying areas with potential to diversify; (b) examines the country's trade policy and global integration efforts to date; and (c) reviews Iraq's trade facilitation challenges and opportunities.

## DIAGNOSTICS OF IRAQ'S TRADE STRUCTURE

### Export growth and orientation

Figure 3.2 shows the average relationship of trade openness to per capita income for each country in the world for the periods 2004–08 and 2014–18.<sup>1</sup> During 2004–08, Iraq's position was in line with world averages for a country at its level of development. However, in 2014–18, Iraq's measured openness to trade declined substantially, placing it below average. Other oil-rich countries—such as Angola, Azerbaijan, and Kazakhstan—experienced similar decreases in trade openness, suggesting that the decline in oil prices affected all of these countries similarly.

Iraq's exports are geographically concentrated: the economy's top 10 export destinations accounted for 91 percent of its total exports in 2018 (up from 89 percent in 2004) (table 3.1).<sup>2</sup> India and China are currently the top two export destinations, with Italy; the Republic of Korea; Spain; Taiwan, China;<sup>3</sup> and the United States consistently among the top 10. Once fuel exports are excluded, Iraq's exports are even more concentrated, with Singapore accounting for

FIGURE 3.2

## Iraq's trade openness, 2004–08 and 2014–18

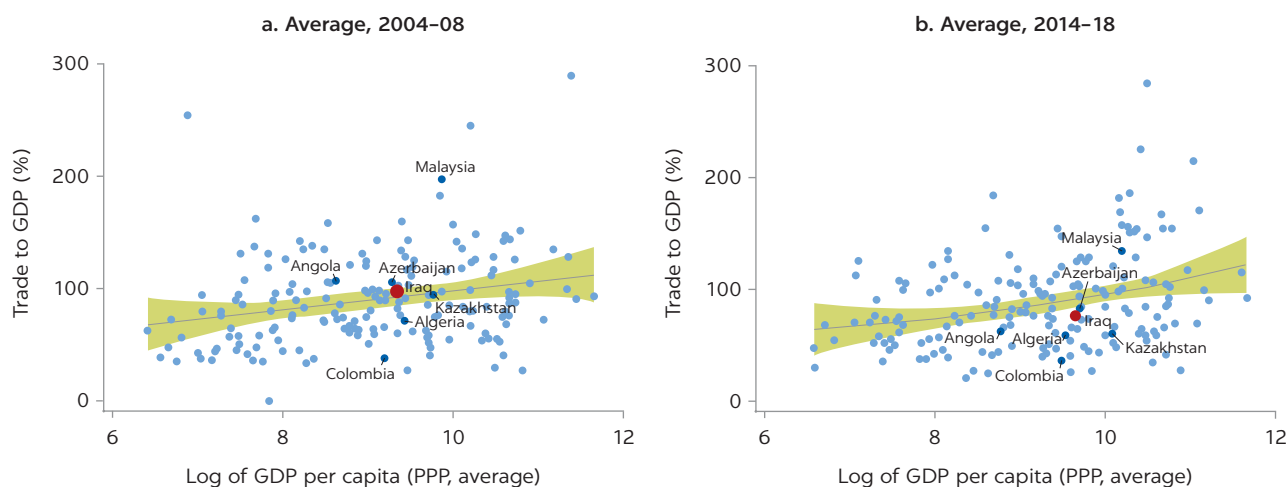


TABLE 3.1 Top economy destinations for Iraqi exports, 2004 and 2018

	2004	SHARE (%)	US\$ MILLIONS	2018	SHARE (%)	US\$ MILLIONS
1	United States	50.59	9,190	India	28.05	28,444
2	Spain	7.10	1,290	China	22.16	22,466
3	Japan	6.44	1,170	United States	11.96	12,126
4	Italy	5.12	930	Korea, Rep.	9.44	9,570
5	Canada	4.67	848	Greece	5.30	5,371
6	Pakistan	4.57	830	Italy	4.46	4,527
7	Taiwan, China	2.99	543	Singapore	3.57	3,622
8	Brazil	2.62	476	Netherlands	2.62	2,660
9	Turkey	2.55	463	Spain	2.12	2,148
10	Korea, Rep.	2.24	408	Taiwan, China	1.75	1,769
	<b>Total</b>	<b>88.90</b>	<b>16,148</b>		<b>91.42</b>	<b>92,703</b>
<b>Excluding fuel exports</b>						
1	Pakistan	50.51	777	Singapore	70.82	3,026
2	Syrian Arab Republic	22.48	346	Oman	5.38	230
3	United States	9.80	151	United Arab Emirates	4.08	174
4	Turkey	9.19	141	Turkey	3.98	170
5	Iran, Islamic Rep.	1.76	27	Malaysia	3.90	167
6	Jordan	1.69	26	India	2.38	102
7	Japan	1.07	16	Korea, Rep.	1.56	67
8	Lebanon	0.76	12	United States	1.47	63
9	Italy	0.66	10	China	1.24	53
10	Kuwait	0.44	7	Pakistan	1.16	50
	<b>Total</b>	<b>98.36</b>	<b>1,513</b>		<b>95.97</b>	<b>4,101</b>

Source: United Nations Comtrade data.

70 percent of the remaining (nonfuel) exports. In 2018, most of those exports were recorded as “special transactions” (Standard International Trade Classification [SITC] code 9310), which means that the nature of the products was not identified. Pakistan’s imports from Iraq are identified as natural gas.

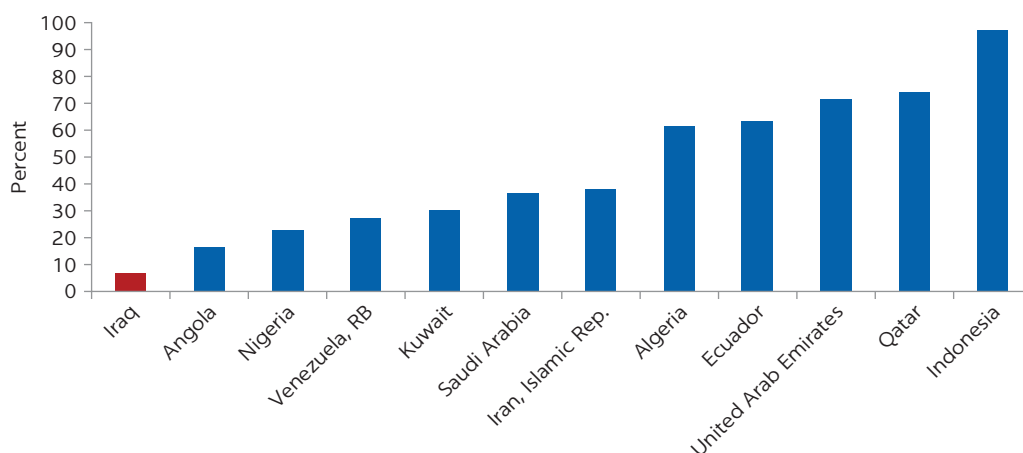
Iraq is one of the most oil-dependent countries in the world, and its most important nonoil export is fruits and vegetables (figure 3.3). Most oil-exporting countries have at least 15 percent of their exports as something other than crude oil. However, in 2018, Iraq’s share of nonoil exports was only 4.1 percent (which means 95.9 percent was oil), and when unidentified “special transactions” are left out, only 0.4 percent of Iraq’s exports were specific goods other than petroleum or petroleum products.<sup>4</sup> This share is down from 2004, when 8.5 percent of Iraq’s exports were nonpetroleum (7.5 percent, if not counting special transactions) (table 3.2). Crude oil’s share in Iraq’s total exports has fallen slightly in recent years, but that fall is explained by the decrease in oil prices, not by a decrease in production or exports, which have reached historic highs (figure 3.4).

Among Iraq’s nonoil exports in 2018 were tropical fruit (fresh and dried), petroleum bitumen and related products, natural gas, gravel and crushed stone, and aluminum. Table 3.3 provides more granularity in terms of the composition of Iraq’s exports in 2004. The main destination for Iraq’s tropical fruits was India, followed in order by Pakistan, Jordan, and China.

The existence of informal trade, or smuggling, into and out of Iraq represents an important caveat to this analysis, because such trade includes products other than crude oil. In particular, Iraq is reported to export significant quantities of gasoline by informal methods (Malik and Gallien 2020). Because the price in Iraq is relatively low (because of differences in national energy policies), Iraqi gasoline is informally exported to Turkey and Jordan, as well as to Iran. There is also reportedly a substantial reexport trade in goods moving through Iraq to Iran in order to evade sanctions applied to Iran. Such goods, which are said to include motor vehicles and consumer electronics, may receive import licenses to enter Iraq in the first instance.

**FIGURE 3.3**

**Share of non-crude oil exports in total merchandise exports, 2016–18 average**  
*mirror data*



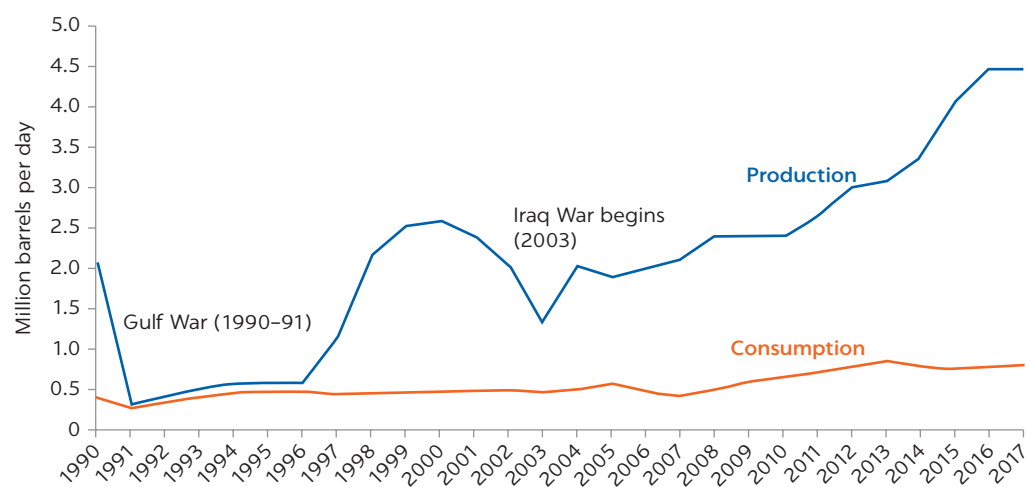
Source: United Nations Comtrade data.

**TABLE 3.2 Iraq's top 10 categories of merchandise exports, 2004 and 2018**

	SITC 2-DIGIT CLASSIFICATION, 2004	SHARE (%)	US\$ MILLIONS	2018	SHARE (%)	US\$ MILLIONS
1	33: Petroleum and petroleum products	91.54	16,628	33 Petroleum and petroleum products	95.89	97,232
2	73: Transportation equipment	1.61	293	93: Special transactions, not classified according to kind	3.70	3,751
3	04: Cereals and cereal preparations	1.19	216	05: Fruit and vegetables	0.13	136
4	28: Metalliferous ores and metal scrap	0.88	160	68: Nonferrous metals	0.06	61
5	93: Special transactions, not classified according to kind	0.87	157	34: Gas, natural and manufactured	0.06	56
6	72: Electrical machinery, apparatus, and appliances	0.58	105	27: Crude fertilizers and crude minerals, not elsewhere specified	0.05	47
7	71: Machinery, other than electric	0.48	87	25: Pulp and paper	0.02	24
8	59: Chemical materials and products, not specified elsewhere	0.31	56	51: Chemical elements and compounds	0.02	18
9	58: Plastic materials	0.29	52	28: Metalliferous ores and metal scrap	0.01	11
10	05: Fruit and vegetables	0.24	44	58: Plastic materials	0.01	11
	<b>Total</b>	<b>97.99</b>	<b>17,799</b>		<b>99.95</b>	<b>101,347</b>

Source: United Nations Comtrade data.

Note: SITC = Standard International Trade Classification.

**FIGURE 3.4****Iraq's total production and consumption of petroleum and other liquids, 1990–2017**

Source: US Energy Information Administration.

**TABLE 3.3 Iraq's top 20 export products, 2004**

	SITC 4-DIGIT AND 5-DIGIT CLASSIFICATION, 2004	SHARE (%)	US\$ MILLIONS
1	33101: Crude petroleum	91.53	16,627
2	73592: Special purpose vessels	1.47	267
3	9310: Special transactions	0.87	157
4	0430: Barley, unmilled	0.67	122
5	2820: Iron and steel scrap	0.53	95
6	0410: Wheat and meslin, unmilled	0.44	80
7	72499: Other telecommunications equipment	0.40	72
8	28402: Copper waste and scrap	0.31	57
9	5812: Products of polymerization and copolymerization	0.26	47
10	0812: Bran, pollard, sharps, and other byproducts	0.23	42
11	59999: Other chemical products and preparations	0.22	40
12	2631: Raw cotton, other than linters	0.17	30
13	0542: Beans, peas, lentils, and leguminous vegetables, dried	0.13	24
14	71842: Excavating, leveling, and boring machinery	0.13	24
15	6841: Aluminum and aluminum alloys, unwrought	0.12	21
16	3411: Gas, natural	0.11	20
17	05201: Tropical fruit, dried	0.10	17
18	5611: Nitrogenous fertilizers and materials, not elsewhere specified	0.09	16
19	89918: Molded or carved articles of wax, gums, and natural resins	0.08	14
20	7143: Statistical machines, cards, or tapes	0.07	13

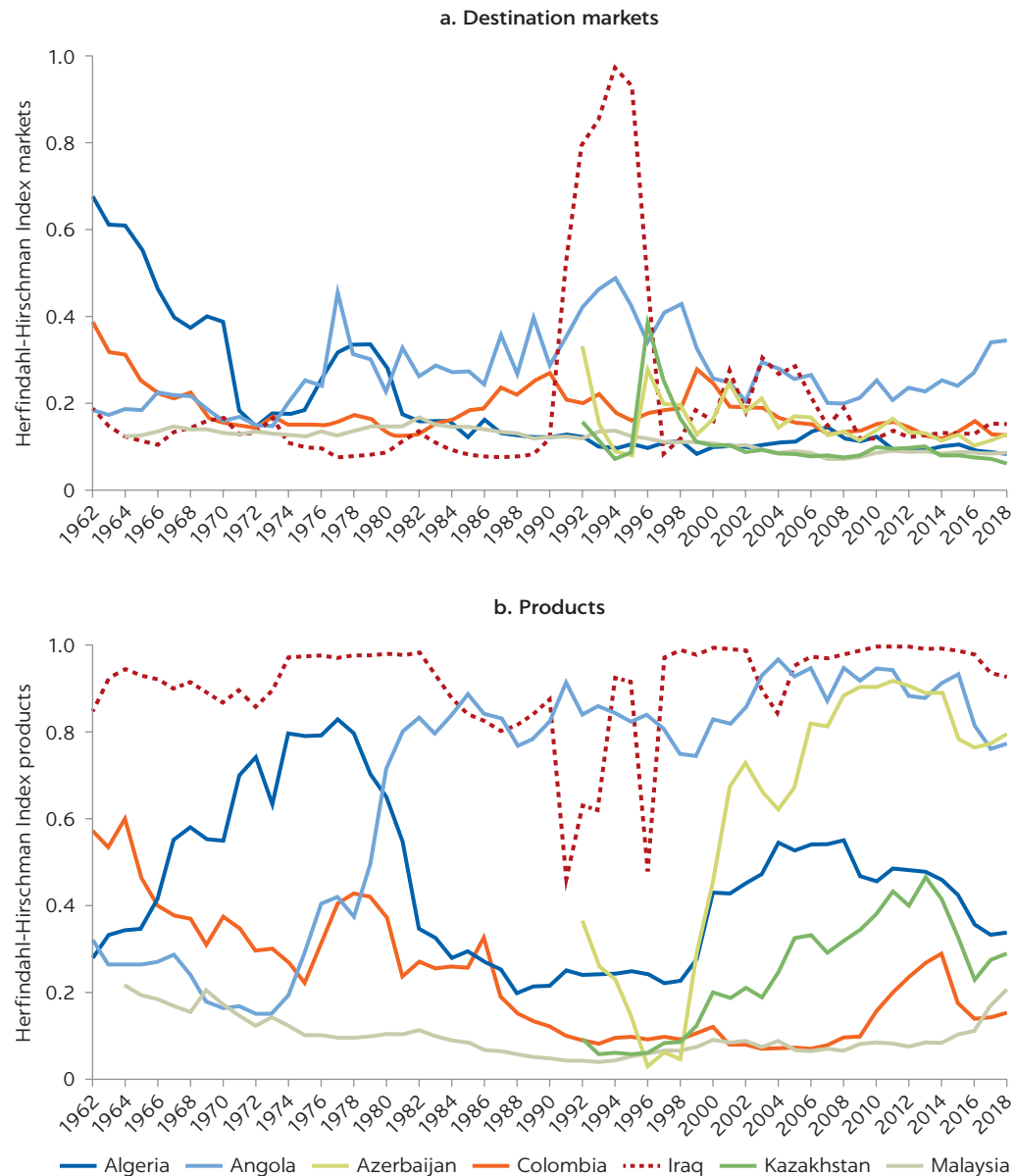
Source: United Nations Comtrade data.

Note: SITC = Standard International Trade Classification.

## Export diversification

Iraq's exports are not well diversified when measured by either the number of products exported or the number of destination markets. Figure 3.5 (panel a) shows that Iraq's exporters reached an average of 88 destinations in the 2004–08 period and 94 in the 2014–18 period.<sup>5</sup> By contrast, Iraq's comparator countries exported to more than 100 destinations in those years. In terms of variety, the number of products exported increased from 408 in the 2004–08 period to 438 in the 2014–18 period (figure 3.5, panel b). All comparator countries exported a significantly larger variety of products in those two periods.

Geographically, Iraq has diversified its export markets somewhat, although they are still concentrated relative to its comparators'. In terms of products, Iraq's exports are among the most concentrated in the world. Figure 3.5 shows that the Herfindahl-Hirschman Index (HHI) of Iraq's destination markets decreased from 0.22 in 2004–08 to 0.14 in 2014–18. Panel b shows that Iraq's product concentration is and has been almost absolute, just below the score of 1, which would correspond to exporting a single product.

**FIGURE 3.5****Evolution of diversification: Herfindahl-Hirschman Index, 1962–2018**

Source: United Nations Comtrade data.

The lack of diversification in Iraq's economy is not new, but Iraq has the opportunity to diversify, just as other countries have (box 3.1). Iraq used to have geographic export diversification similar to that of comparator countries, except during the period after the 1990 invasion of Kuwait, when international sanctions restricted Iraq's exports of oil. This period appears in the HHI as a reduction of concentration, but because oil was not being exported, not because nonoil exports expanded. Iraq's concentration of export destinations also increased in the sanctions years, because some countries stopped buying Iraqi oil.<sup>6</sup>

In the past, diversified exports have coexisted with oil exports in Iraq. Thus, the relaxation of conflict may do more to bring back Iraq's export diversification than low oil prices. According to the theory of Dutch disease, a primary product

## BOX 3.1

## How other countries achieved diversification

**Malaysia**

Cognizant of Malaysia's great dependence in the early 1980s on primary commodities, which accounted for a third of the country's gross domestic product and more than three-quarters of its exports, the Malaysian government launched an economic diversification strategy to increase the importance of higher-value added activities and reduce the country's concentration in tin ore and rubber.

Two industrial policy plans, the National Industrial Policy and the Industrial Master Plans, helped promote Malaysian manufacturing. The former laid the foundation for manufacturing and promoted processing and the development of local technological capabilities. The latter helped improve competitiveness through cluster-based industrial development and vertical diversification. A more recent industrial plan (Industrial Master Plan 3: 2006–20) aims to broaden the scope of Malaysia's economic activity and includes services (with a focus on research and development), technology, logistics, and marketing.

Malaysian manufacturing developed through resource-based industries (petrochemicals, refined petroleum, palm oil, rubber gloves, tires, and prophylactic products). The vertical diversification in the

country's resource base helped the economy in four ways. First, it deepened the economy's structural links. Second, it increased the profitability of firms while creating better-paid jobs for private sector workers and generating more tax revenue for the government. Third, it helped raise productivity throughout the economy. And finally, it helped preserve the country's overall stability.

**Chile**

Although Chile is now a high-income country and a member of the Organisation for Economic Co-operation and Development, the foundations for its diversified and rapidly growing economy were laid in the 1970s, when Chile was a lower-middle-income country. Chile had been heavily specialized in copper, had faced food shortages and foreign exchange crises, and held a large portfolio of recently nationalized state-owned enterprises. It established new private lending institutions with unrestricted interest rates, privatized most of the state-owned enterprises, abolished import quotas, and reduced its average tariff from 94 percent in 1974 to a flat 10 percent in 1979, exempting only automobiles. As a result, growth and diversification proceeded together robustly, and a new set of Chilean products—including wine, fish, and cut flowers—became famous in world markets.

Sources: Cherif, Hasanov, and Zhu 2016; Gutierrez de Piñeres and Ferrantino 1999.

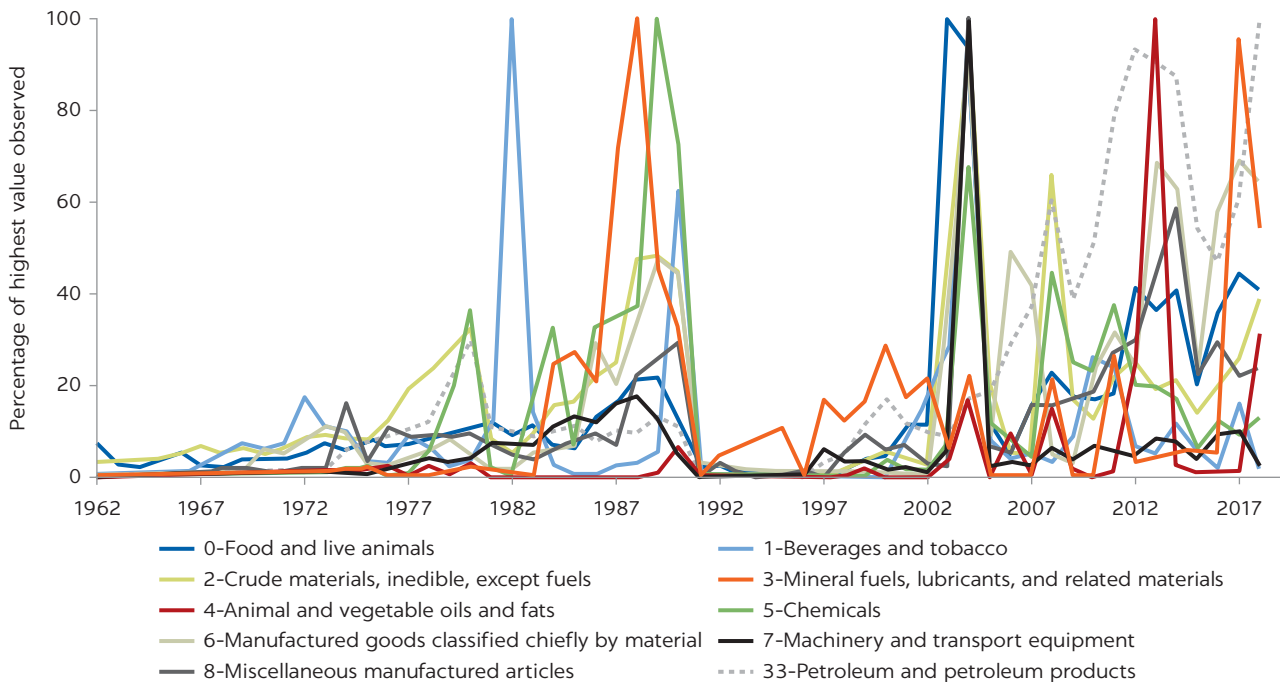
sector that dominates a country's exports, such as oil, draws resources away from other sectors of the economy, inhibiting diversification. However, when Iraq's oil exports fell to virtually zero during the sanctions period following the war over Kuwait in 1990–91, nonoil exports did not rebound. In fact, Iraq's exports were the most diversified in the late 1980s, when Iraq was selling oil on normal terms (figure 3.6).

**Latent potential for diversification**

Iraq's historical exports may give a clue as to its latent potential for diversification. There are many products that Iraq has proved able to export and that it may still be able to export in the future, if the right inputs to be internationally competitive are present (e.g., climate and human capital).<sup>7</sup>

FIGURE 3.6

## Iraq's oil and nonoil exports, 1962–2018



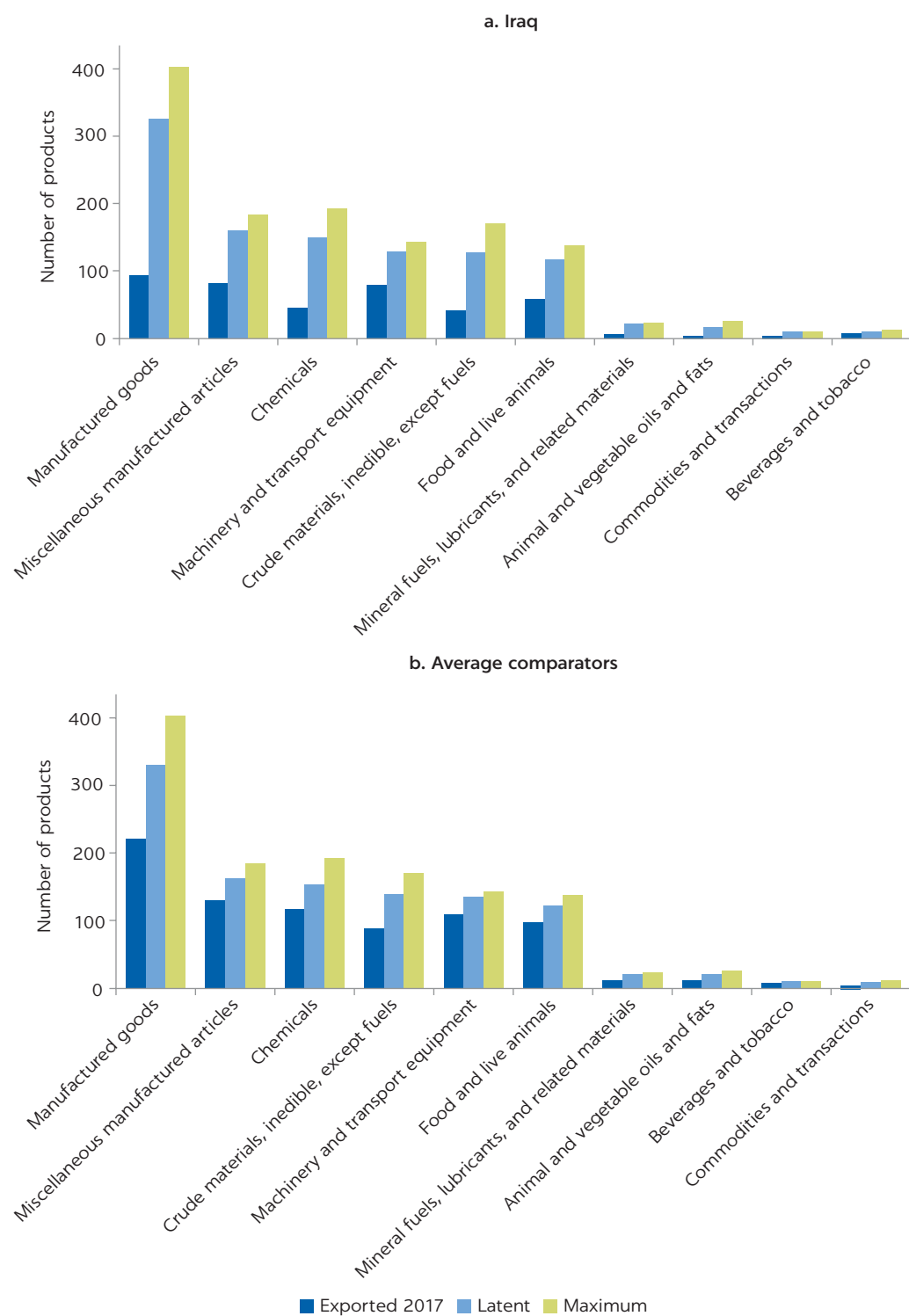
Source: United Nations Comtrade data.

Note: Each series is normalized between 0 and 100.

Figure 3.7 shows the number of exported products within each SITC 2-digit code for Iraq and for various comparators. The first bar reports the number of exported products in 2017, the last shows the number of SITC 5-digit codes present within each SITC 2-digit code (i.e., the maximum number of exportable products), and the middle bar captures the concept of latent trade diversification proposed by Lederman, Pienknagura, and Rojas (2019).<sup>8</sup> Latent diversification is calculated by taking into account the entire history of a country's exports; it is defined as the number of export lines that have been active for at least one year since 1962. Iraq exports a low number of products compared with its comparators. However, its latent diversification is similar to its comparators, which suggests that Iraq has the potential to diversify its export bundle and that it has historical knowledge about the production of many products. Among the most promising industries (those in which the difference between the number of products produced in 2017 and the latent number is high) are manufacturing goods, chemicals, and crude materials other than fuel.

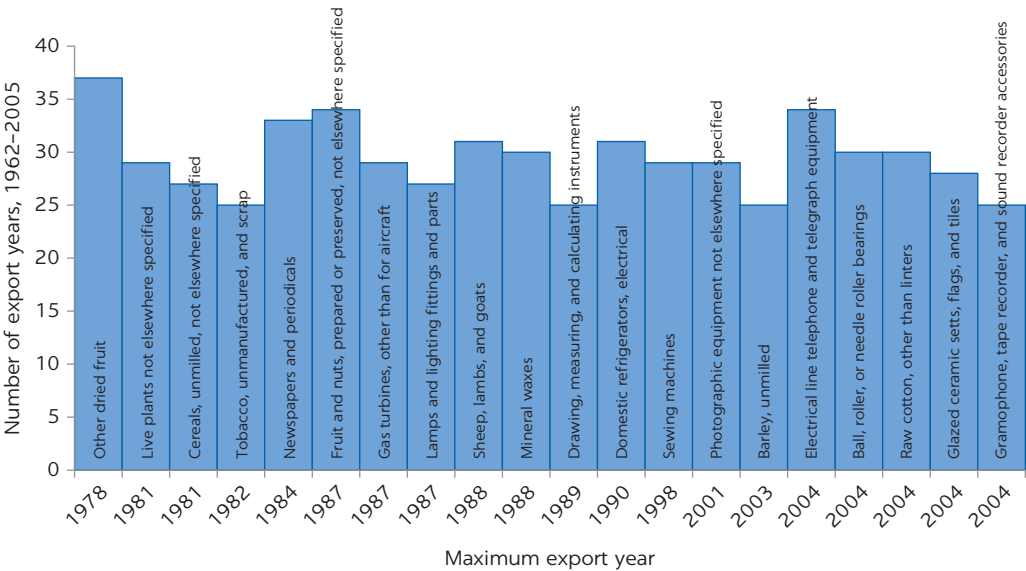
Iraq used to be a frequent exporter of products in the food and live animals category, and it is likely to resume exporting them in the future. The products with the highest number of export-years are other dried fruit (SITC 05209) and fruit and nuts (SITC 0539), which were exported for 37 and 34 years, respectively, over the 1962–2005 period. However, the two most promising products in the category in terms of maximum export value (i.e., in terms of diversification potential) are unmilled barley (SITC 0430) and bran and other residues (SITC 0812). Iraq's exports of unmilled barley reached almost US\$163 million in 2003, and bran and other residues reached US\$42 million in 2004. Other important products that were frequently exported are unmanufactured tobacco (SITC 1210) and plants, seeds, and flowers used in perfumery or pharmacy (SITC 2924) (figure 3.8).

**FIGURE 3.7**  
**Latent diversification**



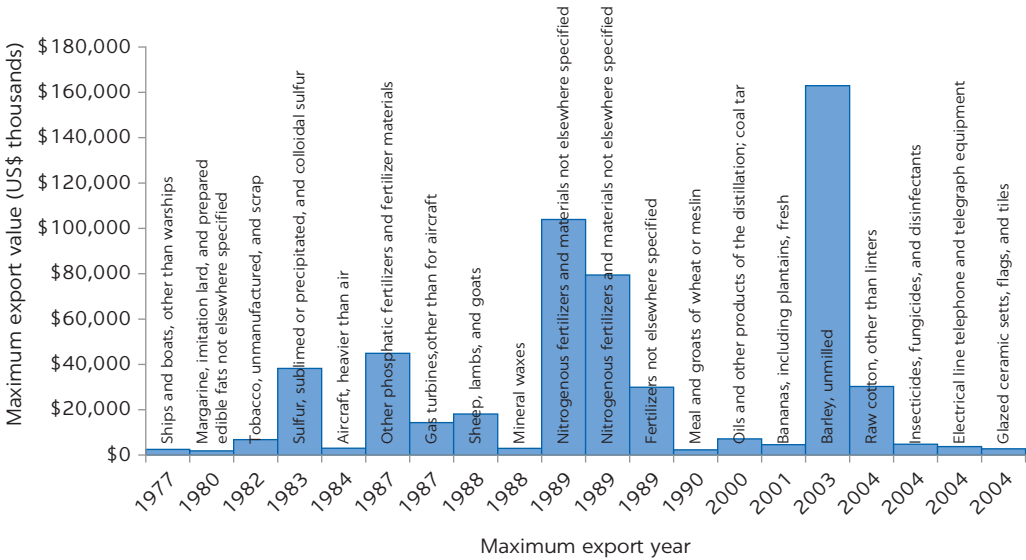
Source: United Nations Comtrade data.

**FIGURE 3.8**  
**Iraq's top 20 latent products in terms of number of export years**



Source: United Nations Comtrade data.

**FIGURE 3.9**  
**Iraq's top 20 latent products (exported for at least 15 years) in terms of maximum export value**



Source: United Nations Comtrade data.

Iraq also has latent export potential in chemical products, manufacturing goods, and machinery and transportation equipment. Figure 3.9 presents the country's top 20 latent products in terms of maximum export value. Products that were exported for less than 15 years are excluded. In addition to food and live animal products, there are important chemical products such as nitrogenous fertilizers (SITC 5611) and other phosphatic fertilizers (SITC 56129), although these products reached their maximum export levels before the Gulf War. Latent

nonagriculture products for which production capacity is likely to still be present—those that reached their maximum exports in the early 2000s—are raw cotton (SITC 2631); products of the distillation of coal tar (SITC 5214); electrical-line telephone and telegraph equipment (SITC 72491); and glazed ceramic setts, flags, and tiles (SITC 66362).

To show the potential of Iraq's latent products, table 3.4 reports the main destinations of the top 20 latent products shown in figure 3.9. The Syrian Arab Republic, China, and Kuwait, in that order, are the most important destinations in terms of overall market potential for the top 20 latent products, when weighted according to the products' latent value (their overall maximum export value). Although exports to Syria and China were concentrated mostly in unmilled barley and nitrogenous fertilizers, respectively, Kuwait was an important trading partner for several different products—in fact, it was a top-five destination for 5 of the 20 products listed in figure 3.9. However, exports to Kuwait reached their maximum a long time ago, which suggests that resuming exports of those products may not be easy in the short term.

In the medium term, Pakistan appears to be a promising destination market for Iraq for several reasons. First, the relationship between the two countries has improved in recent years. And second, Pakistan was once an important trading partner for a number of products, most of which reached their maximum level of export in recent years. Specifically, the products most likely to be exported in the near future are raw cotton (SITC 2631); insecticides, fungicides, and disinfectants (SITC 5992); electrical-line telephone and telegraph equipment (SITC 72491); and glazed ceramic setts, flags, and tiles (SITC 66245).

### Import structure and tariff policy

Iraq's current tariff policy was instituted in 2016, and it featured lower rates than the tariff schedule of 2010. The Kurdistan Regional Government (KRG) operates under a separate customs regime, reportedly with a simpler uniform tariff rate of 5 percent. Historically, there have been internal customs checkpoints at the frontier between the Kurdish region and the rest of Iraq, though it is reported that these have recently been removed. There have also recently been proposals to harmonize the two customs regimes.

The arrangement of two customs regimes dividing an economy's land area is virtually unique in the world, and it exacerbates tensions arising from Iraq's confessional power-sharing arrangement. Virtually all modern economies operate either as unified customs territories, which are defined economically at their borders, or in customs unions with neighboring economies (e.g., the European Union). The few other cases in which a sovereign economy is divided into multiple customs territories arise from coastal or island areas used as reexport zones (e.g., Hong Kong SAR, China; Macao SAR, China; and Curaçao, República Bolivariana de Venezuela), or from unresolved conflicts in which sovereignty is actually disputed (e.g., Cyprus, which is internationally recognized as part of the European Union, but where the Turkish Cypriot community maintains a separate customs territory in the north). It is difficult to maintain two customs territories without a system of internal checkpoints that inhibits trade. Otherwise, traders are incentivized to enter goods across whichever border offers the most favorable customs terms rather than according to normal considerations such as transportation costs.

Iraq's current tariff schedule has a simple average rate of 11.6 percent, with a large number of tariff peaks (table 3.5). The 2016 revision introduced a number

**TABLE 3.4** Export destinations of Iraq's top 20 latent products

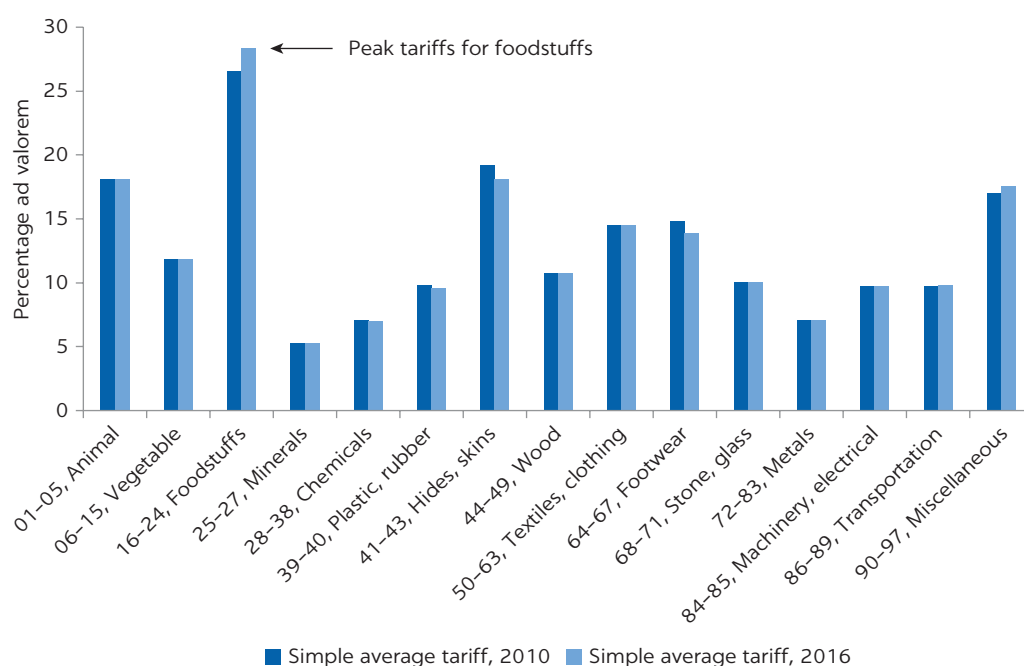
SITC 5-DIGIT CODE	PRODUCT	MAXIMUM EXPORT YEAR	MAXIMUM EXPORT VALUE (US\$ THOUSANDS)	IMPORTER RANK 1	IMPORTER RANK 2	IMPORTER RANK 3	IMPORTER RANK 4	IMPORTER RANK 5
0430	Barley, unmilled	2003	162,958	Syrian Arab Republic (94.53%)	Jordan (3.17%)	Lebanon (2.30%)		
5611	Nitrogenous fertilizers and materials, not elsewhere specified	1989	103,926	China (75.04%)	France (7.35%)	Turkey (4.68%)	Sri Lanka (3.40%)	
2741	Sulfur, not sublimed, precipitated, or colloidal	1989	79,441	Egypt, Arab Rep. (28.44%)	Turkey (18.25%)	Tunisia (15.49%)	India (14.38%)	Italy (5.52%)
56129	Other phosphatic fertilizers and fertilizer materials	1987	44,915	Saudi Arabia (31.71%)	Turkey (15.70%)	Bangladesh (14.83%)	France (14.12%)	Algeria (5.86%)
51323	Sulfur, sublimed or precipitated; colloidal sulfur	1983	38,225	Kuwait (89.46%)	Jordan (10.54%)			
2631	Raw cotton, other than linters	2004	30,244	Pakistan (73.06%)	Turkey (15.99%)	Thailand (5.01%)	Belgium (2.00%)	Korea, Rep. (1.91%)
5619	Fertilizers not elsewhere specified	1989	29,953	Turkey (46.90%)	Thailand (21.63%)	Italy (16.83%)	Indonesia (10.78%)	France (3.76%)
0012	Sheep, lambs, and goats	1988	18,090	Kuwait (97.83%)	Jordan (2.17%)			
7116	Gas turbines, other than for aircraft	1987	14,320	Germany (44.91%)	Italy (30.27%)	United Kingdom (24.82%)		
5214	Oils and other products of distillation; coal tar	2000	7,113	India (98.65%)	Iran, Islamic Rep. (1.35%)			
1210	Tobacco, unmanufactured and scrap	1982	6,845	France (50.69%)	Spain (49.31%)			
5992	Insecticides, fungicides, and disinfectants	2004	4,776	Pakistan (100.00%)				
0513	Bananas, including plantains, fresh	2001	4,616	Iran, Islamic Rep. (100.00%)				
72491	Electrical line telephone and telegraph equipment	2004	3,740	Pakistan (90.04%)	Italy (7.64%)	United Kingdom (1.35%)	Netherlands (0.53%)	Georgia (0.22%)
7341	Aircraft, heavier than air	1984	3,039	Italy (100.00%)				
33262	Mineral waxes	1988	2,933	Germany (19.67%)	Singapore (17.38%)	Pakistan (16.96%)	Kuwait (15.93%)	Denmark (14.17%)
66245	Glazed ceramic setts, flags, and tiles	2004	2,736	Pakistan (99.15%)	United Kingdom (0.85%)			
7353	Ships and boats, other than warships	1977	2,501	Japan (100.00%)				
04602	Meal and groats of wheat or meslin	1990	2,291	Kuwait (58.30%)	Jordan (22.65%)	Turkey (14.32%)	Saudi Arabia (3.36%)	Bahrain (1.37%)
0914	Margarine, imitation lard, and prepared edible fats not elsewhere specified	1980	1,830	Syrian Arab Republic (75.28%)	Jordan (19.59%)	Kuwait (5.13%)		

Source: UN Comtrade data.

**TABLE 3.5** Tariff structures

COUNTRY	SIMPLE AVERAGE TARIFF (%)	DUTY-FREE SHARE OF LINES (%)	ABOVE 15% AD VALOREM SHARE OF LINES (%)
<b>Iraq</b>	<b>11.6</b>	<b>11.2</b>	<b>22.2</b>
Egypt, Arab Rep.	19.1	0.2	21.6
Jordan	9.9	54.5	33.1
Kuwait	4.7	10.5	0.3
Saudi Arabia	5.9	10.9	1.1
Turkey	10.9	23.4	14.4

Sources: World Tariff Profiles 2019; Iraq Ministry of Trade.

**FIGURE 3.10****Iraq's tariff profile, 2010 and 2016**

Sources: UNCTAD Trains database; Iraq Ministry of Trade; World Bank calculations.

of peak tariff lines with rates higher than 30 percent. When compared with other countries in the region, the Iraqi tariff schedule has a higher average rate, a higher share of peak lines above 15 percent, and fewer duty-free lines; in other words, the tariff schedule has a high degree of dispersion. Thus, Iraq's tariff schedule is more likely to cause distortions in economic incentives and to encourage traders to engage in evasion and misreporting than those of other countries in the region (except for Egypt), with a parallel incentive for corruption in the customs agencies.

The 2016 tariff schedule modestly lowered tariff rates in most sectors, though it increased them for foodstuffs, where the average rate was already high. Figure 3.10 shows the simple average tariff rate for each sector. Note that the dispersion in the overall tariff is greater than that portrayed by the figure, because tariffs on certain products are higher than the sectoral average. The products are grouped according to sections of the Harmonized System (HS) established by the World Customs Organization; each section consists of a group of two-digit chapters.

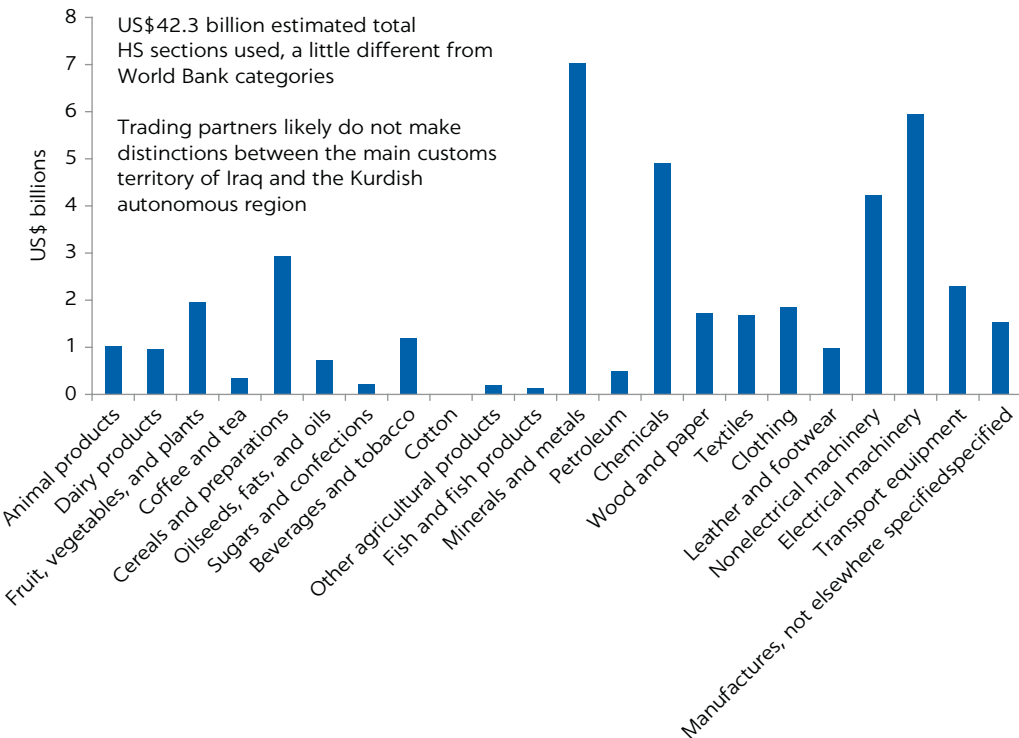
An estimate based on Iraq’s mirror import data suggests that Iraqi tariff revenue for 2017 should have been about US\$6.35 billion, substantially higher than actual collections. For comparison, the actual tariff revenue collected in 2019 was reported to be US\$1.9 billion. This discrepancy suggests that the high dispersion in Iraq’s tariff schedule is in fact attracting evasion. Other reasons for the difference between the estimate and the actual tariffs collected are that the figures apply to different years and that the import data used to benchmark the estimate (figure 3.11) come from trading partners, which may not distinguish between their exports to the Kurdish region and those to the rest of Iraq. It is unclear whether duties collected by the Kurdish region are included in the US\$1.9 billion figure.

More than half of Iraq’s theoretical tariff revenue should be in three categories: machinery and electrical goods (HS 84, 85); processed foods, beverages, and tobacco (HS 16-24); and textiles and clothing (HS 50-63). This grouping suggests that an appropriate program of risk assessment could increase tariff revenues while reducing the number of unnecessary inspections at border crossings (see the following section on trade facilitation). It also suggests that it would be important to understand how the special import regimes for food and machinery, described previously, relate to the customs procedures.

Trade policies other than tariffs

Important features of Iraq’s trade policy date to the period of international sanctions in the 1990s, when Iraq could not export oil, and are no longer suited to

FIGURE 3.11  
Composition of Iraqi imports, according to trading partners’ export data



Sources: UN Comtrade for partners’ trade data; Iraq Ministry of Trade for tariffs; World Bank calculations.  
Note: Estimated total imports = US\$42.3 billion. This figure categorizes imports in accordance with Harmonized System (HS) sections.

present conditions. Iraq's current institutions are designed for a period of severe foreign exchange shortage and have metastasized into a system in which the rights to move goods across borders and to obtain the hard currency needed to move goods, as well as the movement of the goods themselves, are nontransparent and exposed to manipulation and exploitation. This situation may benefit the most connected traders at the expense of small companies.

Between 1996 and 2003, exports and imports to Iraq were closely regulated through the United Nations (UN)-authorized Oil-for-Food (OFF) program. OFF permitted the Iraqi government to sell limited quantities of oil in order to meet the needs of its people by importing food and humanitarian supplies.<sup>2</sup> During this period, all approved imports to Iraq were monitored by UN staff, who reviewed all contracts and ensured that imported goods were on a list of commodities drafted by the UN Security Council. Besides food and humanitarian supplies, the OFF allowed Iraq to import some transportation and communications equipment, spare parts for oil rigs and other infrastructure, and consumer goods. The OFF program was officially concluded in November 2003 (Katzman and Blanchard 2005).

Although the system faces growing challenges, Iraq's supply of food still flows through the Public Distribution System (PDS), which is now administered by the Ministry of Trade (MOT). Through it, food is rationed monthly to all inhabitants at all income levels. However, this program has been plagued by mismanagement, corruption, and operational difficulties since the 2003 US-led invasion. Efforts have been made to revamp the system; in December 2009, the UN World Food Programme and the Iraqi Ministry of Trade signed a memorandum of understanding under which the two parties agreed to work together to improve the supply chain management of the PDS. With agricultural production in decline, food imports have become critical for Iraq. State-owned companies created to channel imported foodstuffs to consumers have in the process become the major operators in the Iraqi food retail sector.

Since 2004, the MOT has managed the residual contracts to receive and distribute goods, assigning mainly nonprofit state-owned enterprises (SOEs) to handle almost all necessity import product categories and involving few private sector entities.<sup>10</sup> The MOT's SOEs include the following companies. The Grain Trading Company focuses on the import, export, storage, and distribution of wheat, barley, and rice. It facilitates the ration card system for flour supplied by the MOT (Khalaf 2018). The largest SOE under the MOT, the Grain Trading Company, is also the only one identified as "risky" across all rankings (largest assets, highest total revenue, largest expenditures, net balance, and total salaries and wages) and is likely to pose a fiscal risk to the economy should it experience idiosyncratic shocks (Habhab and Ayub 2016). The State Company for Iraqi Fairs and Commercial Services is responsible for developing Iraqi exports (except of oil and oil products), running internal and foreign fairs, and providing export-import services for both the public and the private sectors.<sup>11</sup> The State Trading Company for Construction Materials is responsible for the import and distribution of sanitary ware and materials. The State Trade Organization for Consumer Goods is responsible for planning, supervising, and controlling establishments that deal in foreign and internal trade of consumer goods. A few other SOEs are also engaged in imports. In comparison, the MOT's SOEs are significantly smaller than those of other ministries (e.g., the Ministry of Industry and Minerals), and only 16.7 percent of them are profitable; the rest lack basic infrastructure and are unable to compete favorably in the world market (table 3.6).

**TABLE 3.6 Comparison of Iraqi ministries' SOEs and their profits, 2010–15**

CATEGORY	MINISTRY	2010	2011	2012	2013	2014	2015
Number of state-owned enterprises (out of 136)	Ministry of Trade	6	6	6	6	6	6
	Ministry of Industry and Minerals	68	68	67	69	69	67
Percentage of net profit-making state-owned enterprises	Ministry of Trade	16.7	66.7	33.3	16.7	33.3	16.7
	Ministry of Industry and Minerals	10.3	11.8	10.4	11.6	8.7	16.4

Source: Habhab and Ayub 2016.

Finally, Iraq's heavy regime of import management invites rent-seeking and supports a substantial government bureaucracy that would not be needed under a more open regime. The auction mechanism required to obtain foreign exchange is also reportedly subject to abuse and is administered largely by state-owned banks for lack of a private banking sector. At the same time, goods that are approved for import for investment purposes are exempt from duties, but there are no controls to keep goods classified as "investments" from entering the normal stream of commerce. In short, there are substantial opportunities for Iraqi officials to allow privileges to favored traders in a nontransparent manner.

A possible consequence of simultaneous reform of import licensing and customs could be a reduction in informal trade across the border with Iran, which could affect the balance of influence among external actors with a stake in Iraqi affairs. Import licenses are reportedly often issued far in excess of Iraqi domestic demand, enabling automobiles, electronics, and other consumer goods to be moved informally across the Iranian border. This tactic makes it easier to avoid the current US-led sanctions regime, which is costly to the Iranian economy. Reforming Iraqi trade and border policy in support of growth and diversification could thus have the side effect of making it harder to use Iraqi territory to circumvent sanctions on Iran.

## Trade and regional integration

Trade policy can promote domestic and regional peace and stability if properly designed (Cali 2015). Keys to reducing conflict through trade policy include (a) managing revenues from commodity exports (in Iraq's case, oil exports) in a conflict-sensitive way; (b) increasing trade with regional partners, which is made easier when border crossing points are opened and made more efficient; and (c) promoting labor-intensive exports, such as agricultural products, that can enhance employment and thus add to social stability. Lee and Pyun (2016), in their analysis of the effects of trade integration on interstate military conflict, find that an increase in bilateral trade interdependence significantly promotes peace, as does global trade openness. Furthermore, the peace-promotion effect of bilateral trade integration is significantly higher for contiguous countries, which are otherwise most likely to engage in conflict.

However, Iraq's weak performance on logistics and border management hinders it from becoming a major player in regional trade and transit, making it a

**TABLE 3.7 Logistics Performance Index regional comparison, 2018**

COUNTRY	RANK	SCORE	CUSTOMS	INFRASTRUCTURE	INTERNATIONAL SHIPMENTS	LOGISTICS COMPETENCE	TRACKING AND TRACING	TIMELINESS
Turkey	47	3.15	2.71	3.21	3.06	3.05	3.23	3.63
Saudi Arabia	55	3.01	2.66	3.11	2.99	2.86	3.17	3.30
Iran, Islamic Rep.	64	2.85	2.63	2.77	2.76	2.84	2.77	3.36
Lebanon	79	2.72	2.38	2.64	2.80	2.47	2.80	3.18
Jordan	84	2.69	2.49	2.72	2.44	2.55	2.77	3.18
Syrian Arab Republic	138	2.30	1.82	2.51	2.37	2.29	2.37	2.44
<b>Iraq</b>	<b>147</b>	<b>2.18</b>	<b>1.84</b>	<b>2.03</b>	<b>2.32</b>	<b>1.91</b>	<b>2.19</b>	<b>2.72</b>

Source: Logistics Performance Index, 2018.

bottleneck rather than a hub. As can be seen in table 3.7, Iraq underperforms all of its neighbors, even Syria, in virtually every aspect of moving goods across borders. A marginal improvement in border management operations, logistics competence, or trade infrastructure could help Iraq connect with regional markets in a more effective and cost-efficient manner. Iraq even has untapped potential to become a regional transit hub, thanks to its central geographic position. However, national security challenges currently make it risky to move goods within Iraq, so cargo transit traffic is virtually nonexistent.

On the global stage, although Iraq's pursuit of trade liberalization and integration began in 2004, the country has made only minimal progress to date. That year, Iraq formed a working party to negotiate its accession to the World Trade Organization (WTO). Iraq also became a beneficiary developing country under the United States' Generalized System of Preferences that year.<sup>12</sup> However, Iraq's WTO accession negotiations have been slow. In November 2017, after nine years of dormancy, WTO members welcomed Iraq's stated determination to resume its WTO accession process. Iraq subsequently circulated its Memorandum on the Foreign Trade Regime on February 9, 2018—an update to its September 2005 version. Acceding to the WTO will help lock in reforms through international binding commitments and would allow Iraq to benefit from a rules-based, transparent and predictable multilateral trading system governing 164 WTO members to date. The accession process will require sustained engagement with other WTO members and a strong political will to reform.

Iraq's regional integration endeavors have not been very successful either, but great potential exists for such trade. Notably, Iraq participates in relatively few formal trade agreements, and the ones it has joined are not very deep by international standards (i.e., the League of Arab States, the Trade and Investment Framework Agreement [TIFA] with the United States since 2013, and the Partnership and Cooperation Agreement with the European Union since 2012). Furthermore, Iraq withdrew from the Pan-Arab Free Trade Area (PAFTA) in November 2016. However, several studies have found that the benefits for PAFTA members in terms of free trade in goods have been minimal (Al-Atrash and Yousef 2000; Freund and Portugal-Perez 2013; Testas 1998), so a withdrawal did not create significant losses.

Iraq could play a strategic role in its region's trade via the upgrade of the Zakho (Ibrahim-el-Khalil)–Baghdad–Umm Qasr corridor. This move would

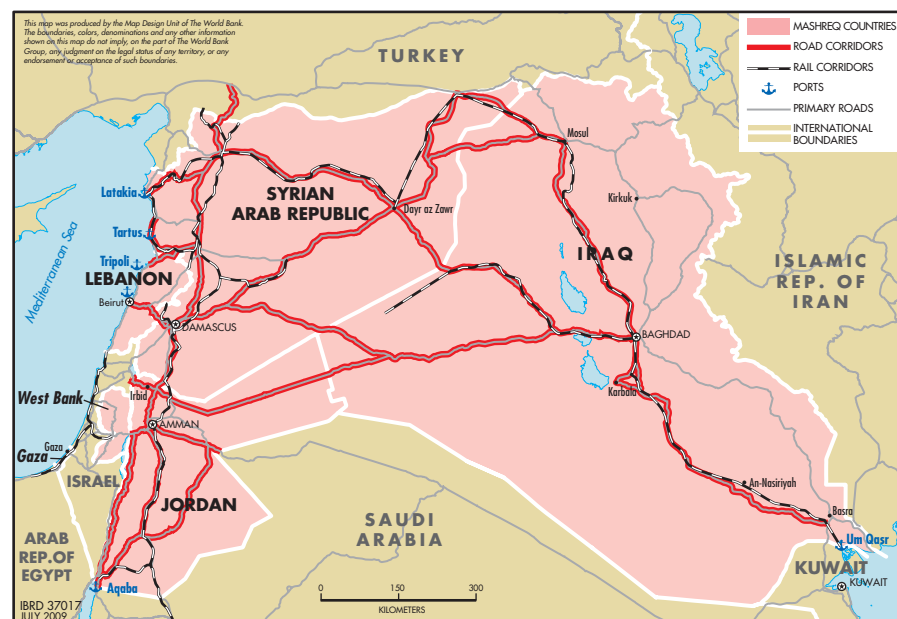
elevate Iraq's strategic trade partnership with Turkey, because it would provide Turkish supply chains access to the Persian Gulf and connect Turkish and Kuwaiti traders by road (as shown in map 3.1). However, Iraq has not yet captured this opportunity at the strategic, policy, or operational level. As a result, there are gaps in (a) developing a full-fledged transit system encompassing border-to-border cargo flows; (b) increasing levels of compliance with international transit agreements; and (c) putting in place the required trade and transportation corridor infrastructure.

With regard to the country's regional integration strategy, the first step could be the full and effective operationalization of that north-south corridor. It has more traffic than others through Iraq, so it would be most likely to attract private sector investment for infrastructure development. It could also serve cargo streams to and from Kuwait and Saudi Arabia. The Iraqi government could also develop a holistic master plan to rehabilitate the country's trade infrastructure—including border crossing posts, road corridors, and possible logistics service facilities—and complement these investments by continuing the recent expansion of the Umm Qasr port.

Moreover, Iraq's trade potential with Kuwait is significant, and Iraq is under-trading with Egypt—both countries present opportunities for deeper regional integration. As seen earlier in this chapter, Kuwait is one of Iraq's most important destinations in terms of both latent value and overall market potential for Iraq's top 20 latent products (in terms of overall maximum export value). Kuwait and Egypt are natural partners for Iraq in any economic and trade integration in the Levant zone because of their markets and trading patterns (World Bank 2014b).

MAP 3.1

### Road corridors of Iraq and the region



## TRADE FACILITATION

Trade facilitation is broadly defined as the streamlining, simplifying, and harmonization of practices and formalities required for international trade by border inspection and regulatory agencies while safeguarding national security and protecting public health and the environment. Trade facilitation reforms reduce trade costs and time spent at borders and increase the predictability of supply chains, thus increasing national competitiveness. The global average reduction in trade costs from the full and effective implementation of trade facilitation measures is estimated to be at least 14.5 percent (Moisé and Sorescu 2013), and the increase in global trade resulting from these measures is calculated to be about US\$1 trillion per year (WTO 2015).

The global trade facilitation compliance framework is synonymous with the WTO's Trade Facilitation Agreement (TFA). Each article of the TFA offers potential solutions to the problems trade-industry stakeholders face when moving cargo internationally. Negotiations are still in progress for Iraq's accession to the WTO, and thus Iraq is not yet obliged to align its policies with the TFA. However, in practical terms, Iraq can use the agreement's provisions as an international standard benchmark to design a trade facilitation strategy and a national trade reform program. Looking forward, Iraq's accession to the WTO will release donor funds for trade facilitation support. WTO Aid-for-Trade disbursements for trade facilitation were the lowest among the 12 areas in which Iraq received financial support in 2019, despite the fact that trade facilitation was the country's second priority at the time, after only WTO accession (WTO 2019).

Iraq's trade facilitation reforms should complement the country's trade diversification strategies and investment attraction policies, especially those related to the exporting of new products to new markets in the agribusiness and manufacturing sectors. The Iraqi government must ensure that new commodities are channeled to markets quickly and predictably via cost-efficient and lean export chains. These trade and investment policies should be complemented with export process simplification programs for priority export chains. Doing so should bring noticeable results: full implementation of the TFA is estimated to boost the number of products exported to each destination by 32.9–35.6 percent for less developed countries (WTO 2015).

Trade facilitation could also deliver enormous practical value for the Iraqi business environment. It is no surprise that trade facilitation policies are persistently requested by domestic and foreign traders, who attribute a large portion of their supply chain costs to bureaucratic delays and superfluous fees at the borders. These policies will be more effective if coupled with initiatives to strengthen supply chain security, given the risky environment in which Iraqi traders and logistics service providers operate. Reform measures should be directed only to compliant traders, thus allowing the detection of illicit or dangerous cargo. Iraq's border agencies should also undertake a multilevel effort to exchange data and information with their counterparts across the border, enhance their collaboration with Iraq's other border control agencies, and establish partnerships with the private sector (WCO 2018).

## Challenges to trade facilitation

Trading across the border is expensive and time-consuming for Iraqis. According to the Doing Business 2020 database,<sup>13</sup> exporting from Iraq costs 4.9 times as much as in the average MENA country, and it takes 4.2 times longer (see table 3.8). Compliance with documentary requirements adds an extra burden to the export procedures. Although reforms to facilitate trade are much needed, the Iraqi government has not implemented any changes in a long time,<sup>14</sup> and thus Iraqi traders have not seen any substantial reductions in the time or cost to import or export. As a result, Iraq ranked 181st out of 190 countries in 2020 on the “trade across borders” indicator.

The effective implementation of trade facilitation programs will require the Iraqi General Commission of Customs (IGCC) to clarify and update its role and mandate in alignment with the government’s strategic priorities. At present, the IGCC needs to reevaluate the efficiency of its organizational model and develop a modernization strategy with clear transformational goals at the governance, legislative, and procedural levels. Unless core customs challenges—such as the lack of a basic customs information system, outdated primary and secondary legislation, and an absence of standard operating procedures—are addressed, Iraq’s chances to successfully implement trade facilitation reforms are very low.

The integrity and ethics of border operations should be a top policy priority. Perception is widespread among Iraq’s trade logistics industry that the IGCC has low levels of integrity. These observations are validated by anecdotal information about informal payments at the borders, by Iraq’s low ranking in the Transparency International Corruption Perception Index (162nd out of 180 in 2019<sup>15</sup>), and by a recent investment climate assessment that indicated that Iraqi customs administration suffers from widespread corruption and bribery (US Department of State 2018). The government is currently working on an anticorruption framework, and it recently established the new High Council on Combating Corruption (2019). Legislation to criminalize bribery has been drafted but not yet enacted: for example, public officials convicted of corruption are currently not prohibited from holding office. The lack of

**TABLE 3.8 Iraq’s performance on the Doing Business indicators for trading across borders**

INDICATOR	IRAQ	MIDDLE EAST AND NORTH AFRICA	OECD HIGH-INCOME	BEST REGULATORY PERFORMANCE
Time to export: border compliance (hours)	85	52.5	12.7	1 (19 economies)
Cost to export: border compliance (US\$)	1,118	441.8	136.8	0 (19 economies)
Time to export: documentary compliance (hours)	504	66.4	2.3	1 (26 economies)
Cost to export: documentary compliance (US\$)	1,800	240.7	33.4	0 (20 economies)
Time to import: border compliance (hours)	131	94.2	8.5	1 (25 economies)
Cost to import: border compliance (US\$)	644	512.5	98.1	0 (28 economies)
Time to import: documentary compliance (hours)	176	72.5	3.4	1 (30 economies)
Cost to import: documentary compliance (US\$)	500	262.6	23.5	0 (30 economies)

Source: Doing Business surveys, 2020.

Note: OECD = Organisation for Economic Co-operation and Development.

transparency in trade procedures (and their associated charges) and government officials' total discretion over clearance create conditions for unethical behavior by customs personnel.

Trade facilitation policies also have to consider supply chain security, particularly in trade operations. Iraq should consider programmatic solutions that ease the flow of cargo in a safe and secure manner. For example, the Iraqi government could look into implementing the World Customs Organization's (WCO's) Framework of Standards to Secure and Facilitate Global Trade, which recommends a range of measures to support secure trade.<sup>16</sup> A national authorized economic operators (AEO) program could link to the respective programs of neighboring countries such as Jordan, Saudi Arabia, and Turkey in order to mutually recognize each other's authorized operators and offer them benefits, which would allow customs officials to focus time and resources on risky cargo. Such a program could also create incentives for better compliance among exporters and importers, because a long-term record of compliance with customs is indispensable for granting AEO status. Annex B describes Kosovo's AEO program, which could serve as a model for Iraq's.

Iraq's land border infrastructure is insufficient. Investigating and developing border infrastructure is a responsibility of the Border Crossings Commission of the Council of Ministers. Currently, the majority of border stations are outdated, and their layouts lead to procedural duplication and delays in the clearance process (box 3.2). Their internet connectivity to the central offices in Baghdad is questionable, hindering the flow of cargo data and information. The facilities do not fully accommodate the needs of inspection agencies other than customs, and it is uncertain whether they could support procedural and instructional reforms related to joint border controls. Recent bilateral initiatives to resume operations at specific border crossing posts, such as the memorandum of understanding with Kuwait to fund reconstruction of the Safwan border crossing and the anticipated reopening of the Iraq-Saudi border crossing in Arar, need to keep the procedural side of trade in mind.

Physical inspections at Iraq's borders contribute to unnecessary delays. All cargo and goods currently undergo physical as well as technical inspection at all operational border crossing posts. Without a risk-management system to determine whether cargo should be subject to control, shipments are inspected at the discretion of customs clearance officials. According to private sector participants, all incoming and outgoing cargo is in practice physically and technically inspected by Iraqi customs at all operational border crossing posts, resulting in additional time and cost to complete customs clearance. Provisions for post-clearance audits are still under discussion and have not been implemented yet, in part because of the low capacity of customs to review declaration documents and identify errors that lead to noncompliance.

Per the Pre-Inspection, Testing, and Issuing of Certificates of Conformity Program of Goods Imported into Iraq law,<sup>17</sup> an extensive list of imported goods require a certificate of conformity to clear customs, including electrical appliances, auto parts, and textile products.<sup>18</sup> The certificates must be issued at the goods' origin by a third party (e.g., Cotecna or Intertek) and attested with the Iraqi embassy, and the inspecting agency has to be officially appointed by the Iraqi Central Organization for Standardization and Quality Control and the Iraqi Accreditation System.<sup>19</sup> For instance, when importing from the United States, the certificate of origin must be signed, notarized, and certified by the US Department of State before being sent to the Iraqi Embassy to be legalized.

## BOX 3.2

**Border crossing posts****Jordan-Iraq border crossing posts**

Jordan and Iraq are neighbors and natural trading partners. However, trade between the two is not any more streamlined than trade between other countries. The export supply chain is disrupted at many border crossing points: Jordanian truckers do not enter Iraq because of the high security risks and the poor condition of Iraqi roads, so their cargo is unloaded from their trucks and loaded again onto Iraqi trucks on the other side of border.

This practice leads to the following problems:

- a. High transportation costs, because traders have to pay for two trucking companies, one on the Jordanian side and one on the Iraqi side, and because the current process involves high administrative fees to Iraqi customs;
- b. Delays at the border, both for loading and unloading operations and for physical inspections, which are conducted by border agencies without any selectivity measures (according to anecdotal information, it may take one to seven days to complete the customs clearance process); and
- c. Frequent corruption and informal payments in order to “fast-track” processing of consignments.

In the absence of an electronic data interchange platform, interactions between Jordanian traders and Iraqi authorities are paper based and on site. Conformity certificates and certificates of origin are the two most burdensome documents required. Conformity certificates must be issued by an authorized third party, must be requested in person at the office of the corresponding agency in Amman, and are issued within two days. Certificates of origin must be attested at the Iraqi embassy in Amman, and their overall cost is about US\$100.

**Turkey-Iraq border crossing posts**

Turkish exports to Iraq are subject to onerous documentary requirements. Turkish traders may need to attest their certificates of origin and commercial invoices at the Iraqi Embassy in Ankara. Moreover, a

certificate of conformity issued by an authorized third party (i.e., Intertek) is required to clear regulated goods. Such a certificate is issued after documentary or physical examination in Turkish territory. According to the Doing Business study, completing a conformity inspection in Turkey takes an average of three days and costs US\$400, but private sector feedback reveals that inspections can take up to a week, depending on the agency conducting them, and charges can be more expensive for high-value shipments.

Excessive delays are recorded at the Ibrahim-el-Khalil border crossing. According to private sector sources, it takes about five hours to complete customs clearance and scanning with Turkish customs. According to the Doing Business study, it takes another almost 60 hours on the Iraqi side for customs clearance and inspections, while the private sector perceives the process to take about a week. These delays are attributed to intrusive inspections by Iraqi customs, which are incentivized by the collection of compulsory fees related to cargo handling and scanning. On top of these fees, Turkish importers must pay for the services of Iraqi customs brokers in order to clear goods, which leads to further delays and high congestion at the border.

There are also numerous bottlenecks along the north-south corridor through Iraq (Ibrahim-el-Khalil to Baghdad to Umm Qasr). Truckers have to interrupt their trips along the corridor for a variety of reasons, including the following:

- a. Turkish trucks are not allowed to continue driving beyond Altun Kupri, where cargo has to be loaded into Iraqi trucks. Furthermore, the Turkish cargo is subject to control by Kurdish authorities to ensure that all required documents (i.e., conformity certificates) are in order.
- b. Turkish goods are subject to an additional check-point at Samarra, where Iraqi customs inspect for prohibited imports (i.e., certain agricultural goods) and collect a high corresponding fee.

And according to feedback from the private sector, completing a conformity inspection when importing from Turkey takes about three days and costs US\$400, which is about 22 percent of the overall time and 35 percent of the overall cost to import to Iraq, as measured by the Doing Business surveys. Several other countries are either removing or streamlining conformity inspections at origin.

Additionally, the roads and highways in Iraq have deteriorated greatly as a result of war and traffic of heavy vehicles, increasing the time and cost of domestic transportation. The Doing Business (World Bank 2020) study reported that it takes about 24 hours for a truck to cover the approximately 580 km between Baghdad and the Umm Qasr port, including container loading, transportation, checkpoints, and traffic. That same trip costs an average of US\$1,379. According to feedback from the private sector, the route from Baghdad to the border with Turkey takes even longer and is even more expensive, although the distance is similar. The bad condition of the roads is another reason trucks from neighboring countries—especially from Jordan—prefer not to operate in Iraq.

Trade processes at the Umm Qasr port are inefficient. Several infrastructure and service improvement initiatives—such as a US\$250 million private investment at the Basrah Gateway Terminal (BGT) allowing the port to receive container ships of up to 14,000 twenty-foot equivalent units and the BGT's expansion into value-added logistics services beyond its core of box handling and storage—are expected to improve the terminal's operational efficiency. However, clearance times remain high. Export containers spend an average of three days at Umm Qasr, from the moment the containers enter the port until they are loaded into a vessel.<sup>20</sup> Traders do not expect to see any substantial improvements in total import or export times unless the proposed improvements are accompanied by clearance process simplification and reduction of red tape. However, these reforms will not be easy, given that the south of Iraq has the most challenging trade logistics of any region of the country, in terms of both customs formalities and ocean access.

All export and import procedures in Iraq are still completed on paper. Indeed, the 2019 UN Global Survey on Digital and Sustainable Trade Facilitation gave Iraq a score of 0 percent on paperless trade.<sup>21</sup> Iraq has neither a reliable customs information system nor any type of electronic data interchange system by which to submit trade-relevant information. None of Iraq's core trade agencies—Customs, the Ministry of Trade, the Port Authority, the Ministry of Agriculture, or other technical border control agencies—provide electronic services to traders. Today, Iraqi exporters are required to submit 11 documents to trade compliance agencies (see table 3.9), while the respective figures for Jordan, Kuwait, and Turkey are 6, 8, and 6. In addition, traders must visit the corresponding agencies in person several times to collect and present documentation. This lack of digitalization partially explains Iraq's poor performance on the Doing Business Trading across Borders ranking as well as why it costs seven times more to comply with export documentation in Iraq than in the rest of the MENA region (table 3.10).<sup>22</sup>

Iraq accepts a few supporting documents in simple copies of the originals, such as the packing list and the bill of lading. However, certificates of origin and phytosanitary certificates need to be provided in original copies.

The whole process of submitting paper documents is cumbersome and costly for traders; it takes about 9 business days and costs about US\$270.<sup>23</sup> The Doing Business 2020 study reported that it takes 24 days and costs US\$1,800 to obtain, prepare, and submit the necessary documents to export a shipment of vegetables

**TABLE 3.9 Documents required to export and import in Iraq**

EXPORT	IMPORT
Commercial invoice	Commercial invoice
Export license	Bill of lading
Export permit	Import declaration
Packing list	Certificate of conformity
Bill of lading	Certificate of origin attested by the Embassy of Iraq
Certificate of origin	Valid import license
Inspection report	
Terminal handling receipt	
Delivery order	
Safety of Life at Sea certificate	
Health certificate	

Source: Doing Business surveys, 2020.

**TABLE 3.10 Documentary compliance time and cost to export and import in Iraq and selected regions**

INDICATOR	IRAQ	MIDDLE EAST AND NORTH AFRICA	SUB-SAHARAN AFRICA	OECD HIGH-INCOME
Documentary compliance (hours)	504	66.4	71.9	2.3
Documentary compliance (US\$)	1,800	240.7	172.5	33.4
Documentary compliance (hours)	176	72.5	96.1	3.4
Documentary compliance (US\$)	500	262.6	287.2	23.5

Source: Doing Business 2020.

Note: OECD = Organisation for Economic Co-operation and Development.

from Iraq to India through the Umm Qasr port. And it takes about seven days and US\$500 to complete documentary requirements when importing auto parts from Turkey through the Ibrahim-el-Khalil border crossing. According to the Doing Business data, it is seven times more expensive to comply with documentary requirements to export into Iraq than into the average MENA country (table 3.10).

Burdensome documentary requirements in Iraq also include the permits and licenses issued by relevant ministries. Import licenses from the Ministry of Trade are restricted to a list of preapproved products, and importers point out that in practice, only goods that cannot be produced in Iraq are allowed to be imported. It takes about one month to issue a license. Licenses are usually valid for one year, and they have to be shown each time during clearance. However, the private sector highlights that the regulation is unclear about the scope, validity, and cost of licenses, which results in several visits to the Ministry of Trade every time a shipment is imported. Licenses from other

agencies are also sometimes required, depending on the type of good being imported.

On the bright side, Iraq's issuance of phytosanitary certificates is relatively efficient. The World Bank's *Enabling the Business of Agriculture* 2019 study gave Iraq a score of 55.39 out of 100 in trading food. Per Iraqi agricultural quarantine regulations from 2012, every exported shipment of agricultural goods must be accompanied by a phytosanitary certificate. The Ministry of Agriculture issues the certificate after conducting an inspection, which usually takes place at the warehouse of the exporter the day after it is requested in person at the ministry. The fee associated with the inspection and the certificate (about US\$100, according to feedback from the private sector) is not public, but it can be requested at an inquiry point in the Ministry of Agriculture.<sup>24</sup>

Domestic customs checkpoints in Iraq have been reduced. Cargo entering the country via the Kurdish region was once charged duties or fees collected by several customs checkpoints between Erbil and Kirkuk, Sulaimaniya and Kirkuk, and Duhok and Mosul. As a result, movement of goods along the corridor became more expensive and time-consuming, and opportunities arose for corruption. However, a recent agreement between the federal government and the government of the Kurdish region to unify the nation's customs procedures removed these domestic customs points. Although the extent to which this measure has been implemented is still unknown, once fully adopted, it is expected to reduce the cost and improve the speed of freight along the Erbil-Baghdad corridor.

There is a lack of cross-border coordination between Iraq's customs agencies, and ideas have not materialized yet for the development of juxtaposed customs offices, where technical and physical infrastructure can be shared across borders. Most importantly, looking into the soft side of operations, Iraqi customs has entered into only one agreement to harmonize its processes and procedures with its counterparts on the other side of the border (in which the Iraqi and Saudi governments agreed to automate and streamline customs procedures between their two countries). Also, in July 2019, Iran and Iraq signed a trade facilitation agreement that aims to remove barriers to trade and targets the removal of tariffs as well as infrastructure investments. The agreement also discussed the establishment of a joint industrial town and the implementation of new quality control methods (Jalilov 2019).

Iraq established a National Trade and Transport Facilitation Committee in 2015 following a United Nations Economic and Social Commission for Western Asia workshop that brought together the Iraqi ministries of trade and transportation and private sector representatives. But despite the alleged creation of the committee, its organizational structure, membership, and functional efficiency are unknown, and there is no online record of its activities since it was established (COMCEC 2015). It is also unclear how well the committee is aligned with the structure and mandate of the National Trade Facilitation Committee (NTFC) on the basis of the principles of the WTO TFA, which are considered the international best practices in this domain. Nonetheless, building this committee's technical capacity and ensuring its long-term financial sustainability are of paramount importance to designing and implementing trade facilitation reforms.

The overall contribution of the trading community to Iraq's policy formulation is limited. Trade-related regulations are not subject to stakeholder consultation before they are finalized, and only some regulatory agencies solicit comments from the general public. It is not required by law to publish the text of regulations before their enactment, nor is it required to solicit comments. There is no specialized body or institutional mechanism tasked with receiving, discussing, or providing input. A fully functional public-private consultation mechanism modeled on the NTFC could potentially play this role.

Similarly, the availability of information about Iraq's trade processes and procedures on the internet is low. Specific information on export, import, and transit procedures is not easily accessible,<sup>25</sup> nor are the fees and charges imposed by government agencies or the forms and documents required for trading across borders. This lack of reliable information is aggravated by frequently changing regulations. Therefore, it is impossible for traders to know beforehand the compliance requirements for importing or exporting their products. They often rely on their contacts within customs and other government agencies to learn about required documents and clearances, and they explain that without such connections it is difficult to trade. This ambiguity also increases supply chain risks and reduces the predictability of trade operations. Moreover, the absence of publicly available standardized operating procedures leads to repeated discretionary decision-making by border officers.

Officers at the border agencies tend to have low professional skills because of weak recruitment standards and often lack training, according to anecdotal information and a relatively recent World Bank diagnostic report (World Bank 2017). Recruitment is not based on prespecified selection criteria, and the minimum requirements used by other countries for such roles (for instance, a university degree) are not prerequisites in Iraq. Training is provided, usually through workshops, but not on a regular or systematic basis, and it usually occurs only to introduce new systems or procedures.<sup>26</sup>

## THE WAY FORWARD

This section highlights key ideas arising from the above analysis for reforms Iraq could make in trade policy, regional integration, and trade facilitation.

### Trade policy and regional integration

Iraq's tariff structure should be simplified and flattened. The current tariff structure, with multiple high peaks, invites corruption and tariff evasion. A simplified tariff schedule with a few basic rates would likely collect more revenue and reduce economic distortions.

The burden of Iraq's import licensing regime should be substantially reduced. On a preliminary basis, automatic licensing should be considered, beginning with the least sensitive products, and the list of products subject to automatic licensing should be gradually expanded. The need test for issuing licenses should also be expanded. If a product can theoretically be produced in Iraq but the imported variety has different specifications and quality, import licenses should not automatically be denied.

The unification of the Kurdish region and the rest of Iraq into a single customs territory is an important goal. Traders should pay the same duties regardless of which border of Iraq they enter through, customs procedures should be uniform, and the impact of any remaining internal trade checkpoints should be minimal. Unifying the tariff regime would require negotiations over the appropriate level of tariffs. The sharing of import duty revenues across the country could be part of the solution to both this problem and the broader problem of regional revenue sharing.

Iraq should continue to participate in the WTO accession process in order to learn from its trading partners in the WTO Working Party. This way, opportunities for reform can be identified and implemented on a rolling basis even prior to accession. As is pointed out in the following section, moves to bring Iraq's border procedures in line with the WTO Trade Facilitation Agreement are likely to reduce the cost, time, and uncertainty of trading in Iraq and promote export diversification.

### **Trade facilitation reforms**

Iraq's customs modernization strategy needs to be updated. Modern trade facilitation policies require the adoption of a one-government approach and policy harmonization among all border inspection agencies. However, Iraq's customs still remain at the core of cargo clearance processes and procedures. The aim of customs should be to ensure maximum compliance, but in a manner that does not impede trade or impose an excessive compliance burden on the business community. To do so, Iraq will also need to ensure consistency between the IGCC's operations in Baghdad and those of the Customs Administration in the KRG and to avoid divergences between the two systems. This goal can be achieved through a unique systems development unit, adequate telecommunications (ensuring quasi-real-time monitoring of operations), and unified clearance policies.

Iraq will also need to strengthen its border agencies' integrity and professionalism (especially that of border inspection officers). A comprehensive review of each agency's human resources policies should be carried out, covering all key staffing issues, followed by the adoption of new policies designed to reinforce the merit principle in all key staffing decisions. This reform should be supported by a competency assessment and a gap analysis. These efforts can be coordinated with the broader initiative to develop a governmentwide anticorruption framework, which—along with the removal of outdated processes and the application of trade automation—would improve the widespread perception among trade stakeholders that customs personnel have low integrity.

Iraq's national trade logistics infrastructure should be improved. The country's border infrastructure is old and outdated, and the layout of the current border stations leads to complex procedures and duplication of work (the same shipments often end up inspected multiple times by different agencies). Many border facilities will need to be redesigned; they should be planned so as to adjust to new operational requirements, in particular (a) the design of inspection, off-loading, and storage areas, bearing in mind the need to consolidate controls; (b) the adoption of new examination policies, which may reduce the need for large border warehouses; and (c) the need for traffic separation

between different categories of users. The new facilities should incorporate international best practices into their designs and procedures, and they should be complemented by cross-border cooperation. Whenever possible, Iraq should explore colocation options with the neighboring country and build on existing memoranda of understanding and cooperation agreements in order to deepen collaboration between their respective border agencies.

Furthermore, Iraq should reclaim its role as a regional transit hub. The Iraqi government may consider proactively developing a strategic plan to facilitate seamless cargo flows along the Ibrahim-el-Khalil–Baghdad–Umm Qasr trade corridor. This plan should smoothly and holistically incorporate both the hard side—corridor infrastructure—and the soft side—transit, regulatory, and procedural reforms. Iraq should also seek admission to the International Road Transports Convention and introduce a seamless transit scheme, which would minimize procedures at its borders. Legislative and regulatory provisions for these measures should be drafted if necessary, and the IGCC should facilitate discussions between the transportation industry, the banking system, and chambers of commerce to introduce a guarantee mechanism. As an intermediate step, the IGCC should prepare a domestic transit system for (a) border-to-border and (b) border-to-inland (and reverse) traffic.

Iraq's trade processes are segmented, often redundant, and prone to arbitrary decisions as well as errors. Furthermore, there is no self-assessment mechanism in place; without one, trade agencies can easily lapse into errors, fraud, or failure to prosecute misdeclaration. Declaration control is weak in Iraq, and key areas of customs control, such as valuation, are largely ignored. New procedures, largely based on principles of client segmentation and risk management,<sup>22</sup> will need to be developed (with input from the business community) and tested. The government should aim to simplify and harmonize all border inspection agencies, including but not limited to the IGCC. Priority should be given to the adoption of user-friendly processes and customized procedures that provide for (a) a national single-window system; (b) authorized economic operator status; (c) clearance of goods on the importers' premises; (d) deferred duty-payment schemes; and (e) simplified and consolidated periodic declarations, as well as those that eliminate delays at the borders and promote automation. Process reengineering efforts should be accompanied by reforms to reduce redundant documentation and reduce or eliminate fees and charges, as appropriate.

Unlike many other countries, Iraq has an extensive national fiber-optic backbone that extends to most major border crossings and ports. This infrastructure would facilitate the implementation of a nationwide customs system. A trade automation master plan, to include all border inspection agencies, should be drafted. However, the Iraqi government should start by fully and effectively automating customs operations. The first measure will be to connect major customs locations with the IGCC headquarters so that declarations lodged, revenue collected, and fraud or irregularities detected can be reported daily. As for customs software, the IGCC should draft system specifications and quickly move forward with procuring an Automated System for Customs Data or any other commercially available system. To avoid the potential problem of having two separate systems for IGCC and KRG customs, the two agencies can ensure that the initial prototype is developed jointly and with the assistance of the donor community.

Finally—assuming the automation level improves in the short to medium runs—the Iraqi government should start developing an interagency electronic data exchange system, possibly in the form of an electronic National Single Window (NSW). Best-practice NSW systems simplify import and export requirements for traders, reduce transaction costs, and improve data integrity. They also reduce opportunities for corruption and rent-seeking, increase transparency and predictability, and facilitate the adoption of modern risk-based approaches across border management agencies (see annex 3.C).

The introduction of risk-management techniques in Iraq's border management controls and clearance procedures could reduce the country's delays at the borders. Only a select number of shipments passing across the border should be physically inspected, and those shipments should be chosen on the basis of clearly defined criteria and intelligence collected prior to their arrival. Risk management should be an integral part of the IGCC's policy, and it should apply to all of customs' organizational functions, including strategic and annual planning, operational and tactical assessments, domestic and international government partnerships, stakeholder programs, and project work. This change will require customs to (a) have access to reliable, up-to-date intelligence and information about risks, (b) establish decision-making processes supported by a framework for coordinated risk identification and response, (c) set up a dedicated risk analysis capability, and (d) have the right balance of controls in place to mitigate identified risks. Risk management should apply not only to customs but also to all border inspection agencies.

On that same note, the Iraqi government should consider adopting a risk-based reward system for long-term compliant traders, such as an AEO certification program,<sup>28</sup> as mentioned earlier in this chapter. The existence of AEO programs in both Jordan and Turkey offers a unique opportunity for mutual recognition of certificates, which would promote the seamless flow of goods across the region.

Public-private ownership of the reform agenda is required. The cross-sectorial nature of trade facilitation calls for close coordination between trade operators and service providers, on one hand, and customs and various ministries and regulatory agencies, on the other. The Iraqi government, with the support of the donor community, should begin the operations of the existing National Trade and Transport Facilitation Committee and further align it with best international practices. Prior to its operationalization, the committee should ensure that a number of key preconditions are in place, such as strong political will, senior management's commitment, transparent and open communication, and clearly defined goals and objectives supported by time and resource commitments. Alternatively, an NTFC that is based on the TFA principles and guidelines should be established. Regardless of its form and institutional design, a national platform for public-private dialogue on trade facilitation will assist in the identification and removal of critical legal, regulatory, and operational barriers to trade. The IGCC and the Ministry of Trade should jointly take the lead in designing, establishing, and operationalizing the committee, with the support of the donor community. The NTFC could also play a pivotal role in developing priorities and a road map or strategic plan (possibly followed by action plans) for trade reforms in Iraq.

Although imperfect and out of date in many respects, Iraq's current customs code is adequate to support basic customs operations. The key problems with

the code are that it does not seem to be applied effectively in most locations and that customs authorities, to a large extent, do not seem to be aware of some of its provisions. The government should consider reviewing the primary and secondary legislation (i.e., the legislation for customs and for other fields affecting customs operations) and submitting appropriate changes to the parliament. In parallel, the government should draft implementation provisions and standard operating procedures and train customs staff on them.

Finally, Iraq's diversification strategy and the restoration of national production of goods other than hydrocarbons can be reinforced by targeted trade facilitation policies. Iraq could enhance regional integration with private sector-development and export-promotion policies (especially in the agribusiness and manufacturing sectors), which should be complemented with process-simplification and automation programs that would increase the predictability and reduce the transaction costs of priority supply chains. Several members of the Organization of the Petroleum Exporting Countries are also turning to trade facilitation to diversify their economies. For example, Bahrain's Vision 2030 strategic plan focuses on trade facilitation through soft and hard infrastructure improvements, such as the establishment of differentiated lanes for border crossing at the King Fahd Causeway. Similarly, as part of its Vision 2030, Saudi Arabia enhanced its electronic trade single window, enabled risk-based inspections, launched an online platform for the certification of imported goods, and upgraded infrastructure at the Jeddah port.<sup>29</sup>

Trade facilitation should also be viewed through the lens of safety and security. Legitimate security concerns have prevented trade facilitation from becoming a policy priority of Iraq in the past several years, which explains Iraq's lack of alignment with international best practices on a wide range of issues, including digitalization, inspections, documentation, and border cooperation. These factors have created high trade costs, delays, and discretion when trading across Iraq's borders. However, security considerations should not stand in the way of implementing economic diversification and contingent trade facilitation policies that would lead to economic development and growth.

Given the current realities of Iraq's political economy, some reforms are likely to face more resistance than others. Both the unification of the customs territory and customs modernization promise increased revenue. By expanding the revenue pie, these reforms could help to moderate the tensions over revenue allocation that plague Iraq's current system, particularly with respect to oil revenue. As for modernizing the import licensing regime, the ability to allocate licenses might be of particular value to certain actors, who would resist any modification to current arrangements even if a more liberal regime would benefit other Iraqis. And as for WTO accession, progress can be made incrementally over an extended period of time. However, because the accession process is in large part an exercise in transparency, it could also face resistance from incumbent stakeholders, who may benefit from the lack of transparency in current trade policies.

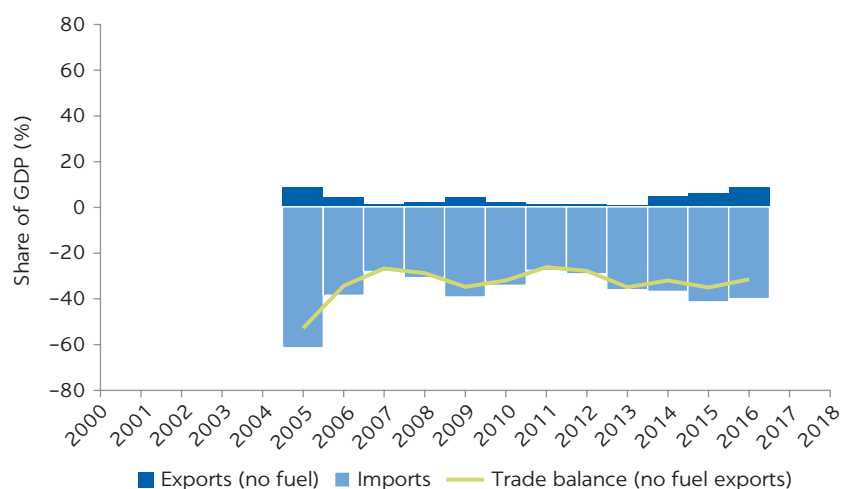
A whole-of-government approach is required to trade policy in Iraq. Although focus should be placed on improving the efficiency of the IGCC's operations, the operational efficiency of the rest of the border inspection agencies also plays a very important role. Improving their efficiency will be particularly important for the agribusiness and light manufacturing commodities that require a series of noncustoms tests and controls, which often lead to

excessive delays at the borders. The Iraqi government should adopt a coordinated border management approach that involves public service agencies working across portfolio boundaries in a synchronized manner to achieve the shared goal of efficient cross-border trade, thus providing a cohesive government response to trade logistics challenges. This coordination will ensure that efficient and effective processes and procedures are used by all regulatory agencies involved with border security or with regulatory requirements for goods crossing international borders.

### ANNEX 3.A: ADDITIONAL FIGURES

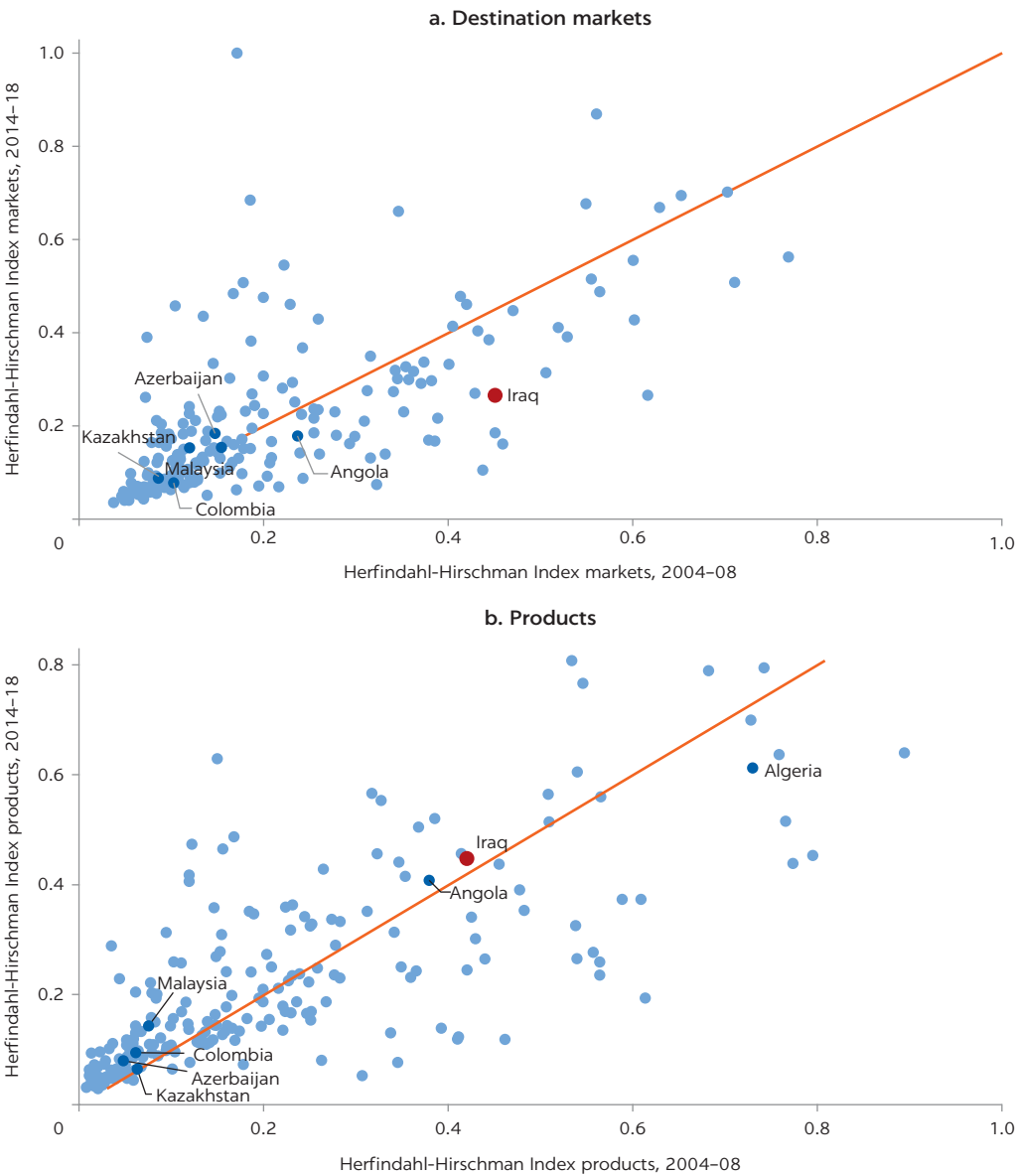
FIGURE 3.A.1

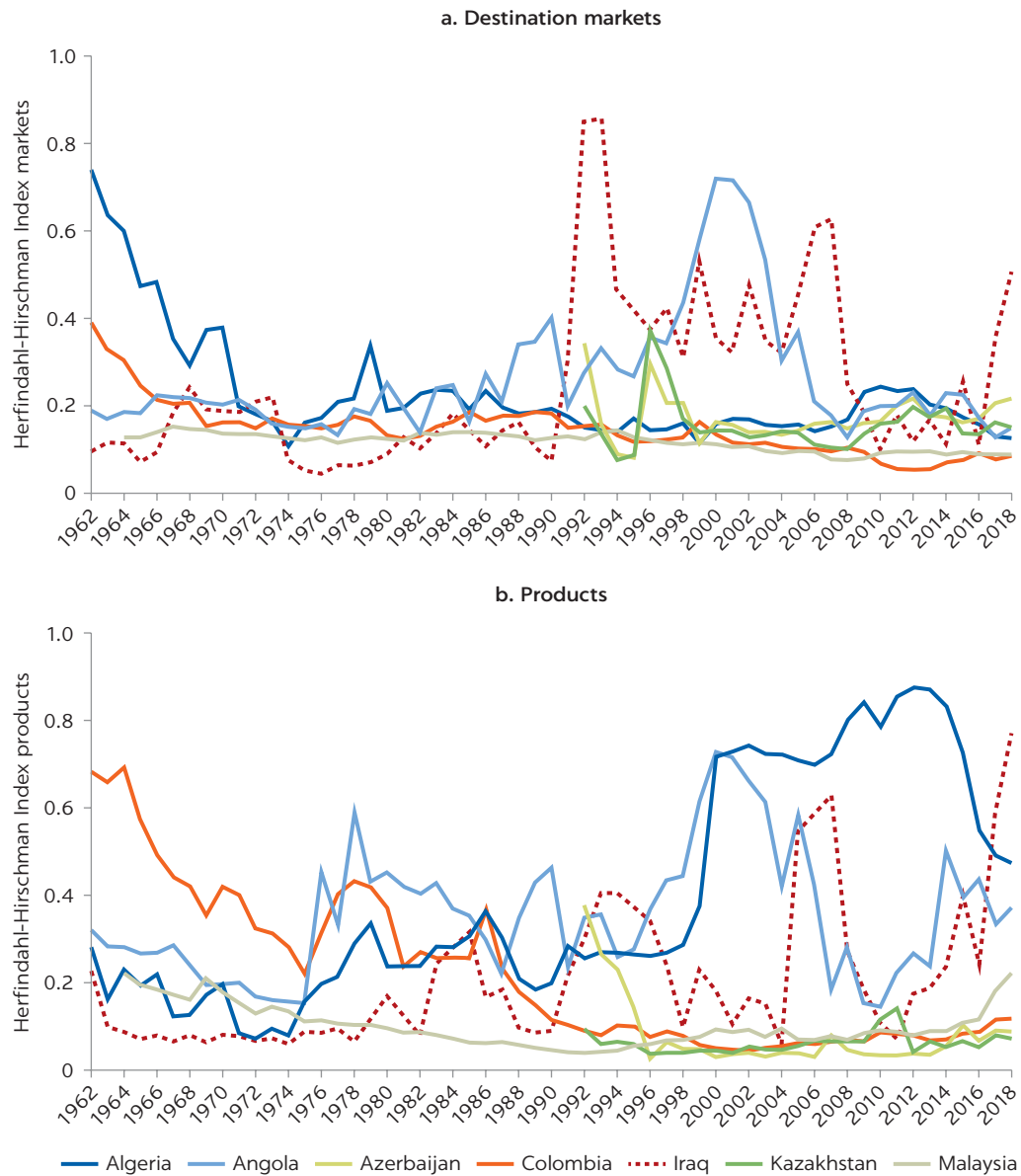
Trade balance without fuel exports, 2000–18



Source: World Development Indicators.

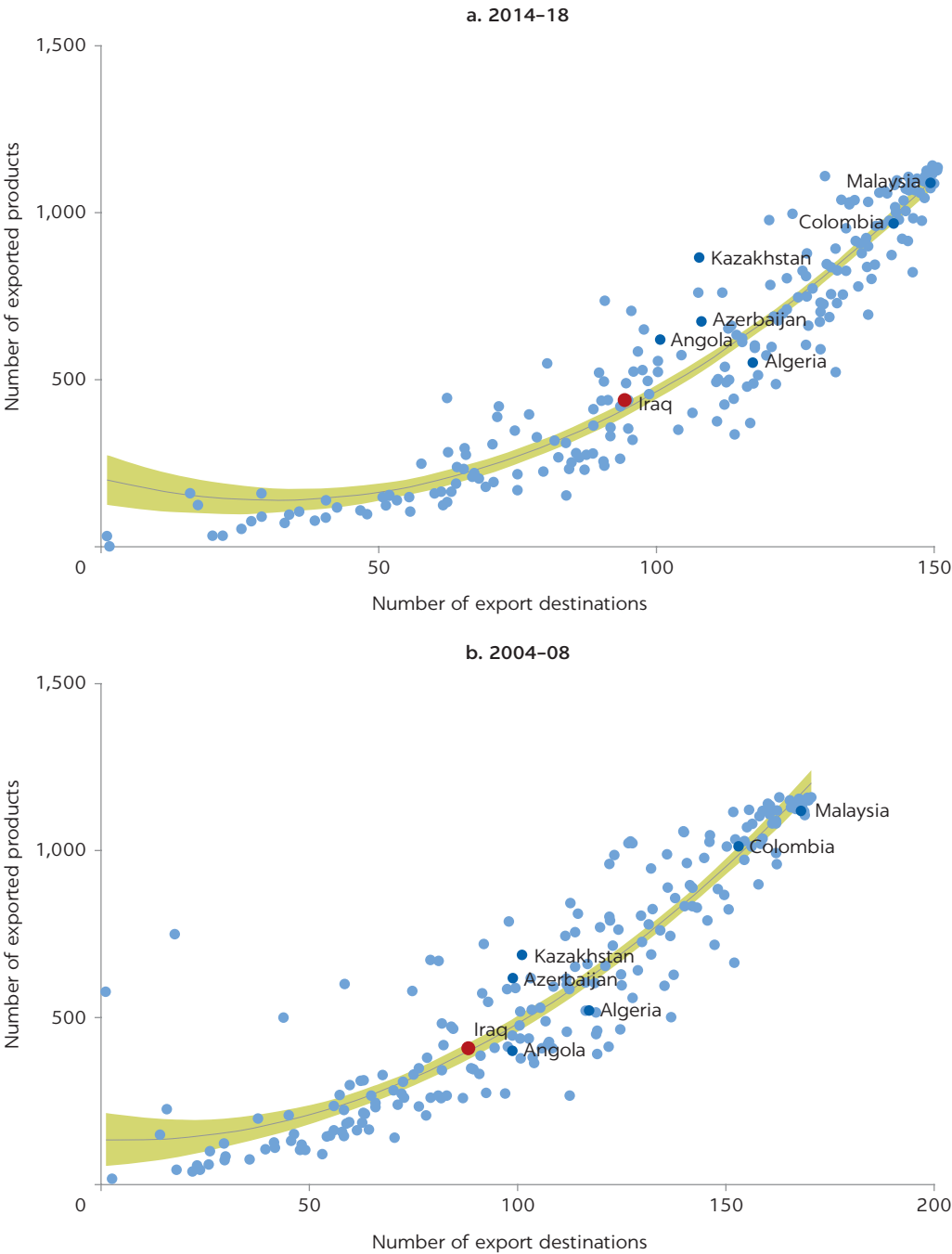
**FIGURE 3.A.2**  
**Herfindahl-Hirschman Index without fuel exports, 2004–08**  
*SITC 33101*



**FIGURE 3.A.3****Evolution of diversification: Herfindahl-Hirschman Index, without oil, 1962–2018**

Source: United Nations Comtrade data.

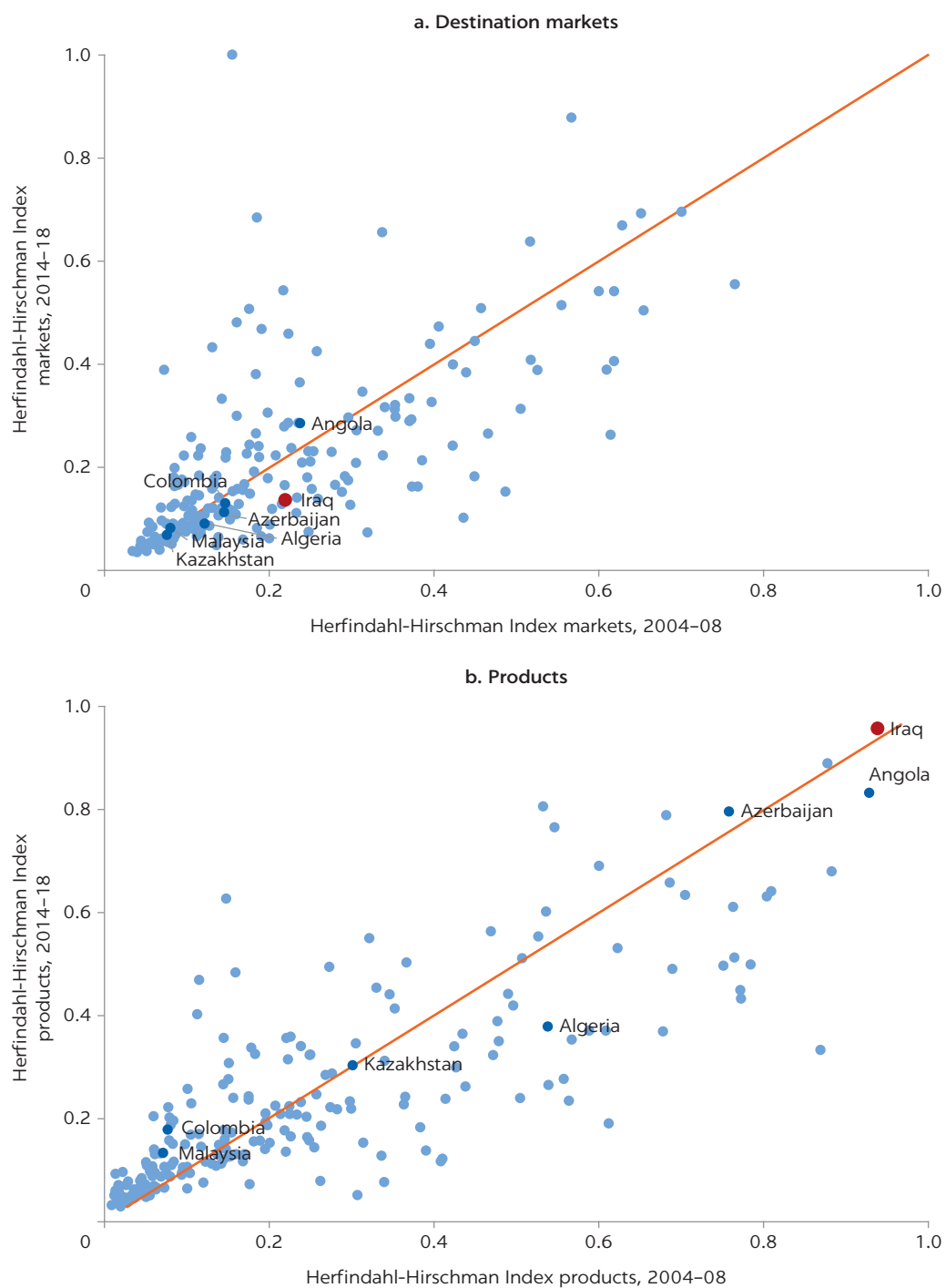
**FIGURE 3.A.4**  
**Number of destinations and products, 2004–08 and 2014–18**



Source: United Nations Comtrade data.

FIGURE 3.A.5

## Herfindahl-Hirschman Index, 2004–08 and 2014–18



Source: United Nations Comtrade data.

Note: Comparator countries are Algeria, Angola, Azerbaijan, Colombia, Kazakhstan, and Malaysia.

### **ANNEX 3.B: KOSOVO'S AUTHORIZED ECONOMIC OPERATORS PROGRAM**

For Kosovo's just-in-time trade logistics companies, delays holding up cargo delivery represent an agonizing loss of potential earnings. The WTO's trade facilitation agreement (TFA) contains provisions for expediting the movement, release, and clearance of goods, including those in transit. Simplified customs procedures are key to optimizing Kosovo's economic potential and for positioning the landlocked country as an effective trade destination in the Western Balkans.

Since 2017, the World Bank has supported Kosovo in becoming one of the first countries in the Western Balkans to introduce an AEO program. This trust-based approach to customs clearance offers preferential status to certified traders that meet a set of security and compliance standards mirroring those of the European Union (EU). Benefits for certified traders include simplified customs procedures, expedited processing and release of shipments, less paperwork, and fewer inspections, which lead to reduced transaction costs and delays and increased supply chain predictability.

#### **Approach**

- Stakeholders confirmed the need to design an AEO program through a time-release study, which measured import and export times and determined bottlenecks in the process of clearing goods at the border.
- Kosovo enacted legislative amendments to establish the AEO status and bring it in line with EU standards.
- Kosovo's customs administration was trained to implement the AEO program; an AEO customs coordinator and a commission composed of seven officers from various departments were designated.
- A targeted communications campaign aimed at businesses raised awareness of the program among customs, other border inspection agencies, and the private sector and promoted the benefits of AEO status.
- The World Bank supported the sharing of international best practices and financed Kosovo's customs administration's trip to the United Kingdom to learn how it had implemented a successful AEO program with more than 600 "trusted traders."
- The World Bank also supported the application process's development, including the design of the AEO certificates in three languages (Albanian, Serbian, and English) and the awarding of certificates to Kosovo's first AEO-certified traders.

#### **Impact**

The Kosovo AEO program has had a clearly defined and measurable impact on private sector development in Kosovo, and it has also contributed to the country's efforts to modernize customs and other border inspection agencies. Orchestrated efforts to operationally link national AEO programs at the regional level will further contribute to the regional integration of the Western Balkans and the seamless flow of cargo across borders.

- **Private sector development.** The Kosovo AEO program saves times and money for domestic small and medium enterprises. The first two companies to benefit from the preferred status were Auto Mita, Kosovo's leading car dealership and official representative for Renault and Nissan, and Galvazink, a zinc processing company. Auto Mita saves more than €8,000 per year in clearance fees at the inland terminal. For Galvazink, procedural simplification for the 400 trucks of raw products it imports and reexports annually results in about €28,000 in savings.
- **Border management modernization.** The program has (a) resulted in better use of human resources, enabling the customs administration to focus its scarce resources on areas of higher risk; (b) improved business processes, resulting in faster processing and clearance times; (c) enhanced compliance through certain features of the AEO program (e.g., random-selection inspections and access to accounting records); and (d) fostered better alignment with international standards, including the WTO TFA.
- **Mutual recognition and regional harmonization.** The World Bank has supported the establishment of AEO programs in Albania, Kosovo, and Montenegro. The AEO programs under development also conform to EU standards. This consistency paves the way for the mutual recognition—and ultimately harmonization—of nationally accredited AEO firms. Once trusted traders are certified by a critical mass of countries, intraregional trade flows will be able to move across borders in a cost-efficient and predictable manner.

### ANNEX 3.C: ETHIOPIA'S ELECTRONIC SINGLE WINDOW

Ethiopia—Africa's sixth-largest economy and second-most-populous nation, home to more than 100 million people—has experienced steady economic growth in recent years. However, burdensome documentary requirements, high levels of physical inspection of imports, and a lack of coordination among border agencies, coupled with low levels of automation and an uncompetitive trade logistics sector, raise the costs of doing business in the country and limit its opportunities to trade. Ethiopia's logistics costs are among the highest in the world, and they hinder the growth of export-driven light manufacturing and agriculture. For example, a study in 2012 estimated that moving a 20-foot, 10-ton container between Guangzhou and Addis Ababa cost US\$4,000 and that half that cost was for moving it the 700 km between the port of Djibouti and Addis Ababa.

Ethiopia's high trade costs can be attributed to various constraints, including a state monopoly on key logistics services; regulatory restrictions on and low performance in these logistics services; shortages of foreign currency, which prolong import times; and delays in obtaining and processing trade documents. To address these challenges, the government (through its "Homegrown Economic Reform" agenda, which aims to transform Ethiopia from a low-income country into an industrialized lower-middle-income country by 2030) is pursuing a multipronged approach that includes improving regulations, processes, and practices that burden private businesses and addressing investment climate issues that have held back investment and productivity growth.

As part of the government's commitment to improving investment and trade, the Ethiopian Customs Commission launched an electronic single window (eSW) for trade in early 2020 with help from the World Bank. The new eSW system connects the country's 16 major cross-border regulatory agencies. It enables traders to submit documentation and receive electronic permits relating to imports and exports through a single window, significantly reducing the time and cost to trade.

## Approach

- Build a blueprint for the eSW (business process reviews, functional and technical architecture, etc.).
- Reform the legal and regulatory framework to support the introduction of the eSW.
- Catalyze consensus for reform with both the private and the public sectors.
- Provide technical assistance to build the eSW system in line with the WTO TFA.
- Introduce new procedures and approaches for customs operations, and train customs officers to use the eSW.
- Introduce the eSW to other relevant border agencies and to the private sector in order to ensure its effective implementation.
- Raise awareness within the trade community about the launch of the eSW.

## NOTES

1. Removing fuel exports would dramatically decrease Iraq's trade openness, because they account for 90 percent of Iraq's merchandise trade.
2. In the absence of official data, Iraq's exports and imports have been estimated using mirror data. That is, other economies' reported imports from Iraq are used to represent Iraq's exports, and other economies' reported exports to Iraq are used to represent Iraq's imports.
3. Taiwan, China, appears as "other Asia" in the United Nations Comtrade data.
4. These transactions are usually for goods imported under customs provisions that do not lead the physical nature of the merchandise to be recorded.
5. The number of destinations remains unchanged when fuel exports are excluded.
6. If fuel exports are excluded, Iraq's export destination concentration index increases, but the country's product concentration drastically decreases. However, nonfuel exports account for a very small share of exports over the entire period.
7. An alternative explanation for Iraq's latent export potential—proposed by Lederman, Pienknagura, and Rojas (2019)—is that if Iraqi exporters have already paid the fixed costs associated with exporting, they will be able to reenter the export market once internal conditions improve.
8. Lederman, Pienknagura, and Rojas (2019) show that latent diversification is an important determinant of trade volatility and that countries with more diversified latent export baskets exhibit lower trade volatility.
9. Illicit oil sales were also conducted on the basis of formal "trade protocols" between Iraq and individual governments (e.g., the Arab Republic of Egypt, Jordan, Syria, and Turkey) or on the basis of "private sector export" agreements between Iraqi authorities and private individuals and entities. The importation of civilian goods under Iraq's trade protocols with its neighbors was not necessarily prohibited by the UN sanctions, and under US sanctions, Iraq was allowed to import additional goods separate from the OFF.
10. In addition, approval from the central bank is required to obtain the necessary foreign exchange for importing.

11. For more information about this company, see <https://web.archive.org/web/20130124134732/http://fairs.mot.gov.iq/index2.html>.
12. Following a complaint about its labor rights, the government of Iraq participated in a hearing held by the Office of the US Trade Representative (USTR) in November 2018 to outline the progress it had made on labor reforms. The USTR continues to engage with the government of Iraq on these issues and formally convened a TIFA council meeting in 2019 (USTR 2019).
13. For more information, see the Doing Business database, [www.doingbusiness.org](http://www.doingbusiness.org).
14. The Doing Business database has not recorded any Trade Across Borders reforms in Iraq in the past 10 years.
15. This index is available at <https://www.transparency.org/cpi2019>.
16. For more information on this framework, see the WCO SAFE page at <http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/frameworks-of-standards/safe-package.aspx>.
17. See the Central Organization for Standardization and Quality Control Law No. 54 of 1979 (Article 3, Clause 8).
18. Other items on the list include food, toys, vehicle tires, chemicals, cosmetics and perfumery products, tobacco products, construction and building materials, kitchenware, stationery, baby care items, and lubricants.
19. See the Doing Business database and [www.intertek.com/government/product-conformity/exports-to-iraq/](http://www.intertek.com/government/product-conformity/exports-to-iraq/).
20. See the Doing Business database.
21. For more information, see the UN's Global Survey on Digital and Sustainable Trade Facilitation database.
22. See the Doing Business database.
23. Organizations that provide this service include [www.arabchamber.com/iraq](http://www.arabchamber.com/iraq), [www.usarab.com/iraq](http://www.usarab.com/iraq), and [www.wcss.com/services/embassylegalization/iraq/](http://www.wcss.com/services/embassylegalization/iraq/).
24. For more information, see the World Bank Enabling the Business of Agriculture database.
25. The IGCC website provides access only to the customs law.
26. See the Doing Business database.
27. Client segmentation is the adaptation of procedures to different categories of operators on the basis of their specific requirements for trade and the levels of risk they represent.
28. The AEO concept is supported by a number of international agreements on trade facilitation, including the WTO's Framework of Standards to Secure and Facilitate Global Trade and the WTO-TFA. These programs are often found under different names, such as the Customs System of Reliable Operators (Argentina), Partners in Protection (Canada), the Golden List Program (Jordan), and the Authorized Economic Operators program (the European Union).
29. See the Doing Business database.

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## 4 Diversification along the Value Chain: From Primary Agriculture to Agrifood

A stronger agrifood sector is critical for Iraq's vision of a more diversified and private sector-led economy. Agriculture already constitutes a substantial share of Iraq's economy (5 percent of total GDP), is the largest source of employment in the country (approximately 20 percent of jobs), and has significant potential to increase private sector investment. Of the 39 million people living in Iraq, 30 percent live in rural areas and are largely dependent on agriculture for their income and livelihood. Agricultural production; food processing; and supporting services in logistics, finance, manufacturing, and technology have large potential for expansion. Currently, agrifood production occupies only a third of Iraq's cultivable area (about 5 million hectares) and is practiced predominantly by small farmers. Additionally, only 3.5 percent of Iraq's agricultural land is under irrigation. Once the country's irrigation system is rehabilitated, crop yields could greatly increase.

The agrifood sector is also a key pathway for overall job creation in Iraq. Increasing its production would create a sizable need for labor (especially to produce high-value crops such as fresh fruits and vegetables), processing, logistics, and services. There are market opportunities for agrifood products both in the short term, through import substitution and export to regional markets, and in the long term, through integrating Iraq into global agribusiness value chains. Exports, spearheaded by dates and other high-value crops, offer opportunities for agribusiness development. The processing of agricultural commodities also adds much value and could create many jobs, because Iraq's current agribusiness value chains are underdeveloped, with a low ratio of product processing from primary agriculture.

As in most conflicts, large numbers of Iraq's rural civilians have been displaced and had their agricultural livelihoods disrupted in recent years. Rebuilding agriculture is an important strategy for postconflict reconstruction. Agriculture is well suited to absorb demobilized combatants, improve food security, and enhance livelihoods. Furthermore, increasing evidence shows that when implemented appropriately, well-timed food security interventions can build resilience to conflict, not only by assisting countries and people in coping with and recovering from conflict but also by contributing to conflict prevention and mitigation while supporting sustainable development more broadly (FAO 2016a).

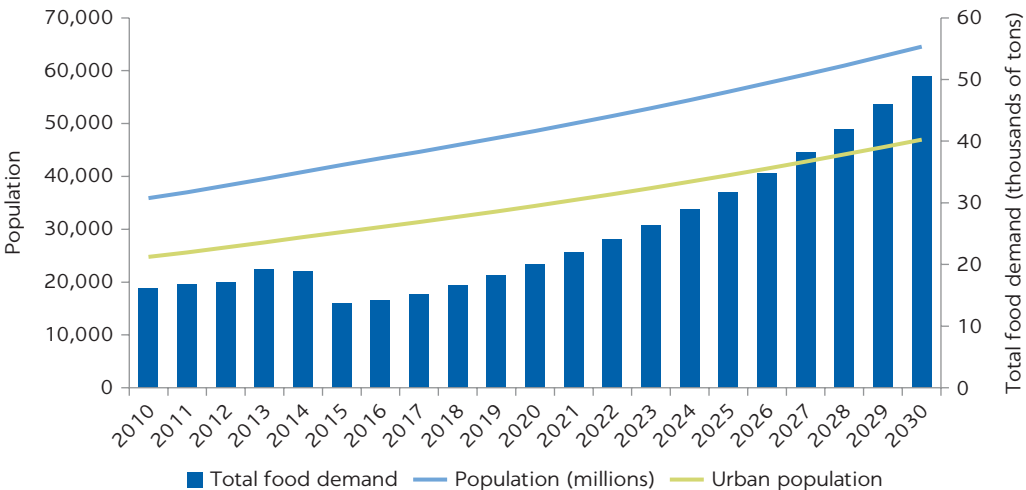
**IRAQ’S AGRIFOOD SYSTEM: STRUCTURAL AND EMERGING CHALLENGES**

Iraq’s population, which is growing by 2.8 percent per year, offers a ready market for increased agricultural production (figure 4.1). Because of this population growth, Iraq’s demand for food will increase by 152 percent by 2030. Iraq’s food production has fallen since 2014, starting with the incursion of the Islamic State of Iraq and the Levant (ISIS). Demand for a more nutritious diet, including fresh fruits and vegetables, will be driven by Iraq’s continued urbanization—the country’s urban population is growing 3.15 percent annually—and by its obesity levels, which currently stand at approximately 30 percent.

Iraq’s conflict cycles have resulted in dysfunctional agrifood value chains and markets. In principle, the country’s diverse resource base, agroclimatic conditions, and available workforce provide an appropriate base for increasing competitive production. In practice, however, the political economy of Iraq has given priority to subsidizing food availability over fostering commercial food markets. The Public Distribution System (PDS)—and, before it, the Oil-for-Food program—and the associated government control of agricultural input and output markets, especially for cereals, created a de facto monopoly for state-owned agricultural enterprises. By paying above-world market prices for cereals and charging below-market prices for production inputs, these state-owned enterprises (SOEs) squeezed out private suppliers from agricultural commodity markets and obliged farmers to rely on SOEs for inputs and seasonal finance.

The governance of Iraq’s food policy framework has allowed for elite capture and has restricted reform or change of dysfunctional policies. Addressing the growing pressures on the national food system will require both a long-term holistic vision and institutionalized coordination between key actors. However, the fragmented nature of Iraq’s political settlement, uncertainty over the stability of the government, the lack of incentives beyond short-termism, and a silo

**FIGURE 4.1**  
**Population growth, urbanization, and total food demand projections, 2010–30**



Sources: Food and Agriculture Organization; Iraqi Central Statistics Office.

mentality, as described in chapter 1, have all prevailed over policies and legislative actions thus far, with far-reaching sustainability and distributional consequences.

The current policy framework has perpetuated a cycle of low producer incentives to raise productivity and quality. It has inhibited farmers' ability to invest in higher-value production systems. Furthermore, it has distorted the allocation of land and labor and restricted the development of markets for more modern farm inputs and for credit. The policies have raised unproductive public expenditures and precluded the development of a more diversified production base.

The cost of the Iraqi government's support for the food system (through both the PDS and input subsidies) is expected to grow as projected revenues from oil decline. The price of Iraq's food imports rose from US\$2 billion in 1985 (or 19 percent of total merchandise imports) to almost US\$11 billion in 2017 (or 21 percent of total merchandise imports) in nominal terms.<sup>1</sup> Currently, about 60–70 percent of Iraq's vegetable consumption is supplied by imports from neighboring countries. The Food and Agriculture Organization (FAO) estimates that Iraq's import dependency ratio for cereals stood at 52 percent in 2016. In addition, between 2013 and 2018, the Iraqi government spent about US\$2.7 billion annually on agricultural input subsidies—including for seeds, fuel, pesticides, fertilizer, and machinery and equipment—as well as on agricultural support activities.

The infrastructure required to support agricultural production and innovation has been severely eroded, especially in key agricultural zones. Because of conflict, many structures essential for farm productivity and value chain links—including irrigation, roads, power supplies, and storage systems—have been destroyed or need major rehabilitation. Also, international sanctions have restricted access to innovation, knowledge, and technology. As a result, Iraq's farming practices and the technologies in its value chains have become outdated and contribute to negative environmental effects.

Climate change exacerbates the challenges facing the Iraqi agricultural sector. Climate projections for Iraq include an increase in average annual temperatures of 2°C and a decrease in average annual rainfall of 9 percent by 2050. Most importantly, climate change will increase the frequency of extreme weather events and the unpredictability of water flows.

Iraq's water resources need to be managed more strategically and efficiently. Extended droughts, changing rainfall patterns, desertification, and salinization call for rapidly scaling up efficient irrigation technologies and switching to water-efficient crops. The country's two main rivers, the Euphrates and the Tigris, face increasing water flow unpredictability and require investments in water management infrastructure. Underground water in most parts of Iraq is brackish, and the level of salinity has gradually increased over time. But despite all this, investment in Iraq's irrigation sector has declined, and many irrigation schemes have been left partially complete or poorly maintained.

Access to finance poses yet another challenge for Iraqi farmers and agribusinesses. The state of Iraq's banking sector, coupled with regulatory constraints and a lack of appetite for risk among both state-owned and private sector banks, has resulted in a severe lack of finance for farmers and agribusinesses. Limited options for finance exist outside government-funded programs delivered by the state-owned Agricultural Cooperative Bank (ACB). Furthermore, according to the Global Findex's 2017 survey, fewer than 3 percent of Iraqi adults living in rural areas borrow money from formal financial institutions, compared with more than 60 percent who borrow from friends and family.

## Delivering diversified growth and employment

Since ancient times, agrifood production has been a cornerstone of Iraq's economy and society and a major contributor to its resilience. The country used to be self-sufficient in a number of agricultural commodities (box 4.1), and despite conflict and the decaying infrastructure, it still currently meets about 50 percent of its domestic food demand through local production (according to the FAO's FAOSTAT database). However, Iraq's agricultural productivity will have to increase significantly in order to meet the demands of future population growth. Other countries in the region import almost 90 percent of their food intake. Although Iraq's agricultural production nearly doubled in the 2009–13 period, growth slowed in 2014 because of ISIS's incursion into the “breadbasket” governorates of Nineveh and Salahaddin, and it has not yet fully recovered. By 2017, only 35 percent of Iraq's arable land was being cultivated, creating an opportunity for investment and scaling up agricultural production.

In 2016 the International Food Policy Research Institute's general equilibrium model approach indicated that productivity-driven growth in agricultural subsectors might contribute to accelerating Iraq's economywide growth, raising household incomes, and improving the country's household income distribution. The model showed that raising Iraq's agricultural productivity could more than double the country's average agricultural growth rates and add an average of 0.7 percent each year to the GDP. As a consequence, not only would the Iraqi economy diversify into agriculture, but agricultural growth would also lift growth in the food processing and service sectors (figure 4.2). Household incomes would rise an additional 3.3 percent, on average, than they would have if the yield targets were not achieved. This rise in household incomes would benefit the poorest households and female-headed urban households the most.

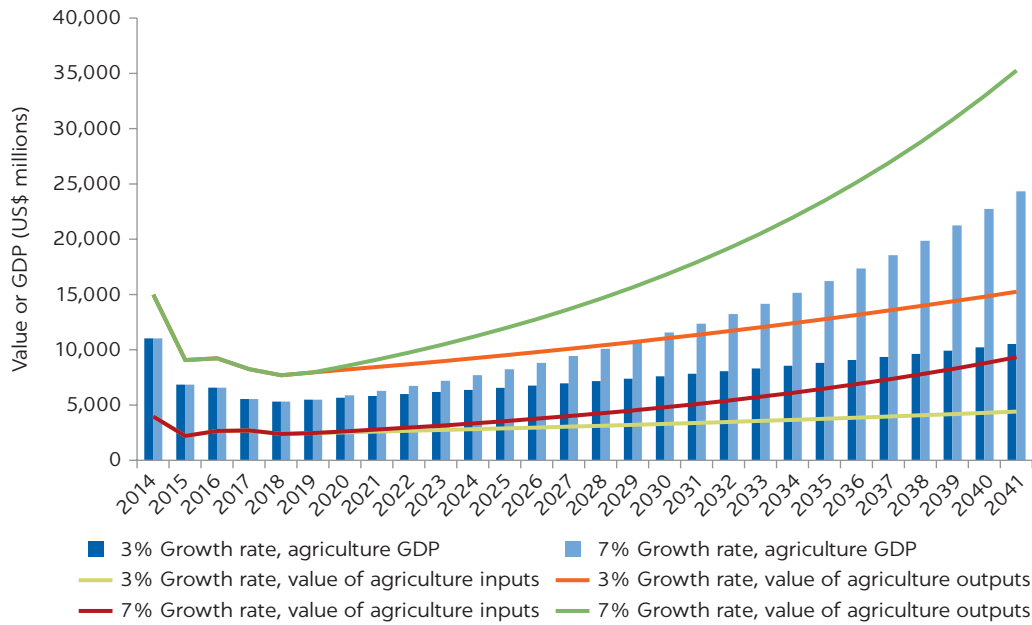
Investment in Iraq's agriculture sector started to rise in 2016, driven mainly by the private sector. Between 2014 and 2017, Iraq's agricultural output fell from about US\$15 billion to about US\$7.6 billion, representing an almost 50 percent decline (figure 4.3). Total investment in agriculture decreased during the ISIS incursion, driven by a decline in public investment, which dropped from US\$349 million in 2014 to US\$93 million in 2015. In the same

### BOX 4.1

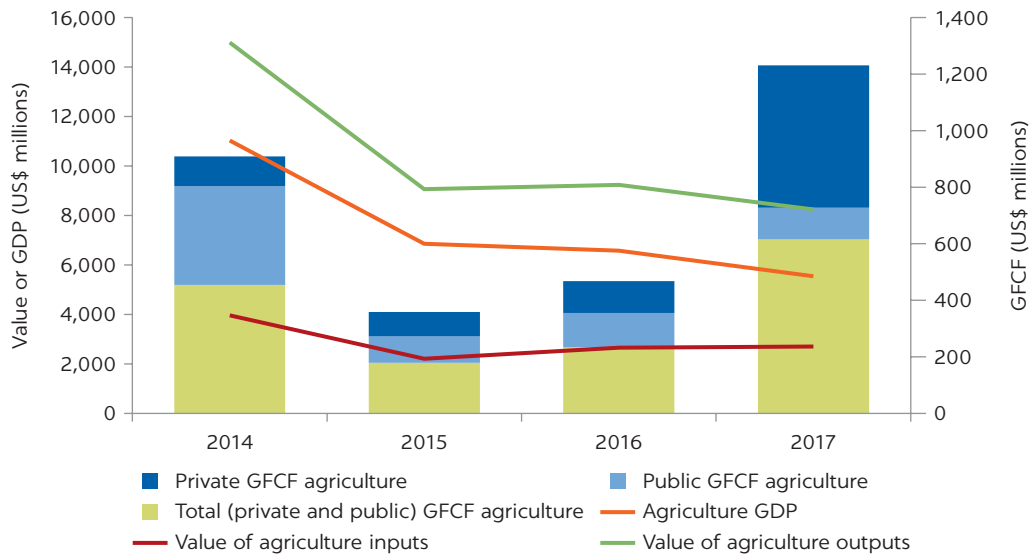
#### Brief history of Iraqi agriculture

Since the beginning of recorded time, agriculture has been the primary economic activity of the people of Mesopotamia and its modern-day successor, Iraq. Agriculture was the country's major economic activity in the 1920s. In the decade starting in 1977, Iraq was self-sufficient in cereals, and its agricultural imports amounted to 22 percent of total imports. Until 1990, Iraq had one of the highest per capita food availability rates in the Middle East because of its relative prosperity and its capacity to import large quantities of food.

However, increased dependency on oil production and social changes shifted Iraq from a net food exporter to a net food importer. Although the agriculture sector remains the second-largest contributor to Iraq's GDP, after oil revenues, its contribution declined from about 9 percent in 2002 to 3.3 percent in 2008 and 3.6 percent in 2009. Agriculture rebounded between 2011 and 2013, experiencing a short period of sustained growth. But conflict returned in 2014, and once again the agriculture sector shrank.

**FIGURE 4.2****Growth scenarios for Iraqi agriculture, 2014–41**

Sources: Food and Agriculture Organization; Iraqi Central Statistics Office.

**FIGURE 4.3****Agriculture GFCF versus value added, 2014–17**

Sources: Food and Agriculture Organization; Iraqi Central Statistics Office.

Note: GFCF = gross fixed capital formation. GFCF measures the value of acquisition of new or existing fixed assets acquired by the private sector, the government, and "pure" households; it is a component of the expenditure in the gross domestic product. It is a good indicator of how much of the new value added in the economy is invested rather than consumed.

period, private sector investment in agriculture fell from US\$104 million to US\$86 million. However, investment has picked up since 2016, led primarily by the private sector, which increased its investment from US\$112 million in 2016 to US\$503 million in 2017. Meanwhile, public sector investment increased only slightly after 2015 (according to 2017 data from the Iraqi Central Statistical Organization).

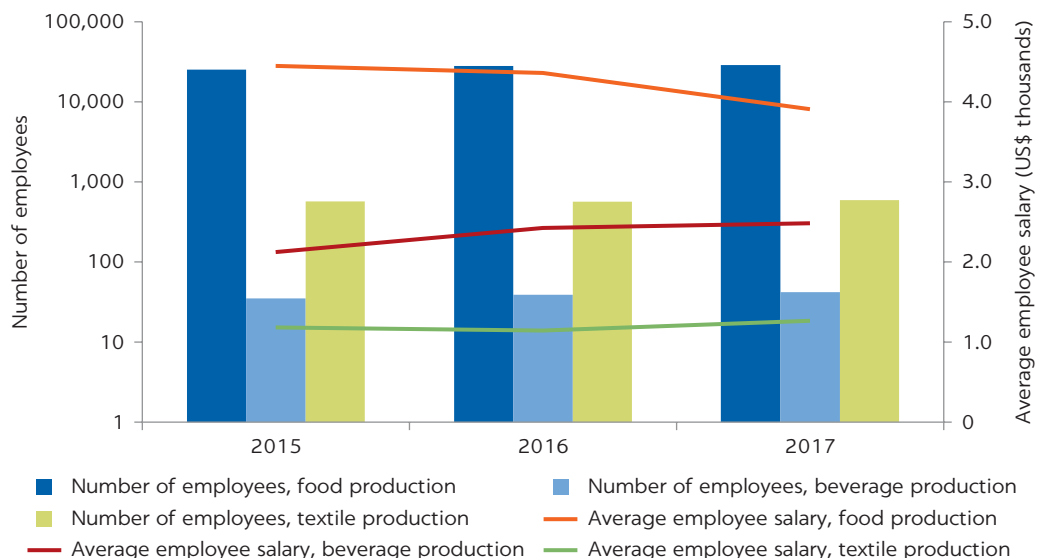
The agrifood sector's contribution to employment could be significantly expanded, in terms of both the number of jobs generated and the income generated (figure 4.4). On-farm and off-farm employment will increase if public policy creates an incentive framework that enables private sector productivity and competitiveness to increase. Analysis shows that in a high-growth environment (double the current growth average), 23,382 small enterprises would be created in the agriculture industry by 2030 (figure 4.5), adding more than 120,000 new jobs (compared to 2015). Even in a low-growth environment, at half the current growth averages of on-farm and off-farm businesses (3 and 3.3 percent, respectively), about 4,139 new small agribusinesses would still be created, adding more than 19,000 new jobs by 2030.

Furthermore, Iraq could leverage its position in the region to integrate regional agriculture markets and serve as a key corridor for agriculture products traveling to the Gulf states and other markets. One such corridor could run from the south to the north, as described in chapter 3, and the other could be oriented east-west. At present, the former corridor is predominant; it runs from the Persian Gulf through Baghdad, Kirkuk, Erbil, and Mosul up to the border with Turkey, and from there into Europe. The east-west route connects Iran, Iraq, the Syrian Arab Republic, Lebanon, and the Mediterranean Sea.

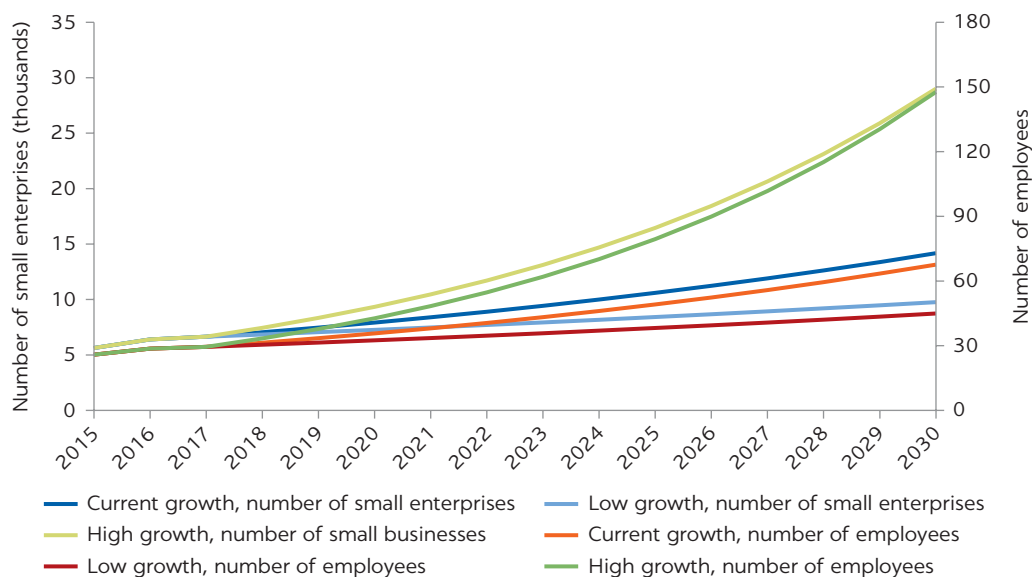
Iraq is experiencing substantial growth in its digital economy. This innovative part of the economy could drive the transformation of the agrifood sector and create a new wave of agrifood-related jobs. In the future, when data on soil and crop health becomes available, Iraq's farmers can be more precise in their application of inputs; agroprocessors can use such data to estimate the upcoming harvest volume and manage the traceability of agricultural produce. These systems could thus help the sector become more competitive and maximize the use of its natural resource endowment.

Three agriculture value chains have exemplary potential to create further employment opportunities and economic growth. The poultry, tomato, and date palm subsectors would benefit from greater investment from the private sector, rapid adoption of innovation and technology, improvements in competitiveness, and growth in employment opportunities. In addition, these subsectors would offer much-needed stabilization in governorates that suffered from prolonged conflict, destruction by ISIS, and public turmoil, such as Basrah, Babylon, Najaf, Anbar, and Salahaddin.

Iraq's poultry industry, including both meat and egg production, has grown steadily since 2014. The industry's contribution to Iraq's agriculture GDP rose from 2.33 percent to 7.38 percent over the 2014–18 period (according to 2018 data from the Iraqi Central Statistical Organization). Nevertheless, its production satisfies only a fraction of local demand, which has also grown steadily. Iraq's domestic poultry industry and poultry imports combined are worth almost 30 percent of Iraq's agriculture GDP. Poultry production is estimated to employ about 14,710 Iraqis. By reducing imports, the poultry industry could create

**FIGURE 4.4****Employment and average salary in Iraq's agriculture industry, 2015–17**

Source: Iraqi Central Statistics Office.

**FIGURE 4.5****Growth projections for small enterprises and employees in Iraq's agriculture industry, 2015–30**

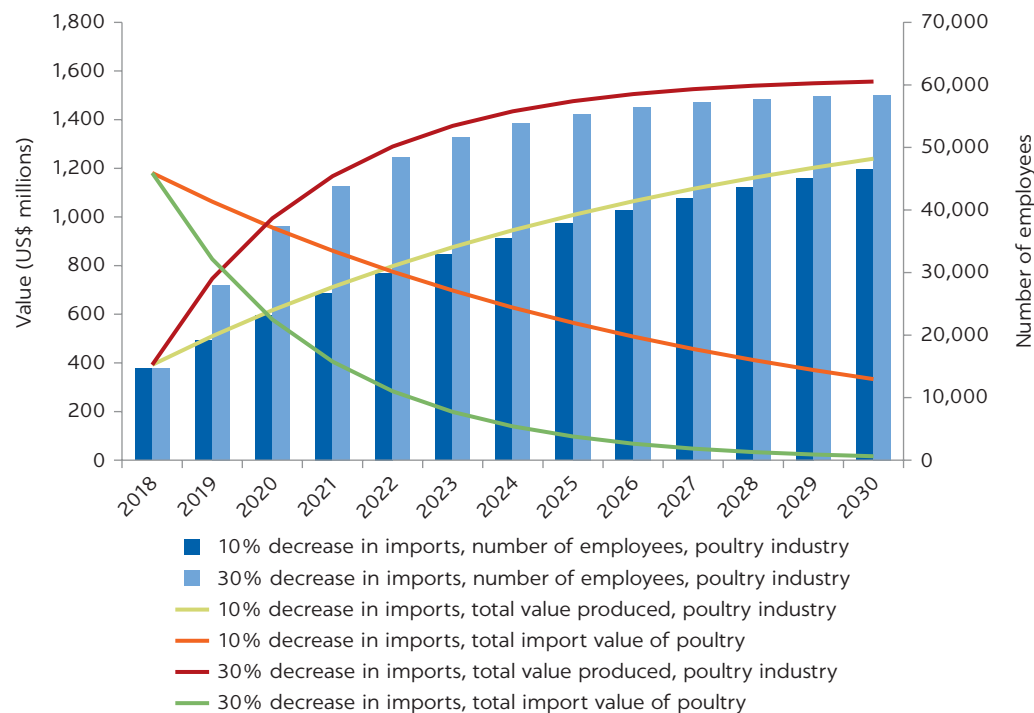
Source: Iraqi Central Statistics Office.

between 35,000 and 40,000 new jobs and raise its contribution to the agriculture GDP by US\$1.2–1.5 billion (figure 4.6).

Tomato production in Iraq also has tremendous unrealized potential. Tomato production has risen in recent years, even though the producer price index for tomatoes from Iraq has held stable at 491 Iraqi dinars/kg (US\$0.41/kg).

FIGURE 4.6

## Growth scenarios and potential job creation for Iraq's poultry industry, 2018–30

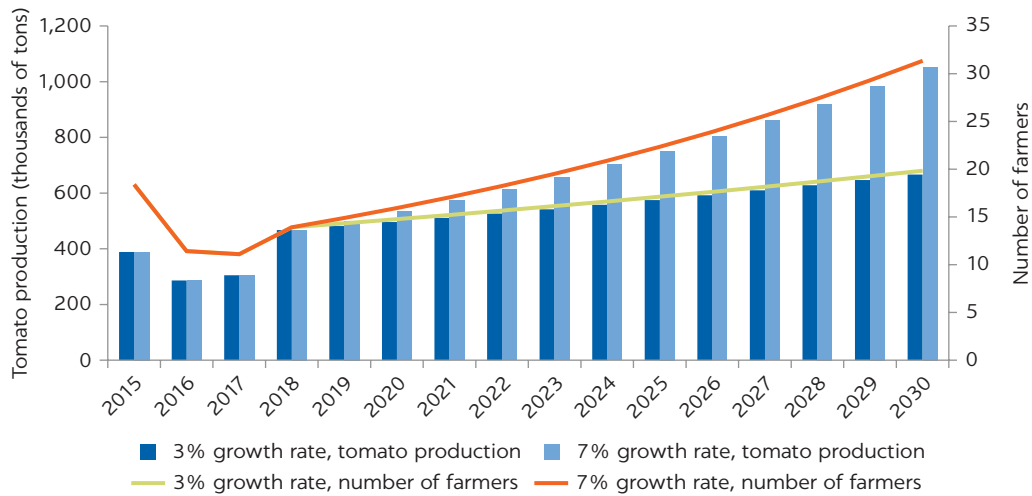


Source: Iraqi Central Statistics Office, 2019.

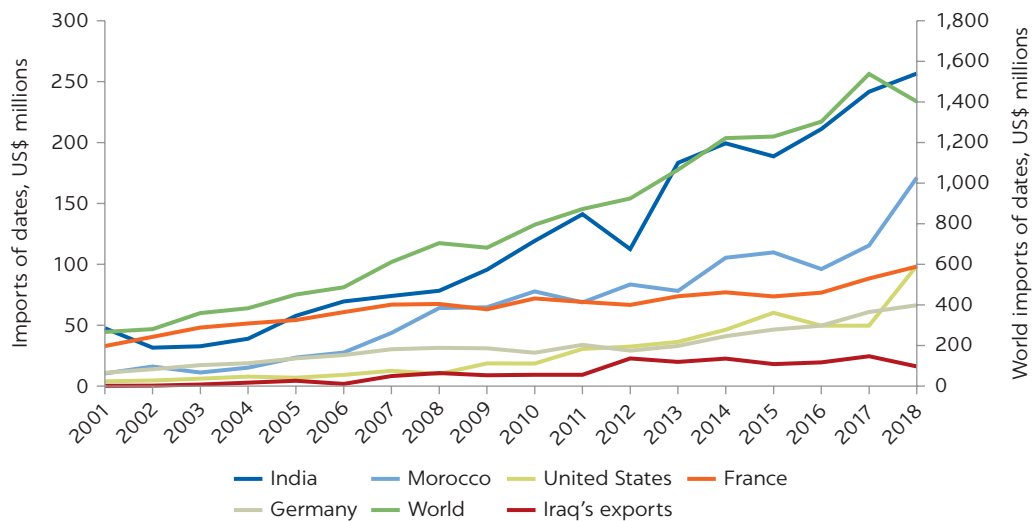
Note: The import value of poultry includes meat and eggs.

Farm-gate prices have been lower in Iran (US\$0.12/kg in 2017) and Turkey (US\$0.15/kg in 2017), providing ground for these neighboring countries to push their surplus tomato production onto the Iraqi market in order to extract hard currency. Nevertheless, Iraq's production of tomatoes is lower than that of poultry or dates, contributing about US\$184 million, or about 3.46 percent, to Iraq's agriculture GDP in 2018 (according to 2018 data from the Iraqi Central Statistical Organization). About 14,000 farmers are estimated to be involved in commercial tomato production. If Iraq's tomato production continues to grow at the same rate as its agriculture GDP (in a growth scenario of either 3 or 7 percent), the jobs created by this value chain could either rise by a third or almost double by 2030 (figure 4.7).

The date palm has historically been the backbone of Iraq's horticulture system. About 160,000 farmers cultivate date palm orchards, which cover a total area of 230,000 hectares, with an average farm size of 1.4 hectares. Dates represent a high-value added product and a growing business globally. The date market was valued at US\$8.7 billion in 2016 and has grown at more than 9 percent annually. However, the quality of Iraq's date production has declined over the years, and the country's storage, packaging, and processing have become inept. Iraq's share of world date exports declined from 45 percent in the 1970s to 8 percent today (figure 4.8)—although dates still represent Iraq's second most valuable export after oil, at US\$120 million per year. With peace and economic recovery, the Iraqi date industry has an opportunity to restore its competitiveness and assert its position in both domestic and export markets.

**FIGURE 4.7****Growth scenarios and potential job creation for Iraq's tomato production, 2015–30**

Source: Iraqi Central Statistics Office, 2019.

**FIGURE 4.8****Top date importers (world) and Iraq's date exports, 2001–18**

Source: Iraqi Central Statistics Office, 2019.

## DRIVERS OF CHANGE: TRANSITIONING IRAQ'S AGRIFOOD SYSTEM

### Policy reforms

A coherent policy framework backed by strong political commitment will be essential for Iraq's agrifood sector to fulfill its potential to increase economic diversification, employment, and food security and to sustain the country's natural resource endowment. This framework should seek to maximize the impact

of public investments in agriculture while significantly increasing the private sector's involvement in the industry. Given Iraq's history, its reliance on oil exports,<sup>2</sup> the complexity of its current political environment, and the weak capacity of its public institutions, the new policy framework will need to take a pragmatic approach to both reforming public institutions and expanding the role of the private sector.

Iraq's policy framework needs to respond to the social challenges of a post-conflict environment. Iraq has one of the world's lowest labor participation rates for women: only 10.9 percent of women work for a wage and only 15 percent participate in the labor market, compared with 75 percent of men. In addition, Iraqi youths suffer disproportionately from lack of access to basic services and jobs. The policy framework needs to (a) address the challenges of social inclusion (with a strong emphasis on the needs of women and youth) and the urban-rural divide and (b) provide a foundation for restoring the social contract, including a focus on collective action such as aggregation and reforming access to land and other key assets.

Iraq's policy framework for agriculture should focus on the provision of an adequate and nutritious diet for all. Iraq's population growth and rising incomes will be a substantial driver of domestic demand for food. However, these factors will alter both the overall demand for food and the types of foods consumed, hence the need for national production to adapt to evolving market demand. Food and nutrition policy goals should include food security and safety as well as the cultivation of highly nutritious foods in order to ensure an adequate and nutritious diet for everyone. Promoting increased production of high-value crops may lead to better diets and more sustainable production systems. Appropriate priority will need to be given to food safety, especially in postharvest systems.

Similarly important is ensuring equitable access to key natural resources and building a stronger land tenure system. Policy reforms in this area will create incentives for individuals and communities to invest in more sustainable resource management practices, which will be fundamental to the future of Iraq's agrifood system. The current landholding system in Iraq represents a mixture of owner-operator, sharecropper, and leaseholder arrangements. The size of landholdings depends on the type of land. Vietnam's experience in addressing land and tenure rights and promoting equitable access to resources shows that doing so can increase productivity and help reduce the root causes of fragility (see box 4.2).

Improvements to infrastructure—including rural roads, rural electricity, irrigation systems, and storage facilities—will link small producers to markets and reduce infrastructure-related risks and transaction costs. Evidence suggests that improving infrastructure saves time for transporting crops, livestock, and other products; increases the volume of marketable goods; and reduces the costs of the inputs needed to produce these goods. For example, poor households in Vietnam have a much greater probability of escaping poverty if they live in communities with access to paved roads (Balisacan and Fuwa 2007). Fan and Zhang (2004) have also demonstrated that investments in rural infrastructure significantly contribute to the growth of agriculture and the decline of poverty.

Identifying and sequencing opportunities to focus food transfer programs is an important step toward building a more sustainable and competitive national food system in Iraq. Given Iraq's social and economic fragility, PDS recipients may have a strong preference for food transfers. However, moving toward a cash

## BOX 4.2

## Country comparison: Vietnam

**Public investment.** In the 1985–2015 period, Vietnam's public expenditure per farmer increased from US\$29.50 (purchasing power parity) to US\$172.70. Between 1993 and 2000, a particular focus was put on rural infrastructure spending, including investments in irrigation and roads, which improved agricultural production and lowered rural poverty. Vietnam's agricultural research spending was low, representing only 1.7 percent of the country's total agriculture spending from 1994 to 2004. However, its impact was substantial because Vietnam focused on the research that would have the greatest effect on agricultural output. Vietnam also substantially increased its investment in primary education, which left its population better educated, by the 1980s, than those of most countries at its income level. And the country increased its investment in technical and professional training, which was essential for economic diversification (IISD 2018).

**Price interventions.** In 1986, the Doi Moi economic reforms put an end to the rationing system and to official prices. By 1990, farmers were able to sell all goods at market prices. Vietnam reformed its trade system by increasing market liberalization, reducing import tariffs, removing import quotas, and reducing restrictions on foreign direct investment (IISD 2018).

**Land and other institutional reforms.** Vietnam redistributed land to its farmers, who could make their own production decisions under the condition that they would meet certain production quotas.

Agricultural land-use tenure was extended to 20 years, and the right to sell and exchange land was introduced in 1993. In 1990, Vietnam's Bank for Agriculture and Rural Development became operational. However, income and collateral requirements constrained the bank's lending, because investments in the agriculture sector are generally seen as riskier than those in other industries. The Bank for Social Policies was created in 2002 to address credit access problems, but it has limited resources (Linh et al. 2019).

**Agricultural output growth.** Between 1990 and 2013, Vietnam experienced remarkable agricultural output growth, outperforming all its major Asian competitors. The volume of its agricultural output rose by 206 percent, crop production by 189 percent and live-stock production by 282 percent (OECD 2015).

**Exports.** Vietnam has been strikingly successful in opening its economy to international trade. When measured using the ratio of traded goods (imports plus exports) to GDP, Vietnam's trade openness improved from 30 percent in 1990 to 79 percent in 2000 and 161 percent in 2012 (OECD 2015).

**Poverty.** Vietnam has achieved remarkable progress in poverty reduction over the past two decades. Between 1992 and 2016, extreme poverty in Vietnam, measured using the \$1.90/day poverty line, fell from 53 percent to 2 percent. After decades of devastating violent conflict, Vietnam transformed from one of the poorest countries in the world in the 1980s to a lower-middle-income country in 2011.

transfer system could create broader benefits to the national food system, including growth in productivity, competitiveness, and employment. Global evidence shows that movement toward cash transfers should be supported by very strong analytical work, any necessary investments to make food markets function, and reforms to ensure that households have predictable and consistent access to affordable food markets.

Reforming the state's intervention policies is an integral part of Iraq's overall economic policy challenge. The growing pressure from declining oil revenues and the increased costs of maintaining Iraq's food system make reform inevitable. Evidence from global experience indicates that price reforms will increase the agrifood sector's contribution to economic diversification (see box 4.3). However, strong political will and a clear strategic vision will be essential to the success of these reforms.

## BOX 4.3

## Country comparison: Brazil

**Public investment.** In the 1985–2015 period, Brazil’s public expenditure per farmer rose from US\$136.70 (purchasing power parity) to US\$1,038.50. In the 1970s, Brazil strengthened its agricultural research and development efforts by putting in place a research network headed by the Brazilian Agricultural Research Corporation. This network’s research resulted in the adoption of new technologies by highly efficient producers. Improved research, extension services, and access to credit all substantially contributed to increasing Brazil’s agricultural productivity (IISD 2018; de Rezende Lopes et al. 2008). In the 2000–13 period, productivity grew by 105.6 percent (Arias et al. 2017).

**Price interventions.** As Brazil reduced its price supports, producers responded to market signals directly, which encouraged productivity and incentivized the growth of the export sector. In the past, Brazil had limited international trade using tariffs, export taxes, import and export restrictions, and monopoly control of exports. However, as international trade was liberalized in the 1990s, trade in agricultural outputs and inputs increased and allowed Brazilian producers to import the latest technology (including machinery, fertilizers, and animal and plant health products) (IISD 2018).

**Other institutional reforms.** Brazil also put in place a subsidized agricultural credit system with low interest rates, intended mainly for capital financing and the purchase of modern inputs. This system increased the productivity of large farms and helped

create a strong export sector in Brazil. Better access to credit facilitated the purchasing of machinery and equipment to expand the area being cultivated and open up new zones for farming (Arias et al. 2017). However, the system’s effect on poverty, inequality, and food security was limited because its policies focused on large farms.

**Trade and agribusiness.** The growth of the Brazilian agriculture sector was led by international trade. The sector accounts for about 5.5 percent of Brazil’s GDP, but it adds significant value, and agribusiness products are responsible for more than 36 percent of Brazil’s exports. Over the past decade, the trade surplus for Brazil’s agribusiness sector has widened to more than US\$50 billion, whereas the country has had a net trade deficit of US\$30 billion for all other goods and services. Brazil has become the world’s largest producer of sugarcane, coffee, tropical fruits, and frozen concentrated orange juice, and it supports the world’s largest commercial cattle herd, at 210 million head. Brazil is also an important producer of soybeans, corn, cotton, cocoa, tobacco, and forest products. However, after a period of intense growth supported by international commodity prices, Brazilian agricultural exports are beginning to decline (Arias et al. 2017).

Brazil was once a large food importer, but it has progressively transformed its agriculture sector over the decades into a modern and strongly competitive sector (Martha, Contini, and Alves 2012).

Iraq’s policy makers will need to use public support systems (including subsidies) to incentivize the refocusing of the country’s agrifood system. Subsidies have an important role to play in enabling producers, processors, and service providers to adopt technologies and innovations that can help transform the agrifood system. Global experience indicates that it is possible to transition away from the imperatives of food self-sufficiency, establishing food price stabilization policies and social protection programs. However, this transformation has been possible only through changing political patterns, reforming governance, modifying the social contract, and providing the agrifood sector with access to technological changes.

Increasing public investment in research and human capital development is essential to improving innovation and productivity. The combination of increased investment in research and extension services with access to credit was key to Brazil’s productivity increases in the 1990s as farmers adopted

new technologies. Public investment in rural infrastructure and services also benefited Chile's export-oriented sectors, particularly those such as fresh fruit and vegetables that required irrigation. In Vietnam, investment in rural infrastructure (particularly irrigation systems and roads) was prioritized from 1993 to 2000, resulting in improvements in agricultural production and reductions in rural poverty.

The high (actual and perceived) risks of doing business in the agriculture sector deter the private sector from investing in it. To get around this problem, public-private partnerships (PPPs) can be promoted as a mechanism for sharing risk and lowering the barriers to entry for the private sector. A combination of market incentives and institutional mechanisms can be incorporated into PPP projects to provide greater certainty for investors and to help overcome the lack of an enabling regulatory environment. Also, an FAO global review of PPPs in agriculture highlighted that PPPs can be a source of collective action (FAO 2016a). Specifically, there is evidence that the PPP approach can encourage inclusive growth by reducing the private partner's transaction costs associated with operations that rely on large groups of smallholder farmers. However, the same report concludes that a sound institutional and regulatory framework is vital to the design of well-performing PPPs, which leads to the following section's recommendations.

## **Institutional reforms**

Addressing the challenges facing Iraq's food system will require the political will to incentivize a new way of working. A well-functioning modern agrifood sector that is integrated with international markets requires an efficient public support system coordinated with universities and strong private sector institutions. Also needed is a wide range of interfaces with other sectors and areas, such as water management, the environment, trade, land administration, education, transportation, social protection, health, and displacement. (See annex 4.A for a summary of the institutional challenges facing the agrifood sector.) Defining the Iraqi government's mandate in the agriculture sector, ensuring effective complementarities and synergies with other sector portfolios, and translating these plans into an effective implementation structure are essential for any administration. It is also essential to ensure that sector mandates do not overlap or leave gaps among their target populations and that interventions are well aligned with each other in order to maximize benefits.

Restoring capacity within the Ministry of Agriculture (MOA) and the Ministry of Water Resources is a priority. Increased investment in public institutional support will improve the performance and coverage of research and extension services, animal health and artificial insemination centers, plant quarantine, and disease control. In addition, addressing specific gaps in the collection and management of information will help the government of Iraq develop policies and implement agricultural interventions. For example, Iraq's agricultural information system needs restructuring and modernization through digitization in order to support the government and the private sector in business planning, investment, and development.

Enabling the evolution of Iraq's agricultural SOEs will create space for a more competitive agrifood sector. Currently, both input and output in the sector are dominated by SOEs. Overall, SOE reform might incur high costs, and it would almost certainly face political opposition, given many politicians' vested interest in the status quo. However, lessons drawn from global experience indicate that

two potential sources of pressure could enable reforms and innovation within SOEs. First, private players could prompt SOEs to increase their competitiveness and adapt to new market rules, as is taking place in China and India. Second, when faced with tighter fiscal space and the need to accelerate growth, most countries shift their public investment objectives toward sectors with high potential for productivity gains, which are critical to achieving sustained high rates of growth. Iraq's agrifood sector would be a logical choice for this increased public investment.

### **Enabling private sector investment and agribusiness development**

Iraq's should be leveraging its agroclimatic conditions; its productive seasons; and its proximity to the Gulf markets, Central and South Asia, and Europe to generate new employment opportunities in agriculture. To achieve this, farmers, processors, and service providers will need to enhance their efficiency, strengthen their focus on quality, prevent postharvest losses, and increase access to and use of appropriate inputs and technology.

Iraq's agrifood sector has already established value chains that allow for high value addition. The country's immediate priority is to identify and invest in interventions that will accelerate the efficiency, competitiveness, and sustainability of these existing value chains. Specific attention should be given to existing high-value production systems that receive little direct government support but have the potential to contribute to export growth, satisfy domestic demand, and spur innovations in the processed food sector, such as dates, poultry and eggs, meat and dairy, legumes, and vegetables. These value chains have historically shown their potential, are directed at both internal and external markets, and can become mutually supportive and stimulate the development of a range of ancillary services (such as input suppliers, machinery and equipment supply systems, storage and handling, and modern irrigation systems) that will further improve the sector's competitiveness. For example, relatively simple upgrades in the date palm sector could significantly increase the export value of Iraqi dates (see box 4.4). Consequently, support to these value chains could expand employment even beyond them.

#### **BOX 4.4**

### **Potential impact of increased access to innovations in the palm date value chain**

Dates are Iraq's only agricultural product whose export value exceeds US\$100 million. Almost 50 percent of Iraq's dates are exported to the United Arab Emirates in bulk, at an average price of just US\$310/ton. From there, they are packed and reexported at a higher price. Ninety percent of Iraq's

production is one variety of date, the Zehdi. Expanding the cultivar list to include the Hillawi, Khadrawi, Sayer, Maktoom, Derrie, Ashrasi, and Barhee varieties of dates will enable Iraq to increase its low date export price to the world average of US\$760.

Identifying critical points of aggregation along value chains will also enable increased product competitiveness. Aggregation points bring together small farmers, off-takers, processors, transporters, and traders and facilitate access to other services (including finance and market information) as part of productive partnerships at that stage of the value chain. Modern approaches for institutionalizing aggregation have been developed across the globe. However, the lessons from this global experience indicate that imposing institutional models on groups of farmers frequently fails. The optimal approach is to allow points of aggregation to evolve toward an institutional model that is appropriate to the social, cultural, and economic context. In postconflict environments, aggregation, a form of collective action leading to productive and commercial partnerships, is an important first step toward reestablishing trust and improving overall governance.

The Iraqi government should provide incentives for accessing, generating, and disseminating climate-smart agriculture solutions at preproduction, production, and postharvest phases of value chains. Iraq urgently needs to deliver on the adaptation and mitigation goals included in its Nationally Determined Contribution to mitigating climate change as well as on various national strategies, including the National Strategy for Water, the National Strategy for Agriculture, the National Strategy for Biodiversity, and the National Framework for the Management of the Dangers of Drought in Iraq. To increase the country's adaptation and resilience, investment is required to adopt new precision irrigation technologies, rehabilitate and maintain off-farm irrigation facilities and other infrastructure, and adopt efficient water management methods, taking into consideration future climate risks and maximizing the resilience of beneficiaries.

In addition, the adoption of climate-smart technologies should be further supported by investments in research and development and in capacity building, both at the government level and in collaboration with farmers. The government could further contribute to significant reductions in greenhouse gas emissions by investing in projects such as solar-powered desalination, energy-efficient infrastructure (including storage facilities), and more efficient use of fertilizers (including by reducing the agriculture sector's dependence on chemicals).

Educational programs—such as virtual hubs, partnerships with international centers of excellence, knowledge innovation labs, farmers' field schools, multimodal outreach campaigns, and a training-of-trainers program—should be promoted. Potential topics for these programs include tissue culture, precision irrigation, mechanized pollination and pruning, computer-based sorting and packaging, fumigation, the use of digital platforms, solar-powered desalination, and hydroponics.

Digital technologies also have great potential to increase agricultural productivity and reduce information asymmetries and market failures. The Iraqi government has a role to play in raising farmers' and entrepreneurs' awareness of new agricultural practices and digital solutions. Digital extension services on pesticide use or weather forecasts can increase on-farm efficiency. Additionally, digitally supported logistics and digital market platforms can (a) link buyers and sellers along the agriculture value chain and consequently lower transaction costs and increase overall welfare, (b) address information asymmetries by improving access to real-time agricultural and market information, (c) help develop the agriculture and business skills necessary for successful project development, and (d) reestablish the MOA's capacity to deliver on its mandate of public-good management in partnership with private sector operators.

Maximizing the agrifood system's economic and social potential will require significant improvements to its efficiency, competitiveness, and quality control. Providing farmers and processors with predictable and timely access to appropriately priced inputs will be crucial. Currently, most agricultural inputs are imported and supplied by SOEs and distributed to farmers by the MOA's State Company for Agricultural Supplies. Reforming the input and machinery supply chains will require a coordinated approach to issues including import regulations, SOE reform, access to finance, and infrastructure investments. However, Iraq could also take advantage of the opportunities created by digital or data-driven solutions. Countries such as Ghana, India, Indonesia, and Kenya are using the digital economy and related solutions to enable farmers to acquire credit ratings, increase access to finance, improve the timeliness and relevance of input supplies, ensure stronger links between production systems and buyers, and enhance the overall competitiveness and resilience of their agrifood sectors.

Iraq's agriculture sector is particularly starved of financial intermediation. The two dominant state banks in Iraq (Rafidain and Rasheed) have traditionally not been involved in agriculture, while Iraq's private banks have had little incentive to get involved. The Agricultural Cooperative Bank (ACB) was set up in the 1940s to provide credit to farmers; but like many centralized, state-owned agriculture banks, it suffers from high rates of nonperforming loans, high capital losses, and consequent liquidity shortages. A 2011 FAO survey that examined 11 such banks in the Middle East and North Africa (MENA) region ranked ACB as the worst-performing of the 11. Its weaknesses effectively limit its role to one-time programs, often via the Central Bank of Iraq, to help farmers during crises with subsidies for inputs such as seeds, fertilizers, or machinery and equipment.

As a result of the lack of agricultural finance, Iraqi farms are overwhelmingly self-financed or informally financed. More than 60 percent of rural households report borrowing from friends and family, compared with fewer than 3 percent that report borrowing from formal financial institutions, including microfinance institutions. Iraq's microfinance sector has been overwhelmingly focused on urban borrowers, who represent more than 90 percent of its clients. Most Iraqis agree that all levels of finance, including microfinance, are desperately needed in rural areas.

Iraq's financial sector is changing rapidly as more private banks start their operations. By 2019, 20 foreign banks were operating in Iraq, most of them from elsewhere in the Middle East. In addition, private and Islamic banks have grown rapidly. Iraq now has 51 private domestic banks in operation, of which 27 are Islamic. The foreign banks are changing Iraq's banking environment with their skillsets and international capital, which in turn have changed the country's banking practices. For example, Iraq's first private digital payment card was launched in 2019.

Digital payment and finance options of all types are becoming more widely available in Iraq. Small private banks, limited in their options and nimbler in their approaches, are seeking new and nontraditional opportunities to offer such services. Several are investing in digital transactions, building on links with telecommunications companies. Investments in the microfinance sector could transform Iraq's provision of finance in rural areas and to marginalized populations, as it has done in Morocco, the Republic of Yemen, and other Arab economies. The relative sophistication of the Iraqi population compared with the low quality of the country's formal financial services may facilitate the adoption of digital finance options and consequently allow Iraq's underbanked

population to leapfrog from financial exclusion to digital financial inclusion. This change represents an opportunity for both nonbank financial institutions and the more nimble and innovative private sector banks.

The use of data-driven technology offers an opportunity to accelerate competitiveness in Iraq's agriculture sector. Digital tools can be used for nonfinancial purposes by farmers and offer a good entry point for the integration of financial services. Data can be collected directly from smallholder farmers using existing mobile technology. These data can then be used to create farmer profiles that can be refined over time and accessed in real time by multiple service providers. Importantly, financial service providers can use the data to build risk profiles for farmers and small and medium enterprises (SMEs) that would enable their access to credit and other services. Furthermore, the digital platforms established to improve access to finance can also respond to the specific demands of youth and women by providing them with information, supporting their training, tracking their progress, and helping them to build better business models. These new ways of providing and accessing services can reduce clientelism, support innovation, and inspire a new generation of entrepreneurs.

Innovations implemented successfully in other countries can be adapted to Iraq's specific circumstances. Programs for rural and agricultural finance that have worked in similarly challenging environments may also work in Iraq. For example, the World Bank's Lighting Africa program builds financing structures on pay-as-you-go purchases, which rely on the ability of the lender to remotely turn off the borrowed asset, whether a lamp or a solar pump, as well as the receipt of remote (mobile) payments. This innovation vastly changes the risk dynamic for the lender, transforming what was essentially a loaned asset into a usufruct, and it helps to expand asset financing to a far broader population than would otherwise be feasible.

The digitization of financial services could also support sharia compliance. The requirements of sharia compliance often add a layer of extra documentation to financial transactions, given the need for a financier to be part of the transaction (for example, a bank's purchase and resale of a product under *murabaha*).<sup>3</sup> This requirement generates higher operational risks, because missing or flawed paperwork could render a transaction noncompliant. In the past 20 years, a wide array of banking tools, from core banking systems to mobile banking apps, have evolved to ensure sharia compliance. Leading areas of Islamic finance, such as the Gulf Cooperation Council states, tend to lag in digitization by up to 20 percent when compared with their conventional counterparts, but this observation may reflect their particular client base rather than any function of sharia compliance.

Additionally, mobile money could bring substantial benefits in a postconflict environment where sending money by road is costly and unsafe. Mobile money makes payments easier, cheaper, and more transparent, and it provides rural communities with new opportunities to access financial services and soft loans.

## THE WAY FORWARD: ADDRESSING UNFULFILLED POTENTIAL AND MANAGING GROWING RISKS

Iraq's agrifood sector has significant potential to contribute to the country's economic diversification, to increase employment, and to reduce fragility. Realizing this potential in the current political economy will require political commitment, increased transparency, the participation of key stakeholders, and

bold actions. A summary of the recommended policy actions follows. (For more detailed technical recommendations, see annex 4.B.)

### **Defining Iraq's future food system**

Mounting social, economic, and political risks are associated with Iraq's current national food system. To manage these risks, Iraq will have to establish a clear vision for the future of the system. The goal is to ensure that the system can contribute to diversified economic growth, inclusive employment, and sustainable resource management.

This vision should be established through a national debate among both state and nonstate actors (the private sector, farmers' cooperatives, academics, non-governmental organizations, religious groups, etc.). The debate could be facilitated by a neutral international agency (such as the United Nations). Areas to be addressed include water and the future of water management, restoring investment in rural infrastructure, SOE reform, the regulatory environment, land reform, and how to reestablish Iraq's position in innovation and technology. The debate's ideal outcome would be a clear, coherent, and coordinated policy and institutional framework for the agrifood sector and an agreed-upon, sequenced set of reforms.

The debate should also identify incentives to increase investment in human capacity and to institutionalize solid coordination between the Ministry of Agriculture and the Ministry of Finance, the Ministry of Planning, and the Ministry of Trade. Furthermore, a key outcome of the debate should be improvements to accountability and transparency, such as the establishment of an online food system dashboard that uses benchmarks to demonstrate how the challenges for Iraq's food system are being addressed.

### **Maximizing existing opportunities for increased competition, innovation, and collective action**

Given that Iraq's oil sector remains the primary focus of the country's elite, the agrifood sector's development could present an opportunity for developing new ways of working. Its value chains—such as for dates, high-value crops, and livestock—have not been subjected to the same level of government control or faced the same governance challenges as those of other commodities.

Within these value chains, public and private actors should focus on strengthening points of aggregation (such as cooling stations, postharvest facilities, and irrigation). Enhancing points of aggregation would increase the access of farmers (especially smallholders) to technologies and service providers (finance, knowledge, market information, etc.). This access to production and processing innovations would in turn improve the value chains' competitiveness. In addition, the aggregation points would provide entry points for institutional models (cooperatives, associations, unions, etc.) that would encourage the institutionalization of collective action and contribute to recalibrating the sector's relationship with the economic elite.

Innovation, knowledge, and new skills will drive change in the agrifood sector. The Iraqi government needs to create the right ecosystem for innovation, which should be done at two complementary levels. The first is to develop a

national technical and vocational education and training program for the agri-food sector, with the encouragement, engagement, and support of the private sector, and to incorporate global lessons learned to ensure that the program attracts women and youth. In tandem, the government should create the conditions for entrepreneurs and investors in the agriculture sector to participate in the food system and should help link them to research partnerships and centers of excellence with business incubation programs.

### **Optimizing the potential of the digital economy**

The growth of the digital economy in Iraq may create unique opportunities for the agrifood sector. Specifically, digital technology can play a powerful role in fostering inclusive growth patterns (including in rural areas and regions impacted by conflict), enabling access to new services and ways of working. Furthermore, the relatively new governance structures of the digital economy may provide ways to circumvent the actors and incentives that dominate the existing political economy.

To maximize this potential, Iraq must extend the enabling environment for digital technologies far into rural areas. As in most countries, Iraq's telecommunications and internet infrastructure is heavily concentrated in urban areas. This concentration has been exacerbated by Iraq's conflicts, which have damaged or destroyed a good deal of the country's physical infrastructure. Focusing new digital infrastructure investment on rural areas would have high returns, not only in supporting the agricultural sector but also in helping to staunch the rural-to-urban migration that has caused much dislocation and unemployment.

These investments in digital infrastructure should be targeted. Focusing on specific marginalized populations in newly liberated areas, or on more productive subsets of the population, can also help to leverage infrastructure and other investments, such as training, to their fullest extent. For example, younger farmers, service providers, and processors not only represent a key demographic group, because youth employment is such a critical goal, but also may yield higher returns, because they are likely to be both more tech-savvy and more open to new ideas and approaches than their elders. Young farmers, in particular, are more likely to take risks in the management of their farms. An analysis in Italy, for example, revealed that more than 12,000 agricultural start-ups were created in one year by men and women between the ages of 25 and 30.

Iraq is blessed with significant natural resources, and its agrifood sector has historically made significant economic and social contributions to its development. However, the country's recent reliance on its oil sector, decades of conflict, and a dysfunctional political environment have undermined the agrifood sector's contributions to employment, economic diversification, and sustainable growth. Moving forward, Iraq has the opportunity to create a vibrant, inclusive, and modern agrifood sector that responds to the challenges of competition, population growth, and climate-related shocks. Seizing this opportunity will require a strong political commitment to a new policy framework as well as investing in new technologies, enabling the private sector, and maximizing the potential of digital technologies.

## **ANNEX 4.A: STATE OF THE INSTITUTIONAL FRAMEWORK OF THE IRAQI AGRICULTURE SECTOR**

The institutions at the core of Iraq's food system remain persistently misunderstood and neglected. Policy and institutional reform—specifically, governing the agriculture and food sectors—have taken a backseat as successive Iraqi governments and the international community have prioritized food and agricultural aid in response to the country's crises and challenges.

Looking forward, Iraq will likely struggle to mitigate any emerging risks to its food security, which could stem from structural challenges (such as the rising population, urbanization, and regional competition) or unexpected shocks (such as COVID-19, climate change, and conflicts), unless it reforms the complex web of institutions governing its food system.

### **Institutional complexity**

A complex web of 27 government organizations—including ministries, SOEs, and governmental bodies (parliamentary and cabinet committees)—are actively involved in Iraq's food system. Additionally, 18 governorate-level and 120 district-level councils and bodies are engaged in the management of the food system, with various degrees of autonomy from the central government, because of Iraq's federal and regional structure. Each organization has its own interests and influence on the food system. These interests vary according to the groups' mandates, financial resources, and distributive authority, which are driven by sectarian, ethnic, and tribal divisions that run deep through Iraqi society. Over the years, these organizations have competed for dwindling financial resources.

### **Institutional state of the Ministry of Agriculture**

At the core of this complex web of competing state institutions, Iraq's MOA is weak in terms of human resources, operations, budget, and mandate (which is restricted to only agricultural production). Despite running two SOEs—the Mesopotamian State Company for Seeds (which buys and sells grain seeds to farmers) and the State Company for Agricultural Supplies (which distributes agricultural machinery)—the MOA is subjugated to the more politically influential ministries and lacks influence in the food system. Depressed oil prices, federalization, the devolution of the ministry's powers, the aging of experienced staff, a lack of technical capacity, and damage to the ministry's infrastructure by conflict have all reshaped the MOA. Now, it is understaffed and unequipped to address the challenges of food security and sustainable agriculture development.

The MOA's budget has been declining since 2015, when the price of oil slumped and Iraq's overall budget decreased. Successive governments allocated less and less to the MOA, even when the federal budget began to increase in 2016, as the price of oil recovered, and the parts of the country liberated from ISIS needed postconflict stabilization through agricultural development. The MOA's budget in 2015 was about US\$426 million; but by 2019, the budget had decreased to US\$142 million. Now, it essentially covers employees' salaries alone, leaving the ministry powerless to tackle food insecurity or respond to any shocks in food prices.

## ANNEX 4.B: TECHNICAL RECOMMENDATIONS

### Policy and institutional reforms

The following reforms will help Iraq's agrifood sector fulfill its potential to help diversify the country's economy, increase employment, and reduce fragility:

- Perform a national audit of the current food system. This high-level national audit can assess whether the food system (including domestic demand, production, employment, trade, nutrition, environmental resources, and their overall implications for the national budget) will be fit for its purpose in 5, 10, and 15 years. The audit should start a high-level debate on the future of food in Iraq, including the future of reforms to price supports, trade policies, and subsidies.
- Transition the PDS to cash-based transfers. Identify geographic areas where cash-based transfers could be piloted and closely monitor the impact of the change on households, food prices, and market competitiveness.
- Identify incentives to institutionalize improved food-system planning between the Ministry of Agriculture and the Ministries of Finance, Planning, and Trade.
- Increase investment in rural infrastructure. One area ripe for investment is the rehabilitation of waterways and irrigation systems. Other priorities include (a) improving connectivity through investment in the road system; (b) supporting the development of postharvest management and storage capacity; and (c) establishing cold storage facilities so that local seasonal products can arrive in the market all through the year, not only when they are in season.
- Inventory the services supported by SOEs in the agrifood sector. This inventory can identify areas where (a) the private sector is growing and can take over the role of the SOE and (b) reducing public investment could crowd in private sector involvement.
- Improve the regulatory environment. In particular, the government of Iraq should identify opportunities to pilot public-private partnerships, focusing on areas that clearly represent value for money and that could generate public benefits in excess of what could be achieved through alternative modes of public procurement or through private investment alone.
- Invest in building the capacity of (a) the national research system, to deliver more and better technologies; and (b) the extension system, to disseminate knowledge to farmers, processors, and service providers. As part of this process, priority should be given to investment that would contribute to gender empowerment.
- Reform land management. The basic principles and legislation should be reformed in order to (a) reduce or reverse the impact of salinization and desertification, (b) maximize the use of agricultural lands, (c) reduce land fragmentation, (d) streamline inheritance laws, and (e) promote joint cultivation of productive land.

### Increasing investment in key value chains

- Identify and prioritize reforms of the regulatory environment for key agrifood value chains. Particular attention should be given to expanding the role of SMEs in the agrifood sector. Reforms should also ensure that women have equal access to financial and technical resources.

- Enable the private sector, especially SMEs, to further invest in the development of value chains in which the private sector is already dominant and the potential for expansion in domestic and export markets is high. The date palm sector shows particularly high potential in this respect.
- Link investors to research partnerships and centers of excellence with business incubation programs. Ensure that business incubation prioritizes the specific needs of women and youth.
- Develop a national technical and vocational education and training program for the agrifood sector. Encourage it to engage and support the private sector. Incorporate global lessons learned to ensure that the program attracts women and youth.
- Increase the productivity of existing high-value chains that receive less direct government support but could contribute to export growth, satisfy domestic demand, and result in innovations in the agroprocessing sector. (Such chains include dates, dairy, and vegetables.)
- Assess key value chains to understand and identify their points of aggregation. Gradually introduce appropriate models that will enable collective action and partnerships around aggregation points to become institutionalized. Ensure that institutional models provide adequate investment in human capital development and empowering vulnerable groups. Specific attention should be given to ensuring the inclusion of women.
- Create incentives and opportunities to access and use climate-smart technologies. These technologies—such as high-quality fertilizers, climate-resilient seeds, precision irrigation systems, solar technologies, and automated crop-growth monitoring—can increase climate resilience, reduce the intensity of greenhouse gas emissions, and contribute to Iraq's resilience to climate change.
- Promote the use of digital technologies in agriculture. These technologies have great potential to increase agricultural productivity and reduce information asymmetries and market failure. Digital information services, run by the extension offices, on pesticide use or water forecasts can increase farm efficiency. Additionally, digitally supported logistics and digital market platforms can link buyers and sellers along the agriculture value chain and thus lower transaction costs and increase overall welfare.

### **Maximizing the potential of the digital economy**

- Extend the enabling environment for digital technologies far into rural areas. Focusing new investment in digital infrastructure on rural areas would have high returns, not only in supporting the agricultural sector but also in helping to staunch the rural-to-urban migration that has caused much dislocation and unemployment.
- Target investments to focus on specific marginalized populations in newly liberated areas, or on more productive subsets of the population. Younger farmers are a key demographic group and may also yield higher returns than their elders because they are likely to be more tech-savvy, more open to new ideas and approaches, and more willing to take risks.
- Encourage the rapid expansion of mobile money and e-commerce transactions. These technologies may lower the risk and friction of financing, particularly for smallholder farmers.

- Support small private banks as they invest in digital payments and transactions, including in links with telecommunications companies. Investment in the microfinance sector, starting from a very low base, could direct Iraq's finance to rural areas and marginalized populations. Iraq's microfinance industry is at a very early stage, so much opportunity exists for laying critical groundwork, including setting up the digital and regulatory infrastructure to create the efficiencies of scale needed to launch a for-profit microfinance industry.
- Duplicate innovations that have worked in similarly challenging environments. Programs to support such tools—including credit scoring systems and retail portfolio loan management—have succeeded in rural agricultural areas as diverse as Burkina Faso, Rwanda, and the Republic of Yemen.
- Link financing to mobile payment systems. The enhanced cash management that arises from phone banking, including automatic bill payments, not only optimizes the use of cash but also creates a trail of credit data on smaller borrowers that can help build credit-scoring approaches for small and remote borrowers, which are entirely missing in Iraq. This change would help both banks and other risk-management providers, such as insurance companies. Good scoring would also reward more-creditworthy farmers with greater access to finance.

## NOTES

1. Iraq's top food imports are wheat, beef and chicken meat, rice, oils and fats, milk, tea, and sugar.
2. The status of Iraq's agriculture industry was not simply caused by the displacing effects of higher oil revenues predicted by Dutch disease. Prevailing public policies in Iraq (and elsewhere in the Middle East and the developing world) actively discriminated against agriculture by deliberately lowering the prices of agricultural products to make them more affordable.
3. *Murabaha*, also referred to as cost-plus financing, is an Islamic financing structure in which the seller and the buyer agree on the cost and markup of an asset. The markup takes the place of interest, which is illegal under Islamic law.

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## Conclusion

Oil wealth has allowed Iraq to obtain upper-middle-income status, but in many aspects, its institutions and socioeconomic outcomes more closely resemble those of a lower-income, fragile country. Wealth creation in the country is overwhelmingly driven by oil, unlike in its peers, which derive their wealth from human capital. Indeed, Iraq's human capital, business environment, quality of service delivery, and governance indicators all sit near the bottom of global rankings; the country's overall economic productivity is on the decline; and Iraq's labor force participation rate, especially by women and youth, is one of the lowest among its income peers as well as in its region. Amid repeated conflicts in an inherently volatile oil-dependent economy, one could credit Iraq for maintaining its territorial integrity and functioning institutions; however, its system has failed to deliver on inclusive growth and better living standards.

The Iraqi political system and the nature of the country's social contract can explain much of this failure to reform or deliver better outcomes. As highlighted in this report, elite bargaining, social-contract bargaining, and a lack of social cohesion are prone to turn into violence. Conflict in Iraq has erupted mainly over competition for power and resources, and the country's elites have exploited ethno-sectarian divisions in order to gain and hold power. However, over the years, the process of elite politics has shifted from sectarian and ethnic power sharing to political party power sharing and polarization, in which contestation and negotiation take place over control of the formal bureaucracy. Iraq's current political settlement, which rests on rent sharing and power sharing among political parties, has led to elite capture, widespread clientelism and patronage, and political paralysis. These problems, in turn, have undermined government effectiveness, hampered the provision of public services and development, and increased fragility. The resulting fragmentation of Iraq's political landscape has led to political instability and paralysis and shifted the topic of contestation once again, toward popular grievances over poor delivery of services, state corruption, and a lack of economic opportunities.

This Country Economic Memorandum highlights at least three encouraging messages despite Iraq's current sociopolitical and economic environment for growth:

First, there is a peace dividend in Iraq, although its benefits have been obscured by short-termism and a focus on oil. Iraq's per capita gross domestic

product (GDP) was around 18–21 percent lower in 2018 than it would have been if not for the conflict beginning in 2014, and Iraq's nonoil GDP is one-third lower than it would have been without conflict. Maintaining peace can by itself be a strong driver of growth. However, Iraq's reliance on oil has had a major impact on its political settlement and economic outcomes. Political parties use oil wealth to fund patronage, notably the provision of public sector employment and subsidies to their supporters. Also, oil wealth has eroded the country's competitiveness, reduced the need for taxation, weakened the accountability link between citizens and the state, and fueled corruption. As a result, the ruling elite has failed to meet people's social demands, including for employment opportunities and adequate service delivery, leading to growing discontent and a breakdown of trust. Amid political instability and elite contestation, the incentive system for decision-makers is biased toward present rewards. Such short-termism undermines the credibility of long-term reform commitments, because the payout of such reforms comes with a large discount factor. However, Iraq's changing political landscape, including the collapse of oil prices and stronger contestation from youth (as shown in the October 2019 protests), could be (a) an opportunity to change the country's socioeconomic and political model into one that redistributes oil wealth in a more transparent manner and invests it in other assets—namely, human capital—and (b) a chance to push for more accountability, good governance, and economic diversification.

Second, Iraq has latent export potential (for a variety of goods) that, if realized, can diversify the country's economy, raise its living standards, and boost its economic resilience. Under the right conditions, including the return of domestic security, Iraq's trade policy can be reformed in a way that brings better prices and quality for consumers. This reform will include trade institutions and regulations that were set up under circumstances caused by past conflicts and are no longer suited for present conditions. For example, reforming Iraq's import licensing regime and unifying the Iraqi customs territory under a single tariff schedule could go a long way toward improving economic performance. Iraq has the geographic position to become a regional transit hub; its logistics performance, much worse than its peers, turns it into a regional bottleneck instead. As such, trade facilitation is an urgent priority. In addition to tackling the country's infrastructure gap, reforms could focus on border management and trade system automation as part of a comprehensive anticorruption framework, using a whole-of-government approach. By forging common economic interests among competing actors, the returns from trade could also be used to promote regional peace and stability. This stability would in turn benefit Iraq by adding resilience to domestic politics and decision-making processes.

And third, agriculture in Iraq can be unwound from its decades-long decline to serve as a pillar of Iraq's vision of a more diversified and private sector-led economy. Agricultural production; food processing; and support services such as logistics, finance, manufacturing, and technology all have great potential to expand and create jobs. Building on historical experiences, Iraq's agrifood sector's development presents an opportunity to develop new ways of working. This opportunity exists in part because the country's agricultural value chains—such as dates, other high-value crops, and livestock—have not been subjected to the same level of government control and governance challenges as those of other commodities in Iraq. Indeed, maximizing the full competitive potential of agrifood value chains will take time, and thus the pervasive short-termist models used for rent extraction may not apply. Reaping the transformational benefits of

agriculture will require immediate reforms to the institutional setup governing food systems; rethinking the sector's subsidy schemes; and devising incentives, including financing, for private operators. Medium-term reforms will have to tackle complementary challenges concerning water and food security, including some related to infrastructure. But those efforts will likely prove worthwhile: rebuilding agriculture is an important strategy for postconflict reconstruction and, along with well-timed food security-related interventions, can build resilience to conflict.

To avoid missing any more opportunities for reform, Iraq's main challenge lies in launching a virtuous cycle that can advance these key pathways to growth. The realities of Iraq's political economy will impose themselves on the reform agenda, especially as it faces the complex contestations described throughout this report. As such, Iraq's growth strategy needs to focus on diversifying the country's asset portfolio by investing in its people, its capital stock, its institutions, and its regional position. Such measures will, on one hand, refocus the country's political settlement on the development agenda and restore the authority of formal state institutions over nonstate actors. On the other hand, they will restore Iraq's social contract; build confidence between citizens and government; and address grievances, particularly by strengthening accountability institutions. Accompanying measures, such as taxation policies and public financial management reforms, could also strengthen the management and allocation of oil wealth and public resources.

Moreover, injecting more competition and contestability can do much to ensure a level playing field between Iraq's large public sector, its politically connected private sector, and its future economic actors—including youth—which could boost the private nonoil economy. This change will involve improving the quality of regulations, as well as of organizations such as the judiciary and market regulators, and increasing the transparency and accountability of national and local governments, capital and financial market institutions, and other actors in order to ensure overall adherence to rules and regulations. Although these reforms might prove difficult to implement in the short term, a gradual approach to reforms could be applied—one that builds a coalition of reformists and encourages deeper ownership among government and other societal actors.

#### ECO-AUDIT

### *Environmental Benefits Statement*

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Iraq is at a crossroads. Almost two decades after the 2003 war, the country remains caught in a fragility trap, facing increasing political instability, growing social unrest, and a deepening state-citizen divide. Amid a multitude of crises—including an oil price shock, the COVID-19 pandemic, and recent instability and protests—coupled with poor economic policies, a lack of reforms, and an inability to tackle corruption, Iraq is having its worst annual economic growth performance in 2020 since the fall of the Saddam regime. But with every crisis comes an opportunity to reform. Iraq can embark on a long but much-needed path toward structural transformation, one that could leave its economy less dependent on oil and more driven by private sector activity. Such a path can no longer be avoided, as has been illustrated by the widespread protests since October 2019. This report highlights what Iraq can do to sustain future growth; it also shows why Iraq has not yet managed to achieve high levels of diversified growth alongside peace, stability, and a better standard of living for its people. Iraq's high levels of fragility and conflict—reinforced by high oil dependency—hinder the country's prospects for economic reform and growth.

Despite Iraq's existing sociopolitical and economic environment, three encouraging messages emerge from this report. First, there is a peace dividend in Iraq. Iraq's per capita GDP was about one-fifth lower in 2018 than it would have been if not for the conflict beginning in 2014. Thus, maintaining peace can by itself be a strong driver of growth. Second, Iraq has latent export potential for a variety of goods that, if tapped, could diversify the country's economy, raise living standards, and boost economic resilience. Third, Iraqi agriculture could be revived to serve as a pillar of a more diversified and private sector-led economy.