World Bank Country Economic Memorandum Team Response to IEN Published Paper by Dr. Hirmis

To the esteemed editors of the Iraq Economist Network,

We have read with great interest the paper published on your network's website on March 8, 2021 and entitled "World Bank's assessment is flawed… Manufacturing is viable in Iraq!" by Dr. Amer K. Hirmis. We would like to provide some of comments for clarification in response to some of the ideas put forward by the paper.

First, we would like to thank the author of the paper for taking time to read and comment on our report "Breaking out of Fragility: A Country Economic Memorandum for Diversification and Growth in Iraq". Indeed, World Bank (WB) reports are written with the spirit of knowledge exchange as well as for stirring healthy and informed public debate over economic and social policies in our client countries.

In summary, the paper of Dr. Hirmis challenges the characterization made by the WB report that the Iraqi economy suffers from "Dutch disease" and argues that the report does not advocate for the manufacturing sector, which has been demised by policy decisions. The paper also argues that the Government of Iraq's (GoI) White Paper fails to mention the role of the Ministry of Industry and Mineral (MoI&M) in the proposed governance/institutional reforms proposed, which risk to undermine the objectives set by such national reform plan.

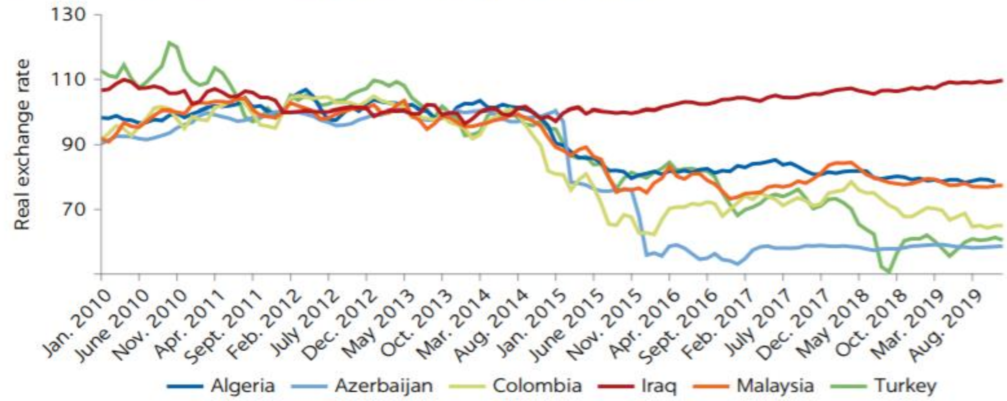
The World Bank is not in a place to comment on the formulation process of the White Paper as this was an Iraqi-led process, which to our knowledge had consulted with government actors, civil society, and international partners. Whether specific arrangements were made to the MoI&M is a question to put forward to Iraqi authorities represented by the White Paper drafting team at the Economic Crisis Cell that was established by the council of ministers.

To focus on the World Bank related comments, we would like to re-iterate the definition of the Dutch Disease. This is a term commonly used to describe an economic phenomenon that arises when large monetary inflows increase the development of one sector, such as natural resources, at the expense of other sectors. The mechanism in which this occurs relates to the utilization of these revenues/inflows in the domestic economy leading to the appreciation of the country's exchange rate vis-à-vis trading partners; resulting in the country's exports becoming more expensive for others to buy, and for imports becoming cheaper. Hence this favors what is called non-tradeable sectors along with imports at the expense of export-oriented sectors (also called tradeable sectors) in an apparent loss of the country's international competitiveness.

The WB report makes this case by computing the reel exchange rate for Iraq since 2010 and comparing it to other natural resource countries and trade partners (figure 2.15 of the report). The largest real appreciation started in 2015 and while the nominal exchange rate was fixed, the movement meant that domestic prices were gradually becoming more expensive than international peers and hence disadvantaging all sectors with export potentials whether in agriculture, manufacturing or services. This is also confirmed by successive IMF article IV assessment on the overvaluation of the Iraqi Dinars during this period (see for example articles IV for 2015, 2017, 2019, 2020 published on IMF website).

FIGURE 2.15

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

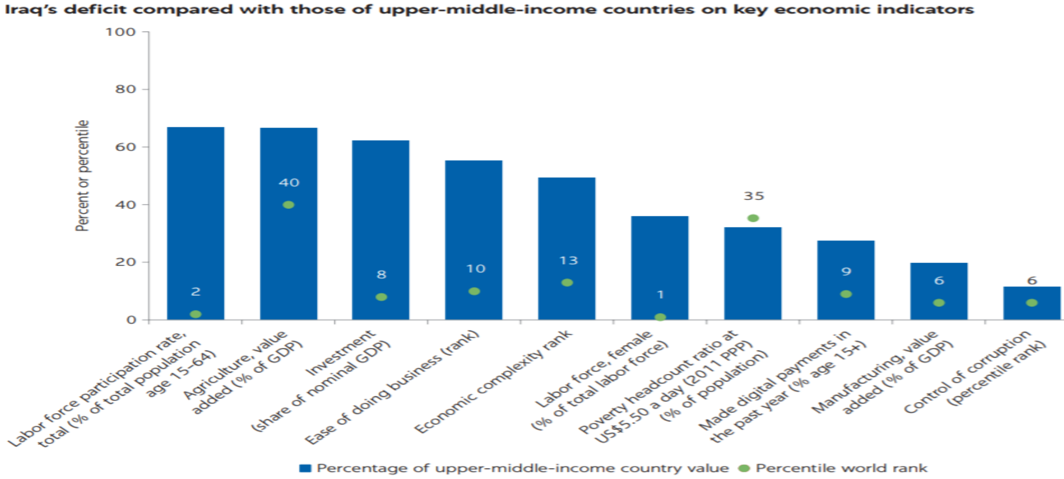


Source: Data from the International Monetary Fund's International Financial Statistics database.
Note: January 2012 = 100.

Nevertheless, the story of the loss in competitiveness is not solely linked to what economists call the price-barriers (or appreciation of the exchange rate). It is also linked to non-price barriers as the World Bank strongly argues across many parts of the report. While chapter 1 provides a political economy framework to explain the worsening socio-economic outcomes and failures of past reform attempts, the report also delves into poor performance across many areas such as declining productivity, poor governance, infrastructure and logistics gap, weak business environment, lack of fiscal space, skills gap and many other (see figure 2.3 from the report). All of which are cross-cutting constraints that have prevented growth in private and jobs-creating productive sectors. This goes in line with what the author of your paper refers to as policy options that successive GoIs have not considered.

FIGURE 2.3

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



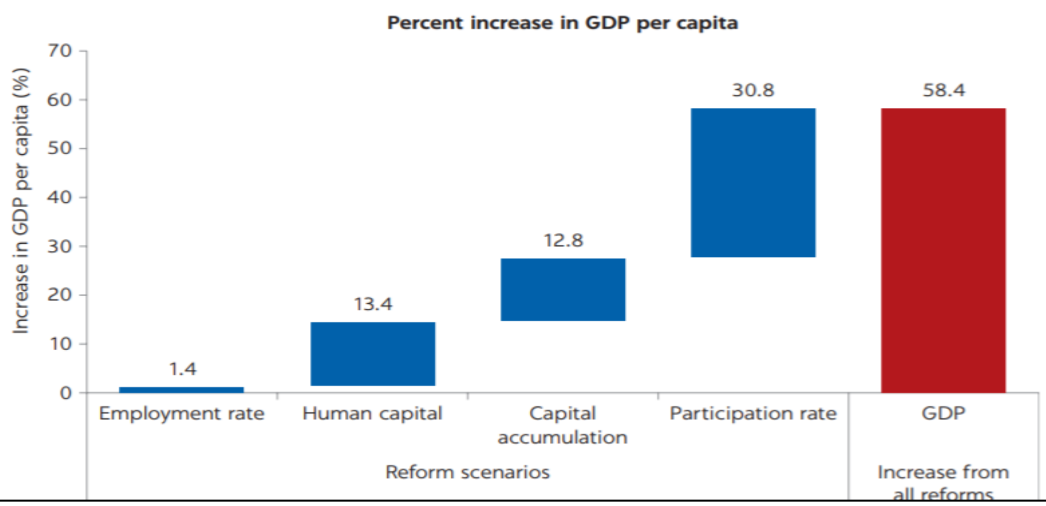
Source: World Bank, World Development Indicators.
Note: PPP = purchasing power parity. For the ease of doing business rank, economic complexity rank, and poverty rate, percentile world ranks are inverted (100 – actual percentile) to make them comparable with indicators such as the participation rate 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.

As a result, and contrary to the conclusion of the paper, the WB report is a call for action to engage in a series of cross-cutting reforms that will enable diversification of the economy away from oil and help create a new economic model anchored around a stronger private sector. The selection of the deep dives on agriculture and on trade is an application of the methodological framework described at the beginning of the report. The World Bank does not claim that those are the only sectors to consider despite having a latent comparative advantage. Not having deep dives on other sectors cannot be interpreted as providing any assessment or value judgment on the potentials for these sectors, but rather a mere selectivity exercise given the size of the report and its emphasize on cross-cutting and political economy constraints. Financial sector, tourism, services, manufacturing, ICT among many others are all important sectors that can be developed if both price and non-price barriers for competitiveness are addressed.

The report goes further and explicitly mentions manufacturing on many occasions be it when describing the link of its demise with the appreciation of the real exchange rate, or whether part of the diversification agenda, or as a latent comparative advantage (see pages 91, 105, 112, and 114 of the report for examples). The report also highlights the role of manufacturing as best practices in natural resource countries that have succeeded in diversifying their economies (see Box 3.1 in the report).

To conclude, what the World Bank report would really like to emphasize is that in addition to economic returns from maintaining peace and stability, there are similar dividends from undertaking structural reforms. The report simulates that If Iraq achieves levels of human and physical capital accumulation, employment rate and labor force participation at par with upper middle-income country peers today, Iraq's GDP per capital would increase by 58 percent (see figure 2.22 of the report). This is a transformational number. The largest economic return would come from raising labor force participation. This means creating more jobs for Iraqis, obviously in the private sector, and dealing with constraints preventing women for entering the labor force. We see that the GoI white paper is a bold roadmap that offers a comprehensive reform strategy with potential for reaping such reforms dividends. However, it will need to popular and political support to be implemented with the highest degrees of transparency.

FIGURE 2.22
Reform scenarios in Iraq



The World Bank team would like to thank the author once again for his candid comments and the Iraq Economist Network for providing the space for this all-important economic dialogue in Iraq. We are happy to engage and learn from your experience so as to improve our analytical and advisory program.