Brief Structural Analysis of the Original Iraqi 2021 Federal Budget, its Subsequent Amendments, Alignment with the White Paper and Break-Even Oil Price

By
Dr. Hashim Al-Ali
International Macroeconomic Development Planning and Fiscal Management Reform Specialist

May 2021

CONTENTS

TABLES AND FIGURES

ACRONYMS

COM	Council of Ministers
COR	Council of Representatives
GOI	Government of Iraq
IQD	Iraqi Dinar
kbd	Thousands of barrels per day
mbd	Millions of barrels per day
MOF	Ministry of Finance
PPP	Public private partnership
SOE	State owned enterprises
WP	White Paper

INTRODUCTION

The Federal 2021 budget has been prepared by MOF and has been submitted to the council of ministers (COM), at the beginning of the budget year (January 2021). The COM has discussed and approved the draft budget and submitted to the council of representatives (COR), for further discussion and final approval. It has been taken about four months for the COR to complete its discussions, amendments/changes and then approved, by 31 March 2021.

The 2021 budget is the first budget prepared within the period for economic and fiscal reforms planned for the Iraqi economy, through the strategic While Paper (WP), prepared, approved and published by the existing transitional government of Iraq. Accordingly, it is expected that such a prepared 2021 budget should, in its major policy and assumption, be based on and in an alignment with the WP strategic contents, so that it would be the right instrument and the appropriate vehicle through which the economy would begin the journey of recovery, transformation, restructuring and reforming.

In this short paper, we would like to shed light on the original budget structure and assumptions and how it was amended by the COR , on aggregate, sectoral and spatial dimension, analysing how the finally approved budget's contents relate to the WP and where there are deviations from the WP's strategic objectives and requirements, the response to COVID-19 aspects, and elaborating on the major issues and challenges that are likely to be faced in the implementation of this approved version.

THE ORIGINAL AND COR AMENDED BUDGET: AN AGGREGATED MACRO ANALYSIS

The MOF 2021 prepared budget and approved by the COM, was of total appropriations (total expenditures) of IQD 164.2 trillion ($113.2 billion). Out of these total expenditure, IQD 136.5 trillion ($94.1 billion) was allocated for the recurrent part of the expenditure and IQD 27.7 trillion ($19.1 billion) allocated to development (capital investment) expenditure.

In contrast, the COR amended version (March 31, 2021) stated that the total budgeted expenditures are IQD 129.99 trillion ($89.7 billion), of which IQD 100.4 trillion ($69.2 billion) is for recurrent expenditure, with a reduced level of 26.4 percent from the MOF budgeted level. While the amount allocated to the investment expenditures by the COR amended version is IQD 29.6 trillion ($20.4 billion) , which indicated an increase over the original submitted budget by 6.7 percent or IQD 1.8 trillion ($1.3 billion). Consequently, the total amended expenditure is reduced by 20.8 percent below that of the original budget.

On the revenue side, the original MOF budget has planned for total revenue for 2021 of IQD 93.2 trillion ($64.2 billion). The main components of this total are: i) IQD 73.0 trillion ($50.4 billion) from oil sector revenue (with the assumption of exporting 3.25 mbd including the 250 kbd from KRI, and with a price of USD 42 per barrel, and an exchange rate of IQD 1450 per each USD). And of non-oil revenue of IQD 20.1 trillion ($13.9 billion).

In comparison, the amended COR version of the approved budget, shows that the total budget revenue during 2021 would be IQD 101.3 trillion ($69.9 billion). This reflects the recent upturn in oil prices. Out of this total, the oil revenue will be amounted to 81.2 trillion ($56.0 billion). This oil revenue figure is derived out of the same exported oil figures as in the original budget document, but with assumed average oil price of $45 pb (up from $42 pb) and unchanged exchange rate and daily export volume. This is plus an increase in the crude oil prices delivered to local uses of IQD 7000 pb ($4.8 pb). While the size of the non-oil revenue stays the same as that used in the original MOF submitted budget document. This is, even though the COR has voted for cancelling the introduction of the income tax proposed by the MOF's original budget. There is no explanation why the non-oil revenue will stay the same after the COR eliminated the proposed income tax scheme, but they (COR) may have assumed that customs and sales tax and other planned fees in the original budget document would yield more if they are going to be more efficiently planned, collected and administered.

The table below depicts all these macro-aggregated budgetary amended by the COR.

TABLE 1: AGGREGATE OF ORIGINAL AND COR-AMENDED 2021 BUDGETS

All figures in billions of IQD

Item	Original budget	Amended Budget (March 31, 2021)	Change	Change (%)
Total Expenditure	164,206.0	129,993.0	(34,213.0)	-20.8%
Recurrent	136,450.4	100,434.1	(36,016.2)	-26.4%
Capital	27,755.6	29,558.9	1,803.2	6.5%
Total Revenue	93,160.0	101,320.1	8,160.2	8.8%
Oil	73,010.9	81,171.1	8,160.2	11.2%
Non-oil	20,149.0	20,149.0	0.0	0.0%
Surplus/ (deficit)	(71,046.1)	(28,672.9)	42,373.2	-59.6%

In relation to the White Paper both the original and subsequently passed budget are deviated from the main principle of the White Paper. This deviation has been accentuated in the amended version by the elimination of the policy related to mobilisation and enhancing domestic non-oil revenue which was meant to lessen the economy's dependence on oil revenues which is exogenously determined. While the bias towards recurrent expenditure is going in the opposite direction of the White Paper's strategic objectives of increasing national productive capacity through better and more capital accumulation, i.e. investment.

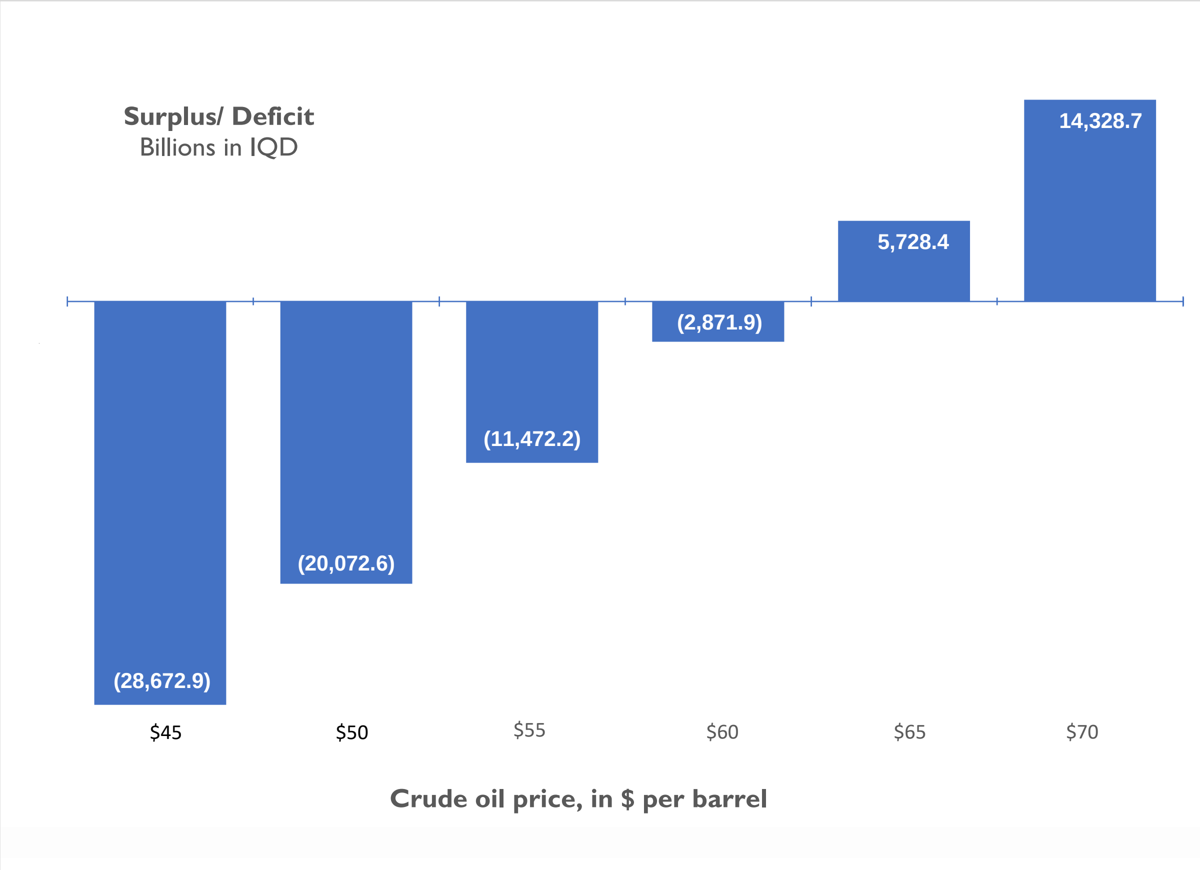
There was a high level of expectancy that the proposed cost-cutting measures and development of new, mostly non-oil, revenues would improve the overall fiscal balance. The February 2021 Article IV staff report certainly had the assumption that most, if not all the White Paper recommendations would be incorporated into the budget. IMF staff made their calculations based on the GOI fully implementing them.

Their estimates of the relative improvement to the overall fiscal balance amounted to IQD 10.2 trillion ($7.0 billion). After the COR revision, that amount reduced by forty-two percent, or IQD 4.2 trillion ($2.9 billion). This was due to the removal of all income, wealth and pension related taxes.

This puts the Ministry of Finance in a predicament as to how best allocate the now reduced expenditure ceiling and non-realised revenue gains first envisioned. While the new Budget has a lower deficit, it isn't clear yet how this will be realised other than through the expected gains from oil prices and possibly production.

Given the significant role and the domination of crude oil export revenue in the budget envelope together with the movements in the international prices overtime, it is helpful to attempt to work out what would be the breakeven crude oil export price for Iraqi crude to finance the federal budget, at the given planned total expenditure and assumed non-oil revenues. Consequently, we have worked the breakeven average price of Iraqi crude oil export, during the budget year to be around $61.67 per barrel. This is on the assumption that nothing else changes.

FIGURE 1: BREAK-EVEN OIL PRICE



If the Iraqi average crude export price goes up above the breakeven price level there would be a surplus, i.e. the total revenue is greater than total budget expenditure, such surplus should be transferred into; a specially created "Stabilisation Fund". The Budget also allows part of this surplus to be redistributed back to the oil producing provinces. This fiscal space, if it eventuates, would be used for any unseen spending eventualities and/or paying for the accumulated public debt.

It should be stressed that Iraq is operating in 'negative fiscal space' at present with not only general government juggling debt against the most pressing needs of society and shrinking central bank reserves but also within the wider public sector and within the state-owned banks operating with weak balance sheets and contingent liabilities in sectors such as electricity supply. The government does have more borrowing room with the IMF but the final Budget's exclusion of many of the proposed fiscal reforms may affect their negotiations in the future.

3/ Dr. Hashim Al-Ali, MEA, "Structural Analysis of the 2021 Budget………"

The coming fiscal 2021 year will most likely see inflationary pressure due to the devaluation of the dinar in the short term, and this will increase the pressure on the budget for areas such as the food rationing system and supporting the vulnerable.

THE SECTORAL ALLOCATION AND REALLOCATION OF THE 2021 BUDGET

Without the final 2021 Budget detail available, it is not yet possible to look at the implications of the revision to the initially proposed Budget at a level beyond the ceilings set in the Budget itself. This has yet to be processed by the Budget Department at the Ministry of Finance who will go through the steps they normally follow to pro-rata the amounts to Ministries and programs.

TABLE 2: EXPENDITURE COMPARISON SUMMARY

All figures in billions of IQD

	Original budget 2021	Amended Budget (31 March)	Change	Change (%)
Total Expenditure	164,206.0	129,993.0	(34,213.0)	-20.8%
Recurrent	136,450.4	100,384.1	(36,066.2)	-26.4%
Operating expenses	120,556.9	90,784.1	(29,772.7)	-24.7%
Compensation of employees	53,839.8	*53,839.8**	0.0	0.0%
Other operating expenses	66,717.1	*36,944.4**	(29,772.7)	-44.6%
Debt funded	15,893.5	9,600.0	(6,293.5)	-39.6%
Capital (=capital expenditure + capital loans)	27,755.6	29,608.9	1,853.2	6.7%

* it is assumed that the wage allocation will not change and therefore, the reduction in the total expenditure would have to be met by reductions in other operating expenses. In the absence of the detailed data, these are only included to illustrate how deep the cut would have to be, if all things stayed the same, in other operating expenses.

TABLE 3:SECTORAL BUDGET ALLOCATIONS

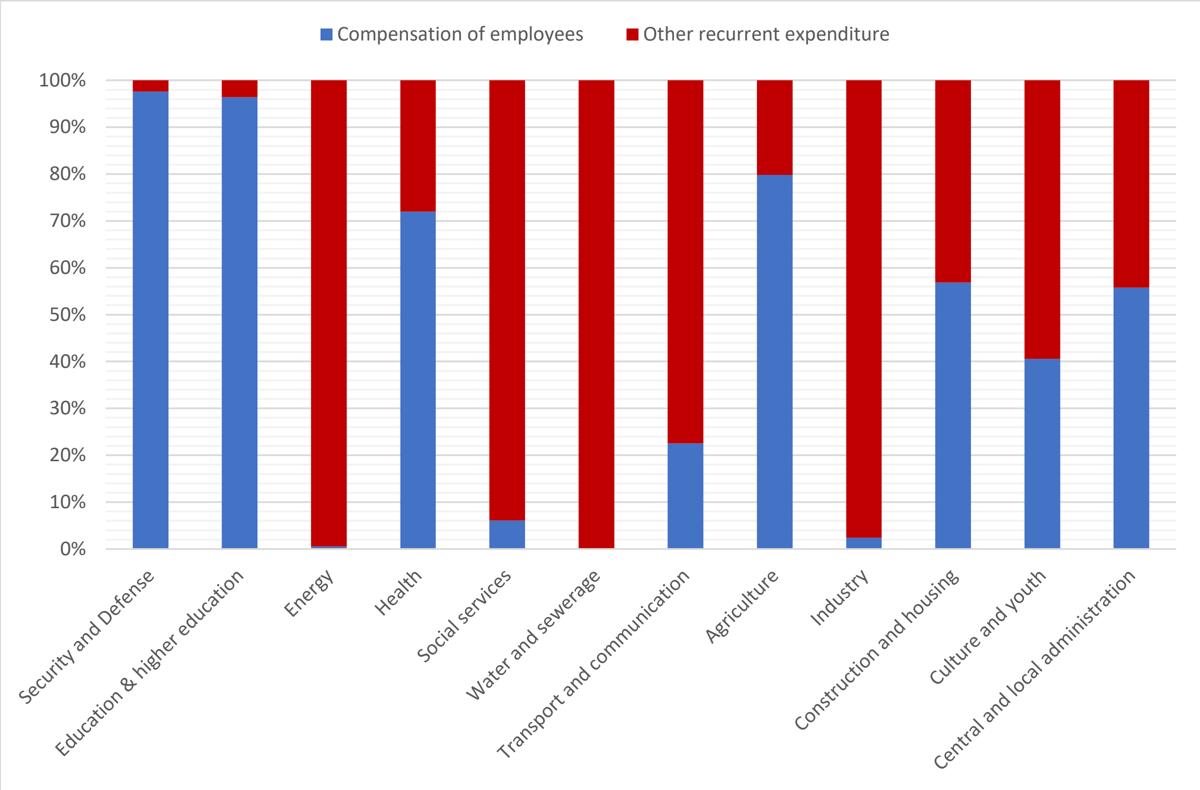
All figures in billions of IQD

Sector	Compensation of employees	Other recurrent expenditure	Total Current	Investment	Debt financing	Grand total
Security and Defense	25,922.2	631.9	26,554.1	961.7	147.0	27,662.8
Education & Higher Education	11,054.2	413.2	11,467.4	285.4	100.0	11,852.8
Energy	89.6	17,020.8	17,110.4	16,262.5	0.0	33,372.9
Health	4,770.0	1,857.5	6,627.5	630.0	48.3	7,305.8
Social services	1,897.2	29,147.4	31,044.6	108.9	217.7	31,371.2
Water and Sewerage	0.0	468.8	468.8	104.3	0.0	573.1
Transportation and Communication	61.8	212.3	274.1	629.0	1.1	904.3
Agriculture	525.3	132.7	658.0	187.8	62.3	908.1
Industry	40.2	1,612.6	1,652.8	33.2	0.0	1,686.0
Construction and Housing	196.4	149.2	345.6	1,252.7	0.0	1,598.3
Culture and Youth	535.6	784.8	1,320.5	229.7	15.4	1,565.6
Central and Local Administration	8,747.2	6,932.2	15,679.4	7,070.3	539.0	23,288.7
Debt Management	0.0	0.0	7,354.4		14,762.0	22,116.4
Grand total	**53,839.8**	**59,363.5**	**120,557.7**	**27,755.6**	**15,892.7**	**164,206.0**

5/ Dr. Hashim Al-Ali, MEA, "Structural Analysis of the 2021 Budget………"

Looking at the labor cost ratio, compared to other operating expenditure, by the sectors that the initial Budget tabled, there is a wide variation seen as shown below.

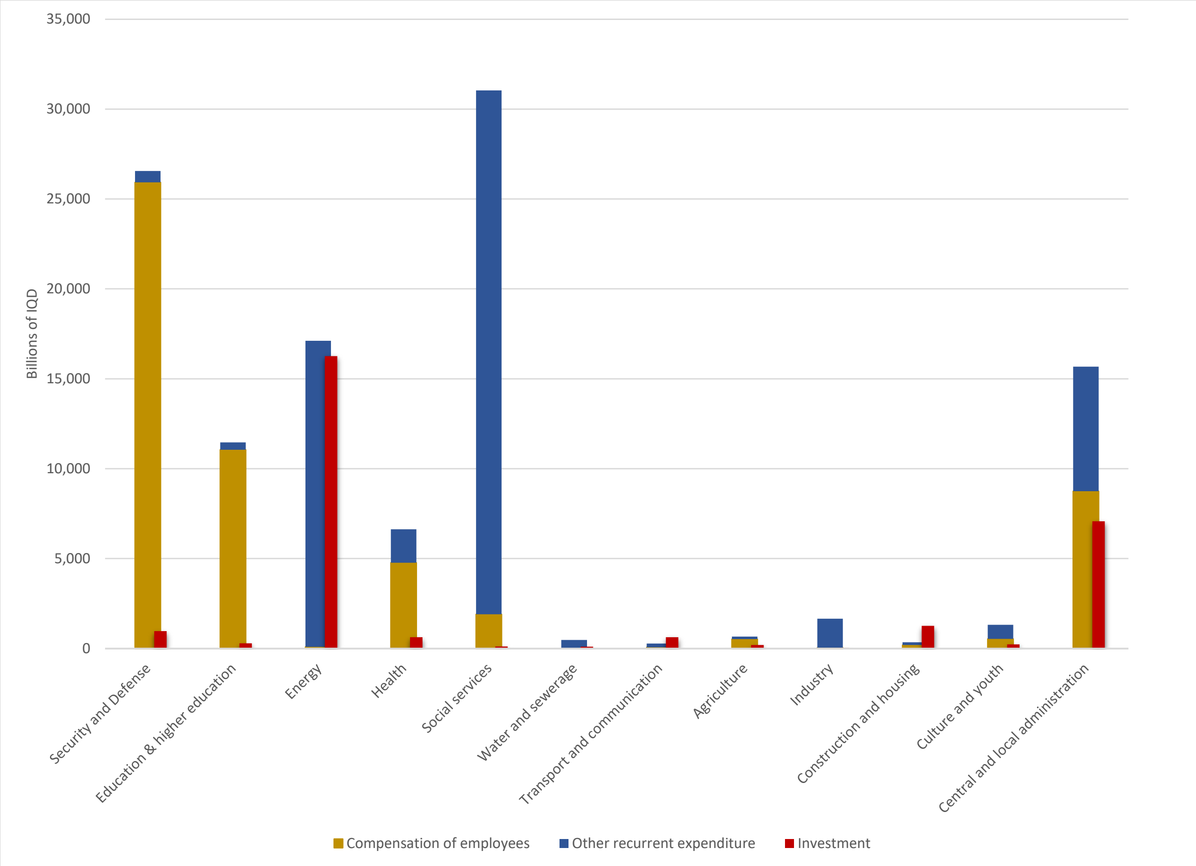
FIGURE 2: DISTRIBUTION BETWEEN LABOR AND OTHER OPERATING COSTS, BY SECTOR



On top of the recurrent expenditure, capital spending is set by the Budget at IQD 29.6 trillion ($20.4b). This is IQD 1.85 trillion (higher than the initially introduced Budget.

The levels of both recurrent and capital spending allocated in the Budget, by main sectors, are shown below.

FIGURE 3: SECTORAL OPERATING EXPENDITURE AND INVESTMENT ALLOCATION



The final budget documentation provided by the MOF will shed more light on any redistribution of this spending on a sectoral basis. The emphasis in the 2021 budget is very much on social protection and continuing the fight for improving the security situation.

The Government Revenue

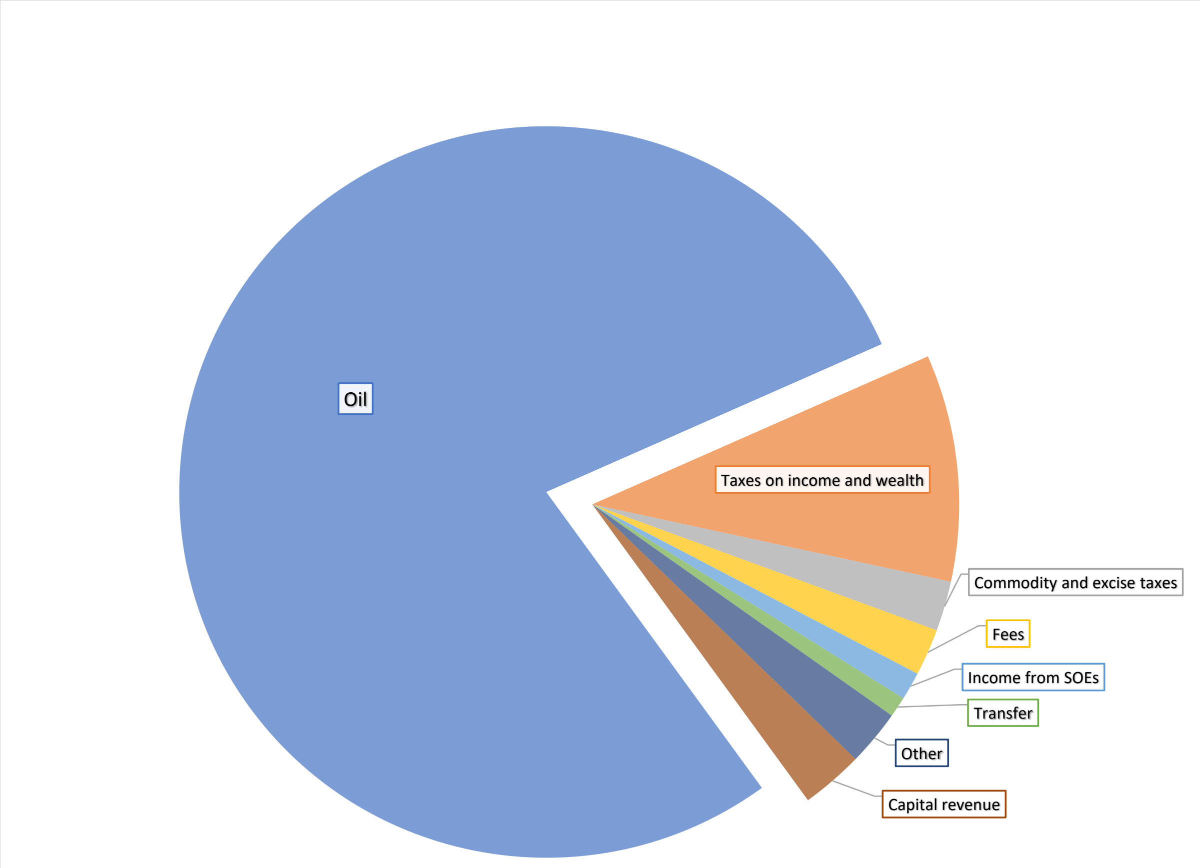
With the recent upturn in oil prices, the conservative price in the budget of $45 per barrel appears to allow for a reasonable amount of fiscal space.

TABLE 4: BUDGET COMPARISON - REVENUE

	2019 Budget	2019 Actual	2020 Actual	Original budget 2021 (IQD billion)	Amended budget 2021 (IQD billion)	Budget 2021 Change (IQD billion)
Total Revenue	105,569.7	107,567.0	63,199.7	93,160.0	101,320.1	8,160.2
Oil	93,741.1	99,216.3	54,448.5	73,010.9	81,171.1	8,160.2
Non-oil revenue	11,828.6	8,350.7	8,751.2	20,149.0	*20,149.0*	0.0
Taxes on income and wealth	3,841.8	2,389.0	3,316.1	9,338.5	#N/A	
Commodity and excise taxes	2,492.4	1,625.5	1,402.1	2,051.6	#N/A	
Fees	537.0	927.1	801.6	1,925.0	#N/A	
Income from SOEs	2,761.3	594.5	1,771.9	1,150.0	#N/A	
Transfer	254.7	1,024.5	504.5	841.2	#N/A	
Other	1,896.3	1,674.2	922.9	2,296.1	#N/A	
Capital revenue	45.1	115.8	32.1	2,546.6	#N/A	
Surplus/ (deficit)	(27,537.9)	N/A	N/A	(71,046.1)	(28,672.9)	42,373.2
Surplus/ (deficit) USD billion	(23.3)	N/A	N/A	(49.0)	(19.8)	29.2

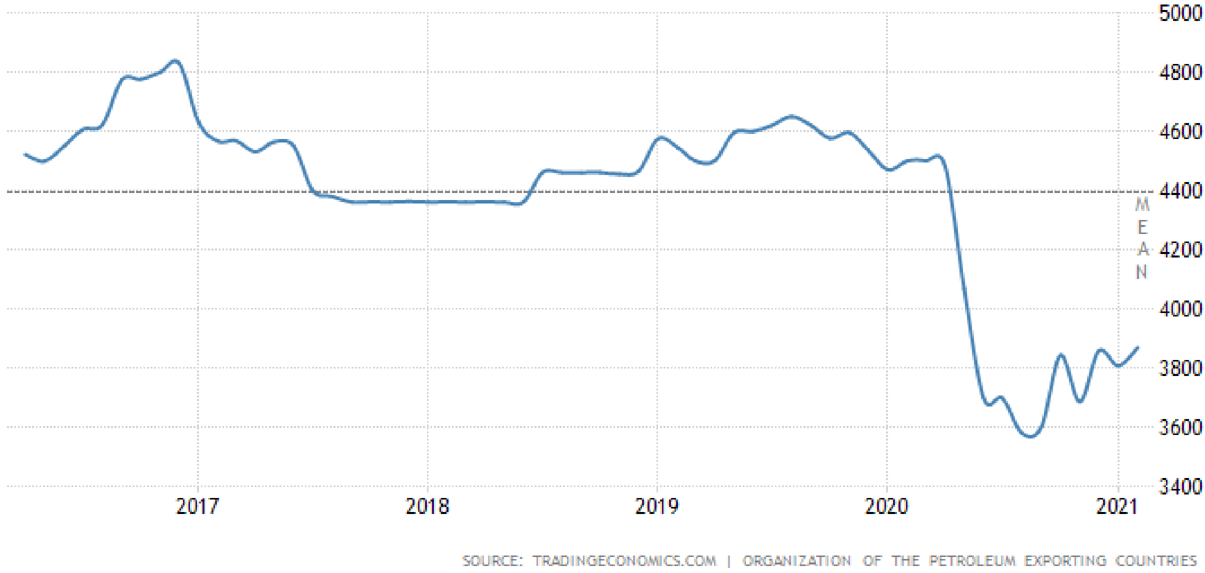
8/ Dr. Hashim Al-Ali, MEA, "Structural Analysis of the 2021 Budget………"

FIGURE 4: OIL AND NON-OIL REVENUE SOURCES - ORIGINAL 2021 BUDGET



Looking at Iraq's oil production, the medium-term outlook is for a recovery from the sharp decrease seen during the latter half of 2020. Certainly 2020 was an exceptional year, the presumed export price per barrel had been $56 in both the 2019 Budget (and by extension, the 2020 budget that didn't eventuate but was carried over from the 2019 Budget) as well as in the medium-term projection published on the Open Budget Survey webpage (via mof.govt.iq). The actual export price achieved was around $37 per barrel for 2020

FIGURE 5: IRAQ OIL PRODUCTION (THOUSANDS OF BARRELS PER DAY)



THE 2021 APPROVED BUDGET AND ITS ALIGNMENT WITH THE STRATEGIC WHITE PAPER

It is well recognized that the 2021 budget is the first prepared annual budget, out of the likely series of annual budgets, that would be prepared and implemented withing the time span of the economic reform, stated in the While Paper (WP). Given this reality, an attempt has been contemplated to find out how the 2021 budget is related and/or in line with the strategic policies recommended by the WP. And whether the aimed at alignment between the budget elements and the related strategic objectives of the WP is observed. Thus, and in order to identify the alignment and/or the deviation of the budget from the main and related principles of the WP, the table below has been designed and prepared to analyse and depict such relationship between the budget and the White Paper, with special focus on the main, though related, economic and fiscal strategic policies and objectives.

TABLE 5: WHITE PAPER COMPARISON WITH 2021 BUDGET

Item	The White Paper	The 2021 Budget	The Outcome
1	Medium-term budgeting based on medium term macroeconomic and fiscal framework	Annual budget	No Alignment
2	Programme-based budgeting	Item and incremental based budget	No Alignment
3	Diversify the economy away from crude oil sector	No clear direction	No Alignment
4	Support productive activities and sectors	Very low allocation to investment & into productive sector	No Alignment
3	Rationalising & reducing government employees wage-bill -To be reduced from 25% of GDP to 12.5% of GDP-	Increased govt. employees wage-bill in absolute term	No Alignment
4	Review the IQD Exchange Rate versus the USD	Have devalued the IQD to USD rate	Alignment
5	Enhancing domestic non-oil revenue	No substantive increases in non-oil revenue	No Alignment
6	Applying an efficient subsidies system	No subsidies being rationalised so far	No Alignment
7	Rationalisation of energy subsidies	Policy being introduced to rationalise the uses	Alignment
8	Developing and encouraging private sector	No clear policy introduced in this direction	No Alignment
9	Rehabilitation of SOE-sell or privatised-	Nothing mentioned in this direction - related article being cancelled	No Alignment
10	Budget deficit should not exceed 3% of GDP	Budget deficit over 11% of GDP (IMF[1])	No Alignment
11	Managing and reducing the public debt	Continue increase and adding to public debt	No Alignment
12	Restructuring the investment programme to be more Productive and Feasible	No visible restructuring has recommended in the budget	No Alignment
13	Encouraging and adopting public private partnership (PPP)	Reducing the importance of the PPP Arrangement	No Alignment
14	Developing and improving the dilapidated Infrastructure Sector in the Economy	No visible budget allocation to develop and enhancing infrastructure sector in Iraq	No Alignment

[1] The estimated GDP for 2021 is IQD 255.9 trillion. Source: IMF Article IV Staff Report, February 2021

From Table 5 it can be seen that out of fourteen selected economic and strategic fiscal WP indicators, only two are consistent and aligned with the WP strategic direction, out of the budget planned expenditure path and policy.

SOME GENERAL REMARKS AND ANALYSIS ON THE BUDGET AND THE ECONOMY

- At the outskirt, there are no large investment projects apparent in the budget documents that can lead the economy to the targeted path of economic diversification and fiscal sustainability, through creating the right productive capacity in the productive sectors, other than the crude oil sector. Hence, it is a caretaker (and perhaps hopeful, in the sense of oil prices) budget as opposed to increasing production, creating growth, job opportunities and lessening the dependency on the crude oil sector, in the economy.

- The budget in its structure has not precisely stated, neither shed light on how to fundamentally address poverty reduction and unemployment in the Iraqi economy, or by how much and when. In other words, it lacks an overall fiscal strategy or coherence with any medium-term perspective.

- Following on the first point above, no emphasis or clear strategic direction and or policies have been put forward and articulated by the budget document vis-à-vis the importance and/or priorities given to the productive sector, particularly agriculture and the manufacturing industry (areas highlighted in the 2030 Sustainable Development Plan).

- Giving emphasis and reallocation of funds towards developing the productive sectors' activities, would undoubtedly generate more domestic non-oil revenue, and diversifying the national economy resulting from expanding these sectors' productive capacity, outputs, exports, higher growth, employment opportunities, and hence, more national/personal income and national wealth.

- Unfortunately, the COR has eliminated article 20 of the budget law, which stipulated the new tax systems and rates on different income groups. By doing so the COR has worked against the fiscal strategies of national revenue diversification, and the objective of mobilisation of the non-oil domestic revenue in the economy. This is definitely working against the WP's recommendations in this area. However, if the COR has done that with alleviating poverty from given segments of the society in mind, that would be more understandable if they had left the original contents of this article to be applicable to high income brackets, i.e. to be applied on the group with monthly income of IQD2,250,000 per month and above.

- Related to the previous point, the newly issued law has changed article 21, (now article 20), by rephrasing the disallowing of government employees to have more than one salary from grade deputy DG and above, to only DG and above. Hence, increasing unjustified public expenditure in the budget.

- The share of private sector development and creating the right enabling environment for private sector and private investors was also curtailed rather than encouraged, particularly when the article that dealt with the rehabilitation of the state owned enterprises (SOE), as a step towards selling and/or privatising them, has been eliminated. The same may be said related to curtailing the uses and discouragement of pursuing PPP type arrangements.

- Furthermore, the budget, despite the discussion and delays, has been treated as a table of numbers to be adjusted and reduced in an arbitrary manner, rather than being considered as a fiscal policy instrument used in the context of medium-term plans, public investment management strategies or tax policy strategies and the like, to direct and reflect the development and restructuring reform priorities, and speeding up the actual implementation of the strategic socio-economic reform and development objectives aimed at in the GOI's White Paper. Therefore there is a general failure of the national budget to be used as an effective fiscal instrument designed, realistically and practically, to achieve the aimed at economic diversification objective, creating the optimal growth in the economy, reducing unemployment, in particular, the structural unemployment, stabilising inflation, mobilising the domestic non-oil revenue, increasing the exports and substituting competing imports, to mention but a few.

- Finally, it is unfortunate that the Iraqi economic reform agenda, at least at this stage, appears to be centered around consideration of the annual budget as the main instrument for steering the reform agenda. Such a tendency may be doing injustice to other significant reform efforts and instruments.

COVID RESPONSE

Iraq's economy was blindsided in 2020 by the international response to COVID-19 and is still finding a pathway out of the pandemic. Compounding the fact, is that there was no budget passed in 2020 in addition to the political pressure to the run-up to the 2021 elections. The fiscal stress caused by the dependence on oil revenue and the significant drop in prices turned cash management into crisis management during 2020. The 2021 budget had to balance financial stress and managing debt in the face of fighting corruption and poverty as well as improving the security situation and supporting the vulnerable in society.

The budget provides support to these overall objectives, even if still depends oil prices to come to the rescue. But there is no specific response to working towards a post-COVID scenario other than boosting the allocation to the health sector to mitigate the impact of the pandemic and improve medical capacity.

The budget does protect the projects supporting health, such as building hospitals and expediting the completion of health and medical projects.