



KURDISTAN REGIONAL GOVERNMENT (KRG): ECONOMIC AND SOCIAL IMPACT ASSESSMENT OF THE SYRIAN CONFLICT AND ISIS INSURGENCY

Sibel Kulaksiz, et al¹

Introduction: The Syrian civil war, which began in 2011 and the ISIS (Islamic State in Iraq and Syria) insurgency which accelerated in June 2014 led to this report. These events caused tens of thousands to flee and many chose the relative safety of the Kurdistan Region of Iraq (KRI). They came as “refugees” from Syria and as Iraqi “internally displaced persons (IDPs).” This happened during a fiscal crisis which led to a 90% drop in fiscal transfers from the central government in Baghdad starting in early 2014.

This Quick Note summarizes a report with the same title on the impact and stabilization costs of the influx of refugees and IDPs. Impact refers to the immediate economic and fiscal effects on the KRI economy and budget. Stabilization cost refers to the additional spending needed to restore the welfare of KRI residents.

This rapid ESIA differs from standard needs assessments. First, the crisis is still unfolding, so it is not conducted in a post-conflict condition. Second, the duration and magnitude of the crisis is uncertain and hence the real impact of the shock will depend on conditions in Syria and Iraq. Third, there has been no significant material damage to KRI’s infrastructure, its housing, and human and physical capital stocks. As such, the impact of shocks has affected flow measures of economic activity such as GDP growth rate, incomes, local and foreign direct investment as well as the provision and access to public goods and services. This ESIA is a rapid assessment that provides a snapshot of a detailed

assessment of selected, highly impacted sectors. The study excludes security-related costs.



Photo By Sibel Kulaksiz, The World Bank
Arbat IDP Camp in Sulaymaniyah, Northern Iraq

The Refugee and IDP Influx: Starting in early 2012 with Syrian refugees and the IDPs in 2014, the situation is now a full blown humanitarian crisis. In early 2015, there were 257,000 Syrian refugees and 1,003,300 Iraqi IDPs in the KRI. Together with the 250,000 IDPs from before 2014, the total number of refugees and IDPs was 1.5 million in 2015.² This is a 28% increase in KRI’s population. Dohuk hosts 60% of IDPs and refugees. The IDPs and Syrian refugees reside in many of the same host communities, placing strains on the local economy and on public services.³ The ESIA provides estimates based on three scenarios. The baseline scenario assumes that

¹ Sibel Kulaksiz, Macro and Fiscal Management Global Practice, the World Bank. The full report with the same title will be available in April 2015. Please look for it at www.worldbank.org.

² The refugee and IDP numbers are obtained from KRG Ministry of Planning; and KRG and United Nations’ *Immediate Response Plan Phase II (IRP2) for Internally Displaced People in the Kurdistan Region of Iraq*.

³ In December 2014, there were 2,350,000 refugees and IDPs in overall Iraq.

the current population of refugees and IDPs will remain unchanged in 2015. The low case scenario has an added 30,000 refugees and 250,000 IDPs, and the high scenario has 100,000 refugees and 500,000 IDPs.

The combination of loss of fiscal transfers and the refugee and IDP crisis impacted all productive and social sectors. Their impacts are still unfolding and significantly depressing economic activity. GDP growth declined from 8% in 2013 to 3% in 2014. Prices and unemployment have increased. More refugees and IDPs entering the labor market are pushing wages down. The ESIA estimates that KRI's poverty rate increased from 3.5% to 8.1%. On public finances this led to sharply lower local revenues, increased borrowing from the private sector and quasi-fiscal deficits of about US\$3 billion (about 25% of fiscal transfer entitlement from the central government) was incurred towards wages and salary payments and for public services and goods, with loss of quality and reduced access. This borrowing supported growth but led to more debt, impacting on fiscal sustainability.

All this is unfolding within a policy framework with long-standing distortions. For example, electricity demand has sharply increased, but the government remains committed to fuel purchased from private refineries to private generators at a fixed price. Although KRI socio-economic outcomes are the best in Iraq, there were limitations in health, education, and infrastructure impeding investment and efficiency.

Overall Stabilization Cost: Overall stabilization cost from the influx is US\$1.4 billion for the baseline scenario for 2015. This is around 5.6% of non-oil GDP, and in the range of major disasters worldwide.

Impact on the economy: The ISIS crises happened during an ongoing KRG budget crisis (since February 2014), and these shocks hit the economy hard. The ISIS crisis presented a direct threat to KRI adversely affecting trade routes. The fighting against ISIS has fragmented the local, national and regional market undermining KRI's role as a safe trade route to the larger southern Iraq market. Economic growth contracted 5%. The initial channel for lower growth was the loss of transfers from Baghdad. KRG's share from the federal budget, 17% minus sovereign expenses, corresponds to US\$12 billion a year, or 80% of KRG's total revenues. This has been withheld

due to political gridlock in Baghdad. The actual amount that has been transferred is about US\$1.1 billion. Both revenues and expenditures saw large declines and the government has large wage arrears. Many contractors have not been paid for months and the construction sector has been badly hit with small companies going bankrupt.

The Ministry of Natural Resources (MONR) steps in: MONR assumed wage and salary obligations by supporting MoF but with lags. MONR borrowed US\$1.5 billion from domestic private sectors and another US\$1.5 billion from international oil firms and suppliers by selling future oil outputs. It also exported US\$1.3 billion worth of oil. The Ministry has also provided transfers for displaced people. It is estimated that it directly contributed US\$1 billion for basic support to IDPs. MONR injected US\$5 billion, 41% of the budgetary resources not transferred from the Baghdad, avoiding a collapse of the economy. However, these are in essence quasi-fiscal activities of the public sector at about 12% of regional GDP in 2014. Deficits for the year could be 14-15% of GDP.

Other Costs: KRI was obliged to source from refineries much further south, leading to increases in fuel prices—from 14% in Sulaymaniyah to 15% in Erbil and 23% in Dohuk, increasing electricity and transport costs. Foreign direct investment flows declined and operations of foreign enterprises have been hurt. Investments declined by two thirds 2014. Erbil Steel, which produced 18,000 tons of steel bars every month, evacuated its workers in June and shut down its facility. The cement sector stopped supplying the southern market for months.

Trade of goods and services: Iraq's exports declined by 25% and imports by 45% between May and July 2014. Turkish exports decreased by one third to US\$1.3 billion in June and July. Services exports declined due to less transit trade and tourism. The number of trucks entering through the Ibrahim Khalil customs with Turkey declined from over 3,000 a day to 600. The ISIS crisis led to a dramatic loss in tourist inflows. These had increased by 33% in 2013 to 3 million, but declined to less than 800,000 in the first six months of 2014.

Costs of stabilizing effects on Human development: This will require US\$834 million (3.5% of GDP) in 2015. The growing influx has put significant pressures on the KRG severely constraining delivery of health, education and social

protection programs. A noticeable share of the population has fallen into poverty or is vulnerable to falling into poverty.

Impact on Social Protection: Due to these multiple crises, the KRI poverty rate more than doubled, from 3.5% to 8.1%. A rough estimate of funds—on average—to bring poverty down to “without-crisis” levels are estimated at US\$54.2 million to US\$87.8 million for 2015. The Federal government had started the implementation of a new Social Protection Law which stipulated an increase in social allowance to reach on average ID 420,000 per household monthly. Kurdish households below the poverty line will be eligible. The Ministry of Labor & Social Affairs (MOLSA) is the main KRG agency to provide social safety net assistance. It manages the cash-transfer social safety net program for vulnerable groups.

Food Security: The governorates most affected by the ISIS crisis, Nineveh and Salahaddin, contribute nearly 1/3 of Iraq’s wheat production and 38% of its barley. Many grain silos have been captured by insurgents. Increased food demand is being met by imports. Domestic agriculture, already declining, has been further disrupted by decreased government contracts. The cost of Public Distribution System (PDS), agricultural budget support to farmers, as well as food assistance to refugees and IDPs dominates government expenditures. While food security in KRI was sustained during the Syrian influx, the recent IDP surge is leading to food insecurity. The PDS for subsidizing food staples is not functioning optimally. The estimate for sufficient food supplies is US\$155.4 million under the baseline scenario for 2015.

Housing Needs: Adequate shelter needs to be provided immediately to over 243,000 vulnerable IDPs. The government has built 26 IDP camps across the three governorates of the KRI with a combined capacity for 223,790 IDPs. The KRG has committed to funding three of these camps. The international community is expected to fund 20 camps with three camps remaining unfunded.⁴ The stabilization costs

for sheltering the IDPs are estimated at US\$111.3 million.⁵

The Health Impact: Between October 2012 and September 2014, due to increased population, the host communities in KRI saw a decline in health spending. While external donors stepped in, significant financial resources are required. The displaced people are at high risk of disease due to environmental factors (e.g., poor water and sanitation facilities) and nutritional deficiencies. In light of this, higher utilization levels of both PHC and hospital services would be expected. It is estimated that the health sector will need additional US\$317 million to stabilize the situation.

The Educational System: It is estimated that there are 325,000 children under 18 among the refugees and the IDPs and 70% of IDP and 48% of refugees children are not enrolled in school. While immediate priorities are infrastructure-related (i.e., school renovation, classroom expansion/construction), it is equally important to deploy and pay teachers, provide textbooks, address language barriers, and insure security and safety of children. It is also important to inform refugees and IDPs of educational opportunities and improve access to services. It is estimated that under the baseline scenario, there is a need for US\$34 million for the refugees and US\$161.5 million for the IDPs to stabilize the sector.

Domestic Energy Demand and Prices: Gasoline prices have increased to ID 900/liter, while diesel prices doubled to ID 950/liter in June 2014 with predictable impact on the economy. The electricity sector is heavily dependent on the government with the Ministry of Finance transferring ID 80 billion monthly in 2013. Tariff levels and collection rates are insufficient to cover operating cost and capital expenditures. Demand is increasing: for example, the demand load in Erbil reached its peak in August 2014, increasing 22% in one year. In Sulaymaniyah additional capacity of 125MW is needed. Systemic problems remain. The 2015 stabilization cost is estimated to be between US\$275 million and US\$517 million across the baseline and high scenarios.

⁴ The 2012 SEINA report; and the KRG Immediate Response Plan.

⁵ This is based on the assumption of a cost of providing shelter of US\$833 per person. This does not include the cost of providing security on camps. There are inevitable costs associated to the securitization of the camp, but that is it beyond the scope of this assessment.

The Water Sector: Water supply and sanitation systems were already facing challenges prior to the crisis. The additional demand for water for refugees and IDPs is estimated at 11%. As a result of the crisis, KRG now needs to meet an additional demand of 17.1 million m³ annually. Sanitation is a concern and major gaps for the sewerage sector relate to the lack of physical facilities: no wastewater treatment plants, no sewage collection networks except in Sulaymaniyah Governorate. It is estimated that the cost of sectoral stabilization is around US\$214.3 million for 2015.

Solid Waste Management: The additional population produced over 1,690 tons of solid waste per day, an increase of 26% on KRI's 2014 daily per capita generated solid waste. Only Dohuk City will continue to accept additional solid waste due to a new sanitary landfill, and its current capacity for recycling. It is expected that from 2015 onward, the following interventions would be required: 1) the closure and rehabilitation of open and uncontrolled municipal solid waste dumps, especially in Erbil and Sulaymaniyah; 2) establishing composting, separating and landfilling facilities, especially in Erbil where there is no waste recycling; and 3) identifying appropriate land and construction of a new sanitary landfill for greater Sulaymaniyah City.

The Road Network: The crisis has resulted in the closure of one of the main trade routes between North and South from Dohuk to Erbil via Mosul. The IDPs who fled using their vehicles also caused a sudden increase in traffic by 20% and humanitarian relief effort with heavy trucks also strained roads. Eight bridges in the KRI have been fully or partially destroyed. The crisis has also strained the municipal road network.

Environmental Impacts: Environmental concerns in the first instance include those with a direct impact on human health in displaced and host communities. These include, low-quality potable water in and outside of camps; increases in raw, undirected sewage outflows, (KRI has no wastewater treatment infrastructure); and increased solid waste dumping without proper disposal. During winter time, increased demand for cooking and heating fuel lead to increases in illegal firewood harvesting as well as in the health impact of indoor air pollution, especially on children and the aged. Also, power and transport infrastructure are

stretched to their limits, resulting in high air pollution loads.

Conclusion: This summary of the ESIA provides a technical assessment of the impact of the crises and stabilization needs to inform the dialogue between the regional and central governments as well as provide input for international efforts to address socio-economic issues. In the short-term, much of the solutions for averting the humanitarian crisis are beyond KRG's control, and requires national and international response. Should the refugees and IDPs remain in the KRI, the ESIA could be used as a gauge of the financial resources needed (in addition to KRG's share from annual budget) to address the needs of displaced people and host communities. The stabilization needs of specific sectors can be used to inform KRG budget allocation decisions.

In the medium-term, structural reforms are required. While it is a priority to provide necessary relief to deal with economic and social issues caused by the crisis, it is also important for the government to develop longer-term strategies to address structural development issues. As refugees and IDPs are likely to remain in the KRI for an extended period of time, they will be seeking employment opportunities. The crisis highlighted KRG's strong dependence and vulnerability on transfers from Baghdad and the insufficient direct contribution of other sectors to KRI's economy. This underlines the recognized need for private sector led economic diversification. Indeed, according to the 2020 KRG Vision, with its natural resources and labor force, the KRI has the potential to accelerate economic growth. A dynamic private sector would provide job opportunities to the population, as well as to refugees and IDPs. The World Bank's upcoming growth diagnostics study will refine and implement this vision while proposing specific policies.

Contact MNA K&L:

*Gerard A. Byam, Director, Strategy and Operations.
MENA Region, The World Bank.*

*Preeti Ahuja, Manager, MNADE
Regional Quick Notes Team:*

*Omer Karasapan and Mark Volk
Tel #: (202) 473 8177*

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