

Iraq Economic Monitor

Toward Reconstruction, Economic
Recovery and Fostering Social Cohesion



*With a Special Focus on Transition to Poverty
Targeted Cash Transfer System*

Fall 2018
Middle East and North Africa Region

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Cover photo of the Mosul Dam, Iraq courtesy of Anmar Qusay.

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ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Combating of Terrorism Financing	IDPs	Internal Displaced Persons
Bpd	Barrel per day	ILO	International Labor Organization
BOP	Balance of Payments	IHSES	Integrated Household Socioeconomic Survey
CWG	Cash Working Group	IMF	International Monetary Fund
CBI	Central Bank of Iraq	INUR	Iraq National Unified Registry
CCT	Conditional Cash Transfer	INOC	Iraqi National Oil Company
CGE	Computable General Equilibrium	IPP	Independent Power Producers
CoMs	Council of Ministers	ISIS	Islamic State of Iraq and Syria
CoRs	Council of Representatives	KRG	Kurdistan Regional Government
CPI	Consumer Price Index	MDTF	Multi Donor Trust Fund
CSO	Central Statistical Organization	MOLSA	Ministry of Labor and Social Affairs
DB	Doing Business	MENA	Middle East North Africa Region
DfID	UK Department for International Development.	OPEC	Organization of Petroleum Exporting Countries
DNA	Damage and Needs Assessment	PDS	Public Distribution System
DPF	Development Policy Financing	PFM	Public Financial Management
EMDEs	Emerging Market Developing Economies	PMT	Proxy-Means Testing
EODP	Emergency Operation for Development Project	PPP	Public Private Partnerships
ESSRP	Emergency Social Stabilization and Resilience Project	RDF	Reconstruction and Development Framework
FATF	Financial Action Task Force	SBA	Stand-By Arrangement
FDI	Foreign Direct Investment	SFD	Social Fund for Development
GCC	Gulf Council Countries	SOEs	State Own Enterprises
Gol	Government of Iraq	SPC	Social Protection Commission
GDP	Gross Domestic Product	TBI	Trade Bank of Iraq
GW	Giga Watt	TSP	Transmission Service Provider
ICA	Investment Climate Assessment	UNDP	United Nations Development Program
ICPI	International Corruption Perception Index	UNOCHA	United Nation Office for the Coordination of Humanitarian Affairs
ICRG	International Co-operation Review Group	WB	World Bank
ID	Iraqi Dinar	WDI	World Development Indicators
IEA	International Energy Agency	WGI	World Wide Governance Indicators

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

The *Iraq Economic Monitor* is a product of the Middle East and North Africa (MENA) unit in the Macroeconomics, Trade & Investment (MTI) Global Practice in the World Bank Group. The report was led by Bledi Celiku (Economist). The report is authored by Ashwaq Maseeh (Economist). The Special Focus is authored by Dhiraj Sharma (Economist). Muna Abeid Salim (Senior Program Assistant) provided outstanding administrative support.

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

EXECUTIVE SUMMARY

Iraq's overall security situation has notably improved after the defeat of ISIS, but significant challenges lie ahead. Iraq has witnessed major political and security transitions in 2017 when Prime Minister Al-Abadi announced in December the victory over ISIS after a war that lasted three years. The defeat of ISIS in Iraq left the government with the daunting tasks of rebuilding the country's infrastructure, reconstruction of liberated areas, establishing security and stability, and providing services for the return of the displaced persons. On May 12, 2018 Iraq voted in parliamentary elections that delivered a win for a political bloc led by Moqtada al-Sadr, while PM Al-Abadi's bloc, once seen as front runner, came in third. The ballots have been recounted after allegations of fraud and completed on August 8th without major change. On September 15th, Iraq's parliament elected lawmaker Mohammed al-Halbousi as speaker, marking a major step towards establishing a new government. On October 2nd, Iraq's parliament elected as president Barham Salih, who immediately named Adel Abdul Mahdi Prime Minister-designate, ending months of deadlock after the national election in May.

Humanitarian conditions remain difficult in many conflict-affected areas. The toll of four years of intensive combat on Iraq's civilian population has been enormous. The conflict claimed the lives of over 67,000 Iraqi civilians since 2014, before the casualty figures started to decrease at the end of 2017. A

recent report by U.N. Office for the Coordination of Humanitarian Affairs (UNOCHA) estimates that of the almost 6 million people displaced since the rise of ISIS in 2014, some 2.0 million remain displaced at the end of June of 2018, and about 8.7 million need humanitarian assistance. Stabilization and reconstruction needs in areas liberated from ISIS are extensive. Dire living conditions, including economic hardship, insufficient basic services such as health, water, and sanitation, are faced by the 3.9 million returnees, and are behind the reluctance of many displaced to return home. Agricultural production has declined by 40 percent leaving nearly 1.9 million Iraqis food insecure; 7.3 million people require health care; 5.4 million need water and sanitation assistance and 4.1 million people need shelter (UNOCHA 2018).

Following the successful liberation from ISIS of all Iraq territory, the Government is putting in place a comprehensive reconstruction package. The recent damage and needs assessment conducted by the Iraqi Ministry of Planning jointly with the World Bank estimated the overall damage at US\$45.7 billion, and more than US\$88 billion in short and medium-term reconstruction needs, spanning various sectors and different areas of the country. US\$30 billion worth of commitments were made mostly in the form of loans and guarantees at the International Conference for the Reconstruction of Iraq, which took place in February 2018 in Kuwait. At the same time, the government endorsed the Reconstruction

and Development Framework (RDF) to reconstruct the liberated areas, forging a renewed social contract based on citizen-state trust and sustainable developments and reforms. At the Kuwait conference, the World Bank pledged a total of US\$6 billion to support the Gol's reconstruction and development agenda making it the biggest development financing partner of Iraq. Furthermore, in April 2018, Iraq's Council of Ministers approved a 5 years National Development Plan (2018–2022) which focuses on key issues including provincial construction, poverty reduction, and social and private sector development. However, reconstruction has been slow due to political uncertainty following elections but more needs to be done urgently to restore basic services and rebuild critical infrastructure.

Poverty has risen sharply. The national poverty rate increased from 18.9 percent in 2012 to an estimated 22.5 percent in 2014. Recent labor market statistics suggest further deterioration of welfare. The unemployment rate, which was falling before the crises, has climbed back to the 2012 level. Almost a quarter of the working-age population is underutilized, i.e., they are either unemployed or underemployed. Many households are prone to adverse shocks; more than a third of the households has experienced an adverse event since the beginning of the crises and one in six households has experienced some form of food insecurity. The universal food ration (Public Distribution System, PDS) remains the most extensive social assistance program, but people have also turned to friends and relatives and humanitarian agencies for assistance. Internally displaced persons (IDPs) have been buffeted by multiple adverse shocks: they have lost much of their wealth through destruction of assets; they have seen family members die, get sick, or become injured at a higher rate; and they have faced loss of jobs or businesses. Fewer IDP adults have a job, so each employed adult in an IDP household supports more than six other household members. Some IDPs have lost access to the PDS. The cumulative impact of these developments on IDPs is visible in several dimensions, including a higher risk of hunger. The Gol is implementing an ambitious reform to improve targeting of social spending, following the introduction of a Proxy Means Testing (PMT) system to

identify the poor. The Gol committed to adopt a unified database of eligible households based on the PMT system across all different social protection schemes.

Despite military success, Iraq continues to face political tensions and social unrest. Large protests against increasing unemployment, corruption and poor public services erupted in July this year, particularly in Iraq's second largest and oil-rich city, Basra, and spread to other cities including the capital Baghdad. The government responded with pledges to increase spending on electricity and water projects (ID3.5 trillion) and create 10,000 jobs. A new commission was created to investigate corruption and other factors inhibiting service delivery. More sustained actions to meet protesters' demands will be possible when a new government is in place. The new government is expected to focus on prioritizing inclusion, economic reforms, justice, and accountability, while ensuring the timely delivery of basic services.

Relations with KRG are improving after the rupture related to the independence referendum in 2017. The relations between Baghdad and Erbil have been strained since last year's referendum on regional independence on September 25th, which was considered illegitimate by the Federal Government, and on budget transfer issue in early 2018. However, tensions between the federal government and the KRG eased when the federal government agreed to temporarily resume transfers that seem to have largely addressed the region's immediate needs, and KRG total revenue is sufficient to pay salaries and pensions.

Economic conditions are gradually improving following the deep economic strains of the last three years. The 2017 rebound of economic growth was constrained by oil production in line with OPEC+ agreement. In 2018, overall GDP growth is estimated to return positive at 1.9 percent thanks to a notable improvement in security conditions, higher oil prices, and expected higher public and private investment. Non-oil growth is estimated to show a strong rebound at 5.2 percent this year, underpinned by broad-based growth in agriculture, industry, and services. Inflation was low in 2017 at just 0.1 percent, but increased demand pushed inflation at 1.7 percent in July 2018. Higher domestic demand and increased credit to the

economy (albeit from a low level) will likely further increase inflation to average 2.0 percent in 2018.

Iraq's fiscal position is estimated to continue to benefit from higher oil prices. In 2018, the overall fiscal balance is estimated to post a surplus of 1.2 percent of GDP due mostly to higher oil prices. The plunge in world oil prices in 2015–16, increased security and humanitarian outlays and weak controls led to sharply lower oil revenues and rapidly widened the budget deficit. It narrowed in 2017 due to the pick-up in oil prices and measures adopted to contain current expenditures within the framework of IMF program and World Bank DPF series. With oil prices expected to rise, the government will have ample fiscal space to finance reconstruction, provided that the process of fiscal consolidation continues. Official financing for the budget has been less urgent with the improvement in the fiscal position. KRG's fiscal position is also estimated to relatively improve in 2018, with the federal government agreeing to reinstate transfers to pay salaries and pensions.

Iraq public debt is estimated to further decline and to remain sustainable. Growth and the positive overall fiscal balance are estimated to further reduce public debt-to-GDP ratio from 67.3 percent in 2016 to almost 55 percent in 2018. The government also adopted a framework to control the issuance of guarantees, which reached US\$33 billion (or 20 percent of GDP) in end-2016 and these guarantees, most related to the electricity sector, are now believed to be under control. In previous years large fiscal deficits have been mainly financed through bilateral and multilateral support, occasional sovereign bond issuance and indirect monetary financing by the CBI.

Higher oil prices since mid-2017 have also been conducive to better outcomes on external balance. Higher oil prices turned the current account balance from a deficit of 9 percent in 2016, into a surplus of 1.2 percent of GDP in 2017 and 2.1 percent of GDP in 2018. International reserves are estimated to increase from US\$49 billion in 2017 (or 6.8 months of imports), to US\$58.3 billion (or 7.7 months of imports) in 2018, rebuilding buffers to external shocks.

The World Bank is supporting the Gol in this critical moment to address recovery needs. Supported projects prioritize five key pillars:

governance, national reconciliation and peacebuilding, social and human development, infrastructure, and economic development. Since July 2015, the World Bank is supporting the reconstruction efforts with the Emergency Operation for Development Project (EODP). In October 2017, the World Bank approved a US\$400 million additional financing to the original project (US\$350 million) to focus not only on the basic infrastructure but also on health and education, with a special attention to the needs of the marginalized youth and women in those areas affected by ISIS. In February 2018, the World Bank approved the Iraq's Social Fund for Development (SFD) project financed with US\$300 million, to improve the living conditions of over 1.5 million poor households in Iraq by increasing access to basic services and creating employment opportunities. This was followed in April 2018 by the approval of the Emergency Social Stabilization and Resilience Project (ESSRP), financed with US\$200 million to increase livelihood opportunities, access to psychosocial services, and expand the provision of social safety nets. In addition, efforts are under way to establish a Multi Donor Trust Fund (MDTF) for coordinated dialogue and donor financing of socioeconomic recovery and reconstruction and deepening critical government reforms.

The outlook is expected to improve considerably due to higher oil prices and the improving security situation. Overall GDP growth is projected to accelerate to 6.2 percent in 2019 sustained by higher oil production. In the following years, oil production is expected to increase only marginally, reducing overall growth to an average of 2.5 percent until 2023, due to the limited capacity of the Gol to mobilize investment in the oil sector. Non-oil growth is expected to remain positive on the back of higher investment needed to rebuild the country's damaged infrastructure network, private consumption and investment. But sustained non-oil recovery will depend on the transition from an immediate rebound as security improves to implementation of a high-quality investment pipeline with sound financing. A more stable security situation will allow for private consumption and investment to pick up, increasing import needs for consumer and capital goods. Inflation is projected to remain low at 2 percent in 2019.

Fiscal and external balances are likely to continue improving as higher oil prices feed through to higher revenues. Largely driven by expected higher oil prices and fiscal consolidation, the fiscal position will remain positive in 2019 but will turn into small deficits by 2020. The current account deficit is expected to remain limited as long as Iraq's oil exports prices continue to rise. Thanks to fiscal restraint, public debt is expected to continue to decline and to remain sustainable over the medium term. The outlook includes making space for post-conflict reconstruction and infrastructure spending. The short-term outlook also includes reviving capital spending and responding to demands for improvements in basic services in 2019 and beyond. Carefully managing spending pressures over the remainder of this year and taking measures in 2019 budget would create space for capital/reconstruction spending while also using some of the oil windfall to build buffers.

Challenges remain due to political risk, dependency on oil revenue and the regional situation. Although higher oil prices are associated with reduced near-term vulnerabilities, the outlook remains subject to considerable uncertainties due to political developments that could also delay economic

recovery in the conflict-affected governorates. Setbacks in security and/or a crisis over formation of the government could weaken growth. While the policy priorities of the new government remain unknown, there is a risk of weak policy implementation and pressure to spend the expected budget surpluses, which would erode the fiscal and external positions. Absence of a clear commitment in the budget on wage bill management and subsidy reduction could weaken the fiscal consolidation and absorb the fiscal space otherwise available for reconstruction. A decline in oil revenue or a shortfall in projected donors financing would result in lower gross reserves and/or higher public debt. Moreover, the outlook provides limited fiscal space to absorb shocks and further expand capital spending. Iraq's capacity to expand oil production and exports remains constrained, further exacerbating risks from a reduction of oil prices. The imposition of sanctions on Iran could curb non-oil trade as Iran is the largest non-oil trade partner of Iraq and result in higher prices of key commodities, while the economic crisis in Turkey is likely to operate mainly through trade channels. Implementing the new enacted law of Iraqi National Oil Company (INOC) may also have adverse impacts on the governance of the oil sector and macroeconomic stability.

ملخص تنفيذي

الذي أجرته مؤخراً وزارة التخطيط العراقية سويةً مع البنك الدولي حجم الأضرار الكلية بمبلغ 45.7 مليار دولار أميركي، وما يزيد على 88 مليار دولار أميركي لاحتياجات إعادة الإعمار على المدى القصير والمتوسط، والتي تغطي قطاعات متنوعة ومناطق مختلفة من البلاد. وقد أسهم المجتمع الدولي بالتزامات تُقدَّر قيمتها بـ 30 مليار دولار أميركي جاء معظمها بشكل قروض وضمانات في المؤتمر الدولي لإعادة إعمار العراق، الذي عُقد في شباط 2018 في الكويت. وفي الوقت نفسه، صادقت الحكومة على إطار عمل إعادة الإعمار والتنمية (RDF) لإعادة إعمار المناطق المحررة، وهي بهذا توطد عقدًا اجتماعيًا متجددًا يقوم على الثقة بين المواطن والدولة والتنمية المستدامة والإصلاحات. وفي مؤتمر الكويت، تعهد البنك الدولي بمبلغ كلي وصل إلى 6 مليار دولار لدعم أجندة الحكومة العراقية لإعادة الإعمار والتنمية وهو ما يجعله أكبر شريك لتمويل التنمية في العراق. علاوةً على هذا، في نيسان 2018، صادق مجلس الوزراء العراقي على خطة التنمية الوطنية الخمسية (2018-2022) التي تركز على قضايا رئيسية بصمتها إعادة الإعمار في المحافظات والتخفيف من الفقر والتنمية الاجتماعية وتنمية القطاع الخاص. ومع ذلك، كان سير عملية إعادة الإعمار بطيئاً بسبب عدم اليقين السياسي في أعقاب الانتخابات، وتبقى هنالك حاجة إلى فعل المزيد وبشكل عاجل من أجل استعادة الخدمات الأساسية وإعادة بناء البنية التحتية الضرورية.

ارتفاع الفقر بشكل حاد. ارتفع المعدل الوطني للفقر من 18.9 في عام 2012 إلى ما يُقدَّر بـ 22.5 في عام 2014. وتشير آخر إحصائيات سوق العمل إلى حدوث المزيد من التدهور في الرفاهية. لقد ارتفع معدل البطالة، الذي كان يتراجع قبل الأزمة، مجدداً ليصل إلى مستواه الذي كان عليه في عام 2012. إن حوالي ربع السكان ممن هم في سن العمل غير مُستخدَمين، أي أنهم إما عاطلين عن العمل أو يبحثون عن عمل إضافي. كما شهد العديد من الأسر صدمات عنيفة؛ فأكثر من ثلث الأسر مرّت بحدث مؤدٍ منذ بداية الأزمة وواحد من بين كل ستة أسرٍ قد مرّ بشكلٍ من أشكال انعدام الأمن الغذائي. ويظل نظام البطاقة التموينية (نظام التوزيع العام، PDS) البرنامج الأوسع من بين برامج المساعدة الاجتماعية، لكن الناس لجؤوا أيضاً إلى الأصدقاء والأقارب والمنظمات الإنسانية طلباً للمساعدة. ولقد تعرّض المهجّرون (IDPs) لصدماتٍ عنيفةٍ متعددة: حيث فقدوا الكثير من ثروتهم بسبب تدمير الممتلكات؛ أو موت فرد أو أفراد من العائلة، أو أصبحوا جرحى بمعدلٍ يعيقهم عن العمل؛ كما واجهوا فقدان الوظائف أو الأعمال التجارية. وقلّة من البالغين بين هؤلاء المهجّرين من يملك عملاً، بحيث أنّ كل البالغ عاملٍ في بيتٍ من البيوت المهجّرة يُعيل أكثر من ستة أفراد آخرين

لقد تحسّن الوضع الأمني العام في العراق بشكلٍ ملحوظٍ بعد هزيمة داعش، إلا أنّ العراق لا يزال يواجه تحديات كبيرة. شهد العراق تحولاتٍ سياسية وأمنية رئيسية في عام 2017 عندما أعلن رئيس الوزراء العبادي في كانون الأول النصر على داعش بعد حربٍ دامت ثلاث سنوات. لقد تركت هزيمة داعش في العراق الحكومة أمام مهامٍ عسيرةٍ تتمثل بإعادة بناء البنية التحتية للبلاد وإعادة إعمار المناطق المحررة وتوطيد الأمن والاستقرار وتوفير الخدمات اللازمة لعودة النازحين. وفي 12 أيار 2018، أدلى العراق بصوته في الانتخابات البرلمانية التي نتج عنها فوزٌ لكتلةٍ سياسيةٍ يتزعمها مقتدى الصدر، بينما حلّت كتلة رئيس الوزراء العبادي، والذي كان يُنظر إليه سابقاً على أنه الأوفر حظاً بالفوز، في الترتيب الثالث. وتمت إعادة العد والفرز لصناديق الاقتراع بعد ظهور مزاعم بحصول تزوير وانتهت العملية في الثامن من آب دون حصول تغييرٍ كبير. وفي الخامس عشر من أيلول، انتخب البرلمان العراقي محمد الحلبوسي رئيساً له، في خطوةٍ مهمةٍ صوب تشكيل الحكومة الجديدة. كما انتخب في الثاني من تشرين الأول برهم صالح رئيساً للبلاد، والذي كُلف بدوره على الفور عادل عبد المهدي بتشكيل الحكومة الجديدة وأنهى بذلك شهوراً من الجمود السياسي نتج عن الانتخابات الوطنية في أيار.

لا تزال الظروف الإنسانية صعبةً في العديد من المناطق التي تأثرت بالنزاع. لقد كانت حصيلة سنواتٍ أربع من القتال المحتدم هائلةً على المدنيين في العراق. لقد أودى النزاع بحياة ما يزيد على 67,000 مدني عراقي منذ عام 2014، قبل أن تبدأ أعداد القتلى بالتناقص مع نهاية عام 2017. ويُقدَّر تقريرٌ صدر مؤخراً عن مكتب الأمم المتحدة لتنسيق الجهود الإنسانية (UNOCHA) بأنه من بين الستة ملايين مُهجّر تقريباً منذ ظهور داعش في 2014، ما يزال حوالي 2.0 مليون منهم مهجراً في نهاية حزيران 2018، وهناك 8.7 مليون منهم تقريباً بحاجة للمساعدة الإنسانية. إنّ حاجات الاستقرار وإعادة الإعمار في مناطق تم تحريرها من داعش هائلة. كما يواجه العائدون إلى منازلهم البالغ عددهم 3.9 مليون ظروفًا معيشيةً مترديةً تشمل صعوباتٍ اقتصاديةٍ وخدماتٍ أساسيةٍ غير كافيةٍ مثل الصحة والماء والنظافة، وهذه كلها تتفرد وراء تردد العديد من النازحين للعودة إلى منازلهم. كما أنّ الإنتاج الزراعي تراجع بنسبة 40 بالمائة ما ترك 1.9 مليون عراقي تقريباً يعاني من انعدام الأمن الغذائي؛ و7.3 مليون فرد بحاجة للرعاية الصحية؛ و5.4 مليون فرد بحاجة إلى مساعدة في مجال المياه والصرف الصحي و4.1 مليون فرد بحاجة للمأوى (UNOCHA 2018).

بعد التحرير الناجح لجميع الأراضي العراقية من داعش، تُعد الحكومة حزمةً شاملةً لإعادة الإعمار. لقد قدّر تقييم الأضرار والاحتياجات

الممول بـ 300 مليون دولار أميركي، لتحسين ظروف المعيشة لما يزيد على 1.5 مليون من الأسر الفقيرة في العراق بزيادة الوصول إلى الخدمات الأساسية وتوفير فرص العمل. وتبع هذا في نيسان 2018 الموافقة على المشروع الطارئ لدعم الاستقرار الاجتماعي والصمود (ESSRP)، الممول بـ 200 مليون دولار أميركي لزيادة فرص المعيشة، والوصول إلى الخدمات النفسية الاجتماعية، وتوسيع نطاق توفير شبكات الحماية الاجتماعية. إضافة لهذا، هناك جهودٌ جارية لإنشاء صندوقٍ ائتماني متعدد المانحين (MDTF) للحوار المنسق وتمويل المانحين للتعاافي الاجتماعي الاقتصادي وإعادة الإعمار وتوطيد إصلاحات الحكومة الحاسمة.

من المتوقع أن تتحسن آفاق الاقتصاد بشكل كبير بسبب أسعار النفط المرتفعة والوضع الأمني الآخذ بالتحسن. من المتوقع أن تزداد وتيرة نمو الناتج الإجمالي المحلي الكلي وصولاً إلى 6.2 بالمائة في عام 2019 والذي يستند في استدامته إلى الإنتاج المرتفع للنفط. ويُتوقع أن يرتفع إنتاج النفط في الأعوام القادمة بصورة هامشية فقط، ما قد يؤدي إلى تخفيض النمو الكلي بمعدل 2.5 بالمائة حتى عام 2023، بسبب القدرة المحدودة للحكومة العراقية على زيادة الاستثمار في قطاع النفط. ومن المتوقع أن يبقى النمو غير النفطي إيجابياً على خلفية ارتفاع الاستثمارات اللازمة لإعادة بناء البنية التحتية المدمرة، وفي استهلاك واستثمار القطاع الخاص. لكنّ التعافي المستدام غير النفطي سيعتمد على تحسّن الوضع الأمني وتنفيذ مشاريع استثمار عالية الجودة بتمويل سليم. ويسمح الوضع الأمني الأكثر استقراراً لاستهلاك واستثمار القطاع الخاص أن يرتفع، ما يزيد من احتياجات الاستيراد للبضائع الاستهلاكية والرأسمالية. ومن المتوقع أن يظل التضخم منخفضاً عند 2 بالمائة في عام 2019.

من المحتمل أن يستمر الميزانين المالي والخارجي في التحسن مع استمرار ما تعود به أسعار النفط المرتفعة من عائدات أعلى. سيظل الوضع المالي إيجابياً في عام 2019، مدعوماً بتوقعات أسعار نفط أعلى والتعزير المالي، لكنه سيتحول إلى حالات عجزٍ صغيرة بحلول عام 2020. ومن المتوقع أن يبقى عجز الحساب الجاري محدوداً طالما استمرت أسعار تصدير النفط بالارتفاع. وبفضل الضبط المالي، من المتوقع أن يستمر الدين العام بالانخفاض ويبقى مستداماً على المدى المتوسط. وتشمل التوقعات

فسح المجال للإنفاق في مجال إعادة الإعمار والبنية التحتية المرتبط بها بعد النزاع. كما تشمل التوقعات على المدى القصير إعادة إحياء الإنفاق الرأسمالي والاستجابة لمطالب إدخال التحسينات في الخدمات الأساسية في عام 2019 وما بعده. ومن شأن عملية الإدارة المتأنية لضغوط الإنفاق خلال ما تبقى من هذا العام واتخاذ إجراءاتٍ في موازنة 2019 أن يوفر فضاءاً للإنفاق الرأسمالي/إعادة الإعمار مع استخدام بعض مكاسب أسعار النفط لبناء مخزون في الوقت نفسه.

ما تزال التحديات قائمة بسبب المخاطر السياسية، والاعتماد على عائدات النفط والوضع الإقليمي. على الرغم من أن ارتفاع أسعار النفط قد تخفف من المخاطر على المدى القريب، إلا أن التوقعات تظل خاضعة لعدم يقين كبير بسبب التطورات السياسية التي من شأنها أن تؤخر أيضاً التعافي الاقتصادي في المحافظات المتأثرة بالنزاع. فمن شأن النكسات التي تحدث في الوضع الأمني و/أو الأزمة التي قد ترافق تشكيل الحكومة أن تؤدي إلى إضعاف النمو. ففي الوقت الذي تظل فيه أولويات سياسة الحكومة الجديدة غير معروفة، ثمة خطورة ترتبط بضعف تنفيذ السياسة والضغط الذي قد يرافق إنفاق الفائض المتوقع في الموازنة، وهو من شأنه أن يضر بالوضعين المالي والخارجي. ومن شأن غياب الالتزام الواضح في الموازنة بخصوص خفض الرواتب والإعانات أن يُضعف التماسك المالي ويمتص الوفرة المالية التي يُفترض أن تخصص لإعادة الإعمار. كما أن من شأن حدوث انخفاضٍ في عائدات النفط أو عجزٍ في التمويل المتوقع للمانحين أن ينتج عنه احتياطيّ إجماليةً أوطأ و/أو دين عام أعلى. علاوة على ذلك، توفر التوقعات فضاءً مالياً محدوداً لامتناس الصدمات وتوسيع الإنفاق الرأسمالي بشكلٍ إضافي. كما تظل قدرة العراق على توسيع إنتاج النفط وزيادة صادراته مُقيّدة، وهو ما يُفاقم المخاطر التي ترافق انخفاض أسعار النفط. ومن شأن فرض عقوباتٍ على إيران أن يكبح التجارة غير النفطية حيث أن إيران هي الشريك التجاري غير النفطي الأكبر للعراق وينتج عن هذا ارتفاع أسعار السلع الرئيسية، بينما نجد بأنّ الأزمة الاقتصادية في تركيا من المحتمل أن تظهر بصورة رئيسية من خلال القنوات التجارية. كما أن تنفيذ قانون شركة النفط الوطنية العراقية (INOC) الذي شُرّع حديثاً قد يكون له أيضاً آثاراً سلبية على حوكمة قطاع النفط وعلى استقرار الاقتصاد.

في البيت. كما فقد بعض المهجرين الوصول الى نظام البطاقة التموينية. فالآثار المترامكة لهذه التطورات على المهجرين يمكن رؤيته بأبعاد متعددة، ضمنها وجود مخاطرة أعلى بالتعرض للجوع. وهنا تقوم الحكومة العراقية بتنفيذ إصلاح طموح لتحسين عملية استهداف الإنفاق الاجتماعي، بعد إدخال نظام اختبار الدخل البديل (PMT) للتعرف على الفقراء. فالحكومة العراقية ملتزمة بتبني قاعدة بيانات موحدة للأسر المؤهلة على أساس هذا النظام بين جميع برامج الحماية الاجتماعية المختلفة.

بالرغم من النجاح العسكري، لا يزال العراق يواجه توترات سياسية وعدم استقرار اجتماعي. اندلعت مظاهرات كبيرة ضد البطالة المتزايدة والفساد وسوء الخدمات العامة في تموز من هذا العام، خاصة في ثاني أكبر مدن العراق، البصرة الغنية بالنفط، وانتشرت الى مدن أخرى بما فيها العاصمة بغداد. واستجابت الحكومة لها بتعهدات بزيادة الإنفاق على مشاريع الكهرباء والماء (3.5 ترليون دينار عراقي) وتوفير 10,000 وظيفة. كما تم تأسيس هيئة جديدة للتحقيق في الفساد والعوامل الأخرى التي تعيق تقديم الخدمات. وسيكون بالإمكان القيام بإجراءات مستدامة أكثر للإيفاء بمطالب المتظاهرين عند تنصيب حكومة جديدة. فمن المتوقع أن تركز الحكومة الجديدة هذه على جعل الشمولية والإصلاحات الاقتصادية والعدالة والمحاسبة في أعلى سلم أولوياتها، مع العمل في الوقت نفسه على ضمان تقديم الخدمات الأساسية بانتظام.

العلاقات مع حكومة إقليم كردستان آخذة بالتحسن بعد الشرح الذي نتج عن استفتاء الاستقلال الذي جرى في عام 2017. شهدت العلاقات بين بغداد وأربيل توتراً منذ استفتاء العام الماضي حول استفتاء الإقليم في الخامس والعشرين من أيلول، والذي اعتبرته الحكومة الفدرالية غير شرعي، وكذلك بسبب تحويلات الموازنة الى الإقليم في مطلع عام 2018. ومع ذلك، خفّت حدة التوترات بين الحكومة الفدرالية وحكومة إقليم كردستان عندما وافقت الحكومة الفدرالية على استئناف تحويلات الموازنة التي بدا بأنها قد غطت بشكل كبير احتياجات الإقليم المباشرة، كما يُعتقد أن عائدات حكومة الإقليم الإجمالية كافية لدفع الرواتب ومعاشات المتقاعدين.

الظروف الاقتصادية آخذة بالتحسن تدريجياً بعد الصعوبات الاقتصادية العميقة التي رافقت الأعوام الثلاث الماضية. فانتعاش النمو الاقتصادي في عام 2017 قيّده إنتاج النفط وفق اتفاقية الدول الأعضاء في منظمة أوبك ودول أخرى من غير الأعضاء. وفي عام 2018، يُقدّر أن نمو الناتج الإجمالي المحلي سيعود إيجابياً عند 1.9 بالمائة والفضل في ذلك يعود الى التحسن الملحوظ في الظروف الأمنية وارتفاع أسعار النفط والمستوى الأعلى للاستثمار المتوقع حدوثه في القطاعين العام والخاص. ومن المتوقع أيضاً أن يُظهر النمو غير النفطي انتعاشاً قوياً عند 5.2 بالمائة هذا العام، مدعوماً بنمو واسع النطاق في الزراعة والصناعة والخدمات. وكان معدل التضخم منخفضاً في عام 2017 عند 0.1 بالمائة فقط، لكن الطلب المحلي المتزايد دفع التضخم الى 1.7 بالمائة في تموز 2018. ومن المرجح أن يعمل الطلب المحلي المتزايد وزيادة الإئتمان الى القطاع الخاص (وإن كان من مستوى واطئ) على زيادة التضخم بمعدل 2.0 بالمائة في عام 2018.

تشير التقديرات الى استمرار ارتفاع الوضع المالي للعراق من أسعار النفط المرتفعة. من المتوقع أن تحقق الموازنة المالية الكلية في عام 2018

فائضاً بنسبة 1.2 بالمائة من الناتج الإجمالي المحلي غالباً بسبب أسعار النفط الأعلى. لقد أدى تدهور أسعار النفط عالمياً في الفترة 2015-2016 والإنفاق المتزايد في المجالين الأمني والإنساني وضعف الضوابط الى انخفاض حاد في إيرادات النفط، كما وسّع سريعاً من فجوة عجز الموازنة، لتعود وتضيق في عام 2017 بسبب ارتفاع أسعار النفط والإجراءات التي تم اعتمادها لاحتواء النفقات الجارية في إطار برنامج صندوق النقد الدولي وسلسلة مشاريع تمويل سياسة التنمية (DPF) التابعة للبنك الدولي. ومع توقع ارتفاع أسعار النفط، يُتوقع أن يكون للحكومة وفرة مالية أكبر لتمويل جهود إعادة الإعمار، شريطة استمرار عملية التعزيز المالي. فالتمويل الرسمي للموازنة أصبح أقل إلحاحاً مع تحسن الوضع المالي. وتشير التقديرات أيضاً الى أن الوضع المالي لحكومة إقليم كردستان سيتحسن نسبياً في عام 2018، مع موافقة الحكومة الفدرالية على استئناف تحويلات الموازنة لدفع الرواتب ومعاشات التقاعد.

تشير التقديرات الى أن الدين العام للعراق سينخفض مزيداً وسيبقى مستداماً. من المتوقع أن يعمل النمو والميزان المالي الكلي الإيجابي على إحداث المزيد من الانخفاض في معدل الدين العام الى إجمالي الناتج المحلي من 67.3 بالمائة في عام 2016 الى 55 بالمائة تقريباً. كما قامت الحكومة أيضاً بتبني إطار للسيطرة على إصدار الضمانات، التي وصلت الى 33 مليار دولار أميركي (أو 20 بالمائة من الناتج الإجمالي المحلي) في نهاية عام 2016 وهذه الضمانات، التي يرتبط معظمها بقطاع الكهرباء، يُعتقد بأنها الآن تحت السيطرة. وفي السنوات الماضية، تم تمويل العجز المالي الكبير بصورة رئيسية من خلال الدعم الثنائي والمتعدد الأطراف، وإصدار السندات السيادية بين الحين والآخر، والتمويل النقدي غير المباشر من قبل البنك المركزي العراقي.

ساعدت أسعار النفط المرتفعة منذ أواسط عام 2017 الى تحقيق نتائج أفضل على صعيد الميزان الخارجي. فقد حوّلت أسعار النفط المرتفعة ميزان الحساب الجاري من عجز نسبته 9 بالمائة في عام 2016 الى فائض بنسبة 1.2 بالمائة من الناتج الإجمالي المحلي في عام 2017 و 2.1 بالمائة من الناتج الإجمالي المحلي في عام 2018. وتشير التقديرات الى أن الاحتياطات الدولية سترتفع من 49 مليار دولار أميركي في عام 2017 (أو ما يعادل 6.8 شهر من الواردات)، الى 58.3 مليار دولار أميركي (أو 7.7 شهر من الواردات) في عام 2018، وهذا ما يعيد بناء مخزون أمام الصدمات الخارجية.

يدعم البنك الدولي الحكومة العراقية في هذه الفترة الحساسة للتعامل مع احتياجات التعافي. تمنح المشاريع المدعومة الأولوية لخمس ركائز أساسية: الحوكمة، والمصالحة الوطنية وبناء السلام، والتنمية الاجتماعية والبشرية، والبنية التحتية، والتنمية الاقتصادية. فمنذ تموز 2015، يدعم البنك الدولي جهود إعادة الإعمار من خلال المشروع الطارئ لدعم التنمية (EODP). وفي تشرين الأول 2017، وافق البنك الدولي على تمويل إضافي بقيمة 400 مليون دولار أميركي للمشروع الأصلي (350 مليون دولار أميركي) للتركيز ليس فقط على البنية التحتية الأساسية بل وأيضاً على الصحة والتعليم، مع اهتمام خاص باحتياجات الشباب والنساء المهمشين في تلك المناطق التي تأثرت بداعش. وفي شباط 2018، وافق البنك الدولي على مشروع الصندوق الاجتماعي للتنمية للعراق (SFD)

RECENT ECONOMIC AND POLICY DEVELOPMENTS

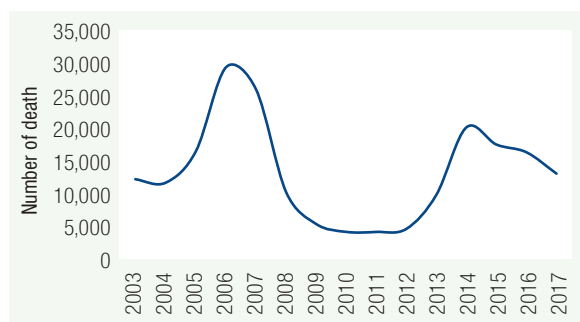
Political and Social Context

Following the declaration of military victory against ISIS in December 2017, security conditions have improved, and Iraqis are shifting their attention toward recovery and the country's political future. Parliamentary elections that were held on May 12th, 2018, resulted in a win for al-Sadr bloc. The winning blocs would have to agree on the nomination of a new prime minister. On September 15th, Iraq's parliament elected lawmaker Mohammed al-Halbousi as speaker, marking a major step towards establishing a new government. On October 2nd, Iraq's parliament elected as president Barham Salih, who immediately named Adel Abdul Mahdi as Prime Minister-designate. The political environment remains difficult, despite an improving security situation, with popular protests regarding weak public services and increasing unemployment. IDPs are returning home in greater numbers, but stabilization and reconstruction needs in areas liberated from ISIS are extensive. Relations between Baghdad and KRG are improving. The Government is putting in place a comprehensive reconstruction package, but the reconstruction has been slow due to political uncertainty after the elections.

Iraq's overall security situation has notably improved after the defeat of ISIS, but significant challenges lie ahead. On December 9, 2017, Prime Minister Al-Abadi announced victory over ISIS after a war that lasted three years. The defeat of ISIS in Iraq left the government with the daunting tasks of rebuilding the country's infrastructure, reconstruction of liberated areas, establishing security and stability, and providing services for the return of the displaced persons. On May 12th, 2018 Iraq voted in parliamentary elections that delivered a win for al-Sadr bloc, while prime minister Al-Abadi's bloc, once seen as front runner, came in third. The winning blocs would have to agree on the nomination of a new prime minister. The ballots have been recounted after allegations of fraud and completed on August 8th without major change. On September 15th, Iraq's parliament elected lawmaker Mohammed al-Halbousi as speaker, marking a major step towards establishing a new government. On October 2nd, Iraq's parliament elected as president Barham Salih, who immediately named Adel Abdul Mahdi as Prime Minister-designate, ending months of deadlock after the national election in May.

Humanitarian conditions remain difficult in many conflict-affected areas. The toll of four years

FIGURE 1 • Casualty Figures Have Been Decreasing



Source: Iraq Body Count, 2017.

of intensive combat on Iraq's civilian population has been enormous. The conflict claimed the lives of over 67,000 Iraqi civilians since 2014, before the casualty figures started to decrease at the end of 2017 (Figure 1). Some 2.0 million people remain displaced at the end of June of 2018¹ of the almost 6 million people displaced since the rise of ISIS in 2014, and about 8.7 million need humanitarian assistance (22 percent of the population). Stabilization and reconstruction needs in areas liberated from ISIS are extensive.² Dire living conditions, including economic hardship, insufficient basic services such as health, water, and sanitation, are faced by 3.9 million returnees, and are behind the reluctance of many displaced people to return home. Agricultural production has declined by 40 percent leaving nearly 1.9 million Iraqis food insecure; 7.3 million people require health care; 5.4 million need water and sanitation assistance and 4.1 million people need shelter (UNOCHA 2018). Hundreds of thousands of people, especially among women and youth, have been brutalized by violence and remain vulnerable and at increased risk to gender-based harassment and exploitation.

Despite military success, Iraq continues to face political tensions and social unrest. Large protests against increasing unemployment, corruption and poor public services erupted in July this year, particularly in Iraq's second largest and oil-rich city, Basra and spread to other cities including the capital Baghdad. The government responded with pledges to increase spending on electricity and water projects (ID3.5 trillion) and create 10,000 jobs. A new commission was created to investigate corruption and other factors

inhibiting service delivery. More sustained actions to meet protesters' demands will be possible when a new government is in place. The new government is expected to focus on prioritizing inclusion, economic reforms, justice, and accountability, while ensuring the timely delivery of basic services.

Relations with KRG are improving after the rupture related to the independence referendum in 2017. The relations between Baghdad and Erbil have been strained since last year's referendum on regional independence on September 25th, which was considered illegitimate by the federal government, and on budget transfer issue in early 2018. However, tensions between the federal government and the KRG eased when the federal government agreed to temporarily resume transfers that seem to have largely addressed the region's immediate needs, and KRG total revenue is sufficient to pay salaries and pensions.

Output and Demand

Iraq's economic conditions are gradually improving from the deep economic strains of the last three years, thanks to a more favorable security environment, higher oil prices and the pick-up in public and private investment. Overall GDP growth is estimated to return positive at 1.9 percent in 2018 and non-oil GDP to rebound at 5.2 percent supported by the broad-based growth in the key economic sectors.

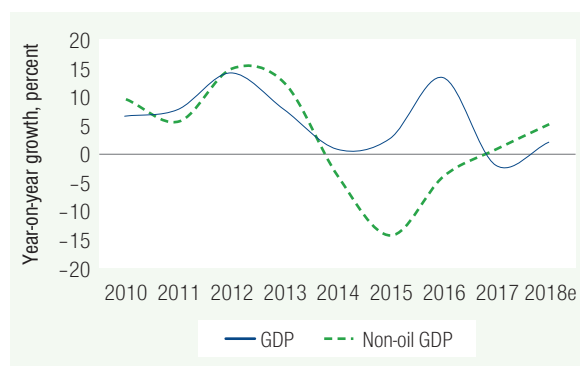
Economic Growth

Economic conditions are gradually improving following the deep economic strains of the last three years. Economic growth in 2017 was constrained by oil production in line with OPEC+ agreement, and investment were lower than expected, especially in construction. In 2018, overall GDP growth is estimated to return positive at 1.9 percent thanks to a notable improvement in security conditions, higher oil prices, and expected higher public and private

¹ U.N. Office for the Coordination of Humanitarian Affairs (UNOCHA).

² OCHA Iraq Humanitarian Bulletin, July 2018.

FIGURE 2 • Overall GDP Growth Is Estimated to Rebound in 2018



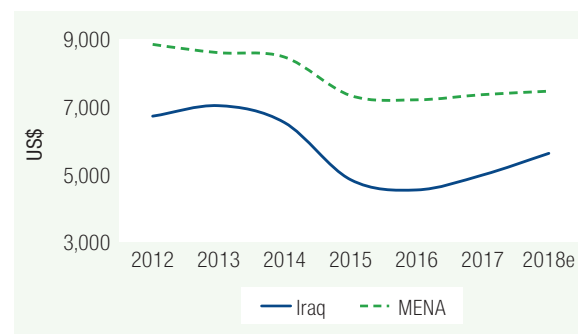
Sources: IMF; and World Bank estimates.

investment. Non-oil growth is estimated to show a strong rebound at 5.2 percent this year, underpinned by broad-based growth in agriculture, industries, and services (Figure 2). The economic rebound in 2018 is also estimated to improve GDP per capita from US\$4,952 in 2017 to an estimated US\$5,597 in 2018, albeit still a lower level compared to 2013 (Figure 3).

Following the ISIS defeat, the GoI is putting in place a comprehensive reconstruction package.

The recent Damage and Needs Assessment (DNA) conducted by the Iraqi Ministry of Planning jointly with the World Bank estimated the overall damage at US\$45.7 billion, and more than US\$88 billion in short and medium-term reconstruction needs, spanning various sectors and different areas of the country. US\$30 billion worth of commitments were made mostly in the form of loans and guarantees at the International Conference for the Reconstruction of Iraq, which took place in February 2018 in Kuwait. At the same time, the government endorsed the Reconstruction and Development Framework (RDF) to reconstructing the liberated areas, forging a renewed social contract based on citizen-state trust and sustainable developments and reforms. At the Kuwait conference, the World Bank pledged a total of US\$6 billion to support the GoI's reconstruction and development agenda making it the biggest development financing partner of Iraq. Furthermore, in April 2018, Iraq's Council of Ministers approved the 5 years National Development Plan (2018–2022) which focuses on key issues including provincial construction, poverty reduction, and social and private

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



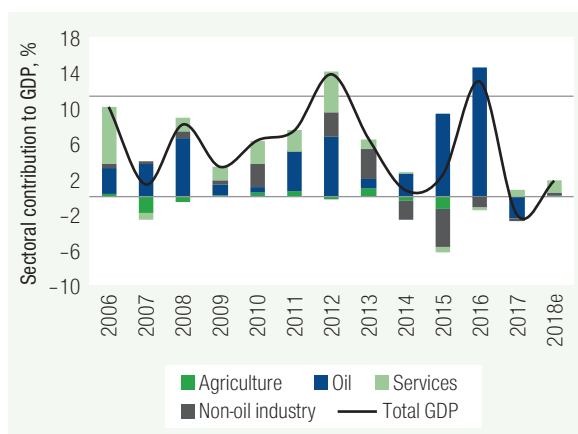
Sources: IMF; and World Bank WDI.

sector development. However, reconstruction effort has been slow due to political uncertainty following elections but more needs to be done urgently to restore basic services and rebuild critical infrastructure.

A more favorable security environment will improve the performance of non-oil industry and services in 2018. The impact of the conflict and contained government spending has had a profound impact on the already weak and under-developed non-oil economy. Non-oil industry was the hardest-hit sector; it contracted by an average of 22 percent in the period 2014–2017 and contributed –2.0 percentage points to overall growth. However, a more favorable security environment and the initial reconstruction effort are estimated to increase the growth rate of non-oil industry to over 6 percent in 2018, and its contribution to GDP growth to 0.3 percentage points. Also, easing of disruptions to supply chains and trade routes by a more stable security situation is estimated to enhance the growth in the services sector in 2018 by almost 5 percent, with its contribution to overall growth being 1.4 percentage points (Figure 4). Non-oil growth in 2018 is estimated to exceed that in MENA oil exporters group for the first time since 2014 (Figure 5).

On the demand side, private consumption and investment are expected to pick up. With millions of Iraqis displaced because of the fighting, revenue streams for many households have disappeared. However, a more stable security situation and higher oil prices allowed for private consumption and investment to pick up, increasing imports' needs

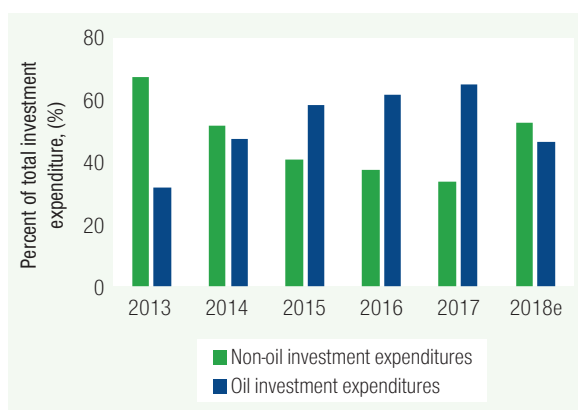
FIGURE 4 • A More Stable Security Environment Is Expected to Increase the Share of Non-Oil Industry to Growth, Especially Services in 2018



Sources: Iraqi authorities; WB; and IMF staff estimates

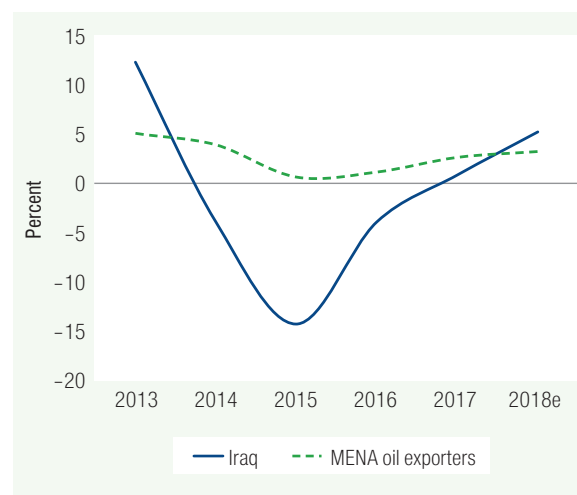
for consumer and capital goods. The GoI is also taking steps to prioritize investment in areas liberated from ISIS and to repair the damaged infrastructure network. Thus, expenditure on non-oil investment is estimated to increase to 53 percent of total investment in 2018, up from an average of 38 percent of total investment expenditure in the 2015–17 period, while oil investment expenditure is estimated to decline to 47 percent, from 62 percent of total investment expenditure in the same period (Figure 6). Due to insecurity and poor business environment, FDI declined from US\$4.1 billion (2

FIGURE 6 • Non-Oil Investment Is Estimated to Increase in 2018



Sources: IMF; and World Bank estimates.

FIGURE 5 • Non-Oil GDP Growth Has Exceeded that in MENA Oil Exporters since 2017



Sources: Iraqi authorities; world Bank; and IMF REO, 2018.

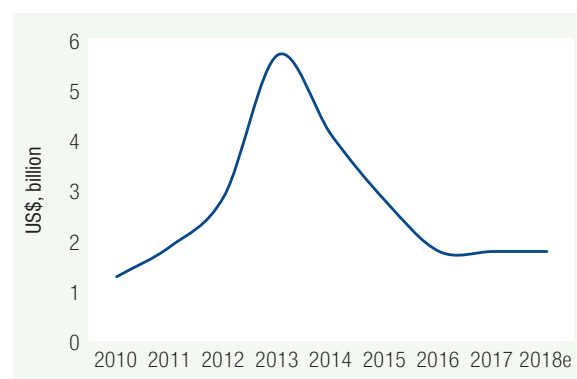
percent of GDP) in 2014 to US\$1.8 billion (0.8 percent of GDP) in 2018, but foreign investment will become increasingly important in the coming years, as the country attempts to move away from its reliance on oil and finances reconstruction needs (Figure 7).

Oil Sector

Iraq remains highly dependent on the oil sector.

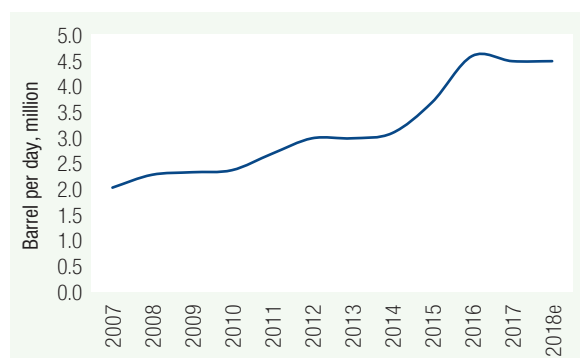
It accounts for over 65 percent of GDP, 92 percent of central government revenue, and almost 100 percent

FIGURE 7 • Foreign Direct Investment Declined since 2014 due to Insecurity and Poor Business Environment



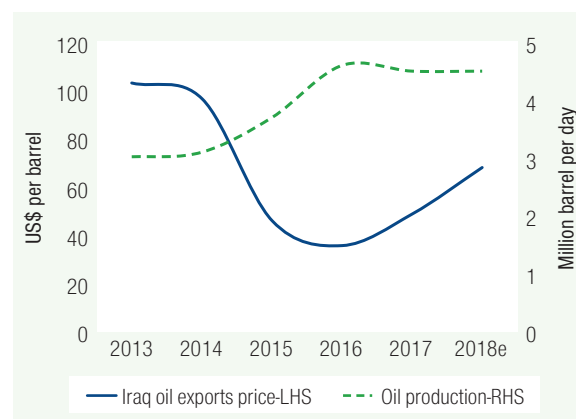
Sources: Iraqi authorities; and IMF staff estimate.

FIGURE 8 • Oil Production Remains the Primary Driver of Growth Despite Declining by 3.5 Percent in 2017 and Expected to Remain Flat in 2018



Sources: CSO; and IMF.

FIGURE 9 • Oil Prices Are Estimated to Further Increase in 2018



Source: Iraq Ministry of Oil.

of the country's exports. Despite the volatile security situation, oil production has tripled since 2003. With 153 billion barrels Iraq has the fifth largest proven crude oil reserves in the world and the rapid increase in production in 2015 and 2016 makes it the world's third largest and OPEC's second largest oil exporter. With 130.5 trillion cubic feet of proven reserves, Iraq's largely untapped natural gas reserves are the twelfth largest in the world. Iraq is also the fourth largest gas flaring country in the world, with more than 50 percent of gas produced flared in-field. The amount of gas currently flared represents an annual economic loss approximately equivalent to US\$2.5 billion and would be sufficient to meet most of Iraq's unmet needs for gas-based power generation. In 2013, the Council of Ministers committed to eliminate routine natural gas flaring by 2030 and in November 2016, Iraq endorsed the World Bank's "Zero Routine Flaring by 2030" initiative. However, limited progress has been achieved to date in terms of flaring reduction as volumes of associated gas have continued to rise since 2014 in tandem with increasing oil production.³

Oil production remains strong despite its decline since 2017 to implement the OPEC+ agreement.⁴ Oil production declined by 3.5 percent in 2017 and estimated to remain flat at 4.5 million barrels per day (mbpd) in 2018 in compliance with its output target under a global pact to cut supplies as well as the stoppage of oil exports through the pipeline

in Iraqi Kurdistan. (Figure 8). Gross oil production from KRG amounts to 300,000 bpd, of which 40,000 destined to local refineries. Major obstacles to further expansion of oil production plans include insufficient water supply and gas injection, and cumbersome bureaucratic procedures.

The recent global increase in the oil price is expected to have a positive impact on government revenues. Higher oil revenues have been driven by the increase in oil prices since mid-2017. Iraq's average crude oil export price decreased from US\$96.5 per barrel in 2014 to US\$35.6 in 2016, before increasing to an average of US\$48.7 in 2017 (Figure 9). As a result, the government hydrocarbon revenue decreased to US\$40 billion in 2016, a 53 percent reduction compared to 2014 and increased to over US\$56 billion in 2017. In 2018, oil revenues are estimated to increase to about US\$82 billion, due to higher oil prices,⁵ a 45 percent increase compared to 2017 (Figure 10).

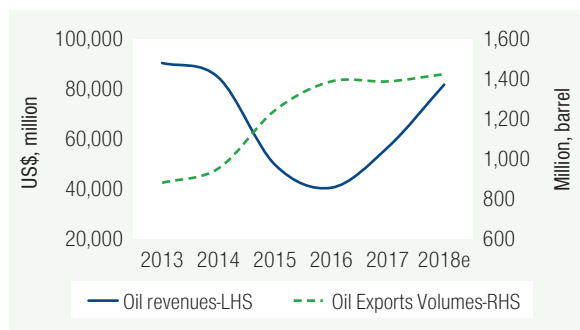
In March 2018, the Iraqi parliament enacted a law establishing the Iraqi National Oil Company (INOC). The INOC is expected to take over the Ministry

³ Iraq vision 2030, hydrocarbon sector policy note, Dec. 2017.

⁴ Iraqi oil production takes place in the heavily protected south and ISIS was unable to decisively damage oil exports.

⁵ Around US\$68 per barrel.

FIGURE 10 • Oil Revenues are Estimated to Increase Around US\$82 Billion in 2018 Sustained by Higher Oil Prices



Source: Iraq Ministry of Oil.

of Oil's responsibilities of managing oil production and exports and contracting with international oil companies. It will also have large discretion over the distribution of its profits—with a maximum of 90 percent to be distributed to the budget—and have a right to operate in any sector of the economy. The new law also exempts INOC from PFM and procurement laws, and the customs code; allows it to contract external and domestic debt outside the budget. The law is currently on hold until a new government is formed. Implementation of the new law could have adverse implications on macroeconomic stability and the governance of the oil sector (see outlook and risks section).

Access to Services

Quality of public services remains deficient especially in conflict-affected areas, but the GoI is implementing multiple projects supported by the World Bank aiming to improve service delivery and address recovery needs.

The delivery of basic social services has been markedly affected by the security situation, but GOI has embarked on a comprehensive reform of social protection programs to improve the living conditions and opportunities of the poor and vulnerable. Despite the large increase in public expenditure, the quality of public services (health, education, electricity, and transport) remains deficient and the recent conflict further undermined

the government capacity to deliver services and cater to the needs of the growing numbers of internally displaced persons (IDPs). Inadequate infrastructure has affected access to quality of public service delivery. Water and electricity shortages, and improper disposal of sewage are bringing constraints on the population's quality of life and private sector development. Meanwhile, the absence of good governance, the spread of administrative and financial corruption, weak accountability and transparency have resulted in low efficiency and effectiveness of the government apparatus and poor quality of public services. Women have been particularly affected by increased insecurity, which imposed restrictions on movement that affected access to education, health, and jobs. Moreover, the cost of the war on terrorism resulted in the crowding out of priorities related to development, reconstruction and social spending. For example, the federal budget law for 2018 included more than US\$18 billion on security and defense—about 21 percent of the total public expenditure—compared with 9.5 percent on education and 4 percent on health.⁶

In the conflict-affected governorates, the already poor-quality services, inadequate infrastructure and low levels of public spending were aggravated by the crisis. The scale and speed of the displacement as a result of the crisis make it a challenge for the government to deliver quality services, especially in the ISIS affected areas where the infrastructure destruction has been most severe and service delivery has been adversely impacted. A huge vulnerable population, including millions of IDPs and refugees, exacerbates pressure on an already weak system, sharpens disparities of access between regions, and is poorly served by the education and health systems and by social safety nets. The latest World Bank report on Iraq DNA in the seven affected governorates estimates that the health and education sector were two of the most affected sectors, which endured substantial damage totaling US\$2.3 billion and US\$2.4 billion, respectively. Such damages have severely affected health care service delivery causing spikes in morbidity and mortality. The recovery needs

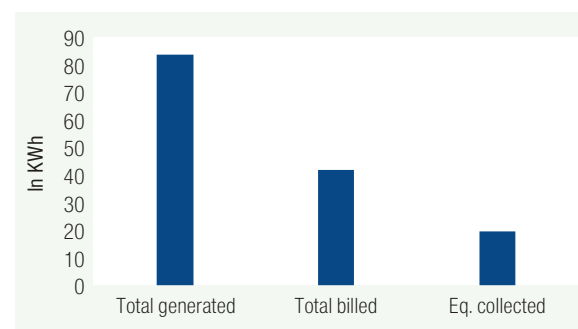
⁶ Iraq, Budget 2018 allocations by sector.

for the health and education sectors were estimated at US\$4.6 billion and US\$4.3 billion, respectively.⁷

The World Bank, as part of the international community, is supporting the GoI in this critical moment to address recovery needs. Supported projects prioritize five key pillars: governance, national reconciliation and peacebuilding, social and human development, infrastructure, and economic development. In July 2015, the World Bank approved a US\$350 million Emergency Operation for Development Project (EODP) to support the reconstruction of damaged infrastructure and restoration of public services in liberated areas. In October 2017, the World Bank approved a US\$400 million additional financing to the original project to expand the reconstruction support in the agriculture and education sectors, with a special attention to the needs of the marginalized youth and women in conflict-affected areas. In February 2018, the World Bank approved Iraq's Social Fund for Development (SFD) project financed with US\$300 million, to improve access to basic services and to increase short-term employment opportunities in targeted communities.⁸ This was followed in April 2018 by the approval of the Emergency Social Stabilization and Resilience Project (ESSRP), financed with US\$200 million to improve the livelihood for more than a million households in liberated areas. In addition, efforts are underway to establish a multi Donor Trust Fund (MDTF) for coordinated dialogue and donor financing of socioeconomic recovery and reconstruction and deepening critical government reforms.

Despite some progress achieved in terms of electricity supply, inadequate electricity services and infrastructure continues to impede private sector development and household and businesses. Although Iraq has made significant progress in improving its power generation, and increasing oil production,⁹ its energy sector continues to face serious issues, including high demand growth of over 10 percent per annum, chronic electricity shortages with grid supply availability of less than 15 hours per day. New generating units (mainly gas turbines) have been installed, but their operation often suffers because of fuel supply problems, especially the lack of infrastructure to provide natural gas. The electricity sector is putting increasing fiscal pressure on

FIGURE 11 • Only about 50% of Energy Billed Is Collected



Source: Iraq Ministry of Electricity.

Iraq's public resources, particularly due to high losses, lower than cost-recovery tariffs, and poor revenue collection. Over 50 percent of electricity is lost before it is billed. Adding to this burden, due to lack of effective metering, billing and commercial management systems (Figure 11), only about 50 percent of the energy billed is collected; leaving the actual electricity paid at less than 30 percent of the total electricity generated. The IMF estimated the deficit of the electricity sector at 5.2 percent of GDP in 2017.¹⁰ Severe power shortages in the conflict-affected governorates, even before the onset of the crisis, imposes huge challenges. According to the DNA report, damages to infrastructure in the most conflict-affected governorates were the highest in the power sector at US\$7 billion, with the recovery needs estimates at US\$9 billion.

Electricity subsidies represent a significant burden on Iraq's budget and consume a major

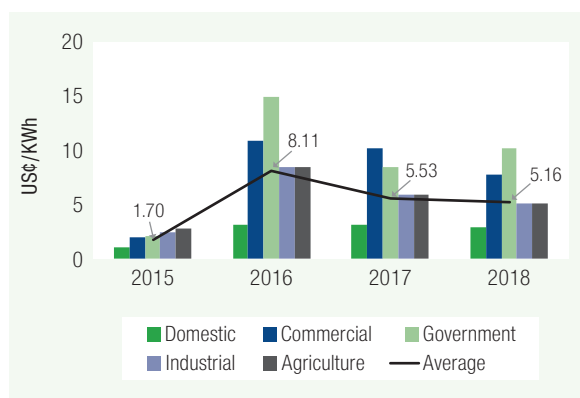
⁷ Iraq Reconstruction and Development, Damage and Need Assessment in affected governorates, The World Bank Group, January 2018.

⁸ The SFD is expected to scale-up across all of Iraq, including KRG, over a period of five years, using a phased approach, with resource allocation based on population and poverty headcount figures in the governorates.

⁹ Electricity production has grown by nearly 10 percent per year over the past 13 years; from a peak demand supply of 5.7 GW in 2003 to about 14.0 GW in 2016 with an estimated investment of about US\$18.0 billion.

¹⁰ See IMF Staff Report, August 2017.

FIGURE 12 • Electricity Tariffs Remain Low and Heavy Burden on the Budget



Source: Ministry of Electricity, 2015 Operating statistics.

portion of the government revenues. The energy sector represents a large fiscal cost for the government both in the electricity tariff and in the fuel used for generators. In 2017, the cost of production of electricity is estimated to amount to US\$11.2 billion, including purchase of electricity from Independent Power Producers (IPPs) and investments. These subsidies include US\$6.7 billion of lost oil exports, corresponding to more than 10 percent of total oil exports from Iraq (excluding KRG) in 2017, and US\$3.2 billion of budget transfers or 5 percent of total government expenditure.

Tariff adjustment has begun but is constrained by weak improvement in the quality of service. Tariff collection covers only about 11 percent of the cost (Figure 11). The authorities recognize the heavy burden of these subsidies on the budget, and plan to reform electricity tariffs, by implementing a progressive tariff increase to improve revenues and reduce subsidy. In January 2016, the Gol has initiated actions to increase tariffs by about fourfold from an average of US\$1.7/KWh to US\$8.0/KWh, but protests from segments of society led the cabinet to lower the tariffs effective January 2017 by an average of 25 percent to about (US\$6.0/KWh) (Figure 12). However, and compared to prior 2015 when tariffs had been frozen for a long time, the overall 2018 tariffs have increased by about threefold. To reach a cost reflective level, the tariffs would need to increase to about US\$13/KWh (MoE 2017 estimate). The World's Bank Doing Business 2018 report ranks Iraq poorly in terms of

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

The Government of Iraq is committed to reform the electricity sector, supported by the World Bank. In 2013, the Cabinet adopted the Iraq Integrated National Energy Strategy (INES) for the period 2013–2030 and a new Electricity Law was issued in March 2017. Both the Strategy and the Law provide the pillars for the sector's reforms and governance; specifically, highlighting the Government's commitment to: (i) private sector participation in the generation and distribution functions, and (ii) decentralized management for the provision of electricity services. To increase electricity supply, the Government is engaging private sector to lead investments in new generation¹¹ and retrofitting the existing inefficient power plants. The World Bank has had a long engagement in Iraq's energy sector. The DPF series has supported the Gol to have in place appropriate policies related to improve energy efficiency by reducing gas flaring and increasing gas to power generation; and reducing energy subsidies. A new world Bank project of US\$250 million is under preparation that aims to improve the reliability, efficiency and accountability of electricity supply in the governorates of Basra, Al-Muthana, Dhi Qar, and Missan by improving transmission and distribution infrastructure, and reducing technical loss of electricity within the transmission and distribution system. The project is also expected to increase the electricity supply reliability in the project areas by reducing the electricity supply interruptions and network technical losses by about 50 percent and 16 percent, respectively, and therefore to increase electricity revenues sales by about 30 percent, with increased billing from 40 percent to over 70 percent.¹²

¹¹ To date, a total IPP capacity of 6000MW has been signed/ongoing advanced negotiations including Mass Global Energy (Bismaya IPP) transaction of 3000MW.

¹² Electricity services reconstruction and enhancement project, World Bank, September 2018.

Poverty, Equity and Vulnerabilities

Poverty remains prevalent at 22.5 percent in Iraq and almost double for IDPs, exacerbated by the conflict, the decline of oil prices and large wave of displacement in recent years. The GoI is introducing comprehensive measures to introduce a new social protection roadmap, a new poverty reduction strategy, focusing on the needs of the returnees and IDPs in the liberated areas, and aiming at improving the targeting for the existing programs, especially the Public Distribution System (PDS). The country has also embarked on a national roll-out of a conditional cash transfer (CCT) program to preserve and enhance human capital.

Poverty has risen sharply. The national poverty rate increased from 18.9 percent in 2012 to an estimated 22.5 percent in 2014. Recent labor market statistics suggest further deterioration of welfare. The unemployment rate, which was falling before the crises, has climbed back to the 2012 level. Almost a quarter of the working-age population is underutilized, i.e., they are either unemployed or underemployed. Many households are prone to adverse shocks; more than a third of the households have experienced an adverse event since the beginning of the crises and one in six households has experienced some form of food insecurity. The universal food ration (Public Distribution System, PDS) remains the most extensive social assistance program, but people have also turned to friends and relatives and humanitarian agencies for assistance. Poverty rate increased in the Kurdistan region from 3.5 percent to 12.5 percent because of the large wave of displacement. In governorates under ISIS occupation, poverty rate doubled to 41.2 percent. Even though the impact was limited in the rest of Iraq, poverty increased in all governorates, especially in the South where the rate remains stubbornly high, at more than 30 percent, due to the economic crisis.

Internally displaced persons (IDPs) have been buffeted by multiple adverse shocks. Fewer IDP adults have a job, so each employed adult in an IDP household supports more than six other household members. Some IDPs have lost access to the PDS. The cumulative impact of these developments on

IDPs is visible in several dimensions, including a higher risk of hunger. Krishan and Olivieri (2016) estimate that the twin crises reduced the per capita consumption of IDPs by almost 22 percent (double the average reduction in per capita consumption for the rest of the population) largely due to an estimated 27 percent increase in the unemployment rate among IDPs (almost three times higher than the average increase for the population as a whole). They estimate that the IDP headcount poverty rate increased from 23 to 38 percent (double the increase in poverty for the population as whole), i.e. 4 out of 10 IDPs became poor as a result of the twin crises.

The GoI launched a second Poverty Reduction Strategy (PRS2) 2018–2022 in February 2018 aiming to increase the coverage ratio and improve efficiency. The new strategy,¹³ aims to reduce Iraq's poverty by at least 25 percent by 2022. This strategy aligns with the Iraq's on-going strategies and plans, including Iraq's Vision 2030, Social Protection Strategic Roadmap, and the National Development Plan 2018–22. Particularly, the new poverty strategy and the Iraqi Vision 2030 share the common pillars of: creating opportunities for generating sustainable income; empowerment and building human capital; and establishment of an effective social safety net. The new PRS also focuses on the needs of the returnees and IDPs in the recently liberated areas, promotes income generation from projects in agriculture and women participation in economic activity, particularly in rural areas.

Iraq has longstanding inefficiencies in its social protection system. The non-age-related social protection system is dominated by the Public Distribution System (PDS), in which the government purchases imported food, along with some domestic procurement, that is then distributed to all families, irrespective of income. The PDS suffers from severe inefficiencies but remains the primary safety net for the poor. This program is large—the 2018 budget allocated ID 1.5 trillion, or 2 percent of the current

¹³ The first PRS-1 finalized in 2009 and adopted by the Parliament in 2010, has reached the end of its initially-envisaged implementation period in early 2016.

budget expenditure—but remains untargeted, covering also 98.6 percent of the non-poor with significant inefficiencies in procurement, distribution, and management. Other safety net programs are not poverty targeted and cover a small share of the poor.

The government is introducing reforms to improve targeting and to create a unified registry of social protection beneficiaries (see Special Focus). Together with the support of the World Bank, Iraq embarked on its social reforms with the adoption of a new Social Protection Law (SP) in April 2014. The law targets various assistance programs more efficiently by replacing broad categories of recipients with a proxy means testing methodology meant to increase coverage and reduce errors of inclusion and exclusion. Under the Social Protection Law, the government's current efforts are focusing on moving from categorical targeting to a new targeting methodology based on proxy means testing. In addition, the establishment of a unified registry of beneficiaries, would enhance the capacity to help IDPs and people with disabilities, and to better identify the poor, as beneficiaries for SP programs. In November 2014, the government adopted its Social Protection Strategic Roadmap 2015–2019 with the vision of having “a comprehensive social protection system for Iraq covering social safety nets, social insurance, and labor market policies”. The number of beneficiary households increased from 850,000 (2016) to 1,100,000 (2017). Of those, 55 percent are female-headed households. The monthly cash assistance for in need households increased from US\$70 to US\$150 on average¹⁴. The World Bank team is now supporting implementation of the roadmap through a technical assistance financed from UK DfID¹⁵ and Japan to support GoI in laying the foundation for the integration of social protection systems and enhancing their efficiency.¹⁶

The GoI is also reforming its social insurance law. The draft of a new pensions and social insurance law has been completed, approved by Council of Ministers (CoM) in 2017, and is currently in the Council of Representatives (CoR) for discussion. The main characteristic of this new law is the integration of the public and private sectors pension schemes. The draft law will address fiscal drains on the treasury caused by

multiple pension rights provided by other laws, which allows individuals to have more than one pension salary. The draft law also introduces mechanisms for voluntary pensions, and along with other measures, are designed to increase pension coverage in the long-term.

Iraq has embarked on a national roll-out of a conditional cash transfer (CCT) program, starting with a pilot at Sadr City 2 area of Baghdad. The overall objective of the program is to preserve and enhance human capital by incentivizing a greater use of education and health services.¹⁷ In July 2017, 50 social workers have visited 6,700 households—who meet at least two of the CCT criteria- to explain the program to beneficiaries and ensure that all required information is collected at the start of the pilot. The pilot is being supported by both the World Bank and UNICEF. Households are expected to meet co-responsibilities of investing in health (maternal and child vaccinations) and education (attendance and staying in school for grades 5–7). The national roll-out, based on pilot program evaluations, will be financed under the World Bank-financed Emergency Social Stabilization and Resilience Project.

The CCT program is also introducing a case management approach to improve the program's efficiency. This will include the following activities: (i) develop social workers competency framework, including their skills and behavioral attributes needed to work with beneficiaries;¹⁸ (ii) conditions assessment, including casework data collection instrument, methodology to define needs and conditions, and intervention application guide; (iii) family development plan to include guidelines for the intervention plan with

¹⁴ Iraq Emergency Social Fund for Development, World Bank, October 2017.

¹⁵ UK Department of International Development.

¹⁶ The World Bank is also providing another TA to Central Statistics Office (CSO) and KRG Statistics Office (KRSO) to implement rapid welfare monitoring survey (SWIFT) to monitor living standards of Iraqi population.

¹⁷ MOLSA has developed the CCT Pilot, including the design, the formation of an operational committee, and a detailed operational manual.

¹⁸ Including conducting home visits, and guidelines which will serve as reference for social workers.

the beneficiary households, template for the family development plan, and how to track it; (iv) referral services manual; (v) guidelines and procedures for implementation support; and (vi) user manual for the Case Management System.

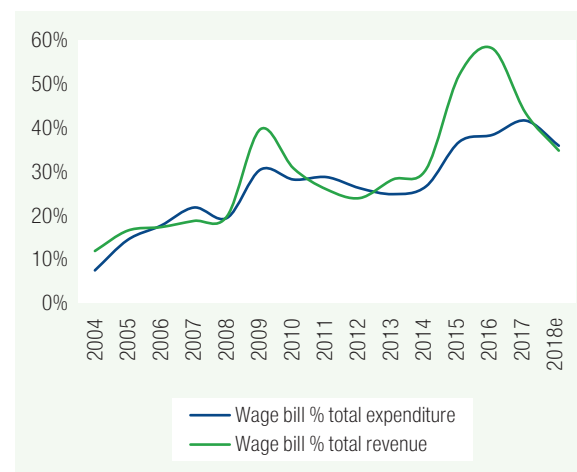
Labor Markets and Employment

Iraq faces a serious shortage of employment opportunities—particularly for young people—and a low labor force participation rate of women. The large public sector is dominant in the economy leading to subdued private sector job growth. The unemployment rate has significantly increased, especially for women and youth and in the conflict-affected areas. The wage bill, at 15 percent of GDP, is among the highest in the region and exceeds most other comparators. Supported by the World Bank and IMF, the Gol has demonstrated a commitment to structural reforms, to control wage bill and mitigate endemic payroll fraud through several key measures. The WB is also assisting the country to strengthen systems and deliver programs to empower women economically and politically, and to influence female labor force participation.

The large public sector dominates the economy. Close to 3 million people are employed in the public sector, representing approximately 42 percent of all jobs. While the oil economy represents well over half of GDP, it produces only about 1 percent of total employment and has few links to non-oil activities. Rather, oil revenues have enabled the rapid expansion of the public sector. Although more than 750,000 new jobs were created between 2007 and 2012, these were not enough to absorb all new participants in the labor market, and four-fifths of these new jobs were generated by the public sector. Despite reform initiatives, the economy remains largely dependent on oil revenues, which—without significant private sector development—continue to fund a bloated public-sector workforce.

Public spending is high by international standards, driven by a large public wage bill. The public-sector payroll lacks centralized control and, therefore, has been growing rapidly. Relatively high public-sector wages and job security make other alternatives appear undesirable, curtailing

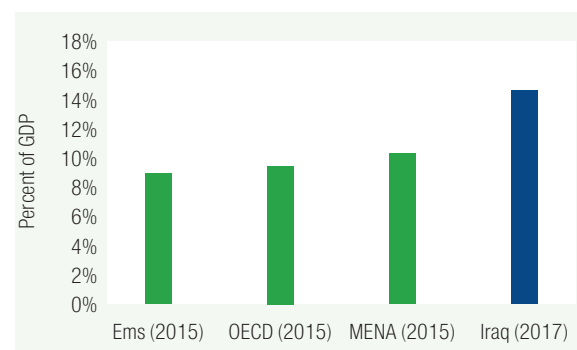
FIGURE 13 • The Wage Bill Is the Largest and Fastest Growing Expense in the Government Budget



Sources: Iraqi authorities; WB; and IMF.

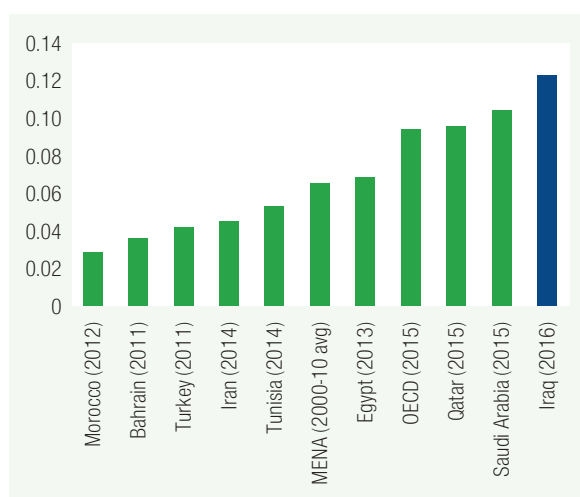
private sector job growth. During 2003–2016 wage expenditures quadrupled in real terms, driven primarily by unchecked hiring of employees, raises in employee compensation, and payroll fraud. The ratio of wages to total government spending and revenues rose even faster during the same period, partly because of the constrained fiscal space following the 2014 twin shocks of oil prices and ISIS conflict (Figure 13). In 2017, at 15 percent of GDP, 42 percent of the budget, and 43 percent of total revenues, Iraq's wage bill dominates comparators (Figure 14) and is the Gol's single largest and fastest growing budget item.

FIGURE 14 • Iraq Is an Outlier in Terms of the Wage Bill



Source: Jobs in Iraq: a primer on job creation in the short run, WB, June 2018.

FIGURE 15 • Large Ratio of Public Sector to Population



Source: Jobs in Iraq: a primer on job creation in the short run, WB, June 2018.

In response to the recent plunge in oil prices, Iraqi governments have made large expenditure cuts. However, these cuts have focused on investment, goods, and have left personnel and social expenditures structurally unchanged. Between 2003 and 2015 the number of central government employees alone more than tripled (from 0.9 to over 3 million) and more than doubled as a share of the labor force (from 15 to 35 percent). By conservative estimates, in 2016 the public sector (including the subnational government and SOEs) employed at least 4.3 million people, or almost two thirds of all working Iraqis. In practical terms, this means that there is currently one public employee for every 8.1 Iraqi citizens. This ratio is very high ratio relative to comparators (Figure 15), including MENA and GCC countries whose public sectors typically deliver a wider array of services to larger and more heterogeneous populations.

Supported by the World Bank and the IMF, the GoI has demonstrated a commitment to control the wage bill and mitigate endemic payroll fraud. GoI's measures include the formulation and implementation of strategies to (i) enable monthly collection of reporting of detailed payroll data from all public sector spending units into a Central Payroll Database starting in October 2017¹⁹ and (ii) transition

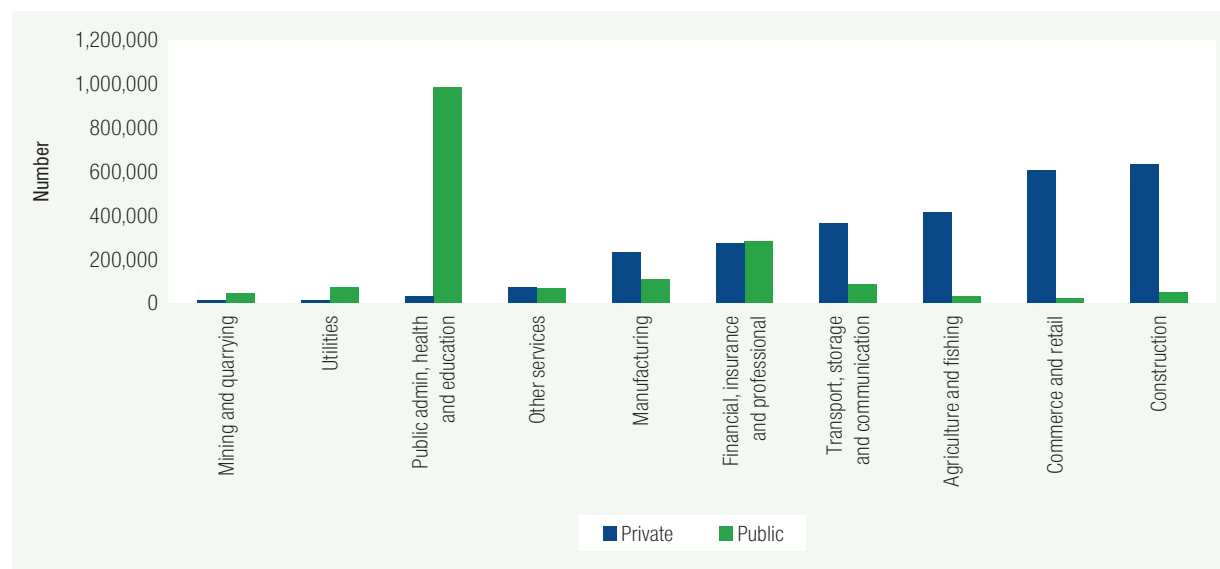
the payment of government salaries from cash to electronic means and to track employee attendance using biometric technologies.²⁰ Together, these reforms support the Government's efforts to control wage expenditure and corruption by building sounder and more transparent payroll and payment systems, that reduce opportunities for payroll fraud. Under the IMF SBA, GoI has also committed to reduce the number of employees through natural attrition. Failure to implement such measures to contain the wage bill could limit the country fiscal space for reconstruction.

The crowding out of the private sector is pervasive. Limited growth in the private sector is a direct hurdle to large-scale employment creation, especially for young Iraqis. The private sector remains relatively small, does not contribute significantly to income generation and fails to absorb and contain unemployment. The security and oil shocks impacted private sector consumption and investments, and limited government spending, particularly on investment projects. The private sector also suffers from dysfunctional infrastructure and energy supply, absence of constructive public-private sector dialogue, widespread corruption, and low available credit. Employment in small and medium enterprises (SMEs) is concentrated in construction, commerce (retail and wholesale trade), transport and communications. Construction is the single largest employment sector in the private sector and one of the largest sectors for jobs in the entire economy (Figure 16). Due to reconstruction activities, the sector has also large potential to grow. Tourism, whose main driver is religious tourism, generated US\$4 billion in export earnings in 2015 and is the largest non-oil export. Transportation, freight, and logistics remain dominated by the state, but growth of SMEs is increasing. Agriculture more broadly provides about 20 percent of employment and contributes 4 percent of GDP and represents a large employer for women. However, in February 2015, Iraqi government launched a Private Sector Development Strategy 2014–2030 in an attempt to stimulate growth and

¹⁹ Council of Ministers' Decision 281 of 2017.

²⁰ Council of Ministers' Decision 313 of 2016.

FIGURE 16 • The Public Sector Dominates in Iraq



Source: Iraq Household Socio-Economic Survey 2012.

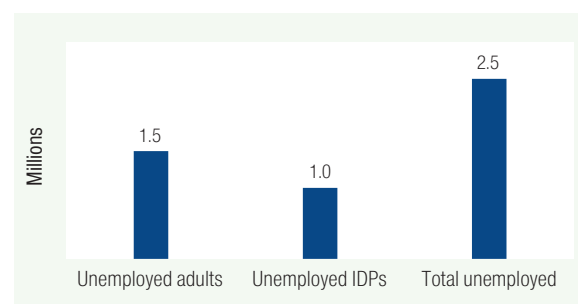
create jobs through diversifying the private sector and promoting investment. The National Development Plan 2018–2022 envisions a rise of the share of private capital by 2022 but recognizes that public investment is likely to still play a large role, and a role that is not limited to the oil sector.

Experience from various conflict and post-conflict settings shows that self-employment, entrepreneurship development, and support for microenterprises can play an important role in generating economic opportunities.

Financial inclusion and microeconomic development opportunities, particularly for vulnerable segments including farmers, have proven especially effective in other post conflict environments. The World Bank's Emergency Social Stabilization and Resilience Project contributes to increasing livelihood opportunities in liberated areas through the provision of microfinance to beneficiaries to carry out income generating opportunities.

The unemployment rate has significantly increased, especially for women and youth and in the areas affected by conflict. Iraq has one of the lowest employment-to-total population ratios in the region, even among men, and the 2014 crisis has led to an estimated reduction in employment by 800,000

FIGURE 17 • Unemployment Has Significantly Increased

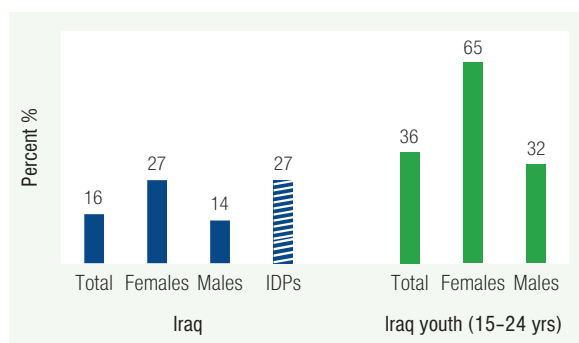


Source: Jobs in Iraq: a primer on job creation in the short run, WB, June 2018.

jobs. At least 2.5 million unemployed Iraqis urgently need jobs (Figure 17). Most of the unemployed are young. Compared to the national unemployment rate of 16 percent, youth unemployment is about 36 percent (2016).²¹ Three groups—youth, women, and IDPs—are affected disproportionately by the paucity of jobs. Iraq has one of the youngest populations in the world. Nearly 50 percent of Iraqis are younger

²¹ Jobs in Iraq: a primer on job creation in the short-run, World Bank, June 2018.

FIGURE 18 • Unemployment Among women is Very High, Especially for Youth



Source: Jobs in Iraq: a primer on job creation in the short run, WB, June 2018.

than 19 years, and 60 percent are below 25 years of age. Low levels of human capital constrain young Iraqis from engaging in productive activities. Of the seven million Iraqi youth, over 3.4 million are out of school. The outsized public sector, the poorly targeted social transfers, and the declining quality of health and education services negatively impact labor participation and constrain young Iraqis from engaging in productive activities (Box 1). Labor force participation rate for women is 19 percent, compared to 74 percent among men—below the median among Arab countries. In particular, fewer than one in ten adult women with intermediate or lower levels of education participates in the labor market. Women who do participate in the labor market are also more likely to be unemployed. In 2016, about 27 percent of women of all ages were unemployed, compared to 14 percent of men; among youth, 65 percent of young women were unemployed compared to 32 percent of young men (Figure 18).

Women's empowerment faces legal, structural, and social barriers, limiting women's choices and agency and negatively impacting their ability to participate in and benefit from political and economic development.²² Current laws impose barriers and constraints on women's ability to work, such as restrictions on women's employment (night work or jobs considered harmful to the health of women), limiting their agency. In addition, while the law requires employers to provide childcare services when they employ women, no decrees

or instructions have been issued.²³ Although there have been some positive legal reforms over the last few years, women remain vulnerable and lack legal support and protection due to the weak enforcement mechanisms. A new World Bank project in Iraq and KRG titled "*Gender and Social Protection in Iraq: Towards Economic Empowerment*", will provide technical assistance to strengthen systems and deliver programs to empower women economically and politically. The project is consistent with the Iraq Social Protection Strategic Framework and PRS2, which highlights gender as a cross-cutting theme across its six pillars.

Social norms can also sometimes push back and resist new changes supported by laws.

Women, especially between the age of 18 to 50, lack legal protection from violence in general even when seeking protection of law enforcement. This can be attributed to both lack of legal protection as well as social norms. Social norms related barriers could be reduced by strengthening gender sensitization training for government officials, by building the capacity of civil society to advocate, monitor and evaluate women's empowerment initiatives, and by promoting positive norms. Strengthening of existing leadership programs and improving SMEs programs available for women would address the constraints at the individual level. The above-mentioned project is supporting Iraq to influence female labor force participation, in two activities: (i) A qualitative and quantitative study to capture the prevalent beliefs and social norms prohibiting women from joining the labor market and (ii) Design, implement, and evaluate interventions to shift the beliefs at the individual, household, and society level.

²² Agency is "the ability to make decisions about one's own life and act on them to achieve a desired outcome, free of violence, retribution, or fear. The ability to make those choices is often called empowerment."

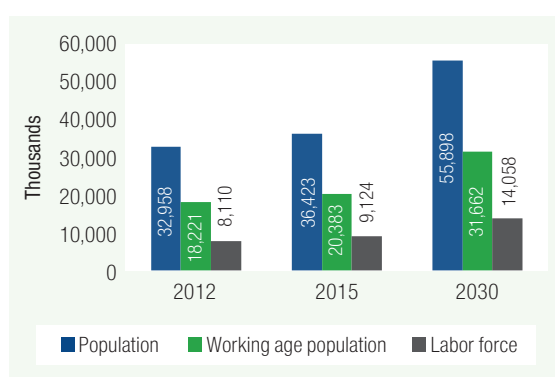
²³ Other legal constraints are the lack of prohibition of gender-based discriminatory practices by employers and lack of equal pay and lack of enforcement mechanisms have slowed down the realization of the recent legal reforms.

BOX 1 • Job Creation in the Short-Run in Iraq^a

Iraq is facing a job crisis of unprecedented proportions. It could foment a resurgence in violence unless the government makes credible and swift progress in job creation and reconstruction. In the short-term, neither private or public sector hiring can create jobs at the desired scale without significant new policy action. The first-best solution for a large scale private sector job creation hinges on structural reforms that must begin now but are achievable only in the medium to longer term. However, the options to deliver large-scale job creation in the short-term, based on investments in construction, agriculture and agribusinesses, small and medium enterprises, and vocational skills. Financing needs for jobs are large, and while business climate reforms are under way, private investment in jobs will be limited. Yet, the recent oil price hike offers the government of a uniquely timely opportunity to make an investment in jobs that makes a real difference. By 2030, Iraq's adult population will increase from 20 to 32 million (figure B1) and the number of Iraqis in need of new jobs is projected to range between five and seven million. Youth, women and IDPs urgently need more access to jobs. Without special attention to their demand for jobs, peace and reconstruction are at risk. Nearly 50 percent of Iraqis are younger than 19 years, and 60 percent are below 25 years of age. The youth population is projected to increase from seven to ten million between 2015 and 2030 (figure B2). Low levels of human capital constrain young Iraqis from engaging in productive activities.

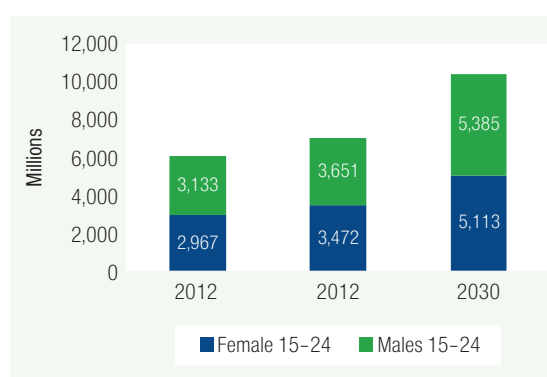
The challenge is further compounded by the fact that Iraq has experienced earlier waves of internal displacement in the course of the conflict of the past decades. About 27 percent of the IDPs are unemployed. The most vulnerable IDPs are women and children—49 percent are less than 18 years old. Options for the short-term job creation would include: (a) construction and public works. Reconstruction and repairs can commence immediately and are potentially job-intensive. In addition, there is a private sector and SME presence in the construction and construction materials sectors, so that there is a direct opportunity for the GOI to use its investments to help build private sector capacity, (b) agriculture and agribusiness to improve food security and generate jobs, particularly for women and returning IDPs. A revived primary agriculture sector will boost job creation through SMEs as farm-to-farm related services and processing scale up the agribusiness sector, (c) support to SMEs and vocational skills development for jobs in services and across other sectors. With the scaling-up of infrastructure and agriculture, SMEs will be able to seize some opportunities and create new jobs through backward and forward linkages. At the same time, it will be difficult for the large number of unskilled job seekers to benefit from new opportunities. Policies that foster vocational skills are a promising way of promoting access to jobs across all productive sectors. However, meaningful reform requires a stable social and political environment and significant political will. The crucial next step is for GOI to define the level of ambition it wishes to pursue, and to shape the pillars of its own jobs strategy.

FIGURE B1 • Labor Structure



Source: World Bank staff estimates.

FIGURE B2 • Youth Population



Source: World Bank staff estimates.

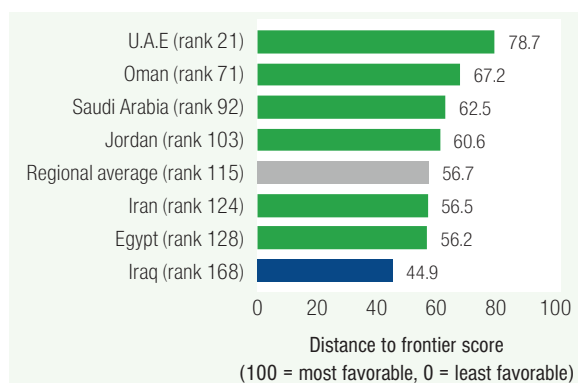
^a Jobs in Iraq: a primer on job creation in the short-run, World Bank, June 2018.

The employment challenge is further compounded by large unemployment among the IDPs and in KRG. About 27 percent of the IDPs are unemployed. The most vulnerable IDPs are women and children, 49 percent are less than 18 years old. Compounding the problem has been a decline in employee training and skills development. The unemployment rate in KRG also increased from 6.5 percent prior to the ISIS conflict to 14 percent in 2016, due to the influx of IDPs and refugees. The

female labor force participation rate in KRG is also one of the lowest in the world, at 14 percent, and the unemployment rate has significantly increased, especially for young women, reaching 69 percent for women aged 15 to 24.²⁴ Of the unemployed women, more than one-third are women with post-secondary school degrees, compared to one-quarter

²⁴ Compared to 24 percent for men in the same age bracket

FIGURE 19 • An Unfavorable Business Environment Remains a Significant Deterrent to Foreign Investment, but Reforms on the Way



Source: World Bank, Doing Business 2018.

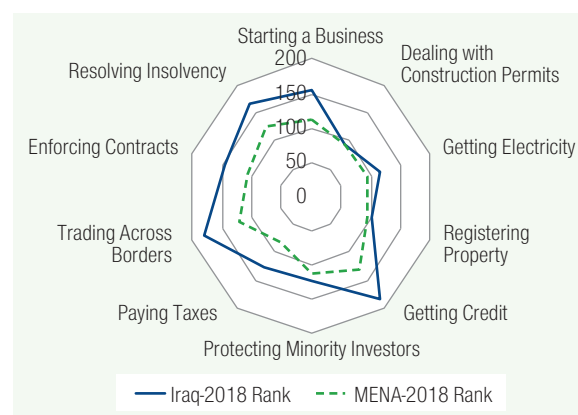
of unemployed men. Almost 80 percent of employed women are employed in the public sector. The KRG three-year reform plan was launched in May 2016 in partnership with the World Bank and via this plan, the KRG intends to create more job opportunities and establish a fund for paying pensions and social security for the private sector labor force.²⁵

Business Environment and Private Sector Development

Absence of good governance, the spread of administrative and financial corruption, and power shortages, among other factors, have resulted in a poor business environment. Implementation of recent reforms and a more stable security environment will help improve business environment in Iraq.

Security concerns, outdated legislation, widespread corruption, and crumbling infrastructure hampers foreign investment. Difficulties with corruption, customs regulations, cumbersome visa procedures, unreliable dispute resolution mechanisms, electricity shortages, and lack access to finance are common complaints from businesses. In Doing Business 2018, Iraq ranks 168 out of 190 economies; significantly behind peer countries in MENA region (Figure 19). It finds that during 2016 and 2017, Iraq has implemented

FIGURE 20 • Ease of Doing Business Slightly Improved, but Remains Below the Average of MENA



Source: World Bank, Doing Business 2018.

substantive changes in the local regulatory framework in two main areas: starting a business and getting credit. In fact, starting a business in Iraq has become easier by combining multiple registration procedures and reducing the time to register a company. Entrepreneurs are no longer required to register separately with the tax authority. The time required to register a company has declined thanks to increased resources at the registry, and an improved online registration system. As a result, Iraq's rank in the ease of doing business improved by 11, from 165 to 154, but still below the average of the MENA region (113) (Figure 20). Iraq has also improved access to credit information by launching a new credit registry managed by the Central Bank of Iraq.²⁶ Iraq performed poorly on several of the other areas that Doing Business measures, including, trading across borders (179), resolving insolvency (168), enforcing contracts (144), and getting electricity (133).

Rampant corruption is undermining efforts to strengthen institutions and their effectiveness. The country is persistently ranked around or below the tenth percentile globally

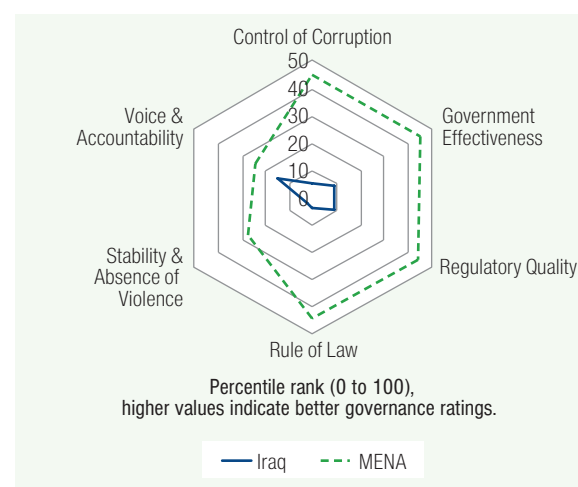
²⁵ Ibid.

²⁶ As of January 1, 2017, the registry listed 234,967 consumers and 4,877 commercial borrowers with information on their borrowing history within the past five years.

based on indicators of government effectiveness, rule of law, and control of corruption (Figure 21). Iraq's performance was particularly poor in the indicators for stability and absence of violence, rule of law, and control of corruption. It is also ranked 169 out of 180 countries in the latest Transparency International Corruption Perception Index in 2017, with only Syria, Yemen, and Libya scoring worse within MENA region. Social unrest has continued periodically due to low quality and availability of basic public services and perception of widespread corruption. In 2016, Iraqi parliament questioned and dismissed the Minister of Trade, Defense and Finance on corruption allegations. Recently, in July 2018 and amid widespread protests over a power crisis, Iraq's PM ordered the suspension of the country's electricity minister until an investigation on poor service delivery is concluded. Payroll corruption, including collection of salaries by "ghost employees", chronic absentees and skimming of salaries, is rife, and hiring and disciplinary decisions are affected by nepotism and bribery. Difficulties with corruption and unreliable dispute resolution mechanisms remain common complaints from companies operating in Iraq. Weak public administration, lack of experienced staff, and weak oversight of government spending provide incentives and opportunities for corruption.²⁷

Efforts continue to address these deficiencies. On September 16, the World Bank Group and the European Union signed a US\$18.1million technical assistance program to strengthen Public Financial Management (PFM) oversight and accountability Institutions in Iraq, increase the efficiency in the management of public resources and delivery of services. The initiative, which will be implemented jointly by the European Union and the World Bank, complements the US\$41.5 million "Modernization of Public Financial Management Systems" program launched by the World Bank in 2017, and currently under implementation. Investors in KRG face many of the same challenges as investors elsewhere in Iraq, but a business-friendly investment law and more stable security situation are generally more attractive to foreign businesses.

FIGURE 21 • The Quality of Governance Remains Critical



Source: World Bank Worldwide Governance Indicator.

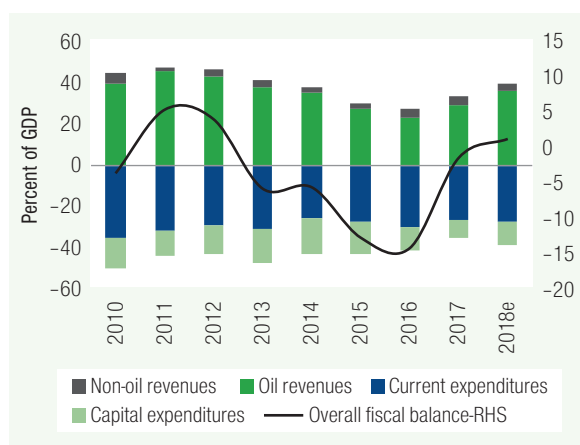
Iraq is keen to reform its business environment. The Government is committed to continuous improvement of the business environment and the investment climate in Iraq, conducive for both domestic and foreign investment that generates positive effects on the domestic economy. The World Bank is supporting the GoI in improving the business environment in areas covered by the DB indicators through implementation of a reform action plan in four priority areas, namely (i) resolving insolvency, (ii) enforcing contracts, (iii) getting credit, and (iv) protecting minority investors; and reforming the business registration at the national level in Baghdad and KRG. The Government is committed to continuous improvement of the business environment and the investment climate in Iraq conducive for both domestic and foreign investment that generates positive effects on the domestic economy.

Public Finance

Iraq's overall fiscal balance is estimated to post a surplus in 2018, as recovering oil prices feed through

²⁷ Transparency International, Coralie Pring, U4 Expert Answer, Anti-Corruption Resource Center 2015.

FIGURE 22 • The Fiscal Position Is Estimated to Improve Due Mostly to Higher Oil Prices

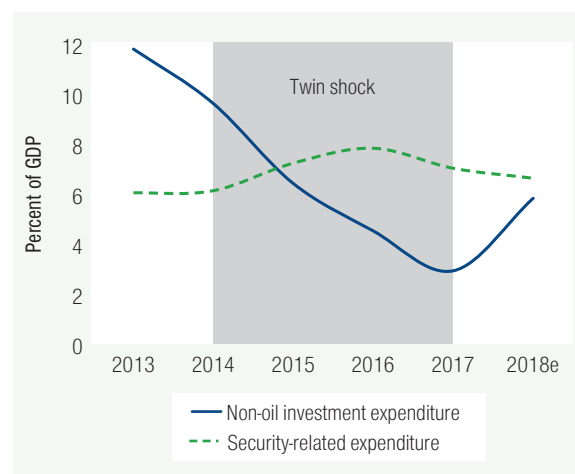


Sources: World Bank; and IMF staff estimates.

to higher revenues. Positive overall fiscal balance and growth are estimated to further reduce the public debt-to-GDP. Higher oil prices will also enable the government to have adequate fiscal space to finance reconstruction, provided that the GoI continues the fiscal consolidation process.

In 2018, the overall fiscal balance is estimated post a surplus of 1.2 percent of GDP due mostly to higher oil prices, estimated to average above US\$67 per barrel (Figure 22). The plunge in world oil prices in 2015–16, increased security and humanitarian outlays, and weak controls led to sharply lower oil revenues and rapidly widened the budget deficit. It narrowed in 2017 due to the pick-up in oil prices and measures adopted to contain current expenditures within the framework of IMF program and World Bank DPF series. Official financing for the budget has been less urgent with the improvement in the fiscal position. A more favorable security situation is estimated to increase the share of non-oil investment to GDP, while the share of the security spending is estimated to decline (Figure 23). Higher oil prices accompanied with careful management of spending pressures over the remainder of the year would create space for capital/reconstruction spending while also using some of the oil windfall to build reserve buffers, provided that the process of fiscal consolidation continues.

FIGURE 23 • The Share of Non-Oil Investment to GDP Is also Expected to Increase



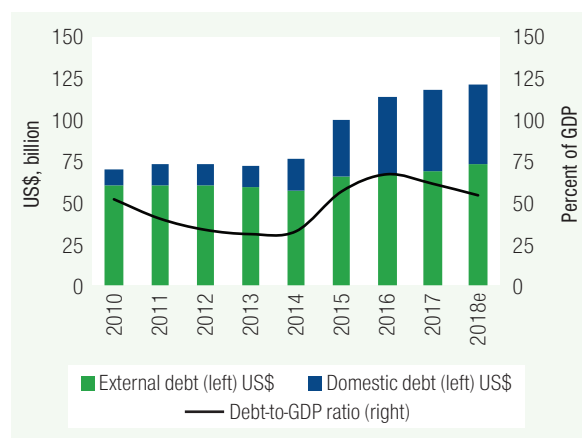
Sources: World Bank; and IMF staff estimates.

KRG's fiscal position is also estimated to relatively improve in 2018. The federal government agreed last March to resume transfers to KRG, sufficiently to pay salaries and pensions, and on the back of implementing measures to improve non-oil revenue. In addition, following the measures announced in 2016 to withhold a significant percentage of government salaries and pensions, KRG in March 2018, abolished the salary cuts for the low-earners government employees and reduced salary cuts for high-earners to as low as 30 percent, down from about 60 percent. The measures announced were in response to anti-government protests, calling for an end to the unpopular salary system introduced in 2016, and in view of the funds sent by the Iraqi government to the region.²⁸

Public debt is estimated to further decline and to remain sustainable. Growth and the positive overall fiscal balance in 2018 are estimated to further reduce public debt-to-GDP ratio from 67.3 percent in 2016 to almost 55 percent in 2018 (Figure 24). The government also adopted a framework to control the issuance of guarantees, which reached US\$33 billion (or 20 percent of GDP) in end-2016 and these

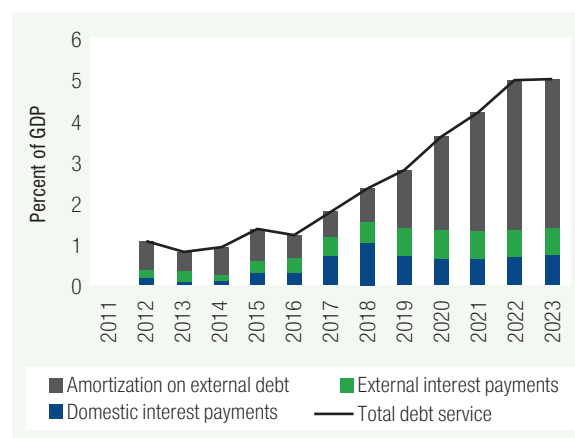
²⁸ <http://www.rudaw.net/english/kurdistan/280320181>.

FIGURE 24 • Public Debt-to-GDP Ratio Is Estimated to Decline



Sources: Ministry of Finance; and World Bank estimates.

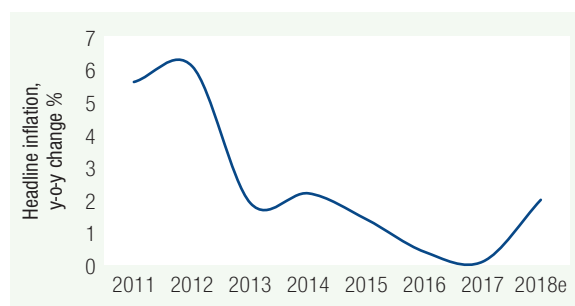
FIGURE 25 • Total Debt Service Will Remain Large



Sources: Ministry of Finance; and World Bank estimates.

guarantees, most related to the electricity sector, are now believed to be under control. In previous year large fiscal deficits have been mainly financed through bilateral and multilateral support, occasional sovereign bond issuance and indirect monetary financing by the CBI. Large borrowing at commercial terms, including through the issuance of Eurobonds is projected to rapidly increase total debt service, which would reach 5 percent of GDP by 2023 (Figure 25).

FIGURE 26 • Inflation Remains Low but Will Likely Increase at 2 Percent in 2018



Source: Iraq CSO.

Inflation, Money and Banking

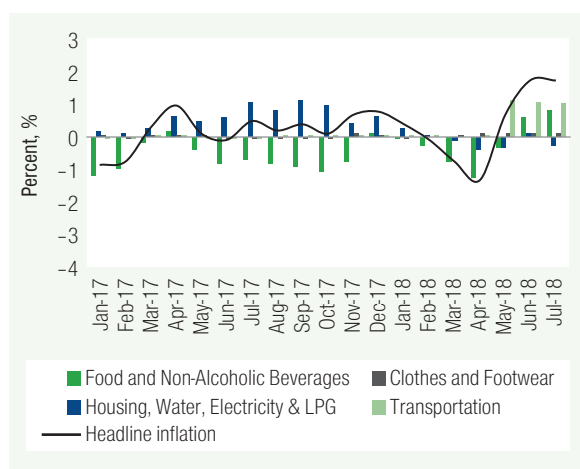
Inflation remains low and the spread between official and parallel exchange rate is narrowing. The financial system remains underdeveloped, but the CBI continues its efforts to develop banking sector and improve supervision. Credit to the private sector is improving. Thanks to its progress in strengthening Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, Iraq was removed from the Financial Action Task Force FATF monitoring.

Inflation remains low. The pegged exchange rate and subdued demand have kept inflation low at just 0.1 percent in 2017. However, higher domestic demand and increased credit to the economy (albeit from a low level) will likely further increase inflation to average 2 percent in 2018 (Figure 26). Rising food

prices and transportation costs led to some pick up in overall inflation at 1.7 percent in both June and July 2018 (Figure 27). Official statistics don't include the conflict-affected provinces, where inflation could be higher due to shortages in fuel and goods.

Broad money and credit to private sector are estimated to improve in 2018, but public banks' NPLs remain elevated. As of May 2018, total liquidity receded 2.8 percent since the beginning of the year. Preliminary data point to a reversal in the y-o-y contraction in CBI's balance sheet beginning July for the first time in 15 months. As a result, the broad money is estimated to stabilize (Figure 28). The share of non-performing loans (NPLs) is high and

FIGURE 27 • Rising Food Prices and Transportation Costs Led to Some Pick-Up in Inflation in June and July 2018



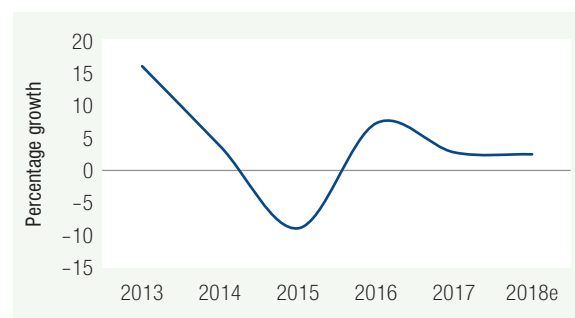
Source: Iraq CSO.

rising, both in public and private commercial banks (respectively 12 and 34 percent) as of March 2018.²⁹ Private sector cash credit extended by commercial banks also increased from about ID18.5 trillion in July 2017 to almost ID21 trillion in June 2018 (11.3 percent increase).

The spread between the official and parallel exchange rates is narrowing. The spread between the official and parallel exchange rates has narrowed to 2 percent in June 2018 from 6.25 percent at end-2017. This reflects a streamlining of documentation requirements for access to the CBI's foreign exchange window and increased foreign currency sales.

Iraq continues to pursue efforts to develop its underdeveloped banking system. The financial sector is dominated by state-owned banks, which provides credits mainly to SOEs. As of September 2017, there were 70 banks operating in Iraq, including 7 state-owned banks (SOBs), 44 Iraqi private banks, and 19 foreign banks. The SOBs account for the bulk of assets and credits, particularly three of them, Rafidain Bank, Rasheed Bank and Trade Bank of Iraq (TBI), which hold around 90 percent of the banking system's assets, 71 percent of total deposits and extend 54 percent of total credit in the Iraq banking sector. In 2018, total credit to the economy is

FIGURE 28 • Broad Money Is Estimated to Stabilize in 2018



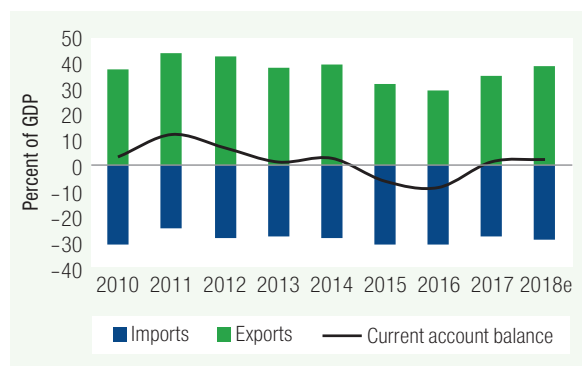
Sources: World Bank; and IMF staff estimates.

estimated at 12 percent of GDP, the lowest level in the Middle East and North Africa (MENA). Private banks are small, and they are mostly active in currency exchanges and wire transfers. Access to finance is very low in Iraq with only 11 percent of adults having a bank account, suggesting that there is a substantial unmet demand for financial services. Capital markets in Iraq are underdeveloped and little reliable data is available for non-bank financial institutions. The CBI has also implemented several measures to simplify access to its foreign exchange window, which has contributed in the decline of the spread between the official and parallel exchange rates. The WB and IMF continue to provide technical assistance to the CBI to strengthen the supervisory and regulatory frameworks and adopt international standards. The WB is currently assisting the CBI to reform its payment system and propose drafting suggestions for legal and regulatory measures and develop an oversight framework.

Iraq is making progress in strengthening its AML/CFT. In July 2018, in light of the progress made in strengthening its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, the Financial Action Task Force (FATF) has removed Iraq from its list of states deemed weak in combating money laundering and terrorist financing. The International Co-operation Review Group (ICRG) also saw concrete progress

²⁹ Iraqi authorities, preliminary estimates.

FIGURE 29 • Higher Oil Prices Are Estimated to Consolidate the Current Account Surplus in 2018



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

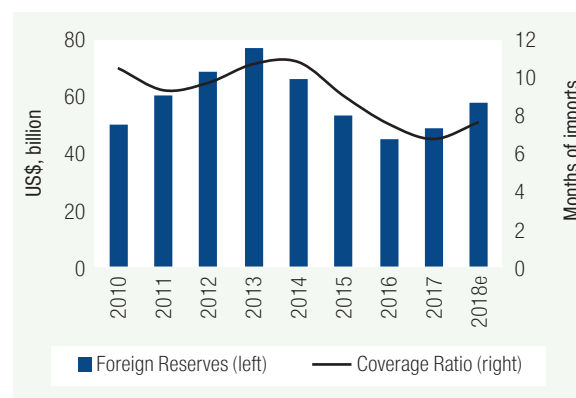
in criminalizing the financing of terrorism, evidenced by good coordination between law enforcement, intelligence agencies.

External Position

Higher oil prices will consolidate the current account surplus for 2018, and also increase international reserves.

Higher oil prices since-mid 2017 has also been conducive to better outcomes on external balance. Higher oil prices turned the current account from a deficit of 9 percent in 2016, into a surplus of 1.2 percent of GDP in 2017 and will consolidate the

FIGURE 30 • International Reserves Are Estimated to Increase as Well



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

current account surplus at 2.1 percent of GDP in 2018 (Figure 29). International reserves are estimated to increase from US\$49 billion in 2017 (or 6.8 months of imports), to US\$58.3 billion (or 7.7 months of imports) in 2018, rebuilding buffers to external shocks³⁰ (Figure 30).

³⁰ The strong reserve accumulation in 2010–2013 smoothed the impact of the fiscal policy adjustment required to maintain external sustainability, and foreign reserves financed most of the balance of payment deficit, when declining from US\$77.8 billion at end-2013 to US\$48.1 billion at end-2017.

ECONOMIC OUTLOOK AND RISKS

Economic Outlook

The outlook is expected to improve considerably due to higher oil prices and the improving security situation. Overall GDP growth is projected to accelerate to 6.2 percent in 2019, compared to 1.9 percent in 2018, sustained by higher oil production. In the following years, oil production is expected to increase only marginally, reducing overall growth to an average of 2.5 percent until 2023, due to the limited capacity of the GoI to mobilize investment needed to rebuild the country's damaged infrastructure network, private consumption and investment.

Non-oil growth is expected to gain momentum on the back of higher investment needed to rebuild the country's damaged infrastructure network, private consumption and investment. But sustained non-oil recovery will depend on the transition from an immediate rebound as security improves to implementation of a high-quality investment pipeline with sound financing. Thus, reconstruction will remain an upside risk for growth (rather than in the baseline) given the continued uncertainty about how it will evolve. A more stable security situation will allow for private consumption and investment to pick up,

increasing import needs for consumer and capital goods. Inflation is projected to remain low at 2 percent in 2019.

Fiscal and external balances are likely to continue improving as recovering oil prices feed through to higher revenues. Largely driven by expected higher oil prices and fiscal consolidation, the fiscal position will remain positive in 2019 but will turn into small deficits by 2020. The current account deficit is expected to remain limited as long as oil exports prices continue to rise. The rebuilding of reserves and emergence of current account surpluses imply that Iraq no longer has large exceptional financing needs in the near term. Thanks to fiscal restraint, public debt is expected to continue to decline and to remain sustainable over the medium term.

The outlook includes making space for post-conflict reconstruction and infrastructure spending. After sharp spending cuts in 2014–17 (focused on capital spending), the short-term outlook also includes reviving capital spending and responding to demands for improvements in basic services in 2019 and beyond. Resources are available given the recovery in oil prices and following the donor conference, although further efforts are required to

strengthen absorption capacity. Carefully managing spending pressures over the remainder of this year and taking measures in 2019 budget would create space for capital/reconstruction spending while also using some of the oil windfall to build buffers.

Risks and Challenges

Challenges remain due to political risk, dependency on oil revenue and the regional situation (Box 2). Although higher oil prices are associated with reduced near-term vulnerabilities, the outlook remains subject to considerable uncertainties due to political developments that could also delay economic recovery in the conflict-affected governorates. Setbacks in security and/or a crisis over formation of the government could weaken growth. While the policy priorities of the new government remain unknown, there is a risk of weak policy implementation and pressure to spend the expected budget surpluses, which would erode the fiscal and external positions. Absence of a clear commitment in the budget on wage bill management and subsidy reduction could weaken the fiscal consolidation and absorb the fiscal space otherwise available for reconstruction. The ISIS threat cannot be considered entirely vanquished unless stabilization is also achieved in Syria.

A decline in oil revenue or a shortfall in projected donors financing would result in lower

gross reserves and/or higher public debt. Moreover, the outlook provides limited fiscal space to absorb shocks and further expand capital spending. On the other hand, every US\$1 per barrel sustained increase in oil prices would add US\$1.5 billion to annual oil revenue. Iraq's capacity to expand oil production and exports remains constrained, further exacerbating risks from a reduction of oil prices.

The recent regional developments could also have an adverse impact. The imposition of sanctions on Iran by the U.S. administration could curb non-oil trade, religious tourism and financial channels as Iran is the largest non-oil trade partner of Iraq and result in higher prices of key commodities, while the economic crisis in Turkey is likely to operate mainly through trade channels.

Implementing the new enacted law of Iraqi National Oil Company (INOC) may have some impact on the governance of the oil sector and macroeconomic stability. The law gives INOC considerable freedom with limited oversight from PFM and procurement laws, raising significant governance concerns. The INOC's freedom to borrow and to operate outside the oil sector could lead to contingent fiscal risks and undermine processes to ensure that capital spending is appropriately vetted, financed and monitored. The accumulation of oil revenues to INOC could also reduce international reserves available to maintain the exchange rate peg. The law is currently on hold until a new government is formed.

BOX 2 • Global and Regional Economic Outlook

Global Economy. Global growth has eased, but remains robust, and is projected to reach 3.1 percent in 2018 (Figure B3). It is expected to decrease in the next two years to 2.9 percent by 2020, as global slack dissipates, trade and investment moderate, and financing conditions tighten. Growth in advanced economies is predicted to decelerate toward potential rates, as monetary policy normalizes and the effects of U.S. fiscal stimulus fade. In emerging market and developing economies (EMDEs), growth in commodity importers will remain robust, while the rebound in commodity exporters is projected to mature over the next two years. Risks to the outlook remain tilted to the downside. They include disorderly financial market movements, escalating trade protectionism, heightened policy uncertainty, and rising geopolitical tensions, all of which continue to cloud the outlook. EMDE policymakers need to rebuild monetary and fiscal policy buffers and be prepared for rising global interest rates and possible episodes of financial market turbulence. In the longer run, EMDEs need to tackle ongoing structural challenges and boost potential growth by promoting competitiveness, adaptability to technological change, and trade openness.

MENA Regional Economy

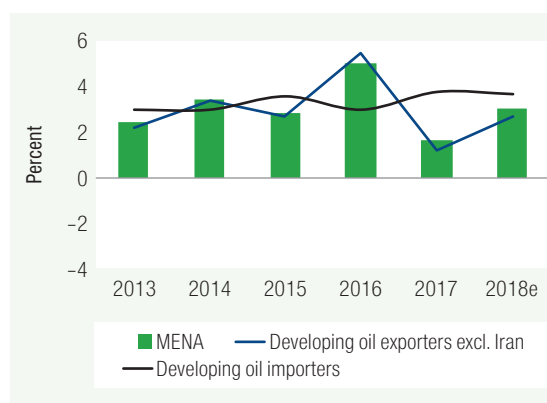
Growth in MENA region is expected to pick-up to 3 percent in 2018 from 1.6 percent in 2017, as oil exporters ease fiscal adjustments amid firming oil prices. The region is also expected to benefit from a favorable global environment, post-conflict reconstruction efforts, and from oil importers' reforms to boost domestic demand and increase foreign investment. Growth in oil importers is expected to rise to 3.7 percent in 2018, as business and consumer confidence is spurred by business climate reforms and improving external demand. Growth in oil exporters is expected to rise substantially to 2.7 percent due to additional government spending, enabled by increased domestic revenues and firm oil prices. Policies to relax foreign investment restrictions have supported higher capital flows and are expected to boost foreign investment and trade flows. Tourism growth is also expected to improve upon stable security conditions. However, fiscal consolidation is expected to be an important headwind for activity among oil importers. In smaller oil importers (e.g., Jordan, Lebanon), external and fiscal imbalances remain a constraint to higher growth in the short-term. Reform programs, such as World Bank-supported initiatives to improve urban investment capacity or electricity performance, are expected to improve growth potential. Similarly, public-private partnerships and bilateral agreements within the region are expected to support private sector participation in infrastructure investment, which benefits economic activity. Risks to the outlook are diverse, but tilt to the downside. Key downside risks include renewed volatility in oil prices, an intensification of geopolitical tensions, and a slower-than-expected pace of reforms. Nonetheless, favorable spillovers from stronger than expected activity in key trading partners and recovery in war-torn areas cannot be ruled out.

FIGURE B3 • Global Growth has Eased but Remains Robust at an Estimated 3 Percent in 2018



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

FIGURE B4 • Growth in MENA Region is Estimated to Pick Up to 3 Percent in 2018



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

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

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SPECIAL FOCUS: TRANSITION TO POVERTY TARGETED CASH TRANSFER SYSTEM³¹

Poverty has been a persistent problem for Iraq. The poverty rate declined modestly between 2007 and 2012, from 22.4 to 18.9 percent.³² But this was accompanied by a 40 percent increase in GDP per capita over the same period. Low elasticity of poverty with respect to GDP reflects the predominance of the oil sector, which constitutes over 65 percent of GDP and 92 percent of central government revenue, and yet employs only 1 percent of the country's work force. Poverty is unevenly distributed across space, with the southern governorates experiencing the highest incidence of poverty.

What little gains were made, were lost to the twin crises of oil price decline and ISIS insurgency soon after; the poverty rate climbed back to the 2007 level (22.5 percent) in 2014. The increase in poverty was most pronounced in

ISIS-affected governorates and among internally displaced persons (IDPs), as well as in the Kurdistan region that experienced spillovers of the conflict.³³

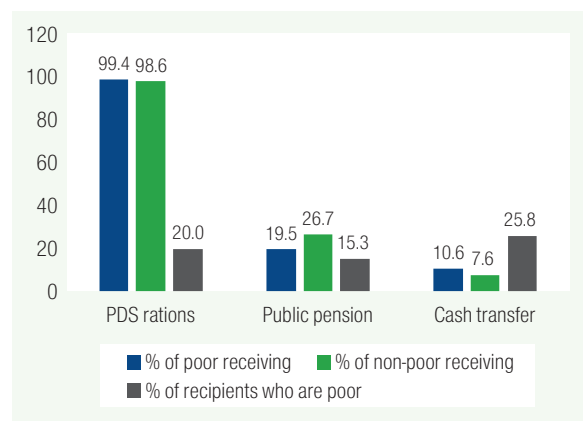
The reduction in poverty before 2012 was driven mainly by an increase in labor income. Yet, because of limited opportunities for employment and earnings, non-labor incomes constitute a significantly larger share of total household income of poorer households. In 2012, households in the poorest decile derived more than 30 percent their total income from public transfers.

³¹ Prepared jointly by Poverty and Equity and Social Protection and Labor Global Practices.

³² Measured by the national poverty line.

³³ The ISIS-affected governorates are Anbar, Salah al-din, and Nineveh.

FIGURE 31 • Incidence of Public Transfers in 2012



Source: World Bank, 2014.

Given the outsized importance in the household budget of poorer households, public transfers play a crucial role in reducing poverty and mitigating vulnerability in Iraq. However, the programs are inefficient and fragmented, which limit their effectiveness. Recognizing this, the country has embarked on a process to adopt a more efficient targeting method. The objective of this note is to describe the evolution of Iraq's cash transfer scheme from categorical to poverty-targeted system. The reforms described below apply exclusively to the Social Safety Net (SSN) program, which is but a small portion of overall social assistance spending.

Pre-Reform Scenario

Public Distribution System (PDS), a universal food subsidy program, is the largest social assistance program in the country. In 2018, the spending on PDS was approximately 1.7 trillion Iraqi dinars, and it accounted for approximately 2.3 percent of 2018 current expenditure.³⁴ Because of universal targeting, the program reaches almost all the poor; 99.4 percent of the poor receive PDS benefits. But this coverage comes at a significant cost because almost all the non-poor (98.6 percent) also receive the benefits (Figure 31). Due to the absence of other systems of social protection, the PDS is also the biggest source of social assistance. In 2012, the PDS transfers

accounted for as much as 30 percent of incomes of the poorest 10 percent and provided 70 percent of the calories of the poorest 40 percent of the population.

The only cash transfer scheme in the country is the Social Safety Net (SSN) program. Until 2014, the eligibility for cash transfers was based on demographic characteristics of the household. Households with orphans, married students, disabled, blind, paralyzed, families of the imprisoned and missing persons, and the unemployed qualified for cash assistance. Due to the categorical targeting criteria, the program was plagued by low coverage of the poor and high leakage to the non-poor. Only 11 percent of the poor received benefits while of those receiving benefits, only 26 percent were poor. The use of demographic characteristics rather than poverty criteria for targeting resulted in a majority of the poor from being left out of the cash transfer program (Figure 31).

The third main social assistance program in Iraq is public pensions, which consists of two mandatory pension schemes covering public and private sector employees. Total expenditure on pensions is around 4 percent of the GDP and a sixth of annual current expenditure.³⁵ Despite such high costs, there are large coverage gaps, with only about 48 percent of the total labor force contributing to and covered by the pension (public) or social security (private) system. Public pensions reached less than 20 percent of the poor (while reaching more than a quarter of the non-poor) because they are not intended as anti-poverty transfers. Of the pension recipients, about 85 percent were non-poor households (Figure 31).

The Reform Process

Despite a difficult political and economic context, Iraq embarked on a gradual reform of its social protection sector in 2014. The new Social Protection Law for Iraq (Law 11/2014) enacted in

³⁴ Source: Staff Report for the 2017 Article IV Consultation (IMF, 2017).

³⁵ Source: Staff Report for the 2017 Article IV Consultation (IMF, 2017).

April 2014 established poverty and means testing as the primary targeting mechanisms. In addition, the Iraq Social Protection Strategic Roadmap developed in November 2014 aimed to have a comprehensive, integrated, and efficient social protection system for Iraq covering social safety nets, social insurance, and labor market policies.

The switch from categorical to poverty targeting necessitated an objective criterion to identify the poor. To meet this need, a proxy means test (PMT) formula (Box 3) was developed using the existing 2012 Integrated Household Socioeconomic Survey (IHSES). As the name suggests, proxy means test uses proxies of income or expenditure to identify whether a household is poor. The appropriate proxy indicators and the weight on each indicator are obtained from regression analysis based on the latest available household expenditure survey (Box 1).

The PMT form was developed in close coordination between the World Bank, MOP, and MOLSA. Several technical discussions on the assumptions underpinning the model and the data

source were held with officials from the Ministry of Planning, Ministry of Labor and Social Affairs, and the Baghdad and Kurdistan Region Statistics Offices. Preliminary models and results were also presented to a high level Iraqi delegation led by the Minister of Labor and Social Affairs at the Social Protection Strategic Roadmap Discussion Form in Istanbul from November 3–7, 2015 (Istanbul 2 Forum). The suggestions and recommendations received in the Istanbul 2 forum were incorporated in the final model, which consisted of 11 indicators on observable household characteristics. The consultative process helped build strong ownership of the tool by the government as evidenced by its swift adoption and implementation.

The new poverty targeting program was launched by MOLSA and Social Protection Commission (SPC) on April 10, 2016, with a budget of IQD 1.9 trillion.³⁶ The program was implemented in multiple stages as following. First,

³⁶ Equivalent to US\$1.6 billion.

BOX 3 • Proxy Means Test for Poverty Targeting

Why do we need poverty targeting?

Governments have limited resources for development activities and poverty alleviation and there are opportunity costs to the use of resources. Targeted use of limited funds improves program efficiency by reaching more number of poor with the same amount of resources and increasing program effectiveness by achieving greater poverty reduction on a fixed budget.

What is the Proxy Means Test?

In countries where a significant share of the population is employed in the formal sector and accurate and comprehensive tax records exist, a means test is often used to identify poor households. In countries where these conditions do not hold, a simple and cost-effective alternative is proxy means testing (PMT). It uses proxies of income or consumption derived from regression analysis to identify the poor. PMT has been used at least since mid-1990s to target social services.

How is the PMT constructed?

Multiple regression analysis is carried out to select the proxy indicators. While there may be many candidate variables, only those indicators that best predict household consumption or income are retained in the final formula.

How is the PMT model assessed?

The use of proxy indicators in place of direct consumption or income measures introduces some error. Some households who are not actually poor will be deemed poor by the PMT formula (error of inclusion) and some households who are poor will be classified as non-poor (error of exclusion). The PMT model is designed to keep both the errors to a minimum.

What indicators are included in the typical PMT formula?

PMT formula is determined by a complex interaction of the underlying data, the target population, and the relationship between the consumption or income variable and the socioeconomic characteristics. Therefore, no two PMT formula are identical. Nevertheless, the indicators most commonly selected are location, demographic composition of the household, dwelling conditions, and ownership of assets.

To prevent households from strategically misreporting the information, the PMT indicators must be easy to observe and verify.

existing beneficiaries requested continuation of cash benefits by filling out a preliminary questionnaire. A unique identifier was assigned to all applicants, and the SPC checked all applications against other databases including public pensions, social security, civil service, tax records, motor vehicle registration, ration card system, and loans for small business. This cross-validation resulted in a list of pre-qualified households that were visited by social workers to fill out the complete PMT questionnaire. After the full PMT information was collected, a PMT score was generated for each household by the MOP Poverty Reduction Strategy team. The score determined the eligibility for cash assistance according to a cutoff point set by the SPC.

Implementation of PMT helped improved the targeting efficiency of the cash transfer system. Before the introduction of PMT, 934,000 households were receiving assistance from MOLSA under categorical targeting. These households were re-assessed using PMT, and 594,000 were found to be eligible according to the PMT criterion while 340,000 that were deemed not eligible were removed from the programme. An additional 515,000 households were subsequently added to the programme through an open window PMT assessment. The number of households that receive monthly cash transfers now totals 1.1 million.

The original PMT formula was derived from the Integrated Household Socioeconomic Survey (IHSES), a comprehensive nationally representative household budget survey carried out in 2012. The country has undergone many socioeconomic changes since then, including the fall in oil prices and the ISIS-related violence and displacement in 2014. The need for an updated formula was felt because it was recognized that the welfare distribution, the indicators that proxy for the welfare status of households, and their relationship to household income or expenditure have changed since 2012.

Recently, the data from the SWIFT survey from 2017/2018 was used to update the PMT formula.³⁷ The survey has a small sample size and incomplete geographical coverage, but it had the advantage of being the only survey of its scope and

coverage since 2014. Separate models have been developed for three regions of the country (North, Center, and South). The SWIFT survey from Kurdistan has recently become available, and a model for the region will be developed once data quality control checks have been completed.

Recertification of cash beneficiaries has begun with the updated PMT model for the governorates of Iraq not organized as a region. This process is expected to be completed by the end of September 2018. Under the recertification process, all existing beneficiaries will be revisited and reassessed with the new PMT formula. Those who no longer qualify will be dropped from payroll. After recertification of existing households and removal of ineligible households, the application will be reopened for replacement households. The extent to which new households can be brought into the program will be limited because of budget constraints.

The application process to replace households involves submitting an application to MOLSA electronically through the online e-Application form. It is particularly important to ensure that the electronic application is possible in previously occupied areas where many poor and vulnerable households may not have been able to apply during the earlier application window. To ensure that as many vulnerable households as possible apply, the World Bank and MOLSA are looking to coordinate with humanitarian actors active in the areas to disseminate information to the vulnerable households and give guidance on how the process works, as well as help with online application to those households who will otherwise not be able to access it. Humanitarian case workers will have an important role play in this respect. After the window for online

³⁷ SWIFT survey is a short survey designed to assess the core socioeconomic conditions of Iraqis in the post-crisis period. The survey also collected expenditure data from a subset of households, which permits an updating of the poverty estimates. The survey was carried out by Kurdistan Regional Statistical Organization (KRSO) in the three governorates in Kurdistan and by Central Statistical Organization (CSO) in the remaining 15 governorates.

application is completed, MOLSA social workers will make home visits to fill out the complete PMT form and assess eligibility under the updated PMT scoring.

Once home verification is complete, MOLSA's registry will then contain the number of households deemed eligible for assistance.

However, without an increase in MOLSA's budget, the total number of beneficiary households will remain around 1.1 million. Consequently, the number of replacement households brought into the program from those deemed newly eligible will depend on the number of existing beneficiaries who are removed during the earlier recertification stage. MOLSA will then enroll these households and process payment using their usual SmartCard technology platform.

It is important to carry out a rigorous evaluation of the accuracy of the PMT model and the characteristics of the newly eligible households. The success of PMT implementation can be partly assessed by the number of households deemed eligible by PMT (coverage rate) compared to the number of eligible households in the survey, as well as by comparing the profile of eligible households in the database to that in the survey. Preliminary analysis comparing the PMT registration database with the 2012 household survey yield inconclusive results. Such an evaluation will be possible after the completion of next household survey (IHSES) that identifies SSN program beneficiaries and determines their poverty status (according to their consumption).³⁸ These data are expected to be available in 2020.

Steps are also being taken to align the targeting mechanisms of humanitarian agencies and the government. Thought will be given particularly to a future transition for some vulnerable households from humanitarian assistance beneficiaries to MOLSA assistance beneficiaries, depending on their needs and the available resources. Analysis is underway to estimate how many existing humanitarian beneficiaries qualify for MOLSA assistance under existing eligibility criteria. This will be important for both humanitarian agencies and the government. If households deemed needy from a humanitarian perspective are not identified as chronic poor by PMT, they will not receive any social support once the humanitarian support comes to an end.

However, if there is a large degree of overlap between households targeted for humanitarian assistance and PMT, in the long term, these households could be transferred to the cash transfer program. Needless to say, MOLSA's capacity to absorb more cases depends on the availability of resources.

Despite its limitations, the PMT formula provides the soundest basis to target the less well-off households for social assistance. It is empirically grounded on the latest available data of national coverage. While there is a common understanding between the Government and the World Bank that the formula must be updated periodically to keep it up to date, such an opportunity will arise when a new round of household budget survey is available. In the meantime, the current PMT formula will underpin Iraq's effort to reform its social protection system.

Looking Forward

While the transition to the poverty targeted cash transfer has already begun to yield results, the poverty targeting system can play a much larger role in improving the efficiency and sustainability of Iraq's social safety net system when coupled with Iraq National Unified Registry (INUR). The establishment of a unified registry and for participation of other government ministries and agencies to support building human capital through the cash transfer program is called for by Law 11/2004. The INUR is expected to: (i) Serve as a tool to identify and assess the needs and conditions to determine eligibility for social assistance programs (benefits and services); (ii) monitor the demand for social assistance programs based on the profiles of needs and conditions of the population; (iii) coordinate and integrate benefits and services; and (iv) monitor and evaluate the quality of the data system and coordination of policies.

³⁸ This analysis cannot be carried out with the recently conducted SWIFT survey because it does not collect information on receipt of public assistance at sufficient detail.

The new targeting system, combined with the unified registry, is expected to address the current fragmentation of databases used across various agencies. It will introduce a unified welfare database in which applicants are well identified based on a single welfare measure for distribution of social assistance. The purpose of consolidating beneficiary information is to achieve a level of efficiency and targeting effectiveness and allow for fiscal consolidation while minimizing the deleterious impact on the poor. The welfare database is currently in operation at MOLSA, and enhancements are underway to allow for its use to target poverty related transfers across multiple programs.

The SSN also needs to increase coverage, considering the likely increase in the number of poor.³⁹ Therefore, a major implementation challenge for the SSN system is rolling-out the SSN program across the country, including in the liberated areas. The targeting tool will be helpful in this regard as well to identify poor and vulnerable households.

Steps are being taken to establish a framework through which development and humanitarian actors can improve coordination of current and planned interventions. Referral of cases from MOLSA or Cash Working Group (CWG) databases requires the establishment of a system that builds on: (i) mapping of existing services of both MOLSA and humanitarian actors; (ii) training of social

workers and; (iii) an effective case management program. To facilitate the process, World Bank will support in the planning of referrals between MOLSA and humanitarian actors in the mapping of services and looking at how and when humanitarian beneficiaries can be transferred to MOLSA services. This will also build the capacity of MOLSA to refer beneficiaries listed in its database, and requires developing an adequate communication plan within MOLSA, including training of social workers, as well as within communities. Integration of beneficiary data across different programs managed by MOLSA, and between humanitarian and public assistance will ensure that benefits are accruing to the right people at the right time, improving the efficiency and effectiveness of social assistance.

In the long term, these activities will provide the foundation to help the GoI develop an integrated social protection system. This involves developing the full suite of tools and services, including a social registry, a case management system, a monitoring system, a grievance and redress mechanism, and a graduation mechanism to institute a countercyclical social safety net system.

³⁹ A combination of the chronic poor and the new poor as a result of displacement.

APPENDIX: SELECTED DATA ON IRAQ

TABLE 1 • Iraq: Selected Economic and Financial Indicators, 2014-2020
(Quota: SDR 1,663.8 Million) (Population: 39.3 Million; 2018 Est.)
(Poverty Rate: 22.5 Percent, 2014) (Main Export: Crude Oil)

	2014	2015	2016	2017	2018e	2019p	2020p
Economic growth and prices							
Real GDP (percentage change)	0.7	2.5	13.0	-2.1	1.9	6.2	2.9
Non-oil real GDP (percentage change)	-3.9	-14.4	-4.0	0.8	5.2	5.2	5.4
GDP deflator (percentage change)	-0.7	-26.1	-14.0	15.3	13.8	-0.8	0.9
GDP per capita (US\$)	6,517	4,812	4,505	4,952	5,597	5,751	5,820
GDP (in ID trillion)	273.6	207.2	201.4	227.4	263.7	277.9	288.5
Non-oil GDP (in ID trillion)	149.5	137.3	132.8	137.1	150.5	165.1	181.6
GDP (in US\$ billion)	234.7	177.7	170.7	192.4	223.1	235.1	244.1
Oil production (mbpd)	3.1	3.7	4.6	4.5	4.5	4.8	4.8
Oil exports (mbpd)	2.60	3.40	3.80	3.80	3.90	4.10	4.10
Iraq oil export prices (US\$ pb)	96.5	45.9	35.6	48.7	61.0	56.9	53.2
Consumer price inflation (percentage change; end of period)	1.6	2.3		0.4	2.0	2.0	2.0
Consumer price inflation (percentage change; average)	2.2	1.4	0.4	0.1	2.0	2.0	2.0
(In percent of GDP)							
National Accounts							
Gross domestic investment	26.0	24.9	20.9	16.8	18.8	19.2	18.8
Of which: public	18.2	15.6	11.8	8.4	10.9	11.0	10.3
Gross domestic consumption	69.6	81.2	87.6	81.5	78.2	80.3	82.6

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TABLE 1 • Iraq: Selected Economic and Financial Indicators, 2014-2020 *(continued)*
(Quota: SDR 1,663.8 Million) (Population: 39.3 Million; 2018 Est.)
(Poverty Rate: 22.5 Percent, 2014) (Main Export: Crude Oil)

	2014	2015	2016	2017	2018e	2019p	2020p
Of which: public	18.3	22.6	23.2	22.2	21.4	20.7	20.3
Gross national savings	28.6	18.4	12.0	18.0	20.9	18.0	15.4
Of which: public	13.0	3.1	-2.1	7.4	13.0	12.4	9.5
Saving - Investment balance	2.6	-6.5	-9.0	1.2	2.1	-1.2	-3.5
(In percent of GDP, unless otherwise indicated)							
Public Finance							
Government revenue and grants	38.2	30.6	27.6	33.8	39.9	39.3	36.2
Government oil revenue	36.0	27.8	23.3	28.8	36.0	35.4	32.2
Government non-oil revenue	2.1	2.8	4.1	4.5	3.3	3.4	3.6
Expenditure, of which:	43.8	43.4	41.8	35.2	38.6	38.2	37.3
Current expenditure	25.5	27.8	30.1	26.8	27.7	27.1	27.1
Capital expenditure	18.2	15.6	11.8	8.4	10.9	11.0	10.3
Overall fiscal balance (including grants)	-5.6	-12.8	-14.2	-1.4	1.2	1.1	-1.1
Non-oil primary fiscal balance, accrual basis (percent of non-oil GDP)	-56.6	-46.5	-45.1	-40.1	-49.7	-46.0	-41.4
Adjusted Non-oil primary fiscal balance, accrual basis (excl. KRG, percent of non-oil GDP)	-54.9	-44.7	-45.1	-39.8	-45.7	-42.4	-38.1
Adjusted non-oil primary expenditure (excl. KRG, percent of non-oil GDP)	58.8	48.9	51.3	47.3	51.1	47.7	43.3
Adjusted non-oil primary expenditure (excl. KRG, annual real growth, percent)	-9.0	-24.7	1.0	-5.0	16.3	0.3	-2.0
Memorandum items:							
Total government debt (in percent of GDP)	32.9	56.7	67.3	61.8	54.7	52.7	51.7
Total government debt (in US\$ billion)	77.1	99.9	114.7	118.5	121.7	124.1	126.5
External government debt (in percent of GDP)	24.8	37.2	39.3	36.2	33.2	33.9	33.7
External government debt (in US\$ billion)	58.1	66.1	67.1	69.7	74.0	79.8	82.3
(In percent, unless otherwise indicated)							
Monetary indicators							
Growth in reserve money	-9.6	-12.6	8.1	-3.3	2.4	4.7	5.0
Growth in broad money	3.6	-9.0	7.2	2.7	6.0	6.0	6.0
Policy interest rate (end of period)	6.0	6.0	6.0	4.0	—	—	—
(In percent of GDP, unless otherwise indicated)							
External sector							
Current account	2.6	-6.5	-9.0	1.2	2.1	-1.2	-3.5
Trade balance	10.9	-0.1	-2.2	7.2	9.2	6.5	4.0

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TABLE 1 • Iraq: Selected Economic and Financial Indicators, 2014-2020 *(continued)*
 (Quota: SDR 1,663.8 Million) (Population: 39.3 Million; 2018 Est.)
 (Poverty Rate: 22.5 Percent, 2014) (Main Export: Crude Oil)

	2014	2015	2016	2017	2018e	2019p	2020p
Exports of goods	39.6	31.8	29.3	35.3	39.0	36.3	32.9
Imports of goods	-28.7	-31.9	-31.5	-28.1	-29.9	-29.8	-28.9
Overall external balance	-10.0	-7.3	-3.8	2.6	5.8	3.1	0.0
Gross reserves (in US\$ billion)	66.7	53.6	45.1	49.0	58.3	63.8	62.7
In months of imports of goods and services	10.9	9.1	7.6	6.8	7.7	8.3	8.1
Exchange rate (dinar per US\$; period average)	1166.0	1167.0	1180.0	1182.0	1182.0	—	—
Real effective exchange rate (percent change, end of period)	4.6	7.0	5.9	-0.6	—	—	—
Financing gap (US\$ billion)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

SELECTED RECENT WORLD BANK PUBLICATIONS ON IRAQ

(For an exhaustive list, please go to: <http://go.worldbank.org/country/iraq/research>)

Title	Publication Date	Document Type
Jobs in Iraq: a primer on job creation in the short-run, World Bank, June 2018.	June 2018	Working Paper
Iraq Economic Monitor Report, From War to Reconstruction and Economic Recovery	Spring 2018	Report
Iraq Reconstruction and Investment, Part 1, Reconstruction and Development Framework, Joint report with Iraqi Government	February 2018	Report
Iraq Reconstruction and Investment, Part 3, Investment Opportunities and Reforms, Joint report with Iraqi Government	January 2018	Report
Damage and Needs Assessment of Seven Directly Affected Governorates	17/1/2018	Report
Systematic Country Diagnostic	3/2/2017	Report
Programmatic Development Policy Financing	1/12/2016	Report
The Kurdistan Region for Iraq: Reforming the Economy for Shared Prosperity and Protecting the Vulnerable.	24/6/2016	Working Paper
Iraq Economic Monitor: Laboring Through the Crisis	1/6/2016	Working Paper
Decentralization and subnational service delivery in Iraq: status and way forward	14/4/2016	Report
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Iraq – Diversified development in a resource-rich fragile state: World Bank background note	1/1/2015	Working Paper

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Title	Publication Date	Document Type
The unfulfilled promise of oil and growth: poverty, inclusion and welfare in Iraq 2007–2012	1/12/2014	Working Paper
A stocktaking of social assistance programs in the Republic of Iraq	8/12/2014	Working Paper
The legal and regulatory framework for microfinance in Iraq	1/1/2014	Working Paper
Republic of Iraq – Public expenditure review: toward more efficient spending for better service delivery	6/8/2014	Report
SABER workforce development country report: Iraq 2013	1/1/2013	Working Paper
Iraq – Country partnership strategy for the period FY13–FY16	13/11/2012	Report
Iraq – Investment climate assessment 2012	1/1/2012	Report
Iraq – Financial sector review	1/1/2011	Working Paper
International Reconstruction Fund Facility for Iraq: World Bank Iraq Trust Fund – progress report	6/12/2010	Working Paper
Status of Projects in Execution (SOPE) – FY10: Middle East and North Africa region – Iraq	3/10/2010	Annual Report
Doing business 2011: Iraq – making a difference for entrepreneurs: comparing business regulation in 183 economies	1/1/2010	Annual Report
Iraq – IEITI Work Plan	1/1/2010	Working Paper
International Reconstruction Fund Facility for Iraq (IRFFI) World Bank Iraq Trust Fund – report to donors: status report as of December 31, 2009	31/12/2009	Working Paper
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