INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/217

IRAQ

2013 ARTICLE IV CONSULTATION

July 2013

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2013 Article IV consultation with Iraq, the following documents have been released and are included in this package:

- **Staff Report** for the 2013 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 12, 2013, with the officials of Iraq on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 30, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its May 13, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Iraq.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

IRAQ

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

April 30, 2013

KEY ISSUES

Context: Since 2003, close engagement with the Fund has helped Iraq maintain macroeconomic stability, despite a difficult political and security environment, external economic shocks, and a weak economic structure. In this context, the 2013 Article IV discussions focused on strengthening policies to realize Iraq's economic potential and make growth more inclusive.

Outlook: The positive trend in oil production and exports contrasts with the weakening economic governance deriving from an increasingly difficult political process and worsening security. The authorities will be able to fend off the danger of the natural resource curse if they can improve political and security conditions, strengthen economic institutions, and implement sound policies. Fiscal policies should aim at financing the needed social and investment spending while building up adequate fiscal buffers to insulate the economy from oil market shocks. On the back of large oil exports, strong current account performance is expected to result in the accumulation of international reserves.

Main policy recommendations: The authorities need to be proactive in addressing medium-term challenges and risks by: (a) ensuring fiscal sustainability and building fiscal buffers to address volatility in oil revenues; (b) stepping up the liberalization of the foreign exchange market; (c) continuing the prudent management of reserves held by the Central Bank of Iraq and the Development Fund for Iraq; (d) deepening the reform of the financial sector, including the creation of a level playing-field for private banks; and (e) accelerating structural reform to promote private sector growth and employment creation.

Approved By
Alfred Kammer and Taline Koranchelian

Discussions were held in Amman, Jordan during March 2–12, 2013. The staff team comprised Messrs. Sdralevich (head), Parodi, Alkhunaizi, Shbaikat, and Said (all MCD), Ms. Kirabaeva (MCM), and Mr. Nielsen (SPR). The team met with Acting Finance Minister Al-Shukri, Deputy Finance Minister Othman, Board of Supreme Audit Head and Acting Governor of the Central Bank of Iraq Al-Turki Said, other senior government officials, and representatives of the Iraqi private sector. Ms. Choueiri (OED) participated in the policy meetings.

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GLOSSARY

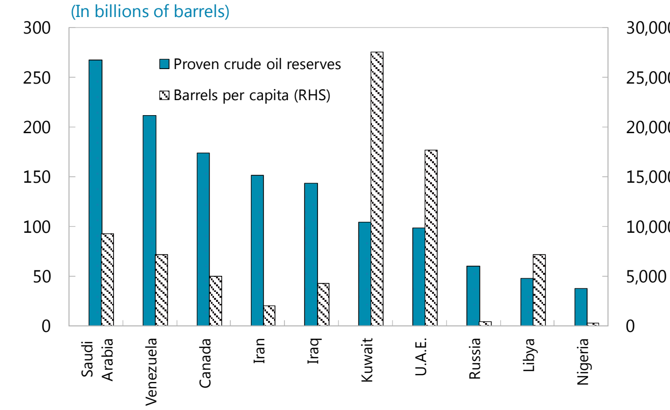
AML	Anti-Money Laundering
APSP	Average Petroleum Spot Price
CBI	Central Bank of Iraq
CFT	Combating Financing of Terrorism
CGER	Consultative Group on Exchange Rates
DFI	Development Fund for Iraq
EITI	Extractive Industries Transparency Initiative
FATF	Financial Action Task Force
FMS	Foreign Military Sales
GCC	Golf Cooperation Council
G-RAM	Global Risk Assessment Matrix
IEA	International Energy Agency
IFMIS	Integrated Financial Management Information System
ILO	International Labor Organization
KRG	Kurdistan Regional Government
MENA	Middle East and North Africa
MPIH	Modified Permanent Income Hypothesis
NRPB	Non Resource Primary Balance
PDS	Public Distribution System
PFM	Public Financial Management
PIH	Permanent Income Hypothesis
SOE	State-owned enterprise
SWF	Sovereign Wealth Fund
UNDP	United Nations Development Program
WEO	World Economic Outlook

BACKGROUND

A. The Iraqi Economy Today

1. **Iraq is exceptionally rich in oil, but its economy suffers from severe structural weaknesses.** Iraq's proven reserves, at approximately 143 billion barrels, are among the highest in the world, with extremely low oil extraction costs. The increase in production since 2003 has contributed to a rise in GDP per capita from $1,300 in 2004 to $6,300 in 2012.[1] During this period, Fund program engagement was instrumental in maintaining macroeconomic stability—even though progress on structural reform was mixed (Box 1). Thus, there are still many weaknesses:

Figure 1. Largest Proven Oil Reserves
(In billions of barrels)

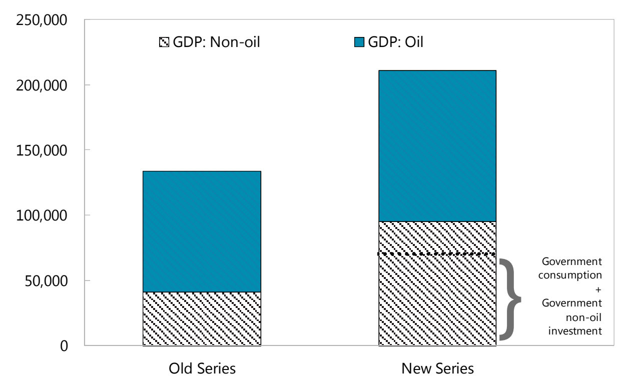


Sources: EIA; and IMF staff estimates.

- **The non-oil sector represents only 46 percent of the economy.** Non-oil activity (services, construction, transport, and a small agricultural sector) is highly dependent on government spending, given the limited direct spillovers from the oil sector, which is operated mostly by international oil companies.

- **The economy is dominated by the public sector.** Government and state-owned enterprises employ approximately half of the labor force. Most of the population depends on government employment or transfers for its income. Moreover, the population sees the public sector as the main vehicle to distribute oil wealth. Rising government employment and high wages contribute to social stability, but improvements in public service delivery have been scarce.

Figure 2. GDP in 2011: Oil vs. Non-Oil
(In billions of Iraqi dinars)



Sources: Iraq Central Statistics Office; and IMF staff calculations.

[1] Staff has replaced Iraq's GDP series previously estimated by staff, used since 2004, with Iraq Central Statistics Office's data. The new series raises GDP significantly (from $114 billion to $180 billion for 2012).

Box 1. Iraq's Program Relations with the IMF

Fund engagement with Iraq over almost a decade has been instrumental to maintain macroeconomic stability and build institutions. The Fund has been closely working with the Iraqi authorities in the context of post-conflict assistance and Stand-By Arrangements since 2004. In the context of Fund programs, the authorities were able to limit fiscal spending, contain inflation, and successfully restructure Iraq's external debt. They also reformed the Central Bank of Iraq (CBI) and implemented new laws and regulations in fiscal and financial sectors.

Iraq's IMF Program Relations

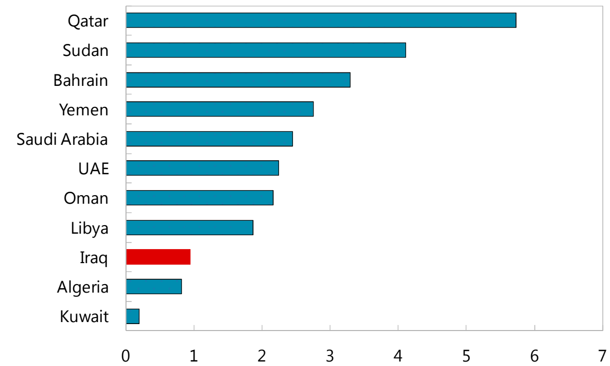
Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Feb 24, 2010	Feb 23, 2013	2,376.80	1,069.56
Stand-By	Dec 19, 2007	Mar 18, 2009	475.36	–
Stand-By	Dec 23, 2005	Dec 18, 2007	475.36	–
EPCA	Sep 24, 2004	–	297.10	297.10

Of the two-year 2010 SBA of SDR 2.37 billion (200 percent of quota), only about SDR 1 billion was disbursed. Despite two extensions for a total of three years, insufficient progress after the second review in March 2010 precluded completion of the third and fourth reviews before the SBA expired in February 2013:

- The program was successful in safeguarding CBI reserves from being used for fiscal financing and protecting central bank independence in 2010–11. However, the CBI's enforcement of exchange restrictions starting in 2011 triggered a multiple currency practice in the foreign exchange market and led to the nonobservance of the two related performance criteria.
- In the context of higher-than-expected oil revenues, the authorities exceeded overall fiscal balance targets in 2010–11, but spending composition was worse than planned because of continued slippages in current spending and persistent PFM weaknesses. Thus, the authorities missed the end-2010 and 2011 performance criteria on current spending and the continuous performance criterion on external arrears.
- Progress on structural reforms was mixed. The authorities initiated efforts to strengthen PFM (introduction of the chart of accounts) and transparency (including becoming EITI-compliant in December 2012), bank supervision (co-sourcing with Ernst & Young), international reserve management (introduction of investment guidelines), and central bank safeguards. However, there was little traction on broader reforms, such as state-owned bank restructuring, which required political consensus across ministries.

- Unemployment is high, and poverty remains pervasive. Unemployment is officially estimated at 11 percent in 2011, although actual levels, particularly among the youth, are likely to be considerably higher. Demographic pressure is strong, with 41 percent of the population under 15 years. The labor force lacks basic skills due to years of war and sanctions, and massive emigration since 2003. Administrative capacity is weak at all levels of government. Poverty is widespread, affecting 22.9 percent of the population according to 2008 data, with 40 percent of poverty in rural areas. Because of low access to services, housing, and education, Iraq occupies the 131st place in the UNDP's Human Development Index.

Figure 3. Foreign Direct Investment, 2012
(In percent of GDP)



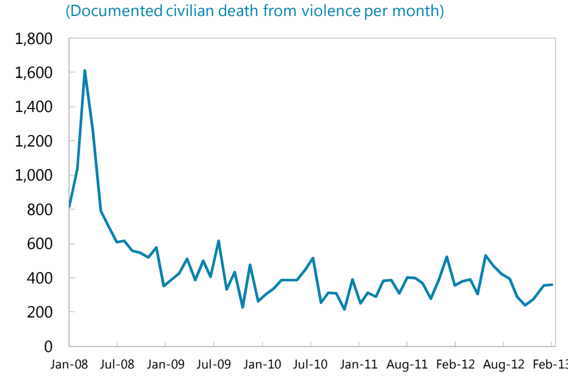
Sources: Country authorities; and IMF staff calculations.

- **The business environment is very weak**. Poor governance, an inefficient judiciary system, inconsistent regulations, and insufficient security keep Iraq at the bottom of global rankings for doing business. Foreign direct investment, particularly in the non-oil sector, is lower than in other oil-exporters in the region.

B. Recent Developments

2. **The political situation deteriorated steadily since the withdrawal of U.S. troops in December 2011.** The government has been plagued by political infighting with increasing sectarian undertones, exacerbated by instability in Syria. Ministers from various parties have been intermittently boycotting the cabinet since early 2012, and parliament has been able to meet only a few times in the course of 2013. Tensions between the semi-autonomous Kurdistan Regional Government (KRG) and the central government remain high due to disagreements about sharing of oil export revenues and territorial disputes. The security situation remained critical in 2013 in parallel to the political crisis, with March recording the highest number of casualties of the past three years.

Figure 4. Violence Indicator, January 2008–February 2013
(Documented civilian death from violence per month)



Source: Iraq Body Count.

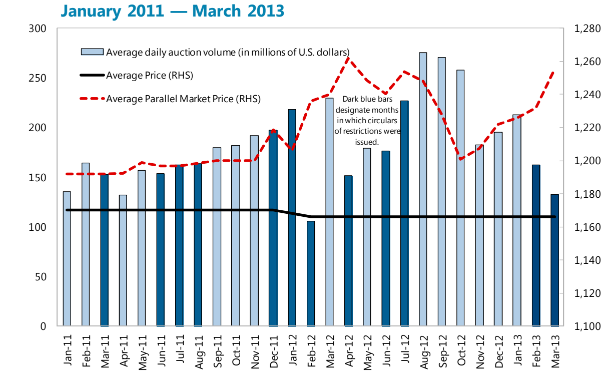
3. **Nevertheless, macroeconomic developments have been broadly positive:**

- **Economic growth** has accelerated from 5.9 percent in 2010 to over 8.4 percent in 2012, when oil production averaged 3 million barrels per day (mbpd), the highest level reached in the last 30 years. In 2013, staff expects growth to rise to 9 percent as oil production increases to about 3.3 mbpd and activity in non-oil sectors (government services, trade, real estate, construction, and transportation) picks up.

- **Inflation** has declined, from about 6 percent at end-2011 to 3.6 percent at end of last year, mostly as a result of lower imported food prices, and is expected to increase only slightly in 2013.

- **Broad money** declined sharply in 2012 after strong growth in 2010–11, reflecting increased political tensions which are likely also the cause of the shift from dinar deposits to foreign currency deposits (now 25 percent of the total).[2] In large part because of loans to state-owned enterprises, credit growth remained high at over 60 percent in 2012.

Figure 5. Foreign Exchange Developments, January 2011 — March 2013



Source: IMF staff calculations.

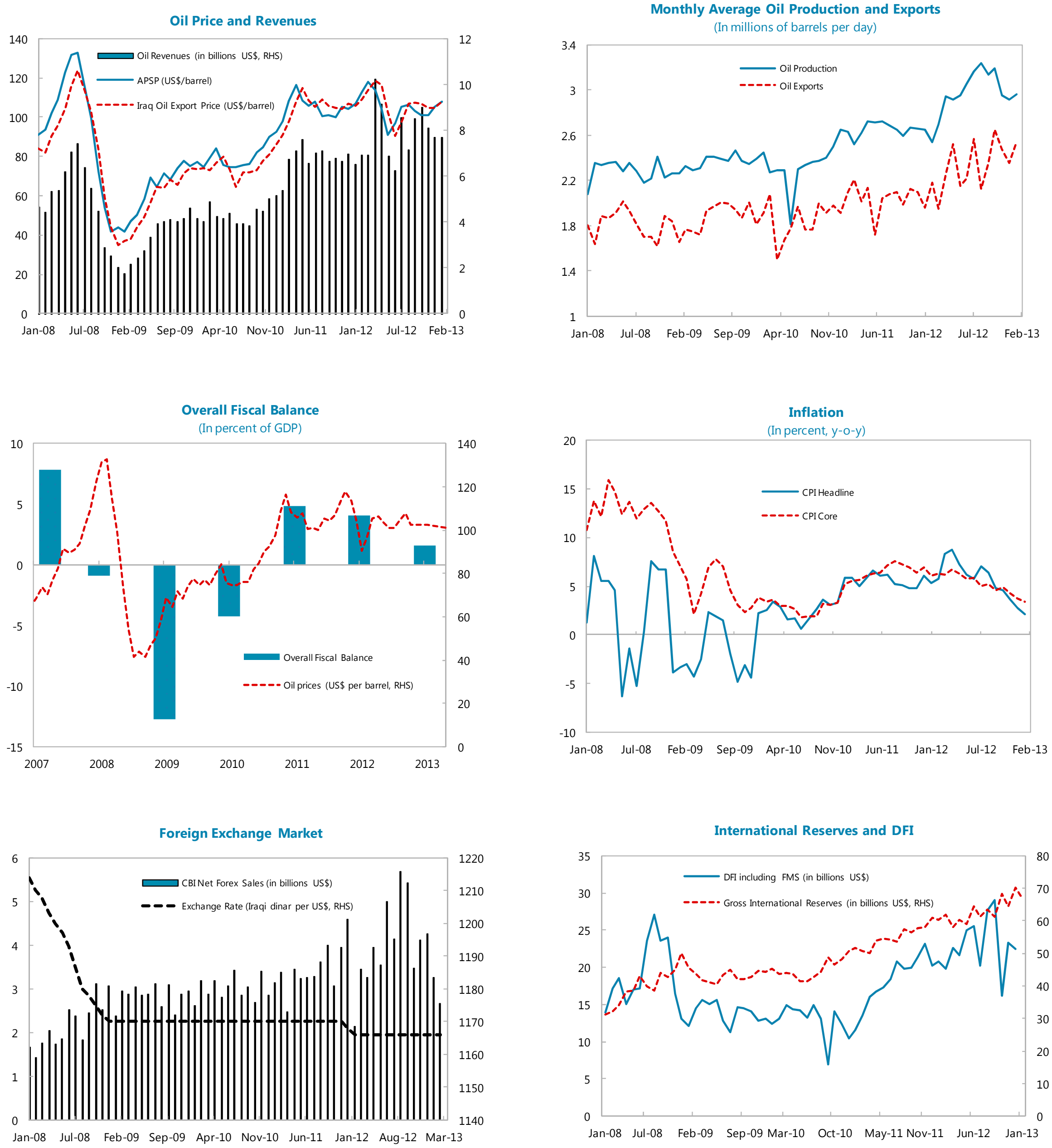
- **The real exchange rate** has been appreciating over the past three years, and remains broadly in line with fundamentals (Appendix 1).

- **Central Bank of Iraq (CBI) international reserves** rose from $61 billion at end-2011 to $70 billion at end-2012 (over nine months of imports, 33 percent of GDP) on the back of rising oil exports, and fiscal reserves held at the Development Fund for Iraq (DFI) have increased from $16.5 billion to $18 billion (six months of salaries and pensions, 8.5 percent of GDP).

- **Fiscal performance has been mixed.** Thanks to higher-than-expected oil revenues and the under-execution of the investment budget, fiscal surpluses reached almost 5 percent in 2011 and 4 percent of GDP in 2012. However, fiscal discipline weakened over the past couple of years, with poor budget planning and execution, large off-budget spending (3 percent of GDP in 2012), low investment execution rates, and serious deficiencies in fiscal reporting. The authorities also continued the practice of directing loans from state-owned banks Rasheed and Rafidain to unviable state-owned enterprises (SOEs), mostly to pay for salaries. The total stock of these loans reached 3.5 percent of GDP at end-2012.

[2] These developments must, however, be interpreted cautiously because monetary aggregates also reflect disproportionately large government and state-owned enterprise deposits.

Figure 6. Macroeconomic Indicators



Sources: Iraqi authorities, and IMF staff estimates and projections.

4. **The 2013 budget raises risks.** In March 2013 parliament approved a final budget that includes large unfunded commitments, which, if fully executed, would imply a deficit of 13 percent of GDP, deplete fiscal reserves, and result in a financing gap of 7 percent of GDP. Draft pension and public-sector wage laws under preparation may also increase fiscal liabilities.

5. The nominal exchange rate in the official market remained stable against the U.S. dollar since 2010, but the rate in the parallel market increased. The CBI pursues a policy of de facto peg to the U.S. dollar, providing a key nominal anchor to the economy. However, in 2011, fiscal expansion and political instability in Iraq and the region led to increase demand for foreign exchange. In late 2011 the CBI started enforcing existing exchange restrictions and introduced new restrictions in response to concerns about money laundering and illegal foreign exchange outflows. As a result, the spread between the official rate and the parallel market rate—which had been up to that point below 2 percent—started to climb, giving rise to a multiple currency practice, and reached over 8 percent in April 2013.

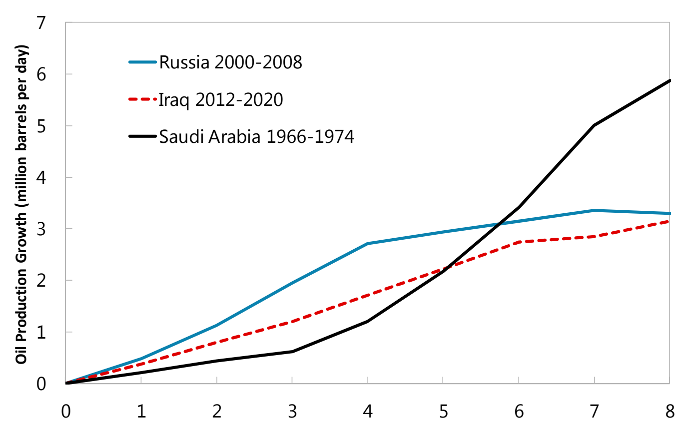
MEDIUM-TERM OUTLOOK, RISKS, AND SPILLOVERS

A. Medium-Term Outlook

6. Over the medium term, Iraq's macroeconomic outlook will continue to be driven by developments in the oil sector (see accompanying Selected Issues paper). Staff projections assume the implementation of sound macroeconomic policies and gradual progress on structural reform. The authorities broadly agreed with the baseline scenario, but noted that policy implementation will be challenging because of the complex political environment, large spending pressures, and security issues. Staff projects that:

- Oil production will rise gradually by about 400–500 thousand barrels per day (tbpd) per year, reaching 5.7 mbpd by 2018. The non-oil sector will grow by about 5 6 percent and reach 51 percent of GDP in 2018. Overall, growth will remain above 8 percent over the medium term.

Figure 7. Iraq Oil Production Take-Off in Context



Sources: International Energy Agency; and IMF staff calculations.

- Strong oil export revenues will lead to higher nontradable prices and cause an appreciation of the real exchange rate. Domestic inflation at 5–6 percent will be higher than inflation in trading partners.

- Containment of current spending growth will allow a ramp-up in investment spending and the build-up of fiscal buffers. Fiscal reserves are targeted to double from about six months of salaries and pensions at end-2012 to 12 months by end-2018.

- Oil exports will support strong current account surpluses over the medium term and boost CBI reserves to $104 billion by end-2018 (eight months of imports).

Iraq: Selected Economic Indicators, 2010–18

	2010 Actual	2011 Actual	2012 Prel.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
GDP Growth, percent	5.9	8.6	8.4	9.0	9.0	8.3	9.0	8.4	8.3
CPI inflation (end of period), percent	3.3	6.0	3.6	5.0	5.5	5.5	5.5	5.5	5.5
General government balance, excl. grants, percent of GDP	-7.2	3.9	4.1	1.6	2.2	3.0	3.6	3.7	3.8
Current account, percent of GDP	3.0	12.5	7.0	3.8	2.9	4.0	4.5	4.1	4.3
Fiscal financing needs, in US$ billion, excl. grants	11.4	-8.2	-10.1	-4.3	-6.5	-9.6	-12.9	-14.4	-16.5
External financing needs, in US$ billion	4.6	-11.2	-3.6	-2.5	-5.9	-9.0	-12.3	-13.8	-15.9
Public debt, percent of GDP	52.2	40.6	34.9	17.3	14.4	11.9	9.8	8.1	6.5
External debt, percent of GDP	45.0	33.8	28.3	11.9	10.0	8.5	7.2	6.1	5.2
Gross reserves, in US$ billion	50.6	61.1	70.3	80.1	84.9	90.5	95.5	99.3	103.7
In months of imports	10.6	9.5	9.3	9.7	9.4	9.2	8.8	8.4	8.1

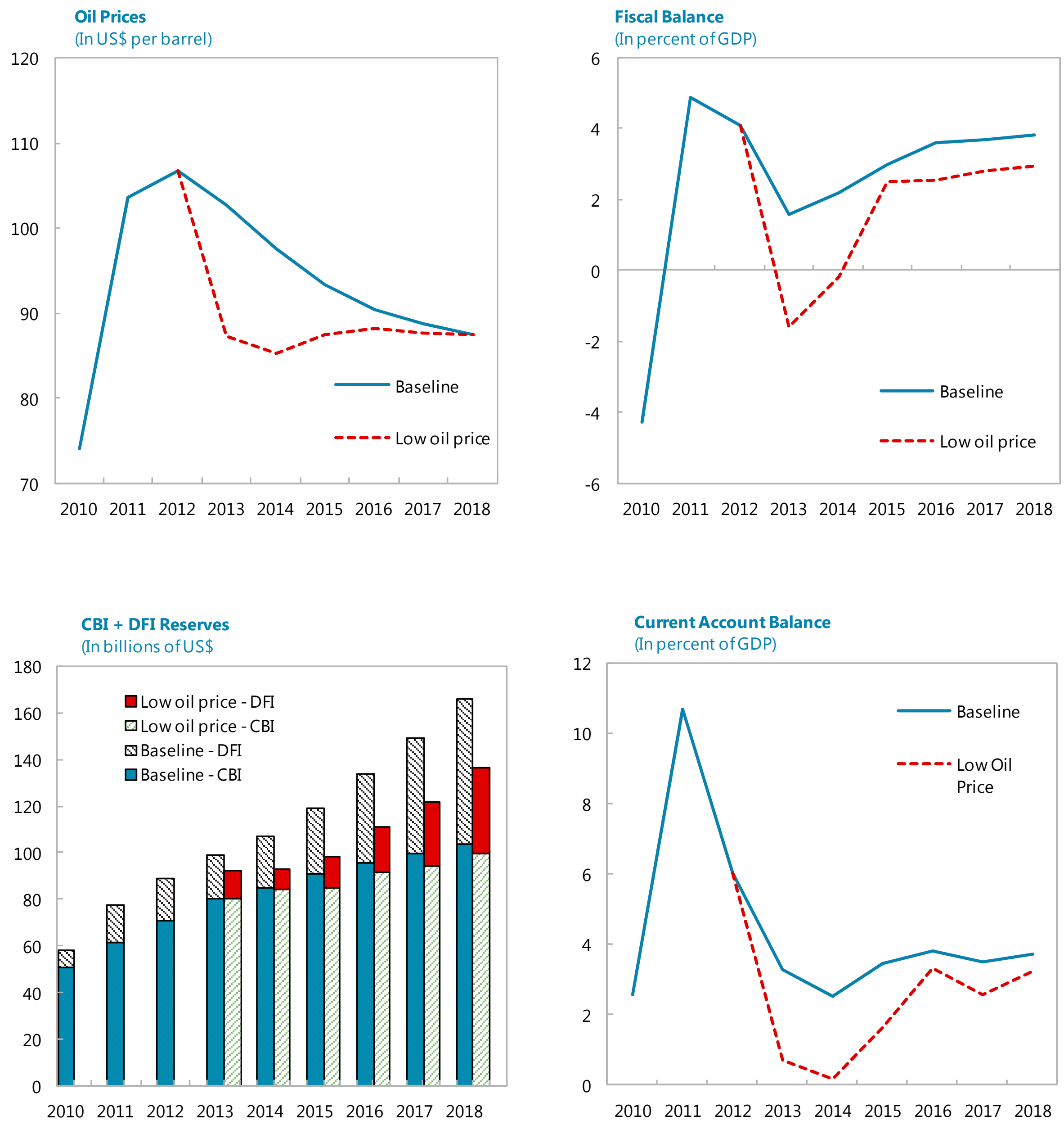
Sources: Iraqi authorities; and Fund staff estimates.

B. Risks and Spillovers

7. **Risks to the macroeconomic outlook remain high.** They include (a) inadequate policy implementation; (b) a deteriorating political and security situation; (c) a larger-than-projected decline in global oil prices; and (d) delays in developing Iraq's oil fields and oil export capacity. (See Risk Assessment Matrix in Appendix 2). These risks can translate into lower oil revenues, deterioration in the fiscal position, pressures to use CBI reserves for fiscal purposes leading to depreciation pressures, and higher inflation. Policies to mitigate their impact include strengthening fiscal institutions and oil revenue management, improving monetary policy transmission, and reducing the economy's dependence on the oil sector. At present, the authorities depend solely on fiscal policy to address these vulnerabilities, underscoring the need for the authorities to urgently build up sufficient fiscal buffers, since Iraq's fiscal and external performance is very sensitive to fluctuations in oil prices. The authorities agreed that building sufficient buffers is essential, but highlighted that containing current spending to achieve this objective will be difficult in the current fragile social context without broad political consensus. Outward spillovers are mostly related to the impact of the oil sector on global markets (Box 2).

8. **A low-case scenario modeling a temporary decline in oil prices stemming from a deeper-than-expected slowdown in emerging markets illustrates the economy's dependency on oil.** Staff estimated the impact of the downside emerging markets Global Risk Assessment Matrix (G-RAM) scenario, envisaging a fall in oil prices 15 percent below the World Economic Outlook (WEO) baseline in 2013. Given the lack of other policy instruments, the authorities would respond to the oil price shock in part through the worsening of the fiscal balance (which would require using up fiscal buffers) and in part by tightening spending (mainly investment expenditure, as they did in response to the decline in oil prices in late 2008). Both CBI and DFI reserves would be lower throughout the medium term. Iraq is even more vulnerable to the tail risk of a much larger fall in oil prices—of the magnitude of the 40 percent oil price shock of 2008–09—which would lead to the complete depletion of the fiscal buffers held at the DFI in less than one year, additional tightening (including on current spending), and depreciation pressures following the sudden drop in oil revenues.

Figure 8. Oil Price Shock Scenario vs. Baseline



Sources: Iraqi authorities; and IMF staff calculations.

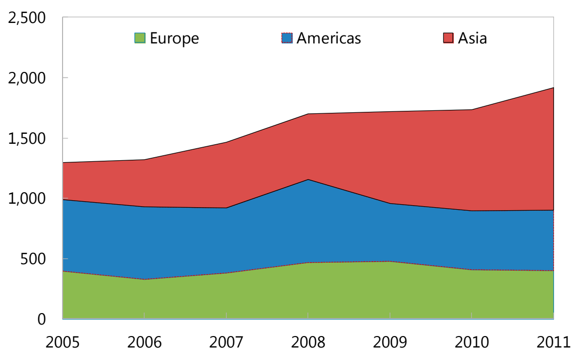
Box 2. The Iraqi Oil Sector: Perspectives and Outward Spillovers

The ramp-up in oil production represents Iraq's main outward spillover to the global economy. Medium-term projections of global demand remain subdued due to concerns over developments in Europe and a possible slowdown in China. The IEA expects demand to increase from 90 mbpd in 2012 (of which Iraq met about 3 percent) to about 96 mbpd by 2017.[1] However, global capacity is expected to rise to approximately 102 mbpd in 2017, with OPEC producing about 37 mbpd. Iraq is currently the second-largest OPEC oil producer (its OPEC quota is currently suspended) and the third-largest oil exporter in the world after Saudi Arabia and Russia. Staff expects Iraq to contribute over 2.2 mbpd in additional oil production through 2017. This amounts to 20 percent of the expansion in global production capacity and the biggest increase within OPEC. Spillovers related to Iraq's oil production might play out through two alternative channels:

- Should global demand turn out weaker than expected, excess production could weaken oil prices.
- Conversely, delays in developing Iraq's export capacity could have a sizable impact on international oil markets, putting upward pressure on prices.

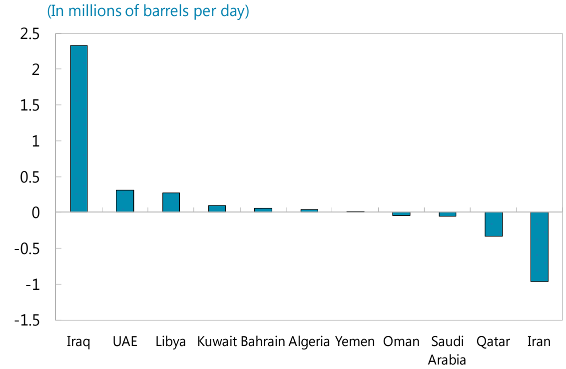
At the regional level, the coming on stream of Iraqi exports might affect the pattern of energy trade and consumption. The authorities are planning a pipeline through Jordan to diversify their oil export routes and export markets by becoming a larger regional supplier of oil.

Oil Exports by Destination
(In thousands of barrels per day)



Sources: Iraqi authorities; and IMF staff calculations.

Projected Change in Total Oil Exports, 2012-2018
(In millions of barrels per day)



Source: IMF staff calculations.

[1] Energy Agency, 2012, "Medium-Term Oil Market Report 2012: Market Trends and Projections to 2017."

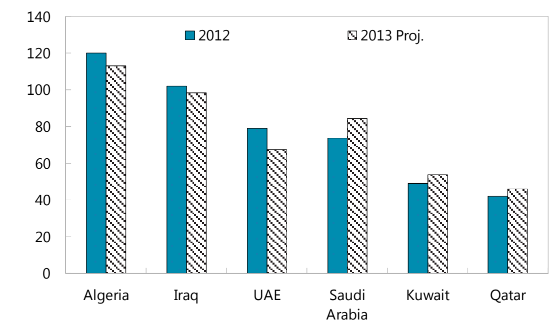
ROLES OF POLICIES IN MANAGING OIL WEALTH

A. Fiscal Policy

In the past, the fiscal stance was pro-cyclical, as higher oil revenues triggered spending increases. With oil revenues soaring, political pressures to boost current spending will grow, compounded by weaknesses in fiscal management. Discussions focused on (a) setting the appropriate fiscal stance in 2013, (b) addressing volatility in oil revenues through fiscal buffers, and (c) strengthening macroeconomic management and fiscal institutions.

9. Fiscal policy should aim at protecting social and investment spending by containing vulnerabilities to oil revenue shocks. With a breakeven oil price of $102 per barrel in 2012, among the highest in the region, Iraq is very vulnerable to a fall in oil prices. At the same time, the high level of current spending makes it difficult to adjust to external shocks without disproportionately cutting investment spending, as happened during the 2008–9 global crisis. Furthermore, the budget is the main transmission channel of oil market volatility on the domestic economy. In this context, fiscal policy should aim at building up fiscal buffers to insulate priority spending from oil market volatility, and to create space for a countercyclical use of fiscal policy, and increasing fiscal space for social spending and investment by rationalizing low-priority current spending. To build up fiscal buffers, the authorities rely on the DFI as a de facto oil stabilization fund. Given that the current legal framework precludes CBI lending to the government, and that Iraq still does not enjoy access to international capital markets, DFI reserves can be seen as an insurance against the impact of oil price shocks or export volume shortfalls.

Figure 9. Break-Even Oil Prices in Context
(In US$ per barrel)



Sources: Country authorities; and IMF staff calculations.

Fiscal Buffers Stress Testing

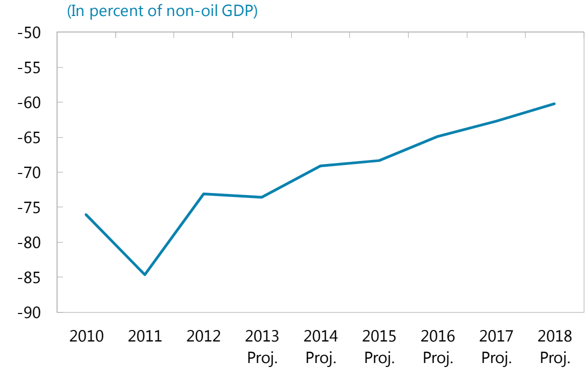
Year	Oil exports (mbpd)	Oil price (US$ per barrel)	Baseline: End-year DFI balance: US$ billion	In months of salaries and pensions	Equivalent to difference in oil prices compared to baseline of US$:	Equivalent to difference in export volume compared to baseline of mbpd:	Memo: Stress Scenarios: 2008-09 oil shock (40% drop in oil prices): Equivalent to difference in oil prices compared to baseline of US$:	GRAM EM scenario (15% drop in oil prices): Equivalent to difference in oil prices compared to baseline of US$:
2013	2.7	102.6	18.1	5.9	-19.2	-0.5	41.0	15.4
2018	4.75	87.5	62.5	12.3	-36.4	-1.98	35.0	13.1

Sources: Country authorities and IMF staff calculations.

10. In 2013, the authorities plan a limited fiscal consolidation. The authorities saw the unfunded commitments included in the 2013 budget as driven by politics. They explained that the actual execution of the budget would aim at meeting priority social and investment spending and maintaining fiscal buffers. They intend to limit spending growth in subsidies for energy producers, rationalize transfers to state-owned enterprises and the universal Public Distribution System (PDS, in-kind food basket subsidy), and contain the increase in public-sector employment. The authorities agreed that the overall surplus of 1.6 percent of GDP in 2013, as suggested by staff, down from an estimated surplus of 4 percent in 2012, was a reasonable projection. The non-oil balance—a better measure of the fiscal impulse to the economy—would remain broadly constant, posting a deficit of 73 percent of non-oil GDP. This fiscal stance would (a) contain demand pressures on the non-oil economy; (b) maintain the fiscal buffers at the DFI to cover about six months of salaries and pensions (equivalent to a negative shock of $19 in oil prices, or 500 tbpd in export volumes); and (c) allow fully executing investment projects in the oil sector, while keeping non-oil sector capital spending constant in nominal terms, in line with implementation capacity.

Figure 10. Non-Oil Primary Fiscal Balance

(In percent of non-oil GDP)

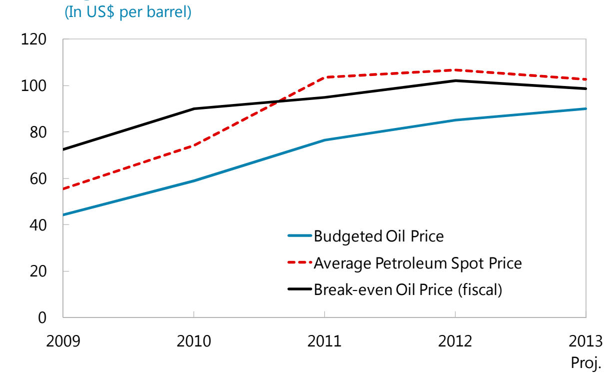


Sources: Country authorities; and IMF staff calculations.

11. Over the medium term, the authorities intend to continue rationalizing spending and increasing buffers. Continued streamlining of current spending could result in sustained fiscal surpluses and double the size of fiscal buffers by end-2018 to 12 months of wages and salaries. By the end of the projection horizon, these buffers would allow Iraq to withstand a negative shock of $36 in oil prices, the magnitude of the 2008–9 crisis, or a decline in exports by 2 mbpd, i.e., back to 2012 levels. The suggested fiscal path, if adhered to, would be consistent with long-term fiscal sustainability (Box 3 and accompanying Selected Issues Paper). However, such significant fiscal consolidation would require broad consensus across the government and the population.

Figure 11. Oil Prices, 2009 — 2013

(In US$ per barrel)



Sources: Country authorities; and IMF staff calculations.

12. A procedural rule could help uncouple budget execution from volatility in international oil markets. Since 2004, conservative oil price and export volume assumptions have been set in the context of IMF-supported programs. In the future, the authorities could adopt procedural rules, preferably by law, to help formulate the annual budget by establishing a baseline oil scenario, identifying sources of financing, setting a realistic discretionary spending path, and assessing fiscal risks. In addition, while Iraq does not yet have the capacity to adopt a numerical fiscal rule based on structural balances, the authorities should consider adopting a simple formula to set oil price assumptions based on a moving average of past prices which would help follow a path to build fiscal buffers.

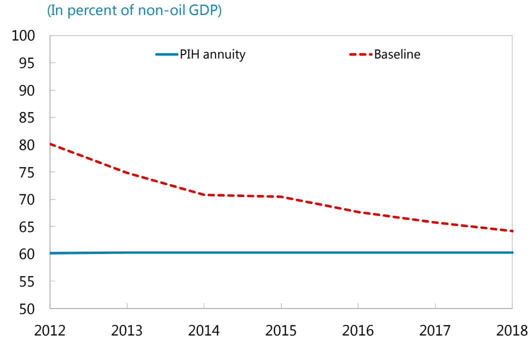
13. Sound fiscal policy implementation requires strong fiscal institutions. A solid institutional framework is needed to ensure that oil revenues are put to productive use in a transparent fashion, and that the fiscal risks are properly addressed, including those arising from contingent liabilities such as possible recapitalization of state-owned banks and enterprises. Iraq has made some progress in adopting a chart of accounts, and has became a full EITI member in December 2012, buttressing oil revenue transparency. The authorities agreed on the importance of strengthening institutions, and confirmed their commitment to adopt a single treasury account, and fully put in place an Integrated Financial Management Information System (IFMIS), which would help improve spending controls, debt management, and fiscal reporting.

Box 3. Long-Term Fiscal Sustainability

- **The Permanent Income Hypothesis (PIH) model allows evaluation of Iraq's long-term fiscal sustainability based on its natural resource wealth (see accompanying Selected Issues Paper).** The PIH model determines a level of constant Non-Resource Primary Fiscal Balance (NRPB) in terms on non-oil GDP consistent with an annuity derived from Iraq's accumulated and expected financial wealth resulting from future oil exports.[1] While the model estimates are subject to large parametric uncertainty and data weaknesses, they provide a useful framework to assess the sustainability of government non-oil spending trends.

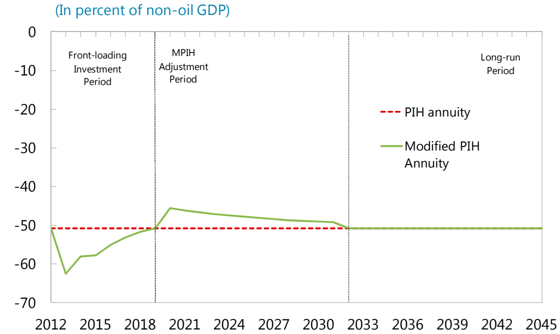
- **The PIH model suggests that Iraq's medium-term fiscal policies, if implemented as outlined in the baseline scenario, would be broadly consistent with long-term fiscal sustainability.** Iraq's projected non-oil primary expenditures are significantly higher than the benchmark PIH expenditure level in 2013–2016, but converge by 2017–2018. This frontloading—justified by Iraq's large investment needs—can be better modeled with the Modified Permanent Income Hypothesis (MPIH) model, which allows for a 'scaled up' spending period, followed up by a 'scaling down' (increase in public-sector savings) to preserve long-term wealth. The need to save in later years could be lessened by the positive growth and tax revenue impact of the additional investment spending upfront, which are conservatively assumed at zero in the model. The results of these tools underline the critical importance of implementing credible spending rationalization policies in public-sector employment, subsidies, and transfers in ensuring long-term fiscal sustainability.

PIH Model vs. Baseline Scenario - Primary Expenditures
(In percent of non-oil GDP)



Source: IMF staff calculations.

Non-Resource Primary Balance
(In percent of non-oil GDP)



Source: IMF staff calculations.

[1] IMF, 2012, "Macroeconomic Policy Frameworks for Resource Rich Developing Countries—Analytic Frameworks and Applications," IMF Policy paper. Available at http://www.imf.org/external/pp/longres.aspx?id=4698.

B. Monetary, Exchange Rate, and Financial Policies

With a severely underdeveloped financial system, high bank liquidity, and administered interest rates, the usual channels of transmission of monetary policy are largely ineffective. Therefore, the principal instrument available to the CBI is foreign exchange intervention, but its effectiveness has been hampered by CBI regulations. Discussions focused on (a) distortions in the foreign exchange market, (b) exchange rate policy, (c) foreign asset management, and (d) banking system restructuring.

14. The de facto fixed exchange rate has served Iraq well. The authorities agreed that a stable nominal exchange rate provides a valuable anchor for inflation expectations in an uncertain environment, and intend to continue implementing this policy for the foreseeable future. In the medium term, staff encouraged the authorities to consider creating the conditions which would make possible a move to a more flexible exchange rate policy. Such flexibility could allow a predictable and gradual appreciation of the nominal exchange rate, triggered by strong oil revenues and the Balassa-Samuelson effect, to accommodate a possible real exchange rate appreciation while keeping domestic inflation low.

15. However, the authorities have been limiting foreign exchange supply to address concerns related to money laundering and terrorism financing. The CBI has recently taken steps to simplify foreign exchange market regulations, but has not eliminated all existing exchange restrictions and the multiple currency practice.[3] The CBI continues to rely on controls to ration the supply of foreign exchange, which have contributed to the increase in the spread between the official auction and parallel market rate. The authorities aim to liberalize the foreign exchange market over the medium term. However, given the limited capacity of the financial sector to implement Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) preventive measures, they consider restricting the supply of foreign currency necessary to stem illegal outflows triggered by regional developments and increased import demand financed by illegal sources.

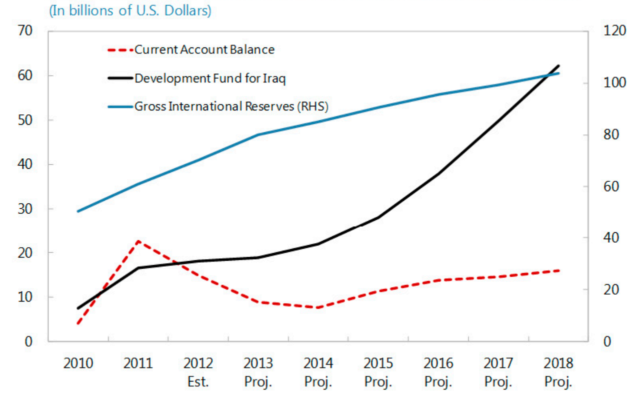
16. In contrast, staff recommended liberalizing the foreign exchange market and improving the AML/CFT regime. Staff noted that effectively limiting supply might be inconsistent with a de facto fixed exchange rate regime. The CBI has ample international reserves to maintain the de facto peg. Furthermore, AML/CFT standards do not contemplate ex-ante controls on foreign currency transactions, but focus on customer due diligence and reporting suspicious transactions to an operational and fully independent Financial Intelligence Unit. In staff's view, accelerating the liberalization of payments for current transactions would therefore be the best approach to eliminating distortions in the foreign exchange market, the exchange rate spread, and the rents it creates. It would also allow removing the exchange restrictions and

[3] See Section IX of Annex I of the Informational Annex for a list of the exchange restrictions and multiple currency practice subject to Fund jurisdiction.

the multiple currency practice, with a view to accepting the obligations under Article VIII. The improvement of the AML/CFT framework, in line with the MENA-Financial Action Task Force (FATF) recommendations, and FATF standards, together with the ongoing efforts in strengthening AML/CFT supervision by the CBI, would help address money laundering and terrorism financing concerns.

17. The size of Iraq's foreign assets (both CBI and DFI) is fueling a domestic debate on their most productive use. Staff projections show that, while CBI reserves are broadly appropriate over the forecast period, fiscal buffers will achieve an adequate level only in the medium term. Furthermore, the legal framework and governance arguments do not support pooling of CBI and DFI reserves. Moreover, the low execution rates of public investment, owing to limited administrative capacity and domestic absorptive capacity, suggest that there is little scope for accelerating the spending of foreign assets in the domestic economy. Increasing the returns to sovereign foreign assets might imply adopting some form of sovereign wealth fund (SWF) as exemplified by international experience (see accompanying Selected Issues paper). On balance, in light of the need to preserve the independence of the CBI and maintain a high level of liquid reserves to address possible pressures on the Iraqi dinar, and given Iraq's weak capacity and governance, it seems appropriate to maintain the current two-tier architecture composed of CBI reserves (invested following prudent guidelines) and fiscal reserves held in the DFI. Should the DFI reserves increase beyond the recommended level of fiscal buffers, it should be possible to modify the DFI structure to allow for a more active management of excess fiscal reserves. The authorities agreed that the management of Iraq's sovereign assets should continue to be cautious, and that a separate SWF would not be appropriate at this stage.

Figure 12. Medium-Term Outlook for International Reserves and DFI
(In billions of U.S. Dollars)



Sources: Iraqi authorities; and IMF staff calculations.

C. Supporting Private-Sector Led Inclusive Growth

With an economy dominated by oil production and public spending, the authorities will need to focus on creating an enabling environment for private-sector development. A stronger financial system, better business environment, and a far-reaching structural reform plan can boost private-sector activity and employment.

Banking System

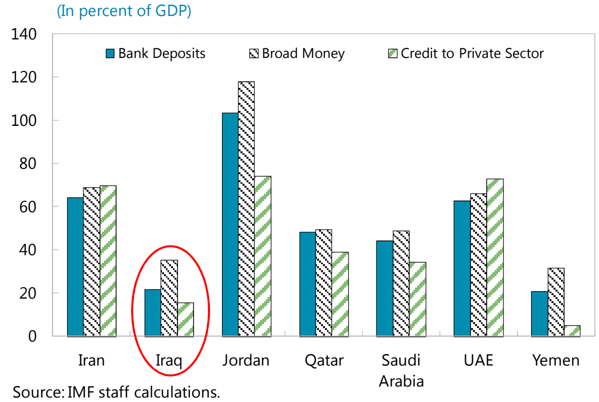
18. Efforts to modernize the financial system have hinged on the reform of state-owned banks. The restructuring of state-owned bank giants Rasheed and Rafidain has been lagging since its launch in 2006. Recently, the CBI has impressed new momentum to the clean-up of the banks' balance sheets from pre-2003 assets and large valuation losses. The next step would be a rigorous audit of the balance sheets and the formulation of plans for their recapitalization, which is likely needed. In the long run, plans to put Rasheed and Rafidain on a sustainable commercial basis can be realized only if Rasheed and Rafidain stop lending to the government or on its behalf.

Box 4. Financial System Development

The financial system in Iraq remains seriously underdeveloped. Total banking assets in Iraq are estimated at 77 percent of GDP, compared to 130 percent in the Middle East and North Africa region, and total credit is about 29 percent of GDP, compared to 55 percent in the region. However, the headline credit figures reflects in large part loans and trade credit extended from state-owned banks to SOEs. Thus, credit to the private sector is estimated at only about 15 percent of GDP.

State-owned banks dominate the financial sector. The 50 private banks are small and focused on trade-related business. Banks Rasheed and Rafidain hold 71 percent of the system's deposits. Together with the Trade Bank of Iraq, established in 2003, they enjoy a symbiotic relationship with the government, based on extension of credit to the government, the frequent execution of quasi-Treasury operations, the almost complete monopoly over government transactions, and historic lax supervision and shareholder control. While Rasheed and Rafidain are very liquid, they are likely not solvent, even though their net worth has so far been difficult to assess given the lack of transparency and the persistence of pre-2003 items on their balance sheets.

Financial Deepening Indicators for Selected Countries, 2011
(In percent of GDP)



Source: IMF staff calculations.

19. Development of the private banking sector requires leveling the playing field with state-owned banks (Box 4). Options include opening up the market for trade finance for government imports and allowing private banks to honor customers' checks to the government. Moreover, the ongoing operational strengthening of banking supervision centered on better staffing, training and co-sourcing, and extension of the supervisory perimeter to include state-owned banks is essential to promote a sound banking system. In addition, the competitiveness of the private banks depends on the modernization of their operations (many banks still lack a core banking system) and strengthening of their governance structure.

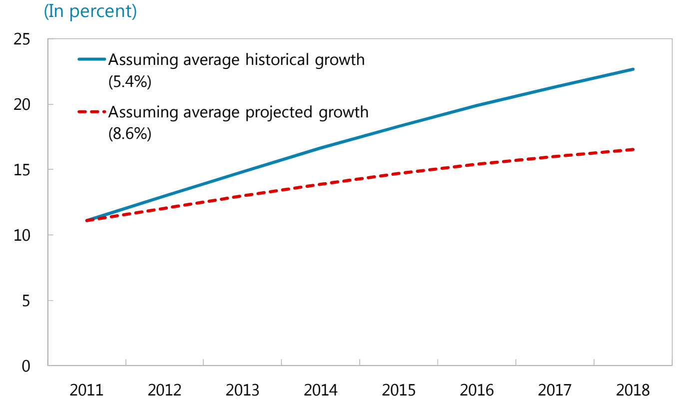
Employment

20. Despite the large size of the public sector, unemployment remains high. The oil sector employs only an estimated 80,000 workers out of a total of about 8 million in the labor force. The government absorbs most entrants to the labor market, with about 40 percent of the workforce in the public sector, up from 31 percent in 2007. Job security and a generous pay structure in the public sector set a high reservation wage and crowd out private employment. As a result, total job creation has been weak, averaging around 1 percent a year. Female participation in the labor force, at only 13 percent, is particularly low compared to international and regional standards. Aggregate labor market indicators also mask large geographical disparity, with official unemployment in some provinces at 20 percent.

21. Over the medium term, demographic trends will put pressure on the labor market. The Fund's labor template, based on conservative assumptions (whole-economy growth projections and average growth-employment elasticity estimates of MENA oil producers), suggests that employment creation in 2013–18 will likely not be strong enough to absorb the 2.1 million total new entrants in the labor force estimated by the International Labor Organization (ILO), leading to a rise in the unemployment rate. These results should be interpreted cautiously given significant data quality issues, but they do underline the need for higher growth or better job-creation strategies to help generate adequate employment.

22. The medium-term projections stress that the current employment model hinging on public-sector employment may soon reach its limits. So far, like other oil-exporting economies in the region, Iraq has relied on the public sector to employ almost half of the labor force, and government hiring has increased at a fast pace (the government hired about 120,000 workers in 2012 alone). Public salaries are in many cases effectively transfers as many employees do not actually work. Moreover, the need to control violence is reflected in the large size of the security forces. The authorities pointed out that the public sector is reaching the limits of absorptive capacity to employ new workers, and that a new model for employment growth is needed. For example, in 2013, the ILO projects about 300,000 new entrants in the labor force, while the authorities expect the public sector to hire about 150,000 new employees, and only 130,000 are projected to be taken in by the private sector.

Figure 13. Unemployment Rate Projections, 2012 — 2018 1/
(In percent)

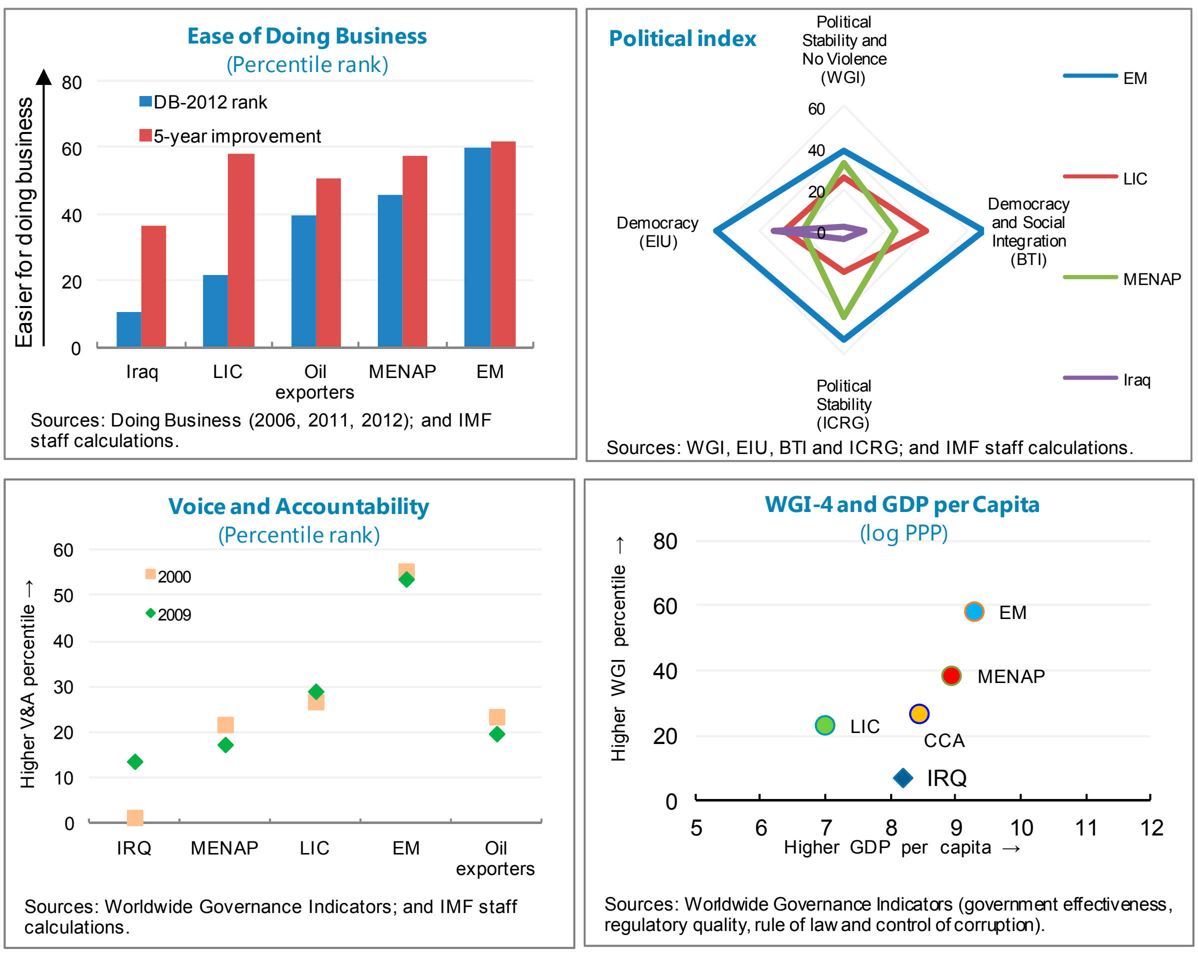


Sources: International Labour Organization; and IMF staff calculations.

1/ 2011 is the latest year with actual data.

23. Private-sector employment creation is hindered by a very weak business environment. Since 2003, the authorities have not undertaken any major reform to create an enabling environment for the private sector. Apart from security problems, red tape is pervasive and governance is poor. The country ranks 165 out of 183 in the World Bank's 2012 Doing Business rankings. Iraq fares particularly badly in starting a business, access to credit, trading across borders, enforcement of contracts, and resolving insolvency. The poor state of infrastructure—particularly the provision of electricity—constitutes a major hurdle for the private sector. Moreover, private companies face competition from the large number of state-owned enterprises—operating in agriculture, manufacturing, and trade—that are generously subsidized and staffed, and enjoy favorable treatment in government contracts and access to public bank financing.

Figure 14. Iraq: Business Environment and Governance



Economic reform agenda

24. Inclusive growth will need progress on the broad economic structural reform agenda. In many aspects, Iraq is still largely a resource-rich transition economy in which the old central planning structure has only been partly dismantled. Ambitious post-2003 reform efforts—exemplified by the International Compact with Iraq—have been only modestly successful. Without progress on the basic reforms, however, Iraq will not be able to promote employment-creating economic activity outside the oil sector and government. Besides the reform of the financial and fiscal sectors,[4] the key areas of the economic agenda include:

- **Energy sector:** A hydrocarbon law has been long delayed mainly because of disagreements between the central government and the KRG. Investment in electricity production, restructuring of electricity producers, and imposition of adequate tariffs are needed. Moreover, distortionary fuel subsidies to producers should be removed.

- **State-owned enterprises:** SOEs absorb large transfers from the government, and many are completely inactive. The authorities should launch a comprehensive triage of SOEs, leading to the operational restructuring, governance reform, and recapitalization of those that can be rehabilitated and the closure of unviable enterprises.

- **Business environment and governance:** Regulation should be streamlined, made more consistent, and focused on assisting, rather than constraining, private-sector operators.

- **Agriculture:** A revival of agricultural production (once one of the mainstays of the Iraqi economy) depends on a reform of the PDS, which has contributed to the decline of domestic production through large food imports.

D. Data Issues

25. Macroeconomic statistics are broadly adequate for surveillance. However, there are significant data gaps and lags in publication, mainly due to capacity constraints, security issues, and lack of coordination with sub-national entities. The authorities are committed to strengthening data quality with the help of Fund technical assistance.

STAFF APPRAISAL

26. Despite a difficult security and political environment, the authorities successfully maintained macroeconomic stability over the past two years. The authorities posted fiscal

[4] For a complete overview of fiscal sector reform, see "Republic of Iraq Public Expenditure Review: Towards More Efficient Spending for Better Service Delivery in Iraq," forthcoming (Washington: World Bank).

surpluses, increased oil exports, kept inflation low, and accumulated sizable external reserves. However, mainly because of limited advance on structural reform and foreign exchange management, progress under the 2010 SBA has been uneven, and only two reviews could be completed.

27. The Iraqi economy has huge potential thanks to its large oil reserves. The challenge is to use the oil wealth to address the economy's weaknesses—including a small non-oil sector, bloated public sector, high unemployment, and a weak business environment—and foster high, sustainable growth and create an enabling environment for the private sector to create jobs needed to improve the living standards of its people. Failure to do so could expose the economy to the harmful effects of the natural resource curse—weak governance, rent-seeking behavior, loss of competitiveness, and a stunted non-oil private sector.

28. Fiscal policies must ensure sustainability and address risks related to oil revenue volatility. Starting in 2013 and over the medium-term, continuous rationalization of current spending, including public employment, energy subsidies, the PDS, and transfers to state-owned enterprises will be needed to create fiscal space to finance investment and accumulate buffers. Sound fiscal planning requires reform of public financial management, notably by introducing IFMIS and a single treasury account, eliminating off-budgetary spending and investment rollovers, and shutting down the quasi-fiscal operations of banks Rafidain and Rasheed.

29. Fiscal rules can provide a framework for fiscal policy. In the first instance, the authorities could establish procedural rules to improve budgeting, including a formula to set oil price assumptions in the budget. Over the medium term, they should aim at building the capacity needed to adopt formal numerical fiscal rules that would de-link oil revenues from the budget.

30. Staff welcomes the CBI's objective to liberalize the foreign exchange market and the recent steps to simplify market regulations. However, staff urges the CBI to take immediate further measures to liberalize fully the supply of foreign exchange, with the objective of lowering the exchange rate spread, removing distortions, eliminating rents, and ultimately complying with Article VIII of the Fund's Articles of Agreement. Staff also encourages the authorities to refrain from introducing any new regulation that could lead to a breach of obligations under Article VIII. In parallel, the authorities need to strengthen the AML/CFT framework in line with MENA/FATF recommendations and FATF standards, to support their efforts to deter money laundering and financing of terrorism. Against this background, staff does not recommend approval of the exchange restrictions and the multiple currency practice listed in the Informational Annex.

31. The stable exchange rate has provided a valuable anchor in an uncertain environment. This policy remains appropriate for the foreseeable future. In the medium term, the authorities should create the conditions that would facilitate moving to a more flexible exchange rate.

32. The current two-tier architecture resting on prudent management of CBI reserves and the use of the DFI as de-facto oil stabilization fund is appropriate. Given the highly uncertain environment and low administrative capacity, staff recommends maintaining a high level of liquid reserves. The authorities should also continue to rely on the DFI—probably Iraq's most successful fiscal institution—to provide oil revenue transparency and help stabilize government spending in the face of oil revenue volatility.

33. Staff welcomes progress in banking sector supervision and state-owned bank restructuring. A stable and secure financial sector is a necessary condition for developing of the private sector and diversifying the economy away from oil. Reform of the state-owned banks should be combined with the development of private banks by ensuring a level-playing field for all banks and more rigorous supervision.

34. Iraq needs sustained high and inclusive growth to reduce poverty and provide opportunities for its population. Growth prospects hinge on implementing a prudent policy mix, enhancing service delivery, rebuilding infrastructure—particularly in electricity—and strengthening the business environment. Boosting the activity of the non-oil private sector is crucial as the employment model based on the public sector is reaching its limits.

35. Efforts are needed to improve the quality and timeliness of economic data, as weaknesses hamper analysis and policy formulation.

36. Staff recommends that the next Article IV Consultation with Iraq take place on the standard 12-month cycle.

Table 1. Iraq: Selected Economic and Financial Indicators, 2010–18

(Quota: SDR 1188.4 million)
(Population: 31.7 million; 2010)
(Poverty rate: 22.9 percent; 2007)
(Main exports: Crude oil)

	2010 Actual	2011 Actual	2012 Prel.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Economic growth and prices									
Real GDP (percentage change)	5.9	8.6	8.4	9.0	9.0	8.3	9.0	8.4	8.3
Non-oil real GDP (percentage change)	9.7	5.7	6.3	6.0	6.0	6.0	6.0	6.0	6.0
GDP per capita (US$)	4,278	5,529	6,305	6,708	7,106	7,501	8,036	8,601	9,229
GDP (in US$ billion)	135.5	180.6	212.5	233.3	254.9	277.4	306.1	337.3	372.4
Oil production (mbpd)	2.38	2.65	2.95	3.33	3.74	4.15	4.66	5.16	5.70
Oil exports (mbpd)	1.91	2.17	2.42	2.70	3.05	3.45	3.85	4.30	4.75
Iraq oil export prices (US$ pb)	74.2	103.6	106.7	102.6	97.6	93.3	90.4	88.7	87.5
Consumer price inflation (percentage change; end of period)	3.3	6.0	3.6	5.0	5.5	5.5	5.5	5.5	5.5
Consumer price inflation (percentage change; average)	2.4	5.6	6.1	4.3	5.5	5.5	5.5	5.5	5.5
Core price inflation (percentage change; end of period)	3.3	7.0	4.2	5.0	5.0	5.0	5.0	5.0	5.0
				(In percent of GDP)					
National Accounts									
Gross domestic investment	21.4	19.3	20.3	21.1	21.5	23.4	24.2	25.1	24.1
Of which: public	15.2	13.0	13.5	14.7	14.6	16.0	16.3	16.6	16.7
Gross domestic consumption	77.9	66.9	70.8	73.2	73.7	72.1	71.7	71.1	72.1
Of which: public	25.2	21.7	21.3	21.6	21.2	21.1	20.7	20.4	20.0
Gross national savings	24.4	31.8	27.3	24.9	24.3	27.3	28.5	29.2	28.2
Of which: public	10.8	17.7	18.1	17.1	17.3	19.5	20.5	20.9	20.9
Saving - Investment balance	3.0	12.5	7.0	3.8	2.9	4.0	4.5	4.1	4.3
				(In percent of GDP, unless otherwise indicated)					
Public Finance									
Government revenue and grants	46.4	49.5	48.2	46.4	45.7	45.5	44.8	44.6	44.1
Government oil revenue	40.0	46.0	44.6	44.4	43.6	43.4	42.5	42.2	41.7
Government non-oil revenue	3.5	2.5	4.1	2.0	2.1	2.2	2.3	2.4	2.4
Grants	2.9	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure, *of which:*	50.7	44.6	44.1	44.8	43.5	42.5	41.2	40.9	40.3
Current expenditure	35.5	31.6	30.6	30.1	28.9	26.6	24.9	24.3	23.6
Capital expenditure	15.2	13.0	13.5	14.7	14.6	16.0	16.3	16.6	16.7
Primary fiscal balance	-3.8	5.6	4.5	2.3	2.8	3.5	4.1	4.1	4.0
Overall fiscal balance (including grants)	-4.3	4.9	4.1	1.6	2.2	3.0	3.6	3.7	3.8
Non-oil primary fiscal balance (percent of non-oil GDP)	-76.0	-84.6	-73.1	-73.6	-69.1	-68.3	-64.9	-62.7	-60.2
Memorandum items:									
Tax revenue/non-oil GDP (in percent)	1.8	1.9	2.3	2.0	2.1	2.1	2.2	2.2	2.3
Development Fund of Iraq (in US$ billions)[1]	7.4	16.5	18.1	18.9	21.9	27.8	37.4	48.4	61.2
Total government debt (in US$ billions)[2]	70.8	73.4	74.1	40.4	36.6	33.1	30.1	27.2	24.3
o/w external debt (in US$ billion)	60.9	61.0	60.2	27.8	25.5	23.5	22.1	20.7	19.3
				(In percent, unless otherwise indicated)					
Monetary indicators									
Growth in reserve money	15.2	9.9	9.2	7.7	8.7	15.7	10.6	9.2	11.0
Growth in broad money	14.8	38.0	4.1	13.8	9.3	8.8	10.4	10.2	10.4
Policy interest rate (end of period)	6.0	6.0	6.0	…	…	…	…	…	…
				(In percent of GDP, unless otherwise indicated)					
External sector									
Current account	3.0	12.5	7.0	3.8	2.9	4.0	4.5	4.1	4.3
Trade balance	6.6	18.8	14.8	12.4	11.8	11.4	10.9	10.5	10.6
Exports of goods	37.9	44.1	44.3	43.5	42.8	42.6	41.7	41.5	41.0
Imports of goods	-31.3	-25.3	-29.5	-31.1	-31.0	-31.2	-30.8	-31.0	-30.4
Overall external balance	1.7	10.5	5.1	4.6	3.4	4.4	4.8	4.4	4.6
Gross reserves (in US$ billion)	50.6	61.1	70.3	80.1	84.9	90.5	95.5	99.3	103.7
In months of imports of goods and services	10.6	9.5	9.3	9.7	9.4	9.2	8.8	8.4	8.1
Exchange rate (dinar per US$; period average)	1,170	1,170	1,166	…	…	…	…	…	…
Real effective exchange rate (percent change; end of period)	1.3	4.7	5.7	…	…	…	…	…	…

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

[1] Excluding escrow account held abroad to purchase military equipment.
[2] Assumes a debt reduction in 2013 by non-Paris Club official creditors, comparable to the Paris Club agreement.

Table 2. Iraq: Central Government Fiscal Accounts, 2010–18

(In trillions of ID; unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenues and grants	73.6	104.6	119.4	126.1	135.8	147.3	159.9	175.4	191.6
Revenues	68.9	102.4	119.4	126.1	135.8	147.3	159.9	175.4	191.6
Crude oil export revenues	59.9	93.4	109.4	117.9	126.7	137.0	148.0	162.3	176.9
Grants	4.7	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	80.3	94.3	109.4	121.8	129.3	137.6	147.0	161.0	175.0
Current expenditures	56.2	66.8	75.8	81.8	85.9	85.9	89.0	95.7	102.7
Salary and pension	28.9	33.9	34.9	41.0	44.7	48.7	53.7	59.2	65.4
Salary	22.6	27.0	28.5	32.9	36.0	39.2	43.2	47.6	52.6
Pension	6.3	6.9	6.4	8.0	8.8	9.5	10.5	11.6	12.8
Goods and services	11.0	12.0	17.5	17.6	18.1	19.1	19.8	20.6	21.4
Transfers	12.5	14.7	16.6	15.2	14.6	14.0	13.5	14.1	14.8
Social safety net (including PDS)	6.3	8.0	6.7	6.7	6.8	7.3	7.9	8.6	9.3
Transfers to SOEs[1]	3.3	3.8	2.9	2.5	2.5	2.5	2.5	2.5	2.5
Other transfers	2.9	2.9	7.1	6.0	5.3	4.2	3.1	3.0	3.0
Interest payments	0.8	1.6	1.0	1.9	1.8	1.7	1.7	1.6	0.8
War reparations[2]	3.0	4.6	5.5	5.9	6.3	2.1	0.0	0.0	0.0
Contingency	0.1	0.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Investment expenditures	24.1	27.4	33.6	40.0	43.3	51.7	58.0	65.3	72.4
Balance (including grants)	-6.8	10.3	10.1	4.3	6.5	9.6	12.9	14.4	16.5
Balance (excluding grants)	-11.4	8.2	10.1	4.3	6.5	9.6	12.9	14.4	16.5
Statistical discrepancy	-0.8	-3.3	-1.1	…	…	…	…	…	
Financing, *of which:*	7.6	-7.0	-9.0	-4.3	-6.5	-9.6	-12.9	-14.4	-16.5
External financing	4.6	-11.2	-3.6	-2.5	-5.9	-9.0	-12.3	-13.8	-15.9
Assets held abroad	2.8	-10.6	-1.8	-0.9	-3.6	-7.0	-11.2	-12.9	-14.9
Project financing	0.2	0.3	0.0	0.9	0.7	0.4	0.4	0.4	0.4
Other financing[3]	2.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.7	-1.5	1.8	-2.5	-3.0	-2.5	-1.5	-1.4	-1.5
Domestic financing	3.0	4.2	-5.4	-1.8	-0.6	-0.6	-0.6	-0.6	-0.6
Memorandum items:									
Security-related expenditure (military and police equipment and salaries)	11.4	9.4	16.7	16.9	18.0	19.6	21.7	23.9	26.4
Primary fiscal balance	-6.0	11.9	11.1	6.2	8.4	11.4	14.6	16.0	17.3
Non-oil primary fiscal balance	-64.6	-83.8	-94.8	-94.3	-98.2	-108.6	-115.4	-124.6	-133.9
External assets held abroad (excluding military equipment escrow accounts)	8.7	19.3	21.1	22.0	25.6	32.5	43.8	56.7	71.6
External assets held abroad in mos. of salaries and pensions	3.9	7.6	6.2	5.9	6.3	7.3	8.9	10.4	12.0
Average Iraq oil export price (US$/bbl)	74.2	103.6	106.7	102.6	97.6	93.3	90.4	88.7	87.5
Crude oil exports	1.85	2.04	2.28	2.70	3.05	3.45	3.85	4.30	4.75

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

[1] For 2010-2013, includes off-budget transfers to SOEs financed by Bank Rafidain.
[2] Five percent of oil exports as mandated by U.N. Security Council Resolution 1483 to finance war reparations to Kuwait until 2015.
[3] Includes the $250 million Development Policy Loan from the World Bank and the IMF 2010–11 SBA disbursements.

Table 3. Iraq: Central Government Fiscal Accounts, 2010–18

(In percent of GDP; unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Actual	Actual	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenues and grants	46.4	49.5	48.2	46.4	45.7	45.5	44.8	44.6	44.1
Revenues	43.5	48.5	48.2	46.4	45.7	45.5	44.8	44.6	44.1
Crude oil export revenues	37.8	44.2	44.2	43.3	42.6	42.4	41.5	41.3	40.7
Grants	2.9	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	50.7	44.6	44.1	44.8	43.5	42.5	41.2	40.9	40.3
Current expenditures	35.5	31.6	30.6	30.1	28.9	26.6	24.9	24.3	23.6
Salary and pension	18.2	16.0	14.1	15.1	15.1	15.1	15.1	15.1	15.1
Salary	14.3	12.8	11.5	11.8	12.1	12.1	12.1	12.1	12.1
Pension	3.9	3.2	2.6	2.6	2.9	2.9	2.9	2.9	2.9
Goods and services	6.9	5.7	7.1	6.5	6.1	5.9	5.6	5.2	4.9
Transfers	7.9	7.0	6.7	5.6	4.9	4.3	3.8	3.6	3.4
Social safety net	4.0	3.8	2.6	2.5	2.3	2.3	2.2	2.2	2.2
Transfers to SOEs[1]	2.1	1.8	1.6	0.9	0.8	0.8	0.7	0.6	0.6
Other transfers	1.8	1.4	2.9	2.2	1.8	1.3	0.9	0.8	0.7
Interest payments	0.5	0.7	0.4	0.7	0.6	0.5	0.5	0.4	0.2
War reparations[2]	1.9	2.2	2.2	2.2	2.1	0.7	0.0	0.0	0.0
Investment expenditures	15.2	13.0	13.5	14.7	14.6	16.0	16.3	16.6	16.7
Balance (including grants)	-4.3	4.9	4.1	1.6	2.2	3.0	3.6	3.7	3.8
Balance (excluding grants)	-7.2	3.9	4.1	1.6	2.2	3.0	3.6	3.7	3.8
Statistical discrepancy	-0.5	-1.6	-0.4	…	…	…	…	…	…
Financing, of which:	4.8	-3.3	-3.6	-1.6	-2.2	-3.0	-3.6	-3.7	-3.8
External financing	2.9	-5.3	-1.4	-0.9	-2.0	-2.8	-3.4	-3.5	-3.7
Assets held abroad	1.8	-5.0	-0.7	-0.3	-1.2	-2.2	-3.1	-3.3	-3.4
Project financing	0.1	0.1	0.0	0.3	0.2	0.1	0.1	0.1	0.1
Other financing[3]	1.5	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.5	-0.7	0.7	-0.9	-1.0	-0.8	-0.4	-0.4	-0.3
Domestic financing	1.9	2.0	-2.2	-0.7	-0.2	-0.2	-0.2	-0.2	-0.1
Memorandum items:									
Security-related expenditure (military and police equipment and salaries)	7.2	4.4	6.7	6.2	6.1	6.1	6.1	6.1	6.1
Primary fiscal balance	-3.8	5.6	4.5	2.3	2.8	3.5	4.1	4.1	4.0
Current expenditures (percent of non-oil GDP)	66.2	70.3	65.8	63.8	60.0	53.6	49.6	47.8	45.8
Non-oil primary fiscal balance (percent of non-oil GDP)	-76.0	-84.6	-73.1	-73.6	-68.6	-67.8	-64.4	-62.2	-59.7

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

[1] For 2010-2013, includes off-budget transfers to SOEs financed by Bank Rafidain.
[2] Calculated as 5 percent of oil exports as per U.N. Security Council Resolution 1483 to finance war reparations to Kuwait until 2015.
[3] Includes the $250 million Development Policy Loan from the World Bank and the IMF 2010–11 SBA disbursements.

Table 4. Iraq: Central Bank Balance Sheet, 2010–13

(In billions of Iraqi dinars, unless otherwise indicated)

	2010	2011	2012				2013
	Dec.	Dec.	Mar. Prel.	Jun. Prel.	Sep. Prel	Dec. Prel.	Dec. Proj.
Net foreign exchange assets 1/	57,191	69,374	65,736	73,186	69,397	79,962	91,331
Foreign exchange assets	59,239	71,411	67,777	75,190	71,443	82,001	93,368
Gold	311	347	366	352	1,983	1,858	1,858
Other	58,928	71,063	67,411	74,838	69,460	80,143	91,510
Foreign exchange liabilities	-2,048	-2,037	-2,041	-2,004	-2,046	-2,039	-2,037
		0					
Net domestic assets	-2,451	-9,219	-7,903	-10,567	-7,834	-14,299	-20,617
Domestic assets	2,049	-2,382	765	-3,660	329	-3,618	-3,618
Net claims on general government	2,045	-2,386	761	-3,665	325	-3,622	-3,622
Holdings of treasury bills	3,236	3,236	3,236	3,236	3,236	3,156	3,156
Holdings of discounted treasury bills	733	325	325	120	120	0	0
Overdrafts	0	0	0	0	0	0	0
Domestic currency deposits	-1,384	-5,563	-2,515	-6,044	-2,982	-5,529	-5,529
Foreign currency deposits	-540	-385	-286	-977	-49	-1,249	-1,249
Claims on nonbank public institutions	0	0	0	0	0	0	0
Claims on commercial banks	4	4	4	4	4	4	4
Monetary policy instruments 2/	-1,467	-2,972	-4,067	-4,051	-3,742	-3,866	-10,184
Of which: CBI bills	-396	-496	-888	-889	-1,333	-745	…
Other items net	-3,033	-3,865	-4,601	-2,855	-4,421	-6,815	-6,815
Reserve money	54,740	60,155	57,833	62,619	61,563	65,663	70,714
Currency issued	27,507	32,157	33,195	34,539	36,199	35,785	41,262
Bank reserves	27,232	27,998	24,638	28,080	25,363	29,878	29,452
Memorandum items							
Reserve money (annual growth, in percent)	15.2	9.9	16.9	14.3	8.8	9.2	7.7
Currency issued (annual growth, in percent)	13.8	16.9	17.2	18.4	19.3	11.3	15.3
Gross foreign exchange assets (in millions of U.S. dollars)	50,639	61,085	58,127	64,485	61,272	70,327	80,076
Foreign exchange liabilities (in millions of U.S. dollars)	-1,757	-1747	-1,750	-1,719	-1,755	-1,749	-1,747
Net foreign exchange assets (in millions of U.S. dollars)	48,883	59,338	56,377	62,766	59,517	68,578	78,328
Gross foreign exchange assets/reserve money (in percent)	108.2	118.8	117.2	120.1	116.0	124.9	132.0
Exchange rate (end of period)	1170.0	1170.0	1166.0	1166.0	1166.0	1166.0	…
Policy interest rate (in percent)	6.0	6.0	6.0	6.0	6.0	6.0	…

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

1/ Valued at market exchange rates.
2/ This mainly represents the ID and US$ overnight standing deposit facilities and CBI bills.

Table 5. Iraq: Monetary Survey, 2010–13

(In billions of Iraqi dinars, unless otherwise indicated)

	2010	2011	2012				2013
	Dec.	Dec.	Mar. Prel.	Jun. Prel.	Sep. Prel.	Dec. Prel.	Dec. Proj.
Net foreign assets	64,319	71,759	70,473	77,506	74,975	85,930	97,298
Of which: CBI	57,191	69,374	65,736	73,186	69,397	79,962	91,331
Net domestic assets	-10,661	2,285	3,007	-5,108	-1,555	-8,842	-9,550
Domestic claims	-4,628	-1,408	2,440	-5,310	-742	-5,343	-3,763
Net claims on general government	-11,964	-14,019	-11,414	-20,122	-16,704	-25,731	-27,506
Claims on general government	12,292	15,939	15,624	16,581	18,473	14,765	…
less: Liabilities to general government	-24,255	-29,958	-27,038	-36,703	-35,178	-40,496	…
Claims on other sectors	7,336	12,611	13,854	14,812	15,962	20,388	23,743
Other Item Net (OIN)	-6,034	3,693	567	202	-813	-3,499	-5,787
Broad money	53,658	74,044	73,481	72,399	73,419	77,088	87,748
Currency outside banks	24,342	28,296	29,141	30,701	29,985	30,594	34,686
Transferable deposits	22,777	37,992	36,193	33,440	34,459	37,059	39,797
Other deposits	6,539	7,756	8,146	8,258	8,975	9,435	13,266
Memorandum items							
Broad money (percentage growth)	14.8	38.0	31.3	13.9	10.8	4.1	13.8
M2 velocity (ratio)	3.0	2.9	3.4	3.4	3.4	3.2	3.1
Credit to the economy (percentage growth)	42.8	71.9	50.2	48.8	54.9	61.7	16.5
Credit to the economy (as a percentage of non-oil GDP)	8.6	13.3	12.0	12.9	13.9	17.7	18.5

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

Table 6. Iraq: Balance of Payments, 2010–18

(In billions of U.S. dollars; unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Prel.	Projections					
Trade balance	9.0	33.9	31.5	29.0	30.0	31.5	33.4	35.5	39.4
(In percent of GDP)	6.6	18.8	14.8	12.4	11.8	11.4	10.9	10.5	10.6
Exports	51.4	79.6	94.1	101.6	109.1	118.1	127.6	139.9	152.6
Crude oil	51.2	79.4	93.8	101.1	108.6	117.5	127.0	139.2	151.7
Other exports	0.2	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9
Imports	-42.4	-45.7	-62.6	-72.6	-79.1	-86.6	-94.2	-104.5	-113.2
Private sector imports	-27.8	-29.6	-39.3	-42.2	-47.4	-50.0	-55.2	-63.1	-68.3
Government imports	-14.7	-16.1	-23.3	-30.3	-31.7	-36.6	-39.0	-41.4	-44.9
Services, net	-7.9	-9.0	-12.6	-15.6	-17.3	-18.9	-20.5	-22.7	-24.4
Receipts	2.8	2.8	2.0	2.2	2.5	2.8	3.1	3.4	3.8
Payments	-10.8	-11.8	-14.6	-17.8	-19.8	-21.6	-23.5	-26.1	-28.3
Income, net 1/	1.6	-0.2	0.6	0.6	0.2	0.5	0.7	1.0	1.3
Transfers, net	1.5	-2.1	-4.7	-5.1	-5.4	-2.0	0.0	0.0	0.0
Private, net	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official, net	1.4	-2.3	-4.6	-5.1	-5.4	-2.0	0.0	0.0	0.0
Current account	4.1	22.5	14.9	8.9	7.5	11.2	13.7	13.8	16.2
(In percent of GDP)	3.0	12.5	7.0	3.8	2.9	4.0	4.5	4.1	4.3
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	3.1	2.6	-1.0	1.8	1.1	1.0	1.0	1.0	1.0
Direct and portfolio investment (net)	1.4	1.9	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Other capital, net	1.8	0.8	-3.0	-0.2	-0.9	-1.0	-1.0	-1.0	-1.0
Official, net	0.4	-0.4	-0.5	-0.2	-0.9	-1.0	-1.0	-1.0	-1.0
Assets	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	0.4	-0.2	-0.5	-0.2	-0.9	-1.0	-1.0	-1.0	-1.0
Disbursements	0.4	0.2	0.3	0.6	0.5	0.4	0.4	0.4	0.4
Amortization	0.0	-0.4	-0.8	-0.8	-1.4	-1.4	-1.4	-1.4	-1.4
Private, net	1.4	1.1	-2.4	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-4.9	-6.1	-3.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.3	19.0	10.8	10.7	8.6	12.2	14.7	14.8	17.2
(In percent of GDP)	1.7	10.5	5.1	4.6	3.4	4.4	4.8	4.4	4.6
Financing	-2.3	-19.0	-10.8	-10.7	-8.6	-12.2	-14.7	-14.8	-17.2
Development Fund for Iraq (increase -)	2.5	-9.1	-1.6	-0.8	-3.0	-6.0	-9.6	-11.0	-12.7
Central bank's Gross International Reserves (increase -)	-6.3	-10.4	-9.2	-9.7	-4.8	-5.6	-5.0	-3.7	-4.4
Fund credit (net)	1.2	0.5	0.0	-0.2	-0.8	-0.6	-0.1	0.0	0.0
Deferred accrued interest 2/	0.2	…	…	…	…	…	…	…	…
Memorandum items:									
Development Fund for Iraq balance (end of period)	7.4	16.5	18.1	18.9	21.9	27.8	37.4	48.4	61.2
Central bank's Gross International Reserves (end of period)	50.6	61.1	70.3	80.1	84.9	90.5	95.5	99.3	103.7
(in months of imports of goods and services)	10.6	9.5	9.3	9.7	9.4	9.2	8.8	8.4	8.1
GDP	135.5	180.6	212.5	233.3	254.9	277.4	306.1	337.3	372.4
Of which: Non-oil GDP	72.6	81.3	98.7	109.9	122.9	137.4	153.7	171.8	192.2

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

1/ Includes interest accrued, deferred, and capitalized.
2/ Estimate of accrued interest on existing stock of debt prior to the implementation of the Paris Club agreement.

Appendix I. Iraq: External Sector Analysis

The balance of payments is dominated by strong oil exports, leading to increasingly large foreign assets and a likely positive net international investment position. The main vulnerabilities stem from the dependence on oil exports and exposure to oil market volatility. The oil sector is very competitive, unlike the small non-oil tradable sector. The exchange rate is broadly in line with fundamentals.

The balance of payments

1. **The current account balance is in a structural surplus, owing to large and rapidly growing oil exports.** The current account surplus, exclusively driven by oil exports, averaged 6 percent of GDP over 2005–12. These surpluses enable the current generation to share the benefits of current oil production with future generations. The main risk for the current account balance is volatility in oil revenues (export volumes and prices).

2. **The financial balance is in a structural small surplus.** The financial balance averaged 4 percent of GDP over 2005–12 driven by government borrowing, which is projected to taper off from 2012 onwards.

3. **Large errors and omissions point to possible unrecorded capital outflows.** Errors and omissions have been generally negative, averaging -3 percent of GDP over the 2005–12 period. Errors and omissions of this size can be expected in an economy with limited data and administrative capacity, and the negative sign suggests that private sector capital outflows might be unrecorded.

4. **The international investment position is estimated to be positive and improving.** The overall balance of payments surpluses have made possible the build-up of significant financial assets abroad both in the DFI and in the form of international reserves of the CBI. As of end-2011, authorities' data show a positive international investment position of about $13 billion. While more recent data are not available, with public sector foreign financial assets close to $90 billion, commercial banks' net asset position of around $5 billion, and external debt of $60 billion (excluding possible late interest on unrestructured debt, mainly to Golf Cooperation Council (GCC) countries, the net international investment position is likely to have strengthened at end-2012.[1] The investment position should continue improving given the projection of rising external reserves and possible external debt restructuring.

[1] In the absence of recent official data, the net international investment position is estimated using cumulative balance of payments data.

Iraq: Reserve Adequacy, 2012-18
(In units indicated)

	2012	2013	2014	2015	2016	2017	2018
Reserves in USD billion	**70.3**	**80.1**	**84.9**	**90.5**	**95.5**	**99.3**	**103.7**
Reserves in months of imports	9.3	9.7	9.4	9.2	8.8	8.4	8.1
Reserves in percent of debt service coming due 1/	4,632	3,104	3,444	3,766	4,075	4,345	4,540
CBI NFA in percent of reserve money	121.8	129.2	127.3	125.1	119.9	113.4	107.1
CBI NFA in percent of broad money	103.7	104.1	102.1	100.7	96.4	91.0	86.1

1/ Excluding short term debt.

Adequacy of international reserves

5. CBI reserves are adequate. The central bank's international reserves of $70 billion at end-2012 (about one-third of GDP) are adequate for balance of payments stability, as indicated by various measures of adequacy which are met with large margins. The extra buffer is appropriate in light of the exceptional political and security risks in the country and in the region and the dependence on a single source of balance of payments revenues. The staff's alternative scenario, simulating a 15 percent drop in oil prices below the baseline in 2013, shows that CBI reserves would be adequate to absorb a shock of this magnitude. CBI reserves would remain at 2013 levels through end-2015, after which reserve accumulation would resume at broadly the same pace as in the baseline scenario.

6. Various simple metrics can be used to assess adequacy:

- **Months of imports**: The ability to finance the economy's imports in the case of a shortfall in exports is reflected in reserves expressed in months of imports of goods and services. The nine months of end-2012 CBI reserves is well above the rule of thumb of a minimum of three months of imports.

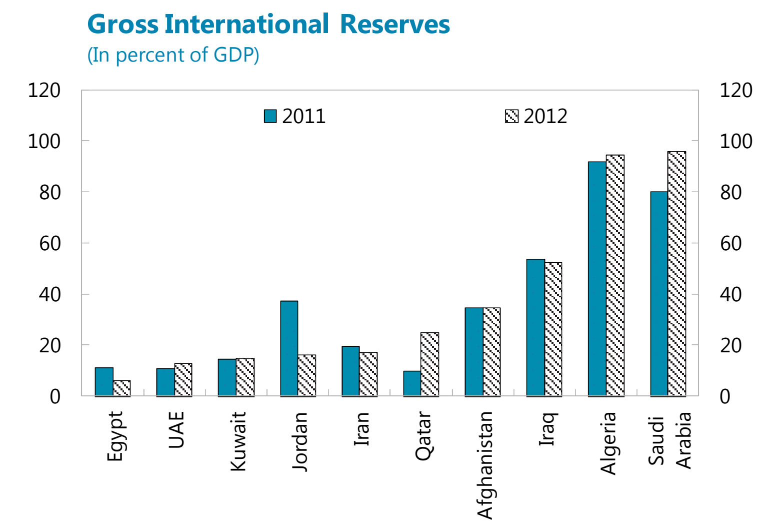
- **Greenspan-Guidotti rule**: The rule suggests holding at least the equivalent of all obligations falling in one year. In the case of Iraq, government obligations in the form total foreign debt payments due, which amount to $1.5 billion in 2013, resulting in a ratio of reserves to debt service of 4600.[2]

- **Monetary measures:** Particularly in countries with open capital accounts, the reserve coverage of the monetary base is useful to reflect the foreign exchange demand potentially arising from the conversion of commercial bank deposits. The coverage of foreign exchange deposits indicates the capacity to meet the banking system's liquidity needs in case of a crisis. In Iraq, owing to the high level of reserves and the limited

[2] Debt service on short term debt is excluded owing to lack of data. Adding government imports for 2013 (which are paid by the DFI directly), annual obligations would increase to about $38 billion.

financial development, end-2012 CBI net foreign exchange reserves covered 122 percent of reserve money and 104 percent of broad money, or approximately four times foreign exchange deposits. In principle, therefore, the CBI reserves would be enough to cover the complete dollarization of the economy. Additionally, a large part of deposits are owned by government agencies and state-owned enterprises, making them less vulnerable to confidence crises.

- **Comparison with peers**: A regional cross-country comparison shows that the current level of reserves as a percentage of GDP is comparable to its closest peers.



Sources: Country authorities; and IMF staff estimates.

Exchange rate developments and assessment

7. The real effective exchange rate has appreciated over the last three years. Since the 2009 Article IV consultation (from end-2009 to end-2012), the real and nominal effective exchange rates have appreciated 12 and 7 percent respectively. Higher inflation in Iraq relative to its trading partners has contributed to a 5 percent real appreciation over this period. As a result of this dynamics, the real effective exchange rate was at end-2012 at about the level of end-2008. With the central bank the main source of funds to the foreign exchange market, foreign exchange auction regulations have led to a widening of the spread between the official and parallel foreign exchange rates from mid-2011 onwards. Using parallel market foreign exchange rates, the real appreciation from end-2009 to end-2012 was 8 percent. The share of foreign currency transacted on the parallel market has varied over time, but it is likely to be relatively small. The weighted real effective exchange rate is therefore likely to be closer to the rate based on the official exchange rate than that based on the parallel market exchange rate.

8. Competitiveness is mixed:

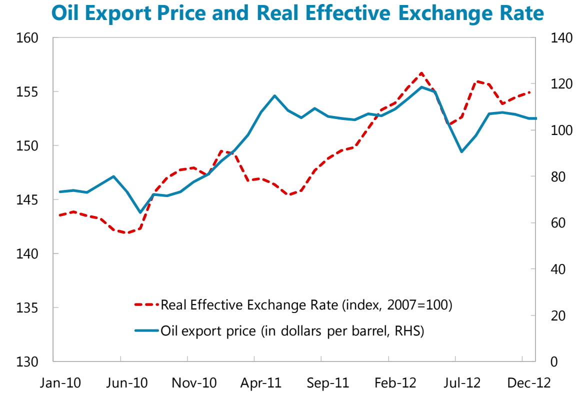
- The oil sector is extremely competitive as the cost of producing oil—below $5 per barrel--is among the lowest in the world. At these levels, neither the real exchange rate level (which in any case has a limited impact on production costs) nor international oil price volatility has any effect on the oil sector's competitiveness.

- In contrast, the internationally-contestable segment of the non-oil sector is uncompetitive, as shown by the lack of any non-oil export sector and the extreme dependence on imports for consumption and investment goods. Even food products are mostly imported, despite the past importance of agriculture as source of exports. However, it is not likely that a more depreciated exchange rate would increase non-oil tradable sector due to the much deeper problems arising from inadequate public sector service delivery (e.g., security, electricity, and rule of law) as well as aggressive public sector hiring, which drives up reservation wages of certain categories of skilled labor.

9. **A quantitative assessment of the real exchange rate using the CGER methodology is problematic.** Applying the quantitative methodology is restricted by data limitations. Furthermore, given Iraq's turbulent recent history, it is difficult to anchor the analysis to a recent representative period where broad macroeconomic aggregates, including the real exchange rate, were in equilibrium. Of the three standard Consultative Group on Exchange Rates (CGER)-methodologies (macroeconomic balance approach, equilibrium real exchange approach, and the external sustainability approach), these constraints limit a quantitative analysis to the external sustainability approach.

10. **The external sustainability approach confirms the broad alignment of the exchange rate with fundamentals.** Estimates using this methodology suggest that the current account norm is a surplus of 3 percent of GDP. In comparison, under the staff's baseline medium term baseline projection, the average current account surplus is 4 percent of GDP. Therefore, the estimated undervaluation of the real exchange rate is close to 10 percent. Given the large margins of errors, these calculations suggest that the real exchange rate is in line with economic fundamentals.

Oil Export Price and Real Effective Exchange Rate



Source: IMF staff calculations.

11. **In the medium term, the increase in oil revenues might lead to an appreciation of the real exchange rate.** In the short run, a major determinant of the real exchange rate is the international price of oil. During 2009 the oil price collapse forced a depreciation of the real exchange rate. As oil prices subsequently recovered, so did the real exchange rate. In a medium term perspective, the real exchange rate is also heavily influenced by the level of oil production in addition to the international oil price. As oil production is currently ramping up, the equilibrium real exchange rate may be appreciating notwithstanding the weakening of oil prices. On the other hand, the current spread between the official and parallel exchange rates may be suggestive of underlying fragilities that could warrant a real depreciation of the official rate.

Appendix II. Risk Assessment Matrix

Nature/Source of Threat	Likelihood of Realization in the Next Three Years	Expected Impact on Economy if Risk is Realized
Inadequate policy implementation, particularly in the fiscal sector, foreign exchange management, and management of CBI reserves (particularly if CBI independence is undermined). *(Short term)*	**Staff assessment: High**	**Staff assessment: High** - Large increases in current spending would lead to monetary financing of the fiscal deficit and use of central bank reserves for fiscal purposes (which is currently forbidden by law), and possibly higher inflation and currency depreciation. - Intervention in foreign exchange auctions results in a shortage of foreign exchange and lack of confidence in the CBI's ability to support the exchange rate which ultimately would lead to pressures to depreciate the dinar.
Deteriorating political and security situation, both domestically and regionally. *(Short term)*	**Staff assessment: High**	**Staff assessment: High** - Political uncertainty is accompanied by higher violence levels, including attacks on oil infrastructure, leading to lower rise in oil production capacity and exports. - Worsening security results in a lower growth rate of the non-oil sector. - As oil accounts for over 90 percent of government revenues, lower oil exports and higher security spending lead to a worsening in the fiscal stance.

Delays in developing Iraq's oil fields and oil export capacity due to worsening security, political instability or technical factors (especially export bottlenecks). *(Medium term)*	**Staff assessment: Medium**	**Staff assessment: High** - Lack of progress in building export infrastructure results in lower fiscal revenue. - A fiscal crisis may ensue in case worsening security lowers oil exports significantly and the government does not cut spending. - Inability to implement fiscal consolidation may lead to an exchange rate depreciation.
Oil price decline triggered by a deeper than expected slowdown in Emerging Markets (synchronized shock triggered by financial sector stresses or setbacks in fiscal and structural reforms). *(Short term)*	**Staff assessment: Medium**	**Staff assessment: High** - As oil revenues account for over 90 percent of government revenues, a sharp decline in oil prices results in lower fiscal revenues. - A fiscal crisis may ensue in case the government does not cut spending and may lead to an exchange rate depreciation.

Appendix III. Iraq: Debt Sustainability Analysis

1. **Iraq's external debt burden continues to ease owing to progress in regularizing Saddam-era external claims.** As of end-2012, total external debt was $60 billion (28 percent of GDP). In 2010, an agreement with China extinguished $6.7 billion out of total claims of $8.5 billion and rescheduled the remainder balance on terms broadly comparable to those of the Paris Club. In 2011, $0.1 billion of small claim commercial debt (i.e., original individual claims below $35 million) was extinguished through deep-discount buy-back operations and in 2012 Algeria agreed to cancel fully its claims of $0.4 billion. With these operations, an estimated $42 billion of claims to non-Paris Club bilaterals and small claim commercial creditors remains to be restructured.

2. **As of end-2012, total restructured and new external debt amounted to $18.2 billion (8.5 percent of GDP).** Current and prospective disbursements are fairly limited (the World Bank and Japan International Cooperation Agency are the main partners) and it is expected that net external public sector financing remain negative over the medium term. Under the staff's baseline scenario, it is assumed that remaining previous-regime bilateral claims are regularized and rescheduled on Paris Club-comparable terms in 2013 and remaining small claim commercial debt are bought back in 2014. By end-2018, total debt is projected to be $20.9 billion (5.6 percent of GDP).

3. **External debt service is projected at about $2–3 billion annually over the medium term.** The debt service to exports ratio will double from 1.5 percent in 2013 to 3 percent in 2014 owing to repurchases to the Fund and assuming the regularization of remaining previous-regime debt. Thereafter, the debt service ratio will gradually revert back to 1.5 percent. The debt service ratio is vulnerable to an oil price or oil production shock, which would have to be extraordinarily large to compromise the capacity to service timely the debt given Iraq's large reserves.

4. **The public sector's total domestic obligations have increased significantly since 2009, but so have its domestic financial assets.** Total obligations increased from ID 5.2 trillion at end-2009 to ID 16.2 trillion at end-2012 (6.5 percent of GDP). The obligations are composed of (1) T-bills held by the banking system and bank loans totaling ID 7.5 trillion; and (2) government-guaranteed loans by state-owned banks to state-owned enterprises totaling ID 8.6 trillion. Given the financial difficulties in the state-owned enterprise sector, the likelihood that these guarantees will be called is very high. Public sector commercial bank deposits—ID 40.5 trillion at end-2012—exceed comfortably the stock of government- and government-guaranteed financial liabilities.

5. **Domestic debt service is projected at about ID 2 trillion annually over the medium term.** Under the staff's baseline scenario—which assumes the rolling over of T-bills, and no new borrowing and issuance of government-guaranteed loans—domestic obligations will decline to just ID 5.7 trillion (1.3 percent of GDP) by end–2018.

Appendix Table 1. Iraq: External Debt Sustainability Framework, 2008–2018

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**72.6**	**80.4**	**45.0**	**33.8**	**28.3**			**11.9**	**10.0**	**8.6**	**7.5**	**6.5**	**5.6**	**-0.7**
Change in external debt	-39.4	7.8	-35.4	-11.2	-5.4			-16.4	-1.9	-1.4	-1.2	-1.0	-0.9	
Identified external debt-creating flows (4+8+9)	-50.6	19.9	-18.1	-24.7	-13.0			-7.0	-4.7	-5.5	-5.8	-5.2	-5.4	
Current account deficit, excluding interest payments	-16.6	3.9	-6.3	-15.3	-9.9			-4.8	-4.1	-5.0	-5.1	-4.6	-4.8	
Deficit in balance of goods and services	-11.5	11.6	-0.8	-13.8	-8.9			-5.7	-5.0	-4.6	-4.2	-3.8	-4.0	
Exports	48.3	36.4	40.0	45.7	45.2			44.5	43.8	43.6	42.7	42.5	42.0	
Imports	36.8	48.0	39.3	31.9	36.3			38.7	38.8	39.0	38.5	38.7	38.0	
Net non-debt creating capital inflows (negative)	-1.4	-1.4	-1.0	-1.0	-0.9			-0.9	-0.8	-0.7	-0.7	-0.6	-0.5	
Automatic debt dynamics 1/	-32.6	17.4	-10.8	-8.5	-2.1			-1.4	0.2	0.3	-0.1	0.0	0.0	
Contribution from nominal interest rate	3.8	4.4	3.3	2.8	2.9			0.9	1.2	1.0	0.6	0.5	0.5	
Contribution from real GDP growth	-5.0	-5.0	-3.9	-2.9	-2.4			-2.3	-1.0	-0.8	-0.7	-0.6	-0.5	
Contribution from price and exchange rate changes 2/	-31.4	17.9	-10.3	-8.3	-2.7			…	…	…	…	…	…	
Residual, incl. change in gross foreign assets (2-3) 3/	11.2	-12.2	-17.2	13.5	7.6			-9.4	2.8	4.1	4.7	4.3	4.5	
External debt-to-exports ratio (in percent)	150.4	220.9	112.4	74.0	62.6			26.7	22.9	19.8	17.5	15.2	13.3	
Gross external financing need (in billions of US dollars) 4/	-16.2	9.3	-4.1	-22.1	-13.8			-7.6	-5.2	-9.3	-12.4	-12.6	-15.0	
in percent of GDP	-12.3	8.3	-3.0	-12.2	-6.5			-3.3	-2.0	-3.4	-4.0	-3.7	-4.0	
Scenario with key variables at their historical averages 5/						8-Year Historical Average	8-Year Standard Deviation	**11.9**	**-0.1**	**-9.5**	**-17.4**	**-24.7**	**-31.0**	**3.9**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	6.6	5.8	5.9	8.6	8.4	6.4	2.7	9.0	9.0	8.3	9.0	8.4	8.3	
GDP deflator in US dollars (change in percent)	39.0	-19.8	14.6	22.8	8.5	18.6	18.6	0.7	0.2	0.5	1.2	1.6	2.0	
Nominal external interest rate (in percent)	5.0	5.2	5.0	8.2	10.2	6.2	2.0	3.7	10.8	11.1	7.7	7.9	7.8	
Growth of exports (US dollar terms, in percent)	64.3	-36.1	33.5	52.0	16.6	27.9	29.8	7.9	7.6	8.3	8.1	9.7	9.1	
Growth of imports (US dollar terms, in percent)	63.2	10.6	-0.6	8.1	34.2	17.4	23.1	17.0	9.5	9.4	8.8	10.9	8.4	
Current account balance, excluding interest payments	16.6	-3.9	6.3	15.3	9.9	11.6	7.6	4.8	4.1	5.0	5.1	4.6	4.8	
Net non-debt creating capital inflows	1.4	1.4	1.0	1.0	0.9	1.0	0.4	0.9	0.8	0.7	0.7	0.6	0.5	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix Table 2. Iraq: Public Sector Debt Sustainability Framework, 2008–2018

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	71.6	84.3	52.2	40.6	34.9	**17.3**	**14.4**	**11.9**	**9.8**	**8.1**	**6.5**	**-0.7**
o/w foreign-currency denominated	71.3	80.4	45.0	33.8	28.3	11.9	10.0	8.5	7.2	6.1	5.2	
Change in public sector debt	-41.2	12.7	-32.1	-11.7	-5.7	-17.5	-2.9	-2.4	-2.1	-1.8	-1.5	
Identified debt-creating flows (4+7+12)	-34.9	27.6	-7.0	-16.2	-9.2	-5.4	-4.1	-4.5	-5.1	-4.9	-4.8	
Primary deficit	0.5	12.4	3.8	-5.6	-4.5	-2.3	-2.8	-3.5	-4.1	-4.1	-4.0	
Revenue and grants	56.4	46.2	46.4	49.5	48.2	46.4	45.7	45.5	44.8	44.6	44.1	
Primary (noninterest) expenditure	56.9	58.6	50.2	43.9	43.7	44.1	42.9	42.0	40.7	40.5	40.1	
Automatic debt dynamics 2/	-35.4	14.6	-14.3	-12.3	-5.7	-2.4	-0.9	-0.6	-0.7	-0.5	-0.6	
Contribution from interest rate/growth differential 3/	-32.4	14.8	-14.3	-12.3	-5.6	-2.4	-0.9	-0.6	-0.7	-0.5	-0.6	
Of which contribution from real interest rate	-27.2	19.8	-10.2	-8.9	-2.7	0.5	0.6	0.5	0.3	0.2	0.0	
Of which contribution from real GDP growth	-5.3	-5.0	-4.1	-3.4	-2.9	-2.9	-1.4	-1.1	-1.0	-0.8	-0.6	
Contribution from exchange rate depreciation 4/	-3.0	-0.2	0.0	0.0	-0.1	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.5	3.6	1.7	1.0	-0.7	-0.4	-0.4	-0.3	-0.3	-0.3	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (off-budget bank financing)	0.0	0.5	3.6	1.7	1.0	-0.7	-0.4	-0.4	-0.3	-0.3	-0.3	
Residual, including asset changes (2-3) 5/	-6.4	-14.9	-25.2	4.6	3.5	-12.1	1.1	2.1	3.0	3.1	3.3	
Public sector debt-to-revenue ratio 1/	127.0	182.6	112.6	82.0	72.3	37.3	31.5	26.2	22.0	18.1	14.8	
Gross financing need 6/	0.9	9.7	3.9	-4.6	-3.8	-1.8	-2.0	-2.8	-3.4	-3.5	-3.7	
in billions of U.S. dollars	1.1	10.8	5.3	-8.2	-8.2	-4.2	-5.1	-7.8	-10.6	-11.9	-13.6	
Scenario with key variables at their historical averages 7/						**17.3**	**16.4**	**16.9**	**18.9**	**21.3**	**24.2**	**-3.4**
Scenario with no policy change (constant primary balance) in 2013-2018						**17.3**	**14.9**	**13.6**	**13.2**	**13.1**	**12.9**	**-1.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.6	5.8	5.9	8.6	8.4	9.0	9.0	8.3	9.0	8.4	8.3	
Average nominal interest rate on public debt (in percent) 8/	0.4	0.3	0.7	1.9	1.2	2.3	3.9	4.0	4.3	4.5	2.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-31.8	21.7	-13.9	-20.9	-7.0	1.6	3.6	3.6	3.1	2.9	0.5	
Nominal appreciation (increase in US dollar value of local currency, in percent)	3.7	0.2	0.0	0.0	0.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	32.2	-21.4	14.6	22.8	8.1	0.7	0.2	0.5	1.2	1.6	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	33.2	8.9	-9.4	-5.1	8.1	9.9	6.0	6.1	5.6	8.0	7.2	
Primary deficit	0.5	12.4	3.8	-5.6	-4.5	-2.3	-2.8	-3.5	-4.1	-4.1	-4.0	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND

IRAQ

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 30, 2013

Prepared By

Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of March, 2013)

Membership Status:

Date of membership: December 27, 1945
Status: Article XIV

General Resources Account	**SDR Million**	**Percent Quota**
Quota	1,188.40	100.00
Fund Holdings of Currency	2,086.87	175.60
Reserve Position in Fund	171.10	14.40

SDR Department	**SDR Million**	**Percent Allocation**
Net cumulative allocation	1,134.50	100.00
Holdings	1,119.08	98.64

Outstanding Purchases and Loans	**SDR Million**	**Percent of Quota**
Stand-by Arrangements	1,069.56	90.00

Latest Financial Arrangements

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	Feb 24, 2010	Feb 23, 2013	2,376.80	1,069.56
Stand-by	Dec 19, 2007	Mar 18, 2009	475.36	0.00
Stand-by	Dec 23, 2005	Dec 18, 2007	475.36	0.00

Projected Payments to the Fund
(SDR million; based on existing use of resources and present holdings of SDRs)

			Forthcoming		
	2013	2014	2015	2016	2017
Principal	111.41	497.64	423.37	37.14	
Charges/Interest	8.55	8.66	3.27	0.24	0.03
Total	**119.96**	**506.31**	**426.64**	**37.38**	**0.03**

Implementation of HIPC Initiative: Not Applicable

Safeguards Assessments

The most recent safeguards assessment of the Central Bank of Iraq (CBI) was completed in 2010 under the SBA that expired in February 2013. While the assessment concluded that significant safeguards risks remain, it noted that the CBI maintains important safeguards recommended by previous assessments, including annual external audits by reputable audit firms and publication of the CBI's audited financial statements.

Exchange Arrangement

The CBI has been conducting foreign exchange auction on a daily basis since October 4, 2003. The CBI followed a policy of exchange rate stability which has translated in a de facto peg of the exchange rate since early 2004. However, from November 2006 until end 2008, the CBI allowed the exchange rate to gradually appreciate. As a result, the exchange rate arrangement of Iraq was reclassified to the category of crawling peg effective November 1, 2006. Since the start of 2009, the CBI returned to its earlier policy of maintaining a stable dinar. Consequently, the exchange rate arrangement of Iraq was reclassified effective January 1, 2009 as a stabilized arrangement.

Iraq continues to avail itself of the transitional arrangements under Article XIV. Eight exchange restrictions (plus one exchange restriction maintained for national or international security) and one multiple currency practice (MCP) are subject to IMF jurisdiction and approval. The exchange restrictions are (i) the limitation that corporates can purchase foreign exchange in the auction for import transactions only; (ii) limitation on the availability of foreign exchange cash for individuals (i.e., one request per month); [1] (iii) maximum limits on the availability of foreign exchange cash in the auction for banks;[2] (iv) maximum limits on the availability of foreign exchange cash in the auction for

[1] This measure gives rise to an exchange restriction because the limitation of one request per month constitutes a governmental limitation on the availability of foreign exchange for payments and transfers by individuals for current international transactions, e.g., basic allocations for tourist or business travel abroad, family living expenses, etc. Furthermore, because of the limitation on the availability of foreign exchange in the non-cash auction to corporates and only for trade transactions, individuals who need to make payments and transfers for current international transactions beyond the maximum limit have no alternative means or channels to get access to foreign exchange, except for resorting to informal sources.

[2] This measure gives rise to an exchange restriction because the maximum cap constitutes a governmental limitation on the availability of foreign exchange for certain payments and transfers, e.g., repatriation of certain investment income by nonresidents, including remittances of profits, dividends or interest. Because of the limitation on the availability of foreign exchange in the non-cash auction by corporates to only trade transactions, they would have no other means or channels to get access to such foreign exchange beyond the maximum limits, except for resorting to informal sources.

money transfer companies and money exchange bureaus;[3] (v) the requirement to pay all obligations and debts to the government before proceeds of investments of investors, and salaries and other compensation of non-Iraqi employees may be transferred out of Iraq; (vi) the requirement to submit a tax certificate and a letter of non-objection stating that the companies do not owe any taxes to the government before non-Iraqi companies may transfer proceeds of current international transactions out of the country; (vii) the requirement that before non-Iraqis may transfer proceeds in excess of ID 15 million out of Iraq, the banks are required to give due consideration of legal obligations of these persons with respect to official entities, which must be settled before allowing any transfer; and (viii) an Iraqi balance owed to Jordan under an inoperative bilateral payments agreement. In addition, one exchange restriction maintained for security reasons should be notified to the IMF under the framework of Decision 144-(52/51). The MCP arises from the absence of a mechanism to ensure that the official exchange rate and the market exchange rate do not deviate by more than 2 percent.

Article IV Consultation

Iraq is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on February 24, 2010. The staff report (IMF Country Report No. 10/72) was published on March 16, 2010, and is available on the internet at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23713.0.

[3] Same as footnote 2.

IRAQ: RECENT TECHNICAL ASSISTANCE, 2005–13

Fund. Dept.	Area of Assistance	Mission Dates
FAD	February 2005	Public Financial Management (Joint FAD-World Bank Mission)
FAD	April 2005	Budget Classification Reform
FAD	November 2006	Financial Management Information System
FAD	December 2006	Oil sector management and fiscal federalism
FAD	May 2007	Tax policy workshop
FAD	March 2008	Public Financial Management
FAD	August 2008	Oil sector—Pricing and Financial Flows
FAD	March 2008	Oil sector—Taxation
FAD	October 2009	Public Financial Management
FAD	May 2010	Public Financial Management
FAD	March 2012	Public Financial Management
FAD	May 2012	Public Financial Management
FAD	December 2012	Public Financial Management
LEG	August 2008	AML/CFT raising awareness workshop
LEG	October 2008	Article VIII acceptance
LEG	February 2009	Workshop for financial intelligence unit and criminal justice officials on AML/CFT measures
LEG	April 2010	Phase One of the Three-Phase AML/CFT Capacity Enhancement and Sustainability Training Program
LEG	July 2010	Phase Two of the Three-Phase AML/CFT Capacity Enhancement and Sustainability Training Program
LEG	October 2012	Article VIII acceptance and AML/CFT assessment
MCM	March 2007	Banking restructuring
MCM	March 2007	Banking supervision
MCM	September 2007	Banking restructuring
MCM	March 2008	Liquidity forecasting and management
MCM	April 2008	Bank restructuring workshop
MCM	July 2008	Reserve management
MCM	August 2008	Bank restructuring workshop
MCM	October 2008	Article VIII acceptance
MCM	December 2008	Reserve management
MCM	January 2009	Bank supervision workshop
MCM	March 2009	Banking supervision workshop
MCM	July 2009	TA coordination summit
MCM	November 2009	Reserve management
MCM	November 2009	Banking supervision workshop-reporting forms

MCM	April 2010	Islamic banking workshop
MCM	August 2010	Reserve management
MCM	August 2010–present	Remote assistance on liquidity management and treasury market development
MCM	April 2011	Risk management workshop
MCM	May 2011	Bank restructuring
MCM	May 2011	Reserve management
MCM	March 2012	Bank restructuring
MCM	October 2012	Article VIII acceptance
STA	January 2006	Balance of Payments Statistics
STA	March 2006	Monetary and Financial Statistics
STA	November 2006	Balance of Payments Statistics
STA	January 2007	Monetary and Financial Statistics
STA	January 2007	Consumer Price Statistics
STA	April 2007	Monetary and Financial Statistics
STA	February 2007	National Accounts Statistics
STA	November 2007	Consumer Price Statistics
STA	February 2008	External Sector Statistics
STA	February 2008	National Accounts Statistics
STA	January 2009	External Sector Statistics
STA	November 2009	National Accounts Statistics
STA	April 2010	External Sector Statistics
STA	July 2010	Monetary and Financial Statistics
STA	February 2012	External Sector Statistics
STA	March 2012	National Accounts Statistics
STA	May 2012	Monetary and Financial Statistics
STA	April 2013	National Accounts Statistics
INS	February 2006	Financial Programming and Policies
INS	February 2007	External Sector Issues
INS	March 2008	Financial Programming and Policies
INS	January 2009	Financial Programming and Policies
INS	January 2010	Financial Programming and Policies

Resident Representative

Mr. Shbaikat was appointed on December 2010 as resident representative for Iraq. Due to the prevailing security situation he is currently based in Amman (Jordan).

RELATIONS WITH THE WORLS BANK GROUP

(As of April 9, 2013)

Title	Products	Provisional and Actual Timing of Missions	Expected and Actual Delivery Date
A. Mutual Information on Relevant Work Program			
The World Bank work program in the next 12 months[4]	**Economic Policy Analysis and Advice** **WB:** - Public spending efficiency and investment management - Trade policy and facilitation - Global experience with resource revenue management - Economic diversification	Sept. 2013 July 2013 Sept. 2013 Sept. 2013	Dec. 2013 Nov. 2013 May 2014 May 2014
	Technical Assistance **WB:** - Multi-sector institutional capacity building - Public Financial Management - Building Capacity of Board of Supreme Audit - Banking Sector Reform - Social Protection - Extractive Industries Transparency Initiative - Pension Reform - Integrated National Energy Strategy - Institutional Strengthening and Capacity Building for the Education Sector **IFC:** - Infrastructure PPPs - Strengthen financial infrastructure, improve banks' corporate governance	May 2013 May 2013 May-June 2013 March 2013 April 2013 May 2013 April 2013 April 2013	June 2013 August 2013 August 2013 June 2013 April 2013 Oct. 2013 August 2013 June 2013 June 2013 Ongoing

[4] Not including infrastructure investments.

	and risk management systems, and provide SME training under Business Edge, especially to women owned enterprises		
The Fund work program in the next 12 months	**Macroeconomic Policy Analysis and Advice** - Staff visit - Article IV consultation - Continuous policy advice	Sept. 2013 March 2014	May 2014
	Technical Assistance - Statistical capacity: national accounts - Public Financial Management - Statistical capacity: CPI - Reserves management - FX new regulations - AML/CFT	April 2013 Mayo 2013 Spring 2013 Continuous Continuous	May 2013
B. Requests for Work Program Inputs			
Fund request to Bank	- Continuous update on Iraq Banking Sector Reform Project - Macroeconomic and financial data to be shared regularly - Logistical support on missions to Iraq	Ongoing basis	
Bank request to Fund	- Fiscal data to be shared regularly - Coordination on macroeconomic policy and management training - Macroeconomic and financial data to be shared regularly, including any restriction on foreign exchange transactions - Sector-specific data	Ongoing basis	
C. Agreement on Joint Products and Missions			
Joint products in the next 12 months	- Budget strategy workshop	May 2013	

STATISTICAL ISSUES

A. Background

1. Data provided to the Fund, while broadly adequate for program monitoring, have serious shortcomings that significantly hamper economic analysis. Macroeconomic statistics have suffered from years of neglect and recent turmoil has added to the difficulties. While the Central Organization for Statistics and Information Technology (COSIT) remained in place, it lacks adequate technical expertise and resources to address the requirements for a modern statistical system. At the Central Bank of Iraq (CBI), statistical capacity is slightly better, but issues of interagency data sharing and data collection responsibilities are hampering progress on external sector statistics.

2. Since 2003, the Statistics Department (STA) has provided considerable technical assistance (TA) in all major datasets, including on dissemination standards. The authorities participate in the General Data Dissemination System (GDDS). The ongoing TA program takes into account the absorptive capacity of the statistical agencies involved, and the contributions of other donors.

B. Shortcoming of Statistical Framework

National Accounts

3. COSIT compiles annual and quarterly national accounts at current and constant (1988) prices. Annual data of GDP by activity are available on the website of COSIT for 2003–10, and quarterly GDP data for 2009–10 and the first quarter of 2011.

4. The national accounts follow the 1968 System of National Accounts (SNA), however, with technical assistance from STA, COSIT is moving towards implementing the concepts of the 1993 SNA. The quality of the national accounts compiled is poor due to the lack of source data. There is no comprehensive source data available for estimating the value added by activity and for GDP expenditure categories. Unreliable estimates of transport margins and goods imports, and limited coverage of the activities of foreign companies operating in Iraq (including in the oil and security sectors), smuggling, and other illegal transactions and activities are among the factors limiting the scope of GDP estimates both by activity and by expenditure. A Household Budget Survey (HBS), restaurants and hotel survey, and money exchange survey have been conducted during 2007, but the results have not been fully utilized. An establishment survey was supposed to be conducted in 2007, but due to the security situation, COSIT was not able to conduct the scheduled survey. The data on the oil sector is generally adequate and timely, but there is little information on nonoil economic activity. COSIT still includes the Kurdistan Territory's contribution to GDP by economic activities as percentages for each activity based on results obtained from previous estimates dating back to 1990. Other activities that started in the Kurdistan Territory after 1990 are not included. There are limited price and volume indicators which could be used for deriving volume measures of GDP. The base year (1988) is outdated and needs to be updated. Work is underway to move the base year to 2004.

5. Data collection is reasonably comprehensive for current price data in the formal sector. Under current procedures, businesses employing more than 10 people must report calendar year data by the following October, and small businesses need to report by the following June. Because there are sizable penalties for noncompliance, respondents usually meet these deadlines. However, with recent changes in the country, there is a risk that the timeliness of data reporting will deteriorate.

6. There is a shortage of quarterly and monthly indicators of economic activity and a lack of timely data for services. Quarterly GDP estimates are based on a limited number of indicators—crude oil output, electricity, rent of dwellings, and government expenditure. Nevertheless, for several industries, extrapolating from out-of-date benchmarks adversely affects data reliability.

Consumer Price Index

7. Based on the HBS 2007, COSIT compiles and disseminates a monthly CPI for all-Iraq (including Kurdistan) and for each governorate. However, the CPI only covers the urban areas in all governorates. Staffing is inadequate in number and training has been received only during STA technical assistance missions. There is not enough computer hardware and software to process the CPI efficiently. Recent technical assistance missions have focused on providing hands-on training on methodologies for compiling the CPI and on methods for making adjustments in the CPI for seasonality and changes in the quality of goods. Limited training has also been provided on methods for constructing the producer price index (PPI) and the wholesale price index (WPI) and on documenting the procedures and methods used to compile the CPI (metadata); work in this area is continuing.

Monetary and Financial Statistics

8. Notable progress has been made in developing the components and structure for compiling a depository corporations survey, but the quality of the data continues to be hampered by several factors: (i) the lack of sufficiently trained staff and adequate internal cooperation within the CBI; and (ii) difficulty in collecting information on banking transactions in the northern region (Kurdistan). The CBI has used a new report form, which provides more breakdowns by sector and type of financial instruments to collect data from commercial banks. However, the CBI reports data for publication in the IMF's International Financial Statistics with a lag of more than three months and the latest reported data are marked "preliminary," indicating that there are problems with their data collection and compilation.

Balance of Payments and IIP Statistics

9. Balance of payments statistics are available to the Fund for 2005–2011 in the IMF's Balance of Payments Manual, sixth edition (BPM6) format.[5] The CBI also compiles and disseminates an annual

[5] The data were submitted by the CBI in BPM5 format and were converted into BPM6 format by STA, beginning in the August 2012 edition of the IFS. The CBI reviewed the converted data prior to publication.

international investment position (IIP) statement. The quality of the information for recent years has improved but timeliness remains a key concern. Further, the presentation is still limited due to coverage problems and some deviations from the internationally acceptable methodologies. Issues regarding the full recording of external debt data continue to impact the coverage and timeliness of balance of payments and IIP statistics. International reserves are compiled consistent with international methodologies and published in the IFS since end-2006.

10. A TA mission (February 2012) noted that the quality of the information remains hampered by the lack of data submission to the CBI from other government institutions and the private sector. The paucity of data exist particularly in the areas of external trade in goods and services and foreign direct investment. As a basis for reconciling flows and positions in the BPM5 framework, the mission also identified a few data reconciliation issues, including inconsistencies in the classifications and recording of portfolio investment transactions and positions. To help address these and other issues, the mission proposed several recommendations, including improved interagency cooperation on direct investment statistics; and adapting the international transactions reporting system to the BPM6 requirements.

External Trade Statistics

11. External trade data have serious problems of timeliness and are of poor quality. A new customs form for imports is available but it is not being used at the customs border due to the security situation and the lack of Customs Department resources at the border outlets.

12. Coverage of private sector imports is constrained by data sources. Only goods that are paid for through the Iraqi banking system are captured. Thus goods that are imported under external payments arrangements (for example, imports for direct investment projects) are not recorded in the balance of payments. The coverage of the external trade statistics excludes the northern region of the country (Kurdistan), and no estimates for smuggling are made.

13. Export data from the oil sector are received from the BOPSD at the CBI. The nonoil export data, which amounts to the equivalent of 3–5 percent of total exports, are compiled based on information from the customs export form. Nonoil export data are provided to the CBI on a monthly basis for crosschecking purposes.

Government Finance

14. Despite the difficult security situation, which has a direct impact on data compilation and analysis, the provision of fiscal data for program monitoring purposes has been satisfactory. Infrequent submission delays occur, and coverage of the Kurdish region remains sketchy. However, the authorities are taking measures to address these shortcomings.

15. In February 2005, an STA mission—held jointly with a parallel FAD and World Bank mission—discussed a work plan aimed at building up reporting as an integral part of a major rehabilitation of the budgetary, accounting, and fiscal management information system. The mission identified institutional, technical, resource, and coordination issues that would need to be addressed prior to developing the government finance statistics (GFS). These include establishing a macro-fiscal directorate-general in charge of developing and disseminating fiscal statistical data, implementing the classification for mapping the chart of accounts and budget classification onto the format of the Government Finance Statistics Manual (GFSM 2001) (an area where significant progress has been made), and preparing preliminary estimates of GFS-compliant data for general government on a best effort basis. The Ministry of Finance has also set up a debt unit with the support of external consultants. Iraq does not report government finance statistics for publication in the Government Finance Statistics Yearbook (GFSY) or IFS. Currently there are no fiscal statistics published by the government beyond the summary of central government budgetary estimates and outturn.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/58
FOR IMMEDIATE RELEASE
May 21, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Iraq

On May 13, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Iraq.[5]

Background

Iraq is exceptionally rich in oil, but its economy suffers from severe structural weaknesses, such as a small non-oil sector, a dominating role of the government in all areas of the economy, and a poor business environment. Nevertheless, partly thanks to the increase in oil production since 2003, Iraq has achieved a rise in GDP per capita from $1,300 in 2004 to $6,300 in 2012 in a very difficult security and political context. During this period, Fund program engagement with Iraq was instrumental in maintaining macroeconomic stability—even though progress on structural reforms and job creation was mixed.

Recent macroeconomic developments have been broadly positive. Economic growth has reached 8.4 percent in 2012 and is expected to rise to 9 percent in 2013 as oil production increases to 3.3 million barrels per day (mbpd). Inflation has declined from about 6 percent at end-2011 to 3.6 percent at the end of last year, and should increase only slightly in 2013. International reserves of the Central Bank of Iraq (CBI) rose from $61 billion at end-2011 to $70 billion at end-2012, and fiscal reserves held at the Development Fund for Iraq (DFI) have increased from $16.5 billion to $18 billion.

Thanks to higher-than-expected oil revenues and the under-execution of the investment budget, fiscal surpluses reached almost 5 percent of GDP in 2011 and 4 percent in 2012. However, with a break-even oil price of about $100, fiscal performance is very vulnerable to oil revenue shocks—either from oil price declines or export shortfalls. Furthermore, fiscal discipline weakened over the past two years, with poor budget planning and execution, large off-budget spending, and low investment execution rates. The 2013 budget includes large unfunded commitments, increasing fiscal risks, including the possible depletion of fiscal reserves, if the budget were to be fully executed.

[5] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The policy of a de facto peg to the U.S. dollar provides a key nominal anchor to the economy, and the nominal exchange rate in the official market has remained stable since 2010. However, since late 2011, the authorities enforced existing exchange restrictions and introduced new restrictions in response to concerns about money laundering and illegal foreign exchange outflows related to the increased demand for foreign exchange. As a result, the spread between the official rate and the parallel market rate—which had been up to that point below 2 percent—started to climb, passing 9 percent in May 2013.

Over the medium term, Iraq's macroeconomic outlook will continue to be driven by developments in the oil sector. Staff projects that oil production will rise gradually by about 400-500 thousand barrels per day per year, reaching 5.7 mbpd by 2018. Overall, growth is projected to remain above 8 percent and inflation at 5–6 percent over the medium term.

Risks to the macroeconomic outlook remain high. They include (a) weak policy implementation, particularly in the fiscal area; (b) further deterioration of the political and security situation; (c) a larger-than-projected decline in global oil prices; and (d) delays in developing Iraq's oil fields and oil export capacity, possibly due to security issues but also insufficient investment in oil infrastructure. These risks can translate into lower oil revenues, deterioration in the fiscal position, pressures to use CBI reserves for fiscal purposes, and higher inflation.

Executive Board Assessment

Executive Directors commended the authorities for maintaining macroeconomic stability in a difficult security and political environment. With risks remaining high, including from oil price volatility, they stressed the need to build fiscal buffers and further strengthen the institutional framework. They urged the authorities to step up reforms to develop the private non oil sector to help generate employment and inclusive growth.

Directors emphasized the need to implement sustainable fiscal policies and address risks from oil revenue volatility. Rationalizing current spending—including public employment, energy subsidies, the Public Distribution System, and transfers to state owned enterprises—is needed to create space for priority social spending and public investment and to accumulate buffers. Enhancing public financial management and avoiding quasi fiscal operations by the state owned banks are also crucial. Directors noted that fiscal rules could provide a framework for fiscal policy over the medium term.

Directors supported the objective of the Central Bank of Iraq (CBI) to liberalize the foreign exchange market and the recent steps to simplify market regulations. Further measures are needed to liberalize fully the supply of foreign currency, with the objective of lowering the exchange rate spread, removing distortions, and complying with Article VIII of the Fund's Articles of Agreement. Directors considered that strengthening the Anti Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework, in line with the Middle East and North Africa Financial Action Task Force (MENA FATF) recommendations and FATF standards, would be more effective than restricting foreign exchange in curbing money laundering and terrorist financing.

Directors agreed that a stable exchange rate, supported by a high level of international reserves, provides a valuable anchor in an uncertain environment. They agreed that the two tier architecture of prudent management of CBI reserves and use of the Development Fund for Iraq (DFI) as a de facto oil stabilization fund is appropriate. They urged the authorities to continue to rely on the DFI to help stabilize government spending and ensure oil revenue transparency.

Directors highlighted the importance of a stable financial sector in developing the private sector and diversifying the economy, and were encouraged by recent progress in strengthening banking supervision and restructuring the Rasheed and Rafidain banks. They encouraged the authorities to ensure a level playing field for public and private banks by opening to private banks access to government business.

More broadly, Directors emphasized that fostering growth in the private non oil sector requires improving the business environment, investing in infrastructure and social capital, reforming state owned enterprises, and enhancing public service delivery. Judicious use of the country's oil wealth can help address these pressing challenges. Improving the authorities' capacity to implement reforms will also be critical.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Iraq: Selected Economic and Financial Indicators, 2010–2013

(Quota: SDR 1188.4 million)
(Population: 31.7 million; 2010)
(Poverty rate: 22.9 percent; 2007)
(Main exports: Crude oil)

	2010	2011	2012	2013
	Actual	Actual	Prel.	Proj.
Economic Growth and Prices				
Real GDP (percentage change)	5.9	8.6	8.4	9.0
Non-oil real GDP (percentage change)	9.7	5.7	6.3	6.0
GDP per capita (US$)	4,278	5,529	6,305	6,708
GDP (in US$ billions)	135.5	180.6	212.5	233.3
Oil production (mbpd)	2.38	2.65	2.95	3.33
Oil exports (mbpd)	1.91	2.17	2.42	2.70
Iraq oil export prices (US$ per barrel)	74.2	103.6	106.7	102.6
Consumer price inflation (percentage change; end of period)	3.3	6.0	3.6	5.0
Consumer price inflation (percentage change; average)	2.4	5.6	6.1	4.3
Core price inflation (percentage change; end of period)	3.3	7.0	4.2	5.0
	(In percent of GDP)			
National Accounts				
Gross domestic investment	21.4	19.3	20.3	21.1
Of which: public	15.2	13.0	13.5	14.7
Gross domestic consumption	77.9	66.9	70.8	73.2
Of which: public	25.2	21.7	21.3	21.6
Gross national savings	24.4	31.8	27.3	24.9
Of which: public	10.8	17.7	18.1	17.1
Saving – Investment balance	3.0	12.5	7.0	3.8
	(In percent of GDP; unless otherwise indicated)			
Public Finance				
Government revenue and grants	46.4	49.5	48.2	46.4
Government oil revenue	40.0	46.0	44.6	44.4
Government non-oil revenue	3.5	2.5	4.1	2.0
Grants	2.9	1.0	0.0	0.0
Expenditure, *of which:*	50.7	44.6	44.1	44.8
Current expenditure	35.5	31.6	30.6	30.1
Capital expenditure	15.2	13.0	13.5	14.7
Primary fiscal balance	-3.8	5.6	4.5	2.3
Overall fiscal balance (including grants)	-4.3	4.9	4.1	1.6
Non-oil primary fiscal balance (percent of non-oil GDP)	-76.0	-84.6	-73.1	-73.6
Memorandum items:				
Tax revenue/non-oil GDP (in percent)	1.8	1.9	2.3	2.0
Development Fund of Iraq (in US$ billions; end of period)[1]	7.4	16.5	18.1	18.9
Total government debt (in US$ billions; end of period)[2]	70.8	73.4	74.1	40.4
o/w external debt (in US$ billions; end of period)	60.9	61.0	60.2	27.8
	(In percent; unless otherwise indicated)			
Monetary indicators				
Growth in reserve money	15.2	9.9	9.2	7.7
Growth in broad money	14.8	38.0	4.1	13.8
Policy interest rate (end of period)	6.0	6.0	6.0	
	(In percent of GDP; unless otherwise indicated)			
External sector				
Current account	3.0	12.5	7.0	3.8
Trade balance	6.6	18.8	14.8	12.4
Exports of goods	37.9	44.1	44.3	43.5
Imports of Goods	-31.3	-25.3	-29.5	-31.1
Overall external balance	1.7	10.5	5.1	4.6
Gross reserves (in US$ billions)	50.6	61.1	70.3	80.1
In months oil imports of goods and services	10.6	9.5	9.3	9.7
Exchange rate (dinar per US$; period average)	1,170	1,170	1,166	-.-
Real effective exchange rate (percent change)	1.3	4.7	5.7	-.-

Sources: Iraqi authorities; and IMF staff estimates and projections.

[1] Excluding escrow account held abroad to purchase military equipment.

[2] Assumes a debt reduction in 2013 by non-Paris Club official creditors, comparable to the Paris Club agreement.

Statement by A. Shakour Shaalan, Executive Director for Iraq
May 13, 2013

Background

1. On behalf of the Iraqi authorities, I thank staff for their engagement and the constructive Article IV Consultation discussions. The authorities highly value the views of the Fund on Iraq's economic policies and appreciate the valuable technical assistance they receive from staff in support of their stabilization and reform efforts.

2. Notwithstanding very challenging security and political conditions, Iraq's economic performance was strong in the past two years. GDP growth picked up to over 8 percent, reflecting higher oil production and buoyant growth in the non-oil economy. Inflation remained low. The fiscal balance recorded surpluses and sizable external reserves were accumulated.

3. Notwithstanding these favorable developments and the prospects of continued high growth in the medium term—driven by developments in the oil sector—the Iraqi economy continues to face challenges and risks. These include mainly a deteriorating political and security situation, volatility in oil prices, and constraints in administrative capacity.

Fiscal Policies and Reforms

4. In 2013, the authorities plan a more gradual fiscal consolidation than in the two previous years, with the fiscal surplus estimated at 1.6 percent of GDP. They also intend to put in place a medium-term fiscal strategy program that would cover more than three years. With oil revenues soaring, political pressures to increase current spending are growing. In March 2013 parliament approved a final budget that includes unfunded commitments, but implies a deficit that is less than in some previous years. While the government recognizes the need to redistribute part of the oil wealth among the population, it is also aware of financing constraints and the importance of maintaining fiscal buffers. Accordingly, the actual execution of the budget will aim at meeting priority social and investment spending, while maintaining fiscal buffers.

5. In particular, the government intends to limit spending growth in subsidies for energy producers, rationalize transfers to state-owned enterprises and to the universal Public Distribution System, and contain the increase in public-sector employment. These measures would help maintain the fiscal buffers at the Development Fund for Iraq (DFI) at about six months of salaries and pensions. They would also enable full execution of investment projects in the oil sector, while keeping non-oil sector capital spending constant in nominal terms, in line with implementation capacity.

Monetary and Exchange Rate Policies

6. The authorities agree with staff that the stability of the exchange rate has provided a valuable anchor for inflation expectations in an uncertain environment. They intend to maintain exchange rate stability in the foreseeable future.

7. In 2011, the central bank of Iraq (CBI) started limiting foreign exchange supply to address concerns related to money laundering and financing of terrorism. To do so, it enforced existing exchange restrictions and introduced new restrictions. With the central bank the main source of funds to the foreign exchange market, foreign exchange auction regulations have led to a widening of the spread between the official and parallel foreign exchange rates. In the absence of sufficient capacity of the financial sector to implement Anti-Money Laundering and Combating Financing of Terrorism (AML/CFT) preventive measures, the CBI finds it necessary to restrict the supply of foreign currency to restrain illicit uses of foreign exchange.

8. The CBI is committed to progressively liberalize the foreign exchange market as capacity to prevent AML/CFT is developed. It has recently taken steps to simplify foreign exchange market regulations and this has led to the elimination of many exchange restrictions. The CBI is working closely with staff on complying with Article VIII of the Fund's Articles of Agreement, as well as eliminating the remaining exchange restrictions and the multiple currency practice.

Structural Reforms

9. Continued capacity constraints, compounded by the difficult political and security situation, have slowed progress in structural reforms. Nonetheless, progress was made in the area of public financial management, with the adoption of a government Chart of Accounts. The authorities also confirmed their commitment to adopt a single treasury account. They will pursue efforts to fully put in place an Integrated Financial Management Information System, which would help improve budgeting, budget execution, spending controls, debt management, and fiscal reporting. With regard to banking sector reforms, effective measures were taken to clean-up the balance sheets of the two largest state-owned banks, Rafidain and Rasheed, of legacy external debt, losses related to the war, valuation losses, and costs associated with issuing the new Iraqi currency. Continued progress is being made in improving transparency in the oil sector as Iraq became a full member of the Extractive Industries Transparency Initiative in December 2012.

10. The authorities appreciate staff's work on sovereign wealth fund options. They concur with staff's view that the DFI is a successful and transparent fiscal institution, which helped Iraq mitigate the effects of negative oil price shocks. They consider that the DFI has been operating as a de facto stabilization fund, allowing the government to accumulate reserves through strong fiscal performance in boom years, and financing spending when oil revenues fall short.

11. Staff notes that growth prospects hinge on implementing a prudent policy mix, enhancing service delivery, rebuilding infrastructure and strengthening the business environment. The authorities fully share this assessment. They are aware that promoting the non-oil private sector is crucial as the employment model based on the public sector is reaching its limits. In an effort to address Iraq's growth and development needs, the Ministry of Planning prepared a five-year National Development Plan following an extensive consultative process. The plan is now being discussed by the Cabinet.