# IRAQ ECONOMIC MONITOR

## Protecting Vulnerable Iraqis in the Time of a Pandemic, the Case for Urgent Stimulus and Economic Reforms

Fall 2020

WORLD BANK GROUP
Middle East and North Africa Region

# Iraq Economic Monitor

## Protecting Vulnerable Iraqis in the Time of a Pandemic, the Case For Urgent Stimulus and Economic Reforms

With a Special Focus on
Impacts of COVID-19 and weak oil prices
on household poverty in Iraq

Fall 2020

Middle East and North Africa Region

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# ACRONYMS

| | |
|---|---|
| ALMPs | Active labor market policies |
| Bbl | Barrel of oil |
| BeneMark | Beneficiary Market Perspectives Survey |
| CAB | Current Account Balance |
| CBI | Central Bank of Iraq |
| COSIT | Central Organization for Statistics and Information Technology |
| COVID-19 | Coronavirus Disease 2019 |
| DE | Digital economy |
| DFS | Digital Financial Services |
| EFPM | Enhanced Frequency Price Monitoring |
| EIA | US Energy Information Administration |
| EITI | Extractive Industries Transparency Initiative |
| FDI | Foreign Direct Investment |
| FSAP | Financial Sector Assessment Program |
| GCC | Gulf Cooperation Council |
| GDP | Gross Domestic Product |
| GEP | World Bank Global Economic Prospects |
| GoI | Government of Iraq |
| HCI | Human Capital Index |
| IDPs | Internally Displaced Persons |
| IEM | Iraq Economic Monitor |
| IFRS | International Financial Reporting Standards |
| ILO | International Labor Organization |
| IMF | International Monetary Fund |
| IQD | Iraqi Dinar |
| ISIS | Islamic State |
| KYC | Know Your Customer |
| LHS | Left hand side |
| MBPD | Million Barrel Per Day |
| MENA | Middle East and North Africa |
| MFI | Microfinance institutions |
| MoF | Ministry of Finance (Iraq) |
| MoH | Ministry of Health (Iraq) |
| MOLSA | Ministry of Social Affairs (Iraq) |
| MoO | Ministry of Oil (Iraq) |
| MSME | Micro-, small and medium-sized enterprises |
| MVI | Multidimensional vulnerability index |
| NGO | Non-Governmental Organization |
| OPEC(+) | Organization of Petroleum Exporting Countries (plus other non-OPEC partner countries) |
| PDS | Public Distribution System |
| Pp | Percentage points |
| R&D | Research and Development |
| RHS | Right hand side |
| SOBs | State-owned banks |
| SOEs | State-Owned Enterprises |
| SSNs | Social Safety Nets |
| SWIFT | Rapid Welfare Monitoring Survey |
| UCT | Universal Cash Transfer Program |
| UMI | Upper middle-income countries |
| UN | United Nations |
| UNHCR | United Nations High Commissioner for Refugees |

| | |
|---|---|
| UNICEF | United Nations International Children's Emergency Fund |
| US | United States |
| WB(G) | World Bank (Group) |
| WDI | World Development Indicators |
| WFP | World Food Program |
| WHO | World Health Organization |
| y/y | year-on-year (growth) |

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

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# EXECUTIVE SUMMARY

## Recent Economic and Policy Developments

***Decades of political, economic and security shocks have shaped major structural imbalances in Iraq's economy, reinforcing Iraq's current fragility trap.*** Iraq remains as one of the most oil-dependent countries in the world. Oil accounted for over 96 percent of exports, 92 percent of government budget revenues and 43 percent of gross domestic product (GDP) in 2019. Overdependence on oil has also increased economic volatility and discouraged investment in other sectors. Multiple security shocks including regional conflicts and ISIS attacks have left little room for non-oil sector growth. An unfavorable business environment has undermined private sector's crucial role in job creation. The large size of the public sector and wage bill rigidity has restricted fiscal space required for investments in human capital and infrastructure and restricted response to economic shocks. Poor service delivery and rampant corruption along with soaring unemployment and poverty rates have led to public grievances even before the global pandemic.

***Iraq's economy continues to face significant macroeconomic challenges following the twin shocks of the COVID-19 pandemic and collapse in global oil markets.*** Iraq's GDP shrank by 6.8 percent year-on year (y/y) in the first half of 2020 (H1-20) reversing a steady improving economic growth trend over the previous two years. Depressed global energy demand and the OPEC+ production cut led Iraq's oil GDP to contract by 10.4 percent (y/y) in Q2-20. Since then, oil production declined to reach a five-year low of 3.58 mbpd in August 2020. Lower economic activity was most pronounced in the services sector, which contracted by 20.7 percent (y/y) in Q2-20, following the introduction of lockdowns and curfews in March 2020. This sharp contraction led non-oil GDP to decline by 9.2 percent (y/y) in H1-20. As of September 2020, geo-mobility data showed activity in workplace areas to have partially improved to around 20 percent below their pre COVID-19 levels. However, the surge in COVID-19 cases, which exceeded 400,000 confirmed cases and 10,000 deaths in October 2020, highlights the ongoing nature of the health crisis and the necessity to focus on saving lives to avoid longer term irreversible impacts of the crisis.

***The twin shocks are taking a toll on fiscal revenues leaving the government with limited financing options.*** While government revenues fell by 47.5 percent (y/y) in the first 8 months of 2020 (8M-20), expenditures remained high at 21.8 percent of GDP due to large share of the public wage bill and pensions. These budget rigidities put pressure on government financing needs which are estimated to reach a staggering 25.8 percent of GDP by end-2020. The Government of Iraq (GoI) has started pursuing

consolidation measures by stopping discretionary spending including pro-growth programs such as those linked to human capital and public service delivery and has focused all available resources on paying the public sector wage bill and pensions. These measures alone will not be enough as oil prices are expected to remain well below the breakeven price (US$58/bbl) to cover these two major spending items. The lack of fiscal space also has negative implications for growth and the ability of the GoI to provide a stimulus to the economy and mitigate the impact of the pandemic. Higher financing needs will create significant challenges for the country's macroeconomic balances and put pressure on the exchange rate and central bank reserves.

***Iraq's economic outlook hinges on the prospects of global oil markets and the capacity of the healthcare sector to cope with the pandemic.*** Improved outlook for oil markets and increased production, as part of the OPEC agreement, are expected to drive growth in 2021 and 2022 in the absence of strong reforms. If the health situation improves, growth is projected to gradually rebound from 2.0 percent in 2021 and to 7.3 percent in 2022 with non-oil economy growth projected to bounce back to an average of 4 percent in 2021–22. As such, the fiscal and external pressures are expected to remain as the twin balances remain in deficit.

***The breadth and depth of economic challenges highlight the urgent need for the implementation of long overdue structural reforms.*** Current cuts to public investment and pro-growth programs are short-term measures to appease the fiscal situation; but cannot be sustained over the medium-term given their implications on growth and poverty. As such they cannot substitute overdue structural reforms. Cognizant of the situation, the GoI's White Paper sets out a blueprint of reforms that if implemented could mark a turning point for Iraq. There are large economic gains to be made from implementing long awaited structural reforms. The World Bank simulates that such reforms could add as much as 58.4 percent to Iraq's per capita GDP growth. The ultimate success of this reform initiative depends on resolute political will and the garnering of public support to lead Iraq out of the fragility trap it has been grappling with for so long.

## Impacts of COVID-19 and weak oil prices on household poverty in Iraq

***The security and economic crises of recent years have left unequal imprints across regions and groups in Iraq.*** After a period of relative lull in violence, poverty fell in 2012 but increased to a record high in 2014 as a result of the ISIS conflict and oil price shock, before falling again slightly in 2017/18 as recovery began. The national trends, however, mask important spatial and group disparities. While the urban-rural gap has been declining, the poverty distribution is now polarized between the historically poor South and the newly poor North, which are characterized by acute and chronic poverty on the one hand, and relatively low levels of poverty in the Center and Kurdistan regions on the other. These spatial disparities, in many cases, are driven by the significant gaps that exist between the displaced and non-displaced population. In both the North and Kurdistan regions, where the vast majority of the IDPs are, the poverty rate among displaced households is more than twice that of non-displaced households. These pre-existing vulnerability disparities mean that the impact of COVID-19 across the country is likely to be different.

***The dual shocks of COVID-19 and oil price will exacerbate these trends and test Iraqi households' resilience further through multiple channels.*** While disruption in supply chains could increase basic prices, households' labor and non-labor incomes are likely to decrease due to the economic slowdown and reduced remittances. Many households may lose most or all of their incomes, especially those in the informal private sector, compelling them to exhaust any meager savings and employ negative coping strategies. A narrower fiscal space could also affect food and public cash transfers. In the absence of a significant government response, these short-term effects coupled with the reduced access to education, healthcare, and other services will have lasting impacts on households' economic growth, intergenerational mobility and the ability to escape poverty. These negative impacts can be profound and persistent, especially, when faced during early childhood. They can significantly limit one's lifetime earnings, upward economic mobility, human capital

accumulation and health; and can, even, transfer on to next generations.

***Poverty in Iraq, even under a benign impact scenario, is estimated to increase in the short-term by 7 to 14 percentage points.*** This means 2.7 to 5.5 million Iraqis would become newly poor due to the twin crises in addition to the existing 6.9 million pre-crisis poor**.** With the pandemic continuing to surge, the government is faced with the difficult tasks of trying to contain the virus and people's health and restart a crumbling economy.

***Furthermore, reducing the public wage bill and pensions could push an additional 0.4 to 1.7 million Iraqis into poverty unless the rightsizing exercise is introduced in a progressive and efficient fashion.*** With Iraq's fiscal space already very tight, the current crises have created even greater constraints on government spending, which has driven the government's plan to address the size of the public wage bill. Rightsizing the public sector could have a significant poverty impact depending on how the reform is implemented. Thus it will be important to consider distributional consequences when determining which public sector workers will be affected. Geographically, reforms such as across the board wage cuts would increase poverty the most in the Kurdistan region and the Center given high shares of public sector workers. However, current poor households in the North and the South would be pushed even further into poverty.

***The policy response needs to address health and livelihood challenges in the short term but also address structural issues through a deeper reforms program.*** Given the worsening poverty trends, the GoI will need to launch an urgent fiscal stimulus to protect the poor and create short-term employment opportunities:

- In the short run, the focus should be on maintaining access to essential goods and nutrition, identifying and reaching those most vulnerable to the pandemic and scaling up targeted social protection; i.e., providing temporary cash and in-kind support to workers and enterprises that have lost jobs or whose incomes were cut due to COVID-19. The GoI should utilize existing systems such as the Ministry of Social Affairs' Unconditional Cash Transfer Program (UCT), which covers 1.35 million households, that would be critical to adequately protect as many poor and vulnerable Iraqis as possible. The GoI could also engage on active labor market policies and programs to protect jobs and increase jobseekers' employability, emulating the positive lessons from around the world. These include wage support programs in the private sector, on-the-job training, reskilling and entrepreneurship programs, as well as public works programs. A strong public response to the crisis should not necessarily entail new costly permanent programs but the urgency for such interventions necessitates fiscal discipline to mobilize resources to this end.
- In the longer-term, low revenues and the cost of responding to the crisis mean that Iraq will face intense pressures to fiscally consolidate during the recovery period. It is essential that this consolidation minimizes the impact of reduced spending and any potential broadening of the tax base on the poor and vulnerable. It is also important to examine efficiency gains and ring-fence spending on pro-growth and pro-poor programs like spending on public investment for human capital and service delivery. Moreover, structural reforms which boost job creation, especially in the private sector, need to be implemented.

# المرصد الاقتصادي للعراق

## حماية الفئات الهشة في العراق في زمن الجائحة :
## الدعوة الى حوافز عاجلة واصلاحات اقتصادية

## مع فصل خاص حول تداعيات جائحة كورونا واسعار النفط المتدنية على حالة الفقر للأسر في العراق

# الملخص التنفيذي

### التطورات الاقتصادية والسياساتية الأخيرة

أسهمت عقود من الصدمات السياسية والاقتصادية والأمنية في تشكّل اختلالات هيكلية في الاقتصاد العراقي ، مما عزز واقع الهشاشة الحالي. ولا يزال العراق واحداً من أكثر الدول اعتماداً على النفط في العالم. إذ شكل النفط أكثر من 96 % من الصادرات ، و 92 % من إيرادات الموازنة الحكومية ، و 43 % من الناتج المحلي الإجمالي في عام 2019. كما أدى الاعتماد المفرط على النفط إلى زيادة وتيرة التقلبات الاقتصادية وتثبيط الاستثمار في القطاعات الأخرى. ولم تترك الصدمات الأمنية المتعددة ، ومنها الصراعات الإقليمية وهجمات داعش ، سوى متسعاً صغيراً لنمو القطاع غير النفطي. وأدت بيئة الأعمال غير المواتية إلى تقويض الدور المهم للقطاع الخاص في خلق فرص العمل. كما عمل الحجم الكبير للقطاع العام و فاتورة الرواتب على تقييد الحيز المالي المطلوب للاستثمار في رأس المال البشري والبنية التحتية بل وأضعف قدرة الاستجابة للصدمات الاقتصادية . وأما ضعف تقديم الخدمات واستشراء الفساد إلى جانب ارتفاع معدلات البطالة والفقر فقد أفضت إلى ظهور تظلمات عامة حتى قبل جائحة كورونا العالمية.

**لا يزال الاقتصاد العراقي يواجه تحديات كبيرة على مستوى الاقتصاد الكلي في أعقاب الصدمة المزدوجة لجائحة كورونا وانهيار أسواق النفط العالمية.** انكمش الناتج المحلي الإجمالي للعراق بنسبة 6.8 % في النصف الأول من عام 2020 (على أساس سنوي) مما عكس اتجاه النمو الاقتصادي المتحسن المطرد على مدى العامين الماضيين. وأدى انخفاض الطلب العالمي على الطاقة وخفض إنتاج دول مجموعة ( أوبك +) إلى انكماش الناتج المحلي الإجمالي النفطي للعراق بنسبة 10.4% (على أساس سنوي) في الربع الثاني من عام 2020. ومنذ ذلك الحين ، انخفض إنتاج النفط ليصل إلى أدنى مستوى له في خمس سنوات عند 3.58 مليون برميل يومياً في آب 2020. وكان تراجع النشاط الاقتصادي أكثر وضوحاً في قطاع الخدمات ، الذي انكمش بنسبة 20.7 % (على أساس سنوي) في الربع الثاني من عام 2020 ، في اعقاب فرض الإغلاق العام وحظر التجول في آذار 2020. وأدى هذا الانكماش الحاد إلى انخفاض إجمالي الناتج المحلي غير النفطي بنسبة 9.2 % (على أساس سنوي) في النصف الأول من عام 2020. وأبتداءاً من أيلول 2020 ، كشفت بيانات التنقل الجغرافي عن ظهور تحسن جزئي في نشاط مناطق العمل ليصل الى حوالي 20 % أقل عما كانت عليه مستويات ما قبل جائحة كورونا. ومع ذلك ، فإن الارتفاع المفاجئ في حالات الإصابة بـفايروس كوفيد - 19، والذي تجاوز 400,000 حالة مؤكدة و 10,000 حالة وفاة في تشرين الأول 2020 ، يسلط الضوء على الطبيعة المستمرة للأزمة الصحية وضرورة التركيز على إنقاذ الأرواح لتجنب الآثار الطويلة المدى التي لا رجعة فيها للأزمة.

**تلقي الصدمة المزدوجة بوطأتها على الإيرادات المالية تاركة الحكومة أمام خيارات تمويل محدودة.** على الرغم من ان الإيرادات الحكومية أنخفضت بنسبة 47.5 % (على أساس سنوي) في الأشهر الثمانية الأولى من عام 2020 ، فأن النفقات ظلت مرتفعة عند نسبة 21.8 % من الناتج المحلي الإجمالي بسبب الحصة الكبيرة التي تعود لفاتورة الأجور العامة والرواتب التقاعدية. وتسببت جوانب التصلب هذه في الموازنة في فرض ضغط على احتياجات التمويل الحكومية التي من المتوقع أن تصل إلى نسبة ضخمة مقدارها 25.8% من إجمالي الناتج المحلي بحلول نهاية عام 2020. وقد شرعت حكومة العراق في متابعة إجراءات تقليص حجم القطاع العام من خلال وقف الإنفاق الاستنسابي أو الاختياري، وشمل ذلك البرامج الداعمة للنمو مثل تلك المرتبطة برأس المال البشري وتقديم الخدمات العامة، وراحت تركز جميع الموارد المتاحة على دفع فاتورة

رواتب القطاع العام والرواتب التقاعدية. ولكن هذه الإجراءات وحدها لن تكون كافية، إذ إن من المتوقع أن تظل أسعار النفط أقل بكثير من سعر نقطة التعادل (58 دولاراً أمريكياً للبرميل الواحد) فلا تكفي لتغطية هذين البندين الرئيسيين للإنفاق. كما كان لنقص الحيز المالي آثار سلبية على النمو وقدرة حكومة العراق على توفير حوافز للاقتصاد والتخفيف من تأثيرات الجائحة. وستخلق احتياجات التمويل المتزايدة تحديات كبيرة لأرصدة الاقتصاد الكلي للبلاد وتلقي ضغوطاً على سعر الصرف واحتياطيات البنك المركزي.

**يتوقف المستقبل الاقتصادي للعراق على آفاق أسواق النفط العالمية وقدرة قطاع الرعاية الصحية على التكيف مع الجائحة.** من المتوقع أن يؤدي تحسن التوقعات فيما يتعلق بأسواق النفط وزيادة الإنتاج ، كجزء من اتفاقية أوبك ، إلى دفع النمو خلال عامي 2021 و 2022 رغم غياب الإصلاحات القوية. وإذا ما تحسن الوضع الصحي ، فان من المتوقع أن ينتعش النمو تدريجياً من 2.0% في 2021 إلى 7.3% في 2022 مع توقع عودة نمو الاقتصاد غير النفطي إلى متوسط يبلغ 4% خلال عامي 2022- 2021. ومع حالة كهذه ، من المتوقع أن تستمر الضغوط المالية والخارجية مع بقاء الرصيدين في حالة عجز.

**إن اتساع وعمق التحديات الاقتصادية يبرزان الحاجة الملحة لتنفيذ إصلاحات هيكلية طال انتظارها.** التخفيضات الحالية في الاستثمارات العامة والبرامج الداعمة للنمو هي تدابير قصيرة الأجل تستهدف التخفيف من وطأة الوضع المالي ، ولكن لا يمكن استدامتها على المدى المتوسط نظراً لما تحمله من تأثيرات على النمو والفقر. وعلى هذا النحو لا يمكنها أن تحل مكانالإصلاحات الهيكلية التي طال انتظارها. وإدراكاً منها لهذا الوضع ،أعدت الحكومة العراقية الورقة البيضاء التي تطرح مخططاً أولياً للإصلاحات التي إذا ما تم تنفيذها يمكن أن تمثل نقطة تحول بالنسبة للعراق. فهناك مكاسب اقتصادية كبيرة يمكن تحقيقها جراء تنفيذ الإصلاحات الهيكلية التي طال انتظارها. ويعتقد البنك الدولي أن مثل هذه الإصلاحات يمكن أن تضيف ما يصل إلى 58.4 % إلى نصيب الفرد من نمو الناتج المحلي الإجمالي في العراق. ولكن النجاح النهائي لمبادرة الإصلاح هذه يعتمد على توافر الإرادة السياسية الحازمة وحشد الدعم الشعبي لقيادة العراق نحوالخروج من واقع الهشاشة الذي ظل يعاني منه لفترة طويلة.

## آثار جائحة كورونا وضعف أسعار النفط على حالة الفقر للأسر في العراق

**تركت الأزمات الأمنية والاقتصادية في السنوات الأخيرة بصمات غير متكافئة على المناطق والجماعات في العراق.** بعد فترة من الهدوء النسبي للعنف ، تراجعت معدلات الفقر في عام 2012 لكنها ارتفعت إلى مستوى قياسي في عام 2014 نتيجة الصراع مع داعش و تدهور أسعار النفط ، قبل أن تنخفض قليلاً مرة أخرى خلال عامي 2017 /2018 مع بدء التعافي. ومع ذلك ، تخفي الاتجاهات الوطنية تفاوتات جغرافية و فئوية مهمة. فبينما واصلت الفجوة بين المناطق الحضرية والريفية تقلصها ، أصبح الفقر يتوزع الآن على قطبي الجنوب الفقير تاريخياً والشمال الفقير حديثاً ، وحيث تتصف هذه الحالة بالفقر الحاد والمزمن في الجنوب ، ومستويات منخفضة نسبياً من الفقر في المركز وأقليم كردستان. وفي كثير من الحالات ، تظهر هذه التفاوتات الجغرافية كمحصلة للفجوات الكبيرة الموجودة بين السكان النازحين وغير النازحين. وفي كل من منطقة الشمال وأقليم كردستان ، حيث تتموضع الغالبية العظمى من النازحين ، يبلغ معدل الفقر بين الأسر النازحة أكثر من ضعف ماهو عليه بين الأسر غير النازحة. وتشير تفاوتات الهشاشة الموجودة مسبقاً الى أن تأثير جائحة كورونا في جميع أنحاء البلاد يُرجّح أن يكون متفاوتاً.

**ستؤدي الصدمة المزدوجة لـجائحة كورونا وتدهور أسعار النفط إلى تفاقم هذه الاتجاهات واختبار قدرة الأسر العراقية على الصمود بشكل أكبر من خلال قنوات متعددة** . في حين أن الاضطراب في سلاسل التوريد يمكن أن يؤدي إلى زيادة الأسعار الأساسية ، فان من المرجح أن ينخفض دخل الأسر العاملة وغير العاملة بسبب التباطؤ الاقتصادي وانخفاض التحويلات المالية. وقد تفقد العديد من الأسر الجزء الأعظم من دخلها أو كله ، ولا سيما تلك العاملة في القطاع الخاص غير الرسمي ، مما سيضطرها إلى استنفاد أي مدخرات ضئيلة واستخدام استراتيجيات التكيف السلبي. كما يمكن أن يؤثر تزايد ضيق الحيز المالي على الغذاء والتحويلات النقدية العامة. وفي ظل غياب استجابة حكومية كبيرة ، سيكون لهذه الآثار قصيرة المدى ، مصحوبة بانخفاض الوصول إلى التعليم والرعاية الصحية والخدمات الأخرى، انعكاسات دائمة على النمو الاقتصادي للأسر ، والتنقل بين الأجيال ، والقدرة على الهروب من الفقر. ويمكن أن تكون هذه الآثار السلبية عميقة ومستمرة ، وبخاصة عندما يواجهها الفرد خلال الطفولة المبكرة، ويمكن أن تحد بشكل كبير من ايرادات الفرد طوال حياته ، ومن الحراك الاقتصادي التصاعدي ، وتراكم رأس المال البشري والصحة ، بل وقد تنتقل إلى الأجيال القادمة.

**تشير التقديرات إلى أن الفقر في العراق ، حتى في ظل سيناريو لأثر مخفف، سيزداد على المدى القصير بنسبة 7 إلى 14 نقطة مئوية.** وهذا يعني أن مابين 2.7 إلى 5.5 مليون عراقي سيصبحون من الفقراء الجدد بسبب الأزمة المزدوجة بالإضافة إلى الرقم الحالي والبالغ 6.9 مليون فقيراً ما قبل الأزمة. وإذ تواصل الجائحة انتشارها الحاد ، تواجه الحكومة المهام الصعبة المتمثلة في محاولة احتواء الفايروس والاهتمام بصحة الناس وإعادة تشغيل اقتصاد متداعٍ.

**يمكن أن يؤدي التقليص المحتمل في فاتورة القطاع العام إلى دفع مابين 0.4 إلى 1.7 مليون عراقي أخر إلى الفقر ما لم تتم عملية إعادة الهيكلة على نحو تدريجي وفعال.** في ظل الحيز المالي في العراق الذي يتصف أصلاً بكونه ضيقاً ، أفضت الأزمات الحالية إلى خلق قيود أكبر على الإنفاق الحكومي ، مما دفع الحكومة الى توجيه خطتها نحو معالجة حجم فاتورة الأجور العامة. ويمكن أن يكون لتصويب حجم القطاع العام أثر كبير على الفقر اعتماداً على كيفية تنفيذ الإصلاحات. ولذلك سيكون من المهم النظر في العواقب التوزيعية عند تحديد موظفي القطاع العام الذين سيتأثرون بذلك. ومن الناحية الجغرافية ، فإن الإصلاحات مثل التخفيضات الشاملة للأجور سوف تزيد من معدلات الفقر بالدرجة الأكبر في إقليم كردستان ومنطقة الوسط نظراً لارتفاع نسبة العاملين في القطاع العام. والى جانب ذلك، سوف يتسبب ذلك في دفع الأسر الفقيرة حالياً في الشمال والجنوب إلى مستوى فقر أسوأ.

**تحتاج سياسة الإستجابة إلى معالجة تحديات الصحة وسبل كسب العيش على المدى القصير ، ولكن يتوجب عليها أيضاً معالجة**

**القضايا الهيكلية من خلال برنامج إصلاحات أعمق.** في ضوء اتجاهات الفقر المتفاقمة ، سيتعين على الحكومة العراقية اطلاق حزمة حوافز مالية عاجلة لحماية الفقراء وخلق فرص عمل قصيرة الأجل :

- على المدى القصير ، ينبغي أن ينصب التركيز على الحفاظ على توفير السلع الأساسية والتغذية ، وتحديد الفئات الأكثر عرضة للجائحة والوصول إليها ، وتوسيع نطاق الحماية الاجتماعية المستهدفة ، أي تقديم الدعم النقدي والعيني المؤقت لمن فقد وظيفته أو انخفض دخله من العمال والشركات بسبب جائحة كورونا. ويجب أن تستخدم الحكومة العراقية الأنظمة الحالية مثل برنامج التحويلات النقدية غير المشروط التابع لوزارة العمل والشؤون الاجتماعية ، والذي يغطي حالياً 1.35 مليون أسرة ، والذي سيكون ضرورياً لتوفير حماية كافية لأكبر عدد ممكن من الفقراء و الفئات الهشة من العراقيين. ويمكن للحكومة العراقية أيضاً المشاركة في سياسات وبرامج سوق العمل النشطة لحماية الوظائف ورفع مستوى القابلية للتوظيف لدى الباحثين عن العمل ، ومحاكاة الدروس الإيجابية من جميع أنحاء العالم. ويشتمل ذلك على هذه برامج دعم الأجور في القطاع الخاص ، والتدريب أثناء العمل ، وبرامج إعادة تأهيل المهارات وريادة الأعمال ، فضلاً عن برامج الأشغال العامة. وبينما لاينبغي بالضرورة أن تشتمل الاستجابة العامة القوية للأزمة على برامج دائمة جديدة ومكلفة ، فأن الحاجة الملحة لمثل هذه التدخلات تتطلب انضباطاً مالياً لتعبئة الموارد باتجاه تحقيق هذه الغاية.
- على المدى الطويل ، سوف يعني انخفاض الإيرادات وإرتفاع تكلفة الاستجابة للأزمة أن العراق سيواجه ضغوطاً شديدة لضبط المالية العامة خلال فترة التعافي. ومن الضروري أن يقلل هذا الضبط من أثر خفض الإنفاق وأي توسيع محتمل للقاعدة الضريبية على الفقراء والفئات الهشة. ومن المهم أيضاً الأخذ بعين الإعتبار كفاءة الإنفاق الحكومي و الى جانب ذلك حماية الموارد المخصصة للبرامج الداعمة للنمو و مكافحة الفقر مثل الإنفاق على الاستثمار العام لرأس المال البشري وتقديم الخدمات. وعلاوة على ذلك ، يجب تنفيذ الإصلاحات الهيكلية التي تعزز خلق فرص العمل ، لا سيما في القطاع الخاص والتي حدد العديد منها في الورقة البيضاء لحكومة العراق.

1

# RECENT ECONOMIC AND POLICY DEVELOPMENTS

## Introduction

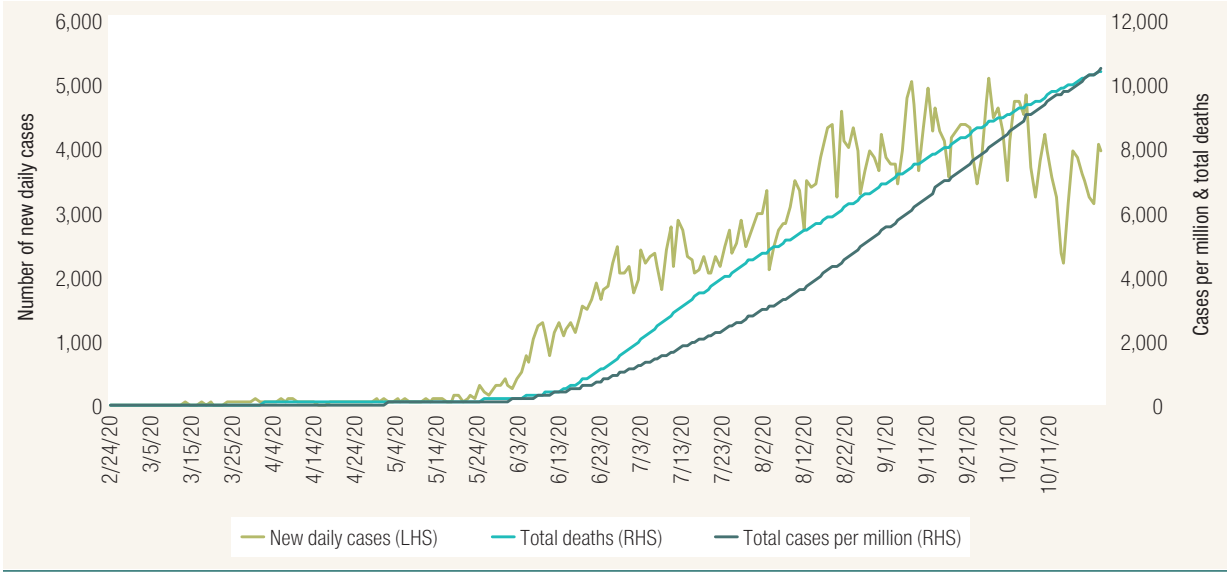
***The global Coronavirus 2019 (COVID-19) pandemic has accentuated Iraq's existing economic challenges.*** Around the world, the COVID-19 health crisis has quickly turned into an economic crisis impacting economic growth and welfare prospects of the most vulnerable households and disproportionately impacting women and informal sector workers. In Iraq, the health crisis has mounted additional pressures over existing economic, social and political challenges. The pandemic has severely impacted the vital oil sector due to the sharp drop in global prices and production volume cuts. The resulting fall in government revenues has further limited the fiscal space needed to respond adequately to additional COVID-19 expenditures in addition to addressing existing structural challenges in expenditures. While sit-ins and street protests have been largely suspended due to health measures introduced since February 2020, the economic pressures on household livelihoods have continued to mount further.

***The recent surge in new COVID-19 cases highlights the urgency of dealing with the health crisis.*** Since the first cases were identified in February 2020, Iraq has remained as the country with the second highest number of cases in the Middle East and North Africa (MENA) region (after Iran). Despite initial control of the spread using stringent lockdowns, new daily cases grew rapidly in mid-2020 as health measures were gradually relaxed. The number of confirmed cases reached over 413,000 by mid-October with total confirmed COVID-19 related deaths passed 10,000 people as curfew hours were reduced and other restrictions were eased (Figure 1). Nonetheless, the authorities strictly enforced cross-border travel at the peak of the religious tourism season in September despite the significance of the sector in economic activity. The recent World Bank COVID-19 Crisis Response Approach Paper[1] lays out a three-stage approach in responding to the crisis which as a first step emphasizes dealing with the health crisis itself to save lives.

***Social and political uncertainties have marginally subsided following the lockdowns***

[1] http://documents1.worldbank.org/curated/en/136631594937150795/pdf/World-Bank-Group-COVID-19-Crisis-Response-Approach-Paper-Saving-Lives-Scaling-up-Impact-and-Getting-Back-on-Track.pdf.

FIGURE 1 • Confirmed COVID-19 Cases and Deaths have Steadily Risen




*Source*: Johns Hopkins CSSE.

***and the transition of the new government.*** The successful interim political transition in May 2020 and the subsequent measures taken by the new government have been productive steps towards rebuilding public trust. The recent Government of Iraq (GoI) White Paper outlining key areas of structural challenges could be the basis of long overdue reforms to put the country on a more economically sustainable path (Box 1.1). The authorities have also made progress in improving the security challenges and addressing governance challenges including better control on customs. The subsided level of social protests due to health measures have also provided the government with room to introduce new steps. The government has announced early general elections will take place in June 2021 which could provide the next elected government with a clear mandate to implement the proposed economic reforms.

## Output and Demand

***The global shockwave of the COVID-19 pandemic reached Iraq's economy early on, reversing the 2019 rebound in gross domestic product (GDP).*** After a 4.4 percent GDP growth in 2019, oil and non-oil sectors simultaneously contracted in the first half of 2020 (H1-20) (Figure 2) as global mitigation measures impacted Iraq even before the first cases were identified in late-February 2020. Border closures, travel restrictions, and other social distancing measures contributed to GDP contracting by 6.8 percent year-on-year (y/y) in H1-20 (Figure 4), the sharpest fall since 2003. The hardest hit sector was services (30 percent of GDP) which contracted by 14.8 percent (y/y) due to mitigation measures that heavily disrupted commerce and religious tourism. Public sector services, the only service sector that grew in real terms in Q1-20, also contracted by 9.8 percent in Q2-20 (y/y) as the collapse in oil prices due to COVID-19 reduced oil revenues (see sections below). Agriculture value-added continued to grow at a rapid pace of 34.3 percent (y/y), with wheat and barley production growing at a slower rate of 43.6 percent and 15.7 percent in the 2020 agricultural season, respectively.[2] Oil GDP shrank by 5.3 percent (y/y) in H1-20 following OPEC+ production cut agreement in Q2-20 (Figure 5) and accounted for half of the overall GDP contraction.

[2] COSIT, August 2020.

## BOX 1.1 GOI HAS ANNOUNCED AN AMBITIOUS ECONOMIC REFORM PLAN – THE "WHITE PAPER"

On October 13, 2020, the new Iraqi government formally approved a comprehensive policy and reform package that will act as a roadmap of overhauling Iraq's economy over the next 3 to 5 years. The White Paper aims to rebalance the economy of Iraq and put it back on a track that enables the state in taking necessary steps to improve it into a dynamic and diversified economy, which creates jobs for citizens to provide for a decent living.

*Overall objectives of the reform package*

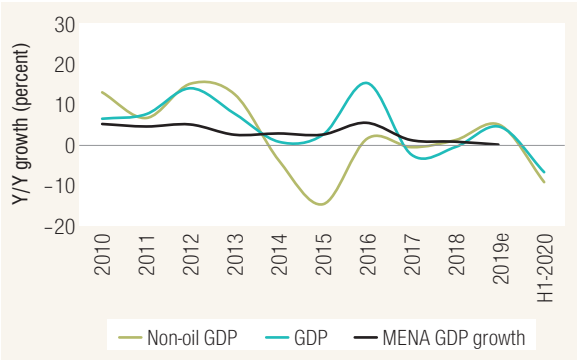
- **Redefine the role of the state** in the economy and society through a gradual re-alignment from a dominant role to focus on supporting law and order, provide basic infrastructure, guarantee the delivery of education and health services and provide social protection to the most vulnerable.
- **Introduce drastic improvement to public financial management** to achieve efficient management of state revenues and effective provision of services.
- **Revive the economy by shifting away from state-dependency** towards a dynamic and competitive economy through tackling key structural impediments.
- **Restructure the financial and banking sector** to transform them into a central growth driver by deepening the sector, increase private sector lending and introduce modern payment systems.
- **Boost productivity and competitiveness** of key sectors like agriculture and manufacturing and manage the impact of the appreciation of the real exchange rate.
- **Protect the most vulnerable groups** in society through universal social protection, education and health services provision by allocating scarce resources for these purposes.

*Major reform areas*

- **Area 1:** Achieve a sustainable fiscal framework through fiscal consolidation, improved domestic revenue mobilization and reforms to the public financial management.
- **Area 2:** Macroeconomic reforms and productive sectors support for sustainable job creation through reforming the financial sector (banking, insurance and capital markets sectors), supporting agriculture, oil and gas sectors, boosting private sector participation, restructuring self-financed state-owned enterprises, boosting human capital and formulating a national strategy for learning and training.
- **Area 3:** Improve essential infrastructure to support growth in other sectors including energy, telecommunications, transport as well as free zones and industrial cities.
- **Area 4:** Provide basic services and consolidate social protection systems, including pension, by prioritizing the poorest segment of the population and protect it from the possible impact of reforms.
- **Area 5:** Develop the governance, legal, and administrative environment to help institutions and individuals in implementing reform. This includes procurement and public investment management, and civil service reforms.

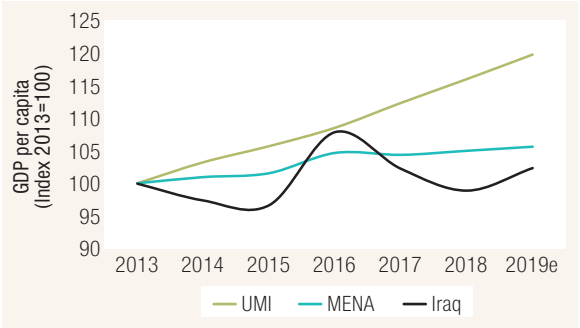
The GoI proposal still needs to be approved by the Parliament but presents a crucial opportunity for changing the trajectory of the economy and reap significant benefits of implementing long awaited structural reforms.

FIGURE 2 • The Positive 2019 GDP Growth Was Reversed in H1-20…



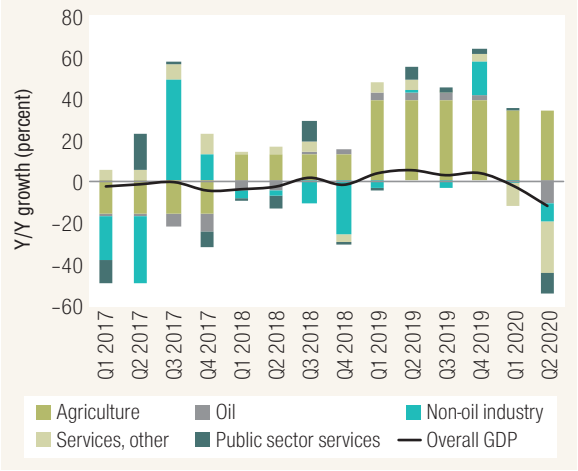

*Source*: Iraqi authorities and World Bank staff calculations.

FIGURE 3 • … Adding to the Challenge of Economic Convergence with Regional and Income Peers



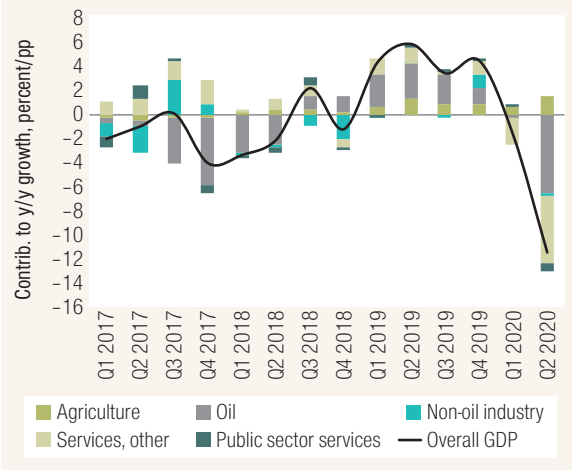

*Source*: World Bank staff estimates and World Development Indicators (WDI).

FIGURE 4 • The H1-20 Contraction Was Broad Based …




*Source*: COSIT and World Bank staff calculations.

FIGURE 5 • …but Was Partly Mitigated by a Strong Agriculture Growth



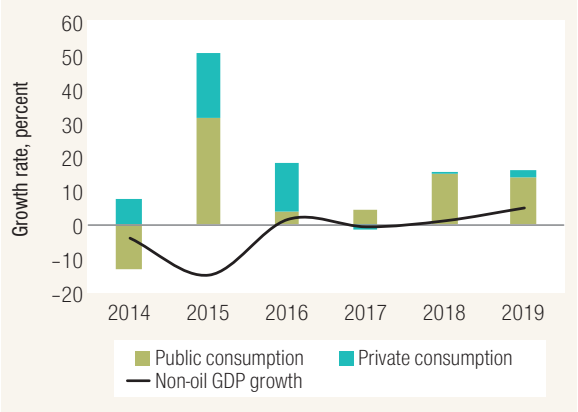

*Source*: COSIT and World Bank staff calculations.

***The COVID-19 containment measures have severely impacted consumption on the demand side.*** Curfews and lockdowns were introduced on March 22 across the country and significantly impacted consumption as commerce, hospitality (restaurants, hotels and religious tourism) and transport sectors. This negative shock further amplified the already low contribution of private consumption to overall growth since 2017 (Figure 6). Government consumption which has been a major contributor to growth in the recent years was also heavily impacted due to the sharp decline in oil revenues. Faced with the challenges of weak demand, the authorities have started easing restrictions in mid-2020 (Figure 7). Based on the latest Google geo-mobility data, mobility in workplace locations in September 2020 was still 20 percent below their pre-COVID trend (up from −38 percent in April).[3]

***Investment has remained weak due to a challenging business climate and foreign direct investment (FDI) growth has been concentrated in the energy sector.*** Inward FDI into Iraq's

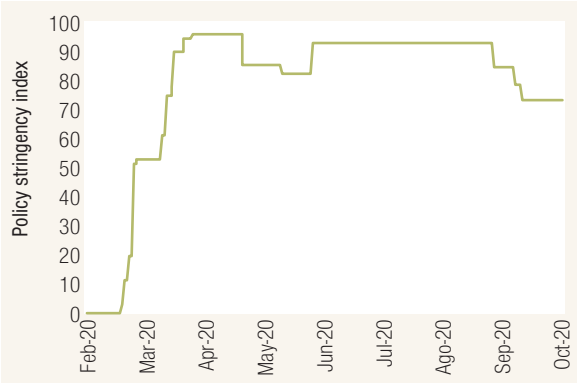
[3] https://www.google.com/covid19/mobility/.

FIGURE 6 • COVID-19 Impacted the Recent Consumption Driven Growth Trend…



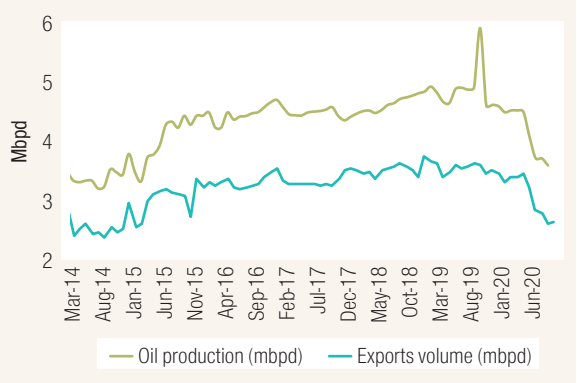

*Source*: World Bank staff calculations.

FIGURE 7 • … Leading to Containment Measures to Become More Growth-Oriented since mid-2020



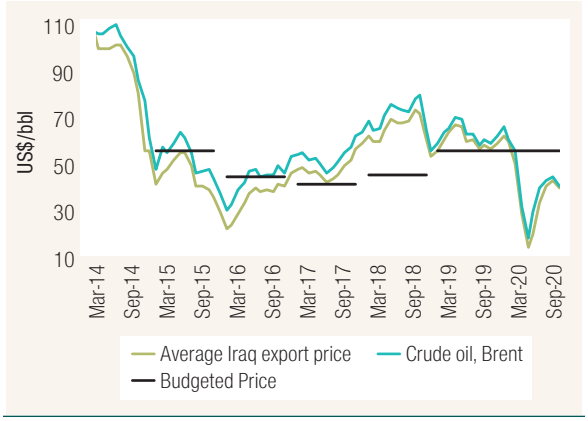

*Source*: Coronavirus Government Response Tracker, University of Oxford.

FIGURE 8 • Oil Production and Exports Plummeted Following Weaker Global Demand and OPEC+ Cuts…




*Source*: Iraq Ministry of Oil (MoO) and World Bank Staff calculations.

FIGURE 9 • …Leading to Oil Prices to Recover but Remain Below the Budgeted Amount




*Sources*: MoO and World Bank Staff calculations.

economy has remained low (1.3 percent of GDP in 2019), a legacy of the country's chronic security and business environment challenges. While COVID-19 negatively impacted the overall investment climate, FDI increased to US$1.4 billion in Q1-20 thanks to new investment contracts following relative improvement in the security situation and a reduction of social protests due to containment measures. However, the majority of new FDI has remained restricted to the oil and energy sectors with higher expected return rates. The cuts in government investment expenditures due to fiscal constraint have also severely impacted investments in H1-2020 (see the Public Finance section).

## Oil and Gas Developments

***The OPEC+ production cut agreement and the soft global demand for an already oversupplied oil market have taken their toll on Iraqi oil crude production and export volumes.*** The COVID-19 crisis led to a fall in oil demand as economic activity fell significantly across the world. In response to the large oil glut in markets, OPEC+ countries agreed to cut production by 9.7 mbpd in April 2020, an amount that will gradually be tapered across 2 years.[4] As part of the agreement Iraq's oil production quota for May-July was set at 3.59 mbpd which is set to increase by 0.2 mbpd for the rest of 2020 if previous quotas are met.[5] Production cuts led to Iraq's crude average daily crude oil production and export volumes in Jan–Aug 2020 to fall by 14.2 percent (y/y) and 12.2 percent (y/y), respectively (Figure 8). In response to previous over production beyond the agreed quota, Iraq's oil production was cut sharply to reach a five-year low of 3.58 mbpd in August 2020.

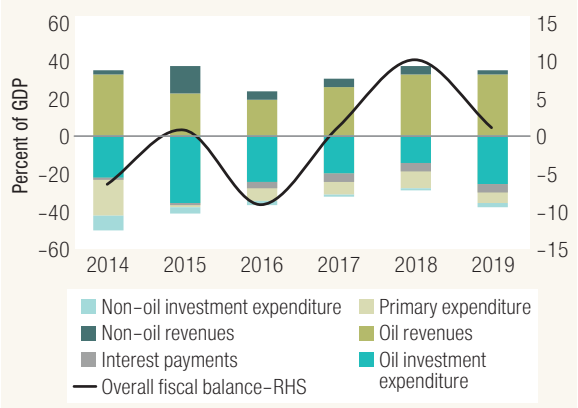
***Production cuts and partial reopening of economies globally have helped push the price of Iraqi oil higher in Q2-20 albeit well below the budgeted price assumption.*** Iraq's average oil export prices steadily recovered to US$40.41/bbl in September 2020 up from a low of US$13.80/bbl four months earlier (Figure 9). The lower price gap between global oil prices and Iraq's oil export prices since 2019 could also reflect Iraq's recent adherence to the Extractive Industries Transparency Initiative (EITI) and/or lower competition from other exporters of similar grade oil. The recent oil price dynamics partly mitigate revenue pressures but as the price remains below the amount envisioned in the original draft budget (US$56/bbl) they will add to fiscal and external sector pressures.[6]

[4] https://www.eia.gov/todayinenergy/detail.php?id=45236.

[5] https://www.argusmedia.com/en/news/2130086-iraq-pledges-to-produce-400000-bd-under-opec-quota.

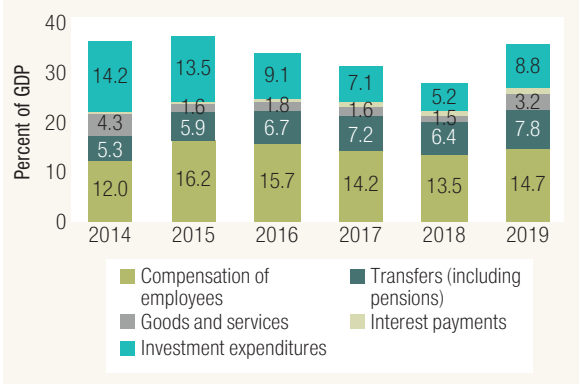
[6] The original 2020 budget was not presented to Parliament given changes in government. The GoI was operating on a one-twelfth rule basis until a draft financing law was

FIGURE 10 • Oil Income, the Major Source of Revenues, Has Been Hit Hard…




*Source*: Iraq Ministry of Finance (MoF) and World Bank staff calculations.

FIGURE 11 • … but Existing Rigidities in Expenditures Including High Wage Bill Remain in Place




*Source*: MoF and World Bank staff calculations.

***Despite the decline in export volumes, the rebound in prices has resulted in oil revenues partially recovering from their trough in April 2020, a recovery that remains far from the windfall of earlier years.*** Iraq's oil export revenues in April 2020 were 80 percent lower than the same month in 2019 but they have recovered to more than twofold in August 2020. Despite the recovery in prices since May 2020, average monthly oil export revenues in the first 9 months of 2020 reached US$3.4 billion, around 48.5 percent below the corresponding value in the same period in 2019. These developments highlight the extent of the challenges facing government finances and exchange rate reserves.

***A series of recent investment project agreements in 2020 aim to improve energy infrastructure.*** Iraq still remains the second largest OPEC oil producer and its current oil production capacity is above 5 mpbd. The Ministry of Oil plans to increase production capacity with further recovery and exploration investments. More recently, the new government which came into power in May 2020 has signed a series of investment contracts with major US energy companies (worth over US$8 billion).[7] These agreements aim to improve the country's domestic energy generation capacity and reduce flaring of associated gas in oil fields. Other recent steps taken in diversifying energy imports include agreements with GCC member countries and Jordan to connect electricity grids.[8]

## Public Finance

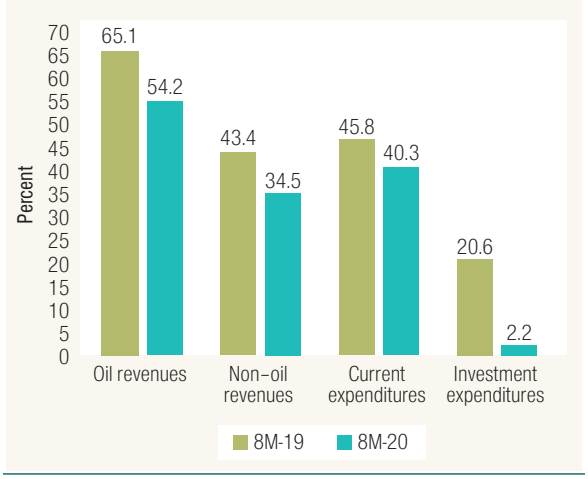
***Declining oil revenues and subdued economic activity continue to exert pressure on government finances in the first half of 2020 (H1-20).*** Iraq's fiscal situation is highly dependent on oil receipts as it constituted 92 percent of total revenues in 2019 (or 35.9 percent of GDP, Figure 10). As such its fiscal situation is highly affected by the volatility in global oil markets. Cuts in oil production due to production caps and lower prices have resulted in 48.3 percent (y/y) drop in revenues in the first 8 months of 2020 (8M-20). Moreover, the GoI and Parliament have been less active on reforms to domestic revenue mobilization. Despite customs and tax efforts, non-oil revenues share in total budget have remained low

submitted in September 2020. This law acts as a modified budget law. Under this financing law budgeted oil price was revised to 44 dollars for the last 4 months 2020.

7 https://www.reuters.com/article/us-usa-iraq-visit/u-s-companies-unveil-iraq-investments-before-premiers-white-house-visit-idUSKCN25F2MT, https://english.alarabiya.net/en/News/middle-east/2020/08/20/Iraq-US-companies-sign-deals-worth-more-than-8-billion-ahead-of-Kadhimi-Trump-meet.

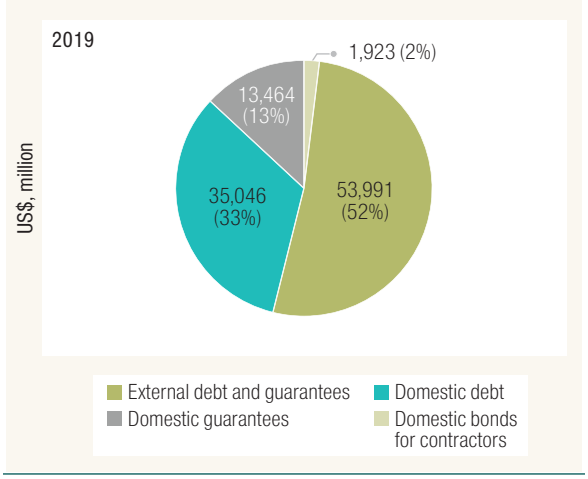
8 https://www.middleeastmonitor.com/20200718-gcc-renews-support-for-project-to-link-power-grids-with-iraq/, https://www.mees.com/2020/10/2/geopolitical-risk/jordan-iraq-ink-power-deal/b1e05a00-04b4-11eb-8503-6b7ebe8cfb8c.

FIGURE 12 • Realization Rates of Budget Target Deteriorated Further as the Economy Deteriorated




*Source*: MoF and World Bank staff calculations.

FIGURE 13 • The Majority of the Stock of Debt and Guarantees Are from External Sources




*Source*: Iraqi authorities and World Bank staff calculations.

in 2019 at 7.8 percent of GDP. Moreover, subdued economic activity led to a decline of 38.3 percent (y/y) in 8M-20 non-oil revenues due to COVID-19 following lockdowns and health mitigation measures. As a result of these events, the budget surplus in 2019 changed to a deficit of 5.5 percent of GDP in 8M-20. This raises the gross financing needs[9] of the budget to 6.6 percent of GDP over the same period.

***Years of fiscal policy loosening through the expansion of public employment, transfers, and changes to the pension law have resulted in rising budget rigidities and have eroded fiscal buffers.*** To showcase the severity of the situation, the public wage bill and pension is estimated at 33.1 percent of GDP in 2020 and will require a US$58/barrel of oil price export to fully cover those expenditures. Faced with this situation, the GoI has resorted to cost savings measures by halting all discretionary spending. As a result, expenditures on goods and services for example dropped by a staggering 40.2 percent (y/y) in 8M-2020. more importantly, severe cuts were observed in public investment. Capital expenditures and investment expenditures in 8M-2020 were only 5.4 percent and 2.2 percent of their respective budget targets for 2020, significantly lower realization rates than the same period in 2019 (Figure 12). While such a policy is merited in the short-term to contain the deficit, it cannot constitute a long-term policy. Such cuts reduce growth-critical human capital spending (see Box 1.2 on Iraq's Human Capital Index) as well as service delivery programs, and undermine oil field expansion plans. Hence this will have significant consequence on growth and poverty levels.

***The growing fiscal deficit has increased financing pressures and contributed to the growth of existing public debt stock.*** With no access to international markets, the deficit is being primarily monetized with financing being secured through the Central Bank of Iraq (CBI) and to a lesser extent by state-owned-banks. The reliance on domestic financing, crowds out private sector financing and puts pressure on the exchange rate. Iraq's public debt stood at 44.6 percent of GDP in 2019 and given the deficit levels and slowdown in growth, it is projected to reach 65.7 percent of GDP by end-2020. Debt and fiscal management faces significant challenges including the absence of a fully ratified budget in 2020 even as of Q4-20. The increasing amount of domestic debt, which is more short-term, has also increases refinancing risks. A large share of existing debt and guarantees stock (52 percent in 2019) consists of external sources out of which around 9 percent are due to legacy external debt owed from prior to 1990 (Figure 13). The majority

[9] Gross financing needs are defined as the budget balance + debt repayment obligations.

## BOX 1.2 THE HUMAN CAPITAL INDEX IN IRAQ

According to the latest edition of the Human Capital Index (HCI) report published by the World Bank in September 2020, a child born in Iraq today will reach, on average, only 41 percent of his or her potential productivity when he or she grows up.

First launched in 2018, the HCI estimates the expected productivity of a child born today as a future worker relative to a benchmark of complete education and full health. Using the latest data on education and health outcomes through March 2020, the 2020 index provides a snapshot of the state of human capital in 174 countries before the COVID-19 pandemic and a baseline to track the pandemic's impacts on human capital over time.

The HCI is composed of five components (see Figure):[a]

**Probability of Survival to Age 5.** 97 out of 100 children born in Iraq survive to age 5.

**Expected Years of School.** In Iraq, a child who starts school at age 4 can expect to complete 6.9 years of school by her 18th birthday.

**Harmonized Test Scores.** Students in Iraq score 363 on a scale where 625 represents advanced attainment (300 represents minimum attainment).

**Adult Survival Rate.** Across Iraq, 84 percent of 15-year olds will survive until age 60. This statistic is a proxy for the range of health risks that a child born today would experience as an adult under current conditions.

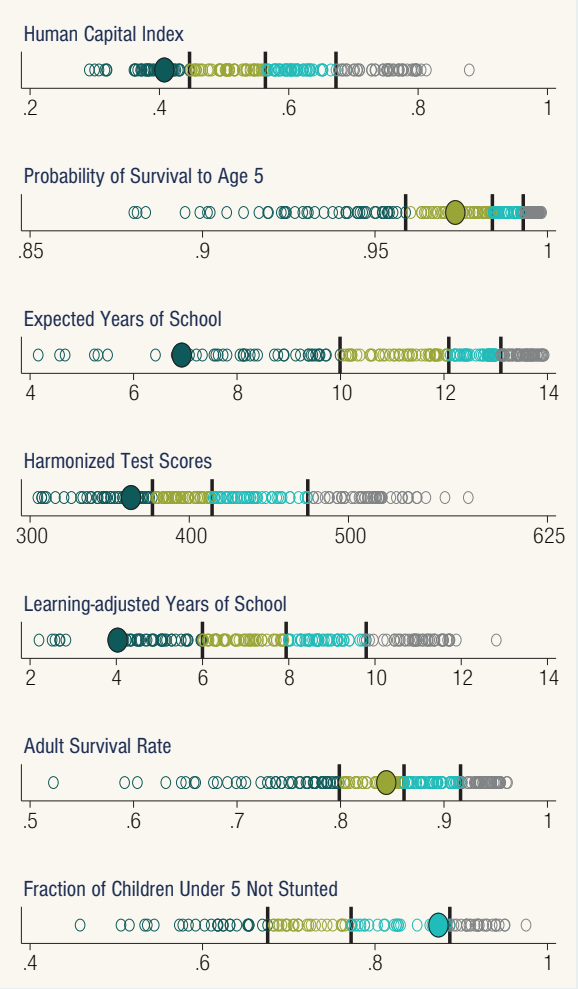
**Healthy Growth (Not Stunted Rate).** 87 out of 100 children are not stunted. 13 out of 100 children are stunted, and so are at risk of cognitive and physical limitations that can last a lifetime.

Iraq's HCI value of 41 percent is the second-lowest among countries with available data in the MENA region, significantly below the averages for the region (57 percent) and all upper-middle income countries (56 percent).

Iraq's poor performance on the HCI is largely attributed to its education outcomes. Based on current enrollment rates, an Iraqi child can expect to complete only 6.9 years of school—compared to 11.3 in the MENA region. When taking into account the quality of learning that actually takes place, this child will achieve only 4.0 learning-adjusted years of school—versus a MENA average of 7.6 years. As a result, more than 40 percent of the time spent in school by an average Iraqi child is "wasted" and fails to translate into productive skills when this child enters the workforce.

The World Bank is supporting the Government of Iraq to address the country's existing human capital challenges. The education sector in particular is of critical importance, as shown by Iraq's lagging values on the education components of the HCI. The World Bank's technical assistance program of Support to Education and Skills Development in Iraq (SESDI), coupled with the forthcoming Public Expenditure Review for the Human Development Sectors (HD PER), aims to strengthen the Government of Iraq's capacity to provide quality education services for improved human capital development.

### FIGURE 1.2.1 • HCI and Components

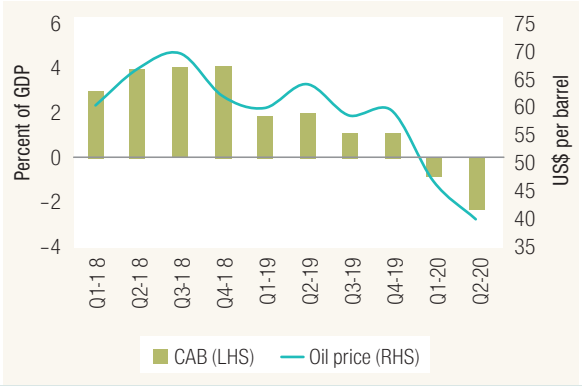



*Note*:
- Large circle represents Iraq
- Small circles represent other countries
- Lines and color of circles indicate quartiles of the distribution

*Sources*:
World Bank. Human Capital Project. https://www.worldbank.org/en/publication/human-capital.
World Bank. 2020. The Human Capital Index 2020 Update: Human Capital in the Time of COVID-19. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/34432.

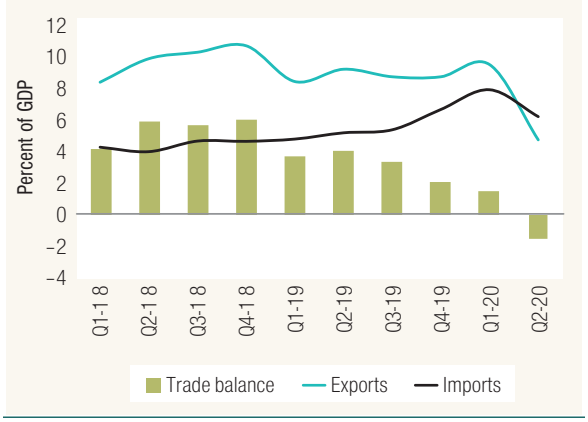
[a] Learning-adjusted Years of School is a product of two HCI components: Expected Years of School and Harmonized Test Scores.

FIGURE 14 • The Decline in Oil Prices Pulled the H1-20 CAB Into Deficit…




*Source*: CBI, MoO and World Bank staff calculations.

FIGURE 15 • … while Imports Grew (y/y)




*Source*: CBI, MoO and World Bank staff calculations

of the stock of debt and guarantees are from external sources). The majority of external debt (66 percent in 2019) is long-term debt and is owed to multilateral and bilateral donors which mitigate debt service costs. Interest payments remained low at 1.1 percent of GDP in 2019.

## External Sector

***The current account balance (CAB) registered a deficit in H1-20 primarily due to a decline in oil export revenues.*** A less favorable terms of trade has turned the previous current account surplus into US$5.9 billion deficit, equivalent to 3.3 percent of 2020 GDP in H1-20 (most recent data) (Figure 14). Exports which are almost entirely dominated by crude oil and petroleum fell by 37.8 percent (y/y) to reach US$25.4 billion in the same period. This was while imports increased by 9.9 percent (y/y) (Figure 15). These trends led Iraq's previous trade surplus to entirely fade away in H1-20, falling to the lowest level in the recent years.

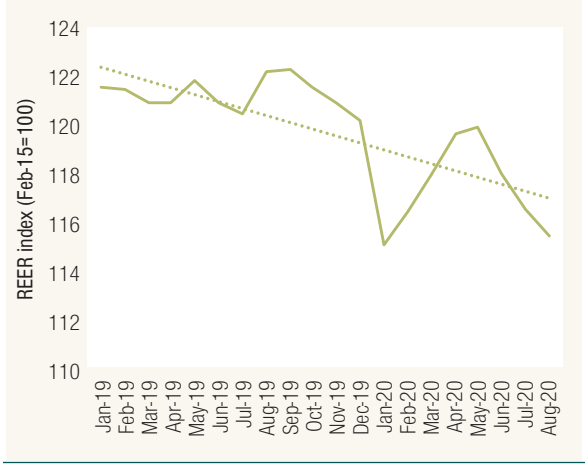
***Imports growth continued in H1-20 albeit at a much slower pace due to border closures in Q2-20 .*** The government's less accommodative fiscal stance meant that public sector imports—dominated by non-capital goods (with refined oil products accounting for 61.6 percent)—declined by 63.7 percent (y/y) in H1-20. Private sector imports contracted at a slower rate of 9.7 percent as the impact of the COVID-19 border closures in Q2-20 was partly offset by a strong growth (19.4 percent, y/y) in Q1-20. Private sector imports is significant in that unlike the public sector 75 percent of private imports consists of capital goods which could have partly mitigated the impact of declining government investments.

***The appreciation of the Iraqi Dinar against neighbor currencies have encouraged imports over the recent years, but recent border closures and protective measures reduced the flow of goods.*** Iraq's imports have become cheaper due to sharp depreciations of Iranian and Turkish currencies since 2019 (Figure 16). The fall in import prices has led to the country's increasing reliance on imports from its two neighbors. Despite continued depreciation of the rial and the lira, Iraq's imports from Iran and Turkey fell to significantly lower levels, US$2.4 and US$2.8 billion in Apr–Aug 2020, respectively.[10] This comes as a result of bordure closures in March, following the spread of COVID-19, recent enforcement of border controls to stop smuggling, and imports ban taken by the GoI on certain consumer products.

***External account pressures have increased due to lower oil prices and rising global***

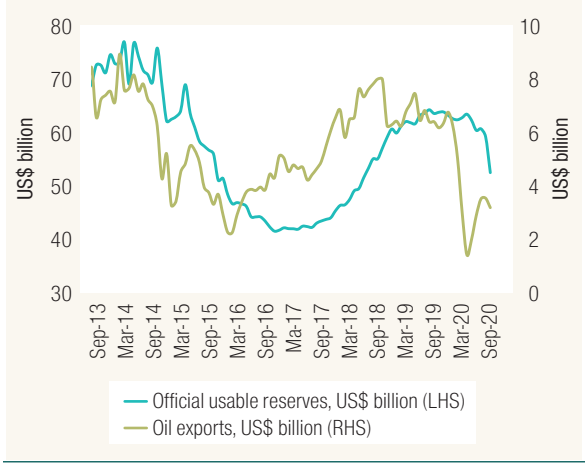
[10] Based on Iran's customs trade data, Iraq imported US$9 billion of goods from Iran in Apr 2019–Mar 2020 and US$1.5 billion in Q1-20 (9.6 percent of Iraq's total imports). Turkey's trade data also suggests that Iraq's imports from its northern neighbor in Q1-20 totaled US$2 billion (13.9 percent of imports).

FIGURE 16 • Iraq's Exchange Rate Has Appreciated Relative to its Main Trading Partners…




*Source*: World Bank staff calculations.

FIGURE 17 • …which Combined with Lower Oil Exports Led to Pressures on CBI Reserves…




*Source*: CBI, MoO and World Bank staff calculations.

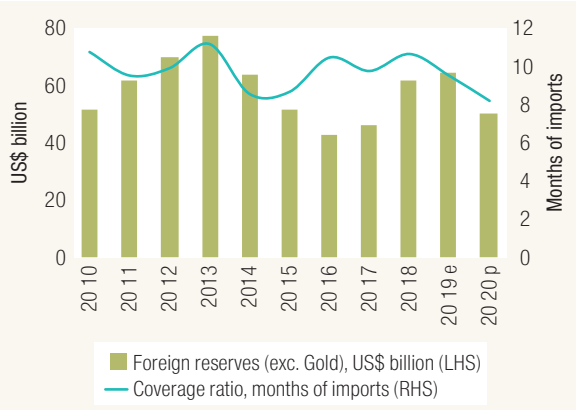
***economic uncertainty but tighter fiscal policy has helped soften their impact in the short run.*** Iraq's main source of external account financing, crude oil (96 percent of exports in 2019), has been heavily impacted by the deterioration of prices and production volumes. However, lower public sector imports has mitigated the full impact of external pressures. Net FDI flows have also remained limited (falling by US$1.9 billion in 2019 and registering a net outflow of 1.1 percent of GDP in H1-20) and were concentrated in the oil and energy sector. The other major sources of external financing, official investment, witnessed net outflow of 5.4 percent of GDP in H1-20 due to heightened global economic uncertainty. As a result of these financing constraints CBI reserves have also come under pressure (Figure 17) with CBI usable reserves (i.e., excluding gold) falling to US$52.3 billion in September 2020. Based on this, usable reserves could fall to below 8.1 months of imports in 2020 (its lowest level in recent years) (Figure 18).

## Monetary Policy and Prices

***Subdued domestic demand and cheaper imports due to depreciation of import partners' currencies have kept inflation in check.*** Headline and core inflation registered only 0.4 and 0.5 percent rise in the first 8 months of 2020 (y/y) (Figure 19 Inflation has remained low due to cheaper imports and weaker demand). The highest increase in consumer prices were in health and education categories a reflection of the higher service delivery costs under the lockdown period (Figure 20). Food, housing and utilities underwent a deflationary trend in the first 8 months of 2020 as imports became cheaper and domestic demand weakened.

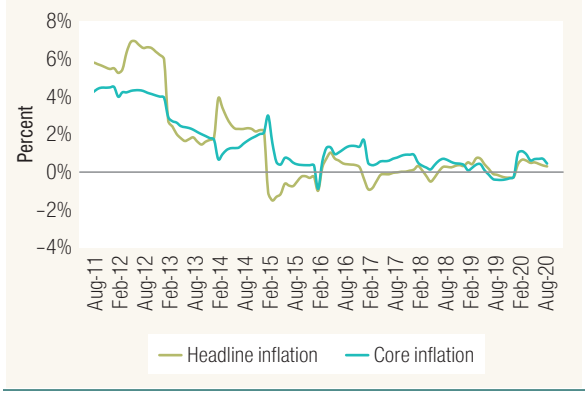
***Authorities have implemented a range of measures to tackle the impact of COVID-19 on the economy.*** Ministry of Finance (MoF) has provided immediate cash assistance of IQ 50 billion (US$42 million) to the Ministry of Health (MoH) to enable it to undertake required measures and provide as needed support to the citizens. Additional funding support amounting to US$37 million has been provided to the MoH from a fund established by the CBI and financial institutions. The authorities have also launched the MINHA program, to assist citizens affected by the coronavirus crisis and who are not receiving any salary or income from the Government (including the existing cash transfer program administered by the Ministry of Labor and Social Affairs). The MINHA program provides a monthly benefit of IQD 30,000 (or the equivalent of US$25) to about 10 million beneficiaries. The

FIGURE 18 • ...bringing Usable Reserves Down to 8 Months of Imports



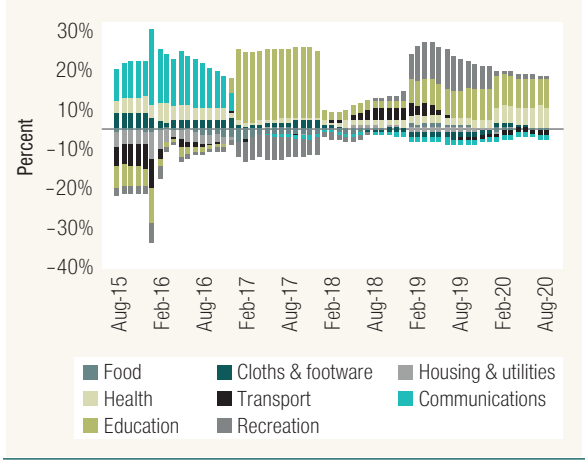

*Source*: CBI, IMF, MoO and World Bank staff calculations.

FIGURE 19 • Inflation Has Remained Low Due to Cheaper Imports and Weaker Demand



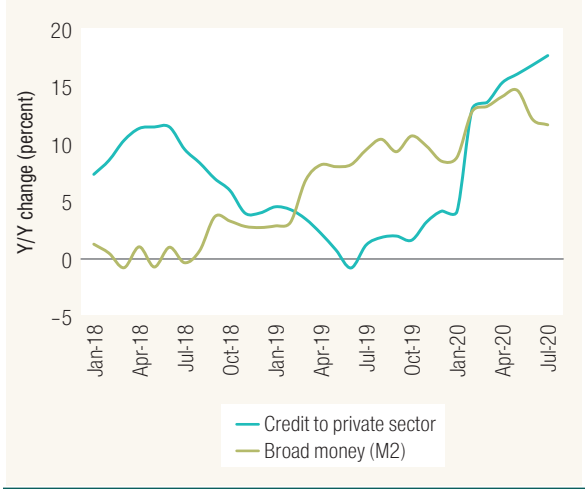

*Source*: CBI and World Bank staff calculations.

FIGURE 20 • Lockdowns and Restrictions have Increased Prices of Health and Education Services




*Source*: CBI and World Bank staff calculations.

FIGURE 21 • Monetary Policy Has Boosted Credit to Private Sector and Money Supply




*Source*: CBI and World Bank staff calculations.

MINHA program utilizes a streamlined and simplified electronic registration process and uses electronic payments mechanisms to disburse the funds to the beneficiaries. Beyond government assistance, there are other cash transfer programs that are delivered to vulnerable populations of internally displaced persons (IDPs) by humanitarian organizations—United Nations (UN) agencies and international non-governmental organizations (NGOs).

***CBI has followed a more accommodative monetary and supervisory policy in the face of the economic downturn to provide support to the vulnerable segments of the economy.*** Facing the pandemic, the CBI responded by reducing reserve requirements by 2 pp to 13 percent in order to mobilize resource for boosting credit growth by the banking sector. This was complemented by a range of other measures including moratoriums on principal and interest payments of loans for micro-, small- and medium-sized enterprises (MSME) which disproportionately suffered from health mitigation measures and providing additional low interest loans under its

## BOX 1.3 KEY CHALLENGES OF THE FINANCIAL SECTOR AND MAJOR POLICY REFORMS[a]

There are a number of factors that limit the financial sector's ability to effectively contribute to Iraq's long-term development as well as to support the significant national reconstruction needs and to finance the private sector. First, the Iraqi banking sector is dominated by under-capitalized and under-provisioned state-owned banks (SOBs) primarily used for quasi fiscal operations. The banking sector remains fragile and dysfunctional, which calls for the continuation of SOBs reforms and rationalization of licensing regime. Second, lack of trust in the financial system is characterized by a largely cash based banking system with low deposits and under-utilization of the electronic payments infrastructure.

Moreover, a non-banking financial sector is at an early stage of development with nascent and underdeveloped capital markets and negligible non-bank financial institutions. The microfinance sector is one of the smallest and least developed in the MENA region. The development of NGO microfinance institutions (MFIs) is limited by the regulatory framework which creates an uneven playing field between NGO MFIs and SME finance companies and the lack of consumer protection or privacy laws for the MFI sector, as well as funding constraints (with heavy reliance on grants, which have been shrinking). Fourth, poor credit intermediation impedes the realization of the full potential of the economy. Access to finance has been identified as a key constraint across multiple sectors, including agriculture, microfinance and housing.

To address the aforementioned challenges, the priority reforms of the Iraqi financial sector include: (a) the improvement of the governance and financial health of SOB's by: implementing corporate governance reforms; undertaking viability and sustainability reviews, International Financial Reporting Standards (IFRS) audit; elimination of directed lending schemes; and installation of core banking systems in preparation for their restructuring; (b) implementing a national financial inclusion strategy; reinforce credit infrastructure including improving the insolvency laws, establishing collateral registries and expanding the credit bureau. The reforms need to be backstopped by legal and judicial measures to strengthen the regulatory and supervisory frameworks including: enactment of laws on Payment System to facilitate digital payments; rollout of National ID; strengthen bank licensing regime (by enacting measures such as higher paid up capital and other prudential requirements to consolidate the banking sector); operationalization of the Deposit Insurance Scheme, etc.

[a] The forthcoming World Bank Financial Sector Assessment Program (FSAP) development module provides an in-depth diagnostic of Iraq's financial sector, its structural problems and the needed policy reforms.

directed "one trillion ID" initiative.[11] In September 2020, the CBI also requested banks to suspend charging commissions on electronic payment transactions for 6 months and provide flexibilities on loans including extending maturities and reduce interest rates. To encourage the usage of electronic payments in lieu of cash, CBI has issued emergency regulations simplifying and streamlining the Know Your Customer (KYC) requirements allowing Iraqi citizens to open e-wallets from home using their existing ID's.[12] Additionally a media campaign has also been launched to educate the citizens of the convenience and health benefits of using electronic payments.

***Measures implemented by monetary authorities contributed to a sharp growth in banking sector credit to private sector and money supply in H1-20.*** Since mid-2019, credit growth to the private sector accelerated as lower public expenditure reduced public sector credit demand leaving the banking sector with more resources to extend credit to the rest of the economy. This trend further accelerated with COVID-19-related monetary measures in H1-20 (Figure 21 Monetary policy has boosted credit to private sector and money supply). Prior to this, credit facilitation to the private sector had been weak due to higher public sector (state owned enterprises, SOEs) credit demand crowding out the private sector combined with the structural limitations of the banking sector geared towards SOEs. Box 1.3 summarizes the main structural challenges of Iraq's financial sector and discusses the main areas of policy reform.

[11] IMF COVID policy response tracker, https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#I.

[12] This is a time bound measure and e-Wallet holders will be required to regularize the e-wallet and comply with CDD requirements in person at a later date.

2

# OUTLOOK AND RISKS

## Outlook

***Iraq's economic outlook is highly uncertain and will depend on the evolution of COVID-19 globally and domestically, global oil markets, the capacity of the Iraqi healthcare system to respond to the pandemic, and the reform process.*** Under a baseline scenario of little reforms and faced with a multifaceted crisis, Iraq's growth is expected to contract by 9.5 percent in 2020, the worst annual performance since 2003. Oil GDP is projected to contract by 12 percent, capped by the OPEC+ production agreement which is assumed to remain at 4 mbpd. Non-oil GDP is forecast to shrink by 5 percent as services sectors are affected by COVID-19 mitigation measures especially the all-important religious tourism. Agriculture production is expected to continue to decelerate in 2020 but remain positive. Iraq's growth outlook hinges on rebound in global growth and oil prices.[13] If the health situation improves, growth is projected to gradually rebound from 2.0 percent in 2021 to 7.3 percent in 2022 with non-oil economy projected to bounce back to an average of 4 percent in 2021–22. The recovery in domestic demand is expected to increase inflation in 2021–22, to an annual average of 2 percent.

***In the absence of public wage bill and pension reforms, the fiscal deficit is projected to remain sizeable at 12 percent of GDP in the medium term amidst a modest recovery in oil prices.*** Employee compensation and pension payments are estimated to remain the largest components of expenditure and jointly account for 30 percent of GDP in 2021–22. Consequently, the debt-to-GDP ratio is projected to remain elevated and increase to above 70 percent of GDP over the forecast period. Securing budget financing under uncertain global market conditions will be challenging. Reliance on domestic financing would increase Iraq's debt service and repayment risks, and crowd out private sector.

***Iraq is also expected to face a persistent current account deficit.*** Oil exports are projected to only increase gradually in the outer years reaching 3.3 mbpd in 2022. Oil prices in current market conditions are forecast to remain under US$50/bbl, which is below the breakeven price for covering the external account deficit. However, low public spending outside

[13] According to the World Bank Global Economic Prospects (GEP), global growth is expected to rebound to 4.2 percent in 2021.

of the wage bill and pension is expected to ease the impact on the CBI reserves as imports are contained. Reserves are projected to reach seven months of imports by 2022.

***Iraq's current economic structure undermines the private sector's role as the main engine of job creation and hence needs to be prioritized in any new reform plan.*** The private sector can benefit from measures in the banking and financial sector that improve access to credit using banking sector saving deposits and better financial intermediation. Reforms to business environment and to service delivery will be key for private sector development. These measures will be key in resolving the demand side challenges in the labor market and act as the main pillar of a more sustainable poverty reduction strategy. A more dynamic private sector could also play an important role in COVID-19 response and economic recovery in the following years.

## Risks and Opportunities

***The drop in oil prices and the COVID-19 pandemic have placed unprecedented strain on Iraq's economy.*** These fragilities are amplified by an already precarious political situation, a significant weak healthcare system, an ineffective social safety nets systems, rampant corruption, and dilapidated service delivery which continue to fuel large scale protests across the country.

***The government has been focusing on tackling the security situation but struggling to take action on economic challenges.*** The new government has found some success in garnering a wider support in the country based on measures taken to reign-in armed groups and control the borders, although there has been some new resurgence of ISIS activity and assassination of activists. The Prime Minister has also responded to the popular protests of the Iraqi youth and announced a June 2021 as a date for new parliamentary elections. While this is a step in the right direction, it raises risks over the capabilities of implementing reform in an election year and resulting loosening of fiscal policy. The country's pre-existing conditions of heavy oil dependence, dominant presence of the state in economic activities, as well as budget rigidities limit GoI's capacity to respond to the COVID-19 and offer a stimulus package to restart the economy.

***The key challenges for Iraq will be to navigate this multi-dimensional crisis amidst unfavorable conditions for international oil markets.*** The implementation of the OPEC+ agreement and a global recession means that growth prospects for Iraq are on the downside. It also underscores the importance of creating fiscal space for advancing the human capital, diversification, and job creation agendas. Even with a recovery in oil prices, Iraq will need to undertake many reforms to rebuild fiscal space by cutting distortionary and strengthening the orientation of macroeconomic policies. A failure to narrow the twin deficits and a rapid build-up in government debt would divert more resources away from productive investment and further reduce foreign exchange reserves and the economy's resilience to shocks.

***The recent government White Paper sets out an important blueprint of reforms that if implemented could mark a turning point in Iraq's economic outlook.*** The new Iraqi government in October 2020 approved a medium term plan as a roadmap of reforms over the next 3 to 5 years which has a large potential for improving Iraq's economic outlook (Box 1.4). The GoI proposal still needs to be approved by the Parliament. The ultimate result of this new reform attempt depends heavily on the outcome of the upcoming elections and the political will and consensus to implement much needed structural reforms. Once approved and fully implemented it can be an important step in future efforts to shift Iraq towards a new and more dynamic economic trajectory.

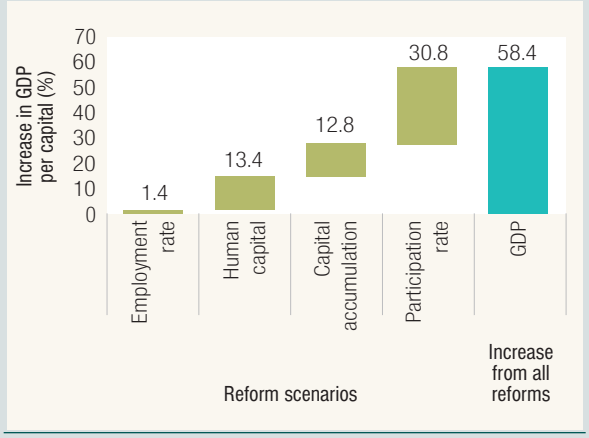
## BOX 1.4 POTENTIAL GAINS OF "BREAKING OUT OF FRAGILITY"

Based on various economic and development indicators Iraq's economy currently resembles a fragile lower income country. Despite the wide range of challenges and foregone opportunities that Iraq has experienced, a vast potential for improving Iraq's economic outlook still remains.

The recent World Bank report "*Breaking out of Fragility: a Country Economic Memorandum on Diversification and Growth in Iraq*" provides pathways for growth for breaking free from the fragility that has grappled Iraq for decades. The report undertakes a simple but illuminating exercise to demonstrate the enormous potential for Iraq's improved economic growth and prosperity.

The report finds that if necessary reforms were implemented to move Iraq in line with the average of key economic indicators of its income group (i.e., upper middle-income countries, UMI), Iraq's GDP per capita could be 58.4 percent higher (Figure B1.4.1 Economic reforms have a large potential to change Iraq's economy). The largest gains come from improvements of labor force participation and human capital reforms (see Box 1.2 The Human Capital Index in Iraq). The COVID-19 has especially impacted investments in these indicators. The fall in revenues and limited fiscal space has come at the cost of investments in human capital and reforms to improve private sector role in generation. These numbers vividly underscore the importance of implementation of key reforms within a medium to long-term framework.

FIGURE B1.4.1 • Economic Reforms have a Large Potential to Change Iraq's Economy




*Source:* World Bank Iraq Country Economic Memorandum 2020.
https://www.worldbank.org/en/country/iraq/publication/breaking-out-of-fragility-a-country-economic-memorandum-for-diversification-and-growth-in-iraq

TABLE 1 • Iraq: Selected Economic and Financial Indicators, 2017–2022

| | 2017 | 2018 | 2019e | 2020p | 2021p | 2022p |
|---|---|---|---|---|---|---|
| **Economic growth and prices** | | | | | | |
| Real GDP (percentage change) | −2.5 | −0.6 | 4.4 | −9.5 | 2.0 | 7.3 |
| Non-oil real GDP (percentage change) | −0.6 | 1.2 | 4.9 | −5.1 | 5.5 | 2.7 |
| GDP per capita (US$) | 5,058 | 5,641 | 5,841 | 4,515 | 4,960 | 5,392 |
| GDP (in IQD trillion) | 231.0 | 265.0 | 276.7 | 213.5 | 234.5 | 254.9 |
| Non-oil GDP (in IQD trillion) | 144.3 | 180.5 | 156.3 | 147.2 | 158.9 | 166.9 |
| GDP (in US$ billion) | 195.5 | 224.2 | 234.1 | 180.6 | n/a | n/a |
| Oil production (mbpd) | 4.46 | 4.61 | 4.84 | 4.04 | 4.02 | 4.44 |
| Oil exports (mbpd) | 3.33 | 3.50 | 3.54 | 3.00 | 2.97 | 3.26 |
| Iraq oil export prices (US$ pb) | 49.1 | 65.5 | 61.1 | 38.3 | 44.0 | 46.3 |
| Consumer price inflation (percentage change; average) | 0.2 | 0.4 | −0.2 | 0.9 | 2.0 | 2.0 |
| | | | **In percent of GDP** | | | |
| **Public Finance** | | | | | | |
| Government revenue and grants | 33.5 | 40.2 | 38.9 | 26.4 | 27.0 | 28.4 |
| Government oil revenue | 28.2 | 36.1 | 35.9 | 23.3 | 24.0 | 25.5 |
| Government non-oil revenue | 5.3 | 4.1 | 3.0 | 3.1 | 3.0 | 2.9 |
| Expenditures | 32.2 | 29.0 | 37.6 | 43.2 | 40.9 | 38.9 |
| Current expenditure | 25.1 | 23.8 | 28.8 | 40.9 | 38.7 | 36.8 |
| Wages and salaries | 14.2 | 13.5 | 14.7 | 24.4 | 22.9 | 21.7 |
| Goods and Service | 1.6 | 1.5 | 3.2 | 2.0 | 1.7 | 1.6 |
| Interest payment | 1.0 | 1.1 | 1.1 | 1.9 | 1.7 | 1.4 |
| Other | 8.2 | 7.7 | 9.8 | 12.6 | 12.5 | 12.0 |
| Investment Expenditure | 7.1 | 5.2 | 8.8 | 2.4 | 2.2 | 2.1 |
| Oil investment | 5.4 | 4.0 | 6.9 | 1.3 | 1.2 | 1.1 |
| Non-oil investment | 1.7 | 1.3 | 2.0 | 1.1 | 1.1 | 1.0 |
| Primary fiscal balance, cash basis | 2.3 | 12.3 | 2.4 | −14.9 | −12.2 | −9.0 |
| Budget balance | 1.3 | 11.2 | 1.3 | −16.8 | −13.9 | −10.4 |
| Gross budget financing needs | −0.8 | −9.7 | 1.5 | 25.8 | 21.5 | 21.5 |
| | | | **In percent of GDP, unless otherwise indicated** | | | |
| **Public Debt** | | | | | | |
| Total government debt (percent of GDP) | 58.9 | 49.3 | 44.6 | 65.7 | 72.3 | 78.8 |
| Total government debt (US$ billion) | 115.1 | 110.6 | 104.4 | 118.6 | n/a | n/a |
| External government debt (percent of GDP) | 35.6 | 30.6 | 23.1 | n/a | n/a | n/a |
| External government debt (US$ billion) | 69.5 | 59.0 | 54.0 | n/a | n/a | n/a |

*(continued on next page)*

TABLE 1 • Iraq: Selected Economic and Financial Indicators, 2017–2022 *(continued)*

| | 2017 | 2018 | 2019e | 2020p | 2021p | 2022p |
|---|---|---|---|---|---|---|
| **Monetary indicators** | | | | | | |
| Growth in broad money | 2.6 | 2.7 | 8.4 | 7.3 | 6.0 | 4.6 |
| Policy interest rate (end of period) | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| | | | **In percent of GDP, unless otherwise indicated** | | | |
| **External sector** | | | | | | |
| Current account | 1.8 | 6.9 | 2.7 | −12.2 | −8.0 | −4.5 |
| Trade balance | 2.7 | 6.1 | 10.5 | −3.1 | −1.1 | 1.9 |
| Exports of goods | 38.1 | 44.0 | 34.8 | 24.4 | 25.2 | 26.7 |
| Imports of goods | 35.4 | 38.0 | 24.3 | 27.5 | 26.2 | 24.8 |
| Gross reserves (US$ billion) | 49.0 | 64.3 | 67.6 | 54.4 | 47.4 | 47.4 |
| In months of imports of goods and services | 10.3 | 11.1 | 10.1 | 9.0 | 7.4 | 7.2 |
| Exchange rate (IQD per US$; period average) | 1182.0 | 1182.0 | 1182.0 | 1182.0 | n/a | n/a |

*Source*: Iraqi authorities and World Bank staff estimates and projections.

# SPECIAL FOCUS: IMPACTS OF COVID-19 AND WEAK OIL PRICES ON HOUSEHOLD POVERTY IN IRAQ

## Introduction

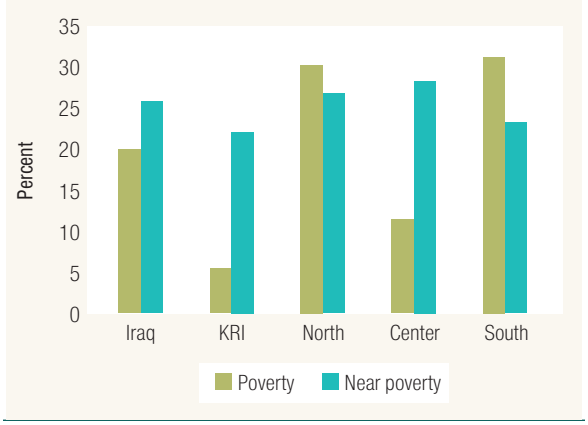
**To assess the impacts of the pandemic and oil price shock in Iraq, the World Bank and UNICEF conducted a rapid assessment at the request of the Ministry of Planning in July 2020.** The note, "Assessment of COVID-19 Impact on Poverty and Vulnerability in Iraq", used data from the most recent household survey, 2017/18 Rapid Welfare Monitoring Survey (SWIFT),[14] and a microsimulation technique, described in Box 2.1, and provided an ex-ante assessment of the crises on poverty and vulnerability. This chapter summarizes the note by focusing on the household poverty impacts under various scenarios explored in the assessment using a microsimulation tool.

## Pre-COVID-19 Pandemic Welfare Conditions in Iraq

**Entering the COVID-19 crisis, 20 percent of the population lived below the poverty line, with significant regional polarization.** Even before the current pandemic, social and humanitarian conditions were already precarious for some sections of the population and in many parts of the country. Nationally, poverty remained high at 20.0 percent in 2017/18 with important spatial disparities (Figure 22). While the historically poor South remained the poorest region, poverty in the

[14] For details on survey design and comparability issues with the previous household surveys see Sharma and Wai-Poi (2019).

FIGURE 22 • National and Regional Poverty and Near-Poverty Rates




*Sources*: Rapid welfare Monitoring Survey (SWIFT) 2017/18; World Bank calculations.
*Note*: National and regional poverty rates for 2017/18 are adjusted for missing districts in the SWIFT survey. See Sharma and Wai-Poi (2019) for imputation methodology. Near poverty numbers are direct estimates from the SWIFT data without imputing for the missing districts.

North increased significantly after 2012 and approximated that of the South in 2017/18. On the other hand, poverty in the Center and Kurdistan regions remained relatively low and even fell in the Center. High poverty rates in the North are largely driven by the significant disparity between the displaced and nondisplaced populations. In both the North and Kurdistan regions, where the vast majority of IDPs are, the poverty rate among displaced households was more than two times higher than non-displaced households (Sharma & Wai-Poi, 2019). Thus, the impacts of the pandemic and the oil price shock are likely to be heterogeneous across the income distribution, regions and groups. This polarization, with the North and the South regions characterized by acute and chronic poverty and relatively low levels of poverty in Kurdistan and the Center region, is of considerable concern (Sharma & Wai-Poi, 2019); as has been seen in recent protests over basic service delivery in the South, this can increase the risk of social tensions and instability.

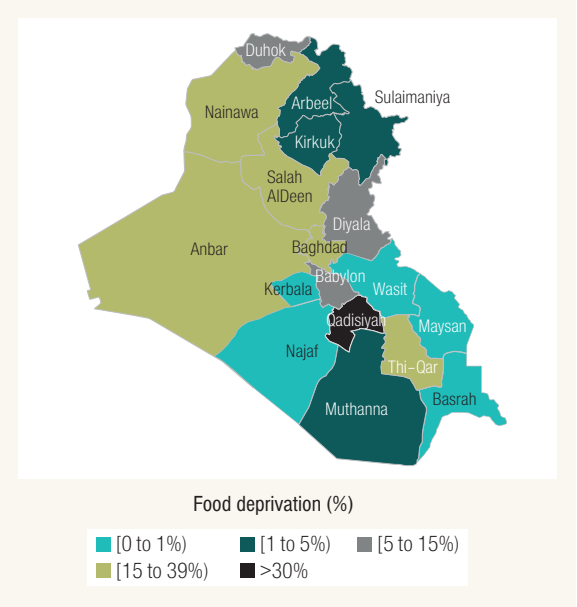
**Moreover, another quarter of Iraqis were living above the poverty line by no more than half, making them very vulnerable to the coming crisis.** Figure 22 also shows the "near-poor", which has been defined here as those with expenditures above the poverty line but below 1.5 times the line. The national 25.8 percent near-poverty rate combined with the 20 percent already in poverty means nearly half of Iraqis were either in poverty or living close to it entering into the pandemic. The near-poverty rate was also above 20 percent in all regions, meaning that even in the better-off areas of Kurdistan and the Center, large numbers of people were vulnerable to becoming poor if prices rose or they lost income.

**Regional disparities persist on non-monetary dimensions as well.** While the prevalence of food insecurity was generally low in the Center and Kurdistan, the Northern and a few Southern governorates, Qadisiya in particular, suffered from acute food deprivation in 2017/18 (Figure 23). Households in these governorates are likely to suffer the most from any food shortages and increased prices during the pandemic. Vulnerability, based on the multidimensional vulnerability index (MVI), which captures household's deprivation in health, education, living standard and financial security dimensions follows a similar pattern—governorates in the North and the South have high multidimensional vulnerability rates and are less resilient to cope with shocks (Figure 24).[15]

**Households in the lower tail of the income distribution and poorer parts of the country are least equipped to cope with the ongoing pandemic.** As discussed in the World Bank and UNICEF (2020) brief, labor income and food price changes are the two main transmission channels through which households are likely to suffer from the ongoing crises. Nationally, on average, food expenditures constituted 41 percent of household budgets and, not surprisingly, households in the poorer South spent the most on food, 47 percent of their budget, in 2017/18 (World Bank and UNICEF, 2020). Furthermore, households in the poorest three deciles spent more than 45 percent of their budgets on food (Figure 25). This is of considerable concern as any food price changes and market disruptions will push many of these households into poverty if not already poor and deepen the intensity of poverty. Although it stresses Iraq's budget, the universal Public Distribution System (PDS), on the other hand, supplies a significant portion of the calorie intake and plays an important, if inefficient, role in Iraqi households' overall welfare (World Bank, 2010), even during the time of crisis when accessible (Phadera,

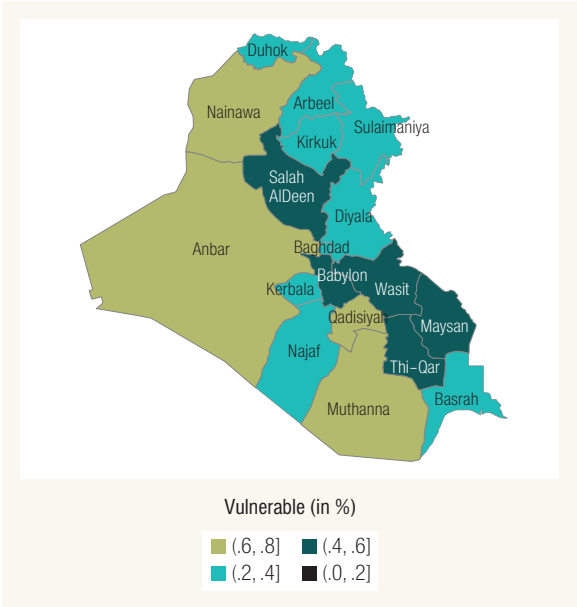
[15] See World Bank and UNICEF (2020) for MVI methodology.

FIGURE 23 • Food Deprivation




*Source*: Rapid Welfare Monitoring Survey (SWIFT) 2017/18; World Bank calculations.
*Note*: Household is considered food deprived if over the last 30 days any member had eaten fewer meals, had no food, or gone to sleep hungry because of lack of food.

FIGURE 24 • Multidimensional Vulnerability

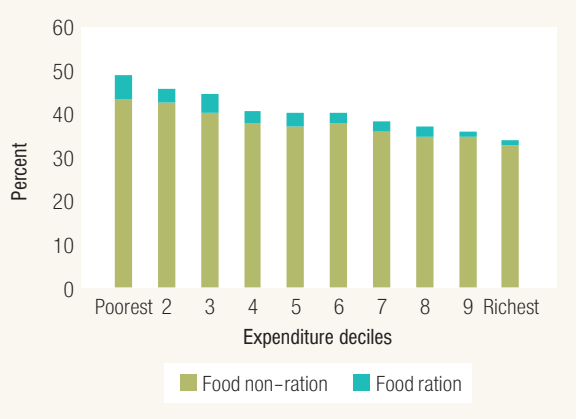



*Source*: World Bank and UNICEF (2020).
*Note*: Multidimensional vulnerability is based on multidimensional vulnerability index (MVI). Households deprived in more than a quarter of the weighted indicators are classified as vulnerable.

Sharma, & Wai-Poi, 2020). Thus, continued supply of PDS may offset some of the losses due to changes in food prices during the pandemic—the value of rations was more than 6 percent of total household budget among the individuals in the poorest decile (Figure 25).

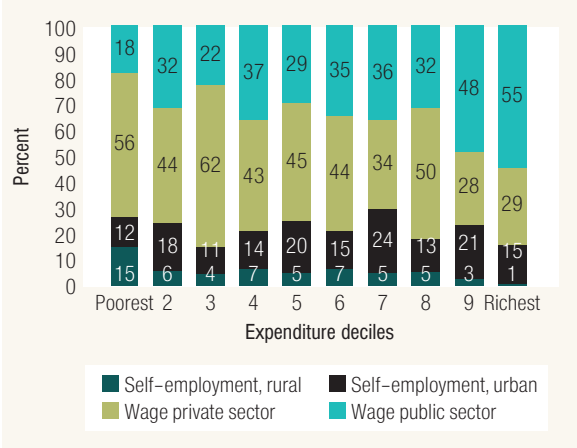
**Self-employment in urban areas and wage employment in the private sector are likely among the first sectors to be impacted by the crises.** Qadisiya and Muthana governorates in the South and Nainawa in the North, in particular, are vulnerable (World Bank and UNICEF, 2020). Furthermore, while a significant portion of individuals in wealthier households are likely to be employed in public sector, poorer Iraqis are mostly employed in private sector (Figure 26).

FIGURE 25 • Share of Food Expenditure in Total Expenditure




*Source*: Rapid Welfare Monitoring Survey (SWIFT) 2017/18; World Bank calculations.

FIGURE 26 • Type of Employment




*Source*: CBI and World Bank staff calculations.

Unemployment and underemployment, particularly among youth and IDPs, are high and likely be exacerbated during the pandemic.

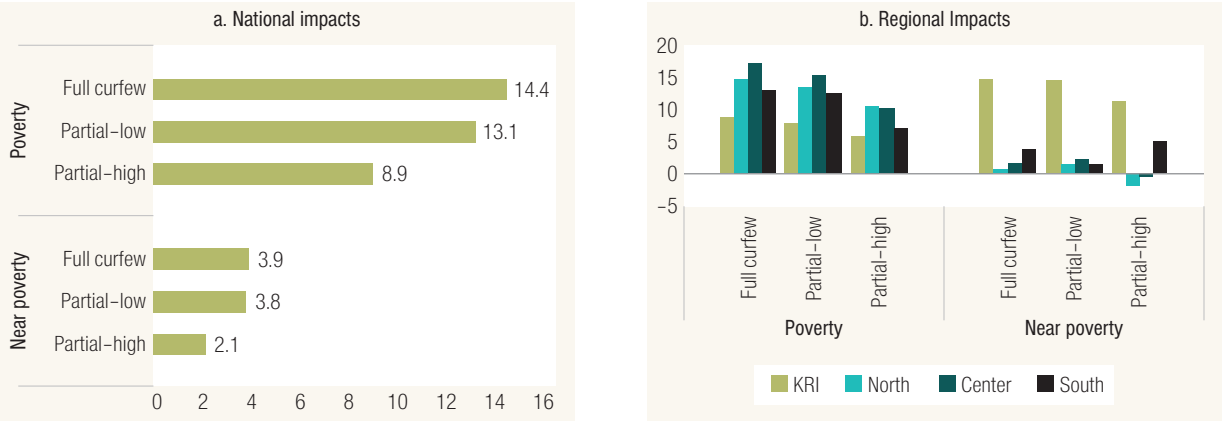
## Impacts of the Twin Crises (COVID-19 and Oil Prices) on Household Poverty

**The World Bank and UNICEF** (2020) **brief explores the poverty impacts of combined changes in food prices and labor income under two scenarios of economic impact—with and without reductions in public sector wages.** The brief considers an increase of 20 percent in food prices as a baseline scenario; however, it also analyses impacts when food prices would increase by 10 percent (baseline-low). Further, it tries to incorporate the government's initial containment policies (full/partial curfew) and possible level of economic activities (high/low) during the removal of daytime curfew during weekdays i.e. partial curfew while modeling household labor income.. The combined effects are assessed under four scenarios—moderate-low baseline, moderate-high baseline, moderate-low baseline-low and moderate-high baseline-low, each of which are evaluated under three categories to incorporate the government's containment policies and associated level of economic activities. Box 2. 1 discusses these scenarios which are applied to each household in the SWIFT survey based on their circumstances.

**The dual burden of a 20 percent increase in food prices and lower labor market income will be felt hard in Iraq**. Nationally, poverty will increase by 14.4, 13.1 and 8.9 percentage points under the moderate-low full curfew, partial-low and partial-high scenarios respectively (Figure 27a). Having a substantial portion of their population in vulnerability (just above the poverty line) coming into the crisis, the Center and North regions will see the highest increase in poverty (Figure 27b). Poverty rates will increase by 10.2–17.2 and 10.5–14.8 percentage points in the Center and North respectively. Moreover, the Kurdistan region will see a significant share of its population falling into vulnerability; near poverty rates will increase by 14.8, 14.5 and 11.3 percentage points under the three economic scenarios respectively.

**Reduced public wages, in addition, would exacerbate the impacts increasing poverty the most in the Kurdistan region and the Center and deepening the gap in the relatively poorer North and South.** With Iraq's fiscal space already very tight, the current crises have created even greater constraints on government spending. As a result, the Government of Iraq (GoI), in its reform agenda, has set the target of halving the share of public sector wages to the GDP in the next three years. However, depending on how these reductions are implemented, changes in public wages could have a significant poverty impact. Under the moderate-high baseline

FIGURE 27 • Combined Impact of Labor Income and Food Price Changes under the Moderate-Low Baseline Scenario (percentage point increases)




*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

## BOX 2.1 MICROSIMULATION METHODOLOGY, ASSUMPTIONS AND SCENARIOS

### Microsimulation

Driven by available data and the on-the-ground reality, the analysis focuses only on the two transmission channels—labor income and food price changes—and assumes no change in PDS transfers. The microsimulation employed is a partial equilibrium analysis and does not account for behavioral responses such as switching to cheaper food items or other substitution. Additionally, the simulation assumes a one-to-one relationship between income and consumption. That is, the impact on income is mirrored on consumption; with many households having little no savings, this is not a strong assumption. In line with national poverty estimates, household expenditure is used as the main measure of welfare. Based on the macroeconomic outcomes, household expenditure is nowcasted from the SWIFT 2017/18 data until the beginning of the pandemic to create a current baseline for the simulation.

### Scenarios

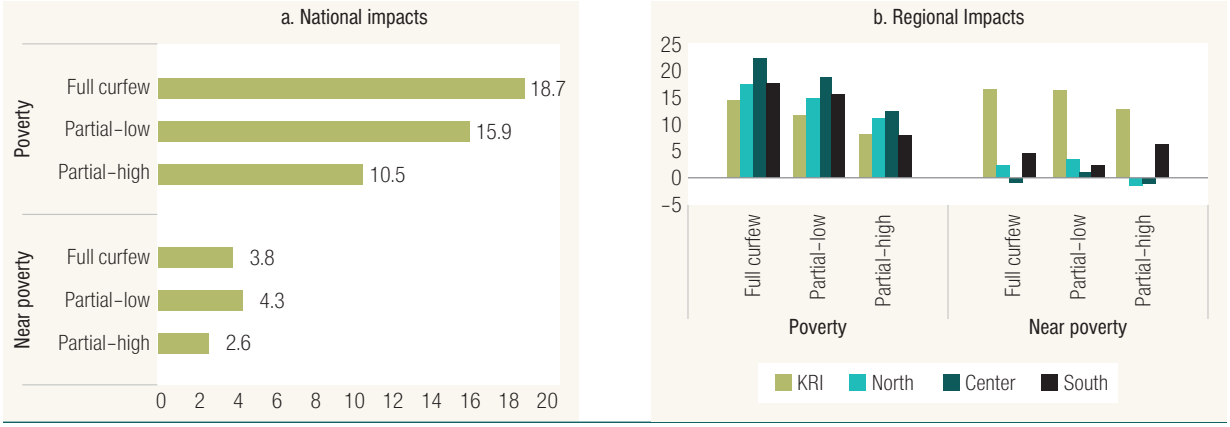
The analysis tires to incorporate the evolving on-the-ground reality and explores poverty impacts under various scenarios.

1. Change in food prices: In a "**baseline" scenario** food prices are assumed to increase by 20 percent with the value of PDS held constant. We also present results when food prices increase by 10 percent and called it as a "**baseline-low" scenario**.
2. Losses in households' labor income: Poverty impacts are assessed under "moderate-low" and "moderate-high" scenarios which are further divided into three categories to incorporate the government's containment policies and associated level of economic activities.
   a. "**Moderate-low**" scenario in which employees in the public sector and self-employed in rural areas are assumed to maintain full incomes while employees in all the other sectors are assumed to lose some portions of their pre-crisis income as follows:
      i. **Full curfew** (limited economic activities): Employees in the private sector, self-employed in urban areas, and non-employed maintain only 80 percent of their pre-crisis incomes.
      ii. **Partial-low** (Partial-curfew with low economic activities): Same as the "full curfew" except half of the private sector employees and urban self-employed can maintain 90 percent of their pre-crises income levels.
      iii. **Partial-high** (Partial-curfew with high economic activities): All the three impacted groups (the private sector, urban self-employed and non-employed) can maintain 90 percent of their pre-crisis incomes.
   b. "**Moderate-high**" scenario is same as the "moderate-low" scenario except public sector employees also lose portion of their incomes due to fiscal pressures from oil revenue shock;, the recently published government white paper on reform explicitly sets a target of halving the share of public sector wages to GDP in the next three years:
      iv. **Full curfew** (limited economic activities): Employees in the public sector, private sector, self-employed in urban areas and non-employed maintain only 80 percent of their pre-crisis incomes.
      v. **Partial-low** (Partial-curfew with low economic activities): Same as the "full curfew" except half of the public sector, private sector employees and urban self-employed can maintain 90 percent of their pre-crisis income levels.
      vi. **Partial-high** (Partial-curfew with high economic activities): All the impacted groups (public sector, private sector, urban self-employed and non-employed) are able to maintain 90 percent of their pre-crisis incomes.
3. Dual effects of changes in food prices and declining income: the analysis mixes the six labor scenarios and two food price scenarios and presents the combined results under twelve different scenarios.

*Source*: World Bank and UNICEF (2020).

scenario, which assumes a uniform decrease in public sector wages, poverty in Iraq would increase by 10.5–18.7 percentage points (Figure 28a). This is an increase of up to around 3 percentage points from the moderate-low scenario (without public wage reductions), indicating how important it will be to consider distributional consequences when determining which public sector workers will see reductions. The Central region, again, will experience the highest increase in poverty (Figure 28b). However, the Kurdistan region will be impacted the most due to public sector wage cuts. The impact on poverty almost doubles from 8.9–14.4 percentage points from moderate-low to moderate-high full curfew scenario Figure 27: Combined impact of labor income and food price changes under the moderate-low baseline scenario (percentage point increases) (27b and Figure 28b). The Kurdistan region will also see many of its relatively

FIGURE 28 • Combined Impact of Labor Income and Food Price Changes under the Moderate-High Baseline Scenario (percentage point increases)



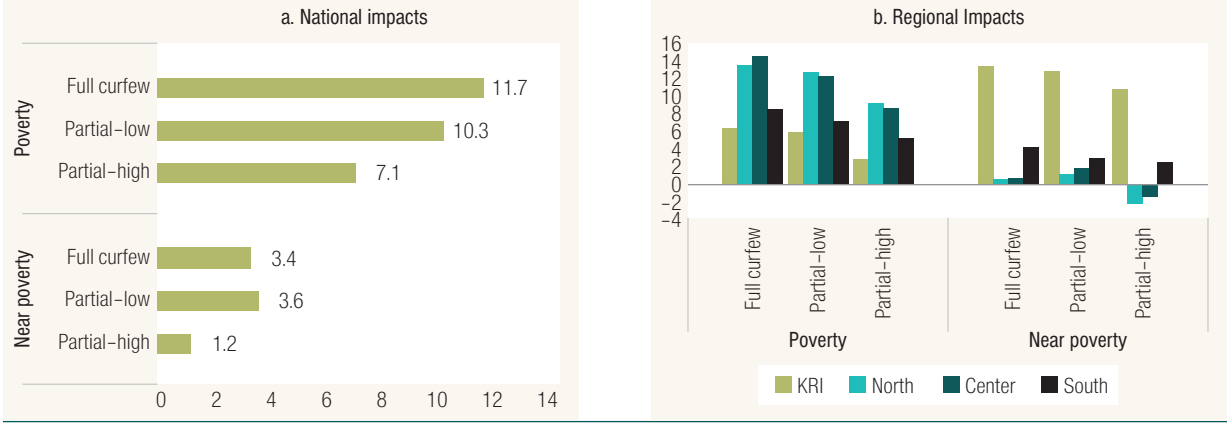

*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

well-off inhabitants fall into vulnerability, just above the poverty line. (Figure 28b).

**Results under the more optimistic "moderate-low baseline-low" scenario are less severe but nonetheless alarming.** National poverty under this scenario would increase by 7.1–11.7 percentage points (Figure 29a). Again, non-poor but vulnerable households in the North and Center will be pushed the hardest and many will fall into poverty (Figure 29). Although the results under the "moderate-high baseline-low" scenario remain substantial, they are less grim than the "moderate-high baseline" (Figure 30).

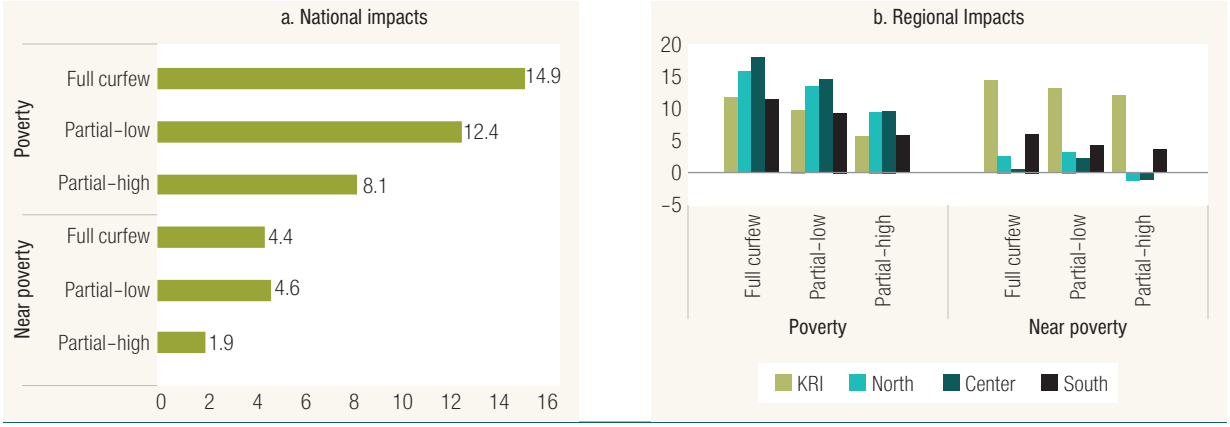
**Even under the less severe scenarios, 2.7 to 5.5 million Iraqis will become poor in addition to the existing 6.9 million pre-crisis poor** (Figure 31). While the number of new poor would be lower with increased levels of economic activity, the government will be faced with a difficult choice of containing the virus and hence the health of its citizens on the one hand and a crumbling economy on the other. Furthermore, different pre-existing levels of wellbeing and resilience mean the pandemic will have varying consequences across the regions. With a large population and many households near

FIGURE 29 • Combined Impact of Labor Income and Food Price Changes under Moderate-Low baseline-Low Scenario (percentage point increases)




*Source*: World Bank estimates from a microsimulation exercise based on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

FIGURE 30 • Combined Impact of Labor Income and Food Price Changes under Moderate-High Baseline-Low Scenario (percentage point increases)

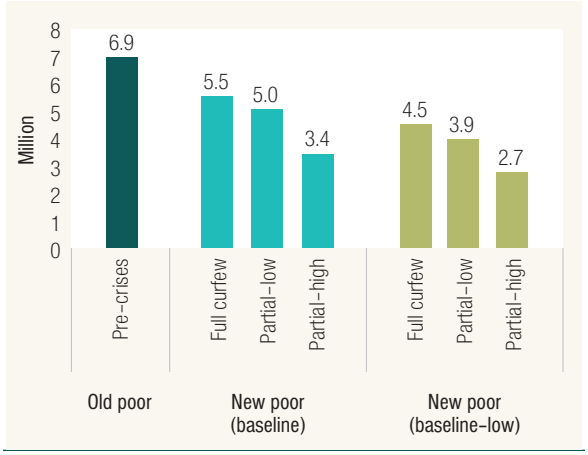



*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

the poverty coming into the crisis, the Center region will host the vast majority of the "new poor"; 42–46 percent of all new poor in the country will come from this region (Figure 32). While the Kurdistan region comprised only 4.2 percent of the total poor in Iraq in 2017/18 (Sharma & Wai-Poi, 2019), it will host a far greater number of the new poor (between 6.5 and 10.3 percent). In contrast, the North and South regions will have lower concentrations of the new poor than the 39.6 and 32.6 percent (Sharma & Wai-Poi, 2019) of the pre-crises poor which they hosted.

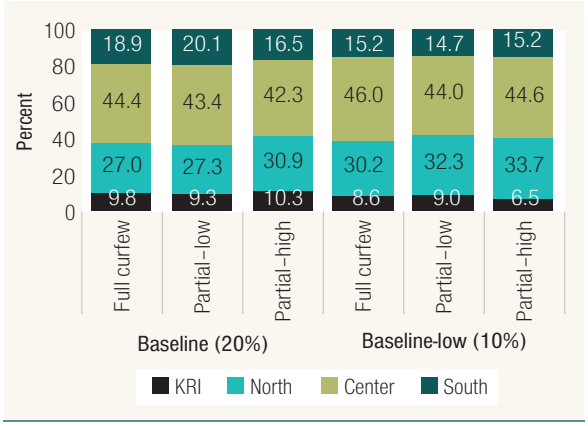
**Under this more likely scenario, even more Iraqis will fall into poverty.** The ongoing crises will push 3.2–7.2 million non-poor into poverty under moderate-high economic impacts (Figure 33). As in the moderate-low scenario, the highest share of the new poor will be concentrated in the Center region (Figure 34). Public wage cuts would push many of the public sector employees in Kurdistan into poverty, thus the region will host a significantly greater share of the new poor than in absence of the wage cuts.

FIGURE 31 • Number of New Poor Individuals under the Moderate-Low Scenario



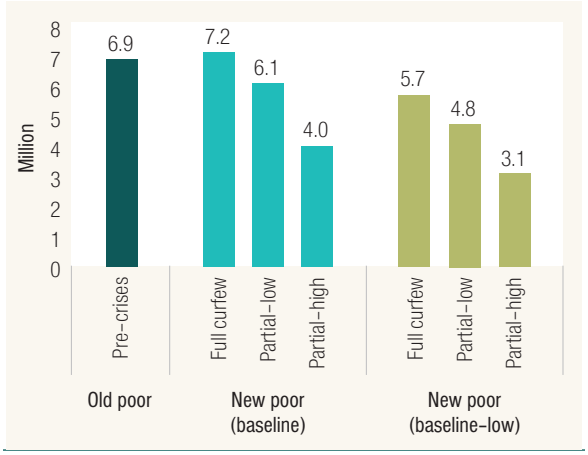

*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

FIGURE 32 • Spatial Concentration of the New Poor under the Moderate-Low Scenario



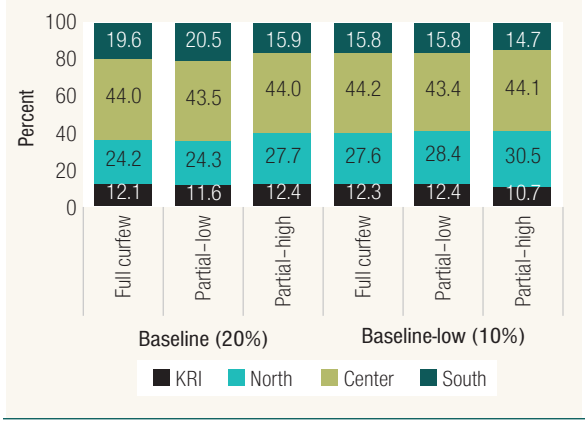

*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

FIGURE 33 • Number of New Poor Individuals under the Moderate-High Scenario




*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

FIGURE 34 • Spatial Concentration of the New Poor under the Moderate-High Scenario




*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

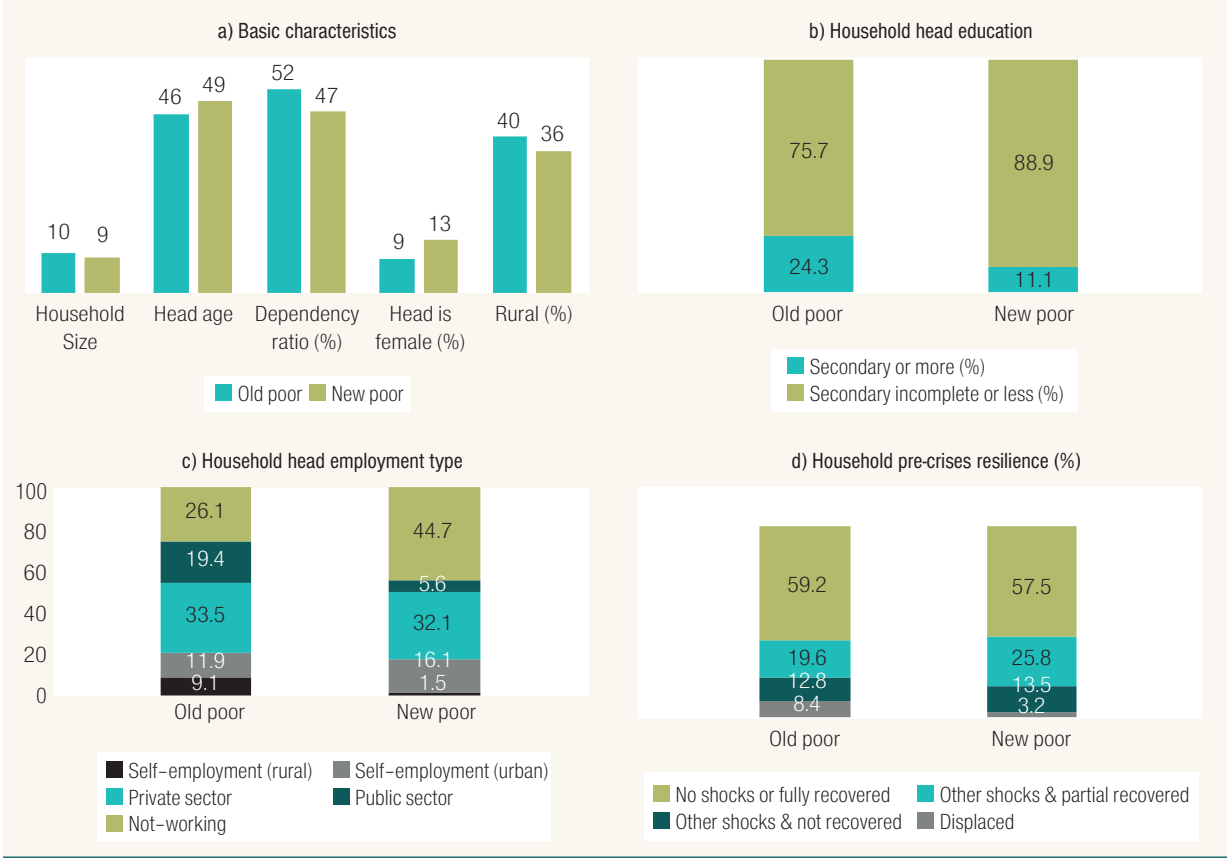
**The twin crises will be detrimental to those with weak resilience but will have significant impact even upon households that are generally considered more resilient.** Compared to the pre-crisis poor, the new poor will be from households with smaller family sizes (10 vs 9 people), slightly older household heads, significantly lower dependency ratios (52 vs 47 percent), that are female-headed and from urban areas (Figure 35a). However, the new poor are more likely be represented by household heads that did not complete secondary education and are either unemployed or in self-employed in urban areas compared to the pre-crisis poor (Figure 35b and Figure 35c). While the largest share of the new poor will be households who had not faced shocks in the past (58 percent), they are more likely be either internally displaced or have faced other shocks earlier (Figure 35d). The new-poor under the partial-low and partial-high scenarios also exhibit similar characteristics (World Bank and UNICEF, 2020).

## Discussion and Conclusions

**While the impact of the crisis on poverty varies by region, the effect is considerable across the country.** Poverty in Iraq could increase by 7 to 14 percentage points; i.e. 2.7 to 5.5 million Iraqis would become poor due to the pandemic in addition to the existing 6.9 million pre-crises poor. With public sector wage cuts, a reform agenda the GoI is considering, an additional 0.4 to 1.7 million Iraqis could fall into poverty if these cuts are made uniformly, as modelled here, highlighting the need to consider exactly how they should be introduced.

**Results from rapid response surveys, while not representative of the broader population, are consistent with significant poverty impacts.** Results from the CCI Enhanced Frequency Price Monitoring (EFPM) and CCI Beneficiary Market Perspectives Survey (BeneMark) show significant increases in prices of basic items and households reporting severe constraints in accessing markets, the ability to continue working and meet basic needs (Cash Consortium for Iraq, 2020). ILO's telephone survey of vulnerable households in June 2020 showed significant job-losses and decreased household labor income. A quarter of respondents that were employed prior to the lockdown had become permanently laid-off, while earnings among those still employed had declined by 40 percent, with younger and informal workers disproportionately impacted. All the three surveys, however, were limited in coverage and not nationally representatives. However, findings from the WFP's nationally representative mobile phone surveys show similar patterns, with prices remaining volatile

FIGURE 35 • Characteristics of the "new-Poor" under Moderate-Low Baseline (Full-Curfew) Scenario




*Source*: World Bank estimates from a microsimulation exercise beased on the Rapid Welfare Monitoring Survey (SWIFT) 2017/18.

due to movement restrictions, resulting in significant price differentials between the places of production and consumption (mostly vegetable prices). Outside of the festive Eid-ul Fitr and Eid-ul Adha occasions, overall food insecurity has been increasing. Similarly, challenges in accessing health care facilities and market remained.

**Given the rate at which the virus is spreading, conditions are likely to worsen further before any improvement.** Iraq is not alone in facing significant increases in poverty due to the pandemic. The World Bank estimates that the number of global poor will increase by 9.3 to 13.3 percent in 2020 (World Bank, 2020). However, years of conflict, displacement and political turmoil have left many people vulnerable and the current crises will test their resilience further. The rising unemployment and underemployment, particularly among youth and IDPs, is likely to worsen. Many households may lose all of their income, especially those in the informal private sector and those with weak resilience to shocks. The longer the crisis continues, the more savings will be exhausted, compelling households to employ negative coping strategies. The analysis here has considered only economic impacts under a moderate scenario; employment-related income losses could be significantly higher. In the absence of a significant government response, it is possible that over half of the population could fall into poverty.

**While the spike in poverty is likely to recede somewhat once a vaccine is produced and distributed, some long-term effects will remain.** As the economy recovers, the short-term surge in poverty will gradually decline as some households work their way back out of poverty. However, for some the crisis is likely to have long-term and potentially permanent

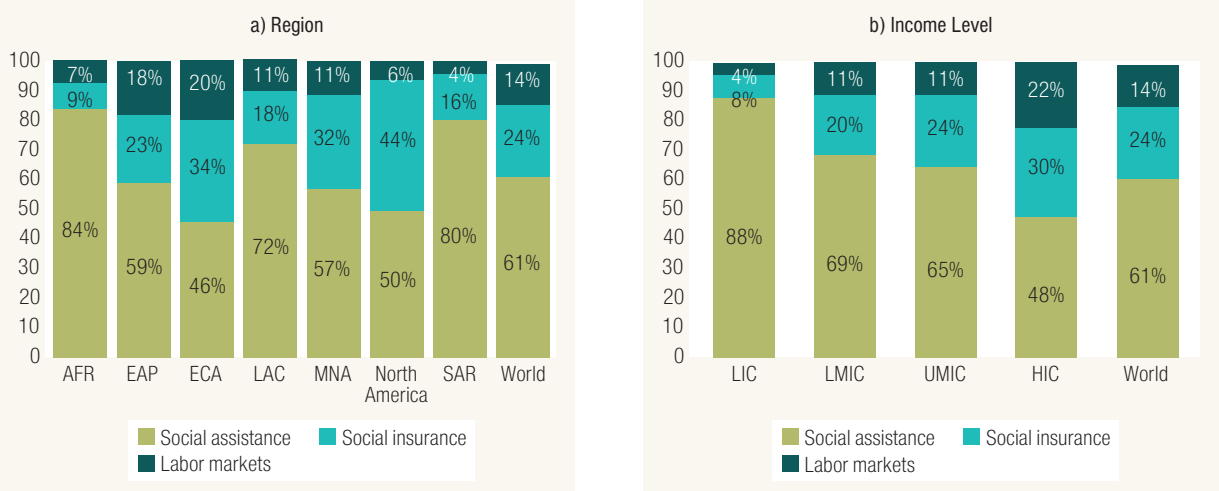
effects. Absent government assistance, already vulnerable households are likely to resort to a range of negative coping strategies to deal with the loss of income and economic opportunities, such as selling productive assets, having children work, and reducing food consumption. Each of these will have long-term consequences: no productive assets means less ability to generate income in the future; children working are less likely to return to schools when they reopen; lower food consumption increases the risk of malnutrition in children and morbidity in adults. These negative impacts can be profound and persistent, especially, when faced during early childhood. They can significantly limit one's lifetime earnings, upward economic mobility, human capital accumulation and health; and can, even, transmit into next generation.

**There are a range of public responses which can be considered for Iraq, drawing on lessons from around the world.** (Gentillini, et al., 2020) provide a comprehensive summary of the global response to the pandemic. Over the past six months, a total of 212 countries or territories have planned or put in place 1,179 social protection measures. These responses can be categorized as social assistance, social insurance or labor market interventions. Social assistance accounts for the majority, globally and among Iraq's Middle East and North Africa neighbors and Upper Middle Income peers (Figure 36: Composition of Social Protection Responses to COVID-19 by Region and Income Level). Half of those safety net measures are various forms of cash-based transfers. In-kind transfers are also substantial (22 percent of the social assistance portfolio, while waiving utility fees or financial obligations occurs in 101 countries.

**Cash assistance is often both generous and temporary; supporting vulnerable Iraqi households in a moment of unprecedented crisis need not set up long-term fiscal obligations.** Cash transfer programs tend to be mostly new, one-off and of a short duration; they are also relatively generous. Half of all safety net measures around the world are some form of cash-based transfer (Gentillini, et al., 2020). A strong public response to the crisis does not necessarily mean costly new permanent programs; around two-thirds of cash transfer programs are new ones, with 29 percent being one-off interventions. Cash-based programs are also relatively generous with transfers representing about 26 percent of average monthly GDP per capita.

**In the short-term, it would be important for the Government of Iraq to use existing systems/ programs to reach an even larger number of poor Iraqis, to help them to cope with the crisis**. For example, the Ministry of Social Affairs (MOLSA) Unconditional Cash Transfer Program (UCT), which

FIGURE 36 • Composition of Social Protection Responses to COVID-19 by Region and Income Level




*Source*: Gentilini et al. (2020, version 13).

covers 1.35 million households in Iraq, is the government's main targeted SSN. It is a poverty targeted cash assistance program that was introduced by the Social Protection Law 11/2014, replacing the old categorical program. While the shift from categorical to poverty targeting has helped MOLSA to direct resources to the real poor in the country, the program faces significant challenges, including limited coverage of the poor. Indeed, the UCT covers around 1.35 million households in Iraq, but many eligible poor Iraqis households are either waiting to benefit from the UCT or have not been assessed for eligibility at all. Therefore, using the UCT to reach and cover these additional households is critical to adequately protect as many poor and vulnerable Iraqis as possible through income support, and thus avoid negative coping mechanisms that could further deteriorate their human capital.

**In addition, in the short term, it is essential for the Government of Iraq to protect jobs as well as put in place programs/mechanisms that help Iraqis to continue increasing their employability.** While formal waged employment outside of the public sector is still relatively limited in Iraq, it is important to maintain these few decent jobs that the private sector offers. Therefore, the Government of Iraq may consider the disbursement of a wage increment to cover part of the worker's wage, conditional on retaining the worker in the firm's payroll. In addition, the Government of Iraq could include the launch of active labor market policies (ALMPs) and programs, emulating the positive lessons from around the world as well as from the MENA region. This includes the creation of wage support programs, especially for young jobseekers in the private sector, offering on-the-job training and subsidy at the same time. Programs can also include the introduction of structured internships as well as self-employment and entrepreneurship support, including access to finance.

**In the medium-term, the Government of Iraq must continue investing in building resilient social protection systems for increased crisis preparedness.** For example, it is important for the government to ensure the robustness of its UCT database through improvements in targeting accuracy. Relatedly, the development of a MOLSA social registry will be key to identify all possible beneficiaries of social programs, and scale-up programs in case of a future emergency/crisis. On the other hand, the development of robust case management, grievance and redress as well as monitoring and evaluation mechanisms will help the government to improve the governance and accountability of social service delivery. All of which will lead to increased effectiveness and efficiency of social protection and jobs programs in the country.

**All the above-referenced investments require significant resources, which could be made available should the Government decides to carry out sensitive yet fiscally sound reforms to existing social protection programs.** For example, Iraq spends, on average, 2.56 percent of its GDP on Social Safety Nets (SSNs), which is high compared to a regional average of 1 percent and a global average of 1.5 percent. However, this spending is driven primarily by large untargeted subsidies (Public Distribution System – PDS), which is universal (and therefore costly) as well as highly inefficient. Reforming the PDS, at least gradually, could lead to important savings that could be reinvested in targeted SSNs, employment programs as well as system-building efforts.

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# SELECTED TOPICS FROM RECENT IRAQ ECONOMIC MONITORS

## Spring 2020 IEM: Navigating the Perfect Storm (Redux)

### Laying the Foundation for a New Economy in Iraq: Digital Transformation (Special Focus chapter):

Leveraging the digital economy (DE) will help Iraq address some of its citizens' concerns as well as accelerate the achievement of its development objectives and fostering resilience in the face of COVID-19. Innovative digital solutions are being deployed to sterilize hospitals, identify and monitor affected populations, offer home-based educational and employment opportunities among others to facilitate the necessary social distancing.

The World Bank Group (WBG) defines the DE framework, as consisting of 1) Digital Infrastructure, 2) Digital Financial Services, 3) Digital Platforms, 4) Digital Skills, and 5) Digital Entrepreneurship. The priority reform areas in Iraq are governance and promoting private sector participation which cut across all five elements of the DE framework and are meant to boost accountability, transparency, and trust.

Transitioning Iraq towards a resilient and inclusive DE will require economic reforms and longer-term development priorities along the five pillars: ensuring affordable access to high-speed internet, achieving widespread adoption of cashless payments, delivering digital government services and improving access to data, upskilling youth with technological know-how, and scaling up the digital entrepreneurship ecosystem. The relevance and urgency of these reforms are all too visible during the ongoing COVID-19 global health crisis.

## Fall 2019 IEM: Turning the Corner: Sustaining Growth and Creating Opportunities for Iraq's Youth

### Transforming Agriculture for Economic Diversification and Job Creation

Strong agriculture sector development is a critical element of Iraq's vision of a more diversified and private-sector led economy. Agriculture contributes a substantial share of Iraq's economy, is the largest

source of employment in the country (approximately 20 percent) and is dominated by the private sector. Thirty percent of the population live in the rural areas and are largely dependent on agriculture for their income and livelihood.

Sizeable growth opportunities exist in the sector, in the short term through import substitution and export on regional markets, and, in the long term, by integrating into global agri-business value chains. Iraq's domestic market offers an immediate consumer base to expand production of grain (wheat), fresh fruits and vegetables, as well as dairy products and meat. Exports offer opportunities for agribusiness development, spearheaded by dates and other high value crops (fresh fruits and vegetables), to respond to regional consumer demand in the short term, and European demand in the medium/long term.

A transformation agenda is possible for agriculture in Iraq, organized around four pillars.

- Building institutional capacity of public agencies in charge of technical support service, as well as the capacity of private producers and value chain organizations.
- Improving competitiveness and fostering market access.
- Investing in high value production systems through R&D, innovation and extension to promote a diversified agri-food sector, adaptation to climate change, and investment in rural infrastructure, agri-logistics and marketing.
- Investing in knowledge and technology used for modern agriculture production and agri-business both at upstream production and downstream at processing and marketing level.

# SELECTED RECENT WORLD BANK PUBLICATIONS ON IRAQ

**(For an exhaustive list go to https://www.worldbank.org/en/country/iraq)**

| Title | Publication Date | Document Type |
|---|---|---|
| Iraq Public Expenditure Review for Human Development Sectors | Forthcoming | Public Expenditure Review |
| Breaking Out of Fragility: A Country Economic Memorandum for Diversification and Growth in Iraq | September 30, 2020 | Country Economic Memorandum |
| The Seasonality of Conflict | August 31, 2020 | Policy Research Working Paper |
| Iraq Economic Monitor: Navigating the Perfect Storm (Redux) | May 4, 2020 | Economic Update |
| Multidimensional Poverty Assessment of Internally Displaced Persons in Iraq | April 6, 2020 | Policy Research Working Paper |
| Iraq's Universal Public Distribution System: Utilization and Impacts During Displacement | February 19, 2020 | Policy Research Working Paper |
| EITI as an Instrument of Fiscal Transparency and Accountability: A Case Study of Two FCV Countries | November 1, 2019 | Brief |
| Doing Business 2020: Comparing Business Regulation in 190 Economies – Economy Profile of Iraq | October 24, 2019 | Working Paper |
| Iraq Economic Monitor, Fall 2019: Turning the Corner – Sustaining Growth and Creating Opportunities for Iraq's Youth | October 20, 2019 | Economic Update |
| EITI as an Instrument of Fiscal Transparency and Accountability in Contexts of Fragility and Violence: A Comparative Case Study of Afghanistan and Iraq (Part One) | August 1, 2019 | Brief |
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| Title | Publication Date | Document Type |
|---|---|---|
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| Jobs in Iraq: A Primer on Job Creation in the Short-Term | February 19, 2019 | Working Paper |
| Arrested Development: Conflict, Displacement, and Welfare in Iraq | January 1, 2019 | Report |
| Bringing Back Business in Iraq: Analytical Note | January 1, 2019 | Report |
| The Reconstruction of Iraq after 2003: Learning from Its Successes and Failures | January 1, 2019 | Publication |
| Iraq – Interventions to Urgently Improve the Quantity and Quality of Drinking Water | January 1, 2019 | Brief |
| Doing Business 2019: Training for Reform – Iraq | October 31, 2018 | Working paper |
| Iraq Economic Monitor: Toward Reconstruction, Economic Recovery and Fostering Social Cohesion | October 1, 2018 | Working Paper |
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