



IRAQ

SELECTED ISSUES

May 2024

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SELECTED ISSUES

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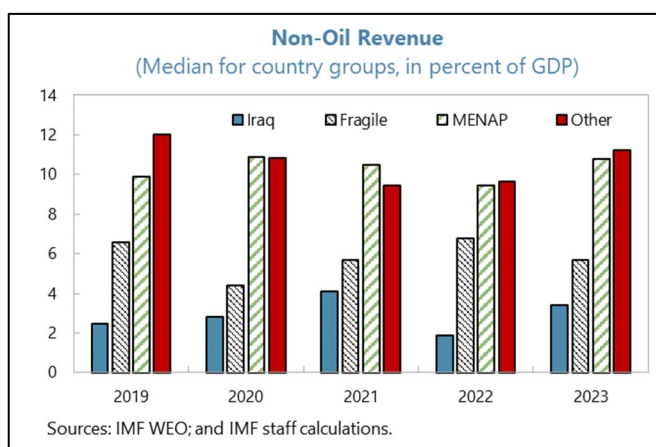
A ROADMAP FOR RAISING NON-OIL REVENUES

Non-oil revenues in Iraq remain persistently low relative to all peer country groups. Raising non-oil revenue should be a key policy priority in context of the prospective transition away from oil and Iraq's large development needs. This paper offers a roadmap for tax policy measures and structural reforms that could be used to raise non-oil revenues. To raise revenues in the near-term, the authorities should review the tariff structure to eliminate exemptions and raise tariffs on luxuries. There is scope to make the personal income taxes more progressive and broaden tax bases. Over the medium-term, the authorities should move towards adopting the value added tax and tackle structural obstacles to revenue mobilization – informality, lack of economic diversification, low levels of financial inclusion and high reliance on cash. In parallel, the authorities should significantly accelerate institutional reforms of revenue and customs administration with support of IMF and other donor capacity development efforts.

A. Introduction

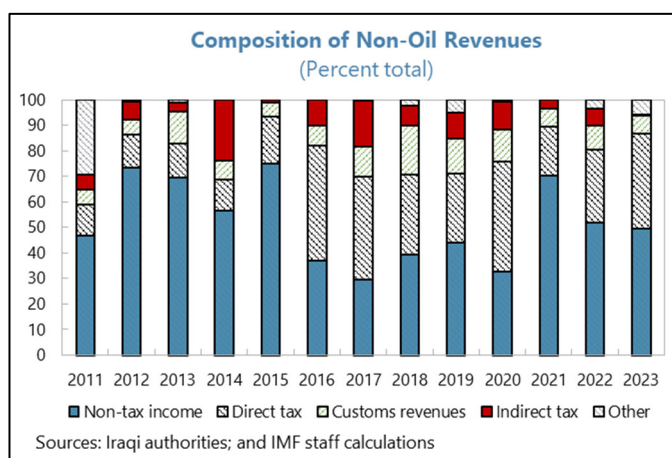
1. Non-oil revenues in Iraq remain persistently low compared to regional peers, other oil exporters as well as fragile and conflict states.

From 2019 to 2023, non-oil revenues as a ratio to GDP have fluctuated between 1.9 and 4.5 percent, averaging 2.9 percent of GDP. This was the lowest average non-oil revenue to GDP ratio among MENAP oil exporters (OE), other oil exporters, and oil exporting fragile and conflict states (below Yemen's 3.9 percent of GDP). The same pattern holds when a longer-term average (from 2011 to 2023) is considered.



2. The composition of non-oil revenues has been volatile, with around three quarters received from non-tax revenues and direct taxes.

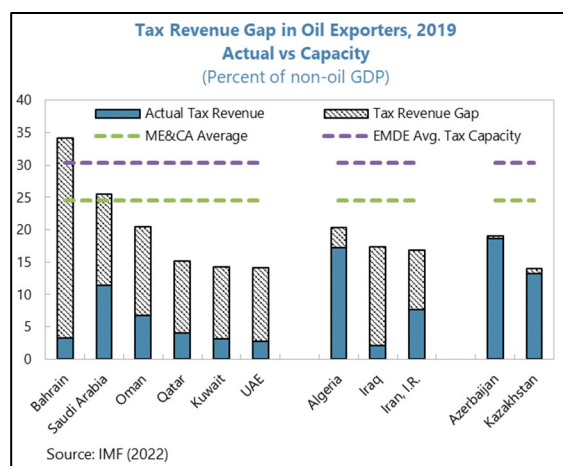
From 2011 to 2023, non-tax revenues have, on average, accounted for around 52 percent of total non-oil revenues (ranging between 30 percent in 2017 and 75 percent in 2015), while direct taxes averaged 26 percent of the total (ranging between 12 percent in 2014 and 45 percent in 2016). Non-tax revenues primarily include



fees for government services, dividends from (non-oil) state-owned enterprises, as well as revenues from disposal of assets.¹ Corporate income tax and payroll taxes make up most of the direct taxes.

3. Raising non-oil revenues is a key priority because of the expected decline in oil prices, as well as the need to ensure long-term fiscal sustainability and meet sizeable spending needs. First, as noted in the 2024 Article IV, under current policies and projected oil prices, Iraq's fiscal position is expected to deteriorate over the medium-term putting fiscal and external sustainability at risk. Although much of the fiscal adjustment will need to rely on reducing expenditure, raising new revenues would still be essential to stabilize debt over the medium-term. Second, ensuring long-term sustainability as the world moves away from fossil fuels would require a significant reduction of Iraq's dependence on oil on a potentially accelerated timetable (IMF, 2023). Third, Iraq has substantial spending needs to accommodate large investments for post-war reconstruction, meeting Sustainable Development Goals (SDGs) adapting to climate change, ending gas flaring, as well as boosting electricity generation and social spending (IMF, 2023).

4. There is considerable potential for raising tax revenue in Iraq. IMF (2022) computed countries' tax revenue gaps based on a model of tax revenues as a function of macroeconomic determinants (e.g., real GDP per capita, inflation, trade openness, etc.) and the unobserved country specific factors that prevent a given country from achieving its tax capacity. The difference between potential and actual tax revenues was estimated to be 15.3 percent of non-oil GDP in Iraq, as of 2019, the second largest gap among MENAP and CCA oil exporters. Closing this gap, however, will be a difficult process requiring prolonged institutional reform.



5. The adjustment scenario envisaged in the 2024 Article IV envisages a minimum of 2.3 percent increase in non-oil revenues, within three years ambitious by Iraq's historical standards, but not unprecedented in other oil exporters. The available cross-country data on non-oil revenues indicates that, the share of periods² in which average non-oil revenues increased ranged from 72 percent in MENAP OE to 39 percent in fragile oil exporters (compared to 50 percent in Iraq). The average size of the increase was 2.3 percent in MENAP OE, higher than the minimum targeted under the Article IV scenario, which in turn, however, is much higher than what Iraq achieved so far (0.6 percent of non-oil GDP). The MENAO OE result, however, is most likely driven

¹ For 2021–2022, the numbers also include unspent funds from line ministries from previous years disbursements reclaimed by the Ministry of Finance.

² This analysis divides the sample of non-oil revenues as a share of non-oil GDP (from 2011 to 2023) into overlapping three-year periods (e.g. first comparing 2014–2016 vs 2011–2013, then 2015–2017 vs 2012–2014, etc.)

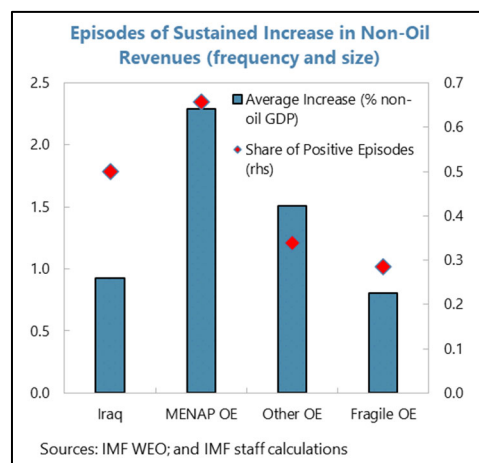
by the introduction of VAT in the GCC countries (see below), something that would only be possible in Iraq over the medium term.

6. This paper outlines tax policy and customs and revenue administration measures that the authorities could take to raise non-oil revenues. It seeks to prioritize measures according to the ease of implementation, considering legislative and capacity constraints, and provide some illustrative and preliminary estimates of yields.

B. Tax and Tariff Landscape in Iraq

7. Much of the tax revenue in Iraq is received from direct taxes, which are applied with exemptions and sometimes inconsistent assessment. On average, around three quarters of the tax revenue in Iraq was received from direct taxes, which is broadly in line with peer oil exporters.

- Iraq has a personal income tax (PIT), which is not very common in the MENAP region, but with lower marginal rates than some comparable countries. The PIT on salary and wage income is withheld by the employer. In 2021, in responses to the declining oil prices, a more progressive schedule for PIT was proposed, but did not garner sufficient support in the Parliament.
- There is a corporate income tax (CIT) of 15 percent (35 percent for companies in the oil industry). Public sector companies are exempt from CIT.
- There is also a 10 percent tax on income derived from real estate.



Importantly, Iraq does not have a fully implemented self-assessment system, which means that the burden of computing a given taxpayer's tax liability is on the tax administration rather than the taxpayer themselves.

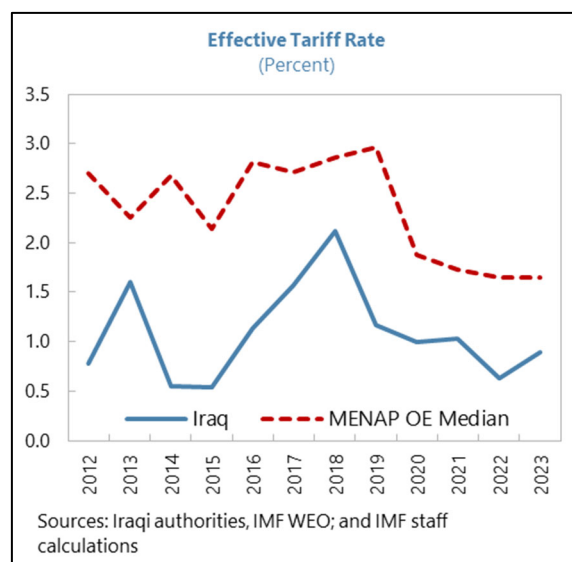
8. Indirect taxes are very small and typically levied on an ad-hoc basis. There is no general sales tax or VAT, and most sales taxes and levies are passed in annual budget laws and are usually temporary (IMF, 2017). For example, in 2015, the authorities introduced a few taxes by decree, for example, a 20 percent sales tax on mobile phone cards, which was cancelled in 2022. A tax on alcohol was effectively obviated by the prohibition on importation of alcohol in 2016.

9. Customs policy in Iraq resulted in a low effective tariff rate despite multiple changes in the tariff structure. Until 2016, a flat tariff duty rate of five percent was applied to any imports. In

Iraq		Iraq 2021 Budget 2/		Algeria		Equatorial Guinea		Nigeria	
Bracket	Rate	Bracket	Rate	Bracket	Rate	Bracket	Rate	Bracket	Rate
0.4	3	0.8	0	0.4	0	0.3	0	0.3	7
0.8	5	1.5	10	0.7	23	0.8	10	0.5	11
1.5	10	2.3	20	1.5	27	1.3	15	1.0	15
Above	15	Above	30	2.9	30	2.6	20	1.5	19
				5.8	33	3.8	25	2.9	21
				Above	35	5.1	30	Above	24
						Above	35		

Source: PwC Worldwide Tax Summaries, available <https://taxsummaries.pwc.com/>
 1/ Bahrain, Kuwait, Oman, Qatar, UAE, and Saudi Arabia do not levy PIT. Kazakhstan has a flat 10 percent rate. Azerbaijan and Angola have more complicated rules, but higher marginal tax rates.
 2/ See IMF (2021a)

2016, the government started to enforce the provisions of the 2010 Law on Customs Duty, which introduced more than ten different tariff rates ranging from 0 to 80 percent. In 2018, the tariff structure was simplified to just four rates (0, 10, 15, and 30 percent) (IMF, 2021b).³ Some of the tariffs were suspended in 2022 to reduce inflationary pressures. In 2023, with Cabinet Resolution 23672, the authorities reintroduced a simplified scheme⁴ with a fixed customs duty based on the size of the shipping container (while duties for goods without containers remained at their earlier levels). Gold, cars, mobile phones and cigarettes (as well as certain other goods covered by the domestic products protection law) are exempt from container-based tariffs and are subject to their own individual rates.⁵



C. The Need and Plans for Institutional Reforms of Revenue and Customs Administration

10. Revenue and customs administration reforms have been the focus of significant capacity development efforts by the IMF. Since 2020, there have been more than six missions focused on these issues, some with support of the IMF Middle East Regional Technical Assistance Center (METAC). The recommendations below are based on Kokoli (2023) and Sakr (2023), who sought to develop comprehensive roadmaps for organizational and other reforms in those two areas.

Revenue Administration

11. Revenue administration agency in Iraq needs significant institutional reform. The General Commission for Taxes (GCT), which is subordinated to the Ministry of Finance is responsible for tax collection.⁶ A comprehensive assessment of tax administration (using TADAT – Tax Administration Diagnostic Assessment Tool) was completed in September 2022 concluding that in all dimensions of the diagnostic, Iraq’s performance was either inadequate or could not be

³ The commitment to simplify the tariff structure was also a structural benchmark for the third review of the 2016 SBA, which was never completed.

⁴ A container-based customs duty was originally proposed in 2018, but its execution was interrupted.

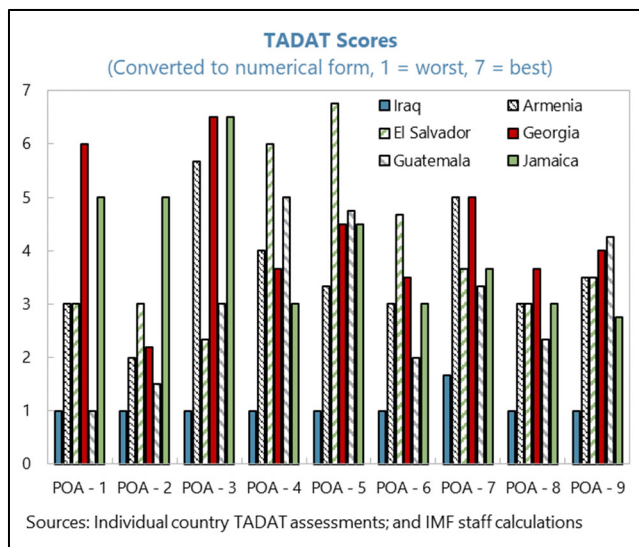
⁵ Electric and hybrid vehicles are exempted from tariffs. Certain agricultural goods as well as those related to solar energy generation are also taxed at very low rates.

⁶ There are separate customs and tax authorities for the Kurdistan region, where tax law differs slightly from the one in the rest of Iraq. For example, employment income is subject to a flat 5 percent rate.

measured.⁷ The largest distance between the average of peer scores and Iraq's scores is in the timely filing and timely payment of taxes (Performance Outcome Areas 4 and 5 respectively).

12. Operational challenges and lack of useful data result in weaknesses in tax compliance

and revenue collection. Corruption within and outside the GCT workforce – driven by low pay, poor infrastructure, highly manual operations, high staff turnover, workload pressures and political instability all impact the performance of GCT. Large numbers of businesses and individuals fail to comply with their basic tax obligations in Iraq. Non-filing or late filing of taxes, late payment, and arrears management, are not adequately addressed due to various factors, including the lack of useful and usable data (Sakr et. al., 2023).



13. Key revenue administration

priorities include the creation of taxpayer register and full implementation of the self-assessment system.

- *A complete and up to date database of taxpayers determines the effectiveness of filing, payment, audit, assessment, as well as collection and enforcement functions.* Existing taxpayer information is neither accurate nor reliable. The GCT primarily focuses on registering taxpayers, when they apply for a tax clearance certificate, which many taxpayers may not do. The GCT should focus on developing and automating clear procedures for registration, cleansing the existing registry (starting with larger taxpayers) and work to detect individuals and businesses who fail to register (Sakr et.al., 2023).
- *Implementation of the self-assessment system would shift the burden of assessing tax liability from the tax administration to the taxpayer.* In the current system, the GCT verifies all tax returns before issuing a tax assessment (furthermore, this is duplicated during the post-assessment audit stage since all filed tax returns are subject to audit). Implementing a self-assessment system is a comprehensive reform that requires changes in the legal framework, strengthening taxpayer registry, and adopting a risk-based approach to audit and verification among other steps (Sofrona, 2023).

⁷ The TADAT assesses the strengths and weaknesses of tax administration with reference to nine performance outcome areas: 1) Integrity of the Registered Taxpayer Base, 2) Effective Risk Management, 3) Supporting Voluntary Compliance, 4) On-time Filing of Declarations, 5) On-time Payment of Taxes, 6) Accurate Reporting of Declarations, 7) Effective Tax Dispute Resolution, 8) Efficient Revenue Management and 9) Accountability and Transparency. See <https://www.tadat.org/tadatAtAGlance> for more information.

14. Recently available evidence suggests that tax administration reforms can yield material revenues. Adan et. al. (2023) find that strengthening country's tax administration to move from 40th to 60th percentile among countries with measured effectiveness of revenue administration can increase revenues by 1.8 percent of GDP with higher effects in emerging markets. Their analysis also highlights the significant impact of some specific measures relevant to Iraq, notably, the establishment of large taxpayer offices (Sakr et. al., (2023) recommend a revamping of the existing structure) and enhancing timely filing of tax declarations (where the gap between Iraq and comparable countries in TADAT sample is the largest). The adjustment scenario in the 2024 Article IV makes a conservative assumption of a small gain from revenue administration (0.2 percent of non-oil GDP).

Customs Administration

15. The General Customs Authority (GCA) collects tariffs at border crossings, and, like the GCT, needs institutional reform. Although no cross-country benchmarking has been done for the Customs Authority (GCA), it has been documented that its practices, procedures, and existing IT systems are outdated. IMF (2022) documents that Iraq's time to clear imports from customs is one of the longest in its peer group. Most records are paper based, and it is difficult to obtain detailed and updated information (Kokoli et. al., 2023).

16. Improvement in customs operations requires coordination between investing in IT (especially by implementing ASYCUDA) and modernizing business processes. The central plank of the Customs Authority reform is the automation of customs operations with the UNCTAD-developed ASYCUDA⁸ World IT system. In May 2021, Iraqi authorities signed a seven-year agreement to implement ASYCUDA in Iraq and the pilot project at Baghdad international airport began operations in October 2023. However, the challenge is that since business processes and procedures at the customs authority do not correspond to best international practices, the software needs to be customized, which may make it costly to modify or update later (Kokoli et. al., 2023). Accordingly, reengineering business processes to make them compatible with automation and best practices is a key priority for customs reform.

17. Over the medium-term customs modernization needs to be supported by a new customs law. Many aspects concerning business process reengineering can be approved via changing GCA regulations. However, legal changes are needed to introduce risk management and risk-based controls, trade facilitation standards and customs valuation practices. Legislative action would also be required to enable changes to the GCA organizational structure. The authorities intend to proceed on a dual track – they have already drafted amendments to the existing legislation with FAD support and, over time, intend to develop a new customs code, though the timeline for that is uncertain (Çeli and Charlet, 2023).

⁸ Automated System for Customs Data is a computerized customs management system that covers most foreign trade procedures, handling manifests, customs declarations, along with accounting, transit and suspense procedures. It is developed by UNCTAD (United Nations Conference on Trade and Development). See <https://asycuda.org/en/about/> for more information.

18. Successful implementation of ASYCUDA has generated additional customs revenues across the world. Evidence available from UNCTAD suggests that in Angola, for example, revenues increased by 44 percent in the first year after ASYCUDA World implementation (in 2018), In Chad, customs revenue doubled after the launch of ASYCUDA World in the international airport. Customs revenue in Bangladesh increased by 11 percent (United Nations, 2023). The Article IV adjustment scenario assumes a 0.3 percent of non-oil GDP⁹ increase in revenues from customs administration improvements – not only from ASYCUDA, but also from better business processes.

D. A Roadmap for Policies to Increase Non-Oil Revenue

Near-Term Steps

19. The need to raise non-oil revenues is immediate, but any policies must consider significant institutional shortcomings identified above and Iraq’s context as a fragile state. Mansour and Schneider (2019) document that fragile states generally rely little on taxation of goods and services and have very variable tax revenue composition, suggesting that tax development and design are very idiosyncratic. Revenue mobilization is also conducive to exiting fragility.¹⁰ In the initial stages of designing the tax system, it is sensible to focus the available collection capacity on effective collection points: borders, the largest companies (including in the mining sector), wages in the civil service and the formal sectors and land (if cadaster is available). The recommendations provided below are only a first step and should be enhanced by undertaking a comprehensive tax policy diagnostic (the last such mission occurred in 2017).

20. There is scope to increase tariffs in Iraq via either taxing luxuries further or reducing the number of goods exempt from tariffs. For example, bringing the effective tariff rate to the 2019–2023 MENAP peer average would imply increasing it from 1.2 percent of imports to 2.0 percent (67 percent increase). This would yield 0.5 percent of 2023 non-oil GDP. Mansour and Schneider (2019) suggest that in the absence of consumption taxes a simple three-rate tariff schedule would be desirable: a low rate of about 10 percent applicable to unprocessed food, medications, agricultural inputs and equipment goods, a standard rate of around 30 percent applicable to most other consumption goods, raw materials, and intermediate consumption and a high rate of, for example, about 50 percent applicable to a short list of luxury consumption goods. In the context of Iraq, this would imply either reducing the number of exemptions, which have recently been expanded, (while appropriately protecting the vulnerable) or increasing the tariff rates on luxury goods (cars have been relied on the past, but jewelry could also be an option¹¹).

⁹ Previous discussions with the authorities indicated that they saw scope for a 50 percent increase in customs revenues (0.3 percent of non-oil GDP).

¹⁰ Gaspar et. al. (2016) document that once countries cross a tax-to-GDP threshold of around 12¾ percent real GDP per capita increases sharply in a sustained manner over the next decade. They suggest that improvements in tax capacity are a key part of state capacity building. In the case of Iraq, this would imply the need to quadruple tax revenue.

¹¹ The Observatory of Economic Complexity (OEC) lists cars as the third most imported item in Iraq (US\$ 2.22 billion) and jewelry as the fourth (US\$ 2.21 billion) as of 2021 (Simoes, et. al. 2011).

21. There is also merit in increasing the progressivity of personal income tax and broadening its base. The 2021 budget proposal (see ¶6) as well as expanding the PIT base (to include pensions, allowances, etc.) was expected to yield 1.7 percent of 2021 non-oil GDP. This proposal would have been broadly compatible with the principles articulated in Mansour and Schneider (2019), although further revenues could be raised by increasing intermediate rates. Furthermore, it would be important that public sector salaries (accounting for 41 percent of the tax base) are not increased to offset the impact of higher personal income tax rate.

22. Quantifying the costs of existing tax exemptions and subjecting them to a rigorous cost-benefit analysis should be a priority in reforming direct taxes. Notable tax exemptions in Iraq include: (i) excluding public sector employee allowances from personal income tax and (ii) excluding state owned enterprises from corporate income tax. The personal income tax scale also includes deductions from taxable income for wives and children. Such exemptions are a form of “tax expenditures” – deviations from a benchmark tax system to provide financial support for individuals and companies. Many countries have tax expenditures, which are estimated to reduce tax revenues by an average of around 4 percent of GDP for countries where data is available (Haldenwang et. al. 2021). The general principles for evaluating such expenditures are described in Beer et. al. (2022). In the case of Iraq, such evaluations would likely require a concerted effort to improve data collection, which would take time. As an intermediate step the authorities could consider the prevalence of similar exemptions in other countries and the scope for eliminating some of them, considering the urgency of raising non-oil revenue.

23. In parallel with the development of the self-assessment system, the authorities could consider simplifying tax filing to the maximum extent. For example, corporate income tax payments could be replaced by lump sum taxes for smaller taxpayers, which would not require detailed accounting. Lump sum taxes could simplify tax administration thereby limiting compliance and litigation costs. Corporate income tax (as well as other taxes introduced in the future) should have a high enough threshold exempting smaller firms given the limited administration capacity, which could then be gradually reduced over time (Mansour and Schneider, 2019).

24. Institutional reforms need to progress as quickly as possible and coordination between federal and Kurdistan regional authorities should be further enhanced. As noted in Section C, there is scope for revenue gains from institutional reforms, but this will take time to materialize. The authorities should also make sure to invest sufficient resources to both customs and revenue administrations as both suffer from difficulties in finding and retaining qualified staff and frequently poor working conditions (especially for customs), or simple lack of manpower. Any difference in tax regimes between Kurdistan and the rest of Iraq can create opportunities for arbitrage (e.g., in the case of cars taxed at different rates, imports of cars have shifted to the Kurdistan region). Although these may be impossible to eliminate given institutional constraints, regular exchange of information and cooperation in enforcement would be useful. There are already welcome examples of closer cooperation between federal customs authorities and the KRG, though progress remains slow.

Medium-Term Steps

25. Over the medium-term, the authorities should work to enhance governance, broaden revenue sources, and gradually expand the reach of the tax system.

- Enhancing governance would typically entail consolidating all tax receipts into the Treasury Single Account and entrusting their management to the Ministry of Finance. It would also be important to treat tax policy and tax administration issues jointly and time reforms in legislation and administration consistently. This can be facilitated by adopting a medium-term revenue strategy, which, in the case of Iraq, could also help reduce uncertainty and coordinate international donor involvement.
- Revenue sources could be diversified by adopting value added tax (VAT) or a general sales tax (GST)¹². In principle, VAT would be preferable, as it is collected throughout the production chain minimizing the incentives for avoidance, but it may be harder to administer effectively. A few design features could help to increase VAT robustness to shocks and administrative challenges such as limiting the number of taxpayers subject to the full VAT regime by having appropriately high registration thresholds, and keeping the legislation simple (e.g., a single rate with limited number of exemptions). The introduction of VAT would take time (staff advice for GCC countries has been to allow for 18–24 months between the political decision and implementation¹³), but gains would be substantial. A simple, back of the envelope calculation of applying a VAT rate of 5 percent (the initial rate for other GCC countries) to 90 percent of private consumption as a share of GDP (as discussed in Alreshan et. al. (2015)) suggests possible revenues of 3.7 percent of non-oil GDP as of 2020. If a VAT were to be implemented, tariffs could be greatly simplified, leaving only the ones needed for the protection of selected domestic industries.¹⁴
- Making the tax system more inclusive would entail gradually lowering registration thresholds for e.g., turnover tax, VAT, etc. It would also be desirable to ensure that all forms of personal income are taxed by withholding using a dual income tax system, where a progressive tax is levied on the salary income and a flat rate on other types of income (e.g., interest, capital gains, etc.).

E. Structural Reforms and Economic Diversification

26. IMF research has identified several other structural determinants of non-oil revenue that are relevant for Iraq. First, low financial inclusion and widespread use of cash fosters non-compliance (IMF, 2022). On the other hand, increasing financial inclusion and access to credit¹⁵ increase incentives for tax compliance. Iraq had a much higher share of currency in circulation in broad money and a much lower incidence of digital payments compared to peer countries. More

¹² Although some sources use these terms interchangeably, general sales tax in this case would only be levied at the final point of consumption, while VAT is levied throughout the production chain.

¹³ See Alreshan et. al. (2015).

¹⁴ Mansour and Schneider (2019) refer to the “unbundling” of the tax system, where every tax is implemented for the sake of one objective.

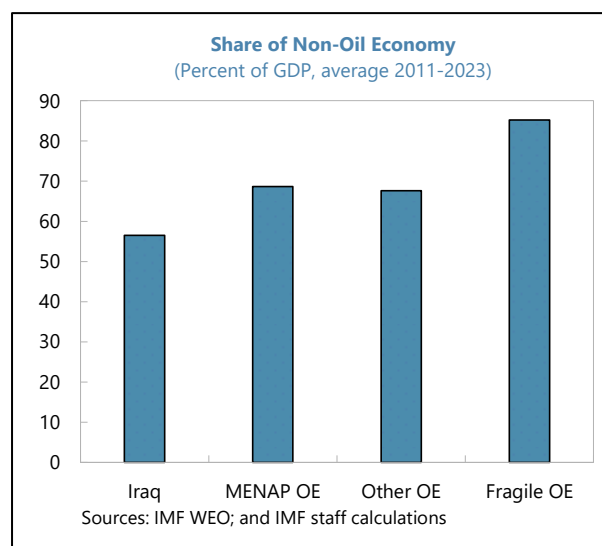
¹⁵ This would require a comprehensive restructuring of the banking sector, which has been a longstanding plank in the authorities’ reform plans.

recently, the authorities have made progress in promoting digital payments by expanding the use of point-of-sale machines, raising the ceilings on bank card transactions, and reducing bank fees. Second, perceived weaknesses in the control of corruption also reduce tax compliance.

27. A large informal sector may weaken revenue collection and further reduce compliance by putting an excessive burden on the formal sector. The informal sector is large in Iraq, reflecting lack of access to credit and high cost of formalization (see accompanying SIP on labor market challenges). Moosa et. al. (2023) note that recent surveys conducted by the Central Statistics Organization (CSO) and the Kurdistan Region Statistics Office (KRSO) in collaboration with the United Nations Development Programme (UNDP) found that 80 percent and 60 percent of businesses, respectively, are informal. The impact of this on GDP is harder to gauge since many informal businesses are very small. Medina and Schneider (2018) present estimates of the size of shadow economy for 158 countries from 1991 to 2015. Although Iraq is not part of the sample, in comparable countries (Algeria, Tunisia, Egypt) the size of the shadow economy is estimated to be between 30 to 35 percent of GDP. Qatar is estimated to have the lowest average size of informal economy in the region at 16 percent of GDP. Reducing informality in Iraq from e.g. 30 percent of GDP to 16 percent of GDP could yield around 0.8 percent of non-oil GDP in revenues (at current levels of tax revenues) and possibly more, if other tax policy measures are effective.

28. The design of tax policy measures should also take into account their possible impact on informality. For example, simplifying tax filing (as suggested in ¶23), taxing income by withholding (¶25) could help reduce informality. Another way to use the tax system to decrease informality is to either exempt the smallest businesses from e.g., CIT or replace it with a lump sum tax. On the other hand, the existence of the tax wedge (additional social security contributions that employers must pay above the wage costs of the employee) could increase informality.

29. Ultimately, the ability to raise non-oil revenue will also depend on economic diversification. Iraq's economy is less diversified than most peers with non-oil economy accounting on average for 57 percent of the total GDP compared to e.g. 69 percent for MENAP OE (average of median share from 2011 to 2023). Increasing the share of the non-oil economy to the MENAP OE median would increase non-oil revenues by 21 percent (0.6 percent of non-oil GDP, compared to the 2.3 percent envisaged from measures). Policy recommendations for increasing economic diversification have been documented in IMF (2023) and include strengthening the electricity sector and reforming the financial sector among others.



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United Nations, 2023, ASYCUDA Report 2022/2023 [Accelerating Climate Smart Trade Facilitation](#), (Geneva)

ADDRESSING LABOR MARKET CHALLENGES: AREAS FOR REFORM

Decades of conflict and instability have hindered human capital development in Iraq, creating large labor market imbalances, with high and persistent unemployment especially among the youth and women. Addressing these imbalances should be a key policy priority amid mounting demographic pressures and increasingly unsustainable public employment policies. This paper provides an assessment of the drivers of labor market challenges, empirically investigates two main features in the Iraqi labor market—the low women participation and high informality, and discusses policy implications and priorities. Policy priorities include strengthening governance and reducing costs of formalization, enacting legislative reforms to phase-out mandatory hiring in the public sector and level the playing field between public and private jobs—including through better aligned pension systems, and implementing education reforms focused on investing in technical and digital skills and reducing skill mismatches. The paper shows that increasing women’s labor force participation could boost Iraq’s potential output significantly. This would require legislative reform and better law enforcement to remove gender-based restrictions and increase equality and protection in the labor market.

A. Labor Market Structure

This section presents key findings from a first-in-a-decade Labor Force Survey (LFS), which was conducted in collaboration with the ILO and released by the Iraqi authorities in July 2022. With the caveat that the survey was collected during the COVID-19 pandemic in 2021 and therefore reflects unusual conditions, the results nonetheless fill important data gaps on the structure of the labor market.

1. Labor force participation rates across gender and education reflect limited economic opportunities, with access especially constrained for women and youth. Labor participation rate is 39.5 percent, well below the average for the MENA countries of 51.8 percent. While participation for males by age groups follows the usual bell-shaped curve of labor supply, for females, the curve is much flatter and does not exceed 20 percent at any age group, reflecting limited access for women of different ages to the labor market. The pattern by education shows that males participate across education levels at close rates, while for females, participation is almost non-existent at levels lower than a university degree and is largely concentrated in university levels or above.

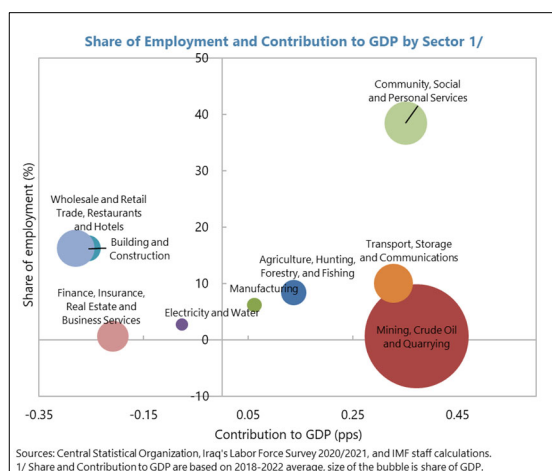
2. Distribution of employment is unbalanced across occupations and economic sectors. Private sector employment is male dominated with more than half of male private employment concentrated in three subsectors (construction, transportation, and trade). On the other hand, about 70 percent of employed women are public employees, compared to only 24 percent in MENA countries. Gender differences in occupations are also distinct. The largest group of employed males are service, sales and trade workers and professionals, while employed females are predominantly professionals, in particular teachers. Like other countries in the region, technicians represent a small proportion in the work force in Iraq at less than 6 percent of occupations.

3. Despite the over-sized public sector, unemployment remains elevated, with striking age and gender disparities. Unemployment rate stands at 16.6 percent, but rates are much higher for women and youth, at 28.2 percent and 35.8 percent respectively (about 7.5 percent higher than the MENA average). Female unemployment is higher across age groups and educational levels. Moreover, long-term unemployment¹ is estimated at 30.8 percent, with the median duration for search for females more than double that of males.

4. The informal sector is very large, representing about two thirds percent of total employment. More than half of employment (54.8 percent) is in the informal sector, where people engage with unregistered businesses or unorganized businesses that do not keep accounts or work with no or casual employees. Moreover, around 26.1 percent of employees in the formal sector have informal contractual arrangements. Informality in Iraq is high by regional and global standards (in MENA and CCA countries for example, informality is about 56 percent).

B. Drivers of Labor Market Challenges

5. Mounting demographic pressures. Like most countries in the MENA region, Iraq has a young and rapidly growing population. The youth represent 38 percent of the total population, resulting in a large number of people entering the labor force every year. The working age population grows at 3.5 percent annually, largely by high birth rates (2.73 percent in Iraq over the past decade, almost 1 percentage point above the MENA region). Population growth is projected to soften in the next two decades, mainly due to a decline in fertility rate, but will remain strong at around 2 percent. The expansion of the working age population is projected to generate more than 780,000 new entrants to the job market annually.



6. Unbalanced economic structure and inadequate growth. The Iraqi economy is heavily concentrated in the oil sector, which represents around 60 percent of GDP in real terms². This has affected the labor market in two ways. First, the oil sector is the main driver of economic growth, but as a capital-intensive sector, it constitutes less than one percent of total employment in Iraq. Second, the undiversified revenue and export bases—oil represents over 90.5 percent of government revenue and 95.5 percent of exports³—increase vulnerability to oil price shocks especially in light of the government's highly procyclical fiscal policy. The resulting greater economic

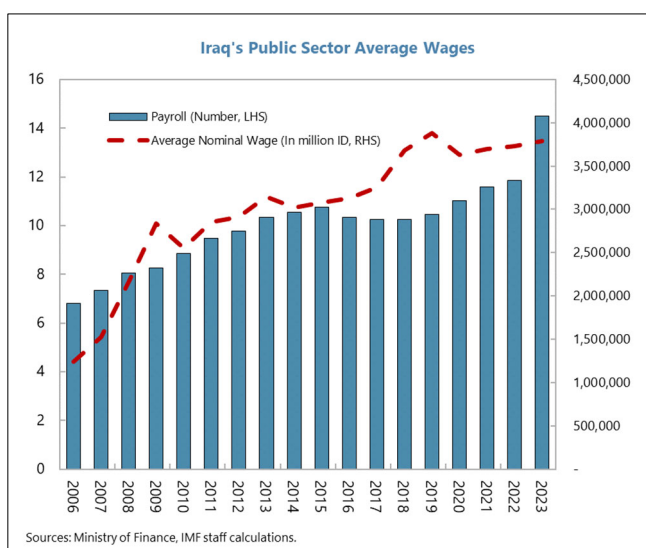
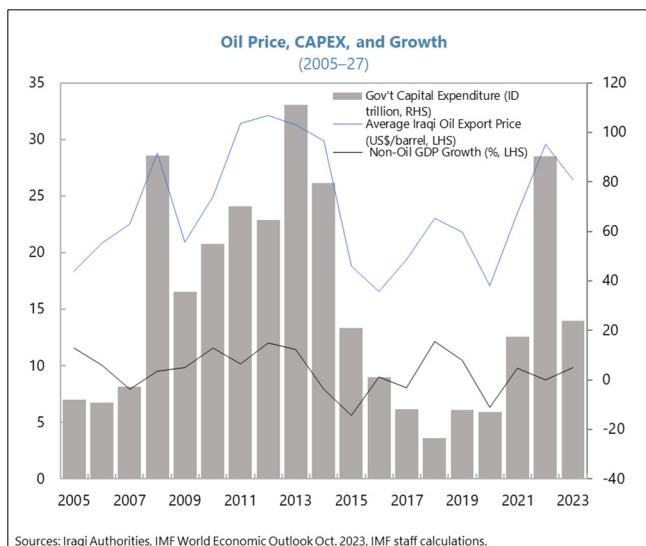
¹ Unemployed people seeking employment for 12 months or more.

² Average 2018–2022 using GDP data in constant prices.

³ When accounting for petroleum products, oil and oil derivatives constitute more than 99 percent of exports.

volatility and lower investment rates have translated over time into lower human and physical capital accumulation, impacting growth and the ability of the non-oil sector to absorb labor entrants⁴.

7. State dominance and distortive public employment policies. The public sector is the largest employer in the economy, with a share of about 40 percent of total employment, which is very high by regional and global standards. Iraq has large and inefficient State-Owned Enterprises (SOEs) that enjoy significant control over strategic and non-strategic sectors, many of which are loss making and heavily overemployed. Both nominal wages and the number of people employed in the public sector have grown substantially over the past two decades, at an average annual rate of 12 and 7 percent respectively, exceeding growth in the economy and the labor force by a large margin. The civil service was generally shielded from spending cuts. Beyond its fiscal implications, public employment is crowding out private employment, distorting labor market and educational outcomes and depriving the private sector of much needed technical and vocational skills. These factors have also contributed to lower productivity in Iraq compared to the region. The distortions arise from the following policies:



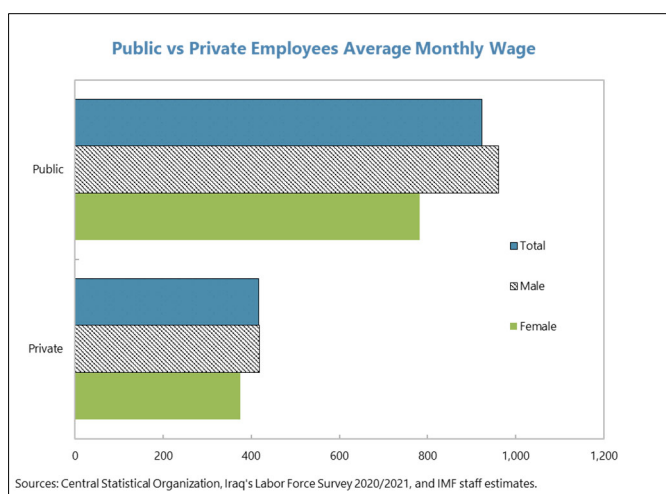
- Besides its perceived stability, public employment comes with a generous compensation package, rendering the public sector the employer of first choice and leading to higher reservation wages in the economy. The lowest wage in the statutory public sector appointment⁵ is about IQD 400,000, which is higher than the minimum wage in the private sector at IQD 350,000. The gap increases sharply above entry level according to the average wage estimates from the LF survey. Survey results also show that the public sector has the lowest percentage of employees with low pay rate, defined as pay less than IQD 2,120 per hour at their

⁴ For instance, non-oil growth averaged 1.3 percent during the past decade, with a coefficient of variation of 6.7 times the average. Meanwhile, working age population grew significantly higher during the same period (3.5 percent), resulting in a large number of people becoming unemployed or discouraged to enter the labor force.

⁵ This which consists of base salary and various allowances such as the educational attainment, position, geographic location, and job safety. It excludes daily waged workers and contractual employees who do not fall under the Public Sector Salaries Law No. 22 for year 2008.

main job. The pay gaps are significantly larger in certain sectors such as mining and quarrying activities, and public administration and defense.

- Upon retirement, civil servants receive greater pension benefits than private sector employees. A recent paper by the IMF, ILO and World Bank finds that public employees are subject to lower retirement age as well as higher livelihood and educational allowances compared to lower benefits and tighter eligibility criteria for private sector pensions. Minimum pension for private sector employees equals the minimum wage while their maximum pension is capped at 80 percent of the reference salary of the last 5 years of service. On the other hand, minimum pension for public employees is IQD 500,000 with no cap on the maximum pension and the reference salary is taken over the last 3 years of service. While the new social security law for private sector employees is a step in the right direction (see ¶ 22), coverage remains low with expected barriers to inclusion under weak enforcement capacity.
- Preference towards public jobs is reinforced by legislations. Anecdotal evidence suggests that some Iraqi youth are willing to wait for years for an opening in the public sector or work in the informal sector rather than actively seek a formal private sector job, and even those who get interim private sector employment are unwilling to commit for long-term contracts in anticipation of their public sector employment⁶. This bias is partially created by laws that are mandating the government to hire all graduates from the health sector⁷ and a certain share of people holding higher education degrees as well as top graduates in each field⁸.



8. Legal and institutional weaknesses. Iraq's Labor Law includes necessary provisions for protecting workers' rights. In certain areas, such dismissal of workers, rules seem stringent, for

⁶ For example, several workers in the education sector have been contracted by the Ministry of Education and working free of charge in anticipation of absorbing them on the government's payroll. Social pressure from this group has been addressed through the Council of Minister's decision No. (130) for year 2021, which specified a monthly salary for lecturers, administrators and workers contracted in this manner until including them in subsequent budget laws.

⁷ Law No.6 from 2000 obliges the government to hire graduates from Iraqi and non-Iraqi schools of medicine, dentistry, pharmacy, nursing, medical and health technology, and medical technicians as well as other health and science degrees.

⁸ Law No.59 from 2017 mandates that public universities and academic institutions designate 20 percent of their allocated vacancies and 15 percent of allocated vacancies of government agencies to those who hold a higher education degree including higher diploma, masters, and doctorate degrees. Furthermore, Law No. 67 obliges the government, including public universities and higher education institutions, to employ the top three science and humanities graduates from public universities and institutions.

instance, on terminating workers contracts in a private company. In other areas, weak enforcement of the law contributes to high informality, leaving workers unprotected and pushing them to seek jobs in the public sector. There is a lack of adequate institutional capacity at the Ministry of Labor and Social Affairs (MoLSA) to monitor the labor market. For example, the number of inspectors is very low, at around 60 work inspectors for around 8.6 million employed persons.⁹ Additionally, there seems to be fragmentation of responsibilities and lack of coordination structures between ministries on cross cutting issues like technical education. Meanwhile, social dialogue in Iraq is weak and that there is little coordination and capacity amongst the unions on policy design and influence. The tripartite committees include representatives from one of the unions that are currently present in Iraq, which cover private, mixed, and cooperative sectors. Such recognition of a single union is against ILO standards on Freedom of Association that is ratified by Iraq. The formation of unions in Iraq is constrained by Law No. 52 for year 1987, which specified the number of unions that can be formed and in which sectors.

9. Poor education outcomes and skill mismatches. Iraq's education quality has severely declined over the past decades, contributing to low human capital compared to the region (Box 2). The prevalence of low educated workforce, with over 55 percent of the employed persons have elementary education or below, adversely affects the level of skills and productivity in the labor market. At the same time, unemployment among those with university degree or above is high, especially among youth (over 60 percent), which is an indication of the deep structural unemployment¹⁰. Skills and qualifications mismatch are large. The LFS results show that a significant portion (67 percent) are under-skilled. This is consistent with an analysis done by UNESCO (2019), which found that two thirds of employees in the Wholesale, Retail and Vehicle Maintenance sectors are underqualified. At the same time, in the manufacturing sector, where most of the workers have advanced degrees, the sector lacks industry specific skills that are not covered by existing training programs. Training opportunities in the private sector are also limited—only 17 percent of surveyed firms offer formal training to their employees, below the 21 percent average for the MENA region.¹¹ Two key factors contribute to these outcomes:

- Public employment policies contribute to the skill mismatch (see ¶17) by skewing student preferences towards degrees that guarantee a public job such as medical degrees. For example, 14 percent of Iraqi graduates in the academic year 2020/2021 were from medical and health related faculties. This is higher than the average for the MENA region of 9.9 percent¹².

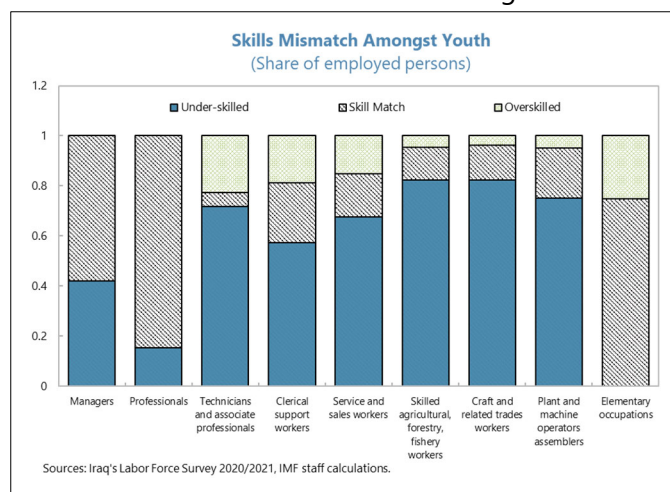
⁹ For comparison, the ratio of inspectors per worker is 15 times higher in Jordan.

¹⁰ Based on students meeting benchmarks in either literacy and/or numeracy according to recent PISA/TIMSS data.

¹¹ According to the World Bank Enterprise Survey (2022)

¹² Data for Iraq is from the Central Statistical Organization while for MENA it is from UNESCO UIS.Stat [UIS Statistics \(unesco.org\)](https://uis.unesco.org/)

- Technical and Vocational Training programs (TVET) are not aligned with Iraq's needs in terms of skills and coverage. There are only 32 centers for TVET programs in Iraq that provide short-term programs of around 2 months. However, the reach and coverage of these programs are weak. Since 2003, less than 15,000 per year on average graduated from these programs which is very low compared to the region and represent a small fraction of what could be targeted from the low-skilled persons in the labor force (currently 1.7 million has low education attainment). Furthermore, there seems to be a disconnect between structuring and designing these programs and implementing them in Iraq as TVET centers fall under the management of governorate councils while policies are put by MOLSA, which makes monitoring and quality assurance of implementation a challenge.



C. Assessing Drivers of Informality in the Iraqi Labor Market

10. The existence of a large informal sector in Iraq is a key factor underlying segmentations and labor market inefficiencies. Informality deprives workers of their voice and formal representation and leaves them without social security and protection.¹³ It also contributes to gender disparities, with women more inclined to prefer the formal sector for greater protection. Informality contributes to lower productivity and wages as the sector attracts low skilled workers who are less likely to get formal training while on the job. On the upside, informality may mitigate the impact of cyclical fluctuations on unemployment. Empirical evidence found that the share of informal employment tends to rise during economic downturns, suggesting a countercyclical role for informality as it provides a buffer for workers who lose their (formal) job during recessions. However, it may be difficult for informal workers to transition back to formality during the recovery owing to loss of human and social capital (networking) (Cardarelli and others 2022).

Factors affecting informality in Iraq

11. We assess to what extent informality in Iraq can be associated with the level of economic development, as opposed to policy distortions, following Cardarelli and others (2022). First, an index of sociodemographic factors is constructed as the simple (unweighted) average of the latest annual values of four variables: the average years of schooling, the share of youth in the population (from the, the share of agricultural employment, and the share of rural population.¹⁴ All these variables likely reflect a country's level of economic development, as least developed countries typically

¹³ According to the ILO (2021), most workers in the private sector in Iraq do not have written work contracts, do not contribute to social protection schemes, are not covered by health insurance by their employers, and most businesses they work for are not registered with any government agency.

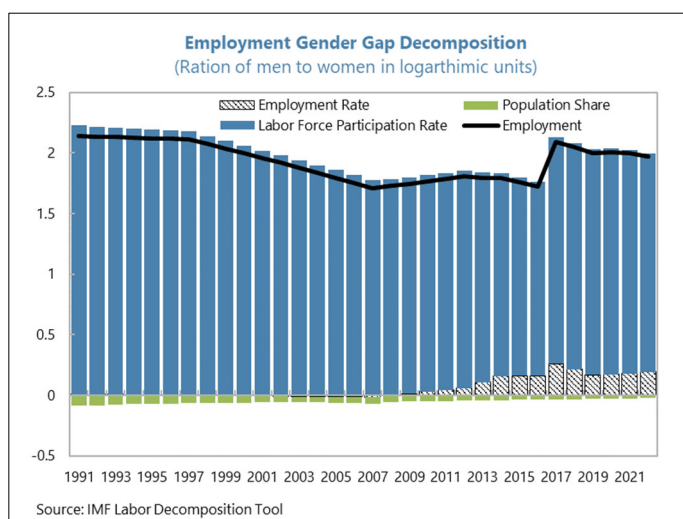
¹⁴ World Bank's World Development Indicators (WDI)

having lower levels of education, a younger population, more agriculture employment, and a higher incidence of rural population. Institutional and policy correlates of informality are then examined. These variables are grouped into four categories: business regulation, taxation, labor market regulation, and governance. Figure 3 illustrates where Iraq stands against other countries vis-a-vis development level and policy indicators in relation to the size of informality. To quantify the contribution of these factors to employment informality in Iraq, we use coefficients estimates from Cardarelli and others (2022), which were estimated with a cross-country linear regression for different sets of countries. A gap analysis is done for Iraq to estimate the contribution of development level and the set of policy variables to labor informality through multiplying the corresponding coefficient by the difference between the value of the explanatory variable for Iraq against the average for the comparator group.

12. Results suggest that excess informality in Iraq is mainly associated with policy distortions, with weak governance as a major contributor. Comparing with advanced countries, the results indicate that the development level explains less than a quarter of informality in Iraq. Policy distortions play the largest role, with about 57 percent of the predicted employment informality surplus in Iraq relative to advanced economies associated with the country's relatively lower quality of governance. Business regulation and tax burden contribute together another 20 percent of the gap. When compared to the Middle East and Caucasus and Central Asia (CCA) region, with a much smaller gap in development level, the importance of policy variables in explaining informality gap becomes larger especially for business and labor market regulations, while governance remains the main contributor. These results confirm survey findings (Informal Enterprise Survey 2023 and ILO 2021) that administrative barriers such as bureaucratic and complex procedures for registration as well as financial costs associated with formalization—including social security contributions, registration fees and other costs such as bribery and gifts—are amongst the key impediments of formalizations cited by informal businesses in Iraq.

D. Empowering Women to Expand Economic Potential

13. Little progress has been achieved in increasing women's engagement in the Iraq labor market over the past decades. Some improvement in the relative share of women in total employment, driven by higher women participation, was achieved after the mid-1990s but this has been largely reversed since 2015. Currently the gap between men and women participation rate in Iraq is about 60 percent, reflecting mainly the low women participation at around 10 percent. Underlying this large gap are a host of structural and policy factors in different areas including health, education, legal rights, and access to

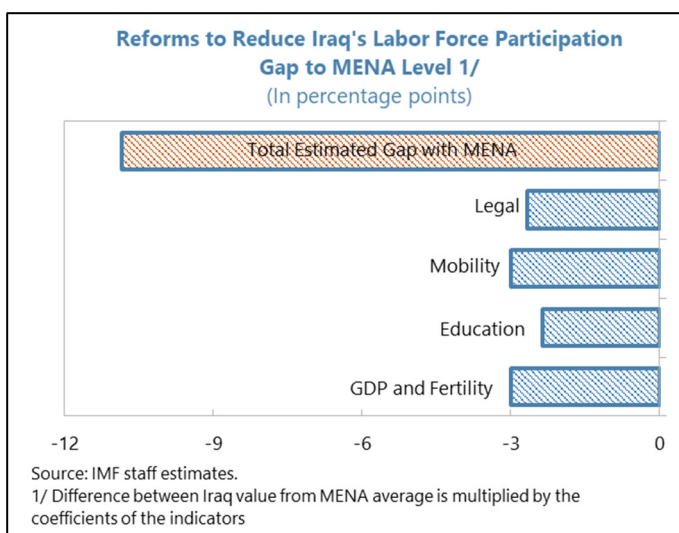
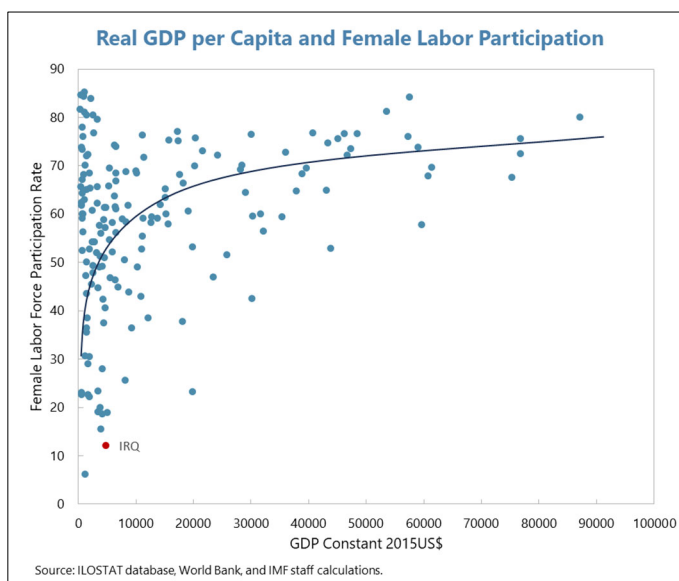
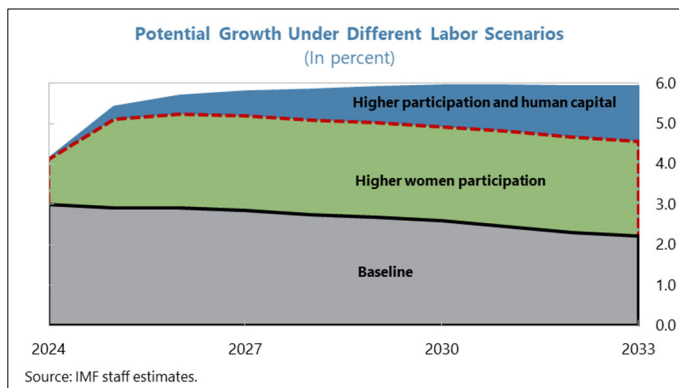


finance gaps, where Iraq compares poorly to comparators (Figure 4). The gap between actual women participation in Iraq and its level implied by the country’s level of development – proxied by income level, is substantial (35 percent), pointing to a large scope for improvement in Iraq.

14. Iraq could harness the large potential in women participation and turn the demographic challenge into a growth opportunity.

Labor has historically been the main contributor to potential growth in Iraq (Box 2). As the working-age population continues to grow over the next decades, albeit at a slower rate, labor supply will consequently increase. Ensuring that the additional labor is more actively engaged in the labor market, especially from increasing women participation, and at the same time ensuring availability of jobs, would avoid the social implications of rising unemployment and help expand potential output and growth significantly.

Compared to the baseline, where women labor participation remains constant at its 2023 level, doubling women participation to close the gap with the region by 2033, would add over 2 percent to potential growth. Improving women education to increase human capital to regional levels, starting gradually after 2025, could add another 2 percent to growth and ensure overall potential growth wouldn’t decline and stabilize at about 6 percent by 2033. These simulations illustrate the significant gains that Iraq could achieve from education and labor market reforms.



15. This would require addressing structural and policy impediments to women’s participation. The empirical analysis presented in Box 2 shows that increasing female educational attainment, removing restrictions on women work and mobility (including current laws that prohibit women from working at night and in certain professions), amending laws that protect women and

help equalize their rights, could help Iraq reduce the current gender participation gap by 10 percentage points and bring it in line with the regional average¹⁵.

E. Policy Implications and Key Reform Areas

16. The current policy of relying on oil revenues to provide public jobs for the fast-growing population is neither productive nor sustainable. Using the elasticity estimates (Box 3), population structure, and economic growth projections under current policies of about 2.5 percent over the medium term, unemployment rate is expected to increase from 16.5 percent in 2021 to around 21 percent by 2033. This would translate into an alarming rate of unemployment among the youth of over 50 percent. If the government were to avoid social and political consequences from rising unemployment by expanding public employment, the wage bill would increase and reach unsustainable levels of over 23 percent of GDP and 50 percent of total budget expenditure by 2033. Such a high wage bill would crowd out other essential budgetary layouts and productive spending and make the budget extremely dependent on oil revenue. Importantly, this would take place against the backdrop of expected decline in oil prices as international efforts to stem greenhouse gas emissions accelerate to address climate change.

17. To reduce unemployment without jeopardizing fiscal sustainability, Iraq needs to boost growth in the non-oil economy closer to 5 percent. A larger role for the private sector in the job creation process would be key to easing the unemployment-fiscal sustainability trade off. Staff estimates that a sustained non-oil growth of around 4 percent annually over the next decade would be required to stabilize unemployment at current levels. Reducing unemployment to single digits, for instance halving the current rate to 8.2 percent, would require higher growth, estimated between 4–5.5 percent annually over the next ten years. However, growth alone may not bring about this large decline in unemployment without addressing the factors underlying structural unemployment.

Policy Priorities

18. Delivering on Iraq's commitment to address unemployment and creating work opportunities will require further efforts. A number of important measures have been implemented, notably the enactment of the 2023 Social Security Law for private sector workers which expands coverage and benefits to all workers, includes voluntary participation for the self-employed and informal workers, and introduces unemployment benefits and insurance for maternity, employment injury and sickness. However, private benefits are still below public ones and effective coverage of the scheme is low, with regulatory hurdles and weak uptake. The government also introduced new active labor market policies, including an electronic platform to match job seekers with potential opportunities in the private sector in 2023 and allowing registered individuals (1.7 million) to apply for zero-interest loans to start a small business. Given the already strained

¹⁵ Evidence from studies on other countries shows that higher public spending on education, better infrastructure, a stronger institutional environment, more equal legal rights, an increase in protection, better sanitation facilities, low adolescent fertility, and narrower marriage age gaps are significantly related to narrower gender gaps in education and participation (see for example Jain-Chandra and others, 2018).

capacity of the MoLSA which manages the program, it is not clear whether the Ministry will be able to carry out these additional responsibilities effectively.

19. A broad diversification is needed to reduce oil dependence and support private sector development. Key reforms include continued efforts to enhance governance and reduce corruption which is a major impediment to a conducive business environment, fixing the electricity sector to ensure sustainable service for both small and large businesses, and financial sector reforms to increase access to finance which is particularly important for SMEs development and their role in creating jobs¹⁶. See accompanying staff report for further details.

20. The reform agenda should also target reducing informality. In addition to the importance of broad governance reform in reducing informality, Iraq needs to particularly focus on streamlining and simplifying business and labor regulations. Enforcing business registration is important to increase formalization but, to avoid the adverse impact on small businesses and employment, it needs to be accompanied by measures to reduce cost of formalization by revisiting the fees and tax procedures and reducing red tape and other bureaucracy costs and time.

21. These efforts should be complemented by comprehensive education and labor market reforms which would help expand Iraq's potential economic growth. There are four priority areas.

22. First, public employment policies should be adjusted in order to create a level playing field between public and private sectors, through the following:

- *Gradually phasing out mandatory public hiring through legislative amendments that limit employment to the needs of the public sector and reduce the coverage of those included in these laws.* There needs to be better alignment between Ministry of Higher Education policies in allowing for creating new medical faculties and acceptance terms in line with the public sector's ability to absorb those graduates.
- *Adopting an attrition-based employment reduction strategy coupled with efforts to identify and eliminate redundant positions to lessen excess employment.* Based on the age structure of public employees, the government could choose a gradual attrition rate, for instance replacing every three retirees with one new hire, with the right gender composition, to ensure rightsizing of public employment does not exacerbate unemployment and gender gaps, and move in tandem with expansion in private jobs.
- *Strengthening control over payroll by completing biometric registration and creating a centralized database of government employees* coupled with detailed and regular reporting requirements by

¹⁶ According to the latest World Bank Enterprise Survey, small and medium firms in Iraq lack adequate access to finance as the biggest obstacle they face, followed by corruption and political instability as well as obtaining business permits for small business. A study by the IMF finds significant gains in employment, labor productivity and economic growth if MENA countries close the SME financial inclusion gap with respect to EMDEs. In Iraq's case, it would translate into a 2.7 percent increase in GDP (above the MENAP and CCA levels, estimated at 1 percent), and a reduction in unemployment of more than 1 percentage point (IMF Policy Paper No. 2019/040).

each government agency on the size of the workforce by grade, type of employment and compensation, as well as retirements, hiring, and promotions. Replacing statutory promotions with performance-based ones within an overall limit would help reduce wage drift.

- *More closely aligning compensation with the private sector and productivity growth*, for example by capping the maximum size of non-wage compensation (allowances) and linking future wage increases to economy-wide productivity gains as well as non-financial benefits such as maternity and unpaid leaves to reduce incentive for women to join the public sector.
- *Enhancing the gatekeeper role of the Federal Civil Service Commission (FCSC) in approving hiring decisions* including for contractual employees and aligning such approvals with the budget planning and execution processes. This should be accompanied by eliminating the provisions in various laws that mandate automatic government employment of university graduates in various areas.
- *Aligning the pension system rules and benefits across the public and private schemes* could help reduce distortions in the labor market, which adversely affect labor mobility and hinders the growth of private sector employment. Currently, the contributory pension scheme for public sector employees provides greater benefits relative to the private sector. This could create incentives for workers to seek public sector jobs and generate a lock-in effect, whereby workers stay in the public sector to accrue their prospective pension benefits.

23. Second, creating the right environment for private sector jobs requires strengthening labor market institutions as well as law enforcement. Ensuring adequate work environment and labor protection would require stronger institutional capacity at the Ministry of Labor to ensure effective labor inspection and active labor market policy management and monitoring. Balancing between protecting workers' rights while maintaining employers' flexibility in attracting the right labor force through hiring and firing regulations are also important, as stringent policies could increase the cost of compliance, leading to higher informality and unemployment. This would require:

- *On the one hand, enhancing the role of labor unions and removing legal and institutional obstacles to forming them.* This should include developing the capacity of the unions and the coordination amongst them to partake a more pronounced role in the tripartite committees and policy dialogue.
- *On the other hand, amending some restrictive regulations*, for instance the labor law articles that govern the firing process where a high-level approval is required to release a worker.

24. Third, implementing broad educational reforms is important to align education curriculum with labor market needs, focusing in particular on investing in digital and entrepreneurial skills. Iraq needs to make significant and efficient investments to rehabilitate and recover the educational sector through additional infrastructure as well as qualified teachers. To ensure service continuity, Iraq can benefit from complementary learning sources such as online learning platforms. Additionally, it needs to develop its current TVET approach through modernizing

the curriculums, increasing outreach and coverage including through partnering with private firms to enhance training capabilities and better tailor programs with job requirements. Skilling programs can be expanded beyond recent graduates to out-of-school students in order to capitalize on the sectors that do not require formal tertiary education, which are labor intensive and have economic potential, such as construction and agriculture.

25. Fourth, Iraq should address impediments to women’s participation in the workforce.

Reforms should focus on increasing women’s education attainment, amend laws that restrict women’s mobility, including removing current restrictions on work hours, and increase protection in the workplace. The recent Approval of council of Ministers to ratify of ILO Convention on the Elimination of Violence and Harassment in the World of Work is a step forward for a major milestone. However, as described above, enforcement is key to ensure that these provisions are implemented and accessible. Maternity leaves should also be aligned in the private sector and public sector, where the latter seem generous in comparison to regional practices (14 weeks compared to 6 months). The Labor Law also allows women, in agreement with the employer, an unpaid leave for up to one year to care for their child after birth. Previous literature found out that paid maternity leaves can boost female employment; however, long leaves can create incentive for women to stay long outside the labor market and cause skill loss (Arena and Maneely, 2018). Other key policies that could increase women’s participation include encouraging diversity practices to allow women to advance in their careers¹⁷, encouraging home businesses and access to finance for female-run businesses, increased use of digital payments which would help women overcome mobility constraints, enforcing the law on availability of daycare at workplace, and improve access to safe transportation.

26. Finally, improving labor market data would be critical for better policy design and monitoring. Data required to further analyze the labor market is either unavailable or outdated and is often spread across different official sources with little or no coordination. There are no regular labor market surveys and information systems on the labor market. Data on education, technical and vocational training are fragmented between different institutions. It would be important for Iraq to leverage digital platforms and methods to collect and maintain data that provides the basis for monitoring labor market structure, developments, and for designing policies.

¹⁷ According to the World Bank’s Gender Data Portal, the female share of employment in senior and middle management for Iraq falls in the lowest quintile of all countries for which there are data between 2010–20.

Box 1. The Education Sector in Iraq

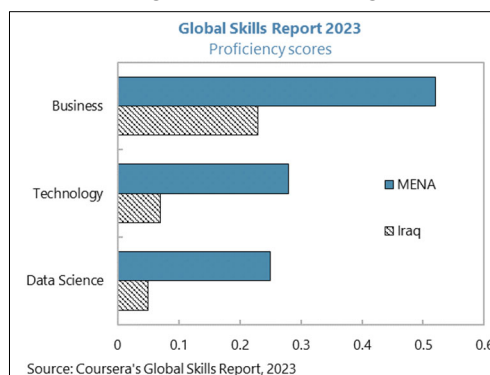
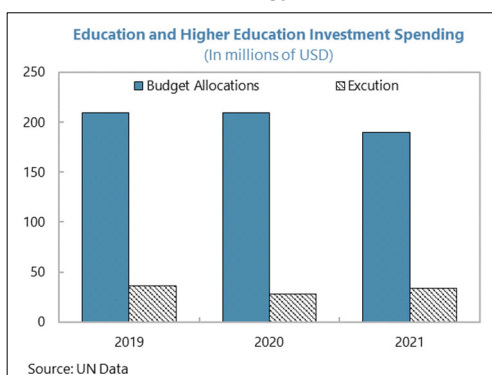
Conflicts and underinvestment have undermined education infrastructure and quality of education outcomes.

According to UNICEF and World Bank assessments, half of the schools in Iraq needs rehabilitation and more than 10,000 additional school buildings are needed. Around 3.2 million of school-aged Iraqi children are out of school, most of which are concentrated in conflict-affected governorates. The cost for reconstruction and recovery of the education sector is estimated to exceed IQD 5.4 trillion. However, public spending has been low and insufficient to address those needs.

Human Capital Index (HCI) points to deterioration in learning outcomes, conveying the productivity of the next generation of a country's workforce.

Despite being one of the best education systems in the MENA region in the 70s-80s, education quality in Iraq today compares poorly to the region as indicated by the low HCI at 0.41, which is the second lowest in the MENA region. The main driver of this weak performance is the number of years that a child is expected to complete in school, which in Iraq is 6.9 years, around half of the average for the MENA region. When adjusted for what students actually learn in Iraqi schools, this number drops to only 4 years due to the poor quality of learning. Enrollment and attendance rates are lower for higher levels of education. While nearly 92 percent of children attend primary education, 22 percent of children in lower secondary levels are out of school, compared to 40 percent in upper secondary levels (ReliefWeb 2021).

Iraq ranks low on global indices for innovation, digital and entrepreneurial skills. In its 2022 Global Innovation Index (GII 2022), the World Intellectual Property Organization ranked Iraq 131st out of 132 economies. Similarly, in the 2023 Coursera's Global Skills report, Iraq ranked 95 out of 100 countries with scores in Business, Technology and Data Science well below the average for the MENA region.



Box 2. Contributors to Potential Growth

Estimating Potential Growth. To illustrate the benefits of reforms that aim at increasing female labor participation and skills, a standard Cobb-Douglas function that relates factors of production to potential output is applied as in the following formula:

$$Y = A \cdot K^\alpha (LH)^{(1-\alpha)} \quad (1)$$

$$\Delta \ln Y = \Delta \ln A + \alpha \Delta \ln K + (1 - \alpha)(\Delta \ln L + \Delta \ln H) \quad (2)$$

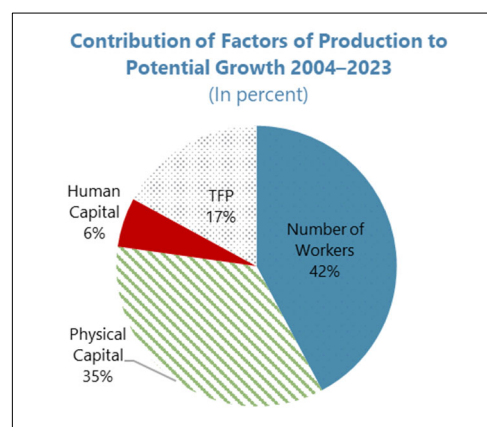
Where Y is the total potential output, A is total factor productivity (TFP), K is the stock of physical capital, L is the quantity of labor, H is the stock of human capital, and α is the income share of capital stock. The function is expressed in equation 2 in difference log form to derive the contributions to potential output in growth term. The growth accounting exercise was applied to Iraq to calculate the contribution of the different factors to potential non-oil GDP growth during the period 2004–2023. The capital stock balance in 2004 was taken from the IMF database on investment and capital stock and was adjusted to remove oil capital stock based on historical average of the share of oil investment in total investment. Capital stock for following years was derived based on non-oil public and private investment flows in constant term and a depreciation rate of 3 percent. Human capital was proxied by the human capital index per person based on years of schooling and returns to education (University of Groningen and University of California, Davis). The calculations used a standard assumption for the value of $\alpha = 0.3$.

The results show that, on average, labor has been the main contributor to potential growth followed by physical capital, while the contribution of human capital is very small. Total factor productivity grew on average by 0.74 percent during the period and contributed 18 percent to average non-oil growth of about 4 percent.

To perform projection of potential growth under different labor market scenarios, labor input was expressed as a function of working age population (p), labor force participation ratio (f), and employment ratio (e):

$$Y = A \cdot K^\alpha (p \cdot f \cdot e \cdot H)^{(1-\alpha)} \quad (3)$$

$$\Delta \ln Y = \Delta \ln A + \alpha \Delta \ln K + (1 - \alpha)(\Delta \ln p + \Delta \ln f + \Delta \ln e + \Delta \ln H) \quad (4)$$



Three scenarios were examined to estimate potential growth over the next decade; the baseline where labor participation remains constant at 2023 level, doubling women's participation to close the gap with the region by 2033, and improving human capital to regional levels, starting gradually after 2025. Results show that Iraq's growth potential is about 3 percent and declining in line with the declining rate of increase in the working age population. Increasing participation of women in the labor force would add over 2 percent to potential growth by 2033 and improving education of the workforce would add another 1.5 percent by 2033, compared to the baseline. This illustrates the significant gains that Iraq could achieve from education and labor market reforms.

Box 2. Contributors to Potential Growth (Continued)

Role of Women Labor Participation. To empirically quantify the effects of different structural and policy factors on FLFP and the labor force participation gender gap in Iraq, we estimate the following Fixed Effect (FE) panel regression for advanced and MENA countries over 1970–2021:

$$Gap_{it} = \alpha + \beta Structural_{it} + \gamma Education_{it} + \delta Policy_{it} + \varphi Legal_{it} + FE + \epsilon_{it},$$

where Gap refers to male labor force participation rate minus the female participation rate in country i at time t . The structural factors relate to GDP per capita (in constant 2015 US\$ terms) and demographics proxied by the fertility rate. Education refers to the female attainment of tertiary education compared to male, measured by the tertiary party index, and the percentage of secondary females enrolled in vocational and technical training. The policy and legal variables are taken from the Women Business and the Law Index on women's mobility (a binary index for freedom for travel, leave home, passport ownership, and work at night), marriage equality (a binary indicator if women has the same marriage and divorce rights and legislation against violence), pension equality (a binary indicator of retirement age and pension benefits) and workplace regulations (a binary indicator on existence of restrictions on women's jobs, and laws against sexual harassment and gender discrimination). These explanatory variables are in line with what has been proposed in the literature (Hakura et al. (2016), Balima and Gomez (2022), and IMF (2016)) as potential drivers of female labor force participation and the participation gap. To address the risk of endogeneity and reverse causality, the lagged values of independent variables were used following the work of Balima and Gomez (2022). Multicollinearity tests based on the variance inflation factor show little evidence of collinearity and the Huber-White estimator was used to obtain heteroskedasticity-robust standard errors.

Results point to the importance of both structural and policy factors. As expected, the high fertility has a negative impact on female engagement in the labor market in both advanced and MENA countries, although the impact on reducing the female-male participation gap is significant only in MENA. The growth impact also has the expected direction in reducing the participation gap with male, in line with the results of the existing literature (see, for example, Verick (2018), Jaumotte (2003) and (IMF 2016)). The education of female relative to male has a positive and significant impact in reducing the participation gap. The mobility indicator which includes ability of women to work at night (one of the legal restrictions in Iraq), also has a strong and significant impact in reducing the gap. Other legal factors related to women equality in marriage, pension, and workplace laws which are expected to lower the participation gap, are either insignificant or have the wrong sign estimation, likely reflecting the impact of weak law enforcement in MENA.

Given data limitations for Iraq, which precludes reliable individual estimates, we use the coefficients from the MENA results to estimate the gap for Iraq and assess the impact of reform that bring the level of explanatory variables to the MENA average (increase female educational attainment, remove restrictions on women's work) and mobility, amend laws that protect women, and help equalize their rights at household and work. Iraq would be able to reduce the estimated male-female participation gap by 10 percentage points, to bring it

Box 2. Contributors to Potential Growth (Concluded)

in line with the MENA average. This would be considered the minimum and Iraq should aspire to align its policies and laws with regions that have smaller gender gaps than MENA.

Dependent variable: Male-Female Participation		
<i>Independent variable</i>	Advanced	MENA
Structural		
Log GDP	-2.31	-1.29
Vocational Enrollment	-0.06***	0.04
Fertility	0.50	2.98***
Education	-22.55**	-3.26**
Policy		
Marriage rights	-0.07***	-0.03
Mobility	-5.74*	-12.92***
Pension Equality	0.001106	0.05*
Workplace environment	-0.02***	0.05***
Constant	64.81***	51.34***
N	551	222
R-squared within	0.74	0.52
Statistically significant at * p<0.05, **p<0.01, *** p<0.001.		
Source: IMF staff estimates.		

Box 3. Responsiveness of Employment to Growth

Estimation of elasticity. The employment to growth elasticity is an indicator that provides a numerical measure of how employment varies with economic output. Two widely used methods to estimate elasticity were used for Iraq. First, the arc elasticity which is given by the following formula:

$$\varepsilon = (\% \text{ change in } E) / (\% \text{ change in } Y)$$

Where E is non-oil employment and Y is non-oil GDP. Using available official data for 6 data points from ILO database during the period 2007-2021, the calculation gives an elasticity of 0.97 for the whole period, and a range between 0.85-1.17 when dropping 2014-2016 (ISIS war impact) and 2021 (Covid impact).

The second approach is to estimate the elasticity from econometric estimation. Following Crivelli and others (2012), the following relation was estimated:

$$\text{Ln}(E_t) = a + \rho \text{Ln}(E_{t-1}) + b \text{Ln}(Y_t) + \text{error term}$$

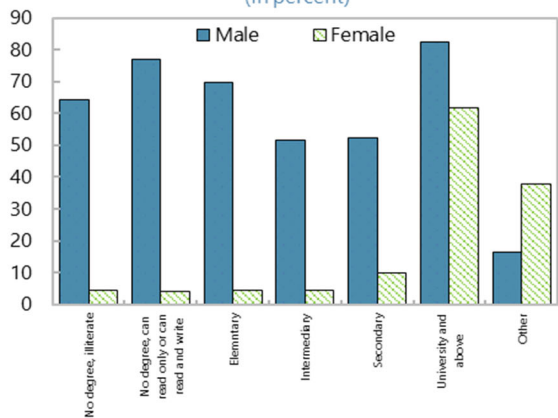
Where $\text{Ln}(E_t)$ is the logarithm of employment and $\text{Ln}(Y_t)$ is the logarithm of non-oil GDP. Estimation on data for the period 2009-2023 using labor data estimates from the Penn World Tables gives the following results.

$$\text{Ln}(E_t) = 0.38 + 0.75 * \text{Ln}(E_{t-1}) + 0.17 * \text{Ln}(Y_t)$$

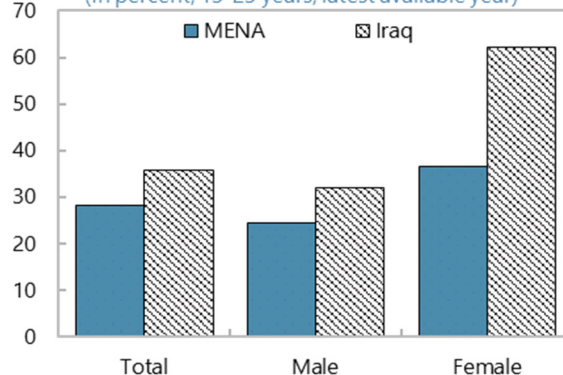
Long-term elasticity is calculated using the formula $b / (1 - \rho)$ which gives an elasticity of about 0.7. Taking a range from both methods, every one percent increase in growth lead to 0.7-1.2 percent increase in employment. These estimates are consistent with findings of other estimates for the region, see for example Kapsos (2005) and Coulibaly and others (2023).

Figure 1. Iraq: Selected Labor Market Indicators

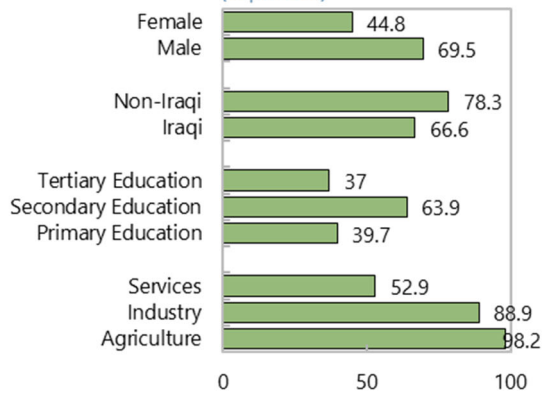
Labor Force Participation Rate by Education and Gender
(In percent)



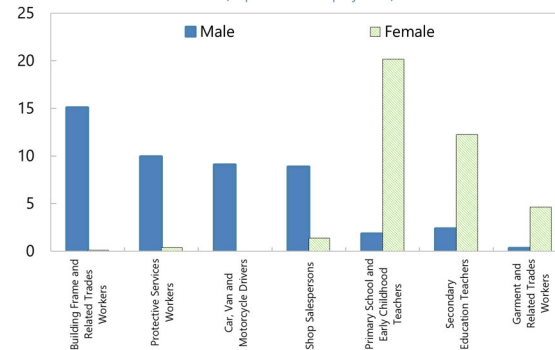
Youth Unemployment Rate by Gender
(In percent, 15-25 years, latest available year)



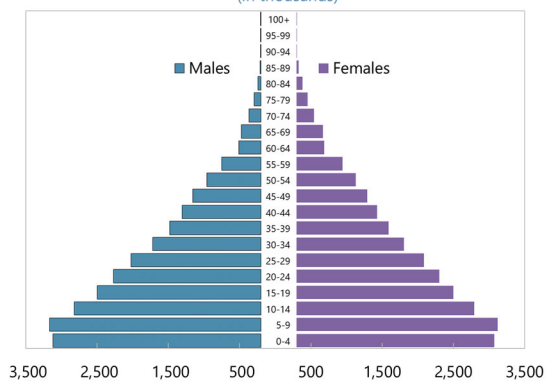
Informal Employment
(In percent)



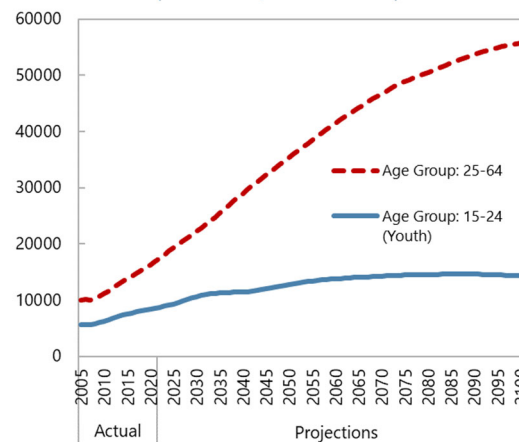
Occupational Categories with Highest Degree of Gender Segregation^{1/}
(In percent of employment)



Iraqi Population by Age and Gender
(In thousands)



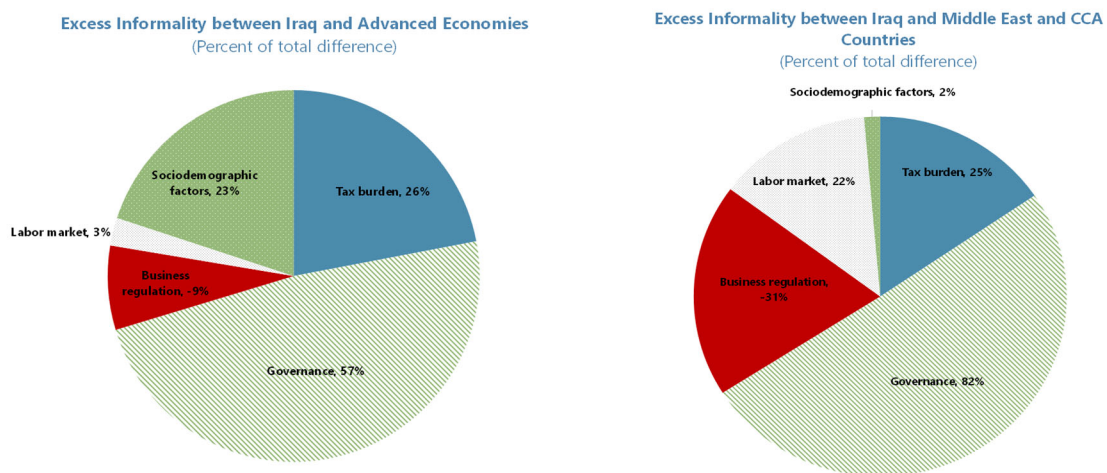
Working Age Population Projection
(In thousands, medium variant)



Sources: Iraq's Labor Force Survey 2020/2021, ILOSTAT database, and IMF staff calculations.

1/ Segregation index measures to which extent labor markets are separated into male and female occupations.

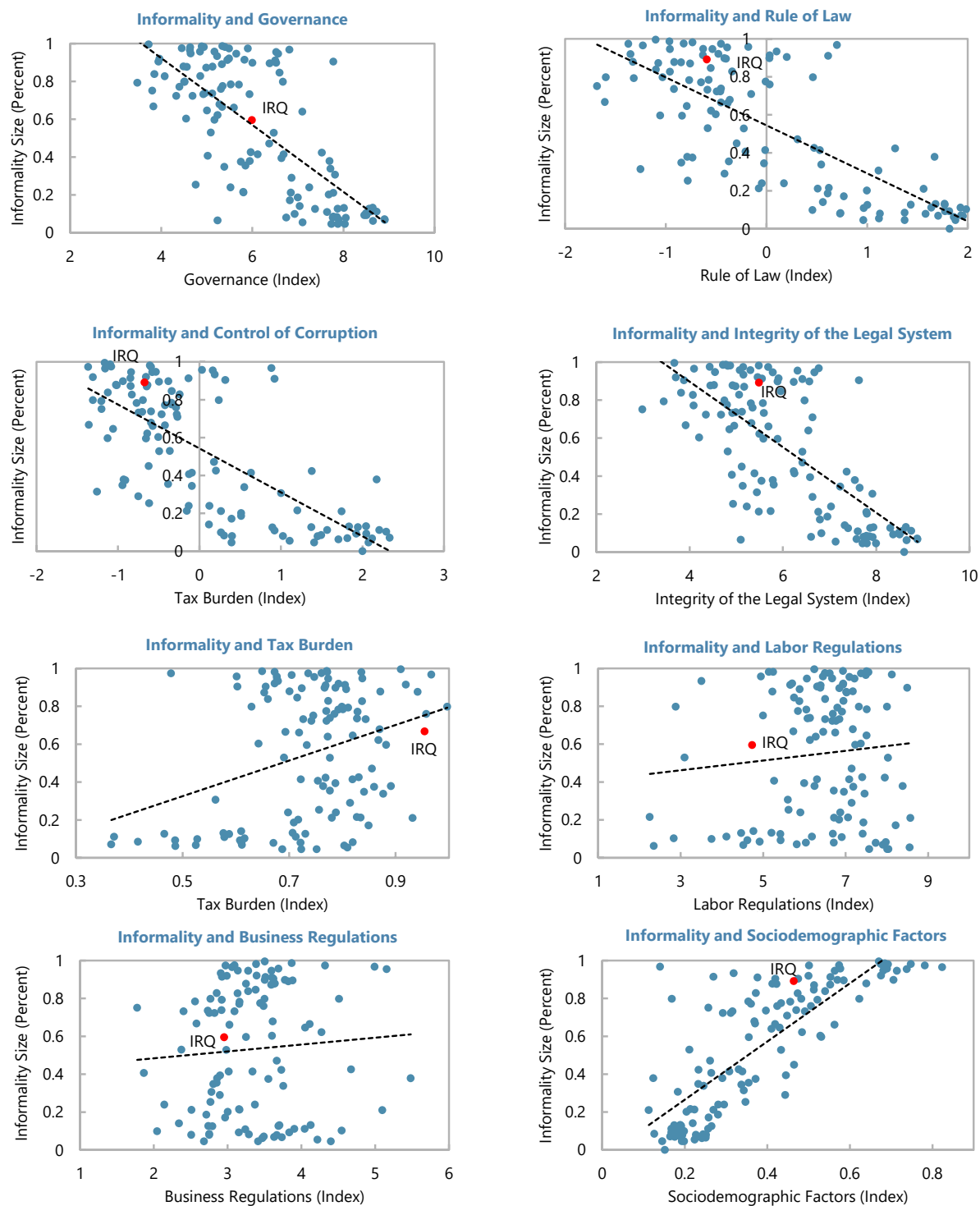
Figure 2. Iraq: Informality Distance to Frontier Economies 1/



Sources: Cardarelli and others (2022), Fraser Institute, Worldwide Governance Indicators, and IMF staff estimates.

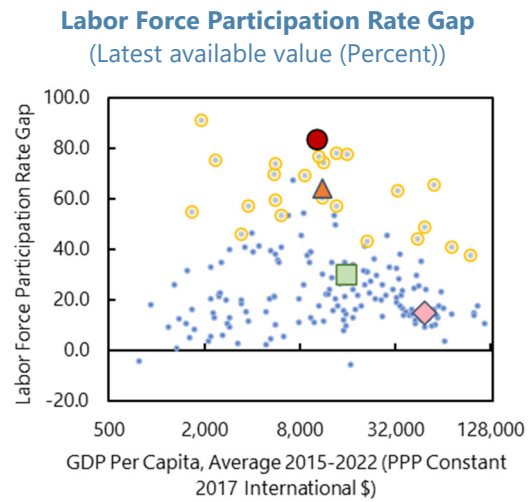
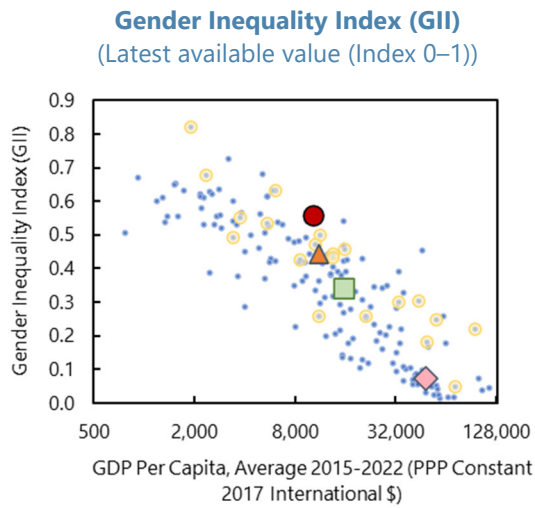
1/ The sociodemographic index (IMF staff estimates) ranges between 0 and 1, where a higher value means lower level of economic development. The business regulation index is proxied by the burden of government regulation index (Fraser Institute based on WEF), which ranges from 1 to 7 and a higher score is associated with a smaller burden. The tax burden index (IMF staff estimates) ranges between 0 and 1, with a higher score signaling greater burden. The labor regulations index (Fraser institute) ranges from 1 to 10, with higher values associated with greater flexibility for employers. Governance index (based on World Bank's Worldwide Governance indicators) ranges from 0 to 10, with higher value indicating stronger governance.

Figure 3. Iraq: Drivers of Informality

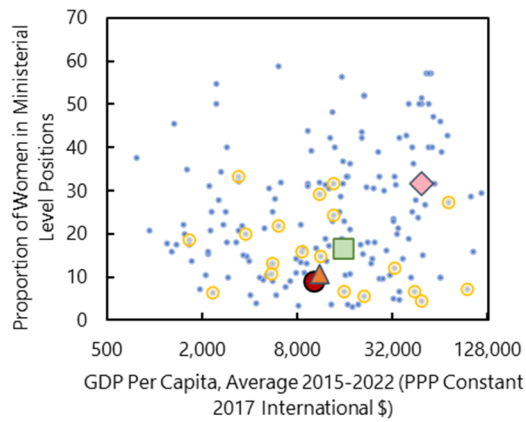


Sources: Cardarelli and others (2022), Fraser Institute, Worldwide Governance Indicators, and IMF staff estimates.

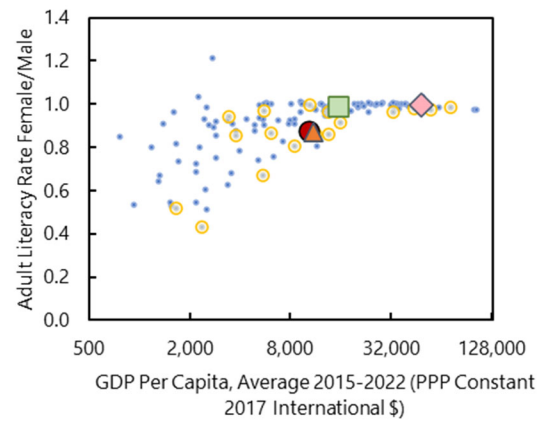
Figure 4. Iraq: Gender Inequality - Selected Indicators



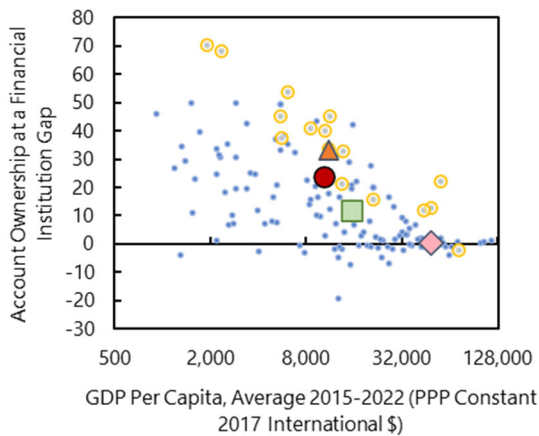
Proportion of Women in Ministerial Level Positions
(Latest available value (Percent))



Adult Literacy Rate Female/Male
(Latest available value (Gender Parity Index))



Account Ownership at a Financial Institution Gap
(Latest available value (Percent))



Women Business and the Law Index
(Latest available value (Index 0–100))

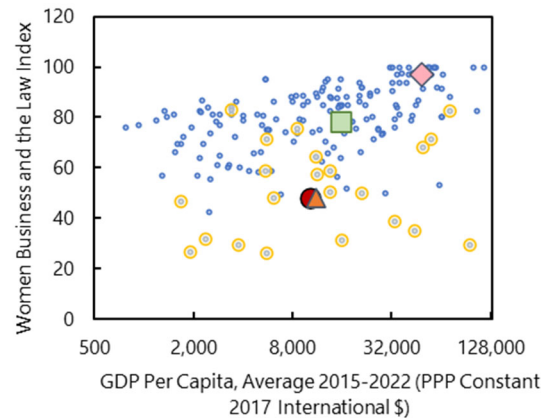
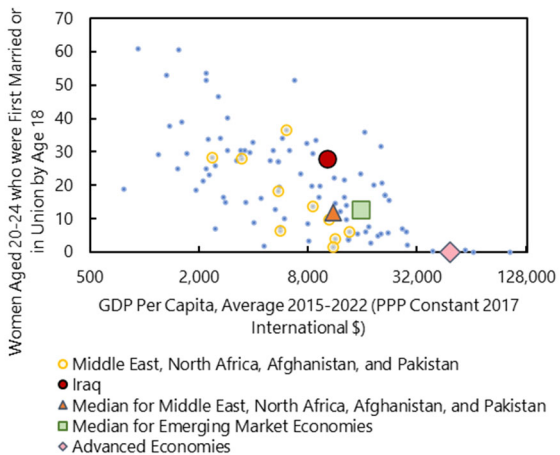
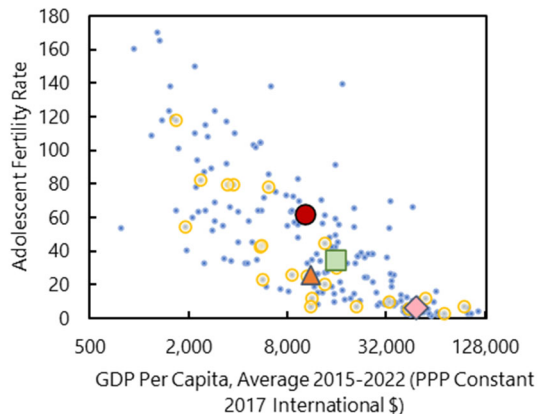


Figure 4. Iraq: Gender Inequality - Selected Indicators (Concluded)

Women Aged 20-24 who were First Married or in Union by Age 18
(Latest available value (percent))



Adolescent Fertility Rate
(Births per 1,000 women ages 15-19)

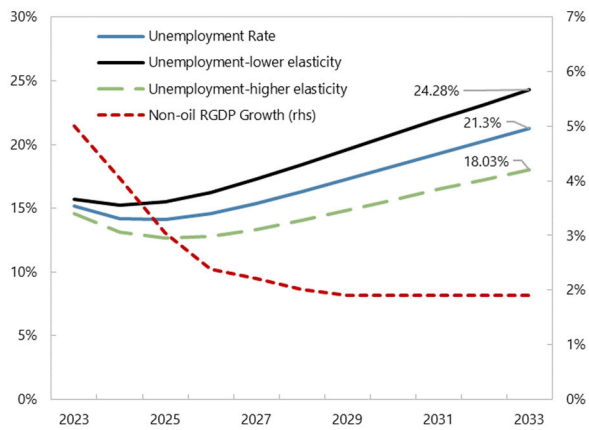


Sources: IMF staff using Global Findex Database, IMF Gender HUB, Gender Statistics, and World Development Indicators (WDI).

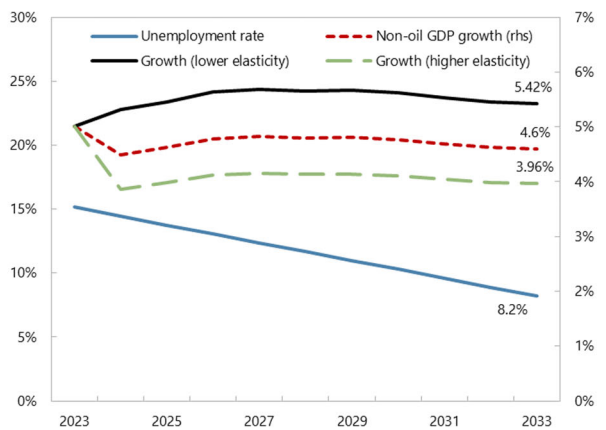
Figure 5. Iraq: Unemployment and Growth Under Different Scenarios

(In percent)

Baseline Growth Scenario



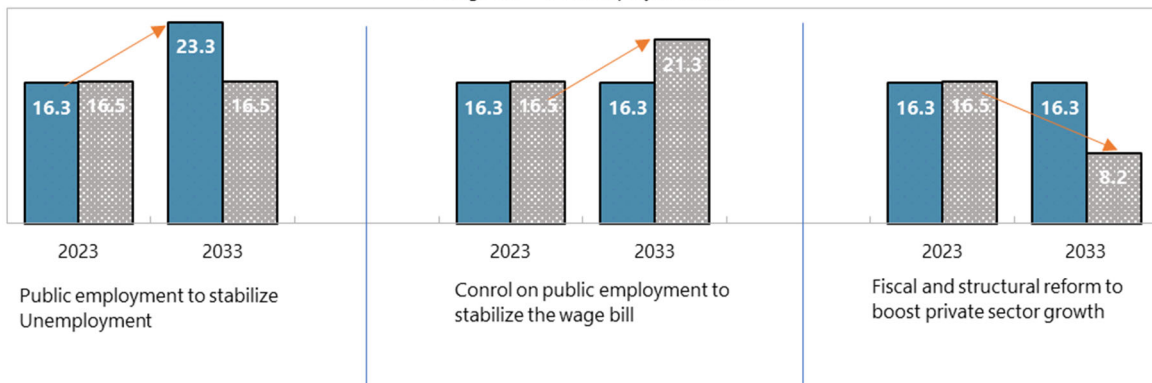
High Growth Scenario



Public Wage Bill and Unemployment Under Different Scenarios

(In percent)

■ Wage bill ■ Unemployment rate



Sources: UN World Population Prospects 2022, Online Edition, ILOSTAT, Iraq's Labor Force Survey 2020/2021, IMF staff projections.

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