

**Iraq: First Review Under the Stand-By Arrangement and Financing Assurances Review—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Iraq**

In the context of Iraq's First Review Under the Stand-By Arrangement and Financing Assurances Review, the following documents have been released and are included in this package:

- The staff report for the First Review Under the Stand-By Arrangement and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on June 15, 2008 with officials of Iraq on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 18, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A supplement to the staff report of August 29, 2008 updating information on recent developments.
- A press release summarizing the views of the Executive Board as expressed during its September 3, 2008 discussion of the staff report that completed the review.
- A statement by the Executive Director for Iraq.

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

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INTERNATIONAL MONETARY FUND

IRAQ

**First Review Under the Stand-By Arrangement  
and Financing Assurances Review**

Prepared by the Middle East and Central Asia Department  
(In consultation with other departments)

Approved by Adam Bennett and Mark Allen

August 18, 2008

- This report is based on discussions held during June 10–15, 2008 in Amman. Staff met with Minister of Finance Al-Zubaydi, Minister of Oil Al-Shahristani, Governor of the Central Bank of Iraq (CBI), Al-Shabibi, and other senior officials. The staff team comprised Messrs. De Vrijer (head), Grigorian, Kock, and Ms. George (all MCD), and Ms. Oliva-Armengol (PDR). Mr. Ibrahim, the Fund’s resident representative for Iraq, assisted the mission.
- A 15-month Stand-By Arrangement (SBA) in an amount equivalent to SDR 475.36 million (40 percent of quota) was approved by the Executive Board on December 19, 2007. The authorities continue to treat the arrangement as precautionary.
- Iraq has met all quantitative performance criteria set for end-March 2008, except for the performance criterion on government imports of petroleum products which was missed by a small margin due to higher-than-expected import prices for kerosene. All structural performance criteria have been met.

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## EXECUTIVE SUMMARY

**Economic activity remained subdued in 2007 but growth prospects have improved in 2008, underpinned by increasing oil production and exports.** Benefiting from better security and improved maintenance, crude oil exports resumed from mid-2007 through the northern pipeline to Turkey. Non-oil activity appears to have picked-up in the latter part of 2007 and in early 2008, except for the drought-hit agriculture sector.

**Inflation has slowed down and monetary and exchange rate policies have been adjusted in response.** Annual consumer price inflation has been in the low single digits since December 2007. However, core inflation (excluding fuel and transportation) remained in double digits (about 12½ percent in June), in part because of higher food prices. The Central Bank of Iraq (CBI) slowed the pace of appreciation and reduced its policy interest rate to 16 percent.

For the remainder of 2008, key elements of the authorities' program include the following:

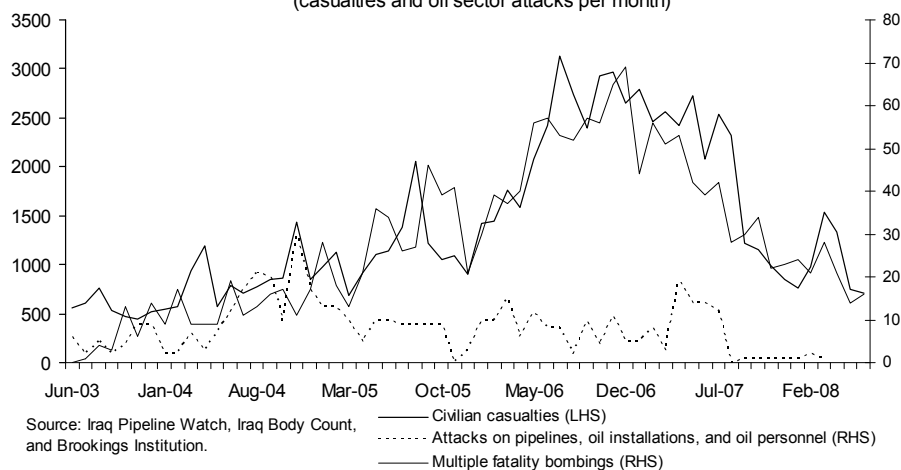
- **The supplementary budget for 2008 provides for a sizable increase in current and capital spending.** The impact on inflation is expected to be modest because of the high import content of the additional outlays. A significant civil service salary increase—to partially compensate for the significant erosion of real wages in recent years—will be implemented gradually in 2008 and 2009.
- **Domestic retail prices of LPG and jet fuel have been increased and the government will continue to refrain from providing direct fuel subsidies,** except for a small subsidy on kerosene. Gasoline and diesel prices are planned to be adjusted again in early 2009.
- **The CBI will increase the pace of appreciation of the dinar and keep the policy interest rate positive in real terms** to keep inflation under control.
- **Priority structural reforms will continue.** Work is underway to improve public financial management (PFM), including by adopting a comprehensive PFM action plan. The CBI will further improve its accounting and reporting practices and adopt new reserve management guidelines. Restructuring plans for the two largest state-owned banks will be developed on the basis of their finalized financial and operational audits, and work will proceed to complete the full set of prudential regulations for commercial banks.

## I. INTRODUCTION

1. **The current SBA for Iraq was approved in December 2007 in support of the authorities' economic program for 2008.** The main objectives of the program are to maintain macroeconomic stability, facilitate higher investment and growth, and move forward with key structural reforms. The arrangement runs through March 18, 2009.

2. **The security situation has improved, but is still precarious and full political reconciliation within the government remains to be achieved.** Despite a reduction in violence since early 2007, periodic flare-ups continue to hamper the pace of economic recovery. During March/April 2008, an offensive was launched by Iraqi security forces against the Mahdi Army (loyal to Shia cleric Muqtada Al-Sadr), followed by a campaign against Al-Qaeda in Mosul. In this period, there were also two bomb attacks on southern pipelines, temporarily interrupting oil exports. The various offensives appear to have ended in May. Since April 2007, ministers from the (secular) Iraqi National List, the (Sunni) National Accord Front, and the Al-Sadr block have withdrawn from the government. In mid-July 2008, the National Accord Front rejoined the government.

Figure 1: Violence Indicators, June 2003–June 2008  
(casualties and oil sector attacks per month)



3. **The Paris Club agreed on November 21, 2004 to a debt reduction for Iraq, equivalent to 80 percent in net present value (NPV) terms, to be achieved in three stages.** The first and second stages, each comprising a 30 percent debt reduction in NPV terms, went into effect in November 2004 and in December 2005 (following approval of the first SBA), respectively. The final stage will comprise an additional 20 percent debt reduction, and depends on completion by end-December 2008 of the second and last review under the current SBA.

4. **The first annual review conference of the International Compact with Iraq (ICI) was held in Stockholm on May 29, 2008.** The international community affirmed its support for Iraq's political, security, and economic reform program. The Fund's main contribution to

the ICI consists of the medium-term macroeconomic policy framework of the SBA-supported program.

## II. RECENT ECONOMIC DEVELOPMENTS

5. **Economic activity remained subdued in 2007 but growth prospects have improved in 2008, underpinned by increasing oil production and exports.** Real GDP growth is estimated to have been only about 1½ percent in 2007, reflecting a decline in agricultural and industrial production. However, crude oil exports began to pick up in the second half of the year, benefiting from better security and improved maintenance, and the resumption of exports through the northern pipeline to Turkey. In January–May 2008, crude oil production averaged 2.3 million barrels per day (mbpd), compared to just above 2.0 mbpd in 2007. There are also indications of a pick-up in non-oil activity in the latter part of 2007 and in early 2008, except for agriculture which is being hit by drought.

6. **Inflation was brought down to 5 percent during 2007**, from 65 percent at end-2006. The overall consumer price level in June fell by some 6 percent relative to a year earlier, reflecting better availability of fuel products and lower black-market fuel prices. Core inflation (excluding fuel and transportation costs) remained at about 12½ percent in June, year-on-year, in part because of increasing food prices.<sup>1</sup>

7. **Higher oil revenues and below-budget investment spending resulted in an overall budget surplus of 13½ percent of GDP in 2007** (the program projected a surplus of 1.5 percent of GDP). The balance of the Development Fund for Iraq (DFI) grew to \$12.6 billion at end-2007. In the first six months of 2008, higher oil exports increased the balance of the DFI by a further \$4.6 billion. There are indications that the measures to improve investment execution have begun to bear fruit.

8. **Monetary and exchange rate policies have been adjusted in response to the slowdown in inflation.** The policy interest rate was reduced in three steps from 20 percent at end-2007 to 16 percent as of July 1, 2008, but remained positive in real terms (defined as the policy rate minus core inflation). The appreciation of the dinar has slowed from about ½ percent per month in the second half of 2007, to about ¼ percent per month during January–June 2008. The appreciation helped to bring inflation down and to reduce cash dollarization. The real demand for dinar currency in circulation expanded by 23 percent in 2007. Gross international reserves increased to \$38.3 billion at end-April 2008, equivalent to about 10 months of imports of goods and services.

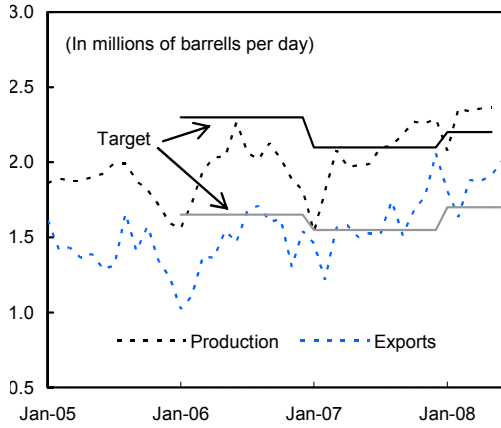
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<sup>1</sup> The definition of core inflation in Iraq excludes fuel and transportation (with an end-2006 effective weight of 35 percent) because these components explain most of the volatility in the CPI. Core inflation excluding food prices was 15.3 percent, year-on-year, in June 2008.

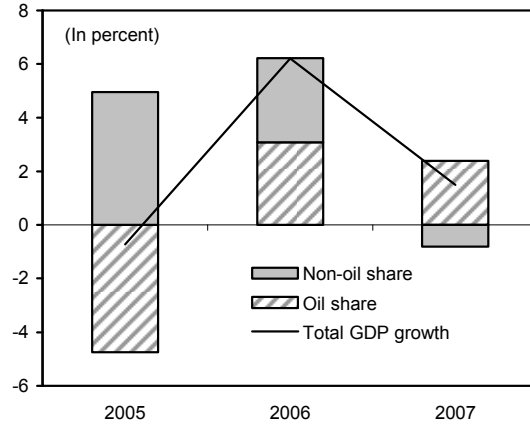


Figure 2. Iraq: Output and Inflation

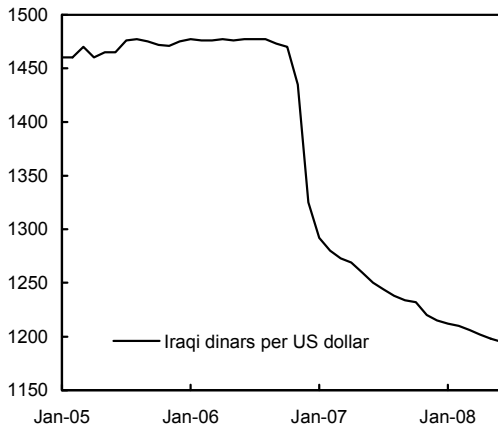
**Oil production and exports have gradually increased...**



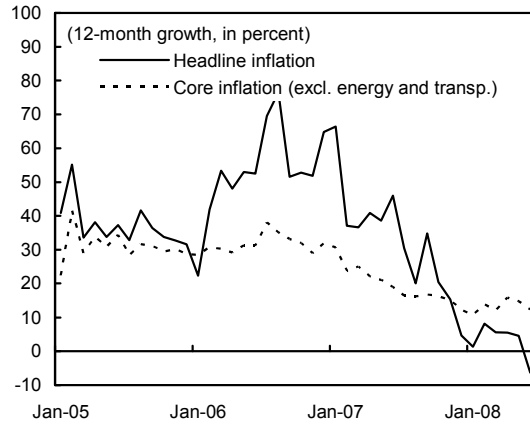
**...but overall output growth remained low.**



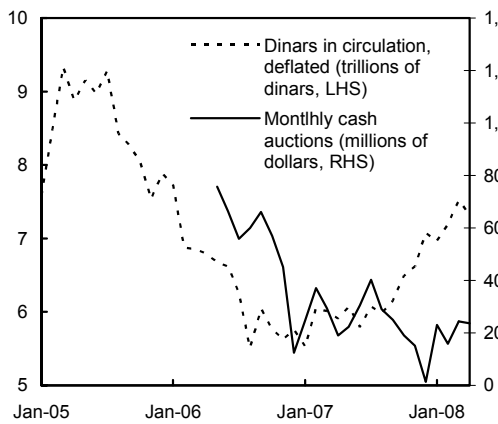
**Appreciation of the dinar...**



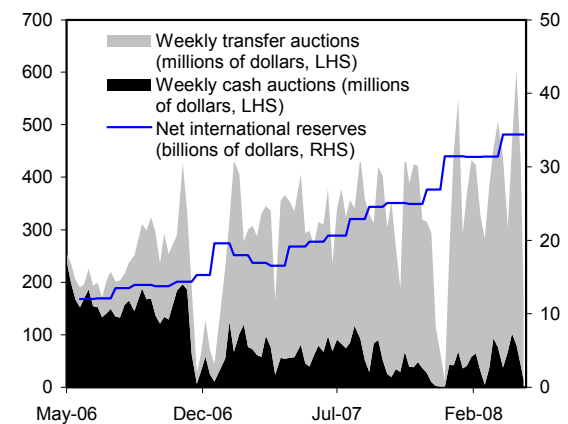
**...has helped bring down consumer price inflation...**



**...and reduce cash dollarization...**

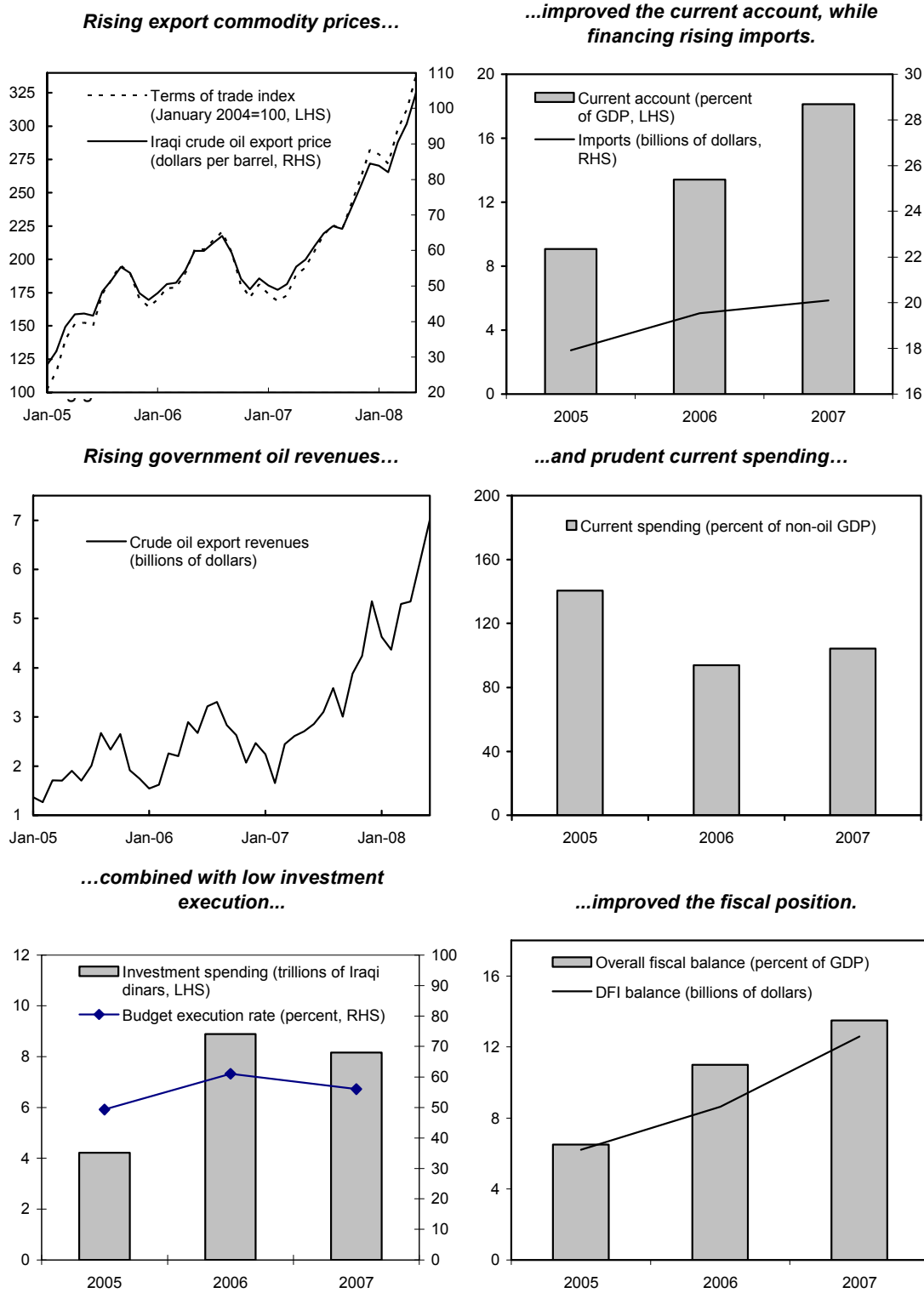


**...while the CBI was able to satisfy market demand for dollars and build up reserves.**



Source: Iraqi authorities and Fund staff calculations.

Figure 3. Iraq: External and Fiscal Indicators



Source: Iraqi authorities and Fund staff calculations.

9. **Iraq has continued to make progress toward resolving outstanding external claims** (Box 1). The authorities are continuing their efforts to restructure Iraq's debt with non-Paris Club creditors. The United Arab Emirates has announced the full cancellation of its claims against Iraq in early July. Also, good faith efforts are underway to reach agreement with the remaining commercial creditors on terms comparable with the 2004 Paris Club debt agreement.

10. **Progress has been made in structural reforms.** The amendments to the pension law have been enacted and the external audits of the CBI net international reserves data at end-2007 and of the CBI 2007 financial statement have been completed as planned. Progress has also been made in modernizing the government's financial management system, banking reform, and in strengthening the statistical database, but with respect to the implementation of the recommendations of the IMF's safeguards assessment report (SAR) the results are mixed. While the external audits of the CBI's 2007 financial statements and of its net international reserves at end-2007 were completed on time and steps have been taken to improve the reconciliation of local banks' current accounts, progress in some other areas has been slow.

### III. POLICY DISCUSSIONS

11. **The discussions on the first review focused on measures to accelerate the reconstruction of the Iraqi economy while maintaining macroeconomic stability.** The authorities and staff agreed that the reduced level of violence and long-awaited expansion of oil production/exports, together with the surge in world market oil prices, have created a window of opportunity. At the same time, spending pressures are mounting with the much higher Iraqi oil export prices projected for 2008 than the budget/program reference price (\$98 per barrel compared to \$57 per barrel), and the resulting stronger fiscal and external positions. The discussions focused on the supplementary budget for 2008 that the government was preparing, the appropriate monetary and exchange rate policy stance, and on implementation of the authorities' structural reform agenda.

12. **The authorities remain strongly committed to the program supported by the SBA.** The attached Supplementary Memorandum of Economic and Financial Policies (SMEFP) outlines their plans for the remainder of the program period.

#### A. Macroeconomic Outlook and Risks

13. **Real GDP growth is projected to increase to 9 percent in 2008, driven by the ongoing expansion of oil output.** Provided the recent reduction in violence takes hold, crude oil production is expected to reach on average at least 2.3 mbpd and exports 1.8 mbpd, both higher than projected at the outset of the program. Although agricultural output in 2008 is likely to be affected by drought, other non-oil economic activities are expected to recover. The annual inflation objective has been increased to 14 percent, slightly above the original

### Box 1. Recent Developments in Iraq's Debt Restructuring Process

Iraq has made important progress to resolve its outstanding external debt, and has already benefited from substantial debt reduction from official and private creditors.

Bilateral agreements with all of Iraq's 18 **Paris Club creditors** have been signed.<sup>1/</sup> The latest agreement was signed with Russia on February 11, 2008 and granted a debt reduction of 60 percent as of end-2005 on a reduced stock of debt of \$4.5 billion.

Paris Club creditors	Nominal debt stock (in U.S.\$ billion)
Before debt restructuring	42.5
Debt relief to date	25.8
<i>Of which:</i>	
First debt reduction, end-2004	14.3
Second debt reduction, end-2005	11.5
<b>Outstanding</b>	<b>16.7</b>

Source: Iraqi Authorities and IMF staff estimates

Note: Amounts do not include capitalized interests as in the DSA tables.

Iraq has signed agreements to reschedule debt with 11 **non-Paris Club creditors** on terms comparable to those of the Paris Club.<sup>2/</sup> The latest agreement was signed with the countries of the former Yugoslavia on January 21, 2008. Negotiations are under way with 11 other non-Paris Club creditor countries, representing an estimated stock of debt of about \$16 billion. A memorandum of understanding has been signed with China (debt stock estimated at \$8.5 billion). On July 7, 2008 the United Arab Emirates has announced the full cancellation of Iraq's debt; debt negotiations with other Gulf countries remain ongoing.

Non-Paris Club creditors (Concluded agreements only)	Nominal debt stock (in U.S.\$ billion)
Before debt restructuring	9.4
Debt relief to date	7.5
<i>Of which:</i>	
Full cancellation	0.2
Cash settlement 1/	5.4
On Paris Club terms 2/	2.0
<b>Outstanding</b>	<b>1.9</b>

Source: Iraqi Authorities and IMF staff estimates

1/ The cash settlement involves a payment of \$614 million in 2008.

2/ Estimated debt reduction following Paris Club terms (two stages, each of 30 percent NPV debt reduction).

Iraq has resolved the bulk of **private creditor claims**. Outstanding claims from the previous debt and cash restructuring exchanges constitute only about 4 percent of total original private claims. On January 30, 2008 Iraq reopened its commercial debt-restructuring program. The offer seems to have been successful and final results are expected to be published shortly. On April 3, 2008, the British High Court sanctioned the liquidation plan for the London branch of Rafidain Bank, clearing the path for the settlement of the related outstanding commercial claims.

1/ Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Republic of Korea, Russian Federation, Spain, Sweden, Switzerland, United Kingdom, and the United States.

2/ Bulgaria, Cyprus, Czech Republic, Hungary, Indonesia, Malaysia, Malta, Slovak Republic, South Africa, Romania, and the former Yugoslavia.

program target, to take into account the pass-through of higher international food prices. Assuming no further declines in black-market fuel prices, the gap between headline and core would likely be reduced.

14. **The economic outlook remains subject to considerable risks.** A reversal of the still fragile security gains and/or political instability could hamper economic growth, add to inflationary pressures, and obstruct timely implementation of the structural reform agenda.

### B. Fiscal Policy and Related Measures

15. **A sizable increase in wages and allowances for the civil service was signed into law in early May 2008** (SMEFP, ¶12). The salary increase, which was not envisaged under the program, would expand the civil service wage bill by some 57 percent compared to the original budget and add roughly 9 percent of non-oil GDP to consumption demand. Staff agreed with the authorities that a wage increase is justified in light of the significant decline in (average) real wages during 2005–07, when consumer prices almost tripled. However, in order to limit the impact of the salary increase on inflation, and taking into account the considerable import content of private consumption, the government has decided to phase in the salary increase gradually by limiting the effective salary increase in 2008 to 40 percent; the remainder will be paid in 2009.<sup>2</sup>

Iraq: Wages and Employment, 2004-08  
(In billion Iraqi dinar unless otherwise indicated)

	2004	2005	2006	2007	2008
Wage bill (non-Defense/Interior)	2,745	4,392	5,249	5,955	10,005
Employment (non-Defense/Interior)	580,647	997,547	1,374,605	1,452,258	1,536,349
Average real wage index (non-Defense/Interior) 1/	100	75.6	39.8	29.0	43.0
Average CPI	100	137.0	209.9	274.6	293.9

1/ Evaluated at mid-year employment level. The average wage index is, to some extent, biased downwards as new hirings most likely took place at lower grade levels.

16. **The draft supplementary budget for 2008, which is expected to be passed by the Council of Representatives in August, provides for significant increases in current and capital spending, while preserving a sustainable fiscal stance overall** (SMEFP, ¶13). In light of the improved security and much higher-than-expected oil revenues, the supplementary budget enables the government to step up investment, partly repair the severe real wage erosion, and accommodate the impact of higher world food prices and war reparations to Kuwait. The inflationary impact of the fiscal impulse is expected to be modest in view of the high import content of the additional outlays. About half of the total expenditure increase provided for in the supplementary budget is allocated to higher public investment in priority sectors, including in the oil sector and at the provincial level. The main

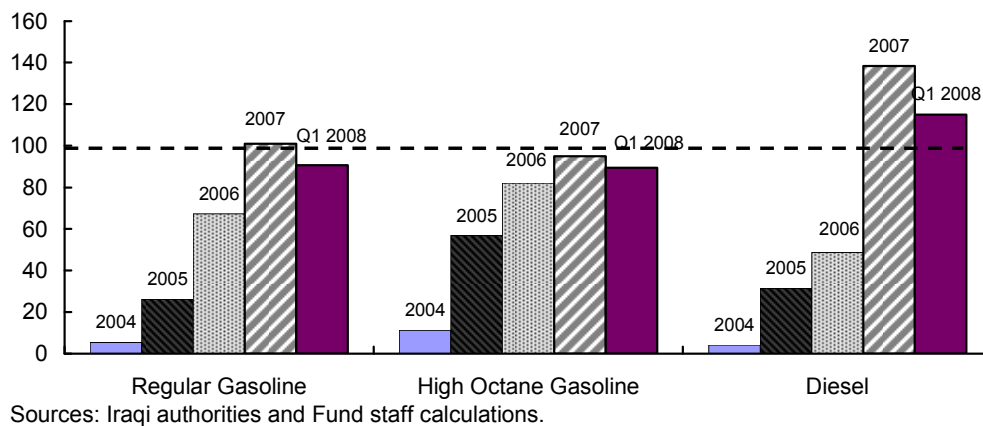
<sup>2</sup> In 2008, some payments were made in June, but most of the increase will be paid in the second half of the year.

increases in current spending, in addition to the civil service wage hike, are for security; the in-kind Public Distribution System (PDS; food imports); transfers to the electricity sector (fuel imports) and public enterprises (wage increase); and war reparations to Kuwait (due to higher oil revenues). To prepare a reform of the PDS as of early 2009, the authorities intend to request technical assistance from the Fund and the World Bank.

17. **On this basis, and taking account of the higher oil revenues, an overall budget surplus of about 2¾ percent of GDP is projected for 2008** (versus a programmed deficit of 8½ percent). As a result, the balance of the DFI would increase to almost \$16.5 billion by end-2008 (the program target is \$5.1 billion).

18. **The government increased the official retail prices of jet fuel and LPG in June and July 2008, respectively, and plans to adjust gasoline and diesel prices in early 2009.** There are no direct subsidies on fuel products, except for a small subsidy on imported kerosene. However, due to higher international oil prices, the indirect subsidy on fuel products resulting from underpricing of crude oil used for domestic consumption is projected to increase to 6½ percent of GDP in 2008, from 5 percent in 2007. The authorities agreed that the surge in world fuel prices necessitates a further adjustment of domestic prices, but preferred to wait until after the provincial elections due later this year. The authorities remain committed to develop, in consultation with the Fund, an automatic fuel price adjustment mechanism that can be implemented early next year.

Figure 4: Official Fuel Prices in Iraq, 2004–08  
(In percent of average fuel prices in other oil-exporting countries in the Middle East and North Africa region)



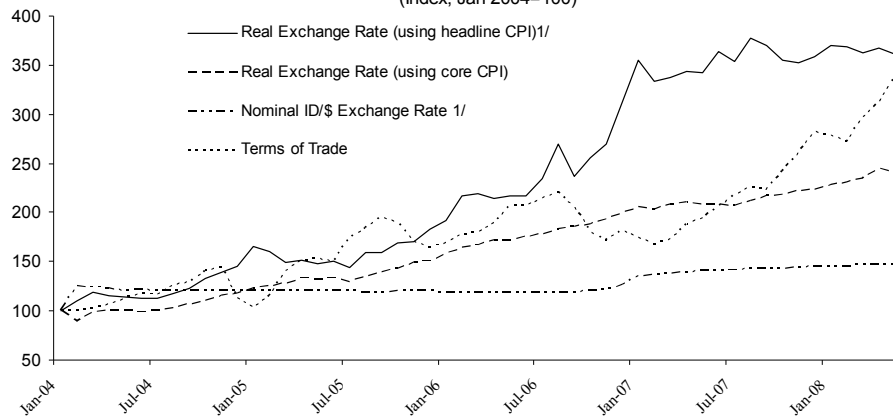
19. **Iraq is actively engaging with the Fund, the World Bank, and other international partners to improve public financial management (PFM; SMEFP, ¶15).** Recent Fund technical assistance has focused on the areas of budget execution, cash management, commitment control, the accounting framework, and fiscal reporting. The

authorities are working with the World Bank on a new capacity building project covering budget preparation, public procurement, and fiscal reporting. Progress is also being made, in cooperation with USAID, to install the Iraq Financial Management Information System (IFMIS) before year-end. Efforts are underway, in consultation with the Fund and the World Bank, to adopt a comprehensive PFM action plan. To enhance the transparency of the budget implementation process, the final fiscal accounts for 2005 have been and those for 2006 are being audited by the Board of Supreme Audit (BSA); the Ministry of Finance will submit soon the final accounts of the Federal Budget for 2007 to the BSA. The census of public service employees is underway, but its completion is delayed to end-September due to technical and security-related problems and difficulties with data collection (SMEFP, ¶16).

### C. Monetary and Exchange Rate Policy

20. **The CBI recognizes that the planned fiscal expansion poses a challenge to keep inflation under control and requires a tightening of its policy stance** (SMEFP, ¶17). The upcoming wage increase and the government's efforts to increase investment spending will intensify price pressures, despite the high import content of both consumption and investment spending. In response, the CBI will increase the pace of appreciation of the dinar to ½ percent per month during the second half of 2008. This would be consistent with a more appreciated equilibrium real exchange rate than was expected at the time the program was approved, as a result of the continued improvement in Iraq's terms of trade since end-2007 and the expansion of domestic demand. The CBI also agreed to keep the policy interest rate positive in real terms to signal its commitment to fight inflation.

Figure 5: Real and Nominal Exchange Rates, January 2004–March 2008  
(Index, Jan 2004=100)



Sources: The Iraqi Authorities and Fund staff calculations.

1/ Increase denotes appreciation.

21. **The authorities are committed to implementing the recommendations of the IMF SAR that was finalized in March 2008** (SMEFP, ¶18). The external audit of the CBI net international reserves at December 31, 2007 and the external audit of the CBI 2007 financial statements have been completed as planned, despite the fire that largely destroyed the CBI headquarters in January. Progress has been made with strengthening the accounting and reporting framework of the CBI with better and more frequent reconciliation of accounts, except for the accounts of the two CBI branches in the Kurdish region. Work is underway,

with technical assistance from the Fund, towards adoption of new reserves management guidelines. Finally, the authorities remain committed to maintaining a liberal exchange system (SMEFP, ¶19).

#### D. Other Structural Issues

22. **The authorities are continuing their efforts to improve governance, especially in the oil sector** (SMEFP, ¶20). Progress is being made with oil-metering. Iraq has joined the Extractive Industries Transparency Initiative (EITI) and the authorities have begun to publish oil export data on the Internet on a monthly basis. Discussions on a new legislative framework for the hydrocarbon sector are continuing.

23. **Commercial bank restructuring has progressed in close collaboration with the Fund and the World Bank** (SMEFP, ¶21). The financial and operational audits of Rasheed and Rafidain banks based on their 2006 financial accounts have been completed despite the insecurity and curfews that limited on-site visits. Although the audits were affected by the loss of information on branch loans and credit files during the war and by limited access to documentation from branches outside Baghdad, the reports provide a good basis for developing restructuring plans for both banks. The CBI has set up a task force to develop a comprehensive set of prudential regulations for commercial banks, for which the Fund has been providing technical assistance. Almost half of the regulations have been prepared—including key regulations on licensing, capital adequacy, credit risk, large exposures, and liquidity—while the remaining regulations are expected to be completed soon (SMEFP, ¶22).

24. **The government intends to rehabilitate the electricity sector.** The supplementary budget for 2008 provides ID 1,439 billion to cover for unpaid electricity supplies via a netting out operation between the electricity sector, oil companies, and the ministry of finance. The reform plan envisages increasing the supply of electricity, followed by measures to improve payment collection and gradual increases in tariffs toward cost recovery levels.

25. **Progress continues to be made in addressing the weaknesses in Iraq's statistical database** (SMEFP, ¶24). The compilation of national accounts data has improved, with technical assistance from the Fund, and the publication of monetary and balance of payments statistics in the IMF's *International Financial Statistics* started in March and July 2008, respectively. The 2007 household expenditure survey was completed and on this basis new weights are being incorporated in the CPI. The updated CPI will be published soon, after completion of a robustness test.

#### IV. PROGRAM MONITORING AND FINANCING ASSURANCES

26. **Iraq has met all quantitative performance criteria set for end-March 2008, except for the one on government imports of petroleum products, and all structural performance criteria were met as well.** Government imports of petroleum products exceeded the program ceiling by a small margin due to higher-than-expected import prices for kerosene. Staff will inform the IMF Executive Board on compliance with end-June quantitative performance criteria and the end-July structural benchmarks before Board consideration of the first review.



27. **The program will continue to be monitored through quarterly quantitative performance criteria and indicative targets, and structural benchmarks.** Additional quantitative performance criteria have been set for end-September and end-December 2008, as specified in Table 8. A financing assurances review will be undertaken before the last scheduled disbursement date if any arrears on Iraq's debt remain at that time. A prior action for completing the first review has also been set (Table 9).

#### V. STAFF APPRAISAL

28. **After several very difficult years, the Iraqi economy finds itself at a point of opportunity.** The recent improvements in security, the incipient recovery of oil production and exports, and the strengthening of fiscal and external positions put Iraq in an excellent position to speed up the rebuilding of its institutions and infrastructure, and to achieve higher economic growth, while maintaining macroeconomic stability. To take advantage of this opportunity, the government will need to: (a) ensure sound management of oil revenues; and (b) press ahead with priority structural reforms.

29. **The authorities are committed to accelerating reconstruction while avoiding an overly expansionary fiscal stance.** Staff views the supplementary budget as acceptable, in light of the much higher-than-foreseen oil revenues and pressing needs for additional spending. Staff welcomes the decision to restrict the effective wage increase this year and considers that the overall domestic demand impact of the revised 2008 budget will be manageable. However, the census of public service employees is overdue and staff urges the authorities to complete this without further delay, in order to computerize the payroll and eliminate ghost workers, and to lay the basis for civil service reform. It is also essential to push ahead with the preparations to streamline the costly and untargeted Public Distribution System. Following several years of public underinvestment, staff welcomes the additional investment allocation, while underlining the need to safeguard the quality of the large public investment program.

30. **The increase in official prices of LPG and jet fuel is appropriate, and staff encourages the authorities to follow up on their intention to increase other fuel prices early next year.** The development of a fuel price adjustment mechanism in the coming months could help reduce the still sizable indirect fuel subsidies.

31. **Staff welcomes the intention of the CBI to tighten its policy stance, in light of the fiscal expansion.** It will be important to step up the pace of appreciation of the dinar to contain inflation, and to keep the central bank's policy interest rate positive in real terms.

32. **The government must push ahead with key structural reforms.** It is important to develop and implement a comprehensive reform plan for public financial management. Modernization of financial intermediation in Iraq will require, as a first step, the adoption of restructuring programs for Rafidain and Rasheed banks, and the completion of a set of prudential regulations for commercial banks. Staff welcomes the efforts made to begin rehabilitating the financial situation of the electricity sector, and encourages the authorities to speed up their efforts to establish a new legislative framework for the hydrocarbon sector to attract the large investments needed to further increase oil production.

33. **Further efforts are needed to strengthen governance and fight corruption**, in particular in the hydrocarbon sector. Building on the recent progress made in oil-metering, metering systems should be extended to all oil sector activities. Staff welcomes Iraq's joining of EITI, and encourages the authorities to strengthen transparency under the initiative as soon as feasible.

34. **Staff urges the CBI to address all recommendations of the IMF's SAR and the external audit report of its 2007 financial statements.** It is particularly important to speed up the adoption of reserves management guidelines.

35. **Staff recommends that the first review under the SBA be completed.** In view of the authorities' strong commitment to the program, and the policies and measures described in the SMEFP, staff supports their request for the establishment of quantitative performance criteria for end-September and end-December 2008. Staff believes that Iraq is making best efforts to reach bilateral agreements on its arrears to official non-Paris Club creditors and that the authorities have been negotiating in good faith to resolve the remaining arrears to private creditors, consistent with the Fund's policy on lending into arrears, and supports the completion of the financing assurances review.

Table 1. Iraq: Selected Economic and Financial Indicators, 2005–09

	2005	2006	2007		2008		2009
	Est.	Est.	SBA	Prel.	SBA	Proj.	Proj.
<b>Economic growth and prices</b>							
Real GDP (percentage change)	-0.7	6.2	1.3	1.5	7.1	9.0	7.3
Non-oil real GDP (percentage change)	12.0	7.5	0.0	-2.0	3.0	3.0	5.0
GDP per capita (US\$)	1,124	1,720	2,115	2,108	2,321	3,198	3,516
GDP (US\$ million)	31,378	49,457	62,574	62,375	70,597	97,246	109,831
Oil production (In mbpd)	1.9	2.0	2.0	2.04	2.2	2.3	2.5
Oil exports (In mbpd)	1.4	1.4	1.55	1.59	1.7	1.8	1.9
Iraq oil export prices (US\$ pb)	43.9	55.6	58.8	63.0	57.0	98.4	106.0
Consumer price inflation (percentage change; end of period)	31.6	64.8	25.0	4.7	12.0	14.0	10.0
Exchange rate (dinar per US\$; period average) 1/	1,469	1,467	1,264	1,255	...	1,195	...
Total government debt (in billions of US\$)	111.5	99.4	101.4	102.3	48.7	43.0	44.9
(In percent of GDP)							
<b>National Accounts</b>							
Gross domestic investment	23.4	18.4	13.9	14.9	28.0	29.0	21.7
<i>Of which:</i> public	19.8	17.0	12.3	11.9	23.7	25.9	18.1
Gross domestic consumption	78.8	71.0	80.5	63.2	77.1	53.4	50.5
<i>Of which:</i> public	60.1	38.4	35.6	34.0	35.7	32.2	30.1
Gross national savings	32.0	31.9	15.9	33.1	24.8	46.4	48.5
<i>Of which:</i> public	26.5	28.1	13.8	25.5	14.6	28.3	31.4
(In percent of GDP, unless otherwise indicated)							
<b>Public Finance</b>							
Government revenue and grants	107.3	80.4	64.7	75.0	67.5	79.0	75.1
Government oil revenue	76.7	65.2	58.9	67.6	57.1	71.5	71.4
Government non-oil revenue	2.7	2.7	2.9	3.8	8.4	6.0	3.6
Grants	27.9	12.5	2.9	3.7	2.0	1.5	0.2
Expenditure, <i>Of which:</i>	100.8	69.4	63.2	61.5	75.9	76.2	61.6
Current expenditure	81.0	52.4	49.4	49.0	52.0	50.1	42.1
Capital expenditure	19.8	17.0	12.3	11.9	23.7	25.9	18.1
Overall fiscal balance (including grants)	6.5	11.0	1.5	13.5	-8.4	2.8	13.5
Primary fiscal balance	6.7	11.6	2.2	14.3	-7.5	3.5	14.7
Gross borrowing/use of external assets	6.4	-2.3	-1.0	-3.1	8.5	-3.4	-13.5
Amortization	0.5	3.1	0.3	0.3	0.7	0.5	0.0
Residual or financing gap/surplus	4.5	1.3	0.0	-1.3	0.0	0.0	0.0
<b>Memorandum items:</b>							
Tax revenue/non oil GDP (In percent)	2.8	1.9	2.0	3.6	2.3	3.8	3.8
External assets held abroad (In US\$ million)	6,203	8,624	10,367	12,584	5,119	16,463	30,816
(In percent, unless otherwise indicated)							
<b>Monetary Indicators</b>							
Growth in reserve money 2/	12.0	29.0	33.0	73.9	16.5	39.0	17.8
Gross CBI foreign exchange assets/Reserve money	129.4	150.3	137.5	124.4	150.2	136.8	171.8
Gross reserves (In US\$ million)	12,016	20,037	26,909	31,455	34,318	50,369	67,607
In months of imports of goods and services	5.8	9.5	8.0	7.7	9.5	13.5	14.4
Policy interest rate (end of period) 3/	7.0	16.0	20.0	20.0	...	16.0	...
(In percent of GDP)							
<b>Balance of payments</b>							
Current account	8.6	13.4	2.0	18.2	-3.2	17.4	26.8
Trade balance	16.1	21.0	12.3	28.6	2.4	23.6	32.2
Exports of goods	73.6	60.5	54.5	60.8	51.5	67.3	67.8
Imports of goods	-57.5	-39.5	-42.3	-32.2	-49.1	-43.8	-35.6
Income and services	-32.5	-17.8	-11.8	-12.2	-12.0	-9.4	-3.5
Transfers	25.0	10.3	1.5	1.7	6.4	3.2	-2.0
Financial account	-7.0	1.3	4.3	0.1	12.7	1.2	-11.7
Direct investment	1.6	0.2	0.9	0.8	0.8	0.5	0.5
Gross borrowing/use of external assets	18.1	5.3	5.8	1.6	14.3	1.1	-12.4
Amortization	-0.5	-3.1	-0.3	-0.3	-0.7	-0.5	0.0
Overall external balance	6.1	16.1	9.9	17.0	9.5	18.6	15.1
Central bank reserves (increase -)	-13.0	-16.2	-11.0	-18.3	-10.5	-19.4	-15.7
Change in arrears	-51.0	-33.0	-1.6	-1.9	-80.1	-65.1	0.0
Errors and omissions	4.5	1.3	3.6	-1.3	0.0	0.0	0.0

Sources: Iraqi authorities and Fund staff estimates and projections.

1/ 2008 at end-June.

2/ Reserve money growth in 2007 reflects the impact of the increase in the required reserves ratio on government deposits from 25 percent to 75 percent per September 2007.

3/ 2008 as of July 1.

Table 2. Iraq: Fiscal and Oil Sector Accounts, 2005–09  
(In billions of ID; unless otherwise indicated)

	2005	2006	2007		2008			2009
	Act.	Act.	SBA	Prel.	SBA	Budg.	Proj.	Proj.
Revenues and Grants	49,469	58,347	50,753	58,714	57,222	57,171	91,231	105,548
Revenues	36,619	49,282	48,448	55,823	55,520	55,459	89,454	105,315
Crude oil export revenues	33,896	43,736	41,725	47,149	42,442	42,442	76,733	94,049
Revenues of oil-related public enterprises	1,456	3,611	4,465	5,729	5,938	5,877	5,842	6,235
Tax revenues	492	593	768	1,228	1,024	1,024	1,505	1,749
Direct taxes	201	353	428	886	559	559	1,040	1,201
Indirect taxes	291	240	340	343	465	465	465	548
Non-tax revenues 1/	776	1,342	1,490	1,716	6,116	5,714	5,374	3,283
Grants	12,850	9,065	2,304	2,892	1,701	1,807	1,777	233
Expenditures	46,477	50,353	49,566	48,153	64,318	66,567	87,953	86,554
Current expenditures	37,332	38,026	38,774	38,332	44,073	44,110	57,871	59,151
Salary and pension	9,389	11,034	14,098	12,815	16,324	16,374	20,556	22,873
Salary	6,625	8,427	10,706	10,446	12,067	12,017	16,177	18,044
Salary (Defense/Interior)	2,233	3,177	5,169	4,491	5,572	5,522	6,171	6,788
Salary (others) 2/	4,392	5,249	5,537	5,955	6,495	6,495	10,005	11,256
Pension	2,765	2,608	3,392	2,368	4,307	4,357	4,379	4,829
Goods and Services (non-oil sector) 3/	13,074	10,226	8,709	7,704	8,613	8,614	11,438	11,922
Budgeted goods and services	3,190	3,853	7,210	5,797	7,571	7,499	10,340	11,922
Overhead costs for donors' financed projects	3,512	2,588	156	776	415	446	439	0
Other goods and services financed by donors 4/	5,612	3,566	913	1,132	628	669	658	0
Goods and Services (oil sector)	5,229	6,610	4,005	5,628	5,105	5,066	5,031	5,435
Oil derivative imports	4,144	4,133	400	210	360	382	382	0
Operating expenditures of oil-related public enterprises	1,085	2,477	3,605	5,418	4,745	4,684	4,649	5,435
Transfers	7,824	7,482	9,336	9,183	11,148	11,174	16,250	12,547
Social safety net (excluding OFFP)	5,299	5,019	4,848	5,450	4,860	4,769	7,379	6,416
Transfers to SOEs 5/	973	1,300	1,726	1,132	2,383	2,383	3,083	2,883
Other transfers 6/	1,552	1,163	2,762	2,601	3,905	4,021	5,788	3,248
Interest payments	86	438	540	623	760	760	760	1,672
Domestic interest payments	86	307	337	416	548	548	548	1,046
External interest payments	0	131	203	207	212	212	212	627
War reparations 7/	1,730	2,235	2,086	2,380	2,122	2,122	3,837	4,702
Investment expenditures	9,145	12,317	9,655	9,337	20,071	19,916	29,959	25,402
Non-oil investment expenditures	6,996	8,989	7,773	7,796	17,623	17,464	27,196	21,848
Domestic financed reconstruction expenditure	2,598	5,980	6,941	6,726	16,659	16,470	26,218	20,654
Grant financed reconstruction expenditure	3,448	2,562	725	874	614	643	633	233
Loan financed reconstruction expenditure	0	0	0	0	349	351	346	960
Oil investment expenditures (including on refineries)	2,150	3,328	1,882	1,540	2,452	2,452	2,762	3,555
Contingency	0	9	1,137	484	175	2,090	123	2,000
Net lending	0	0	0	0	0	452	0	0
Balance (including grants)	2,992	7,994	1,186	10,561	-7,097	-9,281	3,278	18,994
Balance (excluding grants)	-9,858	-1,071	-1,118	7,670	-8,798	-10,993	1,501	18,761
Change in outstanding Letters of Credit [+ increase] 8/	2,947	2,226	...	1,905	...	...	...	...
Financing, of which:	-2,127	-6,741	-1,186	-7,658	7,097	9,281	-3,278	-18,994
External financing	2,721	-3,923	-1,001	-2,653	6,616	8,800	-4,478	-18,915
Assets held abroad	1,462	-2,147	-1,001	-2,430	6,855	9,037	-4,235	-19,875
Project financing	0	0	0	0	349	351	346	960
Other financing 9/	1,486	458	0	0	0	0	0	0
Amortization	227	2,235	222	223	588	588	588	0
Domestic financing	-4,848	-2,818	-185	-5,005	481	481	1,200	-79
Bank financing	-5,156	-1,869	534	-5,272	1,200	1,200	1,200	1,200
T-bills	308	-949	-719	268	-719	-719	0	-1,279
Residual or Financing gap[+]/surplus [-]	2,082	973	0	-999	0	0	0	0
Memorandum items:								
Security-related expenditure	3,176	4,130	9,673	6,804	10,774	10,774	13,055	14,704
Primary fiscal balance	3,077	8,432	1,726	11,184	-6,337	-8,521	4,038	20,667
Non-oil primary fiscal balance	-24,895	-28,977	-38,577	-34,526	-47,164	...	-70,744	-70,627
External assets held abroad	9,111	11,996	15,101	15,314	6,423	6,277	19,550	39,425

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

1/ For 2008 and 2009, includes \$3.125 and \$0.625 billion mobile operator license fees, respectively.

2/ The 2008 wage bill includes an allocation of ID216 billion for salaries of provincial councils and personnel contingent upon the enactment of the draft Provinces Law.

3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.

4/ Includes security spending associated with the implementation of reconstruction projects.

5/ 2008 data excludes an amount of ID1,436 billion included in the Supplementary Budget to settle arrears of the electricity sector to the state-owned oil companies; this cross-settlement is expected to have no net impact on the budget.

6/ 2006 data includes ID270 billion allocated toward government's share of capital in new regional commercial banks. ID1,500 formerly recorded under this item were re-classified as non-oil investment expenditures in the 2006 budget presentation. Finally, ID265 billion were re-classified as debt repayment.

7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.

8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.

9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 3. Iraq: Fiscal and Oil Sector Accounts, 2005–09  
(In percent of GDP)

	2005		2006		2007		2008		2009
	Act.	Act.	SBA	Prel.	SBA	Budg.	Proj.	Proj.	
Revenues and Grants	107.3	80.4	64.7	75.0	67.5	67.5	79.0	75.1	
Revenues	79.5	67.9	61.8	71.3	65.6	65.5	77.5	74.9	
Crude oil export revenues	73.5	60.3	53.2	60.2	50.1	50.1	66.4	66.9	
Revenues of oil-related public enterprises	3.2	5.0	5.7	7.3	7.0	6.9	5.1	4.4	
Tax revenues	1.1	0.8	1.0	1.6	1.2	1.2	1.3	1.2	
Direct taxes	0.4	0.5	0.5	1.1	0.7	0.7	0.9	0.9	
Indirect taxes 1/	0.6	0.3	0.4	0.4	0.5	0.5	0.4	0.4	
Non-tax revenues 2/	1.7	1.8	1.9	2.2	7.2	6.7	4.7	2.3	
Grants	27.9	12.5	2.9	3.7	2.0	2.1	1.5	0.2	
Expenditures	100.8	69.4	63.2	61.5	75.9	78.6	76.2	61.6	
Current expenditures	81.0	52.4	49.4	49.0	52.0	52.1	50.1	42.1	
Salary and pension	20.4	15.2	18.0	16.4	19.3	19.3	17.8	16.3	
Salary	14.4	11.6	13.6	13.3	14.1	14.2	14.0	12.8	
Salary (Defense/Interior)	4.8	4.4	6.6	5.7	6.5	6.5	5.3	4.8	
Salary (others) 3/	9.5	7.2	7.1	7.6	7.6	7.7	8.7	8.0	
Pension	6.0	3.6	4.3	3.0	5.1	5.1	3.8	3.4	
Goods and services (non-oil sector) 4/	28.4	14.1	11.1	9.8	10.2	10.2	9.9	8.5	
Budgeted goods and services	6.9	5.3	9.2	7.4	8.9	8.9	9.0	8.5	
Financed by oil-for-food program (OFFP; other than social safety net)	1.7	0.3	0.0	0.0	0.0	0.0	0.0	0.0	
Overhead costs for donors' financed projects 5/	7.6	3.6	0.7	1.0	0.5	0.5	0.4	0.0	
Other goods and services financed by donors 6/	12.2	4.9	1.2	1.4	0.7	0.8	0.6	0.0	
Goods and services (oil sector)	11.3	9.1	5.1	7.2	6.0	6.0	4.4	3.9	
Oil derivative imports	9.0	5.7	0.5	0.3	0.4	0.5	0.3	0.0	
Operating expenditures of oil-related public enterprises	2.4	3.4	4.6	6.9	5.6	5.5	4.0	3.9	
Transfers	17.0	10.3	11.9	11.7	13.2	13.2	14.1	8.9	
Social safety net (excl. OFFP)	11.5	6.9	6.2	7.0	5.7	5.6	6.4	4.6	
Transfers to SOEs 7/	2.1	1.8	2.2	1.4	2.8	2.8	2.7	2.1	
Other transfers 8/	3.4	1.6	3.5	3.3	4.6	4.7	5.0	2.3	
Interest payments	0.2	0.6	0.7	0.8	0.9	0.9	0.7	1.2	
Domestic interest payments	0.2	0.4	0.4	0.5	0.6	0.6	0.5	0.7	
External interest payments	0.0	0.2	0.3	0.3	0.3	0.3	0.2	0.4	
War reparations 9/	3.8	3.1	2.7	3.0	2.5	2.5	3.3	3.3	
Investment expenditures	19.8	17.0	12.3	11.9	23.7	23.5	25.9	18.1	
Non-oil investment expenditures	15.2	12.4	9.9	10.0	20.8	20.6	23.6	15.5	
Domestic financed reconstruction expenditure	5.6	8.2	8.8	8.6	19.7	19.4	22.7	14.7	
OFFP financed reconstruction expenditure	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Grant financed reconstruction expenditure	7.5	3.5	0.9	1.1	0.7	0.8	0.5	0.2	
Loan financed reconstruction expenditure	0.0	0.0	0.0	0.0	0.4	0.4	0.3	0.7	
Oil investment expenditures (including on refineries)	4.7	4.6	2.3	1.8	2.8	2.9	2.4	2.5	
Contingency	0.0	0.0	1.4	0.6	0.2	2.5	0.1	1.4	
Net lending	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0	
Balance (including grants)	6.5	11.0	1.5	13.5	-8.4	-11.0	2.8	13.5	
Balance (excluding grants)	-21.4	-1.5	-1.4	9.8	-10.4	-13.0	1.3	13.4	
Change in outstanding Letters of Credit [+ increase] 10/	6.4	3.1	...	2.4	...	...	...	...	
Financing, Of which:	-4.6	-9.3	-1.5	-9.8	8.4	11.0	-2.8	-13.5	
External financing	5.9	-5.4	-1.3	-3.4	7.8	10.4	-3.9	-13.5	
Assets held abroad	3.2	-3.0	-1.3	-3.1	8.1	10.7	-3.7	-14.1	
Project financing	0.0	0.0	0.0	0.0	0.4	0.4	0.3	0.7	
Other financing 11/	3.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	
Amortization	0.5	3.1	0.3	0.3	0.7	0.7	0.5	0.0	
Domestic financing	-10.5	-3.9	-0.2	-6.4	0.6	0.6	1.0	-0.1	
Bank financing	-11.2	-2.6	0.7	-6.7	1.4	1.4	1.0	0.9	
T-bills	0.7	-1.3	-0.9	0.3	-0.8	-0.8	0.0	-0.9	
Residual or financing gap[+]/surplus [-]	4.5	1.3	0.0	-1.3	0.0	0.0	0.0	0.0	
Memorandum items:									
Security-related expenditure	6.9	5.7	12.3	8.7	12.7	12.7	11.3	10.5	
Primary fiscal balance	6.7	11.6	2.2	14.3	-7.5	-10.1	3.5	14.7	
Current expenditures (percent of non-oil GDP)	214.4	123.2	100.5	112.9	99.1	...	145.2	128.5	

Sources: Iraqi authorities and Fund staff estimates and projections.

1/ For 2008 and 2009, includes \$3.125 and \$0.625 billion mobile operator license fees, respectively.

2/ The 2008 wage bill includes an allocation of ID216 billion for salaries of provincial councils and personnel contingent upon the enactment of the draft Provinces Law.

3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.

4/ Includes security spending associated with the implementation of reconstruction projects.

5/ 2008 data excludes an amount of ID1,436 billion included in the Supplementary Budget to settle arrears of the electricity sector to the state-owned oil companies; this cross-settlement is expected to have no net impact on the budget.

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7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.

8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.

9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 4. Iraq: Central Bank Balance Sheet 2005–09  
(In billions of Iraqi dinars, unless otherwise indicated)

	2005		2006		2007		2008			2009	
	Act.	Dec.	Act.	Dec.	Act.	Dec.	Proj.	June	Sept.	Proj.	Dec.
Net foreign exchange assets 1/	17,078	25,954	38,218	31,695	41,151	50,096	53,763	58,459	40,859	86,458	86,458
Foreign exchange assets	17,724	26,549	38,219	32,291	41,151	50,096	53,763	58,459	41,182	86,458	86,458
Gold	143	159	192	150	212	192	192	192	150	192	192
Other	17,581	26,391	38,027	32,141	40,939	49,904	53,571	58,268	41,032	86,267	86,267
Foreign exchange liabilities	-646	-596	-0.2	-596	-0.2	-0.2	-0.2	-0.2	-323	0	0
Of which: Borrowing from the IMF	-637	-578	0	-523	0	0	0	0	-250	0	0
Net domestic assets	-3,380	-8,288	-7,490	-8,203	-4,493	-12,100	-13,267	-15,737	-13,496	-36,127	-36,127
Domestic assets	138	-297	-2,474	1,318	-4,189	-3,709	-3,589	-3,469	1,799	-2,988	-2,988
Net claims on general government	128	-309	-2,481	1,307	-4,196	-3,716	-3,596	-3,476	1,788	-2,995	-2,995
Holdings of treasury bills	2,560	4,675	3,956	3,956	3,776	3,596	3,416	3,236	3,236	2,517	2,517
Holdings of discounted treasury bills	707	733	719	719	719	719	719	719	719	719	719
Overdrafts	1,821	0	0	0	0	0	0	0	0	0	0
Domestic currency deposits	-3,577	-5,170	-3,593	-2,156	-3,652	-2,993	-2,693	-2,393	-956	-1,193	-1,193
Foreign currency deposits	-1,382	-546	-3,563	-1,212	-5,038	-5,038	-5,038	-5,038	-1,212	-5,038	-5,038
Claims on commercial banks	9.4	11.9	6.8	11.3	6.8	6.8	6.8	6.8	11.3	6.8	6.8
Monetary policy instruments 2/	-3,731	-8,068	-7,087	-12,930	-3,319	-11,929	-13,739	-16,852	-18,704	-31,707	-31,707
Of which: CBI bills	0	-1,632	-2,687	...	-1,663	...	...	...	...	...	...
Other items net	214	97	2,071	3,408	3,014	3,538	4,061	4,584	3,408	-1,432	-1,432
Reserve money	13,698	17,665	30,728	23,492	36,657	37,996	40,495	42,722	27,364	50,331	50,331
Currency issued	10,257	11,917	15,632	14,970	17,242	17,898	19,287	20,662	17,249	24,342	24,342
Currency outside banks	9,110	10,968	14,109	13,779	15,257	15,593	16,655	17,724	16,014	20,881	20,881
Cash in vaults of commercial banks	1,146	948	1,523	1,191	1,985	2,305	2,632	2,938	1,235	3,461	3,461
Banks reserves	3,442	5,749	15,095	8,522	19,415	20,098	21,208	22,061	10,114	25,989	25,989
Required	2,596	3,572	11,805	7,487	15,273	15,810	16,684	17,354	9,041	20,445	20,445
Excess	845	2,177	3,290	1,035	4,142	4,288	4,524	4,706	1,074	5,544	5,544
<b>Memorandum items</b>											
Reserve money (annual growth, in percent) 3/	12.0	29.0	73.9	33.0	92.3	90.3	42.1	39.0	16.5	17.8	17.8
Currency issued (annual growth, in percent)	27.9	16.2	31.2	25.6	33.4	32.3	33.4	32.2	15.2	17.8	17.8
Gross foreign exchange assets (in millions of U.S. dollars)	12,016	20,037	31,455	26,909	34,122	41,921	45,659	50,396	34,318	67,578	67,578
Gold	97	120	158	125	176	160	163	165	125	150	150
CBI vault + DFI sub-account	11,254	19,221	30,887	26,059	33,517	41,344	45,073	49,802	33,468	67,039	67,039
SDR Account	666	696	410	725	428	417	423	429	725	389	389
Foreign exchange liabilities (in millions of U.S. dollars)	-438	-449	0	-496	0	0	0	0	-269	0	0
Net foreign exchange assets (in millions of U.S. dollars)	11,578	19,588	31,455	26,413	34,122	41,921	45,658	50,396	34,049	67,578	67,578
Exchange rate (end of period)	1,475	1,325	1,215	...	1,206	...	...	...	...	...	...
Gross foreign exchange assets/reserve money (in percent)	129.4	150.3	124.4	137.5	112.3	131.8	132.8	136.8	150.5	171.8	171.8
Reserve money coverage (NFA/reserve money, in percent)	124.7	146.9	124.4	134.9	112.3	131.8	132.8	136.8	149.3	171.8	171.8
Currency outside banks/Reserve money (in percent)	66.5	62.1	45.9	58.7	41.6	41.1	41.1	41.5	58.5	41.5	41.5
Currency outside banks/Non-oil GDP (in percent)	52.3	35.5	41.6	35.7	44.9	42.2	43.4	44.5	36.0	45.3	45.3
Ratio of Reserve money to GDP	29.7	24.3	39.3	29.9	41.9	39.2	38.1	37.0	32.3	35.8	35.8
Policy interest rate	7.0	16.0	20.0	...	17.0	17.0	...	...	...	...	...

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

1/ Valued at market exchange rates.

2/ This mainly represents the ID and US\$ overnight standing deposit facilities and CBI bills.

3/ Reserve money growth in 2007 reflects the impact of the increase in the required reserves ratio on government deposits from 25 percent to 75 percent per September 2007.

Table 5. Iraq: Summary Balance Sheet of Deposit Money Banks, 2005–09  
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	2006	2007		2008			
	Dec.	Dec.	Dec. Prel.	Dec. SBA	Mar. Prel.	Dec. Proj.	Dec. SBA	
Net foreign assets	-5,699	-3,215	-1,493	-3,215	-2,490	-2,395	-3,215	
Assets	5,442	7,763	9,150	7,763	6,271	6,031	7,763	
Liabilities	-11,141	-10,978	-10,643	-10,978	-8,761	-8,426	-10,978	
Net Domestic Assets	11,331	12,087	16,064	20,202	15,890	34,233	29,559	
Domestic credit	-3,680	-6,919	-12,829	-7,644	-11,768	-10,306	-5,708	
Credit to the general government (net)	-5,392	-9,771	-15,678	-11,572	-15,618	-14,763	-11,572	
Credit to the economy	1,711	2,851	2,849	3,928	3,850	4,457	5,864	
Monetary policy instruments	3,731	8,088	7,087	12,930	3,319	16,852	18,704	
Reserves	4,585	6,697	16,496	9,714	21,554	24,998	11,349	
Cash in vault	1,144	948	1,401	1,191	2,139	2,938	1,235	
Deposits at the CBI	3,442	5,749	15,095	8,522	19,415	22,061	10,114	
Of which: required reserves	2,596	3,572	11,805	7,487	15,273	17,354	9,041	
Other Items Net	6,694	4,221	5,309	5,203	2,784	2,689	5,214	
Demand deposits	3,796	6,682	11,303	12,740	9,883	23,879	19,758	
Time deposits	1,835	2,190	3,268	4,247	3,516	7,960	6,586	
<b>Memorandum items</b>			(Annual percentage change)					
Net foreign assets	4.5	43.6	53.6	0.0	23.1	-60.5	0.0	
Domestic credit	-60.9	-88.0	-85.4	-10.5	-121.8	19.7	25.3	
Credit to the economy	115.5	66.6	-0.1	37.8	28.2	56.4	49.3	
Demand deposits	-36.4	76.0	69.2	90.7	41.9	111.3	55.1	

Sources: Iraqi Authorities and Fund staff estimates.

Table 6. Iraq: Monetary Survey, 2005–09  
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	2006	2007		2008		2009	
	Dec.	Dec.	Dec. Prel.	Dec. SBA	Mar. Prel.	Dec. Proj.	Dec. SBA	Dec. Proj.
Net foreign assets	11,379	22,739	36,726	28,480	38,661	56,064	37,644	83,816
Of which: CBI	17,078	25,954	38,218	31,695	41,151	58,459	40,859	86,458
Net domestic assets	3,367	-2,892	-7,920	2,286	-10,156	-6,502	4,714	-10,631
Domestic claims	-3,552	-7,224	-15,310	-6,337	-15,964	-13,782	-3,920	-12,141
Net claims on general government	-5,263	-10,080	-18,159	-10,265	-19,814	-18,239	-9,784	-18,318
Claims on general government	6,414	7,549	8,181	...	6,481	...	...	...
less: Liabilities to general government	-11,677	-17,629	-26,340	...	-26,295	...	...	...
Claims on other sectors	1,711	2,856	2,849	3,928	3,850	4,457	5,864	6,177
Other Item Net (OIN)	6,919	4,332	7,390	8,623	5,807	7,280	8,634	1,510
Broad money	14,746	19,842	28,805	30,766	28,504	49,562	42,358	73,186
Currency outside banks	9,113	10,968	14,232	13,779	15,103	17,724	16,014	20,881
Transferable deposits	3,798	6,684	11,304	12,740	9,885	23,879	19,758	39,229
Other deposits	1,835	2,190	3,268	4,247	3,516	7,960	6,586	13,076
<b>Memorandum items</b>			(Annual percentage change, unless otherwise indicated)					
Net foreign assets	138.3	99.8	61.5	25.2	117.4	52.7	32.2	49.5
Net domestic assets	-65.3	-185.9	-173.9	178.9	427.4	17.9	106.2	-63.5
Net claims on general government	-519.7	-91.5	-80.1	-1.8	-243.0	-0.4	4.7	-0.4
Claims on other sectors	115.5	66.9	-0.2	37.8	28.2	56.4	49.3	38.6
Broad money	1.9	34.6	45.2	55.1	36.5	72.1	37.7	47.7
M2 velocity (ratio)	3.1	3.7	2.7	2.5	...	2.3	2.0	1.9
Credit to the economy (as a percentage of non-oil GDP)	12.5	16.2	9.3	16.7	...	10.4	21.4	12.3

Sources: Iraqi Authorities and Fund staff estimates.



Table 7. Iraq: Balance of Payments, 2005–09 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	2005	2006	2007		2008		2009
	Est.	Prel.	SBA	Prel.	SBA	Proj.	Proj.
Trade balance	5,049	10,378	7,671	17,828	1,690	22,908	35,398
(In percent of GDP)	16.1	21.0	12.3	28.6	2.4	23.6	32.2
Exports	23,106	29,915	34,134	37,914	36,335	65,487	74,445
Crude oil	22,517	29,195	33,280	37,143	35,369	64,617	73,511
Other exports	589	720	854	772	966	869	934
Imports	-18,058	-19,537	-26,464	-20,087	-34,645	-42,578	-39,047
Government imports	-11,921	-12,127	-15,176	-9,660	-20,545	-24,762	-18,659
UN Oil for Food Program (OFFP)	-880	-272	0	-39	0	0	0
Other consumption imports (non-OFFP)	-3,663	-3,834	-6,283	-2,597	-6,359	-8,570	-7,147
Other non-oil related capital imports (non-OFFP)	-2,794	-3,746	-3,961	-2,231	-9,013	-9,962	-6,686
Oil-related capital imports	-2,129	-1,825	-2,110	-2,132	-2,334	-2,531	-3,094
Refined oil products	-2,455	-2,450	-2,823	-2,660	-2,839	-3,699	-1,733
Private sector imports	-6,136	-7,410	-11,288	-10,427	-14,100	-17,816	-20,388
Of which: refined oil products	10	0	-2,268	-1,777	-2,839	-3,699	-4,043
Income, net 2/	-4,444	-3,661	-3,200	-3,409	-3,243	-3,366	1,054
Services, net	-5,740	-5,164	-4,198	-4,175	-5,234	-5,746	-4,880
Transfers, net	7,835	5,085	964	1,084	4,522	3,139	-2,191
Private, net (incl. NGOs) 3/	212	368	790	637	4,873	4,873	1,302
Official	7,623	4,718	174	448	-351	-1,734	-3,493
Receipts	8,749	6,178	1,838	2,305	1,418	1,497	182
Payments	-1,126	-1,460	-1,664	-1,857	-1,768	-3,231	-3,676
Current account	2,700	6,639	1,237	11,328	-2,264	16,935	29,381
(In percent of GDP)	8.6	13.4	2.0	18.2	-3.2	17.4	26.8
Capital account	0	0	0	0	0	0	0
Financial account	-2,207	667	2,687	78	8,970	1,144	-12,851
Direct investment	515	78	557	485	596	519	555
Other capital, net	-2,722	589	2,129	-407	8,374	625	-13,406
Official, net	5,555	2,354	3,524	917	9,726	425	-13,612
Assets 4/	635	-1,796	-799	-3,618	5,712	-3,567	-15,535
Liabilities	4,920	4,150	4,322	4,535	4,014	3,992	1,923
Loan disbursements	0	0	0	0	241	241	550
Amortization 5/ 6/ 10/	-115	-281	-103	-103	-400	-614	0
Capitalized interest payment 6/	5,035	4,431	4,425	4,637	4,173	4,365	1,373
Financial corporations, net 7/	-2,007	-1,517	0	-1,518	0	0	0
Private, net	-6,271	-248	-1,394	193	-1,352	199	205
Errors and omissions	1,418	663	2,278	-796	0	0	0
Overall balance	1,911	7,969	6,202	10,609	6,706	18,079	16,530
(In percent of GDP)	6.1	16.1	9.9	17.0	9.5	18.6	15.1
Financing	-1,911	-7,969	-6,202	-10,609	-6,706	-18,079	-16,530
Central bank (increase -)	-4,079	-8,021	-6,872	-11,418	-7,409	-18,914	-17,238
Reserves (net; increase -)	-4,079	-8,021	-6,872	-11,869	-7,637	-18,914	-17,238
Liabilities (increase +)	0	0	0	-451	-227	0	0
Fund credit (net)	0	0	0	-451	-227	0	0
Disbursement	0	0	0	0	0	0	0
Repayments	0	0	0	-451	-227	0	0
Deferred accrued interest 8/	1,555	842	745	884	704	835	708
Change in arrears (net, decrease -) 9/	-16,012	-16,297	-972	-1,167	-56,567	-63,319	0
Debt forgiveness 10/	16,626	15,507	898	1,091	-56,567	63,319	0
Memorandum items:							
Central bank reserves	12,016	20,037	26,909	31,455	34,318	50,369	67,607
Central bank reserves (in months of imports of goods and services)	5.8	9.5	8.0	7.7	9.5	13.5	14.4
External assets held abroad (In US\$ million)	6,203	8,624	10,367	12,584	5,119	16,463	30,816
GDP	31,378	49,457	62,574	62,375	70,597	97,246	109,831
Non-oil GDP	11,856	21,027	30,761	27,060	37,076	33,571	35,990

Sources: Iraqi authorities and Fund staff estimates and projections.

1/ Excludes U.S. military spending in Iraq.

2/ Includes interest accrued, deferred, and capitalized.

3/ 2008 data include \$3.75bn obtained from telecoms licensing fees.

4/ Includes the use/accumulation of the DFI resources and the UN Oil for Food letters of credit.

5/ Includes the estimates of cash payments to settle the debt owed to small private creditors through cash exchange offer.

6/ Based on Paris Club agreement, the payments of principal and most interest during 2005–10 are deferred and capitalized.

7/ Reflects advance transfers for the execution of letters of credit (L/C).

8/ Estimates of accrued interest on existing stock of debt prior to the implementation of the Paris Club agreement.

9/ Includes debt forgiveness and clearance of arrears on multilateral debt and arrears related to fuel imports from Turkey.

10/ The notional debt forgiveness reflects: (i) the first stage of debt reduction (30 percent) at end 2004; (ii) the second stage reduction (30 percent) at end-2005; and (iii) the settlement of debt owed to private creditors through cash and debt exchanges. Assumes debt reduction comparable to the Paris Club agreement on other debt to official creditors.

Table 8. Iraq: Quantitative Performance Criteria and Indicative Targets  
Under the Stand-By Arrangement, 2007–08 1/  
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at 6/30/07	Performance Criteria				
		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
<i>Cumulative change from June 2007</i>						
Net international reserves of the CBI (floor; in millions of U.S. dollars) 2/ (Actual)	20,635	0 10,820	0 13,487	0 ...	0 ...	0 ...
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0 0	0 0	0 ...	0 ...	0 ...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600 -7,894	2,200 -9,080	3,750 ...	[1,250] ...	[-1,300] ...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100 8,324	2,750 2,385	5,500 ...	[10,250] ...	[14,200] ...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400 195	100 108	200 ...	300 ...	400 ...
Direct government subsidies to the fuel sector (Actual)	...	0 0	0 0	0 ...	0 ...	0 ...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500 0	500 0	500 ...	500 ...	500 ...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0 0	0 0	0 ...	0 ...	0 ...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400 400	400 400	400 ...	400 ...	400 ...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

7/ To be monitored on a continuous basis.

Table 9. Iraq: Prior Action, Structural Performance Criteria, and Structural Benchmarks Under the Stand-By Arrangement

I. Prior Action for Completion of the First Review	Date	Status
Adoption of a supplementary budget that is consistent with program objectives.		
II. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
III. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Underway
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Underway
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Underway
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in September 2008.

3/ Nine key regulations have been finalized.

Table 10. Iraq: Availability of Purchases Under the Stand-By Arrangement, 2008–09

Availability date	Amount of Purchase		Condition
	SDR	% quota	
May 15, 2008	368,404,000	31.00	Completion of the first review and observance of end-March 2008 performance criteria
August 15, 2008	35,652,000	3.00	Observance of end-June 2008 performance criteria
November 15, 2008	35,652,000	3.00	Completion of second review and observance of end-September 2008 performance criteria
February 15, 2009	35,652,000	3.00	Observance of end-December 2008 performance criteria
Total access	475,360,000	40.00	

Source: Fund staff projections.

Table 11. Iraq: Indicators of Fund Credit, 2004–14 <sup>1/</sup>  
(in millions of SDRs, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Disbursements of Fund credit</b>											
EPCA	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	0.0	439.7	35.7	0.0	0.0	0.0	0.0	0.0
In percent of IMF quota	0.0	0.0	0.0	0.0	37.0	3.0	0.0	0.0	0.0	0.0	0.0
<b>Obligations</b>											
Clearance of arrears	55.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of EPCA	0.0	0.0	0.0	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of SBA 2/	0.0	0.0	0.0	0.0	0.0	0.0	50.5	233.2	187.2	4.5	0.0
Total charges and interest	0.7	10.5	14.4	16.1	7.8	19.2	19.5	14.0	4.4	0.1	0.0
Total obligations	56.0	10.5	14.4	313.2	7.8	19.2	70.0	247.2	191.5	4.5	0.0
Total obligations, in percent of:											
Exports of goods and services	0.6	0.1	0.1	1.5	0.0	0.0	0.1	0.4	0.3	0.0	0.0
External public debt	0.1	0.0	0.0	0.5	0.0	0.1	0.2	0.8	0.7	0.0	0.0
Gross reserves	1.0	0.1	0.1	1.5	0.0	0.0	0.1	0.5	0.4	0.0	0.0
GDP	0.3	0.0	0.0	0.8	0.0	0.0	0.1	0.3	0.2	0.0	0.0
IMF Quota	4.7	0.9	1.2	26.4	0.7	1.6	5.9	20.8	16.1	0.4	0.0
<b>Outstanding Fund credit</b>											
EPCA	297.1	297.1	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	0.0	439.7	475.4	424.9	191.6	4.5	0.0	0.0
Total outstanding Fund credit	297.1	297.1	297.1	0.0	439.7	475.4	424.9	191.6	4.5	0.0	0.0
Total outstanding Fund credit, in percent of											
Exports of goods and services	3.3	2.6	1.8	0.0	1.5	1.2	0.9	0.3	0.0	0.0	0.0
External public debt	0.4	0.4	0.4	0.0	1.6	1.6	1.4	0.7	0.0	0.0	0.0
Gross reserves	5.5	3.7	2.2	0.0	1.3	1.1	0.9	0.4	0.0	0.0	0.0
GDP	1.7	1.4	0.9	0.0	0.7	0.7	0.5	0.2	0.0	0.0	0.0
IMF Quota	25.0	25.0	25.0	0.0	37.0	40.0	35.7	16.1	0.4	0.0	0.0

Sources: Fund staff estimates and projections.

1/ Including the hypothetical purchases under the current precautionary SBA, not shown in the balance of payments projections.

2/ The SBA repayments are on an expectations basis.

**APPENDIX. IRAQ—EXTERNAL DEBT OUTLOOK**

1. Iraq has received substantial debt reduction from official and private creditors, but the amount of external debt remains large. By assuming that debt reduction comparable to the Paris Club agreement is applied to non-Paris Club creditor's claims in 2008, the latest estimates of external debt indicate that the stock of debt was \$99.4 billion (201 percent of GDP) at end-2006 and \$102 billion (164 percent of GDP) at end-2007. Without the third stage of debt reduction, external debt would amount to \$43 billion (almost 25 percent of GDP) by 2013. The third stage reduction (expected in 2008) would further reduce Iraq's external debt to about \$33.6 billion (19 percent of GDP) by 2013 (Appendix I, Table 1).<sup>1</sup> The medium-term projections assume that new debt disbursements are mostly from multilateral creditors and Japan.

2. Although the significant increase in world oil prices has reduced Iraq's external debt vulnerabilities, its external debt remains vulnerable to a negative oil shock, particularly when Iraq will start repaying the debt to official creditors. Based on the Paris Club agreement in 2004, the repayment of the remaining debt stock would start in 2011; the interest payments accrued during 2005–10 are mostly capitalized. The debt service remains moderately large through 2008, when those non-Paris Club creditors that have not yet provided debt relief are assumed to provide 80 percent debt reduction. Debt service is projected to increase in 2011 because of Paris Club debt repayments. Simulations include two oil shocks (a production shock that keeps oil production constant at 2.2 mbpd in 2008–13, and a price shock that lowers the oil export price by \$25 per barrel during 2008–09 and by \$30 per barrel during 2010–13), as well as a combined shock in view of the important level of uncertainty under the baseline scenario. Under the combined shock scenario, Iraq would need to use resources from the Development Fund for Iraq and possibly to borrow from international markets to close the financing gaps (Appendix I, Table 2).

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<sup>1</sup> The third stage of debt reduction would be contingent on Iraq completing the second and final review under the current Stand-By Arrangement.

Table 1. Iraq: Estimated External Debt Stock, 2004–13  
(In billions of US\$) 1/

	2004 before debt reduction	2004 after debt reduction	2005	2006	2007	2008	2009	2010	2011	2012	2013
Without the third stage of debt reduction in 2008 (baseline) 2/											
Paris Club official creditors	50.9	31.1	18.6	19.5	20.4	21.2	21.9	22.4	21.2	20.0	18.7
Non-Paris Club official creditors 3/	69.6	69.6	71.6	74.9	78.4	18.0	18.7	19.1	18.0	16.9	15.7
Private creditors 4/	20.7	20.7	19.5	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Multilateral creditors and others 2/	0.9	1.2	1.8	1.0	0.5	0.7	1.3	2.2	3.5	4.7	5.6
Total debt	142.1	122.6	111.5	99.4	102.3	43.0	44.9	46.7	45.7	44.5	43.0
In percent of GDP	551.5	475.7	355.3	200.9	162.5	45.6	42.5	39.3	34.3	29.9	26.2
Total debt service 5/	...	0.2	0.2	1.2	0.8	0.9	0.5	0.8	3.7	3.7	4.4
With the third stage of debt reduction in 2008 6/											
Total debt	142.1	122.6	111.4	99.3	102.2	33.0	33.9	35.4	35.1	34.5	33.6
In percent of GDP	551.5	475.7	355.1	200.8	162.4	35.6	32.1	29.8	26.3	23.2	20.5
Total debt service 5/	...	0.2	0.2	1.2	0.8	0.9	0.4	0.5	2.6	2.6	3.4

Sources: Iraqi authorities; and staff estimates and projections.

1/ The assumptions made in this table are for purposes of illustration and discussion only. While the process of Iraq's debt reconciliation is ongoing, the IMF has had to base its analysis on information that may include as yet unreconciled data. Such use of data by the IMF does not amount to a recognition or denial of any particular claims. The estimates of the debt stock may differ from those in IMF Country Report No. 08/17 to incorporate the latest results of debt reconciliation and settlement.

2/ Includes new debt and arrears related to fuel imports from Turkey in 2006. The projections assume that new debt disbursement is mostly from multilateral creditors and Japan.

3/ Assumes debt reduction comparable to the 2004 Paris Club agreement for creditors with whom a debt agreement has been signed. For the remaining non-Paris Club creditors, such debt reduction is assumed to take place by end-2008.

4/ Assumes that by end-2009 all debt to private creditors would be settled by debt and cash exchanges.

5/ Debt service is actual amount paid, including repayment of arrears to Turkey.

6/ Assumes precautionary SBA during 2005–09.

Table 2. Iraq: External Debt Sustainability Framework, 2004–13  
(In percent of GDP, unless otherwise indicated)

	Estimates				Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
External debt	475.7	355.3	200.9	164.0	44.2	40.9	37.4	32.4	28.1	24.7
Change in external debt (1)	-639.7	-120.4	-154.4	-36.9	-119.8	-3.3	-3.5	-5.0	-4.2	-3.4
Identified external debt-creating flows (2)	-568.8	-75.5	-137.6	-51.3	-73.3	-18.4	-9.8	-8.1	-6.1	-6.7
Current account deficit, excluding interest payments	17.2	-24.7	-22.6	-25.9	-22.6	-28.7	-25.2	-25.9	-27.4	-31.6
Deficit in balance of goods and services	25.2	2.2	-10.5	-21.9	-17.6	-27.8	-23.6	-23.8	-25.1	-29.1
Exports	69.0	74.8	61.2	62.5	68.3	68.7	68.9	69.0	68.9	69.8
Imports	94.2	77.0	50.7	40.6	50.6	40.9	45.3	45.1	43.8	40.7
Net non-debt creating capital inflows (negative) 1/	-44.3	18.2	5.7	8.4	2.9	13.5	18.5	20.5	23.5	26.4
Automatic debt dynamics 2/	-541.7	-69.0	-120.7	-33.9	-53.6	-3.2	-3.1	-2.8	-2.2	-1.5
Contribution from nominal interest rate	22.3	16.1	9.2	7.7	5.2	1.9	1.7	1.6	1.4	1.1
Contribution from real GDP growth	-256.6	2.8	-14.0	-2.4	-9.4	-2.9	-3.6	-3.1	-2.5	-2.1
Contribution from price and exchange rate changes 3/	-307.3	-87.9	-115.9	-39.2	-49.4	-2.2	-1.2	-1.2	-1.0	-0.5
Residual, incl. change in gross foreign assets (1-2)	-70.9	-44.9	-16.8	14.4	-46.5	15.0	6.4	3.1	1.8	3.2
Of which: change in official reserves (increase = positive)	26.4	13.0	16.2	18.3	19.5	15.7	6.7	3.1	1.8	3.2
External debt-to-exports ratio (in percent)	689.3	475.2	328.2	262.6	64.7	59.5	54.3	46.9	40.8	35.4
Gross external financing need (in billions of US dollars) 4/ in percent of GDP	14.3 55.6	-1.1 -3.6	-4.5 -9.0	-11.9 -19.2	-16.4 -16.9	-29.4 -26.7	-29.2 -23.4	-31.9 -22.6	-38.8 -24.5	-50.7 -29.1
External debt service in percent of exports 5/	32.3	22.2	20.0	12.8	8.3	2.8	2.5	4.7	4.1	3.5
Debt-stabilizing non-interest current account (positive = surplus) 6/	-656.9	-95.7	-131.8	-11.0	-97.2	25.3	21.7	20.8	23.1	28.1
Key Macroeconomic Assumptions										
Real GDP growth (in percent)	46.5	-0.7	6.2	1.5	9.0	7.3	10.1	9.4	8.7	8.2
GDP deflator in U.S. dollars (change in percent)	38.0	22.7	48.4	24.3	43.1	5.3	3.1	3.4	3.2	1.7
Nominal external interest rate (in percent)	4.0	4.1	4.1	4.9	4.9	4.9	4.9	4.8	4.7	4.3
Growth of exports (U.S. dollar terms, in percent)	91.7	31.9	29.0	28.7	70.4	13.6	13.9	13.3	12.0	11.5
Growth of imports (U.S. dollar terms, in percent)	203.7	-0.5	3.7	1.0	94.6	-8.8	25.9	12.7	8.7	2.3
Stress Tests for External Debt Ratio										
Limited oil production 7/		355.3	200.9	164.0	45.9	45.6	45.7	42.6	39.4	36.7
Lower oil price in 2008–13 8/		355.3	200.9	164.0	53.5	49.0	47.0	40.8	35.6	31.3
Combined shock—Lower production and lower oil price in 2008–13 9/		355.3	200.9	164.0	55.3	54.1	56.1	52.1	47.9	44.4
Stress Tests for External Debt Service-to-Exports Ratio 5/										
Limited oil production 7/		22.2	20.0	12.8	8.8	3.3	3.5	7.3	7.1	6.7
Lower oil price in 2008–13 8/		22.2	20.0	12.8	11.1	3.6	3.5	6.6	5.7	4.9
Combined shock—Lower production and lower oil price in 2008–13 9/		22.2	20.0	12.8	11.7	4.2	4.8	10.1	9.9	9.3
Memorandum items:										
Real GDP growth under stress scenarios (in percent)										
Limited oil production 7/		-0.7	6.2	1.5	6.0	2.0	2.8	2.9	3.1	3.2
Lower oil price in 2008–13 8/		-0.7	6.2	1.5	9.0	7.3	10.1	9.4	8.7	8.2
Combined shock—Lower production and lower oil price in 2008–13 9/		-0.7	6.2	1.5	6.0	2.0	2.8	2.9	3.1	3.2
Non-interest current account deficit under stress scenarios (in percent of GDP)										
Limited oil production 7/		-24.7	-22.6	-25.9	-20.5	-23.4	-15.6	-12.7	-8.6	-10.0
Lower oil price in 2008–13 8/		-24.7	-22.6	-25.9	-11.1	-18.4	-11.9	-12.4	-13.9	-18.9
Combined shock—Lower production and lower oil price in 2008–13 9/		-24.7	-22.6	-25.9	-8.8	-12.8	-1.5	3.5	6.4	4.6

Sources: Iraqi authorities; and staff estimates and projections.

1/ Includes net FDI, other net private sector inflows (all assumed to be equity), and use of official assets held abroad (Development Fund for Iraq). Projections do not assume the third stage of debt reduction by the Paris Club in 2008, but assume the remaining non-Paris Club claims are settled in 2008.

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

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

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

5/ Debt service is total accrued amount.

6/ Balance that stabilizes the debt ratio at its previous year's level, given assumptions on real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP.

7/ Assumes that oil production remains constant at 2.2 mbpd from 2008 onward.

8/ Assumes that the oil price in 2008–13 is lower than the baseline by US\$25 in 2008–09 and by US\$30 in 2010–13.

9/ Assumes that oil production remains at 2.2 mbpd and the oil price is lower than the baseline by US\$25 in 2008–09 and by US\$30 in 2010–13.



**Attachment I. Iraq: Letter of Intent**

Baghdad, August 10, 2008

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Executive Board of the IMF approved a request for a Stand-By Arrangement (SBA) for Iraq on December 19, 2007, in support of our economic program for 2008. This program aims to build on our important achievements of 2007, notably the sharp reduction in inflation and the elimination of direct government subsidies on fuel products (except for a small subsidy on kerosene). Notwithstanding the still precarious security situation in the first months of 2008, we have continued to make progress in the implementation of our program. In particular, growth prospects have improved as crude oil production and exports have increased considerably compared to previous years while inflation was kept to single digit levels, despite higher food prices. We have also advanced with the implementation of structural reforms.
2. Iraq has met all quantitative performance criteria set for end-March 2008, except for the quantitative performance criterion on government imports of petroleum products, which was missed by a small margin due to higher-than-expected import prices for kerosene. All structural performance criteria have been met. We request completion of the first review under the SBA. We also request establishment of the quantitative performance criteria for end-September and end-December 2008, as proposed in the attached Supplementary Memorandum of Economic and Financial Policies (SMEFP)
3. In the period ahead, we shall strive to maintain macroeconomic stability and take measures that will enable Iraq to move toward a path of high and sustainable growth. The higher oil export volumes together with the recent surge in world oil prices have resulted in much higher-than-foreseen oil revenues. There are also indications that security is improving, which allows us to step up our reconstruction efforts. In this context, we have decided to prepare a supplementary budget. In addition to a sizable increase in government investment, the supplementary budget also aims to partially reverse the sharp decline in real wages of civil servants during the last years. Legislation was enacted in early May that provides for a significant increase in wages and allowances for civil servants. To keep inflation under control, we have decided to implement the wage increase gradually in 2008 and 2009. We will also step up the rate of appreciation of the dinar and maintain a tight monetary policy

stance. Other increases in current spending have been limited to priority expenditures, in particular on security, the electricity sector, and the Public Distribution System to cover higher food import prices. The Government will ensure that the enacted supplementary budget is consistent with our program objectives, as a prior action for completion of the first review.

4. We consider that the much higher world fuel prices will necessitate further adjustments of Iraq's official fuel prices, in order to prevent the re-emergence of the black market, counter smuggling, and reduce the still sizable indirect subsidies. We have already increased the official retail prices of jet fuel and of LPG as of early June and July, respectively. In light of the large increase in official fuel prices effected in 2006–07, we intend to implement further adjustments early next year. To this end, we will soon develop, in consultation with the Fund and the World Bank, an automatic adjustment mechanism for domestic fuel prices.

5. The attached memorandum updates our economic program for 2008. We believe that the policies and measures set forth in the SMEFP are adequate to achieve the objectives of the program that is supported by the SBA. However, we will take any additional measures that may be needed to ensure that the program remains on track. We will consult with the Fund on the adoption of such measures, and in advance of revisions to the policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with such information as it requests on policy implementation and achievement of the program objectives.

6. We intend to continue to treat the SBA as precautionary and consent to the publication of this letter, the SMEFP, and the staff report on the first review under the SBA. Finally, we hope that we can count on the continued support of the international community for the implementation of Iraq's economic policy agenda.

Sincerely yours,

/s/

Dr. Sinan Al-Shabibi  
Governor of the Central Bank of Iraq

/s/

Mr. Baqir S. Jabr Al-Zubaydi  
Minister of Finance of Iraq

## **Attachment II. Iraq—Supplementary Memorandum of Economic and Financial Policies for 2008**

August 10, 2008

### **I. INTRODUCTION**

1. This memorandum supplements the Memorandum of Economic and Financial Policies for 2008 (MEFP), annexed to our letter dated December 4, 2007. It describes additional economic objectives and policies agreed in the context of the first review under the Stand-By Arrangement (SBA). Policies and unfulfilled commitments specified in the MEFP continue to be part of the program.

### **II. RECENT DEVELOPMENTS UNDER THE STAND-BY ARRANGEMENT**

2. Following several years of stagnation in the oil sector, crude oil production started to increase in mid-2007 and continued to climb during the first months of 2008. This positive development was in large part the result of improved security, which enabled the resumption of exports through the north. Crude oil output in January–May 2008 reached 2.3 million barrels per day (mbpd; compared to 2.04 mbpd in 2007) and oil exports in January-May averaged 1.8 mbpd (compared to 1.5 mbpd in 2007). However, the Central Organization for Statistics and Information Technology (COSIT) estimates that real non-oil GDP declined somewhat in 2007, due to lower agricultural and industrial production. As a result, total real GDP growth is estimated at about 1½ percent in 2007.

3. Inflation has been brought down sharply to about 5 percent by end-2007 from 65 percent in 2006. This was accomplished through implementation of a policy package that included fiscal discipline, exchange rate appreciation and monetary tightening, and measures to reduce fuel shortages that resulted in a drop in black-market fuel prices. Annual consumer price inflation remained low in the first half of 2008. Core inflation (which excludes fuel and transportation) remained at about 12½ percent in June, in part because of higher food prices mainly due to the rising world market prices for foodstuffs.

4. Fiscal policy remained restrained in 2007. The fiscal outturn for the year showed a sizable surplus of some 13½ percent of GDP (compared to a programmed surplus of 1.5 percent), because of higher-than-expected oil revenue and underspending on investment, which continued to be hampered by the security situation and limited implementation capacity. As a result, the balance in the Development Fund for Iraq (DFI) increased by almost \$4 billion to \$12.6 billion at end-2007. We have taken measures to speed up the implementation of investment projects, and the execution rate of the investment budget has improved in the first quarter of 2008.

5. The success in bringing down inflation has allowed us to slow down the pace of appreciation of the dinar from roughly ½ percent per month in the second half of 2007 to

about ¼ percent per month in the period January–June 2008. Since November 2006 the dinar has appreciated by 18¾ percent vis-à-vis the U.S. dollar, to ID 1,195 per dollar at end-June 2008. Net international reserves continued to grow and reached a level of \$38.3 billion at end-April. The Central Bank of Iraq (CBI) also reduced its policy interest rate in three steps from 20 percent at end-2007 to 16 percent as of July 1, 2008.

6. All quantitative and performance criteria for end-March 2008 were met, except for the quantitative performance criterion on government imports of petroleum imports (kerosene) for end-March 2008, which was missed by a small margin (Table 1). All structural performance criteria have been met (Table 2).

7. We have also continued to make progress toward resolving external claims; debt relations with 57 countries have been resolved to date. The bilateral debt agreement with Russia, the remaining Paris Club creditor, was signed in February 2008. Bilateral agreements with eleven non-Paris Club official creditors have been signed in total, and active negotiations are underway with several other non-Paris Club official creditors, notably China. On July 7, 2008 the United Arab Emirates has announced the full cancellation of Iraq's debt. However, despite our good faith efforts, negotiations with some key non-Paris Club official creditors are progressing slower than we would wish.

8. Regarding private creditors, the bulk of the claims was already resolved through debt and cash exchanges that closed in 2006. We have reopened our commercial debt-restructuring program for registration of remaining claims during the period January 30–March 15 of this year, in order to settle unresolved commercial claims against Iraq. In May, 110 claimants received an invitation to tender their claims, of which 84 claimants did so. Most of the remaining commercial claims are to be resolved as part of the ongoing liquidation of the London branch of Rafidain Bank.

9. The first annual review conference of the International Compact with Iraq (ICI) was held in Stockholm on May 29, 2008. The conference affirmed the support of the international community for Iraq's political, security, and economic reform program through technical assistance and investment know-how.

### **III. ECONOMIC AND FINANCIAL POLICIES IN 2008**

10. For the remainder of 2008, we intend to speed up the reconstruction of the Iraqi economy, which would be made possible by the improved security situation and the higher oil revenues resulting from the expansion of export volumes and the surge in world market prices. We believe that the sound management of abundant oil revenues is a major challenge. In particular, there is a need to avoid a resurgence of inflation due to an excessively expansionary fiscal stance, which would put a too heavy burden on the CBI to maintain macroeconomic stability. We are therefore determined to preserve an appropriate balance between our fiscal and monetary policies, in order to increase production while keeping inflation low. We will also push ahead with priority structural reforms to pave the way for

high growth over the medium term and to strengthen governance and administrative capacity in the public sector.

11. Real GDP growth is expected to increase to 9 percent in 2008, driven by the ongoing expansion of oil output. Provided the recent reduction in violence takes hold, we expect crude oil production to reach on average at least 2.3 mbpd, higher than projected at the outset of the program. Although this year's agricultural output will suffer due to a drought, we expect other non-oil economic activities to begin to recover. We aim to contain inflation at 14 percent, slightly above the original program target because of the pass-through of higher international food prices. The net international reserves of the CBI are expected to increase to about \$44 billion by end-2008.

#### **A. Fiscal Policy and Reforms**

12. The 2008 budget adopted by the Council of Representatives (CoR) on February 12, was broadly in line with the program, except for a contingency allocation of ID 1.7 trillion that was earmarked to increase civil service wages and allowances through separate legislation. The Law on Government Employee Salaries was enacted on May 4, 2008, and is retroactive to January 1; it excludes employees at the Presidency, the Prime Minister's Office, and the ministries of defense and interior. The salary increase comprises a general wage increase, as well as specific allowances that increase with grade- and education levels to stem the brain-drain from the civil service. In addition, new family and child allowances have been introduced and travel allowances have been increased. As a result, the increase in the civil service wage bill would be much larger than budgeted.

13. We have prepared a supplementary budget that provides for a significant increase in public investment and priority current spending. In order to limit inflationary pressures, the Government has decided to implement the salary increase gradually. The total civil service salary increase this year will be capped at ID 2.9 trillion, bringing the total civil service wage bill to ID 10.0 trillion in 2008. Additional allocations have also been made for security (comprising some new hiring and purchase of equipment) and the in-kind Public Distribution System (PDS) to cover higher food import prices. In view of its mounting costs, we will seek technical assistance from the Fund and the World Bank to assist the Ministry of Trade in preparing an action plan to streamline the PDS as of early 2009. The supplementary budget also makes provision for additional fuel imports for electricity generation and to reduce the stock of payment arrears of the sector to oil companies. In view of the improved investment execution thus far this year, we have increased the investment budget for the oil, electricity, water and sanitation, education, health, and agricultural sectors, as well as at the provincial level. We will continue our efforts to safeguard the quality of investment spending.

14. These policies, and taking account of much higher-than-foreseen oil revenues, should result in an overall fiscal surplus of ID 3.3 trillion (2.8 percent of GDP). As part of our efforts to improve the government's cash management, we intend to reduce the large

outstanding government deposits with commercial banks. In order to maintain a benchmark for market interest rates and help develop a secondary market for treasury bills, we will adhere to a regular bi-weekly issuance in the order of ID 150-200 billion.

15. Together with the Fund, the World Bank and other international partners, we have embarked on an ambitious program to modernize public financial management. The government is developing an action plan that identifies priority measures in this area, notably as regards investment budgeting, budget execution and control, procurement policies, cash management, and the accounting framework (structural benchmark). We are also making progress, in cooperation with USAID, in putting in place the renewed Iraq Financial Management Information System (IFMIS) and expect this system to be fully operational starting with the 2009 budget. We will soon submit the final accounts of the Federal Budget for 2007 to the Board of Supreme Audit (BSA; structural benchmark).

16. Although we are making progress with the data collection for the census of public service employees, this project could not be finalized as planned (structural benchmark for end-June), due to technical and security-related delays and the high labor-intensity of the work. Despite these setbacks, we will invest all our efforts to have the census completed by end-September. On this basis, we will adopt an action plan to eliminate ghost workers and computerize the payroll before year-end, as a first step for a comprehensive civil service reform.

## **B. Monetary and Exchange Rate Policies**

17. The CBI will tighten its policy stance to help curb inflation pressures arising from the planned fiscal expansion, despite the high import content of both consumption and investment spending. The rate of appreciation of the dinar will be increased to about ½ percent per month during the second half of the year. We will further step up the pace of appreciation if needed to achieve our inflation target. In view of the expected price pressures in the second half of the year, it may be necessary to tighten monetary policy. We will keep the policy interest rate positive in real terms (measured against core inflation) to signal our firm commitment to continue fighting inflation.

18. We have made some progress in strengthening the accounting and reporting framework of the CBI, despite the fire that largely destroyed its headquarters in January. The external audit of the CBI net international reserves at end-December 2007 and the audit of the CBI 2007 financial statements were completed as planned (structural performance criteria). Work is underway, with IMF technical assistance, towards adoption of new reserves management guidelines (structural benchmark). Some progress was made in the regular reconciliation in the CBI accounts of local banks' current accounts, and we are continuing our efforts to reconcile suspense accounts, and CBI intra-branch accounts. The frequency of reconciliation of the CBI's account at the Federal Reserve Bank in New York for interest earned on U.S. Treasury bills has been increased to once a month. We will step up our efforts

to establish a register of outstanding off-balance sheet commitments (letters of credit and guarantees). We also intend, with the assistance of external consultants, to establish a modern internal audit function that will meet the requirements set in the central bank law.

19. We remain committed to maintaining a liberal exchange system. We have responded to some follow-up questions in the context of the ongoing review of exchange laws and regulations, and are ready to implement the Fund's recommendations in this area. We also intend to accept the obligations of Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement as soon as possible. In the meantime, we will avoid imposing restrictions on the making of payments and transfers for current international transactions.

### **C. Structural Policies**

20. We attach the highest importance to further increasing transparency and good governance in the oil sector. The meters at the Basra export terminal have been certified by an internationally reputable firm and are fully operational. We have ordered the metering system for the Khor Al-Amyah export terminal, which will be installed in the second half of this year. The implementation of a comprehensive custody-transfer system metering project is ongoing with help from international partners, and thus far some 200 meters have been installed. A computerized tracking system for oil transports by road has also been initiated. The Iraqi Committee of Financial Experts (COFE) is prepared to take over the responsibilities of the International Advisory and Monitoring Board (IAMB) as the audit and oversight body for the DFI by the end of this year. The COFE will continue the IAMB's practice of publishing the audit reports it mandates, and it will present its first semi-annual report, including recommendations, to the Council of Ministers by mid-September 2008 (structural benchmark). Iraq has joined the Extractive Industries Transparency Initiative, and we have requested technical assistance from our international partners to speed up implementation procedures.

21. Our reform program for the banking sector is on track. The financial and operational audits of Rafidain and Rasheed banks have been completed, albeit with a slight delay (structural benchmark). We will now focus our efforts on developing restructuring plans for these banks, which we aim to adopt by end-September 2008 (structural benchmark). The BSA has started work on the reconciliation of the foreign debt held by both banks and the cleaning up of their large suspense accounts, and the results will be reflected in their financial statements for end-2007. The Restructuring Oversight Committee is developing individual strategies for the restructuring of the three smaller specialized state-owned banks, and diagnostic reviews of these banks will start by end-July 2008.

22. We have achieved, in consultation with the Fund, substantial progress toward the completion of a comprehensive set of prudential regulations for commercial banks. Nine key regulations, including on licensing requirements, capital adequacy, loan classification and provisioning, large exposures, and liquidity have been finalized (structural benchmark). The

work on the remaining regulations is expected to be completed in the coming months. With core regulations in place, we are turning our efforts to implementing banking supervision practices according to international standards. In addition, we will continue to work toward changing the commercial banks' accounting system in line with International Financial Reporting Standards, and prepare a set of financial soundness indicators for commercial banks.

#### **D. Other Issues**

23. We will continue our efforts to resolve outstanding external claims under terms that are consistent with the 2004 Paris Club agreement. We will endeavor to finalize the negotiations on a debt agreement with China as soon as possible. Official contacts with the other non-Paris Club creditor countries have been made and will continue with a view to an early conclusion of debt agreements. To resolve most of the remaining private claims, the settlement phase of commercial claims as part of the liquidation of the London branch of Rafidain Bank is expected to begin by September 2008; we hope that the process will be completed as soon as possible.

24. We remain committed to further improving Iraq's statistical database, including by strengthening cooperation between the various data producers. The 2007 household survey, which covered all governorates of Iraq, has been completed. Using the results from the household survey, the weights in the CPI are being updated (structural benchmark for end-May). We will continue our efforts to extend the geographical coverage of the CPI to the Kurdish Region, and to incorporate data from the two CBI branches located in that region into the monetary statistics. Monetary and balance of payments data are being published in the IMF's *International Financial Statistics* since March, and July, respectively, and we are working towards participating in the General Data Dissemination System in the course of next year.

#### **IV. PROGRAM MONITORING**

25. Macroeconomic policy performance will continue to be monitored through quarterly quantitative performance criteria and an indicative target. Additional quantitative performance criteria have been set for end-September and end-December 2008, as specified in Table 1. A prior action for completing the first review has also been set (Table 2). Progress in structural reform will be monitored through benchmarks.



Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets  
Under the Stand-By Arrangement, 2007–08 1/  
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at 6/30/07	Performance Criteria				
		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
<i>Cumulative change from June 2007</i>						
Net international reserves of the CBI (floor; in millions of U.S. dollars) 2/ (Actual)	20,635	0 10,820	0 13,487	0 ...	0 ...	0 ...
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0 0	0 0	0 ...	0 ...	0 ...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600 -7,894	2,200 -9,024	3,750 ...	-2,400 ...	-3,200 ...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100 8,324	2,750 2,385	5,500 ...	11,650 ...	14,400 ...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400 195	100 108	200 ...	300 ...	400 ...
Direct government subsidies to the fuel sector (Actual)	...	0 0	0 0	0 ...	0 ...	0 ...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500 0	500 0	500 ...	500 ...	500 ...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0 0	0 0	0 ...	0 ...	0 ...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400 400	400 400	400 ...	400 ...	400 ...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

7/ To be monitored on a continuous basis.

Table 2. Iraq: Prior Action, Structural Performance Criteria, and Structural Benchmarks Under the Stand-By Arrangement

I. Prior Action for Completion of the First Review	Date	Status
Adoption of a supplementary budget that is consistent with program objectives.		
II. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
III. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Underway
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Underway
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Underway
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in September 2008.

3/ Nine key regulations have been finalized.

INTERNATIONAL MONETARY FUND

IRAQ

**First Review Under the Stand-By Arrangement and Financing Assurances  
Review—Supplementary Information**

Prepared by the Middle East and Central Asia Department

Approved by Juan Carlos Di Tata and G. Russell Kincaid

August 29, 2008

1. This supplement provides an update on developments since the issuance of the staff report. The thrust of the staff appraisal remains unchanged.
2. **All quantitative performance criteria set for end-June under the Stand-By Arrangement have been met, except for the performance criterion on the government wage and pension bill** because payment of the civil service salary increase included in the 2008 supplementary budget started already in June, rather than in the second half of the year (Table 1). In the attached letter, the authorities ask for a waiver for the non-observance of this performance criterion. While staff agrees with the civil service salary increase granted for 2008 as a whole, it was staff's understanding that the new spending pattern would allow this performance criterion to be observed. In the event, it was not but staff supports the authorities' request for a waiver in light of the revised fiscal targets.
3. **Consumer price inflation remained subdued in July.** Consumer prices increased by 1.9 percent in July, largely because of higher fuel and transportation prices. As a result, the CPI fell by 1.4 percent in July (year-on-year), after declining by 6.3 percent in June. Annual core inflation (excluding fuel and transportation) increased to 13.6 percent in July, from 12.4 percent in June.
4. **The Central Bank of Iraq (CBI) has gradually appreciated the dinar**, in line with the policy outlined in the staff report. On August 28, 2008 the exchange rate of Iraqi dinar stood at ID 1,184 per U.S. dollar, compared to ID 1,195 per U.S. dollar on June 30, 2008. The dinar has appreciated by 19½ percent since November 2006, when the CBI started to appreciate the currency to counter dollarization and reduce inflation.
5. **Oil production and exports, including through the northern pipeline, have remained strong in recent months.** In January-June 2008, crude oil production averaged 2.3 million barrels per day (mbpd), in line with the program target. On average, crude oil

exports during January-June reached 1.86 mbpd, above the projected level of 1.8 mbpd for the year as a whole.

6. **Preliminary fiscal data through June indicate a surplus of ID 6.9 trillion or about 6 percent of projected 2008 GDP.** While investment expenditures were below target, most of the surplus was due to higher oil revenues, reflecting higher-than-expected export prices and volumes of crude oil. Consistent with the overall fiscal performance, the balance in the Development Fund for Iraq increased from \$12.6 billion at end-2007 to \$23.6 billion at end-July 2008. On August 6, 2008 the Council of Representatives passed the supplementary budget for 2008, which is in line with the program objectives (a prior action for completion of the first review). The government's wage and pension bill for 2008 as a whole is expected to remain within the fiscal program ceiling.

7. The CBI Board of Directors approved the new **reserves management guidelines** on August 4, 2008 (structural benchmark, Table 2).

8. **The authorities have prepared a draft action plan for modernizing the government's financial management system** with the assistance of the Fund and the World Bank (structural benchmark). A final discussion on technical assistance needs and the timetable for reform efforts in this area is planned to take place in a workshop organized by the World Bank on September 20; the formal adoption of the action plan is expected soon thereafter.

Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets  
Under the Stand-By Arrangement, 2007–08 1/  
(In billions of Iraqi dinars, unless otherwise indicated)

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		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
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Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0 0	0 0	0 0	0 ...	0 ...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600 -7,894	2,200 -9,024	3,750 -6,879	-2,400 ...	-3,200 ...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100 8,324	2,750 2,385	5,500 6,579	11,650 ...	14,400 ...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400 195	100 108	200 172	300 ...	400 ...
Direct government subsidies to the fuel sector (Actual)	...	0 0	0 0	0 0	0 ...	0 ...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500 0	500 0	500 0	500 ...	500 ...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0 0	0 0	0 0	0 ...	0 ...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400 400	400 400	400 400	400 ...	400 ...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

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I. Prior Action for Completion of the First Review	Date	Status
Adoption of a supplementary budget that is consistent with program objectives.	August 6, 2008	Met
II. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
III. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Met on August 4
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Underway
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Underway
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in September 2008.

3/ Nine key regulations have been finalized.

Table 3. Iraq: Availability of Purchases Under the Stand-By Arrangement, 2008–09

Availability date	Amount of Purchase		Condition
	SDR	% quota	
August 15, 2008	404,056,000	34.00	Completion of the first review and observance of end-June 2008 performance criteria
November 15, 2008	35,652,000	3.00	Completion of second review and observance of end-September 2008 performance criteria
February 15, 2009	35,652,000	3.00	Observance of end-December 2008 performance criteria
Total access	475,360,000	40.00	

Source: Fund staff projections.

**Attachment I**

Baghdad, August 29, 2008

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Strauss-Kahn:

Further to our letter dated August 10, 2008, we would like to inform you that Iraq has met all quantitative performance criteria set under the Stand-By Arrangement (SBA) for end-June 2008, except for the quantitative performance criterion on the government's wage and pension bill. This performance criterion was based on our government budget for 2008. Subsequently, however, we adopted, in consultation with Fund staff, a supplementary budget for 2008 which includes an increase in wages and allowances for civil servants. Actual payments of this salary increase started in June, resulting in a higher-than-programmed government wage bill for the first half of the year. To complete the first review under the SBA, we request a waiver of non-observance of the performance criterion on the government's wage and pension bill for end-June.

We will continue to ensure that our economic program for 2008 remains on track. In particular, the civil service salary increase granted for 2008 as a whole is consistent with the fiscal program targets under the SBA.

Sincerely yours,

/s/

Dr. Sinan Al-Shabibi  
Governor of the Central Bank of Iraq

/s/

Mr. Baqir S. Jabr Al-Zubaydi  
Minister of Finance of Iraq





Press Release No. 08/199  
FOR IMMEDIATE RELEASE  
September 3, 2008

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Completes First Review of Iraq's Stand-By Arrangement**

The Executive Board of the International Monetary Fund (IMF) completed today the first review of Iraq's Stand-By Arrangement (SBA), which is designed to support the country's economic program through March 2009. The Board also completed a financing assurances review under the SBA. The SDR 475.36 million (about US\$746.3 million) arrangement was approved in December 2007. It is being treated as precautionary by the authorities (see [Press Release No. 07/301](#)), and no purchase is planned.

As part of the completion of the first review, the Board also approved Iraq's request for a waiver of an end-June 2008 quantitative performance criterion on the government wage and pension bill.

Following the Executive Board's discussion of Iraq's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

“After several very difficult years, economic prospects for Iraq are improving and the authorities are persevering with the implementation of their economic program in 2008. With the recent improvement in security, oil production and exports are increasing while inflation has been reduced. The strengthened fiscal and external positions offer Iraq a good opportunity to rebuild its institutions and infrastructure in order to achieve sustained higher economic growth. The success of these endeavors will hinge on continued improvements in security, sound management of oil revenues, and implementation of key structural reforms.

“To accelerate economic reconstruction and meet other pressing needs, the supplementary budget for 2008 provides for a sizable spending increase. The additional investment, following several years of public underinvestment, is welcome but will require vigilance to ensure that the quality of public investment is maintained. A civil service salary increase will be phased in over 2008 and 2009 in order to avoid overheating the economy. To keep inflation under control, the Central Bank of Iraq will tighten its monetary policy stance, notably by increasing the pace of appreciation of the dinar and by keeping its policy interest rate positive in real terms.

“Some fuel prices were increased in mid-2008, and the government intends to raise other fuel prices early next year to reduce still-sizable indirect fuel subsidies. The Fund stands

ready to assist the authorities in developing an appropriate adjustment mechanism for setting domestic fuel prices.

“It will be important to step up the pace of structural reform. Of particular urgency are the early adoption of a comprehensive reform plan for modernizing public financial management, the finalization of the census of public service employees to eliminate ghost workers, and the streamlining of the in-kind Public Distribution System. In the financial sector, restructuring programs for two major commercial banks based on the completed financial and operational audits should be taken forward, and the set of prudential regulations for commercial banks completed. Establishment of a new legislative framework for the hydrocarbon sector will facilitate investments in the sector.

“Progress has been made in strengthening governance and fighting corruption in the hydrocarbon sector, through oil-metering and Iraq’s participation in the Extractive Industries Transparency Initiative. An extension of the metering system to all oil sector activities will further strengthen transparency in the sector.

“The central bank intends to continue to implement the recommendations of the IMF’s Safeguards Assessment Report and the external audit report of its 2007 financial statements. The adoption of reserves management guidelines is an important step in this regard.

“The authorities are making commendable efforts to conclude debt agreements with official non-Paris Club and private creditors that have not yet provided debt relief to Iraq,” Mr. Kato said.

**Statement by A. Shakour Shaalan, Executive Director for Iraq**  
**September 3, 2008**

**Background**

1. Notwithstanding the vastly improved but still difficult security and political conditions that prevailed in the first months of 2008, the authorities have made significant progress in implementing their economic program under the Fund-supported Stand-By Arrangement (SBA). Oil production and exports have considerably increased compared to previous years and to program projections, strongly enhancing growth prospects. Moreover, the execution rate of the investment budget has improved in the first quarter of 2008, as a result of measures to speed-up implementation of projects. The authorities have also succeeded in bringing down inflation dramatically from 65 percent at end-2006 to about 12 percent at the present time, as a result of a timely adjustment in both monetary and exchange rate policies, as well as continued fiscal discipline and the reduction of fuel shortages. Despite severe capacity constraints, the authorities have advanced their structural agenda in several key areas, including the pension law, the audits of the Central Bank of Iraq (CBI), the government's financial management system, the banking reform, and the statistical database. They also continued to make best efforts to reach bilateral agreements on arrears to official non-Paris Club creditors and have been negotiating in good faith to resolve the remaining arrears to private creditors.

**Economic Policies and Reforms for the Remainder of 2008**

2. The authorities see the improvement in security conditions and the related recovery of oil production and exports, which have resulted in strong fiscal and external positions, as a window of opportunity to move toward a path of high and sustainable growth, in the context of continued macroeconomic stability.

3. The authorities' **fiscal strategy** aims at rebuilding Iraq's economy and institutions, restoring adequate public services, and enhancing the standard of living of the population, while maintaining fiscal sustainability. Higher oil revenues and below-budget investment spending resulted in a budget surplus of 13 ½ percent of GDP in 2007 (versus 1 ½ percent projected in the program). Against this background, and to respond to pressing social and infrastructural needs, the authorities have prepared a supplementary budget providing for higher public investment in key sectors and additional current spending in priority areas. The latter includes notably an expansion in civil service wages and allowances to compensate for the significant decline in average real wages during 2005–07. The authorities concur with staff that the overall domestic demand impact of the revised 2008 budget will be manageable, especially that they have decided to implement the salary increase gradually in order to limit the potential adverse effects on inflation.

4. The government increased the official retail prices of jet fuel and LPG in June and July 2008, respectively, and plan to adjust gasoline and diesel prices early next year. There are presently virtually no direct subsidies on fuel products. Nonetheless, the authorities remain committed to develop, in consultation with the Fund, an automatic fuel price adjustment mechanism to help reduce the still sizable indirect fuel subsidies.

5. Considerable effort is being devoted to advancing **fiscal reforms**. The authorities have launched an ambitious program to modernize public financial management. They are also making progress in putting in place the renewed Iraq Financial Management Information System, which is expected to be fully operational starting with the 2009 budget. Notwithstanding the progress made with the data collection for the census of public service employees, completion of the project was delayed until end-September, due to technical and security-related impediments and the high labor-intensity of the work. The authorities plan on adopting an action plan to eliminate ghost workers and computerize the payroll before year-end, as a first step for a comprehensive civil service reform. Rationalizing the Public Distribution System, with technical assistance from the Fund and the World Bank, also ranks high on the authorities' agenda.

6. The CBI is fully aware of the challenges to **monetary policy** that could result from an expansionary fiscal stance, notwithstanding the high import content of both consumption and investment spending. It intends to increase the rate of appreciation of the dinar to about ½ percent per month during the second half of the year, and to keep the policy interest rate positive in real terms to signal its firm commitment to containing inflation.

7. The CBI remains committed to implementing the recommendations of the IMF safeguards assessment report. The external audit of the CBI net international reserves at December 31, 2007 and the external audit of the CBI 2007 financial statements have been completed as planned, despite the fire that largely destroyed the CBI headquarters in January of this year. Progress has been made with strengthening the accounting and reporting framework of the CBI and work is underway, with technical assistance from the Fund, towards adoption of new reserves management guidelines.

8. **Other structural issues.** Increased transparency and good governance in the oil sector continue to rank high on the authorities' agenda. In this connection, the Iraqi Committee of Financial Experts will fully take over the responsibilities of the International Advisory and Monitoring Board as the audit and oversight body for the Development Fund for Iraq by year-end. Furthermore, important progress has been achieved in installing and operationalizing oil-metering systems. In an effort to enhance transparency and fight corruption in the oil sector, the authorities have also joined the Extractive Industries Transparency Initiative. Finally, discussions on a new legislative framework for the hydrocarbon sector are ongoing.

9. Important steps continue to be taken towards the restructuring of the two largest state-owned banks, in close collaboration with the Fund and the World Bank. The financial and operational audits of the Rasheed and Rafidain banks have been completed, providing a good basis for developing restructuring plans for both banks. At the same time, the CBI has set up a task force to develop a comprehensive set of prudential regulations for commercial banks. Key regulations on licensing, capital adequacy, credit risk, and large exposures have been completed.

#### **Performance Under the SBA and Financing Assurances**

10. As is clear from the staff report, the Iraqi authorities have demonstrated a strong commitment to undertaking significant macroeconomic policies and structural reforms, which has enabled them to meet various quantitative and structural criteria under the program, except for the performance criterion on the government wage and pension bill. They also continue to make best efforts to reach bilateral agreements on arrears to official non-Paris Club creditors and have been negotiating in good faith to resolve the remaining arrears to private creditors, consistent with the Fund's policy on lending into arrears. Against this background, the authorities request a waiver for the non-observance of the performance criterion on the government wage and pension bill, the completion of the first review under the SBA, the establishment of performance criteria for end-September and end-December 2008, and the completion of the financing assurances review. The Iraqi authorities remain fully committed to the objectives of the arrangement, which provides cohesion to their policy framework while anchoring progress towards macroeconomic stability and structural reforms.

11. The Iraqi authorities are grateful for the valuable policy advice and technical assistance they are receiving from staff in support of their stabilization and reform efforts, as well as for the continued support provided by the Fund and its membership.