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Iraq: Staff Report for the 2009 Article IV Consultation and Request for Stand-By Arrangement

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on February 5, 2010 with the officials of Iraq on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 16, 2010. 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 Public Information Notice (PIN).

- A Press Release.

- A statement by the Executive Director for Iraq.

The document(s) listed below will be separately released.

Letter of Intent sent to the IMF by the authorities of Iraq*
Memorandum of Economic and Financial Policies by the authorities of Iraq*
Technical Memorandum of Understanding*
Other Background papers
*Also included in Staff Report

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

Staff Report for the 2009 Article IV Consultation and Request for Stand-By Arrangement

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

Approved by Juan Carlos Di Tata and David Marston

February 16, 2010

- This report is based on discussions held during July 13–16 in Beirut, September 28–October 2 in Amman, October 5–7 in Istanbul, and October 20–21 in Washington, D.C. Staff met with Minister of Finance Al-Zubaydi, Minister of Oil Al-Shahristani, Governor of the Central Bank of Iraq Al-Shabibi, other senior officials, and parliamentarians. The staff team comprised Mr. van Rooden (head), Ms. George, Ms. Oliva (all MCD), and Mr. Bakhache (SPR). Mr. Ibrahim, the Fund's Resident Representative for Iraq, assisted the mission. Mr. Di Tata (MCD) participated in the policy discussions, and Mr. Said and Ms. Sahnoun (World Bank) joined the technical discussions.
- **Context**: Iraq's external and fiscal outlook has worsened significantly owing mainly to the large drop in oil prices from mid-2008 levels. The current account and the government budget have shifted into large deficits in 2009, and, based on conservative oil price assumptions are expected to remain in deficit in 2010–11.
- **Request for a Stand-By Arrangement**: The authorities have requested a two-year SBA in the amount of SDR 2,376.8 million ($3.7 billion), equivalent to 200 percent of Iraq's quota, to cover the country's balance of payments needs. Board approval of the proposed arrangement would unlocked a disbursement of SDR 297.1 million (about $460 million), or 25 percent of quota.
- **The main objectives of the program** are to maintain macroeconomic stability during a period of high economic and political uncertainties (parliamentary elections are scheduled for March 7, 2010), and to provide a framework for deepening structural reforms.
- **Iraq's exchange rate regime is classified as stabilized against the U.S. dollar**. Iraq continues to avail itself of the transitional arrangements under Article XIV.
- **Data provision** is broadly adequate for surveillance and program monitoring, but there are some weaknesses that hamper economic analysis.

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EXECUTIVE SUMMARY

Following a strong economic performance, the Iraqi economy has been seriously affected by the drop in oil prices from their peak levels in mid-2008. As a result, Iraq's external position deteriorated substantially in 2009, with both the external current account and the overall balance of payments shifting into large deficits of about 20 percent and 10 percent of GDP, respectively. With oil export receipts accounting for about 85 percent of government revenues, the lower oil prices had a similar impact on the government's budget. Even though the execution of the budget was seriously hampered in the second half of the year by two bomb attacks on the Ministry of Finance, the budget is estimated to have recorded a deficit of over 20 percent of GDP in 2009.[1]

While Iraq's medium-term economic outlook remains favorable because oil prices and production are projected to increase in the coming years, based on conservative oil price assumptions the current account and overall balance of payments are expected to remain in deficit in 2010 and 2011. Similarly, Iraq's fiscal position is projected to record large, albeit declining deficits in both years, before returning to a surplus position in 2012.

Against this background, the authorities have designed an economic program for the period through end-2011 and have requested the Fund to support it with a new two-year Stand-By Arrangement. The authorities view the new program primarily as a way to provide a sound macroeconomic framework during a period of high economic and political uncertainties. The authorities' fiscal program seeks to contain current government spending while catching up on much-needed investment spending. The budget deficit is targeted to decline to 19 percent of GDP in 2010 and further to 6 percent in 2011, before shifting back into surplus in 2012. Monetary and exchange rate policies will continue to aim at keeping inflation low.

The new program will also help the authorities move forward with their structural reform agenda. In particular, the program aims to advance key reforms in the areas of public financial management, including the management of the country's oil resources, and financial sector development, in close coordination with a Development Policy Loan provided by the World Bank.

The program will provide access to Fund resources, if needed. Based on conservative oil price assumptions and full execution of the government's capital budget, Iraq would have a temporary financing need of almost $5 billion through end-2011. However, oil prices may turn out higher than envisaged and capacity constraints may result in under-execution of the capital budget. If either of these developments were to imply that there is no longer a financing need, the authorities have indicated that they would treat the SBA as precautionary. If drawing on Fund resources becomes necessary, the authorities intend to use the domestic counterpart to finance the budget deficit. This would avoid central bank financing of the government and help preserve the independence of the Central Bank of Iraq (CBI).

[1] Oil price movements have a large impact on nominal GDP and hence also on the GDP ratios. Largely reflecting the decline in oil prices, nominal GDP is estimated to have fallen by almost 25 percent in 2009.

I. INTRODUCTION

1. **The Fund has been closely engaged with Iraq since 2003**. Initial work focused on providing policy advice, mainly on monetary and fiscal policies, and technical assistance to rebuild essential economic institutions. In September 2004, the Fund approved Emergency Post Conflict Assistance (EPCA) for Iraq, which—in combination with a debt sustainability analysis—paved the way for an agreement with Paris Club creditors. Since then, Iraq successfully completed two (precautionary) Stand-By Arrangements (SBA) whose main objectives were to achieve macroeconomic stability, promote growth, and continue with the process of structural and institutional reforms.

2. **The Fund has also been a partner in the International Compact with Iraq, an initiative of the Iraqi government for a new partnership with the international community**. The Compact was launched in May 2007 and entails a medium-term framework for comprehensive political, security, and economic reforms, aimed at facilitating Iraq's integration with the regional and global economy. The Fund contributed to the preparation of the medium-term macroeconomic framework that underpinned the Compact.

3. **Iraq has made substantial progress since 2003**. Despite a difficult security situation, the authorities have demonstrated their commitment and ability to implement sound macroeconomic policies and advance structural reforms. Inflation has been reduced to single digits and the international reserves position has improved markedly. At the same time, domestic fuel prices were raised to eliminate direct fuel subsidies and the pension system was put on a sustainable footing, which created room for priority spending on investment and the social sectors. Several steps have also been taken to strengthen public financial management, improve transparency in the oil sector—including with the help of the International Advisory and Monitoring Board (IAMB)—and rebuild capacity at the central bank, and the authorities have initiated the restructuring of the two largest state-owned banks.

4. **Important advances have also been made in attaining long-term debt sustainability**. In 2004, the Paris Club agreed to reduce Iraq’s external debt by 80 percent in net present value terms. The third and final tranche of this debt relief was granted following the completion of the last review under the second SBA in December 2008. Out of a total of $37.2 billion due to Paris Club creditors, $29.7 billion was cancelled, and the remaining $7.4 billion has been rescheduled. Bilateral debt agreements with several non-Paris Club creditors have already been concluded, but this process is yet to be completed.

5. **Looking forward, serious challenges remain**. First and foremost is the continuing need to improve security. It is also important to maintain a stable macroeconomic environment and improve the business climate to create a viable private sector in order to sustain economic growth and provide much-needed jobs for Iraq’s labor force. In addition, many structural reforms have yet to be finished, including in the areas of public financial management and bank restructuring.

6. **Therefore, in the attached letter to the Managing Director, the Iraqi authorities request a new 2-year SBA to support their stabilization and rehabilitation efforts, and help advance their structural reform agenda**. Their request for a new Fund-supported program responds to the recent deterioration of Iraq's economic outlook associated with a sharp decline in oil export revenues, owing mainly to the fall in oil prices from their highs of 2008. Based on conservative projections for oil prices, this has created significant balance of payments and fiscal needs. The authorities have outlined their program in the attached Memorandum of Economic and Financial Policies (MEFP) for 2010-11 (Attachment II).

7. **This staff report also covers the third Article IV consultation discussions with Iraq since 2003**. At the time of the 2007 Article IV discussions, Directors commended the Iraqi authorities for strengthening economic policies and making progress in structural reforms, despite an unsettled political situation and a very difficult security environment. They noted, however, that the expansion of oil production was lagging, and that inflation, while on a downward path, remained high. The 2009 Article IV consultation discussions took place in a still fragile but more stable environment.

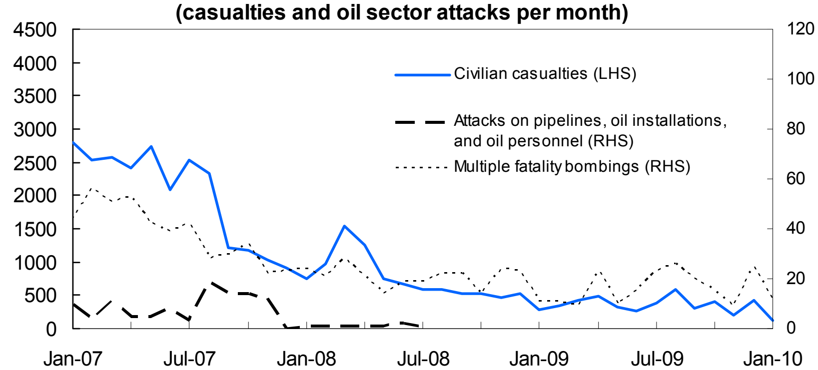
II. Recent Political and Economic Developments

A. Political and Security Situation

8. **Parliamentary elections are scheduled for early March 2010**. These follow the first parliamentary and provincial elections successfully held in January 2006 and January 2009, respectively. While the elections could result in a change of government, the main orientation of economic policies is not expected to change.

9. **Security has improved significantly over the past year, but the recent resurgence of violence shows that the situation remains fragile**. The authorities are strengthening security arrangements after deadly attacks against citizens and government offices. The recent resurgence of hostilities followed the withdrawal of U.S. forces from the cities, but the upcoming elections also appear to explain in part the increase in violence.

Figure 1. Violence Indicators; January 2007–January 2010 (casualties and oil sector attacks per month)



Sources: Iraq Pipeline Watch, Iraq Body Count, and Brookings Institution.

B. Recent Economic Developments

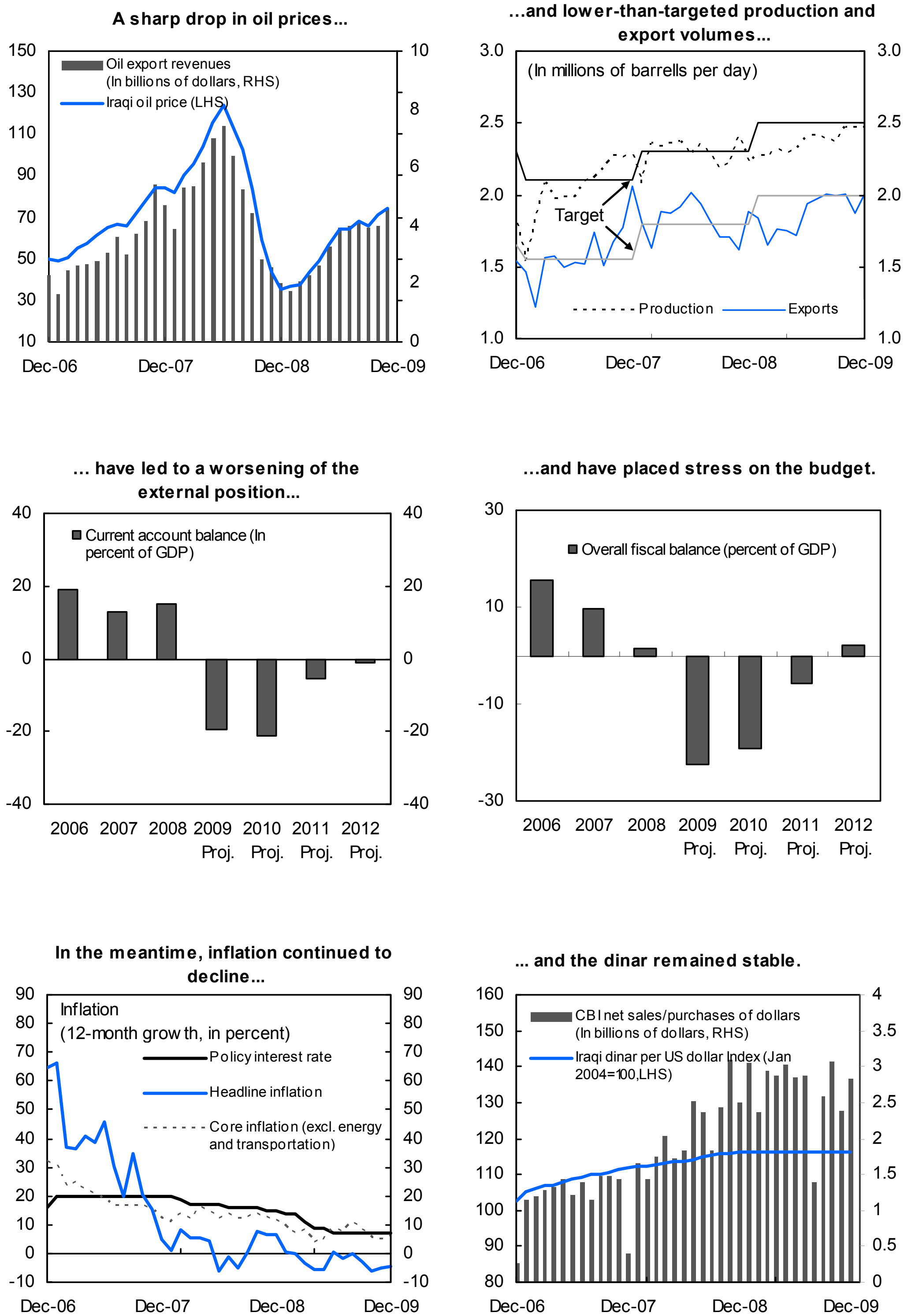
10. **Iraq's economic performance was strong in 2008 aided by record oil prices and improved security**. Oil production rose to 2.3 million barrels per day (mbpd), the highest level since 2003, compared to 2.0 mbpd in 2007. Crude exports reached 1.8 mbpd, compared to 1.6 mbpd in 2007. As a result, real GDP is estimated to have grown by almost 10 percent in 2008, up from 1½ percent in 2007. With the increase in oil export volumes and record-high oil prices, crude oil export receipts reached $61 billion in 2008—65 percent higher than in 2007—and the current account recorded a surplus of 15 percent of GDP.

11. **The government budget registered a lower-than-expected surplus of 1¾ percent of GDP in 2008**. This reflected a significant increase in government spending that more than absorbed the higher-than-budgeted revenues. In particular, a large wage increase was granted to compensate for the erosion of real wages that had occurred during previous years. Current spending rose by 40 percent, with the civil service wage bill and transfers (including those to safety net programs and state-owned enterprises) expanding by about 70 percent. Capital spending rose by 140 percent due to the adoption of a supplementary mid-year budget and a marked improvement in the rate of execution, which increased to over 90 percent of the budgeted amounts.

12. **Performance in 2009 was seriously affected by the drop in oil prices from their peak levels in 2008**. The Iraqi export price fell from a high of $124 per barrel in mid-2008 to a low of $35 per barrel in early 2009, before picking up to around $68 per barrel in the second half of 2009. The average export price in 2009 was $57 per barrel, well below the 2008 average of $92 per barrel. In addition, the volume of oil exports fell below 2008 levels in the first half of the year due to insufficient investment in the sector. With oil exports averaging 1.88 mbpd (compared to an original target of 2 mbpd), oil export receipts amounted to only $39 billion in 2009.

13. **Against this background, economic growth slowed and Iraq's external position deteriorated**. Growth is estimated to have more than halved, to 4 percent in 2009, even though oil production improved towards the end of the year owing to efforts to address bottlenecks. As crude oil exports account for more than 95 percent of Iraq's total exports, the external current account and the overall balance of payments shifted into large deficits in 2009, estimated at about 20 percent and 10 percent of GDP, respectively. The CBI's international reserves declined by $6 billion, to about $44 billion at end-December 2009, a drop of 12 percent. Nominal GDP is estimated to have declined by almost 25 percent in 2009, a much more pronounced drop than originally expected.

Figure 2. Iraq: Macroeconomic Indicators



Sources: Iraqi authorities and Fund staff estimates.

14. **The decline in oil export revenues also put substantial pressure on the government finances in 2009**. Receipts from crude oil exports account for the bulk of total government revenues (almost 90 percent in 2008). Although in 2009 the government tried to contain current spending, these efforts were complicated by the large carry-over effect of the 2008 wage increase and by the need to cover additional security outlays, as the role of Iraqi forces in providing security has been steadily expanding. As a result, and aggravated by the bombings of the Ministry of Finance in August and December that temporarily reduced administrative capacity, investment appears to have borne the brunt of these exogenous shocks. Preliminary data suggest that capital spending was reduced by almost one-third in 2009 relative to 2008, despite the urgent need to improve the delivery of basic public services (including the supply of electricity and water) and address oil infrastructure bottlenecks. Even with the compression of capital spending, however, the budget is estimated to have shifted into a very large deficit of almost 23 percent of GDP in 2009.

15. **Financial savings accumulated in previous years, together with substantial domestic financing, enabled the government to finance the large 2009 budget deficit**. By the end of 2008, the government had built up financial buffers in the DFI and its accounts with the CBI, totaling $21 billion (about one quarter of 2008 GDP).[2] These buffers were run down to just over $10 billion by the end of 2009, despite the mobilization of $3.4 billion in Treasury bills.

16. **Inflationary pressures have eased significantly**. Twelve-month headline inflation declined to 6.8 percent at end-2008 despite that year's fiscal stimulus and prices fell by 4½ percent during 2009, mainly reflecting the drop in fuel prices. Core inflation (excluding energy and transportation) slowed to 6 percent at end-2009, from 12 percent at end-2008.

17. **With the easing of inflationary pressures, monetary and exchange rate policies have been relaxed**. The CBI gradually reduced the policy interest rate to 7 percent in May 2009. The CBI also moved from a policy of allowing the Iraqi dinar to gradually appreciate—the dinar strengthened by 20 percent vis-à-vis the U.S. dollar from end 2006 to end 2008—to one aimed at keeping a stable exchange rate. Since January 2009, the value of the dinar has remained stable at ID 1,170 per U.S. dollar.

18. **The overall performance under the previous SBA that ended in March 18, 2009 was generally good, but two quantitative performance criteria for end-December 2008 were not observed**. Specifically, the performance criterion on the central government fiscal balance was missed (a surplus of ID 1.8 trillion compared to the programmed surplus of ID 3.2 trillion), reflecting mainly a much higher-than-projected execution of the capital

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[2] This excludes the amounts in the Foreign Military Sales (FMS) sub-account of the DFI, which are encumbered for settlement of purchases of military equipment upon delivery.

budget in 2008. The performance criterion on the wages and pensions paid to civil servants was also missed by ID 0.001 trillion. All structural performance criteria were observed, but several structural benchmarks were met with delays, and four have yet to be completed.[3] Box 1 provides a summary of Iraq's key structural reform achievements since 2003.

Box 1. Key Structural Reform Achievements since 2003

Central banking

- Adoption of a new central bank law providing for the independence and accountability of the Central Bank of Iraq (CBI) and prohibiting direct lending to the government.
- Annual external audits of the CBI's accounts, including verification of international reserves.
- Adoption of a full set of prudential requirements for commercial banks.
- Adoption of management guidelines to strengthen the management of international reserves by diversifying currency composition, establishing appropriate duration and credit risk limits, and building capacity for risk analysis.

Banking sector

- Completion of operational and financial audits of the two major state-owned banks, and adoption of a banking sector reform strategy.

Public Financial Management

- Increase of domestic fuel prices and elimination of direct fuel subsidies, and reduction of the size of indirect subsidies (from 10½ percent of GDP in 2006 to 1½ percent of GDP in 2009).
- Adoption of a Financial Management Law and Public Debt Law establishing a comprehensive framework for fiscal policy and allowing issuance of debt securities to finance the budget.
- Submission for audits of completed annual fiscal accounts to the Council of Representatives and the Board of Supreme Audit for the years 2004-2006.
- Adoption of detailed budget classification and chart of accounts in line with the IMF's Government Financial Statistics Manual (GFSM) 2001, within a cash accounting framework.
- Adoption of a PFM action plan covering budget preparation, public procurement, and fiscal reporting.

Oil sector transparency

- Establishment of a single account for oil export proceeds that is externally audited.
- Near completion of oil export metering.
- Publication of all data related to oil exports.

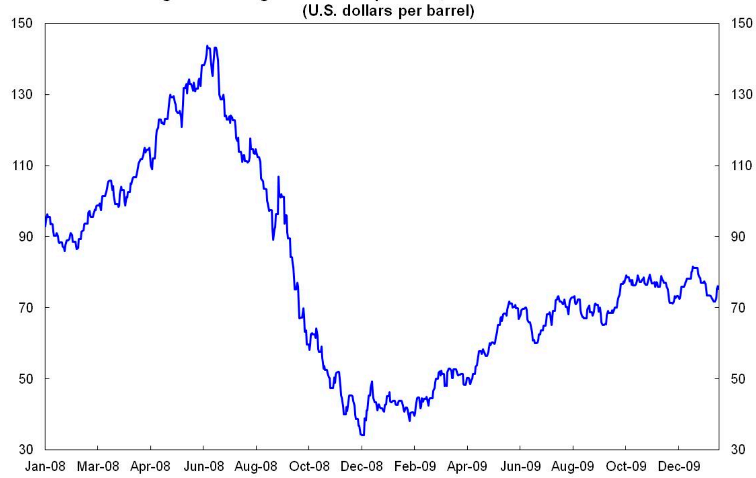
[3] The latter includes the completion of the census of all public service employees, the development of a periodic adjustment mechanism for fuel prices, completion of the new CPI series incorporating new weights resulting from the 2007 household survey, and regular reconciliation in the CBI accounts of local banks' current accounts, intra-branch accounts, and suspense accounts.

III. The Authorities' Program for 2010–11

A. Overall Outlook and Program Objectives

19. **Iraq's economic outlook is strongly influenced by oil price movements and changes in oil production**. Oil prices have been very volatile by historical standards over the last two years and projections are subject to a large degree of uncertainty. International oil prices are expected to increase in the coming years as the global economy recovers, although they are unlikely to return to the record levels of mid-2008. At the same time, oil production is projected to steadily increase over the medium term as domestic and foreign investment in the sector starts to bear fruit. As a result, Iraq's longer-term economic outlook remains strong, provided that security continues to improve.

Figure 3. Average Petroleum Spot Price, Jan. 1 2008–Feb. 4 2010
(U.S. dollars per barrel)



Sources: Bloomberg and Fund staff estimates.

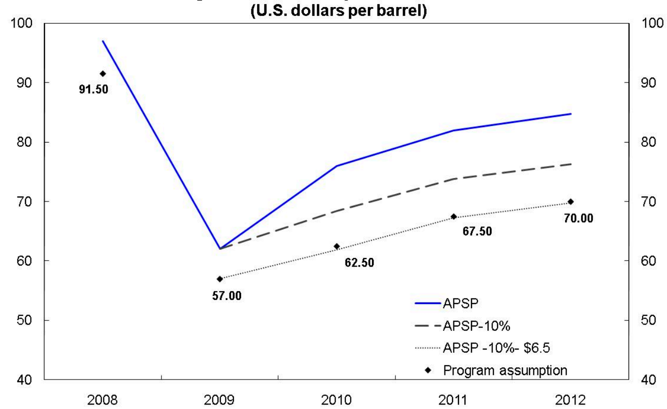
Box 2. Oil Sector Outlook

Iraq is estimated to have at least 115 billion barrels of proven petroleum reserves, the third largest in the world. Over the last 30 years, Iraq's oil production and exports have been badly affected by the war with Iran (1980-88), the first Gulf war (1990–91), subsequent sanctions, and the 2003 conflict. Oil production was 3.5 mbpd before the first Gulf war, but fell to below 1.5 mbpd in 2003, before recovering to 2.4 mbpd in 2009.

The medium term outlook for the oil sector is promising, with ten new contracts recently signed with international oil companies following bid rounds in mid and late 2009. The contracts aim to increase the output of existing fields and develop new fields. Based on these contracts, Iraqi oil production could gradually increase to as much as 7 mbpd by 2016–17 and to over 10 mbpd in later years. Some very large fields were awarded, including Rumaila with an estimated 17 billion barrels in reserves and to be developed by a consortium including British Petroleum and China National Petroleum Corporation; Majnoon, with 12½ billion barrels and to be developed by Shell and Petronas; West Qurna-1, with 8¾ billion barrels and to be developed by Exxon Mobil and Shell; and West Qurna-2, with almost 13 billion barrels and to be developed by Lukoil and Statoil.

20. **The external current account and the overall balance of payments, however, are expected to remain in deficit in 2010 and 2011**. As in previous programs, projections for 2010 and beyond are based on a conservative price assumption for Iraqi oil—$62.5 per barrel in 2010 and $67.5 per barrel in 2011—based on WEO prices discounted by an uncertainty margin of 10 percent and by the quality differential between Iraqi oil and the WEO basket. Iraq's oil exports are projected to increase to 2.1 mbpd in 2010 and to 2.25 mbpd in 2011, although technical and security problems pose significant downside risks. Based on these assumptions, Iraq is expected to have a financing gap of about $5 billion through end-2011. Similarly, Iraq's fiscal position is projected to record large, albeit declining deficits in both years. Financing these deficits, even after mobilizing substantial domestic financing, could exhaust the government's remaining financial balances and result in the accumulation of arrears.

Figure 4. Oil Price Projections, 2008–12 1/
(U.S. dollars per barrel)



Sources: Iraqi authorities and Fund staff estimates.
1/ Projected prices in macroframework, as marked.

21. **To address this situation, the authorities have designed an economic program for the period through end-2011**. The authorities view the new program primarily as a way to provide a sound macroeconomic framework during the upcoming period of political transition, while supporting the government's efforts to address the country's large rehabilitation needs and improve public service delivery—a prerequisite to consolidating political stability and security improvements. The authorities consider macroeconomic stability—together with security—as critical factors to foster private sector development and generate sustainable employment opportunities.

22. **In addition to preserving macroeconomic stability, the new program will also help the authorities move forward with their structural reform agenda**. With many of the structural reforms still unfinished, the program aims to advance key reforms in the areas of public financial management (PFM) and financial sector development, in close coordination with a Development Policy Loan (DPL) provided by the World Bank. Both operations focus on advancing PFM and bank restructuring action plans prepared by the authorities during 2008 and 2009 with the assistance of Fund and World Bank staff.

23. **The program will provide the authorities with access to Fund financing, if needed**. As noted, oil prices are expected to increase in the coming years, and with the projected increase in oil production, Iraq's financing needs are expected to be temporary in

nature. In fact, oil prices have already been increasing in recent months and may turn out to be higher than projected during the program period. In this regard, the authorities have indicated that they intend to treat the SBA as precautionary if at the time of each program review it becomes evident that oil revenues would increase to levels implying that that there is no longer a financing need. Specifically, provided that Iraq is able to sustain an export level of 2.1 mbpd in 2010, the authorities have indicated their intention to treat the program as precautionary if at the time of the program reviews futures prices for Iraqi oil average $73 per barrel or higher. In the same vein, the authorities would also treat the SBA as precautionary if investment remains significantly below budgeted amounts. While the authorities are working to restore and expand administrative capacity in the wake of the two bombings, including with the assistance of the World Bank, to ensure that the disruptions do not lead to poor quality implementation, investment could again fall short of budgeted amounts if capacity issues cannot be fully addressed. Therefore, the authorities would treat the SBA as precautionary if at the time of the second review the rate of execution of the capital budget for the year as a whole is expected to remain below 93 percent (with the difference between 93 and 100 percent equal to the third disbursement).

Box 3. Poverty and Social Development

Poverty is relatively high in Iraq, and while poverty is relatively shallow, many Iraqis are vulnerable to falling below the poverty line. According to Iraq's National Strategy for Poverty Reduction and the World Bank, Iraq has an estimated poverty headcount of almost 23 percent (based on the 2006/07 Household Socio-Economic Survey), but the poverty gap—measured as the gap between the poor's average incomes and the poverty line—is only 4½ percent. Thus, a relatively small increase in people's incomes could lift most of the poor above the poverty line. At the same time, however, a large proportion of the non-poor hovers just above the poverty line, implying that a relatively minor deterioration of economic conditions would substantially increase poverty rates. Meanwhile, the delivery of basic public services, including water and electricity, remains unreliable, while access to medical services and education is limited, especially for the poor.

Almost half of total household income is provided in one way or another by the government. According to the 2006/07 Household Socio-Economic Survey, about 30 percent of all household income comes from public sector employment. An additional 15 percent comes from government transfers including pensions, in-kind transfers through the Public Distribution System, and cash transfers.

Iraq has the lowest employment to population ratio in the region. Out of every 100 Iraqi adults, slightly over one-third (38 percent) is employed, while 5 percent is officially unemployed (available and seeking work). The majority (57 percent) is not in the labor force. The labor force participation of women is especially low, at just over 10 percent.

Refugees have slowly started returning home as security improves, but displacement remains a concern. The United Nations High Commissioner for Refugees estimates that more than 4.7 million Iraqis have left their homes as a result of the recent conflicts. Of these, 2.7 million Iraqis are displaced internally, while about 2 million have sought refuge in countries such as Syria and Jordan.

24. **The program will safeguard central bank independence**. The central bank law prohibits the CBI from financing the budget, and changing the law at this juncture would undermine the hard-won gains made in achieving low inflation and a strong currency. Consequently, the authorities strongly believe in the importance of safeguarding central bank independence and, if the need materializes, intend to use the domestic counterpart of the Fund's support to finance the budget deficit. This would allow for a larger budget deficit than could otherwise be financed from domestic and external resources, avoiding having to compress government spending at a time when the country's rehabilitation needs are high, poverty and unemployment are widespread, and the security situation remains very fragile. It would also allow the government to maintain financial buffers (equivalent to two months of its wage bill) to absorb further shocks.

B. Medium-Term Macroeconomic Framework

25. **With oil production and prices expected to increase over the medium term, economic indicators would improve steadily**:

- Economic growth is projected to accelerate to 7–8 percent a year in the coming years as oil production increases gradually from 2.4 mbpd in 2009 to 2.6 mbpd in 2010, and to 3.1 mbpd in 2012.

- Combined with higher oil prices, this will result in a steady narrowing of the current account deficit. Oil exports are projected to rise from 1.88 mbpd in 2009 to 2.1 mbpd in 2010 and further to 2.5 mbpd in 2012, with the current account deficit declining to 5½ percent of GDP in 2011, and moving back into surplus in 2014.

- While Iraq's overall international reserves (including balances in the DFI) would still fall in 2010, they are projected to stabilize in the following years at a level equivalent to about 7 months of imports, before starting to improve in 2014.

- Following the containment of government current spending and a pick-up in capital spending in 2010–11, the budget would move back into surplus in 2012, and would remain in a sustainable position over the medium-term.

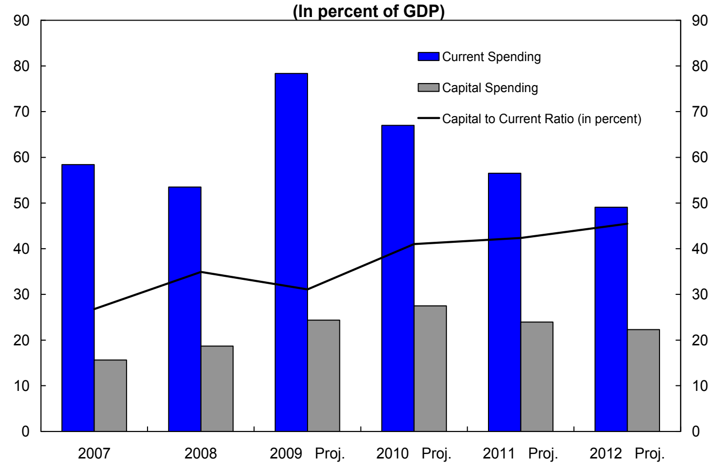
- With appropriate monetary and exchange rate policies, headline inflation is projected to remain low at around 5–6 percent a year in the coming years.

- Iraq's external debt position would also reach a sustainable position provided that further progress is made in concluding agreements with non-Paris Club creditors (see the attached debt sustainability analysis).

C. Fiscal Policy

26. **As noted above, a key element of the authorities' policies is to contain current government spending over the coming period in order to gradually reduce the deficit and make room for investment**. Current spending is set to increase slightly in 2010 and would be kept broadly unchanged in nominal terms thereafter (a performance criterion under the program). This will require some reduction in non-priority expenditures, as the 2010 budget needs to cover the full-year cost of the additional security outlays resulting from the withdrawal of U.S. forces, such as wage payments for tribal militias, purchases of additional military equipment, and maintenance of equipment provided by the U.S. forces. By allowing only a small increase in 2010 and keeping it broadly constant in 2011, current spending will fall from 78 percent of GDP in 2009 to 67 percent in 2010 and 57 percent in 2011. Specifically, the authorities will:

Figure 5. Government Spending, 2007–12
(In percent of GDP)



Sources: Iraqi authorities and Fund staff estimates.

- Contain the wage bill by refraining from raising wages and limiting hiring—besides the tribal militias that are being put on the payroll as part of the security agreement—to new teachers and doctors (MEFP ¶12).

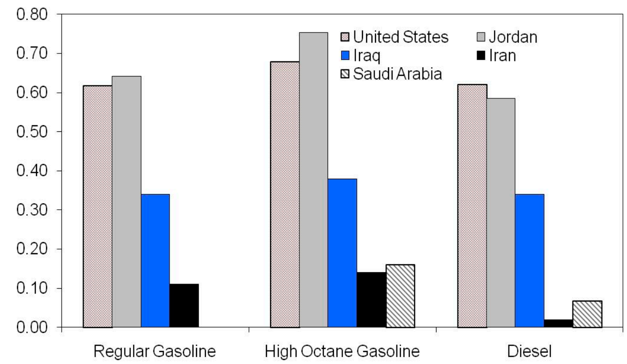
- Complete the census of government civil servants (MEFP ¶15). To overcome delays related to problems in accessing information from the security sector, the scope of the census has been narrowed. Completion of the census for civil servants will allow for the elimination of ghost workers from the payroll and pave the way for an automated human resource database and payroll system.

- Improve the targeting of social spending. While the in-kind Public Distribution System (PDS) reaches nearly all poor Iraqis, in its current form it is an inefficient generalized benefit that distorts private sector activity. As a first step, high-income earners will be excluded from the PDS, and the number and volume of goods distributed through this system will be reduced (MEFP ¶12). The authorities are working with the World Bank and the World Food Program on further developing a well-targeted cash-based safety net that would replace the PDS over time.

- Reduce transfers to state-owned enterprises, which should either gradually become financially viable or be closed (MEFP ¶12).

- Avoid the reemergence of direct fuel subsidies. Fuel prices in Iraq compare favorably relative to those in the region. The authorities are determined not to reverse the gains made in market pricing of fuel products under the previous SBAs (MEFP ¶17). They are also planning to gradually reduce indirect subsidies (estimated at now about 1½ percent of GDP). In this regard, the authorities will continue to work on developing an automatic adjustment mechanism for domestic fuel prices.

Figure 6. Fuel Prices in Selected Countries, Quarter 2, 2009 1/
(In dollars per liter)



Source: Country authorities.
1/ No regular gasoline price for Saudi Arabia.

27. **A substantial recovery in capital spending is envisaged for 2010**. Following the early approval of the 2010 budget by parliament and based on the efforts underway to rebuild and strengthen administrative capacity in the Ministry of Finance, the authorities aim to fully execute this year's capital budget. Investment will focus on improving the delivery of key public services, including electricity, water, health, and education, and on further rehabilitating and expanding the oil sector infrastructure. The latter is urgently needed to ensure an increase in production and export volumes, and is therefore critical to Iraq's medium-term fiscal sustainability. The level of investment in 2010, however, would still remain below the high level recorded in 2008.

28. **With these policies, the budget deficit would decline moderately to 19 percent of GDP in 2010, before falling markedly to 6 percent in 2011, and moving back into surplus in 2012 as oil revenues increase**. In the event that oil revenues are higher than budgeted, half of the additional revenues (up to a specified limit) could be used for further investment. The remaining half would be used to build up buffers in the DFI. If oil revenues are less than budgeted, the authorities will reduce spending and aim to mobilize additional (external) financing. The 2010 deficit will be financed by a further drawing down of government balances in the DFI and the CBI, a significant amount of domestic financing, and external support, including from the Fund. The authorities also intend to use the SDR allocation, equivalent to $1.7 billion, to finance the budget deficit. With regard to domestic financing, the authorities plan to further develop the Treasury bill market by improving the auction process with the assistance of the US Treasury and the Fund. This would enable the government to attract deposits currently held by commercial banks with the CBI and would contribute to the development of a secondary market. The authorities will also start preparations for the introduction of a sales tax with the purpose of broadening the revenue base over the medium-term.

Iraq: Government Finances 2008-12

	2008 Est.	2009 Est.	2010 Proj.	2011 Proj.	2012 Proj.
	(In trillions of Iraqi dinars)				
Total revenues and grants	87.0	58.9	70.8	81.2	91.3
o/w Crude oil export revenues	73.9	45.5	56.1	64.9	74.7
Total expenditures	85.2	76.3	88.7	87.4	88.6
Current expenditures	58.3	60.4	62.9	61.4	60.9
Capital expenditures	27.0	18.8	25.8	26.0	27.7
Statistical discrepancy/returned LCs	…	-2.8	…	…	…
Balance	1.8	-17.4	-17.9	-6.2	2.7
In percent of GDP	*1.7*	*-22.6*	*-19.1*	*-5.7*	*2.2*
Financing	…	17.4	14.0	4.4	…
Use of DFI	…	0.4	8.7	0.0	…
Net external (incl. SDR allocation)	…	-0.3	3.0	0.9	…
MoF deposits with CBI	…	12.1	0.0	0.0	…
Other domestic bank financing	…	1.2	-1.2	0.0	…
Treasury bills	…	4.0	3.5	3.5	…
Financing gap	…	0.0	3.9	1.8	…
Memorandum items:					
Balance in DFI (excl. FMS)	12.1	11.7	3.0	3.0	…
MoF deposits with CBI (end of period)	13.1	1.0	1.0	1.0	…
Iraqi oil export price ($pb)	91.5	57.0	62.5	67.5	70.0
Crude oil exports (mbpd)	1.82	1.88	2.10	2.25	2.50

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

D. Fiscal Structural Policies

29. **Improving public financial management is another key objective of the authorities' program** (MEFP ¶14). In October 2008, a three-year action plan was adopted under the World Bank PFM project that identified priority measures in the areas of budget preparation, reporting and cash management, public procurement, internal audit and control systems, and the accounting framework. Specifically:

- To improve budget preparation, the authorities are moving towards introducing a medium-term budget framework. As part of this, clear priorities and ceilings in line with a sustainable medium-term budget strategy will be included in the budget circular for the preparation of the 2011 budget;

- In the area of reporting and cash management, spending units will be required to submit comprehensive spending reports to enable the Ministry of Finance to better track implementation and strengthen cash management. In addition, the functionality of Iraq's Financial Management Information System (IFMIS), which was developed with assistance from USAID, will be reviewed to ensure that it is consistent with the original objective of establishing an internal commitment control mechanism and a system that can automatically produce regular comprehensive reports;

- To ensure transparency, the authorities will continue to submit in a timely manner the final fiscal accounts for each year to the Supreme Board of Audit and the Council of Representatives;

- The accounting systems and practices will be reviewed to strengthen the internal audit and control systems. Specifically, performance audits examining the process of selection, procurement, and management of the largest capital projects will be undertaken to evaluate the quality of investment spending. In addition, a review of the outstanding stock of advances will be carried out to strengthen discipline in this area. Also, a new procurement framework will be put in place with the assistance of the World Bank.

30. **The authorities also remain committed to continuing the process of creating a transparent and accountable oil sector in Iraq. In this regard, they will**:

- Maintain a single account for all oil export proceeds (MEFP ¶18). In December 2009, the UN Security Council extended the DFI for another year, but requested the authorities to prepare for transitioning to another mechanism. The authorities will maintain a single oil export revenue account, which will continue to be subject to the same principles that currently apply to the DFI, including audits by a reputable external auditor and oversight by the independent Iraqi Committee of Financial Experts (COFE), which would take over the role currently performed by the IAMB;

- Complete the process of becoming a candidate country for membership in the Extractive Industry Transparency Initiative (EITI) (MEFP ¶19). The authorities already publish full information with regard to all crude oil export receipts;

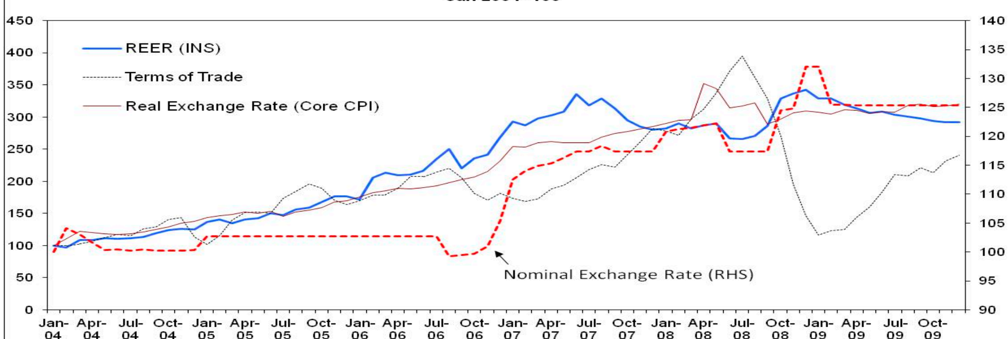
- Complete the installation of domestic metering systems to allow accurate measurement of all domestic fuel flows (MEFP ¶20). The metering of export terminals and pipelines has been almost completed. Completion of the domestic metering system will enable the full reconciliation of domestic flows of oil and oil products with the financial flows between the state-owned oil companies and the budget. In this regard, the World Bank plans to conduct a streamlined public expenditure review in Iraq covering key ministries, including the ministry of oil.

E. Monetary and Exchange Rate Policies

31. **The CBI intends to maintain its present monetary and exchange rate policies, which are aimed at keeping inflation in the single digits and further reducing dollarization**. In the absence of an effective monetary transmission mechanism, the exchange rate remains the CBI's main policy instrument. Up until late 2008, the CBI had allowed the dinar to appreciate gradually to bring down core inflation to near single digit levels. Once inflation was brought under control, the CBI returned to its earlier policy of maintaining a stable dinar, as it had been specified in the last SBA. The CBI also intends to keep the policy interest rate positive in real terms (as measured by core inflation).

32. **The lack of data and large structural changes in the Iraqi economy preclude any meaningful estimation of the equilibrium real exchange rate**. A very crude assessment suggests that the dinar is broadly in line with fundamentals.[4] With the drop in oil prices, it appears that a possible prior undervaluation has disappeared, and that the dinar could even be somewhat overvalued. The relative low levels of headline and core inflation, however, do not suggest any significant deviation from the equilibrium real effective exchange rate. Moreover, as oil revenues are expected to rise substantially over the medium- to longer term, the equilibrium real exchange rate is likely to rise as well. More importantly, a nominal depreciation could undermine confidence in the dinar, destabilize expectations, lead to increased dollarization, and reignite inflation, reversing the hard-won gains made in recent years. The CBI therefore intends to continue to keep the exchange rate stable, but will consult with staff if its reserves were to fall significantly below the program targets.

Figure 7. Iraq: External Indicators, January 2004–December 2009
Jan 2004=100



Sources: Iraqi authorities, Fund staff and INS estimates.

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[4] Rough estimates based on the external sustainability approach aimed at determining the current account balance that would stabilize the country's net foreign asset position relative to GDP suggest that the real effective exchange rate is broadly in line with the equilibrium real exchange rate. The current account norm for 2014 was estimated at a surplus of 2.9 percent of GDP. Under current projections, the current account surplus is expected to be only marginally lower than the norm in 2014.

33. **The authorities are committed to a liberal exchange regime and to removing all restrictions under Fund jurisdiction**. Iraq has a generally unrestricted current account regime and a significantly liberalized capital account. However, four measures have been identified to give rise to exchange restrictions subject to Fund approval. Three relate to a requirement to pay all obligations and debts to the government before relevant payments are transferred abroad, and one to an inoperative bilateral payments agreement with Jordan. The authorities are considering measures to remove the identified restrictions, with a view to accepting Article VIII of the Fund's Articles of Agreement, but it may take time to resolve the last restriction because of the pending resolution of Iraq's debts to Jordan.

F. Financial Sector Reforms

34. **Financial sector development will be important for facilitating private sector activities**. The level of financial intermediation in Iraq remains very low because the banking system is still weak. Broad money was equivalent to 35 percent of GDP at end-2008, while credit to the economy was only 4 percent of GDP. The banking system is dominated by two state-owned banks, Rafidain and Rasheed, which account for 90 percent of total assets. Besides four other small state-owned banks, there are 23 small private banks that service only a small number of trusted clients. Capital markets, besides government securities, are almost nonexistent.

35. **The authorities adopted a banking sector reform program in early 2009**. This program was developed with the support of the World Bank, in coordination with other providers of technical assistance, including the Fund. A key element of the reform program is the operational and financial restructuring of the two largest banks, Rafidain and Rasheed (MEFP ¶22). Operational and financial audits of these two banks were completed by an independent auditor in 2008. Their operational restructuring envisages a new organizational structure, including the establishment of business units (retail, corporate and investment banking); risk management units; and governance, control and support units. The financial restructuring will first involve cleaning up the banks' balance sheets and removing the legacy of bad debts and suspense accounts and working out the fiscal implications. During a second phase, the banks' capital will be brought up to the required levels.

36. **The CBI is further developing its institutional capacity**. The CBI's reserve management practices are being brought in line with the reserve management guidelines adopted in mid-2008, but further training and better reporting are still required (MEFP ¶25). The CBI also completed the set of prudential regulations for commercial banks, and work on the relevant reporting tables for banks is expected to be finalized soon. A full assessment of the banking supervision department at the CBI that is currently underway with foreign assistance should provide a roadmap for further improvement (MEFP ¶23). The accounting

and reporting framework, and the internal audit function of the CBI, will also be strengthened as a control committee appointed by the CBI is developing control procedures and manuals with the assistance of external advisors (MEFP ¶24). To make sure that these reforms move forward at the same time, the CBI is seeking resident advisors with international experience in a broad range of areas such as IT, banking supervision, and reserve management. Finally, commercial banks have been instructed to conform their accounting norms to International Financial Reporting Standards (IFRS), and to prepare a set of financial soundness indicators that could be used by the CBI to monitor sectoral developments (MEFP ¶23).

G. Statistics

37. **The authorities have continued to improve Iraq's statistical database, but further efforts are needed**. Monetary and balance of payments data are now being published in the IMF's *International Financial Statistics* regularly, annual national accounts data have been compiled up to 2007, and the quality of the national accounts has improved in the last year. In addition, a new CPI using the latest household expenditure survey is being rolled out. The authorities have begun participating in the GDDS as of December 15, 2009, a major step forward in the development of Iraq's statistical system. Comprehensive information on Iraq's statistical production and dissemination practices now appears on the IMF's Dissemination Standards Bulletin Board. While the coverage of fiscal statistics has improved, the information is still subject to considerable delays.

IV. Program Modalities

A. Program Access, Duration, Phasing, and Monitoring

38. **Proposed access under the new SBA is 200 percent of quota (SDR 2,376.8 million or $3.7 billion)**. As noted above, this would cover part of the financing gap estimated at about $5 billion in 2010–11. The World Bank is expected to provide a total of $0.5 billion in two tranches in 2010, while bilateral donors are expected to provide some small amounts in 2011. The new program's proposed duration of two years would cover the period for which financing gaps are projected. The program would also allow the authorities to make significant headway in implementing the structural reform agenda, given capacity and security constraints.

39. **The bulk of the financing needs, if they materialize, would arise in 2010**. While the first disbursement upon Board approval would be equal to 25 percent of quota, larger disbursements would follow the completion of the first and second program reviews (40 percent and 90 percent of quota, respectively) if there is a financing need. With this, and the Bank's disbursement of $0.5 billion, the first year of the program would be fully financed. The remaining amount equivalent to 45 percent of quota would be disbursed in 2011.

40. **The program will be subject to two reviews each year, with end-March 2010 being the first test-date**. Performance criteria have been set for: (i) the central government budget balance; (ii) central government current spending; (iii) the DFI balance (floor); (iv) direct fuel subsidies (a zero ceiling); (v) new nonconcessional external debt; (vi) external arrears (a zero ceiling on new and rescheduled debt); (vii) the CBI's net international reserves; and (viii) the CBI's net domestic assets.

41. **The structural conditionality reflects the program's strong emphasis on improving the management of public resources, bank restructuring, and program safeguards**. The rationale behind the benchmarks in the areas of public financial management and oil sector transparency stems from the need to improve the allocation, execution, transparency, and accountability in the mobilization and use of public resources, including Iraq's natural resources. The financial restructuring of the two state-owned banks is crucial to allow these banks to become viable institutions. Benchmarks related to the CBI and its relationship with the Ministry of Finance are essential to strengthen safeguards over Fund resources (see below).

B. Risks, Safeguards, and Capacity to Repay the Fund

42. **The provision of Fund resources directly to the Iraqi budget involves considerable risks**. A first risk relates to the capacity to repay the Fund. The security situation could deteriorate, in which case oil production could be adversely affected. Also, the proposed partnerships with foreign companies could hit obstacles before implementation and oil production may not increase as projected. A second risk is posed by fiscal governance, given the many weaknesses still present in Iraq's public financial management system. A third risk is the possibility of policy slippages, particularly with regard to containing current government spending.

43. **Iraq's capacity to repay the Fund looks adequate**. Foreign exchange earnings from oil exports are expected to increase substantially over the medium and long term as existing fields are rehabilitated and new fields come into production, provided that security improves. Even taking into account possible delays, this is expected to put the government finances on a sustainable footing. Moreover, the CBI's reserve position is expected to remain relatively strong over the medium term, and the program includes a floor under the government's balance in the DFI. At the same time, Iraq's external debt outlook has improved substantially with the final round of debt relief granted by Paris Club creditors last year, and the authorities are seeking to reach agreements with remaining non-Paris Club creditors. Several key creditors (China, United Arab Emirates) have already indicated their willingness to

reschedule on comparable (or better) terms, but the agreements have yet to be finalized. Once agreements with non-Paris Club creditors are secured, Iraq's external debt would reach a sustainable level.

44. **In addition to the heavy emphasis on strengthening public financial management, which would help mitigate fiduciary risks, the program includes a number of measures to strengthen safeguards over Fund resources**. While the obligation to repay the Fund is with the member, the Ministry of Finance and the CBI have agreed on a memorandum of understanding (MOU) clarifying responsibilities (a prior action under the program). Specifically, under the MOU Fund resources for budget support will be disbursed into a treasury account with the CBI. Further, the Ministry of Finance would assume responsibility for servicing the debt to the Fund and ensuring that sufficient funds are available in its accounts with the CBI to meet these obligations.

45. **An update safeguards assessment of the CBI is underway**. The assessment will also focus on the procedures governing the government's treasury accounts with the CBI. An internationally reputable external auditor has already completed a special audit of the CBI's international reserves as of June 30, 2009 (a prior action under the program). The external auditor is expected to complete the full audit of the 2008 CBI accounts in the coming weeks, which will be a key input for the update safeguards assessment. An external auditor will also be appointed shortly to conduct the audit of the 2009 CBI accounts (another prior action). To better safeguard the Fund going forward, the scope of the special audits will be expanded to cover, for all program test dates, CBI data reported to the Fund and the procedures in place over the government accounts at the CBI.

46. **The risk of policy slippages is mitigated by the authorities' commitment to the program**. As noted, the authorities view the program as providing an essential framework to help maintain discipline during a period of large uncertainties. In addition, the recent approval by parliament of a 2010 government budget consistent with the program's objectives provides further assurances that macroeconomic policies will be kept on track.

47. **Another risk relates to the limited administrative capacity of the government and the central bank**. While the institutional capacity of the Ministry of Finance and the CBI has been strengthened in recent years, further improvements are needed. Companion technical assistance projects to help build capacity will continue over the coming years, with support from several organizations. In this context, given that the resources remaining in the Fund's technical assistance subaccount for Iraq are nearly depleted, staff will prepare a request for additional resources to ensure that Iraq's large technical assistance needs continue to be met.

V. Staff Appraisal

48. **Iraq has continued to make progress in rebuilding its economy and achieving macroeconomic stability under very difficult security and political circumstances**. During the last Fund-supported program, inflation was successfully brought down into single digits, the international reserves position was further strengthened, and the CBI's institutional capacity was strengthened. Moreover, with the reduction in violence, the prospects for an increase in oil production and non-oil activity have improved.

49. **Nevertheless, Iraq still faces major challenges, which were exacerbated by the fall in oil prices in 2009**. With both the balance of payments and the government budget heavily dependent on oil revenues, the lower oil receipts have created balance of payments and fiscal gaps, which so far the authorities have been able to cover through the financial buffers built up in previous years. As oil prices and production are projected to increase, these financing gaps are expected to be temporary.

50. **The authorities' economic program for 2010–11 is well focused on maintaining macroeconomic stability and advancing the unfinished reform agenda**. The program will provide an anchor for economic policy during a period of economic and political uncertainties. Also, it will ensure that no time will be lost during the period of political transition after the elections in improving infrastructure and public service delivery and implementing critical reforms to strengthen fiscal governance, enhance oil sector transparency, and develop a financial sector capable of providing essential services.

51. **The program is based on conservative oil price assumptions, which have been incorporated in the budget**. This is appropriate taking into account that over the last two years oil prices have been very volatile and that projections are subject to a high degree of uncertainty. Oil export volumes, however, may be affected by technical or security problems.

52. **At the same time, staff welcomes the authorities' intention to treat the new SBA as precautionary if oil prices continue to rise or the investment budget is significantly underexecuted**. Oil prices have been increasing in recent months and may turn out to be higher than projected during the program period, which may eventually eliminate Iraq's balance of payments need. Similarly, capacity constraints may continue to limit investment spending. In the same vein, staff supports the authorities' commitment to adjust spending and seek additional financing should oil prices turn out lower than envisaged.

53. **The authorities will need to firmly contain current spending, in particular the government wage bill, and streamline transfers**. This would enable the government to increase investment and improve public service delivery, which are critical to ensure social and economic stability. As oil revenues increase, however, the authorities should also seek to rebuild their financial buffers. In addition, they should continue to base their medium-term budget framework on conservative oil revenue assumptions and press forward with reforms

to broaden the revenue base by introducing a general sales tax, which would make the budget less dependent on oil revenues.

54. **The use of Fund resources to finance the budget deficit (if necessary) would be warranted in light of Iraq's particular circumstances.** Given the fiscal dominance and the very close linkages between the balance of payments and the government budget, using Fund resources to finance the deficit would directly address the country's balance of payments needs. At the same time, given the constraints on other sources of external and domestic financing, the additional fiscal space offered by the use of Fund resources would allow the government to avoid a contraction at a time when rehabilitation needs are still large and unemployment is high. It would also allow the authorities to preserve CBI independence and avoid central bank financing of the government.

55. **Staff supports the CBI's intention to continue to manage the exchange rate with a view to keeping inflation under control**. Although difficult to assess, the exchange rate appears to be broadly in line with fundamentals, taking into account the expected increase in oil production. Moreover, a strong and stable currency provides a solid anchor for the public's expectations. The CBI should continue to keep a close watch on inflation and be ready to raise the policy interest rate if core inflation were to pick up again.

56. **The authorities should continue with their efforts to conclude debt agreements with the remaining official and private creditors**. Several non-Paris Club creditors have already indicated their willingness to provide relief on terms comparable to (or better than) those provided by the Paris Club, and the authorities should seek similar treatment from the remaining non-Paris Club creditors. In this regard, 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 of lending into arrears.

57. **Staff also urges the authorities to move forward with their plans to liberalize the exchange regime by removing the exchange restrictions that fall under Fund jurisdiction**. Specifically, the authorities are encouraged to establish a timetable to remove these restrictions promptly, and to subsequently accept the obligations under Article VIII, Sections 2(a), 3, and 4.

58. **There is a need to further improve the accuracy, coverage, and timeliness of macroeconomic statistics**. Efforts are needed in all areas, and coverage, in particular, should be extended to the Kurdish region.

59. **Despite the large risks and uncertainties, staff supports the authorities' request for a two-year SBA in the amount of SDR 2,376.8 million**. Risks and uncertainties cover a broad range, from an increase in violence that would hamper Iraq's development to constraints in administrative capacity and volatility in oil prices. The new Fund-supported program would provide a sound macroeconomic framework during the political transition and, together with a parallel operation of the World Bank, would advance the authorities' agenda to rebuild and improve economic institutions, thus helping to mitigate some of these risks. Moreover, the authorities have demonstrated their commitment to implement sound macroeconomic policies and difficult structural reforms, and Iraq's capacity to repay the Fund looks adequate.

60. It is proposed that the next Article IV consultation be held according to the provisions applying to countries with Fund arrangements.

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Table 1. Iraq: Selected Economic and Financial Indicators, 2007–12

	2007	2008 Ctry. Rept. 08/383	2008 Est.	2009 Est.	2010	2011 Proj.	2012
Economic growth and prices							
Real GDP (percentage change)	1.5	9.8	9.5	4.2	7.3	7.9	7.6
Non-oil real GDP (percentage change)	-2.0	5.0	5.4	4.0	4.5	5.0	5.5
GDP per capita (US$)	1,926	3,085	2,845	2,108	2,505	2,826	3,156
GDP (in US$ billion)	57.0	93.8	86.5	65.8	80.3	92.8	106.2
Oil production (In mbpd)	2.04	2.3	2.3	2.4	2.6	2.9	3.1
Oil exports (In mbpd)	1.59	1.8	1.8	1.9	2.1	2.3	2.5
Iraq oil export prices (US$ pb)	63.0	93.3	91.5	56.5	62.5	67.5	70.0
Consumer price inflation (percentage change; end of period)	4.7	12.0	6.8	-4.4	6.0	5.0	5.0
Core price inflation (percentage change; end of period)	12.3	...	11.7	6.1	6.0	5.0	5.0
	(In percent of GDP)						
National Accounts							
Gross domestic investment	19.8	21.1	28.1	28.1	31.5	28.7	27.6
Of which: public	15.6	17.3	26.1	24.4	27.5	23.9	22.3
Gross domestic consumption	63.7	61.8	55.2	87.5	85.2	78.9	76.7
Of which: public	41.0	33.4	36.9	56.1	50.2	42.3	36.8
Gross national savings	32.5	36.2	43.2	8.7	10.5	23.3	26.5
Of which: public	25.3	24.6	27.8	-2.6	7.7	17.3	25.7
Saving - Investment balance	12.7	15.1	15.1	-19.4	-21.0	-5.5	-1.1
	(In percent of GDP, unless otherwise indicated)						
Public Finance							
Government revenue and grants	83.7	77.5	84.3	76.5	75.4	74.7	73.5
Government oil revenue	74.0	70.9	77.6	68.0	67.0	66.8	66.1
Government non-oil revenue	4.4	5.0	3.9	5.3	6.6	6.7	6.6
Grants	5.4	1.6	2.8	3.1	1.8	1.3	0.8
Expenditure, *Of which:* 1/	74.0	69.8	82.6	99.0	94.5	80.5	71.4
Current expenditure	57.7	52.3	56.4	78.4	67.0	56.5	49.1
Capital expenditure	15.6	17.3	26.1	24.4	27.5	23.9	22.3
Primary fiscal balance	10.5	8.2	2.2	-21.7	-18.0	-4.4	3.8
Overall fiscal balance (including grants)	9.7	7.8	1.7	-22.6	-19.1	-5.7	2.2
Memorandum items:							
Tax revenue/non-oil GDP (In percent)	4.0	3.1	4.2	3.5	3.0	3.9	4.0
External assets held abroad (Ex. FMS, in US$ billions)	9.9	19.8	10.3	10.0	2.6	2.6	4.7
Total government debt (in US$ billions) 2/	103.1	40.4	95.6	90.2	33.8	34.7	35.0
	(In percent, unless otherwise indicated)						
Monetary Indicators							
Growth in reserve money 3/	73.9	41.2	54.5	0.1	13.5	...	...
Growth in broad money	37.3	69.8	35.4	16.1	21.9	...	...
Policy interest rate (end of period) 4/	20.0	15.0	15.0	7.0	...	...	...
	(In percent of GDP)						
External Sector							
Current account	12.7	15.1	15.1	-19.4	-21.0	-5.5	-1.1
Trade balance	23.5	22.6	24.0	-2.9	-3.0	4.1	6.6
Exports of goods	66.4	66.1	71.7	59.7	60.8	61.1	61.5
Imports of goods	-42.9	-43.5	-47.7	-62.7	-63.8	-57.0	-54.9
Overall external balance 5/	25.6	23.5	20.8	-10.2	-14.1	-2.0	2.1
Gross reserves (In US$ billion)	31.5	46.8	50.2	44.3	44.0	43.7	43.8
In months of imports of goods and services	7.7	11.6	11.9	8.5	8.1	7.4	6.9
Exchange rate (dinar per US$; period average) 4/	1,255	...	1,193	1,170	...	...	...

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

1/ 2008 includes expenditures of 11.4 percent of GDP (ID 12.4 trillion) that are outstanding as advances and letters of credit and that have been reclassified mostly as investment spending.
2/ Assumes a debt reduction in 2010 by non-Paris Club official creditors, comparable to the Paris Club agreement.
3/ Reserve money growth in 2007 reflects the impact of an increase in the required reserves ratio on government deposits from 25 percent to 75 percent in September 2007.
4/ 2009 as of December 31.
5/ For comparability, the overall balance in the EBS/08/140 column reflects the new presentation in which the DFI flows have been reclassified as a financing item below the line.

Table 2. Iraq: Fiscal and Oil Sector Accounts, 2007–12
(In trillions of ID; unless otherwise indicated)

	2007	2008		2009	2010	2011	2012
		Ctry. Rept. 08/383	Est.	Est.	Projections		
Revenues and Grants	59.8	86.4	87.0	58.9	70.8	81.2	91.3
Revenues	56.0	84.5	84.2	56.5	69.1	79.8	90.3
Crude oil export revenues	47.1	72.8	73.9	45.5	56.1	64.9	74.7
Revenues of oil-related public enterprises	5.7	6.2	6.2	6.9	6.9	7.7	7.4
Tax revenues	1.1	1.2	1.3	1.2	1.2	1.7	1.9
Non-tax revenues 1/	2.0	4.3	2.7	2.9	5.0	5.6	6.3
Grants	3.8	1.8	2.8	2.4	1.7	1.4	1.0
Expenditures	52.9	77.7	85.2	76.3	88.7	87.4	88.6
Current expenditures	41.7	58.3	58.3	60.4	62.9	61.4	60.9
Salary and pension	13.8	20.6	20.6	27.4	28.4	28.9	28.7
Salary	11.2	16.2	16.8	22.8	22.7	22.9	22.2
Salary (Defense/Interior)	4.9	6.2	6.1	7.8	7.8	8.0	7.6
Salary (others) 2/	6.3	10.0	10.7	15.0	14.9	14.9	14.6
Pension	2.6	4.4	3.8	4.6	5.8	6.0	6.5
Goods and Services (non-oil sector) 3/	9.4	11.4	9.5	10.8	12.8	10.4	11.0
Budgeted goods and services	6.8	10.3	7.1	9.3	11.8	9.5	10.4
Other goods and services financed by donors 4/	1.5	0.7	2.4	1.5	1.0	0.8	0.7
Goods and Services (oil sector)	5.6	5.1	7.3	4.9	5.5	6.1	5.7
Transfers	9.5	17.1	16.0	14.2	11.9	10.8	9.5
Social safety net	5.5	7.4	8.4	6.2	4.3	3.9	3.3
Transfers to SOEs 5/	1.1	3.9	3.0	3.4	3.0	2.6	2.2
Other transfers 6/	2.9	5.8	4.6	4.6	4.5	4.3	4.1
Interest payments	0.6	0.5	0.5	0.7	1.1	1.5	2.0
War reparations 7/	2.4	3.7	3.7	2.3	2.8	3.2	3.7
Contingency	0.5	0.1	0.7	0.0	0.5	0.5	0.3
Investment expenditures	11.2	19.3	27.0	18.8	25.8	26.0	27.7
Non-oil investment expenditures	9.6	16.5	23.2	16.1	21.8	22.0	23.8
Oil investment expenditures (including on refineries)	1.5	2.8	3.8	2.7	4.0	4.0	3.9
Returned LCs				-2.8			
Balance (including grants)	6.9	8.6	1.8	-17.4	-17.9	-6.2	2.7
Balance (excluding grants)	3.1	6.8	-1.1	-24.8	-19.6	-7.6	1.7
Change in outstanding Letters of Credit [+ increase] 8/	1.9	...	0.0	...	...	...	...
Financing, *of which:*	-7.5	-8.6	-1.7	17.4	14.0	4.4	-2.7
External financing	-2.5	-8.6	-0.5	0.1	11.7	0.9	-2.0
Assets held abroad	-2.4	-8.2	0.3	0.4	8.7	0.0	-2.5
Project financing	0.0	0.3	0.1	0.8	1.2	1.8	1.7
Other financing 9/	0.0	0.0	0.0	0.0	3.4	0.0	0.0
Amortization	0.1	0.8	0.8	1.1	1.6	0.9	1.1
Domestic financing	-5.0	0.0	-1.2	17.3	2.3	3.5	-0.7
Bank financing	-5.3	0.0	-1.2	12.2	0.0	0.0	-1.9
Other domestic bank financing	...	...	...	1.2	-1.2	...	...
T-bills	0.3	0.0	0.0	4.0	3.5	3.5	1.2
Statistical disrepancy or Financing gap	2.5	0.0	-0.1	0.0	3.9	1.8	0.0
Memorandum items:							
Security-related expenditure	7.5	13.1	7.1	12.7	14.4	14.5	14.2
Primary fiscal balance	7.5	9.1	2.3	-16.7	-16.9	-4.8	4.7
Non-oil primary fiscal balance	-38.2	-59.3	-64.1	-60.6	-69.7	-66.9	-68.1
External assets held abroad (Ex. FMS)	12.0	…	12.1	11.7	3.0	3.0	5.5
Average Iraq oil export price (US$/bbl)	63.0	93.3	91.5	56.5	62.5	67.5	70.0
Crude oil exports	1.59	1.80	1.82	1.88	2.10	2.25	2.50
GDP Nominal	71.5	112.0	103.2	77.0	93.9	108.6	124.2

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

1/ For 2010, includes $850m in oil bonuses.
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 ID636 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/ 2009 data includes expenditures made in 2009 but allocated in the 2010 budget.
It also includes ID287 bn on transfers to the Kurdish area linked to increase of the unified general budget.
7/ Calculated as 5 percent of oil exports as per U.N. Security Council Resolution 1483 to finance war reparations to Kuwait.
8/ LCs in the Trade Bank of Iraq, full down-payment is customarily required. 2008 LCs and advances to suppliers were re-classified.
9/ Includes the $1.7bn under the new IMF SDR allocation and $1.2tr in soft loans from oil companies obtaining licenses for 2010.

Table 3. Iraq: Fiscal and Oil Sector Accounts, 2007–12
(In percent of GDP)

	2007	2008		2009	2010	2011	2012
	Prel.	Ctry. Rept. 08/383	Est.	Est.	Projections		
Revenues and Grants	83.7	77.5	84.3	76.5	75.4	74.7	73.5
Revenues	78.3	75.9	81.5	73.4	73.6	73.4	72.7
Crude oil export revenues	65.9	65.3	71.6	59.0	59.7	59.7	60.2
Revenues of oil-related public enterprises	8.0	5.6	6.0	9.0	7.3	7.1	6.0
Tax revenues	1.5	1.1	1.3	1.6	1.2	1.5	1.5
Non-tax revenues 1/	2.8	3.9	2.6	3.7	5.3	5.1	5.0
Grants	5.4	1.6	2.8	3.1	1.8	1.3	0.8
Expenditures	74.0	69.8	82.6	99.0	94.5	80.5	71.4
Current expenditures	57.7	52.3	56.4	78.4	67.0	56.5	49.1
Salary and pension	19.3	18.5	19.9	35.6	30.2	26.6	23.1
Salary	15.6	14.5	16.3	29.6	24.1	21.1	17.8
Salary (Defense/Interior)	6.9	5.5	5.9	10.2	8.3	7.3	6.1
Salary (others) 2/	8.7	9.0	10.4	19.5	15.8	13.8	11.7
Pension	3.7	3.9	3.7	6.0	6.1	5.5	5.2
Goods and services (non-oil sector) 3/	13.1	10.3	9.2	14.1	13.6	9.6	8.9
Budgeted goods and services	9.6	9.3	6.9	12.1	12.6	8.8	8.3
Other goods and services financed by donors 4/	2.0	0.6	2.3	2.0	1.1	0.8	0.5
Goods and services (oil sector)	7.9	4.6	7.0	6.4	5.8	5.7	4.6
Transfers	13.2	15.3	15.5	18.4	12.6	9.9	7.7
Social safety net	7.6	6.6	8.2	8.0	4.6	3.6	2.7
Transfers to SOEs 5/	1.6	3.5	2.9	4.5	3.2	2.4	1.7
Other transfers 6/	4.0	5.2	4.4	5.9	4.8	4.0	3.3
Interest payments	0.9	0.4	0.5	0.9	1.1	1.3	1.6
War reparations 7/	3.3	3.3	3.6	3.0	3.0	3.0	3.0
Investment expenditures	15.6	17.3	26.1	24.4	27.5	23.9	22.3
Non-oil investment expenditures	13.5	14.8	22.4	20.9	23.2	20.3	19.1
Oil investment expenditures (including on refineries)	2.0	2.4	3.7	3.5	4.2	3.7	3.2
Returned LCs				-3.7	...	...	...
Balance (including grants)	9.7	7.8	1.7	-22.6	-19.1	-5.7	2.2
Balance (excluding grants)	4.3	6.1	-1.0	-32.2	-20.9	-7.0	1.4
Change in outstanding Letters of Credit [+ increase] 8/	2.7	...	0.0	...	...	...	...
Financing, O*f which:*	-10.5	-7.8	-1.6	22.6	14.9	4.1	-2.2
External financing	-3.5	-7.8	-0.5	0.1	12.4	0.9	-1.6
Assets held abroad	-3.4	-7.4	0.3	0.5	9.2	0.0	-2.0
Project financing	0.0	0.3	0.1	1.1	1.3	1.7	1.4
Other financing 9/	0.0	0.0	0.0	0.0	3.6	0.0	0.0
Amortization	0.1	0.7	0.8	1.5	1.7	0.8	0.9
Domestic financing	-7.0	0.0	-1.2	22.5	2.5	3.2	-0.6
Bank financing	-7.4	0.0	-1.2	15.8	0.0	0.0	-1.5
Other domestic bank financing	...	...	...	1.5	-1.2	...	...
T-bills	0.4	0.0	0.0	5.2	3.7	3.2	0.9
Statistical disrepancy or Financing gap	3.5	0.0	-0.1	0.0	4.2	1.7	0.0
Memorandum items:							
Security-related expenditure	10.5	11.7	6.9	16.5	15.3	13.3	11.5
Primary fiscal balance	10.5	8.2	2.2	-21.7	-18.0	-4.4	3.8
Current expenditures (percent of non-oil GDP)	153.6	146.0	182.1	170.9	160.8	142.4	127.5

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

1/ For 2010 and 2011 include ID1.5tr in mobile operator license fees and $850m in oil bonuses in 2010.
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 ID636 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/ 2009 data includes expenditures made in 2009 but allocated in the 2010 budget.
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, full down-payment is customarily required. 2008 LCs and advances to suppliers were re-classified.
9/ Includes the $1.7bn under the new IMF SDR allocation and $1.2 bn in soft loans from oil companies obtaining licenses.

Table 4. Iraq: Central Bank Balance Sheet 2007–10

(In billions of Iraqi dinars, unless otherwise indicated)

	2007 Dec.	2008 Dec.	2009 Dec. Est.	2010 Dec. Proj.
Net foreign exchange assets 1/	38,219	58,841	49,794	51,502
Foreign exchange assets	38,219	58,841	51,875	51,502
Gold	192	191	244	244
Other	38,027	58,650	51,631	51,259
Foreign exchange liabilities	0	0	-2,081	0
Net domestic assets	-7,492	-11,372	-2,283	2,430
Domestic assets	-2,449	-9,532	2,744	2,744
Net claims on general government	-2,456	-9,536	2,740	2,740
Holdings of treasury bills	3,956	3,236	3,236	3,236
Holdings of discounted treasury bills	733	719	719	719
Overdrafts	0	0	0	0
Domestic currency deposits	-3,583	-8,577	-1,090	-1,090
Foreign currency deposits	-3,561	-4,915	-126	-126
Claims on commercial banks	7	4	4	4
Monetary policy instruments 2/	-7,146	-4,995	-3,988	-1,424
Of which: CBI bills	-2,746	-2,224	-1,184	...
Other items net	2,104	3,155	-1,040	1,110
Reserve money	30,726	47,469	47,510	53,932
Currency issued	15,632	21,304	24,169	27,843
Banks reserves	15,094	26,165	23,341	26,089
Required	11,805	19,416	7,978	9,191
Excess	3,289	6,749	15,363	16,898
Memorandum items				
Reserve money (annual growth, in percent)	73.9	54.5	0.1	13.5
Gross foreign exchange assets (in millions of U.S. dollars)	31,455	50,206	44,337	44,019
Foreign exchange liabilities (in millions of U.S. dollars)	0	0	-1,779	0.0
Net foreign exchange assets (in millions of U.S. dollars)	31,455	50,206	42,559	44,019
Gross foreign exchange assets/reserve money (in percent)	124.4	124.0	109.2	95.5
Exchange rate (end of period)	1215.0	1172.0	1170.0	...
Policy interest rate	20.0	15.0	7.0	...

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

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

Table 5. Iraq: Monetary Survey, 2007–10
(In billions of Iraqi dinars, unless otherwise indicated)

	2007 Dec.	2008 Dec.	2009 Dec. Est.	2010 Dec. Proj.
Net foreign assets	36,726	59,113	50,065	51,773
Of which: CBI	38,219	58,841	49,794	51,502
Net domestic assets	-9,490	-22,238	-7,271	411
Domestic claims	-15,292	-26,391	-8,377	-2,699
Net claims on general government	-18,134	-30,791	-14,650	-11,140
Claims on general government	8,194	6,807	...	...
less: Liabilities to general government	-26,329	-37,598	...	...
Claims on other sectors	2,842	4,400	6,273	8,441
Other Item Net (OIN)	5,802	4,153	1,106	3,110
Broad money	27,235	36,875	42,794	52,185
Currency outside banks	14,232	18,492	21,512	24,782
Transferable deposits	9,735	13,264	15,962	20,552
Other deposits	3,268	5,119	5,321	6,851
Memorandum items				
Broad money (percentage growth)	37.3	35.4	16.1	21.9
M2 velocity (ratio)	2.6	2.8	1.8	1.8
Credit to the economy (percentage growth)	-0.5	54.8	42.6	34.6
Credit to the economy (as a percentage of non-oil GDP)	10.5	13.7	17.8	21.6

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

Table 6. Iraq: Balance of Payments, 2007–14 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2007	2008		2009	2010	2011	2012	2013	2014
		Ctry. Rept. 08/383	Proj.	Est.			Proj.		
Trade balance	13,408	21,188	20,779	-1,931	-2,408	3,787	7,048	9,042	14,525
(In percent of GDP)	23.5	22.6	24.0	-2.9	-3.0	4.1	6.6	7.7	11.2
Exports	37,835	61,998	62,013	39,320	48,826	56,714	65,289	72,092	81,431
Crude oil	37,137	61,284	61,165	38,873	47,906	55,434	63,875	70,229	78,944
Other exports	698	714	849	446	920	1,280	1,414	1,863	2,487
Imports	-24,427	-40,810	-41,234	-41,250	-51,234	-52,927	-58,241	-63,050	-66,906
Government imports	-14,809	-23,170	-25,393	-23,220	-26,291	-25,183	-25,364	-25,542	-26,977
UN Oil for Food Program (OFFP)	107	-80	46	0	0	0	0	0	0
Other consumption imports (non-OFFP)	-3,881	-10,412	-5,905	-10,018	-8,091	-7,279	-7,012	-7,356	-8,088
Other non-oil related capital imports (non-OFFP) 3/	-6,981	-6,407	-13,607	-8,241	-12,814	-13,024	-13,961	-14,349	-15,057
Oil-related capital imports	-1,394	-2,741	-2,779	-2,952	-3,576	-3,865	-3,883	-3,836	-3,832
Refined oil products	-2,660	-3,530	-3,148	-2,009	-1,811	-1,015	-508	0	0
Private sector imports	-9,618	-17,641	-15,841	-18,031	-24,943	-27,744	-32,877	-37,508	-39,929
Of which: refined oil products	-2,369	-3,530	-3,148	-3,278	-4,225	-4,061	-4,568	-5,359	-6,200
Income, net 4/	-3,402	-2,893	-3,226	-4,000	-4,462	-289	-283	-770	484
Services, net	-4,004	-5,170	-6,358	-8,296	-10,978	-10,925	-11,613	-12,175	-12,712
Transfers, net	1,234	1,006	1,874	1,464	1,000	2,337	3,665	2,840	1,176
Private, net (incl. NGOs) 5/	24	2,549	2,549	1,350	1,950	3,900	5,850	6,143	4,914
Official	1,211	-1,543	-674	114	-950	-1,563	-2,185	-3,302	-3,738
Receipts	3,067	1,522	2,384	2,057	1,445	1,209	1,009	209	209
Payments	-1,857	-3,064	-3,058	-1,944	-2,395	-2,772	-3,194	-3,511	-3,947
Current account	7,236	14,130	13,070	-12,762	-16,848	-5,090	-1,182	-1,063	3,472
(In percent of GDP)	12.7	15.1	15.1	-19.4	-21.0	-5.5	-1.1	-0.9	2.7
Capital account	0	0	0	0	0	0	0	0	0
Financial account	7,355	7,403	4,922	6,031	5,535	3,225	3,438	3,796	4,550
Direct investment	964	2,121	1,822	820	1,208	3,101	3,602	4,282	5,075
Other capital, net	6,391	5,282	3,100	5,211	4,327	124	-165	-487	-524
Official, net	5,042	3,957	4,085	5,526	4,696	592	259	-133	-180
Assets 6/	423	87	-54	0	0	0	0	0	0
Liabilities	4,619	3,870	4,139	5,526	4,696	592	259	-133	-180
Loan disbursements 7/	0	241	51	2,208	2,046	1,342	1,241	857	905
Amortization 8/ 9/ 10/ 15/	0	-662	-662	-972	-1,369	-750	-982	-989	-1,086
Capitalized interest payment 10/	4,619	4,291	4,750	4,290	4,020	0	0	0	0
Financial corporations, net 11/	-1,518	0	0	0	0	0	0	0	0
Private, net , and errors and omissions 12/	2,868	1,325	-985	-315	-369	-468	-424	-354	-344
Overall balance	14,591	21,533	17,992	-6,732	-11,313	-1,865	2,256	2,732	8,023
(In percent of GDP)	25.6	24.9	20.8	-10.2	-14.1	-2.0	2.1	2.3	6.2
Financing	-14,591	-21,532	-17,992	6,732	7,957	332	-2,256	-2,732	-8,023
Central bank (increase -)	-11,418	-15,374	-18,751	5,869	318	332	-119	-3,530	-6,148
Reserves (net; increase -)	-11,872	-15,674	-18,751	5,869	318	332	-119	-3,530	-6,148
Liabilities (increase +)	-455	0	0	0	0	0	0	0	0
Fund credit (net)	-455	0	0	0	0	0	0	0	0
Disbursement	0	0	0	0	0	0	0	0	0
Repayments	-455	0	0	0	0	0	0	0	0
Deferred accrued interest 13/	861	748	814	686	239	0	0	0	0
Change in arrears (net, decrease -) 14/	-72	-65,793	-12,063	-10,167	-64,229	…	…	…	…
Debt forgiveness 15/	-3	65,793	12,063	10,027	64,229	…	…	…	…
Development Fund for Iraq (increase -)	-3,960	-6,906	-55	317	7,400	0	-2,137	797	-1,875
Financing gap	...	...	...	0	3,356	1,533	0	0	0
Memorandum items:									
Central bank reserves	31,455	46,829	50,206	44,337	44,019	43,687	43,806	47,335	53,483
Central bank reserves (in months of imports of goods and services)	7.7	11.6	11.9	8.5	8.1	7.4	6.9	7.0	7.8
External assets held abroad (Excl. FMS, in US$ million	9,882	…	10,303	9,986	2,604	2,604	4,741	3,943	5,819
GDP	56,981	93,817	86,525	65,837	80,284	92,837	106,151	117,220	129,474
Non-oil GDP	21,658	33,622	26,825	30,186	33,437	36,864	40,836	45,236	49,633

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

1/ Excludes U.S. military spending in Iraq.
2/ Adjusted from the original document to reflect the new treatment of DFI as a financing item.
3/ Includes private sector imports for government
4/ Includes interest accrued, deferred, and capitalized.
5/ 2008 data include $3.75 billion obtained from telecoms licensing fees.
6/ Includes the U.N. Oil for Food letters of credit.
7/ Reflects the increase in liabilities associated with the SDR allocation of $1.6 billion.
8/ For 2009 and 2010 amortization is based on budget figures.
9/ Includes the estimates of cash payments to settle the debt owed to small private creditors through cash exchange offer.
10/ Based on Paris Club agreement, the payments of principal and most interest during 2006–10 are deferred and capitalized.
11/ Reflects advance transfers for the execution of letters of credit (L/C).
12/ Includes errors and omissions for historical data.
13/ Estimates of accrued interest on existing stock of debt prior to the implementation of the Paris Club agreement.
14/ Includes debt forgiveness and clearance of arrears on multilateral debt and arrears related to fuel imports from Turkey.
15/ The notional debt forgiveness and amortization reflect: (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 de reduction comparable to the Paris Club agreement on other debt to official creditors.

Table 7. Iraq: Quantitative Performance Criteria
Under the Stand-By Arrangement, 2009–10 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at	Performance Criteria		
	12/31/09	3/31/10	6/30/10	12/31/10
Stock of net international reserves of the CBI (floor; eop stock, in millions of U.S. dollars)	44,337	44,257	44,178	44,019
Net domestic assets of the CBI 2/ (ceiling; eop stock)	-1,243	-398	38	1,320
Development Fund for Iraq balances (floor; eop stock; in billions of U.S. dollars, excl. FMS)	9.9	8.0	4.5	2.6
Cumulative flow from beginning of calendar year				
Central government fiscal deficit (ceiling) 3/ 4/ 5/	...	5,382	9,149	17,939
Central government current spending bill (ceiling) 3/ 5/	...	8,141	14,926	27,138
Direct government subsidies to the fuel sector 6/	...	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) 6/ 7/	...	2,000	2,000	2,000
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 6/	...	0	0	0

1/ The Technical Memorandum of Understanding (TMU) provides for precise definitions of all performance variables.
2/ Excluding other items net.
3/ End-March, end-June, and end-December performance criteria are cumulative from January 1, 2010.
4/ The fiscal balance will be measured via the sources of financing. See TMU for details.
5/ The current spending bill includes wages (excluding ministries of defense and interior), public distribution system, and transfers to state owned-enterprises. See TMU for details.
6/ To be monitored on a continuous basis.
7/ Concessionality is defined as loans with a grant element of 35 percent or higher. See TMU for details.

Table 8. Iraq: Reviews and Disbursements under the Proposed Arrangements

Date	Amount of Purchase: In percent of quota	Amount of Purchase: In millions of SDRs	In millions of US$	Condition
February 2010	25	297.10	459.01	Approval of SBA arrangement
On or after May 31, 2010	40	475.36	734.41	Completion of first review and observance of end-March 2010 performance criteria
On or after August 31, 2010	90	1069.56	1652.43	Completion of second review and observance of end-June 2010 performance criteria
On or after February 28, 2011	25	297.10	459.01	Completion of third review and observance of end-December 2010 performance criteria
On or after August 31, 2011	20	237.68	367.21	Completion of fourth review and observance of end-June 2011 performance criteria
Total	200	2376.80	3672.06	

Source: IMF staff projections.

Table 9. Iraq: Indicators of Fund Credit, 2009–16
(In millions of SDRs, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016
Disbursements of Fund credit								
SBA	0.0	1842.0	534.8	0.0	0.0	0.0	0.0	0.0
In percent of IMF quota	0.0	155.0	45.0	0.0	0.0	0.0	0.0	0.0
Obligations								
Repayments of SBA 1/	0.0	0.0	0.0	0.0	364.0	1062.1	824.5	126.3
Total charges and interest	0.0	15.5	28.0	29.6	29.1	22.0	8.7	1.1
Total obligations	0.0	15.5	28.0	29.6	393.1	1084.1	833.2	127.4
Total obligations, in percent of:								
Exports of goods and services	0.0	0.0	0.1	0.1	0.9	2.3	1.6	0.2
External public debt	0.0	0.1	0.1	0.1	1.8	4.9	3.8	0.6
Gross reserves	0.0	0.1	0.1	0.1	1.3	3.1	2.2	0.3
GDP	0.0	0.0	0.0	0.0	0.5	1.3	0.9	0.1
IMF Quota	0.0	1.3	2.4	2.5	33.1	91.2	70.1	10.7
Outstanding Fund credit								
SBA	0.0	1842.0	2376.8	2376.8	2012.9	950.7	126.3	0.0
Total outstanding Fund credit	0.0	1842.0	2376.8	2376.8	2012.9	950.7	126.3	0.0
Total outstanding Fund credit, in percent of								
Exports of goods and services	0.0	5.6	7.5	6.4	4.7	2.0	0.2	0.0
External public debt	0.0	8.1	9.8	9.7	9.0	4.3	0.6	0.0
Gross reserves	0.0	6.5	8.5	8.4	6.6	2.8	0.3	0.0
GDP	0.0	3.6	4.0	3.5	2.7	1.1	0.1	0.0
IMF Quota	0.0	155.0	200.0	200.0	169.4	80.0	10.6	0.0

Sources: IMF staff estimates and projections.

1/ The SBA repayments are on an obligations basis.

ATTACHMENT I. IRAQ: LETTER OF INTENT

February 8, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

In the past few years, despite a very difficult security situation, Iraq's economic performance strengthened considerably owing to improved macroeconomic management and a favorable external environment that lasted until mid-2008. These improvements also reflected the assistance we received from the international community, including from external creditors and the International Monetary Fund (IMF). Growth accelerated, inflation was reduced to single digits, and fiscal and external sustainability improved substantially. Since 2004, we have successfully completed three economic programs supported by the IMF, with our last Stand-By Arrangement (SBA) ending in March 2009.

Already at the time of the last SBA review it became evident that the external environment was deteriorating rapidly due to the sharp drop in international oil prices and the onset of a slowdown in the global economy. As the proceeds from oil exports account for the bulk of Iraq's export receipts and government revenue, the decline in oil prices has posed considerable challenges to our internal and external stability. During 2009, we have been able to absorb much of the adverse impact of these external shocks by using the financial buffers we built up in recent years. However, unless oil prices increase markedly, we would be forced to constrain government spending in 2010 and 2011, at a time when our developmental and security-related needs remain high. A fiscal contraction would hurt the economy and undermine our hard-won macroeconomic stability, and could also contribute to a deterioration of the security situation.

To address these challenges, we have developed the attached economic program for 2010–2011. Our program aims to manage the effects on the Iraqi economy of the lower oil prices and the slowdown in global economic activity. The program focuses on keeping inflation low, increasing growth by boosting oil production, and ensuring fiscal sustainability. While our main focus is on macroeconomic policies, we are also accelerating the pace of structural reforms, especially to improve public financial management and develop the financial sector. To support our efforts, and based on the economic program and the specific targets set out in Tables 1 and 2 attached to this letter, we request a 2-year Stand-By Arrangement from the

IMF in the amount of SDR 2,376.8 million (approximately $3.8 billion), equivalent to 200 percent of Iraq's quota, to help cover our balance of payments needs.

Given the large uncertainties and the high volatility of international oil prices, our projections and the government's budget for 2010 are conservatively based on an average price of $62.5 per barrel for Iraqi oil. In the event that our oil export revenues turn out to be higher than projected, we plan to save half of the additional revenues to rebuild our financial buffers, while using the other half to finance additional investment to improve the delivery of basic public services. Moreover, if by the time of the first or second program review futures markets indicate that we will be able to obtain, on average, an oil price equal to or higher than $73 per barrel for our exports in 2010, we intend to treat the SBA as precautionary, given that we would no longer expect to have a financing need, provided that our oil export volume (projected at 2.1 million barrels per day) is sustained (this issue will be examined in detail at the time of each program review discussion). Vice versa, should oil export receipts fall below our assumptions, we will reduce spending by half of the revenue shortfall and cover the remaining gap by further using our financial buffers and seeking additional external support, including from the IMF. If the revenue shortfall turns out to be sizable, or if the reserve position of the CBI weakens below program targets in between test dates, we will consult on the policy response with IMF staff.

In the same vein, we intend to treat the SBA as precautionary if it is expected that the 2010 investment budget will not be fully executed. Disbursements of capital spending in 2009 fell short of budgeted amounts, due in part to severe disruptions of administrative capacity as a result of the bombings of the Ministry of Finance in August and December. Investment remains a key priority, however, as underscored also by the Council of Representatives' provision of additional investment spending at the time of approval of the 2010 budget. The 2010 capital budget would imply a large increase over last year's estimated investment outturn. In order to ensure that the disruptions of administrative capacity do not lead to poor quality implementation, we are working hard to rebuild and expand capacity, including by restoring information systems and strengthening project approval processes. With these efforts, we will aim to execute the full envelope for the year. If capacity issues cannot be fully addressed, however, investment could again fall short of budgeted amounts. Therefore, at the time of the second review we will reach understandings with IMF staff on the expected rate of execution of the 2010 investment budget. If the rate of execution is expected to be less than 93 percent, we intend to treat the SBA also as precautionary.

We understand that the requested SBA will be subject to semi-annual reviews, semi-annual performance criteria, and structural benchmarks, as set out in the attached Tables 1 and 2, and described in more detail in the attached Technical Memorandum of Understanding (TMU). In this regard, we understand that the completion of the first review under the SBA—expected to take place on or after May 31, 2010—will require observance of the quantitative performance criteria for end-March 2010 specified in Table 1, and that completion of the second review—expected to take place on or after August 31, 2010—will require observance of the quantitative performance criteria for end-June 2010.

We believe that the policies set forth in our economic program are adequate to achieve our objectives but are prepared to take additional measures if necessary. We will consult with the IMF on the adoption of these measures and in advance of any revision to the policies contained in our economic program, in accordance with IMF policies on such consultation. The Iraqi government and the Central Bank of Iraq will continue to provide the IMF with the necessary information for assessing progress in implementing our program, as specified in the attached TMU, and will maintain a close policy dialogue with IMF staff. We authorize the IMF to publish the Letter of Intent and its attachments, as well as the related staff report, on the IMF's website following consideration of our request by the IMF's Executive Board.

Sincerely yours,

//s//	//s//
Mr. Baqir S. Jabr Al-Zubaydi Minister of Finance of Iraq	Dr. Sinan Al-Shabibi Governor Central Bank of Iraq

Attachment II. Iraq: Memorandum of Economic and Financial Policies for 2010–11

February 8, 2010

I. Introduction

1. Since 2004, Iraq has successfully completed three economic reform programs supported by the International Monetary Fund (IMF): one under the Emergency Post Conflict Assistance (EPCA) facility and two (precautionary) Stand-By Arrangements (SBA). During this period, we have made considerable progress under very difficult circumstances, including a very challenging security situation. We have successfully reduced inflation, showed fiscal discipline, and started rebuilding our economic institutions. These achievements have helped us to obtain generous debt relief from Paris Club and other creditors that has substantially improved our external position.

2. These hard-won gains of recent years could be undermined, however, by the large drop in oil prices from their peak levels of mid-2008. After reaching a high in July 2008, when Iraqi crude oil sold for $124 per barrel, prices fell to a low of $35 per barrel in January 2009, before slowly recovering to a level of around $68 per barrel in the second half of 2009. The average export price in 2009 was $57 per barrel, well below the average export price of $92 per barrel in 2008. In addition, due to dire infrastructural problems, the volume of oil exports in the early months of the year fell below 2008 levels (to 1.75 million barrels per day (mbpd) in the first five months). We have been working to address these problems and oil exports reached 2 mbpd towards the end of 2009, bringing the average for the year to 1.88 mbpd.

3. As the proceeds from oil exports account for the bulk of our total export receipts, and for the majority of government revenues, the lower oil prices are posing considerable challenges to our internal and external economic stability. To maintain macroeconomic stability, and foster growth and employment, we have adopted an economic adjustment program for 2010–11 for which we seek support from the IMF under a new 2-year SBA, as well as financial assistance from other international institutions and countries. This Memorandum of Economic and Financial Policies (MEFP) describes our economic objectives and policies, including the structural reforms, for this period.

II. Recent Economic Developments

4. Due to the temporary drop in oil production, real GDP growth is estimated to have slowed to 4 percent in 2009, from almost 10 percent in 2008. There are indications, however, that the improved security situation has supported economic activity in the non-oil sector. The Central Organization for Statistics and Information Technology (COSIT) estimates that

real non-oil GDP grew by about 5½ percent in 2008 and that the pace of non-oil growth remained broadly unchanged in 2009.

5. The Central Bank of Iraq (CBI) has been successful in keeping inflation under control, by managing the exchange rate and by keeping the policy interest rate positive in real terms. When inflationary pressures emerged in 2008, the CBI stepped up the rate of appreciation of the dinar vis-à-vis the U.S. dollar (to about ½ percent per month until late 2008), which also helped counter dollarization. As a result, headline inflation fell to 6.8 percent by end-2008. Inflation remained well below the target of 6 percent in 2009, with prices falling by 4½ percent, mainly because of a further decline in fuel prices. Food price inflation has picked up more recently, however, and core inflation (excluding fuel and transportation) ended 2009 a 6 percent, down from 12 percent at end-2008.

6. With headline and core inflation low, the exchange rate has been stable since the beginning of 2009. The policy interest rate has been reduced gradually to 7 percent. Net international reserves increased to $50.2 billion at end-2008, but have fallen to $44 billion at end-2009, reflecting the drawdown of the government's deposits with the CBI.

7. The government budget recorded a modest surplus in 2008 (almost 2 percent of GDP). Higher-than-expected oil revenues enabled us to increase spending. Particularly, and due also to our efforts to improve the execution of the investment budget, we were able to substantially increase capital expenditures in 2008, compared to the previous year.

8. With the drop in oil prices, the external current account is estimated to have moved into a large deficit in 2009, of over 20 percent of GDP. And as oil revenues account for the bulk of government revenues, the government budget is also estimated to have shifted into a large deficit, of over 20 percent of GDP in 2009. The 2009 budget, which was adopted at a time when sharply lower oil revenues were expected, was designed to support as much as possible our investment program and the required security outlays, while containing current spending. The bombings of the Ministry of Finance in August and December of 2009, however, affected our capacity to fully execute our investment plans. Despite this, the 2009 budget deficit, based on preliminary financing data, is estimated to have recorded a deficit of over ID 17 trillion. This deficit was covered mainly by drawing down the balances the government had built up in the CBI and by mobilizing domestic resources through the issuance of Treasury bills.

III. Economic and Financial Policies in 2010-11

9. The global financial and economic crisis has worsened Iraq's external outlook significantly. The drop in oil export revenues, in particular, presents a major challenge in view of the country's vast reconstruction and rehabilitation spending needs. Under these circumstances, we are determined to strengthen fiscal discipline to better ensure that the reduced public resources are used more efficiently and that fiscal sustainability is preserved.

We have adopted a budget for 2010 that aims to further reduce non-priority current outlays and align the investment budget with our national priorities and implementation capacity. We seek to reduce the government's budget deficits during 2010 and 2011, with a view to returning to a budget surplus in 2012. In addition, we aim to maintain a financial buffer in our accounts equivalent to three months of government wages. Appropriate management of the exchange rate and an interest rate policy aimed at keeping the policy interest rate positive in real terms will continue to be the main instruments to keeping inflation under control. We will also continue to advance our structural reform agenda, with a particular emphasis on public financial management and financial sector reforms.

10. By continuing to pursue sound economic policies and intensifying our efforts to boost oil production, we aim to accelerate the pace of economic growth. We seek to increase average crude oil production and exports to 3.1 mbpd and 2.5 mbpd, respectively, by 2012. As a result, we expect real GDP growth to increase to almost 7 percent in 2010 and to 7½-8 percent in 2011 and 2012. We will also strive to keep inflation at around 5–6 percent in the coming years.

11. As oil prices and production are expected to rise in the medium term, the current account deficit would narrow markedly in the coming years. Since the decline in oil revenues is expected to be temporary until oil production reaches higher levels, we intend to secure adequate financing to avoid a major economic contraction. The international reserves held in the CBI and the DFI (excluding the FMS subaccount) are expected to fall from $55 billion at end-2009 to $46 billion by end-2010 and to broadly remain at that level in 2011 and 2012, before increasing in the following years.

A. Fiscal Policy and Reform

The 2010 Budget

12. The 2010 budget aims to contain current spending to limit the deficit and create room for higher investment outlays. In this regard, we will contain the government's wage bill by refraining from granting new wage increases following the large catch-up in salaries in 2008, which carried over into 2009. In addition, net hiring of non-security personnel in 2010 will be limited to new teachers and doctors, until the civil service census is completed. To limit spending related to the in-kind Public Distribution System (PDS), we have initiated reforms that seek to target the benefits of the program to the poorest Iraqis. In addition, we have decided to reduce the number and volume of goods distributed under the PDS system. At the same time, we plan to expand the new targeted cash transfer system. Generalized transfers, in particular to state-owned enterprises, will be sharply reduced, reflecting the improved financial position of many of these enterprises. As a result of these measures, current spending will be curtailed at ID 62.9 trillion (in the IMF's presentation). By doing so, we have been able to increase the capital budget to ID 25.8 trillion, with an increased focus on

electricity, water and sanitation, health, and agriculture. The overall deficit will be limited to ID 17.9 trillion (19 percent of GDP) in 2010 (in the IMF's presentation).

13. As our financing needs in 2010 will still be substantial, we will step up our efforts to mobilize domestic financing through the Treasury bill market. To that end, we will conduct regular auctions, and refrain from cancellations, while allowing interest rates to be determined by the market. This will have additional benefits by determining a benchmark interest rate, while the development of a secondary market for treasury bills will allow banks to improve their liquidity management. Also, to ensure integrity in our payment and budget systems, we will refrain from accumulating domestic expenditure arrears.

Public Financial Management Reforms

14. Over the next two years, we intend to transform and modernize our public financial management (PFM) system. Late last year, in consultation with the IMF and the World Bank, we adopted a three-year action plan that identified priority measures in the areas of budget preparation, execution and reporting; cash management; public procurement; and the accounting framework. Specifically:

- To improve budget preparation, we will clearly define priorities, set ceilings in the budget circular for current and investment spending in line with a sustainable medium-term budget strategy, and develop overall sector strategies;

- To strengthen reporting and cash management, we will require spending units to submit reports on all spending including investment, advances, and letters of credit no later than two months after the end of each month, and to reconcile these amounts with the cash balances at the beginning and end of the reporting period. Cash releases will be approved only after the Ministry of Finance has reviewed the report from three months before. This will reduce the idle balances in spending units' accounts to the minimum required to ensure the continuity of government operations. Moreover, by end-March 2010 we will review all accounts in the banking system that are classified as central government accounts and reconcile them with Treasury records, and will return any idle balances received from the budget to the central Treasury.

- With regard to advances, we will review the outstanding stock of advances to identify those that are recoverable and set a time schedule for their recovery and for writing off irrecoverable advances based on appropriate authorization at a high level. We will prepare a detailed report to document the results of the review. The basis on which debts have been classified as recoverable or irrecoverable, and actions taken to recover doubtful amounts before recommending that they be written-off will be clearly specified.

- To strengthen internal audit and control systems, we will reexamine our internal policies and procedures at the Ministry of Finance, as well as the accounting systems, processes and internal controls used by the accounting department; and review the internal controls of the largest spending units' operating systems. To strengthen the quality of our investment agenda and accelerate the reconstruction of Iraq's infrastructure, we will ask the Board Supreme Audit (BSA) to review the largest investment projects financed with 2008 budget allocations. This audit report will evaluate (i) the criteria for approving capital investment projects: whether a cost-benefit analysis was carried out; (ii) the procurement process: whether it conformed to international standards of transparency and competitiveness; and (iii) the project management process: whether the projects were delivered on time and within budget. The report will provide recommendations that could be used in the following budgeting process to enhance the agenda on public investment.

- We will also undertake an assessment of the functionality of the Iraq Financial Management Information System (IFMIS) developed with the assistance of USAID, and make the changes required to ensure that this system is fully operational (with the inclusion of a commitment control system and the ability to produce regular comprehensive reports in line with best practices) in 2011.

- We will continue to submit to the BSA and to the Council of Representatives the final accounts for each fiscal year no later than September 30 of the following year. The BSA has already completed the audit of the final accounts of the federal budget for 2005-06, and it is reviewing the 2007 and 2008 accounts.

15. To avoid the obstacles we encountered last year in data collection for the census of public service employees, we have narrowed the coverage to include all central government employees that work outside of security related areas. We will make all efforts to have the census completed by September 30, 2010. After completion of the census, we will move swiftly to eliminate ghost workers and adopt an action plan aimed at developing a computerized human resource database and a computerized payroll system, as a first step toward comprehensive civil service reform. In parallel, the BSA has begun a project to verify the personnel records in the line ministries in order to clean up the existing payroll.

Tax Reforms

16. We have made some progress in developing a medium-term tax reform strategy with the objective of streamlining the tax system, broadening and diversifying the tax base, and increasing revenue collection. As a first step, in 2008 we introduced a mobile phone tax. Looking ahead, we plan to introduce a sales tax in the coming years as a precursor for a value-added tax, and are also considering to reduce the number of income tax brackets. We will seek technical assistance from the IMF and other international partners to support our

tax reform efforts. We will urge the Council of Representatives to adopt the new customs law that will establish a transparent and efficient tariff system with fewer exemptions.

Oil Sector Reforms

17. We will ensure that no direct subsidy is placed on any fuel products in Iraq. Moreover, to continue reducing the size of indirect subsidies to fuel products and counter smuggling, we intend to increase official fuel prices as needed especially if the world prices of fuel products continue to rise. To eliminate hidden subsidies, we will ensure that all ministries, governmental agencies, and public enterprises will pay domestic market prices for fuel purchases starting in 2011. We will also work on developing a periodic adjustment mechanism for fuel prices, with technical assistance from the IMF.

18. We want to ensure that the oil sector is fully transparent, to strengthen accountability of how this important natural resource is used. To that end, we intend to maintain a single account for oil export proceeds and will continue to adhere to the strict transparency and accountability rules that currently govern the DFI. The accounts will continue to be subject to an independent external audit, and to the oversight of the Committee of Financial Experts (COFE). If it were no longer possible to maintain the DFI, we will establish another single account for oil export proceeds governed by similar principles.

19. We will complete the process of becoming a candidate for membership in the Extractive Industries Transparency Initiative (EITI) by March 31, 2010. In addition to regular publication of our production, refining, and export data, we have appointed a senior government official, the Inspector General of the Ministry of Oil, to take the lead on EITI implementation. The next steps will be to convene a stakeholders’ meeting (government, private sector and civil society) and put together a fully costed plan including measurable targets, a timetable for implementation, and an assessment of capacity constraints.

20. To promote transparency and good governance in the oil sector, we plan to complete the metering project in the next years. The metering system for the Al-Basra oil export terminal has already been installed. Moreover, the second phase of the installation of metering systems for the northern pipeline and the Khor Al-Amyah export terminal has started, and will be completed by early 2010. Also, in addition to a computerized tracking system for oil transports by road and rail that is already up and running, a comprehensive domestic custody-transfer metering system is being installed and will be completed by December 31, 2010. These mechanisms would enable a full review of the domestic oil sector allowing the flows of oil and oil products to be fully reconciled with the financial flows between the state-owned oil companies and the budget by mid-2011. In this connection, we also plan to conduct a streamlined Public Expenditure Review of the oil ministry, together with the ministries of health, education, and public works, with the assistance of the World Bank.

B. Monetary and Exchange Rate Policies and Financial Sector Reform

21. The CBI will continue to be independent in the pursuit of its policy objectives. The CBI's monetary and exchange rate policies will continue to be aimed at keeping inflation under control and safeguarding international reserves. The subdued inflationary pressures thus far in 2009 have helped to maintain the nominal exchange rate stable since the beginning of the year and to reduce the policy interest rate to 7 percent. The policy interest rate will be kept positive in real terms (measured against core inflation) to signal the CBI's firm commitment to maintain a low rate of inflation. We are accelerating plans to roll out a new CPI based on more recent household expenditure data, which will help us better monitor underlying inflationary dynamics.

22. The banking sector is in urgent need of reform to foster financial intermediation and enable banks to contribute to the development of a strong private sector. With the help of the World Bank and other international agencies, we have developed a banking sector reform strategy. The first important step will be to finalize the restructuring of Rafidain and Rasheed banks, based on their completed financial and operational audits. In this regard, the foreign liabilities incurred by Rafidain and Rasheed on behalf of the previous regime and the large suspense accounts will need be removed from these banks' balance sheets. We aim to complete the restructuring of the balance sheets of Rafidain and Rasheed by June 30, 2010. Once their balance sheets are cleaned up and restructured, based on the decision already made by the Economic Committee, the capital of Rafidain and Rasheed will be raised to ID500 billion and ID400 billion, respectively. We are also strengthening their internal audit capacity, developing legal arrangements within the banks, and working towards providing missing data identified in the audit reports. The BSA has also completed the financial and operational audits for the three specialized state-owned banks and has proposed an individual strategy for each bank that was discussed by the Restructuring Oversight Committee (ROC). The three banks have set up a restructuring committee which includes BSA members to implement the recommendations from the proposed strategy.

23. We have already completed the set of prudential regulations for commercial banks, including those related to minimum capital requirements, liquidity risk, and anti-money laundering, and will begin the implementation phase. Work on the relevant reporting tables for the banks will be completed soon in consultation with the IMF and other technical assistance providers. At the same time, we are stepping up our efforts to further develop banking supervision practices in line with best international practices. In addition, we have asked the commercial banks to conform their accounting norms to the International Financial Reporting Standards (IFRS) as per end-2009, and to prepare a set of financial soundness indicators that could be used to monitor sectoral developments. Finally, to assess the progress made so far, we are in the process of conducting a full assessment of the banking supervision department.

24. We have continued to strengthen the accounting and reporting framework of the CBI. The CBI has appointed a control committee, which is responsible for developing control procedures and manuals, and for establishing a modern internal audit function with the assistance of external consultants. An internal audit committee including two external experts has also been set up to make recommendations regarding external and internal audit oversight, financial reporting, and controls. We have also reconciled almost all the outstanding suspense accounts and CBI intra-branch accounts, and established a register of outstanding off-balance sheet commitments (letters of credit and guarantees). As of July, the CBI has completed the process of becoming IFRS compliant.

25. We are committed to strengthening the management of international reserves by moving ahead with the implementation of new reserves management guidelines that were adopted in early August 2008. We will follow the guidelines to diversify currency composition and establish appropriate duration and credit risk, build capacity for risk analysis, and work towards establishing a dealing room. We will also provide by end-March 2010 more frequent reports to the CBI board based on the investment criteria established in the guidelines.

26. To improve the functioning of foreign exchange auctions, we plan to develop organized exchange markets outside the central bank, including an interbank foreign exchange market. Our aim is to establish a forward market in Iraqi dinars in the near future.

IV. Program Safeguards and Monitoring, Debt and Data Issues

27. As we intend to use the domestic counterpart of IMF resources for budget support, the CBI—which is the fiscal agent—will request the IMF to disburse the resources directly into a government account at the CBI. To provide adequate safeguards to the Fund, the following steps have been taken or will be implemented in the near future:

- A Memorandum of Understanding has been agreed between the CBI and the government clarifying responsibilities with regard to servicing the debt to the Fund;

- An external auditor has been appointed to undertake the audit of the CBI 2008 financial statements in accordance with International Standards on Auditing, and the audit is expected to be completed by March 31, 2010. The external auditor has already completed a verification of the CBI's international reserves as of June 30, 2009. The completion of the external audit will allow the IMF to prepare a safeguards assessment update by the time of the first review of the program. In the future, the CBI will work with the Ministry of Finance to adopt a timely selection and rotation policy for future audits; an auditor for the 2009 CBI financial statements will be appointed before end-February 2010.

- The external auditor will also undertake special audits of (i) CBI Net International Reserves, and a full count of gold and foreign reserves held at the Central Bank, as of June 30, 2009, (ii) CBI data reported to the Fund, including, but not limited to, Net International Reserves, Net Domestic Assets, credit to government and a full count of gold and foreign reserves held at the Central Bank, as of December 31, 2009, December 31, 2010, December 31, 2011 and the other test dates during the SBA, and (iii) procedures surrounding government accounts at the CBI.

28. Progress has been made in moving toward accepting the obligations of Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement. We have worked with IMF staff to complete the review of exchange laws and regulations and are considering measures to remove the identified exchange restrictions on current international transactions. We remain committed to avoid imposing any restrictions on the making of payments and transfers for current international transactions or introducing any multiple currency practices.

29. We will continue our efforts to resolve outstanding external claims under terms that are consistent with the 2004 Paris Club agreement. Bilateral agreements with twelve non-Paris Club official creditors have already been signed and are being implemented. We will continue our best efforts to reach bilateral debt agreements with the remaining non-Paris Club creditors. The United Arab Emirates has announced the full cancellation of Iraq's debt, and implementation of a bilateral agreement with Greece is awaiting the Greek parliament's approval. Debt reconciliation was completed with Morocco, Egypt, and China, and we hope to sign the relevant debt agreements, particularly with China with which an agreement has been initialed recently, in the near future. Regarding private creditors, most of the commercial debt has been restructured, and is serviced as agreed. We also expect that the proceeds of the liquidation of the London branch of Rafidain Bank will be distributed to private claim holders by the end of the year.

30. Efforts will continue to improve Iraq's statistical database. Monetary and balance of payments data are now being published in the IMF's *International Financial Statistics* regularly, and annual national accounts data have been compiled up to 2007. We will focus on improving the quality of these annual data developing quarterly national accounts data. While the Socio-Economic Household Survey has been completed, the updating of the CPI weights has been delayed for a number of reasons. A new national coordinator for the General Data Dissemination System (GDDS) has been appointed. As of December 15, we are participating in the GDDS and comprehensive information on Iraq's statistical production and dissemination practices now appears on the IMF's Dissemination Standards Bulletin Board.

31. Performance under the program will be monitored through twice-yearly reviews, with macroeconomic policy performance monitored through semi-annual quantitative performance criteria (Table 1). Progress in structural reforms will be monitored through benchmarks (Table 2).

Table 1. Iraq: Quantitative Performance Criteria Under the Stand-By Arrangement, 2009–10 1/

(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at	Performance Criteria		
	12/31/09	3/31/10	6/30/10	12/31/10
Stock of net international reserves of the CBI (floor; eop stock, in millions of U.S. dollars)	44,337	44,257	44,178	44,019
Net domestic assets of the CBI 2/ (ceiling; eop stock)	-1,243	-398	38	1,320
Development Fund for Iraq balances (floor; eop stock; in billions of U.S. dollars, excl. FMS)	9.9	8.0	4.5	2.6
Cumulative flow from beginning of calendar year				
Central government fiscal deficit (ceiling) 3/ 4/ 5/	...	5,382	9,149	17,939
Central government current spending bill (ceiling) 3/ 5/	...	8,141	14,926	27,138
Direct government subsidies to the fuel sector 6/	...	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) 6/ 7/	...	2,000	2,000	2,000
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 6/	...	0	0	0

1/ The Technical Memorandum of Understanding (TMU) provides for precise definitions of all performance variables.
2/ Excluding other items net.
3/ End-March, end-June, and end-December performance criteria are cumulative from January 1, 2010.
4/ The fiscal balance will be measured via the sources of financing. See TMU for details.
5/ The current spending bill includes wages (excluding ministries of defense and interior), public distribution system, and transfers to state owned-enterprises. See TMU for details.
6/ To be monitored on a continuous basis.
7/ Concessionality is defined as loans with a grant element of 35 percent or higher. See TMU for details.

Table 2. Iraq: Prior Actions and Structural Benchmarks Under the Stand-By Arrangement

I. Prior Action for Board discussion of the new Program	Date	Status
Program safeguards		
1. A Memorandum of Understanding must be signed between the CBI and the government, clarifying responsibilities with regard to servicing the debt to the Fund.		Met
2. Completion by an external auditor of a verification of the CBI net international reserves data reported to the IMF as at June 30, 2009, including a full count of gold and foreign exchange holdings at the CBI.		Met
3. Appoint an external auditor to conduct the audit of the CBI 2009 financial statements, including a verification of the CBI net international reserves and net domestic assets data as at December 31, 2009, in accordance with International Standards on Auditing.		Pending

Table 2. Iraq: Prior Actions and Structural Benchmarks Under the Stand-By Arrangement

II. Structural Benchmarks	Date	Status
Program Safeguards and Central Banking		
1. Completion by an external auditor of the audit of the CBI 2008 financial statements in accordance with International Standards on Auditing.	March 31, 2010	
2. Prepare and submit to the Governor of the CBI monthly reports on the status of the CBI's investment portfolio, in light of the investment criteria established in the reserve management guidelines.	March 31, 2010	
3. Provide to IMF staff: (i) the completed special audit data as of December 31, 2009, including on the CBI's net international reserves and net domestic assets, and (ii) the draft 2009 audited financial statements and draft management letter.	March 31, 2010	
Bank Restructuring		
4. Completion of the restructuring of the balance sheets of Rasheed and Rafidain banks.	June 30, 2010	
Public Financial Management		
5. Complete review of all accounts in the banking system that are classified as central government accounts and reconcile them with Treasury records, returning any idle balances received from the budget to the central Treasury.	March 31, 2010	
6. Submit • to the Board of Supreme Audit and to the Council of Representatives the final accounts of the Federal Budget for the year ending December 31, 2008; • to the Council of Representatives and publish the audited accounts of the Federal Budget for the years ending December 31, 2005 and December 31, 2006; and • to the Board of Supreme Audit and to the Council of Representatives the final accounts of the Federal Budget for the year ending December 31, 2009.	 March 31, 2010 March 31, 2010 September 30, 2010	
7. To strengthen reporting and cash management: (i) start receiving monthly reports from spending units on spending, including investment, advances, and letters of credit, no later than two months after the end of each month and reconcile these amounts with the cash balances at the beginning and end of the reporting period; and (ii) approve cash releases only after the Ministry of Finance has reviewed the report from three months before.	Continuous from April 30, 2010	
8. To improve budget preparation for 2011, set ceilings in the budget circular for current and investment spending, in line with a sustainable medium term budget strategy.	June 30, 2010	
9. Prepare a detailed report documenting a review of the outstanding stock of advances to identify those that are recoverable; on the basis of the review, classify the debts as recoverable or irrecoverable; set a time schedule for their recovery, and for writing off irrecoverable advances based on appropriate authorization at a high level. Once actions have been taken to recover doubtful amounts, recommend that they be written-off.	September 30, 2010	
10. Complete an audited review of the largest investment projects initiated in 2008. The review, conducted by the BSA, should discuss the criteria used for approving the projects; the procurement process and the project management process.	September 30, 2010	
11. Completion of census of all central government employees (excluding those employed in the security area).	September 30, 2010	
Oil Sector		
12. Complete the process of becoming a candidate for membership in the EITI.	March 31, 2010	
13. Complete the installation of all domestic metering systems to allow accurate measurement of domestic oil flows.	December 31, 2010	
14. Conduct an audited review of the domestic oil sector to reconcile the flows of oil and oil products at key points in the national system with the financial flows between the various state-owned companies and the budget.	June 30, 2011	
15. Maintain a single account for oil export proceeds, subject to the strict transparency and accountability rules that govern the DFI, including an independent external audit, and the oversight of the Committee of Financial Experts (COFE).	Continuous	

ATTACHMENT III. IRAQ: TECHNICAL MEMORANDUM OF UNDERSTANDING

February 8, 2010

1. This memorandum describes the quantitative and structural performance criteria, benchmarks, and indicators for the third Stand-By Arrangement (SBA) with the International Monetary Fund (IMF). It also specifies the periodicity and deadlines for transmission of data to the staff of the IMF for program monitoring purposes.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATORS

2. The quantitative performance criteria are the following:

(i) a floor on net international reserves of the Central Bank of Iraq (CBI);

(ii) a ceiling on net domestic assets of the CBI;

(iii) a ceiling on the central government fiscal deficit;

(iv) a ceiling on the central government current spending bill;

(v) a floor under the balance in the Development Fund for Iraq (DFI);

(vi) a ceiling on direct government subsidies to the fuel sector;

(vii) a ceiling on contracting and guaranteeing of new medium- and long-term non-concessional external debt contracted or guaranteed by the central government and/or the CBI; and

(viii) a ceiling on external payments arrears on any rescheduled and new debt of the central government and/or the CBI.

II. DEFINITIONS

3. For purposes of monitoring under the program, a **program exchange rate** will be used. This program exchange rate will be set at ID 1,170 per U.S. dollar. The program exchange rate will be used to convert into Iraqi dinars the U.S. dollar value of all CBI foreign assets and liabilities denominated in U.S. dollars, as required. For CBI assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar, they will be converted in U.S. dollars at their respective SDR-exchange rates prevailing as of December 31, 2009, as published on the IMF's website.

4. For the purpose of this program, the **international or world oil price** is understood to be the Average Petroleum Sport Price (APSP) used in the IMF's World Economic Outlook (WEO), which is the simple average of UK Brent, Dubai Fateh, and West Texas Intermediate

spot prices reflecting world exports of light, medium, and heavy crude oil. The **projected international or world price** for a particular year is the latest WEO price projection for that year as released by the IMF's Research Department to IMF staff. IMF staff will provide these oil price projections to the Iraqi authorities. For purposes of assessing whether the SBA will be treated as precautionary, the **relevant projected international or world price** will be the average of APSP futures prices for the current year during the 30-day period prior to the circulation to the IMF's Executive Board of the documents for the respective review. In turn, the **projected Iraqi oil price** for purposes of assessing whether the SBA will be treated as precautionary will be calculated as the difference between the relevant projected international or world price (as defined above) and the average differential between the international price and the actual price at which Iraqi crude has been sold in the preceding 18-month period. IMF staff will make the APSP futures prices available to the Iraqi authorities on a regular basis.

5. For program purposes, **central government** is defined to include the central administration, the Kurdish government, as well as agencies included under Section 6 (the local boards, Iraqi media network, Iraqi national Olympic committee, Bait-Al-Hikma, Ammant Baghdad, Municipality institutions, as well as the General directorates of sewerage and water).

6. **Net international reserves (NIR)** are defined as gross usable reserves minus reserve-related liabilities of the CBI. Gross usable reserves of the CBI are claims of the CBI on nonresidents that are controlled by the CBI, denominated in foreign convertible currencies, and are immediately and unconditionally available to the CBI for meeting balance of payments needs or for intervention in foreign exchange markets, and are not earmarked by the CBI for meeting specific payments. They include CBI holdings of monetary gold, SDRs, Iraq's reserve position in the IMF, foreign currency cash, and deposits abroad, except for the resources of the DFI but including the CBI DFI sub-account. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). Reserve-related liabilities shall be defined as foreign currency denominated liabilities of the CBI to residents and nonresidents with original maturity of one year or less, and all liabilities to the Fund. They include: foreign currency reserves of commercial banks held at the CBI; commitments to sell foreign currency arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Excluded from reserve liabilities are the government's foreign currency deposits at the CBI. As of December 31, 2009, (net) international reserves amounted to US$44.34 billion, all comprising of in reserve assets. The program floors on the net international reserves of the CBI are reported in Table 1.

7. **Net domestic assets of the CBI** include (i) net claims on the general government, comprising of gross claims on the general government minus general government domestic and foreign currency deposits at the CBI; (ii) gross claims on commercial banks; (iii) monetary policy instruments, including dinar and foreign currency denominated term deposits and CBI bills; and (iv) gross claims on non-bank, non-government entities. For the purpose of this arrangement, net domestic assets of the CBI excludes other items net, comprising of net fixed and other assets, minus revaluation accounts and capital and reserve accounts. As of end-December 2009, net claims on the general government amounted to ID 2,740 billion; gross claims on commercial banks stood at ID 4 billion; monetary policy instruments amounted to ID -3,988 billion; and gross claims on non-bank, non-government entities were nil, resulting in a stock of the CBI's net domestic assets of ID -1,243 billion. As of end-December 2009, OIN amounted to ID -1,040 billion. The program ceilings of the net domestic assets of the CBI are reported in Table 1.

8. The **central government fiscal deficit** will be calculated as the sum of domestic and external financing of the central government balance, adjusted for any deviations in the amounts of (i) donor financing for projects and (ii) "other financing" in excess of program projections. Domestic financing includes any form of resident financing of the consolidated budget from (i) the central bank; (ii) commercial banks; (iii) non-bank financial institutions; (iv) nonfinancial enterprises; (v) privatization proceeds; (vi) changes in arrears; (vii) households; and (viii) all other domestic financing not elsewhere classified. External financing includes financing from (i) the Development Fund for Iraq, (ii) donor financing for projects, (iii) other financing not elsewhere classified, net of (iv) the amortization of external debt. The ceilings for end-March 2010, end-June 2010, and end-December 2010 will be measured on a cumulative basis from January 1, 2010. The program ceilings of the central government fiscal deficit are reported in Table 1.

9. The **central government current spending bill** includes the wage and pension bill, the in-kind transfers under the Public Distribution System (PDS), and transfers to state-owned enterprises (SOEs). The **wage and pension bill** includes all wage and pension payments made by the central government, excluding wage payments made by the ministries of defense and interior. Specifically, with reference to the 2009 budget classification, it includes expenditures under Section 1 (except those for the ministries of defense and interior) and Section 6, sub-section 1, items 2(1), 3(1, 3, 5, and 7), 4(1), 5(1), 7(1), 8(1), 9(1), 10(1), 11(1), 12(1), and 13(1). The **Public Distribution System** bill includes the spending reported under Section 7, sub-section 2, item 1(1). The **transfers to the SOEs bill** covers expenditures covered in Section 5, net items covered under subsection 2, items 1(1 to 6). The ceilings on the government current spending bill for end-March 2010, end-June 2010, and end-December 2010 will be measured on a cumulative basis from January 1, 2010. The program ceilings of the central government current spending bill are reported in Table 1.

10. The **balance in the DFI** consists of: (i) the main account held at the Federal Reserve Bank of New York that consolidates all receipts from export sales of petroleum and petroleum products; proceeds from frozen assets in foreign countries; balances related to the United Nations Oil for Food Program; interest or other revenue accrued from income investments (i.e., overnight deposits and repos, interests derived from the PCO, FMS and TBI balances) and T-bills; returned Letters of Credit; and other deposits and revenue covered under the UNCR 1483 (2003) resolution; and (ii) the balance in the PCO account. For program purposes, the balance in the FMS account is excluded from the balance in the DFI. The program floors on the balance in the DFI are reported in Table 1.

11. **Direct government subsidies to the fuel sector** shall comprise of any financial assistance rendered by the Ministry of Finance to fuel-related enterprises. The ceilings for end-March 2010, end-June 2010, and end-December 2010 will be measured on a cumulative basis from January 1, 2010. The program ceilings of the direct government subsidies to the fuel sector are reported in Table 1.

12. A continuous ceiling applies to the non-accumulation of **external payments arrears** on rescheduled debt and new external debt contracted or guaranteed by the central government and/or the CBI. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 31, 2009 and that have not been paid at the time they are due, as specified in the contractual agreements. The program ceilings of the external payments arrears are reported in Table 1.

13. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), the term "**debt**" will be understood to mean a current liability (i.e., not contingent), created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits), and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception

of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair or maintenance of the property. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

14. For purposes of the program, the **guarantee of a debt** arises from any explicit legal obligation of the government or CBI or any other agency acting on behalf of the government to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the government or CBI to cover a shortfall incurred by the loan recipient.

15. The limits on **medium- and long-term external debt** apply to the contracting or guaranteeing by the government and/or the CBI of new, nonconcessional external debt with an original maturity of more than one year. This limit applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt in Fund Arrangements (Decision No. 6230-(79/140), August 3, 1979, as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Iraqi parliament. Excluded from this limit are leases of real property by Iraqi embassies or other foreign representations. External debts will be expressed in U.S. dollar terms, with debts in currencies other than the U.S. dollar converted into U.S. dollars at the market rates of the respective currencies prevailing on December 31, 2009, as published on the IMF's website. The program ceilings of the contracting or guaranteeing of medium- and long-term external debt are reported in Table 1. These limits are applied on a continuous basis to the contracting and guaranteeing of external debt on or after January 1, 2010 and the limit during the period preceding each test date will be the ceiling set for that particular test date.

16. **Concessionality** will be based on currency-specific discount rates based on the Organization for Economic Co-operation Development (OECD) commercial interest reference rates (CIRRs). For loans of an original maturity of at least 15 years, the average of CIRRs over the last 10 years will be used as the discount rate for assessing the concessionality of these loans, while the average of CIRRs of the preceding six-month period will be used to assess the concessionality of loans with original maturities of less than 15 years. To the ten-year and six-month averages of CIRRs, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 29 years. Under this definition of concessionality, only loans with grant element equivalent to 35 percent or more will be excluded from the debt limits. The debt limits also will not apply to loans contracted for debt

rescheduling or refinancing (including the deferral of interest in commercial debt), and credits extended by the IMF and the World Bank.

V. Program Adjustors

17. If oil revenues exceed/fall short of the amounts projected under the program ($22.6 billion in the first half of 2010 (of which $11.8 billion in the first quarter); and $48 billion for the entire year 2010), the **ceilings on the central government fiscal deficit** for end-March 2010, end-June 2010, and end-December 2010 will be adjusted *downwards/upwards* by half of the excess/shortfall as compared to the respective projected amounts, multiplied by the program exchange rate. In case oil revenues exceed the amounts projected under the program, half of the additional revenues can be used only to finance capital spending. In 2010, this additional capital spending will be limited to the equivalent of $4 billion ($2 billion in the first half of 2010), subject to a reassessment in the context of the first and second reviews under the program.

18. The **ceilings on the central government fiscal deficit** will be adjusted (i) *upwards/ downwards* by the cumulative amount (prorated for the relevant period) of any excess/shortfall in external project loans, and/or external debt interest payments, relative to the program amounts (included in the table below); and (ii) *downwards* by the cumulative amount (prorated for the relevant period) of any excess in external budget support grants relative to the program amounts (included in the table below).

Program amounts on External Grants and Loans and
External Debt Service Payments , 2010
(In billions of Iraqi dinars)

	2010
Grants	1,691
Project	1,691
Budget support	0
Loans 1/	2,627
Project financing	1,223
Oil-related soft loans	1,404
Interest on External Debt	715

1/ Excludes the IMF SDR allocation.

19. The **floors under the balance in the DFI** for end-March 2010, end-June 2010, and end-December 2010 will be adjusted upwards/downwards by half of the excess/shortfall in oil revenues as compared to the projected amounts as described in paragraph 17.

VI. Provision of Information to the Fund Staff

A. Data

20. To monitor developments under the SBA, the authorities agree to provide the Fund, the information specified below after SBA approval. The program is designed with semester quantitative performance criteria and the actual outcome should be provided within eight weeks following the end of the semester. However, in order to facilitate regular monitoring, many of the indicators should be provided with higher frequencies, as indicated below.

- CBI gross foreign exchange reserves (weekly) and balances of the DFI held at the FRBNY. This should be reported no longer than 2 weeks after the end of the reference week.
- The monthly balance sheet of the CBI, with a month lag.
- The monthly consolidated balance sheet of the other depository corporations (commercial banks), with an eight week lag.
- The depository corporations (monetary) survey of all commercial banks and the CBI (quarterly), with an eight weeks lag.
- Weekly preliminary monetary and financial aggregates as in "Key Financial Indicators", including exchange rate data (daily), currency in circulation, transferable and other deposits held at commercial banks, balances on government accounts at the CBI, interest rates on loans and on deposits at commercial banks, holdings of government securities, and credit outstanding to the public and private sectors. The data, excluding exchange rates, should be reported no longer than three weeks after the end of the reference period.
- Consumer price index (CPI), including indices for main cities (monthly). These should be reported no longer than a month after the end of the relevant month.
- Detailed revenues, operating and capital expenditure, and financing items of consolidated fiscal and oil operations, and overall fiscal balance. These data should include the execution of the Iraqi budget, operations and deposits of the oil-related state-owned enterprises, disbursements of external assistance and loans, execution of letters of credit financed under the UN oil-for-food program, all operations of the DFI and its sub-accounts, balances of all government accounts held at the CBI and the commercial banks, and outstanding stock of government securities (including treasury bills). These data should be reported on a monthly basis and no later than eight weeks after the end of the reference month.

- Amount of total imports of petroleum products financed from the budget on a quarterly basis starting with the first quarter of 2009. These data should be reported no later than eight weeks after the end of the reference quarter.

- Indicators of oil activity on crude oil and gas production and use, production and sales (export and domestic) of refined petroleum products, including heavy residuals (monthly). These data should be reported no longer than eight weeks after the end of the reference quarter.

- Indicators of non-oil real economic activity (quarterly), including production of cement, fertilizers, and electricity, reported no longer than eight weeks after the end of the reference quarter.

- Detailed data on disbursement of external assistance (both project and budget financing) from the U.S. and other donors, including by recipient sector; foreign debt amortization and interest payments made; and total outstanding domestic and external debt. These data should be reported on a monthly basis no more than eight weeks after the end of the reference month.

- List of short, medium, and long-term government or government-guaranteed external loans contracted during each quarter, identifying for each loan: the creditor, the borrower (ultimate obligor), the amount and currency, the maturity and grace period, repayment terms, and interest rate arrangements (monthly).

- Details on new debt rescheduling and debt relief agreements with bilateral, multilateral, and commercial creditors, including new outstanding amount and currency, schedule of payments (principal and interest), terms of agreement, repayment terms, and interest rate arrangements.

- Foreign trade statistics (imports, exports, re-exports) (quarterly). This should be reported no longer than eight weeks after the end of the reference quarter.

- The balance sheet of the Trade Bank of Iraq (TBI) as well as data on issued, implemented and outstanding Letters of Credit, with no more than an eight weeks lag.

- The amount and terms of concessional loans contracted and their grant element, on a quarterly basis, with no more than eight weeks lag.

B. Structural Reforms

21. The authorities will prepare and send to the IMF reports, with appropriate documentation, indicating progress achieved, explaining any deviations relative to the initial planning, and specifying expected revised completion dates.

C. Other Information

22. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff, for consultation or information.

APPENDIX I. IRAQ: DEBT SUSTAINABILITY ANALYSIS

Iraq's debt sustainability analysis underlines the progress the country has made in recent years in resolving the country's external debt burden (Tables 1 and 2)**.** With the conclusion of the third and last phase of the Paris Club debt reduction agreement, as well as the settlement of almost all private sector debt, Iraq's external debt sustainability has improved significantly**.** Assuming that debt reduction on terms comparable to the Paris Club agreement is applied to all non-Paris Club creditors' claims, Iraq's external debt is projected to fall to about 47.5 percent of GDP at end-2010 and to decline over the medium term. Under the baseline scenario, the medium term projections assume that the new external debt is mostly to multilateral creditors (particularly the IMF and World Bank) and a few bilateral creditors. Under this scenario, gross public sector debt is projected to decline from 137 percent of GDP in 2009 to 28 percent in 2014.

The authorities intend to broaden the debt instruments available to them to absorb shocks and cover their financing needs by deepening the Treasury bill market. This will allow the government to tap private domestic financial resources and help develop an active and liquid domestic capital market. In line with budget projections, the analysis assumes the issuance of $3 billion of Treasury-bills annually until 2011 to help finance the projected fiscal gap. These Treasury-bills would be partially redeemed by 2013-14 as the budget moves back into surplus. By end-2014 the stock of outstanding Treasury-bills is projected at $3 billion.

While the debt ratios show a healthy decline under the baseline scenario, stress tests indicate that:

- *Iraq's external debt is significantly vulnerable to oil price and production shocks***.** With a permanent oil production shock (production remaining at a level 5 percent below the baseline 2010 level), the debt-to-GDP and debt service-to-export ratios would rise rapidly over the medium term; (ii) a price shock of 10 percent (relative to the baseline) would also present difficulties albeit of a lesser importance than the volume shock; and (iii) a combined oil price and production shock would present significantly more severe problems as unsustainable market borrowing would become necessary.
- *Iraq's public debt remains somewhat vulnerable to negative shocks, especially to a depreciation of the exchange rate and oil shocks (through external debt liabilities).* A 30 percent depreciation of the dinar would triple the stock of debt relative to the baseline scenario, exceeding 85 percent of GDP by 2014. An increase of interest rates and a decline of growth rates would also have a negative impact the stock of debt, which would almost double by 2014 relative to the baseline ratios.
- *Major vulnerabilities could also arise if the authorities deviate from the adoption and implementation of sustainable fiscal policies.*

Table 1. Iraq: External Debt Sustainability Framework, 2005–14

(In percent of GDP, unless otherwise indicated)

	Estimates				Projections					
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
External debt	351.6	219.7	181.0	110.5	137.1	47.5	43.5	38.4	31.6	28.1
Change in external debt (1)	-124.6	-131.9	-38.7	-70.5	26.6	-89.6	-4.0	-5.1	-6.8	-3.5
Identified external debt-creating flows (2)	-93.1	-125.9	-60.3	-77.5	52.9	-5.1	-4.2	-7.7	-6.4	-9.7
Current account deficit, excluding interest payments	-22.3	-28.9	-21.1	-20.9	11.6	14.5	3.8	-0.5	-0.6	-3.2
Deficit in balance of goods and services	4.6	-15.7	-16.5	-16.7	15.5	16.7	7.7	4.3	2.7	-1.4
Exports	74.8	67.1	67.9	73.4	61.1	61.7	62.2	62.6	62.7	64.1
Imports	79.3	51.4	51.4	56.7	76.6	78.4	69.9	66.9	65.4	62.7
Net non-debt creating capital inflows (negative) 1/	-1.6	-0.2	-1.7	-0.6	-1.2	-1.5	-3.3	-3.4	-3.7	-3.9
Automatic debt dynamics 2/	-69.1	-96.8	-37.5	-56.0	42.5	-18.1	-4.7	-3.8	-2.1	-2.5
Contribution from nominal interest rate	16.1	9.9	8.4	5.8	7.7	6.5	1.7	1.6	1.5	0.5
Contribution from real GDP growth	2.8	-15.2	-2.6	-11.3	-6.1	-8.2	-3.2	-2.9	-2.5	-1.9
Contribution from price and exchange rate changes 3/	-88.1	-91.6	-43.3	-50.5	40.8	-16.5	-3.2	-2.6	-1.1	-1.1
Residual, incl. change in gross foreign assets (1–2)	-31.6	-6.0	21.6	7.0	-26.3	-84.4	0.3	2.6	-0.4	6.1
External debt-to-exports ratio (in percent)	470.3	327.6	266.5	150.5	224.4	77.0	70.0	61.4	50.4	43.9
Gross external financing need (in billions of U.S. dollars) 4/	-1.8	-7.0	-6.7	-12.4	13.7	18.3	5.9	2.2	2.6	-0.8
in percent of GDP	-5.7	-15.6	-10.8	-12.8	12.5	14.6	4.2	1.4	1.5	-0.4
External debt service in percent of exports 5/	22.3	19.9	13.7	8.9	15.1	13.4	4.0	4.1	4.6	4.0
Debt-stabilizing non-interest current account (positive = surplus) 6/	-102.3	-103.0	-17.6	-49.6	14.9	-104.1	-7.8	-4.6	-6.2	-0.3
Key Macroeconomic Assumptions										
Real GDP growth (in percent)	-0.7	6.2	1.5	9.5	4.2	7.3	7.9	7.6	7.1	6.8
Exchange rate appreciation (U.S. dollar value of local currency, change in percent)	-1.1	0.1	17.0	5.2	2.0	0.0	0.0	0.0	0.0	0.0
GDP deflator (change in domestic currency)	24.0	35.1	6.5	31.8	-28.4	13.7	7.2	6.3	3.1	3.5
GDP deflator in U.S. dollars (change in percent)	22.7	35.2	24.6	38.7	-27.0	13.7	7.2	6.3	3.1	3.5
Nominal external interest rate (in percent)	4.1	4.1	4.8	4.9	5.3	5.8	4.1	4.3	4.4	1.7
Growth of exports (U.S. dollar terms, in percent)	31.9	28.8	28.0	64.1	-36.7	23.2	16.6	15.0	10.7	12.9
Growth of imports (U.S. dollar terms, in percent)	2.5	-7.0	26.5	67.6	2.8	24.8	3.1	9.4	8.0	5.9
Stress Tests for External Debt-to-GDP Ratio										
Lower oil production in 2010–14 7/	351.6	219.7	181.0	110.5	137.1	57.3	67.1	77.4	81.8	99.0
Lower oil price in 2010–14 8/	351.6	219.7	181.0	110.5	137.1	61.2	63.5	61.9	52.3	51.6
Combined shock--lower production and lower oil price in 2010–14 9/	351.6	219.7	181.0	110.5	137.1	68.0	84.5	100.6	110.0	133.1
Stress Tests for External Debt Service-to-Exports Ratio 5/										
Lower oil production in 2010–14 7/	22.3	19.9	13.7	8.9	15.1	14.2	8.3	14.5	24.3	26.0
Lower oil price in 2010–14 8/	22.3	19.9	13.7	8.9	15.1	14.8	8.6	11.8	15.0	12.5
Combined shock--lower production and lower oil price in 2010–14 9/	22.3	19.9	13.7	8.9	15.1	15.9	12.4	22.8	37.9	40.7
Memorandum items:										
Real GDP growth under stress scenarios (in percent)										
Lower oil production in 2010–14 7/	-0.7	6.2	1.5	9.5	4.2	3.9	1.9	2.2	2.3	2.3
Lower oil price in 2010–14 8/	-0.7	6.2	1.5	9.5	4.2	7.3	7.9	7.6	7.1	6.8
Combined shock--lower production and lower oil price in 2010–14 9/	-0.7	6.2	1.5	9.5	4.2	0.6	2.0	2.3	2.4	2.4
Non-interest current account deficit under stress scenarios (in percent of GDP)										
Lower oil production in 2010–14 7/	-22.3	-28.9	-21.1	-20.9	11.6	17.1	9.9	7.7	8.2	4.9
Lower oil price in 2010–14 8/	-22.3	-28.9	-21.1	-20.9	11.6	19.0	7.4	2.2	1.3	-1.9
Combined shock--lower production and lower oil price in 2010–14 9/	-22.3	-28.9	-21.1	-20.9	11.6	22.2	14.2	11.1	10.7	5.8

Sources: Iraqi authorities; and Fund 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.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. 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 $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

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 including capitalized interest.

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 2.47 mbpd (5 percent lower than the baseline value) from 2010 onward.

8/ Assumes that oil price in 2010–14 is 10 percent lower than the Iraqi oil price projections in the baseline.

9/ Assumes that oil production remains at 2.47 mbpd and oil price 10 percent lower than the baseline in 2010–14.

Table 2. Public Sector Debt Sustainability Framework, 2005-2014

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2005	2006	2007	2008			2009	2010	2011	2012	2013	2014	
							I. Baseline Projections						Debt-stabilizing primary balance 10/
Public sector debt 1/	353.1	198.4	175.3	108.5			**141.6**	**55.0**	**53.2**	**47.8**	**37.6**	**30.4**	**-1.9**
o/w foreign-currency denominated	353.1	198.4	175.3	108.5			137.1	47.5	43.5	38.4	31.6	28.1	
Change in public sector debt	-125.5	-154.7	-23.1	-66.7			33.1	-86.7	-1.7	-5.4	-10.2	-7.2	
Identified debt-creating flows (4+7+12)	-92.4	-166.4	-40.0	-55.7			53.2	-4.0	-0.9	-8.5	-9.8	-13.3	
Primary deficit	-6.7	-16.1	-10.5	-2.2			21.7	18.0	4.4	-3.8	-7.3	-10.9	
Revenue and grants	107.3	88.2	83.7	84.3			76.5	75.4	74.7	73.5	74.1	75.1	
Primary (noninterest) expenditure	100.6	72.1	73.2	82.1			98.1	93.3	79.1	69.8	66.8	64.2	
Automatic debt dynamics 2/	-85.7	-150.3	-29.5	-53.5			31.6	-21.9	-5.3	-4.8	-2.5	-2.4	
Contribution from interest rate/growth differential 3/	-89.7	-127.4	-14.3	-49.0			31.8	-21.9	-5.3	-4.8	-2.5	-2.4	
Of which contribution from real interest rate	-92.6	-113.4	-11.5	-37.1			37.7	-13.3	-1.5	-1.2	0.6	0.0	
Of which contribution from real GDP growth	2.8	-14.0	-2.7	-12.0			-5.9	-8.6	-3.8	-3.5	-3.1	-2.3	
Contribution from exchange rate depreciation 4/	4.0	-22.9	-15.2	-4.5			-0.2	0.0	0.0	0.0	0.0	0.0	
Other identified debt-creating flows	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3)	-33.1	11.7	16.9	-11.0			-20.1	-82.7	-0.9	3.1	-0.4	6.1	
Public sector debt-to-revenue ratio 1/	329.0	224.9	209.4	128.8			185.1	72.9	71.2	65.1	50.8	40.5	
Gross financing need 5/	-6.5	-15.5	-9.7	-1.7			22.6	19.1	5.7	-2.2	-3.1	-6.7	
in billions of U.S. dollars	-2.0	-7.0	-5.5	-1.5	4-Year	4-Year	14.8	15.3	5.3	-2.3	-3.7	-8.7	
Key Macroeconomic and Fiscal Assumptions					Historical Average	Standard Deviation							Projected Average
Real GDP growth (in percent)	-0.7	6.2	1.5	9.5	4.1	4.6	4.2	7.3	7.9	7.6	7.1	6.8	7.3
Average nominal interest rate on public debt (in percent) 6/	0.0	0.3	0.5	0.4	0.3	0.2	0.6	1.0	2.8	3.4	3.6	3.3	2.8
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-24.0	-47.4	-6.2	-26.9	-26.1	16.9	25.9	-10.4	-2.6	-2.2	1.6	0.1	-2.7
Nominal appreciation (increase in US dollar value of local currency, in percent)	-1.0	11.3	9.1	3.7	5.8	5.5	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	24.0	47.7	6.7	27.3	26.4	16.8	-25.3	11.4	5.4	5.6	2.1	3.3	5.6
Growth of real primary spending (deflated by GDP deflator, in percent)	-22.6	-30.4	2.9	27.3	-5.7	26.2	19.5	4.1	-7.0	-4.6	3.5	2.9	-0.2
Primary deficit	-6.7	-16.1	-10.5	-2.2	-8.9	5.9	21.7	18.0	4.4	-3.8	-7.3	-10.9	0.1
							II. Stress Tests for Public Debt Ratio						Debt-stabilizing primary balance 10/
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2009-2014 7/							**142.4**	**12.5**	**-0.8**	**-6.0**	**-13.7**	**-11.5**	**3.2**
A2. No policy change (constant primary balance) in 2009-2014							**141.6**	**57.8**	**73.0**	**91.3**	**107.9**	**129.3**	**-8.1**
B. Bound Tests													
B1. Real interest rate is at baseline plus one standard deviations							**138.4**	**61.8**	**63.6**	**62.2**	**56.7**	**53.6**	**0.8**
B2. Real GDP growth is at baseline minus one-half standard deviation							**138.4**	**54.8**	**57.3**	**57.7**	**55.0**	**56.9**	**-2.4**
B3. Primary balance is at baseline minus one-half standard deviation							**138.4**	**57.0**	**58.0**	**55.2**	**47.5**	**42.8**	**-2.7**
B4. Combination of B1-B3 using one-quarter standard deviation shocks							**138.4**	**60.8**	**62.9**	**61.2**	**54.7**	**51.1**	**-0.7**
B5. One time 30 percent real depreciation in 2010 9/							**138.4**	**131.8**	**122.3**	**110.8**	**98.0**	**88.0**	**-5.5**
B6. 10 percent of GDP increase in other debt-creating flows in 2010							**138.4**	**64.0**	**61.4**	**55.3**	**44.7**	**37.1**	**-2.3**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ The implied change in other key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND

IRAQ

Staff Report for the 2009 Article IV Consultation and Request for Stand-By Arrangement

Informational Annex

Prepared by the Middle East and Central Asia Department

February 16, 2010

Contents Page

Annex I. Iraq: Relations with the Fund as of December 31, 2009

I. **Membership status**:
Date of membership: December 27, 1945
Status: Article XIV

II. **General resources account**:	**SDR Million**	**%Quota**
Quota	1,188.40	100.00
Fund holdings of currency	1,017.31	85.60
Reserve Position	171.10	14.40

III. **SDR department**:	**SDR Million**	**%Allocation**
Net cumulative allocation	1,134.50	100.00
Holdings	1,159.86	102.24

IV. **Outstanding purchases and loans**: None

V. **Latest financial arrangements**:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Dec 19, 2007	Mar 18, 2009	475.36	0.00
Stand-By	Dec 23, 2005	Dec 18, 2007	475.36	0.00

VI. **Projected payments to Fund**:
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2010	2011	2012	2013	2014
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	0.08	0.08	0.08	0.08	0.08
Total	0.08	0.08	0.08	0.08	0.08

VII. **Implementation of HIPC Initiative**: Not Applicable.

VIII. **Safeguards assessments**:

The Central Bank of Iraq (CBI) is subject to an update safeguards assessment in respect of the proposed SBA. The earlier safeguards assessment, in conjunction with the SBA approved on December 19, 2007, was finalized on March 7, 2008. It concluded that accounting and control governance at the CBI needs to be strengthened. Steps are being taken to address the issues that continue to give rise to heavily qualified external audit opinions, but accounting and internal control procedures are not yet fully effective. Measures to mitigate the safeguards risks, notably through continued external audits and adoption of foreign reserves management guidelines were recommended.

IX. **Exchange rate arrangement**:

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

Iraq continues to avail itself of the transitional arrangements under Article XIV. Iraq has a generally unrestricted current account regime and a significantly liberalized capital account. However, four measures (plus one exchange restriction maintained for national or international security) have been identified to give rise to exchange restrictions subject to IMF approval, namely, (i) the requirement to pay all obligations and debts to the government before proceeds of investments of investors, and salaries and other compensation of non-Iraqi employees may be transferred out of Iraq, (ii) the requirement to submit a tax certificate and a letter of non-objection stating that the companies do not owe any taxes to the government before non-Iraqi companies may transfer proceeds of current international transactions out of the country, (iii) the requirement that before non-Iraqis may transfer proceeds in excess of ID 15 million out of Iraq, the banks are required to give due consideration of legal obligations of these persons with respect to official entities, which must be settled before allowing any transfer, and (iv) an Iraqi balance owed to Jordan under an inoperative bilateral payments agreement. In addition, one exchange restriction maintained for security reasons should be notified to the IMF under the framework of Decision 144-(52/51).

X. **Article IV consultations**:

The last Article IV consultation was concluded on August 1, 2007. The staff report (IMF Country Report No. 07/301) was published on August 31, 2007, and is available on the internet at http://www.imf.org/external/pubs/cat/longres.cfm?sk=21301.0.

XI. **Recent technical assistance**:

Department	Date	Topic
FAD	November 2006	Financial Management Information System
	December 2006	Oil sector management and fiscal federalism
	May 2007	Tax policy workshop
	March 2008	Public Financial Management
	August 2008	Oil sector—Pricing and Financial Flows
	March 2008	Oil sector—Taxation
	October 2009	Public Financial Management
LEG	August 2008	AML/CFT raising awareness workshop
	October 2008	Article VIII acceptance
	February 2009	Workshop for financial intelligence unit and criminal justice officials on AML/CFT measures
MCM	January 2006	Balance of Payments statistics
	March 2006	Money and Banking Statistics
	November 2006	Balance of Payments Statistics
	March 2007	Banking restructuring
	March 2007	Banking supervision
	September 2007	Banking restructuring
	March 2008	Liquidity forecasting and management
	April 2008	Bank restructuring workshop
	July 2008	Reserves management
	August 2008	Bank restructuring workshop
	October 2008	Article VIII acceptance
	December 2008	Reserve management
	January 2009	Bank supervision workshop
	March 2009	Banking supervision workshop
	November 2009	Reserve Management
	November 2009	Banking supervision workshop-reporting forms
STA	January 2006	Balance of Payments statistics
	March 2006	Money and Banking Statistics
	November 2006	Balance of Payments Statistics
	January 2007	Monetary and Financial Statistics
	January 2007	Consumer price statistics
	April 2007	Monetary and Financial Statistics
	February 2007	National Accounts Statistics
	November 2007	Consumer price statistics
	February 2008	Balance of Payments Statistics
	February 2008	National Accounts Statistics
	January 2009	Balance of Payments Statistics
	November 2009	National Accounts Statistics
INS	February 2006	Financial Programming and Policies
	February 2007	External Sector Issues
	March 2008	Financial Programming and Policies
	January 2009	Financial Programming and Policies

XII. **Resident Representative**

Mr. Ibrahim was appointed on November 30, 2004 as resident representative for Iraq. Due to the prevailing security situation, he is currently based in Amman (Jordan).

ANNEX II. IRAQ: RELATIONS WITH THE WORLD BANK GROUP

As of November 23, 2009

1. Iraq, a founding member of the International Bank for Reconstruction and Development (IBRD), received six loans from the IBRD between 1950 and 1973 for agriculture, education, flood control, telecommunications, and transport. The last loan closed in 1979. Iraq was in non-accrual status from 1990 to December 2004, when it paid its arrears to the IBRD (about US$108 million).

2. The Bank began reengaging with Iraq in 2003, with the preparation of Watching Briefs followed by a Joint Needs Assessment together with the United Nations. A first Interim Strategy Note (ISN) for Iraq, discussed by the Bank's Executive Directors in January 2004, relied on grants from the multi-donor World Bank Iraq Trust Fund (ITF) to finance projects.

A. The Bank Group Strategy and Operations

3. The World Bank's Group's third ISN for Iraq for the period 2009-2011 was discussed by the World Bank's Board of Executive Directors on March 19, 2009. The central guiding principle of the ISN is that the main role for the World Bank is to help Iraq use its resources more effectively and transparently and to lay the ground for private sector development. The ISN includes three thematic areas of engagement: (i) continuing to support ongoing reconstruction and socio-economic recovery; (ii) improving governance and the management of public resources, including human, natural and financial; and (iii) supporting policies and institutions that promote broad-based, private-sector-led growth, with the goal of revitalizing the private sector and facilitating job creation. The ISN includes a $500m envelope for financial support to Iraq in IBRD terms.

4. **Analytical and Advisory Activities.** In addition to financial support, the Bank places special emphasis on its analytical and advisory activities (AAA), including capacity building, policy advice, and economic and sector work, as key vehicles of Bank assistance to Iraq. Examples of recent key analytical work include a Report on the Management of the Public Distribution System (2005), a Public Expenditure Institutional Assessment (2008); and a Poverty Assessment (2009). An Investment Climate Assessment is underway and a Public Expenditure Review is planned.

5. Public finance management reform continues to be a key component of the Bank's engagement with Iraq. The PEIA, issued to the Government in June 2008, outlined steps for strengthening the accountability and transparency of public finance institutions and policies and help Iraq meet the goals set in the Iraq Compact. The PEIA underpins an Iraqi-owned public finance management reform program. A Public Financial Management project, financed through the World Bank Iraq Trust Fund (ITF) was approved in June 2009 to provide technical assistance (TA) to help the GOI's develop a more effective, accountable and transparent public financial management system. The Bank has also provided related support to modernize the public procurement system, including the drafting of a new public procurement law.

6. While focusing on public resource management, the Bank is supporting other key issues: strengthening social safety nets and modernizing the pension system; improving the efficiency and effectiveness of the Public (food) Distribution System; assessing poverty and vulnerability; improving management of oil revenues; and restructuring the state-owned banking system, for which an ITF-financed Banking Sector Reform project was approved in April 2009. The Bank has also provided policy support in a wide range of sectors including education, electricity, health, transport, water supply and sanitation, and water resource management.

7. **World Bank Iraq Trust Fund (ITF)**. Seventeen donors have deposited US$494 million in the ITF. It has financed 21 grants valued at US$507 million, exceeding donor contributions by US$13 million and committing 103 percent of donor deposits to projects. ITF projects focus on helping the GOI strengthen its institutional capacity to deliver services, utilize its resources in an efficient and transparent manner, and implement key reforms. ITF grants finance textbooks, schools, pharmaceuticals and health clinics, improved social safety nets, water supply and sanitation, irrigation and drainage, electricity, environmental management, private sector development, and banking and public finance management reform efforts. The ITF also finances technical assistance to help strengthen Iraqi institutions develop baseline poverty data, and improve social safety net targeting mechanisms.

8. Of the 21 grants, 18 are active projects valued at US$447 million, and 3 projects, valued at US$60 million, are completed. The vast majority of ITF projects are implemented by Iraqi agencies (15 out of the 18 active projects, amounting to US$434 million) to help the GOI develop effective institutions to ensure country ownership. Three projects, totaling US$12 million, finance technical assistance/capacity building activities that are implemented by the Bank at the request of the GOI. Commitments and disbursements continue to increase. Overall, as of November 20, 2009, commitments total about US$390 million (about 79 percent of the grant amounts), and disbursements for project expenditures total US$279 million (about 57 percent of the grant amounts).

9. Three technical assistance projects to be financed by the ITF are scheduled to be approved before the end of the year: (i) *Institutional Strengthening and Capacity Building for the Education Sector Project* (US$3 million) aims to help four education ministries develop a coherent, Iraqi-owned, national education sector strategy; (ii) *Pension Reform Implementation Technical Assistance Project* (US$6 million) aims to help the Ministry of Finance develop a long-term pension strategy that will expand social insurance coverage, and unify the policies and administrative bodies of private and public sector pension schemes; and (iii) *Integrated National Energy Strategy Technical Assistance Project* (US$5 million) finances technical assistance to help GOI formulate an Integrated National Energy Strategy that will include on all branches of the energy sector (oil, gas and power), with particular emphasis on their coordination and on setting the stage for effective medium- and long-term development.

10. **IDA**. In late 2004, Iraq became eligible for exceptional Bank lending under IDA (the Bank’s concessional assistance window). Since then, the Bank has approved 5 IDA projects

amounting to US$509 million, to finance projects in education, roads, electricity and water.[1] Following a lengthy delay in identifying the required steps to make the credits effective, Iraq's parliament ratified the four loans on July 2007, and the water project in September 2009. As of November 20, 2009, commitments total US$279 million (about 55 percent of the credit amounts), and disbursements total US$44 million (about 9 percent of the credit amounts).

11. The Bank engages a Fiduciary Monitoring Agent (FMA) to help supervise ITF and IDA project implementation. The FMA employs about 24 Iraqi professionals to monitor the physical implementation of projects and compliance with procurement and financial management requirements. The FMA visits projects sites and meets with ministry staff on a daily basis and provides monthly progress reports to the Bank.

12. **International Finance Corporation (IFC).** IFC's current portfolio consists of a 10 percent equity stake (US$6.2 million) in Credit Bank of Iraq (CBI) in partnership with the National Bank of Kuwait (NBK)—this has had a strong demonstration effect. IFC has also partnered with the National Bank of Iraq (NIB), and committed US$98 million to support Iraq's first private cement company in Kurdistan—these two projects were cancelled due to sponsor/project issues and security circumstances.

13. IFC is keen to continue investing and supporting the private sector in Iraq. On the investment side, IFC is exploring opportunities in the following areas: (a) establishing trade finance lines with 2 Iraqi banks (Bank of Bagdad and Credit Bank of Iraq); (b) investments in microfinance, in collaboration with US Treasury and OPIC; (c) supporting a Greenfield business hotel in Erbil-recently submitted to the Board; (d) supporting SOE reforms; (e) **e**xploring opportunities for power sector Independent Power Plants (IPP); and (f) investments in the telecom sector.

14. On the advisory side, IFC will try to (a) develop the capacity of IFC's current Iraqi client banks (CBI, National Bank of Iraq); (b) build on the successes of SME management training provided under the first phase of our Business Edge program. Phase II will target up to 6,000 participants in 2 years (20 percent women); (c) develop the capacity of IFC's current Iraqi client banks (CBI, National Bank of Iraq); and (d) explore opportunities in Public Private Partnerships (PPP) in infrastructure (see below). IFC's advisory services have already trained around 200 Iraqi bankers, completed SME advisory to NBI in collaboration with Rabo Bank of Holland, supported the housing construction study together with World Bank

[1] The Third Emergency Education Project (US$100 million) was approved by the Board in November 2005; the Emergency Road Rehabilitation Project (US$135 million) was approved in June 2006; the Dokan and Derbandikan Emergency Hydropower Project (US$40 million) was approved in December 2006; the Emergency Electricity Reconstruction Project (US$124 million) was approved in March 2007; and the Emergency Water Supply Project (US$109.5 million) was approved in June 2008.

and UN-Habitat, and implemented its SME management training program, Business Edge, especially targeting women (3,000 women have already been trained).

15. Collaboration with the World Bank in potential PPP activities. IFC and World Bank are discussing with Iraq's National Investment Commission potential support to the implementation of PPP strategy. This could include capacity building to a PPP unit, identification of PPP projects, and support in implementing one pilot project, preferably an IPP given the need for power generation in Iraq. A detailed action plan is currently being prepared.

B. IMF-World Bank Collaboration in Specific Areas

16. The Bank is working closely with the Fund on the reform program in Iraq. The two institutions have conducted a number of joint missions and organized policy workshops and training courses for Iraqi civil servants and academics, covering public financial management, oil revenue management, intergovernmental finance, investment climate, payment system, banking supervision, social safety nets, and the like. There are no major differences of views between the two institutions on policy issues. The staffs are in broad agreement on the core reform program in Iraq, namely: (i) reinforcing public governance and institutions, including management of oil revenues; (ii) ensuring coherent and well-sequenced market-focused reforms; (iii) strengthening social safety nets; and (iv) improving delivery of essential services, including education and health.

C. Areas in Which the World Bank Leads and There is No Direct IMF Involvement

17. Through ITF- and IDA-funded projects the Bank is providing emergency support to rehabilitate vital public services—education, health, water supply and sanitation, urban infrastructure, power, and telecommunications. The Bank anchors its project work in focused analysis of sector issues, and supports Iraqi capacity-building via policy workshops and training courses. The Bank leads work on gender issues; and has successfully facilitated the GOI’s efforts to undertake an Iraqi Household Socio-Economic Survey (IHSES) as well as a Poverty Reduction Strategy which was completed in June 2009 and included feedback from more than 100 donors and Iraqi stakeholders.

D. Areas in Which the World Bank Leads and Its Analysis Serves as Input into the IMF-Supported Program

18. The Bank has provided policy advice and inputs to the Prime Minister’s Supreme Economic Committee and to key ministries. Bank inputs are provided in the form of policy papers on key reform areas, such as subsidy reform, pension system and social protection, oil revenue governance, public finance management, civil service and payroll reform, restructuring of SOEs and public banks, investment climate, and trade policy and facilitation.

19. The IMF has a strong interest in the areas listed above from the macroeconomic perspective (economic growth and fiscal sustainability, including the phasing out of nontransparent quasi-fiscal operations). The IMF has also a strong interest in governance issues, in particular with regards to oil revenue management.

E. Areas of Shared Responsibility

20. The IMF and the World Bank are working together on macroeconomic and fiscal sustainability, revenue management, the reform of domestic subsidies, financial sector reform (comprising state bank restructuring, strengthening payment system and banking supervision and regulation), public debt management, and statistical capacity building. The Bank and the Fund closely coordinate their capacity building activities in macroeconomic management, public sector governance, private sector development, and social safety nets. The Bank's design of the IHSES benefited from comments provided by the Fund.

F. Areas in Which the Fund Leads and its Analysis Serves as Input into the World Bank–Supported Programs

21. The IMF leads the dialogue on core macroeconomic policies and has taken the lead on debt sustainability analysis, monetary policy, and the management of aggregate expenditures. The Bank is working with the IMF to ensure consistency of the overall macroeconomic and fiscal framework. With the support of the IMF and the World Bank, progress in strengthening budget management and banking sector reform is underway. With support from the IMF, the Government also executed a debt restructuring program with all Paris Club creditors.

G. Areas in Which the IMF Leads and There is No Direct World Bank Involvement

22. The IMF leads the dialogue on monetary and credit policies, exchange rate management, tax policy and administration, and balance of payments issues.

Iraq Country Director: Mr. Hedi Larbi, contact number 5367-224.

Table 1. Iraq: Bank-Fund Collaboration	
Area of Reform	Lead Institution
1. Market-focused reform	
Reform of domestic subsidies	World Bank/IMF
Trade policy and facilitation/WTO accession	World Bank
2. Monetary and credit policies	IMF
3. External sector	
Balance of Payments	IMF
Debt sustainability	IMF
4. Public sector governance	
Public financial management	IMF/World Bank
Oil revenue management	World Bank/IMF
Fiscal Federalism	World Bank/IMF
Payroll reform	World Bank
Tax administration	IMF
Tax policy	IMF
Public debt management	World Bank/IMF
Intergovernmental finance	World Bank/ IMF
Governance and anticorruption	World Bank
5. Public service delivery	
Education and health	World Bank
Power, water and infrastructure	World Bank
Agriculture, and environment	World Bank
Telecommunications	World Bank
6. Private sector development	
Investment climate	World Bank
SOE reform	World Bank
Payment System Reform	World Bank/IMF
Financial sector development, incl. payment system and bank supervision and regulation	IMF/World Bank
Public banks restructuring	IMF/World Bank
Housing Finance	World Bank
7. Human development	
Poverty analysis	World Bank
Pension reform	World Bank/IMF
Social protection strategy	World Bank
Labor market issues	World Bank
Gender issues	World Bank
8. Other	
Statistical capacity building	IMF/World Bank
Sector strategies (agriculture, power, telecommunications)	World Bank

ANNEX III. IRAQ: STATISTICAL ISSUES

A. Background

1. Data provided to the Fund, while broadly adequate for program monitoring, have serious shortcomings that significantly hamper economic analysis. Macroeconomic statistics have suffered from years of neglect and recent turmoil has added to the difficulties. While the Central Organization for Statistics and Information Technology (COSIT) remained in place, its technical expertise has become outdated. At the Central Bank of Iraq (CBI), statistical capacity is slightly better, although the staff need training.

2. Since 2003, the Statistics Department (STA) has provided considerable technical assistance (TA) in all major datasets, including on dissemination standards. The authorities have indicated their intention to participate in the General Data Dissemination System (GDDS), and draft metadata for most data categories have been prepared. The ongoing TA program takes into account the absorptive capacity of the statistical agencies involved, and the contributions of other donors.

B. Shortcomings of Statistical Framework

National accounts

3. COSIT compiles annual and quarterly national accounts at currant and constant (1988) prices. Annual data of GDP by activity are available on the website of COSIT for 2001-07, and quarterly GDP data for 2007 and the first three quarters of 2008.

4. The national accounts follow the *1968 SNA,* however, with technical assistance from STA, COSIT is moving towards implementing the concepts of the *1993 SNA*. The quality of the national accounts compiled is poor, due to the lack of source data. There are no comprehensive source data available for estimating the value added by activity and for GDP expenditure categories. A Household Budget Survey (HBS), restaurants and hotel survey, and money exchange survey have been conducted during 2007 but, the results have not been processed yet. Public sector hotels are not covered in the survey because they are occupied by the coalition forces and their staff. An establishment survey was supposed to be conducted in 2007, but due to the security situation, COSIT was not able to conduct the scheduled survey. The data on the oil sector is generally adequate and timely, but there is little information on non-oil economic activity. COSIT still includes the Kurdistan Territory's contribution to GDP by economic activities as percentages for each activity based on results obtained from previous estimates dating back to 1990. Other activities that started in the Kurdistan Territory after 1990 are not included. There are limited price and volume indicators which could be used for deriving volume measures of GDP. The base year (1988) is outdated and needs to be updated. Work is underway to move the base year to 2004.

5. Data collection is reasonably comprehensive for current price data in the formal sector. Under current procedures, businesses employing more than 10 people must report calendar year data by the following October, and small businesses need to report by the following June. Because there are sizable penalties for noncompliance, respondents usually

meet these deadlines. However, with recent changes in the country, there is a risk that the timeliness of data reporting will deteriorate.

6. There is a shortage of quarterly and monthly indicators of economic activity and a lack of timely data for services. Quarterly GDP estimates are based on a limited number of indicators - crude oil output, electricity, rent of dwellings, and government expenditure. Nevertheless, for several industries, extrapolating from out-of-date benchmarks adversely affects data reliability. The results of the 2007 HSES should provide better indicators.

Consumer price index

7. Consumer price data are available with relatively short lags but do not cover the Kurdish region. Staffing is inadequate in number and training has been received only during STA technical assistance missions. There is not enough computer hardware and software to process the CPI efficiently. Recent technical assistance missions have focused on providing hands-on training on methodologies for compiling the CPI and on methods for making adjustments in the CPI for seasonality and changes in the quality of goods. Improvements in the CPI have been limited by outdated weights, which date back to 1993. Currently, COSIT is in the process of rebasing the CPI based on the 2007 HSES. Limited training has also been provided on methods for constructing the producer price index (PPI) and the wholesale price index (WPI) and on documenting the procedures and methods used to compile the CPI (metadata); work in this area is continuing.

Monetary and financial statistics

8. Notable progress has been made in developing the components and structure for compiling a depository corporations survey, but the quality of the data continues to be hampered by several factors: (i) the lack of sufficiently trained staff and adequate internal cooperation within the CBI; (ii) difficulty in collecting information on banking transactions in the northern region (Kurdistan); (iii) a chart of accounts (COA) that is not fully compliant with current monetary and financial data requirements—the CBI approved in April 2007 a resolution for drafting a new COA by end-2008; (iv) the use of pre-conflict forms for reporting monetary statistics; and (v) the balance sheet presentations for the commercial banks that do not conform with the sectorization and instrument classification of the *Monetary and Financial Statistics Manual (MFSM)*.

9. The recent mission (January 28–February 8, 2008) found that the authorities have made progress in implementing the recommendations from previous missions. More specifically, the mission found that (1) further progress was made in harmonizing the data transmitted to STA and MCD; (2) several balance sheet entries were resolved for proper economic sectorization and classification of financial instruments; and (3) progress was made towards developing data reporting instructions for Other Financial Corporations. The mission helped the authorities to address compilation problems to facilitate the publication in March 2008 of a new country page in the *IFS Supplement on Monetary and Financial Statistics* and an expanded country page in *International Financial Statistics*.

Balance of payments statistics

10. Balance of payments statistics are available to the Fund for 2005 and 2006 in the IMF's *Balance of Payments Manual, fifth edition (BPM5)* format. The quality of the information for recent years has improved; however, the presentation is still limited due to coverage problems and some deviations from the internationally acceptable methodologies. Issues regarding the recording of external debt data seem largely resolved, and balance of payments data might be soon published in the *IFS*. International reserves are compiled consistent with international methodologies and published in the *IFS* since end-2006.

11. A recent TA mission (January 19-February 1, 2008) found that consistent with the previous recommendations the CBI staff has been provided with sufficient technological resources, although limited work space continued to make working conditions very difficult. Furthermore, the quality of the information remains hampered by the lack of data submission to the CBI from other government institutions and the private sector. The lack of data has meant inaccuracies or absence of BOP data particularly in the area of external trade, foreign direct investment and external debt statistics.

12. To help address these and other issues, the mission proposed several short-term recommendations, including : (1) reporting to the IMF updated BOP data for the 2005, 2006, and 2007 in *BPM5* format as well as updated methodological notes when additional data sources are being used; (2) conducting high-level inter-agency discussions to ensure consistency of external trade data and cooperation in conducting CBI's surveys; (3) liaising with the Ministry of Planning and Development Cooperation in order to discuss the exchange of information on foreign direct investment; (4) using data from other depository corporations (ODCs) to compile direct investment data; (5) disseminating comprehensive BOP statistics in the CBI's publications and on its website; and (6) engaging the Ministry of Finance to obtain external debt data.

External trade statistics

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

14. Imports are calculated based on the reconstruction fee form, but are considered to be undervalued and unreliable. Therefore, data for private sector imports were excluded and derived from a survey. Wholesale traders were surveyed at five border outlets to elicit information on imports by economic activity. The coverage of the external trade statistics excludes the northern region of the country (Kurdistan), and no estimates for smuggling are made.

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

Government finance

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

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

Iraq: Table of Common Indicators Required for Surveillance
(As of February 10, 2009)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]
Exchange Rates	01/21/10	1/31/10	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	11/09	1/15/10	M	M	M
Reserve/base money	11/09	1/15/10	M	M	M
Broad money	11/09	1/15/10	M	M	M
Central bank balance sheet	11/09	1/15/10	M	M	M
Consolidated balance sheet of the banking system	11/09	1/15/10	M	M	M
Interest rates[2]	01/21/10	1/31/10	W	W	W
Consumer price index	12/09	1/18/10	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	09/09	11/25/09	M	M	M
Revenue, expenditure, balance and composition of financing[3]– central government	09/09	11/25/09	M	M	M
Stocks of central government and central government-guaranteed debt	--	--	N/A	N/A	N/A
External current account balance	2008	07/09	A	A	A
Exports and imports of goods and services	2008	07/09	A	A	A
GDP/GNP	2009 Q3	01/08	Q	Q	Q
Gross external debt[5]	2008	07/09	N/A	N/A	N/A

Sources: CBI, Ministry of Finance, COSIT.

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); NA: Not available

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March 1, 2010

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

IMF Executive Board Concludes 2009 Article IV Consultation with Iraq

On February 24, 2010 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Iraq.[6]

Background

The Fund has been closely engaged with Iraq since 2003. Initial work focused on providing policy advice, mainly on monetary and fiscal policies, and technical assistance to rebuild essential economic institutions. In September 2004, the Fund approved Emergency Post Conflict Assistance for Iraq, which—in combination with a debt sustainability analysis—paved the way for an agreement with Paris Club creditors. Since then, Iraq successfully completed two (precautionary) Stand-By Arrangements whose main objectives were to achieve macroeconomic stability; promote growth; and continue the process of structural reforms.

Substantial progress has been made since 2003, despite the difficult security situation. Inflation has been reduced to single digits, the international reserves position has improved markedly, and direct fuel subsidies were eliminated, while the pension system was put on a sustainable footing, which created room for priority spending on investment and the social sectors. Several steps have also been taken to strengthen public financial

[6] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

management, improve transparency in the oil sector, and rebuild capacity at the central bank, and the authorities have initiated the restructuring of the two largest state-owned banks. In addition, important advances have been made in attaining long-term debt sustainability. In 2004, Paris Club creditors agreed to reduce Iraq's external debt by 80 percent in net present value terms. Also, bilateral debt agreements with several non-Paris Club creditors have been concluded, although this process is yet to be completed.

Iraq's economic performance was strong in 2008, aided by record oil prices and improved security. Oil production rose to 2.3 million barrels per day (mbpd), the highest level since 2003. As a result, real GDP is estimated to have grown by 9½ percent in 2008, up from 1½ percent in 2007. Crude oil export receipts reached $61 billion in 2008—65 percent higher than in 2007—and the current account recorded a large surplus. The government budget registered a lower-than-expected surplus of 1½ percent of GDP in 2008. This reflected a significant increase in government spending that more than offset the higher-than-budgeted revenues. This increase in government spending reflected in part a large wage adjustment to compensate for the erosion in real wages that had taken place in previous years.

Following the strong economic performance in 2008, more recently the Iraqi economy has been seriously affected by the drop in oil prices from their peak levels in mid-2008. Also, oil production and export volumes have not risen as much as planned due to insufficient investment; production reached 2.4 mbpd. As a result, Iraq's external position weakened in 2009, with oil export proceeds falling to $39 billion and both the external current account and the overall balance of payments shifting into large deficits. With oil export receipts accounting for about 85 percent of government revenues, the lower oil prices had a similar impact on the government's budget, which is estimated to have recorded a deficit of over 20 percent of GDP in 2009. The CBI's international reserves fell by almost $7 billion in 2009, to about $44 billion by year's end, reflecting the use of government deposits at the CBI to finance the budget deficit. Growth is estimated to have slowed to 4 percent in 2009, even though oil production improved towards the end of the year owing to efforts to address infrastructure bottlenecks.

Iraq's longer-term economic outlook is strong as oil prices and production are projected to increase markedly in the coming years. However, based on conservative oil price assumptions, the external current account and the overall balance of payments are expected to remain in deficit in 2010 and 2011. Similarly, Iraq's fiscal position is projected to record significant, albeit declining deficits in both years, before returning to a surplus position in 2012. Financing the budget deficits in 2010–2011, would require additional financial support to fill a financing gap projected at almost $5 billion, even after mobilizing substantial amounts of domestic financing and utilizing the recent SDR allocation of $1.7 billion.

Against this background, the authorities have designed an economic program for 2010–11 that aims to maintain macroeconomic stability during the period of political transition (parliamentary elections are scheduled for early March 2010) and deepen structural reforms, particularly in the areas of public financial management, the financial system, and oil sector transparency. In support of this program, the authorities have requested a new Stand-By Arrangement from the IMF in the amount of SDR 2,376.8 million ($3.6 billion). This amount, together with disbursements from the World Bank under a Development Policy Loan and support from some donors, is expected to cover the financing gap for 2010–11. An important objective of the authorities' fiscal program is to contain current spending in order to gradually reduce the budget deficit and make room for additional investment. Specifically, current spending in both 2010 and 2011 will be kept broadly unchanged in nominal terms at 2009 levels. At the same time, given the urgent need to improve infrastructure and basic public service delivery, a significant increase in capital spending is planned for 2010, following an underexecution of the 2009 capital budget due to administrative capacity constraints associated with security incidents that affected the Ministry of Finance towards the end of the year. Monetary and exchange rate policies will continue to aim at keeping inflation low in 2010 and 2011.

Executive Board Assessment

Directors commended the Iraqi authorities for the progress in rebuilding its economy under extremely difficult security and political conditions. While the medium-term economic outlook remains favorable as oil prices and production are expected to increase in the coming years, major challenges lie ahead. Large fiscal and balance of payment gaps are projected for 2010 and 2011, caused by the lower oil receipts and infrastructure bottlenecks. Directors also noted considerable risks associated with security problems, oil price volatility, and capacity constraints. They welcomed the authorities' strong commitment to consolidate macroeconomic stability and advance the structural reform agenda, particularly in the areas of public financial management and the banking sector. Directors underscored the importance of steadfast implementation of the economic program, which would help unlock much needed resources from other donors and multilateral development banks.

Directors considered that the 2010 budget, based on conservative oil price assumptions, is consistent with the program's objectives. They highlighted the need to contain current spending, in particular through rationalizing the government wage bill and streamlining the in-kind Public Distribution System and transfers to state-owned enterprises. This would create room for targeted social safety nets and for essential investment and reconstruction projects, including improving public service delivery and infrastructure in the oil sector. Directors encouraged further reform efforts aimed at improving budget preparation and execution through developing a medium-term budget framework, and broadening the revenue base by introducing a general sales tax.

Directors welcomed the authorities' continued commitment to strengthen governance and improve transparency in the hydrocarbon sector. Completion of the oil metering system would help facilitate the full reconciliation of oil flows with financial flows between the state-owned oil companies and the budget. Directors congratulated Iraq on becoming a candidate for membership in the Extractive Industries Transparency

Initiative. They encouraged the authorities to establish a successor arrangement for the Development Fund for Iraq with the similar standards of transparency and accountability.

Directors supported the central bank's objective of aiming monetary and exchange rate policies at keeping core inflation in single digits. They called on the authorities to remove the remaining exchange restrictions under Fund jurisdiction. Directors also encouraged the central bank to fully implement the recommendations of the previous safeguards assessment and looked forward to its update. The need to preserve central bank independence was particularly emphasized. Further steps are necessary to strengthen reserve management, banking supervision and prudential regulations, and the AML/CFT framework.

Directors welcomed the authorities' good-faith efforts to conclude debt agreements with the remaining official and private creditors. They encouraged the authorities to continue to work with non-Paris Club creditors, with a view to securing debt relief on terms comparable to those of the 2004 Paris Club Agreement.

While welcoming Iraq's participation in the General Data Dissemination System, Directors called for continued efforts to improve the quality, coverage, and timeliness of macroeconomic statistics.

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

Table 1. Iraq: Selected Macroeconomic Indicators, 2007–10

	2007	2008	2009 Est.	2010 Proj.
Oil and gas sector				
Total exports of oil and gas (in billions of U.S. dollars)	37.7	61.7	38.9	48.4
Average crude oil export price (in U.S. dollars/barrel)	63.0	91.5	56.5	62.5
Crude oil production (in millions of barrels/day)	2.0	2.3	2.4	2.6
	(Annual percentage change)			
Output and prices				
Real GDP	1.5	9.5	4.2	7.3
Non-oil real GDP	-2.0	5.4	4.0	4.5
Consumer price inflation (end-of-period)	4.7	6.8	-4.4	6.0
	(In percent of GDP)			
Investment and Saving				
Gross domestic investment	19.8	28.1	28.1	31.5
Of which: non-government	4.1	2.0	3.7	4.1
Gross national savings	32.5	43.2	8.7	10.5
Of which: non-government	7.1	15.4	11.3	2.9
	(In percent of GDP, unless otherwise indicated)			
Public Finances (cash basis)				
Government revenue (including grants)	83.7	84.3	76.5	75.4
Of which: Oil revenue	74.0	77.6	68.0	67.0
Expenditure	74.0	82.6	99.0	94.5
Of which: Current	57.7	56.4	78.4	67.0
Of which: Capital	15.6	26.1	24.4	27.5
Budget balance (including grants)	9.7	1.7	-22.6	-19.1
Primary fiscal balance	10.5	2.2	-21.7	-18.0
Non-oil primary fiscal balance	-53.4	-64.7	-78.7	-74.2
Total government debt (in billions of U.S. dollars)	103.1	95.6	90.2	33.8
	(Annual percentage change)			
Monetary Sector				
Base money	73.9	54.5	0.1	13.5
Currency issued	31.2	36.3	13.4	15.2
	(In billions of U.S. dollars, unless otherwise indicated)			
External Sector				
Merchandise trade balance	13.4	20.8	-1.9	-2.4
Exports of goods	37.8	62.0	39.3	48.8
Imports of goods	24.4	41.2	41.3	51.2
Current account	7.2	13.1	-12.8	-16.8
Current account (in percent of GDP)	12.7	15.1	-19.4	-21.0
Total external debt (in percent of GDP)	181.0	110.5	137.1	42.1
Central banks gross reserves	31.5	50.2	44.3	44.0
In months of imports of goods and services	7.7	11.9	8.5	8.1
Memorandum Items				
Nominal GDP (in billions of U.S. dollars)	57.0	86.5	65.8	80.3
Local currency per U.S. dollar (period average)	1,255	1,193	1,170	...
Real exchange rate 1/	280.7	342.5	292.0	...

Sources: Fund staff estimates and projections.
1/ Calculated as the nominal exchange rate adjusted for the inflation differential between Iraq and the United States. Increase in the index denotes appreciation.

1/ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$3.6 Billion Stand-By Arrangement for Iraq

The Executive Board of the International Monetary Fund (IMF) today approved a two-year Stand-By Arrangement for Iraq for an amount equivalent to SDR 2.38 billion (about US$3.64 billion) to cover the country's balance of payments needs. The Board's approval makes an amount equivalent to SDR 297.1 million (about US$455 million) immediately available to the Iraqi authorities.

The new arrangement follows a 15-month program supported by a Stand-By Arrangement, which was approved by the executive Board on December 20, 2007 and expired on March 18, 2009 (Press Release No 07/301). The successor arrangement is designed to support Iraq's economic program over the next 24 months through February 23, 2012.

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

"Iraq has made substantial progress in rebuilding its economy and consolidating macroeconomic stability under difficult security and political conditions. The economy was severely affected in 2009 by the drop in international oil prices. The current account and the overall balance of payments are expected to remain in deficit in 2010 and 2011. Similarly, the fiscal position is projected to record large, albeit declining, deficits in both years, before returning to a surplus position in 2012.

"Against this background, the economic program for 2010 and 2011 aims at providing a sound macroeconomic framework during a period of economic and political uncertainties. Consistent with this program, the 2010 budget adopted by parliament seeks to contain current spending while increasing investment to address Iraq's large rehabilitation needs and improve public service delivery. Monetary and exchange rate policies will continue to aim at keeping inflation low.

"The economic program will also help the authorities move forward with their structural reform agenda. Strengthening the public financial management system is critical to improving the allocation and execution of public resources, as well as enhancing transparency and accountability in the management of the country's natural resources. The program also incorporates banking sector reforms, including a restructuring of state-owned banks, with a view to improving the financial services required by a growing economy.

"The authorities intend to treat the new Stand-by Arrangement as precautionary should oil prices turn out to be significantly higher than envisaged, or investment execution be lower than budgeted.

"The authorities have made significant progress in their external debt negotiations with official and private creditors. They remain committed to completing the restructuring of remaining non-Paris Club claims," Mr. Kato stated.

ANNEX

Program Summary

The main objectives of the program are to maintain macroeconomic stability during a period of high economic and political uncertainties (parliamentary elections are scheduled for March 7, 2010), and to provide a framework for deepening structural reforms.

While Iraq's medium-term economic outlook remains favorable because oil prices and production are projected to increase in the coming years, based on conservative oil price assumptions the current account and overall balance of payments are expected to remain in deficit in 2010 and 2011. Similarly, Iraq's fiscal position is projected to record large, albeit declining deficits in both years, before returning to a surplus position in 2012.

Against this background, the authorities have designed an economic program for the period through end-2011 and have requested the Fund to support it with a new two-year Stand-By Arrangement. The authorities view the new program primarily as a way to provide a sound macroeconomic framework during a period of high economic and political uncertainties. The authorities' fiscal program seeks to contain current government spending while catching up on much-needed investment spending. The budget deficit is targeted to decline to 19 percent of GDP in 2010 and further to 6 percent in 2011, before shifting back into surplus in 2012. Monetary and exchange rate policies will continue to aim at keeping inflation low.

The new program will also aim to advance key reforms in the areas of public financial management (PFM) and financial sector development, in close coordination with a Development Policy Loan (DPL) provided by the World Bank. Both operations focus on advancing PFM and bank restructuring action plans prepared by the authorities during 2008 and 2009 with the assistance of Fund and World Bank staff.

Statement by Shakour A. Shaalan, Executive Director for Iraq
February 24, 2010

Background

Notwithstanding extremely difficult security and political conditions, Iraq has continued to make progress in rebuilding its economy and achieving macroeconomic stability over the past few years. Under three successfully completed Fund-supported programs, the authorities reduced inflation to single digits from 65 percent in 2006, while significantly adjusting domestic fuel prices. In addition, they strengthened the international reserves position and implemented significant structural reforms—including to the pension system, and the audit and capitalization of the Central Bank of Iraq (CBI). These accomplishments were made possible by timely adjustments in monetary and exchange rate policies, as well as continued fiscal discipline.

Notwithstanding these developments, the Iraqi economy continues to face daunting challenges, which were exacerbated by the large drop in oil prices in 2009. With both the balance of payments and the government budget largely reliant on oil revenues, the lower oil receipts have given rise to sizeable, although temporary, balance of payments and fiscal deficits. In 2009, the authorities were able to absorb much of the adverse impact of the external shocks by using the financial buffers built up in recent years.

The balance of payments is likely to remain under pressure in 2010 and 2011 and a substantial fiscal deficit will be recorded in 2010 before receding sharply in 2011. Financing these deficits, even after mobilizing substantial domestic financing, could exhaust the government's remaining financial balances. It could also severely constrain government spending at a time when Iraq's developmental and security-related needs remain high, poverty and unemployment are widespread, and the security situation remains fragile. The authorities are also concerned that a drastic fiscal contraction at this juncture would undermine hard-won macroeconomic stability, and could contribute to a deterioration of the security situation.

In view of these developments, the authorities have adopted an economic adjustment program for 2010–11 for which they are seeking support from the Fund under a new two-year Stand-By Arrangement (SBA), as well as financial assistance from other international institutions and countries. The main objective of the program is to maintain macroeconomic stability during a period of high economic and political uncertainties. The program also aims at advancing the authorities' structural reform agenda, notably in the areas of public financial management and financial sector development, in close coordination with a prospective Development Policy Loan provided by the World Bank. The Bank Board is scheduled to consider this loan on February 25, 2010.

The program will provide the authorities with access to Fund financing, if needed. With international oil prices and domestic oil production forecast to increase in the coming years, Iraq's financing needs are expected to be temporary. In this connection, the authorities intend to treat the SBA as precautionary if, at the time of the first and second program review, futures prices for Iraqi oil average US$73 per barrel or higher. With these prices, Iraq would no longer expect to have a financing need, provided that it is able to sustain an oil export volume of 2.1 million barrels per day in 2010.

Similarly, the authorities would also treat the SBA as precautionary if investment remains significantly below budgeted amounts—specifically, if at the time of the second review, the rate of execution of the capital budget for the year as a whole were expected to remain below 93 percent. Disbursements of capital spending in 2009 indeed fell short of budgeted amounts, due in part to severe disruptions of administrative capacity as a result of the bombings of the Ministry of Finance in August and December. Investment remains a key priority, and the authorities are striving to restore and expand administrative capacity, including with the assistance of the World Bank, to ensure that implementation quality is not compromised.

The authorities would use Fund resources to finance the budget deficit, which would directly address the country's balance of payments needs given the very close linkages between the balance of payments and the government budget. At the same time, given the constraints on other sources of external and domestic financing, the additional fiscal space offered by the use of Fund resources would allow the government to avoid an economic contraction. It would also allow the authorities to preserve CBI independence and avoid central bank financing of the government.

Economic and Financial Policies and Reforms in 2010–11

The fiscal strategy aims primarily at containing current spending in order to gradually reduce the deficit and create room for higher investment outlays. A moderate decline in the budget deficit to 19 percent of GDP in 2010 is projected, followed by a marked decline to 6 percent of GDP in 2011, and a return to a surplus in 2012 as oil revenues increase.

To this end, current spending will be kept broadly unchanged in nominal terms beyond 2010. This would ensure a decline in current spending by about 30 percentage points of GDP by 2012. To obtain this target, it is intended to reduce non-priority expenditures immediately. To this end, the authorities will: (i) contain the wage bill by refraining from raising wages and limiting hiring; (ii) complete the census of government civil servants; (iii) improve the targeting of social spending by enhancing the in-kind Public Distribution System initially, and replacing it over time with a well-targeted cash-based safety net; (iv) reduce transfers to state-owned enterprises; and (v) avoid the reemergence of direct fuel subsidies while gradually reducing indirect subsidies.

Considerable effort is being devoted to advancing fiscal reforms. In addition to the reform commitments indicated above, the authorities intend to modernize their public financial management system over the next two years. In this regard, they adopted in October 2008, in consultation with the IMF and the World Bank, a three-year action plan identifying priority measures in the areas of budget preparation, execution and reporting; cash management; public procurement; and the accounting framework, as detailed in the Memorandum of Economic and Financial Policies. They have also made progress in developing a medium-term tax reform strategy with the objective of streamlining the tax system, broadening and diversifying the tax base, and increasing revenue collection. They plan to introduce a sales tax in the coming years as a precursor for a value-added tax, and are also considering reducing the number of income tax brackets. They intend to seek technical assistance from the Fund and other international partners to support their tax reform effort.

Investment remains a key priority, as evidenced in the increase in investment spending in the budget for 2010. Investment will focus on improving the delivery of key public services, including electricity, water, health, and education. It will also aim at further rehabilitating and expanding the oil sector infrastructure given its critical role in maintaining fiscal and external sustainability.

The CBI intends to maintain its present monetary and exchange rate policies, which are aimed at keeping inflation in the single digits and further reducing dollarization in order to enhance the CBI's control over monetary conditions. Up until late 2008, the CBI had allowed the dinar to appreciate gradually to bring down core inflation to near single digit levels. Once the inflation target was achieved, the CBI returned to its earlier policy of maintaining a stable exchange rate as the nominal anchor —as specified in the last SBA. The CBI also intends to keep the policy interest rate positive in real terms.

The structural agenda in the monetary area includes further enhancement of the CBI's reserve management practices. The authorities have prepared prudential regulations for commercial banks, including those related to minimum capital requirements, liquidity risk, and anti-money laundering, and will begin the implementation phase shortly. Further improvements in banking supervision will be sought following the assessment that is currently underway with foreign assistance. Moreover, control procedures and manuals are being developed to help strengthen the accounting and reporting framework, as well as the internal audit function of the CBI.

The Iraqi authorities are committed to strengthening the stability of the financial system. They developed, in coordination with the World Bank and other international agencies including the Fund, a banking sector reform strategy aimed primarily at undertaking the operational and financial restructuring of the two largest state banks. The operational restructuring entails introducing a new organizational structure, including the establishment of business units, risk management units, as well as governance, control and support units. The financial restructuring will consist of cleaning-up the banks' balance sheets from the legacy of bad debts and recapitalizing them.

Increasing transparency and good governance in the oil sector continues to rank high on the authorities' agenda. In this connection, they will maintain a single account for all oil export proceeds and will continue to adhere to the strict transparency and accountability rules that currently govern the Development Fund for Iraq. This account will continue to be audited by a reputable external auditor and overseen by the independent Iraqi Committee of Financial Experts, which would take over the audit oversight role currently performed by the International Advisory and Monitoring Board. In an effort to enhance transparency and fight corruption in the oil sector, the authorities will complete the process of becoming a candidate for membership in the Extractive Industries Transparency Initiative by March 2010.

The authorities are committed to further improve the timeliness, coverage, and accuracy of macroeconomic statistics, despite serious capacity constraints. This will take time. Monetary and balance of payments data are now being published in the IMF's *International Financial Statistics* regularly, annual national accounts data have been compiled up to 2007, and the quality of the national accounts has improved in the last year. A new CPI using the latest Socio-Economic Household Survey is being developed. Iraq began participating in the General Data Dissemination System in December 2009, and comprehensive information on Iraq's statistical production and dissemination practices now appears on the IMF's Dissemination Standards Bulletin Board.

The Iraqi authorities will continue their good faith efforts to resolve outstanding external claims under terms that are consistent with the 2004 Paris Club agreement. With twelve non-Paris Club official creditor claims already signed and currently being implemented, they will focus their efforts on resolving the still outstanding non-Paris Club claims. Regarding private creditors, most of the commercial debt has been restructured, and is being serviced as agreed.

Conclusion

The Iraqi authorities have demonstrated their commitment to undertaking strong macroeconomic policies and implementing economic reforms under three successive Fund-supported programs, including two SBAs. These arrangements have served Iraq well, providing cohesion to the policy framework while anchoring and furthering progress towards macroeconomic stability and economic reforms. The road ahead is still very challenging. The Iraqi authorities are fully committed to the implementation of the new arrangement, although stable security conditions remain a prerequisite for the success of their policies. They would like to express their deep appreciation for the Fund's Executive Board, Management, and staff, for their continued support under difficult circumstances. They are particularly grateful for the valuable policy advice and technical assistance they are receiving from the staff in support of their stabilization and reform efforts.