

IRAQ—PROGRAM NOTE

Current Program Status: The Stand-By Arrangement (SBA) in the amount of SDR 2.38 billion (about US\$3.7 billion) was approved by the IMF's Executive Board on February 24, 2010, and expired on February 23, 2013 after two extensions. The Board completed the first program review on October 1, 2010 and the second review on March 18, 2011, bringing the total resources currently available to Iraq under the arrangement to SDR 1069.56 million (about \$1.7 billion). However, completing other reviews under the arrangement was not possible due to delays in structural reform, restrictions introduced by the CBI in the foreign exchange market, and lack of agreement on potential fiscal liabilities in 2013.

Background

Iraq is estimated to have the world's second-largest oil reserves, with reserves of 143 billion barrels. By the 1970s, Iraq's oil resources had enabled the country to reach middle-income status, with a modern infrastructure, and good education and healthcare systems. Since then, however, the country has suffered through three devastating wars, a long period of economic and financial mismanagement, and international sanctions imposed during the 1990s. These events severely damaged political and economic institutions and undid earlier economic and social gains. By 2004, per capita GDP had fallen to about US\$900 from US\$3400 in 1980, and the country suffered from a crippling debt burden.

The task of rebuilding the country after 2003 remains immense and is made harder by sectarian politics and prolonged violence. Iraq's reconstruction requires not only the rebuilding of its infrastructure, but also of its economic and social institutions and the creation of a business environment that attracts capital and brings with it new technology and skills to modernize the economy. Iraq's huge oil reserves could, in principle, provide the revenues needed to finance the reconstruction, but strong institutions and favorable business environment are needed to use these resources effectively. The longer-term outlook is strong as domestic and foreign investment in the hydrocarbon sector is bearing fruit. According to the Ministry of Oil, oil production averaged 3.1 million barrels per day (mbpd) in 2012, of which 2.3 mbpd are exported, and extraction and exports are projected to increase considerably in the years ahead. Nevertheless, Iraq's economic prospects continue to be subject to significant risks, deriving mainly from institutional and capacity constraints, oil prices volatility, delays in the development of oil infrastructure, and an extremely fragile political and security situation.

Role of the IMF

The IMF commitment to Iraq relies on two main pillars. First, the IMF is helping the authorities in their efforts to maintain macroeconomic stability as a key condition for economic growth and the generation of sustainable employment opportunities for Iraq's large

labor force. Second, the IMF assists the Iraqi authorities in rebuilding essential economic institutions with its policy advice and technical expertise.

- *Macroeconomic stability is at the heart of the IMF programs and economic policy advice.* With the support of four IMF programs, the macroeconomic situation of Iraq has improved substantially since 2003, despite extremely difficult security circumstances and periods of political uncertainty. After experiencing inflation rates of 70 percent in 2007, the Central Bank of Iraq was successful in reducing inflation to the single digits, where it has remained since. The economy is growing with the revival of the oil sector and the improvement in the security situation. And with the support of the international community, debt levels have been brought down to sustainable levels.
- *Policy advice focuses on the fiscal, monetary and financial policy areas.* In the fiscal area, major emphasis has been put on the adoption of policies that support the reconstruction of Iraq and preserve social spending, while maintaining medium-term fiscal sustainability. In the monetary and financial areas, IMF advice has centered on keeping inflation under control, maintaining a broadly stable and liberal exchange rate regime, and modernizing the financial sector to enable the private sector to develop. IMF technical assistance has proven essential in helping the Iraqi authorities develop their institutional capacity and governance infrastructure.

The 2010 SBA

The program aimed to support the reconstruction of Iraq. Following the successful conclusion of Iraq's second SBA program, the IMF's Executive Board approved a new two-year SBA program on February 24, 2010 with an access of US\$3.7 billion (SDR 2,376.8 million, or 200 percent of quota). The program provided a macroeconomic framework supporting the reconstruction efforts during the political transition following the March 2010 parliamentary elections.

The key objectives of the SBA were the preservation of macroeconomic stability and the adoption of policies and measures to promote sustainable growth and poverty reduction. The financial resources envisaged in the context of the program were meant to be made available to respond to the drop in oil prices from their peak levels in mid-2008, which translated into a substantial deterioration of Iraq's external position in 2009 and to a financing gap in the government finances.

Besides preserving macro-stability and providing budgetary support, the program also supported the authorities' medium-term structural reform agenda. This agenda relies on three key pillars:

- *Modernizing Iraq's public financial management system.* This encompasses improvements in the allocation, execution, transparency, and accountability of the mobilization and use of public resources. Priority areas include improving budget

preparation, reporting and cash management, public procurement, internal audit and control systems, and the accounting framework.

- *Developing the financial sector.* This pillar relies on enhancing Central Bank of Iraq (CBI) operations and promoting a banking sector that can provide basic financial services, including, crucially, to the private sector. Reinforcing central banking operations includes rebuilding the capacity of the central bank to conduct monetary and exchange rate policies, supervise banks, and manage the country's foreign exchange reserves. The financial restructuring of the two main state-owned banks is an important step to help establish the conditions for the banking system to extend credit to the private sector.
- *Strengthening governance in the oil sector.* As part of the authorities' efforts to increase transparency and accountability in the oil sector, Iraq became a candidate member to the Extractive Industries Transparency Initiative (EITI) in February 2010, and produced its first EITI report in December 2011. Efforts in this area are also directed at completing the installation of oil metering systems, which will help reconcile oil production and export data with budget revenues from the oil sector, and at maintaining a single account for all oil export proceeds.

During 2012, the authorities succeeded in maintaining macroeconomic stability, but progress on the program slowed down. The combined third and fourth reviews were not completed owing to limited progress in restructuring the state-owned banks and the emergence of distortions in the foreign currency markets that led to the widening of the spread between the official and market exchange rates. IMF staff will continue to support Iraq through surveillance and technical assistance.