

Iraq Economic Monitor

Turning the Corner: Sustaining
Growth and Creating Opportunities
for Iraq's Youth



*With a Special Focus on Transforming Agriculture for Economic
Diversification and Job Creation*

FALL 2019

Middle East and North Africa Region



WORLD BANK GROUP
Macroeconomics, Trade & Investment

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ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Combating of Terrorism Financing	PDS	Public Distribution System
Bpd	Barrel per day	PP	Percentage Point
BOP	Balance of Payments	PPP	Public-Private Partnership
CAB	Current Account Balance	SMEs	Small and Medium Enterprises
CBI	Central Bank of Iraq	SOEs	State-Owned Enterprises
CPI	Consumer Price Index	TFP	Total Factor Productivity
COSIT	Central Organization for Statistics and Information Technology	UMI	Upper Middle Income
DB	Doing Business	WB	World Bank
DSA	Debt Sustainability Analysis	WDI	World Development Indicators
EMDEs	Emerging Market Developing Economies	WGI	Worldwide Governance Indicators
FDI	Foreign Direct Investment		
GCC	Gulf Council Countries		
GoI	Government of Iraq		
GDP	Gross Domestic Product		
GVA	Gross Value Added		
GW	Giga Watt		
HRP	Humanitarian Response Plan		
H1-19	Half Year 2019		
ICA	Investment Climate Assessment		
ICP1	International Corruption Perception Index		
IDP	Internally Displaced Person		
IQD	Iraqi Dinar		
ISIS	Islamic State of Iraq and Syria		
KRG	Kurdistan Regional Government		
MBPD	Million Barrel Per Day		
MENA	Middle East North Africa		
MoF	Ministry of Finance		
MoO	Ministry of Oil		
MW	Mega Watts		
NPLs	Non-Performing Loans		
OPEC	Organization of Petroleum Exporting Countries		

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

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EXECUTIVE SUMMARY

Recent Economic Developments

Iraq's economy is gradually rebounding in 2019¹. GDP grew at 4.8 percent year on year (y/y) in the first half of 2019 (H1-19), reversing the contraction observed in the past two years. Growth comes mainly at the back of a rise in crude oil production (up 6.3 percent so far) and a rebound in non-oil economic activity (up 5.6 percent in H1-19 y/y). The latter is underpinned by better rainfall and record agriculture yields, an improvement in electricity production, and an expansionary fiscal policy linked to growing wage bill and public consumption. Such positive developments are expected to bring the overall real GDP growth to an estimated 4.6 percent by end-2019, reversing a 0.6 percent contraction in 2018, with the non-oil economy likely to accelerate over 5 percent. Iraq's economy has outperformed that of regional peers this year, but its population dynamics requires much higher growth to sustain current level of welfare. Despite recent improvements, Iraq continues to be in need of humanitarian assistance as more than 1.5 million Internally Displaced Persons (IDPs) are yet to return home.

The Government of Iraq (GoI) maintains a policy of fiscal loosening based on expanding subsidies and the public sector wage bill to ensure social peace amidst weak private sector

job creation. This is evident through the expansion of social assistance programs and the decision to assimilate large numbers of individuals into the public sector and the army. As a result, recurrent spending has increased by 28.8 percent in H1-19 (y/y) at the expense of growth-enhancing public investment. This not only puts a drag on growth but also increases social vulnerabilities as the reconstruction program for the liberated areas remains severely lagging, and the infrastructure gap persist elsewhere in the country. Furthermore, domestic revenue mobilization is weak with non-oil revenues representing only 8 percent of budgetary receipts, well below expectations. Customs exemptions coupled with poor tax compliance and collection have led a 24.4 percent decline in taxation receipts, partially offsetting the rise in oil revenues. As a result, the 7.9 percent of GDP surplus in 2018 is expected to turn into a 4.6 percent deficit by end-2019. This will bring public debt-to-GDP to 49.7 percent, up from 49.3 percent in 2018. Rising reliance on short-term and costly domestic financing increases risks and threatens to crowd-out private sector credit.

In the absence of clear structural reforms and accelerated reconstruction efforts, growth recovery in Iraq may be short-lived. This is particularly the case given the oil markets outlook where both prices and exports are expected to weaken given softer global demand and the uncertainty around the renewal of the OPEC++ agreement. Risks over the medium-term continue to be present both on

¹ All analysis in this report includes latest available data from authorities with a cut-off date of October 1st, 2019.

the upstream and downstream. Lack of diversification and budget rigidities linked to the public sector wage bill reduce Iraq's financial buffers and increase its vulnerability to external shocks. They also threaten to further delay reconstruction and outdo the recent positive government efforts especially in the electricity and agriculture sectors. Creating an adequate fiscal space for growth-enhancing programs will be key for diversification and job creation, without which the impressive increases in oil production will mean little for most Iraqis. With IDPs returning to their homes, there will be an increasing need to open economic opportunities and maintain flexible social assistance in these parts of the country.

Lack of jobs, corruption, and poor service delivery remain among the most important risks to growth and fiscal sustainability. Young Iraqis have taken the streets in October 2019 to raise those concerns. These demonstrations exposed the fragility of the existing socio-economic system. The social unrest is expected to be addressed through more short-term fiscal stimulus - cash transfers, public employment and housing schemes among others - to appease demonstrators. However, results might not be satisfactory as job creation and meaningful anti-corruption and structural reforms will require a longer time frame. Diversifying through labor-intensive sectors such as in agriculture could be a path forward and help improve household welfare while deeper structural reforms take place.

In addition to sector-specific policies, a cross-cutting economic reform agenda addressing impediments for private sector-led growth and job creation could build on four pillars.

- **First, a public sector reform program** that ensures macroeconomic stability through fiscal reforms including domestic revenue mobilization and consolidation of recurrent spending; accompanied by reforms to boost transparency and accountability through sound public financial management especially in public investment management and budget accounting and management systems.
- **Second, financial sector reforms** to boost private sector access to credit and financial inclusion through improving the corporate governance of state-owned-banks in preparation for their restructuring; and reinforcing credit

infrastructure including streamlining micro finance regulations, enactment of laws on digital payment systems, rollout of national ID, strengthening bank licensing regime, and operationalization of the deposit insurance scheme.

- **Third, business and investment climate reforms** to lower the costs and complexity of doing business in Iraq. This includes reforms to business registration and operations, investment policies and PPPs. Moreover, addressing digital economy constraints by focusing on affordable access to high-speed internet, digital government services, and scaling up entrepreneurship ecosystem can encourage youth participation in business and improve service delivery.
- **Fourth, building a social protection and labor systems** that provide opportunities for all. This includes improving coverage, targeting, equity, and sustainability of social safety nets and pensions, and developing quality private-sector relevant employment programs and policies. These reforms can create needed fiscal space for investment into human capital programs.

Transforming Agriculture for Economic Diversification and Job Creation

Strong agriculture sector development is a critical element of Iraq's vision of a more diversified and private-sector led economy. Agriculture contributes a substantial share of Iraq's economy (5 percent of total GDP), is the largest source of employment in the country (approximately 20 percent) and is dominated by the private sector. Thirty percent of the population live in the rural areas and are largely dependent on agriculture for their income and livelihood. Agriculture production has large potential for expansion. It occupies only a limited fraction of Iraq's cultivable area (about a third or 5 million ha); it is practiced predominantly by small farmers, and irrigation, once it is rehabilitated, has the potential to greatly increase crop yields. Agriculture is also a key pathway for overall job creation in Iraq. It can offer employment particularly to IDPs and help close the gender gap. Iraq is heavily dependent on food imports, its agriculture can expand based on its comparative advantage to respond to the growing

domestic, and regional and international export demand.

Sizeable growth opportunities exist in the sector. In the short term through import substitution and export on regional markets, and, in the long term, by integrating into global agri-business value chains. Iraq's domestic market offers an immediate consumer base to expand production of grain (wheat), fresh fruits and vegetables, as well as dairy products and meat. Exports offer opportunities for agribusiness development, spearheaded by dates and other high value crops (fresh fruits and vegetables), to respond to regional consumer demand in the short term, and European demand in the medium/long term. Processing of agriculture commodities offers large value added and job creation opportunities, as current agribusiness value chains are under-developed with a low ratio of product processing from primary agriculture.

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

- **Building institutional capacity** of public agencies in charge of technical support service, as well as the capacity of private producers and value chain organizations. This can be achieved through facilitating decentralized administration (vertical coordination) in priority for research and extension services; promoting evidenced-based policy planning and programming; reforming the land tenure regime to boost productivity in the sector; strengthening of intra-governmental coordination (horizontal coordination).
- **Improving competitiveness and fostering market access.** This entails rethinking the role of the state in the sector and encourage private sector involvement, repurposing agriculture subsidies towards more effective agricultural growth, and developing market information systems. Moreover, this involves investing in competitive and quality standards including in traceability and in food safety to boost the potential for exports markets. It also requires improving farmers' access to finance and rehabilitating markets facilities and road network.
- **Investing in high value production systems** through R&D, innovation and extension to promote a diversified agri-food sector, adaptation to climate change, and investment

in rural infrastructure, agri-logistics and marketing. The required financing would be found partly through reallocating the subsidies currently earmarked for agriculture inputs and commodities.

- **Investing in knowledge and technology** used for modern agriculture production and agri-business both upstream at production level and downstream at processing and marketing level. This includes building partnerships with international centers of excellence; exploring the use of knowledge innovation labs; expanding investment in relevant high-performing technologies, such as tissue culture, precision irrigation, and small mechanization; and boosting the use of digital platforms, solar powered desalination, and hydroponics.

ملخص تنفيذي

التطورات الاقتصادية الأخيرة

الضريبي إلى انخفاض إيرادات الضرائب بنسبة 24.4 %، مضلة الزيادة في إيرادات النفط. ونتيجة لذلك، من المتوقع أن يتحول الفائض المالي إلى الناتج المحلي الإجمالي البالغ 7.9 % في عام 2018 إلى عجز بنسبة 4.6 % بحلول نهاية عام 2019. وسيؤدي ذلك إلى رفع نسبة الدين العام إلى الناتج المحلي الإجمالي إلى 49.7 %، بعد أن كانت 49.3 % في عام 2018. إن الاعتماد المتزايد على التمويل المحلي قصير الأجل والمكلف سوف يزيد من المخاطر ويهدد بمزاحمة الائتمان المقدم للقطاع الخاص.

في غياب الإصلاحات الهيكلية الواضحة وبطن عملية إعادة الإعمار، قد يكون تعافي النمو في العراق قصير الأجل. وتبدو هذه الحالة قائمة بشكل خاص إذا ما أخذنا بعين الاعتبار توقعات أسواق النفط حيث يرجح أن تتراجع الأسعار والصادرات بالنظر لتراجع الطلب العالمي والشكوك المتعلقة بتجديد اتفاقية (أوبك ++). وتتواصل المخاطر على المدى المتوسط. إذ يؤدي غياب التنوع الاقتصادي وعدم مرونة الموازنة المرتبطة بفاورة الأجور في القطاع العام إلى التقليل من الفوائض المالية في العراق كما يزيد من هشاشة الاقتصاد أمام الصدمات الخارجية. كما تهدد هذه العوامل بمزيد من التأخير في إعادة الإعمار وتقويض الجهود الحكومية الإيجابية الأخيرة، خاصة في قطاعي الكهرباء والزراعة. وسيكون إيجاد حيز مالي مناسب للبرامج التي تعزز النمو شرطاً أساسياً لتحقيق التنوع وخلق فرص العمل، التي بدونها لن تعني الزيادة الكبيرة في إنتاج النفط سوى القليل بالنسبة لمعظم العراقيين. ومع عودة النازحين إلى مناطقهم، ستكون هنالك حاجة متزايدة لتوفير الفرص الاقتصادية والحفاظ على مساعدة اجتماعية مرنة في هذه الأجزاء من البلاد.

يظل نقص الوظائف، والفساد، وسوء تقديم الخدمات من بين أهم المخاطر التي تهدد النمو والاستدامة المالية. لقد خرج الشباب العراقي في تظاهرات في تشرين الأول 2019 لبدء هذه الهموم والمخاوف. وكشفت هذه التظاهرات عن هشاشة النظام الاقتصادي-الاجتماعي الحالي. ويتوقع أن يتم التعامل مع هذه الاضطرابات الاجتماعية من خلال المزيد من الحوافز المالية قصيرة الأجل - مثل التحويلات النقدية، والتوظيف في القطاع العام، وبرامج الإسكان وسواها - وذلك من أجل تهدئة غضب المتظاهرين. ومع ذلك، فإن النتائج قد لا تكون مرضية لأن إيجاد الوظائف ومكافحة الفساد بشكل حقيقي والإصلاحات الهيكلية سوف تتطلب إطاراً زمنياً أطول. ولكن التنوع من خلال القطاعات الكثيفة العمالة مثل الزراعة قد يمثل طريقاً إلى الأمام ويساعد على تحسين رفاه الأسرة بينما تتواصل الإصلاحات الهيكلية الأعمق.

الاقتصاد العراقي يستعيد عافيته ببطء خلال عام 2019: في النصف الأول من 2019 حقق الناتج المحلي الإجمالي نمواً بلغ 4.8 % بالمقارنة مع العام السابق مما أفضى إلى تحقيق تحول عكسي في الانكماش الذي شهده الاقتصاد خلال العامين الماضيين. ويأتي هذا النمو، وبشكل أساسي، كمحصلة للزيادة في إنتاج النفط الخام (وصولاً إلى 6.3 % حتى الآن) والانتعاش في النشاط الاقتصادي غير النفطي (بزيادة مقدارها 5.6 % في النصف الأول من العام 2019 بالمقارنة مع العام الماضي سنة/سنة). ويعزى الانتعاش الأخير إلى تحسن مستويات هطول الأمطار وإنتاج محاصيل زراعية قياسية، وتحسن إنتاج الكهرباء، وسياسة مالية توسعية مرتبطة بزيادة فاتورة الأجور والاستهلاك العام. ومن المتوقع أن تؤدي مثل هذه التطورات الإيجابية إلى رفع نمو الناتج المحلي الإجمالي الحقيقي إلى ما يقدر بنحو 4.6 % بحلول نهاية عام 2019، مقارنة بالانكماش الذي بلغ 0.6 % في عام 2018، في حين يُرجح أن تتسارع وتيرة نمو الاقتصاد غير النفطي إلى أكثر من 5 %.

لقد تفوق الاقتصاد العراقي في أدائه على نظرائه في المنطقة هذا العام، لكن ديناميكية السكان فيه تتطلب نمواً أعلى بكثير للحفاظ على المستوى الحالي من الازدهار. ولكن وعلى الرغم من التحسن الأخير، فإن العراق لا يزال بحاجة إلى المساعدات الإنسانية حيث أن هناك أكثر من 1.5 مليون من النازحين لم يعودوا إلى مناطقهم بعد.

تواصل الحكومة العراقية اعتماد سياسة مالية توسعية تستند إلى زيادة الإعانات المالية وفاورة أجور القطاع الخاص على توليد فرص العمل. ويبدو هذا واضحاً من خلال التوسع في برامج المساعدة الاجتماعية وقرار استيعاب أعداد كبيرة من الأفراد في القطاع العام والجيش. ونتيجة لذلك، زادت النفقات التشغيلية بنسبة 28.8 % (في النصف الأول من العام 2019 بالمقارنة مع العام الماضي سنة/سنة) على حساب الاستثمارات العامة المعززة للنمو. وهذا لا يضع عائقاً أمام النمو فحسب، وإنما يزيد أيضاً من جوانب الهشاشة الاجتماعية حيث لا يزال برنامج إعادة إعمار المناطق المحررة يعاني من تلكؤ شديد، وحيث لازالت فجوة البنية التحتية قائمة في أماكن أخرى من البلاد. وعلاوة على ذلك، فإن تعبئة الإيرادات المحلية تبدو ضعيفة حيث لا تمثل الإيرادات غير النفطية سوى 8 % فقط من إيرادات الموازنة، وهذا أقل بكثير من التوقعات. وقد أدت الإعفاءات الجمركية جنباً إلى جنب مع ضعف الجباية والامثال

بالإضافة إلى السياسات القطاعية، يمكن لأجندة إصلاح اقتصادي شامل تنصدي للمعوقات التي تحول دون نمو القطاع الخاص وخلق فرص العمل أن تستند إلى أربعة دعائم.

أولاً، برنامج لإصلاح القطاع العام يضمن استقرار الاقتصاد الكلي من خلال الإصلاحات المالية بما في ذلك تعبئة الإيرادات المحلية وحصر النفقات التشغيلية، على أن تصاحب ذلك إصلاحات لتعزيز الشفافية والمساءلة من خلال الإدارة المالية العامة السليمة وبخاصة في إدارة الاستثمارات العامة ونظام محاسبة وإدارة الموازنة.

ثانياً، إصلاحات القطاع المالي لتعزيز وصول القطاع الخاص إلى الائتمان والشمول المالي من خلال تحسين الحوكمة في البنوك المملوكة للدولة استعداداً لإعادة هيكلتها، وتعزيز البنية التحتية الائتمانية بما في ذلك تبسيط ورفع كفاءة اجراءات التمويل للمشروعات الصغيرة، وسن قوانين تغطي نظم الدفع الرقمية، وتعميم البطاقة الوطنية، وتعزيز نظام ترخيص البنوك، وتشغيل نظام تأمين الودائع.

ثالثاً، إصلاحات بيئة الأعمال والاستثمار لتقليل تكاليف وتعقيدات ممارسة الأعمال في العراق. ويشمل ذلك الإصلاحات الخاصة بتسجيل الشركات واعمالها، وسياسات الاستثمار والشراكة بين القطاعين العام والخاص. والى جانب ذلك، فإن معالجة قيود الاقتصاد الرقمي من خلال التركيز على الوصول إلى الإنترنت عالي السرعة بسعر منخفض، والخدمات الحكومية الرقمية، وتوسيع بيئة ريادة الأعمال يمكن أن تشجع على مشاركة الشباب في الأعمال التجارية وتحسن من تقديم الخدمات.

رابعاً، بناء نظم الحماية والعمل الاجتماعية التي توفر الفرص للجميع. ويتضمن ذلك تحسين جوانب التغطية والاستهداف والانصاف والاستدامة في شبكات الأمان الاجتماعي ونظم التقاعد، وتطوير برامج وسياسات توظيف عالية الجودة في القطاع الخاص. ومن شأن هذه الإصلاحات أن تفضي إلى خلق حيز مالي ضروري للاستثمار في برامج رأس المال البشري.

التحول بالزراعة نحو التنويع الاقتصادي وخلق فرص العمل

يعدّ التطوير القوي للقطاع الزراعي شرطاً أساسياً في رؤية العراق لاقتصاد أكثر تنوعاً يقوده القطاع الخاص. تساهم الزراعة بحصة كبيرة من الاقتصاد العراقي (5 % من الناتج المحلي الاجمالي)، وهي أكبر مصدر للعمل في البلاد (حوالي 20 %) ويهيمن عليها القطاع الخاص. ويعيش ثلاثون بالمائة من السكان في المناطق الريفية ويعتمدون إلى حد كبير على الزراعة للحصول على الدخل وسبل العيش. ويحمل الإنتاج الزراعي إمكانات كبيرة للتوسع. ولكنه يشغل جزءاً محدوداً فقط من مساحة العراق القابلة للزراعة (حوالي الثلث أو 5 ملايين هكتار)، وحيث يمارس الزراعة في الغالب صغار المزارعين، وأما الري، فما أن تتم إعادة تأهيله حتى تصبح لديه القدرة على زيادة ناتج المحاصيل بدرجة كبيرة. كما تعتبر الزراعة مساراً رئيسياً لإيجاد فرص عمل شاملة في العراق، إذ يمكن أن تقدم فرص عمل وبخاصة للنازحين وتساعد في سد الفجوة بين الجنسين. وإذا كان العراق يعتمد بشكل كبير على الواردات الغذائية، فإن الزراعة فيه يمكن أن تتوسع استناداً إلى التفاضلية في الاستجابة للطلب المحلي المتزايد كما للطلب الاقليمي والدولي للصادرات الزراعية.

هناك فرص نمو كبيرة في هذا القطاع يمكن أن تتحقق على المدى القصير من خلال استبدال الاستيراد بالتصدير في الأسواق الإقليمية، وعلى

المدى الطويل، من خلال الاندماج في سلاسل القيمة التجارية الزراعية العالمية. ويوفر السوق المحلي للعراق قاعدة استهلاك فورية لتوسيع إنتاج الحبوب (القمح) والفواكه والخضروات الطازجة وكذلك منتجات الألبان واللحوم. وتقدم الصادرات فرصاً لتطوير الأعمال التجارية الزراعية التي تنصدها الثمر وغيرها من المحاصيل عالية القيمة (الفواكه والخضروات الطازجة) للاستجابة لطلب المستهلكين الإقليميين على المدى القصير، والطلب الأوروبي على المدى المتوسط / الطويل. وتوفر معالجة السلع الزراعية فرصاً كبيرة للقيمة المضافة وتوفير الوظائف، نظراً لأن سلاسل القيمة التجارية الزراعية الحالية تعاني من ضعف التطوير وتشتمل على نسبة متدنية لمعالجة المنتجات من من الزراعة الأولية.

أجندة التحول الاقتصادي تبدو ممكنة بالنسبة للزراعة في العراق، وهي تتمحور حول أربع دعائم :

بناء القدرات المؤسسية للدوائر العامة المسؤولة عن خدمات الدعم الفني، وكذلك قدرة المنتجين من القطاع الخاص. ويمكن تحقيق ذلك من خلال تسهيل الإدارة اللامركزية (التنسيق العمودي) في سياق إعطاء الأولوية لخدمات البحث والارشاد، وتعزيز التخطيط وبرمجة السياسات بالاستناد إلى الأدلة العلمية، وإصلاح نظام حيازة الأراضي من أجل زيادة الإنتاجية في القطاع، وتعزيز التنسيق ما بين المؤسسات الحكومية (التنسيق الأفقي).

تحسين القدرة التنافسية وتعزيز الوصول إلى الأسواق. وهذا يتطلب إعادة التفكير في دور الدولة في القطاع وتشجيع مشاركة القطاع الخاص، وإعادة توجيه الإعانات الزراعية لتحقيق نمو زراعي أكثر فعالية، وتطوير نظم معلومات السوق. وعلاوة على ذلك، فإن هذا ينطوي على الاستثمار في معايير التنافس والجودة بما في ذلك في التتبع وسلامة الغذاء من أجل تعزيز إمكانات خلق أسواق جديدة للتصدير. كما يتطلب تحسين وصول المزارعين إلى التمويل وإعادة تأهيل البنى التحتية للأسواق وشبكات الطرق.

الاستثمار في نظم الإنتاج عالية القيمة من خلال البحث والتطوير والابتكار والارشاد لتشجيع قطاع متنوع للأغذية الزراعية، والتكيف مع التغير المناخي، والاستثمار في البنية التحتية الريفية والخدمات اللوجستية الزراعية والتسويق. وهذا يتطلب تمويلاً يمكن بلوغه جزئياً من خلال إعادة تخصيص الإعانات الحكومية المكرسة حالياً للمدخلات والسلع الزراعية.

الاستثمار في المعرفة والتكنولوجيا المستخدمة في الإنتاج الزراعي الحديث والأعمال التجارية الزراعية سواء فيما يتعلق بالمراحل الأولية على مستوى الإنتاج أو المراحل النهائية على مستوى التصنيع والتسويق. ويشتمل ذلك على بناء شراكات مع مراكز التميز الدولية، استخدام مختبرات الابتكار المعرفي، توسيع الاستثمار في التكنولوجيات ذات الأداء العالي، مثل زراعة الخلايا النباتية والري الدقيق والمكننة الصغيرة، وتعزيز استخدام المنصات الرقمية وتحلية المياه بالطاقة الشمسية والزراعة المائية.

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Introduction

The Government of Iraq (GoI) has been in emergency mode since its formation in 2018.

These include managing the domestic political process and the appointment of most cabinet members, stabilizing internal security, establishing a new foreign policy anchored on non-intervention, building trust with neighboring countries, and tackling electricity shortages ahead of the summer period. A year later, the GoI has been relatively successful in many areas. Civilian casualties fell to its lowest level since 2003 (see Box 1). Relationship between Baghdad and Erbil improved markedly. This included the lifting of sanctions on KRG's international flights and commercial banks, resolving outstanding issues on 250,000 bpd agreed under the budget 2019 law, and resuming discussions over a new deal for oil commitments, customs and disputed areas. Moreover, Iraqi leaders have visited all neighboring countries and signed various memoranda of understandings linked with trade, energy, finance and security cooperation². The US also gave Iraq an additional 120 days extension in June 2019 allowing Iraq to

import gas and pay for electricity from Iran. Finally, the active pursuit to tackle electricity supply shortages has led the GoI to sign 5-years deals with Siemens and General Electric worth US\$14 billion to upgrade electricity infrastructure³. The GoI also started the process to link Iraq with the electricity grids of Turkey, Jordan and Gulf countries.

Development challenges remain numerous.

The accumulated heritage of poor basic public services, unemployment, increased poverty as a result of years of conflict and internal displacement, a macroeconomic environment that is highly dependent on oil windfalls and inadequately equipped to withstand external shocks, all present threats to the country's stability. To deal with these challenges and fend some of the rising pressure from the population, the GoI is focusing on economic reforms and long-term development priorities with an objective of creating an enabling environment for private sector-led growth and diversification.

This first chapter of the Iraq Economic Monitor (IEM) examines recent economic and policy developments with a lens on highlighting

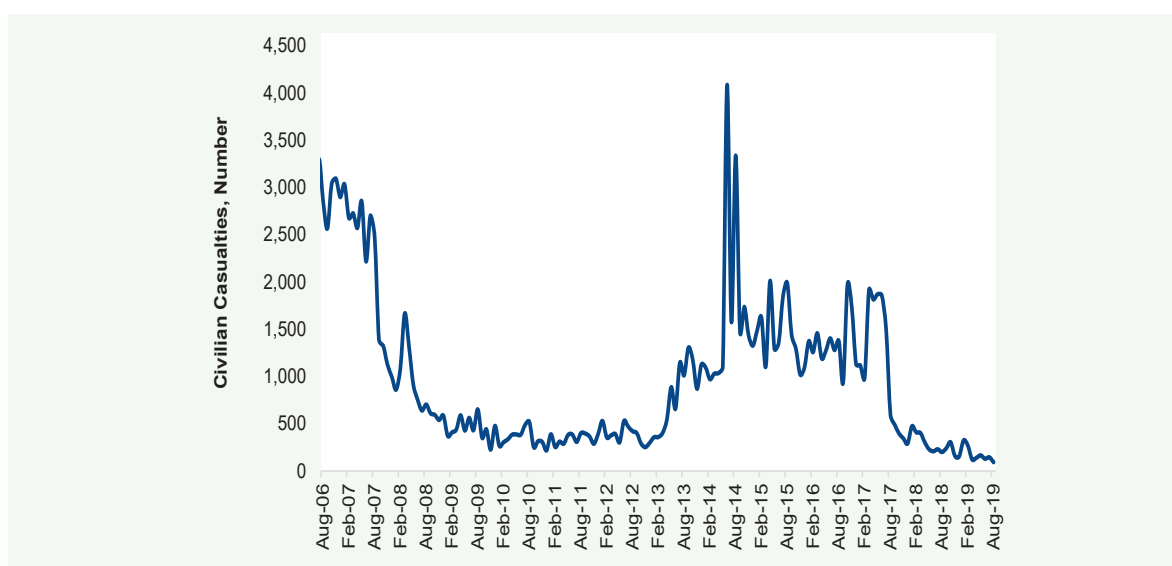
² High level visits included Saudi Arabia, Kuwait, Jordan, Iran and Turkey.

³ The first phase of the agreement with Siemens is worth US\$785 million, includes the construction of a 500 MW gas-fired power plant, the upgrade of 40 gas turbines and the installation of 13 substations and 34 transformers across Iraq.

Box 1 • Iraq's Humanitarian Context

The humanitarian context in Iraq has transitioned into a post-conflict phase, yet vulnerable people continue to face immense challenges. By end-2018, civilian casualties fell to its lowest level since 2003, when the conflict claimed the lives of over 206,548 Iraqi civilians (Figure B1). More than 4 million people have returned home, from an overall high of 6 million at the height of the conflictⁱ. In January 2019, there were approximately 1.8 million IDPs in Iraq, and as of May 2019, that number had fallen to 1.67 millionⁱⁱ. Moreover, an estimated 6.7 million people across Iraq in 2019 (18 percent of Iraq's population of which 98 percent of women and children) are still in need of some form of humanitarian assistance (decreased from 8.7 million in 2018). Dire living conditions, including economic hardship, insufficient basic services such as health, water, and sanitation, are faced by the 4 million returnees. Nearly 2.5 million Iraqis remain food insecure; 5.5 million people require health care; 2.3 million need water and sanitation assistance, 2.6 million children lack access to education and 2.3 million people are in need of shelter and non-food items (Humanitarian Response Plan, 2019). Budgets for the most vulnerable especially IDPs and host communities are still limited, exacerbating the already weak basic services such as electricity, water supply, and infrastructure. With IDPs returning to their homes, there will be an increasing need to open economic opportunities and maintain flexible social assistance in these parts of the country.

Figure B1 • Civilian casualties have been decreasing



Source: Iraq Body Count database.

ⁱ This is in addition to 257,000 refugees are registered with UNHCR in neighboring countries, UNHCR, regional update, September 27, 2019. <https://www.unhcr.org/5d8e11477.pdf>.

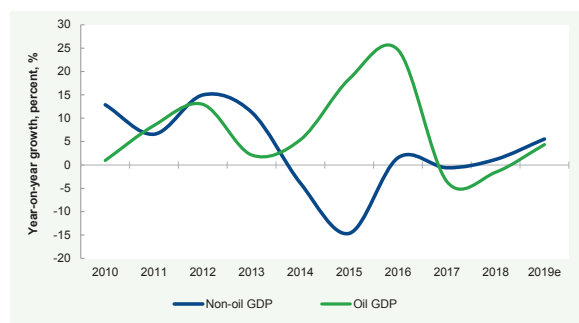
ⁱⁱ Humanitarian Response Plan (HRP), January-December 2019, Feb 2019.

Output and Demand

some of the main macroeconomic policy challenges. It uses the most recent available data to paint a picture of the macroeconomic environment and gives its perspective on the medium-term outlook and risks associated with these macro outcomes.

Iraq's economy is gradually rebounding, after the contraction in the last two years. GDP grew at 4.8 percent year on year (y/y) in the first half of 2019 reversing the contraction of 2017-18. Growth can be mainly attributed to a rise in crude oil production (up

Figure 1 • Non-oil GDP is markedly rebounding in 2019



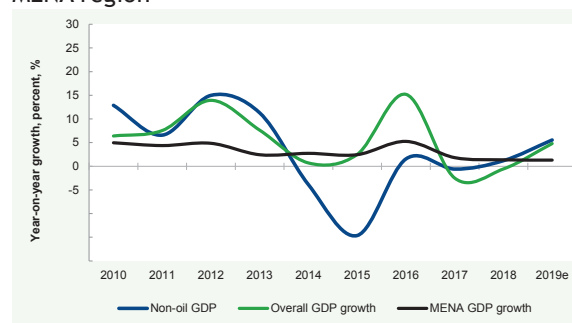
Sources: Iraqi authorities; and World Bank staff calculations.

6.3 percent) and a rebound in non-oil economic activity (up 5.6 percent in H1-19, y/y). Crude oil production is a significant success story for Iraq. Prior to 2014, there had been doubts as to whether production could be sustained above 3 million barrels per day (mbpd), whereas it currently is within striking distance of 5 mbpd. As for the non-oil sector, improvement is underpinned by better rainfall, an improvement in electricity production, and an expansionary fiscal policy linked to higher oil prices in 2018 which persisted into the early part of this year. These positive developments are expected to bring real GDP growth to an estimated 4.8 percent at end-2019, reversing a 0.6 percent contraction seen in 2018, with the non-oil economy likely to accelerate over 5 percent. (Figure 1).

Iraq's economy has outperformed that of other regional peers in 2019, but its population dynamics requires much higher growth to sustain current level of welfare. In 2019, Iraq's growth is expected to outperform the Middle East and North Africa's (MENA) average growth of 1.3 percent (Figure 2). Nevertheless, in per capita terms, GDP has barely grown over the past few years, as fertility rates reached 4.1 following decades of armed conflict and massive displacement (Figure 3). As such, Iraq will need to consistently grow at a much higher pace, exceeding 5 percent yearly, if it is to close the gap with other upper middle-income countries, and more importantly maintain a constant level of economic activity and welfare gains for its growing population.

The recovery has so far been relatively broad-based in 2019 with oil production, agriculture and electricity serving as main pillars of growth (contributing 2.9, 0.6, and 0.2 pp to growth, respectively). Favorable international prices

Figure 2 • Bringing the overall GDP growth to 4.8 percent at end-2019, and to overperform that in MENA region



Sources: Iraqi authorities; and World Bank staff calculations.

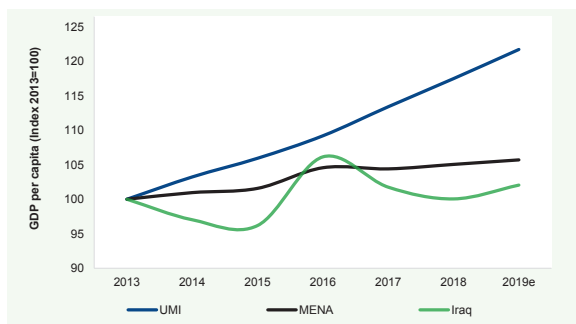
and higher crude oil production led to the oil sector expanding by an estimated 4.4 percent (y/y) in the first half of the year. Oil production has nearly doubled over the past decade, averaging 4.8 million barrels per day (mbpd) in H1 2019, up from 4.5 mbpd in H1 2018. Agriculture sector value-added has increased sharply by almost 39 percent in H1 2019, making it the largest contributor to growth of all non-oil sectors (Figure 4-a). This is largely due to favorable weather conditions and record wheat production despite widespread fires destroying thousands of acres of farmland in late April. With an estimated production of 4.1 million metric tons for 2019-20⁴, a 32.5 percent rise from 2018, such a pickup will have a notable effect in terms of import substitution and of social stability as it boosts farmers' disposable income. Indeed, agriculture is the largest source of employment after the public sector. There was also significant progress in expanding the electricity supply. As new generating capacity has come onstream, electricity production increased to an average of 16,354 MW in the first half 2019 (y/y), 5,1471 MW higher than a year earlier. More investments are needed though to meet high demand, which reached 20,874 MW as of June 2019⁵.

In the context of post-war recovery and improved security, the services sector is also recovering although construction has underperformed. The services sector grew by 3.9 percent in H1-19 and contributed by 1.2 percentage point (pp) to overall growth. This comes primarily from transport, communication, real-estate and government-related services. These tend to benefit from improved security conditions, especially in Baghdad and major cities, and a boost in private consumption due to a

⁴ USDA Foreign Agricultural Service, May 2019.

⁵ Source: Central Bank of Iraq.

Figure 3 • GDP has barely grown in real per capita

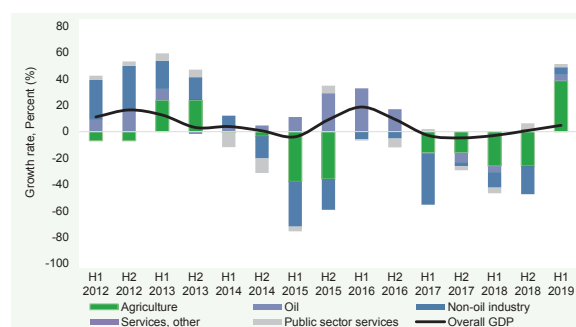


Sources: World Bank staff estimates; and WDI.

rising public sector wage bill (Figure 4-b). Construction on the other hand has seen some growth so far, up 2 percent in the first half of 2019. This is not the performance that would be expected in a post-war recovery phase. Indeed, reconstruction in Mosul and liberated areas has stalled, and severe housing gaps persist in other parts of the country. The construction sector should increasingly be more important as returnees' demand for additional housing units and renovation of the existing ones goes up.

On the demand side, consumption has picked up in 2019 on the back of improved security conditions and an expansionary fiscal policy. Both private and public consumption are estimated to pick up in 2019 driven by considerable improvement in security, increased returns from the internally displaced, and a sizable primary public expenditures expansion. The expansionary fiscal policy and a low-inflation environment are estimated to support household purchasing power, increasing private consumption. Total domestic consumption is estimated to increase to grow by 1.6 percent in 2019, from 0.3 percent in 2018 (Figure 5). Furthermore, increased domestic demand for consumer goods on

Figure 4.a • A broad-based recovery especially with growth in energy, agriculture, and services



Sources: COSIT and World Bank Staff Calculation.

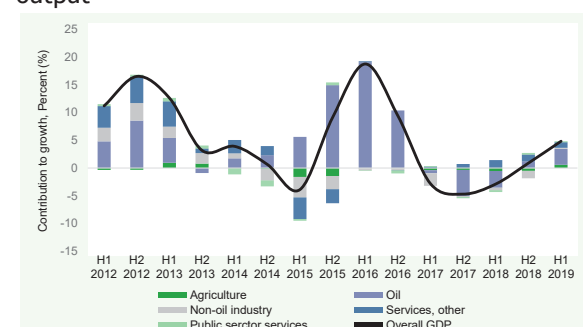
the back of the fiscal stimulus, is estimated to further increase imports of goods to about 34 percent of GDP in 2019, up from 28 percent in 2018. The 2019 budget includes a 27 increase in headline spending, of which a 15 percent increase in spending on the public sector wage bill and pensions.

Overall investment is making little progress given persistent public investment management constraints and unfavorable business environment. Despite an allocation of IQD33 trillion (12.5 percent of GDP) in the 2019 budget law, capital spending declined by 1.1 percent in the first half of the year (y/y). limited absorptive capacity, inefficiencies in public investment management, and weak capacity at the governates level have all contributed to a poor execution rate that did not exceed 5 percent in H1-19 (against 6 percent of GDP in H1-18). Moreover, unfavorable business environment, corruption, cumbersome bureaucracy, and an opaque regulatory environment, are keeping foreign direct investment (FDI) at only US\$1 billion at end-2019 (0.5 percent of GDP), at par with 2018 (Figure 6). Foreign investment ought to become increasingly important in the coming years, as the country attempts to move away from its reliance on oil, finance reconstruction needs and puts in place reforms to de-risk the private sector.

Oil and Gas Developments

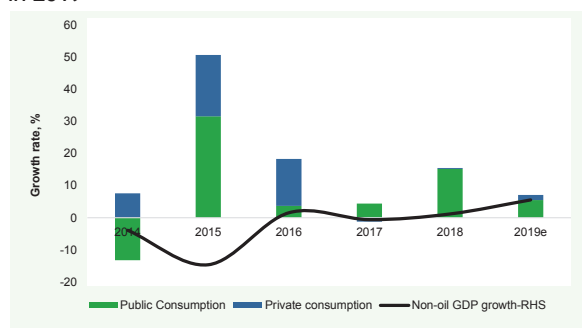
While oil production has been steadily on the rise, recent market dynamics have impacted crude oil exports signaling potential future strains on the budget. Iraq crude oil production has been steadily ramping up as a result of further investments in the field. Production has gone from an average of

Figure 4.b • And in their contributions to overall output



Sources: COSIT and World Bank Staff Calculation.

Figure 5 • Private Consumption is estimated to pick up in 2019

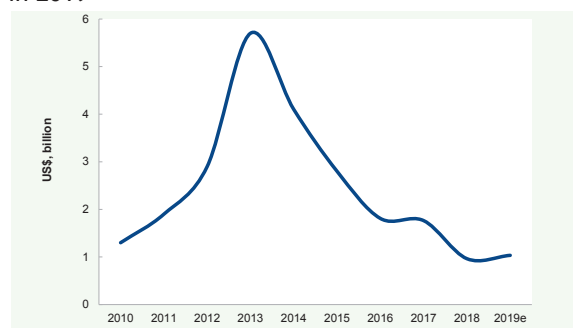


Source: World Bank staff calculations.

3 million barrel per day (mbpd) in 2013 (pre-war with ISIS) to 4.8 mbpd today. Compliance with the OPEC++ agreement quotas, which was extended till March 2020, has capped the Iraq's production slightly below its maximum capacity of 5 mbpd. In the first 9 months of 2019, crude oil exports have reached a total of 969 million barrels (about 73 percent of total production), up 1.64 percent (y/y) from the same period a year earlier (Figure 7). While 97 percent of exports are conducted via Basra ports, the rise is attributed to quantities exported via the Turkish port at Ceyhan and Qayyara oilfield. The increase in oil export volumes has only partially compensated for lower prices. Indeed, Iraqi crude was sold at an average price of US\$61.5 per barrel for the first 9 months of 2019 compared to US\$65.5 per barrel in 2018. As a result, oil exports revenues have dropped by 6.3 percent in the first nine months of 2019 (y/y) reaching a total of US\$59.5 billion. Oil market dynamics are unfavorable for Iraq given the decline in global demand and stricter adherence to OPEC++. The price decline which started in April is gradually eroding fiscal buffers. Actual oil export prices currently stand at 3 dollars above the budgeted price of 2019, much lower than an average of 19 dollars a year earlier (Figure 8).

With a notable improvement in security, Iraq is upgrading its oil industry. GoI has ambitious plans to increase oil production to reach 7 mbpd over the next 5 years. In January 2019, Iraq reached deals with Schlumberger, a US firm, and with Iraqi drilling company, to boost oil production from the giant southern Majnoon oilfield to help nearly double its output to 450,000 bpd by 2021. Iraq is also working to raise the production capacity in the southern and central regions and rehabilitate those destroyed during the conflict in the north, including

Figure 6 • But FDI remains low at only US\$1 billion in 2019



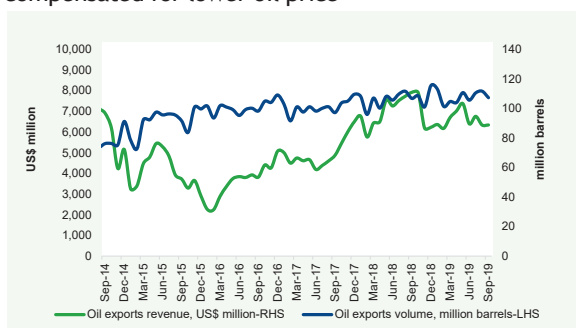
Source: IMF.

the Sumoud refinery in Baiji. Other plans also include using oil to bolster relations with neighbors. Indeed, plans are set to contracting with Kuwait and Iran on the development of joint oilfields on the borders and building new oil pipelines via Jordan and Turkey. Moreover, in September 2019, a total of 7,000 barrels per day were exported to Jordan by trucks. This follows an agreement signed on January 2019, where Iraq agreed to provide Jordan with 10,000 barrels per day (bpd) from the province of Kirkuk⁶. However, boosting oil industry and achieving those plans remain constrained by difficulties to maintain and repair existing transport capacity, insufficient water supply, gas reinjection, and persistent inefficiencies in the contractual and regulatory environment. These plans would also require additional investment in transport, access to water and injection capacity, and storage, mostly to be financed through public resources that have not been fully allocated in successive budgets. Furthermore, it will require an agreement with other oil producers in the future on increasing Iraq's quota under an OPEC++ type of framework.

Iraq's gas sector remains chronically underfunded and underutilized. Lack of investment in gas infrastructure has led to the daily flaring of 1.7 billion standard cubic feet of domestic natural gas produced in association with crude oil. In addition to the negative environmental and health impact, this is roughly equivalent to an annual economic loss of US\$2.5 billion and to more than 10 GW of much needed power generation capacity. Iraq is the second gas flaring country in the World, importing expensive fuels and natural gas to run power plants and suffering

⁶ The agreement did not advertise the price at which oil will be exported. It only indicated that exports will be at a discounted price in exchange for lowering tariffs on Iraqi goods imported through Jordan's Aqaba port.

Figure 7 • Increase in exports volume is partially compensated for lower oil price



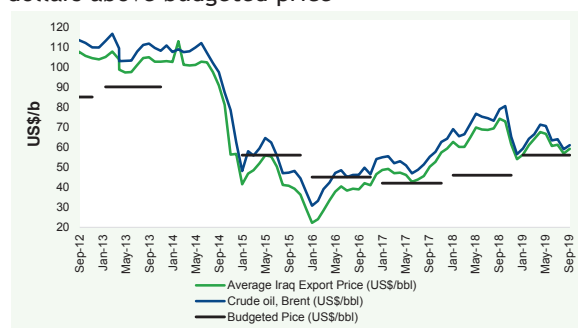
Sources: Iraq Ministry of Oil; and World Bank staff calculations.

consequently from significant fiscal and balance of payment implications. This comes primarily because of inadequate contractual and regulatory frameworks for investment in the gathering, treatment, processing, and transport of natural gas. Moreover, a proliferation of geographically-fragmented, state-managed SOEs as a means of control over all operative aspects of the gas value chain has led to duplication of activities and many inefficiencies that crowd-out private investments. However, Iraq started to take some steps to capture and support increased gas utilization. In mid-July 2019, Iraq's Ministry of Oil signed a memorandum of understanding with Honeywell on the Artawi project to process associated gas from southern oilfields. The project is still in discussion and will require further preparation to materialize.

Public Finance

Iraq's fiscal position is deteriorating in 2019 due to a sizeable fiscal loosening. The rapid expansion of the public wage bill and of social assistance programs coupled with weak domestic revenue mobilization has led to a marked deterioration of Iraq's fiscal position. Data suggests that recurrent spending has risen by 28.8 percent in H1-19 (y/y) coupled with a 33 percent drop in non-oil revenues, only to be offset by a 1.1 percent decline in public investment. As a result, the primary surplus for H1-19 reached IQD8.5 trillion (6.7 percent of GDP), down 48 percent compared to its level in H1-18. Given the observed budget execution trends, untargeted social policies and the unfavorable oil markets prospects, the 7.9 percent of GDP budget surplus in 2018 is

Figure 8 • Actual price of oil exports is only 3 dollars above budgeted price



Sources: Iraq Ministry of Oil; and World Bank staff calculations.

expected to turn into a 4.6 percent of GDP deficit by end-2019 (Figure 9).

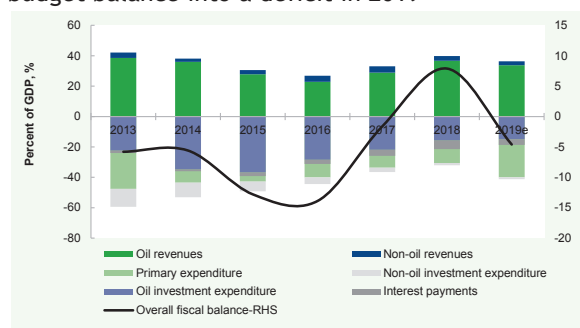
Budget rigidities continue to pile up. The GoI maintains a loosened fiscal policy of expanding the public wage bill and subsidies as a tool to ensure social peace amidst weak private sector job creation (Figure 10). This is evident by the government's latest decision to assimilate all militia fighters into the national army and absorb a large number of graduates from various technical universities into ministries and SOEs⁷. As a result, the public wage bill has so far increased by 13.7 percent in H1-2019 (y/y) and accounts for 51 percent of total spending. This is a 42 percent increase compared to pre-ISIS war in 2014, placing the size of the Iraqi public wage bill ahead of regional and high-income countries (Figure 11). This was also accompanied by a respective rise of 38.5 and 31.7 percent (y/y) in public consumption of goods and services and in social assistance programs, namely for the public distribution system (PDS) and pensions, leaving little fiscal space for public investment. At this rate, Iraq requires a minimum oil barrel price of US\$53 to finance only its recurrent spending for this year⁸. Prior to the ISIS crisis, this number stood at an average of US\$65/barrel in 2013.

Those rigidities are coming at the expense of growth-enhancing public investments. Investment expenditures have declined by 1.1 percent in H1-19, reflecting serious public investment management constraints and limited absorptive capacity. Despite

⁷ Ministry of Oil has hired 3000 petroleum engineers in 5 months already.

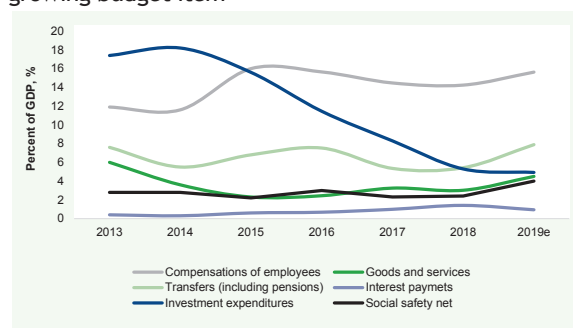
⁸ This number rises to US\$73/barrel if all planned public investments are also accounted for. Those numbers assume that the ambitious non-oil revenue target of IQD11.8 trillion (4.2 percent of GDP) from the 2019 budget law is reached. If not, then the breakeven price increases to respectively US\$60 and US\$80/barrel (including public investment).

Figure 9 • Large fiscal loosening is expected to turn budget balance into a deficit in 2019



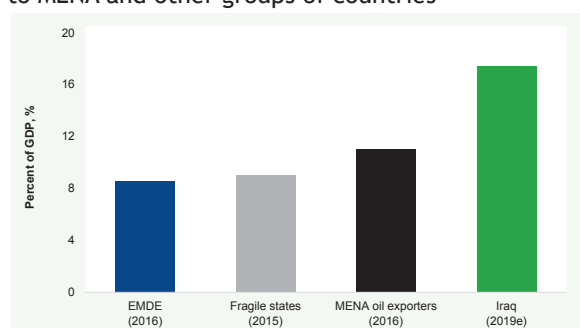
Sources: Iraq MoF; and World Bank staff calculations.

Figure 10 • Wage bill is the single largest and fastest growing budget item



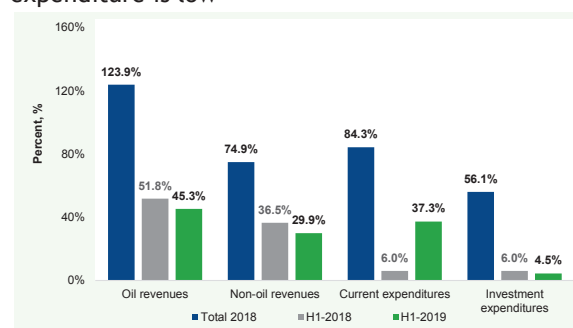
Sources: MoF; and World Bank staff calculations.

Figure 11 • Wage bill is also the highest compared to MENA and other groups of countries



Sources: WDI; and World Bank staff calculations.

Figure 12 • Execution rate for investment expenditure is low



Sources: MoF; and World Bank staff calculations.

large allocations made for public investment (12.5 percent in the 2019 budget law), the execution rate remains below 5 percent in H1-2019, or at IQD1.47 trillion (Figure 12). This compares to over 37 percent execution rate for recurrent spending over the same period. Moreover, while public investments related to the oil sector more than doubled in H1-2019 (y/y), those related to other sectors declined by 23.2 percent. Such results not only put a drag on long-term sustainable growth. It also signals increases in social vulnerabilities and tensions as the reconstruction program for Mosul and the seven liberated areas, service delivery programs across governates, and investment in human capital all remain severely lagging.

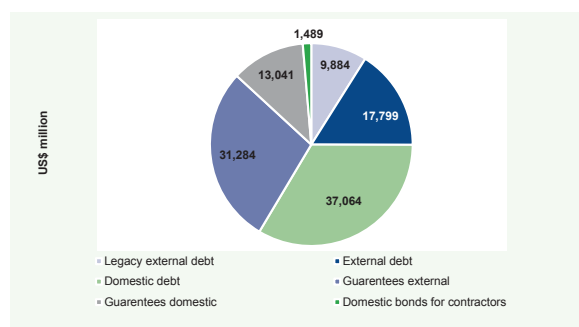
Budgetary revenues remain dominated by oil receipts and poor domestic revenue mobilization. The Iraqi budget is largely dependent on oil-related receipts as they constitute 92 percent of total budget revenues. As such, the improvement in production has translated into a 6.3 percent rise in budgetary oil revenues so far in the first six months of the year

(y/y). Nevertheless, non-oil revenues have been well below budgetary expectations and have declined by a staggering 33.1 percent over the same period (y/y). The decline reflects problems in domestic revenues mobilization attributed to poor tax compliance and collection efforts, expansion of customs exemptions, and low growth in 2018 affecting income tax. At 2 percent of GDP, non-oil tax revenues in Iraq is one of the lowest in the world. Expanding domestic revenue mobilization will be key to reduce reliance on oil and create fiscal space in the future for investments in human and physical capital.

Public debt is rising in 2019 with risks associated with increased reliance on domestic financing. The projected fiscal deficit is expected to increase public debt-to-GDP from 49.3 percent in 2018 to almost 50 percent in 2019. The most recent debt sustainability analysis (July 2019)⁹ concludes that Iraq does not face major solvency risks despite its limited debt carrying capacity. While 53 percent of total debt

⁹ IMF 2019 Article IV Consultation and Proposal for Post-Program Monitoring; Staff Report, July 2019.

Figure 13 • Fifty eight percent of total debt stock is external



Sources. Iraqi authorities; and World Bank staff calculations.

stock¹⁰ is external¹¹ (Figure 13), 68 percent of that stock is long term, 14 percent is held by bilateral donors and multilaterals agencies, and 9 percent is legacy debt acquired prior to 1990 (Figure 14). Moreover, interest payment represents a mere 2.6 percent of budgetary revenues (equivalent to 0.9 percent of GDP). Nevertheless, Iraq faces high liquidity risks as gross financing needs continue to rise. Indeed, gross financing needs are projected to reach around US\$41 billion in 2019 (17.4 percent of GDP). In addition to the primary budget deficit, the largest financing need comes from rolling over domestic debt, and to a lesser extent amortization of external debt (US\$1.7 billion). Domestic debt is typically more expensive and mostly short term, less than one year. As such, it will have to be rolled-over on a yearly basis accentuating liquidity needs over time. More importantly and in the absence of new foreign borrowing, as envisaged in the 2019 budget law, financing the government exclusively from domestic markets would also entail risks from crowding out much needed private sector credit.

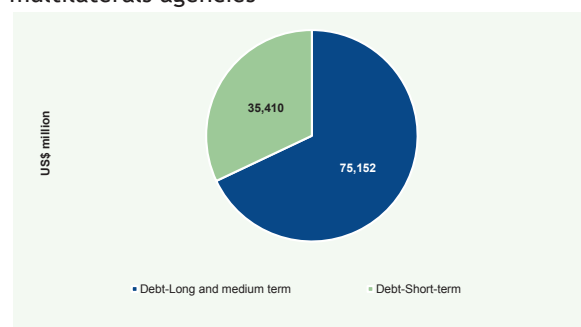
External Sector

Less favorable terms of trade coupled with fiscal loosening have weakened Iraq's external position. Latest available data reveals that the current account balance has declined to 2.3 percent of GDP in Q1-19, down from 3.1 percent in Q1-18 (Figure 15). The deterioration is attributed to two factors. First, to the less favorable terms of trade where Iraq's average oil export price has fallen so far in 2019 (see para 10

¹⁰ Including guarantees.

¹¹ Which includes legacy external debt, external and guarantees external.

Figure 14 • Sixty eight percent of that stock is long term, 14 percent is held by bilateral donors and multilaterals agencies



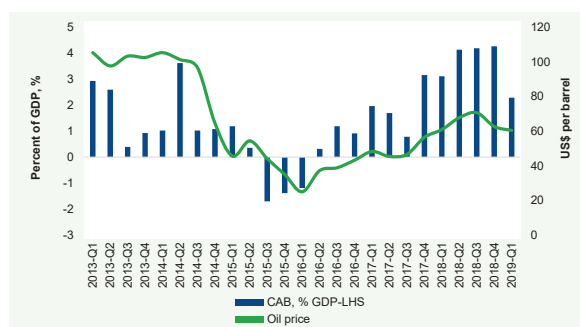
Sources. Iraqi authorities; and World Bank staff calculations.

above). Second, a loosening of the fiscal stance and better aggregate demand resulting in a notable 17 percent rise in imports of goods and services Q1-18 (Figure 16). Those unfavorable dynamics are expected to continue throughout the year. Indeed, the projected dip in international oil price to US\$56/barrel coupled with tougher implementation of Iraq's commitments to the OPEC++ quota agreement on oil exports, and continued rising imports are projected to reverse the 2018 current account surplus of 6.9 percent of GDP into a projected deficit of 4.6 percent of GDP in 2019.

The worsening of the current account balance coupled with lower oil prices are expected to put pressure on the Central Bank of Iraq's (CBI) international reserves. So far, oil export volumes have managed to partially compensate for the lower prices and keeping the CBI's gross reserves at almost US\$68 billion by August 2019 (Figure 17), up 5.3 percent compared to 2018 (y/y). The situation is expected though to reverse going forward given the unfavorable oil markets prospects. Moreover, other sources of external financing are poorly performing. FDI has declined by 52 percent in Q1-2019 (y/y) and net portfolio outflows widened¹². As a result, further pressure is expected on CBI reserves. These are projected to decline to an estimated US\$60 billion at end-2019 (or 6.7 months of imports), from over US\$64 billion in 2018 (8 months of imports), increasing as such the vulnerability of the country to future external shocks (Figure 18).

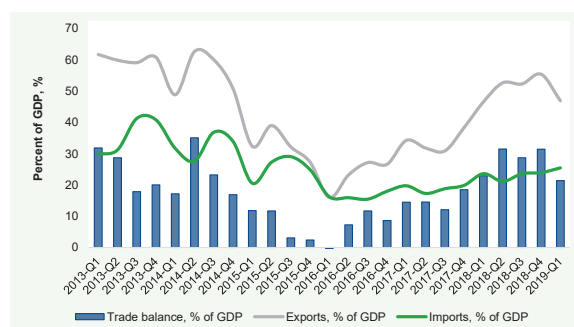
¹² According to CBI data. Net portfolio outflows have risen from US\$6 million in Q1-2018 to US\$282 million in Q1-2019.

Figure 15 • CAB declined to an estimated 2.3% of GDP Q1 2019



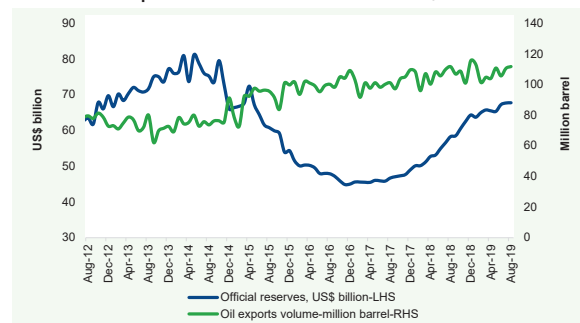
Sources: CBI, Ministry of Oil; and World Bank staff calculations.

Figure 16 • With less favorable trade balance and increased import



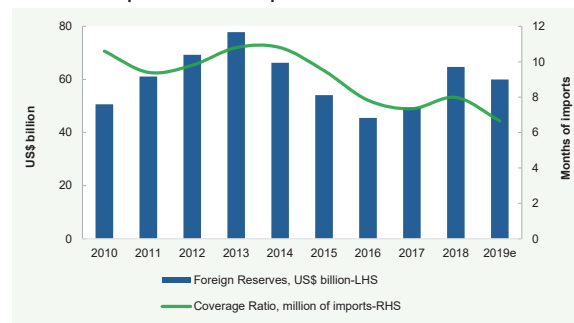
Sources: CBI, Ministry of Oil; and World Bank staff calculations.

Figure 17 • Increased oil exports volume has managed so far to keep the reserves at almost US\$68 billion



Sources: CBI; and Ministry of Oil.

Figure 18 • But the continuous decline in oil prices and lower prices will dip the reserves at end-2019



Sources: CBI; and Ministry of Oil; and World Bank staff calculations.

Monetary Policy and Prices

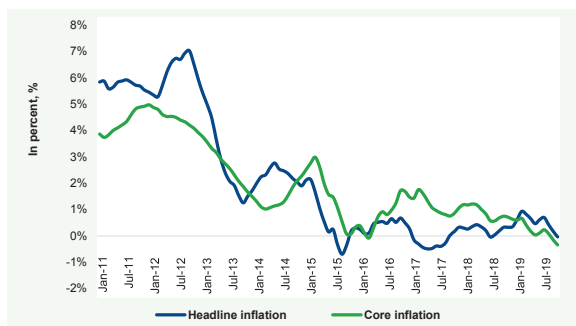
Inflationary pressures remain muted in 2019. Improved security and increased domestic demand have put pressure on the prices of services such as recreation (up 9.4 percent), education (up 8.5 percent) and health (up 2.2 percent) in the first seven months of 2019 (y/y) (Figure 20). Nevertheless, inflationary pressures remain largely muted in 2019 due to lower oil prices and cheaper imported consumption goods following a continued depreciation of both Turkish and Iranian currencies, the two main trading partners for Iraq. Items like food prices rose by only 0.9 percent in the first 7 months of 2019, while consumer goods like apparels and house supplies and appliances prices declined by an average of respectively 1.7 and 1.5 percent over the same period. These three items alone constitute on average 41 percent of total household consumption basket. Such easing in prices is have therefore a favorable impact on Iraqi consumer welfare especially that of the poor. Overall both core and headline

inflation, as measured by the CPI, declines by 0.3 and 0.04 percent (y/y) (Figure 19).

The observed economic pick-up is also supported by an increase in broad money, but public sector borrowing to finance the deficit continues to crowd out credit to the private sector. During the first half of 2019, broad money (M2) is estimated to have grown by 6 percent (y/y), driven by the pickup of overall economic activity (Figure 21). Increased borrowing by the public sector to finance the deficit due to expansionary fiscal policy continues to crowd out the private sector and this resulted in a sharp drop in the extension of credit to the private sector in the second half of 2018 (Figure 22). This continues to be an issue as the government needs to provide greater access and support to the private sector to enable it to play its part in the national development. This is also exacerbated by shortcomings in financial architecture, weakness in credit information and legal procedures.

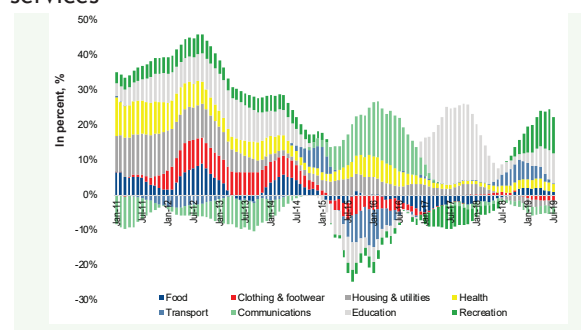
The banking sector is showing signs of improvement. To address the citizens trust deficit

Figure 19 • Deflationary pressures are observed



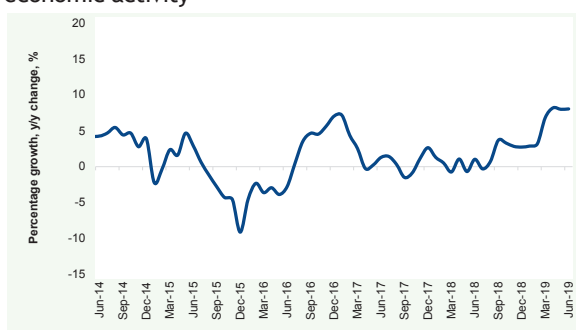
Sources: COSIT and World Bank Staff Calculations.

Figure 20 • Despite rising prices in non-tradeable services



Sources: COSIT and World Bank Staff Calculations.

Figure 21 • Broad money picked up due to increased economic activity



Source: CBI.

Figure 22 • Credit to private sector is decreasing



Source: CBI.

and to increase confidence in the banking system, CBI established the Iraqi Deposit Insurance Company in July 2019. Additionally, the CBI also announced in July 2019 an initiative to stimulate credit to the economy by raising the limits of loans granted to small-and medium sized enterprises (SMEs) to one billion dinars, to support the “One trillion dinars’ initiative” announced in January this year. These measures have increased Iraqi confidence in the banking system and have led to higher levels of deposits (Figure 23). Total deposits of the banking sector are estimated to have increased by almost 15 percent during H1- 2019 (y/y), to an average exceeds ID75 trillion. Increased confidence in the banking sector is also leading to an increase on the total assets, following a sharp drop in assets in end-2017¹³. Assets stood at an estimated ID129 trillion in June 2019 (Figure 24), about 13 percent increase (y/y)¹⁴. There is also continued progress on electronic

¹³ Due to some accounting adjustments carried out by State-Owned Banks.

¹⁴ Accounting adjustments was made for the total assets of commercial banks following International Accounting Standards (IAS) as of January 2012.

payment of public salaries which has reportedly reached 21.2 percent of the entire civil service in May 2019¹⁵.

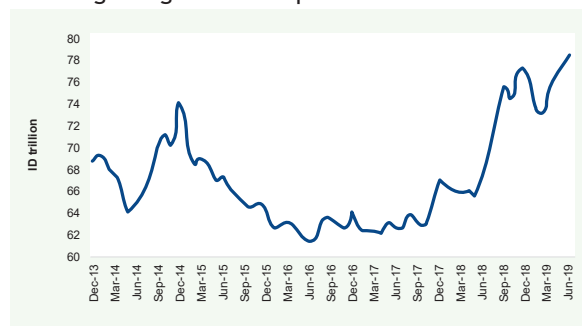
Iraq continues to largely be a cash-based economy. Account ownership data indicates unmet demand for financial services. The fact that only 23 percent of adults have a bank account suggests that there is a substantial unmet demand for financial services (increased from 11 percent in 2014). Iraq has the lowest share of the population with an account at a formal financial institution among peers in the MENA region (20 percent)¹⁶. Moreover, only 11 percent of adults use an electronic payments instrument, which includes a debit or a credit card, sending/receiving remittances through an account, or paying for utilities (Figure 25). At the first Digital Mashreq Forum held in Amman in June 2019, Iraq committed to advancing the digital economy and establishing a conducive regulatory and policy framework for digital payments, investing in an interoperable infrastructure, and striving towards universal financial access¹⁷.

¹⁵ Iraq ICR 2019 using CBI data

¹⁶ World Bank, Global FINDEX Database 2017.

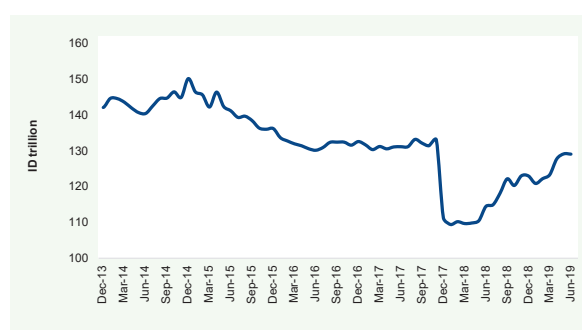
¹⁷ Alexandre Laure, and Marolla Haddad, Note on Digital Transfor-

Figure 23 • Increased confidence in the banking sector is leading to higher total deposit



Source: CBI.

Figure 24 • Figure 24. And to higher total assets

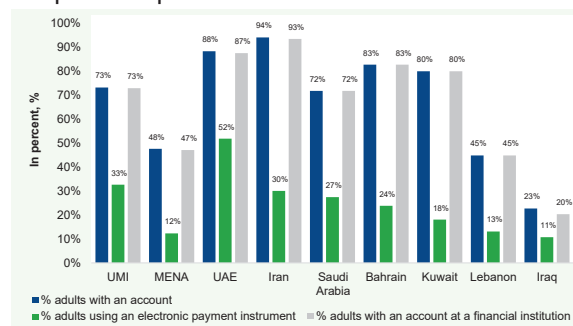


Source: CBI.

Despite reform progress, the financial sector has limited ability to support the significant national reconstruction needs and to finance the private sector. This is due to a banking system dominated by under-capitalized and under-provisioned state-owned banks (SOBs) primarily used for quasi fiscal operations (NPLs stand at an estimated 37+ percent and credit to private sector at 7 percent of GDP - one of the lowest indicators in MENA); lack of trust in the financial system characterized by a largely cash based banking system with low deposits and under-utilization of the electronic payments infrastructure; and a non-banking financial sector at an early stage of development with underdeveloped capital markets and microfinance sector. Additionally, banks in Iraq have little experience in lending to small, and medium-sized enterprises (SMEs), thus limiting financial intermediation. Many banks do not have the necessary skills to analyze credit risk or to carry out cash flow analysis. Financing for SMEs is not well developed even though the CBI has put in place a US\$5 billion line of credit extended to SOBs for on-lending to SME's, agriculture and infrastructure

mation, World Bank, September 2019.

Figure 25 • Account ownership is the lowest compared to peers



Source: World Bank Global FINDEX Database 2017.

projects. It is estimated that fewer than 5 percent of SMEs in the formal sector have received bank loans.

Business Environment and Private Sector Development

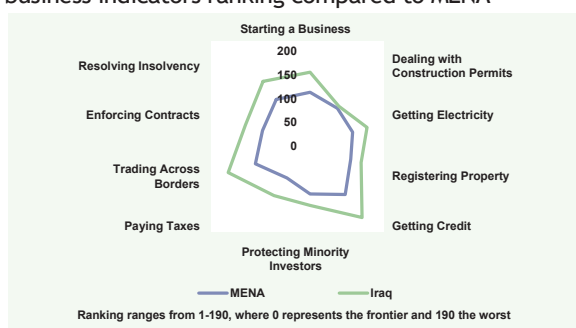
Iraq's business environment compares unfavorably with the world. The country ranks 171 out of 190 countries in the World Bank's 2019 Doing Business rankings, one of the lowest ranking economies in the MENA region (Figure 26). Iraq fares particularly poorly in getting credit (186), trading across borders (181), resolving insolvency (168), starting a business (155), enforcing contracts (143), paying taxes (129), and getting electricity (126). Some progress has been observed though in electricity access, with improved production, and in starting a business as some streamlining of procedures occurred. Nevertheless, the regulatory framework remains unfavorable for business and for fostering both domestic and international investment.

Moreover, structural problems are at the core of private sector development. These include:

- **Weak governance and widespread corruption.** Iraq is persistently ranked below the tenth percentile globally on the World Bank Worldwide Governance Indicators in the 1996-2018 period, specifically in areas of government effectiveness, rule of law, and control of corruption¹⁸. This discourages domestic and international investors from expanding businesses and offers lower quality services to consumers.

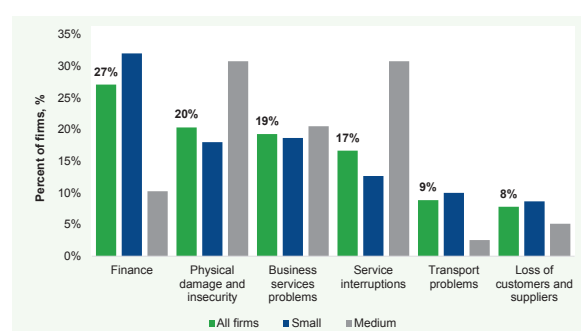
¹⁸ Iraq scored 18 out of 100 in the latest Transparency International Corruption Perception Index 2018, much lower than the MENA average (39).

Figure 26 • Iraq ranks unfavorably on all doing business indicators ranking compared to MENA



Source: Iraq Doing Business 2019.

Figure 28 • Key constraints identified by firms, by size



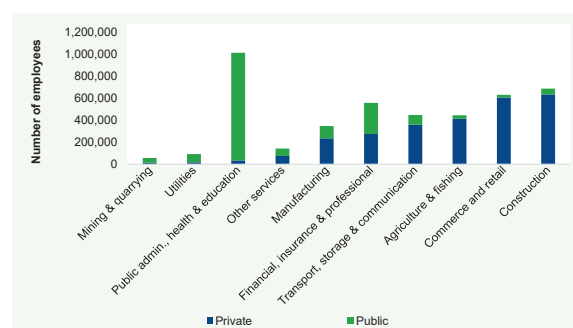
Source: Bringing Back Business in Iraq, World Bank 2019.

- **The dominance of the public sector in commercial activity through its 160+ SOEs** (Figure 27). Such dominance has significantly contributed to low firm entry rates. The annual number of new firm entrants fell from 5,293 firms in 2008 to 2,020 in 2016.¹⁹ Moreover, lack of entrepreneurship endeavors, especially in the formal economy, reduces the pool of young firms. These have been identified as the engine of job creation in many other countries. In Iraq small firms stay small, failing to compete with the few large firms that are mainly SOEs, and do not create enough high-quality jobs²⁰.
- **Limited ability to access finance.** Twenty seven percent of firms identified access to finance as a major impediment to develop their operations. For small firms, this was in effect the top constraint (Figure 28). Access to finance remains an issue given the poor depth of the banking system and the underdevelopment of non-banking financial institutions especially micro-credit and other schemes.

¹⁹ Bring Back Business in Iraq, Analytical note, World Bank, September 2019.

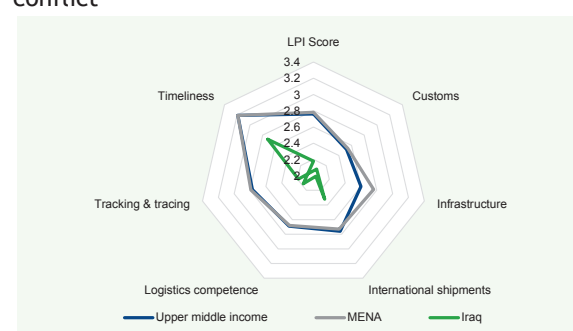
²⁰ Ibid.

Figure 27 • Jobs are dominant by the public sector



Source: Iraq Household Socio-Economic Survey, 2012.

Figure 29 • Logistics quality has deteriorated with conflict



Source: World Bank Logistics Performance Index (LPI) 2018.

- **The deterioration of infrastructure and logistics quality.** Conflict and lack of investments has resulted in a deteriorating quality of logistics, raising pressure on service delivery and operational costs for businesses and making it harder for firms to benefit from businesses opportunities in both Iraq's lucrative domestic markets and regional trade (Figure 29).

A comprehensive reform strategy emphasizing investment climate, rethinking the role of the state in the economy and engaging in digital infrastructure is needed to tackle these constraints. Iraq is a market for 40 million consumers with huge untapped entrepreneurship potential. As such, it offers plenty of opportunities for the private sector to flourish. To do so, the regulatory and structural impediments mentioned previously need to be addressed. A comprehensive reform strategy could focus i) on boosting the investment climate through regulatory reforms for business operation, investment policies and Public Private Partnership (PPP); ii) developing the digital economy especially in terms of affordable access to high-speed internet,

cashless payments, digital government services and data access, and scaling up entrepreneurship ecosystem; iii) engage on corporatization of SOEs and restructuring markets in which SOEs operate to foster more competition. The GoI has set the development of private sector as a development priority and have started addressing some these reforms with support for the donor community.

Outlook and Risks

Outlook

In the absence of structural reforms and accelerated reconstruction, growth recovery in Iraq may be short-lived. Growth is projected to continue its positive trajectory and peak at 5.1 percent in 2020, coming from a low base and benefiting from recovery following years of conflict and continued fiscal loosening. However, growth is expected to decelerate to 2.7 percent in 2021. This is mostly due to an unfavorable international oil markets outlook where both prices and exports are expected to weaken given lower global demand and the uncertainty surrounding the OPEC++ agreement renewal. Non-oil growth is expected to remain positive on the back of improved security conditions and higher investment to rebuild the country's damaged infrastructure. Nonetheless it is likely to remain far short of needs given absorptive capacity. Indeed, in the absence of domestic structural reforms, Iraq's potential growth will remain sluggish as it underutilizes its factors of production, especially on the non-oil side (see Box 2 and Annex). Such no-reform scenario could therefore entail significant costs at both economic and social levels.

Higher spending together with lower oil prices will result in a fiscal deficit projected at 3.3 percent of GDP in 2020 and remain in a similar range in 2021. Persistent fiscal deficits are projected to push public debt to over 48 percent of GDP by 2021. Unless there is a significant reorientation in the fiscal policy for the next 2020 budget to tackle spending rigidities and domestic revenue mobilization, there will be limited fiscal space to sustain post-war recovery, investment in human capital and long-term development. High fiscal deficits coupled with amortization of existing debt, especially the rollover

of domestic treasury bills, signal that Iraq's gross financing needs will be high in the coming years reaching over US\$45 billion (about 18 percent of GDP) over 2020-2021²¹. Over-reliance on the local markets for financing increases cost of debt service and repayment risks, given that domestic debt is more expensive and mostly short-term, and could crowd-out private sector credit.

Lower oil prices and increased imports will keep the current account balance in deficit, projected at an average of 4 percent of GDP over 2020-2021. This is expected to be financed partially by past international reserve accumulation. As a result, CBI's foreign reserves are projected to drop to an estimated US\$51 billion (or 5.7 months of imports) by 2021.

Risks and challenges

Iraq's macroeconomic outlook faces several risks related to the fragile political environment and to structural factors related to economic dependence on oil revenues. The country remains in a fragile situation coming out of a conflict despite improved humanitarian and social conditions. However, reconstruction and structural reforms to de-risk the private sector have yet to pick up in full steam. These delays constitute upside risks to growth, which is expected to remain subdued over the medium term in the absence of reforms. Moreover, downstream risks are linked to the volatility of oil prices and uncertainty over future agreements on oil quotas (see Box 3). Indeed, lack of diversification and budget rigidities linked with increased spending on non-discretionary budget items such as the wage bill reduces Iraq's financial buffers and increases its vulnerability to external shocks. It also threatens to outdo the recent positive government reform efforts especially in the electricity and agriculture sectors.

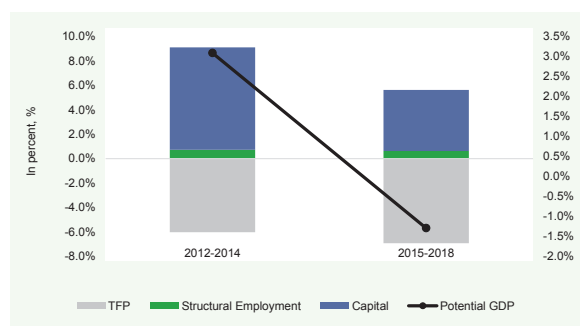
Social unrest over lack of jobs, corruption, and poor service delivery remains one of the more important risks to growth and fiscal sustainability. Iraqis have taken the streets in October 2019 to protest lack of jobs, ramping corruption, and poor quality of services. The demonstrators were mostly young, between the ages of 18 to 30, and were mobilized by social demands. The events have turned

²¹ IMF, Debt Sustainability Analysis (DSA), July 2019.

Box 2 • Potential GDP Estimation for Iraq

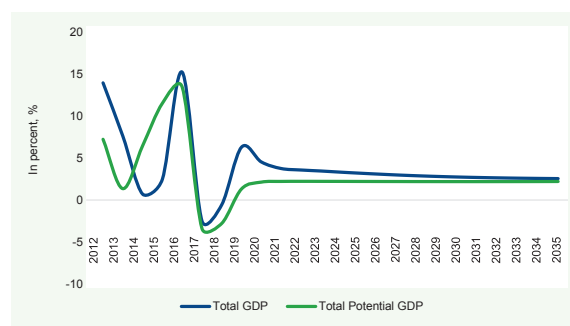
Productivity contributed negatively to economic growth in Iraq and under a no reform scenario potential growth will remain sluggish. Figure B2 summarizes Potential GDP and its decomposition into input factors for the 2012-2014 period and 2015-2018 (see Box 4 for technical details). TFP contributed negatively to growth in both periods and more so in the second period while also the contribution of capital to growth declined mostly driven by the drop-in oil prices which slashed overall investment. This model suggests that under a baseline no-reform scenario Iraq will continue to have sluggish growth on the non-oil sector (Figure B3) (see annex 1 for technical details). Details on growth decomposition and performance will be discussed in the forthcoming World Bank report “Iraq Country Economic Memorandum”.

Figure B2 • Potential GDP Decomposition



Source: WB staff calculations

Figure B3 • GDP and Potential GDP Growth Path



Source: WB staff calculations

violent claiming the lives of more than 100 individuals with thousands of injured and a nationwide internet blackout. These demonstrations exposed the fragility of the system and adds to the downside risks for growth. Social unrest is expected to be met through more short-term fiscal stimulus - cash transfers, public hiring, and housing schemes - to appease demonstrators. However, results might not be satisfactory as creating jobs and fighting corruption will require longer term reforms.

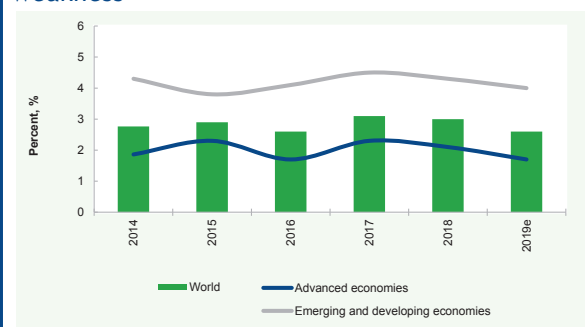
Creating the adequate fiscal space for growth-enhancing programs in human and physical capital will be key for diversification and job creation. In case this does not materialize, increases in oil production will mean little for most Iraqis. With IDPs returning to their homes and with latest demonstrations winding down, there will be an increasing need to open economic opportunities and maintain flexible social assistance in these parts of the country. Concrete measures to boost non-oil revenues and fiscal consolidation measures are needed to reduce macroeconomic risks in the medium term.

Box 3 • Global and Regional Economic Outlook

Global Economy. Global economic activity continued to soften at the start of 2019, with trade and manufacturing showing signs of marked weakness. Global growth in 2019 has been downgraded to 2.6 percent—0.3 percentage point below previous projections—reflecting the broad-based weakness observed during the first half of the year, including a further deceleration in investment amid rising trade tensions (Figure B4). As recent softness abates, global growth is projected to edge up to 2.7 percent in 2020 and to 2.8 percent in 2021. Activity in major advanced economies—particularly in the Euro Area—as well as in some large emerging market and developing economies (EMDEs) has been weaker than previously expected. In Emerging Market and Developing Economies (EMDEs), growth is projected to pick up from a four-year low of 4 percent in 2019—0.3 percentage point below previous projections—to 4.6 percent in 2020-21. Slower-than-expected mining and oil production, combined with domestic policy uncertainties, has delayed the recovery in activity in some of the largest commodity exporters in Sub-Saharan Africa. Downside risks to growth predominate, including rising trade barriers, a build-up of government debt, and deeper-than-expected slowdowns in several major economies

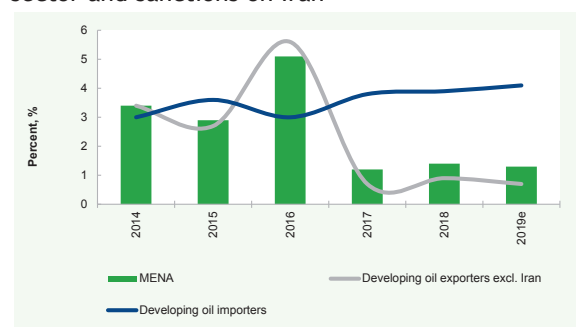
MENA Regional Economy. Growth in the region is estimated to remain subdued in 2019, at 1.3 percent. Activity in oil exporters has slowed due to weak oil sector output and the effects of intensified U.S. sanctions on Iran, despite an easing of the fiscal stance and positive prospects for non-oil sectors in some countries (Figure B5). Oil exporters' growth has remained subdued. Oil production cuts implemented by OPEC and some non-OPEC members (OPEC+) to rebalance global oil markets have constrained oil sector growth in the Gulf Cooperation Council (GCC) economies; however, as suggested by rising Purchasing Managers' Indexes, non-oil activity in large GCC economies is picking up amid easier fiscal stances and higher government spending. Uncertainty about oil prices may also dampen oil exporters' investment and social programs. Many oil importers continue to benefit from business climate reforms and resilient tourism activity. Regional growth is projected to pick up to around 3 percent in 2020-21, supported by capital investment and policy reforms. Risks to the outlook are tilted to the downside, including geopolitical tensions, reform setbacks, and a further escalation of global trade tensions.

Figure B4 • Global growth in 2019 has been downgraded to 2.6 percent, reflecting broad-based weakness



Source: World Bank, *Global Economic Prospects (GEP)*, June 2019.

Figure B5 • Growth in MENA region is estimated to remain subdued at 1.3 percent, due to weak oil sector and sanctions on Iran



Note: The World Bank's MENA aggregate includes 16 economies, and is grouped into three sub regions: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE comprise the Gulf Cooperation Council (GCC); all are oil exporters. Other oil exporters in the region are Algeria, the Iran, and Iraq. Oil importers in the region are Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, and West Bank and Gaza. Syria Yemen, and, as of this publication of *Global Economic Prospects*, Libya, are excluded from regional growth aggregates due to data limitations.

TABLE 1 • Iraq. Selected Economic and Financial Indicators, 2014-2021

	2014	2015	2016	2017	2018	2019e	2020p	2021p
Economic growth and prices								
Real GDP (percentage change)	0.7	2.5	15.2	-2.5	-0.6	4.8	5.1	2.7
Non-oil real GDP (percentage change)	-3.9	-14.6	1.6	-0.6	1.2	5.6	4.4	4.4
GDP per capita (US\$)	6,517	5,047	4,843	5,263	5,882	5,746	6,204	6,535
GDP (in ID trillion)	273.6	207.2	206.7	231.0	265.0	277.8	299.9	316.0
Non-oil GDP (in ID trillion)	149.5	137.3	138.3	140.8	145.6	165.9	181.9	197.8
GDP (in US\$ billion)	234.7	177.7	175.2	195.5	224.2	235.0	253.7	267.3
Oil production (mbpd)	3.1	3.7	4.6	4.5	4.4	4.6	4.8	4.9
Oil exports (mbpd)	2.6	3.4	3.8	3.8	3.9	4.0	4.3	4.3
Iraq oil export prices (US\$ pb)	92.1	44.7	36.0	49.1	65.5	61.7	55.8	54.9
Consumer price inflation (percentage change; average)	2.2	1.4	0.5	0.1	0.4	0.0	2.0	2.0
(In percent of GDP, unless otherwise indicated)								
Public Finance								
Government revenue and grants	38.2	30.6	26.8	33.0	39.8	36.4	37.7	36.0
Government oil revenue	36.0	27.8	22.9	28.9	36.7	33.7	34.6	32.8
Government non-oil revenue	2.1	2.8	4.0	4.2	3.1	2.6	3.2	3.2
Expenditure, of which:	43.8	43.4	40.7	34.6	32.0	40.9	41.0	39.1
Current expenditure	25.5	27.8	29.3	26.4	26.7	36.0	33.0	32.0
Wages and salaries	11.6	16.0	15.6	14.5	14.2	15.6	16.6	16.6
Goods and Service	3.6	2.3	2.4	3.3	3.0	3.2	1.6	1.5
Interest payment	0.3	0.6	0.7	1.0	1.4	0.9	1.6	1.6
Other	10.1	8.9	10.5	7.6	8.0	16.3	13.2	12.2
Investment Expenditure	18.2	15.6	11.5	8.3	5.3	4.9	8.0	7.2
oil related investment	8.7	9.2	7.1	5.5	3.9	3.7	5.2	5.0
non-oil related investment	9.5	6.4	4.4	2.9	1.4	1.2	2.9	2.2
Non-oil primary fiscal balance, cash basis (percent of non-oil GDP)	-55.3	-43.2	-42.4	-42.4	-43.7	-56.3	-49.6	-46.8
Primary fiscal balance, cash basis (percent of GDP)	-5.4	-12.2	-13.2	3.8	13.9	-3.6	-2.2	-2.1
Non-oil budget balance								
Budget balance	-5.6	-12.8	-13.9	-1.6	7.9	-4.6	-3.3	-3.1
Public Debt								
Total government debt (percent of GDP)	32.9	56.2	64.2	58.9	49.3	49.7	48.6	48.6
Total government debt (US\$ billion)	77.1	99.9	112.5	115.2	110.4	115.3	121.9	128.5
External government debt (percent of GDP)	24.8	37.2	37.1	35.6	30.6	32.2	31.5	30.5
External government debt (US\$ billion)	58.1	66.1	65.0	69.5	68.7	72.2	76.2	77.6
(In percent of GDP, unless otherwise indicated)								
Monetary indicators								
Growth in reserve money	-13.6	-12.0	9.2	-4.4	6.7	2.5	5.4	4.7

Growth in broad money	3.9	-9.1	7.0	-25.8	2.7	2.5	6.2	5.4
Policy interest rate (end of period)	6.0	6.0	6.0	4.0	4.0
(In percent of GDP, unless otherwise indicated)								
External sector								
Current account	2.6	-6.5	-8.3	1.8	6.9	-4.6	-4.0	-4.0
Trade balance	10.9	-0.1	-1.7	7.6	13.4	5.7	3.1	3.0
Exports of goods	39.6	31.8	28.6	34.8	41.2	37.6	34.4	32.7
Imports of goods	-28.7	-31.9	-30.3	-27.1	-27.8	-32.0	-29.6	-28.1
Gross reserves (US\$ billion)	66.3	54.1	45.5	49.4	64.7	60.0	56.5	51.5
In months of imports of goods and services	10.8	9.5	7.8	7.3	8.0	6.7	5.9	5.4
Exchange rate (dinar per US\$; period average)	1166.0	1167.0	1180.2	1182.0	1182.0	1182.0	1182.0	1182.0
Sources: Iraqi authorities; and World Bank staff estimates and projections.								

Box 4 • Potential GDP Estimation for Iraq – Technical Annex

Productivity contributed negatively to economic growth in Iraq and under a no reform scenario potential growth will remain sluggish. This box models potential GDP for Iraq, especially for the non-oil economy. Economy-wide potential output is described in a simple Cobb-Douglas production function. A standard function includes capital stock, employment, and a residual (growth in GDP unexplained by observed increases in factor inputs, often labeled as total factor productivity (TFP)).

This model uses non-oil potential GDP in the calculation of a non-oil output gap in its estimates. We assume that the price dynamics are influenced directly via non-oil factors of production given that most of the oil is exported. Oil enters prices indirectly only in as much as it affects wealth and if government spends oil revenues. Non-oil potential GDP is expressed using TFP, non-oil structural employment and the non-oil capital stock:

$$Y_{noil,t} = A_t N_{noil,t}^\alpha K_{noil,t}^{1-\alpha}$$

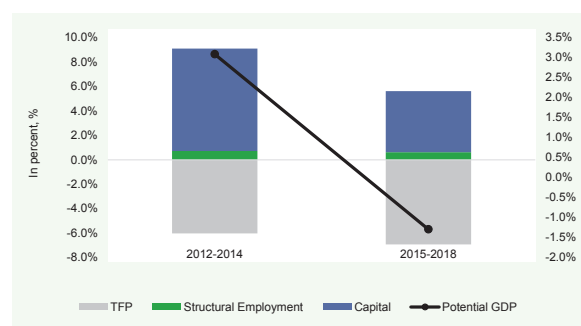
Where A: trend TFP; N: structural employment or $((1 - U_t^*) * LFPR * LF^{1564})$; U_t^* is the natural rate of unemployment (usually determined using the equilibrium solution to labor demand and labor supply -estimated to equal 7.7 percent in 2018); LFPR is the labor force participation rate; LF^{1564} working age population; and K is the capital stock (calculated using the perpetual inventory method while the initial capital stock is calculated using WBG (2019, forthcoming). The share of labor (α) is 0.19 can be obtained by averaging the share of labor compensation in nominal GDP for Iraq, which comes from St. Louis Fed.

Alternatively, one can express economy-wide potential GDP as non-oil potential GDP plus oil Gross Value-Added (GVA), where oil GVA is assumed to be produced at its potential:

$$Y_t = Y_{noil,t} + O_t$$

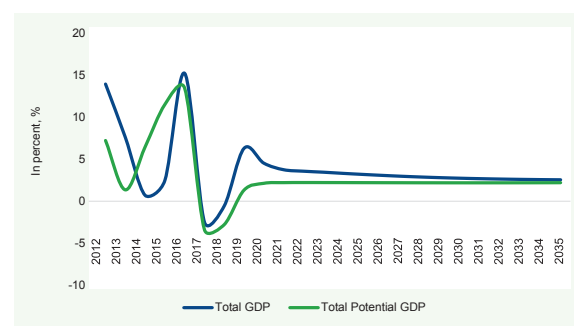
For long-run trends and policies associated with structural change it is useful to decompose potential GDP instead of actual GDP. Using the raw TFP calculations from actual GDP shows significant variations from year to year. This is partly due to noise picked up from not measuring GDP accurately, and missing important variations in the factor inputs (e.g. employment is measured using labor force surveys). Furthermore, policies affect both cyclical and structural variants of output – whereas the focus here is on the long-run. Figure B2 summarizes Potential GDP and its decomposition into input factors for the 2012-2014 period and 2015-2018. TFP contributed negatively to growth in both periods and more so in the second period while also the contribution of capital to growth declined mostly driven by the drop-in oil prices which slashed overall investment. Finally, this model suggests that under a baseline no-reform scenario Iraq will continue to have sluggish growth on the non-oil sector (Figure B3). Details on growth decomposition and performance will be discussed in the forthcoming World Bank report “Iraq Country Economic Memorandum”.

Figure B2: Potential GDP Decomposition



Source: WB staff calculations

Figure B3: GDP and Potential GDP Growth Path



Source: WB staff calculations

SPECIAL FOCUS: TRANSFORMING AGRICULTURE FOR ECONOMIC DIVERSIFICATION AND JOB CREATION

The need to revive Iraq's Agriculture Sector

Strong agriculture sector development is a critical element of Iraq's vision of a more diversified economy less dependent on oil, generating employment and driven by the private sector. While the agriculture sector contributes to only 5 percent of Iraq's GDP, it is the largest source of employment (approximately 20 percent) and is dominated by private sector producers and market agents. A third of the population resides in rural areas where the poverty rate is double that of urban areas (31 versus 15 percent). Food security is an important

issue in Iraq where 2.4 million people across the country require food security assistance (FAO, 2016). The reduced production per capita in recent years has led to a significant degree of malnutrition in rural population, particularly among children (28 percent of the population is undernourished, and almost a quarter of children under 5 are stunted). In addition, human development and other development indicators are also much lower in rural areas compared to urban areas in Iraq. Hence, the Government is focusing on the agriculture sector as part of its priority plans for the country's economy recovery efforts, poverty reduction and shared prosperity.

Agriculture is a particularly important

Box 5 • Why invest in Iraq's agriculture and food system?

The crucial role of agriculture in economic development is widely recognized and there are numerous success stories on how the agriculture sector served for development. This is the case of countries such as China, India, Vietnam, Morocco and Sub-Saharan Africa since 1995 where agriculture has been a lead sector for growth; a source of livelihoods for rural households contributing to reducing poverty and rural-urban income disparities; and a source of environmental services helping to mitigate climate change and conserve water. In India, the sector helped to move millions out of hunger during the Green Revolution and in China it contributed to raise 350 million rural people out of poverty in 20 years. Cross country analysis has shown that growth originating in agriculture is 2-3 times more effective for the poor than growth originating in non-agriculture. The sector is also labor-intensive. Jobs are not only created on-farm, but also in upstream (input supply and primary production), midstream (handling and processing), and downstream (distribution and marketing) sectors.

As other sectors of Iraq's economy, agriculture has not fully modernized following three decades of conflict and isolation. Public policy has focused on the short-term challenges of food security while deep market inefficiencies remained unaddressed. As a result, sector performance is well below potential and food imports make up 30% (or US\$9.38 billion in 2018) of the total imports. In the current fragile post-conflict context of Iraq, with appropriate policy reforms and targeted investments, the agri-food sector can make a significant contribution to employment, economic diversification, social stability, and contribute to climate resilience. Already, the sector is the largest source of private jobs and employs 20 percent of Iraq's workforce. Women make up over 50% of agricultural work force compared to just 9% across all sectors—highlighting the sector's importance for social inclusion. The sector has a strong multiplier effect on others economic activities, including services and transport. A 1% increase in Agriculture GDP growth would lead to 1.2 percent increase in total employment (compared to just 0.35 percent for the industrial sector). Improving the country's economic outlook depends on the agri-food sector.

pathway for overall job creation in Iraq – one of the highest priority issues facing the country.

In the aftermath of decades of conflict and violence, Iraq is facing a jobs crisis. After Yemen and Syria, Iraq has the third highest number of Internally Displaced Persons (IDPs). More than one third of Iraq's youth and close to 30 percent of women are unemployed—a rate that is nearly twice as high as the national average. An estimated 1.8 million Iraqis remain internally displaced while over 4 million Iraqis have returned to their places of origin to resume their lives and livelihoods after years in displacement. To a large extent their decision to return has been tied to their ability to earn a living – which for the rural returnees (47 percent) is linked to the recovery of the agriculture sector. Today, Iraq needs 2.5 million new jobs, and future demand for jobs by the youth is rapidly rising, with a projected 70 percent between 2015 and 2030. In the absence of a vibrant private sector, the current and future new labor market entrants cannot be absorbed. However, pre-conditions for job-intensive growth are not yet in

place. In the long term, macroeconomic stability, a significantly improved investment climate, reformed institutions and strong governance will be necessary to catalyze job creation in diversified economic sectors at scale, and particularly in agriculture and agribusiness (see Box 5).

Agriculture production has large headroom for expansion: it occupies only a limited fraction of Iraq's cultivable area; it is practiced predominantly by small farmers well below their potential. Of the total land mass area of 43.7 million hectares, about 22 percent, i.e., 9.5 million hectares, is suitable for agriculture. But, only about 5 million hectares have been under crop production traditionally with large variations between the years due to climatic and/or economic reasons, and overall decrease recently due to the conflict (estimated at 2-4 million hectares being cultivated). There exist roughly three different agriculture zones in Iraq. Grains, primarily wheat and barley, are Iraq's main crops in the north and center-north rainfed areas. In central and southern Iraq,

where agriculture depends mainly on irrigation from the Tigris and Euphrates rivers, mixed farming systems are predominant. Dates are a major cash and food crop with fruit trees interplanted in date palm orchards (over 300,000 ha are permanently in tree crops – mostly dates but also some olives, grapes, oranges, apples, and other fruit orchards). Vegetables, mainly tomatoes and potatoes, are important irrigated crops. Crop yields have increased somewhat over the past decade but are low by any comparative standards (e.g., cereals 2.75 tons per ha vs. 4.1 tons world average).²² Livestock raising is extensively practiced and inland fisheries and backyard poultry raising are valuable as a source of protein and income for the rural population. Iraq raises a significant amount of livestock including sheep and goats, cattle, camels, and buffaloes. Before the first Gulf war, livestock production represented 30-40 percent of the total value of agricultural production and contributed significantly to household nutrition. Performance of small ruminants' sector, namely sheep and goats were severely damaged during the last two decades, due to massive selling outside the Iraqi borders, loss of genetic potential and reduction in herd size. The small ruminant sector in Iraq also suffers from the lack of any kind of organization among the producers (FAO, 2017).

Irrigation, once it is rehabilitated, has the potential to greatly increase yields. The total managed irrigated area is estimated at two thirds of the total cultivated area, all of it equipped for full or partial control irrigation. The agriculture sector is the main consumer of water with 85 percent of the total, yet water efficiency is low due to the weakness of water management institutions, weak monitoring and regulatory capacity. Following years of destruction during the conflict, the irrigation system is in serious disrepair. Currently, only 20 percent of farmers have access to full irrigation compared to 65 percent before the conflict. As a consequence of the poor state of repair of irrigation and drainage schemes, salinization of Iraq's agricultural lands has become a severe issue. Around 60 percent of cultivated land has been seriously affected by salinity, causing yield losses of 30 to 60 percent. The situation is especially severe in central and southern Iraq where irrigation has been

²² Agriculture and Rural Development Indicators, World Bank Data (2018).

most extensive. Rapid rehabilitation of irrigation and drainage systems can contribute to rapidly raise agriculture productivity levels in the country and reduce food imports and would have very high social and economic returns.

Iraq is heavily dependent on food imports; agriculture can expand to respond to the growing domestic and regional and international export demand. There has been a steady increased dependence on imports in order to meet domestic food needs which has made Iraq a major importer of agricultural products. Increasing dependence on food imports rose from US\$ 2 billion in 1985 (or 19 percent of the total merchandize imports) to almost US\$11 billion in 2017 (or 21 percent of the total merchandize imports) in nominal terms. The top food imports are wheat, cattle and chicken meat, rice, oils and fats, milk, tea, and sugar. Currently, about 60-70 percent of vegetables consumption is supplied by imports from neighboring countries. FAO estimated the Import Dependency Ratio (IDR) for cereals at 52 percent in 2016.

Domestic production has significant scope to grow given the rapidly rising domestic food demand and Iraq's potential comparative advantage to develop some agri-food exports. Given the paucity of recent data on agricultural productivity, the deep economic distortions, and the difficulty of extrapolating past trends into the future in a post-war context, it is not clear to what extent Iraq has a comparative advantage in the production of staple crops. High input subsidies—in the case of wheat and barley seed, they reach 70 percent of the cost of production—do not translate into increase in productivity and promote inefficient use of scarce inputs such as land and water. The situation is different in the case of Iraq's vegetable production (box 6), livestock and fruit orchards. The livestock and vegetable sub-sectors are both characterized by minimal government intervention in the commodity markets; a more level playing field for private sector activity; a proven ability to compete with imports; and the need for less expensive, more scale-neutral investments. Such investments are less risky, and as a consequence, are more accessible to lower income farmers; the fruit/vegetables sector benefits from wide participation by women; and has an ample scope for adding value through processing and

Box 6 • Vegetable production in Iraq

Vegetable production is increasing particularly near urban centers where relatively modern farming techniques are applied. However, achieving and maintaining quality standards has been a major challenge for producers and processors in this value chain. Currently, about 60-70 percent of vegetables consumption is supplied by imports from neighboring countries.

The vegetable value chain presents the potential for further improvement. The latter should not only be sought at the level of the production, among others by means of protected cultivation and training to improve product quality, but also should add to the ability of farmers to create stronger connections with markets. Tomatoes are the most important crop for the domestic market. Potato growing is a promising commodity and is labor intensive. It has seen significant growth over the last few years due to involvement of Dutch potato seed suppliers. Most potatoes are produced in the Kurdistan Region, though there are potential in other regions; for instance, in Mosul and north-west of Baghdad, an important potato producing region in Iraq in the recent past.

marketing. There is also an extensive range of readily transferrable, modern technologies that could be used to advantage in both sub-sectors. Catalyzing food production for domestic markets and export of products in which Iraq can solidify its comparative advantage on regional markets is a promising development pathway in the short term, if macro-economic, regulatory and institutional limitations to the growth of private sector jobs in agri-related business are circumvented and a sound incentive framework to attract private investment is established.

In the longer term, repurposing subsidies towards productivity enhancing public expenditures in R&D and innovation, infrastructure and marketing would yield major benefits in terms of increasing competitiveness of the agri-food sector, more efficient use of land and water, and job growth. However, a significant shift in that direction requires deep structural reforms which are difficult to implement and will take time and potentially result in more unemployment during the transition period. In the short term, investment in infrastructure rehabilitation, including the repair of Iraq's rural transportation infrastructure and irrigation schemes through public works, and the growth of agriculture and agribusiness are considered the two most feasible paths for job creation at the scale needed and with the urgency that the country is facing.²³ Public works and private investment in the agri-food sector, at all levels of the supply chains – including, production, processing and marketing – is an important pathway

for creating both on- and off-farm jobs in Iraq due to their strong backward and forward linkages.

The Challenges for Iraq's Agriculture Development

After years of war and social unrest, Iraq's agriculture is facing a number of challenges common to all sectors of the economy but more pronounced in the agriculture sector. The challenges faced by agriculture relate to the problems caused by the war, the social unrest, and institutional and economic issues, essentially on three fronts: (i) state-driven policies that have distorted markets and provided insufficient or perverse incentives for private sector development, (ii) sector institutions that have been allowed to deteriorate and are unable to provide the required services; and (iii) disrepair of the rural economic infrastructure, prominently roads and irrigation networks. As a result, the sector's contribution to GDP has declined from 9 percent in 2005 to about 5 percent in 2017 (FAOSTAT). The security situation and rural poverty have contributed to this decline with an outflow of people from the countryside to the urban areas seeking employment and economic opportunities for displaced families. The declining importance of agricultural relative to manufacturing and service sectors is to be expected in the type of structural transformation required for Iraq. In the short term, it leaves limited but attractive opportunities for private investment-led growth

²³ World Bank, Vision 2030 – Jobs in Iraq, 2017.

until the time the required reforms in the inputs and commodities markets are undertaken, and agriculture support services and rural infrastructure can undergo a more profound structural transformation.

For decades, GOI has subsidized farm inputs and controlled the price of strategic crops; this has distorted markets with consequent negative impact on agriculture development.

Government policies in the agricultural sector have been characterized by central top-down state determination characterized by high levels of inputs subsidies and extensive commodity price controls. The main subsidized inputs have been fertilizers, seeds, insecticides, and farm equipment and machinery. Similarly, subsidized grain production has been emphasized. The highly subsidized “food basket” provided by GOI, with heavy support to staples, has been an essential policy measure to ensure food security. But subsidized food rationing on a national scale, together with imported food, has had a negative impact on the local grain market with consequent depressing effects on producer prices and on agricultural sector investments. Iraq stands out relative to other MENA region countries in terms of the magnitude of food subsidies. The high prices paid by Government for some domestic commodities have distorted the market, thus limiting private sector investments and innovations. The sub-sector’s dependency on government subsidies limits the development of a competitive private agriculture sector, transparent markets and diversified smallholder farming systems.

The current incentive framework needs to be more conducive to private sector investment in agriculture and food production. In the current context of the country, there are limited incentives to invest in agricultural value chains and related processing industries. Problems include unclear requirements for registering and closing businesses, license requirements, limited communications and transport infrastructure, difficult access to finance and a non-competitive business environment that lacks transparent and clear legal frameworks for rules-based market competition. The country ranks 147th out of 160 countries on the 2018th Logistic Performance Index; among the lowest rankings in the MENA region (see Figure 29). Similarly, the last World Bank Enabling Business of Agriculture Assessment

(2019) reveals weak policy and regulatory framework in key agricultural markets in Iraq relative to other countries.

There are shortcomings in terms of the institutional capacity of public agencies in charge of advisory and technical services, notably the Ministry of Agriculture (MoA) and the Ministry of Water Resources (MoWR). MoA’s and MoWR’s institutional capacity has deteriorated over the past two decades. The weak public institutional support has translated into a drastic reduction of the performance and coverage of the research and extension services, animal health and artificial insemination centers, plant quarantine and disease control mainly due to lack of staff incentives and physical infrastructure. In addition, there are significant sector specific “gaps” in statistical information, which hinder GOI from effectively developing agricultural policies and implementing agricultural interventions. There is no functional agricultural statistical system for producing accurate and timely statistics on crop, livestock and agro-industry production on a regular basis with standard statistical methodology. There is also limited analytical capacity for agricultural strategy and investment planning within ministries, research institutes and universities. The agricultural information system needs restructuring and modernization to support GOI and the private sector for business planning, investment and development.

Water quality and management, due to the disrepair of irrigation networks, and consequent salinization are a key constraint to irrigated crops.

By MENA regional standards, Iraq is relatively well-endowed with water resources. Per capita average water availability in Iraq is twice as high at 2,200 cubic meters per capita per year, compared with half that amount in MENA on average. Unfortunately, the state of irrigation network has been allowed to deteriorate. The problem ranges from widespread deterioration of irrigation infrastructure to poor operation and maintenance of the systems, inefficient water use, soil salinity, weak institutional support, and the lack of a regulatory framework for the efficient use and pricing of irrigation water. Water losses in irrigation schemes, all over Iraq, are substantial. By and large, water is conveyed to farmers’ fields through very poorly maintained distribution systems made of earth canals and ditches which suffer significant water

losses because of infiltration, seepage or leakage. Finally, irrigated areas are confronted with salinization problems which significantly depress yields. As water shortages are projected to worsen with climate change, salinization problems will worsen even more without deliberate strategies to adapt. FAO estimates that approximately 60% of cultivated land is negatively affected by salinity, and 20-30% has been abandoned. If this is not corrected, salinization is bound to lead to land degradation phenomena in central and southern Iraq and will continue to result in sluggish productivity growth in agriculture.

Iraq's Large Agriculture Growth Opportunities

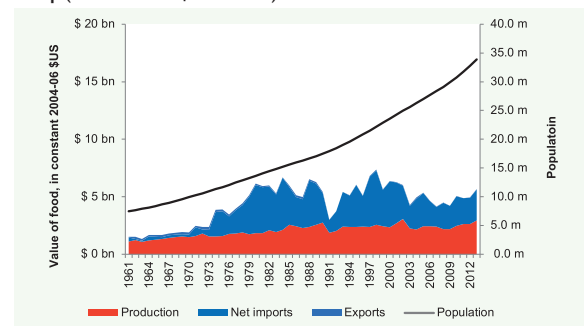
Iraq's agriculture and agribusiness have large opportunities for development, in the short to medium-term through import substitution and export on regional markets, and, in the long term, by integrating into global agri-business value chains. Before the first Gulf war, Iraq was a breadbasket in the Middle East and once the infrastructure damaged by years of conflict is back in service and key irrigation schemes are operational, Iraq's agri-food sector can take off again. Very large yield gaps in Iraq relative to productivity in countries with a comparable climate and natural resources, and relative to the simulated potential yields in the region, mean that there is significant room for improvement and scope to attain productivity gains. Iraq's rich human capital endowment, with a large and growing youth population, means that there is also sufficient available labor. Productivity gains in agriculture would translate into pro-poor growth, create a large number of jobs given high labor intensity of Iraq's agri-food sector, at twice the rate of labor intensity for the economy on average, and deliver especially high benefits for Iraq's women.²⁴ At the same time, the scope for job creation in sectors other than agri-food and construction at the scale needed is currently limited.

²⁴ Al-Haboby, Ashr, Clemens Breisinger, Dario Debowicz, Abdul Hussein El-Hakim, Jenna Ferguson, Roberto Telleria, and Teunis Van Rheenen (2016). "The Role of Agriculture for Economic Development and Gender in Iraq: a Computable General Equilibrium Model Approach." *The Journal of Developing Areas*. Vol. 50. No. 2. Pp. 431-451.

Based on historical trends and considering Iraq's significant land potential, large current unemployed and/or underemployed labor force, and expansion of markets on which Iraq can gain a comparative advantage, it is possible to identify value chains or sub-sectors promising for short- and medium-term expansion. This is the case for import substitution on the domestic market and expansion of exports on the regional markets in the short term, as is happening with the production of dates. In the long term, Iraq can successfully target more sophisticated markets (Europe, Central Asia) where it is currently poorly positioned to compete, as it is yet to integrate into global agri-value chains. Iraq's participation in these value chains is limited by the difficulty meeting necessary food safety standards and product quality regulations, as well as the poor state of the processing, cold storage, and transportation infrastructure.

Iraq's domestic market offers an immediate consumer base to sustain expansion of production of grain, fresh fruits and vegetables, as well as dairy products and meat, considering that it has comparative advantage in a number of those products. Iraq is currently heavily dependent on imports for meeting its domestic food demand both for grains and other commodities (Figure 30). There is ample room for growth through reliance on the domestic market which is expanding rapidly given the high increase in the population (from 28 million in 2007 to 39.8 million in 2018). The increase in population together with income per capita increase are combining to create a sizeable consumer base with new middle-class tastes. This promises not only greater consumption of staple grains, but also a significant dietary transition into more high-value foods, including poultry, as well as more animal feeds such as corn and soy products. The country has a significant agricultural land potential (over 9 million ha suitable for agriculture with only a fraction currently used) which would allow for production expansion for grain (wheat), fresh fruits and vegetables, as well as livestock. Since 1961, Iraq's population grew at around twice the rate of agricultural output, with food imports increasing dramatically to make up for the shortfall in production (estimated at \$9.38 billion in 2018). It is clear that, to the extent that productivity gains are achieved, domestic production can substitute a large

Figure 30 • The rising food demand and imports in Iraq (const. US\$ billion)*



Source: World Bank staff calculations.

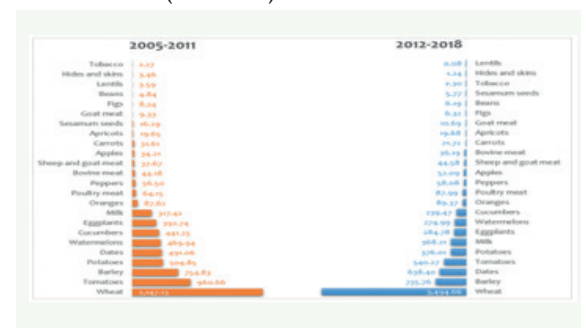
* Source: Gross, Steven (2018). "The WOW Factor: Wheat, Oil and War in Iraq." Unpublished World Bank estimates.

share of imports of both rainfed cereals, notably wheat from the northern part of the country, and other commodities such as vegetables and fruits that are grown under irrigation in the southern part of the country and in the production of which Iraqi farmers have a comparative advantage over regional neighbors.

As Iraq rebuilds key irrigation and transport infrastructure, it can gain a significant part of that market share. Figure 31 shows that, besides dates and cereals, there are several fruits and vegetables with significant volume of production and that exports are already taking place (Dates - Box 7) – meaning that the base for improvement exists. Iraqi farmers have a comparative advantage in production of irrigated fruits and vegetables, and irrigation is readily available in the southern part of the country. Iraq is also strategically positioned to derive a competitive advantage through trade. With road and other logistics investments, in the short-to-medium term, the country has the potential to export to markets in close geographic proximity. In the longer term, it could even develop the capacity to export to other markets that are out of reach at present (South and Central Asia, and Europe). More needs to be done, clearly, to exploit Iraqi agribusiness opportunities, particularly in terms of facilitating policies and regulations and their enforcement, building capacity to meet quality and phytosanitary standards, overcoming the country's logistics, and improving its national cold chain infrastructure.

The agriculture sector offers value added opportunities through processing; notably, fresh

Figure 31 • Agriculture production of selected commodities (1000 MT)



Source: World Bank staff calculations.

fruits and vegetables which can serve as a raw material to produce a wide array of processed products. As already demonstrated in many countries, the agri-food sector can be a powerful source of growth, job creation and poverty alleviation. The development of this sector typically accelerates and accompanies broader economic development. Rising demand—especially for fruits and vegetables, livestock and dairy products, poultry and eggs, and other goods with relatively high-income elasticity—stimulates product and process innovations and the development of stronger backward and forward linkages within the agri-food system and the local economy. This occurs when investments are made inter alia to improve productivity and quality, reduce product losses, and utilize by-products as inputs into agriculture or other industries. Domestic and export systems then become mutually supportive and each stimulate the development of a range of ancillary services which further improve competitiveness. Employment expands throughout the agri-food system and eventually overtakes employment directly engaged in agriculture. Currently, Iraq's agribusiness value chains are under-developed with a low ratio of food processing to primary agriculture. Hence, Iraq's agro-processing sector has a large untapped potential for development following the above pathway and become competitive with imported processed products.

More broadly, deliberate and strategic interventions on the part of the Government should play a key role in fostering the short- and long-term technological and institutional change

Box 7 • Production of dates, a key export product

Date is a key product for which Iraq has maintained comparative advantage on international markets in spite of all difficulties encountered by the agriculture sector during the periods of conflict. Iraq is once again the world's biggest date exporter, with 24 percent of the world market. In terms of value, dates are the top non-oil export product, accounting for 70% of the value of the country's agri exports. This value has more than doubled in the past 10 years - over US\$123 million per year (average 2012 – 2018) vs. US\$45 million (2006 – 2011).

As the global demand is increasing, the ongoing initiatives in Iraq on improvement quality should be continued (US\$80 million plan). Ninety percent of Iraq's production is made of one variety of date, the Zehdi. The ministry is expanding the list of cultivars to include the Hillawi, Khadrawi, Sayer, Maktoom, Derrie, Ashrasi and Barhee varieties, more aligned with market demand. The improved cultivar list will enable the country to increase its current low export price (US\$360/ton compared to a world average of US\$760/ton). Almost half of Iraq's dates are exported in bulk to UAE, fetching an average price of just US\$310/ton. They are then packed and re-exported at a higher price.

Farmers have now returned to the areas liberated from ISIS and are starting to get their orchards back into production.

Large numbers of trees planted during 2013-17 will start producing, with overall average yields set to rise rapidly over the next five years. Iraq has an unprecedented area of date palms, more than twice the previous high point reached in 1996. Date palm inventory could go up to 40 million trees in 10 years with introduction of more marketable varieties. This should provide significant opportunities to increase exports and value-added provided work on improved varieties is continued and strengthened, knowledge is adequately disseminated to small producers, and investment in post-harvest management and technology is increased.

for agro-processing development. Development of food processing industries does not take place spontaneously and in Iraq it is constrained by several factors such as the weak overall macroeconomic environment, volatility and cumbersome business regulations (see Section III below). Hence, deliberate multi-sector strategic interventions, with a territorial development focus, would need to play a key role in moving forward this critical agenda. Those interventions would need to include defining the "Rules of the Game" for market competition and cooperation, compensating for market failures, and fostering investment in physical infrastructure and human capital. Attracting international food companies to produce locally can also help to create jobs and raise living standards.

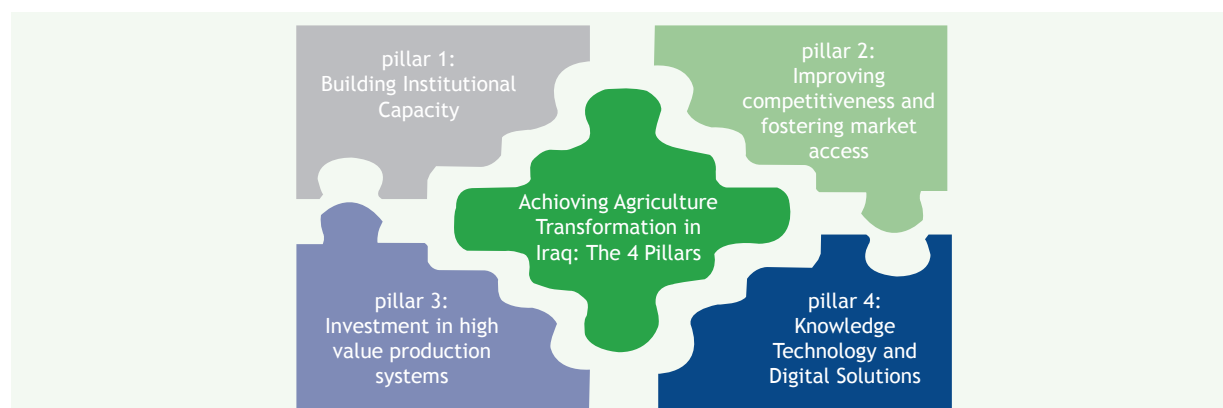
Towards an Agriculture Transformation Agenda

To address the above challenges and maximize the economic, social and environment contributions of the agriculture sector, GOI should consider focusing on four Policy and Action Pillars at the core of its agriculture transformation agenda (Figure 32).

Pillar One: Building Institutional Capacity.

The sustainable management of modern agriculture systems to integrate the domestic and global trade requires an efficient public support system well-coordinated with strong private sector institutions and universities. A wide range of interfaces are needed with other sectors and areas: water management, environment, trade, land administration, education, transport, social protection, health, and displacement. Defining the Government's policy

Figure 32 • Achieving agriculture transformation in Iraq: The four pillars



Source: World Bank.

mandate in the agriculture sector, ensuring effective complementarities and synergies with other sector portfolios, and translating these into an effective implementation structure are all valid concerns for any given administration. It is important to ensure that sector policies do not overlap or leave gaps in serving their target populations. It is also important that the interventions are well aligned, in order to maximize the benefits. In Iraq, there are numerous government agencies interfacing directly with the Ministry of Agriculture and the Ministry of Water Resources. In addition to these, there are clusters of private (agribusiness, financial institutions), public (research institutes, schools, universities), and non-governmental and international stakeholders that play key roles in how farmers are served.

Key areas of focus may include:

- i. Enhancing the effectiveness and efficiency of service delivery, facilitating decentralized administration (vertical coordination), including Water Use Associations, in priority for research and extension services.
- ii. Promoting evidenced-based policy planning and programming, by leveraging data and using integrated information technologies to improve current monitoring on performance indicators.
- iii. Reforming the land tenure regime as it is a major constraint and contributes to land

degradation and to the low productivity and slow growth of the agricultural sector.

- iv. Strengthening of intra-governmental coordination on agricultural policy and strategic cross-cutting issues (horizontal coordination).

Pillar Two: Improving competitiveness and fostering market access. Maximizing the agriculture potential by improving competitiveness and fostering market access, will require first reforms to the current regulatory environment. The aim of these reforms will be to stimulate sustainable, inclusive and competitive growth, and expanding on and off farm income diversification and employment. In this regard, it is clear that the subsidy policy has to be reconsidered. Attaining the goal of Pillar Two will require also improving access to finance on the part of producers, and the strengthening/rehabilitation of market facilities and rural road network.

Policy reforms: Moving forward, GoI should consider reallocating the public support currently provided to the agri-food sector through subsidies to productivity enhancing public expenditures in R&D and innovation to promote a diversified agri-food sector, promote adaptation to climate change, and investment in rural infrastructure, agri-logistics and marketing. To make the agriculture sector more productive, resilient and sustainable, global experience suggests that it is possible to deliver on the desired outcomes of an efficient and competitive

Box 8 • Repurposing agricultural subsidies

Lessons from international experience show that “repurposing agricultural subsidies” requires an integrated approach. Brazil succeeded in dramatically increasing productivity of grains, while also developing unrivaled agri-export industries through investment in innovation, research, market infrastructure and skills, ultimately becoming a global agriculture powerhouse. Pakistan’s Punjab is currently implementing a shift from extensive subsidies to staples to SMART-Punjab package of investments in public goods, research, incentives for the adoption of more sustainable and higher productivity technologies, and stimulate a more diversified, productive and environmentally sustainable agricultural sector.

agriculture sector and improve farmer welfare through a more efficient allocation of public expenditure without compromising the level of support currently provided to producers (Box 8). In the case of Iraq, such a “repurposing” would entail reallocation of direct income support through subsidies to productivity enhancing public expenditures in R&D and innovation, rural infrastructure and marketing. It would be particularly important to provide incentives for agricultural diversification, including the adoption of salt- and heat-tolerant crop varieties and developing export value chains, processing capacity and domestic distribution networks in Iraq. This would pave the way for increased performance of agriculture, greater social inclusion and more sustainable environmental and health outcomes, while curbing input and output market distortions. Distributional consequences of alternative approaches to implement a program of “repurposing subsidies” need to be carefully evaluated as part of a reform program.

This can be achieved through the following key measures:

- i. Facilitating of shifting the role of the Government from market-actor to market-enabler.
- ii. Investing in competitive standards, including traceability.
- iii. Improving food safety and quality standards that can increase the potential of the food trade sector.
- iv. Improving farmers’ access to finance.
- v. Rehabilitating and expanding markets facilities and road network.

Pillar Three: Investment in high value production systems. The aim is to maximize Iraq’s

comparative advantage of agro-climate, productive seasons and its proximity to the Gulf markets, Central and South Asia, and Europe. Farmers, processors, and service providers will need to enhance their productive efficiency, strengthen focus on quality, prevent crop post-harvest losses, increase access to and use of appropriate inputs and technology. Investment should be focused on high value-added agricultural systems and supply chains (horticulture, meat and dairy, legumes, poultry and eggs, etc.) at production and agro-processing level, including ancillary activities (private input, machinery and equipment supply systems, storage and handling, modern irrigation systems, etc.)

Key actions may include:

- a. Undertake a comprehensive assessment of value chains and identify opportunities and challenges to improved competitiveness with value chains having potential.
- b. Assess which varieties/species, and attendant production technologies, are likely to maximize Iraq’s seasonal and geographical comparative advantage.
- c. Invest in ways to improve economies of scale and systems of aggregation.
- d. Identify sustainable models for increasing unit value through improved on-farm practices, post-harvest storage and handling, agro-processing, and export marketing.
- e. Support the rehabilitation and expansion of irrigation systems and drainage as required for key value chains.

Pillar Four: Knowledge, Technology and Digital Solutions. With the scarce land and increasing population, and a depleting natural resource base, sustainable agriculture intensification and diversification is not an option for Iraq's agriculture but a necessity. Developing a resilient agriculture sector will require technologies and practices that build on agro-ecological knowledge that enable smallholder farmers to counter environmental degradation and climate variability and change in ways that maintain sustainable agricultural growth. In parallel, digital technologies can be deployed to improve efficiency and enhance overall competitiveness.

Key actions may include:

- a. Building partnerships with international centers of excellence.
- b. Exploring the use of knowledge innovation labs.
- c. Identifying success stories from Iraq and other MENA countries and scaling them up.
- d. Expanding investment in research in relevant high-performing technologies, such as tissue culture, precision irrigation, and small mechanization.
- e. Increasing the use of digital platforms, solar powered desalination, and hydroponics.

The above transformation agenda is expected to have a major impact in Iraq's key areas of economic growth, poverty reduction and environmental preservation:

- **Import substitution:** there is potential to reduce cost of importing food for the large and growing domestic market; Iraq's population is growing by an annual rate of 3 percent; agricultural and processed food imports make 30 percent of the total import bill.
 - **Food security and nutrition:** Agri-food sector could play an important role in better nutrition security: increasing incomes through agricultural development and redirecting support to more nutritious agricultural products (such as fruits and vegetables) would enhance nutrition security.
 - **Environmental conservation:** Investment in agriculture will help protect Iraq's natural resource base by improving water and soil management and reduce salinity.
- **Agriculture GDP Growth:** projections indicate that achieving Iraq's Net Domestic Product (NDP) yield targets for fruits and vegetables, livestock, and cereals would lead to a 27 percent increase in Agriculture GDP in the short to medium term (average annual increase in Agriculture GDP of 4.9 percentage points); this will increase both rural and urban household incomes, even more so for female headed households.
 - **Employment:** potential to add over half a million jobs to the economy (in the short-run) and potential to add about 2.5 million jobs (medium-term, 5-10 years).

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