Analysis

ECONOMIC POLICIES IN IRAQ: CHALLENGES AND OPPORTUNITIES

Dr. Basim Abd Al - Hade Hassan
July 2020

Iraq is undergoing perhaps its most serious financial, health, and political crisis of the last two decades. However, the greatest challenge is financial, with revenues decreasing as a result of the shock of falling demand for oil as a result of the Coronavirus crisis.

This study attempts to answer this question: What is the expected magnitude of the financial crisis in Iraq? What solutions and economic policies can alleviate this crisis, especially in light of the many other challenges, including a new government, an unstable political environment, and the health challenge of combatting the Coronavirus? To study the issue, an analytical descriptive method was used, relying on relevant data and indicators in an attempt to deconstruct the problem and develop appropriate solutions for overcoming the complex crisis this year.

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Hashemite Kingdom of Jordan

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Introduction

Iraq is undergoing perhaps its most serious financial, health, and political crisis of the last two decades. However, the greatest challenge is financial, with financial revenues decreasing as a result of the shock of falling demand for oil as a result of the Coronavirus crisis, which has made the government unable to maintain financial sustainability. With revenues expected to decrease by at least half this year, the public treasury has arrived at what is known as a "financial gap," as revenues cannot cover general expenditures. The basic problem will be the ability to sustain salaries and wages, which represent approximately IQD 60 trillion annually.

Current expectations indicate that the pandemic may be more or less over by the end of the third quarter of this year, amid an agreement between OPEC and OPEC - Plus countries to decrease production, alongside the expected growth in demand for commodities, to bridge the financial gap caused by the Corona pandemic. With the partial return to business in most countries, oil prices are expected to increase to USD 50 by the end of this year. Iraq may benefit from this increase and realize an increase in financial revenues, but these outcomes depend on achieving the assumed inputs.

This study attempts to answer this question: What is the expected magnitude of the financial crisis in Iraq? What solutions and economic policies can alleviate this crisis, especially in light of the many other challenges, including a new government, an unstable political environment, and the health challenge of combatting the Coronavirus? To study the issue, an analytical descriptive method was used, relying on relevant data and indicators in an attempt to deconstruct the problem and develop appropriate solutions for overcoming the complex crisis this year.

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Theme One: Iraqi Economic Challenges

The Iraqi economy faces many challenges that hinder its growth. Despite the growth in financial revenues achieved over the past years as a result of increased oil prices, Iraq has not optimally exploited that situation to overcome the challenges. In this section, we note the most significant challenges.

One: Financial and Administrative Corruption

Financial and administrative corruption is one of Iraq's biggest challenges, as has been previously noted by those at the highest levels of government. Most Iraqi prime ministers have mentioned the problem, including the current prime minister, Mr. al - Kadhimi. The basic problem in studying the topic remains the difficulty of determining the actual level of corruption. Drawing on certain reports and indicators may clarify some aspects of corruption. For example, annual reports issued by the Iraqi Commission of Integrity point to the recovery of approximately USD 10 billion worth of corruption observed by the Commission from 2009 - 2019. On the other hand, UN reports on corruption indicate that there is an estimated USD 17 billion stolen through oil smuggling, fake companies, and unimplemented contracts.[1] Although its rank has improved over the previous year, Iraq still occupies a low rank on the Corruption Perceptions Index published by Transparency International. In 2019, Iraq was ranked 162nd out 180 countries on the index.[2] According to the report itself, political corruption is considered the main reason for corruption in the Middle East, including Iraq. In this regard, the Commission of Integrity's annual reports note the issuance of 14 verdicts in corruption cases against officials, either ministers or at the minister level, in addition to 124 verdicts at the level of director - general or special levels, over the past three years alone (2017 - 2019). Furthermore, the percentage of members of parliament who have disclosed their financial debts decreased to 38%, 16%, and 35%, respectively, for the aforementioned years. This indicates the weakness of the regulatory body itself.[3]

1 See: Annual Report, Commission of Integrity, various years, published on the Commission website: / http://nazaha.iq; Sarmad Kowkab al-Jamil, et al., The Iraqi Economy: Challenges and Choices, https://makingpolicies.org/ar/posts/economy.arabic.php

2 2019 Corruption Perceptions Index report, Transparency International, https://www.transparency.org/en/cpi/2019/results.

3 Annual Report, Commission of Integrity, various years, source previously mentioned.

Two: The Mono - Economy

The indicators confirm the Iraqi economy's inability to escape the rent - seeking issue that has troubled it over recent years due to the fact that oil revenues have represented 95% of average total annual revenues. In this context, the relationship between oil revenues and general revenues may be described in modern financial terms as the "Bathtub Theory."[4] According to this theory, public revenues recover whenever they are injected with elevated financial resources generated by positive external shocks (rising oil prices); by contrast, revenues diminish when they experience negative external shocks (sinking oil prices). This metaphor highlights the reality of Iraq's narrow general revenue base, its persistent mono - economy, and its inability to diversify, as well as its 99% exposure abroad due to its dependence on imports and the disruption of its production base. It is worth noting that the investment spending of the past decade and a half has suffered from two problems, low rates of implementation and fluctuation. In terms of actual spending ratios in public budget plans, we observe decreased ratios of implementation due to poor security conditions, poor administration, and corruption. The average ratio of implementation was 60% for the aforementioned period (2017 - 2019), which had a negative impact on growth in the non - oil production sectors in particular and the Iraqi economy in general. The share of GDP represented by non - oil sectors remains very low. For example, agriculture constituted 2% of GDP and manufacturing represented 1%.[5]

On the other hand, although the volume of tax revenues increased in absolute terms during the past years, their relative importance to total public revenues remains very weak and unstable, especially after the suspension of the customs tax and the adoption of the reconstruction tax in its place in 2003. Despite the increased relative tax contribution, up to 6% in 2009, this is not due to an improvement in tax revenue so much as a relative change resulting from the decline in oil revenues due to the global financial crisis. The tax contribution decreased thereafter to about 4% during 2019, which highlights the weak financing role of tax revenues in creating general revenues, as well as the need for tax reform to correspond with the goal of diversifying general revenues.

The low relative share of taxation out of total gross general revenues can be attributed to two sets of factors. The first are at the macro level and include the following:

1. Lack of security and political stability over most past years, which undermined the ability to collect tax revenues in many departments, along with the negative consequences of those situations on the economy, and thus on the size of the tax base.

2. Neglect of taxes and reliance on oil revenues, or what may be called "sleeping on a cushion of oil," after increased oil revenues due to the rise in oil prices to more than USD 100 in some years.

3. Weak oversight and high level of tax evasion resulting from the worsening phenomenon of administrative and financial corruption.

4 See: https://www.universalcargo.com/the-bathtub-theory-of-economics-and-life/.

5 Annual Statistical Report, various years, published on the Ministry of Planning/Central Statistical Organization website: http://www.cosit.gov.iq/ar

In addition, there is a second set of reasons related to the fiscal situation itself, including the following:[6]

1. Legislative amendments that appeared during previous years and included granting taxpayers more tax exemptions on the one hand, while also tending towards lowering the income tax rate on the other.

2. Failure to find new tax streams, as well as the inaccuracy of the taxpaying process, as many tax streams remain outside the reach of tax accountability, such as exchange offices, mobile stores, and internet cafés.

3. Dependence on traditional methods for assessing taxes, especially external aspects subject to taxation or the activity subject to it, such as the rental of housing inhabited by the taxpayer, the rental of the place or activity in which the economic activity is carried out, or the number of machines used.

4. Elimination and restriction of customs duties to the reconstruction of Iraq fee only (at 5%) since 2003, and continuing to operate under this system until 2016, despite the issuance of Customs Tariff Law No. 22 of 2010, which remained blocked for nearly six years, thus wasting major tax resources.

Three: Unemployment and Poverty

Unemployment and poverty are among Iraq's economic and social challenges and are the natural result of a lack of effective economic policies and strategies, as well as the succession of economic and security crises over the past years. The most recent official statistics available indicate that the unemployment rate in Iraq is 14% of the workforce, and it has risen among young people aged 15 - 24 to more than 34%. If we add underemployment, the rate rises to about 40%.[7] Meanwhile, the poverty level represents up to 20% of the total population.[8] These metrics, along with unfair income distribution on one hand, and unequal job opportunities in the public sector (bloated with more than three million employees) on the other hand, pushed young people towards the widest popular demonstrations seen in Iraq since 2003. These demonstrations regained steam in October of last year and are ongoing in the capital's downtown and in the capitals of the southern governorates (which have more poverty according to statistical reports). The demonstrations have disrupted transportation and affected overall economic life in these cities.

This challenge has grown even more difficult this year with the spread of the Corona pandemic and the government's challenge in the health sector. About 35,000 people have been infected with the virus as of the end of June, and the average daily cases exceed 2,000. With the decreased general revenues due to decreased oil prices and the lack of allocations to the health sector, the social challenge has become perhaps the primary challenge facing the new government.

6 See: Republic of Iraq, Tax Strategy for 2004, Order No. 49 of the Coalition Authority, 122004/19/; Public Financial Reports, Iraqi Ministry of Finance website: http://mof.gov.iq/Pages/MainMof.aspx.

7 See: https://raseef22.com/article/33155-surprises-arab-unemployment-the-report-of-the-arab-monetary-fund; http://cosit.gov.iq/ar/?option=com_content&view=article&layout=edit&id=1220.

8 See: https://www.arab48.com, Economy/News-and-Reports/162020/02//Iraq-Decline-rate Poverty-to-20

Four: Difficulties of the Investment Environment

Iraq occupies the 172nd spot out of 190 countries, scoring only 44.7 points out of 100 on the Doing Business report for 2020.[9] Iraq declined in most of the report's measures, including starting a business, dealing with construction permits, getting electricity, registering property, paying taxes, trading across borders, protecting investors, enforcing contracts, access to credit, and resolving insolvency. Despite all the benefits guaranteed by the amended and improved Investment Law No. 13 of 2006, Iraq has not succeeded in attracting foreign capital. This is evidence of the basic problem of the National Investment Commission's management of the investment file, along with the governorate investment commissions, formed under the aforementioned law, as well as many other obstacles, most notably:[10]

1. Institutional obstacles, such as the problem of routine and bureaucracy, as well as the lack of understanding of the nature of investment projects and their negative handling, whether in terms of adhering to the timelines specified in the investment law in force in the pre - permit phase or in terms of the facilities required in the post - permit phase.

2. Lack of transparency and clarity. The economic environment lacks the all - important transparency needed for companies and capital owners to make investment decisions. Here, transparency refers to information that helps companies and investors predict future domestic economic conditions and that can structure and guide future investment plans and appropriate decision - making.

3. The problem of allocation of land for investment projects. The investment commissions typically suffer from this problem for a variety of reasons: changes in classification of the land, failure to modernize basic designs of cities, ongoing ownership disputes over land, etc. Note that the lands are owned by other entities and not the investment commissions.

4. The ineffectiveness of the one - stop shop directorate (formed by the investment commissions) because the ministry representatives in this directorate lack the authority required to facilitate the process of granting permits. This leads to delays in the sector approvals needed from the relevant ministries in the time period specified by law (the investment law specifies 15 days for the ministries to issue opinions), which in turn delays the granting of the investment permit.

5. In most governorates, infrastructure, which is considered one of the most important pillars of the investment environment, is seriously deteriorating.

6. Political tensions negatively affect the work of the investment commissions, especially in the choice of senior management. Note that many cadres within the investment commissions are not specialized in investment work.

9 Doing Business report: https://arabic.doingbusiness.org/.

10 Hassan, Dr. Bassim Abdulhadi, Obstacles to Foreign Investment in Iraq and Possible Opportunities, research presented at a dialogue conference in Baghdad, prepared by the Iraqi Institute for Intellectual Dialogue and sponsored by the Iraqi Parliament, Baghdad, 14 - 152017/1/.

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Theme Two: Financial Shock and Potential Deficit

Due to the delay in the approval of the general budget for this year, expenditures were disbursed in accordance with Rule 1 / 12 from the previous year's budget stipulated in the Financial Management Law.[11] The first four months passed peacefully with revenues covering expenditures. However, this year's crisis appeared at the beginning of May, and its magnitude can be projected by the expected financial outlook for the remaining eight months of the current year (from May to the end of the year), according to the effects of the Corona pandemic and the fall of the price of oil below twenty dollars.

One: Estimated Revenues

The expected revenues for the public treasury for the next eight months can be projected by creating three scenarios for oil revenues. The first scenario assumes an average oil price of USD 30 per barrel, the second uses USD 35, and the third uses USD 40.[12] Exports are assumed to be 2.8 million barrels per day (according to Iraq's share after the recent OPEC agreement). These assumptions yield expected oil revenues of IQD 24.2, 28.2, and 32.2 trillion, respectively, for the three scenarios.

Other revenues made up about IQD 300 billion of total revenues, as estimated by the Ministry of Finance for January of this year (see Appendix 1). Thus, if our assumptions hold at this monthly level for the remaining eight months, they will reach approximately IQD 2.4 trillion.

Accordingly, the total expected general oil revenues and other revenues for the next eight months will reach IQD 26.6, 30.6, and 34.6 trillion, respectively, for the three scenarios (see Chart 1).

11 Financial Management Law No. 6 of 2019, Article 13/One.

12 It should be noted that approximately USD 10 of each barrel produced in Iraq go to foreign oil-extracting companies and do not go to the public treasury. So as not to complicate the analysis, the expected prices were preserved without excluding the share of oil companies. See:
Ali Mohsen Ismail, International Reserves and the Foreign Currency Sales Window at the Central Bank of Iraq, p. 6, study prepared by the governor of the Central Bank of Iraq and published on the Central Bank website, https://cbi.iq/static/uploads/up/file-152214572823873.pdf.

Chart 1: Scenarios of Expected Expenditures and Revenues (IQD trillion)*

Eight - Month Projections (5 - 12 / 2020)	Scenario One (pessimistic)	Scenario Two (neutral)	Scenario Three (optimistic)
Revenues	26,6	30,6	34,6
Expenditures	40,7	40,7	40,7
Deficit	14,1	10,1	6,1

*Exchange rate calculated at IQD 1200 per USD, as declared by the Central Bank of Iraq.

Two: Estimated Expenditures

Appendix 2, which includes the Ministry of Finance's estimate of current expenditures for the month of January 2020, shows that current expenditures totaled IQD 5088 billion. Note that salaries and wages and social welfare allocations make up 85% of those expenditures and total approximately IQD 4.4 trillion, illustrating the domination of these expenditures. Thus the budget needs about IQD 40.7 trillion to cover current expenditures for the remaining eight months, from May to the end of the year, assuming the freezing of investment expenditures.

Thus, the probable deficit will be approximately IQD 14.1, 10.1, or 6.1 trillion, respectively, for the three scenarios. The question here is how to cover this deficit? What are the solutions that financial and monetary policies can offer in this regard?

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Theme Three: Financial Policy Between Deficit and Reform

Financial policy can help address the crisis by restructuring expenditures and revenues in the general budget, as follows:

One: Reduce Expenditures

Given the above data, we propose freezing investment expenditures (for this year) as well as reducing current expenditures, as follows:

1. Reduce salaries of special grade employees by 25%. Deduct 10% from the salaries of job grades 7 and up (converted to bonds) for the purpose of financing the government with internal debt from outside the banking system and not crowding out the private sector on bank credit. Bonds should be for different time periods (three years for grades seven through five and four years for grades four through one) provided that these bonds are negotiable on the Iraqi Stock Exchange. This will provide approximately 10% of the total salaries and wages, i.e. about IQD 2.6 trillion for the eight months.

2. Pay salaries every 35 days instead of every 30 days, which will provide almost a full month's salaries by the end of the year, i.e. approximately IQD 3.3 trillion. The government can announce their payment at a later time during the next year, as financial revenues improve.

3. Eliminate multiple salaries as well as pensions for members of the Council of Representatives and the governorate councils. (Due to the lack of available relevant data, it is difficult to estimate the size of the amounts realized from this.)

4. Negotiate with countries supporting Iraq to postpone payment of debt installments this year.

5. Eliminate the ration card for those whose salary exceeds IQD one million and for the entire family whose head of household's salary exceeds IQD two million.

6. Eliminate some embassies and commercial, military, and cultural attachés (for at least five years), keep a very limited number of them, and reduce the numbers in other embassies to the minimum.

Two: Increase Revenues

Work to increase general revenues as follows:

1. Privatize the 157 losing and currently unproductive public sector companies.[13] The 44 profitable companies can select a private sector partnership for their management. This will save financial resources from the public treasury, as well as minimize the administrative burden and endemic corruption in these companies.

2. Collect outstanding debts owed to mobile

13 Public Corporate Restructuring Report: Reality and Vision Towards Reform, The Prime Minister's Advisory Commission, iraqieconomists.net/ar/20150306///.

phone companies, estimated at up to USD 1.4 billion,[14] and specify a fixed yearly date for arranged payment amounts to the government.

3. Transfer all profits of governmental institutions and companies to the public treasury during this year (compared to half of them transferred under previous general budgets).

4. Activate the electronic collection project for water, electricity, taxes, and Ministry of Interior services that was begun more than two years ago but so far has not been put into effect.

5. Sell barrels of oil to refineries for at least 75% of the global selling price. Note that barrels are currently sold to refineries for the equivalent of USD 4, and the profits realized are distributed to affiliates of the refineries and thus do not accrue to the public treasury.[15]

6. Use the gas that accompanies oil production. Annual losses from its burning and the failure to utilize it are estimated at USD 45 billion.[16]

7. Optimize border crossings. Note that this operation, along with proposal (4) above, constitute loss of revenue to the public treasury of about IQD 10 trillion yearly. The operation of border crossings can be developed, as follows:

A. Advertise the crossings as investment opportunities, although the investor will not recover the capital of the project and its profits from any sovereign fees, as these fall within the jurisdiction of the Ministry of Finance. Recovery will depend on the fees for certain services approved by the Border Crossing Authority, as well as the investor's participation with certain entities operating at the crossing, with their fees in return for providing them with infrastructure in the form of laboratories or storage facilities. Joint management of public installations is a practice in many countries that believe in a true partnership between the public and private sectors. On that basis, investment will flourish with the reality of infrastructure at the border crossings through the creation of model crossings according to modern plans that guarantee all the needed services. This would be considered an investment gain for the government, especially in light of its scant financial resources. In terms of the benefits accrued to the investor, they consist of revenue from lots, parking, and trucks, in addition to fees for domestic transportation, the creation of shopping centers and hotels, in addition to labor inside the border crossing to load and unload trucks. The revenues from such activities can be based on the principle of partnership, which realizes gains for the government also.

B. Activate the operation of the commercial exchange one - stop shop at crossings whose mission will be to create electronic links and automated operating procedures at the border crossing. The goal should be paperless transaction, due to the importance of speedy generation of information, improved monitoring and collection methods, and minimized corruption. Note that the procedures of the Customs Authority for taking effective steps towards automating its work has been delayed, despite the issuance of decisions by the Council of Ministers in this regard.

14 Statement of Deputy Zaitoun al-Dulaimi, member of the Parliamentary Economic and Investment Committee, https://www.zawya.com/mena/ar/sory/ZAWYA20151216090927.

15 Mohsen Hassan, Iraqi Capabilities Available to Compensate for Oil Losses in Light of the Consequences of Corona...An Assessment, Al-Bayan Center for Studies, 2020, p. 12, http://www.bayancenter.org/20206142/06//.

16 Shatha Khalil, Iraq's Gas Wealth: As Oil Production Increases, So Does the Burning of Gas, https://rawabetcenter.com/archives/99513.

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Theme Four: Monetary Policy and Difficult Solutions

Financial solutions usually have politically undesirable social consequences. Moreover, the depth of this crisis requires enacting more than one policy. Monetary policy can provide solutions in tandem with financial policy via two instruments, as follows:

One: Reduce the Dinar's Exchange Rate

Some projections indicate the crisis will continue beyond the current year,[17] which means that the options of borrowing money or reducing salaries cannot continue. For this reason, we propose choosing to reduce the exchange rate to cover the deficit, in addition to its role in addressing the general budget imbalance resulting from the increase in salary allocations and wages to total public expenditures and the government's inability to sustain these allocations, which negatively affects the sustainability of the public debt. Likewise, the importance of this timing lies in the presence of a recession, which lessens the impact of reducing rates. Consequently, this phase can be exploited due to flexible demand as a result of the financial crisis and merchants' willingness to bear part of the increase in prices by reducing their profit margin. This in turn reduces the inflationary impact of the rate reduction on vulnerable groups.

17 Regional Economic Outlook: Middle East and Central Asia, International Monetary Fund, 2020, file:///C:/Users/User/Downloads/mreo0420-full-report-arabic.pdf.

Possible upsides of the rate reduction:

1. Reduces aggregate demand and thus imports, and improves the state of the balance of payments.

2. Minimizes demand for the dollar due to increase in prices, thus strengthening foreign reserves.

3. Decreases the amount of public expenditures valuated in local currency at a rate equivalent to the value of the reduction.

4. Strengthens the competitiveness of local products, thus reducing unemployment by repatriating projects and improving their competitiveness (at a rate that depends on the level of the reduction).

By contrast, there are some possible disadvantages:

1. Increases government expenditures in dinars in proportion to the price increases.

2. Affects the poor classes of society according to the likely general percentage rise in prices.

Proposed Scenarios:[18]

Scenario One: Reducing the exchange rate from IQD 1200 / USD to IQD 1400 / USD will achieve an increase in government revenues of about 17%. Assuming an oil price of USD 35 per barrel this year and exports of 2.4 million barrels per day, government revenues will increase to about IQD 28.2 trillion (according to the proposed price) instead of IQD 24.2 trillion (according to the current price). This means an additional IQD 4 trillion over the next eight months.

Scenario Two: Reducing the exchange rate from IQD 1200 / USD to IQD 1600 / USD will achieve an increase in government revenues of about 33%. Using the same assumptions for Scenario One, government revenues will increase to about IQD 32.2 trillion instead of IQD 24.2 trillion, which means an additional IQD 8 trillion.

As opposed to reducing salaries, reducing the exchange rate will not affect contracts entered into between individuals and between individuals and the government. This holds true for bank loans owed by the employee, as reducing salaries creates a problem for the employee in repaying the loan, but if the government forgives all or part of the loan, it does not gain much from reducing salaries.

On the other hand, the impact of reducing the exchange rate on vulnerable groups may be mitigated by supporting them with part of the increase achieved by the government via the difference between the old and new exchange rate. In other words, part of the revenues accruing from the reduced exchange rate could be used to support those under the poverty line. Likewise, we believe that prices will not increase at a significant rate because merchants will sacrifice part of their profit margins in order to address falling demand and declining sales, as noted above.

Two: Indirect Financing

According to Article 26 of its amended Law No. 56 of 2004,[19] the Central Bank of Iraq may not lend to the government, but it may purchase government securities in the secondary market, i.e. indirect financing. The amount of financing the Central Bank can offer will depend on several indicators, most notably the impact of inflation, debt sustainability, and the effect on the size of foreign reserves. Regarding the impact of inflation, the decline in the general level of rates, expected to reach 0.8% this year due to the crisis (as shown in Appendix 4), dispels inflationary concerns, and therefore debt sustainability and the impact on reserves will be the factors most influencing the

18 It is worth noting that the current Iraqi currency denominations are 250, 500, 1,000, 5,000, 10,000, 25,000, and 50,000 dinars. Prices are limited according to these denominations given the absence of small monetary denominations. Thus, the current exchange rate (IQD 1200/USD) does not allow the merchant to sell commodities imported in dollars for less than IQD 1500 because there are no denominations of currency that would enable him to sell for less than that. On the other hand, we believe that the proposed exchange rate reduction process (according to the first scenario) will not increase prices for global commodities because the commodity that the merchant imports in dollars will continue to sell at IQD 1500 as a result of the lack of flexibility in demand and the reduction of expenditures. Thus, merchants' profits will decrease to IQD 100 instead of IQD 300. In the second scenario, the proposed exchange rate reduction process will raise the rate by a specific percentage, so the commodity that the merchant imports in dollars will sell at IQD 1750 instead of IQD 1500, and thus the merchant's profit will decrease to IQD 150 instead of IQD 300 (knowing that he will not be able to sell at IQD 2000 due to low demand and lack of flexibility, as mentioned above). Certainly, the rate of increase is relative to other commodities (of higher value), and the rate of increase in price will be less than world commodities.

19 Central Bank of Iraq Law No. 56 of 2004 (amended).

amount of financing that can be provided by the Central Bank.

As far as the second indicator, debt sustainability, available statistics indicate that the ratio of domestic debt to GDP in Iraq was as much as 15% in 2019, up from 7% in 2010. Despite domestic debt decreasing to about IQD 38.3 trillion at the beginning of this year, its ratio to GDP will be greater, with expectations of the latter declining by - 4.7% due to the economic crisis (see Appendix 4). If we add foreign debt, which amounts to USD 25 billion, the ratio will further increase. However, on the other hand, some recent studies on debt burden indicate the lack of a specific ceiling that can be adopted, depending on the specifics of each country, especially in terms of the diversification of the economy.[20] If we consider Iraq from this perspective, the foreseeable debt ceiling becomes very low due to the lack of economic diversification and its rentier nature. Thus, it is not possible to move towards more debt. If we look at the situation from another perspective, the crisis is not a typical one and thus calls for non - traditional solutions. This allows rethinking domestic borrowing specifically to overcome the crisis, as the current situation of shrinking demand and individual hedging against future uncertainty makes it difficult to issue bonds to the public, as occurred in 2015 and 2016, as well as the difficulty of borrowing from abroad.

With regard to the third indicator, to calculate the possible impact of financing on the size of foreign reserves, an analytical relationship between government spending and foreign currency sales can be adopted at the Central Bank, as shown in Appendix 3. In this respect, it is clear that the rate of impact of government expenditures on the foreign currency sale window is not fixed but differs according to the total foreign currency demand (which is governed by several factors). However, we can observe that the average rate is estimated at about 65% for the years 2010 - 2013, which saw relative stability in prices and financial revenues. In years marked by negative foreign shocks, including 2009 (the global financial crisis) and 2014 - 2018, we find that the average demand for foreign currency rose to about 75% of the amount of government expenditures. This is explained as the result of the lack of large government spending in dollars, which reduces domestic demand. Consequently, all the demand moved to the currency sale window, and the pessimistic expectations of individuals contributed to their hedging the dollar in their financial assets. We expect the Central Bank's financing of the government will have a negative impact on the amount of foreign reserves, by about 75%. If the Central Bank deducts treasury transfers by USD 10 billion, for example, it will contribute to a decrease in the reserve (currently estimated at USD 64 billion) equivalent to USD 7.5 billion.

On the other hand, despite the increase to IQD 57 trillion in domestic currency issued in the first quarter of this year, foreign reserves continue to cover the amount of issued currency at a rate of about 130%. This is considered an elevated rate according to international indicators for adequacy of reserves, which allows the Central Bank to provide indirect financing based on the above data.

20 Al-Mustafa, Pintor, Limits of Sustainable Public Debt and Economic Growth: Between Theory and Reality, Projections on the State of Arab Countries, Arab Monetary Fund, 2018.

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Theme Five: Conclusion and Recommendations

The Iraqi economy suffers from many challenges and extensive imbalances, especially its mono - economy and lack of diversification, the prevalence of financial and administrative corruption, and rising rates of unemployment and poverty. Amid this complex financial crisis, the new government's challenges have increased, and the reform process has become more difficult. This paper has attempted to offer several solutions to address the crisis and has reached a set of findings and recommendations.

One: Conclusion and Findings

1. Iraq is suffering from its most dangerous and complex crisis (economic, health, political) in two decades, especially with the structural imbalance of a general budget about 95% dependent on oil proceeds.

2. Projected oil and other revenues for the eight months from May to the end of the year (according to the mid - range scenario) are estimated at IQD 30.6 trillion.

3. Current expenses for the eight months from May to the end of the year are estimated at IQD 40.7 trillion, assuming investment expenses are frozen through the end of the year.

4. The general budget deficit is projected to reach approximately IQD 10.1 trillion this year (according to the mid - range scenario).

5. The general budget receiving indirect financing from the Central Bank is considered the best loan solution for financing the deficit in the current circumstances, given the difficulty of other forms of borrowing.

6. The current crisis is the best time to reconsider the exchange rate of the Iraqi dinar because the current stagnation will reduce the impact of the currency devaluation on prices.

7. Certain non - oil revenues are squandered because of poor management of those resources or lack of ability to collect the revenues for various reasons.

Two: Recommendations

1. Adopt a number of financial reforms to restructure the general budget and achieve financial sustainability through pressure on expenditures, particularly employee compensation, as it constitutes about 65% of current expenditures, either by reducing salaries or paying salaries every 35 days.

2. Implement online tax collection and enforce the law for border crossings and taxes in order to enhance the contribution of non - oil revenues to the public budget with revenues amounting to about IQD 10 trillion.

3. Provide indirect financing (via the secondary market) from the monetary authority to address the budget deficit and buy time until economic reforms are achieved.

4. Reduce the exchange rate of the Iraqi dinar to provide greater revenues to the treasury in the short term, given its role in achieving balance in the balance of payments in the medium term.

5. Form an agency, affiliated with the prime ministership, that refers and monitors investment projects within the general budget instead of in the ministries. In other words, the ministries handle planning the investment projects they need within their fields, while the proposed agency handles implementation. Separating planning from implementation will help curb corruption in government projects.

6. Reconsider the experience of investment bodies in Iraq (departments and work mechanisms) as the key to economic reform through the creation of an attractive investment environment. Focus on improving Iraq's standing vis - à - vis international foreign investment metrics, ease of doing business, and other indicators that play a role in strengthening foreign investor confidence in the economy.

7. Increase general non - oil revenues via various measures in financial policy (as indicated in the body of this paper).

8. Create economic partnerships with neighboring countries according to need in the Iraqi economy, particularly in the agricultural and transport sectors, to act as automatic buffers in defense of domestic product, given the current unfair competition and the policy of dumping followed by these countries.

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Appendices

Appendix 1: General Revenues for January 2020

Component	Total Revenue (IQD billion)	Percentage of Total Revenues (%)
Oil revenues and mineral resources	6390	95.0
Income and wealth taxes	31.7	0.5
Commodity taxes and production fees	97.6	1.5
Fees	85.9	1.3
Share of budget from public sector profits	19.1	0.3
Capital revenues	0.9	0.0
Transfer revenues	25.9	0.4
Other revenues	76.3	1.1
Total	**6727**	**100.0**

Source: Iraqi Ministry of Finance website, https://bit.ly/31XNecS

Appendix 2: Current Expenditures for January 2020

Component	Expenditures (IQD billion)	Percentage of Total Expenditures (%)
Employee compensation	3334	65.6
Service requirements	8.8	0.2
Commodity requirements	59.1	1.2
Asset maintenance	5.9	0.1
Capital expenditures	2.3	00
Grants, benefits, and debt servicing	644.8	12.7
Foreign obligations and aid	00	00
Special programs	1.4	00
Social welfare	1032	20.3
Total	**5088**	**100.0**

Source: Iraqi Ministry of Finance website, https://bit.ly/2ZP9BPi

Appendix 3: Public spending and Annual Sales of Foreign Currency for 2006 - 2020

Year	General Expenditures	Percentage of Total Expenditures (%)	Expenditures (IQD billion)	Percentage of Total Expenditures (%)
IQD trillion	Foreign currency sales (USD billion)	Currency sales (IQD trillion)	3334	65.5
Exchange rate 1200	Impact of public spending on currency sales (13/)	0.2	8.8	0.2
2006	38.8	11.1	13.3	34%
2007	39	15.9	19.1	49%
2008	59.4	25.8	30.9	52%
2009	52.5	33.9	40.7	77%
2010	64.3	36.1	43.3	67%
2011	69.6	39.8	47.7	68%
2012	90.3	48.6	58.3	64%
2013	106.8	55.7	66.8	62%
2014	83.5	54.4	65.3	78%
2015	70.4	44.3	53.3	75%
2016	76	33.5	40.2	52%
2017	75.5	46.5	55.8	74%
2018	80.9	47.1	56.5	70%
2019	111.7	51.1	61.3	55%
2020 (first quarter)	17.4	13.6	16.3	93%

Source: Table prepared by the researcher using Annual Economic Reports, Central Bank of Iraq, various years.

Appendix 4: Certain Aggregate Economic Indicators for 2017 - 2020

Years	2017	2018	2019	2020(*)
Real GDP growth	- 2,5	- 0,6	3,9	- 4,7
Inflation	0,1	0,4	- 0,2	0,8
Total public finance balance (proportion of GDP)	- 1,6	7,9	- 0,8	- 22,3
Current account balance (proportion of GDP)	1,8	6,9	- 1,2	- 21,7

Source: Table prepared by the researcher using Regional Economic Outlook, International Monetary Fund, file:///C:/Users/User/Downloads/mreo0420-full-report-arabic.pdf

*Projected numbers

Appendix 5: Domestic Debt and its Proportion of GDP for 2010 - 2019

Years	Domestic Debt (USD billion)	GDP (USD billion)	Domestic Debt's Percentage of GDP
2010	9.9	138.5	7%
2011	12.4	185.7	6%
2012	15.4	218.0	7%
2013	13.9	234.6	6%
2014	17.9	228.4	7%
2015	33.5	164.7	20%
2016	39.4	166.6	23%
2017	39.6	190.6	21%
2018	34.8	212.4	16%
2019	31.9	219.1	15%

Source: Table prepared by the researcher using data available on the Central Bank website: https://cbiraq.org/Default.aspx

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Dr. Basim Abd Al - Hade Hassan

Dr. Bassim has written and published many economics papers and articles in scientific journals and local and Arab newspapers. He has also published many books, including Vision for Iraq's Economic Future (Iraq Center for Studies in Baghdad, 2006), Assessment of Economic Reform Policy in Iraq (Iraqi Institute for Economic Reform in Baghdad, 2010), The Financial Dimension in the Development of Certain Monetary Variables in Iraq from 2003 - 2013 (Al - Bayan Center for Strategic Studies in Baghdad, 2016), Monetary Impact on Financial Policy in Iraq After 2003 (House of Cultural Affairs in Baghdad, 2018), and Economic Lights (Palette Printing Company, 2019).

Iraq is undergoing perhaps its most serious crisis in almost two decades, with financial revenues decreasing as a result of the shock of negative demand for oil as a result of the Coronavirus crisis, The government has become unable to maintain financial sustainability, as revenues are expected to decrease by at least half this year, and the public treasury will reach a so - called "financial gap."

Current expectations indicate that the pandemic may be more or less over by the end of the third quarter of this year, amid an agreement between OPEC and OPEC - Plus countries to decrease production, alongside the expected growth in demand for commodities, to bridge the financial gap caused by the Corona pandemic. With a partial return to business in most countries, oil prices are expected to increase to USD 50 by the end of this year. Iraq may benefit from this increase and realize an increase in financial revenues, but outcomes are contingent on realization of the assumed inputs.

What is the expected magnitude of the financial crisis in Iraq? What solutions and economic policies can alleviate this crisis, especially in light of the many other challenges, including a new government, an unstable political environment, and the health challenge of combatting the Coronavirus? To study the issue, an analytical descriptive method was used, relying on relevant data and indicators in an attempt to deconstruct the problem and develop appropriate solutions for overcoming the complex crisis this year.

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