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Iraq and the IMF

Press Release:

IMF Executive Board Approves US$5.34 billion Stand-By Arrangement for Iraq
June 6, 2016

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Iraq: Letter of Intent, Memorandum of Economic Financial Policies, and Technical Memorandum of Understanding

June 19, 2016

The following item is a Letter of Intent of the government of Iraq, which describes the policies that Iraq intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Iraq, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

Baghdad, June 19, 2016

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431, USA

Dear Ms. Lagarde:

1. As you know, the Iraqi economy has been hit by a double shock since mid-2014.

2. First, the attacks by the so-called Islamic State in Iraq and Syria (ISIS) have put Iraq in great danger. Iraqi security forces have made notable progress in the fight against ISIS, with the help of our international partners. However, these attacks have resulted in the loss of thousands of lives and caused a dramatic humanitarian crisis. More than 4 million people have been displaced in the northern regions since June 2014, in addition to 250 thousand Syrian refugees that Iraq has been sheltering since the civil war erupted in neighboring Syria. Nearly half of the internally displaced persons are children, forced to live in difficult conditions and to face serious health risks. The refugee crisis is also putting great pressure on Iraq's infrastructure system and public services. Furthermore, the war has destroyed public and private assets and infrastructure, is seriously hampering economic activity in the non-oil sector, and has undermined domestic and external trade.

3. Second, world oil prices have fallen by about 50 percent since mid-2014, causing a huge external shock to our balance of payments and our budget revenue, which depend predominantly on oil export receipts. The shock has caused a strong deterioration of the current account balance, drained our international foreign exchange reserves, and opened a large budget deficit and financing gap.

4. To address these shocks, the government has started to implement a large fiscal adjustment since early 2015, which we consolidated by starting a Staff-Monitored Program (SMP) that you approved in December 2015. The objective of the SMP was to demonstrate good performance in order to move to a possible IMF financing arrangement as soon as possible. As reported in the attached Memorandum on Economic and Financial Policies (MEFP), we have met three of the five indicative targets at end-December 2015 and March 2016 and all three structural benchmarks for the first review of the SMP.

5. Against this background, the government requests a three-year Stand-By Arrangement (SBA) with access of SDR 3,831 million (230 percent of our quota). The government commits to implement the economic and financial policies during 2016–19 described in the attached MEFP in order to gradually bring expenditure down to the new lower level of oil revenues and achieve debt sustainability. The MEFP describes the large fiscal consolidation that the government already implemented in 2015 and plans to continue to implement in 2016. In 2016, the government will only execute 85 percent of the level of non-oil primary expenditure authorized in the 2016 budget approved by parliament because oil prices have been substantially lower than the $45 oil price per barrel on which the 2016 budget was based. Under the public financial management laws of the country, the government has the authority to execute less than the budget approved by parliament when the revenue is less than assumed in the budget. In order to minimize the impact of the fiscal consolidation on the poor, the government will protect social spending and commits to maintain such spending above a floor during the SBA. The MEFP describes also the foreign exchange policy, public financial management, banking supervision, anti-money laundering, countering the financing of terrorism, and anti-corruption measures that the government commits to implement during 2016–19.

6. The government believes that the measures and policies set out in the attached MEFP are appropriate for attaining the objectives of this program and will take any further steps that might be necessary to that end. It will consult with the IMF staff on the adoption of such measures prior to any revision of the policies described in the attached MEFP.

7. The government will provide IMF staff with any relevant information referred to in the attached Technical Memorandum of Understanding (TMU) concerning progress made under the program.

8. The government intends to make public the content of the IMF staff report, including this letter, the attached MEFP, the TMU, and the informational annex of the staff report. It therefore authorizes the IMF staff to publish these documents on its website once the Executive Board has approved this SBA.

Sincerely yours,

/s	/s
Hoshyar Mahmoud Zebari	Ali Mohsen Ismail Al Allaq
Minister of Finance of Iraq	Acting Governor of the Central Bank of Iraq

Attachments:

I. Memorandum of Economic and Financial Policies

II. Technical Memorandum of Understanding

Attachment I. Memorandum on Economic and Financial Policies

1. This Memorandum on Economic and Financial Policies (MEFP) presents recent economic developments in 2015–16, and outlook and economic and financial policies in 2016–19 in regard to Iraq's Stand-By Arrangement (SBA) with the International Monetary Fund (IMF).

Background, Recent Economic Developments, and Performance Under the Staff-Monitored Program

A. Background

2. The attacks by the so-called Islamic State in Iraq and Syria (ISIS) have put Iraq in great danger. The Iraqi security forces have made notable progress in the fight against ISIS, with the help of our international partners. In fact, a significant portion of the territory captured by ISIS after its invasion has already been retaken. However, the war is not likely to end soon and will continue to affect the lives of Iraqis as well as the national economy.

3. The ISIS attacks have boosted the number of internally displaced persons—estimated at 3.7 million people in April 2016. Close to 10 million Iraqis (or almost one third of the population) need humanitarian assistance. With 246,000 Syrian refugees, Iraq is the fourth largest hosting country in the region for people fleeing Syria. Refugees—60 percent of whom are women and children—mostly reside in the north, including in the Kurdistan Region where they have been granted residency status including the right to work. This refugee inflow is adding to the already difficult internal humanitarian situation faced by the Iraqi government.

4. As a continuation of its economic and political reform agenda, the government of Iraq adopted a comprehensive plan, building on the reforms announced by the Prime Minister in August 2015. The plan focuses on six key pillars, namely: security, stabilization and reconstruction; integrity and transparency; executive actions; legislation; selection of senior administration employees and appointment of employees; and activation of lending for housing, manufacturing and agricultural projects. The plan aims at improving the budget and increasing revenues by ID 20–33 trillion annually in the medium and long term. The initial steps, to start before July 2016, include administrative reforms (not requiring changes in laws), amendments to existing transfer regulations and implementation of new taxes. The plan also calls for strengthening the role of the Commission on Integrity.

B. Recent Economic Developments

5. *Real GDP contracted by 2.4 percent in 2015 in spite of the strong growth (12.8 percent) of oil production*, all located in areas under control of the Iraqi government and the Kurdistan Regional

Government (KRG). Non-oil production is estimated to have contracted by 18.7 percent.[1] In January–May 2016, Iraq produced 4.4 mbpd, of which production in the Kurdistan Region and the production of the North and Midland Oil Companies was estimated to be 0.8 mbpd, and the federal government exported 3.3 mbpd, at an average price of $29 per barrel compared to $45 assumed in the 2016 budget. In 2015, average consumer price inflation (CPI) was low at 1.4 percent, but is likely underestimated because CPI coverage excludes areas occupied by ISIS. In April 2016, the CPI was 1.9 percent, year-on-year.

6. *The current account deficit widened to 6.4 percent of GDP in 2015*, financed mainly by the use of $13 billion of official foreign exchange reserves, which fell to $53.4 billion (9.9 months of imports of goods and services) at end-2015.

7. *In 2015, the fiscal deficit increased to 14.3 percent of GDP because of the fall in oil prices in spite of a large fiscal consolidation* that reduced the adjusted non-oil primary balance (NOPB)[2] by 13.5 percent of non-oil GDP and adjusted non-oil primary spending by 30 percent in real terms, mostly via cuts in non-oil investment, goods and services and transfers. The resulting deficit was financed mostly by the issuance of T-bills subscribed and loans provided by the state-owned banks Rasheed, Rafidain and Trade Bank of Iraq (TBI) (in an amount equivalent to 9.8 percent of GDP), of which 44 percent was refinanced at the discount window of the Central Bank of Iraq (CBI). The deficit was also financed by two loans of $1.2 billion each by the IMF[3] and the World Bank, the drawdown of government deposits in the CBI and the state-owned banks (ID 3.7 trillion, 2.0 percent of GDP) and the accumulation of arrears to domestic suppliers (ID 5.2 trillion or 2.8 percent of GDP at end-December 2015 ¶11), and international oil companies (IOCs, ID 4.1 trillion or 2.2 percent of GDP). During the first quarter of 2016, the fiscal deficit amounted to 2.4 percent of GDP and the non-oil primary deficit to 5.6 percent of GDP as oil revenue was significantly less than programmed owing to the lower-than-programmed oil prices (¶5) and the authorities prioritized the payment of wages, pensions, transfers, and interest to the detriment of spending on goods and services and non-oil investment. Oil investment continued to be executed and was financed by the accumulation of arrears to international oil companies (IOCs, ¶11).

8. The *spread between the official and parallel exchange rates* increased from 3 percent on average in December 2016 to about 9 percent in May 2016, while the CBI decreased the volume of its auctions of foreign exchange on the official market.

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[1] This estimate includes the full territory of Iraq, including the territory occupied by ISIS. To make this estimate, an adjustment was made to the production numbers collected by the statistical office COSIT after June 2014 to account for the fact that COSIT numbers do not report most of the production in the ISIS-occupied territories after that date.

[2]To facilitate comparison across years, the NOPB data was adjusted to account for a full year estimate of federal government transfers to the Kurdistan Regional Government (KRG) in 2014 and 2015, for which actual transfers were made for only 2 and 5 months, respectively.

[3] See IMF Country Report No. 15/235. Iraq: 2015 Article IV Consultation and Request for Purchase under the Rapid Financing Instrument.

9. The *yield on Iraqi $ bonds maturing in 2028* increased from 7.5 percentage in May 2015 to 12.5 in January 2016 and then fell to about 11.0 percent in May 2016.

10. In January 2016, the U.S. announced a $2.7 billion loan for sales of military equipment to Iraq and, in February 2016, Germany announced a project loan of €500 million for Iraq.

C. Performance Under the Staff-Monitored Program

11. *Program performance under the Staff-Monitored-Program (SMP)* [4] *was broadly satisfactory*.

- *Three out of the five indicative targets at end-December 2015 under the SMP were met* (Table 1):
    - The *non-oil primary balance* remained above the programmed floor by ID 5.2 trillion ($6.1 billion) owing to the under execution of wage and pension expenditure, goods and services and transfers, in spite of an over execution of investment expenditure and the underperformance of non-oil revenue.
    - The *stock of gross reserves of the CBI* exceeded the programmed floor by $274 million.
    - The *net domestic assets of the CBI* remained below the programmed ceiling by the amount of ID 13 trillion.
    - *Social spending* was slightly under the programmed floor (by ID 1.0 trillion) because of cash constraints at the end of the year.
- *External arrears* exceeded their zero ceiling by $3.556 billion at end-December 2015 and by $4.670 at end-March 2016, which are the amount of valid bills issued by IOCs outstanding for more than three months. The Government has been conducting discussions with IOCs to gradually pay these arrears by September -2016 and not to accumulate any new arrears after June 30, 2016 under the Stand-By Arrangement (performance criterion—PC–on the stock of arrears outstanding to IOCs and continuous PC on zero accumulation of new external arrears, Table 3). Timely payment to IOCs is essential to secure oil investment and oil revenue, which will remain the main source of financing for Iraq's public spending and imports.
- *Preliminary estimates indicate that three indicative targets (IT) at end-March 2016 were met and two were missed* (Table 1):
    - The *stock of gross reserves of the CBI* exceeded the programmed floor by $7 billion.
    - The *net domestic assets of the CBI* remained below the programmed ceiling by the amount of ID 19 trillion.

[4] See IMF Country Report No. 16/11. Iraq: Staff-Monitored Program.

- The *non-oil primary balance* remained above the programmed floor by the amount of ID 10 trillion ($8.5 billion) owing to the under execution of all non-oil primary spending items (¶7).

- *Social spending* was under the programmed floor (by ID 1.6 trillion) because of cash constraints. With the assistance of the international aid package, the government commits to catch up on the execution of such spending by year-end.

- *The government has met all the structural benchmarks (SB) for the first review of the SMP* (Table 2):

  - The Ministry of Planning has completed a *survey of domestic arrears* on investment spending accumulated by all ministries of the federal government at end-February 2016.

  - The Ministry of Finance and the Central Bank of Iraq (CBI) compiled *a list of all bank accounts controlled by the Ministry of Finance and all spending and sub-spending units of the central government* in CBI, state-owned and commercial banks at end-December 2015. The total amount of these deposits is ID 9.3 trillion, out of which ID 2.9 trillion was held at the CBI, ID 3.7 trillion at Rasheed Bank, ID 2.5 trillion at Rafidain Bank, ID 0.2 trillion at the Trade Bank of Iraq (TBI), and zero in other banks.

  - The Rasheed Bank and the Rafidain Bank have appointed Ernst and Young to *audit their 2014 financial statements according to international standards*.

  - The SB for the second review of the SMP has not yet been met: progress is being made on the drafting of amendments to the draft Financial Management Law to be approved by the Minister of Finance. It is a SB for the first review of the SBA (¶25).

Economic and Financial Policies for 2016–19

12. *The economic outlook has worsened since the assessment at the time of the SMP discussion (November 2015) owing to further weakening of global oil prices*. The further sharp decline in projected Iraqi oil prices from $45.0 to $34.5 in 2016 (and by a similar magnitude in future years) has opened a large financing gap of $14 billion a year without further measures or financing. With additional fiscal adjustment of about 3 percent of non-oil GDP per year in 2016 and beyond compared to the SMP (through measures discussed below), and additional use of foreign exchange reserves, the financing gap would be reduced to $4.9 billion in 2016 and $13.2 billion during 2017–19, which could be filled by the IMF, the World Bank, and donors. The proposed fiscal retrenchment in 2016 would entail a reduction in the adjusted non-oil primary deficit by 3 percent of non-oil GDP compared to the 2016 budget. The ongoing war against ISIS, along with the sharp fiscal retrenchment, is projected to lead to a 5 percent contraction of non-oil GDP in 2016. But, assuming the level of oil production that has already been achieved in early 2016 due to significant investment in the past as well as ongoing investment in the oil sector, the average level of oil output in 2016 should increase by 21 percent over last year's average. Hence, overall real GDP is expected to grow by 10.3 percent in 2016. The current account deficit would widen to 11 percent of GDP in 2016 owing to the drop in oil prices, but improve over the

medium term as oil prices recover somewhat, structural reforms are implemented, and progress is made to retake territories controlled by ISIS. The increase in oil prices and the fiscal consolidation—which would need to be continued after the program period—would bring the overall fiscal deficit down to less than 1 percent of GDP in 2021 and the balance of payments back into surplus by 2021. The public debt would peak at 85 percent of GDP in 2018, and gross official foreign exchange reserves would bottom out at $31.5 billion (5.1 months of imports of goods and services) in 2020.

A. Foreign Exchange Policy

13. *The government is committed to maintaining the peg with the U.S. dollar*. The peg provides a key nominal anchor in a highly uncertain environment with policy capacity weakened by the conflict with ISIS. The CBI will increase the sale of foreign exchange for valid current exchange transactions on the official market in order to reduce the spread between the official and parallel exchange rates (¶8).

14. *The government will gradually remove remaining exchange restrictions and multiple currency practice (MCP) with a view to eliminating exchange rate distortions*. Such a move towards acceptance of the obligations under Article VIII of the IMF's Articles of Agreement will send a positive signal to the investment community that Iraq is committed to maintain an exchange system that is free of restrictions and MCPs for current international transactions and thus facilitate creation of a favorable business climate. As a first step, the Council of Ministers will approve and introduce to parliament an amendment of the Investment Law, or the CBI will issue clarifying implementing regulations, to remove the limitation on transfer of investment proceeds that gives rise to an exchange restriction (SB Table 5), as recommended by a recent technical assistance mission of the IMF. As a second step, the CBI will, by the end of 2016, make the weekly limits on the purchase of cash at the weekly foreign currency auctions indicative, in the sense that any bank requiring additional cash for their clients' legitimate travel expenses will be able to obtain the required amount above these limits on the basis of appropriate documentation. The CBI will make the public aware of such a policy by explaining it through a press conference and on its external website.

B. Fiscal Policy

15. In order to maintain macroeconomic stability and achieve debt sustainability, the government commits to pursue its fiscal consolidation efforts to bring spending in line with available resources in 2016–19. This will require: (i) a sizable reduction in the adjusted non-oil primary balance[5] (PC, Table 3), of about 11 percent of non-oil GDP (ID 4.3 trillion, or $3.6 billion) over 2016–19; and (ii) a large increase in mostly domestic but also external financing over the short run that will remain compatible with debt sustainability in the medium run.

[5] The non-oil primary fiscal balance is defined as the difference between non-oil revenue and non-oil primary expenditure, i.e. excluding interest payments, see Technical Memorandum of Understanding (TMU), ¶8.

16. In order to minimize the impact of the fiscal consolidation on the population, the government will protect social spending, i.e. spending on health, education, and transfers in support of the social safety net, the internally displaced and the refugees (IT, Table 3).

17. In order to strengthen debt sustainability, the government will renew discussion with Iraq's non-Paris Club (PC) creditors towards which it still has unresolved external arrears in an amount of $41 billion that were accumulated under the pre-2003 Saddam regime. Those arrears make most of the total stock of the external debt stock, which amounted to $67 billion at end-2015. Negotiations with these creditors will continue to seek implementation of debt relief on the same terms as with the PC creditors, i.e. an 80 percent net-present-value reduction. The government will also examine with the PC the possibility of requesting a net-present-value neutral rescheduling of the remaining claims of PC creditors.

18. To ease the cash constraint in 2017, the authorities have agreed with the government of Kuwait on a further postponement of the payment of overdue war reparations to Kuwait amounting to $4.6 billion (ID 5.4 trillion or 4.3 percent of non-oil GDP) beyond 2017.

19. In order to facilitate implementation of the budget sharing arrangement between the Federal Government and the KRG, the Federal Government is looking into improving its modalities. In this regard, both parties are considering netting out the KRG oil receipts, which the KRG plans to have audited by international audit companies starting on July 1st, 2016, with the budgetary transfers to which the KRG would be eligible under the budget sharing arrangement. In the meantime, the performance criterion on the non-oil primary balance (¶32) for the Federal Government will have an adjuster in case the budget sharing agreement with the KRG is not implemented (TMU, ¶14).

Fiscal Program in 2016

20. In 2016, the government commits to contain the non-oil primary deficit to no more than ID 65.2 trillion (53.3 percent of non-oil GDP), compared to ID 76.7 trillion (56.3 percent of non-oil GDP) in the 2016 budget. The Council of Ministers' approval and circulation to parliament of a quarterly budget execution report that presents the projection of revenue and expenditure for the remainder of 2016 reflecting this change, an explanation of variations from the 2016 budget, and the measures to be taken to ensure that the budget execution remains in line with the macroeconomic framework agreed under the SBA is a prior action (PA, Table 5). Approval by the Minister of Finance and dissemination to the spending units of a spending plan for the latter in line with the macroeconomic framework agreed under the SBA is another PA. This fiscal program will be achieved through the implementation of the following measures:

- collect at least ID 7.4 trillion (6.1 percent of non-oil GDP) in *non-oil revenue*, compared to ID 8.8 trillion (6.5 percent of non-oil GDP) in the 2016 budget, in spite of the downwards revision of non-oil growth to -5 percent compared to zero in the budget, due to the following measure:
    - increase in personal income tax revenue through a reduction of exemptions, which will yield ID 0.3 trillion in 2016 (¶23);

- *contain non-oil primary expenditure* to ID 72.6 trillion (59.4 percent of non-oil GDP) compared to ID 85.5 trillion (62.8 percent of non-oil GDP) in the 2016 budget; this reduction will be borne mostly by the following measures:

  - *reduction of the wage bill* by ID 3.0 trillion, through natural attrition, delaying hiring of new staff, reduction of discretionary benefits, and revising wages of military and security personnel in light of observed number of staff absent without leave; this will still leave room for an increase in the wage bill by ID 3 trillion compared to 2015;

  - *reduction of pension payments* by ID 1.8 trillion, by the enforcement of the existing rules preventing collection of multiple pensions or collecting pensions without minimum contribution period or below legal pensionable age; this will still leave room for an increase in pension payments by ID 1 trillion compared to 2015;

  - *reduction in goods and services* by ID 2.2 trillion, while making room for the increase in electricity charges from ID 360 billion to ID 675 billion, as a consequence of the fivefold electricity tariff increase decided by the Council of Ministers (¶24); this will still room for an increase in goods and services by ID 1.9 trillion compared to 2015 excluding electricity charges;

  - *reduction of transfers* by ID 2.4 trillion, including through less spending to replenish the food stocks of the Public Distribution System (PDS) in light of the higher than programmed level of the these stocks at end-2015; this will still leave room for an increase in transfers by ID 4.5 trillion compared to 2015, and an increase of the social safety net transfers by ID 1.8 trillion, including an increase of the PDS by ID 0.2 trillion;

  - *reduction of non-oil investment expenditure* by a further ID 3.6 trillion through prioritizing projects already started and focusing on the most crucial new ones, and delaying other projects to later years; this will imply a cut of non-oil investment expenditure by ID 7.3 trillion compared to 2015;

  - the wage, pension, and other cuts also include *significant burden sharing by the Kurdistan Regional Government (KRG)*, which is broadly commensurate with its share in the budget of the federal government: while the transfers to KRG were to amount to ID 13.1 trillion in the 2016 budget, this figure will be reduced to ID 9.8 trillion in the revised fiscal program for 2016.

21. In order to finance the non-oil primary fiscal deficit (ID 65.2 trillion), the interest payments (ID 2.8 trillion) and the oil investment expenditure (ID 14.7 trillion), the government will have recourse to oil revenue (ID 56.6 trillion), domestic financing (ID 21.5 trillion) and external financing (ID 4.5 trillion):

- The *domestic financing* will be covered by the issuance of Treasury bills (ID 14.9 trillion), out of which most (up to ID 12.6 trillion) will be refinanced by commercial banks at the discount window of the CBI, the issuance of national bonds for the general public (ID 5 trillion), and the drawdown of government deposits in the banking sector (ID 4 trillion). The amount of central bank indirect monetary financing will be revisited on the occasion of the first review in light of the success in raising domestic financing by other means. If oil revenue is higher than programmed, the government commits to save the excess oil revenue collected over the amount programmed in order to reduce the indirect monetary financing of the budget deficit by the CBI.

- The *external financing* will be covered by loans from the IMF under the SBA ($1.9 billion), the World Bank under a Development Policy Loan to be disbursed in December 2016 ($1billion), a bond issued with full guarantee of the United States ($1 billion), loans by the World Bank guaranteed by France ($450 million), the United Kingdom ($430 million) and Canada ($120 million) budget support loans by the Japanese International Cooperation Agency (JICA, $200 million), and a Eurobond issuance in the last quarter of 2016 ($1billion). The external financing will also be covered by project loans from the U.S. government ($2.7 billion, ¶11), Germany (€167 million, i.e. the €500 million disbursed over three years, ¶11), JICA ($323 million), the World Bank ($120 million), Italy ($66 million), and the Islamic Development Bank ($54 million).

22. The government will not resort to the accumulation of arrears to finance the deficit. It commits to a zero ceiling on new external arrears to its external creditors after June 30, 2016 (continuous PC, Table 1), a gradual elimination of the existing stock of outstanding arrears to IOCs by the end of 2016 (¶11), and regular inventories of domestic arrears with a view to ensuring that new arrears do not accumulate and to paying down existing ones after proper audit (¶25, third bullet).

C. Revenue Reforms

23. In order to strengthen revenue, the government will implement the following measures:

- *Broaden the tax base of wages*. The Council of Ministers approved a decision to include all salaries and wages of non-military government employees above grade 2 including base salary, supplemental pay, bonuses, overtime and any other allocations (excluding allocations for wife and children), in the taxable base (PA, Table 5). This decision is expected to yield additional tax revenue of ID 0.3 trillion in 2016 and ID 0.6 trillion in 2017 when it will be implemented for the full year.

- *Audit the financial statements of the Development Fund for Iraq and Successor Account 300/600 at the CBI* to check that all oil revenue reaches the treasury and monitor the use of the resources deposited in that account. The Ministry of Finance will continue to have all the transactions moving the balance of its foreign exchange account 300/600 at the CBI audited by an international audit company every six month and will post the audit reports on its external website within six months after the end of each audited semester (SB, Table 5).

- *Conduct diagnostics of the tax and customs codes* to simplify them and broaden the tax base. The Ministry of Finance will, by end-September 2016, prepare tax policy measures to increase tax and customs revenue, with technical assistance from the IMF and the World Bank. Such measures could include the introduction of a value added tax[6] or sales tax, a personal income tax on pension earners, excise taxes, ... The government will introduce tax policy measures to increase non-oil tax revenue in the 2017 draft budget.

- *Conduct diagnostics of the tax and customs administrations* with a view to modernize them and broaden the tax base, with technical assistance from the IMF, the World Bank, the World Customs Organization, and the United Nations Conference for Trade and Development (UNCTAD). The Ministry of Finance will, by end-December 2016, propose a strategy to strengthen the tax and customs administration, with technical assistance from the IMF and the World Bank. The Customs Administration will, by end-August 2016, propose a strategy to implement the UNCTAD ASYCUDA information system in its administration.

D. Expenditure Reforms

24. In order to decrease expenditure, the government will implement the following measures:

- *Control the evolution of wages and pensions* by a combination of the following measures:
  - implementing a hiring freeze in sectors other than security, health and education in 2016;
  - conducting audits by the Board of Supreme Audit (BSA) of the wage and pension recipients by end-August 2016 to first identify, and then cancel payments to, ghost workers and ghost pensioners (two SB, Table 5); and
  - changing, by end-December 2016, the parameters of the public pension system as proposed by the World Bank.[7]
- *Reform the electricity sector* by a combination of the following measures:
  - implementing the progressive electricity tariff schedule designed by the Ministry of Electricity in 2015, which could yield nearly ID 2.2 trillion (1.8 percent of non-oil GDP) in additional revenue for the electricity sector; the additional revenues will be used to finance off-budget investment

[6] The introduction of a 5 percent VAT, as decided by the Gulf Cooperation Council states for 2018 could yield annual revenue of 2 percent of GDP in these countries.

[7] According to the World Bank, amending the pension law 9/2014 to introduce the following parametric changes would yield cumulative savings of over ID 1 trillion through 2018 and ID 31 trillion through 2028: (1) decreasing the accrual rate from 2.5 percent to 1.5 percent; (2) increasing the minimum length of service from 15 years to 20 years for pension salary eligibility; (3) changing the base wage for pension calculation from the last three years to the last seven years; and (4) reducing the qualifying conditions for survivorship pensions to only spouses, parents, and children (World Bank, Iraq - Emergency Fiscal Stabilization, Energy Sustainability, and State-Owned Enterprise Transparency Development Policy Financing, December 2015, ¶52, p.24).

and repay bank loans of the electricity companies;[8] the tariff increase will not increase the tariff for the consumption below 600 kilowatts per month in order to shield the poorest; and

  - reducing gas flaring by using it for electricity production, which, according to the World Bank, could yield about ID 1.4 trillion ($1.2 billion, or 1.1 percent of non-oil GDP) in budget savings per year with an upfront cost of $0.5 billion starting in 2017:[9] to that end, the Ministry of Oil paid all its 2015 arrears to the Basra Gas Company (BGC) amounting to $204 million, will pay its outstanding 2016 arrears of $140 million by end-May, will pay its estimated remaining gas purchase from BCG in 2016 amounting to $700 million within the contractual 45 day-period after billing, and will use at least $145 million of its investment budget in 2016 to finance the gas flaring-reducing investment project at the BGC.

- *Reform the Food Public Distribution System (PDS).*[10] The Ministry of Labor and Social Affairs (MOLSA) is setting up a Proxy Means Testing (PMT) data base with the assistance of the World Bank. When that database is completed, the MOLSA will have a database that will be used to determine eligibility for cash transfers based on available budget. This same database could be utilized by other programs (i.e. PDS) to target their assistance (cash or in-kind) to the poor households based on their welfare scores as determined by the PMT.

- *Reform state-owned enterprises (SOEs)*. Non-financial SOEs in Iraq include a large variety of public entities, including ministries' directorates/departments, and bodies. There are 176 SOEs in Iraq, with over 550,000 employees, of whom 30 to 50 percent are estimated to represent excess labor. Many of these SOEs have limited rationale beyond providing public employment. As a result, they are structurally loss-making and present a large burden for public finances. The exact scope and scale of the economic, financial and fiscal cost that SOEs represent in Iraq is, however, unknown due to poor reporting of key financial and economic statistics on the 176 non-financial SOEs. Similarly, the transparency of financial SOEs is limited. With the assistance of the World Bank, the government has started to set up a database to monitor the fiscal risks of non-financial SOEs. Building on this information, the government will elaborate measures to restructure the non-financial SOEs on the occasion of future reviews of this SBA.

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[8] In 2015, total electricity consumption was 42 TWh, revenue amounted to ID 0.8 trillion while the cost of producing electricity, with oil supplied at $5 per barrel, amounted to ID 5 trillion. This tariff increase has the potential to increase the electricity sales to ID 3 trillion and reduce the gap with production cost to ID 2 trillion. In 2015, the central government consumed 4.5 TWh. This tariff increase will increase the cost of its electricity bill from ID 73 billion in 2015 to ID 675 billion in 2016, compared to ID 360 billion in the 2016 budget. Credits for electricity consumption were revised upwards accordingly in the revised fiscal program for 2016 (¶20).

[9] World Bank, December 2015, ¶62, p.28.

[10] Moving to a more targeted PDS could yield annual savings of up to ID 1.8 trillion (1.4 percent of non-oil GDP). See "*Food and Electricity Subsidies*" in IMF Country Report No. 15/236. Iraq: Selected Issues.

E. Public Financial Management Reforms

25. In order to strengthen fiscal discipline, the government will implement the following measures:

- *The Minister of Finance will approve a new draft of the Financial Management law in line with World Bank and IMF comments on the last draft submitted to the Shura Council* (SB, Table 5). This draft will include: prior Ministry of Finance approval of multi-year commitments; two set of budget execution reports: one on a cash basis, and, another one that will gradually include more and more elements measured on an accrual basis; and codification of the current intention not to invest any surplus oil revenues in domestic assets.

- *Improve Government Finance Statistics (GFS) reporting*. Building on the IMF technical assistance recommendations, the Ministry of Finance will send to the IMF staff fiscal reporting tables (including revenue, expenditures and financing) at end-December 2015, end-March 2016 and end-June 2016 in compliance with the IMF Government Finance Statistics Manual 2014 (GFSM 2014, SB for the first review, Table 5). It will publish quarterly fiscal reporting tables in compliance with the IMF GFSM 2014 with a quarter lag on the external website of the Ministry of Finance starting on January 1, 2017.

- *Survey, audit and pay domestic arrears*:

  - The government will monitor with quarterly surveys the accumulation of arrears by systematically recording in detail and monitoring the existing unpaid obligations on a regular basis. It will complete of a survey of all domestic arrears, i.e. payment due for more than 90 days, at end-June 2016, including: (i) current spending (salaries, pensions, goods and services and capital purchases), managed by the Ministry of Finance; and (ii) non-oil investments (projects and any associated penalties), managed by the Ministry of Planning. The Ministry of Finance will elaborate a consolidated report on all these arrears for the included ministries. (SB for the first review, Table 5).

  - On the basis of each of these surveys, the government will prepare plans for the orderly payment of the arrears, following an independent audit of the arrears by the BSA and a repayment schedule in line with the government's financing capacity. In its revised fiscal program for 2016 (¶20), the government has included the issuance of two-year bonds in a provisional amount of $2.5 trillion carrying an interest rate of 5 percent to repay part of the ID 7.5 trillion in domestic arrears on non-oil investment identified by the Ministry of Planning (¶11). The government will set the amount of this issuance in light of the results of the audits of these arrears by the BSA, who will conduct it by end-August 2016, and its financing capacity.

  - The government will observe a ceiling on the accumulation of domestic arrears on non-oil investment as surveyed by the Ministry of Planning (IT, Table 5). The scope of this IT will be widened to include all domestic arrears on the occasion of future reviews in light of the results of the survey of domestic arrears on current expenditures on the occasion of the first review.

This IT will be upgraded to a PC on zero accumulation of domestic arrears as soon as the government has developed the ability to reliably monitor and prevent them.

- *Take steps to move to a Treasury Single Account (TSA)*. As a first step, the Ministry of Finance and the CBI compiled a list of all bank accounts controlled by the Ministry of Finance and all spending units and sub spending units of the federal government, in CBI, state-owned and commercial banks at end-December 2015 (¶11). Going forward, the Ministry of Finance will implement the following measures:

    - Constitute a working group comprising representatives of the Ministry of Finance, CBI, Al Rasheed and Rafidain Banks and TBI to take stock on the readiness of the payment and settlement systems in the country, and develop a plan for modernizing systems to enable operation of a TSA by end-December 2016.

    - In light of the existing and planned banking and financial management information technology infrastructure, develop a strategy, design and action plan for the phased development of the TSA by end-March 2017.

    - Create a Cash Flow Management Unit (CMU) and mandate it to develop cash flow forecasts that will identify cash needs over the course of the budget year as one of its core responsibilities (by end-June 2016) with the support of technical assistance by the IMF. These cash flow forecasts should include details of all receipts and payments into and from the central government accounts and should be used to inform the spending units about funding operations. The CMU will develop: 12-month rolling revenue cash forecasts by end-September 2016; and 12-month rolling expenditure cash forecasts based on the larger spending units by end-December 2016. Throughout 2017, the government will build CMU capacity to develop accurate in-year cash plans, including scenario analysis.

    - Set up a Cash Management Committee (CMC) by end-December 2016 to : (i) oversee the timely and orderly financing of the budget including monitoring of all outflows and monitor all inflows in the TSA/Treasury main accounts, all revenue collection and spending; (ii) monitor the macro-fiscal, macro-economic and monetary situation and activate corrective actions in a timely manner; (iii) ensure coordination and sharing of information between the key stakeholders; and (iv) facilitate policy discussions. Chaired by the most senior official of the Ministry of Finance, the CMC will include representatives of the Debt Management Department, the Budget Department, the Treasury, the Ministry of Oil, large spending units, and the CBI.

    - Gradually incorporate all government-related cash operations in the TSA, initially through the use of zero-balance operations during 2017–18, in light of the results of the audits of the financial statements of Rasheed Bank and Rafidain Bank and in sync with the implementation of their restructuring strategy (¶28) and the liquidity situation of any other bank where the government has accounts.

- *The following closing dates will apply for the 2016 budget execution:* for commitments in respect of ordinary operating expenditures and non-oil capital expenditures, November 30, 2016; for commitments in respect of other expenditures, December 20, 2016; for payment orders, December 31, 2016; and for payment order processing by accountants, payment authorization, and regularization of expenditures, January 31, 2017. Thus, the supplementary accounting period will be limited to accounting operations, and an end-of-year circular will be sent by the end of September 2016 specifying the deadlines for expenditure commitments and validation to ensure that all commitments can be closed out by November 30, 2016.

- *Design and implement a commitment control system for budget execution, in line with IMF technical assistance recommendations*. To avoid emergence of new arrears, the immediate focus will include:

    - preparing a monthly budget execution report based on inputs from spending units;
    - implementing cash rationing for each spending unit;
    - improving the recording of commitments: decisions by the Minister of Finance and the Minister of Planning requiring all spending units to record all existing commitments; and production, by the Ministry of Finance, of a report of all recurrent and investment commitments (by project) in coordination with the Ministry of Planning (two SB, Table 5);
    - prohibiting any commitment beyond quarterly allocations;
    - designing the templates required for a manual commitment control system based on the Appendix 3 to the December 2015 FAD technical assistance report (by end-June 2016);[11]
    - conducting training for spending units on the new system, including a clear definition of commitments (by end-August 2016);
    - requiring all spending units to record all existing commitments (by end-September 2016);
    - Ministry of Finance to produce a report of all recurrent and investment commitments (by project) in coordination with the Ministry of Planning as at end-December 2016;
    - ensure that commitment control functionality is designed in the Integrated Financial Management Information System (IFMIS) by end-July 2016; and
    - test the commitment functionality in the IFMIS pilot sites (in line with IFMIS pilot plans) by end-2018.

[11] IMF, Fiscal Affairs Department, Strengthening the Draft PFM Law and Budget Execution, Suzanne Flynn, Jacques Charaoui, Janis Platais, Tawfik Ramtoolah, and Arun Srivastava, December 2015.

- *Design and implement an Integrated Financial Management Information System (IFMIS) with the assistance of the World Bank:*

    - as a first step, the Ministry of Finance will adopt, by end-June 2016, a road map detailing its core functional requirements, such as: the chart of accounts, multi-year expenditure tracking; carry-over of resources from one year to the next; and management of advances and cash management arrangements;

    - as a second step, the Ministry of Finance will take the necessary steps to hire a company to develop the IFMIS: it will publish the final standard bidding documents on its web site by end-July 2016, and sign the contract with the selected IFMIS vendor by end-February 2017;

    - as a third step, the Ministry of Finance will develop, test and accept the IFMIS by end-November 2018; and

    - as a final step, the Ministry of Finance will progressively roll out the IFMIS to pilot sites including the Ministry of Finance, the Ministry of Planning, the Ministry of Interior, the Ministry of Construction, Housing and General Municipalities, and the Baghdad and Babil Governorates by end-June 2020.

- *Implement Public Investment Management (PIM) reform with the assistance of the World Bank in line with Decree 445 of October 18, 2015 on PIM:*

    - design the organizational structure of the PIM Central Unit at the federal Ministry of Planning (by April 2016) and make this structure fully operational (by end-December 2016);

    - make and publish on the Ministry of Planning website a detailed inventory at both ministry and governorate levels of the portfolio of public investment projects (on-going and new projects with a minimum cost of US$10 million), having a feasibility study made through cost–benefit analysis and expenditure efficiency (by end-June 2016);

    - conduct a capacity needs assessment for the PIM Central Unit at the federal Ministry of Planning and in the two IFMIS pilot governorates of Baghdad and Babel (by end-November 2016); and

    - conduct training for the PIM Central Unit in line with the recommendations of the capacity needs assessment with a preliminary focus on the Logical Framework Approach and the Integrated Project Appraisal at a basic level (by end-2017).

- *Audit budget execution*. The BSA will submit its report of the execution of the 2015 budget to parliament before the government submits the draft 2017 budget to parliament.

- *Strengthen Debt Management*. The capacity of the Public Debt Directorate will be strengthened with technical assistance support from the Japanese International Cooperation Agency (JICA), one of the largest bilateral and concessional lenders to Iraq. Starting in October 2015, a workshop was held with support from a debt management expert from JICA. This will be followed by a package of training programs consisting of a series of seminars and practical trainings for strengthening the capacity of the Public Debt Directorate. Some training courses may be held in cooperation with neighboring countries and international financial institutions. As a first step, the Public Debt Directorate will seek assistance to strengthen its debt recording systems.

F. Anti-Corruption Measures

26. In order to combat corruption, the government will implement the following measures:

- The Council of Ministers will approve—after review by the Shura Council and forward to the parliament by January 2017 draft amendments to the 2011 law establishing the Commission on Integrity in order to strengthen its governance, accountability and oversight, and independence, and provide it with powers in line with the United Nations Convention Against Corruption (SB, Table 5). The draft amendments will include the essential elements of a legal framework including clarity regarding the institution's mandate, which consists of: its objectives and functions and its powers to achieve them; clear governance and oversight and an accountability structure; operational and financial autonomy; eligibility criteria for appointments; and clear and transparent rules and procedures for dismissal, and protection for its management and staff. The draft amendment will also include requirements to set-up a comprehensive asset (in Iraq and abroad) declaration regime for senior public officials, their family members, and associates, and a requirement to publish the asset declaration.

- In line with UNCAC requirements, the Council of Ministers will adopt and forward to the parliament by December 2016 amendments to the Criminal Code to criminalize all corruption acts including illicit enrichment, bribery in the private sector, and obstruction of justice.

- In line with UNCAC requirements, the Council of Ministers will adopt and forward to the parliament by February 2017 several draft legislations that are currently being finalized by the Commission on Integrity to strengthen the legislative anti-corruption framework. The draft laws are related to access to information, conflict of interest, asset recovery, and protection of whistleblowers and witnesses.

G. Banking Supervision

27. As of December 31, 2015, there were 56 banks operating in Iraq including 7state-owned banks (SOB) of which one is an Islamic bank, 32 Iraqi private banks, of which 6 are Islamic banks, and 17 foreign branches, of which 5 are Islamic banks. The SOBs dominate the financial sector and account for the bulk of assets and credits. Three of the SOBs, Rafidain Bank, Rasheed Bank and Trade Bank of Iraq (TBI), account for around 90 percent of the banking system's assets.

28. The financial positions of Rasheed Bank and Rafidain Bank are fragile following years of quasi-fiscal operations. As a first step to restructure these banks, the Ministry of Finance appointed international auditors to audit their latest financial statements according to international standards, in

cooperation with the Executive Committee for the restructuring of these banks and the World Bank. The auditors will submit their audit reports to the Ministry of Finance by end-August 2016. As a second step, the Ministry of Finance will, by end-December 2016, elaborate a restructuring plan for these two banks, in cooperation with the Executive Committee for the restructuring of these banks and the World Bank, in light of the results of the aforementioned audits.

29. The CBI will continue to implement reform measures to enhance the stability of the banking sector in Iraq which includes inter alia:

- working on reviewing and assessing CBI prudential regulations with the assistance of the IMF Middle East Technical Assistance Center (METAC) and the World Bank;
- strengthening banking supervision including for AML/CFT, with IMF and World Bank technical assistance;
- compiling and publishing financial stability indicators, elaborated with IMF technical assistance (by end-December 2016);
- enforcing the minimum capital requirement of banks of ID 250 billion ($214 million), a level to which all private banks except one have increased their capital;
- contracting a consultant to assist the CBI in rating banks, whereby they have already rated 17 banks: three banks were rated "*satisfactory*", eight banks rated "*fair*" and six banks "*marginal*";
- contracting a consultant to assist the CBI in upgrading the prudential regulations on "*Liquidity*" and "*Capital Adequacy Ratio*";
- preparing a Deposit Insurance Scheme which stipulates the establishment of a corporation to be licensed by the CBI, of which banks will have the opportunity to take a share in the capital;
- contracting a private firm to provide the CBI with a credit registry system for sharing information among banks on their common existing and potential borrowers;
- issuing a banking law for financial institutions offering Islamic services;
- penalizing, financially and administratively, banks and non-bank financial institutions for any non-compliance with laws and regulations in force; and
- introducing the international bank account number (IBAN) system in Iraq.

Building on the safeguards assessment conducted by the IMF in December 2015, the government will strengthen the legal framework of the CBI to provide for independent oversight of the CBI's operations. The Governing Council of the CBI will, by end-October 2016, approve a new charter for the Audit Committee prohibiting Central Bank of Iraq executive representation on the committee (SB, Table 5). The Council of Ministers will, by end-December 2016, approve and introduce to parliament amendments to the Law on the Central bank of Iraq to strengthen CBI governance and the internal control framework, in line with the IMF safeguards assessment's recommendations (SB, Table 5). Specifically, the CBI Law should be amended to: (i) specify external auditor selection criteria and timely appointment (i.e. before the end of the fiscal year for which the financial statements need to be audited); (ii) shift the authority to appoint the external auditor from the Ministry of Finance to the CBI; (iii) provide for multi-year appointment terms for the external auditor; (iv) provide for timely publication of audited financial statements; (v) establish an audit committee, including its mandate and composition, and representation on the CBI Board; (vi) change the CBI Board's composition to a non-executive majority; (vii) strengthen the autonomy of the chief internal auditor; and (viii) require market-based rates for lender of last resort operations. The proposed amendments should be developed in consultation with the IMF.

H. Anti-Money Laundering and Countering the Financing of Terrorism Measures

30. *The government will implement reforms to strengthen the anti-money laundering and combating the financing of terrorism (AML/CFT) framework*. This will contribute to improve the integration of the domestic financial system into the global economy, lower transaction costs, improve governance, reduce the size of the informal sector, disrupt ISIS funding, and reduce the terrorist threats it poses.

- As a first step, the government will adopt a by-law to set up a mechanism to comply with the relevant United Nations Security Council resolutions related to terrorism and terrorism financing in line with Recommendation 6 of the Financial Action Task Force on Money Laundering and Terrorism Financing (FATF) by end-August 2016, (SB, Table 5). In addition, the CBI will, by end-August 2016, adopt regulations imposing AML/CFT preventives measures for licensed entities to implement the 2015 law in line with the relevant FATF Recommendations.

- As a second step, the CBI will develop its supervisory capacity to enhance the compliance by these entities with AML/CFT obligations. In this respect, it will adopt risk-based AML/CFT onsite inspection procedures by end-January 2017, and tools for AML/CFT offsite monitoring of licensed entities by end-April 2017. It will allocate 5 experienced supervisors by end-March 2016 to properly cover AML/CFT issues during onsite examinations and ensure effective implementation. The CBI will recruit 5 additional experienced supervisors by end-January 2017.

- The CBI, in coordination with the AML/CFT Council, will provide the Financial Intelligence Unit (AML Bureau) with all the necessary financial, human, and technical resources to ensure a fully operational and effectively functional unit. The CBI will provide an appropriate budget to the AML Bureau by end-December 2016. Furthermore, the AML Bureau will recruit 5 additional experienced financial analysts[12] by end-March 2017 to analyze the suspicious transactions reports and disseminate them on a timely basis to the law enforcement agencies. The AML Bureau will recruit 5 additional experienced financial analysts by end-March 2018.

[12] As per May 2016, the FIU has 7 analysts.

- The government will adopt a comprehensive cash-couriers' regulation to implement the requirement of Article 34–35 of the AML/CFT Law and in line with FATF Recommendation by end-December 2016. The Customs Administration will then take the appropriate measures to effectively implement the regulation in order to detect the physical cross-border transportation of currency and bearer negotiable instruments that are suspected to be related to terrorist financing, money laundering or associated predicate offenses, or that are falsely disclosed.

Program Modalities and Monitoring

31. The program will have quarterly reviews and set quarterly PC on the non-oil primary balance, the stock of total public debt, the stock of net domestic assets of the CBI, official foreign exchange reserves, the absence of new external arrears, the stock of outstanding arrears to IOCs and two IT on social spending and the stock of outstanding domestic arrears on non-oil investment, starting in June 2016 (Table 3). Each program review will set a few SB in areas that are essential for the success of the program (Table 5 contains the list for the first, second and third reviews). The first review should be completed on or after September 15, 2016, the second review on or after December 15, 2016, and the third review on or after March 15, 2017.

Table 1. Iraq: Quantitative Targets Under the Staff-Monitored Program, 2015–16 [1/]

(In billions of Iraqi dinars, unless otherwise indicated)

	Dec-15				Mar-16				Jun-16	Sep-16	Dec-16
	Prog. [2/]	Adj. Target	Est.	Status	Prog. [2/]	Adj. Target	Est.	Status	Prog. [2/]	Prog. [2/]	Prog. [2/]
Stock of gross international reserves of the CBI (floor; eop stock, in millions of U.S. dollars)	51,100	53,433	53,707	Met	43,064	43,640	50,567	Met	38,945	37,849	42,517
Net domestic assets of the CBI (ceiling; eop stock)	12,956	9,487	-3,441	Met	22,029	21,349	2,549	Met	27,186	28,912	23,677
Central government non-oil primary balance (floor) [3/]	(68,801)	(68,969)	(63,674)	Met	(20,949)	(20,949)	(9,927)	Met	(39,365)	(58,621)	(76,705)
Social spending (floor) [3/]	17,456		16,494	Not Met	4,355		2,789	Not Met	8,710	13,829	18,949
New external arrears on existing / rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) [4/]	0		3,556	Not Met	0		4,670	Not Met	0	0	0
<u>Memorandum item:</u>											
Iraq oil export price (US$ / barrel, average for the quarter)	39.56		40.57		41.5		24.9		43.6	45.8	49.1

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

1/ The Technical Memorandum of Understanding (TMU) of December 22, 2015 in IMF Country Report No. 16/11 provides definitions.

2/ IMF Country Report No. 16 /11.

3/ Cumulative from January 1.

4/ To be monitored on a continuous basis. The December 2015 target is cumulative from November 1.

Table 2. Iraq: Prior Action and Structural Benchmarks Under the Staff-Monitored Program, 2016

Measures	Scheduled review by which the measure will be completed	Macroeconomic justification	Status
Prior action for Management approval			
Approval by the Council of Ministers and introduction to Parliament of amendments to the draft 2016 budget to bring it into line with the macroeconomic framework agreed under the Staff-Monitored Program.		Preserve macroeconomic stability.	Met.
Structural benchmark			
Completion by the Ministry of Planning of a survey of domestic arrears on investment spending accumulated by all ministries of the federal government at end-September 2015. Details should include the amount of the arrear, the identity of the creditor, the bill, the identification of the goods or the services delivered, and the credit line in the budget authorizing such spending.	1rst review	Strengthen cash management.	Met.
Compilation by the Ministry of Finance and the Central Bank of Iraq (CBI) of a list of all bank accounts controlled by the Ministry of Finance and all spending and sub-spending units of the central government in CBI, state-owned and commercial banks. Details should include balances at end-December 2015, account number, title, location, purpose, authority, signatories.	1rst review	Strengthen cash management.	Met.
Appointment of one or several international auditors to audit the latest financial statements of Rasheed Bank and Rafidain Bank according to international standards.	1rst review	Strengthen financial sector stability.	Met.
Approval by the Minister of Finance of a draft of the Financial Management law in line with World Bank and IMF comments on the last draft submitted to the Shura Council.	2nd review	Strengthen public financial management.	Not Met.

Source: Iraqi authorities.

Table 3. Iraq: Performance Criteria and Indicative Targets Under the Stand-By Arrangement , 2016–17 [1/]

(In billions of Iraqi dinars, unless otherwise indicated)

	2016			2017			
	Jun	Sep	Dec	Mar [2/]	Jun [2/]	Sep [2/]	Dec [2/]
	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.
Performance Criteria							
Gross international reserves of the CBI (floor; eop stock, in millions of U.S. dollars)	39,298	34,910	42,665	41,051	39,881	39,008	40,081
Net domestic assets of the CBI (ceiling; eop stock)	13,122	17,200	7,184	9,303	11,028	12,438	11,781
Central government non-oil primary balance (floor) [3/]	(32,918)	(49,145)	(65,156)	(15,995)	(31,990)	(47,985)	(63,980)
Gross public debt (domestic and foreign) (ceiling; eop stock)	137,483	142,208	143,584	147,708	152,942	162,213	167,278
New external arrears on existing / rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) [4/]	2,300	0	0	0	0	0	0
Stock of outstanding arrears to international oil companies (ceiling)	3,600	0	0	0	0	0	0
Indicative Target							
Social spending (floor) [3/]	7,434	12,619	18,228	2,876	7,434	12,619	18,228
Stock of outstanding domestic arrears on non-oil investment (ceiling)	7,500	7,500	7,500	7,500	7,500	7,500	7,500
Memorandum item:							
Transfer to the Kurdistan Regional Government [3/]	3,852	6,841	9,828	2,452	4,908	7,367	9,828
External Financing [3/ 5/]	(1,655)	(5,660)	(1,375)	(314)	(628)	(527)	835
International contributions to fill the financing gap [3/ 6/]	-	1,508	5,797	704	1,761	8,011	9,904
Iraq oil export price (US$ / barrel, average for the quarter)	35.7	37.5	39.9	40.3	40.3	40.3	40.3

Source: Iraqi Authorities, and Fund Staff estimates and projections
1/ The attached Technical Memorandum of Understanding (TMU) provides definitions.
2/ Indicative targets. Performance criteria for these dates will be set on the occasion of the first review.
3/ Cumulative from January 1.
4/ Continuous. The June 2016 Target is cumulative from the signature of the Letter of Intent.
5/ See Table 4 of the Staff Report for more details.
6/ See Table 4 and Text Table 3 of the Staff Report for more details.

Table 4. Iraq: Social Spending [1/]

(In billions of Iraqi dinars, cumulative from the beginning of the year)

	Dec-15		Mar-16		Jun-16		Sep-16		Dec-16	
	Prog.[2/]	Est.	Prog.[2/]	Est.	Prog.[2/]	Rev. Prog. [3/]	Prog.[2/]	Rev. Prog. [3/]	Prog.[2/]	Rev. Prog. [3/]
Total Social spending (floor)	17,456	16,494	4,355	2,789	8,710	7,434	13,829	12,619	18,949	18,228
Social Safety Net	1,215	1,104	496	0	991	765	1,487	1,215	1,982	1,800
Public Distribution System (PDS - food subsidies)	2,250	1,503	556	0	1,112	450	1,667	900	2,223	1,485
Wheat and rice subsidy	1,604	1,102	396	0	792	270	1,188	630	1,585	1,080
Assistance and subsidy to Iraqi refugees	192	0	0	0	0	0	95	0	189	0
Assistance and subsidy to internally displaced persons	900	720	0	3	0	33	445	450	889	900
Farmer subsidies	457	405	0	0	0	45	226	180	452	405
Health Ministry and Environment Ministry - wages	2,546	2,591	668	637	1,335	1,260	2,003	1,889	2,671	2,520
Higher Education Ministry - wages	2,035	2,186	564	446	1,128	1,035	1,691	1,553	2,255	2,070
Lower Education Ministry - wages	6,258	6,882	1,676	1,703	3,352	3,149	5,027	4,724	6,703	6,300
Health Ministry and Environment Ministry - goods and services						324		864		1,350
Higher Education Ministry - goods and services						25		65		99
Lower Education Ministry - goods and services						77		149		219

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

1/ The Technical Memorandum of Understanding (TMU) of December 22, 2015 in IMF Country Report No. 16/11 and the attached TMU provide definitions.

2/ The TMU of December 22, 2015, in IMF Country Report No. 16 /11 excludes spending on goods and services of the health and education ministries in the definition of the social spending floor.

3/ The attached TMU includes spending on goods and services of the health and education ministries in the definition of the social spending floor.

Table 5. Iraq: Prior Actions and Proposed Structural Benchmarks Under the Stand-By Arrangement, 2016–17

Measures	Scheduled review by which the measure will be completed	Macroeconomic justification	Status
Prior actions			
Council of Ministers' approval and circulation to parliament of a quarterly budget execution report that presents the projection of revenue and expenditure for the remainder of 2016 reflecting the fiscal program agreed under the Stand-By Arrangement (SBA), an explanation of variations from the 2016 budget, and the measures listed in ¶20 of the Memorandum of Economic and Financial Policies (MEFP) to be taken to ensure that the budget execution remains in line with the macroeconomic framework agreed under the SBA.		Preserve macroeconomic stability.	Met.
Approval by the Council of Ministers of a decision to include all salaries and wages of non-military government employees from grade two upwards including base salary, supplemental pay, bonuses, overtime and any other allocations (excluding allocations for wife and children), in taxable base for all employees subject to the income tax.		Increase non-tax revenue.	Met.
Approval by the Minister of Finance and dissemination to the spending units of a spending plan for the latter in line with the macroeconomic framework agreed under the SBA.		Preserve macroeconomic stability.	Met.
Structural benchmarks			
Completion by the Ministry of Finance of fiscal reporting tables at end-December 2015, end-March 2016 and end-June 2016 in compliance with the IMF Government Finance Statistics Manual 2014.	1st review	Improve fiscal transparency.	
Approval by the Minister of Finance of a draft of the Financial Management law in line with World Bank and IMF comments on the last draft submitted to the Shura Council, as specified in ¶25 of the MEFP.	1st review	Strengthen public financial management.	
Completion by the Board of Supreme Audit of an audit of the government wage earner payroll to identify ghost wage earners, i.e. people who perceive wages without legal or regulatory justification.	1st review	Decrease current expenditure.	
Completion by the Board of Supreme Audit of an audit of the government pensioner payroll to identify ghost pensioners, i.e. people who perceive wages without legal or regulatory justification.	1st review	Decrease current expenditure.	
Adoption by the Council of Ministers of a by-law to set up a mechanism to comply with the relevant United Nations Security Council resolutions related to terrorism and terrorism financing in line with Recommendation 6 of the Financial Action Task Force on Money Laundering and Terrorism Financing (FATF) .	1st review	Strengthen link with international financial system.	
Completion of a survey of all domestic arrears, i.e. payment due for more than 90 days, at end-June 2016, including: (i) current spending (salaries, pensions, goods and services and capital purchases), managed by the Ministry of Finance; (ii) non-oil investments (projects and any associated penalties), managed by the Ministry of Planning. The Ministry of Finance will elaborate a consolidated report on all these arrears for the included ministries.	1st review	Improve fiscal transparency.	

Table 5. Iraq: Prior Actions and Proposed Structural Benchmarks Under the Stand-By Arrangement, 2016–17

Measures	Scheduled review by which the measure will be completed	Macroeconomic justification	Status
Structural benchmarks			
Decisions by the Minister of Finance and the Minister of Planning requiring all spending units to record all existing commitments.	2nd review	Improve cash management.	
Posting by the Ministry of Finance on its external website of the financial statements of the Development Fund for Iraq and Successor Account on December 31, 2015 audited according to international standards.	2nd review	Improve fiscal transparency.	
Approval by the Governing Council of the Central Bank of Iraq of a new charter for the Audit Committee prohibiting Central Bank of Iraq executive representation on the committee.	2nd review	Strengthen governance of the central bank.	
Approval by the Council of Ministers and introduction to parliament of draft amendments to the 2011 law establishing the Integrity Commission in order to strengthen its governance, accountability and oversight, and independence, and provide it with powers in line with the United Nations Convention against Corruption, as specified in ¶26 of the MEFP.	3rd review	Combat corruption.	
Ministry of Finance to produce a report of all recurrent and investment commitments (by project) in coordination with the Ministry of Planning.	3rd review	Improve cash management.	
Approval by the Council of Ministers and introduction to Parliament of amendments to the Law on the Central bank of Iraq to strengthen CBI governance and the internal control framework, in line with the IMF safeguards assessment's recommendations, as specified in ¶30 of the MEFP.	3rd review	Strengthen governance of the central bank.	
Approval by the Council of Ministers and introduction to Parliament of an amendment of the Investment Law, or issuance of clarifying implementing regulations by the Ministry of Finance, to remove the limitation on transfer of investment proceeds that gives rise to an exchange restriction.	3rd review	Improve the business environment by eliminating restrictions for current international transactions.	

Source: Iraqi authorities.

Attachment II. Technical Memorandum of Understanding

1. This memorandum defines the quantitative performance criteria (PC) and indicative targets (IT) for the economic program of the Iraqi authorities during the period June 2016–June 2019 under the Stand-By Arrangement (SBA). These PC, presented in Table 3 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated June 19, 2016 reflect the understandings reached between the Iraqi authorities and the staff of the IMF. It also specifies the periodicity and deadlines for transmission of data to the staff of the IMF for monitoring purposes.

A. Performance Criteria and Indicative Targets

2. The PCs are the following:

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

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

(iii) a floor on the central government non-oil primary balance;

(iv) a ceiling on the stock of outstanding arrears to international oil companies (IOCs);

(v) a continuous ceiling on new external payments arrears on any existing, rescheduled and new debt of the central government and/or the CBI; and

(vi) a ceiling on the total gross public debt (domestic and foreign).

3. The indicative targets are the following:

(i) a floor on the central government social spending; and

(ii) a ceiling on the stock of outstanding domestic arrears on non-oil investment expenditure.

B. Definitions

4. An exchange rate set at Iraqi dinar (ID) 1,180 per U.S. dollar ($) will be used for monitoring purposes. This exchange rate will be used to convert into Iraqi dinars the U.S. dollar value of all CBI foreign assets and liabilities denominated in U.S. dollars, as required. For CBI assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar, they will be converted to U.S. dollars at their respective SDR-exchange rates prevailing as of May 19, 2016, as published on the IMF's website. The same rules will be used to convert external debt related parameters.

5. For monitoring purposes, unless specified otherwise, central government is defined to include the central administration, the Kurdistan Regional Government (KRG), as well as agencies included under Section 6 of the federal government budget (the local boards, Iraqi media network,

Iraqi national Olympic committee, Bait-Al-Hikma, Ammant Baghdad, Municipality institutions, as well as the General directorates of sewage and water).

6. **Gross international reserves (GIR) of the CBI** are claims of the CBI on nonresidents that are controlled by the CBI, denominated in foreign convertible currencies, and are immediately and unconditionally available to the CBI for meeting balance of payments needs or for intervention in foreign exchange markets, and are not earmarked by the CBI for meeting specific payments. They include CBI holdings of monetary gold, SDR holdings, Iraq's reserve position in the IMF, foreign currency cash, holdings of non-resident equity and debt securities, and deposits in foreign currency abroad, including foreign exchange account of the government (300/600). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). For program monitoring purposes, the stock of foreign assets of the CBI shall be valued at program exchange rates (¶4). The external auditor of the CBI will audit the stocks of official foreign exchange reserves within two months after the test dates.

7. **Net domestic assets (NDA) of the CBI** include: (i) net claims on the general government, comprising of gross claims on the general government minus general government domestic and foreign currency deposits at the CBI; (ii) gross claims on other depository corporations; (iii) monetary policy instruments, including dinar and foreign currency denominated term deposits and CBI bills held by other depository corporations; (iv) net claims on public nonfinancial corporations; and (v) claims on the private sector. For the purpose of this SBA, net domestic assets of the CBI exclude other items net (OIN). OIN is the net value of nonfinancial assets, capital and reserve accounts, IMF account adjustments (differences between national record and IMF record), and provisions. The external auditor of the CBI will audit the stocks of net domestic assets within two months after the test dates. For this paragraph, the general government is defined as the central government as defined in ¶5 and all other government entities on which the CBI holds claims or towards which it holds liabilities.

8. **The central government non-oil primary balance** is defined as the difference between non-oil revenue and non-oil primary expenditure measured on an accrual basis. Non-oil revenue is defined as total revenue and grants excluding oil-related receipts (exports of crude oil and refined products, and transfers from oil-related state-owned enterprises). Non-oil primary expenditure is defined as total expenditure, including off-budget spending approved by government decree, excluding (i) interest payments on domestic and external debt; and (ii) all oil-related spending (including war reparations).

9. **Arrears outstanding to international oil companies (IOCs)** are defined as bills of IOCs validated by the Ministry of Oil and due for more than three months after their invoice.

10. **New external payments arrears on rescheduled debt and new external debt contracted or guaranteed by the central government, excluding the KRG, and/or by the CBI** are defined as follows:

- External payment arrears consist of external debt service obligations (principal and interest) falling due that have not been paid within the grace period specified in the contractual agreements falling due after June 30, 2016.

- As set out in the Guidelines on Public Debt Conditionality in Fund Arrangements, paragraph 8, adopted by Executive Board Decision No. 15688-(14/107) of December 5, 2014, the term "*debt*" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

  - *Loans*, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements).

  - *Suppliers' credits*, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided.

  - *Leases*, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

  - *Arrears*, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation within the contractual grace period are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

- For program purposes, external debt is defined based on the residency of the creditor.

11. The **total public debt contracted or guaranteed by the central government** is defined as follows:

- The term "debt" is defined as in the preceding paragraph (¶10).

- Total public debt is the sum of domestic and external debt, with external and domestic debt defined based on the residency of the creditor.

- Total public debt excludes the debt contracted by the KRG.
- Total public debt includes the claims of the CBI on the central government.
- Total public debt includes the arrears as defined in ¶¶9 and 13 but excludes any repayment of domestic arrears on non-oil investment listed in the MEFP (in ¶25, third bullet point, second sub-bullet point) since the repayment of these arrears need to wait the results of the audit of their validity by the Board of Supreme Audit.
- Total public debt excludes short-term supplier related credit (less than 90 days).
- An external auditor will audit the total public debt contracted or guaranteed by the central government as defined in ¶11 within two months after the test dates.

12. **Social spending** (Table 4 of the MEFP) is defined as the sum of expenditure on the social safety net, the public distribution system, wheat and rice subsidies, assistance subsidies to Syrian refugees and the internally displaced, farmer subsidies, and wage expenditure and goods and services of the health, environment and the higher and lower education ministries. The annual targets will be set at 90 percent of the above expenditure in the budget agreed to under the SBA. Expenditure will be measured at the time the Ministry of Finance transfers the money to the spending units.

13. The **stock of outstanding domestic arrears on non-oil investment expenditure** is the value of unpaid bills related to non-oil investment for more than 90 days after their invoice, as measured by the regular surveys of the Ministry of Planning.

C. Adjustors

14. The floor on the central government non-oil primary balance and the ceiling on total public debt will be adjusted if the actual amount of the transfer of the central government to the KRG is less than the programmed amount. In that case, the floor on the central government non-oil primary balance will be adjusted upwards, and the ceiling on the total public debt will be adjusted downwards, by the absolute amount of the difference.

15. The ceilings on the stock of net domestic assets (NDA) of the CBI will be adjusted upwards in case foreign financing, defined for purposes of this paragraph and the three following paragraphs as the sum of external financing and international contributions to fill the financing gap as indicated in Table 3 of the MEFP, is lower than programmed to a limit of ID 1.18 trillion. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing and capped at the values enumerated in the previous sentence.

16. The ceiling on the stock of net domestic assets (NDA) of the CBI will be adjusted downward in case foreign financing is higher than programmed. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing.

17. The floor on the stock of gross international reserves of the CBI will be adjusted downwards in case foreign financing is lower than programmed to a limit of $1 billion. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing and capped at the values enumerated in the previous sentence.

18. The floor on the stock of gross international reserves of the CBI will be adjusted upward in case foreign financing is higher than programmed. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing.

D. Provision of Information to the Fund Staff

19. To monitor developments under the SBA, the authorities agree to provide the Fund, the information specified below after the approval of the SBA. The economic adjustment program of the Iraqi authorities is designed with quarterly PCs and ITs and the actual outcome should be provided within eight weeks following the end of the quarter. However, in order to facilitate regular monitoring, many indicators should be provided with higher frequencies, as indicated below.

Key Financial Indicators

- Weekly preliminary monetary and financial aggregates as in "*Key Financial Indicators*" including exchange rate data (daily), currency in circulation, transferable and other deposits held at commercial banks, balances on government accounts at the CBI, interest rates on loans and on deposits at commercial banks, holdings of government securities, and credit outstanding to the public and private sectors. The data, excluding exchange rates, should be reported no later than three weeks after the end of the reference period.

Real Sector

- Indicators of oil activity on crude oil and gas production and use, production and sales (export and domestic) of refined petroleum products, including heavy residuals, and associated prices (monthly). These data should be reported no later than two months after the end of the reference month.

- Indicators of non-oil real economic activity (quarterly), including production of cement, fertilizers, and electricity, reported no later than two months after the end of the reference month.

- Total GDP, reported no later than twelve weeks after the end of the reference quarter.

- Consumer price index (CPI), including indices for main cities (monthly). These should be reported no later than a month after the end of the relevant month.

Monetary and Financial Sector

- CBI gross foreign exchange reserves (weekly) and balances of the foreign exchange account of the government (300/600). This should be reported no later than 2 weeks after the end of the reference week. The value of the CBI gross foreign exchange reserves at the end of each quarter as defined in ¶6 will be audited by the CBI's external auditor and the audited value will be transmitted to the Fund within two months after each test date.

- The monthly balance sheet of the CBI, with a month lag. The value of the CBI net domestic assets at the end of each quarter as defined in ¶7 will be audited by the CBI's external auditor and the audited value will be transmitted to the Fund within two months after each test date.

- The monthly consolidated balance sheet of the other depository corporations (commercial banks), with an eight-week lag.

- The monthly assets and liabilities of the central government (ministry of finance and line ministries) in the banking sector with an eight-week lag.

- The depository corporations (monetary) survey of all commercial banks and the CBI (monthly), with an eight-week lag.

- The latest balance sheet and income statement (quarterly) of the Trade Bank of Iraq as well as data on issued, implemented and outstanding Letters of Credit, with no more than a six-week lag.

- The latest balance sheet and income statement (quarterly) of the Rasheed and Rafidain Banks.

- Quarterly financial stability indicators of the banking system, distinguishing the state-owned banks and the private banks, with an eight-week lag.

Fiscal Sector

- Detailed revenues, operating and capital expenditure, and financing items of consolidated fiscal and oil operations, and overall fiscal balance. These data should include:

  a) the execution of the Iraqi budget reported on a monthly basis;

  b) transfers to and from the KRG reported on a monthly basis;

  c) social spending as defined in ¶12 and total transfers (including in support of the social safety net—public distribution system—the internally displaced, and on refugees;

  d) domestic payments arrears on non-oil investment expenditures, as documented by the survey of the Ministry of Planning, defined in ¶13.

e) payments and/or arrears in payments to international oil companies as defined in ¶9 on a quarterly basis with an eight-week lag;

f) disbursements of external assistance and loans including issuance of Eurobonds and loans from the Trade Bank of Iraq (TBI);

g) execution of letters of credit financed through the TBI or by other means;

h) all operations of account 300/600 and its sub-accounts;

i) other forms of multilateral and bilateral assistance, exceptional financing resources, and other financing resources (such as issuance of domestic or foreign bonds, loans securitized by futures oil revenue, etc);

j) balances of all government accounts held at the CBI and the commercial banks (including government and/or line ministry deposits, and those of spending and sub-sending units);

k) amounts related to all off-budget and on-budget advances; and

l) outstanding stock of government securities (including treasury bills) held at/by commercial banks, the CBI, and pension funds. These data should be reported on a monthly basis and no later than two months after the end of the reference month.

Balance of Payments

- A preliminary quarterly balance of payments, compiled by the CBI, should be provided three months after the end of the reference quarter.
- Foreign trade statistics (imports, exports, re-exports) (quarterly). This should be reported no later than eight weeks after the end of the reference quarter.
- Amount of total imports of petroleum products financed from the budget and total value of imports of petroleum products on a quarterly basis starting with the first quarter of 2016. These data should be reported no later than eight weeks after the end of the reference quarter.
- Detailed data on disbursement of external assistance (both project and budget financing) from all external creditors and donors and foreign debt amortization and interest payments made. These data should be reported on a monthly basis no more than eight weeks after the end of the reference month.

Public Debt

- Stock of public debt as defined in ¶11 on a quarterly basis with an 8 weeks lag audited by an external auditor.

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

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

Structural Reforms

20. Structural benchmarks comprise a critical component of the SBA. In accordance with agreed benchmarks (Table 5 of the MEFP), the authorities will prepare and send to the IMF staff reports, with appropriate documentation, documenting completion.

Other Information

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