For the Iraqi Prime Minister, a Slew of Economic Challenges

by Ahmed al-Hajj **(/experts/ahmed-al-hajj)**

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ABOUT THE AUTHORS

Ahmed al-Hajj (/experts/ahmed-al-hajj)

Ahmed al-Hajj is an Iraqi economic expert, member of the Iraqi Federal Parliament, and member of the Governorate Council of Sulaymaniyah. He has published academic economic research in a number of articles and has appeared on a number of television programs.

Brief Analysis

With the choice of the economist Adil Abdul-Mahdi as the new Iraqi Prime Minister, he faces the daunting task of guiding the government through necessary economic reform, service quality improvement, and reconstruction. Economic issues represent one of the most major challenges in Iraq today, and in order to truly effect change, Adbul-Mahdi must alter a single-source economy, major public debt, weak monetary policy, a fragile banking system, and financial corruption. Though overcoming these obstacles is not impossible, the Prime Minister must act quickly and with the full support of both domestic and international forces if he is to change the course of Iraq's economic system.

Debt and Capital Flight

Perhaps the most immediate challenge is accurately predicting government revenues. With oil making up some 93 percent of total revenues in the federal budget, Iraq's economy has become especially unstable in the face of oil price volatility brought about by widespread challenges in the region. Moreover, according to the Parliament's Financial Committee estimates, oil revenues are consistently overestimated in draft budgets, as the government rarely receives the full amount of projected oil revenues. Moreover, the unofficial version of the 2019 General Budget estimated that non-oil revenue would cap out at $10 billion, down from $12 billion in 2018. The new prime minister must be especially cautious against overestimating revenue with figures unrepresentative of on-the-ground realities, as this would complicate all subsequent economic planning.

Understanding available revenue is especially vital due to Iraq's massive public debts. This is an issue with which Abdul-Mahdi is intimately familiar: in 2004, he headed the Iraqi delegation to the Paris Club in an attempt to renegotiate Iraq's debts, which then amounted to $39 billion. The negotiations were a success, and member states agreed to write off 80 percent of the country's debt, reducing the total figure to just $7.8 billion. Yet in subsequent years, Iraq's public debt crisis has returned and even worsened due to failed economic policies, declining oil prices, and the depletion of the country's revenues in the war against the Islamic State.

Today, Iraq's total public debt is estimated at $124 billion, three times as large as when Abdul-Mahdi arrived at the Paris Club **(https://www.addustour.com/articles/289266--العراق-يخفض-ديون-باريس-نادي-اتفاق-دولار-مليار-39-من-بدلا-الى-7-8-مليار)** almost fifteen years ago. According to the unofficial 2019 draft budget, Iraq will owe $3 billion in interest on loans alone, on top of $9 billion in payment installments this year. At a total of $12 billion, negotiations for debt servicing will present a difficult test for Abdul-Mahdi, especially given Iraq's limited cash reserves.

As of late 2014, estimates placed these reserves at around $80 billion. However, the collapse of oil prices and increase in state expenditures have drained these reserves to less than half their 2014 numbers. The government's indirect borrowing from the Central Bank—through its purchase of government securities in accordance with Article 26 of the Federal Central Bank Law—has only exacerbated the issue. The Central Bank announced last month that Iraq's foreign reserves are at $60 billion.

Economists also question the common practice of foreign currency auction by the Central Bank, through which it maintains a fixed exchange rate. This practice, however, is conducive to financial corruption and capital flight. Foreign currency flight is a particular challenge for Iraq: **figures (https://www.sarayanews.com/article/385859)** provided by the late Chairman of the Parliamentary Finance Committee Dr. Ahmed Chalabi show that $312 billion has left the country from 2005 to 2014. While the prime minister could limit the outward flow of capital by abandoning fixed exchange rate in favour of a free-floating regime, such a reform would prove difficult since it collides with the vested interests of powerful figures benefiting from the corruption currency auctions allow.

Liquidity Shortfalls

It is equally challenging to translate the reserves that stay inside Iraq into a capital market. The country's fragile and undeveloped banking sector—considered among the worst in the world—further restricts the wealth-inducing use of the currency actively in circulation. Most citizens do not trust banks, and consequently only a few thousand people per region have bank accounts. Limited reserves have rendered Iraqi banks unable to extend loans to investors who are in turn incapable of contributing to development projects. Even when loans are available, those taking out loans are often forced to pay a broker in order to actually retrieve the borrowed sums.

Neither has the Iraqi stock market been able to carry out its most basic functions of buying and selling bonds and shares. More broadly, most citizens only trustcash in their hands, reverting to electronic banking only rarely. Consequently, the Central Bank is pushed to continue printing paper money. The amount of Iraqi Dinars now totals IQD 60 trillion, with around IQD 39 trillion in circulation and IQD 21 trillion stored in the Central Bank's vaults. Even so, approximately half of the currency in circulation is practically reserve stocks, stored in households and safes. In effect, more than half of all cash at people's disposal is outside of economic activity.

This is clear result of a weak federal monetary policy, which has weakened the purchasing power of Iraqi currency. As a result, the Central Bank has committed itself to maintaining the currency's value by selling dollars in the market and depleting the Bank's foreign currency reserves, all in order to uphold monetary stability. Some traders try to protect themselves from exchange rate losses by dealing in foreign currencies rather than the local currency to buy and sell certain commodities. Therefore, weak monetary policy and the lack of monetary stability are key factors rocking the Iraqi economy. In order to reverse the current domestic purchasing power, the new Prime Minister must first create a sense of trust in the banking system. Federally mandated reforms structured to stimulate investment and achieve economic growth will go far towards helping in this respect.

A Menu of Options

As is evidenced above, Abdul-Mahdi faces a difficult test if he is to effectively implement economic reform inside Iraq. Nonetheless, the Prime Minister has a number of options available to begin situating Iraq on a path towards economic stability. Here, decisiveness is key: Abdul-Mahdi must quickly implement radical reforms of fiscal, monetary and credit policy, and he must ensure the participation and support of the parliament as well. These internal changes must be coupled with an advocacy of social reform, as trust in a system where Iraqis do not face discrimination because of their religion, denomination, nationality, ethnicity, or gender will also encourage them to engage in Iraq's economic future.

Any reform, no matter how expansive, must also grapple with the realities of Iraq's system of financial corruption. Iraq ranks a dismal 169th out of 180 countries on the 2017 **Corruption Perceptions Index (https://www.alhurra.com/a/451969/الفساد-في-العراق-حقائق-وأرقام.html)** . Experts have pointed to a number of governmental contracts for oil export and infrastructure projects where billions of dollars have been wasted. Rahim al-Darraji, a member of the Parliament's Integrity Committee, has confirmed that some $228 billion has been wasted on infrastructure contracts, most of which exist only on paper. The enormous scale of administrative corruption in Iraq has led to a lack of public services, deterioration of infrastructure and industrial and agriculture development. Corruption has understandably eroded trust among Iraq's public, and it is likely that any true reforms must dismantle this system in order to be effective.

In order to move forward on these monumental challenges, Abdul-Mahdi should work with international expectations and recommendations. Iraq should implement strict laws on money laundering and work towards compliance with international standards and commitments. The government should also work with both the International Monetary Fund and the World bank, as they have stood with Iraq through adversity and played a role in writing off the Paris Club debts and others in 2004.

Finally, the new Iraqi government must abide by international transparency standards and allow international regulatory organizations, civil society organizations, and the media to participate in fighting corruption. Hopefully, these measures can create a sense of trust and confidence between the people and the government by involving non-governmental actors in the process of economic reform. In many ways, Abdul-Mahdi is responsible for ensuring that political actors take responsibility for that which they have always been historically responsible—the economic future of the country. While this is a tall order for Abdul-Mahdi, he may also represent the last chance for reform in Iraq and the overall preservation of the country. ❖

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