

PROGRAM INFORMATION DOCUMENT (PID)**CONCEPT STAGE**

July 22, 2015

Report No.: AB7758

Operation Name	First Fiscal Stabilization and Inclusive Growth Programmatic Development Policy Loan
Region	MIDDLE EAST AND NORTH AFRICA
Country	Iraq
Sector	General energy sector (20%); Banking (20%); Central government administration (40%); Public administration- Other social services (20%)
Operation ID	P155962
Lending Instrument	Development Policy Lending
Borrower(s)	Republic of Iraq
Implementing Agency	Ministry of Finance
Date PID Prepared	July 7, 2015
Estimated Date of Appraisal	August 27, 2015
Estimated Date of Board Approval	October 1, 2015

I. Key development issues and rationale for Bank involvement

The First Fiscal Stabilization and Inclusive Growth Programmatic DPL operation (DPL1 thereafter) supports Iraq's reform drive towards structural fiscal consolidation, strengthening the macroeconomic framework, and laying the foundation for sustainable and inclusive growth.

Two large shocks—the ISIS insurgency and the sharp drop in global oil prices—have exacerbated long-standing structural vulnerabilities and are threatening Iraq's development. Recent advances by the

Islamic State of Iraq and Syria (ISIS) group, have thrown parts of Iraq into violent chaos and instability. This situation is creating a large humanitarian and social crisis. It is also hurting the economy through a negative impact on consumer and investor confidence, the destruction of infrastructure and assets, the disruption of trade routes, and is creating large public spending pressures. The oil price shock is also hurting public finances, external balances, and medium-term growth prospects. The economic disruption has resulted in a marked contraction in GDP per capita, from about \$7,000 in 2013 to about \$5,000 in 2015.

Notwithstanding their negative impact, these shocks present an opportunity to address structural bottlenecks to growth and shared prosperity. The authorities have responded to the economic impact of the shocks by a combination of adjustment and financing on the fiscal side, and by maintaining their commitment to the exchange rate peg, which is supported by a sufficient level—if rapidly declining—foreign exchange reserves, on the balance of payments side. With the arrival of a more inclusive and reform-minded government in September 2014, the authorities have also seized the crisis to embark on a much needed structural reform agenda aimed at relieving macroeconomic pressures, structurally strengthening public finances and laying the foundations for sustainable and inclusive growth through reforms aimed at raising the efficiency of the economy while mitigating the distributional impact of reforms on the poor and vulnerable groups as well as on groups who feel that they are not receiving their fair share of support from the state.

While the oil price shock is exogenous, the breadth and intensity of the ISIS shock could change if the Government simultaneously addresses the current violence and focuses on delivering development results. While the ISIS insurgency became visible in Iraq in June 2014, its emergence has deeper roots. These are related to Iraq's fragmentation along ethnic, religious, and political lines, to the 2003 foreign military intervention and to the war in Syria since 2011. Coopting groups that perceive they are economically and socially marginalized is critical to a sustainable solution as these perceptions are at the core of grievances between different groups. Addressing these development aspects is critical to lessening violence risks and would help the state become more resilient to future shocks. The conflict mitigation aspect of the DPL has a strong bearing on the Twin Goals of eliminating extreme poverty and boosting shared prosperity

II. Proposed Objective(s)

The proposed operation is built around three pillars, which are also the operation's Program Development Objectives (PDOs): (1) Improve the efficiency of budgetary spending; (2) Improve energy efficiency; and (3) Reform state-owned enterprises. Each pillar of the proposed DPL supports long-run program objectives as follows:

1. *Improve the efficiency of budgetary spending.* The first pillar includes reforms aimed at improving the efficiency of the social targeting system, pension reform, the public investment management system, the wage bill, and public debt management.
2. *Improve energy efficiency.* Within the second pillar, reforms will focus on reducing gas flaring, expanding gas-to-power generation, and reducing electricity subsidies.
3. *Reform state-owned enterprises.* The third pillar addresses inefficiencies among SOEs (both financial and non-financial) in Iraq and the need to transition towards a market-based economy.

III. Preliminary Description

The DPL1 is the first of three lending operations in a series aimed at supporting Iraq's economic reform measures. The operation has twelve prior actions structured around three pillars. The overall objectives of the DPL operation are twofold: (1) structural fiscal consolidation through structural reforms intended to improve the macroeconomic framework; and (2) laying the foundations for sustainable and inclusive growth through structural reforms aimed at raising the efficiency of the economy and mitigating the distributional impact of economic shocks. These policy reforms, over a three year period, are projected to generate significant structural fiscal savings for public finances while also laying the foundation for sustainable and inclusive growth.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Overall the macro-level reforms proposed in the DPL are unlikely to adversely impact welfare. While it is difficult to assess the direct impact of some of the broader reforms on poverty and shared prosperity, insofar as the proposed reforms prove effective in improving the efficiency of public spending, reforming SOEs and improving energy efficiency, they will free up resources that could be potentially reoriented for welfare improving expenditure. In particular, an increase in the supply of electricity can lead to cost savings for households—preliminary analysis comparing 2014 and 2012 data suggests that when power supply through the public grid increased, household expenditures on energy declined, as a result of substitution away from more expensive fuel sources. Finally, a more efficient and well targeted system of social spending is expected to have positive impacts on the poor and vulnerable.

Environment Aspects

The reforms supported by the proposed DPL are not likely to have significant negative effects on the country's environment, forests or other natural resources. As per OP 8.60, the World Bank assessed whether specific country policies supported by the DPL series are likely to cause significant effects on the country's environment, forests, and other natural resources. The assessment concluded that the policies supported by the proposed DPL are not likely to have negative impacts on the country's natural assets.

V. Tentative financing

The proposed loan will be disbursed in a single tranche upon loan effectiveness.

Source:	(US\$ billion)
Borrower	0
International Bank for Reconstruction and Development	US\$[1] billion
Total	US\$[1] billion

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