PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: AB7797

Operation Name	Emergency Fiscal Stabilization, Energy Sustainability, and State-Owned Enterprise Transparency Development Policy Financing
Region	Middle East And North Africa
Country	Republic of 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 Financing
Borrower(s)	Republic of Iraq
Implementing Agency	Ministry of Finance
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I. Country and Sector Background

Iraq is a state in the midst of a confrontation with the Islamic State of Iraq and Syria (ISIS), which has plunged the non-oil economy into a deep recession. Compounding the country's economic fragility is the rapid fall of oil prices. At the same time, Iraq is slowly emerging from a protracted institutional transition and political instability that has weakened institutional capacity and the State's ability to deliver on the social contract with the Iraqi people. The Emergency Fiscal Stabilization, Energy Sustainability, and State-Owned Enterprise Transparency Development Policy Financing (DPF) seeks to safeguard Iraq's economic stability and basic service delivery and to mitigate the impact of these shocks facing the country while setting the ground for future reforms to improve expenditure management, energy sustainability and financial transparency in state-owned enterprises.

The ISIS insurgency has created a humanitarian crisis and put pressure on fiscal spending. Expanding from Syria, ISIS made rapid inroads into Iraq in June 2014. The group currently controls major cities such as Mosul, Iraq's second largest city, and Ramadi, the capital of the Anbar governorate, as well as key international trade routes (borders with Syria, Jordan, and Turkey), and it has intermitently held parts of the oil infrastructure such as the Baiji refinery, the country's largest. Critically, ISIS has not been able to directly and materially impact Iraq's oil production, as it is predominently located in the southern part of Iraq (around Basra), and, to a lesser extent, in the northern part. Over three million Iraqis have been internally displaced, and 245,000 Syrian refugees are now registered in Iraq; this humanitarian crisis is also bringing to the fore the shortcomings of past efforts aimed at improving service delivery. Progress in fighting ISIS has been expensive. Security-related budgetary expenditure (military and policy equipment and salaries) is projected to increase by over US$1.7 billion in 2016 (IMF Staff Monitored Program, 2015). Moreover, the conflict has been a key driver of the severe contraction of the non-oil economy, by 7 percent in 2014 and by an estimated 6.7 percent in 2015. ISIS-controlled areas have particularly suffered as productive assets and infrastructure have been detroyed, trade routes have been cut or severely curtailed, and investor and consumer confidence decreased.

The sharp drop in oil prices, which has dropped by over 50 percent since June 2014, has severely impacted Iraq's non-diversified and hydrocarbon-dependent economy. Iraq has the fifth largest proved crude oil reserves in the world with 141.4 billion barrels. With the rapid increase in production experienced in 2015, the country is now the world's third largest and OPEC's second largest oil exporter. With about 112 trillion cubic feet of proven reserves, Iraq's proven natural gas reserves are the 12th largest in the world. The hydrocarbon sector accounts for over 65 percent of GDP, more than 90 percent of central government revenue, and 98 percent of the country's exports. As a result, the fall in oil prices has resulted in a sharp and sudden deterioration of the country's public finances and external balance. Oil revenue in the government budget fell by an estimated 19.3 percent of 2015 GDP between 2014 and 2015 and export revenue fell by a similar 19.3 percent leading to a sharp deterioatation in the current account balance. The fall in oil prices from 2014 to 2015 would have resulted in a budgetary revenue loss of 24 percent of 2015 GDP (US$41 billion) were it not for the sizable increase in oil production and exports that the government managed to achieve. With the persistently low oil price, Iraq is expected to continue facing fiscal pressures in 2015-16.

II. Operation Objectives

The DPF is supporting the Government of Iraq's economic reforms. The program development objectives are in line with the Government's strategy that supports broader goals such as inclusive growth, efficient service delivery, and social protection measures. The proposed operation is structured around three pillars, which are also the program's development objectives, namely: improving: (1) expenditure management; (2) sustainability of energy supply; and (3) transparency of state-owned enterprises. The first pillar includes reforms aimed at improving public wage policy, public investment and debt management, and the pension system. Within the second pillar, reforms will focus on reducing gas flaring, expanding gas-to-power generation, and reducing electricity subsidies. The third pillar tackles the lack of transparency among financial and non-financial SOEs.

III. Rationale for Bank Involvement

The supported reforms contribute to the World Bank Group's strategic goals of ending extreme poverty and boosting shared prosperity in a sustainable manner and to the World Bank Group's MENA Strategy. Bank involvement aims to contribute to peace and stability in the MENA Region by addressing upfront the drivers of instability in an effort to mitigate against increased fragility and conflict. In Iraq, one of the main drivers of instability and conflict has been the weakened relationship between the Government and the people, disparities in access to services, and a perceived lack of representation and voice among various groups. The DPF program strengthens the relationship between the citizens and the state by first, helping to stabilize the macroeconomic situation without which, FDI and economic growth would decline further, and unemployment and poverty would increase. It also contributes to improving the efficient delivery of services to the people with particular emphasis on the strategic and socially sensitive electricity sector. The Government, motivated by the current fiscal crisis, has embarked on a program of reforms which, to succeed, will require strong buy-in of the population and substantial external financing and assistance.

IV. 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$ 1.2 billion
	Total	US$ 1.2 billion

V. Tranches *(if applicable)*

	(US$ billion)
Single Tranche	US$ 1.2 billion
Total	US$ 1.2 billion

VI. Institutional and Implementation Arrangements

The responsibility for implementing the program in the Government rests with the Ministry of Finance (MoF). The MoF is responsible for the implementation of the DPF-supported program as well as for coordinating the actions among the concerned institutions. Together with the MoF, line ministries and agencies engaged in DPF-supported reforms will collect the necessary data for the identified monitoring indicators. Given the multi-sector and multi-agency nature of the DPF reforms, the Prime Minister's Office has also committed to continuously monitor implementation of the reforms against agreed plans and timelines and will work closely with the World Bank DPF team and the Ministry of Finance.

VII. Risks

The overall risk rating of this operation is high. Major risks that could prevent the operation from achieving its development objectives include political and governance risks, macroeconomic risks, fragility, conflict and violence risks, fiduciary risks, and stakeholder risks. While candidly assessing those risks, the Bank is looking carefully at ways to mitigate them, through close reading of the country's political economy and the region's strategic dynamics. While risks to this DPF are high, they should be weighed against the counterfactual: the risks of inaction, and absence of support from the World Bank to the current reform momentum. Other development partners are sharing the risk with the Bank. The IMF moved quickly with the disbursement in July 2015 of a US$1.24 billion Rapid Financing Instrument and the Government of Japan is providing budget support through parallel financing. The IMF reached a staff-level agreement on a Staff-Monitored Program (SMP) in November 2015.

VIII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Overall, the macro-level reforms proposed in the DPF 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 the sustainability of energy supply, they will free up resources that could be potentially reoriented for welfare-improving expenditure. A gender-neutral expansion in social services and essential infrastructure, if forthcoming, will likely disproportionately benefit women and girls, and help address existing gender gaps in access to health and education infrastructure. Any expansion in the supply of electricity to households (consequent to the proposed reforms) can lead to cost savings for households. Preliminary analysis comparing 2012 and 2014 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.

Environment Aspects

As per OP 8.60, the World Bank assessed whether specific country policies supported by the DPF 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 DPF are not likely to have negative impacts on the country's natural assets. The reform programs supported under improving energy efficiency objective would help in the reduction of gas flaring, thereby reducing climate change effects, as there will be reduction of methane to the atmosphere resulting in less environmental degradation. Similarly, the strengthening gas-to-power strategy under this same objective would promote the use of natural gas in power generation instead of the more polluting fuel oil and diesel. This will significantly improve air quality by reducing energy-related emission that lead to air pollution, reducing the related impacts on human health.

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