



#TEAMEUROPE

Credibility, Priorities and Sustainability of Iraqi Budget 2023-2025

Analytic note (Final Version)

Strengthening Public Finance and Financial Markets (FFM) in Iraq

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Acronyms and Abbreviations

AE	Actual Estimate
BBL	Barrels
BE	Budget Estimate
BPD	Barrels per day
CBI	Central Bank of Iraq
CEDP	Cost-Effective Decarbonization Pathway
COFOG	Classification of Functions of Government
EST	Estimated
GDP	Gross Domestic Product
GHG	Green House Gas
GFSM	Government Finance Statistics Manual
GOI	Government of Iraq
IQD	Iraqi Dinar
KDP	Kurdistan Development Party
KRG	Kurdistan Region Government
KRI	Kurdistan Region of Iraq
MDA	Ministries, Departments, and Agencies
MoD	Ministry of Defence
MoF	Ministry of Finance
MoO	Ministry of Oil
MTEF	Medium-Term Expenditure Framework
NDC	Nationally Determined Contributions
NDP	National Development Plan
PRS	Poverty Reduction Strategy
PUK	Patriotic Union of Kurdistan
SDG	Sustainable Development Goals
TBI	Trade Bank of Iraq
T-bill	Treasury Bill

Executive Summary

The Government of Iraq has for the first time in history passed a 3-year budget for fiscal years 2023, 2024, and 2025. Law 6 of 2019 had a provision to this effect but wasn't utilized thus far. This is indeed a very big achievement for the government and the country which will no longer have to wait for the budget to be passed by the House of Representatives before incurring expenditure. This is a game-changer since Iraq has not only been slow at passing budgets, but three out of the past nine years saw no budget passed at all – in 2014, 2020, 2022.

However, the budget law does not make an estimation of resources for the 3-year period. Nor does it make a projection of the level and composition of public expenditure. The spending agencies do not have the assurance about the resources they are likely to receive over the medium term. Neither has their inputs sought in preparing medium-term budget for their ministries. Hence, this Budget remains primarily an annual budget of the fiscal year 2023, more than half of which has already passed.

The budget for 2023 stipulates an Expenditure of 199 trillion Iraqi Dinar (IQD) (\$153 Billion) and Revenues of 135 trillion IQD (\$104 Billion), with an overall projected deficit of 64 trillion IQD (\$49 Billion). While 87 percent of the total revenues are oil revenues, 13 percent are non-oil revenues including from tax, customs, and duties. Of the total expenditure, 75 percent is proposed to be on current expenditure and 25 percent on investment expenditure.

The Budget 2023 has made a specific allocation of 49.4 trillion IQD (\$ 38 billion) for investment programs. This is a major increase from the previous years' allocations for investment spending and shows the government has a high priority for the government investment program projects, licensing contracts, regional development projects, port projects. It has made a significant provision for the projects that are financed by foreign loans. The government has also made a significant allocation for the Iraq Fund for Development, Poverty Alleviation Strategy, and Poverty Projects. It is unclear what the basis of this allocation is. There is no evidence of the investment budget being linked to the national development priorities laid out in the National Development Plan.

Among the current expenditures, the public sector salaries comprise the most (39.5 percent), followed by social welfare (18.7 percent), grants, subsidies, and foreign assistance (16.2 percent), and goods and services (14.7 percent). Owing to the pressure from the employees and public at large, the government decided to add 607,650 new employees to be funded by the state budget. This is a significant 21.6 percent increase over 2022 level and leads to a total of 3,426,822 employees in the public sector. This has increased the public sector wage bill to 59 trillion IQD (\$45.4 billion), which is 29.6 percent of the total budget. This when combined with Pension, the total spending on salary and pension become 75 trillion IQD (\$57.7 billion) which is 37.6 percent of the total budget.

The Budget Law provides ministry-wise budget allocation, based on which, the GIZ staff has estimated the allocation by the classification of functions of government (COFOG). The highest allocation of 99 trillion IQD or 50 percent of the budget allocation is for Economic Affairs, followed by allocation of 30 trillion IQD or 15 percent on General Public Services, 19 trillion IQD or 10 percent on Public Safety and Order, 12 trillion IQD or 6 percent for Defense. The allocation on Human Capital – Education (15 trillion IQD), Health (10 trillion IQD), and Labor and Social Welfare (6 trillion IQD) are 8 percent, 5 percent, and 3 percent respectively of the total budget allocation.

The budget proposal includes a budget allocation to the Kurdistan Region of Iraq (KRI) of 16.2 trillion IQD (\$12.4 billion), representing 8.1% of total spending, while its contributions are 13.3 trillion IQD (\$10.2 billion) from oil export revenues. Tensions between KRI and the federal Government of Iraq had erupted over Articles 13 and 14 of the Federal Budget Law 13 of 2023 which detail the management of the Kurdistan Region's oil income, and potentially impacts sovereignty of KRI from their perspective. However, these tensions are now resolved, and the federal government and the Kurdistan region signed an agreement on July 27, 2023, regarding full compliance to implementing the provisions of the Federal General Budget Law, which was legislated by the Parliament and published in the Iraqi Gazette.

The 2023 budget is an expansionary budget. The estimated total expenditure of 199 trillion IQD (\$153 billion) is a 70 percent increase over the highest ever level of expenditure reached in 2022. However, the budget execution in the current fiscal year, until April 2023, has been only 30.9 trillion IQD (\$23.8 billion), which is only 15.5 percent of the total budget estimate (the execution of investment budget is only 7.3 percent in contrast). Also, the average budget execution during the past 8 years has been only 74 percent. This reflects the poor absorption capacity and a very low probability of achieving the 2023 budget estimate for expenditure.

The estimation of oil revenues, on the other hand, is realistic based on its production capacity, international price and the exchange rate assumed in the budget. It is based on oil exports of 3.5 million barrels per day, whereas Iraq's production capacity of crude oil is between 4.5 million to 5 million barrels per day. The oil price is set to \$70 per barrel, whereas the current price is \$75.42 per barrel, and the average price during past one year has been \$80.11 per barrel. The conversion rate of 1300 Iraqi Dinars (IQD) to \$1 is assumed, whereas the current exchange rate is 1\$ equals to 1309 IQD and the average rate over the past year has been 1\$ equals to 1458 IQD.

However, the estimation of non-oil revenues of 17.3 trillion IQD (\$13.3 billion) seems unrealistic as it sees a sudden jump of 106 percent from 8.4 trillion IQD in 2022 and is the highest ever in history. The estimated 277 percent increase in the customs tariffs and 45.9 percent in Direct Taxes look highly ambitious and unrealistic. There is no mention of a domestic resource mobilization strategy in Budget Law that explains how this increase would happen.

Based on the reality check on the achievement of non-oil revenues targets set in the budget and executing the expenditure budget, especially the investment budget, and based on Iraq's absorption capacity reflected in its budget execution in the past, the budget looks highly incredible.

Article 6 (iv) of the Federal Financial Management Law number 6 of 2019, sets out the upper limit of fiscal deficit at 3 percent of the GDP. The estimated budget deficit in Budget 2023 is 64.4 trillion IQD, which is 18.7 percent of the GDP (with the non-oil primary fiscal deficit being 78.3 percent of the non-oil GDP). These break the deficit ceiling set by law and are the highest ever fiscal deficits in history caused by an unprecedented expansionary budget. It will be very difficult to sustain them with the given level of resources. Considering the volatility of international oil prices, the risk to sustainability is even higher. Following the fiscal rule targeting a gradual reduction of the non-oil primary fiscal deficit and building a fiscal stabilization buffer would help to carefully balance the goals of improving resilience to oil price volatility and long-term sustainability.

Iraq's public debt had declined sharply from its 2020 peak, with the debt-to-GDP ratio more than halved between 2020-22. This drastic improvement was owed to a range of factors including sustained high oil prices and rising domestic inflation. Following a 25-percentage point drop in 2021, the government debt-to-GDP ratio declined further to 43 percent of GDP in 2022. However, an unprecedented budgetary deficit of 18.7 percent of the GDP in 2023 will

have a significant impact on the debt sustainability. In addition to a high public debt, guarantees and other contingent liabilities pose significant risks to debt sustainability. Service guarantees, mostly in the electricity sector, were estimated at over \$21 billion in 2017 (7.8 percent of the 2022 GDP) but were not included in public debt. The state budget of 2023 includes several guarantees including mostly on the electricity sector.

Iraq is among the countries most vulnerable to climate change shocks both in physical (temperature rise, water scarcity, extreme events) and financial terms. Iraq's dependence on oil revenues would leave it vulnerable to new economic risks amid the global transition towards a decarbonized world, wherein oil as a commodity loses its role in fueling the global economy. As part of the Paris Agreement, Iraq has made unconditional and conditional commitments to reduce greenhouse gas (GHG) emissions by 1-2 and 13 percent, respectively, relative to the business-as-usual baseline. The bulk (over 90 percent) of Iraq's current GHG emissions originate in the energy sector, and over a half of them represent fugitive emissions due to gas flaring.

Preliminary estimates of the cost of achieving Iraq's adaptation and mitigation goals point to significant investment needs. The World Bank's Country Climate Development Report (2022) estimates that \$223 billion in total investments will be needed by 2040 to address climate adaptation and mitigation challenges while closing the development gap. There is a budget allocation of only 1.16 trillion IQD or US\$ 0.89 Billion in the 2023 Budget which is insignificant to the needs of climate mitigation and adaptation, as per its commitment to the NDC in 2021.

The House of Representatives has made several changes to the Budget presented by the government in an unprecedented manner. Of major significance is the addition of 220,000 new job positions in the government sector and removing ceilings from several job categories which will lead to an increased burden on the exchequer. The second major change is the addition of new investment projects to the budget as per proposals of the Members of the House of Representatives. This alters investment priorities set by the government and adds to the financial burden on limited resources. The Prime Minister has moved a petition in the Federal Supreme Court to quash the changes made in the budget by the House of Representatives on grounds of their unconstitutionality and government's unaffordability. The matter is still pending a hearing in the Federal Supreme Court.

Analysis of Iraq Budget 2023-2025

I. Introduction of the 3-Year Budget – A major step forward

Law 6 of 2019, Article 4, enables the government to prepare a 3-year budget. The Iraq government has for the first time prepared a 3-year budget for years 2023, 2024 and 2025, which has been passed by the House of Representatives in the form of Law no. 13 of 2023. However, the published Law includes detailed budget provisions for only 2023, not for the outer years of 2024 and 2025.

As per Article 8 of the Law, while the funds appropriated in this Law shall be expended by December 31st of fiscal year 2023, and Revenues generated in fiscal year 2023 shall be recorded as revenue for the Federal Budget through Dec. 31st, 2023, the Revenues received after the end of fiscal year 2023 shall be recorded as revenues for the Federal Budget for fiscal year 2024, and this shall also apply to subsequent fiscal years. The difference with previous practice is that revenues received after the end of current fiscal year on December 31, 2023, will be deemed to be revenues of the next fiscal year 2024 without waiting for parliament's approval. Likewise, for the fiscal year 2025.

For the budget allocations for development, as per Article 63 of the Law, the Federal Ministers of Finance and of Regional Development will have the right to reallocate the remaining amounts of the respective allocations for investment projects for the development of regions, investment projects for border crossings, and special programs for border crossings that were not financed from the 2023 budget to the 2024 budget, and for the following budget years.

As per Article 65 of this Law, the provisions of this Law shall apply to the general budget for the fiscal years ending on Dec. 31st, 2023, Dec. 31st, 2024, and Dec. 31st, 2025, provided that the same amounts set forth in this Law shall be allocated for the second and third years and shall be amended for the Council of Ministers on the basis of a proposal by the Ministry of Planning and the Ministry of Finance with the approval of the House of Representatives for the second and third years.

These provisions of the Law will ensure that the country will have the budget for fiscal year 2024 and 2025 on January 1st of those years respectively regardless of whether the government could submit the budget proposals with amended allocations for those years and were approved by the House of Representatives. The detailed budget provisions approved by the House of Representatives for the fiscal year 2023 under Law 13 of 2023 shall apply until those provisions are amended/ approved by the House of Representatives for the fiscal years 2024 and 2025.

This is indeed a very big achievement for the government and the country will no longer have to wait for the budget to be passed before undertaking any development/ welfare expenditure. This is a game-changer since Iraq has not only been slow at passing budgets, but three out of the past nine years also saw no budget passed at all – in 2014, 2020, 2022. The government had to continue spending without the budget authorized by the House of Representatives. Not anymore.

However, is the 3-year budget a Medium-Term Expenditure Framework (MTEF)? Well, the 3-year budget approved by Law 13 of 2023 does not make an estimation of resources for the 3-year period. Nor does it make a projection of the level and composition of public expenditure

in outer years 2024 and 2025. The spending agencies do not have the assurance about the resources they are likely to receive over the medium term. There are no top-down budget ceilings provided by the Ministry of Finance to Ministries, Departments and Agencies (MDAs) for the 3-year period. Neither were MDAs asked to prepare or have prepared their budget estimates for a 3-year period. This makes it difficult for them in not only planning multiyear expenditures, but also giving them the confidence to change policy direction.

Hence, this Budget remains primarily an annual budget of fiscal year 2023, more than half of which has already passed. The 3-year budget cannot, therefore, be called a Medium-Term Expenditure Framework (MTEF). In that sense, it is a missed opportunity. It is advisable that the government prepares a MTEF from 2024-2026 onwards.

Box 1: Essential Features of a Medium-Term Expenditure Framework (MTEF)

Essential Features of MTEF

A MTEF can generate good fiscal performance through its impact on the quality of budgeting and budget credibility and by helping reduce shortcomings of annual budgeting by adopting following features.

- ***Budget realism.*** The revenue that the government can reasonably expect to collect and the new borrowing that it can safely undertake should place an upper limit on spending. This would contrast with the past when the government formulated ambitious annual spending plans based on unreasonable expectations about potential revenue and borrowing capacity.
- ***Spending driven by medium-term sector strategies.*** Rather than preparing an annual budget by making incremental changes to current programs, determining priorities based on the latest political imperative, and resource allocation based on an assessment of priorities within and between sectors as per agreed objectives and policies.
- ***Spending agencies with a voice.*** Instead of focusing primarily on compliance with expenditure controls, ministries, departments, and other spending agencies should have significant input into the design of sector strategies and some flexibility in managing their resources to pursue sector objectives and implement sector policies efficiently.
- ***Budgets containing multiyear spending allocations.*** To the extent possible, spending agencies should have a predictable resource envelope to ensure effective decision making, which is currently lacking as the budgeting involves annual negotiations over incremental resources.
- ***Budget funding linked more closely to results.*** A shift in focus from control of inputs to flexibility in the mix of inputs to produce specific outputs and outcomes would be possible that will allow greater emphasis on allocating resources according to the results achieved by spending programs and provides more discretion over the choice of inputs used to achieve results.
- ***Greater fiscal transparency and accountability.*** The MTEF can provide a clearcut mechanism for monitoring government performance against approved plans, which would make it easier for the House of Representatives and citizens to hold the government accountable for their choice of fiscal policies.

II. Budget for 2023

The budget for 2023 stipulates a total of 199 trillion IQD (\$153 Billion) in expenditures, of which:

- 150 trillion IQD (\$115 Billion) are current expenditures (operational, special programmes, debt)
- 49 trillion (\$38 Billion) are capital expenditures (capital investments and investment loans).

Revenues are estimated to be 135 trillion IQD (\$104 Billion)

- roughly 87% of which will be generated by the oil sector on an Oil price assumption of \$70 at a conversion rate of 1300 IQD to \$1.
- Roughly 13 % of which are generated through the non-oil revenue.

Accordingly, the overall projected deficit is 64 trillion IQD (\$49 Billion). Following herewith is a broad summary of the Budget 2023.

Table 1: Summary of Iraqi Budget 2023

SUMMARY OF IRAQI BUDGET 2023								
			US\$Billion	IQD billion		IQD billion	US\$Billion	
Total Expenditures			153.09	199,022	Total Revenues		134,553	103.5
	% Total							-
Current Expenditures (IQD bn)	75%		115.05	149,559	Oil Revenues (IQD bn)	87%	117,253	90.2
Debt Repayment			9.81	12,751	Oil Export Revenues		116,253	89.4
Operating Expenditure			102.48	133,221				-
<i>Public Sector Salaries</i>			45.40	59,014	Oil Exports bpd	3,500,000		-
<i>Social Welfare (Pensions, Social Security, etc)</i>			21.49	27,941	Federal	3,100,000	102,967	79.2
<i>Goods & Services (inc. maintenance)</i>			16.90	21,967	KRI	400	13,286	10.2
<i>Grants, subsidies, interest payments, foreign aid, ...etc</i>			18.69	24,299	Iraq Oil Price \$/bbl	70		-
Programs (Special & Government)			2.76	3,587	1\$/IQD	1300		-
					Other Oil Revenues		1,000	0.8
					Non-Oil Revenues (IQD bn)	13%	17,300	13.3
Investment Spending (IQD bn)		25%	38.05	49,463	New taxes		2,995	2.3
Non-Oil Investment Spending		17%	25.72	33,437	Other taxes, custom tariffs, and other non-oil revenues inc 50% of KRI custom tariffs		14,305	11.0
<i>Programs (Special & Government)</i>	3,669							
<i>Investment Spending</i>	29,768				Deficit (IQD bn)		-64,469	-49.6
Oil Investment Spending inc KRI		8%	12.33	16,026	Financing		64,469	49.6
<i>Federal IOCs</i>	12,552				MoF A/C balance end of 2022		23,000	17.7
<i>KRI IOCs</i>	2,448				Ongoing foreign, & Tel. lending of projects		9,965	7.7
<i>Ministry of Oil</i>	1,025				T-Bill discounting by the CBI		23,504	18.1
					Borrowing from Rafidain/Rasheed/TBI		3,000	2.3
					Domestic Bonds		5,000	3.8

Source: Federal Budget Law 13 of 2023

III. Priorities under Budget 2023

1. Allocation for Category of Expenditure

The budget gives a high priority to investment spending with 25 percent of the total allocation assigned to that. This is one of the highest proportionate allocations for investment spending in economic history of Iraq.

Table 2: Allocation by Current and Investment Spending

Category of Expenditure	BE 2023 Billion IQD	BE 2023 Billion USD	Percent
Current Expenditure	149,559	115	75
Investment Expenditure	49,463	38	25
Total Expenditure	199,022	153	100

Source: Federal Budget Law 13 of 2023

2. Allocation by Investment Programs

The Budget 2023 has made a specific allocation of 49.4 trillion IQD (\$ 38 billion) for different investment programs.

Table 3: Allocation by Investment Programs in Budget 2023

Investment Programs	Budget 2023 Trillion IQD	Budget 2023 in Billion USD
Government Investment Program Projects	3.663	2.82
Financing projects through foreign loans	9.964	7.66
Port projects including Faw Port	1.601	1.23
Iraqi Fund for Development	1.0	0.77
Poverty Alleviation Strategy	0.5	0.38
Petro Dollar Projects	2.0	1.54
Poverty projects	0.1	0.08
Regional Development Projects	2.5	1.92

Investment Programs	Budget 2023 Trillion IQD	Budget 2023 in Billion USD
Licensing contracts, including the region	15.0	11.54
Local projects for oil companies	1.425	1.10
Projects of the rest of the ministries, including the region, except for loans and development of regions	7.648	5.88
Total Investment	45.401	34.92

Source: Federal Budget Law 13 of 2023

The budget 2023 clearly shows the government has a high priority for the government investment program projects (\$2.82 billion), licensing contracts including the region (\$11.5 billion), regional development projects (\$1.9 billion), port projects including the Faw port (\$1.2 billion), and projects for the rest of the ministries (\$5.8 billion). It has made a significant provision for the projects that are financed by foreign loans (\$7.7 billion).

The government has also made a significant allocation (\$1.23 billion) for projects contributing to poverty reduction by financing the Iraq Fund for Development (\$0.77 billion), Poverty Alleviation Strategy (\$0.38 billion), and Poverty Projects (\$0.08 billion).

It is unclear what the basis of this allocation is. Is it the National Development Plan laying priorities for different sectors and projects, or they are ad-hoc decisions by the Ministry of Finance. There is no evidence of the budget linked to the national development priorities laid out in the plan. Also unclear is whether the intra-sectoral allocations are guided by the sector strategies if they exist for specific ministries. While the NDP 2018-2022 has lapsed and the new NDP 2023-2027 is under preparation, the strategic goals of the NDP are not likely to change significantly and should have been factored in while setting inter-sector priorities.

Box 2: Strategic Goals of the National Development Plan 2018-2022

Strategic Goals of the National Development Plan 2018-2022

1. Lay the foundations for good governance.
2. Achieve economic reform in all its financial, monetary, banking, and commercial dimensions.
3. Accomplish recovery of the communities affected by displacement and insecurity.
4. Provide the conditions for an enabling environment for all forms of investment and strengthen the role of the private sector.
5. Increase the rate of economic growth in line with the potential and requirements of the Iraqi economy.
6. Increase the real per capita income.
7. Reduce unemployment and underemployment rates.
8. Make possible security for the poorest and most vulnerable groups.
9. Boost sustainable human development indicators.
10. Lay the foundation for decentralisation to strengthen spatial development.
11. Align the general development framework with urban structures based on the foundations of urban planning and spatial comparative advantages.

Source: National Development Plan 2018-2022, Ministry of Planning

The NDP for 2018–2022 had set out sectoral priorities for development and the achievement of the SDGs over the five-year plan period, with a focus on reconstruction and recovery following years of conflict. The NDP is complemented by the Poverty Reduction Strategy (PRS) for 2018–2022, which identifies six key outcomes for the Government and its partners: higher and sustainable incomes; improved health; improved education; suitable housing; social protection; and emergency response. The Government has also engaged in developing a “Vision 2030” that is aligned with the 2030 Agenda for Sustainable Development and the SDGs and identifies and addresses medium- and long-term strategic development priorities.

Mr. Mohammad al-Hakim, Advisor to Iraqi Prime Minister, in his public address on the Budget 2023 on June 29, 2023, informed that the House of Representatives have added several investment projects in the project to serve their own constituencies. This is against the parliamentary norms and unprecedented.

3. Allocation of Current Expenditure

Public sector salaries comprise the most of current expenditure (39.5 percent), followed by social welfare (18.7 percent), grants, subsidies, and foreign assistance (16.2 percent), and goods and services (14.7 percent).

Table 4: Allocation of Current Expenditure by Category

Current Expenditure	BE 2023 IQD Billion	BE 2023 USD Billion	Percent
Debt Repayment (Interest)	12,751	9.81	8.5
Public Sector Salaries	59,014	45.40	39.5
Social Welfare	27,941	21.49	18.7
Goods & Services	21,967	16.90	14.7
Grants, subsidies, foreign assistance	24,299	18.69	16.2
Programs (Special & Government)	3,587	2.76	2.4
Total	149,559	115.0	100.0

Source: Federal Budget Law 2023

Public Wage Bill expansion

Since the public sector wage bill constitutes most of the Current Budget, let us examine it in some detail. Owing to the pressure from the employees and public at large, the government decided to add 607,650 new employees to be funded by the state budget. This is a significant 21.6 percent increase over 2022 and leads to a total of 3,426,822 employees. This has increased the public sector wage bill to 59 trillion IQD (\$45.4 billion), which is 29.6 percent of the total budget. This when combined with Pension, the total spending on salary and pension adds to 75 trillion IQD (\$57.7 billion) which is 37.6 percent of the total budget.

Table 5: Public Wage Bill Expansion

Public Sector Employees Ex-KRI				
Public sector employees	2023	2022	Change	Percent Change
Total Number of Employees	3,426,822	2,819,172	607,650	21.6%
Salaries (IQD bn)	59,014	43,214	15,800	36.6%
Pensions (IQD bn)	16,110	13,208	2,902	22.0%
Salaries & Pensions (IQD bn)	75,124	56,422	18,702	33.1%

Source: Federal Budget Law 2023, Ministry of Finance

It may be noted that the additional 607,650 public sector jobs include 394,656 contract positions converted to permanent employment which accounts for 65 percent of additional positions. These job conversions nevertheless significantly increase the public sector wage bill especially with regards to future liabilities.

It may also be noted that there is no change in Public Sector jobs in KRI and the total number of public sector employees remain at 681,979.

There is no indication that the budget includes a new salary scale for government employees as is being continually demanded by them. This may trigger a continuation of demonstrations demanding a separate legislation to improve the salaries of the lowest paid government workers.

Mr. Mohammad al-Hakim, Advisor to Iraqi Prime Minister, in a public statement issued on 29th June 2023 said that the government has added 729,000 employees in the budget. This is greater than 607,650 included in the budget.

He further added that the House of Representatives during the discussion on the budget have decided to add 220,000 more jobs in the public sector without the concurrence of the government. This would increase the additional jobs in the budget to 949,000 and the total public sector employees to 3,768,172 in the federal government of Iraq. If employees in KRI are added, the total number of employees would be 4,450,151. This is a significantly high and unsustainable expansion of the public sector wage bill.

Mr. al-Hakim also informed that several ceilings on jobs have been removed by the House of Representatives, which has the potential to make the wage bill completely unsustainable.

The Government of Iraq has submitted a petition before the Federal Supreme Court to appeal against the decision of the House of Representatives to include additional job positions in the budget.

Social Welfare

There is an allocation of 27.9 trillion IQD (\$21.5 billion) in Budget 2023. This is significantly higher from previous years. The expenditure on social welfare includes pensions, social security, etc., but it is not clear from the budget what the breakup of the social welfare expenditure is.

Since Iraq does not follow the functional budget classifications and does not have a programmatic budget, it is difficult to decipher the allocations by programs. The government has also not provided the ministry wise allocations to either the public or development partners; hence, there is a limitation to do a more detailed analysis.

4. Allocation by Classification of the Functions of Government

The ministry-wise allocation of the Budget 2023 is presented in **Annex 1**. The ministry-wise allocations are reflected in its functional classification wise budget allocation as below.

Table 6: Sector-wise allocation in Budget 2023

(Amount in Billion IQD)

Classification OF Function of Government	Operating Cost (1)	Debt (2)	Total Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)	Percent Allocation
General Public Services	18,359	400	2,060	9,298	30,117	15%
Defense	9,853	-	33	2,160	12,046	6%
Public Order and Safety	18,098	-	27	1,239	19,364	10%
Economic Affairs	55,594	12,351	40	31,042	99,026	50%
Environment Protection	504	-	134	517	1,155	1%
Housing and Community amenities	576	-	600	3,784	4,960	2%
Health	7,986	-	1,110	807	9,903	5%
Recreation, Culture and Religion	1,792	-	12	531	2,335	1%
Education	14,565	-	39	509	15,114	8%
Labor and Social Affairs	6,003	-	8	10	6,021	3%
Total	133,329	12,751	4,064	49,897	200,041	100%

Source: GIZ Staff estimates based on the Federal Budget Law 2023

The Budget Law provides ministry-wise budget allocation, based on which allocations have been converted to above classification of functions of the government (COFOG) as per

Government Finance Statistics Manual (GFSM) 2001¹. The detailed COFOG as per GFSM 2001 is presented in **Annex 2**.

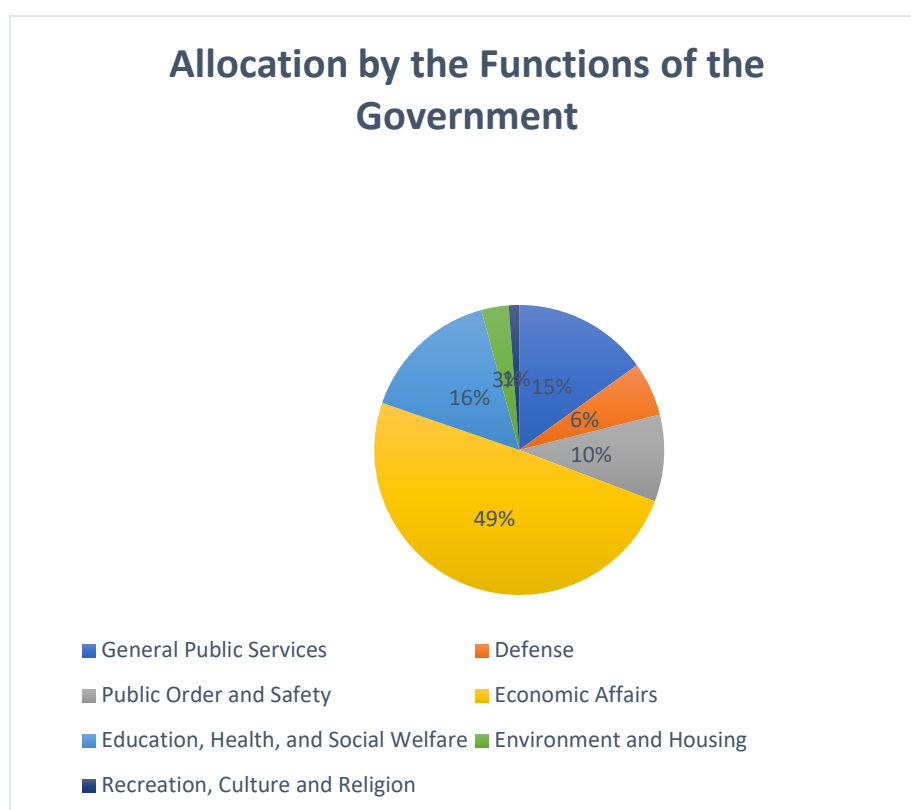
It is evident that the highest allocation of 99 trillion IQD or 50 percent of the budget allocation is for Economic Affairs, which includes 23 trillion allocations on Oil, 15 trillion IQD allocation for Ministry of Electricity, 39 trillion on Ministry of Finance that includes 26 trillion IQD of Operating Expenses and 12 trillion of Public Debt, and 7 trillion IQD on Trade.

This is followed by allocation of 30 trillion IQD on General Public Services, or 15 percent of the overall budget allocation, of which 18 trillion IQD is on Operating Cost and 9 trillion on Capital Expenditure.

This is followed by allocation of 19 trillion IQD on Public Safety and Order, or 10 percent of the total budget allocation, of which, 18 trillion IQD is on Operating Expenditure. This is followed by allocation of 12 trillion IQD for Defense, or 6 percent of the total budget allocation, of which, allocation on operating cost is 10 trillion IQD and 2 trillion for capital expenditure.

The allocation on Human Capital – Education (15 trillion IQD), Health (10 trillion IQD), and Labor and Social Welfare (6 trillion IQD) are 8 percent, 5 percent, and 3 percent respectively of the total budget allocation.

Figure 1: Allocation by Classification of Functions of Government



Source: GIZ Staff Estimates based on the Federal Budget Law 2023

¹GFSM 2001 incorporates the Classification of the Functions of Government (COFOG) of the OECD and the UN.

Based on the further analysis of allocation by the classification of functions of the government, 62 percent of the capital budget allocation is for Economic Affairs and 19 percent for the General Public Services. Among the Special Programs, 51 percent allocation is for General Public Services, 27 percent for Health, and 15 percent for Housing and Community Amenities. Among the Operating Expenditure, 42 percent is for Economic Affairs, 14 percent for Public Order and Safety, 14 percent for the General Public Services, and 11 percent for Education.

One of the main agendas of the budget is the Principle of Cooperation in the Field of Energy in Iraq, which includes:

1. Principles of Cooperation with Siemens Energy AG (Phase One) to finance electricity projects with a total amount of 1,860 million euros (one billion eight hundred and sixty million euros), provided that the amount of \$202 million should be financed in 2023 in favor of the Ministry of Electricity.
2. Principles of Cooperation with General Electric International Inc. to finance projects of the Ministry of Electricity with a total amount of \$3,453 million (three billion four hundred and fifty-three million dollars), provided that an amount of 460 million dollars should be financed in 2023 in favor of the Ministry of Electricity.

The Budget 2023 has following provisions regarding the foreign loans for the energy sector.

Table 7: Foreign Loans for Energy Sector

Item	Budget allocation in Billion IQD
Borrowing from banks with the guarantee of international export institutions to finance projects of the Ministry of Electricity, General Electric International Inc. (Principles of Cooperation on Energy)	598.0
Borrowing from banks with the guarantee of the German Export Corporation and other international organizations to finance electricity projects, Siemens Energy AG (Principles of Cooperation on Energy)	262.6
Total	860.6

Source: Federal Budget Law 2023

The loss-making electricity sector burdens public finances while hampering private sector development. Caught in a cycle of inefficiency, loss-making and underinvestment, the electricity sector recovers only about a tenth of its cost and incurs annual losses in excess of 3 percent of GDP (over 6 percent of GDP if the implicit fuel subsidy is factored in). The lack of reliable access to electricity is a major constraint to private sector development and a source of social discontent. As the demand for electricity is projected to grow with the increasing population and rising temperatures, a continuation of past trends and policies is becoming increasingly unsustainable. An ambitious sectoral reform strategy should seek to ensure sustainability.

5. Allocation to Kurdistan Region of Iraq (KRI)

The budget proposal includes a budget allocation of 16.2 trillion IQD to the KRI, representing 12.7% of total spending excluding sovereign expenses, or an effective 8.1% of total spending. While its contributions are 13.3 trillion IQD in oil export revenues based on exports of 400,000 bpd at an average price of \$70/bbl, and 50% of custom tariffs, amounting to 11.2% of total revenues.

However, the KRI's effective share is larger by 2.7 trillion IQD, or 16.5%, as the federal Ministry of Oil (MoO) would assume some of the payments for the International Oil Companies operating in the KRI, while the federal Ministry of Defence (MoD) would assume some of the Peshmerga's salaries.

Table 8: Kurdistan Region of Iraq (KRI) Share and Contribution to Federal Budget

Kurdistan Region of Iraq (KRI) Share & Contribution to Federal Budget Proposal (IQD bn)					
KRI Share of Federal Budget			KRI Contribution to Federal Budget		
	% of Total			% Total	
KRI Share of Federal Budget	10.1%	20,143	KRI Contribution to Federal Budget	11.6%	15,651
Direct		16,210	Oil Export Revenues : 400k bpd @ \$70/bbl		13,286
Budget Allocation	16,210		Non-oil Revenues- 50% KRI Custom Tariffs (est)		1,804
Indirect		3,933	Non-oil Revenues- Others (est)		561
MoO KRI IOC Payments	2,448		Balance: Contribution less effective share		-4,492
MoD Peshmerga Salaries	228		Balance: Contribution less direct share		-559
Social Welfare Allocations	1,117*				
Others	140				
KRI Revenues: Budget Allocations (Direct & Indirect) + KRI Direct Revenues					
KRI Total Revenues		21,947			
KRI Share of Federal Budget (Direct + Indirect)		20,143			
Non-oil Revenues- 50% KRI Custom Tariffs (est)		1,804			

Source: Estimate based on 2023 Budget Law

Tensions between KRG and the federal Government of Iraq has erupted over Articles 13 and 14 of the Federal Budget Law 13 of 2023 which detail the management of the Kurdistan Region's oil income. The Kurdistan Development Party (KDP) took issue with three aspects of the proposed Budget Law:

- In a departure from the initial draft, the new budget law stipulates that the 400,000-bpd oil produced in the KRI would be marketed through the government owned SOMO company. Revenues would be deposited to a bank account managed by the KRG Prime Minister, subject to audit and supervision by the Gol. This is economically sensible as the oil can be marketed at a higher price (KRI oil had to be sold at a discount in the past due to legal uncertainties in dealing with the KRI). However, it effectively makes the revenues "run through" central Iraq, reducing the KRI's semi-autonomous status.
- The article notes, that in case of a dispute in this context between the Kurdistan Region and the Iraqi government, a joint committee would meet to negotiate a solution. Shiite parliamentarians have reduced the time to reach a solution before budget cuts can be implemented against the KRI from 30 to 15 days.
- The article further notes, that the Kurdistan Regional Government (KRG) is obliged to give priority to the payment of salaries of the KRG employees and pensioners, and to pay investment entitlements to the governors of the Kurdistan Region as stipulated in the budget. If this does not occur, the Prime Minister may take specific measures to send the financial entitlements directly to the provinces. This was initially proposed by Patriotic Union of Kurdistan (PUK) as wages in Kurdish governorates had been withheld in the past when KDP delayed the salaries for employees in the governorates of Sulaymaniyah and Halabja. KDP considers this a significant interference into KRG affairs, undermining KRIs autonomy.

However, these tensions are now resolved, and the federal government and the Kurdistan region signed an agreement on July 27, 2023, regarding full compliance to implementing the provisions of the Federal General Budget Law, which was legislated by the Parliament and published in the Iraqi Gazette.

IV. Budget Credibility

1. Realism of Revenues

a) Oil Revenues

Oil Revenues are estimated to be 117.2 trillion Iraqi Dinars (\$90.1 billion) which are 87 percent of the total revenues.

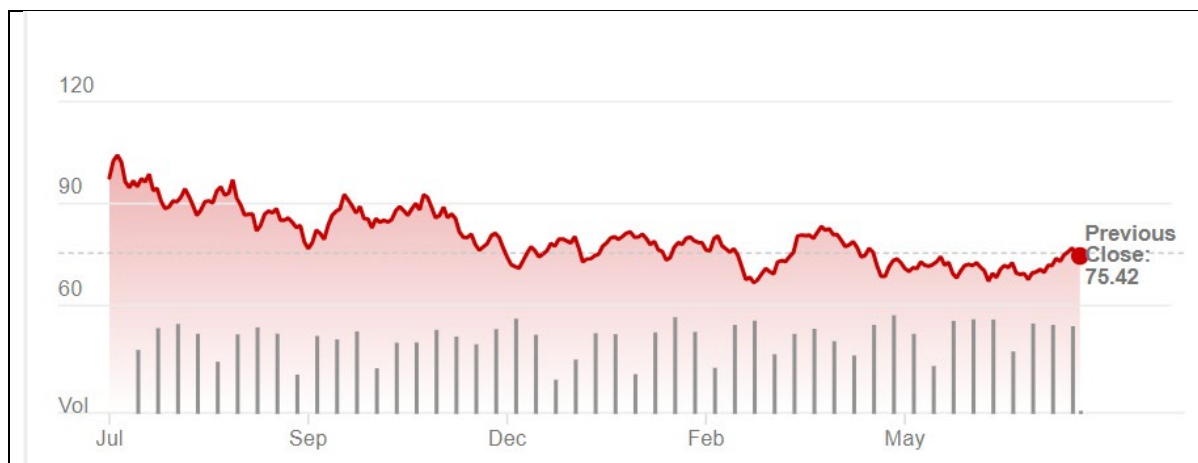
The estimation of oil revenues is based on oil exports of 3.5 million barrels per day, including 400,000 barrels per day from KRG. Iraq's production capacity of crude oil is between 4.5 million to 5 million barrels per day.

The price is set to \$70 per barrel, whereas the current price is \$75.42 per barrel, and the average price during past one year has been \$80.11 per barrel, with a high of \$104.22 on July 19, 2022, and low of \$66.74 on March 17, 2023.

The conversion rate of 1300 Iraqi Dinars (IQD) to \$1 is assumed, whereas the current exchange rate is 1\$ equals to 1309 IQD and the average rate over the past year has been 1\$ equals to 1458 IQD.

Hence, the estimation of Oil Revenues in the budget is realistic based on its production capacity, price and the exchange rate assumed in the budget.

Figure 2: International Price of Crude Oil over past one year \$/bbl



Source: US Oil UTI

b) Non-Oil Revenues

Non-Oil Revenues are estimated to be 17.3 trillion IQD (\$13.3 billion), which is 13 percent of the total revenues and are expected to increase by 53.7% from 2022.

Table 9: Non-Oil Revenues in Federal Iraq

(Amount in IQD Billion)

Non-Oil Revenues	BE 2023	AE 2022	Percent Change
Direct Taxes (inc. Income, company)	2,950	2,022	45.90%
Private Sector Custom Tariffs	2,542	674	277.15%
Indirect Taxes (inc. taxes on mobile, internet, cigarettes, alcohol, ...)	164	464	-64.66%
Profit & Investment Income	75	241	-68.88%
Service Fees	27	268	-89.93%
Others	5,110	3,401	50.25%
Total	10,868	7,070	53.72%

Source: Federal Budget Law 13 of 2023

There is an expected increase in the collection of Direct Taxes and the Private sector Customs Tariffs, but a reduction of Indirect Taxes.

The estimated 277 percent increase in the customs tariffs looks ambitious and unrealistic. There is no mention of a strategy in the Budget Law that explains how this increase would happen. Likewise, an increase of 45.9 percent in Direct Taxes looks optimistic, but without understanding the steps the government would take to enhance this, it is difficult to conclude if it is realistic.

Neither income nor sales tax reform are mentioned in the Budget Law. Further, the proposal for taxing sales of gasoline (5%), gas (10%), and crude oil (1%) have been rejected by the House of Representatives in response to public concerns of rising prices of oil products and economic challenges of Iraqi refineries.

In the budget law, the government appears to commit to raising fees and tariffs on basic services and infrastructure which could add significantly to Iraq's budget and help create incentive structures for private investment into infrastructure. These plans, however, have been seen in the past and always failed.

Table 10: Trends in Revenues

	<i>(Amount in Trillion IQD)</i>				
	2019	2020	2021	Est. 2022	BE 2023
Oil Revenue	92.5	57.1	96.7	154.0	117.2
Non-Oil Revenue	6.8	6.0	13.1	8.4	17.3
Total Revenue	99.3	63.2	109.9	162.4	134.5

Source: (i) IMF estimates for Actual Estimates of 2019 to 2022. (ii) Federal Budget Law 13 of 2023 for BE 2023

The 2023 budget estimate of 117.2 trillion IQD for oil revenues seems achievable considering past trends. Iraq could collect 154 trillion IQD in 2022 and it within its reach due to its production capacity and realistic estimated price and exchange rate.

However, the 2023 budget estimate of 17.3 trillion IQD for the non-oil revenues sees a sudden jump of 106 percent from 8.4 trillion IQD in 2022 and is the highest in the past 5 years. It seems unrealistic to achieve this in absence of a clear-cut strategy for domestic resource mobilization.

2. Realism of Expenditure

a) Expansionary Budget

The Budget of 2023 has estimated a total expenditure of 198.9 trillion IQD, which is the highest ever in history. The highest level of expenditure until now had been in 2022, when it had reached 116.9 trillion IQD. The Budget Estimate for 2023 is 70 percent increase over the highest expenditure level. It is thus an unprecedented expansionary budget.

Table 11: Trends in Public Expenditure in Past 5 years

	<i>(Amount in Trillion IQD)</i>				
	2019	2020	2021	AE 2022	BE 2023
Current	77.7	75.7	90.3	104.9	149.6
Investment	19.2	15.4	20.7	12.0	49.4
Total Expenditure	96.9	91.1	111.0	116.9	198.9

Source: (i) IMF estimates for 2019, 2020, 2021. (ii) Ministry of Finance for AE 2022 and BE 2023.

The Budget Estimate for 2023 is 312 percent higher than the 2022 Actual Estimate for the Investment Budget, 43 percent higher for the Current Budget, and 70 percent higher for the Total Budget. It seems highly optimistic and unrealistic to achieve this level of expenditure.

b) Budget Execution

The average budget execution in the past 8 years has been 74.3 percent. Going by the past trends in budget execution, one can understand the absorption capacity of the government machinery.

Table 12: Budget Execution During Past 8 Years

<i>(Amount in Trillion IQD)</i>			
Year	Budget Estimate	Actual Estimate	Execution Percent
2015	119.46	70.4	58.93
2016	105.9	67	63.27
2017	96.63	74.83	77.44
2018	102.77	81.74	79.54
2019	127.59	111.72	87.56
2020*	0	76.08	
2021	129.99	102.85	79.12
2022*	0	116.9	
Average Execution Percent			74.31

Source: Open Budget Survey published by Ministry of Finance

*Note: there was no budget in 2020 and 2022

If this level of budget execution efficiency is maintained in 2023, the total execution at the end of fiscal year 2023 would be 147.7 trillion IQD. That would be still expected to be 26 percent higher than the 2022 actual expenditure, which will require special efforts.

However, the budget execution until April 2023 has been only 30.9 trillion IQD, which is only 15.5 percent of the total budget estimate, and reflects the poor absorption capacity and a very low probability of achieving the budget estimate for expenditure.

Table 13: Budget Execution in 2023 until April 2023

(Amount in trillion IQD)

	Budget Estimate 2023	Actual Expenditure till April 2023	Execution Percent
Current Budget	149.6	27.3	18.2
Investment Budget	49.4	3.6	7.3
Total	198.9	30.9	15.5

Source: Ministry of Finance, Republic of Iraq

The execution percent of investment budget, especially, is very low at 7.3 percent. As per international benchmarks, it should have reached 15 percent at the end of March and 40 percent at the end of June 2023. While the Ministry of Finance has not yet published its June budget execution report, the April execution of investment budget falls short of the March norm.

On the Current Budget, the international norm is one-twelfth expenditure every month. In the first four months until April 2023, the expenditure from the current budget should have reached 49.9 trillion IQD. However, it could reach only 27.3 trillion IQD. In percentage terms, the execution should have reached 33.3 percent of the budget estimate, but it has reached only 18.2 percent.

3. Credibility of the budget

Based on the reality check on the achievement of non-oil revenue targets set in the budget and executing the expenditure budget, especially the investment budget, based on Iraq's absorption capacity reflected in its budget execution in the past and current fiscal year, the budget looks highly incredible.

Mr. Mohammad al-Hakim, Advisor to Iraqi Prime Minister, in his public address on the budget on June 29, 2023, admitted that the government may not be able to spend the entire budget and that budget estimates are the upper limits to the expenditure. He said that the government has allocated 30-40 percent more than what can be spent in the year to ensure the ministries have the upfront authorization to spend and they don't need to go back to the House of Representatives if there were additional demands during the year.

He further said that volatility of Revenues is a challenge as the volume of oil revenues is 87 % of total revenues and depends on the fluctuating international oil prices. The government plans to tackle this through controlling the financing of expenditure through the Ministry of Finance's cash management system. MoF will release money to Ministries, Departments, and Agencies (MDAs) only if there is sufficient cash based on revenue flows. It will restrict the release of funds if there is cash shortfall and prioritize expenditure in specific months of cash deficit. Thus, the actual fiscal deficit will be significantly lower than the budgeted one. This further adds to the questions on the credibility of the budget.

V. Fiscal Sustainability of Budget

Article 6 (iv) of the Federal Financial Management Law number 6 of 2019, sets out the upper limit of fiscal deficit at 3 percent of the GDP in the budget planning stage. The estimated budget deficit is 64.4 trillion IQD, which is 18.7 percent of the GDP. This is the highest level of deficit in the past 5 years and is a big climb-down from a surplus of 45.5 trillion IQD (11.4 % of the GDP) in 2022.

Table 14: Unsustainable Fiscal Deficit in 2023

(Amount in trillion IQD)

	2019	2020	2021	Est. 2022	BE 2023
Total Expenditure	96.9	91.1	111.0	116.9	198.9
Current	77.7	75.7	90.3	104.9	149.6
Investment	19.2	15.4	20.7	12.0	49.4
Total Revenue	99.3	63.2	109.9	162.4	134.5
Oil Revenue	92.5	57.1	96.7	154.0	117.2
Non-Oil Revenue	6.8	6.0	13.1	8.4	17.3
Deficit	2.4	-27.9	-1.1	45.5	-64.4
Deficit as percent of GDP	0.8%	-13.9%	-0.4%	11.4%	-18.7%

Source: (i) IMF estimates for 2019, 2020, 2021. (ii) Ministry of Finance for AE 2022 and BE 2023.

As per IMF estimates, the non-oil primary fiscal deficit has widened from 45 percent of non-oil GDP in 2019 to an estimated 63 percent of non-oil GDP in 2022 and is projected to remain elevated. As per budget estimates of 2023, the non-oil primary fiscal deficit has climbed to 78.3 percent of the non-oil GDP.

With gradually declining global oil prices, both fiscal and external current account balances are expected to turn into deficits over the medium term, resulting in renewed financing pressures, drawdown of foreign exchange reserves, and exhaustion of fiscal savings. This outlook is subject to additional downside risks related to a faster decline in oil prices, social unrest, escalation of geopolitical tensions, and realization of contingent liabilities, notably in the electricity sector.

The 2023 budget law should have avoided a procyclical spending boost and aim to increase savings with a gradual tightening of the fiscal stance, but alas, it did not.

As per Article 2 of the Law 13 of 2023, the Federal Minister of Finance, or the person authorized by him, is authorized to make up the actual deficit in the budget according to the amounts indicated in the above table for financing the deficit and from the sources indicated below:

- 1- Issuance of transfers from the Treasury.
- 2- Issuance of government bonds to the public.

- 3- Issuance of Treasury bonds and transfers to state banks, withdrawn from the Central Bank of Iraq.
- 4- Loans from Trade Banks.
- 5- Issuance of foreign bonds.
- 6- Borrowing from international financial institutions.
- 7- Bonds guaranteed by international export guarantee institutions.

Following is summary of government’s plan to finance the deficit:

Table 15: Deficit Financing Plan

(Amount in Billion IQD)

Source	Financing
MoF A/C balance end of 2022	23,000
Ongoing foreign, & Tel. lending of projects	9,965
T-Bill discounting by the CBI	23,504
Borrowing from Rafidain/ Rasheed/TBI	3,000
Domestic Bonds	5,000
Total	64,469

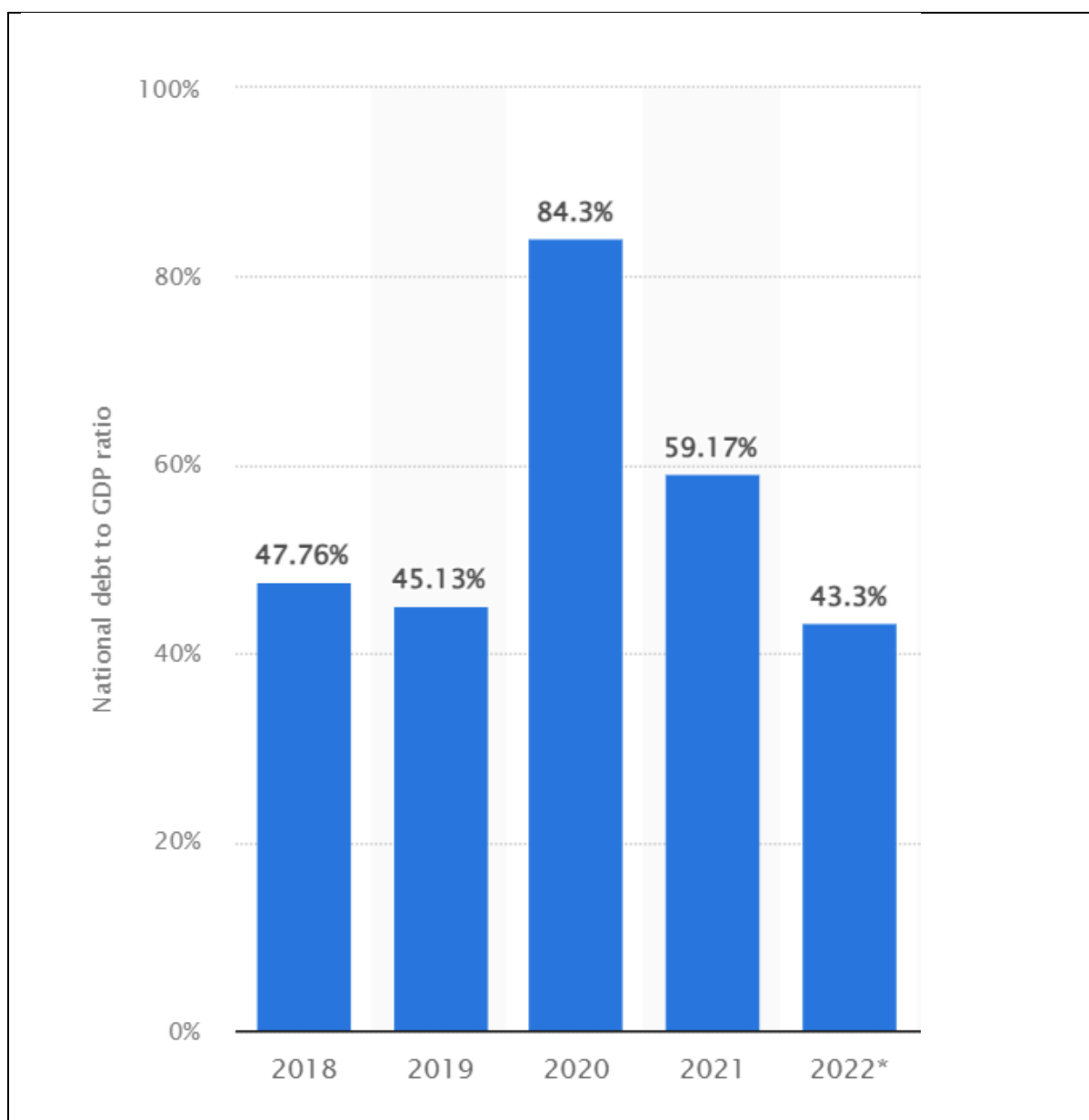
Source: Federal Budget Law 13 of 2023

A sound fiscal framework would allow to better manage Iraq’s oil wealth and reduce vulnerabilities in a highly uncertain global environment. Following the fiscal rule set out in the law and targeting a gradual reduction of the non-oil primary fiscal deficit and building a fiscal stabilization buffer would help to carefully balance the goals of improving resilience to oil price volatility and long-term sustainability; containing the growth of current expenditures—most importantly the government wage bill—while raising non-oil revenues to create the space for priority social and development needs; and reducing Iraq’s dependence on oil.

VI. Public Debt Sustainability Analysis

Iraq’s public debt had declined sharply from its 2020 peak, with the debt-to-GDP ratio more than halved between 2020-22. This drastic improvement was owed to a range of factors including sustained high oil prices and rising domestic inflation. Following a 25-percentage point drop in 2021, the government debt-to-GDP ratio declined further to 43 percent of GDP in 2022. The 2021 decline in debt ratio was mainly driven by a combination of post-devaluation increase in inflation—which pushed real interest rate down below zero—and a strong economic recovery helped by high oil prices. These factors are expected to continue in 2022: growth remained robust, inflation elevated, and the real interest rate negative. Large fiscal surpluses stemming from record oil revenues had allowed the government to reduce debt in 2022, including by clearing external arrears for energy imports from Iran.

Figure 3: Iraq National Debt in relation to the GDP



Source: Statista 2023

However, an unprecedented budgetary deficit of 64.46 trillion IQD (\$49.6 billion) in 2023, will have a significant impact on the debt sustainability. The fiscal deficit is projected to be 18.7 percent of the GDP and the non-oil primary fiscal deficit is expected to be 78.3 percent of the non-oil GDP.

To finance the deficit of 64.469 IQD or \$49.6 billion, the government plans to borrow 41.469 trillion IQD or \$31.9 billion. The public debt at the end of 2022 was estimated to be \$116.28 billion. This will rise to \$148.18 billion at the end of 2023, if the budget is executed as planned. This will make the public debt 56 percent of the GDP, returning close to the level of 2021.

In addition to a high public debt, guarantees and other contingent liabilities pose significant risks to debt sustainability. Service guarantees, mostly in the electricity sector, were estimated

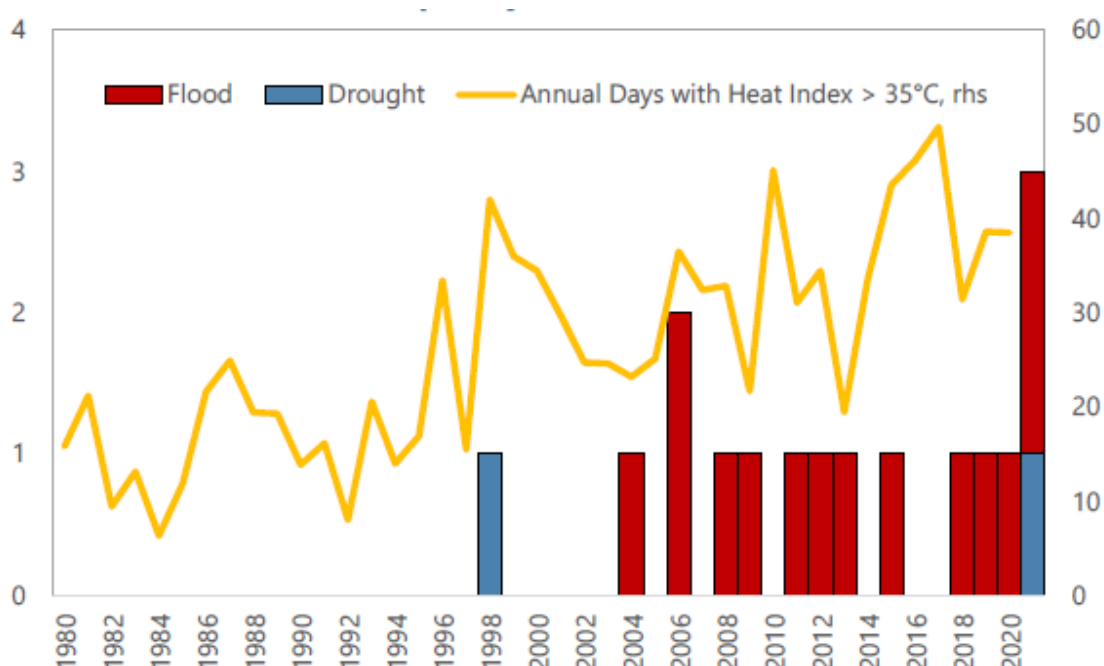
at over \$21 billion in 2017 (7.8 percent of the 2022 GDP) but were not included in public debt. The state budget of 2023 includes several guarantees, especially in the electricity sector. The state pension fund could trigger additional liabilities. Moreover, there are potentially significant contingent liabilities in the banking sector related to the need to restructure and recapitalize the two largest state-owned banks. Estimating the total size of these needs will require an international audit.

VII. Climate Change and Budget

Iraq is among the countries most vulnerable to climate change shocks both in physical (temperature rise, water scarcity, extreme events) and financial terms. Rising temperatures and more frequent natural disasters, salination, and desertification threaten habitability of major parts of the country and the livelihoods of millions, particularly in the agriculture sector and risk aggravating Iraq’s fragility. At the same time, Iraq’s dependence on oil revenues would leave it vulnerable to new economic risks amid the global transition toward a decarbonized world, wherein oil as a commodity loses its role in fueling the global economy.

Average temperatures have already risen by 1.5 degrees Celsius during the past forty years, and disasters have been frequent and damaging.

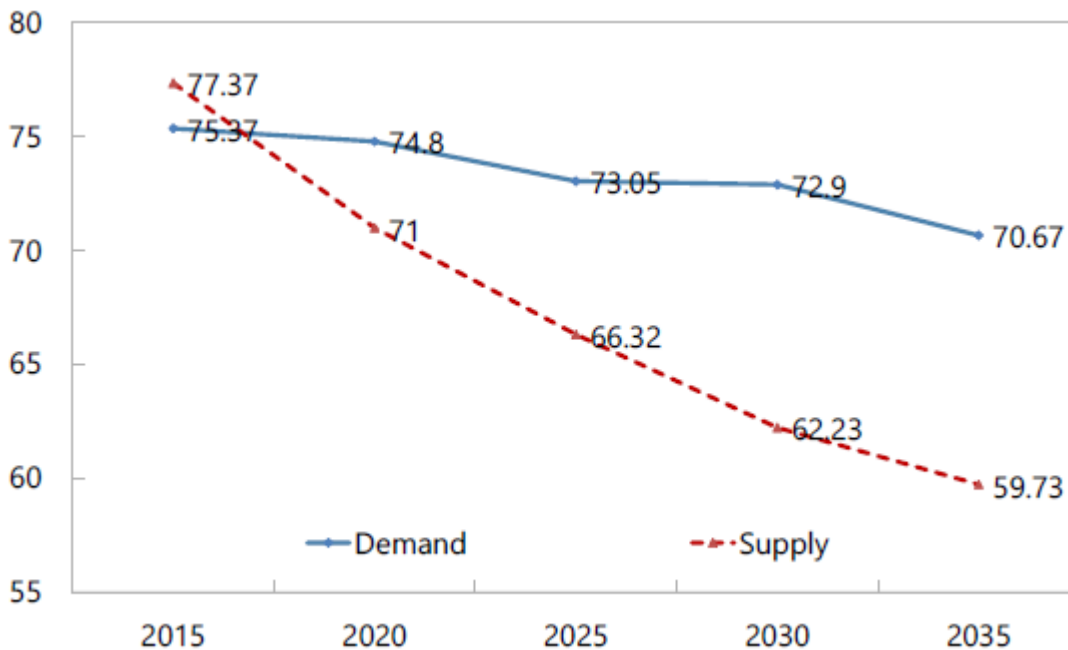
Figure 4: Extreme Heat Days and Climate Related Disaster in Iraq



Sources: *The Emergency Events Database (EM-DAT)*, *Centre for Research on the Epidemiology of Disasters (CRED) / Université catholique de Louvain (UCLouvain)*, Brussels, Belgium, and *World Bank Climate Change Knowledge Portal*.

Water scarcity has been identified as a key climate adaptation challenge. Iraq is already facing a water shortage, and the authorities estimate the demand-supply gap to reach 15 percent by 2035 due to a sustained decline in water supply owing to a variety of factors, including construction of dams in upstream countries, inefficient water transmission and distribution mechanisms, and mismatches between water availability and the water-intensity of crops.

Figure 5: Widening Water Deficit (In billions of cubic meters)

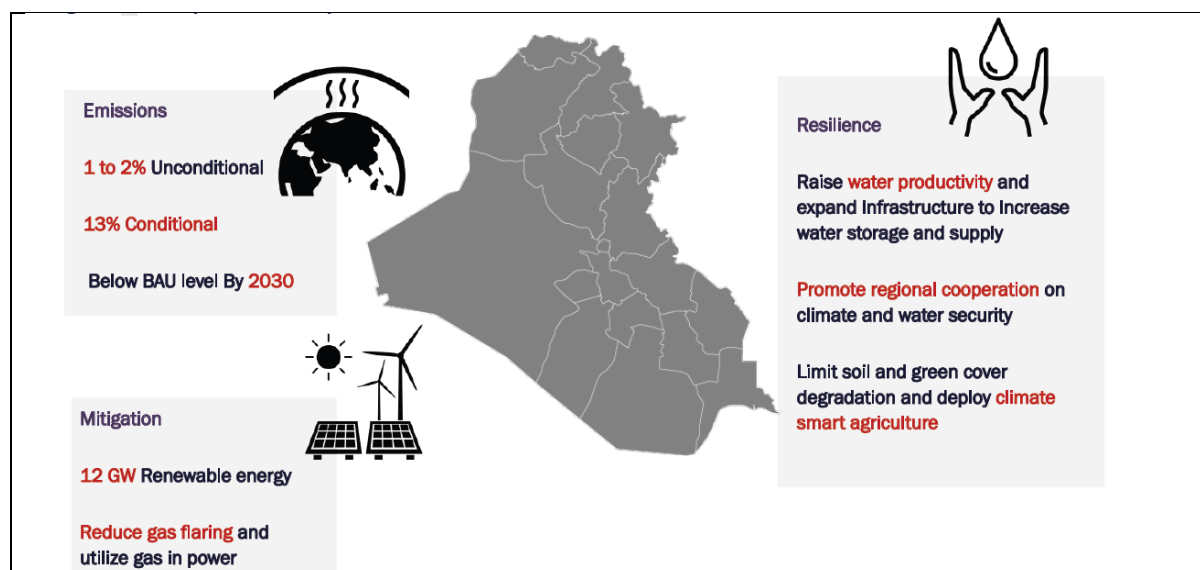


Source: Iraq Water Strategy

Reducing emissions by the energy sector is another critical challenge. As part of the Paris Agreement, Iraq has made unconditional and conditions commitments to reduce greenhouse gas (GHG) emissions by 1-2 and 13 percent, respectively, relative to the business-as-usual baseline. The bulk (over 90 percent) of Iraq’s current GHG emissions originate in the energy sector, and over a half of them represent fugitive emissions due to gas flaring. The authorities have set a goal of ending gas flaring by 2025.

In 2021, as part of the Paris Agreement, the authorities published their first Nationally Determined Contribution (NDC) document, which outlines the broad contours of their climate adaptation and mitigation strategies. Specific plans, cost estimates, and execution procedures are being developed. With the help of the United Nations Environmental and Development Programs, the authorities are working on a National Adaptation and Mitigation Plans as well as a “Green Paper.” The next National Development Strategy is expected to incorporate these plans into the overall development strategy.

Figure 6: Snapshot of Iraq's NDC commitments, 2021



Source: World Bank Country Climate Development Report 2022

Preparing for these challenges will entail a significant retooling of the fiscal framework while making the space for larger public investments. Preliminary estimates of the cost of achieving Iraq's adaptation and mitigation goals point to significant investment needs. The World Bank's Country Climate Development Report (2022) estimates that \$223 billion in total investments will be needed by 2040 to address climate adaptation and mitigation challenges while closing the development gap. The bulk of the bill is divided between alleviating water scarcity (\$48 billion), capturing gas flaring, and greening the electricity sector (\$144 billion). Affording such investments within a fiscal framework aimed at reducing oil dependence will require a significant boost of non-oil revenues and reorientation of expenditures toward greening the economy.

Table 16: Summary of Iraq's investment needs to mitigate and adapt to climate change.

Component	Investment Needs by 2040 (US\$ billion)
Rehabilitation of hydraulic infrastructure and irrigation, and reclamation of irrigation	42
Water and agriculture non-structural investments	6
Eliminate gas flaring and utilize it in power generation	29
Adopt the Cost-Effective Decarbonization Pathway (CEDP) for the power sector	63
Overhaul the power grid	52
Adopt the High Ambition transport decarbonization pathway	31
Total	223

Source: World Bank Country Climate Development Report 2022

There is a budget allocation of only 1.16 trillion IQD or US\$ 0.89 Billion in the 2023 Budget which is insignificant in comparison to the needs of climate mitigation and adaptation, as per its commitment to the NDC in 2021.

VIII. Showdown between Government and the Parliament

As described earlier in the report, the House of Representatives has made several changes to the Budget presented by the government. This is unprecedented and one does not recall any such incident from the recent political history of Iraq.

Of major significance is the addition of 220,000 new job positions in the government and removing ceilings on several job categories that will lead to an increased burden on the exchequer. The House of Representatives was responding to the continuing agitation by the public and government officials demanding more jobs and higher salaries. They are trying to be socially responsible without considering the financial constraints. They expect the government to reprioritize but there is limited fiscal space with the government and the budgetary deficit is already touching an all-time high.

The second major change is the addition of new investment projects to the budget as per proposals of the Members of the House of Representatives. These projects are, apparently, meant to serve the constituencies of those members. These were discussed in the parliamentary debate, but the government was not ready to include them in the budget. Hence, the House of Representatives directly included them in the budget.

Government's stand is that rather than creating more jobs in the public sector, which are fiscally sustainable, it will use its investment spending to leverage creation of job opportunities in the private sector. The number of public sector employees and the public sector wage bill is among the highest in the world. The public sector wage bill of 59 trillion IQD (\$45.4 billion) is 29.6 percent of the total budget and 17.2 percent of the GDP. If we add pensions to the salaries, the combined compensation to public sector employees is 75 trillion IQD (\$57.7 billion), which is 37.6 percent of the total budget and 21.9 percent of the GDP. This is ex-KRI. If one adds KRI, the numbers would be even larger. Clearly, there is no scope for adding more employees or increasing their salary to the budget.

Likewise, the investment budget is an all-time high, and the addition of new projects would raise the level of resources required and reprioritize investments that the government feels is in the best interest of the country.

Neither the government nor the House of Representatives are ready to compromise. Accordingly, the Prime Minister has moved a petition in the Federal Supreme Court to quash the changes made in the budget by the House of Representatives on grounds of their unconstitutionality and government's unaffordability. The matter is still pending a hearing in the Federal Supreme Court.

Annex 1: Ministry-wise allocation of Budget 2023

Table 17: Ministry-wise allocation of Budget 2023

(Amount in Thousand Iraqi Dinars)

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
A. General Public Services					
Parliament	383,765,567	-	-	35,107,000	418,872,567
National Board for Accountability and Justice	27,436,670	-	548,920	1,737,538	29,723,128
Property Claims Board	60,686,321	-	-	-	60,686,321
Diwan of Financial Supervision	99,422,580	-	1,701,000	10,308,472	111,432,052
Union Board	97,638,768	-	-	15,225,000	112,863,768
High Commission for Human Rights	32,213,599	-	3,240,000	-	35,453,599
Federal Public Service Council	36,501,602	-	-	22,700,000	59,201,602
Presidency of the Republic	83,200,000	-	-	11,000,000	94,200,000
Iraqi Academy of Sciences	5,017,663	-	-	1,026,000	6,043,663
Cabinet Secretariat	74,315,328	-	150,307,524	695,725,397	920,348,249
Presidency of the Council of Ministers	235,105,871	-	477,000,000	516,137,063	1,228,242,934
A- Office of the Prime Minister	210,612,208	-	-	18,537,770	229,149,978
B - Command of the Special Division (12,000 members)	8,940,371	-	-	-	8,940,371

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
C- Other bodies affiliated to the Council of ministers and the Reconstruction Fund for Areas Affected by Terrorist Operations	15,553,292	-	477,000,000	497,599,293	990,152,585
External	792,644,422	-	-	44,673,755	837,318,177
Immigrants and immigrants	201,278,271	-	150,000,000	5,271,821	356,550,092
Kurdistan Region	13,428,663,041	400,000,000	-	2,669,208,048	16,497,871,089
A-Provincial local councils	58,626,349	-	-	2,228,032	60,854,381
B- Public and local administration in Kirkuk Governorate	34,147,321	-	45,000,000	196,678,954	275,826,275
C- The Independent High Electoral Commission	224,539,500	-	380,455,000	15,963,550	620,958,050
Dhi Qar Governorate Reconstruction Fund	1,916,174	-	-	197,862,000	199,778,174
Basra Governorate	481,968,082	-	137,241	1,666,618,452	2,148,723,775
Nineveh Governorate	175,239,210	-	105,000,000	323,835,308	604,074,518
Baghdad Governorate	163,135,303	-	-	556,009,360	719,144,663
Dhi Qar Governorate	114,653,963	-	-	246,170,505	360,824,468
Diyala Governorate	139,869,779	-	24,624,489	122,197,774	286,692,042
Babylon Governorate	178,442,086	-	38,216,800	261,943,095	478,601,981

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
Al Anbar Governorate	198,450,627	-	105,000,000	162,854,858	466,305,485
Maysan Governorate	110,494,324	-	-	310,790,637	421,284,961
Wasit Governorate	118,996,376	-	-	166,623,275	285,619,651
Sacred Najaf Governorate	114,010,603	-	-	103,817,677	217,828,280
Al-diwanayah Governorate	155,746,036	-	-	127,085,231	282,831,267
Al-muthanna Governorate	74,371,125	-	-	88,584,719	162,955,844
Sacred Al-karbala Governorate	116,092,427	-	-	79,779,006	195,871,433
Saladin Governorate	98,035,499	-	102,000,000	123,626,878	323,662,377
Council of State	6,940,069	-	-	1,527,760	8,467,829
Sub-Total General Public Services	18,358,670,427	400,000,000	2,060,230,974	9,298,454,228	30,117,355,629
B. Defense					
National Security Council	352,647,186	-	16,000,000	32,590,000	401,237,186
The Iraqi Board for the Control of Radioactive Sources	2,933,943	-	-	169,843	3,103,786
Iraqi National Intelligence Service	258,698,798	-	-	48,844,000	307,542,798
Martyrs Foundation	342,291,328	-	-	12,172,625	354,463,953
Anti-terrorism agency	695,055,255	-	-	102,798,464	797,853,719
Border Crossings Board	98,381,524	-	-	411,706	98,793,230
Military Industry Board	251,078,900	-	-	32,000,000	283,078,900
Atomic Energy Authority	28,763,000	-	2,920,000	4,337,000	36,020,000
Defense	7,822,872,818	-	14,234,261	1,926,603,546	9,763,710,625
Sub-Total Defense	9,852,722,752	-	33,154,261	2,159,927,184	12,045,804,197

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
C. Public Order and Safety					
Political Prisoners Foundation		-	-	2,787,205	2,787,205
Popular Mobilization Forces Board	3,570,036,381	-	-	173,666,909	3,743,703,290
Internal	12,952,174,283	-	23,662,113	911,651,565	13,887,487,961
Justice	868,769,710	-	3,000,000	128,326,747	1,000,096,457
Supreme Judicial Council	692,686,347	-	500,000	21,700,000	714,886,347
Federal Supreme Court	14,316,950	-	-	837,000	15,153,950
Sub-Total Public Order and Safety	18,097,983,671	-	27,162,113	1,238,969,426	19,364,115,210
D. Economic Affairs					
The National Board for Investments	11,139,735	-	-	3,000,000	14,139,735
Civil Aviation Authority	120,738,920	-	-	203,400,000	324,138,920
Iraq Recovery Fund	13,730,050	-	-	1,230,000	14,960,050
Finance	26,438,006,758	12,350,981,021	28,274,027	387,353,401	39,204,615,207
Trade	7,219,390,696	-	-	17,595,000	7,236,985,696
Transport	79,682,429	-	1,085,000	2,753,300,000	2,834,067,429
Agriculture	1,433,122,145	-	10,170,000	494,837,765	1,938,129,910
oil	7,482,695,007	-	-	15,804,566,000	23,287,261,007
planning	73,666,625	-	-	7,297,189,050	7,370,855,675
Industry and minerals	937,190,739	-	-	183,575,350	1,120,766,089

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
Electricity	11,610,210,213	-	-	3,890,565,702	15,500,775,915
Telecommunications	151,303,124	-	-	2,515,250	153,818,374
D- Provincial investment commissions	18,076,190	-	-	391,200	18,467,390
Securities Commission	2,263,589	-	259,200	26,036	2,548,825
The Iraqi Commission for Monitoring the Allocation of Federal Revenues	2,490,177	-	-	2,000,000	4,490,177
Sub-Total Economic Affairs	55,593,706,397	12,350,981,021	39,788,227	31,041,544,754	99,026,020,399
E. Environment Protection					
Water resources	452,247,144	-	114,183,000	476,186,134	1,042,616,278
Environment	51,442,818	-	20,000,000	40,579,768	112,022,586
Sub-Total Environment Protection	503,689,962	-	134,183,000	516,765,902	1,154,638,864
F. Housing Community amenities					
Construction, housing, and public municipalities	575,853,936	-	600,000,000	3,784,407,000	4,960,260,936
Sub-Total Housing and Community amenities	575,853,936	-	600,000,000	3,784,407,000	4,960,260,936

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
G. Health					
Health	7,986,241,849	-	1,110,259,739	806,676,664	9,903,178,252
Sub-Total Health	7,986,241,849	-	1,110,259,739	806,676,664	9,903,178,252
H. Recreation, Culture and Religion					
Shiite Endowment office	1,139,953,660	-	-	320,000,000	1,459,953,660
Sunni Endowment Office	354,567,726	-	-	85,397,834	439,965,560
Office of Endowments of the Christian, Yazidi, and Sabeen-Mandaean Religions	7,867,696	-	-	5,511,000	13,378,696
Youth & Sports	116,939,316	-	1,988,000	75,000,000	193,927,316
Culture	172,519,436	-	10,273,500	45,000,000	227,792,936
Sub-Total Recreation, Culture and Religion	1,791,847,834	-	12,261,500	530,908,834	2,335,018,168
I. Education					
Al Imam Al Aadam (Peace be upon Him) University College	28,553,475	-	-	500,000	29,053,475
Imam Al-Kadhim (peace be upon him) College of Islamic Sciences University	27,434,389	-	-	500,000	27,934,389

The Ministry	Operating Cost (1)	Debt (2)	Special Programs (3)	Capital Expenditure (4)	Total Allocation (5) (1+2+3+4)
Education	11,636,392,587	-	26,443,015	233,528,052	11,896,363,654
Higher education and scientific research	2,872,761,368	-	13,000,000	274,450,700	3,160,212,068
Sub-Total Education	14,565,141,819	-	39,443,015	508,978,752	15,113,563,586
J. Labor and Social Welfare					
Labor and social affairs	6,002,903,187	-	7,802,057	9,888,000	6,020,593,244
Sub-Total Labor and Social Affairs	6,002,903,187	-	7,802,057	9,888,000	6,020,593,244
All Ministries	133,328,761,834	12,750,981,021	4,064,284,886	49,896,520,744	200,040,548,485

Source: GIZ staff estimates based on Budget Law 2023

Annex 2 GFSM 2001—Classification of Expense by Function of Government

Table 18: Classification of Expense by Functions of Government

Total outlays	
701 General public services	706 Housing and community amenities
7011 Executive and legislative organs, financial and fiscal affairs, external affairs	7061 Housing development
7012 Foreign economic aid	7062 Community development
7013 General services	7063 Water supply
7014 Basic research	7064 Street lighting
7015 R&D ¹ General public services	7065 R&D Housing and community amenities
7016 General public services n.e.c. ²	7066 Housing and community amenities n.e.c.
7017 Public debt transactions	707 Health
7018 Transfers of a general character between different levels of government	7071 Medical products, appliances, and equipment
702 Defense	7072 Outpatient services
7021 Military defense	7073 Hospital services
7022 Civil defense	7074 Public health services
7023 Foreign military aid	7075 R&D Health
7024 R&D Defense	7076 Health n.e.c.
7025 Defense n.e.c.	708 Recreation, culture, and religion
703 Public order and safety	7081 Recreational and sporting services
7031 Police services	7082 Cultural services
7032 Fire protection services	7083 Broadcasting and publishing services
7033 Law courts	7084 Religious and other community services
7034 Prisons	7085 R&D Recreation, culture, and religion
7035 R&D Public order and safety	7086 Recreation, culture, and religion n.e.c.
7036 Public order and safety n.e.c.	709 Education
704 Economic affairs	7091 Pre-primary and primary education
7041 General economic, commercial, and labor affairs	7092 Secondary education
7042 Agriculture, forestry, fishing, and hunting	7093 Postsecondary nontertiary education
7043 Fuel and energy.	7094 Tertiary education
7044 Mining, manufacturing, and construction	7095 Education not definable by level
7045 Transport	7096 Subsidiary services to education
7046 Communication	7097 R&D Education
7047 Other industries	7098 Education n.e.c.
7048 R&D Economic affairs	710 Social protection
7049 Economic affairs n.e.c.	7101 Sickness and disability
705 Environmental protections	7102 Old age
7051 Waste management	7103 Survivors
7052 Wastewater management 7053 Pollution abatement	7104 Family and children
7054 Protection of biodiversity and landscape	7105 Unemployment
7055 R&D Environmental protection	7106 Housing
7056 Environmental protection n.e.c.	7107 Social exclusion n.e.c.
	7108 R&D Social protection
	7109 Social protection n.e.c.
¹ R&D = Research and development. ² n.e.c. = not elsewhere classified.	

Source: International Monetary Fund Government Financial Statistics Manual