IMPACT OF COVID-19 ON THE IRAQI ECONOMY
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1. FOREWORD

This paper builds on the “Impact of the Oil Crisis and COVID-19 on Iraq’s Fragility” published in August 2020 by the United Nations Development Programme (UNDP). It explored how the COVID-19 pandemic and diminishing oil revenues are affecting various dimensions of Iraq’s fragility. A series of forthcoming papers will provide more details on key aspects of Iraq’s challenging political, social, economic and security context.

UNDP will present these additional thematic policy papers in the coming months, looking at the implications for social protection, the impact on environmental sustainability, social cohesion and the socioeconomic impact on vulnerable households. The aim of these policy documents is to offer a comprehensive overview of how the pandemic is affecting the social and economic context of Iraq. This responds to the recent call from the UN Secretary-General for ideas on surviving and recovering from the pandemic so that families and businesses can stay afloat, and the foundation for an inclusive recovery can be laid to ensure attainment of the Sustainable Development Goals (SDGs).

This current paper draws on various sources from within and outside the United Nations, using the latest information available at the time of writing. As the COVID-19 pandemic is a rapidly evolving global phenomenon, however, economic and social circumstances for both Iraq and the wider world are likely to change rapidly.

UNDP would like to thank Barbara-Anne Krijgsman as the lead coordinator for these policy papers and Bryn Welham as the main author of the current paper. Great appreciation also goes to the UNDP Regional Centre for Arab States and the UNDP Iraq Country Office team for their support.
2. EXECUTIVE SUMMARY

This paper analyses the macroeconomic impact of the COVID-19 pandemic on Iraq. It sets out a number of conclusions and recommendations for different stakeholders. These aim at responding to the macroeconomic challenges created by the pandemic while ensuring continued progress towards achievement of the Sustainable Development Goals (SDGs).

The global and regional context

Economic conditions have dramatically worsened as a result of COVID-19. Both global and regional growth forecasts have been repeatedly downgraded. Current estimates for 2020 global economic growth predict an unprecedented contraction of global gross domestic product (GDP) of 4 to 6 percent. These forecasts note in particular that oil producers in the Arab States have been hit hard by the pandemic.

Iraq’s economy in the run-up to the COVID-19 pandemic

From 2017 to 2019, key macroeconomic and fiscal conditions were broadly positive for Iraq. Both oil and key non-oil sectors grew relatively consistently, leading to good fiscal results, with budget surpluses and declining public debt levels in 2018 and 2019. Iraq also saw positive current account surpluses and the build-up of substantial foreign reserves.

Yet long-standing structural challenges remained. Iraq’s economy is characterized by overdependence on oil, which accounts for most of the economy, almost all export revenue and nearly all government revenue, but without generating significant employment. Non-oil private-sector activity is limited, highly informal and generates very little government revenue. Fiscal policy has tended to be highly procyclical, tracking changes in oil prices. Unemployment, poverty and social exclusion are widespread, with estimates from 2017 suggesting that one third of the population experienced multidimensional poverty, a concept that looks beyond income to consider access to basic goods and services.

The impact of COVID-19 on Iraq’s macroeconomic and fiscal position

Iraq now faces a significantly worsened economic outlook through ‘twin shocks’. First, oil prices experienced a historically unprecedented fall in early 2020, followed by a modest recovery later in the year. Second, starting from March 2020, the Government imposed a range of restrictions on economic and social activities in a bid to control the spread of COVID-19. While these restrictions are key to staunching infection, they have substantially reduced activity across the economy, far beyond the oil sector.

These shocks are having a profound impact on key macroeconomic indicators. GDP is expected to contract by nearly 10 percent in 2020. Iraq’s fiscal position has dramatically worsened, and the deficit is forecast to reach nearly 30 percent of GDP in 2020, an unprecedented level. This deficit is driven by a collapse in revenue rather than a sharp increase in expenditure. The composition of public spending—with a focus on wages, pensions and social transfers—will make it difficult and/ or inappropriate to reduce expenditure in any meaningful way over the short term. The striking imbalance between revenue and expenditure will result in rapidly increasing debt levels for at least the three years between 2020 and 2022. While Iraq does not face an immediate risk of debt default given the level of its international US dollar reserves held at the Central Bank of Iraq, and its capacity to borrow from a range of sources, the current fiscal position is not sustainable for the long term.

The decline in oil prices combines with other effects to pressure Iraq’s external position. Foreign exchange reserves are being used up, threatening the dinar to dollar peg. There are a number of possible scenarios...
where a rapid monetary adjustment caused by the exhaustion of foreign reserves could create potentially serious macroeconomic dislocations.

**Income and employment**

Employment was already a challenge in Iraq before COVID-19 hit. In 2019, Iraq’s labour force participation rate was one of the lowest in the world, and below the regional average, at around 50 percent. It was particularly low for women. Initial high-level estimates of the fallout of COVID-19 restrictions on employment suggest a significantly negative impact. Informal estimates find that formal unemployment has already increased beyond its 2018 level of 10 percent, and is particularly high among internally displaced people, women and youth. More detailed surveys of the impact of the COVID-19 lockdowns on small and medium enterprises have also registered significant negative effects on employment that are likely to disproportionately affect marginalized groups. Some losses in employment and other income sources may endure after lockdowns are lifted as the overall reduction in economic activity puts the viability of small and medium enterprises at risk.

**Poverty and vulnerability**

Models from the World Bank and the United Nations Children’s Fund (UNICEF) suggest that in the ‘most likely’ scenario, which incorporates the actual experience of the national lockdown period, income poverty will increase by 11.7 percentage points—or by over 50 percent—taking the poverty rate up from 20 percent in 2017-2018 to just over 31 percent in 2020. Using a broader multidimensional approach to poverty that considers access to basic goods and services alongside income, 42 percent of the total population is expected to be vulnerable to poverty as a result of the pandemic. There is a divide in poverty risk. Households drawing their income from the public sector will be much less affected, while those working in the private sector, particularly in low-income work and the informal sector, and female-headed households, stand a much greater risk of poverty. A key variable will be the strength and timeliness of the economic rebound.

In terms of social protection, public-sector salaries and public assistance are the most stable forms of income for many households. The Public Distribution System of subsidized essential goods will become more important for household welfare, particularly for those on the lowest incomes and/or experiencing unemployment. Adequately financing this large item of expenditure in the context of severely constrained public finances will be a challenge. Overall, existing social protection schemes are not well equipped to help the poorest in society.

**Recommendations**

Iraq’s current macro-fiscal economic situation is daunting. ‘Do nothing’ is not an option given the massive imbalance between public revenue and expenditures. Yet despite the need for reform, significant cuts to public expenditure are neither feasible nor desirable given its role in protecting vulnerable households. This suggests a short-term government agenda focused on rapidly identifying additional deficit financing options; avoiding an unplanned monetary adjustment; and improving the quality and targeting of public expenditures where possible. In the longer term, the Government should develop plans to: institute credible fiscal rules to better manage the impact of changing oil prices; invest in private-sector development and economic diversification to boost employment; develop incentives to progressively bring workers and firms into the formal sector; rationalize the public-sector wage bill; and redesign public assistance schemes to focus on the neediest households and informal workers.
3. THE GLOBAL AND REGIONAL ECONOMIC CONTEXT

3.1 The global economic context

Global economic conditions have dramatically worsened as a result of COVID-19 (Box 1). At the end of 2019, major forecasters were expecting steady economic growth for 2020, albeit at a slower pace than in previous years. Over 2020, however, all major macroeconomic forecasting institutions have repeatedly downgraded expectations for global growth, and for supporting metrics such as growth in trade and productivity. Recognizing the unprecedented nature of the change in global economic circumstances, institutions such as the Organisation for Economic Co-operation and Development (OECD), the World Bank and the International Monetary Fund (IMF) have issued regular updates to their usual biannual global economic forecasts. Iraq faces a challenging global economic context in managing the economic impacts of the COVID-19 pandemic (Figure 1).

Unsurprisingly, this dramatically worsening economic climate is forecast to drive increasing poverty across the world. While forecasters assume that the economic impact will be most severe in advanced economies, developing countries will nevertheless face a notable but less extreme reduction in growth. This will have immediate consequences in deepening poverty and slowing attainment of the Sustainable Development Goals (SDGs). Estimates suggest a severe hit to the global labour market, with the equivalent of 130 million to 300 million jobs lost through fewer hours worked. This is expected to push over 34 million people into extreme poverty in 2020, with just over half the increase occurring in African countries. Between now and the 2030 endpoint of the SDGs, a pessimistic scenario suggests that COVID-19 could potentially propel an additional 130 million people across the world into extreme poverty compared to previous baseline trends, bringing the total to over 680 million.
Box 1: The unprecedented nature of the COVID-19 economic shock

The COVID-19 pandemic is an unprecedented shock to the global economy:

- The size of the impact on national economies is almost unparalleled in peacetime. The scale of GDP declines being reported—particularly in developed countries—is typically associated with wartime effects.

- The synchronized nature of the impact, happening across all countries at broadly the same time, is also unprecedented. This varies from, for example, the 2008 global financial crisis, which acutely affected wealthy countries but at a time when other parts of the world were still growing.

- The comprehensive impact across all sectors of the economy is unusual. Previous economic shocks tended to affect a particular sector, but leave others relatively untouched. The COVID-19 shock is affecting almost all sectors at the same time.

The impact on national economies can be characterized as both a supply and demand shock. It is influencing both the ability to produce goods and services (supply), and the ability to consume goods and services (demand). The manifestations are direct and indirect, and will occur in the short and longer term.

- Direct impacts come from the immediate burden of sickness and ill-health, and they fall mainly on those infected with the virus, and upon the health sector attempting to treat them.

- Indirect impacts are typically much more extensive and relate to changes in economic behaviour more broadly. These could be voluntary, as people and their employers seek to avoid infections, or government mandated through measures to restrict economic and social activity. If export markets across the world are depressed, global demand for products will decline. Indirect impacts can also relate to financial movements as investors seek a ‘flight to safety’ and begin pulling money out of more risky markets.

- Short-run effects mean household and personal incomes will fall as a result of the direct and indirect effects, and many business will see reduced income and may be forced to suspend operations. Uncertainty regarding the future will cramp business investment and household consumption. This will spur increases in poverty and unemployment for households, reduce income for firms and diminish tax revenues for governments.

- Long-run effects include student education suffering as schools and universities are closed for extended periods. The risks are particularly high for female students, who in many places are already less likely to be in school. Students in developing countries in general, and particularly in rural and remote areas, or in poor households, will be excluded from distance learning given gaps in telecommunications infrastructure and access to digital devices. These losses could be reversed, but the longer the pandemic continues, the harder it will be to remediate reductions in human capital formation. In addition, some businesses will simply close for good, and some unemployed people will never return to the labour market. This will lead to a permanent loss of capital and labour, weakening future output growth.

The direct and short-term effects are the most obvious to quantify. Many countries have extensive tracking of infections and deaths in hospitals. Economic data and surveys will gradually provide a clear picture of changes to income and employment. The long-term effects, particularly those caused by the indirect impacts of the pandemic, will be much harder to measure and may not be clear for quite some time.

Sources: IMF 2020b; World Bank 2020e.
3.2 The regional economic context

Regional economic forecasts for the Arab region are similarly negative, and have also been repeatedly downgraded (Figure 2). For example, IMF regional forecasts for July indicate a contraction of 4.7 percent for the region, two percentage points lower than forecast in April 2020. This was the lowest level in 50 years, below even the 2008 global financial crisis or the 2014 oil price shock. This largely represents continued weaknesses in oil prices, with commensurate effects on the growth potential of oil-producing States. World Bank forecasts from April 2020 suggest a 5.2 percent decline in Middle East and North Africa GDP per head over 2020, also an unprecedented fall. According to some estimates, even before the onset of the COVID-19 pandemic, the region’s economies had not fully recovered from the 2008 global financial crisis or from the 2014 drop in oil prices.

Oil producers have been hit particularly hard, with oil prices falling significantly from 2019 levels. As a result, economic forecasts for 2020 and 2021 note a significant divergence in prospects for countries that export or import oil. IMF forecasts for all regional oil producers predict a decline in GDP of 7.3 percent in 2020, with a modest recovery of 3.9 percent in 2021. These figures are worse than the general predictions for the region as a whole. Overall, countries with large oil sectors are seeing a dramatic decline in terms of trade, while those that import oil are seeing a benefit, although this gain is more than offset by the wider negative impacts from COVID-19.

Figure 2: Regional GDP growth

Regional GDP growth (annual percentage change)

Source: IMF 2020e. MENAP = the Middle East, North Africa, Afghanistan and Pakistan.
4. IRAQ’S ECONOMIC STATUS BEFORE THE COVID-19 PANDEMIC

This section provides a brief overview of Iraq’s economic position before the economic shock from COVID-19. It outlines the background to current economic challenges, referring to previous years and the structural features of Iraq’s economy.

Iraq’s economy and society have been hampered by insecurity since 1991. Leading up to the early 1990s, Iraq had achieved significant progress in certain social indicators related to basic education and health services, albeit alongside low economic growth. The first Gulf War of 1991, the invasion of Iraq in 2003, the continuing insecurity of the post-2003 era, and finally the conflict with and occupation of the Islamic State of Iraq and the Levant (ISIL) between 2013 and 2017 have cumulatively taken an enormous toll. While there are no estimates of the total costs of all of these conflicts, the 2013-2017 conflict with ISIL alone incurred estimated direct costs of US $47 billion across affected governorates, and resulted in cumulative losses in output of $107 billion dollars (72 percent of GDP at the start of the conflict in 2013). As large as this figure is, it does not account for the deleterious, long-term effects on social cohesion, education, the emigration of skilled workers and the general investment climate, all of which can impede economic development.

Iraq’s current economic context is characterized by extreme dependence on oil (Box 2). It is one of the world’s largest producers, and the third largest oil exporter, with an 8.3 percent market share worth $83.3 billion in 2019. It holds the world’s fifth largest proven reserves of petroleum at 144.2 billion barrels. Iraq is also one of the world’s most oil-dependent countries: 56 percent of GDP, 99 percent of export revenues and 90 percent of taxes come from oil. Decades of conflict, by severely constraining non-oil economic development, sustained an economy and society centred on oil production and exports.

Box 2: Iraq’s political economy settlement

Iraq’s dependence on oil creates political tendencies that interact and shape the economy and society at large. A number of countries in the region and across the world, particularly commodity producers, share these features. Broadly, they characterize a ‘neo-patrimonial’ or ‘rentier’ state, where control over commodity wealth shapes the distribution of economic and political power. They typically restrict inclusive development, and include the following.

- Politics focuses on elite competition for access to oil wealth while maintaining a minimal level of acquiescence from the population by distributing cash or in-kind benefits to households. This reduces the incentive for long-term investment in high-quality universal public services, and a productive, diversified economy.

- Corruption is high, as rentier states use subjective political criteria to distribute shares of resource wealth to secure the loyalty of particular groups.

- Accountability to citizens is low, as state revenue is overwhelmingly derived from resource wealth rather than general taxation. This reduces citizen engagement with the State, and prevents development of a ‘State-citizen’ fiscal contract where taxes are paid in exchange for public services.

Source: UNDP 2020b.

From 2017 to 2019, headline macroeconomic and fiscal conditions were broadly positive for Iraq. Relatively flat oil prices but slowly rising volumes led to oil-related GDP growing only slightly over this period, and being outpaced by non-oil GDP. Overall GDP and GDP per head measures of income expanded. Inflation remained low at under 1 percent each year, and 2019 saw a bumper harvest (Figure 3).
Major non-oil sectors that grew strongly in 2019 included agriculture, which ballooned a staggering 39 percent due to good rainfall. Electricity generation rose above the expected target. Manufacturing and building and construction—key sectors employing a large informal labour force—increased production (Figure 4). Wage hikes from government and higher public spending, alongside low inflation and good harvests for farmers, increased consumption and household welfare.

These positive macroeconomic indicators led to positive fiscal results (Figure 5). The Government recorded budget surpluses of 11.2 and 1.3 percent of GDP in 2018 and 2019, respectively. Public sector debt fell from 49.3 to 44.6 percent of GDP between these two years, with around 60 per cent by value borrowed externally. These favourable fiscal conditions permitted the Government to respond to the demands of citizen protests in late 2019 by further expanding public-sector employment.

Current account surpluses of 6.9 and 2.5 percent of GDP in 2018 and 2019, respectively, allowed the accumulation of substantial financial reserves, which reached over $65 billion, or around 10 months of import cover, by 2019.
The public sector is present in most parts of the formal economy. It is unsurprisingly dominant in services (e.g., health, education, water) but also operates as a major actor in many other economic sectors. The financial sector, in particular, is dominated by a small number of State-owned banks operating predominantly in the oil sector, and holding 71 percent of all financial deposits.\(^{19}\)

Iraq also remains affected by the repercussions of past and ongoing conflicts, with an estimated 1.38 million internally displaced people from the 2013-2017 conflict with ISIL as well as refugees from other regional conflicts, notably Syria.\(^{20}\)

Employment is shaped by oil dependency and the public sector. Even prior to COVID-19, Iraq’s formal labour force participation rate was one of the lowest in the world, both for men at 72 percent and for women at 16 percent.\(^{21}\) Unemployment was high, with around half of the rapidly growing youth population not in employment, education or training (NEET).\(^{22}\) The informal nature of the labour market makes the real level of unemployment difficult to accurately assess, however. Since most workers operate in the informal economy, their contact with formal institutions of tax collection, social insurance and social protection is minimal. The large public sector commands a wage premium above the private sector, leading to extreme competition for public-sector positions.\(^{23}\)

While the oil industry dominates the economy, it is not job-intensive. It creates a small number of relatively highly paid formal jobs, estimated at just over 1 percent of employment.\(^{24}\) Notably, it does not generate the mass formal employment that would begin to have a positive impact on Iraq’s informal and underutilized workforce.

Partly as a result of skewed employment, poverty, inequality and social exclusion are widespread, particularly among certain groups.\(^{25}\) This coupled with ongoing insecurity has meant no real progress in poverty or income inequality between 2012 and 2017. Poverty remains concentrated in larger households, female-headed households and those...
with a less-educated household head, and among women, the internally displaced and the young. The working poor are concentrated in the private and informal sector, with public-sector employment associated with higher wages and lower poverty. Poverty is regionally imbalanced, with the Kurdistan and Baghdad regions experiencing lower levels, and the southern region especially seeing higher levels (Figure 6).

Figure 6: The poverty headcount varies by region

Poverty headcount by region – percentage of population in income poverty


Estimates from 2017 suggest that just over one third of the population lives in multidimensional poverty, a higher level than under measures of income poverty, which was estimated at around 20 percent immediately before the pandemic began. Given pervasive multidimensional poverty, the World Bank estimates that an Iraqi child today will only be 40 percent as productive in later life compared to a situation of receiving a full education and good health care. The 2019 Human Development Index, a composite measure of health, education and income, ranked Iraq 120th in the world overall and in the ‘medium’ human development category, with slow but broadly steady improvements since the 1990s. The 2019 level was below the Arab regional average on the index, although Iraq displays a notably higher degree of income equality than many other countries in the region.
5. THE ECONOMIC IMPACT OF COVID-19 ON IRAQ FROM 2020 TO 2022

This section summarizes the economic impact of COVID-19 on Iraq in 2020, with an outlook for 2021 and 2022. It focuses on macroeconomic and fiscal effects, with the following section considering employment, income and poverty in more detail.

5.1 Macroeconomic conditions

Amid the pandemic, Iraq now faces a significantly worsened economic context. The relatively positive macroeconomic climate of 2019 has given way to the ‘twin shocks’ of 2020. These entail a rapid and significant fall in oil prices affecting Iraq’s key industry and export, and COVID-19 restrictions on social and economic activity that weigh on the rest of the economy. Taken together, these represent a major and rapid reversal of macroeconomic and fiscal fortunes that will pose real challenges until at least 2022.

Oil prices experienced a historically unprecedented fall in early 2020, followed by a modest recovery later in the year. Globally, March 2020 saw the single largest monthly decline in oil prices on record, with the drop-off in the first half of 2020 deeper than any previous global recession, including the 2008 global financial crises. For a brief period in April 2020, certain oil prices were trading at historically unprecedented negative values. Over 2020, average annual prices for Iraq’s oil are forecast to decrease by over 50 percent, from $61 to $30 a barrel, although as with any forecast of oil prices, there will be significant uncertainty around precise figures. The trajectory of oil prices and the relationship to Iraq’s economic circumstances is discussed in Box 4.

Starting from 22 March 2020, the Government imposed a range of restrictions to control the spread of COVID-19 (see Box 3). These have included business and factory closures, restrictions on travel and public gatherings, movement restrictions in and between governorates, as well as general curfews. They placed Iraq towards the top of the Stringency Index of COVID-19–related restrictions, as measured by Oxford University from March to July 2020. While these restrictions have stopped infections, they also substantially reduced activity across the economy.

The twin shocks have had a dramatic impact on key macroeconomic indicators. Forecasts for Iraq’s GDP in 2020 and beyond have been progressively reduced in successive quarters, in common with countries across the world. Forecasts from early 2020 suggest that GDP growth is expected to be negative at –9.7 percent in 2020 with non-oil GDP contracting by 4.4 percent; and with a modest recovery beginning in 2021 and continuing in 2022 (Figure 7).

These projections are uncertain, however. The trajectory of the pandemic and associated restrictions within Iraq, the region and globally is very difficult to predict. The future direction of oil prices, which greatly determine Iraq’s macroeconomic position, is also uncertain, and clearly linked to COVID-19. Forecasts from early 2020 are likely to be substantially revised over coming months as events unfold.
The impact of the pandemic extends far beyond the oil sector. While oil dominates Iraq’s economy overall, other sectors are also reporting significant negative effects. They are predominantly affected by movement restrictions rather than the decline in oil prices. Lockdowns, first imposed in March 2020, were lifted in various stages from May 2020 onwards. Quarterly economic activity outcomes on a sector-by-sector basis for 2020 are not yet available, although particular fallout is expected in:

- **Agriculture**: Although agriculture is a small part of GDP (around 2 percent) it employs around 18 percent of the workforce. Restrictions on movement within Iraq reduce the opportunity to take goods to market. Restrictions on gatherings limit the ability of agricultural firms to employ seasonal workforces. Supply chain disruptions may affect prices and/or the availability of agricultural inputs over the medium term, although recent surveys of Iraq’s food security suggest that disruptions to supply are not currently a major issue.

- **Services**: The retail, wholesale, hospitality, accommodation, catering and other consumer-focused services have reportedly been severely affected by the lockdown. Temporary closures of many non-essential businesses and the introduction of social distancing rules have sharply curtailed the operations of most customer-facing enterprises, with knock-on effects on their supply chains.

- **Religious and other tourism**: Estimates suggest that religious and other tourism activity accounts for about 6 to 7 percent of GDP and around 6 percent of employment. Restrictions on international travel, on travel within Iraq and on gatherings of large groups are likely to heavily reduce visitor numbers over 2020. The risk of COVID-19 may even dissuade potential tourists from travel for months or even years to come, leading to a longer-term reduction in visitor numbers.

Regarding the external sector, 2020 and 2021 will see a reversal of the relatively positive context of 2018 and 2019 (Figure 8). Over 2020, the current account is forecast to turn sharply negative by an estimated 18 percent, and remain negative (albeit at a lesser level) for 2021 and 2022. This is due to both the fall in oil prices and a large rise in imported goods through an increase in spending by the Government. As a result, foreign reserves built up in the Central Bank—estimated at 10 months of imports in 2019—will be run down rapidly as the exchange rate is defended. This is already underway, with reserves dropping from $65 billion in June 2020 to $58 billion in September 2020. They are forecast to go below three months towards the end of 2021. Dwindling reserves will gradually put increasing pressure on the exchange rate, with the risk of a significant unplanned realignment of currency values. External sector forecasts are particularly uncertain, however, given that government policy on exchange rate levels and use of reserves may swiftly change forecast trajectories.
Box 3: Actions to respond to the COVID-19 pandemic

The Government of Iraq has taken a number of steps to curb COVID-19. As of 12 September, close to 2 million tests had been performed nationwide, with 282,672 positive results. Out of these, 217,396 people recovered and 7,881 died. Early on, and with the support of donors and the UN system, the Government invested in new laboratories to expand testing capacity, increased the availability of personal protective equipment for health staff, and established a number of isolation wards for COVID-19 patients. The Ministry of Health has issued and regularly updated public health guidelines. Given an evolving situation, measures are likely to change at short notice.

In early 2020, the ministerial Committee for National Health and Safety was established to help contain the outbreak. Federal authorities implemented curfews and movement restrictions to limit social contact, with some lifting of restrictions from May 2020 onwards. Schools and universities were closed but are now gradually reopening with certain additional distancing rules. Businesses and factories, with the exception of restaurants, have been allowed to reopen provided they respect precautionary health and physical distancing measures. The Iraqi Red Crescent Society has undertaken a nationwide disinfection campaign to sterilize markets, shops, residential areas, hospitals, health institutions, prisons, mosques and shrines. Travel between provinces has been restricted, and all government bodies have been directed to support health services. International travel both into, and out of, the country has also been limited, with visitors subject to restrictions on their movement upon arrival in Iraq. These controls have gradually eased.

The Central Bank launched a number of schemes to prop up the financial sector, including payment holidays, deferral of loan interest and general liquidity facilities. It announced a moratorium on interest and principal payments by small and medium-sized enterprises through its directed lending initiative (the ‘1 trillion Iraqi Dinar’ initiative), and encouraged banks to extend maturities of all loans where possible. The bank has encouraged the use of electronic payments to contain the transmission of the virus, and instructed vendors to eliminate commissions on such payments for six months. On the fiscal side, the authorities reduced spending on non-essential areas and safeguarded budgetary allocations to the Ministry of Health. The Committee for Health and National Safety is introducing a cash transfer scheme targeting workers in the private sector who do not receive salaries or benefits from the Government.

Source: IMF COVID-19 Policy Tracker; World Bank 2020b; newspaper reports.

5.2 Fiscal conditions

As a result of macroeconomic shifts, Iraq’s fiscal position has dramatically worsened. The deficit is at an unprecedented level. With an assumption of Iraqi oil selling at an average price of $30 a barrel over 2020 (a World Bank scenario), the budget balance is expected to swing from a 1.3 percent of GDP surplus in 2019 to a massive –29.6 percent deficit in 2020, and –20 and –17 percent of GDP in 2021 and 2022, respectively (although, as noted elsewhere, forecasts for later years are subject to considerable uncertainty). See Figure 9.

Figure 9: Iraq’s fiscal position has dramatically declined

Budget balance – percentage of GDP

Source: World Bank 2020b. 2020 figures are estimates; 2021 and 2022 are projections.
The deficit is driven by a collapse in revenue rather than a spike in expenditure. In 2020, an estimated 92 percent of government revenue will come from oil. Non-oil revenue declined by 24 percent in 2019 to around 3 percent of GDP. This leaves Iraq with one of the world’s lowest non-oil revenues to GDP figures. Overall, total government revenue has substantially fallen following the oil price crash (Figure 10).

Expenditure was already rising prior to the pandemic, climbing 26 percent from 2018 to 2019 as a result of increases in the wage bill and other items following citizen protests. As a result, capital expenditures, already low outside the oil sector, are expected to face significant reductions. Current forecasts suggest that the wage bill alone will account for more than all government revenue over 2020, before ameliorating somewhat in 2021 (Figure 11).

On the other side of the fiscal equation, expenditure will be difficult to reduce in any meaningful way. Spending to respond to COVID-19 pressures will increase demands on the exchequer. But the main components of public spending—the wage bill and pensions—are ‘sticky’ and cannot be rapidly reduced. They are also considered extremely politically sensitive, given their role in sharing the benefits of oil wealth more widely as part of the political settlement. Electricity prices, among the cheapest in the region, are currently subsidized to the tune of $12 billion a year under the settlement. The national electricity company operates with large losses and a structural deficit.

In addition, there will be increasing financing demand from the Public Distribution System, which already accounted for around 10 percent of government recurrent expenditure in 2018, as well as for other forms of social assistance. Increased expenditure on health services will be required to tackle the pandemic’s direct public health effects.

Expenditure was already rising prior to the pandemic, climbing 26 percent from 2018 to 2019 as a result of

This dramatic imbalance between revenue and expenditure will have a significant impact on debt levels for at least the three years from 2020 to 2022 (Figure 12). Total debt is expected to nearly double from 44.6 percent of GDP in 2019 to 87.4 percent in 2022. Around 60 percent of debt in 2019 was externally contracted, meaning its real value is vulnerable to changes in the exchange rate. This figure may well rise depending on how the Government chooses to raise financing. As well as this general growth in debt, there are also growing and specific contingent risks to public finances. Two major State-owned banks are reportedly struggling with non-performing loans made to the oil sector. The national electricity company operates with large losses and a structural deficit. While liquidity support and interest payment holidays from the Central Bank may alleviate some challenges on these issues, these measures will erode the quality of the bank’s balance sheet over time and represent an additional fiscal risk over the medium term.
The country’s growing macroeconomic and fiscal imbalances pose a serious risk to debt sustainability in the coming years. The expected 29 percent deficit for 2020 is not sustainable for any extended period of time. While public debt interest costs as a percentage of GDP are expected to only increase modestly from 2020 to 2022, and remain below 2 percent of GDP, or roughly 4 percent of expenditure, financing will need to be found in large quantities just as the market is tightening, capital at a global level is moving to ‘safe havens’, and Iraq is seen as a riskier borrower.\(^{40}\)

Iraq does not face an immediate risk of debt default given its substantial international dollar reserves at the Central Bank, although the situation will rapidly worsen as these are progressively used up. Iraq’s credit rating outlook has already been downgraded by ratings agencies with regard to its debt risk.\(^{50}\) The country will need to rapidly develop a financing plan to meet the short-term needs of the exchequer. It is likely that this will require a range of borrowing from domestic and international sources as well as short-term support from international financial institutions and potentially neighbouring countries. Overall, financing the debt burden for the short to medium term represents the overriding policy priority, as discussed below.

Unfortunately, Iraq’s fiscal institutions will find it very challenging to manage these circumstances. Previous policy decisions have led to a highly procyclical fiscal policy that does not respond to fluctuations in oil prices. There has been a rough correlation between changes in oil prices and changes in government spending of around 0.7.\(^{51}\) At present, the rapidity and scale of the fiscal turnaround over 2020 means that the Government does not intend to pass a full budget for this year. The current Government was formed relatively recently, following political deadlock and social unrest. Media reports suggest that it believes that plunging oil prices have rendered planning assumptions for the 2020 budget redundant. Instead, it will focus on developing the 2021 budget, while acknowledging the risk that Iraq’s current fiscal situation will prove unsustainable in the long term.\(^{52}\)
Box 4: The trajectory of oil prices and Iraq’s macroeconomic position

Iraq’s short- to medium-term macroeconomic and fiscal fortunes are intimately tied to changes in oil prices. A rapid recovery in oil prices may mean only limited macroeconomic impacts from COVID-19 and a potential return to ‘business as usual’. On the other hand, a long-term depression in oil prices—perhaps caused by a structural downward shift in global demand—would represent a much greater challenge for Iraq’s economic model.

At a global level, oil prices have experienced extreme volatility over 2020. Brent crude prices fell almost 70 percent from January to mid-April, a larger decline than that experienced after September 11 or any previous global economic recession. Total oil demand fell by almost 5 percent in the first quarter of 2020, and is projected to decrease 20 percent in the second quarter of 2020. Overall, oil demand is expected to drop by over 8 percent in 2020 compared to the previous year—a greater decline than the previous 4 percent record of 1980. The reduction in demand is not being matched by a fall in supply. The apparent failure of OPEC+ to reduce production in 2020 despite agreements means that oil inventories have risen significantly.

Projections for oil prices in the near future do not point to a rapid recovery to pre-COVID-19 levels. Iraq’s annual average price for oil in 2019 was estimated at $61 a barrel, and is forecast at only $30 a barrel over 2020 and around $40 in 2021 and 2022. Even these forecasts must be seen as subject to significant uncertainty. As of late August 2020, global spot prices for various types of oil were around $40-45 a barrel. Oil futures for 2022 and later are only marginally above this level. Recent forecasts from the International Energy Agency expect global demand for oil to continue to fall as the impacts of COVID-19 spread.

Critically, these forecasts for oil prices do not reach Iraq’s estimated ‘fiscal break-even points’. Iraq’s 2019 budget was forecast to balance at around $59 a barrel. The break-even price for the budget has risen, however, as a result of increases in payroll costs emerging from the December 2019 protests. According to some estimates, Iraq’s current pattern of public spending with an increased wage bill, higher pensions and more demand for Public Distribution System goods will require an oil price of around $76 per barrel to finance recurrent spending, and $58 a barrel simply to meet the public-sector wage and pensions bill alone.

This provides a sobering medium-term projection for Iraq’s macroeconomic and fiscal situation. Unless there is a dramatic and unexpected increase in oil prices, the macroeconomic conditions of a substantially negative fiscal deficit and current account deficit are likely to continue for at least the next two to three years.

Source: IMF 2020f; World Bank 2020b; IMF 2020e; IEA 2020b and 2020c.

5.3 The external sector and monetary impacts

The fall in oil prices combines with other effects to pressure Iraq’s external position. The oil price decline represents a massive income shock to Iraq as a whole. Overall, far fewer dollars are flowing into the region from either oil exports, non-oil exports or foreign direct investment (FDI). The United Nations Economic and Social Commission for Western Asia estimates that the Arab region is likely to lose 45 percent of FDI inflows in 2020.53 Iraq will be particularly affected since its FDI was already heavily skewed towards the oil sector.

At less than 1 percent of GDP, remittances to Iraq are very low compared to the regional average.54 A drop-off will not materially affect the country’s external position, but will have an impact on households that rely on remittances to supplement their income.
With foreign exchange reserves gradually being used up, the dinar to dollar peg is threatened. The World Bank predicts that current reserves can last until the end of 2021 before moving below the benchmark of three months of import cover. This provides a window of stability to prevent an immediate and unplanned monetary adjustment. A slight recovery in oil prices towards the second half of 2020 is expected to reduce the speed of the outflow of dollars, but this merely postpones rather than halts any unscheduled adjustment. Should the government choose to instruct the Central Bank to sell its foreign reserves to finance its deficit, which is one of the options for meeting immediate financing needs, this would accelerate depletion and bring forward the date at which they are exhausted.

There are scenarios where a rapid monetary adjustment caused by the exhaustion of foreign reserves creates potentially serious macroeconomic dislocations:

- **Rapid devaluation of the dinar**: If reserves are used up rapidly, and/or citizens and businesses lose confidence in the dinar, a massive run on dollars and basic goods could result. If people divest their excess dinar holdings, buying goods or dollars, prices could rise rapidly on the basis of a self-fulfilling cycle of inflation and devaluation. At this point, the pegged exchange rate will likely be unsustainable and lead to a sudden and massive devaluation. This will result in high inflation, likely operating alongside price increases as a result of the hoarding of basic goods. The purchasing power of households and the Government will significantly decline.

- **Inflation as a result of direct financing of the deficit**: In another scenario, if the Central Bank finances the government deficit directly, this will likely lead to high inflation and potentially hyperinflation, although this practice is currently prohibited under Article 26 of the 2004 Central Bank law.

- **Profiteering and corruption from parallel rates**: If there is a prolonged period of parallel market currency rate differentials with the bank rate, this will facilitate profiteering from those with ready access to dollars and reduce market confidence in the Central Bank’s currency arrangements.

While foreign reserves last and confidence in the value of the dinar continues, these scenarios can be avoided, but the current relatively positive situation of subdued inflation may not remain. Annual consumer price increases are projected to remain low at just over 1 percent in 2020 and are forecast to remain low out to 2022. This will help maintain the purchasing power of households, which will also benefit from the continued public distribution of heavily subsidized essential goods. There are medium-term risks of inflation, however (Figure 13). These can come from the monetary sector, which could potentially lead to a dramatic and sudden increase. They may also come from prolonged disruption to global supply chains that make certain imported goods (or goods with a high import content) scarce, pushing up prices regardless of the monetary situation.

![Figure 13: Over the medium term, inflation could start to rise](source: World Bank 2020b. 2020 figures are estimates; 2021 and 2022 are projections.)

### 5.4 The financial sector

Global financial conditions are tightening. Market volatility has spiked, and emerging and frontier markets have seen the largest capital outflows on record. Borrowing costs have risen for many emerging markets and middle-income countries. For an economy like Iraq, dependent on oil and with many large State-owned enterprises operating in...
key sectors of the economy, there are numerous channels through which COVID-19 effects can disrupt the financial sector.\textsuperscript{58} These include:

- **Rising non-performing loans as economic activity slows, pressuring bank solvency and overall access to capital, particularly where a fiscally stressed government and its State-owned enterprises are a major customer.**

- **Tighter credit to the private sector as banks deal with a shrinking capital base and reduced economic opportunities for lending.**

- **Losses due to local currency devaluation where banks have a negative net foreign asset position.**

- **Risks to the Government where it is a shareholder or owner of public banks, and also a guarantor (formally or informally) of certain aspects of bank lending and customer deposits.**

Iraq’s financial sector was already under pressure prior to COVID-19, and now faces additional risk. Even during the relatively benign conditions of 2019, large State-owned banks were burdened by legacy assets and loans to State-owned enterprises. Banks across the financial sector were facing rising rates of non-performing loans, in particular those made to the oil sector. Credit to the private sector remained constrained overall, partly as banks prefer lending to State-owned enterprises.\textsuperscript{59} Together with a tightening of global credit conditions, this made it hard for the few formal business in operation to access temporary credit in the short to medium term. Previous assessments from the IMF had called for improvements to bank supervision to build resilience.\textsuperscript{60}

The current status of the financial sector now reduces the Government’s ability to borrow and represents a significant contingent fiscal risk. If the Government decides to try and borrow domestically, it will further squeeze available credit for the formal sector. If borrowing internationally, credit to the Government will be more expensive. In terms of contingent risks, international evidence suggests that fiscal risks like financial crises tend to co-crystalize, and that the financial sector is often a major fiscal risk through emergency recapitalizations. A macroeconomic crisis can easily turn into a financial crisis, and then trigger a cascade of other risks. Furthermore, financial crises tend to be some of the most expensive in terms of the percentage of GDP required to rectify them.\textsuperscript{61} Iraq is not in a position to engage in a serious recapitalization of its banking sector. Such an effort will only add to pressure on already stretched public finances. This puts a premium on ensuring close supervision of the financial sector, in particular State-owned banks, so it remains sustainable and does not require government capital injections.
6. INCOME, EMPLOYMENT AND POVERTY AS A RESULT OF COVID-19

A challenging macroeconomic context will affect individuals, their income and their household welfare (Box 5). This section takes the high-level discussion of macro-fiscal variables and explores what this means on the ground for Iraq’s population, and in particular the impact on different regions and types of households. The discussion focuses on the current and future trajectory of employment and income-based measures of poverty. Other studies in this series will detail the impacts of COVID-19 on poverty, social inclusion and social protection at the household level.

Box 5: COVID-19 impacts on household poverty and human development

There are numerous channels through which the impacts of COVID-19 on the economy will come to affect households in particular. Some are obvious and immediate—for example, falls in household income and increases in inequality. Others are longer term and less obvious. These impacts will not be felt evenly through the population. They are expected to fall disproportionately on those groups already experiencing disadvantage and exclusion.

The immediate consequences of COVID-19 in terms of household welfare will likely come from:

1. The impact on labour income through the loss of earnings due to sickness, reduced hours and/or lower salaries, or unemployment.

2. The impact on non-labour income through reduced remittances and/or less informal support from family and other networks that are also under financial strain. This could potentially be offset by government assistance.

3. Direct impacts on consumption through changes in the prices of essential goods, particularly food, as well as increased costs of health care.

4. Service disruptions, such as the closure of schools and associated school feeding programmes, a lack of access to public health-care facilities as a result of COVID-19 pressures, and disruptions in the mobility required to access services due to lockdowns.

While these impacts will most obviously affect household income, other measures of poverty that take a more multidimensional approach will also register a downturn. Globally, progress on the Human Development Index could noticeably retreat. Projections suggest a reversal of the last six years of global gains. On some measures of human development, conditions today as a result of COVID-19 are equivalent to deprivation levels last seen in the mid-1980s.

While some of the technical discussion on poverty statistics focuses on metrics of income and employment, this can obscure a great deal of variation and detail within these figures. In designing a response to COVID-19, governments will need to be aware of the different dimensions of poverty that households can experience, and the degree to which varying types of households and individuals can be differentially affected.
Box 5: COVID-19 impacts on household poverty and human development, cont.

Basic food security, for example, can be a challenge even when household incomes appear robust if the price of food begins to rise substantially. In other cases, the education of children is likely to suffer from prolonged school and university closures. Household budgets to fund out-of-pocket and/or social insurance-based health costs will be reduced. And inequalities in household capabilities (e.g., through Internet and mobile phone access) will be exacerbated. These impacts will have longer-lasting effects on household well-being, and will not immediately show up in simple measures of household monetary income.

Certain groups are likely to suffer much more than others and recent reports and studies are already starting to confirm this. They include women, the elderly, people with disabilities, ethnic or national minorities, displaced people and people living in informal settlements. In many cases, these categories will overlap, leaving individuals and households at an extra disadvantage. Poorer households living in dense or overcrowded conditions, for instance, are at higher risk of infection. Such households will also struggle to access quality health care to treat the disease. High-contact and public-facing jobs that cannot be done from home are disproportionately done by low-income individuals. People working informally, often the majority of workers in many developing countries, usually have no access to formal contributory unemployment insurance schemes, and may face catastrophic incomes losses from economic restrictions to combat COVID-19.

Women are particularly at risk. School closures and elderly care will add to the disproportionate amount of time that women already spend on unpaid care work compared to men. Women are usually more exposed to infection from COVID-19 due to their larger share of jobs in the health and service sectors. And they can face a higher likelihood of domestic violence during home confinements. Further, many service sectors most affected by the economic shock have higher concentrations of female workers. Globally, UN Women expects that an additional 47 million women and girls will be pushed into poverty by the end of 2021 as a result of the pandemic.

A further issue is that inequalities will likely widen between countries. High-income countries with well-developed welfare and health systems will be starting in a better place to manage the economic and public health consequences. The tightening of global capital markets will mean that low-risk, high-income countries will find it easier to finance a comprehensive COVID-19 response as markets seek safe returns. Low-income countries with a higher credit risk will face particularly expensive borrowing—or potentially be unable to borrow at all. This will significantly reduce their ability to respond to the public policy challenge of COVID-19.


6.1 Employment and income

The entire Arab region is expected to be badly affected by COVID-19 in terms of poverty and employment. The ranks of the poor across the region may rise by 14.3 million people, to more than 115 million overall.62 This is around a quarter of the entire population of Arab countries. In a region where 14.3 million people were already unemployed, the International Labour Organization estimates losses equivalent to 17 million full-time jobs in the second quarter of 2020 alone.63

Iraq’s employment context was already challenging before COVID-19. Its formal labour force participation rate was one of the lowest in the world at around 50 percent in 2019, below the regional average. Rates were 72 percent for men and 16 percent for women.64 Around 58 percent of people working were employed in the private sector.65 Most private-sector employment
is informal and concentrated in micro-, small and medium enterprises. Workers here are outside formal systems of social insurance, and social protection and welfare. Growth of the businesses they work for or own is typically constrained by their informal status.\(^66\)

Household surveys suggest that unemployment was highest among women and youth prior to the crisis. The labour force contains a substantial NEET cohort.\(^67\) In Iraq’s political and security context, a large share of unemployed young people is typically seen as a long-term risk to social stability.

Initial aggregate national estimates suggest a strongly negative impact from COVID-19 restrictions on employment. Lockdowns significantly cut into Iraq’s large service sector, which constitutes around half the non-oil economy, and covers job-rich areas such as transport, trade, banking and religious tourism. Informal estimates suggest that unemployment has already surged beyond its 2018 level of 10 percent, and is particularly high among the internally displaced.\(^68\) Rapid small-scale surveys indicate that a quarter of those employed before the COVID-19 pandemic have been laid off, with over one third of younger workers made redundant.\(^69\)

One less negative feature of the labour market is that the reduction in oil production is less directly felt in terms of overall unemployment since the sector does not employ a large number of people. This impact on the private sector is in contrast to the public sector, where employment has broadly been maintained. Public-sector employment is relatively extensive at around 40 percent of the workforce.\(^70\)

More detailed studies of fallout on small and medium enterprises are registering significant concerns. In a survey of employers in April 2020, 90 percent reported that cash-flow reductions were preventing their businesses from returning to normal following an easing of lockdown restrictions; many were unable to pay suppliers. The most common strategy for coping with these pressures was to lay off staff. Firms reported an average 52 percent reduction in production and a 70 percent reduction in sales.\(^71\)

The survey looked more specifically at individual sectors within Iraq that generate the most jobs outside public-sector employment. Enterprises in all of these sectors reported significant reductions in employees and hours worked. The construction and manufacturing and service sectors appeared most affected, with wholesale and retail relatively less so (Table 1).

These employment impacts are likely to disproportionately affect marginalized groups (Box 6). Global evidence suggests that informal, casual

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage of employees losing jobs at a firm</th>
<th>Percentage of employees with reduced hours or days at a firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction and manufacturing</td>
<td>52</td>
<td>65</td>
</tr>
<tr>
<td>Food and agriculture</td>
<td>45</td>
<td>50</td>
</tr>
<tr>
<td>Services</td>
<td>39</td>
<td>90</td>
</tr>
<tr>
<td>Wholesale and retail</td>
<td>21</td>
<td>51</td>
</tr>
<tr>
<td><strong>All sectors</strong></td>
<td><strong>40</strong></td>
<td><strong>60</strong></td>
</tr>
</tbody>
</table>

Source: IOM 2020b.
and/or low-income workers typically bear the brunt of income and job losses in low and middle-income countries. Many sectors most affected—such as retail, construction and general services—make most use of low-wage and flexible informal labour that provides an income to the poorest people. Many construction jobs depend on government investment that has been suspended or is typically the easiest item to cut, resulting in particular challenges for low-paid daily rate construction workers.

Although a small part of GDP, the agriculture sector is prominent in terms of its share of the labour market (Table 2). It also risks being negatively affected. Households relying primarily on small-scale farming tend to be among the poorest households. The sector, which employs just under 20 percent of the workforce, has faced difficulties as a result of movement restrictions. This means that farmers may cultivate less land and be less able to access markets to sell their goods, reducing next season’s harvest and this season’s income. This may result in both short and long-term consequences for income.

| Percentage of total employment | 18.7 |
| Value added in percentage of GDP | 2 |


Some of these negative effects on employment and income may endure after lockdowns are lifted. The significant reduction in the economic activity of small and medium enterprises endangers not only their collective role as major employers but also their long-term viability. In the April survey, many enterprises indicated a risk of permanent closure as a result of the lockdowns. Should a large share ultimately fail, the backbone of the non-oil economy will be severely affected. The inability of firms to rapidly recover their previous financial position puts longer-term economic development and diversification at risk as firms cut back on investment and expansion.

Iraqi migrant labourers in Iran, Kuwait and elsewhere remain vulnerable, and face significant logistical and financial challenges in returning home given travel restrictions. These workers will suffer from COVID-19 induced job losses, expired labour visas or residency permits, and strict quarantine measures. This will also affect households in Iraq who depend on their remittances. Although not macroeconomically significant at less than 1 percent of GDP in 2019, remittances represent around $700 million in financial support for Iraqi households. In the longer term, the sudden return to Iraq of large numbers of migrant workers would put extra pressure on the Government to provide financial support, adequate health care and other basic services for their reintegration into Iraqi society.

Box 6: The regional impact of COVID-19 on women and young people in the labour force

A large number of workers and businesses will suffer as a direct result of the pandemic and the accompanying economic and social restrictions. Experiences from earlier outbreaks of disease point to particularly negative effects on women and young people.

The Arab region faces specific challenges regarding female and youth unemployment. The female formal labour force participation rate of 20 percent was already the lowest of all regions worldwide before the crisis. The region also has the highest rate of youth unemployment, at 27 percent on average in 2019, rising to 43 percent for young women. The United Nations Economic and Social Commission for West Asia estimates that women in the Arab world will lose approximately 700,000 jobs as a result of the outbreak.

Young women are at particular risk since young people in general are typically less well established in the labour market. An estimated 75 percent of youth in the region work informally, making it harder for them to access formal systems of social insurance, and to take advantage of formal job training and capacity development schemes.

Source: UNESCWA 2020.
6.2 Poverty and social protection

Before the pandemic, Iraq’s progress on reducing poverty had already stalled, in part due to the conflict with ISIL, as well as impacts from the reduction in oil prices. While overall income poverty was estimated at 20 percent of the population in 2018-2019, broader measures of poverty from 2017 that include non-monetary factors estimated that around a third of Iraqis fell into this category. Poverty rates (the poverty headcount), ‘near poverty’ rates (those households at up to 1.5 times the income defined as being in poverty), and the ‘poverty gap’ (the average fraction of the poverty line that the poor require to escape income poverty) vary among regions (Figure 14).76

There is a divide in poverty risk between households drawing their income from the public and private sectors. Informal workers in the private sector are at greatest risk of missing out on contribution-related social assistance. As their work is not formally registered, they will not receive official unemployment or workers compensation benefits, although they may receive other forms of social assistance.78 This is in contrast to those working in formal jobs, for example, in the public sector, who are unlikely to lose their jobs entirely, although reports suggest that some may be experiencing a degree of temporary salary reductions.79 Such households typically have a higher income as a result of public-sector employment paying higher wages than private-sector employment.

The pandemic also poses risks of undercutting the food security of low-income and informal-sector households. Agricultural conditions for food production were relatively good in early 2020, and prices of staple food items have been fairly stable in recent months.80 There is not yet evidence of a widespread increase in food insecurity, although the situation is continuing to change, and bearing in mind that around 1.7 million people are already considered food insecure.81 A major risk to the purchasing power of households comes from the potential for a sudden currency collapse and consequent imported inflation. This could be particularly severe for Iraq given that around 60 percent of the country’s food is imported.82 A more remote possibility, which would also have a dramatically negative impact on household purchasing power, would be Central Bank financing of government expenditure, leading to hyperinflation, although this is not permissible under existing laws.

In terms of social protection, public-sector salaries and public assistance are the most stable forms of income for many households. The

COVID-19 will have a number of direct and indirect effects on poverty levels. Lower incomes will result from unemployment and/or reduced working hours as a result of the shrinkage and/or closure of certain firms. Workers may also be absent from work as they recover from the illness or care for vulnerable or sick family members, a burden likely to fall most heavily on women. The resulting economic slowdown will also affect asset prices, typically in a downward direction, and households that hold wealth in non-financial assets may see a reduction in their value. Although official statistics operate with substantial time lags, in June 2020, a short survey of displaced households and returnees—some of the most vulnerable households across Iraq—suggested that three quarters of respondents had been finding it harder to meet their basic needs since the start of the pandemic.77

![Figure 14: Levels of poverty remain high in much of Iraq across different measures](image-url)

Poverty measures by region
(percentage of population, 2017/18)

<table>
<thead>
<tr>
<th>Region</th>
<th>Poverty headcount rate</th>
<th>Near poverty headcount rate</th>
<th>Poverty gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iraq</td>
<td>20%</td>
<td>30%</td>
<td>25%</td>
</tr>
<tr>
<td>KRB</td>
<td>25%</td>
<td>40%</td>
<td>35%</td>
</tr>
<tr>
<td>North</td>
<td>15%</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>Centre</td>
<td>10%</td>
<td>20%</td>
<td>15%</td>
</tr>
<tr>
<td>South</td>
<td>15%</td>
<td>25%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Public Distribution System of subsidized essential goods will therefore become more important to household welfare. Surveys from 2017-2018 indicate, unsurprisingly, that food ration goods from the system make up double the proportion of food consumed in poorer households compared to average households. Informal workers will have access to the system and to some other short-term limited assistance programmes established by the Government in response to the pandemic. But it is most likely that they will need to fall back in part on savings and/or family support, although recent research suggests that only around one in seven low-income households have any form of savings at all.

The gap in social assistance for this group represents the most obvious ‘missing part’ of the Government’s support to vulnerable groups. Existing social protection schemes are not harmonized with each other to maximize their ability to help the poorest. These systems are likely to become more expensive amid additional pressure to meet increased need, coupled with significant fiscal pressure from the drop in oil revenue. On the other hand, the Public Distribution System cost $1.4 billion in 2018, a likely manageable 2.3 percent of recurrent expenditure.

A key variable in the discussion of household poverty relates to the strength and timeliness of the economic rebound. World Bank simulations showing the impacts of lower income and higher food prices on poverty suggest that the increase could be treated as a short-term shock, from which a large share of households will recover within 6 to 12 months as the crisis ends and the economy regains its footing. If temporary job losses become permanent, however, the newly poor will be trapped in poverty over the longer term. One additional channel for this entrapment could be via housing, as the crisis may lead to a surge in informal settlements because people cannot afford rental accommodation. See also Box 7.

**Box 7: Scenarios for changes in poverty as a result of COVID-19**

Modelling by the World Bank and UNICEF put forward a number of different trajectories for the poverty rate in Iraq, using different assumptions of changes to income and cost of food. Models used data from the 2017-2018 Rapid Welfare Monitoring Survey and other pre-COVID-19 surveys on poverty, income and deprivation. The exercise provided some estimates for how Iraq’s population will be affected in aggregate by the COVID-19 pandemic over time.

The analysis looked at reductions in household welfare through income poverty (the loss of employment/labour income combined with increases in food prices), and through a broader ‘multidimensional vulnerability index’ that encompasses income and household access to a range of eight basic goods and services. A household was defined as vulnerable if it is deprived of more than one quarter of the categories. Government assistance through the Public Distribution System was assumed to remain stable.

**INCOME POVERTY**

In the ‘most likely’ central scenario that incorporates the actual experience of the national lockdown period, poverty increased by 11.7 percentage points—around one half. The poverty rate rose from 20 percent in 2017-2018 to just over 31 percent in 2020. In population terms, this means an extra 4.5 million people in income poverty. The modelling suggested that children under age 18 would face an even higher increase in poverty, reaching a rate of 37.9 percent. There were regional variations with the highest poverty rates forecast for the northern governorates (43.6 percent) followed by the southern governorates (39.6 percent). The poverty rate was lower in the centre and Kurdistan Region governorates at 26 percent and 11.9 percent, respectively.
Box 7: Scenarios for changes in poverty as a result of COVID-19, cont.

The highest poverty rates are forecast for the northern governorates

Poverty rate – baseline compared to model (percentage of population below poverty line)

Source: World Bank and UNICEF 2020. The projection values assumed a ‘moderate-low’ impact scenario where food prices rose by 20 percent, and employees in the public sector and self-employed people in rural areas were assumed to maintain full incomes, while employees in all other sectors were assumed to lose 20 percent of their pre-crisis income. These assumptions operated alongside others regarding the length and stringency of lockdown/curfew restrictions. This was the ‘baseline’ scenario assumption. Other assumptions resulting in other scenarios were also modelled.

MULTIDIMENSIONAL VULNERABILITY

In the most likely central scenario, the multidimensional vulnerability approach found that 42 percent of the total population was vulnerable to poverty as a result of the pandemic. This figure is higher than the income poverty measure given a broader definition of poverty. Similar regional patterns were evident.

These scenarios bring home the magnitude of the impacts of COVID-19 on household poverty, although the likelihood of them unfolding in reality is not clear. Reports of mass layoffs of the lowest paid and most vulnerable informal workers in small and medium enterprises in many parts of the country indicate that a significant drop in income is already occurring. But food prices appear stable, suggesting that, for the moment, the ‘double shock’ of falling incomes and rising food prices can be avoided. The scenarios emphasize the need for the government response to be broad-based and inclusive, and committed to ensuring that the poorest households receive the protections they need.

7. POLICY RECOMMENDATIONS
This section proposes policy options for the short and longer terms, building on the analysis above. The economic impacts of COVID-19 mean that, overall, Iraq faces increasing poverty and inequality in the coming years. As recently noted by the UN Deputy Secretary-General in remarks to a global gathering of finance ministers, the world could see a potentially significant setback in overall progress towards the SDGs. The intention of these recommendations, therefore, is to support the Government of Iraq in developing its national policy responses to fallout from the pandemic while keeping a focus on achieving the global Goals.

Iraq’s current macro-fiscal economic situation is daunting. ‘Do nothing’ is not an option. The economic challenges are numerous and interlinked. Almost all short-term problems are connected to the global fall in oil prices, which is beyond Iraq’s direct control. Most immediately, the Government’s ability to deal with increasing poverty, forecast to affect up to 42 percent of the population using a broad-based definition, is severely compromised by a lack of revenue. More ominously, Iraq currently has many of the ingredients of a macroeconomic crisis, particularly with regard to the stability of the currency, the level of Central Bank dollar reserves and confidence in the existing monetary situation. The length and severity of the oil price depression will directly determine the Government’s response. With a rapid rebound in oil prices and associated government revenues, the current situation can be managed within existing policies at the cost of extensive (and likely expensive) borrowing. Analysis of the future of the oil market does not suggest a rapid and significant rebound in prices, however. Actual current oil price futures for 2021 and 2022 are not meaningfully higher than today’s prices. In the more likely context of a prolonged oil price depression, Iraq will need to make dramatic and painful changes to its macroeconomic model.

Despite this need, massively cutting public expenditure is neither feasible nor desirable given the role of public expenditure in protecting vulnerable households. The wage bill, pensions, Public Distribution System and other social assistance collectively provide broad-based (if limited) social benefits across the country. Furthermore, these expenditure items are widely seen as contributing to political and social stability through their role in distributing the benefits of oil wealth to the wider population as part of the political settlement. Rapid and severe cuts to such programmes may lead to serious social protest, and a potential downward spiral in social trust and national security.

This suggests that the government agenda should focus on two fronts. First, it should rapidly identify additional financing options, avoid an unplanned monetary adjustment, and improve the quality and targeting of public expenditures. Second, it should support the non-oil private-sector economy to grow and reduce dependence on oil, while continuing to provide employment for a large number of the most vulnerable and low-income households by extending social assistance schemes. To maintain public support for these policies, the Government should develop them in an inclusive manner, and ensure clear communication and transparency in execution.

The recommendations provided below are aligned with recent thinking on increasing fiscal space to address the consequences of the COVID-19 pandemic and ensure that the Government can still adhere to the 2030 Agenda. The proposals build on the premise that fiscal space for SDG spending can be increased through reallocating expenditures, increasing revenue generation, expanding social security coverage, deploying fiscal and foreign exchange reserves, improving the management of debt and improving the overall macroeconomic governance framework. Each of these matter for Iraq in both the short and long term. As a result, the policy recommendations should be seen in the broader context of managing fiscal affairs so as to maximize financing for investment in the SDGs.

Short-term policy recommendations cover a number of areas:

- **Financing the deficit**: The Government should rapidly develop a financing plan to cover the
short- and medium-term imbalance between revenue and expenditure. Sources of finance will include: issuing domestic debt, of which around $13 billion has already been approved by Parliament; accessing foreign debt if acceptable terms can be identified; taking loans from international financial institutions if acceptable terms can be agreed; and bilateral loans from neighbouring countries. The Government reportedly has started pursuing each of these options through various routes. It could also consider, at the extreme, limited direct financing from the Central Bank but only under a clear policy framework that maintains market confidence in the value of the dinar.

- **The monetary and financial sector:** The Government and Central Bank should rapidly and confidentially review a number of scenarios and policy options regarding the currency regime, and determine a course of action that will sustain both confidence in the dinar and acceptable levels of foreign exchange reserves without triggering uncontrollable inflation. The bank should continue to provide liquidity through its current facilities, and to encourage or formally mandate debt holidays or the rescheduling of debt payments from major non-financial corporations. The Government and the bank should rapidly assess the health of the two State-owned banks and consider extending temporary liquidity loans.

- **Expenditure policy:** The Ministry of Finance should quickly review public expenditure to reduce non-essential spending and reprioritize expenditures into health, social protection and support for the wage bill. It should undertake rapid actions to reduce and retarget spending within the wage bill to protect low-income workers and pensioners, and reduce spending on high salaries and pensions. The Government should also consider rapid electricity tariff reform given the size of the current subsidies, with a view to raising costs for wealthier and larger consumers. Importantly, the Government should avoid simply not paying its bills since the size of the public sector means that a flood of arrears could paralyse the broader economy.

- **Social protection:** The Government should review the Public Distribution System and other social assistance schemes with a view to creating an inclusive cash assistance system. This should be aimed at delivering a minimum level of social protection to vulnerable households, while avoiding a narrow focus on extreme poverty and minimizing exclusion errors. As part of this, the Government should look at innovative means (e.g., mobile phone channels) to provide cash assistance to the most vulnerable, and consider direct food aid to the poorest regions and areas. The Government should take particular care to ensure that distribution channels for social assistance factor in gender issues and specific barriers faced by women and girls. Where appropriate, the Government should consider expanding eligibility for public assistance schemes to informal workers.

- **Support for private business:** The Government should introduce further support for small and medium enterprises that provide the backbone of private-sector employment for low-income and vulnerable households. For the small number of formal non-governmental companies, the Government should consider holidays from pension/social security contributions or other charges in return for no layoffs or other employment guarantees. For both formal and informal businesses, the Government should devise a package of measures, for example, tax holidays, utility payment holidays, potential direct staff salary support or furlough schemes. This could help maximize the number of businesses that can continue operating and providing employment.

Medium- to long-term policy options that will reduce Iraq’s position as a resource-dependent rentier economy would include the following:

- **Commit to a set of credible fiscal rules to better manage the impact of changing oil prices.** The Government should take firm action to end its
procyclical fiscal stance. The establishment of stronger fiscal governance institutions to smooth the swings of oil revenue will be critical to avoiding similar macroeconomic problems in the future. It will reduce Iraq’s vulnerability to day-to-day changes in oil prices, and allow for more sustainable spending and investment over the long term. It will also send a signal to domestic and international investors that Iraq seeks to operate with lower levels of fiscal risk, and therefore reduce the cost of borrowing overall.

- **Invest in private-sector development and economic diversification.** This is a long-term mitigation strategy for most of the problems emerging from the COVID-19 challenge. It would comprise a multifaceted agenda across a range of public policy areas. Building a diversified and gender-inclusive private-sector-led economy that invests in high-growth industries, such as green power generation and digital technologies, is the best ‘insurance policy’ against future swings in oil prices (Box 8).

Iraq has received a great deal of policy advice on how to build a more dynamic non-oil private sector that can generate wealth, employment and revenue. Putting forward a credible plan to begin this reform agenda would start the process for the long-term, and again signal to potential investors that Iraq wishes to do things differently in the future.

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**Box 8: Building back greener in the Arab world**

The Arab region continues to face long-term environmental and ecological challenges alongside the short- to medium-term economic and social impacts of COVID-19. It is the world’s most water-scarce and food-import-dependent region, and has emerged as a global climate hotspot with temperatures rising faster than the world average.

The response to COVID-19 therefore needs to incorporate a ‘green recovery’. This means ensuring that policies to respond to the impacts of the pandemic in the short, medium and long term support the transition towards a low-carbon economy (backing climate change mitigation) and incorporate actions that will aid communities in managing a warmer and dryer environment (in line with climate change adaptation).

This ‘green recovery’ could take a number of different forms in different countries and sectors. In terms of the economy, it would mean focusing a fiscal stimulus on green investment; ensuring that tax and subsidy regimes promote environmentally sustainable economic activity and raise the cost of harmful activity; supporting agriculture to manage water resources responsibly; and diversifying the economy away from dependence on fossil fuel exploitation.

These points are particularly important for Iraq. The country’s continued dependence on rain-fed agriculture for both domestic food supply and a large segment of private-sector employment means long-term challenges as temperatures rise. This implies a need to focus on improved water management to safeguard and share existing resources among competing needs.

Developing a diversified and dynamic non-oil private sector is an urgent requirement. This will benefit from an emphasis on ‘future proof’ green technology and climate-friendly ways of doing business. These steps will begin to address a long-term question on the viability of Iraq’s current economic model as a fossil fuel exporter, given a global shift towards low-carbon economies that will dramatically reduce demand for oil, and therefore its price. If Iraq can ‘grow back greener’, it can invest the oil revenues of today in developing the non-oil green economy of tomorrow.

*Source: UNDP, forthcoming.*
• **Develop incentives to progressively bring workers and firms into the formal sector.** This kind of economic reform is typically both politically unpopular and a logistical challenge; however, it is a necessary part of the long-term process of fostering a dynamic private sector that is economically inclusive. The Government should develop and begin implementing a series of policies that will improve returns to formality within the economy and reduce the attraction of operating informally (Box 9).

• **Rationalize and review the public-sector wage bill.** At present, the public-sector wage bill funds neither an effective public service nor a well-targeted welfare or income support scheme. To improve public-sector efficiency overall, public employment should be overhauled, and jobs and staff matched to clear roles and responsibilities. This will be a long-term effort, but one that will support steps to make Iraq’s private sector more effective by building the Government’s ability to deliver effective social and economic services. This need not necessarily require massive layoffs. Reforms can be gradually accommodated through natural wastage, retirement and redeployment.

• **Redesign public assistance schemes to focus on the neediest households and informal workers, and to improve consistency and coordination.** Social transfers are essential for supporting the poor, but the current mix of public assistance schemes is not well targeted at the neediest households and/or those outside the formal labour market, and risks generating significant deadweight costs. Given the political settlement’s commitment to universal distribution of certain goods and services, this would mean targeting benefits to the neediest within a universal scheme. The current multiplicity of schemes is somewhat disjointed and could be streamlined into a smaller number of more effective schemes. This redesign could take advantage of the possibilities offered by digital technology (e.g. mobile phones, biometric ID cards, etc.) to modernize the delivery of social assistance.
Box 9: Formalization in the Arab region

The economies of the Middle East and North Africa operate with widespread informality among both workers and businesses, making them among the most informalized economies in the world. Global evidence suggests a close correlation between higher levels of formality and higher levels of economic development. Within developing countries, businesses with higher skills, higher income and high turnover are far more likely to operate formally. Long-term economic development typically involves the gradual formalization of economic activity. Most governments seek—at least in their stated policy goals—to increase formality.

Policy discussion around informality increasingly recognizes that many low-income workers and small-scale business owners face limited incentives and opportunities to formalize. Often, ‘informal is normal’, and for many workers, informality is not a choice. Recognizing these issues shifts the policy debate away from ‘informality as a problem’, where the focus is on driving down rates of informality as rapidly as possible, and towards how to best support informal workers and businesses as part of a much longer-term transition to higher levels of formality.

The MENA region offers many examples of how increasing support to informal workers and businesses as part of a long-term transition can happen.

- **Improving unemployment assistance to incentivize formalization:** In the early 2010s, Egypt and Jordan introduced reforms that strengthened unemployment insurance systems. Other countries in the region have longer-standing and more developed schemes, including Algeria and Bahrain. An effective system can be one incentive to encourage workers and businesses on the edge of formality to formalize.

- **Offering training and development outside formal structures:** Worker training programmes provided by a government or other public agency are usually aimed at formal workers. There are examples of successful programmes specifically aimed at informal workers, however, with a view to increasing their chances of obtaining better and likely more formal jobs. Programmes in Yemen targeting informal agricultural workers with hands-on training and job placement services that avoided classroom-based learning and assumptions of functional literacy were successful in building skills for formal work in the future.

- **Simplifying business and employment regulation:** Making rules and procedures around employment easier to follow can have a major impact on the likelihood of informality. In some countries, such as Egypt, employers have the right to close or downsize a formal business, albeit through a cumbersome process. In others, such as Tunisia, making formal workers redundant is time-consuming, expensive and uncertain, with final decisions on termination sometimes lying with government officials and not the business concerned. Rules for hiring and termination of workers that strike the right balance between worker protection and labour market flexibility can reduce the disincentives some businesses face with regard to formalization.

- **Reducing the tax wedge:** The tax wedge refers to the share of formal employment income that is paid in income taxes and social security charges. Countries such as Egypt and Morocco have tax wedges that are as high as OECD countries at nearly 40 percent of wages. Other countries—for example, Jordan and Lebanon—have far lower tax wedges. Designing a tax system that reduces tax wedges faced by low-income formal earners can be a key part of encouraging the shift of informal workers into the formal sector.

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