KURDISTAN REGION OF IRAQ

REFORMING THE ECONOMY FOR SHARED PROSPERITY AND PROTECTING THE VULNERABLE
KURDISTAN REGION OF IRAQ
REFORMING THE ECONOMY FOR SHARED PROSPERITY AND PROTECTING THE VULNERABLE

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Foreword

There is a simple premise underlying this Economic Reform Roadmap: that Kurdistan region can and will have a better future if we work together to enable it.

We have become overly dependent on the price of oil. KRG’s public spending has been inefficient, our public sector workforce has been unsustainably large, and our policies have been inhibiting the private sector. Due to lowering oil prices, we are feeling the impacts of this economic shock and we must begin to adapt.

Under the auspices of the President “Masud Barzani” and in light of 2020 vision of KRG to put our people first, we will try implement these reforms without lowering living standards and we will also ensure that public spending works for all of us. We will direct public spending to the issues that matter most to our peoples’ lives.

The process of adapting our economy to prepare for a better future is outlined in this economic reform roadmap: “KRG Reforming the Economy for Shared Prosperity and Protecting the Vulnerable”. This document was become official by a KRG Council of Ministers decree on June 2016 signed by the Prime Minister, His Excellency Nechirvan Barzani. It clearly lays out a plan for investing in our people by making improvements in many sectors including education, health, and jobs while also diversifying our economy away from oil. With this roadmap, citizens have a score card by which to assess each ministry’s progress. I believe we can manage to achieve all of the steps outlined in this roadmap, but not without diligence and the participation of all of our ministries and our whole society.

In addition to our focus on security and protecting our communities, we must also consider our economic goals. It is necessary to promote the private sector and attract foreign investment to prepare not only for a larger but also more productive work force. We should make it easier to start, run, and close a business. We should promote entrepreneurship, especially among young citizens who are the key to KRG’s future. Moreover, there is need to enable private sector development proactively by making our borders more efficient for transit trade. Also investing in technical and vocational education and training (TVET) is another aspect. Agriculture, water, electricity, health, tourism and other important sectors should be also improved through specific programs that are illustrated in this report.

If we can imagine the future of Kurdistan region with a vibrant private sector, efficient and functioning public services, job growth, and universal access to quality K-12 education, we can also plan for how we will achieve those goals.

Although we face challenges, I believe there is a lot to be optimistic about. Through these reforms we will build on our strengths: young population, entrepreneurial spirit, fertile agricultural land, and committed Government officials.

Dr Ali Sindi
Minister of Planning, KRG
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<td>ALMPs</td>
<td>Active Labor Market Policies</td>
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<td>BMI</td>
<td>Business Monitor International</td>
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<td>BOI</td>
<td>Board of Investment</td>
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<td>BSA</td>
<td>Board of Supreme Audit</td>
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<td>CBI</td>
<td>Central Bank of Iraq</td>
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<td>CC</td>
<td>Combined Cycle</td>
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<td>CCT</td>
<td>Conditional Cash Transfer</td>
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<td>CMC</td>
<td>Communication and Media Commission</td>
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<td>CoA</td>
<td>Chart of Account</td>
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<td>CoCI</td>
<td>Chamber of Commerce and Industry</td>
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<td>CPI</td>
<td>Consumer Price Index</td>
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<td>CSP</td>
<td>Community Support Program</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>DBR</td>
<td>Doing Business Report</td>
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<td>DNO</td>
<td>Norwegian Oil Company</td>
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<td>DPS</td>
<td>Dohuk Power Station</td>
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<td>DTM</td>
<td>Displacement Tracking Matrix</td>
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<td>ECOSOC</td>
<td>Economic and Social Council</td>
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<td>EMIS</td>
<td>Education Management Information Systems</td>
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<td>EU</td>
<td>European Union</td>
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<td>FAO</td>
<td>Food and Agriculture Organization</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FINI</td>
<td>Food Insecurity Nutrition Initiative</td>
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<td>FTA</td>
<td>Free Trade Area</td>
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<td>GCC</td>
<td>Gulf Cooperation Council</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GDRB</td>
<td>General Directorate for Roads and Bridges</td>
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<td>GFMS</td>
<td>Government Finance Statistical Manual</td>
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<td>GIZ</td>
<td>German Corporation for International Cooperation</td>
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<td>GOI</td>
<td>Government of Iraq</td>
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<td>GRP</td>
<td>Gross Regional Product</td>
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<td>GTZ</td>
<td>German Agency for Technical Cooperation</td>
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<td>HRMIS</td>
<td>Human Resources Management Information System</td>
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<td>IATA</td>
<td>International Air Transport Association</td>
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<td>ICAO</td>
<td>International Civil Aviation Organization</td>
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<td>IOCs</td>
<td>International Oil Companies</td>
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<td>ICSID</td>
<td>International Center for Settlement of Investment Disputes</td>
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<td>ICT</td>
<td>Information and Communication Technology</td>
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<td>ID</td>
<td>Iraqi Dinar</td>
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<td>IDPs</td>
<td>Internally Displaced Persons</td>
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<td>IEA</td>
<td>International Energy Agency</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>IFIs</td>
<td>International Financial Institutions</td>
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<td>IFMIS</td>
<td>Integrated Financial Management Information System</td>
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<td>IHSES</td>
<td>Iraqi Household Socio-Economic Survey</td>
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<td>ILO</td>
<td>International Labor Organization</td>
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<td>IMC</td>
<td>Intern-Ministerial Committee</td>
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<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
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<td>IOM</td>
<td>International Organization of Migration</td>
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<td>IPPs</td>
<td>Independent Power Producers</td>
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<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
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<td>IRM</td>
<td>Investment Reform Map</td>
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<td>IRU</td>
<td>International Road Union</td>
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<td>ISIS</td>
<td>Islamic State in Iraq and Syria</td>
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<td>IT</td>
<td>Information Technology</td>
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<td>ITC</td>
<td>Iraqi Tax Code</td>
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<td>JFPR</td>
<td>Japan Fund for Poverty Reduction</td>
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<td>JICA</td>
<td>Japan International Cooperation Agency</td>
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<tr>
<td>KDMS</td>
<td>Kurdistan Development Management System</td>
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<td>KIPA</td>
<td>Kurdistan Institute for Public Administration</td>
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<td>KRG</td>
<td>Kurdistan Regional Government</td>
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<td>KRI</td>
<td>Kurdistan Region of Iraq</td>
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<td>KRSO</td>
<td>Kurdistan Regional Statistics Office</td>
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<td>LFS</td>
<td>Labor Force Survey</td>
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<td>LMIS</td>
<td>Labor Market Information System</td>
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<td>MoA</td>
<td>Ministry of Agriculture</td>
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<td>MENA</td>
<td>Middle East and North Africa</td>
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<td>MFN</td>
<td>Most Favored Nation</td>
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<td>MNR</td>
<td>Ministry of Natural Resources</td>
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<td>MoCH</td>
<td>Ministry of Construction and Housing</td>
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<td>MoE</td>
<td>Ministry of Electricity</td>
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<tr>
<td>MoFE</td>
<td>Ministry of Finance and Economy</td>
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<td>MoP</td>
<td>Ministry of Planning</td>
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<tr>
<td>MoTC</td>
<td>Ministry of Transportation and Communications</td>
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<tr>
<td>MoTI</td>
<td>Ministry of Trade and Industry</td>
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<tr>
<td>MTEF</td>
<td>Medium Term Expenditure Framework</td>
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<td>MTFF</td>
<td>Medium Term Fiscal Framework</td>
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<tr>
<td>MW</td>
<td>Mega Watt</td>
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<td>PAYG</td>
<td>Pay-As-You-Go</td>
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<tr>
<td>PDS</td>
<td>Public Distribution System</td>
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<tr>
<td>PER</td>
<td>Public Expenditure Review</td>
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<tr>
<td>PFM</td>
<td>Public Financial Management</td>
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<tr>
<td>PIM</td>
<td>Public Investment Management</td>
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<td>PIMS</td>
<td>Public Investment Management System</td>
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<td>PMT</td>
<td>Proxy Means Test</td>
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<td>PPP</td>
<td>Public-Private Partnership</td>
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EXECUTIVE SUMMARY

1. **The Kurdistan Region of Iraq (KRI) is a constitutionally recognized semiautonomous region in northern Iraq.** Its government, the Kurdistan Regional Government (KRG), based in Erbil, has the right—under the Iraqi constitution of 2005—to exercise legislative, executive, and judicial powers according to the constitution, except in what is listed therein as exclusive powers of the federal authorities. The Iraqi constitution defines the Kurdistan Region as a federal entity of Iraq. KRG has a parliamentary democracy with a regional assembly that consists of 111 seats.

2. **KRI has been largely immune to the insecurity and conflict witnessed elsewhere in Iraq, especially following the 2003 Iraq War.** This has allowed KRG to promote its burgeoning private sector and attract foreign investments in both oil and non-oil sectors. However, starting from mid-2014, the plunging of oil prices coupled with increasing threats to security have intensified pressure on the overall Iraqi as well KRI’s economies, necessitating a need for action to address the immediate and medium-term challenges presented in this report. Government of Iraq (GoI)’s fiscal position has deteriorated and political tensions have increased with widespread demonstrations demanding reforms across legislative, executive, and judicial branches.

3. **KRG is facing a wide range of immediate and medium to longer-term challenges that are intrinsically linked to the overall macroeconomic situation of Iraq as well as the regional and global environment.** The immediate challenge consists in coping with (a) the deep fiscal crisis, and (b) the security and social problems brought about by the conflict with the Islamic State in Iraq and Syria (ISIS) group and the resulting influx of Syrian refugees and Iraqi Internally Displaced Persons (IDPs). These challenges are clearly immediate priorities for the KRG, and would bear significant repercussions nationally and internationally if inadequately addressed. The medium to longer-term challenges pertain to moderating dependence on the oil sector and transforming the KRI economy into a diversified one that supports private sector-led economic growth and job creation in a sustainable manner.

4. **Similar to the rest of Iraq, the fiscal crisis and the security challenge posed by the ISIS insurgency have had a significant adverse impact on economic growth in the KRI.** The fiscal shock is severe. KRG has been dealing with the fall in revenues by a combination of postponing its investment projects, letting payments fall in arrears including wages and salaries of government employees, borrowing domestically from private and foreign companies and banks, and borrowing externally. The impact of reduced investment in infrastructure will be felt in the medium-term through lowering private sector productivity and crowding out private investment. Also, arrears in payments to oil companies and contractors create an uncertain business environment. These, in turn, discourage investment both foreign and local. The ISIS insurgency has put significant pressures on the Government through increased security spending and the influx of refugees and IDPs.
5. To address short-term as well as medium- to long-term structural issues, the Government requested the World Bank support to develop and implement a structural economic reform roadmap. This work is a response to an official request of the KRG Prime Minister H.E. Nechirvan Barzani in a letter to the World Bank President Dr. Jim Yong Kim in February 2016 seeking a partnership for growth and development to address the economic and social challenges. As a response to the Government request, this report proposes reform options for fiscal adjustment and for the diversification of the economy in addition to social mitigation measures to protect the vulnerable from impacts of the external shocks. The proposed economic reform roadmap is expected to guide policy makers in KRG as they address the immediate and more medium- to long-term challenges facing the region in the context of increasing vulnerabilities confronting Iraq as a whole. This work builds upon the World Bank’s extensive analytical and technical assessments conducted under the Economic Growth Diagnostics Study for the KRI, as well as technical assistance for social protection reform and modernization of public procurement system. The report also draws on IFC’s experience with the private sector in KRI over the last few years to identify the necessary reforms that would help KRG move to the next level of attracting necessary private sector investments in the context of a challenging domestic and regional environment. KRG is in need of a structural economic reform roadmap, which is inclusive and serves as Government’s umbrella framework for reform actions in the short to medium-term. The Ministry of Planning (MoP) laid out broad objectives as guidelines for policy formulation through the Kurdistan Region of Iraq 2020: A Vision for the Future, with the diversification of the KRI’s economy away from the oil sector being at the core of these objectives. The success of these reforms and the ability to deal with multiple shocks will require support from KRG’s partners. This report is the first phase of the potential World Bank assistance to the KRG to design and implement long-standing reforms. The second phase of the technical assistance is expected to provide implementation support for the Government. The KRG has already started implementing austerity measures including wage bill and subsidy reforms.

Initial Conditions: Structural Issues and Recent Multiple Crises

Similar to the rest of Iraq, the KRI economy is characterized by severe dependency in four areas:

1. High dependency on the oil sector. Either directly or indirectly, KRI’s economy is highly dependent on oil sector. Despite a series of negotiations, a dispute with the central government about the sharing of oil revenues and the budget transfer has not been resolved. Oil export revenues, which had been received from the central government as budgetary transfers (recently suspended), constituted about 85 percent of the Government’s fiscal revenues. However, the sector’s estimated share is only 1 percent in region’s employment. Such a high level of oil sector dependency has become a “Dutch disease” particularly at times of high oil prices. Combined with a difficult enabling environment for private sector business development, skill formation that is not as advanced as desirable, and strong incentives for people to seek jobs in the public sector, it undermines other sectors’ competitiveness in local and international markets and suppresses private sector development and domestic production in tradable sectors and exports.
High oil dependency has created a rentier state, a boom-bust business cycle and an uncertain business environment. The boom period concealed the structural problems the KRG faces. In the past, flush with oil money the Government became complacent to identify and address the structural problems. The current bust period has brought all structural problems to the surface.¹

II. An excessive role of the public sector in the economy. The public sector dominates the KRI economy. The KRG public spending to GDP ratio is over 50 percent, compared to 61 percent for the whole Iraq. The KRG is the main employer with a share of more than 50 percent in total employment (26 percent in non-military employment). Similar to the rest of Iraq, payments for salaries, pensions, social assistance and subsidies (electricity, fuel, water supply, and agriculture) comprise over 50 percent of the budget. Taxes constitute only 4.7 percent of total revenue. As a result, public expenditure is a primary driver of economic growth. A key problem is high volatility of public expenditure, which translates into high volatility of growth through the fiscal multiplier.² Volatility of expenditure originates, in turn, from volatility of the KRG revenues, which varies widely reflecting fluctuations in oil prices, interruptions in production and transportation of oil driven by conflict, and most importantly the dispute with the central government about sharing of oil revenues. Despite the strong entrepreneurial spirit and potential, the local private sector in KRI is small and under-developed due to the significant crowding out by the public sector.

III. Dependency on imports. Due to the relatively undiversified nature of the overall Iraqi economy, there is a large gap between demand for and local production of tradable products in KRI (hydrocarbon exports account for around 95 percent of the total export basket of Iraq—the highest among Upper Middle Income Commodity Exporters). The gap is filled by imports, which amount to about 90 percent of non-oil GDP. Local production is confined to retailing of imported products, small-scale tradables, and other services including bloated public services. Exports of locally produced goods are very limited. This is a typical feature of a rentier economy. This is aggravated by weak behind the border policies. Under the current policy regime, it is hard for the local businesses to compete with imports to diversify and grow.

¹ To manage the oil revenue better KRG approved a law that authorizes establishment of a Sovereign Wealth Fund (The Oil and Gas Revenue Fund Law, approved in April 2015), which could help pursue a dual objective of stabilizing the economy and saving to optimize the investments. The law identifies five areas where oil revenues may be allocated for: the Kurdistan Region’s annual budget, investment spending, oil infrastructure, environmental protection, and a “future generation’s” wealth fund. This is a step in the right direction, which will also help with establishing accountability and transparency in spending the natural resource revenues. However, although the law and a fund could provide the necessary infrastructure for fiscal management of natural resource revenues, by themselves they are not sufficient. A carefully designed principle for operating these funds, e.g., a fiscal rule, and the political will to pursue those principles are equally important.
² One would expect a high fiscal multiplier in KRI because income tax rate and marginal propensity to save are very low although marginal propensity to import is high.
IV. Weak financial system and dependency on cash-economy. An inclusive and efficient financial system is critical for private sector development. A well-developed financial system would fund greater investment for larger numbers of people. KRI has a poorly developed financial sector, including weak financial infrastructure and low access to finance, especially for small and medium-sized enterprises (SMEs). There is a strong preference for cash in business transactions. Around three percent of companies rely on the banking sector for investment and working capital (over 20 percent in the Middle East and North Africa). This is explained partly by the pervasive atmosphere of mistrust in the banking sector created by frequent financial disruptions and instability in the region.

These structural challenges have been aggravated by a series of recent shocks:

- Conflict with the ISIS group since mid-2014 within 13 miles of Erbil;
- Influx of 1.8 million Syrian refugees and Iraqi IDPs increased KRI’s population by 28 percent;
- A sharp decline in international oil prices, from US$115 a barrel in June 2014 to US$35 in December 2015 which means less revenues from direct sales; and
- A sharp fall in revenue transfers from the central government, from US$12 billion in 2013 to US$1 billion in 2014, which was suspended in June 2015.  

6. The growing inflow of Syrian refugees and internally displaced Iraqis into the KRI has imposed additional strains on the budget and service delivery. This major influx severely constrained the Government’s ability to deliver health, education, and social protection programs to the increased population. The standard of living of the population has deteriorated, and many people have fallen into or are vulnerable to falling into poverty. As a result of the multiple crises, the poverty rate for KRI doubled in host communities—with the largest increase in Dohuk which experienced the highest influx of IDPs. When the IDP and refugee population is included, the poverty rate increased even higher: poverty in KRI increased to 12.5 percent in 2014. More than 75 percent of the refugees and IDPs are women and girls who are very vulnerable. KRG is providing public goods for the entire region and delivering services to this increased population. The needs of the displaced population are significant and cannot be adequately met under the fiscal crisis that the KRG is confronted with. According to the joint World Bank and KRG Ministry of Planning study entitled The Kurdistan Region of Iraq: Assessing the Economic and Social Impact of the Syrian Conflict and ISIS, the stabilization needs assessment of the IDPs and Syrian refugees were evaluated at US$1.4 billion in 2015.

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3 In December 2014, a new agreement was reached between KRG and the Central Government to resolve the dispute. According to this agreement, KRG would export 550,000 bpd through Ceyhan, Turkey (250,000 bpd from its own fields and 300,000 bpd from federal fields) for the Central Government State Oil Marketing Organization (SOMO). In return, the Central Government would resume transferring the 17 percent of its budget to KRG. The agreement was not been fully implemented; KRG did not receive its 17 percent share fully, and has delivered less than 550,000 bpd to SOMO. Dispute continued. Finally, in June 2015, the Central Government suspended transfers, and KRG stopped delivering its oil to SOMO and continued exporting independently.
Diversifying the KRI Economy: Main Contours of a Structural Economic Reform for the KRI

7. **Kurdistan Region of Iraq 2020: A Vision for the Future provides the KRG’s overarching view for its structural reforms.** Presented in 2013, the Vision calls for “a Kurdistan Region of Iraq where all people enjoy the benefits of freedom, health, welfare, and economic security and opportunity.” It defines policy priorities in four areas: Putting People First (health, education, inclusivity, and labor); Building the Region (infrastructure); Creating an Economically Prosperous Region (agriculture, the private sector, and environmental protection); and Putting Government to Work for the People (effectiveness, transparency, fiscal responsibility, and civil service reform). By producing the Vision, the KRG has established the foundation upon which any structure economic reform for the KRI must be built.

8. **The KRG is committed to significant structural reforms to secure fiscal consolidation and achieve sustainable and inclusive growth in the KRI.** The region is faced with multiple challenges but also with an opportunity to move forward with long-standing reforms and diversification of the economy. The deteriorating fiscal deficit exposes KRG to greater risks and calls for gradually strengthening fiscal position by containing expenditure growth and improving revenue generation. KRG will use the opportunity to reform the economy to address continuing structural issues. The Government is committed to implementing much-needed critical reforms ranging from subsidies and public employment to financial sector and energy sector reforms. These will contribute to a higher degree of efficiency in public spending. Furthermore, deepening economic reforms aimed at diversifying the economy away from oil would help encourage private sector development and create jobs.

9. **Rebalancing of the public sector is essential to cope with the uncertain and volatile revenue transfers and to support the private sector-led economic diversification.** The strategy that could bring the region out of the fiscal crisis and gradually put the region’s economy on a balanced and sustainable growth path needs to have two core pillars and supporting structural policies. These core pillars are fiscal consolidation for macro-stability and laying the foundations for sustainable and inclusive growth. The Government should introduce fiscal reforms to strengthen its fiscal capacity to isolate core expenditures from fluctuations in fiscal revenues, and enhance its budget credibility and sustainability in the medium and long term.

10. **Fiscal adjustment includes expenditure and revenue-side measures.** Expenditure-side reforms would include rationalization and reprioritization of public expenditures including targeting subsidies and retrenching excess civil servants while simultaneously preparing them for the private sector with adequate retraining and other direct labor market policies. These reforms would increase the productivity of public expenditure and crowd in private investment supporting diversification. Rebalancing requires redistribution of public expenditure towards infrastructure (where private investments and financing are not forthcoming or there is no commercial viability for private investments), education, and health services, which could be achieved by restructuring subsidies and resizing public
sector employment. The Government has already launched an unprecedented fiscal adjustment equivalent to 37 percent of GDP in less than three years, by slashing almost half of its expenditures. On the revenue side, revenues collected from regional sources should be raised to cushion the impact of volatility in oil prices and the central government budget transfers. There is also a need to underpin fiscal adjustment with strengthening of the public financial management system, starting with the resumption of annual budgets, and their approval by the regional legislature (a constitutional requirement), to restore the cycle of accountability, on which systems of improved financial control and management, reporting, procurement, accounting, and external audit can be built.

11. **Connecting sector strategies to resource allocation is critical.** To cope with the volatile fiscal situation and highly unpredictable budgetary process, the medium-term expenditure planning should be delinked from the short-term revenue transfer estimates. This would require a medium term fiscal framework (MTFF) which in turn could be developed into a full medium term expenditure framework (MTEF) to guide annual budgeting. Such a framework should be based on identification of essential needs, some agreed upon standards to budget for core expenditures, and the fiscal capacity of KRG. The MTFF/MTEF would also assure the quality and sustainability of expenditure levels by ensuring that capital projects are properly budgeted and completed as planned, rather than their completion being contingent on the fluctuations of oil revenues and transfers.

12. **In the medium-term, spurring private sector activities in non-oil sectors is a core objective of the Government.** To achieve this objective, an enabling business environment coupled with entrepreneurship support (particularly for the youth labor force) and firm-level support to improve productivity, quality, innovation, and local and global market access would be critical. Policies and programs to enable SMEs to grow would be critical to create jobs. At the same time, encouraging larger companies to become competitive both in the local and global market, preferably in partnership with Foreign Direct Investment (FDI) and/or public sector, would be also important. Building a strong, diversified, and competitive private sector is a critical economic objective as discussed in the Vision 2020. A large number of complementary policy tools in a variety of areas could be used in conformity for an extended period to achieve this goal. A prioritized and sequenced program would include (i) reforming laws and regulations that make it difficult to start, run and close a business; (ii) piloting and scaling up interventions to promote entrepreneurship, especially among the youth; (iii) scaling up firm-level interventions related to product and service quality upgrade and innovation by becoming a part of local or global value chain; (iv) building a strong advocacy and lobbying organization for the private sector development; (v) making the borders more efficient so that transit trade can grow; (vi) putting in place an effective technical and vocational education and training program; (vii) increasing access to finance, especially for SMEs; and (viii) improving infrastructure services (especially power).

13. **KRI’s financial sector needs to be strengthened to contribute to private sector development.** Despite a large number of banks operating in KRI, its banking sector remains underdeveloped. It does not serve its basic function of channeling financial resources to the private sector to support its development. Banks are not engaged in their core function
of providing loans to KRI’s real-sector economy or financing long-term investment projects. As a simple yardstick, to bring the ratio of private credit to GDP from a current 2 percent to the MENA region average of 50 percent, banks would need to provide credit to the KRI private sector of ID 15 trillion (US$13 billion). Presently, banks in KRI are facing a severe liquidity crisis, which has crippled their operations and has had negative effects on KRI’s economy. The current situation is exacerbated by weak banking-sector supervision as functions of the Central Bank have been subordinated to the direct control by the KRG Ministry of Finance and Economy (MoFE).

Prospects for Growth and Development of the KRI

14. **Services could play an important role in economic diversification efforts.** Services are essential inputs in any form of production, as well as a major component of the regional connectivity, hence a key determinant of KRI’s competitiveness and ability to join and move up regional and global value chains. Services could also become an important source of exports outside the oil and gas sector, along models in the region, and provide jobs outside the public sector. Being landlocked, the KRI is even more relying on services; this situation could be turned into an opportunity, and KRI could become a platform for transit and services provision in the region, given it is sharing borders with large potential markets. In particular, the KRI could become a gateway for the provision of a large array of services in other areas of Iraq. Therefore, this is a win-win situation for overall Iraq. This will require, however, that the KRI first removes a number of barriers to services trade that remain, given that services trade mainly takes place at the intermediary level and within global networks. It will also require restoring some legal certainty, adapting modern laws and regulations, and building capacity (skills, standards, and infrastructure). Beyond the economic dimension, the reform of the regulatory framework and the improvement of the services offered in the KRI will first and foremost benefit the local population, given that major gaps exist, for example in the health or education sectors.

15. **Regional connectivity can be improved through ICT and transport services.** There are complementarities to be realized from trade in IT services in addition to the benefits of enhanced ICT services as an enabling platform for trade. In addition to being an important sector of the economy, ICT, and broadband in particular, is a powerful enabler of trade development. The transformative role of digital technologies in the KRI resides in its ability to create jobs, diversify the economy and increase the overall competitiveness and efficiency of the private sector. To harness this potential, the KRG, in coordination with the central government authorities, needs to foster the development of high-speed Internet connectivity and the IT market through a set of actions and regulatory reforms. These include i) opening the market to competition through new licenses, open access policies, new supply models such as PPPs, and sharing of infrastructure; ii) strengthening the monitoring capabilities and regulatory powers of the Ministry of Transport and Communications; iii) leveraging the geopolitical location to establish KRI and the rest of Iraq as a hub for international connectivity that serves the regional and international Internet markets; iv) devising an IT strategy to address the weaknesses in supply and demand of IT services; and v) stimulating innovation in content development in the Kurdish language. Based on good geostrategic location, in addition to ICT services,
transport network plays a very important role for the economic development of the region. Transport sectors in KRI is mainly dependent on roads as the most developed transport sector, but it is neither well-connected nor maintained at the proper level. Besides this sector, air transport needs significant upgrade. Railway sector and logistic hubs are not developed which is a constraint for KRI to benefit from regional economic opportunities. Furthermore, the legislation for the transport sector is outdated. It is necessary to carry out customs and trade facilitation reforms to strengthen cooperation among neighboring counties. Therefore, with improved transport and ICT services, KRI has a significant potential to become a transport and logistics hub for the whole region based on its proximity to major markets and relatively safe geopolitical position.

16. **Electricity sector reforms can reduce fiscal burden, enhance energy trade, and improve electricity service delivery.** Although power generation capacity in KRI has expanded manifold over the last decade due to private sector investments, the sector continues to be characterized by heavy fiscal burden of subsidies, dependence on costly liquid fuels to address natural gas shortages, transmission bottlenecks, high technical and commercial losses, low tariffs, poor institutional capacity, and poor quality of supply. A strategy based on three pillars is proposed to address the immediate as well as longer term challenges in the KRI’s power sector: (i) *Adopt an enabling legal, policy and regulatory framework* based on clear roles and mandates for different entities. The framework would include a new electricity law, an independent sector regulator, unbundling of the vertically integrated sector, corporatization of sector entities, and their eventual privatization. (ii) *Undertake crucial infrastructure investments* to ensure adequate power availability, reliability, reduction of losses, and trade of surplus electricity with neighboring areas of Iraq as well as Turkey. Given the constrained fiscal situation, it is imminent that private sector resource induction would be required. However, private sector investments need to be undertaken carefully to ensure that current sector performance attracts adequate private sector interest, as well as sufficient ramp-up in institutional capacity and legal-policy-regulatory framework to manage a complex ecosystem. (3) *Undertake measures to support performance improvements and accountability.* This would include a systematic rationalization of electricity tariffs as well as a focused program for loss reduction and revenue enhancement. While full privatization of the distribution business is a complex undertaking, loss reduction and revenue enhancement can be achieved through a well-structured contract with the private sector to manage billing and collection services. In addition, a clear policy framework and robust program for energy efficiency, energy conservation, and renewable energy can help contain the growing electricity demand.

17. **Agriculture presents an opportunity for the KRI, and the sector’s development will be associated with divergent needs for investment and labor.** KRI’s agricultural sector has been subjected to numerous shocks during the past 30 years, including low priced food imports under the oil-for-food program, the oil boom (which moved resources out of agriculture to the public sector and construction), and high cereal subsidies (which moved resources out of non-wheat commodities). To restart the sector, in addition to required agricultural investment projects, KRG must work on the following fronts: i) data improvement should start including a launch of an agricultural survey, price collection, creation of soil and water maps as well as a land registry; ii) all subsidies, taxes, import
bans, and licensing fees should be reconsidered; and iii) an effective research and extension mechanism should be put in place, which should be undertaken in coordination with the Ministry of Agriculture and Water Resources, the existing Research Stations, and the Colleges of Agriculture. Furthermore, a significant agricultural rehabilitation program can generate localized economic activity and employment.

18. **Investments in the water sector are required to reach a more sustainable use of water.** Water shortages are becoming increasingly common. The sector is faced with dwindling supplies due to smaller inflows into KRI and deteriorating water quality. Yet, the demand for water from agriculture, households and industry (including for oil sector) is increasing rapidly. In addition, water is needed for hydropower and environmental flows. The increasing water shortages are likely to increase over time as upstream riparians are planning to develop more water infrastructure, making KRI increasingly vulnerable. The policy mix for addressing gaps between supply and demand will depend on a range of social, environmental, economic, and technical factors. Closing the gaps is within KRG’s reach if it makes the necessary adjustments to include supply management strategies into an integrated approach that also addresses demand-side issues. To reap benefits of the large investments that have been made in developing water resources, it is recommended that the Government introduces broad and poverty-targeted interventions affecting not only water resources development and management but also water service delivery. Priority areas would be: (i) water security planning and management; (ii) improving service delivery; and (iii) strengthening governance mechanisms and water users associations.

**Strengths of the Region and the Way Forward**

19. **The KRI has strengths and opportunities to get the economy out of the fiscal crisis and on a balanced sustainable growth path.** These include: (i) large oil and gas resources; (ii) fertile agricultural land; (iii) young population; (iv) central location at crossroads of trade routes; (v) a government that is determined to implement reforms; (vi) a donor community that is eager to help; (vii) the entrepreneurial spirit of its population; and (viii) a relatively stable location as of now to do business in comparison to the rest of the country. If these strengths and opportunities are used effectively in a supportive policy environment, the KRI economy has a good chance to overcome the current difficulties and have a more diversified economy and sustainable high growth in the medium to longer term.

20. **The acceleration of economic growth and diversification of the KRI economy requires simultaneous effort in the main sectors of the economy.** The Government could begin the reform process which should involve sectoral restructuring and further developing the legal and regulatory framework needed for a market economy. Sectoral reforms should be implemented in tandem and in a well sequenced manner. This is because the effectiveness of reform in one sector is often dependent on the success of reform in other sectors of the economy. In KRI, these linkages will be accounted for by sequencing and coordinating reform in and among the various sectors. This roadmap brings together concrete sectoral policy reforms for Government’s implementation.
Mitigating the Adverse Social Impact and Building a Robust Social Protection System

21. **The most immediate priority is to stabilize the economy without further increasing socio-political fragility.** Strengthening and retooling social protection mechanisms to deal with the emergency are critical priorities for the Government. In light of the emergency, social protection should be a top short-term priority. Existing social protection mechanisms should be strengthened and to extent possible retooled to handle the ongoing social and humanitarian crisis. The Government has recently developed a robust social protection framework to protect the poor and the vulnerable. Furthermore, the reform program proposes a range of actions, which should be carefully assessed to identify the vulnerable population groups likely to be affected, and to estimate the size of the adverse welfare impact. In particular, actions related to changes and increases in income taxes; phasing out and lowering subsidies on petroleum, electricity, wheat, and on agricultural inputs have the potential to adversely impact less-well off households. In addition, given the size of the public sector, which employs individuals of varying education levels, some of the proposed reforms to the civil service, such as rationalization of public sector employment, could adversely affect the less-well off.

22. **The poor and the vulnerable will need to be protected.** The proposed reforms affect different groups of the population in a heterogeneous manner. A poverty and social impact analysis exercise should be undertaken to understand the size and nature of the impacts of the reform program as a whole. This exercise will help estimate the size of the compensating transfer needed to protect the poor and vulnerable in a fiscally sustainable way. For social safety nets, targeting is the main challenge. The categorical targeting used in KRI does not consider the poverty line or the size of the household leading to high leakage. The transfer of ID 150,000 is allocated to beneficiary household regardless of size of the household nor its status, as defined relative to the poverty line or consumption level. Cash transfers use broad social categories instead of more effective targeting mechanisms to determine eligibility which explains why the majority of the poor do not benefit from this program. As such, only 11 percent of the bottom quintile currently are receiving the cash transfer. Currently, a proxy means test (PMT) to determine eligibility under such a poverty-targeted safety net program is being developed, and discussions are underway about transitioning the Social Security Network (SSN) from a categorically targeted program to one where eligibility is determined based on the PMT. This targeted safety net system will be underpinned by a unified registry, and transparent and fair governance and grievance mechanisms.

23. **Even prior to the crisis, KRI had been faced with the challenge of reforming its social protection system.** KRI faces the daunting task to increase the size and dynamism of the private sector where most future employment growth is expected to come. The employment challenge comes from the small size of the private sector, a fast growing labor force due to natural population growth and geopolitical events. The employment-to-population rate in KRG stands at 22 percent and is similar to the average for the non-GCC Middle East. The employment rate is very much affected by the very low labor force participation rate of working age (15-64) women at 14 percent that nevertheless rises to 17 percent if students are excluded.
The pensions and social insurance system in KRI is not sustainable, suffers from low coverage, and is inefficient. In 2014, the total pension spending in KRG was estimated to be around ID 1.3 trillion (or 2.8 percent of GDP), which is high compared to other economies at a similar stage of demographic ageing. More than 50 percent of the labor force in KRI is covered by the social insurance system. However, most of them are employees in the public sector. In the private sector, around 84 percent of the labor force is not covered. Also, only around 50 percent of people above the age of 65 in KRG are currently receiving a benefit from the pensions system (mostly retired public sector employees). The rest of the elderly have to rely on informal care, or public transfers as social assistance (non-contributory social safety nets). The main challenges of the social insurance system in KRI can be summarized in four points: (i) administrative capacity is low; (ii) schemes are inequitable and financially non-sustainable; (iii) the system is fragmented, leading to distortions in the labor market between the public and the private sector; and (iv) the system suffers from low coverage in the private sector.

To address the above challenges, KRG has outlined an ambitious strategic framework for reforming social protection in KRI. The KRG Social Protection Strategic Framework supports implementation of this reform through an integrated package of strategies, legislation, institutions, and programs. The proposed strategies align well with, and provide the mechanisms for implementation of, the Vision 2020 policy priorities. The strategies are as follows: (i) KRG will create an effective labor supply of well-equipped job seekers and skilled workers through the education and training systems and market driven incentives; (ii) KRG will take measures to reduce the duality between employment in the public sector and private sector and thus contribute to a more dynamic private sector; (iii) KRG will develop regulatory and institutional frameworks based on timely data analysis, well-designed employment policies, and constructive dialogue among the social partners; (iv) KRG will implement parametric reforms to the current schemes to ensure financial sustainability and will move towards integrating public, private and other (occupational) pension schemes; (v) KRG will design and implement conventional and alternative mechanisms to expand pensions and social insurance coverage; (vi) KRG will design and implement an Unemployment Insurance Program; (vii) KRG will use poverty as a main determinant of eligibility for its social safety net programs (including the PDS) and provide effective social care for vulnerable and disadvantaged groups; and (viii) KRG will protect its human capital by providing incentives for better health and education.

Risks to the Reform Program

There are substantial risks that could jeopardize the success of the reform program, which is ambitious and far-reaching in its implications. The risks range from security threats to political and economic challenges. Political tensions between the KRG and the Central Government could continue to persist. Furthermore, political tensions between the main political parties in the KRG could endure. In parallel, security risks remain significant. ISIS could continue to pose a security threat to the KRI. The potential for a takeover of Mosul by the Iraqi military force may increase the influx of IDPs to the KRI. Moreover, oil prices could remain depressed for a protracted period of time, thereby
limiting the scope for higher fiscal revenues and economic growth. Should any of these risks materialize, their impact on the progress of the reform program may be disruptive.

The Lay-Out of the Report

27. The detailed action plan presented in this reform roadmap is prepared in light of the strategic objectives discussed above. This work builds on an ongoing productive engagement of World Bank Group teams with line ministries, private sector, academia and the international partners which resulted in development of in-depth technical assessments and analytical work in all sectors of the economy, as well as IFC’s growing footprint in the region across diverse sectors. The findings and policy recommendations of these evidence-based analytical work are based on comprehensive consultations with all stakeholders in KRI. The report covers economy-wide issues such as private sector development, trade and investment regime, labor market as well as sectoral issues. The first chapter provides a macroeconomic background while second and third chapters introduce proposed short-term reform actions in the form of fiscal consolidation measures and medium-term targets to lay the foundations for diversified, sustainable and inclusive economic growth. The fourth chapter discusses upcoming social sector reform actions to address ongoing major social and humanitarian crisis in KRI. The fifth and sixth chapters focus on the governance issues and reform actions including accountability, institutional framework, and judicial oversight. The final chapter presents proposed implementation modalities of the three-year structural economic reform roadmap.
1. MACROECONOMIC BACKGROUND

1.1. *After buoyant growth during 2011-2013, the KRG economy has mirrored the path of the overall Iraqi economy and experienced a significant downturn since 2014.* The region remains highly dependent on oil, with most of the labor force employed by the public sector. The oil sector, which is the main engine of growth is capital intensive industry and absorbs only about 1 percent of the labor force. Since mid-2014, the fall of revenues has dried government liquidity and curbed public investment and economic growth, which has discouraged foreign investment in oil developments and other private investment. Consumption has been also affected by the increasing tighter government finances and growth of arrears on the government’s payroll. The regional conflict is adding on this crisis. The violence driven by the Islamic State of Iraq and Syria (ISIS) insurgency and clashes with the region’s armed forces Peshmerga, has dampen economic growth in the oil and non-oil sectors. The ISIS overran about a third of Iraq and large parts of Syria since 2014, which has disrupted foreign investments and driven 1.8 million Syrian refugees and displaced Iraqis into the KRI, adding to government spending pressures.

1.2. *Combined with the increased security spending and oil price shock, the cut back of transfers from the federal government has seriously deteriorated the KRG Government finances.* The KRG has escalated independent oil export sales (albeit at a substantial discount to market) and slashed government spending since mid-2014. Debt and arrears on payments of the government payroll and on payments to the IOCs have mounted. The compression of government spending this year, expected to continue in 2017, has led to the cutting of government investment, further dragging down the economy, including the non-oil sector. Growth deceleration could extend into 2016 and 2017, driven by low oil revenues and fiscal adjustment. The economic growth is expected to remain sluggish in 2016-2018, with government spending, private consumption, exports, and investment to remain depressed by low oil prices and a tight government budget.

1.3. *As with the rest of Iraq, fiscal consolidation is urgently needed to address the current crisis.* The Government has already started taking expenditure-side measures. Budget cuts announced in December 2015 include downsizing government paid allowances and subsidies on the payments of rents and electricity bills of senior civil servants, although this has created tremendous political pressures. Further fiscal reforms will address the size of the wage and salaries bill and the pension payroll, which currently consumes about 70 percent of the KRG budget, and reduce subsidies for petroleum products and for the electricity sector. The reforms will address, in particular, the issue of “ghost workers,” and the need to strengthen public sector staffing controls. The announced current cuts on the government budget this year will curb household incomes and spending.

1.4. *Poverty rate is increasing in KRI as a result of the fiscal crisis and the regional conflict.* The twin crises—the fiscal crisis, and the influx of Syrian refugees and displaced persons from the rest of Iraq—starting from mid-2014, adversely affected the welfare of the host community (existing residents of KRI). In the second half of 2014, poverty rates had increased to 6 percent. Most of this increase was driven by an increase in poverty among the host community in Dohuk, which experienced the largest influx of internally
displaced persons. When the IDP and refugee population is included, poverty rate increased even higher. An alternate estimate using a microsimulation approach suggests that poverty in KRI increased to 12.5 percent in 2014. This estimate includes the IDP population, which was on average less-well off than the Kurdish population, and experienced a large negative welfare shock upon displacement.

I. Output Performance and Inflation

1.5. **Oil has been a substantial driver of economic development within the KRI.** Legislation designed to encourage private investment and economic diversification (the 2006 Kurdistan Investment Law) effectively lowered financial barriers to entry for both local and foreign investors into KRI markets and played a supporting role in overall economic growth. During pre-2014 period, the growth performance was to a large extent underpinned by oil revenue transfers that reached about US$12 billion by 2013 from the central government in account of increasing oil production and exports by Iraq. Such inflows funded KRG’s budget, which were used to pay government employee salaries, capital expenditures and other priority investments in health and education sectors. In 2013, real GDP increased by 8 percent in KRI with oil production as the primary growth driver. The construction sector also expanded while both public and capital spending increased. Per capita nominal GDP recorded an increase by around 12 percent between 2008 and 2011, estimated at US$4,452 in 2011. However, strong economic growth between 2007 and 2013 was accompanied by very modest declines in poverty within the KRI.

1.6. **In 2014, a combination of factors has adversely affected the overall economy.** First, and foremost, KRI’s share from the federal budget of about US$12 billion a year (US$1 billion per month) has not been transferred because of the political gridlock. Ministry of Finance and Economy reports that only US$1.1 billion was transferred for the entire year. Similarly, in 2015, there was no fiscal transfers. Second, the humanitarian response offered to the IDPs, who add up to more than five times the number of refugees from Syria has brought significant pressures on the KRG. Third, ISIS-related issues have affected domestic economic activities, and international trade and investment. Both current revenues and expenditures registered large declines and the government has been able to pay wages and salaries for its staff only partially and with lags. Investment spending by the public sector as of June 2014 was 60 percent of its 2013 level, and the execution of the investment budget has now been put on hold. Currently, over 4000 projects that were under implementation have been suspended.

1.7. **Investments are declining.** The period 2007 to 2013 saw a boom in economic activity in the KRI, and foreign investment flows, particularly in the construction sector. While construction dominated, associated sectors, including cement, tourism and real estate have also seen significant increases. The Board of Investment (BOI) maintains data on licensed and approved non-energy sector investments financed by the private sector. Figure 1.1 below shows the increase in investment projects, followed by a drop off in 2014. The BOI estimates that between 2006 and 2012 the region received US$22 billion in investment, 21 percent of which was FDI or joint ventures. According to the BOI, licensed investment projects declined from US$12.4 billion in 2013 to US$4.4 in 2014. As a result
of sharp decline in government capital spending, construction projects have been suspended and cement production plants are operating below full capacity. Property prices have fallen by about 50 percent by early 2016 from their peak reached in early 2014. The three major private oil companies (the Anglo-Turkish firm Genel Energy, DNO of Norway, and the UK’s Gulf Keystone Petroleum) have cut their investments in new oil field developments.

![Figure 1.1: KRI: Licensed Investment Projects (US$ millions)](image)

Source: KRG Board of Investment, December 2015.

1.8. **As a coping strategy, the Ministry of Natural Resources (MNR) has been providing support to the KRG and assumed wages and salaries payments albeit with lags.** In addition to small amount of borrowing from banks, the MNR by and large seems to have covered the deficits. The Ministry has borrowed about US$1.5 billion from domestic private sector and another US$1.5 billion from international companies and suppliers by selling its future oil output. It also exported about US$1.3 billion worth of oil. Wages and salaries payments as well as other transfers to a number of ministries and funding of investment projects seem to have softened the impact of the budgetary crisis. The Ministry has been not only paying wages and salaries (with delay) and has directly incurred about US$1 billion in order to provide the IDPs with basic support. These expenses include diesel imports and de facto electricity subsidies as well as health and education services. It has been financing some of its investment projects and it spent about US$2 billion in 2014. The Ministry provided about US$2.6 billion in 2013 for investment projects only.

1.9. **As expected, fiscal crisis had a contractionary impact on the KRI economy.** With public and private expenditure being almost 60 percent down, aggregate demand remained low and hence GDP growth was considerably less than in the previous years in 2014. It is estimated that GDP growth in 2014 was about 3 percent, down from 8 percent in 2013. Had it not been for the support of the MNR, the economy would have registered a negative growth rate for the GDP in 2014.
1.10. **Consumption has been hit hard.** The economic downturn that began in mid-2014 in line with the accelerated deterioration of fiscal revenues has consequently hit private and government consumption. Total consumption is estimated to have declined by 14 percent in 2014 and 24 percent in 2015. Government consumption dropped 27 percent in 2015. The Government cut wages and the purchase of goods and services which affects the provision of public services. Private consumption has also declined given the large size of the labor force employed by the Government. Property values and sales of cars and consumer goods have fallen sharply.

1.11. **Inflation has remained subdued in the KRI, as in the rest of Iraq, anchored by a pegged exchange rate, price controls, and subsidies.** The exchange rate peg to the US Dollar and government controls of electricity, fuel and basic food prices have been key factors containing inflation during 2010-2015. Consumer price inflation was 3.7 percent on average during 2012-2014, and it fell to 0.8 percent in 2015 from 3.9 percent in 2014 (in overall Iraq, inflation rate declined from 2.2 percent in 2014 to 1.4 percent in 2015). In KRI, food prices—about 40 percent of the Consumer Price Index (CPI)—fell by 2.5 percent in 2015. However, electricity prices have increased significantly in recent years (Figure 1.3). Figure 1.4 presents inflation comparisons in Iraq’s selected governorates. The official exchange rate remained fixed to the US dollar at ID/US$ 1,166 during 2012-2015. In December 2015, Central Bank of Iraq devalued the official exchange rate by 1.4 percent to ID/US$ 1,182.

![Figure 1.2: KRI: Total CPI and Food Prices](image1)

![Figure 1.3: KRI CPI: Electricity Prices](image2)

**Figure 1.2: KRI: Total CPI and Food Prices**
(average annual % change)

**Figure 1.3: KRI CPI: Electricity Prices**
(average annual % change)

*Source: Ministry of Planning KRSO.*
II. Non-Oil GDP Estimates

1.12. Public administration and construction sectors have the highest share in non-oil GDP. In 2014, the RAND Corporation and Ministry of Planning KRSO provided an estimate of 2012 non-oil GDP based on sectoral value added in all sectors on a consistent national income accounting framework basis. Based on these figures, a detailed assessment of sectoral growth rates have been carried out in consultation with the KRSO, key ministries, and the representatives of the private sector for 2013 and 2014. Estimated sectoral growth rates were mostly derived from actual production data reported by key ministries to the KRSO as well as by the private sector. The GDP estimate for 2012 is US$24.1 billion. Sectoral growth rates for 2013 and 2014 are based on production data from sectoral ministries. The results show that public administration and construction sectors have the highest contribution to GDP while other non-oil sectors improve their contribution to growth only marginally in the last few years. The agriculture and manufacturing sectors have lagged behind. Production and investment in agriculture and manufacturing activities have been undermined by low labor productivity in non-oil activities, low protection from imports, weak operation of markets, and the ISIS insurgency. The economic crisis has induced some people to go back to agriculture, but the lack of modern technology and low capacity has made farming a survival activity. Some large scale manufacturing has emerged such as the Coca Cola and Awamedica (a pharmaceutical company) with factories located in Erbil. However, of the total numbers of factories in the region only 54 percent were operating in 2015.
1.13. The weak operation of markets for goods and services, including financial services, and for labor has discouraged the growth of non-oil sector activities. Most recently, since 2015, non-oil activities have been additionally harmed by the ISIS occupations and clashes with the Peshmerga as productive assets and infrastructure have been destroyed, internal and external trade disrupted, and the confidence of households and investors undermined.

### III. Employment and Growth

1.14. Public sector employment has been expanding. Job creation has not kept pace with the growth in the labor force and new jobs are increasingly being created in the public sector rather than the private. Between 2007 and 2012, more than 750,000 new jobs were created in Iraq, more than 80 percent of which were public sector jobs. Consequently, the share of public sector employment (which includes public administration, and other public sector jobs in education, health, utilities and other services) increased from 42.4 percent in 2007 (already higher than the national average of 34.7 percent in 2007) to 44.3 percent in 2012 (national average was 39.1 percent) and further to 53 percent in 2014 (Figure 1.7). The Government should be reversing this trend by supporting private sector-led job creation which has the potential to reach many more of the poor. In 2012, 73 percent of the employed urban poor (primarily in construction, commerce and retail, and transport, storage and communication) and 78 percent of the employed rural poor (primarily in agriculture and construction) worked in the private sector.

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**Figure 1.5: Share of Economic Sectors in GDP, 2012**

- Public Administration, 23%
- Agriculture, 5%
- Manufacturing, 6%
- Electricity, 2%
- Construction, 19%
- Wholesales and Retail Trade, 9%
- Home Ownership and Rental, 10%
- Accommodation and Food Services, 4%
- Transport and Storage, 7%
- Miscellaneous Services, 7%
- Financial Services, 1%
- Information and Telecommunications, 7%
- Quarrying, 0%

**Figure 1.6: Share of Economic Sectors in GDP, 2014**

- Public Administration, 27%
- Agriculture, 3%
- Quarrying, 0%
- Manufacturing, 6%
- Electricity, 2%
- Construction, 36%
- Wholesale and Retail Trade, 9%
- Home Ownership and Rental, 9%
- Accommodation and Food Services, 3%
- Transport and Storage, 0%
- Miscellaneous Services, 7%
- Financial Services, 1%
- Information and Telecommunications, 7%
- Employment and Growth

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**Source:** RAND Corporation.

**Source:** World Bank estimates.
1.15. **In KRI, the services sector has the highest share in total employment, however it is public-sector oriented.** While consistent throughout the KRI, the labor market, as a whole, is skewed towards service-oriented jobs as illustrated by Figure 1.8. Labor force survey data shows that the service sector is most represented by the KRI public sector. Furthermore, KRI’s labor force participation rate among women (12.2 percent) is one of the lowest in the region compared to overall Iraq (14.7 percent), Jordan (15.3 percent), and Iran (16.4 percent). When women do find employment within the KRI it is primarily within the service sector (93.1 percent) as opposed to the agricultural (4.7 percent) or industrial (2.2 percent) sector. Oil sector employs about 1 percent of the total KRI labor force.

**Figure 1.8: KRI: Employment by Economic Activities (% of total employment)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>11</td>
<td>21</td>
<td>68</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>20</td>
<td>70</td>
</tr>
<tr>
<td>2013</td>
<td>5</td>
<td>19</td>
<td>76</td>
</tr>
<tr>
<td>2014</td>
<td>10</td>
<td>16</td>
<td>74</td>
</tr>
</tbody>
</table>

*Source: KRG Labor Force Surveys.*
1.16. **The Government is focusing on increasing the quality of labor force.** Human capital is a key factor of production, therefore, policies related to labor and education are important. Large population movements, such as the influx of IDPs and refugees into KRI, increased the population and available workforce, although many hope to return to their homes. In any event, population of KRI has increased which reduces per capita income but increases available labor. The key issues in this context are of course the availability of jobs, especially in the private sector, and the quality of human capital of newcomers. Also, quality of labor force participation directly affects output growth and productivity. Another issue is the hours worked. Compared to hours worked in high growth economies, KRG employees spend very limited time at work.

1.17. **While KRG has made remarkable progress in improving its education sector, there is still some way to go.** There are human capital or labor quality issues that need to be addressed. The leading non-oil sectors in the KRI economy (primarily construction, real estate, and tourism) were able to thrive in part due to less reliance on technical or high skilled employees. For the group of economies with similar per capita income, KRI’s average enrollment rate is about 10 percentage points lower. This makes it obvious that improving educational attainment is necessary to support sustainable economic growth. Given the need to constrain the public sector wage bill, improvements to the education sector outcomes in the near term should be aimed at through improvements in the productivity of the existing cadre of teachers rather than increasing their numbers.

IV. Poverty and Vulnerability

1.18. **Poverty is increasing in the whole country but at a higher rate in ISIS-affected governorates including KRI.** The structural vulnerabilities that were evident prior to the crisis have been exacerbated by the ongoing violence and economic and social disruptions. Microsimulation estimates suggest a reversal of the hard-won welfare gains of the past, with poverty rising in overall Iraq from 19.8 percent in 2012 to 22.5 percent in 2014. Poverty was accompanied by a massive human capital deficit—in health, education and access to basic services. Many Iraqis live close to the poverty line, vulnerable to increases in the price and availability of necessities, and/or the loss of assets and livelihoods. According to the World Bank projections, the recent shocks have increased the number of people living below the poverty line by an estimated 2.8 million by end-2014. IDPs make up half a million of Iraq’s poor in 2014, with an estimated poverty rate of 40 percent, almost twice the average. The Kurdistan Region experienced a quadrupling of poverty rates to 12.5 percent, due to the large influx of IDPs and Syrian refugees and the increased competition for jobs, goods and services. The IDP population was on average less-well off than the Kurdish population, and experienced a large negative welfare shock upon displacement. In the ISIS-affected governorates (Nineveh, Al-Anbar and Saladin), the direct impact of economic, social and security disruptions is estimated to have doubled poverty rates to 41.2 percent. The other governorates in Iraq have also seen a notable increase in the head count rate.
Figure 1.9: Distribution of the Additional 2.8 million Poor Iraqis in 2014

Source: World Bank staff microsimulation estimates.

1.19. **Household consumption is declining.** As a result of the 2014 crisis, total income, which includes both labor and non-labor income, is estimated to have declined in almost all of Iraq’s governorates. Consumption per capita contracted by 14 percent in the KRI compared to declines of 11 percent in the South, 9 percent in the Center, 9 percent in the rest of the North, and 8 percent in Baghdad (Figure 1.11).

Figure 1.11: Change in Consumption Per Capita Income, 2014 Crisis Impact (% change)

Source: World Bank staff microsimulation estimates.

V. Fiscal Issues and Budgetary Process: The Need for a Medium Term Fiscal Framework

1.20. **KRG faces peculiar challenges that complicate the design of effective fiscal policies.** Under the circumstance where no agreement has been reached with the central government on the oil revenue sharing and the budget transfer, oil economy has a predominant role in KRI: about 45 percent of all value added and more than 90 percent of all fiscal revenues are estimated to be generated by the oil sector. As such, the economic
and fiscal dependency on oil is deeper than that of economies with much higher natural resource potentials. For instance, Saudi Arabia possesses about 5 times more oil reserves than KRI in per capita terms; however, its economic dependency ratio is identical to that of KRI and its fiscal dependency ratio is much lower, at 78 percent. In KRI, threats posed by volatility and exhaustibility of natural resources are amplified by geopolitical turmoil. First, the revenue volatility faced by KRG is much higher than what other resource-rich economies face. In addition to oil price fluctuations, KRG’s revenues suffer disruptions that stem from the conflict with ISIS and disagreements with Baghdad. For instance, KRG received only US$1 billion of its US$12 billion share from the federal budget in 2014. Second, as a region within a federal structure, KRG is credit-constrained. Therefore, it is unable to close its financing gap. As a result, KRG has accumulated large arrears with domestic creditors and international oil companies in recent years. Third, KRI’s future revenue stream is obscured by political and legal uncertainties. The relationship with Baghdad, the status of regional conflicts, and low public revenues have significant effects on KRG’s fiscal inflows.

1.21. **The KRG government finances have worsened since 2014.** Government revenues shrank from 87 percent of GDP in 2013 to 38 percent of GDP in 2014 reflecting multiple shocks. The contribution from tax revenues have remained small. The deterioration of government finances during 2014-2015 has dried government liquidity and slashed public investment. Government expenditures remained high despite sizable fiscal adjustment. Debt and arrears on payments of the Government payroll have mounted since 2014.

| Table 1.1: KRG: Government Finances, 2012 – 2015 (% of GDP) |
|-----------------|--------|--------|--------|--------|
| **2012** | **2013** | **2014** | **2015** |
| **Revenues (including oil)** | 78.7 | 87.3 | 37.8 | 55.8 |
| of which: | | | | |
| Taxes | 1.9 | 2.0 | 2.7 | 3.5 |
| Social security contributions | 0.5 | 0.4 | 0.2 | 0.3 |
| Other revenues | 43.8 | 47.9 | 14.7 | 22.2 |
| **Expenditures** | 79.8 | 89.2 | 49.6 | 58.1 |
| Current expenditure | 71.3 | 79.3 | 43.8 | 55.1 |
| Wages and salaries | 17.8 | 19.7 | 23.3 | 23.3 |
| Social security benefits | 6.8 | 9.1 | 7.8 | 6.9 |
| Goods and services | 10.1 | 9.7 | 4.8 | 5.0 |
| Other current expenditure | 36.6 | 40.8 | 8.0 | 19.9 |
| Capital expenditure | 8.5 | 9.9 | 5.9 | 3.0 |
| **Overall balance** | (1.1) | (1.9) | (11.8) | (2.3) |
| **Non-oil balance** | (1.1) | (1.9) | (25.6) | (22.4) |
| **Balance excluding oil and Fed. Gov transfers** | (33.6) | (38.9) | (32.0) | (32.1) |
| **KRG Debt** | 2.9 | 7.6 | 30.0 | 75.5 |
| Arrears | - | - | - | 36.4 |

*Source: KRG Ministry of Finance and Economy, Ministry of Natural Resources, and World Bank staff estimates.*

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4. The KRG handles two separate budgets. The MNR transfers only a part of oil revenues to the MoFE. The rest is used to pay for the MNR operating expenses, payments to IOCs, and defense expenditure.
1.22. **KRG’s non-oil revenues are low.** In 2015, revenues from taxes contributed with only about 3.5 percent of GDP. Government workers pay 5 percent on monthly salaries. Salaries in the private sector are subject to a 12 percent tax, of which 5 percent is paid by the employee and 7 percent paid by the employer. Companies pay 15 percent tax on their sales, but any project registered in and licensed by BOI is exempt from taxes and import tariffs. IOCs are exempted from paying taxes. A general sales tax doesn’t exist, and few taxes are subject to a reported weak tax administration and compliance. Vocational taxes at rates that range between 3 percent and 10 percent are charged to revenue from shops and independent technical professions such as carpeting and blacksmith. There is a 9 percent tax on the rental of houses and 2 percent tax on the rental of lands. The general custom duty rate is 5 percent, but imports of intermediate produces by factories licensed by the BOI pay no duties on their imports of intermediate and capital goods; factories not licensed by the BOI pay only 1 percent duty. Several goods are exempted from customs duties such as basic food products, medicines, and stationary. Five star hotels and restaurants are exempted from taxes for 7 years if located outside Erbil city and for 5 years if located inside Erbil city. Also hotels and restaurants granted an excellent or first class category rate by the BOI are exempted for taxes.

1.23. **Adjusting government expenditure has not been easy, given the large wage, social security, and defense spending demands.** Government expenditures fell from around 90 percent of GDP in 2013 to 50 percent of GDP in 2014 reflecting cuts on the purchase of goods and services, and payments to IOCs and contractors. In 2015, total expenditure rose to 58 percent of GDP driven mainly by partial past due payment to IOCs and contractors, and defense spending driven by the growing ISIS insurgency in the region. The KRG resumed payments to the three main IOCs since September 2015 (about ID 87 trillion) but the payments barely covered operational expenses and left little space for additional oil development investments. The Government unveiled spending cuts in December 2015 which included slashing allowances of Ministers and other officials by as much as 50 percent, and eliminating allowances for rent and electricity bills of senior civil servants. In March of 2016, wages and salaries were cut across the government, excluding payments to the Peshmerga. The cut ranged between 15 percent for salaries below ID 200,000 per month to 75 percent for senior staff salaries and 80 percent for minister salaries. The average cut was about 60 percent on the wage bill. The Government also established a committee to review non-salary expenses and to propose further austerity measures.

1.24. **Debt is increasing rapidly.** KRG’s government debt reached about US$17 billion at the end of 2015 (Figure 1.12), of which accumulated arrears were about US$8 billion. The KRG planned to issue international bonds in the amount of US$500 million, but this has not

![Figure 1.12: KRG Government Debt (US$ millions)](image)

Sources: KRG, World Bank estimates.
materialized. The Government is looking to sell some assets for serving the accumulated debt, including payment arrears.

1.25. **The budgetary process of KRG needs urgent improvement so that the budget can become a more effective policy tool.** In this way, risks to economic growth could be managed and the achievement of the Vision 2020 document which aims to diversify its economy could be attained. The current capacity of the MoFE is limited. Whether budget allocations are in line with priorities is not clear. On the spending side, line ministries do not provide sufficient and timely information to the Ministry. During the reform years, the Ministry and the KRI Government could benefit from a budgetary process as described below.

1.26. **The first step in the process is the determination of the resource envelope,** or the volume of resources from revenues, domestic and foreign borrowing, and other revenues (such as oil revenues or privatization proceeds) likely to be available consistent with economic growth targets. This is the starting point for any system of public resource management and prioritization. In the case of KRI, there is no determination of the resource envelope, except the capital budget. Furthermore, current arrangements do not lead to the establishment of a budget constraint, or the resource envelope, which would necessitate the adjustment of expenditures and their prioritization. While at one level this is one of the results of lack of a MTFF, it is also the result of lack of appropriate budgetary process.

1.27. **The attainment of the Vision 2020 targets, which are medium-term targets, require a medium-term budgetary approach.** Essentially this is the MTEF which is a process for determining available public resources and allocating these resources in line with government priorities. It seeks to cap spending within the limits of what is affordable and increase predictability of resource flows over the medium term. It is based on the notion that the policy decisions made by government will be disciplined by resource realities over the medium term and that the most effective way to restructure spending so that policy decisions reflect resource availabilities is by taking a medium term perspective. It is important to note that before KRG develops a medium term budgetary approach, it needs to put in place an annual budget process followed by disciplining resource allocation policies with a medium term perspective.

1.28. **Required reforms to link policy, planning, and budgeting are institutional and organizational.** While KRG’s fiscal situation has been seriously problematic starting in 2014, much remains to be done to ensure that budgetary process and resultant expenditures are linked with strategic priorities and are efficiently utilized. The budgetary discipline in 2014 and 2015 has been achieved essentially through a system of cash rationing. An efficient public finance framework, particularly if the Vision 2020 is to be implementable, require a number of steps with associated processes. In general, there are three sets of considerations in the assessment of budgetary processes and these are:

- Legal basis of budget preparation and execution process, including documentation, coverage, assignment of expenditures, controls and requirements of accountability and transparency.
• A process for identification of a resource envelope that determines total available resources and establishes the budget constraint.
• A sound budget preparation process that prioritizes expenditures in line with needs and available resources to ensure public service delivery.

1.29. **KRG’s fiscal revenues are susceptible to oil price volatility.** This dependency is critical given that KRG’s non-oil local revenue to GDP is very low. KRI has a narrow export base as about 90 percent of its exports are oil based. The MTFF will need to take this issue into account. Alternative price and quantity scenarios need to be produced and factored into the MTFF and in this way resource flows can be estimated and disruptions to budgetary process could be minimized. Recent large swings in petroleum prices have shown the volatile nature of such markets. These large terms-of-trade shocks necessitate appropriate policy response and mechanisms to mitigate their impacts on the economy. During the reform years, the Government should give priority to developing adequate policies and institutions to mitigate the detrimental effects of price booms and busts.
2. **FISCAL CONSOLIDATION**

2.1. **KRG’s fiscal pressures are mounting.** The decline in oil prices brought large decreases in economic activity as fiscal revenues decline, with second round effects on investment and the financial situation of oil and gas companies. In the absence of a buffer and an agreement on budgetary transfers from the Central Government, KRG will need to re-assess medium-term spending plans and carry out fiscal adjustment. The KRG’s response going forward aims to contain current expenditures while protecting priority spending categories, in light of the security situation and influx of refugees and IDPs. The Government should contain current spending by refraining from public sector wage increases, freezing public sector hiring, reducing transfers to state-owned enterprises and subsidies.

2.2. **Subsidies, transfers, and arrears create distortions.** Explicit and implicit subsidies often have hampered resource allocations in KRG. Furthermore, the arrears are high and this undermines financial discipline and deters the emergence of the required norms of behavior needed for a market economy. Subsidies, both explicit and implicit, are detrimental to competition, which reduces the role of price signals in guiding resource allocation. Fostering a market economy and raising productivity requires the elimination of these distortions.

2.3. **KRG has taken significant steps for fiscal adjustment.** Between 2014 and first quarter of 2016, the Government has conducted a large fiscal adjustment in the amount of ID 10.1 trillion, equivalent to 37 percent of GDP, by cutting half of its expenditures. The Government cuts included ID 3.5 trillion from current expenditures, ID 2.3 trillion from capital spending, ID 1 trillion reduction in MNR-financed expenditures, and ID 3.4 trillion reduction in salary and wage bill. The Government also phased out some subsidies including fuel (i.e., gasoline and diesel subsidies) which provided a fiscal saving of ID 2 trillion between 2014 and 2016. By switching to natural gas, the Government has reduced fuel purchase costs for the power sector by ID 3 trillion. Furthermore, KRG removed subsidized loans for buying apartment buildings, subsidized industry loans, and subsidized agriculture loans. On the way forward, the Government plans on reforming subsidized electricity, direct support for power producing companies, and industry’s access to cheap energy. KRG’s goal for 2016 is to reduce electricity fuel subsidies from US$1.5 billion to US$500 million. By mid-2017, the Government plans to privatize distribution and collection in electricity sector. In the next three years, through progressive introduction of fiscal reforms, including revenue and expenditure-side measures, the Government expects to cut fiscal deficit by as high as ID 15.8 trillion under the low oil prices scenario.

2.4. **As the decline in oil prices could prove to be persistent, KRG should adjust its fiscal position to ensure fiscal sustainability.** Given the large magnitude of Government’s fiscal adjustment, clear macro-fiscal targets should be established to improve the quality

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of austerity measures. The adjustment should be anchored by medium-term fiscal consolidation and would require limiting current spending. Careful prioritization and appraisal of sizable investment projects would also be important to ensure medium-term growth dividends. Priority projects should move forward. Through a macroeconomic framework, the Government could link broad development plans to economic policy formulation. This will ensure that spending, revenue, and debt targets are consistent with growth targets as part of a Medium Term Fiscal Framework. In addition, the role of the MNR should be revisited, as it seems to be conducting quasi-fiscal expenditures outside the control of Treasury authorities.

A. CIVIL SERVICE AND WAGE BILL REFORM

2.5. **An effective and fair public sector is a prerequisite for sustained economic growth and inclusive social development, and this is duly recognized in the Vision 2020.** In particular, the Vision 2020 includes two interlinked pillars that call for policies to “put people first by focusing on health, education, the social safety net and the labor market” (Pillar 1) and “put the Government to work for the people through an effective and honest Government, a transparent, efficient, and equitable public finance system and civil service reforms” (Pillar 4). Achieving these objectives would require significant and consistent efforts over a long time horizon.

2.6. **Public sector is very large in KRG.** Between 2007 and 2012, the share of the public sector jobs in KRG increased from 41.9 percent to 44.2 percent (above the national average). Around 90 percent of public workers are entitled to retirement benefits. Additionally, public sector jobs imply working fewer hours relative to the private sector. For KRG, this gap increased from 2007 to 2012—from 22 percent fewer hours relative to the median hours worked in the private sector to 27 percent fewer hours. The possibility of a public sector job, with greater job security, benefits, and fewer hours of work, raises the reservation wage among the working age population, and limits active job search as people wait and queue for openings in the public sector. In 2012, an average male in the working age population received 20 percent more in the public sector by having completed primary education relative to being illiterate. However, the premium for getting an additional level is almost negligible thereafter until he completes tertiary education. Table 2.1 below shows an evidence of a slowdown in job creation between 2012 and 2014, except in the financial, insurance and other services sectors—which turn out to be security sector related jobs when disaggregated further.
Table 2.1: Employment by Sectors

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2012</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dohuk</td>
<td>Slemani</td>
<td>Erbil</td>
</tr>
<tr>
<td>Agriculture &amp; mining</td>
<td>9,091</td>
<td>75,376</td>
<td>18,375</td>
</tr>
<tr>
<td>Commerce &amp; transport &amp; others</td>
<td>39,801</td>
<td>174,097</td>
<td>89,645</td>
</tr>
<tr>
<td>Financial, insurance &amp; professional</td>
<td>17,474</td>
<td>33,999</td>
<td>15,743</td>
</tr>
<tr>
<td>Public administration, health &amp; education</td>
<td>60,293</td>
<td>56,499</td>
<td>120,109</td>
</tr>
<tr>
<td>Total</td>
<td>154,173</td>
<td>428,655</td>
<td>315,209</td>
</tr>
</tbody>
</table>

2.7. The size of public sector employment is much higher than international standards, and it has also been growing at an unsustainable rate. Even allowing for security issues and the fact that one-in-three of the residents of the KRI are students (therefore a large number of teachers is justified), a disproportionate share of the labor force is employed in the public sector (around 680,000) which corresponds to 11.6 percent of the total population employed in broad public sector (including military and police) and 8.3 percent employed as civil servants. The international norm for civilian employment as percentage of population ranges from 3.5 percent to 6 percent respectively for low and middle income countries and is around 5 percent for the Middle East and Central Asia region. The share of public sector employment increased from 42 to 44 percent between 2007 and 2012, and went up to 46 percent in 2014. On average, between 2007 and 2012, KRI added approximately 32,300 jobs per year in the private sector and 31,900 jobs per year in the public sector. In contrast, in the 2012-2014 period, the private sector lost jobs at the rate of 13,000 per year, while the public sector added jobs at the rate of 17,000 per year.

2.8. Wages, salaries, and untargeted subsidies constitute the bulk of non-military public expenditure leaving insufficient resources for much needed infrastructure and for the non-wage outlays for quality education and health services. Until the recent cuts in public sector wages and the emergence of salary arrears, the expansion in public sector employment has been accompanied by an increase in earnings among public sector employees, from already high levels compared to the private sector. The initial conditions in KRG are extremely challenging in terms of the size and compositions of public sector employees, the de facto role of government employment as a social safety net, its weak
administrative capacity and the lack of systems to carry out operations, and evidence-based analyses. KRG’s wage bill is rather high. In 2012, public sector employees earned 30 percent more than private sector workers, excluding benefits. Within the public sector, men earned, on average, 20 percent more than women in 2012. Given the sharp reduction in government revenues and oil prices, public sector wages have become a substantial financial liability that limits the ability of the KRG to make critical public investments and deliver services effectively. This situation is compounded by large un-targeted subsidies, which create dependence, discourage hard work and crowd out productive public expenditure. The KRG provides untargeted subsidies in a number of areas, from electricity to food to social welfare payments. These end up benefiting people who do not need assistance and reduce the ability of the government to fund services that will not only benefit the poor but will benefit all of the KRI through enabling a growing economy.

Figure 2.1: KRG Public Sector Salaries and Wages, 2010 - 2014 (ID millions)

Source: KRG annual budget figures (2010-2014).

2.9. The oversized public sector employment has fiscal implications. The dire fiscal situation has consequences for funding public services and investments compromising citizens’ welfare and limiting economic growth. The Government has recognized this and in recent years the rate of increase in civil servant wages and salaries has been declining. A hiring freeze was introduced in 2014 (with exceptions of some proficiencies such as doctors) and the pay for senior civil servants has been reduced. However, a more strategic and comprehensive approach to the challenge is required.

2.10. The way forward is to turn the public sector from a (bureaucratic) employer of last resort to a meritocratic professional body that hires on the basis of priority needs of the region and fiscal affordability. Thus, Government employment should no longer serve as a de facto social safety net where those hired by the government do not have the skills necessary to do the job they are recruited for. Recruitment should be transparent and limited, and on the basis of justified needs of ministries and departments, and budget affordability. Public sector pay, in turn, should be reviewed, and the large public sector pay premium eliminated. This will also level the playing field between the public and private
labor markets and will reduce the number of students pursuing studies expecting a public sector job instead of getting skills required by the private sector.

2.11. **The Government has recently introduced several short-term austerity measures to balance the budget.** The payroll of government employees was cut—salaries of high-ranking officials by 75 percent and other employees by 10-20 percent. This is intended as a temporary measure by the Government: “withholding a portion of salaries that will be paid back later when fiscal situation stabilizes.” However, this plan presents a strong risk of building up unsustainable arrears in the medium-term. Therefore, the KRG as it revisits many aspects of its governance, should carefully reconsider salary structure going forward. There is both a need to bring public sector pay into line with regional labor market comparators, and to restructure the overall pay and grading system, to ensure equal pay for equal work, and greater transparency and affordability. Salaries of region’s armed/security forces will remain unchanged. The Government also intends to reduce the public sector employment. This is a more challenging task because there is no employment registry and a functioning payroll management system in place including the job descriptions of the positions. It is not clear how many positions are needed and who performs what.

2.12. **A strategic objective for KRG is to align the public sector with the Vision 2020 and existing fiscal constraints.** This will require significant preparatory operational and analytical reviews to introduce at first wage freezes, wage cuts, hiring freezes, retirements, retrenchments and eventually adopting new criteria and measures for the hiring of civil servants. It also means building a stronger database of existing public sector staffing, modernizing establishment and payroll control systems, overhauling human resource management systems, including regular staff appraisals, and creating new institutions, such as a regional public service commission to set and implement public service policies and processes, including more meritocratic hiring and promotion practices.

2.13. **An essential part of this will be the creation of a voluntary separation program with different options that are in line with the labor laws.** Doing so will require technical assistance and database development, including collecting data on employee skills, and should be a goal for the medium term. This will include using various levels of incentives. The critical issue in implementing the voluntary separation program is how to retain the ‘best’ employees.

**Policy Response**

2.14. **A three-pronged approach would translate Vision 2020 into action.** The reforms will be sequenced and gradual (Table 2.2). Typically, civil service reforms are very challenging and can take many years to fully implement, requiring sustained, high level support in government. Further, civil service reform and private sector expansion need to proceed simultaneously.
### Table 2.2: Public Service Reform: A Three-Pronged Approach

<table>
<thead>
<tr>
<th>1. Sustainability &amp; Establishment Control</th>
<th></th>
</tr>
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<tbody>
<tr>
<td><strong>High Priority: to be done in near term (1-2 years) and on-going</strong></td>
<td>Assign and convene a high level committee (e.g., a High Level Authority for Civil Service reform at the Prime Minister’s Office composed of Ministers) to confirm the need for civil service reforms. Plan and launch a reform process. Create a KRG public service commission to ensure new rules and processes are followed.</td>
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<tr>
<td></td>
<td>Posts vacated due to attrition (retirement, resignation, or death) will not be filled with new hiring but met by reallocating and re-prioritization of existing staff. Existing pay cuts should be generally maintained, pending adoption of a new and more affordable public sector pay policy.</td>
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<tr>
<td></td>
<td>Conduct a payroll audit to eliminate “ghost” employees. Eliminate improper hires.</td>
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<td></td>
<td>Review governance framework for parastatals with a view to improving their performance and better controlling staffing levels.</td>
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<td><strong>Medium Priority: to be completed in the medium term (3-5 years)</strong></td>
<td>Establish medium-term wage bill to total expenditure and regional GDP targets, tapering them downwards to more sustainable levels, consistent with the MTFF/MTEF, and track adherence.</td>
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<td></td>
<td>Restrict any increases to the overall civil service pay scale, and limit all promotions and step increases to only the defined criteria in the regulations.</td>
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<tr>
<td></td>
<td>Analyze the civil service salary scale for structure and in comparison to private sector wages. Review and rationalize civil service allowance types, amounts and eligibility, and ensure allowance equity across ministries. Develop a new public service pay policy.</td>
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<tr>
<td></td>
<td>Launch a series of functional reviews of the main ministries of the KRG, examining mandates, organizational structures and staffing levels. The reviews will also examine the scope for efficiency gains through contracting out.</td>
</tr>
<tr>
<td></td>
<td>Institute a voluntary separation program to shed public sector workers, and a program of equitable separations for staff identified as redundant by functional reviews.</td>
</tr>
<tr>
<td><strong>Lower Priority: Reforms to be done in longer term (5-7 years)</strong></td>
<td>Assess the role of government in delivery of key services and determine which can be contracted out.</td>
</tr>
<tr>
<td></td>
<td>Assess ministries’ structures and mandates to eliminate sprawling.</td>
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<td>Consider policy to reduce the number of civil servants including severance packages.</td>
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<th>2. Civil Service Foundational Reforms</th>
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<tbody>
<tr>
<td><strong>High priority: to be done in near term (1-2 years) and on-going</strong></td>
<td>Build a database of existing staffing levels by organization, and analyze the drivers of staffing levels, revisiting policy as required.</td>
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<td>Designate the PM’s office or other existing high level body, such as a regional Public Service Commission, as the authority over the civil service providing it with sufficient capacity to manage and oversee the civil service and its regulation, including reviewing the legal framework and existing regulations.</td>
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<td></td>
<td>Build establishment control system, tied to agreed organizational structures and staffing levels, in turn linked to a verified and centralized payroll program.</td>
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<td>Create attendance system, including number of hours worked.</td>
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<td><strong>Medium Priority: to be done in the medium term (3-5 years)</strong></td>
<td>Improve capacity of departments targeting those with critical service delivery/ economic mandates.</td>
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<td></td>
<td>Create a basic performance appraisal system with individual job descriptions, performance plans, ensure regular staff assessments, and end automatic progression up a scale.</td>
</tr>
<tr>
<td><strong>Lower Priority: Reforms to be done in the longer term (5-10 years)</strong></td>
<td>Conduct basic skills assessment of civil servants.</td>
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Establish training plans for ministries based on skills assessments.
Support development of the Kurdistan Institute for Public Administration (KIPA).
Build and maintain employee records and develop a unified Human Resources Management Information System (HRMIS).
Work with education institutions on skills mismatch of incoming civil servants.

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<th>3. Recruitment Practices</th>
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<tr>
<td><strong>High Priority:</strong> KRG will initiate this work to prepare for further recruitment (1-2 years)</td>
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<tr>
<td>Build upon the merit-based recruitment previously initiated.</td>
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<tr>
<td>Jobs to be advertised based on approved terms of reference with basic deliverables.</td>
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<tr>
<td><strong>Medium Priority:</strong> to be done in the medium term (3-5 years)</td>
</tr>
<tr>
<td>Recruitment can be centralized for all positions or only for higher grades</td>
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2.15. **Civil service reform will assist in reducing the role of the government as main employer and support the growth of non-oil sector activities.** The reform will reinforce the professionalism of the civil service, which would require improving on the selection criteria, recruitment and promotion systems, and dismissal procedures. The reform will also address the re-sizing of employment across government ministries and entities, including the state enterprises. Improving the efficiency and financial viability of state enterprises is crucial for fiscal sustainability. The reform will review delivery prices and costs, ensuring the cost recovery in the provision of goods and services. The reform will include reviewing of the size of employment, accountability in the delivery of products and services, and accountability in the management staff. Fiscal reforms will address the size of the wage and salaries bill and the pension’s scheme, which currently consumes about 70 percent of the KRG’s budget. The reform will address, in particular, the issue of “ghost workers” (people who are on the public payroll but do not actually work or may not exist).

2.16. **The recent review of the public administration by RAND Corporation and MoP proposes a number of reforms and these need to be considered and their financial implications to be estimated.** Since most people are in the public sector, getting civil servants into productive jobs is a major issue. As economic diversification is an objective, the Government will develop an action plan using the RAND-MoP study for public sector reforms. Addressing disincentives and barriers to employment in the private sector will boost growth and productivity and is likely to lead to more investment.

**B. Subsidies, Social Benefits, and Pensions Reform**

2.17. **Subsidies, social benefits and pensions impose pressure on the overall budget,** with subsidies for electricity, water and agriculture reaching US$2.4 billion per year. Pensions and social benefits constitute 12.2 percent of the total GDP.\(^6\) Pension incomes, which are not explicitly designed to as an anti-poverty transfer, reach less than 20 percent of the poor, and more than a quarter of the non-poor. About 85 percent of pension recipients belonged to non-poor households in 2012.

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2.18. The KRG should start moving away from public sector employment and universal subsidy systems as the main social support for the poor, in favor of supporting private sector-led growth and developing more targeted social safety nets. Fiscal reforms will include reducing the subsidies for petroleum products and for the electricity sector. Social transfers should ensure that they target the most vulnerable groups such as those covered by the food program and other social benefits. Increasing fiscal savings is essential not only to raise public investment but also for raising fiscal savings. Government current spending on pensions should be rationalized and tax compliance strengthened. These actions will reduce borrowing requirements from the government on the banking sector and open room for private sector credit sector.

C. Revenue Generation Measures

2.19. Currently, almost all KRG public revenue comes from oil exports, which is unstable because of volatility in oil prices. In addition, there has been a long standing issue concerning the oil revenue sharing and the budget transfer with the central government. Local taxes, a more stable part of public revenue, constitutes only 2.6 percent of GDP and 4.7 percent of total revenue—one of the lowest in resource rich countries: 17.8 percent in Azerbaijan, 35.2 percent in Botswana, 15.5 percent in Malaysia, and 5.3 percent in Saudi Arabia. Such a low level of tax revenue of KRG is the result of a combination of (a) low rates, (b) low compliance because of widespread informality in the economy, and (c) low enforcement. This situation perpetuates dependence on oil prices and volatility of government revenue and expenditures.

![Figure 2.2: KRG: Tax Revenues and Total Revenues](ID billions)

2.20. KRG has a presumptive tax system. It is based on the Iraqi Tax Code of 1982 with amendments made in 2007 and 2011. Tax liability is based largely on pre-determined deemed taxable income schedule prepared by the Tax Authority rather than an account-based self-assessment system. It diverges in some ways from the tax system of the Central Government. Corporate income tax rate is a flat rate of 15 percent. According to the Tax Law, tax is calculated based on net accounting profits per audited financial statements. In
the absence of audited financial statements or if these statements are found unreliable by the tax authority, corporate taxable income assessment is made based on pre-determined deemed profit schedules for sectors. It is very common for the tax authority to disregard the financial statements and assess the companies’ tax liabilities on a deemed profit basis. Income taxation is based on a deemed income tax system. Essentially, the tax authority determines the taxable incomes on the basis of deemed income schedules, which are prepared annually taking account of the nature of the businesses and economic conditions in the region. The exercise involves significant discretion. For contractors and purchases from public agencies taxable income (deemed profit) is calculated as a percentage of the contract amount or purchase value.

2.21. **Business income tax ID and import license ID numbers are separate, so there is no single identification number linking the level of business activity and level of imports to the same company.** While this is only one type of cross-check that can be used to help validate income levels, it is potentially one of the most accessible, and the reluctance to unify these two ID numbers and exploit the linked information indicates an important direction for improving the regulatory framework. Across the border in Turkey, for example, the income and import tax identification systems are identical.

2.22. **The tax enforcement office is not organized in such a way that permits the collection of relevant information to allow most types of income cross-checking.** Tax office staff lack business experience and thus lack the technical skills to properly examine business records. Enforcement tools are limited, and political authorities prefer to avoid antagonizing businesses with tax enforcement. As a result, the tax morale appears to be low, i.e., firms assume that most other firms do not pay the regulated amounts of taxes, thus they avoid penalizing themselves by paying when others do not pay. Even so, the presumptive, or lump sum tax can be imposed whether firms have profits or not. This also contributes to low tax morale.

2.23. **Revenue generation measures are required to reduce the extreme dependence either on the volatile central government budget transfer or on oil revenue and vulnerability to swings in oil prices.** Customs duties on imports should be rationalized to international levels to balance raising government revenues and fostering the growth of non-oil sector activities. Revenues from taxation should become an increasing source of government revenues. Enhancing the sources of government revenues from taxation is crucial for reducing the exposure to the fluctuations affecting the oil sector. Taxation should concentrate in few taxes, to keep it simple and easy to enforce, be broad based, and tax administration should be effective to reduce tax avoidance and tax evasion. The adoption of a value added tax (VAT) broad based, and raising the corporate income tax to international levels should be considered. Elimination of multiple taxes and fees that produce low revenues but imply high administrative costs should be considered as a main pillar of a tax reform.

2.24. **To isolate the essential public expenditure from volatile oil prices, KRG should increase local tax revenue substantially.** Policy measures could include:
- Review the rate structure and composition of taxes to determine tax potential of KRI and raise tax rates accordingly.
- Strengthen controls to reduce informality and improve compliance.
- Set up a well-staffed taxation unit that is capable of managing the tax system and enforcing the tax laws effectively.
- Keep the current system of presumptive taxation for the time being, but develop a modern tax system for the longer-term that introduces self-assessment, initially for large tax payers, and other taxes such as sales tax, and VAT.

2.25. **Government has the opportunity to improve the tax base while also keeping the tax morale high.** By improving data collection, and by establishing a regulatory environment that encourages formalization of economic flows, Government can enhance information about the tax base and increase private participation in the tax system. By generating more reliable information about the tax base, KRG can establish the medium-term fiscal resources that will finance the Government’s program, including investments in infrastructure.

2.26. **A new tax policy needs to be sequenced as a reform package, and new revenues should be accompanied by agreed improvements in services.** Changes in the tax regime should be matched with improvements in enforcement in order to avoid encouraging informality and unequal tax avoidance. Cross-agency information sharing to ensure enforcement should be facilitated by Government. Elements of the new tax regime should be disseminated through an appropriate public information plan, as should agreements on how to improve public services. A more reliable and steady flow of public revenue, more evenly enforced across firms, will be an advantage not only to KRG, but to Iraq as a whole.

2.27. **Public-private dialogue should be strengthened.** KRG could facilitate private sector participation in the tax and regulatory system in order to implement a pro-growth policy. The private sector needs confidence measures from Government to be convinced that participation in the tax system is worthwhile. To realize the mutual benefits of such an accord, the Planning and Finance ministries could strengthen public-private dialogue that can yield a broad-based and constructive agreement on better public services and higher private sector compliance with formal systems.
3. STRUCTURAL REFORMS TO LAY THE FOUNDATIONS FOR SUSTAINABLE AND INCLUSIVE PRIVATE SECTOR-LED GROWTH

3.1. **KRI’s economy is suffering from severe structural weaknesses.** The Government is facing the challenge of delivering public services to the Kurdish people, Syrian refugees and Iraqi IDPs amid a severe fiscal shock while fighting with ISIS. Excessive dependence on oil sector makes KRI’s economy highly vulnerable to changes in international oil prices. However, even before the regional conflict and fiscal crisis, KRI’s economy was already suffering from structural economic issues such as a small non-oil sector, large public sector, and a weak business environment. Addressing the current crisis with an immediate plan to kick start growth and inspire confidence is the Government’s priority. The Government is committed to address not only the current crisis, but also to lay the foundations to address the long-standing structural policy weaknesses.

3.2. **KRG should accelerate structural reforms to liberalize the economy, especially to support reforms for easing business regulation and strengthening competition.** Accompanying measures that would help limit the adverse impact of fiscal consolidation on the growth of the non-oil economy include deeper reforms to diversify the economy away from oil, particularly by improving the business environment and banking sector, creating incentives for private entrepreneurship, and increasing private sector employment. The overall economic situation calls for efforts to stimulate development in non-oil sectors of the economy. At the same time, social protection reforms will be conducted to protect the most vulnerable.

3.3. **Entrepreneurship and firm-level supports are essential to harness the benefits of an enabling business environment.** To maximize the benefits of an enabling business environment, policies and interventions to promote entrepreneurship particularly for the youth population and to enable existing firms to grow and create more jobs would be essential. The younger generation needs to be exposed to entrepreneurship so that they do not view public employment as the only viable option as they enter into the job market. Similarly, existing firms need to improve their product and service quality so that they can supply to new markets and thus can grow and create jobs. Hence firm-level support for technology and product upgradation, improving managerial and business practices, and accessing new markets would be also needed.

3.4. **Supporting economic growth will require the acquisition of skills for private sector-led development.** The KRG has made progress in terms of school enrollment and improving universities but there is a need to review the capacity and skill base of the young and working age people which encompasses basic human competencies and organizational skills. Improving workers skills is a fundamental source of economic and social progress. Technology absorption requires a skilled labor force. In this context, ensuring that the education system in KRI (from basic through post-secondary education) helps gear youth
to meet labor market needs will be critical. Also, current public sector employees who will search for jobs in the private sector will need re-training to acquire required skills.

A. FINANCIAL SECTOR REFORM

3.5. The financial sector in the KRI is dominated by banks, however, private sector credit remains low. There are 49 banks operating in Kurdistan consisting of 43 private banks and six state-owned banks. Despite a large number of banks, the banking sector in KRI remains underdeveloped and has made a limited contribution to KRI’s economy. Total outstanding loans provided to the private sector as a share of GDP in 2015 stood at an estimated 2 percent. This is significantly lower than in the comparators Azerbaijan and Turkey, where a corresponding figure stands at 31 percent and 70 percent, respectively (Figure 3.1). It is also substantially lower than the average across the MENA region of 50 percent. Such a low contribution reflects the fact that banks in Kurdistan are not engaged in their core function of providing loans to KRI’s real-sector economy or financing long-term investment projects. In private banks, lending to the private sector accounts for only 6 percent of total assets. The majority of bank assets are sitting idle: about 60 percent of private banks’ total assets are in the form of cash and cash equivalents. At the same time, the banking sector has a significant potential to contribute to the development of KRI’s economy. As a simple yardstick, to bring the ratio of private credit to GDP from a current 2 percent to the MENA region average of 50 percent, banks would need to provide credit to the KRI private sector of ID 15 trillion (USD 13 billion).

Restoring liquidity in KRI’s banking sector

3.6. The banking system in the KRI is experiencing a severe liquidity crisis. This crisis has resulted from multiple shocks that KRI has been subjected to since 2014. Facing significant cash shortages, many private banks have restricted their customers from withdrawing cash from their bank accounts. Most banks cannot facilitate transfer of money within the KRI and between the KRI and the rest of Iraq. Bank lending to the private sector has virtually stopped and private banks do not issue letters of credit or guarantee.

3.7. This liquidity crisis was caused by the Central Bank of Iraq’s (CBI) branches in Erbil and Sulaymaniyah freezing current accounts that commercial banks have placed with them. Banks’ cash reserves were further depleted by KRG-issued checks, which banks
KRG needs to restore liquidity in the banking sector. KRG has removed billions of dollars in cash deposits at Central Bank of Iraq’s (CBI) branches in KRI. This move has led the CBI branches in Erbil and Sulaymaniah (the two CBI branches operating in KRI) to freeze current accounts that commercial banks have with them. It is estimated that about US$5 billion of bank deposits with the Central Bank in KRI have been affected.\footnote{Official data on the amounts of private bank deposits frozen at the CBI branches in KRI is not available. The US$5 billion estimate is anecdotal evidence obtained during interview with the CBI in KRI.} Banks’ cash reserves were further depleted by KRG-issued checks (estimated at US$1 billion), which banks cashed to their customers but then were unable to exchange for cash at the CBI branches in Erbil and Sulaymaniah as the latter had no cash to do so. Restoring liquidity in the banking sector by having the CBI branches in Erbil and Sulaymaniah unfreeze commercial bank deposits and honor KRG-issued checks needs to be addressed to re-launch the banking system in KRI. It could be best addressed by the Government of Iraq and Kurdistan Regional Government settling their disputes. In the absence of such solution, effective options for restoring liquidity in the banking system are limited.

KRG needs to restore people’s trust in the banking system. Even prior to this crisis, public confidence in the banking system was low and now it has severely deteriorated. Building public trust is a long process and there is no quick solution to it. As a first step, KRG needs to re-establish a stable macro-fiscal environment in the region. Second, banking regulation and supervision in the KRI need to be restored to ensure good governance. Third, KRG can link with the Government of Iraq in an ongoing effort to establish a deposit insurance system that would safeguard people’s deposits with banks.

Addressing banking sector regulatory issues

The banking sector regulatory environment in the KRI is facing two fundamental issues. First, the CBI branches in Erbil and Sulaymaniah have been subordinated to the control of KRG Ministry of Finance and Economy instead of being controlled by the CBI. Second, public banks in the KRI are regulated by the KRG MoFE and operate without a license from the CBI.

This situation poses a systemic risk for KRI’s banking sector. Banking regulation and supervision fall under an exclusive authority of the Government of Iraq.\footnote{According to Article 107 of the Iraqi Constitution.} With KRI’s banking sector effectively cut off from the Central Bank of Iraq, the sector appears to be going into an unregulated mode with no effective oversight from either Baghdad or Erbil. To ensure good banking sector governance, the CBI branches in Erbil and Sulaymaniah should be de-linked from KRG’s MoFE and restored as an integral part of the Central Bank. This is a crucial step necessary to bring KRI’s banking system back into the functioning mode with independent oversight and necessary regulation. Moreover, state-owned banks...
operating in the KRI need to be de-linked from the oversight of KRG MoFE, brought under the supervision by the Central Bank, and obtain a banking license from the Central Bank.

Improving banking sector competition

3.12. **Private banks in the KRI operate on an uneven playing field compared to state-owned banks.** Until recently, legislation did not allow government agencies and state-owned enterprises to hold deposits or current accounts in private banks. Nor could they make salary payments through private banks. In addition, government agencies and state-owned enterprises were not allowed to accept letters of credit or checks issued by private banks.

3.13. **This situation distorts competition in the banking sector and has a number of negative consequences.** First, private banks do not have access to important liquidity sources, which KRG has effectively directed to state-owned banks, thus putting private banks at a significant disadvantage. Second, as state-owned banks have had an exclusive ability to service KRG, the efficiency of their services has not been checked by competition from private banks. Third, since private banks do not have access to salary accounts of KRG employees, they cannot assess their salary history and consequently, provide them with loans, thus limiting their access to finance.

3.14. **Recent changes proposed by the Government of Iraq have tried to make an equal playing field for both, state-owned and private banks.** However, the situation on the ground has not changed. KRG authorities continue to direct all government agencies’ and state-owned enterprises’ cash flow activities to state-owned banks. To address this issue, KRG needs to enforce new regulation and demonstrate that both, state-owned banks and private banks have equal access to serving government agencies and state-owned enterprises. By doing so, KRG would not only promote an equal playing field for all banks working in the region but would also set an example of promoting fair banking-sector competition for the rest of Iraq.

Improving banking sector infrastructure

3.15. **Credit information sharing services are an essential element of a banking sector infrastructure necessary to facilitate financial market intermediation.** When making a decision on credit extension, banks vitally rely on information about creditworthiness of prospective borrowers. Thus, the availability of well-functioning credit registries (which house this information) can be directly linked to banks’ willingness to extend loans to private sector players.

3.16. **Presently, banks operating in the KRI have no ability to check a prospective borrower’s credit history** as there is no credit registry. The CBI has its credit registry but it appears to be largely incomplete and non-functional. At the same time, the CBI (with

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support from USAID) is currently working on regulations to introduce a credit registry in Iraq. KRG should link up with the CBI to ensure credit registry coverage for Kurdistan.

B. AGRICULTURE SECTOR REFORM

3.17. **KRG’s agricultural sector has been subjected to numerous shocks.** First, the oil-led expansion of employment at the public sector crowded out employment in the agricultural (and other non-oil) sector(s). Agricultural wages increased sharply, from US$5 per day in 2002 to more than US$30 per day during 2011-13. The agricultural sector became uncompetitive, which combined with the currency appreciation (the so-called “Dutch disease”) increased food commodity imports. Currently, 80 (20) percent of fruit and vegetable consumption during the winter (summer) comes from imports, mostly from Iran and Turkey.

3.18. **Second, the agricultural sector has turned to mono-culture, that is, production of wheat and (less so) barley.** An estimated 90 percent of KRG’s agricultural output comes from cereals. This expansion was a result of the high prices at which GoI was purchasing wheat. During 2005 - 2012, the procurement price of wheat was above US$600/ton, evaluated at current exchange rate, compared to the world price of US$200/ton. That is, KRG wheat farmers received (at least, until recently) a multiple of the world price, even under generous assumptions about transport costs. The GoI did not honor the agreed wheat price. Only a portion of the 2014 purchases has been paid to the farmers and nothing for the 2015 purchases.

3.19. **Employment in agriculture sector is declining.** At the national level, employment in agriculture sector fell in absolute terms for both men and women between 2007 and 2012. While agriculture’s share in total employment in KRI fell from 25 percent of jobs for women to 22 percent and from 8 percent to 7 percent among men; there was some increase in agricultural employment in absolute terms (almost 9000 jobs for men and 5400 jobs for women). At the same time, the share of households with some diversification, i.e., with members employed in both agriculture and non-agriculture, increased in KRI; and this group made welfare gains at the national level (with a halving of poverty among these types of households).

3.20. **Competitiveness is low.** The collapse of the oil prices, from more than US$100/bbl prior to mid-2014 to less US$50/bbl during 2016Q1 (and associated fiscal pressure), the considerable decline in world grain commodity prices, the apparent discontinuation of high wheat subsidies (which makes as much as half of wheat production uncompetitive at current world prices), and the conflict surrounding the region (which makes exports to the traditional destination of the Gulf countries much more expensive) present a number of challenges.
3.21. **But these are not the only challenges.** Other challenges contributing to low competitiveness include degraded soil quality, water pollution, availability and the decline of the water table, low-productivity seeds, limited cold storage facilities, poor agricultural logistics, and lack of knowledge. To increase the competitiveness of agriculture in order to fully account for domestic consumption needs and also foster exports, the Government should focus on following areas.

**Sectoral transfers**

3.22. **Wheat program.** It appears that the costly subsidies of wheat are coming to an end. As a short term step, the wheat purchases already made should be honored at the agreed price. As a medium term, the wheat (and barley) subsidies should be formally phased out, to end the crowding out of resources for other higher valued commodities such as fruits, vegetables, and animal products.

3.23. **Input subsidies.** There are various input subsidies (such as fertilizers, seeds, chemicals, and fuel). At present, it is not clear how much they cost and who receives them. Again, given the fiscal pressures, these subsidies should be discontinued.

**Trade policies**

3.24. **Import bans.** In order to protect locally produced food commodities, KRG imposes import bans. Yet numerous market participants question their effectiveness while others argue that they lead to corruption. The effect of such bans should be examined closely, and if they are, indeed ineffective, they should be removed. If they are effective, they should be rationalized.
3.25. **Import duties.** There are some import duties on numerous items, including agricultural machinery. Private sector representatives report that the effect cost of a medium-sized tractor, which costs about US$20,000 at the border, is subject to an additional US$5,000 cost in due to import duties, and licenses. Such duties should be eliminated. Any reduction in fiscal revenue could be balanced by the reduction in input subsidies. Elimination and/or streamlining of import bans and import duties should be coordinated with the GoI, since it affects both KRG and Iraq.

**Farmer support**

3.26. The objective of farmer support programs should be to diversify the crop base to meet consumption demands and export potential, to raise crop yields to global standards, to make farmland well-developed and sustainable, and to integrate farmers into a modern food supply chain. For this, a number of farmer support initiatives are proposed.

3.27. **Agricultural research.** Currently, KRI research is undertaken by four research centers. In the past, these centers were funded by FAO. A number of problems are faced by the centers. First, they (or, at least, the one in Erbil) are engaged in numerous activities. Second, they are underfunded. Third, their results do not reach producers. Fourth, release of new varieties is subject to delays by the Iraqi Ministry of Agriculture, which often takes as much as two years to approve them. The research stations should form an independent entity, thus reducing the bureaucratic delays. They should also narrow their focus and prioritize their activities on research that is relevant to the production needs of Iraq in general and KRG in particular. Such research should be undertaken in conjunction with overall Iraq’s agricultural research capabilities. The research stations should also collaborate with the Colleges of Agriculture as well as the MoAWR.

3.28. **Extensions services.** Extensions services are practically non-existent, which is why research findings do not reach producers. To address these issues, the MoAWR should reform its Department of Extension, Training and Research and collaborate with the Research Stations and the Colleges of Agriculture, thus creating an effective education-research-dissemination “triangle.” The Department should be responsible for training extension agents, conducting crop research, and providing regular information to farmers.

3.29. MOAWR should review the current subsidy and crop insurance programs for rationalization and rebalancing to meet world prices over a phased period.

3.30. To integrate farmers into a modern supply chain, MOAWR should upgrade certification, infrastructure and technical support across the agricultural supply chain. This should include establishing standards of good agricultural practices, and providing support to the private sector to upgrade supply chains and to invest in land and agribusiness.

**Sectoral and market information**

3.31. **Agricultural survey.** The information on agriculture is very limited and of poor quality, not surprisingly, since there is no recent agricultural survey in the region. A survey should be undertaken soon, so the information on issues such as farm size, composition of
labor, input used, price received for output and prices paid for inputs should become readily available and subjected to research by the Universities.

3.32. **Market information.** Price information is currently limited. Prices collected by the central vegetable markets (which are already compiled) should be collected on a daily basis (currently they are weekly). These prices should made available to the public to ensure that farmers, traders, importers, and government have all access to them. These data will also be very useful for research purposes. Further, the MOAWR should collect data on agro-climactic conditions, land, water, crop production and pricing, and animal husbandry production. This should be accomplished through an initial baseline survey and ongoing collection of market information. Currently, there is no Department of Agricultural Economics in any of the four Agricultural Colleges. At least one of the colleges should establish an Agricultural Economics Department whose research could focus on market information for more informed policy making. This Department should collaborate closely with the research stations and extension services.

Regulatory framework

3.33. The licensing requirements appear to be excessive and not always clear. In addition to increasing the cost of production, these requirements induce corruption. The process should be streamlined, and to the extent possible should be handled by one agency (a type of “one-stop-shop”). The streamlining and cost rationalization of the licensing procedures should be undertaken in coordination with the GoI.

3.34. **Food vouchers**

Eliminating PDS could boost agriculture in the region, limit the distortions currently in place in the market for staple foods, and provide better targeted assistance to the poor. This could be accompanied by a transition to ‘smart cards’ linked to biometric identification underpinned by a universal registry. This reform is already under discussion. There are some global experiences that could be taken into consideration. For example, in late-2014, the Supplemental Nutrition Assistance Program (SNAP, previously known as the food stamps program) in the US was changed to incorporate a similar initiative, the Food Insecurity Nutrition Initiative. This initiative boosts the purchasing power of existing SNAP or food stamps at farmers markets. If a SNAP recipient used US$10 of their benefits at a farmers’ market to purchase fresh fruits and vegetables, they received US$20 worth of produce. The US$10 gap is financed by the USDA and private donations, which benefit both low income households and local, small farmers.

C. **WATER SECURITY AND MANAGEMENT**

3.35. **Water shortages are becoming increasingly common.** The sector is faced with dwindling supplies due to smaller inflows into KRI and deteriorating water quality. Yet, the demand for water from agriculture, households and industry (including for oil sector) is increasing rapidly. In addition, water is needed for hydropower and environmental flows. The increasing water shortages are likely to increase over time as upstream riparians are
planning to develop more water infrastructure, making KRI and the rest of Iraq increasingly vulnerable (in the absence of basin wide agreements for the Euphrates and Tigris river basins). The fast increasing demand is partially the result of large inefficiencies in the use of water resulting in high evaporation losses and network losses, whereas management practices in agriculture and other water uses result in water logging, salinization and pollution which is affecting the quality of the available water resources.

3.36. **KRG’s vision for water security requires a broad spectrum of goals.** Foremost is to ensure a supply of water for the people that is adequate both in quantity and quality. In order to foster this goal, specific actions must be taken internally outside transboundary water issues: distributing and allocating water supplies based on demand management; using technology to more efficiently use water such modern irrigation and on-demand irrigation distribution systems; recycling water; more responsible management of groundwater resources, mitigating droughts; promoting public private partnership; and establishing ways to cooperate effectively with riparian neighbors. A strategy that optimizes supply and demand across the full spectrum of water users is an integral component to water security, as is consideration of hydrologic variability and droughts, which amplify water scarcity issues. The institutions, policies, and practices that help achieve water security simultaneously help protect and advance other essential areas like human health, socioeconomic development, and ecosystem services.

3.37. **To satisfy KRI’s future water needs, both supply-side and demand-side strategies must be sought.** Supply-side strategies include increasing the amount of freshwater available through the improved use of existing and proposed dams, and implementing new water allocation and reservoir operation strategies. Surface water and groundwater will each be important contributors to the overall freshwater supply. Controlling the demand for water is equally important to ensure that each sector is provided with a reliable supply of water.

3.38. **The nature of water use and associated problems varies greatly between the KRG governorates.** The policy mix for addressing gaps between supply and demand will depend on a range of social, environmental, economic, and technical factors. Closing the gaps is within KRG’s reach if it makes the necessary adjustments to include supply management strategies into an integrated approach that also addresses demand-side issues. To encourage a more sustainable use of water and to reap benefits of the large investments that have been made in developing water resources, it is recommended that the government introduce broad and poverty-targeted interventions affecting not only water resources development and management but also water service delivery. Priority areas would be: (i) water security planning and management; (ii) improving service delivery; and (iii) strengthening national and local governance mechanisms and water users associations.

**Priority 1: Water security planning and management**

3.39. **KRI’s water resources are characterized by significant inter- and intra-annual variability,** even not counting the effects of global climate change. There is also a limited scope to increase storage capacity, and an increasing demand from domestic, industrial and
agricultural sectors. Responses are constrained by lack of an integrated water policy. Institutions for water resources planning and management need to be strengthened at the central level, and the administration of water entitlements needs to be more transparent and accountable at all levels. Achieving water security will require a critical look at the resilience of existing and future infrastructure. It will also require measures on demand management such as: i) pricing to reflect the scarcity value of the resources, coupled with targeted subsidies to ensure the protection of the poor; ii) incentives for the reduction of consumption in urban areas (metering, programs to decrease losses in water systems and at household level); iii) improving efficiency in agricultural productivity; and iv) investments to close the water cycle by the reuse of water.

3.40. **Cooperation over shared water resources, both domestically and internationally, is fundamental to the achievement of water security.** Today, approximately 50 percent of supply of surface water originates outside its borders and development upstream is projected to significantly reduce the amount of water that reaches its borders between now and 2035. Turkey and Iran are each pursuing independent plans that address their respective socioeconomic development objectives through expansion of irrigated agriculture, industrial activities, and energy generation. Construction of infrastructure in support of these objectives has already had an impact on the hydrology and water quality within the shared watersheds as dams and other water diversions have been constructed. Ongoing development in the riparian states will continue to put pressure on KRG’s efforts to achieve water security unless cooperative measures are taken. There is a need for cooperation among Iraq (including KRG), Turkey, Syria, and Iran so that collective efforts can be made to conserve water and introduce water efficiencies in the water consumption.

**Priority 2: Improving water services including rural sanitation**

3.41. **Agriculture suffers from persistently low productivity.** Years of investment have marginally improved water efficiency, but overall productivity remains very low. In addition, groundwater is over-abstracted, leading to falling water tables, and progressive salinization of aquifers and farmland. Priority actions include modernization of irrigation infrastructure and institutions; adoption of higher-value, water-efficient crops; improved crop husbandry and post-harvest operations; delegation to local and farm-level organizations; and a strategy of supply and demand management for groundwater sustainability.

3.42. **Water supply services are intermittent and there are high technical losses, and lack of good management.** The low tariffs render utilities dependent on state subsidies. A widespread unregulated informal water sector meets extra demand, at high cost to the poor. Wastewater treatment is limited. Investments in water supply and sanitation infrastructure for service delivery are necessary. Also, service delivery institutions need to be reformed to increase efficiency, reduce losses, and recover costs through public-private partnerships.

3.43. **In recent years there has been less improvement in productivity, and water availability for irrigation is increasingly constrained.** The Government has long led the expansion of irrigation, but performance has been suboptimal, and reforms have not yet
been introduced to improve efficiency and water service. Faced with this challenge, the irrigation sector has been wrestling with three deep-seated problems: low water use efficiency, a high reliance on government financing, and poor standards of management and maintenance. Much of the search for improved investment and institutional models in irrigation and drainage has been driven by the need to resolve these three problems.

**Priority 3: Strengthening governance mechanisms**

3.44. *Service providers should be given incentives to perform efficiently.* One solution that has been tested over the last two decades has been participatory irrigation management involving the Water Users Associations (WUA) in the financing and management of schemes. This solution had its logical culmination in the irrigation management transfer, the handover of responsibility for scheme operation and maintenance (O&M) to farmers and their organizations. This solution promises to relieve the government of both the fiscal burden and the responsibility for asset management and maintenance and to improve efficiency by empowering farmers. However, efficiency has risen only marginally, and there are many schemes in which O&M is beyond farmers’ capacity—for example, the management of headworks and major distribution systems. In addition, major irrigation investments are often simply beyond the financial capacity of farmers.

3.45. *Public Private Partnership (PPP) concept could be one way of bringing in efficient management skills and fresh funds and relieving government of fiscal and administrative burdens.* A number of PPP arrangements show that investment, operation/maintenance and management are the key functions for private sector involvement. The key point is that the objective is improved efficiency—timely and less expensive water service responsive to farmers’ needs. It is important to design the most appropriate institutional setup. Given that the private sector is demonstrably efficient in many of the functions in irrigation, it is likely that in many cases a PPP arrangement would in fact be optimal. However, a third-party service provider could be public (for example, a reformed and financially autonomous government agency) or private (for example, a private irrigation service provider looking for business or a WUA turning into a private corporation).

**Box 3.1: Lessons Learned**

| Global experience demonstrates the requirements to build water—and therefore state—resilience. Water scarce countries, such as Australia, Singapore, India, United States, and Chile, have demonstrated that with appropriate political will, water vulnerability can be transformed into water resiliency. The common lessons learned are: |
| Integrate Communities: More rapid delivery programs with strong citizen engagement to close the water supply and sanitation and irrigation service gaps, particularly in poor, peri-urban and rural areas. |
| Build Secure Water Services: Introduce integrated urban water management and agricultural water productivity systems which simultaneously address sustainability of water services and water resources (institutions and infrastructure). |
Introduce Technology and Tariffs for Water: Establish progressive pricing and quantitative controls to drive allocation and development and adoption of innovative technologies (including solar desalination, wastewater reuse, drip irrigation) to address water shortages at lowest possible cost through both incremental supplies and demand management.

Expand international water management agreements: Establish multi-country technical platforms for information exchange, analysis and dialogue in support of political agreements on shared water resources, along with enhanced water resource monitoring and modeling capacity.

Water Resources

3.46. Based on average annual rainfall, the Region is divided into three area: assured rainfall area (over 500 mm); semi assured rainfall area (350-500mm); and un-assured rainfall area (less than 350 mm). The growing demand will have to be satisfied from a shared resource, since the region is both in an upstream and downstream position: 50% of the surface water resources originate from the upstream neighbors, Turkey and Iran. On the other hand, water resources management also directly affects downstream water availability in central Iraq. Both climate change and increased water use by the upstream neighbors are likely to have negative impacts on the availability of surface water resources. To cope with these challenges—growing demand, sharing of water resources and a decrease of the available resources—there is a strong case for having trans-boundary agreement to share and jointly manage water resources. Water scarcity is increasing and is a binding constraint on the economic and social development.

Surface Water Resources

3.47. Surface water is an important source of water. It is in the form of rivers and springs. Water resources are largely associated with the quantity of rainwater and snow falling on main water basins and with the policy of operating dams and water reservoirs built upstream the shared rivers in Turkey and Iran. The absence of international water sharing agreements among these states results in instability of available water resources from one year to another. It is expected that more water shortages and reduced water quality are expected to occur in the future, after Turkey and Iran completion of its irrigation projects. These two states seek to cultivate about one million hectares, with water fed from the Tigris water basin. Consequently, the Tigris flowing into Kurdistan Region and Central Iraq will experience more water flows reduction.

Springs

3.48. Springs are traditionally the main source of water supply (both irrigation and drinking water) in Kurdistan’s mountainous regions.

Groundwater Resources

3.49. Groundwater is one of the most used water resources. It is the major resource for drinking water, irrigation and for other urban and rural life uses. Statistical results for 2006 indicate that total number of exploited wells was about 19,448 wells, of which 79 percent
were used for drinking, 18 percent used in agriculture, and the rest were exploited for industrial, and agricultural extension and research purposes.

**Water Demand**

3.50. The present beneficial use of all water resources is about 3 billion m$^3$, out of available water resources of 6.5 billion m$^3$.

**Oil Fields**

3.51. Conservative estimates of development of the oil sector indicate that oil production will increase. As oil production increases, the demand for water to support the industry will increase as well (it takes 1.5 barrel of water to produce one barrel of oil). Accounting for potential water losses along the water distribution network, the gross water demand for the oil sector will increase. Gross water demand for refineries is projected to increase as well. In a water-scarce future there is no justification to use freshwater to support oil production.

**Dams**

3.52. There are three large dams (Derbendi Khan, Dokan and Dohuk). High variability of the climate and hydrological regime differences of the hydrogeological characteristics and the presence of karst phenomena cause major variations of unit flows and many other hydrological parameters. Storage of winter flows would secure more water for the several usages in summer (irrigation, drinking water, industry, tourism and hydropower). The policy is to increase storage capacity in Kurdistan region by building small (ponds) and large dams.

**Dam Safety**

3.53. Though dams are believed to be in good conditions and there is some inspection for major dams, there is no systematic inspection for dams to ensure their safety and there is no program for dam safety. An independent unit needs to be established for this purpose. It is recommended that for each dam an emergency preparedness plan be prepared.

3.54. **Water supply and sanitation systems were already facing challenges prior to the crisis in providing continuous service to the KRI population.** The proportion of the population using improved access to water is above 90 percent. The quality of service, however, in terms of continuity of access and water pressure, remains poor. The water consumption in KRI is estimated to range between 373 and 400 liters per capita per day. This remains very high relative to the median water consumption of middle-income countries of about 162 liters per capita per day. The high consumption is largely explained by over-design of the system which is further aggravated by modest prices.$^{10}$ Furthermore, the cost recovery of operations and maintenance (O&M) is only 4.4 percent.

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$^{10}$ In the range of US$1 per month for an apartment in Erbil and Dohuk.
Table 3.1: Water Fee Collection Revenues as a Proportion of O&M in 2011

<table>
<thead>
<tr>
<th></th>
<th>Expenditures</th>
<th>Revenue</th>
<th>Water fees collection as a proportion of O&amp;M (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>119.2</td>
<td>153.5</td>
<td>5.2</td>
</tr>
</tbody>
</table>

Sources: MOW data, SENA report, and World Bank staff calculations.

3.55. **The sharp increase in access to water supply services has not been accompanied by similar investments in wastewater infrastructure.** Sanitation remains a major concern, most notably in IDP camps. The major gaps relate to physical facilities, namely the lack of wastewater treatment plants and sewerage collection networks, except in the Sulaymaniyah Governorate where the capital city and a few municipalities have storm water networks. This lack of sanitation increases public health risks and environmental pollution. On the water supply side, the use of groundwater\(^{11}\) has resulted in lowering of the water table, which results in higher costs to treat and pump the water. Furthermore, there is a significant gap between the rural and urban areas in terms of population with access to improved water sources and sanitation facilities.

3.56. **Cost efficiency in service delivery.** Water and wastewater authorities do not cover their operation and maintenance costs through their revenues, hence compromising their financial viability. Non-revenue water is thought to be high although no reliable data are available as most households do not have meters. Yet, the fact that the majority of the households complain about insufficient supplies suggests that despite the high design standards, a significant part of the water produced does not reach consumers. Another source of inefficiency is over-employment. Reducing these inefficiencies in operating costs can generate large benefits in the long run. Yet, as long as tariffs remain very low and authorities can rely on operating transfers, the incentives of government agencies to strive for efficiency are minimal. Changing these incentives—including by amongst others improving billing and collection efficiencies and also increasing water and wastewater tariffs for all users—will be critical.

3.57. **Before making any changes to the tariffs, utilities should first address their low billing and collection efficiencies.** Fixing the gaps in the billing systems will generate additional revenue while it reduces the pressure to increase tariffs to ensure the sustainability of the water supply service. It will also make the water and sewer directorates less dependent on government funds to operate and maintain their systems while providing consumers with more incentives to use water and wastewater services more efficiently. Affordability is not a very critical issue right now in the Iraqi context. The majority of households do not pay for their water and wastewater services.

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\(^{11}\) The estimated use of wells is estimated at 35 percent in Erbil city center and 40 percent outside the city. In Sulaymaniyah, in the city it is 2 percent while it reaches 70 percent outside the city; and in Dohuk it is 2 percent in the city and 40 percent outside the city.
KRG could conserve significant amounts of water by using advanced technologies for water metering. “Smart meters,” which measure consumption and relay the information to a central body for monitoring and pricing, can help Government authorities see how much water is being used and where, and serve as the foundation for enforcing a more robust water tariff. The UAE, which has one of the highest rates of water consumption in the world, is about from having all of Abu Dhabi covered by smart meters and reforming water tariffs based on the metering scheme.

**Lack of revenue flows**

3.58. This will require better billing and collection practices, more customer awareness on the cost of the service and the need to use water more conservatively and slow steps in the direction of customers paying more cost-reflective tariffs, and the explicit formulation of subsidy policies. Institutional changes that provide utilities with more autonomy, but that will require large reforms internally. For now, there could be an intermediate step of ring-fencing water and wastewater operations in the directorate to move to more autonomy and accountability.

**Irrigation**

3.59. Land use in most areas is dominated by rain-fed agriculture with little water requirements. One of the bottlenecks identified for the development of agriculture is the poor irrigation system, limited in coverage and technology. The level of irrigation use is far lower now than in the past, and considerable potential exists for increased use of irrigation to support production of high value crops. In KRG irrigation is considered essential on three accounts: (a) to minimize climatic risks; (b) to ensure quality of products essential to commercial agriculture; and (c) to provide adequate incomes and living standards in the rural areas. For fruit and vegetables, irrigation is essential for quality and timely production, besides increasing yields substantially. It is expected that, with irrigation, small farmers would move to more high-value crops and specialized markets, and away from near subsistence agriculture.

3.60. Approximately 150,000 ha are irrigated. Modern irrigation methods (sprinkler and drip irrigation) are still at their early stage of implementation.

3.61. The present consumption of water in the agriculture sector is high, and the current overall irrigation efficiency is low. Immediate water conservation measures has to be implemented in the agriculture sector to ensure that sufficient water is available to support all water users.

3.62. Crop production is the major source of income for 75 percent of farmers, while the rest depend on livestock cultivation. Grains, primarily wheat and barley, are KRI’s main crops. Animal husbandry is practiced extensively and backyard chicken raising are a valuable source of protein and income for rural populations.
3.63. The agricultural sector consumes 77 percent overall water resources. As a result, when a drought occurs, agriculture is among the hardest hit. For example, in 2008 and 2009, drought damaged almost 40 percent of Iraq’s cropland, and Ninewa and Erbil experienced damage to over 50 percent of their cropland. Compounding the threats of drought, the cultivated land requiring irrigation for wheat alone has expanded by 33 percent between 2000 and 2010.

**Droughts management**

3.64. In the last 10 years there was frequent occurrence of droughts in the region which affected agricultural production as well as availability of water resources and caused more overdrafts of groundwater aquifers. This may also contribute to the migration from the rural areas to the urban centers.

**Subsidies**

3.65. Since there are no charges for irrigation water, all operation and maintenance (O&M) cost for small and large irrigation schemes can be considered as a subsidy. The annual subsidy amount for that can be as estimated as about US$3 million (US$20/ha X 150,000 ha irrigated). In addition, there is a subsidy for pumping of groundwater because farmers do not pay irrigation water charges and other users do not pay the actual O&M cost. This definitely results in having no incentive for water saving and is one of the major causes of overdraft in the groundwater aquifers. Also, the above subsidy does not include the salaries of the irrigation department staff that works on O&M which can be added to this cost.

**Table 3.2: Recommended Actions for Addressing Water Scarcity**

<table>
<thead>
<tr>
<th>Level I</th>
<th>Level II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IA: Irrigation System Modernization</strong></td>
<td><strong>IIA: Integrated Basin Management</strong></td>
</tr>
<tr>
<td>• Rehabilitation and modernization of existing irrigation systems</td>
<td>• Hydro-geological monitoring and assessment</td>
</tr>
<tr>
<td>• Modernization of private wells irrigations systems (conversion to pipe distribution systems)</td>
<td>• Demand management</td>
</tr>
<tr>
<td>• Improved on-farm water management (incl. participatory management)</td>
<td>• Supply management</td>
</tr>
<tr>
<td><strong>IB: Drainage and Water Quality Improvement</strong></td>
<td>• Conjunctive use</td>
</tr>
<tr>
<td>• Drainage improvements</td>
<td>• Water quality management</td>
</tr>
<tr>
<td>• Development of a comprehensive water quality management framework and action plan</td>
<td>• Participatory groundwater management</td>
</tr>
<tr>
<td><strong>IC: Participatory groundwater management projects</strong></td>
<td><strong>IIB: Institutional Strengthening in WRM</strong></td>
</tr>
<tr>
<td><strong>ID: Appropriate technologies for treatment of wastewater and re-use in agriculture in rural communities</strong></td>
<td>• Data collection and management</td>
</tr>
<tr>
<td></td>
<td>• Capacity building and training</td>
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<tr>
<td></td>
<td>• Information dissemination</td>
</tr>
<tr>
<td></td>
<td>• Public awareness raising</td>
</tr>
<tr>
<td></td>
<td><strong>IIC: Public Private Partnership (PPP)</strong></td>
</tr>
<tr>
<td></td>
<td>• PPP in water supply, wastewater treatment and I&amp;D projects should be</td>
</tr>
</tbody>
</table>


IE: Investment in small dams and water harvesting used to bring in a third-party service provider to improve efficiency.

Institutions

3.66. The Ministry of Agriculture and Water Resources is the bulk water supplier and is responsible for the water planning, operating dams, hydropower stations and irrigation schemes. There are two general directorates that deal with water resources and dams: the General Directorate of Water Resources and the General Directorate of Large Dams. The General Directorates of Water Resources has several departments: Departments of Studies and Design, Department of Irrigation Projects, Department of Groundwater and Department of Small Dams (ponds). The total number of staff in that directorate is as follows:

- General Directorate of Water Resources. Total number of employees is 1,585 out of that a total of about 686 staff are technical staff (engineers, geologists, agriculturists)
- General Directorate of Large Dams. Total number of employees is 110 out of that there are 50 engineers and 15 geologists, and 7 agriculturists, while there are also about 650 employees in the governorates.

Water sector reform

3.67. So far, little efforts to reform the water sector have been carried out except for drafting a new water law. The new law will include clear statements about the need to develop water resources in an environmentally sustainable way including the impact of climate change, promote users participation and include also the two universal principals for water use: users of water should pay and polluters of water should pay.

Box 3.3: New Models for Service Delivery

Transfer of O&M activities to an independent company through a contract process has been used in Vietnam with some success in the North of the country where Irrigation Management Agencies (IMAs) sign seasonal contracts with Village Cooperatives. With World Bank financial support, China and Turkey has adopted a similar approach known as Self-Irrigation and Drainage Districts consist in the creation of financially autonomous Water Supply Corporations (WSCs) which sell bulk water to Water User Associations. This new model has proven to be much more effective in providing services and properly maintained infrastructure than conventional government irrigation and drainage management. One of the main reasons for the adoption of that model has been the fragmentation of irrigation management in the past based on administrative limits of townships, counties, and prefectures leading to inefficient and uncoordinated management.

Groundwater management

3.68. Statistical results indicate that total number of exploited wells was about 19,448 wells, of which 79 percent were used for drinking, 18 percent used in agriculture, and the rest were exploited for industrial, and agricultural extension and research purposes. It is to be noted that the above number of wells at present is higher because of the continuous drilling, the continuous issue of licenses and the illegal drilling of wells. The groundwater
resource has undergone severe depletion as illustrated by the serious drop in the ground water table and the increase in soil salinity levels. Under these circumstances, the majority of the population has resorted to digging privately owned/used shallow ground water wells inside their dwellings, which poses serious health risks as the water extracted is highly contaminated groundwater and would need to be properly treated before it can be safely used domestically.

**Research and capacity building**

3.69. Continuing research and advancement in technology shall be promoted to address issues in the water sector in a scientific manner. Innovations in water resources sector should be encouraged, recognized and awarded. It is necessary to give adequate grants to the update technology, design practices, planning and management practices, preparation of annual water balances and accounts for the site and basin, preparation of hydrologic balances for water systems, benchmarking and performance evaluation. It needs to be recognized that the field practices in the water sector in advanced countries have been revolutionized by advances in information technology and analytical capabilities. A retraining and quality improvement program for water planners and managers at all levels in KRG, both in private and public sectors, needs to be undertaken. The goal would be therefore to provide a platform to build knowledge, capacity and a network of professionals and practitioners in KRG, across a range of priority areas that might include:

- Sustainable water resources management policy, planning, institutions and incentives.
- Integrated urban water management (IUWM) including non-traditional water.
- Agricultural water productivity.
- Groundwater management.
- Closing water service gaps for the poor and for displaced populations.

**Reliable and comprehensive water security indicators**

3.70. Proper water resources management relies heavily on the availability of accurate spatial and temporal information to provide the essential basis for sound management decisions. Groundwater monitoring is of fundamental importance, especially when groundwater resources are threatened by over-exploitation and quality deterioration. Constant and accurate monitoring of water quality, water levels and water extraction in an aquifer is a sine qua non of successful water management. No steps have been taken to determine the following water security indicators:

- Water security plans including diversity of water supply for major cities such Dohuk, Erbil and Sulaymaniyah.
- Interdependence - Share of renewable resources from transboundary aquifer or river.
- Groundwater health – aquifer recharge rate relative to average annual withdrawals.
- Efficiency of agricultural water – water productivity in terms of GDP generated per cubic meter.
- Inclusiveness - Service gap for sanitation.
- Health - Share of urban and industrial water treated.
- Financial sustainability - Weighted average of urban and agricultural water tariffs as percent of O&M costs.

### D. SERVICES SECTOR REFORM

3.71. *Services and services trade could play an important role in the growth and development of the KRI.*, including to support its economic diversification efforts. Services are essential inputs in any form of production, as well as a major component of the region’s connectivity, hence a key determinant of KRI’s competitiveness and ability to join and move up domestic, regional and global value chains. Services could also become an important source of exports outside the oil and gas sector, along models in the region, and provide jobs outside the public sector. For example, GCC countries have heavily invested in services sectors such as retail and wholesale trade, tourism and hospitality, finance and construction, which should contribute to more than 60 percent of their GDP growth and jobs creations (McKinsey, 2015). Specific examples include the financial sector in Bahrain, airlines and logistics in Qatar and the United Arab Emirates, tourism in Dubai.

3.72. *As a landlocked region of Iraq, the KRI is even more relying on services; this situation could be turned into an opportunity.* KRI has the potential to become a platform for transit and services provision in the country and region, given that it shares borders with large potential markets. In particular, services cross borders more easily than goods, and the KRI could become a safe gateway for the provision of a large array of services in other regions of Iraq, as well as abroad, from tourism to back office or professional services outsourcing. This will require, however, that the KRI first removes a number of barriers to services trade that remain in place. Provided that services trade mainly takes place at the intermediary level and within global networks, protecting “infant” services industries would have the opposite effect of that desired and exclude them from global trade flows. In the services sector, given the importance of reputation and skills, one needs to become importer first to benefit from intra-network transfers of all kinds (capital, knowledge, know-how, technology) and build a reputation. It will also require (i) restoring some legal certainty and security; (ii) adapting laws and regulations that are often more than 30 years old and outdated; and (iii) building capacity (skills, standards and infrastructure).

3.73. *Beyond the economic dimension, the reform of the regulatory framework and the improvement of the services supply in the KRI will first and foremost benefit the overall Iraqi population.* Given that major gaps exist, for example in the health or education sectors, that result in Iraqi nationals seeking locally-unavailable services abroad—with extra costs for both those consumers and the state (e.g., when medical procedures that are not locally available must be sought abroad and the expense reimbursed).

3.74. *Given the fiscal situation, the KRG will not be able to harness this challenge alone:* fostering foreign investment, encouraging private sector initiatives, and promoting PPPs will be essential components of any policy aimed at developing a competitive services sector. Private sector services companies in the KRI have been so far excessively
focused on public procurement, caught in a vicious circle with delays in governmental payments that resulted in an incapacity to invest and develop their capacities; these firms have also been excessively opportunistic with a focus on higher short-term returns (e.g., boom in real estate) and no long-term vision and investment—only an opening and scaling up of services firms will allow a concentration and specialization of the firms to reach critical size and become competitive on global markets. Furthermore, these firms have been excessively inward looking and did not explore the opportunities offered by foreign markets.

3.75. **In a number of services sectors, the KRG has drafted strategic plans in the early 2010s, which have not been implemented.** In the tourism sector, for example, initiatives have been launched, but the conflict has hampered short-term prospects for successful development. This time off could be used to prioritize the reforms and focus on medium to long-term investments, such as infrastructure, skills, or the quality of the tourism offer. The oil and gas sector could also be used as a stepping-stone for diversification: local sourcing and workforce development programs are in the pipeline and could help upgrading domestic services and developing a competitive sector with some export potential. Health services are also typically lagging, in spite of huge needs, both locally (e.g., oncology in the southern regions of Iraq) and in the region. A holistic approach could be adopted that links upgrading in the services (from clinics to laboratories) as well as the pharmaceutical industry (generics). From professional services to retail, opportunities exist and need to be better exploited, but require the state to play an incubator role.

**A source of exports and economic diversification**

3.76. **Services trade, whether embedded in goods or stand-alone, represents an important diversification, upgrading and growth potential that has remained largely untapped.** Iraq, along with many other MENA countries, remains too dependent on the export of raw materials (oil and gas), confined at the bottom of the productivity chain when emerging countries moved up the value chain (Müller-Jentsch, 2005). As illustrated below, Iraq was an outlier in terms of services trade contribution to GDP in the region, with a contribution in percentage half that of the MENA Region (16 percent), the Arab world (14 percent), and even fragile and conflict affected countries (13 percent). The margin for growth is therefore important, and the KRI could be the front runner and driver of this strategy.
The KRI will need to remove constraints to become an exporter of services

In Iraq, and even more so in the KRI, many restrictions remain in services sector. GCC countries have heavily invested in services sectors such as retail and wholesale trade, tourism and hospitality, finance and construction, and rely on services to contribute to the essential of their GDP growth and jobs creations. Iraq (including the KRI) should follow this path and some of the premises of this strategic move are already observed with an early boom in real estate/construction and tourism/hospitality prior to the crisis. In KRI, some restrictions remain on the establishment and practice of foreign professionals that should be removed to unleash the potential of this sector and create local jobs and growth. These include:

- In all professions: legal uncertainty (sometime conflicting requirements from different authorities, e.g., for tax exemptions or reporting schedules, or rules regulating the professions that may vary across Iraqi regions), nationality requirements, equivalence for diplomas, residency requirements for visas
- In the accounting/auditing sector: restrictions on the performance of audits by foreign firms and professionals (need signature of local auditor)—only advisory services; use of old accounting standards (need for double reporting that is costly for companies)
- in the legal sector: registration of foreign firms

Typically, in the KRI, international professional services firms help foreign investors with their activities and relations with the government and tax authorities (more than 90 percent of the clientele of the firms interviewed). While some of the firms started with foreign staff only, they have progressively substituted expatriates with local graduates (for example, Deloitte went from 100 percent foreign staff in 2011 to 36 percent today). Most of them have a regional footprint with offices in Jordan, Dubai, and Lebanon.
Services development responds to the KRI’s specific needs in its difficult geo-political context

3.79. The services sector offers greater perspectives for private sector employment than any other sector, in particular for women and the youth. According to RAND (2014), the KRI could expect the following three sectors to employ a substantial share of the workforce and have above-average employment growth compared to the rest of the economy: (1) construction; (2) transport, storage, and communications; and (3) wholesale and retail trade. In OECD countries, services represent 75 percent of the jobs (with the highest level of employment in the services sector for the 15-29 age group). Given the potential of tourism in the KRI, it is important to note that the hospitality sector is the main source of “first jobs” for low-skilled workers. The development of ICT services is a common factor of increase of youth employment. With regards gender issues, two services sectors alone (communication services and retail/hotels/restaurants) represent more than half of the jobs held by women (52 percent compared to 33 percent of jobs held by men) (World Bank, 2011). The 2012 World Development Report (World Bank, 2011) suggested that increases in female employment levels (but not male) between 1995 and 2005 were correlated with increases in international trade and new opportunities in the services sector. In particular, the report stressed that new ICT-enabled jobs in services (e.g., information processing in banking, insurance, printing and publishing, and call-centers) were mainly taken up by women, and that teleworking offered new opportunities for men and women to better combine family and professional lives. In the KRI, the female participation to labor force between the age of 35-44 is below 20 percent, compared to more than 90 percent for men (RAND, 2014).

3.80. Services trade integration strategies could include spatial (regional) planning as a policy objective. In Morocco, for instance, the Atlantic coast with the economic and administrative capitals has traditionally been the economic driver of the country; it is the objective of an ambitious spatial planning policy—backed by services trade integration projects—to develop new growth poles: Tanger-Tétouan and Fès-Meknès as trade platforms respectively with Europe and the Maghreb, Marrakesh and Agadir for tourism, Ouarzazate for solar power (Ministère des Affaires Etrangères, 2006). Larger scale projects (such as cross-border transport, energy and telecommunications networks) could allow the construction of adequate infrastructure and the development of efficient and competitive services available to a larger share of the population. Services trade, under all four modes, could be used to serve spatial planning objectives. Tourism and transports, energy projects, as well as construction and retail will be key to the harmonious development of the KRI.

3.81. Efficient services are needed to connect the region to the rest of the world. KRI has a proximity to large markets that are in important need for services delivery. The KRI could become a platform for transit and services provision in the region. In addition, the KRI offers a safer environment than other regions in Iraq or neighboring countries. Thus, it could become a safe gateway to Iraq and other fragile states in the region: services trade is particularly suited to this type of remote provision. Due to problems with the transit of persons in the region, however, the KRI will heavily rely on new technologies and
telecommunications in particular—for take-off of trade under modes 2 (e.g., tourism) and 4, notable changes in visa procedures will be required.

**Services trade as a source of economic diversification: looking beyond the borders**

3.82. **Efforts need to be made by the KRG to diversify the economy.** This would entail the setting-up of an export promotion agency, and the creation of incentives and export support schemes, in particular for SMEs that facilitate access to credit or other financial instruments. Dubai is used by many in the literature as a model for the region in terms of diversification and use of services towards this end. However, a recent IMF report pointed that “replicating the same model to create financial, trade, tourism, transportation, and logistics hubs in a limited geographic region may be difficult for the whole country (UAE) and its Gulf neighbors” (Callen et al., 2014). The KRI will have to compete with a number of players in the region trying to diversify into the services sector. Lebanon, Jordan and Turkey are also contenders. While some services are resource-specific, such as tourism, competition in other services that can be delivered remotely will be based on quality and price (including reputation and skills). A SWOT analysis has to be conducted in the different services sectors to identify the potential of the KRI and inform its policy decisions. In some sectors, like professional services, IT-enabled services, health, where competition is regional or global, niches could be identified: in particular, language and cultural affinities might help building a comparative advantage in some niches (e.g., development of content in Kurdish language, cultural/historical and religious tourism).

**Promoting private sector and long-term initiatives**

3.83. **The excessive dependence on public procurement/spending drowns the region into a vicious circle:** the absence of payments of public orders results in cash flow problems, which in turn affect the firms’ capacity to invest and become competitive. Services firms that are not competitive cannot tap into new markets and increase their dependency on public orders.

**Figure 3.4: Vicious Circle: Dependency on Public Sector**

3.84. **Private sector development in the KRI is still at the embryonic stage.** A small number of conglomerates—often family-owned—have activities in a wide array of sectors. This is somewhat characteristic of emerging economies, in particular in the MENA region.
There are very few companies that are specialized in one services sub-sector only. Very often, the entry in new services sub-sectors is motivated by quick returns on investment: for example, the construction sector has boomed in the early 2010s but the prices have since collapsed and many projects abandoned. Given the political situation in the region, security services have, in turn, mushroomed. The challenge will be to turn short-term business opportunism into long-term investments and capacity building—even more so in a resource-rich country whose objective should be to maximize long-term returns.

3.85. **Connection to international major services networks will have to play a major role in KRG’s strategy.** However, a number of vested interests remain and there is a diffuse protectionist inclination (e.g., the idea that nascent industries or sectors should be protected). For example in professional services, such as legal services, foreign nationals or firms still face a number of barriers that should be removed. It is an essential condition for the KRI’s economy to move from a model of family-owned business model to a competitive and scaled-up services industry.

**The role of the state as incubator**

3.86. **The state is excessively paternalistic, although some progress has been observed.** For instance, in the standards and conformity assessment, the government delegated its powers to private companies—which is a good move towards greater efficiency. Outsourcing and privatization of government functions should be encouraged (RAND, 2014). With regard private sector initiative, the State should play the role of an incubator rather than a contractor or competitor.

3.87. **Given the excessive number of civil servants, an issue to tackle would be the conversion of public into private sector jobs.** Some obsolete and non-competitive industries are still run by the Ministry of Trade and Industry and should be updated and privatized or abandoned with appropriate reconversion plans. A reconversion scheme could be put in place as part of the public sector downsizing efforts (government and state-owned enterprises) to help workers transition from public to private jobs. A number of recommendations towards this end are made in RAND (2014) that include financial severance packages (voluntary and involuntary separation programs), training and job matching programs.

3.88. **In addition, the Government could put in place structures aimed at facilitating business and encouraging entrepreneurship.** A number of key business climate issues remain in the KRI that should be addressed (see RAND, 2014).

3.89. **Start-up costs are lower in services that are mainly SMEs, and therefore represent a serious hope for diversification and reduced reliance on the public sector.** For example, in the transition countries of Eastern and Central Europe, the SME sector has been the largest creator of new jobs and the vast majority of these new enterprises were small businesses. The Government of Iraq adopted for 2014-2020 a Private Sector Development Strategy, which included a pillar on SME development. A number of schemes exist to promote entrepreneurship and SMEs. In Kuwait, for example, where 95
percent of national workers are public servants, and more than 90 percent of GDP is
generated by oil revenues, the government established a National Fund for SME
Development that is intended to build an inclusive, collaborative, and innovative ecosystem
for entrepreneurs. The SME Fund is due to finance up to 80 percent of capital for feasible
small and medium projects submitted by Kuwaiti nationals. Other incentives include the
creation of a business-friendly environment for SMEs and an entrepreneurship culture
development.

3.90.  There is a need to develop greater synergy between the public and private sectors,
for instance in the context of public-private partnerships (PPPs) that could be further
developed. Among others, the IFC has been playing an advisory role as the KRG has
moved to expand and formalize PPP use in the KRI. The KRG intends to expand the use
of PPPs to accelerate the development of the region’s infrastructure and to improve the
provision of services for the region’s inhabitants. In line with recommendations from the
IFC, the KRG has been examining the experiences of Turkey, India, and Jordan in PPP
implementation and has been working to develop a specific law to regulate all forms of
PPP activity. In association with the Ministry of Planning, the World Bank Group has been
providing support to the KRG to develop a proper legal framework for PPPs that is tailored
to the Region’s needs and inspired by relevant best practices, success stories and
international guidelines (Lipson, Ismail Ali and Ala Al-Kazzaz, 2014). Furthermore, IFC
has arranged a US$375 million financing package for an energy sector project which will
provide electricity to millions of people in Iraq—particularly in the KRI, where a migrant
crisis has strained power infrastructure.

3.91.  The government has made efforts to promote foreign investment, for instance
through the Board of Investment. The spillover effects of these investments could be
maximized through a legal framework encouraging technology and knowledge transfers.
In a number of services sectors, cooperation with foreign firms has helped building local
capacity and developing competitive services. For example, the Zagros Group developed
wind and solar energy projects with a German company, oil and gas product development
with a US company; Awamedica developed local pharmaceutical capacities with Swedish
management model and recent partnerships with European firms; STER Group developed
its competence in security services with a US company, and in building engineering with
a Dutch group. These partnerships and transfers of all kinds (not only financial, but
knowledge, know-how, technologies) should be encouraged through a more secure legal
environment for investors.

Reducing legal uncertainty and modernizing the laws

3.92.  A recurrent complaint in the private sector is legal uncertainty. For instance, there
is uncertainty about exemptions that might be granted by one ministry and then denied by
another; uncertainty about taxes, rules on liquidity transfers; standards applied across Iraq
and the KRI governorates. The Investment Law, while revised in 2009, still needs
improvement. According to State Department (2015), “In the KRI, the KRG adopted a
Consumer Protection Law through its passage of Law Number 9 of 2010. In the KRI,
investors sometimes find it challenging to de-conflict seemingly opposing regulations from
relevant stakeholder ministries and investment entities. The emergence of new regulations with little advance notice, as well as requirements related to investment guarantees, have also slowed projects. While the KRI does not stipulate that a local partner is necessary to acquire an investment license, government officials sometimes encourage this practice.”

3.93. **In many areas, laws have been inherited from the old regime and are obsolete.** Iraq (including KRI) would need to upgrade the laws and regulations of many services sectors to meet international standards. The duality of standards and controls represent important additional costs for business. This is the case for instance in the accounting/auditing sector where old standards are applied and international firms applying the IFRS are facing double reporting costs. The KRG is lagging behind the central government in moving to these new standards. With regards standards and conformity assessment, much progress has been made with the intervention of private companies; however, a number of controls are still carried out by the administration (list of goods); in addition, on food, obsolete regulations affect the development of the distribution/retail sector, with a residual competence of the Ministry of Health, and a lack of harmonization across Iraq and KRI governorates—for example, inspection requirements and the regulation of expiration dates do not match international standards, raising the cost of assessment.

3.94. **The result of these obsolete regulations is the need to outsource/import services**, for instance in the health sector (a central plan for accreditation of the health institutions was adopted but not implemented, and clinics in Turkey benefit from a large inflow of KRI patients looking for higher quality treatment), and certification or professional services (laboratories in Turkey and Gulf countries). In the distribution sector, the obsolescence of the laws result in smaller scale distribution/retail and higher prices with lesser quality for consumers. Better regulation would result in greater services development opportunities in the KRI and, eventually, services exports.

**Building capacity**

3.95. **The KRI is facing a number of capacity problems in the services sector that need to be remedied:** these include both infrastructure and skills. This is the case for certification, for example, where new laboratories would be needed and staff trained. This could be done in partnership with the private sector. Similarly, in the health sector, equipment is either outdated or new but not operational due to a lack of expertise among medical staff. Investment in infrastructure stopped in 2015 as a result of the fiscal crisis, while the KRG was still trying to upgrade health centers. The Kurdistan Medical Control Agency has developed its capacities in 2013 but still needs additional experience and upgraded facilities.

3.96. **Related is the issue of skills and their availability.** Curriculums should be adjusted to meet the needs of modern services. This is the case for example in the health sector, tourism, transports, or professional services. Some private initiatives have emerged, in cooperation with foreign companies or universities, to upgrade the KRI’s education supply. This is the case for instance in the health sector where the University of Kurdistan in Erbil
has developed a joint program and curriculum with the University of Graz in Austria to update the training of local graduates. The country is still lacking a number of specialists, for instance in intensive care or oncology (PET scans have to be done abroad in spite of existing machines in Erbil).

3.97. **Participation to global services networks could contribute to the upgrading of both hard and soft components of services competitiveness** with a number of transfers made within networks (technology, knowledge, and know-how). For example, in the accounting sector, the “big four” that established in the KRI progressively substituted foreign accountants with local graduates and trained them abroad to have them qualified in international standards.

*The movement of people*

3.98. **The movement of people is essential to the development of services**: either the consumer (so-called Mode 2 in GATS terms—for example tourism) or the service provider (so-called Mode 4 in GATS terms—for example when a lawyer accompanies her client abroad) might have to cross the border for the transaction to take place.

3.99. **The current political situation and the refugee crisis affect the fluidity of cross border movements of people, including within Iraq**. Some private firms reported additional costs associated with the difficulty to obtain visas. The recent refugee crisis has exacerbated these problems, for instance with the removal of visa exemptions for Turkey. Given the number of services transactions taking place between the KRI and Turkey (for example for medical treatment abroad, construction or professional services), trade in services is likely to be severely affected. On the other hand, since the KRI is a net importer of most services, the new Turkish visa policy might contribute to reduce this deficit, for example for patients willing to be treated in Turkey who will now seek treatment in the KRI. This creates even more a sense of urgency with regards the need for local services upgrading.

**E. Tourism Sector**

3.100. **The KRI is well located next to important potential tourism markets**: Turkey, Iran, and other regions in Iraq. It can be reached by land or by air, with two international airports in Erbil and Sulaimaniyah and 26 airlines flying to/from KRI. Its main assets are its unspoiled mountain scenery and ancient archeological sites. Its cultural heritage is important, ranging from music to arts and crafts, clothing, textiles, rugs, etc. The religious tourism sector has also developed, attracting a number of tourists from around the world (the Ministry of Endowment and Religious Affairs estimated at 1 million the number of tourists who visited Islamic, Christian, Yezidi and Kakai sites at the tourism peak time). The region also counts facilities for ski and hiking.
The assets: A strong potential

3.101. Considered as the oldest inhabited citadel in the world, and estimated to be at least 7,000 years old, the Erbil citadel has been placed on the UNESCO’s list of World Heritage Sites in 2014. It is the only one of the four Iraqi sites that is not on the danger list. The Citadel is a protected site under the legislation of Iraq and of the Kurdistan Region. The authority in charge of its revitalization efforts, the High Commission for Erbil Citadel Revitalization (HCECR), is working in a strategic partnership with UNESCO and other agencies to conserve and rehabilitate the Citadel through programs of physical improvements within the framework of detailed studies and plans that have been the basis for the Conservation and Rehabilitation Master Plan for Erbil Citadel.

Map 3.1: UNESCO World Heritage Sites in Iraq


3.102. Often, the tourism potential of the KRI is not sufficiently exploited. For example, little knows about the battlefield of Gaugamela that opposed Alexander and Darius and changed the course of history. Many of the sites are hard to reach and lack the infrastructure (access and hospitality, other services) necessary for the development of tourism. Tourists are largely left on their own with too rare organized tours or excursions. The region is not part of package tours that would attract tourists on a larger scale. Thus, the tourism potential is largely untapped.

The current situation: A severe crisis with no signs of short-term recovery

3.103. Number of tourists are declining due to the regional conflict. Tourism in the KRI has boomed at the beginning of the 2010s, reaching a peak-high of 3 million visitors in 2013. However, the war with ISIS that started in 2014 resulted in a dramatic drop in tourist arrivals: -48 percent in 2014 and -27 percent in 2015.
3.104. **Tourist arrivals from outside the region (Iraqi) have been most affected by the conflict**, with their number dropping from almost 2 million in 2013 to 753,000 in 2015. Their share of total arrivals remained unchanged, however. By contrast, the share of foreign tourists has been reduced by half, almost, from 19 percent to 11 percent, with their number dropping from 559,000 to 120,000. Foreign tourist arrivals are now essentially limited to business visitors, NGOs and international organizations or foreign officials.

3.105. **Erbil remains the most visited region of the KRI, representing two-thirds of the tourist arrivals.** It was the region less affected by the crisis, benefiting from local tourism in particular. By contrast, the Dohuk region has seen the number of its visitors divided by more than 6 in two years.
3.106. **Recent restrictions on visas (March 2016—as part of Turkey’s commitments vis-à-vis the European Union to deal with the refugee crisis) are likely to increase the problem of tourist arrivals**, in particular in the Dohuk region where Turkish nationals represent the bulk of visitors. Restrictions on the movement of people between KRI and other governorates of Iraq have also dried out the main source of tourists in KRI (two thirds are out of the region tourists).

3.107. **This situation (combined with the drop in oil prices and the slowing down of investments in the field) has resulted in a number of tourism projects being postponed.** In Erbil, the main international chains had plans to build luxury hotels. These included Starwood (USA, two properties), The Address (Dubai), Marriott (USA), Radisson Blu (USA), Kempinsky (Germany), Accor Sofitel (France), Grand Hyatt (USA). Constructions and programs are now on hold or abandoned.

**Development plans and reforms engaged**

3.108. **2014 should have witnessed the consecration of Erbil as the Arab tourism capital**, with 4 million expected tourists, providing stability and security in a distressed region. Previously, in 2013, the Ministry of Municipalities and Tourism, General Board of Tourism, had adopted a Tourism Strategic Plan based on the following axes:

- **The development of the administrative structure of tourism for sustainable tourism development management.** The focus would be on structural requirements for sector development, including the strengthening of policy development, planning, marketing, media, and communication strategies. Also there is a need for the private sector to participate.

- **The development of tourism sites and products.** This includes the identification of tourism assets and promising sites for tourism and the development of tourism...
products on the basis of groups (zones/clusters) in every Governorate. Assets include natural sites; from mountains, lakes, caves archaeological sites recreational areas, historical heritage and provincial centers.

- **The improvement of quality in the tourism sector and its competitiveness.** This includes the development of mechanisms for the overall quality and the adoption of international standards in tourism facilities and products. Additionally there is a need to encourage private sector organizations to develop and implement a quality management system.

- **The development of tourism brand strategy.** The tourism brand is the expression and competitive identity of the region. It is central to all marketing communication tools, and should be based on market research studies.

- **The preparation of a tourism marketing strategy.** This includes strategic positioning and mechanisms for communication, media, and education. The channels of communication include traditional and modern tools required to create an image of the activities and events geared to the target markets.

- **The development of tourism education.** This includes the development of tourism education and training based on current situation, programs and curricula development, educational institutions empowerment, and program identification.

- **The state's role in the development and support of the tourism sector.** This includes the role of government to enhance the attractiveness of tourism investment. By supporting the sector development via regulatory framework, legislation and programs to increase the attractiveness of tourism projects to investors and to create investment incentives.

- **The environment impact and waste management.** This includes guidelines for tourism institutions on proper waste management methods to reduce the impact of their activities on the natural environment.

- **The development of infrastructure.** This includes components for infrastructure development of road and transport networks, airports, electricity, water and communications in support of the region's economy and the tourism sector.

- **The development and modernization of legislation, laws and regulations for tourism.** This includes the preparation and development of legislation, laws and regulations that will support and strengthen the tourism sector with a focus on standards contributing to the development of projects, institutions and tourism facilities for investment, and environment quality management to sustain competitiveness.

3.109. **Due to the crisis, the implementation of the Tourism Strategic Plan has been delayed.** The KRG has been very active in initiating parts of the strategic plan, including the development of the Board of Tourism, the deployment of marketing efforts, data collection, the establishment of a training center, and support to the private sector. However, this could not counteract the effects of the crisis.

3.110. **In parallel, the World Bank commissioned Roland Berger Strategy Consultants to conduct a Rapid Tourism Assessment Scoping in the KRI** (2014) that was organized around three work streams and set of recommendations:
The first work stream promoted the concept for an enhanced operating license regime for travel agencies and tour operators that are key players in the tourism sector. It stressed that the legal framework as well as the process to obtain an operating license in this market segment posed a number of challenges in the KRI.

The second work stream proposed a scheme for a quality certificate to be granted by the Board of Tourism in various segments of the tourism sector with a view to improve the overall quality of tourism companies and thereby to create a positive effect on the development of the tourism industry as a whole.

The third work stream provided an overview of current regulatory constraints for private sector investments that are essential for the development and growth of the tourism industry (see table below). Given the horizontal nature of most of these measures, the table summarizes major challenges faced by the private sector.

Table 3.3: Major Constraints for Private Sector Investment in Tourism in KRI

<table>
<thead>
<tr>
<th>General issue</th>
<th>Constraints or challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Major constraints related to land and construction</strong></td>
<td></td>
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</tbody>
</table>
| Access to land | • Clarification of land ownership often an issue in rural areas  
• BOI with difficulties to obtain land in rural areas where the MOAWR is responsible  
• Difficulties to obtain land near airports due to security concerns |
| Land designation | • (Re-)designation needs to comply with the master plan and is often a challenge outside of cities |
| Construction permit | • Long waiting times for obtaining the construction permit  
• High fees need to be paid to the union of engineers  
• Cumbersome process |
| **Major constraints related to labor** | |
| Entry visa | • Limited transparency when obtaining entry visa for staff without a university degree |
| Residency permit | • Frequent change of regulations  
• Limited transparency when obtaining residency permits for staff without a university degree |
| Work permit | • Uncertainty regarding future regulations |
| **Major constraints related to capital and goods** | |
| Import of goods | • No clear legal basis for current practices  
• Applied regulations vary at different border posts  
• Regulations keep changing resulting in uncertainty  
• Issuance of import license sometimes substantially prolonged  
• Long waiting times at border posts  
• Very good knowledge of import process required |
| **Major constraints related to operations** | |
| Competition law | • Uncertainty about future practices |
| Consumer protection law | • Uncertainty about future practices |
| Operating licenses | • No major constraint, but bureaucratic processes are cumbersome |
| Taxation | • Taxation based on industry profit schedules, not actual revenues |
| **Governmental incentives framework** | |
| GBOT Small Loan Project | • Process is not standardized yet.  
• Process is lengthy and cumbersome, requiring a high number of site visits and follow-up by the investor.  
• Investors face difficulties in providing acceptable guarantees. |
Clarification of land ownership and (re-)designation of land can be problematic.
All payments were stopped in November 2013 due to the fiscal issues.

BOI Investment License

- If investors are not decided on the location, i.e., the governorate in which to invest, they are dealing with three different entities.
- The eligibility assessment lacks transparency and accountability.
- The availability of land is limited and the inter-ministerial collaboration under-developed.
- Inconsistencies exist across governorates with respect to licensing assessment.
- Delays occur with the provision of public infrastructure and services.
- Land disputes can arise despite the allocation of a land plot.
- Process takes in practice up to one-year; the desired “one-stop-shop” is not yet implemented.

Non-regulatory constraints

| Tourism infrastructure | • Touristic sites not yet fully developed
| | • Limited public transportation between cities
| | • Language barrier
| | • Limited availability of well-trained tour guides
| | • Insufficient payment infrastructure for foreigners
| Security and perceptions | • Unstable security situation in regions and countries surrounding the KRI
| | • Limited awareness of the relative safety of the KRI
| Access to finance | • Challenge to debt financing
| Underdeveloped banking and insurance sector | • Housing and project finance still premature
| | • Few banks offer loans; these loans generally have a high interest rate and a short repayment period
| | • Simple banking procedures can be cumbersome
| | • Limited access to simple insurance products
| Qualified labor | • Supply of qualified labor does not meet the demand in the KRI


Recommendations

3.111. In spite of the crisis, the Tourism Strategic Plan and the Roland Berger exercise remain a useful tool and guidance for the KRG to develop its tourism potential. The Government should therefore pursue its efforts to implement this plan. However, given the political context, priorities should be reviewed. In particular, foreign tourists are unlikely to visit areas close to regional conflict. Tourism within Iraq or with neighboring countries will be affected by two adverse effects: the KRI will remain attractive as long as it will feel safer than the rest of the country or region; on the other hand, restrictions on the movement of people (due to the war and the refugee crisis) will continue to hamper the local/regional tourism that represents the bulk of tourist arrivals in the KRI.

3.112. It remains, that the best prospects, in the short term, are probably for tourism within Iraq (due to the relative stability and safety of the KRI compared to the rest of Iraq), and efforts to promote tourism in the region should resume in Baghdad. The focus of promotional activities led by the Board of Tourism should shift accordingly.

3.113. While tourism could play a major role in the diversification of the KRI’s economy, the current crisis does not offer immediate prospects for recovery. The KRG
should therefore concentrate its efforts on long-term actions and investments, rather than short-term marketing and branding strategies. These long-term efforts include the development of tourism sites and products, infrastructure, education and quality. Programs could be developed accordingly.

3.114. **This should be done in partnership with the private sector**, although investors seem to have deserted the tourism industry in the region. Partnerships are essential, in particular, to improve transport connections, the referencing of Kurdistan Region in major tour operators’ catalogue, and the supply of hospitality services. Partnerships with international organizations and the civil society should contribute to the rehabilitation of major tourist sites, as illustrated by the work done in partnership with UNESCO at the Erbil citadel. Infrastructure, education and the legal framework remain the prime responsibility of the KRG (potentially in partnership with donors). Private initiatives could be encouraged to develop a local supply of satellite services (guided tours, transports, arts and crafts, restaurants and hospitality).

3.115. **The KRG has started to invest in the elaboration of tourism statistics**. These efforts should be pursued, in particular with the objective of analyzing the tourism spending in the region. The Tourism Satellite Account allows the measurement of the direct and indirect economic impact of tourism and the design of tailored strategies to increase tourism receipts. Technical assistance should be put in place to help the KRG adopt these statistical methods.

**F. ENERGY SECTOR REFORMS**

3.116. **The energy sector (oil, natural gas and power) is KRG’s most significant economic sector.** Oil accounts for more than half of GDP, whilst the gas and electricity sectors contribute significantly to economic growth, job creation and the quality of life for the Kurdish people. Securing the provision of reliable and efficient electricity supply in the long-run is key for increasing private sector productivity, job creation and sustained growth. The challenges that KRG faces in its energy sector are not only physical in nature and economic and financial; they are also legal and regulatory and, more significantly, policy and institutional—including the need to re-build and re-enforce institutions and their technical and management capacity. These challenges are hampering effective strategic management of the sector as well as planning, development and operation of its physical infrastructure.

3.117. **KRG’s energy sector, including electricity has suffered from decades of conflict and sanctions that have left its institutions weakened and have resulted in chronic under-investment and deterioration in infrastructure.** This situation improved considerably between 2005 and 2013 as the KRG adopted proactive policies and encouraged the private sector to invest in oil and gas exploration and production (E&P), petroleum refining, and independent power generation projects (IPPs), all of which saw tremendous investment in these sectors. However, such successes were not followed up with sector reform and were, in any case, set back when the current financial crisis commenced in 2014 affecting KRG’s ability to pay its suppliers which slowed down private investment.
3.118. **Energy subsidies are becoming unaffordable.** Most of the Government subsidies for energy are used for purchase of liquid fuel, as the domestic gas sector is still not producing enough gas to feed the power stations. It is now evident that improved electricity pricing policies, which reflect market prices, are essential. For example, the economic losses in the electricity sector are estimated around US$2.1 billion representing 80 percent of the economic subsidies in KRG. The subsidies have become unsustainable with the decrease on fiscal revenues, and increased defense spending.

**Electricity Sector**

3.119. **Electricity sector remains vertically integrated, even as extensive private sector participation has been achieved in power generation.** The electricity sector is currently under the jurisdiction of the KRG Ministry of Electricity (MoE). The Ministry operates as a vertically integrated (generation, transmission and distribution) electric utility with three distribution directorates in Erbil, Dohuk and Sulaymaniyah. The MoE currently directly owns all transmission and distribution facilities, all the hydroelectric power plants and a few older and very small thermal generation peaking plants. Over the last decade, the KRG has successfully expanded installed power generation capacity through Independent Power Producers. Installed generation capacity has expanded from lower than 500 MW in 2007 to higher than 5000 MW in 2015, and more than 90 percent of the generation capacity is now owned and operated by the private sector.

3.120. **Prevailing fiscal crisis is affecting the rapid expansion of generation capacity.** More than 97 percent of the generation capacity in KRI is owned and operated by independent power producers (IPPs). With a series of IPP generation projects queued up over the next few years, MoE had intended to increase the generation capacity from about 5000 MW in 2015 to more than 9,000 MW by 2020. However, given the impact of the fiscal crisis since 2014 on both KRG investment budget and the appetite from foreign investors, most new power generation projects have been put on hold or cancelled, with only one additional IPP at Zakho expected to start construction in the near to medium-term.

3.121. **Meanwhile, electricity demand in KRI is growing at a high rate.** Electricity demand has been growing at a double digit rate in the recent years and is expected to continue growing at a rate of between 9 and 11 percent per year. This extraordinary high electricity generation demand growth is not only a reflection of economic development and the impact of absorbing 1.8 million IDPs and refugees, but is also due to high system losses and low end-user revenue collections.

3.122. **Despite rapid expansion in connections, there is a significant fall in supply duration.** Since 2007, there has been a rapid expansion in the connection of households to the public electricity grid. Meanwhile, despite rapid generation capacity addition, supply duration has been deteriorating such that 93 percent of households receive electricity for more than 12 hours now, while it was as high as 22 hours prior to the refugee crisis. This is in sharp contrast with the rest of Iraq, especially Baghdad, where more than three-quarters of all receive less than 8 hours of electricity a day.
3.123. **The electricity sector’s challenges require policy and structural reforms.** Poor operational efficiency, high levels of electricity theft, and outdated network equipment of the distribution sector are main contributors to the high distribution losses. Deficient metering, billing and revenue collection processes are main contributors to the high distribution losses. This is exacerbated by highly subsidized and low tariffs leading to not only the sector’s poor financial performance but also the failure to improve the quality and reliability of the electricity service. Improvements in power supply reliability and availability would need to be complemented with improved revenue management systems and non-technical loss reduction approaches. This would not only help reduce the sector’s fiscal burden but also in turn would lay a foundation for electricity efficiency use as the tariffs are regularly increased. Although technical losses reduction involves the use of power systems planning and modeling tools and embarking on the related investments, global experience suggests that non-technical losses are highly correlated with poor management practices rather than ownership. Critical conditions for success in sustainable reduction of losses in electricity distribution include: accountability, ownership through participation, and enhancement of social development and equity principles.

<table>
<thead>
<tr>
<th>Sector Challenge</th>
<th>Description</th>
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<tr>
<td>Excessive losses</td>
<td>Total losses (technical and non-technical) are on the order of 30-50 percent, with the estimate varying according to the source. This means that up to half of the electricity generated does not translate to revenues, with dire consequences for the KRG to recover its costs from the sector.</td>
</tr>
<tr>
<td>High generation cost</td>
<td>KRG MoE’s total annual operating costs (fuel and generation and other power purchase agreement costs plus MoE operational budget) reached nearly US$3.5 billion in 2015. The main driver of these costs has been an over-reliance on liquid fuels (e.g., diesel, light and heavy fuel oil) due to delays in developing KRI’s natural gas resources at all levels, including extraction, processing and pipeline infrastructure. Liquid fuels are roughly six times more costly than natural gas (18 cents vs. 3.2 cents) and run at a much lower efficiency and output factor. Approximately US$2.5 billion per year of excess cost was spent on liquid fuels by 2015 prompting an MoE strategic shift in 2016 away from plants without access to gas to those that have gas available.</td>
</tr>
<tr>
<td>Low efficiency generation</td>
<td>The existing fleet of IPPs were built using small, low efficiency ‘E-class’ turbine technology in open cycle configuration (OCGT), which is very fuel-intensive (32-34 percent efficient) compared to the newer, larger ‘F’ and ‘H-class’ fuel-efficient turbines (38-42 percent efficient in OCGT increasing to 58-62 percent efficiency in combined cycle (CCGT)). The KRG is gradually addressing this by encouraging conversion of existing OCGT IPPs to CCGT (Erbil and Sulaymaniyah) which will increase their efficiency to about 51-53 percent and entering new power purchase agreements which specify the larger, more efficient ‘F-class’ technology (Zakho).</td>
</tr>
<tr>
<td>Unsustainable fiscal subsidies</td>
<td>The total annual fiscal cost of the electricity sector excluding investment is about US$3.25 billion (US$3.5 billion of total costs less US$250 million in revenue) at present. This represents about 25 percent of the entire KRG budget.</td>
</tr>
</tbody>
</table>

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12 MoE estimate.
13 MoE data from November 2014. These fuel prices may or may not reflect true economic costs and further work on this issue is needed with MNR.
Inadequate investment

According to Ministry of Planning, less than US$200 million was budgeted in 2015 to finance critical investments in transmission and distribution. As a result of delayed investments, the high voltage transmission grid could become saturated and pose a bottleneck in delivery of available electricity.\(^\text{14}\)

Risk of substantial penalties

If investment in the electricity transmission and distribution grids is not increased and damaged interconnections with neighboring grids improved,\(^\text{15}\) the KRG could face the prospect of paying capacity charges under the growing number of power purchase agreement contracts with IPPs.\(^\text{16}\)

Potential for increased blackouts

With demand growing at 9-11 percent per year\(^\text{17}\) and generation capacity capped by infrastructure and fiscal constraints, consumers could see a return to widespread electricity blackouts in the near future if adequate investment in transmission and distribution grids is not achieved.

### Electricity Sector Reform Objectives

3.124. *The KRG MoE’s long-term goal is to address the electricity sector challenges in a comprehensive manner* in order to ensure adequate supply to meet the present and future demand of all consumers across KRG at a competitive, fiscally sustainable cost. The long-term goal would be attained through four immediate objectives:

- Contain fiscal burden of subsidies and losses;
- Improve electricity service delivery for consumers;
- Secure necessary investment for the transmission and distribution sector; and
- Step-away from government ownership of sector functions.

3.125. *A strategy based on three pillars is proposed to address the immediate as well as longer term challenges in the KRI’s power sector.* The three pillars are as follows:

- **Adopt an enabling legal, policy and regulatory framework** based on clear roles and mandates with regard to policy, regulation, grid expansion, load dispatch, single buyer, generation, distribution, fuel provision, electricity trading, and energy efficiency. The framework would include a new electricity law, an independent sector regulator, unbundling of the vertically integrated sector, corporatization of sector entities and their eventual privatization. The Government would continue to shoulder the responsibility for policy and governance, apart from some crucial functions such as sector planning, investment approvals, international trading, load dispatch, and market oversight. The transition from a vertically integrated sector structure to a more distributed structure would require a step-by-step approach. This would include accounting and administrative separation of various businesses, establishment of a regulatory cell, and selective private sector participation (under regulation by contract) in the first phase. In a subsequent phase, the businesses can be carved out as separate corporatized entities, and finally out-up for full privatization.

\(^{14}\) Parsons Brinckerhoff

\(^{15}\) Obstacles include: (i) war damage to the Kirkuk-Mosul 400 kV line which prevents exports to the rest of Iraq; and (ii) the lack of an international standard grid code which will prevent exports (e.g., from Zakho IPP) to Turkey.

\(^{16}\) Detailed estimate of surplus power and associated penalties has been requested from PB.

\(^{17}\) World Bank Electricity RAS Concept Note, October 2014.
• Undertake crucial infrastructure investments to ensure adequate power availability, reliability and reduction of losses. Given the constrained fiscal situation, it is imminent that private sector resource induction would be required in all segments of the electricity sector. Private sector investments in high voltage transmission lines could strengthen connectivity across KRI, facilitating transfer of cheaper power from second stage of combined-cycle power plants. Further, high voltage networks can facilitate the evacuation of surplus power to the rest of Iraq as well as to neighboring Turkey. Electricity trade with neighboring areas would be crucially important in ensuring revenues from utilization of the excess generation capacity in face to fixed capacity charges. Indeed, the attractiveness of investments in electricity transmission (as well as gas pipelines) is likely to be significantly enhanced through trade agreements with neighboring areas. However, private sector investments in transmission and distribution need to be undertaken carefully to ensure that current sector performance attracts adequate private sector interest, as well as sufficient ramp-up in institutional capacity and legal-policy-regulatory framework to manage a complex ecosystem.

• Undertake measures to support performance improvements and accountability. This would include a systematic rationalization of electricity tariffs as well as a focused program for loss reduction and revenue enhancement. Based on a detailed assessment of commercial losses, the Government should develop a loss reduction and revenue enhancement program focused on consumer segments and geographies that account for the largest share of losses. While full privatization of the distribution business is a complex undertaking, loss reduction and revenue enhancement can be achieved through a well-structured contract with the private sector to manage billing and collection services.

3.126. The World Bank has initiated a Technical Assistance program to support the KRG in the reform and performance improvement efforts over the near term, and lay the foundations for the reforms and investments in the subsequent periods.18 Table 3.5 summarizes the prioritized energy sector reform options.

Table 3.5: Electricity Sector Reforms and Performance Improvement

<table>
<thead>
<tr>
<th>1. Legal, Policy and Regulatory Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High Priority: to be done in near term (1-2 years) and on-going</strong></td>
</tr>
<tr>
<td><strong>Sector Structure</strong>: Conduct expert consultations to outline a new sector structure, including clarification of roles and mandates with regard to policy, regulation, grid expansion, load dispatch, single buyer, generation, distribution, fuel provision, electricity trading, energy efficiency, and demand side management.</td>
</tr>
<tr>
<td><strong>Electricity Law</strong>: Develop a draft electricity law and conduct consultations with relevant stakeholders. Present it to the parliament for legislation.</td>
</tr>
</tbody>
</table>

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18 The World Bank technical assistance program includes the following studies: (i) Tariff Rationalization and Subsidy Reduction Strategy; (ii) Strategic Communication Exercise; (iii) Pathways for Private Sector Participation in Transmission; and (iv) Pathways for Distribution Strengthening, Loss Reduction and Revenue Enhancement.
**Regulatory Cell within MoE**: Establish and ring-fence a regulatory cell within MoE as a precursor to an independent sector regulator. Develop tariff determination models and provide training to regulatory cell members.

**Ring-fenced Sector Functions**: Within the existing structure, ring-fence generation, transmission, distribution, trading and fuel supply businesses to function nominally as separate entities. Segregate their assets, functions and manpower, structure transactions between them, and foster separate energy and financial accountability for each.

**Medium Priority: to be done in the medium term (3-5 years)**

**Independent Sector Regulator**: Based on the statutes of a new Electricity Act, establish an independent sector regulator. The regulator would develop regulations for tariff, performance, and competitive bidding processes.

**Corporatization of Sector Entities**: Establish generation, transmission, distribution, trading and holding entities as separate corporate bodies registered under the companies act. Establish their board of governors, management as well as performance accountability mechanisms. These corporatized entities may be privatized at a suitable stage.

**Lower Priority: Reforms to be done in longer term (5-7 years)**

**Full Privatization of Sector Entities**: Privatize sector entities after the legal and regulatory frameworks have been promulgated, electricity markets have been established, and entities have been corporatized.

### 2. Infrastructure Strengthening

**High priority: to be initiated in near term (1-2 years) and on-going (Implementation of activities likely to continue into the medium term)**

**Natural Gas Availability**: Enhance the availability of natural gas and eliminate the use of diesel for power generation. Resolve outstanding disputes in the gas sector.

**Gas Pipeline**: Design and initiate construction of a gas pipeline parallel to the existing oil pipeline to connect gas fields in Central KRI with power plants in Eastern KRI.

**Private Sector Participation in High Voltage Transmission**: Enable private sector participation in development of high voltage transmission networks. This would also enable adequate transmission of nearly 4000 MW of additional capacity.

**Private Sector Participation in Distribution**: Explore private sector participation options to attract investments as well as to improve commercial performance of the distribution business. While full privatization may be difficult, initially billing and collection services could be outsourced under robust contracts as a first step.

### 3. Performance Improvement and Accountability

**High priority: to be initiated in near term (1-2 years) and on-going (Implementation of activities likely to continue into the medium term)**

**Tariff Rationalization Pathway**: Develop and implement a multi-year pathway and a strategy for tariff rationalization. The approach could start with improved supply and cost-covering tariffs for high-end commercial and industrial consumers.

**Loss Reduction Plan**: Design and implement a loss reduction plan. Based on a detailed assessment of commercial losses, develop a loss reduction and revenue enhancement program focused on consumer segments and geographies that account of the largest share of losses.

**Medium Priority: to be done in the medium term (3-5 years)**

**Policy and Program for Demand-Side Management**: Develop and implement a clear policy and a program for energy efficiency, energy conservation, renewable energy, and demand side management.
Natural Gas

3.127. **Potentials are high for natural gas production.** The KRG MNR estimates that KRI could hold as much as 200 tcf (5.6 tcm) of natural gas reserves. The main discovered fields that can contribute to production are Khor Mor, Kurdamir, Topkhana, Bina Bawi, Miran and Chemchemal. Khor Mor is currently used for local gas supply to power stations in Bazian and Erbil, while the goal for Kurdamir and Tophana fields is to deliver gas for export and local use in addition to Bina Bawi and Miran. Chemchemal is not yet developed. All of these developments are taking place in partnership with international operators. There is also potential for production from yet-to-be-discovered fields.

3.128. **Long-term production projections are optimistic.** The IEA projects that KRG gas production could reach 20-29 bcm/a by 2035. This would represent about a seven times increase of current production. Although this can be an excessively optimistic scenario, there are major opportunities for expanding gas production. Current gas production in the KRI amounts to 3-4 bcm/a and is entirely for domestic use. Miran and Bina Bawi, the KRI’s two largest discovered gas fields, could together produce 11 bcm/a, while Kirkuk and Khurmala could add 2.5 bcm/a and 2 bcm/a, respectively, if currently flared gas is captured. The expansion of Khor Mor could also add 5 bcm/a while Chemchemal could produce 6 bcm/a if a resolution of the dispute with Dana Gas is reached.

3.129. **The KRG has set gas utilization priorities that emphasize satisfying domestic needs for power generation and industry before moving on to possible exports.** As a top priority, the KRG plans to replace diesel and other liquid fuels with gas in all the KRI’s power plants within the next two to three years. The first step in this direction was the 2013 signing of a landmark gas sales agreement with DNO (Norway) and its partner, Genel Energy (Anglo-Turkish) covering supply from the Summail gas field to the Dohuk Power Station. However, although the field was connected to the IPP in 2014 through a gas pipeline that was built for this purpose, it was no longer capable of supplying sufficient gas quantities due to inaccurate calculation of reserves. The pipeline, nonetheless, will be incorporated into the future gas pipeline from central and south KRI to Turkey, and will supply gas to Dohuk and Zakho IPPs as well.

3.130. **Domestic gas demand will be influenced by different factors.** Converting the IPPs to combined-cycle operation will reduce gas demand growth for power generation. Industrial use is expected to grow, primarily for cement industry. There is also room for developing a gas grid for residential and commercial use in the future covering the major cities. However, given the relatively small population and the geographical location, which may be unattractive to large scale gas-based industries, the domestic market is likely to remain modest.

3.131. **With respect to future gas exports, Turkey is an important market for the KRI.** Turkey’s rapidly growing economy requires significant quantities of gas, which currently represents one third of its primary energy consumption. Turkey’s Ministry of Energy and Natural Resources estimates that between 2013 and 2023, the country’s demand for natural gas will increase by an average of 13% per year. With a growing population and economic expansion, Turkey is expected to become a major regional player in the global gas market by 2030. The KRG’s emphasis on diversifying its energy sources and developing closer relations with Turkey is a key strategy to ensure the region’s long-term energy security.

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gas will rise from approximately 45 bcma to nearly 70 bcma. The KRI intends to export 10 bcma to Turkey by 2019-2020 and to double the export to 20 bcma by the early 2020s. This is expected to be through building a gas pipeline that will run parallel to an existing oil pipeline, both of which were the result of an agreement that the KRG and Turkey reached in 2013. However, the final plans and costs for the gas pipeline project have not yet been finalized, and the current European gas price decline would affect the economics. If agreement is successful, initial export volumes to Turkey are expected to be anchored on development of KRI’s two largest discovered gas fields, Bina Bawi (7 tcf) and Miran (4 tcf). Exports from these fields can potentially begin in 2018, commencing at 4 bcma and ramping up to 10 bcma. The KRG could also export gas to federal Iraq given its geographic proximity and the current high-priced gas import deal it has with Iran. Alternatively, the KRG could increase its power generation and export electricity to federal Iraq and/or Turkey.

3.132. *To effectively manage natural gas opportunities, it is important to establish proper conditions for attracting investments*; advance natural gas production and improve policy, legal and regulatory framework including pricing; develop gas infrastructure including pipeline and end-user infrastructure; advance effective contractual and commercial framework for future projects; and enable market conditions that provide sufficient security/collateral to the O&G developers to allow them to secure financing/raise funding for the necessary infrastructure. Growth markets for natural gas and derivative products should be identified, including: domestic power generation; industrial use; petrochemical use (such as fertilizer and ammonia); and other application.

**Upstream Oil**

3.133. *Recently, KRG has experienced the two extremes of a boom-bust cycle.* When the KRG opened up exploration acreage to foreign investors in 2006, investor appetite was strong, buoyed by optimistic estimates of undiscovered hydrocarbon potential, high oil prices, and improvements in the political and security environment. Early drilling results were positive, particularly for the first-mover companies that had taken the most promising acreage. Large amounts of development capital flowed into the sector, and several projects began commercial production. Field development plans by the various operators pointed towards potential production levels of more than one million barrels per day. Over the last two years, however, the business environment facing international oil companies (IOCs) in Kurdistan has deteriorated across almost all fronts. Disappointing drilling and production results have been encountered on some high-potential projects. Oil prices, which exceeded US$100 per barrel for almost four years, have dropped to less than half that level since late 2014. And IOCs have not been getting paid for much of their current oil production because of the fiscal crisis. As a result, several IOCs have withdrawn from KRI, and most of those that remain are deferring investments until commercial conditions improve.

3.134. *Nevertheless, despite deteriorating commercial conditions, there are still some bright spots in KRI’s oil and gas sector.* All of the large currently-producing oil fields have further significant upside production potential. In addition, development of the 11 tcf Bina Bawi and Miran gas fields will bring about improvements in fuel supply for domestic
power generation and open up a significant new revenue stream in the form of gas exports to Turkey. Between 2006 and 2013, the KRG entered into production sharing contracts (PSCs) covering more than 50 exploration blocks. These blocks comprise almost the entirety of the KRI. Twenty-eight IOCs participated. Early on, most participants were small-capitalization, frontier exploration companies such as Genel Energy, DNO, Gulf Keystone, Western Zagros, and Oryx Petroleum. Later on, major oil companies such as ExxonMobil, Chevron, and Total also took exploration blocks. Following the award of PSCs, exploration and development activity accelerated rapidly. From 2005 to 2013, oil companies drilled over 160 wells, and total upstream capital investment—drilling plus facilities construction—was an estimated US$4.5 billion (Wood Mackenzie).

3.135. *Oil production in the region has increased very rapidly,* growing from less than 10,000 barrels per day in 2008 to over 500,000 barrels per day in 2015 (Figure 3.8). The majority of current production comes from three projects: the Khurmala Dome field, operated by Kurdish company KAR Energy, the Taq Taq field, operated by Genel Energy, and the Tawke field, operated by DNO. Total commercial reserves in the region are estimated at 5.3 billion barrels (Wood Mackenzie).

![Figure 3.8: KRI Oil Production](image)

*Sources: Ministry of Natural Resources, and World Bank estimates.*

3.136. *The Kurdistan Crude Pipeline (KCPL), completed in late 2013, is the principal export corridor for oil produced in the region* (Map 3.2). The KCPL carries oil produced from Khurmala Dome, Taq Taq, Tawke and the other KRG-administered fields plus the NOC-operated fields in Kirkuk to the Turkish border at Fishkhabour, from where the oil flows through the BOTAŞ-operated pipeline to the oil terminal and storage facility at Ceyhan on the Mediterranean Sea. For 2015, KCPL throughput has averaged 560,000 barrels per day, of which 413,000 barrels per day came from KRG-administered fields and
147,000 barrels per day came from the Kirkuk fields. The pipeline has a capacity of around 700,000 but is being expanded to reach a capacity of 1 million barrels per day. The SOMO-operated Iraq-Turkey pipeline is affected by damages caused by militant activity.

Map 3.2: Regional Pipeline Infrastructure

3.137. **KRI’s oil sector liabilities are mounting.** The KRG entered into a number of pre-paid oil sales contracts with oil trading companies. However, with the fall in global oil prices and with a growing discount paid for KRI oil, the amount of oil delivered to the trading companies at Ceyhan fell far short of the amount needed to repay the advances. As a result, the KRG has accumulated debts with the trading companies totaling an estimated amount of US$2.3 billion. Producers have responded by slashing upstream investment which in turn will reduce future oil production capacity.

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22 The addition of pumping stations is still under discussion with KAR.
Downstream Petroleum

3.138. **The KRI has two relatively large refineries:** (i) Kalak, which is near Erbil and operated by Kurdish company KAR Group (operator of Khurmala field), that has a capacity of 100,000 bpd with a near-term planned increase to 185,000 bpd by 2018, and (ii) Bazian, which is near Sulaymaniya and operated by Kurdish company Qaiwan Group, that has a capacity of 34,000 bpd with plans to increase to 100,000 bpd by 2018. DNO operates a 5,000 bpd refinery at its Tawke field, and there are many other small and basic ‘topping plants’ that are operated by local companies. The KRI’s total refining capacity, with the topping plants, is around 170,000–200,000 bpd. However, although the KRI currently has a surplus of naphtha and heavy fuel oil, these refineries have technical constraints on the production of light products such as diesel and gasoline, and therefore require additional upgrades to satisfy local fuel demand. Moreover, the MNR’s policy is to close unlicensed topping plants and consolidate others into larger units. It has also tendered for the construction of three new refineries, which would together add 150,000 bpd of capacity, in Sulaymaniya, Dohuk and Erbil.

3.139. **To make up the difference between current consumption and production from local refineries, KRG imports petroleum products.** KRI consumed approximately 250,000 bpd of petroleum products in 2014. In some instances, KRG conducted swaps wherein crude oil is exported in exchange for imported refined products. Petroleum products are subsidized in the domestic market. Therefore, the planned refining expansion, if carried out efficiently, may lead to satisfying the local demand of oil products.

3.140. **To effectively manage downstream oil opportunities and increasing the value-added from domestic oil production, KRG will need to develop regulatory reforms with a focus on:**

- Contractual and commercial framework governing existing and future activities;
- Enabling conditions for attracting investment;
- Legal and regulatory reforms including pricing, subsidies, and fuel standards; and
- Enabling measures for increasing refining capacity (including refurbishment of existing units), optimization of import arrangements and fuel substitution.

**Assessing the Effects of an Energy Subsidy Reform**

3.141. **The World Bank is currently conducting an Energy Subsidy and Tariff Reform Study** covering both Iraq and KRI that aims to estimate the economic effects of removing energy subsidies. Initial assessments using a Computable General Equilibrium Model point out that a removal of all energy price subsidies with full compensation to households can result in a 37 percent reduction in government deficit (Griffin, 2016) (Table 3.6). This simulation assessed the effects of setting the domestic prices of crude oil and natural gas at the international reference prices and electricity tariffs at the cost recovery prices. The simulation considers a scenario where all households are being compensated to keep their real income constant.
Table 3.6: Government Accounts: Preliminary Results of CGE Simulation, 2015

<table>
<thead>
<tr>
<th></th>
<th>Reference Case: No changes in subsidies (Billon ID)</th>
<th>Scenario: No energy subsidies and compensation to households (Billon ID)</th>
<th>% difference between Scenario and Reference Case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>17,684.8</td>
<td>19,093.3</td>
<td>8.0%</td>
</tr>
<tr>
<td>Non-Oil Revenue</td>
<td>11,204.1</td>
<td>11,980.6</td>
<td>6.9%</td>
</tr>
<tr>
<td>Oil Revenue</td>
<td>6,480.8</td>
<td>7,112.6</td>
<td>9.7%</td>
</tr>
<tr>
<td>Expenditure</td>
<td>19,664.3</td>
<td>20,331.1</td>
<td>3.4%</td>
</tr>
<tr>
<td>Consumption</td>
<td>10,039.6</td>
<td>11,233.2</td>
<td>11.9%</td>
</tr>
<tr>
<td>Subsidies</td>
<td>7,136.3</td>
<td>- 0.2</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Energy Subsidies</td>
<td>7,136.6</td>
<td>0.1</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Crude Oil</td>
<td>2,240.5</td>
<td>0.0</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Electricity Consumption</td>
<td>4,896.1</td>
<td>0.1</td>
<td>-100.0%</td>
</tr>
<tr>
<td>Transfers to Households</td>
<td>2,486.5</td>
<td>9,096.2</td>
<td>265.8%</td>
</tr>
<tr>
<td>Transfers to RoW</td>
<td>1.9</td>
<td>1.9</td>
<td>0.0%</td>
</tr>
<tr>
<td>Operational Balance</td>
<td>- 1,979.5</td>
<td>- 1,237.8</td>
<td>-37.5%</td>
</tr>
</tbody>
</table>

Source: Griffin, 2016 (preliminary estimates).

Diversification within the hydrocarbon sector

3.142. **Iraq (including the KRI) needs to diversify its exports outside the oil and gas sector.** The hydrocarbon sector, however, could serve as a stepping-stone for diversification. Indeed, the sector attracts most of the FDI and, in turn, transfers likely to help the upgrading of the economy. The immediate objective of the KRG should therefore be to maximize the local benefits and spillover effects of FDI in the sector. This implies the upgrading of the services sector to meet the demand and the level of standards required by multinationals in the field. The Government has taken a number of initiatives towards this end:

- With regards skills and workforce development, the KRG has encouraged local capacity building through various channels, including transfers of skills from expatriates to nationals, liaison with universities to produce graduates with adequate skills, scholarships and internships. These efforts were supported by the government as well as financial contributions of companies, and could be included in production sharing contracts. According to the Ministry of Natural Resources, the local oil and gas industry workforce has reached 76 percent in 2012, and its objective was to achieve 90 percent in 2016.

- The Government has introduced an online registration system for oilfield services companies (OSCs) wishing to be listed on approved vendors lists (AVLs). As of 2016, this new registration system will apply for all the services companies willing to work for over 25 international oil companies (IOCs) operating under 40 production sharing contracts (PSCs). This registration and list system ensures the
evaluation of services providers (OSCs) on the basis of criteria such as corporate, financial, quality, health, safety and environment management, workforce development, or specific technical requirements. The KRG also funds development projects to help local OSCs build capacity and meet those standards. Once registered on the AVLs, services companies will receive invitations to tender directly from oil companies. The figure below gives an indication of the number of companies providing services to IOCs in the KRI.

**Figure 3.9: Services Provided to the Oil and Gas Industry in KRI**

![Bar chart showing services provided to the oil and gas industry in KRI]

*Source: KRG Ministry of Natural Resources, 2016.*

3.143. **Despite these efforts, the contribution of the oil and gas industry to local development has been considered unsatisfactory to date.** The value created by the sector to be retained in the region should be increased. The regulations have unspecific expectations with regards local development contribution, open to alternate interpretation. While a number of obligations and programs have been progressively put in place, including the MNR’s workforce development program and the approved vendors list, progress still needs to be made.

3.144. **A holistic approach to the oil and gas sector’s development could be put in place.** A new policy document is being prepared by the MNR that addresses the issues of workforce development, local enterprise development, and community development. This initiative, to the extent it does not create unnecessary new burdens to trade and investment, could be swiftly implemented. A number of programs exists to support local capacity building in cooperation with the oil and gas companies. IFC, for instance, accompanied similar reforms with its Business Edge program that helps upgrading local SMEs. The holistic dimension of this reform is important: it is about being inclusive (e.g., skills
developed in this context should also benefit other sectors) and embracing a wide spectrum of reforms from university curriculums to export promotion efforts.

3.145. It is important to accompany these upgrading programs with diversification efforts to reduce the dependence on oil and gas sectors. Once up to international standards, local services companies could be incited to export and diversify their clientele portfolio. It is essential to the long-term sustainability of the local services firms. So far, this dimension is absent from the MNR’s plans.

3.146. It is also important to avoid that the procurement and local content rules become, in turn an obstacle to FDI in the region. There is a thin line between incentives and requirements that should not be crossed. Some countries have been too far in local content requirements and have hampered the benefits of participation to global value chains, unduly increasing the cost of procurement and reducing their attractiveness for investors. Substitution will take place naturally because the cost of expatriates is always higher than local staff; it cannot be forced, however, because the import of certain services or skills is often a prerequisite to the transfer of skills to local staff. Services tasks are skill-intensive, and one cannot circumvent the learning process. Lessons from the recent work on global value chains and trade in value-added suggest that the ability to import competitive inputs is a condition to export competitiveness. Thus, while substitution is desirable, it should take place only when the local economy can provide competitive inputs. It is about creating the right incentives and building local capacity, facilitating transfers from the lead firms, and moving up the value chains.

G. REGIONAL CONNECTIVITY

3.147. The role of ICT and transport services is important in improving KRI’s regional connectivity. Connectivity is a major issue in the MENA region. There are complementarities to be realized from trade in IT services in addition to the benefits of enhanced information and communication technologies (ICT) services as an enabling platform for trade in other sectors. Combined with improved transport services, ICT can help increase the overall enabling environment for KRI for enhanced economic cooperation and trade integration in the MENA region. There is a large opportunity for telecommunications services trade. With improved infrastructure and services, KRI has a significant potential to become a transport and logistics hub for the whole region based on its proximity to major markets and relatively safe geopolitical position.

3.148. Proposed reform measures will significantly benefit the whole Iraq and not only the KRI, therefore improving connectivity is a win-win situation for the entire country. The benefits could be easily achieved with better regional connectivity that mainly depends on trade and transport facilitation at the border crossing points. The better connected region through trade facilitation, customs modernization, regulatory reforms, and improvement of all transport modes directly imply higher competitiveness for the entire country.
Transport Sector

3.149. **KRI is well positioned and it can play a significant role in the regional connectivity if it has a well-developed transport sector.** KRI is located on the way from East to West and from the North to the Middle East. Thus, trade between Iraq, Jordan, Turkey, and Iran is currently going through KRI. If the network in KRI, as well as in the rest of Iraq, is further developed, it can play an important role not only in regional trade but also as an international route linking the Far East with Europe.

**Map 3.3: Trans-European Motorways (2011) and Asian Highway Route Map (2014)**

![Map 3.3: Trans-European Motorways (2011) and Asian Highway Route Map (2014)](image)

*Source: UN.*

3.150. **KRI plays a main role in transit transport for Iraq.** Majority of imports at east and north-east of Iraq is done through transit trade from the KRI. In 2014, top importers were Turkey (37.3 percent of total imports), China (15.4 percent), Iran (12.5 percent), United Arab Emirates (6.8 percent), Korea (4.9 percent), Italy (4.3 percent), USA (3.8 percent), and Germany (3.3 percent). Map 3.4 presents trade volumes from Iraq’s borders. Transit trade is a highly important business in KRI that employs many low-income workers, as well as serving many sectors with inputs. Reforms that support transit trade will play to KRI’s strengths as well as serve other parts of Iraq.
3.151. **KRI, as well as the whole Iraq, continues to suffer from weak and underdeveloped infrastructure sectors.** The lack of a sectoral strategy, chronic underfunding, weak institutions, and a conflict-affected environment compound the problem. Transport infrastructure, an important enabler of private sector participation, lacks capital investments to maintain basic standards in KRI. Similarly, effective transport institutions are needed to deliver needed investments. Beyond investments, a fundamental sectoral transformation is required within a sequenced program which supports the development of a strategy and vision.

3.152. **Over the past decade, KRI has invested in development of the transport sector.** New airports were constructed, regional and main road networks were upgrading, and rural access to villages and remote communities was expanded. KRI also invested in building a tunneling system to reduce travel distances, time as well as travel interruptions due to the severe weather conditions especially in the northern KRI. Transport sector is managed by two ministries, namely, Ministry of Construction and Housing (MOCH) which is mandated with the management of the roads and bridges while Ministry of Transport and Communication (MoTC) is responsible for formulating and overseeing transport services policies and regulations related to roads, public transport, aviation and railways.

3.153. **KRG needs a transport master plan to guide the development of the sector.** There is a Transport Master Plan developed for Iraq, but it does not cover deeply KRI. A specific transport plan for KRG does not exist and authorities agree they need such a document as
a solid base for the development of the transport sector and its sub-sectors. Specific guidelines are needed at the regional level.

**Roads and Bridges**

3.154. *Institutional capacity, including management of the road network, is gradually being developed.* The General Directorate for Roads and Bridges (GDRB) under MOCH has the overall mandate to plan, construct and maintain the primary, secondary and tertiary road network while the road departments at the governorate and municipal levels oversee such roles for the local roads. All road management duties remain the responsibility of the GDRB including design, preparation of studies and supervision of works. The agency is also responsible for the construction and operation of the axle-load control stations.

3.155. *Due to the long years of isolation, GDRB lack human resources capacity to effectively manage the road network.* Staff have limited ability to plan, design, supervise and enforce regulations. Over the past few years, basic road asset management system has been developed and GDRB staff has been trained for overall road management. However, international techniques to plan and manage the road network assets have not been fully implemented and the systems are not regularly fed with data and updated. Some progress was done in adoption and applying of international standards on procurement and environmental and social safeguards.

3.156. *Additional resources would be needed for road maintenance and construction.* Considerable investment was going into the regional highways in previous years and the KRI seems to benefit from its position as connection point between neighboring countries with the rest of Iraq and Iran. Investments in road construction and maintenance have been impacted since 2014 with very little resources allocated. During the period between 2010 and 2013, KRG has made substantial investments in improving its road network allocating about US$544 million to this sector in the three governorates. This investment included about US$316 million for new roads construction and US$228 million for maintenance. KRG’s investment in maintaining the main and secondary roads (5,800 km) until 2014 averaged about US$57 million annually while the needs are about US$60 million. This has not created extensive maintenance backlog, but coupled with heavy traffic and reduction of available funding for about two years, caused heavy burden for the aging network. It also impacts newly built roads because routine maintenance activities have been significantly reduced to emergency maintenance only or even disappeared. Road maintenance is underfunded. Expanding road network requires a significant maintenance budget. Without adequate maintenance, the expected value of the investments will not be obtained. Additional damages to the road network are caused by the transport of oil and gas trucking industry. Axle weight control has to be installed as well.

3.157. *The ambitious roads program is falling behind schedule* because of low capacity of the road construction industry in terms of skills and equipment, and lack of financial resources. The following map presents existing and planned transport corridors presented in the Transport Master Plan of Iraq. In KRI, road network condition is deteriorating faster than estimated due to rapid increase in number of registered vehicles, lack of financial
resources, and lack of knowledge in maintenance and management practice. KRI Highway Master Plan has not been followed due to the current security and fiscal crises. Thus, the plan has to be updated or a Transport Master Plan for KRI needs to be developed for all transport modes.

Map 3.5: Iraq’s Transport Corridors

![Map of Iraq’s Transport Corridors]


3.158. **Institutional bottlenecks in the development infrastructure are mostly related to the organization, jurisdiction, and lack of legislation—in particular for design, maintenance and supervision.** Law No. 3, adopted by the Kurdistan Parliament in 2007, authorizes MOCH to perform construction permit, maintenance and design related services by its own activities or through subordinated implementation agencies (GDRB in the case of roads). Preparation of studies and designs is being done both internally (within GDRB if expertise is sufficient) and externally (by hiring consultants). There are no other laws and by-laws defining such activities. Manuals and specifications are the Iraqi ones. Regulations on how to implement projects is originated at the Ministry of Planning (i.e., how to finance projects, and process of implementation). General conditions of contracts are issued by KRG MoFE, however these are outdated, but still in use throughout Iraq. MOCH issues permits, and there is a regional planning council that has to concur on this, as well as other ministries before MOCH can act. Ministry of Municipalities and Tourism deals with territory under boundaries of districts/municipalities. The Government collects revenues and it is distributed according to needs and priorities, but the system of estimating needs and prioritization is weak. Road user charging system does not exist, i.e., no registration fees, no heavy transport fees, and no fuel levies or excise tax on fuel import or retail price.

3.159. **In freight transport, there are a number of challenges not allowing facilitation of trade.** There are three border crossing points for import and 13 for exports. Different authorities (i.e., Ministry of Trade and Industry, Ministry of Agriculture, and Ministry of
Health) are issuing licenses for exports and imports, and there is no uniform procedure. Quality control is conducted by various institutions and there is no precise procedure. Cost of license for import or export is too high. Ministry of Trade and Industry cannot completely monitor re-exports. Taxes per kg of cargo have to be paid to the airport authorities (around US$0.5-1.5 per kg). Taxes per seat of passenger flights have to be paid to the Iraqi Airways, and the charge is US$15 for international passengers and US$5 for domestic passengers. These charges are expected to increase in July 2016 to US$25 and US$10 respectively.

3.160. **Company registration and establishment is not difficult.** Company licenses for transportation are issued on the company name in the specific transportation sector, and the requirements are related to the number of trucks, drivers, etc. Licensing taxes are approximately US$200-300 on annual basis. There is almost no insurance provided by freight forwarders, both for drivers, vehicles and freight. There is no real market for insurances—premium rates are high.

3.161. **There are some attempts to organize artificial city logistic, but it is not in use.** There are only a few places in Erbil where people try to distribute some freight, but these locations are illegal. There are also some companies offering city logistics but this has not been applied as there are no rules and legislation that forbid transporting of freight through the city.

**Map 3.6: Preferred Locations for Freight Distribution Centers**

![Map 3.6: Preferred Locations for Freight Distribution Centers](source: Transport Master Plan of Iraq.)
**Public Transport**

3.162. *Inter-urban and inter-city public transport system operates on a very low level of reliability and efficiency.* Public transport system is underdeveloped with no clear procedures. MOTC is responsible for development of public transport but the capacity of the ministry is limited. There are three public transport syndicates in KRI, and each governorate has its own responsible person for transport (head of syndicate). The proposed public transport network is presented within Kurdistan Highway Master Plan. Transport master plans for governorates have been produced and they are comprehensive, but KRG does not have enough financial instruments to implement proposed measures.

**Map 3.7: Future Public Transport Corridors**

*Source: Kurdistan Highway Master Plan (2010).*

3.163. *People use private cars as the public transport system is unreliable and frequently delayed.* There are no regular timetables for taxies, mini- and small buses—they start when the bus is full. There are two bus terminals in Erbil and one of these terminals is new. It was built based on the concession agreement with a foreign investor.

**Air Transport**

3.164. *Iraq’s airspace is managed by Baghdad.* Civil aviation sector in Iraq consists of the General Establishments of Civil Aviation and Iraqi Airways. Aviation legislation is managed by federal authorities for overall Iraq. ICAA is the only signatory of ICAO dating back to 1947. In KRI, local air traffic controllers manage take-off and landing at the KRI airports. The KRG MoTC lacks strong capacity in air transport despite it being of crucial importance to the KRI with two international airports operational at Erbil and Sulaymaniyah with a third planned for Dohuk. Sulaymaniyah Airport has almost reached
limits and need immediate measures to be applied. Erbil Airport also requires investments and a development plan for the planned airport expansion. Maintenance of infrastructure is provided by the airport itself. Infrastructure is not in condition as it was previously due to lack of funding. Pavements need a lot of attention soonest as they are deteriorating. The financial issues are not the only obstacles for maintenance—additional challenges include lack of labor and educated staff. Further, large number of cargo procedures cause delays especially for imports.

3.165. **Year 2015 has been a challenging for EIA as the conflict and concerns over security in the region have seen suspension of airlines, change of traffic patterns, and closure of airspace.** EIA has remained fully operational and has recorded a modest growth in passenger numbers of around 6.6 percent to 1,665,701 departing and arriving passengers. On average, around 4,550 passengers arrive or depart Erbil each day. Average passenger growth in period 2006-2013 was approximately 30 percent while in 2012-2013 it was 54 percent due to the Turkish Airlines and Gulf Airline flights. Turkish Airlines was, on average, 80 percent loaded while it dropped due to crisis to 40 percent. Further decline in passengers is expected as Turkey recently implemented visas. Previously, a traffic study estimated a growth of 18 percent in air traffic, however it averaged 6.6 percent because of crisis.

3.166. **The fall in cargo tonnage in 2015 reflects the downward pressure on economic activity in the region.** Imports fell by 28 percent to 24,235 tons. Since the peak of 38,752 tons in 2013, cargo tonnage is down by 37 percent in 2015. Ground handling lasts for approximately 24-36 hours, and it can be reduced with installment of new procedures for cargo handling as there are many duplicated procedures. Additionally, there are significant obstacles and delays in cargo clearance at the EIA.

**Railways**

3.167. **The MoTC has not yet developed capabilities in the railways sector** as it is still under planning and currently there are no operational railways in the region. The railway transport sector is elaborated only within the Transport Master Plan of Iraq.

3.168. **With the development of transit rail link though KRI and short link in Iran, railway connection to the Mersin port in Mediterranean Sea could be much shorter.** Short link to Turkey is necessary in order to bypass conflict area in Syria where the existing railway line passes though. Currently, the main railway link connecting KRI to Western Europe goes from Mosul, and this line further continues through Syria to Turkey, either towards Mersin port (E-70 and E-97) or via Malatya to Ankara (E-70). Connection though Iran could start from the closes railway station Mahabad, 290 km far from Erbil. This railway station further connects to the main railway network via Tabriz. Links toward China and Korea go through the Central Asia Regional Economic Cooperation countries. The figure below presents existing and planned railway network in Iraq and within the region.
3.169. **The poor condition of the road network has significantly affected mobility, particularly for the poor, and especially in rural areas.** Most of the population is inadequately serviced by unpaved roads with the impact falling disproportionately on certain income groups. Support in improving road asset conditions and develop public transport system on certain level will considerably increase access to health services, education and job opportunities. Further, it will be a critical foundation for future regional integration and increased trade in the sub-region.

3.170. **There is a need to address immediate challenges within political realities, with approaches that can improve over time.** Transport corridor operations will require infrastructure investments, trade facilitation and customs modernization. Given the fragile circumstances and complex political economy context, an incremental and practical approach anchored in a coherent program of immediate, medium, and longer term support will be the way forward. The transport sector should immediately focus on the core issues such as the following:

**Trade & Customs**

- Establishment of Regional Trade Facilitation Agency.
• Establishment of regional working group with Turkey and Iran in order to discuss trade transit though KRI, and upgrade of main road transport corridor(s).
• Trade facilitation reforms at border crossings and a plan for logistic hubs.
• Technical assistance for overall Iraq, including the KRI, on customs reform and PPP introduction.

Licensing

• Establishment of the working group to uniform procedures for issuance of export and import licenses.

Transport Master Plan

• Development of a Transport Master Plan for KRG as a strategic document for development of transport sector and improvement of connectivity. Transport Master Plan has to provide prioritization for road network upgrade, and development of logistic hub network.
• Development of the new public transport system, separately for inter-urban and inter-city public transport.

International Standards

• Adopting international standards and practices for planning and programing, procurement, financial management, environmental and social safeguards, supervision, design and maintenance.

Education and Training

• Modernize curricula and address quality issues in transport sector training. Of particular importance is provision of basic skills for planning, design, maintenance and management of infrastructure as well as the logistics.
• Consult with Ministry of Education and Ministry of Higher Education to address skills gap.

ICT Sector

3.171. **ICT can drive KRI’s economic growth, enabling trade expansion and trade diversification.** ICT services help connect, innovate, and transform local trade regimes; they create the necessary enabling environment for trade to flourish. Connectivity enhances virtual platforms for outsourcing and offshoring activities. Innovation lends itself to the development of new hybrid goods and services across industries by harnessing the power of communication technologies. Transformation happens through the development of digital platforms that can facilitate the administration of trade processes for businesses and governments. ICT services have become an important foundation for trade competitiveness in an increasingly connected world. Coupled with advances in transportation technologies and logistics, ICT enables new organizational innovations in which industry supply chains
can now span countries and borders, increasing global trade both within industries and between them. KRG has the potential to benefit from enhanced regional connectivity.

**Broadband infrastructure and service expansion**

3.172. *The broadband market in the KRI is showing relatively rapid progress compared with the rest of Iraq, but there is still considerable room for growth.* The adoption of ICT and in particular the widespread use of high-speed Internet services, contribute to the GDP growth, job creation and economic diversification of the KRI. The telecom market in the KRI is a regional market, hosting a combination of regional and local operators that compete and complement each other in the provision of voice and broadband services. Fostering competition and the development of state-of-the-art telecom services, particularly broadband, has a direct and indirect impact on the services sectors in the KRI as well as in the rest of Iraq. The mobile broadband market in the KRI is relatively competitive, yet service adoption is lagging behind. Currently around 30 percent of the KRI population is using mobile broadband services compared to 15 percent in all of Iraq, over 60 percent in Jordan, Turkey, and Egypt and over 100 percent in some of the Gulf countries. Fixed broadband services, particularly over high-speed infrastructure, are also lagging behind comparator regional countries. In sum, the broadband market in the KRI and in Iraq can greatly benefit from more competition and the adoption of Ultra-Fast Broadband (UFB) infrastructure.

**Figure 3.10: Comparison of Mobile Broadband Penetration of KRI with Iraq and the MENA Region**

(% of 3G subscribers per population, 2015)

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<tr>
<th>Country</th>
<th>KRI</th>
<th>Iraq</th>
<th>MENA Region</th>
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Sources: KRG Ministry of Transport and Communications, and Telegeography 2015.
Figure 3.11: Comparison of Fixed Broadband Penetration of KRI with Iraq and the MENA Region (% of household subscriptions by technology, 2015)

Sources: KRG Ministry of Transport and Communications, and Telegeography 2015.

3.173. In the KRI, the Ministry of Transport and Communication proactively introduced competition and private sector entry in the sector, yet going forward, the Ministry has to tackle a set of constraints that are impeding further market development. The KRG MoTC has licensed private operators in the fixed broadband market (outperforming the rest of Iraq that keeps this segment under government control). These operators are targeting the introduction of next generation, high speed fiber optic networks. However, competition in the fixed broadband market remains limited and mostly controlled by two providers: Allai Newrooz in Erbil and Kurdtel in Sulaymaniyah. In the mobile market, the Ministry has licensed 4G spectrum, the newest wireless technology which is still not available in the rest of Iraq, to deliver higher speed mobile broadband services. However, the market is still not delivering the best in class broadband services to everyone in the KRG and this is primarily linked to the following constraints:

- **The monopolistic vertically integrated fixed infrastructure providers.** Allai Newrooz in Erbil and Kurdtel in Sulaymaniyah, have monopoly over the fixed infrastructure in all the major cities. This dominance/monopoly constitutes a considerable barrier to the entry of new service providers at all levels of the broadband value chain. Competition in infrastructure and in service provisioning can bring about considerable benefits to the consumers as well as the economy and can lead to lower prices, better quality, innovative service and overall more mature markets.

- **Restricted access to existing essential infrastructure.** There are currently no regulatory tools to remedy for the dominance of the two fixed infrastructure providers. This is apparent in the limited number of alternative operators. The Ministry has devised price ceilings on wholesale and infrastructure services sold to other service providers. However this measure does not ensure the open access to essential facilities that fosters competition in services. Dominant operators are still likely to discriminate between their affiliated service providers and alternative new entrants.
• **Limited broadband infrastructure in remote areas.** Broadband, and in particular fixed infrastructure appears to be limited outside of the main urban areas. This is a major limitation to the benefits that broadband can bring to the KRI. Expanding the fixed broadband infrastructure and the access at the local level. Therefore the development of a competitive, private sector driven expansion of broadband infrastructure should be coupled with financial and regulatory mechanisms to address the inevitable divide between urban and rural areas.

• **Fragmented mobile market.** Although a number of operators are offering competing mobile broadband services in the KRI, several factors limit the ability of operators to effectively compete regionally and nationally. First, the 3G operators, licensed by Communication and Media Commission (CMC), are not able to acquire 4G spectrum licenses in the KRI. Second, regional 4G operators cannot provide the service in the rest of Iraq. This suboptimal and fragmented market structure limits competition in the KRI and the rest of Iraq and hinders the expansion, maturity and innovation of both the regional 4G and the national 3G operators.

**Policy Response**

**Fostering competition in the KRI market**

3.174. *To address these bottlenecks, the KRG should devise sector strategies along with specific regulatory interventions that foster competition and address digital divide issues through proactive policies.* If these issues were addressed, the economic and social opportunities achieved from the universalization of high speed Internet services would be considerable and would have a transformative impact on the KRI. In this respect, an overarching policy and a holistic approach to the development of the broadband market can bridge the gap between the current situation and the policy aspirations of the KRG development targets of stimulating private sector productivity, creating new jobs and diversifying the economy. The MoTC, in cooperation with other government agencies can develop a comprehensive KRG telecommunications policy and strategy to stimulate competition in the broadband market and introduce open and public consultation with all stakeholders. This strategy can be devised in cooperation with the central government authorities to highlight the potential regional as well as national gains from fostering the development of the telecom market in the KRI. In specific terms, the MoTC should plan in the next three to four years to implement the following actions and strategies:

- Similar to the licensing of the two incumbent fixed operators, the KRG MoTC can introduce new facilities-based broadband operators. The KRG should open the opportunity for new private sector operators to lay infrastructure and provide service across the whole broadband vertical chain and on a regional basis rather than for each governorate. Priority should be given to new service providers at the access service layer.
- Devising a set of regulatory tools to encourage market entry, issue and implement open access regulations and address dominance and anti-competitive practices with priority
to non-discriminatory and transparent wholesale price regulation and wholesale reference offers.

- Designing new models of infrastructure supply using public private partnerships to expand fiber access and backbone networks beyond urban areas.
- Encouraging and regulating the sharing of infrastructure between telecom operators, between telecom and electricity networks and between telecom and transport. This would entail designing digital infrastructure maps as a tool to identify market gaps, issuing guidelines and regulations for infrastructure sharing among operators and coordinating with the Ministry of Electricity the terms and conditions of the use of the electricity transmission and distribution network to deploy fiber networks.
- Strengthening cooperation and agreements between the CMC and the KRG MoTC, on monitoring and regulating the 3 local mobile operators, in particular on issues related to frequency usage, interconnection, quality of service and pricing.

**Market regulation and monitoring capacities of the MoTC**

3.175. *Progress in the expansion and the development of the regional broadband market requires extensive market analysis and monitoring by the MoTC.* The capacity in the MoTC has not been translated into regular monitoring of the market and analysis of the gaps in supply and demand. There are currently neither a baseline nor frequent analysis of the telecom and broadband markets in the KRG. Moreover, cooperation of MoTC with regional and national operators and the provision of market data and information can be improved in order to give the MoTC a solid basis for devising sound and informed policies.

3.176. *The MoTC needs to improve its technical and regulatory capacity.* In the next three years and as one of the major prerequisite for market regulation and interventions, the MoTC needs to improve its technical capacity to monitor the market. The MoTC should improve transparency by adopting a transparent and consultative approach to devising new rules and regulations.

**International connectivity market**

3.177. *Along with the south of Iraq, the KRI has a prime geopolitical location that enables Iraq to become a hub for international connectivity.* This geopolitical location has the potential to serve the Internet markets of the GCC region and the International traffic between Europe and Asia. Transiting international traffic through Iraq and the KRI generates higher Internet capacity for the whole country at competitive prices, creates new business opportunities for domestic investors and provides new jobs in infrastructure deployment.

3.178. *There is considerable interest among domestic and foreign investors in the KRI as a regional hub for Internet traffic.* Many sources have reported ongoing projects and negotiations with international partners to expand fiber infrastructure from the submarine cable landing points in Al Faw to Turkey and Iran via the KRI. However, the rules and regulations for such infrastructure deployment projects are still obscure. So far, the KRI MoTC has licensed four operators to provide international terrestrial connectivity through
Iran and Turkey to provide international connectivity services to local users, but has no official plans to leverage the position of KRI as a potential transit hub for regional and international markets.

Map 3.9: Terrestrial Internet Routes Connecting Submarine Cables to Europe via Iraq and MENA Countries


3.179. MoTC, in cooperation with central government authorities should strengthen transparent licensing processes and develop a common vision for regional Internet connectivity. The MoTC and the related agencies in the KRG can adopt a more transparent approach to licensing infrastructure that transit Internet traffic through the KRI. A clear vision can leverage domestic and international investors to bring about benefits to local investors, more fiscal revenues, and better service to the consumer.

The Information Technology market

3.180. The IT market in the KRG is in its nascent stage. The IT market in the KRG is characterized by low demand and low supply of IT services, such as software products and networking, as well as IT enabled services such as business process outsourcing. Important economic and social opportunities can arise from stimulating the development of this market including job creation outside of the public sector, increasing the size of the services sectors, and transforming the trade, logistics and energy sectors.

3.181. Low demand for local IT services along with shortage in skills appear to be major constraints for the development of the IT market. On the demand side, there is weak demand from big companies in oil, construction and telecom as they tend to develop their own solutions or outsource to international IT companies. The Government has developed
the KRG IT blueprint strategy which aims at digitizing government processes and services. The full implementation of this strategy will help boost demand for IT services and therefore help the market mature and expand. However, labor supply skills are constraints to the development of this market: weak skills in languages, management and communications are cited as important constraints for demand of local labor in IT and IT enabled services. Finally, IT companies are failing to attract skilled labor and fresh graduates have a considerable preference for jobs in the public sector.

3.182. **The KRG needs to tap on the opportunity of the underserved Kurdish language content market.** Another opportunity for local entrepreneurs and investors rests in the regional market for specialized entertainment, educational and localization of digital content in the Kurdish language. The opportunity lies in the extended geographic area of Kurdish speaking customers and the relatively low supply in this market. The Government can incentivize academic institutions, NGOs, and the private sector to organize Hackatons and application competitions to stimulate innovation. The government can also support SMEs in this area.

3.183. **A local IT strategy is needed to foster the IT market.** To boost the development of this market, the KRG should devise a local plan and strategy that brings together all concerned government agencies and develop a long-term plan to address weaknesses in supply and demand of IT services and the need to improve technical and soft skills. The government can also partner with the private sectors, academic institutions and international stakeholders to develop technology parks and innovation incubators.

**Box 3.4: Prioritization of ICT Sector Policy Recommendations**

The proposed recommendations, in particular those related to the broadband market and international connectivity, can help the KRI, as well as the rest of Iraq, to foster the adoption of advanced broadband services for the benefits of consumers and the economy as a whole. Therefore their implementation should build on the synergies between the regional and national markets. This may require in some cases coordination with the central government authorities. The below table highlights the measures that should be implemented by KRG MoTC in the next four years, listed in order of importance. All proposed policy recommendations are also summarized in the policy matrix annex of this report. KRG authorities may rely on external assistance to implement these reforms while strengthening the internal technical and institutional capacity of the MoTC.
H. DIVERSIFICATION OF THE ECONOMY AND EMPLOYMENT CREATION OVER THE MEDIUM-TERM THROUGH PRIVATE SECTOR DEVELOPMENT

3.184. **Over and above the restoration of peace and security, the achievement of significant and sustained welfare gains will be predicated on economic growth and the diversification of the economy away from oil.** In Iraq, as in many other developing countries, the heavy reliance on oil for growth, exports and government revenues also occurs within the context of a narrow and non-inclusive power structure that privileges ‘short-term private enrichment over longer-term collective welfare enhancement.’ As the World Bank (2012) report highlights, the translation of natural resource rents into development gains will require credible intertemporal commitment on the part of government to both extractive companies and its citizens, as well as a more inclusive process of decision making and public accountability so that resource rents are allocated towards investments in service delivery and public good provision. To address the multiple development challenges facing KRG, an expansion in job creation led by a diversified private sector will be essential, which in turn requires a favorable investment climate, the availability of finance on competitive terms, flexible labor market mechanisms and institutions, and appropriate infrastructure.

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3.185. **In KRG, there are opportunities for an expanded role of the private sector, if the appropriate enabling environment is made available.** It will be imperative for the public sector not to crowd out the private sector in being able to compete for talent and business. Rather, the key challenge for government is to put its significant revenues to efficient use, making critical investments in health, education, infrastructure and regional development, and in creating a well-targeted and comprehensive system of safety nets for the poor and vulnerable (World Bank, 2012, Iraq PER). The creation of a large and diversified set of jobs remains one of the fundamental development challenges for Iraq. Across the world, poverty reduction is most often driven by an expansion in employment and increases in labor earnings; and the private sector is usually the primary engine of job creation.

3.186. **The large informal sector poses an important challenge.** Streamlining registration and licensing procedures will reduce the regulatory burden of entry into the formal sector. Reform of the tax and regulatory regime can also encourage formalization and compliance by small firms. Moreover, expanding the access to finance and business support services will enable informal firms to compete in the formal economy. In the end, firms choose to formalize based on a rational comparison of costs and benefits; and the formal economy can grow when these benefits outweigh the costs.

3.187. **There is a strong potential role for the private sector to play in partnership with the public sector** to enhance infrastructure quality and access, and this will require reforms of the regulatory environment to attract adequate investment and greater use of public private partnerships (PPPs) to address service delivery, especially as a stepping stone to broader private sector led financing and provision of key services. When available, public sector investment in infrastructure is not of adequate size and composition to act as a driver of growth. In this context, FDI tends to be concentrated in non-tradables, thus compromising export growth, and weak governance acts as a constraint to effective public-private partnerships and, more generally, private sector development. Similarly, financial sector reforms will be needed to expand access to competitive financing for private businesses. Easing the regulations governing land and facilitating registration and the use of property as collateral will also be important. The “resource corridor” approach holds particular promise, especially as lessons emerge from other resource-rich economies. The key idea is to use a set of complementary investments by international and domestic private investors and the government to manage natural resource development in a way that generates spillover activities. Of course, parallel interventions are necessary to maintain security and promote an inclusive mode of natural resource development.

**Private firms’ access to finance**

3.188. **Access to finance is regularly identified as a major constraint to doing business in KRI.** The underdeveloped financial and banking services, the inability of individuals and companies to issue letters of credit, and the fact that services lag behind international levels of development have led the private sector to abstain from dealing with governmental banks.
3.189. *To ameliorate this situation, the KRG needs to strengthen the rights of borrowers and lenders* by amending the securities laws to allow more flexibility in secured transactions law by:

- Introducing the possibility of a non-possessory security pledges in a single category of revolving movable assets;
- Ensuring that non-possessory security pledges allow a general description of the collateral without requiring a specific description of the collateral;
- Allowing that a security right extend to future or after-acquired assets, and extend automatically to the products, proceeds or replacements of the original assets;
- Allowing for general description of debts and obligations in collateral agreements and in registration documents so that all types of obligations and debts can be secured by stating a maximum rather than a specific amount between the parties;
- Establishing a collateral registry that is computerized, unified geographically, and that is indexed by the name of the grantor of a security right;
- Developing a predictable priority system that would grant as high of a priority to secured creditors both inside and outside bankruptcy proceedings as possible; and
- Authorizing parties to agree on out of court enforcement of debt obligations.

**Regulatory regime**

3.190. *The importance of high-quality business regulation is a key determinant of KRI’s future growth rate.* Improving the business environment is therefore essential for boosting the growth potential of the economy. This underscores the importance of finalizing the following legislative reforms:

- Drafting a new Competitiveness Law
- Drafting an Anti-Monopoly Law
• Drafting a Consumer Protection Law
• Amending the Industrial Zones Law
• Drafting a Social Security Law
• Drafting an Environmental Law

3.191. These should be written in accordance with international best standards and good regulatory practices, through a coordinated effort with all relevant ministries and private sector and civil society stakeholders.

Institutional coordination

3.192. It is important for KRG to identify a “champion of reform” that can take the lead on some initial regulatory reform efforts. The current institutional regulatory framework in KRI is fragmented. There is no single unit in charge of leading and coordinating regulatory reform efforts. The “champion of reform” role, which has so far been undertaken by the Ministry of Planning, could continue to be led by the ministry, although other supporting institutions and processes will be also needed. It will be important to establish working groups including representation from government agencies, and from the private sector that will identify and discuss regulatory assessment and reform recommendations.

Diversifying in manufacturing

3.193. As the security situation improves, the KRG can encourage expanded production of manufactures by improving critical infrastructure for manufacturing and by enhancing security for the movement of goods through the KRI. KRI is host to a few factories that were intended to supply all of Iraq, but security problems restricted access to the rest of the Iraqi population. However, recent trade data (and satellite images) indicate that substantial amounts of imports from Turkey are transiting through KRI to Southern Iraq. Improvements in security should be of advantage to all sectors, and to Iraq as a whole, given the volume of trade transiting between KRI and the rest of Iraq. A PPP may be used to provide financing for private firms that would complete stalled infrastructure projects. An initial step is to set up a supplier database with information about each firms’ capacity, to provide to potential investors.

3.194. Encouraging foreign investment is particularly important as investors could bring not only an infusion of capital, but also knowledge. To facilitate the transfer of knowledge to local firms, KRG could also provide incentives for foreign firms to partner with local firms, such as additional incentives for purchasing inputs from domestic firms. Alternatively, KRG could facilitate connections between potential foreign investors and domestic firms, and offer incentives to investors who are willing to provide technical assistance to domestic firms.
Box 3.5: Prioritization of Private Sector Development Reform Actions

A private sector-led economic growth and job creation agenda is critical for KRG to promote economic diversification and sustainable economic development. The private sector is relatively weak and nascent in a state-dominated oil-dependent economy. A multipronged strategy is required to promote private sector development, which should include the following action items (but not necessarily limited to):

High priority action items (within 6-36 months):

- Pilot innovative entrepreneurship development program specially targeting the youth and scale up the interventions that seem most effective.
- Pilot firm-level support to improve firm productivity, product quality upgradation and innovation, and access to markets and scale up interventions.
- Promote an enabling investment climate covering necessary legal and institutional reforms based on the findings from Doing Business Study, Enterprise Survey, and other primary and secondary research.

Medium to long-term action items (3-5 years):

- Develop and implement an economic diversification strategy focusing on competitive sectors in KRI.
- Enhance the productivity of agro-business sector.
- Improve connectivity to global economy through strengthened trade and customs policy, procedures, and development of ICT and infrastructure.

I. BUSINESS ENVIRONMENT AND INVESTMENT REGIME

**Investment climate**

3.195. The overly complex regulatory framework suffers from duplicative and overlapping regulations. This leads to an inefficient regime for doing business with high cost for businesses, particularly for small enterprises. The regulatory system should be thoroughly evaluated and reformed, and government officials should be trained in good regulatory practices.

3.196. The Government should establish a rule-based open investment climate. Private investors should have easy access to facilitating institutions; they should not see government offices as controllers of specific privileges, but rather as the implementing agency of a transparent and rule-based regime. The willing participation of the private sector in the tax and regulatory system will allow Government to implement a pro-growth policy.

3.197. Public and private sector trust can be enhanced through public-private dialogue as a means to establish the main priorities of the private sector and the role of the public sector in maintaining a constructive business climate. Public-private dialogue can explore areas of agreement where constructive reforms can benefit both sectors.
Investment reform map

3.198. **The KRG needs to identify current barriers to investment and determine whether its current policy mix can be reformed to attract more FDI in a wider variety of sectors.** The KRG would benefit from a comprehensive FDI strategy. FDI can be a good source of capital, know-how and technology. Foreign firms can provide jobs for local workers and training that can help upgrade the skill base of the local labor force. They can also provide links to a wider network of partners and clients. It will be useful if KRG undertakes an investment reform map (IRM) process to assess the type(s) of rules and regulations that can be reformed or instituted to best help KRG grow and develop, set priorities for reform and create an action plan with concrete timelines. This reform map should focus on the overall environment, allowing foreign businesses to seek and discover the KRI’s many advantages.

3.199. **Exports potential needs to be tapped and supported.** Iraq has a very low level of exports, much lower as a percent of GDP and particularly in terms of the number of firms that export, than other MENA countries or other FCS states. This characteristic is replicated—and magnified—in the Kurdistan Region. This issue was there even before the security situation was exacerbated. This speaks to the need for assessing the regulatory and administrative barriers to trade and to developing a strategy for attracting investment with the capital, technology and networks to help KRI firms develop export potential.

**Figure 3.13: Percent of Firms Exporting at least 1% of Production**

![Figure 3.13: Percent of Firms Exporting at least 1% of Production](image)


**Investment law**

*The Investment Law, KRG BoI, and Supreme Investment Council constitute much of the legal and institutional structure of the investment regime in KRI.* Currently, the law provides very generous tax breaks for investors, but there is little information available to assess whether these incentives align with the needs of investors, and of whether these
incentives are necessary—particularly compelling, given the fiscal state of the KRG. The Government should create a mechanism to assess the utility of existing incentives and to regularly reevaluate incentives to ensure that they do not have unintended, negative consequences, such as limiting competition by favoring some types of companies, or misuse of resources.

Training in settlement of investment disputes

3.200. An element that is demonstrably important for foreign investors is the existence of a reliable dispute resolution mechanism. KRG is legally unable to sign investment agreements; the international investment regime is determined in Baghdad. Since 17 December 2015, Iraq is a member of the ICSID Convention. Iraq is also signatory to seven bilateral investment agreements, of which two are in force: Japan (2014) and Kuwait (1966) and party to the Organization of Investment Cooperation investment treaty, League of Arab States investment agreement, the Arab League investment agreement and the Arab Economic Unity Agreement. It has signed a Cooperation Agreement in 2012 and has established a TIFA with the United States (entered into force in May 2013). Iraq is not a party to the New York Convention (the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958). Iraq has bilateral free trade area (FTA) agreements with the United Arab Emirates (UAE), Oman, Qatar, Algeria, Egypt, Jordan, Lebanon, Syria, Tunisia, Yemen, and Sudan. KRG BOI staff should be trained in ICSID rules and norms and their implications for Iraq (including KRI), and should clearly advertise this avenue to potential investors. Given its recent entry into ICSID, training in the international settlement of disputes and, importantly, on dispute prevention, would be key.

Investment retention

3.201. An investment retention unit should be created. Much of current investment worldwide is reinvestment, and efforts could be made to retain more existing investment, even in the face of tough external challenges. The creation of a sub-unit for investment retention within the BOI would be one step, to provide regular communication with investors to assess needs, to prevent disputes (which can be very costly) and for capturing lessons from existing investors to use to attract new and hopefully sustainable ones.

Investment promotion

3.202. KRG needs a strong promotion tool that can show potential investors its assets and potential, explain procedures and the legal framework, and respond to questions in a timely manner. KRG suffers several challenges in terms of attracting investors. Its location within a conflict region is one clear challenge, as is communicating its relationship with the rest of Iraq. The KRG BOI has a website aimed at investors that contains information on potential investments in several major languages. Funding for the maintenance of its Website has run out, however, and training programs have been cut. Information is important to attract and inform investors, so it is essential to provide resources to BOI for investment attraction; to update and revamp Website and to provide
training for BOI staff (conditional upon offering internships and commitment to securing internships and training in all new investments).

**Board of investment**

3.203. *Investment Law gives BOI a wide range of responsibilities* including “creating a suitable environment so as to achieve economic development in the region and investment strategies, plans, and policies and submit them to the Council for approval …” (Article 10/6). But, BOI interprets its mission very narrowly only to issue investment licenses for projects with a project cost of US$1 million and more. This largely reflects its institutional and technical capacity. Under Article 13 of the Investment Law, the chairman has the right contracting persons inside or outside the region to perform tasks to achieve the goals of the Board. This right has been rarely used.

3.204. *Technical and monitoring capacity of the BOI is very limited.* It does not have any follow up and monitoring activity for investment projects and to learn from the implementation process and improve the investment environment. Recommendations include providing technical assistance improve BOI’s technical and administrative capacity and establishing a one-stop shop in BOI.

**Supreme investment council**

3.205. *The Investment Law also gives the Council broader responsibilities to improve the business environment*, but the Council focuses on only a few activities such as monitoring BOI’s activities, approving the high visibility projects, and allocating free land. The Council, which is chaired by the Prime Minister, has the potential of serving as an effective high-level policy-making and policy coordinating body. This potential is not used. Recommendations include:

- Restructure the Council and redefine its role as the highest policy making body dealing with investment climate and business environment supported by a technically capable and effective secretariat operating under the Council of Ministers.
- Merge the inactive Economic Council into the Supreme Investment Council.

**Starting and closing a business**

3.206. *Enterprise surveys have identified burdensome bureaucratic procedures for opening, running and closing a business as a private sector impediment*. The legal and regulatory environment for doing business is outdated and confusing, which is particularly burdensome for smaller businesses attempting to navigate their way. Lengthy waits for approvals for licenses to start up business, some needing approvals for multiple ministries, is a key complaint, as is the cumbersome process of closing a business. Some private sector entities also identified access to land as an issue.
The Doing Business in Iraq data points to procedures required to start a business as particularly cumbersome; Iraq ranks 154 out of 189 countries. In the country as a whole, starting a business requires 10 procedures that take on average 29 days at a cost of 40 percent of per capital income. Compared to neighbors, as depicted in the Figure 3.14 below, Iraq is the furthest from the frontier. This is replicated in KRI, where it takes 21 days to obtain a construction-related permit and 73.4 days to obtain an import license in Sulaymaniyah (in Baghdad getting an import license takes 15 days).

**Figure 3.14: Starting a Business: Distance to the Frontier, 2016**

![Distance to the Frontier](image)


Entry barriers are particularly burdensome to small businesses, and data from the Ministry of Trade and Industry indicates that the large majority of private firms in the Kurdistan Region are small. Many firms are also informal, and the literature draws some parallels between excessive regulations with respect to startup costs and informality and corruption. Practices of the informal sector is the second most important business obstacle to firms, according to the Enterprise Survey data, second only to insufficient electricity and more of an obstacle than political instability. Figure plots the percent of firms in various governorates of Iraq that cite informal sector practices as a main constraint.
Figure 3.15: Firms Identifying Practices of Competitors in the Informal Sector as a Major Constraint (percent)

![Bar chart showing firms identifying practices of competitors in the informal sector as a major constraint.](image)


**Customs time and number of procedures**

3.209. *In Erbil, it takes 38 days for goods to clear customs and nearly half of all firms use imported inputs.* Reducing customs time through improving both hard and soft infrastructure could be key, particularly if there is interest in developing export capacity and attracting efficiency-seeking FDI.

Figure 3.16: Days to Clear Imports through Customs

![Bar chart showing days to clear imports through customs.](image)


**Establishing a quality system**

3.210. *Special attention is needed to support internationally-recognized quality certification.* The Government should bolster quality system so that firms can be internationally certified at home. Currently in the KRI, only 6 percent (of 179 firms)—
mostly in Erbil—have internationally recognized quality certification and less than 1 percent use technology licensed from international firms.

**Figure 3.17: Percent of Firms with an Internationally-Recognized Quality Certification**

![Bar chart showing the percent of firms with an internationally-recognized quality certification in different regions of Iraq.](chart)


**Matching workers skills to companies’ needs**

3.211. *The skills gap renders the outputs of the educational system incapable of meeting and anticipating the private sector’s needs.* There is a clear gap between the output of the educational system (including graduates, research for personal promotions and advancements, Master’s theses and PhD dissertations), particularly in sectors related to production and administrative issues, and the actual skill needs of the region’s markets and various economic sectors.

3.212. *A number of mechanisms can help address this issue.* KRG could establish a public-private coordinating mechanism to survey market-based needs; coordinate training programs (avoiding duplication of training programs by developing an umbrella mechanism for the public sector to coordinate efforts to maximize results without taxing resources); enlist firms, domestic and foreign, to train people through internships, mentorships, apprenticeships, work-study programs, seminars; and partner with universities, particularly business and technical schools as well as high schools. This could lead to a longer-term skills training initiative that, by producing results, could increase the prestige and desirability of working in the private sector.

**Payment system**

3.213. *The most common complaint from business managers is the lack of a viable banking and payments system.* Beyond investments, the private sector is looking to Government to establish and maintain a stable environment for private investors. While such a system had existed before the economic crisis, private businesses feel unable to re-establish it without public enforcement. Low confidence in the banking system creates high transaction costs and a high share of cash payments. A high share of cash payments eliminates critical information on the level of economic activity and encourages informal
transactions. The Government needs to work with the private sector to support and secure confidence in an efficient formal payment system among firms.

![Figure 3.18: Number of Commercial Banks per 100,000 Adults, 2013](image1)

![Figure 3.19: Percent of Working Capital Provided by Non-banks (%)](image2)

Source: World Bank WDI; author’s calculations.  

3.214. **Collective agreement to re-establish vital institutions—such as the banking and payments system—should be established.** Public intervention and public enforcement will be needed where no private agents feel they can secure a new payments system and ensure enforcement of regulations that will be beneficial to all. Government will need to re-establish trust in the banking system. Arrangements may be needed with the Central Bank to ensure a lender-of-last-resort facility.

### J. BUILDING STRONG PRIVATE SECTOR ORGANIZATIONS FOR ADVOCACY AND LOBBYING

3.215. **Private sector development is a key objective for KRG, but there is a need for “champions” to achieve this objective both in the private sector and in the Government.** Globally, strong business organizations, as self-help institutions, play an important role for building a vibrant private sector. They identify the problems the private sector faces, develop policy solutions, build coalitions, and organize effective lobbying activities to influence public opinion and policy. In KRI, business organizations (together with their partners in the Government—possibly in the MoTI) can become the champion of private sector development.

3.216. **The Chamber of Commerce and Industry (CoCI) is the main active business organization in KRI.** The main objective of CoCI is establishing business contacts particularly in other countries rather than serving as an advocacy and lobbying body in KRI. It lacks capacity to conduct economic and policy analysis, identify needs for the private sector, and influence public opinion and policy.
3.217. **CoCI has a strong bias towards trading in its policy stance.** Industrial development seems to be a secondary objective. This reflects the dominance of traders in its membership. The main policy actions would be to:

- transform the region’s CoCI into a modern advocacy and lobbying organization, and
- set up a partner organization in the government.

3.218. **Substantial technical assistance is needed to realize these actions.** CoCI is in the process of building partnership with Swedish CoCI to receive such assistance.

**K. Trade Policy**

3.219. **Improving KRI’s trade regime is a priority on KRG’s reform agenda.** The current regime (zero tariffs on all imports plus a 5 percent flat reconstruction levy on about half of tradeables) was imposed by Coalition Provisional Authority in 2003. KRI’s un-weighted average most favored nation (MFN) duty rate is 1.3 percent, one of the lowest in the world (10.8 percent in Turkey and an average of 10 percent in all developing countries). A new duty schedule was prepared in 2011. It has an average MFN rate of 12.3 percent and 12 non-zero bands. It has not yet been implemented partly because of strong opposition from businesses engaged in trading (importers). If the Government decides not to implement the new tariff regime, then it is advisable to introduce an import surcharge of 4-5 percent on all KRI imports.

3.220. **So far, very little progress has been made on WTO accession.** Central Government applied WTO for membership in 2004, however trade-related reforms that need to be undertaken during the accession process are still pending. Iraq/KRI cannot take advantage of technical assistance available at WTO and elsewhere, and improve and lock-in trade reforms. It is recommended to speed up the negotiations and participate in negotiations actively jointly with the Central Government to become a WTO member.

3.221. **The customs system is prone to arbitrary decision, mis-declaration, fraud, and loss of revenue.** KRI has four customs posts. The customs administration faces many problems including outdated procedures, segmented processes, excessive physical checks and long delays, limited ICT capability and uncoordinated customs units, lack of appropriate customs valuation, and very poor integrity and governance. Satellite images of the number of trucks waiting for passage indicate that border procedures cause fairly lengthy delays at the border. Plans have been made with the World Bank in the past few years to reform the customs system but not yet been put in practice. Customs administration is under central government’s jurisdiction according to Iraqi Constitution. Recommendations include:

- Work with the central government to put in place a comprehensive reform and modernization program focused on adoption of international standards as well as investment in much needed customs infrastructure.
- In parallel, continue partial improvements in KRI’s border posts.
3.222. *This medium to long-term objective needs to be prioritized, sequenced, and adjusted to evolving circumstances.* It also needs collaboration of various ministries led by the MoFE. Likely international partners include World Bank, World Customs Organization, and UNCTAD.

3.223. **KRG’s current system does not conform to international norms and procedures.** Also, KRG has no technical and institutional capacity to implement a modern system. This poses a potential threat to public health, and a barrier to exports. Regulatory standards and enforcement are critical to protecting the health of the KRI population. Within the context of global trade, many countries seek harmonization of their own regulatory standards and procedures with those of other countries such as the United States, for example related to imported and exported food, pharmaceutical products, and medical devices. Regulatory systems require establishment of standards, mechanisms for inspection/verification and quality assurance, and mechanisms for enforcement. These should all be practical, efficient and effective.

3.224. **A number of improvements have been made in recent years including setting up new sampling and testing laboratories in Erbil, Sulaymaniya, and Dohuk,** signing agreements with Bureau Veritas, TUV, and Cotecna to carry out verification and issuance of certification of conformity in countries of origin as well as check points at specified borders. KRG has also drafted a new law to replace the old law, which has not yet been sent to the Kurdistan Parliament. The Government should ensure that the system to be put in place by the new legislation will include separation of standards setting, conformity assessment and certification, and measurement and calibration functions; investment in infrastructure and capacity building; encouragement of private laboratories; and arrangement of mutual recognition programs with trading partners. It is also important to seek technical assistance from the donor community to build the technical, physical, and institutional capacity in KRI.

3.225. **Export promotion is critical in non-oil sectors.** In KRI, export of non-oil products is negligible. This perpetuates heavy dependence on oil exports and inhibits employment creation. There is export potential in a number of non-oil subsectors including unprocessed and processed agricultural products, leather and leather products, petrochemicals, pharmaceuticals, and construction material, but KRG has not taken any measure to take advantage of this potential. Recommendations include:

- Prepare a comprehensive export diversification program, which would include setting up an export promotion agency, introducing export incentives such as duty/tax drawback, dedicated credit to exporters and loan guarantee schemes and trade insurance system to ease access to credit and reduce risks.
- Start implementing the four industrial city projects preferably in partnership with the private sector.
- Implement a single-factory export processing zones scheme until industrial city projects are completed.
3.226. **Discussions are ongoing between KRG and Turkey to take measures to improve the functioning of border posts and management of trade flows.** Informal cross border trade between KRI and Turkey is important and takes place in both directions either through the border station (false declaration) or smuggling. Under-invoicing is a common form of informal imports from Turkey. Close collaboration between KRG and Turkish Government and between business organizations is needed to reduce informal cross-border trade. Recommendations include:

- Establish on both sides of the border industrial centers to create employment and business opportunities. KRG can plan one of the industrial cities close to the Turkish border.
- Restructure fuel subsidies in KRI switching from general to targeted subsidies to narrow the price differentials with Turkey.
- Work with the Central Government to implement the customs reform.
- In collaboration with Turkey, strengthen border control system and open new border crossings to ease border traffic.

3.227. **Economic and trade cooperation agreements are important to benefit from regional opportunities.** Iraq has a few regional and bilateral trade and economic cooperation agreements. They are effectively defunct. Iraq has recently signed economic partnership and cooperation agreements with the US, EU, UN agencies, Turkey, and Iran. Agreement with EU has not yet been ratified. The agreements with the US, EU and UN Agencies in particular have long lists of technical assistance clauses of which KRG does not take full advantage of. Recommendations include:

- Press on Central Government for ratification of the EU agreement.
- Make every effort to take full advantage of the technical assistance clauses of all economic cooperation agreements not only to strengthen the trade policy, but also to improve the legal and institutional environment for the private sector.

L. **Labor Market and Employment Promotion Programs**

3.228. **KRG faces the daunting task to increase the size and dynamism of the private sector where most future employment growth is expected to come from.** The employment challenge comes from the small size of the private sector, a fast growing labor force due to natural population growth and geopolitical events, and weak policies at MOLSA. Specifically at the labor market level, the activities of MOLSA can be considered more appropriately to be pilots rather than programs while there is no centralized coordination, even operational information, of these activities. The scant records of programs with various international, regional and bilateral agencies that MOLSA keeps, suggest that existing programs are not only of small scale but also ad hoc and they depend to a large extent more on what donors are willing to support than what MOLSA can deliver within the strategic priorities of the regional government taking into account the capacity of MOLSA itself.
3.229. **The structure of the labor market in KRI has a number of unique features shaped by the region’s history and the resulting economic and population characteristics.** For example, the urbanization rate is high. This has been partly the result of the destruction of many villages and concurrent concerns about safety in rural areas. Moreover, urbanization rates tend to rise during the ordinary course of development as a result of internal migration of citizens in pursuit of more economic opportunities in the cities—including higher wages compared to those in agriculture. Urbanization coupled with the Government’s commitment to education, including public subsidies to post-secondary education, have raised education enrollments at all levels. The following statistics summarize the KRI’s labor market and population dynamics:

- One-in-three of the residents in KRI are in school/college/university;
- Two-out of three are below the age of 25; and
- 38,000 post-secondary education graduates of working age (with one-third of them being male) are out of the labor force\(^2^4\) compared to the nearly 100,000 officially unemployed of all education levels.

3.230. **One major challenge in KRI is that the share of public employment exceeds that of the private sector (53:47).** The size of the public sector has been often and severely criticized, especially in terms of discouraging job seekers to get a private sector job in the hope that there will be employment also for them in a government post. However, nearly two-thirds of public sector employment is in what one can label as largely non-discretionary sectors (such as defense and education).

3.231. **The employment-to-population rate in KRI stands at 22 percent and is practically the same as the average for the non-GCC Middle East.**\(^2^5\) Looking from a household perspective, the average household has 5.9 members of whom 4.6 (60 percent) are below the age of 25, 2 (34 percent) are students, 1.3 (22 percent) are employed and 0.1 (2 percent) unemployed.\(^2^6\) Figure 3.20 shows that one-in-three residents are in school, two out of three are below the age of 25, and just over one-in-five employed.

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\(^{24}\) That is, they are “inactive” or “idle,” not even unemployed.

\(^{25}\) The comparators are Jordan, Lebanon, Syria, West Bank and Gaza and Yemen where the employment rate averages 23 percent. See ILO/UNDP (2013).

\(^{26}\) The information is derived from the 6 rounds of the biannual Labor Force Surveys (LFS) that sampled nearly 40,000 households, 225,000 individuals and 50,000 workers.
Figure 3.20: Average Household (HH) Size (number) and its Composition (%)

Source: KRG LFS 2012 R1 through 2014 R2.

3.232. The employment rate is very much affected by the very low labor force participation rate of working age women (15-64) at 14 percent that nevertheless rises to 17 percent if students are excluded. The female unemployment rate is very high (at 21 percent overall and 51 percent for the female youth aged 15-24) compared to the male unemployment rate (4 percent overall and 11 percent for the male youth). The female labor force participation rate in KRI is indeed among the lowest in the Middle East (with the exception of Saudi Arabia) though the female unemployment rate is similar to that in the region (with the exception of Lebanon).

Figure 3.21: Very Low Employment Rate

... comes from the very low labor force participation rate of women

... does not come from the very high unemployment rate of women

Source: KRG LFS 2014 R2; RAND.
3.233. The rising educated unemployment in KRI is not unique though the speed at which it rises is. The education sector in KRG had not been well developed until recently. Its output has been largely absorbed by the Government either in the form of teachers or in other government jobs. This trend is accentuating as KRG caters more for its own needs and education institutions are being pressed into the service of the region. What might have been small-scale provision for the elite is now expanding fast to serve the development goals and individuals’ aspirations. In fact, the rate of growth of the education sector has been prodigious, and this is manifested in the labor market as shown in Figure 3.23.

3.234. The increase in education eventually started rising much faster than the public sector can absorb. This fast growth has led to the emergence of educated unemployment as a potential challenge. Since a graduate often has the option of accepting a non-graduate job, rather than be unemployed, it has also led to the issue of graduate unemployment, as well as gender variances, as shown in Figure 3.24.
3.235. **KRG is facing an employment challenge of large proportions even if one assumes that there will be no significant increase in the annual numbers of job seekers (women, IDPs, refugees and foreign workers hired at low wages on short term contracts).** The current annual population growth is about 140,000 (even without factoring in refugees and IDPs) which corresponds to around 2.6 percent of the population. As current labor force participation rates, this will also be the rate of growth of job seekers. Based on international estimates of the impact of output growth on employment, a medium case scenario for KRI suggests that for employment to increase annually by 50,000—a number that would prevent unemployment from rising—would require future economic growth rates to be consistently five percent or more per annum in the region. And if future workers were to be absorbed predominantly by the private sector, the relatively small private sector would need to increase annually by 10 percent or more. The backlog of inactive educated workers plus the already educated unemployed and the increasing share of educated workers among the job seekers means that others who join the labor market with basic—and worse, if
lower—education may face bleak employment prospects, increased risk of poverty, and continuing dependence on welfare benefits. In addition to specific policies for employment and social assistance, policies would therefore be required that would raise “all boats” from sound macro management to sectoral policies. Most future job seekers will be educated at further and higher levels.

**Figure 3.25: Projected annual number of new labor market entrants till 2020**

![Graph showing projected annual number of new labor market entrants till 2020]

*Note: Adapted from RAND and KRG Ministry of Planning (2014), An Assessment of the Present and Future LM in the Kurdistan Region – Iraq: Implications for Policies to Increase Private Sector Employment.*

3.236. The **KRG Vision 2020 seeks to create employment opportunities for the population, and therefore increase self-reliance and reduce dependency on SSN.** This requires private sector growth and the employment therein. In turn, this requires job seekers to be employable and employers to be able to attract qualified employees. The former requires a good education and training system. The latter requires good policies. At present the majority of the labor force is employed in the public sector that also serves as a *de facto* SSN. This is draining the budget while it creates a duality compared to the private sector where wages, benefits and conditions of employment are inferior to those in the public sector. This is particularly evident in the case of women workers who tend to be employed in the public sector or not be in the labor force at all.

Moving away from this unsustainable equilibrium requires measures to increase education enrollments, improve the skill level of job seekers, and a reduction in the role of Government as an employer. KRG aims at creating an effective labor supply of well-equipped job seekers and skilled workers through the education and training systems and market driven incentives. Despite the recent commendable increase in education enrollment at all levels, especially at post-secondary education, a large share of young people face the prospect of entering the labor market with little education. One-in-four girls have dropped out by the age of 15 (compared to one-in-ten boys). And nearly one-third of
boys and as almost 40 percent of girls are out of school before they complete secondary education.

Figure 3.26: Out of School Rates by Age and Sex, 2012


3.237. Existing workers need lifelong upgrading of their skills, especially in the current era of changing production techniques and job turnover across occupation and sectors. Investment in human capital does not stop at the end of the school cycle. New recruits typically need some pre-employment or induction training. Internships and apprenticeships are critical avenues for enhancing skills at the workplace. Such training will be demand driven, that is, aligned with and sponsored by employers who will be prepared to co-fund such training but also be made part of the institutional function of the organization.

3.238. KRG aims at increasing labor demand to accelerate employment creation among its population, especially in the private sector. This part of the strategy requires a two pronged approach. First, public administration reforms that would: (i) Downsize the civil service; (ii) release funds for public investments; (iii) contribute to private sector growth though better regulatory and legal framework to improve investment climate; (iv) decrease the duality in the labor market and the educational credentialism that comes with it; and (v) address training needs for private sector jobs. Second, rationalizing the public sector and cutting government spending must go hand in hand with promoting private enterprises. The aim will be to create a highly productive private sector.

3.239. KRG aims at developing an institutional framework based on timely data analysis, well-designed employment policies, and constructive dialogue among the social partners. KRG lacks the necessary institutions, statistics and mechanisms that are critical for analyses, design and implementation of evidence-based measures, monitoring and evaluation of policies all to be intermediated though a constructive social dialogue among the stakeholders. A new labor law has already been drafted whose ratification will be expedited after negotiation and agreement with the social partners. Similarly, a KRG Skills Development Strategy is pending approval. And the implementation of a Regional Employment Policy that was inaugurated in May 2015 is lagging.
3.240. **Though no substitute for good economic policies and the creation of a healthy private sector and an effective education system, active labor market policies (ALMPs) can help, if properly designed.** These include employment services, career guidance, job counselling, labor market information system (LMIS), and support for SMEs. ALMPs can be useful in countering education and labor market failures, mitigating costs arising from unemployment by facilitating the reintegration in employment, and promoting efficiency and equity. They can help reintegrate some groups, including the youth or the displaced persons.

3.241. **Related to this are necessary improvements in social dialogue and the regulatory environment that would make it easier for businesses to operate and grow.** This can be facilitated through a consultative forum for labor, social and economic issues, and can be called “Economic and Social Council” (ECOSOC). It can comprise elected representatives from the relevant constituencies (public and private sectors, and civil society) who may discuss challenges and advise the executive and legislative branches of government to address these issues. All proposed reform actions are summarized in the policy matrix attached as the annex of this report. The table below presents the prioritized timeline for reform actions in labor market and employment promotion programs.

### Table 3.7: Proposed Prioritization of Reform Actions: Labor Market Programs

<table>
<thead>
<tr>
<th>Year</th>
<th>Labor Market Reform</th>
<th>Responsibility</th>
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<tbody>
<tr>
<td>2016</td>
<td>Strategies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Expedite implementation of the Regional Employment Policy</td>
<td>• MOLSA</td>
</tr>
<tr>
<td></td>
<td>• Develop KRG Skills Development Strategy</td>
<td>• MOLSA</td>
</tr>
<tr>
<td></td>
<td>Legislations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Discuss the draft labor law and align it with the SPSF</td>
<td>• MOLSA and social partners (employers and workers)</td>
</tr>
<tr>
<td></td>
<td>Institutions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Establish the High Authority for Civil Service Reform</td>
<td>• Prime Minister’s Office</td>
</tr>
<tr>
<td></td>
<td>• Establish the High Level Council for Human Development that will ensure coherence between economic and employment policies and oversee implementation of the KRG SPSF</td>
<td>• Prime Minister’s Office, MoP, MOLSA, economic and social line ministries, and partners</td>
</tr>
<tr>
<td></td>
<td>Programs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Undertake demographic analysis in the context of education planning leading to universal enrollment till age 15</td>
<td>• MOE in cooperation with KRSD</td>
</tr>
<tr>
<td></td>
<td>Administration</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Initiate preparatory work for developing the LMIS Review of existing labor market databases and indicators Stocktaking of existing labor market programs and policies</td>
<td>• KRSD with relevant agencies (that can provide LM data: MoP, MOLSA, MOI, MoFE)</td>
</tr>
</tbody>
</table>
### 2017 Strategies
- Develop admissions policy
- Approve KRG Skills Development Strategy
- MoP and MOLSA/MOL

### Legislations
- Enact the New Labor Law
- MOLSA/MOL

### Institutions
- Establish the ECOSOC
- MoP with economic ministries, social partners and civil society

### Programs
- Start implementing measures for universal education access with link to Conditional Cash Transfers (CCTs) as needed
- MoFE with MOLSA (for CCT)

### Administration
- Start implementation of the LMIS
- KRSO with relevant agencies (that can provide LM data: MoP, MOLSA (MOL/KSAI), MOI, MoFE)

### 2018-2020 Strategies
- Implement the three policies: employment, skills development, and admissions

### Legislations
- Implement the new labor law

### Institutions
- Operationalize the new institutions

### Programs
- Continue implementing measures for universal education access with link to CCTs as needed

### Administration
- Continue implementing and updating the LMIS

## M. Capacity Building on Macroeconomics Statistics

3.242. **There is need for continuing capacity building on compilation of economic statistics that organization such as RAND and UNFPA have started.** Under the reform roadmap framework, training will be provided to selected staff across ministries and the KRSO. Capacity building will continue addressing the current limitations in grasping statistical concepts, and techniques and in the understanding of macroeconomic, fiscal, and social issues and policy.

3.243. **Macroeconomic statistics should be improved to provide necessary information for policy making and monitoring of economic developments in the region.** Capacity, resources (technical staff and electronic infrastructure), methodologies, organization, and coordination related to data collection and the production of useful and reliable statistics should be improved. Priority should be given to the systematic collection of production data by economic sectors and data for the compilation of annual GDP by economic sectors.
and by main expenditure categories at current and constant prices, and the production of high frequency indicators for key non-oil economic sectors. Labor force and employment statistics should also be compiled at least twice a year to support analytical studies and policies for the development of the non-oil sector and social protection. Much of this is already being done via the Kurdistan Region Labor Force Survey and CPI calculations, and the improvements suggested by RAND. The KRSO was also actively involved in the 2012 GDP calculation.

3.244. The Ministry of Planning KRSO would be provided with the resources required to launch key economic surveys to support key statistics and indicators for agriculture, manufacturing, construction, and selected services such as education and health, and employment in the oil and non-oil sectors of the economy. Price statistics would further improve the reliability of CPI calculations and the development of a Production Price Index that could improve the compilation the GDP statistics by economic sectors.
4. SOCIAL SECTOR REFORMS AND MITIGATION MEASURES

4.1. Today, KRI is facing a major social and humanitarian crisis. Adding to long-term structural issues, the fiscal shock due to declining oil prices and lack of budgetary transfers from the Baghdad Government, and the increased security spending due to the regional conflict have had a significant impact on KRI’s economy and its ability to deliver public services. The scale and speed of the displacement crisis make it challenging for the Government to deliver basic services especially in the context of a fiscal crisis. In KRI, 1.8 million internally displaced people and Syrian refugees are confronted with numerous and diverse needs. This is placing strains on the local economy and access to public services. The Government needs resources and international partnership to address humanitarian issues.

4.2. In addition to social protection reforms, KRG aims at protecting its human capital by providing incentives for better health and education. Preserving human capital requires creating fair opportunities to all. The Government’s strategy is to contribute to poverty reduction by smoothing consumption and by promoting more equal opportunities in terms of access to and use of education and health services. Furthermore, through a rigorous social protection reform, the Government aims at protecting the current poor population from the impacts of recent shocks as well as bringing social mitigation measures to correct the potential impact of upcoming economic reforms on the vulnerable people. Similar to the rest of Iraq, the implementation of the KRG pension system focuses on two important aspects: i) design and implement a financially and fiscally sustainable, adequate, equitable, and eventually unified pension system for both private, and public sector workers; and ii) design and implement a non-contributory universal minimum pensions (social pensions) in order to protect the elderly from falling into poverty.

A. SOCIAL PROTECTION REFORM TO PROTECT THE VULNERABLE FROM EXTERNAL SHOCKS

Social Insurance and Pensions

4.3. Since the mid-1950s social insurance programs have been implemented in KRG. Currently there are two social insurance schemes in KRG.

i) Pensions scheme covering public sector employees, administered by MoFE, and covering the risks of old-age, disability and survivorship;

ii) Social security scheme covering private sector employees, administered by MOLSA, and covering the risks of old-age, disability, and survivorship (i.e., widows and orphans), health, and work injury.

4.4. In 2014, the total pension spending in KRG was estimated to be around ID 1.3 trillion (or 2.8 percent of GDP). More than 50 percent of the labor force in KRG is

27 For overall Iraq, the total pension spending was estimated at around ID 9 trillion (or 3.8 percent of GDP) in 2014.
covered by the social insurance (pensions) system. However, most of them are employees in the public sector. In the private sector, around 84 percent of the labor force is not covered. Also, around 50 percent of people above the age of 60 in KRG are currently receiving pension payments (mostly retired public sector employees). The rest of the elderly have to rely on informal care, or public transfers as social assistance (non-contributory social safety nets). The main challenges on coverage of pensions and social insurance are very similar in KRG and rest of Iraq. Less than 2 percent of the working age population in overall Iraq is covered by the private sector pension scheme, and around 28 percent of the working age population is covered by the public sector pension scheme.

Figure 4.1: Pensions Spending vs. Old-Age Population

![Pensions Spending vs. Old-Age Population](image)

Source: World Bank Pensions Database.

4.5. Both social insurance (pensions) schemes in KRG were designed as PAYG contributory self-financed mechanisms defined-benefit system. In such a system, pensions are calculated according to a formula based on wages, and length of service, where current contributors pay for current beneficiaries. In the private sector, contribution rates from wages are 17 percent, which are 12 percent from employers, and 5 percent from employees (14 percent for pensions, 2 percent for work injury, and 1 percent for sickness and maternity). In the public sector, contribution rates from wages are 19 percent which are 12 percent for employer (Government), and 7 percent for employee (only pensions are covered in the case of the public sector). The major difference between KRG, and the rest of Iraq is that during the post-war period between 2003 and 2006, new retirees from the two schemes in Iraq received “flat-emergency” pension payments instead of regular pensions as computed according to the Social Security Law. Today, there are around 2
million people receiving such pensions from that period directly from the federal budget, while there are an increasing number of beneficiaries (currently more than 200,000) receiving pensions from a pension fund, also Pay-As-You-Go Defined-Benefit (PAYG-DB), that was created in 2006. In KRI, on the other hand, no pension fund was created and public sector employees’ contributions are directly paid to the general budget, and pension payments are directly paid by the general budget as well. Table compares public and private sector pension schemes in KRI and the rest of Iraq.

Table 4.1: Public and Private Sector Pension Schemes in KRI and the Rest of Iraq

<table>
<thead>
<tr>
<th>Scheme Demographics</th>
<th>Private Sector Pension Scheme in KRI</th>
<th>Private Sector Pension Scheme in rest of Iraq</th>
<th>Public Sector Pension Scheme in KRI (A proper fund has not yet been created)</th>
<th>Public Sector Pension Scheme in rest of Iraq (since 2007)</th>
<th>Pension payments from general budget, rest of Iraq</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Contributors (total)</td>
<td>78,525</td>
<td>199,525</td>
<td>682,000</td>
<td>3,850,000</td>
<td>-</td>
</tr>
<tr>
<td>Number of Beneficiaries (total)</td>
<td>659</td>
<td>16,161</td>
<td>246,619</td>
<td>259,206</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Old Age Survivors (widows, orphans, others)</td>
<td>103</td>
<td>1240</td>
<td>-</td>
<td>137,602</td>
<td>-</td>
</tr>
<tr>
<td>Invalidity Survivors (widows, orphans, others)</td>
<td>429</td>
<td>7,510</td>
<td>-</td>
<td>101,604</td>
<td>-</td>
</tr>
<tr>
<td>Average Wages (in ID)</td>
<td>475,000</td>
<td>189,000</td>
<td>760,000</td>
<td>740,000</td>
<td>-</td>
</tr>
<tr>
<td>Average Monthly Pension (for all beneficiaries)</td>
<td>226,315</td>
<td>200,000</td>
<td>425,000</td>
<td>410,000</td>
<td>330,000</td>
</tr>
<tr>
<td>Average Old Age Replacement Rate</td>
<td>47.6%</td>
<td>12.3</td>
<td>2.8</td>
<td>16.1</td>
<td>-</td>
</tr>
<tr>
<td>System Support Ratio</td>
<td>119.2</td>
<td>12.3</td>
<td>-</td>
<td>119.2</td>
<td>119.2</td>
</tr>
<tr>
<td>Average Monthly Wage</td>
<td>475,000</td>
<td>189,000</td>
<td>760,000</td>
<td>740,000</td>
<td>-</td>
</tr>
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<td>-</td>
</tr>
<tr>
<td>System Support Ratio</td>
<td>119.2</td>
<td>12.3</td>
<td>-</td>
<td>119.2</td>
<td>119.2</td>
</tr>
</tbody>
</table>


4.6. **The public sector scheme has currently a support ratio**\(^{28}\) **of three contributors for each beneficiary (682,000 contributors vs. 246,639 beneficiaries).** The private sector scheme has a high support ratio of 120 contributors for each beneficiary (78,525 contributors vs. 652 beneficiaries). However, it is important to note that the private sector scheme also pays more than 2,000 “end of service indemnity” payments per year to those members who end a job contract but do not qualify for a pension.

4.7. **The benefit formulas for pension calculations in both sectors have high accrual rates by international standards (2.5 percent),**\(^ {29}\) **and are based on last wages (the three last wages in the case of the private sector scheme, and the last wage in the public sector scheme).** Qualifying conditions are different in both schemes. In the private sector the minimum length of service is 20 years if the retirement age is reached (55 for women, and 60 for men), or 30 and 25 years of service for men and women respectively at any other age, otherwise individuals can only receive a lump-sum payment, instead of a regular

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\(^{28}\) System support ratio: number of contributors over number of beneficiaries; System dependency ratio: number of beneficiaries over number of contributors.

\(^{29}\) Accrual rate is used in a defined-benefit scheme for a pension benefit calculation relative to earnings per year of service.
pension. In the public sector the minimum length of service is 15 years, the minimum retirement age 50, and compulsory retirement age is 63, according to the law.

4.8. **The current legislative framework for both schemes is not well defined.** Compliance in KRI and the rest of Iraq has been quite different although originally they had in place the same legal framework. An amendment of Law 27 of 2006, which mandated the creation of a fund, included as well the integration of the pension schemes for the public and the private sectors in Iraq. A few steps have already been taken in this respect, and a new Pensions Law was in place in 2014 in Iraq (Law 9/2014). However, such law does not respect many of the principles based on international best practices, and Iraq is in the process of undertaking amendments to the law. On the other hand, in KRI, there is partial compliance with the previous Law 27, however no fund has been created. With respect to the private sector pension schemes, in KRI and rest of Iraq, there is a partial compliance (full implementation has never taken place) with the same law 1971 with minor differences and amendments.

4.9. **The current main challenges of the social insurance system in KRG can be summarized in four points:**

(i) *Low administrative capacity* of the social insurance schemes in KRG, which requires significant upgrading, and there is need for appropriate databases, record-keeping, and information technology systems. At this moment, the administration and assessment of the schemes is very difficult. Neither one of the schemes have adequate financial governance of administrative operations and social insurance benefits.

(ii) Based on the current design, the public sector scheme is *financially not self-sustainable*. In fact, today the revenues from contributions are already not covering the pension expenditures (in 2014, revenues from contributions were ID 1.1 trillion while pension expenditures were already ID 1.2 trillion). The private sector scheme is not yet in deficit given its large support ratio. However, it is financially unsustainable—in the long run, revenues from contributions will not be sufficient to cover pension spending. The scheme is also regressive (it penalizes low income earners in favor of high income earners). Unless some reforms are implemented, an increased amount of resources from the general budget will be required in order to maintain such schemes.

(iii) The system is *fragmented*, the public sector scheme is more secure and generous than the private sector scheme and this creates distortions in the labor market, attracting more employees towards the public sector, and negatively affecting private sector development. Also, labor mobility is restricted by the current qualifying conditions of pension benefits, and the lack of pension portability rights. An individual working for the public sector would need to contribute at least 15 years in order to qualify for a pension. If the individual leaves public service before this minimum length of service, such right is lost.
The system also suffers from incomplete coverage. While the labor force in the public sector is almost 100 percent covered, around 84 percent of the labor force in the private sector is not covered at all. Also, in the private sector the contribution density is low and irregular, and most contributors receive only returns of contributions and will never be able to qualify for a regular pension.

Policy Response

4.10. The Vision 2020 document indicates that reforms will include the creation of a regional pension system that will be attractive for the growing private sector. The goal is to design and implement a pension system that could provide a fair alignment between the contribution rate, with retirement age, and pension benefits (based on length of service and wages). Besides being adequate, the system needs to be financially sustainable, as well as economically and administratively efficient (particularly allowing public sector employees to move easily to the private sector).

4.11. KRG’s strategic direction involves reforms in two areas: The first strategy will reform current social insurance system towards integrating public, private, and other pension schemes (occupational). This strategy will address the main challenges of administrative capacity, pension system designs, and fragmentation. The second strategy will design and implement: i) conventional and alternative mechanisms to expand social insurance coverage; ii) social pensions; and iii) an Unemployment Insurance (UI) program.

4.12. KRG aims at reforming current social insurance systems towards integrating public, private, and other pension schemes. The strategy is to design a new pension system (including disability, survivors and old-age programs) that will respect the principles of a well-designed pension system based on international best practices. While there is no single best way of structuring a public pension system, the choice is by no means arbitrary, and any proposed reforms will be: (i) considered with respect for the KRG’s enabling conditions and capacities; and (ii) evaluated using generally accepted principles of pension reform developed from international best practices. Such principles include adequacy, financial sustainability, and coverage, but also fairness, economic and administrative efficiency, affordability, as well as predictability. The system will cover both private and public sector employees. Other current special schemes in KRG (such as occupational schemes for university professors) will also be considered under the same umbrella.

4.13. Implementation of this strategy will result in considerable cost savings, particularly in the medium and long-term. In 2014, revenues from contributions in the

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30 Benefits are adequate when they (i) provide sufficient income to protect participants from falling into poverty in the event that they become disabled or after they have retired and (ii) provide a reliable mechanism for smoothing consumption between a participant’s working years and his or her old age.

31 A pension system is sustainable only when it has the capacity to pay current—and future—benefits over a long horizon under reasonable assumptions without shifting substantial burdens to future generations and without having to cut benefits, increase contributions, or change qualifying conditions. This can only be accomplished if pension systems are designed and periodically tweaked using careful actuarial modeling.

32 A pension scheme involves long-term promises, and consequently the full effect of any reform will also be in the long-term.
public pension sector scheme in KRG represented around ID 1.1 trillion, while pension spending represented already more than ID 1.2 trillion. The scheme is already in deficit. Considering that the number of contributors (civil servants, and military) has been increasing from 444,350 in 2008 to more than 680,000 in 2014, the implicit pension debt (pension promises to contributors, and pensioners) has also been considerably increasing. In the absence of any reform, the current annual pension payments of more than ID 1.2 trillion (to less than 300,000 beneficiaries at the moment) is expected to exponentially increase. In the absence of reform, pension spending is expected to increase to more than ID 3 trillion in less than five years, which would represent a deficit of the pension scheme of more than ID 2 trillion. In the medium and long-term, pensions spending and deficit are estimated to increase even further. The cost savings of implementing the strategy could represent between ID 2 and 5 trillion in the short term, more than ID 10 trillion in the medium term, and more than ID 20 trillion in the long term. These cost savings in the pension system could be used for other deserving programs in KRG, such as health and education. The implementation will also result in a clear understanding of a transparent financing mechanism of the pension system. Public and private sector employees will have the same pension rights and consequently this new pension system implemented under this strategy will eliminate some of the current obstacles to labor market flexibility.

4.14. **KRG aims at designing and implementing conventional and alternative mechanisms to expand social insurance coverage, and social pensions.** As indicated in the Vision 2020 document, the new pension system will be attractive to the growing private sector. Currently almost 85 percent of the labor force in the private sector is not covered by any type of pension scheme, while almost 100 percent of the labor force in the public sector is covered. In this respect the objective of this strategy is to expand coverage in the private sector. The strategy is to expand coverage beyond the current 16 percent of the labor force in the private sector to ensure old-age income security for all.

4.15. **Implementation of this strategy in KRI is expected to result in an increase of thousands of contributors from the private sector.** The implementation is expected to result in an increase of the number of people receiving pensions above the age of 65. More than 100,000 people above the age of 65 that are currently not receiving any pension will be receiving one when this strategy is implemented.

4.16. **KRG aims at designing and implementing an unemployment insurance program.** One policy priority indicated in the Vision 2020 is the development of a comprehensive unemployment insurance system. This system will protect individuals from unexpected job loss, and will raise the security of working in the private sector.

<p>| Table 4.2: Proposed Prioritization of Reform Actions: Social Insurance and Pensions |
|-----------------------------------|---------------------------------|-----------------------------|
| <strong>Social Insurance and Pensions Reform</strong> | <strong>Responsibility</strong> |
| Strategies | • Work on a well-designed pensions system (old-age, disability, survivorship) | • MoFE and MOLSA |
| Legislation | • Start drafting new Pensions and Social Insurance Law | • MoFE and MOLSA |</p>
<table>
<thead>
<tr>
<th>Programs</th>
<th>2017 Legislation</th>
<th>Administration</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Design a capacity building program for senior directors and teams involved in social insurance tasks</td>
<td>• Enact new Pensions and Social Insurance Law</td>
<td>• Start implementing the Pensions Administration Systems (PAS)</td>
</tr>
<tr>
<td>• Start developing the appropriate Pensions Administration System (including IT systems, databases, and collection mechanism)</td>
<td></td>
<td>• MoFE</td>
</tr>
<tr>
<td>Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Initiate the establishment of the KRG Social Insurance Authority (draft structure, TOR, by-laws)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue the capacity building program on pensions economics</td>
<td>• Issue unemployment insurance regulations</td>
<td>• Start implementing the Pensions Administration Systems (PAS)</td>
</tr>
<tr>
<td>• Initiate a capacity building program on pensions policy analysis and actuarial capacity</td>
<td></td>
<td>• MoFE and MOLSA</td>
</tr>
<tr>
<td>Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Start implementing the Pensions Administration Systems (PAS)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018 Strategies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Expansion of coverage (actives and beneficiaries)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Issue unemployment insurance regulations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Operationalize the KSIA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue the previous capacity building programs, and alternative mechanisms to expand coverage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Implement the PAS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019 Strategies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Introducing Unemployment Insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Issue new social pensions regulations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue the previous capacity building programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Start producing actuarial studies/analyses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue implementing PAS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2020 Legislations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Implement social pensions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Implement the unemployment insurance program</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Continue implementing the capacity building programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Maintain the PAS</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Social Safety Nets

4.17. The KRI population benefits from a number of schemes that could be classified as non-labor income. The PDS, cash transfers, remittances (internal and external), Zakat in addition to the government subsidies on some basic commodities and services represent the main social safety net schemes. While labor incomes account for 58 percent of the total income of the bottom 10 percent in KRI, its share falls to 42 percent for the bottom 10 percent living in the south of Iraq. At the same time, ration or PDS transfer receipts as a source of non-labor income are also smaller in KRI, accounting for less than 20 percent of non-labor incomes on average, and 42 percent of non-labor incomes among the bottom decile. The relatively low share of ration transfers in KRI is compensated by relatively high shares of pension and capital income. Overall, pensions make up between 22 to 30 percent of average non-labor incomes, but are roughly half as important for the bottom 10 percent of the consumption distribution. The PDS budget allocated for KRG for 2015 amounts to approximately US$357 million (assuming 17 percent of the Iraq total PDS budget for 2015 of US$2.1 billion). The PDS is almost universally distributed. Based on the results of the IHSES 2007-2012, the PDS reaches 98 percent of the total population (about 5.4 million) then it is expected that an amount of US$68 is allocated per beneficiary. It is important to note that the distribution is not dependent on the size or the poverty level of the household. The share of recipients of the PDS who are poor is shown in Figure 4.3.

Table 4.3: Public Distribution System: Coverage, Targeting, and Leakages

<table>
<thead>
<tr>
<th>Governorate</th>
<th>Share of population receiving (%)</th>
<th>Share of poor population receiving (%)</th>
<th>Share of non-poor population receiving (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dohuk</td>
<td>99.08</td>
<td>100</td>
<td>98.83</td>
</tr>
<tr>
<td>Sulaimania</td>
<td>99.24</td>
<td>99.59</td>
<td>99.21</td>
</tr>
<tr>
<td>Erbil</td>
<td>98.56</td>
<td>99.39</td>
<td>98.45</td>
</tr>
</tbody>
</table>

Figure 4.2: Share of Poor Recipients (%)


4.18. MOLSA provides limited institutional care for the elderly, orphans, and physically and mentally handicapped children and adults. In 2014, MOLSA maintained a number of facilities, including kindergartens, orphanages, institutes for the disabled,
elderly homes, and cooperative society workshops—which altogether served approximately 7,691 individuals, as shown in Table 4.4. However, many of these facilities lack essential equipment and supplies and are not designed to promote independent living or integration into society. In view of the limited number of beneficiaries and the restricted scope of work of these facilities and programs, their effect on the livelihoods of households and beneficiaries is practically negligible.

Table 4.4: Social Care Provided by KRG MOLSA

<table>
<thead>
<tr>
<th>Program</th>
<th>Micro-credit</th>
<th>Women in Shelters</th>
<th>Cases in Homes for Delinquent</th>
<th>Children in KGs</th>
<th>Cases in Institutes for Disabled</th>
<th>Children in Socio-Cultural Centers</th>
<th>Hotline for Child Care (Calls)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of beneficiaries</td>
<td>7,157</td>
<td>92</td>
<td>844</td>
<td>1,697</td>
<td>930</td>
<td>4,220</td>
<td>3,918</td>
</tr>
</tbody>
</table>

4.19. **MOLSA is the main agency in charge of providing unconditional cash-transfer (UCT) assistance in KRG.** This program uses categorical targeting in channeling cash assistance to specific groups that are considered vulnerable. The eight categories eligible for the UCT through the SSN Department are: (i) orphans; (ii) married students; (iii) those with disabilities caused by aging; (iv) those with disabilities caused by illness; (v) the blind; (vi) the paralyzed; (vii) families of the imprisoned and missing persons; and (viii) the unemployed. The Women’s Social Care Department covers categories, including children of divorced women, divorced women, widowed women, and disabled women. The total financial assistance by beneficiaries is presented in Figure 4.3. Prior to 2012, a financial assistance of ID 30,000 per household was given monthly. In 2012, this allowance was increased to ID 150,000 per household, and in 2014, a total of 191,482 households were benefiting from both family and disability allowances.

**Figure 4.3: Distribution of Beneficiaries per cases in KRG, 2010-2014**

![Graph showing distribution of beneficiaries per cases in KRG, 2010-2014](source: KRG MOLSA 2014 Report.)

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33 KRG MOLSA 2014 Report.
4.20. The categorical targeting of MOLSA does not consider the poverty line nor the size of the household leading to high leakage and inequity. The transfer of ID 150,000 is allocated to beneficiary households regardless of size of the households or its poverty level, which increases considerably the risk of exclusion and inclusion errors.\(^{34}\) As for the cash transfer for disability cases, these are provided based on a medical report issued by a specialized commission. This is subject to some controversy, as reported by MOLSA officials. The medical reports leave ample room for interpretation thus the continuous variations and increased number of disability beneficiaries without any consideration for either poverty line or household size. The UCT’s use of broad social categories instead of more effective targeting mechanisms to determine eligibility (such as Proxy-Means Testing or geographical targeting) explains why the majority of the poor do not benefit from this program as shown in Table 4.5.

Table 4.5: Percent of Recipients of Non-Labor Income in KRG, 2007 and 2012

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rations (PDS)</td>
<td>Pension Social Protection</td>
<td>Domestic Remittances</td>
<td>Zakat</td>
<td>International Remittances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>20%</td>
<td>20%</td>
<td>16%</td>
<td>16%</td>
<td>0%</td>
<td>25%</td>
<td>23%</td>
<td>22%</td>
<td>28%</td>
<td>41%</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>2</td>
<td>20%</td>
<td>20%</td>
<td>18%</td>
<td>20%</td>
<td>38%</td>
<td>22%</td>
<td>21%</td>
<td>21%</td>
<td>27%</td>
<td>25%</td>
<td>11%</td>
<td>18%</td>
</tr>
<tr>
<td>3</td>
<td>20%</td>
<td>20%</td>
<td>21%</td>
<td>17%</td>
<td>19%</td>
<td>21%</td>
<td>20%</td>
<td>18%</td>
<td>24%</td>
<td>15%</td>
<td>20%</td>
<td>17%</td>
</tr>
<tr>
<td>4</td>
<td>20%</td>
<td>20%</td>
<td>24%</td>
<td>24%</td>
<td>0%</td>
<td>20%</td>
<td>17%</td>
<td>21%</td>
<td>13%</td>
<td>14%</td>
<td>26%</td>
<td>27%</td>
</tr>
<tr>
<td>5</td>
<td>20%</td>
<td>20%</td>
<td>21%</td>
<td>23%</td>
<td>43%</td>
<td>12%</td>
<td>18%</td>
<td>19%</td>
<td>8%</td>
<td>5%</td>
<td>35%</td>
<td>29%</td>
</tr>
</tbody>
</table>


4.21. In looking at the distribution of the population of KRI per quintile, and by plotting the number of beneficiaries from the UCT in each of the quintiles, it is noticed that a considerable percentage of beneficiaries are distributed in the richest quintiles. As shown in Figure 4.4, only 11.3 percent of the population in the lower consumption quintile (i.e., the poorest) are receiving cash transfers from MOLSA. The right panel shows that UCT expenditures benefit a significant share of households in the richest quintiles. It is evident that the UCT program suffers from weak coverage—many poor households are not benefitting and leakage (many rich households do benefit).

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\(^{34}\) Exclusion errors refer to excluding eligible (i.e., below the poverty line) households, while inclusion errors refer to inclusion of ineligible households in the cash transfer program.
4.22. **At the same time, the implementation modality differs between governorates.** The distribution of beneficiaries from MOLSA assistance per governorates is seen in Figure 4.5. Though using the same laws and regulations, the processing differs between governorates in terms of collecting applications from households expressing interest to benefit from the UCT, the use of Information Technology, processing for eligibility, selection of beneficiaries, receipt of transfers, and monitoring and evaluation.

**Figure 4.4: Schematic Representation of Targeting Inefficiency, 2012**

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Number of beneficiaries</th>
<th>UCT expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>22,250</td>
<td>40 Billion</td>
</tr>
<tr>
<td>(richest)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>38,467</td>
<td>72 Billion</td>
</tr>
<tr>
<td>3</td>
<td>38,467</td>
<td>72 Billion</td>
</tr>
<tr>
<td>2</td>
<td>40,541</td>
<td>69 Billion</td>
</tr>
<tr>
<td>1</td>
<td>46,764</td>
<td>84 Billion</td>
</tr>
<tr>
<td>(poorest)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.23. **The discussion on adequate targeting and distribution of beneficiaries per region comes in line with the work undertaken by the World Bank in looking at the poverty map.** The poverty map is a tool that combines the strengths of the household budget survey and population and housing census to estimate poverty rate at small level of geographical disaggregation. That is why looking at poverty alleviation and targeting are inter-linked.
The distinction between poor area and areas where the poor live is an important issue and this is where targeting comes into application. That is why the most obvious use of poverty maps is for targeting of antipoverty programs. Based on the 2012 Household Survey data, the World Bank report “Where are Iraq’s Poor: Mapping Poverty in Iraq” highlighted that:

1- Sulaymaniya has the lowest rates of poverty in all of Iraq. In more than two-fifths of its Nahiyas, estimated poverty rates are 2 percent or lower, and all but two Nahiyas have headcount rates of less than 10 percent. However, the number of beneficiaries from MOLSA unconditional cash transfer program is very high.

2- In Dohuk, the overall poverty rates are low and roughly 6 percent. Estimated poverty headcount rate at the Nahiyah level range from 3 percent in some Nahiyas to 10 percent in others. However, the largest number of poor persons are in two Nahiyas: Dohuk qada center (10,600) and Zakho qada center (11,600). These Nahiyas are the largest in terms of population in Dohuk. The data looking at number of beneficiaries for the UCT reveals otherwise that Dohuk has the lowest numbers. This raises questions about the selection methodology and stresses once more the need to reconsider the techniques used for targeting.

4.24. The role of social workers has weakened due to the changes of laws and instructions, and lack of sufficient staffing. The process of raising awareness of communities to the program, filling in applications, guiding households through the application all the way to follow up and case management need to be done by trained and dedicated social workers. The role of social workers as part of the administrative structure of MOLSA existed at one point in time, but the changes in laws did not observe well the function. Again, in view of regional differences and the uneven availability of resources and assistance, the role of social workers has been maintained in Dohuk to a certain extent, unlike other governorates. Social workers in Dohuk do still follow up on households’ annual updates. In Erbil and Sulaymaniya, however, households are expected to take the initiative to come into MOLSA offices to fill in their annual update. This remains occasional without any proper means for follow up or validation. That is why the number of households who enter the system and those who are expected to graduate for any reason remains unknown, leading to an additional burden on the resources needed for the program.
4.25. On the implementation level, the transfer amount increased from ID 30,000 to ID 150,000 in 2011 and kept the same since then. The amount of monthly cash transfer remains very close to the poverty line defined informally for KRI at ID 142,000. The spending in 2014 on the cash transfer programs amounts to 1.3 percent on non-oil GDP which is considered relatively high yet only 11.8 percent of the poorest quintile benefit of UCT.

4.26. Looking at poverty necessitates a broad perspective that touches on human development in general bringing the dimensions of both education and health. These two factors are directly linked to the definition of social protection. In KRI, poverty levels show disparities across regions, as well as urban versus rural areas. In education, the results of a UNICEF study show that the number of out-of-school children of age ranging between 5 and 14 years) has reached 127,115 in KRI (69,989 girls and 57,126 boys). This dimension of school exclusion shows that there are gender-specific differences. On the health front, although there is considerable reported variability across the governorates, neonatal deaths (<1 month of age) account for about one-third of all infant (0-11 months of age) deaths (1,270 of 3,833), and infant deaths account for about two-thirds of all under-five child deaths (3,833 of 5,776, 66 percent). The infant mortality rate (27.09 per 1,000 live births) and the under-five child mortality rate (40.83 per 1,000 live births) in KRI are considerably higher than comparators.

4.27. The absence of citizen engagement goes in parallel with lack of a communication plan for MOLSA. Citizen engagement is defined as a two-way interaction between citizens and governments or the private sector, which give citizens a stake in decision-making with the objective to improve intermediate and final development outcomes. In addition,

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participatory mechanisms are important to make governments and service providers accountable. It is a form of participatory feedback and monitoring by beneficiaries and communities. MOLSA programs are not designed to account for any feedback. Households are not well aware of the social programs, the conditions for eligibility, and how the selection process of beneficiaries is done. A separate initiative at Dohuk, where the SSN department with assistance from USAID, has been able to develop a system of data collection and uses technology made available to the public to ensure a proper follow up and feedback from beneficiaries. However, a Grievance Redressing mechanism was not put in place in the initial design of the program. Complaints could be submitted but no uniform processing has been established.

Policy Response

4.28. **KRG Vision 2020** states “Our aim is to improve living conditions of the poor, address the causes of poverty and foster upward mobility. Our goal is also redesigning our programs so that by 2020, assistance is targeted to those in need and creates economic opportunities for all.” The current situation in KRI requires reformative efforts to get aligned with the aims of the Vision, including enhancing social care services. Implementation the Vision 2020 will be supported through principles of better targeting, better care, and overall inclusion. This is in line with the strategic directions of the Poverty Reduction Strategy set by KRG in 2009.

4.29. **The KRG Social Protection Strategic Framework suggests the initiation of a targeting methodology that sets up the poverty line to determine eligibility for financial assistance.** The process would generate a database that could be adopted in the reform of the PDS if it is intended to limit the distribution to the lowest quintile of the population as determined by the targeting methodology (Proxy Means Testing and geographical targeting). The process will go in parallel with what the GoI had initiated by first adopting a new Social Protection Law that brings in best practices in targeting and case management. This had helped the clean-up of the database and reduced considerably the rate of exclusion and inclusion, and set up the way for the application of new parameters. Along the same lines in KRI, it is expected that the suggested programs to initiate targeting for the cleaning of the current database using poverty line as a parameter, as a first step, is expected to reduce exclusion errors and reach more of the estimated 12 percent of the population who live below the poverty line.

4.30. **KRG will adopt poverty levels as a dimension in the selection of beneficiaries from social assistance program.** This will allow KRG to have a broader perspective in linking vulnerability to the economic variations which in turn affects the livelihoods and consumption of all. Household welfare levels will be the determinant of whether eligible for assistance or not. Adequate targeting mechanisms allow for adequate coverage thus greater impact in more equitable and effective manners.

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37 A Grievance Redress Mechanism is a system by which queries or clarifications about the project are responded to, problems that arise out of implementation are resolved and grievances are addressed effectively.
4.31. **KRG will restructure its social care services to meet the objectives of providing planned coordinated and effective services with a systematic outreach to beneficiaries.** Social assistance programs at MOLSA suffer fragmentation and lack of coordination. This has implications in terms of limited and scattered coverage, and increase in the likelihood of inclusion and exclusion errors, weak referral systems and limited awareness among staff and beneficiaries about other programs and benefits which become key obstacles to children’s, families’ and communities’ access to essential benefits and services.

Table 4.6: Proposed Prioritization of Reform Actions: Social Safety Net Reform

<table>
<thead>
<tr>
<th>Year</th>
<th>Social Safety Net Reform</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>Strategies</td>
<td>• Initiate dialogue at the policy level on the need to reform the sector. Focus on targeting and preservation of human capital.</td>
</tr>
</tbody>
</table>
|      | Legislations | • Start the discussion on Social Assistance Law  
• Build on the momentum gained by the proposal under study at Parliament | • Parliament, MOLSA, MOE, MOH, MoP, KRSO |
|      | Institutions | • Design of KRG Social Assistance Institution (KSAI) | • MOLSA |
|      | Programs | • Start the design of the targeting methodology Proxy Means Test (complete the questionnaire and agree on a design)  
• Finalize the design of CCT pilot program. Complete the technical set up. Form the steering Committee | • MOLSA, MoP, MOH, MOE, KRSO  
• CCT Technical Committee (representing relevant agencies) |
| 2017 | Legislations | • Enact KRG Social Assistance Law | • Parliament |
|      | Institutions | • Operationalize the KSAI | • MOLSA |
|      | Programs | • Questionnaire of PMT in use  
• CCT pilot program started | • MOLSA, KRSO  
• MOLSA with relevant partners (MOE, MOH, KRSO) |
|      | Administration | • Start the design of KRG Unified Registry | • MOLSA, KRSO, MoFE |
| 2018 | Institutions | • Establish the KSAI to implement the law | • MOLSA |
|      | Programs | • PMT uses as a targeting methodology | • MOLSA, KRSO, KSAA |
|      | Administration | • Put in place a Grievance Redress Mechanism GRM  
• Build beneficiaries database  
• Build blocks for a unified registry | • MOLSA, KSAI |
<table>
<thead>
<tr>
<th>2019</th>
<th>Institutions</th>
<th>• KSAI overlooks the implementation of the law and the various programs</th>
<th>• KSAI</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Programs</td>
<td>• CCT pilot completed. Scaling up in process.</td>
<td>• Steering Committee, KSAI</td>
</tr>
<tr>
<td></td>
<td>Administration</td>
<td>• Database developed</td>
<td>• KSAI, KRSO</td>
</tr>
<tr>
<td>2020</td>
<td>Programs</td>
<td>• Complete scaling up of CCT in KRG</td>
<td>• Steering Committee</td>
</tr>
<tr>
<td></td>
<td>Administration</td>
<td>• Unified registry in place</td>
<td>• MoP, KSAI, MoFE</td>
</tr>
</tbody>
</table>

### B. EDUCATION SECTOR REFORMS

4.32. The progress made in the KRI in the past decade has been commendable. The success in the KRI education sector should be attributed to the Government’s commitment to upgrade the education provision system in its governorates. The KRI Government is committed to implementing educational reforms of inclusive and quality K-12 education, relevant secondary education and transparency and accountability in education provision. The reforms are formalized in the Vision 2020, a policy reform roadmap that was also aligned with Iraq National Education Strategy (INES 2011-2020) of quality curriculum and improved teaching to prepare students for the demands of the global knowledge economy.

4.33. The increase in the number of education institutions has helped KRG respond to growing demand for education. The region established 2,200 K-12 schools during 2003-2012. In addition, the number of tertiary education institutions increased from 3 in 2003 to 28 in 2015. Furthermore, net enrollment rates for post-primary education have increased substantially between 2007 and 2012 in KRI, from 48 to 61 percent at the intermediate level, and from 23 to 38 percent at the secondary level.\(^\text{38}\) In order to further improve the school environment, the government plans to have libraries, laboratories and introduce technology use in classrooms for students to enjoy cutting edge learning. Moreover, to diversify student learning interests and improve perception of schools among children as a fun learning place, the schools should offer extracurricular activities, such as sports, arts, theater and music beginning in the primary level.

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\(^{38}\) The education system in KRI now consists of two tiers (primary and secondary) instead of the three tiers (primary, intermediate and secondary). However, the new two tier system has not been fully implemented.
4.34. **Education in the KRI has been steadily improving, but much remains to be done.**

In 2007, KRI’s working age population was much more likely than that of the rest of Iraq to be illiterate or have less than primary education. In 2007, for instance, the share of working age adults in KRI with less than primary education was 23 percentage points higher than the national average of 34 percent. However, outcomes have been improving over time and the deficit is being gradually bridged. Those 30 and above (in 2012) started out with much higher levels of illiteracy and incomplete primary education relative to Iraq and lower completion levels of education. In contrast, the pattern is reversed for those age 29 and below. These young people are much more likely than their counterparts to have higher levels of education.\(^39\)

4.35. **School infrastructure needs to be improved.** The education system has expanded access rapidly in the past decade, nearly doubling the number of students from 2003 to 2013 (Vernez et al, 2014). However, expansion of the school system has not kept pace with demand for school spaces. With the influx of IDPs and refugees into the KRI, school crowding and infrastructure shortages have likely worsened. Many schools—in particular in rural areas—lack key basic infrastructure. Potable water and sewage connections are missing in a quarter of all KRI schools (40 percent of rural schools). Both construction of new schools, as well as improved water and sanitation for existing schools remain key to improving access to education.

\(^{39}\) Gross enrollment rates in KRI are above 100 percent even at the intermediate and secondary levels, the highest in the country. Moreover, net enrollment rates for post-primary education have increased substantially between 2007 and 2012 in the KRI, from 48 to 61 percent at the intermediate level, and from 23 to 38 percent at the secondary level. The large differences between gross and net enrollment result from the KRG’s overreliance on holding children back in school when they face academic troubles. In 2012, only 70 percent of children passed 9\(^{th}\) grade, and 40 percent passed 12\(^{th}\) grade.
4.36. **Due to increased demand, further steps need to be taken to improve infrastructure and the quality of the education system.** School infrastructure and education quality are closely linked in the KRI. The number of Kurdish kindergarten students grew by 50 percent over a five-year period (2005-2010), as the Ministry of Education put emphasis on making schools for this grade level more available. In terms of education services, both elementary and high schools are within easy reach everywhere, particularly in KRI, where elementary and high schools are reachable within 6 and 10 minutes respectively. According to the data, student enrollment nearly doubled from the 2003-2004 to the 2012-2013 academic years (Figure 4.8). Similarly, both the number of students and the number of schools doubled or close to doubled during that same time period. Due to increase in the birth rate and the KRG’s commitment to universal basic education for both boys and girls, enrollment in KRI schools is projected to increase approximately by 69,000 to 111,000 students annually over the next decade or so (RAND and KRG Ministry of Planning 2014). Therefore, while schools are within easy reach the increased demand for education has caused increased crowding, reliance on double shifts, and a school infrastructure shortage.

**Figure 4.8: Enrollment Growth from 2003-2004 to 2012-2013**

![Enrollment Growth Chart]

4.37. **Insufficient instructional time, exacerbated by double shifts, is another problem for teachers.** Teachers in KRI schools do not have enough hours in the school day to fully cover the new curriculum. This problem is exacerbated by a shortage of school buildings that forced many schools to teach in shifts due to increased number of refugee and IDP students, further reducing instructional time in classes. Many schools have had to implement two or more shifts, and some schools have had to begin sharing a building with another school, which is affecting quality of teaching and learning. KRI children in double shifts receive 539 hours of instructional time in grades 1-6 (in comparison with the OECD average of 794 hours) and 595 hours of instructional time in grades 7-9 (in comparison
with the OECD average of 892 hours). Much needs to be done in this area to tackle insufficient instructional time due to overcrowding, multiple shifts, and lack of school facilities. One solution to this problem (until there is adequate supply of school buildings to reduce the double shifts) is to increase the number of school days from 170 to 190 per year.

4.38. **KRG is dedicated to reforming the education sector.** Important reforms already implemented to date include development of an upgraded curriculum, mandatory education up to grade 9 (as previously mandatory education was through grade 5), the requirement that teachers have a bachelors degree (the previous requirement was for two years of tertiary education), and more. Furthermore, to simplify the education system, the government divided the education levels into two instead of three categories: basic and secondary levels only. The basic level, also the compulsory level, consists from grades 1-9 and the secondary level now includes grades from 10-12. However, the two tier system has not been fully implemented in all the schools in KRI. The Government has developed implementation strategies for educational priorities. The priority to ensure equal access of K-12 education has been emphasized and action has been taken to increase enrollment and access in KRI governorates’ schools. There has been a plan to build, staff and equip 9000 new classrooms in the next five years. Since 2014, the government added special Kindergarten classes to existing primary schools to accommodate increasing early childhood education demand in the region. The KRI government did recognize the diverse school age population and responded by introducing teaching in Arabic, English along with the existing Kurdish language instruction. Also in the beginning of 2016, the government rolled out a pilot in 100 schools to introduce, math, science and English classes at the primary level. The teachers responsible for teaching these subjects have been trained in English language teaching.

4.39. **To offer quality education, the Government is improving the formal qualifications of teachers.** While up to 60 percent of the teachers in KRI have received some training on the new curriculum, it has still been insufficient. The minimum qualification of teachers has been upgraded to a four years bachelor’s degree from a two years diploma. New universities have been set up under the Ministry of Higher Education to offer a four year teaching degree to prospective teachers. In addition to universities, three new teacher training institutes have been set up in the respective governorates in KRI. In 2015, the Government in collaboration with the University of Birmingham, offered 70 local instructors a four-month teacher training opportunity in UK with daily sessions of 150 minutes each. Furthermore, efforts have also been made for continuous in-service professional development of teachers at a newly established teachers training institute (Professional Development Centers) in Erbil.

4.40. **Another important action plan within the provision of quality education priority is the revision of the outdated curriculum.** The respective ministries in KRG rightly dealt with the curriculum problem by adopting a phased approach to curriculum revision and development to be implemented across K-12. In collaboration with the UNICEF and EU, the government also revised the outdated, ‘learning for testing’ curriculum with more ‘learner-centered,’ play based curriculum. In order to ensure that quality curriculum is
taught by trained professionals, the government plans to establish a Quality Assurance Directorate within the Ministry of Education. The aim is to oversee the performance of students and assess their learning capacity to better prepare them to compete in international assessments, such as the Trends in International Mathematics and Science Study (TIMSS). Furthermore, to establish student performance benchmarks, the government needs to update and implement the Education Management Information Systems (EMIS) to identify, gather and analyze data on select student performance indicators over time. The Government can also explore opportunities to forge public private partnerships to establish and administer student assessments that can bring student learning assessments at par with assessments in international schools. Therefore, to develop suitable PPPs in education arena, government officials need to improve their own capacity in identifying private parties and developing successful PPPs.

4.41. **To ensure inclusive and quality education reforms from preprimary to grade 12 the Government recognized the policy priority for increased accountability and transparency.** The Government plans to develop clear roles and responsibilities within the ministries, especially within Ministry of Education. In a similar vein of clear responsibilities, government aims close collaboration within ministries and school management and grant more autonomy to schools to promptly address day to day issues. In 2011-2013 government with the support from British Council piloted revised school standards for principals and teachers. Also lines of communication between school management and parents should be open. Even within this policy action, the use of EMIS can be beneficial to assess school performance through performance indicators that can channel parent feedback into improvement of education provision.

4.42. **Following the development of a solid education foundation, the Government’s next priority is to improve the capacity and quality of secondary level TVET.** The Government plans to establish an independent Technical Vocational Education and Training (TVET) Governing Council to study the trends in local and international job markets, coordinate between employers and education institutions to offer new and innovative TVET options to secondary level students that include practical workplace experiences. The Government also recognized the need to educate students on the importance of relevant post-secondary TVET training to stay competitive in the job market. The PPPs between the Government Council and the major private corporations could help schools align the curriculum and train secondary school TVET graduates with skills sought after in the private sector rather than to rely solely on the public sector for limited work opportunities.

*Putting in Place an Effective Technical Vocational Education and Training Program*

4.43. **An adequate skill pool is a prerequisite for private sector development.** Private sector employers are increasingly emphasizing ‘hard’ or technical skills, as well as ‘soft’ skills such as customer service and teamwork. Supply for this pool comes from the formal education system, which includes general or regular education (basic, secondary, and postsecondary) as well as TVET (secondary and postsecondary). In KRI, both the general and TVET systems face significant challenges in terms of access (adequacy of facilities) and quality (curriculum and teacher training). Employers cite gaps in both technical and
non-technical skills, thus, these institutions are not providing for adequate supply in the skill pool. For example, a 2012 RAND survey of business establishments in the KRI found that the most difficult occupations to hire into include technical occupations (37 percent of employers cited this deficit) and sales and customer service (25 percent), the latter emphasizing more ‘soft skills.’ In KRI, TVET programs should be designed to provide the occupational-specific technical training, but also provide students with onsite job experience through internships and other direct linkages to promote practical experience and development of soft skills that can only be honed on the job.

4.44. **Labor market indicators point to a skills deficit and skills mismatch as being one of the problems in KRI.** According to the 2011 Iraq Business Enterprise Survey, 34 percent of the firms interviewed in Iraq identified inadequacy of skills in the local labor market as a constraint, which is almost 13 percentage points higher than the average in the MENA region and 7 percentage points higher than among all countries. Furthermore, the RAND survey of business establishments found that 40 percent of employers indicated that graduates of secondary schools are poorly or very poorly prepared for work, and 25 percent of employers indicated that graduates of postsecondary institutions were not prepared for work (Constant et al., 2014). Among the deficiencies cited including lack of experience, lack of educational qualifications, and lack of appropriate skills.

4.45. **There are three main types of TVET education in the KRI.** The first is provided by the Ministry of Education, which oversees secondary-level vocational education. Until recently, there has been little investment in these schools in terms of curriculum development, teacher training, and facilities upgrades, and that has contributed to a few students wanting to attend these schools. With the help of GTZ and RAND, the Ministry of Education prepared a restructuring program for formal technical education. Implementation of the program has not yet started because of lack of funds. The second type of TVET are the postsecondary TVET institutions, which fall under the auspices of the Ministry of Higher Education and Scientific Research (MOHESR). There are both two-year technical institutes and four-year technical colleges that offer a range of degree programs and specializations. These institutions draw on graduates from both secondary vocational and secondary general education schools. The third source of TVET programming is overseen by the Ministry of Labor and Social Affairs (MoLSA), which has retraining centers in six areas in KRI. These programs are geared for adults who have not completed their basic or secondary education, or require retraining to improve their human capital for the job market. These centers are not adequately equipped for skill-development and face a number of critical constraints such as outdated curricula and teaching methods; inadequate number of trainers with the right skills; poorly equipped physical facilities and inadequate equipment; no involvement of private companies in the program (apprenticeship, internship, on-the-job-training); and no after training follow up and placement services. These centers will need to be part of a broader strategy of improving TVET in the KRI to meet the skill needs of the private sector, and will be an important tool to provide opportunities for job seekers to obtain training that will improve their job prospects.

4.46. **Strengthening the education and vocational training system in partnership with the private sector and curricula reform to better reflect the technical skills sought by the**
private sector will be important in bridging the skills gap and expanding employment in the private sector. Traditionally, the pay, hours and benefits premium earned by public sector employees relative to those who work in the private sector inhibit the ability of the latter to attract and retain talent. The most urgent and significant need is to strengthen the secondary TVET system run by the Ministry of Education and adult training run by the Ministry of Labor and Social Affairs. It is also important to sustain the improvements in both the general secondary and postsecondary system and develop strong linkages to employers. This will require substantial technical assistance, planning and coordination that could be better put together under multi-donor funding.

4.47. **Secondary, postsecondary, and adult training TVET requires close coordination between multiple stakeholders** including the MoE, MOHESR, and MoLSA, as well as employers, to ensure there is consistency across standards and the development of pathways for career development and progression that expand the options for students to transition into the labor market or continue into postsecondary education. RAND has developed a roadmap to implement improvements in TVET including a recommended governance structure, upgrading the curricula and instructor skills, and putting in place a mechanism to guide students beginning in late basic education and continuing into secondary education to advise students about their options and means to achieve their professional goals (Constant et al., 2014).

4.48. **There are a number of donor-supported TVET programs in KRI funded by UNIDO, ILO, SIDA, and GIZ.** However, they are designed and implemented independently with different curriculum and teaching methods without any coordination and relation with the government’s own programs. These programs should be rigorously evaluated, and a cost benefit analysis conducted. Early evidence from observation studies suggest that the outcomes appear to be limited and the costs high. Effective coordination of these programs at the MoP is necessary for more productive use of scarce donor money. Transforming the existing TVET structures into a modernized system requires a holistic, collective and coordinated reform efforts, in close collaboration within and across concerned line ministries as well as donor partners and education stakeholders. In order to prevent mismatch between the TVET graduates’ skills and labor market’s demand, it is essential that the TVET reform to be viewed and tackled within a comprehensive sector reform framework.

4.49. **The table below presents the prioritization of proposed reform actions in the education sector.**

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### Table 4.7: Prioritization of Education Sector Reform Actions

<table>
<thead>
<tr>
<th>Year</th>
<th>Programs</th>
<th>Education Reforms</th>
<th>Responsibility</th>
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</table>
| 2016 | Programs          | • Increase access to schools and classrooms, either through construction or provision of rental space at all levels, to reduce shifts in schools and increase instructional time. | Ministry of Education  
                                         |                                 | Ministry of Planning  
                                         |                                 | Ministry of Finance and Economy |
|      | Institutions      | • Establish Early Childhood Taskforce sub-committees in governorates                                                                                                                                             | Ministry of Education |
|      | Program           | • Disseminate the revised curriculum to all schools.                                                                                                                                                              | Ministry of Education |
|      | Program           | • Continue the teacher training programs for basic and elementary school levels                                                                                                                                   | Ministry of Education |
|      | Programs          | • Introduction of Arabic and English teaching for math and science teaching at the primary level                                                                                                                | Ministry of Education |
| 2017 | Programs          | • Improvement of school environment by introducing libraries, laboratories, extra curricular activities and technology use in the curriculum.                                                                 | Ministry of Education  
                                         |                                 | Ministry of Higher Education and Scientific Education |
|      | Programs          | • Improvement in basic facilities in most public schools, such as electricity and potable water                                                                                                                  | Ministry of Education  
                                         |                                 | Ministry of Electricity  
                                         |                                 | Ministry of Agriculture and Water Resources |
|      | Institutions      | • Development of teachers training programs at a newly established teachers training center (Professional Development Center) in Erbil.                                                                           | Ministry of Education  
                                         |                                 | Ministry of Higher Education and Scientific Research |
|      | Strategy          | • Quality assurance mechanism to be in place from Kindergarten to grade 12.                                                                                                                                       | Ministry of Education |
|      | Strategy          | • Student learning assessments at basic and secondary levels in preparation for participation in international assessments.                                                                                         | Ministry of Education |
| 2018 | Institutions      | • Establishment of independent TVET Governing Council to study local and international job market trends.                                                                                                       | Ministry of Labor and Social Affairs |
| 2016-2020 | Program | • Plan to build 9000 new classrooms                                                                                                                                                                           | Ministry of Education |

### C. Health Sector

4.50. *Despite improvements during the last decade, the health sector in the KRI is facing major challenges.* The influx of 1.8 million IDPs and Syrian refugees has placed an additional burden on the system, particularly in the areas where these populations are concentrated. All KRI residents are eligible for care that is nearly free of charge in public
hospitals and primary health care centers, but these hospitals and centers are often overwhelmed, fall below international norms for quality, and deliver services inefficiently. Almost all physicians work only a fraction (usually less than fifty percent) of the 30 hours per week they are contracted and paid for in the public sector before leaving for their private office practices (this is known as “dual practice”). Most primary care is delivered in a comprehensive network of primary health care centers (PHCs) which are located throughout the region. Basic preventive and curative services are not always provided due to insufficient numbers and qualifications of medical professionals, and absent or non-functional equipment (e.g., basic laboratory equipment; dental chair or x-ray machine for dentist). Although there are some very small co-pays for public sector health services, almost all health care is financed by the KRG budget.

4.51. **KRI witnessed improvements in health status as evidenced by achieved progress in infant and child mortality, immunization coverage and under five nutritional status, but concerted efforts are still required to maintain gains and realize further improvements.** Infant mortality was estimated at 28 deaths per 1,000 live births in the KRI in 2011, contrasting with the 32 deaths per 1,000 live births registered in overall Iraq. Similarly, child mortality averaged 32 deaths per 1,000 live births in the KRI, while the general child mortality rate for Iraq was estimated at 37 deaths per 1,000 live births. With respect to immunizations, around 47 percent of children in the KRI had received all recommended vaccines in 2006. This percentage increased to 64 percent by 2011. As to childhood nutrition, indicators for the percent of children under-five years in the KRI who suffer from under-weight, wasting and stunting are 7, 5, and 15 percent, respectively. The latter two indicators are comparable to figures for the rest of the country—but the prevalence of stunting in the central and southern regions of Iraq is significantly higher—around 25 percent of children under the age of five. Overall, stunting, as a measure of child nutrition, has declined faster in the KRI than the rest of Iraq.41

4.52. **KRI is going through a demographic and an epidemiological transition which is having an impact on the ability of the health sector to respond to changing and increasing health demands.** Such transition is typically characterized by decreasing birth and premature death rates, aging of the population, and transition from predominance of communicable, maternal and child diseases toward increased prevalence of non-communicable diseases. Non-communicable diseases such as cardiovascular diseases, malignancies, and kidney diseases are the main causes of mortality in the Region in need of targeted monitoring and prevention efforts. On a positive note, KRI residents can access public hospitals relatively quickly—on average only 19 minutes away. As with education, there is evidence of progress but much remains to be done to strengthen the health system and rebuild a cadre of trained health care and medical professionals. One of the most acute needs is for enhancing the professional training, stature and responsibilities of nurses (at all three levels of training) across the region.

4.53. **Health expenditure in the KRI followed a positive trend in the 2008 – 2011 period.** The increase in expenditure was over and above the inflation rate and the growth in

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population, resulting in a real increase in the per capita health expenditure. Recurrent per capita health expenditure in this period increased by 45 percent from US$76 to US$110.

4.54. **Public spending on health relative to total government spending in the KRI stands at 5.5 percent, which compares favorably to that of the national aggregate for Iraq.** According to the latest National Health Accounts (NHA) data for Iraq, public sector health spending out of the total public sector spending in 2008 was around 4.8 percent. In comparison, in the same year KRI recorded a 5.5 percent on health spending. These percentages are comparable to comparators in the MENA region but lower than levels in OECD countries. The available NHA data also indicates that total health spending as a percentage of GDP in the whole of the country was around 3.3 percent—and the per capita health spending level was US$137. Out of total health expenditures, 74 percent was from public sources and 25 percent from private sources, and 1 percent represents donor assistance.

4.55. **Health service delivery and health financing is mostly public with some private participation and investment.** Public sector services are administered by the Ministry of Health in Erbil which owns and operates a large network of primary and secondary health care facilities with no or nominal contributions paid by the households. These facilities are financed through general revenues and follow traditional line-item budgeting processes. The MoF&E approves an annual allocation for Ministry of Health services and all employees are salaried staff under civil service guidelines. Alongside the public sector, investment in private health facilities across the region is also present. These facilities are financed largely by direct out-of-pocket payments.

![Figure 4.9: Hospital Beds by Governorates and Public-Private Mix](image)

Source: Ministry of Planning KRSO, 2011.

4.56. **While the health workforce has been increasing, the sector still faces shortages in human resources and has not reached its targets.** For example, there are 0.7 physicians/1000 population compared to 2/1000 target; 0.1 dentist/1000 population compared to 0.5/1000 population target; and 1.1 nurses / 1000 population compared to 2/1000 population target. A 2012 RAND report found that growth rates and delivery
efficiency that by 2020 the KRI would need almost a 20 percent increase in physicians to maintain the present physician-to-population ratio.

4.57. The growing inflow of Syrian refugees and internally displaced Iraqis into the KRI in the 2012-2014 period has imposed substantial strains on the health sector. The convergence of a massive influx of IDPs and a protracted budget crisis in 2014, in particular, has tested the ability of the KRG to respond to the growing health needs of the refugee and IDP populations. This influx of refugees has resulted in resurgence of polio (after 14 years of polio free status) and other infectious diseases affecting the local population (e.g., leishmaniasis). While the KRG health system and health indicators are generally better than the rest of Iraq, sustainability of providing good quality health services for an increased population is beyond the KRG’s capacity. Contrary to expectations, recurrent health expenditures did not increase in response to the Syrian refugee nor IDP crises. Both have negatively impacted per capita health spending on the host community. The loss of these financial flows at a per capita level for the host community in the KRI has potential implications for overall health system performance, including equity and responsiveness of the system. While external donors have striven to support the KRG in managing the impact of these effects, a significant amount of financial resources is still required to restore stability to the health sector and to enable the KRI health authorities to cope with influx of the displaced and provide quality services for all KRI residents. In a World Bank assessment of the impact of the Syrian crisis on the health sector in KRG, results indicated that in a low influx scenario, the total stabilization cost for the October 2014 – December 2015 period adds to a little over US$339 million, which translates to nearly US$362 per refugee/IDP. Importantly, this stabilization cost is assumed to go on top of the expected annual health sector budgets of 2014 and 2015 had the budgetary crisis not occurred.

4.58. Since 2010, the Kurdistan Regional Government has been working closely with the RAND Corporation to help guide reform of the health care system in KRI. The RAND work assisted the Government assess and analyze key health sector issues, dialogue with health leaders on policy options and provided recommendations for phased implementation in multiple areas such as financing, primary care, and quality. Some of the key health sector challenges identified by RAND are the following:42

- Insufficient public spending on health to adequately meet the current demand for health care, especially with the increased influx of IDPs.
- Limited revenue generation due to low patient co-payment and contributions in the public sector.
- Lack of data and capacity at the Ministry of Health to implement financing reforms.
- Limited hospital management capacity, outdated facilities, and equipment.
- Inadequate and inefficient staffing.

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4.59. **Moving forward, in 2013, the Ministry of Planning prepared its 2020 development vision which addresses the challenges and articulates a vision for health sector focusing on the following key areas:** (i) adopting a sound health financing system centered on social health insurance, (ii) improving the availability and quality of clinical services, (iii) promoting preventive services, and (iv) improving public sector management, regulatory and policy capacity.

4.60. **Against this background, the agenda for health sector reform in the next few years has been prioritized by the MoH in the following key areas:**

- Strengthening primary health care including providing a basic package of essential services and increasing focus on preventive services. In May 2012 the Minister of Health defined this package of services for each level in the primary care system.
- Health financing reform aimed at moving from the current budget-based system to an accountable health service, as well as exploring the feasibility of moving towards social health insurance (SHI) system, supplemented by private insurance, along with an organizational structure to manage the system.
- Addressing the dual-practice phenomenon among physicians working in both the public and the private sector and revise provide payment based on pay-for-performance mechanisms.
- Strengthening the use of data for decision making through the expansion and use of the management information system to help guide management decisions aimed at improving quality of care.
- Improving the quality of health services and patient safety by pursuing international accreditation standards for health care facilities.
- Strengthening regulation and public private partnership: Instituting a policy framework for private sector participation in health financing/insurance and/or service delivery.

**D. HOSTING FORCIBLY DISPLACED PERSONS FROM SYRIA AND THE REST OF IRAQ**

4.61. **The Kurdistan Region currently hosts majority of Iraq’s internally displaced population.** Along with refugees from Syria, the KRI is hosting the internally displaced population that is large relative to the size of the hosting community and its economy by any measure. The KRG’s approach towards these forcibly displaced populations has been quite generous. Refugees from Syria, upon registration with UNHCR, become eligible to the right to residency and work. A similar policy is in place for IDPs. The majority of displaced persons live outside camps. The management of camps is gradually being handed over to government agencies such as the Erbil refugee council. There is no restriction on movements into and out of camps, and services to the camps (land, water, and electricity) are provided by the KRG. The Government’s High Committee of Needs Assessment faced this issue under the leadership of Ministry of Planning through Immediate Response Plan 1 and Immediate Response Plan 2 in 2014 and 2015. The Ministry then followed up programs with UN agencies to deal with these issues.
4.62. *The prolonged nature of the regional conflict and the large scale of the influx put pressure on Government to deliver public services.* The fiscal crisis is affecting the Government’s ability to provide basic services to the increased population. The KRG has not been able so far, leverage international support and assistance, to help address economic and social development issues linked to refugee and IDP influx. Supporting the government in making the case for greater international support will relieve some of the immense pressure on service delivery, and competition for jobs, housing, goods and services in a struggling economy.
5. **ACCOUNTABILITY**

5.1. *Institutional capacity and governance weaknesses are at the root of many of Region’s development challenges.* Therefore, establishing strong Public Financial Management institutions and systems is a necessary priority to enable governance and accountability. This is in line with the KRG’s 2020 Vision’s “Putting Government to Work for the People” pillar, particularly the components related to effectiveness of the government, budget administration and transparency reform.

5.2. *A first step is the development of a medium term macro-fiscal framework (MTFF) for the KRG,* based upon regularly updated assumptions of sustainable oil and other revenues. In due course, this could be developed into a simple top-down medium term expenditure framework (MTEF) which would provide the main spending agencies a more reliable picture of their resource envelopes over the medium term. A MTFF would also help the authorities better manage the reduction of arrears and, in due course when oil revenues improve, set aside resources for a Regional Stabilization Fund to cushion future volatility in oil prices or GoI transfers.

A. **PUBLIC FINANCIAL MANAGEMENT REFORM**

Restoring annual budgeting and accounting

5.3. *The foundation of a strong PFM system in any jurisdiction is ensuring that budget estimates are prepared regularly, submitted to the legislature for approval, reported and accounted for in a timely way, and published.* For various reasons—the need to put KRG on a war footing to counter the encroachments of the ISIS, the breakdown in the traditional system of revenue transfers from Baghdad along with central approval of spending plans, the collapse of oil prices, and other political factors—the KRG has not had a published annual budget for the past three years. Instead of spending against legally appropriated budget heads, the KRG has operated, in effect, a non-transparent cash release budget system, in which arrears in some areas (such as the wage bill and payments to suppliers and contractors) have been allowed to accumulate, to free cash for urgent security related spending. On the revenue side, oil exports have been sold forward, and it is unclear how proceeds have been banked and accounted for. Formal budgeting rules have, in effect, been set aside, and informal PFM practices have proliferated. When, for an extended period, there is no annually approved budget, everything becomes off-budget and control systems break down.

5.4. *The first step for KRG is re-establishing annual budgets and accounts, based upon the authorization of spending,* in the sectors for which the KRG has constitutional responsibility, by the Kurdistan Regional Legislature. In the short run, this likely means renewed emphasis to the existing Iraq budget laws and regulations, in the longer term, it will be necessary to review and revise the existing legal framework to make it consistent with the special status of the KRG. In the latter context, there is a need to align the legal framework for PFM with current country-wide moves to decentralize spending responsibility to sub-regional levels of government (as anticipated in the Vision document
and provided for in recent GoI laws), together with a system of fiscal transfers from the KRG central budget, and greater revenue raising powers for governorates and districts.

**Budget preparation and execution**

5.5. *Once the basic discipline of annual budgeting has been re-established, attention can be paid to improving the quality of budgets.* Strengthening the planning tools of the budget is essential to enhance its credibility and effectiveness. At present, there is no systematic process for aligning sector expenditures with strategic priorities. Budget requests do not appear to reliably reflect strategic priorities within sectors, or more broadly across sectors. The lack of budget predictability makes it difficult for ministries to effectively plan and implement programs that are policy based rather than unconnected projects.

5.6. *Budgetary tools for monitoring spending need to be strengthened.* At present, in the absence of regular approved and published budgets, information sharing from the MoFE with line ministries is not systematic and these ministries often lack reliable data on the availability of funds and therefore cannot commit expenditures in a timely fashion. With no published annual budget, consequential factors affecting budget execution in the KRG include: low credibility, lack of transparency, accountability and predictability, weak reporting, no monitoring and evaluation processes, and upstream and downstream constraints on capital and recurrent expenditures. No Treasury Single Account (TSA) is in place at either the national or the local governmental levels. Cash management is required to ensure that the government has sufficient cash available to meet its financial obligations as they fall due, and to invest temporary surpluses to generate interest income. There is no mechanism in place to sweep/reverse sweep overnight balances held by budget units in various government bank accounts into a main TSA. The bank accounts of the Government ministries and agencies are currently maintained with state-owned banks (Dasemya previously called Al Rafedain, and Sarhldan previously called Al Rasheed) and used to receive MoFE cash releases and to make payments for budget expenditures.

5.7. *To monitor arrears and commitments, a system needs to be put in place.* Currently, an effective system of commitment control and reporting does not exist, which is important to control arrears. There is an urgent need to implement a system of commitment control and reporting that will enable the MoFE to monitor commitments made by spending units. In turn, this is dependent on regular annual budgets approved by the KRI legislature, without which a commitment control system cannot function.

**Accounting and reporting**

5.8. *KRG needs better accounting and better reporting, which provide the information necessary for improved decision-making and for accountability, which in turn will lead to more effective use of public resources.* Public sector entities and their stakeholders need to understand the full, long-term economic impact of their decisions on financial performance, financial position and cash flows. This context creates a direct challenge to governments to improve management of resources and report high-quality information to their stakeholders (i.e., citizens, parliament, donors, investors and financial markets). There
is an urgent need to enhance the quality of accounting and financial reporting in KRG. Therefore, a gap analysis of financial statements against, in the first instance, existing Iraq PFM laws and regulations, and, after that, international reporting standards is warranted. The main objective of this gap analysis would be to help implement more effective public financial management in KRG through better quality accounting and financial reporting. This gap analysis would attempt to compare the prevailing government accounting in KRG with both national and international standards to identify the specific differences so as to charter a transition path for adoption in the future. This diagnostic tool for gap analysis could later be used by all stakeholders for any further research or decision on harmonization of government accounting system in KRG with international standards. This will entail benchmarking financial reporting and auditing practices in KRG, their regulatory framework, and accountancy professional development, against international standards and practices. Having qualified, competent and experienced accounting and auditing professionals would also be a key element in supporting MoFE and line ministries. Therefore, the general accountancy development would be needed together with a specific accounting training plan and identified areas of improvements that would effectively benefit the KRG context. Related to this is a need to look at accounting systems, the extent to which they are automated and coordinated with the development of an IFMIS for the GoI as a whole.

5.9. There is an urgent need to develop a well-designed CoA with comprehensive and consistent segments notably for economic and functional classification. The system of classifications of government transactions has to fulfill several critical functions, including assessment of the economic impact of these transactions, policy formulation, resource allocation, performance management, and accountability. This should be facilitated through the development of a comprehensive Chart of Account (CoA) with specific and distinct segments to allow these multiple purposes, before moving forward in the Integrated Financial Management Information System (IFMIS) and program budgeting reforms. The main segments of a modern CoA are economic, administrative, and functional. Additional segments are added according to specific needs (i.e., programs, geographic, and source of funding). Traditionally, budget preparation has been essentially a yearly incremental and bottom-up exercise. The current budget classification framework contains weaknesses and does not allow deriving directly the main and common analytical measures of fiscal policy which leads to reducing comprehensiveness and consistency of the analytical framework.

Internal controls and internal audit

5.10. For the internal controls to be effective in KRG, procedures should be clear, predictable and standardized. Oversight and internal controls are carried out within each spending unit by internal auditors. A recent assessment of internal financial control function was conducted by an international consultancy firm financed under the World Bank-funded Public Financial Management Reform Project achieved in August 2013 at the federal level in Baghdad. Owing to the fact that KRG internal control systems are built on the same structure of procedures as at the federal level, the recommendations of this study are pertinent. The assessment reported a need for the development of a holistic public internal control strategy across the entire public administration to establish complimentary
roles for the various control-related institutions and activities and to reflect the objectives of this strategy in primary and secondary legislation.

5.11. **The internal audit function, which is also a vital part of a PFM system and core to a country’s accountably framework, is not functional and appears to be fragmented and quite ineffective.** The current scope of internal audit function is similar to that of a financial controller, where ex-ante verification is performed by the internal audit department before payment is made to the beneficiaries. There is little or no internal audit focused on systems monitoring. The verification covers all expenditures, including salaries earned centrally in the respective ministries. The internal audit function is almost exclusively restricted to the compliance and regularity of transactions. Internal auditors do not produce a regular report highlighting the findings and conclusions during the period of review or the identified issues and risks except when they are requested specifically to provide assurance on certain issues. In the first instance, the non-functioning of internal control systems in the KRG is likely due to weakness in system design and staff capacities. However, other experiences show that internal control systems languish where there is absence of demand for timely and relevant internal audit reports. This in turn is a product of weak overall accountability for efficient and effective use of public resources. The Vision goal of a modern KRG PFM system points to a need to look at the incentives of senior managers and the overall ethics of stewardship of public resources in the KRG. And the starting point for strengthening internal control and audit is a published and comprehensive budget.

**B. PUBLIC INVESTMENT MANAGEMENT**

5.12. **Public investment can be an important catalyst for economic growth, but the benefit of additional investment depends crucially on its efficiency.** With regard to public investment, the KRG, through its Ministry of Planning, has developed its Kurdistan Development Management System (KDMS) which when fully functional will provide an online mechanism for submitting, reviewing, approving and/or rejecting project requests submitted by different bodies such as Ministries and Governorates. The KDMS will facilitate fast, harmonized, and transparent processing of requests, but also effective coordination of efforts among different stakeholders, and efficient tracking and monitoring of all development activities within the KRI. In this way, mainstreaming the KDMS will go a long way toward achieving the Vision goal of matching investment budget spending to KRI priorities in a cost effective way.

5.13. **Despite significant progresses made by KRG in a recent past with regard to the strengthening of its Public Investment Management (PIM) system, there are a few remaining issues to be tackled from now:** 1) Inconsistent/informal planning with line ministries: While most factors (such as the need by the population, and feasibility of the project) are taken into consideration when submitting projects to the KRG MoP, the process often is not formal nor consistent; 2) Limited information to inform project selection: To be able to conduct appropriate project selection, the MoP requires sufficient information on project costs and potential benefits, and to ensure they are consistent with the policies the KRG has adopted for the sector in question. However, historically the line
ministries have provided only limited information to the MoP, and that information was often inconsistent and incomplete; 3) Low execution rate: In recent years, the execution rate for public investment projects in KRG has remained low. The four-year average of execution rate was 36 percent in 2009 - 2013; and 4) Low levels of ex-ante and ex-post evaluation: Effective pre-project appraisal and post-project assessment can help ensure projects are designed and implemented effectively. However, there is relatively little evaluative information collected on capital investment projects in the KRI. Also, there is very little ex-post evaluation conducted in the region. The General Directorate of Capital Investment Projects has developed a strategy to address the above mentioned challenges and has prepared a roadmap for implementation that needs to be redefined based on the following key objectives.

5.14. **The proposed PIM Roadmap for KRG covers the following phases:**

- **PIM/PPP Framework:** The objective is to establish a public investment/PPP decision process to cover project prioritization (based on cost-benefit analysis and expenditure efficiency), financing modalities (e.g., on budget or through PPPs) and continuous monitoring of the fiscal affordability of all projects. In order to move forward on improved public investment/PPP framework, strong collaboration between MoP and MoFE will be considered as highly critical. The adoption of a formal system of public investment/PPP project appraisal will provide the basis and conditions for KRG to forward only those initiatives that are demonstrably the most economically and socially attractive for society. Such a system would allow for the transformation of “investment ideas” into “public investment/PPP projects,” and, afterwards, into “public investment/PPP decisions.” This kind of system would be designed to put projects through the project life cycle, starting with the identification of a project idea, concept, and ending with the final handover to operations and the ex-post evaluation stage.

- **3-Year PIM Action Plan:** The main objective will be to strengthen the existing KRG PIM System (PIMS) as a comprehensive set of concepts, techniques, standards and methodological procedures, and as a uniform information and document depository and management system for the formulation, preparation and evaluation of projects. This action plan will be implemented in line with five preliminary recommendations, namely:

  - **First, develop and apply agreed criteria for deciding on KRG’s pipeline of investment projects.** The initial action will be browsing through the KRG portfolio of projects in order to make investment decisions. This action will focus on completing the best projects rather than initiating new ones and on ensuring funding for recurring subsequent costs (operation and maintenance). At the same time, the KRG MoP and MoFE will review all projects that are not disbursing in order to identify implementation bottlenecks, address them, or reallocate funding elsewhere if the project is deemed irredeemably stalled. Based on integrated cost-benefit analysis of projects, a PIM working group will then prioritize those projects that are not yet included in the updated “Building the Kurdistan Region of Iraq / The Socio-Economic Infrastructure” (2012 SEINA).
Second, improve capital project design, appraisal, selection and budgeting. This action would be aimed at ensuring the use of standard criteria in project screening. To improve the procedures for capital project design, integrated project appraisal, selection and budgeting, it would be recommended that general technical guidance for ex-ante evaluation be developed based on a multi-phase evaluation process. A comprehensive Handbook for Economic Appraisal of Public Investment Projects will be developed for the design, costing and integrated evaluation of public investment projects with the inclusion of applied case studies.

Third, use specific sector guidelines and templates to build a framework for the design of projects, from their appraisal to their selection and inclusion in the budget. This action would involve strengthening strategic planning across the Government and especially in those sectors responsible for large public infrastructure. It would be recommended that a variety of project appraisal methodologies be drafted as soon as possible, including guidelines, instructions and templates. Among other things, it would be recommended that specific methodologies for Economic Appraisal of Public Investment Projects be developed in some key sectors.

Fourth, improve implementation and monitoring of public investment/PPP projects. The objective of monitoring and ex-post evaluation would be to determine the efficiency and efficacy of investment initiatives through a feedback structure with management controls and measurements of the short, medium and long-term results of projects. The PIM working group will monitor closely the performance of public investments and report its findings to the Parliament.

Fifth, develop capacity building and training. The implementation of a fully functioning PIMS would require skilled staff and training of existing civil servants. It is unlikely that these changes can happen contemporaneously across all line ministries, and other public agencies, and as a consequence, decisions would have to be taken about which sectors to focus on first.

5.15. The strengthening of the PIM system is conducted in KRI and the rest of Iraq which will bring significant benefits to the whole country. It is expected joint capacity building training courses for government officials from federal and regional levels will be organized in 2017, and an Integrated Bank of Projects will be established in 2018. The proposed short-term and medium-term PIM system actions are summarized in Figure.
5.16. In addition, the development of a MTFF (and in due course a MTEF) will help planners manage the size of the PIP in the coming years, by reference to the likely availability of total budget resources, and the need to have sustainable balance between investment, the wage bill and other categories of spending. Furthermore, in reviewing the existing stock of projects which have started but have now stalled for lack of funds, it may be necessary to perform triage, permanently cancelling projects where justification is weak, costs have escalated to unreasonable levels, or design is fundamentally compromised.

C. PROCUREMENT REFORM

5.17. Public procurement is pivotal to public trust in governance and is considered to be one of the barometers for the quality of public administration, making it a priority reform area for KRG. Public procurement is a key aspect of public administration that links the public financial system with social and economic outcomes, and as such is a major determinant of the quality of community services and infrastructure, and the effectiveness of the government. This function cuts across almost all areas of planning, program management, and budgeting. Weaknesses in public sector procurement remain a significant barrier to sustainable development in many countries as it invariably reduces development outcomes and lead to high cost of doing business that, in turn, deter rapid private sector development as well. Various studies show that government procurement accounts for a substantial proportion of Gross Domestic Product (15-20 percent or more in most countries).\(^{43}\) In developing countries, public procurement in one form or another accounts

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\(^{43}\) Government Procurement at GATT/WTO: 25 Years of Plurilateral Framework by Margaret Liang, 2007.
for 40-50 percent of government expenditure.\textsuperscript{44} Prior to the fiscal crisis, KRG had a large procurement level. In 2013, Iraq approved a US$120 billion budget and around US$10 billion of supplementary budget. Government spending of US$52 billion was under public procurement and KRG’s share was around US$9 billion. This figure is a rough proxy for the magnitude of public procurement in the Kurdistan Region before the crisis.

5.18. \textit{Civil society’s increasing demand for greater results and a more efficient public service delivery can be met through procurement reforms.} Strengthening procurement systems and utilizing modern tools such as PPP, are increasingly viewed as one of the most significant priorities in many countries for delivering services, improving the investment climate, and facilitating private sector-led economic growth. It has been recognized by the OECD (2007)\textsuperscript{45} that “public procurement is the government activity most vulnerable to waste, fraud and corruption due to its complexity, the size of the financial flows it generates and the close interaction between the public and the private sectors.”

5.19. \textit{Public procurement continues to remain as one of the most problematic areas for overall Iraq including the KRG.} This is constantly criticized by local citizens and international organizations. However, on a positive note, some positive developments has been undertaken by the federal government such as: i) Standard Bidding Documents (SBDs) has been developed, piloted and disseminated, to be mandated in July 2016; ii) implementation manual has been prepared and published on the Ministry’s website; iii) training strategy was prepared, and in collaboration with universities training programs started to build capacity of procurement professionals. In parallel; other positive developments in the Kurdistan Region took place in line with KRG Vision 2020 of ‘effective, transparent, trusted and honest government.’ KRG MoP launched in March 2013 a self-assessment of public procurement, followed by extensive stakeholder consultations. Figure 5.2 presents the self-assessment, conducted by the Inter-Ministerial Committee (IMC) with the support of the World Bank, confirmed existence of major weaknesses along the four pillars (left) and the associated 12 indicators (right graph) of OECD-DAC WB assessment tool. To address those weaknesses, a clear need for modernizing the public procurement system was identified.


\textsuperscript{45} www.oecd.org/document/5/0,3343,en_2649_34135_41883909_1_1_1_1,00.html
5.20. **The Government is taking steps to reform the procurement system.** The self-assessment exercise and stakeholder consultation led to MoP adopting a comprehensive and multi-faceted reform program, one that would reflect positively on the performance of the government function in all sectors. The future of public procurement system in KRG as a vision by the IMC led by MoP can be summarized in Figure 5.3 below.

**Figure 5.3: The Future Public Procurement in Kurdistan Region**

5.21. **The Government has a clear plan to reform the public procurement system on the way forward.** The KRG adopted revisions of public procurement legal framework by issuing of consolidated and modern Public Procurement Regulations in February 2016 which is expected to become effective in July 2016. Other positive steps taken by the Government in this regards include: i) completion of readiness assessment and
development of a roadmap for e-procurement, and ii) development of draft SBDs for construction works, pre-qualification, goods and consultancy services. As a minimum, the following actions are envisioned to continue with the reform of public procurement system in the region:

- Finalizing and mandating the SBDs to improve transparency and accountability in the mobilization and use of public resources;
- Finalizing and enacting the annex of procurement regulation in “procurement under public private partnership;”
- Finalizing and issuing of the explanatory notes on the new procurement regulations;
- Building the capacity of public and private sectors on the new regulations and use of SBDs; and
- Further enhancing the transparency in public procurement through preparation for a phased approach e-procurement system starting with the establishment of a Single Portal Website and Information System.

5.22. The top priority of the policy recommendations would be to ensure the proper implementation of the newly enacted procurement regulation in 2016. The implementation of the new public procurement regulations will be done through (i) strengthening the policy unit functions and resources; (ii) establishing a complaint mechanism system; (iii) finalizing and issuing of the explanatory notes on the new procurement regulations; and (iv) issuing the Doing Business with KRG under the new procurement regulations, and developing a toolkit for the private sector companies. The World Bank will continue its support to modernize and reform public procurement system in Iraq, including the Kurdistan Region, under the new loan of Public Financial management (PFM) Institutional Development and Capacity Building Project. The new PFM project will support the transition and proper implementation of the new legal framework as well as enhance transparency and modernize the public procurement system in the Kurdistan Region.

D. Audit Reform

5.23. The KRG Board of Supreme Audit (BSA) is assessed to be underdeveloped and underperforming and in urgent need for a long-term capacity building program.46 Supreme audit institutions are the lead public sector audit organization and one of the key players in the public governance system. By ensuring that money is well spent, these audit institutions can contribute to national development and the fight to reduce poverty. The KRG BSA provides overall guidance for maintaining a system of internal controls and conducts the external audits after the implementation of the budget. There is an urgent need to modernize KRG external audit practices of the BSA that faces a number of challenges. One of the main challenges is the ineffective institutional structure because of the existence of two BSA structures: one in Erbil covering Dohuk and Erbil Governorates, which is mandated to audit MoFE's reports; and the second structure in Sulaymaniyah, which only covers the Governorate of Sulaymaniyah. There is a need to upgrade BSA’s auditing

practices in order to meet sound international standards. It is critical to improve the level of collaboration with BSA Baghdad and exchange of expertise, which would improve the external audit function in the whole country. Also BSA is advised to move forward with twinning arrangements with regional and international auditing institutions to help building its capacity and knowledge of regional and external experiences. Furthermore, staff capacity requires enhancement.

5.24. **In order to modernize the KRG BSA external audit practices, significant reforms are required.** These reforms include: i) enhancing the legal and institutional framework, its link to the parliament, the legislatures, and the executive (Government and its administration authorities) to ensure strong, independent, and effective audit institute and limit opportunities for inappropriate interference in the organization’s work; ii) improving KRG BSA governance structure and organization to enable the institutions to meet all of its mandates in efficient and effective manner; iii) gradually implementing international standards of financial, compliance, and performance audit with related audit methodologies; and iv) providing capacity building for staff at all levels. It is also necessary for the KRG MoFE to follow up on BSA findings, and ensure that remedial action is taken.
6. INSTITUTIONAL FRAMEWORK AND JUDICIAL OVERSIGHT

6.1 Institutional development and governance are the key drivers of growth by providing incentives to accumulate physical and human capital. Indeed business transactions take place under the institutional framework that establishes the rules of the game. If rules are not implemented properly and interest groups capture the enforcement capacity of the state, incentives for rent seeking, not production, are created, resulting in poor productivity and a low standard of living. There must be institutions that can provide checks and balances for the players in the economy, both public and private which requires a functional and independent judicial system.

6.2 The importance of an enabling environment where entrepreneurial activity is rewarded cannot be overemphasized. In fact, in all modern market economies the fundamental mechanism that drives growth is massive ongoing restructuring; the main issue is ensuring that the institutional environment can support such a process. If this process is continuous, then TFP will be high, and living standards can be improved on a sustained basis. In poorly governed societies, productivity is miserably low. This is an economy-wide issue, and the Government will maximize its efforts to create the conditions for market institutions and improve governance, which is a prerequisite for new investment.

6.3 International experience shows that sustaining economic growth is much more difficult than starting it and that sustained growth depends on institutional reforms. Institutional reforms need to be seen from a broad perspective of governance affecting the entire economic system and hence economic growth. Major policy reforms and evolving legal framework of KRI are very much part of this process of institution building. As shown by the experience of successfully developing middle income economies, the full effectiveness of first generation reforms, such as, privatization, and other sectoral reforms depends on parallel institutional reforms, such as legal and judiciary, property rights, and rule of law. Experience has also shown that there are a variety of institutional arrangements and there is no simple universal way to transform first-order economic principles into unique policy packages. This process tends to be context-specific and is heavily influenced by a given country’s political institutions, and other mechanisms which resolve conflict of interest among various groups, and ultimately by political power. In addition to determining growth potential, economic institutions have an impact on other important factors, including the distribution of resources in the future. Hence, economic institutions influence the size of the pie, the national income, as well as the division of pie among different groups and persons in a given country.

6.4 KRG has been adopting laws and regulations to support the development of foundations of market institutions and much of its economic performance over the long

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47 See recent work as reviewed by Jones and Vollrath (2013) and Acemoglu (2009) corroborate Levine and Renelt findings and ask the question: what determines the accumulation of capital, investment, and the accumulation of human capital education or skill acquisition?
term will depend on developing these effectively. Turning to specific market—sustaining economic and political institutions—which are likely emerge out of the interactive process described above over time, the following taxonomy could guide the discussion and give an account how far KRG has come along and needs to go along these dimensions of institutional development. In fact, relatively speaking, KRG has been having a stable government and enjoying political stability in the past few years and hence it can push for institutional development policies as presented in Figure 6.1.

Figure 6.1: Institutional Development and Productivity Increase

6.5 Recently created oil fund supports institutional development and if properly designed it could also be an effective economic management tool. In early April 2015, KRG enacted the Oil and Gas Revenue Fund which authorized the Cabinet of Ministers to establish a Board with the objective of providing transparent public reporting of earnings from exports, refined products, and oil company bonuses within the framework of the KRG’s oil and gas contracts, the Kurdistan Oil and Gas Law no 22 of 2007 and the Iraq Constitution of 2005. Within this framework, oil earnings may be allocated for five different areas; (i) KRI’s annual budget; (ii) capital spending; (iii) oil infrastructure; (iv) environmental protection; and (v) a “future generation’s” wealth fund. The Fund will be audited according to international standards. At the same time it is important, to ensure that utilization of the Fund is within the framework of MTFF and avoid fragmentation of sources of spending.

6.6 Enhancing competition and new business creation is part of institutional development. Even if all productive assets are held privately, an absence of competitive markets impedes resource allocation and interferes with the use of resources in the most
productive ways. For this reason, monopolies and uncompetitive behavior need to be monitored. KRG will adopt appropriate regulations to deal with these factors so that incumbents in the market do not block the entry of businesses. Simultaneously, the Government will nurture the creation of new businesses to increase competition as well as output. KRI has inherited a legal framework that is based on Iraqi socialist system and there is a need for major reforms in this area. Regulatory policies are key determinants of short to medium term growth. The World Bank’s 2015 Doing Business Report provides a cross-country analysis of regulatory policies and best practices are labeled as “the frontiers” and this can provide guidance to the KRG economic policymakers.
7. IMPLEMENTATION MODALITIES

7.1 **KRG will implement the economic reform roadmap through an inclusive and inter-ministerial process in participation of all stakeholders.** The implementation will be overseen by Ministry of Planning with close partnership from the Prime Minister’s Office. The reform actions will be conducted and delivered by assigned Government officials from line ministries under the leadership of senior KRG officials. Given this reform roadmap’s all-encompassing aims, the KRG’s Council of Ministers (COM) will retain overall authority for overseeing and coordinating participation and action from the ministries and Government offices involved, and the Secretary of the Steering Committee will track progress. Rather than the entire COM, the KRG could consider including only those ministers who will be responsible for implementing this roadmap. Because of the all-encompassing nature of the roadmap, such a subset is likely to include most ministers.

7.2 **During the process, consultations with relevant Government offices, private sector representatives, civil society members, and other stakeholders will be conducted.** Consultations and focus group meetings will be carried out with these groups at all stages of the roadmap implementation. Task forces will be created for each reform sector composed of relevant Government officials and international partners. The reforms actions will be implemented in partnership with international organizations. In the medium-to long-term, reforms will be delivered by the Government in collaboration with development partners, in selected areas, through a combination of various tools including technical assistance, capacity building, analytical work, knowledge sharing, and project financing.
7.3 **For economic and social development of the KRI, this economic reform roadmap will represent Government’s umbrella roadmap combining input from all groups in the Government.** The steering committee and task forces would engage the Council of Ministers when appropriate.

7.4 **To operationalize Government’s reforms, a coordination structure will be put in place to facilitate implementation of economic reform actions.** This will help development partners to interact with public and private sector counterparts for the purpose of supporting specific actions in various sectors. The Government will develop a mechanism with a coordination structure presented below. Task forces and special committees will report implementation progress to the steering committee, and the steering committee will brief the executive authority through the Secretary. The steering committee will meet on the relevancy of the topic. Each task force will prepare a detailed terms of reference presenting how specific reforms will be implemented and in what timeframe. A budget will be made available to the Secretary for overseeing the implementation of the roadmap.

**COORDINATION STRUCTURE**

Executive Authority
KRG Prime Minister and Deputy Prime Minister

↑

Council of Ministers
Cabinet Ministers meetings facilitated by a Secretary

↑

Task Forces and Special Committees
Composed of implementation teams from public/private sectors and IFIs

The modalities of engagement will entail six components:

1. Provide support and guidance to task forces to implement reform actions.
2. Technical assistance for implementation to government line ministries.
3. Analytical work: Additional targeted analytical work in identified reform areas.
4. Investment and infrastructure projects: The implementation of the investment projects in some sectors such as ICT; transport, customs and logistics; and energy would
translate into investment projects to be funded by the WB, IFC, the private sector and other development partners.

5. Advocacy with non-government stakeholders including private sector and development partners. The objective is to contribute to building support and partnerships in reform areas through regular meetings with key stakeholders.

6. A communication strategy will be developed to generate greater awareness and understanding of the need for economic reforms. All steps of reform will involve communication with different stakeholders:

- Internal Communication.
- External Communication.
- Communications tools and products: Multiple communication tools will be utilized, including print (Kurdish, Arabic, English), radio, visual and social media.
<table>
<thead>
<tr>
<th>Main policy area</th>
<th>What is the issue? (i.e., a stated fact on an issue affecting the economy)</th>
<th>What is the constraint? (i.e., a policy related problem that needs to be addressed)</th>
<th>What actions Government has taken so far to remove the constraint?</th>
<th>What more needs to be done?</th>
<th>Priority level</th>
<th>Responsible ministry or agency</th>
<th>Potential international partner and technical assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. FISCAL CONSOLIDATION</td>
<td>Civil service and wage bill reform</td>
<td>Moving away from public sector employment</td>
<td>The size of the public sector workforce is unsustainable. Many public sector employees do not have adequate training or skills appropriate for the private sector. Productivity is low and performance incentives weak. A significant public sector pay premium exists which discourages searching for private sector jobs.</td>
<td>Public sector employment has been reviewed.</td>
<td>Establish a high-level authority under PM to set and launch a Civil Service Reform Program (CSRP). Create a KRG Public Service Commission to monitor implementation. Functional reviews of mandates, organization and staffing of main Ministries Departments and Agencies (MDAs). Address the re-sizing of employment across Ministries and entities, including the state-owned enterprises. Improve the public sector employment selection criteria, recruitment and promotion systems, and dismissal procedures. Equitable separation for redundancies, Voluntary Retirement Scheme (VRS) for staff choosing to leave.</td>
<td>High priority (June 2016 – December 2019)</td>
<td>Ministry of Planning Ministry of Finance and Economy Ministry of Labor and Social Affairs Office of the Prime Minister</td>
</tr>
<tr>
<td>Issue</td>
<td>Description</td>
<td>Action</td>
<td>Responsible Party</td>
<td>Timeframe</td>
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<tr>
<td>Excessive public sector salaries and wages</td>
<td>The wage bill, including pensions consume about 70 percent of the KRG budget.</td>
<td>The Government has taken austerity measures on wage bill.</td>
<td>High priority (June 2016 – December 2019)</td>
<td>Ministry of Planning, Ministry of Finance and Economy, World Bank Group, RAND</td>
<td></td>
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</tr>
<tr>
<td>Policy reform development is lagging</td>
<td>The Government has taken austerity measures on wage bill.</td>
<td>Develop a time-bound action plan. Address the issue of “ghost workers.”</td>
<td>November 2016 – November 2018</td>
<td>Ministry of Planning</td>
<td></td>
<td></td>
<td></td>
</tr>
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<td>Ministry of Planning, Ministry of Finance and Economy, World Bank Group, RAND</td>
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</table>

**State-owned enterprises reform**

<table>
<thead>
<tr>
<th>Issue</th>
<th>Description</th>
<th>Action</th>
<th>Responsible Party</th>
<th>Timeframe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improving the efficiency and financial viability of state enterprises is crucial for fiscal sustainability</td>
<td>The reform will review delivery prices and costs, ensuring the cost recovery in the provision of goods and services.</td>
<td>The reform will include reviewing of the size of employment, accountability in the delivery of products and services, and accountability in the management staff.</td>
<td>November 2016 – November 2018</td>
<td>Cabinet Ministry of Planning</td>
</tr>
<tr>
<td>Management of public enterprises</td>
<td>Public sector governance and financial management framework deficiencies</td>
<td>No action</td>
<td>November 2016 – November 2018</td>
<td>Ministry of Planning</td>
</tr>
</tbody>
</table>

**Subsidies and social benefits reform**
| Electricity tariff reform | Insufficient cost recovery. Electricity tariffs cover only 15 percent of generation costs. | Lack of adequate institutional and legal frameworks to advance a tariff reform. | The Government has requested the World Bank to commission a cost of service and tariff design study. | Review subsidies and estimate their fiscal cost as part of fiscal management reforms. Increase power tariffs while providing a safety net for poor consumers. Set-up an independent power regulator who would be responsible for periodic revision of tariffs among other issues. Enact an institutional and legal framework that enables a smooth tariff reform, while improving the quality of services and protecting the poor. Introduce smart-meters and energy accountability systems. Implement private sector franchisee models for curbing losses and improving collections. Launch a communication campaign to encourage consumers to refrain from theft and pay bills in time. | June 2016 – December 2019 | Ministry of Electricity Ministry of Finance and Economy | World Bank Group |
| Agriculture sector: wheat program | Very costly subsidy, equivalent to (more than) twice the world price of wheat. They “crowd out” investment and productive activities associated with high value crops, such as fruits and vegetables. They are not fiscally sustainable in the current environment | The Government purchased wheat but has made partial payments for the 2014 crop and no payments for the 2015 crop. | Make payments to farmers for wheat purchases already made under the posted price arrangements. Gradually phase out wheat subsidies. Ex-ante assessment of the possible welfare impact on households below or close to the poverty line. | High priority (June 2016) | Ministry of Planning |
### Agriculture sector: input subsidies

| There are various input subsidies (e.g., fertilizers, seeds, chemicals, and fuel). | Not fiscally sustainable in the current environment. They misallocate resources by using more of the item that is subsidized. | Eliminate all input subsidies. Ex-ante assessment of the possible welfare impact on households below or close to the poverty line. | High priority (August 2016) | Ministry of Agriculture and Water Resources |

### Start moving away from universal subsidy systems as the main social support for the poor.

| The cost of subsidies on petroleum products and electricity sector is high. | The most vulnerable social groups should be targeted. | Ex-ante assessment of the possible welfare impact on households below or close to the poverty line. | High priority (August 2016) | Cabinet Ministry of Finance and Economy Ministry of Labor and Social Affairs World Bank Group RAND |

| Social transfers will ensure that they target the most vulnerable groups such as those covered by the food program and other social benefits. | The most vulnerable social groups should be targeted. | Implementation of alternative targeting methods (geographic, PMT, community) to identify beneficiaries eligible for social transfers; Unified registry in the medium- to long-term. | High priority (August 2016) | Ministry of Planning Ministry of Labor and Social Affairs World Bank Group |

### Increased fiscal savings from pension reform

| Pension spending has a high share in the budget | There is a need reduce inefficient Government spending. | Government current spending on pensions will be rationalized and tax compliance strengthened. | High priority (August 2016) | Ministry of Planning Ministry of Finance and Economy World Bank Group RAND |

### Revenue generation measures

| Tax revenue | Low level of tax revenue in KRI (2.6 percent of GDP) is the result of a combination of (a) low rates, (b) low compliance because of widespread informalities in the economy, and (c) low enforcement. This causes dependence on oil export proceeds and volatility of government revenues. | Review the rate structure and composition of taxes to determine the appropriate tax system for KRI. Raise the tax rates. Strengthen controls to reduce informality and improve compliance. Set up a well-staffed taxation unit that is capable of managing the tax system and | High priority. Start in July 2016. | Ministry of Finance and Economy CIDA RAND |
enforcing the tax laws effectively. The current system of presumptive taxation is appropriate at this time. Develop a modern tax system for the longer-term that introduces self-assessment, initially for large tax payers, and other taxes such as sales tax, and VAT.

| Tax administration | Low tax compliance and limited enforcement promote informal activity among formal firms and restrict the tax base. | Lack of agency information exchange that affects cross-checking of valid income reporting; limited enforcement tools; high rate of cash transactions. | Created a highly limited tax enforcement agency. | Arrive information systems to allow relevant cross-checking of firms’ income and employment, and establish appropriate enforcement mechanisms. | High priority. Start in July 2016. | Ministry of Finance and Economy | CIDA |
| Civic participation | Government needs willing participation of the private sector in the tax and regulatory system in order to implement a pro-growth policy. | The private sector needs confidence measures from Government to be convinced that participation in the tax system is worthwhile. | Government strives for accountability despite political competition between parties within the central government. | Launch the kind of public-private dialogue that can yield a broad-based and constructive agreement on better public services and higher private compliance with formal systems. | January — December 2017 | Ministry of Planning Ministry of Finance and Economy | World Bank Group |

### 2. STRUCTURAL REFORMS TO LAY THE FOUNDATIONS FOR SUSTAINABLE AND INCLUSIVE GROWTH

**Financial sector reform**

| Banking sector liquidity | Banks have no cash to perform banking activities and support KRI’s real sector of economy | Deposits of banks with the CBI branches in Erbil and Sulaymaniyah have been frozen by KRG | None | Unfreeze banks’ deposits at the CBI branches in Erbil and Sulaymaniyah | High priority (December 2016) | Central Bank (Erbil and Sulaymaniyah branches) KRG Ministry of Finance and Economy | None | Enable the CBI branches in Erbil and Sulaymaniyah to cash KRG-issued checks | January 2017 | Central Bank |
### Banking sector regulation

<table>
<thead>
<tr>
<th>Issue</th>
<th>Action</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBI branches in Erbil and Sulaymaniyah have been cut off from the Central Bank and operate under the control by the KRG MoFE</td>
<td>De-link CBI branches in Erbil and Sulaymaniyah from the KRG Ministry of Finance and make them operate under the Central Bank</td>
<td>September 2016</td>
</tr>
<tr>
<td>State-owned banks in KRI are managed by the KRG MoFE and operate without a license from the Central Bank</td>
<td>Make state-owned banks in KRI licensed by the Central Bank and subject to Central Bank regulation and supervision</td>
<td>October 2016</td>
</tr>
</tbody>
</table>

### Banking sector competition

<table>
<thead>
<tr>
<th>Issue</th>
<th>Action</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private banks operate in an uneven field compared to state-owned banks</td>
<td>Enforce legislation allowing Government agencies to place deposits, current and salary accounts with private banks, and accept letters of credit and checks issued by private banks</td>
<td>November 2016</td>
</tr>
</tbody>
</table>

### Banking sector infrastructure

<table>
<thead>
<tr>
<th>Issue</th>
<th>Action</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks have no means to assess credit history of potential clients</td>
<td>Link up with the CBI to ensure credit bureau coverage for the KRI</td>
<td>December 2016 – until completion</td>
</tr>
</tbody>
</table>

### Agriculture sector: trade policies

<table>
<thead>
<tr>
<th>Issue</th>
<th>Action</th>
<th>Priority and Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import bans</td>
<td>Unclear if they work</td>
<td>Medium priority (January 2018), Ministry of Planning</td>
</tr>
<tr>
<td>Import duties</td>
<td>They tax agriculture</td>
<td>High priority, Ministry of Trade and Industry</td>
</tr>
</tbody>
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### Agriculture sector: farmer support

<table>
<thead>
<tr>
<th>Area</th>
<th>Problem Description</th>
<th>Proposed Solution</th>
<th>Priority</th>
<th>Responsible Ministry</th>
<th>RAND-supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural research and extension services</td>
<td>The research station is very weak and has too many responsibilities. There are no extension services.</td>
<td>Strengthen the research capabilities, make it more focused. Establish the links with the College of Agriculture. Establish extension services. Extension should be developed in conjunction with the Research Station and the College of Agriculture.</td>
<td>Medium priority (December 2017)</td>
<td>Ministry of Agriculture and Water Resources</td>
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<td></td>
<td>The ultimate beneficiaries of research, the farmers, do not receive any benefit due to lack of adequate research and extension services. Farmers receive no information on new technologies.</td>
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<td>RAND-supported</td>
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### Agriculture sector: market and sectoral information

<table>
<thead>
<tr>
<th>Area</th>
<th>Problem Description</th>
<th>Proposed Solution</th>
<th>Priority</th>
<th>Responsible Ministry</th>
<th>RAND-supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price information</td>
<td>While prices are collected in the central market, they are collected only at weekly frequency while the method of collection is not clear. Farmers and traders do not receive the correct signals, thus impeding their ability to make the informed trade and investment decisions.</td>
<td>Make the price collection process more transparent, more frequent. Make prices publicly and widely available.</td>
<td>Medium priority (January 2018)</td>
<td>Ministry of Agriculture and Water Resources Universities</td>
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<tr>
<td>Agricultural survey</td>
<td>An agricultural survey was carried out several years ago. More recent information is needed. Lack of knowledge on the sector leads to poor policy decisions.</td>
<td>An agricultural census was carried out by KRSO in 2011-12 and used as basis for an agricultural survey. Conduct an agricultural survey, to be repeated every few (e.g., three) years. Diagnose the agricultural sector using the existing survey and IHSES 2012.</td>
<td>Medium priority (January 2018)</td>
<td>Ministry of Agriculture and Water Resources Universities</td>
<td>RAND-supported</td>
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### Agriculture sector: regulatory framework

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<thead>
<tr>
<th>Area</th>
<th>Problem Description</th>
<th>Proposed Solution</th>
<th>Priority</th>
<th>Responsible Ministry</th>
<th>RAND-supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensing procedures</td>
<td>Excessive and unclear licensing requirements They increase the cost of production They induce corruption</td>
<td>Reduce and rationalize the licensing requirements. To the extent possible, move all (or most) licenses relevant to agricultural production under one office (“one-stop-shop”)</td>
<td>High priority (November 2016)</td>
<td>Relevant Ministries</td>
<td>IFC</td>
</tr>
</tbody>
</table>
# Water security and management

| Water security | Water shortages are becoming increasingly common. The sector is faced with dwindling supplies due to smaller inflows into KRG and deteriorating water quality. | Lack of investment in water infrastructure, storage, and distribution systems. Water supply services are intermittent and there are high technical losses, and lack of good management. The low tariffs render utilities dependent on state subsidies. A widespread unregulated informal water sector meets extra demand, at high cost to the poor. Wastewater treatment is limited. | KRG’s vision for water security requires a broad spectrum of goals. Foremost is to ensure a supply of water for the people that is adequate both in quantity and quality. | Investments in water supply and sanitation infrastructure for service delivery are necessary. Also, service delivery institutions need to be reformed to increase efficiency, reduce losses, and recover costs through public-private partnerships. Specific actions include: (i) planning and managing water security including water diplomacy; (ii) improving service delivery; and (iii) strengthening national and local governance mechanisms and water users associations. | High priority (September 2016 – December 2019) | Ministry of Planning Ministry of Agriculture and Water Resources KRG Governorates | RAND |
| Groundwater management | Groundwater is one of the most used water resources. It is the major resource for drinking water, and irrigation. The major issues are groundwater depletion and poor quality. | Lack of proper regulatory framework to monitor abstractions and enforce drilling; and lack of investment in water harvesting and groundwater management. | Implement technical measures to improve operational efficiency. Review legal and institutional framework to enable sustainable groundwater management, including: (a) establish a mechanism to regulate and monitor the water use of the entire aquifer; (b) plan groundwater use in a way that optimizes the lifetime of the aquifer and maximizes the economic benefits; and (c) anticipate groundwater quality changes during the life of intensive aquifer development. | High priority (September 2016 – December 2019) | Ministry of Agriculture and Water Resources | RAND |
| Water supply and sanitation systems | Sanitation remains a major concern. The major gaps relate to physical facilities, | There is a significant gap between the rural and urban areas in terms of population with access to improved | Support investment in rural sanitation and rural/urban water supply; wastewater treatment; metering and | High priority (September 2016 – | Ministry of Natural Resources | RAND |
namely the lack of wastewater treatment plants and sewerage collection networks. This lack of sanitation increases public health risks and environmental pollution.

On the water supply side, the use of groundwater has resulted in lowering of the water table, which results in higher costs to treat and pump the water.

| Irrigation | Irrigation is considered essential on three accounts: (a) to minimize climatic risks; (b) to ensure quality of products essential to commercial agriculture; and (c) to provide adequate incomes and living standards in the rural areas. For fruit and vegetables, irrigation is essential for quality and timely production, besides increasing yields substantially. It is expected that, with irrigation, small farmers would move to more high-value crops and specialized markets, and away | Lack of investments; and poor performance of existing irrigation system. Modern irrigation methods (sprinkler and drip irrigation) are still at their early stage of implementation. The present consumption of water in the agriculture sector is high, and the current overall irrigation efficiency is low. | Minor rehabilitation of small scale irrigation schemes mainly canal lining. | Investments in modernization of existing irrigation schemes (climate proofing of existing schemes); conversion of schemes to on-demand pipe distribution and investments in drip and sprinkler irrigation; transfer of irrigation schemes to water users association; cost recovery on O&M; and promotion of PPPs. Investments in water harvesting and small dams and in reuse of wastewater. | December 2019 | Ministry of Agriculture and Water Resources | February 2019

- Investments in water harvesting and small dams and in reuse of wastewater. | High priority (September 2016 – December 2019) | Ministry of Agriculture and Water Resources |
Tourism sector

| Development of the tourism sector | After a boom at the beginning of the decade, tourism has plummeted due to the political crisis in the region: the number of tourists has dropped by almost 50 percent between 2013 and 2015. | The implementation of the 2013 Tourism Strategic Plan has been delayed by the crisis. | The Government has adopted in 2013 a Tourism Strategic Plan and has started its implementation, including through the development of the National Board of Tourism, the deployment of marketing efforts, data collection, the establishment of a training center, and support to the private sector. | Further implement the Tourism Strategic Plan, and shift priorities in response to the crisis by focusing on long-term investments: development of tourism sites and products, infrastructure, education and quality. Review and implement the recommendations made in the 2014 Rapid Tourism Assessment Scoping:  
- Improve the legal framework for licensing of travel agencies and tour operators,  
- Improve the quality of services through the adoption of a quality certificate.  
- Remove the main regulatory and non-regulatory constraints for private sector that have been identified by the assessment. | Start in November 2019 | Ministry of Tourism | Private sector investors |

Energy sector reform

Energy sector reform

Electricity: legal, regulatory and policy framework

<p>| Comprehensive electricity law | A comprehensive legal statute is needed to govern the sector, define roles and responsibilities, provide the regulatory and market mechanisms, foster | The discussion on future sector structure and the need for a comprehensive electricity law is at a nascent stage. | At present, independent power producers are being regulated through provisions of the bilateral contracts. MoE has initiated some discussions about the | Conduct expert consultations to outline a new sector structure, including segregation of the roles and mandates with regard to policy, regulation, grid expansion, load dispatch, single buyer, generation, | Initiate within six months. Duration: 6-9 months | Ministry of Electricity | World Bank Group |</p>
<table>
<thead>
<tr>
<th>Regulation of electricity sector</th>
<th>Economic efficiency through competition, promote operational efficiency, and ensure delivery of quality power to consumers at lowest possible cost.</th>
<th>Sector structure, need for enhanced private sector participation and overarching reforms.</th>
<th>Distribution, fuel provision, electricity trading, energy efficiency, and demand side management.</th>
<th>After initiation.</th>
<th>Ministry of Electricity</th>
<th>World Bank Group</th>
</tr>
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<tbody>
<tr>
<td>In the absence of an independent regulatory authority, generation tariffs are determined through bilaterally negotiated contacts, whereas retail tariffs are usually delayed, and do not reflect the cost of service (even as a much higher willingness to pay is demonstrated by fees charged by local diesel based generators).</td>
<td>There is no legal statute that mandates an independent regulator. Tariff related decisions are taken by MoE broadly on an ad-hoc basis. Political economy of tariff rationalization process may make it difficult to hand-over this responsibility to an independent regulator.</td>
<td>Government has initiated a study on cost of service and tariff rationalization pathways with support of the World Bank. The study includes development of tariff determination models and training of MoE personnel to use them.</td>
<td>Establish and ring-fence a regulatory cell within MoE as a precursor to an independent sector regulator. Develop tariff determination models and provide training to regulatory cell members.</td>
<td>Initiate after new EA Duration: 1-2 years</td>
<td>Ministry of Electricity</td>
<td>World Bank Group</td>
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<tr>
<td><strong>Cost of Service and Tariff Pathway Study</strong> under WB funded technical assistance is already underway</td>
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| Corporatization of sector entities | A vertically integrated electricity sector under the ministry has multiple roles, which diffuses accountability as well as presents conflicts of interest, leading to poor sector performance. | The vertically integrated operation needs to be unbundled into separate corporate entities for generation, transmission, distribution, trading and a holding company, while the policy and regulation functions need to be detached. This would foster transparent performance accountability as well as | The Government has initiated a study on “Pathways for Distribution Strengthening, Loss Reduction and Revenue Enhancement,” which includes examining options for corporatization and privatization of the distribution business. | Within the existing structure, ring-fence generation, transmission, distribution, trading and fuel supply businesses to function nominally as separate entities. Segregate their assets, functions and manpower, structure transactions between them, and foster separate energy and financial accountability for each. | Initiate within 6 months Duration: 9-12 months | Ministry of Electricity | World Bank Group |
| UNDP “Pathways for Distribution Strengthening Study” under WB funded technical assistance is already underway |
facilitate privatization going forward.

Establish generation, transmission, distribution, trading and holding entities as separate corporate bodies registered under the companies act. Establish their board of governors, management as well as performance accountability mechanisms. These corporatized entities may be privatized at a suitable stage.

Initiate within 18 month
Duration: 1-2 years
Ministry of Electricity
World Bank Group

Electricity: infrastructure strengthening

| Electricity availability | Low availability of electricity even as installed power generation capacity remains under-utilized. | Lack of adequate availability of natural gas for power is affecting generation, forcing the use of expensive imported diesel instead, and also imposing significant burden of take-or-pay charges on the government. | Private sector participation has already been introduced in power generation through the IPP program with good results. This has improved the availability of power from less than 500 MW in 2005 to more than 5000 MW in 2015. | Enhance the availability of natural gas and eliminate the use of diesel for power generation. Resolve outstanding disputes in the gas sector. | Initiate in June 2016
Duration: 1-2 years
Ministry of Natural Resources
World Bank Group |
|------------------------|-------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| Construct a gas pipeline parallel to the existing oil pipeline to connect gas fields in Central KRI with power plants in Eastern KRI. | Initiate preparation in June 2016
Duration: 2-3 years
Ministry of Natural Resources
World Bank Group | Lack of adequate transmission capacity connecting key generation and load centers, as well as KRI with other regions of Iraq inhibits the transfer of available power (or cheaper power) to areas affected by supply shortfalls. | MoE has tied-up with some IPPs to take-up the construction of some sections of transmission lines. However, investment of an estimated US$568 million is still needed for the critical high voltage network. | Enable private sector participation in development of high voltage transmission networks. This would also enable adequate transmission of nearly 4000 MW of additional capacity. | Studies already initiated. Implementa
tion duration: about 2 years
Ministry of Electricity
World Bank Group |
| Electric distribution | High technical losses linked to dilapidated distribution network, Poor maintenance and inadequate investment in distribution network. | Under a World Bank funded technical assistance study, the Government is Explore private sector participation options to attract investments as well as to | | | |

| Electricity availability | Low availability of electricity even as installed power generation capacity remains under-utilized. | Lack of adequate availability of natural gas for power is affecting generation, forcing the use of expensive imported diesel instead, and also imposing significant burden of take-or-pay charges on the government. | Private sector participation has already been introduced in power generation through the IPP program with good results. This has improved the availability of power from less than 500 MW in 2005 to more than 5000 MW in 2015. | Enhance the availability of natural gas and eliminate the use of diesel for power generation. Resolve outstanding disputes in the gas sector. | Initiate in June 2016
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<table>
<thead>
<tr>
<th>Financial and energy accountability</th>
<th>Weak financial and energy accountability leads to high losses and poor collections which impose a heavy fiscal burden.</th>
<th>High commercial losses are arising from low tariffs, inaccurate metering and billing, and unmetered consumption.</th>
<th>Tariff revisions have been undertaken intermittently in the past. However, a structured approach aimed at reaching cost-covering tariffs is needed. Government has initiated a “Cost of Service and Tariff Design Study” with World Bank grant funding.</th>
<th>Develop and implement a multi-year pathway and a strategy for tariff rationalization. The approach could start with improved supply and cost-covering tariffs for high-end commercial and industrial consumers.</th>
<th>Study underway.</th>
<th>Ministry of Electricity</th>
<th>World Bank Group “Cost of Service and Tariff Design Study” under WB-funded technical assistance</th>
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<tbody>
<tr>
<td>Demand side management and renewable energy</td>
<td>Demand for electricity continues to grow at a high rate</td>
<td>There is a need manage electricity demand</td>
<td>No clear policy</td>
<td>Develop and implement a program for energy efficiency, energy conservation, renewable</td>
<td>Study underway.</td>
<td>Ministry of Electricity</td>
<td>World Bank Group “Pathways for Distribution Strengthening Study” under WB-funded technical assistance is already underway</td>
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</tbody>
</table>

**Electricity: performance improvement and accountability**

- **Unreliable and old distribution lines, and inaccurate metering and billing.**
- **Increase in installed generation capacity needs to be complemented with increased network capacity to deliver this power to end-consumers.**
- **Examine the options for private sector participation in power distribution.**
- **Improve commercial performance of the distribution business.** While full privatization may be difficult initially, billing and collection services could be outsourced under robust contracts as a first step.
- **In parallel to private sector participation, initiate performance improvement and institutional strengthening measures.**
- **Studies already initiated.**
- **Implementation duration: about 2 years**

**Financial and energy accountability**

- **Weak financial and energy accountability leads to high losses and poor collections which impose a heavy fiscal burden.**
- **High commercial losses are arising from low tariffs, inaccurate metering and billing, and unmetered consumption.**
- **Tariff revisions have been undertaken intermittently in the past. However, a structured approach aimed at reaching cost-covering tariffs is needed. Government has initiated a “Cost of Service and Tariff Design Study” with World Bank grant funding.**
- **Develop and implement a multi-year pathway and a strategy for tariff rationalization. The approach could start with improved supply and cost-covering tariffs for high-end commercial and industrial consumers.**
- **Study underway.**
- **Implementation duration: 3-5 years**

**Demand side management and renewable energy**

- **Demand for electricity continues to grow at a high rate**
- **There is a need manage electricity demand**
- **No clear policy**
- **Develop and implement a program for energy efficiency, energy conservation, renewable**
- **Initiate over the next 1-2 years.**
- **Ministry of Electricity**
<table>
<thead>
<tr>
<th>Oil sector</th>
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<tbody>
<tr>
<td><strong>Downstream oil development</strong></td>
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<tr>
<td>Downstream oil opportunities are not properly materialized. KRG has limited</td>
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<td>refining capacity and imports products for domestic consumption.</td>
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<td>Limited regulatory reforms to enhance downstream oil opportunities not yet</td>
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<td>materialized</td>
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<tr>
<td>KRG will need to develop regulatory reforms with a focus on: (i) Contractual</td>
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<td>and commercial framework governing existing and future activities; (ii)</td>
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<td>Enabling conditions for attracting investment; (iii) Legal and regulatory</td>
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<td>reforms including pricing, subsidies, and fuel standards; (iv) Enabling</td>
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<td>measures for increasing refining capacity (including refurbishment of</td>
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<td>existing units), optimization of import arrangements and fuel substitution</td>
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<td>Start in January 2019</td>
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<td>Ministry of Natural Resources</td>
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<tr>
<th>Regional connectivity</th>
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<tr>
<td><strong>Transport sector</strong></td>
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<tr>
<td>Legislation and regulations</td>
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<tr>
<td>Outdated or lack of relevant legislation (mainly for design, supervision</td>
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<td>and maintenance) of transportation infrastructure.</td>
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<td>Excessive cost of construction and maintenance.</td>
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<td>Low quality of construction, supervision and maintenance works.</td>
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<td>Plans have been made with the World Bank to update regulations, but not</td>
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<td>yet been performed.</td>
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<td>Review and update legislation, regulations, manuals and guidelines for</td>
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<td>planning, design, construction, supervision, maintenance of transport</td>
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<td>infrastructure.</td>
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<td>Strengthen controls, in particular towards excessive use of infrastructure</td>
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<td>(overloading).</td>
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<td>April 2017 – December 2020</td>
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<tr>
<td>Ministry of Construction and Housing</td>
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<td>Ministry of Transport and Communications</td>
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<td>JICA</td>
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<td>SIDA</td>
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<td>EU</td>
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<td>UNESCWA</td>
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<td>UNDP</td>
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<td>USAID</td>
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<td>Public transport</td>
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<tr>
<td>Trucking</td>
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<td>Trade facilitation and customs procedures</td>
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<td>Roads and accessibility</td>
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<tr>
<td>Road management</td>
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<td>Road construction and consulting industry</td>
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<td>Issue</td>
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<td>Road user charges</td>
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<td>Logistic hubs</td>
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<td>ICT sector</td>
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<td>Broadband infrastructure and service expansion</td>
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<td>Area</td>
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<tr>
<td>Regulatory Coordination</td>
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<td>Market regulation and monitoring capacities of the MoTC</td>
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<td>International connectivity market</td>
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<td>Information Technology market</td>
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<td>Digital content in the Kurdish language</td>
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</table>

Diversification of the economy and employment creation over the medium-term through private sector development

<p>| Development of a vibrant private sector | Private sector is at a very nascent stage in a traditionally state-dominated natural resource-rich economy. | Lack of new start-ups. Lack of firm productivity and growth. | Unclear | Piloting and scaling up most effective entrepreneurship development program especially among the youth. Piloting and scaling up most effective firm-level interventions to enhance productivity, product quality | High priority (September 2016 – September 2019) | Ministry of Trade and Industry Ministry of Planning World Bank Group |</p>
<table>
<thead>
<tr>
<th>Job creation in the private sector</th>
<th>More than 50 percent labor force is employed in the public sector.</th>
<th>Slow progress in economic diversification and job creation in non-oil private sector.</th>
<th>The Government is keen on increasing labor force flexibility, creating better working conditions, enhancing protection for private sector jobs, and matching the skills of the labor force with market demand.</th>
<th>Reform the labor legislation, and vocational and education systems.</th>
<th>Start in September 2016</th>
<th>Ministry of Planning</th>
<th>Ministry of Labor and Social Affairs</th>
<th>World Bank Group</th>
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<tbody>
<tr>
<td>Gap between worker skills and companies’ needs</td>
<td>Matching workers skills to companies’ needs</td>
<td>There is a clear gap between the output of the educational system and the actual skill needs of the region’s markets and various economic sectors. This gap renders the outputs of the educational system incapable of meeting and anticipating the private sector’s needs.</td>
<td>RAND conducted a region-wide representative survey of employers regarding their labor market needs.</td>
<td>Conduct surveys of market skills needs; coordinate training programs; enlist firms, domestic and foreign, to train people through internships, mentorships, apprenticeships, work-study programs, seminars; and partner with universities.</td>
<td>Start in September 2016</td>
<td>Ministry of Education</td>
<td>Ministry of Higher Education and Scientific Research</td>
<td>RAND</td>
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<tr>
<td>Institutional capacity and coordination</td>
<td>No single unit leading and coordinating regulatory reform efforts.</td>
<td>Lack of coordination among entities.</td>
<td>Identify a reform champion to take the lead on regulatory reform, coordinate efforts, set priorities, and establish communication with stakeholders.</td>
<td>January 2017 – December 2018</td>
<td>Prime Ministry</td>
<td>Ministry of Planning</td>
<td></td>
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<tr>
<td>Access to finance</td>
<td>Private sector firms have difficulty accessing finance</td>
<td>Underdeveloped financial and banking services, and the inability of individuals and companies to issue letters of credit.</td>
<td>Amending the securities laws to allow more flexibility in secured transactions law.</td>
<td>October 2016 – June 2018</td>
<td>Ministry of Finance and Economy</td>
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<tr>
<td>Topic</td>
<td>Description</td>
<td>Action</td>
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<td>End</td>
<td>Responsible Agencies</td>
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<tr>
<td><strong>Burdensome regulations</strong>&lt;br&gt;Establish a private-sector oriented regulatory regime</td>
<td>KRG’s regulatory framework is overly complex, containing duplicative and overlapping regulations. Private sector suffers from the application of practices and procedures that have no basis in law.</td>
<td>Finalize key laws (including competitiveness law, anti-monopoly law, consumer protection, industrial zones, social security and environmental legislations) in accordance with international standards and good regulatory practice.</td>
<td>October 2016 – June 2018</td>
<td>Ministry of Trade and Industry</td>
<td>World Bank Group</td>
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<td><strong>Diversifying into manufacturing</strong>&lt;br&gt;KRI is host to a few factories that were intended to supply all of Iraq, but security problems restricted access to the rest of the Iraqi population.</td>
<td>Because of the security situation, sufficient raw materials do not reach these factories. Improvements in security. The World Bank has started a technical assistance program to reform the industrial licenses.</td>
<td>Ensure private commitment to these factories while ensuring security for transit of goods. Improve critical infrastructure for manufacturing. Consider PPPs to provide financing for private firms that would complete stalled projects. Offer incentives for private investors in manufacturing.</td>
<td>June 2016 - onwards</td>
<td>Ministry of Planning&lt;br&gt;Ministry of Defense&lt;br&gt;Ministry of Trade and Industry</td>
<td>USAID</td>
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<tr>
<td><strong>Diversifying into services</strong>&lt;br&gt;Services are a major potential source of diversification for the economy, but firms need upgrading to be competitive.</td>
<td>The services sector is still concentrated in a few family-owned firms that are disconnected from major global networks. Some opening has taken place and foreign services firms established local offices.</td>
<td>On the basis of regulatory diagnostics, remove major constraints to competition and trade in the services sector, including through the removal or revision of obsolete regulations in the professions. Put in place with the assistance of the international organizations and major trading partners a program of upgrading in priority services sectors that would include hard (infrastructure, facilities) and soft (regulation, skills) components of competitiveness.</td>
<td>September 2016 – December 2019</td>
<td>Ministry of Planning&lt;br&gt;All technical ministries targeted by the reforms</td>
<td>Technical assistance from international partners on services trade promotion strategy</td>
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<tr>
<td><strong>Diversifying and creating jobs in services ancillary to the oil and gas industry</strong>&lt;br&gt;The contribution of the oil and gas industry to local development has been considered unsatisfactory to date.</td>
<td>The Kurdistan Oil and Gas Law as well as production sharing contracts have clear but unspecified expectations with regards to local A number of obligations and programs have been progressively put in place, including the MNR’s workforce development</td>
<td>The MNR plan for workforce, local enterprise and community development should be finalized and implemented, drawing upon</td>
<td>June 2016 - onwards</td>
<td>Ministry of Natural Resources</td>
<td>International Oil Companies</td>
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<td>Business environment reforms</td>
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<tr>
<td><strong>Procedures to start up a business</strong></td>
<td>Reforms are needed to reduce time and number of procedures to start and close a business.</td>
<td>Lengthy waits for approvals for licenses to start up business, some needing approvals for multiple ministries, is a key complaint, as is the cumbersome process of closing a business.</td>
<td>The World Bank will start a technical assistance in July 2016 in the areas of business registration and industrial licensing reforms.</td>
<td>Streamline the process to start and close a business and make it more transparent. Consider setting up a one-stop shop for both domestic and foreign businesses.</td>
<td>July 2016 – until completion</td>
<td>Ministry of Trade and Industry Board of Investment</td>
<td>World Bank Group</td>
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<tr>
<td><strong>Customs times and procedures</strong></td>
<td>Customs procedures are lengthy.</td>
<td>It currently takes 38 days for goods to clear customs. Many firms rely on imported inputs, and this delay increases their cost and reduces efficiency.</td>
<td>Assess the reasons for the delays. Improve both hard and soft infrastructure.</td>
<td>Start in March 2017</td>
<td>World Bank Group</td>
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<tr>
<td>Quality infrastructure</td>
<td>Low level of quality certification</td>
<td>Currently in the KRL only 6 percent (of 179 firms) have internationally recognized quality certification and less than 1 percent use technology license from international firms.</td>
<td>Improve the quality system so that firms can be internationally certified at home.</td>
<td>Start in February 2018</td>
<td>World Bank Group</td>
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<td>Payment system</td>
<td>Low confidence in the banking system creates high transactions costs and a high share of cash payments.</td>
<td>A high share of cash payments eliminates critical information on the level of economic activity and encourages informal transactions.</td>
<td>Government needs to work with the private sector to support and secure confidence in an efficient formal payment system among firms.</td>
<td>Start in November 2016</td>
<td>Ministry of Finance and Economy Central Bank</td>
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<tr>
<td>Investment climate</td>
<td>Low visibility on public strategy and public role in the business sector</td>
<td>Beyond the immediate fiscal crisis, the private sector wants clear signals on the support they can expect from public investments and from rules governing private investment.</td>
<td>Government has announced a few reforms, but is mostly focused on short term matters, and the private sector focus also remains short term.</td>
<td>July 2017 – July 2019</td>
<td>Ministry of Finance and Economy Ministry of Planning</td>
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<td></td>
<td>Government will establish a medium-term plan; provide clear motivation for business procedures; and professionalize regulatory enforcement.</td>
<td></td>
<td>World Bank Group</td>
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<tr>
<td><strong>Building strong private sector organizations for advocacy and lobbying</strong></td>
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<tr>
<td>Private sector (self-help) organizations</td>
<td>Private sector organizations are very weak. They have no capacity for effective advocacy and lobbying.</td>
<td>There is no “champion” for private sector development in both private and public sectors.</td>
<td>Encourage Chambers of Commerce and Industry to transform the organization into a modern advocacy and lobbying institution. Set up a partner organization in the Government.</td>
<td>Start in July 2016</td>
<td>Ministry of Trade and Industry</td>
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<tr>
<td>Trade policy</td>
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<td></td>
<td>Encourage Chambers of Commerce and Industry to transform the organization into a modern advocacy and lobbying institution. Set up a partner organization in the Government.</td>
<td></td>
<td>Swedish Chamber of Commerce and Industry World Bank Group</td>
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<tr>
<td>WTO accession</td>
<td>Iraq is not a member of the WTO.</td>
<td>Trade-related reforms that need to be undertaken during the accession process are still pending. Without WTO membership, Iraq cannot take advantage of</td>
<td>Follow-up with the central government to speed up the negotiations and participate in negotiations actively to be a member as soon as possible.</td>
<td>Start in January 2019</td>
<td>Technical work in Ministry of Trade and Industry, and other concerned ministries WTO USAID</td>
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<tr>
<td>Category</td>
<td>Description</td>
<td>Trade Policy</td>
<td>Start Date</td>
<td>Responsible Parties</td>
<td>Implemented By</td>
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<tr>
<td>Transit trade</td>
<td>Kurdish and other businesses trade a large number of goods across KRI into the rest of Iraq and between Turkey and Iran. Border procedures cause fairly lengthy delays at the border. Allowed informal trade facilitators and informal truckers to engage in transit trade.</td>
<td>Trade procedures can be facilitated and quickened while improving customs information systems, and while maintaining employment for residents earning their living in the transit trade business.</td>
<td>December 2016</td>
<td>Customs Administration Ministry of Planning Ministry of Trade and Industry</td>
<td>Turkish officials</td>
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<tr>
<td>Customs administration</td>
<td>Problems are manifold: outdated procedures, segmented processes, excessive physical checks and long delays, limited ICT capability and uncoordinated customs units, lack of appropriate customs valuation, and very poor integrity and governance. The system is prone to arbitrary decision, mis-declaration, fraud, and loss of revenue. Plans have been made with the World Bank to reform the customs system but not yet been put in practice. Customs administration is under central government’s jurisdiction according to Iraqi Constitution. Press on the central government to put in place a comprehensive reform and modernization program focused on adoption of international standards as well as investment in much needed customs infrastructure. This cannot be achieved over night, but will start as soon as possible. Continue partial improvements in KRI’s border posts.</td>
<td>Start in January 2019</td>
<td>Requires collaboration of various ministries led by the Ministry of Finance and Economy</td>
<td>World Customs Organization UNCTAD</td>
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<tr>
<td>Non-tariff barriers to trade, including standards and conformity assessment, testing and certification, border inspection</td>
<td>KRG’s current system does not conform to international norms and procedures. Also, KRG lacks technical and institutional capacity to implement a modern system. The Ministries of Planning and Health share responsibilities and some standards might vary from region to region within KRG and within Iraq. This is a barrier to trade. The current situation poses a threat to public health. A number of improvements has been made in recent years including setting up new laboratories in Erbil, Sulaymaniya, and Dohuk, signing agreements with Bureau Veritas, TUV, and Cotegna to carry out verification and issuance of certification of conformity in countries of origin as well as check points at specified borders. KRG has also drafted a new law to replace the old one. Ensure that the new system to be put in place by the new legislation will include: separation of standards setting, conformity assessment and certification, measurement and calibration functions; investment in infrastructure and capacity building; encouragement of private laboratories; and arrangement of mutual recognition programs with trading partners.</td>
<td>January 2019</td>
<td>Ministry of Planning Ministry of Health</td>
<td>EU Turkey</td>
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</table>

Technical assistance available at WTO and elsewhere, and improve and lock-in trade reforms.
| Export promotion (goods) | Export of non-oil products is negligible | This perpetuates heavy dependence on oil exports and inhibits employment creation. | There is export potential in a number of non-oil subsectors including unprocessed and processed agricultural products, leather and leather products, petrochemicals, pharmaceuticals, and construction material, but KRG has not taken any measure to take advantage of this potential. | Prepare a comprehensive export diversification program, which would include setting up an export promotion agency, introducing export incentives such as duty/tax drawback, dedicated credit to exporters and loan guarantee schemes and trade insurance system to ease access to credit and reduce risks. Start implementing the four industrial city projects preferably in partnership with the private sector. Implement a single-factory export processing zones scheme until industrial city projects are completed. | January 2018 | Ministry of Trade and Industry | EU CIDA World Bank Group |

| Export promotion (services) | There are virtually no exports of services outside traditional sectors such as transports. | Diversification outside the oil and gas sector is needed, and services firms be incited to look beyond the domestic market. Dependence on public procurement has been a major obstacle to diversification and scaling-up to become internationally competitive. | The Government made efforts in the tourism sector. | Services development and export promotion strategy should include the following pillars:  
• An analysis of the SWOT and market opportunities in priority sectors;  
• A regulatory audit in the priority services sectors;  
• Coordination among ministries to elaborate a negotiation strategy with major trading partners; and | January 2018 – December 2020 | Coordination among line ministries hosted by a lead Ministry | Technical assistance from international partners on the different pillars of the services promotion strategy |
| Movement of services providers | Visas, residency and nationality requirements represent major obstacles to trade in services for the movement of services providers or consumers. The war and the refugee crisis have added to the existing constraints to the movement of people across borders. Firms have important additional operation costs due to the visa and residency requirements. Recent measures taken by Turkey might affect the prospects of services trade in the region. Measures have reinforced existing barriers. Iraq has been exposed to increasing obstacles raised by neighboring countries. Explore the consequences on trade and economic activity of the new obstacles to the movement of people in the region. Facilitate the movement of services providers and key personnel by facilitating visa procedures and removing unnecessary nationality or residency requirements. February 2017 Ministry of Foreign Affairs |
| Informal trade with Turkey | Informal cross border trade between KRI and Turkey is large and takes place in both directions either through the border station (false declaration) or smuggling. Under-invoicing is very common for imports from Turkey. Informal trade reflects inadequate operations at border posts and results in loss of revenue. Discussions are ongoing between KRG and Turkey to take measures to improve the functioning of border posts and management of informal trade. Close collaboration between KRG and Turkish government and between business organizations is needed to reduce informal cross-border trade. Establish on both sides of the border industrial centers to create employment and business opportunities. KRG can plan one of the industrial cities close to the Turkish border. Restructure fuel subsidies in KRI switching from general to targeted subsidies to narrow the price differentials with Turkey. Work with the Central Government to implement the customs reform, which has been on the reform agenda for some time. In collaboration with Turkey, strengthen border control systems and open new border crossings to ease border traffic. December 2017 – December 2018 Ministry of Finance and Economy Ministry of Trade and Industry Ministry of Agriculture and Water Resources Chambers of Commerce and Industry Turkey |
| Economic and trade cooperation agreements | Iraq has a few regional and bilateral trade and economic cooperation agreements. They are effectively defunct. The agreements with the US, EU and UN Agencies in particular have long lists of technical assistance clauses Press on central government for ratification of the EU agreement. Make every effort to take full advantage of the technical January 2019 Ministry of Foreign Affairs Ministry of Trade and Industry |
Iraq has recently signed economic partnership and cooperation agreements with the US, EU, UN agencies, Turkey, and Iran. Agreement with EU has not yet been ratified.

<table>
<thead>
<tr>
<th>Investment regime</th>
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<tr>
<td>Investment strategy</td>
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<tr>
<td>Investment Law</td>
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<td>Investment current law</td>
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<td>Investment dispute mechanisms</td>
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<tr>
<td>Board of Investment</td>
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<td>Supreme Investment Council</td>
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<tr>
<td>Labor market and employment promotion programs</td>
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<tr>
<td><strong>Implementation of employment promotion programs for a dynamic labor market</strong></td>
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<tr>
<td>Distortions brought on by the large size of the civil service, skills issues on the supply side, and lack of opportunities in the private sector</td>
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<tr>
<td>Small economy that needs to absorb large numbers entering the labor market, with the civil service acting as “employer of last resort” distorting the labor market</td>
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<tr>
<td>Comprehensive social protection strategy developed</td>
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<tr>
<td>Implementation of the strategy, including a new labor law, as well as new governance and institutional mechanisms to ensure coordination across social policy areas</td>
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<tr>
<td>High priority (June 2016 – June 2020)</td>
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<tr>
<td>Ministry of Labor and Social Affairs Prime Minister’s Office</td>
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<tr>
<td>World Bank Group RAND</td>
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<tr>
<th>SMEs and entrepreneurship promotion</th>
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<tr>
<td>There is a need for valorization or encouragement of private entrepreneurship.</td>
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<tr>
<td>The SME sector has the potential of being the largest creator of new jobs outside the public sector but the Government has to put incentives in place.</td>
</tr>
<tr>
<td>RAND 2014 provided some recommendations.</td>
</tr>
<tr>
<td>Adopt a private sector development strategy that includes measures on SMEs and entrepreneurship promotion. Put in place incentive mechanisms to help financing SME projects.</td>
</tr>
<tr>
<td>High priority (June 2016 – June 2020)</td>
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<tr>
<td>Ministry of Finance and Economy</td>
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<td>RAND</td>
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<tr>
<th>Capacity building on macroeconomic statistics</th>
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<tr>
<td><strong>Improving macroeconomic statistics to provide necessary information for policy making and monitoring of economic developments in the region</strong></td>
</tr>
<tr>
<td>Lack of resources (technical staff and electronic infrastructure), methodologies, and coordination related to data collection.</td>
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<tr>
<td>The KRSO needs resources to launch key economic surveys, support key statistics and indicators for agriculture, manufacturing, construction, and key services such as education and health, and employment in the oil and non-oil sectors of the economy.</td>
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<tr>
<td>RAND has worked with the Ministry of Planning KRSO to develop the Kurdistan Region Labor Force Survey, now implemented by the KRSO on a periodic basis, in addition to CPI calculations. The first comprehensive Gross Regional Product estimation for the KRI was done by RAND and the KRSO, with recommendations for annual GRP calculation.</td>
</tr>
<tr>
<td>Priority will be given to the systematic collection of production data by economic sectors and price data for the compilation of annual GDP by economic sectors and by main expenditure categories at current and constant price.</td>
</tr>
<tr>
<td>September 2016 – December 2019</td>
</tr>
<tr>
<td>Cabinet Ministry of Finance and Economy Ministry of Planning KRSO</td>
</tr>
<tr>
<td>World Bank Group UNDP RAND</td>
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<tr>
<td>Capacity building for technical staff</td>
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### 3. SOCIAL SECTOR REFORMS AND MITIGATION

#### Social safety nets

| Understanding the welfare impact of the reform program | Poverty and social impact analysis | Lack of information and assessment on what are the potential positive and negative impacts of the medium-term reform program on the poor and vulnerable | Ex-ante assessment of the possible welfare impact on households below or close to the poverty line. | Start developing a baseline and designing an impact assessment before the reform program begins (June 2016) | RAND |

| Improving the targeting efficiency of social protection programs | Very low coverage of the poor of the existing cash transfer program | Vague legislative framework and low capacity for implementation | Comprehensive social protection strategy developed | Implementation of new targeted methods (geographic, PMT, community); and identification of eligible beneficiaries underpinned by a unified registry (long-term). | High priority (June 2016 - June 2018) | New institutions proposed to be created for this work: The Kurdistan Social Protection Institution | World Bank Group RAND |

#### Social insurance and pensions

<p>| Equitable, adequate and sustainable pensions system for | High spending but low coverage of current pensions schemes. No unemployment | Low administrative capacity, vague legislative framework, financially- | Comprehensive social protection strategy developed | Integrating public and private pensions scheme, increasing coverage, and putting in place | High priority (June 2016) | New institution proposed: The Kurdistan Social | World Bank Group RAND |</p>
<table>
<thead>
<tr>
<th>KRG with wide-coverage insurance scheme in place.</th>
<th>unsustainable system, and low coverage.</th>
<th>unemployment insurance program.</th>
<th>- June 2020)</th>
<th>Insurance Authority</th>
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<tr>
<td><strong>Education sector</strong></td>
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<tr>
<td><strong>Ensure access to K-12 education</strong></td>
<td>Lack of adequate school infrastructure and teaching and learning materials. Increased demand for education.</td>
<td>Lack of resources to provide sufficient and adequate learning environment for the students. Lack of data and strategic planning for school construction.</td>
<td>The Government has initiated actions to build and equip 9,000 new classrooms over the five years; consolidation of rural schools underway; student transportation system being developed. KRG began process to contract out construction of 500 new schools.</td>
<td>Make plans to build schools along with land allocation and plans for financing.</td>
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<tr>
<td><strong>Ensure quality of teaching and learning</strong></td>
<td>Shortage of qualified teachers in key subject areas Insufficient policy framework that governs quality assurance and standard of learning</td>
<td>Lack of resources to hire and train teachers and supervisors; lack of technical capacity to design effective recurrent support for teachers and supervisors. 65 percent of teachers lack bachelors degrees. Teachers lack content knowledge and instructional methods to teach new curriculum. Lack of capacity to develop and implement a solid quality assurance mechanism with a clear set of learning standards. Low infrastructure and technological capacity in the education system. Lack of capacity to assess student learning outcomes</td>
<td>The Government initiated actions to establish teacher professional development centers (PDCs) Academic standards being developed School quality assurance framework being developed Curriculum revised Ministry of Education is keen on participating in TIMSS Ministry of Education contracted with Birmingham College to develop in-service regional teacher training centers.</td>
<td>More capacity building for the Ministry of Education staff to develop the quality assurance mechanism and learning standards More support is needed to continue the provision of teacher training and to promote improvement of support for supervisors More capacity building for the Ministry of Education staff to be able to administer the TIMSS</td>
</tr>
<tr>
<td><strong>Ensuring safe, healthy school facilities</strong></td>
<td>25 percent of schools lack potable water and sewage connections</td>
<td>Budget, maintenance and construction capacity at the scale needed</td>
<td>Ongoing maintenance</td>
<td>Make plans at scale to improve basic school facilities</td>
</tr>
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</table>
### Putting in place an effective technical vocational education and training program

| Technical vocational education and training (TVET) | TVET programs are very weak: old curriculum and teaching methods, insufficient trainers, inadequate equipment and facilities, no after training activities. | There is no adequate skill pool for private sector development. High unemployment especially among young population and over employment in the public sector are serious problems. | There are a few government-run and donor supported TVET programs. However, they are uncoordinated and lack local matching funding. RAND developed a phased set of recommendations for improving TVET. | With technical assistance prepare and implement a comprehensive TVET program. | November 2018 – November 2019 | Ministry of Labor and Social Affairs Ministry of Education Ministry of Higher Education and Scientific Research | UNIDO EU Germany RAND |

### Health sector

| Preventive, primary, and curative care | Commendable improvements were made since 2000, but the sector is plagued by underinvestment in physical and human capital, inefficiency, low standards, over use of curative care, financial incentives that result in low efficiency, equity and quality of health care services. | A health care reform project has been submitted to the Parliament for approval but the project has stalled. | A number of reforms have been initiated but have yet to be implemented. This is the case of the ‘Ministry Plan of Work for Health’ that was adopted by the Ministerial Council but not approved by the Parliament. Investments in infrastructure started but stopped. In the pharmaceutical area, the Medical Control Agency has developed its ability to test drugs but upgrading is required. The health insurance, Medical Council, and family physician/specialized centers, dual practice system reforms are still embryonic. RAND provided a detailed set of primary care quality | Put in place a health sector reform strategy that deals with preventive and primary as well as curative care. Reform plans need to be implemented in a number of key areas:  
- Adopt higher standards for health care quality and safety, for example through hospital accreditation and competency-based licensing and re-certification of all health professionals;  
- Develop information systems including, (a) a more comprehensive management information system for primary care centers and hospitals, (b) a system for medical records, (c) disease registries, (d) a system for making and documenting referrals, and (e) health | June 2016 – December 2019 | Ministry of Health, Ministry of Planning Ministry of Higher Education and Scientific Research Ministry of Finance and Economy | RAND |
and access recommendations. RAND developed and implemented a Management Information System (MIS) but it needs to be institutionalized. A publication containing detailed findings from and recommendations for the primary care MIS is forthcoming.

- surveillance from primary care centers and hospitals;
- Develop PPPs;
- Develop an emergency and mobile networks;
- Establish specialized centers (e.g., for oncology) and incorporate them into a system based on continuity of care (from primary to referral and hospital services and back); and
- Reform health education and training curricula; and

In the area of pharmaceuticals, efforts toward greater pharmaco-vigilance (surveillance and regulatory oversight) are needed, with increased quality criteria, stricter rules for prescription, storage and distribution, and fight against counterfeiting drugs.

PHCs and public hospitals need significant investment to bring equipment and facilities up to modern standards.

| Health financing | Low efficiency, equity and quality of health care services due to lack of financing. Underinvestment in physical and human capital. | Budget allocation is insufficient to provide services in the public sector and to finance appropriate levels of services, | RAND provided recommendations on implementation of health insurance and dual practice reform. | Develop a health insurance system that equitably deals with the provision of an appropriate benefits package of care, efficiently reimburses providers, and includes private providers. Introduce a reformed medical insurance and health financing scheme that promotes efficiency and quality with an increased role of private financing. Develop and implement physician dual practice | June 2017 | Ministry of Health
Ministry of Finance and Economy | RAND |
| Health sector management | The Ministry of Health does not have the capacity, personnel, or funding required to implement and manage a modern system of health care delivery. Most hospital administrators lack management training. | Health sector civil service reform to enable management of labor by the relevant ministry. Data needed to make good management decisions, and set financing policy. The private sector is expanding rapidly without regulatory guidance or a strategic investment process. | Publication on recommended structures forthcoming and detailed strategic plan in process. Restructure public health sector and its management. Reorganize MOH to emphasize efficiency, policy development, and implementation of new financing schemes. Develop job descriptions, training programs, career paths, and a staff performance appraisal system to improve management capacity. Decentralize managerial and budget authority, and accountability to local public hospitals. Increase private hospital regulation and oversight. | June 2017 | Ministry of Health Ministry of Planning Ministry of Finance and Economy | RAND |

**Hosting forcibly displaced persons from Syria and the rest of Iraq**

| Leveraging international donor support for the displaced people | The Government’s High Committee of Needs Assessment faced this issue under the leadership of Ministry of Planning through Immediate Response Plan 1 and Immediate Response Plan 2 in 2014 and 2015. The Ministry then followed up programs with UN agencies to deal with these issues. | Access humanitarian support from the international community for short-term relief and support of refugees. Leverage financial resources from international community beyond humanitarian assistance focused on investment in infrastructure and public service delivery. Access concessional finance from international development organizations: The UN, the World Bank, and the Islamic Development Bank announced a financing | June 2016 - onwards | United Nations RAND |
initiative in October 2015 to support recovery of countries hosting significant refugee populations.

### 4. ACCOUNTABILITY

#### Public financial management reform

<table>
<thead>
<tr>
<th>KRG budget process</th>
<th>Lack of an annual budgetary process</th>
<th>No budgets for the KRG have been prepared in past three years</th>
<th>Develop an annual budgetary process covering all MDAs under the KRG, submit to regional parliament for approval and publication. Develop a MTFF and in due course a MTEF to guide annual budgeting, and the establishment of a Regional Stabilization Fund.</th>
<th>High priority (2016-2020)</th>
<th>Ministry of Finance and Economy Capacity Building Team</th>
<th>RAND</th>
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<tbody>
<tr>
<td>Budget classification</td>
<td>Current budget classifications are outdated.</td>
<td>The current budget classification framework contains weaknesses and does not allow deriving directly the main and common analytical measures of fiscal policy which leads to reducing comprehensiveness and consistency of the analytical framework.</td>
<td>Improve budget classifications in accordance with GFMS.</td>
<td>Medium priority (2018-2020)</td>
<td>Ministry of Finance and Economy</td>
<td>USAID UNDP</td>
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<tr>
<td>Treasury management</td>
<td>No TSA is in place</td>
<td>The lack of TSA is preventing effective cash management to ensure that the Government has sufficient cash available to meet its financial obligations as they fall due, and to invest temporary surpluses to generate interest income.</td>
<td>Evaluate the options for the TSA, and prepare a timetable for its implementation</td>
<td>High priority (2016-2020)</td>
<td>Ministry of Finance and Economy Central Bank</td>
<td>USAID UNDP</td>
</tr>
<tr>
<td>Budget execution</td>
<td>No effective system of commitment control and reporting is in place.</td>
<td>Weak control of commitments and absence of reporting leads to over expenditure, increase of arrears, and misallocation of resources.</td>
<td>Implement a system of commitment control and reporting, with detailed spending estimates.</td>
<td>High priority (2016-2020)</td>
<td>Ministry of Finance and Economy</td>
<td>USAID UNDP</td>
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<tr>
<td>Accounting and financial reporting</td>
<td>KRG quality of accounting and financial reporting needs enhancement</td>
<td>The quality of current accounting and financial reporting does not provide the necessary information for better decision making that would lead to better use of public resources.</td>
<td>Review adequacy of existing accounting and reporting against existing regulations, and develop a plan for strengthening and bringing KRG performance closer to international standards. Review the implementation status of a GFMIS.</td>
<td>High priority (2016-2020)</td>
<td>Ministry of Finance and Economy</td>
<td>USAID UNDP</td>
</tr>
<tr>
<td>Internal controls and internal audit</td>
<td>Existing internal controls are not well followed, and there is a need also to strengthen standards of control and internal audit.</td>
<td>An internal audit function based on international standards does not exist. Internal auditors act as internal controllers performing pre-audit. There are no annual audit plans. Audit is not based on risks. No clear mechanism of audit reporting.</td>
<td>Review the operation of the financial control framework over budget execution. Sample, map, and benchmark control processes for major expenditure lines. Provide advisory support for the development of the government internal audit assurance function, with emphasis on audit planning and audit techniques. Introduce professional good practices in internal auditing in Government.</td>
<td>Medium priority (2019-2022)</td>
<td>Ministry of Finance and Economy</td>
<td>USAID UNDP</td>
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### Public investment management

| PIM Management | KRG faces the problem of allocating scarce resources towards competing priority needs. Effective project appraisal can support appropriate choices of Modernization of budget management practices is lagging. Initial phase of Kurdistan Development Management System (KDMS) development including technical assistance from RAND to pilot the process of linking capital budget requests to the Vision 2020 | Modernization of budget management practices is lagging. Initial phase of Kurdistan Development Management System (KDMS) development including technical assistance from RAND to pilot the process of linking capital budget requests to the Vision 2020 | The following activities will be developed in the KRI to improve the current public investment procedures and to install a complete PIMS in the region: i) Improve the capital investment project design, appraisal and selection; ii) | High priority (September 2016 – December 2019) | Ministry of Planning | World Bank Group DFID RAND |
outputs and designs, and reduce the risk of excessive costs of operation. There is also a large backlog of stalled projects, on which payments have been suspended because of lack of cash.

**PIM Framework**
- A simplified Economic Appraisal Guideline for public investment projects
- A simplified project selection and prioritization criteria guidelines
- Sector specific project preparation and evaluation methodologies for: i) roads; ii) electricity transmission and distribution; and iii) education.

**Improve public investment framework**
- Public investment process is not part of a well-defined medium-term budget framework
- While the MoP has a public investment process, the focus is on the feasibility of individual projects, rather than the overall size and sectoral distribution of the PIP, and its integration into a MTFF/MTEF.

**Procurement reform**
- According to the Investment Climate Assessment, there is a perceived weakness of awarding public contracts.
- Public procurement has been a significant source of governance concerns and burdened by outdated and contradictory rules. Transparent procurement remains a challenge.
- An inter-ministerial task force has been formed to lead the reform and modernization of the procurement system. New public procurement regulations have been enacted in February 2016.

**Develop capacity building**
- Development in project design, appraisal and selection
- Enhance KRG legal and regulatory framework of PIMS
- Improve public investment in terms of project management and ex-post evaluation.

KRG should look into alternative financing of the capital investment budget to finance the infrastructure needs. Triage of the existing stock of stalled projects should be conducted.

**Develop a MTFF/MTEF as a major policy tool to support both PIM and annual budgeting.**

**High priority (September 2016 – December 2019)**
- Ministry of Finance and Economy
- Ministry of Planning

**Medium Priority Training of the implementing agencies:**
- Ongoing World Bank Group

**Government’s procurement practices**
- Implement the newly enacted public procurement regulations through i) training the implementing agencies on the new regulations; ii) enacting the annex of procurement regulation on “Procurement under PPP;” iii) issuance of the explanatory

**Ministry of Planning**
- Training of Inter-Ministerial Committee
- Inter-Ministerial Committee

**World Bank Group**
- USAID
- UNDP
Capacity of procurement workforce is weak. Contract management is also weak, and large arrears to contractors and suppliers have arisen, exacerbated by cash shortages.

<p>| To be effective in July 2016. Annex of procurement regulation on &quot;Procurement under PPP&quot; has been prepared. Training of trainers has been done on implementing the new regulations. |
| Bank technical assistance Enacting the annex of procurement regulation: December 2016 Issuance of the explanatory notes: September 2016 Issuance of Doing Business: July 2016 Strengthening the policy unit functions: January 2017 Establish the complaint mechanism system: December 2017 Issue the SBD in September 2016 to be mandated in March 2017 |
| Increase transparency and public access to information through publication of procurement and contract award notices for majority of tenders on the e-portal. Sustain capacity-building of public sector procurement officers. |</p>
<table>
<thead>
<tr>
<th>Judicial oversight</th>
<th>Audit reform</th>
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<tbody>
<tr>
<td>Strength judicial system</td>
<td>Legal Framework</td>
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<tr>
<td>Independence of the judicial system</td>
<td>KRG-BSA law does not provide the necessary independence, and effectiveness of the institute and limit the opportunities for inappropriate interference in the organization’s work.</td>
</tr>
<tr>
<td>KRI has the chance to develop strong institutional framework, including an independent judicial system, which is a key for property rights and market system, and private sector growth.</td>
<td>KRG-BSA law needs revision, strengthening, and clarification in a number of areas to ensure strong, independent, and effective audit institute and limit opportunities for inappropriate interference in the organization’s work.</td>
</tr>
<tr>
<td>Parliament</td>
<td>KRG-BSA</td>
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<tr>
<td>KRG-BSA governance structure and organization needs revision to enable the</td>
<td>KRG-BSA</td>
</tr>
<tr>
<td>Inefficient internal rules and procedures, no system for monitoring KRG-BSA own</td>
<td>KRG-BSA</td>
</tr>
<tr>
<td>The current governance structure and organization does</td>
<td></td>
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</tbody>
</table>
not serve the purpose of KRG-BSA to enable the institute to meet all aspects of its mandate in an efficient and effective manner.

performance, no vision, mission and set of values, no code of ethics.

institute to meet all of its mandates in efficient and effective manner.

| Audit methods | KRG-BSA falls significantly short of meeting the most basic standards set by INTOSAI for compliance, financial, and performance audit. | Examples of constrains: KRG-BSA audit methods, procedures and outputs, are not in accordance with INTOSAI standards, no assurance that the audits KRG-BSA are complete, accurate, and reliable, no financial or performance audit is undertaken. | The immediate and most pressing priority for KRG-BSA is to raise the professional standard and technical competence of its compliance and financial audit so that it meets the relevant basic INTOSAI standards. In the long run, KRG-BSA will develop its performance audit. This would include developing the necessary audit manuals and train all staff on the developed audit methodologies based on risks. | (2016-2020) | KRG-BSA | UNDP USAID |
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