FOR AGENDA

EBS/07/138

December 5, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Iraq—Request for Stand-By Arrangement and Cancellation of Current Arrangement**

Attached for consideration by the Executive Directors is a paper on a request for a Stand-By Arrangement for Iraq and the cancellation of the current arrangement, which is tentatively scheduled for discussion on **Wednesday, December 19, 2007**. A draft decision appears on page 26. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Iraq indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. De Vrijer (ext. 36259), Mr. Grigorian (ext. 38605), and Mr. Kock (ext. 36299) in MCD.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

IRAQ

Request for Stand-By Arrangement and Cancellation of Current Arrangement

Prepared by the Middle East and Central Asia Department

(In consultation with other departments)

Approved by Adam Bennett and Adnan Mazarei

December 5, 2007

- This report is based on discussions held during September 28–October 1 and October 29–November 1 in Amman, Jordan, and October 16 and 19 in Washington, D.C. Staff met with Minister of Finance Jabr Al-Zubaydi, Governor of the Central Bank of Iraq (CBI) Al-Shabibi, Minister of Oil Al-Shahristani, other senior officials, and representatives from the banking community. The staff team comprised Messrs. De Vrijer (head), Grigorian, and Kock (all MCD), Frécaut (MCM), and Ms. Oliva-Armengol (PDR). The mission was assisted by Mr. Ibrahim (Resident Representative, based in Amman).

- The Iraqi authorities request a Stand-By Arrangement in support of their program for 2008 outlined in the accompanying Memorandum of Economic and Financial Policies. The main objectives of the program are to maintain macroeconomic stability, facilitate higher investment and output in the oil sector, and to move forward with key structural reforms that were initiated under the predecessor arrangement. Access is proposed at SDR 475.36 million (40 percent of quota), and the arrangement would cover a fifteen month period through March 2009. The authorities intend to treat the arrangement as precautionary.

- Iraq continues to avail itself of the transitional arrangements under Article XIV. The Fund is conducting a review of Iraq's foreign exchange regulations. The de facto exchange rate regime is a crawling peg to the U.S. dollar.

- Data provision is broadly adequate for program monitoring, but there are some delays in data provision and weaknesses that hamper economic analysis.

- The authorities are expected to continue their practice of publishing the staff report.

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Attachments

GLOSSARY

BSA	Board of Supreme Audit
CBI	Central Bank of Iraq
COFE	Committee of Financial Experts
CPI	Consumer Price Index
DFI	Development Fund for Iraq
FMIS	Financial Management Information System
GDDS	General Data Dissemination System
GFSM	Government Financial Statistics Manual
IAMB	International Advisory and Monitoring Board
ISAR	Interim Safeguards Assessment Report
ID	Iraqi Dinar
MEFP	Memorandum of Economic and Financial Policies
MOF	Ministry of Finance
MOO	Ministry of Oil
UNSCR	United Nations Security Council Resolution
WTO	World Trade Organization

EXECUTIVE SUMMARY

Iraq's performance under the program supported by the 2006–07 SBA was good, especially in light of the difficult circumstances. The fiscal stance was successful in containing current spending, but fell short in the implementation of the ambitious investment program, which, combined with the difficult security situation, prevented the envisaged expansion of oil output. Rising oil prices, however, more than offset the production shortfall, thus helping to preserve fiscal sustainability. High inflation was sharply reduced by appreciating the exchange rate, tightening monetary policy, and controlling current government spending. CBI policies also helped to reduce dollarization, and the accumulation of net international reserves exceeded expectations significantly.

Progress has also been made with structural reforms, although much remains to be done. Achievements include sharply adjusting domestic fuel prices and all but eliminating direct budget subsidies on fuel products; enacting legislation to allow importation of fuel products by the private sector; amending the new pension law to make the pension system fiscally sustainable; bringing the chart of accounts and budget classification in line with the GFSM 2001; modernizing the payment system; and strengthening the accounting and reporting framework of the CBI.

The Iraqi authorities have requested a successor SBA to build on the achievements of the program supported by the current arrangement. Access is proposed at SDR 475.36 million (40 percent of quota), and the arrangement, which will be treated as precautionary, will cover 15 months through March 2009.

The main objective of the new program is to maintain macroeconomic stability, facilitate higher investment and output in the oil sector, and move forward with key reforms that were initiated under the current arrangement. The 2008 program envisages an increase of oil output to 2.2 mbpd, and overall GDP growth to reach 7 percent. Annual consumer price inflation is targeted to decline to 12 percent. The 2008 government budget makes room for sizable investment while maintaining fiscal sustainability and the continued avoidance of direct fuel subsidies. Key structural reforms under the program include the strengthening of public financial management and the accounting framework of the CBI; the restructuring of the two largest public banks; and strengthening governance in the oil sector.

With the current favorable world oil price outlook and assuming a gradual increase in oil export volumes, the overall fiscal position would be sustainable. There is, however, little room for fiscal slippage and raising oil output is critical. Debt sustainability would be achieved when the third tranche of the Paris Club debt rescheduling (20 percent in NPV terms) is triggered upon completion of the final review of the proposed SBA and progress is made in rescheduling the remaining debt from non-Paris Club official creditors on comparable terms.

I. INTRODUCTION

1. **A Stand-By Arrangement (SBA) for Iraq was approved on December 23, 2005 in an amount equivalent to 40 percent of quota (SDR 475.4 million).** The arrangement originally ran through March 22, 2007, but was extended twice. The first extension to September 28, 2007, was to allow more time to reach program objectives and implement reforms, while the second extension to December 28, 2007, served to keep a policy framework in place during discussions for the requested successor SBA. Reviews for the program were concluded on August 2, 2006 (first and second reviews), March 12, 2007 (third and fourth reviews), and August 1, 2007 (fifth review). This precautionary SBA supported a program aimed at maintaining macroeconomic stability, paving the way for sustainable growth, and achieving external debt sustainability.

2. **The Paris Club agreed on November 21, 2004 to reduce Iraq's debt by 80 percent in net present value (NPV) terms, to be achieved in three stages.** The first and second stages each comprised a 30 percent debt reduction in NPV terms and went into effect in November 2004 and in December 2005, respectively. The final stage will comprise an additional 20 percent debt reduction, conditioned on completion by end-December 2008 of the final review of the third year of one or more upper credit tranche arrangements with the Fund.

3. **The International Compact with Iraq, an initiative of the Government of Iraq for a new partnership with the international community, was formally endorsed on May 3, 2007.** The Compact aims to put in place a medium-term framework for comprehensive political, security, and economic reforms. The Fund's main contribution is through preparation of the medium-term macroeconomic framework of the program supported by the SBA.

4. **Despite serious difficulties, the authorities have demonstrated their commitment and ability to implement macroeconomic-policies and advance structural reforms.** Under the SBA they used appropriate monetary and exchange rate policies to bring down inflation; implemented fuel price adjustments; contained the wage and pension bill to make budgetary room for investment and priority social spending; and advanced structural reforms in public financial management and central bank operations. However, the macroeconomic situation remains fragile, economic growth has been below target, and many reforms are unfinished. The authorities therefore propose a successor SBA-supported program to consolidate macroeconomic stability and advance their reform agenda.

5. **In a letter to the Managing Director, the Iraqi authorities request an SBA in support of their program outlined in their MEFP for 2008, and the cancellation of the current SBA** (Attachments I and II). The arrangement, which the Iraqi authorities intend to treat as precautionary, will cover the period from December 2007 through March 2009.

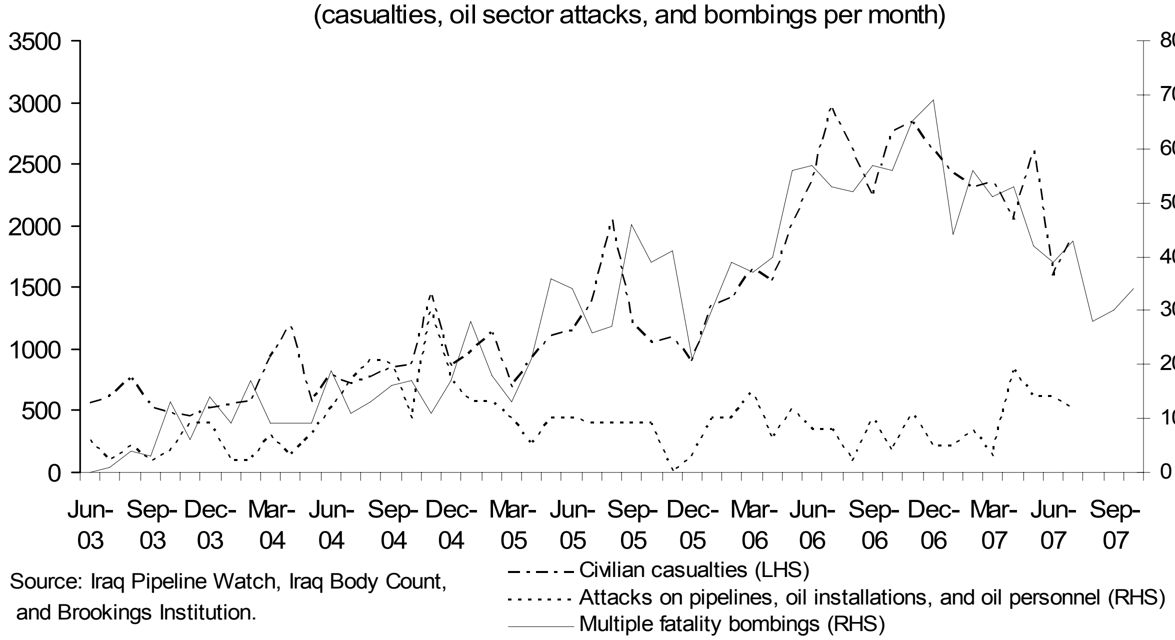
II. Recent Developments

A. Political and Security Situation

6. **The political consensus has weakened but the government of Prime Minister Al-Maliki has remained in power.** Since April, ministers from the secular Iraqi National List, the (Sunni) National Accord Front, and the Al-Sadr block have withdrawn from government. However, despite the political tensions, key ministers have remained in place, including the ministers of finance and oil.

7. **The security situation continues to hamper economic recovery.** After a dramatic deterioration in security in 2006, there are signs of improvement this year. The situation, however, remains difficult and the economy continues to suffer from the violence. Although most parts of the government are functioning, the security problems are straining its capacity to develop and implement policy.

Figure 1: Violence Indicators, June 2003–October 2007
(casualties, oil sector attacks, and bombings per month)



Source: Iraq Pipeline Watch, Iraq Body Count, and Brookings Institution.

8. **The number of displaced persons has increased and poverty is worsening.** The United Nations' refugee agency estimates that in September 2007 more than 2.2 million Iraqi's were internally displaced, up from 1.9 million in April. Another 2.2 million have fled the country, mostly to neighboring Syria (1.2–1.4 million) and Jordan (0.5–0.75 million). The deteriorating living conditions have resulted in the emigration of professionals and skilled labor, hampering economic development and reconstruction efforts. Iraq's statistical agency estimates that 43 percent of the Iraqi population lives on less than $1 a day, with much of the poverty due to the high rate of unemployment.

9. **Corruption remains a serious problem.** Transparency International lists Iraq second-lowest among 179 countries surveyed for its 2007 Corruption Perception Index. The authorities are well aware of the problem and have taken up the challenge of fighting corruption, which had become entrenched after decades of authoritarian rule. The Board of Supreme Audit has taken a more active stance in auditing ministries and government agencies, a National Integrity Commission has been set up, and the maximum amount at which procurement decisions can be made at the ministerial level has been lowered significantly from what it was shortly after the war.

B. Developments Under the Current SBA

10. **The main objective of Iraq's first SBA-supported program was to maintain macroeconomic and financial stability, while undertaking sufficient investment to secure the basis for sustainable growth over the medium term and improving governance.** Performance under the program was good, especially in light of the unstable political and security situation, although growth has remained below expectations:

- The very difficult security situation combined with slow implementation continued to impede the pace of investment, thus preventing the envisaged expansion of oil output. Although oil output has reached 2.1 million barrels per day (mbpd) in recent months, average production for 2007 is unlikely to exceed 2 mbpd, broadly unchanged from 2006. Oil exports have increased slightly in recent months, partly on account of resumed shipments through the northern pipeline to Turkey, and are projected to reach 1.6 mbpd this year, compared to 1.5 mbpd in 2006. Overall economic growth reached 6.2 percent in 2006, but is projected to decline to 1 percent this year, with oil production flat and indicators of non-oil activity pointing to a slowdown.

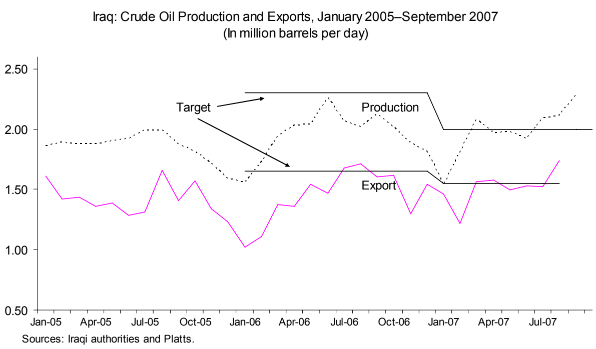
- The fiscal program was successful in containing current spending and preserving fiscal sustainability, but fell short in implementing the ambitious investment program. The wage bill and other current spending were kept under control, which has helped to contain underlying inflation pressures. The authorities put on hold the implementation of a fiscally unsustainable new pension law until 2008, after corrective amendments that will make the pension system sustainable were adopted in October 2007. Investment spending was below target due to a combination of political, security, and administrative factors, although there has been a pick-up in 2007. On the revenue side, higher crude oil export prices compensated for the shortfall in oil production. These developments combined to generate a budget surplus of 12 percent of GDP in 2006 and a small projected surplus of 1½ percent in 2007 (taking into account the adverse impact of the appreciation of the dinar on oil revenue), while DFI balances grew to $12.1 billion by end-October 2007.

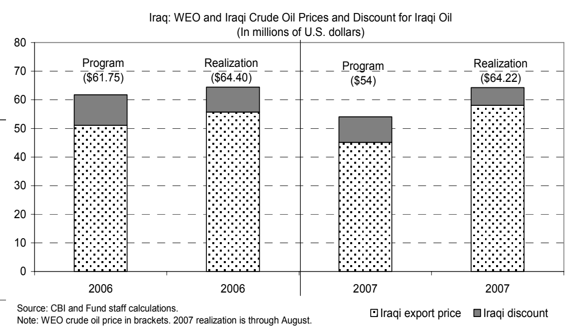
- Inflation was brought under control with a policy package including exchange rate appreciation, tight monetary policy, and control of current government spending.

Box 1. Shortfall and Offset in Iraqi Oil Exports

- **Production and export of crude oil have been lower than expected under the SBA-supported program.** In December 2005, crude oil production and exports were expected to reach 2.25 and 1.65 mbpd, respectively, in 2006 and 2.7 and 2.1 mbpd in 2007, which was revised to 2.3 and 1.7 mbpd at the time of the third and fourth reviews, in March 2007. These targets have generally not been met, except in recent months, when both production and exports have picked up.

- **The shortfall in oil production has been offset by higher world market prices and a lower discount for Iraqi oil.** The average monthly world market price for crude oil (an average of three benchmark prices published in the World Economic Outlook) increased by 20 percent in the period January 2006–August 2007 compared to 2005. The average price of Iraqi oil increased by 27 percent in the same period, partly due to a decline in the discount on Iraqi oil of about $2 per barrel. The lower discount partly reflects a higher share of Iraqi exports to markets in Asia, which pay a higher price for the heavier and more sulfur-rich Iraqi oil than U.S. and European markets.





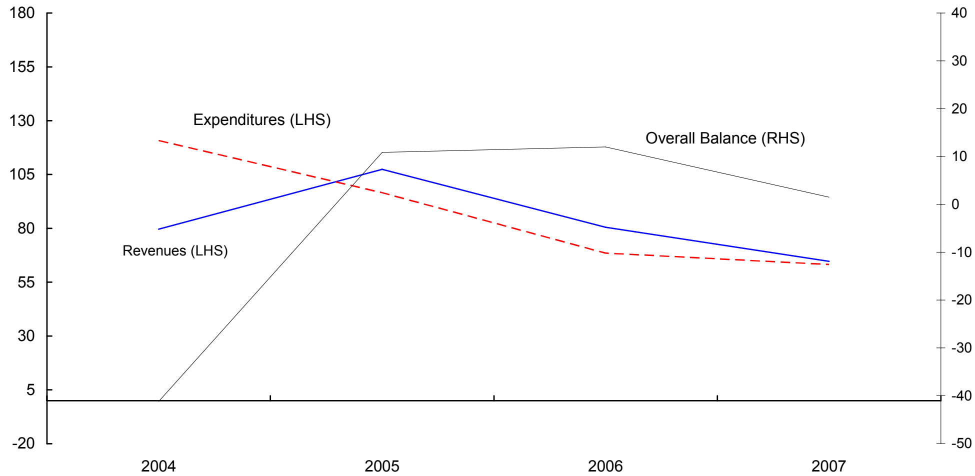
- **Higher prices offset about two thirds of the production shortfall in 2006, while in 2007 higher prices more than offset for the shortfall**. In 2006 higher world market prices and a lower discount combined to compensate $2.4 billion of the $3.7 billion shortfall due to lower than expected production, leaving a cash deficit of $1.3 billion compared to program projections. In 2007 the offsetting factors, in particular higher world market prices, generated $7.1 billion to compensate a production shortfall of $3.1 billion. Without the offset of higher world market prices and a lower discount the production shortfall would have depleted the DFI by the end of 2007. This illustrates how fragile Iraq's public finances have been in recent years and underscores the urgency to raise oil output.

Iraq: Shortfall and offset in oil export revenues
(in millions US dollar)

	2006	2007
Shortfall 1/	3,730	3,128
Offset, *of which*	2,441	7,132
Higher world market price	1,404	5,633
Lower Iraqi discount	1,037	1,499
Cash deficit /surplus	-1,289	4,004
DFI balance		
Realized / projected	8,624	9,402
Without offset	6,183	0

1/ Calculated as the difference between projected and realized export volumes times the projected export price.

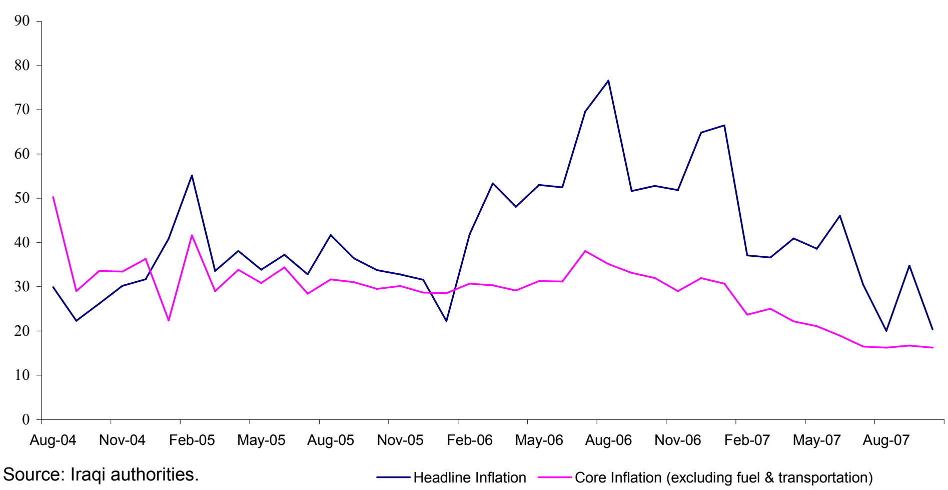
Figure 2: Fiscal Developments, 2004–07
(In percent of GDP)



Sources: Iraqi authorities; and Fund staff estimates and projections.

Annual inflation jumped from 32 percent at end-2005 to 65 percent by end-2006, mainly because of violence-related fuel shortages. The CBI responded by letting the exchange rate of the dinar to the dollar appreciate by 16 percent since November 2006 to ID 1,232 by end-October 2007, and by raising its policy interest rate in two steps to 20 percent as of January 2007. These policies, together with measures to reduce fuel shortages, helped bring down consumer price inflation to 20 percent, and core inflation (excluding fuel and transportation) to 16 percent by October 2007. Annual inflation is expected to remain below the target of 25 percent by year-end.

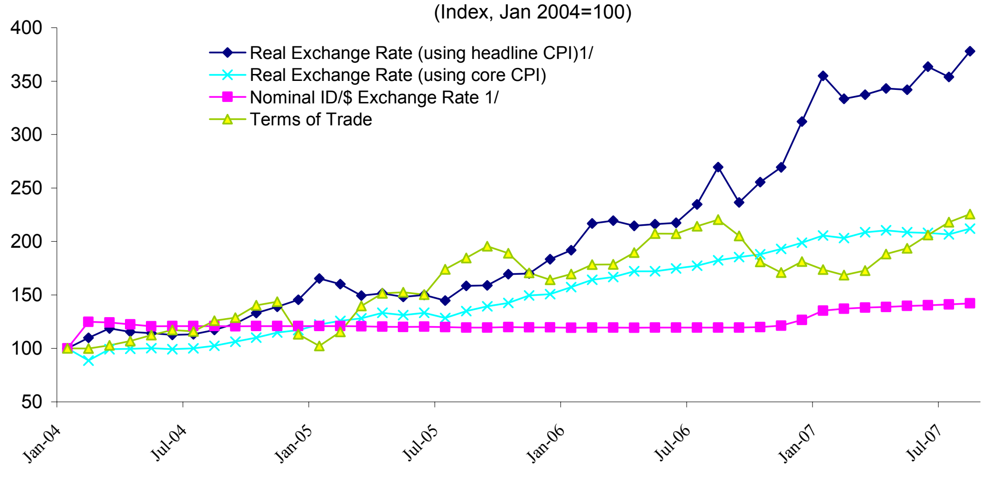
Figure 3: Annual Consumer Price Inflation, August 2004–October 2007
(In percent)



Source: Iraqi authorities.

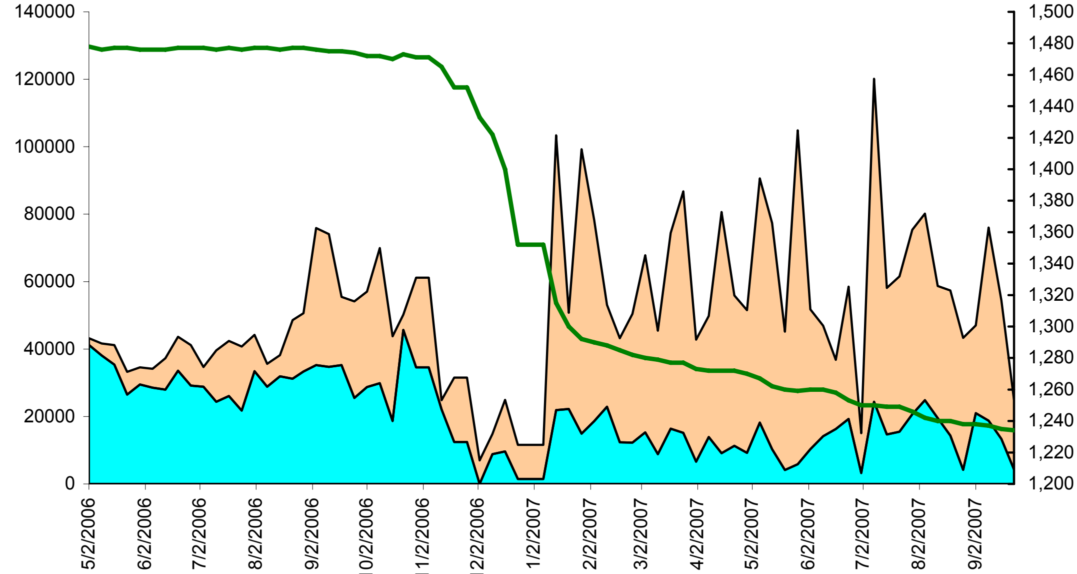
- The tight monetary and exchange rate policies also helped to reduce dollarization, while accumulation of net international reserves exceeded expectations. Real demand for dinar currency in circulation expanded by 9 percent between end-November 2006 and end-August 2007, after it had fallen by 37 percent between end-December 2005 and end-November 2006. Also, in 2007, cash sales of dollars at the foreign exchange auction—a key indicator of dollarization—were substantially below 2006 levels. Dollar sales for bank transfers, which largely represent the financing of imports and the increasingly important remittances to Iraqi refugees abroad, recovered quickly in early 2007 and have remained well above 2006 levels since then. This did not signal increased pressure on the exchange rate as increased sales of dollars by the government, reflecting efforts to increase the execution rate of the investment budget, enabled the CBI to accumulate reserves well in excess of program expectations, bringing net international reserves of the CBI to $25.5 billion by end-October 2007. The CBI absorbed excess liquidity by using its standing deposit facilities, issuing CBI-bills, and, in September 2007, increasing the required reserves ratio on government deposits from 25 percent to 75 percent. Despite improved macroeconomic management, considerable reserve accumulation, and lower inflation, Iraq's internationally traded bond has underperformed, suggesting that investors are pricing in a higher country risk premium.

Figure 4: Real and Nominal Exchange Rates, January 2004–August 2007
(Index, Jan 2004=100)



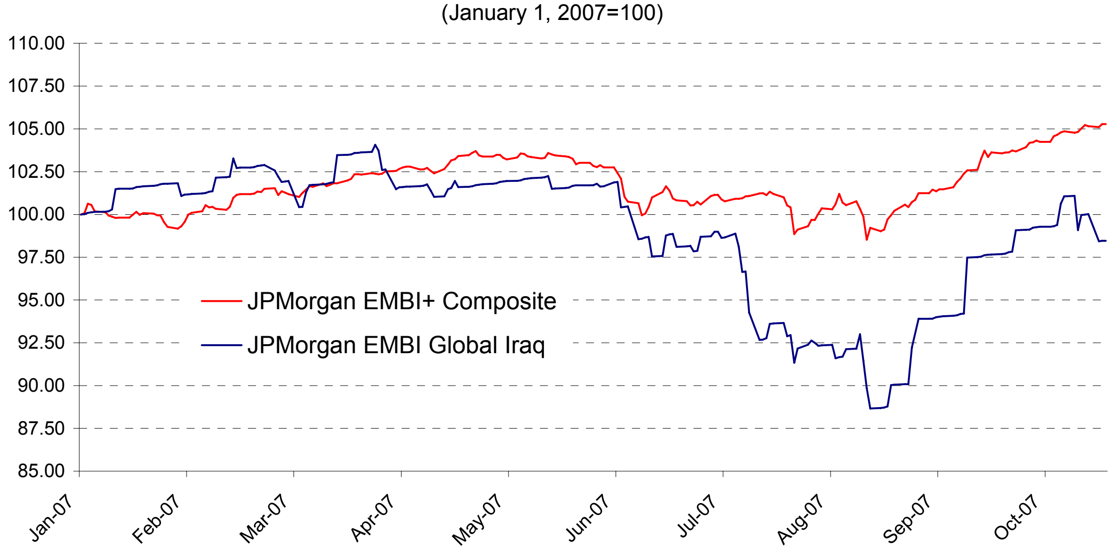
Sources: The Iraqi Authorities and Fund staff calculations.
1/ Increase denotes appreciation.

Figure 5: Daily Foreign Exchange Sales and Nominal Exchange Rate
May 2006–September 2007
(In thousands of U.S. dollars and ID/$)



Sources: Iraqi authorities and Fund staff estimates.
Note: Foreign exchange sales are weekly averages of daily sales.

Figure 6: J.P. Morgan EMBI+ Composite and Iraq Bond Indices, January–October 2007
(January 1, 2007=100)



Source: Bloomberg

11. **All quantitative performance criteria under the SBA through June 2007 were met, but one structural performance criterion was missed.** Staff will inform the Executive Board on the outcome of the end-September quantitative performance criteria before Board consideration of the successor SBA. The security situation has caused further delays in

conducting the census of public service employees, and the data collection phase of the census was not completed by end-November as planned.

12. **Progress has been made with structural reforms, despite the lack of security and capacity constraints:**

- Prices of domestic fuel products were increased significantly and brought in line with those in other oil-exporting countries in the region. Direct budgetary subsidies, which amounted to almost 13 percent of GDP in 2004, were eliminated in 2007 (with the exception of a small subsidy for kerosene), while the price adjustments also helped to fight smuggling.[1]

- Legislation and administrative regulations were enacted to allow importation of fuel products by the private sector, which has begun in 2007, including in the south.

- Amendments to the new pension law were passed by the Council of Representatives in October 2007. The amendments aim at making the new pension system fiscally sustainable, notably through a gradual reduction of replacement rates to sustainable levels.

- As part of its efforts to modernize public financial management, the government has brought the chart of accounts and budget classification in line with the GFSM 2001, within a cash accounting framework. However, the work on the FMIS was terminated following the abduction of an external consultant in May 2007, and in light of the difficulties to align the system to the needs of the Iraqi government.

- An audit of the CBI end-2006 net international reserves and the audit of its 2006 financial statements were finalized, and the CBI has begun to address weaknesses in its accounting and reporting framework. Also, the CBI's capital was raised to the statutory level.

- The payment system is being modernized, and an up-to-date real-time gross settlement system and an automatic clearing house are operational. Preparations for the restructuring of the two largest state-owned banks (Rafidain and Rasheed) are underway.

13. **Iraq has continued to make progress toward resolving outstanding external claims.** Bilateral agreements have been signed with all Paris Club creditors, except Russia. Progress has been much slower with non-Paris Club creditors, where Iraq has announced

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[1] Indirect subsidies remain large (estimated at almost 12 percent of GDP in 2006) as domestic refineries receive crude oil for a fraction of the export price. Total (direct and indirect) fuel subsidies in 2004 were estimated at 30 percent of GDP (SM/05/264; 7/11/05).

agreements with ten creditor countries.[2] A special purpose vehicle has been established to facilitate official creditors desiring to securitize their claims, while avoiding the emergence of a multiplicity of different securitizations. Iraq has resolved all but about 4 percent of private creditors' claims.

14. **Data provision has been adequate for purposes of program monitoring, but weaknesses remain.** Oil sector data are readily available, but there is little information on the non-oil economy. Consumer price data are timely and coverage is adequate (but excludes the Kurdish region), although the basket of goods is outdated. The CBI has recently produced a monetary survey, which also excludes the Kurdish region. Fiscal reporting is adequate to monitor budget execution, but should be more timely.

III. The Authorities' Program for 2008

15. **The requested SBA should help the authorities to consolidate and advance the achievements of the program supported by the current arrangement.** In broad terms the program aims to: (i) maintain macroeconomic stability; (ii) facilitate investment and higher output in the oil sector; and (iii) advance priority structural reforms. The program envisages a 2008 budget that makes room for sizable investment while maintaining fiscal sustainability; the continued avoidance of direct fuel subsidies; the strengthening of public financial management and the accounting framework of the CBI; the restructuring of the two largest public banks; and improving governance in the oil sector.

16. **The program will have ambitious yet realistic macroeconomic objectives for 2008.** Based on the recent upturn in oil production and exports, in particular through the North, and further progress in executing the investment program in the oil sector, the program envisages that oil output will increase to 2.2 mbpd and oil exports to 1.7 mbpd in 2008. With a modest pick-up of non-oil growth, overall GDP growth of 7 percent should be achievable. The program also aims to bring annual consumer price inflation down to 12 percent in 2008. The net international reserves of the CBI are expected to increase to about $34 billion by end-2008.

A. Fiscal Policy and Related Issues

17. **The 2008 budget submitted to parliament envisages a further increase in investment and a moderate rise in current spending (¶10).**[3] The budget is based on a

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[2] Bulgaria, Cyprus, Czech Republic, Hungary, Indonesia, Malaysia, Malta, Romania, Slovak Republic, and South Africa. The total debt to non-Paris Club official creditors is estimated at $76.8 billion (123 percent of GDP), of which bilateral agreements have been signed for $6.9 billion. More than 85 percent of unscheduled debt is to the Gulf countries and China.

[3] Paragraph numbers refer to the relevant paragraphs in the MEFP.

conservative oil export price assumption of $57 per barrel and oil exports of 1.7 mbpd, which would generate oil-revenues slightly higher than the expected 2007 outturn. Receipt of $3.75 billion (5.3 percent of GDP) in fees for auctioned mobile phone operator licenses will provide a one-off boost to revenues. The government intends to limit new hiring, and not to grant any general wage increases. On this basis, the overall fiscal deficit is expected to increase to almost 8½ percent of GDP in 2008, while leaving sufficient resources in the DFI to maintain fiscal sustainability over the medium term.[4] In the event that oil revenue in 2008 differs substantially from the budget assumptions, the government will discuss with the Fund on how to proceed in order to attain the program objectives.[5]

18. **An ambitious investment program has been prepared for 2008 (¶12).** In the oil sector, the program includes projects to increase production and export capacity in the South and to better secure the northern export pipeline. Measures are also being taken to speed up implementation of reconstruction projects that could not be undertaken in previous years, in particular in the electricity, water and sanitation, health, and education sectors. Total investment spending is planned to more than double in real terms in 2008, provided that the security situation allows full implementation of the investment program. The authorities are aware of the need to ensure the high quality of public investment while taking account of implementation capacity constraints.

19. **The government is determined not to provide any direct budget subsidies on fuel products,** except for a small subsidy on imported kerosene (¶15). To preserve the cost recovery gains made under the current SBA, the authorities, with technical assistance from the Fund, will develop a periodic adjustment mechanism for fuel prices. The MOO will continue to facilitate private sector fuel imports to further reduce shortages and contain inflationary pressures.

20. **The census of public service employees is underway, albeit with delays caused by the complexity of the task and the security situation (¶14).** The authorities are endeavoring to complete the census by end-June 2008. This will form a basis for an action

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[4] The program contains a performance criterion on the fiscal deficit which is monitored from below the line, i.e., budget financing from domestic bank accounts, the DFI and other financing net of amortization. Since December 2006, the DFI has a subaccount, the Foreign Military Sales (FMS) account, into which funds are earmarked for spending on military equipment. The program assumes that the lag between the signing of contracts (and the earmarking of funds into the FMS) and the final execution of the contract (depletion of funds in the FMS) will not be large and will mainly fall within the same fiscal year. If the lags turn out to be significantly longer than expected, the fiscal deficit could capture cash outlays from different budgets and could therefore deviate from the performance criterion. The timing of withdrawals from the FMS is linked to the timing of contract execution (as opposed to contract signing) and is not under the control of the authorities. This issue will be revisited at the time of the next review.

[5] If the government wants to increase spending above the budget limit, it needs to pass a supplementary budget that will be discussed with the Fund.

plan to be adopted by September 2008, that will aim at eliminating ghost workers and computerizing the payroll and eventually at establishing a bank transfer system for wage payments.

21. **Steps are being taken to streamline the social safety net (¶16).** In addition to enhanced monitoring and improved procurement procedures, the authorities are considering to limit the rations in the Public Distribution System, and to further limit eligibility of well-off families. The draft 2008 budget provides for an expansion the coverage of the new cash-based Social Safety Net, which presently covers about 800 thousand families.

22. **The authorities remain committed to strengthening public financial management (¶17).** Following the termination of the FMIS, the government has requested Fund technical assistance to help it identify priorities in this area and to develop a reform plan. To strengthen transparency and accountability, the authorities intend to submit to the BSA, and subsequently to the Council of Representatives and the public, the final accounts of the federal budget for 2007 (as required by the 2004 Financial Management Law).

23. **The government is preparing a medium-term tax-reform strategy with assistance from international partners, including the Fund (¶18).** Priority reforms are to establish an efficient tax system for the oil sector conducive to private sector activities, and possibly to introduce a sales tax. In the interim period, the corporate income tax will be kept at 15 percent, and the 5 percent customs duty (reconstruction levy) will be maintained while exemptions will be reduced.

B. Monetary and Exchange Rate Policy

24. **The CBI intends to maintain its present exchange rate and monetary policy stance, which helps to de-dollarize the economy, until core inflation is firmly under control (¶19–20).** Although the lack of data and the many structural changes in the economy preclude an estimation of the equilibrium real exchange rate, it is likely that the improvement in the terms of trade have resulted in an appreciation of the equilibrium real exchange rate. With the nominal exchange rate fixed to the dollar until end-2006, the adjustment of the real exchange rate to its new equilibrium was reflected in persistent high core inflation which was validated by the pervasive cash dollarization. The still high core inflation rate seems to indicate that the nominal appreciation of the dinar since November 2006 has reduced but may not have fully eliminated the undervaluation of the real exchange rate. Therefore, the CBI will continue the gradual appreciation of the dinar until core inflation has come down to near single digit levels. Once this has been achieved, the CBI would return to its previous policy of maintaining a stable exchange rate while continuing to provide the full amount of foreign currency demanded at the cut-off rate at the daily auction. The CBI will also keep its policy interest rate at 20 percent until core inflation is near single digit levels. Provided inflation continues its downward trend, the policy rate could then be reduced gradually, while

maintaining a positive real interest rate and taking into account the impact on inflation expectations.

25. **The monetary program for 2008 is designed to accommodate the projected accumulation of net international reserves and a growing real demand for dinars (¶20).** The floor on net international reserves in the program is set with a sufficient margin to allow the CBI room to maneuver should monetary conditions change. The CBI will continue to absorb excess liquidity by issuing CBI-bills and giving banks unrestricted access to its standing deposit facilities.

26. **The CBI is preparing to add new monetary policy instruments to its tool kit (¶21).** It intends to continue to support a liquid secondary market of tradable instruments by continuing to sell treasury bills it receives from the MoF as part of the rescheduling of CBI claims. The CBI also plans to develop a central depository system, while the MoF will continue with the regular bi-weekly issuance of treasury bills. Restructuring the presently largely inactive banking system will also help towards developing a secondary market and, over time, give the CBI the option to conduct open market operations.

27. **The CBI will continue its efforts to strengthen its accounting, auditing, and reporting systems (¶22).** The CBI has made some progress in implementing the recommendations of the Fund's ISAR, which covered three of the areas of the safeguards framework (external audit, financial reporting, and controls). Work on an update of the ISAR, which will also include the internal audit and legal structure safeguards areas, is substantially complete. The update identified a number of key actions, including maintaining proper accounting records and regular reconciliation of CBI accounts, as well as adopting reserves management guidelines. Also, the external auditor for the audit of the CBI net international reserves at end-2007 and the audit of the CBI 2007 financial statements will be appointed before Board discussion of the proposed arrangement, while completion of the audits will be performance criteria under the program. The authorities also plan to amend the central bank law, with technical assistance from the Fund.

C. Banking Sector Reform

28. **The authorities are convinced that development of financial intermediation is critical to accelerate economic growth in Iraq and therefore place bank restructuring high on their reform agenda (¶29).** International auditors will soon be appointed to undertake operational and financial audits of Rafidain and Rasheed, the two largest banks, that are scheduled to start in early December 2007 (prior action) and should be completed by end-April 2008. The terms of reference for the audits have been approved by the Restructuring Oversight Committee and agreed with the Fund and the World Bank. Diagnostic audits for the three small remaining state-owned banks will also start in 2008.

29. **Comprehensive restructuring programs based on the results of the audits for Rafidain and Rasheed banks will be adopted by end-September 2008.** In the meantime,

measures to improve the banks' governance have been taken. Progress is also being achieved in the reconciliation of their foreign debt, and toward the liquidation proceedings for the London branch of Rafidain Bank. The cleaning-up of the books of Rafidain and Rasheed banks is underway, in particular to resolve their very large suspense accounts. Recapitalization of the two banks will be financed with the issuance of government bonds.

30. **The authorities are also making efforts to strengthen the financial sector infrastructure (¶30).** A set of prudential regulations applicable to all commercial banks will be compiled and applied by end-July 2008, and the switch from domestic accounting standards to International Financial Reporting Standards is under preparation. Progress also continues to be made in expanding the payment system.

D. Other Issues

31. **Fighting corruption, notably in the oil sector, and improving transparency in the management of public resources is a high priority for the authorities (¶27).** They have made efforts to ensure a smooth transition when the Iraqi COFE takes over the IAMB responsibilities for oversight and monitoring of the DFI by end-2007.[6] They intend to implement a number of IAMB recommendations, including for the COFE to continue the IAMB practice of publishing audit reports and making recommendations in semi-annual reports to the Council of Ministers. A metering system in the export terminal of Basra is operational and metering systems in other ports and oil installations are being put in place, in line with IAMB recommendations. The authorities also plan to join the Extractive Industries Transparency Initiative.

32. **The authorities are taking steps to revitalize the public enterprise sector (¶31).** A program to provide subsidized bank loans—the cost of which will be fully reflected in the budget—to restart the activities of commercially viable public enterprises, has started. In addition, a microfinance scheme has been established. The authorities are committed not to provide any government guarantees on bank loans under these programs. A National Investment Commission has been set up to implement the new investment law (adopted in November 2006) which aims to attract foreign investors.

[6] Protections against claims available to the DFI in the U.S have been extended through 2008.

Box 2. Recommendations of the IAMB

The IAMB was established by the United Nations Security Council in 2003 and will be in operation until December 2007 to act as an audit oversight body for the DFI.

Several audits mandated by the IAMB concluded that the overall financial system of controls is deficient and that financial management reforms need to be pursued further. The audits noted large un-reconciled differences regarding oil extraction, production and export sales, and found that basic administrative procedures in ministries are outdated and ineffective. Based on these audits the IAMB makes the following key recommendations:[1]

- Install comprehensive metering equipment in line with standard oil industry practice;
- Discontinue the use of barter transactions. If some barter transactions remain necessary, transparently reflect them as sales and purchases so that these transactions become less prone to misappropriation and corruption;
- Continue to take concrete steps to follow up on all audit findings and implement recommendations, including to improve financial reporting and control systems in key ministries;
- Seek resolution with the U.S. Government concerning the use of resources of the DFI which might be in contradiction with UNSCR 1483; and
- Continue the independent oversight work, upon dissolution of the IAMB, by the Government of Iraq's COFE, with regular reporting to the public and the international community.

1/ These recommendations are listed in a draft report that is scheduled to be issued in December 2007. Fund staff conduct much of the IAMB's secretariat-related work and are currently finalizing the draft report.

33. **The authorities reiterated their commitment to free trade policies and an open exchange system (¶23–24).** Negotiations to join the WTO continue, and bilateral meetings on market access for goods and services with a number of members started in 2007. Work toward accepting the obligations of Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement is also ongoing. In the meantime the authorities remain committed to avoiding restrictions on the making of payments and transfers for current international transactions, introducing new or intensifying trade restrictions for balance of payments purposes, or resorting to multiple currency practices.

34. **With most of the Paris Club bilateral agreements signed, efforts are now focused towards resolving still outstanding non-Paris Club and commercial external claims.** Understandings with China have been reached on part of the debt, and progress is being made with the remainder. Despite Iraq's good faith efforts, progress has been slow with the Gulf countries and Russia (the only remaining Paris Club creditor). The reconciliation of

most of the remaining unresolved claims of private creditors is ongoing as part of the liquidation of the London branch of Rafidain Bank.

35. **The authorities will step up their efforts to further improve the timeliness, coverage, and accuracy of macroeconomic statistics.** Work to improve the CPI is progressing. The 2007 household survey is expected to be completed by year-end, which will allow the authorities to update the CPI weights by end-May 2008. They are also working to extend overage of the CPI and monetary statistics to the Kurdish region. Work towards GDDS participation is ongoing and it is expected that Iraq will start submitting data for the IMF's *International Financial Statistics* shortly.

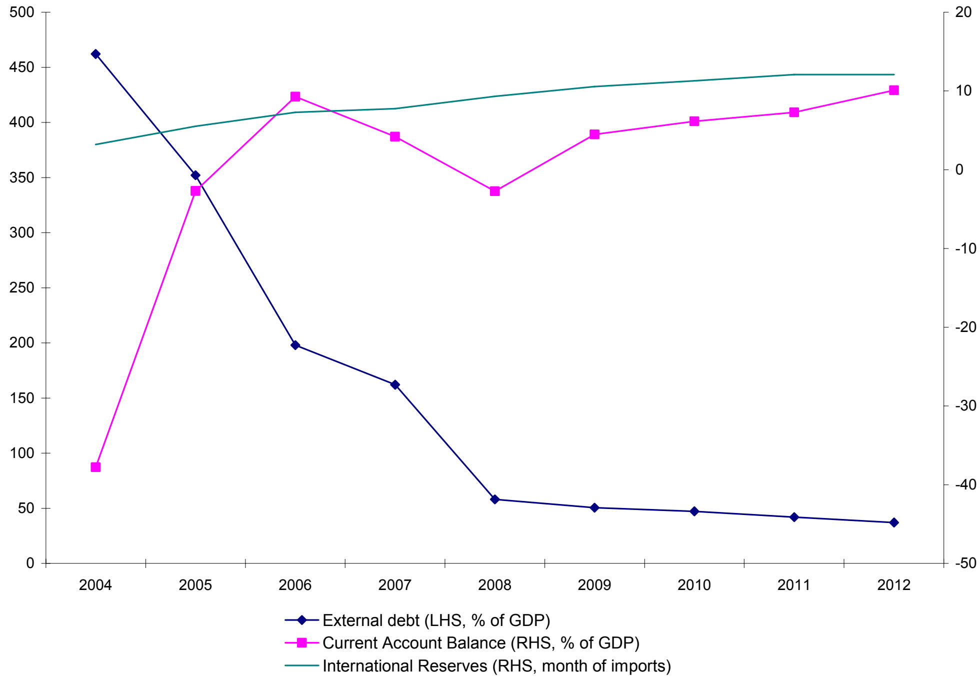
IV. PROGRAM MODALITIES AND RISKS

A. Medium Term Outlook and Capacity to Repay the Fund

36. **Iraq's medium-term outlook is favorable, provided there is an improvement in security.** The present circumstances constrain the effectiveness of macroeconomic policies and the authorities' ability to implement reforms. In light of the government's limited ability to increase the rate of implementation of their oil investment program, oil production is expected to increase only gradually over the next few years, while non-oil output may grow moderately. Inflation is targeted to decline further, reflecting the policy actions taken by the CBI, the continued control of government current spending to avoid excessive demand pressures on Iraq's small non-oil economy, and the expansion of private imports of fuel products to reduce shortages. The increase in government investment should have only a limited impact on inflation, in view of its high import content and considerable unused capacity in the economy. With the current favorable world oil price outlook and assuming a gradual increase in oil export volumes, the overall fiscal position would be sustainable. However, there is little room for fiscal slippage, in view of the projected fall in the balance of the DFI during 2008–10 to absorb the projected fiscal deficits and the need to finance the sizable amortization payments of the rescheduled debt beginning in 2011. The external current account balance is expected to deteriorate in 2007–08 and improve gradually thereafter, as oil exports would increase only slightly and because of higher investment-related imports and lower inflows of foreign grants. Gross international reserves are expected to gradually increase to a level equivalent to 12½ months of import cover by 2012.

37. **The favorable medium term outlook is subject to substantial risk.** The threat that the security situation poses to the government's ability to raise investment and production in the oil sector remains the largest risk to the outlook. Raising oil output is critical to avoid financing gaps, as staff's alternative scenario shows (see below). A further weakening of the political consensus could derail the government's structural reform program and jeopardize budgetary discipline. The risk of oil price fluctuations is mitigated by the conservative oil price assumption of $57 per barrel in the 2008 budget. Oil prices in the medium term are projected to be in line with WEO forecasts.

Figure 7. Current Account Balance, External Debt
and International Reserves, 2004–12



Sources: Iraqi authorities; and Fund staff estimates and projections.

38. **If investment and production in the oil sector cannot be increased as projected, lower oil revenue would lead to high fiscal and external deficits, and sizable financing gaps from 2010.** In staff's illustrative alternative scenario oil output remains flat at 2.1 mbpd, causing overall GDP growth to remain low over the medium term. Even with the current favorable oil price outlook this would lead to high fiscal deficits from 2008 and depletion of the DFI by 2009. A negative oil price shock would further deteriorate the outlook. Absent access to significant external borrowing, drastic spending cuts would be unavoidable.

Iraq: Medium Term Outlook - Alternative Scenario

	2007	2008	2009	2010	2011	2012
Real GDP (percentage change)	4.3	1.2	2.0	2.9	3.1	3.2
Oil production (mbpd)	2.1	2.1	2.1	2.1	2.1	2.1
Consumer price inflation (percentage change)	25	12	10	10	10	10
Current account balance (percent of GDP)	4.4	-5.6	-1.2	-5.5	-8.9	-10.4
Overall fiscal balance (percent of GDP)	4.6	-11.5	-10.0	-13.4	-14.6	-15.2
DFI (in US$ million)	12,407	5,274	0	0	0	0
Financing gap (percent of GDP)	0	0	3.4	13.4	17.4	18.0

Sources: Iraqi authorities and Fund staff projections.

39. **Iraq has received substantial debt reduction from official and private creditors, but further reduction is needed to achieve external debt sustainability** (Appendix I)**.** The first two stages of the Paris Club debt rescheduling, rescheduling of some of the non-Paris Club debt, and most of the private sector claims thus far have reduced Iraq's external debt to $101.5 billion at end-2007 (about 162 percent of GDP). To make the debt sustainable, the third tranche of Paris Club debt rescheduling (worth 20 percent in NPV terms) is needed upon completion of the final review of the proposed SBA, as well as progress in rescheduling the rest of the debt from non-Paris Club creditors at terms comparable with those granted by the Paris Club. This would bring the debt down to $32.7 billion (46 percent of GDP) by end-2008 and secure debt sustainability over the medium term.

40. **If purchases were to be made under the precautionary arrangement, Iraq should have the capacity to repay the Fund.** Total Fund credit would peak at 1.2 percent of GDP (46 percent of quota) by end 2008, and most of it would be repaid before payments for the rescheduled debt to Paris Club creditors start in 2011, with the entire Fund exposure eliminated by 2012. Total debt service to the Fund in any year would not exceed 0.7 percent of exports of goods and service. Even with only a projected gradual expansion of oil output, Iraq should be in a position to meet its obligations to the Fund. Under the baseline scenario external surpluses would continue throughout the medium term.

B. Proposed Arrangement

41. **The successor SBA would be precautionary and cover a 15-month period, ending in March 2009, in support of the authorities' economic program for 2008 (¶33–34).** Access is proposed at SDR 475.36 million (40 percent of quota), with six equal purchases of SDR 79.23 million (6.67 percent of quota) each. Implementation of the program will be monitored through prior actions, quantitative and structural performance criteria, an indicative target, and structural benchmarks, as specified in the MEFP. In addition, the program will be monitored through two (semiannual) reviews. The first review will focus, inter alia, on progress made with developing an action plan to modernize the government's financial management information system and on the completion of an audit of the CBI's net international reserves. The second review will focus on progress made with developing an action plan to restructure the two large state owned banks and a periodic adjustment mechanism for fuel prices.

42. **If needed, the regular reviews will be combined with financing assurances reviews.** The fully financed program and the authorities' commitment to continue its good faith efforts to reach a debt rescheduling agreement with official and private international creditors, provide assurances that Iraq will be in a position to repay the Fund any purchases it may make under the arrangement.

V. Staff Appraisal

43. **Iraq's performance under the current SBA has overall been good, especially in light of the very difficult security and political circumstances.** In particular, the authorities took a major step in increasing domestic fuel prices to regional levels, thereby all but eliminating direct budgetary subsidies on fuel products. They have also successfully mounted a policy response to bring a high rate of inflation sharply down. Fiscal discipline has been maintained throughout the program period. Despite the lack of security and capacity constraints, structural reforms continued.

44. **Nevertheless, Iraq still faces enormous challenges and much remains to be done.** The ongoing violence has severely reduced the rate of execution of the public investment program, which, combined with attacks on oil installations, kept oil production virtually flat. Non-oil economic activity also suffered. As a result, economic growth was much below target. Reforms to strengthen the financial management of the government and the CBI, as well as to modernize the banking sector are still at an early stage. While the installation of a metering system in the Basra oil-export terminal is an important step forward, further progress is needed to significantly reduce corruption in the oil sector and elsewhere.

45. **The proposed SBA will support the authorities' economic program for 2008 that aims to build on the progress made under the current SBA and address the unfinished agenda.** The main objectives of the new program will be to maintain macroeconomic stability, facilitate investment and higher output in the oil sector, and advance priority structural reforms to pave the way for higher economic growth and to strengthen administrative capacity and governance in the public sector.

46. **The implementation of the proposed program carries significant risks.** The exodus of professionals has weakened the policy implementation capacity of the government, and also harmed the economy as a whole. Although Iraq's medium-term outlook is favorable, this depends critically on the security situation improving. Continued violence would hamper investment and thereby the expansion of oil output and overall economic activity. This, in turn, would result in uncovered financing gaps and possibly worsen commodity shortages leading to higher inflation. The unsettled political situation could reduce the ability of the government to maintain fiscal discipline and undertake reforms. The lack of strong governance in some areas also remains a concern.

47. **Staff welcomes the priority given in the draft 2008 budget to increasing investment while containing current spending and maintaining fiscal sustainability over the medium term.** Staff believes that a gradual expansion of oil production is achievable, provided the envisaged investments in the oil sector are realized. The ambitious increase in public investment in 2008 requires sustained efforts to ensure its quality. The government will also need to ensure that the wage and pension bill remains within budget. In this connection, the amendments to the new pension law are a key step to make the pension

system sustainable. It is also important to complete the census of public service employees without further delay and to computerize the payroll, in order to put the future management of the wage bill on a sound footing. Staff support the authorities' intention to further streamline the Public Distribution System, while stressing the need to protect the poor.

48. **Staff welcomes the CBI's commitment to continue the gradual appreciation of the exchange rate and to keep its policy interest rate unchanged until annual core inflation has decreased to close to single digit levels.** The CBI should continue to keep a close watch on inflationary developments and adjust its policy stance as needed. It is also important for the government to further reduce shortages, including by supporting private sector fuel imports. If inflation continues to decline, the policy interest rate could be reduced gradually, while seeking to maintain this rate positive in real terms. Once the inflation objective has been reached, it is appropriate for the CBI to return to its previous policy of maintaining a stable exchange rate.

49. **Staff underscores the need to accelerate structural fiscal reforms, notably in public financial management.** The termination of the FMIS is a setback. Therefore, the authorities should step up their efforts to develop, with Fund technical assistance, a realistic action plan to modernize public financial management, in order to address the most pressing needs. Staff welcomes the commitment of the authorities to publish the audited fiscal accounts for 2007. It is also important to streamline the tax system in order to broaden the tax base and improve incentives for economic activity.

50. **Staff welcomes the authorities' focus on banking reform.** To significantly strengthen financial intermediation in Iraq, it is crucial to move ahead with developing and implementing restructuring programs for Rafidain and Rasheed banks, based on the results of their audits. At the same time, it is important for the government to adhere to its commitment to refrain from providing government guarantees on bank loans. The efforts to strengthen banking supervision and expand coverage of the payment system should be stepped up. The CBI should continue to strengthen its accounting, auditing, and reporting systems.

51. **It is crucial to push ahead with reforms in the oil sector, notably in light of the need to strengthen governance and fight corruption.** The government's commitment to ensure that the COFE will fully take over the tasks of the IAMB as an audit oversight body for the DFI is welcome. Staff encourages the government to expand metering to all upstream and downstream oil sector activities as soon as possible. In order to ensure that fuel prices continue to cover costs, it will be important to develop a periodic price adjustment mechanism to allow prices to change in line with costs. In view of Iraq's large future investment needs to increase oil production, efforts should continue to establish a new legislative framework for the hydrocarbon sector.

52. **Staff urges the authorities to continue their efforts to conclude debt agreements with the remaining official and private creditors.** In light of the good faith efforts

undertaken by the authorities, staff hopes that the process of resolving Iraq's debt to non-Paris Club creditors will accelerate and that an agreement with Russia will be signed soon.

53. **Staff underscores the need to further improve the accuracy, coverage, and timeliness of macroeconomic statistics**, notably of data on the real sector, public finance, and the balance of payments. It is important to update the weights of the CPI and to continue efforts to extend the coverage of statistics to the Kurdish region.

54. **The staff supports the authorities' request for a precautionary Stand-By Arrangement in an amount of SDR 475.4 million for a period of 15 months.** While the implementation of the program is subject to higher than usual risk because of the security situation, the authorities have demonstrated their commitment to undertaking strong macroeconomic policies and implementing economic reforms. The staff therefore believes that their program merits the support of the Fund.

Proposed Decision

1. Iraq has requested a Stand-By Arrangement in an amount equivalent to SDR 475.36 million for a period of fifteen months from December 19, 2007.

2. The Fund approves the Stand-By Arrangement for Iraq set forth in EBS/07/138 and decides that purchases may be made under the arrangement on the condition that the information provided by Iraq on implementation of the measures specified as prior actions in Table 2 of the Memorandum of Economic and Financial Policies attached to the letter from the Governor of the Central Bank and the Minister of Finance of Iraq, dated December 4, 2007, is accurate (EBS/07/138, 12/5/07).

Table 1. Iraq: Selected Economic and Financial Indicators, 2005–12

	2005		2006		2007		2008	2009	2010	2011	2012
	SBA	Est.	SBA	Est.	SBA	Proj.	Projections				
Economic growth and prices											
Real GDP (percentage change)	2.6	-0.7	10.4	6.2	10.4	1.3	7.1	7.5	10.4	9.6	8.9
Non-oil real GDP (percentage change)	8.0	12.0	8.0	7.5	7.5	0.0	3.0	5.0	7.0	7.0	7.0
GDP per capita (US$)	1,189	1,124	1,452	1,723	2,097	2,115	2,321	2,742	2,984	3,256	3,536
GDP (US$ million)	33,182	31,379	41,741	49,527	62,038	62,574	70,597	85,655	95,625	106,935	118,923
Oil production (In mbpd)	2.0	1.9	2.3	2.0	2.3	2.0	2.2	2.4	2.7	3.0	3.3
Oil exports (In mbpd)	1.4	1.4	1.65	1.5	1.7	1.55	1.7	1.9	2.2	2.5	2.8
Iraq oil export prices (US$ pb)	43.0	43.9	46.6	55.7	45.1	58.8	57.0	68.2	66.4	66.0	65.7
Consumer price inflation (percentage change; end of perio	20.0	31.6	15.0	64.8	30.0	25.0	12.0	7.0	5.0	5.0	5.0
Exchange rate (dinar per US$; period average) 1/	1,500	1,469	1,500	1,467	1,500	1,264	...	...	...	...	...
Total government debt (in billions of US$)	51.2	110.5	52.2	98.1	56.4	101.4	48.7	50.5	52.3	51.1	49.8
	(In percent of GDP)										
National Accounts											
Gross domestic investment	29.1	31.6	29.0	14.4	23.7	13.9	28.0	27.6	28.3	28.4	28.8
Of which: public	25.6	19.4	26.6	13.0	17.9	12.3	23.7	21.9	21.6	21.1	20.9
Gross domestic consumption	95.4	83.4	87.1	80.3	91.0	80.5	77.1	66.3	63.8	62.4	59.4
Of which: public	59.6	59.7	57.2	41.0	39.7	35.6	35.7	31.2	30.3	29.4	28.8
Gross national savings	14.7	28.9	26.1	23.7	14.6	15.9	24.8	32.3	34.7	36.0	39.2
Of which: public	14.6	30.9	17.6	25.3	4.8	13.8	14.6	18.6	21.0	23.1	28.1
	(In percent of GDP, unless otherwise indicated)										
Public Finance											
Government revenue and grants	93.6	107.4	96.3	80.5	60.7	64.7	67.5	65.5	66.2	67.1	67.8
Government oil revenue	67.8	76.7	72.9	65.2	49.2	58.9	57.1	62.1	63.0	64.0	64.8
Government non-oil revenue	2.6	2.8	3.0	2.9	3.0	2.9	8.4	3.2	3.0	3.0	3.0
Grants	23.2	27.9	20.4	12.5	8.5	2.9	2.0	0.2	0.2	0.1	0.0
Expenditure, *Of which:*	104.5	96.5	105.3	68.5	73.8	63.2	75.9	68.5	66.1	64.1	62.3
Current expenditure	78.9	77.2	80.0	55.4	55.9	49.4	52.0	46.2	44.1	42.4	40.7
Capital expenditure	25.6	19.4	25.3	13.0	17.9	12.3	23.7	21.9	21.6	21.1	20.9
Overall fiscal balance (including grants)	-10.9	10.9	-9.0	12.0	-13.1	1.5	-8.4	-2.9	0.1	3.0	5.6
Primary fiscal balance	-10.8	11.1	-8.2	12.5	-12.4	2.2	-7.5	-1.3	1.6	4.8	7.0
Gross borrowing/use of external assets	11.9	6.4	9.3	-2.3	12.0	-1.0	8.5	3.7	1.0	0.7	-2.2
Amortization	0.6	0.5	0.3	2.5	0.2	0.3	0.7	0.0	0.0	2.3	2.1
Residual or financing gap/surplus	0.0	0.1	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Tax revenue/non oil GDP (In percent)	2.4	2.8	4.2	1.9	2.0	2.0	2.3	2.8	2.9	3.0	3.0
External assets held abroad (In US$ million)	3,992	6,203	285	8,624	2,467	10,367	5,119	2,499	2,502	3,220	7,186
	(In percent, unless otherwise indicated)										
Monetary Indicators											
Growth in reserve money	12.9	12.0	20.6	29.0	20.1	33.0	16.5	14.6	...	...	...
Gross CBI foreign exchange assets/Reserve money	98.8	129.4	99.2	150.3	133.3	137.5	150.2	168.4	...	...	...
Gross reserves (In US$ million)	9,311	12,016	11,013	20,037	21,050	26,909	34,318	42,689	50,810	57,196	64,717
In months of imports of goods and services	3.1	5.5	3.6	7.7	6.1	8.0	9.5	10.9	11.7	12.5	12.5
Policy interest rate (end of period)	7.0	7.0	7.0	16.0	20.0	20.0	...	...	...	...	...
	(In percent of GDP)										
Balance of payments											
Current account	-14.4	-2.7	-2.7	9.3	-9.1	2.0	-3.2	4.7	6.4	7.6	10.4
Trade balance	-4.9	3.3	1.1	15.7	-6.0	12.3	2.4	12.2	13.9	15.0	17.3
Exports of goods	68.7	63.0	68.9	57.4	46.5	54.5	51.5	56.4	56.8	57.3	57.4
Imports of goods	-73.6	-59.7	-67.7	-41.6	-52.5	-42.3	-49.1	-44.2	-42.9	-42.3	-40.1
Income and services	-30.8	-32.4	-22.4	-17.3	-10.7	-11.8	-12.0	-6.5	-6.5	-6.2	-5.6
Transfers	21.4	26.4	18.5	10.9	7.6	1.5	6.4	-1.0	-1.0	-1.2	-1.4
Financial account	18.6	9.9	6.8	0.8	14.3	4.3	12.7	4.4	1.7	-1.6	-4.1
Direct investment	0.9	1.6	0.7	1.1	0.9	0.9	0.8	0.7	1.1	1.2	1.3
Gross borrowing/use of external assets	23.2	21.9	14.3	6.2	15.7	5.8	14.3	5.1	1.9	0.5	-2.4
Amortization	-0.6	-0.5	-0.3	-2.5	-0.2	-0.3	-0.7	0.0	0.0	-2.3	-2.1
Overall external balance	4.2	7.3	4.0	16.4	5.2	9.9	9.5	9.1	8.1	6.0	6.3
Central bank reserves (increase -)	-4.2	-13.0	-4.0	-16.2	-5.1	-11.0	-10.5	-9.8	-8.5	-6.0	-6.3
Change in arrears	-84.3	-42.4	-2.9	-33.2	-1.3	-1.6	-80.1	0.0	0.0	0.0	0.0
Errors and omissions	0.0	0.1	0.0	6.1	0.0	3.6	0.0	0.0	0.0	0.0	0.0

Sources: Iraqi authorities and Fund staff estimates and projections.

Table 2. Iraq: Fiscal and Oil Sector Accounts, 2005–12
(In billions of ID; unless otherwise indicated)

	2005		2006		2007		2008	2009	2010	2011	2012
	SBA	Est.	SBA	Prel.	SBA	Proj.	Budget	Projections			
Revenues and Grants	45,490	49,505	60,316	58,495	47,464	50,753	57,222	70,566	81,876	95,465	110,340
Revenues	34,211	36,655	47,529	49,430	40,781	48,448	55,520	70,337	81,660	95,270	110,327
Crude oil export revenues	31,919	33,896	42,109	43,736	35,242	41,725	42,442	59,480	68,958	80,041	91,878
Revenues of oil-related public enterprises	1,020	1,456	3,513	3,611	3,179	4,465	5,938	7,427	8,931	10,929	13,577
Tax revenues	372	495	821	585	858	768	1,024	1,424	1,650	1,881	2,098
Direct taxes	119	207	222	345	489	428	559	641	734	841	964
Indirect taxes 1/	252	288	599	240	369	340	465	783	916	1,040	1,134
Non-tax revenues 2/	900	809	1,087	1,498	1,502	1,490	6,116	2,006	2,120	2,418	2,774
Grants	11,279	12,850	12,787	9,065	6,683	2,304	1,701	229	216	195	14
Expenditures	50,797	44,497	65,935	49,754	57,688	49,566	64,318	73,734	81,785	91,168	101,305
Current expenditures	38,368	35,560	47,698	40,187	43,304	38,774	44,073	49,801	54,558	60,333	66,279
Salary and pension	8,591	9,282	12,899	10,959	15,172	14,098	16,324	17,844	19,131	20,456	22,073
Goods and Services (non-oil sector) 3/	13,600	13,019	15,265	12,191	12,559	8,709	8,613	9,626	11,052	12,711	14,537
Budgeted goods and services	4,094	3,135	6,802	5,818	8,052	7,210	7,571	9,626	11,052	12,711	14,537
Financed by oil-for-food program (OFFP; other than social safety net)	1,429	760	0	220	0	0	0	0	0	0	0
Overhead costs for donors' financed projects 4/	2,867	3,512	3,539	2,588	1,890	586	415	0	0	0	0
Other goods and services financed by donors 5/	5,210	5,612	4,925	3,566	2,618	913	628	0	0	0	0
Goods and Services (oil sector)	6,788	5,212	6,090	6,560	2,935	4,005	5,105	5,777	6,686	7,817	9,248
Oil derivative imports	5,768	4,128	4,090	4,082	378	400	360	377	388	399	410
Operating expenditures of oil-related public enterprises	1,020	1,085	2,000	2,477	2,559	3,605	4,745	5,400	6,298	7,418	8,837
Transfers	7,724	6,232	10,858	7,928	10,325	9,336	11,148	11,802	12,324	12,882	13,478
Social safety net (excluding OFFP)	4,500	3,751	5,000	5,500	5,733	4,848	4,860	5,341	5,754	6,193	6,658
Transfers to SOEs	1,160	900	1,260	1,299	1,726	1,726	2,383	2,283	2,183	2,083	1,983
Other transfers 6/	2,064	1,581	4,597	1,129	2,866	2,762	3,905	4,178	4,387	4,606	4,837
Interest payments	69	86	481	313	548	540	760	1,777	1,917	2,465	2,349
Domestic interest payments	69	86	249	182	334	337	548	1,192	1,018	895	771
External interest payments	69	0	237	131	214	203	212	585	899	1,571	1,579
War reparations 7/	1,596	1,730	2,105	2,235	1,762	2,086	2,122	2,974	3,448	4,002	4,594
Investment expenditures	12,430	8,936	15,862	9,463	14,030	9,655	20,071	23,557	26,652	30,060	34,051
Non-oil investment expenditures	8,800	6,587	10,530	7,702	10,893	7,773	17,623	18,695	20,896	23,250	26,419
Domestic financed reconstruction expenditure	3,049	2,189	6,050	4,693	8,209	6,941	16,659	17,522	19,302	20,994	24,458
OFFP financed reconstruction expenditure	1,070	478	0	0	0	0	0	0	0	0	0
Grant financed reconstruction expenditure	2,992	3,448	4,068	2,562	2,105	725	614	229	216	195	14
Loan financed reconstruction expenditure	0	0	413	0	578	0	349	944	1,378	2,062	1,947
Oil investment expenditures (including on refineries)	3,630	2,349	5,331	1,761	3,003	1,882	2,403	4,862	5,756	6,809	7,632
Contingency	0	0	2,375	104	354	1,137	175	375	575	775	975
Balance (including grants)	-5,308	5,008	-5,619	8,741	-10,224	1,186	-7,097	-3,168	91	4,297	9,035
Balance (excluding grants)	-16,587	-7,842	-18,404	-324	-16,907	-1,118	-8,798	-3,397	-125	4,102	9,021
Change in outstanding Letters of Credit [+ increase] 8/	...	2,947	...	2,226	...	...	...	...	...	...	...
Financing, *Of which:*	5,308	-2,095	5,619	-6,354	10,224	-1,186	7,097	3,168	-91	-4,297	-9,035
External financing	5,484	2,721	5,619	-3,522	9,224	-1,001	6,616	3,944	1,285	-2,320	-7,058
Assets held abroad	2,528	1,462	5,411	-2,147	8,830	-1,001	6,855	3,000	-93	-1,047	-5,547
Project financing	0	0	413	0	578	0	349	944	1,378	2,062	1,947
Other financing 9/	3,249	1,486	0	458	0	0	0	0	0	0	0
Amortization	293	227	205	1,833	185	222	588	0	0	3,335	3,459
Domestic financing	-176	-4,816	0	-2,833	1,000	-185	481	-777	-1,377	-1,977	-1,977
Bank financing	0	-5,124	0	-1,884	1,000	534	1,200	1,200	600	0	0
T-bills	-176	308	0	-949	0	-719	-719	-1,977	-1,977	-1,977	-1,977
Residual or Financing gap[+]/surplus [-]	0	34	0	-161	0	0	0	0	0	0	0
Memorandum items:											
Security-related expenditure	3,360	2,405	8018	3,248	9,753	9,673	10,774	12,587	13,871	15,464	17,334
Primary fiscal balance	-5,239	5,094	-5,136	9,054	-9,675	1,726	-6,337	-1,390	2,008	6,762	11,384
Non-oil primary fiscal balance	-27,759	-22,696	-39,338	-29,973	-42,021	-38,577	-47,164	-57,658	-63,440	-69,582	-77,191

Sources: Iraqi authorities, and Fund staff estimates and projections.

1/ Projections assume that the private sector will start importing petroleum products, thereby increasing substantially the base for import duties in 2009–12 .
2/ For 2008, includes $3.75 billion mobile phone operator license fees.
3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.
4/ Overhead costs associated with donor-financed reconstruction.
5/ Other goods and services financed by donors include security spending associated with the implementation of reconstruction projects.
6/ 2006 data includes ID 270 billion allocated toward government's share of capital in new regional commercial banks. ID 1,500 formerly recorded under this item were re-classified as non-oil investment expenditures in 2006 budget presentation. Finally, ID 265 billion were re-classified as debt repayment.
7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.
8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.
9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 3. Iraq: Fiscal and Oil Sector Accounts, 2005–12
(In percent of GDP)

	2005		2006		2007		2008	2009	2010	2011	2012
	SBA	Est.	SBA	Prel.	SBA	Proj.	Budget		Proj.		
Revenues and Grants	93.6	107.4	96.3	80.5	60.7	64.7	67.5	65.5	66.2	67.1	67.8
Revenues	70.4	79.5	75.9	68.0	52.2	61.8	65.5	65.3	66.0	67.0	67.8
Crude oil export revenues	65.7	73.5	67.3	60.2	45.1	53.2	50.1	55.2	55.8	56.3	56.5
Revenues of oil-related public enterprises	2.1	3.2	5.6	5.0	4.1	5.7	7.0	6.9	7.2	7.7	8.3
Tax revenues	0.8	1.1	1.3	0.8	1.1	1.0	1.2	1.3	1.3	1.3	1.3
Direct taxes	0.2	0.4	0.4	0.5	0.6	0.5	0.7	0.6	0.6	0.6	0.6
Indirect taxes 1/	0.5	0.6	1.0	0.3	0.5	0.4	0.5	0.7	0.7	0.7	0.7
Non-tax revenues 2/	1.9	1.8	1.7	2.1	1.9	1.9	7.2	1.9	1.7	1.7	1.7
Grants	23.2	27.9	20.4	12.5	8.5	2.9	2.0	0.2	0.2	0.1	0.0
Expenditures	104.5	96.5	105.3	68.5	73.8	63.2	75.9	68.5	66.1	64.1	62.3
Current expenditures	78.9	77.2	76.2	55.3	55.4	49.4	52.0	46.2	44.1	42.4	40.7
Salary and pension	17.7	20.1	20.6	15.1	19.4	18.0	19.3	16.6	15.5	14.4	13.6
Goods and services (non-oil sector) 3/	28.0	28.2	24.4	16.8	16.1	11.1	10.2	8.9	8.9	8.9	8.9
Budgeted goods and services	8.4	6.8	10.9	8.0	10.3	9.2	8.9	8.9	8.9	8.9	8.9
Financed by oil-for-food program (OFFP; other than social safety net)	2.9	1.6	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overhead costs for donors' financed projects 4/	5.9	7.6	5.7	3.6	2.4	0.7	0.5	0.0	0.0	0.0	0.0
Other goods and services financed by donors 5/	10.7	12.2	7.9	4.9	3.3	1.2	0.7	0.0	0.0	0.0	0.0
Goods and services (oil sector)	14.0	11.3	9.7	9.0	3.8	5.1	6.0	5.4	5.4	5.5	5.7
Oil derivative imports	11.9	9.0	6.5	5.6	0.5	0.5	0.4	0.4	0.3	0.3	0.3
Operating expenditures of oil-related public enterprises	2.1	2.4	3.2	3.4	3.3	4.6	5.6	5.0	5.1	5.2	5.4
Transfers	15.9	13.5	17.3	10.9	13.2	11.9	13.2	11.0	10.0	9.1	8.3
Social safety net (excl. OFFP)	9.3	8.1	8.0	7.6	7.3	6.2	5.7	5.0	4.7	4.4	4.1
Transfers to SOEs	2.4	2.0	2.0	1.8	2.2	2.2	2.8	2.1	1.8	1.5	1.2
Other transfers 6/	4.2	3.4	7.3	1.6	3.7	3.5	4.6	3.9	3.5	3.2	3.0
Interest payments	0.1	0.2	0.8	0.4	0.7	0.7	0.9	1.6	1.6	1.7	1.4
Domestic interest payments	0.1	0.2	0.4	0.3	0.4	0.4	0.6	1.1	0.8	0.6	0.5
External interest payments	0.1	0.0	0.4	0.2	0.3	0.3	0.3	0.5	0.7	1.1	1.0
War reparations 7/	3.3	3.8	3.4	3.1	2.3	2.7	2.5	2.8	2.8	2.8	2.8
Investment expenditures	25.6	19.4	25.3	13.0	17.9	12.3	23.7	21.9	21.6	21.1	20.9
Non-oil investment expenditures	18.1	14.3	16.8	10.6	13.9	9.9	20.8	17.4	16.9	16.3	16.2
Domestic financed reconstruction expenditure	6.3	4.8	9.7	6.5	10.5	8.8	19.7	16.3	15.6	14.8	15.0
OFFP financed reconstruction expenditure	2.2	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant financed reconstruction expenditure	6.2	7.5	6.5	3.5	2.7	0.9	0.7	0.2	0.2	0.1	0.0
Loan financed reconstruction expenditure	0.0	0.0	0.7	0.0	0.7	0.0	0.4	0.9	1.1	1.4	1.2
Oil investment expenditures (including on refineries)	7.5	5.1	8.5	2.4	3.8	2.3	2.8	4.5	4.7	4.8	4.7
Contingency	0.0	0.0	3.8	0.1	0.5	1.4	0.2	0.3	0.5	0.5	0.6
Balance (including grants)	-10.9	10.9	-9.0	12.0	-13.1	1.5	-8.4	-2.9	0.1	3.0	5.6
Balance (excluding grants)	-34.1	-17.0	-29.4	-0.4	-21.6	-1.4	-10.4	-3.2	-0.1	2.9	5.5
Change in outstanding Letters of Credit [+ increase] 8/	...	6.4	...	3.1	...	...	...	...	...	...	...
Financing, *Of which:*	10.9	-4.5	9.0	-8.7	13.1	-1.5	8.4	2.9	-0.1	-3.0	-5.6
External financing	11.3	5.9	9.0	-4.8	11.8	-1.3	7.8	3.7	1.0	-1.6	-4.3
Assets held abroad	5.2	3.2	8.6	-3.0	11.3	-1.3	8.1	2.8	-0.1	-0.7	-3.4
Project financing	0.0	0.0	0.7	0.0	0.7	0.0	0.4	0.9	1.1	1.4	1.2
Other financing 9/	6.7	3.2	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	0.6	0.5	0.3	2.5	0.2	0.3	0.7	0.0	0.0	2.3	2.1
Domestic financing	-0.4	-10.4	0.0	-3.9	1.3	-0.2	0.6	-0.7	-1.1	-1.4	-1.2
Bank financing	0.0	-11.1	0.0	-2.6	1.3	0.7	1.4	1.1	0.5	0.0	0.0
T-bills	-0.4	0.7	0.0	-1.3	0.0	-0.9	-0.8	-1.8	-1.6	-1.4	-1.2
Residual or financing gap[+]/surplus [-]	0.0	0.1	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Security-related expenditure	6.9	5.2	12.8	4.5	12.5	12.3	12.7	11.7	11.2	10.9	10.7
Primary fiscal balance	-10.8	11.1	-8.2	12.5	-12.4	2.2	-7.5	-1.3	1.6	4.8	7.0
Current expenditures (percent of non-oil GDP)	244.4	204.2	244.6	130.2	100.4	100.5	99.1	99.6	97.1	95.6	93.5

Sources: Iraqi authorities and Fund staff estimates and projections.

1/ Projections assume that the private sector will start importing petroleum products, thereby increasing substantially the base for import duties in 2009–12 .
2/ For 2008, includes $3.75 billion mobile operator license fees.
3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.
4/ Overhead costs associated with donor-financed reconstruction.
5/ Other goods and services financed by donors include security spending associated with the implementation of reconstruction projects.
6/ 2006 data includes ID270 billion allocated toward government's share of capital in new regional commercial banks. ID1,500 formerly recorded under this item were re-classified as non-oil investment expenditures in 2006 budget presentation. Finally, ID265 billion were re-classified as debt repayment.
7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.
8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.
9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 4. Iraq: Central Bank Balance Sheet 2005–09
(In billions of Iraqi dinars, unless otherwise indicated)

	2005		2006		2007				2008				2009
	Act.	SBA	Act.	SBA	Act.	Prel.	Proj.	SBA	Proj.	Proj.	Proj	Proj.	Proj.
	Dec.		Dec.		Mar.	Jun	Dec.		Mar.	Jun.	Sept.	Dec.	Dec.
Net foreign exchange assets 1/	17,078	12,993	25,954	15,869	21,018	26,306	31,695	31,809	33,986	36,277	38,568	40,859	53,601
Foreign exchange assets	17,724	13,639	26,549	16,515	21,614	26,901	32,291	32,438	34,514	36,736	38,959	41,182	53,636
Gold 2/	143	119	159	119	159	153	150	175	150	150	150	150	150
Other	17,581	13,520	26,391	16,397	21,455	26,748	32,141	31,260	34,364	36,586	38,809	41,032	53,486
Foreign exchange liabilities	-646	-646	-596	-646	-596	-596	-596	-630	-527	-459	-391	-323	-36
Of which: Borrowing from the IMF	-637	-637	-578	-637	-555	-545	-523	-637	-455	-387	-319	-250	0
Net domestic assets	-3,380	811	-8,288	777	-1,951	-6,398	-8,203	-11,918	-8,454	-9,398	-11,431	-13,496	-22,243
Domestic assets	138	3,161	-297	3,161	2,543	1,921	1,318	172	1,439	1,559	1,679	1,799	1,480
Net claims on general government	128	3,152	-309	3,152	2,531	1,908	1,307	161	1,427	1,548	1,668	1,788	1,469
Holdings of treasury bills	2,560	2,528	4,675	2,528	4,675	4,495	3,956	3,988	3,776	3,596	3,416	3,236	2,517
Holdings of discounted treasury bills	707	707	733	707	733	719	719	719	719	719	719	719	719
Overdrafts	1,821	1,821	0	1,821	0	0	0	0	0	0	0	0	0
Domestic currency deposits	-3,577	-596	-5,170	-596	-1,739	-656	-2,156	-3,972	-1,856	-1,556	-1,256	-956	-556
Foreign currency deposits	-1,382	-1,307	-546	-1,307	-1,138	-2,651	-1,212	-575	-1,212	-1,212	-1,212	-1,212	-1,212
Claims on commercial banks	9.4	8.7	11.9	8.7	12.4	12.7	11.3	11.3	11.3	11.3	11.3	11.3	11.3
Monetary policy instruments 4/	-3,731	-3,316	-8,088	-3,350	-6,663	-8,940	-12,930	-10,176	-13,302	-14,366	-16,518	-18,704	-25,155
Other items net	214	966	97	966	2,169	622	3,408	-1,915	3,408	3,408	3,408	3,408	1,432
Reserve money	13,698	13,804	17,665	16,646	19,067	19,908	23,492	19,890	25,532	26,879	27,138	27,364	31,358
Currency issued	10,257	9,679	11,917	12,022	12,924	13,529	14,970	11,587	15,732	16,184	16,716	17,249	19,767
Currency outside banks	9,110	8,815	10,968	10,949	11,551	11,976	13,779	13,045	14,195	14,458	15,236	16,014	18,352
Cash in vaults of commercial banks	1,146	864	948	1,073	1,373	1,553	1,191	1,458	1,537	1,725	1,480	1,235	1,415
Banks reserves	3,442	4,124	5,749	4,624	6,144	6,379	8,522	6,845	9,800	10,695	10,421	10,114	11,591
Required	2,596	3,329	3,572	3,829	4,275	4,045	7,487	4,898	7,913	8,318	8,696	9,041	10,360
Excess	845	795	2,177	795	1,869	2,333	1,035	1,948	1,887	2,377	1,726	1,074	1,230
Memorandum items:													
Reserve money (annual growth, in percent)	12.0	12.9	29.0	20.6	7.9	12.7	33.0	20.1	33.9	...	...	16.5	14.6
Currency issued (annual growth, in percent)	27.9	20.7	16.2	24.2	8.5	13.5	25.6	20.1	21.7	...	...	15.2	14.6
Gross foreign exchange assets (in millions of U.S. dollars)	12,016	9,311	20,037	11,013	16,978	21,521	26,909	21,050	28,761	30,614	32,466	34,318	42,650
Gold	97	82	120	82	125	123	125	139	125	125	125	125	119
CBI vault + DFI sub-account	11,254	8,547	19,221	10,235	16,156	20,700	26,059	20,171	27,911	29,764	31,616	33,468	41,839
SDR Account	666	682	696	696	698	699	725	796	725	725	725	725	692
Foreign exchange liabilities (in millions of U.S. dollars)	-438	-441	-449	-431	-468	-476	-496	-500	-439	-383	-326	-269	-28
Net foreign exchange assets (in millions of U.S. dollars)	11,578	8,870	19,588	10,582	16,511	21,045	26,413	20,550	28,322	30,231	32,140	34,049	42,622
Exchange rate (end of period) 5/	1,475	1,465	1,325	1,500	1,273	1,250	...	1,500	...	...	...	...	...
Gross foreign exchange assets/reserve money (in percent)	129.4	98.8	150.3	99.2	113.4	135.1	137.5	133.3	135.2	136.7	143.6	150.5	171.0
Reserve money coverage (NFA/reserve money, in percent)	124.7	94.1	146.9	95.4	110.2	132.1	134.9	130.2	133.1	135.0	142.1	149.3	170.9
Currency outside banks/Reserve money (in percent)	66.5	63.9	62.1	65.8	60.6	60.2	58.7	58.3	55.6	53.8	56.1	58.5	58.5
Currency outside banks/Non-oil GDP (in percent)	52.3	...	35.5	...	29.9	31.1	35.7	...	35.4	34.8	35.4	36.0	36.7
Ratio of Reserve money to GDP	29.7	30.0	24.3	36.1	24.3	25.4	29.9	25.4	31.9	32.9	32.6	32.3	29.1
Policy interest rate	7.0	...	16.0	...	20.0	20.0	...	...	...	...	...	...	...

Sources: Iraqi authorities, and Fund staff estimates and projections.

1/ Valued at market exchange rates.
2/ Valued at market prices.
3/ This includes both SDR holdings and the reserve tranche position.
4/ This mainly represents the ID and US$ overnight standing deposit facilities and CBI bills.
5/ SBA columns show the program exchange rate.

Table 5. Iraq: Summary Balance Sheet of Deposit Money Banks, 2005–09
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	2006	2007	2008	2009
	Dec.	Dec.	Dec.	Dec.	Dec.
	Actual		Projections		
Net foreign assets	-5,717	-3,215	-3,215	-3,215	-3,215
Assets	5,424	7,763	7,763	7,763	7,763
Liabilities	-11,141	-10,978	-10,978	-10,978	-10,978
Net Domestic Assets	11,348	12,087	20,202	29,559	39,266
Domestic credit	-3,663	-6,919	-7,644	-5,708	-3,673
Credit to the general government (net)	-5,392	-9,771	-11,572	-11,572	-10,772
Credit to the economy	1,729	2,851	3,928	5,864	7,099
Monetary policy instruments	3,731	8,088	12,930	18,704	25,155
Reserves	4,585	6,697	9,714	11,349	13,006
Cash in vault	1,144	948	1,191	1,235	1,415
Deposits at the CBI	3,442	5,749	8,522	10,114	11,591
Of which: required reserves	2,596	3,572	7,487	9,041	10,360
Other Items Net	6,694	4,221	5,203	5,214	4,779
Demand deposits	3,796	6,682	12,740	19,758	27,038
Time deposits	1,835	2,190	4,247	6,586	9,013
Net foreign assets	4.2	43.8	0.0	0.0	0.0
Domestic credit	-60.1	-88.9	-10.5	25.3	35.7
Credit to the economy	117.7	64.9	37.8	49.3	21.1
Demand deposits	-36.4	76.0	90.7	55.1	36.8

Sources: Iraqi authorities and Fund staff estimates and projections.

Table 6. Iraq: Monetary Survey, 2005–09
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	2006	2007	2008	2009
	Dec.	Dec.	Dec.	Dec.	Dec.
	Actual		Projections		
Net foreign assets	11,361	22,739	28,480	37,644	50,385
Of which: CBI	17,078	25,954	31,695	40,859	53,601
Net domestic assets	3,384	-2,897	2,286	4,714	4,018
Domestic claims	-3,534	-7,229	-6,337	-3,920	-2,204
Net claims on general government	-5,263	-10,080	-10,265	-9,784	-9,303
Claims on general government	6,414	7,549	...	...	...
less: Liabilities to general government	-11,677	-17,629	...	...	...
Claims on other sectors	1,729	2,851	3,928	5,864	7,099
Other Item Net (OIN)	6,919	4,332	8,623	8,634	6,222
Broad money	14,744	19,842	30,766	42,358	54,403
Currency outside banks	9,110	10,968	13,779	16,014	18,352
Transferable deposits	3,798	6,684	12,740	19,758	27,038
Other deposits	1,835	2,190	4,247	6,586	9,013
Net foreign assets	137.9	100.1	25.2	32.2	33.8
Net domestic assets	-65.1	-185.6	178.9	106.2	-14.8
Net claims on general government	-519.7	-91.5	-1.8	4.7	4.9
Claims on other sectors	117.7	64.9	37.8	49.3	21.1
Broad money	1.9	34.6	55.1	37.7	28.4

Sources: Iraqi authorities and Fund staff estimates and projections.

Table 7. Iraq: Balance of Payments, 2005–12 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2005		2006		2007		2008	2009	2010	2011	2012
	SBA	Est.	SBA	Prel.	SBA	Proj.			Projections		
Trade balance	-1,636	1,024	476	7,787	-3,725	7,671	1,690	10,476	13,300	16,059	20,630
(In percent of GDP)	*-4.9*	3.3	1.1	15.7	-6.0	12.3	2.4	12.2	13.9	15.0	17.3
Exports	22,781	19,772	28,745	28,412	28,861	34,134	36,335	48,343	54,321	61,245	68,306
Crude oil	22,176	19,184	28,073	27,692	27,969	33,280	35,369	47,297	53,319	60,179	67,171
Other exports	605	589	672	720	892	854	966	1,047	1,002	1,066	1,135
Imports 2/	-24,416	-18,749	-28,269	-20,625	-32,586	-26,464	-34,645	-37,867	-41,021	-45,186	-47,676
Government imports	-14,596	-10,993	-14,456	-12,346	-17,027	-15,176	-20,545	-20,589	-21,468	-23,093	-23,474
UN Oil for Food Program (OFFP)	-1,929	-880	0	-272	0	0	0	0	0	0	0
Other consumption imports (non-OFFP)	-3,528	-2,915	-5,089	-4,603	-6,598	-6,283	-6,359	-6,964	-7,597	-8,320	-8,826
Other non-oil related capital imports (non-OFFP)	-3,450	-2,625	-4,882	-3,225	-5,690	-3,961	-9,013	-9,114	-9,930	-10,764	-10,764
Oil-related capital imports	-2,261	-2,129	-2,113	-1,825	-2,414	-2,110	-2,334	-3,027	-3,485	-4,009	-3,884
Refined oil products	-3,428	-2,445	-2,372	-2,420	-2,325	-2,823	-2,839	-1,483	-457	0	0
Private sector imports	-9,820	-7,755	-13,813	-8,279	-15,560	-11,288	-14,100	-17,279	-19,553	-22,093	-24,201
Of which: refined oil products	0	0	-2,429	0	-2,419	-2,268	-2,839	-3,461	-4,112	-4,451	-4,229
Income, net 3/	-3,741	-4,420	-2,237	-3,428	-1,240	-3,200	-3,243	-302	-488	-314	-28
Services, net 2/	-6,477	-5,740	-7,093	-5,164	-5,383	-4,198	-5,234	-5,245	-5,696	-6,296	-6,646
Transfers, net	7,090	8,290	7,721	5,393	4,706	964	4,522	-881	-1,001	-1,305	-1,609
Private, net (incl. NGOs) 4/	500	500	600	600	800	790	4,873	1,302	1,498	1,558	1,603
Official	6,590	7,790	7,121	4,793	3,906	174	-351	-2,183	-2,499	-2,863	-3,212
Receipts	7,699	8,749	8,525	6,178	5,304	1,838	1,418	182	167	146	146
Payments	-1,109	-959	-1,404	-1,385	-1,398	-1,664	-1,768	-2,365	-2,666	-3,009	-3,359
Current account	-4,763	-845	-1,133	4,589	-5,642	1,237	-2,264	4,048	6,116	8,144	12,347
(In percent of GDP)	-14.4	-2.7	-2.7	9.3	-9.1	2.0	-3.2	4.7	6.4	7.6	10.4
Capital account	0	0	0	0	0	0	0	0	0	0	0
Financial account	6,172	3,106	2,821	380	8,857	2,687	8,970	3,727	1,607	-1,758	-4,826
Direct investment	300	515	300	531	550	557	596	638	1,094	1,319	1,554
Other capital, net	5,872	2,591	2,521	-151	8,307	2,129	8,374	3,089	513	-3,077	-6,379
Official, net	7,504	6,753	5,839	2,804	9,643	3,524	9,726	4,400	1,771	-1,945	-5,360
Assets 5/	3,943	2,007	3,607	-1,151	7,008	-799	5,712	2,386	-72	-787	-4,055
Liabilities	3,561	4,746	2,232	3,954	2,635	4,322	4,014	2,014	1,842	-1,157	-1,305
Loan disbursements	0	0	275	0	459	0	241	550	866	1,350	1,224
Amortization 6/ 7/	-200	-115	-136	-281	-82	-103	-400	0	0	-2,507	-2,529
Capitalized interest payment 7/	3,761	4,861	2,093	4,235	2,258	4,425	4,173	1,464	977	0	0
Financial corporations, net 8/	0	-2,007	-1,247	-1,517	0	0	0	0	0	0	0
Private, net	-1,632	-2,155	-2,071	-1,437	-1,336	-1,394	-1,352	-1,312	-1,258	-1,132	-1,019
Errors and omissions	0	23	0	3,023	0	2,278	0	0	0	0	0
Overall balance	1,409	2,283	1,688	8,102	3,215	6,202	6,706	7,774	7,723	6,386	7,522
(In percent of GDP)	4.2	7.3	4.0	16.4	5.2	9.9	9.5	9.1	8.1	6.0	6.3
Financing	-1,409	-2,283	-1,688	-8,102	-3,215	-6,202	-6,706	-7,774	-7,723	-6,386	-7,522
Central bank (increase -)	-1,409	-4,079	-1,688	-8,021	-3,150	-6,872	-7,409	-8,371	-8,121	-6,386	-7,522
Reserves (net; increase -)	-1,409	-4,079	-1,688	-8,021	-3,150	-6,872	-7,637	-8,599	-8,121	-6,386	-7,522
Liabilities (increase +)	0	0	0	0	0	0	-227	-228	0	0	0
Fund credit (net)	0	0	0	0	0	0	-227	-228	0	0	0
Disbursement	0	0	0	0	0	0	0	0	0	0	0
Repayments	0	0	0	0	0	0	-227	-228	0	0	0
Deferred accrued interest 9/	0	1,182	0	709	0	745	704	596	398	0	0
Change in arrears (net, decrease -) 10/	-27,987	-13,302	-1,195	-16,424	-783	-972	-56,567	0	0	0	0
Debt forgiveness 11/	27,987	13,916	1,195	15,634	718	898	56,567	0	0	0	0
Memorandum items:											
Central bank reserves	9,311	12,016	11,013	20,037	21,050	26,909	34,318	42,689	50,810	57,196	64,717
Central bank reserves (in months of imports of goods	3.1	5.5	3.6	7.7	6.1	8.0	9.5	10.9	11.7	12.5	12.5
GDP	33,182	31,379	41,741	49,527	62,038	62,574	70,597	85,655	95,625	106,935	118,923
Non-oil GDP	10,716	11,856	12,999	21,027	34,221	30,761	37,076	39,747	43,423	47,438	51,824

Sources: Iraqi authorities and Fund staff estimates and projections.

1/ Excludes U.S. military spending in Iraq.
2/ Imports for 2005 do not fully account for the cost of freight and insurance, which have been added under services for other estimates and projections.
3/ Includes interest accrued, deferred, and capitalized.
4/ The 2008 amount includes $3.75 billion obtained from mobile phone license fees.
5/ Includes the use/accumulation of the DFI ressources and the UN Oil for Food letters of credit.
6/ Includes the estimates of cash payments to settle the debt owed to small private creditors through cash exchange offer.
7/ Based on the 2004 Paris Club agreement, the payments of principal and most interest during 2005–10 are deferred and capitalized.
8/ Reflects advance transfers for the execution of letters of credit (L/C).
9/ Estimates of accrued interest on existing stock of debt prior to the implementation of the 2004 Paris Club agreement.
10/ Includes debt forgiveness and clearance of arrears on multilateral debt and arrears related to fuel imports from Turkey.
11/ The notional debt forgiveness reflects: (i) the first stage of debt reduction (30 percent) at end-2004; (ii) the second stage reduction (30 percent) at end-2005; and (iii) the settlement of debt owed to private creditors through cash and debt exchanges. Assumes debt reduction comparable to the Paris Club agreement on other debt to official creditors.

Table 8. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the Stand-By Arrangement, 2005–07 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	Performance Criteria							
	9/30/05	12/31/05	3/31/06	6/30/06	9/30/06	12/31/06	3/31/07	6/30/07	9/30/07
Cumulative change from September 2005									
Net international reserves of the CBI (floor; in millions of U.S. dollars)	8,500 2/	-1,000	-1,000	-1,000	-1,000	-1,000	0	0	0
(Actual)		+3,041	+3,635	+3,554	+5,252	+9,770	+8,503	+12,545	
Lending to the government and the private sector by the CBI (ceiling) 3/	5,100 2/	0	0	0	0	0	0	0	0
(Actual)		0	0	0	0	0	0	0	
Cumulative flow from beginning of calendar year									
Government primary fiscal deficit (ceiling; deficit [+]/surplus[-]) 4/ 5/	...	5,400	1,950	3,600	4,850	5,300	...	...	...
(Actual)		-5,102	-819	-4,752	-11,220	-8,947	...	...	...
Central government total financing (ceiling) 4/ 5/	...	...	...	...	...	...	3,000	5,350	5,700
(Actual)							-1,688	492	
Government wage and pension bill (ceiling) 4/ 6/	...	6,650	2,400	4,750	7,100	9,500	2,525	5,050	7,575
(Actual)		7,069	2,051	3,898	5,875	7,792	1,644	3,770	
Revenue of oil related enterprises, including those remitted to the budget (floor) 4/	...	900	700	1,500	2,100	2,800	750	1,500	2,850
(Actual)		1,456	509	1,454	2,651	3,611	1,144	2,501	
New medium-and long-term nonconcessional external debt (with original maturities of one year of more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 7/	...	500	500	500	500	500	500	500	500
(Actual)		0	0	0	0	0	0	0	
External arrears on new borrowing (in millions of U.S. dollars; ceiling) 8/	...	0	0	0	0	0	0	0	0
(Actual)		653	0	0	0	0	0	0	
Indicative targets									
Government imports of petroleum products (ceiling) 4/ 9/	...	6,000	1,700	3,400	4,000	4,200	100	200	300
(Actual)		4,128	1,045	1,884	3,120	4,082	104	110	
Revolving government credit to the State Oil Marketing Organization (ceiling)	...	...	...	...	...	...	300	400	400
(Actual)							400	400	

1/ See Technical Memorandum of Understanding for precise definitions of all performance variables.
2/ Estimated.
3/ Rolling over t-bills does not constitute new lending.
4/ Flows for 12/31/05 are cumulative for 2005. Flows for 2006 and 2007 are cumulative starting 1/1/2006 and 1/1/2007, respectively.
5/ Starting in 2007, the budget deficit will be monitored from below the line (i.e., from the financing side).
6/ Excluding salaries paid by ministries of defense and interior (see Technical Memorandum of Understanding for precise definition).
7/ This ceiling excludes loans with a grant element of 35 percent or more of up to Yen 350 billion for reconstruction projects to be contracted with the government of Japan in 2007.
8/ This will be monitored on a continuous basis.
9/ Starting in 2007, this no longer comprises all imports of petroleum products made directly by the government of Iraq but instead comprise of imports of petroleum products financed from the budget.

Table 9. Iraq: Prior Actions, Structural Performance Criteria, and Structural Benchmarks
Under the Stand-By Arrangement

I. Structural Performance Criteria	Date	Status
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Final audit of CBI 2005 Financial operations and statements.	May 15, 2006	Completed on October 1, 2006
Adoption of fully detailed budget classification and chart of accounts in line with the IMF's Government Financial Statistics Manual (GFSM) 2001, within a cash accounting framework.1/	June 30, 2007	Met on July 28, 2007
Completion by Ernst & Young of (a) a final audit of the net international reserves data reported to the IMF as at December 31, 2006, including a full count by Ernst & Young of gold and foreign exchange holdings at the CBI, and (b) an interim audit report of CBI 2006 financial statements in accordance with International Standards on Auditing.	May 31, 2007	NIR audit completed on time; interim audit report completed on July 15, 2007
Completion of census of all public service employees (central government and military).	June 30, 2007	Not met; replaced with a new PC (see below)
Completion of the data collection for the census of all public service employees (central government and military).	November 30, 2007	Not met
II. Structural Benchmarks		
Implementation of payment system regulations.	June 30, 2006	Met
Establishment of an audit oversight committee, to become effective on or before December 31, 2006, including the participation of independent international audit experts, to continue the work of the International Advisory and Monitoring Board (upon its dissolution) in overseeing and making public audits of the Development Fund for Iraq and oil export sales.	September 30, 2006	Met in November 2006; IAMB mandate has been extended to December 31, 2007
Reform of pension law in line with sustainable pension system	September 30, 2006	Met in December 2007
Approval by Council of Representatives of law liberalizing private gasoline imports	September 30, 2006	Met
Commencement of operation of Real Time Gross Settlement system (RTGS) linking headquarters of commercial banks to the CBI.	August 31, 2006	Met
Commencement of payments clearing system between the headquarters of commercial banks and the CBI through the Automatic Clearing House (ACH).	November 30, 2006	Met
Full capitalization of CBI to the stipulated ID 100 billion, based on the 2005 audited financial statements and taking into account the restructuring of outstanding claims on the central government that are on the December 31, 2005 balance sheet of the CBI.	December 31, 2006	Met in February 2007
Adopt a CBI Board-approved timetable for the full implementation of IFRS as the bank's financial reporting framework	March 31, 2007	Met on April 1, 2007
Appoint an internationally reputable audit firm to conduct an operational and financial audit of Rasheed and Rafidain banks based on their 2006 financial accounts.	April 30, 2007	Underway
Address the lack of proper accounting records being maintained by the CBI, one of the major issues giving rise to E&Y's disclaimed audit opinion for 2005. 2/	June 30, 2007	Underway
Establish adequate control procedures for reserves management, including developing reserves management policy and investment guidelines.	June 30, 2007	Underway

1/ The budget classification and chart of accounts will be deemed in line with the IMF GFSM 2001 if it is consistent with the methodology and high level classification defined in the technical assistance report of the IMF's Fiscal Affairs Department entitled "Iraq Budget Classification Reform" (July 2005).

2/ The following issues should be addressed: (i) the lack of reconciliations of local bank's current accounts; (ii) unreconciled suspense accounts and interbranch accounts; (iii) unreconciled differences on accounts managed on behalf of the Ministry of Finance, including the DVI; and (iv) insufficient information to support amounts, and to ensure the completeness and valuation of off-balance sheet commitments.

Table 10. Iraq: Indicative Quantitative Benchmarks Under the Stand-By Arrangement
(In Iraqi dinars per liter, unless otherwise indicated)

	Sep.	Prior	03/31/06		06/30/06		09/30/06		12/31/06		03/05/07	06/30/07	
	2005	Action	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prior action 3rd & 4th reviews	Prog.	Actual
Official domestic price of petroleum products (equal to or above, by specified dates)													
LPG (per 12 kg cylinder)	250	600	700	600	800	1,000	900	1,000	1,000	1,000	3,000	3,000	3,000
Regular gasoline	20	100	130	100	155	175	175	175	200	250	300	350	400
Premium gasoline 1/	50	250	300	250	350	350	400	350	450	350	...	...	...
Blended gasoline	...	...	...	...	...	...	...	...	...	350	400	450	450
Kerosene	5	25	50	25	75	75	90	75	115	75	150	200	150
Diesel	10	90	110	90	125	125	155	150	175	150	350	350	400

1/ Starting 2007, premium gasoline is to be sold only by the private sector at unregulated prices.

Table 11. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the New Stand-By Arrangement, 2007–08 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at	Performance Criteria			Indicative Targets	
	6/30/07	12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
Cumulative change from June 2007						
Net international reserves of the CBI (floor; in millions of U.S. dollars)	21,045	0	0	0	0	0
Lending to the government and the private sector by the CBI (ceiling) 2/	5,230	0	0	0	0	0
Cumulative flow from beginning of calendar year						
Central government total financing (ceiling) 3/	...	7,600	2,200	3,750	5,400	7,200
Government wage and pension bill (ceiling) 3/ 4/	...	10,100	2,750	5,500	8,250	11,000
Government imports of petroleum products (ceiling) 3/	...	400	100	200	300	400
Direct government subsidies to the fuel sector (ceiling)	...	0	0	0	0	0
New medium-and long-term nonconcessional external debt (with original maturities of one year of more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 3/ 5/	...	500	500	500	500	500
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 6/	...	0	0	0	0	0
Indicative target						
Revolving government credit to the State Oil Marketing Organization (ceiling)	...	400	400	400	400	400

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.
2/ Rolling over T-bills does not constitute new lending.
3/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.
4/ Excluding salaries paid by ministries of defense and interior.
5/ Consessionality is defined as loans with a grant element of 35 percent or higher.
6/ To be monitored on a continuous basis.

Table 12. Iraq: Prior Actions, Structural Performance Criteria, and Structural Benchmarks
Under the New Stand-By Arrangement

I. Prior Actions	Date
Adoption by Cabinet of the 2008 government budget, in line with program objectives.	
Appointment of an external auditor to undertake the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	
Appointment of an external auditor to undertake an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	
Commencement by an internationally reputable auditor of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	
II. Structural Performance Criteria	
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008
III. Structural Benchmarks	
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008
Adoption of reserves management guidelines by the CBI.	March 31, 2008
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008
Completion of census of all public service employees (central government and military).	June 30, 2008
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008
Completion of a comprehensive set of prudential regulations for commercial banks.	July 31, 2008
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008

Table 13. Iraq: Availability of Purchases Under the Stand-By Arrangement, end-2007–09

Availability date	Amount of Purchase SDR	% quota	Condition
Proposed schedule new SBA			
December 19, 2007	79,226,667	6.67	Program approval
February 15, 2008	79,226,667	6.67	Observance of end-December 2007 performance criteria
May 15, 2008	79,226,667	6.67	Completion of the first review and observance of end-March 2008 performance criteria
August 15, 2008	79,226,667	6.67	Observance of end-June 2008 performance criteria
November 15, 2008	79,226,667	6.67	Completion of second review and observance of end-September 2008 performance criteria
February 15, 2009	79,226,665	6.67	Observance of end-December 2008 performance criteria
Total access	475,360,000	40.00	

Source: Fund staff projections.

Table 14. Iraq: Indicators of Fund Credit, 2004–12 1/
(In millions of SDRs, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Disbursements of Fund credit									
EPCA	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	554.6	316.9	79.2	0.0	0.0	0.0
In percent of IMF quota	0.0	0.0	0.0	46.7	26.7	6.7	0.0	0.0	0.0
Obligations									
Clearance of arrears	55.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of EPCA	0.0	0.0	0.0	0.0	148.6	148.6	0.0	0.0	0.0
Repayments of SBA 2/	0.0	0.0	0.0	0.0	0.0	0.0	99.0	227.8	138.7
Total charges and interest	0.7	10.5	0.0	4.4	23.2	28.3	24.0	16.1	4.8
Total obligations	56.0	10.5	0.0	4.4	171.7	176.9	123.0	243.9	143.5
Total obligations, in percent of:									
Exports of goods and services	0.5	0.1	0.0	0.0	0.7	0.6	0.4	0.7	0.3
External public debt	0.1	0.0	0.0	0.0	0.5	0.5	0.4	0.7	0.4
Gross reserves	1.0	0.1	0.0	0.0	0.8	0.7	0.4	0.7	0.4
GDP	0.3	0.0	0.0	0.0	0.4	0.3	0.2	0.4	0.2
IMF Quota	4.7	0.9	0.0	0.4	14.4	14.9	10.4	20.5	12.0
Outstanding Fund credit									
EPCA	297.1	297.1	0.0	297.1	148.6	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	79.2	396.1	475.4	376.3	148.6	0.0
Total outstanding Fund credit	297.1	297.1	0.0	376.3	544.7	475.4	376.3	148.6	0.0
Total outstanding Fund credit, in percent of									
Exports of goods and services	2.8	2.0	0.0	1.8	2.3	1.7	1.2	0.4	0.0
External public debt	0.4	0.4	0.0	0.6	1.7	1.4	1.1	0.4	0.0
Gross reserves	5.5	3.7	0.0	2.1	2.5	1.8	1.2	0.4	0.0
GDP	1.7	1.4	0.0	0.9	1.2	0.9	0.7	0.2	0.0
IMF Quota	25.0	25.0	0.0	31.7	45.8	40.0	31.7	12.5	0.0

Sources: Fund staff estimates and projections.

1/ Including the hypothetical purchases under the current and prospect precautionary SBA, not shown in the balance of payments projections.
2/ The prospective SBA repayments are on an expectation basis.

APPENDIX: IRAQ—EXTERNAL DEBT OUTLOOK

1. Iraq has received substantial debt reduction from official and private creditors, but the amount of external debt remains large. By assuming that debt reduction comparable to the Paris Club agreement is applied to non-Paris Club creditor's claims in 2008, the latest estimates of external debt indicate that the stock of debt was $110.5 billion (352 percent of GDP) at end-2005 and $98 billion (198 percent of GDP) at end-2006. Without the third stage of debt reduction, external debt would amount to about $50 billion (about 42 percent of GDP) by 2012. The third stage reduction (expected in 2008) would further reduce Iraq's external debt to about $36 billion (30 percent of GDP) by 2012 (Appendix, Table 1).[7] The medium term projections assume that new debt disbursement is mostly from multilateral creditors and Japan.

2. Under the program scenario, Iraq's external debt remains vulnerable to a negative oil shock, particularly when Iraq will start repaying the debt to official creditors. Based on the Paris Club agreement in 2004, the repayment of the remaining debt stock would start in 2011; the interest payments accrued during 2005–10 are mostly capitalized. The debt service remains moderately large through 2008, when non-Paris Club creditors, that haven't yet provided debt relief, are assumed to provide 80 percent of debt reduction. Debt service is projected to increase in 2011 because of Paris Club debt repayments. Simulations for two oil shocks (a production shock that keeps oil production constant at 2.1 mbpd in 2007–12, and a price shock that lowers the oil export price by $10 per barrel during 2008–12) show that Iraq would require significant borrowing from international markets to close the financing gaps (Appendix, Table 2)

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[7] The third stage of debt reduction would be contingent on Iraq completing the final review of the third year of upper credit tranche arrangements with the Fund.

Table 1. Iraq: Estimated External Debt Stock, 2004–12
(In billions of U.S. dollars) 1/

	2004 before debt reduction	2004 after debt reduction	2005	2006	2007	2008	2009	2010	2011	2012
Without the third stage of debt reduction in 2008 (baseline) 4/										
Paris Club official creditors	42.6	28.4	19.2	19.9	20.7	21.4	22.0	22.4	21.3	20.3
Non-Paris Club official creditors 2/	68.8	68.8	70.1	73.2	76.8	23.3	24.2	24.7	23.3	21.8
Private creditors 3/	20.7	20.7	19.5	4.0	3.0	3.0	3.0	3.0	3.0	3.0
Multilateral creditors and others 4/	0.9	1.2	1.8	1.0	0.9	1.0	1.3	2.2	3.5	4.7
Total debt	133.1	119.1	110.5	98.1	101.4	48.7	50.5	52.3	51.1	49.8
In percent of GDP	516.5	462.2	352.3	198.0	162.1	68.9	58.9	54.7	47.8	41.9
Total debt service 5/	...	0.2	0.2	1.2	0.4	0.9	0.7	0.7	3.7	3.7
With the third stage of debt reduction in 2008 6/										
Total debt	133.1	119.1	110.5	98.1	101.4	32.7	34.3	36.1	36.1	36.0
In percent of GDP	516.5	462.2	352.3	198.0	162.1	46.3	40.1	37.8	33.8	30.2
Total debt service 5/	...	0.2	0.2	1.2	0.4	0.9	0.6	0.5	2.4	2.5

Sources: Iraqi authorities and Fund staff estimates.

1/ The assumptions made in this table are for purposes of illustration and discussion only. While the process of Iraq's debt reconciliation is ongoing, the IMF has had to base its analysis on information that may include as yet unreconciled data. Such use of data by the IMF does not amount to a recognition or denial of any particular claims. The estimates of the debt stock may differ from those in EBS/07/21 to incorporate the latest results of debt reconciliation and settlement.
2/ Assumes debt reduction comparable to the 2004 Paris Club agreement for creditors with whom a debt agreement has been signed. For the remaining non-Paris Club creditors, debt reduction is assumed to take place by end-2008.
3/ Assumes that by end 2007 all debt to private creditors would be settled by debt and cash exchanges.
4/ Includes a new debt and arrears related to fuel imports from Turkey in 2006. The projections assume that new debt disbursement is mostly from multilateral creditors and Japan.
5/ Debt service is actual amount paid, including repayment of arrears to Turkey.
6/ Assumes precautionary SBA during 2005–08.

Table 2. Iraq: External Debt Sustainability Framework, 2004–12
(In percent of GDP, unless otherwise indicated)

	Estimates			Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012
External debt	462.2	352.3	198.0	162.1	68.9	58.9	54.7	47.8	41.9
Change in external debt (1)	-582.4	-109.9	-154.2	-35.9	-93.2	-10.0	-4.2	-6.9	-5.9
Identified external debt-creating flows (2)	-534.7	-74.8	-137.2	-44.3	-22.2	-18.8	-12.3	-12.8	-12.2
Current account deficit, excluding interest payments	17.2	-12.8	-18.0	-9.3	-3.6	-7.3	-8.8	-9.8	-12.3
Deficit in balance of goods and services	25.2	15.0	-5.3	-5.6	5.0	-6.1	-8.0	-9.1	-11.8
Exports	69.0	64.1	58.1	55.1	52.0	56.9	57.3	57.7	57.8
Imports	94.2	79.2	52.8	49.6	57.0	50.8	49.3	48.6	46.1
Net non-debt creating capital inflows (negative) 1/	-44.3	5.2	1.1	-1.0	-7.0	-2.0	0.2	0.6	3.0
Automatic debt dynamics 2/	-507.5	-67.1	-120.3	-33.9	-11.6	-9.6	-3.8	-3.6	-2.9
Contribution from nominal interest rate	20.6	15.5	8.8	7.4	6.8	2.6	2.4	2.2	1.9
Contribution from real GDP growth	-240.3	2.8	-13.8	-2.0	-10.2	-4.2	-5.5	-4.7	-3.8
Contribution from price and exchange rate changes 3/	-287.8	-85.4	-115.2	-39.3	-8.2	-7.9	-0.7	-1.1	-1.0
Residual, incl. change in gross foreign assets (1-2)	-47.8	-35.1	-17.0	8.4	-70.9	8.8	8.1	6.0	6.3
Of which: change in official reserves (increase = positive)	26.4	13.0	16.2	11.0	10.5	9.8	8.5	6.0	6.3
External debt-to-exports ratio (in percent)	669.7	549.2	340.9	294.0	132.5	103.5	95.5	82.9	72.5
Gross external financing need (in billions of US dollars) 4/	10.1	1.0	-0.3	1.2	2.8	-4.0	-6.1	-5.6	-9.8
in percent of GDP	39.2	3.3	-0.6	1.9	3.9	-4.7	-6.4	-5.3	-8.3
External debt service in percent of exports 5/	29.9	25.0	19.4	13.9	14.5	4.5	4.2	7.9	7.0
Debt-stabilizing non-interest current account (positive = surplus) 6/	-599.6	-97.1	-136.2	-26.6	-89.5	-2.7	4.6	3.0	6.4
Key Macroeconomic Assumptions									
Real GDP growth (in percent)	46.5	-0.7	6.2	1.3	7.1	7.5	10.4	9.6	8.9
GDP deflator in U.S. dollars (change in percent)	38.0	22.7	48.6	24.7	5.3	12.9	1.2	2.1	2.1
Nominal external interest rate (in percent)	4.0	4.1	3.9	4.7	4.8	4.5	4.5	4.5	4.4
Growth of exports (U.S. dollar terms, in percent)	91.7	13.2	42.9	20.0	6.4	32.7	12.3	12.7	11.5
Growth of imports (U.S. dollar terms, in percent)	203.7	2.3	5.2	18.7	29.8	8.1	8.3	10.2	5.5
				Stress Tests for External Debt Ratio					
Limited oil production 7/		352.3	198.0	162.1	71.0	64.4	64.3	59.7	55.0
Lower oil price in 2007–11 8/		352.3	198.0	162.1	75.8	64.3	60.0	52.6	46.1
				Stress Tests for External Debt Service-to-Exports Ratio 5/					
Limited oil production 7/		25.0	19.4	13.9	15.4	5.3	5.7	12.1	12.0
Lower oil price in 2007–11 8/		25.0	19.4	13.9	15.4	5.3	5.7	12.1	12.0
Memorandum items:									
Real GDP growth under stress scenarios (in percent)									
Limited oil production 7/		-0.7	6.2	1.3	4.2	2.0	2.9	3.1	3.2
Lower oil price in 2007–11 8/		-0.7	6.2	1.3	7.1	7.5	10.4	9.6	8.9
Non-interest current account deficit under stress scenarios (in percent of GDP)									
Limited oil production 7/		-12.8	-18.0	-9.3	-1.5	-1.5	2.8	6.2	8.0
Lower oil price in 2007–11 8/		-12.8	-18.0	-9.3	-1.6	-1.5	2.7	5.5	6.7

1/ Includes net FDI, other net private sector inflows (all assumed to be equity), and use of official assets held abroad.

2/ Derived as [r - g - r(1+ g) + ea(1+r)]/(1+g + r + gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation. (increase in dollar value of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as [-r (1+g) + e a(1+r)]/(1+g+r+g r) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ Debt service is total accrued amount.

6/ Balance that stabilizes the debt ratio at its previous year's level, given assumptions on real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP.

7/ Assumes that oil production remains constant at 2.1 mbpd from 2008 on.

8/ Assumes that oil price in 2008–12 is US$10 lower than in the baseline.

Attachment I

Baghdad, December 4, 2007

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The Executive Board of the IMF approved a request for a Stand-By Arrangement (SBA) for Iraq on December 23, 2005, and the fifth and final review under the SBA was completed on August 1, 2007. Despite the difficult security and political environment, we made good progress in implementing the economic programs for 2006 and 2007 that were supported by the SBA. We have maintained fiscal discipline and preserved a sustainable balance in the Development Fund for Iraq. Following a surge in consumer prices in 2006, largely due to security-related shortages of fuel products, we succeeded in bringing inflation down sharply in 2007, in particular by allowing the exchange rate of the dinar to appreciate. We have also taken measures to reduce fuel shortages. However, the security situation prevented the envisaged increase in investment and production in the oil sector, thereby keeping economic growth below target. We continued to make progress in the structural area. In particular, we significantly increased the prices of domestic fuel products and brought them in line with those in other oil-exporting countries in the region. As a result, we eliminated direct budgetary subsidies on fuel products, except for a small subsidy on kerosene.

2. We are fully aware that much remains to be done to create the conditions for sustainable economic growth and to reduce Iraq's vulnerability to negative oil shocks. Therefore, we are determined to make further progress in strengthening macroeconomic policies and in undertaking structural reforms. Our program for 2008 seeks to maintain macroeconomic stability, facilitate investment and higher output in the oil sector, and advance structural reforms to pave the way for higher growth and to strengthen governance and administrative capacity in the public sector.

3. The attached Memorandum on Economic and Financial Policies (MEFP) sets out our economic and financial program for 2008. We believe that the policies and measures described in the MEFP are adequate to achieve the objectives of the program, but we will take any additional measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We consent to the publication of this letter, the MEFP, and the attached Technical Memorandum of Understanding.

4. In support of the implementation and success of our program for 2008, we hereby request the approval of a 15-month SBA with the Fund (December 2007–March 2009) in an amount equivalent to SDR 475.36 million or 40 percent of quota, and the cancellation of the current SBA effective immediately prior to that approval. We intend to treat the requested arrangement as precautionary (i.e. we do not intend to make the purchases under the arrangement that will become available upon its approval and after observance of its performance criteria and completion of its reviews). We will provide the Fund with such information as it requests on policy implementation and achievement of the program objectives. Finally, we hope that we can count on the continued support of the international community for the implementation of Iraq's policy agenda.

Sincerely yours,

/s/ /s/

Dr. Sinan Al-Shabibi
Governor of the Central Bank of Iraq

Mr. Baqir S. Jabr Al-Zubaydi
Minister of Finance of Iraq

Attachment II: Iraq—Memorandum of Economic and Financial Policies for 2008
December 4, 2007

I. Developments Under the Current Stand-By Arrangement

1. The current precautionary Stand-By Arrangement (SBA) has supported Iraq's economic programs for 2006 and 2007, which aimed at maintaining macroeconomic stability while laying the groundwork for sustainable growth over the medium term and improving governance. Despite very difficult circumstances, we have made good progress in implementing our macroeconomic policies. All quantitative performance criteria since the approval of the SBA in December 2005 were met and several important structural reforms were undertaken. The difficult security situation, however, has hampered investment and prevented the envisaged expansion of oil output, thereby keeping economic growth below target. Shortages of key commodities, especially fuel products, led to an unexpected increase in inflation to 65 percent by end-2006. In response, we have taken corrective policies—including a gradual appreciation of the exchange rate, a tightening of the monetary policy stance, and containment of current government spending—which helped to counter the dollarization of the economy and to reduce inflation. Also, we have taken measures to reduce fuel shortages, including by clamping down on smuggling and other irregularities in the supply chain. As a result, annual consumer price inflation has fallen back to 20 percent in October 2007 from 65 percent during the year of 2006.

2. The overall fiscal position in 2006 and 2007 was more comfortable than envisaged because of higher oil export prices and lower expenditures. In particular, there was a shortfall in investment due to the security situation and limited implementation capacity. The fiscal outturn for 2006 showed a sizable surplus of 12 percent of GDP. The surplus resulted in an accumulation of balances in the Development Fund for Iraq (DFI) of ID 2.9 trillion, as compared to a programmed reduction of almost ID 8.7 trillion, and in a sizable build-up of government deposits at the CBI. In 2007, we have taken measures to speed up the implementation of investment projects, in particular by: (i) accelerating cabinet approval of large projects; (ii) shortening the procurement period; (iii) raising the threshold for projects that can be approved at the line-ministry and governorate level; and (iv) ensuring that budget allocations are made available to line-ministries and governorates on a timely basis. As a result, the execution rate of the investment budget is increasing in 2007, while current spending is expected to be close to budget. Taking account of the effect of the appreciation of the dinar on oil revenues, we expect an overall fiscal surplus of about 1½ percent of GDP in 2007. By the end of 2007, we expect to maintain the balance in the DFI at about ID 13 trillion.

3. The timely adjustment of monetary and exchange rate policies by the Central Bank of Iraq (CBI), together with the maintenance of fiscal discipline and the reduction of fuel shortages, were critical for bringing inflation down. At the height of inflation, the CBI responded by allowing the exchange rate to gradually appreciate from mid-November 2006

by about 16 percent to ID 1,232 per dollar at end-October 2007. In addition, the CBI raised its policy interest rate in two steps from 12 percent in October 2006 to 20 percent as of early January 2007. Net international reserves continued to grow and reached a level of $25.5 billion at end-October 2007.

4. On the structural side, progress was made in several key areas despite the lack of security and capacity constraints. Official prices of domestic fuel products were increased significantly and brought in line with those in other oil-exporting countries in the region. As a result, we succeeded in eliminating direct budgetary subsidies on fuel products (which amounted to about 8 percent of GDP in 2005), except for a small subsidy on kerosene. Legislation and administrative regulations were enacted to allow importation of fuel products by the private sector. As part of our efforts to modernize public financial management, the chart of accounts and budget classification have been brought in line with the IMF's *Government Finance Statistics Manual (GFSM)* 2001, within a cash accounting framework. The Council of Representatives (CoR) has passed in October 2007 amendments to the new pension law in order to make the pension system fiscally sustainable, in particular by a gradual reduction of replacement rates. An audit of the CBI end-2006 net international reserves and the audit of its 2006 financial statements have been finalized, and the CBI has begun to address weaknesses in its accounting and reporting framework. Also, the CBI's capital was raised to the statutory level. The payment system is being modernized, and a real time gross settlement system and an automatic clearing house are now operational. Preparations for the restructuring of the two largest state-owned banks are underway.

5. We have also continued to make progress toward resolving external claims. Understandings on debt restructuring have been reached with Russia, the only outstanding Paris Club creditor, but an agreement remains to be signed. Bilateral agreements with ten non-Paris Club official creditors have been signed and active negotiations are underway with several non-Paris Club official creditors, notably China. However, despite our good faith efforts, negotiations with some other key non-Paris Club official creditors are progressing slowly. A Special Purpose Vehicle has been established to provide single securitization of restructured debt to official creditors. The bulk of the claims of private creditors has been resolved through debt and cash exchanges, and most of the remaining claims are in the process of reconciliation with claims that are being settled as part of the liquidation of the London branch of Rafidain Bank.

6. With the help of the international community we have launched an International Compact for Iraq (ICI) to support a process of comprehensive political, security, and economic reform. The macroeconomic component of the ICI is consistent with our economic program under the SBA.

II. Economic and Financial Policies in 2008

A. Macroeconomic Objectives of the Program

7. Notwithstanding the progress made under the current SBA, the Iraqi economy still faces enormous challenges. Low investment and stagnating output in the oil sector, largely due to the difficult security situation, remain a bottleneck for future growth, as well as for providing better social and public services, and maintaining fiscal sustainability. In addition to the measures taken to speed up project implementation, improvements in the security situation and governance in the sector are necessary to achieve significant progress in this area. The containment of current government spending and an appropriate management of the exchange rate, supported by a continued tight monetary stance, remain prerequisites for keeping inflation low. It is also important to further reduce shortages through continued government support of private sector fuel imports and stepping up investment in the domestic fuel sector. Much remains to be done to strengthen the financial management of the government and the CBI, as well as to reform the banking sector.

8. Our economic program for 2008 will build on the progress made in strengthening macroeconomic policies and in structural reforms. The broad objectives of the program are to maintain macroeconomic stability, facilitate investment and higher output in the oil sector, and advance priority structural reforms to pave the way for higher growth over the medium term and to strengthen governance and administrative capacity in the public sector. The successful completion of the program will also trigger the third and final stage of debt reduction under the 2004 Paris Club agreement, and thereby contribute to fiscal and external sustainability.

9. The program will have the following macroeconomic objectives for 2008: (i) achieving real GDP growth of about 7 percent, driven by an expansion of oil output from 2.0 million barrels per day (mbpd) in 2007 to 2.2 mbpd in 2008; and (ii) containing annual consumer price inflation at 12 percent. The net international reserves of the CBI are expected to increase to about $34 billion by end-2008.

B. Macroeconomic Policies

Fiscal policy and related issues

10. The key objectives of our fiscal strategy remain to promote the rebuilding of Iraq's economy, to restore adequate public services, and to protect the standard of living of the population, while maintaining fiscal sustainability. As the political and security situation remains volatile, the reconstruction of the economy, notably the oil sector, and the appropriate management of the government's limited resources continues to be a difficult challenge. We are keenly aware that there is little room for fiscal slippages and that it is of the utmost importance to increase investment and production in the oil sector to maintain fiscal and external sustainability. In this context, our fiscal policy focuses on prioritizing the

use of available resources towards our investment program and essential spending in education, health, and security, while containing other current expenditures. We are also determined to consolidate the progress made in eliminating direct fuel subsidies and to step up our efforts to strengthen public financial management and governance.

11. The draft 2008 budget adopted by Cabinet allows for a sizable investment program, including in the oil sector, and a moderate rise in current spending (prior action). The draft budget envisages government revenue to increase to ID 50.8 trillion in 2008, including oil exports revenue of ID 42.4 trillion and the one-off revenue from the sale of cellular phone licenses (ID 4½ trillion). Oil revenue in 2008 is based on a projection of oil export volumes of 1.7 mbpd, in line with our efforts to increase oil production, and a prudent oil export price of $57 per barrel. Total government spending, excluding grant-financed expenditures, will be limited to ID 57.5 trillion in 2008, including a limited amount related to the carry-over of investment spending that was committed in 2007 but for which payment will take place in the first part of 2008. The budget aims to limit the overall fiscal deficit to ID 7.1 trillion or 8.4 percent of GDP in 2008. The deficit will be financed by drawing down part of the balance in the DFI and by using some of the bank deposits accumulated during 2006–07. We aim to maintain a balance in the DFI of at least ID 6.1 trillion for future operations. The total financing of the central government budget deficit in 2008 will be subject to a performance criterion under the SBA.

12. Increasing investment and output in the oil sector is crucial to generate the resources needed to revitalize the economy and maintain fiscal and external sustainability. To this end, we are embarking on a number of targeted investment and rehabilitation projects. A project to enhance the production capacity of oil wells in the South is underway. We have increased the protection of the Kirkuk-Ceyhan pipeline and exports through the North have resumed since July, albeit still with interruptions. We expect oil production and exports in the North to reach at least 0.1 mbpd on average in 2008. Work has started to upgrade the export facilities at the port of Khor Al-Amyah, which is planned to be completed by mid-2008. In view of the uncertainties related to the security situation and the gestation period of new investment projects in the oil sector, oil production is expected to increase gradually in the period ahead. We will significantly step up our efforts to accelerate the execution of reconstruction projects, in particular in the electricity, water and sanitation, health, and education sectors.

13. To create room for higher investment outlays and maintain fiscal sustainability, we intend to limit the increase in current spending in 2008. The wage bill will rise only moderately as we have decided not to grant any general wage increases and there will be only limited hiring, mostly in the education, health, and security sectors. The recent adoption of the amendments to the new pension law will allow us to put the pension system on a fiscally sustainable path, broadly in line with our understandings with Fund staff. Starting in 2008, an extra-budgetary pension fund will be created that will receive all pension contributions but will pay out only to new pensioners, while the budget will continue to be responsible for the pensions of existing retirees. We are committed to managing the new pension fund in a

transparent manner, in line with international good practices, and are receiving technical assistance from the World Bank and USAID in this area. The wage and pension bill (except for wages of the defense and interior ministries) will be limited to ID 10.8 trillion and will be subject to a quantitative performance criterion.

14. In order to put the management of the government wage bill on a sound footing, we are undertaking a census of public service employees. Because of further delays caused by the security situation, the data collection phase of the census had to be extended and we now expect to receive the completed questionnaires back from government agencies by end-February 2007, three months later than planned. We aim to complete the census report by end-June 2008 (structural benchmark). On this basis, we will adopt an action plan to eliminate ghost workers and computerize the payroll by September 2008. We intend to establish a bank transfer system for wage payments once the banking system has acquired the capabilities to efficiently handle such operations as a result of the ongoing modernization of the payment system.

15. We are determined not to provide any direct budget subsidies on fuel products in 2008, except for a small subsidy on imported kerosene, and will take any measures that may be needed to that effect (quantitative performance criterion). The State Oil Marketing Organization (SOMO) will continue to use the revolving government credit with a ceiling of ID 400 billion to finance its imports of fuel products. Building on the progress we have made under the current SBA, we intend to strengthen the financial management of the fuel sector, in order to further reduce distortions and inefficiencies. In this context, we intend to develop, with technical assistance from the Fund, a periodic adjustment mechanism for fuel prices, based on changes in domestic production costs and import costs (structural benchmark). We will also continue to facilitate private sector fuel imports, in order to further reduce shortages.

16. We will step up our efforts to streamline the social safety net. In line with the recommendations of the World Bank, we will continue our efforts to rationalize the in-kind Public Distribution System through enhanced monitoring and improved procurement procedures. We also intend to limit the number and rations of goods in the basket, increase the price of the ration card, and further restrict eligibility of well-off families. We are in the process of further expanding the coverage of the new cash-based Social Safety Net, which presently covers about 800 thousand poor families, who received cash benefits of ID 80 thousand to ID 120 thousand per month, depending on the size of the family.

17. Much remains to be done to strengthen the effectiveness and transparency of budgetary management. External support for the Financial Management Information System (FMIS), which had started on a trial basis in January 2007, was terminated following the abduction of an external consultant in May. As a result, and in light of the difficulties we experienced to adapt this system to our needs, the FMIS is no longer in use. It remains crucial, however, to modernize the existing semi-automated legacy system which remains time-consuming and vulnerable. We have requested Fund technical assistance to help us

identify priorities for modernizing public financial management in light of our needs and the progress we have made in recent years, including the work on the FMIS. We intend to adopt an action plan for reform in this area by end-July 2008 (structural benchmark). To improve the government's cash management, we will closer align the transfer of cash allocations to line-ministries and governorates with the rate of execution of their investment programs and reduce the large outstanding government deposits with commercial banks. To strengthen transparency and accountability, we will submit the final accounts of the Federal Budget for 2007 to the Board of Supreme Audit, and subsequently submit the audited accounts to the Council of Representatives and publish them, as required by the 2004 Financial Management Law (structural benchmarks).

18. We are making progress in developing a medium-term tax reform strategy with assistance from international partners, including the Fund. Our objective is to streamline Iraq's tax system in order to support economic development, while broadening the tax base and increasing revenue collection. In this context, it is important to ensure that the tax system for the oil sector is compatible with the expansion of private sector activities. We intend to simplify the personal income tax system by raising the tax-free threshold and we will consider the reduction of the number of tax brackets (currently: four brackets). We will maintain the corporate income tax rate at 15 percent, and the customs duty rate (reconstruction levy) at 5 percent, while reducing exemptions. We are also considering the introduction of a sales tax as a precursor for a value-added tax.

Monetary and exchange rate policies

19. The key objectives of monetary and exchange rate policies in Iraq are to reduce inflation and counter dollarization in order to enhance the central bank's control over monetary conditions. The appreciation of the exchange rate has succeeded in increasing the demand for dinars and contributed significantly to the drop in inflation. The CBI will continue to gradually appreciate the exchange rate until annual core inflation (excluding fuel and transportation) has come down to near single-digit levels, from 16 percent in October. We will continue to keep a close watch on the effects of this policy on inflation and adjust the pace of appreciation as needed. Once our inflation target has been achieved, the CBI will return to its previous policy of maintaining a stable exchange rate as the nominal anchor for the economy. The CBI will continue to provide the full amount of foreign currency demanded at the cut-off rate on the daily auctions.

20. The CBI will maintain its policy interest rate at its present level until annual core inflation has come down to near single-digit levels. Provided headline inflation continues its downward trend, the policy interest rate could be reduced gradually while seeking to maintain a positive real interest rate. Our monetary program for 2008 envisages a further growth in money demand, in particular currency in circulation, that is consistent with the projected accumulation in net international reserves and the continuation of the CBI's policy of no lending to the government and the private sector. The program includes a floor on the

net international reserves of the central bank (performance criterion). In order to absorb a significant part of the additional liquidity in the banking system that resulted from the build up of government deposits in commercial banks in 2007, the CBI has increased the required reserves ratio on government deposits from 25 percent to 75 percent as of September 2007. The CBI will continue to provide banks unrestricted access to its standing deposit facilities.

21. We continue to prepare the ground to broaden the available menu of monetary policy instruments, in order to eventually influence monetary conditions through open market operations. To this end, we will develop a central depository system and the Ministry of Finance will continue with the regular bi-weekly issuance of treasury bills. The CBI will continue to issue its own bills and sell in the secondary market the treasury bills received annually from the Ministry of Finance as part of the rescheduling of CBI claims.

22. The CBI is committed to continue implementing the recommendations of the Interim Safeguards Assessment Report (ISAR) and of the Ernst & Young audit of its 2006 financial statements. We have appointed an external auditor to undertake the audit of the CBI 2007 financial statements and net international reserves data as at end-December 2007 (prior actions). The completion of these audits will constitute structural performance criteria under the program. Other key measures in the pipeline are: (i) the implementation of regular reconciliation in the CBI accounts of local banks' current accounts, intra-branch accounts, and suspense accounts (structural benchmark); (ii) the adoption of reserve management guidelines (structural benchmark); (iii) the implementation of regular reconciliation procedures for the CBI's account at the Federal Reserve Bank in New York (FRBNY), including for interest earned on U.S. Treasury bills; and (iv) the establishment of a register of outstanding off-balance sheet commitments (letters of credit and guarantees). We may request technical assistance from the Fund in some of these areas. To increase transparency, the CBI has published on its website the 2005 and 2006 audited financial statements along with the auditor's opinion.

External sector policies

23. We remain committed to maintaining a liberal exchange system, and in practice there are no restrictions on international current and capital transactions unrelated to anti-money laundering or counter-terrorism measures. We are ready to implement the Fund's recommendations that may result from the ongoing review of exchange regulations, and intend to accept the obligations of Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement as soon as possible. In the meantime, we will avoid imposing restrictions on the making of payments and transfers for current international transactions. The CBI is also committed to avoid the application of administrative measures to limit the quantity of foreign exchange sold at the daily auction (performance criterion).

24. We are determined to continue adhering to our open trade policies. In this context, we will step up our efforts to secure Iraq's accession to the World Trade Organization (WTO),

which would constitute an important step toward the country's integration into the world economy.

25. We will continue our good faith efforts to resolve outstanding external claims under terms that are consistent with the 2004 Paris Club agreement. We will endeavor to reach a bilateral debt agreement with Russia and finalize the negotiations on a debt agreement with China as soon as possible. Official contacts with the other non-Paris Club creditor countries have been made and will continue with a view to an early conclusion of debt agreements.

26. To resolve most of the remaining claims of private creditors, the liquidation of the London branch of Rafidain Bank is underway and we are hopeful that the process will be completed as soon as possible. We also plan to make fully operational the recently established debt management unit in the Ministry of Finance by early-2008, and have now centralized government authority to contract new external and domestic debt at that ministry.

C. Structural Policies

27. Increasing transparency and good governance in the oil sector remains a top priority. We will ensure a smooth transition when the International Advisory and Monitoring Board (IAMB) hands over its responsibilities as audit and oversight body for the DFI to the Iraqi Committee of Financial Experts (COFE) by the end of this year. The COFE will continue the IAMB's practice of publishing the audit reports it mandates, and it will present its first semi-annual report, including recommendations, to the Council of Ministers by mid-September 2008 (structural benchmark). All meters at the Basra export terminal have been certified and are operational, and the metering system in the Khor Al-Amyah export terminal will be installed in the second half of 2008. We will also step up our efforts to implement a comprehensive custody-transfer system metering project with help from international partners. To enhance transparency, we will refrain from undertaking barter transactions in crude oil or petroleum products; any remaining barter transactions will be registered and reported as sales and purchases in the financial statements of SOMO. The Ministry of Oil has started to publish on its website information on production, export, and processing of crude oil, as well as on the import of petroleum products. We also remain committed to join the Extractive Industries Transparency Initiative, and will request technical assistance from our international partners to speed up the process.

28. In view of the large future investment needs in the oil sector, we will continue our efforts to secure the passage of a comprehensive hydrocarbon law. Concomitantly, we will continue the work on the accompanying legislation pertaining to re-establishing the Iraq National Oil Company, reorganizing the Ministry of Oil, and setting the parameters for revenue distribution and intergovernmental fiscal relations.

29. With a view to modernizing the banking sector, we will continue to implement the December 2006 memoranda of understanding on the restructuring of Rafidain and Rasheed banks. The contract with the international auditors has been signed, and they have started

their operational and financial audits of both banks under terms of reference agreed upon with the Fund and the Bank (prior action). The audits will be completed by end-May 2008 (structural benchmark). Based on the findings of the audits, an operational restructuring program for Rafidain Bank, and an operational and financial restructuring program for Rasheed Bank will be adopted by end-September 2008 (structural benchmark). The Supreme Board of Audit has also begun work on the reconciliation of the foreign debt held by both banks and the cleaning up of their large suspense accounts, and the results will be reflected in their financial statements for end-2007. The Restructuring Oversight Committee is developing individual strategies for the restructuring of the three smaller specialized state-owned banks, and diagnostic reviews of these banks will start by end-June 2008.

30. Strengthening the regulatory and supervisory framework is crucial for the establishment of a sound banking sector in Iraq. Our priority in this regard is to complete a comprehensive set of prudential regulations for banks by end-July (structural benchmark), and to take measures to enable the timely issuance of CBI regulations. In addition, we will continue to work toward changing the commercial banks' accounting system in line with International Financial Reporting Standards, and to prepare a set of financial soundness indicators for commercial banks. We have further widened the coverage of the real time gross settlement payment system and the automated clearing house, and most commercial banks' headquarters and the Ministry of Finance are now connected to the CBI. In 2008, we intend to further expand coverage to commercial bank branches.

31. We are proceeding with measures to rehabilitate public enterprises that are considered commercially viable. Some 21 public enterprises have been selected to submit a business plan to Rafidain and Rasheed banks, in order to obtain financing to re-start their operations on a commercial basis. Thus far, four loans in a total amount of ID 8.2 billion have been made to public enterprises in the textile and fertilizer sectors. Government support to these enterprises will be temporary and limited to partial interest subsidies, and will be fully reflected in the budget. To stimulate the creation of small enterprises, the government has set up a microfinance scheme under which it will provide partial interest subsidies that are also included in the budget. Loans extended under this scheme will be processed by Rafidain and Rasheed banks according to their normal lending rules. We are committed not to provide any government guarantees on bank loans to public enterprises or other banks, nor on loans related to the microfinance scheme. We have set up the National Investment Commission, which will develop and monitor investment policies and regulations envisaged in the new investment law that aims to attract private sector investments.

D. Statistics

32. We will step up our efforts, with technical assistance from the Fund, to improve the accuracy, coverage, and timeliness of macroeconomic statistics. Despite serious capacity constraints, we will submit economic and financial data to the Fund within the time-lags specified in the attached Technical Memorandum of Understanding (TMU). We are on track

to complete the 2007 household survey before year-end, and will update the weights in the CPI by end-May 2008 (structural benchmark). We are also continuing our efforts to extend the geographical coverage of the CPI to the Northern Region, and to incorporate data from the two CBI branches located in Kurdistan into the monetary statistics. We plan to start submitting monetary data for the IMF's *International Financial Statistics* in the coming months and we are working towards participating in the General Data Dissemination System in the course of next year.

III. Program Monitoring

33. We agree that the program will be monitored through prior actions, two semi-annual reviews, quantitative performance criteria and an indicative target, and structural performance criteria and benchmarks. Financing assurances reviews will be required for purchases under the arrangement if Iraq has sovereign external arrears to private creditors or, by virtue of Iraq's imposition of exchange controls, there are outstanding non-sovereign external payments arrears. The quantitative performance criteria (PC) and indicative target (IT) have been specified in Table 1 for the net international reserves of the CBI (PC floor), lending to the government and the private sector by the CBI (PC ceiling), the central government total financing (PC ceiling), the government wage and pension bill (PC ceiling), government imports of petroleum products (PC ceiling), direct government subsidies to the fuel sector (PC ceiling), new medium-and long-term nonconcessional external debt contracted or guaranteed by the government (PC ceiling), external arrears on new borrowing (PC ceiling), and the revolving government credit to the State Oil Marketing Organization (IT ceiling). Prior actions, structural performance criteria, and structural benchmarks are listed in Table 2. Appropriate definitions of all key performance indicators are defined in the attached TMU.

34. We also agree that the second through the final purchases under the program will be subject to quarterly quantitative performance criteria. The third disbursement will be conditional on performance criteria and the successful completion of the first review which will focus, inter alia, on progress made with developing an action plan to modernize the government's financial management system and on the completion of an audit of the CBI's net international reserves. The first review will also define quantitative performance criteria for end-September and end-December 2008. The fifth disbursement will be conditional on performance criteria and completion of the second review which will focus, inter alia, on progress made in bank restructuring and with developing a periodic adjustment mechanism for domestic fuel prices.

Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the New Stand-By Arrangement (SBA), 2007–08 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at	Performance Criteria			Indicative Targets	
	6/30/07	12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
Cumulative change from June 2007						
Net international reserves of the CBI (floor; in millions of U.S. dollars)	21,045	0	0	0	0	0
Lending to the government and the private sector by the CBI (ceiling) 2/	5,230	0	0	0	0	0
Cumulative flow from beginning of calendar year						
Central government total financing (ceiling) 3/	...	7,600	2,200	3,750	5,400	7,200
Government wage and pension bill (ceiling) 3/ 4/	...	10,100	2,750	5,500	8,250	11,000
Government imports of petroleum products (ceiling) 3/	...	400	100	200	300	400
Direct government subsidies to the fuel sector (ceiling)	...	0	0	0	0	0
New medium-and long-term nonconcessional external debt (with original maturities of one year of more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 3/ 5/	...	500	500	500	500	500
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 6/	...	0	0	0	0	0
Indicative target						
Revolving government credit to the State Oil Marketing Organization (ceiling)	...	400	400	400	400	400

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.
2/ Rolling over t-bills does not constitute new lending.
3/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.
4/ Excluding salaries paid by ministries of defense and interior.
5/ Consessionality is defined as loans with a grant element of 35 percent or higher.
6/ To be monitored on a continuous basis.

Table 2. Iraq: Prior Actions, Structural Performance Criteria, and Structural Benchmarks
Under the New Stand-By Arrangement

I. Prior Actions	Date
Adoption by Cabinet of the 2008 government budget, in line with program objectives.	
Appointment of an external auditor to undertake the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	
Appointment of an external auditor to undertake an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	
Commencement by an internationally reputable auditor of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	
II. Structural Performance Criteria	
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008
III. Structural Benchmarks	
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008
Adoption of reserves management guidelines by the CBI.	March 31, 2008
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008
Completion of census of all public service employees (central government and military).	June 30, 2008
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008
Completion of a comprehensive set of prudential regulations for commercial banks.	July 31, 2008
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008

Attachment III: Iraq—Technical Memorandum of Understanding

December 4, 2007

1. This memorandum describes the quantitative and structural performance criteria, benchmarks, and indicators for the second Stand-By Arrangement (SBA) with the International Monetary Fund (IMF). It also specifies the periodicity and deadlines for transmission of data to the staff of the IMF for program monitoring purposes.

I. Quantitative Performance Criteria and Indicators

2. The quantitative performance criteria are the following:

- a floor on net international reserves of the Central Bank of Iraq (CBI);
- a ceiling on lending to the government and the private sector by the CBI;
- a ceiling on the central government total financing;
- a ceiling on the government wage and pension bill;
- a ceiling on government imports of petroleum products;
- a ceiling on direct government subsidies to the fuel sector;
- a ceiling on external arrears on existing rescheduled debt and new borrowing; and
- a ceiling on contracting and guaranteeing of new medium- and long-term non-concessional external debt.

3. The quantitative indicative target is a ceiling on the revolving government credit to the State Oil Marketing Organization (SOMO).

II. Definitions

4. For purposes of monitoring under the program, a program exchange rate will be used. This program exchange rate will be set at ID 1,200 per U.S. dollar. The program exchange rate will be used to convert into Iraqi dinars the U.S. dollar value of all CBI foreign assets and liabilities denominated in U.S. dollars, as required. For CBI assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar, they will be converted in U.S. dollars at their respective SDR-exchange rates prevailing as of December 17, 2007, as published on the IMF's website.

5. **Net international reserves (NIR)** are defined as gross usable reserves minus reserve-related liabilities of the Central Bank of Iraq. Gross usable reserves of the CBI are claims of the CBI on nonresidents that are controlled by the CBI, denominated in foreign convertible currencies, and are immediately and unconditionally available to the CBI for meeting balance of payments needs or for intervention in foreign exchange markets, and are not earmarked by the CBI for meeting specific payments. They include CBI holdings of monetary gold, SDRs, Iraq's reserve position in the IMF, foreign currency cash, and deposits abroad, except for the resources of the Development Fund for Iraq (DFI) but including the CBI DFI sub-account. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). Reserve-related liabilities shall be defined as foreign currency denominated liabilities of the CBI to residents and nonresidents with original maturity of one year or less, and all liabilities to the Fund. They include: foreign currency reserves of commercial banks held at the CBI; commitments to sell foreign currency arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies. Excluded from reserve liabilities are the government's foreign currency deposits at the CBI. As of June 30, 2007, net international reserves amounted to US$21.0 billion, comprising US$21.5 million of reserve assets and US$0.5 million of reserve-related liabilities. The floor will be measured from June 30, 2007.

6. **Claims of the CBI on the central government** comprises holdings by the CBI of treasury bills (including accrued interest) plus the outstanding balance in the government overdraft account at the CBI. Also included are the claims on nonbank public institutions and claims on commercial banks. As of end-June 2007, treasury bill holdings by the CBI amounted to ID 5,214 billion and claims on commercial banks stood at ID 13 billion. The balance of the overdraft account at the CBI was nil and there were no claims on non-bank public institutions. The ceiling will be measured from June 30, 2007.

7. The performance criterion on the **central government total financing** will be calculated as the sum of domestic and external financing of the central government balance, adjusted for any deviations in the amounts of (i) donor financing for projects and (ii) "other financing" in excess of program projections. Domestic financing includes any form of resident financing of the consolidated budget from (i) the central bank; (ii) commercial banks; (iii) non-bank financial institutions; (iv) non-financial enterprises; (v) privatization proceeds; (vi) changes in arrears; (vii) households; and (viii) all other domestic financing not elsewhere classified. External financing includes financing from (i) the Development Fund for Iraq, (ii) donor financing for projects, (iii) other financing not elsewhere classified, net of (iv) the amortization of external debt. The ceiling for end-2007 will be measured on a cumulative basis from January 1, 2007; the quarterly ceilings for 2008 will be measured on a cumulative basis from January 1, 2008.

8. **Wage and pension bill** includes all wage and pension payments made by the central government, excluding wage payments made by the ministries of defense and interior. Specifically, with reference to the 2008 budget classification, it includes expenditures under Section 1 (except those for the ministries of defense and interior) and Section 6, sub-section 1, items 1(1), 2(1), 3(1, 3, 5, and 7), 4(1), 5(1), 7(1), 8(1), 9(1), 10(1), 11(1), and 12(1). The ceiling for end-2007 will be measured on a cumulative basis from January 1, 2007; the quarterly ceilings for 2008 will be measured on a cumulative basis from January 1, 2008.

9. **Government imports of petroleum products** shall comprise imports of kerosene made directly by SOMO on behalf of the Government of Iraq. The ceiling for end-2007 will be measured in a cumulative basis from January 1, 2007; the quarterly ceilings for 2008 will be measured on a cumulative basis from January 1, 2008.

10. **Direct government subsidies to the fuel sector** shall comprise of any financial assistance rendered by the Ministry of Finance to fuel-related enterprises. The ceiling for end-2007 will be measured on a cumulative basis from January 1, 2007; the quarterly ceilings for 2008 will be measured on a cumulative basis from January 1, 2008.

11. A continuous ceiling applies to the non-accumulation of **external payments arrears** on existing rescheduled debt and new external debt contracted or guaranteed by the central government or the CBI. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 17, 2007 and that have not been paid at the time they are due, as specified in the contractual agreements.

12. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), the term "debt" will be understood to mean a current liability (i.e., not contingent), created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits), and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of

the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair or maintenance of the property. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

13. For purposes of the program, the guarantee of a debt arises from any explicit legal obligation of the government or CBI or any other agency acting on behalf of the government to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the government or CBI to cover a shortfall incurred by the loan recipient.

14. The limits on **medium- and long-term external debt** apply to the contracting or guaranteeing by the government of new, nonconcessional external debt with an original maturity of more than one year, excluding obligations to the IMF. This limit applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt in Fund Arrangements (Decision No. 6230-(79/140), August 3, 1979, as amended by Decision Nos. 11096-(95/100), October 25, 1995, and 12274-(00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. External debt will be considered to have been contracted at the point the loan agreement or guarantee is ratified by the Iraqi parliament. Excluded from this limit are leases of real property by Iraqi embassies or other foreign representations. External debts will be expressed in U.S. dollar terms, with debts in currencies other than the U.S. dollar converted into U.S. dollars at the market rates of the respective currencies prevailing on December 17, 2007, as published on the IMF's website.

15. Concessionality will be based on currency-specific discount rates based on the Organization for Economic Co-operation Development (OECD) commercial interest reference rates (CIRRs). For loans of an original maturity of at least 15 years, the average of CIRRs over the last 10 years will be used as the discount rate for assessing the concessionality of these loans, while the average of CIRRs of the preceding six-month period will be used to assess the concessionality of loans with original maturities of less than 15 years. To the ten-year and six-month averages of CIRRs, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 29 years. Under this definition of concessionality, only loans with grant element equivalent to 35 percent or more will be excluded from the debt limits. The debt limits also will not apply to loans contracted for debt rescheduling or refinancing.

16. The revolving government credit to SOMO shall comprise all credits provided by the Ministry of Finance to the Ministry of Oil and/or directly to SOMO for the purpose of importing fuel derivatives. The indicative ceiling for end-2007 will be measured on a

cumulative basis from January 1, 2007; the quarterly indicative ceilings for 2008 will be measured on a cumulative basis from January 1, 2008.

III. Provision of Information to the Fund Staff

Data

17. To monitor developments under the SBA, the authorities agree to provide the Fund, the information specified below after SBA approval. The program is designed with quarterly quantitative performance criteria and the actual outcome should be provided within eight weeks following the end of the quarter. However, in order to facilitate regular monitoring, many of the indicators should be provided with higher frequencies, as indicated below.

- CBI gross foreign exchange reserves (weekly) and balances of the DFI held at the FRBNY. This should be reported no longer than 2 weeks after the end of the reference week.

- The monthly balance sheet of the CBI, with a month lag.

- The monthly consolidated balance sheet of the other depository corporations (commercial banks), with an eight week lag.

- The depository corporations (monetary) survey of all commercial banks and the CBI (quarterly), with an eight weeks lag.

- Weekly preliminary monetary and financial aggregates, including exchange rate data (daily), currency in circulation, transferable and other deposits held at commercial banks, balances on government accounts at the CBI, interest rates on loans and on deposits at commercial banks, holdings of government securities, and credit outstanding to the public and private sectors. The data, excluding exchange rates, should be reported no longer than three weeks after the end of the reference period.

- Consumer price index (CPI), including indices for main cities (monthly). These should be reported no longer than a month after the end of the relevant month.

- Detailed revenues, operating and capital expenditure, and financing items of consolidated fiscal and oil operations, and overall fiscal balance. These data should include the execution of the Iraqi budget, operations and deposits of the oil-related state-owned enterprises, disbursements of external assistance and loans, execution of letters of credit financed under the UN oil-for-food program, all operations of the DFI and its sub-accounts, balances of al government accounts held at the CBI and the commercial banks, and outstanding stock of government securities (including treasury bills). These data should be reported on a monthly basis and reported no more than eight weeks after the end of the reference month.

- Amount of total imports of petroleum products financed from the budget on a quarterly basis starting with the first quarter of 2007. These data should be reported no later than eight weeks after the end of the reference quarter.

- Detailed data on disbursement of external assistance from the U.S. and other donors, including by recipient sector; foreign debt amortization and interest payments made; and total outstanding domestic and external debt. These data should be reported on a monthly basis no more than eight weeks after the end of the reference month.

- List of short, medium, and long-term government or government-guaranteed external loans contracted during each quarter, identifying for each loan: the creditor, the borrower (ultimate obligor), the amount and currency, the maturity and grace period, repayment terms, and interest rate arrangements (monthly).

- Foreign trade statistics (imports, exports, re-exports) (quarterly). This should be reported no longer than eight weeks after the end of the reference quarter.

- Indicators of oil activity on crude oil and gas production and use, production and sales (export and domestic) of refined petroleum products, including heavy residuals (monthly). These data should be reported no longer than eight weeks after the end of the reference quarter.

- Indicators of non-oil real economic activity (quarterly), including production of cement, fertilizers, and electricity, reported no longer than eight weeks after the end of the reference quarter.

- The balance sheet of the Trade Bank of Iraq (TBI) as well as data on issued, implemented and outstanding Letters of Credit, with no more than an eight weeks lag.

- The amount and terms of concessional loans contracted and their grant element, on a quarterly basis, with no more than eight weeks lag.

Structural Reforms

18. Review of the structural reforms specified in the memorandum of economic and financial policies and as prior actions, structural performance criteria, and structural benchmarks (Table 2). The authorities will prepare and send to the IMF reports, with appropriate documentation, indicating progress achieved, explaining any deviations relative to the initial planning, and specifying expected revised completion dates.

Other Information

19. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff, for consultation or information.

Attachment IV: Iraq—Stand-By Arrangement

Attached hereto is a letter (the "Letter"), dated December 4, 2007 , with its attached Memorandum of Economic and Financial Policies (the "Memorandum") and Technical Memorandum of Understanding (the "TMU"), from the Governor of the Central Bank and the Minister of Finance of Iraq requesting a Stand-By Arrangement and setting forth:

(a) the objectives and policies that the authorities of Iraq intend to pursue for the period of this Stand-By Arrangement;

(b) the policies and measures that the authorities of Iraq intend to pursue during the first year of this Stand-By Arrangement; and

(c) understandings of Iraq with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and the policies and measures that the authorities of Iraq will pursue for the remaining period of this Stand-By Arrangement.

To support these objectives and policies, the International Monetary Fund (the "Fund") grants this Stand-By Arrangement in accordance with the following provisions:

1. For a period from December 19, 2007 to March 18, 2009, Iraq will have the right to make purchases from the Fund in an amount equivalent to SDR 475.36 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this Stand-By Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 396,133,335 during the first year of the arrangement, provided that purchases shall not exceed the equivalent of SDR 79,226,667 until February 15, 2008, the equivalent of SDR 158,453,334 until May 15, 2008, the equivalent of SDR 237,680,001 until August 15, 2008, the equivalent of SDR 316,906,668 until November 15, 2008, and the equivalent of SDR 396,133,335 until February 15, 2009.

(b) The right of Iraq to make purchases during the remaining period of this Stand-By Arrangement shall be subject to such phasing as shall be determined.

(c) None of the limits in (a) or (b) above shall apply to a purchase under this Stand-By Arrangement that would not increase the Fund's holdings of Iraq's currency subject to repurchase beyond 25 percent of quota.

3. Iraq will not make purchases under this Stand-By Arrangement that would increase the Fund's holdings of Iraq's currency subject to repurchase beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the floor on net international reserves of the Central Bank of Iraq, or

(ii) the ceiling on lending to the government and the private sector by the Central Bank of Iraq, or

(iii) the ceiling on the central government total financing, or

(iv) the ceiling on the government wage and pension bill, or

(v) the ceiling on government imports of petroleum products, or

(vi) the ceiling on direct government subsidies to the fuel sector, or

(vii) the ceiling on new medium- and long-term non-concessional external debt (with original maturities of one year or more) contracted or guaranteed by the government,

as specified in Table 1 and paragraph 33 of the Memorandum, and further specified in the TMU, is not observed, or

(b) (i) after December 31, 2007, if Iraq has not carried out its intention with respect to enacting amendments to the pension law to make it fiscally sustainable, as specified in Table 2 and paragraph 13 of the Memorandum, or

(ii) after March 31, 2008, if Iraq has not carried out its intentions with respect to the completion by an external auditor of an audit of the Central Bank of Iraq's net international reserves data reported to the Fund as at December 31, 2007, including a full count of gold and foreign exchange holdings at the Central Bank of Iraq, as specified in Table 2 and paragraph 22 of the Memorandum, or

(iii) after June 30, 2008, if Iraq has not carried out its intentions with respect to the completion by an external auditor of the audit of the Central Bank of Iraq's 2007 financial statements in accordance with International Standards on Auditing, as specified in Table 2 and paragraph 22 of the Memorandum, or

(c) if at any time during the period of the arrangement:

(i) the ceiling on the external arrears on existing rescheduled debt and new borrowing set out in Table 1 and paragraph 33 of the Memorandum, or

(ii) the structural performance criterion on the avoidance of administrative measures limiting participation or bids in the Central Bank of Iraq's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism, as set out in Table 2 and paragraph 23 of the Memorandum,

is not observed, or

(d) after May 14, 2008 and November 14, 2008 until the respective reviews contemplated in paragraph 4 of the Letter and paragraph 34 of the Memorandum are completed, or

(e) unless, for so long as Iraq has outstanding sovereign external arrears to private creditors, or by virtue of its imposition of exchange controls there are outstanding non-sovereign external payment arrears, a financing assurances review is completed, or

(f) if at any time during the period of the Stand-By Arrangement, Iraq:

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Iraq is prevented from purchasing under this Stand-By Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Iraq and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Iraq will not make purchases under this Stand-By Arrangement during any period in which Iraq: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a non-complying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9331-(89/167), or (c) pursuant to paragraphs 17 and 31 of Decision No. 8955-(88/126) on the Compensatory Financing Facility, or (d) in respect of a purchase under Decision No. 11627-(97/123) SRF on the Supplemental Reserve Facility and Contingent Credit Lines, or (e) pursuant to paragraph 1(b) of Decision No. 5703-(78/39) or paragraph 10(a) of Decision No. 4377-(74/114); or (ii) is failing to meet a repayment obligation to the PRGF-ESF Trust established by Decision No. 8759-(87/176), or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRGF-ESF Trust Instrument.

5. Iraq's right to engage in the transactions covered by this Stand-By Arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or limit the eligibility of Iraq. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Iraq and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this Stand-By Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Iraq, the Fund agrees to provide SDRs at the time of the purchase.

7. Iraq shall pay a charge for this Stand-By Arrangement in accordance with the decisions of the Fund.

8. (a) Iraq shall repurchase the amount of its currency that results from a purchase under this Stand-By Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Iraq's balance of payments and reserve position improves.

(b) Any reductions in Iraq's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of reduction.

9. During the period of this Stand-By Arrangement Iraq shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Iraq or of representatives of Iraq to the Fund. Iraq shall provide the

Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Iraq in achieving the objectives and policies set forth in the Letter and Memorandum.

10. In accordance with paragraph 3 of the Letter, Iraq will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Iraq has outstanding purchases in the upper credit tranches, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Iraq's balance of payments policies.