Japanese ODA Loan

Ex-Ante Evaluation (for Japanese ODA Loan)

1. Name of the Project

Country: The Republic of Iraq
Project: Fiscal Reform Development Policy Loan
Loan Agreement: March 31, 2016
Loan Amount: 25,000 million Yen
Borrower: The Government of the Republic of Iraq

2. Background and Necessity of the Project

(1) Current State and Issues of the Economic and Financial Sector in Iraq

With the fifth largest crude oil reserves in the world and the 12th largest natural gas reserves (World Bank), Iraq is blessed with natural resources, but the country's economy depends heavily on the oil and gas sectors, which account for 65 percent of the country's gross domestic product, 93 percent of revenue, and 98 percent of exports. Iraq is thus greatly affected by falling oil prices and the expansion of armed insurgents like the radical Islamic group ISIL, leading to contracting economic growth figure in 2014 of around ▲2.2 percent (World Bank). The country's financial growth versus GDP fell by 5.6 percent in 2014, due in part to the impact of ISIL invasions (World Bank). In 2015, falling crude oil prices throughout the year are expected to result in a revenue drop of 23.4 percent and a budget deficit of 14.5 percent (World Bank). Although the amount of public debt trended between 30–40 percent of GDP during the 2012–2014 period, the expectation of ballooning budget deficits in 2015, coupled with Iraq's need to pay the outstanding balances it incurred in 2014 and other factors, will bring its capital requirements to an estimated 31.9 billion US dollars with public debt rising to 61.7 percent of GDP (World Bank). In order to compensate for its budget deficits, Iraq is expected to borrow some 2.44 billion US dollars from the IMF and World Bank while internally issuing government bonds and borrowing from domestic banks as well. One of the primary factors driving the budget deficit is the fact that nearly half of the nation's workforce receives either a salary or pension due to employment as a public servant or at a state-owned company. This money is estimated to rise to around 20.3 percent of GDP (2015, IMF), making it essential that Iraq begin reforming its public employee hiring and pension system as well as its state-owned companies. Meanwhile, the generous subsidies Iraq issues to ensure food, fuel, and electricity supply for its citizens account for around 1.8, 2.5, and 5 percent of its GDP, respectively. Reforming these subsidy programs is another urgent task. Finally, Iraq's increasing foreign borrowing make it essential that the country work to establish fiscal discipline that includes appropriate public finance and debt management.

Furthermore, as indicated above, Iraq holds some of the world's most extensive crude oil reserves, yielding a production volume of 3.21 million barrels a day (2013 annual average, Iraq Ministry of Oil). Because the country has not established enough gas treatment facilities to handle the associated gases emitted as a result of its crude oil production, 69.8 percent of the entire 1,963 MMscfd produced is incinerated (Iraq Ministry of Oil). Iraq must meet demand for natural gas thermal power stations and the like by importing natural gas, a practice which costs the government some 6.0 billion US dollars annually. If Iraq could use all of the associated gases it incinerates to produce electricity, it would not only be able to eliminate this government spending, but could also be expected to secure an additional 6.5 GW or so of new electricity generation. Going forward, the Republic of Iraq needs to consider introducing combined cycle gas turbines in its electric sector to improve electric power generation efficiency. It also needs to work towards the effective use of associated gases that it is currently incinerating by involving the ministries involved in both domestic supply and demand.

(2) Development Policies for the Economic Sector in Iraq and the Priority of the Project

Among the targets set forth in the National Development Plan 2013–2017 that was announced by the Iraqi government in 2013 are putting a stop to growing government expenditures and properly managing public finances. This Fiscal Reform Development Policy Loan is designed to strengthen the management of public finances and promote reforms in state-owned enterprises and the like, based on the development strategies issued by the Republic of Iraq. In addition, the reform program that Prime Minister Al-Abadi submitted and received cabinet approval for on August 9, 2015 has administrative and financial reforms, public service improvements, and anti-corruption initiatives as its core components, so this loan is likely to provide further support for these aims.

(3) Japan and JICA's Policy and Operations in the Economic Sector

Japan's Country Assistance Policy for Iraq (June 2012) stipulates "strengthening economic infrastructure" and "basic living infrastructure rehabilitation) as priority areas, citing electricity reconstruction and capacity-building at executing agencies as key issues. This loan is thus consistent with this policy. JICA has been providing support for Iraq's electricity sector in the form of ODA loans, including the Hartha Thermal Power Station Rehabilitation Project (loan agreement signed February 2015 in the amount of 20,224 million yen) and others totaling 204.6 billion yen. In addition, JICA is implementing the Study on "Gas Master Plan (Natural Gas Utilization Plan)" as a data collection survey, as well as country-focused training program for "the Project Management for PMTs".

(4) Other Donors' Activities

① World Bank: This loan is jointly financed by the World Bank, which is providing 1.2 billion US dollars (loan agreement signed December 2015).

② IMF: The IMF approved a Rapid Financing Instrument (RFI) in July 2015, and has already disbursed around 1.24 billion US dollars (75 percent of the quota). The IMF and the Iraqi government also agreed on a Staff Monitored Program (SMP) in November 2015 to lay the groundwork for future financial assistance as well. The IMF is also offering technical cooperation (contributed by the British government) to support the preparation of reports in line with International Financial Reporting Standards (IFRS) as well as the supervision of financial systems. Technical cooperation is also planned to support the calculation of macroeconomic indicators.

③ US Agency for International Development (USAID): USAID is planning to offer legislative development support for the establishment of a credit bureau.

(5) Necessity of the Project

This program is significant in that it supports optimized national budget management in the Republic of Iraq, improved energy efficiency, and promotes further reforms at state-owned enterprises, thus addressing the country's red-ink fiscal management conditions and supporting Iraq's national development policies aimed at stable macroeconomic management. It is also in line with the policy of the government of Japan and JICA, and thus, it is highly necessary and relevant for JICA to support for the implementation of the program.

3. Project Description

(1) Project Objective(s)

The objective of the Program is to reconstruct Iraq's finances through supporting key elements of the Republic of Iraq's medium-term development priorities, (1) expenditure management; (2) sustainability of energy supply; and (3) transparency of state-owned enterprises, thereby contributing to laying the foundation for sustainable, inclusive economic growth.

(2) Project Site/Target Area

Entire country of Iraq

(3) Project Component(s)

The program supports the Iraqi policies related to the reforms indicated in the policy matrix below with the aims of ongoing reform activity and encouraging policy dialogue with Japan.

Reform	Objective	Prior Actions
Improve expenditure management	Public wage reform	(1) Reduction in the basic annual salary of top public sector employees
	Public Investment Management (PIM) reform	(2) <u>Get prime minister approval for the public investment management framework which covers project feasibility, implementation, operation, and ex-post evaluation phases</u>
	Public debt management	(3) <u>Establish a debt management section to handle overall management of debt/guarantee obligations within Public Debt Office of Ministry of Finance</u>
	Pension reform	(4) Carry out a a pension committee campaign to clean its retiree data registry resulting in the removal of at least 30,000 non-eligible retirees
Improve the sustainability of energy supply	Reduce gas flaring	(5) <u>Get approval for implementation plan proposed by the Ministry of Oil setting forth targets for the reduction of gas flaring for the period 2015-2018, in support of the objective of achieving zero gas flaring by 2030 from the Energy Committee of the Council of Ministers</u>
	Expand gas use to power generation	(6) Get approval for the establishment of an inter-ministerial committee, including the Ministers of Oil, Electricity, and Finance, which shall be tasked with developing an action plan to utilize gas in electric power generation from the Council of Ministers
	Reduce electricity subsidies	(7) Get the Energy Committee of the Council of Ministers to approve the implementation of a new

		unsubsidized commercial tariff for large commercial consumers (except hospitals)
Improve the transparency of state-owned enterprises	Non-financial SOEs reform	(8) Set up a database to monitor the fiscal risks of non-financial SOEs. Get prime minister approval for the establishment of a Financial Risk Management Committee and update/publish financial and employment data of said non-financial SOEs.
	Financial SOE and banking sector reform	(9) Get a cabinet decision on leveling the playing field between public and private banking institutions
		(10) Establish the Combatting of Money Laundering and the Financing of Terrorism Law, aimed at reducing money laundering activities and the financing of terrorism.

Note: Underlined reforms are either scheduled for implementation or currently being implemented with cooperation from JICA.

(4) Estimated Project Cost (Loan Amount)
Loan Amount: 25,000 million Yen (Joint financing: USD 1.2 billion from the World Bank)

(5) Schedule
The program is scheduled to commence in January 2016. Policy actions were achieved by November 2015, and the completion of program is defined as the completion of disbursement (scheduled for April 2016).

(6) Project Implementation Structure
1) Borrower: The Government of the Republic of Iraq
2) Executing Agency: Ministry of Finance
3) Operation and Maintenance System: Ministry of Finance coordinates with related ministries within the Government of Iraq to carry out reforms.

(7) Environmental and Social Consideration/Poverty Reduction/Social Development
1) Environmental and Social Consideration
   a. Category: C
   b. Reason for Categorization: The program is not located in a sensitive area, nor has sensitive characteristics, nor falls into sensitive sectors under the the JICA's Guidelines for Environmental and Social Consideration (promulgated in April 2010), and the program is likely to have minimal adverse impact on the environment.
2) Promotion of Poverty Reduction: N/A
3) Promotion of Social Development (e.g. Gender Perspective, Measure for Infectious Diseases Including HIV/AIDS, Participatory Development, Consideration for Persons with Disability, etc.): N/A

(8) Collaboration with Other Schemes or Donors
Because this loan is jointly financed by the World Bank, monitoring will take place in collaboration with that institution. JICA will be in charge of monitoring the debt management sector, while other sectors will be primarily monitored by the World Bank.

(9) Other Important Issues: N/A

4. Targeted Outcomes

(1) Quantitative Effects

1) Performance Indicators (Operation and Effect Indicator)

Reform	Indicator	Baseline	Target (2017 1Q)
Improve expenditure management	Reduction in the basic annual salary of top public sector employees as a ratio of annual GDP per capita	September 2015: 1.9%	1.7%
	Percentage of capital projects valued at over US$500 million for which a feasibility study with cost-benefit analysis is done.	2015: 3% of the total number of projects	5% of the total number of projects
	Approval and publication on the ministry of finance website of a public debt management strategy in line with international best practice.	2015: No debt management strategy	Debt management strategy approved and published
	Improved financial sustainability of the State Pension Fund through better governance as measured by a reduction of the cash benefit spending of the National Board of Pension.	2015: Total amount of pension-related cash benefits (to be determined at the end of 2015)	5% nominal reduction compared to the end of 2015
Improve the sustainability of energy supply	Reduced gas flaring—measured by the amount of additional (associated) gas processed	2014: 656 MMscf/day	1,070 MMscf/day
	1) Establishment of an inter-ministerial committee and development of an action plan for gas-to-power; 2) Fuel switching to generate power from petroleum products to gas—measured as total volume of gas supplied to GT power production	1) 2014: No specific Committee in place and no Action Plan for Gas-to-Power developed 2) 2014: 600 MMscf/day	1) Specific inter-ministerial committee in place and an Action Plan developed 2) 840 MMscf/day
	1) Increased tariffs for energy-intensive consumers-- measured by the retail price of electricity sold 2) Improved service delivery-- measured by total electricity sold	1) 2014: 30.74 Iraqi dinars/Kwh 2) 2014: 44 million MWh	1) 31.05 Iraqi dinars/Kwh 2) 47.6 million MWh
Improve the transparency of state-owned enterprises	Improved transparency, reporting, accountability, and assessment of fiscal risks stemming from non-financial SOEs as measured by the publication of consolidated annual reports	2014: No report published	Annual report published
	Ratio of state deposits in private banks to state deposits in all banks	January 2015: 0%	5%
	Progress in implementing FATF action plan.	June 2015: Zero of 8 actions in FATF action plan completed to the satisfaction of FATF	At least 5 of 8 actions in FATF action plan completed to the satisfaction of FATF

(2) Qualitative Effects
Improved fiscal legislation, improved debt sustainability

(3) Internal Rate of Return: Not calculated

5. External Factors and Risk Control

There should be no extreme worsening of the security or political/economic status of Iraq compared to current conditions.

6. Lessons Learned from Past Projects

(1) Lessons learned from evaluating similar projects
A lesson cited in the ex-post evaluation for the Indonesia Development Policy Loans (I–IV), for example, was that from the perspective of the donors, development policy loans (DPL) and technical cooperation projects are complementary with each other and are expected to generate synergetic effects throughout the various stages of the reform process. With the Fiscal Consolidation Development Policy Loan and the Fiscal and Public Service Reform Development Policy Loan implemented in Jordan in 2014 and 2015 as well, JICA divided roles and responsibilities with its joint financing partner the World Bank in order to achieve policy targets, while also moving forward with technical cooperation using JICA resources in order to achieve targets set by JICA alone.

(2) Lessons for this project
Based on the lessons cited above, there is a need to link policy-level reforms with ground-level reforms in this program as well. JICA is in the process of dispatching experts for the purpose of conducting country-focused training in the debt management and public spending areas as well as in debt and fiscal management.

7. Plans for Future Evaluation

(1) Indicators to be Used: Same as those listed in 4. (1) 1).

(2) Timing
One year after the completion of the Program