

**Ex-Ante Evaluation**  
**Middle East Division II, Middle East and Europe Department**  
**Japan International Cooperation Agency**

**1. Name of the Project**

Country: The Republic of Iraq (Iraq)

Project: Fiscal Reform Development Policy Loan (II)

Loan Agreement: October 26, 2017

**2. Background and Necessity of the Project**

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

Iraq is rich in natural resources, with the fifth largest crude oil reserves and the 12th largest natural gas reserves in the world. On the other hand, industries other than gas and oil have not matured. The economy relies heavily on the oil and gas sectors, which account for 93% of the revenue and 98% of the exports. The country's economic growth rate has been volatile, increasing to 7.6% in 2013 due to rising oil prices and decreasing to 0.1% in 2014 due to falling oil prices and attacks by the armed Islamic extremist group known as Islamic State of Iraq and Levant (hereinafter referred to as "ISIL"). In 2015, Iraq achieved an economic growth of 2.9%, driven by the active construction industry. Meanwhile, the budget deficit reached 5.4% of GDP in 2014 under numerous adverse conditions, such as the decline in oil revenue due to falling crude prices and the increase in expenditure due to deteriorated security conditions. The budget deficit was estimated to increase to 12.3% of GDP in 2015 not only because ISIL attacks boosted security spending and but also because over 3.2 million internally displaced people (UNHCR Global Focus 2015 Year-end Report) raised emergency aid spending. In addition to this swelling budget deficit, credits for the payment of arrears to domestic and foreign creditors have increased since 2014. As a result, the public debt was estimated to rise to 61.3% of GDP in 2016 (IMF Country Report No. 17/251) although projections in 2013 indicated that it would remain below 20% in the medium term.

One of the major factors driving the budget deficit is salaries and pensions for civil servants and state-owned enterprise employees, who account for half of the nation's workforce. This personnel cost, which includes salaries to nonexistent civil servants and pension payments to non-eligible beneficiaries, is estimated to account for approximately 30.1% of GDP (IMF). It is therefore critical to reform public employees' employment system and pension scheme. In addition, the

Government of Iraq, which can hardly keep track of or manage its debt while the external debt is increasing, needs to restore fiscal discipline, including strong public financial and debt management.

Moreover, in the energy sector, Iraq is flaring 69.8% of its associated gas produced with oil (the Iraqi Ministry of Oil), due to lack of gas treatment facilities to handle the associated gas, while it is importing natural gas for gas-fired power generation and other purposes. If all the wasted associated natural gas is utilized to generate electricity, Iraq can not only reduce its budget deficit but also increase the power generation capacity by about 6.5 GW. Therefore, it is urgent to improve the use of associated natural gas. In addition, the Government of Iraq provides generous electricity subsidies worth around 5% of GDP (World Bank) although it collects only 30% of the electricity revenue. It is therefore essential to review the revenue collection mechanism and the electricity subsidy scheme.

Furthermore, the Iraqi economy is dominated by state-owned enterprises, which enjoy preferential treatments despite their inefficiency, which makes Iraq's private sector less competitive and Iraqi companies less productive than other firms in the region. In addition, state-owned enterprises tend to lack transparency in their management. Against these backdrops, state-owned enterprise reforms are required to achieve high economic efficiency.

Iraq's medium-term development strategies are manifested in the inaugural speech of Prime Minister Abadi in September 2014 and the Strategic Priorities in Ministries: 2014-18 Action Plan, which lays out six strategic priorities: a secure and stable Iraq; upgrading services to and the standard of living of citizens; encouraging a shift towards the private sector; increasing oil and gas production to improve the financial sustainability; administrative and financial reforms of government institutions; and improving federal-local relations. The Fiscal Reform Development Policy Loan (II) (hereinafter referred to as "this Program") is designed in accordance with these development policies of the Government of Iraq to enhance public financial management, improve the energy sector, and promote state-owned enterprise reforms including their privatization.

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

This Program is aligned with the following three Priority Areas identified in Japan's Country Development Cooperation Policy for the Republic of Iraq (July 2017): strengthening economic infrastructure; basic living infrastructure

rehabilitation; and strengthening governance. In the public financial sector, JICA has provided the Fiscal Reform Development Policy Loan (Loan Agreement signed in March 2016 for 25 billion JPY) and dispatched a Fiscal Management Expert. In the energy sector, JICA has implemented several ODA Loan projects valued at a total of 204.6 billion yen, including the Hartha Thermal Power Station Rehabilitation Project (Loan Agreement signed in February 2015 for 20.224 billion JPY). In addition, JICA has conducted a study on “Gas Master Plan (Natural Gas Utilization Plan)” and organized a country-focused training program on Project Management for ODA Loan Project Management Teams.

Moreover, this Program is expected to contribute to SDG 8 (promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all) and SDG 9 (build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation) by reducing gas flaring and promoting the efficient use of natural gas to achieve stable power supply and improving the transparency and governance of state-owned enterprises to activate the economy.

### (3) Other Donors' Activities

The World Bank provided a development policy loan of 1.2 billion USD in December 2015 and another development policy loan of 1.443 billion USD in December 2016 through co-financing arrangements with JICA. In addition, the World Bank is planning to provide a budget support of approximately 1.0 billion USD in 2017. The International Monetary Fund (IMF) approved a Stand-By Arrangement (SBA) in July 2016 to promote fiscal adjustment, diversify financial sources, and support structural reforms, providing approximately 5.3 billion USD to Iraq according to the progress of the structural reforms over the coming three years. In addition, at the Ise-Shima Summit in May 2016, G7 leaders committed to providing a budget support of 3.6 billion USD in total to Iraq, which was proceeding with domestic reconciliation and reforms while fighting on the frontline against ISIL. Thus, the international community has recognized the necessity of providing continued support to Iraq.

## **3. Project Description**

### (1) Project Objectives

By assisting the Government of Iraq with its continued efforts to improve expenditure rationalization, enhance energy efficiency, and reform state-owned

enterprises to solve problems faced by the country, this Program aims to improve the public finances, thereby contributing to sound economic and social development to achieve the self-sufficient development of the country.

(2) Project Site / Target Area

The entire country of Iraq

(3) Project Components

This Program will assist the Government of Iraq with its policy reforms structured around the following pillars to ensure the continuity of the reforms and facilitate dialogue with the Government of Japan.

(a) Improve expenditure rationalization: reform the public sector wage bill, improve public investment management, strengthen public debt management, and carry out the pension reform and the social safety net reform in order to curb inefficient and ineffective spending and redirect resources to public investment and basic services.

(b) Improve energy efficiency: invest in the expansion of natural gas processing capacity in order to reduce gas flaring and increase natural gas allocations for power generation.

(c) Reform state-owned enterprises: disclose financial accounts of state-owned enterprises in order to improve the transparency and governance of inefficient state-owned enterprises.

The Policy Matrix is shown below.

Objective	Policy Action (Accomplished by the end of November 2016)
Improve expenditure rationalization	<p>#1. The Council of Ministers has issued a decision requiring all Ministries, Departments, and Agencies (MDAs) to</p> <p>(a) transition by FY 2020 to electronic payment of all civil servants' compensation (inclusive of benefits and allowances) and</p> <p>(b) install by FY 2018 biometric identification systems to verify civil servants' daily attendance.</p>
	<p>#2. The following systems have been introduced to two pilot MDA units:</p> <p>(a) an electronic payroll system for at least 30 percent of civil servants and</p> <p>(b) a new biometric attendance system for all civil servants.</p>
	<p>#3. In line with the Public Investment Management Framework, which was adopted under Decree No 445 dated October 18, 2015, the Minister of Planning has submitted to the Council of Ministers the list of investment projects that are consistent with the government's priorities.</p>
	<p>#4. Pursuant to the Prime Minister's instruction, the Ministry of Finance has started publishing quarterly Public Debt Bulletins, which</p>

	<p><u>include all data on external debt of the central government.</u></p> <p>#5. The Council of Ministers has approved and submitted to the Council of Representatives the draft Integrated Social Insurance Law, including the integration of the public and private pension schemes.</p> <p>#6. The Council of Ministers has issued a decision to exclude non-eligible beneficiaries of the Social Safety Net System and to redirect the assistance to the poor, based on the targeting method stipulated in Article 6 of the Social Protection Law No. 11 of 2014.</p>
Improve energy efficiency	<p>#7. The Council of Ministers has approved and submitted to the Council of Representatives the FY 2017 draft budget which includes ID 1.4 trillion to cover payments from the Ministry of Oil to associated natural gas processors for</p> <p>(a) processed / dry gas, LPG and condensate deliveries and</p> <p>(b) projected investment requirements for processing capacity expansion, toward the reduction of gas flaring.</p> <p>#8. The Council of Ministers has approved the Ministry of Electricity Loss Reduction Policy Directive 2016 to enhance revenue collection.</p>
Improve the transparency and governance of state-owned enterprises	<p>#9. The Council of Ministers' Secretariat has published on its website a report detailing the financial results based on FY 2015 closed financial statements of the largest nine non-financial state-owned enterprises including taxes, dividends, subsidies/transfers, loans (principal and interest), and loan guarantees.</p>

\* The underlined reform will be facilitated under the leadership of JICA.

#### (4) Estimated Project Cost (Loan Amount)

Japanese ODA Loan amount: 30,000 million yen (Co-financing amount: 1,443 million USD from the World Bank)

#### (5) Schedule

This Program is to start budget support in January 2017. All the policy actions were accomplished by the end of November 2016. This Program will be deemed complete when the final disbursement is made (planned in March 2017).

#### (6) Project Implementation Structure

- 1) Borrower: The Government of the Republic of Iraq
- 2) Executing Agency: The Ministry of Finance
- 3) Operation and Maintenance Agency : The Ministry of Finance

#### (7) Collaboration and Division of Roles with Other Projects and Donors

##### 1) Japan's Assistance Activities

As a succeeding program of the Fiscal Reform Development Policy Loan (Loan Agreement signed in March 2016 for 25 billion yen), this Program is aimed at supporting and facilitating the reforms carried out by the Government of Iraq under the previous program. In the energy sector, JICA also assisted in

formulating the gas master plan (Study on “Gas Master Plan (Natural Gas Utilization Plan)”), which included suggestions for reducing gas flaring. In addition, JICA has dispatched an expert and organized a training program for the Public Debt Management Department of the Ministry of Finance of Iraq to strengthen public debt management capacity as specified in the policy reform matrix.

(8) Environmental and Social Consideration / Poverty Reduction / Social Development

1) Environmental and Social Consideration

i) Category C

ii) Reason for Categorization: It is because this Program is likely to have minimal adverse impact on the environment as specified in the JICA Guidelines for Environmental and Social Considerations (published in 2010).

2) Cross-Cutting Issues: None in particular

3) Gender Classification: Not subject

(9) Other Important Issues: None in particular

**4. Targeted Outcomes**

(1) Quantitative Effects

1) Performance Indicators (Operation and Effect Indicators)

Objective	Indicator	Baseline value in 2015	Target value in 2018
Improve expenditure rationalization	Percentage of verified central government civil servants whose compensation and daily attendance is tracked electronically	0%	Above 30% <sup>1</sup>
	Percentage of capital projects that exceed 100 billion ID (about 85 million USD) for which a feasibility study with cost-benefit analysis was conducted	2013: 5%	Above 20%
	<u>Share of the domestic debt in total public debt</u> <sup>2</sup>	<u>33%</u>	<u>Above 35%</u>

<sup>1</sup> The minimum target value is set at 30% for both (1) electronic payroll and (2) biometric attendance.

<sup>2</sup> This may change according to the Medium-term Debt Management Strategy (MTDS) to be released next year.

	Improved social insurance efficiency, coverage, and sustainability as measured by the expected actuarial deficit period (years until going into deficit from 2015)	13 years	Above 28 years
	Improved social safety net efficiency (1) coverage ratio of the poor (2) inclusion error <sup>3</sup>	(1) 11% (2) 43%	(1) At least 50% (2) At 20% or below
Improve energy efficiency	Reduction in gas flaring (1) expansion in Iraq's gas processing capacity (2) amount of locally produced gas-to-power allocation	(1) 671 MMscfd <sup>4</sup> (2) 570.9 MMscfd	(1) 1300 MMscfd or above (2) 1200 MMscfd or above
Improve the transparency and governance of state-owned enterprises	International Standards of Accounting and Reporting (ISAR) Benchmark of Corporate Governance Disclosures	0%	Above 15%

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(2) Qualitative Effects

Enhanced financial discipline and improved debt sustainability

(3) Internal Rate of Return

Not calculated.

## 5. Prerequisites and External Factors

(1) Prerequisites

None in particular

(2) External Factors

There will be no significant changes in the reform policies of the Government of Iraq. The security, political, and economic situations in Iraq will not deteriorate.

## 6. Lessons Learned from Past Projects

The ex-post evaluation of the Development Policy Loans (I-IV) in the Republic of Indonesia (evaluated in 2009) drew a lesson that it is necessary to facilitate coordination between Development Policy Loan (DPL) and Technical Cooperation projects because they are complementary with each other and expected to generate synergistic effects throughout the various stages of the

<sup>3</sup> This refers to the proportion of households that are covered by social security although they are too well off to qualify for the benefits.

<sup>4</sup> This stands for million standard cubic feet per day, which is a unit of gas flow.

reform process. When the Fiscal Consolidation Development Policy Loan and the Fiscal and Public Service Reform Development Policy Loan were provided to Jordan in 2014 and 2015, respectively, the roles and responsibilities were divided between JICA and its co-financing partner, the World Bank, to achieve the targets set for the policy issues, and JICA used its own resources for technical cooperation to attain the targets set by itself. Based on the above-mentioned lessons, this Program is also coordinated with other JICA schemes, such as a country-focused training program on public debt and investment management and a JICA expert dispatched to improve fiscal and debt management in order to link policy-level reforms to field-level improvements.

## **7. Evaluation Results**

This Program is aimed at assisting the Government of Iraq in improving expenditure rationalization, enhancing energy efficiency, and reforming state-owned enterprises. These efforts are aligned with the development issues and policies of Iraq as well as the assistance policies of Japan. Moreover, this Program is expected to contribute to SDG 8 (promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all) and SDG 9 (build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation) by reducing gas flaring and promoting the efficient use of natural gas to achieve stable power supply and improving the transparency and governance of state-owned enterprises to activate the economy. Therefore, it is highly necessary to implement this Program.

## **8. Plan for Future Evaluation**

(1) Indicators to be Used

Per 4. (1) – (3)

(2) Timing

Ex-post evaluation: 2 years after project completion