

Iraq

Technical Assistance in Fiscal Year 2017

Since 2014, Iraq has been hit by the conflict with the Islamic State in Iraq and Syria and a slump in oil prices. The oil price decline has resulted in a massive reduction in fiscal and export revenue, pushing the fiscal and balance of payments deficits to unsustainable levels. A SBA was approved by the IMF Executive Board in July 2016 with access to SDR 3.8 billion to assist the Iraqi authorities in the current crisis. The program aims to address the urgent balance of payments need, bring spending in line with lower global oil prices, and ensure debt sustainability. It also includes measures to strengthen PFM, enhance financial sector stability, protect the poor, and curb corruption. In this context, METAC held six off-site missions –of which two were joint with FAD—to help the authorities strengthen bank regulations, PFM, RA and data, and meet their commitments under the SBA.

Banking Regulation and Supervision (November 20-28, March 5-12, April 22-25)

Strengthening banking supervision is critical to monitor and contain the damage caused by the crisis in Iraq on the banking system. Accordingly, as part of the IMF Stand-By Arrangement, the Central Bank of Iraq (CBI) committed to prepare regulatory changes to strengthen prudential standards and bank supervision, with the support of METAC and other external consultants. In this context, METAC has developed a two-year TA program to upgrade the regulatory framework:

- The first mission of the program focused on aligning regulations on capital adequacy ratio and liquidity measurement with the requirements of Basel II/III. The regulation on capital adequacy ratio focused on the common equity Tier 1 capital, capital conservation buffer, and leverage ratio. The regulation on liquidity aligned the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) with Basel III, and set a minimum floor in local currency, in each major currency, taking into consideration the particularity of the Iraqi banking system. The regulation on liquidity also defined additional metrics to measure and manage liquidity risk that include: contractual maturity mismatch; concentration of funding; and market-related monitoring tools, and emphasizing on liquidity governance.
- The second mission completed the drafting of regulations on (i) risk management framework, (ii) loan classification and provisioning, (iii) credit risk management to provide a comprehensive bank-wide view of credit exposures consistent with a bank's risk appetite, (iv) measuring and managing concentration risk, (v) large exposures measured on solo and on a consolidated basis, and (vi) related parties' exposures, in line with BCBS guidelines, and after considering the Iraqi context. These regulations set out certain detailed requirements and reporting obligations for banks.
- The third mission aimed at discussing with a group of the CBI officials the regulations drafted with METAC assistance in November 2016 and March 2017. The mission trained the CBI officials on the implementation of these regulations, and prepared them to oversee the implementation and train other CBI supervisors and officials.

PFM (August 30-September 5, February 19-25)

The fiscal pressures have amplified the weaknesses underlying the public finance management system in Iraq, in particular as regards commitment controls and cash management. The SBA includes several key measures on strengthening PFM, including to initiate the payment of accumulated arrears and avoid further accumulation. In this context, METAC held two missions to assist the authorities in meeting their commitments under the SBA:

- The first mission helped the MoF in (i) preparing a new draft of the Financial Management law (FML) in line with World Bank and IMF comments; and (ii) the design and implementation of a commitment control system for budget execution, starting by preparing a monthly budget execution report based on inputs from spending units, implementing cash rationing for each spending unit, improving the recording of commitments, and prohibiting any commitment beyond quarterly allocations. Subsequently, METAC reviewed and provided additional guidance to the new draft FML, and discussed with the authorities the design and steps required to implement commitment controls.
- The authorities had also committed to monitor arrears more closely and to take steps to implement a TSA. An FAD/METAC TA mission visited Amman, Jordan to review progress in implementing these critical reforms. Three presentations, on the abovementioned topics, were provided and discussed with the authorities. The mission also discussed the progress made in implementing previous FAD/METAC recommendations related to commitment controls and cash management, and proposed options and steps for introducing a TSA, taking into account Iraq's constraints.

Revenue Administration (February 5-9, March 19-23)

METAC organized two off-site missions, one joint with FAD in Baku and one in Amman:

- The first mission—organized jointly with FAD tax policy—discussed tax policy options for increasing non-oil tax revenue and options for short-term revenue mobilization. The discussions were primarily guided by two inter-related objectives: (i) simplify the tax system and improve its neutrality, and (ii) increase non-oil tax revenue in the short term, primarily from policy changes. Although the simplification measures could help raise additional revenue without fundamental changes in the tax and custom administrations operations, the mission identified many operational areas requiring improvement, including information technologies both in tax and customs, and a more effective management of large taxpayers in the tax administration. The establishment of a modern and well-functioning LTO was identified as an important initiative that could increase revenue in both the short and long term.
- A second mission advised on the establishment of a modern LTO. A small unit in Baghdad conducts post-filing verification checks on the tax returns of a limited number of larger taxpayers. However, this falls well short of an LTO structure and modern compliance management methodologies. The mission reviewed the existing practices for management of large taxpayers and the current understanding within the Tax Department regarding the types of non-compliant behavior by large taxpayers and their relationship to compliance management

strategy and activities. It also delivered workshops on the role, objectives, and functional design of an LTO, as well as a time-bound work plan to establish an LTO, including allocation of responsibilities, performance indicators and resource requirements.

Statistics (January 8-14, January 29-February 2, February 26-March 2)

METAC undertook three off-site missions to assist Iraq on external sector, national accounts, and price statistics:

- The first mission on external sectors statistics was held in Baku, Azerbaijan. The mission found that some of the previous mission's recommendations were implemented, and the statistical discrepancy (net errors and omissions) in the preliminary balance of payments data for 2016 has declined substantially. The mission advised on how to treat imports financed by the foreign exchange auction and recommended introducing the enhanced international transactions reporting system; and enhancing the inter-institutional cooperation.
- The second mission on national accounts statistics was held in Amman, Jordan. The mission assisted the Iraqi Central Organization of Statistics and Information Technologies (COSIT) in improving the source data and integrating product balances in the core national accounts compilation system. It suggested a standardized template to be used on all product balances, allowing the simultaneous compilation of values and volumes, specifying the valuation elements from supplier to the final user. While the challenging political and security conditions are considered as serious constraints, the mission observed some areas where concrete actions (with adequate political support) can be taken, including the treatment of foreign companies in the Iraqi economy, strengthening the data exchange and the use of available administrative data.
- The third mission in Amman, Jordan, provided follow-up assistance to COSIT in enhancing price statistics. The mission trained COSIT staff on the weighting procedures in compiling the national CPI, adopting appropriate indexes at the elementary level of aggregation, both for the CPI and PPI, treating missing prices, and introducing new and replacing the old products. The mission agreed with the authorities on a time table for the implementation of the recommended improvements, taking into account the planned updates of the base year.