

## Iraqi Dinar needs political support...to serve the economy!

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### Introduction

The Iraqi Dinar (IQD) was devalued by nearly 23 percent on Saturday, December 19, 2020, from its previous (official) price of 1,182 IQD down to 1,450 IQD per one US\$. The ministry of finance said the devaluation has been agreed with the International Monetary Fund (IMF), and serves the diversification of the Iraqi economy. <sup>i</sup>

Typically, devaluation serves the following key purposes: it makes exports more *price-competitive*, and hence leads to more exports being sold, though this may not necessarily lead to a corresponding fall in the value of imported goods/services. Policymakers also hope that currency devaluations leads to ‘expenditure-switching’, that is consumers spend their money on output of domestic firms, rather than on imports. Expenditure-switching may, additionally, be supported by imposing (new/extra) tariffs on imports and/or introduce quotas, which directly reduce expenditure on imports. These measures are also aimed at improving both the balance of trade and (indirectly) the balance of payments. Finally, depending on the elasticities of supply of goods, inflationary pressures might ensue in the short- to medium-term.

In Iraq, the policy makers at the Ministry of Finance and Central Bank of Iraq (CBI) have on the same day expressly outlined the reasons for the IQD’s devaluation:

“First, there was a feeling that IQD was over-priced in comparison with the US\$ <sup>ii</sup>; encouraging imports, the exodus of capital, and discouraging foreign investment and tourism, with the economy thus leaning towards commerce and retail trade rather than productive sectors; second, overall, given over-priced IQD, the Iraqi economy becomes less competitive, and the Iraqi markets controlled by imports; third, high valued IQD, in general, does not encourage investment in sectors Iraq wishes to develop, e.g. agriculture, tourism, industry and services; fourth, adjusting the value of the IQD will increase the proceeds from oil revenue in IQD, and will lessen the budget deficit, but the timing of the devaluation now is organically linked with the acute decline in the state’s oil revenues, and the price of the IQD should reflect this reality.” <sup>iii</sup>

Arguably, the IQD’s devaluation presents a litmus test to Prime Minister Mustafa al-Kathimi and his finance minister Ali Allawi. In so doing they have bought precious time - this is the moment of truth! Decisive political and economic actions are now needed to protect the IQD and the economy from sliding into the abyss. Al-Kathimi must now subvert the deliberate and well-organised *intruders* (defined below) who since 2003 continue to exacerbate a cycle of fragmentation of the economy and society in Iraq. It is al-Kathimi’s supreme obligation to provide against the *intruders*, which aim to deepen strife, acting against the common good.

To save the Iraqi economy from collapsing, Messrs al-Kathimi and Allawi have a short-term window: January-June 2021. They will be well-advised to focus on three critical issues - politics, economics and export-oriented diversification...

### Politics

The Iraq industrialist Mu’taz Kamuna sums it up neatly: commenting on the IQD’s devaluation, he fears that the “control of the militias and the armed groups (the *intruders*) over politics, economic and arms gives them a significant opportunity to compete, denying Iraq industrialists any advantage” (brackets added). <sup>iv</sup> In the same vein, Muhammad al-Ma’muri, an investor in agriculture, notes that “the government has supported imports of agriculture goods and neglected supporting local produce” (*ibid*).

For the devaluation to have any chances of success, al-Kathimi must challenge, indeed tackle head-on, the armed militias (the *intruders*) and stop them undermining the authority of the ‘state of Iraq’ and the economy in favour of self-serving plutocratic/religious political class. The Islamist militias and the armed groups/the Hashd, etc. are allegedly financed (in part) by domestic and foreign patrons from Iraqi petro dollars circulated via money laundering, networked trade, control of border posts and outright

corruption. It has not been in their interest to encourage domestic production; such a strategy would not serve their foreign patrons.

This challenge *can't* be wholly addressed in six-months. But January-June 2021 might be crucial in taking decisive steps to curtail the damaging activities of the *intruders*, by bringing forward workable economic reforms in Iraq, however imperfect these may be, as the 'White Paper' shows. To establish fiscal balance sooner, corruption and retrieving looted money (which is conservatively around \$200 bn)<sup>v</sup> has to take priority. The *intruders* form the 'deep state', and a daily *security challenge* to which al-Kathimi must rise. They are a formidable disruptive economic and political force.

If al-Kathimi does not take swift and decisive actions to diminish the activities of the *intruders* and co-opt the Uprising's fervour of the young Iraqis who are seeking a sovereign Iraq - Watan, then the effects of the IQD's devaluation, the implementation of the measures in the 'White Paper' and attempts to manage public finances will all be diminished. The masses of the unemployed will, amongst others, lose trust in his ability to effect change that serves the poorer sections of the society - the vulnerable!

### **Economic**

In an interview with TRT on August 18, 2020 Mr Allawi shows, as expected, a deep understanding of the challenges facing the Iraqi economy.<sup>vi</sup> His October 2020 'White Paper' contains two key formidable challenges: first, rationalising 'operational expenditure' by 13 percent of GDP down from the current 25 percent, through reducing the size, wages and the "benefits" public servants bestow upon themselves. Second, diversify the economy by deploying the private sector, to absorb exceedingly high unemployment rates.

This is a tall order. However, as in politics, so in economics, Mr Allawi can lay the foundations for change over the next six months (and possibly beyond).

None of the tasks set out below is new. What is new is the *urgency* of the actions needed, and the decisiveness with which Allawi should implement these. For example:

1. Pairing SOEs (State Owned Enterprises) with international firms, to gradually cut the heavy subsidies, create new skills and increase productivity - Škoda Auto is a good example to tailor to Iraqi conditions;
2. Expand and implement a huge infrastructure investment. Government borrowing for investment (*not* consumption) is an acceptable 'golden' rule - construction of sea-ports, power-stations, roads, railways, schools, hospitals, housing, etc. will absorb a large number of the unemployed and the new entrants to the labour market;
3. Change current laws and introduce new ones to create a conducive environment for the private sector to invest and do business, making it an attractive alternative employer to the public sector;
4. Revive and expand the manufacturing (including petrochemicals) and agriculture sectors. This is a tried, successful, strategy to turn Iraq into an export-led economy. South Korea is a good example to examine;
5. Restructure the banking sector - this requires swift and bold moves to stop laundering money (in part) through currency auctions and networked trade. Transparency in banking must be established to diminish corruption;
6. Enforcement of an efficient and effective *progressive tax* system; the current system has many loopholes and enables corruption to be exercised by the tax collectors. Corporation tax must induce investment by the private sector;
7. Government must rationalise budgetary spending and allocations, concentrating on investment and the reconstruction of, say, Mosul. Government must not relax such rationalisation once oil prices rise again (if they do); and
8. Government must start immediately a process of the retrieving (literally) looted money through corruption, conservatively estimated at around US\$200 billion. The government must stress allegiance to nation-building, not religious parties, sects, or ethnicities, thus restoring proper norms and values of conduct. Transgressors must face an impartial legal system - the law;
9. And, so on...

Given the above, it is surprising to note that the DRAFT 2021 budget allocates just over \$83 bn to 'operational expenditure' only \$10 bn less than total anticipated receipts for 2021? This puts Mr Allawi's rhetoric about aiming to achieve fiscal balance in question. Another surprise is the allocation of \$2.5bn to al-Hashd, equivalent to 40 percent the funds allocated to Defence, and more than the allocation to the Ministries of Higher Education and Health, in the

era of COVID-19 pandemic. Also, some \$450 million goes to the Shi'i waqf (endowment) and nearly \$200 million to the Sunni waqf. Taken together, the religious endowments receive nearly eight times more than the ISIS-devastated Mosul <sup>vii</sup> - to which only \$86 million has been allocated.

Arguably, such allocations are a reflection of the strength of influence of religious parties (and their militias) on government. At a time when the economy is in dire straits, such allocations cast doubt about the government rhetoric re: saving the economy!

### **Diversification of the economy**

Decisive change of *course* in economic policies is urgently needed over the next six months.

The *imperative* of multi-pronged policy initiatives to *begin* diversification has never been so acutely felt in Iraq. Whilst the Iraq government works with IMF and WB (World Bank), recent proposals by the latter for diversifying the Iraqi economy through the prism of agrifood needs close scrutiny (see WB 2020 - Ch.4). Though the context is different, and though massive transformations have taken place since, the WB's proposal is reminiscent of its proposals to the Iraqi government in 1952 (see IBRID, 1952; 40; 97 in particular). <sup>viii</sup>

Whilst vitally important in the context of Iraq, agriculture alone will not on its own absorb the anticipated 4.5-5.0 million new entrants to the labour market by 2030, let alone the high unemployment. Also, to augment the government's coffers, labour needs to be clawed back from a (large) 'informal sector' and pay tax through gainful employment. In the digital age, Iraq can't afford to make the same mistakes its governments made in the 1940s through to 2020. A vast economic literature points to the advantages of diversification through export-oriented manufacturing <sup>ix</sup> when supported by legal framework, physical and social infrastructure, and strong world-class education and health sectors. Both security and business environment are vital for FDI (Foreign Direct Investment) to participate with government and the private sector to initiate *economic development*, which would also mean increasing women's participation in the labour market.

Otherwise, as the cynics would have it, the long-term objectives of the 'White Paper' might dissipate into the ether, as did those set out in many National Development Plans in Iraq.

### **In summary**

The Iraqi government of Mustafa al-Kathimi must take decisive action over the next six months to protect the IQD and the economy from sliding into the abyss. By devaluing the IQD, Messrs al-Kathimi and Allawi have bought precious time; the IQD should be supported by actions that will secure real (positive) change in the economy and the country's finances. After all, the value of a currency reflects the extent of the health of an economy.

The diversification of the economy must be led by investment in export-oriented manufacturing, with forward and backward linkages permeating the whole economy.

The question is: will Messrs al-Kathimi and Allawi turn a 'bleak house' into one with 'realistic expectations' - this is the moment of truth!

### **End Notes**

<sup>i</sup> See <http://www.mof.gov.iq/Pages/MOFBannerHeadlineDetail.aspx?BannerNewsID=886>, and <https://cbi.iq/news/view/1624>. Both websites accessed on Dec. 20, 2020.

<sup>ii</sup> This assertion is contrary to findings of a recent report from researchers at the CBI, which suggests that on the basis of PPP (purchasing power parity) the IQD is undervalued by anything between 4-14 percent at 1,182 IQD = 1 US\$. See Mahwoos, A. Hussain and Muhammad, B. Qasim (2020) 'Iraqi Dinar: 1200 IQD/US\$?' (Available at the <http://iraqieconomists.net/> accessed on November 23, 2020)

<sup>iii</sup> See answer to question no. five: 'reasons for changing exchange price/rate?' posted at the Ministry of Finance's website, noted in <sup>i</sup> above (original in Arabic; author's translation).

<sup>iv</sup> See al-Hurra, December 20, 2020 - 'The devaluation of the Iraqi currency ... a correct decision at a dangerous time' (<https://www.alhurra.com/iraq/2020/12/20/%D8%AE%D9%81%D8%B6->

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%D9%88%D9%82%D8%AA-%D8%AE%D8%B7%D9%8A%D8%B1-%C2%A0, accessed on Dec. 20, 2020).

<sup>v</sup> Allawi, A (2020) 'The Political Economy of Institutional Decay and Official Corruption – The Case of Iraq' (Available at: <http://iraqieconomists.net/en/2020/05/19/the-political-economy-of-institutional-decay-and-official-corruption-the-case-of-iraq/> accessed on June 20, 2020).

<sup>vi</sup> See TRT, a Turkish public broadcast service ([https://www.youtube.com/watch?v=lqMB92\\_CAK4](https://www.youtube.com/watch?v=lqMB92_CAK4), accessed on December 14 2020). In the interview, Ali Allawi shows, as expected, a thorough and deep understanding of the multiple challenges currently facing Iraq - security, high unemployment, problems at the border posts, wide-spread corruption, bloated public service, low productivity, lack of conducive environment for doing business, an economic crisis "of the first order", etc. Iraq, he said is at a crossroads. The IMF, he said in the interview, provides finance (through special drawing rights/Stand-By Agreement – SBA) if needed, the WB helps in project development and finance; projects assisting social groups, etc.

<sup>vii</sup> See Table 'B' in 'The DRAFT 2021 Federal Budget' (available at <http://iraqieconomists.net/ar/wp-content/uploads/sites/2/2020/12/Budget-bill-2021.pdf>, accessed on December 30, 2020).

<sup>viii</sup> Later, an IBRD's report acknowledged that prior to 1958 "the industrialisation of the country was neglected... total development expenditure during the financial years 1951/52–1958/59 for 'industry and power' was 13 percent, compared to 32 percent for agriculture, 24 percent for transport and communications and 28 percent for housing and building" (IBRD, 1963:18).

<sup>ix</sup> Overall, non-oil Iraqi exports form a scant proportion of the total - in 2019, they formed 3.9 percent of total exports ([www.cosit.gov.iq](http://www.cosit.gov.iq)). Iraq suffers from decades of chronic deficit in the balance of trade. This is in part a reflection of the facts that: manufacturing sector comprises a mere 0.86 percent of GDP (first half of 2020, at 2007 constant prices), agriculture only 4.29 percent, building and construction a scant 1.93 percent and, in contrast, 'general government' 7.24 percent, more than eight times the contribution of manufacturing (see [http://cosit.gov.iq/documents/national\\_accounts...](http://cosit.gov.iq/documents/national_accounts...), Table 5, accessed on Dec. 23, 2020). Thus, excluding manufacturing from a strategy of economic diversification in the way the WB appears to do, is not a good omen?

## References

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END

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