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EXECUTIVE SUMMARY IRAQ

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EXECUTIVE SUMMARY

Rising Public Debt and its Impact on the Fiscal Sustainability of the Iraqi Economy

Although Iraq managed to reduce its external debt following the rescheduling of debts owed to the Paris Club and other countries at the end of 2004, and to write off more than %80 of the country's outstanding debt, it is notable that public debt has increased in recent years, particularly domestic debt which has become one of the main sources for financing the government's general budget deficit. This debt is used to cover the government's domestic obligations, including salaries, wages, and other operational expenses, as well as external commitments, in addition to servicing interest and installments on public debt. Meanwhile, a substantial portion of external loans is allocated to finance operational budget expenditures. On another front, the need for external and domestic borrowing continues to grow in response to a series of economic, political, and security crises, driven by poor economic diversification and heavy reliance on the oil sector as a primary source for financing the general budget. This sector accounts for more than %90 of the total expected and realized revenues, in addition to contributing over %60 of the GDP. Moreover, the rampant financial and administrative corruption across most sectors of the Iraqi state consumes the largest share of allocations intended for investment and infrastructure projects.

Governing expenditures accounted for %86 of total spending, including allocations for salaries and wages (employee salaries, pensions, and social safety net payments), as well as expenses related to servicing interest payments and public debt installments, the expenditures of oil companies operating in Iraq under licensing round contracts, and expenditures for purchasing food basket items, energy, and medicine. These expenses exceed the projected oil revenues by more than USD 10 billion and are covered through domestic and external borrowing. It is noteworthy that external borrowing sources are diversified across more than 21 international and regional lending institutions. This deficit is expected to continue over the next five years due to the escalating increase in salaries, wages, pensions, and the social safety net, particularly following the recruitment of over one million public sector employees in 2023.

The increased reliance on domestic and foreign borrowing to finance the general budget deficit will certainly lead to an increase in Iraq's external and domestic debt. The IMF's estimates indicate that public debt will continue to increase for the years 2029–2024, rising from USD 128.1 billion in 2024 to USD 181.9 billion in 2026, and then to USD 298.8 billion in 2029. The debt-to-GDP ratio will increase from %48.2 in 2024 to %62.2 in 2026, and then to %86.6 in 2029. Although the IMF adds outstanding debts, amounting to USD 40.902 billion and incurred by Iraq in the 1980s to finance the Iraq-Iran war, Iraq has not paid any interest on these unclaimed debts since 2004. When these debts are subtracted, external debt and public debt drop to record levels. Nevertheless, projections still indicate that the size of domestic public debt will rise to alarming levels, reaching USD 257.7 billion and representing %74.7 of the GDP for 2029.

Accordingly, the key observations regarding Iraq's public debt can be summarized as follows:

1- The rising public debt in Iraq has not led to financial sustainability as it has been and will continue to be used to finance current expenditures, not investment expenditures, which could generate new capital additions that would in turn generate returns for interest payments and public debt installments.

Recommendation: Loans should be directed toward productive investments in development projects that generate sustainable financial returns, while avoiding their use to cover operational expenses. This would help enhance financial sustainability and ensure the future repayment of public debt.

2- Future oil revenues linked to global markets may be insufficient to pay the interest bill and public debt installments due to the significant expansion in current spending and the tendency to resort to external and domestic borrowing to cover the growing government deficit. Therefore, in order to achieve sustainable economic growth, fiscal policy must be reformulated and implemented to achieve greater sustainability at the level of public finance and public debt.

Recommendation: Fiscal policy and the expenditure structure should be reformed by controlling current expenditures, such as salaries and the pension system, and diversifying revenue sources to reduce dependence on oil. This can be achieved by revitalizing non-oil sectors and expanding the export base, thereby strengthening the Iraqi economy's ability to achieve financial stability and withstand external shocks.

3- Interest payments and annual installments on public debt have risen significantly, reaching levels that exceed double the investment allocations for basic services for citizens, such as health, education, municipalities, and housing. This has impacted the social welfare of the population, in addition to increasing unemployment and poverty rates.

Recommendation: Resources should be reallocated toward essential service sectors such as health, education, and housing, while implementing structural reforms that enhance the efficiency of public spending and strike a balance between debt servicing and improving citizens' living standards.