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- KRG OIL EXPORTS: PROGRESS TOWARD STABILITY OR TEMPORARY TRUCE?
- THEN AND NOW: BUDGETS, OIL PRICES AND THE ECONOMY

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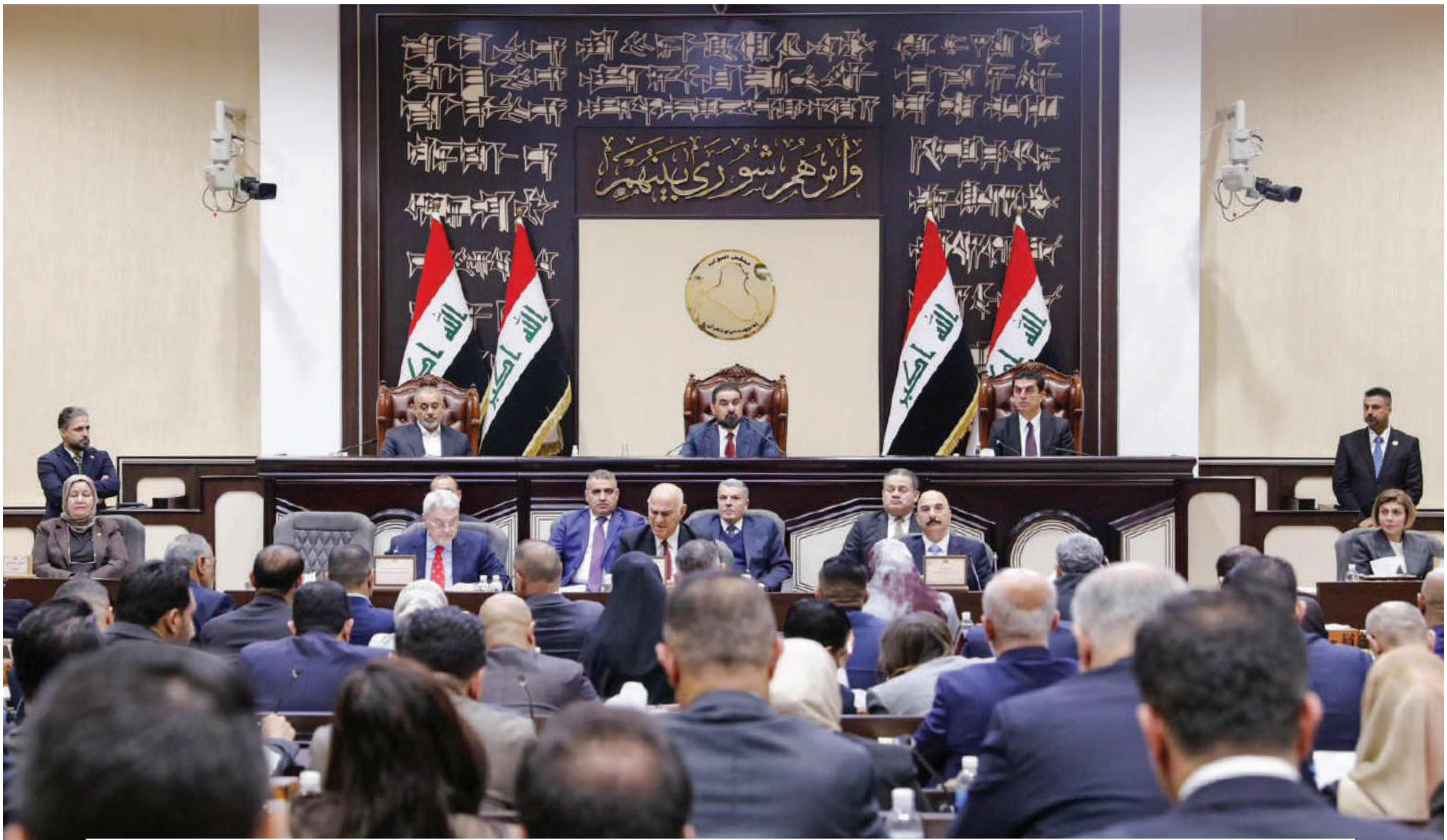


Source: Iraqi Parliament

KRG Oil Exports: Progress Toward Stability or Temporary Truce?

MOHAMMED HUSSEIN

After a halt of more than two years, oil exports from Iraq's Kurdistan Region via Turkey resumed in September 2025. The shipments are tied to a transitional arrangement under which the Federal Government of Iraq (GoI) markets and sells crude produced by the Kurdistan Regional Government (KRG) and international oil companies (IOCs) in return for regular budget order[1]. The arrangement does not resolve legal disputes between Baghdad and Erbil, but analysts have argued that it nevertheless represents a positive first step. This article examines whether the oil-for-budget arrangement constitutes a sustainable "win–win" outcome or is merely a temporary fiscal workaround. It assesses whether the deal can meaningfully stabilize the KRG's public finances, even if it does not resolve the deeper legal and political disputes over oil authority that lie at the core of the conflict.

The deal, which was described as historic by state leaders in Baghdad[2], is embedded in the three-year federal budget law and seeks to address a practical problem: how to restart oil exports and allow the GoI to pay the salaries of KRG civil servants and pensioners.

The key features of the deal are outlined as follows:

- The federal State Organization for Marketing Oil (SOMO) handles the export of the Kurdistan Region's crude through the Iraq-Turkey Pipeline (ITP). This part has been well-implemented and exports have been flowing for more than three months under this arrangement.
- In return for ceding this control to the federal government, the KRG receives regular budget transfers to enable it to pay public servants. However, Erbil is supposed to submit financial data and a portion of non-oil revenue. This part is partially implemented, with payments remaining irregular.
- The deal includes a stop-gap IOC payment and cost-recovery framework, under which $16 per barrel is allocated as an interim figure for the IOCs producing the oil. This arrangement is tied to amendments in the budget law and is intended to remain in place until a third-party assessment moves forward. This component has been operationalized, with initial payments already disbursed.
- An independent assessment to determine production and export costs will be conducted by third-party consulting firm Wood Mackenzie. The firm is expected to assess costs and help regularize payments, which should reduce ad-hoc bargaining. The firm has already been contracted and is expected to commence work shortly.[3]

The immediate benefit of the deal is cash-flow smoothing[4], which has improved conditions for both the KRG and the IOCs. For the KRG, restarting exports functions as a macro-stabilization tool, rather than merely an energy decision. For IOCs previously selling into the local market at heavily discounted prices (about $30s per barrel)[5], operating under a $16-per-barrel cost-recovery framework represents a clear improvement.

Similar immediate benefits for the GoI include gaining greater control and oversight over northern exports, as well as access to the oil revenues generated by the Kurdistan Region's oil fields. However, these immediate effects capture only part of the picture and there are additional fiscal, institutional, and political implications.

The impact of the deal on the KRG and GoI

One way to assess the impact of the deal on Baghdad and Erbil is to compare three possible fiscal paths for both KRG and GoI: 1) a baseline scenario where the agreement does not hold and cooperation breaks down, 2) a pessimistic scenario where there is partial compliance and narrow cooperation, and 3) an optimistic scenario where cooperation on oil exports and salary payments is sustained over the long-term.

The baseline scenario is the most historically informed, with the export shutdown period showing how unusually sensitive the KRG's public finances are to access to ITP. For Baghdad, such a breakdown would imply renewed disruption of northern exports, weaker revenue predictability, and a return to ad-hoc political bargaining over budget execution. This outcome would lead to deteriorating cooperation, substantial revenue losses, and broader macroeconomic distortions. Here, intergovernmental transfers would become politically contested when federal finances come under pressure.

In practice, this tension surfaces first in the KRG's cash flow, where payment delays are immediate, highly visible, and spark popular political backlash.

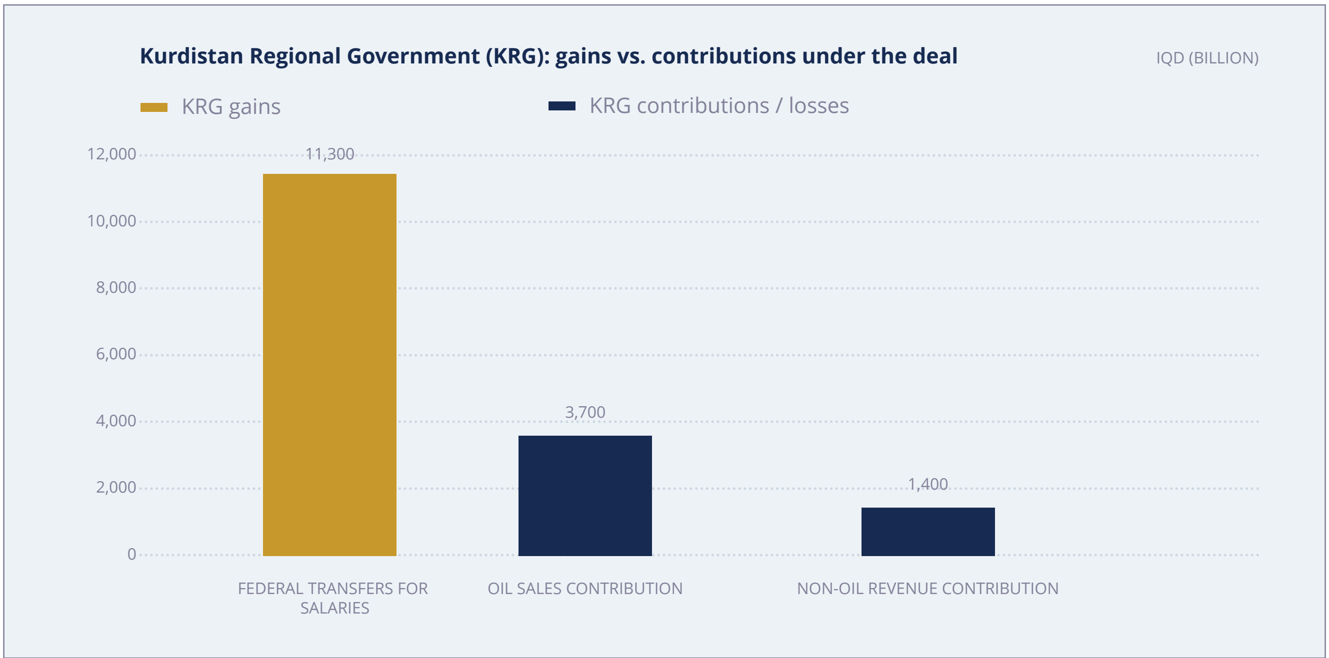
Over the past two years, the Kurdistan Region effectively lost the equivalent of three months of salary payments, or more than 12% of the KRG's actual fiscal entitlements.

The pessimistic scenario envisions a situation where salary-payments for KRG continue irregularly and investment and development spending remain constrained. Under this outcome, the KRG has hard time avoiding outright fiscal collapse and remains trapped in a low-investment and low-growth equilibrium. For Baghdad, this scenario preserves short-term stability, but at the cost of continued fiscal strain, limited reform momentum, and ongoing reliance on interim arrangements rather than institutional solutions. Iraq's current economic outlook is characterized by rising budgetary pressures and persistent rent-seeking dynamics that shape government formation and policy choices.

Given these dynamics, the pessimistic scenario is relevant and a partial-compliance scenario appears likely in the near term. It is also the scenario in which the deal survives, but without delivering the deeper fiscal or institutional transformation that either side ultimately needs.

In contrast, the optimistic scenario assumes sustained cooperation on oil exports and salary payments. For the KRG, the fiscal gains (as illustrated in Figure 1) are clear: improved cash-flow stability, reduced political volatility around wage payments, and a gradual shift away from crisis-driven fiscal management toward a minimum level of predictability. "This scenario could also pave the way for a more durable settlement if both governments — particularly the KRG — remain committed to the fiscal and technical terms of the agreement," according to Ahmad Haji Rasheed, a long-serving Kurdish member of the Iraqi Parliament's Finance Committee.[6]

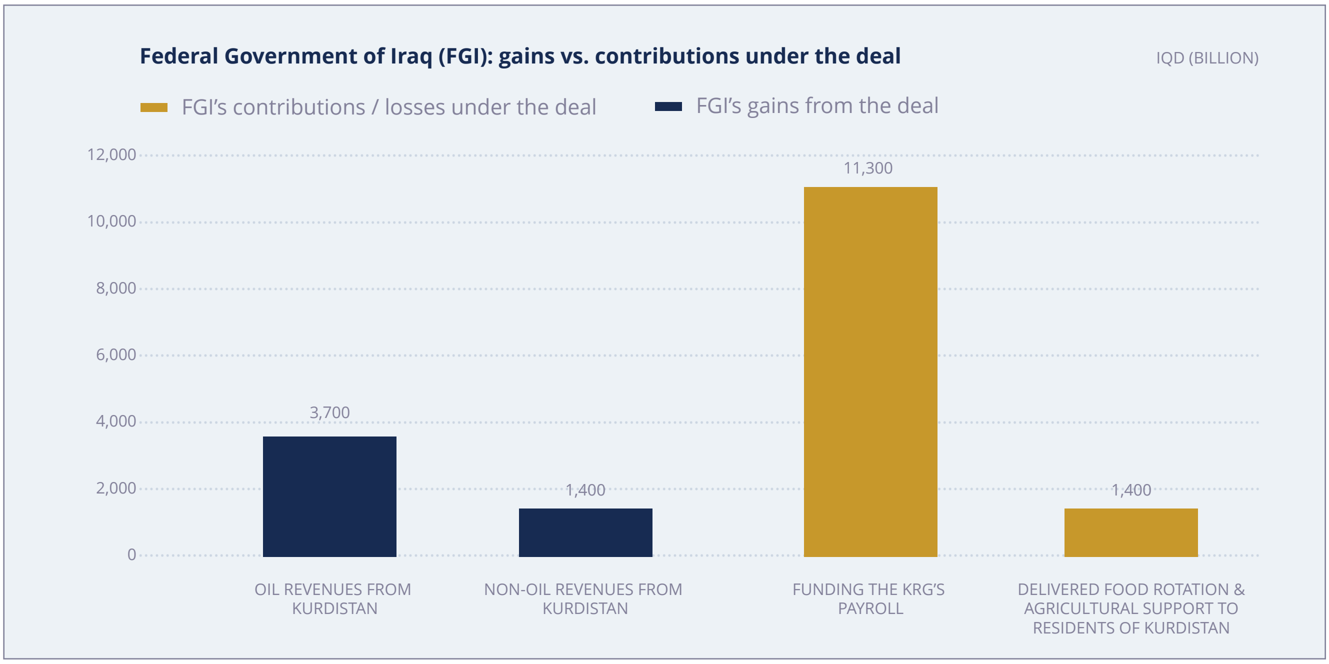
Figure 1 KRG's projected gains and contributions under the full-deal implementation



Figures are projected under a full-deal implementation scenario, in which the GoI fully funds the KRG's payroll and the KRG fully commits to federal contributions and submits oil at current production levels (188,000 bpd for export and 50,000 bpd for local consumption). The figures are indicative and vary with political and market dynamics. Although only 10 months of salary and non-oil revenue transfers are implemented in 2025, the calculations assume 12 months for clarity under a full-year scenario. Estimates are based on publicly available monthly data from the Iraqi Ministry of Finance and SOMO.[7]

For Baghdad, the gains from an optimistic scenario are different, but no less important. Beyond improving oversight of northern oil flows through SOMO, resumption of the exports via ITP provides Iraq with a strategic diversification of crude export routes, reducing its near-total dependence on southern terminals at Basra. This matters at a time when security risks in the Gulf — and the potential disruption of traffic through the Strait of Hormuz — remain a serious macroeconomic vulnerability for Iraq[8]. By maintaining an outlet to Mediterranean markets, the GoI lowers export-concentration risk, improves revenue resilience, and reduces the likelihood of regional security shocks. The arrangement also allows SOMO to expand its market share by responding to rising market demand following European embargoes on Russian oil by partially substituting for Urals crude.[9]

Figure 2 GoI's projected gains and contributions under the full-deal implementation



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A Win-Win Deal

Economically, a deal becomes "win–win" when it moves both sides closer to a stable cooperative equilibrium. For the KRG, the 2025 arrangement provides greater revenue certainty and political stability, delivered through regular and predictable budget payments. "Kurdistan's labor market has already begun to reflect these improvements," as economic activity has revived around oil fields where production has resumed or increased, according to Mohammed Dalo, the owner of a service-provider operating in the oil sector.[11]

For Baghdad, the gains are largely at the strategic level. The GoI must commit scarce budgetary space (as shown in the Figure 2) to transfers to the KRG at a time when the IMF has repeatedly warned about its rising fiscal vulnerabilities and rigid spending structures[12]. But in practice, Baghdad is willing to absorb that cost because fiscal instability in the Kurdistan Region does not remain contained: it spills into national politics, complicates security arrangements, and undermines investor confidence in Iraq as a whole. From this perspective, the transfers function less as a concession to Erbil and more as a tool to contain broader risks.

It also delivers clearer export oversight and greater transparency over KRI-produced oil through SOMO marketing. This is consistent with the GoI's interpretation of sovereign authority over crude exports. "It feeds into Baghdad's centralist instinct against the post-2003 federalism," according to Wael Mundher[13], a constitutional scholar and administrative team member at the Ein Network for Monitoring Elections and Democracy. It holds the view that control over resources underpins sovereignty — especially in a quintessential rentier state like Iraq. [14]Beyond domestic political and constitutional drivers, the deal was also shaped by external pressure, with U.S. officials urging the resumption of northern exports.[15]

For Erbil, the principal cost is reduced fiscal autonomy (or independent oil sells), which is likely to reshape the Kurdistan Region's political economy over time. Governments that rely heavily on conditional transfers tend to prioritize short-term compliance and liquidity management over longer-term institutional development, unless such arrangements are paired with incentives to broaden non-oil revenues and strengthen public financial management. Thus, concerns about the KRG deviating from the agreement remain subtle at the current dynamics.[16]

Risks Facing The Deal

One of the key weaknesses of the 2025 deal is that it sits on top of Iraq's fundamental fragilities, especially amid the ongoing decline of oil prices. Without policy adjustments, medium-term debt and external risks rise. Iraq needs a credible fiscal framework that smooths spending across oil-revenue cycles[17]. If oil prices keep dropping and OPEC+ constraints tighten, Baghdad's ability to sustain transfers to Erbil will be tested. This is a common problem for intergovernmental transfers in classic reinter-economies like Iraq: the center's shock becomes the periphery's wage delay.

Furthermore, implementation-gaps can quietly undermine cooperation. The deal hinges on agreement over export volumes, production costs, and payment scheduling. If the independent cost assessment is delayed or becomes contested, payments to IOCs quickly turn into a pressure point.

The interim agreement explicitly anticipated such assessments to address IOC compensation[18]. This is a matter of concern for KRG as well as the IOCs, according to one of the KRG's leaders who participated in negotiating the deal[19].

Some of the IOCs operating in the Kurdistan Region believe that, under the interim arrangement and in the absence of an independent cost audit, they are receiving roughly 75% or less of what they consider their "fair contractual entitlement."[20] The IOCs continue to cooperate because the alternative would be a production halt, prolonged uncertainty over cost recovery risks that erode confidence and weaken the deal from within. This concern is expected to be addressed in the first quarter of 2026 by tasking the third-party consultant firm to assess and audit production and export costs of the oil.

Moreover, there are broader regional risk-dynamics. The pipeline corridor is not a neutral conduit; it is an instrument of leverage. Oil flows can be interrupted by legal disputes and political decisions taken in Ankara or Baghdad, regardless of production conditions on the ground.[21]

Additionally, settling outstanding payments to IOCs remains a critical issue. The KRG owes more than $1 billion in arrears to IOCs for past exports and cost-recovery claims. With Baghdad now controlling export revenues, repayment effectively depends on federal approval. This has turned IOCs' demands for credible guarantees into a test of Baghdad's intentions. Until the arrears are cleared and enforceable payment mechanisms are in place, the outstanding obligations will continue to weigh on investor confidence and limit the stabilizing impacts of the deal.

And finally, investor sentiment must be addressed. Even when production resumes, investors continue to price in instability. A transitional deal may restore cash flow and keep fields operating, but it does not automatically unlock new capital expenditure. This is evident in the continuous production decline over the past three years. As a result, many operators have opted to remain in a holding pattern — maintaining production while deferring longer-term investment decisions until the institutional framework becomes clearer. [22]

Conclusion: The Road Ahead

Analysts familiar with Iraq's political economy tend to be cautious about the political optimism around the 2025 deal. The arrangement is the best as a workable truce — one that tests whether Iraq can move from discretionary bargaining toward more rules-based fiscal federalism in its oil sector.

The potential upside is real. Steadier exports, fewer budget shocks, and a platform for technical fixes — such as metering, audited costs, and more transparent marketing — that could help lower political tensions and stabilize fiscal relations between the GoI and KRG. But the risks are equally real. If the cost-audit process stalls, or if federal fiscal space tightens, the system could slide back into familiar patterns of delayed payments, rising arrears, and political retaliation. Over the medium-term, the path to durability remains clear: a coherent oil and gas legal framework, credible intergovernmental transfer rules, and public financial management reforms that reduce dependence on the wage bill while strengthening non-oil revenues. This is precisely the direction recommended for Iraq's macroeconomic stability[23]. Until those reforms are in place, the deal's most important lesson is a modest but critical one: in Iraq, partial agreements are better than no deal at all.

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20.The figures are based on estimates provided by two industry sources—employees of Gulf Keystone Petroleum, which operates the Shaikan field, and Forza Petroleum, which operates the Hawler license—who were interviewed for this article. The estimates reflect what international oil companies expect to receive under a fully implemented agreement, once a third-party consulting firm is engaged to audit production and export costs and determine cost recovery in line with contractual terms.
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Source: Iraqi Finance Ministry

Then and now: Budgets, oil prices and the economy

The Economic challenges and Opportunities of the Upcoming Iraqi Government

AHMED TABAQCHALI

Iraq's upcoming government, irrespective who emerges to form the new administration following the elections of November 2025, will not have the benefits of the huge budget surpluses of 2021-22 that allowed the outgoing government to introduce the expansionary three-year budget of 2023-25[1], which boosted the economy. and broadened popular support. The tailwinds of prior strong oil prices, that expanded the prior government's economic agenda, are reversing into headwinds, thereby restricting the upcoming government's economic agenda.

However, the current political, societal, and economic scene is very different from that of 2022 with the country enjoying the fruits of three years of solid stability and strong economic growth. An index of the country's stock market, the Rabee Securities U.S. Dollar Equity Index, ended 2025 at an all-time high, having had a powerful three-year rally with a gain of of 224.5% during that time, with the driver being the undergoing secular transformation of Iraq's economy following decades of conflict[2]. This paper reviews the economic challenges and opportunities of the upcoming administration, arguing that higher than expected oil prices would change the picture for the better, but would not alter the trajectory for a new dynamic that would shape the upcoming and future governments' economic policies. The new dynamic takes the form of sovereign debt to augment oil revenues to support government expenditures, that comes with its own challenges in which the form of debt undertaken. Each of domestic and foreign debt, comes with its own implications for the economy that would shape governments' fiscal and economic policies. Moreover, both come with debt servicing costs, which in coming years will account for larger and larger portions of total spending; which in combination with the implication of the type of debt, will ultimately will force a rethink or a reset of the social contract that has defined the political order since 2003, and thus address the economy's structural imbalances that were perpetuated in every budget over the last two decades.

Notes on Data: Figures used through the piece are the author's estimates based on the following sources:

- Central Bank of Iraq (CBI).
- Key Financial Indicators. https://cbi.iq/news/view/94
- Monthly statistical bulletin. https://cbi.iq/page/122
- Ministry of Finance. https://www.mof.gov.iq/In-Year-Reports.aspx
- U.S. Energy Information Administration (EIA) as of January 30th, 2025 https://www.eia.gov/dnav/pet/hist/RBRTED.htm
- The Wall Street Journal (WSJ) market data report as of December 31, 2025, and January 30, 2026. https://www.wsj.com/market-data/quotes/futures/UK/BRENT CRUDE/contracts
- World Bank Development indicators. https://data.worldbank.org/indicator/FM.LBL.BMNY.GD.ZS?locations=IQ-JO-EG-SA-IR-AE-1A

Then and now: Challenges

By the end of 2022, the government, formed earlier in October by the Coordination Framework (CF), found itself blessed with a significant financial treasure chest. Oil prices, as measured by Brent crude prices, had averaged US dollars (USD) 100.9 per barrel (/bbl) in 2022, which coupled with the absence of a budget for that year that otherwise would have spent most of the resultant high oil revenues, led to the accumulation of a budget surplus of Iraqi dinar (IQD) 31.7 trillion. This provided the new government with the wherewithal to embark on an expansionary fiscal policy, that is partly a reflection of longstanding patterns in Iraqi economic policy and partly a reflection of the need for the CF to broaden popular support and acquire greater legitimacy following a year of deadlock over government formation fraught with political conflict[3].

In March 2023, the government unveiled a three-year 2023-25 budget with unprecedented annual spending plans of IQD 199.0 trillion, studded with populist measures, that benefitted from the IQD 31.7 surplus and from relatively high Brent crude prices during its execution — at least for the first two years. Even though Brent prices were lower than those for 2022 by 18.3%, 20.2%, and 31.5% in 2023, 2024, and 2025 respectively, oil revenues in IQD were higher by an extra 10.3% due to the revaluation of the IQD against the USD in February 2023, a decision by the Central Bank of Iraq (CBI) in February 2023, yet it was blessed by the new government before it went into effect. [4]

Consequently, the government was able to execute the budget's expenditures relatively easily for 2023 and 2024, but not so much for 2025. The combination of Brent crude prices that averaged USD 81.5/bbl for the period, and the significant historic under-execution of investment spending, the budget's deficits for 2023 and 2024 were significantly less than the expected deficits IQD 64.5 trillion in 2023 and IQD 64.00 trillion in 2024 (Table 1 below). However, Brent crude prices that averaged USD 69.1/bbl lower in 2025 meant that the government had difficulties in executing its expenditures and resorted to payment delays, the build-up of significant arrears to third parties, and the freezing of all new capital and investment spending projects. Nevertheless, it still ended 2025 with an estimated deficit of IQD 19.8 trillion (Table 1 below).

Table 1: Budget execution for 2022-25

Federal budget execution (IQD bn)	2025 e	% vs. 2024	2024	% vs. 2023	2023	% vs. 2022	2022
Total expenditures	**144,100**	**-4.3**	**150,527**	**5.4**	**142,436**	**8.8**	**129,962**
Programs - Special and government	**566**	**-36.3**	**887**	**-19.5**	**1,061**	**18.9**	**860**
Operating	566	-36.3	887	-19.5	1,061	18.9	860
Investment spending (within non-oil investment spending)							
Operating expenditures	**111,481**	**2.3**	**108,972**	**7.5**	**100,804**	**6.0**	**94,765**
Public sector salaries	67,166	11.8	60,053	21.4	47,217	7.6	43,614
Social welfare (pensions, social Security, etc.)	26,708	0.1	26,693	6.4	24,988	0.8	24,783
Goods and services (inc. maintenance)	7,292	-34.2	11,080	-27.4	14,112	-13.9	16,076
Grants, subsidies, foreign aid, etc.	10,114	-5.0	10,649	-30.0	13,841	27.5	10,029
Miscellaneous payments	201	-59.6	497	-29.6	645	59.5	261
Debt servicing	**10,237**	**-33.3**	**15,354**	**-6.7**	**16,378**	**43.1**	**9,316**
Amortization	8,387	-10.2	9,343	-4.5	9,766	17.5	8,060
Interest payments	1,850	-69.2	6,012	-10.0	6,612	81.0	1,257
Investment spending	**21,817**	**-13.8**	**25,313**	**4.4**	**24,193**	**-3.4**	**25,020**
Non-oil investment spending	8,007	-38.7	13,053	-1.6	13,262	19.4	10,694
Oil investment spending	13,810	12.6	12,260	10.8	10,931	-31.1	14,326
Total revenues	**124,311**	**-11.7**	**140,774**	**3.6**	**135,681**	**-19.2**	**161,697**
Oil revenues	109,614	-14.1	127,536	0.1	125,882	-22.4	154,039
Non-oil revenues	14,697	11.0	13,238	26.0	9,799	21.8	7,659
Surplus/deficit	**-19,789**		**-9,753**		**-6,754**		**31.736**

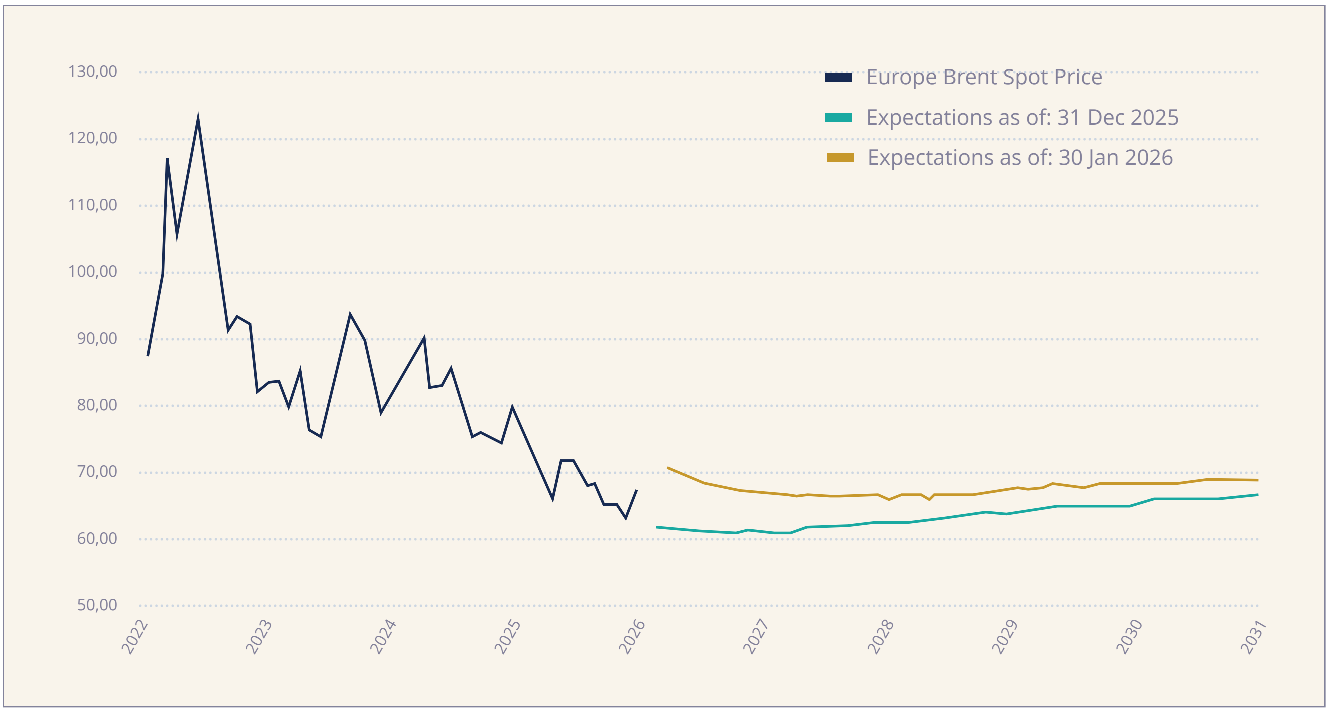
Notes:[5] Boosted by the budget after the non-oil economy expanded by 13.8% in 2023, a further estimated 2.5% in 2024, and a projected 1.0% in 2025, which coupled with the relative stability of the last few years, meant that the country enjoyed solid economic growth during these three years –while the momentum slowed in 2024, and more so in 2025, these increases are on top of the 13.8% achieved in 2023.

The financial backdrop for the upcoming government could not be more different. For starters, oil prices are lower and market expectations are for continued lower prices, although the rate of decline is slowing (Figure 1 below). Assuming that the upcoming government will be formed by March-April timeframe, it is unlikely that a budget for 2026 will be submitted to the Council of Representatives (CoR) before the summer, and passed into law before autumn. Thus, the outgoing and the upcoming governments will be implementing the "one-twelfth rule" for most, if not all, of 2026 —meaning that the government can spend up to a twelfth of the annual appropriations made in 2023-25 on a monthly basis. As such expenditures for 2026 are likely to flat with those of 2025, with possible further declines in non-oil investment spending. Revenues on the other hand would mostly be determined by oil revenues, which would be driven by declines in oil prices, in which Brent crude prices for 2026 are expected to average about 12% lower than those for 2025 —based on market expectation for future oil prices as of the end of 2025. However, these declines should be somewhat offset by increased exports, and thus oil revenues for 2026 should be down an estimated 6%; which in combination with estimates of flat non-oil revenues, means that total revenues would be down about 5%. All of which leads to an estimated deficit of IQD 26 trillion by the end of 2026, that most likely would be funded by the issuance of domestic debt, and or by the accumulation of further arrears.

Higher than expected oil prices, will improve the picture but will not alter the trajectory for the need of debt to augment oil revenues. In particular, the US-Iran tensions, raised expectations for Brent crude prices for 2026, by about 10%, following the arrival of the "beautiful armada". [6] Thus, potentially increasing oil export revenues by an estimated IQD 7.0 trillion, and lowering the deficit to an estimated IQD 19.0 trillion by end of 2026.

All things being equal, beyond 2026, the upcoming government's budgets will reflect a contractionary fiscal policy, or the reverse of that of the outgoing government. Such a policy would be marked by spending constraints and probably cuts to non-essential expenditures. Investment spending will likely bear the brunt of any cuts, which will restrict infrastructure developments. Moreover, such a budget would also include increasing non-oil revenues from custom tariffs, rationalising of subsidies, and taxes, including income taxes for individuals and corporations. Moreover, unlike the treasure chest of a surplus of IQD 31.7 trillion, the upcoming government will instead inherit increased debt from the estimated deficits for 2025-26, which it will need to service.

Figure 1: Market Expectations for Future Oil Prices
As measured by Brent Futures Contacts (USD per barrel)



However, even such a fiscal policy will not negate the role of debt to augment declining oil revenues. Higher oil prices would change the picture for the better but would not alter the trajectory for debt to increasingly augment oil revenues to support government expenditures. With increased debt comes increased annual debt servicing costs — interest payments and repayments — which in successive years will account for larger portions of total spending. Over time, this leads to a crowding out of other budget spending and less flexibility for future budget planning.

Compounding the challenges beyond 2026, is that issuing debt becomes more complicated, as the form of debt has major consequences beyond increased annual debt servicing expenses. The form of debt, domestic and foreign, comes with its own implications for the economy that would shape governments' fiscal and economic policies.

Raising new domestic debt needs to consider the form and the amount of the current stock of domestic debt estimated at IQD 96.0 trillion by the end 2025. The easy option for prior governments was the issuance of T-Bonds, most of which are bought by the state-owned banks who subsequently sell most of them to the CBI, whose holdings of such bonds was IQD 45 trillion at the end of 2025. This form of debt, known as debt monetization, effectively increases the amounts of IQDs circulating in the economy in the process supporting consumption, and thus demand for imports. Ultimately, this will have negative consequences for the CBI's foreign reserves and, in time, on the IQD's exchange rate against the USD. The outgoing government and its predecessor had modest success in issuing bonds to the public, but the uptake was modest as the total amount raised was IQD 14.1 trillion at the end of October, with most of the that taken by private sector banks and not the public, thereby underscoring the challenges of issuing government bonds to the public.

Similarly, issuing new foreign debt needs to consider the amount and form of foreign debt, which is projected to be IQD 71.8 trillion by the end of 2025, about IQD53.3 trillion of which is legacy arrears accumulated under the pre-2003 regime during the Iraq-Iran War that is essentially frozen. Thus, foreign debt is effectively estimated at IQD 18.5 trillion. Issuing foreign bonds, such as Eurobonds, has not been explored much in the past, as only three Eurobonds were issued for a total of IQD 6.1 trillion, of which the only amount outstanding is an estimated IQD 1.3 trillion that matures in 2028. Therefore, it is an option for the upcoming government, but foreign bond holders would require transparency and would demand a scrutiny of the government's ability to fund its expenditures as well its debt servicing. Moreover, a precondition could be for the government to enter into an IMF program that would involve reforming the budget and the government's fiscal policy — in other words many of the reforms that prior governments have avoided despite severe economic and financial crisis like that of 2020[7]. Nevertheless, Iraq's foreign debt level is low and allows the government the ability, subject to reform conditions, to issue Eurobonds. [8]

Finally, the data on domestic and foreign debt levels do not include the outgoing government's arrears to third parties, which are projected to be IQD 15 trillion by the end of 2025, and would likely increase meaningfully by the end of 2026. These would need to be repaid, which would be either by raising debt, or by diverting funds from elsewhere such as diverting capital spending funds for the first three months of 2025 to cover some of the arrears of 2024.[9]

Then and Now: Opportunities

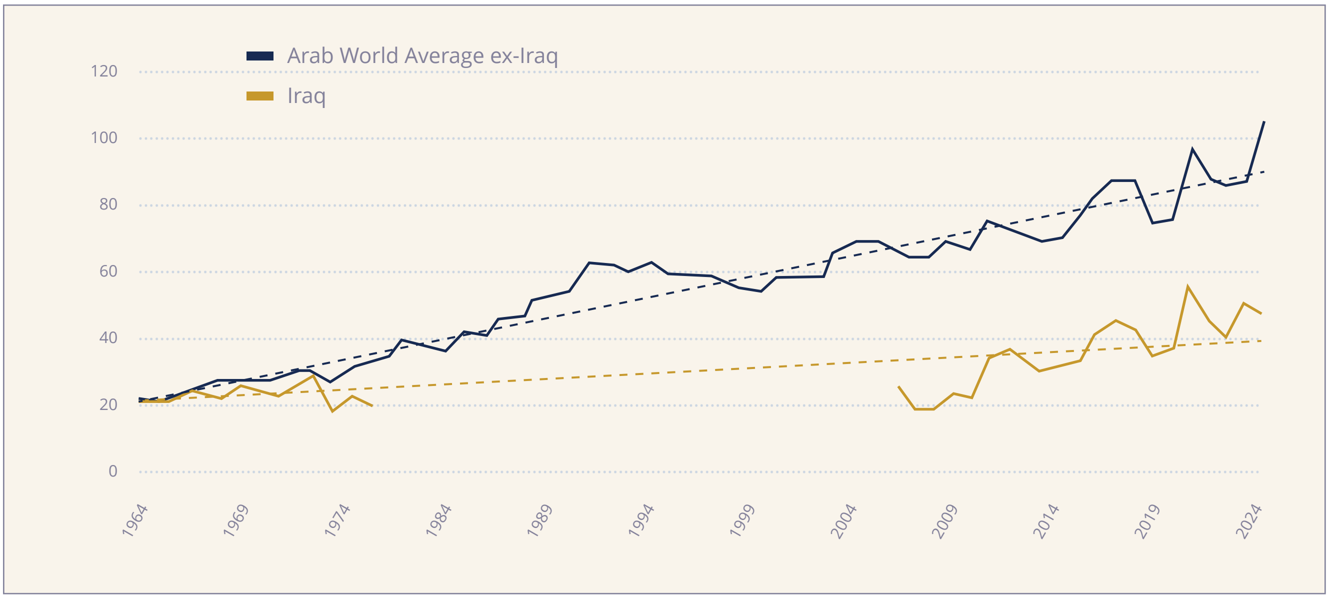
These challenges notwithstanding, a number of key positives will soften their effects; each of them is better on the eve of the upcoming government formation than they were in 2022. First, the cumulative positive effects of the relative stability that the country has enjoyed over the past few years created a stable and predictable macroeconomic framework for businesses and individuals to operate in and to plan for capital investments on a scale last seen in the 1970's and early 1980's before the onset of the decades of conflict. The outgoing government has also upgraded urban infrastructure, particularly in Baghdad. [10]

Second, the prior government made progress in addressing electricity challenges, especially in terms of gas capture and reducing gas flaring.[11]

Third, and probably the most important, is that the banking sector is on a much better financial footing than it was following the introduction of the Central Bank of Iraq (CBI)'s updated regulations on foreign transfers in November 2022 "as part" of an ongoing process of encouraging the move towards the adoption of banking. At the time, this represented a seismic shift to the country's cash-dominated economy, in which large informal sectors drive the bulk of economic activity. In the ensuing months, the CBI and the government introduced a raft of measures to accelerate the adoption of banking and strengthen the banking system. The most significant of which is the multi-year comprehensive banking sector overhaul, taking effect in late 2025, which aims to modernise the sector, align it with international best practices, and attract direct international institutional investments into the sector.

The upshot is an ongoing significant structural fundamental development accelerating the adoption of banking and bringing about a transformation of the sector and its role in the economy through the creation of credit, which will contribute towards the growth of the private sector and ultimately contribute to diversifying the economy. All of these developments should accelerate the evolution of the banking sector to catch up with those of the region and can be seen in the ratio of broad money to Gross Domestic Product (GDP). The logic being the extent of the development of a banking infrastructure in an economy is associated with the level of increase in broad money, as a consequence of the role that banks play in the creation of money through the provision of credit.[12]

Figure 2: Broad money as % of GDP
Dotted lines are trendiness, sources [13]



Fourth and finally, the incremental measures that the outgoing government implemented — including taxes and custom tariffs, automation, digitisation, better collection, and regulatory and administrative reforms — should help to increase non-oil revenues in upcoming budgets. [14]

What next?

The overarching theme is that the reversal of the tailwinds of higher oil prices into the headwinds of lower prices will play a significant role in the upcoming government's budget choices for the next few years through implementing a contractionary fiscal policy. Such a policy, marked by spending constraints and reduced subsidies, matched by likely increased taxes and custom tariffs, will test the social contract that defined the post-2003 political order, i.e., the patrimonial role of the state as a redistributor of oil wealth in exchange for social acquiescence of its rule.

However, even such a fiscal policy will not negate the role of debt, and the likelihood of debt augmenting declining oil revenues. Higher oil prices would change the picture for the better, but would not alter the trajectory of debt increasingly augmenting oil revenues — and with that debt servicing, in successive years, accounting for larger and larger portions of total spending. This, in combination of the effects of the form of debt undertaken, over time, leads to a crowding out of other budget spending and less flexibility for future budget planning, in particular effecting the components of spending associated most with the state's patrimonial role.

The silver lining for the country, if not for the governing elite, is the increased need for sovereign debt over the next few years will play a big role in developing the country's bond market. Ultimately, this will bring with it "bond market discipline"[15] that has the potential to force the governing elite, and the public, into accepting the need to reform the social contract, and address the resultant economic structural imbalances that were perpetuated in every budget over the last two decades; and crucially which both have refused to accept despite the series of economic crises that arose from it. [16]

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