

Collateral Damages of Iraq's Currency Devaluation



By Mohammed Hussein & Shwan Rauf

June 2021



Rayan Building, No 5, Alley 41,
Shoresh District 101, Slemani
Kurdistan Region / Iraq



09647725276043



@Pasewan



PasewanOrg



contact@pasewan.com



PASEWAN

Iraq's Central Bank (CBI) depreciated the Iraqi Dinar (IQD) by nearly 18 per cent from IQD1,180 to IQD1,450 against the US Dollar (USD). This devaluation negatively impacts millions of “losers” – i.e., those who are most affected by inflation resulting from the decision – with no obvious “winners” except for the Government of Iraq (GoI) and the Kurdistan Regional Government (KRG) whose expenditures are mostly paid in IQD while receiving USD for their exports, of which more than 98 per cent is crude oil.

This article will attempt to assess the inflationary impact of a devalued IQD on vulnerable Iraqi groups and will suggest some policy actions to mitigate the negative impacts of the decision.

Following Iraq's regime change in 2003, the IQD was valued at IQD1,500 to USD1. This valuation was based on a number of factors, including Iraq's foreign reserves, external debts, employment rate, and population, and on the price of crude oil. Later, when the price of crude oil reached USD120 per barrel, the value of the IQD appreciated by CBI to 1180 IQD for 1 USD. The parallel informal exchange rate had always stayed lower than 5% to the formal one.

The subject of devaluing the IQD was raised again in 2014 when Iraq faced twin crises of a decreasing oil price and a war against the Islamic State of Iraq and Syria (ISIS). In 2020, the COVID-19 global pandemic and negative oil price shock resulted in the GoI implementing desperate policy actions such as devaluing the IQD to deal with several structural challenges, including the nation's balance of payment deficit.

Iraq's Vulnerable People

Iraq's poverty rate had increased to [31.7 per cent](#) by July 2020, which implies that nearly 12.8 million Iraqis exist below the poverty line. The devaluation of Iraq's currency will have a major economic effect and social implications for most Iraqi citizens, not just the nation's most impoverished. Iraq depends heavily on imports and any devaluation of its currency effectively reduces the real income of at least 7.7 million citizens who survive on GoI and KRG's public payrolls and pensions.

According to [WFP's monitored baskets](#), in December 2020 the average price of a Cash-Based Transfer Basket (CBT) of 2,100 kilocalories per person, per day, increased by 6 per cent month-on-month and 10 per cent year-on-year, while the average price of the Survival Minimum Expenditure Basket ([SMEB](#)) increased by 6 per cent month-on-month and 17 per cent year-on-year. The SMEB has seven components including Food, Non-Food, Rent, Electricity, Water, Transportation, and Communication.

The CBT food basket consists of wheat flour, rice, lentils, sugar, salt, pasta, chicken, vegetables/leaves/tubers, milk, and vegetable oil. The price of the CBT food basket has increased by 14 per cent since the currency was devalued. The inflationary impact of the IQD devaluation varies in different provinces. In January 2021 Baghdad reported the greatest increase in the price of the CBT basket at 31 per cent month-on-month, with Ninawa reporting 14 per cent, and Najaf and Salah al-deen 12 per cent during the same period. Meanwhile, Anbar and Basrah reported the lowest increase with a 2 and 3 per cent rise, month-on-month, respectively, and Sulaymaniyah reported a zero per cent change, according to the same [WFP report](#).

Devaluing the IQD is considered a political strategy to maximise the public income, received in USD and generated from exporting oil, but is also partially justified as a strategy to increase the competitiveness of Iraqi products in a domestic market swamped with cheap imports. Iraq's neighbour nations and main trading partners – especially Iran, Turkey, and Syria - have also undergone currency depreciation, leaving Iraq's market open to influxes of very cheap imports. While this may have been good for Iraqi consumers, it also pushed millions of manufacturing Iraqis and farmers out of business.

Theoretically, a slow and gradual devaluation of the IQD could be expected to decrease production costs and, eventually, increase the competitiveness of Iraqi manufactured products against imports. However, this is unlikely to happen unless key structural issues such as poor law enforcement, under-resourced infrastructure, inadequate customs' duties, and outdated production technology, are addressed and rectified. Currently, the expected positive effects of currency devaluation on production costs and price competitiveness are offset by the nation's unfriendly business environment, ranked at 172nd (among 190 countries) in the World Bank's [Ease of Doing Business index rank](#).

Thus, not only have millions of Iraqis lost some portion of their purchasing power, but it is also difficult to find local businesses which have benefited from the currency devaluation strategy.

How to protect vulnerable Iraqis?

Not supporting the many millions of Iraqis who have been negatively impacted as a result of the currency devaluation could be a high-risk proposition for the nation's governing regime. There could be security and political implications of leaving this group of citizens as prey for radical armed groups and sectarian anti-establishment organisations. To mitigate this risk, the governments must improve and develop the existing social security systems.

The Public Food Distribution System (PFDS) is the most effective social safety net in Iraq, and the most efficient one to address this issue. The system provides four essential food items to almost all Iraqis on the monthly basis. The Iraqi government recently published a reform agenda [White Paper](#) to make the PFDS more efficient and effective in helping vulnerable citizens. Such a commitment implies supporting the households most in need with an uninterrupted monthly food ration of essential food items such as flour, rice, oil, and sugar.

In addition, the most vulnerable populations, including IDPs (Internally Displaced People), refugees, returnees, widows, single parents, and people with special needs could be supported with specific subsidies and transfers. Often the PFDS is inadequate in supporting these vulnerable groups, especially when additional financial assistance is required to rebuild livelihoods destroyed by the war against ISIS or as a result of the COVID-19 pandemic. This concept is supported by the International Monetary Fund (IMF), which also [suggests](#), “Protecting the vulnerable will be of paramount importance and requires boosting significantly the targeted cash transfers and expanding their coverage, as well as improving the targeting of other parts of the social safety net.” Iraq’s most vulnerable communities include women, youth, IDPs, and the elderly.

These groups are still suffering socio-economic repercussions of the currency devaluation and COVID-19. The current social protection framework is not sufficiently established to proactively target all vulnerable groups because databases fail to identify the neediest citizens, resulting in financial support and subsidies often not reaching those who need them the most.

However, with appropriate policies to mitigate the risk of poverty, the devaluation of the IQD could have a positive impact in addressing some parts of the economic imbalances experienced in Iraq. Earlier currency exchange rates did not accurately reflect Iraq's economic reality and did not favour Iraq as much as serve the interests of foreign countries and neighbouring trade partners. As such, some economists have argued for a [flexible exchange rate](#), instead of the fixed one, to ensure the value of the IQD is as high as the amount of the CBI's foreign reserve and, vice-versa, allow it to be lowered when the reserve is lower.

Policy Recommendations:

I. Reform the current Public Food Distribution System

Such reform should improve the quality and quantity of food items and should establish an eligibility criterion ensuring it is only accessible to low-income people. For instance, establishing an individual monthly income threshold of IQD 150,000 linked to the eligibility criteria would eliminate millions of recipient families who do not genuinely need the assistance and are overcrowding it. In this way, the fund could be used better to help needy families.

Further, data-driven decision making, and policy planning are important to reduce the endemic corruption associated with the PFDS. The programme needs to target the poor and omit citizens in the fourth and fifth quantile income distribution groups (upper-middle-class or higher). This will ensure that resources are allocated to genuinely needy, low-income citizens.

II. Implement protectionist policies

Currency deprecations in Turkey, Iran, and Syria have exposed Iraq's markets to cheap imports, thereby negatively impacting Iraqi producers. A devaluation of the IQD cannot be a standalone solution to improving the price competitiveness of Iraqi manufactured products. Governments must acknowledge that Iraq's high production costs are a result of a difficult business environment and endemic corruption, more than the fixed exchange rate. Hence Iraqi businesses need governments to implement protectionist policies such as tariffs, subsidies, import quotas, and other sessional restrictions to be placed on imports. Such protectionists policies could be essential in helping domestic producers, in various sectors, survive until the business environment improves and other macroeconomic issues are addressed. Without anti-dumping duty, millions of Iraqis will stay out of business regardless of the value of the IQD against the USD.

III. Address workers' needs, challenges, and concerns

The majority of impoverished Iraqis work in the country's poorly regulated, informal sector. [More than half](#) of the total labour force work informally. Addressing the needs, challenges, and concerns of informal workers should be considered in most policy actions related to the immediate implications of the currency devaluation, medium and long-term solutions.

IV. Ensure policies remain flexible

Policies must remain flexible to facilitate support from the international community and humanitarian and development agents. Some of these entities have the potential to significantly support the vulnerable citizens negatively impacted by the currency devaluation.