IRAQ’S PETROLEUM : SOURCE OF PROSPERITY OR CURSE FOR POVERTY?

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Iraq’s Economy, A Quick Review

In the aftermath of Iraq’s struggle with the devastating economic blows stemming from various internal and external factors, such as the dealing with a war against extremist organization Islamic State (IS) and induced-recession caused by Covid-19, Iraq’s economic revival is underway . Iraq’s dawn of economic resurgence hangs in the balance unless oil dependency is reduced, and fiscal sustainability is guaranteed . On March 3, 2024, the International Monetary Fund (IMF) mission issued a statement highlighting the state of economic growth in Iraq following a meeting between IMF and Iraqi authorities in Amman . The mission statement outlines Iraq’s economic outlook and risks; forecasting economic growth but also pointing out acute challenges that must be addressed to ensure high economic growth . In spotlight, Iraq’s overdependence on oil revenues introduces Iraq to medium-term vulnerabilities to volatility in global oil prices .

In their official statement, the IMF advises Iraq to reduce its oil dependency and ensuring fiscal sustainability while protecting critical social and investment spending . Heeding IMF’s advice, Iraq will be required to make room for significant fiscal adjustment focused on (1) control of the public wage, and (2) increase non-oil tax revenues . IMF’s statement concludes that higher economic growth is a necessary first step to absorb the rapidly expanding labor force and to boost non-oil exports and broaden the tax base . Working on policy priorities for Iraq first and foremost requires rebuilding fiscal buffers to reduce the economy’s vulnerability to oil price shocks . In view of the current circumstances, this policy brief addresses the negative consequences of Iraq's excessive reliance on oil revenues and the significant policy changes that could be implemented to mitigate it, especially by drawing insights from developed oil-producing countries .

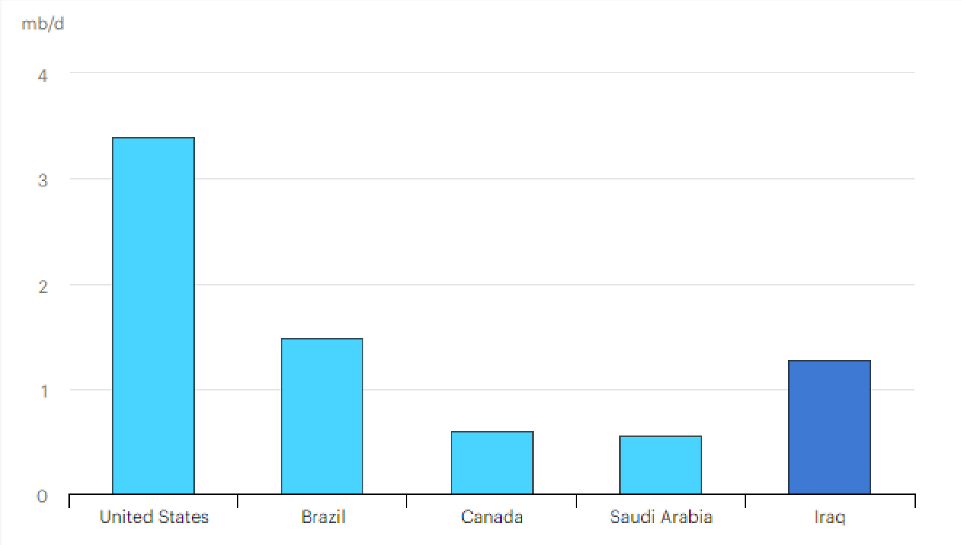
Oil, People, and Policy in Iraq

Oil is an indispensable commodity that supplies energy to millions of automobiles, ships, and aircraft across the globe. In industries such as aviation, where alternative energy sources (e.g., electricity) are inferior in energy density to petroleum fuels, oil remains an essential and progressively irreplaceable source of energy. Iraq, the lush river land of the Middle East, is the fifth largest oil producer in the world and will continue to be central to the stability of global oil markets, according to studies by International Energy Agency. The country reached a monthly 4.60 mb/d oil production[1] and is aiming to reach 6 mb/d by 2030 indicated in Graph 1 below, Iraq would overtake Canada and become the world's third largest oil producer.[2]

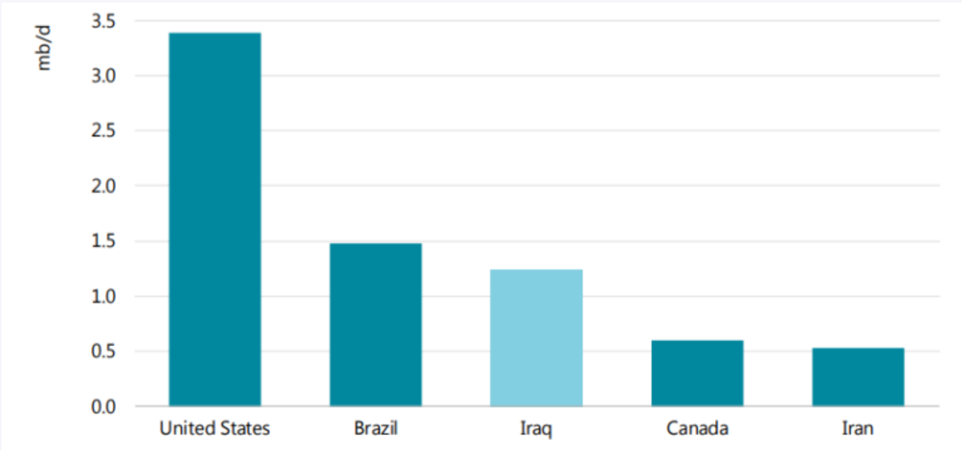
The projections for the next phase of Iraq's oil development will be significantly influenced by three factors in addition to global market conditions: (1) ensuring sufficient water for injection into reservoirs, (2) attracting foreign capital, and (3) a conducive political and security environment. The oil industry accounts for the main driver of economic development and a significant contributor to the overall GDP of Iraq's economy.[3] Oil continues to be the country's top export by 99% and generates an enormously rapid amount of wealth. According to the World Bank studies, the Iraqi budget depends on the oil revenues by 86.4%[4] and estimates indicate oil accounted for 61% of GDP (2022)[5]. However, not much of the revenue from oil is transferred to the Iraqi people, who face pervasive multidimensional poverty, high unemployment, and sporadic access to essential amenities.

Iraq's convoluted relationship with oil has led the country to a destabilized economy and vast levels of corruption in the government. Uneven economic development and income inequality across the country is readily felt in the daily lives of ordinary citizens. Without clearly defined oil policies to efficiently regulate revenues and a significant safety net to withstand the unpredictable fluctuations of oil prices, Iraq remains in a dire financial position in terms of future investments from its oil wealth. Oil governance is fundamental to addressing issues of poverty on a national scale. The objective of this policy brief is to examine the interdependence of oil revenues and the Iraqi budget, as well as the subsequent effects on the economy's overall performance and people in general, particularly those living in poverty.

Projected Global Oil Production Growth by 2030



Global Oil Production Growth Forecast for 2018-30. Source: IEA



Global Oil Production Growth Forecast for 2018-30. Source: IEA

Snapshot of Iraq's Oil Economy

Oil Reserves	145 billion barrels
Crude oil production (monthly updated)	4.60 million bpd (2023)
Oil price per barrel	70$
Foreign Currency Earnings	90% (in USD) (IMF)

Foreign Reserves	112 billion dollars (IMF)

Table 1: background on Iraqi oil economy. Source: Iraqi News Agency (INA),[7] Iraqi Oil Report (IOR).[8]

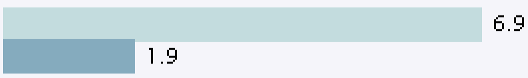
Background: Iraq's exposure to financial insecurity during the period 2024-2028 is forecasted due to fluctuations in oil price and output growth. The economy's dependence on the oil industry for decades consistently weakened industrial and agricultural output. This is one of the major drivers of widespread unemployment in all sectors. In a growing population of 44 million, only 1% of the Iraqi population are employed by the oil industry. Economic reconstruction after Iraq's several wars have been slow in strengthening the private sector or establishing new enterprise, thus weakening the Iraqi official currency- the dinar.

Other than oil, agriculture, industry, and services sectors contribute to the economy and their 2024-25 forecast[9] are indicated below. Real non-oil GDP is estimated to have grown by 6% in 2023.[10] However, agricultural activities' contraction affected by water shortage and a general stagnation in non-oil industries leave government revenues vulnerable in comparison to the oil industry. Iraq exports approximately 70% of its crude oil to Asia, especially India and China, through gulf ports, while the rest is exported through the Turkish port of Ceyhan to Europe and America.[11]

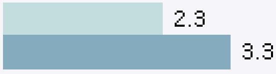
GDP Projections for 2024 (light blue) and 2025 (dark blue)

- **Agriculture**

- **Industry**



- **Services**



Budget Estimates (2023-2025)

Budget total revenue	$103.502 billions
Expenditure	$153.008 billion
Fiscal deficit	49.51 billon (32.4%)
Official Exchange rate	$1 = 1,300 Iraqi dinars

Table 2: Iraqi Budget Estimates for 2023-25.

Budget, Oil and Poverty

The mismatch between revenue and expenditure highlights the imbalance in the Iraqi budget. Reliance on oil revenues factors into the difference between the money Iraq generates and the money it spends in the budget. 92% of the income Iraq earns in foreign currency comes from Oil revenues, which is subject to extreme changes for two main reasons: the volume of crude production and exports, and the selling price of the commodity. The implication of cheap oil for the Iraqi economy is contingent upon how prepared Iraq is to cope with lower oil prices given that it has direct impact on the budget and could widen the deficit gap between revenues and expenditures. In cases of decrease in oil production and exports such as, the suspension of oil exports from the Kurdistan Region on March 24, 2023, due to disputes between Türkiye and Iraq and the questionable nature of oil sales, subjects Iraq to greater financial insecurity. On March 24, 2023, the Paris-based International Chamber of Commerce sided with Iraq in an oil dispute with Türkiye, which has so far cost the Kurdistan Region $7 billion[12] and has resulted in a continued export ban. As a result, the financial burden has been shifted to Iraq by providing 615 billion dinars (about $2 billion)[13] to ensure the salaries of employees in Iraqi Kurdistan, which the KRI had previously secured through independent oil sales.

Iraq's lack of external fiscal buffers enables severe damage to the country's economy and by far the population in its entirety: in the absence of economic buffers, a sudden decline in oil export earnings results in slower economic growth, which discourages new investments and slows production of goods and services along with dim employment prospects. This is a key point because fiscal budgets built over optimistic price projections will directly contract public spending and increase foreign borrowing when faced with a slump in oil prices. While foreign borrowing can infuse local markets with foreign currency and enable the government to invest in strategic initiatives, it is unsuitable to use it to fund projects, items that could otherwise be covered by the budget, such as government employee salaries. Over-reliance on oil revenues to fill in gaps in the budget directly and indirectly impact the Iraqi population since they depend on the government for nearly all facets of life, such as public spending and provision of services. This is particularly significant considering that public wages account for over $58 billion (76 trillion dinars),[14] or nearly half of the Iraqi budget.

Those who are poor or live below the poverty line are particularly impacted by the implications of a budget crisis due to their reliance on government initiatives to ease the burdens of poverty. Consequently, it is implausible how the Iraqi government can strategize to reduce the poverty rate when the country's oil wealth contributes to the escalation of poverty levels across the country. Most importantly, the absence of an up-to-date registry of those who fall under the poverty category and means of finding and reaching out to them undermines any effort to address poverty issues in Iraq.

Budget Allocation to Address Poverty Alleviation: The 2023-2025 spending plan allocates $36.6 billion in annual infrastructure investment, including the creation of a special fund to support the poorest provinces. The bill also contains financial aid to 600,000 families in a bid to lower poverty rates. This government initiative and the likes are fundamentally unreliable as lower oil prices translate into a larger budget deficit which directly affects the funds and social safety nets meant to alleviate poverty and support vulnerable families.

Income Inequality and Oil: The Paradox of Plenty?

Analyzing the relationship between oil and income inequality is necessary to effectively address poverty issues. With high and stable oil revenues, oil becomes instrumental in improving human capital, institutional quality, and mitigating income inequality. However, volatility in oil revenues, among other factors, impedes equitable income distribution.[15] A country's response to its oil wealth and volatility plays a crucial role in mitigating detriments associated with oil volatility. In weak democracies, such as Iraq, instead of devising policies that center around driving income equality, oil has fueled corrupt establishments, prevented long-term economic growth, and has almost never been directed towards initiatives that promote development.[16] In Iraq, oil is not the sole contributor to income inequality and poverty: other factors such as a precarious political situation, ineffective social safety nets, weak health infrastructure, rampant corruption, and dilapidated service delivery[17] are all creating real impact on rising numbers of poverty in Iraq.

National poverty rate (2023 estimates)	(30-32% and in some governorates over 50%)
Poverty Line	110,000 IQD per individual monthly ($2.44 per day)
Unemployment rate	15.5%

Table 3: Poverty Numbers in Iraq.

What Does Poverty Look Like in Iraq?

Costs of being poor in Iraq start with a comprehensive set of issues such as unemployment, bad housing, not earning enough to eat, limited to no access to healthcare and education. **When we ask who is poor in Iraq, the answer depends on how we measure poverty.** Developing a poverty measure considers several metrics from narrow to broad, objective to subjective, measurable to amorphous. The World Bank and World Food Program (WFP) have measured poverty through a compound of social factors and consumption patterns of Iraqi households. The poverty line has recently been determined at 110,000 IQD ($83.93) per individual in a month. Anyone below this level of income is considered extremely poor.

Above: Non-poor **Poverty Line (income threshold):** 110,000 IQD ($83.93) **Below:** Extremely Poor

Poverty reduction efforts and policies cannot be divorced from studying geographical locations. This is because cost of living, among other factors, change across geographical locations in Iraq regardless of resource-rich regions. For instance, state of poverty in Al-Muthana Governorate (highest poverty rate in Iraq over 50%) is different from Sulaymaniyah Governorate (the lowest level of poverty in Iraq: lower than 5%) per 2018 surveys by Iraqi Ministry of Planning. Thus, geographic adjustments and calculating the current cost of necessities are all important indicators to track the many faces of poverty. **Poverty is a complex societal issue in Iraq and while there is no one cause of poverty; the oil economy contributes to the rising trends of poverty either directly or indirectly.**

Box 1: What is the Resource Curse/the Dutch Disease?[18]

Although not inevitable, the 'resource curse' and 'Dutch disease' are often given as reasons for the poor economic performance of countries rich in natural resources. The latter occurs when an inflow of foreign money associated with the discovery of new oil and gas resources leads to an exchange rate appreciation, with negative consequences for other traded sectors, and a shift of domestic finance and labor into the oil and gas sector. The 'resource curse' in oil- and gas-producing countries describes rent-seeking behavior by elites, inequalities between districts and ethnic groups within a country, and volatility in earnings. It has been more significant in resource-rich countries with weak institutional development and poor governance.

The relationship between oil and gas production and economic growth in low- and middle-income countries is not straightforward but is affected by governance conditions and the effectiveness of institutions. Similarly, the effect of rents from oil and gas production on income inequality is affected by governance: where high oil and gas rents are associated with corruption, they lead to higher income inequality. However, there is some evidence to suggest that income inequality falls in the short term and increases over time as oil and gas revenues increase. The fall in income inequality is due to the redeployment of factor inputs to the oil and gas sector, reducing growth in other sectors.

Poverty Studies in Iraq

The Iraq Household and Socioeconomic Survey (IHSES) 2012/13 is the only nationally representative survey that measures household expenditure measuring the poverty rate. It collects detailed data on household income and expenditure, health and education, employment and job search, displacement, housing and access to services, and many other socioeconomic indicators from more than 25,000 households.[19] However, until this point, there is no data indicating oil-driven poverty and the causes and consequences of such impact on Iraqi poor. **In analyzing oil-driven poverty, it is important to understand that oil volatility rather than oil abundance widens income inequality**. However, lack of data proves to be a challenge to measure such impacts on oil-driven poverty. For this paper's purpose, a map of oil-rich regions and their poverty rate is digitally provided to see the link between oil wealth and poverty.

Oil and Poverty Research: The only study addressing the link between oil and poverty in Iraq is conducted by the World Bank in 2014.[20] Since then, a lot has changed. Despite recovery from steep decline of oil prices and pandemic-induced recession of 2020-21, poverty levels are rising, at least according to unofficial sources.[21] Low income and substandard health, education, and living standards indicate the multidimensional nature of poverty among the Iraqi households.

Multidimensional Poverty: Another study conducted in 2018 measuring poverty levels per governorate called the Multidimensional Poverty Index (MPI), which addresses poverty through an integrative approach on a global scale developed by the Oxford Poverty and Human Development Initiative (OPHI). Consisting of 10 indicators divided into 3 dimensions of poverty depicted below, the MPI index ranges from 0 to 1, with 0 meaning lower poverty and 1 meaning more severe poverty. **The most recent MPI for Iraq is conducted in 2018 where the national MPI value stood at 0.033 and intensity of poverty at 37.9%.**[22]

Dimensions of poverty	Indicator	Deprived if
Education	Years of Schooling Child School Attendance	No household member has completed five years of schooling Any school-aged child is not attending school up to class 8
Health	Child Mortality Nutrition	Any child has died in the family Any adult or child for whom there is nutritional information is malnourished

Living Standard	Electricity	The household has no electricity
	Improved Sanitation	The household's sanitation facility is not improved (according to Millennium Development Goal guidelines [MDG]), or it is improved but shared with other households
	Safe Drinking Water	The household does not have access to safe drinking water (according to MDG guidelines) or safe drinking water is more than a 30-minute walk from home, roundtrip.
	Flooring	The household has a dirt, sand, or dung floor
	Cooking Fuel	The household cooks with dung, wood, or charcoal
	Assets Ownership	The household does not own more than one radio, TV, telephone, bike, motorbike, or refrigerator, and does not own a car or truck

Table 4 : Dimensions of Poverty based on the global MPI score. Each indicator carries a certain weight that contributes to the overall MPI score.[23]

For Iraq, the argument for poverty causes and consequences center around the impact of the oil-rich economy. Considering oil as a massive driver for inequality has merit. This is because without buffers, such as effective policies to manage the oil income, an abrupt loss of export earnings such as halts on KRI oil, means slower or negative growth, higher inflation, and less government revenue.[24] **But how does this translate into poverty?** This in turn translates into fewer jobs, pricier food, and less social assistance. In other words, poverty. Determining who and which segment of society will be most adversely affected by oil price fluctuations is, therefore, a critical component in developing measures to protect the poor. Considerable progress must be made regarding the Iraqi government's long-neglected internal reforms concerning oil-driven income inequality. A quarter of the population lives below the poverty line, and the middle class barely escapes the detrimental effects of frequent financial shocks; this is entirely attributable to the oil wealth among a select few.

Box 2 : The Link between Poverty and Oil[25]

In the mid-90's, economists Jeffrey Sachs and Andrew Warner found a strong negative correlation between a country's dependence on mineral exports and oil and their gross domestic product (GDP). These countries also suffer from high rates of poverty, malnutrition, child illiteracy, corruption, authoritarianism, civil war, and even indebtedness. Collectively, these observations are known as the resource curse. Reports from Oil Change International (OCI), a research, communications, and advocacy organization focused on exposing the true costs of fossil fuels and facilitating the ongoing transition to clean energy, found that countries that produce oil tend to be poorer, more violent, more corrupt, and less productive economically than they should be.

Interestingly, OCI reports find that although one of the primary reasons consistently provided for continuing to fund fossil fuels is poverty alleviation; most oil, gas and coal projects financed by multilateral development agencies do not target the poor as project beneficiaries.

Oil Contracts and Policy in Iraq

Iraqi oil policy follows budgetary arrangements and contract practices with International Oil Companies (IOCs)[26] under the financial and legal framework adopted by the central government. The type of oil contract is called Technical Service Contracts (TSCs). The characteristics of TSCs enable IOCS to engage in long-term oil exploration and development without relinquishing control over that country's extracted natural resources and reserves. The contract stipulates that all capital expenditures of relevant parties are covered, including any cost overruns that may occur after production reaches the minimum level of production. However, the legal framework governing oil and natural resources in Iraq fails to explicitly delineate the government body or institutions with the authority to regulate oil contracts, as well as determine the revenue sharing mechanisms. The TSCs do not touch on this topic either.

An important controversy relating to the distribution of oil wealth is that since it is owned by the entire Iraqi population, its profits ought to be distributed equally. This argument finds its merits in Article 111-112 of the Iraqi Constitution illustrated in Table 5 below. The legal language of the Iraqi Constitution contributes to the ambiguity surrounding the control and distribution of oil and other natural resources, as it merely states that all Iraqi citizens, across all regions and governorates, own oil and gas. No specific group or geographic region is identified as the owner of the resources. In situations where the legal status of oil and gas ownership is ambiguous, at least a proportionate share of the oil revenues should be equitably distributed across all provinces, especially in addressing issues of education, healthcare, and standard of living. A poverty rate of 30% raises serious questions regarding the management of oil revenue and whether there are fiscal buffers to reduce poverty levels.

Article	Section	Content
111		**Ownership of Oil and Gas**
		Oil and gas are owned by all the people of Iraq in all the regions and governorates.
112	1	**Management and Distribution**
		The federal government, in collaboration with producing governorates and regional governments, manages oil and gas extraction, ensuring fair revenue distribution based on population, and allotments for historically deprived and damaged regions. These regulations are to be governed by law.
	2	**Strategic Development Policies**

		The federal government, in conjunction with producing regional and governorate governments, formulates strategic policies to maximize the benefits of oil and gas wealth, employing advanced market techniques and encouraging investment.

Table (5): Iraqi Constitution Articles (111-112) on Ownership of Natural Resources.

Issues with Fiscal Revenues

Governments are primarily motivated to invest in oil exploration due to substantial fiscal revenues. Oil revenues are potentially transformative and leave a lasting impact on the economy's overall shape. This does not mean that oil producing economies perform better than non-producers and, in many cases, they perform worse.[27] The important point of analysis is the amount of fiscal revenues that governments of oil producing countries receive, which is subject to the type of contract with the oil companies. Given the technical service contracts enforced in Iraq, the Iraqi government has had the advantage of large fiscal returns.

Fiscal revenues are not problematic in and of themselves, but rather in their management. Weak fiscal policies have thus far resulted from the absence of a clear and effective legal framework governing the management of oil revenues. The two primary revenue challenges that the Iraqi government continues to face are: ensuring a steady and predictable flow of revenue and allocating revenues effectively. These concerns have been mitigated in high-income oil producers like Norway by establishing sovereign wealth funds that serve as buffers against production fluctuations or, more likely, oil price fluctuations. **Given the disastrous impacts of oil price fluctuations, Iraq could take a page out of Norway's playbook by establishing buffers to shield its economy from these market shocks.**

Fiscal Buffers: creating external and fiscal buffers to cushion a plunge in oil prices are a key policy shift necessary to alleviate the relatively poor performance of oil producing economies. One of the main advantages of incorporating fiscal buffers into a country's economic structure is enhancing macroeconomic resilience to financial shocks.

Norway's Oil Industry: Lessons for Iraq

Converting a finite resource like oil into a lasting generational and widely felt prosperity is perhaps found in very few countries. Norway, known for its Scandinavian solution in avoiding the oil curse, leads the list of top oil-rich countries for investing the oil for the public good. Prudent planning and good fortunes of the oil industry together helped Norway in achieving high growth and low-income inequality since oil discovery in 1969.

Norway's Story: before finding oil in the Norwegian continental shelf, Norway enjoyed a relatively stable and equitable economy. Gaining independence in 1841 from Denmark, Norway closely tied its economic fortunes with a vibrant shipping industry, agriculture and fish exports. After four decades of economic development, Norway became rich and prosperous by 1875. There are two underlying factors that distinguishes the history of Norway's economic vitality before oil discovery.[28]

1. The advantage of having a stable, wealthy, and equitable economy with highs standards of living.
2. Norway's representative government ensures that politicians and officials will never become as corrupt as others in most oil-rich countries.

- The highly specialized, incorrupt and independent Norwegian bureaucracy naturally eliminated competing elites who usually depend on external influence for career advancement and position.
- Participatory democracy and an independent judiciary opened the Norwegian culture to rule-based governance and policymaking centered around public interests.

The 10 commandments of oil: Within merely 2 years of oil discovery, the Norwegian model[29] or commonly known as the 10 Commandments of Oil, was introduced in 1971 laying out the main principles for national oil policy. The Norwegian model ensures that oil is utilized for the public good and, by recognizing the ubiquitous nature of the petroleum industry, guarantees that it will not have a negative influence on other industries or the environment.

Avoiding the Oilification of the Economy: The Norwegian approach to oil management is centered on fiscal prudence as a governmental strategy. Taking lessons from the Dutch Disease of the 70s, the Norwegian government prudently avoided the oilification of the economy by moderating welfare spending.[30] To avoid negative impacts of oil on the overall economy, Norwegian policymakers have taken a fiscally conservative approach and supported slowing down production and investments to ride out the collapse in oil prices since the 70s.

This stands in stark contrast to oil-rich countries that have spent unrelentingly, made possible by the wealth that has been generated from oil rapidly, destabilizing their economies and sabotaging the potential for economic growth and development. For instance, the oil industry directly leads to displacing other essential industries that are critical for economic development, as vital sectors such as manufacturing may never receive as much attention and support necessary to fuel diverse economic activities.[31]

The Government Pension Fund Global: established in 1990, the Government Pension Fund Global is perhaps the most instrumental oil policy to insulate Norway from the boom-and-bust cycles of oil. Norwegian policymakers introduced this instrument as a direct measure to avoid government budget reliance on oil revenues. The objective is: the revenues from oil exports will not be converted into domestic currency and thus avoiding exchange rate pressure on it which eventually reduces the government's reliance on the revenues.[32] Functioning as a financial shock absorber, the Fund will save the accumulated revenues and invest it into international financial markets. Norwegian Pension Fund, popular for being the largest sovereign wealth fund, holds in excess $1 trillion in assets-twice the size of Norway's GDP.[33] Budgetary and fiscal rules ensure that the government cannot withdraw more than the annual expected returns of the fund set at 3%.[34]

Conclusion and Recommendations

The negative link between oil wealth and poverty rate in Iraq highlights the volatility of Iraq's economic situation due to its heavy reliance on oil revenues. Regardless of its position as one of the largest oil producers on the global energy map, Iraq consistently faces financial challenges when it comes to addressing economic disparities and rising levels of poverty at different levels throughout the country. Imbalances in the budget characterized by instability in oil prices leaves a widespread impact on the Iraqi population generally. The Iraqi economy has been significantly impacted by the oil industry's failure to foster industry growth and economic diversification. This adverse effect is typical of the mismanagement of oil revenues, which further exacerbates income inequality and impedes initiatives to alleviate poverty. Redefining conservative fiscal policies to manage oil revenues serves as an important measure to cope with fluctuations in oil prices and their immediate adverse effects on the budget. By adopting the model of Norway and modifying it to be applicable to existing circumstances in Iraq, the country could successfully manage its oil industry in the benefit of its population at large.

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