

Article

The Role of Non-Oil Revenues in Achieving Financial Sustainability for the General Budget in Iraq

Amjed Jasim Naeemah Al-Nassar*¹

1. Sumer University, Department of Accounting

* Correspondence: amjed.jasim@uos.edu.iq

Abstract: This study examines the role of non-oil revenues in achieving fiscal sustainability for the general budget in Iraq. Data were collected from the World Bank database, and the study sample covered Iraq during the period (2019-2023). Random effects panel data models were run to compare the study hypothesis. The results indicate that non-oil revenues are a key factor in enhancing fiscal sustainability, through reducing the structural deficit and achieving a more flexible and stable structural fiscal balance. There is also a relationship between the growth of non-oil revenues and a decline in the public debt-to-GDP ratio, reflecting the vital role of these revenues in controlling debt. This study provides evidence that the increase in non-oil revenues during years (2019-2023) contributed to reducing the budget deficit gap, especially in light of oil price volatility, providing public finances with relative flexibility in covering current expenditures. This study provides numerous pieces of evidence and guidelines related to diversifying revenue sources, which reduces the inequality and class differences resulting from the unequal distribution of oil revenues. It also ensures that all citizens contribute to and benefit from the financial system. Non-oil revenues are used to finance education, health, and infrastructure, contributing to raising social welfare, reducing poverty, and improving the treatment of unemployment. Few previous studies have addressed the relationship between non-oil revenues and financial sustainability, and this study aims to fill this knowledge gap. This study may also help relevant authorities in Iraq understand the level of non-oil revenues and how they appropriately impact financial sustainability, which will help improve revenue levels in line with the nature of the state's work and principles.

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1. Introduction

Iraq's economy is heavily dependent on oil. Still, there is a growing trend toward diversifying revenues by developing non-oil sectors such as agriculture, industry, and tourism, to enhance financial sustainability and reduce the long-term fiscal deficit. Financial sustainability is one of the strategic goals countries seek to achieve to ensure economic stability and reduce the risks resulting from fiscal deficits and rising public debt levels. Non-oil revenues are a key component in supporting financial sustainability, especially in rentier countries like Iraq, where oil revenues constitute a significant portion of the economy. Several recent studies show that over-reliance on oil revenues makes the finances vulnerable to fluctuations in global oil prices, which calls for strengthening the role of non-oil revenues in financing public expenditures (IMF, 2023; World Bank, 2023).

Diversifying government revenue sources is also a pivotal element in achieving financial sustainability by expanding the tax base, improving collection efficiency, and adopting innovative financial tools (OECD, 2022). In the Iraqi context, official reports indicate that non-oil revenues still represent a small share of total budget revenues, despite

reform initiatives implemented by the government following recurring financial crises (Ministry of Finance – Iraq, 2023).

This topic is becoming increasingly important in light of the challenges facing Iraq in achieving a stable and sustainable fiscal budget that enables it to finance public expenditures while reducing its total dependence on oil revenues. This makes studying the impact of non-oil revenues on achieving fiscal sustainability vital for a deeper understanding of the financial reality and the development of effective alternative strategies.

Research Problem

Iraq relies heavily on oil revenues, increasing its vulnerability to financial volatility and reducing its ability to achieve fiscal sustainability. Despite reform initiatives, non-oil revenues remain a small percentage of the general budget (Habeeb & Hasan, 2023; IMF, 2024). This highlights the importance of examining the extent to which these revenues contribute to achieving lasting financial balance and stability.

Research Objectives

The current study aimed to:

- a. Identify the sources and volume of Iraqi non-oil revenues.
- b. Examine the extent to which non-oil revenues contribute to supporting the financial sustainability of the government budget.
- c. Identify the impact of increasing non-oil revenues on reducing dependence on oil.
- d. Explore effective ways to develop non-oil revenues to support the Iraqi economy.

Research Significance

The importance of this study lies in its theoretical perspective, which highlights the role of diversifying non-oil revenues in achieving sustainable financial stability, thereby enriching the economic literature related to rentier states. From a scientific perspective, the study contributes to establishing a framework for proposing effective solutions and policies that strengthen the Iraqi economy and reduce its dependence on oil revenues.

Literature Review and Hypothesis Development

Due to the volatility of the global energy market, countries that rely primarily on oil revenues are facing significant financial constraints. This situation necessitates the development of new financial channels and support for more reliable alternatives. In this context, non-oil revenues are a key pillar of ensuring financial stability. These revenues are diversified and can be collected from various sources, such as taxes, fees, and investment returns, which are less volatile compared to oil revenues. This stability enables governments to plan their financial affairs for the long term and better cope with economic crises and unexpected events. Recent trends in government expenditures also demonstrate that countries' increasing reliance on non-oil revenues leads to improved financial stability by reducing deficits, reducing the need for loans, and strengthening public financial management. Therefore, this research will examine and explore the level of non-oil revenues and their relationship to financial sustainability, as established in several previous studies. It will also present the level of non-oil revenues in Iraq.

Non-Oil Revenues

Non-oil revenues are defined as the total revenues collected by the government from non-oil resources, such as taxes, customs duties, and public services. They are considered an important element in supporting budget stability in rentier countries (Al-Khafaji, 2021). Non-oil revenues can be defined as one of the strategic options for reducing reliance on depleting resources by diversifying economic activities to achieve balance in public finances (Mahmood *et al.*, 2023).

Non-oil revenues represent a more stable source of income than oil revenues and are crucial for enhancing economic resilience to external influences (World Bank, 2022). In oil-producing countries, fiscal sustainability relies on developing non-oil revenues through

taxes, revenues from public institutions, and fees, as a tool to reduce the risk of oil market volatility (International Monetary Fund, 2023).

Therefore, non-oil revenues are the financial resources on which the state relies, apart from oil resources. They are considered a pivotal element in building a sustainable and comprehensive economic model based on reducing financial fragility and expanding the government's revenue base.

Non-Oil Revenue Metrics

Researchers and funding institutions use a variety of metrics to evaluate and analyze non-oil revenue performance, including:

a. Non-Oil Revenue to GDP Ratio

This measure indicates the percentage and size of non-oil revenues that contribute to the national economy. Therefore, a high ratio is a positive indicator of a country's ability to diversify its income sources and reduce its dependence on oil resources (World Bank, 2022).

b. Non-Oil Revenue to Total Revenue

This measure reflects the percentage of non-oil revenues that constitute total government revenues. The higher this percentage, the less dependence on oil and the better financial sustainability (IMF, 2023).

c. Growth Rate of Non-Oil Revenues

This indicator measures the rate of growth in non-oil revenues over a specific period, reflecting the efficiency of tax and customs policies (Al-Hadithi & Abbas, 2021).

From the above, the level and percentage of non-oil revenues to the gross domestic product in Iraq during the period (2019-2023) were obtained, and the following chart illustrates this.

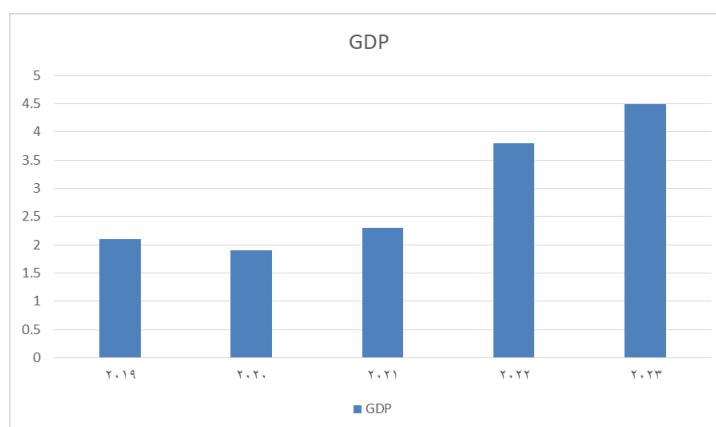


Figure 1. GDP diagram.

Fiscal Sustainability

Fiscal sustainability is defined as an indicator of governments' ability to continue implementing their current fiscal and tax policies without requiring major changes that could negatively affect long-term economic stability (International Monetary Fund, 2022).

Financial sustainability in nonprofit organizations is defined as the ability to secure diverse and stable sources of income that help them provide their services without the complete need for donations or government support (Bryson *et al.*, 2021). Financial sustainability occurs when companies can balance what they spend with what they earn, ensuring sufficient profits for future investment and avoiding excessive financial risks (Lins *et al.*, 2020). Financial sustainability is also known as an important element for achieving sustainable development, as it requires flexible financial policies that can adapt

to economic shocks and contribute to achieving social and environmental justice (United Nations, 2023).

It is clear from the above that financial sustainability means achieving a fluid financial balance that helps organizations meet their current and future obligations without the need to overuse resources or increase debt. This ensures that the organization is able to adapt to various economic challenges.

Financial Sustainability Metrics

Sustainability measures vary, reflecting the level and percentage of sustainability, depending on the public debt ratio or primary balance, the financial revenue ratio, and many others. The following explains each of them:

1. Public Debt to GDP Ratio:

This ratio is used as an indicator to measure a country's ability to meet its obligations relative to the size of the economy. Exceeding this ratio to specific levels, such as exceeding 70% in developing countries, indicates weak financial stability and increased exposure to potential financial risks (International Monetary Fund, 2023).

2. Primary Balance as % of GDP:

This indicator represents the net budget deficit or surplus, excluding interest on debt. It is the most prominent tool used to measure structural financial stability. Continuing to achieve a sustainable primary surplus helps control public debt (Escolano *et al.*, 2022).

3. Sustainable Revenue Ratio:

This ratio reflects the level of reliance on permanent revenues, such as taxes and fees, compared to non-permanent or rent revenues. An increase in this ratio is an indicator of a stable financial structure (OECD, 2022).

4. Debt Service Coverage Ratio:

This indicator is used to assess a country's efficiency in paying debt interest and installments through its operating revenues. A decline in this ratio to less than 1 indicates weak financial sustainability (World Bank, 2023).

5. Non-Oil Revenue Dependency Ratio:

This indicator is particularly important in oil-dependent countries, as it helps assess the extent of diversification of public revenue sources. Increasing the level of non-oil revenue is a positive indicator of economic diversification and reducing dependence on natural resources (Alsharif & Hassan, 2023).

The Relationship between Non-Oil Revenues and Financial Sustainability

Non-oil revenues are an important element in enhancing financial sustainability, particularly in countries with a high dependence on natural resources such as oil. Achieving fiscal sustainability requires diversifying government revenue sources and ensuring their stability. This helps the state cover its obligations, avoiding the risks of global market fluctuations. Over-reliance on oil revenues exposes economies to the risk of external shocks, while diversifying non-oil revenue sources, such as taxes, fees, and customs revenues, contributes to supporting fiscal stability and providing greater fiscal space for development spending (IMF, 2024; OECD, 2023). The study by Alshahrani & Alsadiq (2022) confirmed that in some oil-dependent countries, there is a statistically significant direct relationship between the increase in non-oil revenues and the development of levels of financial sustainability, as diversifying sources of income is an important factor in reducing the financial deficit and achieving a sustainable budget balance in the medium and long term.

Improving tax administration and expanding its tax base contribute to improving the flexibility of public finances and enhancing the state's ability to finance social and investment spending without the need for borrowing (ESCWA, 2023). Meanwhile, in Iraq, International Monetary Fund reports have shown that non-oil revenues remain extremely

low, ranging between (1.9%-4.5%) of GDP during the period (2019-2023), the lowest ratio among oil-exporting countries (IMF, 2024). The International Monetary Fund (IMF) emphasizes in its Article IV Consultation with Iraq that the continuation of this situation limits the government's ability to absorb external shocks and poses a direct threat to fiscal sustainability. The report recommends the importance of expanding the tax base, implementing a value-added tax, and improving customs collection efficiency as essential measures to increase non-oil revenues and ensure long-term fiscal stability in Iraq (IMF Country Report No. 24/129, 2024).

2. Materials and Methods

Research Methodology

The population and sample of the study, data collection, an explanation of all the variables in their model, the statistical methods employed, and a summary of the research process followed are all included in this section.

Research Approach

The current research falls within the descriptive and analytical studies. It is an analytical research, in which the sample is used to survey the study population. Data from the annual reports for Iraq were used to support the research objectives and purposes, in line with the accepted hypotheses of the research, to conduct statistical analysis, and to achieve the framework objectives. The results of the tests were interpreted using the significance level ($\alpha 0.05$), which is equivalent to the confidence level (0.95). Therefore, the analytical approach relies on collecting and analyzing data in a realistic manner, while the descriptive approach reflects a description of the research variables through the theoretical background and the presentation of a set of previous studies primarily related to the topic.

Population and Sample of the Study

The study population consisted of all annual reports for Iraq, while the study sample consisted of annual data regarding (non-oil revenues and financial sustainability) during the period (2019-2023).

Data Collection

The information about the study was compiled by relying on secondary sources, which included references to many previous studies published in refereed and specialized scientific journals related to the subject of the study.

Research Variables

This section includes a presentation of all study variables, and how each variable was measured was explained as follows:

Dependent variable: Financial sustainability, measured using the debt-to-GDP dynamics equation, whose equation is as follows:

$$\Delta d = (1+g)/(r-g) \cdot t - t \cdot d - t \cdot pb$$

Independent variable: Non-oil revenues, measured by GDP, and its equation is as follows:

$$\text{Non-oil revenues} / \text{GDP} = \text{Total revenues} - \text{Oil revenues} / \text{GDP}$$

Statistical Methods

The study data were analyzed using the E-Views statistical analysis program, which helped analyze all data and test all hypotheses using a set of statistical methods, namely:

Descriptive Statistics: This statistical method was used to infer and describe all study variables by calculating the mean and standard deviation, and working to determine the highest and lowest values for each variable.

Regression Analysis: To test the study hypotheses, the statistical method of regression analysis was applied, by calculating the fixed effect model (FEM) through the ordinary least squares (OLS) method, and the random effect model (REM) through the

generalized least squares (GLS) method. The clear difference between these two models is through the assumption of unobserved heterogeneity between individual entities, so that the fixed effect model works on assuming the entity characteristics of the independent variables, while the random effect model is not randomly correlated or distributed, and when there is any correlation, the effect of the random effect becomes ineffective, which leads to it being more consistent and appropriate to achieve reliable estimation.

3. Results and Discussion

Table 1. Descriptive Statistics.

Variables	Mean	Std. Dev	Min	Max
Debt-to-GDP	60.71332	17.22124	4.284797	95.73931
GDP	56.57675	4.373737	14.10534	60.09503

By reviewing Table 1, it became clear that the averages and standard deviations were calculated for all study variables. The mean of the financial sustainability variable (Debt-to-GDP) was approximately (60.72) and the standard deviation was (17.22). Comparing the highest and lowest values of this variable with the mean, it became clear that there is a good level of financial sustainability through the debt-to-GDP ratio, which positively reflects on the economy in Iraq. As for the non-oil revenues variable, the mean was (56.57) and the standard deviation was (4.37), indicating that the economic situation in Iraq relies well on non-oil revenues, such that there is a level of revenue that is included in the oil elements or sources and non-oil sources.

Regression Analysis

The study hypothesis was tested using a random effect test, with Hausman's value being greater than 1% (Hausman, 1978; Wooldridge, 2010). Table 2 shows non-oil revenues and their impact on fiscal sustainability in Iraq.

Table 2. Hypothesis Testing Variables.

Variables	Coef.	Z	P> Z
GDP	.1177736	2.58**	.010

*, **, and *** refer to the 10%, 5%, and 1% levels of significance, respectively.

According to Table 2, the GDP variable is positive and statistically significant at the 5% level, indicating a positive relationship between non-oil revenues and fiscal sustainability. This suggests that Iraq's management of non-oil revenues will increase its fiscal sustainability, which will in turn impact its economic performance. Interestingly, countries with higher levels of economic development tend to exhibit stronger fiscal sustainability levels and performance. Based on these results, the first hypothesis is accepted. This result is consistent with Al-Shammari (2024) the results showed a significant positive impact of non-oil revenues on financial sustainability indicators, including a decrease in the public debt ratio and the achievement of a primary surplus

4. Conclusion

The study focused on identifying the role of non-oil revenues in achieving financial sustainability for the general budget in Iraq, and relied on data for the period between (2019-2023). It is clear from the previous analysis of the study variables that there is diversification of public revenues in Iraq, such that it is not an option but rather a strategic necessity. The data proved that excessive dependence on oil made public finances fragile in the face of fluctuations in global oil prices. It also showed that non-oil revenues are a key factor in enhancing financial sustainability, through reducing the structural deficit and

achieving a more flexible and stable structural financial balance. It has also been shown that improving the efficiency of tax collection and expanding the tax base may significantly contribute to reducing the quality of financing and enhancing confidence in public finances in the long term. Therefore, through the regression analysis that was conducted, it was shown that there is a relationship between the growth of non-oil revenues and the decline in the ratio of public debt to GDP. This reflects the vital importance of these revenues in controlling debt. Consequently, the growth of non-oil revenues enhances the government's ability to finance public investment and important and basic services, which leads to achieving sustainable economic growth, and is reflected in the country's oil level.

Recommendations

The study recommended the need to adopt a fiscal policy that contributes to achieving comprehensive reform by raising the efficiency of tax collection and expanding non-oil revenue sources as a basis for financial sustainability. It is also necessary to restructure the tax system in Iraq to achieve tax justice and reduce reliance on indirect taxes, which greatly impact vulnerable groups. The study also recommends the need to create and develop new revenue sources, such as imposing fees on digital services, and activating the level of returns from government real estate and companies with the private sector. Therefore, it is necessary to enhance and develop the level of transparency in public revenue management and work to improve financial governance to raise the confidence of local and international investors..

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