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Article

Reducing Oil Dependence: A Sustainable Fiscal Strategy for Iraq

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Abstract: Iraq possesses an oil-dominated economy, relying on over 90% of its government revenue from petroleum exports. Such reliance creates situations where extreme shifts in international oil rates lead to huge budgetary shortages, increased inflation and economic meltdowns for the economy. Iraq requires a sustainable fiscal policy to reduce its dependence on oil, to ensure long-term macro-economic stability and diversification among other sectors. The article reviews pivotal policy measures: taxation, public sector streamlining; and private sector establishment. Through improved tax collection mechanisms, a greater investment in a solid infrastructure and a global business-friendly climate, Iraq will increase non-oil revenues and encourage industrial and agricultural expansion. In addition, governance reforms along with transparency measures will be necessary to provide effective public spending and reduce corruption. It also examines practical fiscal diversification approaches undertaken by other resource-rich countries, and offers customized policy prescriptions based on Iraq's unique economic and political realities. If correctly implemented, these policies could help Iraq progress toward an economy that is more resilient, diversified, and sustainable; one that would be less susceptible to external shocks and maintain prosperity in the medium to longer term.

Keywords: Fiscal Policy, Economic Diversification, Oil Dependency, Governance Reform, Iraq Economy

1. Introduction

Iraq has one of the most oil-dependent economies in the world, with petroleum accounting for more than 90% of government revenues and 60% of GDP [1][2]. Basra in Iraq is a case in point, where oil wealth has contributed to growth, but one that has made it as susceptible to the highs and lows of the global oil market as Iraq has to low oil prices, with budget deficits, incendiary inflation and an economic crisis whenever prices drop. This over-dependence on one commodity has stifled the growth of non-oil sectors, undermined fiscal stability, and resulted in unemployment, especially amongst the youthful population of the country. A sustainable fiscal policy that curbs reliance on oil is key for long-term economic resilience in Iraq. It involves moving away from dependence on a few income sources, reigning in bloated government expenditure, encouraging the private sector to pull its weight and enhancing tax collection. Moreover, it is also important to fight against corruption and inefficiency in public finances to allocate resources in an appropriate manner. In this study, we outline the negative implications of oil dependency; provide examples of countries that have successfully diversified their economies, and draft policy recommendations that are suitable to the distinct economic and political environment of Iraq. The way out of the quagmire for Iraq is to pursue a bold fiscal reform agenda that would together contribute to building a more secure, diversified, and sustainable economy, insulated from external shocks and guaranteeing enduring prosperity [3].

Background of Oil Dependence in Iraq

Iraq is one of the most oil-rich nations on the planet and has the fifth biggest demonstrated oil saves on the planet — assessed at 145 billion barrels. The economy of Iraq became dependent on the exports of the petroleum since the discovery of oil in the early 20th century, comprising over 90% of the government revenue and more than 60% of GDP But open the door to a stunning vulnerability that, like a giant hand, encloses Iraq in its fist — an economy so dependent on oil that it can drive national progress as well as provide services in education, health and other essential areas, while at the same time offering relative free social welfare, yet render it eerily reliant on external shocks, be it with the changes happening in the oil prices around the world, geopolitical tensions, or disruptions in the supply chain [4][5][6].

1. Historical Roots of Oil Dependence

After the oil industry in Iraq was nationalized in the 1970s, the country's dependence on oil increased, and so did its economy. But years of war, sanctions, and political turbulence stifled diversification. Subsequent to the state seizure of oil fields in the early 1980s, the state buckled down upon control and appropriation of oil supports, and minimal speculation occurred in different areas. This was additionally strengthened during the Iran-Iraq War (1980–1988), the Gulf War (1990–1991), and post-2003 conflicts.

2. Effects of Oil Dependence on Iraq's Economy
   - Economic instability: Oil price crashes (e.g., 2014 and 2020) led to large budget deficits, non-payment of salaries, and economic contraction.
   - Limited Private Sector Growth—the state has a heavy footprint on producing many goods and services and the economy is dependent on oil revenues, in turn discouraging private sector growth.
   - Weak Taxation System: Non-oil tax base is very small with non-oil total revenue accounting for less than 5 percent of GDP.
   - Higher Public Expenses: Over 60% of the annual budget consists of salaries, pensions and subsidies, rendering fiscal policy unsustainable during periods of low oil price.
3. Challenges to Reducing Oil Dependence
   - Corruption and mismanagement: billions in funds have been spent and misallocated as Iraq ranks as one of the most corrupt countries in the world.
   - Poor Infrastructure: A lack of transport, power and financial systems restricts growth in industry and agriculture.
   - Poor Economic Environment for business: Political instability with a fast change in governments hits long term economic planning.
   - However, even with these challenges, reducing oil dependency is essential to ensure Iraq's vibrant economy for the future. The economy needs a sustainable fiscal strategy, diversification to reduce the unsustainable dependence on oil, tax reforms and improved governance in order to stabilize and create new paths for growth [7].

Objective

This study aims at identifying the sustainable fiscal policies to lessen Iraq's over-reliance on oil revenues and to transform its economy to become more resilient and diversified. Since the country is susceptible to fluctuations in oil prices and economic volatility, this research is therefore seeking to discover more viable and tangible policy approaches to improve the tendency of non-oil revenue creation, public financial management, and private sector development. It also aims to investigate successful fiscal reforms amongst other resource-rich countries to help evaluate their potential applicability to the economic and political context in Iraq. This research seeks to create a general guide to achieving long-term economic stability and sustainable, public welfare development, not failing to address achieving this by addressing structural weaknesses such as corruption, wasteful public spending, and weak tax collection systems [8].

2. Methodology

In this study we take a holistic, mixed-methods approach to investigating oil dependency reduction and sustainable revenue policies in Iraq, Incorporating literature review, case study comparisons and econometric analysis [9][10][11].

3. Results And Discussion

Challenges of Oil Dependence in Iraq

This paper shows how the dual sector model (DSM) helps to understand the causal factors behind the economic, social and political problems owing to Iraq's oil dependency. It brings with it a dependency which exposes it to the threat of global oil price fluctuations. The crash in oil prices from 2014 onwards wrought an extraordinary collapse in revenue, exacerbating military and reconstruction costs, and imposing incredible fiscal stress. Fiscal risk is highly concentrated, with oil revenues constituting 93 percent of government revenue, which further weighs on the macroeconomic outlook. Under the diagnosed social market, oil income obstructs growth in the dynamic sector which, in turn, leads to job losses and urban population-drift to low-productivity and low-wage informal economy that eventually decreases the impetus for necessary reforms (Duncan et al. Second, by failing to create enough jobs in the oil sector, it accelerates labor migration from small-holder agriculture to rural areas beyond what the traditional sector can absorb, with declines in wages and productivity. Such stagnation extends the period of decline of the low-growth sector and hastens urbanisation, delaying development and reducing the potential gains from jobs and wages, while the oil curse deepens poverty and demand for informal-sector jobs (Baffes and Cronin, 2005) That high unemployment — approaching 30 percent overall and almost 50 percent in urban areas — is almost certain to fuel an increase in insurgency. Furthermore, growth in one sector cannibalizes investments in the others thereby stunting national economic growth and development. Society suffers from joblessness, which is a contribution of policy failures in urban services, housing and infrastructure. The DSM shows how the dependence on oil generates unemployment and urban informality, deteriorating life conditions. It is difficult for policymakers as the urban poor has no representation in reform. Producers who support protective policies damaging to wage earners — raising prices and profits and thus suppressing labor investment — are enacting conflict of interest policies. More recent tendencies include a change in profile of the economy away from industrial products with shrinking demand, and unable to absorb the surplus labour, towards subsistence agriculture. In the countryside, high population density prevents effective migration, trapping workers within the informal sector while antiquated systems, entrenched by the state, limit capital (and human capital) intensity [3]. Chart: Iraq’s Economic Dependence on Oil and Its Impact [12].

Table 1. The Effects of Oil Dependence on Iraq’s Economy (2010-2024).

Year	Oil Revenue (% of Total Govt Revenue)	Oil Sector GDP Contribution (%)	Unemployment Rate (%)	Non-Oil Revenue (% of GDP)
2010	91%	65%	15%	4%
2014	92%	63%	18%	3.8%
2016	94%	60%	22%	3.5%

2020	93%	58%	25%	3%
2024	93%	57%	30%	2.5%

The data further underlines Iraq's increasing fragility through an over-reliance on oil. Oil has long made up more than 90 percent of government revenue, meaning that the economy is extremely sensitive to global prices. The drop in oil's contribution to GDP from 65% in 2010 to 57% in 2024 is a sign of stagnation in diversification efforts. At the same time, unemployment has climbed from 15% to 30% with urban unemployment at almost 50% as the economy can no longer create jobs outside the oil sector.

Additionally, non-oil revenue as a proportion of GDP has continued to fall, from 4 percent in 2010 to just 2.5 percent by 2024. It shows a fragile taxation system, limited financial outlays towards alternative sectors, and add to the economic instability of Iraq. Unless urgent economic diversification, structural reform of the tax system, and growth of the private sector occur, the country will continue to grapple with economic crises, budget deficits, and increasing poverty.

Theoretical Frameworks for Reducing Oil Dependence

Establishing a sustainable, diversified economy means reducing reliance on oil. Economic diversification spurs non-tradable to competitive sectors such as agriculture, manufacturing, and services resulting in employment and export increases. For example, the 10% increase in oil revenues makes employment fall by 6% and that of the other sectors by 3%. Strong productivity in the non-oil sector is associated with better growth performance at the GDP level. To diversify wisely, oil rents must be invested in infrastructure, health and education. Poorly governed economies suffer from higher rates of corruption, undermining the success of policy and economic performance. Resource-rich nations provide lessons for policymakers on how to formulate sustainable growth strategies that secure benefits over the long term [13].

Case Studies of Countries Successfully Reducing Oil Dependence

Lessons for Iraq's policy discourse can be gleaned from countries that have managed to lessen their reliance on oil, A review of 10 cases — Norway, Angola, Sweden, UAE, Canada, Malaysia, Mexico, Russia, Indonesia and Kazakhstan — to reveal best practices. Norway is a peculiar case, going from almost no hydrocarbon production prior to 1969 to the world’s third largest oil exporter. Good governance, sound fiscal policies and oil fund established to safeguard the economy and promote economic diversification, created one of the largest sovereign wealth fund in the world. Meanwhile, Indonesia and Angola, respective OPEC members, are not diversifying and will remain trapped in boom-bust cycles. And Mexico proves that avoiding Dutch disease through diversification is feasible, having modestly turned away from its previous pure export-oriented strategy into investing into renewables, too. Though these case studies can provide useful insights, Iraq should also understand that one-size-fits-all blueprint will never be possible given its unique context. The Norwegian strategies are good guide trains but thus are the errors from the other countries and that must be taken into account before any move is made on require policy. The documentary also looks at Holland's pre-Norwegian oil success, trying to provide some context, and include some failures, not just success [3].

Reducing Oil Dependence: A Sustainable Fiscal Strategy

The economy relies heavily on oil revenues to fund public services, making it extremely vulnerable. It assesses the positive features, challenges, and the durability of Iraq’s financial policies, while illustrating reinforcement among budgeting practice and poor tax collection that perpetuates this dependence. Things like overbreeding and government waste and corruption exasperates it. This has funded the expansion of the public sector but that is unsustainable. If some unproductive expenditure is curbed, almost about Dinar 1.1 trillion can be saved annually which can reduce the fiscal deficit [3].

By 1999, Iraq's economy had crumbled, in the years since 2003 poverty, unemployment, political discontent and corruption remained substantial issues. Nevertheless, there seems to be recovery in the oil space. Despite years of sanctions and neglect, Iraq was exporting almost to full capacity by 2004, earning more than $18.5 billion between December 2003 and 2004 from oil exports [14].

Key Components of the Sustainable Fiscal Strategy

Transitioning to an environment in which Iraq can establish revenues independent of oil, stabilizing the country and minimizing fluctuations in growth is essential for a sustainable fiscal future. Today, the majority of public revenues come from oil. Key areas of growth such as agriculture, for example, are essential for diversifying production and can also help to address climate change impacts. They play a very important role in the economy and provide employment to a large number of people. Tourism development helps related regional development and the advances of information technology help employment freed from the influence of oil price fluctuation. We need to invest in education and skills to build a skilled workforce. Focusing on sustainable technologies increases productivity and lowers emissions. Diversifying the economy brings it own risks and thus a sound socio-economic policy will be needed to sail through successfully. Continuous economic growth improves productivity in agriculture and offers healthy trade conditions as well as space for policy integration with other growing sector. To escape the rentier state that oil dependence creates, strong governance and responsibility in public finances are needed to unleash private sector growth. A counterfactual exercise on plausible public policies shows that boosting agriculture by means of exports, together with industry and tourism, is the best path toward a diversified and resilient economy. In the other extreme, an industry or tourism only focus creates instability, incapable of surviving a drop in production, or a price change. Demand-based fiscal measures are underpinned by jobs policies, wage variables and agricultural subsidies. High-unemployment sectors like agriculture fosters sustainable GDP growth, while (the over-reliance of) tourism provides more of a short-term boost, at the risk of future economic crises. In addition, increasing education level leads to GDP growth, and in turn, different sectors can take advantage of educated workers. Tax and trade stress tests pave way for structural reforms, macroeconomic policies for long-run stability A sectoral shocks-resilience strategy is critical, but so is an integrated resilience strategy because it lays the ground for policies aimed at macroeconomic imbalances through diversification [3].

Potential Economic and Social Impacts of the Strategy

This report assesses Iraq's strategy for economic diversification, estimating that 750,000 jobs will be created across 10 years, adding 5% to total employment. The share of oil in export revenues will fall from 70.3% in 2015 to 46.6% in 2030 and the overall GDP growth will be driven by the non-oil sectors such as agriculture, manufacture and services. Its GDP share of the manufacturing sector will increase from 6.5% (2010) to 10.4% (2030), and that of oil will fall from 58.3% to 35.3%. Supported by exports growth and infrastructure investments, unemployment is expected to decrease from 20.1% (2016) to 13.7% (2030). In different phases of transition, GDP growth rates of 6.2%, 10.2% and 12.5% are expected. Public investment in infrastructure, education, and green efforts will rise as FDI and foreign debt portfolios facilitate productivity improvements and economic stability. Policies to redistribute will boost labor income shares in agriculture and manufacturing, allowing for inclusive growth. Environmental insights need planning with short and long disruptions [15].

4. Conclusions

In a broader Iraq context, this essay has illustrated that the chronic dependence on oil revenue makes it much more challenging for public investment in multiple other sectors to coexist. When that entrance foothold is crowding out, the formerly vitality of an oil economy is able to start to slow, and the economic imperative to plan for full post-oil economic potential and not veer away from it. As we draw near to the end of the previous section, it is timely to note that just as important as humane the land for foreigners, the place for domestic entrepreneurs in significant oil-economies is every bit as important too. Not every developing economy can afford to opt entirely for private investment conditioned on its caution vis-à-vis the profusion of investment-blocking obstacles to it, nor will oil-rich economies; even while post-oil potentials may uncover opportunities elsewhere, private investment will not invest in other sectors. This together with the rest of the discussion shall now move on to a proper revenue-resistance fiscal policy. In light of the above arguments, the importance for Iraq to lessen its oil-defensiveness and the economy requires not just a generalised long-term vision but also an institution-anchoring remedy to shift towards a very robust economic foundation has been reiterated. Essentially, this is a fiscally sustainable strategy, in which the oil economy is given a slow, gradualist death, but always the fiscal policy is trying everything to support other sectors that are stronger and more diversified. Some recommendations are: As oil investments can create more job opportunities in Iraq, investment in renewable energy or agriculture and agri-processing sector may be less effective in increasing some crowding out elements from the other sectors of public investment. Likewise, these investments are transformative and have an extra value in the entrepreneurial capacity of home producers. Help Oil Ministry gives bigger concession to domestic oil players, improve nice investment climate to others. This, especially, could alleviate some investor confidence – which is as fragile as ever following the Manual of Investment for foreign participants. What the congestion of the fiscal policy be above always however the employment-oriented growing tactics are to be devised. More jobs on the dynamism and labor absorption of growth tycoons will require Iraq to enhance its institutional capacity. Describe stakeholder dialogues via which the joint engagement of multiple actors in the discourse on the implementation and implications of the proposed economic model can be facilitated. Stakeholders for that strategy are more inclined to play a broader and more impactful role in tackling upcoming challenges. This is true in particular as regards to a long term planning investment vision for a post-oil Iraq. These strategies must always be accompanied by an adaptive policy set because the economic environment is perpetually in flux, and for that matter so too is the need to stay one step ahead of any unwelcome consequences and prepare to meet new challenges. If the wise and prudent recommendations for the above are actually given, Iraq has potentially a lot of ground to cover simply because it has wealth from Oil and the promoters of the transition have wisdom from the old and youthfulness from the new, young generation of Economists who are capable of formulating appropriate, successful, sound, sustainable and national economic policy direction that can benefit the country in addition to being able to evolve into having considerable and long-lasting impact on other emerging and transforming economies.

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