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# Oil Economics and its Impact on Economic Development

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**Abstract**

The purpose of this research paper is to investigate the significant impact of the oil industry on the process of economic development in Iraq for the period (2010-2024) in light of the predominance of oil receipts as the almost sole means of financing the budget of the country. In the research work, the descriptive-analytical approach will be used in order to explore trends in oil production, exports, and receipts in connection with macroeconomic dynamics in terms of Gross Domestic Product (GDP). According to the results, there is an evident correlation between changes in oil prices and economic growth in Iraq as a rentier economy with structural weaknesses and weak contribution of non-oil industries. It is proved that increasing the quantitative indicators of oil production does not contribute to sustainable development due to the focus of government expenditures on current expenses and not on investments. As a result, there is no correlation between GDP growth and social welfare. In conclusion, it is necessary to diminish the automatism in dependence of economic indicators from oil rents through diversification of the economy.

## 1. Introduction

Oil is one of the main sources of economic resources affecting the economies of many nations, due to its contribution to creating income generation and financing economic activities and development projects. The revenues earned from oil have become the main source of financing budgets in many countries producing oil, thus making such economies very sensitive to events taking place in the international market of oil, including the price, demand, and supply [1]. It is clear that the significance of oil is more prominent in the case of Iraq, which is considered as the main source of revenues for the state budget and plays a major role in financing expenditures, investments, and development projects. Even though there are financial gains resulting from the wealth of oil, the heavy dependency on oil has made the Iraqi economy vulnerable to external changes, especially in light of the lack of contributions from other economic sectors to GDP. Weakness in economic diversification and dependency on oil revenues are considered as one of the main challenges facing the Iraqi economy [25].

The significance of oil does not just depend on the amount of income generated from oil but also involves the way this income is used to develop the economy. The use of income from oil production in industry, agriculture, infrastructure, and education, in addition to giving strength to the private sector, can help create a more diverse economy and lower the influence of changes in oil prices on the economy [3]. Therefore, the current research considers oil economics and its influence on economic development in Iraq through studying the role of the oil sector in the national economy and implications of oil income for economic development and investments, along with the main difficulties involved in the exploitation of oil wealth to reach economic development. In spite of the abundant oil resources and the creation of financial income that plays an important role in financing the public budget and stimulating economic activities in the country, the high level of reliance on oil remains among the main problems for economic development of Iraq. According to the Iraqi economic practice, the increase of the oil income does not always result in the balanced economic development due to the lack of diversification of income sources, insignificant contribution from non-oil productive industries, and influence of the international oil price changes [2].

The research question is how to make use of the oil income for the purpose of achieving sustainable economic growth, developing productive industries, creating job opportunities, and improving the living standards in Iraq instead of being dependent on oil income. Therefore, this paper examines the connection between oil economics and economic development in Iraq and analyzes the positive and negative impacts of oil dependency on the economy of the country. The main research question is related to what is the impact of oil economics on economic development in Iraq, and to what extent do oil revenues contribute to achieving balanced and sustainable economic growth?

The importance of this research is due to the fact that the main factor influencing the Iraqi economy is oil. This is a fundamental resource, which is the basis for covering all expenditures of the country and implementation of economic

and service projects. The research will try to evaluate the influence of the oil revenues on the economic development and possibilities of using the oil wealth for the economic diversification. Revealing the correlation between oil economics and economic development, describing the influence of oil prices and revenues on the economic indicators of the country and making a contribution into the research of oil-dependent economies and rentier economies. From practical perspective, getting results that could be useful for revealing the problems of the oil-dependency and showing the necessity of spending oil revenues on productive purposes, such as industrial, agricultural and infrastructural spheres. The research pursues the following objectives:

1. Determining the present situation in the oil industry and its significance to the Iraqi economy.
2. Conveying the role of oil revenues in funding the national budget and economic activities.
3. Making analysis on the influence of oil price changes on economic growth and financial stability in Iraq.
4. Estimating the degree of using oil revenues in developing productive and economic sectors.
5. Determining the main problems associated with the dependence of the Iraqi economy on oil.
6. Determining the correct approaches to the use of oil riches in order to achieve economic diversification and sustainable development.

### 1.1 Research Hypothesis

In the present research, it is supposed that high dependence on oil revenues influences negatively on the vulnerability of the economic development path in Iraq due to the changes in oil prices; the efficiency of allocating oil revenues to productive sectors is an important condition for economic diversification and sustainable development.

### 1.2 Research Methodology

The descriptive-analytic method of investigation is used for the purpose of the study, and it is suitable for the subject of investigation. Through such methodology, the current state of oil economics of Iraq can be described and its significance to the economy of the country can be made clear as well as its impact on the indicators of economic development due to the oil income and its prices.

### 1.3 Research Scope

This study is conducted in the Republic of Iraq, with particular attention to the status of the oil sector and its implications for the national economy. The period (2010–2024), in order to track developments in the oil sector and oil revenues and analyze their impact on economic development. Oil economics in terms of production, exports, prices, and revenues, and their implications for economic growth, investment, productive sectors, and sustainable development in Iraq.

## 2. The Theoretical Framework of Oil Economics and Economic Development

Among the natural resources, which played an important role in forming the global economy, oil should be noted due to its importance as the major resource for providing energy, conducting business and industry activities, supporting international trade, and bringing incomes to the countries producing oil. This resource is especially important for those countries whose economy is mostly dependent on oil export because their economic conditions depend on the level of production, export volume, and oil price [1]. The significance of oil economics research is especially great for Iraq owing to the major part played by this resource in financing the state budget and earning foreign currency. Although this natural resource provides a lot of financial benefits, its conversion into development of the national economy requires proper management of incomes and investments in production and other spheres of the economy [2].

### 2.1 The Concept of Oil and Its Economic Importance

Oil is one of the most strategic and economic resources. Its role has increased greatly as a result of the expanding uses of the resource in the fields of energy, transport, and industrialization. The significance of this resource is not only because of its role as a source of energy that can be used for transport and power plants. It is also used in petrochemical industries for manufacturing plastic, fertilizers, and others. Thus, oil is a key resource in production and international trade and a resource whose prices influence costs and economic activities [1].

In addition to being the main energy provider for export earnings, oil may also affect the structure of economies through its effect on the allocation of resources among productive sectors. If there is a sharp rise in oil exports, it may lead to the creation of an extra demand in the economy and channel more resources towards the extraction industry as well as other non-tradeable sectors, thus decreasing the competitiveness of other productive sectors such as manufacturing and agriculture. Such situation is called Dutch disease and demonstrates how natural resource abundance may create structural problems due to lack of diversification policies [12].

It is equally significant that the oil sector is very capital-intensive and its capability to create employment opportunities is rather constrained than other industries. Large number of financial resources, sophisticated technologies, and special skills are needed for oil exploration and production. Thus, an increase in oil production can bring substantial benefits to

the national economy without creating enough job opportunities at the same time. IMF highlights that energy industry in the oil-exporting Arab states is very capital-intensive and unable to create enough job opportunities for increasing population of workers. This problem concerns Iraq specifically, since public sector employment accounts for a large portion of the country's overall employment. In order to gain more developmental advantages from oil resources, their benefits should be partially directed at labor-intensive areas such as manufacturing, agriculture, and private services [4].

In economic terms, oil is an important resource from the point of view of finance. Producing countries get money from the exports of the resource to international markets. Money can then be used in financing government budget, investment plans, and development plans. Oil is a source of foreign exchange, which helps the exporting countries in financing their importations of goods and services. Thus, oil should not be considered just as a commercial resource [2].

The fluctuations in the oil price have economic implications for resource-based economies in several ways including the impact on revenue, expenditure, investment, and economy. When international oil prices go up, this results in higher government expenditure and investments, while lower international oil prices lead to lower government revenue and, consequently, lower expenditure and investment. Procyclical fiscal policies tend to arise in such a situation as the government expenditure is correlated with the international oil prices. The research conducted by Bova et al. reveals the existence of procyclical fiscal policies in resource-rich countries due to government expenditure, and fluctuations in commodity prices can have a significant impact on fiscal revenue [5].

Oil prices are known for exhibiting high levels of volatility depending on the state of the global supply and demand. In terms of supply, oil prices in the international market are affected by decisions made regarding oil production, geopolitics, disruptions in oil production, as well as availability of oil reserves and inventories. With regard to demand, global economic growth, industrial output, and transportation needs may determine consumption of oil in the global market. All these dynamics take place in the international oil market thus making it hard to make predictions about oil prices, and posing risks for oil-exporting countries due to external revenue fluctuations. According to U.S. Energy Information Administration, some of the most important determinants of crude oil prices are short-term supply and demand dynamics along with geopolitics and inventories [6].

There are different factors influencing the oil market, including the demand level across the world, the level of production in oil-exporting countries, politics and security, as well as economic events in the global economy. All these factors influence the oil price and, thus, revenues of oil-exporting countries. According to the International Monetary Fund, oil-price volatility and the inability to forecast the future trend is a serious problem in managing fiscal policies in oil-dependent countries, especially when the expenditures are linked to revenues [17].

The susceptibility of the economy to the changes is higher if the oil revenues account for the main sources of finance for the budget. When the prices are high, the volume of funds is increased and spending on different programs and services can be increased as well. At the same time, low prices reduce the volume of revenue and budget constraints occur. In case some expenditures cannot be reduced in the short-term period, bigger deficits, delayed investments, or borrowings occur [7]. The significance of the management of oil revenue becomes even more clear when the example of Iraq is taken into consideration. According to the International Monetary Fund, the oil sales revenue in the period of 2003 to 2018 amounted to more than USD 850 billion. Yet, poor governance, public financial management issues and lack of institutional capacity caused significant portions of these revenues to be used for current expenditure instead of being invested in human and physical capital development [7].

It clearly shows that just having oil resources and making huge revenues from them is not enough, per se, for economic growth. It depends on what kind of policies will be used for the management of these revenues. The use of oil revenues for the development of infrastructure and productive projects could contribute to more stable economic base formation [7]. Sachs and Warner conducted a study of the link between natural-resource endowment and economic growth. Economies that had higher ratios of natural-resources exports to GDP grew more slowly in 1971–1989 than some other countries which were less dependent on such resources. It was noted by Sachs and Warner that such connection persisted even when controlling for such variables as trade policy, government efficiency, and investment [8].

However, this evidence does not imply that natural resources necessarily retard growth. On the contrary, it means that there is no certainty that natural resources will lead to positive results. The influence of the country's oil wealth depends on how successfully the state can manage its resources, diversify its activities, and make its institutions and policies efficient [8]. This question is especially important for Iraq due to its high reliance on the role of oil in the generation of its state income. It was estimated by the International Monetary Fund that approximately 92% of budget revenues from Iraq were provided by oil revenues in 2018 [7], demonstrating the lack of diversification of sources of budget revenues. Another economic aspect of oil is its impact on the creation of balance of payments and the financial position of the external sector of oil exporting countries. The export of oil brings considerable income in the form of foreign currency, which helps to pay for imports and to increase foreign exchange reserves and overall international financial position of the country. Excessive reliance on oil exports makes the external sector of the country vulnerable to changes in international oil prices. The fall of oil prices will lead to lower export income and will create difficulties in maintaining foreign exchange reserves in case of high imports and the lack of other foreign currency sources [2]. Therefore, not only should the importance of the role of oil be assessed in terms of revenues, but also in the state's capacity to invest these revenues in order to boost production, job creation, and increase of welfare [7].

### 2.2 The Concept of Economic Development and Its Relationship with Oil

"Economic development involves an ongoing process that tries to improve economic and social conditions in society through increases in productive capacity, economic sector development, improvements in standards of living, and creation of more employment opportunities. This is not only about increasing GDP or per capita income but about how much the people have been benefiting from what is available to them in terms of essential services and opportunities in education, jobs, and health care,". Economic development includes more aspects than growth, while the latter is a mere quantitative increase in output. Economic development involves qualitative changes in economy, society, and structure [9] [10].

The difference between economic growth and economic development is significant in analyzing the performance of economies that depend on natural resources. Economic growth basically entails the growth in the level of economic production in terms of increases in real Gross Domestic Product (GDP), while economic development encompasses a wider concept that includes changes in the standards of living, employment possibilities, income distribution, poverty levels, and structural changes in the economy. Hence, an increase in the national income is not sufficient to conclude that the benefits of economic progress have been shared by all members of society. As per Todaro and Smith, development should be analyzed in terms of economic performance and changes in social and institutional factors that affect the welfare of people [10].

The United Nations Development Programme introduced a human development approach that was based on enlarging people's choices and putting their well-being into the focus of development process. There were defined three basic dimensions: longevity of life, acquisition of knowledge, and access to sufficient resources for decent living. Income is very significant for improvement of well-being of people, but it is not the final goal of development process, [9].

When assessing economic development, one needs to consider the set of indicators which are not confined to the national income and GDP growth. The Human Development Index (HDI), created by the United Nations Development Program, is an example of a more complex measure used for development assessment and consists of three key dimensions: long and healthy life, knowledge, and decent standard of living. Each dimension corresponds to specific indicators, which include life expectancy, education, and gross national income per capita. This system of indicators allows differentiating between the growth of national wealth and the improvement of the quality of people’s life. In oil-based economies, this measure is especially relevant since high oil revenues may lead to growth in national income without bringing corresponding benefits in terms of health, education, and standard of living [9].

The theory of the Resource Curse helps to shed light on the puzzling issue of how nations endowed with rich natural resources might have less diversification of their economy and lower sustainability of economic growth in comparison with nations with limited natural resources. This phenomenon may occur when the government relies excessively on the revenues obtained from the exploitation of natural resources, and there is little motivation for the creation of new sources of income and economic development. Besides, reliance on oil exports can make national economies vulnerable to the impact of external changes in prices, as well as generate institutional and structural problems. the thesis of the resource curse in order to account for the distortion effects of mineral wealth on economic development in the case where the proper economic policies are not developed [11].

Finally, the concept of the Dutch Disease offers another way to understand the difficulties encountered by those economies which rely on the export of natural resources. An increase in oil revenues leads to a significant inflow of foreign currency, which in turn can lead to an increase in the real exchange rate, meaning that domestically produced products become more expensive relative to imported products. Moreover, the development of the oil industry may cause diversion of capital and talent to the oil industry at the expense of other industries. This could decrease the competitiveness of other industries, especially manufacturing and agricultural, and lead to greater import dependency. the boom in the extraction industry can be the reason for pressure on traded goods industries and even de-industrialization [12]. This approach is also useful in the case of Iraq [13].

Management of oil revenue is a critical aspect that determines whether the natural resource wealth will play any role in promoting sustainable economic development. This is because oil is a non-renewable resource, whose revenues are highly variable, depending on the market situation. In order to promote sustainable economic development, the government needs to strike a balance between consumption and savings and investment. Over-dependence on oil revenue to finance recurrent expenditure can be detrimental to long-term development and exposes public finance to sharp reductions in the price of oil. As such, a good fiscal policy framework should strive to stabilize public expenditure, save, and invest a reasonable portion of oil revenue in productive activities. This includes investing in infrastructures, health, education, and other productive activities in order to increase productive capacity of the economy. IMF highlights the need for resource-abundant countries to convert their diminishing natural resource wealth into productive assets [7].

Economic development involves investment in both physical and human capital, infrastructure development, institutional improvement and encouragement of production activities. It also entails channeling of funds towards projects that enhance production capabilities and create jobs as opposed to increasing expenditure without an equivalent level of production [10].

The link between oil and economic development may prove positive in situations where money from oil production is channeled towards projects necessary for the growth of the economy. The money can be used in construction of transport

networks, electricity networks, water supply systems, educational institutions, hospitals and investments in industries and agriculture. Oil money can also help to bring in new technology and equipment, train the workforce and improve the investment climate [2]. Such benefits are not automatic. Excess reliance on oil may lead to reduced interest in other sectors of the economy and make expenditure the main driver of activities. Drop in prices of oil may reduce funds available for undertaking such projects. Therefore, reliance on one source of income makes one vulnerable to external shocks [2].

According to the World Bank, the Iraqi economy recorded a growth rate of 7% per year, on average, during 2007–2012. In addition, the reduction in poverty during the same period was modest. The source of growth was mainly due to the development of the mining and oil sector, accounting for almost half of GDP and much of the government revenue and exports, providing a small share of employment [14]. The above figures show that there is a difference between the growth rate of the economy and its effects on job creation and social welfare. While the increase in the amount of oil production results in an increase in GDP, it is not necessarily accompanied by job creation, which is proportional to the increase in production, since the oil industry is a capital-intensive industry that uses advanced technology and huge investments. Thus, development involves channeling some oil revenue into industries capable of absorbing labor [4].

Volatility of public income due to fluctuations in oil prices is another issue in oil-exporting countries. If the prices are rising, then the government tends to increase its spending, and if the prices are falling, then the government finds it difficult to maintain the same level of spending. According to the International Monetary Fund, oil price volatility makes the fiscal policy of Iraq susceptible to exogenous factors [7]. Economic diversification entails an expansion of the industrial base and diversification of the sources of income and exports in such a way that the economy will not remain hostage to one single industry. Economic diversification does not entail giving up the oil sector; rather, it involves using the oil wealth to develop other economic sectors [10].

Diversification should involve improved investment climate, development of infrastructure, development of the private sector, financing of productive ventures, and matching education and training to labor market demands. Diversification will also involve putting emphasis on productive ventures that help earn sustainable incomes. According to the IMF, financial buffers and expenditure rules have to be adopted to lessen the effect of oil revenue volatility and preserve investments spending during times of falling prices [7]. Thus, it can be said that the connection between oil and economic development in Iraq relies on how efficient the resource management is. Oil brings considerable financial resources that could be used for development, service provision, and infrastructure development. However, dependency on oil without diversification of income and production sources could prevent an economy from achieving sustainable growth. The problem is how to provide for current demands and develop a productive base at the same time.

### 2.3 The Status of Oil Economics in Iraq (2010–2024)

Oil occupies a central position in the Iraqi economy. The state depends on it to generate most public revenues, finance government expenditure, provide foreign currency, and support foreign trade. During 2010–2024, the oil sector experienced changes in production, exports, and revenues, influenced by production capacity, economic and security conditions, oil-price fluctuations, and global demand [15].

#### 2.3.1 Developments in Oil Production, Exports, and Revenues

#### a. Developments in Crude Oil Production

Crude oil production in Iraq followed an upward trend during most of the study period, owing to the expansion of extraction operations and the development of several oil fields. Table 1 illustrates production developments [16].

**Table (1): Development of Crude Oil Production in Iraq (2010–2024)**

| Year | Production (million barrels/day) | Year | Production (million barrels/day) |
|---|---|---|---|
| 2010 | 2.359 | 2018 | 4.410 |
| 2011 | 2.359 | 2019 | 4.576 |
| 2012 | 2.942 | 2020 | 3.998 |
| 2013 | 2.980 | 2021 | 3.971 |
| 2014 | 3.110 | 2022 | 4.453 |
| 2015 | 3.744 | 2023 | 4.118 |
| 2016 | 4.164 | 2024 | 3.862 |
| 2017 | 4.469 | | |

*Source: Organization of the Petroleum Exporting Countries (OPEC), Annual Statistical Reports, various issues.*

The chart shows an upward slope in crude oil production in Iraq, which has increased from 2.359 million barrels per day in 2010 to its highest of 4.576 million barrels per day in 2019. This is due to the increased investments in oil fields development post-2003. There was a decline in production to 3.998 million barrels per day in 2020 due to the outbreak of the coronavirus disease and the resultant reduction in global demand. However, there has been recovery of production up to 4.453 million barrels per day in 2022 before declining to 3.862 million barrels per day in 2024. Development perspective indicates that the country is highly dependent on exporting vast amounts of oil without developing any industries that will make use of oil resources and add more value to their economy [15].

**b. Developments in Crude Oil Exports**

Oil exports are the primary source of foreign revenues and are linked to production levels, international demand, and decisions aimed at regulating the oil market [15].

Table (2): Development of Iraqi Crude Oil Exports (2010–2024)

| **Year** | Exports (million barrels/day) | Year | Exports (million barrels/day) |
|---|---|---|---|
| 2010 | 1.890 | 2018 | 3.444 |
| 2011 | 2.166 | 2019 | 3.524 |
| 2012 | 2.423 | 2020 | 3.029 |
| 2013 | 2.390 | 2021 | 3.018 |
| 2014 | 2.515 | 2022 | 3.317 |
| 2015 | 3.004 | 2023 | 3.422 |
| 2016 | 3.803 | 2024 | 3.313 |
| 2017 | 3.802 | | |

*Source: Organization of the Petroleum Exporting Countries (OPEC), Annual Statistical Reports, various issues.*

The exports were similar to production, amounting to about 3.313 million barrels a day in 2024 and 1.890 million barrels a day in 2010. The narrow difference in production and exports is indicative of low capabilities for local refinement and may help explain the dependence on imports of oil derivatives like gasoline, despite the fact that the country remains a major crude-oil exporter.

This type of economic arrangement increases the level of dependency and leads to foreign currency outflows needed to cover imports of energy resources. Redirecting more oil resources for local processing can satisfy local needs and allow exports of additional oil derivatives with higher added value [12].

**c. Oil Revenues and Their Contribution to Total Public Revenues**

Oil revenues are the primary source of financing the public budget in Iraq, making the country's fiscal position highly dependent on oil prices and export volumes.

Table (3): Oil Revenues and Their Share of Total Public Revenues (2010–2024)

| Year | Oil revenues (trillion IQD) | Total revenues (trillion IQD) | Oil share (%) |
|---|---|---|---|
| 2010 | 61.7 | 70.8 | 87.1 |
| 2011 | 97.9 | 108.7 | 90.1 |
| 2012 | 111.0 | 121.3 | 91.5 |
| 2013 | 105.4 | 115.2 | 91.5 |
| 2014 | 99.5 | 117.3 | 84.7 |
| 2015 | 58.1 | 71.9 | 80.7 |
| 2016 | 51.5 | 53.0 | 97.3 |
| 2017 | 70.3 | 76.8 | 91.5 |
| 2018 | 99.3 | 105.7 | 93.9 |
| 2019 | 94.2 | 107.4 | 87.7 |
| 2020 | 52.1 | 62.6 | 83.2 |
| 2021 | 77.5 | 88.8 | 87.3 |
| 2022 | 125.0 | 131.6 | 95.0 |
| 2023 | 112.5 | 121.3 | 92.7 |
| 2024 | 127.53 | 140.77 | 91.0 |

*Source: Central Bank of Iraq, Annual Statistical Bulletin, various issues (2010–2024).*

The table presents the overwhelming dependence on oil in the state budget of Iraq for the period 2010-2024. The percentage of oil was varying from 80.7% in 2015 to 97.3% in 2016, staying above 88% for the majority of years and reaching 91% in 2024. These data suggest the high sensitivity of the Iraqi budget to changes in the world oil market. The maximum percentage of oil in 2016 did not mean at all the particularly good state of this industry, but rather the collapse of revenue sources outside of oil and the inability of the tax system to collect funds in any other way. It confirms the idea of the resource curse, according to which the ease of resource collection can hamper development of agriculture, industry, tourism [11].

**d. Developments in Gross Domestic Product and Oil Prices**

The performance of the Iraqi economy is closely related to oil-price developments because oil revenues play a major role in financing public expenditure and economic activity.

Table (4): Gross Domestic Product and Iraqi Oil Prices (2010–2024)

| Year | GDP (USD billion) | Iraqi oil price (USD/barrel) |
|---|---|---|

| | | |
|---|---|---|
| 2010 | 138.462 | 79.5 |
| 2011 | 185.471 | 106.5 |
| 2012 | 217.810 | 107.3 |
| 2013 | 234.652 | 106.0 |
| 2014 | 234.658 | 97.7 |
| 2015 | 177.500 | 51.7 |
| 2016 | 174.902 | 43.2 |
| 2017 | 195.472 | 53.1 |
| 2018 | 224.232 | 69.8 |
| 2019 | 234.092 | 64.0 |
| 2020 | 207.860 | 41.5 |
| 2021 | 207.691 | 69.8 |
| 2022 | 264.182 | 95.0 |
| 2023 | 253.881 | 78.5 |
| 2024 | 276.206 | 80.6 |

*Source: Central Bank of Iraq, Annual Statistical Bulletin, various issues (2010–2024).*

There is a positive correlation between oil prices and GDP between 2010 and 2024 in the table provided. In 2022, the country's GDP was recorded at USD 264.182 billion, when the oil price was USD 95 per barrel. On the other hand, in 2016, GDP dropped to USD 174.902 billion when the price of oil went down to USD 43.2. Subsequently, GDP increased to approximately USD 276.2 billion in 2024, when the oil price went down to USD 80.6 per barrel.

From the data provided, it is clear that the economy of Iraq is significantly affected by changes in the price of oil in the global market. Nevertheless, it is not enough to prove that there is a causal relationship between the two factors or for one to be able to conclude that economic growth in Iraq is nominal. This is because Iraq is heavily dependent on its oil revenues, thus exposing national income and government spending to elements beyond the control of policymakers [19].

### 2.3.2 The Importance of Oil to the Iraqi Economy and the Challenges Facing It

The oil industry plays an essential role in the Iraqi economy in view of financing the budget of the country, serving as the source of foreign currency, ensuring international transactions, and enabling the government to fund public projects and programs. Oil revenues affect other industries via government spending, driving development in trade, transport, construction, and services sectors. Nevertheless, developmental outcomes are contingent on the efficiency of government revenue allocation and its contribution to enhancing the domestic production capacity.

The Iraqi economy suffers from structural problems due to low diversity of public revenues and the poor contribution of non-oil assets. This makes the budget vulnerable to price changes, as low prices or reduced export volumes lead to the decline in the size of available funds for spending and investment. According to the International Monetary Fund, the oil price necessary to balance the budget of Iraq increased to around USD 84 per barrel in 2024, against USD 54 in 2020 because of the rise in spending and poor growth in non-oil revenues [17].

There are also some technological and administrative problems related to infrastructure, efficiency of production and processing, transport and storage, utilization of associated gas, transparency, and management of natural resources and contracts that oil industry encounters. To resolve these issues, more efficient management of this sector and some share of its revenues to be invested in development of other economic sectors is needed [18]. In this way, the significance of the oil industry is defined not only by its revenues but also by the ability of the state to transform them into investments and human capital.

### 2.3.3 The Implications of the Oil Sector for Economic Development in Iraq

The impact of the oil sector on the Iraqi economy is not determined solely by production or revenue volumes. It also depends on how revenues are transmitted to other economic activities and reflected in development indicators. Oil revenues finance government expenditure, but their developmental impact varies according to resource-management efficiency, investment quality, and the ability of economic sectors to transform expenditure into production, employment, and improved public services [13].

#### 2.3.3.1 The Implications of Oil Revenues for Economic and Investment Performance

**a. The Impact of Oil Revenues on Economic Growth**

The effect of oil revenue on Iraqi economic growth occurs via the financing of the state budget. The revenues obtained from oil exports are used in the execution of expenditure programs, in the work of public institutions and in project funding. Their influence on other economic activities happens via the demand for goods and services and development of trade, transport, construction, and other industries. If it is not supplemented by increased local production, the effect will be limited due to the increase in imports [20].

Non-oil GDP growth in Iraq, according to the International Monetary Fund, declined from 13.8% in 2023 to about 2.5% in 2024 due to reduced public investment, deteriorated trade balance, and constrained financing leading to accumulated payment arrears. They prove that high oil revenues do not automatically mean non-oil economic growth, unless the conditions for the investment and production of local products exist [20].

Thus, apart from the amount of expenditure that can be financed from the oil revenue, one needs to look at how the expenditure boosts GDP, enhances productivity, and creates economic activities. When growth is financed through spending, then the decline in revenue will lead to reduced growth, unlike when growth is financed by building productive capacity through spending [12].

**b. The Impact of Oil Revenues on Public Investment and Capital Formation**

Public investment is one of the ways by which revenue from oil can be translated into sustainable development through investment in infrastructure such as transport, energy, water, and telecommunications. Such investments are necessary in providing basic services, reducing the cost of production, facilitating the movement of goods and people, and creating a conducive environment for private sector investment [14].

Developmental outcomes of investments will not only depend on the resources devoted to such investments but also on the selection of the projects, efficient implementation of such projects, adherence to schedules, and ability to make economic and social gains. The International Monetary Fund has stressed the need to protect non-oil capital expenditure especially in transport, commerce, electricity modernization, and gas developments due to their importance in improving economic efficiency and productive capacity.

Productive investment of oil revenue thus becomes significant provided that such projects are evaluated, monitored, and based on the needs of the economy. Efficient public investment may also provide opportunities for private sectors to invest [15].

**c. The Impact of Oil on Employment Opportunities and Living Standards**

Activities involving oil have an effect on the labor market both directly through employment opportunities created in extracting, transporting, refining, and other related services, and indirectly through government expenditure supporting economic and service activity. However, the capacity of the oil industry to create employment on a large scale is constrained in relation to the size of the labor force. Development of other sectors becomes a necessity in order to increase employment [23].

Expenditure on quality services and the provision of services to the targeted individuals, in addition to linkages between social expenditure and employment-enhancing policies, may lead to improved living standards through oil revenues. According to the International Monetary Fund, labor market reforms, vocational training, and good business environment contribute to non-oil growth and employment in Iraq [4].

The social impact of oil wealth should consequently be measured not only by government expenditure but by tangible improvements in employment, service quality, purchasing power, and living conditions.

**2.3.4 Strengthening the Developmental Impact of Oil Wealth in Iraq**

**a. Improving the Efficiency of Public Expenditure Management**

Achieving maximum developmental benefits from oil revenues will require improvements in budgeting process and implementation so that the financial decisions made will be based on economic priorities rather than the revenues available in that year. Some of the actions that will be necessary include focusing on projects with positive returns, improvement in procurement and contracting processes, enhancing implementation monitoring, and decreasing delays and financial inefficiencies [14].

This is especially critical in consideration of the findings of the International Monetary Fund regarding the fiscal risks associated with expenditure growth, decline in revenues from oil, and arrears that have accrued over time. Some of the recommendations have been improving public financial management and expenditure efficiency in order to minimize the risks [17].

The establishment of a medium-term fiscal framework to control expenditures in case of changes in oil revenues and to avoid any permanent obligations due to temporary increase in prices will also be critical [16].

**b. Increasing the Contribution of Non-Oil Sectors to GDP**

In order to achieve a sustainable developmental impact of oil wealth, a portion of it should be used for activities that will create goods and services and provide job opportunities. Manufacturing, agriculture development, SMEs development, and expansion of productive services will lead to an increase in value added and reduce the degree of import dependency [13].

All this needs a good investment climate with better infrastructure, more convenient administration, improved banking, increased access to funding, and better professional and technical skills. According to the International Monetary Fund, reform of governance, business climate, financial system, and labor market will improve the growth prospects of Iraq's non-oil economy and enhance the private sector [20].

Diversification does not imply the reduction in the significance of oil industry but implies the use of oil resources for building complementary productive sectors, which will allow using oil wealth for economic base development and not its sole financing [21].

### c. Strengthening Economic and Institutional Sustainability in Oil Resource Management

Economic sustainability would involve managing oil reserves from a vision that would respect the rights of future generations and be able to balance the need for funding now and in the future. It would entail the development of greater transparency in the handling of oil revenues and contract obligations, better oversight and accountability, more efficient planning and implementation institutions, and investment in projects with concrete outcomes [17].

The development of the energy sector is equally crucial. This entails increasing efficiency in production and refining processes, developing infrastructure related to energy, using natural gas, and decreasing dependency on foreign gas. The International Monetary Fund has highlighted developing gas reserves and updating electricity supply as means of improving energy security and efficiency along with other necessary reforms [17].

Sustainability thus cannot just depend on the availability of oil revenues but also on the institution's ability to manage them in an efficient way and use them as productive resources, services, and human capital. Efficient economic and institutional management will help to increase Iraq's capability to use oil resources in sustainable development [24].

## 3. Research Findings

The results show the dominant presence of the oil industry in the country's fiscal system. The contribution of oil revenues to public finance is the highest among all other revenues throughout the whole period of the research, which means that the budget is extremely vulnerable to external factors and does not allow long-run fiscal planning. It confirms the rentier state theory according to which lack of accountability is associated with reliance on external rents rather than tax. It was found out that there is a strong numerical and cyclical link between oil prices and the country's GDP. The country's economic performance usually decreases if prices go down and vice versa. It demonstrates the country's dependence on the international market of oil and lack of productivity and innovations in other industries. Increases in oil production and its exports do not lead to a significant gap between these indicators since domestic refinery is underdeveloped. Iraq continues to export crude oil, but imports refined one losing the value addition.

The highest level of dependence on oil, especially in 2016, is not evidence of a particularly strong oil sector. It also indicates a dramatic drop in the level of income from sources other than oil and weak tax collection infrastructure. It helps prove the theory of a resource curse and shows the necessity to diversify the economy and increase incentives for reforms. High specialization of the oil sector leads to its inability to provide jobs in significant amounts. It contributes to the discrepancy between GDP growth and creation of new jobs and shows the necessity to optimize resource distribution and enhance the ways of using oil wealth for improving the welfare of the population, especially those who are vulnerable. The analysis shows the poor conversion of oil revenues into sustainable investments. The government spending showed great emphasis on consumption and public transfers rather than on investments in human and physical capital. It led to the lack of development of stabilizing financial mechanisms and made economic indicators susceptible to the global cycle.

## 4. Recommendations

The Iraqi government needs to shift from its current policy of crisis management to a fiscal structural rule which links the level of expenditures to medium-term revenue forecasts and not current revenues. There is need for an independent sovereign wealth fund which has a proper framework and is established to manage any surplus arising from oil during times when prices are high. There is need for restructuring of the public expenditure priorities where subsidies and over expenditure are reduced and instead, investments made in essential sectors like infrastructure development and provision of services. There is need for strict efficiency standards for the implementation of such projects so that there is productive use of oil revenues.

There is need for a national diversification strategy which will focus on tax and financial incentives in sectors which have comparative advantages like agriculture, manufacturing and tourism. There is also need for partnerships with the private sector in order for it to create national income and employment. There is need to enhance the fiscal capacity of the country through tax reforms and improved revenue collection such that more revenues come from the non-oil producing sectors of the economy. It will foster the fiscal connection between the citizens and the government while at the same time encouraging better service delivery.

The domestic energy industry can be enhanced through a coordinated approach that entails the construction of new refineries, upgrading of the already existing facilities as well as the exploitation of the associated gas for the generation of power and industrial manufacturing process. The objective is to lower the cost of petroleum products imports and at the same time be able to export high value-added products. The good governance in the management of the oil contracts and revenues will entail activation of parliamentary and public supervision as well as the adoption of international financial disclosure standards. Such measures will facilitate the allocation of oil revenues towards sustainable development goals as well as prevent corruption that acts as the main impediment to sustainable development.

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***Declaration***

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