

Structural Distortions in the Iraqi Economy

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Abstract

The Iraqi economy relies heavily on the oil sector, with low contribution rates for other economic sectors to the GDP. Of course, this indicates fragility and weakness in the production structure due to the increasing dependence on the only rent resource, which is the oil sector, and this made it vulnerable to changes in prices supplier globally. The importance of the research comes from the fact that the conditions and wars had a clear impact on the collapse of the real economic sectors, not to mention the spread of the phenomenon of financial and administrative corruption, which became the main obstacle to economic reform policies, as well as a clear absence of economic planning and the desired development trends .The imbalance in the economic structure resulting from the income derived from the oil sector and the dependence of economic activities in financing on this resource only, made the national economy vulnerable to fluctuation and fluctuation of oil prices globally or subject to the influence of external factors, which led to a clear confusion in the financing of government budgets, and created a repulsive environment For investment and the flight of national capital abroad, therefore, the contribution of the private sector to the development process has receded, despite the economic openness that the national economy witnessed after 2003. On economic thought, development priorities, and the rules of the relationship between economic policy on the one hand and fiscal and monetary policies on the other hand... the fiscal policy has failed to perform its role in the economy, and the monetary policy's preoccupation with restoring the outputs of the confused fiscal policy made the process of coordination and interaction between the fiscal and monetary policies weak, which had an impact. negatively on their performance. Also, the poor financial management in Iraq, and limiting its role to distributing oil resources

to meet life-sustaining requirements (such as salaries and operational requirements), the financial policy has lost its leading role and position in economic affairs, with its lack of many economic and financial information that enables the decision maker to take the right decisions that That would bring about a astate of economic development.

Key words: Structural Imbalance, Structural Distortion, Economic Development, Monetary policy, Fiscal policy.

Introduction

It is known that the Iraqi economy depends mainly on oil as the main source of income, while the contribution of the basic sectors has deteriorated significantly since the nineties as a result of the economic blockade imposed on Iraq, and the deterioration intensified after the occupation, that is, after 2003, when the role of the agricultural sector receded due to the products cheap imported products, which made many local products unprofitable, and most manufacturing projects stopped and tourism revenues decreased, especially religious tourism, despite the increasing number of visitors to the holy shrines, and most private sector projects stopped until the government became the largest employer and its workers suffer from disguised unemployment so that Productivity per capita is almost zero. The oil and natural gas sector also suffers from a lack of development, as Iraq imports natural gas, although it burns the gas produced from oil wells in the air instead of using it, and the wasted gas can supply nearly 3 million homes with energy, and also helps to revive the process industry, and mitigate the negative effects of environmental pollution.

Research Problem

The poor levels of performance of economic policies in general and fiscal policy in particular - which played a serious role in the misuse of oil revenues - and the resulting manifestations of underdevelopment and the deterioration of levels of production and productivity in various economic activities. Iraqi

Research Hypothesis

It is not possible to achieve economic development without removing the structural distortions and structural imbalances that the Iraqi economy suffers from due to the dominance of the oil sector and the weak contributions of the productive economic sectors. Therefore, a strategy based on diversifying sources of income must be adopted to achieve sustainable development.

Theories in Economic Development

Before starting the subject of the research, it is necessary to put forward the theoretical basis on which the research mechanism is based, as it is located at the heart of the economic development process, which distinguished between two theories:

Balance Growth Theory

It is the theory that was invented by the economist R. Nurkse (1907 - 1959). Which assumes that the government in any developing country needs to make large investments in a number of industries simultaneously, and this leads to expanding the size of the market, increasing productivity and providing incentives for the private sector to invest. R. Nurkse

realized that expansion and balance between the main agricultural and industrial sectors are necessary so that each of these sectors provides a market for the other's products and, in turn, provides the raw materials for the development and growth of the other sector. Nurkse also indicated in his theory the necessity of distributing capital intended for investment among all economic sectors according to their importance in the economy, so that these investments can achieve a boost in economic growth in a way that achieves balance and helps create a state of sectoral interdependence within the national economy. And when we look at the possibility of applying this theory to the reality of the Iraqi economy, we find that more than 75% of the financial resources are allocated to the operational budget, and less than 25% of the financial resources goes to the investment budget - and what is allocated for investment, despite its scarcity - takes forms of unproductive spending. Therefore, the Iraqi society turned as a result of economic policies into a non-productive consumer society, and the economic sectors were subjected to deterioration and their contributions to the formation of the gross domestic product (GDP) decreased. Therefore, it is difficult to apply this theory to a unilateral economy that relies mainly on one sector that is "depleting", which is the oil sector.

Unbalance Growth Theory

The theory of unbalanced growth, whose economist A. Hirschman crystallized in his book "The Strategy of Economic Development" in 1958, is based on the necessity of directing most of the investments in the early stages of growth to one sector known as the leading sector, and he emphasized that the plan Development that applies an unbalanced growth strategy is the best way to achieve progress, because it is investment in the leading strategic sectors that leads to finding new investments, and that the development process needs an imbalance in its early stages, as growth moves from the leading sectors to the dependent sectors, due to its ability to create external economies from which other sectors benefit, and every new project would generate savings and advantages (regulators' profits, social profits) from which another new project would benefit, and so on, and developing countries need a strong push to finance the investment program. Allocated to some industries, but not all, which is what happened in the United States or Japan, and since no country is able to provide the necessary financing necessary for all sectors, the national plan must direct investments to build social capital, or to establish direct productive activities, where one of them creates external savings, while the other benefits from them, and every development of the first encourages private investment, and this action would create an economic imbalance that is considered The driving force for growth, which occurs in two levels, either an imbalance between the social capital sector and the direct production sector, or an imbalance within the sector itself, with the condition that the leading sector contains the greatest amount of forward and backward momentum, for example, the creation of the automobile industry This will lead to the creation of the tires, glass and batteries industries, as well as prompting investors to establish intermediate industries. (Salman, Jamal, 2015: 98-99). The leading sector is defined as the sector that has forward and backward linkages with the rest of the other economic sectors. In rentier economies - as is the case with the Iraqi economy - the oil sector cannot be a leading sector because of its weak forward and backward links with the rest of the economic sectors, because it is more linked to the external economy. Therefore, the manufacturing sector is the best sector that can be a leading sector, as it enjoys relatively high forward and backward links with the rest of the economic sectors (Salman, J, 1985: 272-27), but unfortunately since 2003, that is, after the occupation, the contribution of the industrial sector in Iraq has deteriorated. Most of the existing industrial projects were disrupted, and the contribution of this sector to the formation of the gross domestic product (GDP) declined sharply, and thus the gap between the economic sectors deepened and the structural imbalance in the economy increased. The economy is difficult to achieve due to structural distortions in the structure of the national economic.

The Structure of the Iraqi Economy

The composition of the Iraqi economy and its structure depend mainly on the export of crude oil, whose financial returns constitute more than 95% of the government budget and its contribution to the formation of GDP by 70% - 75%, and thus the rentier features of the Iraqi economy became clear and the absence of an effective strategy to direct these rentier returns to invest in Non-oil activities, which reflected negatively on the structure of the Iraqi economy and its overall variables. For example, one study indicated that “the rate of losses of the Iraqi economy due to not exploiting gas energies for the period from 2012-2016 only is 147 billion dollars.” (Nizar Ahmed, Iraq’s losses from Idle gas projects - from the Internet) .

There is no doubt that the Iraqi economy has been exposed for more than fifty years to violent shocks as a result of the conditions of political instability, despite the direction of the economic policy of the state after 2003 towards encouraging the private sector within the framework of the market economy policy and economic, financial and commercial openness, and the private sector could have played an important role in the process of construction and development if given the real opportunity, but the lack of a clear strategy for the future of this sector and the lack of a work mechanism by government agencies to develop it, so the parasitic import sector (without setting controls and restrictions) dominated the nature of the work of this sector and it helped that is the Iraqi market, which was thirsty for the types of commodities and luxury goods that were missing in previous periods, and the state continued to marginalize this sector through the lack of a supportive economic policy for it, which led to the following:

- The flight of local capital to neighboring countries.
- Orient the remaining capital at home towards marginal non-productive activities that targeted quick profit.
- High production costs as a result of the high prices of services such as electricity, transportation.... etc.
- The absence of real and clear instructions and controls for granting licenses to establish companies, projects and factories, but they were granted at random.
- The absence of an attractive environment for investment as a result of the state of chaos and instability.

Structural Imbalances in Economic Sectors

The imbalance in the structure of the economic sectors appears clearly through the decrease in the percentage of the contribution of the productive commodity sectors (agriculture and industry) in the formation of GDP, as the statistical data indicates a decrease in the percentage of the contribution of the manufacturing sector from 4.2% in 2002 to 0.4% in 2017, and it continued to decline until Most of its production facilities stopped due to the economic chaos witnessed by the Iraqi economy and the systematic sabotage operations that included most of the industrial sector companies such as iron industries, petrochemical industries, textile industries, and food industries, in addition to that, the state did not invest the large financial returns that it obtained after 2003 in the process .These companies were rehabilitated and restarted, but were neglected, so the state of deterioration continued, and the percentage of the contribution of this sector to the formation of GDP decreased. As for the agricultural sector, its contribution to the formation of GDP also decreased from 9% in 2002 to 1.5% in 2017, until the local supply of agricultural products did not meet the increasing demand for them, and this situation continued to this day without taking any measures, until it neglected many from arable land and turned into barren lands, its people suffer from poverty and the search for other work

outside the scope of this basic and important sector. (Central Statistical Organization, Annual Statistical Abstract 2017).

Hence, we note that there is an inverse relationship between the development of the crude oil sector and the development of the economic sectors, especially the productive ones (agriculture and industry). The growth rates of the oil sector are often positive and high, while the productive sectors grow at negative rates. As for the relative contribution of the distribution and services sectors in the GDP, which includes "transportation, communications, storage, wholesale and retail trade, the financial and insurance sector, and real estate services," it constituted a contribution rate of 9% in the formation of GDP, as it ranked third after the oil sector. The services sector ranked second, as its contribution to the formation of GDP amounted to 21%, due to the increase in government spending on these services as a result of the increase in oil financial resources. (Annual Statistical Collection - Central Statistical Organization, Ministry of Planning 2016).

From here we notice the depth of imbalance, distortion and imbalance between the commodity production sectors on the one hand and the services and distribution sector on the other hand. The dominance of oil activity and the increase in its contribution to the formation of GDP, which amounted to an average of 70% compared to the small percentage of the commodity production sectors, and the service sector's occupation of the second place after the oil sector does not reflect a positive effect, but rather negative effects on the labor market, as it includes professions and activities that belong to services that are characterized by weakening productivity. This made this sector capable of absorbing the labor force and disrupting it at the same time, being a sector of poor productivity and low performance efficiency.

It is known that the Iraqi economy is a rentier economy and the sources of income are linked to external demand and not to production and productivity. Therefore, the decline in production in the commodity and productivity sectors and the weakness of the investment process in these sectors led to an increase in the supply of the labor force due to the weak ability of the economy to generate new job opportunities until unemployment became a phenomenon. The familiar and destructive economic economy, estimated by the International Labor Organization at 33% for the year 2016 (ILO report, 2016), and the government has become the largest user of manpower in its official agencies and institutions (especially in the army and police), where employment is concentrated in this sector (General government services) to constitute a percentage of more than 35% compared to 6% in the industrial and oil sectors. (Annual Statistical Abstract - Central Statistical Organization, Ministry of Planning 2016)

Third Section

Directions of Economic Policies in Iraq

It is possible to distinguish between two phases that characterized the directions of economic policies in Iraq, namely:

The first stage: The stage of economic collapse and inflationary financing for development.

The period 1990-2003 witnessed the circumstances of the imposition of United Nations economic and trade sanctions and the international blockade on Iraq, which caused negative social and economic effects on the Iraqi people. Basic needs, especially foodstuffs, and a significant increase in unemployment with low levels of exploitation of productive capacities, and the blockade led to the spread of poverty and social unrest. The blockade imposed on the

export of oil also contributed to a significant deterioration in oil revenues in addition to the large burdens of the war, which led to a large and dangerous financial deficit and the growth of internal and external public debt. The government resorted to financing this deficit through internal borrowing from the Central Bank and commercial banks, which is inflationary financing that causes in continuous growth in the money supply compared to a small growth in the gross domestic product. This was reflected in the form of a wide cash issuance and a dangerous government bank debt. One of the results of that was a significant rise in inflation rates and the deterioration of the Iraqi dinar exchange rate, and economic policy played a serious role in bringing the economy to a state of collapse. Economic collapse as a result of the following factors:

1. Expansionary fiscal policy resulting from large government spending - as a result of the high volume of military spending and reconstruction expenditures, offset by limited financial revenues.
2. Subordination of monetary policy as a result of the decline in its role in directing economic activity or facing the inflationary effects of fiscal policy until it became subordinate to it, i.e. to fiscal policy, providing it with means of expansion and facilitating for it the capabilities of bank financing for the deficit and standing idly by in front of the requirements of fiscal policy without being able to curb the resulting inflationary effects. This made it an adaptive and excessively expansionary policy with the aim of providing the necessary funds for the purpose of covering the government deficit, by two means:
 - A. Uncontrolled cash release.
 - B. Financing through commercial banks, which is financing that increase the supply of currency in circulation.
3. Distortions in the tax and financial system: The most important distortion in the financial system is the large deficit resulting from the huge volume of public spending, which is offset by a small amount of tax revenues and fees. Justifications or positive results.

The second stage: Economic Policies after a year (2003)

Successive governments have adopted an economic policy based on how to spend abundant financial resources, and adopted a strict monetary policy that focused on reducing the manifestations of inflation and neglected the goal of growth and employment, in addition to the absence of coordination between fiscal and monetary policies. This can be explained as follows:

The low efficiency of public spending and the negative fiscal policy, as the dependence of the state's general budget on the conditions of the economic cycle and the conditions of demand for oil in global markets deepened. Oil revenues remained the only source and the main channel that feeds the general budget. The higher the oil prices, the higher the revenues and the entry of large sums into the budget. Economic growth depends on the amount of oil financial resources that are injected as a result of the positive external supply shock, in a way that exceeds the spending leaks in it, and shrinks Growth when tunnel leaks exceed the level of injection into the economy, and this is what affected the work of fiscal policy in Iraq in two directions: (Falah K Ali, 2011).

Granting relative priority to expenditures related to consumer welfare at the expense of investment expenditures, and preferring consumer welfare over issues of growth and stability for socio-economic reasons resulting from the people's suffering for many years of deprivation.

The economic surplus achieved from the sources of oil rents in the absence of alternatives to diversify financial resources, as other sources of surplus are considered secondary and insignificant. Tax revenues, for example, do not exceed 1% in the best cases of the total revenues of the general budget.

The adoption of the rentier budget on an operational basis based on the generation of a wide class of occupants of government jobs, as the government has turned into a protective entity, as the state is more like a social insurance company that works in three directions:

- A. No layoffs of workers and employees - for economic and social reasons.
- B. Not ready to give up any salary concessions that were achieved in favorable economic conditions.
- C. Decreased contribution of tax revenue.

This added to more obstacles and reflected the negative results of the work of fiscal policy in achieving the goals of economic growth. Thus, monetary policy alone bore the high inflationary burdens generated by the continued pressure on aggregate demand resulting from government spending.

Tight monetary policy

The monetary policy, through the measures taken by the Central Bank of Iraq, was able to make a clear shift towards the use of indirect monetary tools, especially - open market operations and the legal reserve ratio - to achieve achievements in stabilizing the exchange rate of the Iraqi dinar and in saving the banking system from deterioration as a result of the security situation and economic chaos. Monetary policy was forced to tighten due to the exacerbation of inflation, but inflationary trends soon returned for the following reasons:

- A. Partial liberation of some goods and services provided within the government support program, which led to a significant increase in prices, especially food commodities, fuel and government services.
- B. The rise in the prices of local services, which started chasing the prices of local and imported commodities
- C. Confused and irresponsible government intervention.

Lack of coordination between fiscal and monetary policies:

In order for the economic policy to succeed, there must be some kind of integration between the fiscal and monetary policies, but in Iraq the fiscal policy is based on a rapid response to the expected movement of oil revenues linked to the conditions of demand for oil in the global markets, while the central bank relies on implementing its policy. Cash on following the conditions of the local financial environment, this matter made each party focus on a field different from the field of work of the other policy. This requires addressing.

The matter is a high degree of coordination to unify their efforts, because the absence of this coordination leads to a contradiction between them that drains a measure of scarce resources.

The state of poor coordination between these two policies became clear after the phenomenon of stagnant inflation worsened, as fiscal policy gave priority to addressing stagnation in arranging its objectives for this stage. As for the monetary authority, it believes that priority should be given to addressing inflation, so it aims to achieve price stability as a first stage. Therefore, this problem will remain as long as there is an absence of an economic

strategy that draws a road map that guides economic institutions - whose work is characterized by weak performance efficiency and a low level of productivity - by anticipating a set of main goals. However, talking about an economic strategy at the present time seems far-fetched, which confirms the continuation of the state of challenge in front of the financial and monetary authorities to reach economic partnerships that take their way to implementation.

Results & Recommendations

Results

The impossibility of applying any of the development theories to the Iraqi economy - neither the theory of balanced development nor the theory of unbalanced growth - and therefore we lack a theoretical basis on which a mechanism can be relied upon, and from here it is necessary to adopt a development strategy based on diversifying sources of income and reducing dependence on a source One is depleted, which is the oil sector, and giving utmost importance to human development as the cornerstone of sustainable development.

Iraq loses more than a billion dollars annually with every drop of one dollar in the price of a barrel of oil it exports, and that low prices harm the economy and exacerbate the budget deficit, especially since the economy relies more than 95% on oil imports and the budget deficit persists. The volume of investment allocations has decreased and many projects have stopped at a time when the economy is suffering from a serious deterioration in infrastructure and major service projects, and therefore a new appropriate and effective strategy must be adopted to restructure the Iraqi economy.

The financial shocks that the Iraqi economy was exposed to as a result of the drop in oil prices is a bell ringing for the real danger facing the economy in the present and the future, and the need to reconsider economic policies, restructure the economy and remove structural distortions because their survival and failure to address them means the impossibility of achieving sustainable development. And financial re-planning, tightening financial control over aspects of public money spending, combating corruption, and the need to reduce unnecessary expenditures.

Recommendations

The need to adopt a well-defined strategy to diversify sources of income, reform its structure, reduce dependence on the oil resource, and create new alternatives that contribute to stability and pave the way for sustainable development through the following:

In the short term

1. Reforming the tax system, reducing evasion, activating the work of the tax administration, and eliminating the rampant corruption that contributes to weakening tax revenues.
2. Compress operating expenses and rationalize the expenditure of financial resources.
3. Activate oversight in all ministries and all state institutions to reduce the manifestations of financial and administrative corruption, which has become a sustainable phenomenon.

In the long term

1. The necessity of adopting an economic policy based mainly on the principle of diversifying the productive structure, and creating new income-generating sectors, and

- this requires the development of intensive investment programs to exploit the advantages available to diversify the economic structure and get rid of the increasing dependence on rentier resources.
2. Restarting suspended industrial projects and reviving them, in addition to the need to establish new projects that contribute to raising the contribution of the manufacturing sector and revitalizing this basic sector, which has been crippled and seriously deteriorated.
 3. Giving great attention to the agricultural sector and addressing the phenomenon of desertification that afflicted large areas of agricultural lands as a result of water scarcity and deliberate neglect of this vital sector, and the necessity and support of farmers by directing agricultural investments towards the exploitation of arable lands and cultivation of basic and necessary crops instead of relying on imports from abroad. As the revitalization of this sector, including (vegetable and animal), can contribute to the provision of hard currency through self-sufficiency.
 4. Revitalizing the tourism sector and benefiting from religious tourism in supporting and financing the general budget in foreign currency and stopping the state of deterioration it suffers from.
 5. Stop wasting natural gas and contract with specialized international companies to provide Iraq with an important source of financial revenues and limit the import of gas from neighboring countries.
 6. Benefiting from the vast untapped mineral resources, foremost of which is the sulfur present in large quantities in Al-Mishraq, phosphates in Akka-Shat, red mercury in Amarah and other minerals.
 7. Reviving the private sector, giving it a spirit and revitalizing it, and providing an attractive environment for investment, as this sector is qualified to face financial crises if it is supported by the state with laws and regulations that protect the investor and the application of the policy of preventing random imports.
 8. Paying maximum attention to the human element, as the element of real wealth, and this requires improving the efficiency of the labor force in the economic sectors, whose numbers in government sectors exceed more than 4.0 million employees, most of whom are in disguised unemployment and low productivity that needs to be rehabilitated through training programs that qualify them Workers to improve the level of performance and raise the level of productivity in all economic sectors.

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