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# IRAQ

## The Unfulfilled Promise of Oil and Growth Poverty, Inclusion and Welfare in Iraq, 2007-2012

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# STRENGTHENING THE GROWTH-EMPLOYMENT-WELFARE NEXUS

## POLICY NOTE I

### The Unfulfilled Promise of Oil and Growth: Poverty, Inclusion and Welfare in Iraq, 2007–2012

#### *Modest Welfare Improvements Despite Healthy GDP Growth*

Between 2007 and 2012, Iraq's GDP grew at a cumulative rate of over 40 percent, and averaged an annual rate of 7 percent between 2008 and 2012. Yet, per capita consumption, the basis for measuring poverty, grew by only 9 percent in cumulative terms, or at 1.75 percent per year. Economic growth translated into very modest rates of poverty reduction, and in 2012, a fifth of the Iraqi population remains below the poverty line. Moreover, welfare improvements did not trickle down as fast to the poor. The top 40 percent of the consumption distribution experienced annual growth in real per capita consumption of almost 2 percent, compared with 0.7 percent for the bottom 20 percent.

#### *Why? Because the Links between Growth, Employment, Earnings and Welfare are Weak*

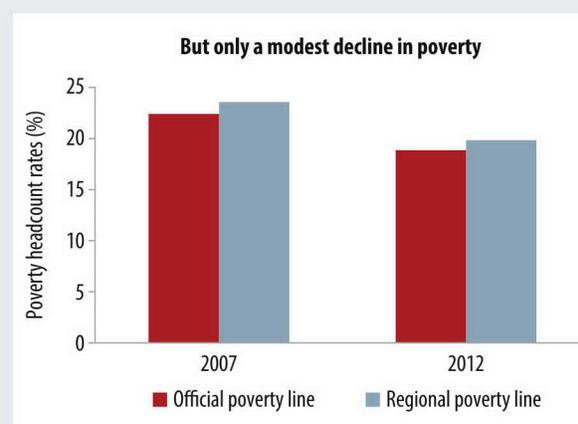
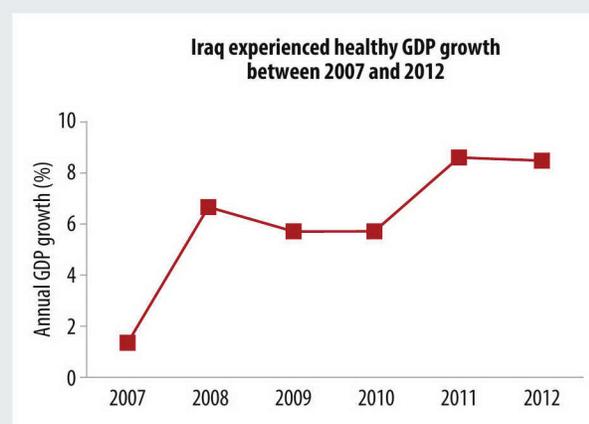
The modest decline in poverty in Iraq between 2007 and 2012 was driven by an increase in earnings

among the employed rather than an expansion in employment or higher public transfers. In particular, economic growth was not associated with job creation in the private sector, where the majority of the poor are employed.

#### *GDP Growth Did Not Lead to Substantial Employment Generation*

The sectors of the economy that drove overall growth in GDP did not create jobs. Recent economic growth has been driven by the oil sector, which represents almost half of Iraq's GDP and almost all exports. But the oil sector accounts for only 1 percent of employment in Iraq, and growth in the oil sector does not directly create new jobs. In fact, a 1 percent increase in oil output generated a 0.2 percent reduction in employment in the sector.

Growth did not go hand in hand with employment growth in other sectors of the economy either.



Even in the manufacturing sector, which employs 10 percent of the labor force and is relatively labor intensive; a 1 percent increase generated an increase in employment of 0.6 percent during the 2007 to 2012 period. Overall, job creation was inadequate to absorb the growing workforce.

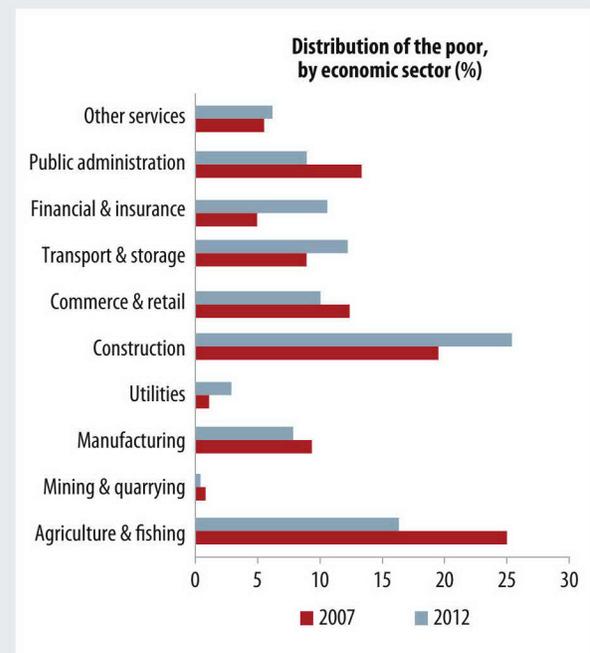
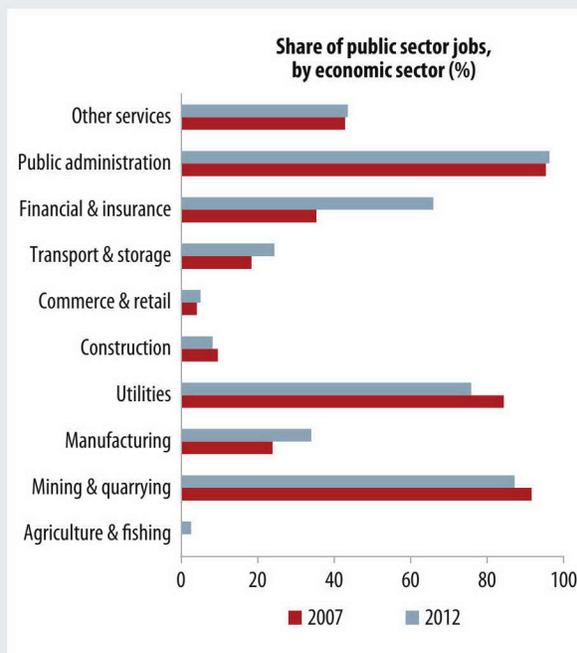
*New Jobs and Increases in Earnings Were Concentrated in the Public Sector, Not in the Private Sector, Where Most of the Poor Work.*

While oil did not directly create jobs, oil revenues did enable a significant expansion in public sector jobs. 80 percent of new jobs were created in the public sector, especially in the financial, insurance and professional services sector, with accompanying increases in wages and salaries. Moreover, these new public sector jobs have absorbed less educated workers, with 60 percent of these jobs going to workers with less than primary education. At the same time, earnings grew rapidly in the oil and mining, public administration, health and education sector, by 7 percent or more per year. Both are dominated by the public sector.

In contrast, agriculture and construction, which employ more than a fifth of the population, and a third of Iraq's poor, barely experienced any increase in earnings. Agricultural incomes fell by 2.5 percent, whereas construction earnings increased by a mere 0.8 percent. With employment and earnings falling in agriculture, rural livelihood options are becoming insecure. In the southern governorates, poverty among households dependent on agriculture has risen sharply, and while people are leaving agriculture, they have nowhere to go as the local economy continues to stagnate.

*Public Sector Expansion Has Created Economy Wide Distortions in the Incentives to Look for Work and to Invest in Education*

The increasing possibility of a public sector job, with greater job security, benefits and fewer hours of work, has in effect, raised the reservation wage among the working age population, and limited active job search as people wait and queue for openings in the public sector.



A one percentage point increase in the public sector employment rate in the governorate of birth lowers labor force participation among adults by 30 percent; and by 40 percent among young Iraqis of working age.

With the expansion in public sector jobs for less educated men, the returns to education in the public sector level off after primary school, and do not pick up again until after tertiary education. As a result, the incentives to invest in education beyond primary school have become limited.

### *The Private Sector is Getting Crowded out; and its Ability to Grow is Severely Constrained*

Iraq's private sector is getting increasingly crowded out by the public sector, and is unable to match superior pay, benefits and working hours to attract talent. Many private businesses are small and informal; mainly operating in retail and trade and construction and transportation services. Agricultural jobs are also overwhelmingly in the private sector.

The World Bank's Doing Business 2012 Report ranks Iraq 164 out of 183 economies in terms of the costs of doing business. Private sector firms cite fundamental constraints to growth - lack of reliable power supply, the political and security environment, corruption, inadequate access to credit, land and other capital and the lack of a trained workforce (Iraq Investment Climate Assessment, 2012).

## *What Needs to Be Done*

### *Establishment and Maintenance of Peace and Security*

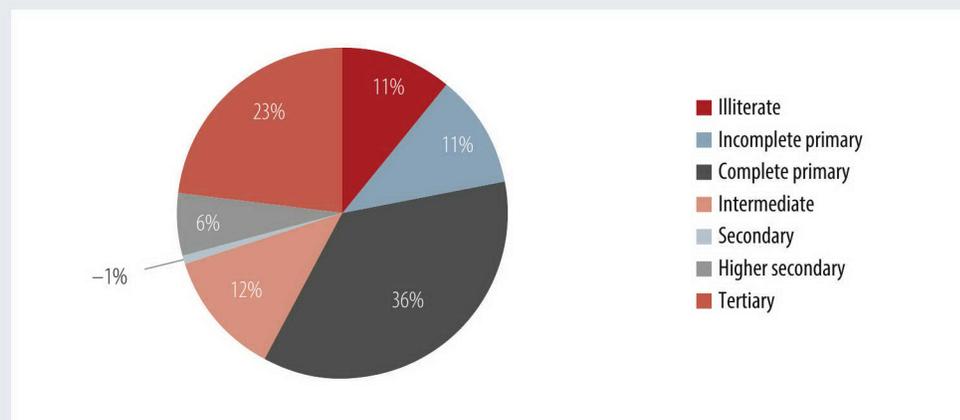
- Prerequisite for economic growth and welfare improvements

### *Growth, Oil Management and Economic Diversification*

- Greater oil revenue transparency
- Minimize the impact of oil revenue volatility through the creation of a sovereign "parking fund" and a fiscal stabilization fund
- Strengthen the links between the oil sector and manufacturing; encourage private investment in construction, banking, industry and tourism
- Rationalize the role of the public sector; increase the efficiency of public expenditure

### *Private Sector Led Job Creation*

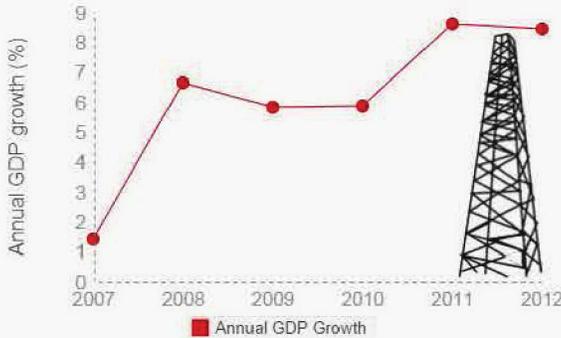
- Create an enabling business and investment climate including finance on competitive terms, and flexible labor market mechanisms and institutions
- Eliminate regulatory barriers and discriminatory implementation and enforcement of rules and regulations
- "Resource corridors" to generate spillover activities
- Improve power and transport infrastructure
- Invest in a technically skilled workforce



***For Economic Growth to have a Positive Impact on Welfare, it Needs to Generate Employment and Income for Those Who Need it the Most.***

# The Unfulfilled Promise of Iraq's Economic Growth

Between 2008 and 2012, Iraq's GDP grew at an average rate of 7% each year.



Yet, **20%** of the Iraqi population remains below the poverty line



## WHY? Because the links between growth, employment, earnings and welfare are weak.



The oil sector represents almost **50%** of GDP, but only **1%** of employment



Growth in the oil sector did not directly create new jobs

**80%** of new jobs & higher earnings were in the public sector, not in the private sector - where most of the poor work



Agriculture & construction, which employ **1/3** of Iraq's poor, barely experienced any increase in earnings

Expansion in the public sector has lowered incentives to search in the private sector for jobs



Fewer people are looking for work in expectation of getting public sector jobs

## WHAT NEEDS TO BE DONE?

Economic growth needs to generate employment and income for those who need it the most

Establishment and maintenance of peace and security



Pre-requisite for economic growth and welfare improvements

Growth, oil revenue management & economic diversification



Ensuring positive spillovers from oil to industry and services

Private-sector-led job creation



Create an enabling business and investment climate and improve power and transport infrastructure

# ADDRESSING THE CONSEQUENCES OF IRAQ'S DIFFICULT LEGACY

## POLICY NOTE II

### The Unfulfilled Promise of Oil and Growth: Poverty, Inclusion and Welfare in Iraq, 2007–2012

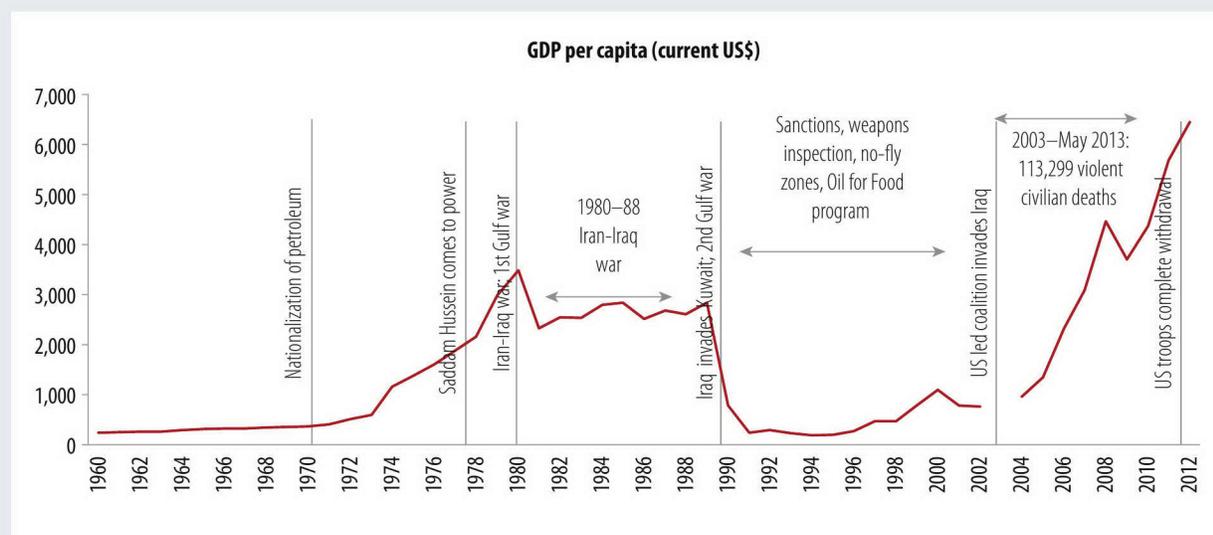
#### *Three Decades of Violence and Insecurity*

Iraq has been a nexus of conflict and fragility since the early 1980s, and has experienced multiple types of conflict: insurgency, international war, sectarian strife, persistent terrorism, regional fragmentation, and spillovers from conflict in other countries. A promising endowment of natural resources (land, oil, and gas) and human capital has been repeatedly confounded by war and repression. The immediate focus of this report is Iraq's economic and social development spanning a period of relative stability, following the end of the sectarian violence of 2007, and ending in 2012, prior to the militancy and insurgency in the northern governorates of the summer of 2014. However, the legacy of three decades of violence and instability has been far-reaching in terms of the structure of the state and the economy; a massive human capital deficit; and the exclusion of parts of the country from the development process.

#### *A Skewed Role of the State*

The invasion of Kuwait and the subsequent sanctions era marked a fundamental rupture in Iraq's development trajectory. With the government focused on regime survival, and the private sector unable to work, the formal sector began to function increasingly through administrative fiat, while market activities shifted into the informal sector. This marked the beginning of large-scale detachment between the state and its citizens, laying the grounds for profound marginalization.

The resumption of growth in 2007 was driven by expanded crude oil production. Oil revenue has since been an enabler of public sector employment growth rather than a source of productive and economy wide investments. At the same time, state owned enterprises remain dominant; the decline of agriculture has continued unabated; and continuing civil conflict has further fragmented the economy and society.



Internal integration is limited and spatial divergence has become pronounced, with very limited devolution of functions, powers and revenues to sub-national governments and 90 percent of total public spending executed through the federal government and its deconcentrated structures.

### *A Massive Development Deficit*

Iraq's historical endowment and comparative advantage in human capital has been steadily eroded as a consequence of 30 years of violence, and the accompanying destruction and deterioration in infrastructure and severe shortages of qualified personnel. Girls and women lag behind in education, health, and workforce participation.

Today, Iraq has one of the lowest employment-to-adult population ratios in the region, and male and female rates of employment and labor force participation are low and stagnant. Male labor force participation was around 74 percent and female labor force participation around 11.5 percent in 2012.

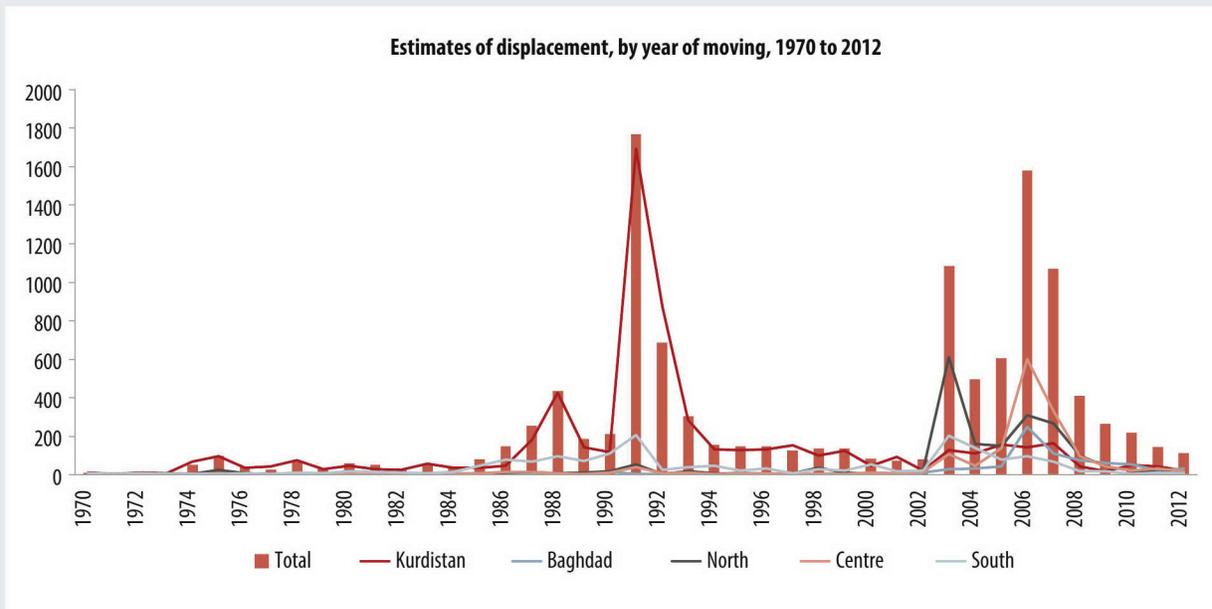
There is also evidence of long-term deterioration in health outcomes. Until the mid-1970s, Iraqi males enjoyed higher life expectancy than their counterparts in the Middle East and North Africa (MENA)

region. Since 1980, the beginning of the Iran-Iraq war, they have lagged behind. In 2011, Iraq's Infant Mortality Rate was the highest in the region, barring Yemen.

Similarly, adult male and female literacy rates in Iraq are below the MENA average and well below the average for similar upper middle-income countries. For cohorts born after 1975, who were of school going age during the Iran-Iraq war and thereafter, progress in education stalled. For Iraqis of all ages, the most prevalent level of education is primary schooling or less, and 18 year olds in Iraq today are as likely to have completed primary school as those 30 years older.

### *Unequal Spaces*

Relative peace and stability alone, where experienced, has not been sufficient for economic revival. Displacement and civilian deaths during the 2007 to 2012 period have been concentrated in Baghdad, the North, and in some of the Central governorates. The absence of peace and security has implied little change in welfare in Baghdad and the North, where the post-2003 violence was concentrated. It is only in the Centre where peace and stability have to some extent combined with an improvement in economic



activity, and where job growth has outpaced the growth in the male working age population.

While the South and Kurdistan were both subject to severe prosecution under the Saddam Hussein regime, they have remained relatively untouched by the post 2003- violence; yet, they appear to be on opposite trajectories. In Kurdistan, outcomes are improving significantly for the young, and they are catching up to the rest of the country. On the other hand, while there is some improvement in educational attainment over cohorts within the South, the gap with the nation is widening.

Male employment has not kept up with the growth in working age male population in the South, while, in contrast, employment growth outpaced growth in the working age population for men in the Centre. In the southern governorates, and with the exception of Basra, the last five years appear to have compounded the neglect of the past.

### *What Needs to Be Done*

#### *Establishment and Maintenance of Peace and Security*

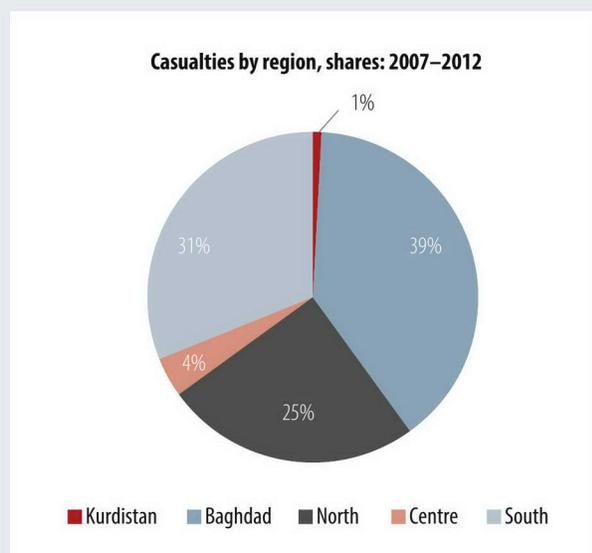
- A broad-based and inclusive development process will help secure a fragile peace

#### *Strengthen the Citizen-State Relationship*

- Build “bottom-up” accountability by providing citizens with information
- Improve “top-down” accountability through a joint commitment from all levels of government to address the most glaring gaps in social and public services
- Link capacity building of sub-national governments directly to spending activities or the development of targets
- Align expenditure and revenue assignments with accountability mechanisms and needs

#### *Bridging the Human Capital Deficit and the Spatial Divide*

- Invest in infrastructure to guarantee basic level of access to education, health and basic services for all Iraqis, with a particular focus on the South
- Gender-sensitive design of the schooling and health system
- Improve the quality of education, curricula, and strengthen vocational training in collaboration with the private sector



***The Legacy of Violence in Iraq Has Been Far-Reaching—the Loss of Life and Livelihoods; the Displacement of People; the Destruction of Social Infrastructure and Markets; Weakening the Rule of Law and Governance, and by Severely Constraining Economic Activity.***

# Iraq's Difficult Legacy: Three Decades of Instability

A promising endowment of natural resources (land, oil, and gas) and human capital has been repeatedly confounded by war and repression.

## A skewed role of the state

State unable to provide fundamental services including:

### peace & security



Ensuring law and order and a safe environment remain challenges.

### economic development



Oil revenues financed public sector expansion, further crowding out the private sector and leaving out the poor.

### basic services



Basic services, such as health, education, and other social services are lacking.

## Which implies a massive development deficit

### Gender disparities



Girls, women lag behind in education, health, and workforce participation.

### Employment



Rates of employment and labor force participation are low and stagnant.

### Literacy



The most prevalent level of education is primary schooling or less for Iraqis of all ages.

## Unequal Spaces

Disparities in human capital between different regions

### Continued insecurity

The absence of peace and security has limited welfare gains in many governorates.



(Anbar, Diyala, Salahadin, Kirkuk, Nineveh, Baghdad)

### Economic revival

Relative peace and security in some governorates was accompanied by revival in economic activity and job growth.



(Babylon, Wasit, Karbala, Najaf, Erbil, Sulaimaniya, Duhok, Basra)

### Continued neglect

Decades of exclusion from the development process have been compounded by recent neglect, leading to increases in poverty in some governorates.



(Thi Qar, Missan, Qadisiya, Muthanna)

# EXPANDING PROTECTION TO THE POOR AND VULNERABLE

## POLICY NOTE III

### The Unfulfilled Promise of Oil and Growth: Poverty, Inclusion and Welfare in Iraq, 2007–2012

#### *A Significant Share of the Iraqi Population Remains Vulnerable to Falling Into Poverty*

A significant share of Iraq's population consumes at levels close to the poverty line and remains vulnerable to falling into poverty. In other words, a small increase or decrease in incomes and consumption can lead to large changes in the incidence of poverty. For instance, a five percent increase in the cost of basic needs (including food, fuel, clothing and shelter) in Iraq would raise poverty by 16 percent, while a ten percent increase would raise poverty by more than 30 percent.

#### *The Less Well-Off Rely Heavily on Public Assistance*

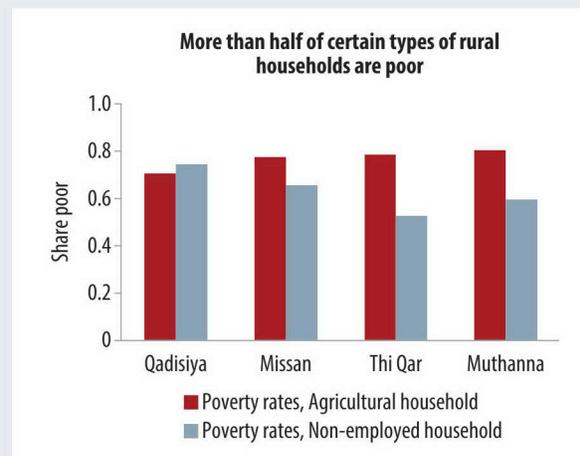
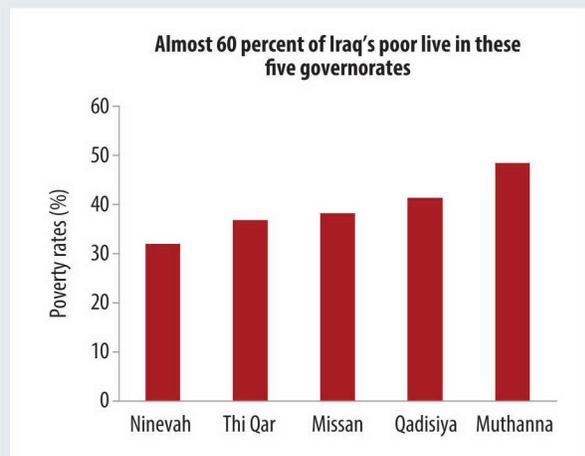
The poor are disproportionately dependent on non-labor incomes and, in particular, on transfers from the Public Distribution System (PDS), due to a lack of assets and employment opportunities. Public and private transfers still account for 36

percent of total income for the bottom decile, of which more than 80 percent is comprised of public transfers. In some parts of the country, such as the South, more than 60 percent of income for the bottom 10 percent of the distribution comprises of transfer income rather than earned incomes.

#### *High Rates of Poverty Among Certain Types of Households*

Despite significant poverty reduction in rural areas between 2007 and 2012, poverty among rural households remains high. Similar households face higher poverty simply because they live in rural areas. For instance, at each education level, poverty rates are almost double in rural areas. An urban household whose head has primary education has the same likelihood of being poor as a rural household whose head has completed higher secondary education.

The concentration of the poor has also increased: in 2012, five governorates—Nineveh, Thi Qar,



Missan, Muthanna and Qadisiya—accounted for almost 60 percent of Iraq’s poor, compared to 40 percent in 2007.

About half of Iraq’s poor live in the South—in Thi Qar, Missan, Muthanna and Qadisiya. High poverty rates in the South also combine with poor human development outcomes, and limited livelihood options, especially in rural areas. In the South, especially, agriculture has been in long term decline, with falling employment and earnings. Consequently, rural households that are completely dependent on agriculture and have been unable to find employment in other sectors faced extraordinarily high poverty rates, of 70 percent in some places.

### *Many Dimensions of Deprivation*

Over and above consumption expenditures, Iraqi people take into account many other dimensions when evaluating their own welfare—education, health, housing and basic services, local labor markets and security concerns. In determining subjective self-assessments of poverty status, the largest weight is placed on lack of consumption or income, with smaller but relatively equal weight on educational deprivation or on place of residence. In contrast,

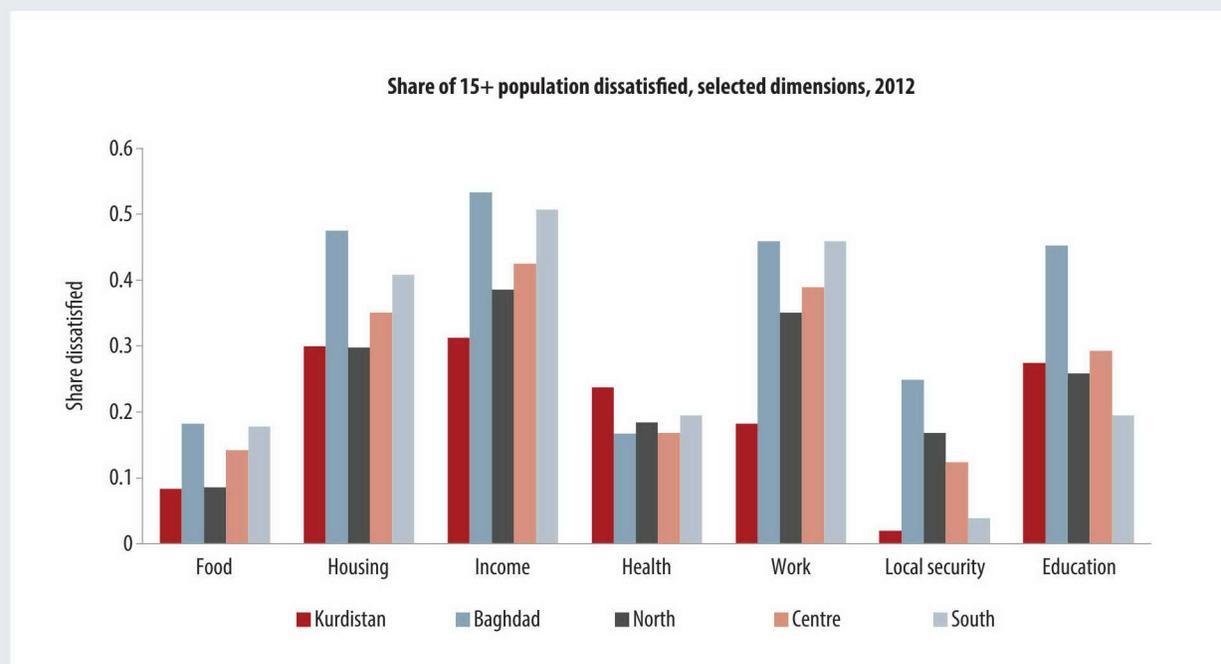
dissatisfaction with life appears to be driven more by where an individual lives, reflecting the additional importance of location specific factors including security concerns, local labor market conditions and service delivery.

Using these deprivations to construct a multidimensional index of deprivation; headcount rates would be higher than as measured by consumption poverty—25.6 percent—if derived from the subjective poverty measure and 28.4 percent if the life (dis)satisfaction measure were used (compared to 19.8 percent consumption poverty) in 2012.

### *Only One Dimension of Protection*

While welfare and deprivation are multidimensional, only one source of protection covers all of the poor: the Public Distribution System. It is hugely important, and is the overwhelming source of calories for the poor and bottom 40 percent, accounting for 74 and 64 percent of their total caloric consumption respectively in 2012.

Yet, it covers only one aspect of deprivation—basic caloric needs; while nutritional deficiencies remain an important challenge, influenced by a broad range



of factors, including early marriage, and spatial inequality in access to basic services. Moreover, the universal nature of the PDS and the lack of other safety nets imply that barring a few exceptions, demand for PDS items is almost inelastic. As a result, any one-shot reform of the PDS will have an adverse welfare impact in the absence of a significant expansion in earnings and employment opportunities, and a comprehensive safety net system.

### ***A Comprehensive Safety Net is Needed***

Ensuring adequate and quality work for Iraqis is a long-term challenge. Over and above the continuing violence and insecurity, the private sector has been increasingly crowded out of market activities. Access to adequate infrastructure including reliable power supply and capital are major hurdles to job creation. Moreover, with low average education levels, the workforce lacks the skills for many private sector and entrepreneurial activities. Many Iraqi children are still dropping out or never going to school because of financial considerations; social norms; and worryingly, lack of interest. In part this is due to the deterioration in infrastructure, lack of qualified teachers, poor teaching quality and curriculum, but also because the incentives to invest in education have become distorted. Unless the private sector can create jobs and reward investments in education appropriately, this vicious cycle of low human capital and poor employment opportunities will continue.

Therefore, in the short term, there is no substitute for a comprehensive and diversified safety net system that addresses the multiple deprivations of the poor, and targets pockets of high poverty.

### ***What Needs to Be Done***

#### ***Establish and Maintain Peace and Security***

- Essential for service delivery and reviving local markets and economic activity

#### ***Design and Implement a Comprehensive Safety Net***

- Nationwide public works program, with spatially differentiated components to:
  - Provide employment and incomes in the immediate term;
  - Rebuild local infrastructure and service delivery;
  - Invest in skills for future employment.
- Physical labor works to build roads, schools, health posts, sanitation improvements; environmental and agricultural projects; complemented with social services in urban areas
- Specifically target young men who have the highest rates of joblessness, and prepare them for future employment in formal labor markets
- Targeted conditional cash transfers to ease financial constraints and provide incentives to attend school and access health care
- Where poverty rates are very high, especially in rural parts of the South, universal programs would have enormous benefits

***The current Public Distribution System is inadequate to address multiple deprivations in human capital and labor market opportunities faced by poor and vulnerable Iraqi population. However, the continuing instability and insecurity in the country have made it difficult to put in place alternative means of securing livelihoods, either through public intervention or through the revival of local economic activity.***

# The Many Faces of Vulnerability in Iraq

A significant share of the Iraqi population remains vulnerable to falling into poverty, despite a 40% GDP growth from 2007-2012

