

# The Unfulfilled Promise Of Oil and Growth

**Poverty, Inclusion and Welfare in Iraq  
2007–2012**

## OVERVIEW



**WORLD BANK GROUP**



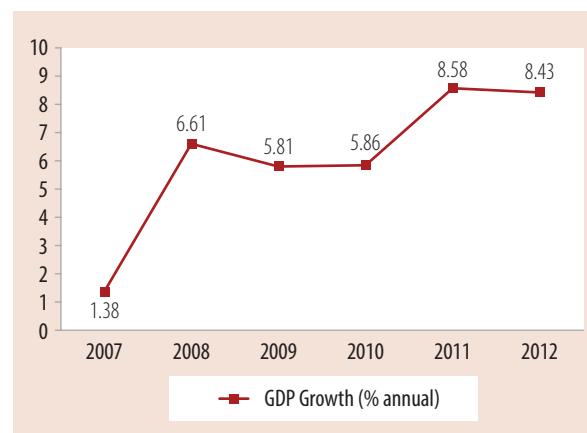
# Overview

## Wealth is Hard to Come by; but Poverty is Always at Hand<sup>1</sup>

With one of the world's largest proven oil reserves, and strong economic growth following the establishment of a civilian elected government in 2005–06, Iraq appears to have firmly entered the ranks of upper middle-income countries (per capita GDP 2472 constant 2005 US\$ in 2012). This poverty and inclusion assessment provides the first in-depth analysis of Iraq's economic and social development spanning the period 2007 to 2012, since the end of sectarian war of 2006–07, accompanied by recovery in the oil sector, a massive scaling up of oil revenues, and extensive efforts by the government to meet the high expectations of the people. In principle, this period of relative stability, accompanied by enviable rates of economic growth could have finally set the stage for inclusive growth.

Yet, economic growth translated into very modest rates of poverty reduction, and in 2012, a fifth of the Iraqi population remains below the poverty line. 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. Per capita consumption, the basis for measuring poverty, grew by only 9 percent in cumulative terms, or at 1.75 percent per year. 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.

**FIGURE 1:** Annual GDP Growth in Iraq, 2007–2012 (%)



Source: World Development Indicators, 2012.

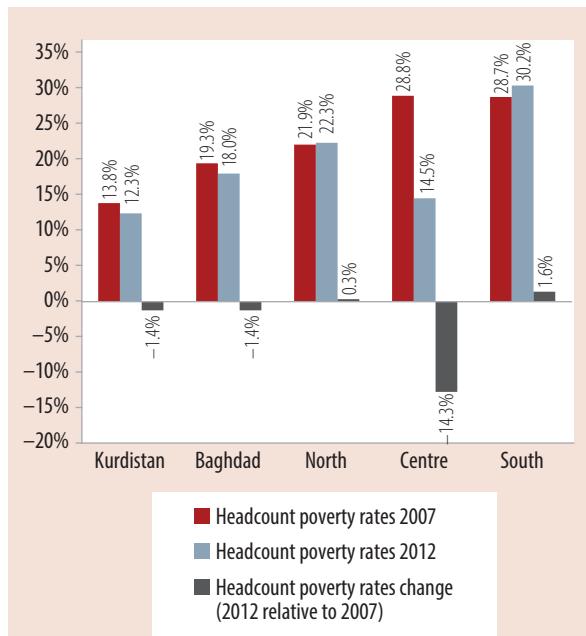
## The Poor are the Silent Ones of the Land<sup>2</sup>

During the 2007 to 2012 period, poverty rates, measured on the basis of per capita expenditures, fell by a modest 4 percentage points. Almost 1 in 5 Iraqis had expenditure levels below the amount required to meet a minimum nutritional requirement and to cover basic non-food needs such as clothing and shelter in 2012. Moreover, a significant share of Iraq's population consumes at levels close to the poverty line and remains vulnerable to falling into

<sup>1</sup> The Electronic Text Corpus of Sumerian proverbs: <http://etcsl.orinst.ox.ac.uk/cgi-bin/etcsl.cgi?text=c.6.1#>.

<sup>2</sup> The Electronic Text Corpus of Sumerian proverbs: <http://etcsl.orinst.ox.ac.uk/cgi-bin/etcsl.cgi?text=c.6.1#>.

**FIGURE 2:** Division Headcount Rates (Percent) and Changes (Percentage Point), 2007–2012\*



Source: Authors' calculations, IHSES 2007 and 2012.

\* Kurdistan includes Erbil, Duhouk, Sulaimaniya; North includes Kirkuk, Nineveh and Salahadin; Centre includes Najaf, Karbala, Wasit, Babylon, Anbar and Diyala; South includes Basra, Qadisiya, Thi Qar, Missan and Muthanna.

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.

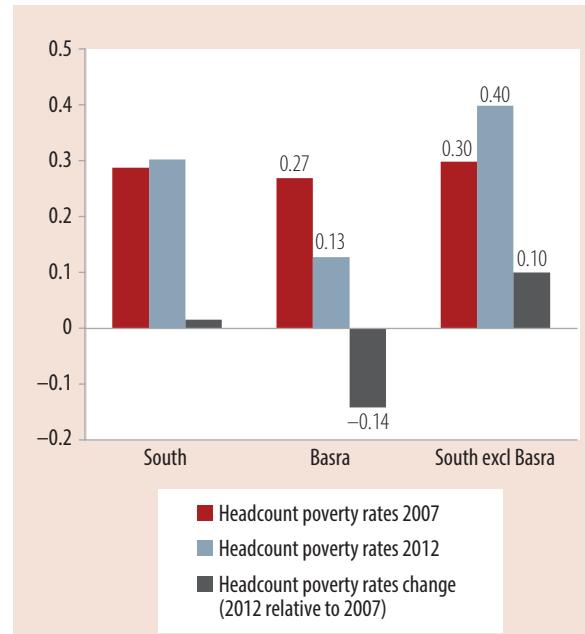
Poverty in Iraq, as in the developing world, goes well beyond material deprivation—the inability to satisfy basic needs of food, shelter, clothing and other necessities that make up a minimum standard of living. Over and above the material deprivation, household self-assessments of their welfare status incorporate a range of other measurable and unmeasurable dimensions of welfare. More than a fifth of the Iraqi populations have current expenditure levels that are below the stated minimum incomes needed to cover basic needs. Similarly, more than a quarter of adult Iraqis (aged 15 and above) consider

their families to be poor or very poor; and one in five are dissatisfied with their life (2012). This dissatisfaction stems from a number of dimensions, the most important of which are housing, income, work and education; with a third of adults reporting being somewhat or very dissatisfied.

What welfare improvements were experienced between 2007 and 2012 have been uneven—across space and across groups. Poverty reduction was driven by rural areas, where headcount rates decreased by 8 percentage points. Moreover, welfare improvements were concentrated almost entirely in the central part of the country—Najaf, Karbala, Wasit, Babylon, Anbar and Diyala—where poverty rates fell by 14 percentage points; as well as in Kirkuk and Salahadin. In contrast, poverty increased sharply in five governorates—Nineveh in the north and Qadisiya, Thi Qar, Missan and Muthanna in the south.

Consumption has also grown faster for the non-poor than the poor. Household size and composition, the

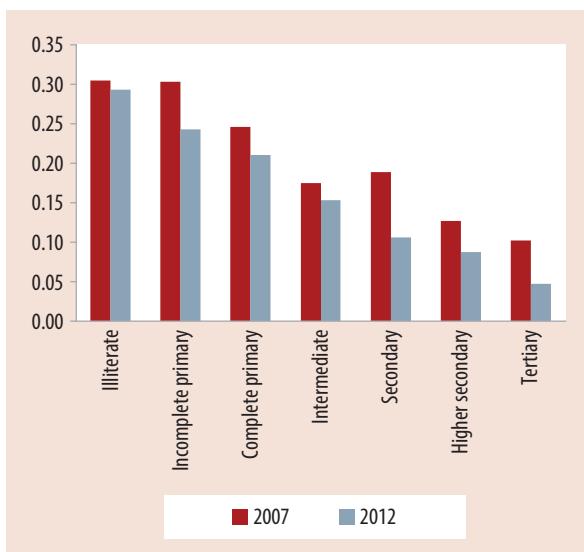
**FIGURE 3:** Poverty in Basra and the Rest of the South, 2007–2012\*



Source: Authors' calculations, IHSES 2007 and 2012.

\*The rest of the South includes the governorates of Thi Qar, Muthanna, Qadisiya and Missan.

**FIGURE 4: Poverty Headcount Rates by Education of the Head of Household**



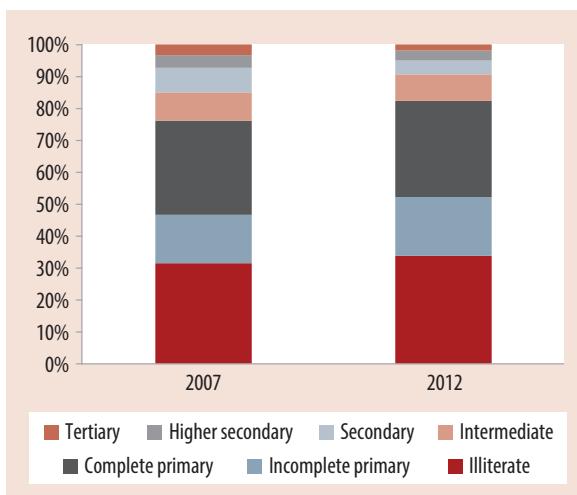
Source: Authors' calculations, IHSES 2007 and 2012.

education and sector of work (in general) of the head of household and the location of the household are all strong determinants of consumption and poverty. But households dependent on agriculture and construction are no less likely to be poor relative to households with heads who are unemployed or out of the labor force; while public sector jobs are in general associated with a lower probability of poverty.

What explains this modest performance in terms of broad-based welfare improvements and what needs to be done to build a more inclusive development path in the future? This is the fundamental question addressed by the report. To a substantial extent, these outcomes are the legacy of three decades of violence, fragility, and institutional weakness, one that has been incredibly hard to overcome. The continued absence of peace and security in some parts of the country has limited the scope for economic revival. Together, these have influenced the development strategy adopted by the state, which has had limited success in spreading the benefits of the nation's oil riches and economic growth.

In any country with such an onerous legacy, the path to development will require sustained and committed

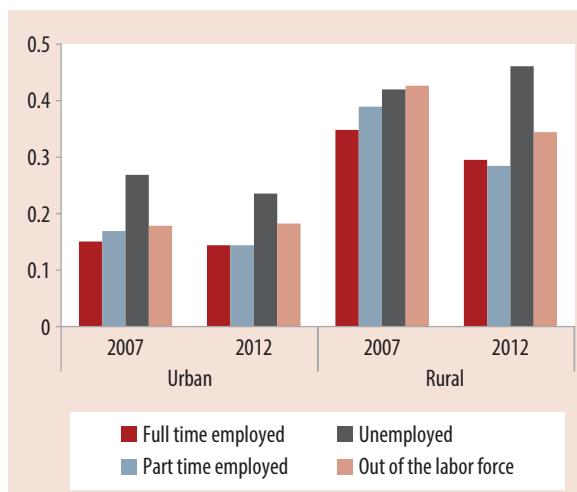
**FIGURE 5: Share of the Poor, by Education of the Head of Household**



Source: Authors' calculations, IHSES 2007 and 2012.

efforts. However, Iraq's relationship with violence is not yet at an end: in 2013, sectarian violence led to an increase in civilian mortality that has not been seen since the 2007 spike in violence. Moreover, a violent insurgency in 2014 has left parts of the country outside of government control, leading to massive internal displacement in parts of the country yet

**FIGURE 6: Poverty Headcount Rates by Employment Status, Urban and Rural Households, 2007 and 2012**



Source: Authors' calculations, IHSES 2007 and 2012.

again. Perhaps the lessons from the 2007 to 2012 period can provide answers to inform a more inclusive and sustainable development path for the future.

### **You Don't Speak of That Which You have Found. You Talk Only about What You have Lost<sup>3</sup>**

*The potentially beneficial effects of Iraq's promising endowment (agriculture, hydrocarbons, and human) have been negated by recurrent violence and instability, leaving the country with significant challenges of delayed development today. Significant gaps in human capital and access to basic services remain unfilled, and regional disparities across a range of outcomes are stark. With low rates of labor force participation, and limited education, young Iraqis are unable to productively participate in the economy, and the potential for discontentment with the state is real. Girls lag behind boys in access to education and women earn sharply lower wages when they enter the labor markets. Early childhood nutrition poses a challenge, and is affected by a range of factors including inadequate nutrition among young mothers.*

While Iraq's progress in poverty reduction may have been modest with respect to the healthy rates of economic growth; any progress at all is commendable in face of the far-reaching and challenging consequences of Iraq's difficult legacy. The country 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.

An important consequence of these three decades of violence and fragility, has been a skewed economic structure, with the public sector in particular, playing an inflated role. For much of this period, while the private sector was unable to function, many activities were implemented through administrative fiat, giving privileged access to state enterprises and certain cadres, especially during the sanctions era.

Many market activities shifted to the informal sector, with consequent effects on productivity, investment horizon, and job quality.

The US-led invasion of Iraq in 2003 was followed by the establishment of a civilian government. However, a rapidly deteriorating security situation transformed into the sectarian civil war of 2005-06, resulting in high levels of displacement across the country and within Baghdad. The security situation made it impossible for the government to focus on reconstruction (especially for fragile network infrastructure like electricity and water) or chronic and accumulating sector problems such as agricultural decline. As a result, broad-based economic development and diversification, which needs such basic infrastructure, was effectively on hold until some semblance of stability could be restored.

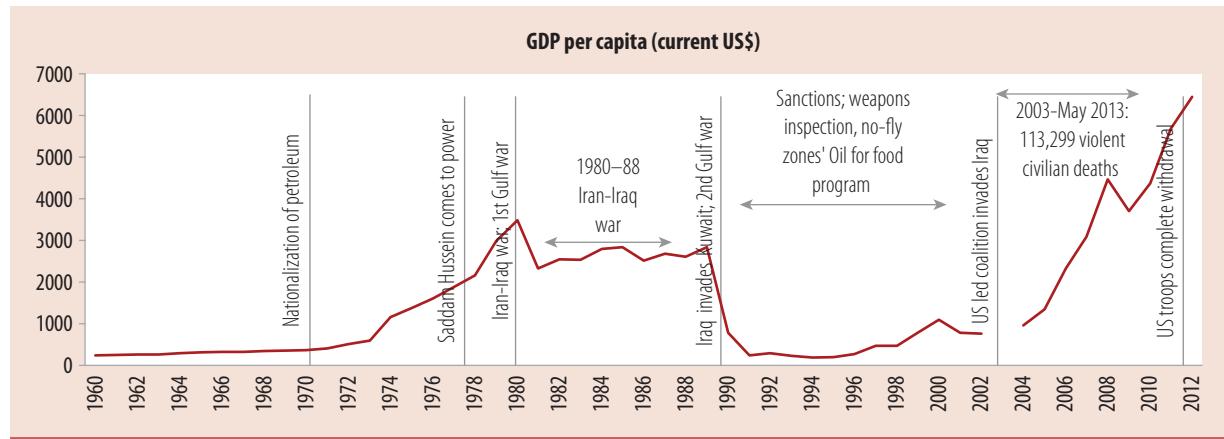
In terms of economic growth, the oil sector started to ramp up production, but in an enclave model of development: the focus of the companies was on oil-field rehabilitation and export infrastructure, with limited local spillovers. With restored oil production coming on stream at a time of high and rising global oil prices, large amounts of revenue and spending began flowing through the government, but in a context of very weak public financial management (PFM) and governance mechanisms. In the face of instability, the government had no appetite to undertake major reform of state-owned enterprises (SOEs), even though many had been defunct since the 1980s.

While oil remained the main driver of economic and fiscal developments, there were other bright spots, notably the reopening of trade with Iran and a revitalization of the pilgrimage cities (Najaf and Karbala), also linked to increased openness with Iran. But there was no transformation in the structure of GDP; it is noticeable that the share of oil rents in GDP remained broadly stable from the

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<sup>3</sup> The Electronic Text Corpus of Sumerian proverbs: [#](http://etcsl.orinst.ox.ac.uk/cgi-bin/etcsl.cgi?text=c.6.1)

**FIGURE 7:** GDP Per Capita (current US\$), 1960–2012, and Timeline



Source: World Development Indicators (2012); estimates for 1990–1996 from CSO, Iraq.

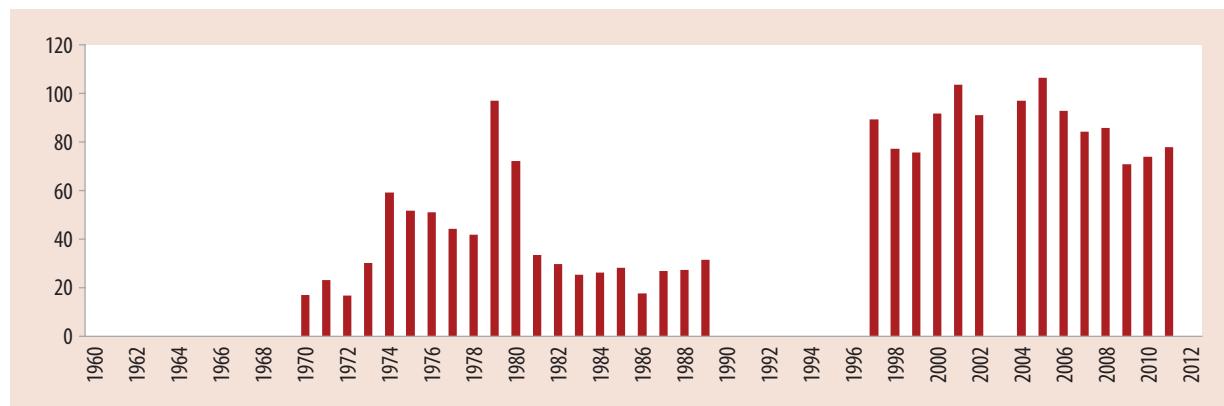
mid-1990s to the present, despite the tumultuous events during this period. The crude oil sector accounted for 44 percent of real GDP in 2012.

Very little structural policy reform took place during the reconstruction period, and private sector development is probably the weakest reform area of all. Iraq ranks 169 for starting a business and 189 for resolving insolvency—the worst score in the world—because it is not possible to legally close a business. The informal sector in Iraq is very large vis-à-vis the formal sector and formal sector firms are squeezed between SOEs with open-ended funding and informal firms that don't have to comply with the same rules as them.

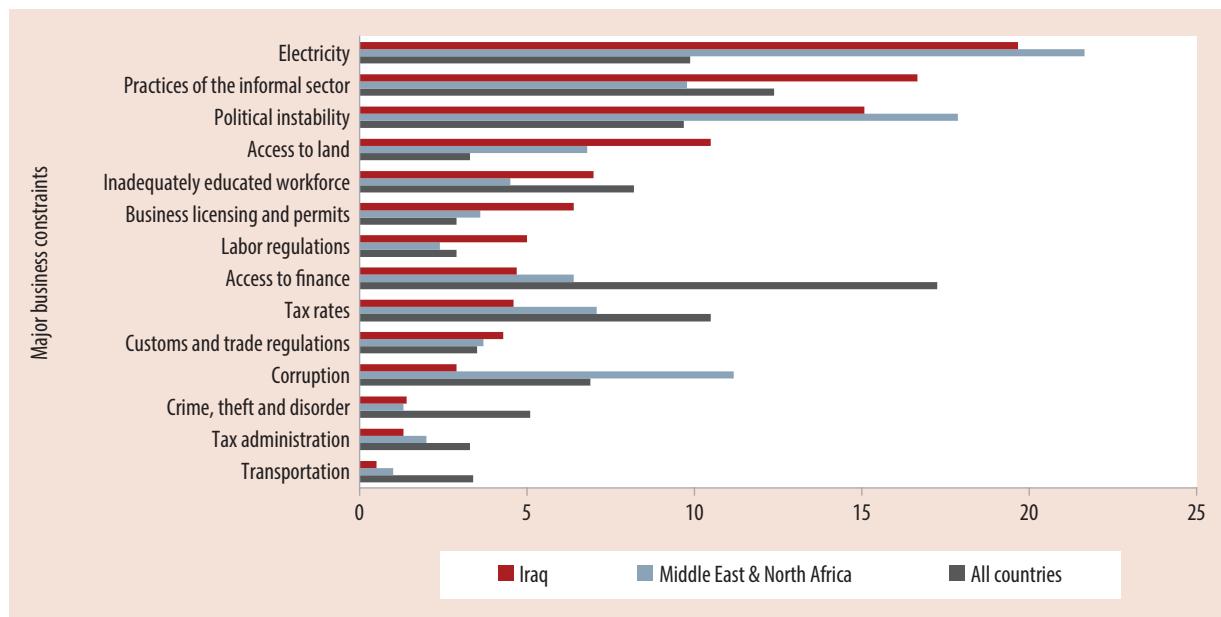
Another consequence of these lost decades has been the erosion of human capital, the destruction of essential infrastructure and the loss of qualified staff to deliver basic services. Stagnation and deterioration in human capital matter especially because they are currently affecting the younger cohorts of Iraq's working age population. Almost half of the population of Iraq is below the age of 30, and the generational deficit in human capital will have significant implications for the future.

In the 1980s, Iraq had one of the best educational systems in the region. Iraq's 1970 Provisional Constitution guaranteed the right to free education at all levels for all its citizens and stated that education

**FIGURE 8:** Oil Rents (% of GDP), 1960–2012



Source: World Development Indicators (2012).

**FIGURE 9:** Major Business Constraints, Iraq 2012

Source: Authors' calculations, World Bank Enterprise Survey, Iraq, 2011.

was compulsory. In 1978, the state launched a mandatory campaign for combating illiteracy, in which it was obligatory for all Iraqi citizens between the ages of 15 and 45 to join. The program supported participants until they achieved fourth-grade level of reading, writing and mathematics. The Iran-Iraq war, the first Gulf war and the subsequent sanctions, as well as the decades of violence that followed led to large scale destruction and deterioration in infrastructure and severe shortages of qualified teachers. Today, adult male and female literacy rates in Iraq are below the MENA average and well below the average for similar upper middle income countries.

There is evidence of the long term impact of conflict on educational outcomes across generations. For one, illiteracy rates for the cohort in their mid-30s or younger in the 2012 are actually higher relative to those in their late 30s. These cohorts were born after 1975, were of school-going age during the Iran-Iraq war and thereafter, when the mandatory literacy campaign became harder to implement. 12 percent of those born in the 1980s, who might have been in primary school at the time of the first Gulf war, are illiterate in 2012. For Iraqis of all ages, the

most prevalent level of education is primary schooling or less: among 18–27 year olds, about 60 percent of have no more than primary education and 18 year olds in Iraq today are as likely to have completed primary school as those 30 years older. The incidence of intermediate, secondary and higher secondary school taken together is around 30 percent for young Iraqis ages 18–22, the same as for Iraqis in their 40s. While this in itself is worrying, within this group, over time, the share of higher secondary graduates has remained stagnant with some improvements in tertiary education only evident among the youngest cohorts. Overall these trends suggest a stalling of progress in education and a possible worsening of outcomes for some cohorts.

Health outcomes have also worsened. 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. As may be expected in periods of violent conflict, this trend is linked to the increased rates of adult male mortality since 1980. Despite the Iran-Iraq war, adult male mortality fell slightly between 1980 and

## CONFLICT, GROWTH AND DEVELOPMENT

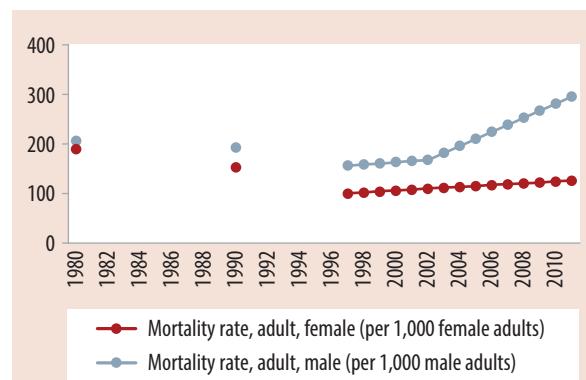
The relationship between growth, development and conflict can run both ways. On the one hand, a negative shock to economic growth is associated with a significantly higher likelihood of conflict. On the other, episodes of conflict can also negatively affect growth and development. This report uses innovative analysis to establish and quantify the negative relationship between conflict and economic growth on the one hand, and the positive relationship between development efforts and growth on the other.

Estimates suggest that compared to a district with no civilian casualties, a district with the average number of casualties experienced between 5.7 and 11.4 percent lower growth during the period from 2003 to 2010. On the other hand, a doubling of development and reconstruction projects increased growth between 5.8 and 8.4 percent. This suggests that while development efforts by the government and other actors can mitigate the negative role of violence, the required effort to compensate for the negative growth effect of violence is substantial. Moreover, violence disproportionately affects growth in poorer parts of the country, while development efforts are more effective in richer parts of the country. This implies that it will take an even larger development effort to maintain growth when violence affects poorer districts.

Thus, on a macro-economic level, and absent the establishment of peace and security in the nation, maintaining growth can in itself be a challenge in Iraq, and without these two pre-conditions in place, poverty reduction and broad-based prosperity will be difficult to sustain.

1990. This trend appears to continue until the mid-1990s. However, since 2002, Iraq has witnessed a sharp increase in male mortality: from 167 per 1000 to 295 per 1000 in 2011. Worryingly, the adverse impacts of the protracted insecurity on health and basic services infrastructure is also reflected in rising adult female mortality since the 1980s, and a deterioration in infant mortality relative to the rest of the region. In 1960, Iraq's ranking by infant mortality rate within the region was roughly in the middle (World Development Indicators, 2012). While across the region, these rates have come down sharply, Iraq has not brought down IMR at the same pace. In 2011, Iraq's IMR was the highest in the region, barring Yemen (and possibly Djibouti). There is also evidence of deteriorating nutritional outcomes for young children: according to a 2007 World Food Program report, 22% of children aged 0–5 were stunted (low height for age, and indicator of chronic malnourishment); and almost 10 percent of children

**FIGURE 10: Mortality Rate, Adult (per 1,000 Adults), Iraq, 1980–2010**



Source: World Development Indicators (2012).

were underweight.<sup>4</sup> More recent analysis of IHSES 2012 suggests that almost a third of Iraqi children are stunted; an outcome which is correlated not only with parental wealth and the ability to satisfy caloric and nutritional requirements, but also with varying access to health care and services across space and with early motherhood and maternal malnutrition.

Finally, Iraq has one of the lowest employment-to-adult population ratios in the region; only the Palestinian Territories have a lower rate. This is also in contrast to many of the other oil-rich countries in the region. Moreover, in the last two decades, the adult male employment-to-population ratio has remained stagnant at 58 percent, and at the same time, male labor force participation (LFP) has declined, especially among the youth. While the latter could suggest increasing years of education, it is also likely that the ten percentage point decline in male youth LFP is because the decades of insecurity, violence and limited job opportunities have left young people frustrated and discouraged. As in the rest of the MENA region, gender differences in labor market participation are striking in Iraq. Contrary to men, data from the World Development Indicators suggest that adult female labor force participation has been slowly increasing over time, albeit from much lower levels.

<sup>4</sup> World Food Program, 2007. Comprehensive Food Security and Vulnerability Analysis: Iraq.

## EARLY MOTHERHOOD AND CHILD STUNTING

Stunting is a primary manifestation of malnutrition in early childhood, including malnutrition during fetal development brought on by the malnourishment of the mother, both of which are likely correlated with the income level of the household. Stunting and child underweight rates vary in Iraq with household incomes, with the highest prevalence rates among the poorest 20 percent of the population, where a third of children aged 0–5 years are stunted. However, stunting rates are high even for the richest portion of the population, with more than a fifth of children having low height-for-age, suggesting widespread malnutrition in the past among all segments of the population.

Stunting is more prevalent among the children below 36 months, suggesting that perhaps malnourished mothers may be giving birth to malnourished children, with some of the nutritional deficit being bridged with time as infants move from breastfeeding to a food diet. 35 percent of Iraqi children below the age of 1 are stunted, compared to a third of children aged 12 to 35 months, and approximately a fourth of children aged 26 to 60 months.

This suggests that over and above household incomes (and the ability to provide basic food and nutrition) and the place of residence (which determines access to health and other basic services); maternal malnutrition also plays an important role. We find that in fact, early motherhood poses particular risks in terms of child malnutrition.

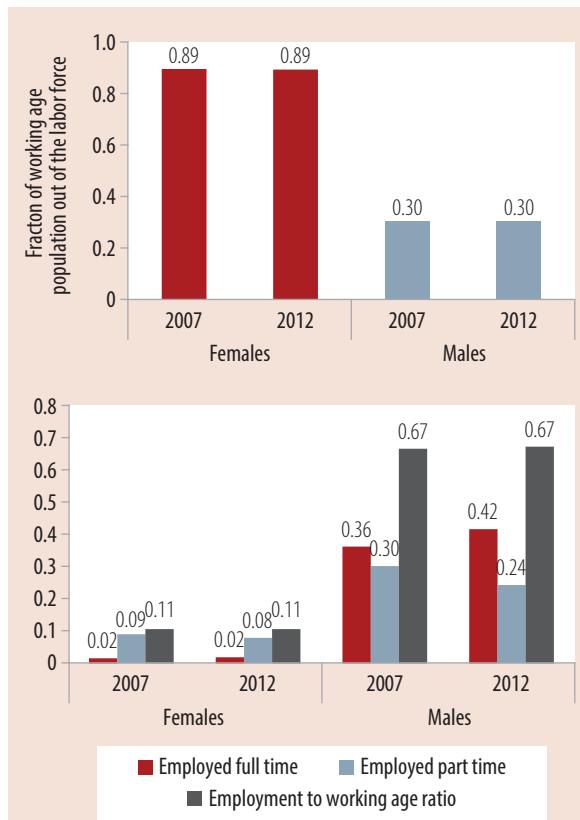
In Iraq, by age 16, 5 percent of girls are married; and by age 18, 11 percent of all girls are married. On average, between 40 and 50% of those who get married before the age of 18 also bear a child by that age. The prevalence of relatively high rates of early marriage, and correspondingly, early motherhood in certain well-off governorates, explains their relatively high stunting rates, despite relatively high welfare levels.

The relatively high rates of child stunting in Iraq is thus explained by a combination of factors:

1. Place of residence: Living in an urban area reduces the likelihood of having a stunted child in the household by 5.2%. Households living in Baghdad and the southern governorates are 17.6 and 20.4 percent more likely to have stunted children, relative to those living in Kurdistan.
2. Household welfare: Children belonging to households at the bottom of the wealth distribution are more likely to be stunted. Households belonging to the top 4th and 5th quintiles are 5 and 10 percent less likely to have a stunted child relative to those belonging to the bottom quintile.
3. Early childbirth: A mother aged 12–23 is 12 percent more likely and a mother aged 24–30 is 7 percent more likely to have a stunted child relative to mothers aged 31 or above.

Spatial divergence also became more pronounced. Whereas the Kurdish region had been the most victimized before the 1990s, with de facto independence from Baghdad, food and nutrition distribution was directly implemented by UN agencies. These had more flexibility—and access to cash—than the Baghdad government for the rest of Iraq, meaning

**FIGURE 11: Labor Market Outcomes, Share of Working Age Population (ages 15–64), 2007–2012\***



Source: Authors' calculations, IHSES 2007 and 2012

Note: \* ILO definition, 7 day recall.

that basic needs could be met more effectively. On the other hand, the southern provinces saw a double negative impact: the destruction of wars now compounded by a failed rebellion. In principle, these trends should have moderated post-2003 since Iraqi government could direct resources to areas of greatest deprivation. The administrative system for governorates not in a region is de-concentrated and therefore might be insulated from capacity differentials across regions. In practice, there seems to be a significant variation in the quality of delivery of common services across the country: the equalizing role of the central government was not effective.

With the uneven nature of security restoration across the country, the ingredients for a new set of divergences between the provinces were now

**TABLE 1:** Completed Level of Education, Share of Iraqis Aged 15–64: Division Relative to National, 2007–2012

Education level (Share of working age population), All Iraq	2007		2012	
Illiterate or incomplete primary			0.34	
Complete primary to secondary school			0.47	
Higher secondary and higher			0.16	
	Kurdistan relative to Iraq		Baghdad relative to Iraq	
	2007	2012	2007	2012
Illiterate or incomplete primary	23.01	17.81	-13.01	-12.51
Complete primary to secondary school	-19.03	-14.26	12.62	7.29
Higher secondary and tertiary	-5.92	-3.56	1.75	5.24
	North relative to Iraq		Centre relative to Iraq	
	2007	2012	2007	2012
Illiterate or incomplete primary	4.85	3.60	-3.51	-4.07
Complete primary to secondary school	-2.18	-1.18	0.11	3.91
Higher secondary and tertiary	-2.13	-2.40	2.62	0.12
	South relative to Iraq			
	2007	2012		
Illiterate or incomplete primary	4.27	3.35		
Complete primary to secondary school	-4.17	-1.75		
Higher secondary and tertiary	-0.27	-1.59		

Source: Authors' calculations, IHSES 2007 and 2012.

in place. Since the southern provinces were finally out of the grip of a hostile government in Baghdad, and home to many of the country's oil fields, the pace of economic development could pick up. While oil continued in the enclave development model, other sources of economic activity such as pilgrimages, trade with Iran, and the Basra port, came into play as drivers of regional growth. On the other hand, the provinces north and west of Baghdad were in effect contested regions: between sects, ethnicities, tribes, and insurgents, all interacting in different ways with the government. In particular, the government faced a complex calculation vis-à-vis the provinces: those with clear majorities of one sect could be taken for granted—perhaps to their detriment—while those with more finely balanced populations could also attract more competition for influence but also more violence and insecurity.

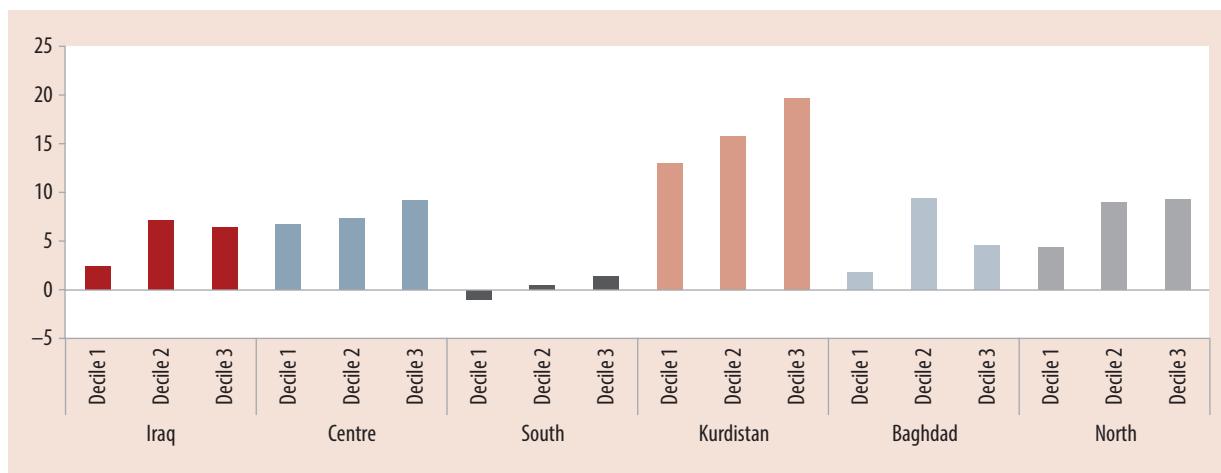
Today, Kurdistan and the South appear to be on opposite trajectories. Poverty trends mask the improvements in education and labor market outcomes that have been experienced in the three Kurdish governorates, which have also experienced a significant increase in population. Older generations in Kurdistan (those 30 and above in 2012) started out with much higher levels of illiteracy and incomplete primary education relative to Iraq and lower levels of complete primary education and higher education.

In contrast, the pattern is reversed for those in their 20s. These young people are much more likely than their counterparts to have secondary and higher levels of education.

In the South, in contrast, young people in their 20s are further behind their peers than their fathers were. A 60 year old in the South was 5 percent more likely to be illiterate and 2 percent less likely to have secondary education than an average 60 year old Iraqi while a 20 year old person is 8 percent more likely to be illiterate and 6 percent less likely to have secondary education. Similarly, health outcomes are also work in the southern governorates. 35 percent of children aged 0-5 in the southern governorates are stunted, double the rate in Kurdistan and significantly higher than that in other parts of the country.

In the southern governorates, and with the exception of Basra, the last five years appear to have compounded the neglect of the past, and the human capital deficit has been accompanied by declining male employment and labor force participation, suggesting that men are dropping out of labor force is due to discouragement. These southern governorates also had the lowest rates of full time employment in 2012, declining female employment, and among the lowest rates of part-time employment.

**FIGURE 12:** Changes in Per Capita Labor Income between 2007 and 2012 ('000s of Iraqi Dinar) for the Bottom 3 Deciles of the Consumption Distribution, National and by Division



Source: Authors' calculations, IHSES 2007 and 2012.

### *It Became Cloudy, but it Did Not Rain. It Rained, but Not Enough for People to Undo Their Sandals<sup>5</sup>*

*The Iraqi state faces long term challenges: sustained progress towards development would have required major efforts—establishing rule of law and good governance, reviving economic activity in the private sector and large scale and transformational investments in infrastructure, education, health and social services. The limited instruments available to the state in a continued fragile environment as well as significant pressure to show results implied the adoption of a relatively myopic two-pronged policy to redistribute oil revenues: by continuing the universal food subsidy system and expanding public sector employment and earnings. Even this expedient strategy however, left out certain parts of the country and certain groups, contributing a further weakening in the relationship between citizens and the state; while the major obstacles to development remained unchanged.*

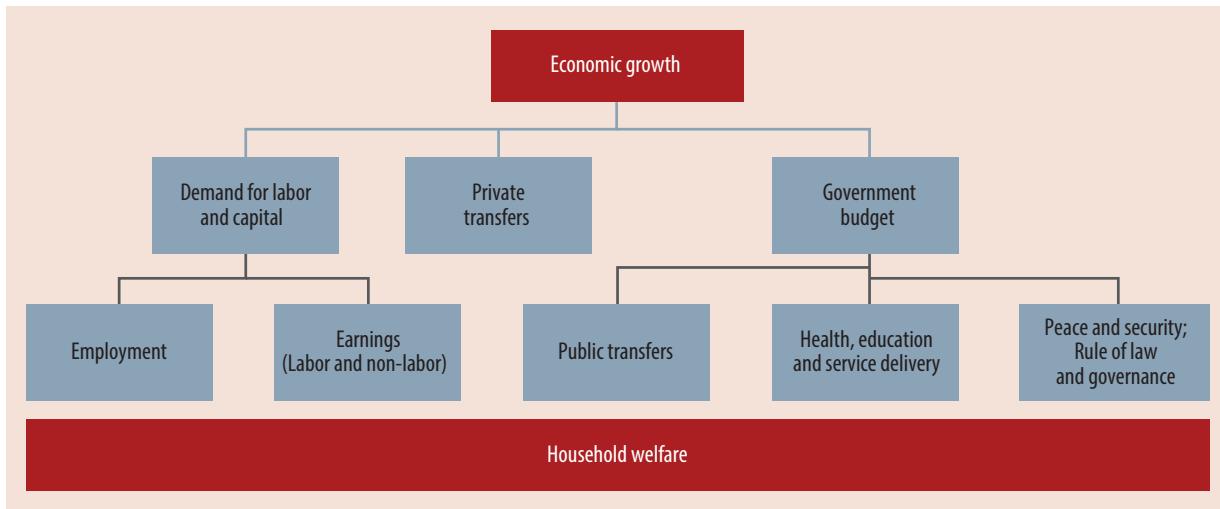
The weak links between economic growth and welfare improvements are explained in part by the structure of the economy. Growth has not been accompanied by an expansion of jobs and earnings in the private sector, where most of the poor work. The current development strategy thus has primarily

focused on distributing benefits through expanding public sector employment, bringing in relatively less educated men, while expanding the wage and benefit gap with the private sector. This has had important unintended consequences, dampening labor force participation among men and women in a market with already widespread labor market discouragement. Moreover, it has skewed the incentives to invest in education, especially for men; while limiting the incentives for women to participate in private sector employment. The other major strategy is maintaining the public distribution system, which is a universal food subsidy. A single universal social protection program has guaranteed a basic level of calories to all, but is inadequate in a context where a significant share of the population faces multiple dimensions of deprivation.

Given this strategy, it should be no surprise that the primary driver of poverty reduction between 2007 and 2012 was not through private sector led growth and employment generation. Rather, it occurred primarily through earnings increases, especially for public sector employees; accompanied by some expansion in low-skill public sector jobs.

<sup>5</sup> The Electronic Text Corpus of Sumerian proverbs: <http://etcsl.orinst.ox.ac.uk/cgi-bin/etcsl.cgi?text=c.6.1#>.

**FIGURE 13: Economic Growth and Welfare: Main Channels**



Iraq's fundamental challenge—an economic structure that translates the benefits of Iraq's endowment to a selected few—remains unchanged.

Economic growth during the period was driven by the oil sector, which represents half of the total GDP, the bulk of government revenues, and almost all export revenues. While the sector grew at an annual rate of 8 percent, it only accounts for 1 percent of jobs, and thus had almost no direct impact on employment. Other sectors which grew—utilities, construction, and commerce and retail—created few new jobs.

Of the 750,000 new jobs that were created, which were inadequate to absorb labor market entrants, 80 percent were in the public sector, a majority of which were created in the financial, insurance and other professional services sector. While employment in this sector grew by 15 percent per annum, output grew by less than 4 percent per year, suggesting that these were not high skill, high productivity jobs. Indeed, 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 employment fell by 5 percent each year, and incomes, by 2.5 percent, whereas construction earnings increased by a mere 0.8 percent. While poverty reduction was led by welfare improvements in rural areas, certain types of rural households, those completely dependent on agriculture for their livelihoods, faced sharp increases in poverty in the southern governorates.

The current development strategy thus has primarily focused on distributing benefits through expanding public sector employment and maintaining the public distribution system, which is a universal food subsidy. The particular features of public sector employment expansion in Iraq has functioned more as a safety net, bringing in relatively less educated men, while expanding the wage and benefit gap with the private sector. This has had important unintended consequences, dampening labor force participation among men and women in a market with already widespread labor market discouragement. Moreover, it has skewed the incentives to invest in education, especially for men; while limiting the incentives for women to participate in private sector employment.

**TABLE 2:** Growth, employment and labor incomes across economic sectors

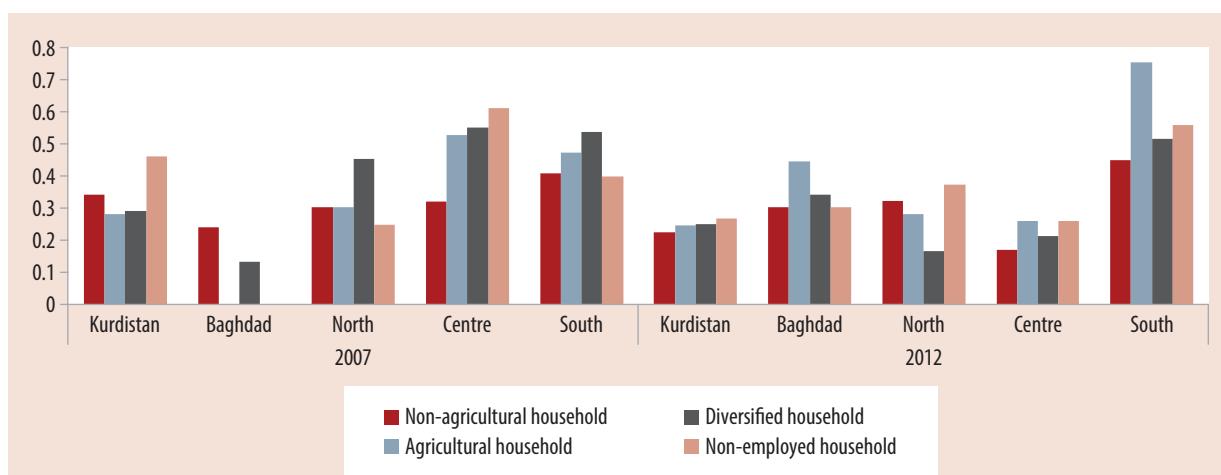
Economic Activities	Employment			Earnings		
	Annual growth rate (%) 2007–12	Labor Share (%) 2012	Annual growth rate 2007–12	Output elasticity of labor	Annual growth rate 2007–12	Output elasticity of earnings
Agriculture & fishing	2.69	8.94	−4.78	−1.78	−2.54	−0.95
Mining & quarrying	7.80	1.02	−1.29	−0.17	8.26	1.06
Manufacturing Industry	9.45	9.67	5.96	0.63	4.74	0.50
Utilities	16.08	2.21	1.87	0.12	5.94	0.37
Construction	15.30	13.63	2.96	0.19	0.82	0.05
Transport, storage & communication	7.96	11.43	3.65	0.46	6.65	0.84
Commerce and retail	12.39	15.61	0.17	0.01	6.93	0.56
Financial, insurance	3.61	14.37	15.51	4.30	3.23	0.89
Public administration	5.66	17.23	−2.81	−0.50	6.95	1.23
Other services	4.00	5.89	1.90	0.47	4.64	1.16
Total	7.09	100.00	1.95	0.27	4.77	0.67

Source: Authors' calculations, IHSES 2007 and 2012.

Female labor force participation in Iraq is amongst the lowest in the region. There are many factors at play, many of which increase the opportunity cost of women to work—conservative social norms, their dual responsibilities in the home and outside, and security risks. Yet, the labor market systematically rewards women less than similarly qualified men, lowering the benefits to work. Men earn a substantial premium in the labor market relative to women

irrespective of the sector they are working in. In 2012, men earned 20 percent more than women if they were working in the public sector. This gender wage gap dramatically increases up to almost 8 times of that observed in the public sector when considering workers in the private sector.

The nature of public sector job increases also has important long-run implications, especially for

**FIGURE 14:** Trends in Headcount Rates of Different Types of Households, by Division, 2007 and 2012

Source: Authors' calculations, IHSES 2007 and 2012.

Iraq's youth. Youth labor force participation in Iraq is low and stagnant. Only 40 percent of Iraqis between the ages of 15 and 24 who are not in school, are employed or looking for work. This means that 6 out of every 10 young Iraqis who are not in school are neither working nor actively seeking work. However, labor force participation rates vary significantly by the level of education of the youth. It ranges from 25 percent for illiterate individuals to 66 percent for those with tertiary education. In contrast, the employment rate does not vary much by education. This implies much higher unemployment rates among the highest educated youth. In 2012, unemployment rates rose to almost 25 percent among youth with tertiary education in comparison to about 5 percent for illiterate youth.

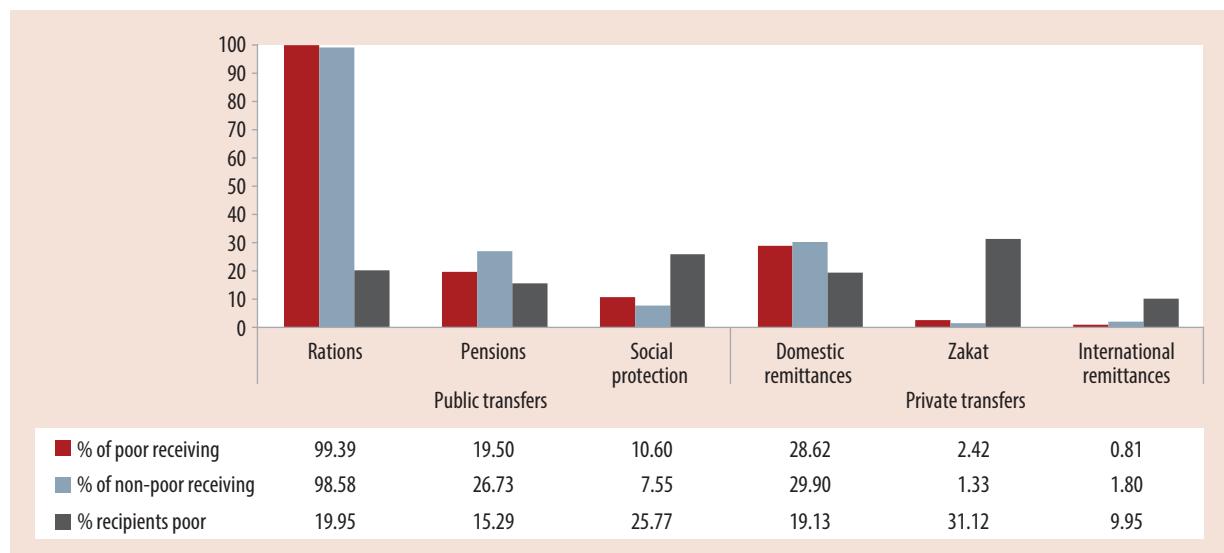
The expansion of public sector employment between 2007 and 2012, which primarily took the form of jobs for men with less education, has two major implications for Iraq's youth. First, the increasing possibility of a public sector job, with greater job security, benefits and fewer hours of work, will raise the reservation wage among the working age population and in particular new entrants into the labor market. As a result, young people in particular, have limited active job search as they wait and queue for

openings in the public sector. In fact, an increase of one percentage point in the public employment rate of the governorate of birth reduces the labor force participation of the youth by more than 40 percent, from already low levels.

Second, the increasing availability of relatively well-paying public sector jobs to less educated people has also distorted the returns to education. When we examine the earnings gains for each additional education level, we see that in 2012 an average male in the working-age population received 20 percent more in the public sector by having complete primary education relative to being illiterate. However, the premium for getting an additional level is almost negligible thereafter except when he completes tertiary education. Thus, the signals from the public sector are currently suggesting to young Iraqis that there are little gains to going beyond primary education, and these can further inhibit educational attainment in a country where the median education level is only primary school.

The other major element of the current strategy for is the social protection provided by the Public Distribution System. Iraq's PDS, the largest publicly subsidized food distribution system in the world, remains

**FIGURE 15:** Share of Poor and Non-Poor Individuals Receiving Public and Private Transfers, 2012

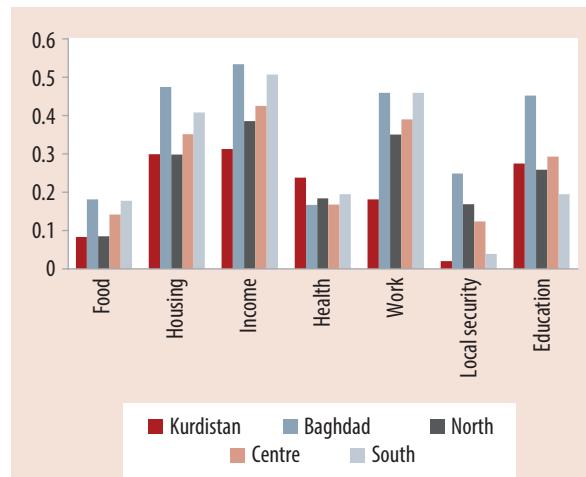


Source: Authors' calculations, IHSES 2007 and 2012.

the only safety net covering the poor and vulnerable in the country. Yet, the PDS remains 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.

Moreover, it is inadequate to protect the poor and vulnerable across the range of dimensions they are deprived in. In a nation where the median level of educational attainment is only primary schooling; where significant gaps remain in access to health care and other essential services; where employment rates remain stagnant; and where peace and security is still a concern; poverty and vulnerability goes well beyond material deprivation. Each of these deprivations is even starker in some parts of the country, in rural areas and in the southern governorates in particular. These broader elements of welfare are reflected in the subjective self-assessments of welfare expressed by Iraqis: for instance, more than 40 percent of adults aged 15 and above in the southern governorates of Thi Qar, Missan, Qadisiya, Muthanna and Basra reported being dissatisfied with their incomes, work and housing. Continued violence and protracted insecurity in Baghdad is reflected in its residents' widespread dissatisfaction—the highest in the nation—across a range of dimensions

**FIGURE 16:** Rates of Dissatisfaction, Selected Dimensions, by Division



Source: Authors' calculations, IHSES 2012.

## MEASURING THE DEPENDENCE ON THE PDS

While the PDS provides a level of broad food security to the poor and vulnerable in Iraq, it also covers more than 95 percent of the non-poor, and is therefore, a very expensive safety net program, involving a sizeable fiscal burden. Moreover, in its current form, it suffers from significant inefficiencies in procurement, distribution, and management, and implies significant macro-economic distortions because of its heavy reliance on food imports and its universal nature. For this and many other reasons, including the need for the introduction of a comprehensive safety net system going beyond food subsidies, the government of Iraq is considering further reforms to the PDS.

In order to better understand the potential impact of any such reform, the report analyzes consumer behavior in terms of the responsiveness of household demand to possible changes in prices and incomes. The estimates suggest that Iraqi households are almost non-responsive in terms of altering demand to changes in food prices of ration items and their free market equivalents. If, for example, the price of ration brown flour increases 10 percent, consumers living in rural areas would decrease their demand for ration by only 0.3 percent if they are in the bottom 40 percent of the consumption distribution. Most ration items are normal goods i.e. their consumption increases when incomes increase, and are necessary goods, so that consumption increases are on average lower than income increases. However, there are exceptions—ration brown flour is a marginally “inferior” good in urban Iraq: if household incomes increased by 10 percent, demand for ration brown flour would decrease from 0.5 up to 1.5 percent in urban areas.

However, there are also some indications that ration goods slowly become less preferred at least for those households who have larger budgets. With higher welfare levels in Kurdistan relative to urban Iraq, and in urban Iraq relative to rural Iraq, the flexibility of consumer demand to changes in prices increases. Thus, as the economy grows, consumers face greater options and ability to substitute away from ration items and increase their consumption of free market goods. In sum, as the income levels rise and with well-functioning markets, some segments of the population will naturally substitute away from the PDS and increase their consumption of market substitutes. Overall, this suggests that while any one-shot reform will have adverse and sizeable welfare impacts, over time, and with increases in incomes, some households may not be as significantly affected. Conversely, it will be important to put in place a comprehensive safety net before considering major reforms to the PDS.

including food, work, income, local security, education, and housing.

However, the only safety net that almost universally covers the poor is the PDS, which guarantees a certain level of food security but cannot address other vulnerabilities and deprivation—in human capital, economic opportunities and earnings, service delivery and housing, internal integration and security. These will require a comprehensive safety

net, substantial and sustained investments by the government in establishing the rule of law, in infrastructure, and in service delivery, as well as the revival and growth of the private sector.

## **Whoever Has Walked with Truth Generates Life<sup>6</sup>**

*The analysis in the report points to the myriad and deep-rooted challenges to poverty reduction and broad-based prosperity in Iraq. More than in most countries, poverty and deprivation in Iraq are symptomatic of its daunting legacy of violence and fragility, of a skewed economy heavily dependent on oil and on public intervention, and of decades of lost development. Addressing the goal of broad-based and sustainable development in this context and with continuing violence will require a concerted and multi-sectoral approach, combining short-term and medium-term efforts.*

In identifying areas for policy action, a few key principles are critical to keep in mind:

- Peace, security and economic growth are foundational pre-requisites for development, without which welfare gains will be difficult to realize and sustain;
- Sequencing will be very important to secure gains from reform, and supply and demand side constraints will need to be relaxed simultaneously: for instance, investing in education access and quality will not bear fruit absent adequate productive employment opportunities that generate appropriate returns on the labor market;
- Taking advantage of spillovers and complementarities, such as spatially targeted public works programs to generate employment and increase incomes which also have the potential to redress the infrastructure deficit and build skills for future jobs;
- Finally, while there is clear scope for urgent action, other efforts are also needed that will require a medium to long term horizon.

The foundational pre-requisite to economic growth and how and whether it translates into shared prosperity and poverty reduction is the establishment and maintenance of peace and security. That being said, an inclusive and broad-based development process can mitigate the risks of recurring violence, and vice versa, the deterioration of socio-economic conditions can severely test a fragile peace.

Moreover, Iraq will need to strengthen the natural links between growth and welfare through better management of oil resources, diversified development of the economy, enabling the private sector and implementing a well-designed and comprehensive safety net system. If the status quo - the current relationship between, growth, redistribution and poverty reduction - remains unchanged, it will take a sustained and significant effort in terms of growth and/or redistribution to achieve meaningful poverty reduction in the medium term. In other words, if nothing else were to change, and Iraq wanted to halve poverty by 2030, an average annual rate of GDP growth of roughly 7 percent would have to be maintained over the next 15 years, which is a challenge for any country. If a more ambitious target were conceived, GDP would have to grow even faster. The fundamental challenge is that the relationship between GDP growth and consumption growth is weak; and strengthening the relationship between the two, which will require a change in the composition and drivers of growth, will translate into larger gains in terms of poverty reduction for the same rate of GDP growth.

An economic growth process that creates employment and increases earnings, while maintaining incentives for labor participation and investments in education, is the least costly path to poverty reduction and inclusion. At the same time, Iraq faces a large deficit in infrastructure, services and human capital, which will need to be redressed. Moreover, targeted interventions are called for, to address long-standing inequities across space and groups.

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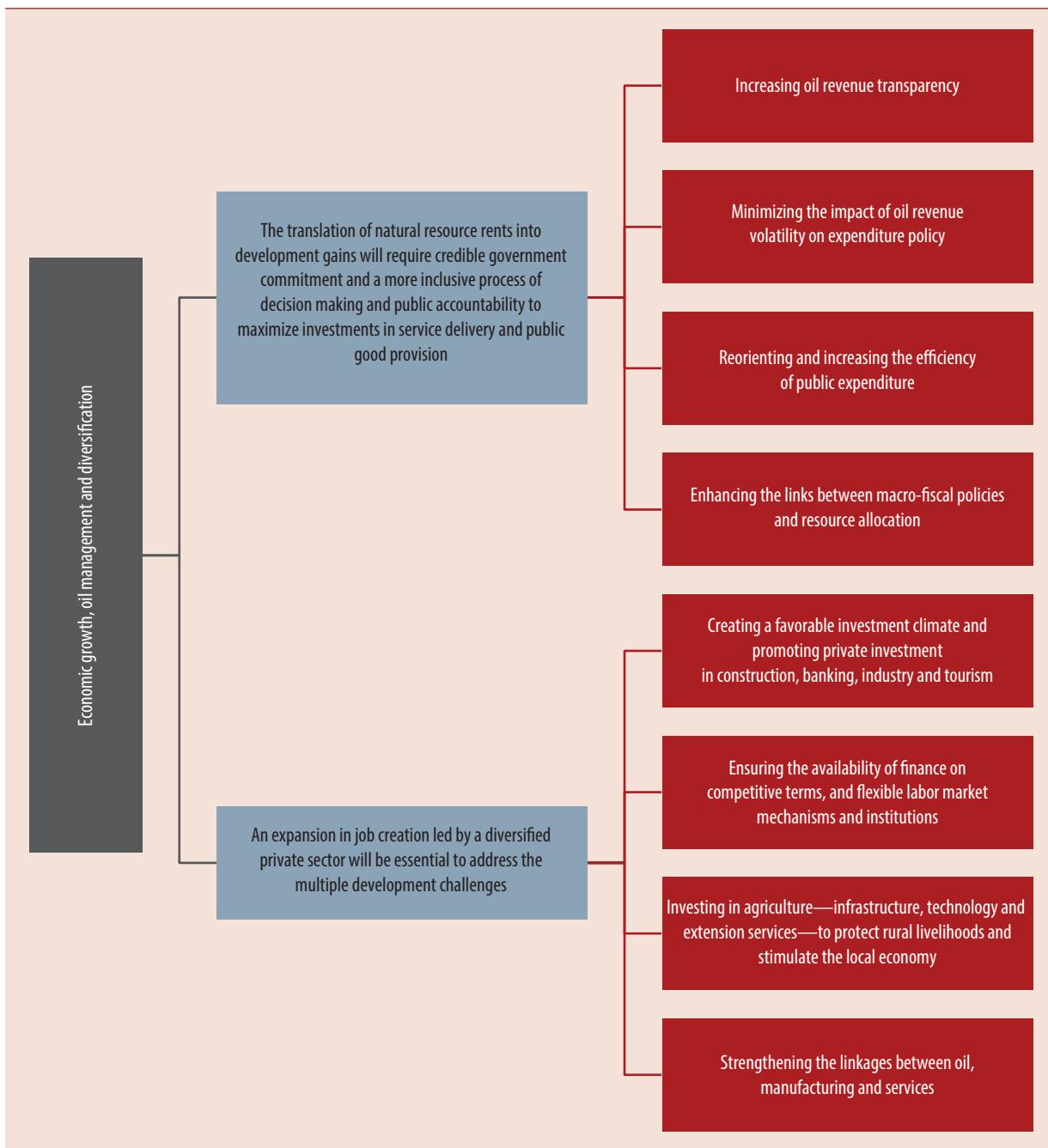
<sup>6</sup> The Electronic Text Corpus of Sumerian proverbs: <http://etcsl.orinst.ox.ac.uk/cgi-bin/etcsl.cgi?text=c.6.1#>.

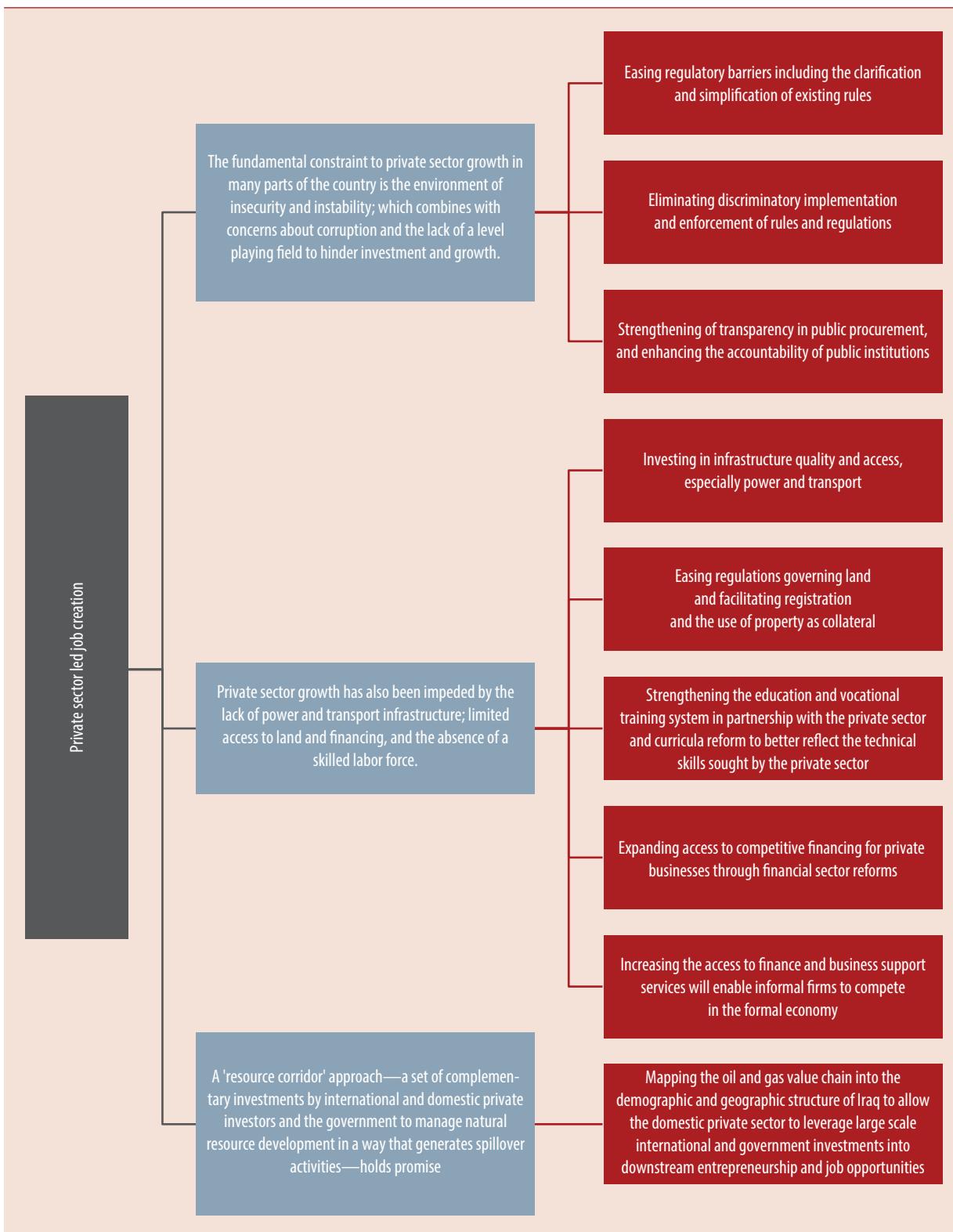
A comprehensive policy framework for enhancing the welfare of Iraq's citizens will require a three-pronged approach:

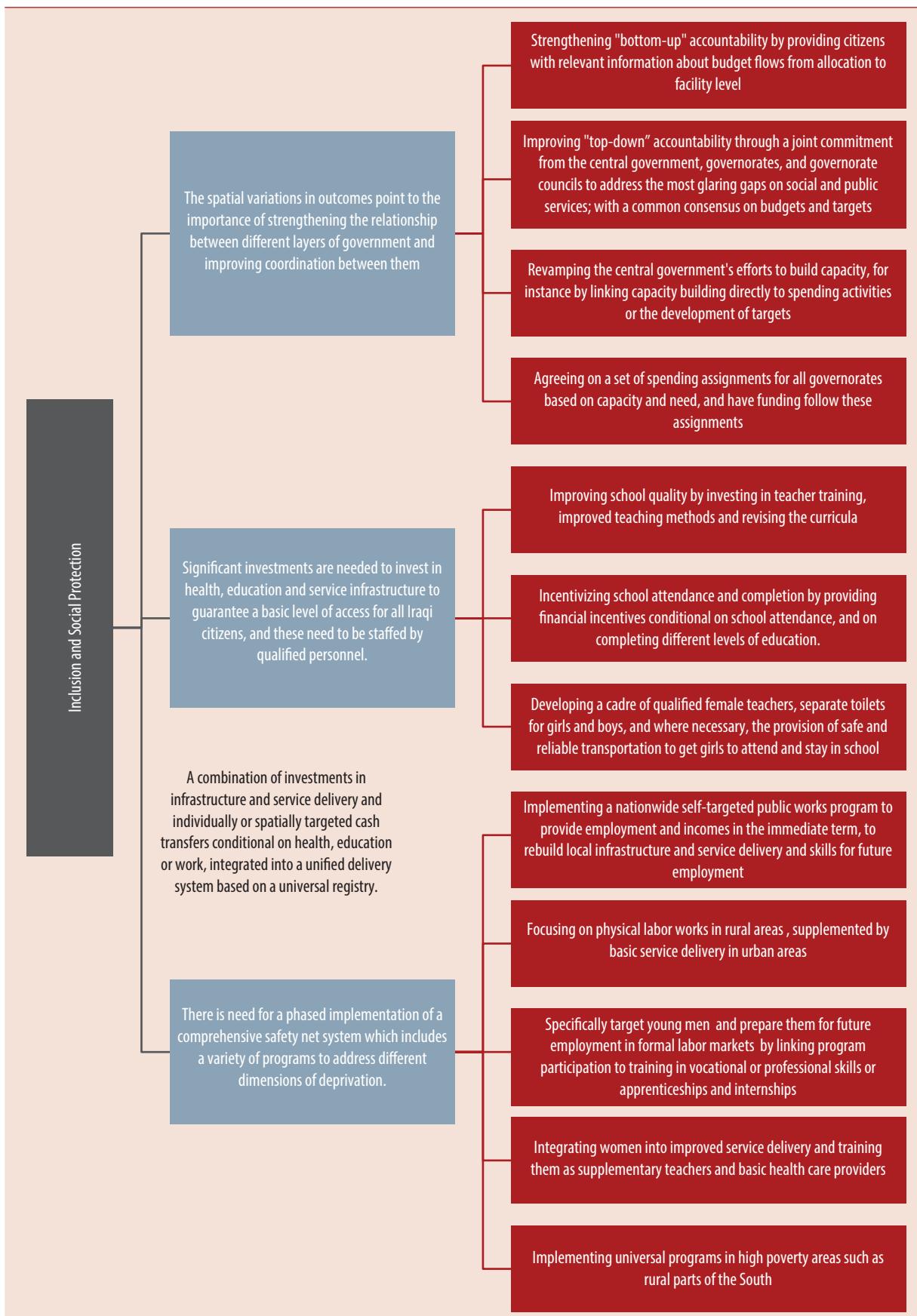
1. Establishing and maintaining peace and security is a fundamental pre-requisite
2. Maintaining economic growth, managing oil revenues, promoting the diversification of the economy in favor of non-oil and private sector led activities. While these will bear fruit in the medium and long terms, the seeds must be sown now.
3. Implementing an effective and comprehensive system of safety nets to address the multiple deprivations and vulnerabilities of the population, while redressing the human capital deficit.

The report recommends a series of policy priorities and actions organized along three themes, which are summarized below.

Iraq faces numerous and difficult challenges ahead on its path to poverty reduction. These are made more complex by the recent crises, compounding the problem of persistent poverty in some areas with the emergence of newly deprived parts of the country, and the increased vulnerability of the population to poverty due to a new wave of internal displacement and far-reaching economic disruptions. The findings of this assessment can underpin a new strategy for poverty reduction that promotes truly inclusive growth, policy approaches that support alleviating disparities in income, and those across space and gender, and special programs to target pockets of deep and stubborn poverty. It also needs to take into consideration the urgent needs brought to the fore by the current crisis and yet another wave of forced displacement.













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