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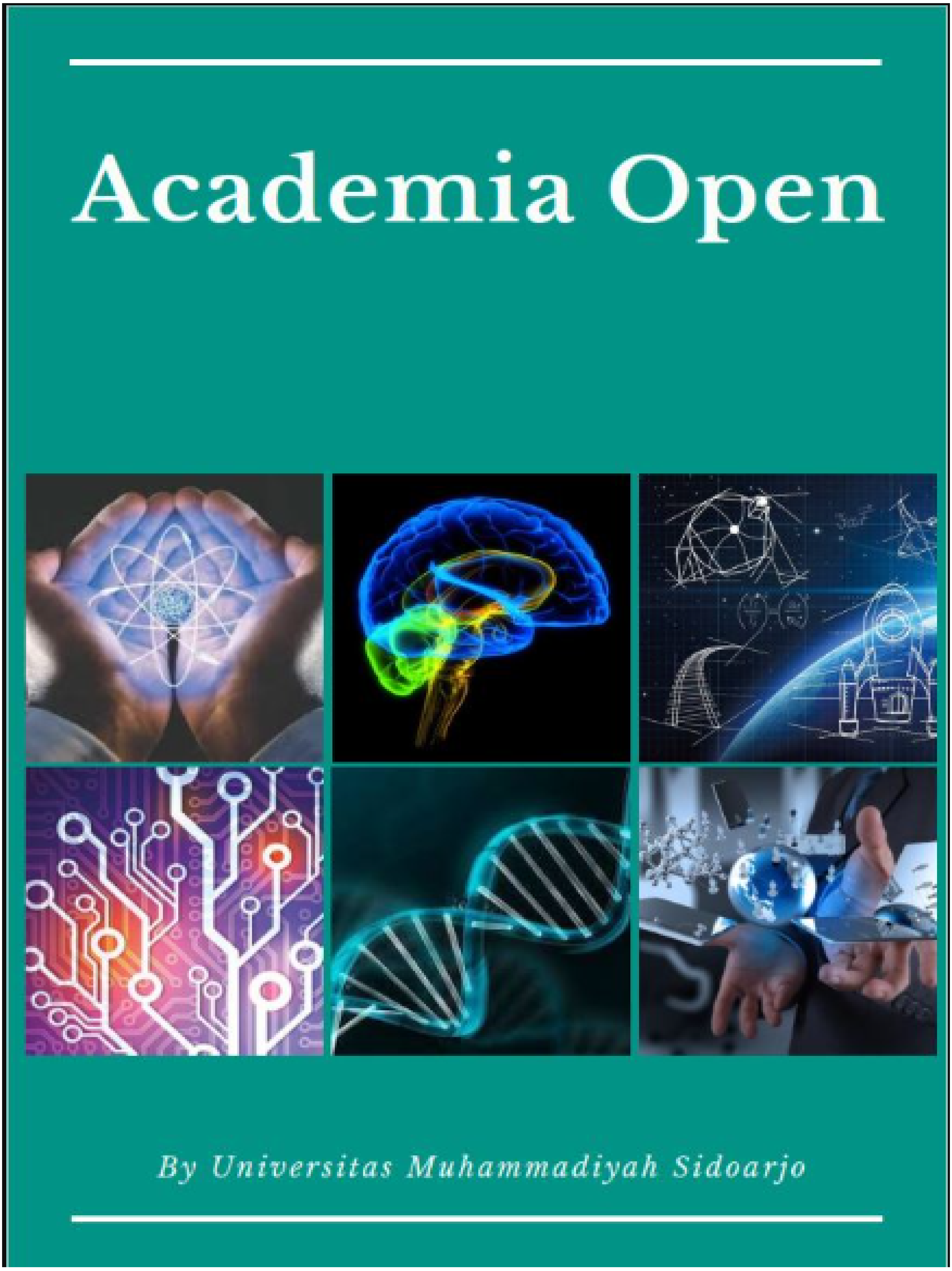

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The role of fiscal policy in Iraq after 2003 in diversifying sources of income: an analytical study: Peran kebijakan fiskal di Irak setelah 2003 dalam diversifikasi sumber pendapatan: sebuah studi analitis

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Abstract

General Background: Resource-dependent economies face persistent challenges in achieving sustainable growth and economic diversification. **Specific Background:** Iraq's economy is characterized by heavy reliance on oil revenues, weak non-oil sectors, and fiscal imbalances that constrain long-term development. **Knowledge Gap:** Despite numerous fiscal reforms, limited evidence explains why diversification outcomes remain weak within Iraq's public revenue and expenditure framework. **Aims:** This study examines fiscal policy instruments, public revenue composition, and their role in supporting economic diversification in Iraq. **Results:** The findings indicate that oil revenues dominate total public revenues, while non-oil sectors contribute marginally to gross domestic product, reflecting structural imbalances and inefficient public spending patterns. **Novelty:** The study provides an integrated analysis of fiscal, sectoral, and institutional factors shaping diversification outcomes in the Iraqi economy. **Implications:** The results highlight the need for balanced fiscal policies and stronger support for productive sectors to reduce oil dependency and promote economic stability.

Keywords: Fiscal Policy, Economic Diversification, Public Revenues, Oil Dependency, Iraqi Economy

Key Findings Highlights:

1. Public revenues in Iraq remain highly concentrated in the oil sector.
2. Non-oil productive sectors contribute weakly to economic structure.
3. Fiscal imbalances limit progress toward diversification goals.

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Introduction

The fiscal policy is considered one of the main pillars of macroeconomic policy. It bears the responsibility of organizing the financial framework through its tools—namely public expenditures and revenues—in order to achieve all desired economic objectives and ensure stability. Accordingly, fiscal policies occupy a crucial position within macroeconomic policies, as they represent the other side of economic activity. The paths taken by both the financial and real sectors are expected to move in harmony to achieve economic stability and avoid creating inflationary or deflationary trends, especially when one sector lags behind the other. In Iraq, fiscal policy plays a central role in the allocation and distribution of financial resources based on the needs and requirements of the national economy. This contributes to the provision of essential services, both from an economic and social perspective.

The Importance of the Research

The importance of this research lies in the role of fiscal policy in Iraq in diversifying income sources and reducing dependence on a single rentier resource (the oil sector). This dependence poses economic and financial risks that threaten the economy, hindering diversification and impacting financial resources, especially given the crucial role of oil prices in determining Iraq's financial future.

The Research Problem

For decades, the Iraqi economy has suffered from near-total reliance on oil revenues as its primary source of national income, making it vulnerable to economic and financial risks stemming from fluctuations in global oil prices. After 2003, despite the economic and political transformations the country has undergone, the implemented fiscal policies have not been clearly successful in achieving the desired economic diversification.

The Research Hypothesis

Fiscal policy in Iraq after 2003 has had a limited and ineffective impact on diversifying income sources due to excessive reliance on oil revenues and the weak direction of public spending and investment towards non-oil sectors. Research Objective

This research aims to analyze the effectiveness of fiscal policy in Iraq after 2003 in achieving diversification of national income sources, by studying fiscal policy tools (such as public spending and public revenues), identifying the obstacles facing the economic diversification process, and proposing ways to enhance the role of fiscal policy in supporting non-oil sectors and achieving sustainable development.

Section One

Fiscal Policy (Concept and Tools)

The emergence of financial thought is largely linked to the rise of governmental systems when a public body assumes the management and regulation of a country's financial affairs. This aims to regulate the relationships between all economic activities and sectors, on the one hand, and the individuals within society, on the other, and the resulting transactions and exchanges. Interest in studying societal financial matters has been largely tied to the extent of government intervention in managing economic, social, and political affairs. This intervention did not occur on a large scale until modern times, serving as a starting point for developing new and modern perspectives on addressing various crises and achieving economic stability. This necessitates the design and implementation of macroeconomic policies, including fiscal policy, to address the causes of imbalances and their impact on GDP and employment.

First Requirement: The Concept of Fiscal Policy:

The concept of fiscal policy varies according to different historical periods and economic, intellectual, and social conditions. One such definition describes it as "a set of measures taken by the government through changes in its spending or taxation levels to have a comprehensive impact on the economy in general, in order to achieve specific objectives, including price stability, full employment, and economic growth." [1].Fiscal policy is also defined as a mechanism that links government revenues and expenditures, designed to address economic fluctuations, reduce or eliminate unemployment and inflation rates, and ultimately achieve economic growth[2].

Fiscal policy may be expansionary when the goal is to stimulate aggregate demand, as is the case during recessions. In this situation, the government may employ one of the following policies: a deficit spending policy, a deficit without spending policy, or a spending policy without a deficit. Conversely, during periods of economic boom leading to inflation, the government may adopt a contractionary fiscal policy, which essentially involves implementing the aforementioned policies.[3] The concept of fiscal policy refers to the relationship between government spending and revenues, which it uses to counter economic fluctuations in order to reduce or eliminate unemployment and inflation rates, as well as to achieve sustainable and manageable economic growth [4].

After reviewing the preceding concepts, fiscal policy can be defined as a set of measures employed by the government, specifically the Ministry of Finance, aimed at achieving economic stability. It is a tool at the disposal of the state, enabling it

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to utilize revenues and expenditures to achieve specific objectives, including developing and advancing the national economy, addressing inflation and recession, and redistributing income and wealth among members of society.

Second Requirement: Tools of Fiscal Policy

Fiscal policy is considered one of the most important tools used by the government to achieve economic stability and stimulate growth. It encompasses decisions related to public revenues (such as fees and taxes) and public expenditures. Through this policy, the state seeks to influence aggregate demand levels and guide the economy towards goals such as increasing production, reducing unemployment, and controlling inflation.

First: Public Government Spending

This refers to the spending program that aligns with the nature of the state in various economic, social, and political aspects of life. It aims to address the expenditures of the government and its affiliated local bodies. The evolution of public spending reflects the development of the state and its responsibility towards achieving economic stability and the consequent availability of the right conditions that lead to economic development and social justice in countries around the world [5].

Second: Public Revenues:

These are the cash amounts that the state receives from its public bodies, whether economic or sovereign revenues, which enter the state treasury permanently and are neither refundable nor divisible, and are intended to finance public spending [6].

Third: Taxes:

Taxes are among the most important tools of fiscal policy because they are a significant source of public revenue that flows into the state treasury. A tax is defined as a sum of money that individuals are legally obligated to pay to the state or one of its agencies as a final contribution to public expenses, without any private benefit in return for paying that tax. Taxes are divided into direct taxes, such as income tax and capital gains tax, which are levied on individuals, and indirect taxes, such as sales taxes and production taxes. Taxes affect the volume of economic activity, increasing or decreasing it according to the prevailing conditions of the national economy**[2].**

Fourth: Public Debt:

Public debt is a modern tool used in fiscal policy. It is an integral part of fiscal policy, whether it is domestic or international debt. Modern fiscal theory emphasizes the legitimacy of deficit financing for the general budget. It also contributes to financing productive projects and driving economic development. Therefore, it is a tool capable of guiding economic activity, provided that this debt is used appropriately[7].

Section Two: The Reality of Fiscal Policy in Iraq and its Challenges After 2003

Iraq witnessed profound political and economic transformations after 2003, which directly impacted its financial and economic structure. The political change led to a comprehensive restructuring of state institutions, including the financial system, posing significant challenges for policymakers in formulating and implementing an effective fiscal policy that responds to the new realities. Despite the availability of oil resources, which constitute the primary source of public revenue, fiscal policy in Iraq faced numerous difficulties, including excessive reliance on oil revenues, weak economic diversification, and escalating rates of corruption and financial mismanagement.

The importance of studying the reality of fiscal policy in Iraq after 2003 stems from the growing need for deep financial and structural reforms aimed at achieving economic stability, ensuring equitable resource distribution, and enhancing the efficiency of public spending. Furthermore, the challenges that accompanied this period, such as security and political crises and fluctuating oil prices, necessitate an analysis of the implemented fiscal policies, identifying shortcomings and proposing solutions.

The first requirement: The main challenges facing fiscal policy in Iraq after 2003

Iraq after 2003 witnessed significant political and economic transformations that directly impacted the management of financial and economic affairs. Political changes, accompanied by security and structural instability, contributed to a complex environment in which fiscal policy faced considerable challenges. While fiscal policy is a fundamental tool for achieving economic stability and stimulating development, Iraq encountered numerous difficulties in this area. These difficulties included near-total dependence on oil revenues, weak economic diversification, a growing budget deficit, widespread administrative and financial corruption, and a weak institutional framework. Furthermore, regional and international circumstances, along with internal challenges, affected the state's ability to formulate and implement effective fiscal policies.

First: Primarily Reliance on Oil Revenue:

Iraq is considered one of the most oil-dependent countries in the world. Over the past decade, oil revenues have constituted more than 99% of its exports, approximately 85% of its general budget revenues, and nearly 42% of its GDP. This excessive

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reliance on oil exposes the Iraqi economy to macroeconomic fluctuations. The decline in oil revenues, resulting from the COVID-19 pandemic, had a significant impact on GDP in 2020, which contracted by 15.7%. This decline in oil revenues also led to a substantial decrease in public spending, particularly investment spending, further exacerbating the contraction of the Iraqi economy in 2020[8].

Second: The State Budget Deficit

The Iraqi economy is exposed to factors such as economic recession, tax evasion, and flawed demographic, political, and financial policies that lead to public expenditures exceeding public revenues, resulting in a state budget deficit. Below is a table showing the surplus and deficit during the period from 2004 to 2020.

Years	Actual revenueBillion dinars	Actual revenue percentage	Actual expenditure is one billion dinars	Actual expenditure percentage	The actual surplus or deficit is one billion dinars.	Actual surplus or deficit percentage%
2004	32982.74	3	32117.49	3	865.248	1
2005	40502.89	3	26375.18	2	14127.72	9
2006	49055.55	4	38806.68	3	10248.87	7
2007	54599.45	4	39031.23	3	15568.22	10
2008	80252.18	6	59403.38	5	20848.81	14
2009	55209.35	4	52567.03	5	2642.328	2
2010	69521.12	5	64351.98	6	5169.133	3
2011	99998.78	8	69639.52	6	30359.25	20
2012	119466.4	9	90374.87	8	29091.62	19
2013	113767.4	9	106873	9	6894.368	5
2014	105386.6	8	83556.23	7	21830.4	14
2015	66470.25	5	70397.52	6	-3927.26	-3
2016	54409.27	4	67067.44	6	-12658.2	-8
2017	77335.96	6	75490.12	7	1845.84	1
2018	106559.8	8	80873.19	7	25686.65	17
2019	107567	8	111723.5	10	4156.53-	-3
2020	63199.69	5	76082.44	7	12882.8-	-9
□□□□□□□	1,296,284	100	1,144,731	100	151,554	100

Table 1.
Source: Official website of the Central Bank of Iraq

As shown in the table above:

1. Total actual revenues amounted to approximately 1,296.284 billion dinars. The highest revenue percentage was achieved in 2012, reaching approximately 9%, followed by 2013 (9%), and then 2019 (8%).

1. Actual expenditures amounted to 1,144.731 billion dinars.
2. The actual budget deficit for the years 2015, 2016, 2019, and 2020 amounted to approximately 33.652 billion Iraqi dinars.

Third: Weakness of the Tax System

The tax system generally suffers from weak revenues, as well as a lack of diversity in tax bases in most developing countries, including Iraq. This is due to the numerous challenges and obstacles facing the implementation of tax policy as a component of the budget and a tool for stimulating economic growth and stability in Iraq. Therefore, there are several obstacles and reasons that lead to the weakness of the tax system in Iraq, including: [9]-

1. Reliance on oil revenues to finance the budget weakens the role of taxes, relegating them to the secondary source of funding for public spending.
2. Weaknesses in tax administration and tax collection have led to a decline in revenues. This is due to a lack of information and data from taxpayers, as well as administrative and financial corruption and the proliferation of ill-conceived tax exemptions after 2003.
3. The absence of an accounting system in the private sector makes revenue collection difficult. Furthermore, the widespread informal sector has resulted in lost tax revenue.
4. A lack of cultural awareness in society regarding the role of taxation in developing the financial system and its contribution to economic development and improved services.
5. The low level of education and technical expertise among tax officials, coupled with a lack of skills and training, leads to a decline in tax revenues.
6. Weak oversight, whether internal or external, hinders the development of the tax system and has led to widespread tax evasion.

The second requirement: Policies and implementation methods

Administrative and operational policies are an essential part of any organization or business entity, as they define the

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general framework within which operations are managed and decisions are made. These policies aim to ensure the efficient and effective achievement of strategic objectives, adherence to regulations and laws, and the promotion of good governance.

Implementation methods refer to the mechanisms and procedures followed to implement these policies in practice. These methods include developing implementation plans, defining responsibilities, and establishing monitoring and evaluation standards to ensure compliance and address any deviations. Understanding the complementary relationship between policies and implementation methods is key to ensuring improved institutional performance, providing the highest quality services, and enhancing the satisfaction of both beneficiaries and employees.

First: Tax system reform

The tax system is a fundamental pillar of any national economy, as it constitutes the primary tool upon which the state relies to finance its public expenditures and achieve its economic and social objectives. To develop and reform the tax system in Iraq, there are a number of procedures, which are: [4]

1. Oil revenues cannot be relied upon to cover current expenditures. Instead, they should be allocated to increasing capital accumulation, whether in the production of goods or services.
2. The government must rely on taxes as a secondary source of funding for current expenditures. Indirect taxes, which are unsuitable for primitive societies and fail to achieve social justice, unlike direct taxes, should not be relied upon.
3. The tax administration must develop and improve its treatment of citizens to gain their satisfaction and trust. This is crucial for the successful implementation of its policies.
4. To reduce obstacles in the tax system, tensions between taxpayers and the tax authority must be alleviated, fostering exchange, trust, and cooperation.
5. The tax law in Iraq must be developed and amended, as these laws are influenced by the economic and social ideologies adopted by the ruling authority. This amendment may involve increasing, decreasing, or eliminating certain taxes.

Second: Combating Administrative and Financial Corruption:

Administrative corruption can take many forms, such as bribery, embezzlement, nepotism, favoritism, forgery, abuse of political influence, arbitrary decision-making in processing transactions, leaking sensitive information, neglecting and misusing public funds, and extorting citizens and residents by imposing fictitious fees to facilitate administrative transactions. This corruption varies in its levels; it may appear through a corrupt employee in a ministry who accepts bribes, for example, or it may extend to an entire department involved in administrative crimes through the collusion of the director with his subordinates[10].

Administrative corruption can be combated through a set of measures, which are:[11]

1. Streamlining work processes and setting deadlines for completing transactions are key factors in combating corruption.
2. Regular employee transfers can facilitate and reduce the prevalence of bribery.
3. Establishing specialized committees to develop a comprehensive employee performance system, conducting periodic inspections across departments and ministries, and preparing related reports.
4. Creating a classification system that categorizes public sector jobs according to the nature of their duties into classes and ranks requiring a consistent level of qualifications and knowledge (i.e., adopting a standard of competence and experience).
5. Determining a salary scale for each category within the classification system after conducting a comparative study of similar jobs in the public and private sectors.
6. Establishing an effective and independent oversight system tasked with supervising and monitoring the practices of ministers and employees in every ministry and institution.
7. Activating service management, meaning that it should encompass all public departments, institutions, and municipalities, with priority given to public service departments.
8. Working to find the necessary ways to escape the tunnel of corruption and terrorism without falling into a vicious cycle, which begins with repairing the massive damage to the value system, patterns of thinking, and the accompanying ills such as opportunism, negativity, and distorted communication with oneself and others.
9. Spreading ethical, religious, cultural, and civilizational awareness among all citizens.

Third: Adopting a Program and Performance Budget

A program and performance budget is a type of budget that aims to link public expenditures to specific objectives. Through it, the objectives to be achieved are defined, and the amount of expenditures required to implement the programs planned for inclusion in the budget is estimated, with the goal of achieving those objectives. This budget also includes setting objective standards and metrics that help measure the extent of program implementation and evaluate its efficiency and performance.

The US Economic Development Commission defined program and performance budgeting as a set of methods that enable program managers to focus precisely on implementing the objectives within their responsibilities, with the ability to compare progress in achieving these objectives in terms of working hours, materials used, and time[12].

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Section Three: Fiscal Policy Mechanisms in Iraq for Diversifying Income Sources

Diversifying income sources is a strategic objective pursued by all countries with rentier economies, such as Iraq, to reduce their excessive dependence on the oil sector. Since 2003, Iraqi fiscal policy has faced significant challenges in this area due to political instability, weak institutions, and the absence of a clear economic vision. With the recurring crises resulting from fluctuating global oil prices, the urgent need has arisen to adopt effective fiscal policy mechanisms aimed at broadening the economic base and activating non-oil sectors. These mechanisms include reforming the tax system, stimulating domestic and foreign investment, supporting small and medium-sized enterprises (SMEs), and adopting financial plans that ensure the sustainability of revenues independent of oil revenues. This research aims to analyze the most prominent fiscal policy mechanisms employed in Iraq to diversify income sources and to evaluate their effectiveness in light of current economic challenges.

First: Diversifying Economic Sectors Contributing to the Gross Domestic Product (GDP)

This indicator represents the contribution of the productive, distributive, and service sectors of the economy, generated by individuals within the country and resident foreigners, to the Gross Domestic Product (GDP) over a specific period, usually one year. GDP measures all goods and services produced within a country during a given timeframe, encompassing all economic activities. Therefore, it serves as an indicator of the size of a nation's economy, as it measures the total output of goods and services, thus accurately and clearly reflecting the economic situation of a country.[13] In addition to encompassing the performance of all its constituent sectors, the GDP data allows for forecasting current and future trends in the country's economic development, enabling us to formulate policies for the future.[14] In Iraq, three main sectors contribute to the formation of the gross domestic product, as we mentioned previously. These sectors consist of sub-activities. The first is the productive sectors (agricultural, industrial, oil, electricity-water, and construction). The second is the distribution sectors (transport, wholesale-retail, insurance, and finance). The third is the services sector (housing, social development, and personal services). These sectors, over the course of two decades, have remained diverse in their formation of the gross domestic product. When tracing the composition of the gross domestic product of the Iraqi economy, we find that it has been characterized by structural imbalance due to the primary and main dependence on oil to finance its resources. Extractive industries have taken the lead in their contribution to the formation of the gross domestic product at the expense of the decline in the productivity of the basic economic sectors represented by agriculture, manufacturing, and other activities, which has resulted in the failure to achieve economic balance. The continued decline in the contribution of productive sectors to GDP, coupled with a clear government tendency to support commodity-based activities at the expense of service and distribution activities, has led to structural imbalances in the relative distribution of the national economy's sectors.

These imbalances constitute obstacles to progress and development, ultimately resulting in fluctuating productivity in non-oil sectors, a low contribution to GDP, and a high degree of dependence on the oil sector. The following table illustrates the contribution of the main economic sectors to GDP during the period 2004-2022.

Table (2)

The development of the contribution of local sectors to the formation of the gross domestic product (GDP) in Iraq for the period (2004-2020)

Years	**Sectors**	**2004**	**2005**	**2009**	**2010**	**2015**	**2016**	**2019**	**2020**	**2021**	**2022**
Production sectors	**Agriculture %**	6.9	6.9	5.2	5.2	4.1	3.9	3.7	6.2	3.3	2.9