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The Challenge of Fiscal Diversification in Iraq

A Reading into the Reality and Future of Non-Oil Revenues (2023-2025)

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I. Abstract

Achieving structural transformation requires accelerating the pace of financial and administrative reform. This includes completing the digital transformation, automating the tax and customs systems to control border crossings, and updating economic laws and legislation to limit unjustified exemptions, as well as integrating the informal sector into the formal economy by providing incentives and facilities for small and medium-sized enterprises (SMEs).

Ultimately, expanding the tax base and revitalizing non-oil productive sectors, in parallel with redefining the economic role of the state, remain the two fundamental pillars for building a resilient economy capable of absorbing external shocks and securing the future of coming generations.

II. Introduction

Political economy and public finance scholars agree that oil abundance can turn from a "developmental blessing" into a "structural curse" if misused and if strategic visions for diversifying national income sources are absent. This phenomenon is known in economic literature as the "Resource Curse," where the easy and massive influx of oil revenues leads to the paralysis of other productive sectors, the inflation of the state administrative apparatus, and the erosion of institutional incentives to build an efficient and fair tax and customs system.

Iraq stands today as one of the most prominent global examples embodying this structural curse; since the decision to nationalize oil in the 1970s, the Iraqi economy has gradually slipped into the abyss of the "rentier trap." This has made the state almost absolutely dependent on crude oil export revenues to finance its inflated consumption expenditures, primarily current expenditures, in exchange for an almost complete decline of real productive sectors, such as agriculture, industry, and value-added services.

The recurring financial crises that battered Iraq following the collapse of oil prices in global markets, as occurred in 2008 and 2014, and during the COVID-19 pandemic in 2020, as well as the crisis of the suspension of oil exports through the southern outlet following regional geopolitical tensions in February of this year, have exposed the deep structural fragility of the Iraqi economy. When oil prices fall or oil export chains are disrupted, the state finds itself unable to secure unavoidable current expenditures, such as salaries, pensions, and debt service, without resorting to borrowing or depleting the foreign reserves held at the Central Bank, which threatens the monetary and financial stability of the entire country.

Based on the aforementioned, enhancing non-oil revenues in Iraq is no longer merely an intellectual luxury or an economic choice subject to political maneuvering; rather, it has become an existential necessity and a structural imperative to ensure the sustainability of the state and protect the rights of future generations.

III. The Conceptual and Classificatory Framework of Non-Oil Revenues

Non-oil revenues are defined as all financial flows and receipts collected by the state's public treasury from economic sectors and sources unrelated to the extraction or sale of crude oil. These revenues can be classified, according to financial and accounting categorization, into the following chapters:

1. Taxes on Income and Wealth: Direct taxes imposed on income earned by individuals and corporations, such as income tax and corporate profit tax, in addition to taxes imposed on property and real estate wealth.
2. Commodity Taxes and Production Fees: Indirect taxes imposed on goods and services upon their domestic

production, consumption, or importation from abroad, such as customs duties and sales tax.

3. Service Fees: Financial amounts collected by state institutions in exchange for providing direct services to citizens or the business sector, such as passport issuance fees, court fees, real estate registration fees, and customs fees.

4. The Budget's Share of Public Sector Profits: Revenues that accrue to the public treasury as a share of the net profits achieved by companies, institutions, and banks wholly or partially owned by the state.

5. Transfer Revenues: Funds received by the government without providing an immediate direct commodity or service in return, including transfers between government institutions, grants, donations, and received subsidies.

6. Other Miscellaneous Revenues: Various receipts that do not fall under the previous classifications, such as legally imposed fines and penalties, and sales of miscellaneous products and services.

7. Capital Revenues: Revenues resulting from the state's disposal of its capital assets, such as the sale of government land or real estate, or the recovery of debts

and loans previously granted to other entities.

8. Non-Oil Revenues Transferred from the Kurdistan Region: The share collected locally by the Region from fees, taxes, and border crossings, which it is obligated to transfer to the federal treasury in accordance with the budget law and the political and financial agreements between the Center and the Region.

IV. Maximizing Non-Oil Revenues in Reform Visions: The "White Paper" as a Model

The White Paper represents a structural reform program aimed at restoring the financial balance of the Iraqi economy by reducing unjustified public expenditures and increasing non-oil revenues, in order to reduce the almost total reliance on oil, which historically finances approximately 93% of the public budget. The paper diagnosed a fundamental structural problem represented by the meager contribution of non-oil revenues to the gross domestic product compared to developing and emerging countries. To remedy this imbalance, the paper proposed several executive mechanisms:

- Comprehensive Digital Transformation (Automation): Transitioning from traditional paper-based transactions to electronic systems in customs and taxes, and implementing the global "ASYCUDA" system at border crossings to ensure accurate assessment of fees and limit financial corruption.

- Networking of Sonar Devices: Electronically linking customs inspection systems to control violations, limit the smuggling of goods, and protect local products.
- Developing Tax Administration: Building an integrated database for taxpayers and expanding the "tax base" to integrate informal economic activities into the state's formal system.

V. Alternative Growth Engines and the Activation of Non-Oil Sectors

The transition from the rentier model to a diversified economy requires the activation of strategic sectors capable of generating value added and job opportunities. These sectors can be divided into two categories:

1. Rapid Employment and Direct Production Sectors

- Construction and Agriculture Sectors (Immediate Employment Engines): These sectors are characterized by a high absorptive capacity for labor (especially unskilled), and they contribute to enhancing food security and reducing imports, which preserves hard currency within the country.

- Industry and Local Production Sector: This is based on revitalizing manufacturing industries to link financial stability with local production, and transforming oil revenues from consumption budgets into capital assets invested in building factories.
- Small and Medium Enterprises (SMEs): These constitute the backbone of the modern economy; it is estimated that bridging the financing gap for these enterprises is sufficient to increase gross domestic product by 2.7%, in addition to alleviating the pressure on inflated government employment.

2. Enabling and Supportive Sectors (Infrastructure)

- Electricity and Renewable Energy Sector: Reforming the electricity grid and moving toward solar energy is a prerequisite for reducing production costs and ensuring the continuity of industrial and commercial projects.
- Financial and Banking Sector: Reforming it aims to facilitate credit, provide soft loans for startups, and promote digital financial inclusion to reduce reliance on paper cash.

- Tourism and Services Sector: Iraq possesses a historical and religious heritage that makes it an attractive tourist destination, which requires modernizing infrastructure and digitizing tourism services to provide real incentives for investors.

VI. Actual Performance of Non-Oil Revenues for the Years (2023-2025)

The trajectory of non-oil revenues in Iraq during the triennial budget period (2023-2025) witnessed clear fluctuation, but it recorded a general trend toward gradual growth in its contribution to the financing structure of the public budget, as a result of certain governmental reform measures.

The table below provides an analytical comparison between oil and non-oil revenues and their actual contribution percentages:

Table 1. Analytical Comparison Between Oil and Non-Oil Revenues

Fiscal Year	Total Actual Revenues Trillion) (Dinar	Actual Oil Revenues Trillion) (Dinar	Oil Contribution (%)	Actual Non-Oil Revenues Trillion) (Dinar	Non-Oil Contribution (%)
2023	135.681	125.882	92.78%	9.799	7.22%
2024	140.774	127.536	90.60%	13.238	9.40%
2025	124.185	109.208	87.94%	14.997	12.06%

The table was prepared by the researcher based on data from the Republic of Iraq, Ministry of Finance, Accounting Directorate, Consolidation Department (Report on Actual Expenditures and Revenues up to December for the years 2023, 2024, 2025).

The financial data for the performance-gap analysis (planned versus actual) show an optimistic bias and a structural exaggeration in estimating non-oil revenues when preparing budgets:

- In 2023: The planned estimates for non-oil revenues amounted to approximately 17.3 trillion dinars, whereas the actual amount achieved did not exceed 9.799 trillion dinars, with an execution rate of only 56.6%.
- In 2024: The planning gap widened, as those revenues were estimated at 27.2 trillion dinars, while only 13.238 trillion dinars were actually recorded, with an execution rate of approximately 48.6%.
- Challenges of 2025: Public finance faced a setback in presenting the budget schedules for 2025 as a result of global oil price fluctuations and the failure to resolve financial disputes with the Kurdistan Region. Despite this, the relative contribution of non-oil revenues rose

to reach 12.06% of total actual revenues, driven by a decrease in total oil revenues and a relative improvement in collection instruments.

VII. Structural Obstacles to Maximizing Non-Oil Revenues

The stagnation of non-oil revenues below targeted levels is not solely due to a lack of economic activity, but is attributable to overlapping structural, legislative, and administrative obstacles:

1. Legislative and Legal Challenges

- Obsolescence of Tax and Customs Laws: Fundamental laws (such as Income Tax Law No. 113 of 1982 and Customs Law No. 23 of 1984) remain incapable of keeping pace with modern economic transformations such as e-commerce and digital services.
- Prevalence of Exceptions and Exemptions: The legal system suffers from a multitude of tax and customs exemptions granted to various entities under the guise of encouraging investment or bilateral agreements, which empties the laws of their content and shrinks the tax base.

2. Administrative and Institutional Obstacles

- Lack of Automation and Arbitrary Assessment: The continuous reliance on paper transactions and personal (arbitrary) assessment by tax officials weakens oversight, creating a favorable environment for evasion and financial manipulation that squanders billions of dinars annually.
- Absence of Electronic Interlinkage Between State Institutions: Weak digital coordination among state departments (the Companies Registrar, Customs, Taxes, the Central Bank, and commercial banks) makes it difficult to track the movement of funds and verify the authenticity of commercial invoices.
- Customs Duplication: The existence of two separate customs systems between the Federal Government and the Kurdistan Region represents a structural loophole that leads to the fragmentation of customs policy and the loss of public revenues.

3. Economic and Social Challenges

- Inflation of the Public Sector and Atrophy of the Private Sector: The number of government employees has multiplied excessively since 2005, leading to the inflation of current expenditures and state dominance over economic activity, in contrast to a business environment that is repellent and unstimulating for the private sector.

- Informal Economy: United Nations Development Programme (UNDP) studies indicate that about 80% of micro, small, and medium enterprises operate outside the state's formal umbrella, which deprives the treasury of a massive tax base.
- Weakness of the Banking Sector: The three government banks (Rafidain, Rasheed, and the Trade Bank of Iraq - TBI) control 86% of deposits and 82% of credit, and direct most of their funds toward financing government expenditures, depriving the private sector of the liquidity needed for growth.
- Distorted Subsidy Culture: Society has become accustomed to receiving basic services at near-free prices as an acquired rentier right; for example, subsidizing the electricity sector costs the treasury about 10 trillion dinars annually, while 58% of generated energy is lost as a result of violations and technical losses, without collecting the corresponding bills.

VIII. Fiscal Sustainability Gap Analysis and Warnings from International Institutions

The actual financial data for 2025 confirm the depth of the structural imbalance in Iraq's public finances; it is clearly evident that non-oil revenues fall short of covering the state's current expenditures, revealing a massive financing gap:

1. The Sustainability Gap in Numbers (Year 2025)

- Total actual non-oil revenues: 14.97 trillion dinars.
- Total actual current expenditures: 119.16 trillion dinars.
- Result: Non-oil revenues cover only 12.5% of current expenditures, meaning there is an operational financing gap of 87.5%, fully covered by oil revenues.

2. Inability to Cover the Salary Bill

When comparing non-oil revenues against the salaries, wages, and pensions item alone:

- Employee salary bill: 60.44 trillion dinars.
- Retiree pension bill: 20.00 trillion dinars.
- Total unavoidable salary obligations: 80.44 trillion dinars.

- Result: Non-oil revenues are insufficient to cover a quarter (18.6%) of the total salary and pension bill in the Iraqi state.

This situation is known in economic literature as a "Fragile Balance," where the state relies on the volatile rentier financing lever to plug the deficit, which threatens financial stability in the event of any shock in global energy markets.

3. Warnings from the International Monetary Fund (IMF)

The International Monetary Fund's warnings in the 2024 Article IV Consultation report confirmed the danger of this expansionary path. The Fund's experts noted that the rapid expansion in government employment critically threatens Iraq's fiscal sustainability.

The Fund warns that should oil prices fall below the $80-per-barrel level, this will lead to a sharp and immediate widening of the fiscal deficit, given the rise in the "oil breakeven price" (necessary to achieve financial balance in the Iraqi budget) to about $84 per barrel in 2024, compared to only $54 in 2020.

The Fund also expects the wage and salary bill to rise to account, on its own, for about 50% of total public spending by

2033, unless public employment policies are brought under control. This structural expansion in current expenditures will inevitably lead to a chronic fiscal deficit, undermining the fiscal space available for the investment and social spending necessary for rebuilding the country and developing non-oil sectors.

IX. Conclusion

The economic reading of the reality of the Iraqi economy shows that non-oil revenues still represent a secondary resource incapable of securing the state's basic operational requirements, keeping the country's fiscal sustainability hostage to the fluctuations of global oil markets. To transition the Iraqi economy from a fragile rentier condition to sustainable stability, there is an urgent need to adopt a comprehensive reform strategy based on diversifying sources of income and reducing the almost total reliance on oil revenues.

In this regard, this proposition aligns with the vision presented by Dr. Ali Merza in his book Economic and Oil Papers: Iraq and the World - Volume Two. He holds that non-oil revenues cannot be increased through top-down administrative decisions or by imposing arbitrary taxes in an economy suffering from deep structural distortions. Instead of temporary solutions, Dr.

Merza affirms the inevitability of launching a comprehensive "structural revolution" to revitalize local production (agricultural and industrial), reform the education sector to suit the requirements of development, empower the private sector, and protect public funds through sovereign wealth funds.

This path necessarily requires a radical shift in the state's economic philosophy, transforming it from a mere distributor of rent into a sponsor and regulator of economic activity.

Accordingly, achieving this structural transformation requires accelerating the pace of financial and administrative reform. This includes completing the digital transformation and automating the tax and customs systems to control border crossings, updating economic laws and legislation to limit unjustified exemptions, as well as integrating the informal sector into the formal economy by providing incentives and facilities for small and medium-sized enterprises.

Ultimately, expanding the tax base and revitalizing non-oil productive sectors, in parallel with redefining the economic role of the state, remain the two fundamental pillars for building a resilient economy capable of absorbing external shocks and securing the future of coming generations.

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