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Reconsidering Expenditure Priorities in Iraq: A Targeted Basic Income

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In a nutshell

- *While Iraq has experienced greater political inclusion over the last two decades, economic inclusion remains elusive.*
- *Our analysis indicates that 1) Political inclusion cannot be relied on to achieve economic inclusion, and 2) Iraq's post-2003 political arrangement have on balance worked to restrict economic inclusion.*
- *Government spending and transfers of oil income have not been widely dispersed but concentrated among public sector workers and well-connected contractors.*
- *Because of the strong incentives for official corruption, it is hard to adequately counter corruption through mostly legal and regulatory reforms or economic liberalization.*
- *Iraqi labor markets are highly distorted and hence unable to provide jobs to enough people, let alone reduce poverty.*
- *We propose a targeted basic income scheme to more equitably distribute Iraq's oil revenues.*

This policy brief highlights a paradox of Iraq's development experience since 2003. The country has moved from dictatorship to a political arrangement where elections are regularly contested and people openly criticize the government on satellite television and social media. At the same time, Iraq has found it hard to translate mostly rising—but also severely fluctuating—oil revenues into investment in infrastructure, education and health sectors, as well as employment opportunities outside the public sector. Hence the popular protests—themselves an indication of Iraq's political transformation—that criticize endemic corruption, inadequate public services and lack of jobs.

This raises doubts about the supposed benefits of political inclusion, often presented as a necessary gateway for economic inclusion and widely dispersed prosperity (see for example Acemoglu and Robinson 2012 & 2019). Indeed, we use World Bank World Governance Indicators, UNESCWA and other data to show that although Iraq's political institutions have become more inclusive along important dimensions, this inclusion has not been associated with rising investment or improved outcomes in health and education, employment outside the public sector or economic growth. That is, Iraq's system of ethno-sectarian power sharing has not promoted economic inclusion and likely made inclusion more difficult (Yousif and El-Joumayle, 2022).

First, Iraq's post 2003 political arrangements have allowed powerful political entities to use oil rents to create and sustain support networks to remain in power, sometimes through bogus government contracts as well as favoritism in public sector hiring. This means that less is left for investment in people (in their education and health, for example) as well as in physical capital formation. Given existing structures that provide strong incentives to use public organizations for private political gain and weak rule of law, corruption has become a regular part of the functioning of Iraq's existing political institutions. Within this logic incorruptible officials may not be allowed to remain in post. Allegations of official corruption can nonetheless be utilized against political rivals. Anti-corruption efforts that focus mainly on legal and regulatory actions (see IMF, 2019: 20) or that emphasize market liberalization, privatization and de-regulation (see Mauro, 1997) are likely to be inadequate or misguided. It is unrealistic to expect the beneficiaries of state flows in government to restrict those income streams, and the solidification of corruption in Iraq has occurred in the context of rising openness to global prices and markets. Incentives will have to be restructured looking ahead.

Second, we argue that political inclusion has been unable to reverse the decline in institutions and state capacity that Iraq has experienced over the last decades. Indeed, Iraq's post-2003 political arrangements have likely contributed to their decline, with conflict, economic sanctions, and brain drain, accelerated by policy measures such as de-baathifcation, all contributing over time to weakening state capacity. Meanwhile, Iraq's ethno-sectarian system of power sharing, which seeks political representation and inclusion on the basis of ethnicity, sect and even gender, has itself constrained state capacity even as it directs benefits to powerful political actors that comprise Iraq's governing class (Yousif and El-Joumayle, 2022).

In addition to rent flows in the shape of government contracts, these powerful patrons are able to offer work in the public sector that is often unrelated to merit, and the number of employees in the public sector has more than tripled since 2003. While it provides jobs and hence economic security to those able to land a government job, the favouritism in hiring makes the public sector less productive than what it would be otherwise.

The fierce competition to secure public sector employment is connected to Iraq's poorly developed public welfare system, which the IMF (2021: 14) describes as "fragmented and inefficient." The system consists of proxy-targeted cash transfers as well as non-targeted programs, such as the public distribution system, pensions and public employment. The lack of specific knowledge about who is poor, necessitates proxy targeting of transfers, for example to war widows, households with orphan children and divorced women, where the poor are disproportionately represented. In 2020, roughly 1.4 million households (not all poor) received cash payments at the cost of 1.6 percent of GDP (IMF, 2021: 13-14). In contrast, the public distribution system is near universal (highly paid civil servants are excluded) and was set up originally as a basic rations program when Iraq was subject to economic sanctions in the 1990s. Its universality has made it highly popular and the program cost 0.5 percent of GDP in 2020 (IMF, 2021: 14).

In these conditions public sector employment is a key vehicle to achieve economic security, for those who can obtain it. It is also an expensive mechanism: in 2017 public sector wages and salaries absorbed roughly two-fifths of total public spending, rising from 14 percent in 2005 (Yousif et al., 2020: 10); by 2020, the state was allocating 24 percent of GDP to wages and salaries of public sector workers (IMF, 2021: 5). At the same time, jobs generated in the private sector have tended to be informal and unorganized, with little to no job security or pension benefits.

Moreover, too few of these private sector jobs have been created, and it is consequently not possible to rely on the working of the Iraqi labor market to create enough well-paying jobs. As with other countries in MENA, the responsiveness of employment to rising GDP in Iraq is low, even less than in MENA comparators, and the employment elasticity of output is essentially zero (UNESCWA, 2021: 33). There are structural and institutional reasons for these outcomes. Among these are Iraq's economy that is dominated by oil, which is highly capital intensive and employs relatively few personnel; education systems that do not adequately prepare labor market entrants, complicated by Iraq's brain drain; and inappropriate labor and business regulations to name a few (see Yousif, 2022 for a full discussion). Yet, many of these require solutions that are long term. The upshot is that it is not possible for Iraq's labor markets to generate enough jobs to absorb new labor market entrants today.

We recommend a rebalancing of state expenditure towards those that are presently not employed in government and who are more likely to be engaged in informal activities and hence poor. We propose a targeted basic income scheme. We provide three scenarios with corresponding benefits and total costs (see Yousif and El-Joumayle, 2022). As expected, the costs vary with the number of people covered and the generosity of the benefit. For example, one scenario that offers all Iraqis a benefit equal to $2 per day would cost 17 percent of 2020 GDP, less than what the government spent on wages and salaries in 2020. The cost is reduced if public sector employees are excluded from the program.

Of course, there are difficulties associated with such a scheme. The costs of the various scenarios are sizable although they can be reduced if the benefits do not cover the entire population as indicated above. Expatriate Iraqis should also be excluded, as most reside in countries that are better off than Iraq and their inclusion would swell costs. As with any initiative, funds dedicated to this scheme might be misdirected or misused, so care will need to be taken to devise appropriate disbursement mechanisms.

We should however avoid exaggerating the negatives while simultaneously underestimating the benefits of a basic income scheme. The expected reductions in labor supply are likely to be somewhat offset by the encouragement of entrepreneurship, as occurred when a basic income program was implemented in Iran. The encouragement of innovation and investment would work to partly counterbalance the presumed displacement of public investment by the basic income, a criticism that is sometimes made of the basic income. Moreover, the social rate of return on the spending of the basic income by recipients is likely to be high and might exceed that of some government expenditures given the past performance of spending on government contracts and public sector employment. In fact, the basic income might work to complement government investments in infrastructure, education and health. There are other advantages too, including improved mental health and reduced anxiety on the part of income recipients (Banerjee, Niehaus and Suri, 2019: 13). The choice is thus less between consumption versus investment, much of which is financed by the state, and more about who receives government transfers: favored groups or the general public.

In sum, while we recognize the difficulties, we posit that a targeted basic income scheme represents a fairer distribution of Iraq's oil rents, presently concentrated on public sector workers and powerful political groups that are dominant in the state. A basic income would lighten the pressure on the state to provide more government jobs, which typically have increased in periods when oil prices are rising.

Regular competitive elections, a free press and media as well as other freedoms can and should be celebrated as important ends in their own right. However, there is no guarantee that these will provide a means to achieve greater economic inclusion. In fact, we argue that the particular form of political inclusion that has been taken up in Iraq, in the context of conflict and declining institutions, has likely worked to constrain economic inclusion. There is thus is no easy or reliable link between political and economic inclusion. We propose instead a targeted basic income scheme through which ordinary, including poor, Iraqis would benefit and share in their country's oil wealth.

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