The role of structural imbalance of public expenditures in the structural imbalance of economic activities in Iraq for (2004-2022)

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Abstract

The Iraqi economy has historically faced challenges due to ineffective financial management, which has disrupted its economic framework and led to a persistent reliance on the oil sector for funding economic activities and improving its stagnant conditions. The study found that a distortion exists within the actual production structure, as the non-oil production sectors contribute minimally to the gross domestic product, while service sectors dominate, revealing a failure among policymakers to allocate economic resources effectively to achieve objectives that would enhance social and economic benefits continuously and sustainably. The study suggested that it is essential to increase the production sectors' contribution to the gross domestic product and also emphasized the importance of implementing a sovereign fund in Iraq, which would help to rectify structural imbalances and boost development sectors. The research revealed a notable, long-lasting disparity in public expenditure that favored present-day spending. This fundamental imbalance had both direct and indirect effects on the overall GDP structure. The research suggested optimizing current expenditures, boosting investment spending, enhancing the GDP, and reducing complete reliance on oil.

Keywords: public expenditures, structural imbalance, economic activities, non-oil sectors.

INTRODUCTION

The Iraqi economy possesses distinct traits that set it apart from numerous other economies. A key feature is its reliance on a single revenue source (oil revenue), which has exacerbated structural imbalances within the economy and has notably influenced the approaches taken in fiscal policy. A significant aspect of this is the increase in public expenditure driven by revenue from oil, where Iraq's fiscal policies are marked by a paternalistic approach to public finances. Moreover, there is another form of imbalance, evidenced by a greater emphasis on current (operational) expenses rather than on investment spending, leading to budgetary pressures and significant financial constraints due to the disproportionate nature of the components in the overall budget. One of the adverse effects of this situation has been the rise in surplus demand for consumer goods and services, predominantly imported from other countries, which has further intensified the structural imbalance within Iraq's general budget, particularly in recent years.

Research Problem: Public spending suffers from a structural imbalance in favor of current spending to finance government activities, cover debt, and maintain social protection programs. The repetition of these consumption roles over the long term has created a sustained wave of imbalances in the structure of the Iraqi economy.

The Importance of the Research: The Iraqi economy is characterized by a set of characteristics that distinguish it from many other economies. The most important of these characteristics is that it is a country with a single rent (oil rent), which has deepened the structural imbalances in the economy in general and fiscal policy trends in particular. Most notable of these is the expansion of public spending based on (oil) rent revenue (i.e., fiscal policy in Iraq is characterized by what is known as paternalistic public finance). Another imbalanced

characteristic is the focus on current (operational) expenditures more than on investment expenditures, to the extent that this has become a burden on the budget and a heavy financial constraint due to the imbalance in the components of the general budget.

Research Hypothesis: The persistence of a structural imbalance in public spending leads to a similar and sustained imbalance in all economic activities that comprise GDP.

Research Objective:

1. Analyse the structure of public spending and determine the relative contribution of current and investment spending.

2. Analyse the structure of GDP and the trend of economic activities during the research period.

3. Analyse the relationship between the structural imbalance in public spending and the structural imbalance in GDP.

Structural Imbalances: A Theoretical Framework

1. The concept of economic structural imbalance

The economic structure refers to the set of ratios and relationships existing between the elements of economic life that belong to a certain economic entity at a certain time and place. Others define the economic structure as a system of relationships that has its laws and is characterized by internal unity and self-regulation, provided that any change in the relationships leads to a change in the system itself (Hussein Shenawa Majeed, 2011, 116).

The concept of structural imbalance pertains to the disproportional relationships among the various elements and components within the economic structure, as well as the extent and regularity of these imbalances over time, or the transformation in their essential characteristics to the degree that they can influence economic growth

and development processes. Structural imbalance is also characterized as a disruption in the proportional relationships of the economic structures that make up the economic system, which is contrary to what economic theory suggests about the proportional connections between them (Saad Mahmoud Al-Kawaz and Samir Hanna Bahnam, 2010, 45).

Simon Kuznets points out that structural imbalance can be identified and measured by calculating the difference between the relative importance of each sector to GDP and the relative importance of each sector's labor force to the total labor force. This difference represents the degree of sectoral imbalance. By summing the degrees of sectoral imbalances (regardless of their sign) and comparing them to their counterparts in developed economies, which do not exceed 20%, we can obtain the structural imbalance in the economy (Salem Tawfiq Al-Najfi, 2002,47). From this, it becomes clear that structural imbalance refers to an imbalance in the general equilibrium relations between the elements and components of the economic structure, whose basic characteristics change to the extent that it affects the stability of the economy and thus causes it to lose its state of general equilibrium. (Hossam Ayed Safouk, 2023, 30)

2. Explaining Structural Imbalances Using the Second Gap Model

The basic idea of this model is that there is a close relationship between domestic savings and external financing. The lower domestic savings are compared to the investments required to achieve the targeted growth rate; the greater the need for external financing. During the early stages of the development process, the need for financing increases to bridge the gap between domestic savings and the investments required to be implemented in a manner that exceeds what can be managed from domestic savings. (Hassan Hadi Saleh, 2007, 75-76) This leads to the need for external financing, and the need for external financing

increases to finance foreign trade due to the value of imports exceeding the value of exports over a given period. (Fadila Januhan, 2006, 16)

Economists have emphasized the importance of the equality of both gaps over the past period, and it is not certain that they will be equal in any future period. This means that income consists of a combination of consumer and investment goods, in addition to goods destined for foreign markets. (Abdul Karim Jaber, 2012, 19-20)

3. Types of Structural Imbalances

Countries seek to identify the shortcomings in their economies and diagnose the weaknesses in their economic policies in preparation for correcting them and eliminating the imbalances and distortions affecting their economies. (Salem Ali Al-Jundi, 1995, 176)

The most important of these imbalances are the following:

1. Internal structural imbalance: This refers to the imbalance between domestic output and consumption, i.e., the disproportion between the current domestic demand for goods and services and the current domestic supply of those goods and services. (Kamel Badan Saleh, 2012, 37-38) Internal imbalances are often due to financial imbalances (Samir Khalaf Bandar, 2018, 56), imbalances in the monetary structure (Adnan Hussein Younis et al., 2017, 25), and production imbalances (Ali Majeed Al-Hamadi, 1989, 9).

2. External structural imbalances: The structure of developing countries' economies is responsible for the imbalances that result in their balance of payments. Furthermore, external shocks to developing countries' economies and the international division of labor cause an imbalance between developed and developing countries, which then leads to the emergence of external structural imbalances. (Ramzi Zaki, 1980, 97)

Indicators Of Structural Imbalance in Public Expenditures and Structural Imbalance in Economic Activities in Iraq

1. Structural Imbalance Index of Public Expenditures

The index of the relative contribution of current and investment government spending was used during the research period to show us the extent of the structural imbalance in public expenditures. According to Table (1) and Figure (1), the contribution of current expenditures to total public expenditures ranged between (66%) in 2013 as a minimum and (94%) in 2020 as a maximum, while the relative contribution of investment expenditures ranged during the research period between (6%) only in 2020 as a minimum and (34%) in 2013 as a maximum.

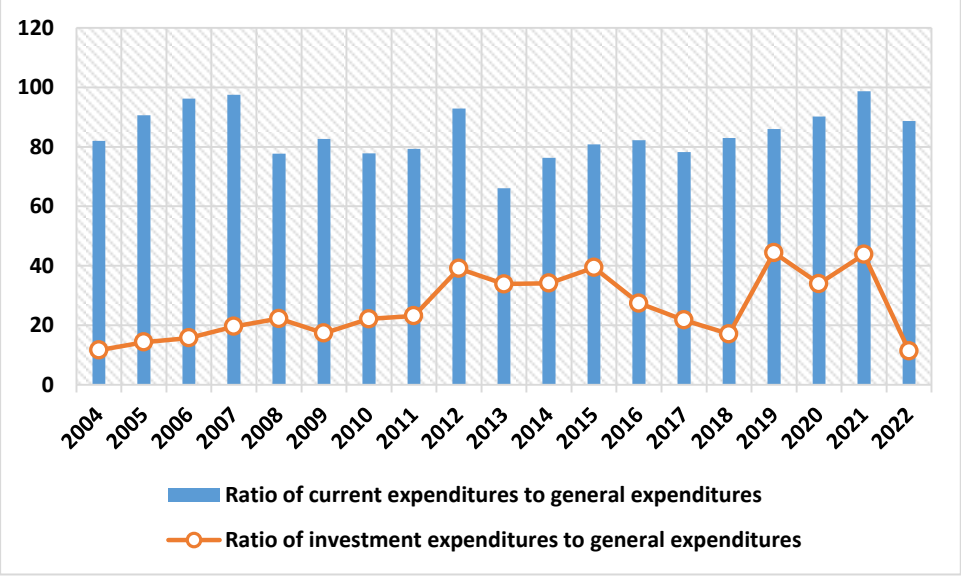
Table (1): Current and investment expenditures in Iraq for (2004-2022) (million dollars, %)

Year	Current expenditures	Ratio of current expenditures to general expenditures	Compound growth rate of current expenditures	investment expenditure	Ratio of investment expenditures to general expenditures	Compound growth rate of investment expenditures
2004	18998.23	81.99		2700.79	11.65	
2005	18424.86	90.61		2583.4	14.38	
2006	21961.55	96.2		3597.03	15.75	
2007	26071.58	97.53		5249.81	19.64	
2008	43840.05	77.73		12553.24	22.26	
2009	39265.86	82.64	0.1287	8246.71	17.35	0.2045
2010	46650.3	77.82		13293.45	22.17	
2011	52073.12	79.26		15241.12	23.19	
2012	64998.81	92.88		25172.34	39.08	
2013	67535.85	66.1		34631.86	33.89	
2014	72869.01	76.28		32620.11	34.15	
2015	47828.97	80.85	0.0042	23342.05	39.45	0.0984
2016	46355.26	82.24		15469.1	27.44	
2017	49601.38	78.18		13835.68	21.81	
2018	56346.93	82.91		11613.72	17.08	
2019	70202.99	85.92		19639.41	44.45	
2020	57663.15	90.19		2539.13	33.97	
2021	60624.58	98.68	0.0457	2687.84	43.83	-0.233
2022	61845.22	88.66		2876.66	11.4	

Source: Ministry of Planning, Central Statistical Organization, Statistical Abstract, Public Finance Accounts, various years.

It seems that there has been a structural imbalance skewed towards current expenditures, which has negatively impacted investment expenditures, whose importance has diminished throughout most of the research period. This imbalance is indicative of several economic realities, including the rise of consumerism within society, the erosion of financial discipline, the increase in public debt, a decrease in government trust in the economy, as well as in individuals and institutions, along with other adverse signs that suggest the mismanagement and loss of financial resources generated from crude oil sales.

Figure (1): The relative contribution of current and investment spending to total government spending in Iraq for (2004-2022) (%)



Source: Ministry of Planning, Central Statistical Organization, Statistical Abstract, Public Finance Accounts, various years.

2.Structural Imbalance Index of Economic Activities

The relative contribution index of economic activity sectors was used to express the extent of structural imbalance in local economic activities in Iraq.

Table 1 shows that the oil sector's contribution to GDP ranged between a maximum of 57.87% in 2004 and a minimum of 40% in 2017. Non-oil commodity sectors recorded a contribution to GDP ranging between a maximum of 16.62% in 2020 and a minimum of 8.34% in 2022. Distribution sectors recorded a contribution to GDP ranging between a maximum of 22.99% in 2016 and a minimum of 12.33% in 2008. Finally, service sectors recorded a contribution to GDP ranging between a maximum of 33.44% in 2020 and a minimum of 15.59% in 2006.

Thus, there is a structural imbalance in the economic activity sectors that make up the GDP, which was in favor of the oil sector at the expense of the deterioration and distortion of the rest of the economic activities. The development of one sector, the oil sector, expresses a frightening sectoral concentration and a bleak rentierism desired by decision-makers throughout the research period. This has led to a weak structure of the GDP and a lack of diversity, which has been negatively reflected in the weakness of non-oil public revenues due to the deterioration in the performance level of local economic activities.

Table (2): The relative contribution of economic sectors to the gross domestic product in Iraq for the period (2004-2022) (%)

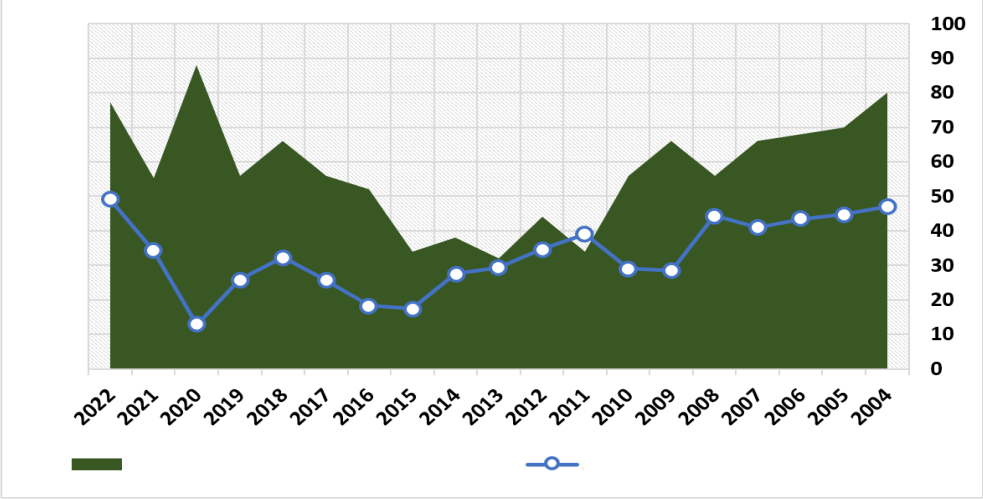
Year	Relative contribution of the oil sector	Relative contribution of the commodity sector excluding oil	Relative contribution of the distribution sector	Relative contribution of the service sector
2004	57.87	10.9	15.01	16.71
2005	57.63	12.86	14.43	15.59
2006	55.29	11.98	14.42	18.81
2007	52.95	12.09	14.22	21.2
2008	55.51	11.13	12.33	21.93
2009	42.86	14.36	15.91	27.63
2010	44.99	15.97	14.79	24.89
2011	53.03	14.08	12.46	21.02
2012	49.73	14.97	15.07	20.82
2013	45.9	16.56	15.96	22
2014	43.87	16.36	16.33	23.78
2015	33.49	16.04	22.99	28.26
2016	34.23	15.93	22.67	28.11
2017	40	14.31	21.74	25.29
2018	44.69	12.3	20.43	23.76
2019	41.42	15.46	18.95	25.47
2020	29.37	16.62	21.38	33.44
2021	45.69	11.35	17.64	25.83
2022	57.26	8.34	15.38	19.41

Source: Ministry of Planning, Central Statistical Agency, Statistical Abstract, National Accounts, various years.

Figure 2 confirms many facts, the most important of which is that the structural imbalance of the oil sector's contribution to the commodity sector was highly volatile during the research period. This indicates that the contribution of both sectors was not at all uniform or desirable, and that the structural imbalance is of a long-term type, in addition to the prevalence of concentration in the oil sector, which created a forced migration of many workers towards oil activities because their income is relatively higher than the rest of the sectors of local economic activities.

The structural imbalance of current expenditures' contribution to investment expenditures was also violently volatile throughout the research period. This confirms the exposure of local markets to violent waves of fluctuations resulting from the shift in current expenditures from intensity to lightness and vice versa. This rendered the values of most economic variables unstable, pushing economic stability further away and paving the way for instability. The difference between the two imbalances represents a gap in financial resource waste throughout the research period. Figure 2 confirms the preponderance of current expenditures over investment expenditures, which was higher than the difference between the oil sector and the commodity sector. This illustrates the extent of the lack of rationalization in public finances, which has driven the expansion of current expenditures at the expense of investment expenditures, which are relied upon to build strategic projects and infrastructure. Perhaps behind these economic realities lie political motives, often entailing numerous paradoxes that have resulted in a crumbling economy.

Figure (2): The amount of difference in the contribution of the oil sector compared to the commodity sector, and current expenditures compared to investment expenditures in Iraq for the period (2004-2022) (%).

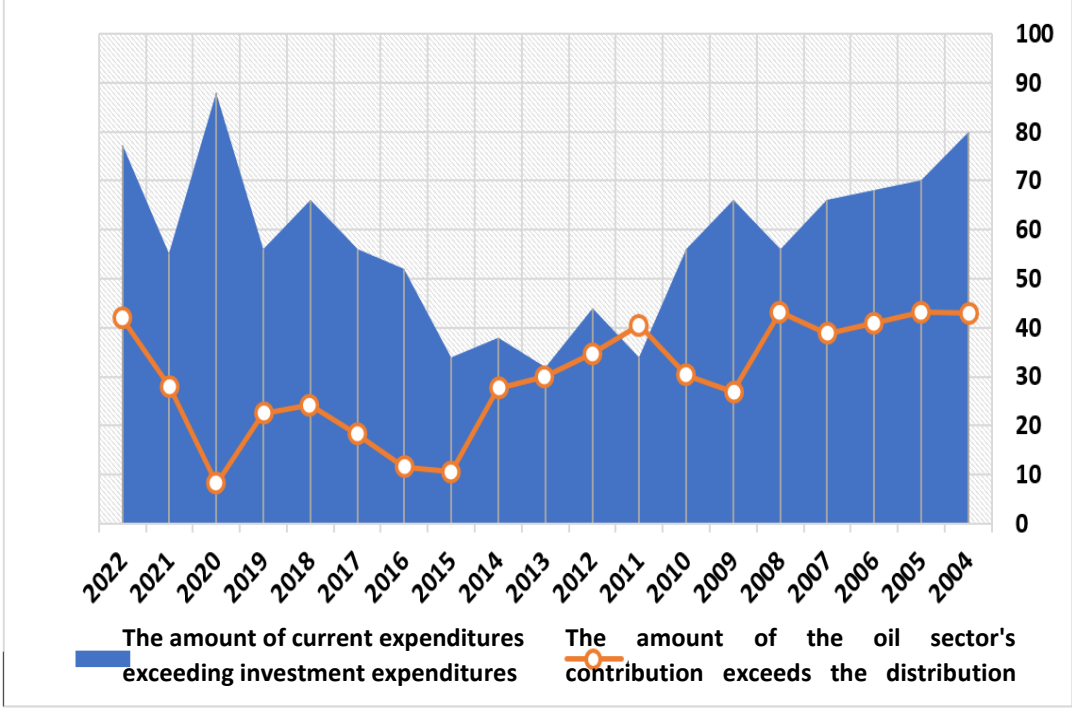


Source: Researcher's work based on data from Figure (1) and Table (1). The difference was calculated on the basis of subtracting the relative contribution of the dominant sector from the weaker sector, as stated in the above classification.

Figure 3 also confirms the reality of the significant fluctuations occurring over time in the difference in the contribution of the oil sector compared to the distribution sector. This indicates successive imbalances and bottlenecks in both sectors, most of which are attributed to international fluctuations and changes, some of which are local, which have negatively impacted overall economic performance. Figure 3 confirms the dominance of the difference in the contribution of expenditures over the difference in the sectoral contribution of oil and

distribution activities. The gap in financial resource waste is high in distribution activities, indicating the existence of a large financial surplus during the research period that was not properly utilized. This led to the waste and loss of these financial surpluses and the misallocation of economic resources for production and distribution. This means that the economic policies pursued were irrational and incorrect, and reinforced the persistent structural imbalance in both public expenditures and production activities.

Figure (3): The amount of difference in the contribution of the oil sector compared to the distribution sector, and current expenditures compared to investment expenditures in Iraq for the period (2004-2022) (%)

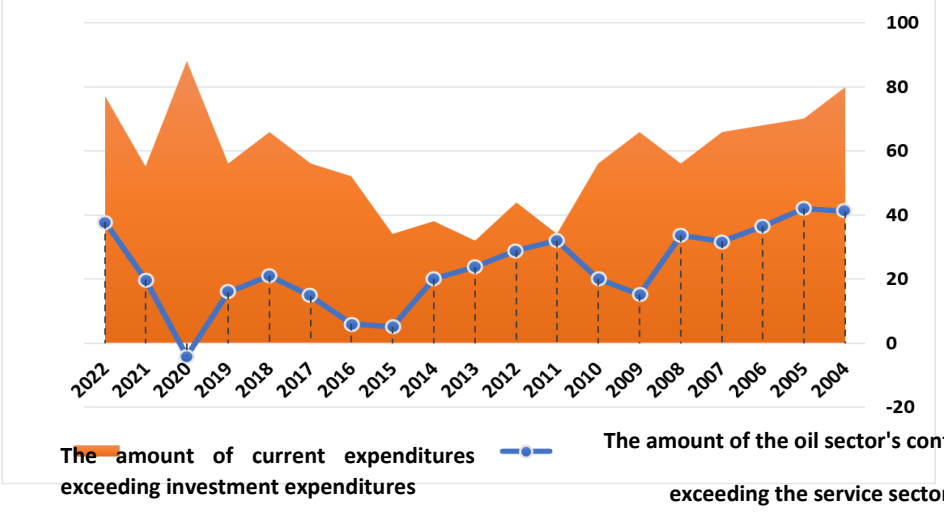


Source: Researcher's work based on data from Figure (1), Table (1).

Based on Figure (4), the variations in the service sector's contribution were less pronounced compared to those of other economic sectors. This is attributable to the significance of service activities in creating added value within the gross domestic product (GDP). Additionally, during the study period, service activities held the second position following the oil sector regarding their contribution to GDP in Iraq. This may have helped cushion the intensity of fluctuations in these activities.

The difference between the two is also smaller than that of other economic activities. This means that the financial resource waste gap was at its lowest level in service activities. This opens the way for decision-makers to support and enhance service activities, allocating the necessary funds for their development. The service sector could be the sector best qualified to lead development after the oil sector in terms of GDP.

Figure (4): The Difference in the Contribution of the Oil Sector to the Service Sector, and Current Expenditures to Investments in Iraq for (2004-2022) (%)



Source: Researcher's work based on data from Figure (1), Table (1).

CONCLUSIONS

1. Public expenditures increased in general, but current expenditures were much larger than investment expenditures, which reinforced consumerism among individuals, while all public and private investments in the country declined.

2. There is a structural imbalance in the GDP sectors, and this imbalance is sustained by the imbalance in the structure of public spending, which supports the research hypothesis.

3. Most of the fluctuations and instability in the GDP sectors were due to fluctuations and instability in public spending, meaning that most of the structural imbalances affecting GDP were due to the structural imbalance in public spending throughout the research period.

RECOMMENDATIONS

1. Rationalize current spending and limit it to fluctuations in oil prices in international markets, and increase investment spending to support the domestic investment structure and develop the economy's ability to withstand external crises and shocks.

2. Diversify output, revive the role of the local manufacturing industry, and utilize crude oil as a supporting raw material for that industry, giving it a competitive advantage in local markets.

3. Reduce reliance on crude oil revenues to finance the general budget, which has caused continued structural imbalances in spending and, consequently, output, and utilize oil revenues to strengthen the local investment environment.

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