STRENGTHENING THE GROWTH-EMPLOYMENT-WELFARE NEXUS

POLICY NOTE I
The Unfulfilled Promise of Oil and Growth: Poverty, Inclusion and Welfare in Iraq, 2007–2012

Modest Welfare Improvements Despite Healthy GDP Growth

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

Why?
Because the Links between Growth, Employment, Earnings and Welfare are Weak

The modest decline in poverty in Iraq between 2007 and 2012 was driven by an increase in earnings among the employed rather than an expansion in employment or higher public transfers. In particular, economic growth was not associated with job creation in the private sector, where the majority of the poor are employed.

GDP Growth Did Not Lead to Substantial Employment Generation

The sectors of the economy that drove overall growth in GDP did not create jobs. Recent economic growth has been driven by the oil sector, which represents almost half of Iraq’s GDP and almost all exports. But the oil sector accounts for only 1 percent of employment in Iraq, and growth in the oil sector does not directly create new jobs. In fact, a 1 percent increase in oil output generated a 0.2 percent reduction in employment in the sector.

Growth did not go hand in hand with employment growth in other sectors of the economy either.
Even in the manufacturing sector, which employs 10 percent of the labor force and is relatively labor intensive; a 1 percent increase generated an increase in employment of 0.6 percent during the 2007 to 2012 period. Overall, job creation was inadequate to absorb the growing workforce.

**New Jobs and Increases in Earnings Were Concentrated in the Public Sector, Not in the Private Sector, Where Most of the Poor Work.**

While oil did not directly create jobs, oil revenues did enable a significant expansion in public sector jobs. 80 percent of new jobs were created in the public sector, especially in the financial, insurance and professional services sector, with accompanying increases in wages and salaries. Moreover, 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 incomes fell by 2.5 percent, whereas construction earnings increased by a mere 0.8 percent. With employment and earnings falling in agriculture, rural livelihood options are becoming insecure. In the southern governorates, poverty among households dependent on agriculture has risen sharply, and while people are leaving agriculture, they have nowhere to go as the local economy continues to stagnate.

**Public Sector Expansion Has Created Economy Wide Distortions in the Incentives to Look for Work and to Invest in Education**

The increasing possibility of a public sector job, with greater job security, benefits and fewer hours of work, has in effect, raised the reservation wage among the working age population, and limited active job search as people wait and queue for openings in the public sector.
A one percentage point increase in the public sector employment rate in the governorate of birth lowers labor force participation among adults by 30 percent; and by 40 percent among young Iraqis of working age.

With the expansion in public sector jobs for less educated men, the returns to education in the public sector level off after primary school, and do not pick up again until after tertiary education. As a result, the incentives to invest in education beyond primary school have become limited.

The Private Sector is Getting Crowded out; and its Ability to Grow is Severely Constrained

Iraq’s private sector is getting increasingly crowded out by the public sector, and is unable to match superior pay, benefits and working hours to attract talent. Many private businesses are small and informal; mainly operating in retail and trade and construction and transportation services. Agricultural jobs are also overwhelmingly in the private sector.

The World Bank’s Doing Business 2012 Report ranks Iraq 164 out of 183 economies in terms of the costs of doing business. Private sector firms cite fundamental constraints to growth - lack of reliable power supply, the political and security environment, corruption, inadequate access to credit, land and other capital and the lack of a trained workforce (Iraq Investment Climate Assessment, 2012).

What Needs to Be Done

Establishment and Maintenance of Peace and Security
- Prerequisite for economic growth and welfare improvements

Growth, Oil Management and Economic Diversification
- Greater oil revenue transparency
- Minimize the impact of oil revenue volatility through the creation of a sovereign “parking fund” and a fiscal stabilization fund
- Strengthen the links between the oil sector and manufacturing; encourage private investment in construction, banking, industry and tourism
- Rationalize the role of the public sector; increase the efficiency of public expenditure

Private Sector Led Job Creation
- Create an enabling business and investment climate including finance on competitive terms, and flexible labor market mechanisms and institutions
- Eliminate regulatory barriers and discriminatory implementation and enforcement of rules and regulations
- “Resource corridors” to generate spillover activities
- Improve power and transport infrastructure
- Invest in a technically skilled workforce

For Economic Growth to have a Positive Impact on Welfare, it Needs to Generate Employment and Income for Those Who Need it the Most.
The Unfulfilled Promise of Iraq's Economic Growth

Between 2008 and 2012, Iraq’s GDP grew at an average rate of 7% each year. Yet, 20% of the Iraqi population remains below the poverty line.

Why? Because the links between growth, employment, earnings and welfare are weak.

The oil sector represents almost 50% of GDP, but only 1% of employment.

80% of new jobs & higher earnings were in the public sector, not in the private sector - where most of the poor work.

Expansion in the public sector has lowered incentives to search in the private sector for jobs.

Growth in the oil sector did not directly create new jobs.

Agriculture & construction, which employ 1/3 of Iraq’s poor, barely experienced any increase in earnings.

Fewer people are looking for work in expectation of getting public sector jobs.

What needs to be done?

Economic growth needs to generate employment and income for those who need it the most.

Establishment and maintenance of peace and security.

Growth, oil revenue management & economic diversification.

Private-sector-led job creation.

Pre-requisite for economic growth and welfare improvements.

Ensuring positive spillovers from oil to industry and services.

Create an enabling business and investment climate and improve power and transport infrastructure.