

Oil Slump Leaves Iraq With 'Army' of Unemployed Youth

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Editor's note: This article is part of an ongoing WPR series (<http://www.worldpoliticsreview.com/series/4/commodities-cycle>) on the impact of falling oil and commodities prices on resource-exporting countries.



Iraqi workers are seen at the Rumaila oil refinery, near Basra, Iraq, Dec. 13, 2009 (AP photo by Nabil al-Jurani).

Plunging oil prices have put Iraq in an economic bind, and according to The New York Times (<http://www.nytimes.com/2016/02/01/world/middleeast/battered-by-war-iraq-now-faces-calamity-from-dropping-oil-prices.html>), “much tougher economic times are ahead.” In an email interview, Frank Gunter (<http://cbe.lehigh.edu/faculty/economics/frank-r-gunter>), a professor of economics at Lehigh University and author of “Political Economy of Iraq: Restoring Balance in a Post-Conflict Society” (<http://amzn.to/1Mb3meB>),” discussed the impact on Iraq of low oil prices.

WPR: How important is oil for Iraq's economy and government revenues, and what impact have falling oil prices had on domestic politics, both in Baghdad and between Baghdad and the Kurdish Regional Government?

Frank Gunter: Oil exports generally account for over 90 percent of the Iraqi central government's revenues. And since the central government and the Kurdistan Regional Government (KRG) now employ more than half the country's labor force, paying salaries and pensions dominates government expenditure. Since the collapse of oil prices began in 2014, Baghdad and the KRG have struggled to pay their employees and retirees, at the same time as defense expenditures to fight the self-declared Islamic State have increased. As a result, there has been a sharp reduction in government spending on infrastructure.

The impact on Iraqi politics will depend on how long low oil prices last. If there is a fairly rapid recovery of oil prices in late 2016 or early 2017, then the impact on domestic politics will be limited.

However, if Iraq faces a decade or more of sub-\$60 oil, then economic disruption and the accompanying political instability will be severe.

How likely is an extended period of low oil prices? A combination of factors on both the demand and supply side suggest that oil prices for the next decade will likely remain somewhere between \$20 per barrel—the level where Middle East producers can cover their costs—and \$60 per barrel, which would allow recently developed U.S. fracking operations to remain minimally profitable. That means there should be some cause for worry in Baghdad.

WPR: How have falling oil revenues compounded other issues facing Iraq, notably security and the fight against the Islamic State?

Gunter: While the Islamic State appears to be in decline, due in part to its tightening finances, an extended period of low oil prices will be politically destabilizing in Iraq. Even after adjusting for retirements and the low labor force participation rate among women, there will be an additional 330,000 Iraqis looking for their first job every year for the next decade. When oil prices were high, the central government and the KRG created hundreds of thousands of government jobs each year to absorb the expected increase. However, the collapse of oil revenues has led to a growing “army” of unemployed Iraqis who are mostly young, mostly male and mostly uneducated and unskilled.

In 2014, it was estimated that over 80 percent of young Iraqi males were either unemployed or underemployed. Without a job, a young man has little chance of getting married, and he becomes an embarrassment to his family and to Iraqi society at large. Is it any surprise that this growing army of unemployed young men is fertile recruiting ground for criminal, militia, tribal or religious groups that can provide purpose and pay? The potential for future political instability is therefore large.

WPR: What steps is Iraq taking to diversify its economy away from oil, and what other sectors present opportunities for diversification?

Gunter: In all four of its post-2003 Development Plans, the Iraqi government has advocated for economic diversification, citing the potential of agriculture and agribusiness, residential construction, international tourism, small manufacturing, and the creation of a vibrant service sector. However, there has been little progress in reducing oil dependency, due to perverse incentives, corruption and regulatory hostility. Government jobs pay an estimated 40 to 60 percent more than private-sector jobs requiring the same education or skills. They also earn generous pensions, have more relaxed work intensity, and may provide the opportunity to extract bribes. As a

result, many unemployed Iraqis with valuable education or skills would rather pursue the low probability of obtaining a government job than accept immediate employment in a lower-paid, more demanding job in the private sector.

Corruption is also a severe burden on private businesses and therefore job creation in Iraq. A survey of small businesses conducted by the Center for International Private Enterprise in 2008 in six Iraqi cities showed that one-fifth of private businesses paid 40 percent or more of their revenues—that's revenues, not profits—in bribes to an unending line of corrupt government officials. This extraction of bribes from private businesses is facilitated by regulatory hostility. According to the World Bank, Iraq's private-sector regulations rank 161st among the 189 countries evaluated. Efforts to diversify Iraq's economy will fail in the absence of freezing government compensation, reducing corruption, and adopting a regulatory environment friendlier to the private sector. These changes will require more political wisdom and courage than the Iraqi government and KRG leadership have shown over the past several years.

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