

LIVELIHOODS POLICY BRIEF NO. 7

REGIONAL INSTABILITY AND ECONOMIC RECOVERY IN IRAQ

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The International Organization for Migration (IOM) implements livelihood programmes in displacement-affected communities across Iraq. Through the Enterprise Development Fund, IOM helps to bridge gaps in access to finance for small and medium enterprises, promoting a sustainable recovery from the lasting effects of conflict and supporting climate adaptation and mitigation efforts. This report is part of the Policy Briefs series, which seeks to disseminate knowledge on pressing issues relevant for local economic recovery in Iraq.

OVERVIEW

Iraq continues to face significant challenges in the path towards a sustainable economic recovery and durable solutions for displacement. As of December 2023, IOM estimated about 1.1 million internally displaced persons (IDPs) and 4.9 million returnees (IOM, 2023a). Despite years of progress, many IDPs and returnees continue to live in substandard conditions and face important barriers to livelihood access. A recent assessment in Salah al-Din Governorate, for instance, found that 74 per cent of IDPs and 42 per cent of returnees lack a stable source of income (IOM, 2023b). Across the country, and particularly in the south of Iraq, these challenges are compounded by declining water availability and increasing salinization due to climate change. Environmental degradation has reduced farming productivity and undermined rural households' core means of income generation, pushing many to migrate to urban areas (IOM, 2023c). Conflict and climatic shocks have contributed to an increasing poverty rate over the past decade, reaching 25 per cent in 2022 (IMF, 2023a).

The country's economy, heavily reliant on the oil sector, experienced 7 per cent gross domestic product (GDP) growth in 2022, driven by increased oil prices and production adjustments (World Bank, 2023a). However, the non-oil sectors, particularly agriculture, have stagnated partly because of growing water shortages linked to climate change and chronic gaps in access to finance, infrastructure and public services that undermine business competitiveness. Small and medium enterprises are responsible for most private sector employment and represent one of the most dynamic sectors of the economy but face important barriers in accessing the financial resources necessary to expand.

Global and regional instability linked to the war in Ukraine and the Israel-Gaza crisis are poised to impact Iraq's economic and commercial landscape significantly. These conflicts have led to significant fluctuations in international oil and food prices (FRED, 2023; Trade Economics, 2023). Research shows that geopolitical risk increases oil prices and negatively affects investment and employment in the places directly involved in the conflict and in neighbouring countries (Chi-Wei Su et al., 2019; Caldara and Iacoviello, 2022). Regional conflict also tends to negatively affect bilateral trade, even in

countries not directly involved in hostilities (Saeed, 2013). These findings suggest that continued regional instability will have an important effect on Iraq's economy, potentially increasing oil revenues but further depressing non-oil sectors. Business confidence is likely to be undermined by increasing uncertainty.

Growing tension at regional level threatens Iraq's stability and its path to economic resurgence. Empirical evidence underscores the importance of macroeconomic stability as instrumental in reducing the likelihood of conflict re-emerging (Bazzi and Blattman, 2013). Post-conflict nations with sluggish growth rates are at a doubled risk of falling back into conflict compared to those experiencing robust growth rates (UNDP, 2008). Economically vulnerable segments of society, including communities affected by conflict displacement and environmental degradation, are particularly exposed to the impact of negative economic shocks. Buffering these shocks is therefore paramount to prevent a setback in the country's recovery.

In the short term, policy efforts should be aimed at buffering the impact of regional instability on private sector recovery in Iraq, with a focus on areas where livelihoods have been disrupted by past conflict and ongoing environmental degradation. Continued international support is vital in supporting the Government of Iraq's efforts in this direction. In terms of long-term strategies, Iraq should strive for economic resilience. These efforts involve reducing oil dependency by diversifying the economy and encouraging the development of various sectors including technology, climate-resilient agriculture and manufacturing. For a robust private sector, creating a favourable business environment with more incentives for investment is critical. In agriculture, investing in sustainable practices is crucial in combating land degradation, which can be achieved through water conservation techniques, reforestation and renewable energy sources. Strong institutions and governance structures are essential for long-term stability, including transparent systems for managing Iraq's natural resources and policies that foster sustainable economic growth and an equitable distribution of wealth.

CHALLENGES FOR ECONOMIC RECOVERY IN IRAQ

Iraq is still suffering the consequences of decades of war in its territory. The latest estimates point to 1.1 million internally displaced persons and 4.9 million who have returned to their places of former habitual residence, many of whom continue to live in substandard conditions (IOM, 2023d). The number of IDPs peaked at over 3.3 million in November 2015 before declining steadily to just over 1.1 million by April 2023. The count of returnees began to rise in December 2014, overtaking the number of IDPs by mid-2016. Since then, the number of returnees has grown consistently, reaching close to 5 million by April 2023.

Many IDPs and returnees face economic insecurity as they rely on irregular earnings or subsistence agriculture and have limited access to water and public services, making them vulnerable to macroeconomic shocks. In Salah al-Din, for example, 74 per cent of IDP households and 42 per cent of returnees have unstable sources of income (IOM, 2023b). Similar findings were observed in Ninewa, where 77 per cent of IDP households and 62 per cent of returnees lack a stable source of income (IOM, 2023e). A key concern is the limited resilience of these economically vulnerable populations in the face of negative economic shocks. Most IDPs and returnees lack savings to buffer a loss of income or increase in prices. In Ninewa, only 14 per cent of IDP households and 22 per cent of returnee households said they would be able to afford an unexpected expense, compared to 18 per cent of IDPs and 23 of returnees in Salah al-Din.

The oil sector accounts for around 90 per cent of government revenue in Iraq (World Bank, 2022a). In 2022, the increase in oil prices allowed Iraq to experience an economic rebound with 7 per cent GDP growth driven by the oil sector (World Bank, 2022a). Taking the opportunity of the increase in revenues from the oil sector, the Iraqi government approved an expansion of the budget of 150 billion United States dollars (USD) to fund investment projects, infrastructural projects, and public spending that stimulates consumption and wages

(IMF, 2023b; Coface, 2023). However, the increase in oil revenue has not been sustained due to price fluctuations and global fears of recession. In 2023, despite growing demand for Iraqi oil from India and China, oil earnings fell 32 per cent, dampening GDP growth (Mikkelsen, 2024; IMF, 2023a).

As Iraq maintains a deep-rooted dependence on the oil sector, climate change vulnerability and water shortages drew agricultural activities to contraction in 2022 (World Bank, 2023a). Climate change and environmental degradation also led to the displacement of over 135,000 people in central and southern Iraq between 2016 and 2022, representing an estimated 15 per cent of the population in affected areas (IOM, 2023a; IOM, 2023f). Iraq is facing extreme weather and ecological shifts, with a recent IOM study finding that 82 per cent of assessed locations face droughts and sandstorms, and issues such as water scarcity and soil degradation becoming increasingly widespread. Nearly all locations indicated loss of crop production, livestock deaths or reduced fishing yields as a result of environmental factors, resulting in large-scale abandonment of agricultural, livestock and fishing activities. In 71 per cent of assessed locations, the majority of households no longer practice these trades. Despite these challenges, support remains limited, with only a tiny fraction of locations receiving aid.

In Iraq, around 38 per cent of the population is employed in the public sector, one of the highest rates in the world (ILO, CSO, KRSO, 2022). The private sector has been constrained by decades of war, with small and medium enterprises facing bureaucratic and financial barriers to expansion and formalization. As a result, private companies are often located in the informal sector, which accounts for 54.8 per cent of total employment. These employment dynamics, particularly in the underdeveloped private sector, have led to almost a double unemployment rate among the youth (36%) compared to the rest of the population (16.5%) in 2022 (ILO, 2023).

CHALLENGE 1: INSTABILITY IN THE REGION

The Israel-Gaza crisis has led to further polarization in the region and discontent in several Arab and Muslim countries towards Israel (Alshamary and Huggard, 2023). This could increase tensions in neighbouring countries and alter existing regional alliances. ACLED, an independent source of data on conflict events across the world, reported a sharp increase in explosions and instances remote violence¹ (+255%), battle-related violence (+34%), protests (+53%) and riots (+47%) in the Middle East from the third to the fourth quarter of 2023. While most of these can be attributed to Israel and the Occupied Palestinian Territories, the rest of the region also saw a doubling in protests and instances of remote violence. In Iraq, the number of explosions and instances of remote violence increased by 51 per cent between the third and fourth quarters of 2023, partly as a result of clashes between United States forces and groups including Harakat Hizbullah al-Nujaba, Kataib Hizbullah and units of the Popular Mobilization Forces. Protests in Iraq saw a 58 per cent increase over the same period (ACLED, 2024).

Escalating tensions in the region due to the conflict could further destabilize the Iraqi economy by discouraging foreign investment and hampering reconstruction and development efforts in the country. Additionally, the dependence on Iran for electricity and gas supply, which account for 40 per cent of Iraq's power needs, represents a possible vulnerability in an increasingly volatile regional context (Wahab and Ross, 2023).

The Israel-Gaza crisis has produced catastrophic humanitarian conditions, with 1.9 million people, nearly 85 percent of Gaza's population, displaced within its borders (United Nations, 2024). This humanitarian crisis is likely to strain regional resources and international aid. Iraq, already dealing with its internal displacement issues and hosting Syrian refugees, could see a diversion of global attention and resources towards Gaza, potentially affecting the aid available for existing refugees and IDPs within Iraq. At the global level, the humanitarian system is facing unprecedented strain due to a widening gap between funding and the escalating need for aid, with a USD 4.5 billion shortfall reported in 2013, leaving important demands unmet (Barnett and Walker, 2015).

¹ According to ACLED, 'remote violence refers to events in which the tool for engaging in conflict did not require the physical presence of the perpetrator. These include bombings, Improvised Explosive Device (IED) attacks, mortar and missile attacks, etc.'

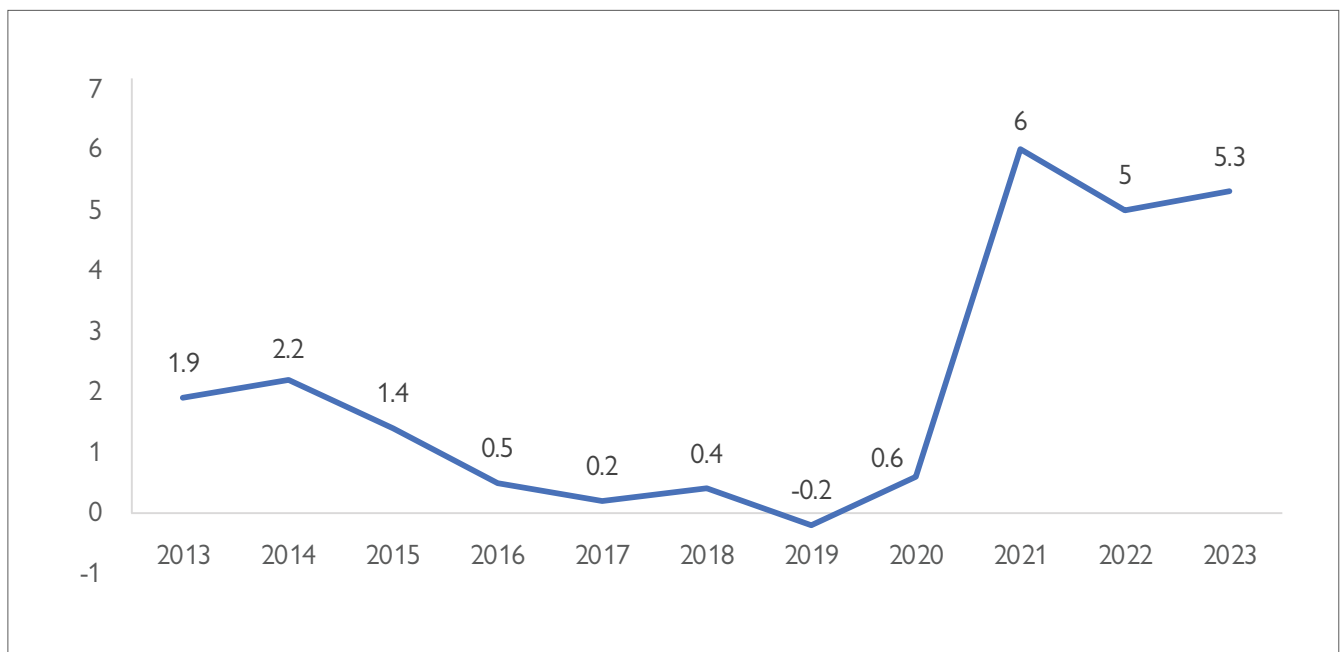
CHALLENGE 2: INCREASE IN FOOD PRICES

Inflation in Iraq grew after the pandemic and peaked at the beginning of 2023, when the central bank took measures to stabilize prices (IMF, 2023c). By 2022, the Iraqi inflation rate was 5 per cent, expected to stay stable for 2024 (Figure 1). The increment in oil prices allowed the central bank to boost the revaluation of the Iraqi dinar, producing a devaluation in the unofficial market. International food prices were essential contributors to inflation, as Iraq has high food import requirements, and disruptions to the supply chain have increased the price of commodities (FAO, 2023).

The war in Ukraine has profoundly impacted global food markets, significantly affecting countries like Iraq, which rely heavily on agricultural imports. One of the immediate consequences of the conflict has been the disruption of grain supplies. Ukraine is a major exporter of wheat and other grains, and the war has drastically reduced its export capacity (WFP, 2022a). Satellite images showed reduced wheat production in Ukraine after the war, affecting global trade and prices (Lin et al., 2023). The global shortage in wheat and price hikes for essential commodities have caused growing food insecurity in the Middle East region (Yazbeck et al., 2022).

Iraq imports a significant portion of its food supply and has faced soaring prices since March 2022, particularly in staples such as wheat and cooking oil (WFP, 2022b). This situation has put considerable strain on Iraqi households, who were already grappling with economic challenges and food insecurity before the conflict (Ramani, 2022). Communities affected by displacement face specific vulnerabilities in terms of livelihoods and food security. In Salah al-Din, about 61 per cent of IDPs, 39 per cent of returnees and 49 per cent of stayees have enough funds for food only (Figure 2). Furthermore, returnees have the highest number of respondents with limited expenditure capacity, even for food (26%) (IOM, 2023b). Similar findings were observed in Ninewa, where 33 per cent of IDPs and 36 per cent of returnees only have enough funds for food, while 49 per cent of IDPs and 29 per cent of returnees are forced to limit expenses even for food (IOM, 2023e). Many host community members also face economic vulnerabilities, resulting in competition for employment and other resources that can negatively impact social cohesion in displacement-affected communities.

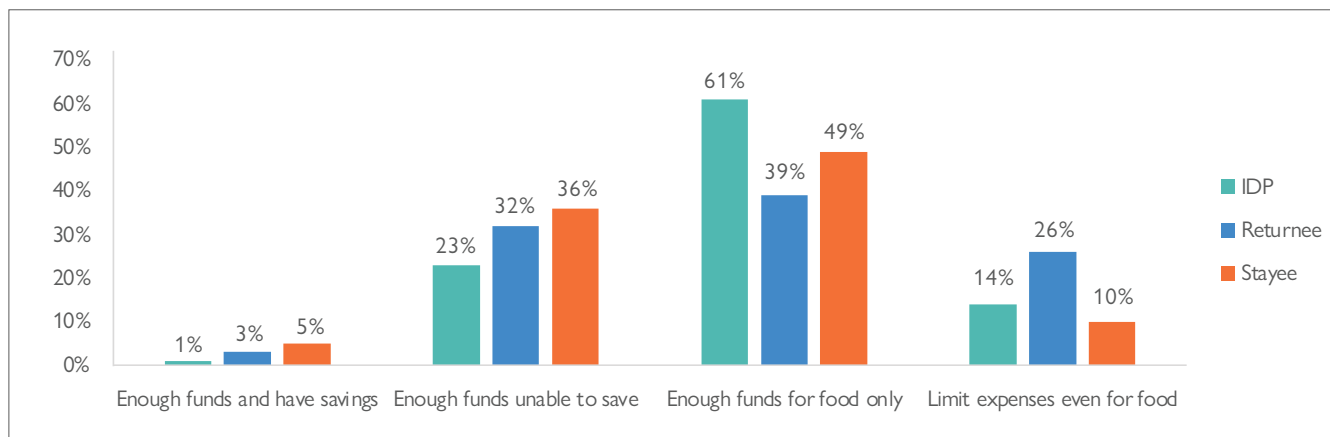
Figure 1: Inflation rate in Iraq



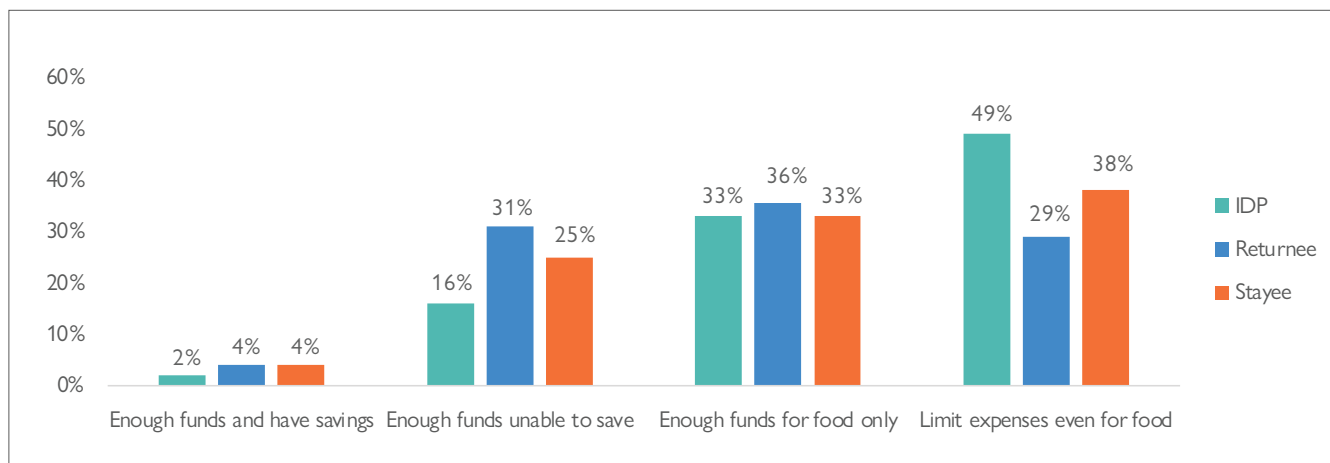
Source: IMF, 2023c. This chart displays Iraq's inflation rate from 2013 to 2023.

Figure 2: Financial status of households in Salah-al Din and Ninewa, Iraq

SALAH-AL DIN



NINEWA



Sources: IOM, 2023b. IOM, 2023e

Iraq has been compelled to respond to the rising food prices with measures to mitigate the impact on its population (Ramani, 2022). The country implemented wheat and cooking oil subsidies to ease the burden on citizens. The government also provided a USD 70 monthly allowance to economically vulnerable citizens to help them cope with the increased cost of living. Despite these efforts, the situation remains challenging, with food prices sometimes doubling, leading to protests and public discontent in several regions nationwide (Zidane, 2022).

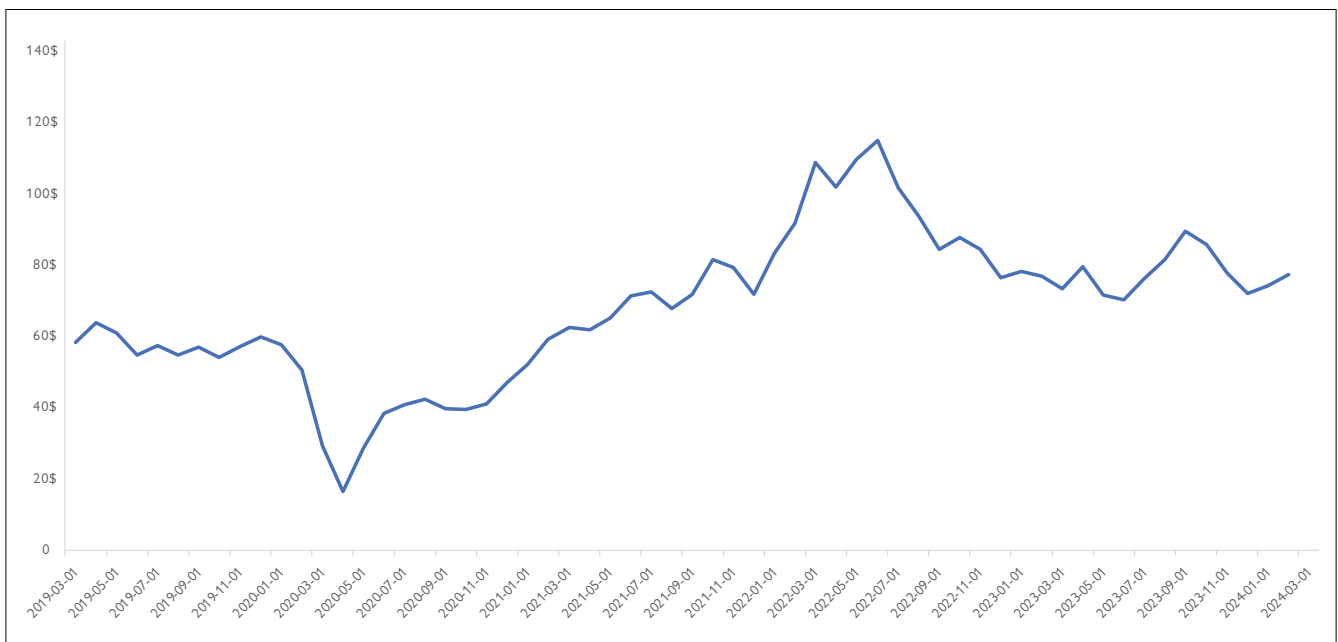
The longer-term impact of the war in Ukraine on Iraq’s food security remains uncertain. The research literature has shown several studies linking food insecurity with war (see Martin-Shields and Stojetz (2019) for a review). Iraq and other countries that depend on grain imports will likely continue to face challenges in securing affordable food supplies. The situation underscores the need for Iraq to explore alternative sources and strategies for food security, including bolstering domestic agricultural production and diversifying its import sources to mitigate the risks posed by global supply chain disruptions.

CHALLENGE 3: VOLATILITY IN THE GLOBAL OIL MARKET

Both the Israel-Gaza crisis and the war in Ukraine have influenced the international oil market, leading to notable consequences for oil-producing nations such as Iraq (Zhang et al., 2024). The conflicts led to a surge in global oil prices due to concerns over supply disruptions. In previous years, the

oil price declined significantly after the COVID-19 pandemic in 2020, but the price gradually increased as the market recovered (Figure 3). Oil prices have shown high levels of volatility with peaks and troughs in recent years.

Figure 3: Crude oil price



Source: [Trading Economics](#). Crude Oil WTI.

As a major oil-exporting country, Iraq found itself in a complex situation. On the one hand, the higher global oil prices could lead to increased revenues from oil exports, which is crucial for Iraq's economy, given its heavy reliance on oil for national income. On the other hand, this benefit was offset by the increased volatility and uncertainty in the global oil market. The volatility in oil prices made fiscal planning more complex as the government grapples with fluctuating revenues in a worldwide market sensitive to geopolitical events. Higher oil prices also increase the costs of imported goods, contributing to inflationary pressures within the country (Appiah-Otoo, 2023). The trade-off from exploiting oil is the typical curse or blessing of natural resources (Sachs and Warner, 2001). The literature emphasizes that countries need strong institutions, good governance and practical policy frameworks to turn natural resource wealth, such as oil, into a lasting blessing rather than a curse (Van der Ploeg, 2011).

The Government must balance the benefits of increased oil revenue with the financial hardships of its population due to rising living costs and climate change. Iraq faces increased temperatures, reduced rainfall, and more frequent and severe dust storms, impacting water resources, agriculture and public health (Adamo et al., 2015). Climate change negatively impacts livelihoods, with recent assessments suggesting that most rural households in central and southern Iraq reduced farming activity in the last five years (IOM, 2023c; IOM, 2022). The situation underscores Iraq's vulnerability to external shocks in the oil market and highlights the need for economic diversification (Jacobsen et al., 2023). The diversification of GDP sources is crucial for Iraq's long-term financial stability and its ability to withstand future global market shocks. The Government's efforts to diversify the economy, attract alternative foreign investment and create sustainable job opportunities have faced increasing challenges from heavy reliance on the extractive sector (World Bank, 2022b).

CONCLUSION AND RECOMMENDATIONS

Regional and global instability, particularly the repercussions of the Israel-Gaza crisis and the war in Ukraine, threaten to disrupt Iraq's economic recovery and development. Growing tensions in Iraq linked to regional conflict dynamics show that the country is exposed to negative spillovers from these crises. Geopolitical uncertainty risks affecting business confidence and investment by small and medium enterprises, which are responsible for most private sector employment and job creation in Iraq. At the same time, the global rise in the price of food and other basic goods is negatively affecting Iraqi consumers. Volatility in oil prices following a 2022 spike in revenues shows the limitations of relying on the extractive sector to support fiscal expansion aimed at buffering these shocks (IMF, 2022).

The effects of these intersecting shocks will be felt heavily by the most economically vulnerable segments of society, including displacement-affected communities recovering from the 2014 conflict with ISIL and rural households bearing the brunt of climate change. Despite progress in recent years towards the achievement of durable solutions to displacement, many IDPs and returnees continue to lack access to reliable livelihoods. Economic vulnerabilities are also common among host communities, with competition for employment representing a possible source of social tensions should economic conditions deteriorate further. In parallel, environmental degradation and climate-induced challenges have impeded agricultural productivity and hurt rural livelihoods, as evidenced by the widespread reduction in farming, livestock and fishing activities due to water scarcity and salinization (IOM, 2023c).

Given these multifaceted challenges, recommendations for Iraq should address both short- and long-term strategies. In the short term, it is crucial that efforts focus on mitigating the impacts of regional instability on private sector recovery in areas affected by past conflict, large-scale displacement and environmental degradation. International actors and the government should ensure adequate and continued support to prevent economic setbacks that may generate social tensions and hinder further progress towards the achievement of durable solutions for displaced persons. For long-term resilience, Iraq must focus on diversifying its economy to reduce its dependence on oil and promote the conditions for sustainable private sector development. It is also important to step up investment in climate adaptation and mitigation efforts, including sustainable agricultural practices to counter environmental degradation and employment opportunities for climate migrants in urban areas.

Strengthening governance and building robust institutions are crucial to sustainably harnessing Iraq's natural resources and securing a stable economic future. Supporting the expansion of small and medium-sized enterprises and their contribution to the Iraqi economy contributes to economic diversification and resilience. Given longstanding barriers in access to finance, interventions that facilitate access to credit, establish loan guarantees and promote private investment focused on small and medium enterprises play an important role in supporting Iraq's private sector recovery (IOM, 2023g).



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