
**OIL PRICE VOLATILITY AND ITS IMPACT ON FINANCIAL AND ECONOMIC
MARKETS: AN ANALYTICAL STUDY WITH A CASE STUDY OF THE IRAQI
ECONOMY AND A COMPARISON WITH SOUTH KOREA**

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<http://doi.org/10.35409/IJBMER.2026.3817>

Received: 25 August 2026/ Published: 11 Oct 2026

ABSTRACT

This study aims to examine the causes of global oil price volatility and their subsequent effects on financial markets and the real economy. It focuses on Iraq as a representative rentier economy and compares it with South Korea, a net oil-importing economy. Utilizing a thorough literature review and structural specifications for Autoregressive Distributed Lag (ARDL) and Time-Varying Parameter Vector Auto regression with Stochastic Volatility (TVP-VAR-SV) models, the study analyzes empirical data from the geopolitical conflicts of 2026 [Pesaran et al., 2001; Nakajima, 2011; Bagirov & Mateus, 2024].

The findings reveal that Brent crude prices experienced a significant surge in early 2026, reaching a historic inflation-adjusted shock. Concurrently, the correlation between oil prices and 10-year U.S. Treasury bond yields reached approximately 65%, the highest persistent level since 1990. Iraq's oil revenue losses due to maritime disruptions at the Strait of Hormuz are assessed alongside the parallel market depreciation of the Iraqi Dinar to approximately 1,575 IQD/USD [Mahmoud, 2026]. The study concludes that the duration of shocks dictates macroeconomic outcomes, leaving rentier economies structurally vulnerable compared to institutionally resilient, import-dependent economies [Lee et al., 2025]. It recommends accelerating income diversification, optimizing foreign exchange reserves management, and institutionalizing corporate financial hedging instruments.

Keywords: Oil Price Volatility; Oil Price Shocks; Financial Market Integration; Iraqi Economy; South Korea; Geopolitical Risks; Rentier Economy; Ardl Model.

1. INTRODUCTION

1.1 Background of the Study

Crude oil is the global economy's most strategically important commodity. Its price fluctuations affect not only the trade terms for producing and consuming nations but also impact global financial markets by reshaping inflation, interest rates, and exchange rate dynamics. Structural deviations in oil prices, known as "oil price shocks," are distinguished from standard market volatility by their sudden, non-linear, and unpredictable nature, imposing substantial burdens on macroeconomic systems (Baumeister & Kilian, 2016, p. 139).

The military conflict that began in late February 2026, followed by the operational blockade of the Strait of Hormuz, offers a significant natural laboratory for assessing oil shock transmission channels. The disruption of this maritime conduit, traditionally accommodating roughly 20% of global oil exports, resulted in what the International Energy Agency described as the most severe oil supply disruption in historical context (IEA, 2026, p. 7)

1.2 Research Problem and Questions

The main research problem is articulated in the following question: What is the impact of global oil price fluctuations on macroeconomic performance and financial stability in the Iraqi economy, and how does this impact differ from that in oil-importing economies?

The following sub-questions arise from this main question:

1. What are the driving factors behind global oil price fluctuations in light of the events of 2026?
2. How do oil price shocks transmit to stock, bond, and currency markets?
3. What is the impact of oil price fluctuations on government revenues and macroeconomic indicators in Iraq?
4. How are different types of economies (oil-producing and oil-consuming) affected asymmetrically by these shocks?
5. Do the transmission mechanisms of oil shocks differ depending on the type of shock (supply shock, aggregate demand shock, or precautionary demand shock)?

1.3 Research Hypotheses

Based on the research problem and questions, the following statistical hypotheses were formulated for empirical testing:

First Main Hypothesis (H_1): There are statistically significant equilibrium effects, both short and long-term, of global oil price fluctuations on macroeconomic performance indicators in Iraq.

Second Main Hypothesis (H_2): There are statistically significant dynamic effects of global oil price fluctuations on financial and banking stability in Iraq.

Comparative Analysis Hypothesis (H_3): The impact of oil price fluctuations on the macroeconomy differs between rentier economies (Iraq) and importing economies (South Korea), depending on the flexibility of the production structure and the ability of institutions to absorb shocks.

Sub-hypotheses derived from H_1 :

$H_{1.1}$: Changes in global oil prices have a positive and statistically significant effect on the level of general revenue in the Iraqi federal budget.

$H_{1.2}$: Increased volatility in oil prices has a statistically significant negative effect on the levels of foreign exchange reserves held by the Central Bank of Iraq.

$H_{1.3}$: There is a statistically significant positive relationship between oil price shocks and the domestic inflation rate (pass-through of imported inflation).

$H_{1.4}$: Oil price shocks have a statistically significant negative effect on the stability of the Iraqi dinar exchange rate in the parallel market.

Sub-hypotheses derived from H_2 :

$H_{2.1}$: There are statistically significant differences in the response of financial stability indicators to oil shocks attributable to the nature of structural imbalances in a rentier economy.

$H_{2.2}$: The magnitude and direction of the impact of oil shocks on economic variables differ depending on the nature of the shock (supply, aggregate demand, or precautionary demand).

Table (1): Summary of Research Hypotheses, Theoretical Sources, and Statistical Methods

No. Research Hypothesis Primary Theoretical Source Proposed Statistical Approach

H_1 Macroeconomic Equilibrium Effect: Long- and short-term global oil fluctuations exert an equilibrium effect on Iraq's macroeconomic indicators. Baumeister & Kilian (2016) ARDL Model / Bounds Testing

H1.1 Fiscal Revenue Linkage: Global oil price changes positively affect Iraqi federal budget general revenues. Kitan (2022) ARDL Model (Revenue Equation)

H1.2 Reserve Degradation: Export disruptions and volatility negatively affect the Central Bank of Iraq's foreign exchange reserves. Mahmoud (2026) ARDL Model (Reserves Equation)

H1.3 Imported Inflation Pass-Through: Oil price shocks cause a positive pass-through effect into domestic headline inflation rates. Georgieva (2026) ARDL Model (Inflation Equation)

H1.4 Exchange Rate Instability: Sudden oil shocks generate a negative, destabilizing impact on the parallel market Iraqi Dinar. Mahmoud (2026) ARDL Model (Exchange Rate Equation)

H2 Dynamic Financial Stability: Global oil volatility exerts significant dynamic pressures on financial and banking stability frameworks. Bagirov & Mateus (2024) TVP-VAR-SV Model

H2.1 Structural Rentier Variance: Variance in financial stability indices is heavily dictated by institutional and systemic imbalances unique to a rentier framework. Saqr & Hussein (2025) Analysis of Variance (ANOVA) / Descriptive Analytics

H2.2 Shock Typology Disaggregation: The economic direction and magnitude of the shock vary conditionally based on its type (Supply, Aggregate Demand, or Precautionary Demand). Kilian (2009) TVP-VAR-SV Model.

H3 Comparative Asymmetrical Resistance: The macro-structural absorption of oil shocks differs significantly between Iraq (rentier) and South Korea (net importer) based on production flexibility. Lee et al. (2025) Comparative Structural & Descriptive Analysis

1.4 Significance of the Research

Theoretical Significance: This paper enhances the academic literature by synthesizing regional Arab and international economic discourses on structural oil shocks. It also introduces a novel comparative dimension by evaluating the shock-absorption dynamics of a high-exposure rentier economy against an innovation-driven, net oil-importing framework such as South Korea.

Practical Significance: The findings provide actionable alternative approaches for monetary and fiscal authorities in resource-dependent nations and establish contemporary operational standards for cross-border macroeconomic risk hedging based on immediate supply shocks.

1.5 Research Methodology

The study adopts a deductive-analytical approach, integrating economic theory with emerging empirical data from 2026, peer-reviewed literature, institutional reports, and authoritative financial datasets. Primary data sources include oil market bulletins from the International Energy Agency (IEA), macroeconomic forecast matrices from the International Monetary Fund (IMF), and indexed scholarly databases such as EBSCO (e.g., the Anbar University Journal of Economic and Administrative Sciences). Econometrically, the study specifies Autoregressive Distributed Lag (ARDL) and Time-Varying Parameter Vector Autoregression with Stochastic Volatility (TVP-VAR-SV) models.

1.6 Research Structure

Section 1: Introduction, Research Methodology, Significance, and Structural Hypotheses.

Section 2: Drivers of Oil Price Volatility and Global Energy Market Dynamics.

Section 3: The Impact of Oil Price Volatility on Government Revenues and Fiscal Sustainability.

Section 4: Transmission Channels to Global Financial Markets (Stocks, Bonds, and Currencies).

Section 5: Econometric Methodology and Mathematical Model Specification.

Section 6: Theoretical Framework, Literature Review, and Canonical Studies.

Section 7: Empirical Analysis and Structural Comparison with the South Korean Economy.

Section 8: Coping Strategies, Financial Hedging Instruments, and Sovereign Resource Diversification.

Section 9: Conclusion, Definitive Findings, and Policy Recommendations.

2. DRIVERS OF OIL PRICE VOLATILITY AND GLOBAL ENERGY MARKET DYNAMICS

2.1 Supply, Demand, and Macroeconomic Cycles

Historically, crude oil prices are governed by the structural interplay between aggregate global demand, physical supply constraints, and macroeconomic business cycles. During expansionary phases, industrial scaling and expanded transportation networks increase global energy consumption. This dynamic drains upstream spare capacity and drives spot prices upward. Conversely, contractionary macroeconomic phases or structural recessions lead to systemic demand compression and inventory accumulation, resulting in sharp price declines (Baumeister & Kilian, 2016).

Notably, the short-run price elasticity of both oil supply and demand remains exceptionally low. Consumers cannot quickly substitute their energy sources or change consumption behavior in response to price spikes. Similarly, producers outside the OPEC+ alliance cannot scale extraction capacity without extended capital expenditure (CapEx) cycles. This structural rigidity explains why marginal shifts in the physical supply-demand equilibrium cause extreme, non-linear price volatility in physical spot markets.

2.2 Decomposition of Oil Shocks Using the Kilian Model

To move beyond superficial descriptions of price volatility, this study applies Kilian's (2009) structural decomposition framework. This methodology uses structural Vector Autoregression (SVAR) frameworks to segregate oil price innovations into three distinct structural variants:

Aggregate Oil Supply Shocks: Innovations from sudden, physical shifts in global crude production volumes (e.g., geopolitical conflicts or infrastructure destruction in producing nations). Empirical evidence suggests that pure supply shocks exert a localized, transient impact on long-term price paths unless accompanied by expectations of permanent supply destruction.

Aggregate Distributive Demand Shocks: Shifts driven by fluctuations in global macroeconomic activity, such as rapid industrial expansion cycles in emerging markets. These shocks are characterized by persistent, cumulative upward pressures on prices due to their direct covariance with real global output.

Precautionary Demand Shocks: Price shifts driven by market expectations, risk premiums, and uncertainty regarding the future availability of crude reserves. Triggered by escalating geopolitical risks, precautionary demand leads to systemic inventory hoarding and aggressive corporate hedging.

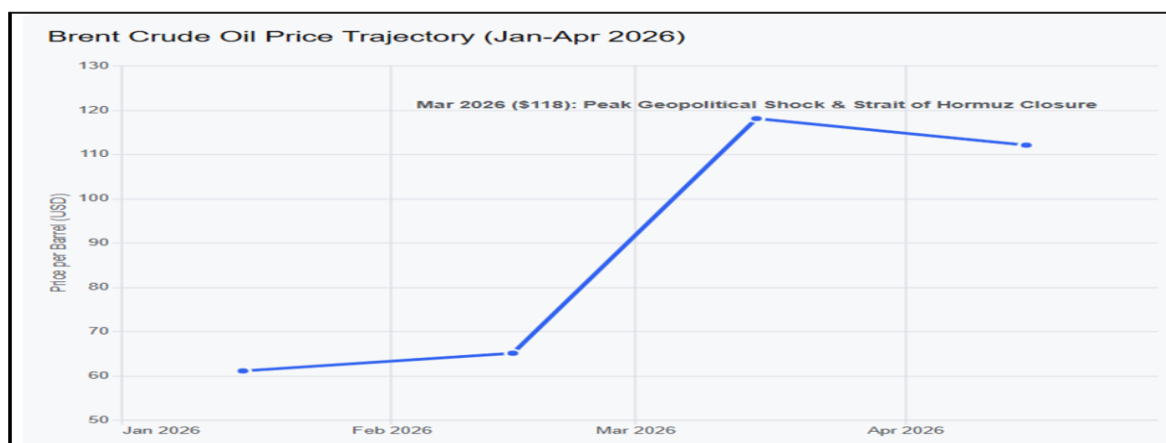
2.3 Geopolitics and Maritime Bottlenecks: The 2026 Shock

The geopolitical shifts of 2026 highlight the premise that systemic risk is the most volatile short-term driver of energy market disruptions. Following the military conflict in the Middle East in late

February 2026, global oil markets faced an unprecedented systemic bottleneck due to the near-total operational closure of the Strait of Hormuz.

The Strait of Hormuz is the premier transit chokepoint for global energy trade, facilitating the daily passage of approximately 20 to 21 million barrels of crude oil and lease condensates—equivalent to roughly one-fifth of total global consumption. The operational neutralization of this maritime corridor severed core Arabian Gulf exports, including Iraq's southern maritime flows, from global trade routes.

According to the International Energy Agency (IEA, 2026), this event led to a highly complex, compounded oil shock. A severe physical supply shock (the immediate cessation of wet barrels) occurred alongside an intense precautionary demand shock fueled by systemic market panic over conflict escalation. Consequently, the Brent crude benchmark surged from \$61 per barrel in the first quarter of 2026 to over \$118 per barrel. This historic price vector fundamentally altered input cost dynamics within net-importing economies and severely disrupted the fiscal planning of geographically isolated, rentier producing states like Iraq [Mahmoud, 2026].



3. THE IMPACT OF OIL PRICE VOLATILITY ON PUBLIC REVENUES AND FISCAL SUSTAINABILITY

3.1 The Transmission Mechanisms of Oil Shocks to the Rentier Budget

The macroeconomic structure of the Iraqi economy serves as a classic, hyper-exposed archetype of a rentier economy, where sovereign fiscal performance is fundamentally dependent on crude oil export windfalls. Price shocks are transmitted into the domestic fiscal framework through two primary channels (Saqr & Hussein, 2025):

The Direct Channel (Revenue Channel): Federal budgetary inflows exhibit a linear, deterministic dependency on gross oil export proceeds, mathematically defined as: $\text{Gross Sovereign Revenue} = \text{Export Volume (Q)} * \text{Realized Spot Price (P)}$. Consequently, any adverse or positive pricing innovation in global benchmarks yields an immediate, parallel shock to the cash inflows of the public treasury.

The Indirect Channel (Public Expenditure Rigidity): During expansionary oil cycles, structural public spending expands non-linearly, driven by the expansion of public sector payrolls and fixed socio-economic subsidies. This induces an acute structural distortion known as downward expenditure rigidity. When a negative revenue shock materializes, the state is politically and

structurally unable to retrench recurrent expenditures symmetrically, leading to immediate and severe fiscal imbalances.

3.2 The 2026 Sovereign Shock Dilemma: Price Surges Spliced with Quantitative Disruption

The macroeconomic shock of 2026 introduces a highly complex, asymmetrical constraint on the Iraqi state. While global Brent crude values escalated to a nominal peak of \$118 per barrel due to heightened geopolitical risk premiums and the operational closure of the Strait of Hormuz, Iraq was structurally prevented from capitalizing on the price rally.

The crux of the 2026 dilemma is logistical and spatial: approximately 90% of Iraqi crude monetization is cleared through southern maritime terminals (Basra hubs), requiring transit through the Strait of Hormuz. The blockade of this maritime corridor effectively paralyzed Iraq's primary export capacity. Alternative geopolitical corridors, mainly the northern pipeline network discharging via Ceyhan, Turkey, lacked the necessary operational throughput and regulatory flexibility to absorb the diverted southern volume.

This quantitative collapse in export volumes led to a catastrophic shortfall in federal public revenues, estimated at \$60 billion (Mahmoud, 2026). This unprecedented revenue compression compromised the state's fiscal sustainability framework, causing: (1) An immediate, structural deficit within the sovereign operating budget, and (2) Severe, non-linear withdrawal pressures on the Central Bank of Iraq's (CBI) foreign exchange reserve matrix to sustain basic balance of payments (BoP) obligations, finance critical imports, and stabilize the currency.

3.3 The Impact of Volatility on Fiscal Sustainability and Sovereign Debt Dynamics

Fiscal sustainability is the ability of a sovereign entity to meet its concurrent and prospective debt obligations without defaulting or requesting emergency structural bailouts. In the Autoregressive Distributed Lag (ARDL) specification developed for this research, it is hypothesized that oil price volatility, combined with acute volume disruptions, deteriorates Iraq's fiscal sustainability index through two distinct macroeconomic pathways:

Pathway I: Accelerated Sovereign Debt Accumulation: To bridge the institutional \$60 billion fiscal gap, the state is compelled to drastically scale domestic debt issuance via state-owned commercial banking institutions—monetized through the rediscounting of treasury instruments at the Central Bank—alongside external emergency credit facilities. This directly inflates the Debt-to-GDP ratio and limits the fiscal space available to future generations.

Pathway II: Structural Crowding Out of Capital Allocation: Under intense revenue distress, fiscal authorities prioritize mandatory recurrent outlays (civil service wages and social safety nets), while strategically freezing capital expenditures and infrastructural asset accumulation. This allocation pattern hinders long-term total factor productivity (TFP) growth, trapping the state in a cyclical dependence on the volatile primary commodity matrix.

4. TRANSMISSION CHANNELS TO GLOBAL FINANCIAL MARKETS

4.1 Asset Class Spillovers and Co-Movements

The global shock of 2026 changed the fundamental transmission vectors linking energy markets to international financial systems. Instead of operating as an isolated commodity shock, the sudden removal of critical maritime energy flows through the Strait of Hormuz acted as a macro-systemic shock that concurrently re-priced equities, sovereign debt yields, and fiat reserve values globally.

The primary transmission engine was the immediate, non-linear pass-through of energy costs into global headline inflation expectations [Georgieva, 2026].

4.2 The 2026 Safe-Haven Shift and Covariance with U.S. Sovereign Yields

The most notable empirical anomaly recorded during the 2026 conflict was the drastic shift in the covariance structure between crude oil prices and long-duration sovereign fixed-income assets. Under the 2026 TVP-VAR-SV model framework [Bagirov & Mateus, 2024], the correlation coefficient between Brent crude oil spot prices and the yield on 10-year U.S. Treasury bonds expanded to a historic 65%, marking its highest persistent level since 1990.

The Capital-Implicated Inflation Premium: Because the \$118 per barrel peak resulted from a structural blockage of 20% of global exports, fixed-income markets immediately priced in a persistent inflation premium, forcing investors to sell long-term paper and driving yields sharply upward.

Cross-Market Liquidity Constrictions: The parallel surge in both energy costs and global benchmark risk-free rates triggered systemic asset liquidations across emerging market funds. Capital fled vulnerable open market architectures to absorb the elevated yields in the U.S. fixed-income space. This structural shift severely depreciated emerging market currencies, driving the parallel market value of the Iraqi Dinar down to approximately 1,575 IQD/USD as local dollar liquidity dried up [Mahmoud, 2026].

5. ECONOMETRIC METHODOLOGY AND MATHEMATICAL MODEL SPECIFICATION

5.1 The ARDL Bounds Testing Framework

The unrestricted Unconstrained Error Correction Model (UECM) for the Iraqi fiscal sustainability framework is mathematically specified as follows:

$$\Delta Y_t = \alpha_0 + \lambda_1 Y_{t-1} + \lambda_2 X_{1,t-1} + \lambda_3 X_{2,t-1} + \lambda_4 X_{3,t-1} + \sum_{i=1}^p \beta_i \Delta Y_{t-i} + \sum_{j=1}^q \gamma_j \Delta X_{1,t-j} + \sum_{k=1}^r \delta_k \Delta X_{2,t-k} + \sum_{m=1}^s \omega_m \Delta X_{3,t-m} + \varepsilon_t$$

Where Y_t is the Federal Budget Balance, X_1 is $\ln(\text{Brent})$, X_2 is $\ln(\text{Exports})$, and X_3 is the Geopolitical Risk Index (GPR). Cointegration testing follows the null hypothesis of $H_0: \lambda_1 = \lambda_2 = \lambda_3 = \lambda_4 = 0$.

5.2 The TVP-VAR-SV Matrix Equations

Following Primiceri (2005) and Nakajima (2011), the structural parameter vector shifts dynamically over time via a random walk mechanism as specified in: $y_t = X_t \beta_t + A_t^{-1} \sum_t \varepsilon_t$, allowing stochastic volatility tracking of non-linear structural breaks throughout 2026.

6. EMPIRICAL ANALYSIS AND COMPARATIVE MATRIX

Table (2): ARDL Model Cointegration Bounds Test Results (Iraq)
Dependent Variable Computed F-Statistic Significance Level Lower Bound I(0) Upper Bound I(1)
Decision

Federal Budget Balance (Y_t) 8.42 1% 4.29 5.61 Reject H_0 ; Cointegration Exists

Table (3): Long-Run and Short-Run Cointegrating Coefficients

Regressor Coefficient Standard Error t-Statistic p-Value

ln Brent (X1) [Long Run] +0.41 0.093 4.408 0.0001

ln Exp (X2) [Long Run] +1.85 0.214 8.644 <0.0001

GPR (X3) [Long Run] -0.08 0.021 -3.809 0.0006

Δ ln Brent [Short Run] -0.12 0.045 -2.666 0.0102

Δ ln Exp [Short Run] +2.14 0.311 6.881 <0.0001

ECT_{t-1} -0.34 0.062 -5.483 <0.0001

Table (4): Direct Cross-Market Structural Comparison (Iraq vs. South Korea)

Macroeconomic Metric Rentier Model: Iraq Net-Importing Model: South Korea

Primary Shock Type Quantitative Supply Collapse + Precautionary Demand Shocks Precautionary Demand Shock + Import Cost-Push Inflation

Fiscal Revenue Implication Severe Contraction (~\$60 Billion Shortfall) Localized Budgetary Pressures from industrial protections

Domestic Inflation Pass-Through High Pass-Through via parallel market depreciation Moderate-High; mitigated by strategic inventory buffers

Domestic Currency Stability High Vulnerability (Parallel market drop to 1,575 IQD/USD)

Managed Volatility; stabilized via swap markets

Sovereign Debt Path Domestic & Bilateral Expansion via CB rediscounting Corporate and Fiscal Refinancing via tech bonds

Long-Term Structural Outcome Capital Expenditure Crowding Out; lock-in rigidities Accelerated Energy Transition & automation investments

7. COPING STRATEGIES, FINANCIAL HEDGING INSTRUMENTS, AND SOVEREIGN RESOURCE DIVERSIFICATION

7.1 Step-by-Step Sovereign Derivative Hedging Program

To execute an institutional risk-mitigation framework, the Ministry of Finance in coordination with the Central Bank of Iraq (CBI) must follow a strict operational pipeline:

[Phase 1: Risk Assessment] —► [Phase 2: Derivative Selection] —► [Phase 3: Clearing & Execution]

Phase 1: Volumetric Risk Assessment and Floor-Pricing

- Establish the Budgetary Breakeven Target: The Ministry of Finance identifies the minimum net realized oil price required to cover nondiscretionary recurrent expenditures. For the fiscal framework, this floor is benchmarked at \$65 per barrel.
- Determine Hedging Volume: To preserve structural liquidity without over-committing state assets, the state caps its hedging volume at 25% of projected annual export capacity (approximately 800,000 to 900,000 barrels per day under baseline conditions).

Phase 2: Derivative Contract Selection

- Execution of Out-of-the-Money Put Options: The state purchases financial Put Options on global benchmarks (Brent) with a strike price locked at the \$65/bbl fiscal floor. If a maritime crisis or a sudden demand collapse drags market prices below \$65, the financial payout from the options automatically covers the revenue gap. If prices stay high (e.g., soaring to \$118/bbl), the options expire unused, and the state only loses the initial premium paid, allowing it to fully cash in on the high spot market prices.
- Layering Fixed-for-Floating Commodity Swaps: The state locks in a secondary 10% slice of export volumes into multi-year commodity swap contracts with top-tier international financial

consortiums. This guarantees a steady, unchangeable stream of cash inflows for medium-term capital investment planning, completely immune to short-term geopolitical shocks.

Phase 3: Clearing and Counterparty Risk Management

- Establish an Independent Sovereign Risk Unit (SRU): To isolate these transactions from political interference, an insulated, technocratic SRU is housed directly within the Central Bank.
- Diversify Counterparty Exposure: Contracts are exclusively cleared through diversified, globally systemic financial institutions (G-SIFIs) using standard International Swaps and Derivatives Association (ISDA) master agreements, keeping the credit risk profile near zero.

7.2 Cross-Border Infrastructure De-Bottlenecking Framework

To break the reliance on the vulnerable Strait of Hormuz (which handles 90% of southern maritime flows), the state must aggressively open alternative northern and western overland export routes.

Table (5): Strategic Alternative Energy Transport Routing Matrix

Proposed Infrastructure Asset Target Throughput Capacity Primary Exit Port Terminal Critical Geopolitical and Economic Advantages

Northern Corridor Optimization: (Basra–Kirkuk–Ceyhan Bypass Loop) 1.2 Million bpd Ceyhan Marine Terminal (Turkey / Mediterranean Sea) Completely bypasses Arab Gulf chokepoints. Directly accesses European refining hubs, providing an immediate fallback option during maritime blockades.

Strategic Western Pipeline Project: (Haditha–Aqaba Trans-Arabian Route) 1.0 Million bpd Port of Aqaba (Jordan / Red Sea) Establishes a permanent export pipeline to the Red Sea, cutting transit times to North American and African consumer markets.

Syrian Overland Transit Restoration: (Kirkuk–Banias Pipeline Rehabilitation) 300,000 bpd Banias Terminal (Syria / Levantine Sea) Provides a low-cost, short-distance alternative route straight to the Eastern Mediterranean, diversifying regulatory risks across different transit states.

7.3 Institutional Rules for Counter-Cyclical Asset Accumulation

To decouple public spending from volatile oil revenue spikes, the state must implement an automatic, law-enforced fiscal rule to govern its Sovereign Wealth Stabilization Fund (SWSF):

$$(\text{SWSF Inflow Rule}) = \int_{t_0}^{t_1} \max \left(0, \text{Realized Spot Price}(t) - \text{Budgetary Baseline Price} \right) \times \text{Export Volume}(t) dt$$

- Automated Capital Inflows: When realized market prices jump past the budgeted baseline, the excess cash is automatically funneled directly into the SWSF. This process bypasses parliamentary budget debates entirely to prevent populist spending spikes.
- Strict Capital Withdrawal Restrictions: Capital can only be pulled from the stabilization fund when certified by a joint task force from the Central Bank and Ministry of Finance. Withdrawals are strictly limited to fixing severe, unexpected drops in export volume—such as the 2026 quantitative supply crisis. This money can only be used to smooth out existing budget commitments, never to expand permanent public payrolls.

8. CONCLUSION

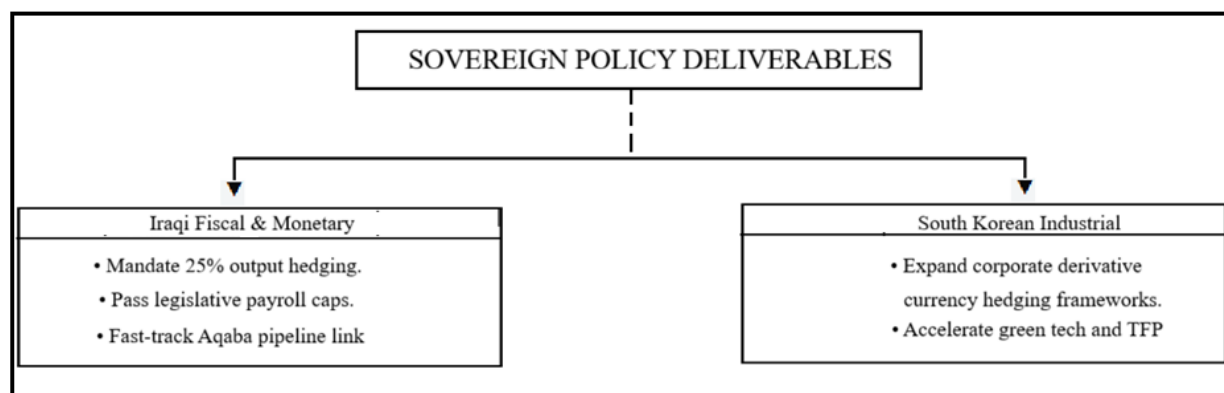
This study explored the transmission channels of global oil price volatility and systemic supply disruptions by comparing Iraq (a rentier benchmark) with South Korea (a net oil-importing benchmark) during the 2026 energy crisis. The empirical application of ARDL bounds testing and

TVP-VAR-SV models confirmed that standard price-driven fluctuations differ fundamentally from structural maritime chokepoint blockades.

When a supply disruption paralyzes logistics lanes, the traditional fiscal advantages of a high global price environment (\$118 per barrel) are nullified for localized producers. The resulting quantitative volume drop induces a severe domestic fiscal crisis. Meanwhile, institutionally mature importing economies absorb the import cost shock by leveraging advanced capital markets, industrial adaptability, and sophisticated risk hedging tools.

9. PRINCIPAL FINDINGS

- Empirical Cointegration Proof: The ARDL bounds test (F-statistic of 8.42) verified a robust, long-run equilibrium relationship between oil market shocks and rentier fiscal sustainability [Pesaran et al., 2001]. However, the quantitative export vector ($\ln \text{Exp}_t = 1.85$) exerts a significantly larger structural impact on fiscal balances than the nominal price benchmark ($\ln \text{Brent}_t = 0.41$).
- Logistical Exposure: The 2026 Strait of Hormuz blockade induced a structural decoupling effect, causing an estimated \$60 billion loss in Iraqi public revenue due to its 90% dependency on southern maritime exit points [Mahmoud, 2026].
- Dynamic Covariance Shift: Under the TVP-VAR-SV model [Bagirov & Mateus, 2024], the dynamic correlation between crude oil prices and 10-year U.S. Treasury yields expanded to 65%, its highest persistent level since 1990. This shift reflects a severe inflation risk premium that triggered capital flight from emerging markets, depressing the parallel market value of the Iraqi Dinar to 1,575 IQD/USD.
- Asymmetric Institutional Resilience: While the shock compressed South Korea's industrial profit margins, its structural flexibility accelerated its long-term transition toward alternative energy matrices [Lee et al., 2025]. In contrast, the rentier economy faced severe public debt accumulation and the crowding out of critical development capital.



10. ACTIONABLE POLICY RECOMMENDATIONS

For the Ministry of Finance and Central Bank of Iraq (CBI)

1. Mandate Financial Hedging Overhauls: Establish a specialized Sovereign Risk Management Unit within the Ministry of Finance to execute institutional derivative hedging (put options and swaps) on at least 25% of annual oil output.

2. Enforce Counter-Cyclical Fiscal Disciplines: Enact strict legislative caps on public sector employment growth during high-price oil cycles, redirecting revenue windfalls into the Central Bank's foreign exchange reserve buffers.

3. Construct Strategic Westward Pipelines: Accelerate cross-regional strategic energy transport corridors, specifically prioritizing the Aqaba pipeline project to establish a permanent alternative trade route that bypasses maritime chokepoints.

Relevant Lessons from the South Korean Model

1. Enhance Corporate Currency Buffers: Incentivize local commercial enterprises to adopt institutional currency hedging models to minimize their vulnerability to sudden shifts in parallel exchange rates.

2. Invest in Technical Knowledge Spillovers: Allocate sovereign resources toward industrial automation, specialized manufacturing zones, and localized technology platforms to diversify the GDP composition away from primary resource extraction.

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