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Technical Committee for Developing National 5-year Plan
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**Public Investment
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Preliminary assessment of investment budget performance in Iraq:

The preliminary assessment of annual investment budget performance shows low percentage of implementation and disbursement compared with the volume of funds allocated. As listing investment projects in the plan depends on the proposals made by the implementing bodies which are often the beneficiaries of such projects, this indicates poor performance of implementing bodies in terms of assessing their implementation capacity. It also indicates that implementing bodies propose allocations for their projects without any real feasibility studies. Assessing budget performance, there is exaggeration in demanding allocations, resulting in inflation of state budget and holding large amount of money that could have been allocated to other fields or sectors that effectively push economy forward. Monitoring practical procedures in preparing and implementing annual investment plans developed during 2004-2008, the following can be noticed:

- 1- First of all, distribution of resources between current and investment expenditure was not based upon a clear socio-economic vision. In addition, allocations for investment expenditure was marginal, as the political and security conditions put a huge burden over expenditure, resulting in many commitments in terms of current side of the budget. This had a notable negative impact on investment volume (e.g. the average percentage of amounts allocated for investments during this period out of total state budget was around 22 per cent).
- 2- The process of selecting projects and listing them in the investment approach suffered many shortcomings due to lack of vision for ministries and other bodies tasked with project selection process, and absence of prioritizing projects according to scientifically-based technical and economic feasibility studies. Therefore, listing projects in the plan was based upon ministerial willingness in most cases.
- 3- In spite of existing documentation of National Development Strategy (NDS) for 2004-2007 and 2007-2010, annual allocations were not in line with such strategies. For example, during the period of 2006-2009, the total amounts allocated for investment was IQD 70406.7 billion, while the amount proposed under development strategies for the same period was around IQD 190068.5 (USD 153 billion). This means that the ratio of actual allocation to strategy proposed allocation reached around 37 per cent which is a moderate percentage. Moreover, the situation gets worse if we take into account the actual disbursement of investment allocations.

Accordingly, we can conclude that there was no sound investment policy which is based upon an economic vision that utilizes the resources to maximize benefits of using them in developing financial resources, increasing welfare, developing human resources to increase their cultural capacity, and paying attention to education, health, etc. based upon the links between the various activities and sectors.

At macro economic level, poor implementation of investment plan may be attributed to lack of coordination between state financial policy and investment policy, resulting in huge growth in public consuming expenditure without any notable improvement in public services, noting that funding such expenditure depends increasingly on oil revenue. This takes place at expense of investment expenditure which obtains a low percentage of national income, leading to low investment rate and inevitably low percentage of economy growth rate. The following table shows the ratios of public consuming expenditure, public investment expenditure, and fixed capital formation to GDP was around 19.3 per cent, 2.8 per cent, and 5.4 per cent, respectively in 2002. Compared with 1990, the respective ratios were 25.2 per cent, 13.1 per cent, and 25.5 per cent. This represents a notable decline of investment policy as the ratio of public investment expenditure to GDP was only 6.3 per cent and 7.2 per cent in 2006 and 2007, respectively. In 2005, however, and due to relative improvement in investment activity, ratio of fixed capital formation to GDP increased again, reaching around 17% in 2006 and around 31.4 per cent in 2007. This represents a positive indication, serving economic growth in Iraq, as shown in realizing a high growth rate during 2008.

Table 1: Gross domestic production, public consuming expenditure, public investment expenditure, and total fixed capital formation in Iraq (1990-2007) at current rates (IQD million)

| Year | GDP (1) | Public consuming expenditure (2) | Public investment expenditure (3) | Fixed capital formation (4) | 1:2 % | 1:3 % | 1:4 % |
|------|-------------|---|--|--------------------------------------|----------|----------|----------|
| 1990 | 24398.1 | 6142.0 | 3196.7 | 6220.1 | 25.2 | 13.1 | 25.5 |
| 2000 | 50213699.9 | 5944656.8 | 347037.0 | 146525.7 | 11.8 | 0.7 | 0.3 |
| 2001 | 41314568.5 | 6488987.4 | 578860.9 | 2531440.9 | 15.7 | 1.4 | 6.1 |
| 2002 | 41022927.4 | 7919966.3 | 1162240.5 | 2199076.8 | 19.3 | 2.8 | 5.4 |
| 2003 | 29585788.6 | 3631594.9 | - | - | 12.3 | - | - |
| 2004 | 47958545.6 | 13608947.3 | 4253733.0 | 2857807.0 | 28.3 | 8.9 | 6.0 |
| 2005 | 64000056.6 | 14683390.3 | 5423127.0 | 10182362.2 | 22.9 | 8.5 | 15.9 |
| 2006 | 95587954.8 | 14984454.1 | 6027681.0 | 16282945.7 | 15.6 | 6.3 | 17.0 |
| 2007 | 107828462.5 | - | 7723043.7 | 33832163.2 | - | 7.2 | 31.4 |

Investment expenditure and investment rates:

Considering the role of economic activities in aggregate growth is essential to reflect economy structure and development, as well as contribution of these sectors in aggregate demand on goods and services. The relative importance of each sector in aggregate growth can be determined by calculating the ratio of actual increase in GDP to actual increase in economy at large. The relative contribution of sectors to GDP is shown in the following table:

Table 2: Relative contribution of economic activities to GDP: 1990-2008 (%)

| Description | 1990 | 2004 | 2005 | 2006 | 2007 | 2008 |
|--------------------------|------|------|------|------|------|------|
| Agriculture | 8.1 | 11.4 | 6.6 | 5.8 | 5.1 | 3.5 |
| Crude oil | 46.2 | 57.4 | 61.5 | 55.5 | 53.9 | 56.2 |
| Manufacturing industries | 6.7 | 2.7 | 1.9 | 1.5 | 1.7 | 1.5 |
| Construction | 7.1 | 1.5 | 4.6 | 3.6 | 3.5 | 3.8 |
| Transportation | 5.2 | 4.8 | 7.7 | 7.1 | 6.9 | 7.7 |
| Services | 8.5 | 13.5 | 9.6 | 11.2 | 12.2 | 12.5 |

As the table above shows, crude oil plays a crucial role in GDP compared with lower relative importance of other sectors. The contribution of crude oil to GDP rose from 46.2 per cent in 1990 to around 56.2 per cent in 2008. Similarly, the relative importance of the agricultural sector rose from 8.1 per cent in 1990 to 11.4 per cent in 2004. However, it gradually declined, reaching 3.5 per cent in 2008. As for manufacturing industries sector, it declined from 6.7 per cent in 1990 to 2.7 in 2004 and 1.5 per cent in 2008. This indicates a notable shortcoming in the investment policy as the oil sector took hold of the industrial sector allocations in the investment budget, leading to a lower relative importance of manufacturing industries sector in GDP. In addition, this shows a notable decline in national production of goods, opening the way for importation to meet domestic demand.

Based upon the economic theory, the actual investment rates are the basic condition for realizing the targeted growth rates, and they show interrelation between growth rates and actual investment expenditure through relationship with GDP. Formation of new investments is crucial in determining economic growth rates and increasing income at accelerated rates in order to overpass population growth rates and improving individual living conditions. Therefore, investment is important as it is the basic condition for realizing quick economic growth rates which are a necessary conditions to increase per capita income rate, although it is not the only condition to realize a balanced economic development.

Below are investment percentages extracted after calculating investment expenditure with disbursement from foreign grants:

Table 3: Public investment expenditure and GDP during 2004-2008 (IQD million)

| Year | Public investment expenditures and disbursement from foreign grants | GDP at current rates | % |
|------|---|----------------------|------|
| 2004 | 5697551.0 | 47958545.0 | 11.9 |
| 2005 | 6856426.8 | 64000065.0 | 10.7 |
| 2006 | 6570834.9 | 95587954.0 | 6.9 |
| 2007 | 8024431.0 | 107828462.0 | 7.5 |
| 2008 | 20753935.0 | 155635503.6 | 13.3 |

In spite of the notable improvement in percentage of investment expenditure in GDP during 2008, such percentages are still far below the rates needed to realize the targeted growth rate and accelerate economic growth. Reviewing actual public investments during 2004-2008, total investment allocations reached around IQD 67273148 million, while the actual disbursement for the same period was IQD 29460053 million, with implementation percentage of 43.8 per cent. Such volume of investment expenditure led to a notable increase in economic growth rate (i.e. 12.5 per cent). This rate is very large in a very short period of time, indicating that there are other important factors that contributed to realize such rate. This requires defining these factors and find out about their role in growth. The following table shows development of public investment volume in Iraq during the period in question compared with development of annual growth rate in GDP.

Table 4: Annual growth rates of investment allocations and GDP during 2004-2008

| Year | Investment allocations | | Annual growth rate in GDP (%) |
|-----------|-------------------------------|------------------------|-------------------------------|
| | Annual increase (IQD billion) | Annual growth rate (%) | |
| 2004-2005 | 379.3 + | 6.6 | 4.4 |
| 2005-2006 | 6046.1 + | 98.6 | 10.2 |
| 2006-2007 | 546.1 + | 4.5 | 0.4 |
| 2007-2008 | 17764.3 + | 139.6 | 10.7 |

As the table above shows, there is a notable fluctuation in investment growth rates, indicating another shortcoming in investment policy which is developed without any scientific approach and linking it to surrounding changes.

Fixed capital formation and capital output rates:

The concept of capital output rate is one of the basic concept for determining investment policy efficiency as it links two important variables (i.e. capital/capital formation and GDP). Although there are other important factors that determine economic growth level, capital factor remains the most important one. Regardless of different development concepts, it is fair to say that there is a consensus on the idea that achieving a higher growth requires higher investment, as fixed capital formation is one the essential factors to determine investment activity rate.

As for sectoral distribution of total fixed capital formation, the following table shows the structure of this formation distributed by main economic activities. The table shows that there is a notable bias towards service activities compared with fluctuation in goods sector contribution.

Table 5: Proportional distribution of total fixed capital formation during 2004-2007 (%)

| Economic activity | 2004 | 2005 | 2006 | 2007 |
|-------------------|------|------|------|------|
| Crude oil | 21.5 | 39.1 | 24.1 | 27.0 |
| Goods | 61.9 | 25.1 | 46.7 | 29.0 |
| Distributional | 2.8 | 8.7 | 6.5 | 4.0 |
| Services | 13.6 | 26.9 | 22.5 | 39.9 |

During 2004-2007, total fixed capital formation reached around IQD 63705.9 million. The table below shows total formation by economic activity:

Table 6: Total fixed capital formation during 2004-2007 at fixed rates

| Economic activity | Formation (IQD million) | (%) |
|-------------------|-------------------------|-------|
| Crude oil | 17503.3 | 27.5 |
| Goods | 22748.3 | 35.7 |
| Distributional | 3356.3 | 5.3 |
| Services | 20098.0 | 31.5 |
| Total | 63705.9 | 100.0 |

To calculate capital output rates during the period in question, change in GDP by economic activity was measured and compared with total formation. The results in the table below, which shows capital output rates, are close the historical data of Iraqi economy, except for crude oil sector as the rate is exaggerated compared with the real situation of the sector which is marked by high capital efficiency. However, due to the limited time of the period in question and fluctuated oil production because of the conditions Iraqi economy went through, this was reflected on the extracted results. As for total capital output rate (i.e. around 4.3), it shows that Iraqi economy has to do a lot to realize the required economic growth rate on the one hand and increase investment rates on the other.

Table 7: Capital output rates during 2004-2007

| Economic activity | Change in GDP (IQD million) | Total formation (IQD million) | Capital output rate |
|-------------------|-----------------------------|-------------------------------|---------------------|
| Crude oil | 1062.3 | 17503.3 | 16.5 |
| Goods | 2876.5 | 22748.3 | 7.9 |
| Distributional | 838.1 | 3356.3 | 4.0 |
| Services | 10028.5 | 20098.0 | 2.0 |
| Total | 14861.3 | 63705.9 | 4.3 |

Proposals to enhance investment policy in Iraq

As shown above, there are many obstacles facing efficient implementation of investment policy. Some of these are technical such as poor implementation capacity of project implementing bodies, poor performance of contractors, unstable security conditions, etc. as identified by Ministry of Planning and Development Cooperation. Other important reasons include poor macro economic policies which have failed so far to draw up sound and integrated economic policies which anticipate macro economic developments in which Iraqi economy functions in order to adopt a new economic policy that can improve investment situation in Iraq.

Previously, Public Investment Department made many proposals it deems fit to facilitate implementation of investment projects as follows:

- 1- Adhere to timelines for preparation and implementation of state budgets
- 2- Order bodies proposing projects to submit technical and economic feasibility studies for the proposed projects
- 3- Simplify procedures for acquisition of lands allocated for project implementation

- 4- Pay attention to designs and tables of quantities
- 5- Pay attention to quality control to ensure high technical level of project implementation
- 6- Ensure complete coordination between ministries and governorates whether at project proposing stage or project implementation stage
- 7- Make decision-making more efficient to accelerate project implementation
- 8- Enhance coordination between the bodies responsible for drawing up economic policy (i.e. Ministry of Planning and Development Cooperation, Ministry of Finance, and Central bank of Iraq).