

## **NDP SECTORAL PAPER # 12: VISIONS AND ECONOMIC POLICIES**

### **1. Introduction:**

In 2003, the state inherited a deteriorating socio-economic situation represented in poor production, lower standards of living, wide-spread unemployment, high inflation rate, deteriorating infrastructure, poor public services, notable discrepancies in provincial development, etc. In addition to the consecutive wars since 1980 and international economic sanctions, central economic policies played a great role in disturbing most sectors in the society, mainly the private sector which notably played a minor role. As a result, the economy entered a vicious circle between the causes and effects. Therefore, it was necessary to get out of this circle.

Up to now, the changes made have not met the expectations at the socio-economic level, as the political and security issues influenced all economic sectors and consumed too much resources compared with the benefits gained.

On the other hand, the consuming and investment expenditure policy seems unclear and lacks a clear strategy. This is proven through state federal budget documents, as budget investment expenditure, which is responsible for state capital formation, was moderate compared with budget consuming expenditure which still represents the bulk of state federal budgets. In addition, the country lacks the concept of economic institution and multiple economic decision-making centers, as well as clear definition of the federal and local government roles.

This paper will shed light on the main socio-economic challenges Iraq, the basic vision of the national 5-year plan and how to apply it at macro economic level, leaving the sectoral aspects to the sectoral studied and papers.

### **2. Challenges**

#### **A- Economic challenges**

First: Iraqi economy is still suffering from the dominance of oil sector, as the domestic production of oil sector represents a high percentage of GDP (i.e. 44 per cent during 2004-2008). Furthermore, oil sector is the main source for current and investment expenditure. This situation constitutes a big challenge to development of other sectors which depend of the oil price fluctuations and consumer oil demand policies, although all development plans since the 60s stressed the importance of avoiding such dependency.

Second: The hegemony of oil sector along with the recession in goods activities (except for oil) forms another challenge since this situation will undermine the role of these activities in meeting domestic and foreign demand on their goods, resulting in over importation activities and transferring a considerable percentage of value added abroad. During 2004-2008, the contribution of goods activities (except for oil) in GDP reached 28.6 per cent for goods activities and 33.4 per cent for service activities. This shows that expenditure on trade, transportation, as well as social and personal services was financed by crude oil export returns rather than value added in such activities.

Third: The dominance of public sector in the economic process at the expense of the private sector. During the last few years, the share of the public sector in GDP reached 70 per cent, mostly in the form of owning crude oil production and other strategic activities such as electricity, transportation, and industry, as well as a very high percentage of total fixed capital formation.

## B- Social challenges

Iraq faces large social challenges represented in high unemployment rate, especially among the youth and women; and disguised unemployment especially in the state institutions which suffer from poor performance and productivity. In addition, Iraq faces critical educational and health problems; high poverty percentage; and poor attainment of MDGs. Following is a summary of the main social challenges:

### First: Education

All educational strategies emphasizes the right to education for all, enhancing compulsory education, promoting gender equality, empowering the poor to obtain educational opportunities, and improving quality of education through paying attention to curricula, staffing, and all requirements of the educational process. However, the related indicators show that male enrollment rate is 85 per cent, compared with 82 per cent for females. In addition, dropout percentage is very high and schools suffer from lack of supplies, multiple shifts, and poor conditions of school buildings, especially in rural areas. At the level of higher education, the huge horizontal expansion of universities negatively affected the quality of higher education outputs. Furthermore, there is lack of coordination between educational system outputs and labor market needs, as there is a focus of humanities which need less financial and human resources.

### Second: Health

MDGs include 14 goals related to health, and the indicators show improvements towards achieving such goals. However, the gap is still wide between the current situation and what should be achieved by 2015. This requires addressing many problems and difficulties facing realization of such goals, mainly lack of potable water supplies and appropriate sewage and waste treatment. In addition, the health system suffers serious problems such as low number of beds and doctors per 1000 people compared with international standards, and poor bed occupancy rate especially in public hospitals (i.e. 60%), indicating distrust in health services provided by public health institutions.

### Third: Housing

The estimated housing requirements range between 1-3.5 million units based upon housing studies. This shows a big housing deficit that the plan should address by developing policies and procedures to overcome this problem. In this respect, the private sector and foreign investment should take a leading role.

### Fourth: Poverty reduction

Data on poverty shows that the absolute poverty line reached IQD 77,000 monthly, compared with IQD 34,000 monthly for abject poverty line, and 23 per cent of the population are under poverty line. On the other hand, income distribution indicators are hindering poverty reduction. In 2007, average per capita income reached IQD 125,000 monthly, and income distribution inequality reached 40 per cent. This requires developing government policies to increase average per capita income and individual share of GDP; reduce the number of population under poverty line; realize equal distribution of income; and focus investment on labor intensive activities to overcome high unemployment rate which reached around 15 per cent according to the census conducted in 2008.

#### Fifth: Employment and unemployment

Tackling unemployment is one of the biggest challenges, as unemployment rate which reached around 15 per cent according to the latest census conducted in 2008. However, unemployment rate among the youth reached 30 per cent compared with 32.5 per cent for women. In addition to unemployment, there is a high percentage of disguised unemployment especially in the public and informal sectors. All of these constitute challenges in front of the plan to address them. Reviewing employment strategies and policies, participation rate in economic activity by economically active people reached in 2008 51 per cent or 15221,000 people with different qualifications. Based on such high unemployment rates, and unless there are efficient employment rate, the situation will become worse and dependency rate will increase to 1:4, noting that the current employment policy is based upon employment in the public sector which is already overstaffed with more than 2,5 million public servants.

#### Sixth: Youth

The youth represent the basic human energy for production, development, as well as social, cultural, and economic advancement. Therefore, they should be cared for, taking into account individual trends and openness to global cultures according to their age group. In spite of improvement in educational level according to the Iraq Household Socio Economic Survey (IHSES) in 2007 whether by sex or environment, such improvement was not reflected on employment as shown in the high unemployment rate. In addition, 24 per cent of the workforce are illiterate, 41.2 per cent can read and write, and 43.1 per cent hold a primary education certificate according to IHSES. The quality of youth in terms of education, culture, and skills represents a basic challenge for Iraqi economy and requires adoption of effective policies to develop and employ the youth.

#### C- Duality of spatial development

Spatial development in Iraq is marked with dominance of duality of spatial development represented in relatively developed governorates and areas compared with other economically, socially, and culturally underdeveloped areas due to the investment policies that did not pay balanced attention to all regions of Iraq. Duality of development was not restricted to different development levels among the governorates, but also included discrepancies between urban and rural areas. Such pattern led to concentration of population economic activity, and services in numbered cities which attracted manpower from outskirts and rural areas. The

concentration of human and development resources in certain areas has negative economic and social effects that the plan should address by giving local administrations more powers to determine their development needs and involving them in defining the strategic activities within their areas, which serve national or provincial interest.

#### D- Environmental challenge

Environmental dimension of development in Iraq did not receive the deserved attention during the last decades, whether at national strategy or project level. In addition, Iraq lacks systems for environmental follow up and monitoring, resulting in pollution of all environmental elements represented by air, water, and soil. Environmental problems worsened also due to the use of prohibited weapons during the wars especially uranium to destroy military facilities. Addressing environmental problems and disseminating environmental awareness represent a notable challenge in front of this plan towards realizing sustainable development which strikes a balance between the economic, social, and environmental dimensions.

#### E- Rural development

Rural areas in Iraq are economically, socially, culturally structurally underdeveloped. They also suffer from poor productivity, seasonal and disguised unemployment, poor contribution to GDP, and poor provision of services although the specialized surveys show that poverty intensify in rural areas, resulting in migration to urban areas especially big cities. Accordingly, the plan should pay special attention to develop rural areas, including reviving of rural settlement plans and strategies by assembling small villages in one big village whose population is big enough to provide basic services such as education, primary health care, roads, etc.

### 3- Economic vision

Iraqi economy face challenges which affect Iraqi individuals and households who live at lower living standards compared with other countries rich in natural resources. Such challenges require comprehensive economic visions which are based upon optimal use of resources in a way that enhances production capacity of economy; diversifies its resources; eliminates dependence on oil sector; strengthen the role of private sector; ensures equal distribution of income; and reduces agony of poor people by curbing inflation and reducing unemployment and poverty rates. In addition, the economy should be led by an economic institution that has a broad vision to realize sustainable development within its economic, social, and environmental dimensions under the rule of law; as well as disseminate equality among all people in Iraq.

In addition to the internal vision, Iraqi economy should be open to external world on the basis of equality and economic and cultural integration; making use of such openness to support transitional economic process whether through attracting foreign investment and providing it with the facilities needed or by acquiring the experience and knowledge transfer.

### 4- Vision objectives

The economic vision, through implementation of the national 5-year plan which is based on public investment and contribution of foreign investment during the coming years, to build a strong and diversified economy that is able to compete internally and externally, lay out the foundations to strengthen private sector, market economy, and free competition.

Such vision will help the government draw up the steps necessary to program the shift from central dominance of public sector in economic decision-making to a participatory approach with other sectors in development process and reconstruction to ease the burden over the public sector. From social perspective, the vision is based on building and caring for the human, and realizing welfare and equality among all people based on consistent and sustainable approaches.

#### 5- Principles of vision

The main principle for economic vision is transparency in decision-making, so that all categories of the society will be involved at all stages of the vision. The second principle is integration and coordination between economic activities in order to realize balanced and sustainable growth and social activities that care for citizens through providing education, health, and employment services; reducing discrepancies among governorates, regions, and urban and rural areas depending on population and deprivation; and providing economic, financial, and human resources as well as relative advantages for these spatial components. The third principle is empowering the private sector and other sectors to contribute effectively to economic process on the basis of economic efficiency in line with free market and competition principles. The last principle is continuity of central government role in direction and creating an appropriate environment to realize the objectives and principles of the vision and supervise directly strategic facilities and infrastructure to ensure equality for all components of the society.

#### 6- Vision implementation means

##### A- Oil and gas sector development

Oil and gas sector, especially at this stage, is one of the main sectors that should be focused on, as it is the main source for development process in Iraq. To maintain such status, it is necessary to carry out the following:

First: Increase crude oil production from 2.4 m/b/d in 2009 to 5.4 m/b/d in 2014, with an average annual increase of 600,000 b/d (i.e. 3 m/b/d in 2010).

Second: Such increase will need USD 12-12.5 billion a year or USD 60-62.5 billion during the plan years, except for funds needed for infrastructure, transportation, and storage.

Third: It is expected that oil exports will on average constitute 80 per cent of GDP, and barrel price was estimated at around USD 40. Accordingly, the total accumulated revenue at the end of the plan (i.e. 2014) will be around USD 242 billion, with an annual growth rate of about 12.5 per cent.

##### B- Development of non-oil sectors

Aiming to develop non-oil sectors, get out of recession, provide more goods and services to citizens, meet demand on local products by striking a balance between domestic products and imported products, and estimate investments needed, we propose the following alternatives:

1<sup>st</sup> alternative

Level of GDP production in these activities was highly affected by oil price hikes in 2008. Therefore, the average increase between Q3 and Q4 of 2008 was used to estimate GDP in 2009 (4%). To give a huge push for investing in these activities during the plan years, the plan assumes that GDP will grow by a composite annual growth rate of 8 per cent according to the table below.

1<sup>st</sup> estimate- using 2007 as base year, so that the investment required is USD 91 billion.

2<sup>nd</sup> estimate- using 2008 as base year, so that the investment required is USD 125 billion.

2<sup>nd</sup> alternative

Under this alternative, growth of GDP of activities other than oil sector will be linked to oil production. In this respect, two rates for oil production were adopted. First, 10 per cent, representing the increase between 2006 and 2007. Second, 12.5 per cent which is the assumed rate for increasing oil returns during the plan years. Therefore, we will have 4 estimates for 2009, and for each estimate there is a certain amount of investment is needed (in USD and IQD) as follows:

10 percent growth rate

1<sup>st</sup> estimate-2008 as base year

Investment required IQD 142180 billion (USD 127 billion)

2<sup>nd</sup> estimate-2007 as base year

Investment required IQD 114028 billion (USD 102 billion)

12.5 percent growth rate

3<sup>rd</sup> estimate-2008 as base year

Investment required IQD 154408 billion (USD 138 billion)

4<sup>th</sup> estimate-2007 as base year

Investment required IQD 119272 billion (USD 106 billion)

Summary-USD billion

Estimates	GDP without oil	Oil production	Total
1 <sup>st</sup> alternative			
1 <sup>st</sup>	91	60	151
2 <sup>nd</sup>	125	60	185
2 <sup>nd</sup> alternative			
1 <sup>st</sup>	127	60	187
2 <sup>nd</sup>	102	60	162
3 <sup>rd</sup>	138	60	198
4 <sup>th</sup>	106	60	166

Therefore, the amount of investment needed during the plan years ranges between USD 151 billion and USD 198 billion. It is expected that the federal budget cannot secure more than USD 75-100 billion during the plan years. Therefore, it is necessary to look for foreign investment and private sector, while working on grants and loans.

Alternatives of estimated investment of GDP for economic activities without oil for the plan years (2010-2014)  
 (1<sup>st</sup> alternative)  
 IQD/USD billion

Year	GDP at current rates	Annual increase (%)	2009 estimates 1- 2008 as base year, 4% increase rate 2- 2007 as base year, 4% increase rate	Capital output	2010-2014 estimates, 8% growth rate		Investment needed	
					2010	2014	IQD	USD
2006	43215.3							
2007	50200	16						
2008	68851	37						
Q3 2008	17184							
Q4 2008	17814	4						
(1) 2009			54296	4	58640	79779	101931	91
(2) 2009			74469	4	80426	109419	139800	125

Alternatives of estimated investment of GDP for economic activities without oil for the plan years (2010-2014)  
(1<sup>st</sup> alternative)  
IQD/USD billion

Year	GDP of crude oil at current rates	Annual increase (%)	2009 estimates 1- 2008 as base year, 10%, 12.5 increase rate 2- 2007 as base year, 10%, 12.5 increase rate		Estimates of 2014 based upon 8% growth rate from 2009 levels					
			10%	12.5			IQD		USD	
			1st level	2nd level	3 <sup>rd</sup> level	4 <sup>th</sup> level	1st level	2nd level	3 <sup>rd</sup> level	4 <sup>th</sup> level
2006	52852	-								
2007	58203	10								
2008	87528	50								
Q1 2008	22036	-								
Q2 2008	28971	30								
Q3 2008	25906	-11								
Q4 2008	10624	-59								
Q4 2007	20027	-								
During plan years	Exports									
2010	34560									
2014	62208	12.5								
(1) 2009			75736	77457	111281	113809	142180	154408	127	138
(2) 2009			60742	63534	89249	93352	114028	119272	102	106



## 6. Policies needed to implement the vision

### Overall policies

#### A- Fiscal policies

First: Work on diversify sources of finance in order to increase contribution of non-oil sources, adopt appropriate tax policies, and reconsider fees of public services.

Second: Reconsider expenditure structure to reduce expenditure in operational paragraphs and save funds to be directed to investment in order to cut the gap in investment requirements and funds allocated by state budget.

Third: Link provincial development funds with population, degree of needs and deprivation, and provincial capabilities in line with this plan.

Fourth: Coordinate issuance and purchasing of public bonds and loaning between the concerned bodies to support the budget fiscal position.

Fifth: Look for foreign finance through the grants and loans committed by other countries to Iraq and speed up procedures to make use of them.

Sixth: Restructure and reform the banking sector, so that it can provide the banking service needed for development process in and outside Iraq.

Seventh: Strengthen financial management as well as follow up with and monitor public expenditure.

Eighth: Implement structural reforms at macro economic level as agreed with IMF and ICI.

Ninth: Improve quality and timing of issuing financial and economic statements by public departments to support economic planning process.

#### B- Monetary policy

First: Implement the rigid monetary policy to curb inflation rationally. Although such policy maintains a good level of purchasing power of national currency, yet there should be a balance with liquidity needed for development process.

Second: Although linking interest rate with finance capacity is accepted, a stable economic situation requires a stable interest rate that help increase the credit needed for private sector in order to finance development process and overcome the current severe recession. In this way, Iraqi economy will remain revenue-based and importing on the long run, especially as inflation rate reached 2.7 per cent in 2007-2008 according to COSIT data.

#### C- Regional and decentralized policies & federal government

The expected trend is to give a greater role to local administrations. As of 2006, funds are allocated for provincial development outside investment allocations. This is a

critical issue, and it is necessary to empower governments to manage funds directed to them whether under the provincial development program or under the public investment program which also serves the governments. In both cases, provincial councils should take their role in defining their development needs to include them in the national 5-year plan.

In this respect, we present the following policies:

First: Involve local authorities in defining development priorities, especially in the field of social services, provided that the federal government will be responsible for planning and implementing strategic projects that serves all over Iraq in consultation with concerned local authorities.

Second: Distribute investments equally and on sound economic basis to create integration among regions and governorates, based upon relative advantage as well as regional and provincial development capacity.

#### D- Private sector supporting policies

As mentioned earlier, and according to all economic standards, the private sector plays a limited role. From development perspective, such role is the reason for current economic recession, as the government is focusing on other issues. Therefore, it is necessary, based upon free economy philosophy and market mechanisms, to revive and empower the private sector to become an active partner in decision-making and drawing up economic process. On the other hand, improving the role of private sector in socio-economic life, will ease the burden over the state.

As the state historically has played the patronage role using the main natural resource (i.e. oil), such resource is at risk as many consumer have started to look for energy alternatives for oil. Therefore, if we are not able to build a strong and diversified economy, we will continue to face huge financial problems related to development process.

In this respect, we propose the following policies:

First: Enhance public and private sector partnerships (PPP) and concession contracts.

Second: Transform general companies to private or mixed companies by making use of the currently effective laws, especially Law No. 21 and Law No. 22 of 1997.

Third: Reform financial sector, improve banking system performance, and expand loaning by giving loans to SMEs at preferential conditions and funding them.

Fourth: Improve infrastructure such as electricity and transportation to help the private sector Transport its production requirements at reasonable cost.

Fifth: Simplify public procedures, develop investment promotion laws, and create an investment environment to improve Iraq's competitive position in dealing with businessmen an investors.

Sixth: Open the way for direct and indirect foreign investment as well as develop regulating legislation.