

Public Financial Management and its Impact on the Development of Iraq

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Introduction

1. Oil sector tend to be relatively deficient in the spread effects associated with production and consumption linkages.
2. In examining linkages in the petroleum sector, the conclusion is that in an export orientated economy, financial linkages are by far the most important medium to induce other sector development.
3. The difference between production and consumption linkages on one hand and fiscal linkages on the other is vital to the understanding of the unique problem that exists in this sector.

Forward and Backward Linkages vs. Financial Linkages

- The difference between forward and backward linkages and financial linkages are:
 - The relevant success or failure of the forward and backward linkages is worked out through the market;
 - The relevant success or failure of financial linkages will depend on Government action relating to the willingness to make money generated through the export of oil available to be spent (budget allocation) and its productive investment policy.
- It is through this mechanism which will make Public Financial Management to have an important and vital role for economic development.

Fiscal Linkages

- Fiscal Linkages – Inter-sectoral effects associated with Government expenditure of incremental revenue collected from expanding a given industry.
- For Iraq, the inter-sectoral impact associated with incremental Government expenditure can be categorised as follows:
 1. Direct Government investment in infrastructure or through state enterprise.
 2. Indirect investment to support the private sector through industrial estate, R&D, grants, subsidies, free or low cost credit etc.
 3. The distributional aspect of Government expenditure such as tax relief, indirect subsidies, public sector salaries which will have a positive impact on private consumption.

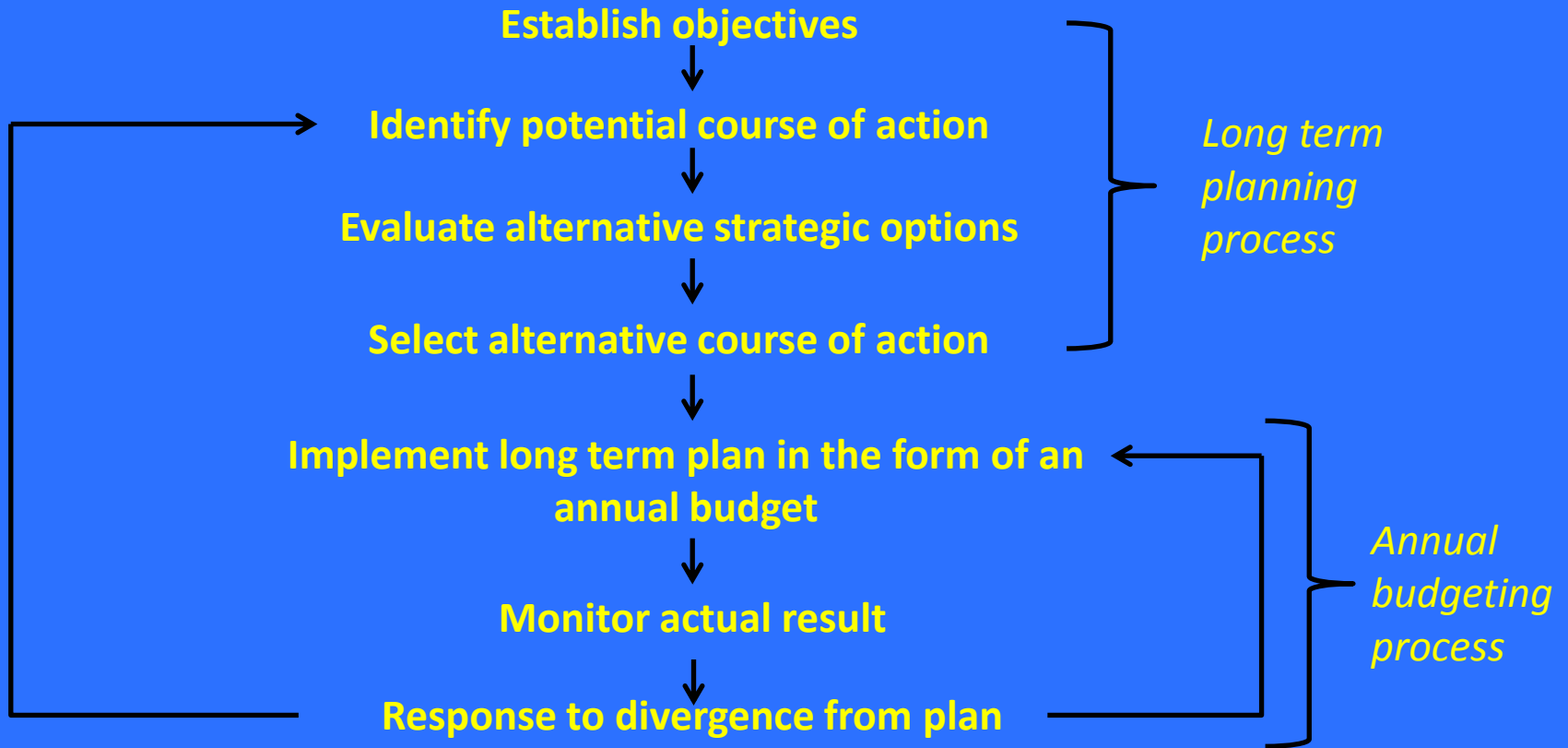
Budget Policy Objectives

The following objectives should be adopted for budget policy:

1. To increase the rate of investment through direct and indirect Government investment as well as assisting private investment.
2. Channel the flow of investment into fields judged to be most desirable from the point of view of society.
3. Regulate the purchasing power in accordance with the overall pattern specified by the development plan.
4. Modify the inequality in income distribution in a manner consistent with the best interest of the population.
5. Check the rise in price by subsidising the price of certain goods and services.

In general, this should ensure the spread effect so that the process of diversification and socio-economic development is achieved.

Linking Budgeting to Long-Term Planning



Observations

- The failure to achieve an improvement in the economy is partly the result of the current unstable condition.
- However the most important factors are related to the weakness and vagueness of the administrative arrangement of Government organisations and the outdated budgetary planning and control, caused by a weak and insufficient skill capacity.
- These can be summarised as follows:
 - Lack of clarification and delineating the responsibility of central and local Government which has resulted in the distortion of authorisation and accountability;
 - Weak and limited skill capacity to plan and manage economic resources;
 - Policy of allocation during the past period were biased towards short-term rather than long-term strategic framework;

Observations

- The adopted budget allocation neither directed to promote investment nor consumption but rather to provide an ad-hoc assistance used to create pseudo structural change.
- The experience of the previous years shows that budget allocation decisions are made without due regard to the strategic objectives and follows an outdated budgetary process.
- Allocation made without the knowledge of either the nature or size of the interaction between the different categories of expenditure (type or function) and the various sectors in the economy.
- The state of the limited skill capacity indicates that a high level expenditure is not always desirable. This may actually lead to a situation where projects are undertaken irrespective of their economic or social viability.

The Way Forward

1. To achieve improvement in economic structural development and an effective allocation of expenditure, some adjustments in the size and composition of the budget are required through:
 - rationalisation of expenditure
 - mobilisation of additional skills to reshape economic management
2. Rationalisation of expenditure relates to:
 - elimination of unproductive and wasteful spending
 - reduction of unnecessary subsidies
 - review of Government expenditure on public administration
 - elaborate cost/benefit analysis and efficiency audit (VFM) to be undertaken
3. To maximise the benefit to and from private sector, a higher weighting should be given to the sectors with long-term prospects, strategic importance and wider impact of the economy.

The Way Forward

4. Adopt a declared stable budgeting policy to eliminate speculation through linking budget to long-term planning.
5. Given the inherent inefficiency in Government expenditure, more is now required from the private sector as a parallel force shaping the economy. Government is therefore required to improve efficiency and effectiveness of its support. This can be achieved through:
 - New Incentives : recalibration of existing system together with appropriate priority ranking for activities concern.
 - Sector-by-sector review of private investment intention, market potential, technology transfer and financial possibilities.
 - Making available adequate information on local markets to enable investors to make correct decisions. Public information will therefore need to be of more value and relevance.

Final Remarks

The approach outlined will need certain requirements:

1. Structural requirements:

- relate to organisational arrangement of Government agencies and departments (local and central) especially those involved in the budgetary system as well as delineation of responsibility and authorisation on both levels.

2. Operational requirements :

- Skill requirement of Government officials will require:
 - a. capacity enhancing programme such as training, enrich education system etc;
 - b. utilising the skill of Iraqi development experts who have a proven ability especially those who are involved with several international organisations and Governments;
 - c. the need to initiate strong regulatory framework to nurture good governance and to avoid the abuse of the public office for private gain;
 - d. for this to happen, a strong accountability and control system is required to deter any expected malpractices.