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# Iraq's Investment Deficit and Underfunded Infrastructure. By Mohammed Hussein\*

In [his recent article "Iraq's Government Investments: Between Ambitions and Stumbling,"](#) Dr. Mudhr Mohammed Salih, former Deputy Governor of the Iraqi Central Bank and financial adviser of the Iraqi Government, fairly described the political and administrative dynamics that prevent investment in infrastructure; basically showing how endemic corruption, institutional limitations, and red-tape groups take away resources from infrastructure investment. As a result, the article suggests that Iraqi government's direct dealing with international partners as the most likely feasible option to keep some investment in the underfunded infrastructure, assuming that direct dealing with international partners would help bypass impediments. Certainly, this can be one of the options, but it can't be neither a sustainable and nor an easy one.

This article is an attempt to touch on some other approaches that could help address the investment deficit before the one suggested by the Dr. Mudhr's article.



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The same challenges that have brought Iraq to the current investment deficit are likely to hinder the international partners' engagement as long as the challenges are not tackled in their roots. The ruling elite and political parties' patronage networks that have created the tough investment climate can ruin whatever the approach the Oil for Reconstruction Deal with China might achieve. As the challenges are so systemic and institutionalized, it is unlikely to find a solution by engaging international partners to bypass the impediments.

Dr. Mudher's article realistically shed light on the ongoing fiscal challenges and how they have limited the resources for public investment. Additionally, it described how the investment management is not based on economic calculations but rather on political deals. Therefore, direct government to government deal with international partners is the only available option. This approach is understandable, but for how long can Iraq depend on it? One of the big challenges is tackling the obstacles that prevent the Iraqi government from scaling up infrastructure investment. The obvious answer is to blame the ruling elite and populist blocs that manipulate public funds to feed their patronage networks and satisfy constituents rather than considering the whole economic needs and infrastructure.

So, who can help addressing the investment deficit, which certainly can't be short-term and neither an easy solution? The governments are too weak. The Iraqi parliament is overwhelmed by populist MPs. The private sector, as in any other conflict-ridden economy, is too weak and



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mostly informal. Non-state armed groups starkly use public resources for their ends and sometimes to challenge state institutions. This tough reality shows why there is neither a reformist leadership to start tackling the root causes of the investment deficit nor a leadership that can resolve problematic issues through bypassing them and working with international partners.

Looking at the government move to change the status quo; the cabinet is trying to get the parliament ratify another borrowing bill in late October to authorize more internal borrowing and finance public spending. It withdrew the 2020 budget draft bill, in which total spending is set to increase by 10 trillion IQD compared to the 2019 budget law, but investment allocations decreased by almost 2 percent. Moreover, the reality is much worse than the figures in the budget laws. Usually, Iraqi governments spend less than the allocations in budget laws. Till July 2020, investment spending was [about 1.7](#) percent of the total spending, while it is about 23 percent in the proposed budget draft. Similarly, actual investment spending in 2019 was [15.3 percent](#) of the total spending but nearly 25 percent in the budget law, according to Iraq's Finance Ministry accounts. Figure 1 reports both investment and current spending in the past three years up to July 2020.



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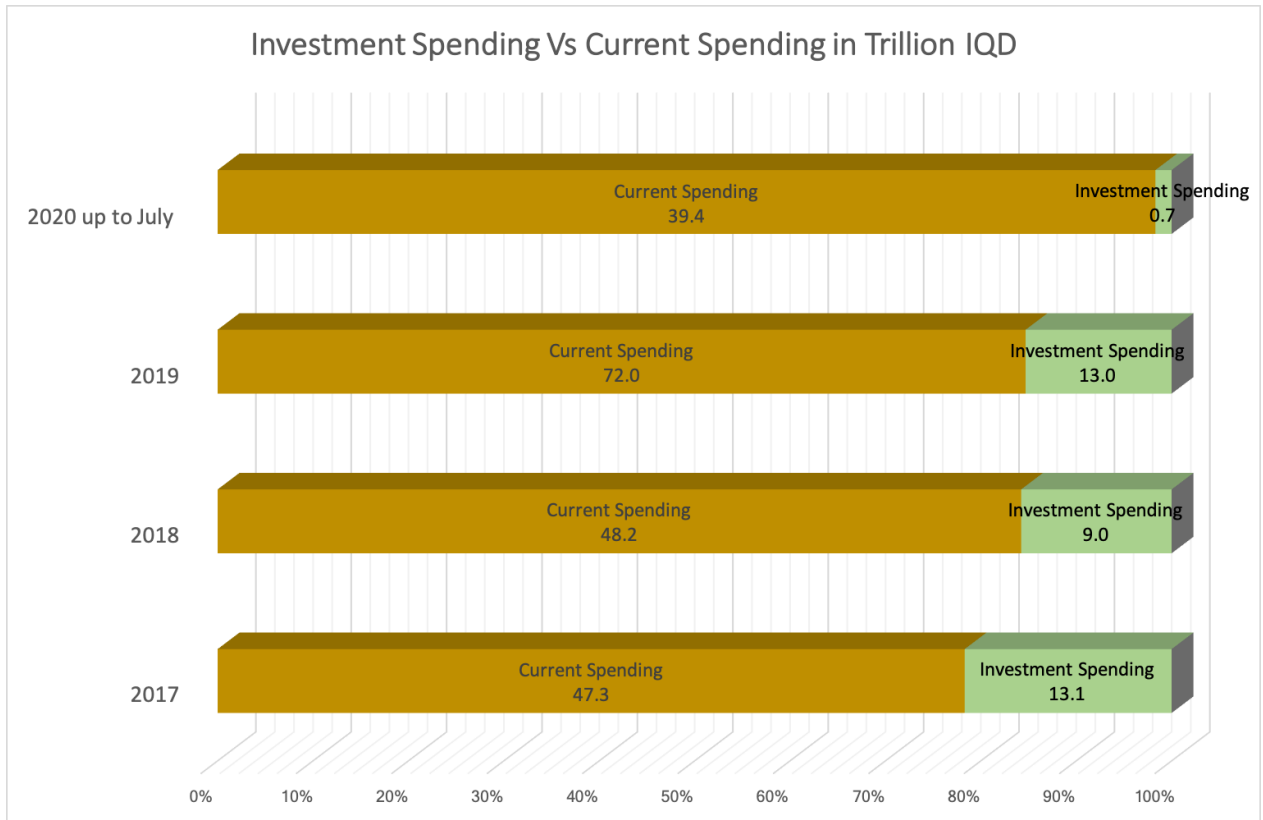


Figure 1 illustrates all the investment and current spending of the federal government according to the published data on the website of [Iraq's Finance Ministry](#)

### Where to Navigate for Sustainable Solutions?

As Dr. Mudher's article links the investment deficit to the structural economic and political impediments, the poor investment management can't be addressed without structural institutional reform. Here,



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institutions refer to all the regulatory and policy actions that shape law-enforcement, property rights, competitive open market, and general stability that create a proper environment to allocate scarce resources. Such a reform certainly can't be short-term. Even the recently published government White Paper set three years expectation to tackle some of the impediments. However, many crucial reform steps can be taken now.

In the short-term, some impediments can be addressed to revitalize part of the non-oil economic activities in the fast-job creating sectors such as agriculture, tourism, and services sectors. It just needs to shift the current fiscal policy towards investing more in the infrastructure. It does not need to wait for the oil price recovery if the cabinet, alongside with the parliament, work together on changing the fiscal approach and reforming the regulatory frameworks to restructure the current fiscal approach. Allocating more funds for infrastructure right now does not need waiting for oil price recovery. It needs slashing the bloated payroll to fund public investment that makes taxi drivers and farmers benefit from better streets and bridges. It is not going to be an easy trade-off in the 2021 budget law but it is doable. If there is no political leadership to take the risk for the needed reforms and no parliament blocs to help with the needed regulatory reforms, no international partner can help.

In addition to the fiscal approach, Iraq's unwritten social contract also plays a big role in allocating public resources to short-term political gains rather than capital investment. The core of the impediments is systemic.



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It is an evolutionary result of several decades of “Socialist Political Economy” of the Baath Regime and then the post 2003 Muhasasa System, where various groups compete over public resources to satisfy constituents by oil rents and public jobs. Therefore, the investment barriers are institutional and political. They are located in parliament as well as state institutions controlled by the red-tape groups. Simply, they are politically devised man-made problems, and their solutions can be found only within the same arena. Again, it is not something the international partners are willing (or able) to resolve.

To set realistic expectations, the investment deficit, as well as most of the other economic issues, can be addressed with a comprehensive reform programme, similar to the White Paper. The reform programme needs to design a new transitional social contract based on which the economic role of the state, relationship between government and private sector, and the whole market dynamics should be redefined. It needs to start with reforming what can be fixed today (as the aforementioned solutions) and then lay foundations for other medium- and long-term solutions. However, changing or establishing a new social contract means a long social and political process.

Iraq’s oil rent can’t satisfy a 40 million population, so the old (unwritten) social contract in most rentier states can’t work anymore. Even the agreed Iraqi Constitution in 2005 is apparently not working properly with regard to the distribution of oil wealth by Iraqi governments, including the Kurdistan Regional Government (KRG); both



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cannot provide jobs and subsidized services (health, schooling, food distribution, electricity, and refined oil products) as they used to do. In return, citizens are not keeping their voices quiet towards whatever the ruling elite does. They do not give up their rights in exchange for having public jobs and subsidized services that are not available anymore. Iraq cannot afford a rentier model similar to the Arab Gulf States. The ongoing salary protests in the KRG and the recent anti-corruption protests in the major Iraqi cities highlight the new dynamics. It emphasizes the need for a new social contract as well as a new governance-model that can deliver services and provide jobs.

### **Taking the Challenges as Business Opportunities for the Private Sector**

The investment deficit and underfunded infrastructure would not be addressed only by the Iraqi government given the fiscal constraints of low oil price. Involving the private sector in smartly designed solutions is very much needed. Policies should be designed to take most of the current challenges as business opportunities. For instance, transforming neighborhood-generator owners and employees to private bill-collector firms would help fix much of the shortages in the electricity and running water sectors in addition to providing more money for investment in these sectors. With some smart electric and water meters, they can collect the bills better than state employees. They, ultimately, reduce some of the public funds wasted in these sectors and help the government increase revenues for infrastructure investment. Under such arrangements, private generator owners keep their jobs guaranteed while the state gets rid of the polluting deiseal generators.



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Such a solution makes citizens, the government, and generator-owners better off at a time when 50 percent of energy billed gets lost due to the lack of proper billing mechanism, effective metering, and commercial management systems, according to [a 2019 World Bank report](#).

Besides, until the fiscal deficit will be eased land for reconstruction can be another option. Iraqi governments can give valuable urban and commercial lands to private companies in exchange of building roads, bridges, schools, and hospitals. Such a deal will improve the underfunded infrastructure and revitalize the construction labour market as well. Here, local and international companies might be involved to compete on viable deals directed to improve the neglected infrastructure.

Likewise, the high poverty and unemployment rates can be taken as an opportunity to supply cheap labor force provided the public sector stops the competition with the private sector by offering attractive salaries and benefits. This is what Iraq's private sector needs, in addition to other protectionist measures, for being price competitive against imports. Here, the role of government to provide enforcement and parliament to afford suitable regulatory frame are needed. A reformist leadership is needed to translate the ongoing food security concerns into an opportunity for food processing factories and provide market for agricultural products.





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Some of the aforementioned solutions can be taken now. They need a functional government and reformist leadership rather than oil money or international partners' engagement. They can lay foundations for some of the solutions Iraq needs to revitalize its fast-growing sectors like agriculture, tourism, services, construction, and small industries. Even to address Iraq's vulnerability towards external shocks (oil price fluctuations) these solutions are crucially needed as they increase non-oil economic activities.

What would prevent the current cabinet and parliament to address the investment deficit in the 2021 budget draft, to put a ceiling on current spending and increase infrastructure investments? Why parliament does not initiate some regulatory reforms that are needed to ease business registration process, stimulate local and foreign investments, and reform the financial sector? These questions should be discussed and answered in public in a transparent manner. Problems and solutions are located here, and this is where public debates should start. If Iraqi citizens and civil servants are convinced of the harmful effects of double payroll recipients, ghost employees, and armed groups in the border-ports that take much of the public funds needed to pay salaries and provide services, they would have an incentive to be involved in any proposed reform effort. They would defend their interests against the corrupt ways of manipulating public funds. Here, a smart leadership would involve most of the Iraqis in the battle of corruption.



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Lack of investment in non-oil infrastructure is an outcome of wrong fiscal policies which have been focusing on current expenditures and neglecting monitoring and evaluation of public investment projects. The issues are a pure outcome of political and regulatory mismanagement. They have to be addressed by the same means. The Iraqi economic and policy challenges are properly identified in most of the reports by Iraqi economists and international institutions that have been published as well as development plans like Vision 2030, National Development Plan 2018-2022. However, they are not reflected in the investment strategy of the post 2003 governments, neither in most of the policies that have been made to organize the economy.

To sum up, this article is not to overlook the role of international partners that certainly can play a vital role in funding infrastructure investment. However, they cannot help that much if Iraqis do not take the lead in reforming the economy and addressing the investment impediments. Only addressing the root causes of the investment deficit can put Iraq on the path of sustainable development.

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