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Investment Policies in Iraq, 1950–87

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The emphasis on investment as a basic and strategic component of a country's economic and social development should perhaps not be overdone. It is not, of course, the only component, for there are other strategic factors, such as entrepreneurial ability, the required skills and know-how, the efficient utilization of resources, political and social stability, and other elements that complement the factor of capital. But investment remains one of the most important determinants of a country's economic growth. An examination of Iraq's investment policies at this point is thus quite timely, particularly in view of the special conditions the country is currently experiencing after its emergence from a war that proved long, costly, and far-reaching in its economic and social ramifications.

Naturally, macroeconomic policy (financial, monetary, trade, price, and wage), as well as foreign exchange, plays a major part in investment policy and in determining general investment trends. They also have important implications for development strategies and thus for investment strategies in general.

Our aim in this study is to examine the investment policies of Iraq and their evolution from 1950 to the present, focusing on volume of investments, their sectoral distribution and impact on development, the relative share of the public and private sectors, the position taken regarding foreign investment in the country, and the role of macroeconomic policies and their effectiveness in this regard.

It will become apparent in the course of this discussion that three strategic variables were most influential in the determination of

Iraq's investment policy and trends for the period under consideration. These are

- The oil factor, or more specifically, oil production, exports, and revenues, and the foreign exchange generated. (Iraqi investments, which contain a high foreign component, were heavily dependent on this factor.)
- The social imperatives of the ruling party.
- Political changes that have occurred in the country since the fifties and seventies.

These three variables directly influenced general trends in the country's investment policies in terms of the role of the public and private sectors, the role of domestic investment, and, finally, in terms of the nature and impact of international monetary, financial, and development policies on these national investment policies.

Perhaps the most important activities reflecting such policies were the national construction and development plans announced by successive governments during the four decades since 1950. It is both natural and logical to turn to these primary sources for basic information on the evolution of investment policies in Iraq during this period. But the emphasis will ultimately be on contemporary investment policies, that is, those of the late 1980s. However, this period is marked by Iraq's recent emergence from a hard and protracted war that dragged on for some eight years. The war was a major factor behind the reconsideration of a number of economic and social imperatives that had prevailed in the seventies and the first half of the eighties. It will become apparent in the course of this study that political changes in 1958 and in the decade that followed led to basic changes in the country's investment policy. Oil was also pivotal in inducing change during the fifties, and then again in the seventies. However, at every stage, the social and political perspectives of the ruling party tended to color the general direction of these changes, because the process of development in Iraq—and thus Iraq's investment policies—was not subject only to economic considerations but also to other, noneconomic considerations. These noneconomic considerations nevertheless permit one to gauge the achievements of the policies, their performance, their shortcomings, and their evolution in terms of size, direction, and impact in every sphere—economic, social, and political.

Given these (noneconomic) considerations, which were linked in turn with the economically and politically strategic factor of oil, our examination of the evolution of Iraq's investment policies over the past four decades will be within the framework of the economic and political changes that occurred during that period. The first stage is from the early fifties up to 1958, the second is 1958–64, the third, 1964–68, and finally, 1968 to the present. A significant part of the long stretch from 1968 to the present was dominated by the war between Iraq and the Islamic Republic of Iran, which continued until August 1988. This phase witnessed important economic developments that began in 1982 and acquired practical importance for Iraq's investment policies as of 1987. These developments will continue to have a major impact on investment policy well into the next decade.

In this context, our investigation of Iraq's investment policies has been divided into four parts. The first part considers the evolution of these policies in terms of the development plans approved during each phase, namely, the decade of the fifties up to 1958, the sixties up to 1968, the seventies up to 1980, and finally the war years of the eighties up to the present. For each phase, we shall consider the volume of investment and sectoral allocations after discussing briefly the economic and noneconomic factors influencing every aspect of investment policymaking.

The second part of this study considers the status of these policies vis-à-vis the public sector, private sector, and the role of each in the national economy.

The third part considers briefly the position adopted regarding foreign investment in the country, while the fourth part attempts to examine the role of macroeconomic policies in the national economy generally. This includes the effectiveness of financial, monetary, price, and trade policies, foreign exchange, wages and salaries, and the impact of these variables on the size and mode of capital formation, on economic resource utilization and distribution between the various productive sectors, on the amount of foreign exchange earned, on the balance of payments, and, finally, on the level of economic performance in general and economic growth in particular.

This examination should enable us to arrive at definite conclusions regarding investment policies in Iraq and to forecast just what can or cannot be achieved during the next decade, within the limits of uncertainty that such forecasting entails and the relative conservatism of our estimates.

Investment Policies, 1950–58

Oil began to play a significant role in Iraq's economy during the early fifties, helping to finance the Government's budget as well as development projects. The starting point was the increase in oil revenues that began in 1951, following the fifty-fifty profit-sharing agreement on royalties, which had motivated the Government to establish Iraq's Development Board in 1950. The Government assigned 70 percent of these oil revenues to the Development Board to finance major capital development projects in the country. The Board was charged with preparing development plans that the Ministry of Development, established in 1953, proceeded to execute and finance, passing both responsibilities on to the ministries concerned once the process was under way. However, the Board's tasks did not include economic policymaking for the country as a whole, nor were the institutions directly concerned with the development process, such as the Industrial Bank and the Agricultural Bank, subject to the Board's authority. Neither was the Board permitted to manage the investment of private sector savings or interfere in the preparation of the government budget or guide financial and banking institutions or even control the supply of foreign exchange earnings. Its functions were restricted to preparing development programs and executing only the programs assigned to it with the oil revenues so allocated.[1]

Be that as it may, the large increase in oil revenues during the early fifties, and the establishment of the Development Board with its assignment of 70 percent of these revenues to investment objectives, marked the advent of a new economic policy based on large-scale government planning and involvement, and with that a dynamic and highly centralized investment policy. These developments were preceded in the period immediately following the Second World War by the establishment of the Industrial Bank and the Agricultural Bank. Both provided long-term loans for investment and development ventures, clearly illustrating the trend

[1]Jawad Hashim and others, *Appraisal of Economic Growth in Iraq, 1950–1970*, Part II, "Developing Commodity Sectors," pp. 196–97.

toward encouraging private sector participation in government investment ventures, especially in industry. The subsequent emergence of the Development Board served to reinforce this trend further.

During this time, the Government was influenced by a number of reports and studies undertaken by specialized foreign missions. These also contributed to an explanation of the Government's economic and investment policies, whether aggregate, sectoral, or geographic. The reports were placed at the disposal of the Development Board, and a brief description of each follows.

- The International Bank for Reconstruction and Development (IBRD) report, *The Economic Development of Iraq*.[2] This 1952 report called for establishing a balanced government investment plan and improving the country's irrigation potential, dams, roads, agriculture, health, and education; in other words, investing in infrastructure and utilizing agricultural output and oil to establish industries that were tailored to meeting basic domestic requirements. The IBRD mission urged the Government to encourage private investors rather than to assume ownership of projects. The mission's report became the basis for the Development Board's investment policies and the development work that followed.[3]
- The Danish economist, Carl Iversen's *A Report on Monetary Policy in Iraq*, 1954.[4] Iversen emphasized the need for a monetary policy that can secure the maximum possible economic balance and stability, expanding in a stable fashion to avoid inflation while maintaining adequate foreign exchange reserves. He underscored the need for coordination between monetary policy and investment spending by the Development Board, and the need to base this spending on coordinating expenditures and earnings on the one hand and expenditures and resources available for project implementation

[2]International Bank for Reconstruction and Development, *The Economic Development of Iraq*, Report of a mission organized by the IBRD at the request of the Government of Iraq (Washington: IBRD, 1952).

[3]Kathleen M. Langley, *The Industrialization of Iraq* (Cambridge, Massachusetts: Harvard University Press, 1962), p. 83.

[4]Carl Iversen, *A Report on Monetary Policy in Iraq* (Baghdad: National Bank of Iraq, 1954).

on the other. His conclusions prompted the Government to take seriously the threat of inflation that was expected, and in turn impelled it to adopt a free import policy consistent with the continuous spending on development typical of development programs at that time.[5] The report also argued that industrialization was not a strategic factor in development, although Iversen did appreciate the importance of industrialization over the long run.

- Lord Salter's report (1955), *The Development of Iraq: A Plan of Action.*[6] Salter emphasized the importance of the country's natural resources, especially arable land and abundant water, and the need to give greater attention to irrigation, drilling, and agricultural development. He also drew attention to population growth and the constant increase in the demand for food. Agricultural development was necessary for both meeting domestic demand for food and increasing exports. He did not regard industrialization as urgent and called for limited industrial growth, which was both desirable and inevitable, affirming that the Development Board should invest some of its resources in projects leading to rapid and substantial returns, in particular large-scale housing ventures. Salter's report prompted the Board to form a special division for housing affairs, in addition to irrigation projects and the provision of immediate assistance to farmers, all of which would benefit every stratum of society.[7]
- Arthur D. Little report (1952), *A Plan for Industrial Development.*[8] This company drew up an industrial scheme that would provide, at a cost of 43 million Iraqi dinars, direct employment for 35,000 workers and indirectly employ 25,000 others, over a period of five to six years. The plan would be implemented in four stages. The company's report emphasized the need for industrial credits to finance long- and medium-term invest-

[5]Langley (cited in fn. 3), p. 84.

[6]Lord Salter, *The Development of Iraq: A Plan of Action* (Baghdad: Iraq Development Board, 1955).

[7]Langley (cited in fn. 3), pp. 84–85. Also, Thomas Balogh, *Economic Development Policy in Iraq* (translated by Mohammed Hasan, Baghdad, 1958), pp. 40–42.

[8]Arthur D. Little, Inc., *A Plan for Industrial Development* (Cambridge, Massachusetts, 1952).

ments as well as to provide the needed capital for pioneer enterprises.

Thus, 1951 marked a turning point for Iraq's investment and development policies, thanks to revenues from oil. Since then, oil has become a crucial and dynamic component of economic activity, emerging as the principal source of investment spending in the country and of foreign exchange to finance imports, whether consumer goods to counteract the anticipated inflation from large-scale spending or producer goods needed for the development process. The Government of that time gave thoughtful and due consideration to the modes of spending, the management of the country's expanding oil resources, and their allocation at the central government level.

The Development Board was founded in 1950 (by Law No. 23) to formulate economic and financial plans to develop Iraq's resources and raise its people's standard of living. At first, the Board enjoyed considerable administrative, legal, and financial autonomy, and all oil revenues were assigned to its budget. But the volume and flow of these revenues became so large that the Government subsequently reduced the allocation to 70 percent, leaving 30 percent for financing its own general expenses. In 1953 the Ministry of Development was created and charged with executing the Board's investment schemes, which served to limit the Board's authority and in time led to the Government assuming full control of development policy.[9]

The most serious problem facing development programs in those early years was project implementation. Total annual allocations to investment schemes during 1951–58 amounted to ID 418.5 million, but only ID 225.1 million was disbursed. The ratio of investments implemented to investments targeted was therefore no more than 54 percent, with significant variations between sectors; the largest difference (63 percent) occurred between the building and services sectors.[10] This rendered the state's executive agencies unable to fulfill their mission of placing the program's projects under implementation, whether to the Government (ministries,

[9]Balogh (cited in fn. 7), p. 32.

[10]Hashim and others (cited in fn. 1), Part I, pp. 66, 267, and 268.

government agencies) or to contracting parties or agencies charged with monitoring the implementation of the plan.[11]

Apparently, the Development Board did not expect such a large inflow of oil revenues over the short term, which was the cause of its failure to utilize the funds made available to it. The result was that development planning lacked the boldness to match the means available. According to Lord Salter, the Board was in a state of perpetual confusion as to how to implement fully the projects assigned to its budget. Balogh believes that the widening permanent gap between planning and implementation was due, above all, to vacillation in spending, perhaps for the same reason cited by Salter. This view is supported by the fact that the Board was unable to implement even one sixth of the funds earmarked for industrial projects. The Board increased its loans to municipalities and various projects established by other agencies in a bid to compensate for this inadequate spending, but in fact these were more like assistance outlays rather than true lending. Moreover, most of the projects financed were long term and thus could only mature over the long run, except perhaps for housing, dams, and reservoirs, which helped save the country from the destructive threat of floods. As a result, the substantial spending that the Development Board undertook was not matched by comparable growth in production.

Much criticism was leveled at the Development Board and its investment schemes. Among the major criticisms were the following:[12]

- The conservatism of its policy, as the Board shied away from projects that might affect the prevailing social order, particularly in the agricultural sector; that is, programs were planned within and on the basis of the prevailing system, with no attempt to change that system.
- The Board did not endorse a policy of dynamic industrialization or strive to develop manufacturing for the purpose of achieving industrial independence and self-reliance.
- The financing of projects was not undertaken within the framework of a unified economic development plan for the econ-

[11]Ibid., pp. 166–67.

[12]Ibid., pp. 46–48.

omy as a whole, nor did the Board establish clear-cut development strategies or study the potential consequences of its projects, whether direct or indirect.

- The Board's programs were based solely on economic considerations. Long-term investments were given precedence over projects with a direct impact on production, even though the latter could have borne fruit over the short term and may have shown tangible results much sooner.

However, in all fairness, now that four decades of continuous development have elapsed, and given the economic, social, and political conditions that prevailed in the fifties, the Board performed rather well. It may even be regarded as a success, considering all the constraints encountered: more specifically, its lack of experience in planning, the shortage of technical skills, unsuitable economic and political conditions, the lack of the complements to capital development, the national economy's limited absorptive capacity, and the absence of adequate infrastructure. Moreover, to give the agricultural sector the necessary attention required that efforts focus on projects in irrigation, dam construction, and water storage, installation of roads, bridges, and electricity and water networks on a large scale, in addition to building houses, schools, and hospitals. For this reason, the Board could not implement its programs in full. Spending could not keep up with the growth in oil revenues, which was itself the principal engine of developmental investment during that period.

Investment Policies, 1958–68

If oil revenues were the principal factor influencing investment policy during 1950–58, political transformations in the subsequent phase, 1958–68, were a key factor in the formation of these policies, in the size of investment, in direction, and in allocation of funds. This second phase was characterized by four basic changes, the last of which occurred in 1968. Among the consequences of the first three was the deterioration of relations between the Government and the foreign oil companies operating in Iraq, which were genuinely prejudicial to Iraq's sovereignty over its own oil resources, resulting, as we shall see, in modest growth in oil revenues. Official negotiations with these companies failed to reach a mutually satisfactory agreement, which prompted the Government to enact the famous Law No. 80 of 1961. By this law, Iraq was able to recover 99.5 percent of its territories previously subject to the oil concessions. This act impelled the oil companies to pursue a policy of blatant pressure by manipulating the rate of oil production, sometimes increasing and sometimes reducing it, throughout the period under consideration. This policy naturally affected oil returns, which fluctuated accordingly, declining in some years and rising in others, though by no more than 0.3 percent. Although output in 1968 was increased by 54.5 percent, in 1969 it declined by 1.8 percent.[13] The vacillations in revenues generally coincided with political changes that occurred during this time, resulting in a comparative deterioration in the role of oil revenues in financing investments while augmenting the political transformation in investment policy trends (volume, financing, and sectoral distribution).

As for investment policy, emphasis shifted from agriculture to industry, on the grounds that the latter yielded quicker results and more widely distributed benefits, than the agricultural sector, from which only a minority of large landowners had thus far profited.[14]

At the same time, the proportion of oil revenues assigned to investment development objectives was reduced from 70 percent to 50 percent. The remaining 50 percent was transferred to the Government's regular budget, which was normally directed to public consumption expenditures.[15]

The most significant modification in the planning process during this period was the enactment of Planning Board Law No. 18 of 1966, which endorsed the principle of comprehensive planning for the national economy and affirmed the need to avoid restricting it to economic considerations alone. The text proclaimed in no uncertain terms that among the tasks of the Board was "coordination between economic, financial, monetary and trade policies to ensure the implementation of the plan . . . and to submit comments on the annual budget proposal of the State within the general framework of the plan, in addition to orienting the private sector

[13]OPEC, *Annual Statistical Bulletin, 1970*, Tables (13) and (78), pp. 24 and 118.

[14]Hashim and others (cited in fn. 1), Part I, p. 50.

[15]Ibid., p. 87.

toward the plan's development objectives."[16] Perhaps this was the first indicator of the need for coordination between development and investment plans on the one hand, and the Government's macroeconomic policies on the other.

Another important development that affected investment policy during this period was the rather sudden move toward nationalization that occurred in July 1964, when 27 private companies in the following sectors were nationalized: weaving and textiles, food products, chemical industries, tanning and leather, and building materials. All commercial banks and insurance companies were also nationalized; these, along with cement and cigarettes, became confined to the public sector. On the other hand, only large industries were nationalized; small and intermediate projects remained in the private sector. The total capital of the industrial enterprises nationalized amounted to nearly ID 17.5 million.[17]

The Detailed Economic Plan for 1961–65, which followed the change of government of 1958, is the plan on which our analysis of new investment policies is based. There are several reasons for this choice. For one, the plan was indeed detailed; for another, the greater part of it continued to be implemented up to the middle of 1968. Moreover, it rested on specific principles, in terms of objectives and priorities, which in turn were linked with macroeconomic policies. It was also based on a fairly extensive economic analysis of current and projected ends, means, and realities.

Total investment funds assigned through this plan amounted to ID 556.3 million, 30 percent of which was absorbed by the industrial sector. The agricultural sector obtained no more than 20.3 percent, which reduced its standing to fourth place, as the building and housing sector received 25.2 percent, and transport, communications, and storage, 24.5 percent. The industrial sector thus gained precedence, an aim that was in keeping with the overwhelming desire of the new generation generally, and intellectuals in particular, to transform the industrial sector into the principal engine of development. Their motive goes back to the belief popular at that time: industry is the basis for economic development

[16]See Paragraphs 2, 3, and 4 of Article (7) in Planning Board Law No. 18 of 1966.

[17]For a good, detailed study of the nationalization decisions, see Safa' Al-Hafez, *The Public Sector and the Scope of Socialist Development in Iraq* (Beirut: Dar Al-Farabi, 1971), p. 79 ff.

generally, and to overcome backwardness and poverty requires developing this sector, even at the expense of agriculture. It was a widespread belief common to all developing countries, impelling them to apply development strategies geared principally to industrialization.

The Detailed Economic Plan for 1961–65 adopted the concept of comprehensive planning at the national economy level. It sought to strike a balance between economic development in all sectors, with due regard to the mutually reinforcing effect of growth in all these sectors and growth of the economy as a whole. It aimed at an annual growth in national income of no less than 8 percent and at reducing dependence on oil by developing the productive capacities of industry and agriculture and increasing their contribution to national income generation by no less than 7.5 percent annually in the agricultural sector and no less than 12 percent in the industrial sector. It also considered the need for balance between the size of national expenditures and their rate of growth on the one hand and between the available productive capacity and its rate of increase on the other; this was to guard against the effects of inflation or recession and to achieve short-term monetary and economic stability. The plan did not fail to link its projects to the broader objectives of Arab economic integration and sought to achieve full employment and expand social services (such as education and health).

Perhaps one of the most important points emphasized in the new plan was the need to coordinate investment policies and macroeconomic policies (that is, financial, monetary, credit, trade, and wage policies). It was the first time that mention was made of these policies and the need for such coordination.[18]

According to the plan, it was most significant that in the list of revenues oil revenues did not comprise more than 69.5 percent of the total. Two other important sources for the plan were external loans (16.9 percent) and domestic borrowing (5.3 percent). This was an important development in sources of financing development plans for Iraq, marking a departure from the decade of the fifties, when planning depended almost exclusively on oil revenues.

[18]See Law No. 78 of 1965 Regarding Five-Year Plan 1965–69.

Investment Policies, 1968–80

The period 1968–80 was characterized by important and decisive political and economic developments. In July 1968 a party came to power that had definite social imperatives, and its economic and political objectives were very different from the forms of government that had prevailed in the fifties and up to the end of the sixties. It was socialist in orientation and did not acknowledge individual decisions on production, allocation, and pricing, in view of the glaring inequality in the distribution of income and wealth. These considerations conditioned the investment policies of the time and were manifest in the political changes initiated by the new Government on the one hand, and in the social orientation of that Government on the other. The new Government was also nationalistic, raising the slogan: "Arab oil for the Arabs." Thus, it believed in the need to free national wealth from the domination of the foreign investor, which was personified then by the foreign oil companies. A major confrontation occurred with the oil companies, which culminated in the 1972 decision to nationalize these companies, a process that was completed the following year.

This situation continued until September 1980, at which time the war between Iraq and the Islamic Republic of Iran broke out. This signaled the start of a new phase whose influence on investment policy continues to this day. We shall discuss this phase in more detail in the next section.

The current phase ended, therefore, as it had begun, with important political developments exercising a decisive impact on investment policy in Iraq throughout the seventies and eighties.

The general national development objectives were as follows:

- To achieve an advanced economic level and increase the Iraqi individual's income to raise his standard of living and realize prosperity and social justice.
- To develop the agricultural sector by increasing productivity and diversifying output, applying modern methods in production technology, in addition to transforming productive and social relations into advanced socialist productive relations; also, to complete horizontal growth and work more toward vertical expansion.
- To increase industrial production, focusing on light industries for the production of consumer goods to meet local demand,

directing any surpluses into export, in addition to developing the national oil sector in terms of production, marketing, and processing.

- To maintain full control over external and internal trade and to expand and diversify exports.
- To support the public sector in all economic branches, as it constitutes the basis for the socialist transformation, and to support the private sector within the limits prescribed; also, to employ all available means to help this sector fulfill its developmental role.
- To link investment policy with savings policy and concentrate on encouraging national saving, with the assurance of full employment for all able-bodied persons in all productive sectors.
- To coordinate regional development projects in Iraq and productive projects in the Arab countries in light of the requirements of Arab economic integration.

One of the most significant results of these developments was that oil revenues increased substantially and at an accelerating rate throughout the seventies, especially after the price adjustment of 1973, increasing from about $521 million in 1970 to nearly $26 billion in 1980. The greatest increases occurred in 1979 ($21.3 billion in 1979, up from $10.9 billion in 1978), and in 1980 when the per barrel price of oil reached its peak.[19] Naturally, this increase affected the volume of investments, reflected in the two Development Plans of 1970–74 and 1976–80, which were, until then, the largest in Iraq's history. The total allocations of the Revised Five-Year Plan for 1970–74 were about ID 1,169 million; the percentage share of each productive sector was 16 percent for agriculture, 19 percent for industry, 10 percent for buildings and services, and 15 percent for transport and communication. Total allocations to commodity sectors were thus about 60 percent. The remaining 40 percent was channeled into large-scale ventures, loans to government departments and institutions, as well as international commitments. In commodity sector allocations, industry came first, receiving 31 percent, or ID 710 million, followed by

[19]Arab Monetary Fund, General Secretariat of the Arab League, Arab Fund for Economic and Social Development, and Organization of Arab Petroleum Exporting Countries, *Joint Arab Economic Report, 1981* (Dubai: Arab Monetary Fund), Table (6–10), p. 236.

agriculture at 27.6 percent, transport and communication at 25 percent, and, finally, buildings and services at 17 percent.[20]

One observes in this pattern of investment a definite shift of emphasis from agriculture to industry, with industry now acquiring absolute priority, compared with a lower degree of precedence in the previous Five-Year Plan (1965–69). The emphasis on communications remained the same, indicating continued concern for infrastructure in the Iraqi economy. The plan's allocations to the various sectors show that the relative importance of each sector for realizing the country's development goals was kept in mind during formulation of the new development policy, as was the sector's maximum potential for implementation.[21]

However, the largest Five-Year Development Plan in Iraq's history till then (the Explosive Plan, as it was then called) was for 1976–80. It was labeled "explosive" because of the massiveness of its macro allocations, which were nearly ID 15.1 billion.[22] This amount was ten times the figure for the previous plan (1970–74) and was followed by what was called the Big Push strategy for development, which sought to eliminate backwardness on every economic front—goods and services, economy, and society—and was motivated by optimistic projections of continued increases in crude oil prices in the international market and therefore in revenues. These revenues did indeed increase throughout the years of the 1976–80 plan, reaching nearly $77 billion.

The industrial sector continued to hold its lead position in terms of volume of allocations and, therefore, relative importance, which came at the expense of the priorities in the Government's investment policy. Meanwhile, despite agriculture's very large allocations, in absolute terms, this sector continued to occupy fourth place. Buildings and services came in second, and transport and communications third, meaning that the two sectors received the lion's share of commodity sector assignments (45 percent) and 35.7 percent of total assignments, confirming the Government's commitment to expand infrastructure and improve social services.

[20]Ministry of Planning, *Progress in Planning* (Baghdad, 4th ed.), p. 57.

[21]Ibid.

[22]Ministry of Planning, Central Statistical Organization, *Annual Abstract of Statistics, 1982* (Baghdad), Table (2–6), p. 126.

Investment Policies During the War Years, 1980–87

From September 1980 until August 1988, Iraq endured one of the longest and harshest trials in its history: the war with the Islamic Republic of Iran and the subjection of Iraq's economy and every other aspect of life to armed assault, subversion, and destruction. The war brought oil exports through the Persian Gulf to a standstill, and oil pumped through the Syrian Arab Republic for export from Mediterranean ports also ceased to flow. Thus, Iraq's oil interests suffered badly. As the export of crude continued to diminish, oil revenues deteriorated from just over $26 billion in 1980 to $9.7 billion in 1983, and then to $7 billion in 1986. As of 1987, however, they began to increase again, after new and strategic pipelines were laid to pump oil, first through Turkey and then through Saudi Arabia. This secured for the country $11.3 billion in oil revenues during that year.[23] The decline in Iraq's oil exports, and therefore revenues, was not due solely to these causes. There was also the accompanying decline in demand for oil in the industrialized countries, a consequence of the general economic stagnation that pervaded the first half of the eighties; this not only led to reduced oil exports,[24] but also to the deterioration of its nominal and effective prices from $34 a barrel in 1981 to $13.5 a barrel in 1986.[25] As oil and oil revenues are essential sources for financing economic and social development plans in the country, and for defining their size and scope, the process of development was the first to be affected by the adversities in the oil sector during the war years. The war also had an impact on the labor force, as a large portion of the manpower was enlisted into the armed forces. The overall result was suboptimum utilization of available productive capacity on the one hand and decline in production and investment performance in other economic sectors on the other.

[23] *Joint Arab Economic Report, 1988* (cited in fn. 19), Statistical Annex, Table (4–3), p. 259.

[24] For oil production for 1979–82, see Organization of Arab Petroleum Exporting Countries, *Ninth Annual Report of the Secretary General, 1982*, Table (2–5), p. 45. For 1983–87, see *Joint Arab Economic Report, 1988* (cited in fn. 19), Statistical Annex, Table (4–15), p. 271.

[25] See, in this regard, *Joint Arab Economic Report, 1988* (cited in fn. 19), Statistical Annex, Table (4–2), p. 258.

Government Policy Toward Public and Private Investment

The public position toward private investment since the thirties and up to the sixties can generally be described as one of continuous support. The Government enacted legislation to promote private investment in the industrial sector generally. In the mid-forties it established the Industrial Bank and Agricultural Bank to help industrialists and agricultural producers, providing them with customs and tax exemptions, land, and financial facilities. The Government also participated in industrial projects, through its industrial expenditures, in a further token of encouragement and support. Its role until the early fifties was largely one of patronage, seeking to help the private sector establish itself and lay the groundwork for expansion. It adopted free trade and liberal economic policies and did not interfere in private ventures except to a very limited degree. Private enterprise dominated all productive sectors, including the foreign oil sector and manufacturing, however modest, simple, and limited in scope in the latter; meanwhile, agriculture was almost completely under private sector control. The Government's role here was minimal, restricted to providing credit facilities as well as the necessary infrastructure in the form of roads, bridges, and dams. The public sector was therefore circumscribed and did not extend beyond public utilities, railroads, ports, and airports,[26] except to include a few specialized banks and one of the commercial banks.

Then came the fifties. Government revenues increased following the revision of the 1950 oil agreements, as described earlier. Its investment role grew, and the sector expanded side by side with the private sector. We noted earlier that the Government's position on private investment did not change, remaining one of support and encouragement, while the general trend in investment policy was liberal and supportive of the private sector. The Government's role in economic activity remained limited to a few industries that the private sector was reluctant to enter into, either because of its limited means, or the intimidating effect of its inexperience in such ventures, or skepticism about their feasibility and potential for success, or the lack of entrepreneurs willing and able to undertake

[26]For a highly detailed review, see Langley (cited in fn. 3).

them. Thus, during the fifties, the Planning Board devoted most of its effort to channeling government investment into infrastructure, in particular for the agriculture sector (dams and aqueducts), transportation sector (roads and bridges), and transport (railroads, ports, and airports). Government activity extended to the oil sector in the areas of petroleum products (distillation plants) and distribution of production (filling stations, which were commissioned to the private sector until 1958). It is also apparent that most of the expansion in public investment benefited private enterprise and always supported it; the same applies to the many financial laws that were promulgated, which served to support the private sector through tax exemptions, financial grants, land allocations, the provision of low-priced energy, and exemption of primary material imports from customs duties, in addition to providing loans and credit facilities.

As a result, the private sector came to dominate economic activity during the fifties. The public sector's contribution to GDP in 1953 and 1956 did not exceed 11.7 percent and 14.3 percent, respectively, while its contribution to gross fixed capital formation was about 49 percent for both years. By 1960, its share of GDP was still no more than 18.6 percent and its contribution to gross fixed capital formation, 42.1 percent,[27] which is indicative of the primacy of the private sector during the fifties. The share of the private industrial sector in economic activity and in value added to industry, for example, was about 88.3 percent in 1953 and 88.2 percent in 1956, with an increase in absolute terms from ID 17.4 million to ID 28.3 million. Private capital invested in industry amounted to about ID 4 million in 1953, rising to nearly ID 20 million by 1956;[28] these figures reflect the Government's investment policy during this time, which was consistent with the recommendations of the foreign experts drawn upon by the Planning Board.

The beginning of the republican era in July 1958 saw no change in government investment policy toward the private sector. The new Government provided every form of support and encouragement, especially for the industrial sector, resulting in an ex-

[27]Hashim and others (cited in fn. 1), Part I, Statistical Annex (21), p. 288, and Statistical Annex (30), p. 298.

[28]Ibid., Part II, pp. 283–84.

pansion in private industrial enterprises and a relative increase in capital investments therein.

However, an important change occurred in government policy toward public investment during July 1964, when 27 industrial, commercial, banking, and insurance companies were nationalized, and a central Economic Organization was created to manage the nationalized companies. The Government drew a dividing line between the public and private sectors in certain definite areas:

- The banking and insurance sectors were incorporated into the public sector;
- The cement, asbestos, and cigarette industries were placed under the exclusive control of the public sector;
- In other industries, such as weaving, textiles, and foodstuffs, only the larger industrial projects were nationalized, with small and medium-sized projects remaining within the private sector.

The nationalization laws thus played a decisive role in expanding and consolidating the public sector. Although they curbed the scope of the private sector, they did not oppose it; on the contrary, it continued to play an important role in every economic activity. In the industrial sector, where the impact of nationalization was more strongly felt, the number of industrial corporations increased by nearly 40 in the year after nationalization. This trend continued throughout the second half of the sixties despite the partial stagnation of the sector immediately after the decision to nationalize and the trend toward expansion in relatively small industries.[29] The period 1965–68 witnessed a significant increase in private industrial activity, whether in terms of the number of companies, the amount of production, the value added, or the number of personnel, but this expansion was most noticeable in the small business sector.[30]

Among the most important factors contributing to this expansion was the enactment of a new development law that improved conditions for developing private industry. Moreover, the private sector was regarded as a national capital asset with important economic and social functions in the development of the national economy; the public sector was not to replace it, but both were

[29]Ibid., p. 441.

[30]Ibid., p. 443.

to complement one another in a joint effort to bolster the economic and social development of the country.[31]

Thus, the private sector continued to hold a relatively important place in industry by the end of the sixties, although the public sector controlled the largest industrial projects. The share of the private sector in value added to industry was about 45 percent, and the sector continued to dominate agriculture, transportation (excluding railroads), air transport, contracting, and construction, and no less than 50 percent of trade and imports. Meanwhile, investment in the financial and banking sector became state controlled. Despite this, the share of the public sector in GDP and in gross fixed domestic capital formation did not exceed 26.1 percent and 58.6 percent, respectively, for 1968,[32] suggesting that the private sector continued to play a relatively large role in the Iraqi economy—four years after nationalization.

However, an important change occurred in investment after 1968. It followed a fundamental political change that resulted in a Government with openly socialist leanings, inclined toward expanding the role of the state in the national economy generally (including reduction of individual forms of agricultural production, placement of all foreign trade under state jurisdiction, centralization of internal trade, and bolstering the leadership role of the public sector in industry). The objective was to transform Iraq into a socialist society, and these imperatives were reflected in the changes that followed the socialist public sector's participation in all economic sectors.[33]

Public investment thus dominated the manufacturing field, especially in the leading strategic and heavy industries, while private investment was assigned to small consumer goods industries. The public sector also prevailed over foreign trade sectors and achieved extensive control of internal trade. However, the private sector has retained a certain importance within the Iraqi economy even up to the present, for it now participates actively in economic activity to the extent of 40 percent of non-oil GDP and about 25

[31]Ibid.

[32]Ibid., Part I, Statistical Annex (21), p. 288, and Statistical Annex (30), p. 298.

[33]For details, see Arab Baath Socialist Party of Iraq, *Central Report of the Ninth National Conference* (June 1982), pp. 106–108 and 130–47.

percent of gross fixed domestic capital formation—a 5 percent increase compared with 1975.[34]

In contrast to the trend in the late sixties, investment policy during the latter part of the eighties, and especially since the beginning of 1987, was directed to supporting and promoting the private sector. Certain businesses in the public sector were transferred to the private sector, and the latter was permitted to initiate similar ventures within certain areas so far reserved to the public sector, as well as to invest in agricultural, industrial, and trade activities that were competitive with that sector. The Government also granted the private sector numerous tax exemptions, discarded the upper limits on company capital, and permitted the provision of concessional credit facilities to the sector. It provided a number of incentives for Arab investment in the country[35] and deregulated agricultural commodity prices and the prices of many other manufactured commodities. A move was made to develop the financial market by increasing its capacity to handle domestic investments and expedite the circulation of private and joint venture stocks, removing the obstacles to these operations, in particular by modifying legal stipulations to make them compatible with the new changes in investment policy toward the private sector.

In this context, the Government dissolved the Planning Board and replaced it with an Advisory Planning Authority. Development plans became indicative, to be ratified as general indicators and trends.[36]

One may regard these developments in the investment climate in Iraq as part of a more general trend that has swept the Arab region generally in recent years, with the aim of revitalizing the

[34]On the role of the state in economic activity in Iraq from the fifties to the present, see "Evaluation and Future of the Role of the State in Economic Activity in Arab Countries Promoting Social Justice and Redistribution of Income," paper submitted to Seminar on the Role of the State in Economic Activity in the Arab World, Arab Planning Institute, Kuwait, May 27–29, 1989.

[35]See, in this regard, Ibrahim Al-Khafagi. "The Private Sector in the Post-War Era: Prospects and Future Trends," paper submitted to Seventh Conference of the Iraqi Economists Union on Basic Economic Trends in Iraq After the War, Baghdad, January 17–19, 1988.

[36]For a summary of these developments, see Inter-Arab Investment Guarantee Corporation, *Report on the Investment Climate of the Arab Countries*, 1987 and 1988 issues (Kuwait, 1988 and 1989), in particular the sections on Iraq.

private sector and assigning it a greater role in Arab national economies.

Policy Toward Arab and Foreign Investment

We turn now to an examination of policy toward foreign investment, which has been absent from the Iraqi scene since the nationalization of the foreign oil companies in 1972 and 1973. Moreover, the attitude toward foreign investment has by no means been favorable since the revolution of July 1958. Nor does it seem to be changing, even today, except for specifically Arab investments.

In 1988, Arab Investment Law No. 46 was issued to encourage this form of investment to assist in the economic and social development of the country. The law grants Arab investors the right to participate with Iraqi investors in the initiation of Iraqi investment projects, provided that Iraqi participation does not exceed 49 percent of the project capital. In other words, the law permits Arab investors absolute shareholder majority as a form of encouragement. Furthermore, the law sets the paid-up capital of the investment project at the equivalent of half a million dinars and allows Arab capital in the form of capital assets; it also stipulates customs and tax exemptions, facilities, and guarantees for the project. Iraq's Ministry of Planning has defined the main areas of Arab investment to be in industry, agriculture, livestock, tourism, and mining; outside these sectors, foreign investment is strictly prohibited.[37]

This position on foreign investment in the country may be regarded as official up to the present. We believe that it represents the national consensus on this type of investment, and one that derives originally from the bitter experience with the Western oil companies that had operated in Iraq since the 1920s. It should be borne in mind that Iraq has never felt the need for foreign investments, thanks to the ample domestic funds at its disposal during the fifties, and then again in the seventies. Thus, investment flows to Iraq have been negligible since the forties. Moreover, foreign investments in the past (in the thirties, and even in the seventies) were confined to the oil sector, to the currency exchange

[37]Ibid., 1988, pp. 258 and 270–72.

sector, and to transport and ports. In 1936 a foreign-owned railway project was purchased; in 1952, ownership of the Basra seaport was transferred to the Iraqi Government; in 1951, the Government recovered its crude oil fields for direct exploitation, as well as the concession to distribute petroleum products in the Iraqi market, thus giving it a monopoly over oil distillation and distribution within Iraq.

All these nationalization measures occurred through agreements arrived at amicably. But the first severe blow directed at the foreign oil companies was the famous Law No. 80 of 1961, which recovered for the Government 99.5 percent of the land area formerly subject to the oil concession; this concession had in fact encompassed the whole of Iraq's territory, from the north to the south. Nevertheless, the companies continued to control the largest oil fields, which did not become completely nationalized until June 1972.

As for currency exchange, foreign investments were estimated at ID 2.3 million until July 1964, when they were nationalized. The value of foreign investments nationalized during that year was generally estimated at ID 4.5 million, all of which was compensated.[38]

With the nationalization of the foreign oil companies in 1972 and 1973, the role of foreign investment in Iraq effectively ended. To this day it has not made a comeback, nor is it likely to do so in the foreseeable future.

Macroeconomic Policies and Investment

Iraq is, of course, an oil country, and its oil revenues, as we have seen, finance the country's public investments; 90 percent of total investment allocations committed since the fifties and up to the present have been based on oil revenues. These revenues generally exceeded planned investments and actual expenditures during the fifties and the seventies, encountering some difficulty during the sixties. Thus, public investment policy tended to operate on the assumption of limitless financing for Iraqi development, an assumption apparently backed by the continuing increase in oil exports and thus in the volume of oil revenues accrued. These two

[38]For more details, see Al-Hafez (cited in fn. 17), pp. 80–99.

variables remained high and increased in parallel—although oil revenues grew more rapidly during the latter part of the seventies and early eighties as oil prices increased steadily up to 1982. This increase took place as the oil market began to show signs of weakening (the early eighties) and the industrial capitalist countries encountered economic stagnation. The result was a severe blow to the oil countries generally and to their expectation of continued demand for high-priced oil along the lines prevailing in the late seventies.

Despite all the setbacks that have been encountered, oil and oil revenues are likely to be the paramount sources for financing economic and social development, even though policymakers are now aware that oil is a nonrenewable and unstable resource that cannot be relied upon indefinitely.

If we return once again to the seventies, and before that to the fifties, we find that in the various historical phases through which Iraq passed, macroeconomic policies did not command much attention, thanks to abundant financing from oil. After reviewing the conditions of developing countries generally, one finds these policies acquiring special importance in countries where financial resources are scarce, or which suffer from fluctuations and instability in financial revenues, whether from domestic sources (taxes, production surpluses) or external sources (exports, foreign loans). These conditions differed, both qualitatively and quantitatively, from those that prevailed in the oil countries (including Iraq) since the mid-seventies and, in the end, in the fifties as well. Moreover, the effect of such policies becomes most apparent where the economy is characterized by a private sector that dominates the public sector in both size and impact and obtains its financing from local sources, of which the most important are private savings, bank loans, and accumulated profits rechanneled into productive enterprises. In this case, financial and monetary policies have a direct, tangible, and active impact, or even an indirect impact, on the productive activities of the private sector, in terms of size, sectoral trends, output cost, and prices and profits, and thus in terms of the general composition, size, and direction of private investments.

The private sector in Iraq was the dominant sector during the fifties, when its contributions to GDP and gross fixed capital formation averaged 75 percent and 50 percent, respectively. These ratios are comparatively high and are indicative of the importance of this sector at the time. Thus, macroeconomic policies had an important effect on the sector's productive and investment activities, and monetary policies tended to encourage and support it through the extension of banking, industrial, agricultural, and trade and credit facilities, and by permitting interest rates to shift in response to the supply and demand for credits, though within a legally prescribed ceiling.

The exchange rate of the dinar was relatively stable and was at first pegged to sterling (as Iraq was at that time a member of the sterling area) but was later pegged to the dollar, following Iraq's signing of the agreement establishing the International Monetary Fund (1945). The stability of the exchange rate contributed to the stability of prices, especially of imported goods, and to reducing the risk factor for private investors. Oil revenues provided the needed foreign exchange for meeting the import demands for both investment and consumption. Relatively liberal trade policies also helped to stabilize prices somewhat, as well as to counter the inflationary pressures that followed from development spending, which increased substantially in the wake of accelerating oil revenues.

Because the Government at that time assigned 30 percent of revenues to its general expenses, this helped redress the deficit on current expenditure in the budget but, at the same time, it reduced dependence on taxes. Thus, personal income increased while tax rates remained fixed, and government consumption expenditures increased side by side with the increase in personal consumption expenditures, compounding the inflationary pressures of development spending in the public sector. These pressures were countered by opening the door to imports on the one hand and by encouraging investment in the private sector on the other, to provide the economy with a supply of goods and services; this cushioned the inflationary effect of the large expansion in public and private spending in the face of a relatively small production potential and limited absorptive capacity.

The Government tried to encourage private investment in industry by adopting a protectionist policy and sought to create import-substitution industries for consumer goods. It did not rely on taxes to counter inflation, as the share of revenue from income tax to GNP in 1953 was no more than 0.8 percent and remained effectively unchanged through 1959, when it amounted to 0.9 percent. Thus, taxes were not among the Government's effective and available monetary tools for sustaining the progress of the Iraqi economy in general.

As for wages and prices, the Government left these to market forces and did not interfere in the operation of the market, pursuing a liberal import policy with full freedom for the private sector in productive activities—industrial, agricultural, trade, transport, etc.

It may be argued, therefore, that the general imperatives of government development spending policy at this time were what determined, for the most part, the patterns of growth in economic activity and gross capital formation, as well as their forms, and the extent of utilization of available economic resources and their mode of allocation between the various productive sectors. Spending policy was generally conservative despite the relatively huge sums expended and despite the increase in imports; the balance of payments remained in favor of the national economy and thus led to positive accumulations of foreign exchange.

The macroeconomic policy followed by the Government in the fifties maintained a secure external position for the country. A contributing factor was that actual expenditures were always lower than investment commitments or the oil revenues obtained. This was reflected in the continuous increase in accumulated foreign financial reserves throughout the fifties, rising from $113.7 million in 1951 to $180.9 million in 1953, and to $257 million in 1958.[39] The country enjoyed a balance of trade surplus during this time except for 1958, when Iraq retaliated against the tripartite aggression against Egypt by suspending its oil flows from Mediterranean ports.

The relatively stable rate of exchange alone led to stability in domestic prices, because of the importance of importables for Iraq, but externally the effect on the volume of exportables in general was limited. Oil prices are determined in the global market, so that changes in the exchange rate of the dinar do not affect them. For other, non-oil exports, however, their size and their quality—whether as raw materials or as agricultural commodities—together with the price elasticity of demand, reduce the importance of exchange rate variations. As a result, the effectiveness of the foreign exchange rate as a monetary measure is limited as far as

[39]International Monetary Fund, *International Financial Statistics Yearbook* (Washington, 1981).

exports are concerned; it is also limited for importables because of the low elasticity of domestic demand for them. Being important investment or consumer goods, local demand for them is not price sensitive, particularly when development expenditures are large and there is a continuous rise in personal income, leading to increased demand because of an increase in the marginal propensity to import and consume.

We have already mentioned that the share of general government expenses from oil revenues was raised from 30 percent to 50 percent after the emergence of the Republican Government in Iraq in 1958. Thus, 50 percent of oil revenues were assigned to financing development plans during the sixties, of which the most important was the Five-Year Development Plan for 1965–69. It was observed in these plans that the available financial resources were below optimum for financing target investments. The resource deficit was corrected with a shortfall in actual expenditures against planned allocations on the one hand and by resort to external borrowing on the other. This development is important because it suggested a willingness on the part of the Government to look abroad at that time more than ever before. The Government also planned to draw on internal bank credits to finance part of its planned investments. However, it is clear that the Government was most reluctant to rely on foreign borrowing; actual external loans did not exceed ID 16 million, or 17.5 percent of the original amount planned (that is, ID 91.5 million). Tax policy during this time could not compensate for the drop in oil revenues that ensued from differences with the foreign oil companies, as proceeds from taxes were extremely low, whether in absolute terms or as a percentage of national income.

Among the consequences of the increase in the share of the general budget to 50 percent of oil revenues was a rate of growth in government consumption expenditures exceeding growth in national income. General government expenditures increased between 1953 and 1956 by 273.5 percent, but the percentage increase in national income was no more than 170.2 percent.[40] Direct and indirect taxes—excluding the tax on income of the oil companies—rose by 132 percent.[41] This meant greater reliance of gov-

[40]Hashim and others (cited in fn. 1), Part I, p. 87.

[41]Ibid., p. 89.

ernment consumption expenditures on oil revenues, and at the expense of public investment and development expenditures, as confirmed by the decline in the ratio of the latter to national income from 16 percent in 1957 to 9 percent in 1969.[42] It was only natural that this would lead to a decline in the rate of growth of national income generally, unless the non-oil sector could compensate for the shortfall in public investment expenditures—which did not occur. The private non-oil sector concentrated more on investment in buildings, especially residential, than on productive machinery and equipment, which was to be expected, given the uncertainty in economic policy trends in general, and it remained so throughout the sixties.

All these developments suggest a lack of coordination between the Government's financial and development policies. Monetary policy was also weak despite government control of the banking sector and the financial sector. There was no clear or convincing evidence for the effectiveness of interest rates as a monetary tool, given the atmosphere of uncertainty that prevailed, especially after the nationalization decisions of July 1964. Nor were the other quantitative measures of monetary policy very effective without an organized and developed financial market and the high liquidity that banks usually enjoyed. Consequently, the Central Bank sought to follow a selective and qualitative monetary policy, imposing direct credit controls to influence the trend in bank credits away from the trade sector and toward other productive sectors, especially industry and agriculture.[43]

No change occurred in the exchange rate of the dinar, which was pegged to the dollar, and here the ineffectiveness of the exchange rate policy referred to becomes apparent. It applied to the most important exportables, namely oil, whose price is determined by international market forces, but not to non-oil exports, which are small and vary in availability for export; nor did it apply to importables for which the price elasticity of demand is low because of the great need for these goods whether for development or consumption. Thus, the role of exchange rate policy was for the

[42]Ibid., Statistical Annex (6), p. 270.

[43]On the effectiveness of monetary policy in Iraq, see *The Economics of Money and Banking in Capitalist and Socialist Developing Countries* (Baghdad: Mosul University Press, 2nd ed., 1986), in particular section on Iraq (Part II-1986, Chap. 40).

most part restricted to achieving stability in domestic prices along the lines discussed earlier.[44]

Although the Government was more restrictive and protectionist than before, maintaining control over most foreign trade, it established a monopoly on certain food imports, such as sugar and tea, as well as the import of automobiles, medicines and medical supplies, and agricultural and food products. It also competed with the private sector in certain trade activities and established the General Organization for Trade. However, the imports of this Organization were only 28.1 percent of Iraq's total imports in 1969, while its exports in 1968 were only 10.9 percent of total exports, suggesting that the private sector continued to play a relatively large and important role in Iraq's foreign trade.[45] Owing to the modest increases in oil revenues, imports increased slowly between 1960 and 1966, and subsequently declined to reach a trough in 1968. Eight years later, they were still no more than 15 percent higher than the 1960 level.[46] The balance of trade (non-oil) encountered a perpetual deficit throughout the fifties and sixties, and even to the present. If oil is included, however, a continuous surplus in this balance is obtained, though it varies from year to year with the fluctuations to which oil exports were always subject.

As for wages, the Government set them for personnel in its economic sectors but kept them open for workers in the private sector and did not attempt to intervene except to ensure adherence to the minimum wage laws of the country. The same applied to commodity pricing; those commodities that the Government handled were subject to price control, while others were left to the private sector to determine, in accordance with supply and demand in the open market. The policy of the Government was generally one of competition with the private sector, except in the major consumer goods mentioned earlier, whether basic, such as food, or nonbasic but in high demand, such as automobiles, or for construction, such as cement; these commodities were subject to strict price controls.

Perhaps the most significant aspect of this period, as far as in-

[44]See Ministry of Planning, Central Statistical Organization, *Annual Abstract of Statistics, 1974*, Table (145), p. 209.

[45]Ministry of Planning, *The Provisional Detailed Framework*, pp. 196–98.

[46]Ibid., Table (75), p. 197.

vestment policy is concerned, is the shift toward making the public sector the leading sector in the economy in general, and in investment in particular. The 1964 decisions to nationalize were a turning point toward that end. The share of the public sector in gross fixed domestic capital formation rose from 56.2 percent in 1963 to 63 percent in 1964, even though it subsequently declined to 57.5 percent in 1969; the percentage share of the private sector, on the other hand, rose from 37 percent in 1964 to 42.5 percent in 1969.[47]

The decade of the seventies was characterized by a very aggressive government investment policy. Development spending increased to an extent that overwhelmed the limited production capacities available and the inelastic supply of goods and services; its utilization increased, leading to greater scarcity in available manpower and the large-scale import of Arab and non-Arab labor. This increase was particularly noticeable in the second half of the seventies, especially from 1977 onward. There were signs of shortages in labor and commodities in the services sector (for example, transport), building materials, and infrastructure, where scarcity in services cannot be met by imports from abroad. The interplay of these factors led to increasing costs, wages, and prices. The growth in personal income contributed, which in turn led to greater demand and persistent pressure on prices, compelling the Government to intervene to curb inflation through subsidies or through price determination, fixing, and control policies for most goods and services. Residential and office rents were fixed, as were transportation fares, medical fees, and tourism fares. Prices were set for essential consumer goods, primary materials, and production requirements, in addition to quasi-essential commodities. Luxury commodities were left to the open market. The prices of essential commodities could not be manipulated by the authorities concerned, while an increase in prices of quasi-essential commodities by up to 10 percent was permissible provided prior approval from those authorities was obtained.

It is important to note that this price policy could not establish industrial commodity prices in the private sector in a sound or accurate manner owing to the absence of the unified cost accounting system in the sector's projects. Moreover, the policy was com-

[47]Ibid., pp. 115–17.

mitted to a standardized profit margin for all similar products irrespective of differences in quality. Also, keeping luxury items open to market pricing mechanisms encouraged the private sector to invest in such industries instead of in centrally priced essential commodities.

The Government did not try to intervene in wages, except in setting the minimum, which it continually tried to raise as prices and inflationary pressures have been climbing since the mid-seventies. The purpose was to improve the standard of living of the working class. As of 1974, the Government provided its workers and employees with basic increases in wages and salaries in a bid to increase purchasing power. The precedent was actually set by the private sector, which had increased its wages, impelling the Government to improve its workers' wages to keep up. This step may have contributed to narrowing the gap between wage incomes.

The Government continued to adhere to its trade and protectionist policies, whether through customs duties or by adopting a quota system. High import duties were imposed on consumer goods while customs duties on capital and intermediate goods remained moderate, thus encouraging private sector expansion of consumer industries and the application of capital-intensive, creative production measures, given the scarcity of labor in the latter half of the seventies. The quantitative protectionism, or quota system, was more effective in protecting national industries, which increased substantially the number of commodities prone to protection during the seventies in comparison with the previous decade.

The Government also subsidized exports through a subsidy fund and through a customs reimbursement scheme for duties imposed on inputs that went into the production of export commodities, to help make them competitive with similar foreign commodities.

However, it is an accepted fact that excessive and prolonged protectionism undermines healthy competition between domestic and foreign commodities. It also reduces the efficiency of domestic projects and prevents them from attaining economic maturity, leading to expansions that have no market basis. This creates (a) a surplus production capacity that adds to the costs of their output and makes them uneconomical; (b) a wastage of resources, and thus the imposition of high prices that the consumer has to bear;

(c) the production of commodities of inferior quality; and (d) the emergence of monopolies and the disappearance of healthy competition.

On the other hand, the financial policy pursued tended to encourage private investment in various productive fields, especially those that hitherto discouraged private capital flows because of the risks involved, the paucity of anticipated profits, or reluctance to invest in specific geographic locations. As a result, legislation was enacted that exempted industrial projects from certain taxes and customs duties that either added to the costs of their output (such as taxes and duties on required inputs) or curbed their profits (income tax on profits). These exemptions were necessary for industrial projects whose production was directed to meeting domestic demand or exports, making their output competitive with foreign products, locally and abroad, since the exemptions reduced project costs and increased profits.

Monetary policy remained aggressive. This was true of the credit policies of the Bank of Mesopotamia, which was the sole commercial bank in the country, and of the industrial and agricultural credits that were extended by their respective banks. The same applied to the Real Estate Bank, which provided real estate credits very cheaply, on a large scale, and at low interest rates.

The Industrial Bank varied its interest rates according to region in a bid to encourage investment in areas that were less economically developed than the capital, Baghdad. Monetary authorities also tried to plan credits and establish an upper credit ceiling for borrowing sectors generally. Loans were highly concessional and soft. As a result, monetary expansion was large and domestic liquidity very high, including the liquid assets of the Bank of Mesopotamia.

Effectively, domestic and foreign public borrowing disappeared, thanks to abundant government funds from continued increases in oil revenues. For this reason as well, the Government enjoyed surpluses throughout the second half of the seventies. Its deposits in the Central Bank and the Bank of Mesopotamia increased, giving it a satisfactory financial standing. Because of its dominant position in the economy, the public sector received most of the commercial bank credits (about 75 percent) while it simultaneously increased its deposits in the Bank of Mesopotamia as a result of its substantial production and marketing activities.

What can be readily inferred from surveying the evolution of macroeconomic policy during the seventies is that it was generally aggressive, in both the oil and the non-oil sectors, and therefore high growth rates in GDP were realized. These rose from 7.7 percent during 1970–74 to 12.3 percent during 1976–80, and averaging 11.3 percent for the entire decade (1970–80) at 1975 prices. The manufacturing sector achieved a cumulative growth rate between 1970 and 1980 of just over 13 percent; agriculture grew extremely slowly during this period, at 1.4 percent, while growth in the oil sector reached 10 percent.

The per capita share of GDP, at 1975 prices, increased from ID 282.6 in 1970 to ID 356.2 in 1975, reaching ID 543.2 in 1980. As for fixed capital formation, its percentage share in GDP (again at 1975 prices) increased from 12.5 percent in 1970 to 25.9 percent in 1975, rising to 33 percent by 1980. The percentage share of the private sector in GDP, however, declined from 45.1 percent to 14 percent, then rose again to 21.7 percent, for the same three years.

All these figures reveal high growth rates, a substantial growth in capital formation, and an increasing dominance by the public sector over economic activity, in conjunction with the social imperatives of public authorities during the seventies. The same trends are evident in the contribution of the public sector to non-oil GDP, which rose from about 30.68 percent in 1968 to 43.7 percent in 1975 and reached 52.6 percent by 1980.[48] However, these figures also reflect the continued importance of the private sector in economic activity, which also increased (by about 47.4 percent), despite the expanded central role of the state in the economy.

During 1980–87, all macroeconomic policies were essentially aggressive, as the economy was transformed into a war economy. The aggressive nature of these policies was not surprising considering the extremely high costs of modern warfare. Invariably, these policies affected civilian investment, a substantial portion of which was redirected to supporting the military effort, which grew to an unprecedented level.

Among the first consequences of the war was a sharp drop in oil exports and revenues, impelling the Government to resort to domestic and foreign borrowing. At the same time, it tried to

[48]Ministry of Planning, Central Statistical Organization. *Annual Abstract of Statistics*, 1970–82.

revitalize oil production and exports by expanding production facilities and transferring oil by pipelines, which was accomplished. Oil exports increased in the later years, albeit at a much lower rate than at the start of the eighties. In another development, government spending was increased in all areas, especially the military, although social services also benefited and much was spent on construction of roads and buildings.

But the war also generated economic and financial problems. The oil sector retreated in both exports and prices, leading to the depletion of the country's foreign exchange and a reduced capacity to import or finance the growing public expenditures for both investment and consumption. The demand increased for domestic and foreign labor to operate productive projects and direct economic activity, which imposed greater financial burdens on the economy in general and on the balance of payments in particular.

The Government thus had to apply restrictive macroeconomic policy measures, whether in investment and consumption expenditures or in imports, while promoting increases in production and greater productivity in the public sector. At the same time, it sought to curb the relatively high rate of private consumption in a bid to mollify rising prices and limit the foreign debt burden.

Conclusions and Prospects

Perhaps the most important conclusion to be derived from this detailed study of the evolution of investment policy in Iraq over the past four decades is that oil was the cornerstone of this policy. It was and remains the principal source of investment financing and of the foreign exchange needed to finance the very large imports of capital goods that go into the country's development. It is clear from what has been discussed that economic development in Iraq was affected by developments on the oil scene—production, exports, and revenues. The rate of economic growth in the fifties increased when oil revenues increased, that is, following the fifty-fifty profit-sharing agreement negotiated with the foreign oil companies that operated in Iraq at that time. The same occurred in the mid-seventies, after the oil price adjustments and the nationalization of those foreign companies. Economic growth during the sixties declined, and this paralleled a recession in the oil sector that extended from the late fifties until the early seventies. The process is indicative of the close connection between oil revenues, investment, and noninvestment government expenditures, and the economic growth of Iraq.

GDP depended, and continues to depend, on oil production for the most part. The latter consistently made up a large percentage of the former, notwithstanding the decline of its contribution during the war years, which led to a proportionately higher share for non-oil economic sectors benefiting from the recycling of oil revenues in their direction by way of capital formation in these sectors. The relative decline in the contribution of oil was not so much due to significant growth in the other sectors as to the stagnation of exports and revenues because of the war and the recession that befell the advanced industrial countries at the turn of the eighties. Thus, growth in the non-oil sectors provides a more authentic picture of the condition of economic growth generally in Iraq than any debates over oil versus non-oil GDP growth.

The interplay of the oil factor, political change, and the social imperatives of the ruling party determined the size of investment, its form, and its direction in the various productive sectors. This study has described the evolution of investment policy side by side with the evolution of the forms of capital formation, sectoral and commodity. Perhaps the most important observation in this regard is that most of the accumulation was in the public sector, which suggests the importance of this sector for realizing investments based on oil revenues—which belong to the Government anyway. It is therefore not surprising to find public investment the principal source of capital formation specifically and of the country's economic development generally.

Large-scale and continuous development investment spending since the early fifties led to high growth rates for Iraq compared with other developing countries, whether in oil or non-oil. It also led to continuous improvements in per capita income and standard of living.

Having examined the changing imperatives of the Government in Iraq, we can attempt to forecast how trends will unfold in the nineties, other things being equal, including the social and political imperatives of this Government.

The public sector will continue to play a fundamental and leading role in the national economy by virtue of its size, while its relative importance will remain high even as its dominance over the economy is reduced. It is a necessity to a developing economy that continues to struggle for self-development under adverse external conditions and difficult internal economic conditions owing to the war, the country's foreign debt, and declining growth in oil exports.

Because of the continued relative importance of the public sector, government investment policies will still have a major impact on the country's development, in terms of volume of investment, sectoral assignments, and regional trends, and also because the oil sector remains central for financing development. Although domestic sources of financing will probably increase, they will remain limited in comparison with oil.

As the tacit assumption of unlimited financing for the country's development proved erroneous, and with the realization that unqualified dependence on oil export revenues is also a mistake, investment policies will tend to become more conservative in terms of investment volume, especially when the limits of absorptive capacity are taken into consideration.

The inclination will be toward horizontal expansion in the public sector, with greater attention being given to productive, financial, and administrative efficiency, to the rationalization of economic resources, and to reducing wastage of scarce resources through irrational or economically unjustified use. Also, public projects will most likely acquire greater freedom in the management of their resources, output direction, and product pricing.

An inclination now exists to deregulate prices, and this trend will probably continue into the next decade. However, the Government's role of monitoring from a distance will remain, to curb any economically unjustified price increases.

The private sector will be permitted a greater role in economic resource investment and will be given all forms of support and material and financial facilities. This will provide the banking sector with an opportunity to play a more active part in domestic investment financing, its management, and support.

Economic feasibility studies of projects will command greater attention and will preclude implementation; projects will also be examined for the efficiency of their performance.

We anticipate the devotion of greater attention to sectoral linkages and the forward and backward linkages of proposed projects in each sector.

We also anticipate revived interest in the agricultural sector because of its extreme importance as a food source, and in the prevention of bottlenecks in that sector. Its allocated investments will grow, and emphasis will be placed on efficient implementation and on preventing wastage in actual investment expenditures. However, we expect the development of the industrial sector and improvements in infrastructure to continue to command attention by virtue of their importance to development, and their sectoral investment allocations will therefore remain high.

Greater attention will be given to cultivating talents and scientific and managerial expertise and to developing middle management; emphasis on administrative efficiency will be placed above any other requirements unrelated to the effective and competent management of projects.

However, against these optimistic future projections, several qualifying conditions must be kept in mind:

First, Iraqi markets are characterized by either a general absence of competition in certain specific productive sectors or very limited competition. At best, the prevailing market situation is one of a few monopolies. Not even monopoly competition exists in the true sense of the word. What does exist is a sellers' market over which the sellers have clear control and with abundant liquidity among many social groups. This situation, along with large government spending, will inevitably lead to large increases in prices. Increases occur after the cancellation of price setting for many commodities, leading to high inflation in agricultural commodity prices in particular and in a very short time (no more than a few weeks), forcing the Government to return to pricing certain popular agricultural consumer goods.

Second, the primacy of the profit motive in the private sector contributes to this factor and is more important than the trend toward greater investment or consideration of the social or political consequences that may ensue. Thus, the private sector's preoccupation with limitless profit and short-term financial (rather than economic) returns will shape society's position (and that of the state in particular) toward that sector in future.

Third, a real risk of distortions exists in pricing and resource assignment if the two-tier system continues in the public and private sectors. This problem must be addressed, for it will definitely erode the effectiveness of the price system, whether in the unregulated private sector or the regulated public sector.

Fourth, unqualified deregulation of prices leads to galloping inflation under conditions of postwar scarcity. It will be difficult to curb that inflation without government intervention, so that a certain measure of government monitoring of prices will be needed.

Fifth, continued adherence to an aggressive investment policy, without limit, can only aggravate these inflationary pressures and increase demand for both domestic and imported goods and services. This will increase the domestic and foreign deficits as well as the external debt, leading to a drawdown on foreign financial reserves, a deterioration of the actual and effective exchange rate of the dinar, reduced exports, stagnation of domestic liquidity and therefore domestic demand, and so on.

All of these require the adoption of a highly conservative investment policy for the coming decade.

Last, but certainly not least, is the danger of continued dependence on oil, its exports, and revenues. This danger and its negative consequences will remain with us as long as macroeconomic policies fail to emphasize the development of domestic economic resources as the basis for development, thereby minimizing the contribution of oil by developing other, non-oil sectors in the national economy.

Comment

Abdel Wahed Al-Makhzoumi

I would like at the outset to express my appreciation for this good study, which dealt with investment policy in Iraq over a period of close to four decades. Its treatment of the subject was organized and logically sequenced, which enabled the reader to get a clear idea of the message that the writer wanted to convey. I believe that a critique of this study will not be easy by any means, since I agree with most of the points raised in it. I agree in particular with the following points:

- That the revenues from oil exports were the mainstay during that period as a source of financing that investment policy, and they constituted a primary source of foreign exchange needed for the purchase of capital goods and for other development expenses that must be paid in foreign exchange to agencies implementing the investment projects.
- That the growth of the economic sectors, other than crude oil extraction and exports, reflected changes in those sectors during the period covered better than the overall growth rate of gross domestic product (GDP) (oil and nonoil). Isolating the impact of the crude oil sector, with its sharp fluctuations and high share in GDP, would give a clear picture of developments in other sectors of the economy.
- The author succeeded in highlighting the interaction and the interdependence during that period between oil and oil export revenues on the one hand, and political changes, social orientation, and ideologies of the ruling party on the other, and how they determined the size, pattern, and direction of investment. The investment policy of the Development Board in the fifties was conservative, implementation was low, and there was an ongoing emphasis on investments in the agricultural sector, mainly to satisfy the Development Board regarding its list of investment projects. There was a clear tendency toward involving the private sector in joint ventures with the Government in the industrial sector. This orientation

changed in the seventies to central planning; the diagnosis of obstacles to development; the specification of resources and potentialities and general development objectives; a shift of emphasis to the industrial sector; and high implementation rates. New sources of investment financing were sought, both domestic and foreign, including foreign borrowing that began with the Five-Year Plan 1961–65, and the pursuit of following what the author called a shock development strategy.

The author dealt with the investment policy in Iraq in that period in an objective manner. He is not an advocate of any policy followed during the period under consideration nor is he among those writers who sharply oppose any of these policies in such a way that their conclusions are clear from the outset. He presents faithfully what he knows, and in a manner that helps the reader understand the circumstances and the economic and noneconomic factors that had a clear impact on determining the form, content, size, and direction of investment policy in Iraq.

The evidence used in the intertemporal comparisons of annual growth rates and sectoral contributions to economic development is derived from the estimated figures of GDP growth rates and national income in Iraq, in real terms and in current prices during the period 1950–87. Because of the statistical situation in Iraq during that period, caution should be exercised in using these figures as regards the accuracy and comparability of some of them. They were prepared by various agencies and persons. Some were prepared based on different concepts and were modified to fit into a time series with earlier estimates; others were revised or re-estimated by the same agency or by others.[1]

Regarding foreign investments in Iraq—excluding Arab investments—there were no direct investments following the Revolutionary Command Council's Decision No. 1646 of November 1, 1980, which decreed the liquidation of foreign participation in the capital of private companies in Iraq within a year. Arab nationals are not considered foreigners. But there are facilities for temporary investments accompanying the implementation of projects by foreign companies in Iraq.

[1]For more information, see "Development of National Income Statistics in Iraq," prepared by Abdel Hussein Zeini, published by the Baghdad Chamber of Commerce (1973).

The effects of macroeconomic policies in Iraq, as a developing country, were not different from those in most developing countries. However, financial policy, especially government spending, played a leading role, and the economy was open to the outside world to satisfy domestic demand depending on the availability of foreign exchange.

If I may add some remarks and ideas, the first thing that came to my mind was that the study needed a brief presentation of the methods followed by the planning bodies in investment planning in Iraq during the period under consideration, how the plans were prepared and finalized, the effects of changes in the plans (which were relatively many), and the extent to which planned objectives were achieved. Such a presentation would have added to the study's usefulness and would have been a summary of excerpts from various parts of it.

I expected also to find a comparison of forecasts or objectives of the various investment plans and the achievements realized. Such a comparison would usually take the form of comparative tables or charts showing GNP and the other major national account aggregates (normally agriculture, manufacturing industries, and other sectors). They would have shown the degree of realism in setting objectives and the benefits derived from the planning experience over the years.

With regard to the method of presenting the figures included in the text, and recognizing the difficulty of obtaining figures on the Iraqi economy in the form and detail necessary to present them suitably, I did not feel that my distinguished colleague established a base and then followed it.

The author leads us through an experiment in investment planning based on what was written about these plans and programs, or on laws and regulations that defined their powers and concepts, and on published results. We notice from this survey that an attempt was made to control government development spending through development programs during the period 1950–58. This attempt, which was disrupted by a political change, was characterized by centralized planning and implementation of government investment spending. After 1959, there was a period of centralized planning and decentralized implementation. After the enactment of the Planning Board Law of 1966, there was overall economic planning, which was not limited to economic aspects but extended to coordinating economic, monetary, and trade policies, evaluating the draft of the annual state budget, and guiding private sector activities to ensure that they conformed to development plan objectives. This development took place after foreign borrowing emerged as a new source of investment finance in the 1961–65 plan, and the attempt to link plan projects to the objectives of Arab economic integration, and to coordinate (at the macroeconomic level) the investment policy with the financial, monetary, credit, trade, and wage policies for the first time in the 1965–69 plan. The development plans covering the period 1965–80 were established in the light of different political and economic developments, social orientations that differed from what went before, and favoritism, which left a clear impact on the size of investments and on the nature and direction of the investment policy. Reading the study, however, it is not easy to find a clear itemization of the outcome of all of these developments, whether they produced the essential results and in which direction, and the extent to which objectives were realized. I am confident that careful investigation will yield positive results.