

Observations on Iraqi Resource Allocation.

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The situation in Iraq is complex and confused in all aspects; institutional, political, economic and public administration.

The absence of accountability and chaotic economic management coupled with weak governance and dysfunctional organizational arrangements play a major part in the decline that the Iraqis experience today.

All these were, in part, the result of dividing Iraqi citizens into groups based on ethnicity, religion and sects, with sub groups within these categories competing to benefit themselves by directing state resources for their own benefit, rather than that of the whole population.

In this contribution we will focus on one aspect; Public Finance and Budgeting, taking into consideration the structure and characteristics of the Iraqi economy.

The dominant role that revenue generated in the oil sector plays in financing government activities in Iraq is well recognised. No other significant alternative financial resource exists. The nature of the oil sector is, however, an enclave sector, characterised by weak forward (production) as well as backward (consumption) linkages with the rest of the economy, making the role of the oil sector for inducing or leading the overall development process in Iraq neither direct nor spontaneous.

Given this factor, a need has arisen for an alternative means which can be used to compensate for this lack of strong interaction between the oil and non-oil parts of the economy.

One way to achieve this is by employing the government budget as a medium to spread the development which has taken place in the oil sector across other sectors of the economy. As such, the government budget is thus seen to play a dual role.

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Firstly, as a means by which developments in the oil sector are directed to induce and facilitate the development of other sectors in the economy and secondly, as an instrument for economic stabilisation and development policies.

Both these roles cannot be successfully carried out unless two conditions are met.

Firstly, the willingness of the government to transmit the oil sector development into other sectors, by making the revenue gained from oil exports available for the financing of the development of other sectors. In other words, financing budget allocation.

Secondly, this willingness must be matched by the ability to spend in an efficient and productive way, i.e. proper and well thought out methods of allocation.

Characteristics of the Iraqi Economy

In a country like Iraq, the environment is somewhat different from what we have seen in previous studies of other countries. These differences are summarised as follows:

1. Government assumes direct ownership of the major financial resource generating facilities, namely oil production and export facilities.
2. Oil revenue received directly by government produces in the first instance, merely a rise in government bank deposits. It is only when government injects them into the domestic income streams that the impact of this revenue is generated.
3. It follows from (2) that government expenditure is the main financial linkage between the oil sector and the rest of the economy. Under the existing arrangement, oil revenues are automatically neutralised and do not have any effect on the economy until they are disbursed through government budgets. This exogenous nature of oil revenue and the institutional arrangement of revenue receipts and their utilisation makes the Iraqi economy different from other primary commodity exporting countries. In other countries production facilities are in the hands of the

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private sector, in which case the problems of monetary stabilisation which do arise are confronted. In the case of Iraq, however, government can manipulate its expenditures to prevent such problems from happening.

- 4 Leakage in the form of taxes is negligible if it exists at all.

Such specific characteristics of the Iraqi economy will influence, to a large extent, the structure of models that can be developed.

This paper argues that given the important role of the government budget and the size of its impact on the macro and micro levels of the economy, one might expect that during the last period and, as a result of the large sums spent by government, that the outcome could have been one of a high rate of growth and real structural development. That such an outcome could not only be achieved but could also be sustained in the future without very much reliance on a similar high level of future government expenditure.

The current economic situation is mainly a consequence of past undue spending policies. During the past period, budgets have always deviated from plan in such a way that actual expenditure far exceeded its planned level and, in many instances, was different from the planned structure. T

he concentration on high consumption is one example of such a deviation from the planned sectoral and functional structure of spending. Such changes could influence the private sector's attitude by investing heavily in areas like trade. This could lead to an increase in the supply of such activities to a level higher than the market required and negatively influence investment in industrial and other productive projects.

The failure to achieve improvements in the economy is partly related to the current unstable environment. However, the most important factors are related to the weakness and vagueness of the administrative arrangement of government organisation and the process of budgetary planning and control system such as:

1. Lack of clarification and delineating the responsibility of the central and local government. This stems from the confusion between federal and

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decentralised structures of the state organisation. This will lead to a distortion in the authorisation and accountability arrangements that are necessary for good performance;

2. Weak and limited skill capacity to plan and manage the economic resources by linking budgeting to development planning;
3. Government budgeting during the previous years has done very little to add to the development of the different aspects of the economy. There seems to be very little that has been done to achieve any improvement in the economy. This is because policies of allocation during the previous years were biased towards a short-term rather than a long-term strategic framework;
4. Budget expenditures include a large proportion allocated to purposes which neither serve to promote investment nor development. Rather, they provide an ad hoc assistance used to create pseudo-structural change. The existence of which may hinder the achievement of the required real and sustainable structural transformation.
5. The experience of the previous years show that budget allocation decisions are made without due regard to a planned target. This, in itself, is a serious point since this lack of harmony often causes hesitation in the market as to which aspiration to follow- that of the plan or that of the budget;
6. The allocations made during past periods were made without the knowledge of either the nature or the size of the interaction between the different categories of expenditure (type or function) and the various sectors in the economy. This has resulted in a disparity between both the level of expenditure and the level of sectoral development requirement.
7. The state of the limited skill capacity of the economy indicates that a higher level of expenditure is not necessarily always desirable. On the contrary, it may create a situation where unnecessary projects are undertaken irrespective of their economic or social viability;
8. Government expenditure levels of past periods have created a pattern of activities which have relied heavily on the importation of material for its implementation and operation. This, apart from social side effects, has left its

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mark on the characteristic and magnitude of the Iraqi development. Through keeping development within the capacity of indigenous resources, especially manpower, with some degree of foreign supply, the process could evolve smoothly without the experiences of the past. Moreover, it would have reduced the leakage out of the economy by reducing the size of imports.

The way forward

The most important cause of the decline in economic structural development and activity is the lack of effective allocation of government expenditure and the inability of the private sector to offset this effect.

In order to prevent a further deepening of the problem some adjustment in the size and the composition (pattern of allocation) of the budget may be warranted. Measures to that effect may take one of two forms: rationalisation of expenditure or mobilisation of additional skills to reshape the economic management of the country.

Rationalisation of expenditures would comprise a restructuring and reprioritisation of public expenditure. This could mean the elimination of unproductive and wasteful spending, a reduction of unnecessary subsidies on various goods and services and a review of the enormous amount of government expenditure on public administration. In addition, an elaborate cost-benefit analysis or value for money audit may be undertaken to ensure the optimal spending policy.

While economic efficiency is an appropriate criteria for resource allocation, in spending money to maximise the benefits to and from the private sector a higher weighting should be given to those sectors which have long-term prospects, strategic importance and wider linkages in the economy, i.e. those having the maximum impact multiplier.

Government should adopt a declared stable budgetary policy. This is most important from the point of view of the private sector since it eliminates speculation and reduces uncertainty in private sector planning. Such an adjustment would be more effective if carried out within the long term development planning framework.

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Measures to raise additional government revenue, so as to reduce the effects of uncertain oil revenues and increase budget allocations, could include a wide range of tax and non-tax measures. The latter may be the easiest for government to administer, at least in the short-run. All that needs to be done is to rationalise subsidies and put a price on goods and services that are currently provided by government.

Of course, tax and non-tax measures have to be studied and evaluated in the light of the government's commitment to raising the standard of living.

The essence of the new situation is that, despite (and because of) the inefficiency in government expenditures more is now required from the private sector, as a parallel force shaping the economy than ever before. The most adequate measure is, therefore, for the government to improve the efficiency and effectiveness of its support to this sector. To this end, several steps could be taken.

First, new incentive schemes for the private sector are needed in order to make them more sensitive to the scale of private commitment, to the marketing risk involved and also, to the developmental priorities. Most of these are possible and can be administered easily. Technically they require a recalibration of the existing system of incentives together with the appropriate priority ranking for the nature of activities concerned.

Second, for domestic developments a sector by sector review of private investment intentions, market potential, technology transfer requirement and financing possibilities will have to be carried out as a joint government and private sector exercise. Special attention should be given to those sectors (or activities) which promise a growth potential and substantial linkage effects such as those sectors with high impacts for example, agricultural processing, secondary petro-chemicals etc.

Thirdly, a serious problem facing businesses is the lack of adequate information on the local market to enable a decision maker to make the correct decision. Businesses wishing to enter into new fields have difficulty in identifying, for example, the size of government purchases of various goods and services, future

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prospects for government spending in areas of relevance and other market information.

Often such information is available but is of a poor quality. An adequate policy should, therefore, be derived regarding the process of making public information more of value and of relevance to the making of sound decisions.

Final remarks

A framework of budget preparation and implementation such as the one suggested above will no doubt entail fulfilling certain requirements, some of which are structural and relate to the organisational arrangement of government agencies involved in the budgetary system.

This calls for a delineation of responsibility and authorisation between central and local government.

Other requirements are operational and relate to the skill capacity of government officials.

For this to end, capacity enhancing programmes should be undertaken and utilise the skills of Iraqi development experts who are involved with International organisations such as the World Bank, IMF and UNDP, rather than foreign consultants who have no real understanding for the socio-economic and cultural environment of Iraq.

Government will need to initiate a strong regulatory framework that nurtures good governance to avoid the abuse of public office for private gain. In order for this to be achieved, strong external accountability and control systems are required to deter such malpractice which was, beside environmental uncertainty, the cause for not achieving the intended objectives.

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