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Iraq: Economic Reform Falls Short of Expectations [redacted]

Iraq's economic reform program has helped but far from cured its economic problems. The reform measures have improved the availability of consumer goods, boosted efficiency in the public sector, and raised the competency of Iraqi economic leaders and managers. Widespread discontent over rising inflation and the private sector's reluctance to invest in the country's economy, however, have slowed the pace of liberalization and limited its impact. Baghdad plans further reforms, but they are unlikely to be broad enough to help the economy significantly, especially given President Saddam Husayn's penchant for maintaining tight control. The economy remains heavily dependent on the state-controlled oil sector, and prospects for a large rise in oil revenues during the next few years are slim. [redacted]

Motivations for Reform

Serious economic problems that threatened Iraq's staying power in the war with Iran prompted Baghdad in 1987 to adopt its most sweeping economic reforms since nationalization in 1964. After pursuing a "guns-and-butter" policy that drained its financial resources in the early years of the war, Iraq in 1983 adopted strict austerity measures and began borrowing heavily from foreign governments and banks. Baghdad's financial situation reached a crisis point in 1986 when low world oil prices depressed revenues and large debt payments fell due. Iraq's inability to service its debt caused most lenders to cut off credit lines to Baghdad and forced the regime to adopt even more austere measures. The following year Iraq launched a program to liberalize its socialist economy—despite opposition from some Ba'th Party leaders—because of the urgency of its economic problems and strong support from President Saddam Husayn. [redacted]

Reform Measures Since Early 1987

Public-Sector Restructuring. Iraq initially focused on increasing efficiency in the bloated public sector. The regime shrank, merged, and eliminated economic organizations at all levels, including the ministerial level. State organizations—a bureaucratic layer between ministries and state enterprises—were abolished, giving the enterprises more autonomy. The regime closed most unprofitable enterprises. [redacted]

Baghdad repealed its labor law, which had guaranteed employment for all Iraqis, allowing state enterprises to transfer and release employees. Western press reports indicate the government gave thousands of civil servants the option of resigning without penalty or accepting new public- sector jobs, often as lower-status factory workers. Iraq also introduced incentives for public-sector employees, including profit sharing and productivity bonuses. [redacted]

Privatization. Iraq has concentrated since 1987 on encouraging private-sector involvement in the economy. Press reports indicate Baghdad has offered at least 100 businesses and land parcels for sale, mostly in the agriculture, light industry, and service sectors. The government has also sold shares of public-sector industries to the private sector and increased the share of private ownership allowed in mixed companies from 49 percent to 75 percent. [redacted]

New Foreign Exchange, Trade, and Investment Regulations. To promote exports and private-sector imports, the regime revised regulations to allow exporters to retain 40 percent of their foreign exchange earnings to buy imports instead of converting them into Iraqi dinars, according to press reports. In addition, imports bought with foreign exchange held outside Iraqi banks are no longer subject to quotas under the annual foreign trade plan. The regime also allocated the private sector a higher share of import licenses under the plan. [redacted]

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Iraq introduced new incentives to encourage private investment, including a 10-year tax holiday for private industrial enterprises and the opening of some markets to the private sector without public-sector competition. Baghdad passed its first foreign investment law in 1988 to expand opportunities for non-Iraqi Arab investment. Iraq offers especially favorable incentives for Arab investments exceeding 500,000 Iraqi dinars, including profit repatriation of 20 percent of the original investment per year, partial income tax exemption, exclusion of output from price controls, and cancellation of import taxes on inputs.[1] [redacted]

New Economic Leadership. To implement Iraq's new economic policies, Saddam brought in many experienced, often Western-educated technocrats in 1987 to replace less qualified Ba'th Party ideologues in key economic positions. Saddam transferred several of these technocrats from the President's Office, where he had apparently been grooming them. Saddam also expanded the size and authority of the President's Office to increase his control of economic affairs. [redacted]

Limited Impact of Reforms

The reform program has had positive results, but they have generally fallen short of Baghdad's expectations. The most noticeable effect has been on supplies and prices of consumer goods. Privatization of the agricultural sector and the removal of many agricultural price controls have caused supplies of locally produced fruits, vegetables, certain meats, and eggs to increase greatly since 1987. More luxury goods have also become available, especially since the cease-fire with Iran last year, as private businessmen have used foreign exchange held in offshore accounts to import consumer goods, according to press reports. [redacted]

Despite greater supplies, prices of consumer goods have risen sharply, especially since the cease-fire, as the Iraqi populace boosted spending to meet pent-up

[1] One Iraqi dinar equals US $3.22 at the official exchange rate and roughly US $.50 at the black-market exchange rate. [redacted]

Modest Imp ... ons for US-Iraqi Economic Relations

The greater ... of Western-educated technocrats in Iraqi econo ... ecision making will probably contribute ... ter US-Iraqi commercial ties. US-Iraqi trade ... ncreased significantly in recent years because of ... acquisition of US agricultural credits, its ... regard for US technology, and its strong des ... improve bilateral relations. Foreign exchange ... ges, however, will limit further large increases ... qi purchases of US goods and services unless US ... s provide financing. Baghdad's likely continued ... on non-Arab foreign investment will restrict in ... nent opportunities.[redacted]

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