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### Iraqi Public Investment Priorities to Accelerate Growth of Agriculture

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## #4

### Iraqi Public Investment Priorities to Accelerate Growth of Agriculture

#### **DISCLAIMER**

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# Iraqi Public Investment Priorities to Accelerate Growth of Agriculture

This paper suggests some priority public sector investments that can stimulate improved competitiveness of Iraqi agriculture while avoiding the more severe economic distortions occasionally caused by current input and output subsidies.

Agricultural production decisions in Iraq are, at best, weakly linked to market signals and comparative advantage. Small farmers make production decisions largely based on subsistence needs (instead of on enterprise profitability), while commercial farmers seek to minimize financial risks through rent-seeking, thus make production investment decisions largely based on access to public subsidies and guaranteed markets. Past and current public subsidies to agriculture expose little relationship to Iraqi comparative advantage and resource use efficiency criteria, thus exacerbating inefficient resource utilization by farmers.

Appropriately targeted public sector infrastructure investments can reduce business uncertainties. Reducing uncertainty encourages farmers and other agribusinesses to make production investment decisions based on comparative advantages and market signals. This in turn improves resource use efficiency, competitiveness and profit potential. Additionally, in an oil-rich economy such as Iraq, provision of certain types of public infrastructure and other public goods and services (e.g., grid electricity, irrigation infrastructure and water delivery systems, etc.) is a legitimate social overhead function. And if this type of subsidy eventually is made available to all productive sectors and sub-sectors, it does not unduly distort cost structures.

Examples of such investments are:

1. Irrigation system rehabilitation that stabilizes an optimum reliable irrigation water supply to presently cultivated agricultural land. These investments need to be accompanied by a long term commitment between the public water authority and farmers of a rehabilitated irrigation command area to respect the economics of production. This can be achieved by agreeing to a cropping plan that optimizes economic returns to water and other factors of production, based on criteria of comparative advantage and market signals.
2. Investment in an irrigation system serving land not suffering from salinity problems, can achieve an output response from one season to the next. On the other hand, land reclamation investments to combat salinity have a longer term payoff. Additionally, reclamation investments usually are

more expensive per unit of land reclaimed. Additionally, often for no or low-salinity land now being cultivated (or in rotation fallow), a significant part of the work can be carried out largely with hand labor, thus providing much-needed employment.

3. Electricity infrastructure to guarantee 24/7 grid electricity to agribusinesses (and other productive enterprises) at competitive prices. Public funds can also provide interim solutions (such as non-grid temporary supply) subsidized to equate to grid prices.
4. Reinforce current policies to provide fuel to appropriate agribusinesses on a priority basis at a favorable price (in the longer run, to be equalized with other productive sectors),
5. Infrastructure necessary to supply reliable potable water to agro-industries that require it (and later, to all productive sectors).

The level of subsidies referred to above should be equated to similar subsidies of regional competitors in a way to approximate a “level playing field” for Iraqi agriculture. To be effective, the public investment priorities specified above must be accompanied by appropriate operational policy changes. Such changes can be expected to lead to increased investments by private sector entrepreneurs in commercial farming operations and in other agribusiness enterprises throughout selected product value chains. As competitiveness improves, subsidy levels can be phased downward. Some of the more urgent complementary operational policy changes needed are summarized in other essays of the agricultural policy dialogue series.

Other interim public sector investments to consider can be designed to accelerate the pace of private sector investment in competitive product value chain activities. Such investments can offset depressed economic conditions caused by years of public sector mismanagement, and/or can offset continuing non-commercial business risks faced by Iraqi agribusinesses.

For example, a venture capital fund might be constituted and administered under a trust arrangement (with an international financial institution to facilitate effective management). Such a trust fund would share with private sector investors the provision of at-risk capital to establish or to rehabilitate commercial farming operations and other agribusinesses. Such risk-sharing public-private partnerships can offset non-commercial risks encountered by a new or rehabilitated enterprise. Under existing conditions in Iraq, these may include high security risks, high transaction costs due to weak or broken linkages in value chains, uncertainty and unusual difficulties in obtaining a reliable supply of inputs at a competitive cost, unreliable energy supplies, etc. Several options can be explored as to trustee participation in

management of assisted enterprises, final disposition of venture capital investments, and other operational aspects of such a trust fund.

Investment in improving the knowledge and skills of production and other agribusiness enterprise workers and managers also is a legitimate public sector function. Public sector investments that provide operating subsidies, other than those for irrigation and potable water, electricity and fuel mentioned above, inevitably result in economic distortions and inefficiencies in the use of agricultural factors of production. Such distortions and inefficiencies reduce competitiveness, profitability and growth potential. Additionally, such inefficiencies negatively impact the general welfare of Iraqi citizens through decreased consumer welfare.