

## Privatization of State-Owned Enterprises

### Executive Summary

*“The objective of this initiative is to improve the level of the public companies as firms operating on purely economic principles and turn into real self-financing institutions and not firms that depend on direct or indirect government subsidy.” (White Paper, 2020, p. 60)*

Industrial production in Iraq is dominated by 176 state-owned enterprises (SOEs) that tend to be high-cost, low-quality producers. Not only are they the leading providers of essential services such as electricity and water but also SOEs account for a large proportion of all consumer goods and industrial inputs. Further reflecting their major impact on the country, SOEs are, collectively, the largest employers after the national government with an estimated 600 000 persons on their payrolls. Since Iraq is experiencing high levels of unemployment and underemployment, providing jobs is usually considered the greatest advantage of SOE.

Unfortunately, SOE retard Iraq’s economic development for at least six reasons. First, they tend to be low-quality/high-cost producers resulting in consumers paying too much and receiving too little. Second, even with massive direct and indirect subsidies, almost 80% of are unprofitable. As a result, maintaining SOE is a large fiscal burden that reduces funds available for needed investment in critical sectors such as the provision of essential services. Third, SOE suffer from massive overemployment which is a waste of the country’s human talent. Fourth, SOE tend to increase the costs and reduce the efficiencies of private firms that are either upstream or downstream of the SOE. This limits the possibilities of private sector growth in employment. Fifth, as is true in other countries, SOE tend to cause more damage to the environment thorough pollution than private sector firms in the same industry. Finally, with few exceptions, each SOE is controlled by a political party as a source of jobs and funds for party loyalists. This not only facilitates corruption but also is politically destabilizing.

Maximizing the benefit to the Iraqi people of SOE privatization will be challenging and will require careful planning and deliberate execution. To increase the likelihood of successful privatization/liquidation, this paper proposes a four-step process.

First, create a consensus on the characteristics of a successful privatization/liquidation. These include reducing the current excessive fiscal burden of SOE, encouraging diversification from oil dependency, and, probably most important, ensuring that SOE privatization/liquidation doesn’t result in a substantial increase in unemployment and underemployment.

Second, create the proper policy and political environment. The politics of SOE privatization/liquidation is complex. And yet, without support by the country’s political leadership, rationalization of SOE will fail. The most important GoI action is for the Council of Representatives to pass a comprehensive privatization/liquidation law. As discussed in detail in this paper, this law should establish two organization: a high-level committee chaired by the PM and a committee of technocrats who will be responsible for developing the specific privatization/liquidation process.

Third, carefully plan and execute SOE privatization/liquidation. Key to creating support for privatization/liquidation and constraining corruption are transparency and accountability. The process of classifying SOE firms into “Successful” companies to be privatized, “Troubled” companies to be restructured, and “Failed” companies to be liquidated must be based on clear standards applied in a transparent manner. Preventing a substantial rise in unemployment and

underemployment especially among young men will require both political will and substantial changes to Iraq's education and labor markets.

Finally, act to improve the chances of success of newly privatized SOE. The two highest barriers to success for private businesses in Iraq are the difficulties of obtaining finance and dealing with the complicated and bureaucratic regulatory system. Increasing access to finance and rationalizing regulation will, of course, not only increase the likelihood of success of newly privatized SOE but also help diversify Iraq from oil dependency.

For almost two decades, progress in SOE privatization/liquidation was caught on the horns of a dilemma. When oil prices are low, as in 2020, the need for diversification from oil, the necessity of invigorating the private sector, is clear. However, low oil export earnings mean a dearth of funds for restructuring SOE. However, when oil prices are high, as in the last quarter of 2021 and the first quarter of 2022; increased oil export revenues reduce the incentive for radical change. In other words, when oil prices are low there is the political will but no fiscal resources. And when oil prices are high there are fiscal resources but little political will. In order to create the necessary conditions for increased long-term economic prosperity and accompanying political stability, the country's leadership must be willing to accept the short-term political cost of privatizing/liquidating SOE.