

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 enterprises¹ (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.

¹ Legal definition of State-Owned Enterprise in Iraq: A public company is a “self-funded economic unit which is fully owned by the state, has a legal personality, financially and economically independent, and operates according to economic basis.” *Amended Public Companies Law No. 22 (1997)* Note that public-private joint ventures are not considered public companies.

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.

Call for Action

White Paper (2020) on Restructuring State-Owned Enterprises

“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, pp. 60-61) There are six important issues that were specifically cited in the *White Paper*.

1. **“Enacting a law for restructuring public companies**, transforming them into private companies and subsidiary companies, organizing their incorporation, operation, management, liquidation, and bankruptcy, in the same way as applicable to private sector companies, and applying management accountability over their performance.”
2. **“Collecting the most recent financial data** for all public companies by the Economic Reform Unit within the Prime Minister's Office in order to conduct an integrated analysis of the financial situation of these companies to get a clear image about their business and effectiveness, and to assess their viability.”
3. **“Classifying Public Companies** as *“Successful Companies”* to be totally or partially privatized or converted into mixed joint-stock companies, *“Troubled Companies”* to be restructured and transformed into successful companies within three years, *“Failed Companies”* to be liquidated.”
4. “Implement a program by Ministry of Finance to **phase out the financial support** provided to the public companies at an annual rate of (30%) up to 2024 when all public companies become fully self-financed.”
5. “Implementing a **transitional plan for sale and purchase of the goods and services** provided by these companies.”
6. **“Addressing employment imbalances** in these companies following the previous procedures by transferring the surplus labor to public works”, to private sector employment, or early retirement on public sector pension. These options will require a modern private sector labor law on employment and retirement benefits.

SOE Characteristics: Unfortunately, financial and non-financial data for individual SOE are limited. While the government lists 176 SOE each with 1 to 15 factories or other establishments, there is only reliable data including the number of employed for 136 SOE. It is believed that many of the 40 SOE for which the Government of Iraq (GoI) lacks current data are not independent organizations but rather extensions of ministries with no commercial objectives. Of the 136 SOE which have submitted detailed data, 3 are financial institutions which governed by different legislation than other SOE. In addition, companies partially owned by the GoI – mixed companies – are not considered SOE by Iraq law.² Table 1 shows the number and profitability of SOE by ministry.

² GoI (2016) *Performance and Fiscal Risks from Non-Financial State-Owned Enterprises in the Republic of Iraq*, pp. 7 and 13

Table 1: SOE by Ministry

Ministry	Official Count	Data Available	Profitable
Industry and Minerals	71	71	11
Electricity	24	23	1
Oil	18	14	8
Finance*	12	3	2
Transportation	10	6	3
Construction, Housing, and Public Municipalities	8	8	2
Trade	7	6	1
Agriculture	7	2	1
Defense	6	0	NA
Culture	4	0	NA
Water Resources	3	3	1
Communications	3	0	NA
Health	2	0	NA
Education	1	0	NA
	176	136	30

* Financial entities governed by non-SOE legislation.

While SOE factories, warehouses, research centers and marketing offices are located throughout Iraq; 88 of SOE headquarters, 65% of the total, are in Baghdad. The second highest concentration in is Basra with 11 headquarters, 8% of the total.³

Why Privatize or Liquidate Iraq’s SOE? Although the quality of data is poor, it is estimated that roughly 20 percent of existing SOE factories are currently profitable.⁴ The highest percentage of profitable SOE are associated with the Ministry of Oil where 62% of SOE are profitable while, at the other extreme, only 4% of the SOE associated with the Ministry of Electricity reported a profit. Some of the currently unprofitable firms are potentially profitable with a reasonable amount of investment and improved management. The GoI *White Paper* refers to firms that are either profitable or might be profitable with some investment and improved management as “Successful Companies”. Another 25–30 percent of the SOE factories are empty shells - “Failed Companies”; destroyed during conflict, severely mismanaged, or looted to bare walls. However, employees of these wrecked SOEs continue to be paid for showing up. The remaining half of SOEs would require large-scale investment, managerial restructuring, or a sharp workforce reduction to have any chance of achieving profitability - “Troubled Companies”.⁵

³ GoI (2016) *Performance and Fiscal Risks from Non-Financial State-Owned Enterprises in the Republic of Iraq*, p. 11.

⁴ GoI (2016) *Performance and Fiscal Risks from Non-Financial State-Owned Enterprises in the Republic of Iraq*, Table 7, p. 20.

⁵ GoI (2020) *White Paper*, p. 60.

According to a GoI study: “The financial relationship between the SOEs, state banks, and central government is complex, intertwined and relatively opaque.⁶ Direct subsidies to SOE amount to about 3% annually of all government budgetary expenditures, roughly the same amount that is spent on elementary and secondary education. In addition, there are a myriad of indirect subsidies. These indirect - often hidden – subsidies include the provision of fuel, electricity, and water at below market, sometimes zero, prices. Also, SOE have been able to obtain large amounts of financing from state owned banks at generous terms often with the expectation that such loans will not have to be repaid.

The harm to the Iraq economy is greater than the direct and indirect burden on the national budget. SOE severely constrain the country’s private sector. The Board of Supreme Audit mandates that government agencies buy goods and services from SOE unless SOE prices are more than 10 percent higher than the private sector competition. Also, since SOE tend to be high cost/low quality producers, they reduce the efficiency of both upstream private sector suppliers and downstream private sector buyers. It is not just a matter of the quality of the SOE good or service. Since SOE are politically connected, any commercial dispute will most likely be resolved in the SOE’s favor regardless of the facts. This imposes additional risk on any private firm that sells to or buys from a SOE.

SOE dominance in Iraq reduces the country’s ability to compete in global markets and make Iraq a less desirable location for foreign direct investment. In addition, World Bank studies of SOE in multiple developing countries show that SOE tend to be less concerned with protecting the environment. Even after adjusting for infrastructure age, SOE tend to pollute more than private firms. Finally, a large dependency on SOE tends to retard long-term economic growth because of their inflexibility and unwillingness to innovate.

Conclusion: *privatization, or liquidation of SOE is essential to the economic and political future of Iraq.* This discussion of a plan for SOE privatization/liquidation is divided – somewhat arbitrarily - into four topic areas:

- I. The characteristics of a successful privatization/liquidation. Privatization could include joint ventures with either domestic or international private sector partners.
- II. Creating the proper policy and political environment.
- III. Planning and executing SOE privatization/liquidation.
- IV. Improving the chances of success of newly privatized SOE.

I. Characteristics of a Successful Privatization/Liquidation.

Before the transitioning of SOE to privatization/joint venture/liquidation can begin, there must be a consensus among the country’s senior leadership on the goals of such a transition. The most critical characteristic of a successful SOE privatization/liquidation is to not increase potentially politically destabilizing unemployment or underemployment among young Iraqis. This will be

⁶ GoI (2016) *Performance and Fiscal Risks from Non-Financial State-Owned Enterprises in the Republic of Iraq*, p. 5.

discussed separately below. The other important characteristics of successful privatization or liquidation are reducing the fiscal burden of subsidies and facilitating private sector growth. In other words, SOE privatization/liquidation would help diversify the Iraqi economy from its almost total dependency on oil export revenues.

Privatizing SOE evaluated as “Successful Companies” will require a detailed plan that answers many questions.

- How to constrain the corruption that has turned many SOE privatization efforts in other countries into economic and political debacles?
- How can the GoI best seek expertise and guidance in privatization/liquidation from international organizations and other countries?
- How to select and motivate high quality managers for SOE before and during the privatization/liquidation process?
- How can appropriate levels of maintenance be sustained during the transition to privatization/liquidation?
- What is the best way to build relationships with foreign companies/countries to facilitate joint ventures?
- How to create incentives to properly motivate the new owners of privatized SOE? These incentives should encourage long-term profitability rather than short-term gains from looting. A related question is how to identify strong managers with global industry knowledge to maximize chances that newly privatized firms will succeed?
- Should privatized firms receive assistance with tariffs, indirect or direct subsidies, or privileged access to finance? Or would such special advantages reduce the likelihood that privatized SOE will become high quality/low-cost producers?

Probably the greatest challenge is ensuring that SOE privatization/liquidation does not result in a substantial increase in unemployment and underemployment. Iraq already suffers from high levels of unemployment and underemployment with an estimated 80% of young Iraqi males being currently un- or underemployed. And, every year, about 1 million young Iraqis become old enough to work. Adjusting for retirements, deaths, and the very low labor force participation rate among women; Iraq must create about 340,000 new jobs each year just to keep the unemployment and underemployment rates from rising.

II. Creating the proper policy and political environment

The Politics of SOE Privatization: Reform to SOEs and any other aspect of Iraq’s ministries requires first and foremost political will. The structure of these entities is deliberate in design. Iraq’s ruling political parties use these organizations in a way to capture state revenues. Each year, hundreds of millions of USD is diverted to the private bank accounts of the ruling parties. The primary function of the SOE is therefore to generate revenue for the ruling elite. Its second function is to operate and support the ministry or government agency. In a sense, SOE are already “privatized” since as part of the muhasasa system, each SOE benefits a non-governmental group. Therefore, SOE currently represent the private interests of the dominant political parties and not the interests of the ministry or the formal government. How can these groups be convinced to give up the cash and jobs of SOE that they control?

- The first step to gain political support or, at least acquiescence, for privatization/liquidation is to encourage transparency and accountability of these SOEs. In other words, begin to publicly reveal critical data such as SOE balance sheets, income and cost statements, true employment, and actual production of goods or services.
- A key element to encouraging the necessary transparency is focusing on freedom of information which has been a consistent demand made by Iraqi civil society. Contracts and tendering of SOEs should be made public in a timely manner. Indeed, revealing and exposing the deals made by SOEs and following the resulting money transfers is the first step to any solution. Such transparency can help garner public support and put pressure on the elite to cease filling their party accounts with funds diverted from state coffers.
- Another aspect of the Iraqi political environment that will affect SOE privatization/liquidation is a growing generational divide. The collapse of oil prices that began in 2014 combined with the expense of fighting ISIS and rebuilding the country after ISIS was defeated in 2017 severely constrained GoI expenditures. As a result, the GoI broke a decades old commitment to create enough government jobs each year to provide employment for new college graduates. As a result, an estimated 40% of recent college graduates are unemployed or underemployed. This has led not only to widespread protests but also to a growing interest among young Iraqis in starting their own businesses – in entrepreneurship. To an increasing extent, young Iraqis see SOE as barriers to their private sector ambitions rather than as providing a desirable career path. Over time, this excluded generation of young Iraqis is expected to grow in numbers and political influence.
- Once SOE accounts have been made transparent, transitioning the SOE to the private sector will also change the political balance. Private sector firms have strong incentives to push back against elites' attempts to dominate the former SOE.
- Of course, even when the work of the SOEs has been shifted to the private sector, the government will still need to have a role in ensuring accountability and transparency of the privatized SOE.

Progress in SOE privatization/liquidation is caught on the horns of a dilemma. Collectively, SOE are a major drain on the GoI budget that is financed with oil export earnings. 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. Also, during periods of low oil prices, the government focuses on maintaining employment at almost any cost to restrain political instability. 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 no political will.

Engaging political leadership and critical stakeholders. It is an absolute necessity that Iraq's political leadership wholeheartedly accept the necessity of the rationalization of SOE through privatization or liquidation. Without such rationalization, Iraq will not be able to create a productive economy providing a better quality of life for the Iraqi people. In other words, long-term political success depends on a robust and growing economy which requires rationalization of SOE.

The few successful and many failed privatizations and liquidations of SOE point to two critical factors. First, it should be clear to everyone that SOE privatization/liquidation efforts have the firm support of the political leadership. Half-hearted or hedging efforts will fail. Second, SOE employees at all levels must be engaged in the preparation and execution of privatization/liquidation. An earnest effort must be made to inform everyone at SOE from senior management to the most junior employee of the necessity of these efforts and seek recommendations to facilitate the transition. Of course, the nation's leadership should be prepared for some of those affected to attempt to obstruct the process but even when forcing change, leadership must keep the lines of communication open and avoid even the perception of secret deals or arrangements. There should be a charter and bylaws that clearly specify of the authority and responsibilities of all government and non-governmental organizations associated with SOE privatization/liquidation.

- The most important GoI action is for the Council of Representatives to pass a comprehensive privatization/liquidation law. This law should establish two organizations:
 - **First:** A high-level committee chaired by PM to provide top cover and demonstrate government support.
 - **Second:** A new high-level committee of technocrats, a SOE Privatization/Liquidation Commission, should be given responsibility for developing the specific process for SOE privatization/liquidation including corporate and marketing strategy, business plans, incentive schemes, management control systems, labor redundancy, and technology catch-up. This committee should include representatives from relevant provincial and local governments and might include representatives of the NIC, international organizations such as the World Bank and IFC, and Iraq's private sector.
 - The SOE Privatization/Liquidation Commission will be responsible for the success or failure of SOE privatization/liquidation and the success of privatized firms in the private sector.
 - This commission should have its own charter, secretariat, and an adequate budget.
 - The proposal in 2006 to establish a SOE Economic Reform Commission provides detailed guidance for the new committee's structure, goals, duties, authorities, and powers.⁷ In addition, the GoI should consider the organization and operation of similar organizations in other nations such as the German Truehand Trust which organized the large scale SOE privatization after the German reunification and the Prime Minister Delivery Unit which was created to support the UK Prime Minister's top priorities.
 - An additional advantage of establishing such a committee is that it can deal with the hostile criticisms that any realistic attempt at SOE privatization/liquidation will incur from ministries, SOE employees, and the general public.
- The SOE Privatization/Liquidation Commission should decide which ministry or organization should be tasked to execute the decisions of the Commission. This ministry or organization would be responsible for the detailed management of SOE privatization/liquidation. Possible this responsibility could be tasked to the Ministry of Industry and Minerals or the Ministry of Planning.
- There should be dedicated long-term funding for the privatization/liquidation effort.

⁷ GoI (2006) *SOE's Economic Reform Commission* (Ministry of Planning Version)

- There will be many expected and unexpected expenses associated with privatization/liquidation. Without a dedicated fund, such expenses may stall the process.
- Unfortunately, the GoI suffers a credibility problem because of previous disputes over joint ventures. Some foreign partners argue that the GoI tends to seek to revise agreements in its favor after the foreign partner has made irreversible financial commitments. A dedicated long-term funding commitment combined with clear public guarantees from senior government officials that contracts will be executed as negotiated should reduce the credibility problem.

Revisions of SOE regulations. Substantial regulatory changes are necessary both SOE law and in the current regulation of the private sector to not only level the playing field between existing private firms and privatized SOE but also increase chances of success of privatized SOE.

The key SOE regulation, *Law No. 22 of 1997 on State Companies* must be almost completely rewritten.

- Especially Chapter 9: “Change of the State Company” and Chapter 10: “Liquidation of Companies” A revision proposed in 2018 is still awaiting action.

III. Planning and executing SOE privatization/liquidation

Stop the bleeding. The direct and indirect SOE subsidies severely constrain fiscal policy in Iraq. With the rise of ISIS and fall in oil prices that began in 2014, the GoI was forced to sharply cut investment and run arrears to suppliers to maintain salaries and pensions for government employees including those of SOE. While the price of oil is about \$100 per barrel in early 2022, substantial oil price variance is expected over the next decade. Therefore, pending privatization/liquidation, it is critical to stop the bleeding, constrain direct and indirect SOE budget expenditures.

- Immediately freeze direct subsidies, wage bills, and SOE hiring
- Bank credit to SOE should be monitored to ensure that it is based on a sound business plan and not simply to offset SOE losses.
- Complete bio-metric census of SOE employees
 - Identify double-dippers and ghost workers

Transparency to constrain corruption is critical. The preparation and execution of privatization/liquidation must be a completely transparent process to maintain public support and reduce corruption. Many previous SOE privatization attempts especially in Russia and the Eastern European countries have resulted in foreigners and crooked oligarchs defrauding the people. As a result, privatization is often viewed as a scheme for transferring state assets into the private accounts of persons with political connections. One of the best ways of fighting this perception is radical transparency.

- About half the Iraqi population have smart phones with internet capability and therefore can participate in e-governance. Every contract and document associated with SOE

privatization or liquidation should be immediately posted online in an accessible searchable format.

- Decisions, but not deliberations, of the high-level commission should be released electronically no later than two business days after meetings.

Classify Public Companies: A careful evaluation of each SOE revenues, expenditures, production, and employment is necessary before privatization/liquidation decisions can be made.

- Junior civil servants from each SOE could be carefully selected and entrusted with the collection, aggregation, and reporting financial and non-financial data for their SOE.
- Following the example of the CBI, all SOE should have their balance sheets and income statements audited by a Big Four accounting firm. This will require a revision of Article 42 of the *Law 22 of 1997* and maybe the *Civil Service Law of 1940*.
- The *Accounting Law of 1940* should be repealed to allow the adoption of a modern accounting system for SOE consistent with GAAP or International Financial Reporting Standards (IFRS). While the private sector in Iraq generally uses IFRS, SOE do not.

Based on financial and physical audit results, each SOE factory should be sorted into one of three categories – Successful, Troubled, or Failed - based on (1) financial viability, (2) public policy priorities e.g. strategic interests, (3) market failures e.g. natural monopolies.^{8 9} Among the one to a fifteen factories, farms, financial institutions, service organizations, etc. associated with each Iraqi SOE, it is important to estimate whether each firm is likely to survive and possibly thrive after privatization. One possibility is to use the Curran method to evaluate probably privatization success. As discussed below, Curran developed five success factors and five failure factors that provide a crude method of predicting privatization success.¹⁰ After this evaluation, SOE will be divided into three categories.

- “Successful Companies” are to be totally or partially privatized or converted into mixed joint-stock companies,
- “Troubled Companies” to be restructured and transformed into successful companies within three years, possibly through the signing management contracts – contracts between government and a private party to manage a SOE
- “Failed Companies” to be liquidated. Current workers not retained or hired by private companies will be pensioned off or transferred to other public sector employment.
- Curran Success and Failure Factors for Privatization/Joint Ventures
 - a. Success factors for Iraq privatized SOE. To the degree that a firm possesses one or more of these factors, its chances of a successful privatization are higher.
 - i. Natural resource based e.g. petroleum, natural gas, phosphate
 - ii. High transportation costs relative to value of product e.g. cement
 - iii. Goods or services are in demand by Iraqi consumers or private sector businesses i.e. not dependent on demand by other SOE or the GoI
 - iv. Good or service is used in construction
 - v. Firm is currently operating i.e. not an empty shell

⁸ GoI (2020) *White Paper*, p. 61.

⁹ IMF (2021) *State-Owned Enterprises in Middle East, North Africa, and Central Asia*, p. 92

¹⁰ See Gunter (2021) *The Political Economy of Iraq*, pp. 200-203 and Curran (2006) *Success and Failure Factors for 200 SOE*

- b. Failure factors for privatized SOE. To the degree that a firm possesses one or more of these factors, its chances of a successful privatization are lower.
 - i. Product depends on a complex supply chain.
 - ii. Product is the result of a complex or time sensitive manufacturing process.
 - iii. Products with strong economies of scale that will require large export markets
 - iv. Good or service production is heavily dependent on continuing direct or indirect government subsidies
 - v. Good is in an international market already dominated by low-cost, high quality international suppliers e.g. inexpensive cotton clothing
- c. According to Curran's 2006 evaluation, firms in the cement, petroleum, refining, fertilizer, and electricity generation had the greatest likelihood of joint venture or privatization success. Of course, there have been many product and process changes since 2006 so an updated calculation of potential joint venture/privatization success is necessary.
- d. It should be possible to relatively quickly identify a few successful SOE companies that are of interest to international businesses and rapidly move to negotiate a joint venture in a transparent manner.
 - i. Several early successful privatizations of this type will not only provide insight into how best to handle the complications of such agreements but also help maintain privatization/liquidation momentum.

Dealing with labor redundancies. Whether a SOE firm is evaluated as successful, troubled, or failed; the problem of excess employment must be dealt with. Of the current estimated 600,000 SOE employees, possibly 250,000 and maybe as many as 400,000 will become redundant during privatization or liquidation. The privatization/liquidation process must improve the life of the employees as well as the finances of the government. A roadmap must be developed to ensure that these redundant workers do not add the already large number of unemployed or underemployed Iraqis. While some will choose to retire on their government pensions, a large percentage will be seeking employment elsewhere in the economy. Among the options are:

- Iraq simultaneously suffers from high unemployment of unskilled labor and a shortage of skilled labor. Education and vocational training could provide better employment opportunities and improved quality of life to workers rendered redundant by privatization/liquidation.
 - Vocational training must be driven by private sector demand, not the existing skill set of instructors.
- Transferring redundant SOE labor to public works will require some regulatory changes. It is probably best if such programs were small projects in all the provinces rather than in large projects directed by Baghdad. Funding could be from GoI expenditures, market loans with GoI guarantees, and loans/grants from international organizations.¹¹
- Implement mandatory early retirement for SOE employees who are older than 50 years of age and yet not eligible for a government pension under current law. Transitioning from a SOE paycheck to a pension may substantially reduce government expenditures because

¹¹ Government of Iraq (2020) *White Paper*, pp. 60-62.

former workers would no longer be eligible for the variety of financial benefits currently provided to SOE employees.

Ownership issues: Privatization is not a binary decision. For example, Poland, had a three-part privatization process. First, the Polish government disposed of its shares in any SOE where the government held less than 10 percent of the shares. Second, over 2,000 Polish companies were directly privatized by selling the SOE assets or entering joint ventures. Finally, about 1,000 Polish SOE were converted into a joint stock firms prior to sale. Shares were then sold either to the public or to an individual investor. With respect to Iraq, there are a dozen possible combinations of ownership and management by state and private entities.¹² It is unlikely that a single ownership/management format would be optimal for every proposed privatization. Therefore, the commission should be open to creative solutions to expected transition challenges. Among the less common options to be considered are:

- Gradual shifting of profits or net earnings from state to private owners.
- Contract with private sector management of SOE before complete privatization/liquidation.
- Providing tax incentives to encourage stock ownership in privatized SOE
- Allowing managers and employees of a privatized SOE to purchase stock at discount.
- For some firms, partial privatization, such as a public-private partnership, might be optimal.
- If the privatized SOE is expected to become a monopoly, it might be beneficial to impose specific price and production regulations.
- In politically sensitive areas, the commission should consider the possibility of the GoI renting existing firm assets to the newly privatized SOE rather than simply transferring such assets or selling them to such firms.

Transitional sales and purchases of SOE goods and services during privatization/liquidation:

An important responsibility of the SOE Privatization/Liquidation Commission is to minimize supply chain surprises associated with privatization/liquidation. There should be a transitional plan for each factory to be privatized/liquidated. This plan should include a description of any significant impact on both suppliers to and customers of each SOE. Of course, privatization/liquidation will be disruptive at least in the short-term. However, in the cases where privatization/liquidation of an SOE factory results in a severe, even if temporary, hardship to either suppliers or customers, the plan should describe the necessary adjustments and investments necessary to ameliorate the disruption.

- As Iraq makes progress towards diversification from petroleum dependency, the usefulness of its five-year *National Development Plans*¹³ will tend to decrease and the GoI budget will become the primary guide to government priorities. However, in the meantime, it is important that the effects of SOE privatization/liquidation be integrated into every section of the next five-year plan for the years 2023-2027.

Proof of Concept of Privatization/Liquidation: As noted above, regardless of the amount of careful preparation, once the actual privatization or liquidation process begins, unforeseen

¹² Gunter (2021) *The Political Economy of Iraq*, Table 10.3, p. 194.

¹³ Government of Iraq (2018) *National Development Plan: 2018-2022*, Chapter 5, pp. 94-95.

difficulties will be revealed. Therefore, it is critical that one or a few SOE factories be immediately identified for privatization and one or a few factories be identified for liquidation so that lessons learned from these privatization/liquidation efforts can be used to facilitate the privatization/liquidation of the rest.

IV. Improving the chances of success of newly privatized SOE

Surveys reveal that the lack of access to finance and associated financial services is the most serious barrier to business success in Iraq's private sector. The banking system is moribund with the dominant state-owned banks unable or unwilling to lend to private sector entities. Private banks are limited in size and, for the reasons discussed in detail in the World Bank's now discontinued "Iraq: Doing Business"¹⁴ survey; they generally avoid lending to private firms. It is not just the availability of finance but also the lack of financial services that burden private businesses in Iraq. For example, core banking which allows a business to make a deposit in one branch and withdraw funds from another branch generally doesn't exist. In addition, only the two largest state-owned banks have branches in most towns. Reforming the state-owned banks will be an expensive and drawn-out process but there are some options to improve financial access for newly privatized SOE in a timely manner.

- Encourage foreign banks to open offices in Iraq and make private sector loans. Currently, there are less than two dozen foreign banks with branches in Iraq.
- Simultaneously, encourage the creation of public and private credit registries which are essential for profitable private sector lending.
- Revise banking regulations to allow mobile banking/e-banking. The experience in other countries is that widespread e-banking reduces the cost of businesses to make payments or transfer funds while – unlike cash payments - providing an electronic trail which complicates corruption.
- Encourage the World Bank's IFC as well as the export credit agencies of other countries to finance trade with and investment in the Iraq private sector.

In addition to difficulties in obtaining financial services, newly privatized SOE face the challenge of dealing with an extremely complicated and bureaucratic regulatory system. A new project currently requires the approval of at least thirteen ministries or agencies. And after the privatization is complete, there are over nine agencies that will make periodic inspections. The average firm must deal with close to 100 inspections a year – about two per week. Obtaining necessary imports is also a complex often delayed process. The unnecessary complexity of regulation tends to especially burden the creation and expansion of businesses and associated employment in Iraq's private sector. Therefore, rationalization of the regulatory environment of Iraq's private sector would not only increase the likelihood of successful SOE privatization but also help ameliorate the country's unemployment/underemployment problem.

- The World Bank's *Iraq 2020: Doing Business*¹⁵ and the GoI's *National Development Plan: 2018-2022*¹⁶ provide detailed guidance on improving Iraq's regulatory environment.

¹⁴ World Bank (2020) *Iraq: Doing Business 2020*, pp. 21-37.

¹⁵ World Bank (2020) *Iraq: Doing Business 2020*, pp. 21-37.

¹⁶ Government of Iraq (2018) *National Development Plan: 2018-2022*, Chapter 5, pp. 75-98.

- An Iraqi equivalent of the US Small Business Administration could encourage an expansion of the private sector by providing loan guarantees, education, and entrepreneurship training. If successful, the growth of the number of Iraq's small businesses would provide needed job opportunities.

As noted above, unless corruption is constrained, the chance of a successful SOE privatization is reduced. While progress in reducing the reality and perception of corruption in Iraq has been made, it is still a major barrier to economic development. Based on the many failures and few successes of anti-corruption strategies in Iraq and elsewhere, we now know what works. What is required is the political will to develop and execute an integrated Iraq-specific anti-corruption strategy.¹⁷

Conclusion

SOE privatization/liquidation must balance opposing incentives. Careful planning is necessary for success, but the GoI must rapidly privatize/liquidate SOE both to reduce dependency on volatile oil exports and to maintain momentum. One lesson of previous failures in Iraq to make progress in privatizing/liquidating SOE is that the longer the process takes, the less likely it is to succeed. In part, a slow privatization/liquidation process increases the likelihood that internal political changes or external challenges will shift the attention of the nation's leadership and privatization/liquidation efforts will quietly die. There is already concern that the early 2022 increase in oil prices will reduce the incentives for making the necessary hard decisions such as those associated with SOE privatization/liquidation. This would be a mistake because if there is one thing that is certain is that future oil prices are uncertain. The argument for radical change is well expressed in the GoI 2020 *White Paper*.

“The *White Paper* aims to rebalance and reposition the Iraqi economy on a track that allows the state to take appropriate steps in the future to transform it into a diversified and dynamic economy, creating opportunities for the people to live a decent life, through proposing a set of comprehensive reforms and policies, as described in the subsequent sections. Implementation of these reforms requires harsh measures, though bitter, to address the current severe financial crisis. With that in mind, ***implementation of such set of reforms requires political courage, buy-in and acceptance of the Iraqi people*** – with the political elites and in the forefront – and ensuring their participation in the implementation of these difficult, yet indispensable economic measures to provide the minimal fiscal space needed to embark on the program of reform set forth in the proposed paper.”¹⁸

This article was published by the Iraq Britain Business Council's (IBBC) Advisory Council on behalf of the organization.

¹⁷ Gunter (2021) *Corruption Worse Than ISIS: Causes and Cures for Iraqi Corruption*, pp. 14-24.

¹⁸ Government of Iraq (2020) *White Paper*, p. 2

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