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State Owned Enterprises Reform In Iraq

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ABBREVIATIONS AND ACRONYMS

ADR	Alternate Dispute Resolutions
BDS	Business Development Services
FDI	Foreign Direct Investment
GoI	Government of Iraq
IPCC	Iraq Property Claims Commission
NID	New Iraqi Dinar
QIZ	Qualified Industrial Zones
SEZ	Special Economic Zones
SME	Small and Medium Enterprises
SOE	State Owned Enterprises
WTO	World Trade Organization

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REPUBLIC OF IRAQ
State-owned Enterprise Reform in Iraq

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PREFACE

To provide guidance and information on the many economic challenges that Iraq faces, the Bank is preparing a series of notes dealing with three broad clusters: Economic Reform and Transition, Poverty Safety Net and Social Development, and Public Sector Management. Fitting within the Economic Reform and Transition cluster this note will be revised when the other notes are produced. Four sub-tasks are planned under this cluster:

Incentive Framework for a Market Economy—focusing on the transition strategy overall and the choices and policy options in domestic and external price liberalization;

Oil and Gas Sector Reform—focusing on critical energy sector issues and options for pricing and institutional reform in managing oil resources’

Investment Climate, Financial Sector and State-Owned Enterprise Reforms---focusing on key institutional issues in private- sector development and the supporting financial framework of financial sector development and on the reform options for state-owned enterprises; and

Agricultural and Rural policy and institutional framework—focusing on key issues in agriculture and rural development.

The investment climate note builds on the Needs Assessments presented at the Madrid donors’ conference in October 2003, synthesizes the findings of consultations between the World Bank and the Iraqi State Owned Enterprise delegation at two sets of capacity-building workshops held in Amman, Jordan in February and May 2004 on the subject of “State Owned Enterprise Reform in Iraq,” with lessons from regional and international best practices. These workshops, together with prior and subsequent formal and informal discussions between both sides, have resulted in the emergence of an Iraqi-owned strategy together with a set of detailed priority actions. The workshops and discussions were highly interactive and included study tours, general debates, case studies, and specific relevant best-practices presentations from experts familiar with the region.

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EXECUTIVE SUMMARY

Introduction

For the people and economy of Iraq to regain prosperity and a position of leadership in the region, they must lighten and eventually shed the dead weight of state-owned enterprises (SOEs). That reform – a difficult undertaking anywhere, but one that has been successfully accomplished in many countries – represents an essential step in modernizing and rebuilding Iraq's economic strength.

Many SOEs – employers of an estimated 500,000 of the country's roughly 4 million current jobholders -- urgently require new investment, up-to-date technology, and improved management, ingredients the hard-pressed Iraqi state cannot provide. The previous ban on non-Arab foreign direct investment and the effects of three wars and a decade of international economic sanctions have meant that something like 90% of Iraq's industrial capacity – the SOE share – is seriously decapitalized, asset-starved, obsolescent, inefficient, saddled with high production costs, over-staffed, and -- as a result of looting – in a state of physical degradation.

SOEs and their employees are therefore expected to bear the brunt of the necessary economic adjustment. It is clear, however, that many of the 192 enterprises counted so far will simply not be able to compete. With high unemployment --50 percent of the workforce is thought to be either jobless or underemployed -- the transition from state to market will, at least initially, inevitably bring significant job losses. To avoid a social crisis, reform measures will have to be complemented by extensive provisions – a resilient social safety net – for displaced workers and their families. The dismantling and restructuring of the SOEs, moreover, cannot proceed successfully without public approval. To gain that, reformers will need to mount an energetic, sensitive process of consultation and education, a campaign that explains the short-term costs of change and the longer-term benefits it will produce and that wins the consent of the groups and individuals most affected.

Antipathy to private and particularly foreign investment is strong in Iraq, a legacy such a campaign will also have to address, but the issue of SOE privatization is not likely to arise immediately. Indications are that, given their current state, few enterprises are likely to attract much interest from investors. An initial attempt to lease companies has not yet been successful. Furthermore, given that the interim government will not be in a position to dispose of SOE assets, privatization is not an option for the short term, at least not until a representative Government is elected and a legal and regulatory framework for privatization has been put in place.

This paper concentrates on the choices to be made in designing such a framework so that, once the security situation is under control and elected authorities are in office, SOE reforms can proceed effectively and at a pace commensurate with Iraq's urgent need for such change.

Size, performance and reform needs of SoEs

Although almost all Iraqi SOEs are damaged, technologically obsolescent (with equipment mostly installed in the 1970s) and heirs to years of insufficient re-investment, maintenance, and repair, they have for a long time performed a key role in a wide variety of sectors. They have been the sole providers of essential public utilities and the leading providers of a large number of public goods and services as well as of consumer and industrial products. All have suffered from distorted policies which have undermined their viability, while many have also been damaged and some destroyed by wars.

Grouped under 11 line ministries (Table 1), Iraqi SOES are relatively modest in terms of numbers, but many in fact consist of several separate enterprises. In addition there are believed to be a number of other national and sub-national enterprises as well as 43 mixed-ownership firms, in which private companies, individuals, former Ba'ath party representatives and line ministries hold shares.

Table 1: Summary of SOEs as Per Their Former Affiliation With Line Ministries

Ministry/Commission	No.
Agriculture	10
Electricity	11
Finance	9
Health	1
Housing and Construction	15
Industry and Minerals (MIM)	48
Military Industrial Complex (now with MIM)	48
Irrigation	11
Oil	19
Trade	8
Transport and Communication	12
Total	192

SOEs can be categorized into two broad groupings:

- Enterprises that deal in tradable goods and services, and
- Enterprises that provide public goods and services

At first sight this distinction seems straightforward. However, individual infrastructure ministries, for example, control construction and manufacturing enterprises that fit comfortably in the first category.

Most SOEs are large. For example, the enterprises under the Ministry of Trade employ on average 4,000 people; those of the Oil Ministry—3,500; those of Mining and Minerals—2,000; while the SOEs of the Ministry of Housing and Construction employ on average 800 people. Many SOEs are holdings for 5-15 constituent enterprises covering many medium-sized and even small SOE branches, a few of which have less than 100 employees. These SOE branches are located at different

sites, quite far from the main headquarters and act as separate entities in carrying out technical functions. The branches do not have commercial autonomy since they are not registered as legal entities. They are not allowed to sign contracts directly with customers or receive credit from banks.¹

Of course some SOEs are utilities, providing services such as electricity, telecommunications, water and ports. In reforming these enterprises, it will be necessary to address a range of specific sectoral policy and regulatory issues more complex to tackle than those involved with industrial or trading enterprises. Other SOEs form part of the oil sector, and these again will require separate treatment depending on the government's policy towards the oil sector.

Most Iraqi SOEs were shut down after war damage and looting interrupted normal operations. Many have not restarted, and those that have are, in most cases, operating only partially. Most need some capital to accomplish repairs and secure raw materials before they can restart at all, let alone break even. Most also carry from 30-50 percent more staff than would normally be needed elsewhere for similar production. The overstaffing is complicated by a substantial number of ghost workers listed on the payrolls, whose salaries serve both social-safety-net and rent-seeking purposes.

Context, constraints and challenges

It is clear that without further investment Iraqi SOEs cannot survive. The financial weakness of the government does not permit Iraq to continue supporting loss-making enterprises. Even if the government continues to provide such support, it is unlikely that the vast majority of these enterprises could stand full competition from market forces. If nothing is done, many will move toward eventual closure with consequent job losses, social turmoil and avoidable loss to the economy.

Hence, Iraq must attract private investment into its SOEs if they are to survive, modernize and expand. The second critical need of Iraqi SOEs is modern, commercially adept management expertise. Finally, it must be clear that the primary purpose of SOE reform in Iraq should be to build strong, competitive enterprises throughout a market-oriented economy.

To achieve the above, a number of constraints must be overcome and challenges faced. The following list of obstacles reflects the fears of selected Iraqi policy makers:

- Over-employment in the SOES, giving rise to fears of large-scale layoffs and associated negative social consequences;
- Legislative constraints – laws in force which prevent effective implementation of the program, e.g. labor laws
- Lack of appropriate regulatory frameworks and institutions (particularly in the case of utility and financial sectors);

¹ For example, the State Enterprise for Construction Materials Industry accounts for 12 plants producing bricks, plastic pipes, and several other types of stone.

- Lack of effective institutions to implement the SOE reform program;
- Poor condition of the enterprises;
- Complete lack of financial viability in some enterprises;
- Weakness of the Iraqi capital market and capital market institutions;
- Popular antagonism toward foreign investment;
- Lack of domestic capital to invest in purchasing shares of SOEs;
- Corruption in SOEs, leading to strong self-interested opposition from SOE managers and/or line ministry officials; and
- Danger of concentrating ownership in a single ethnic group or a few families.

Each of the above impediments – including, of course, the security situation -- will need to be tackled resolutely and intelligently if SOE reform is to succeed. If over-employment in the SOEs means that large-scale layoffs and associated negative social consequences are feared, then this concern stands as by far the most significant barrier to reform action and must be addressed. Among employed Iraqis, one of about every eight holds an SOE job; upwards of 3.5 million are employed in the private sector (3.7 million were so registered in 2001). Some working-age Iraqis are not in the labor force: students, homemakers, people with disabilities, etc, but among the estimated 28-60 percent unemployed are also the former military (currently on stipends), former police, workers dislocated by disruptions of war, seasonal agricultural workers as well as unemployed persons in a normal job transition period. Because of this very high rate of joblessness – even without SOE reform – it is a matter of priority to prepare a range of measures to cushion workers from the effects of enterprise reform. These social-safety-net measures will likely include

- Generous redundancy or severance payments;
- Retraining programs to impart or upgrade needed skills;
- A range of programs to assist workers to re-enter the job market – such as the establishment of employment agencies;
- Public works programs.

It will be important to introduce these safety net measures in an integrated fashion so that laid-off employees can benefit from them whenever and wherever necessary and in parallel to the reform of SOEs.

Although Iraq lacks most of the laws, regulations, and associated institutions required to permit the smooth development and implementation of a SOE-reform program, it has time to rectify this deficiency, given that there are no plans to proceed with rapid privatization. It is, however, important to proceed to design and put in place the necessary laws and institutions as soon as possible. Laws and institutions specific to SOE reform are discussed in section 5 below. Other key laws, regulations, and institutions related to the investment climate will need to be put in place quickly,

since without such measures, investors will not muster the confidence to act on SOE privatization or other market opportunities.

Many enterprises are in a poor condition, and the technology in most is considerably out of date. Some of these conditions may be remedied, while for others it will be better to face reality and liquidate them. It will be necessary to complete ongoing surveys of enterprises to determine which are altogether unviable, which require restructuring, and which are clearly viable. In this regard, subsidized input prices need to be considered as well, since enterprises, which rely heavily on subsidized energy inputs and seem currently profitable, may not actually prove viable if those prices are increased.

Foreign investment is a critical contribution to the reconstruction process, both in general and for state enterprises in particular. Nevertheless, misplaced fears about foreign investment among some Iraqis could act as a brake on the enterprise reform program. In fact, the fear is exaggerated. Countries that are part of the global trading system compete with one another to attract foreign investment, valuing foreign investors as a very welcome and useful means of creating new jobs and building the local economy. To insure that Iraq also welcomes foreign investment as a critical contribution to the reconstruction process, an extensive public education program is needed to bring popular apprehensions out into the open, discuss them and lay them to rest.

The Iraqi capital market is certainly weaker than that of many other countries. Nevertheless there are over 100 enterprises listed on the Baghdad Stock Exchange and there is a history of investment in shares. Experience from other countries has shown that citizens usually have more money than expected to trade in shares if the opportunities are attractive and the marketing is effective. The capital market will need to be strengthened as privatization establishes new companies join it. Technical assistance to strengthen the exchange and assist companies to comply with listing requirements will be necessary.

Corruption in SOEs, leading to strong self-interested opposition from SOE managers and or line Ministry officials needs to be addressed. Changes in the governance of state enterprises would make corruption less likely, since a transparent and competitive process would select managers on the basis of merit, and line ministry officials would be less involved in running enterprises.

The SOE reform program should not lead to further concentration of wealth, but should instead be a part of greater democratization of capital ownership in Iraq. Achieving this goal requires designing a clear strategy to use the program to spread wealth rather than concentrate it. Public offers of shares and opportunities for SOE employees to acquire shares are two approaches to be considered.

Finally, the process of seeking public understanding should be as much one of consultation as education. Through seminars, workshops, and by formally inviting responses to consultation papers the views of interested parties should be sought so as to take them into account when designing the program. An excellent opening step is to prepare, circulate, and discuss a policy document that can help

- Create certainty about privatization aims and policy and provide a clear statement of government commitment that helps clear the air and remove doubts about the policy direction;
- Build public awareness and support;
- Reduce opposition;
- Appeal to outsiders -- taxpayers and consumers -- rather than dealing always with insiders -- employees and management;
- Show the longer term, general, dynamic effects of the policy as well as the immediate, static, transaction-related costs; and
- Give the bureaucracy the resolve to tackle difficult issues and in particular backing those individual bureaucrats who are trying to bring about change.

An institutional and legal framework for enterprise reform

It is important to construct a very robust institutional and legal framework for enterprise reform. Experience has shown that the effectiveness of and respect for the institutions dedicated to implementing reform and eventual privatization are critical to success. Clear definition of roles and responsibilities must be complemented by transparent, publicized procedures. Conditions currently prevailing in Iraq mean that a solid institutional framework and concentrated authority for the enterprise reform program, preferably underpinned by legislation, is particularly important. Reviews of SOEs in the governorates have highlighted the conflicting interests of various parties (e.g., government ministries, provincial governors, powerful managers, local militias) who may lay claim to current or future SOE value. Such rivalries represent a major barrier to progress and will have to be dealt with up front.

Some countries have relied on line ministries to tackle the reform; others have opted for a centralized agency. Given concern over concentration of power, the model of decision taking by a commission involving a range of interests is more likely to succeed in Iraq. This approach is also normal for privatization agencies generally headed by a commission of ministers and other senior figures. Representatives of labor and the private sector should also be included. This commission or board is usually chaired by the minister of finance, or even by the prime minister or another minister. Other key ministers are often members. It would be useful if the commission were ethnically and politically balanced. Effective staffing of such an entity – the Enterprise Reform Commission (ERC) -- requires special skills and experiences not usually found in the public sector, such as financial, accounting, legal, and communications.

Most institutional frameworks for enterprise reform/privatization involve three levels of decision-making, an arrangement which seems to be suitable for Iraq as well. The levels are cabinet/PM, cabinet subcommittee/privatization commission, and

executive/implementation. The executive level needs to be close to key decision-makers to facilitate maximum influence and access.

The SOE reform / privatization process and its institutional framework should be underpinned by primary legislation. The adoption of privatization legislation with public debate gives political legitimacy to enterprise reform and privatization and gives legal authority to act to a specialized unit.

Similarly, a strong executive body is needed, since weakness in that unit would lead to failure in overcoming opposition from vested interests. An effective body needs attributes such as (i) the administrative authority to require state enterprises and government ministries to comply with its requirements, (ii) the necessary professional skills to implement the program – talents and experience not usually found in the public sector, and (iii) adequate resources for implementation. The institutional structure should furthermore provide for a delegation downwards as far as possible and for a high degree of professionalism to ensure that complex matters are handled effectively and quickly.

Finally, a privatization law will be needed if a duly elected sovereign Iraqi government decides on such a policy. In that case, a law should establish an institution responsible for privatization together with a supporting executive body, state their powers and duties, ensure that they are kept small enough to remain effective and ensure the right mix of professional, commercial, political and administrative skills. Finally it should state what can be privatized (e.g. all government property, broadly defined to include direct and indirectly owned, managed or controlled property).

Pre-privatization interim measures and institutional arrangements for “permanent” SOEs

The Bank’s “Bureaucrats in Business” study (1995) identified the following preconditions for successful SOE management:

- The existence of hard budget constraints
- Factor market disciplines (capital and labor)
- Competition
- Corporate Governance free of political interference, and
- Commitment to eventual privatization

The current ownership arrangements for state enterprises in Iraq, Iraq – owned by line ministries of which they are effectively part – are less than ideal. It would be best practice for all SOEs not already in a corporate form that will either be slated for privatization or remain in the state sector in the medium term to be converted to a corporate form (so-called corporatization) under the commercial law. International best practice would suggest that rather than line ministries (and on occasion various other state enterprises) being the shareholders of an SOE, ownership should be consolidated in the one organization responsible for privatization and for holding state assets. This would mean that the shares of all SOEs should be held by such a body, which would be responsible for exercising the rights, duties and privileges of

shareholders conferred by commercial law. It would be the responsibility of this body to:

- Vary the Memorandum and Articles of Association.
- Appoint and remove the directors.
- Approve and receive dividends.
- Approve the amalgamation, winding up, or transfer of the company.

An important corollary of this approach is that serving public officials would be barred from serving on SOE boards. There will also be a need for some form of independent audit function to report on the activities and financial position of SOEs on a regular basis.

The current framework for management and financial oversight of SOEs is in need of radical reform. Implementation of timely, accurate, and consistent financial information (probably in accordance with International Accounting Standards) will be a crucial step in ensuring the accountability of each SOE's board of directors. All employees of SOEs that remain in the state sector should lose their status as civil servants and sign new employment contracts as employees of the state enterprises. Other steps include devising new, open, and competitive mechanisms for constituting the boards and management of corporatized state enterprises, as well as new personnel management policies.

These reforms could cover areas such as the creation of new posts, recruitment of staff, conditions of service and salaries and other benefits. Reforms should also be considered in the areas of performance evaluation and monitoring as well as rewards for superior performance and penalties for under-performance. The possibility of potential contractual arrangements between line ministries and state enterprises in respect of non-commercial obligations should also be examined. Underpinning these arrangements would be new approaches to financial management of SOEs. Within a hard budget constraint, SOEs need greater freedom to take commercial decisions without first seeking approval from Baghdad. They should have permission to commit funds and make purchases on their own account. Last but not least, environmental issues should also be examined and an approach to dealing with them built into the program.

Choice of method of reform

The choice of program objectives and transaction objectives will affect the methods used. There is a wide range of methods, for example:

- Sale of businesses, assets and shares by tender or auction;
- Sale of shares by public offer;
- Free distribution of shares to the population;
- Management / employee buy-out of enterprises;
- Concessioning of enterprises or leasing of assets;
- Contracts for the management of enterprises; and
- Contracts for the provision of services.

Based on the above, Iraqis will need to select a method and design a master plan to be reviewed on an annual basis. Its objective is to outline a broad strategy, schedule activities and monitor their progress. Furthermore, the plan would take into consideration other support programs such as sector reforms, legislative changes, and Iraq's privatization experience of the 80s. Since some methods are clearly better at achieving certain objectives than others, it is essential that the condition and needs of the enterprises should strongly influence the method of reform chosen.

Introduction

The purpose of this discussion paper on State-owned enterprise (SOE) reform in Iraq is to highlight policy options for such reform and suggest ways forward. The paper focuses on tradable sector SOEs. A separate paper planned to deal with SOEs that provide public goods and services will review the specific issues they face.

1. Like many other authoritarian and centrally planned economies, Iraq's economy was dominated by the state. Public enterprises operated in key sectors of the economy under high protection; input and output prices were controlled and heavily subsidized. Non-Arab foreign direct investment was forbidden, and with the sanctions of the past decade, Iraq became essentially a closed economy. While most of Iraq's pre-war trade was through the oil-for-food program, some trade took place outside the program. A parallel economy developed (managed by Saddam family members who controlled significant segments of the black markets which flourished following the sanctions) with its negative impact on governance and the poor. In this environment, the state of Iraq's State-Owned-Enterprises (SOEs) deteriorated seriously with de-capitalization of assets, lack of access to modern technology, and no incentives to raise productivity.

2. Iraq's transition to greater openness to international markets and exposure to international competition will inevitably result in important adjustment costs in the non-oil sectors. SOEs, many of which will be unable to compete, are expected to bear the brunt of that adjustment. With high unemployment, the transition from state to market will inevitably, at least initially, result in significant job losses which will need to be managed to avoid the social crises experienced elsewhere in oil-producing countries. Indications are that, given their current state, SOEs are unlikely to attract much interest from investors. Furthermore, given that the interim Government will not be in a position to dispose of SOEs' assets, privatization should not be a short-term option, available only once a representative Government is in place and a legal and regulatory framework for privatization has been put in place.

3. SOE reform is an important issue that must be handled effectively if the Iraqi economy is to succeed, to return to its natural position as one of the leading economies of the region, and to meet the aspirations and expectations of the Iraqi people to live in a modern, successful economy that creates jobs and wealth, drives growth and allows open and equitable participation in the world economy. Most Iraqi SOEs are in poor condition and variously suffer from under-capitalization, inefficiency, high production costs, over-staffing and physical degradation as a result of looting. New investment, modernization and improved management are urgently required in many cases. Continuation of past policies without reform is not an option.

4. Other countries have faced similar problems and adopted a range of different approaches to SOE reform. To assist in deciding which approach Iraq should adopt, the World Bank has been engaging with Iraqi policy-makers and is continuing the dialogue on the subject. This chapter synthesizes the findings of the recent consultations between the World Bank and Iraqi policy-makers at two sets of capacity-building workshops held in Amman, Jordan in February and May 2004 on

the subject of SOE reform. Together with prior and subsequent formal and informal discussions between both sides, these workshops have resulted in the emergence of an Iraqi-owned strategy and a set of detailed priority actions. The workshops and discussions were highly interactive and included general debates, expert papers, case studies, and specific relevant best-practices presentations from experts familiar with the region.

5. Another critical point is that much progress is predicated on an improvement in the security situation. At the time of writing (June 04) the security situation is such that it is very difficult to move around Iraq without risk of attack. Economic progress in general, and much work on SOE reform in particular, will only be possible if there is a significant improvement in the security environment

6. This paper sets out some of the key issues being discussed and outlines preparatory steps that must be taken to enable a program to move forward. The emerging consensus it describes on strategies and priority actions on SOE reform will also serve to inform Iraqi public and private sector stakeholders, interested outside donors and governments, and particularly Iraqi civil society.

7. SOE reform is a complex and controversial policy area involving a host of different political, economic, and social issues. Effective SOE reform requires careful handling; multi-disciplinary skills; and a firm grasp of a wide range of financial, legal, institutional, economic, social, and environmental questions. The experience of other countries has been very extensive, and it is possible to identify clearly both common mistakes to avoid as well as techniques and tactics that will help ensure success.

8. Although SOE reform is often equated with privatization, that course is an important aspect of enterprise reform, but not the only one. Other key aspects include:

- structural reform – to increase competition within the economy;
- regulatory reform – to redefine the role of government in the economy and to improve oversight of enterprises and sectors, particularly those public and private sectors of the economy where there are monopoly concerns;
- corporatization – changing SOEs so they have the same legal form and legal obligations as private enterprises;
- management reforms - to improve the quality and effectiveness of management and the management of human resources within companies;
- labor and labor-market reforms – to facilitate flexible labor markets and deliver new job creation;
- governance reforms – to improve the governance of enterprises in both private and public sectors;
- financial reforms – to improve the quality and accuracy of financial management in SOEs
- capital-market reforms – to create a modern capital market to allow Iraqi businesses to raise capital and to encourage Iraqi's citizens to invest in shares

9. It will be important to design and implement a wide range of these reforms in order to achieve success, which will be, in turn, critically dependent on other policy reforms, notably those relating to:

- Fiscal stabilization
- Financial sector reform
- Internal market liberalization (including labor-market reforms)
- External trade policy reforms
- Economic growth, diversification, and competitiveness
- Public administration reform

10. Of course the willingness of the private sector to invest in both SOEs and new businesses which can absorb employment will be critically related to improvements in the overall investment climate. Action to improve it through new laws and regulations and strengthened institutions should thus be a high priority. Creation of that enabling framework for the private sector is a high priority.

11. One of the issues highlighted by this paper is the need to do very considerable preparatory work before a reform program can go forward. The absence of hard data in this paper emphasizes the need for extensive data-gathering. Work to consult with key stakeholders and educate the public is also a very high priority. Further policy analysis will be required before a comprehensive program can be designed.

12. It is also important to stress that reforms will have social consequences. The SOEs at present are regarded as part of the social safety net, a role they will have to relinquish if they are to prosper. Alternative, more focused arrangements need to be put in place to provide a social safety net. If such measures are not taken, the difficulty of SOE reform will be compounded by the confusion and conflict between the two roles. This paper sets out such a social safety net strategy.

13. The prospects for reform are also linked in an important fashion with the reconstruction process on which very significant funds will be spent, some of them for work by a number of SOEs. Their participation will provide them an occasion to improve their capabilities as well as to strengthen their finances.

14. Despite the complexity of the challenges involved, it is clear that undertaking a substantive and effective program of SOE reform is fundamental to improving the competitiveness and productivity of the Iraqi economy.

The role of the state in the Iraqi economy

The role of the state in the Iraqi economy is a key question that Iraqis need to address and discuss. As the role of government has changed dramatically in all countries over the past 20 years, many other states are seeking to reduce public-sector employment. In Iraq it is unlikely that GoI can continue to carry out all the tasks that have accumulated. Priorities have to be established and the role and tasks of government – particularly those that relate to central management of the economy - pruned to realistic levels

~~15.~~ In the last century, there was a perceived need in Iraq for government to draw on the economic resources of the country, to create infrastructure, social services, and formal economic activity where little then existed. State enterprises were created to assist in this task. New challenges demand new responses. If Iraq is to adapt to global market conditions, it must reengage its present industrial base, attract capital, focus on profitable lines of production, update production methods, put the labor force back to work, and deal with the inefficiencies of both production methods and labor deployment.

~~16.~~ It might be thought that once the Iraqi oil sector is once again fully up and running and modernized, a process which will probably take some five to ten years, then Iraq will be able to afford to subsidize inefficient state enterprises once more and continue with the same economic policies as in the Saddam era. In reality this is not a real option. Creating an efficient and dynamic private sector is critical to success in an oil-rich economy. Other oil-rich economies such as Saudi Arabia, Algeria, and the Gulf states have recognized this and are striving to privatize SOEs and encourage strong private-sector development.

17. Attainable long-term (20-30-year) goals for national economic growth could incorporate, among others:

- a strong and diversified national economy
- a high standard of living at the level of OECD countries
- an advanced and sustainable national scientific and technological capacity
- a sustainable physical environment
- a high quality of life combined with preservation of traditional ways of life and values.

18. To implement policies to promote economic growth and prosperity and tackle poverty, the GoI does not need to engage directly in production through state enterprises whose performance, world experience shows, improves under private ownership. In a competitive, market-oriented economy, ownership of state enterprises can often be an unnecessary burden.

19. The experience of Iraq's neighbors, particularly the oil rich Gulf States, is relevant to Iraq's choices. All these countries experienced growth through the 1970's and the 1980's as a result of public-led investment driven by a huge surge in oil revenues. This pattern led to large SOE sectors. At the same time that the state in

these countries became a dispenser of welfare, the SOEs became a vehicle for distributing this benevolence through the provision of both tradable and public goods and services at prices considerably below cost. These policies drove deep and substantial inefficiencies into these economies, which became starkly evident as a result of the oil-pricing crisis of the mid 1990's. In virtually every case the concerned Governments now recognize their earlier errors and are now trying to reverse these policies. This attempt is very difficult, as these policies rest at the heart of the political economy of these states. Nevertheless electricity tariffs are creeping up throughout the Gulf; gradually SOEs are being transferred to the private sector; and significant efforts at economic diversification are taking place.

20. Indeed if these experiences are illustrative, Iraq's challenge will be as much to constrain the SOE sector from growing as to reduce it. These neighboring experiences also provide strong clues as to what might happen to Iraq if it fails to address the reform of SOEs:

- SOEs will continue to grow in size and cost to the budget
- General productivity in the economy will be severely impacted, as SOEs will not be able to provide needed goods and services
- Capital and labor markets will be distorted in a negative way with further cost to productivity
- The private sector, the future engine of growth, will be crowded out by an unnecessarily strong and powerful State, and
- The opportunity to attract private domestic and foreign investment into these SOEs will be lost.

In Jordan some preliminary work on the analysis of the impact of SOE reform, shows that GDP would have been impacted by several percentage points had SOE reform not taken place. In this economy with just under \$US10 billion in GDP, SOE reforms generated \$1 billion of new investment, \$1 billion in state proceeds over 10,000 additional jobs, and significant improvement in the quality of service and goods delivery.

State owned enterprises in Iraq – size, performance and need for reform

21. The SOEs have for a long time performed a key role in a wide variety of sectors in Iraq. They have been the sole providers of essential public utilities and the leading providers of a large number of public goods and services as well as of consumer and industrial products. But all have suffered from a chronic lack of investment and from distorted policies, which have undermined their viability, while many have also been damaged, and some destroyed by war and subsequent looting. They comprise about 90% of total industrial capacity, although almost all are damaged, have obsolescent technology (mostly installed in the 1970s) and have suffered from years of insufficient re-investment, maintenance, and repair.

22. Grouped under 11 line ministries (Table 1), the number of Iraqi SOEs is relatively modest with 192 SOEs identified to date, many of which in fact comprise several separate enterprises. In addition there are believed to be a number of other national and sub-national enterprises. There are also 43 “mixed” ownership firms, in which private-sector companies, individuals, former Ba’ath party representatives, and line ministries hold shares.

Table 1: Summary of SOEs as Per Their Former Affiliation With Line Ministries

Ministry/Commission	No.
Agriculture	10
Electricity	11
Finance	9
Health	1
Housing and Construction	15
Industry and Minerals (MIM)	48
Military Industrial Complex (now with MIM)	48
Irrigation	11
Oil	19
Trade	8
Transport and Communication	12
Total	192

23. SOEs fall into two broad groupings:

- Enterprises that deal in tradable goods and services, and
- Enterprises that provide public goods and services

At first sight this distinction seems straightforward. However, individual infrastructure ministries, for example, control construction and manufacturing enterprises that fit comfortably in the first category.

24. Most SOEs are large. For example, the enterprises under the Ministry of Trade employ on average 4,000 people; those of the Oil Ministry—3,500; those of Mining and Minerals—2,000; while the SOEs of the Ministry of Housing and Construction employ on average 800 people. Many SOEs are holdings for 5-15 constituent enterprises covering many medium-sized and even small SOE branches, a few of which have less than 100 employees. These SOE branches are located at different sites, quite far from the main headquarters and act as separate entities in carrying out

technical functions. The branches do not have commercial autonomy since they are not registered as legal entities. They are not allowed to sign contracts directly with customers or receive credit from banks.²

25. Of course some SOEs are utilities, providing services such as electricity, telecommunications, water and ports. In reforming these enterprises, it will be necessary to address a range of specific sectoral policy and regulatory issues more complex to tackle than those involved with industrial or trading enterprises. Other SOEs form part of the oil sector, and these again will require separate treatment depending on the government's policy towards the oil sector. It should be noted that even with the government retaining full control and ownership of oil revenues, actual production activities can be carried out by private companies or joint ventures. In Saudi Arabia Aramco and SABIC are examples of this kind of approach,

26. Most Iraqi SOEs were shut down after war damage and looting interrupted normal operations. Many have not restarted, and those that have are, in most cases, operating only partially. Most need some capital to accomplish repairs and secure raw materials before they can restart at all, let alone break even. Most also carry from 30-50 percent more staff than would normally be needed elsewhere for similar production. The overstaffing is complicated by a substantial number of ghost workers listed on the payrolls, whose salaries serve both social-safety-net and rent-seeking purposes.

27. It is clear that without further investment Iraqi SOEs cannot survive. The financial **weakness** of the government, and the many competing demands for limited revenues, do not permit Iraq to continue supporting loss-making enterprises. Even if government continues to provide such support, it is unlikely that the vast majority of these enterprises could stand full competition from market forces. If nothing is done, many of these enterprises will move towards eventual closure with consequent job losses, social turmoil, and avoidable loss to the economy.

28. From the preceding analysis of state enterprises, the following conclusions emerge.

- Return on the investments in SOEs is negligible. There is a huge loss of opportunity in terms of the revenue that the government could have generated on these investments.
- Even before the recent hostilities, most SOEs were unable to generate sufficient resources for current operations or expansion of business. Because they are heavily dependent on Government budgetary support but generate little, if any tax revenue, they feed fiscal imbalances.
- The resources consumed by SOEs could be redeployed to very much better uses, such as new schools, new medical facilities, and improved water supplies.

Iraq must attract private investment for its SOEs if they are to survive, modernize and expand. The scale of the capital investments required is such that only private sources can be realistically relied on to provide it. Were the state to provide the necessary

² For example, the State Enterprise for Construction Materials Industry accounts for 12 plants producing bricks, plastic pipes, and several other types of stone.

resources – beyond the modest emergency amounts required to restart operations - then other key investment priorities in the economy, such as critical social spending, would have to be neglected. In addition, there is no guarantee that such state investment would not be at least partially wasted, given the poor past record of such outlays in Iraq and the lack of commercial expertise of SOE managers. Indeed, modern, commercially adept management expertise is the second critical need of Iraqi SOEs, again an ingredient that can only be provided from private sources.

29. Given these realities, the primary purpose of SOE reform in Iraq should be to build a strong, modern competitive enterprise sector, a goal endorsed by participants in the polling exercise carried out at the May 2004 seminar.³ The following, in a rough order of priority, were their suggested objectives⁴ for an enterprise reform program in Iraq, in order of priority:

1. To foster sustainable economic and social development and a competitive market economy that encourages investment, employment, trade, and higher living standards in Iraq;
2. To upgrade SOEs through improved technology and better management;
3. To reduce the financial drain of SOEs on the state - subsidies, unpaid taxes, loan arrears, guarantees given;
4. To strengthen efficient capital markets;
5. To mobilize sources of private finance to fund investments for which the state can no longer pay;
6. To promote effective corporate governance, autonomy, and accountability in those limited number of enterprises in which the GoI retains an interest;
7. To promote general competition in the economy by abolishing monopolies;
8. To promote wider ownership by the public of enterprises;
9. To reduce conflict between groups over the central state machine by reducing the amount of resources controlled by the state and spreading ownership throughout society;
10. To promote integration of the domestic economy into the world economy; and
11. To gain maximum revenues from individual sales in order to fund government expenditures, trim the public sector deficit, and pay off public debt

³ The seminar was conducted for the World Bank by Adam Smith International (ASI) and involved discussions between experts from the World Bank and ASI with a wide range of Iraqi policy-makers from the main economic ministries.

⁴ In addition to program objectives, there should be enterprise-specific transaction objectives. For a discussion of these, see appendix 1.

30. It is interesting that economic efficiency and enterprise-strengthening objectives are near the top of the list while revenue-raising objectives are at the bottom of policy-makers' priorities. Further, building consensus on program objectives and design is a high priority, and to this end a series of further workshops should be held in Baghdad in the near future.

What are the challenges that the Government will have to overcome?

31. Every SOE reform program faces barriers and obstacles. These ought to be clearly identified at an early stage to inform program design and enable remedial measures. In Iraq the impediments to successful reform are substantial. The Iraqi policy-makers polled during the May 2004 SOE reform workshop identified the following obstacles, in order of priority:

12. Over-employment in the SOES, giving rise to the fear of large-scale layoffs and associated negative social consequences;
13. Legislative constraints – laws in force which prevent effective implementation of the program, e.g. labor laws;
14. Lack of appropriate regulatory frameworks and institutions (particularly in the case of utility and financial sectors);
15. Lack of effective institutions to implement the SOE reform program;
16. Poor condition of the enterprises;
17. Complete lack of financial viability in some enterprises;
18. Weakness of the Iraqi capital market and capital market institutions;
19. Fear of foreign investment among the population;
20. Lack of domestic capital to invest in purchasing shares of SOEs;
21. Corruption in SOEs, leading to strong self-interested opposition from SOE managers and or line ministry officials; and
22. Fear of concentrating ownership in a single ethnic group or a few families.

32. None of these obstacles is insuperable. However, each impediment will need to be tackled resolutely and intelligently if the program is to succeed. Of course, moreover, improvement in security is a precondition for successful SOE reform, as well as all other types of reform. A further challenge worth mentioning is the need to reform distorted input and output pricing, a subject discussed below along with the obstacles defined by workshop members.

Over-employment in the SOES, giving rise to the fear of large-scale layoffs and associated negative social consequences

33. Concern over the future of SOE employees is by far the most significant barrier to reform action. Iraq in mid-2004 faces a set of challenges -- many of them common to developing economies -- which rarely combine in such force: political transition from an especially harsh dictatorship, and then from occupation to sovereignty, transition from command to market economy, deteriorated and disinvested infrastructure, war-

damaged industrial facilities, out of date processes and technological isolation after more than a decade of sanctions, overwhelming international debt, and poor internal security. These multiple problems make the concerns of workers about their future that much more important.

34. Iraq has a total population of 25.9 million, of whom 96% are below retirement age and just over half -- 13.2 million -- are of working age, 15 to 60. Most are under 40, with relatively high potential to participate in the workforce. Within this working-age group, some 500,000 are currently employed in SOEs and upwards of 3.5 million are employed in the private sector (3.7 million were so registered in 2001). Some within this age group are not in the labor force: students, homemakers, people with disabilities, etc. Most Iraqis in this age group are unemployed for one or another reason: the former military (currently on stipends), former police, workers dislocated by disruptions of war, seasonal agricultural workers as well as unemployed persons in a normal job transition period. This last group is in a minority now. Unemployment estimates range from 28 to 60 percent. MoLSA Estimations say that 22% of the working age is unemployed and 28% is underemployed.⁵

35. Economic transition invariably causes uncertainty at the individual, firm, community, and national levels. Basic needs and earnings are no longer guaranteed. The labor force becomes vulnerable to risks against which the former regime protected them. Throughout the country there is talk of restructuring and privatization and fear that jobs will be changed, or worse, eliminated. Absent the full-employment policy of a socialist economy, workers confront the unfamiliar task of finding a new job, one that may not be secure, and one under which there is an uncertain safety net to support them when the next market shift hits. Every working person supports a family of three or four dependents.

36. These job-insecurity concerns represent one of the more formidable impediments to privatization in Iraq, as elsewhere, and one that is often exploited by opponents of reform. The reason for this unpopularity is that people in most countries continue to associate privatization primarily with job losses. They do not see labor adjustment as a natural and dynamic process. The positive drivers of privatization such as new investment, modernization, and improved productivity and the many other economic benefits seem intangible when compared to the immediate human impact of reforms.

37. And there can be no doubt that, in Iraq, as elsewhere over the short-term, privatization and other forms of economic adjustment will lead to job losses in those sectors and SOEs that are no longer viable or suffer from overstaffing and levels of redundancy. Because of this, as a matter of priority, a range of measures should be prepared to cushion workers from the effects of enterprise reform. These social-safety-net measures will likely include

- Generous redundancy or severance payments;
- Retraining programs to impart or upgrade needed skills ;
- A range of programs to assist workers to reenter the job market – such as the establishment of employment agencies;

⁵ This data is the best available as of May 2004 and is drawn from a number of sources notably the Ministry of Industry and Minerals.

- Public works programs.

38. There are of course a variety of alternatives in the design of such programs. For example, in the redundancy area, the Chinese model provides a monthly payment for a set period in contrast to the lump-sum payoff approach adopted in most other countries.

39. It will be important to be open and honest about the short-term negative employment impacts of enterprise reform and to introduce these safety-net measures so that laid-off employees can benefit from them whenever and wherever necessary and in parallel to the reform of SOEs. Designing the necessary social-safety measures is one of the highest priority technical assistance needs.

40. Difficult though these problems are, Iraqis can take heart from the many other countries that have successfully tackled major over-employment in SOEs, using a range of techniques based around those described above.⁶

Legislative and institutional constraints

41. Although Iraq lacks most of the laws, regulations, and associated institutions required to permit the smooth development and implementation of a SOE-reform program, it has time to rectify this deficiency, given that there are no plans to proceed with rapid privatization. It is, however, important to proceed to design and put in place the necessary laws and institutions as soon as possible. Laws and institutions specific to SOE reform are discussed in section 5 below. Other key laws, regulations, and institutions related to the investment climate will need to be put in place quickly, since without such measures, investors will not muster the confidence to act on SOE privatization or other market opportunities.

Poor condition/lack of financial viability of the enterprises

42. Although many enterprises are in a poor condition and, in most, the technology is considerably out of date, many are also capable of being revived. In some cases private investors in many countries have done an excellent job of turning around inefficient, out-dated, loss-making state enterprises, and can do the same in Iraq. For example, in India, private investors have bought antiquated, state-owned, sugar and textile mills that were actually closed, reopened them and are now making profits. In general the international experience of private sector involvement in the tradable sector has been very positive. (see Box below)

⁶ For further information on the international experience, see the Labour Restructuring Toolkit, prepared for the World Bank by Adam Smith International

Box: Empirical surveys of privatization

Meggison and Netter (2001) survey cross-cutting studies that evaluate the impact of privatization on firm performance. The most comprehensive studies use a similar methodology to compare performance measures before and after privatization (over at least three-year periods) for large numbers of companies in developed and developing countries, privatized mainly through public share offerings (Meggison, Nash, and van Randeborgh 1994; Boubakri and Cosset 1998; D'Souza, Nash, and Meggison 2000). These studies find similar results. Weighted averages of the mean values show that profitability, defined as net income divided by sales, increases from an average of 8.6 percent before privatization to 12.6 percent afterward. Efficiency rises from an average of 96.9 percent in the year of privatization to 123.3 percent in the period after privatization. Between 79 and 86 percent of firms see increases in output per worker. Most firms achieve economically and statistically significant increases in output (real sales) after privatization and significant decreases in leverage. Capital investment spending increases slightly, whereas employment changes are ambiguous (see later discussion). Accounting for most of the performance improvements are changes in the incentive and management structure, along with improved corporate governance.

Source: An Assessment of Privatization, Sunita Kikeri, John Nellis (2004).
<http://rru.worldbank.org/Documents/kikeri-nellis.pdf>

43. However, some enterprises will be difficult to revive. In these cases it will be better to face reality and liquidate them, rather than throw more good money after bad. The assets of these enterprises can be sold and put to new, more productive uses. For example, as set out below, the Iraqi Ministry of Industry and Minerals estimates that 10 of its 53 enterprises are economically unviable in any circumstances and will need to be liquidated. It will be necessary to survey enterprises to undertake a categorization process and determine which are altogether unviable, which require restructuring and which are clearly viable.

Popular fear of foreign investment

44. In countries which have been relatively closed to the outside world, foreign investment is often feared as an unknown factor that will cause an influx of lots of foreigners and somehow undermine national traditions and national independence. Even in the United States, such anxiety surfaced in recent decades over Saudi Arabian purchases of farm land and Japanese acquisition of such landmark real estate as Rockefeller Center. For many decades, Turkey barred foreigners from acquiring seafront property. In fact, the fear is exaggerated. . Countries that are part of the global trading system compete with one another to attract foreign investment, valuing foreign investors as a very welcome and useful means of creating new jobs and building the local economy.

45. Iraq, too, should welcome foreign investment as a critical contribution to the reconstruction process, both in general and for state enterprises in particular. Since, however, misplaced fears about foreign investment in some parts of the Iraqi

population could act as a brake on the enterprise reform program, an extensive public education program is needed to bring the apprehensions out into the open, discuss them and lay them to rest. Several countries with a history of nationalism and suspicion of foreign involvement, such as Mexico, Peru and Argentina, have accepted huge quantities of foreign investment in sensitive sectors of the economy after effective public education was carried out. In addition to their capital, foreign investors bring new approaches and techniques that can help Iraq compete more effectively on a global basis and, in turn, help secure jobs. Portfolio investors inject new money into the economy through the stock exchange. In fact the main risk that Iraq faces is that foreigners will consider Iraq too unstable an environment to invest in. These are some of the messages that the Government needs to get across to the population.

Weakness of the Iraqi capital market/ Lack of domestic capital to invest in purchasing shares of SOEs

46. The Iraqi capital market is certainly weaker than that of many other countries. Nevertheless, over 100 enterprises are listed on the Baghdad Stock Exchange, and there is a history of investment in shares. Experience from other countries has shown that citizens have more money than is usually expected to trade in shares if the opportunities are attractive and the marketing is effective. The capital market will be strengthened as new companies join it through the privatization program. Technical assistance to strengthen the exchange and assist companies to comply with listing requirements will be necessary. In the Middle East and North Africa, in any case, instead of any particular shortage of capital, there are weaknesses in the institutional framework and an absence of sufficient attractive investment opportunities. In Kuwait, after the Gulf War some \$3 billion of flight capital returned to the country and was invested in privatization once the conditions were right.

Corruption in SOEs, leading to strong self-interested opposition from SOE managers and/or line ministry officials

47. Corruption is always a high barrier to effective reform. When individuals are benefiting illegally from the status quo, it is always more difficult to persuade such entrenched interests to accept change. Reducing corruption is, of course, one of the reasons for privatization. When real people own an enterprise, they have no incentive to steal from themselves and every incentive to stop others doing so. The governance changes for state enterprises discussed in section 5 would also make corruption less likely in advance of privatization, as managers would be appointed through a transparent and competitive process on the basis of merit, and line ministry officials would be less involved in running enterprises.

Fear of concentration of ownership in a single ethnic group or a few families

48. As part of a greater democratization of capital ownership in Iraq, privatization should not lead to further concentration of wealth. To insure this outcome, requires that a clear strategy be designed to use the program to spread wealth rather than concentrate it. Public offers of shares and opportunities for SOE employees to acquire shares are two approaches to consider.

Other constraints

49. The constraints listed above are by no means the only ones. For example subsidized input prices are sending confusing economic signals. Oil and energy prices are at a fraction of regional levels, let alone world levels to the point that motor fuel costs less than a tenth as much as in Kuwait and Saudi Arabia. This means that enterprises which rely heavily on subsidized energy inputs and seem currently profitable may be neither profitable nor viable if prices rise. This concern adds further uncertainty to policy planning.

50. One-company towns where a single SOE is the dominant employer and major layoffs are likely pose another difficult issue and will often require special treatment. In the case of Egypt there are number of towns in the Nile Delta where textile mills are the main employer. This issue has prevented serious reform taking place. The point made previously about integrating social-safety-net provisions is especially important in such cases.

51. Since a number of the impediments discussed above are related to public perceptions as much as to real difficulties, public consultation and communication are critically important means to address misconceptions. To achieve the public understanding necessary for success will be challenging as long as so much rhetoric and superficial criticism color discussion of enterprise reform. Breaking with oft-stated historical positions on the role of state enterprises is a great challenge that demands of both public and government courage and a vision of a better way. It is especially critical to have the resolve to do what is right when the problems of state enterprises threaten the public finances of the State and can often seem, large, complex and even insurmountable. The need for a sustained communications effort is discussed at greater length in section 7.

An institutional and legal framework for enterprise reform

I.1. Which institutional framework for Iraq?

52. There are many choices of ways to undertake an SOE reform program – do it quickly, do it slowly; involve many enterprises, or just a few; use these methods, or those. But international experience shows that however a country chooses to design its program, it is important to construct a very robust institutional framework to implement it. This global experience has shown that:

- The effectiveness of and respect for the institutions dedicated to implementing privatization is critical to success of the policy.
- Transparent, publicized procedures are essential to maintain public credibility of the process.
- Decision-making at macro- and micro-management levels must be clearly divided so that the same decision is not continually revisited, or revised.
- Clear allocation of roles and responsibilities confines different decisions to the persons best placed to recommend or take the decisions.

53. Different countries have utilized a variety of different institutional frameworks. A few developed countries, notably Britain, have relied on line ministries to carry out the process. This example has not been followed in developing countries, where line ministries have not had the capacity to manage privatization. Most developed and virtually all developing countries have set up specialized agencies for the purpose. Even Germany entrusted a single entity with privatizing all 13,000 SOEs.

54. Iraq is likely to have to adopt such an approach. Line ministries do not possess the specialized skills, and it would be a waste of resources to try and build the necessary capacity in each of them, even if it were possible to do so and respect civil-service pay scales.

55. Current conditions in Iraq mean that a solid institutional framework and concentrated authority for the enterprise-reform program, preferably underpinned by legislation, is particularly important. If a professional agency with effective legal powers is not established, it is possible that the program could either fail completely or be characterized by badly handled, and in some cases corrupt, practices which would yield poor results and discredit the program.

56. Among alternative options, one approach involves giving all power to a centralized agency, as in Germany. Another approach involves sharing power between a centralized agency and line ministries, as Jordan did. It started with a privatization unit in the office of the prime minister and then moved on to create a Privatization Commission under a special law. For each significant privatization or group of privatizations a committee is created involving both the line ministry and the Commission. Sometimes the committee is chaired by the line minister and sometimes

by the head of the Privatization Commission. Decision-making is joint, but the bulk of the work is done by the Commission's professional staff.

57. Establishing who is responsible for what and who has authority to do what in enterprise reform will be of particular importance in Iraq. Otherwise each attempt to move forward will be subject to negotiation between various interested parties without it being clear who has the authority to decide. This bargaining will result in an unmanageably large number of difficult decisions being referred upward to the cabinet and the prime minister. This can paralyze the process. To expedite privatization in Pakistan the Government recently appointed an additional Minister of State to help resolve the situation. Reviews of SOEs in the governorates have highlighted the significant obstacle formed by the conflicting interests of various parties (e.g., government ministries, provincial governors, powerful managers, local militias) who may lay claim to current or future SOE value. In light of such contention, managing a privatization transaction in the short-term without both clear allocation of authority and painstaking technical and political preparation by a professional organization promises to be fraught with danger. At present no one institution has overall responsibility for SOE reform. Some line ministries, notably the Ministry of Industry and Minerals, are pushing ahead to try and privatize assets, mainly through leasing. The Ministry of Finance has certain supervisory responsibilities, particularly in relation to staff numbers.

58. It would seem unwise to give any single existing ministry full responsibility for SOE reform first, because none has the capacity and, second, because concentration of power in an organization headed by one minister is unlikely to be acceptable in Iraq's conflict-ridden and divided society.

59. Given concern over concentration of power, the model of decision-taking by a commission that brings together a range of interests is more likely to be successful. This is also the norm for privatization agencies which are generally headed by a commission of ministers and other senior figures. In some countries, representatives of labor and the private sector are also included. This approach provides the transparency that is essential if the program is to gain the confidence of the political class as well as the population at large.

60. In many countries the commission or board is chaired by the minister of finance, in others by the prime minister or another minister. Other key ministers are often members. If judged necessary, it would be possible to ensure that the commission in Iraq was ethnically and politically balanced so that major political groups believed themselves to be on the inside of the decision-making process. Given sensitivity about the word "privatization," it may be preferable to refer to the body as an Enterprise Reform Commission.

61. Another key to success in Iraq will be effective staffing. As noted above, privatization requires special skills and experience not usually found in the public sector, such as financial, accounting, legal and communications skills, as well as the experience to utilize these skills in the context of a privatization transaction. It will not be possible to find the appropriate skills within the civil service, nor to attract such skills at either current rates of pay or those being envisaged for the top levels of the civil service. It will be necessary to pay market rates sufficient to attract young Iraqi

lawyers, accountants and other professionals from their jobs in Iraq as well as other Middle Eastern and western countries.

I.2. Core requirements for an effective institutional structure

62. Most institutional frameworks for privatization involve three different levels of decision-making:

- Cabinet/prime minister or president level – few decisions are taken at this level and they are usually of an overall policy nature that provide guidance on labor issues, liabilities to banks and financial institutions, environmental liabilities, and other recurring issues, as well as decisions on which enterprises to include in the program at any given time.
- A cabinet subcommittee or privatization commission. Its members are normally key ministers, supplemented, in the case of a privatization commission, by experienced private-sector/civil-society figures. This is the body that takes the key decisions in the course of a transaction, approving the choices of privatization method and of preferred bidder, for instance. Line ministries usually have a role on the committee, at least on a case-by-case basis. A number of countries, such as Jordan and Peru, also have transaction-level committees.
- The executive/implementation level, a unit of professionals headed by a senior figure who leads the privatization program.

63. Levels two and three are often combined in the same organization, with the commission overseeing the executive body. In later years, there is cost recovery from proceeds, with donor funding sometimes a possibility in the early stages.

64. International experience demonstrates that an effective institutional structure for privatization will have the following key characteristics:

An effective institutional setting

65. To have maximum influence and access, the executive body needs to be close to key decision-makers, reporting, in many countries, to the prime minister's/president's office or to the finance minister. The nature of its relationship to the political leadership will vary according to its legal status, but the key factor is the attention and the support of a strong, central figure within government.

Legal authority

66. International best practice and experience illustrate that the privatization process, program, and institutional framework should be underpinned by primary legislation. The adoption of privatization legislation with public debate gives the reforms political legitimacy as well as the legal authority a specialized unit needs to act. It explicitly displays the government's political commitment to the policy, sending a clear message to the public service and public enterprise that the government is serious and committed and that obstruction will not be tolerated. A specific law on privatization

clearly establishes the powers, duties and functions of the supervisory and executive body and the roles to be played.

Strong executive body

67. A weak executive body will fail to overcome opposition from vested interests. An effective agency needs the following attributes:

- The administrative authority to require state enterprises and government ministries to comply with its requirements. SOEs and line ministries frequently resist privatization, and unless the executive body has the power to obtain information and instruct that actions be taken, progress will be frustrated. Purely advisory bodies are unlikely to be effective.
- The necessary professional skills to implement the program. Privatization requires special skills and experience not usually found in the public sector, such as financial, accounting, legal, and communications skills, as well as the experience to utilize these skills in the context of a privatization transaction. For this reason a unit staffed by civil servants is unlikely to be effective, as it will be constrained by civil-service pay scales.
- Adequate resources to implement the program. Privatization is a resource-intensive process. It requires both a substantive core team in an executive body, as well as access to many outside consultants. Governments frequently underestimate costs and inputs needed, and they often need access to external resources in order to finance the program. However, the core team needs to be kept lean, with many tasks contracted out to the private sector.

An effective head of the executive body

68. This person should be able to command respect both within government and with the public at large. He/she should have excellent managerial skills and sound experience in successful project implementation and commercial negotiations, but critically, also needs to be a public advocate for change, committed to the success of the process.

A close relationship between the executive body and the political decision-makers

69. The executive unit and its advisers must gain the support and confidence of top decision-makers. An effective executive body produces well-formulated, high-quality recommendations to be approved in a timely fashion without significant alteration by the political authorities. The professionals in the executive body, therefore, should have ready access to the decision-makers, an advantage that reporting through civil service lines of command is unlikely to deliver effectively.

Appropriate delegation of decision-making

70. Privatization is a time-consuming and technically complex process involving many thousands of individual decisions, many of which are quite complex and require extensive analysis. It is not really possible to divide a privatization process into

decision-making on the one hand and implementation on the other. For a process to work smoothly the institutional structure must have two key features:

- decision-making must be delegated as far as possible, to those who have the greatest competence to take the decisions in question
- a high degree of professionalism is required in every part of the institutional structure, in order to ensure that complex matters are handled effectively and decisions taken quickly and at the most suitable level. In practice, the executive body will take the large number of implementation decisions needed in the course of a given transaction, while the supervising cabinet sub-committee/commission decides key or sensitive issues, and the cabinet limits itself for the most part to major policy issues.

I.3. A privatization law

71. The contents of a privatization law and the associated institutional and decision-making framework must avoid over-design and elaborate processes and adopt an approach that reflects the needs and resources of Iraq. It is desirable that policies, procedures, and implementing arrangements reflect most of the provisions set out below to insure that the primary privatization law is not over-burdened.⁷

A law should:

- Make provision to establish an institution responsible for privatization (e.g. Enterprise Reform Commission, ERC) [[with a supporting executive made up of specialists (supported with specialist advice and assistance).
- State the powers, duties and functions of the ERC and grant the necessary authority to the Board to carry out privatization policy and implement transactions according to a specified process.
- Ensure that the ERC will be small enough to be effective but representative of government, the private sector and different elements of Iraqi society.
- Ensure that privatization is a private sector activity in a public sector setting and brings to bear a mix of commercial, political and administrative skills and experience as needed.
- State what can be privatized – e.g. all government property, broadly defined to include direct and indirectly owned, managed or controlled property.

⁷ Detailed provisions of a law are set out at appendix 2.

I.4. Institutional arrangements for SOEs that remain in the state sector

72. State management of SOEs is difficult to get right. A Bank study “Bureaucrats in Business”⁸ identified the following preconditions for successful SOE management:

- The existence of hard budget constraints
- Factor market disciplines (capital and labor)
- Competition
- Corporate governance free of political interference, and
- Commitment to eventual privatization

73. These conditions are rarely met in the MNA region. More often than not SOEs under-perform from both a capital- and labor-efficiency perspective. Qatar is one country that has managed to follow most of the conditions, and as a result its SOEs perform remarkably well.

74. The current arrangements for state enterprises in Iraq – owned by line ministries of which they are effectively part – are less than ideal. It would be best practice for all SOEs not already in a corporate form that will remain in the state sector in the medium term to be incorporated under commercial law. But who should exercise then ownership?

75. Options for Iraq would include (i) continuing with line-ministry control, but seeking to improve governance arrangements, (ii) creating a new holding company to manage state assets and (iii) transferring ownership and control to the organization responsible for privatization. Of the choices, the first two create incentives to retain the organizations under state control. If structured properly, the new privatization agency is more likely to take a balanced view of appropriate policy.

76. International best practice would suggest that rather than having line ministries (and on occasion various other state enterprises) as SOE shareholders, ownership should be consolidated in the organization responsible for privatization.

77. This would mean that the shares of all SOEs should be held by such a body (as suggested earlier, the Enterprise Reform Commission of Iraq (ERC)), which would be responsible for exercising the rights, duties, and privileges of shareholders conferred by commercial law. The ERC would be responsible for:

- Varying the Memorandum and Articles of Association.
- Appointing and removing directors.
- Approving and receiving dividends.
- Approving the amalgamation, winding up, or transfer of the company.

78. In discharging these responsibilities, the ERC could be obliged to consult with the concerned ministry but not bound by the results of that consultation. As the owner, the ERC would mandate changes in management, financial, and human resource policies. In particular it would mandate a transparent and competitive procedure for the selection of board members and senior management.

⁸ World Bank; Bureaucrats in Business – The Economics and Politics of Government Ownership (1995)

79. It could be a requirement that recruitment to the positions of SOE board director and chief executive should be competitive, triggered by open advertisement of the selection criteria and minimum qualifications in several publications. The shortlist formed should be available for public inspection (on a website, for instance).

80. Serving public officials, however, would be barred from serving on SOE boards for the following reasons:

- The whole emphasis of the proposed reforms is to make SOEs operate in a manner more akin to private companies. Public officials rarely have any inclination for, training in, or experience of, commercial matters.
- The presence of public officials on SOE boards is another channel for political interference in the management of such enterprises.
- The primary duty of company board directors is to act in good faith in the interest of the company they direct. In discharging this duty, they are neither representatives nor delegates of the shareholders and must not restrict their discretion as to the way they discharge it. A public official has a similar duty to his ministry, whose interests on particular issues will not necessarily always coincide with those of the company. In such cases, public officials would face acute conflicts of interest.

81. Any provisions in law giving ministers powers to intervene in the management of SOEs would be repealed.

82. The current framework for management and financial oversight of SOEs is in need of radical reform. Implementation of timely, accurate and consistent financial information (probably in accordance with International Accounting Standards) will be a crucial step in ensuring the accountability of each SOE's board of directors. There will also be a need for some form of independent audit reporting on the activities and financial position of SOEs on a regular basis.

83. All employees of SOEs that remain in the state sector should lose their status as civil servants and sign new employment contracts as employees of the state enterprises. **This transition will need to be carefully managed, to deal with concerns employees may have on issues such as tenure and pensions.**

84. A significant danger in passing responsibility for ownership to a specialized agency is that it becomes over-attached to its role and, to maintain its patronage power, seeks to resist the privatization of enterprises under its control. A variety of approaches can be taken to guard against this danger. These include:

- Only transferring ownership of enterprises subject to privatization in the short-term. (But this move would have the disadvantage of giving many line ministries and enterprises an additional reason to try to classify SOEs as due to remain in state hands for the medium term).

- Restricting the role of the ERC in respect of enterprises classified for retention in state ownership only to the selection of board members.
- Placing a defined life on the ERC, such that it has to complete the task of privatization of all enterprises in, say, 5 years, after which time ownership of remaining SOEs would be transferred to a new body.
- Recruiting the staff of the ERC on short-term, rolling contracts and choosing people with a clear commitment to the privatization program and no pecuniary motive for making a career out of controlling state enterprises. They can be paid good bonuses for early sales and finishing up the program.

85. Even if, alternatively, line ministries retain control, it would be preferable to improve governance arrangements by introducing open and competitive processes for constituting the boards and management of corporatised state enterprises, as well as new approaches to personnel management policies in state enterprises.

86. A state holding company for all SOEs is also a possibility, but other countries have found that these tend to become empires in their own right and reluctant to press necessary reforms.

I.5. The role of line Ministries with regard to SOEs.

87. Line ministries' key responsibility is for overall sector policy – to define it and the range of instruments required to develop it and to insure its implementation. In too many countries SOEs became a substitute for an effective sector policy, and grappling with the problems of failing SOEs consumed the bulk of the attention of the line ministries.

88. Of course some SOEs can help line ministries implement sector policy by performing various non-commercial roles, notably – in Iraq – employing large numbers of non-productive workers. The fact that some SOEs have non-commercial objectives is often cited as a reason why they cannot be reformed or privatized.

89. However, one approach to the problem of non-commercial objectives is to put SOEs under contract to the ministries so that each SOE's non-commercial objectives, functions and powers, once defined, would be set out in an enforceable contract. Effectively, the SOE would become the government's agent for implementing certain elements of social policy. In any case, if any SOEs perform social functions for their employees, (such as kindergartens, health and vacation facilities), these would likely be separated from the SOEs in question.

90. Once an SOE's non-commercial activities have been identified, a figure could be put on the cost to the SOE of undertaking them and, to the extent that this is possible, on the value of the benefits flowing from them, with some identification of the beneficiaries or classes of beneficiaries.

91. The basis of calculation would be set out clearly and in detail, in each case, in the contract. It would be necessary to create dedicated budgetary control and financial and management information systems for each non-commercial activity.

92. Once the costs and benefits of non-commercial activities have been objectively analyzed case by case, it may well be that some no longer make a worthwhile contribution to social welfare and should be discontinued in favor of more effective approaches.

93. The government would then compensate the SOE (its agent) for the identified cost of undertaking non-commercial activities. The compensation should take the form of a grant payable before the calculation of the SOE's profit and declaration of dividend. This transaction should not affect the government's overall financial position, since such sums as the government receives from the SOEs at present (if any) are diminished by the cost of the non-commercial activities. The contract would create transparency where at present there is obscurity, produce a more appropriate allocation of responsibilities between ministries and the boards of directors of the SOEs, and improve the SOEs by removing an obvious excuse for poor performance.

I.6. Short-term steps: corporatization, management, financial and HR reform

94. Iraqi leaders do not want to rush into a policy of privatization. However, the period ahead provides an excellent opportunity for useful preparatory work for future reforms, a time for collecting and analyzing necessary data, conducting policy planning, developing options, continuing capacity-building, designing institutional arrangements, and implementing public awareness programs needed to build public understanding and support.

95. This preparatory work is required to move SOE reform plans ahead so that the government to be elected in early 2005 has sufficient policy analysis and policy options in place in order to act effectively without extensive delay.

96. A variety of short-term steps should also be carried out irrespective of the degree to which Iraq proceeds down the privatization path. The most important of these steps could be described together as commercialization. A series of measures designed to improve the effectiveness of state enterprises would transform the SOEs into corporations (subject to commercial law), install professional and accountable directors to oversee their activities, and make their employee's contractors rather than civil servants.

97. New approaches to financial management of SOEs are needed. Again these should involve converting current practices to resemble those used in the private sector. Iraqi SOEs need both greater independence and greater responsibility in handling their financial affairs. Within a hard budget constraint, SOEs need greater freedom to take commercial decisions without first seeking approval from Baghdad. This would mean giving them the permission to commit funds and make purchases on their own account, with subsequent inspection to identify wrongdoing.

98. It is clearly important to proceed as soon as possible with necessary research in order to determine the best means of achieving the various commercialization steps set out above.

99. Other preparatory work should include a comprehensive, enterprise-by-enterprise, information-gathering exercise on legal, financial, and operational issues. Without accurate data it is impossible to design effective policy options. Experience from around the world has shown that when data collection in general - and legal due diligence in particular - is not performed effectively at an early stage the privatization process and specific transactions will be delayed or blocked.

100. Environmental issues should also be examined and an approach to dealing with them built into the program. One element of the privatization of state-owned facilities in most countries involves the identification and quantification – usually through environmental audits or similar assessments -- of environmental problems or liabilities attached to SOEs. Experience in many privatization programs has demonstrated considerable merit in integrating environmental issues into the privatization procedure so as to make cleaner sale possible; eliminate the possibility that Government will be held liable for environmental problems after the divestment; and -- in many cases – even increase the price paid for the privatized entity. The purchaser also benefits in a number of ways, but most importantly in that the environmental requirements of the regulatory authorities are identified in full and their costs can be incorporated into business and investment planning. Citizens benefit, in that long-standing environmental problems are finally tackled.

I.7. Program design and choice of methods of reform

101. The choice of program objectives and transaction objectives will affect the methods used. Among the wide range of methods are:

- Sale of businesses, assets and shares by tender or auction;
- Sale of shares by public offer;
- Free distribution of shares to the population;
- Management / employee buy-out of enterprises;
- Leasing or concessioning of enterprises or assets;
- Contracts for the management of enterprises; and
- Contracts for the provision of services

102. Clearly some methods do better in achieving certain objectives than others. An objective of promoting wider public ownership of enterprises will best be achieved either by public offer of shares or by some form of free distribution of shares.

103. Objectives of upgrading SOEs through improved technology and better management and of mobilizing sources of private finance to fund investments which can no longer be paid for by the state are more likely to be met by selling SOEs to private companies with the management and financial strength required to improve management and make the investments required.

104. In practice, the condition and needs of the enterprise should strongly influence the method of reform chosen. For example:

- It is neither feasible nor responsible to sell the public shares in loss-making companies with poor financial records and low quality management.
- If substantive investment in an enterprise is required, neither leasing the enterprise for a limited period nor arranging a management contract will succeed in attracting that investment.
- If an enterprise has high value assets, then it is unlikely that the management and employees will be able to raise the funds to purchase it, particularly if the banking sector is in poor condition, as in Iraq.

105. A weak enterprise in need of considerable investment needs will likely need a substantial private company (often known as a strategic investor) to inject the funds and management skills required to turn it around. If, on the other hand, an enterprise has reasonable quality management and is of a reasonable size with good financial records and a history of profits, then its shares could be offered for sale to the Iraqi public. The sale of a number of such enterprises could offer the opportunity to widen considerably the number of Iraqis owning shares in a form of economic democratization.

106. Iraq has previous experience with a variety of different privatization methods. In order to inform current policy thinking, it would be particularly useful to evaluate their impact in the 1980s and 1990s with particular focus on the industrial and agricultural sectors. Evaluating lessons from those efforts could contribute to formulating a new SOE reform program.

107. Once policy and objectives have been established, it will be important to develop a schedule – a master plan – of the proper sequence for SOE reform. The results of options studies of individual enterprises should be brought together into this document, which should identify priorities and set out a time-bound work plan.

108. This master plan should

- i)* Provide the government with a broad strategy outline and schedule of activities, setting out various SOE reform methods, including an overall indication of and time-frame for various decisions that will have to be made to implement various transactions;
- ii)* Set out a time-bound action plan for implementation of the program.
- iii)* Identify support programs such as sector reforms, changes in the legislation and regulatory framework, etc. that will have to be dealt with to ensure smooth implementation of SOE reform
- iv)* Provide government with a tentative monitoring and control tool for managing the program;

- v) Provide government with a basis for reviewing the overall, long term economic impact envisaged from the reform program.

109. The master or sequence plan should be reviewed on an annual basis to identify accomplishments and constraints encountered during the preceding year. The annual review should update the prioritization of the privatization objectives, the projects to be implemented, and the relevant measures needed. This rolling-plan approach should ensure that the goals of SOE reform remain clear and consistent while providing for flexibility in implementation as circumstances change. Following the adoption of a clear SOE reform policy, extensive technical assistance will be required to produce the option studies and master plan.

The need for public awareness and consultation

110. Public acceptance of enterprise reform is essential if an effective program is to proceed. Along with considerable public misunderstanding and disquiet in Iraq about various aspects of potential reform plans goes a widespread lack of knowledge of the problems of state enterprises and realistic remedies for them. Without a thorough, comprehensive program of public awareness to dispel these misunderstandings, the available policy options will be severely handicapped.

111. Reforming state enterprises and increasing private – including foreign -- participation in economic activity raise sensitive and complex questions the answers to which will be critical to Iraqis' future prosperity.⁹ If progress is to be assured, it is essential to have constructive discussion leading to a common understanding on the need for change.

112. The government will need to launch an enterprise-reform public awareness program to reach out to the different stakeholder groups, preceding that effort with research to determine stakeholder concerns locally and nationally and establish how best to assuage them. Key stakeholder groups include:

- Employees and managers of SOEs;
- customers of SOE services;
- suppliers to SOEs;
- branches of the civil service in involved sectors, particularly those in line ministries which control the enterprises concerned;
- communities surrounding SOEs; and
- interested journalists and other opinion-formers.

113. The process of seeking public understanding should be as much one of consultation as education. Through seminars, workshops, and by formally inviting responses to consultation papers the views of interested parties should be sought so as to take them into account when designing the program.

⁹ For an analysis of these issues, see 'Building Support for Privatization – Key Strategies & Techniques' Adam Smith International, 2004.

114. An excellent opening step is to prepare, circulate, and discuss a policy document. A well-drafted policy statement on SOE reform, which goes through an extensive consultation process before adoption, will have many benefits, including:

- Creating certainty about privatization aims and policy and providing a clear statement of government commitment that helps clear the air and remove doubts about the policy direction;
- Building public awareness and support;
- Reducing opposition;
- Showing how the policy benefits Iraq and the general Iraqi public;
- Appealing to outsiders -- taxpayers and consumers -- rather than dealing always with insiders -- employees and management;
- Showing the longer term, general, dynamic effects of the policy as well as the immediate, static, transaction-related costs;
- Giving the bureaucracy the resolve to tackle difficult issues and in particular backing those individual bureaucrats who are trying to bring about change; and
- Providing evidence of commitment to potential investors.

115. Of course such public consultation documents vary depending on the point in the process when they are issued and the precise objectives at the time. The level of detail with regard to program, timetable, and targets will obviously differ according to how much preparation has been done. It may well be advisable to issue several such documents at different stages in the process.

116. Transparency and a completely free flow of information will be essential. The gains from reform are real but often are not immediately obvious. Therefore, constant provision of factual information is of particular importance. Transparency and accountability in the privatization process will engender public confidence in the process.

117. A key element of transparency should be a process for evaluating the enterprise reform exercise, which ensures that lessons learned are put into practice. To instill confidence and credibility in the evaluation, reports on completed transactions and reform policies should be published. The evaluations – by an independent observer -- should compare outcomes to objectives; detail valuations and their utility; measure the choice of methodology and options and the completeness of procedures, including the provision of information; gauge marketing efforts undertaken to maximize investor interest; and assess bid evaluations and procedures, engagement of outside consultants and related matters.

118. In evaluating a privatization transaction the independent evaluator should be required to examine all major aspects of the sale that have a bearing on propriety and value for money. The evaluator should have access to the key parties involved in the preparing and executing the sale, among them managers and employees of the

enterprise being privatized, bidders, institutional investors, advisers, industry and academic experts, and consumer groups. The evaluator will also need access to all documents relating to the privatization. In addition to specific transactions, policy reforms such as corporatization should also be independently evaluated.

Interim needs – dealing with the current crisis in SOEs

119. Substantive reform of the SOE sector to involve private investment and management is essential to the long-term success of the Iraqi economy. However, there is a shorter-term challenge: to restart SOEs that are currently non-operational.

120. Restarting industry is critical to involving the labor force in productive activity and to preserving the existing industrial base for later economic reform. From economic reform can flow new job creation in the private sector. A restart is now on the agenda of the Ministry of Industry and Minerals (MIM), the home of the bulk of the industrial SOEs, including a few SOEs with roles in the civilian economy recently folded into MIM from the military-industrial complex (MIC). It requires a sorting procedure to separate the least and the most promising units; there are many estimates and no firm decisions about which is which. The MIM Technical Department, in closest touch with production, in Spring 2004 estimated the division of MIM SOEs as follows:

Total number MIM (excluding new MIC inheritances) SOE companies (many include multiple plants):	53
Non-commercial institutional SOEs (unlikely privatizations):	6
SOEs capable of sustaining their salaries and operating costs:	14
SOEs, destroyed or economically unviable in any conditions:	10
SOEs, capable of break-even production to pay salaries:	23

121. The ministry wants to restart the viable SOEs so that they can keep their staff working and off the streets, cover their salary bills, contribute to critical supplies, help kick start the economy, and buy time for medium term restructuring. Among other overall objectives of the restart strategy are:

- a) Preventing disturbances among up to 400,000 SOE employees and their families, with potential consequential damage to SOE factories;
- b) Securing supplies of essential materials from local producers for reconstruction;
- c) Introducing a credible and sustainable salary system; and
- d) Avoiding – at the least -- dislocation of medium-term industrial development strategy and -- at most -- contributing directly to industrial development

The primary necessity is to provide funds to carry out necessary repairs at viable SOEs, and only there. Preliminary estimates suggest that meeting electric power needs will cost around \$300 million, basic repairs to viable SOEs some \$350 million more and support to SOE start-up costs some \$100 million.

122. The current plan of the MIM is to disburse funds to SOEs for electricity connections, repairs, and initial salaries on ~~performance management~~ condition that they cover all operational costs and salaries within 5 months and introduce a sound salary system. The criteria specifying a disbursement schedule and incremental performance would be set individually in each SOE and agreed upon by management and a legitimate representative of the workers.

123. Clearly it will be necessary to undertake through investigation of the real costs of rehabilitation at each facility. Very few thorough investigations of Iraqi SOEs have been done to date. One exception is the Iraqi Southern Fertilizer Company, where a fairly detailed investigation was conducted. This revealed that initial estimates of repair costs at circa \$80m were grossly exaggerated and that government expenditure of \$15m was sufficient to get the plant going. Interestingly, the study also showed that getting this profitable plant moving again was a sensible investment decision on the part of the government. The fertilizer plant was used as a case study at the May 2004 SOE Reform Workshop, and the bulk of Iraqi participants recommended modest short-term state investment to enable restart followed by some form of private investment, whether joint venture or outright sale.

124. At the time of writing, Iraq has approved some \$100m in emergency repairs to certain enterprises. The GoI appears to intend financing these emergency repairs itself, rather than relying on donor funding. This course is no doubt sensible, as disbursement of budget funds will be much quicker than donor funds, and the government will have a greater incentive to ensure the funds are spent wisely.

125. However, there is a need for technical assistance in determining which enterprises are potentially viable and should therefore receive repair assistance, and then in determining accurate repair needs and costs at those SOEs. If the performance-agreement route is pursued, then assistance will also be required in that area. Last, there will be a need to design an emergency redundancy scheme sooner rather than later for those in the non-viable enterprises to be closed.