

**PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: AB1061

Project Name	IQ-EMERGENCY PRIVATE SECTOR DEVELOPMENT
Recipient	Ministry of Planning and Development Cooperation
Implementing Agency	Ministry of Planning and Development Cooperation
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I. Key Development Issues And Rationale For Bank Involvement

Key development issues

1. Iraq needs rapid economic growth if it is to meet the aspirations of its 26 million people. Income levels are low—GDP per head is estimated at \$840 in the year 2003—and there are high levels of unemployment and under-unemployment. Some estimates place this number at 50% or more, with an official estimation of unemployment at 28%. Increased oil production is one part of this equation and will help on the income side, but it will do little for jobs. The other part and the key to jobs is a growing private sector. Growing the private sector requires action on a number of critical dimensions. This project addresses four dimensions:

- Creating the necessary institutional underpinnings for the private sector—to facilitate and promote investment and markets, as well as provide pressure points for reform.
- Resolving some critical market failures facing the private sector—the sanctions regime and the conflict within Iraq has destroyed connections with the outside world. There is no insurance industry to help bring lost capacity back on line.
- Facilitating the development of some key building blocks of the financial sector—a payments system and a system of effective property rights.
- Providing essential infrastructure—a modern private sector cannot survive without reliable telecommunications.

2. Relative to the size of the Iraqi economy, the formal private sector is quite small. The oil-led state-owned enterprise (SOE) sector, a large agriculture sector, and the public sector account for the majority of employment in the country. The private sector is characterized by very few large companies, a number of small-medium enterprises (SMEs) and a very large number of micro-enterprises. It is estimated in excess of 90% of the over 100,000 enterprises fall within the last category. Most large enterprises are in the state sector. Because of the sanctions regime, there is very little in the way of exports and the services sector is very weak. Constraints to private sector activity include virtually every aspect of the investment climate (infrastructure, finance, security, business regulation, etc.). Moreover, businesses have suffered from the conflict—capacity has been destroyed. Yet at the same time, there are opportunities: there will be huge reconstruction flows; there are export-ready SMEs based on a proud and vibrant artisanal manufacturing past; and there are potential comparative advantages in the oil and agricultural sectors, the SOE sector that is ripe for reform, the religious tourism industry, and the information communications technology.

3. The private sector cannot develop and be able to compete if it does not have rapid access to financial services, such as an efficient network of branch banks. Modern financial systems depend on computerized information processing and settlement mechanisms to move money through local and global telecommunications networks. This network is a precondition for establishing a national payments and settlements (P&S) system that is in line with the requirements of a market economy. The Iraqi Central Bank, supported by the Government, wants to establish a proper P&S system by connecting some 80 nodes/locations across the country. Likewise property rights are critical to the financial sector—if contracts cannot be enforced and if property rights cannot be secured, it is unrealistic to expect significant financial sector development.

4. In the trade regime, most aspects of a modern supply chain are heavily dependent on telecommunications. This is an area which offers substantial productivity gains to Iraq (this could be as much as 20% of GDP). Trade facilitation systems, including customs management, general logistics management, and inventory controls require efficient and reliable data communications systems. Telecommunications lies at the heart of modern marketing and selling—connecting to customers, reviewing market information and even internet sales. If trade is to be expanded in Iraq, national and international connectivity will have to be increased. As Iraq eliminates its networking bottlenecks, it should be able to acquire its imports more cheaply, organize its primary and secondary production more efficiently, operate its markets more efficiently (goods, assets, labor, capital), and exploit its intellectual and human capital more effectively. It should also be better able to attract and exploit FDI. Telecommunications is, therefore, a fundamental necessity for Iraq's trade facilitation.

5. Low telecommunications penetration, old technology and small backbone data transmission capacity mean Iraq's telecommunications does not meet the needs of a modern private sector. Iraq currently has an average of 4 fixed telephones per 100 people provided by the state-owned national operator—Iraq Telecommunications and Post Company (ITPC), 2 mobile phones by 100 people—provided by 5 private regional operators, and 2 Internet connections per 1000 people. Jordan, for example, has penetration levels of 20, 20 and 10 per 100 people, respectively. Iraq's telecommunications indicators are obviously low by regional and international standards and cannot support a vibrant private sector. All these indicators will be significantly improved with the establishment of a national long-distance backbone network. The absence of such a network has been the biggest bottleneck in developing the sector further. In particular, it will encourage private sector participation by allowing private mobile, internet, and voice telephone operators to interconnect.

The Rationale for the Bank's Involvement

6. The proposed Project is fully consistent with the World Bank's Interim Strategy Note for Iraq (January 2004), which emphasizes the need for short-term employment generation, institutional capacity building, and rapid rehabilitation of critical infrastructure as prerequisites for long-term sustainable recovery. Indeed, the Project addresses all three aspects. Furthermore, the proposed operation supports the Government of Iraq's (GOI) objective to create a dynamic private sector by improving the investment climate where the private participation can flourish.

7. There are important reasons for the Bank to be involved at this stage in supporting the investment climate, SOEs reform, and telecommunications infrastructure development:

- The Iraqi authorities have expressed a strong desire for the Bank to take the lead in these areas.

- These areas have not received as much attention as other areas of the reconstruction agenda. Nevertheless, they are of high importance, as sustainable job creation will not happen without these building blocks being in place.
- The Bank is in a position to share international experiences and best practices based on the Bank's considerable international experience with private and financial sector development, SOEs reform, and telecommunications infrastructure in conflict-affected areas (including Bosnia-Herzegovina, Ethiopia, West Bank and Gaza, and Afghanistan).
- Telecommunications is a sector in which the private sector can take the leading role. However, there remain important roles for government oversight and investment. Governments must develop and enforce policies along with the regulatory environment required to promote private provision of services. The GOI has recognized these imperatives, and has/would promulgate policies that support such a role. On the other hand, governments should play a role in extending access beyond that which the market would provide alone. This is particularly the case in Iraq considering: (i) the prevailing difficult security situation; (ii) the current organizational and political restructuring, both at the ministerial level and within the ITPC, that would delay the implementation of urgently needed projects; and (iii) the necessity to provide the private sector the infrastructure support required to enable other services' delivery.
- Bank financing, unlike the financing of many other donors, will be implemented by Iraq through the country's own institutions (ministries and agencies), that will ensure Iraqi ownership and build Iraq's institutional capacity, both crucial for the country's sustainable development.
- The Bank will integrate financing of specific initiatives with policy advice, assisting the GOI with urgent policy decisions, while laying the ground for sector restructuring essential for long-term sustainability of the private sector.

II. Project Objectives

8. The principal objective of this Project is to provide a number of critical elements to the basic underpinnings of a sound investment climate, from both the institutional and financial aspects. The project will also make available essential infrastructure without which a modern private sector cannot survive, namely a reliable national payment system supported by the necessary telecommunications infrastructure. An important secondary objective is supporting some immediate job-creating opportunities.

III. Project Description

9. The Project combines the following four components:

- (i) Development of the institutional framework to enable PSD and FSD;
- (ii) Providing support for specific private sector opportunities that will lead to job creation;
- (iii) Providing support to the establishment of a payments system; and,

- (iv) Building part of the telecommunication national backbone network to support the requirements for a fully-functioning financial payments system, corporate data needs, and the transmission capacity needed by all public and private operators.

Component (i): Development of the institutional framework to enable PSD and FSD (US\$5 million)

10. This component would help establish and/or strengthen institutions that support or encourage the private sector and financial sector in Iraq, to enable them to play their appropriate role. Institutions are defined as (i) organizations—public sector and private sector bodies, for instance, those concerned with investment promotion and SOEs reform, competition authority, chambers of commerce, business and economic schools; and (ii) systems and regulations that establish “rules of the game,” such as, property rights, absence of expropriation, the rule of law, the absence of corruption and graft. At present, these institutions either do not exist or require significant modernization.

11. The Project would complement institutional creation with business planning, design of procedures, design of any necessary rules and regulations, provision of start-up facilities, training, support of twinning arrangements, support for the initial activities of the agency, and provision of any other necessary technical assistance. For entities that already exist, the full range of activities may not be required. In all cases, a business plan will be developed. If the business plan identifies that the proposed entity is not feasible because of conditions on the ground, then support for the agency in question will be suspended. The entities that would be targeted for this assistance include:

- (i) *Investment Promotion Agency*. International experience in post conflict countries shows that an early focus on building investment facilitation and promotion capacity is a key to private sector development.
- (ii) *SOE Reform Agency*. Most large enterprises in Iraq are SOEs. SOE reform is needed to improve the competitive environment. International experience shows that the establishment of a central agency to coordinate these reforms is a critical first step.
- (iii) *Export Promotion Agency*. For the private sector to grow, export markets are essential. Because Iraq has been cut off from the international community, this will require a lot of support. An agency that can focus on the issues and constraints facing private sector exporters will be helpful in developing an export culture in Iraq.
- (iv) *Alternate Dispute Resolution Capacity*. Strong property rights is a fundamental requirement for financial markets and the private sector. An important initial measure that will support this strengthening is the establishment of an Alternate Dispute Resolution Capacity.

Component (ii): Private Sector Opportunities (US\$7 million)

12. The project will provide direct support to the private sector through a matching grant scheme. The direct support to the private sector will work on a pilot basis through two existing funds. The fund presently based in the Ministry of Trade (the Export Support Fund) will focus on export market development. The fund based in the Ministry of Planning (the Development Fund) will deal with reconstruction needs of the private sector. The funds will adopt international best practice in terms of governance and design.

13. The matching grant provides a grant to a private sector enterprise, or association of enterprises to support financially an activity that leads to some *economic additionality*. If it is supporting exports, it leads to increased exports, if it brings in technology, it leads to improved productivity and if it gets idle capacity up and running, it leads to new jobs. The core idea of the grant is that it matches a contribution

from the SME itself for the defined activity—export market development or technology/know-how training or equipment rehabilitation. This means to some extent the program is *demand driven*.

Component (iii): Payments System Supporting Infrastructure (US\$3 million)

14. This component will provide the critical infrastructure to underpin the payments system in Iraq. This is an essential precondition to the establishment of an effective financial system in Iraq. It would fund the infrastructure needed to support Iraq's Central Bank needs to link its offices in Baghdad with the headquarters of the banks in Baghdad, and then to establish transmission links to banks in other provinces/districts of Iraq. Because of the reported absence of good and reliable land lines communications, a wireless network (WI-FI) based on digital radio technology will be established in Baghdad. Satellite links (VSAT) combined with wireless networks will be established within the next year for connecting the rural areas.

Component (iv): Telecommunications national backbone network (US\$40 million)

15. The component would focus on upgrading the national backbone network. While the backbone network is designed to deal with the urgent ITPC needs of improving national and international connectivity, the backbone network, however, should also be seen as a facilitator and enabler of further competition and private participation in the provision of services. ITPC will be expected to interconnect with all interested service providers and sell them transmission capacity they may need at cost-based prices in line with the principles of transparent regulation and fair competition. The proposed digital microwave backbone would connect Baghdad and key Iraqi cities and would replace the old analogue microwave system. The Iraq Telecommunications and Post Company (ITPC) has confirmed that the upgraded digital microwave backbone network will be implemented on existing sites and will use existing buildings. There will be some rehabilitation work which, as necessary, will be done through an ITPC led project. The national backbone includes three parts: (i) supply, installation and commissioning of a long-distance backbone network on a single responsibility basis; (ii) supply of essential tools and test equipment; and (iii) provision of training and operational support.

- Part One—Microwave Links: consists of supply, installation and commissioning of a fully functional digital telecommunications long-distance backbone network (radio microwave and multiplexing), and associated facilities such as towers, antennas, air-conditioning, spares parts, diesel generators with rectifiers and back up batteries and rectifiers.
- Part Two—Supply and Installation of Essential Tools and Equipment: enables the installation of the components of other parts of the proposed network, including but not limited to installing antennas, air-conditioning, spares parts, diesel generators with rectifiers and back up batteries and rectifiers.
- Part Three—Training and Operational Support: provides for training and operational support to develop the ITPC staff with the skills necessary to operate and maintain the various equipments to be deployed as well as to manage ITPC more efficiently.

Safeguard policies

16. The Project will be processed under Operational Procedure (OP) 8.50 (Emergency Recovery Project). The Project is expected to be rated as a category "C"; all sites, buildings, and access roads are already in use by ITPC to house the existing old analogue system. Based on section 13 of OP 4.01, exemption has been sought from the Bank's executive management (March 2004) in order that any Environmental Assessment requirements will not be conducted prior to project appraisal. Furthermore,

there are no negative social impacts associated with the Project. Indeed, the impact is likely to be positive as many of the measures included in this Project will generate additional employment.

IV. Implementation Arrangements

17. The MoPDC will be the coordinating agency of the project. However, the project will be managed by a Project Management Team (PMT) that comprises staff from the MoPDC, the Ministry of Trade and the ITPC. The PMT will have a director and project managers representing the beneficiary agencies, in addition to financial management specialist(s), procurement specialist(s), environmental and social safeguard specialist(s), as well as other technical and implementation specialists. These arrangements will be further discussed and refined with the client during project preparation and appraisal.

18. International and local consultants will be recruited to assist the two project management teams to finalize subproject design, prepare tender documents, evaluate bids, and sign contracts. Project works will be grouped into large sector contracts for equipment supply and works to simplify implementation and permit direct disbursement of funds. Public beneficiaries of the project's proceeds will follow the Bank's procurement guidelines in procuring the defined equipment and services. Potential beneficiaries from the matching grant scheme will follow commercial practices and guidelines which will be developed and monitored by the implementation agency and which are acceptable to the Bank. The preferred method of disbursing funds is direct payment by the Bank to contractors upon the instruction of the implementing agency and in accordance with the contract between the implementing agency and the supplier.

19. The security situation could prevent Bank staff and international consultants from traveling to Iraq during project preparation and implementation. Project supervision would primarily rely on local Iraqi and international consultants with presence in Iraq, supported by Bank staff working from outside Iraq. Regional consultants with a branch office in Baghdad have been recruited to assist with project preparation.

Potential Risks

20. The proposed project is subject to substantial risks, including: (i) security issues; (ii) political risks; and (iii) unfamiliarity with Bank safeguards and procedures (accountability, financial management, and procurement). To mitigate these risks, training on project management and procurement has been provided. The project provides for additional training and capacity building for PMT staff. We will also design the project in a way which permits the use of funds un-disbursed under one component to fund activities under other components.

V. Tentative Financing

Source:	(\$m.)
RECIPIENT	0
SPECIAL FINANCING	55
Total	55

VI. Tentative Processing Schedule

Pre-Appraisal Decision Meeting	October, 2004
Appraisal	December 2004
Negotiations/Approval	April, 2005

VII. Contact Point

Contact: Mohammad A. Mustafa
Title: Lead Private Sector Development Spec.
Tel: 202-473-0152
Fax: 202-522-2151
Email: Mmustafa@worldbank.org
Location: Washington D.C. (IBRD)

VIII. For More Information Contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-5454
Fax: (202) 522-1500
Web: <http://www.worldbank.org/infoshop>