

Part I. Generating growth and employment

Chapter 2. Creating jobs and rebuilding services

Iraq's reconstruction needs are enormous and are likely to generate massive labor demand. Reconstruction is driven by the need to rebuild the country's depleted physical and social capital. Thirty years ago, Iraq led the Middle East and North Africa region in social development indicators; since then many of these indicators have declined to the levels characteristic for the low-income countries. Access to infrastructure services is nominally high (e. g., almost universal connection to the national electricity grid; 83 percent access to an improved water source), but the quality of these services has declined dramatically in the past decade. In 2004, 85 percent of households had unstable electricity supply—the national grid supplies 3–6 hours of electricity daily. A mere 20 percent of households have safe and stable drinking water.

While reconstruction and associated public-sector jobs are important in the initial phase of Iraq's recovery, they will not create a sufficient number of jobs to meet the population's needs in the long term, even if recovery is on a massive scale. The private-sector job engine must be engaged to meet the demand, and it needs equal prominence from the beginning. Many countries in Middle East and North Africa region and elsewhere in the world tried to create jobs by applying a statist industrial strategy. This was the case of Iraq in the 1970s. In the long run, the experiences have been disappointing. Instead, a successful growth model must equally rely on the entrepreneurial talents of the nation and on the state as the provider of key public goods, such as the rule of law, the appropriate regime for trade and investment, and the safeguards of strong social safety nets.

Labor market conditions and outlook

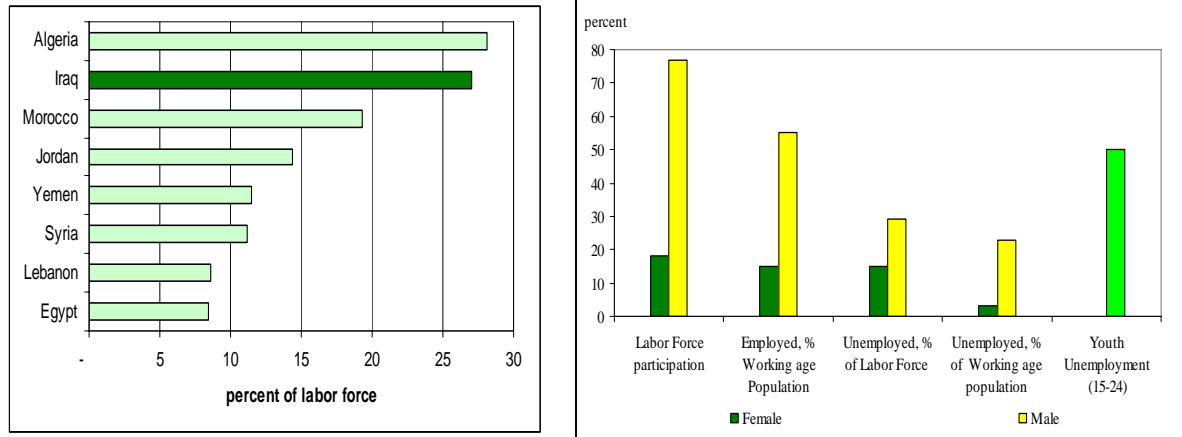
Iraq has a high population growth rate, a very young population, and a substantial growth rate for its labor force—2.4 percent per year. Every year, 170,000 new workers enter the labor market (ILO 2004).ⁱ The outlook is for continued rapid growth of labor supply: population growth will remain high, as declines in fertility are likely to be offset by the much-awaited improvements in maternal and children's health. In this respect, some of the features of Iraq's labor market are similar to other labor-abundant Middle East and North Africa countries, such as Algeria, Iran, and Syria. Some lessons learned by these countries could apply to Iraq.

The demand for labor is currently too low to absorb all new entrants and the existing unemployed. Conflicts and economic decline have destroyed vast number of jobs in both formal and informal sectors.ⁱⁱ Already before the 2003 invasion, employment in large and medium enterprises was about one-third less than in 1985–89. As for the small (family-based) enterprises, the Iraqi Federation of Industries, which unites small artisan-type family firms, reported in 2004–05 that out of some 30,000 members barely 4,000 were active. As a result, Iraq has one of the highest unemployment rates in the region—close to 30 percent (figure 2.1). Among the urban youth, more than half are unemployed. Iraq

also has very high underemployment (over 23 percent); its female labor participation rate (13 percent) is low even by Middle East and North Africa standards.

Figure 2.1. Unemployment in Iraq, 2004

Iraq's unemployment is among the highest in the region... and Iraqi youth is the most vulnerable to it.



Source: ILO (2004); World Bank staff estimates.

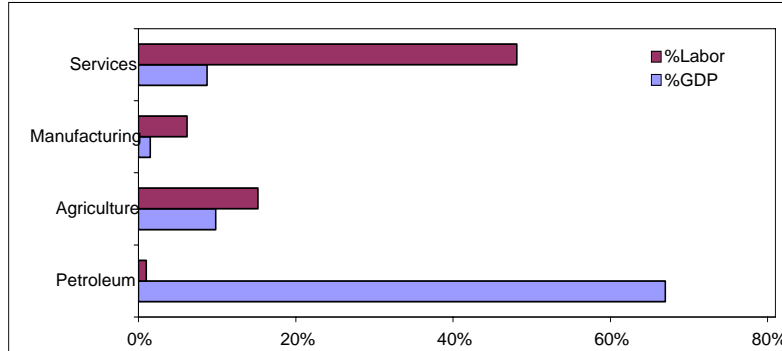
Analysis of other episodes of conflict indicates a very strong reciprocal relationship between the lack of security and high unemployment (World Bank 1998 and 2003b). Although 25 years of conflict and isolation have greatly exacerbated Iraq's labor problems, their roots lie deeper, and are similar to Middle East and North Africa countries unaffected by conflict. These problems are captured by three contrasts: (a) between the oil sector and the rest of the economy; (b) between the private and public sectors; and (c) between job opportunities for men and women.

The oil sector versus the rest of the economy

Oil generates less than 1 percent of demand for labor in Iraq (figure 2.2). Like any petroleum-based economy, Iraq faces the challenge of using its oil wealth to foster growth and job creation in downstream sectors. In the 1970s and 1980s Iraq's state-led diversification was well advanced, but most downstream enterprises could function only by relying on massive input subsidies, artificially high output prices, and hyper-protectionist barriers. In the 1990s, even this artificial diversification waned: currently, the petroleum sector accounts for about two-thirds of GDP.

Figure 2.2. Iraq’s labor market, 2004

*Employment by sector and structure of GDP by sector.
(percent)*



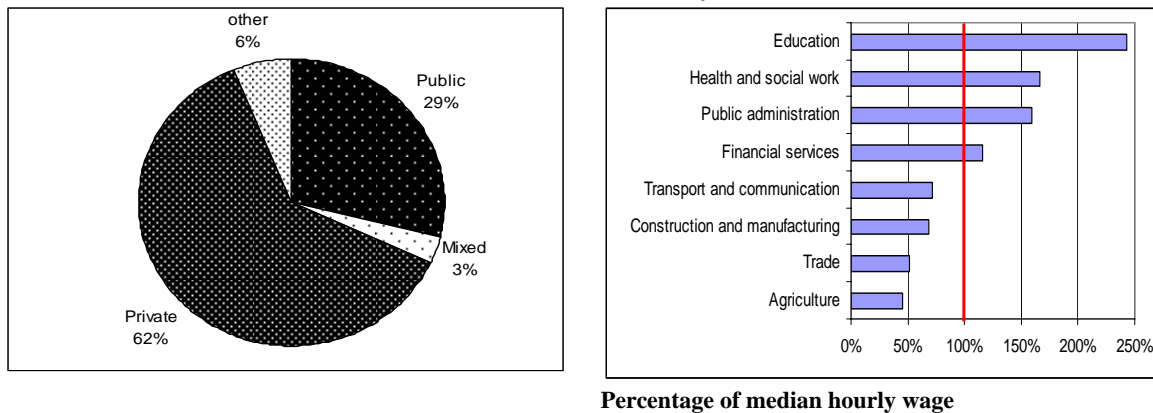
Source: Ministry of Planning and Development Cooperation/UNDP 2005; and World Bank and IMF staff estimates.

The public sector versus the private sector

The current state of the labor market documents the difficulties of reconstruction stifled by insecurity and institutional weaknesses (figure 2.3). Security costs have eaten into the government investment budget.ⁱⁱⁱ Foreign aid moved much slower than originally expected. Private enterprise is also hampered by conflict, and most of its demand for jobs lies in the informal sector. These jobs are very low-paid and carry no social protection (box 2.1).

Figure 2.3. Iraq’s employment and hourly wages, 2004

Most jobs are created in the private ...but its wages are the lowest in the sector...



Note: Breakdown of wages by firm ownership is not available. It is approximated by sectoral distribution: public administration and social services are in the public sector; agriculture, trade, construction, and manufacturing are of either private or mixed ownership. “Other” is unspecified.
Source: Ministry of Planning and Development Cooperation/UNDP 2005

Box 2.1. The informal sector in Iraq

Since late 1980s, Iraqi households had increasingly relied on the informal sector to cope with economic hardships caused by the Iran-Iraq war, the first Gulf War, and economic sanctions. The number of Iraqis seeking additional income from informal economic activities grew so quickly that in 1989 the Iraqi Council of Ministers convened three times to discuss the issue of state employees working “outside the official working hours.”

Today, the economic condition of households has improved, and public sector salaries have risen dramatically compared to the pre-2003 period, benefiting about 1 million employees and their families and increasing consumption spending. However, unemployment remains very high. Security concerns continue to stifle private investment, both domestic and foreign, and prevent market mechanisms from playing their anticipated role. Slow job creation in the public sector, and the inability of the formal private sector to absorb all surplus labor combined with rapid population growth produce a pool of workers who can find employment only in the country’s expanding informal economy.

A World Bank study of the informal economy in 110 countries (Schneider 2002) found that the average size of the informal economy as a share of official GNI in 2000 was 41 percent. Such estimates are arrived at by measuring inconsistencies in the national accounts (for example, the difference between actual and expected currency holdings; or using electricity consumption as a proxy for actual GDP level). Data gaps in Iraq are massive (see box 1.1) and do not even allow the approximate evaluation of the size of the informal sector. In assessing the current state of the informal economy in Iraq, we can rely only on anecdotal evidence.

Iraq’s current economic difficulties are typical for conflict-torn countries. Economic agents pursue multiple strategies to cope with hardship and diversify their sources of income. Schneider and Enste (2002) show that the informal economy encompasses a number of activities with different degrees of sophistication and criminality. The informal sector offers both legitimate and illegitimate income opportunities. Legitimate ones are derived from pursuing economic activities similar to those in the formal sector, such as flea markets, street selling of small quantity goods, small scale food production, transport, and repair and recovery services. Illegitimate activities comprise smuggling, corruption, kidnapping for ransom, extortion, and larceny. Present-day Iraq is rife with both types of activities.

Given typically high risk levels, informal economic activities are not necessarily rewarding and may actually deepen the poverty trap (Morrisson 1991). Nevertheless, the informal economy remains a major job engine in Iraq, and for many Iraqis, it is the only chance for survival. Informal activities provide the vulnerable with at least some income opportunities where formal mechanisms remain paralyzed by conflict.

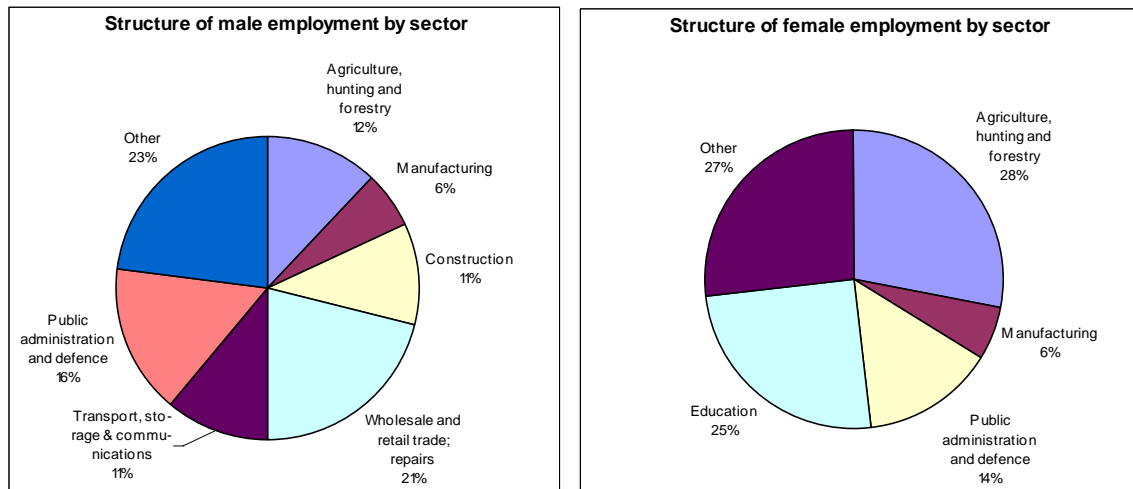
Once the security improves and more jobs are created in construction, services, and public administration, the public sector’s demand for labor will likely grow. Simultaneously, reconstruction will fuel job creation in the private sector, first in construction and services, and then in broader range of sectors, including downstream industries. Long-term efficiency considerations require that industrial restructuring remains compatible with the pricing system reforms and open trade regime that now exists in Iraq. Long-term development prospects will suffer if attempts are made to revive the industrial behemoths of the past that could function only behind the hyper-protectionist barriers.

Men’s jobs versus women’s jobs

Another contrast in the Iraqi job market is its gender gap. The pool of female jobs is much smaller and less diverse than jobs available to men. Two features that stand out are

the prevalence of female workers in education and a large share of female jobs in agriculture. In education women predominate in absolute terms, filling 60 percent of all positions. In only three other sectors is women's share above the 17 percent average—agriculture, health, and social and financial intermediation (32–38 percent of the total). Of these three sectors, only agriculture is a fairly large employer of women (figure 2.4).

Figure 2.4. Employment by sector and gender, 2004



Source: Ministry of Planning and Development Cooperation/UNDP 2005.

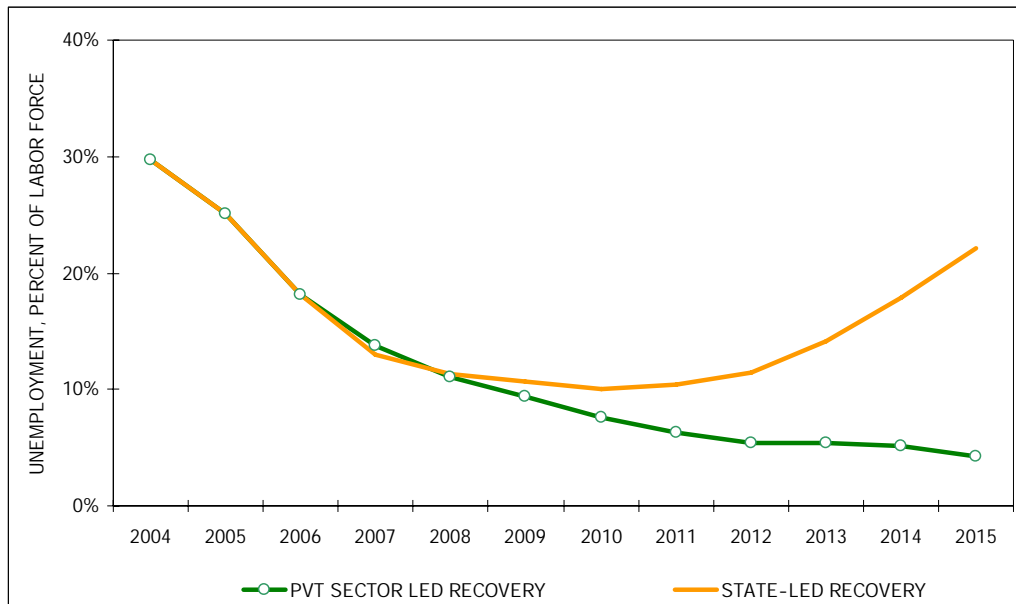
Prospects for employment growth

The outlook for the Iraqi labor market depends on the growth paradigm it follows. The short-term prospects are clearer: once the reconstruction process gets under way, demand will surge for both skilled and unskilled labor for rebuilding infrastructure, social services, and the like. Much of what needs to be done in these first years will have to be initiated by the state. Experience of other countries demonstrates, however, that beyond the first five to eight years, labor-market outcomes are likely to diverge:

- Some labor-abundant countries choose to maintain the leading role of the state in investment and service delivery (e. g., Egypt, Venezuela). Almost all of them face decelerating growth outcomes and stubborn unemployment problems. Large public sectors provide quality employment for the lucky few; but they also crowd out private investment. In some cases (such as Bosnia and Herzegovina), privatization progressed, but the state was less successful in addressing efficiency and accountability concerns, which stifled the private-sector response.
- Other countries used the early reconstruction years to establish a facilitating regime for private enterprise and then moved to gradually reduce the state's role in the productive sectors, relying increasingly on public-private partnerships (e. g., Chile, Indonesia). In these countries private businesses proliferated and pulled into the labor force large numbers of unemployed and part-time workers.

Analytical scenarios for the Iraqi labor market were formulated for this study. The findings of this analysis are summarized in figure 2.5. The first reconstruction years (2005–08) are similar under either scenario, as large public resources are channeled into public goods provision. In the later years, however, the state-led model is likely to encounter the problem of declining efficiency. In contrast, if the government supplements large public works program with early action to create a credible, transparent, and supportive environment for its private entrepreneurs, the private sector’s demand for labor will grow very fast and absorb large numbers of unemployed.

Figure 2.5. Unemployment scenarios for private-sector and state-led recoveries



Source: World Bank staff estimates.

Jobs, investment, and diversification

Job creation is primarily driven by investment—typically by a mix of public and private investment. In Iraq, this presents four challenges:

- The need to strengthen public-sector investment, particularly to avoid the “resource curse”—distortions that often accompany public investment and that were so typical for Iraq in the past
- The need to address the problems of the state-owned enterprise sector
- The need to develop quickly significant levels of private investment
- The need over the long term to encourage investment and diversification through a strong and competitive industrial sector.

Strengthening public-sector investment

Efficient management of public-sector investment is critical in promoting economic growth and employment (box 2.2). An examination of other Middle East and North

Africa countries, which were spared by conflicts, but embraced the same state-led development model, reveals problems similar to those of Iraq: declining productivity, massive hidden unemployment, rising workers' insecurity, and undermined public finances. For example, in the 1990s Iraqi enterprises were shut off from their export markets and were shedding labor. Even the remaining employment rolls were overstaffed significantly,^{iv} while the public-sector productivity was eroding fast. Such overstaffing is not unique to Iraq—public sectors of most Middle East and North Africa countries face the same problem. Recent estimates put labor redundancies in public enterprises at about 35 percent in Egypt and nearly 40 percent in Jordan (Ruppert Bulmer 2002). All of these problems were typical for the socialist model as well, which had much in common with Iraq's development path. Even in Western Europe labor encountered a similar dilemma: policies intended to provide economic security for organized labor, to enhance human capital, and to promote socially responsible development have eventually become a source of economic insecurity.

Even under the private-sector-led development model and beyond the reconstruction years, government will remain an important provider of formal-sector employment in Iraq. However, the government's role in the economy needs to be redefined from being the primary employer to a partner in creating and sustaining opportunities for employment. A vital state role in improving social services—especially health, education, and social security—is essential to establishing the conditions that will permit workers to thrive and economies to grow at competitive rates.

Box 2.2. The resource curse

All oil-exporting countries use mineral wealth to spur growth and job creation in the nonoil sector. The state captures most oil revenues and typically plays a central role in this process. In the Middle East and North Africa region, this state-led development model was embraced by many resource-poor countries as well. The model, which is defined in a recent World Bank study as “interventionist–redistributive” (World Bank 2004d), can be characterized by (a) a preference for redistribution and equity in economic and social policy; (b) a preference for states over markets in managing national economies and in providing welfare and social services; and (c) the adoption of import-substitution industrialization and the protection of local markets from global competition. During the 1980s, this Middle East and North Africa development model delivered some of the highest growth rates in the world (3.7 percent per capita a year), low-income inequality, and dramatic improvements in human development indicators. Iraq was at the forefront of these gains, leading the region in many human development indicators.

The collapse of oil prices in the mid-1980s has made the interventionist development model unaffordable. In the late 1980s, a growing number of Middle East and North Africa states recognized that it was not performing and opted for restructuring. Iraq, however, moved in the opposite direction: wars and international isolation provided the former regime with a justification to tighten the interventionist grip further. It came at a price of rapid increases in public debt and declining productivity in most sectors of the economy.

Reducing wage (and benefits) premiums in the public sector will help to improve the competitiveness of the private sector for skilled labor. It would be more efficient if wages in the public sector are set in line with productivity and not merely according to education credentials and years of service. Recruitment to public-sector jobs must also be based on an appraisal of future performance. Better conditions of work in small and

medium enterprises, side by side with their growth, are needed in order to create more formal-sector employment and thus give more balance to the labor market.

Reforming state-owned enterprises

Iraq faces specific challenges with regard to jobs in its state-owned enterprises. With over 500,000 workers on the payroll, state-owned enterprises are a major source of employment. Yet, appraisals undertaken in 2004 suggest that many of these enterprises are grossly overstaffed (DFID 2004). The challenge for state-owned enterprises is to find their way to being profitable in a liberalized Iraqi economy, which welcomes foreign investment and imposes a very low level of import duties. The outlook will differ for the two big groups of state-owned enterprises. The utilities, which produce nontradable goods and services, are more difficult to restructure, because of their critical role in supporting the rest of the economy and the welfare of households. The state-owned enterprises involved in tradable goods, however, cannot be immune from competition and will need to be restructured soon. Protecting them by reviving the previous protectionist regime would only hamper long-term growth prospects. A number of state-owned enterprises, for example in the petrochemical sector, can, with sufficient financing for rehabilitation, potentially be profitable even with inputs priced at world market levels. Chapter 3 provides more detailed analysis of a trade policy regime that could ensure optimal growth outcomes.

Promoting private-sector investment

The National Development Strategy envisages the private sector becoming the prime job generator in Iraq. A shift from the public to the private sector as the main engine of growth and employment requires more than the realignment of price incentives. For private enterprise to be able to offer a sufficient number of jobs for the Iraqi population, it must generate investment through a strong enabling investment climate. To create more jobs, private-sector employers need clear property rights, a regulatory framework, and low entry and exit barriers. Strong public-sector governance is essential: corruption drives many private firms into the grey economy and discourages possibly even a greater number of entrepreneurs from launching their own business. Private entrepreneurs also need access to finance: at present, Iraqi state-owned banks are stalled, while small local private banks do not have sufficient capital to handle the risks of lending to the emerging private sector.

A number of Middle East and North Africa countries have tried, with a varying degree of success, to facilitate the development of national enterprise. In most cases the share of value added in the private sector increased only marginally in the 1990s, with the same unfortunate pattern characterizing the share of the private sector in total investment. This disappointing outcome is explained by the limited progress in making the investment climate more accommodative. Barriers to entry, in the time and cost of administrative approvals, remain quite high. Access to finance is still very limited. Regulations do not facilitate the restructuring of businesses that are still viable, whereas nonviable firms are

not permitted to close operations expeditiously, thereby raising the social and economic costs of bankruptcy. The judicial system is slow, and enforcement is unpredictable. Businesses also suffer from weaknesses in the financial system and in the administration of licensing, regulations, taxes, and import duties. Furthermore, weaknesses in telecommunications and transport infrastructure greatly impede business activity and investment. In all of these areas, Iraq has made important first steps, primarily in adopting business-friendly legislation. But much remains to be done.

Reconstruction flows present an enormous opportunity to develop the private sector. For the Iraqi entrepreneurs to benefit fully from the reconstruction drive, efforts are needed to foster business skills, entrepreneurial development, and business associations. Bureaucracies will need training in administering public investment and conducting regulatory oversight. The greatest possible Iraqi participation in the allocation and use of these reconstruction funds is essential to ensure that they not only serve genuine needs, but are seen to do so. A focus on institution building would reflect investors' various needs. They need to know their property rights are respected. They need competitive costs of business, so they can make a profit. And whether Iraqis believe it now or not, the private sector will benefit from competition. This theme of institution building is important particularly in postconflict or transition situations. Experience has shown that, where perceived risks are high, initial investors may not be particularly professional, a deformity that can be very hard to change later. Moreover, work can begin in this area now. As the experience in West Bank and Gaza shows, institutional reform can be initiated and continue even in the most hostile environments.

Another promising area now is the potential of small and medium enterprises to generate jobs. Assistance with moving the unemployed into self-employment can be very effective. Help can be given in setting up business plans and in securing credit. In addition, industrial estates can be set up to provide infrastructure and other facilities to small enterprises. Much of what constitutes support to small enterprises dovetails with encouraging competition in product and financial markets. Labor legislation (minimum wage, health, and safety regulations and other regulations on business registration, zoning, etc.) must be applied intelligently to small enterprises, neither forcing firms out of business nor condoning hazardous or underpaid employment.^v

The UN-World Bank Joint Needs Assessment noted the existence of micro lending programs in southern Iraq that could be expanded, and the assessment proposed the establishment of a credit facility for small and medium enterprises. This could be particularly effective in major cities. As an example, it might aim to support subcontracting between larger and smaller enterprises, especially in diversifying oil-related activities and in raising value added in agricultural processing. An immediate possibility would be to link credit programs for small business explicitly to new job creation. Much can be done to assist small businesses by encouraging them to associate freely and express their common concerns, by supplying information on market trends, or by liberalizing markets and thus making such trends transparent.

The key priority is to strengthen critical institutions that support the private sector. At present the authorities' attention is drawn to business constraints, such as the weak infrastructure, financial system, and security. What is less obvious is that the necessary institutional underpinnings for a strong private sector are also very weak. The building blocks of a competitive investment framework include:

- Creating a commercial legal and regulatory regime.
- Building the institutional capacity of the public sector.
- Strengthening the private sector's institutional capacity.
- Increasing the capacity of businesses to access markets for trade and investment.
- Developing the framework for regional economic development institutions.
- Revitalizing the infrastructure to facilitate trade by addressing key bottlenecks, such as customs administration.

A multiphased approach is required. The first phase would support specific priority areas with the following type of support: (a) a business plan for the institution, which deals with strategy and direction, organizational issues, resource and training needs, and sustainability questions; (b) guidance and training on operating processes; (c) support for feasibility studies on initiatives; (d) seed financing for initial initiatives; and (e) draft enabling regulations. The second phase would apply the lessons learned from the first phase to a much wider array of institutions (competition authorities, customs administrations, nongovernmental organizations, industry associations, and the like). This follow up would also provide a second round of support for the first-phase activities.

A considerable amount of effort already seeks to encourage Iraqi private-sector involvement in reconstruction. Nevertheless, more could be done, particularly in regard to the flows that the government is managing itself. What's needed is to build a strong procurement system for both internally developed and internationally provided flows, so as to encourage Iraqi private-sector participation. The proposed economic development zones do not rely on any tax or customs advantage for their justification. They are a response to the need to maintain security, control red tape, and provide infrastructure. In an environment where these problems are insurmountable on a countrywide scale, development zones will encourage focused resolution of these issues.

Iraq needs a public awareness campaign on the benefits of a strong private sector in meeting the challenges of generating jobs, diversifying the economy, and sustaining growth. In Iraq, a strongly held philosophy, shared with some Middle East and North Africa neighbors, views public investment as sufficient to meet these challenges and sees foreign investment as a major challenge to sovereignty. Iraq's huge reconstruction needs will clearly absorb all the public investment funds available; broader growth and job creation can be ensured only if private enterprise is engaged fully.

Finally, implementation capacity is required. Energizing the private sector will require a significant effort, including—as an essential matter—close attention from the senior leadership of Iraq. Many of the agenda items will require coordination across ministries. The final recommendation therefore is the establishment of an interministerial working

group on the investment climate, to coordinate with other aspects of economic reform and act as a bridge to the infrastructure and financial sectors.

Encouraging investment and diversification

Openness to trade and export diversification is critical for enhancing the efficiency of investment in an oil-exporting country. Otherwise, there is a risk that high public spending to expand infrastructure and employment will recreate a closed economy riddled with high inflation and exchange-rate distortions. Under this scenario, the existing polarities in the Iraqi economy and labor market will only become sharper. A small group of mineral–resource–based industries will integrate successfully into the global economy, providing quality jobs to the privileged few, while the majority of the nation will remain in the informal sector, with low skills and low pay (Taylor 2002).

Iraq has a new foundation on which it can recreate a diversified economy. The challenge, however, is to do it on a firm basis, by investing in vital social services and infrastructure; improving the quality of human capital; and maintaining a regime supportive of private investment and foreign direct investment. The losses from recreating a rent-seeking environment with massively distorted prices, which existed under the previous regime, could be massive.

Integration into the global economy through the World Trade Organization and open regional trade agreements can give a strong impetus to export diversification. Evidence for other developing regions suggests that trade agreements can have a positive and significant impact on export variety in sectors such as textiles and garments, wood and paper, machinery, and transport. Chapter 3 discusses these issues in greater detail.

Foreign investors can be a source of developing export potential and value added in oil-exporting countries. In Mexico, foreign companies generate nearly two thirds of manufactured exports (UNCTAD 2002). In addition to capital, technology, and managerial know how, transnational corporations also provide enhanced access to global, regional, and national markets. Value added is increasingly being created as multinational corporations build long-term direct supply relationships with locally owned producers, rather than extracting local resources into foreign-owned production, transport, and distribution facilities. Local firms also gain from the presence of export-oriented affiliates by copying their operations, employing staff trained by foreign companies, and benefiting from improvements in infrastructure.

Policies to promote the benefits of foreign investment are particularly important for oil-dependent economies and are essentially policies to strengthen the investment climate. The introduction of a flat, uniform tax for corporate and personal income and a value-added tax, together with elimination of customs duties and speeding up of customs procedures, can greatly enhance the benefits to firms for becoming involved in international trade. The investment climate also improves by removing restrictions and approval requirements for foreign investors and relying on domestic legislation to govern all investment, without distinguishing between foreign and domestic investors. Avoiding

the targeting of certain industries through subsidies or investment incentives will mitigate problems of distorted investment decisions, bureaucratic discretion, and corruption.

Expanding export product variety at the firm level will require overhauling viable state-owned enterprises and encouraging entry by new exporters. Evidence from other developing countries suggests that both of these initiatives require substantial resources. Many of Iraq's industrial firms have a legacy of narrow product lines, weak management and information systems, poor product quality, and overly centralized structures. The experience of transition economies suggests that upgrading the export potential of existing state-owned enterprises that are considered viable can require substantial time and resources. Nonetheless, upgrading is worthwhile because it enhances export potential while maintaining employment. A restructuring plan for product-constrained firms, such as textile companies in Poland, for example, included the following steps:

- *Financial restructuring.* Steps include extending the maturity of existing loans, converting government debt into equity, enhancing access to working capital, and providing long-term loans to finance capital investment and restructuring.
- *Product restructuring.* Steps include introducing new products, optimizing certain existing products to act as "cash cows" in the short term, and marketing products more effectively.
- *Product rationalization and consolidation.* Measures may include closing certain plants, subcontracting specific tasks, retrofitting machinery, and investing in selected new equipment.
- *Management restructuring.* Steps involve introducing quality controls, accounting, information management, and other control systems (Taylor 1994).

The restructuring requires good coordination among many institutions, public and private, with a focus on the long-term profitability of the company in question.

Labor market policies

A variety of labor market institutions, regulations, and programs can broadly improve working conditions and the functioning of the labor market in Iraq. In addition, specific measures can help to mitigate the effects of conflict and industrial restructuring on the labor force. The broad institutional interventions could focus on the following labor market policies:^{vi}

- *Legislation.* As the private sector gains prominence, modern labor legislation is needed that determines terms of hiring and firing and employment conditions. Draft legislation is under consideration and needs to be codified soon.
- *Industrial relations.* A good record of negotiation between capable workers' and employers' associations is a sign of industrial democracy in action. Both parties to the collective bargaining process should be representative and independent. The rules of the negotiating process should be set by labor regulations, and the rules for dismissing labor should be transparent and designed to prevent arbitrary decisions. The new Iraqi

Labor Code (currently in draft) lays down the conditions under which a workers' association must be recognized for bargaining purposes. Through an active bargaining process, social partners can expect to play a constructive role in the formulation of state policy on employment and related safety and health standards.

- *Labor-intensive public works.* Such public projects provide temporary income and employment by providing immediately needed services with low start-up and overhead costs (such as security guard duties, cleaning and painting, reconstruction of buildings, and irrigation works). Such activities could create thousands of jobs.
- *Training and skills development.* The National Development Strategy calls for a strategy for sustainable job opportunities, especially for vulnerable groups. Rehabilitation of vocational training centers operated by the Ministry of Labor and Social Affairs would help to upgrade the skills of the unemployed and to prepare the labor force to use new technologies necessary to compete in a global economy. There is an urgent need to develop a training system reflecting the demand for labor arising from the private sector. The ministry has the key role in monitoring the quality of training. School leavers are likely to require most of this training, and there will be a need to include vocational training in secondary schools as well. To be most useful, such initial training needs to prepare young workers for learning a variety of skills in later life. State-provided training outside the education system needs credibility in the eyes of employers.
- *Microfinance programs.* These programs help vulnerable groups to meet their emergency needs and to build assets. Microfinance programs should be designed to generate as many jobs as possible and could be specifically targeted to assist returning refugees and internally displaced persons.
- *Employment support programs.* Focusing on generating jobs at the local level, these programs are run by local councils and civic and nongovernmental organizations.
- *Job-matching services.* Such services reduce periods of unemployment and raise productivity by facilitating the connection between employers and jobseekers. They require the collection and dissemination of labor market information. In 2003 the Ministry of Labor and Social Affairs initiated a nationwide job-matching service; by end-2004, the ministry had registered more than 0.6 million active jobseekers.

Active labor market policies also extend to helping particular groups in the labor market in the aftermath of conflict or industrial restructuring. Policies can help to reintegrate demobilized army personnel and retrain displaced state-owned enterprise workers, as discussed below. In other postconflict countries, incentives to employers in the form of wage subsidies or social security payment credits have been efficient in assisting such disadvantaged groups.

Mitigating the effects of conflict

Iraq's reconstruction efforts provide an opportunity not only to restore infrastructure and services interrupted or damaged by conflict, but also to reintegrate former soldiers into the postconflict workplace (box 2.3). The scale of the proposed reconstruction is substantial and could support a variety of goals. Iraq's budgeted capital spending averaged 24 percent of GDP in 2004–05, and donors have also undertaken additional large capital spending outside of the budget framework. Yet, given the existing security risks, the actual levels of investment have been lower than anticipated, and in any case most of the investment taking place is capital- and import-intensive. The International Labour Organization estimates that the employment impact of the Madrid package of financial assistance is likely to be insufficient to significantly affect overall employment, perhaps providing temporary jobs to only 10 percent of the unemployed in a year.

Box 2.3. Jobs and reintegration for demobilized soldiers

To help former soldiers and militia members to find civilian jobs and better reintegrate into society, international evidence indicates that it is important to develop a new sense of identity, one not linked to the conflict. A healthy civilian identity can be encouraged through remunerative employment, vocational training, and constructive work that contributes to individual and community well being. Training and work activities of ex-soldiers and militia members can contribute to the reestablishment of values, behaviors, and norms.

There are very few examples of successful reintegration programs among postconflict societies. However, several interventions may be considered to cater for ex-soldiers and to give them access to the postwar restoration and reconstruction of infrastructure. Well-targeted demand-driven skills enhancement can help ex-combatants to enter the labor market or to become entrepreneurs. Microcredit and small business development support can assist the most entrepreneurial clients, and labor-intensive public works foster temporary employment opportunities. In addition, employment-specific and psychosocial support services frequently feature as essential ingredients of any comprehensive reintegration program.

Source: World Bank 2004a; United Nations and World Bank 2003b.

Mitigating the effects of industrial restructuring

As recovery and industrial restructuring proceeds, designing measures to cushion workers from the effects of enterprise reform is a matter of priority. These social safety-net measures will likely include:

- Generous redundancy or severance payments
- Retraining programs to impart or upgrade needed skills
- Programs to assist workers to reenter the job market, such as the establishment of employment agencies
- Public works programs.

These measures may take a variety of forms. Egypt has successfully transformed a number of state-owned enterprises, making use of a generous compensation scheme. The government redundancy scheme may provide a lump-sum payoff or offer a monthly payment for a set period. Vouchers can be used to pay for retraining, which could also

kick-start private-sector training institutions (with quality control by the Ministry of Labor and Social Affairs). Above all, redundancy is to be handled in a transparent manner, according to principles in the new Iraqi Labor Code. Negotiation with workers and their representatives can make the criteria used in the redundancy process more acceptable. Managing redundancy in a fair and acceptable manner will also be the first stage in establishing an appropriate industrial relations climate within functioning state-owned enterprises and will contribute to good labor practices even in those units that are subsequently privatized.

It is 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 state-owned enterprises. Difficult though these problems are, Iraqis can take heart from the many other countries that have successfully tackled major overemployment in state-owned enterprises.

More broadly, the experience of other Middle East and North African countries suggests that well-designed labor market programs can help tackle a variety of labor-market dislocations. However, the experience also suggests that, despite their political appeal and contribution to poverty alleviation, such policies do little to remedy structural problems in labor markets or to reduce high unemployment. Only a small share of the labor force is likely to be covered by these programs. Furthermore, active labor market policies need to be carefully targeted and monitored, as such programs may have high fiscal costs.

Summary of recommendations

To immediately improve the labor content of the reconstruction effort, the Iraqi government could undertake these measures:

- Divert resources to more employment-intensive programs and use more employment-intensive techniques for approved projects.
- Scale down the size of projects to make them feasible for local execution.
- Exercise the technical supervision needed to use more unskilled labor and still meet proper standards.
- Build up the capacity of municipalities and local bodies to supervise and implement small-scale construction.
- Build up the capacity of local contractors to undertake labor-intensive construction projects.
- Increase the local raw material content of purchases of inputs and encourage their production by small-scale enterprises.
- Encourage the growth of sectors, such as housing, with strong linkages to the domestic economy. Given the big housing deficit with apparently 1.5 million units to be constructed or repaired, housing programs are likely to stimulate activity in many other industries as well.
- Improve the access of low-income groups to productive infrastructure and basic social services.

- Design local development strategies that focus on job creation and income generation and incorporate elements of basic social protection and social dialogue at the local level.

To generate economic growth and productive employment in the short term, the government may wish to consider the following steps:

- Strengthen implementation and coordination across ministries to improve the investment climate, possibly by establishing an interministerial working group.
- Conduct a public-awareness campaign on the benefits of a strong private sector in meeting the challenges of job generation and economic diversification.
- Strengthen critical institutions, including the commercial, legal, and regulatory codes; the rules of access to various markets for trade and investment; the frameworks for regional economic development; and the infrastructure to facilitate trade.
- Create a supportive environment for private entrepreneurs by establishing clear property rights and regulatory frameworks, low entry and exit barriers for businesses, access to finance and infrastructure, and strong public-sector governance.
- Provide training to government staff in administering public investment efficiently and conducting regulatory oversight.
- Reduce public-sector wage and benefit premiums to improve the private sector's competitiveness for skilled labor. Set public-sector wages to reflect productivity.
- Implement measures to cushion workers from the effects of enterprise restructuring, including generous redundancy payments, retraining and reentry programs, and employment opportunities through public works.

In the longer term, the government may wish to consider the following steps to build labor-market institutions and improve working conditions:

- Maintain efficient management of public-sector investment, proceed with the restructuring state-owned enterprises that produce tradable goods, and decide what to do with those that produce nontradables. Formulate an action plan for upgrading the export potential of state-owned enterprises, including financial, product, and management restructuring. Improve conditions of work in small and medium enterprises to create more formal-sector employment and thus give more balance to the labor market.
- Encourage Iraqi private-sector involvement in reconstruction. Build an efficient procurement system for both internally developed and internationally provided flows. Support economic development zones to offer security and infrastructure services and to minimize red tape.
- Foster private-sector business skills, entrepreneurial development, and business associations.
- Improve social services to establish the conditions that will permit workers to thrive and economies to grow at competitive rates.
- Enhance the potential of small and medium enterprises to generate jobs by

helping with business plans and credit and by providing infrastructure facilities by setting up industrial estates. Consider establishing a credit facility for small and medium enterprises and link its availability to new job creation. Apply labor legislation (e. g., minimum wage, health, and safety regulations) intelligently to small and medium enterprises, neither forcing firms out of business nor condoning substandard employment.

- Use the requirements of the World Trade Organization and open regional trade agreements as tools of economic diversification.
- Encourage foreign investors by removing restrictions and streamlining approval requirements.
- Avoid granting investment incentives to selected industries, to mitigate problems of distorted investment decisions, bureaucratic discretion, and corruption.

Notes

ⁱ These numbers appear low, given the estimated annual population growth of 2.8 percent. If the population growth rate is correct, the number of new jobseekers could be closer to 200,000 a year.

ⁱⁱ The formal sector is characterized by a formal relationship between the employer and employee, typified by the latter's access to social insurance (pensions, unemployment insurance, severance schemes). The informal sector comprises vast number of jobs in which workers do not have access to social insurance and are in temporary or unstable relationships with employers, which are often small or medium enterprises. Many non-OECD economies have much larger informal than formal employment sectors.

ⁱⁱⁱ Reports indicate that actual investment spending in 2004–05 was well below the budgeted levels in many sectors. However, this needs to be validated, as the quality of budgetary reports is weak.

^{iv} Recent state-owned enterprise appraisals suggest that a large number of their staff positions are redundant (DFID 2004).

^v The new Iraqi Labor Code raises the possibility of slightly different legislative approaches for companies with fewer than 15 regular employees.

^{vi} This section draws on ILO (2004a).