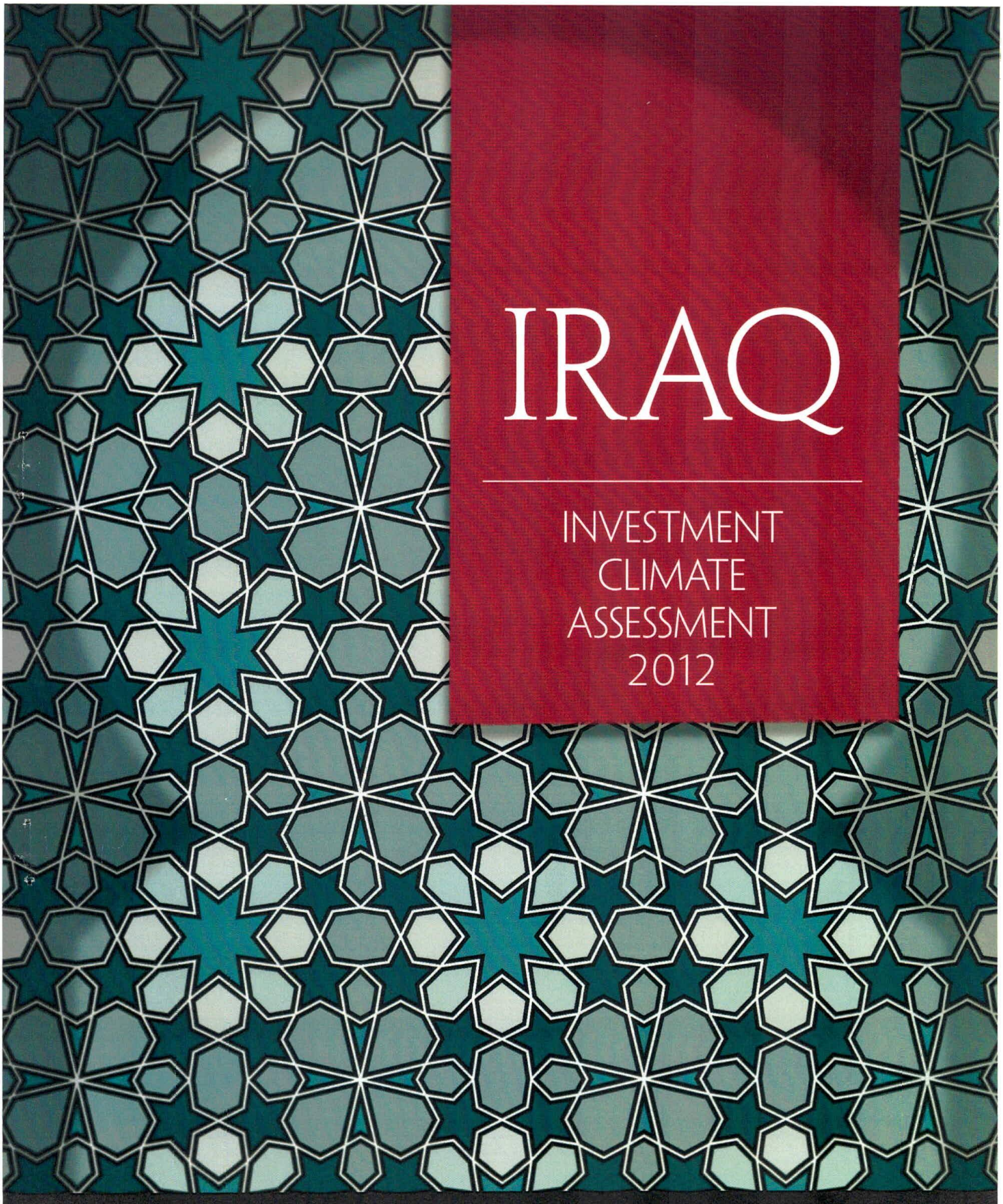

IRAQ

INVESTMENT CLIMATE ASSESSMENT 2012

THE WORLD BANK

IRAQ

INVESTMENT CLIMATE ASSESSMENT

2012

Inger Andersen, *Vice President*
Loïc Chiquier, *Sector Director*
Hedi Larbi, *Country Director*
Simon C. Bell, *Sector Manager*
Hooman Dabidian, *Task Team Leader*



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ABBREVIATIONS AND ACRONYMS

CBI	Central Bank of Iraq
CEM	Country Economic Memorandum
CIPE	Center for International Private Enterprise
CPA	Coalition Provisional Authority
COSIT	Central Organization for Statistics and Information Technology
DM	Deutsche Mark
DFID	Department for International Development
ES	Enterprise Survey
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoI	Government of Iraq
GW	Gigawatt
ICA	Investment Climate Assessment
ICG	International Crisis Group
ICSID	International Center for Settlement of Investment Disputes
ILO	International Labor Organization
IQD	Iraqi Dinar
IPO	Initial Public Offering
IPP	Independent Power Producer
ISIC	International Standard Industrial Classification
ISN	Interim Strategy Note
ISX	Iraqi Stock Exchange
IT	Information Technology
KRG	Kurdistan Regional Government
MENA	Middle East and North Africa region
MIM	Ministry of Industry and Minerals
MSME	Micro, Small and Medium Enterprises
MW	Megawatt
OECD	Organization for Economic Co-operation and Development
PPP	Public Private Partnership
PSD	Private Sector Development
SEZ	Special Economic Zone
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprises
SOE	State-Owned Enterprise
TBI	Trade Bank of Iraq
TFP	Total Factor Productivity
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
USAID	United States Agency for International Development
USD	United States Dollar

FOREWORD

This report was initiated at the request of the Iraqi government to assess the local investment climate and identify those high priority factors which most significantly impede private sector development in Iraq, in an effort to prioritize the recommended investments, institutional and regulatory reforms which would most significantly contribute to sustainable private sector growth and increased productivity.

Key findings of the report are: (i) the effects of oil-driven state development, conflict, sanctions and delayed reforms have significantly shaped Iraq's economy and limited potential for private-sector led growth over the past 60 years; (ii) the leading constraints to firms operating in Iraq are identified as electricity supply, political instability and corruption, as well as public sector dominance and lag in education; and (iii) reforming market governance, investing in infrastructure and trade, strengthening factor markets and reforming the weak but pervasive State-Owned Enterprises (SOEs) are key priorities to enable private-sector led growth in Iraq. The report subsequently makes reform recommendations based on the Bank's international experience in post-conflict, oil-based economies.

This Investment Climate Assessment (ICA), the first to be conducted by the World Bank in Iraq, comes at a particularly important juncture in Iraq's economic, political and institutional history and will serve as a solid baseline for future assessments of private-sector led growth within the Iraqi economy.

The ongoing effects of the global financial crisis, fluctuating oil prices, the regional wave of social and political change across the Middle East and North Africa and enormous local demand for improved infrastructure and services are urgent indicators of the need for economic reform—one which holds great promise for a more effective, diversified, inclusive and sustainable public-private partnership for growth in Iraq.

Inger Andersen
Vice President
Middle East and North Africa Region
The World Bank

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EXECUTIVE SUMMARY

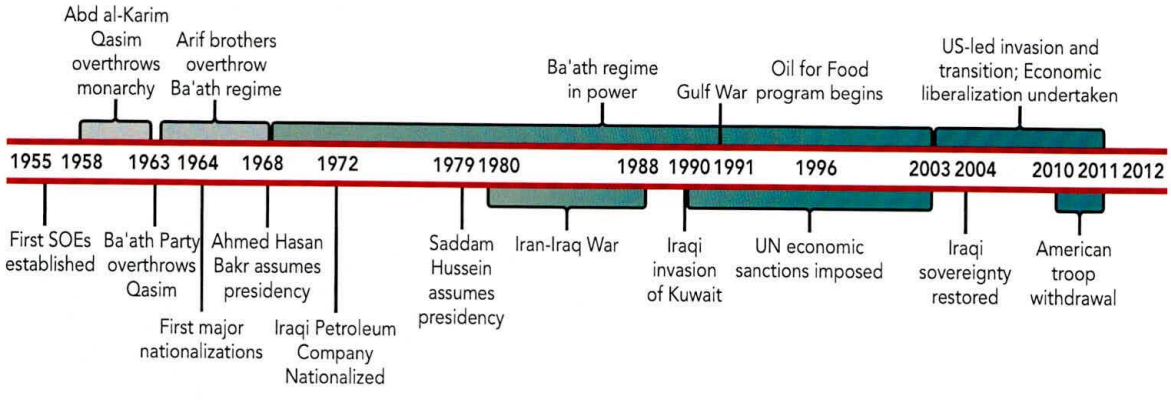
Despite decades of war and instability, Iraq's abundant natural resources, strategic geographic location and cultural history endow Iraq with tremendous potential for growth and diverse economic development. Driven by windfall oil revenues in recent years, the Government of Iraq has invested heavily in rebuilding the infrastructure of the country, and its abundant oil reserves ensure that progress can continue steadily.

Decades of socialist economic policy, however, have tightly bound Iraq's economy to the state. Consequently, the private sector today has limited role or presence, and incentives for its expansion are nearly absent. Because of the state's long-term dominance, credit systems and access to finance are severely limited. In addition to the general insecurity they have caused, Iraq's conflicts have further generated other problems, such as a marked exodus of educated, skilled Iraqis, a sustained isolation from global networks of information and trade and significant destruction of infrastructure. As a result, Iraq suffers from unsteady electricity and water supplies, the transport system remains under-developed, and its agricultural and industrial capacities severely reduced. In addition to securing and stabilizing the country, these key challenges must be addressed in order for Iraq to truly fulfill its economic potential.

To better identify and understand the problems facing the Iraqi economy and the performance of its private sector, this Investment Climate Assessment, the first by the World Bank in Iraq, is based on an Enterprise Survey of 756 firms implemented between February and December 2011 in close collaboration with the Government of Iraq's Central Organization for Statistics and Information Technology (COSIT).

Respondents to the Enterprise Survey listed electricity, instability, and corruption as the three most severe obstacles to doing business in Iraq. A second tier of constraints further include access to finance, informal sector competition, access to land, theft/crime/disorder, and taxation. Per the survey results, the average firm suffered nearly 600 power interruptions per year, with some firms reporting three outages per day. This unstable power supply

Figure 1: Overview of Iraq, 1955–2012



results in significant sales losses. Corruption further acts as an economic burden on firms surveyed, with firms reporting that bribes are commonplace, often to smooth frequent inspections from authorities, including government agencies and municipal police forces. Tax inspections are also frequent, accompanied by the expectation of bribe payments, as are payments necessary for establishing telephone, electricity, and other connections, as well as to obtain government contracts. As a reflection of the political instability in Iraq, security and crime are also major concerns, with many surveyed firms spending considerably on protection. It is important to note however, that the magnitude of these problems often varies significantly between different regions and sectors.

Other problems faced by firms interviewed for the Enterprise Survey include poor access to finance and land, as well as competition from State-Owned Enterprises (SOEs) and the informal sector. Nearly half of the firms surveyed reported having great difficulty in obtaining financing; fewer than 7% reported having a loan. Other forms of credit are also low, and some small and micro-enterprises have no access to banks. Financing difficulties are markedly worse for smaller firms. Firms also reported difficulty and delays in registering land, with many firms further reporting poor access to land for investment in general, a problem caused by widespread government ownership of prime land and inefficient methods of allocation to the private sector. With regard to competition from the informal sector, firms report difficulties confronting competition from unregistered companies, many of which infringe upon the rights of registered businesses, and face lower costs due to their noncompliance with formal rules.

Overall, the Enterprise Survey suggests significantly higher costs of doing business in Iraq than elsewhere in the region. Losses are principally generated from unreliable electricity, payments due to corruption, damage due to poor transport, and trade infrastructure and logistics, as well as theft and other criminal activity.

To significantly reduce unemployment and generate jobs for its growing workforce, Iraq must thus diversify its productive economy, transition to private sector-led growth by restructuring its non-oil SOEs, and provide opportunities for private sector participation. SOE reform and ownership transfer yields far greater benefits when it is accompanied by measures to promote free and fair competition. Strengthened private sector participation can further allow the State to focus on its regulatory and public service function. International experience demonstrates that many transition economies have generated greater employment and growth from the new entry of enterprises in sectors formerly dominated by the state than from the transfer of ownership of existing ones.

To expand and rebuild Iraq's infrastructure, investments must continue to be made, by both the state and the private sector, with opportunities abounding in the construction, banking, industry, energy, and tourism sectors. Furthermore, Iraq must create a legal and regulatory environment that supports, attracts and enables the private sector to sustainably invest in infrastructure expansion and rehabilitation. Additionally, the state will need to provide support through regulations and incentives to small and medium enterprises to improve their competitiveness and potential for productivity.

INTRODUCTION

Spanning over 430,000 km², Iraq has historically been at the crossroads of civilizations and has played a critical role in regional trade, transport and culture. Iraq's abundant natural resources, strategic geography and cultural history render it a nation with tremendous potential for diverse economic development.

The effects of oil-driven state development, conflict, sanctions and delayed reforms have, however, significantly impacted Iraq's economy over the past 60 years. Extended conflict with Kuwait and Iran, economic sanctions and the 2003 US-led invasion are examples of key events in the history of Iraq which have significantly impacted the development and growth of its economy and private sector.

Iraq's recent economic growth has depended primarily on the high price of oil. As a result of rising oil prices, the Government of Iraq (GoI) has been able to keep its macroeconomic program largely on track with 2011 oil export revenues reaching $77 billion, a 54% increase from 2010. Average oil prices have been systematically rising since 2010, reaching US$109 per barrel in January 2012. While the nominal exchange rate, the main tool of monetary policy, has remained stable, the protracted political impasse and deteriorating oil infrastructure have, however, constrained Iraq's oil output.

The public sector is currently the main employer in Iraq and includes 176 SOEs. While the oil economy represents more than half of Gross Domestic Product (GDP), it accounts for only about 1% of total employment. Job creation remains one of Iraq's largest development challenges. International experience suggests that employment generation by a large public sector is unsustainable. Long-term job growth instead requires the development of an attractive investment climate and a predictable and low cost of doing business, so that a robust and productive private sector can generate employment and raise standards of living.

Figure 2: Timeline of Conflict in Iraq, 1958–2012

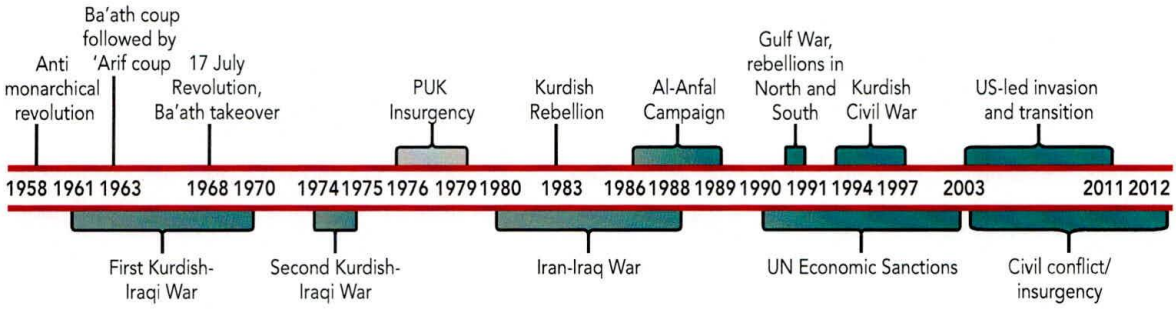
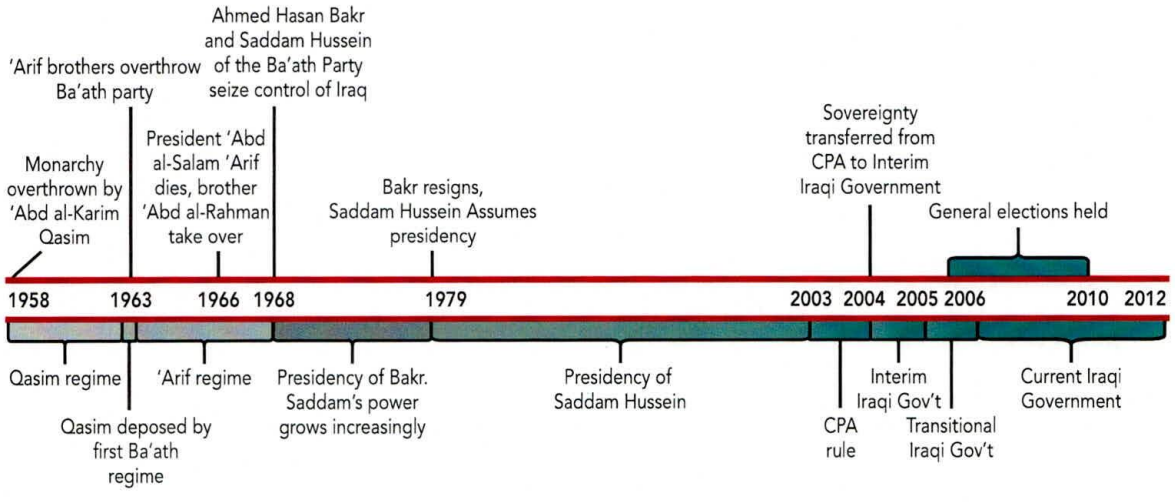


Figure 3: Regime Changes in Iraq, 1958–2012



Although the potential for private sector engagement in post-conflict Iraq is significant (see box 1), the country's private sector is both under-developed and unsupported. Most private businesses in Iraq are very small and informal, mainly operating in retail and trade, construction and transportation services, as well as in light industry in the textile, food, engineering, and chemicals fields. A survey coordinated by the United Nations and International Labor Organization (ILO) found that the great majority are owned by sole proprietors, with most of the remainder being family partnerships. Many of the employees in these small and medium enterprises (SME) are unskilled, short-term laborers. Iraq only possesses a handful of large, typically family-run multi-industry conglomerates, active in retail, trade, telecommunications, and construction, among other sectors.

Economic diversification in Iraq must thus be undertaken through two parallel actions: (i) Reform of the SOE sector and (ii) Development of Iraq's non-oil private sector. A thriving business environment is thus required in order to attract domestic and foreign investors and ensure sustainable private sector growth.

Box 1: Priority Areas for Private Sector Engagement in Iraq – A Snapshot

Iraq's geographical location, abundant natural resources, tourist attractions and immense need for reconstruction, improved health and education services are examples of priority areas within which the private sector can play a significant role as suggested below:

Agriculture was once Iraq's largest sector after oil, but has diminished greatly. Only 58% of irrigable land is utilized (13.2 million acres of a potential 22.9 million). Though agriculture currently accounts for approximately 2–4% of GDP (decreasing from 9% in 2002), and provides 25% of overall employment, Iraq continues to import 80% of its food supply. According to the recent ILO/UN survey, agriculture comprises 10% of SME activity in the north, 4% in the south, and none in the center. The potential for private sector led growth in the agricultural sector is thus significant. However, long-term economic growth and development beyond subsistence farming is dependent on government stability, a consistently favorable agricultural policy, significant infrastructure investments, and agreements with Syria and Turkey over the Tigris and Euphrates rivers. The signal from Parliament in its April 2011 decision to allocate $5 billion for investment in agriculture was thus regarded as particularly positive.

Iraq's physical location and resources grant it the potential for significantly expanded trade relationships. Iraq's ports in Basrah province alone have significant potential for growth: 35 million tons of cargo cross Iraq annually, bound for Syria, Turkey, and ultimately, Europe. This number could eventually rise to 60 million tons. Trade with the eastern Mediterranean states is further poised to grow as Iraq expands its ports and transport infrastructure, especially at the Al-Faw peninsula on the Persian Gulf, with an annual planned capacity of 99 million tons. Consequently, Iraq's ports and their potential for private sector activity hold major promise of a productive crossroad between East and West, with Iraq having the further advantage of significant land trade with Turkey and its access to the European Union.

While it will require further political stability and security, Iraqi tourism stands to be a major growth sector, having received over 1.5 million international visitors in 2010, compared to fewer than 900,000 in 2008. The Shi'a holy cities of Najaf and Karbala already receive millions of pilgrims per year and Najaf has further been designated the Capital of Islamic Culture for 2012 by the Islamic Educational, Scientific and Cultural Organization. Other religious sites, including those of Sunni and Christian significance, as well as Iraq's renowned archeological sites and cooler, greener northern regions each hold significant potential touristic appeal. Currently, Iraq suffers from a shortage of hotels and other tourist infrastructure, but this has been a prime area for investment and continued private sector engagement. Over USD 400 million has been invested in 2011 alone with most projects located in Erbil, Mosul, Basrah, and Najaf. Potential for increased private sector engagement in tourism is thus significant.

Although lead contractors are currently mostly foreign, the construction sector offers considerable potential to private Iraqi firms. 154 senior international business leaders surveyed by the Economist Intelligence Unit view construction as the most promising non-energy sector in Iraq with over USD 14 billion of real estate deals and over USD 6.7 billion of infrastructure projects already planned. The construction sector will undoubtedly grow further as it acts out Parliament's agreement from April 2011 to invest USD 37 billion in infrastructure, offering significant potential to a thriving private sector to actively engage.

ICAs AT THE WORLD BANK

Investment Climate Assessments (ICA) are critical instruments to: (i) quantify features of the investment climate that matter most for productivity and income growth, especially for the poor; (ii) track changes in the investment climate within a country, and (iii) compare performance within regions or countries. ICAs focus on microeconomic and structural dimensions of a nation's business environment, viewed in an international perspective. To this end, ICAs look in detail at factors constraining the effective functioning of product markets, financial and non-financial factor markets, and infrastructure services which include weaknesses in the legal, regulatory and institutional framework. ICAs also provide the tools and analytical framework to identify reform priorities in a country's investment climate, by linking constraints to firm-level costs and productivity.

Indeed, Iraq's current National Development Plan highlights key challenges to the development of the private sector. These include: (i) poorly-defined role for the private sector and reliance on an institutional framework that does not incentivize the private sector; (ii) overly bureaucratic procedures and lack of regulations allowing for increased private sector activity; (iii) underdeveloped credit system and stock market with reduced borrowing and lending capabilities, and (iv) hindrance to participate in the global economy due to lack of information, skills and technology.

Further, the World Bank's Doing Business 2012 Report ranks Iraq 164 out of 183 economies.[1] ***Iraq ranks second to last amongst the economies in the Middle East and North Africa region (MENA), significantly behind regional best performers on a global level*** such as Saudi Arabia (12), United Arab Emirates (33), and Qatar (36). However, Iraq's performance is uneven. While it ranks favorably on some topics, with its highest ranking on the "Paying Taxes" (49) and "Registering Property" (98) indicators, it lags behind most countries on several others, such as "Resolving Insolvency" (183), "Trading Across Borders" (180) and "Starting a Business" (176). Annex II lists details of Iraq's standing across all Doing Business indicators and recommendations for reform.

Similarly, the World Bank Group's Interim Strategy Note (ISN) for Iraq (2009) focuses interventions on three key thematic areas of engagement: (i) supporting policies and institutions that promote broad-based, private sector-led growth which will support the transition to a more private sector oriented development process over the medium to long term; (ii) improving governance and the management of public resources, including human, natural and financial; and (iii) continuing to support ongoing reconstruction and socio-economic recovery.

[1] The Doing Business Report measures regulations that encourage or constrain business activity across 10 core areas or "indicators" (Starting a business, Dealing with construction permits, Registering property, Getting credit, Protecting investors, Paying taxes, Trading across borders, Getting Electricity, Enforcing contracts and Closing a business) in 183 economies. A higher ranking on the Report's overall ease of doing business index corresponds to a more business-friendly regulatory environment.

Table 1: ICA Survey Sample Structure

Iraq (Manufacturing and Services) – 2011 Total of 756 firms			
Firm Size (%)		**Firm Location (%)**	
	Sample	**Governorate**	**Sample**
Small (>=5 and <=19 emps)	65.48	Ninewa	12.30
Medium (20<=x<99 emps)	32.14	Kirkuk	10.05
Large (100+ emps)	2.38	Baghdad	20.11
Ownership structure %		Babil	10.05
	Sample	Karbala	5.95
Private domestic individuals, companies or organizations	97.70	Najaf	5.82
Private foreign individuals, companies or organizations	1.06	Thi Qar	4.63
Government or State	0.33	Basrah	6.75
Other	0.91	Sulaymaniyah	15.34
Ownership structure %		Erbil	8.99
	Sample	**Sector**	
Government Owned >=10%	0.66		**Percent**
Private	99.34	Manufacturing	63.49
Ownership structure %		Services	36.51
	Sample	**Region**	
Foreign Owned >=10%	1.06		**Percent**
Domestic	98.94	KRG	24.34
Market Orientation %		Capital City	20.11
	Sample	Non-KRG	55.56
Exporters >=10%	5.17	**Top manager's gender**	
Non-Exporters	94.83		**Sample**
Corporate form		Female	1.06
	Sample	Male	98.94
Shareholding company with shares trade in the stock market	1.06	**Principle owner's gender**	
Shareholding company with non-traded shares or shares traded privately	1.32		**Sample**
Sole proprietorship	93.78	Female	6.91
Partnership	2.91	Male	93.09
Limited partnership	0.93		

Thus, following a request from the Government of Iraq, the World Bank has undertaken a first ICA, the objective of which is "to support Iraqi policy makers in their reform process by identifying the main obstacles to private sector development in order to accelerate private sector investment and growth in Iraq's oil-dependent and public sector-dominated economy". This ICA quantifies those factors which most significantly impede private sector development in Iraq and will inform government strategy and policies, providing clarity to policymakers on issues to address as a priority. The ICA can further provide a stimulus

The Kurdistan Region in the north of Iraq has been significantly more peaceful, stable, and prosperous than the rest of the country and has enjoyed a relatively stable and self-contained economic system. Private investment, both domestic and foreign, has thus flourished. As of October 2010, there were over 1,200 private foreign firms in Kurdistan, 730 of them Turkish, reflecting the huge volume of trade with Turkey. Additionally, there are about $1.5 billion in joint ventures between Kurdish and foreign firms, and nearly $22 billion in projects in the region funded by Iraqi investors, mostly Kurds. Both Asiacell and Korek, two of Iraq's three main mobile phone providers, are owned by Kurdish business conglomerates. However, like the rest of Iraq, the government is a major employer. Despite the existence of a significant number of large private firms, the Kurdistan Regional Government (KRG) employs 1 million people, equivalent to over 20% of its population.

Source: Special Inspector General Report for Iraq Reconstruction

for systematic policy dialogue on the business environment between the government and the business community, which in turn would further shape the private sector development (PSD) agenda. The ICA can also provide a standardized method for assessing and comparing progress on improving investment climate conditions in Iraq going forward.

The ICA is based on an Enterprise Survey of 756 firms implemented between February and December 2011 in close collaboration with COSIT and through a local consulting firm (Asharq Research Company Ltd). A stratified sample was drawn from the best-available population of firms through business census data provided by COSIT and registration data by the Chambers of Commerce. The survey covered firms in the manufacturing and services sectors across ten governorates in Iraq.

The ICA also benefitted from customized focus group discussions with the private sector, held in ten different cities across Iraq (including the Kurdistan region), the objective of which were to solicit private sector views and suggestions on policy reforms to enhance the business environment.[2] A High Level Stakeholder workshop was held in Istanbul, in March 2012, to disseminate the interim findings of the study and seek feedback from Iraqi Government representatives.

The ICA thus: (i) summarizes and analyzes survey results; (ii) provides GoI with recommendations to enable private sector growth and (iii) presents a summary of potential World Bank support to catalyze immediate support to the GoI including a best-practice toolkit for SOE reform; and specific measures to strengthen market governance, improve infrastructure and trade and enhance access to finance, labor and land.

[2] Annex VI summarizes the focus group structure and findings.

MAIN IMPEDIMENTS TO PRODUCTIVITY

KEY MESSAGES TO GOVERNMENT

- The leading impediments to Iraqi firms are electricity supply, political instability and corruption with variations noted across sectors and governorates;
- Despite these challenges, firm productivity is nonetheless comparable to several other countries in the MENA region and strongly suggests the potential for private sector led growth should the Government implement reforms for an improved business environment;
- City-specific and sub-national interventions must be tailored to complement national-level investment climate policy and institutional reform.

According to Enterprise Survey respondents, the leading constraints to firms operating in Iraq are electricity supply, political instability and corruption (identified by 73%, 70% and 68% of responding enterprises respectively as a "major" or "very severe" obstacle).

A second tier of constraints, imposing serious obstacles to between 42 and 48% of responding firms, include access to finance, practices of informal sector competitors, access to land, "theft, crime and disorder" and tax rates. Tertiary concerns included transport, business licensing and operating permits, and tax administration.[3]

Disaggregating by sector, manufacturing firms are clearly more constrained than are service firms by electricity supply and informality, while services firms are more likely than manufacturing firms to identify access to land, access to finance and business licenses and permits as serious constraints.

Disaggregating by size, large firms are generally more likely to identify serious constraints than are smaller firms across a number of different dimensions, including most of the leading constraints (figure 5). Exceptions where smaller firms were more likely to identify problems as serious include access to land and business licensing and operating permits. Unlike many other countries in the region (and globally), in Iraq access to finance is identified as a greater constraint by large firms than by SMEs.

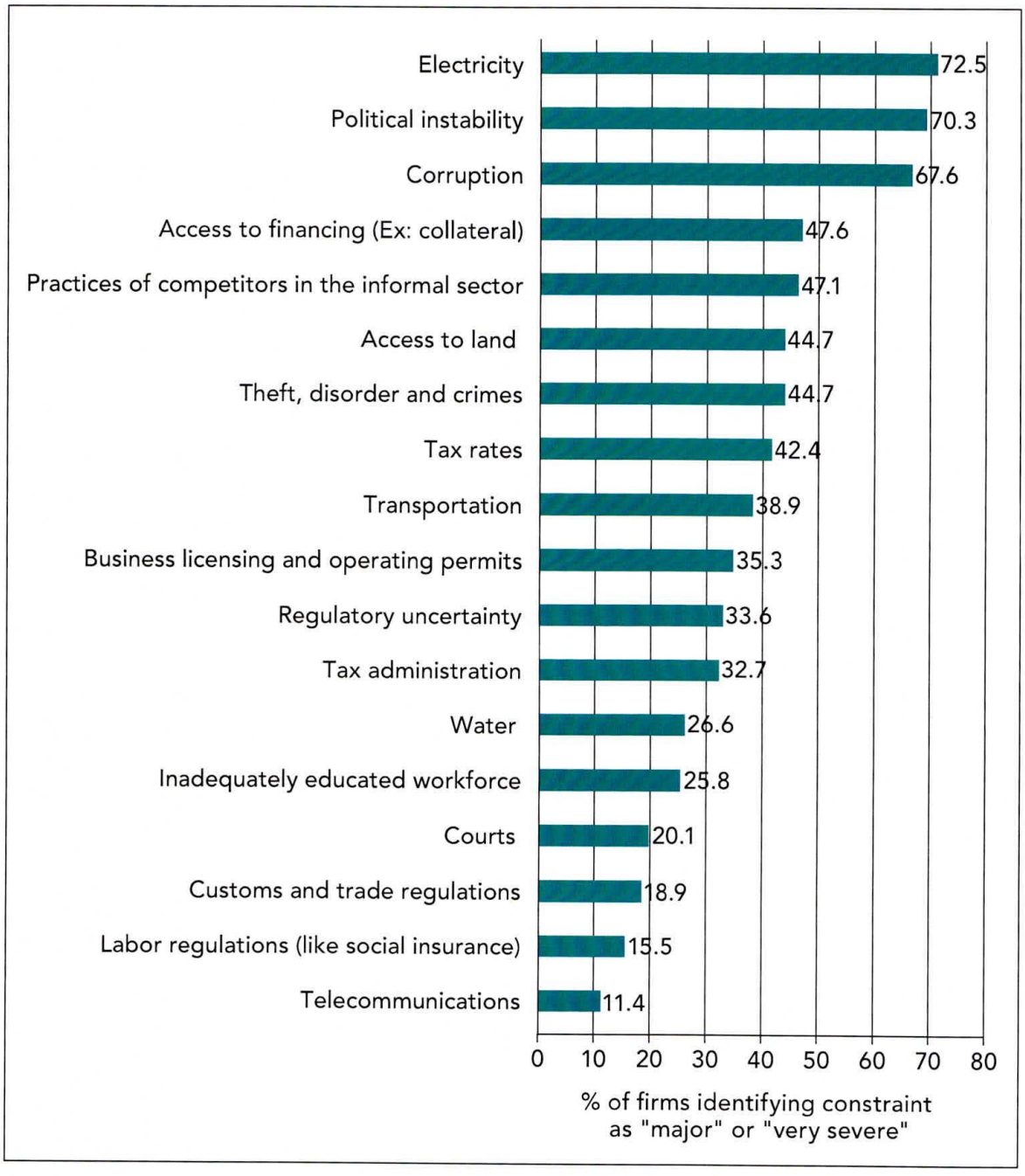
By location, firms in Baghdad appear to be generally more constrained than firms in other parts of the country. Firms in the KRG appear particularly blessed in terms of electricity supply, and generally being outside of Baghdad appears to yield fewer constraints in terms of political instability, informal competition, crime, theft and disorder.

Further geographic disaggregation however shows that only informal sector competition is identified by a substantially higher percentage of firms in Baghdad than elsewhere. Kirkuk leads in the problems of corruption, access to land, licenses and permits. Basrah is worst for theft, crime and disorder, tax rates and tax administration, regulatory policy uncertainty and water supply. Najaf stands out in terms of problems with courts and telecommunications. Finally, firms in Sulaymaniyah are far more likely to identify lack of educated workers as a serious constraint.

The survey suggests that firms operating in Iraq indeed face substantially higher costs than firms operating in other MENA countries. In fact, electricity failures impose tremendous costs on firms in Iraq (14% of sales), as do losses of goods in transit to markets. Average estimates of direct losses from theft exceed those measured in other countries. Costs from corruption, to the extent that they are measurable, are also substantial. These costs vary by firm characteristic—for example they increase with firm size and are much higher in Baghdad than in other cities (figure 8).

[3] In theory, these perceptions reflect the shadow costs of constraints to firms and their sequencing is reflective of their marginal impact. In practice, perceptions can be subject to a variety of biases, and of course reflect private rather than social perspectives. It is natural to ask whether the perceptions of constraints relate to real excess costs, distortions or other impediments to efficient operation.

Figure 4: Constraints to Enterprises in Iraq



Source: World Bank, Enterprise Survey, 2011.

Sales losses in Iraq were reported to be higher than those in Syria, Lebanon, Libya, Egypt, Jordan and Morocco with electricity failures and loss of goods in transit being the principal impeding factors. Losses in Baghdad in particular were further recorded to be most significant.

The survey suggests that larger firms face higher costs than small and medium size firms. The constraint imposed by electricity certainly grows with firm size, as reflected by the cost of interruptions. Corruption is a greater cost to the medium size firms.

Figure 5: Constraints to Firms in Iraq, by Size

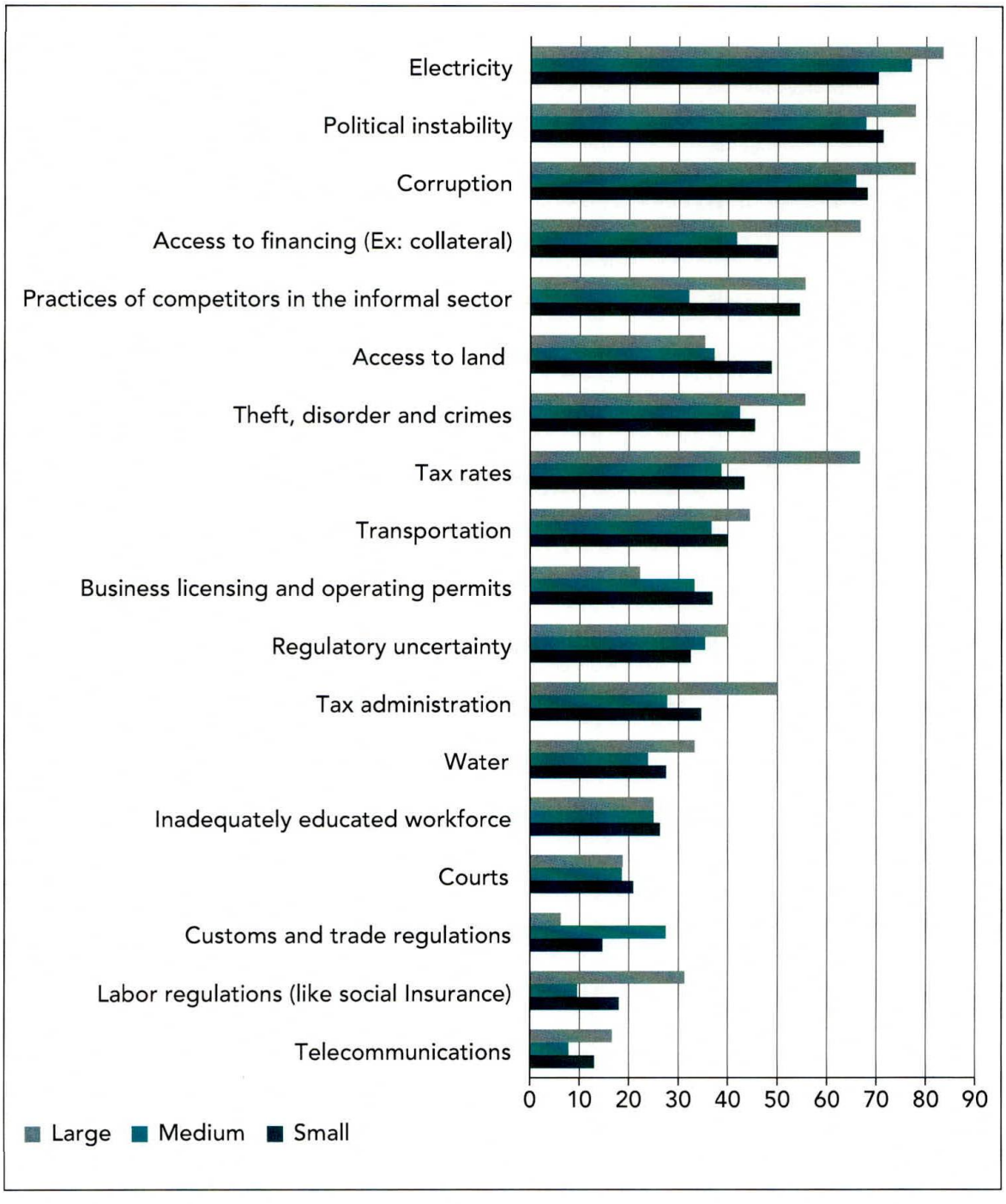


Figure 6: Constraints to Enterprises in Iraq, by Region

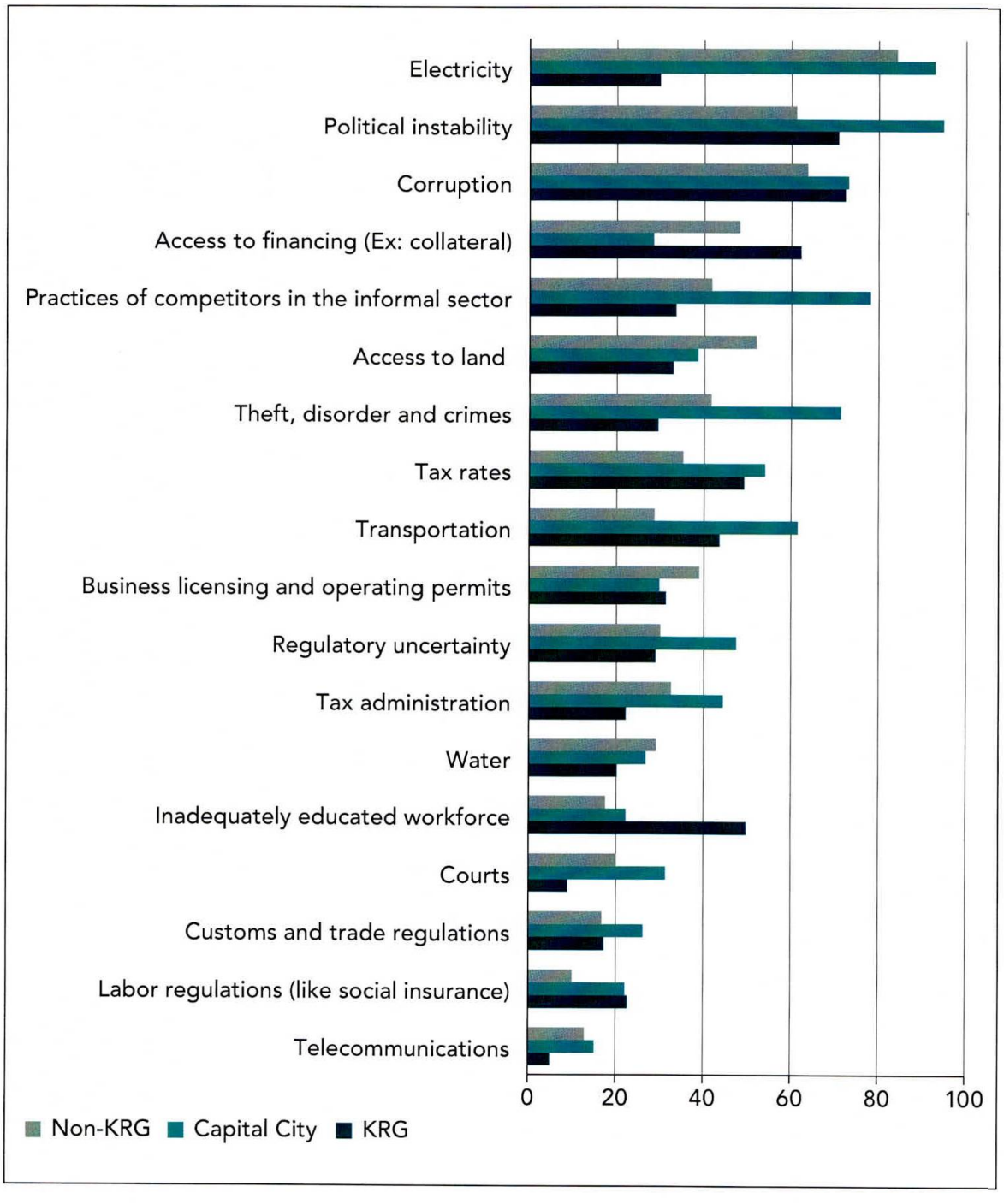
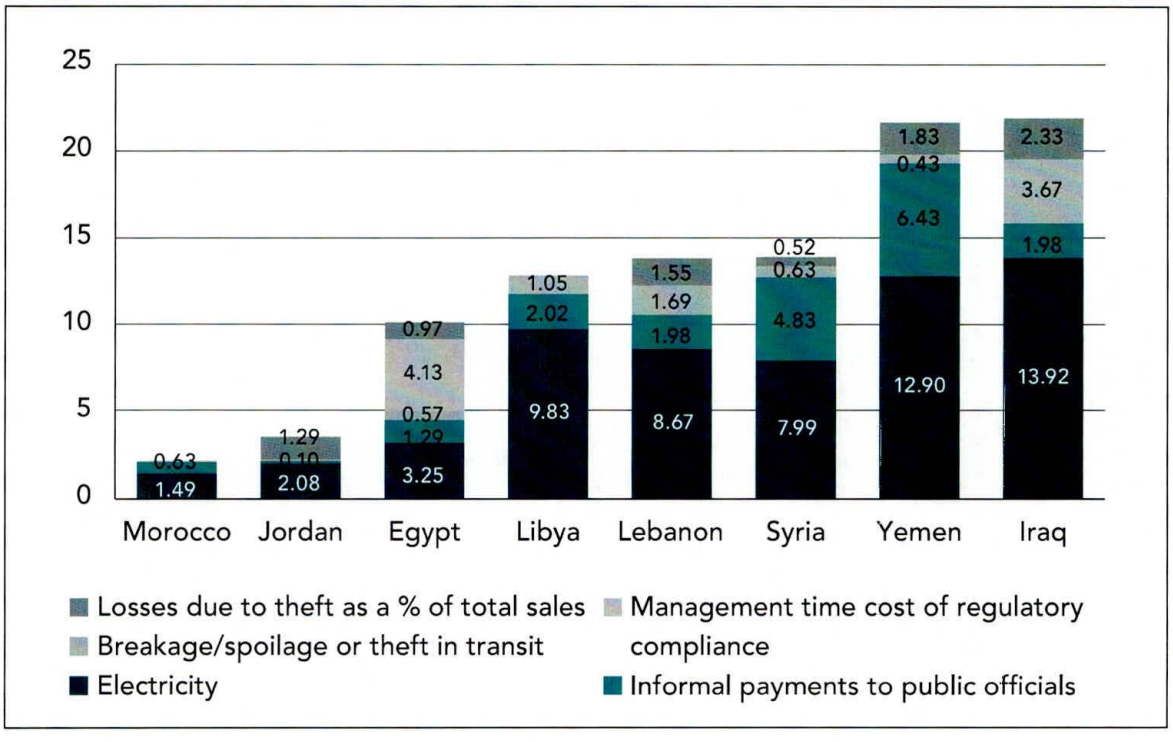


Figure 7: Losses Due to Investment Climate Weaknesses in Iraq and Comparators



Adversely affected by deficient infrastructure, corruption, informal competition and crime, productivity of firms in Iraq is nonetheless comparable to several other countries in the MENA region. While firms in Iraq compare favorably to Yemen, it is almost on par with Lebanon, Algeria and Morocco while countries like Jordan and Egypt are setting the benchmarks for the region[4] (figure 9).

Productivity by sector presents a more nuanced and diverse picture of Iraqi firms. Compared to firms in other countries that operate in the same sector, a striking diversity in the relative performance of firms in Iraq is noticeable. While Iraqi firms are among the better performing in the region in textiles & garments, chemicals, pharmaceuticals, non-metal, metal and equipment sectors, there is ample scope for improved productivity in food, processing and electronics sectors (figures 10–14).

Small and medium firms operate with higher efficiency than large firms in terms of capacity utilization. Large firms report using about 63% of existing capacity while small and medium firms utilize close to 72% (table 2). It is likely that large firms are affected disproportionately more by a slump in global demand conditions. However, larger firms operate for longer hours (large and medium firms operate for 64 and 65 hours respectively) each week.

[4] Total factor productivity of firms is used. The country aggregate is average across all firms in the manufacturing sector. See Annex III for the years of the most recent surveys available that were used to calculate the total factor productivity of comparator countries. Morocco is used as the baseline country for this comparison.

Figure 8: Investment Climate Losses Vary Widely by Firm Characteristic and Location

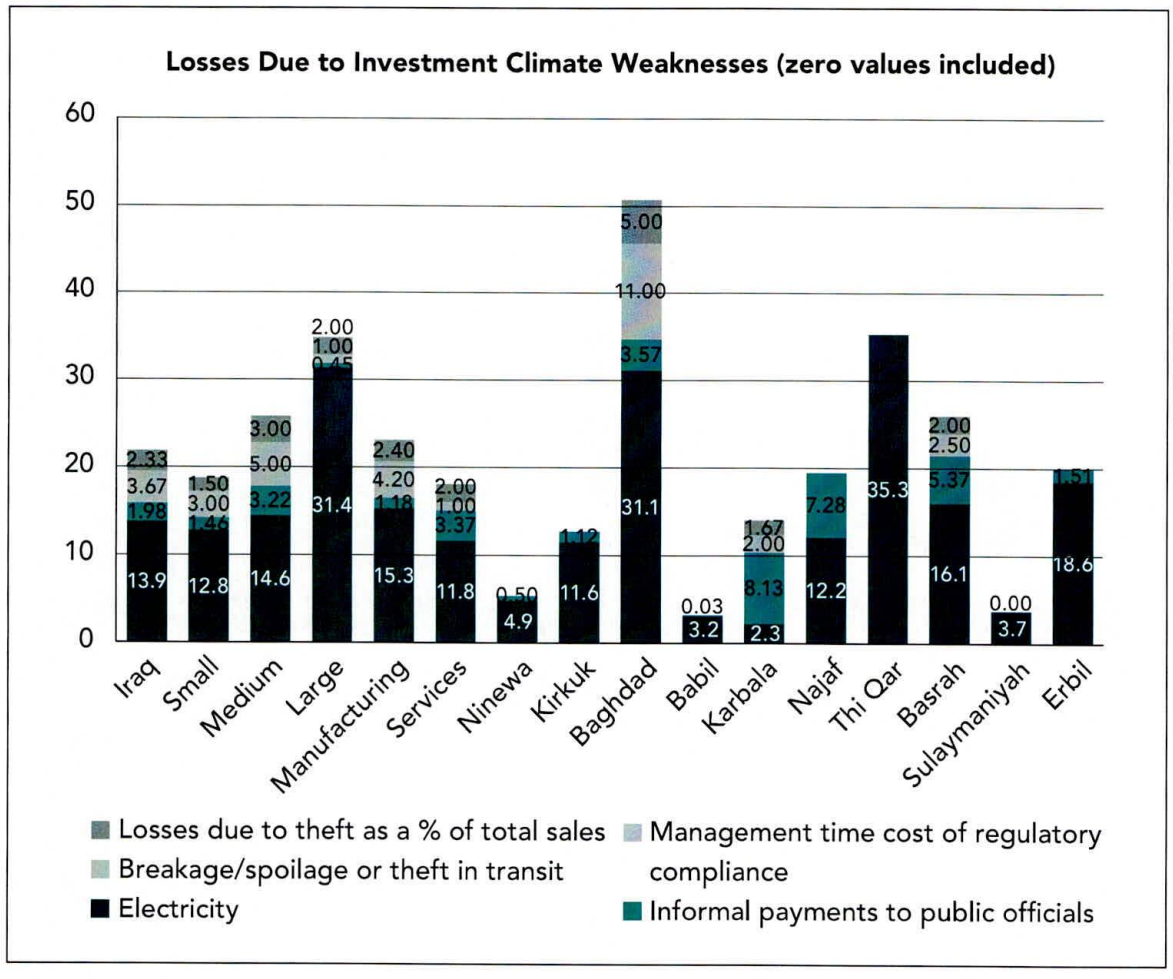
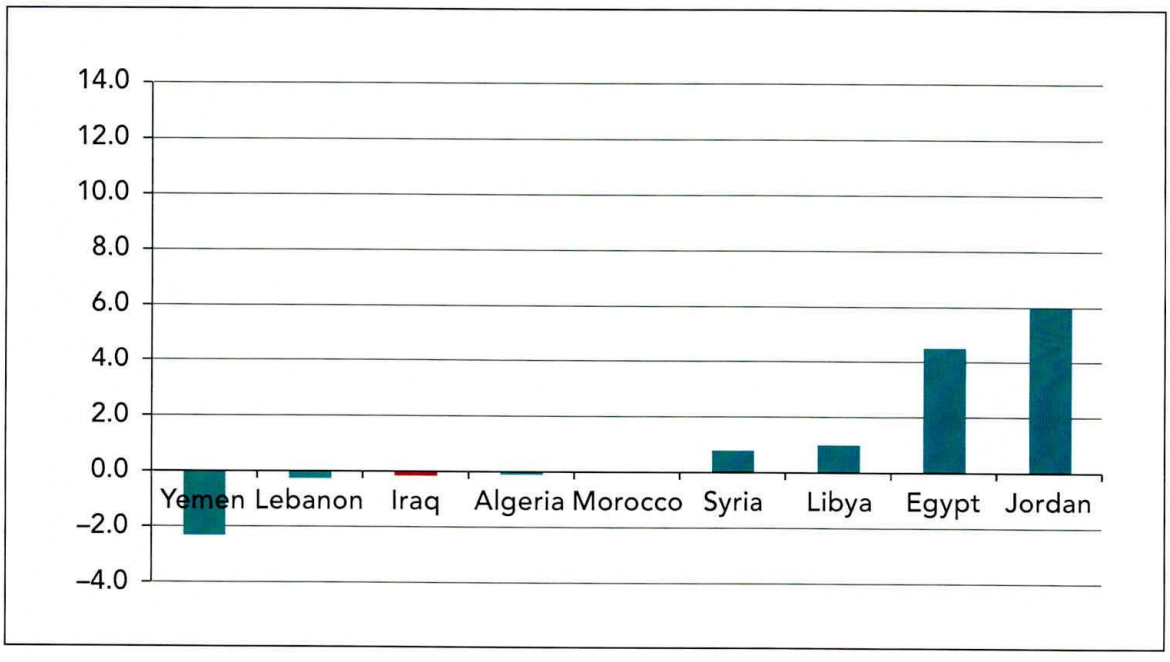


Figure 9: Productivity Gap Analysis: Iraq and Comparators

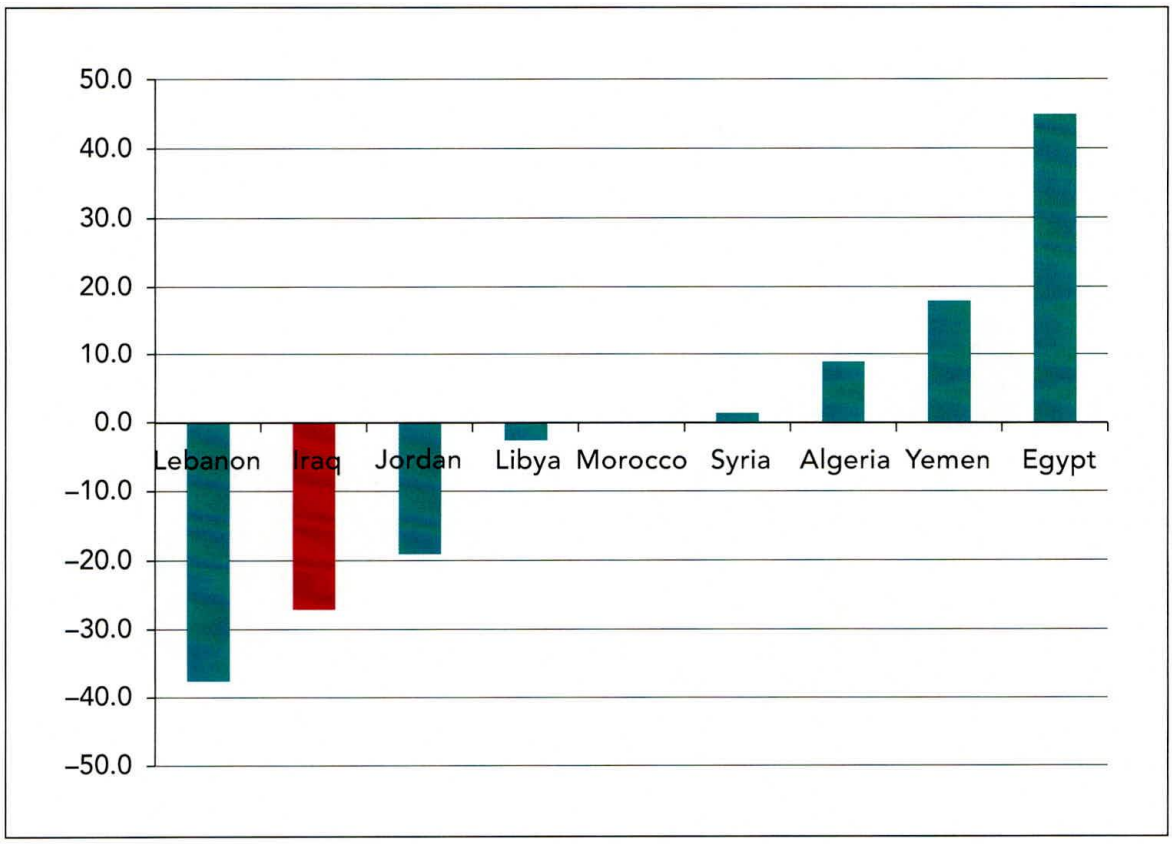


Box 2: Summary of Methodology Used to Estimate Average Firm Productivity by Country

Productivity is defined as the part of production that cannot be explained by the quantity of physical inputs. It is common in evaluating productivity to compare between economies or sectors by comparing residuals of a linearized Cobb-Douglas production function. Total factor productivity (TFP) is taken to be reflected by the residual after regressing total sales on material inputs, labor and capital. The equation used is: $\log Y = \alpha \log L + \beta \log K + \gamma \log M + \varepsilon$

Where: Y = Sales, L = Labor (Total cost of labor), M = Materials (Cost), K = Capital Stock (net book value), ε = Residual (TFP)

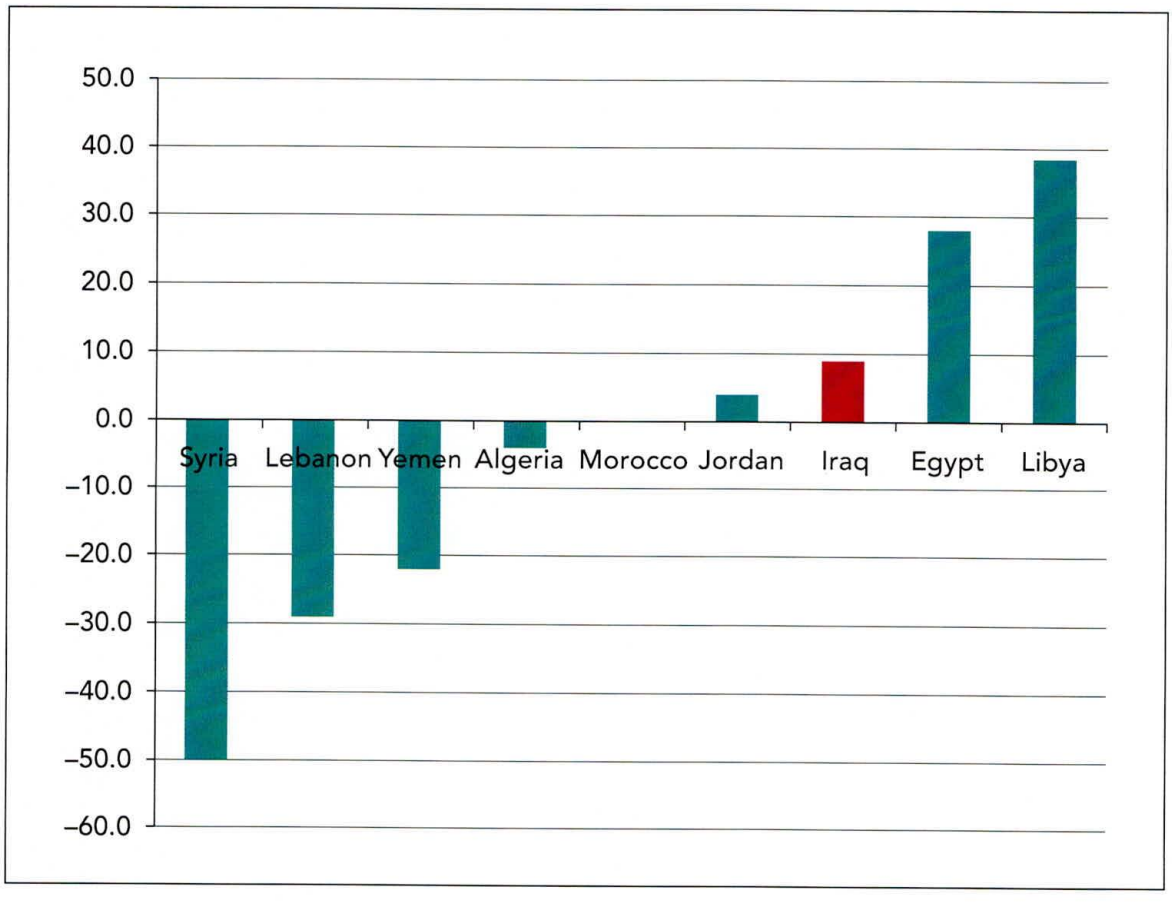
Figure 10: TFP of Firms in Food & Processing Sector: Iraq and Comparators



There is a wide degree of variation in capacity utilization between sectors. The food sector operates for the longest number of hours (64 hours) and utilizes the highest percentage of available capacity (table 3). The electronics sector operates for the least number of hours per week (46 hours) while the metals and equipment sector reports the least percentage of capacity utilization.

Productivity of the labor force and cost competitiveness are two critical factors to enhance both firm productivity and the ability to attract foreign investment. Unit labor costs

Figure 11: TFP of Firms in Textiles & Garments Sector: Iraq and Comparators



(measured as cost of labor per unit of value added) are central to determine a country's competitiveness in the global marketplace. In overall terms at the country level, only Algeria compares favorably to Iraq in terms of labor costs. By sectoral disaggregation of unit labor costs, Iraq is among the most competitive in the textiles, chemicals and metal sectors and least competitive in the electronics sector in the MENA region, lagging behind Algeria, Libya, Egypt and Syria (figures 15, 16).

Labor productivity (defined as total sales per worker employed) in Iraq displays dramatic variation across sectors—the labor force in the chemicals and pharmaceuticals sector is twice as productive as that in the electronics sector and appears to be inversely correlated with firm size in Iraq. Labor productivity in large firms is almost half of that of small firms (figure 17). While unit labor costs are most competitive among small firms, medium firms are the least competitive. Overall, labor productivity is highest in the chemicals and pharmaceuticals sector, and second highest in the metals and equipment sector. In general, the sectors that have the most productive labor also seem to be operating most competitively in terms of unit labor costs (figure 18).

Understanding the correlates of Iraq's productivity to various investment climate conditions enables the Government to better help inform the prioritization of investment climate reforms towards enhanced competitiveness. Two econometric

Figure 12: TFP of Firms in Electronics Sector: Iraq and Comparators

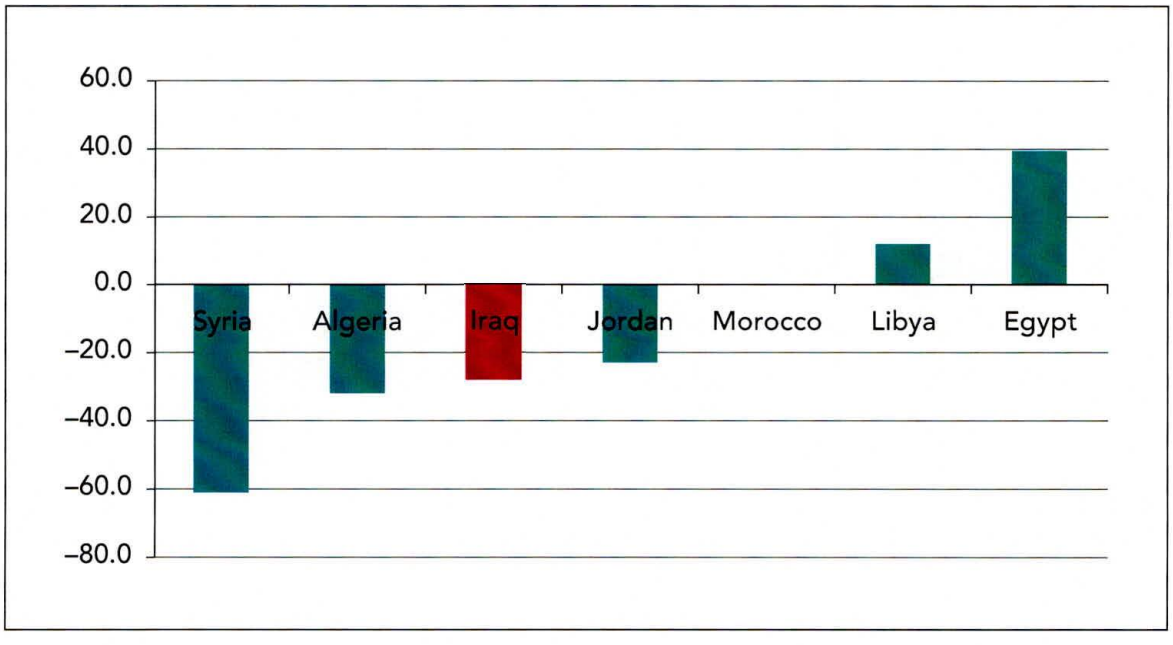


Figure 13: TFP of Firms in Chemical, Pharmaceuticals, and Non-Metal Sector: Iraq and Comparators

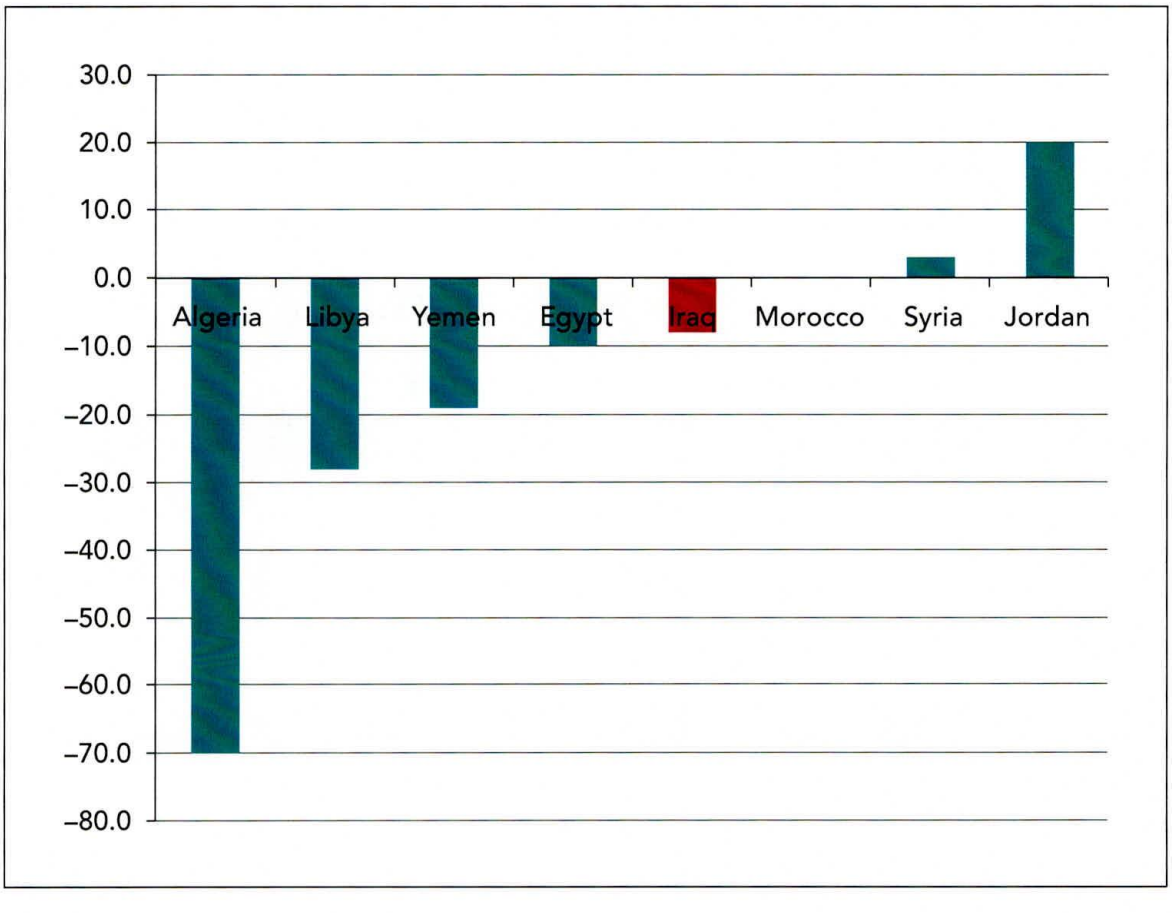
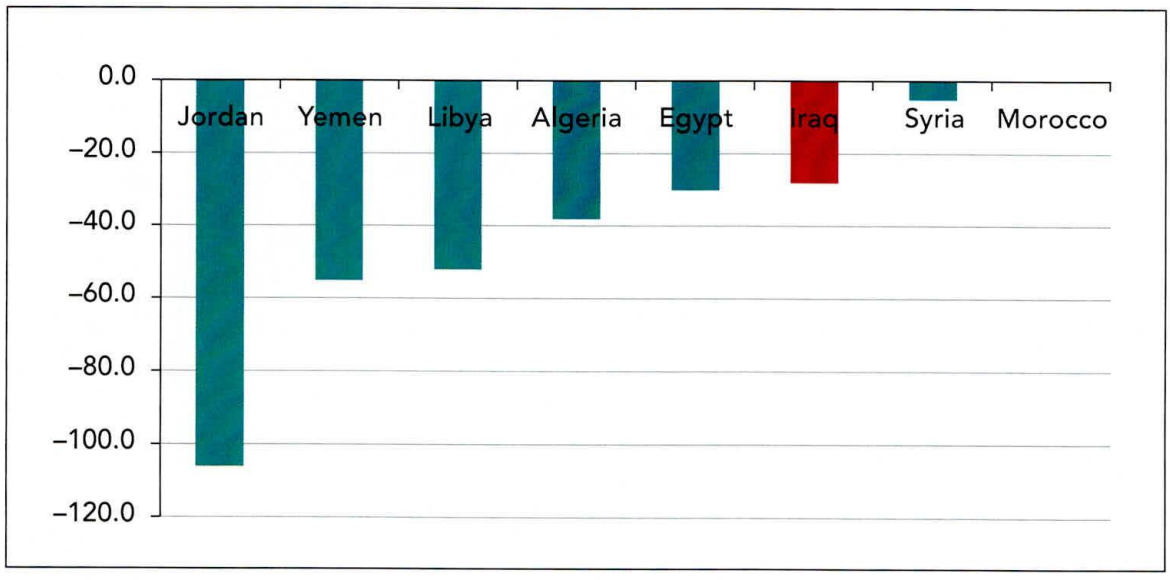


Figure 14: TFP of Firms in Metals and Equipment Sector: Iraq and Comparators



approaches were applied to the survey data described in Annex IV. In Iraq's case, both approaches produced very similar results with by and large the same significant relationships with the same direction of association between explanatory variables and firm level performance.

Based on the results of the analysis (see table 4), the survey data suggests the following:

- Excessive government regulation is counter-productive: the higher the degree of regulation (reflected in terms of the percentage of total time spent by senior management to follow and comply with government regulation) the lower the productivity of firms, confirming the importance of regulatory reform and rationalizing and modernizing bureaucratic processes.

Table 2: Iraq: Average Capacity Utilization, by Firm Size

	Iraq	Small	Medium	Large
Average capacity utilization (in percent)	71.5	71.6	71.8	63.5
Average number of hours of operation (per week)	57.7	54.1	65.1	64.0

Table 3: Iraq: Average Capacity Utilization, by Manufacturing Sector

	Iraq	Food	Textiles	Electronics	Chemicals	Metals
Average capacity utilization (in percentage)	71.5	77.5	71.4	68.0	67.9	66.6
Average number of hours of operation (per week)	57.7	63.5	52.1	46.4	56.4	50.3

Figure 15: Textiles and Garments Sector: Unit Labor Cost by Country

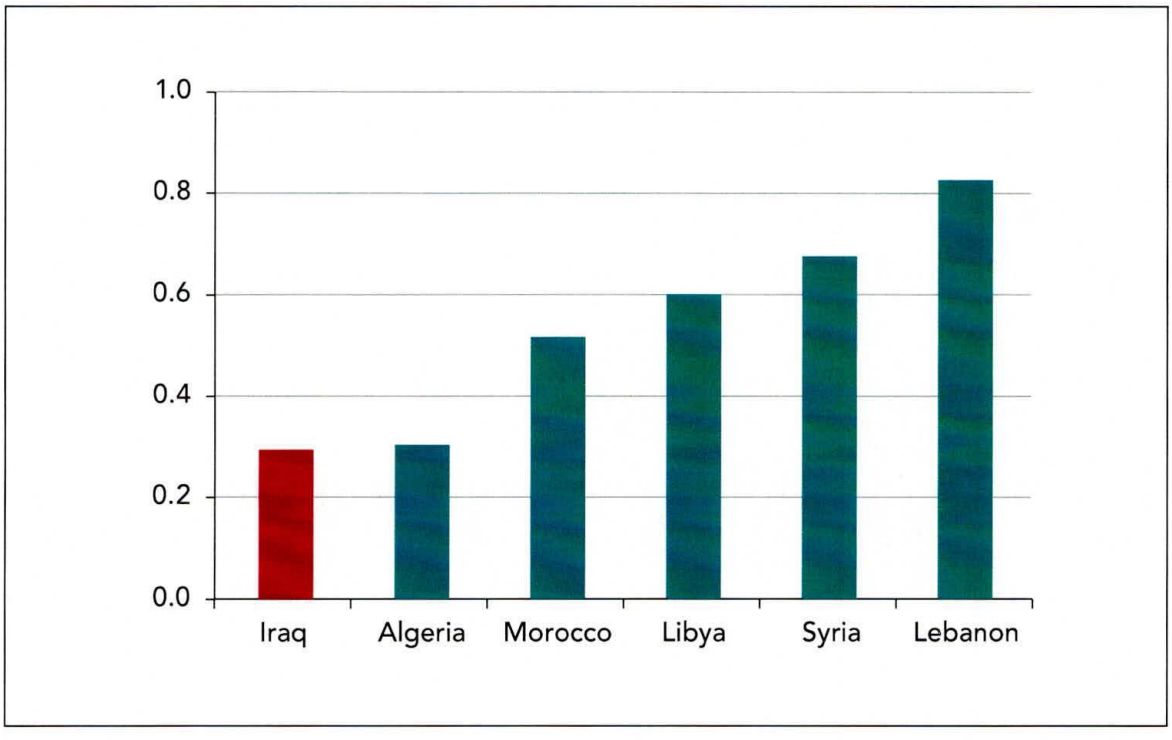


Figure 16: Electronics Sector: Unit Labor Cost by Country

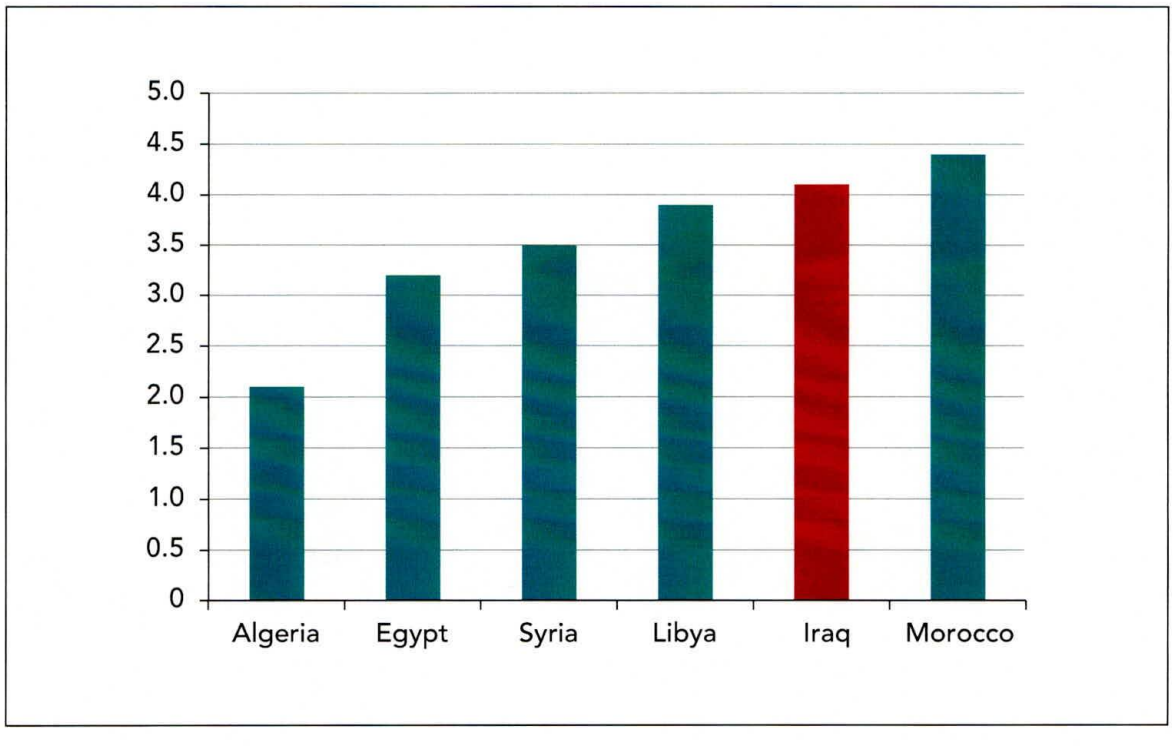


Figure 17: Iraq: Labor Productivity and Unit Labor Cost by Firm Size

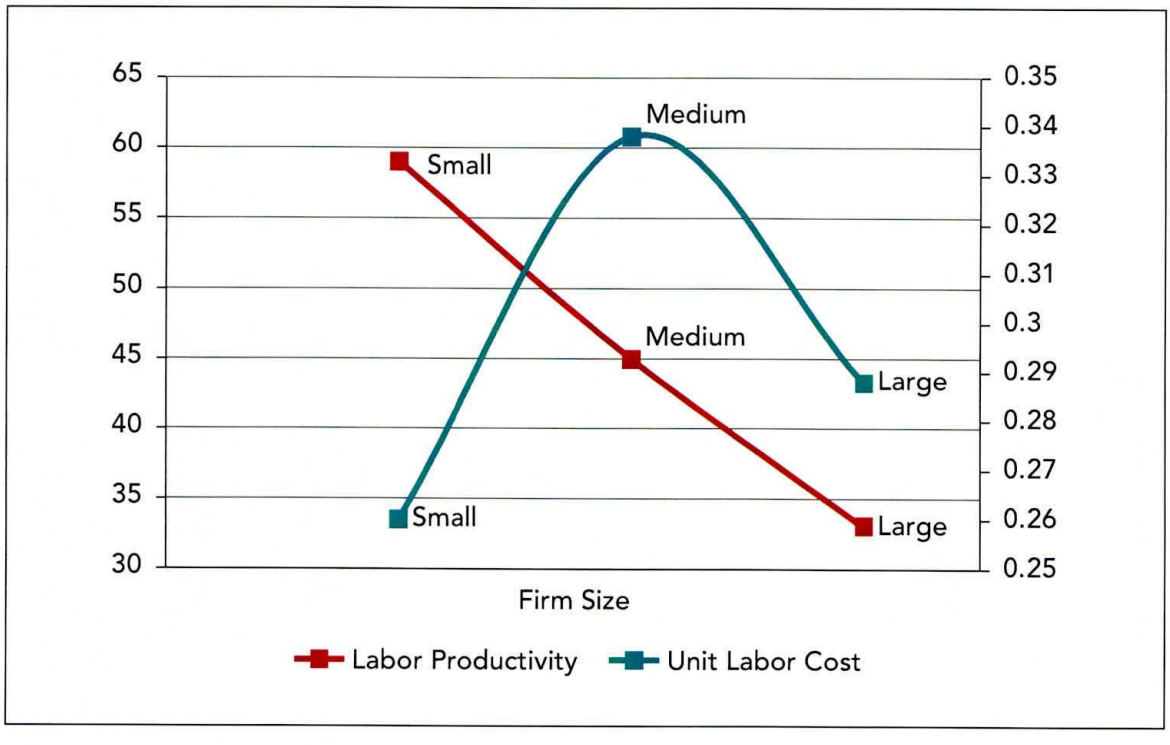
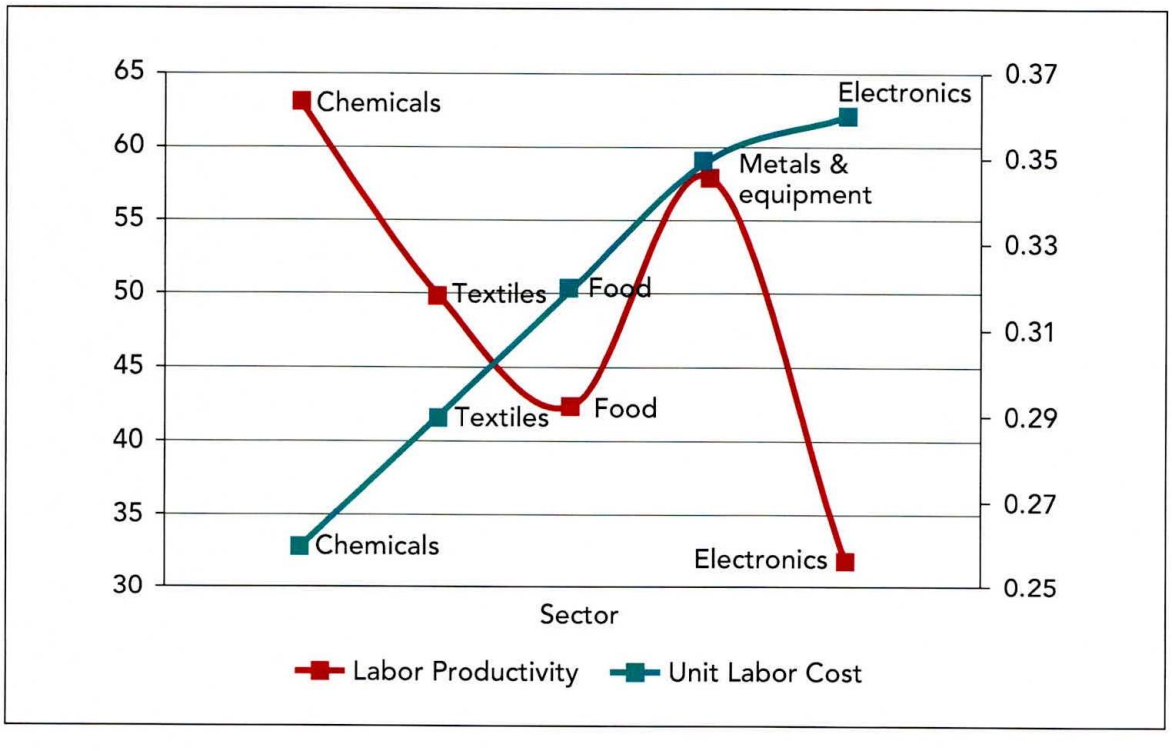


Figure 18: Iraq: Labor Productivity and Unit Labor Cost by Sector



- Firms in leather, non-metallic products, plastics and rubber and fabricated metal product sectors tend to be more productive.
- Though not many firms in Iraq (only about 11%) consider labor laws (such as social insurance) a seriously binding constraint, they do affect firm productivity negatively.
- Firms that face a fair degree of domestic competition tend to be more productive than others, confirming the link between competition and productivity.
- Use of foreign technology is positively associated with firm productivity.
- Government ownership is negatively related to productivity, controlling for other firm characteristics. This is consistent with a view that highlights the advantages of private ownership and competition in productive sectors.
- Female ownership of firms enhances productivity. Firms that have female ownership are positively related to productivity, controlling for other firm characteristics. This is consistent with a growing body of literature and international experience pointing to the advantages of fair competition and gender-inclusive societies in making economies more productive and competitive. The existence of gender-related barriers can thwart the economic potential of women as entrepreneurs and workers, and such barriers have an adverse impact on enterprise development, productivity, and competitiveness. Consequently, addressing gender-specific barriers to entrepreneurship and leveraging the full participation of both men and women in the development of Iraq's private sector together represent a significant opportunity to unleash its productive potential to strengthen economic growth.

A set of regressions was run to determine the connection of labor productivity (measured as total sales per worker employed) with indicators of firm characteristics and investment climate conditions. These results present the effect of investment climate attributes on labor productivity. Table 5 summarizes the findings of this analysis:

- Labor productivity is inversely related to the size of the firm expressed in terms of employment. This is in accordance with standard economic theory and reflects the diminishing marginal productivity of labor.
- Use of email is positively associated with labor productivity. Firms that use modern communication technologies are also likely to be employing skilled and educated labor and hence very productive.
- Electricity is a major constraint for firms in Iraq. An overwhelming majority of firms in Iraq (73%) have reported electricity as the most binding constraint to their operations. Thus it may appear counter-intuitive to find a positive association between firms with electricity as a severe constraint and labor productivity. However, the causality may be running in the reverse direction—Firms that are competitive, expanding and productive may be impacted more severely by the lack of access to electricity. These are further the firms that one would expect to complain about the lack of sufficient and reliable supply of electricity.
- Excessive regulation is bad for labor productivity. Firms with senior management spending a high proportion of their time in dealing with regulations are likely to be less productive.
- Labor in firms that face higher level of domestic competition is likely to be more productive than otherwise.

- Use of foreign technology is associated with higher labor productivity.
- Firms that paid to make their own security arrangements so as not to disrupt their operations are likely to be more productive. Proactive management that ensures efficient working conditions for their labor is likely to be more successful.
- There is a negative association between firms that invest in human capital and provide training for their employees and their labor productivity. This could be a case of reverse causality—Firms that find their staff resources lacking in terms of education and appropriately matching skill sets for their operations are the ones likely to be investing in formal training programs to bridge the skill gap and hence can be expected to be less productive than otherwise.
- Labor in older firms is likely to be more productive. In a competitive economy, more productive firms survive longer and take time to grow and build markets.
- Firms with female ownership are likely to be more productive. It is an entirely plausible assumption that the marginal productivity of female entrepreneurs, in the initial stages of economic and social inclusion, are higher than their male counterparts who had never faced entry barriers. This is a convergence-based explanation.

Innovation is a complex process that involves creating, absorbing, adapting and applying new ideas by risk-taking firms in order to be more productive and/or cost-cutting in their operation. It can originate from both domestic and foreign sources. At Iraq's stage of technological development, there is ample scope for further progress on this front. An existing firm can become more productive through improved managerial or production processes or through product innovation. Innovation has several dimensions but given the data limitations, the ICA focuses on specific innovative behaviors of existing firms such as quality certification, licensed usage of foreign-owned technology, capacity and production expansion plans, current capacity utilization, introduction of new processes or technology to reduce costs, use of email, maintenance of own website, and access to high speed internet. All these aspects of a firm's operations are associated with innovative and more productive patterns.

A quick survey of relevant data suggests that innovative activity rises with firm size, foreign investment and exporting (tables 6 and 7) with the notable exceptions being quality certification and capacity utilization. However, the sample size of firms with ISO certifications is too small (2.5% of all firms) to reach any definitive conclusion. Similarly, it is also likely that large firms and exporting firms by nature of their operations and volatile market conditions need to maintain larger capacities on average. This is further supported by the fact that these firms have bigger expansion plans despite their (relatively lower) current level of capacity utilization.

Large, exporting, and foreign-invested firms, on average lead in the use of licensed foreign technologies, capacity expansion plans, introduction of new processes and technologies, use of email, own websites, and high speed internet (tables 6, 7). For instance, about 31% of large firms in the sample use foreign-owned technologies as opposed to 16% of medium firms and a mere 2% of small firms. They also lead clearly in terms of use of modern communication technologies and introduction of new processes and technology

Table 4: One-Step Regression on the Manufacturing Sector

Variable	Coefficient	Std. Err.	t	P>t
Ln (Capital)***	0.12	0.03	4.51	0.00
Ln (Labor)***	0.38	0.05	7.13	0.00
Ln (Material)***	0.17	0.03	5.86	0.00
Senior management time spent in dealing with regulations (percent)***	–0.01	0.00	–3.11	0.00
Severely constrained by labor laws (Y/N)*	–0.06	0.03	–1.89	0.06
Domestic competition is important(Y/N)**	0.05	0.02	1.95	0.05
Use of foreign technology (Y/N)*	0.32	0.17	1.91	0.06
Government ownership (in percent)*	–0.01	0.00	–1.76	0.08
Female ownership (Y/N)**	0.30	0.13	2.23	0.03
Leather sector***	0.94	0.27	3.49	0.00
Plastics and rubber sector*	0.55	0.31	1.75	0.08
Non-metallic mineral products**	0.54	0.26	2.08	0.04
Fabricated metal products**	0.54	0.27	2.02	0.04

Data notes:
Figures in the first column are the values of the regression coefficients.
***, **, and * denote statistical significance at the 1%, 5% and 10% levels.
Only significant variables are reported in the tables. (See Annex IV for a comprehensive list of variables used in the regression.)

Table 5: Labor Productivity and Investment Climate Attributes

Variable	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
Number of permanent employees***	–0.747	0.079	–9.45	0.000	–0.902	–0.591
Use of email (Y/N)**	0.416	0.167	2.49	0.013	0.088	0.745
Electricity (Severely constrained)***	0.136	0.029	4.67	0.000	0.079	0.193
Senior management time spent in dealing with government regulations(% of total time)***	–0.015	0.005	–3.13	0.002	–0.024	–0.006
Faces stiff domestic competition(Y/N)***	0.103	0.032	3.26	0.001	0.041	0.165
Use of foreign technology (Y/N)***	0.701	0.217	3.23	0.001	0.275	1.128
Paid for security (Y/N)**	0.223	0.113	1.98	0.049	0.001	0.445
Firm providing training to staff (Y/N)**	–0.509	0.227	–2.24	0.026	–0.956	–0.063
Age of the firm (in years)*	0.186	0.107	1.74	0.083	–0.024	0.397
Presence of female ownership (Y/N)**	0.284	0.145	1.96	0.051	–0.001	0.569

Data notes:
Figures in the first column are the values of the regression coefficients.
***, **, and * denote statistical significance at the 1%, 5% and 10% levels.
Only significant variables are reported in the tables. (See Annex IV for a comprehensive list of variables used in the regression.)

Table 6: Iraq: Innovation Indicators by Firm Size

Innovation indicators (in percent of all firms)	Iraq	Small	Medium	Large
ISO certification	2.55	0.95	6.38	0.00
Using technology licensed from a foreign-owned company	6.69	1.58	15.54	30.77
Firms planning to expand capacity in the next two years	44.10	41.92	46.90	61.54
Capacity utilization	71.47	71.63	71.83	63.54
Introduced new process or technology to reduce costs	22.59	16.35	32.65	61.54
Use email	19.58	9.09	37.84	69.23
Have a website	8.13	2.19	14.86	76.92
Have high speed internet	13.96	6.90	23.65	76.92

(62% of large firms versus 33% and 16% for medium and small firms respectively). Only 22% of domestic firms introduced new processes or technology over the last two years compared to 33% by foreign-invested firms and about 8% of domestic firms have their own websites as opposed to 33% of foreign-invested firms. Similar patterns repeat themselves if we observe firms by their market orientation. An overwhelming majority (78%) of exporting firms demonstrate innovation by way of introducing new processes or technologies relative to a small minority (19%) of non-exporting firms.

To further explore the correlates of innovation, a set of logistic regressions were applied to the enterprise survey data to better understand characteristics of innovative firms. In this model a binary dependent variable is defined as whether or not a firm has undertaken an innovation. We use the firms that introduced a new process or technology in order to reduce the production cost of existing products in the last two years as proxy for innovative behavior. While the practice in the recent investment climate assessments is to use firms that introduce a new product line or upgrade an existing product line as reflecting

Table 7: Iraq: Innovation Indicators by Firm Ownership and Market Orientation

Innovation indicators (in percent of all firms)	Domestic	Foreign-invested	Exporter	Non-exporter
ISO certification	2.37	12.50	13.04	2.01
Using technology licensed from a foreign-owned company	6.81	11.11	8.70	6.59
firms planning to expand capacity in the next two years	43.89	62.50	73.91	42.49
Capacity utilization	71.57	58.25	51.50	72.45
Introduced new process or technology to reduce costs	22.34	33.33	78.26	19.78
Use email	19.07	55.56	65.22	17.29
Have a website	7.84	33.33	13.04	7.88
Has high speed internet	13.35	55.56	65.22	11.38

innovation, this is the closest question available in Iraq's enterprise survey that captures innovation at the firm level. Control variables were introduced for firm size, sector, foreign ownership and exporter status.

The logistic regression is used to predict the probability of the occurrence of an event (in this case, the event is a firm carrying out an innovative action) by fitting data to a logistic curve. It makes use of several "predictor" variables. The event variable is binary—either it occurs or it doesn't. Explanatory variables can be binary, categorical or continuous. A series of logistic regressions were run on the 2011 manufacturing survey data for Iraq using standard firm characteristics and other explanatory variables that included indicators of regulatory burden, access to finance, competitiveness conditions, and infrastructure constraints. All independent variables were checked for multicollinearity.

Based on the results of the analysis, the survey data suggests the following:

- Exporting firms are much likelier to innovate than non-exporting firms. This is to be expected as these firms face stiffer global competition. Competition from the informal sector also is not associated with the likelihood of innovation.
- Firm size is strongly related to the likelihood of introducing new processes or technology.
- The age of a firm is associated with innovation. The older a firm is, the more likely it is to innovate.

REFORM STATE-OWNED ENTERPRISES

Enable the Private Sector

KEY MESSAGES TO GOVERNMENT

Reform of Iraq's SOEs is urgently needed in order to level the playing field for the private sector, thereby bolstering economic diversification and growth. High priority actions for immediate and full implementation thus include:

- Implement the Government of Iraq Road Map for SOE Reform;
- Establish a Public Private Partnership (PPP) unit within the Ministry of Finance;
- Enact a best-practice PPP law as well as a complete set of sector-specific modern commercial laws and regulations;
- Conduct a complete review of government assets, including their viability and potential;
- Develop support measures for excess employment, including mechanisms for absorption into the private sector.

Iraq's centralized economy has been affected by the commonly referred-to "Dutch Disease" and has historically been dominated by SOEs, a legacy of the state-planning system of Iraq's former regime. Iraq's SOE sector includes a large variety of public entities, including ministries, directorates, departments, holdings, and bodies.[5] A lack of consistency and completeness in the Government's data is a major source of confusion and makes the task of identifying all of Iraq's SOEs difficult. According to the latest Iraqi-led data collection, Iraq counts 176 SOEs. The largest share (76) are held by Ministry of Industry and Minerals (MIM), followed by the Ministries of Oil (16), Finance (13), and Construction and Housing (11). These numbers are continually changing. While some SOEs are being liquidated, the ownership and management of many others (e.g., 27 military-industrial SOEs) are being transferred from one ministry to another.[6]

It would be more accurate to consider many SOEs as directorates in a classic central-planning bureaucracy, rather than as single firms operating in a commercial manner.[7] For instance, MIM's 76 SOEs include 250 factories and over 200,000 employees. MIM's industrial SOEs are organized into six main sub-sectors: engineering, chemicals and petrochemicals, textiles, construction, food and pharmaceuticals, and industrial services. MIM's factories produce over 200 products and services, ranging from baby food to cement to systems engineering.[8] Most, if not all, of MIM's products are traded in competed markets.

While many SOEs have restarted operations after years of damage and looting, a significant number remain inoperable. The main asset of such inoperable SOEs would tend to be land and buildings. Even though not operable and not producing goods or services, many such SOEs continue to keep workers on payroll. SOE employment is said by the Government to have stood at about 633,000 in 2010. Under current conditions, Iraq's SOEs are considered to be at least 37% overstaffed.[9]

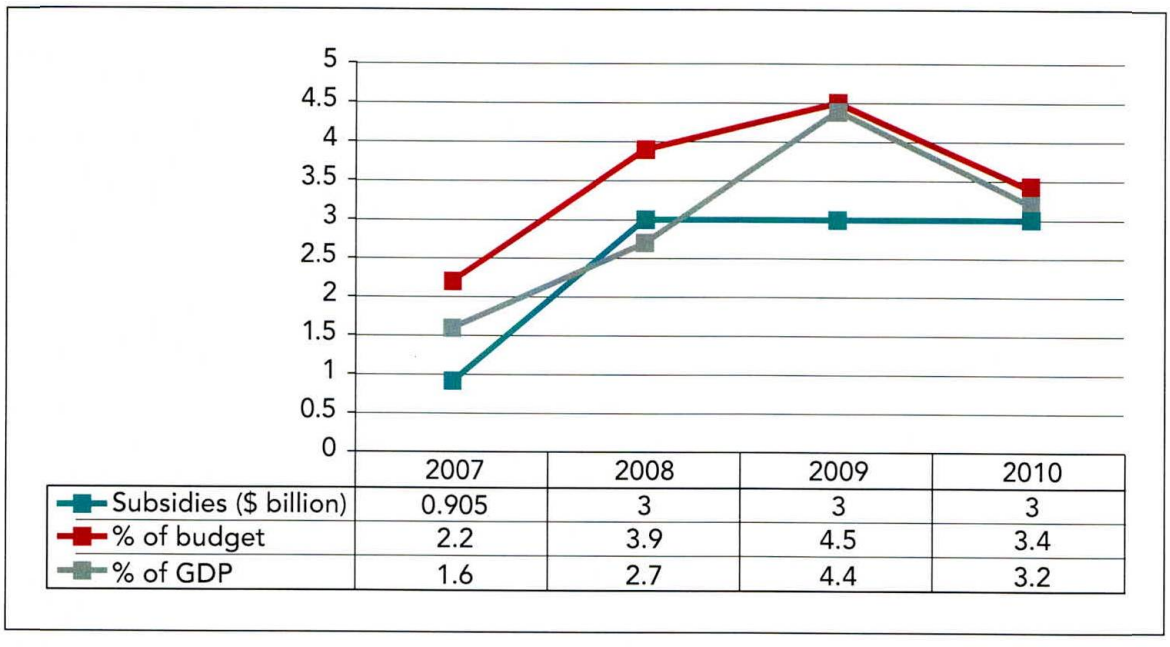
While confronted with major budget deficits due to fluctuating oil revenues and growing public sector costs, the Federal Budget has allocated increasingly large subsidies

DUTCH DISEASE

"Dutch Disease" was named for the problems experienced by the Netherlands following the discovery and initial exploitation of vast domestic reserves of natural gas. The rapid growth in petroleum exports led to an appreciation of the exchange rate and put upward pressure on the costs and prices of non-traded domestic goods and services, diminishing their competitiveness and eroding the diversity and balance of the domestic economy. Similar symptoms have been subsequently identified in almost all countries where petroleum exports play a major economic role.

[5] For instance, a training commission is included in the list of Ministry of Industry and Minerals (MIM) SOEs.
[6] United Nations and World Bank, 2010.
[7] Desai, October 2009.
[8] United Nations and World Bank, 2010.
[9] Ibid.

Figure 19: Annual Budget Subsidies for Iraq's SOEs



	2007	2008	2009	2010
Subsidies ($ billion)	0.905	3	3	3
% of budget	2.2	3.9	4.5	3.4
% of GDP	1.6	2.7	4.4	3.2

Source: United Nations and World Bank, 2010.

to SOEs in recent years. For instance, the absolute amount of SOE subsidies has grown from $0.9 billion in 2007 to $2.9 billion in 2009, rising from 2.2% of the budget to 4.5% (figure 19). These funds have been mainly used to cover SOE salaries and other employment benefits. In addition, many SOEs have been given government guaranteed loans to cover operating expenses.

Despite its substantial oil revenues, Iraq has many pressing needs for public funding and cannot afford annual subsidies of $1–3 billion to keep uncompetitive SOEs afloat. As other experience from MENA shows (box 3), privatization and public-private partnerships (PPPs) can be a substantial source of both sales proceeds and annual savings in the form of taxes and foregone subsidies.

Unable to compete on quality as a result of insufficient foreign direct investment and domestic innovation, Iraq's manufacturers cannot compete on price due to high input costs. This reflects, in part, inefficiencies among Iraq's manufacturers—especially manufacturing SOEs. A transformation of Iraq's industrial SOEs into globally competitive firms is essential. Many of MIM's SOEs are an unsuitable and inadequate base upon which to build such industrial firms. An influx of foreign investment, management, and linkages to global markets and supply chains is needed.[10] Foreign investors will require ownership and control in order to make such commitments to a country still fraught with such risk

[10] In Jordan, most privatizations involved a foreign strategic investor who could improve management and integration into global markets. The privatized firms made over $1 billion in capital investment during 2000–2007, which equates to 11.4% of overall foreign direct investment (FDI). In addition, construction of a new passenger terminal under a build-operate-transfer arrangement at Queen Alia International Airport is generating an additional $750 million in FDI.

Box 3: Fiscal Impact of Jordan Privatization

Fourteen privatization transactions and two public-privatization partnerships (PPPs) undertaken by the Government of Jordan during 2000–2007 successfully raised $2.6 billion in sales proceeds and otherwise benefited Jordan's macroeconomic stability, competitiveness, consumers, and labor. The privatizations include Jordan Telecommunications Company (JTC) (2000, 2002); Arab Potash Company (2003); Jordan Phosphate Mines Company (2005); seven aviation sector businesses, including Royal Jordanian Airlines (2000–2007); and three power sector companies (2007). Using most of the $2.6 billion in privatization proceeds to buy back Paris Club debt at a discounted rate, Jordan succeeded in reducing its external debt/GDP ratio from 100% in 2000, to 89% in 2004, and 60% in 2008. Thus, privatization contributed to lower interest charges and overall macroeconomic stability. In addition, as of 2008, these privatized companies' annual contribution to the Treasury—in the form of taxes, royalties, and dividends—amounted to about $380 million.

Source: Gokgur and Christen, 2009.

and uncertainty as Iraq. Elsewhere in the region, privatized firms and PPPs have shown major gains in financial performance and productivity (Box 3).[11]

Continued state ownership of industrial firms that sell products into competed markets will tend to encourage protectionism of such SOE-supplied markets. In addition to Iraq's problems with high-cost material inputs without encouraging the protection of state-owned manufacturers that would sustain and perhaps further raise already-high input prices. Numerous studies of worldwide experience have demonstrated that no justification exists for maintaining state-owned manufacturing firms that sell into competed markets.[12]

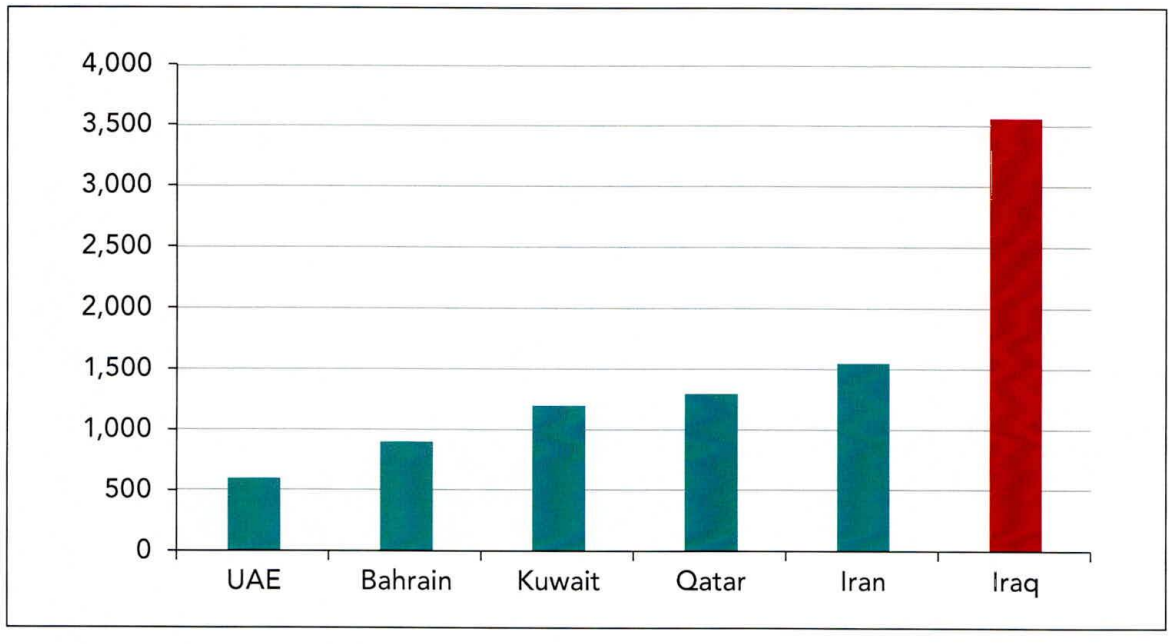
Key transportation nodes—including Iraq's airports and three seaports—are state-owned, run-down, and inefficiently operated. This is clearly seen in the average cost of moving a standard shipping container through each of the Gulf's main seaports. Iraq suffers from the highest shipping costs—more than double the average cost for Iran, three times the cost for next-door Kuwait, and more than five times the cost for UAE or Saudi Arabia (figure 20). Similarly, Iraq's airports are unsuited to handle large volumes of air cargo.

Iraq's state-run electric power and telecommunications sectors are unable to support efficient manufacturing and distribution systems. While mobile telephone penetration has reached 67% with three licensed operators, fixed line operation and fiber—upon which internet access is still based—remain in a woeful state. By 2002, fixed line density rates had fallen to below 4%. While Iraq's telecommunications sector has attracted $3.7 billion in investment, much of this is likely going into mobile rather than to upgrade the

[11] For instance, in Jordan, sales revenue per employee grew 50–200% during 2000 to 2008 at the privatized Royal Jordanian Airlines, Jordan Telecommunications Company, and power sector companies. Gokgur, N. and R. Christen, "Impact of Restructuring and Privatizing of State-Owned Infrastructure and Non-Infrastructure Enterprises in Jordan, 1994–2008," (2009).

[12] J. Nellis, The Economist: Special Survey on State Capitalism

Figure 20: Average Import/Export Cost, Per Container (US$)



Source: World Bank, Doing Business, 2012.

state-run fixed line system that provides internet connectivity. Further, Iraq's electric power grid has been severely damaged. Demand growth and generation shortages have left the grid in a state of near collapse. Power generation barely meets half of demand, leading to frequent blackouts. The Government has estimated that $28 billion of near-term investment is needed to fill the gap.

Privatization of Iraq's SOEs—especially SOEs involved in tradable goods—and inducement of PPPs is therefore urgent. Investment climate survey data and other evidence indicate that Iraq's international competitiveness—and its economy's capacity to generate growth and create quality employment, outside the oil sector—is severely constrained by high input costs, transportation bottlenecks, and a general lack of reliable infrastructure.

Retrenchment of excess staff at Iraq's SOEs is a legitimate concern, but can be managed. Available data suggest that up to 234,000 (37%) of the estimated 633,000 workers at Iraq's SOEs are redundant. While its SOEs were in better shape than those of Iraq before privatization, Jordan's approach to worker redundancy suggests a way forward. On protection of SOE workers, the Government of Jordan sought as a matter of policy to avoid involuntary retrenchments in the course of privatization. The fourteen privatized firms saw only a 2% net loss in employment. This has been more than offset by indirect job gains elsewhere.[13] For instance, it is estimated that privatization and other reforms in Jordan's telecommunications sector generated 25,000 additional jobs.[14]

[13] Gokgur and Christen, 2009.

[14] Government of Jordan, Ministry of Planning and International Cooperation, 2011.

While some observers are willing to grant the state a role in infrastructure, recent experience from the MENA region demonstrates the potential of private operators to outperform the state in terms of efficient investment and delivery of critical services. For example,

- In Jordan, following partial sale with control of Jordan Telecommunications Company to France Telecom, waiting times for fixed-line connections dropped dramatically, from almost ten years pre-privatization to just a few days. One-time fixed line connection fees, for both residences and businesses, have also been cut by 75%. Almost all fixed-line tariffs have been halved since 1998. Fixed-line reliability has improved greatly.
- In air transport, following its restructuring and privatization, Royal Jordanian has substantially increased its destinations, flight frequencies, and customer satisfaction.[a]
- Among Gulf Cooperation Council countries, an internal World Bank study found that unit costs for power and water supplied by privately-run independent power producers (IPPs) and independent water and power producers (IWPPs) tended to be 25–33% below unit costs at state-run power and desalination plants. Moreover, reliability and availability was almost ten percentage points higher (e.g., 93% availability, versus 84%) at the privately-run plants.
- Private operation of seaports has provided huge gains. For instance, in Jordan, private operation of Aqaba port nearly doubled container throughput between 2003 and 2008, and practically eliminated waiting times. Lloyds now rates Aqaba as among the three best container terminals in the Middle East/South Asia.[b]
- In Saudi Arabia, within three years of private operators taking over at Jeddah port, inbound and outbound clearance times were cut in half (or better) at one container terminal, the number of container lifts per hour tripled, and waiting times to berth container vessels were cut to about one-tenth the pre-privatization waiting times.[c]

[a] Gokgur and Christen, 2009.
[b] Ibid.
[c] Bakr, 2001.

The Government of Iraq will want to move forward rapidly, despite inherent difficulties, to accomplish the gains promised by privatization for macroeconomic stability, fiscal resources and flexibility, and global competitiveness. The Government will also want to emphasize practical measures in terms of goals, institutional framework, sales process, treatment of SOE insiders, preparations for sale, sales method, and post-sale arrangements described in further detail in the toolkit provided below.

In 2010, the Government approved a national policy of corporatization of Iraq's SOEs, based on a "Road Map" (Annex VII) derived from international best practices. This program, which is likely to unfold over a period of up to ten years, will remove the surplus labor from the SOEs, help SOEs develop business and investment plans, and gradually commercialize them in preparation for converting their ownership into shares. In addition to being a significant economic reform, this program, over the long term, may open additional opportunities for foreign and local investors.

LESSONS FROM OECD EXPERIENCE

The objectives for privatization sales transactions should be clearly identified and prioritized at the start of the process, in order to highlight tradeoffs and guide the preparation and conduct of the sale. While emphases have varied from country to country, sales objectives have commonly included the following: (i) fiscal gains from sales proceeds, increased corporate taxes, and discontinuation of subsidies; (ii) increased investment, from foreign and domestic sources; (iii) competitiveness gains, from improvements in enterprise efficiency and performance; and (iv) support for capital market development, through public share offerings. Under Iraq's present circumstances, it seems most appropriate to emphasize increased investment and competitiveness gains. Maximizing sales proceeds seems of less importance, given Iraq's ongoing oil revenues coupled with ongoing SOE subsidies.

Institutional framework. Key considerations include the privatization program's emphasis on transparency, organization of decision-making, and use of outside advisors.

- Transparency is essential for maintaining public support for SOE sales and for forestalling future charges of corruption. Necessary transparency has been found to result from (i) development and publication of clear and comprehensive laws, regulations, and procedures to govern SOE privatization; (ii) publicity on upcoming privatization transactions and dissemination of relevant information on SOEs up for sale; (iii) reliance on a competitive sales process (e.g., public auction, open tender, or public share offering); (iv) equal treatment of foreign and domestic investors; (v) rules to avoid or disclose conflicts of interest; and (vi) publication of privatization sales results and oversight by an appropriate public body. OECD experience "shows that open, transparent, and competitive processes generate better outcomes in terms of price and quality of buyers.... The gains in terms of better outcome and...credibility generally outweigh the costs of running competitive processes."[a]
- Centralization of decision-making for privatization is most appropriate for a transition country with a large portfolio of SOEs. The authority for organizing and concluding SOE sales has usually been centralized in either the finance ministry or a dedicated privatization agency. In East Germany, for instance, whose industrial sector was woefully outmoded and uncompetitive, the *Treuhandanstalt* privatization agency wielded broad authority in selling or liquidating 12,000 industrial enterprises – with consent from the agency's board required only particularly large transactions – and settling creditor claims.[b]
- At least for large or complex sales, outside advisors should be retained to perform key tasks. These may include conversion of SOE financial statements to international standards, valuation, preparation of information (sales) memoranda, investor search, negotiation, management of a public share sale, and resolution of legal issues. Some transition economy governments have not wanted to retain outside advisors in order to save on fees (which may amount to 5% of transaction value) or to follow their advice. This has significantly detracted from the transparency of such countries' privatization programs, the quality of buyers, and sales proceeds.[c]

(continued on next page)

LESSONS FROM OECD EXPERIENCE *(continued)*

Sales process. The enterprise preparation and sales process should be designed to facilitate the sale of controlling ownership stakes to outside investors, including foreign investors. For instance, open processes of pubic auctions, open tenders, and public share offerings are preferable. A survey of 125 empirical studies of enterprise restructuring in the transition countries of Central Europe, the former Soviet Union, Mongolia, and Vietnam finds that privatization is strongly associated with post-privatization enterprise and that more enterprise restructuring results from sale to foreign investors (versus domestic investors), to dominant shareholders (versus a large number of dispersed shareholders), to outsiders (versus insiders), and to new managers (versus existing managers).[d]

Treatment of insiders. SOE insiders (e.g., management and workers) should be treated fairly, but should not be allowed to delay any sale and—if possible—should not receive any preferences in a privatization transaction. This recommendation is based on negative experiences from Central Europe and Russia. That said, experience from various OECD countries highlights the need for early consultation with insiders—e.g., on reasons for the sale and measures to address insider concerns.[e]

Preparations for sale. Preparations for privatization transactions require decisions on whether to do any pre-sale restructuring, how to value the SOE, and how best to attract potential buyers.

- Pre-sale restructuring of SOEs should be avoided, or at least minimized. For small and medium-sized SOEs, experience indicates that these should be sold "as is," at the best price possible, and as quickly as possible.[f] It is probably worthwhile to lay off or otherwise redeploy redundant labor. But new capital investments should be left to the new owners.[g] If an enterprise is particularly large or distressed, no investor may be interested in the entire enterprise. In such cases, governments should be prepared to accept for separate business units or assets of the SOE.[h]
- Especially for small SOEs, it is likely most appropriate to focus on sale of the underlying land.[i]
- Liquidation can be an efficient sales method for enterprises that are insolvent or difficult to audit. Liquidation involves the sale of SOE assets and use of the asset sale proceeds to pay off enterprise debts. The buyer assumes none of the SOE's debt and avoids exposure to hidden or contingent liabilities. This may be highly desired by the potential buyer of an SOE or SOE group with a complex or opaque capital structure. Liquidation was a main method in Poland's successful privatization program. Between 1990 and 1993, 40% of Poland's 8,441 medium/large SOEs entered a liquidation or court-supervised insolvency process.[j]
- Elaborate discounted cash flow valuations of the "going concern" value of medium/large SOEs are generally as waste of time and advisory fees. A book value valuation, so long as it includes the value of the real estate, will usually make the most sense.[k]
- Rather than focusing beforehand on a theoretical assessment of SOE "value," sellers should focus on procedures to maximize the potential buyers and minimize their potential

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LESSONS FROM OECD EXPERIENCE *(continued)*

uncertainty. Practical steps to achieve this include a clear and comprehensive information memorandum; multi-year financial statements, prepared according to international standards and independently audited; opportunities for due diligence by potential buyers; a standardized draft sale/purchase agreement; certainty of title and liabilities; and an open tender process—consisting of well-advertised requests for expressions of interest followed by technical/financial bids by short-listed bidders.

Sales method. The sale method chosen for a particular SOE should reflect the privatization authority's particular goals and the nature and needs of the SOE in question. The major sales methods are as follows:

- *Trade sale* – This would involve sale of 100% of the SOE to a strategic investor, or in some cases a financial investor. Because a trade sale conveys full control, the seller can expect that an additional "control premium" will result in higher sales proceeds. Full control will encourage more effective management. Trade sale opportunities may attract potential foreign investors. Organization of a public tender to support a trade sale will take time and entail transaction costs. The great majority of medium/large SOEs will tend to be suitable candidates for this method.
- *Public share sale* – An initial public offering (IPO) of shares is a way of helping develop the local capital market and enlisting capital market support in supervising and financing the privatized firm. Ownership and control tend to be dispersed in a public share sale, resulting in lower sales proceeds. This method is more time-consuming and expensive than a trade sale. An IPO poses significant upfront and continuing demands on a country's capacity for securities regulation and protection of public shareholders. This method tends to be suitable mainly for large, well-known, profitable, and well-run SOEs.
- *Management and/or worker buyouts* – This method offers speed and support from SOE insiders. But it is less transparent, likely to arouse public criticism, and less likely to improve a firm's competitiveness. MBOs/MEBOs should be limited to small SOEs that are highly dependent on technical staff.
- *Mixed sale* – This may combine, for instance, a partial trade sale with a public share offering. It should be designed so that the new management team can exercise clear control. This method can give public shareholders the chance to share in the upside in a well-managed privatized firm. This approach is, however, the most complex, time-consuming, and costly to organize. A mixed sale may be most appropriate for a medium/large SOE of potential interest to a foreign or other strategic investor.

Post-sale arrangements need to be satisfactory in order for the privatized firm to prosper. Key lessons, especially from the Central European transition experience, are as follows:

- Post-sale restrictions (e.g., on re-sale, line of business or worker layoffs) on an SOE's buyer should be avoided or minimized. Such restrictions may severely impede the development of secondary markets and prolong original inefficiencies.

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LESSONS FROM OECD EXPERIENCE *(continued)*

- Post-sale commitments (e.g., on future capital investment, labor retention, service levels) by the buyer, which may be difficult to monitor and enforce, should be minimized. A higher sales price is preferable to post-sale commitments.[l]
- The government should develop transparent and predictable regulations and incentives to reduce the risk and cost associated with environmental mitigation or remediation.
- Residual government shareholdings can be a disincentive, especially in a trade sale.
- Arrangements to allow the government to retain special powers through a "golden share" should be used infrequently, if at all. If golden shares are used, their powers should be narrowly-defined, time-limited, and invoked under strictly-defined circumstances.[m]

[a] OECD, September 2002.

[b] Despite almost DM 67 billion in sales proceeds, the need to pay off SOE creditors left the Treuhand with debts of DM 450 billion. These debts were financed through bonds to be paid off over thirty years. Czada, R. "The Treuhandanstalt and the Transition from Socialism to Capitalism," Ferenuniversitat Hagen, 1996.

[c] World Bank, "Privatization Practice Note," March 2003.

[d] World Bank, "The Determinants of Enterprise Structuring in Transition," September 2000.

[e] OECD, 2002.

[f] World Bank, "Privatization: The Lessons of Experience," 2002.

[g] A study of privatizations in Mexico found that pre-sale labor cutting tended to increase the value of the SOE but that pre-sale capital investments actually tended to reduce the SOE's value. Lopez-de-Silanes, F. "Determinants of Privatization Prices," Quarterly Journal of Economics 112 (1997).

[h] World Bank, "Selling State Companies to Strategic Investors," 1995.

[i] In about 70% of 194,000 small privatizations in Poland, which was considered a great success, the purchaser actually just purchased a leasehold. World Bank, "Eastern European Experience with Small-Scale Privatization," a collaborative study with Central European University, 1994.

[j] Blaszcyk and Woodward, "Privatization and Company Restructuring in Poland," 1999.

[k] Welch and Fremond, 1998.

[l] OECD, 2002.

[m] OECD, 2002.

Many of the principles highlighted in the toolkit above will apply to the structuring and negotiation of much-needed PPPs. In addition, it will be important for the Government of Iraq to organize itself to maximize interest and value gained from PPP opportunities. This may involve the following measures:

- Establishment of a PPP unit within the Ministry of Finance, which would monitor Iraq's public sector capital investment needs and available capital budget, in order to identify desirable and realistic opportunities for PPPs;
- Passage of a best-practice PPP Law,[15] which provides—for example—sufficient authority for a private developer to collect fees that would otherwise go to government

[15] UNIDO, with support of the World Bank, has prepared draft PPP legislation which is based on a review of the existing legal framework in Iraq. This draft legislation is currently being reviewed by the Legislation Working Group of the Prime Minister's task Force for Economic reforms.

agencies,[16] clarity on the treatment of unsolicited proposals, establishment of a PPP life cycle that includes up-front feasibility studies, and clear articulation of PPP program goals and value-for-money principles; and

- To support both privatizations and PPPs, it will be important for Iraq to pass a complete set of modern commercial laws and regulations, dealing for instance with the power sector, telecommunications sector, and fair competition.

POTENTIAL WORLD BANK GROUP SUPPORT

The World Bank has extensive international experience with SOE reform and can continue to provide technical assistance to the Government in achieving this major step in enabling the private sector including:

- Assist in the design and establishment of a PPP unit within the Ministry of Finance as per international best practice;
- Review and advise on PPP law and sector-specific commercial laws and regulations;
- Assist in the design and establishment of an Asset Valuation Unit.

[16] The State's control of rent creates explicit opportunities for corruption which could be reduced by introducing transparency and competition in the SOE sector through PPPs.

STRENGTHEN MARKET GOVERNANCE

Promote Private Sector Competition

KEY MESSAGES TO GOVERNMENT

Corruption, the informal sector, crime and violence play a significant role in obstructing private sector growth in Iraq with security costs seriously impacting growth and investment.

Recommendations to the Government to control corruption and crime include:

- Undertake systematic clarification and simplification of existing rules to reduce opportunities for discretion;
- Strengthen public procurement transparency and introduce financial accounting and management systems;
- Establish an anonymous call-in service with delegation to take appropriate downstream legal action against corruption;
- Improve youth training programs to provide access to practical skills, increase employability and reduce rate of crime.

Strategies to reduce informality further include:

- Reduce regulatory burden of entry into the formal sector by streamlining registration and licensing procedures;
- Create incentives, through access to finance and business support mechanisms, for the informal sector to formally compete;
- Examine tax and regulatory regimes to assure easy entry and compliance for smallest firms;
- Expand support for microfinance.

Paramount to the creation and sustainability of a strong investment climate are the assessment of reasonable costs and the consistent enforcement of clear and transparent rules. Without these critical ingredients, delays and corruption take center stage, thereby deterring entrepreneurial attention and reducing productivity. Similarly, a country's governance quality is a critical part of the investment climate, shaping investment decisions and guiding entrepreneurial activity either towards growth and job creation or towards rent- and privilege-seeking. High costs of formal participation, weak services and legal protections, and lax legal and regulatory enforcement can also encourage growth of the informal sector, both among firms that never formalize and among formal firms that conceal part of their activities.

In Iraq, the combined effect of corruption, weak legal institutions, and informal competition suggests an economic arena that is particularly unattractive to private sector engagement. Crime in particular imposes direct losses on firms, requires expenditures on security and/or "protection", thereby significantly increasing uncertainty.

CORRUPTION

For firms operating in Iraq, corruption is the constraint that is third most likely to be identified as "major" or "very severe", identified by about 70% of survey respondents as a serious problem.[17] A report by the International Crisis Group (ICG) further severely criticized Iraq's efforts to tackle rampant corruption. Iraq currently ranks 178th out of 182 in Transparency International's Corruption Perceptions Index and has been in the bottom four since 2006. Only in *"voice and accountability"* does Iraq approach the regional average, but only because MENA lags other regions in this dimension. Iraq's rating in the Worldwide Governance indicators for "control of corruption", "rule of Law" and "political stability" are in the bottom 5% of all countries. The Global Integrity Index (2008) makes clear that, while Iraq has adopted some good laws (including a strong anti-corruption law), implementation is exceptionally weak.

In spite of a somewhat low rate of reported payments overall, in specific contexts firms acknowledge that gifts or informal payments to officials (i.e. bribes) are quite common. For example, results show that the average firm experiences a total of 12.3 inspections from four leading agencies. In the case of municipal police, 41% of firms report the inspection involves the expectation of informal payment. For tax inspections, 27% of firms acknowledge the expectation of a bribe. Inspections do not affect all firms equally—for example, large firms receive a much larger average number of tax inspections than do SMEs, while SMEs get more visits from municipal police (figure 24). Medium firms appear to be magnets for labor/social security and fire/building safety inspections.

[17] It is important to note that surveys are limited in their ability to quantify corruption in at least two ways: first, managers are inclined to underreport corruption if it involves an admission of incorrect behavior on their part; and second, businesses have direct experience only of certain kinds of corruption, usually involving direct payments to officials—but not necessarily to others, such as patronage or misuse of public funds.

Figure 21: Worldwide Governance Indicators for Iraq and MENA Region

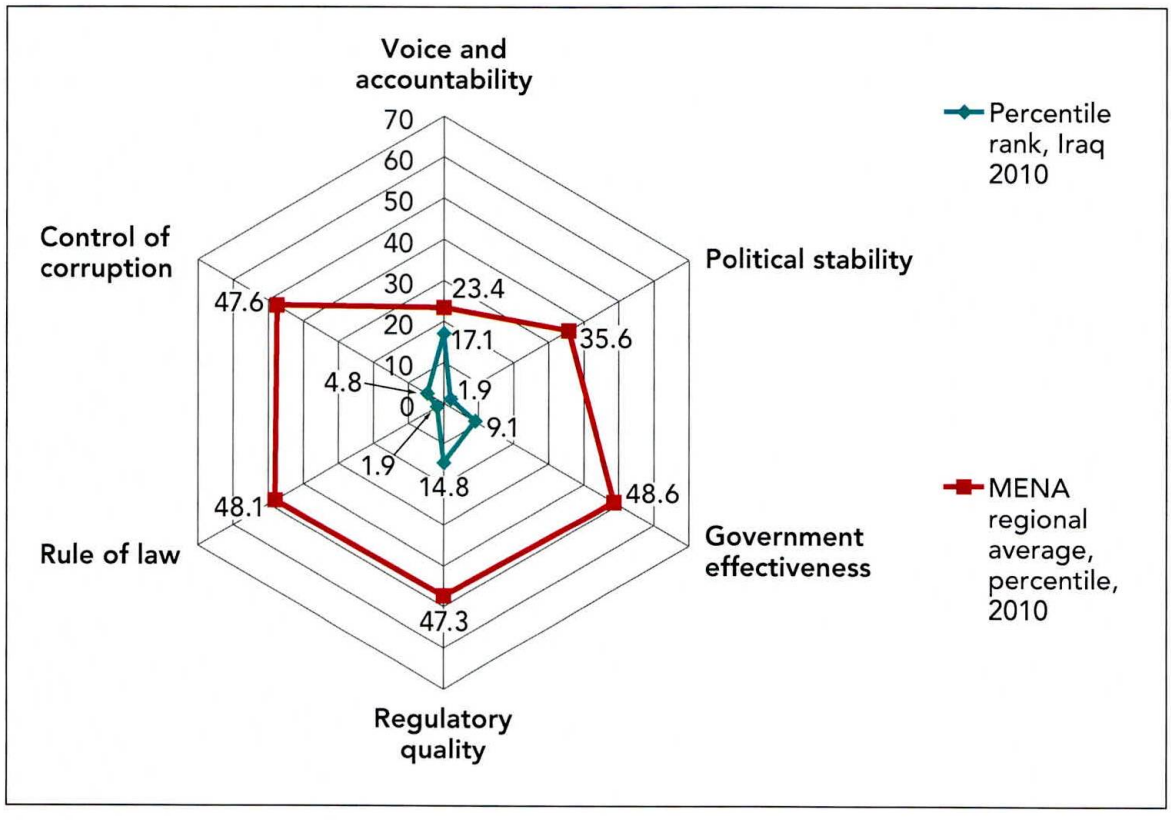


Figure 22: Informal Payments to Public Officials

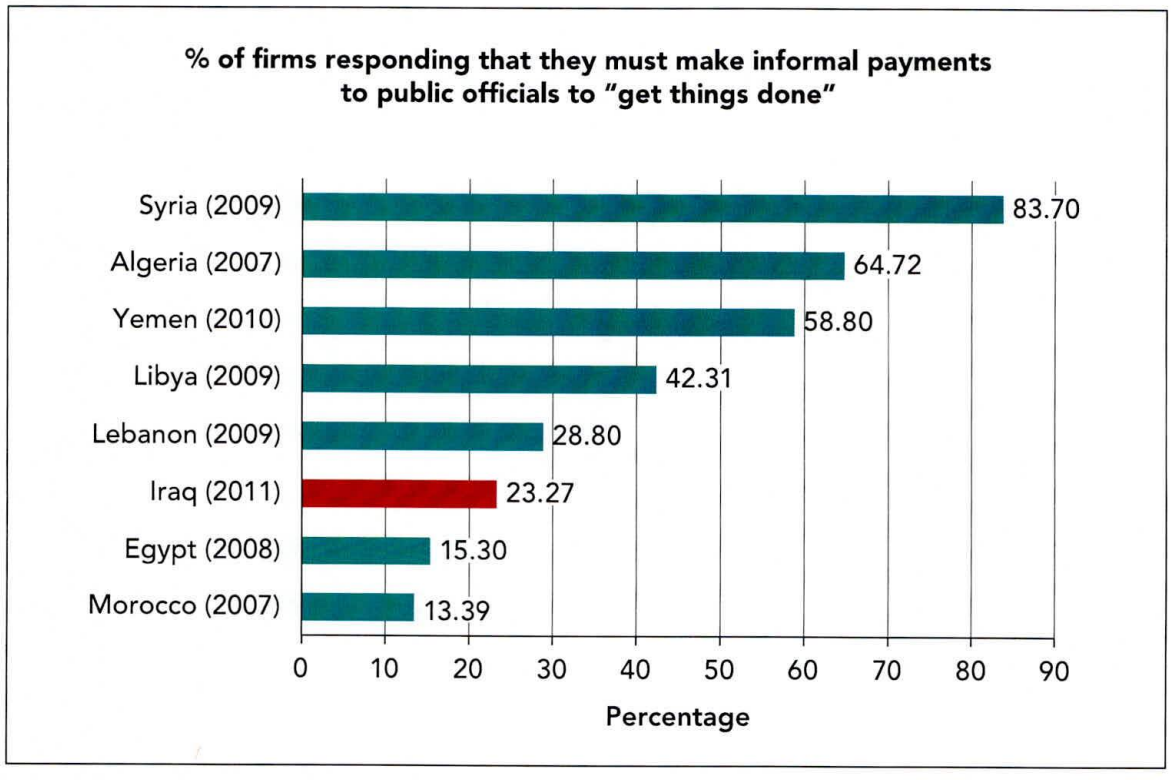


Figure 23: Inspections and Informal Payments

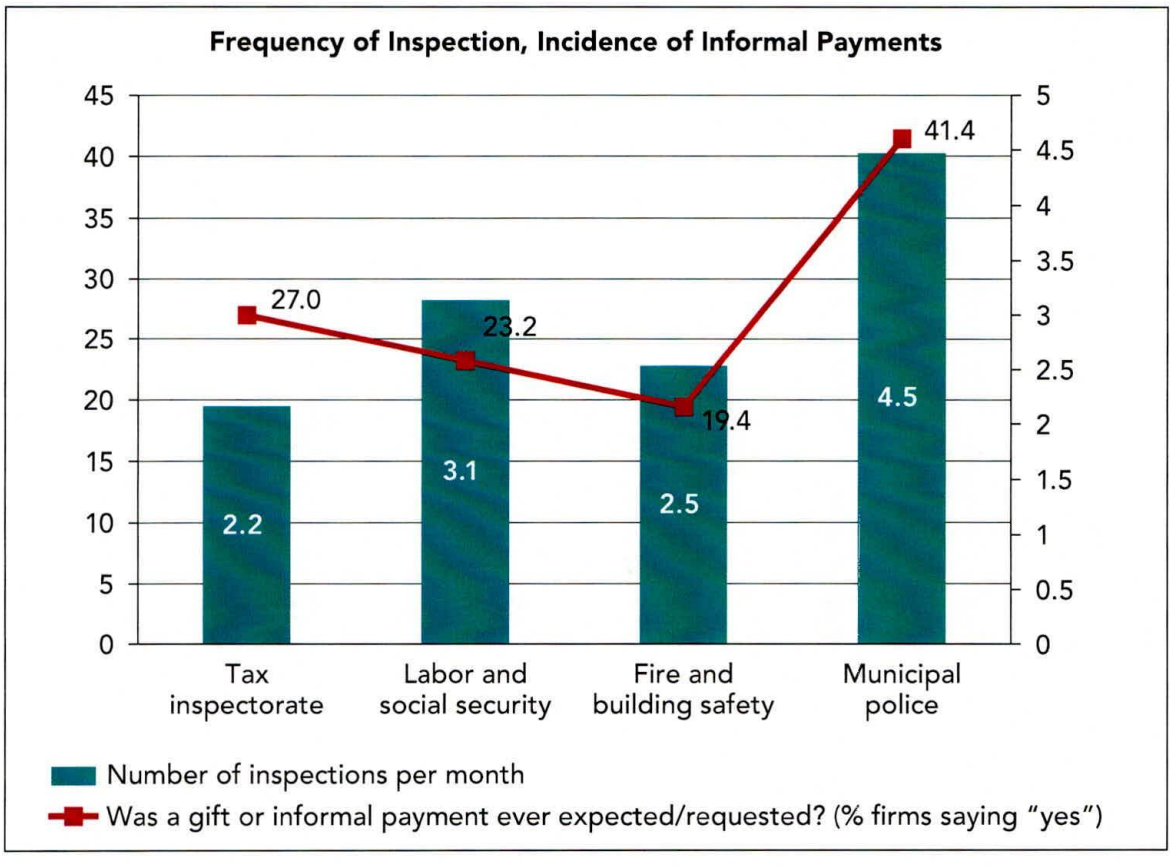
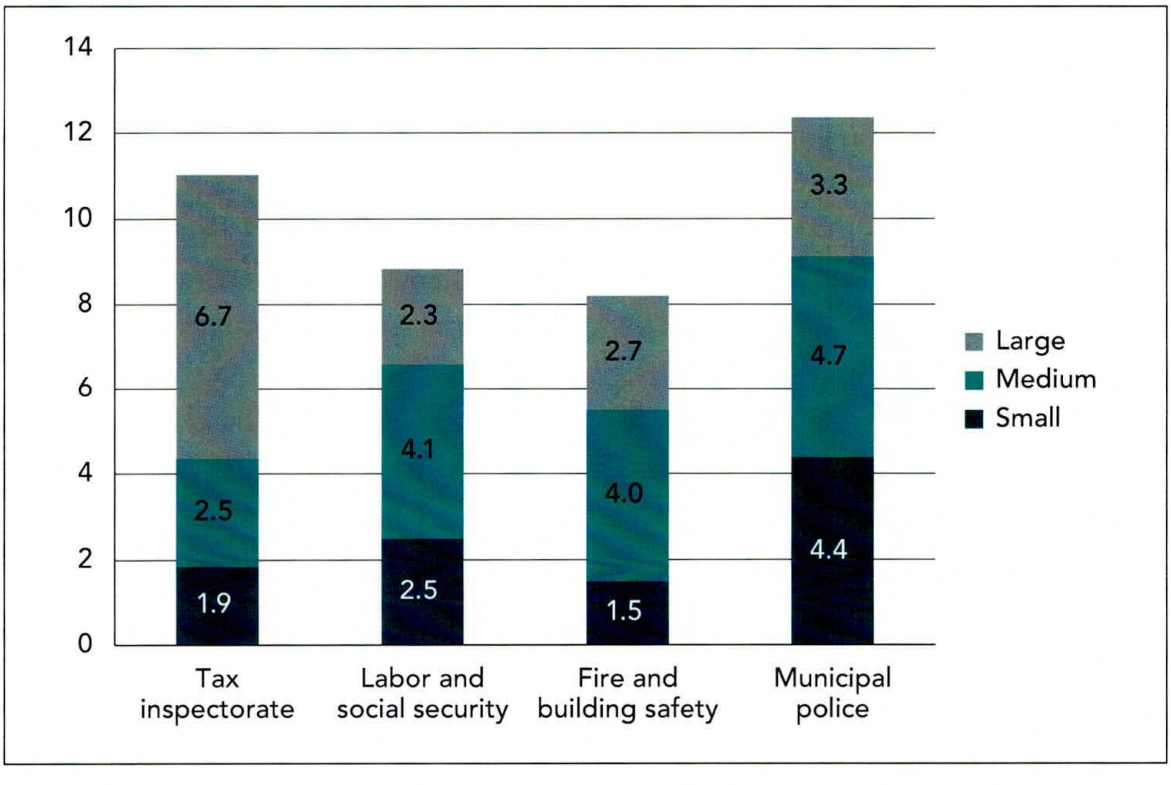


Figure 24: Number of Inspections

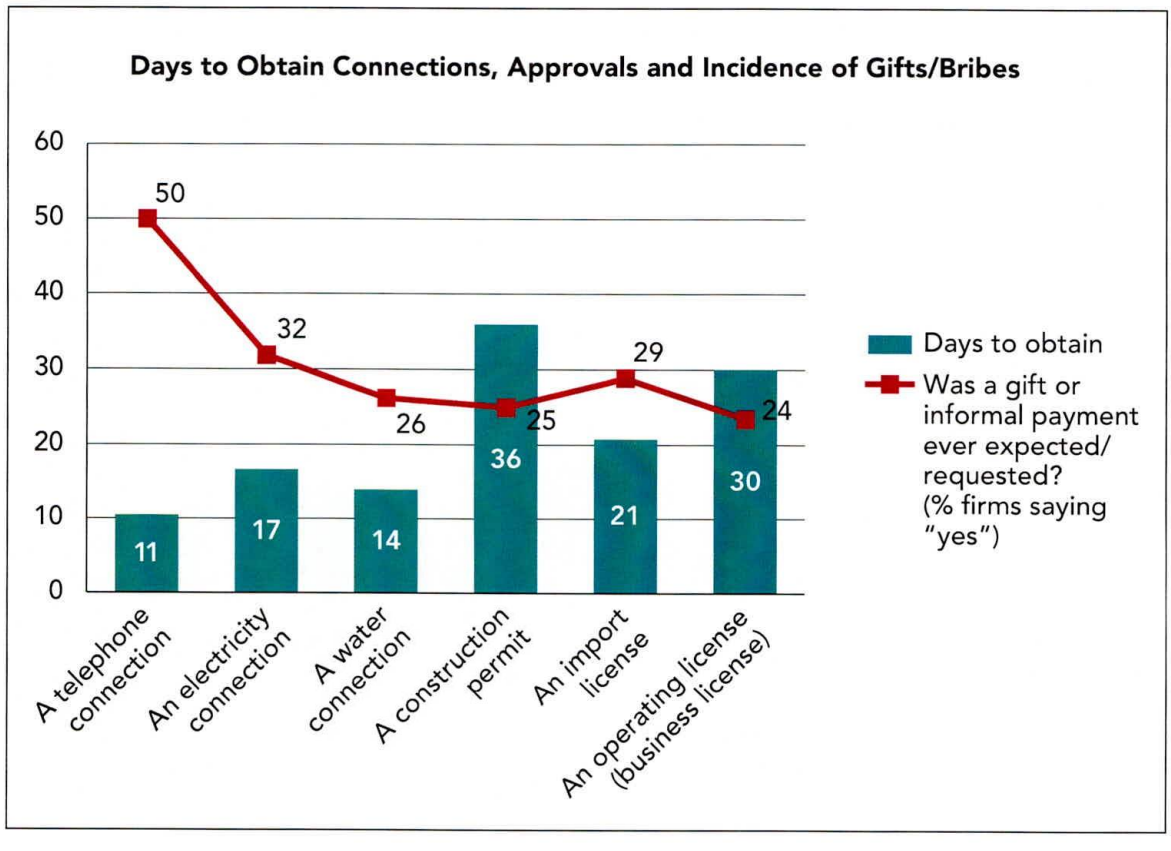


Obtaining approvals or access to services is another context for payments. Most approvals come relatively quickly in Iraq compared to other MENA comparators. However, in the case of a telephone connection, 50% of firms say that an informal payment is expected, while 32% of firms report it is expected for an electricity connection, 29% for an import license, 26% for a water connection, and 25% for a construction permit (figure 25).

A third context for corruption is in public procurement. Overall, 21% of responding firms either obtained or tried to obtain a government contract in the prior 12 months, suggesting the importance of public sector demand. This experience is unevenly distributed: whereas less than 16% of small firms have obtained or tried to obtain a government contract in the prior year, almost 29% of medium-sized firms and 56% of large firms have done so. Similarly, 21% of firms report that a payment or gift is expected to secure a government contract. This is roughly comparable with regional norms (figure 26). However, the amount of payment where required as a percentage of contract value (5%) is lower in Iraq than in several comparator countries.

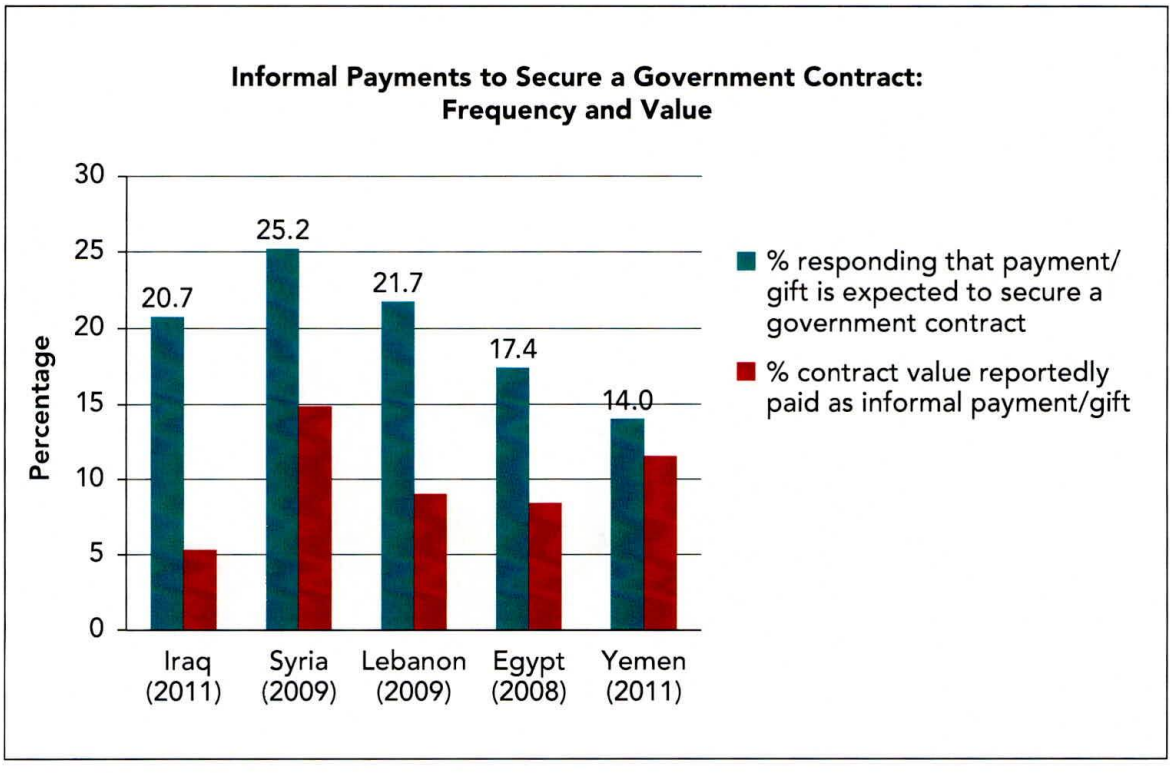
Finally, the justice system provides private firms with another forum for corruption.[18] In this regard respondents were asked to evaluate whether or not they agreed that courts

Figure 25: Time to Obtain Connections and Incidence of Gifts



[18] The Code of Civil Procedures contains provisions relating to arbitration proceedings. There is no specialized legal framework for mediation. Iraq is not party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention) and is not a member state of the International Center

Figure 26: Frequency and Value of Informal Payments



were "fair, impartial and uncorrupt". In Iraq, 31% agreed, the remaining 69% did not (figure 27).

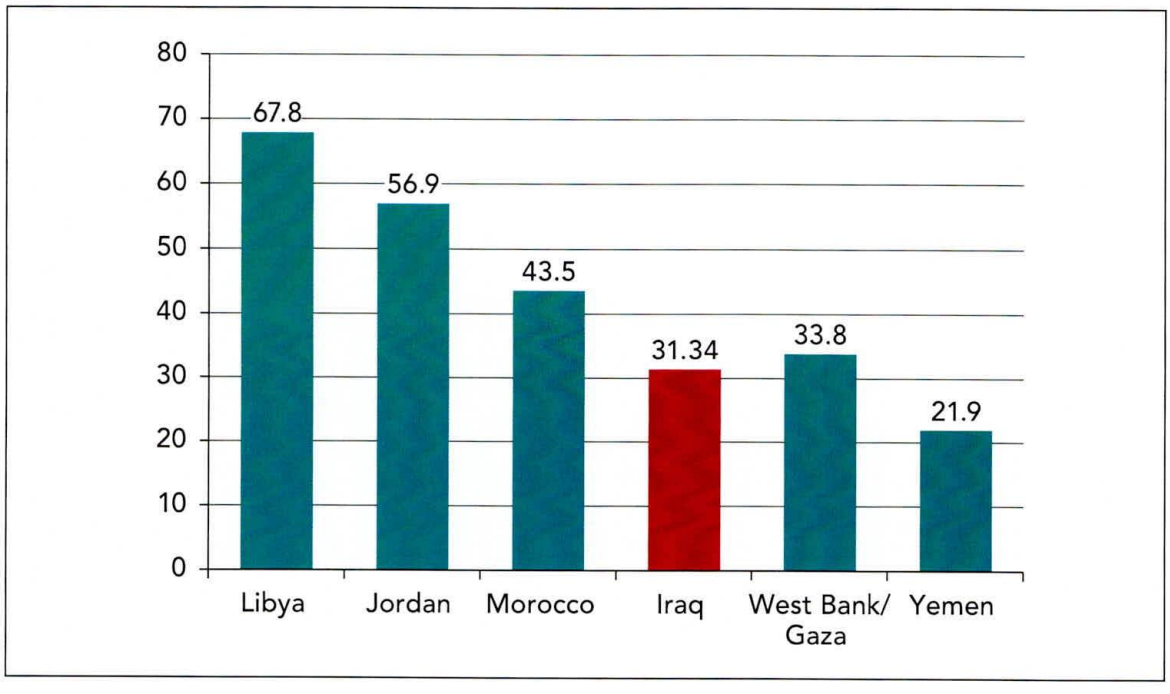
The Government of Iraq should thus consider adopting a consolidated, modern statute on arbitration based on the UNCITRAL[19] Model Law on International Commercial Arbitration, establishing arbitration as a possible alternative to judicial settlement of disputes in line with international practice and available for settlement of disputes in procurement contracts as found appropriate. Regional countries that have enacted such legislations include Bahrain, Egypt, Oman, and Lebanon.

By sector, transport firms are the most likely among services firms to report the need for informal payments (75%), followed by firms in hotels and restaurants (33%). Among manufacturers, exporters are much more likely than non-exporters to find such payments necessary. By region, firms in Basrah are the most likely to report the need for informal payments (85%) followed by firms in Najaf (66%) and in Karbala (52%). These payments sum to an average "tax" of about 2% of annual sales but are reportedly 13% for exporters.

for Settlement of Investment Disputes (ICSID) convention. However, it is a signatory to the League of Arab States Convention on Commercial Arbitration (1987) and the Riyadh Convention on Judicial Cooperation (1983). The 2006 National Investment Law provides for disputes between foreign investors and the state to be resolved by arbitration. The quality of the legal framework for Arbitration and Dispute Resolution is considered to be an obstacle. A commercial arbitration center was recently opened in Iraq.

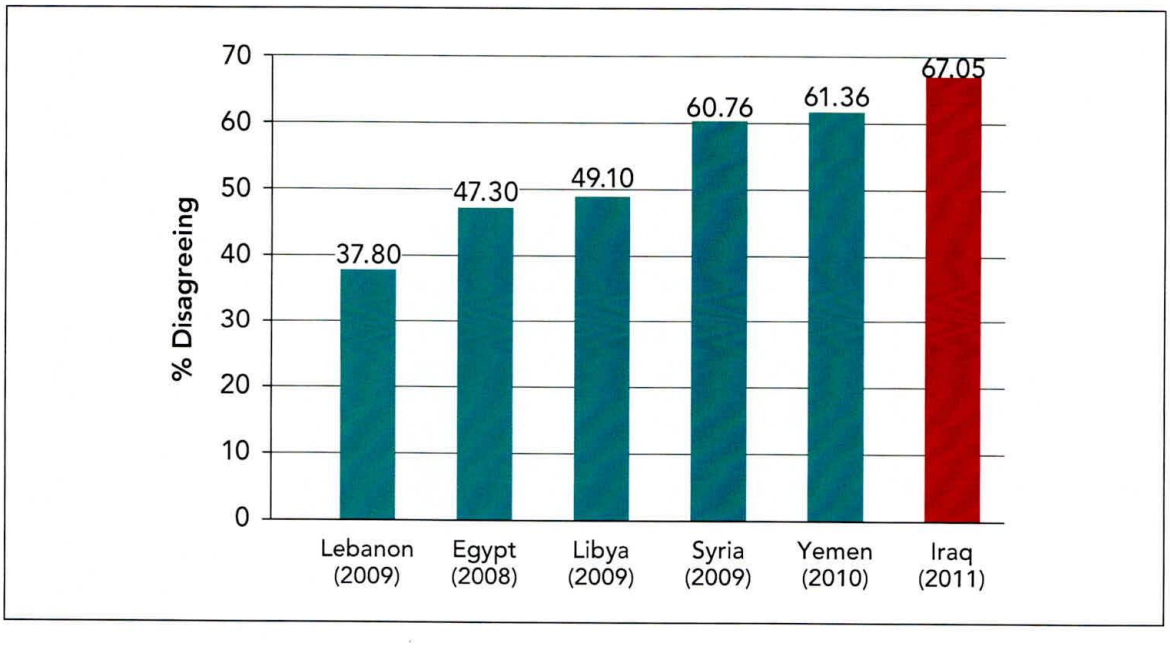
[19] United Nations Commission on International Trade Law (UNCITRAL).

Figure 27: Are Courts Fair, Impartial, Uncorrupt (% Agreeing)



While the purpose of these payments is not stated, there is evidence that they relate to the uncertainty associated with bureaucratic discretion and the potential for long delays. The latter suggests a potential connection between speed payments and the huge delays involved in moving goods through ports and customs while the former links to the discretion businesses attribute to officials' interpretations of rules affecting them. 67% of surveyed firms in Iraq disagreed that official interpretations of regulations were consistent and reliable, the highest rate of disagreement in MENA to date (figure 28).

Figure 28: Interpretations of Regulations Consistent, Predictable (% Disagreeing)



FROM PRIVILEGE TO COMPETITION: APPROACHES FOR CORRUPTION CONTROL

The route to sustained private-led growth and job creation in MENA requires improving the credibility of reforms, the effectiveness of policies and their equitable enforcement. This is the central message of the World Bank Flagship Report: *From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa.* Barriers to firm entry and to sound competition—some due to government policies, and others to the discriminatory way in which rules are implemented and enforced—have restrained the emergence of a dynamic private sector in the region. While progress with reforming the rules varies between countries, Iraq suffers from discretionary and arbitrary implementation of policies, and from lack of government credibility to really change a deeply rooted status quo of privileges and unequal treatment of investors. Engaging in a reform agenda that signals a credible commitment to reduce discretion will require a change in the way policymaking is conducted. It will also require institutional reforms. The flagship report does not offer a standard recipe of reforms, instead focusing on three approaches, each applicable to Iraq:

Reduce the opportunities for rent-seeking and foster competition. With the proper regulatory environment, governments can encourage entry in all sectors of the economy by removing formal and informal barriers to competition.

Reform Institutions. Private sector development policies will need to be systematically anchored in elements of public sector and institutional reforms to reduce discretion and opacity, and improve the quality of services provided to firms—hence reducing transaction costs. Build strong rule-bound market institutions to which substantial decision making power over economic outcomes is delegated. Increase transparency and accountability of all public bodies that interact with the private sector and regulate markets. Ensure equity in market governance, therefore reducing de jure and de facto barriers to competition.

Mobilize key stakeholders around a dedicated long term growth strategy. A new form of partnership is needed between the government and the main stakeholders to underpin stronger reform alliances and broader participation in designing, implementing, and evaluating policies. Capable and inclusive business associations and an institutionalized, transparent and inclusive process for private sector consultation should be engaged in the identification of policy issues, the design of reforms and the monitoring and evaluation of their implementation.

Ongoing public financial management reforms in the area of budget, expenditure and procurement management will play a role. In the long term, reforms to public administration and public financial management form an important part of the solution. Critical to this will be Government commitment and resources to build and strengthen institutions, procedures, and information systems for public financial management to control corruption, including the supreme audit authority, and management of budget, expenditure, procurement, and revenue.

Table 8: Connection of Anti-Corruption to Investment Climate Reform

Corruption depends upon:	Anti-corruption efforts should:	Policy measures include:
The level of benefits under public control	Reduce benefits under public control	Privatize, deregulate, reduce the state
The riskiness of corrupt "deals"	Increase the risk to receivers and payers	Reform civil service, build capacity to detect corruption
The relative bargaining power of the briber and bribe	Limit the bargaining power of the briber and bribe	Increase competition and transparency; simplify procedures

Source: Rose-Ackerman, May 1996.

The issue of rents can be addressed by a continued withdrawal of the state from direct control of economic activities and the opening of ever-broader segments of the economy to competition. Privatization and regulatory simplification are two key means towards this end. Opportunities for discretion can be reduced both by reducing rents controlled by public officials and by redesigning taxes and regulations to be more simple and transparent.

Regulatory reforms can clarify and simplify procedures with which firms must comply, and reduce room for discretionary enforcement. Iraq's singularly low ranking in all but three of the ten Doing Business indicators is richly suggestive of the potential reform agenda. Coherent and concrete action plans can be developed to reduce the delays, costs and complexity of routine procedures such as business registration and licensing, and to establish a clear and efficient procedure for even more complex procedures such as approving building permits and bankruptcy. A legal reform commission supported by international and local expertise could work to modernize the commercial legal framework, which could potentially strengthen the basis for credit, investment and corporate efficiency and transparency, while reducing the cost of business transactions and dispute resolution.

CORRUPTION IN THE WORDS OF BUSINESS LEADERS
FOCUS GROUP SNAPSHOTS

- "Officials interpret the laws the way that helps achieve their interests"
- "The officials don't know the laws. They don't honor the law. That's why we face difficulties in dealing with them."
- "Each official interprets the law as he wishes taking interest into consideration. This generates confusion and thus will jeopardize interests of the companies' owners."
- "Bribery has become the hallmark of tax inspectors."
- "You are expected to be well connected in order to win a contract."
- "If you don't pay the bribe, you will be black listed. If you pay them the bribe, they will keep visiting you for more."

INFORMALITY

Informality reflects entrepreneurs' weighing of the costs and benefits of formality; reducing the burden of compliance with taxes and regulations will shift that balance. The benefits of formality can be increased by strengthening the legal framework to better enforce contractual and property rights. Similarly, creating a regulatory and legal framework that expands the availability of credit provides further incentive for formal participation.

Firms in Iraq must register either with the Ministry of Trade or another agency depending on the industry. The majority of Iraqi businesses are not registered, however. According to a survey conducted in 2011 by the Center for International Private Enterprise (CIPE), 55% of firms surveyed are not registered with any authority, though most of the remaining firms are registered with the Ministry of Trade. This figure increases for major urban areas, with a significant majority of businesses in Baghdad, Basrah, Karbala, and Erbil registered.

Given the high level of informal activity, it is thus not surprising that practices of firms in the informal sector was the fifth leading constraint identified by the formal sector firms surveyed in Iraq for this report. It was especially troubling to manufacturing firms in the chemicals and pharmaceuticals sector and in the machinery and equipment sector (figure 29). Firms located in Baghdad (79%) were more troubled by the informal sector than those in other locations, but over 60% of firms in Babil and Kirkuk also identified informal sector competition as a serious constraint. Business leaders participating in World Bank-held focus group remarked that unregistered, illegal, and counterfeit companies even compete successfully with legitimate businesses in obtaining government contracts.

The objection of firms to informal competition does not appear to inhibit firms from informal practices however. As one indication, Iraqi firms produce the lowest estimate of the "*percentage of sales reported for tax purposes*" of any country surveyed in MENA (figure 30). On average they estimate that only 40% of sales are reported to government for tax purposes. However, large firms actually estimate a lower level of sales reporting for tax purposes (34%) than do SMEs (40%). Exporters report a higher level of compliance.

INFORMALITY CAN TAKE MANY FORMS INCLUDING:

- Informal operators who can undercut the costs of the formal sector by evading regulations and payments relating to tax, labor, public health and safety, and trade;
- Formal operators who hide a portion of their activity "in the shadow" by evading some portion of their tax, labor or trade obligations or other rules;
- Competitors who package inferior goods under international brand names or otherwise violate trademarks, patents or copyrights; and
- Privileged competitors who are not subject to enforcement of formal rules due to their relationship with influential officials.

Source: World Bank, Syria – Investment Climate Assessment Update, 2009.

Figure 29: Practices of Competitors in the Informal Sector

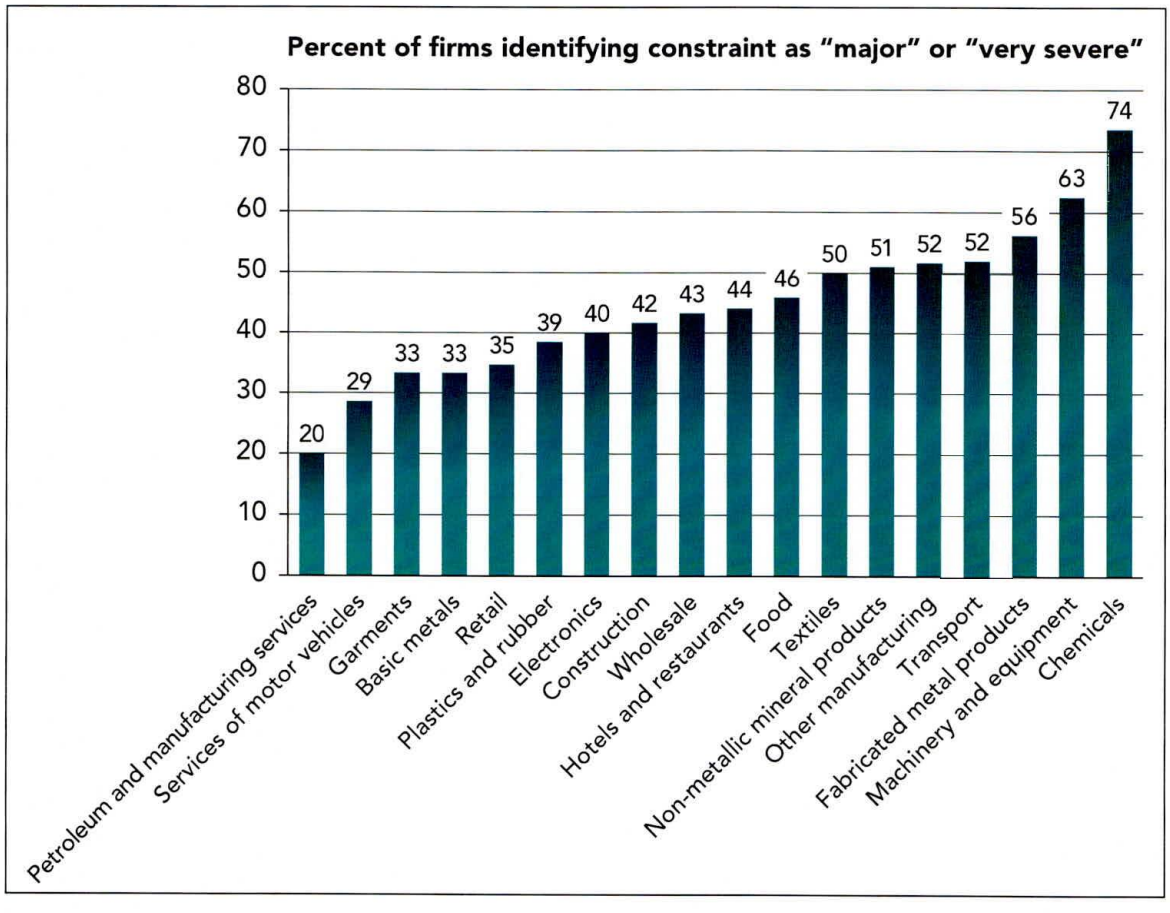
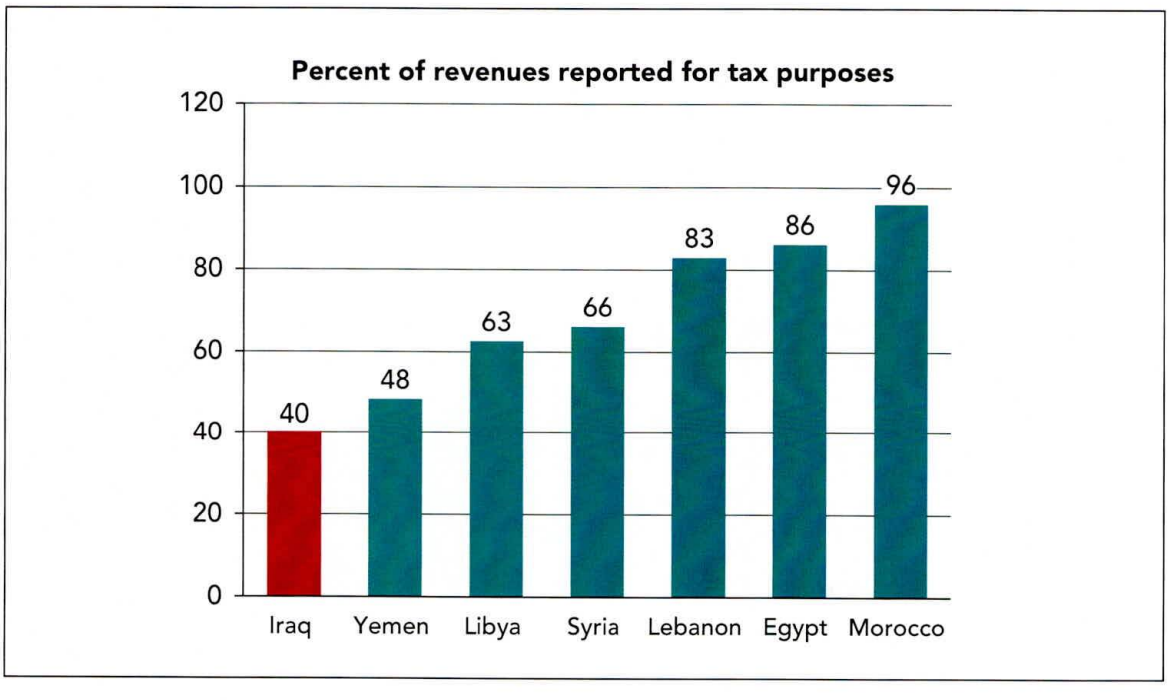


Figure 30: Non-Reporting of Revenues in Iraq and Comparators



Most striking is the variance by location: firms in Ninewa, Erbil and Sulaymaniyah estimate that less than 10% of sales value is reported for tax purposes, whereas firms in Karbala estimate 74% of sales are reported and in Babil 86%.

International experience demonstrates that the decision of firms to informally do business is not one which is made at random or out of overt disregard for the law alone. Rather, an economy's degree of informality tends to be directly related to the cost of doing business including taxes and other burdens, particularly when these are assessed to be excessive. Similarly, those markets in which legal enforcement and the quality of public services are consistent, effective and impartial tend to see higher degrees of formality in the private sector.

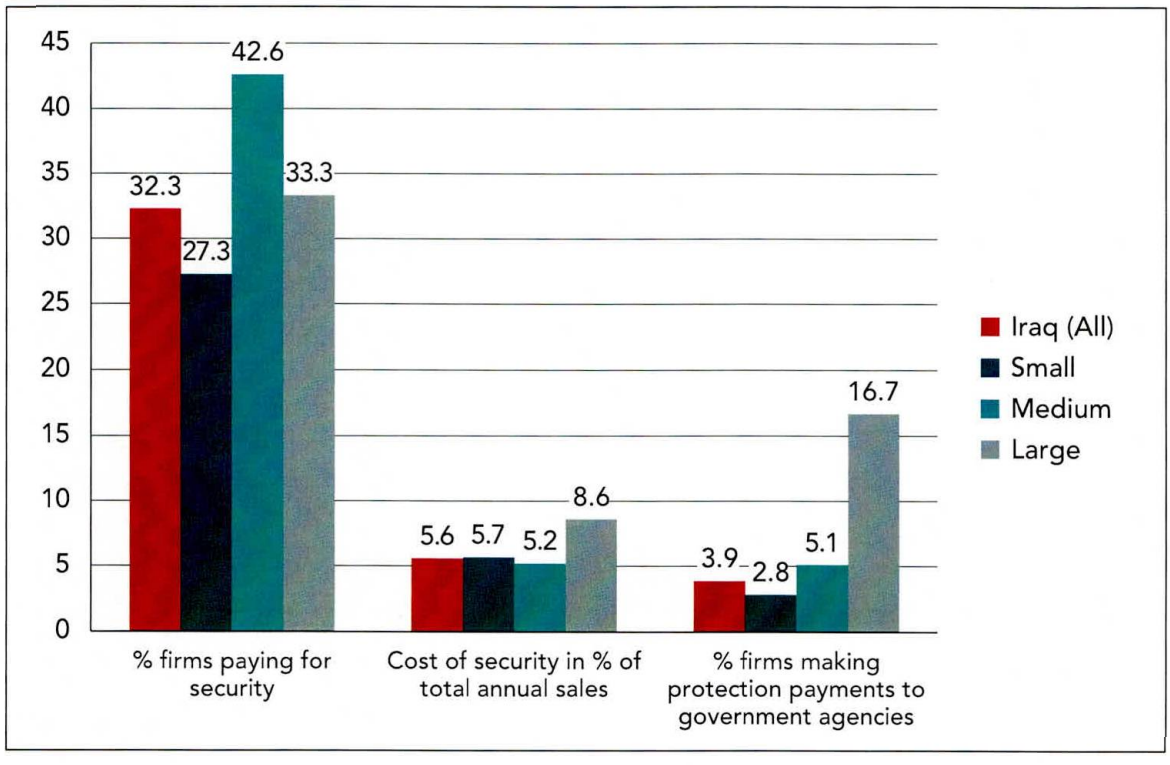
Both corruption and informality have important links to a country's tax, legal and regulatory system. A recent United States Agency for International Development (USAID) study on taxation in Iraq observes several problems with the tax system: (i) it was not designed for a modern, decentralized market economy; (ii) it does not provide enough guidance to the requirements of compliance, giving tax administration officers a wide discretion and inconsistent implementation; (iii) it lacks neutrality and is too complex and imprecise; and (iv) highly fragmented, it needs consolidation into a single tax law. In general, the more burdensome, opaque and discretionary a country's regulation, the greater will be corruption and informality. More efficient regulation, targeted tax reform and better public services can help to reduce corruption and informality and allow Government to better achieve its underlying social goals.

SECURITY AND CRIME

While not among the top constraints, theft, crime and civil disorder ranks seventh for all firms and sixth for large firms. Overall, although only 8% of firms experienced a crime, nearly 17% of large firms experienced one. The experience of crime is quite different across regions. In KRG, only 3% of firms experienced crime, while in Baghdad, nearly 14% of firms had. Medium-sized firms are the most likely to report having paid for security (43%), small firms the least likely (figure 31).

The results can be explained by the investment that firms must make to purchase their own security services, which in turn plays an important role in reducing the rate of actual crime occurrences. For the one third of large firms that do pay for security, they spend relatively more as a percentage of sales—nearly 9% compared to 5.2% for medium and 5.6% for small firms. An additional security-related expense is protection payments. Almost 17% of large firms report making protection payments to government agencies. Paying for protection to public agencies is far more common in Najaf (25.6% of respondents) and Karbala (15%) than elsewhere. The prevalence of private security has reduced police accountability; one focus group participant from Basrah noted that "policemen are not expected to protect us as we have our own guards."

Figure 31: Experience of Security Costs, Iraqi Firms



In summary, corruption, the informal sector, crime and violence play a significant role in obstructing private sector growth in Iraq. This is most clearly demonstrated in the high costs of security that many firms must invest in to safeguard their assets and staff.

POTENTIAL WORLD BANK GROUP SUPPORT

The World Bank Group could:

- Advise on ways in which to streamline regulations and provide incentives for the informal sector to formally compete, based on international best practice and experience;
- Assist in the design and implementation of a targeted employment strategy, aimed at recruiting, engaging and building the capacity of the unemployed in an attempt to preempt crime;
- Undertake a detailed review of public procurement systems in an effort to assess alignment with international best practice in fostering transparency and competitiveness for private sector growth.
- Conduct a study of tax incentives and make explicit reform recommendations for consolidation, revision and simplification of the tax law in accordance with international best practice.

IMPROVE INFRASTRUCTURE AND TRADE

Optimize Private Sector Operations

KEY MESSAGES TO GOVERNMENT

Private sector operations have been impeded to date by a lack of access to reliable infrastructure services including power, water and transport. Significant strengthening and reform of Iraq's legal and regulatory environment will be further required to attract the private sector to sustainably invest in the Government's plan for infrastructure expansion and rehabilitation.

Key recommendations to the Government are thus to:

- Increase electricity supply through public investment in new power generation while strengthening transmission and distribution systems;
- Develop and implement a strategy for needed policy, legal and regulatory reforms to encourage competitive and transparent private sector involvement;
- Establish a regulatory reform body to oversee regulation of the private sector;
- Reform water and energy utilities to emulate the private sector model and become self-sustainable;
- Invest in new and improved water and transport infrastructure;
- Streamline and simplify customs clearance procedures;
- Invest in modern logistics services at ports and border crossings.

Reliable and affordable infrastructure services are essential to firm competitiveness and economic diversification. Deficiencies in the provision of infrastructure increase firms' operating costs and reduce the incentive for future investment. Unreliable supply discourages investment in sectors intensely reliant on a particular infrastructure service, and can divert capital to often inefficient self-provision.

POWER SUPPLY

The physical destruction of infrastructure and domestic insecurity has left Iraq with a legacy of weakened power supply. The Iraqi Government has pursued an ambitious program of investment in generation, transmission and distribution. Yet in spite of massive construction and rehabilitation, deterioration of the electricity system, direct damage incurred through recent conflicts, and significant underinvestment over the past decade have contributed to chronic shortages. The Government is currently investing significantly in infrastructure development, but will also need to reform the sector, build weakened capacity and develop its institutions to improve the efficiency and effectiveness of management.

Access to adequate power supply remains one of the key impediments to growth in the Iraqi private sector with a majority of firms surveyed reporting inadequate power supply to seriously affect sales and growth potential. A reviving economy and growing consumer demand, combined with price subsidies, have led to constant shortages of power across Iraq in recent years with conflict, sanctions and underinvestment contributing to lack of supply.

The average firm suffered nearly 600 interruptions per year, resulting in a loss of 14% of sales (figure 32). As a participant in a Bank focus group responded, "every six hours there is a power outage for two hours, that's why so many [smaller, private] factories had to shut down." To supplement public power supply, 86% of firms own or share generators, which focus group participants reported as being very costly, and recognize as only being a stopgap solution. Services firms experienced more frequent interruptions than did manufacturing firms, but lower sales losses. Among manufacturing firms, the losses experienced by large firms were far higher than those experienced by SMEs, in spite of the fact that all large firms owned generators. One explanation is that large firms, in spite of experiencing a smaller number of interruptions, reported being without power more hours per month than did SMEs.

Dependence on generators is lowest in Erbil and Sulaymaniyah, which also are the two locations where the identification of electricity as a serious constraint is the lowest.

Doing Business further suggests that getting an electricity connection for a warehouse is relatively easy and cheap compared to the rest of the region, although expensive by OECD standards. Survey responses confirm a quick connection—17 days is the average reported wait—but 32% of respondents say a gift or informal payment was expected to get connected. Reported delays were longest in Karbala.

The gap between supply and demand poses a substantial challenge to the Ministry of Electricity, which it has attempted to address through massive ongoing investment

ELECTRICITY IN THE WORDS OF BUSINESS LEADERS

FOCUS GROUP SNAPSHOTS

- *"Our business depends on availability of electricity. The power outage means cessation of business."*
- *"Electricity has been the problem of all Iraqis. It burdens the private sector in Iraq. We so far don't rely on the national electricity but instead on the generators. The national electricity covers only six hours a day"*
- *"We have no other choice [but generators]."*
- *"Electricity is an obstacle to businessmen. It is badly needed to operate the machines. This requires large electricity generators in the absence of the national electricity. The generators will need fuel and operators accounting for abnormal expenses amounting to four or five million dinars per month."*
- *"The electricity sector is worsening. The unreliable power supplies are never guaranteed plus they are costly and don't satisfy the need like the national electricity does. With the alternative power we are confined with certain operation hours. The generators can easily be obtained but it is so costly and leads to the increase of costs."*
- *"Reliance on the electricity generators is so hectic. So many problems accompany the generators. This way we are unable to continue our business activities."*

Figure 32: Power Supply Indicators

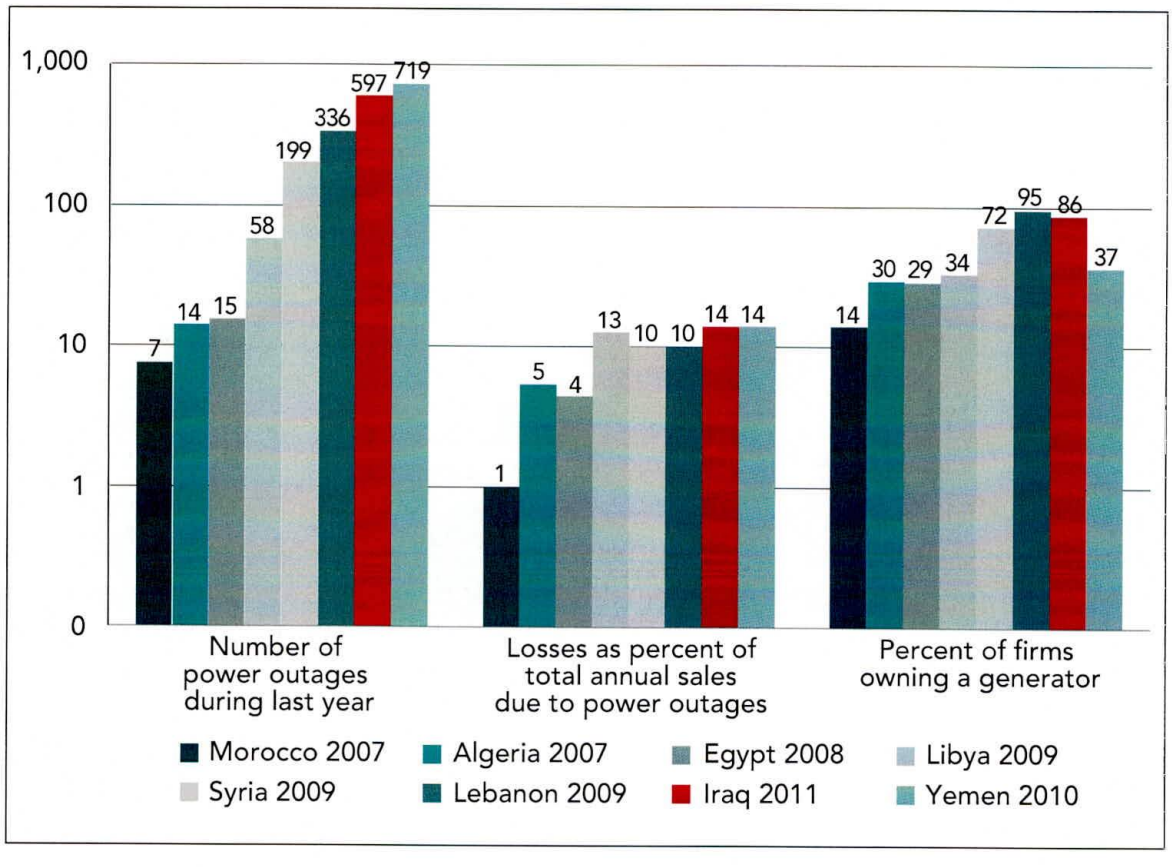
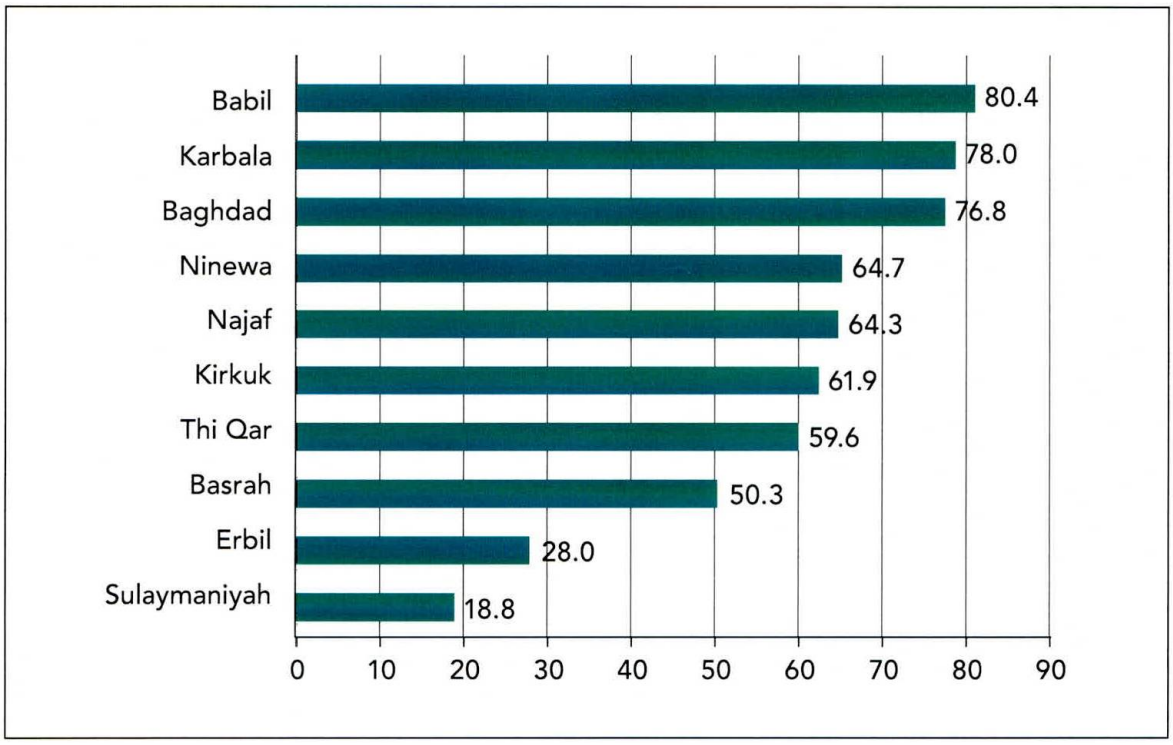


Figure 33: Electricity from Own Generator (%)



in new power generation, import of power from neighboring countries, and temporary small generation. New generating capacity must be combined with improved operation and maintenance, upgrading and expansion of transmission and distribution networks, and greater use of natural gas and alternative energy sources. There remains a continuing need to reform the electricity sector, strengthen institutions, and build capacity. Pricing clearly matters as it creates the incentive for efficient use and conservation. Electricity tariffs and subsidies need to be carefully targeted to encourage economically sensible power use, yet to benefit low-consumption, low-income consumers.

The Ministry's "2015–2030 Electricity Master Plan" further confirms that power demand in Iraq will average 32 GW by 2030 with approximately USD 28 billion of investment necessary between 2015 and 2030. Of this total, approximately USD 21.13 billion is intended to be funded by private investors. The Ministry of Energy has invited power developers to build, finance and operate four new power plants across the country to provide 2,750 MW of additional electricity generation capacity. This is in accordance with the strongest desires of private sector firms—to have a steady electricity supply—who voiced this as among the most significant concerns and a major impediment to production and the conduct of business.

In addition to the physical infrastructure requirements to meet the goals set out in the Master Plan, Iraq will need to create a legal and regulatory environment that supports, attracts and enables the private sector to effectively mitigate risks and secure loans against land, plant, equipment and revenue flows. The Ministry of Electricity and its partners will further need experienced personnel with legal and contractual skills and more expertise in project financing and implementation.

Indeed, as seen in many countries, the private sector can play an active role in power generation and financing under PPP arrangements. To attract needed private financing and management expertise, the Government could:

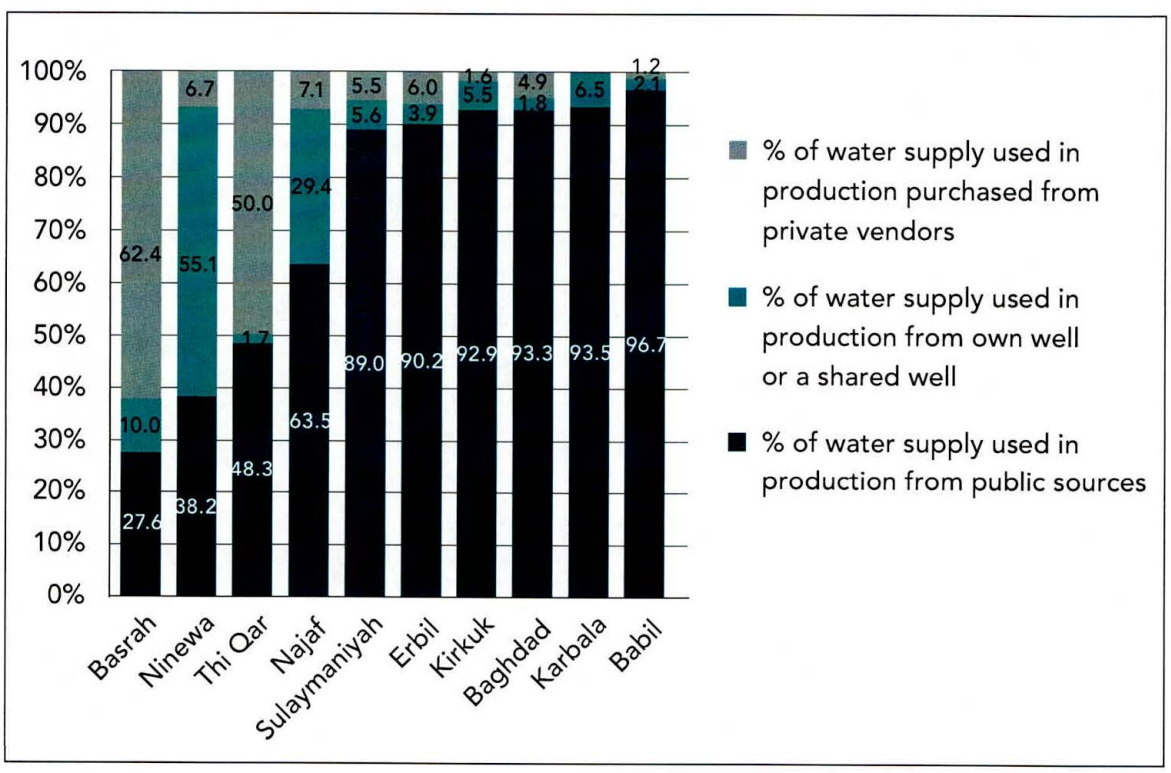
- Develop and implement a strategy for needed policy, legal and regulatory reforms to encourage competitive and transparent private sector involvement;
- Establish a government PPP unit to regulate private sector engagement;
- Oversee development of needed infrastructure and implementation of necessary regulations;
- Designate a working team within the Ministry of Electricity to coordinate with the PPP unit on the development, assessment and preparation of new IPPs.

WATER SUPPLY

Although water supply is not a leading constraint to Iraqi firms, it does impose select challenges. The Joint UN–World Bank Needs Assessment estimated total needs for rehabilitation and reconstruction of water supply and sanitation facilities in Iraq to be about USD 6.8 billion. The severe drought of 2008 was a further reminder of Iraqi dependence on rainfall for adequate supply.

As per survey results, the average manufacturing firm in Iraq reported experiencing 17 water outages per month. The average frequency of such interruptions varies by location,

Figure 34: Sources of Water, by Location



from a high of around 67 in Thi Qar to a low of four in Sulaymaniyah and Babil. To supplement public water supply, many firms rely on their own wells or commercial water providers. Firms in Basrah and Thi Qar rely on private vendors as their leading source of water supply, while firms in Ninewa rely on their own wells for a majority of their supply. However, self-provision is not necessarily the cure to water woes: 88% of manufacturing firms in Basrah identify water supply as a "major" or "very severe" constraint.

Consumers, whether urban, industrial or agricultural, need incentives and assistance to conserve water and adopt more sustainable water use practices. At the same time, measures must address the rapid increase in urban water demand. For consumers, proper pricing encourages conservation and better water management. To encourage production and improved management, Iraq can establish a regulatory framework for these services and encourage more involvement by the private sector. A key incentive would be a tariff policy that enables water and sanitation authorities and companies to recover costs and provide users with quality services in a sustainable manner.

TRANSPORT AND TRADE

Excluding the oil industry, Iraq's main trade relationships are with its immediate neighbors. In 2009, countries receiving the most Iraqi non-oil exports were Syria (USD 86 million), Jordan (USD 23 million), Iran (USD 11 million), and Turkey (USD 10 million). Furthermore, in 2010, Turkey and Syria were the top two exporters to Iraq (at USD 11 billion and USD 8 billion in goods, respectively) with Iran the third significant exporter to Iraq, at USD 4 billion in 2009. The importance of effective and efficient internal and external transport networks is thus paramount to thriving trade.

Although transport is not among the top 10 constraints overall, despite the effects of years of conflict and weak security, it is identified as a serious problem by the majority of certain categories of firms. These include foreign-owned manufacturers, exporters, firms catering to national rather than local markets, chemical sector manufacturers, and firms in Sulaymaniyah, Thi Qar, Najaf and Baghdad. Iraqi firms report the highest average rate of losses due to breakage, spoilage and theft in transit of any of the MENA countries documented.

Furthermore, security and inefficiency in the processing of goods at borders and ports lead to long processing times. The World Bank Logistics Performance Index (2010) for Iraq suggests that Iraq lags behind both the region and other middle income countries in trade logistics efficiency, ranking globally at 148th of 155 countries evaluated. Its performance is consistently weak across indicators, but is especially poor in terms of tracking and tracing, timeliness and infrastructure. The Index details suggest the root of some delays: a very high percentage of shipments are physically inspected (50% vs. 16% in Morocco); and an extraordinarily high percentage of goods receive multiple inspections (50% vs. 1% in Morocco). Furthermore, Iraq has the highest number of agencies involved in imports and exports (11 vs. 4 in Morocco).

Based on the very few exporters responding, Iraq is perhaps MENA's poorest performer in terms of import/export delays (figure 35). Enterprise survey results confirm that on

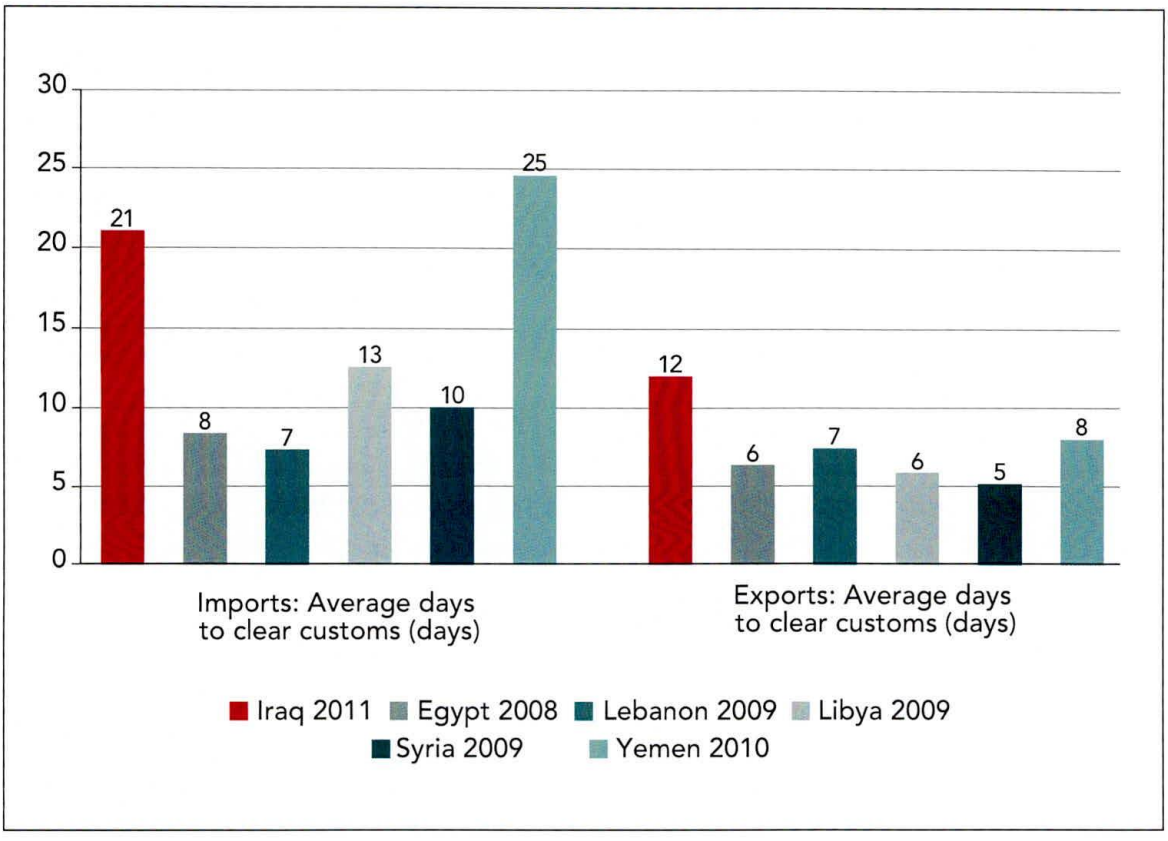
average it takes 12 days to clear customs for exports. Importing is even slower (21 days) and behind the regional norm. A comparison of parallel enterprise surveys shows that only Yemen takes more average days to clear goods through customs. Focus group participants, however, responded that the export sector is mostly under state control, and what is exported is often damaged by poor storage at borders and ports after the aforementioned long delays.

Doing Business's "Trading Across Borders" indicator ranks Iraq 180th in the world out of 183 countries rated, the very worst in the MENA region noting that its calculations of time to import and time to export includes 50 days for document preparation, and six to ten days for inland transport.

World Bank experience suggests three key approaches to alleviate the trade logistics challenges:

1. **Diagnostics:** A comprehensive trade facilitation audit that would assess the legal and institutional landscape for trade in Iraq as well as the physical infrastructure of key trade corridors.
2. **Focused pilot project** at a key border crossing focused on both physical and procedural improvements as follows:
   a. **Physical improvements** to include construction/refurbishment of infrastructure and equipment for selected expansions of the crossing station, including customs and technical control facilities and labs;

Figure 35: Import and Export Clearance Time: Iraq and Comparators



b. **Technical assistance** to cover the formulation of a revised regulatory framework, development of plans for the shared customs and border inspection posts; and training on new procedures and systems. Specific activities could address the following:
   - Adoption of simplified and standardized customs and border inspection procedures (compliance measurement and risk management), with the ultimate objective of moving towards international standards;
   - Human resource management to develop customs/border inspection expertise and enhance system integrity;
   - Training for customs personnel;
   - Creation of a partnership among border inspection agencies and the trade/industry community; and
   - Adoption of audits and account management processing to facilitate trade and trade data exchanges.

3. **Policy and procedural reforms** consistent with the Doing Business reform agenda for "trading across borders", designed to streamline and accelerate imports and exports at the border, but also focusing on the tremendously high cost of inland transport. Obvious focal points would be eliminating redundant or overlapping jurisdictions, documentary requirements and inspections.

In summary, access to adequate power supply, water supply and efficient transport services remain some of the key impediments to growth in the Iraqi private sector. There is thus a strong potential role for the private sector in the construction and operation of Iraq's infrastructure (including transport, water and ports). Significant strengthening and reform of Iraq's legal and regulatory environment will be required to attract the private sector to sustainably invest in the Government's plan for infrastructure expansion and rehabilitation.

POTENTIAL WORLD BANK GROUP SUPPORT

To support the Government in its infrastructure investment and reform program, the World Bank can:

- Finance infrastructure projects through World Bank Loans or IFC investments;
- Provide technical assistance on required legal, regulatory and institutional reforms to more sustainably attract private sector engagement in infrastructure;
- Advise on international best-practice PPP contractual arrangements in infrastructure;
- Provide support in environmental and social impact assessment and management plans, among other aspects of engineering studies.

ENHANCE ACCESS TO FINANCE, LABOR AND LAND

Boost Private Sector Productivity

KEY MESSAGES TO GOVERNMENT

Private sector opportunities are constrained by difficulty of access to land, skilled labor and finance. Key recommendations to the Government thus include:

- **Land** policy must focus on easing regulations and registration, increasing attention to special economic zones, and streamlining the allocation of state-owned land:
  - Modernize land registry to facilitate the use of real property as collateral;
  - Simplify procedures and streamline regulatory mechanisms in Special Economic Zones, while allowing private sector participation in the development, management and operation of the zones;
- To address **labor market** inefficiencies and unemployment:
  - Strengthen education system to ensure better alignment of technical skills with market needs;
  - Build capacity of existing excess public sector labor force to transition effectively into the private sector;
- To improve firms' **access to finance:**
  - Accelerate reform programs including bank restructuring and easing regulations;
  - Remove impediments for private banks in doing business with the Government and state-owned enterprises, ensuring regulatory oversight by the Central Bank of Iraq (CBI);
  - Improve the depth and quality of credit information available to creditors;
  - Strengthen microfinance and Islamic finance programs.

LAND

Land and real estate typically account for between a half and three-quarters of a country's asset value and constitute a major input to productive activities, whether in agriculture, industry or services. Where land is hard or excessively costly for investors to access, where land title is insecure, or where ownership rights are constrained by policy, a vital economic resource cannot yield its full benefit to citizens. For international investors, delays associated with securing land access and obtaining building permits is a top concern and often a key deterrent to entering a market.

The combination of public control of land and subsidization seen in most countries of the MENA region creates an economic rent, which invites discretion and preferential allocation based on political (as opposed to commercial) criteria. A further key problem with extensive control of land by public agencies is that many agencies have little incentive to put it to efficient use, hence simply hold it idle or allocate it inefficiently to low value uses. Thus most land with potential commercial value is never allocated by markets, making land available for private investment artificially scarce and expensive.

In Iraq, this pattern is very much in play wherein access to land ranked as the sixth most frequently identified serious constraint in the ICA survey. As a result, land for private investment has been artificially constrained and allocation decisions at both the national and local levels have historically favored special interest groups and individuals, and have been subject to extensive abuse and corruption. Physical land use plans exist but are described as outdated and widely ignored. There is substantial informal and illegal land use in Iraq, including largely unregulated settlements and slums in many urban areas. Cadastral systems are also outdated and paper-based. This may explain why Iraq ranks in the bottom half of nations internationally in terms of registering property.

Land reform in Iraq should strive to reduce state engagement in land markets, better define property rights, reduce information asymmetry, and improve contract enforcement. This includes long-run measures to create transparent, secure and predictable markets, recognizing that comprehensive land reform requires enormous resources, political capital, and legislative effort.[20]

Doing Business 2012 places Iraq at 98th of 183 countries rated on the "registering property" index. While property registration is not procedurally complex, it is time-consuming (51 days) and costly compared to regional norms, consuming about 7% of property value. Insecurity of tenure or short-term rights can increase uncertainty and reduce incentives for investment. Furthermore, land and buildings are a primary form of collateral in Iraq, securing 42% of loans overall and 100% of loans for large enterprises. For smaller firms, personal land ownership matters, as 79% of small firms' loans and 69% of medium firms' loans are secured by personal assets of the firms' owner such as his/her house and land. The process of registering property (or transferring to new owners) can thus be simplified and streamlined. Also, above a threshold value,

[20] Muir and Shen, October 2005.

LAND ALLOCATION IN IRAQ – A SNAPSHOT

According to the 2010 US State Department Investment Climate Assessment for Iraq, "The land market is highly centralized and managed by the national government. The State Properties Directorate of the Ministry of Finance is responsible for the overall management, allocation, sale and/or lease of all state-owned land. The Directorate allocates land to the Ministry of Municipalities and Public Works (MMPW), which in turn is transferred to municipalities to be sold to private interests for residential development through an auction process. Various other ministries such as Housing and Construction and Agriculture, have major land management and land allocation responsibilities. Land in Baghdad is managed through the Mayoralty Properties Directorate. Allocation of state-owned land to public and private interests for major commercial and industrial projects is managed through national land allocation committees." Under the National Investment Law, foreigners cannot own land in Iraq except to develop residential real estate projects. However, since late 2010, foreigners could obtain land through long-term leases of up to 50 years. Various terms apply depending on the location and use of the land. Iraq does not yet have a centralized and accessible database of land plots.

registration could be based on a flat fee rather than a percentage of property value. Finally, there is room to standardize forms and computerize databases and procedures to speed up the process.

Iraq has a legal framework for Special Economic Zones (SEZs) offering special incentives to foreign companies but these are not commonly applied.[21] ***Iraq currently has four designated Free Zones:*** The Basrah/Khor al-Zubair Free Zone at the Khor al-Zubair seaport; the Ninewa/Falafel Free Zone in the north; the Al-Qa'im Free Zone on the Iraqi-Syrian border; and an undeveloped zone in Fallujah in the planning stages. In the Kurdistan region, a separate zone is being developed in Sulaymaniyah, to be led by private master developers. Of these, only the Ninewa/Falafel zone has any operating businesses in it and the level of activity is not significant.

In developing industrial or special economic zones, it is important to rely on private developers within the context of a clear and transparent regulatory framework. The Government needs to remove itself, as much as possible, from individual transactions and day-to-day management of land development. The recent PSD Flagship Report notes that, within a proper regulatory framework and subject to competitive, market-based land access, private developers (unlike public developers) face incentives to efficiently develop zones and optimize infrastructure delivery. They can bring specialized knowledge of zone development and marketing, and may also have access to the financing required for zone development.[22]

[21] World Bank, Investing Across Borders, 2012.
[22] Benhassine, 2009.

As a constraint, access to land varies widely in its severity by region and sector. For example, in Kirkuk and Basrah it is identified by more than nine in ten firms as a serious problem, and in Najaf by more than four in five firms. However, it is much less a problem in KRG and Baghdad than in much of the rest of the country. Among manufacturing sectors, firms in textiles and machinery and equipment appear the most constrained (figure 37). Among service firms, transport firms (64%) and those in hotels and restaurants (60%) were most likely to identify access to land as a serious constraint. In addition, around 55% of firms involved in service of motor vehicles and wholesale trade identified the problem as serious.

In general, firms in Iraq were somewhat less likely to own the main land on which their business is located than were firms in several other countries in the region (figure 38). This average masks substantial difference by firm size, sector and location (figure 39). Ownership rises substantially with firm size, is more common among manufacturers than service firms, and is more common outside of KRG than within. The ownership rate is very high in Karbala and Ninewa, very low in Kirkuk, Basrah and Sulaymaniyah.

As the owner, enabler and regulator of land markets, the Iraqi Government can work towards improving its performance: Rationalizing public land use, introducing market-based incentives, and allowing private developers to develop, manage, operate and

Figure 36: Access to Land: Regional Variation

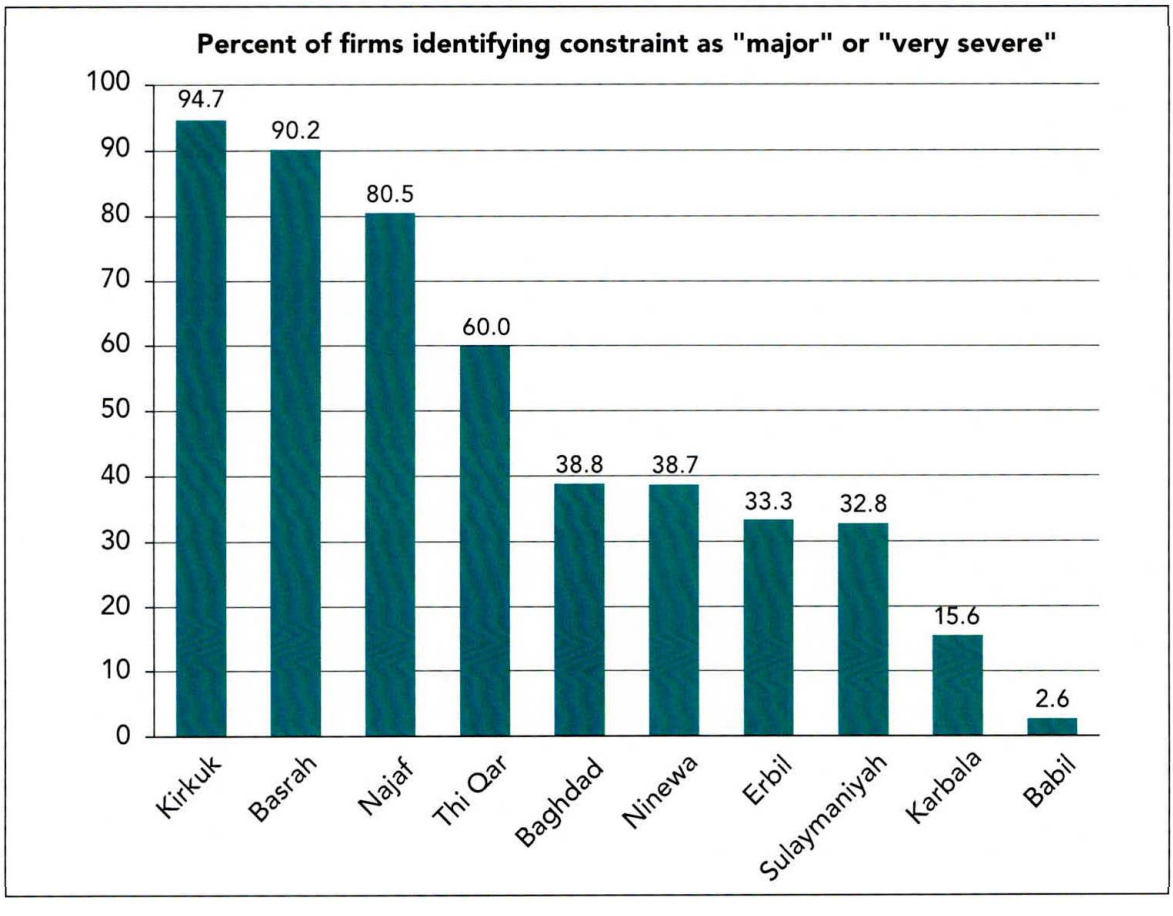


Figure 37: Access to Land

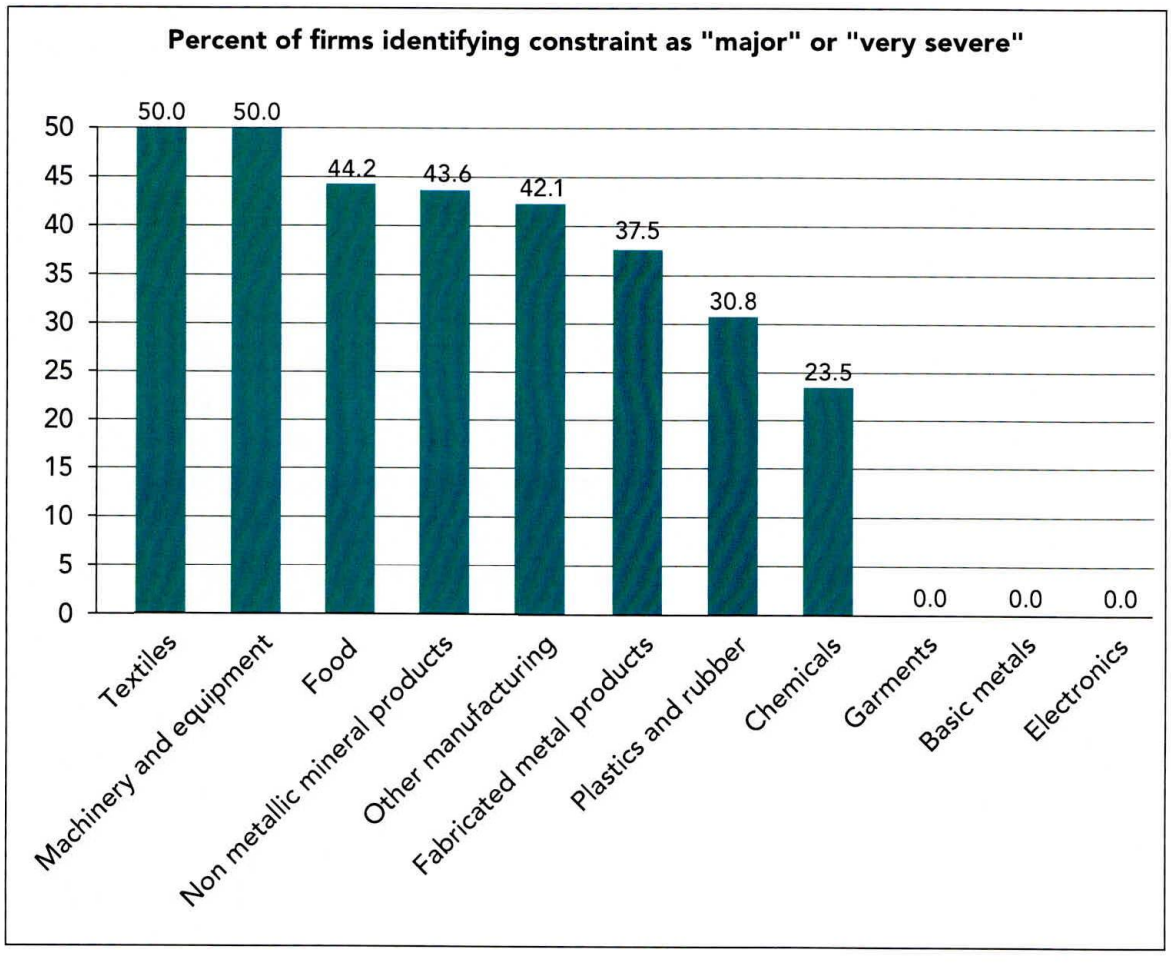


Figure 38: Land Ownership

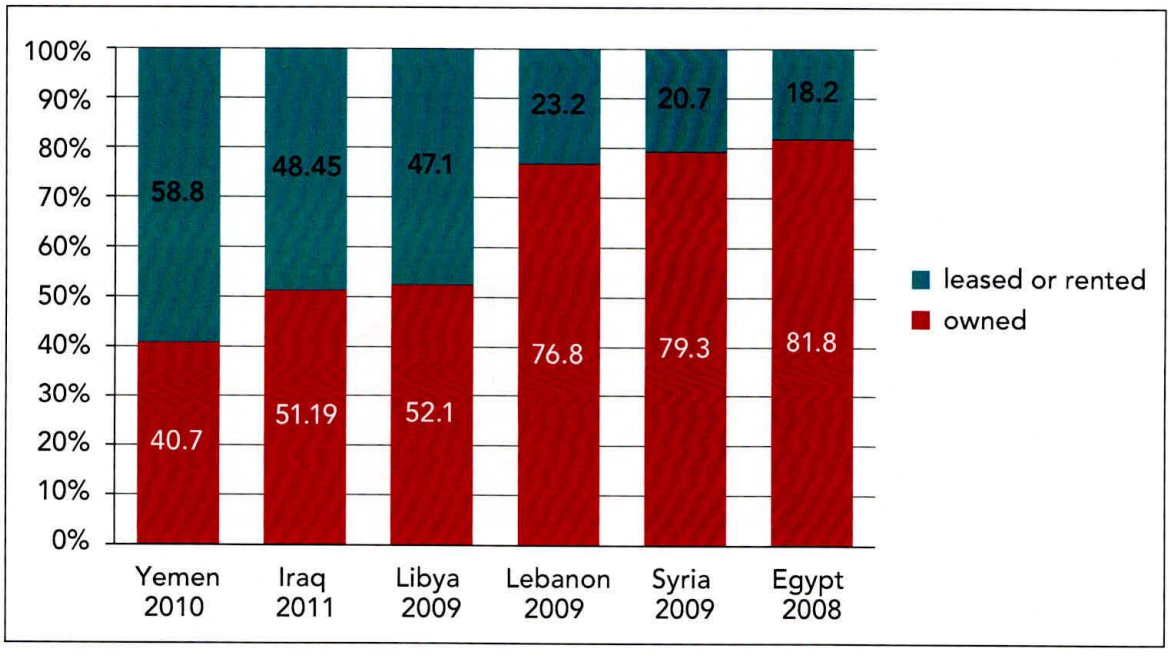
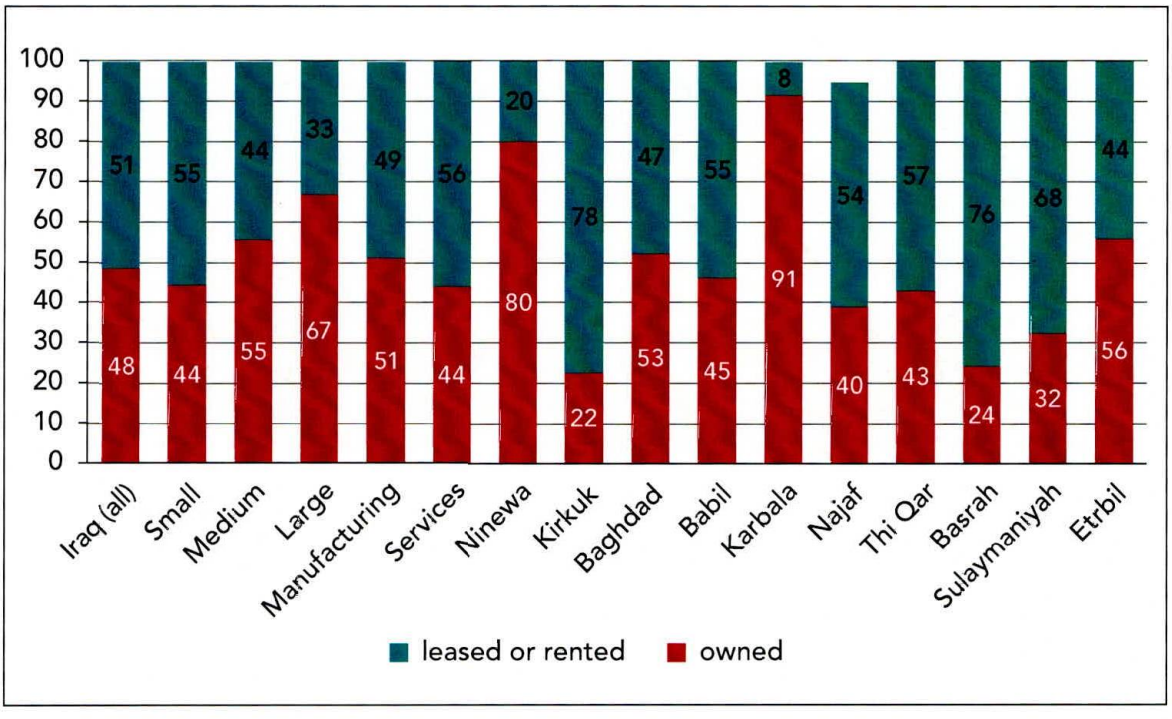


Figure 39: Land Ownership in Iraq



maintain industrial zones.[23] Iraq could embrace a six-step asset management approach to public land:[24]

- Formulate an explicit and coherent public land management policy, based on economic efficiency, fiscal health and environmental sustainability;
- Recognize the cost of fixed asset ownership and use, moving from a free-good to opportunity-cost approach;
- Build a land information system based on a consolidated inventory of public land and property assets;
- Create accountability mechanisms and incentive structures for public asset management to achieve efficient outcomes;
- Decentralize management responsibility while strengthening leadership and regulation. Central government can retain responsibility for national policies, regulations and monitoring, while allowing local government to play a role in setting local land use, disposing of public land, and retaining proceeds of land sale or lease to finance service delivery;
- Allocate public land to the private sector through transparent, market-driven processes, such as auctions, rather than obscure Government sales. Even when public policy goals justify some element of price subsidy, the government should use competitive allocation among developers.

[23] Benhassine, 2009.
[24] Adapted from Kaganova, Olga and James McKellar, 2006.

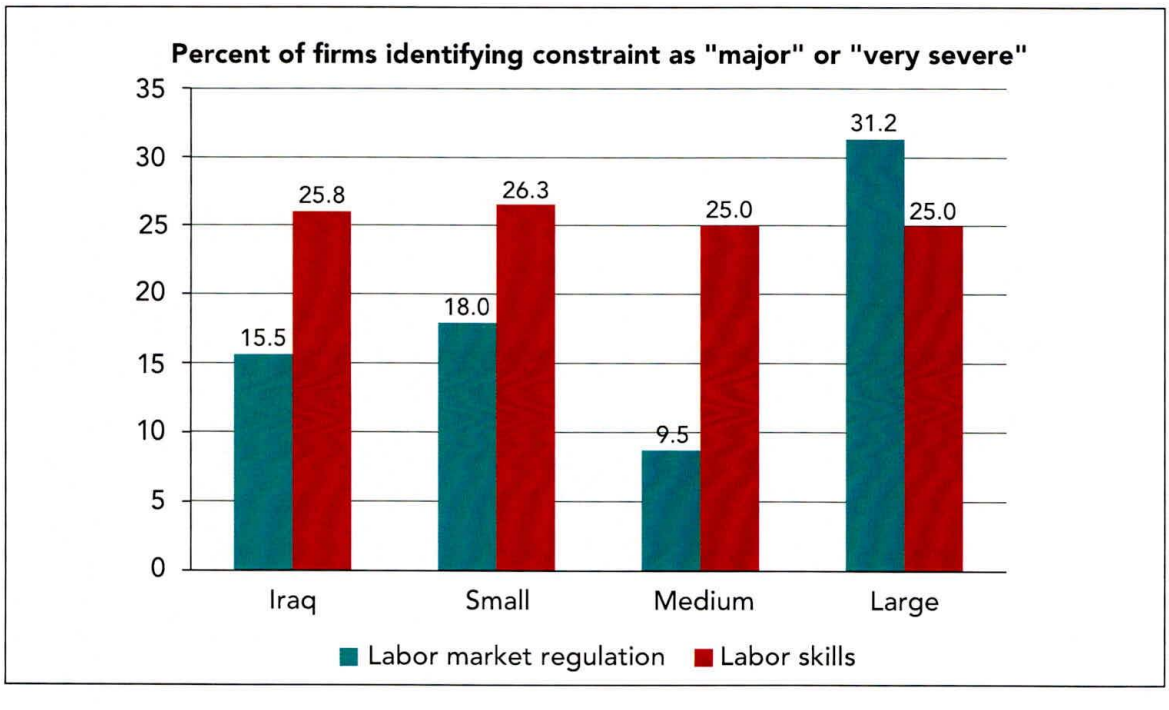
LABOR & GENDER

Job creation remains one of Iraq's greatest challenges for development and is faced by significant youth unemployment, inadequate training, a weak but pervasive public sector and constraining regulatory and legal environment. Reports on unemployment rates vary with most ranging between 23–28% of the total population. An estimated 450,000 workers enter the labor force each year, but unemployment for males aged 15–29 is 28%, a statistic generated by few job opportunities as well as low levels of education and skills.

According to 2011 COSIT labor market statistics, more than 38% of the labor force has no education, and only 11% of the Iraqi population has diplomas or higher degrees. The role of vocational training centers in training the Iraqi labor force is important, with reported satisfactory performance of the vocational training centers operated by the Ministry of Labor and Social Affairs. However, the sustained effectiveness of these centers and whether they develop training systems responsive to labor market demands requires further assessment. With more potential investments flowing to Iraq, the role of these centers will be increasingly important in training and job matching

Emigration and displacement have also played a pivotal role in shaping the current labor market. Pre-2003 estimates of Iraqis overseas ranged from 1 million to 2 million. Following the US-led invasion, this figure has at least doubled; the total figure of Iraqis in exile has been estimated at 4 million. By 2007, Refugees International deemed Iraq the "fastest-growing refugee crisis in the world", while the United Nations called the crisis "the worst human displacement in Iraq's modern history". By 2006, estimates for the total percentage of the professional and skilled classes of Iraq that had fled reached 40%.

Figure 40: Firm Perceptions of Labor Market Constraints to the Investment Climate



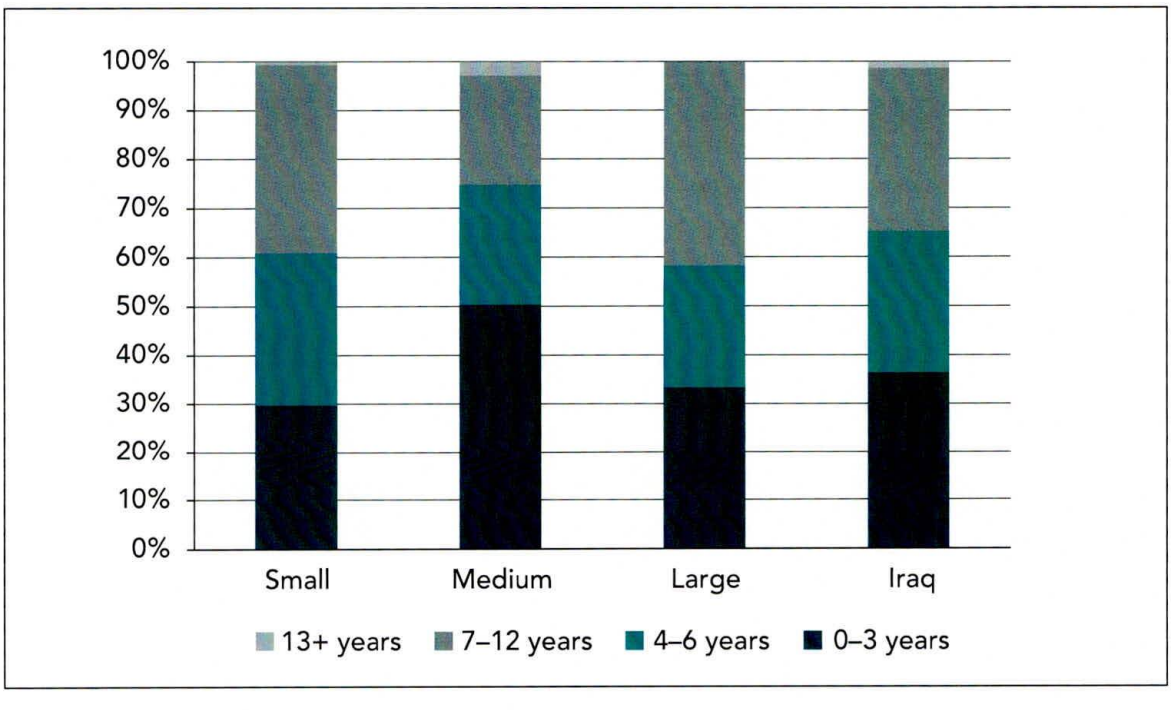
The result of this emigration has been a severe understaffing in necessary services, such as medical facilities and schools, which has led to the closure or cancellation of various clinics, schools, and other facilities.

Public and SOE employees account for 40% of total employment. According to COSIT 2011 statistics, public sector employees total approximately four million, rendering the Government of Iraq one of the largest governments in the world as a percentage of population. The perception of secure, relatively highly paid jobs in the public sector thus attracts skilled and educated workers, simultaneously challenging private sector businesses to recruit qualified workers.

Only about 26% of firms consider an inadequately educated labor force as a major or severe obstacle. The quality of education and level of education of the workforce have a large impact on firm productivity. This could be due to the fact that larger firms are more likely to be producing more value-added goods or employing complex technological processes. As the production moves up the value chain and becomes more technologically sophisticated, it gets harder to be satisfied with the available skill sets of workers or to find available workers with sufficient education or training requisite of their production process. It is also important to note that concerns about the inadequately educated labor force tend to be higher in the Kurdistan region than the rest of Iraq.

There is clear evidence that the market rewards higher levels of education and that investment in labor skills enhances productivity. Figure 41 summarizes the average number of years of education of a typical production worker. Even by regional standards, the Iraqi workforce is characterized by a smaller percentage of workers with some tertiary

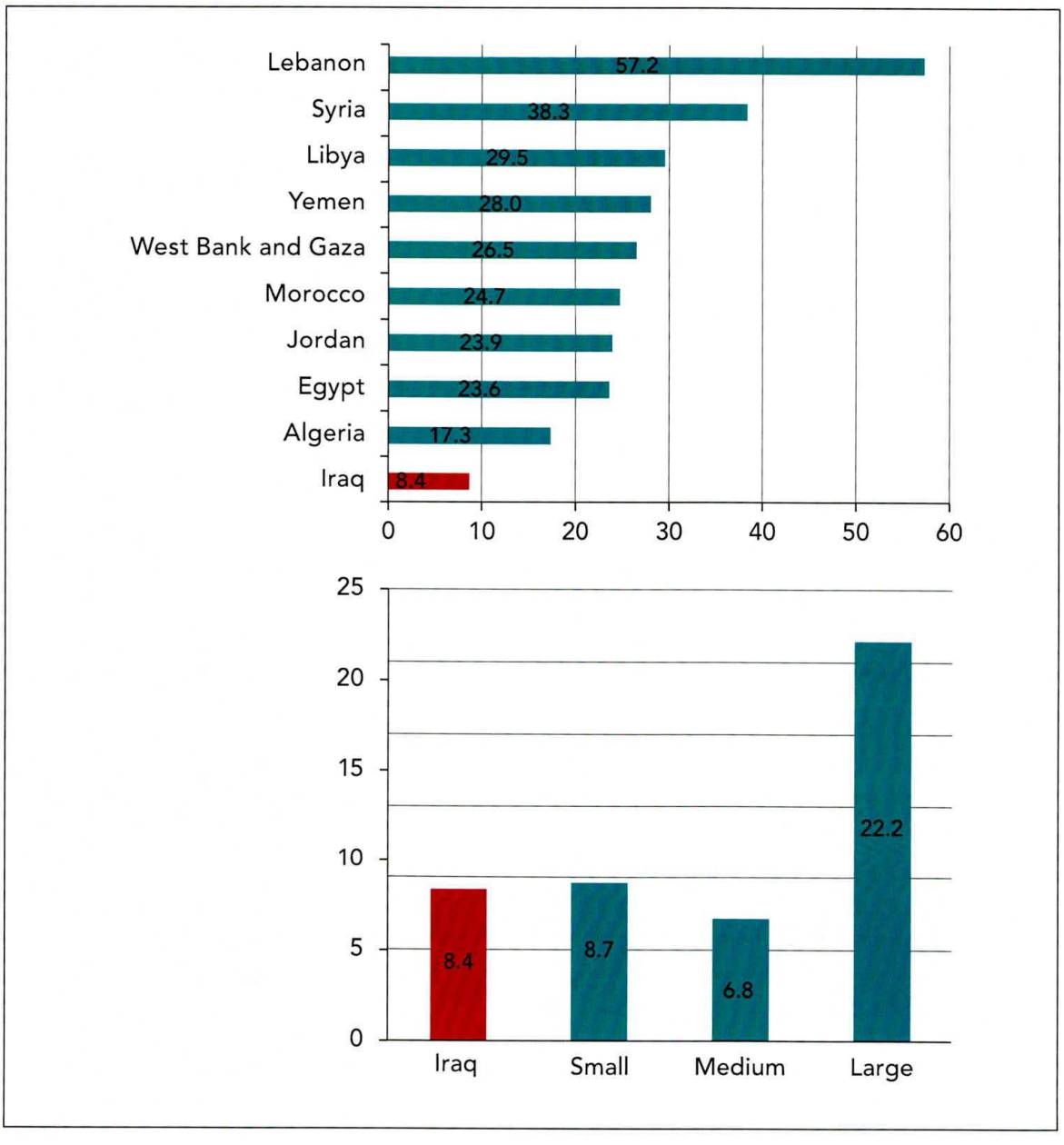
Figure 41: Average Education Attainment of Workers in Iraq



education. Less than 2% of production workers in the country have some tertiary education. In medium firms about half of the workers have less than three years of education. In large firms, 42% of the workers have some secondary education. As is the trend in other countries, larger firms employ a higher percentage of workers with better education than do other firms.

The proportion of firms offering formal training programs to its permanent full time employees is significantly lower in Iraq than among comparator countries in the MENA region. In several countries, firms tend to impart formal training to augment the existing skill sets of their workers and to compensate for shortcomings in their education system. While in Lebanon about 57% of the firms train their workers, the proportion of firms offering such training is less than 9% in Iraq (figure 42). However, large firms

Figure 42: Provision of Training to Workers (in percent of all firms)



perform better in this regard—about 22% of them train their workers. A larger proportion of foreign-invested firms and exporting firms provide training (13%). Also, firms with a larger share of higher educated workers seem to invest more in training programs. This is consistent with the hypothesis that firms require workers that can be trained in the use of new technologies.

Iraq compares well with its regional comparators in terms of search time. It takes the least amount of time (1.3 weeks) to hire an unskilled worker and most time to hire a manager (2.8 weeks). Iraq is the most time-efficient country among its comparators in hiring unskilled labor. In terms of hiring skilled technicians and managers only West Bank and Gaza does better than Iraq (1.7 weeks and 2.6 weeks respectively for skilled labor, 2.1 weeks and 2.8 weeks for management vacancies).

A recent World Bank report, "Confronting Poverty in Iraq" (2010), further shows that only 13% of Iraqi women are in the labor force, a far lower rate than virtually all of Iraq's neighbors. Figure 43 shows that the relatively few women who do participate in the labor force are heavily concentrated in public sector wage jobs, especially education (non-poor, educated, mostly urban women) or at the opposite end of the spectrum—non-wage agriculture (poor, less-educated, mostly rural women).

The enterprise survey data, as well as a cross country comparison on gender indicators further suggests that, despite recent economic growth, Iraq suffers from particularly significant gender inequality in labor force participation, educational attainment, and training. This suggests that Iraq can make better use of its human resources by more fully utilizing the talents and abilities of its female population. Data from the 2009 World Development Indicators show lower female labor force participation rate, literacy rate, primary completion rate, primary and secondary enrollment, and employment in the nonagricultural sector than for males (table 10). Both male and female literacy rates have slightly improved since 2000, but despite this, Iraq witnessed a major decline in the female primary completion rate.

Table 9: Average Time to Fill a Vacancy by Region (in Number of Weeks): Iraq and Comparators

Country	Skilled	Unskilled	Managers
Iraq	2.6	1.3	2.8
Egypt	12.5	22.5	30.2
Jordan	10.5	9.8	—
Lebanon	6.5	3.7	7.2
Libya	7.8	3.0	6.1
Syria	8.3	3.7	11.3
West Bank and Gaza	1.7	—	2.1
Yemen	—	—	8.4

Figure 43: Household Socioeconomic Survey



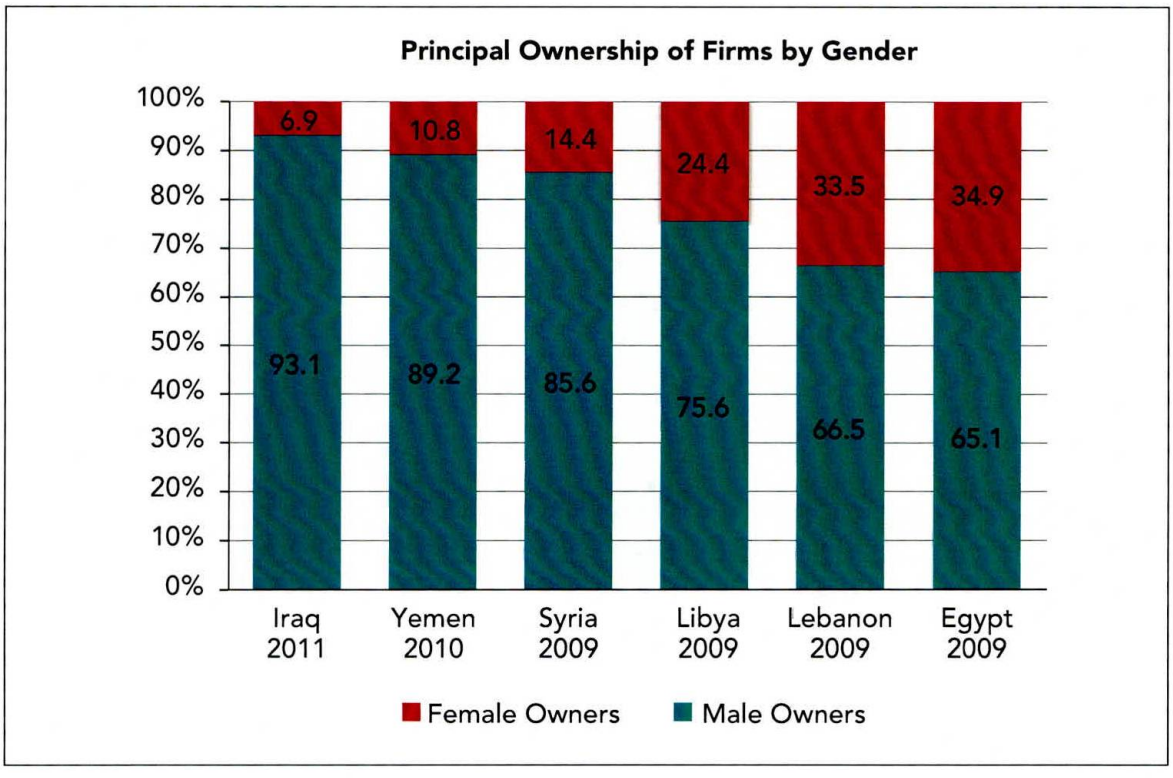
Table 10: World Development Indicators for Iraq Show Gender Inequality

Indicator	2009
Labor Force Participation Rate, Female (% of female population ages 15–64)	15
Labor Force Participation Rate, Male (% of male population ages 15–64)	71
Literacy Rate, Adult Female (% of females ages 15 and above)	70
Literacy Rate, Adult Male (% of males ages 15 and above)	86
Primary Completion Rate, Female (% of relevant age group)	54
Primary Completion Rate, Male (% of relevant age group)	73
Ratio of Female to Male Primary Enrollment	84
Ratio of Female to Male Secondary Enrollment	75
Share of Women Employed in the nonagricultural sector (% of total nonagricultural employment)	12

Source: World Bank, "World Development Indicators," World Development Report, 2012.

Only 7% of sampled firms reported that a woman was one of its principal owners. By this measure, female ownership is less common than in any MENA countries surveyed to date (figure 44). Within the Iraq sample, the incidence of firms with a female as one of the principal owners is markedly higher among large firms (44%) than in small firms (5%) and medium firms (8%). Firms with female ownership were further found to be markedly more likely to identify tax rates, an inadequately-educated workforce, and

Figure 44: Women are Very Unlikely to be Formal Enterprise Owners in Iraq



competition from the informal sector as serious ("major" or "very severe") constraints. By contrast, firms with only male owners were more likely to identify electricity supply, water, business licensing and operating permits, political instability, and access to land as serious constraints.

A pattern similar to the low female participation rate can be seen in female management rates within the Iraqi enterprise sample. The incidence of firms with a female as a senior manager is higher among large firms (11%) than among SMEs (1% of both small and medium-sized firms). However, it is still a very low rate of female management when compared to other MENA countries (figure 45). Iraq goes hand in hand with Yemen, with a striking 1% of firms having female managers, compared to Syria and Lebanon with 23% and 29% female management respectively.

When asked their reasons for not hiring more women (figure 47), senior managers' main reason (regardless of firm size), was that the security situation made it difficult for women to commute to work. This issue was a key consideration for 54% of firms. Governorates where this belief was held the strongest are Basrah (94%), Najaf (80%), Karbala (78%), and Sulaymaniyah (75%). The second most commonly identified reason for not employing more women was that women were absent from work more often than men. While the exact reason for this perception is unknown, it might be attributed to female household and childcare responsibilities or even to the unstable security situation.

Figure 45: Women are Very Unlikely to be Senior Managers in Iraq

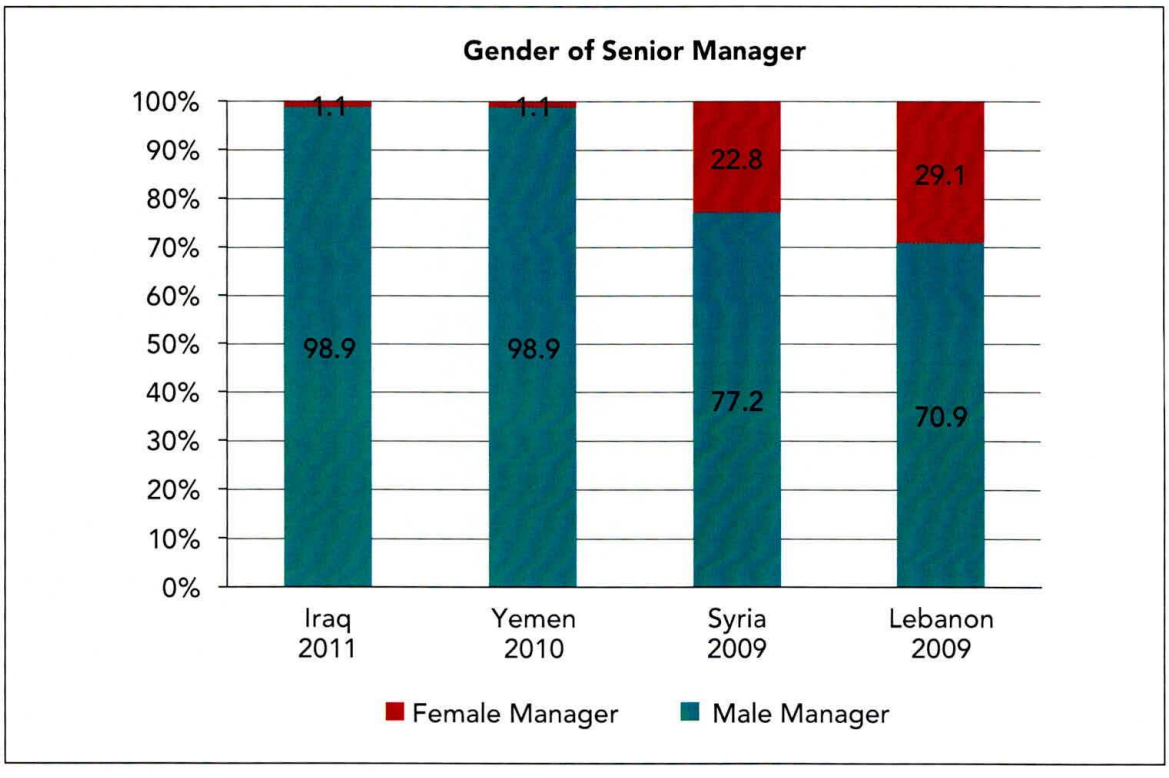


Figure 46: Women are Very Unlikely to Have Formal Private Sector Employment in Iraq

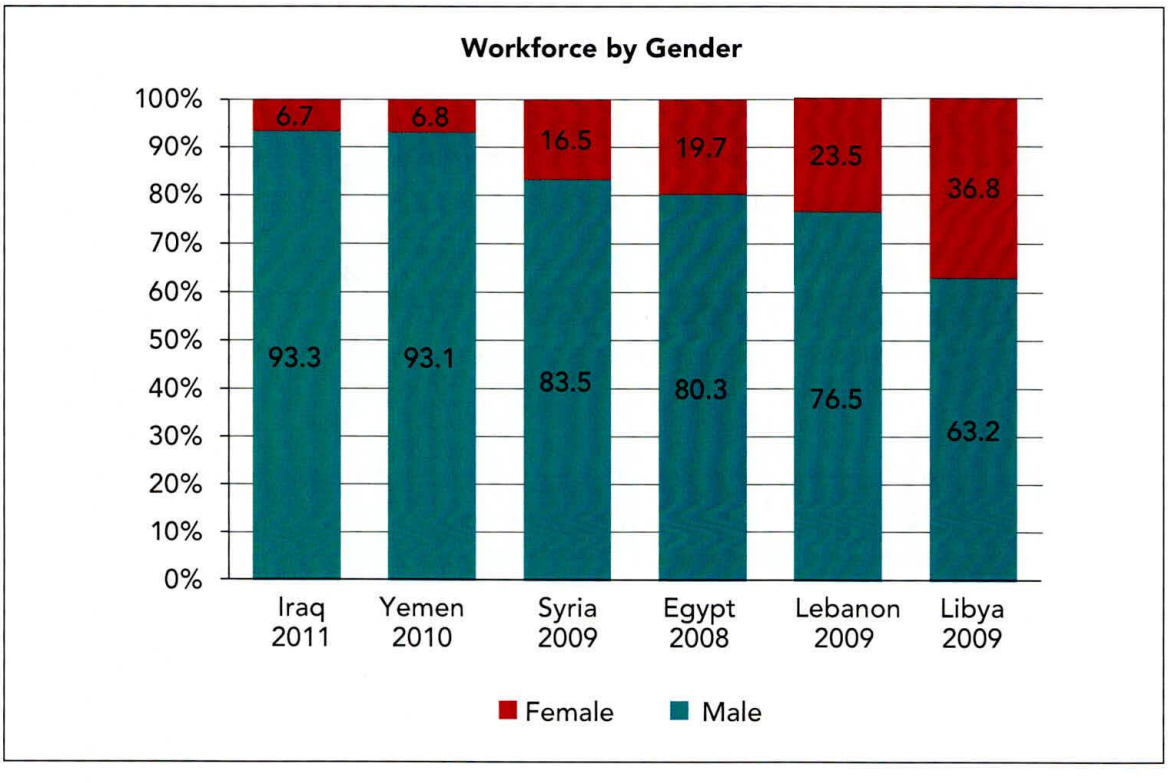
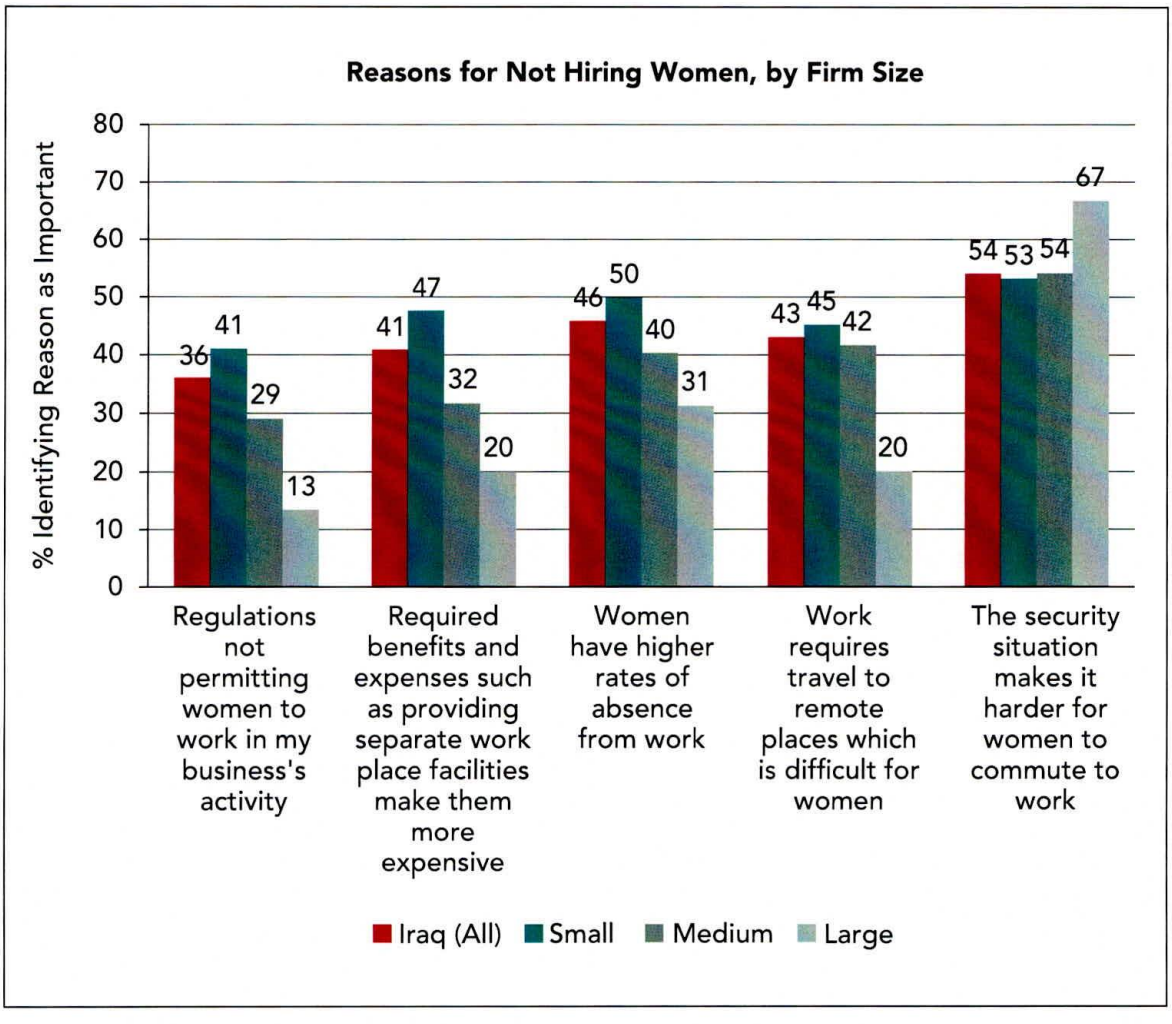


Figure 47: Reasons for Not Hiring Women



"In the government sector women have rights and advantages like maternity leave which are denied in the private sector" quoted one focus group participant. This may act to discourage women from seeking private sector jobs. Firms without female owners tend to be more likely to identify key factors for not hiring women, which raises the possibility of a male bias against hiring women. Male-owned firms are more likely to identify regulations, required benefits, the higher rate of absence, the requirement of travelling to remote places, and the security situation. Services firms consider the requirement to travel to remote places and the security situation most constraining when hiring women.

However, as highlighted in the productivity section above it is important to note that female ownership of firms does enhance productivity. The existence of gender-related barriers can thus reduce the economic potential of women as entrepreneurs and workers, and such barriers have an adverse impact on enterprise development, productivity, and competitiveness.

In summary, job creation remains one of Iraq's largest development challenges with international experience demonstrating that job creation is more likely to be generated

by the private sector with the key to sustainable job-generation being foreign and domestic investment in productive areas. Experience further confirms that employment generation by a large public sector, an approach which has been under implementation since nationalization efforts, is not a sustainable solution. It is estimated that with a median age of 21, approximately 450,000 youth enter the labor force every year. The government has recognized the need for labor market reform to increase coverage, flexibility and coherence, and has initiated a debatable process of labor law reform, covering employment conditions and prerequisite permits both for domestic and expatriate employment. A judicious combination of short term measures (tax incentives and credit guarantees to viable labor intensive MSMEs, youth-oriented training programs tailored to job market conditions, etc.) and a long term strategy that fosters inclusive growth, reforms the education systems, and provides adequate social protection to workers and job seekers in the private sector is critical to Iraq's future labor market interventions.

ACCESS TO FINANCE

The financial sector in Iraq is relatively small and its contribution to GDP is limited. The banking system dominates the Iraqi financial system, accounting for more than 75% of its assets. The banking system is small, assets-to-GDP ratio is equivalent to 73% of

The government has acknowledged the need for labor market reform by drafting a new labor law. However the initial draft presented to Parliament does not appear to reflect several principles of international good practice that would tend to maximize growth and formal employment. Effective labor laws place most hiring, firing, and labor use decisions in the hands of employers, who can best judge the needs of their enterprises and the performance of individual employees. While protections are needed against discriminatory practices, unsafe working conditions, and unfair dismissal, most redress should occur ex post rather than ex ante, so as not to impede efficient labor use As it stands, the draft law places the Ministry of Labor actively in between employers and workers, requiring public bureaucrats to second guess routine employment decisions. This could potentially create significant problems for the private sector in Iraq. First, the draft would require routine labor recruitment to be approved by the Ministry of Labor. The legal and bureaucratic procedures stipulated in the draft law could constrain flexible labor markets and efficient labor use, imposing extra costs and delays for employers, biasing them towards greater capital intensity and limiting productivity growth. Second, some of the prescribed penalties for violating certain parts of the law are severe, such as imprisonment for three to twelve months. This will further deter companies from formal registration and formally employing workers, compounding Iraq's chronic problem business informality. In order to encourage employment and private-led growth, the draft law should be revised to keep decision-making in the hands of employers, utilizing regulation in appropriate, ex post application to protect the rights of workers. Laws should facilitate rather than deter business formality. Social safety nets, rather than labor restrictions, should protect workers from negative consequences of private market cycles and individual business ups and downs.

GDP compared to 130% for the MENA region. The banking sector is dominated by public ownership, where state-owned banks account for 91% of total system assets. There are currently 43 banks, seven of which are state-owned and 36 are small private banks of which nine are Islamic and seven have foreign participation.

Private banks compete on an unlevel playing field with state-owned banks. Based on instructions from the government, state-owned enterprises and government agencies are not permitted to do business with the private banks, which is a major impediment to the development of a viable private banking sector. Government agencies and state-owned enterprises are not allowed to place deposits with private banks, nor can state-owned enterprises receive loans from private banks. Moreover, payments to the government (taxes and other payments) cannot be made by checks drawn on a private bank. The large state-owned banks benefit from an implicit government guarantee on deposits. In contrast, depositors in the private banks are not protected. Moreover, private banks have very little access to the lucrative business of issuing letters of credit for imports by the government and state-owned enterprises. Several banks are now able to issue such letters of credit. The newly established state-owned bank, the Trade Bank of Iraq (TBI) was set up explicitly to handle trade finance and has a monopoly on issuing letters of credit to the government and state-owned enterprises.[25] Overall, the financial system is dominated by public ownership, lacks competition and plays a limited role in the overall economy.

The Government of Iraq has adopted a Financial Sector Reform Strategy, which was developed with the support of the World Bank. The strategy focuses on the restructuring of state-owned banks, the dominant financial institutions. It also flags the importance of attaining a level playing field. Strengthening the regulatory and supervisory framework is one of the key pillars, as well as modernizing the financial institutional infrastructure. Enhancing access to finance and ensuring that the financial system plays a more prominent role in economic development is critical for sustainable and inclusive economic growth was one of the key messages agreed on. The Government of Iraq, specifically the CBI and the Ministry of Finance, have endorsed the strategy, and started the actual implementation of reforms.

Despite recent reforms, services offered by most banks are still generally limited, and trade financing, foreign exchange dealings, and payments services continue to constitute the bulk of banking business. Enterprises face major constraints in accessing financial services. Private commercial banks offer an increasingly wide range of services in the area of business lending. Banks generally offer trade financing, including letters of credit, guarantees, bills discounting, working capital and project lending, domestic and external settlements, and foreign exchange transactions. The bulk of loans are short-term, although some banks offer project financing and several banks grant SME financing at up to three years maturity. Also some Islamic banks provide funds of longer maturity. However, since private banks are relatively small they are not able to take on large projects as syndication of loans is not yet used. All this limits private banks' ability to provide financial services. A clear difference between the composition of lending between private

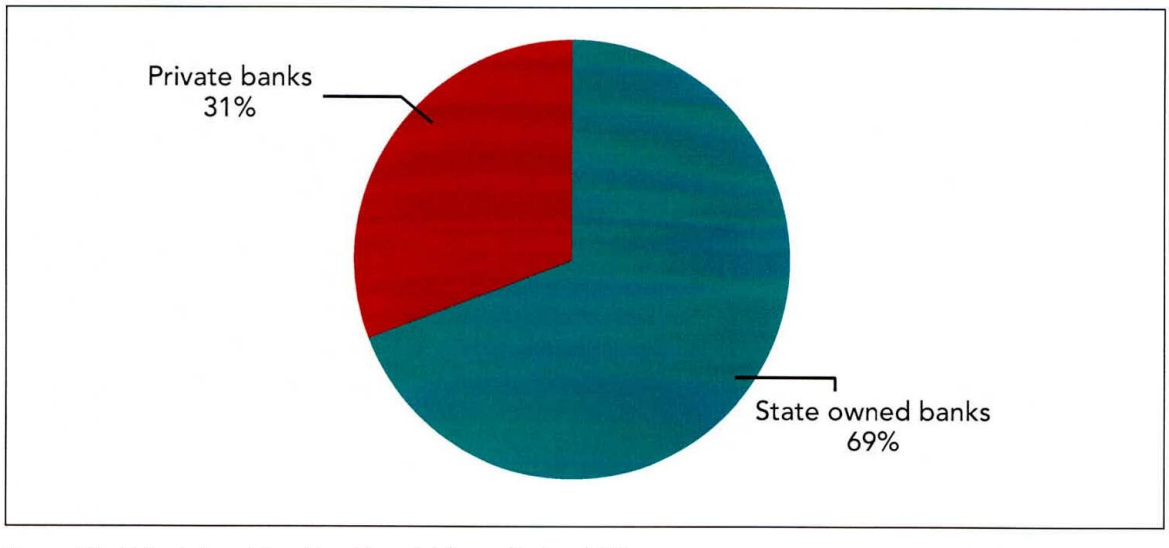
[25] In principle, the TBI may delegate letters of credit of less than US$ 5 million to one of the private banks. In practice it does so only for letters of credit less than US$ 2 million; furthermore, procedures for doing so are not fully transparent.

banks and state-owned banks shows the heavy concentration of lending to wholesale and retail trade accounting for 37%, while consumption gets 24%, and only 6% is allocated to the manufacturing sector.[26] Interviews with banks and market participants, as well as available statistics, indicate that bank services are generally rather limited, and that trade financing, foreign exchange dealings, and payments services constitute the bulk of banking business.[27]

Though rising since 2008, credit remains low by international standards. An increase of 75% was witnessed in 2010, reflecting a near doubling of credit by the state-owned banks, and a 50% increase in credit by private banks. Over the last three years credit to the economy has expanded by close to 40% on average. While bank credit has increased, the fundamental magnitudes are unlikely to have changed much. The share of bank financing of enterprises is still significantly lower than other MENA countries (13%) and other middle-income countries (19%). Credit amounted to an estimated 11.2% of GDP in 2011. This is much lower than the average of 55% of GDP for all MENA countries, but not too far from that of "state-led" countries in the MENA region, showing an average of 13% of GDP.

Overall, Iraqi firms' access to finance is very low compared to other MENA countries (figure 49). Financial intermediation is weak, and credit remains low by international standards, amounting to an estimated 11.2% of GDP in 2011. This is much lower than the average of 55% of GDP for all MENA countries, but not too far from that of "state-led" countries in the MENA region, showing an average of 13% of GDP. Access to finance is the fourth leading constraint identified by firms in the Iraqi enterprise survey. Consistently,

Figure 48: Structure of the Banking System (Share in Credits to the Economy)



Source: World Bank, Republic of Iraq Financial Sector Review, 2011.

[26] More than 63% of the ICA sample are manufacturing firms (mainly in food, non-metal, metal, chemicals, and other manufacturing industries) and 37% are services firms (mainly in hotels and restaurants, retail, wholesale, and construction).

[27] World Bank, Republic of Iraq Financial Sector Review, 2011.

Iraq ranks 174 of 183 countries in the Doing Business 2012 "getting credit" indicator. More than 48% of firms consider it a major or very severe constraint. The size distribution is striking. While only 5.14% of small firms report having a loan, 9.36% of medium enterprise as opposed to 23.53% of large enterprises have a loan (figure 51). A higher percentage of firms have a line of credit or overdraft facility, although access still increases substantially with size: 18.9% of small firms, 36.3% of medium-enterprises, and 55.6% of large firms report having such a facility.

The total level of credit in the economy is low in Iraq especially for SMEs. SMEs in Iraq mainly rely on the Kafala Company, as well as some special governmental programs and funds in different ministries, including the Ministry of Agriculture and the Ministry of Labor and Social Affairs, that provide loans to SMEs. However, this does not completely cover their needs, since there are enterprises that do not have physical access as there are no bank branches in their villages. Moreover, the number of branches in relation to the population size is relatively low. There is also lack of interest on the banks' side to lend to SMEs. Banks in Iraq are risk averse when it comes to providing loans, where they focus only on large firms, which they consider less risky.

Figure 49: Percentage of Firms having a Bank Loan

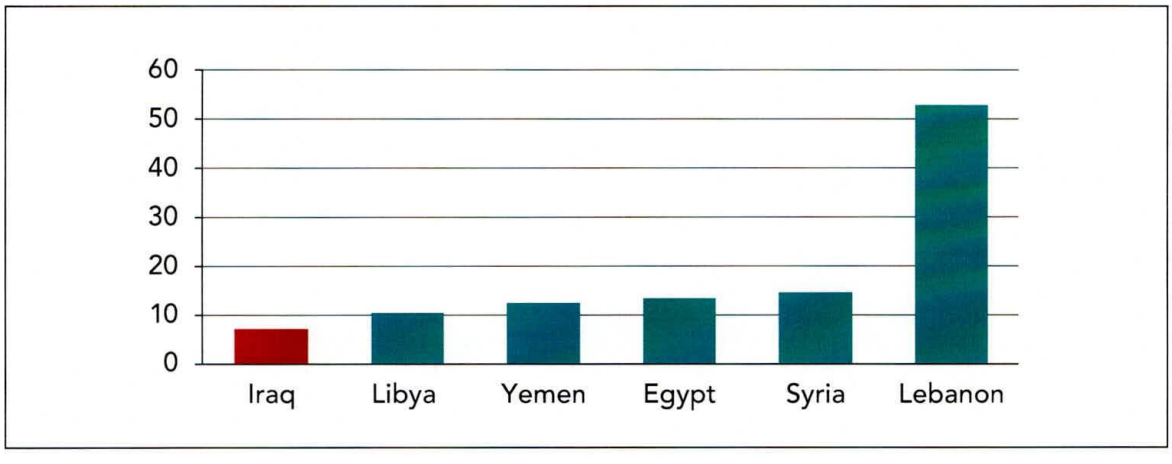


Figure 50: Firms Having a Loan

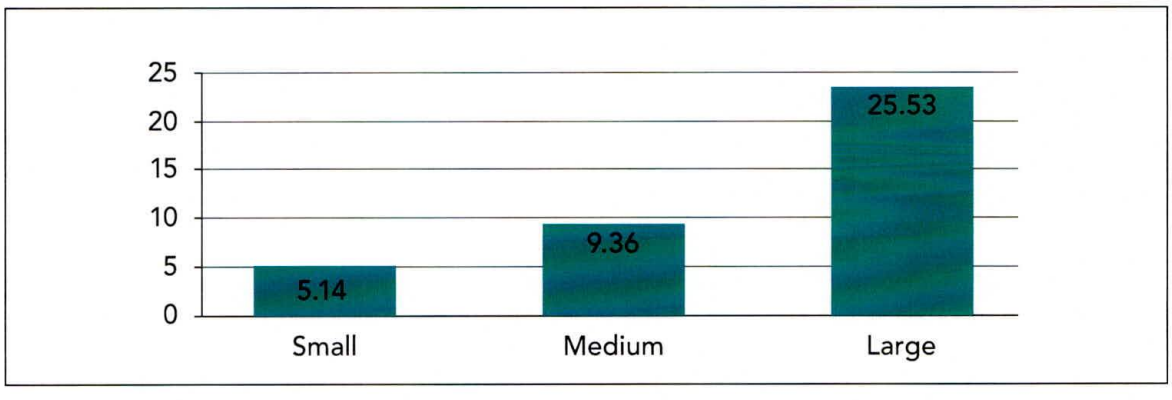


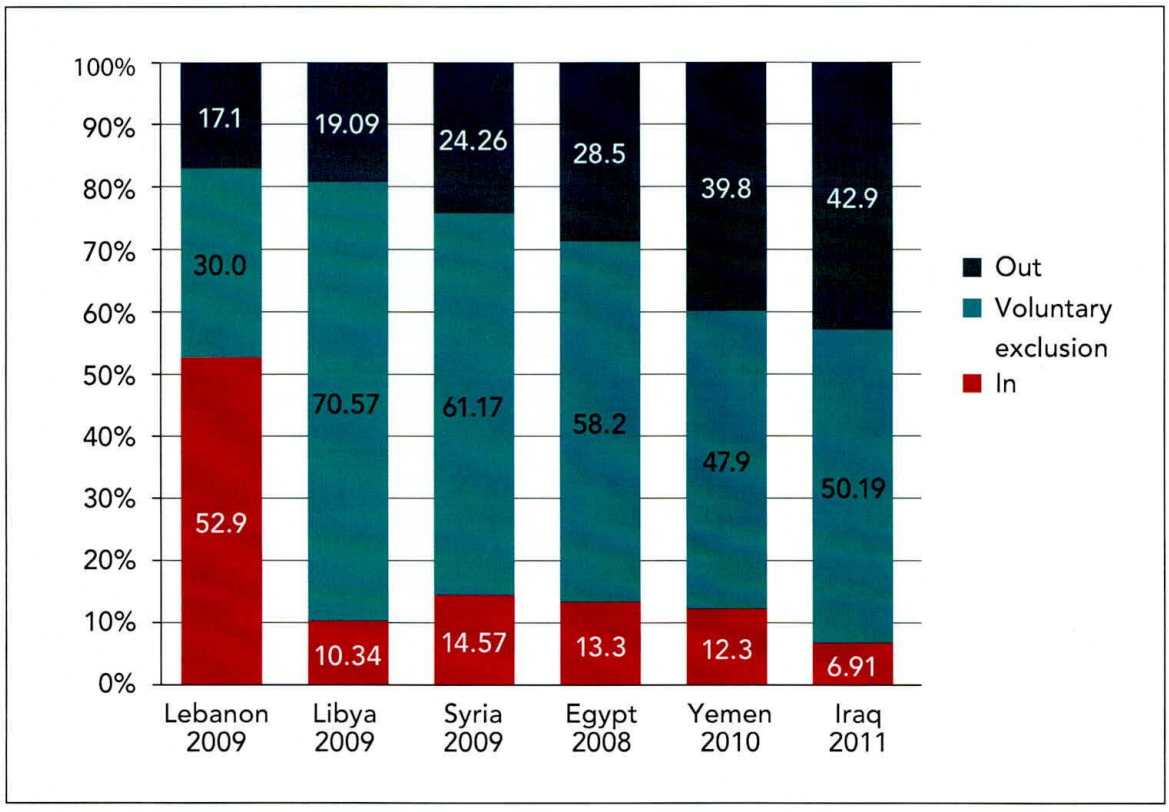
Table 11: Doing Business 2012 "Getting Credit"

Doing Business 2012 "Getting Credit" (Iraq ranks 174 of 183 countries)	Iraq	Middle East & North Africa	OECD
Strength of Legal Rights Index (0–10)	3	3	7
Depth of Credit Information Index (0–6)	0	4	5
Public Registry Coverage (% of Adults)	0	8.1	9.5
Private Bureau Coverage (% of Adults)	0	9.3	63.9

Source: World Bank, "Doing Business," 2012.

Many of the firms that do not have a loan report that they did not apply for one.[28] This includes half of all firms that either do not need a loan or do not want to deal in interest rates—voluntary exclusions (figure 51). One of the reasons could be the reluctance to use financial products that are not Islamic (*Shari'a*-compliant). However, an additional 43% of firms report being involuntarily excluded either by the terms of lending such as the collateral required, the interest rate, or application procedures.

Figure 51: Access to Finance, Iraq and Comparators



Source: World Bank ISC, (2011).

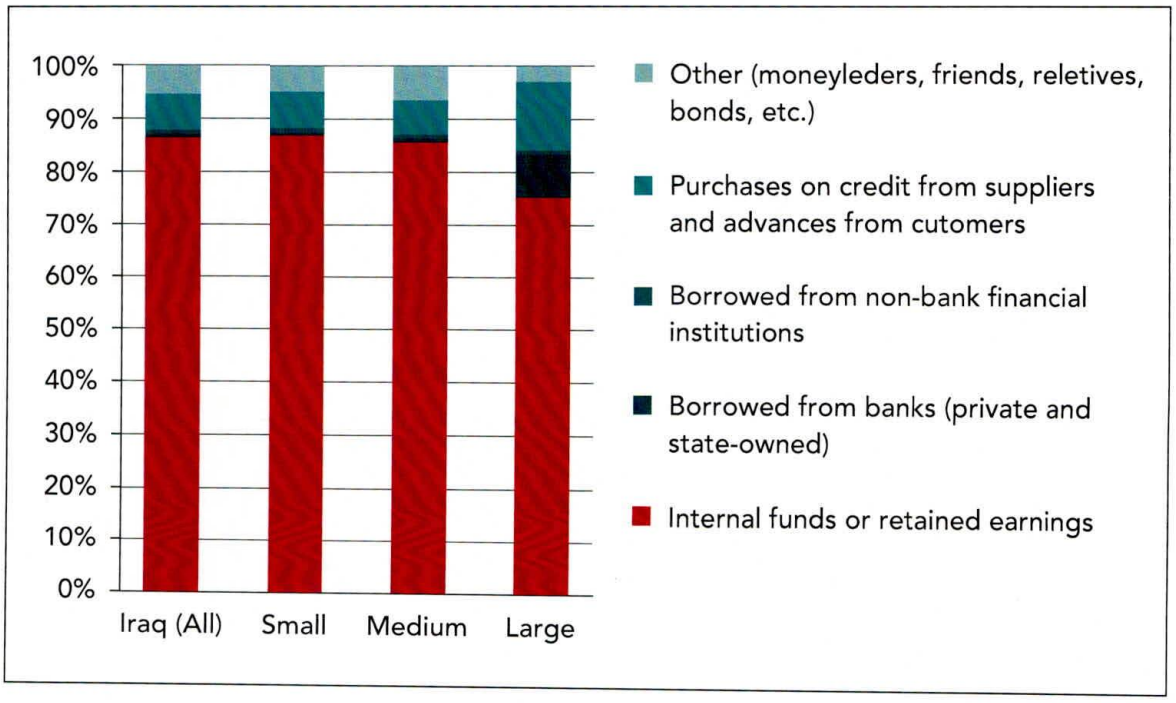
[28] According to the USAID Micro Small and Medium Enterprises (MSME) finance study, respondents expressed a strong resistance to high interest rates, 84% of those with no loans cited high interest rates as one of the reasons, 83.4% of firms indicated they would be willing to pay an interest rate of up to 4%, while almost no firms expressed a willingness to pay above 10%.

Enterprises expressed a strong resistance to high interest rates, 84% of those with no loans cited high interest rates as one of the reasons, 83% of firms indicated they would be willing to pay an interest rate of up to 4%, while almost no firms expressed a willingness to pay above 10%.[29]

The World Bank's "Iraq Financial Sector Review (2011)" summarizes the key challenges constraining development of the financial sector and limiting financial intermediation. These include: (i) a large number of state-owned banks and insurance companies lacking a clear strategy for moving forward; (ii) weak capitalization of the banking sector; (iii) an inadequate legal framework, including weaknesses in companies law, lack of corporate governance codes, bankruptcy law, and collateral law; (iv) a poor interest rate and loan structure with limited flexibility and a focus on short-term lending except for real estate; (v) an absence of credit rating agencies; and (vi) limited implementation capacity for the financial sector regulatory and supervisory framework.

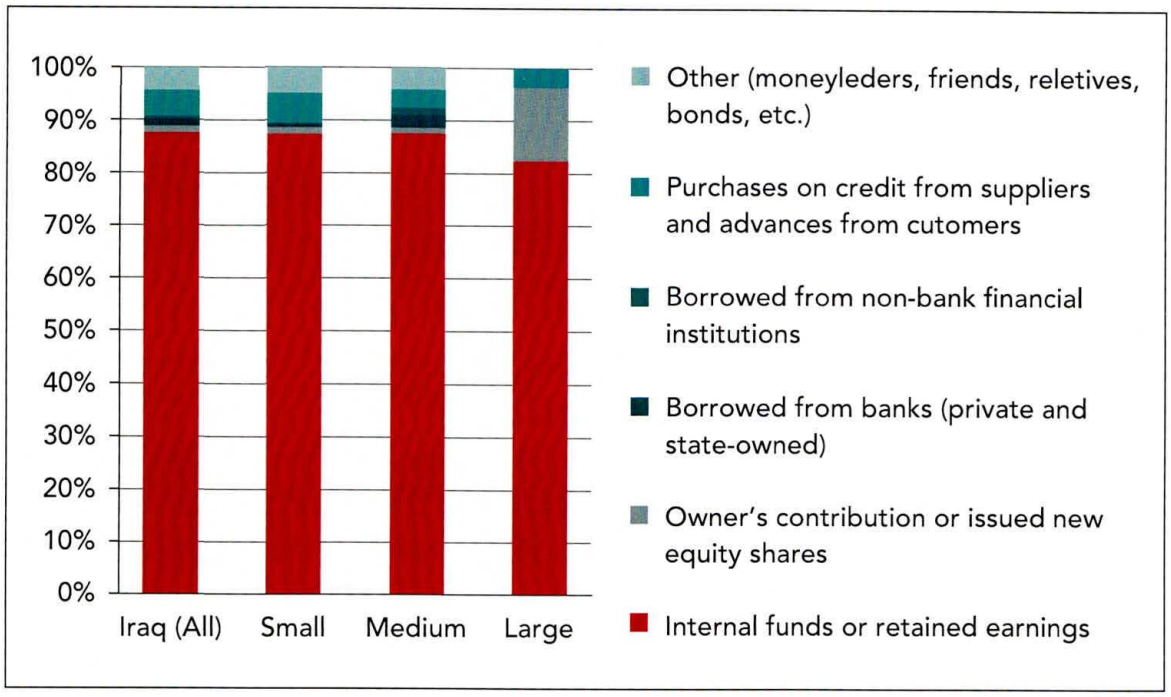
Private firms in Iraq mainly rely on internal funds or retained earnings for financing both their working capital and new investments. Bank financing is relatively unimportant when it comes to financing working capital (0.9%), and new investments (1.3%). However, large firms stand out in their greater reliance on bank financing for working capital (8%) than that of small and medium firms (0.7% and 0.8% respectively). However, large firms report deriving no investment financing at all from banks, and overall banks account for only 1.5% of total investment finance for the firms surveyed. Small and medium firms surveyed mention their high reliance on moneylenders, friends, and

Figure 52: Sources of Financing, Working Capital



[29] USAID, 2010.

Figure 53: Sources of Financing, New Investments



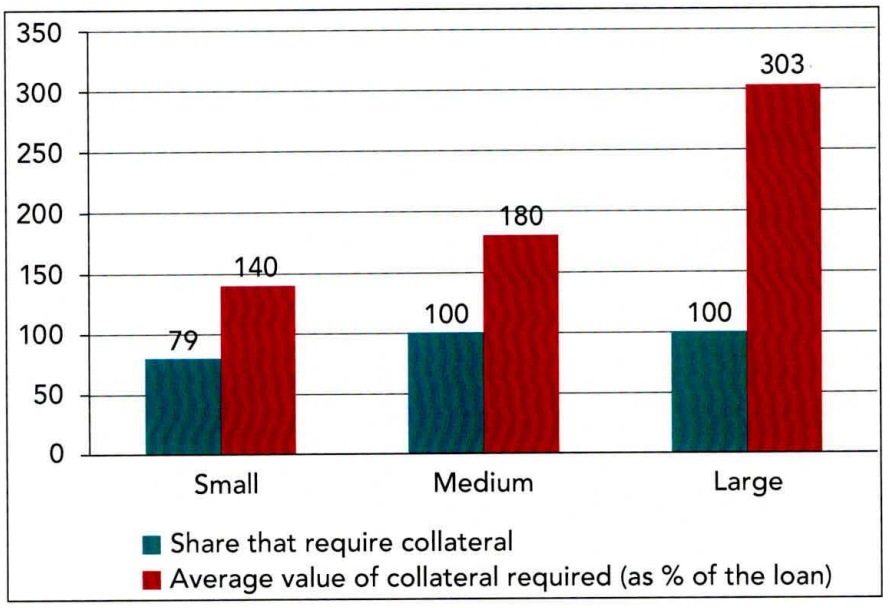
relatives for financing their working capital and new investments. These moneylenders are mainly governmental programs offered by different Ministries and Kafala Companies that provide microfinance.

Collateralization in Iraq does not follow MENA regional patterns. First, only 79% of small firms are required to have collateral, as opposed to all medium and large firms. In other countries, that pattern is generally reversed; with a fraction of large firms being able to borrow based on reputation rather than secured collateral. Second, unlike other countries, the value of collateral as a percentage of loan amount increases by firm size, and consistently exceeds loan value. Small firms report collateral value at 140% of loan value, medium firms at 180% and large firms at 303% (figure 54). The demand for less collateral from small firms could be attributed to the fact that they have access to credit guarantees under the Kafala Company that was established with support from the USAID.

Overall, the collateral system in Iraq is still very underdeveloped. Iraqi banks have difficulty in all components of the secured lending chain: registration, enforcement, and selling of collateral. Iraq does not have a central collateral registry, and collateral enforcement is a very time-consuming and unpredictable process.[30] However, it is worth noting that the authorities are making efforts on that front. The CBI has compiled a non-limitative list of acceptable types of collateral. One of the reasons why Iraq ranks low in the "getting credit" indicators is rooted in weak laws and institutions supporting secured credit and a complete lack of either public or private credit information. The type of collateral provided is generally in the form of real property, most commonly personal property.

[30] World Bank, "Republic of Iraq Financial Sector Review," 2011.

Figure 54: Collateral in Iraq



Firms report that collateral is more likely to be the personal real assets of the owner rather than assets of the company (figure 55). Surprisingly, a number of SMEs reported being able to use movable assets, inventories and other forms of collateral, while no large firms were able to use anything except real property. Naturally, small firms would not have a wide variety of options when it comes to collateral. Large firms however, are unlikely to use anything but real property as collateral. In general, the reliance on real property and personal assets to secure loans, combined with the high value of collateral compared to loan value, signal a system with serious difficulties with regard to collateral enforcement.

A large percentage of Iraqi firms in the sample were found to have their financial statements audited externally. Like most other countries, external auditing increases with firm size. Exporting firms are much more likely than non-exporters to have an external auditor (figure 56). Large firms can afford to hire auditing firms, which is a costly task in Iraq. The extent and sophistication of bookkeeping and financial reporting in general is strongly correlated with access to finance, even after controlling for firm size.[31] In spite of a somewhat high level of auditing, the percentage of income which firms estimated as reported for tax purposes is extremely low (40%) in Iraq compared to other MENA countries. This high degree of informality would suggest that any accounts firms keep may not be very reliable. Bankers may not have much faith in the accuracy of the balance sheets of many potential clients.

Over half of microenterprises in Iraq find access to finance constraining to their operations. Only 3% of these enterprises have a loan, and 3% have an overdraft facility. The main reason provided for not having a loan was that they did not need one (37%), followed by their disbelief in interest rates and their concern that these loans were not

[31] USAID, 2010.

Figure 55: Types of Collateral

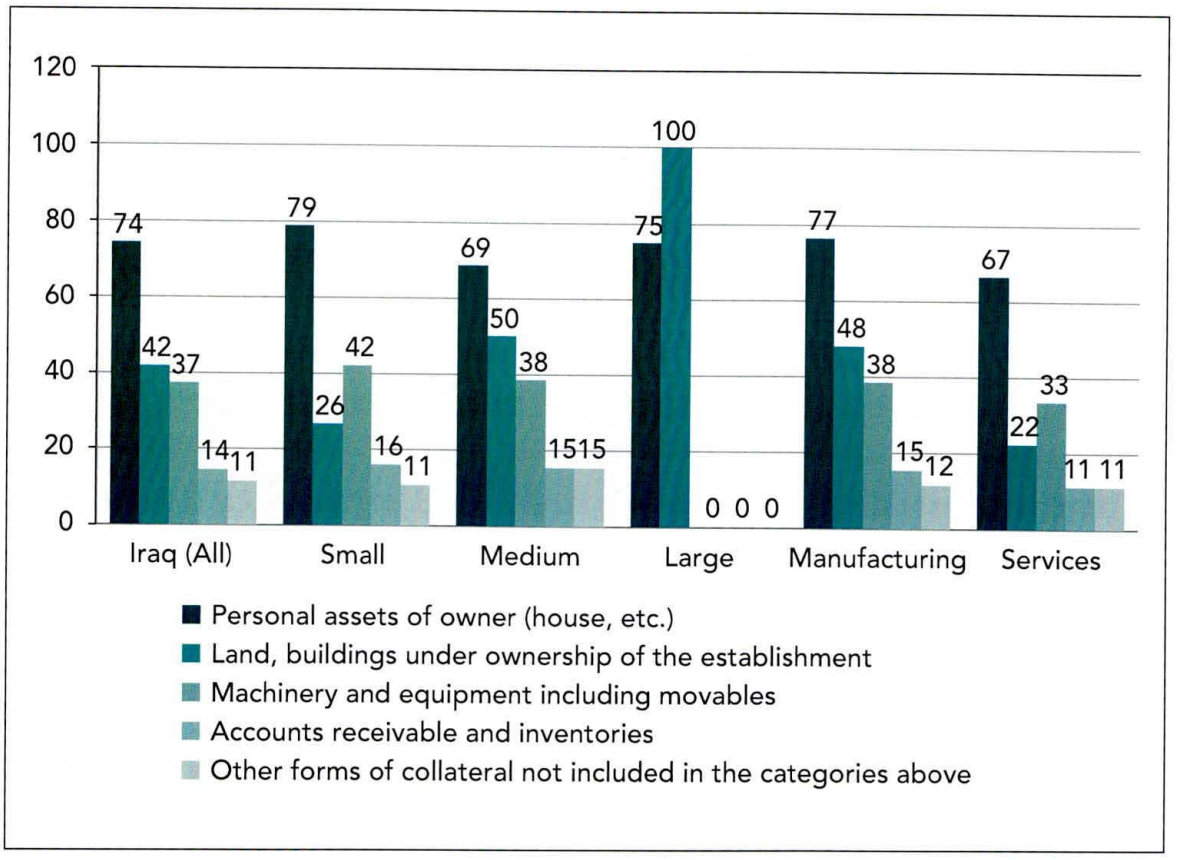
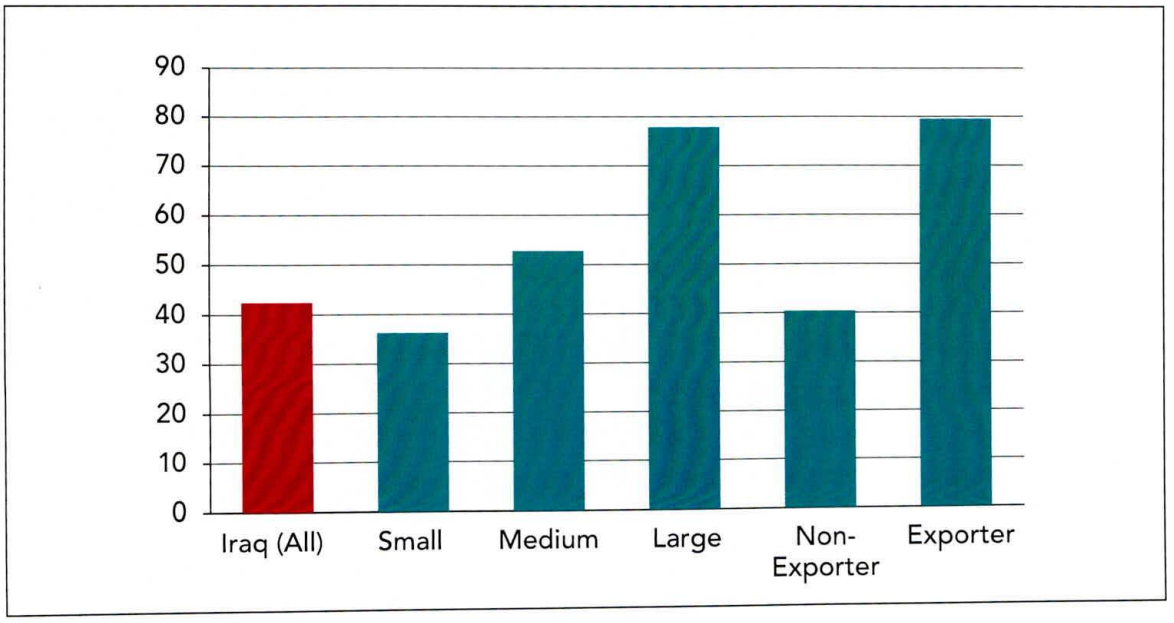


Figure 56: Share of Firms Whose Financial Statement are Audited by External Auditors



Islamic *Shari'a*-compliant (16%). Islamic finance has become very popular in Iraq, and could target those firms. Micro firms mainly rely on internal funding or retained earnings for financing their working capital and new investments, with the second main source being credit from suppliers and advances from customers. Micro firms do not rely on

banks (whether international or commercial) for financing working capital and new investments. The average micro firm reports 60% of their revenues for tax purposes, the highest among different firm sizes, and over 83% of micro firms get their statements checked by an external auditor.

The capital market in Iraq is concentrated on the Iraq Stock Exchange (ISX). The stock exchange is small and under-developed but has potential to provide issuers with access to sources of permanent and long term capital via the issuance of equity and corporate bonds to institutional and retail investors, domestic and foreign. It is currently at a crucial stage of its development. Activating the privatization program in a way which would place at least a proportion of the shares of currently state-owned companies into the hands of Iraqi citizens and institutional and foreign portfolio investors could, over several years, see ISX rival its regional peers in size and depth.

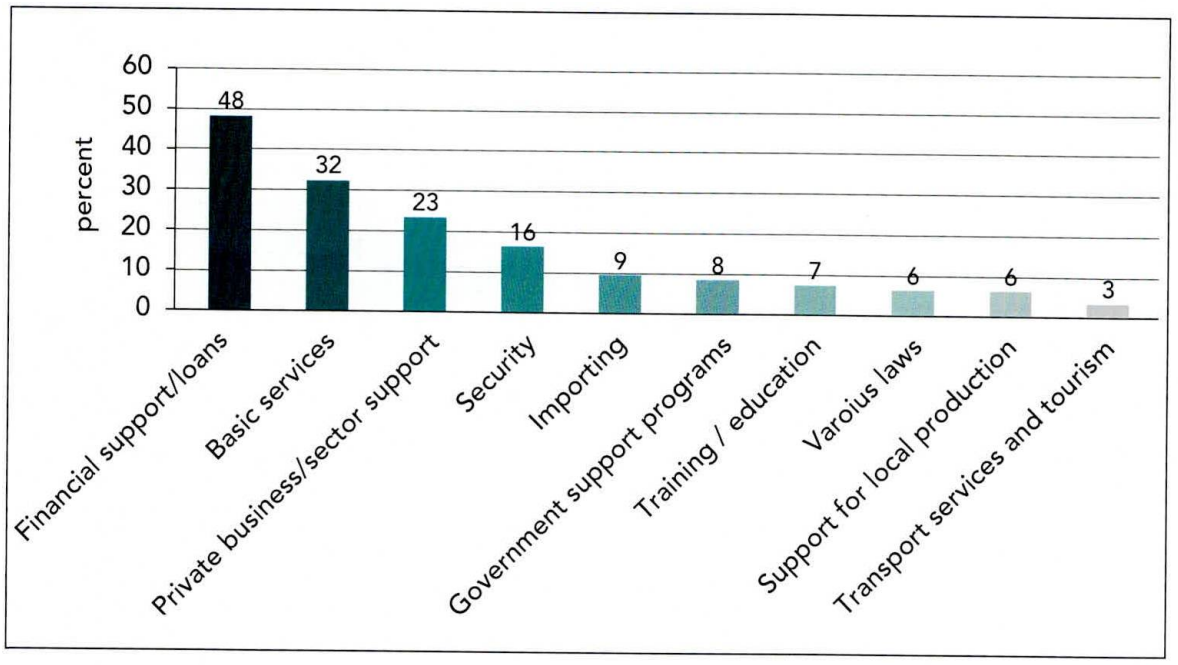
It is probable that there is (unsatisfied) demand from life insurance companies and pension funds for medium/long term debt securities in order to match long term liabilities with long term assets. There appears to be no issuance of such securities currently by either the government or the private sector. The absence of government debt beyond one year inhibits the latter as there is no "risk free" yield curve off of which to price corporate bond issues.

Capital market development requires improvements in all of the necessary underpinnings of a market in which issuers and investors can have confidence. These include the laws on contract enforcement, shareholder and creditors rights, efficient and fair judicial processes, corporate governance and accounting and auditing standards which (at least) match regional benchmarks. It also requires an effective, fair and efficient regulatory framework within which to operate. This should have as its objectives the protection of investors, ensuring that the market is fair, efficient and transparent, and the reduction of systemic risk.

The insurance sector in Iraq is dominated by the state-owned insurance companies that benefit from being the sole provider of insurance services to the government. The law requires the government to make use of a public tender process when purchasing insurance services, but even though the public process is used, there is little trust in the market. It is almost always the state-owned insurance companies that are awarded the contracts.

In summary, Iraq has a broad and challenging agenda of reforms needed to strengthen financial intermediation to support private-led growth. As a simple yardstick, to bring the credit to GDP ratio from 10% to GDP to the average level for MENA countries of 55% will require an increase in credit of ID 45 trillion. The planned increase in bank capital levels will be sufficient to support such a lending level, assuming that enhanced banking and banking supervision skills ensure no deterioration in credit quality. According to a CIPE business survey, firms in Iraq are in need of more financial services (figure 57). Access to finance is considered by enterprises in Iraq as a primary area where the government needs to take action and proceed with reforms.

Figure 57: Areas Where Government Support is Needed



Source: CIPE Business Survey (2011).

POTENTIAL WORLD BANK GROUP SUPPORT

To optimize the management and use of public **land** in Iraq and curb corruption, the World Bank can provide technical support in:

- Stocktaking and management of all public land and introduction of a modern land registry system;
- Development of a comprehensive public land management policy;
- Review of existing development and operation practices as well as the legal and regulatory regimes for the economic/free zones;

World Bank support to the government in the strengthening of the **labor market** could include in-depth advisory services to:

- Develop demand-driven educational and capacity building curricula and
- Harmonize public and private sector employment benefits.

To improve firms' **access to finance**, World Bank can support the government in the operational, institutional and financial restructuring of state-owned banks, and the modernization of the overall banking system could include in-depth advisory services to:

- Strengthen the regulatory and supervisory framework of bank and non-bank financial institutions;
- Introduce risk management and corporate governance best-practices;
- Build capacity of banks and entrepreneurs;
- Develop an enabling environment for *Shari'a*-compliant financing.

LOOKING AHEAD

Strategy for Reform

Iraq has undertaken several steps towards reform (Box 4), yet, as shown in the preceding chapters the agenda ahead is enormous and investor response to these tentative first steps to date, outside a very few sectors (e.g. petroleum) has been low. Clearly, the challenge of security remains, but international experience also indicates that, to get a strong private investment response in non-oil sectors, Iraq will not only need both to change its policies, but also to convince investors that the "rules of the game" will be clearly, fairly and consistently applied to all.

Establishing a clear strategy to reduce existing barriers to investment and to level the playing field is important, and requires the establishment of strong, rule-bound institutions to apply the rules and regulations governing markets. Once such institutions are in place, with proper safeguards to ensure transparency of their rules and procedures, it is important to delegate substantial decision-making power to them. Within these institutions, incentives should focus on performance, while mechanisms for interaction with stakeholders should provide important feedback and accountability.[32] The economic diversification experience of Malaysia as a resource-abundant country is instructive (Box 5).

As described in the sections above Iraq faces many challenges in developing and optimizing its business environment to enable a strong investment climate and sustainable private sector led growth. With these challenges however comes significant potential and opportunity to enact sustainable and impactful change to Iraq's economy and society as a whole.

The World Bank Investment Climate Assessment, the first of its kind undertaken by the World Bank, converges on several consistently obtrusive impediments to firms operating in Iraq, including lack of access to reliable electricity, developed industrial land, skilled labor, and finance.

[32] For more details with reference to the region, see Benhassine, From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa (Washington: World Bank, 2009).

Box 4: Reforms Underway

Reform progress in Iraq has been slow, and expressed intent has far outpaced impact. Iraq achieved no reforms as measured by the Doing Business indicators in 2011, or in the three prior years.

In 2009, however, the Parliament approved a revised investment law allowing, among other things, foreign ownership of land for housing projects. In 2010, the Cabinet approved an authorizing framework for the National Investment Commission (NIC). The Commission will be responsible for implementing a $66 billion PPP infrastructure package to leverage private sector capital and management skills for public and social infrastructure including schools, hospitals and housing, and to reclaim agricultural land. It has also established a one-stop shop for foreign investors to "facilitate the processing of the investment licenses applications, issuing the license, allocating the land, securing tax exemptions, and facilitating the entry and exit of investors and their employees." It has created an "investment map" of opportunities, and an investor guide "the necessary information to facilitate entry and exit procedures to and from Iraq and how to enjoy the many benefits of the investment law." The Government also established a high-level Task Force for Economic Reforms and Private Sector Capacity (TFER), which was mandated to lead the entire range of reforms. It is headed by the Prime Minister's Chief Advisor. The Task Force established seven technical working groups on: (1) Legislative reform, (2) SOEs restructuring, (3) SME development, (4) Investment policy, (5) Social dialogue, (6) Land reforms and, (7) Tax policies.

Corruption, informality and a general lack of security further disincentivize competition. Equally significant in stunting competition is the heavily subsidized, pervasive, yet weak state-owned sector.

Organizing for Reform within Government.[33]

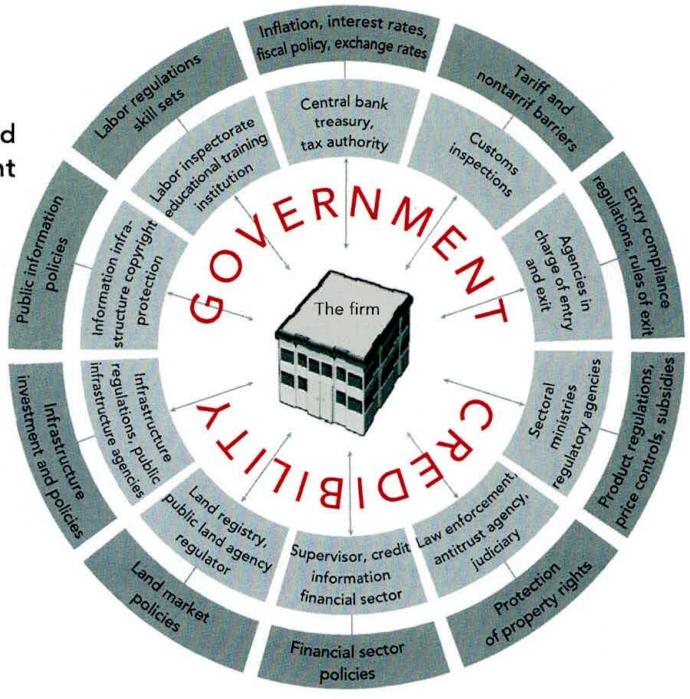
Like several other countries in the region, Iraq benefits from a wealth of advice on policy reforms, and a large body of recommendations, plans and strategies from consultants on various elements of its economic reforms. However, regional experience suggests that even where there is the political will to reform, expert diagnostics are not enough to succeed in strengthening the investment climate. Reform initiatives often lose momentum due to the lack of institutionalized inter-ministerial coordination, open public-private dialogue, efficient project management, and effective monitoring. Individual reforms can and do contribute to a better investment climate, but a better process for managing the reform process may be able to assure more coherence, higher quality, better implementation and higher return on investment. Although many countries have appointed various inter-ministerial bodies charged with pursuing economic reform and/

[33] Substantial portions of this section are adapted from Meneval and Saadani, "Business Environment Reform in MENA," 2009.

or enhanced competitiveness, they are often established without well-defined operating procedures, methodological tools and operating capacity that would permit them to have deeper impact. Furthermore, for many measures, however expertly drafted, there may be little underlying consensus among key stakeholders as to their design.

Figure 58: Policies, Institutions and Credibility Influence Investment Response

The Firm and Its Investment Climate: Rules and Policies and the Institutions that Implement Them



Box 5: Malaysia: Growth with Equity[a]

Malaysia's stability and social consensus behind its growth strategy is commonly credited in large part to its commitment to equity. Zagha (2004) observes that "natural resource rents did not give rise to a small privileged elite which designed policies for its own benefit—as has been the case in other developing countries suffering from institutional weaknesses induced by a 'resource curse'—but that the rents were invested in growth and service delivery." He goes on to observe that the mechanisms of equity were not through direct redistribution of income or commodity subsidies, but rather through "mechanisms that facilitate upward mobility: universal education, equitable distribution of land, expansion of small and medium scale enterprises in some countries, privileged access to lending and other resources, emphasis on rural growth through agricultural research and extension, infrastructure investment and access to loans."

[a] Zagha, N. Roberto and Oleksiy Shvets. Scaling Up Poverty Reduction: Lessons and Challenges from China, Indonesia, Korea and Malaysia (Washington: World Bank (PREM) for Shanghai Conference on Scaling Up Poverty Reduction, 2004.)

Other Governments in the region are working to improve the reform process by revisiting the way they implement their economic strategies, to systematically improve the quality of the preparation and implementation of initiatives (box 6).

The first step is to develop an initial reform action plan based on in-depth knowledge of the local context. As second phase, focusing on implementation, involves establishing a four-part institutional framework to manage the reform process, including:

- A central high level decision-making body, building on the role of existing forums such as the Prime Minister's Task Force for Economic Reforms and the Council of Minister's Secretariat (COMSEC) Regulation Reform Unit;
- A reform management unit at the center of government with a clear mandate and role;
- Public-private working groups;
- Project Implementation Units; and
- Strengthening the role of Parliamentary Committees to scrutinize draft laws.

The reform management unit has the operational responsibility for facilitating and monitoring the reform process. It can marshal in one place economic, legal, administrative,

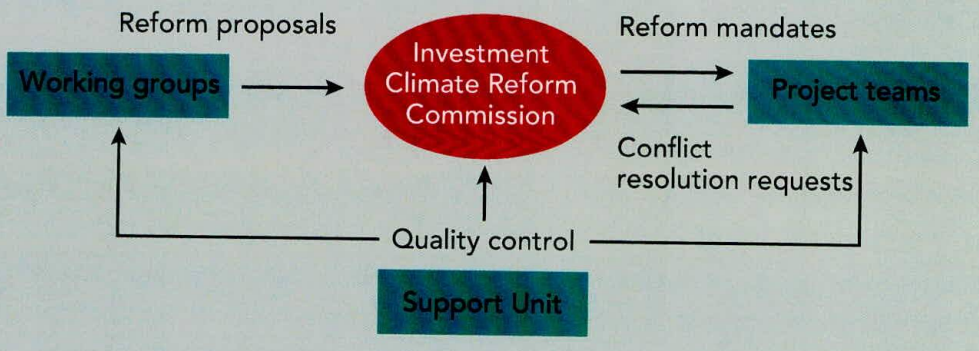
Box 6: Organizing for Reform in Morocco

Morocco found its reform process impeded by a weak ability to plan and carry out reforms across Ministries.

With assistance from the World Bank, Government designed a process based on best practice principles:

- Preparation of reforms: a careful selection of priorities; consultation with stakeholders, use of an inter-ministerial coordination process.
- Implementation of reforms: Assignment of adequate human and financial resources, good monitoring, introduction of a conflict-resolution system, formal quality control procedures.

Streamlined reform process, utilizing a standard project cycle for preparation, approval and implementation of reforms; new inter-Ministerial Commission led by the Prime Minister.



and IT expertise. The unit needs to be established as a credible facilitator of the reform process, and be able to monitor and follow up the reform process. It also needs to be able to mobilize additional expertise as needed. The Government of Morocco is currently experimenting with this approach, introducing a standard project cycle for reforms under an inter-Ministerial Commission led by the Prime Minister.[34] This process it oversees is credited with achieving Morocco's 21 place jump in the overall Doing Business index for 2012. Although Iraq has designated a Task Force to lead reforms, it would need greater political authority and technical capacity to fulfill this key role.

Business-Government Consultation

Strong, broad-based, systematic dialogue between government and the business community can improve reform quality, strengthen implementation, and deepen Government credibility with investors. Several of the "East Asian Tigers" have benefited from such consultations, as have a number of middle income countries pursuing sustained, long-term growth. In a number of contexts around the world, market-oriented reform programs have benefited from a focused dialogue between government and business leaders on reform priorities, strategy and specific measures. The potential benefits of effective business-government consultation include improved information for public (and private) decisions; greater consensus about and ownership of policy reforms; improved transparency of government decisions and functions; greater accountability of public decision-makers; more resources for implementation of agreed actions; and reduced costs of business-government transactions through the building of trust and routine dialogue (social capital). This dialogue can feed into a reform oversight mechanism like the one described in the previous section.

A strategy to establish effective consultation requires:

- First, top-level government commitment to the process at the outset and throughout (e.g. a Prime Minister or leading reform Minister chairs major meetings);
- Second, clear authority, responsibilities and objectives for the consultation (which creates sufficient incentive for private sector members to participate);
- Third, a membership that authoritatively represents both the private sector (including both large players and SMEs) and the key economic decision-makers in Government; and
- Fourth, logistical and resource support to facilitate effective meetings, communication, monitoring, and analysis.

The consultative process can be structured around the investment climate reform process described above. Public-private working groups can be organized around key issues, sectors or regions to generate a shared set of understandings, priorities and solutions. Focusing reform-oriented dialogue on enhancing competitiveness in key sectors or clusters can mobilize action on critical impediments influencing costs.

[34] Meneval and Saadani, 2009.

Innovation and Competitiveness

Beyond broad policy reforms, private sector development involves building industries that can compete in global markets and create demand at home for labor, inputs and services. The ability of individual industries to grow depends on effectively competing in global and regional markets. Often, however, this competitiveness is constrained because of inappropriate policies and regulations, insufficient hard and soft infrastructure services or lack of financing and technology. A number of countries have managed to develop new industries that managed to compete effectively in global markets. Whether in electronics in Malaysia and Singapore, car parts and assembly in Morocco or salmon from Chile, Governments often play an active role in creating the foundation for sustained and strong private sector expansion and job creation. Iraq faces a challenge in mobilizing the private sector at the industry level to create new opportunities in the global economy. Scientific and factual analytics at the industry level can help the Iraqi Government and private sector to form sector-specific agendas to work together to define opportunities and remove constraints.

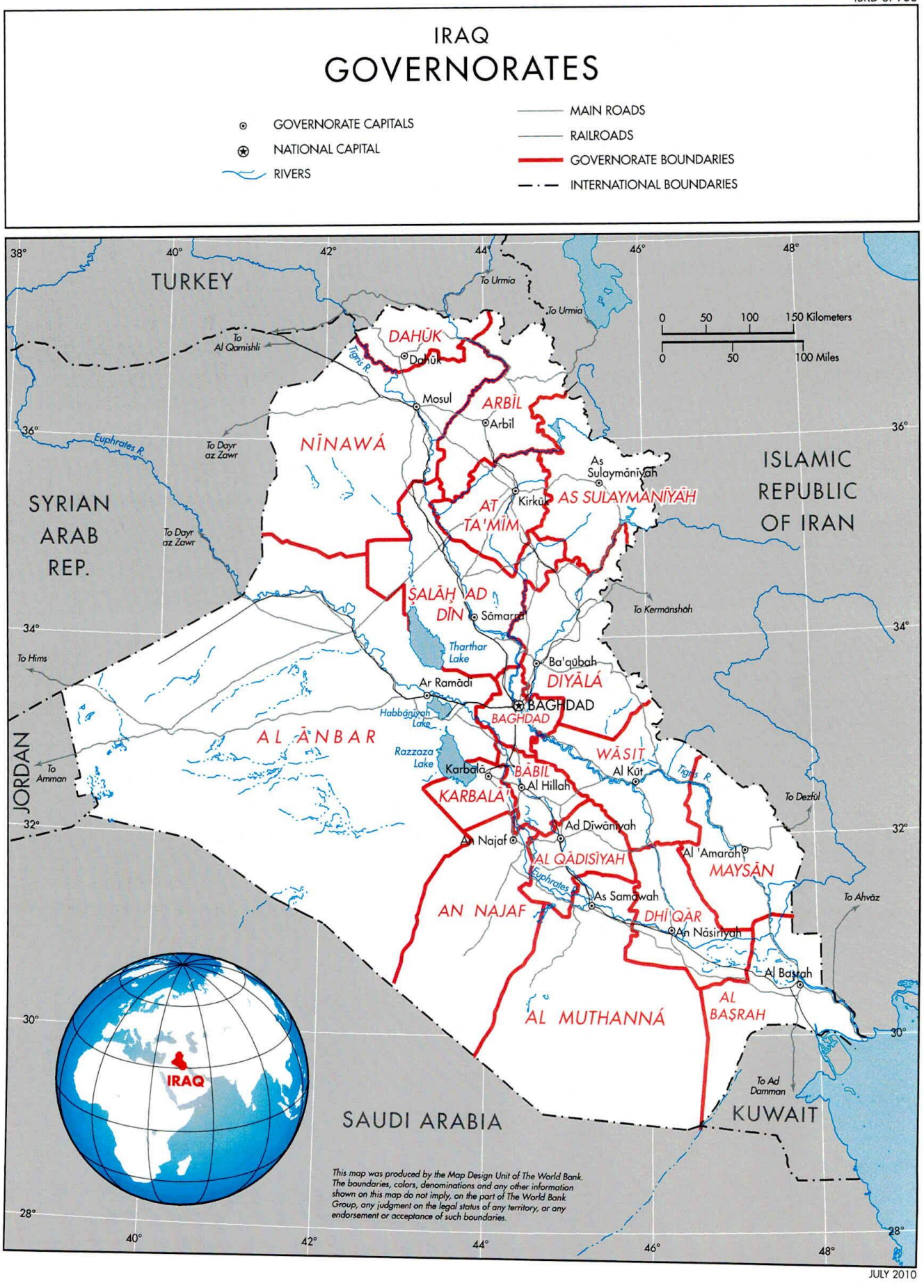
Further, strengthening the standards infrastructure and harmonizing Iraqi standards with international standards, as a means to enhance competitiveness, ease compliance of both domestic and foreign producers and better integrate with the international economy.

The World Bank Group and other development partners can thus provide systematic support through advisory interventions, beginning with careful benchmarking and analysis of key sectors such as construction, agribusiness, ICT and tourism; and moving to consensus-building through public-private dialogue; and then supporting a focused action plan to enhance sectoral competitiveness.

ANNEX I

Iraq at a Glance

IBRD 37966



JULY 2010

Key Development Indicators	Iraq	M. East & North Africa	Middle income
(most recent 2010)			
Population, mid-year (millions)	32.3	382.8	4,970.8
Surface area (thousand sq. km)	435	11,371	82,907
Population growth (%)	2.5	1.8	1.2
Urban population (% of total population)	66.5	57.6	—
GNI (Atlas method, US$ billions)	93	2,396	18,523
GNI per capita (Atlas method, US$)	2,380	6,384	3,726
GNI per capita (PPP, international $)	3,370	10,732	6,751
GDP growth (%)	0.8	4.0	8.0
GDP per capita growth (%)	23.1	1.6	5.6
(most recent estimate, 2003–2009)			
Poverty headcount ratio at $1.25 a day (PPP, %)	—	3.6	—
Poverty headcount ratio at $2.00 a day (PPP, %)	22.9[a]	17	—
Life expectancy at birth (years)	68	72	69
Infant mortality (per 1,000 live births)	31	26	38
Child malnutrition (% of children under 5)	7	12	—
Adult literacy, male (% of ages 15 and older)	86	82	88
Adult literacy, female (% of ages 15 and older)	70	65	77
Gross primary enrollment, male (% of age group)	106	105	110
Gross primary enrollment, female (% of age group)	89	98	107
Access to an improved water source (% of population)	79	89	90
Access to improved sanitation facilities (% of population)	73	89	59

(continued on next page)

EXCHANGE RATE

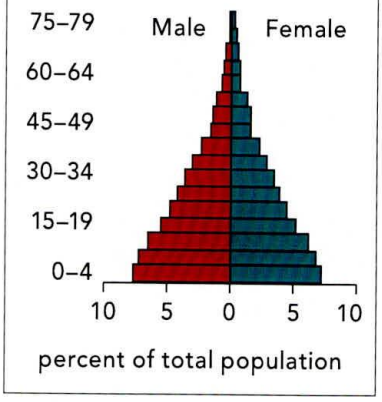
(As of January 31, 2012)

Currency unit: Iraqi Dinar (IQD)
US$ 1 = 1,165.50 IQD

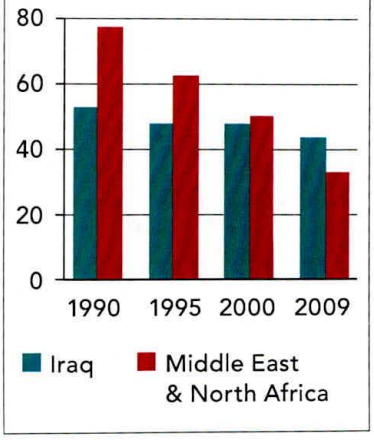
FISCAL YEAR

January 1–December 31

Age distribution, 2008

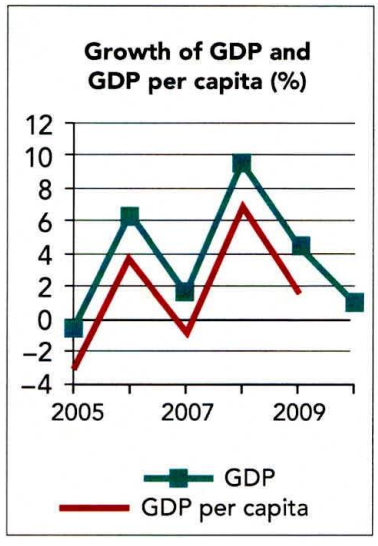


Under-5 mortality rate (per 1,000)



Net Aid Flows	1990	2000	2010
(US$ millions)			
Net ODA and official aid	63	102	2,192
Top 3 donors (in 2010):			
United States	—	—	1,623
Japan	—	—	144
European Commission	—	—	54
Aid (% of GNI)	0.12	—	3
Aid per capita (US$)	3.34	3.96	68
Long-Term Economic Trends			
Consumer prices (annual % change)	—	—	3.3
GDP implicit deflator (annual % change)	—	3.61	25.22
Exchange rate (annual average, local per US$)	0.31	1930	1170
Terms of trade index (2000 = 100)	—	100	141
Population, mid-year (millions)	18.9	25.1	32.3
GDP (US$ millions)	48,422	25,857	81,112
Agriculture	—	5.4	8.6
Industry	—	84.4	70.1
Manufacturing	—	0.9	17.0
Services	—	10.3	21.3
Household final consumption expenditure	—	—	46
General gov't final consumption expenditure	—	—	42
Gross capital formation	—	—	29
Exports of goods	—	—	62.6
Imports of goods	—	—	56.3
Gross savings	—	—	27.7

Note: Figures in italics are for years other than those specified. 2010 data are preliminary.
— indicates data are not available. [a] Data from Iraq Poverty Report.
Development Economics, Development Data Group (DECDG).



1980–1990	1990–2000	2000–2010
(Average annual growth %)		
3.4	3.3	2.9
0.2	–4.7	21.4
—	—	5.9
—	—	–1.7
—	—	178.9
—	—	10.7
—	—	—
—	—	—
—	—	—
—	—	—
—	—	—

Balance of Payments and Trade	2010	2011 (est)
(US$ millions)		
Total merchandise exports (fob)	50,753	78,122
Total merchandise imports (cif)	45,644	55,380
Net trade in goods and services	5,109	22,742
Current account balance	–1,422	9,069
as a % of GDP	–1.8	7.9
Workers' remittances and		
compensation of employees (receipts)	—	—
Reserves, including gold	50,632	61,064
Central Government Finance		
(% of GDP)		
Current revenue (including grants)	75.6	77.2
Tax revenue	1.6	1.3
Current expenditure	59.2	49.5
Overall surplus/deficit	–9.1	7.4
Highest marginal tax rate (%)		
Individual	—	—
Corporate	—	—
External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	87,169	88,492
Total debt service	—	—
Debt relief (HIPC, MDRI)	—	—
Total debt (% of GDP)	106.7	37.1
Total debt service (% of exports)	165.8	56.6
Foreign direct investment (net inflows)	1,271	2,095
Portfolio equity (net inflows)	—	—

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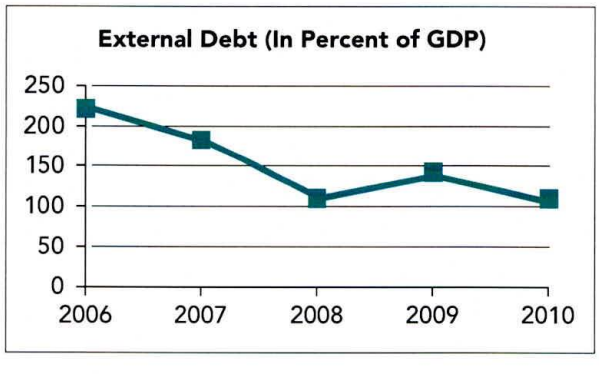

Private Sector Development	2000	2011
Time required to start a business (days)	–	77
Cost to start a business (% of GNI per capita)	–	115.7
Time required to register property (days)	–	51
Ranked as a major constraint to business	**2000**	**2011**
(% of managers surveyed who agreed)		
n.a.	—	—
n.a.	—	—
Stock market capitalization (% of GDP)	—	—
Bank capital to asset ratio (%)	—	—
Technology and Infrastructure	**2000**	**2010**
Paved roads (% of total)	84.3	—
Fixed line and mobile phone		
subscribers (per 100 people)	3	80
High technology exports		
(% of manufactured exports)	—	*0.1*
Environment		
Agriculture land (% of land area)	21	*20*
Forest area (% of land area)	1.9	1.9
Nationally protected areas (% of land area)	—	*0.1*
Freshwater resources per capita (cu. meters)	*1,333*	1,132
Freshwater withdrawal (billion cubic meters)	66.0	—
CO2 emissions per captiva (mt)	3.0	*3.3*
GDP per unit of energy use		
(2005 PPP $ per kg of oil equivalent)	4.4	*3.2*
Energy use per capita (kg of oil equivalent)	1,011	*1,034*

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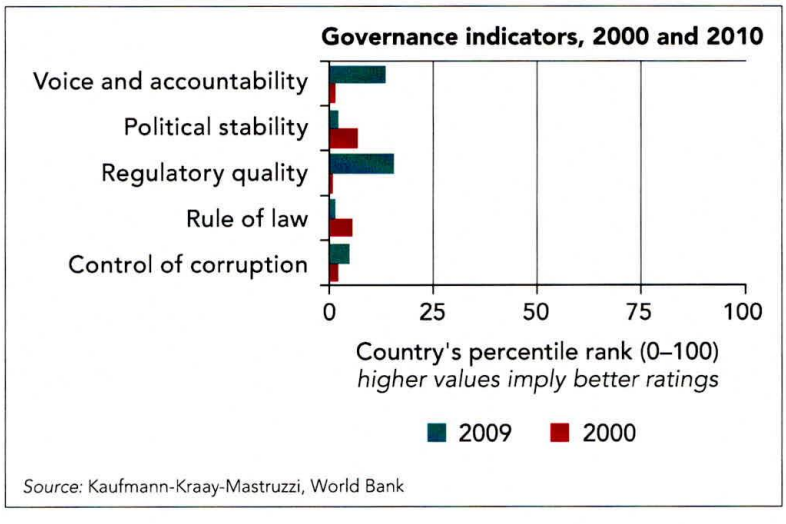

Source: Kaufmann-Kraay-Mastruzzi, World Bank

World Bank Group portfolio	2000	2011[b]
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	–	250
Disbursements	–	250
Principal repayments	–	0
Interest payments	–	3
IDA		
Total debt outstanding and disbursed	–	508
Disbursements	–	150
Total debt service	–	0
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	–	15.9
of which IFC own account	–	15.9
Disbursements for IFC own account	–	15.9
Portfolio sales, prepayments and		
repayments for IFC own account	–	0
MIGA		
Gross exposure	–	5
New guarantees	–	5

Note: Figures in italics are for years other than those specified. 2009 data are preliminary.
— indicates data are not available.
– indicates observation is not applicable. b. As of March 22nd, 2012 Development Economics, Development Data Group (DECDG).

Millennium Development Goals

With selected targets to achieve between 1990 and 2015 (estimate closest to date shown, +/– 2 years)	Iraq			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2010**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	—	—	—	—
Poverty headcount ratio at national poverty line (% of population)	—	—	—	—
Share of income or consumption to the poorest quintile (%)	—	—	—	—
Prevalence of malnutrition (% of children under 5)	11.9	22.6	15.9	—
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	76	74	86	—
Primary completion rate (% of relevant age group)	58	—	56	—
Secondary school enrollment (gross, %)	40	38	37	—
Youth literacy rate (% of people ages 15–24)	—	—	85	83
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	79	79	77	—
Women employed in the nonagricultural sector (% of nonagricultural employment)	—	—	16	12.1
Proportion of seats held by women in national parliament (%)	11	—	6	25
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	46	45	43	39
Infant mortality rate (per 1,000 live births)	37	36	34	31
Measles immunization (proportion of one-year olds immunized, %)	75	80	87	73
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	89	84	78	63
Births attended by skilled health staff (% of total)	54	—	72	—
Contraceptive prevalence (% of women ages 15–49)	14	—	44	—
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15–49)	—	—	—	—
Incidence of tuberculosis (per 100,000 people)	64	64	64	64
Tuberculosis cases detected under DOTS (%)	130	75	64	48
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	81	80	80	79
Access to improved sanitation facilities (% of population)	—	67	69	73
Forest area (% of total land area)	1.8	1.9	1.9	1.9
Nationally protected areas (% of total land area)	0.1	0.1	0.1	0.1
CO2 emissions (metric tons per capita)	2.9	3.7	3.0	3.0
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	—	—	4.4	3.0

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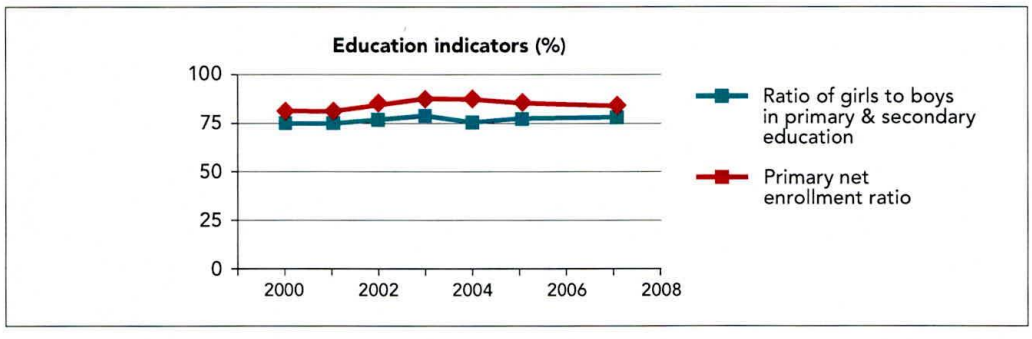
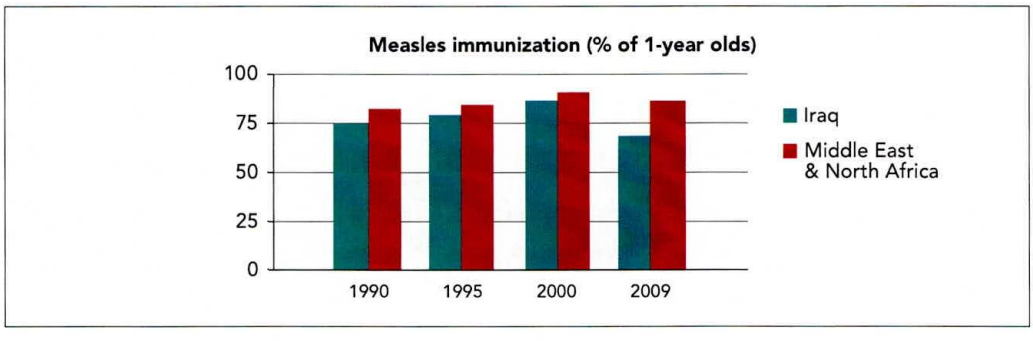
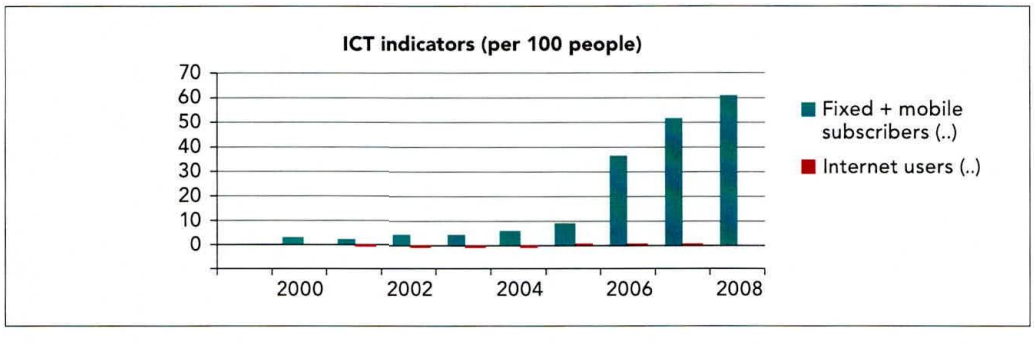
With selected targets to achieve between 1990 and 2015 (estimate closest to date shown, +/– 2 years)	Iraq			
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	3.9	3.0	2.7	5.0
Mobile phone subscribers (per 100 people)	0.0	0.0	0.0	75
Internet users (per 100 people)	—	—	0.1	2.5
Personal computers (per 100 people)	—	—	0.8	—







Note: Figures in italics are for years other than those specified.
— indicates data are not available.
Development Economics, Development Data Group (DECDG).

Selected Macroeconomic Indicators

	2006	2007	2008	2009	2010e	2011p	2012p
Economic growth and prices							
Nominal GDP (US$ billion)	45.1	57.0	86.5	64.2	81.1	111.1	118.7
Real GDP (% change)	6.2	1.5	9.5	4.2	0.8	9.6	12.6
of which non-oil GDP (% change)	*7.5*	*–2.0*	*5.4*	*4.0*	*4.5*	*5.0*	*5.5*
GDP per capita (US dollars)	1,568	1,926	2,845	2,056	2,531	3,381	3,528
Oil production (million bpd)	2.0	2.0	2.29	2.38	2.35	2.65	3.10
Oil exports (million bpd)	1.40	1.59	1.82	1.88	1.85	2.10	2.50
Consumer price index (% change)	64.8	4.7	6.8	–4.4	3.3	5.0	5.0
National Accounts							
Gross domestic investment	15.4	17.7	33.4	29.3	29.4	31.3	36.9
of which public	13.9	13.6	31.4	25.6	25.5	27.2	32.1
Gross domestic consumption	72.1	66.0	49.4	90.2	73.0	69.0	66.6
of which general government	38.6	38.7	36.2	60.2	42.0	38.1	38.3
Gross national savings	30.8	30.2	52.5	15.5	26.2	29.8	32.4
of which public	28.2	28.7	30.1	–0.9	15.8	18.0	22.0
Fiscal and oil sector accounts							
Revenues and grants	80.7	84.3	85.8	80.3	75.6	74.6	73.0
of which oil revenues[1]	65.5	74.0	72.8	62.4	65.4	68.7	67.1
Expenditures	66.5	71.9	87.1	102.4	84.7	83.0	84.6
Operating expenditures	52.6	55.0	55.7	80.6	59.2	55.7	52.6
Capital expenditures	13.9	13.6	31.4	25.6	25.5	27.2	32.1
Overall fiscal balance (including grants)	14.2	12.4	–1.3	–22.1	–9.1	–8.4	–11.6
Balance of Payments							
Current account balance	18.9	12.5	19.2	–13.8	–3.2	–1.5	–4.5
Trade balance	27.1	23.3	24.5	–9.5	6.3	10.0	7.1
Merchandise exports	66.3	66.4	71.7	59.8	62.6	67.7	66.4
of which oil (in percent of total exports)	*97.7*	*98.2*	*98.6*	*99.5*	*98.7*	*98.8*	*98.4*
Merchandise imports	39.1	43.1	47.2	69.3	56.3	57.7	59.3
External Public Debt							
Estimated Debt Stock (US$ billion)	99.0	103.1	95.6	92.5	97.0	47.2	55.1
(in percent of GDP)	219.6	181.0	110.5	137.9	106.7	37.1	32.6
(in percent of exports)	*327.6*	*266.5*	*150.4*	*221.2*	*165.8*	*56.6*	*48.8*
Memorandum Items							
Iraqi oil price (US$ per barrel)	55.2	63.0	91.5	55.6	74.2	97.0	85.0
Gross Reserves (US$ billion)	20.0	31.5	50.2	44.3	50.6	57.2	65.1
Gross reserves in months of imports	*9.3*	*7.8*	*11.3*	*9.6*	*7.8*	*8.0*	*8.6*
Primary fiscal balance (in percent of GDP)	14.8	13.3	–0.8	–21.6	–8.3	–7.3	–10.6
Exchange rate, ID per US$1 (period average)	1,467	1,255	1,193	1,170	1,170	1,170	—

Source: Iraq authorities and IMF staff estimates.
(1) Including revenues of oil-related public enterprises. (2) APSP (average petroleum spot price) is a simple average of UK Brent, Dubai, and West Texas Intermediate spot prices reflecting world exports of light, medium, and heavy crude oil.

ANNEX II

Doing Business Reforms

Indicator	2012	2011	Change in rank from last year	Global Best Practice (2012)	Regional Best Practice (2012)
Starting a Business					
Rank	*176*	*174*	*–2*	*New Zealand*	*Saudi Arabia (13)*
Procedures (number)	11	11	—		
Time (days)	77	77	—		
Cost (% of income per capita)	115.7	107.8	–7.9		
Min. capital (% of income per capita)	35.5	43.6	+8.1		
Dealing with Construction Permits					
Rank	*120*	*102*	*–18*	*Hong Kong (China)*	*Saudi Arabia (4)*
Procedures (number)	13	14	+1		
Time (days)	187	215	+28		
Cost (% of income per capita)	469.8	506.8	+37		
Getting Electricity					
Rank	*46*	*47*	*+1*	*Iceland*	*United Arab Emirates (10)*
Procedures (number)	5		—		
Time (days)	47	47	—		
Cost (% of income per capita)	609.9	60.6	+50.7		
Registering Property					
Rank	*98*	*96*	*–2*	*Saudi Arabia*	*Saudi Arabia (1)*
Procedures (number)	5	5	—		
Time (days)	51	51	—		
Cost (% of property value)	6.9	6.4	–0.5		
Getting Credit					
Rank	*174*	*168*	*–6*	*United Kingdom*	*Saudi Arabia (48)*
Legal Rights Index	3	3	—		
Credit Information Index	0	0	—		
Public registry coverage (% adults)	0	0	—		
Private bureau coverage (% adults)	0	0	—		
Protecting Investors					
Rank	*122*	*120*	*–2*	*New Zealand*	*Saudi Arabia (17)*
Disclosure Index	4	4	—		
Director Liability Index	5	5	—		
Shareholder Suits Index	4	4	—		
Investor Protection Index	4.3	4.3	—		

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Indicator	2012	2011	Change in rank from last year	Global Best Practice (2012)	Regional Best Practice (2012)
Paying Taxes					
Rank	*49*	*46*	*–3*	*Maldives*	*Qatar (2)*
Payments (number)	13	13	—		
Time (hours)	312	312	—		
Total tax rate (% profit)	28.4	28.4	—		
Trading Across Borders					
Rank	*180*	*179*	*–1*	*Singapore*	*United Arab Emirates (5)*
Documents for export (number)	10	10	—		
Time for export (days)	80	80	—		
Cost to export (US$ per container)	3,550	3,550	—		
Documents for import (number)	10	10	—		
Time for import (days)	83	83	—		
Cost to import (US$ per container)	3,650	3,650	—		
Enforcing Contracts					
Rank	*140*	*140*	—	*Luxembourg*	*Yemen, Rep. (38)*
Procedures (number)	51	51	—		
Time (days)	520	520	—		
Cost (% of debt)	28.1	28.1	—		
Closing a Business					
Rank	*183*	*183*	—	*Japan*	*Bahrain (25)*
Time (years)	No Practice	No Practice	—		
Cost (% of estate)	No Practice	No Practice	—		
Recovery rate (cents on the dollar)	0	0	—		
Overall ease of doing business	**164**	**159**		**Singapore**	**Saudi Arabia (12)**

Suggested Reforms to Improve Iraq's Ease of Doing Business

Suggested Reforms	Short-Term	Medium -Term
Starting a business	Reduce number of procedures, cost and time to register a company by: • Eliminating the minimum capital requirement; • Introducing standard articles of association and making lawyers' involvement in signing incorporation documents optional; • Replacing the publication of incorporation in a local newspaper with electronic publication on the Ministry of Trade website; • Eliminating the requirement for a company seal; • Eliminating the requirement to obtain and legalize special company books.	Further reduce procedures, time and cost to register a company by: • Implementing an integrated system for checking the uniqueness of the company name; • Eliminating the requirement to obtain a business license from the municipality for companies not operating in the sectors related to public health or safety; • Consolidating government approvals and payment of fees at one access point; • Making online registration possible.
Dealing with construction permits	Reduce number of procedures, cost and time to obtain a construction permit by: • Improving process guidelines that are available online and at the Baghdad Municipality; • Establishing risk-based guidelines for obtaining a location clearance from the regional authority; • Eliminating the requirement to obtain an approval from the Ministry of Communications on certain construction projects; • Streamlining the process for obtaining a clearance on completed construction approval from the National Center of Construction Laboratory.	Further reduce procedures, cost and time to obtain a construction permit by: • Adopting a unified construction code; • Consolidating location clearances by updating zoning regulations and digitizing city zoning maps; • Establishing a one-stop shop for building permit clearances; • Developing an online system for processing construction permits;
Registering property	Reduce procedures, cost and time to transfer property by: • Introducing "fast-track" procedures in property registration process; • Mapping internal processes at the property registry in order to identify bottlenecks; • Unifying the valuation of properties completed by the Real Property Registry Office and the Tax authority and establishing standardized ways of valuing properties.	Further reduce procedures, cost and time to transfer property by: • Computerizing municipal property records; • Investigating options to lower the fees to register properties or introducing a flat fee for property registration; • Creating a single-access point for property transactions.

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Suggested Reforms to Improve Iraq's Ease of Doing Business *(continued)*

Suggested Reforms	Short-Term	Medium -Term
Getting credit		Strengthen the rights of borrowers and lenders by amending the securities laws to allow more flexibility in secured transactions law by: • Introducing the possibility of a non-possessory security pledges in a single category of revolving movable assets; • Ensuring that non-possessory security pledges allow a general description of the collateral without requiring a specific description of the collateral; • Allowing that a security right extend to future or after-acquired assets, and extend automatically to the products, proceeds or replacements of the original assets; • Allowing for general description of debts and obligations in collateral agreements and in registration documents so that all types of obligations and debts can be secured by stating a maximum rather than a specific amount between the parties; • Establishing a collateral registry that is computerized, unified geographically, and that is indexed by the name of the grantor of a security right; • Developing a predictable priority system that would grant as high of a priority to secured creditors both outside bankruptcy proceedings as possible; • Authorizing parties to agree on out of court enforcement of debt obligations. Facilitate access to credit information by introducing a public credit registry at the Central Bank of Iraq that: • Includes both firms and individuals, • Collects and distributes positive and negative information, • Covers at least 0.1% of the adult population, • Includes historical information for more than 2 years, • Distributes data on all loans (or at least loans below 1% of income per capita and coverage of above 1% of adult population), • Collects credit information from retailers, trade creditors, utility companies and financial institutions, • Guarantees that borrowers can inspect their data. Further improve score on the Credit information index by: • Transferring the task of credit information sharing to a private credit bureau.

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Suggested Reforms to Improve Iraq's Ease of Doing Business *(continued)*

Suggested Reforms	Short-Term	Medium -Term
Protecting investors	Increase investor protections by: • Requiring shareholders approval of large related-party transactions; • Mandating disclosure of personal conflicts of interest by company directors and officers; • Increasing disclosure obligations in the annual reports in case of related-party transactions; • Requesting an independent assessment of large related-party transactions before approval; • Providing shareholders with rights to hold the directors and the approving body liable for damages resulting from a related-party transaction; • Stating clearly in the law the directors' duties to act appropriately when operating the company. • Allowing shareholders to have access to any documents of the company; • Granting shareholders the right to request for the appointment of a government inspector;	Make it easier for investors to enforce their rights through the courts by: • Allowing plaintiffs to request categories of documents from the defendant without identifying specific ones; • Allowing parties to a trial to directly question (orally or in writing) the opposing party and witnesses during trial; • Offering shareholders owning 10% or less of shares inspect transaction documents before filing suit.
Paying taxes	Reduce the number of payments and time to pay taxes by: • Improving accessibility of tax rules and regulations.	Further reduce the number of payments and time to pay taxes by: • Making it optional to pay social security on a quarterly (rather than monthly) basis for those firms that would so prefer; • Introducing electronic filing and payment of taxes.
Trading across borders	Reduce the number of documents and time to trade by: • Streamlining the document requirements for trading.	Further reduce the number of documents and time to trade by: • Introducing risk-based inspections to reduce number of physical inspections of the goods • Allowing for electronic submission of documentation • Creating a single window for trade transactions.

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Suggested Reforms to Improve Iraq's Ease of Doing Business *(continued)*

Suggested Reforms	Short-Term	Medium -Term
Enforcing contracts	Reduce the time to enforce a contract by: • Setting limits on the number and duration of adjournments, and allowing for active case management by the judge; • Collecting statistics on the performance of the judiciary; • Mapping processes at the courts to identify points of delay.	Further reduce the time to enforce a contract by: • Establishing a specialized commercial chamber or court; • Introducing simplified rules for undisputed and small claims.
Closing a business	Improve insolvency procedures by: • Undertaking a review of the insolvency system in order to understand the reason of the limited number of insolvency proceedings in Iraq.	Further improve insolvency procedures by: • Developing a proper legal framework giving companies the option to be sold as a going concern; • Adopting guidelines that facilitate out-of-courts workouts; • Improving efficiency of the judicial system.

ANNEX III

Gap Analysis Methodology

The Iraq ICA uses a standard World Bank 'gap analysis' methodology to compare the productivity of firms in different countries and illustrate the relative effect of business environment on firm-level productivity using the recent enterprise survey data for manufacturing firms. In this framework, we assume the existing business environment in a country of choice (in this case, Morocco based on results from latest available enterprise survey conducted in 2007) as the base-level scenario to assess the gap between productivity levels of firms in comparator countries and Iraq.

The prevailing business environment in a country and their relative effect on firm performance is accounted for by factoring in information available on total sales, material, labor and capital stock of the firms in these countries. All the relevant variables are converted to international dollars using the purchasing power parity exchange rates for comparability for firm performance across countries. The data for implied PPP exchange rates are obtained from IMF's WEO database. To control for outliers, all data points that exceed three standard deviations from the mean of any single variable used in the regression are dropped. The regression analysis conducted for this purpose and a detailed description of variables and other technical details are presented below.

Variables description

- **The sales variable**: Sales – log (Total sales/PPP exchange rate) using total sales during the last complete fiscal year.
- **The labor variable**: Cost of labor – log (Total labor /PPP exchange rate) using total annual cost of labor including wages, salaries, bonuses and social payments.
- **The material variable:** Material – log (Material/PPP exchange rate) using total annual cost of raw materials and intermediate goods used in production.
- **The capital stock variable:** Capital stock—log(capital stock/ PPP exchange rate) using the net book value of machinery, vehicles and equipment—the value of assets after accounting for depreciation.

Firm size category	Specification
Small	Labor ≥5 & ≤19
Medium	Labor ≥20 & ≤99
Large	Labor ≥100
Industrial sector	**Description**
Food & processing	Food
Textiles and garments	Textiles, garments, leather tanning and configured
Electronics	Electronics
Chemicals, Pharmaceuticals and non-metal	Chemicals, non-metallic mineral products, plastics and rubber
Metal and equipment	Basic metals, fabricated metal products, machinery and equipment

- **List of comparator countries:** The countries used for comparison and the respective years of firm-level survey used for each country is specified below: Algeria (2007), Egypt (2008), Jordan (2006), Lebanon (2009), Libya (2009), Morocco (2007), Syria (2009), West Bank and Gaza (2006), Yemen (2010) are used with Iraq (2011).

Firm size classification and industrial sector

Productivity performance is also assessed by firm size and sector. For comparability of performance across countries, standardized definitions of firm size and a common classification of industrial sectors in manufacturing firms need to be employed:

- **Specification of regression used**: $\log Y = \alpha \log L + \beta \log K + \gamma \log M + \varepsilon$ Where, Y is firms' output proxied by total sales, L is labor proxied by total cost of employing labor, M denotes intermediate raw materials used in production and K is the total capital stock. and ε is the error term.
- **The gap analysis:** $P(X) - P(Y) = \text{Gap}$ where P(X) stands for the productivity of the base country (Morocco in our analysis) and P(Y) is the productivity of the comparator country. The coefficients are normalized to '100' scale for better interpretation purposes.

ANNEX IV

Productivity and Investment Climate Conditions

Two techniques are used to estimate the determinants of productivity:[35]

1. The **traditional two-step approach**: in the first step, firms' output (sales) is regressed on labor (log of number of workers), materials (log of cost of material inputs), and capital stock (i.e. log of net book value of fixed assets), and in the second step, the residuals (also Total Factor Productivity) from the first stage are regressed on the investment climate and firm characteristics variables and;
2. A **one-step approach**, where the investment climate variables are included in the TFP (or first stage regression) since inputs for TFP may be correlated with investment climate variables[36]; i.e.

$$\log Y_{it} = \alpha_L \log L_{it} + \alpha_M \log M_{it} + \alpha_K \log K_{it} + \alpha'_{IC} IC_{P,i} + \alpha'_C C_{P,i} + \alpha'_{DR} D_r + \alpha'_{Ds} D_j + \alpha'_{DT} D_t + \alpha_P + u_{it}$$

where, Y is firms' output (sales), L is labor, M denotes intermediate materials, K is the capital stock, IC and C are time-fixed effect vectors of other investment climate and control time-fixed effects (firm characteristics), and Dr, Dj and Dt are the vectors of state, industry and year dummies.

The investment climate variables are:

1. **Infrastructure & Services**: (a) 3 dummy variables each taking the value of one if water, electricity, and telecommunication, respectively, are the major obstacles confronting firms and zero otherwise), (b) a dummy for use of email in interactions with client suppliers; and (c) another dummy for use of website;
2. **Business-Government Relations:** (a) Percentage of management time spent complying with regulatory requirements; (b) a "bribe" dummy variable for whether or not the firm makes gifts or informal

[35] The enterprise survey only covered the formal private sector, hence the analysis does not include the Government sector or the informal sector.

[36] See Escribano, Alvaro and J. Luis Guasch (2004).

payments to public officials to *contracts*; (c) Dummy for whether labor regulations are the most important deterrents to changing employee numbers;

3. **Degree of Competition**: (a) dummy variable taking the value of one if pressure from local competitors is "fairly / very important", or zero otherwise; (b) another dummy for foreign competitors;
4. **Capacity Innovation and Learning:** (a) dummy variable for "quality" i.e. whether the firm has an internationally-recognized quality certification, (b) dummy variable for "foreign technology" i.e. whether the firm uses foreign licensed technology, (c) dummy for whether the firm developed a new process or technology to reduce cost;
5. **Crime:** (a) a dummy variable for "theft" i.e. whether the firm experienced losses to theft, robbery, vandalism, or arson, (b) a dummy for "security" i.e. whether the firm paid for security the previous year;
6. **Finance:** three dummy variables for each of 'access to loans' (whether the firm has a loan from a financial institution) and 'access to overdrafts' (i.e. whether the firm has an overdraft), and 'audited'(i.e. whether firm is audited or not); a dummy for "finance constrained" firms i.e. firms barred from making credit applications due to high interest rates, burdensome application procedure, strict collateral requirements, corruption in credit allocation(it is necessary to have contacts or make informal payments to get the loan), and firms whose applications were turned down;
7. **Labor Relations**: (a) number of years (in logs) of managerial experience, (b) a "training" dummy—if the firm's permanent staff have received training internally or externally; and,
8. **Firm characteristics**: (a) age of firm (in logs), (b) percentage of the firm owned by foreign nationals,[37] (c) percentage of the firm owned by the government (d) gender – dummy for female-owned firms, (e) percentage of sales exported, (f) percentage of inputs purchased from abroad, and (g) industrial sector dummies (for food, textile, garment, chemical, plastic, mineral, basic metals, fabricated metal products, machinery and equipment, electronics, and construction industries).

A correlation matrix is employed to test multicollinearity among explanatory variables. There was no suggestive evidence for the existence of multicollinearity. The models are estimated (using robust-OLS) on the data of 346 Iraqi manufacturing firms and the results are presented below:

The results of both techniques are qualitatively similar.

Main findings:[38]

- Excessive government regulation is counter-productive: the higher the degree of regulation (reflected in terms of the percentage of total time spent by senior management to grapple with government regulation) lower the productivity.

[37] The 2011 enterprise survey in Iraq contains limited number of foreign owned, exporting, and large firms (reflecting the structure of the formal economy), which limits the analysis and the significance of any reference to such categories.

[38] To better understand variations in firm productivity at the sectoral and regional levels an extensive survey coverage is required.

- Productivity in leather, non-metallic products, furniture and fabricated metal product sectors is higher than in other sectors.
- Though not many firms in Iraq (only about 11%) consider labor laws (like social insurance) a seriously binding constraint, they do affect firm productivity negatively.
- The security situation in Iraq impacts firm productivity negatively. Firms that are concerned about safety spend on security services, personnel and equipment and are relatively less productive than firms that don't perceive such a threat to their operations. Almost three fourths of all firms in Iraq report political instability in the country to be the most binding constraint. In terms of firm perception, this is only behind electricity as the most severe constraint.
- Female ownership of firms enhances productivity. Firms that have female ownership are positively related to productivity, controlling for other firm characteristics. This is consistent with a growing body of literature and international experience pointing to the advantages of fair competition and gender-inclusive societies in making economies more productive and competitive.

Variable	One-step estimation	Two-step estimation
Senior management time spent in dealing with regulations	(–0.01)***	(–0.01)*
Constrained by labor laws	(–0.06)*	(–0.08)**
Paid for security services (safety constrained)	(–0.12)††	(–0.40)***
Female ownership	(0.30)**	(0.24)†
Leather sector	(0.94)***	(0.72)***
Non-metallic mineral products sector	(0.54)**	(0.34)**
Fabricated metal products sector	(0.54)**	(0.43)**
Furniture sector	(0.41)††	(0.22)†

Notes: Figures in parenthesis are the values of the regression coefficients.
***, **, * denote statistical significance at the 1%, 5%, and 10% levels.
††,† denote statistical significance at the 15% and 20% levels

ANNEX V

Survey Methodology

- **Enterprise Survey Methodology:** An Enterprise Survey is a firm-level survey of a representative sample of an economy's private sector. The surveys cover a broad range of business environment topics including access to finance, corruption, infrastructure, crime, competition, and performance measures. The World Bank has collected this data from face-to-face interviews with top managers and business owners in over 130,000 companies in over 135 economies. More detailed information about the Enterprise Surveys can be found on the Enterprise Surveys website (http://www.enterprisesurveys.org/).

  This annex provides a brief description of the Iraq Enterprise Survey. It outlines the survey implementation methods, sample description as well as additional information that may be useful when using the data or following the Iraq Investment Climate Assessment. Data was collected in Iraq between February and December of 2011.

- **Who Conducts the Surveys:** Due to sensitive survey questions addressing business-government relations and governance-related topics, private contractors, rather than any government agency or an organization/institution associated with government, are hired by the World Bank to collect the data. Confidentiality of the survey respondents and the sensitive information they provide is necessary to ensure the greatest degree of survey participation, integrity and confidence in the quality of the data. Surveys are usually carried out in cooperation with business organizations and government agencies promoting job creation and economic growth, but confidentiality is never compromised.

  Given the sample design, a complete and updated list of establishments as well as information on all critical variables (number of employees, business sector, and location) are required to draw the sample. Central Organization for Statistics – COSIT (with the cooperation of the Kurdistan Regional Statistical Office – KRSO and Chambers of Commerce) provided the World Bank with a total of 1,065 firms in total.

- **Who is Surveyed:** The Enterprise Survey is answered by business owners and top managers. Sometimes the survey respondent calls company accountants and human resource managers into the interview to answer questions in the sales and labor sections of the survey. Typically 1,200–1,800 interviews are conducted in larger economies, 360 interviews are conducted in medium-sized economies, and for smaller economies, 150 interviews take place.

  Typically, the manufacturing and services sectors are the primary business sectors of interest in conducting Enterprise Surveys. This corresponds to firms classified with ISIC codes 15–37, 45, 50–52, 55, 60–64, and 72 (ISIC Rev.3.1). Formal (registered) companies with 5 or more employees are targeted for interview. Services firms include construction, retail, wholesale, hotels, restaurants, transport, storage, communications, and IT. In each country, businesses in the cities/regions of major economic activity are interviewed.

  In the Iraq Enterprise Survey, adequate representation was given to firms of all sizes, industries and locations in the final sample of establishments. Six broad business categories are covered by the survey—food, non-metallic mineral products, chemicals/rubber products, other manufacturing, retail/wholesale, and other services. Size was defined by 3 levels following the standardized definition for the Enterprise Surveys: small (5 to 19 employees), medium (20 to 99 employees), and large (more than 99 employees). The number of employees was defined on the basis of reported permanent full-time workers. Similarly, regional coverage included 10 sub-national locations (Governorates) in Iraq: Ninewa, Kirkuk, Baghdad, Babil, Karbala, Najaf, Thi-Qar, Basrah, Sulaymaniyah, and Erbil. These 10 governorates were chosen by COSIT (http://cosit.gov.iq/english/) with the cooperation of KRSO (http://www.krso.net/).

- **The Survey Structure:** The Enterprise Surveys utilize two instruments: the Manufacturing Questionnaire and the Services Questionnaire. Although many questions overlap, some are only applicable to one type of business. For example, retail firms are not asked about production and nonproduction workers. The standard Enterprise Survey topics include firm characteristics, gender participation, access to finance, annual sales, costs of inputs/labor, workforce composition, bribery, licensing, infrastructure, trade, crime, competition, capacity utilization, land and permits, taxation, informality, business-government relations, innovation and technology, and performance measures.

  Over 90% of the questions objectively ascertain characteristics of a country's business environment. The remaining questions assess the survey respondents' opinions on what are the obstacles to firm growth and performance. English questionnaires (Manufacturing and Services Questionnaires) were provided to the implementing contractor for translation to Arabic and Kurdish. The translated questionnaires were back-translated into English by a third party so that instances of sub-optimal translation could be identified and corrected.

- **Non-response:** Survey non-response must be differentiated from item non-response. The former refers to refusals to participate in the survey altogether whereas the latter refers

to the refusals to answer some specific questions. As with all surveys, Enterprise Surveys suffer from both problems and different strategies were used to address these issues.

Item non-response was addressed by two strategies: (i) For sensitive questions that may generate negative reactions from the respondent, such as corruption or tax evasion, enumerators were instructed to collect the "refusal to respond" as a different option from "don't know"; (ii) Establishments with incomplete information were re-contacted in order to complete this information, whenever necessary. However, there were clear cases of low response.

Survey non-response was addressed by maximizing efforts to contact establishments that were initially selected for interview. Attempts were made to contact the establishment for interview at different times/days of the week before a replacement establishment was suggested for interview. Survey non-response did occur but substitutions were made. The number of firm contacts per realized interview was 1.37. The number of rejections per contact was 0.06. Statistical problems due to item non-response, selection bias, and faulty sampling frames are not unique to Iraq. All Enterprise Surveys suffer from these shortcomings, but in very few cases they have been made explicit.

ANNEX VI

Focus Group Discussion

On behalf of the World Bank, Asharq Research Company Ltd targeted ten governorates in Iraq in which to conduct focus group discussions. The governorates were chosen as representing the different geographical variables and ethnic groups of Iraq: Baghdad; Erbil; Basrah; Najaf; Babil; Karbala; Anbar; Sulaymaniyah; Thi Qar; Kirkuk. For participants in the discussions, Asharq field teams invited managers in manufacturing and services firms, specifically in the construction, food, plastics and chemicals sectors, and transport, storage and communications sectors, respectively. Firm sizes ranged from small (5 to 19 employees) to large (more than 99 employees).

Each focus group was asked to discuss issues in Iraq affecting business and the private sector. Their responses are summarized below:

Electricity

- Unequivocal consensus that the lack of steady electricity, weak infrastructure in the sector, and frequent outages severely impinges on the private sector as well as the general population.
- Participants also agreed that generators are the only immediate, but expensive, solution.
- Participants expressed dismay that the government has been unable to meet demand.

Imports and Exports

- Near consensus that the crippling delays in clearing imported and exported goods are generated by insufficient as well as unqualified and poorly-trained customs and border staff.
- Delays also result from corruption: bribes facilitate faster clearance of goods.
- Participants in Erbil and Sulaymaniyah noted that far fewer problems exist at land borders in the Kurdistan Region, except for crossings to the southern part of Iraq, as well as at airports.

Political Instability

- Most participants agreed that political instability has led to a lack of security, which has in turn negatively affected business. They further agreed that stability is crucial for Iraq's economic growth.

- Participants in Erbil and Sulaymaniyah remarked that the Kurdistan Region is generally more stable and secure, but is affected by instability in the rest of Iraq.
- A respondent in Anbar noted that the economy is at the whim of political parties' interests.

Corruption

- Most reported that municipal inspections are frequent and act more as extortions, with bribes or gifts expected.
- Further extortionist inspections are carried out by tax officials seeking bribes, carrying threats of levying crippling taxes.
- Participants broadly agreed that bribes greatly facilitate the establishment of electrical and water connections, as well as the obtaining of building and import licenses.
- The majority of participants agreed that government contracts are not granted based on meritocratic principles, and that nepotism, patronage, and bribery are hallmarks of the government procurement process.
- Regret and dismay was widely expressed over the fact that bribery is necessary to facilitate business in Iraq, but one respondent in Anbar pointed out that "if we don't make bribes, we will suffer and our activities will be negatively affected."

Legal System

- Participants almost universally saw the courts as corrupt and having failed to achieve justice. They noted that the government has never lost a case brought against them.
- Participants generally agreed that officials' interpretation of laws and regulations are inconsistent, unpredictable, and often serve their own interests.

Crime

- Consensus was reached that, despite improvements, crime is still a significant inhibitor of development in Iraq.
- Most participants traced the prevalence of crime to widespread unemployment.
- Firms reported spending considerably on security services.
- Participants in the Kurdistan Region noted a far lower incidence of crime than in other eight governorates surveyed.

Informality

- Participants agreed almost universally that competition from illegal businesses affects their activities.
- Respondents in Anbar and Thi Qar remarked that such competitors are backed by militias, while others believed they received government support.
- Most participants pay bribes to tax inspectors rather than filing taxes, as they feel the tax levels are too high.
- However, one participant noted that the prevalence of tax evasion has led to the frequent inspections from which all firms suffer.
- Another participant stated that if he disclosed his financial details, it would jeopardize his security.

Labor

- No consensus was reached on this issue. Some respondents said Iraq was not lacking in availability of qualified labor, while others said precisely the opposite.

- Some participants hoped that the government would open training centers to teach necessary skills.
- One participant even noted that it is the state's responsibility to develop private sector skills.
- Attitudes towards employing women also varied, with some stating there was "no room for women employment," while others said they did employ women.

State Dominance

- Remarking on the prevalence of the state in Iraq's economy one participant stated that the state should promote private establishments as partners.
- Another noted that the state no longer had as great a role as it used to, with political instability hindering reconstruction and revitalization of state assets.
- Respondents thought that the state should focus on development plans to rebuild Iraq's infrastructure, providing the fundamentals for the private sector to operate.

ANNEX VII

Summary of "Road Map" for SOE Reform

The Government of Iraq's new policy to reform its SOEs is based on a detailed "road map," created in 2010. Its focus is on the restructuring, corporatization and commercialization of SOEs (whereby they take on the organizational and managerial form of a modern commercial enterprise) rather than their privatization, though the former may facilitate the latter.

To achieve these goals, the GOI created, with assistance from the World Bank, the Task Force for Economic Reforms (TFER), which will work with line ministries to develop Restructuring Support Teams (RSTs) in each ministry. Restructuring will be gradual, and will achieve important milestones in the transformation process in three phases:

1. Stabilized operations – strategically, organizationally, and operationally. Line ministries will create Business Development Units, to work with a forthcoming Restructuring Committee.
2. Market-driven operations – driven by demand and guided by the companies' customers, and covering costs. In this transitional phase, SOE Management Boards will be established to ensure governance and corporatization of SOEs.
3. Competitive performance – optimized market position, commercially financed, and strategically partnered. The Restructuring Committee will become the Agency for Corporatization, and will manage continuing social, business, labor, and legislative reforms.

Restructuring should be a holistic overhaul of present and future operations of the SOE in order to optimize strategy, design, and implementation of its business. Throughout the process, the Government should seek to:

- Support a climate conducive to innovation and knowledge-based activity necessary for sustainable growth;
- Formulate and implement sector development strategies and policies to enhance overall competitiveness, taking into account links and integration with other sectors;

- Ensure a smooth and effective implementation of the planned institutional process and in particular ensure rapid formulation and adoption of the necessary legislative and regulatory frameworks;
- Implement all other support measures for the creation of a business environment conducive to the integration of the SOEs into the private sector, and of the conditions for development of sustainable markets;
- Introduce other measures aimed at promoting Iraqi-made products and brands in a context also of sound economic diversification and import substitution strategies.

The World Bank will expect the GOI to take the lead to achieve this by several steps:

1. Basic Priority Legislation:

   - The Economic Reform Law covering the establishment and management of the Agency for Corporatization, including bylaws and associated Governmental Acts for transfer of assets and establishing criteria, procedures and modalities for transparent asset management;
   - Investment and Company Laws;
   - Financial services and banking;
   - Support measures for excess employment, including mechanisms and tools for their absorption in the private sector;
   - Fiscal regime;
   - Performance management contracts for tasking SOEs' managers in implementing restructuring measures aimed at enhancing competitiveness and self reliance of SOEs;
   - Public Private Partnership schemes.

2. Other Support Priority Legislation:

   - Public procurement;
   - Liquidation and other forms of transformation of non-viable SOEs;
   - Competition and antitrust;
   - Bankruptcy Law;
   - Standards;
   - Customs;
   - Accounting and auditing;
   - Insurances.

3. Social mitigation package and public education programs to ensure public understanding and acceptance of the restructuring process and to support redundant employees.

4. Establishment of an SME Development Directorate (SMEDD) under the Ministry of Labor and Social Affair, which will assist SMEs in gaining access to financing needed for start-up businesses and/or expansion of existing enterprises. The GOI

will ensure that financial sector regulations effectively address SME constraints and that appropriate legal and regulatory instruments are introduced to allow assets commonly held by SMEs to be used as collateral. The GoI will undertake necessary steps to make public procurement and public-private partnerships open to the SME sector.

The GOI will need to assess its SOEs for reform on a case-by-case basis by the following actions:

1. Preparation of a Short Term Action Plan, including:

    - A Diagnostic Analysis under the responsibility of the Restructuring Units of the line ministries;
    - A potential Short Term Action Plan to achieve immediate viable objectives for improving short term performances.

2. Formulation of a Preliminary Business Appraisal and SOEs classification: Initial evaluation and classification of the viability of individual SOEs, to be classified as follows:

    - Viable, self operating, immediately attractive and ready for investments;
    - Non-self operating, but potentially viable, needing restructuring;
    - Hybrid (viable/nonviable through segmentation), needing substantial restructuring;
    - Low priority for investment/continue normal operation or liquidate company/assets.

3. In-depth diagnosis and assessments of specific SOEs by the following criteria:

    - Operations;
    - Finances;
    - Strategy;
    - Organization and governance areas;
    - Social issues.

While these actions will contribute to Iraq's transition to a market economy, the immediate goal of restructuring and corporatization will be to ensure the achievement of competitiveness and self-reliance objectives, properly supported by necessary social mitigation measures. As in other transition economies, restructuring of state enterprises is a long term and often-ongoing process, requiring proper planning and progressive implementation.

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