



IEN Policy Papers

Private Sector Development: Iraq's Long-lost Solution. By Mohammed Hussein*

Six years passed since the Iraqi government launched its [Private Sector Development Strategy 2014-2030](#), aiming to reform regulatory frames and market conditions towards private sector-led growth. Several international partners (including UNDP, World Bank, GIZ, and USAID) also attempted to help realize some goals of the strategy. Along with the strategy, Iraqi leaders have always been advised to diversify the rentier economy to cope with their challenges of unemployment ([at 13 per cent](#)) and poverty ([at 31.7 per cent](#)), but things are not moving forward. The economy is still heavily state-dominated and crude oil-dependent, whereby oil revenues constitute more than 98 per cent of exports, 63 – 67 per cent of GDP, and up to 93 per cent of Federal Budget revenues.

What has hindered the private sector development (PSD) strategy remains as a set of institutional challenges. Although most of the challenges are technical, they can be addressed once a reformist political leadership is in charge. This article is an attempt to find out how the institutional challenges hindered the PSD strategy, assuming that institutions enforcing laws and regulating the private sector matter for economic growth. It also suggests some policy recommendations that could help to tackle the challenges given the current potentials and political constraints.

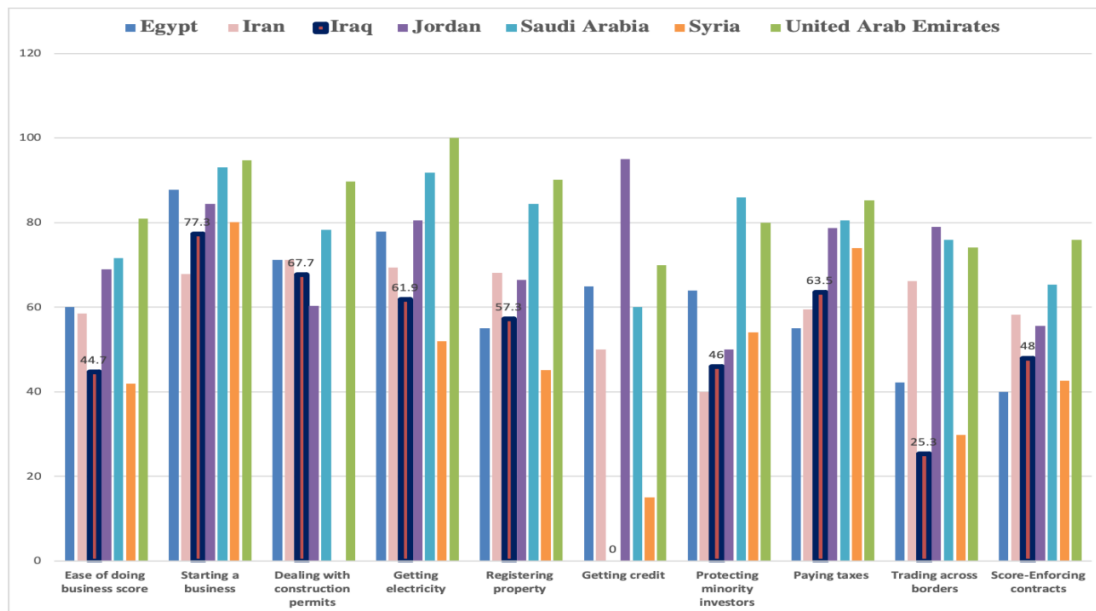
The Iraqi government's PSD goals were outlined as reforming the legal and regulatory framework, improving access to finance, and providing financial stimulants and incentives to private sector growth. It also affording programmes to pave the way for public-private partnership (PPP) by integrating private firms with state-owned enterprises (SOEs), which are mainly out of business. The overall aim of the strategy was to strengthen the private sector and improve its productivity to become more competitive.

Currently, Iraq's economy is struggling with multiple challenges and imbalances, suffering decades of chronic conflicts, poor management, and continuous institutional decay. The GDP contracted by 11 per cent in 2020, and the national poverty [rate raised to 31.7](#) per cent from 20 per cent in 2018 as a result of the recent multi-faceted shock of COVID-19 pandemic and oil price down. The political leadership, represented in the Federal government of Iraq (GoI) and Kurdistan Regional Government (KRG) still operate within the same rentier dynamics, by which

IEN Policy Papers

their duties are shortened in selling crude oil and then distributing its revenues through bloated payrolls. All the issues and structural imbalances kept the Iraq's business environment unfriendly and repulsive even compared to the regional and neighboring peers as Figure 1 demonstrates.

Figure 1. Iraq's Score in World Bank's 2020 Ease of Doing Business Index, Compared to Its Neighboring and Regional Peers



Source: The World Bank's Ease of Doing Business score is an average of scores for each of the Doing Business topics as the Figure 1 shows: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, and enforcing contracts. Source of the data is World Bank's Doing Business Index <https://bit.ly/3rU8Q3e>.

Looking for PSD in the Aftermath of the Shock

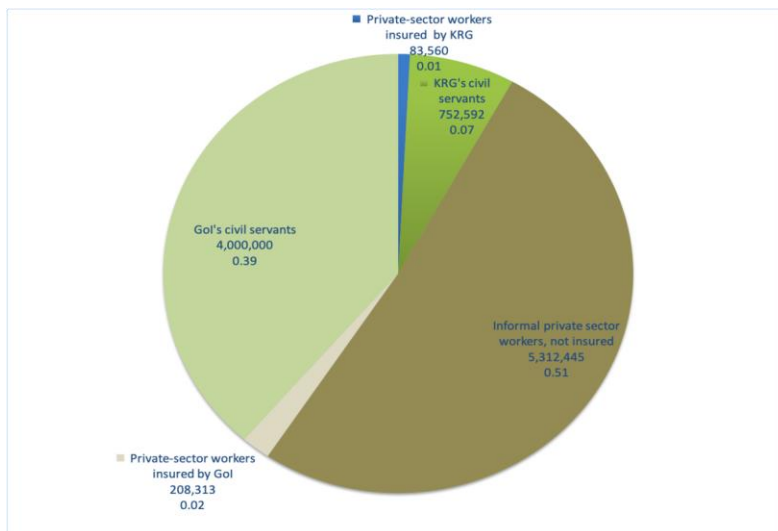
The multifaceted shock of COVID-19 pandemic and the global oil price drop exacerbated the economic and political environment that have hindered the PSD strategy. Luckily, the shock worked as a wake-up call and made several state leaders ask for economic reform and PSD programmes. The Iraqi Government's reform-agenda known as [White Paper](#) was the right step in this direction. It properly outlines what needs to be done for reviving job-creating sectors such as tourism, industry, agriculture, and transportation and ultimately diversify the economy. However, key ideas and reform spirit of the White Paper were not reflected in the 2021 budget

IEN Policy Papers

law. It was the first test for the integrity of the state leaders who called for reform and also a big disappointment for those who wanted to take the shock as an opportunity to reform.

Before the shock, Iraq’s private sector was too weak and somehow dependent on public expenditures. More than 90% of private and public factories were out of work. Some of them bankrupted during the 2014 double shock (oil-price crash and war against the so-called Islamic State of Iraq and Al Sham-ISIS), and others could not compete cheap imports after the 2004 open-door policy. The unemployment to population ratio, at ages 15-24 years was already 21.5 per cent for men and 61.6 per cent for women. Plus, limited access to finance, endemic corruption, and poor law enforcement was significantly obstructing local and foreign investments. The impediments have kept many start-ups, self-employees, and small businesses informal. The informal economy (usually associated with low productivity and misallocation of resources) is estimated to be livelihoods of more than half of the labour force (and more than 5 million workers) without child labourers that have crowded Iraqi streets and recently raised concerns of UNICEF and ILO.

Figure 1: Sectoral Labor Division in Iraq



Source: ` (World Bank Group 2020) and (Center for Future Studies 2020). The total number of the labour force is taken from World Bank’s open data. The number of private workers insured by Iraq’s Ministry of Labour and Social Affairs is taken from the ministry’s website: <https://bit.ly/2C9H4vT>. The number of the KRG’s insured private workers is taken from Kurdistan Labour Syndicate.



IEN Policy Papers

As elsewhere in the region, the recent shock diminished non-oil economic activities in tourism, retail, and services (where most of the Iraq's private economic activities take place). It also wiped out the majority of the informal jobs in the first phase of the pandemic (March to April 2020). After April 2020, with the second phase of the COVID-19 containment measures, some businesses opened and started to recover. Some micro, small, and medium enterprises (MSMEs) went bankrupted and others reduced their work. A recent [panel study](#) shows that the pandemic disruptions have lowered production and sales by 50 per cent in the 822 surveyed firms. Besides, The shock dramatically reduced Iraq's oil revenue from [\\$6.195 billion in January to \\$1.423 billion](#) in April 2020.

In addition to the direct impacts on the already weak private sector, the aforementioned economic challenges pushed the governments to cut from some very needed public spending. GoI lowered investment spending in 2020 [to 4 per cent](#) of the total spending. The KRG stopped financing the majority of its infrastructure projects after slashing its payroll by 21 per cent. The reduced investment spending is vital for the private sector not because it is needed for the underfunded infrastructure; it rather provides a market for many private firms that work as technical contractors in the services and construction sectors. This spending is much needed this year given the COVID-19 economic implications.

Landing another blow against the climate needed for any recovery and then PSD programme, the Central Bank of Iraq (CBI) depreciated Iraqi Dinar (IQD) against USD by nearly 23 per cent. According to the [White Paper](#), one of the key goals of the devaluation was to increase competitiveness of local products, while there are not enough products to compete with some very basic imports. The devaluation lowered real incomes for at least 7.7 million Iraqis who depend on GoI's and KRG's payrolls. It would prolong recovery from the multifaceted shock and further weaken SMEs and informal businesses working in retail and services sectors. The devaluation was an attempt to increase public revenues since the governments sell oil in USD but make expenditures mostly in IQD. Theoretically, a slow and gradual IQD-devaluation could have decreased production costs and ultimately increased competitiveness, but this cannot be a realistic dream before fixing the key structural issues and imbalances and improve the enabling environment for the private sector.



IEN Policy Papers

How the Institutional Challenges May Play Out?

Many factors prevented implementing the PSD strategy, but lacking a reformist willingness is always the core issue. The post-2003 ruling elite is known for being good at designing strategic development and reform plans but not implementing them. Since 2003, [73 development](#) documents have been prepared to help Iraq, but none of them has been properly implemented. The leadership is overwhelmed with inter-elite conflicts and security challenges.

Besides, the quality and functionality of state-institutions have deteriorated over time. Lacking law enforcement institutions to protect people's lives and livelihoods from extortions and illicit activities is always a challenge. The institutional deficit, with all its symptoms such as fragile security, the spread of non-state armed groups, and weak law-enforcement increased pre-existing barriers to market competition. They have created an unbalanced playing field in favour of corrupt business people to bypass competition, benefiting their links to the political parties and armed groups. As a result, they have kept the investment climate very unfriendly and the private sector too weak.

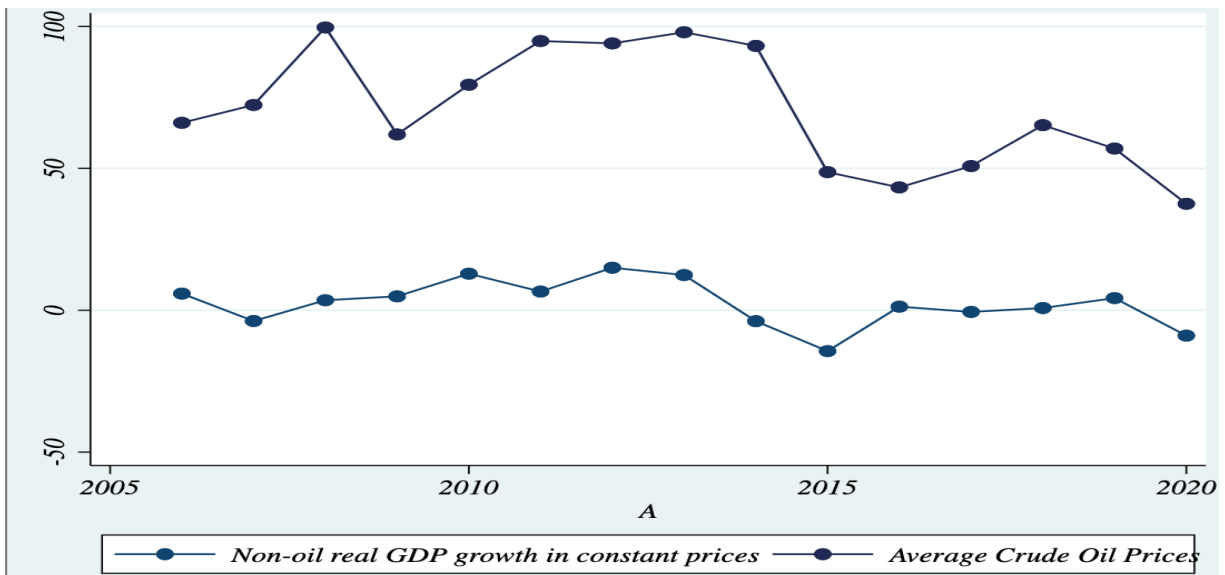
For instance, one of the lasting challenges that have hindered PSD and contributed to the tough business environment is getting a business license to kick-off investment projects. Although Investment Law Number 13 (2006) is supposed to facilitate a single-window system and provide the investor with a business license within two weeks, the reality is different. The law contradicts several other laws and the investor still needs a business license from investment offices of all relevant ministries. Eventually, getting the business license might take months/years, or it might not be granted at all since the allocated land for the project would be occupied by political parties' militias.

Besides, the recently increasing oil revenues is also important to be under radar as it is very determinant for any PSD programme. The revenue usually has dual effects either to hinder or foster the PSD strategy. As the recovered demand in the international oil market pushed crude oil above \$60 pb, it released part of the fiscal pressures facing GoI and KRG. Meanwhile, it may reduce politicians' incentive to reform. The politicians tend to keep the current business as usual rather than pursuing PSD that cannot yield short-term electoral gains. The increasing oil revenues could provide resources to pursue counter-cyclical approaches and foster post-COVID-19 recovery. Supporting SMEs and the people who lost their livelihoods due to the pandemic also needs oil revenues. Either way, the rising oil revenues have always had a positive correlation with non-oil private economic activities in Iraq. Most of Iraq's private firms depend on public spending and work as contractors of the governments. Data shows that non-oil

IEN Policy Papers

economic activities in Iraq increase, or decrease, parallel to international crude oil price fluctuations as Figure 4 demonstrates.

Figure 4. Iraq’s annual percentage change of the non-oil GDP growth (the lower curve), increases or decreases, parallel to International crude oil price fluctuations (the upper curve) after 2010.



Source: Macrotrends <https://bitly/32hMgbL> and [FRED](https://fred.stlouisfed.org/)

Given the political constraints and challenges that have hindered the PSD strategy, designing a realistic approach is very much needed. Any reform or PSD programme should start with practical steps from where the interests of the ruling elite do not contradict development goals. This practicality is needed for a while at least to bypass the current political complications. Otherwise, the anti-reform backlash would deter many needed preliminary steps. For instance, creating agricultural rural jobs and fostering food-processing industry is where nobody opposes.



IEN Policy Papers

It is good for farmers, investors as well as the ruling elite because this is where they can find a market for local products and non-oil public revenues increase. It also helps reducing poverty and unemployment that currently posing multiple political and security threats. This target is not that difficult as domestic consumer's taste is already in favour of Iraqi products. Currently, the price of one KG of Iraqi lemon is between 3500 to 4000 IQD, while one KG of imported lemon is between 1000 to 1500 IQD. Similar price differences exist for most of the Iraqi food products.

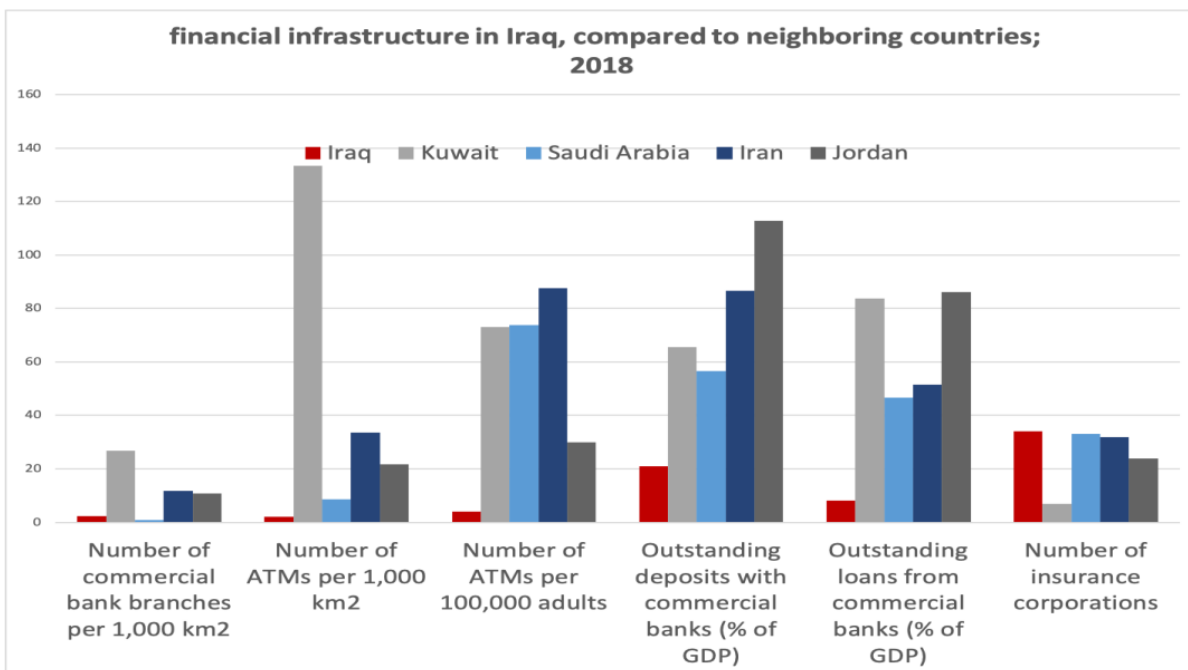
Moreover, restoring order and implementing customs duty in border entry points is also another area where the majority of Iraqi people and the ruling elite can get together to support reform. The customs duty is normally expected to provide 7-8 trillion IQD for the state treasury, but the GoI receives [one trillion](#) IQD. The issue is not only the lost revenues wasted on untaxed imports and corruption; it's affecting local products by opening smuggling doors for cheap imports. Here, lack of law enforcement and policing undermines public revenues and hurt private businesses. However, any attempt to clean state institutions from patronage networks of the ruling political parties would create more obstacles than supporters for reform.

To improve the business enabling environment, GoI and KRG can take some actions today with their available resources as part of a tailored Iraqi PSD programme. Starting with reforming business registration procedures, there needs to be a new and easy single-window system to absorb the informal workers and incentivize them. The governments can afford to have a strong labour inspection mechanism to make sure informal labourers have contracts and economic activities are going within legal frames. The governments and CBI can encourage investment in technology to grow productivity to revitalize fast job-creating sectors. There are some success stories to learn from. Over the past 10 years, local aluminium and iron manufacturing projects boomed to the level that can meet local demands. Iraq Aluminum Extrusion, an example of this factories, employs around 100 skilled workers. They invested in technology to grow productivity until becoming competitive enough to replace Turkish imports, depending on their competitive advantages, not monopoly or customs duty to safeguard them.

In addition to the business enabling environment, reforming the financial sector is also a key step to push for the PSD strategy. Most of Iraq's banking sector and financial institutions are fragile, incompetent, and short-term profit-oriented. They are not in the position to support any reform or PSD programme. Regardless of the number of commercial banks operating in Iraq, (more than 70 banks), the economy is heavily relying on cash transactions. This is another factor preventing GoI and KRG from implementing the Pension and Social Security Law of Workers that made the private job market undesirable. Therefore, upgrading and digitalizing the banking sector can provide a great foundation for any economic reform.

IEN Policy Papers

Figure 5. Iraq’s Financial Infrastructure, Compared to the Neighboring Countries



Source: IMF Open data sets.

Such a poor banking sector can't help observe the informal economic transactions, enforce labour laws, and detect money laundering. For instance, if CBI would attempt to expand its SMEs-loans to include the rural cash-based informal businesses, this banking sector is unworkable. Benefiting international partners and donors, the governments can facilitate technical assistance and coaching to both private and state-owned banks and financial institutions to build capacity and increase their scale and productivity. They can help linking educational institutions and other skills-development programs to the financial sector. Some universities, like Al-Nahrain University in Baghdad and private universities in the Kurdistan Region of Iraq (K.R.I) already have private sector linked programs.



IEN Policy Papers

What Can be Done Now?

Again, the PSD strategy could be a realistic dream whenever it is backed by a reformist political willingness. Although economic solutions, sometimes, play out slowly and longer than expected, Iraq's tourism, agriculture, and the light food industry hold great potentials. It could be a medium and long-term realistic goal once policy and regulatory actions pursued to address the impediments. It is indeed the most rational solution to the current economic and job market challenges but neither a short-term and nor an easy one. It needs to start what can be done today and pave the way for what should be done in the medium and long term. The increased oil revenue can serve this purpose by providing loans to MSMEs instead of increasing military and security spending as GoI and political blocs did in the 2021 budget law. Given Iraq's socio-economic challenges, any economic reform and PSD programme needs to be inclusive and pro-poor. It should include, in short and medium-term, unemployed youth and women in impoverished rural areas. With the loans already provided by CBI, the reform programme could revitalize fast job-creating sectors (agriculture, tourism, and construction) even during the current financial strains. Encouraging agriprenurship and startups in tourism and services could be a fast rural job-creating strategy.

Regarding the PSD strategy, there are dire needs to address the business impediments and create a friendly enabling environment. It only needs a reformist political willingness to reduce some heavy red-tape procedures. It is not hard to amend the existing labour law and make it more inclusive towards informal workers. Making the CBI loans accessible for young start-ups by easing eligibility conditions is also something achievable today. Likewise, restoring order in border ports and reforming customs duty to safeguard domestic products, resolving Erbil-Baghdad oil and financial disputes to come up with a unified national customs duty are steps that can be done now.

Preparing the ground for the PSD strategy or any reform programme, Iraq's institutionalized corruption must be addressed. GoI and KRG need to mobilize all the supports they get from NGOs, international entities, and local religious and cultural figures in battling the corruption. They need to establish various decentralized mechanisms to detect illicit activities and promote transparency. Here, they have supports of thousands of activists, journalists, and professionals who have been taking the streets and voluntarily speaking up and struggling against the endemic corruption. They are the best ally for any reform programme once a proper mechanism is designed to organize their supports. Besides, opening up state institutions for NGOs and media overseeing directly improve the performance of the institutions, which is very much needed to improve the business environment and promote PSD or any economic reform programme.



IEN Policy Papers

Making Iraq's private sector gender-inclusive can help addressing the low female labour participation (about [12 per cent](#)). It is a symptom of the weak private sector but also a reason for keeping nearly half of the population idle and not contributing anything to the economy. In some areas, there are cultural barriers for women to apply for private jobs because the private sector is perceived as an unsafe environment, unsecured job, and low-paid; while the perception is different for public jobs that are seen as safer with life-long security and other benefits. Government protection through formalization can help to change the perception. Any microfinance can address this priority. Special regulations to protect them from gender wage gap, manipulation, sexual harassment, and to promote affording child care in the private sector might directly [reduce barriers](#) they face to enter the private sector job market.

Policy Recommendations:

1. Any economic reform or PSD programme depends on how law enforcement institutions work adequately (in all national, provincial, and district levels). Protecting people's lives and livelihoods from all sorts of extortions and illicit activities is the pre-condition for any meaningful reform.
2. In a line with the White Paper, privatizing some of the state-owned enterprises (S.O.E) or engaging the private sector with a viable public-private partnership (P.P.P) may strengthen market forces, increase competition, and revitalize the enterprises.
3. Removing bureaucratic impediments, introducing policy reforms to strengthen the accountability of the public sector, and granting on-arrival visas for foreign investors are steps that can be taken now. Given the corruption-associated risks, the bureaucracy-reduction steps need the direct engagement of local and international NGOs and media.
4. In the medium and long term, GoI needs to gradually incentivize members of the armed groups towards the private job market contrary to what the 2021 budget law encourages. The ultimate goal is to attract segments of Iraq's armed men into economic activities in the private sector, and it can happen only if the private sector affords opportunities better than what they gain from armed groups.
5. The currency depreciation in Turkey, Iran, and Syria have exposed Iraq's market to very cheap imports that pushed thousands of producers out of business. Given Iraq's high production cost due to the tough business environment domestic products cannot be price competitive without protection by tariffs, subsidies, import quotas, and other sessional restrictions placed on certain food imports.



IEN Policy Papers

6. In a line with the 2021 budget law, GoI can finance the on-halt investment projects, especially infrastructural, agricultural, and services projects; The projects improve the needed infrastructure for private economic activities. For the next budget laws, GoI and KRG need to put a ceiling on current spending and scale-up investment spending to improve infrastructure and reconstruct the war ruined areas.
7. Regarding the rising poverty rate, reforming the current Public Food Distribution programme is highly required. GoI should improve the quality and increase the quantity of the food items after imposing an eligibility criterion to make it accessible only for low-income people, not everyone, including those who may not need it.
8. Addressing the rising unemployment, a specific Iraqi tailored microfinance programme in tourism, agriculture, dairy and other agro-industry businesses would create viable market opportunities for millions of impoverished Iraqis in rural areas. It will have great multiplier effects and restore the value-chain that links up the rural economy to urban centres. The CBI's already programme to lend SMEs should be restructured towards this purpose by easing the conditionality of the loans.

From the Labor Market Perspective

In any medium and long-term plans, GoI has the incentive to prioritize fast-growing sectors such as agriculture, services, tourism, construction, and small industries. The timely achieved improvement is needed to release the ongoing demographic and political pressures.

1. Setting up vocational training on market activities, skills, and small business management is a key strategy to improve productivity and develop the vibrant private sector for enterprises already struggle with the tough business environment.
2. Connecting universities and schools to the labour market, GOI's relevant ministries should prepare to supply the private sector instead of over-crowding security and military forces. The policy shift requires renovating curricula to focus on applied sciences and technical skills needed for the current labour market.
3. Designing new marketing tools, organizing periodical fairs, workshops, and conferences for start-ups to demonstrate their products and services might improve the competitive environment. GoI's ministries of planning, agriculture, industry, and culture can help conduct these marketing strategies and facilitate inter-sectoral cooperation and exchanges. For instance, they can lead farmers to invest in the type of tomatoes that are commercially viable for canning factories.

IEN Policy Papers

4. To create some balances between public and private job markets, Iraq's tax-policy needs to be addressed to increase tax rates for public employees and decrease for private ones, given the benefits public employees enjoy (as a pension, paid maternity, sick leave, and lifetime job security), but not available in the private sector.
5. Iraq's informal workers' needs, challenges, and concerns require medium and long-term solutions, but they should be considered in most of the policy actions to deal with immediate economic issues. The informality is usually associated with high poverty, low productivity, under-employment, and misallocation of resources. Optimal policies should be designed soon to incentivize the registration process by ensuring informal firms and workers and adding them to the tax-paying lists, a win-win solution for both GOI and the informal workers.

References

1. A televised press conference of Finance Minister Ali Allawi: <https://bit.ly/3losum1>
2. Center for Future Studies. "hkumati ney Iraq w Qayrany Abwri Haremy Kurdistan: Lamparw synaryokan [The New Iraq's Government and Economic Crisis in Kurdistan Region: Hinders and Sceinaros. 2020. Accessed June 18, 2020. https://www.centerfs.org/future-ranges-no-4-of-year-2020-ku/#_Toc33192903.
3. Jaafar, Razaq. June 15, 2020. Razaq Jafar is secretary general of Iraqi Federation of Industries. He was interviewed for this study by phone.



(*) Mohammed Hussein is economic expert and follow of the Iraqi Economists Network.

Copyright IEN, 16. May 2021