

Private sector investment in Iraq - What strategy for the next Prime Minister?

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Iraq is in turmoil. The protests of the Iraqi youth, which started on October 1st 2019, are calling for the end of corruption, inequality in income distribution, high unemployment and the current (ethno-sectarian) political system and outside interference. They are also calling for a better life and, metaphorically, for their ‘own country’ (*watan*).

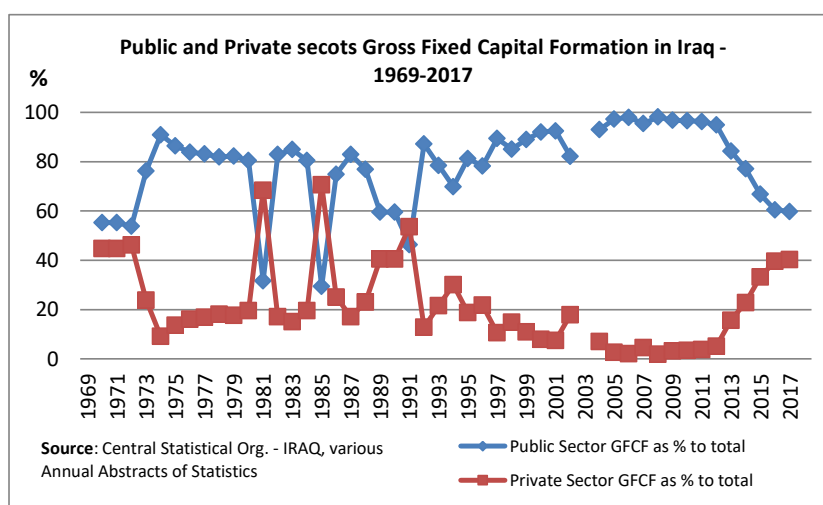
The protests have so far claimed the resignation of Adel Abdul-Mahdi, the outgoing prime minister. The appointment of a new prime minister is imminent. However, it is not certain whether president, Barham Salih, or, indeed, the current parliament itself will remain in place for a long time. The system they are part of has failed.

Politics aside, this situation compounds an already unfavourable environment for doing business in Iraq, as strongly indicated in a recent World Bank report (Oct. 2019). Political instability, uncertainty and indecision provide no comfort for the private investor.

There are, however, a number of reasons why the next prime minister should be bold and determined to make fundamental changes to encourage private sector investment. There is a need to ameliorate the severe structural problems in Iraqi economy to lessen its dependence on oil exports. The enormous challenges they face include high youth unemployment (at ca. 25 percent), young population (60 percent under 30 years of age) and growing at around 3 percent pa., over 700,000 people entering the labour market each year, hundreds of thousands of senior schools and university graduates, to mention a few. They must act fast, deep and wide. None of these challenges is easy! The new prime minister must be willing to *make economic development* in the face of adversities. New strategies are a must, reversing old ways of doing things.

This brief note provides a few suggestions relating to what the next prime should do to induce (domestic and foreign) private investment in the economy.

First though **history**. The graph below shows the dominance of public sector investment (gross fixed capital formation) over the last 50 years. The decline in private investment intensified following the 1964 nationalisation of major private sector concerns, in industry, banking and commerce.



Private sector's share of *non-oil* GDP declined from 87.3 percent in 1950 to 62.5 percent in 2010 (Hirmis, A.K. 2018a: 57). It was 61.8 percent in 2017 (cosit.gov.iq/n.accounts/2018, p.10).

Structure and ownership

The private sector's role in the economy has been relegated for nearly 60 years now. Its previously wide-ranging economic activities have now been confined to mainly in retail and trade, construction, transport and ICT (<http://cosit.gov.iq/AAS2017...>). Crafts and light industry are the province of the private sector.

The majority of businesses are owned by sole proprietors, with the rest being largely family partnerships: the country has few large, multi-industry conglomerates. However, large private businesses are emerging in ICT, particularly mobile communications, in technical services for the oil and gas sector, and in manufacturing. Productivity in the private sector varies: Iraqi private firms perform better in this regard than others in the MENA region in textiles and garments, chemicals, pharmaceuticals, non-metals and equipment; by contrast, food processing and electronics have a relatively low level of productivity (WB 2017; WB 2019; and RoI, 2014: 41, *apud* Idris, I. 2018).

Skills and education

As Christine van den Toornhas (2019) has remarked a key first step “will be education reform to prepare young Iraqis for private sector employment...It is clear that the issue is not a lack of demand...a lack of training in basic business skills such as finance and accounting, and a lack of core professional abilities, from critical thinking, research and report writing to being able to work with common software programs...This points to the urgent need to completely overhaul the public education system, including modernizing the curriculum...(short-term solutions include)... a nationwide series of accredited, specialized, one- or two-year programs that focus on developing language, business and professional competencies” Back in 2003, Nancy Birdsall (2003: 61) had observed that “Development and democracy require a fast uptake of Iraqis, including girls and women, into secondary school. They require replacing a school system focused on doctrinal propaganda with a system responsive to new demands for marketable skills.”

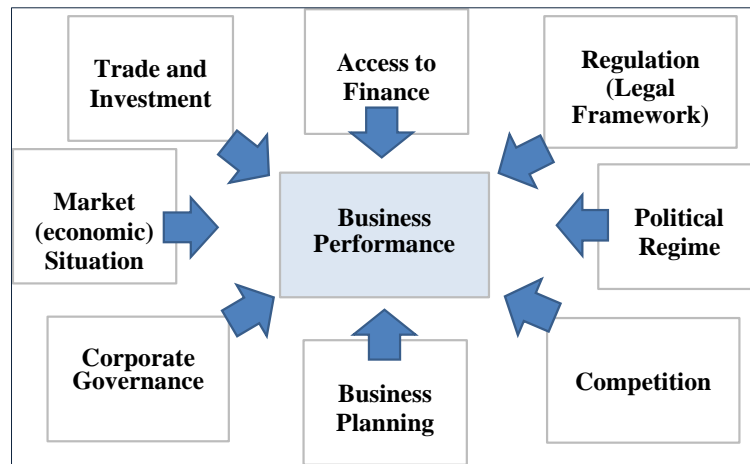
The wider issues

Second, the wider issues facing any future Iraqi prime minister in relation to inducing private sector investment go beyond industry structure, ownership, skills and education, noted above. The next prime minister should have a robust and realistic vision for Iraq's economy, and its *characterisation*. They should decide for example whether they wish to build a capitalist, market, economy, where the private sector plays a key role whilst government plays an enabling role for wealth and jobs creation, especially in the productive sectors, like manufacturing and agriculture? On this point government has dithered since 2003. Now there is an opportunity to decide on the character of the Iraqi economy going forward.

The prime minister and his advisors should, critically, have clear views of the *dynamics of private sector performance*; the business environment needed for investment to take place, and for firms to operate successfully. Private investment takes place on a very simple and familiar premise: the anticipated reward is worth taking the risk – i.e. reward vs. risk.

On the **investment side**, the World Bank's October 2019 report on ‘Doing Business 2020 – Iraq’ clearly shows why both the domestic and foreign private investors are weary and reticent. Iraq fails on all the measured indicators used to assess the business environment – the ease of doing business. Iraq currently does not provide a favourable business environment. These indicators include ‘getting electricity’, registering property, obtaining credit, enforcing contracts and, inter alia, resolving insolvency. Iraq came 172nd out of 190 countries, very close to the bottom. In short, the next prime minister, and his advisors, must rise to an enormous challenge. And, this is one of the yardsticks for judging the success or failure of the next prime minister's administration.

On the side of **operation and performance**, the latter, typically, depends essentially on *eight factors* both internal and external to the firm, as shown in the Figure below.



Economic history of market economies shows that growth is generated mainly by the private sector; the government plays an enabling role, through its economic policies, regulation, support for innovation and trade, and ensuring political stability within a democratic framework. Government also subsidizes and regulates education, health services and physical infrastructure. However, regardless of the stage of economic development, a number of factors come together to influence both private investment level/structure and the performance of the firms, as indicated above.

Firms also need to consider in detail their profit and loss accounts – in the process of making profits (if they do), firms typically make allowances for wages, interest-bearing loans, or equity raised privately or from commercial/state banks. In addition, taxation, dividends, retained earnings, are also considered. Decisions on these matters constitute part of the firm’s behaviour, and could affect its future direction – e.g. expansion, diversification, or even closure. In the case of Iraq, there is also a consensus amongst observers that tackling corruption, bureaucracy and doing without an ethno-sectarian system of government is critical for economic development. Corruption, bureaucracy and cronyism deny many qualified potential employees *access* to jobs they deserve to have. Security and political stability are also a must for sustained private investment.

In other words, a large number of factors need to be taken into account in balancing the rewards versus the risks at the firm level. The new Iraqi government must account for this.

Finally, at the **strategic (macro) level**, the new prime minister has at least three options to stimulate private sector investment, accounting for the eight factors noted in the Figure above.

Option one is to introduce a radical and swift reform concerning doing business in Iraq, creating a conducive environment to induce private investment, by removing constraints facing it. The new prime minister would be well-advised to take a leaf from the World Bank’s recommendations for doing business in Iraq. They should also take a leaf from the government’s own ‘Private Sector Development Strategy 2014-2030’ which recommends amending current laws and regulations governing the private sector which impede the sector’s growth. These include Investment Law 13 of 2006; Company Law 21 of 1997; Industrial Development Law 164 of 1964; Implementation of large projects Law 157 of 1973 and the Economic Establishment Law 98 of 1964). On the other hand, the private sector investors should observe the rule of law, especially the Labour Law (37) 2015.

The new prime minister should also seriously consult with Iraqi ‘Chambers of Commerce’ and ‘Confederations of Industry’ to develop an awareness of their concerns, aspirations and the dynamics of their performance.

Option two is to start with restructuring and rejuvenating the ‘State-owned enterprises’ (SOEs), to improve their productivity, keeping in mind the socio-political impacts this option might have. The SOEs, most of which are dysfunctional and inefficient assume a

drain on government's budget due to underemployment, redundancy and maladministration. The SOEs have also assumed control over the sectors concerned and in effect crowded-out most non-oil private firms (WB, 2017). The new prime minister could introduce a form of partnership with the (domestic or foreign) private sector to rejuvenate the SOEs, based on, say, 30-40 years lease, profit-sharing, joint operation, ensuring continuous professional development for Iraqi workers and continuous research and development (R&D). When in operation, major ventures should be linked with Iraqi/foreign universities, to encourage innovation. Such partnership arrangements do not have to take the form of BOT (Build-Operate-Transfer) or BOOT (Build-Own-Operate-Transfer) business models. A new model could be struck, having the advantages of minimizing public cost for investment, reducing public debt, allowing for innovation, improving productivity (especially via FDI – Foreign Direct Investment), and, improve good governance, transparency etc. These arrangements could be applied to the manufacturing, agriculture and physical infrastructure of the economy, to start with.

Option three is to widen the remit of the proposed 'Construction Council' which the current/new parliament will consider in the form of a 'Construction Council Bill.' This was forwarded by cabinet to parliament on September 17, 2019 (<https://gds.gov.iq/ar/cabinet-approves-the-draft-construction-council-bill/>). For the Bill to induce private investment its current objectives and mechanisms need fundamental review and amendments to widen its remit so that SMEs could, for example, gain access to finance. Also, the Bill must not become another mechanism to further corruption and money laundering. It must ensure that Council works on strictly professional basis, avoiding the politicisation of its remit/work. Critically, the new 'Construction Council' must be regulated by, say, a new *independent* 'Office for Economic Development Responsibility' (OEDR) ensuring that Council performs and delivers major/SME projects *efficiently* and *effectively*. This means that the operator *must not* be the regulator, which is the case in many Iraqi institutions at present. Otherwise, the seeds of corruption will be easily sown (<http://iraqieconomists.net/en/2019/10/10/the-construction-council-bill-2019-a-critique-by-dr-amer-k-hirmis/>). On this basis, the new prime minister could make a real difference and amend the current broken system of doing business in Iraq.

Of course the above three options are inextricably linked, indeed they could be implemented in parallel.

In all these options, education and economic development must be strongly linked, as noted above. University and vocational training graduates need to end up in jobs created by expanding productive and service sectors, taking advantage of the 'digital revolution.' In short, there must be close link between education (curricula) and the skills needs in the labour market. All girls and boys should have access to education to advanced level (up 16-18 of age), so that they would make informed decisions for themselves, in life and in participating in the labour market (Hirmis, A.K. 2018b). This is especially important at the micro-firm-level, ensuring the skills required are provided.

In summary

The new prime minister will be faced with many challenges, noted above, and none is easy!

Stimulating private sector investment is one area where they can turn these challenges into opportunities. The new prime minister will need to muster great wisdom and determination to rise to these challenges, and assist in wealth and jobs creation. Learning from Iraq's own history and also from foreign experience in economic growth, is always rewarding. The new prime minister should seek well-reasoned, workable advice and apply it in the Iraqi context. This is one way of enhancing state craft. Iraqis will be watching the new prime minister very closely, and will demand results!

END

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