



COALITION PROVISIONAL AUTHORITY
BAGHDAD

PPSD

ACTION MEMO

May 2, 2004

FOR: THE ADMINISTRATOR
THROUGH: Ambassador Richard Jones, Deputy Administrator
FROM: [REDACTED] Director, Private Sector Development
SUBJECT: State Owned Enterprises Action Plan

This Memorandum provides a State Owned Enterprise (SOE) strategy for your consideration. It is intended to provide the future Government of Iraq with the opportunity to transition the SOEs toward a market based environment while addressing immediate needs, reducing subsidies, and seamlessly transitioning workers from non-performing SOEs to the private sector. Given the current political and cultural climate, the following recommendations, scoped to be achievable in the limited time left us, can position the Government of Iraq for a good start. We have discussed aspects of this plan with Minister Tofiq (Industry and Minerals) and others, and we have reason to think that this approach will be fairly considered. We will take the next steps in this plan in coordination with other key Iraqi officials.

Attachment A contains the detailed strategy for SOEs, from which this summary has been drawn.

ELEMENT I: STAYING WITHIN THE 2004 BUDGET

Goals

Ensure that the \$750 million provided for SOEs in the 2004 budget is sufficient to last the year and to allow for capital investment. Manage the overall headcount in ways perceived by Iraqis as painless and perhaps even beneficial.

Actions

Work with the Ministries and SOEs to initiate an Identification Card program aimed at reducing "ghost" workers, thought to represent as much as 20% of payroll costs.

Begin a new dialog with Iraqi counterparts about using CPA programs to offer attractive voluntary programs, including retirement and separation bonuses, and other incentives (paid access to vocational training and focused recruiting for PMO jobs, access to Private Sector Development loan and business programs) to motivated SOE employees.

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Private Sector
Development—
General

Work with the Ministry of Finance to clarify the implementation of CPA Order #30. Ensure all SOEs are on the 11-tier management system. Salary subsidies from MOF should not exceed the amounts under the 4-tier system (with a few exceptions). Rules on transfer of profits from SOEs to MOF are controlled by statute. If these rules were relaxed for SOEs which fund their respective salary needs, firms could provide merit and performance based increases cleared by their ministries and MOF. This would push firms to cover their own payroll costs and address the incorrect perception that the 11-tier system means a 40% raise. This approach is favored by CPA Finance.

ELEMENT II: SETTING VIABLE SOES ON A TRACK TOWARD ECONOMICALLY APPROPRIATE GOVERNANCE

Goals

Assist viable SOEs to operate independently, eliminating the burden on Ministers to "serve" as CEO. Encourage transition to independent enterprises, easing fears among employees and the Iraqi public. Permit independent SOE Boards of Directors to convene and to take action, increasing SOE attractiveness for eventual investment opportunities.

Actions

Amend Law 22 slightly to permit the establishment of government-owned holding companies that would own other state-owned enterprises. While holding companies are likely the best remaining option, we will look for ways to build "trust-like" characteristics into them or even to create trusts if the legislation can be managed, although that may turn out to be unworkable.

Set up government-owned holding companies, as well as boards of directors at the holding companies and corporate level. For selected holding companies, with viable SOEs, provide resources, as available, to establish proper control and accounting systems, to conduct regular independent audits, to speed operational improvements, and to support planning for strategic transactions. If the holding company approach proves unworkable, we can try to establish independent government commissions for the same purpose.

ELEMENT III: FIX OR EXPAND SOES IN STRATEGIC SECTORS OR GEOGRAPHIES

Goal

Speed the recovery or growth of selected SOEs (i.e. those in cement or other crucial construction materials, or those in sensitive, economically geographic areas).

Actions

Effectively utilize those funds that have been allocated to provide capital and operational expertise aimed at crucial SOEs. If available, additional DFI monies could also be allocated to these needs. Turnaround teams may be made available (if resources and staff permit and the

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holding company's board of directors and Ministry approve) to speed operational improvement. To the extent possible, these efforts will rely on Iraqi experts and officials.

Approach Madrid and other multi-lateral or bilateral donors to ensure that efforts and resources are consistently focused on the most crucial SOEs.

We will need to provide for meaningful oversight of this effort from the future U.S. embassy.

ELEMENT IV: ENSURE FAIR COMPETITION

Goal

Ensure that private sector firms are not subject to unfair, chilling competition from SOEs.

Action

Work with OGC to seek language in the draft competition policy law that limits the government's ability to give preferential treatment to SOEs, or to limit competition with SOEs, and that requires SOEs to operate in commercially appropriate ways.

RECOMMENDATION (1): Approve Element I.

Approve: _____ Disapprove: _____ Approve with modification: _____

RECOMMENDATION (2): Approve Element II.

Approve: _____ Disapprove: _____ Approve with modification: _____

RECOMMENDATION (3): Approve Element III.

Approve: _____ Disapprove: _____ Approve with modification: _____

RECOMMENDATION (4): Approve Element IV.

Approve: _____ Disapprove: _____ Approve with modification: _____

ATTACHMENTS: Tab A: Detailed Strategy

COORDINATION: PMO – Admiral Nash (ok)
OGC – Col. [REDACTED] (ok) b(6)
OMB and Finance – [REDACTED] (ok)

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STATE OWNED ENTERPRISE APPROACH

Previous efforts at State Owned Enterprise (SOE) reform have been stalled by keen political sensitivities. Left unaddressed, however, the SOEs impose high subsidy and other costs, and they pose real risks. These other costs and risks include the potential for social unrest, perpetuation of a welfare dependence, shortages of key materials (construction, fertilizer, etc.), the creation of government monopolies, and the suppression of private sector industry. This memorandum proposes a program, crafted with an eye to political practicality, for putting the SOEs on a road to reasonable reform, reducing both the high costs, and the risks.

The program, which focuses on the approximately 150 non-oil, non-electricity SOEs, consists of three main parts:

1. Making the Workforce Issues Manageable;
2. Saving What is Viable, Salvaging What's Not;
3. Avoiding Future Problems.

The first part of this document goes into detail on these three main elements of the plan, in essence describing what we think should be done. The second part of the document addresses the specific timing and assignments for action on the plan, the "how's" of getting the job done.

In this second section, we specifically identify what we think can be accomplished prior to June 30. Our goal is to get enough launched now so that the future sovereign government, in 2005, will find it easy to make economically logical choices about SOEs.

Part I: Elements of the Reform Plan

Iraq is actually fortunate that its non-energy SOEs comprise no more than 5% of its workforce and probably a smaller proportion of its GDP. Certainly, some countries in the former Soviet bloc had it worse. Our proposed approach calls for active, immediate, and relatively painless steps to shrink the size of the payroll subsidy, without forced job reductions. Next we propose to put viable companies on a glide path to reform, allowing maximum economic freedom for appropriately motivated corporate governance structures. We also address the non-viable companies and their employees. Finally, we suggest a few actions to head off inappropriate legal and regulatory actions prior to final decisions by the sovereign government on the long term status of SOEs.

Making the Workforce Issues Manageable

It is no small thing to reduce the budgeted \$500 million in 2004 salary subsidies (an amount that could increase under certain circumstances) without triggering social troubles among what may be as many as 500,000 SOE employees. Consequently, we

have tried to devise ways to reduce the size of the problem using incentives and reassurance, although the biggest results come from addressing "ghost" worker fraud. Specifically, we suggest:

1. Dealing with "Ghost" Workers. We have some evidence that some considerable portion, perhaps 20% or more, of the SOE payroll consists of "ghost" workers, whose pay is siphoned off by corrupt managers and officials. Field experience suggests that one way to deal with this is through photo identification cards for employees paired with a matching process for pay packets. Such systems are already being deployed within the Iraqi ministries.
2. Enticing Accelerated Retirements. Based on early indications of the savings from ghost worker program, we could fund some level of one time bonuses for workers of a certain age who opt for early retirement. By making the bonus a one-time payment, we reduce the subsidy in future years.
3. Encouraging Voluntary Resignations. We have a number of tools for enticing non-retirement age workers out of the SOEs.
 - a. On the same principle as with retirees, we could offer bonuses for those who choose to separate. This reduces future year subsidies.
 - b. We can also make vocational training and access to reconstruction jobs preferentially available to SOE volunteers. Locating vocational training centers and PMO/MOLSA placement offices in selected SOEs would make this option more attractive.
 - c. We can offer certain PSD loan and small business training and consulting programs to SOE volunteers, again on a preferential basis.
4. Clarifying the Pay Policy. We believe the Ministry of Finance should issue a joint statement with other SOE-owning Ministries on the issue of compensation, with emphasis on the 4-tier and 11-tier systems. Specifically, the policy should make clear that any shift to an 11-tier system that involves an increase in total payroll outlays, must be paid for by the SOEs own funds and will not be supplemented by increased subsidies from the central treasury. If an SOE cannot afford the increase or the transition, it should not begin it.

Taken together, these actions should yield substantial reductions in the payroll subsidy costs and in the political inertia tied to the size of the SOE workforce. It will be important, in implementing these actions, to pay close attention to facility-level communications to make sure that the voluntary nature of options 2 and 3, and the financial incentives are clearly understood. In addition, personnel at non-viable SOEs should be offered additional options for transfer to viable SOEs, to further reassure them.

Saving What is Viable, Salvaging What is Not

A path must be found to redeem those companies which are viable, while disposing of the assets of those that are not. Since only a future sovereign government has the power to alter the ownership status of the SOEs, we have attempted to propose actions now that will leave the 2005 elected government with an economically sensible choice for ownership reform that is difficult not to make. Our program seeks, then, to deal with viable SOEs first, touching on their governance structures, control and accounting capabilities, and on the turnaround or expansion of their operations. Subsequently, we propose a program for easing the transition of agency and non-viable SOEs.

Viable SOEs

The viable SOEs present special challenges. Our goal is to structure them to become effective competitors and significant self-supporting employers, while making it as easy as possible for their ownership to change. We also address the issue of performance improvement, particularly for a subset of the viable firms whose improved or restored operations in critical locations may be useful in advancing security and other interests. For this subset, we suggest an emergency action program.

Governance

We believe that all viable SOEs should be grouped, on a logical basis (related industry perhaps) into some number of holding companies or trusts. These entities, owned by the government, should have boards of directors, composed to be as independent as possible. The creation of these boards will have the important effect of relieving government ministers of the role of CEO of SOEs.

1. As part of the establishment of the holding companies or trusts and the boards, we will initiate contracts for the provision of certain outside services, namely
 - a. An outside audit firm for each trust and its subsidiary companies. This work would begin after the work in the next item is well along.
 - b. An outside accounting firm for each subsidiary company charged with implementing adequate accounting and control systems and procedures in each viable subsidiary, capable of generating auditable financial statements in accordance with international accounting standards
 - c. An outside investment banking firm on retainer to the trust. The role of these firms, which would not begin until late 2004 or early 2005, would be to prepare a menu of strategic options for the trust's consideration. These options should include, but are not limited to:
 - i. Spin-off of all or part of the equity or assets of the subsidiaries to private Iraqi investors or others

ii. IPO of the subsidiary

iii. ESOP

2. The boards of the holding companies or trusts should be appropriately compensated, with the possible exception of government members of the board. In addition, there should be incentives for board members tied to the proceeds of any strategic transaction involving their trust's companies. We may also want to offer the board members bonuses based on cash generation, but these should be capped with care.
3. We should provide, in law, that the boards of the holding companies or trusts will have the authority, after the accession to power of the future elected, sovereign Iraqi government, to engage in strategic transactions involving their subsidiary companies, unless specifically instructed not to by the relevant government authority of that future government. Proceeds of any such transaction, of course, belong to the government.
4. The boards should also be able to pursue interim steps such as leasing of SOEs and joint ventures. Counsel should advise on the appropriate requirements for transparency and for control, in the case of joint ventures, to avoid problems with alienation of the control position currently owned by the government.
5. The boards shall be considered the stewards of the assets under their care, and it shall be their duty to try, through the mechanisms normally in the power of such boards, to improve the performance of their subsidiary companies.
6. The boards also have important communication responsibilities both with regard to their SOEs management and employees and with regard to the Iraqi public. They need to craft and deliver a message that social needs can be met, and that the nation's assets can be preserved, even while considering and perhaps following new paths for ownership of assets

The idea here is simple: sometime, shortly after the election and installation of the future, fully sovereign government of Iraq, the boards of the holding companies or trusts with viable companies will receive bids for the ownership of the trust as well as alternative options including IPOs and ESOPs. These bids, assuming operational improvements and a better security environment, should be attractive and the timing should be such that it is the easiest moment for the future government to say "yes."

Performance Improvement

For SOEs brought under the umbrella of holding or trust companies, we propose an emergency action program to accelerate the improvement or restoration of operations of a

select group of critical SOEs. For other viable, but non-critical SOEs, we propose the same performance improvement process, but on a less urgent timetable.

The *Emergency Action Program* consists of the following steps:

1. Identification of viable SOEs in critical areas;
2. Approach DFID, Madrid Donors, USAID, and others to see if any turnaround management capability can be deployed on short notice to the selected SOEs. Alternatively, we can consider using other funding sources to compete for provision of appropriate consulting services;
3. Perform an initial assessment with an eye toward outlining a directionally correct action plan. This plan does not have to be scientific, or perfect, it just has to be good enough to get things started;
4. Review the plan and allocate capital using either the 2004 budget or DFI funds that may be available.

There is some money in the 2004 budget for capital improvement. A portion of these funds should be allocated to the priority SOEs. The remainder should be held in reserve to ensure that we can make all the 2004 payrolls. As the ghost worker and voluntary reduction programs kick in, it will be possible to commit funds from the reserves.

We have also requested \$140 million from DFI for the SOEs. This money would be used for capital equipment and other projects contemplated in the emergency action program, ghost worker and voluntary reduction initiatives, as well as for the accounting, audit, and investment banking contracts discussed previously. Without these supplemental funds, it will be difficult to move as broadly as we propose here.

Agency SOEs

We have a list of Agency SOEs, meaning SOEs that really should be continued as government agencies. Examples include the geological survey, water testing service, and building and soil examination. We recommend issuing appropriate orders reassigning and reclassifying these entities, a process dependent on the signing of the consolidation order. It is important to do as soon as conditions permit and to include these agencies in the 2005 budgeting process.

Non-Viable SOEs

There are approximately 50 non-viable SOEs, housed in about 5 ministries. The types of business include textiles, paper mills, and, not surprisingly, missiles and explosives. It is our view that there is not time, resources, or good enough odds to save these firms. In the case of some of the military enterprises, there is neither wish to restore them nor any alternative use.

Our objective with these SOEs is to ease the transition of the people, and position the GOI to recover as much cash as possible from disposal of the remaining assets. Given the press of other priorities, we suggest that these tasks be divided for the GOI to handle. Specifically, we suggest that MOLSA be tasked with the transition of the people, drawing on support from ongoing job placement, vocational training, and private sector development programs.

The task of recovering value from defunct assets should go to the MIM. A special office, possibly with outside accounting or auditing support, should be established to turn dead assets into cash. Counsel should advise on whether this can be accomplished by the interim government, or must wait for the fully sovereign GOI. // 44, 27

Avoiding Future Problems

There are two potential long term problems that we should attempt to head off now. The first is to impede any future tendency to carve out a privileged or monopoly position for SOEs, to the disadvantage of real private sector companies. The second is to ensure control over the substantial landholdings embedded in the SOE properties.

With regard to the SOE advantages, we understand that OGC is including useful restrictions in the anti-trust legislation they are drafting. With regard to landholdings, we believe that the most we can accomplish in the near term is an inventory of the holdings. Additional recommendations may follow on this point.

Part II: Implementation, Timing, and Responsibility

Our goal for implementation is to do enough prior to June 30 to give us reason to think that the overall program, or at least the most sensitive elements, will be hard to derail. There are a limited set of things we can attempt to get done before June 30. While all of these tasks have been assigned for discussion purposes to SOE resources, it is intended that wherever possible, implementation be carried out by Iraqis (especially MIM and other ministry officers), based on their understanding of and agreement with this plan.

Pre-June 30 Tasks

Here are the most important things we need to get done before June 30 (with the lead responsibility in parentheses). All of these actions are meant to be taken after consultation and coordination with Iraqi counterparts. Completion of some of these tasks is contingent on availability of supplemental funds from DFI. The contingent tasks are marked with an asterisk.

1. Amend law 22 to provide for holding companies or create a trust law for purposes of holding the viable SOEs
 - a. David Luft, Commerce Dept. Counsel, OGC

2. Create boards for the holding companies or trusts needed, nominate members and a chairman for each
 - a. Bien, Luft in coordination with Ministers and other Senior advisors
3. Assign the SOEs into the appropriate holding or trust companies
 - a. Bien, Luft, Ministers, Senior Advisors
4. Bid, negotiate and sign contracts for control system, audit, and investment banking work*
 - a. Bien, Luft
5. Initiate the employee ID process and set a roll out plan (it will take longer than the time remaining to implement, but we can start now)*
 - a. Bien, Finance Senior Advisor and Ministry
6. Develop retirement and voluntary separation plans*
 - a. Carreau
7. Carefully craft a communications plan for each SOE and each facility, customizing our message to be clear and as reassuring as possible. Initiate rollout timed with the implementation of the ID process and the availability of the retirement and separation incentives
 - a. Bien, Luft
8. Assign someone to head the Emergency Action Program and get it launched. The capital requirements for this are tied to DFI monies.*
 - a. Bien
9. Prepare appropriate orders shifting agency-SOEs to their intended ministries
 - a. Bien
10. Include in the anti-trust law, currently being drafted, provisions impeding the government's ability to create non-oil monopolies, or other preferences for SOEs.
 - a. OGC
11. Work with MOLSA on transition of staff from defunct SOEs
 - a. Senior Advisor, MOLSA

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Private Sector Development and Other Programs

All these funds and services could be made available to a selected city or area on an expedited, even preferential, basis.

1. Medium Size Business Assistance
 - a. Middle Market Loan Fund (Loans from \$500k up to \$5 million)
 - b. Firm Level Assistance – consulting to help firms with project planning prior to access of loans
 - c. Classroom training – aimed at managers of mid-size companies. Will cover all aspects of business
 - d. Consulting Service – expertise available to help firms improve and expand their operations
2. Small Business Assistance
 - a. Small Business Loan Fund (Loans from \$25k to \$500k)
 - i. Eventually via the IFC and private banks
 - ii. Depending on DFI allocations we may be able to set up an interim fund
 - b. Firm Level Assistance – as above
 - c. Classroom training – aimed at owners and operators of small businesses. Will cover all key aspects including Entrepreneurship training for those wanting to get started
 - d. Consulting Service – A “business-in-a-box” program aimed at helping start up businesses and the expansion of small businesses. Will tie in to small business loans
3. Micro-Lending
 - a. Loans under \$25k
 - b. Please note that a program that would have made \$2 million or more available to Fallujah has been cancelled because the Iraqi Privately-Owned banks in Fallujah are fearful of participating
4. Business Centers and Business Associations
 - a. We can open business centers as a resource to the business community in a number of locations
 - b. We can provide training and support for local business groups. Note that the associations must have boards freely elected by dues paying members
5. Vocational Training and Employment Centers
 - a. Could be focused on rapid availability to a city or area
 - b. Link to PMO jobs with potential for preferential access
6. SOE Reform
 - a. Emergency turnaround support could be focused on selected, appropriate SOEs in a particular area

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The decision whether or not to support DBX should rest on whether Bill thinks the chance of a successful terrorist attack is significant and/or whether something between now and April 6 is likely to lead to DBX's cancellation. Bill is the better judge of the terrorist risk. If he thinks it is significant and we can't protect against it, the event should be cancelled. If we think there is a significant chance DBX will be cancelled for some other reason, we should cancel it now because the negative impact of canceling the event increases as we get closer to the date of the event.

I have been and remain in favor of CPA taking a back seat on DBX because neither the CPA nor DBX gains anything from CPA's endorsement, but CPA stands to lose from an endorsement if anything goes wrong, including cancellation of the event. The enthusiasm of [redacted] for DBX makes CPA's involvement feel more promotional than supportive. If the decision is taken to proceed, I recommend a clear signal be sent to the press and others that this is a private, not a CPA, event. A clear signal should also be sent to CPA people associated with supporting the event that they stay in the background and let the organizer organize the event. I also suggest that if Michael's assessment is that there is a significant chance DBX might not happen, the event should be cancelled or postponed now with a plausible explanation for it that is not related to security.

Private Sector Development
Coalition Provisional Authority (CPA)
Republican Palace - Room S107
Baghdad, IRAQ

3/7/2004

ØPSD

FROM: [REDACTED] PSD

SUBJECT: State-owned Enterprises – Proposals for moving forward

This document lays out two proposed approaches to SOEs, each comprising a complete set of actions. These actions have been developed with an eye toward the sensitivities that understandably emerge when this topic is discussed. This document has been minimally discussed with other concerned offices and officials. There will no doubt be considerable input and reaction and we need an opportunity to walk it around and get additional input and ideas.

Issues:

1. Burn Rate/High Subsidy Requirements/Social Concerns
2. Few Sustainable SOEs
3. Threat to Private Sector
4. Problems with Strategic Transactions
 - a. Inexperience
 - b. Political football

Policy Options

For purposes of discussion, we are considering a passive approach and an active one, depending on our appetite for the work. The elements of each approach can be combined to create something in the middle.

Passive Approach

The passive option is based on taking minimal action and allowing time to reduce the scope and magnitude of the SOE issue. Growth of the real private sector will drive this process naturally, and reasonably quickly, but there are risks that need to be addressed. The risks, a subset of the four issues cited above, and some suggested solutions, follow:

1. Running out of Cash – it is not likely, but it is possible, that SOEs may use up all of the cash budgeted for their salary and other subsidies. RESPONSES:
 - a. Help the government institute VOLUNTARY buyout and retirement programs to lower headcount and burn rate
2. Government Monopolies – it is possible, and maybe probable, that the future government may succumb to pressure to declare SOEs exempt from competition or to move to hobble competition with them. RESPONSES:
 - a. Put legal hurdles in the way of this through the drafting of the anti-trust law currently on the agenda for OGC
 - b. Work with IMF and others to educate and discourage official thinking along these lines

- c. Condition bi-lateral or multi-lateral programs on preservation of an open competitive marketplace
- 3. Uneven Playing Field – SOEs may take advantage of their position to kill off real private sector competition (especially for reconstruction contracts and subcontracts) by underbidding. This is possible because there is no real requirement that they make a profit, or a market return on assets or equity, and because they have substantially subsidized factor costs. RESPONSES (these have not been reviewed or discussed with the PMO, which will have reasonable and serious concerns about them):
 - a. Require the PMO (USAID funds cannot go to SOEs) to review SOE bids with an eye to reasonableness. A more stringent version of this would be to reject any unreasonably low SOE bid or to automatically bump up SOE bids by some amount for purposes of evaluation, but to accept their bids as given if they are still low after the penalty.
 - b. Alternatively, the PMO could accept SOE bids only if they are, well below the low priced private bidder. This will go some way to make SOE returns comparable to private returns and at least doesn't reward them for their privileged position.

Active Approach

The active approach aims to deal directly with the full suite of SOEs issues using all tools available to us, within the practical political limits. This option focuses in full on each of the four issues noted above. Specifically:

- 1. Burn Rate/High Subsidy Requirements/Social Concerns
 - a. Cut costs in a socially sensible manner
 - i. Reduce ghost workers (photo id teams)
 - 1. May yield a 25% reduction or more
 - 2. Could be implemented quickly
 - ii. VOLUNTARY Buyouts, pension bonuses
 - iii. Preferential targeting for vocational training, stipends
 - 1. Coordinate with PMO to get trainees into jobs
 - iv. Preferential access to PSD loan and small business incubator programs
 - b. Increase real profits at "quick recovery/high likelihood" SOEs
 - i. Provide capital, accounting/audit, consulting and other support for enterprises with a good shot at generating cash
 - 1. We have the funds and resources to do this
 - ii. Create a program that certifies certain SOEs as behaving like economically private companies and exempt them from any PMO or other bid restrictions (see item 3 in prior section)
- 2. Few Sustainable SOEs
 - a. For potentially viable SOEs
 - i. See 1b. above
 - b. For "Agency" SOEs

- i. Move to their owning Ministries as appropriate
 - c. For SOEs that are likely not viable
 - i. Isolate them in a structure that allows rapid transition for their employees
 - 1. Re-assign the employees of these companies to MOLSA (not discussed with MOLSA) for preferential access to job placement. Compensate MOLSA via the trust/holding company discussed below
 - a. MOLSA would oversee what amounts to protracted unemployment benefits for these people and would actively try to move them off the rolls and into real jobs
 - b. Supplement the benefits with preferential programs and buyouts as in section 1a above
 - c. The benefits should phase out over time
 - ii. Develop disposition plans for the assets, structured in compliance with issues of alienation of government property
3. Threat to Private Sector
 - a. Same as under passive approach
4. Problems with Strategic Transactions (inexperience, political football)
 - a. Use trust/holding company approach to isolate the non-agency SOEs whether viable or not
 - i. Board of the Trust (or individual company?) would have ultimate responsibility for approving strategic transactions, once that authority can be granted by the post-election sovereign government
 - ii. We could transition the MIM into the trust/holding company, after re-assigning other ministries' SOEs to it
 - iii. Combine MIM and Trade?
 - b. Establish independent corporate boards for the trust and for the individual companies, even though government ownership continues. Boards might consist of Iraqis and others.
 - i. Supplement the trust and the individual corporations in it with audit, consulting, and strategic transaction services
 - ii. Develop IAS compliant audit systems for the viable companies
 - iii. Prepare books for use in possible JV's and strategic transactions
 - 1. Solicit bids, due post-election for appropriate strategic transactions
 - iv. In the event that bids are unsatisfactory, explore other ways to transfer ownership via ESOPs, IPOs, distributions to a citizen owned mutual fund, and other mechanisms
 - c. Review utility and legality of Joint Ventures and Lease Programs
 - d. Keep up the pressure by encouraging true private sector enterprises that compete with SOEs. We can do this through our FDI initiatives, our consulting programs, and our lending and equity programs.

Annex A

Military Industry Commission Companies (MIC's) to Ministry of Industry and Minerals (MIM):

Enterprise Name	Area of Activity	Total Amount of Workers	Buildings Level of Destruction(%)	Machines Destruction and Looting(%)	Assign Employees and Assets to:
1. Al Saheed	Copper production	1,300	11.9%	45%	MIM
2. Tareq	Pesticides, chemicals	896	30.6%	25%	Ministry of Finance
3. Hammurabi	Pistols, small arms	636	2.8%	15%	Ministry of Finance
4. Al Tahady	Electromechanical	399	10.4%	35%	MIM
5. Ibn Waleed	Heavy armored veh. Rep.	926	10.5%	60%	Ministry of Finance
5. Al Ikhaa	Mechanical, optics	2,382	1.7%	20%	MIM
7. Al Rasheed	Co2 producer, mechanical	2,290	43.2%	50%	Ministry of Finance
8. Asahf al Kabir	Concrete additives	86	26.1%	35%	Ministry of Finance
9. Al Noaman	Plastic injection, irrigation	643	6.0%	10%	MIM
10. Al Uboor	Mechanical machining	1,217	70.4%	100%	Ministry of Finance
11. Al Mansour	Solar cells, IC, gases	670	0.2%	5%	MIM
12. Radhwan	Machining	760	34.0%	60%	Ministry of Finance

Enterprise Name	Area of Activity	Total Amount of Workers	Buildings Level of Destruction(%)	Machines Destruction and Looting(%)	Assign Employees and Assets to:
13. Al Nidaa	Dies, molds, gears	1,281	41.8%	80%	Ministry of Finance
14. Al Salam	Construction Equip.	752	7.7%	100%	Ministry of Housing
15. Ibn Majed	Eng. Mfg. Marine et.al.	1.648	21.6%	30%	MIM

MIC's to Ministry of Labor and Social Affairs (MOLSA):

Enterprise Name	Area of Activity	Total Amount of Workers	Buildings Level of Destruction(%)	Machines Destruction and Looting(%)	Assign Employees and Assets to:
1. Training Center	All defense SOE's specialties	N/A	N/A	N/A	Ministry of Labor

MIC's That Will Have Surviving Assets and Employees Transferred to Other Iraqi Government Agencies:

Enterprise Name	Area of Activity	Total Amount of Workers	Buildings Level of Destruction(%)	Machines Destruction and Looting(%)	Assign Employees and Assets to:
1. Jaber ben Hayan	Plastic, rubber, filters	904	25.7%	95%	Ministry of Finance
2. Yarmuk	Ammunitions, barbed wire	2,708	65.8%	100%	Ministry of Finance
3. Al ezz	Electronic switching	1,046	23.7%	100%	Ministry of Finance
4. Al Kadissiya	Guns, grenades, mortars	3,035	69.9%	100%	Ministry of Finance

Enterprise Name	Area of Activity	Total Amount of Workers	Buildings Level of Destruction(%)	Machines Destruction and Looting(%)	Assign Employees and Assets to:
5. Al Fidaa	Hydraulic, pneumatic systems	1,285	50.2%	100%	Ministry of Finance
5. Al Karama	Missiles, mechanical	2,287	51.4%	40%	Ministry of Finance
7. Al Qaqa	Explosives, powder, TNT	5,365	36.6%	85%	Ministry of Finance
8. Bader	Tools, dies	1,631	82.8%	100%	Ministry of Finance
9. Tabook	Powder for cartridges	532	0.3%	20%	Ministry of Finance
10. Al Hadhar	Chemical products	572	70.6%	100%	Ministry of Finance
11. 7 Nissan	Fuses, military shells	2,652	94.2%	100%	Ministry of Finance
12. Al Hareth	Radars, welding equipment	1,387	0.0%	60%	Ministry of Finance
13. Al Kindi	R & D radars	976	38.0%	90%	Ministry of Finance
14. Sanahareeb	Irrigation systems	675	22.3%	100%	Ministry of Finance
15. Salahuddeen	Communication, radars	2,900	34.2%	75%	Ministry of Finance
16. Ibn Rushd	Qa, testing, inspection	448	50.0%	100%	Ministry of Finance
17. Hutten	Ammunition, guns, mortars	5,473	25.9%	70%	Ministry of Finance

ANNEX A

Column 1	Column 2	
Transfer of SOEs between Ministries:		
• Hand Woven Carpets	Ministry of Industry & Minerals (MIM)	Ministry of Culture (MoC)
• Dairy Products	MIM	Ministry of Agriculture (MoAG)
Consolidations of SOEs into Ministries as State Agencies:		
• Geological Survey and Mining (Geological Survey portion only)	MIM	Agency Status
• Spec. Institute for Engineer Industries	MIM	Agency Status
• Al Kadisiah (Irrigation & Drainage Networks)	MWR (Ministry of Water Resources)	Agency Status
• Al Hadba'a (Development & Maintenance of Reclamation & Irrigation projects)	MWR	Agency Status
• Al Muthana (River Dredging)	MWR	Agency Status
• Al Fao (Irrigation & Reclamation)	MWR	Agency Status
• Fourat Design (Consult for Irrigation, Drainage & Dams)	MWR	Agency Status
• Al Nassr	MWR	Agency Status
• National Center for Labs (Building & Soil Exams)	Ministry of Housing & Construction	Agency Status
• National Center for Consultancy (Engineering designs & services)	Ministry of Housing & Construction	Agency Status
• Kimedia (Drug & Medical Supply Purchaser)	Ministry of Health	Agency Status
• Animal Resources	Ministry of Agriculture	Agency Status
• Horticulture / Forestry	Ministry of Agriculture	Agency Status
• Veterinary	Ministry of Agriculture	Agency Status
• Grain Board	Ministry of Trade	Agency Status
• Food Stuffs	Ministry of Trade	Agency Status
• Grain Processing	Ministry of Trade	Agency Status
• Export and Import	Ministry of Trade	Agency Status
• International Fairs	Ministry of Trade	Agency Status
Meterology	MoTrans	Agency Status
Private Company	MoTrans	Agency Status

(operates terminals and licenses companies that provide passenger transportation between terminals)

SOEs to be Merged:

Ministry of Housing & Construction (MoHC):

- Al Idresi Engineering Center
- Al Youm Al Adeem -Construction Company
- Ramadan Mubarak- Construction Comapny
- Al Taheer- Construction Company
- Taj Al Ma'arik- Construction Company
- Al Jihad- Construction Company
- Al Anfal- Construction Company

Ministry of Industry & Minerals (MIM):

- Design and Industrial Construction
- Design and Consultation

Other Consolidations:

Land Transport	Ministry of Transportation	Partial Agency Status
• (IntraCity Bus Component Only)	(MoTrans)	
Iraqi Port Authority	MoTrans	Split into Agency and SOE
• Port Operating Authority-Stevedoring and Port Operations (SOE Status)		
• Independent Port Authority- Regulatory and Oversight Functions (Agency Status)		
Iraqi Water	MoTrans	Split into Agency and SOE
• Transfer regulatory function to Ministry of Transportation (Agency Status)		
Retain operating function as an SOE		
Al-Dhilal(passenger/freight transport)	MoTrans	Transfer to 2 separate SOEs
• Transfer freight forwarding services and associated personnel and assets to MoTrans Land Company SOE		
• Transfer passenger transport services and associated personnel and assets to MoTrans Passenger Company SOE		

COALITION PROVISIONAL AUTHORITY ORDER NUMBER XX

REALIGNMENT OF MILITARY INDUSTRIAL COMPANIES

Pursuant to my authority as Administrator of the Coalition Provisional Authority (CPA), and under the laws and usages of war, and consistent with relevant U.N. Security Council resolutions, including Resolutions 1483 and 1511 (2003),

Furthering commitments to promote public order and safety and restore the conditions of security and stability for the Iraqi people,

Having worked closely with the Governing Council to ensure that economic change occurs in a manner acceptable to the people of Iraq,

Recognizing that many state-owned enterprises previously engaged in military industrial production (heretofore "military industrial companies") sit idle and largely abandoned throughout Iraq,

Concerned that buildings and factories of companies formerly assigned to the military industrial commission (or "military industrial companies") often contain stockpiles of hardware and materials that remain deployable for violent uses against Coalition Forces and the people of Iraq, and that employees of these companies remain needlessly underemployed and unable to utilize their skills to promote the welfare of Iraq,

Determined to secure and dispose of these stockpiles and to assign responsibility for reconstituting military industrial companies and reassigning their employees as necessary for the promotion of peace, security, and stability in Iraq;

I hereby promulgate the following:

Section 1 Purposes and Objectives

This Order promotes public order and safety for the Iraqi people by providing for the security and destruction of materials abandoned after the closure of military industrial companies throughout Iraq. This order also restores conditions of stability in Iraq by assigning responsibility for the personnel and assets of military industrial companies to appropriate ministries and facilitating the reconstitution of such companies for peaceful and resourceful uses.

Section 2 Military Industrial Companies

CPA/ORD/xx March 2004/01

- 1) Military industrial companies subject to this Order include those state-owned enterprises listed in Annex A. The absence of appropriate responsibility for the facilities and assets of these enterprises has been determined by the Administrator to constitute a continuing threat against Coalition Forces and the people of Iraq if not appropriately secured.
- 2) State-owned enterprises formerly assigned to institutions dissolved under CPA Order No. 2 (CPA/ORD/23 May 2003/02), Dissolution of Entities, and those enterprises formerly assigned to the military industrial commission are generally subject to inclusion in Annex A.
- 3) The military industrial commission is an entity dissolved under CPA Order No. 2 (CPA/ORD/23 May 2003/02).
- 4) The Administrator retains authority to add state-owned enterprises to Annex A if it is determined that such enterprises previously engaged in military industrial production and either (a) threaten public order and safety on account of stockpiles and/or abandoned materials that may be used for violent purposes against Coalition Forces and the people of Iraq, or (b) have real property or other tangible assets that the enterprise as presently constituted cannot adequately safeguard and thus stand in danger of being looted, severely damaged, or destroyed.
- 5) The Minister of Industry shall be notified of any additions or deletions to Annex A within ten days of such action being taken by the Administrator. The Minister of Industry shall also inform the Administrator of any state-owned enterprise known to have been engaged in military industrial production, but not listed in Annex A

Section 3

Disposition of Military Industrial Assets and Employees

- 1) The Administrator retains authority to secure facilities and dispose of the material assets of enterprises listed in Annex A so long as the Administrator finds that such facilities or assets or the lack of control over such facilities and assets constitute a continuing threat to Coalition Forces and the people of Iraq.
- 2) The Administrator also retains authority to reclassify and/or reorganize the enterprises listed in Annex A, so long as the Administrator finds such reclassification and/or reorganization essential to the safety of Coalition Forces and the people of Iraq, the preservation of assets and property for the people of Iraq, or the restoration of societal conditions necessary to the self determination of the Iraqi people. Where an enterprise listed in Annex A is not reassigned to another Iraqi ministry, the liabilities of such enterprise shall be assumed by the Ministry of Finance.

- 3) The Administrator further retains authority to reassign otherwise unemployed workers of the enterprises listed in Annex A to other Iraqi ministries, governmental agencies, governmental instrumentalities, or state-owned enterprises, so long as the Administrator finds such reassignment furthers the security and safety of Coalition Forces and the people of Iraq or furthers the restoration of societal conditions necessary to the self determination of a free people.
- 4) To ensure continuity in the economy of Iraq and the salaries of workers reassigned under this Section, the Minister of Finance will assure that the budget of any enterprise reassigned and/or reclassified under this Section, and the associated payroll information for any employee reassigned under this Section, shall follow that enterprise or employee to their new ministry or place of employment. Employees reassigned under this Section shall be guaranteed a salary commensurate with the salary paid by their former employer.
- 5) The Minister of Industry must be notified in writing of any action taken under this Section, and within 14 days of such notice may issue an opinion as to whether such action serves the interests of the Iraqi people. The Minister of Industry may make specific recommendations for alternative courses of action, keeping in mind that the Administrator retains full authorization under the laws and usage of war to ensure and restore public order and security in Iraq.

Section 4 Assignment and Consolidation

- 1) Responsibility for military industrial companies and the assets and personnel thereof not listed in Annex A shall be assigned to the Ministry of Industry and Minerals or such other ministry as the Administrator deems appropriate. These companies shall include all state-owned enterprises formerly supervised or owned by institutions dissolved under CPA Order No. 2 (CPA/ORD/23 May 2003/02), or formerly assigned to the military industrial commission.
- 2) Military industrial companies assigned to the Minister of Industry and Minerals under this Section may be subject to consolidation pursuant to the procedures set forth in other CPA Orders.

Section 5 Administrative Instructions

The Administrator may delegate authority to issue Administrative Instructions to clarify and implement this Order.

Section 6 CPA/ORD/XX March 2004/XX

Inconsistent Legislation

Any provision of Iraqi law that is inconsistent with this Order or Annex A is hereby suspended to the extent of such inconsistency.

Section 7

Entry into Force

This Order shall enter into force on the date of signature.

L. Paul Bremer, Administrator
Coalition Provisional Authority

COALITION PROVISIONAL AUTHORITY ORDER NUMBER XX

CONSOLIDATIONS OF STATE-OWNED ENTERPRISES

Pursuant to my authority as Administrator of the Coalition Provisional Authority (CPA) and under the laws and usages of war, and consistent with relevant U.N. Security Council resolutions, including Resolutions 1483 and 1511 (2003),

Having worked closely with the Governing Council to ensure that economic change occurs in a manner acceptable to the people of Iraq,

Acknowledging the Governing Council's desire to bring about significant change to the Iraqi economic system by promoting economic reconstruction and the conditions for sustainable development in a competitive global marketplace,

Determined to encourage more efficient Iraqi governance by consolidating government functions carried out by certain state-owned enterprises into government agencies,

Further committed to improve the production and economic performance of some Iraqi state-owned enterprises by merging them together,

I hereby promulgate the following:

**Section 1
Purpose**

This Order provides for the consolidation and reorganization of certain state-owned enterprises into government ministries or agencies. This Order also clarifies the operation of existing procedures with respect to the merger of two state-owned enterprises.

**Section 2
Consolidation**

- 1) The state-owned enterprises listed in Column 1 of Annex A shall be consolidated into the Iraqi ministries listed opposite those companies in Column 2 and may be reorganized or reclassified as appropriate under the particular economic facts and circumstances so long as such reorganization remains consistent with this Order. The Administrator shall have the authority to add to and remove state-owned enterprises from Annex A. The Governing Council or a minister may propose to the Administrator a state-owned enterprise for consolidation. Generally, state-owned enterprises selected for consolidation will be those that are not a complete business, but which provide a needed and valuable service, the operations and assets of which

CPA/ORD/XX March 2004/XX

can be successfully transferred to a ministry. State-owned enterprises that include any private ownership shall not be consolidated pursuant to this Order.

- 2) Such consolidation shall be effected on approval of the Administrator and executed under the direction of the minister of the ministry into which the state-owned enterprise will be consolidated (the "gaining ministry"). The minister shall have the authority to reorganize the state-owned enterprise or components thereof in a manner that effectively integrates the enterprise into the respective ministry.
- 3) The minister may, in his or her sole discretion, and as provided by law, sell or otherwise dispose of any surplus assets, except real property and cultural property (as defined in the Convention for the Protection of Cultural Property in the Event of Armed Conflict of 1954), of the state-owned enterprise or the ministry that are no longer necessary to the continued functioning of such enterprise or ministry as a result of the consolidation; provided, however, that such sale or disposition is accomplished through a transparent and market-based transaction between two parties with independent interests, operating in good faith and at arms-length, resulting in fair market value compensation to the ministry. The proceeds of any sale or disposition under this Section shall be paid to the Ministry of Finance, which may, in its discretion and with a view toward encouraging the sale of unnecessary surplus assets, pay up to 50% of such proceeds to the gaining ministry, so long as the proceeds are paid through the gaining ministry's existing accounts and reported in line with usual budget procedures.
- 4) Once the consolidation of a state-owned enterprise is complete, the minister shall submit a completion certificate to the Ministry of Finance, the Governing Council and the Administrator.
- 5) The completion certificate shall contain, at a minimum, the following:
 - a) the name of the consolidated state-owned enterprise;
 - b) the name of the relevant ministry;
 - c) any assets disposed of as part of the consolidation and the amounts received as a result of that disposal;
 - d) the date on which the consolidation was completed;
 - e) the budget for the consolidated state-owned enterprise within the ministry, including a sheet of spent, committed, and remaining budget allocations for the current year; and

Comment: Revisions in response to comments from UK and IMF.

- f) a list of employees consolidated into the relevant ministry.
- 6) After submission of the completion certificate and approval of budget allocations for the current year by the Ministry of Finance, paragraph (3) above shall no longer be applicable and Iraqi law shall prevail. The Ministry of Finance shall expedite procedures for reviewing submitted completion certificates, and current year budget allocations shall be deemed approved if not acted upon within two weeks of submission.
- 7) In cases where the state-owned enterprise is consolidated into a ministry that did not supervise or own the state-owned enterprise, the gaining ministry shall agree in writing with the releasing ministry on the terms of the consolidation, including, with respect to the payment and identification of any and all outstanding obligations, disposition of assets and employee-related matters. Such an agreement is not required where the former ministry of the state-owned enterprise has itself been dissolved prior to the consolidation, including all ministries dissolved pursuant to CPA Order No. 2.

Section 3

Contracts, Property and Budgets

- 1) By operation of this Order, the ministry into which the state-owned enterprise is consolidated shall be substituted for the state-owned enterprise as a party in each contract to which the state-owned enterprise is a party. Upon consolidation, the substituting ministry shall be entitled to exercise all of the rights and receive all of the benefits of the enterprise.
- 2) Notwithstanding paragraph (1) above, the substitution of the relevant ministry for the state-owned enterprise in a contract shall not constitute an explicit or implicit waiver of any immunity, including sovereign immunity, to which the relevant ministry is entitled. Nor shall the relevant ministry retain benefits and entitlements concerning revenue generation, such as raising funds by issuing debt, making loans from a bank other than the Central Bank of Iraq, or holding a bank account outside the Central Bank of Iraq.
- 3) Except as set forth in Section 2(3), title to all property owned by the state-owned enterprise being consolidated – whether movable or real, tangible or intangible – shall be transferred to the relevant ministry. The relevant ministry shall accomplish such transfer of property through the means or procedures prescribed by Iraqi law.
- 4) After a completion certificate is delivered to the Governing Council and the Administrator, the Ministry of Finance shall transfer to the relevant ministry the

Comment: Addition in response to IMF comments.

allocation of the national budget associated with the state-owned enterprise being consolidated.

Section 4 Legal Identity

- 1) Upon the date that the completion certificate is submitted to the Governing Council and the Administrator, the state-owned enterprise shall no longer have a separate legal identity and shall cease to exist.
- 2) Notwithstanding paragraph (1), the authorities granted by law, regulation or rule to the state-owned enterprise being consolidated shall be transferred to the relevant ministry and may be exercised by the relevant ministry as part of its own authorities.

Section 5 Modifications to the State Companies Law

To effectuate the terms of this Order, the State Companies Law shall be modified as follows:

- 1) Article 31, Paragraph First of the State Companies Law, No. 22 of 1997 (the "State Companies Law") shall be amended to read in full: "It is permissible to merge two or more wholly state-owned enterprises into a single state-owned enterprise, provided they engage in a similar or integrated activity. If all of the state-owned enterprises involved are owned by a single ministry, the relevant minister may propose the merger. If each of the state-owned enterprises involved is owned by a different ministry, ministers of all involved ministries must agree in writing to the merger, including with respect to which ministry will ultimately own the state-owned enterprise resulting from the merger (for the purposes of Article 31, 32, 33 and 34, the 'new enterprise')."
- 2) Article 31, Paragraph Second of the State Companies law shall be amended to read in full: "The involved minister or ministries shall prepare a proposal describing the merger and submit it for final approval to the Administrator in consultation with the Governing Council."
- 3) Article 32 of the State Companies Law shall be amended to read in full: "Once the Governing Council has approved the merger pursuant to Article 31, Paragraph Second, the ministry that will ultimately supervise or own the new enterprise shall amend the original contract or draw up a new contract. The board of directors shall amend the basic law or draft a new basic law."

- 4) Article 33 of the State Companies Law shall be amended to read in full: "The ministry that will ultimately own the new enterprise shall inform the Registrar of the amended contract or provide the Registrar with the new contract. The merger shall be considered valid as of the date of the Governing Council's approval, unless otherwise specified by the Governing Council. On the date the merger becomes valid, the corporate status of the enterprise or enterprises being merged into the new enterprise shall expire. The Registrar shall issue a new certification of establishment."
- 5) Article 34, Paragraph First of the State Companies Law shall be amended to read in full: "The Governing Council shall publish notice of its merger decision in the Official Gazette of Iraq and, if available, the bulletin issued by the Registrar."
- 6) Article 34, Paragraph Second of the State Companies Law shall be amended to read in full: "The rights and obligations of the enterprise or enterprises being merged shall revert to the new enterprise."
- 7) Following the transfer of full governmental authority to the Interim Iraqi Government, the duties of the Administrator and the Governing Council under this Order shall be assumed by the body vested with national executive authority.

Section 7 Administrative Instructions

The Administrator may delegate authority to issue Administrative Instructions to clarify and implement this Order.

Section 8 Inconsistent Legislation

Any provision of Iraqi law that is inconsistent with this Order or Annex A is hereby suspended to the extent of such inconsistency.

Section 9 Entry into Force

This Order shall enter into force on the date of signature.

L. Paul Bremer, Administrator
Coalition Provisional Authority

(b)(6) (O-6)

From: (b)(6)

Sent: Friday, April 09, 2004 9:48 PM

To: (b)(6) b(2)

Cc:

Subject: RE: Meeting of the Executive Board Econ Policy Group and guests on SOEs Friday, 10 April at 5pm

Please find attached Mr. [REDACTED] paper on SOEs which will be the basis of discussion. Thank you.

-----Original Message-----

From: (b)(6)

Sent: Thursday, April 08, 2004 1:25 PM

To: (b)(6)

(b)(6) b(2)

Subject: Meeting of the Executive Board Econ Policy Group and guests on SOEs Friday, 10 April at 5pm

Ambassador Jones has asked to convene a meeting to discuss state-owned enterprises. The meeting will be at 5pm on Saturday, 10 April, in the Ambassador's Conference Room. The Senior Advisors of Ministries which have SOEs are invited to attend.

In early winter last year a privatization plan was proposed to the GC and was summarily rejected. A severance plan also faltered. Since approximately January, there have been no hard decisions about SOEs.

On funding, the original proposal was \$500M for SOE salaries and \$500M for "capital expenditures". The original four-tier salary structure would use less than the \$500M set aside, however, if the eleven-tier salary structure is used, then the estimates are approximately \$680M. Also, the \$500M cap-ex monies were reduced. Thus there is approximately \$780M available for both salaries and other expenditures.

Attached please find documents concerning some of the history of this issue. Thank you.

(b)(6)

Deputy Executive Secretary

Executive Secretariat

(b)(6) b(2)

4/9/2004

φ PSD

Creating the Mandate for Change

How to Address the Challenge of State Owned Enterprises in Iraq

A Concept Paper

by

[REDACTED]
Senior Advisor
Ministry of Trade
Tel. [REDACTED]
E-Mail [REDACTED] b(2)

Background

The Ba'athist ideology in the sphere of organization of Iraq's economy largely followed examples models developed in the Soviet Union prior to the fall of Communism. Thus state owned enterprises (SOEs) played a leading role in the development of the economy although private enterprise was tolerated to a far larger degree than in the Soviet Union. The ministries of Finance, Agriculture, Oil Water, Communication, Electricity Housing, Industry and Minerals, Transportation, and Trade all own SOEs. Following Soviet models these SOEs also fulfill a social function far larger than those played by large enterprises in western developed economies. *Dealing with the challenge of state owned enterprises is thus a question of change management which must deal not only with the economic role of SOEs but also with the roles they play as symbols of Iraq's achievements and as social centers.*

Change Management

Any program which claims to address the challenge the SOEs pose to future development of Iraq's political economy must be one which can operate within the following constraints:

- Time
- Money
- Social and Political Inertia
- Lack of alternative employment.

The time remaining before return of sovereignty to an Iraqi government militates against a program of immediate and comprehensive privatization. Moreover, because privatization is likely to be accompanied by layoffs, promoting immediate privatization at this time is likely exacerbate political tensions. However, doing nothing is also a poor strategy because the employees of many of these companies realize that the status quo is not a solution and is in fact unsustainable due to budget constraints.

Given the constraints outlined above, it would appear prudent to create a process of incremental steps designed to reform the SOE sector of the economy. The process should be accompanied by an educational media campaign that makes it clear to employees of SOEs that there is no immediate threat to their jobs, but that there is a process of reform designed to address the problems in the SOEs and that privatization is one of the goals of the reform process. *Fundamental to this process is that SOE management, and SOE employees as well as the public at large be educated to begin to think of SOEs as independent entities responsible for their own future rather than as arms of the government.*

The Incremental Steps

Creating the process of reform could involve the following steps:

1. Amending the existing Iraqi SOE law to allow for the creation of Trust(s) which would hold the SOEs of each ministry
2. Appointing a Board of Trustees for each Trust
3. Appointing outsiders to the Board of Directors of each SOE
4. Charging the Board of Trustees with seeking donor technical assistance for the SOEs in the Trust
5. Restructuring each SOE to make them viable candidates for full or partial privatization, leasing of select assets, joint ventures with foreign partners, etc.

Creating a Trust which would function as a holding company for a particular ministry's SOE's if accompanied by a proper educational publicity campaign could counter many of the fears associated with privatization. The educational publicity campaign should emphasize that purpose of the Trust is to safeguard the assets incorporated in the SOEs for the people of Iraq, create a structure which will be used to find and fund appropriate technical assistance for each SOE to help reform and restructure the SOEs so that the employees and the companies in whole or in part can be incorporated into a growing and vibrant private sector in Iraq.

The composition of the Board of Trustees is a critical element for the acceptance of the "process of reform." The Board needs to have one or two non-Iraqi businessmen who would be on the Board because of their stature, expertise, and ability to network in the international business/political community. The number of people perceived to be politicians appointed to the Board needs to be minimized because politicians do not appear to be highly regarded in Iraq. The Iraqis appointed to the Board could be drawn from private sector business and from cultural fields such as art, literature, music. The goal is to have a Board that is above all perceived as trustworthy and secondarily will look at the problems of each SOE from an unprejudiced perspective. The function of the Board of Trustees is to find and obtain official donor and non-governmental-organization technical assistance which will create a business plan for each SOE. The process of creating the business plan will involve creating financial statements in accordance with international accounting standards, addressing the technical and engineering challenges present in each SOE, marketing and sales plans. The business plan will address how the

company and or its assets can become viable components of the private sector economy. Among the factors to be considered is the conservation of human capital through retraining to provide the workforce with the skills needed to compete effectively in the new Iraqi economy.

To help drive this process of reform forward at least one non-Iraqi should be appointed to the Board of Directors of each SOE. (Neither of the two out of nine Board members appointed by the minister to an SOE under Law no. 22 has to be an Iraqi.) It will be the function of this non-Iraqi to start each SOE on the process of collecting adequate financial and business information to form the basis of future plans.

A balance sheet should be drawn up listing the company's assets. An agreement may have to be reached with the Ministry as to what assets are included in what the company owns. Some estimate of current value needs to be made using best available information.

A projected income and expenditure statement needs to be created for at least two years. This should list all expected expenditures and all sources of income. This will enable the Board of Trustees to form a minimal picture of what we can expect to happen in the company and provide a basis of planning for the future.

Neither of these steps needs the involvement initially of outside professionals. In fact involving outside professionals before these steps are taken would be counter productive. Without this information, outside consultants can do nothing and it will be the first thing they will ask for. Having ready whatever can be gathered before involving donor technical assistance will speed the process and make it substantially less expensive.

The technical assistance would be brought in as a second step to help create the business plan which will lead to privatization, leasing of assets, etc. Part of the assignment for the Board of Trustees and for the Board of each SOE is to evaluate the potential for an Employee Stock Ownership Plan (ESOP) and where it is a viable option to move toward implementation of an ESOP **structured as in the U.S. where the shares are held in a trust for the employees.** That the shares be held in a trust is a crucial element for creating conditions of widespread private property ownership which is a fundamental cornerstone of a modern democratic system.

Benefits of this Approach

This approach has a number of benefits. First and foremost it gets the Ministers out of the business of functioning as Chief Executive Officers of the SOEs. This will allow ministers to focus on questions of government rather than questions of business. The educational campaign and Boards of Trustees composed of respected dignitaries will do much to lessen fears of privatization leading to joblessness. The charge to the Board of Trustees to include ESOPS in their planning should strengthen public and SOE support for this process of reform.

Critical Missing Elements

There is no Trust Law in Iraq. The lack of a Trust Law makes it difficult to establish a Trust to act as a holding company for a ministry's SOEs. The lack of a Trust Law also means that shares owned by employees would in short order be held by oligarchs as in a number of former Warsaw Pact countries. To overcome these difficulties an existing law such as Law no. 22 of 1997 could be amended to enable the formation of trusts or a new law created by CPA order.

SOE SKETCH

This document lays out two proposed approaches to SOEs, each comprising a complete set of actions. These actions have been developed with an eye toward the sensitivities that understandably emerge when this topic is discussed. This document has been minimally discussed with other concerned offices and officials. There will no doubt be considerable input and reaction and we need an opportunity to walk it around and get additional input and ideas.

Issues:

1. Burn Rate/High Subsidy Requirements/Social Concerns
2. Few Sustainable SOEs 30-50 of 192
3. Threat to Private Sector
4. Problems with Strategic Transactions
 - a. Inexperience
 - b. Political football

\$ 780 m. '04 budget
for salaries
in budget +
comp & subsidies

Policy Options

For purposes of discussion, we are considering a passive approach and an active one, depending on our appetite for the work. The elements of each approach can be combined to create something in the middle.

Passive Approach

The passive option is based on taking minimal action and allowing time to reduce the scope and magnitude of the SOE issue. Growth of the real private sector will drive this process naturally, and reasonably quickly, but there are risks that need to be addressed. The risks, a subset of the four issues cited above, and some suggested solutions, follow:

1. Running out of Cash – it is not likely, but it is possible, that SOEs may use up all of the cash budgeted for their salary and other subsidies.

RESPONSES:

- a. Help the government institute VOLUNTARY buyout and retirement programs to lower headcount and burn rate
2. Government Monopolies – it is possible, and maybe probable, that the future government may succumb to pressure to declare SOEs exempt

from competition or to move to hobble competition with them.

RESPONSES:

- a. Put legal hurdles in the way of this through the drafting of the anti-trust law currently on the agenda for OGC
 - b. Work with IMF and others to educate and discourage official thinking along these lines
 - c. Condition bi-lateral or multi-lateral programs on preservation of an open competitive marketplace
3. Uneven Playing Field – SOEs may take advantage of their position to kill off real private sector competition (especially for reconstruction contracts and subcontracts) by underbidding. This is possible because there is no real requirement that they make a profit, or a market return on assets or equity, and because they have substantially subsidized factor costs. RESPONSES (these have not been reviewed or discussed with the PMO, which will have reasonable and serious concerns about them):
- a. Require the PMO (USAID funds cannot go to SOEs) to review SOE bids with an eye to reasonableness. A more stringent version of this would be to reject any unreasonably low SOE bid or to automatically bump up SOE bids by some amount for purposes of evaluation, but to accept their bids as given if they are still low after the penalty.
 - b. Alternatively, the PMO could accept SOE bids only if they are, well below the low priced private bidder. This will go some way to make SOE returns comparable to private returns and at least doesn't reward them for their privileged position.

Active Approach

The active approach aims to deal directly with the full suite of SOEs issues using all tools available to us, within the practical political limits. This option focuses in full on each of the four issues noted above. Specifically:

1. Burn Rate/High Subsidy Requirements/Social Concerns
 - a. Cut costs in a socially sensible manner
 - i. Reduce ghost workers (photo id teams)
 1. May yield a 25% reduction or more
 2. Could be implemented quickly
 - ii. VOLUNTARY Buyouts, pension bonuses
 - iii. Preferential targeting for vocational training, stipends
 1. Coordinate with PMO to get trainees into jobs

- iv. Preferential access to PSD loan and small business incubator programs
 - b. Increase real profits at "quick recovery/high likelihood" SOEs
 - i. Provide capital, accounting/audit, consulting and other support for enterprises with a good shot at generating cash
 - 1. We have the funds and resources to do this
 - ii. Create a program that certifies certain SOEs as behaving like economically private companies and exempt them from any PMO or other bid restrictions (see item 3 in prior section)
2. Few Sustainable SOEs
- a. For potentially viable SOEs
 - i. See 1b. above
 - b. For "Agency" SOEs
 - i. Move to their owning Ministries as appropriate
 - c. For SOEs that are likely not viable
 - i. Isolate them in a structure that allows rapid transition for their employees
 - 1. Re-assign the employees of these companies to MOLSA (not discussed with MOLSA) for preferential access to job placement. Compensate MOLSA via the trust/holding company discussed below
 - a. MOLSA would oversee what amounts to protracted unemployment benefits for these people and would actively try to move them off the rolls and into real jobs
 - b. Supplement the benefits with preferential programs and buyouts as in section 1a above
 - c. The benefits should phase out over time
 - ii. Develop disposition plans for the assets, structured in compliance with issues of alienation of government property
3. Threat to Private Sector
- a. Same as under passive approach
4. Problems with Strategic Transactions (inexperience, political football)
- a. Use trust/holding company approach to isolate the non-agency SOEs whether viable or not
 - i. Board of the Trust (or individual company?) would have ultimate responsibility for approving strategic transactions,

once that authority can be granted by the post-election sovereign government

- ii. We could transition the MIM into the trust/holding company, after re-assigning other ministries' SOEs to it
- iii. Combine MIM and Trade?
- b. Establish independent corporate boards for the trust and for the individual companies, even though government ownership continues. Boards might consist of Iraqis and others.
 - i. Supplement the trust and the individual corporations in it with audit, consulting, and strategic transaction services
 - ii. Develop IAS compliant audit systems for the viable companies
 - iii. Prepare books for use in possible JV's and strategic transactions
 - 1. Solicit bids, due post-election for appropriate strategic transactions
 - iv. In the event that bids are unsatisfactory, explore other ways to transfer ownership via ESOPs, IPOs, distributions to a citizen owned mutual fund, and other mechanisms
- c. Review utility and legality of Joint Ventures and Lease Programs
- d. Keep up the pressure by encouraging true private sector enterprises that compete with SOEs. We can do this through our FDI initiatives, our consulting programs, and our lending and equity programs.

27 Voc Training
CFR
did Ind. Commission
SOE Training CTR
are to be x-fund
to MoISA
Min Ind & Min Int. and Mo HHC
SOE Training CTR
ministries still w. them
perf access to small bus Dev Prog.

3 DFD
work on
a transition
plan - gets more
external
support from
other sources
3 Legal steps on
an occupier's
maintain form
of SOEs - e.g.
may have to pay
for taking away
power.

(b)(6) (O-6)

From: (b)(6) (O-6)
 Sent: Monday, March 22, 2004 6:54 PM
 To: (b)(6) (O-6)
 Cc: (b)(6) (O-6)
 Subject: Finnish Incident

b(2)

Lead/Hyp
 PVT Sec Dir,

COL

here's a quick synopsis:

Background: Finish business delegation has intermittently contacted us concerning facilitation of meetings within Baghdad. Nothing specific was asked, but they (the Finns) were aware that Private Sector Development existed and could help them with some meetings. The nominal leader of this delegation, (b)(6) sent the following information to Mr. (b)(6) (a staff member who received Mr. (b)(6) email because the person with whom Mr. (b)(6) talks with normally to make arrangements is on vacation):

"The Finnish fact finding mission will include the following persons/companies:

(b)(6)

Technology Industries of Finland (head of mission)
 Fortum national oil & gas company
 Ensto electrical components
 Valtra - agricultural tractors
 Schauman - UPM-Kymmene woodworking industries,

Biohit - health care/ laboratory equip.
 Air-Ix - consulting, industrial management, energy
 Desec - railway repair equip
 Wärtsilä - generators for power production
 Embassy of Finland (Damascus)

We will arrive via Amman on Sunday 21st March either on RJ flight or by road and we'll stay in Baghdad until Friday 26th. As we are an "almost official" fact finding delegation our main task will be to get as clear idea as possible of the actual situation and future prospects in the country in general and especially in the reconstruction. I guess it means discussions with well informed people in respective sectoral ministries and organisations and with generalists where useful."

This information was sent on 16 Mar. LT (b)(6) then picked up the ball and established communication with Mr. (b)(6). The last information LT (b)(6) has was a couple of days ago when Mr. (b)(6) said he would call once he was on the ground here. Mr. (b)(6) did not know what exactly his delegation wanted as far as meetings were concerned so he did not pass any information to LT (b)(6). The next time LT (b)(6) talked to Mr. (b)(6) was when Mr. (b)(6) called this morning with the news of the incident. Victims were Mr. (b)(6) (b)(6)

Events:

At approximately 1100, Mr. (b)(6) called LT (b)(6) to inform him that, "...two of the delegation members were shot and killed on the road to BIAP..." Phone call was through another party (Iraqi friend of Mr. (b)(6) named (b)(6) (sp?)). CAPT (b)(6) was informed of the incident and reported same to Force Protection and later to COL (b)(6) and Mr. (b)(6) (DVB). From then until approximately 1200, additional information was sought. Mr. (b)(6) indicated that the victims may have been followed from their hotel en route to their

3/22/2004

meeting with the "Ministry of Electricity". The victims (2) were being driven by an Iraqi driver in a blue BMW and were supposedly attacked with small arms fire from a "black Audi" (reported by the driver). Both Finnish business men were killed. The driver survived (unknown if the driver was wounded).

There are only 9 members of the Finnish delegation, not ten because one business man remained behind in Finland. Name unknown.

Mr. [REDACTED] was anxious to get the rest of the delegation out of Baghdad and said that he arranged flights on Royal Jordanian that afternoon (and needed to be at the airport by 1345 or so). He also indicated that he thought that there were people watching his hotel, and thus was concerned about leaving without protection. Coalition forces were unavailable to send a security detail to the hotel, but arrangements were made to meet the Finnish businessmen outside the 14th July Bridge, and then to provide further transportation via a security detachment (rendezvous within the Green Zone). This security detail would take them to the airport. Those arrangements were conducted and the businessmen were taken to the airport (departing the Green Zone approximately 1400). Note: [REDACTED] agreed to billet the business men at their secure airport facility because they couldn't fly out the same day. Five business men were taken to BLAP. The Finnish Embassy person remained behind as did one other business man (name unknown).

The Iraqi police were apparently involved and secured the bodies and transported them to the Ministry of Health where they are currently located awaiting disposition. The Senior Advisor for Foreign Affairs and Strat Comm were also informed of the incident.

v/r

[REDACTED]

b(6)

b(6)

[REDACTED] CAPT, USN
Chief of Staff
Office of Private Sector Development
Coalition Provisional Authority
Baghdad, Iraq

[REDACTED]

b(2)

3/22/2004

Free Iraq Loan Fund

3/26/04
CPA Prt Sec
DAN -

The Fund will make medium term loans to Iraqi companies and banks for investment projects such as manufacturing expansion and capital equipment purchase. Loans will be \$500,000 - \$5,000,000 and mature in 3-5 years. Iraqi subcontractors will be eligible.

Investors in the Fund:

- CPA (supplemental): \$25 mm equity
- [DFI : \$50 mm equity]
- OPIC: \$110 mm debt
- Citibank et al \$15 mm debt
- Total \$[150] [200] mm

The Fund will be a professionally managed offshore NGO exempt from Iraq tax and banking regulation. It will maintain representative offices in major Iraqi cities.

The Fund is not intended to compete with banks but to satisfy Iraqi companies' immediate credit needs and to "warehouse" loans until the Iraqi private sector banks mature.

The Fund intends to sell its seasoned and diversified loan portfolio to Iraqi private sector banks as the banks' capital base and sophistication increase.

The Fund anticipates disbursing its capital over 18 months and completing the disposition of its assets within 3 years of starting operations. Remaining proceeds will fund the endowment of an Iraqi scholarship foundation.

For more information, contact:

CPA Private Sector Development

Attn: [REDACTED]@orha.centcom.mil

b(2)

3/25/04

Private Sec.
Dues

DRAFT

- 1) OBJECTIVES
 - a) Assist the non-oil Private Sector onto a high growth trajectory
 - b) Influence the creation of a legal, regulatory and government framework consistent with a vigorous free market and limited government
 - c) Communicate to Iraqis and the World the Progress of the Private Sector
- 2) Capital Market Actions
 - a) Consulting Team
 - b) Capital Availability (including OPIC and Exim relationship)
 - i) OPIC Citibank Facilities
 - ii) Middle Market and Foreign Bank Private Sector Bank Inclusion
 - c) IFC/World Bank/IMF Projects and Relationship
 - d) Private/Venture Equity
 - e) Stand up the stock exchange
 - f) Micro-Lending Wrap Up
- 3) CPA Actions
 - a) Ensuring Effective Iraqi Participation in Reconstruction Subcontracts
 - b) Define and Roll out the Business Centers
 - c) Develop Independent, Self-Sustaining Associations Implement a training Program for the Iraqi Private Sector
 - d) Encouragement of FDI and Business Partnerships
 - e) Local Economic Stimulus Program and Reference Summary
- 4) Legal, Regulatory, and Institutional Actions
 - a) Refine & Implement Action Plans, consistent with objectives, for
 - i) MIM and the SOEs (Lettie -- Please attach as supplement)
 - ii) Trade (Bernie/Tracy -- Please attach as supplement)
 - iii) MICs and MOST (Marcel/Marcus -- Please attach as supplement)
 - b) Complete the Development of Necessary Legal Frameworks
 - c) Ensure Implementation of the Legal Framework by the Government
- 5) IO Issues
 - a) Bi-weekly press backgrounders: Iraqi Focused and International
 - b) PSD bulletin via email
 - c) Business Group
 - d) Business Updates (written, press release, meetings)
 - e) Business Guidance and FAQs (Cliff Notes, handouts, web)
 - f) Economic Stimulus Options (Quick Reference Summary)
- 6) Ad Hoc Projects
 - a) Delegations and Trade Missions
 - b) DBX (Private Sector Event)
 - c) Speaker Series, Op-Ed Series (Iraq and external)
 - d) Representational events
- 7) Themes
 - a) If economic freedom is taken, political freedom will vanish
 - b) Government should have limited and enumerated powers
 - c) Stop giving things away; no goodies without gains for our principles

[REDACTED] FS-4) b(6)

Bremer

From: [REDACTED]
Sent: Monday, March 08, 2004 8:07 PM
To: [REDACTED]
Cc: [REDACTED]
Subject: Alternative Concept to Oil Trust

b(2)

P. Sect. Development

Please give the attached info memo to AMB Bremer. Thank you.

[REDACTED] Director
Private Sector Development
Coalition Provisional Authority (CPA)
Republican Palace - Room S107
Baghdad, IRAQ

[REDACTED] b(2)

3/9/2004



COALITION PROVISIONAL AUTHORITY
BAGHDAD

INFO MEMO

March 8, 2004

FOR: THE ADMINISTRATOR
FROM: [REDACTED] Director, Private Sector Development
SUBJECT: Alternative concept to achieve the same effect as an Oil Trust

During our road show in Europe, Ali Allawi and I discussed the merits of an Oil Trust among other economic policy matters including a cash compensatory payment for the elimination of the food basket and energy subsidies. The idea arose of using a large and permanent cash compensatory payment to simultaneously replace the energy and food subsidies and achieve many of the objectives of an Oil Trust. The cash payment would be mandatory, irrevocable, and quarterly or more frequent and would be a fixed percentage of Government oil revenues, say 50%. A rough estimate is that such a replacement for subsidies would be approximately revenue neutral at 50% of oil revenues given today's oil production levels.

Enacting such a cash compensatory payment system is only cosmetically different from a regular dividend from an Oil Trust. However, a permanently enacted large cash compensatory payment might be far easier to achieve politically and could be more directly applied to easing the burden of reducing subsidies. A well-conceived mandatory cash payment system could achieve many of the long term goals of an Oil Trust, i.e., redirecting oil revenues to the people, diversifying control of the nation's wealth, improving transparency, and forcing the government on the margin to tax the people to meet its needs.

As a concept, and as an alternative to the political complexities of enacting an Oil Trust, I think the idea has considerable merit. Ali said there had already been some discussion along these lines at the Governing Council and thought there would be a lot of support there for further developing the idea. It is potentially an elegant solution to two of the largest reform challenges facing the Iraqi economy. I hope the opportunity to pursue this idea isn't lost because I am leaving, so I wanted to make you aware of it. If there is any way I can help with this after I leave, I would be happy to devote time to it.

ATTACHMENTS: None

COORDINATION: None



COALITION PROVISIONAL AUTHORITY
BAGHDAD

INFO MEMO

FOR: THE ADMINISTRATOR
FROM: [REDACTED] Director, Private Sector Development
SUBJECT: Directing Supplemental Funds to Iraqi Businesses and Iraqi Workers
CC: Ambassador Richard Jones, Chief Policy Officer
Admiral David Nash, PMO

Probably the biggest opportunity to stimulate the economy and build the private sector in Iraq will come from ensuring that as much as possible of the Supplemental funds are directed toward Iraqi businesses and Iraqi jobs. We estimate that properly directed, the Supplemental funds could create 500,000 or more Iraqi jobs. [REDACTED] of our group has prepared the attached memo describing several risks in the RFP process that could significantly reduce the amount of work that gets awarded to Iraqi businesses for Iraqi jobs. Our biggest concerns are the following:

- Iraqi businessmen are out of the loop and unless the RFP's direct a certain share of the work go to them, the work will go to bidders who are more familiar with the RFP process and who are already known to the likely large prime contractors.
- If the contracts require US or other high standards for the work, Iraqi businesses may not be able to compete. In many cases, foreign standards may not be necessary for the work and may add unnecessarily to costs. ✓
- If not prohibited in the RFP's, contractors may prefer hiring imported labor because it is cheaper or easier. Permitting imported labor will divert income and skill development away from Iraqis and may set a damaging precedent for Iraq's economy becoming dependent on imported labor for lower-skill jobs.
- The RFP's may contain other requirements or prohibitions that handicap Iraqi bidders. Examples include a prohibition on SOEs performing work or requiring insurance that Iraqi companies cannot obtain.

I have asked [REDACTED] to work with the contracting people in Washington and I will be working with [REDACTED] to see that Iraqis benefit to the greatest extent possible from the expenditure of the Supplemental funds. Many key decisions affecting the awarding of the work will be made in the next several weeks. Your awareness of the importance of this issue for stimulating the economy and developing the private sector, and your support, will help make our efforts more effective.

UNCLASSIFIED

That Iraqi firms
have sufficient
working capital as
construction ramps up?
11/24

NEW
LPR HAS SEEN
03/123-45
P.S.D. General
Nov [REDACTED]
We
must fix this
After what are
we doing to
ensure

Program Description

The Emergency Supplemental Appropriation Act ("Supplemental") calls for \$18.4 billion in funds to be directed towards post war reconstruction in Iraq. The Iraq Infrastructure Reconstruction Office (IIRO), headed by Admiral (Ret.) Nash, is responsible for administering the Supplemental. The IIRO has offices in Baghdad and Rosslyn, VA. The RFP's are being drafted in Virginia and will be released on December 5, 2003. A committee will select the PM's by early February 2004. The Supplemental will be awarded through 25 contracts to prime contractors who will act as Project Managers (PM). There are approximately 2000 large projects in the Supplemental, which will be distributed after the selection of the PM's.

The Opportunity

While the direct benefits of the Supplemental to Iraq are clear, there is a potential to derive secondary, tertiary and auxiliary benefits from its implementation.

The secondary benefit would be the establishment of a strong local private sector that would gain the expertise and wherewithal necessary to continue rebuilding Iraq, beyond the Supplemental. In addition to construction and engineering companies, there is an opportunity for setting up local manufacturing facilities for building materials, which could lead to further development of the Iraqi industrial sector. Programs that encourage investments in such facilities should be implemented as soon as possible, allowing for set up time, so that these facilities can supply their products whenever they are needed in the coming months.

The tertiary benefit would be the creation of a large, well-trained pool of Iraqi labor force that can provide the manpower required for the reconstruction and development of the country. Inevitably, some contractors will seek to use imported labor (using speed, cost and experience as arguments), however, it is not a good long-term policy to exclude Iraqis from this reconstruction effort. Iraq has an educated, hard working population that is eager to rebuild its country, and Iraqis have been able to overcome isolation during the past 12 years through their entrepreneurial and innovative spirit. Therefore, participation in the Supplemental, through Iraqi or foreign firms, would give Iraqis an opportunity to catch up in a short order and to become productive members of their society.

The auxiliary benefit would be the establishment of a strong Iraqi service industry. The scope of the Supplemental is enormous and requires tremendous amounts of supporting services (e.g., housing, transportation, and food, to name a few). While multinational service companies will enter the Iraqi market, there will remain great opportunities for Iraqis to participate in this field. Directing a portion of the \$45 million from the micro-small-medium enterprises category in the Supplemental towards the establishment of such supporting services companies in Iraq, would be one way to aid in this process.

Should the potential mentioned above be realized, it could be a major catalyst for igniting the Iraqi economy through the creation of hundreds of thousands of new jobs and allowing a large number of companies to emerge in various sectors. That is the reason why we believe this is a high priority item and requires special attention.

Potential for Job Creation

Our preliminary analysis indicates that approximately 10% to 20% of the dollar value of the Supplemental could be eligible for Iraqi participation. The Iraqi participation is assumed to be predominantly in construction related activities as reflected below in the Supplemental Category Breakdown. Detailed analysis by project would yield a more precise number and could pinpoint the specific types of jobs that can be created. Such an analysis must be conducted in cooperation with the IIRO, which has the relevant data and whose input is invaluable in this process.

Supplemental Category Breakdown

Supplemental Categories	Value	Potential Iraqi Participation			
		Low Range Estimate		High Range Estimate	
Electric sector	\$5,560	\$501	9.0%	\$1,228	22.1%
Water resources and sanitation	\$4,332	\$632	14.6%	\$1,253	28.9%
Security and law enforcement	\$3,243	\$224	6.9%	\$374	11.5%
Oil infrastructure	\$1,890	\$67	3.5%	\$201	10.6%
Justice, public safety infrastructure, and civil society	\$1,318	\$87	6.6%	\$146	11.0%
Healthcare	\$793	\$108	13.6%	\$188	23.7%
Transportation and telecommunications	\$500	\$67	13.4%	\$113	22.6%
Roads, bridges, and construction	\$370	\$56	15.0%	\$111	30.0%
Education, refugees, human rights, and governance	\$280	\$7	2.5%	\$14	4.9%
Private sector development	\$153	\$2	1.6%	\$6	3.7%
Total Iraq-Related Supplemental	\$18,439	\$1,750	9.5%	\$3,632	19.7%

Our evaluation considered yearly Iraqi salaries of \$1,500 to \$3,000, which we believe to be representative across the country. Considering that labor costs could account for 25% to a third of revenues, we grossed up those salaries by 3 to 4 times to reflect labor cost in terms of revenues. Therefore, our assumed eligible Iraqi participation could translate to approximately 200,000 to 520,000 in new jobs created, at the middle of the range. With a potential to create such a large number of jobs, it is important that we focus our effort to ensure this potential becomes reality.

Potential Jobs Created

	Yearly Salary			
	\$1,500	\$2,000	\$2,500	\$3,000
Total Potential Jobs Created - High Range Estimate ^(a)				
3 to 1	807,017	605,263	484,210	403,508
3.5 to 1	691,729	518,796	415,037	345,864
4 to 1	605,263	453,947	363,158	302,631
Average	701,336	526,002	420,802	350,668
Total Potential Jobs Created - Low Range Estimate ^(a)				
3 to 1	388,821	291,616	233,293	194,411
3.5 to 1	333,275	249,956	199,965	166,638
4 to 1	291,616	218,712	174,970	145,808
Average	337,904	253,428	202,742	168,952

(a) Assuming a gross up of labor cost by factors of 3, 3.5 and 4 times to reflect margins

Recommendation

We have identified three broad areas through which the above goals may be achieved. While there are numerous ways to address those three areas, we have identified the following alternatives.

Drafting of the RFP

Including language in the RFP that encourages subbing to Iraqi businesses and to those who plan to employ Iraqi rather than imported labor is at the heart of this approach. This can be achieved through setting hard or soft targets and we believe a combination of the two would be best. The latter would be accomplished through language that recommends the use of Iraqi subs and labor, setting the expectation that this would be considered in the evaluation of the bids and would have a specific number of bid points allocated to it. Potential PM's would be asked to come up with creative ways to incorporate Iraqis in their bids such as: a) setting up training programs for workers; b) hiring and enrolling Iraqis in management training programs; c) including specific Iraqi subs in their bid; d) setting up joint ventures with Iraqi businessmen, etc. This language would be present in all the RFP's.

Hard targets are more difficult to stipulate across all RFP's because each contract has its unique requirement. Therefore, hard targets should be set on a case-by-case basis. While the specific parameters will vary by contract requirement and availability of labor and expertise, we recommend the following criteria to be considered (all ranging from 0% to 100%):

- Minimum Iraqi labor participation levels by PM's and subs (e.g., low level participation for healthcare equipment procurement and high level for irrigation and drainage projects)
- Minimum number of bids by Iraqi subcontractors
- Minimum amount allocated for training and development of the labor force and managerial capabilities, including tuition reimbursements
- Credit for using Iraqi suppliers, provided that the materials are manufactured in Iraq
- IIRO participation in the subs' selection process, possibly at the pre-screening stage, if and when appropriate

Since subcontracts will be awarded by the PM's after they receive the prime contract, it is important that IIRO retains the ability to dictate which of the criteria mentioned above must be incorporated in the various subcontracts. In addition, as part of the ongoing review process, IIRO will monitor the PM's compliance with these criteria.

Standards for the Supplemental

IIRO is currently contemplating the use of European Union standards for the Supplemental, however, it is not clear whether the metric or English system will be used. While it is imperative to have high standards in the Supplemental (i.e., a power plant should not fall apart and become obsolete in three years), it is equally important that those standards are appropriate for Iraq (i.e., some EU and US standards should be adopted as is and others should be adjusted according to local needs). Liberalizing product completion standards would not only allow Iraqi firms to compete with standards they conform to, but also to maintain the infrastructure being placed and build on it in the future.

In instances where EU or US standards must be adhered to, special consideration should be given to the involvement of local Iraqi firms or at a minimum Iraqis (e.g., managers, engineers and laborers) in the process. Such involvement may have training costs associated with it, which may be addressed through a combination of the Supplemental's training budget and the PM's. The RFP can highlight the requirement that PM's would play the role of good corporate citizens in Iraq. This is similar to the concept followed by foreign companies setting up manufacturing plants in rural areas in the US, where these companies invest in communities because they have long term interest in their viability. Since the PM's may not have a long-term interest in Iraq, they may need to be encouraged to do so through the RFP requirement.

Inquiry and Referral Systems

A critical factor in determining the success of this effort is the ability of Iraqi firms to learn about the available opportunities and participate in them and of the PM's to get to qualified Iraqi subs and employees. Therefore, it is important to establish an excellent inquiry system for Iraqi businessmen, a reliable referral system for PM's and a strong training program for Iraqi firms and Iraqis.

The complaints often voiced by Iraqi businessmen regarding contracting work is that they usually do not find out about it at all and if they do, it is usually too late or the lead time so short they cannot participate. In addition, Iraqi businessmen often do not know whom to contact at the CPA and the prime contractor. The CPA has tried to address this issue by posting all contracts on its website and the IIRO will do the same for the Supplemental. A comprehensive inquiry system may include any or all of the following:

- Posting of all information on IIRO website
- Posting of all information with Baghdad Business Center, Iraqi Business Center, Kirkuk Business Center and other business centers as they are formed. In addition, all contracts should be posted on the business centers' newsletters
- Posting of contracts in local Iraqi newspapers
- Posting of contracts to relevant business organizations (e.g., various chambers of commerce and industry specific groups and organizations), which in turn would be expected to share that information with ALL its members in a timely manner
- Distribution of all updates via email to companies which are registered with the IIRO
- Listing of all primes and subs on IIRO website and at the business centers

Until more Iraqi companies gain Internet access, local newspapers and business organizations are probably the ideal way to communicate with them. To date, local newspapers have not been used by the CPA because of the short lead-time for contract award, lack of order to advertise and the large number of newspapers in the market. All those obstacles can be overcome with the Supplemental. We believe that a detailed execution plan is necessary for an excellent inquiry system to be implemented.

Furthermore, we believe that a strong training program for Iraqi firms in three areas is another key to ensure success in our effort. These areas include RFP process, cultural and technical skills training. The first may be offered to registered or certified Iraqi firms only, both to give

them an incentive to register and to offer the training to serious contenders only. Such a program could especially be helpful to small and medium sized companies who may not have in house expertise with RFP types of projects. Cultural training can be combined with the RFP process training and can focus on shifting away from the old way of doing business as well as understanding the nuances of doing business with US firms. Technical training can be directed to specific areas of expertise and provided on an as needed basis.

In addition to training at the firm level, there is a need for training the Iraqi work force. This can be done through vocational schools and on the job training. The goal here should be to provide workers with specific and general skills and act as a labor conduit to companies interested in hiring Iraqi workforce.

While it is important to address Iraqi businessmen and Iraqi workers' needs, it is equally important to support the PM's and various foreign subs, especially since we are demanding from them to include Iraqis in their work plans. A reliable referral system can include the following:

- Certification process for all Iraqi firms interested in participating in the Supplemental.
This does not need to be to the exact standards used by US firms, instead, it could be adjusted to local standards
- Vetting process to ensure that firms associated with the former regime are excluded from the Supplemental
- Rating system for Iraqi firms, completed by current and future contractors
- Events and conferences that allow for face-to-face meetings among Iraqi and foreign firms, initially in the region (e.g., Amman, Kuwait or Dubai) and eventually in Iraq
- Database/white pages for Iraqi businesses by type and region

In addition to the referral system, a comprehensive cultural training should be offered, especially to PM's. This would be a small investment that could provide a lot of dividends in the future. As with the inquiry system, a detailed execution plan is necessary to ensure proper implementation of the referral system.

Next Steps

Below is a list of suggested steps to be taken in order to achieve what is presented above. These steps can be grouped in terms of short term vs. long term and/or by relevant categories. However, the first step is to agree on what is presented above and then we can prioritize accordingly.

1. Detailed analysis of the contracts being awarded to determine eligibility of Iraqi participation in the Supplemental, in an effort to set participation targets.
2. PSD input in drafting the soft and hard targets of the RFP as it relates to Iraqi participation.
3. Determine which procurement items would be feasible for manufacture in Iraq.
4. Conduct a survey of building products manufacturers in Iraq (type, capacity, region, etc.) and devise a plan to encourage investments where there is a gap in local manufacturing.
5. Determine the standards used in the RFP and identify where it might be feasible to begin vocational training now, such that a work force will be ready to start as soon as needed.

6. While US regulations require all primes and subs of the Supplemental to carry personal liability insurance, we need to understand if that is even possible for Iraqi firms and if this requirement can be waived for Iraqi firms.
7. Determine how we treat Iraqi vs. Iraqi American firms.
8. According to US regulations, an SOE is not allowed to participate as a subcontractor in the Supplemental. However, we should explore how we may be able to allow Iraqi SOE's to participate as a way towards privatizing them.
9. Inquire if the Baghdad or Iraqi Business Centers publish a newsletter similar to the one published by the Kirkuk Business Center.
10. Prepare an infomercial in Iraqi newspapers that outlines the Supplemental process and directs Iraqis towards the steps they need to take to participate.
11. Make the list of US primes and subs available to Iraqi businessmen and Iraqi employees.
12. Prepare RFP process and cultural training program.
13. Identify appropriate certification process by Iraqi firms.
14. Identify appropriate vetting process for Iraqi firms.
15. Identify appropriate rating system for Iraqi firms.
16. Investigate upcoming Iraq related events in the region and determine the viability of utilizing them as forum for PM's to meet with Iraqi firms.
17. Review the database being prepared by Iraqi Business Center for content to determine transferability for Supplemental purposes.

PRAT Sec Dev.

Iraq Stock Exchange

Briefing for Ambassador Richard Jones
February 20, 2004
Office of Private Sector Development

Ann
+ Joy.



History

- Baghdad Stock Exchange (BSE) opened in 1991
- Government-owned, tightly controlled by the Ministry of Finance
- Baath Party members routinely engaged in illegal seizures of listed company shares
- BSE ceased trading on March 19, 2003 by order of the Ministry of Finance due to war
- Since BSE closure, 300,000+ investors' brokerage accounts have been frozen
- 51 Broker Members (and associated employees) have been unable to pursue their livelihood
- Private transactions have been occurring, some illegal



BSE should not re-open

- Owned by the Iraqi Government and controlled by the Ministry of Finance
- Regulated price controls for price fluctuation both upward and downward
- Membership and investment is limited by law
- Capital raising does not conform to free market principles



Capital Raising Issues

- Only banks (not brokers or investment banks) are permitted to underwrite initial public offerings
 - Limits competition in IPO underwritings
 - Limits distribution to potential shareholders who are not “insiders”
- Only method to raise capital in the secondary market is through “rights” offerings to existing shareholders
 - Non-shareholding members of the public can only participate in the event that existing shareholders oversubscribe
 - Principle of one dinar par value in secondary offerings means existing shareholders purchase each additional share for one dinar regardless of actual value.
 - Companies may charge more, but only one dinar is booked as capital to the company’s balance sheet; remainder are reserves
 - Results in inappropriate reporting of capital for listed companies



Proposed Capital Market Reform

- New interim securities law days away from Governing Council submission
- Law establishes Securities and Exchange Commission (SEC), Iraq Stock Exchange (ISX) and Depository Operations Center (DOC)
- ISX to be independent and not-for-profit
- Regulatory reforms include removing price controls, new governance structure and greater operational efficiencies

Interim Securities Law

to GL in
coming week
of 2/21

3 new Institutions
SEC
ISA. Ex
Deep Op Ctr

- Provides a legal vehicle for a new stock exchange in conformance with IOSCO principles for capital markets
- Maintains pre-existing practices as appropriate
- Incorporating international best practice while retaining Iraqi market culture

International Standards Introduced

- Creation of independent oversight regulator
- Creation of central depository for clearing and settlement
- Overhauling governance structure to include public members of both the SEC and the Board of Governors of the ISX
- Establishing governance committees at the ISX, including an audit committee

SEC

Dep Op Ctr.
Trade Data & 3 days

ISX.



Maintaining Iraqi Market Culture

- Maintaining an on-floor trading system
- Allowing investors to observe trading (new controls will be implemented)
- Maintaining a dealer to dealer marketplace
- Retaining substantial elements of market regulation, while expanding regulatory and enforcement roles



Creation of new entities

- SEC as oversight regulator for ISX
- ISX as new stock exchange
- DOC as new centralized mechanism for clearing and settlement

SEC—Independent Statutory Regulator

- Independent of Ministry of Finance
- Equivalent status as a Ministry—reports to executive branch of government
- Five member Commission, two full-time, three part-time from a diversity of backgrounds
- Training to be provided both in country and overseas, as practicable
- Regulatory provisions for removal of Commissioners in the event of corruption, fraud, malfeasance
- Concerned about ability to report to “government watchdog” in event of undue influence from the executive branch

of stock left part
C Benita
JMP & personal
person etc
2 yr Stensat
Law
for Interior Law
expect Final Law to be
~ May 99
IS?



ISX—Self-Regulatory Organization

- Independent from Ministry of Finance
 - Overseen by the SEC
- Not-for-profit
 - Budget must balance at the end of each fiscal year
 - Any profits to be reinvested in Exchange infrastructure, human resources, systems
- Compliance Committee
 - Chaired by a public member of the Board
 - Will provide a vehicle for investigations regarding fraud, manipulation, undue influence, Code of Conduct violations



ISX

- Seven member Board of Governors
 - Initial members
 - Nominated by CPA, appointed by Governing Council
 - Two-year sunset clause
 - Shorter than normal term
 - Elected by Exchange members through a General Assembly process annually
 - Staggered terms to maintain intellectual capital *total together 2 terms = 6 yrs.*
 - Representatives from brokerage firms, listed companies and the public (e.g., business people)
 - Regulatory provisions for removal in the event of fraud, manipulation, malfeasance or failure to comply with Exchange regulations

Regulatory Reforms at the ISX

- Removing artificial controls on price fluctuations of individual stocks *was $\pm 5\%$ from prev days average*
 - Establishing ("circuit breakers") for trading halts
- Completely revising corporate governance structure
 - Establishing Board of Governors in conformance with best practice
 - Establishing governance committees, including a Compliance Committee to provide an internal audit function relating to the activities of the Board and Staff of the Exchange
- Membership Policies/Cmte review to ensure appropriate barriers to entry



Regulatory Reforms at the ISX

- Regulations to provide rigorous sanctions in the event of wrongdoing by the Board of Governors or Exchange Staff
 - Publication to Exchange Board, Staff, Members and the public, of sanctions imposed as appropriate
- Focus upon market regulation
 - Having an increased on-floor presence, using capital market experts, during the initial transition period
 - Enhancement of surveillance, investigative and enforcement functions of the Exchange
 - Business Conduct Committee will act on Exchange investigations, make findings, impose and publish sanctions as appropriate

Operational Efficiencies

- Removing barriers to efficient trading practices
 - Withdrawing Exchange sign-off prior to entry of trades
 - Establishing Floor Official (member) system of rulings for on-floor resolution of trading disputes real-time
- Shortly distributing RFP for electronic trading system
- Establishing transparent, non-preferential membership and listing requirements

will look to avoid involvement w Bats & this 7 shares

were 114
need at least
10-12
to get
started
about
50-60

Operational Efficiencies

*There has been illegal
off-market trading
since war - will
need to regularize*

- Installation of new systems
 - Satellite Communication for remote branch office of DTCC-NY
 - Local Area Network
 - New hardware and software
 - Newly renovated physical plant including workstation equipment
- Systematizing process for broker/client communication
- Publication of trading information for local, national and international media



Coordination with the IASD

- Enhance member regulation
 - Sales practices and “Know your Client”
 - Internal controls and Codes of Conduct
 - Enforcement through restrictions on membership if required standards are not met
 - Training potentially coordinated through an NGO; as well as conducted at the ISX
- ISX will also have member regulation policies primarily focused upon trading and supervision



Next Steps

- Submission of interim securities law to Governing Council; approval timeframe uncertain
- Working with listed companies to collect accurate shareholder information prior to listing on ISX
- Drafting interim regulations
- Awaiting completion of network/hardware shipping and installation
- Training for DOC and ISX staff

This etc



Timetable

- Interim securities law submitted to Governing Council within days (most significant gating factor)
- First draft of interim regulations completed within one week
- Completion of network and hardware installation anticipated within two weeks
- Completion of start-up training within three weeks
- Identification of ten listed companies for start-up within two weeks



Transition Structure

- Projected start date: Mid-March
- Plan to ensure smooth transition to trading after 1 year halt
 - Staggered listing process for former BSE companies to ensure compliance with listing standards and to not overburden the DOC
 - 5-10 on Day One
 - Roll-out over the following few months
 - Rigorous market regulation to control fraud, manipulation and unreasonably volatile price fluctuations