

**MENA-OECD Investment Programme's Iraq Project
Brief on Capstone Meetings with the Government of Iraq
2-3 February 2014
Baghdad, Iraq**

Introduction

Funded by the United States Department of State, the Iraq Project of the MENA-OECD Investment Programme (the Programme) has worked with the Government of Iraq (GoI) since 2007 on economic policy through policy dialogue, research, and capacity building. This work has been developed based on the priorities of the GoI and on OECD standards, instruments, and expertise – in particular in investment policy and private sector involvement in infrastructure.

During the implementation of the project, the Programme developed, in consultation with the GoI and subject-matter experts, a series of policy insights and recommendations. These were presented to a high-level audience in four capstone meetings, held in Baghdad, 2-3 February 2014.

- Meeting 1: Catalysing investment into Iraq,
- Meeting 2: Public-private partnerships (PPP) and Iraq's infrastructure development,
- Meeting 3: Improving public procurement to expedite development, and
- Meeting 4: Reforming policy to meet the growing demand for housing.

The meetings, which were broadly covered in local and regional media, assembled parliamentarians, high-level GoI officials, technical experts, international organisations, OECD-member country embassies, and OECD staff.

The following is a concise brief highlighting the main policy recommendations discussed at the capstone meetings.

Catalysing investment into Iraq

To improve Iraq's investment climate, the Gol should strengthen its policy-making institutions, improve investor protection, promote economic zone development, and better target government investment. These actions will send positive signals to domestic and foreign investors and help mitigate the significant risks many investors perceive in the Iraqi economy, and encourage private investment and economic diversification.

Institutional development

The Gol's well-established institutions, such as the Prime Minister's Advisory Commission (PMAC), should lead the design of Iraq's economic development strategies to ensure that these strategies promote private investment and private sector-led growth. In addition, the National Investment Commission and the Provincial Investment Commissions should have clear mandates, which distinguish between promotion of investment opportunities and regulation of investor activity.

Improve investment protection

Investors perceive a number of risks in Iraq related to direct or indirect expropriation, unreliable dispute resolution mechanisms, insufficient land rights, cumbersome company registration procedures, and uncertain contract enforcement. To show its commitment to mitigating these risks, the Gol should ensure that the clauses in the Investment Law No.13 of 2006 are enforced. These include ensuring non-expropriation without fair compensation; granting ownership rights of land for housing projects and long leases for others; implementing dispute resolution mechanisms, and instituting non-discrimination between domestic and foreign investors. In addition, the Gol can continue to implement the rehabilitation company registration procedures carried out by the Ministry of Trade.

The Gol should continue to work towards adopting international investment protection standards. The Gol should also adhere to the International Centre for Settlement of Investment Disputes (ICSID) and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Iraq is also party to a number of bilateral and multilateral investment treaties, but could further expand its network treaties. In addition, the Gol can continue to improve its capacity to negotiate international trade agreements as part of a process to prepare Iraq for adherence to the World Trade Organisation.

Economic zones

The Gol should use spatially delimited economic zones – including investment, industrial, and free zones – to encourage private sector development. Economic zones provide an alternative business environment, offering considerable protection against investor risks and cumbersome regulation. Further, economic zones can function as channels for vertical policies, i.e. measures designed to provide inputs to promote new business activity and develop new industries. In addition, economic zones can allow the Gol to test legal and regulatory reforms on a pilot basis. Then, based on the results, the Gol can expand the reforms throughout Iraq.

Iraq continues to develop free zones and industrial zones, and should seek to develop investment zones as sheltered and streamlined environments to attract strategic investment. The Gol should collaborate with potential anchor investors from the private sector to develop tailored incentives, quality infrastructure, and sector-specific administrative services that mitigate some investor risks for zone users. In addition, the Gol should continue to prepare a regulation for the establishment and management of investment zones, as allowed by the Investment Law No. 13 of 2006, and continue to work towards piloting investment zones.

Government role in investment

Public investment, such as that channelled through Iraq's State-Owned Enterprises (SOEs), often leads to unintended market distortions. Instead, the GoI should focus public investment on developing infrastructure and providing public goods; these are prerequisites for sustainable economic development.

Public-Private Partnerships (PPPs) and Iraq's infrastructure development

Greater private sector participation in Iraq's infrastructure development may expedite project delivery, increase private investment, and hasten infrastructure rehabilitation. To facilitate private sector involvement, the GoI can use Public-Private Partnerships (PPP) as permitted under Article 15 of the Companies Act No. 22 of 1997. PPPs are, however, more complex than public procurement: they require different and often far-reaching government technical capacities, and – particularly in civil law legal systems such as Iraq's – a dedicated legal framework. Consequently, to employ PPPs successfully and to help establish a track record of successful engagement with the private sector, the GoI should adopt PPP legislation, develop a technically capable PPP unit, and provide sovereign guarantees.

Legislation and contracts

Iraq needs legislation that permits foreign investors to provide public services under PPP arrangements and clarifies the GoI's authority to employ PPPs, establish specialised institutions, and develop dispute resolution mechanisms. Specific PPP legislation shows political commitment and reassures private sector developers and financiers – few financiers will lend without appropriate legislation. The PPP law can clarify the framework for PPP arrangements and allow specific provisions to protect the public interest. To support PPPs, the GoI should institute quality public procurement laws.

The GoI should develop standardised PPP contracts which use internationally recognised contract principles. Standardised contracts establish contractual quality, consistency, and efficiency. In turn, this decreases the time to develop individual PPPs and helps to develop and institutionalise efficient monitoring processes.

Institutional capacity and piloting PPPs

PPP projects are often highly complex. The range of capacities needed to select, research, develop, contract, implement, and monitor such projects is extensive. The GoI needs to develop the capacity to negotiate on an equal footing with bidders, who recruit top-notch expertise, to prepare contracts. The GoI should develop a specialised PPP unit – supported by a stable group of expert advisors to build the unit's negotiation, contract management, and project management capabilities – to drive the PPP process. Typically this unit would be located within the Ministry of Finance. The PPP unit should seek to develop a solid track record of engagement with the private sector, and to build the capacity of other ministries and individual governorates to use PPP arrangements through careful institutional co-ordination.

PPP unit experts should have sound knowledge of PPPs from financial and legal perspectives, a good grasp of project development and management, and experience in implementing projects. Then, the GoI can carefully develop pilot PPP projects with a high social impact – for example, housing or waste management projects. Encouraging PPPs may also help rehabilitate Iraq's State-Owned Enterprises.

Sovereign guarantees

To build a successful PPP programme, financiers and lenders will want assurance that the obligations of the counterparty are obligations of the sovereign – be it on the federal or governorate levels. This will lower the cost and increase the availability of capital significantly. The Gol could give this assurance either by providing a guarantee by the sovereign of the contracting authority's obligations or by structuring the transaction so that a sovereign entity is a party to the applicable agreements.

While investors have access to guarantees from Iraqi banks to ensure payment of costs of governmental construction contracts and granted land for investment projects, Iraq does not have legislation permitting sovereign guarantees – defined as guarantees backed to the fullest extent by the state. Consequently, the Council of Representatives needs to approve the issuance of sovereign guarantees on a case-by-case basis. To ensure the necessary efficiency and flexibility, the sovereign guarantee process should be delegated to an authority, whose range of action is delineated in legislation.

Improving public procurement to expedite development

A well-functioning public procurement system will attract foreign investors, deliver quality public services and infrastructure, and ensure procured goods and services yield the maximum value for money. The Gol has prioritised developing standardised procurement practices, consistent with Iraq's legal tradition and capacities, which respect international legal standards. The Gol seeks to ensure that the system has:

1. Open and competitive bidding;
2. Fair and equal treatment of all bidders, in line with international standards;
3. A streamlined and transparent evaluation system, with performance standards; and
4. An institutionally independent dispute resolution mechanism.

This can help the Gol administer and complete current and planned projects, whether via ministries or local governments. After establishing standards and standardised capabilities at the central level, the Gol can decentralise authority for procurement implementation.

Public procurement law, regulations, contracts and bidding documents

The Gol needs to enact a clear public procurement law based on internationally recognised principles. Transparent regulations on procurement and standard terms of public contracts encourage participation in tenders and promote competition. In addition, the Gol should implement initiatives that support public procurement reform, such as civil service reform and developing competency frameworks and career paths for public officials, including public procurement officials. Specific and clear legislation on protection of whistle-blowers would also encourage the reporting of irregularities and help monitor procurement activities.

For bidding documents, the Gol should require all public procurement entities to use international standards and internationally defined terms. This will inspire confidence among foreign bidders and encourage competition in tenders.

Arbitration and dispute resolution

Within a regulatory framework that guarantees the rights of all parties, the Gol should establish, in addition to existing judicial procedures, an arbitration system that functions as an independent dispute resolution mechanism. The Gol should also ensure proper enforcement of arbitral decisions. This will help ensure the protection that foreign investors expect.

Awareness-raising

Easy and free access to information, such as relevant laws and regulations, tender specifications, and contract terms, are important for bidders to develop their proposals and cost estimates. For example, the GoI should continue to work towards publishing all relevant information on tenders in Arabic and English on government procurement webpages.

The GoI should consult with the private sector to prepare bidding documents for government contracts. This will encourage more national and international bidders to participate. In particular, an independent entity reporting to PMAC could help engage international bidders.

Reforming policy to meet the growing demand for housing

With Iraq's burgeoning population, demand for housing is growing. Meeting this demand is a challenging task, in particular because of Iraq's regulatory system. Iraq should revise its regulatory framework to encourage the private sector to construct a large proportion of new housing units. A strengthened role for the private sector in housing construction will help obviate the need for the GoI to design, plan, develop, and sell individual housing projects. In the long-term, the GoI should consider revising its housing supply subsidies to better serve disadvantaged individuals and households.

In Iraq's housing system, government departments allocate land for residential development to private investors; however, the private investor must accept a range of performance requirements to retain the land title. This creates significant and, in part, avoidable risks for investors, who may lose the land title after substantial investment. Instead, the GoI could pilot reform by auctioning public land to private investors, in particular in the metropolitan areas. In addition, the GoI could rezone and redevelop informal settlements in cities to free valuable land that could be released on the market through auctions to developers. Inhabitants could be resettled in new apartment buildings, taking up a fraction of the space currently occupied.

The following table, discussed in the meeting, represents a reasonable programme of housing reforms during the next five-year period.

Housing system component		Key recommendations
Supply	Regulatory Framework	Look to lessen rent level controls for residential real estate.
		Cancel property taxes.
		Eliminate rental income tax and real estate transfer tax.
		Collect tax on vacant land.
		Introduce fixed annual property tax, with banding.
	Land planning system	Need price signals for land, move towards auctioning, and then selling land.
	Housing supply	Gradually involve the private sector in supplying housing – initially as a delivery partner through PPPs, and then as investors in a liberalised housing market.
If developers have to pay for land, they will develop it. Government can gradually move out of managing individual projects.		

Housing system component		Key recommendations
Demand	Housing finance	Lessening lending conditions for housing units, whether through the National Housing Fund, Real Estate Bank of Iraq, or others.
		Relax stipulations to qualify for the National Housing Fund loans, while slowly phasing out concessional loans.
		Encourage more savings to help develop more housing units – in particular by encouraging the increase of funding in the National Housing Fund and the Real Estate Bank. In addition, look to privatise commercial banks.
		Move gradually from subsidising housing supply towards income transfers to help low-income buyers.

Conclusions and next steps

The reconstruction of Iraq presents an unrivalled opportunity for economic growth. Opportunities for investors abound in almost every sector of the economy. At the same time, potential investors into Iraq face substantial risks – real or perceived – that in many cases prevent them from investing. As a result, only the most profitable opportunities attract investment, either in the oil and gas sector or in the sectors responding to the demand created by the spending of oil revenue.

Concerted Gol action on multiple fronts is needed to encourage sustainable growth in general and to diversify from hydrocarbons in particular. For example, the Gol can continue to reform Iraq's legal and regulatory framework in line with Articles 25 and 26 of the Constitution of Iraq. This may involve amending or removing laws and regulations which are not suitable with a legal and regulatory framework conducive to attracting private investment. One example is in the Ministry of Trade which has improved its administrative procedures for company registration.

These meetings have looked at four aspects of such concerted action. Investment zones present an opportunity to attempt economic reform on a smaller scale, rather than reforming a highly complex and interconnected existing system all at once. Public-private partnerships can speed up the development of urgently needed infrastructure, while engaging the private sector and setting up a strong track record of Gol engagement with the private sector. Efficient, streamlined, and transparent public procurement will help ensure that oil revenues are well spent. Finally, an increased role for the private sector in housing provision could be introduced on a pilot basis, recognising that the current system will fall far short of meeting the burgeoning demand.

The Programme, with support from the Swedish International Development Co-operation Agency (Sida), intends to continue to support the Gol. In the next project phase, 2014-2016, the Programme will concentrate on investment policies and investment promotion. A review of the Iraqi investment policy framework will analyse the legal framework in detail and benchmark it against OECD good practices. An investment promotion diagnostic, coupled with capacity building, will help Iraq's central government and governorates engage with investors, understand their needs better, and improve their record in securing investment projects.

Participating Senior Gol Officials

Invitee	Position	Ministry/Organisation
Aziz Shawan, representing Rosch Shaways, Deputy Prime Minister for Economic Affairs	Chief of Staff	Deputy Prime Ministry for Economic Affairs
Mohammed Salman Al-Saady	Vice Chairman, Member of Council of Representatives	Economic and Investment Committee, Council of Representatives
Abdul Abbas Hamoud Salmen Shawya'a	Committee Member, Member of Council of Representatives	Economic and Investment Committee, Council of Representatives
Thamer Ghadhban	Chairman	Prime Minister's Advisory Commission
Sami R. Al-Araji	Chairman	National Investment Commission
Riyadh Yousef Aboud	Chairman	Infrastructure Committee, Office of the Deputy Prime Minister for Infrastructure
Mahdi M. Al-Ala'q	Deputy Minister	Ministry of Planning
Azhar Saleh	Director General for Public Procurement	Ministry of Planning
Mohammad Jaber	Director General, State Commission of Housing	Ministry of Construction and Housing