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USAID TIJARA PROVINCIAL ECONOMIC GROWTH PROGRAM

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INTERNATIONAL TRADE WTO ACCESSION

Report on State Owned Enterprises (SOEs) in Iraq

TIJARA
PROVINCIAL ECONOMIC GROWTH PROGRAM

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ACRONYMS

AFC	Agency for Corporatization
AoA	Agreement on Agriculture (Uruguay Round)
BDU	Business Development Unit
CPA	Coalition Provisional Authority
DG	Director General
FAO	Food and Agriculture Organization (of the United Nations)
FAS	Foreign Agriculture Service (of USDA)
GATT	General Agreement on Tariffs and Trade
GOC	Government Owned Corporation
GoI	Government of Iraq
IMF	International Monetary Fund
IU	Investment Unit
MIM	Ministry of Industry and Minerals
MoA	Ministry of Agriculture
MoT	Ministry of Trade
OECD	Organization for Economic Cooperation and Development
PPP	Public-Private-Partnerships (of *USAID/Tijara*)
PSDP-I	Private Sector Development Programme for Iraq
RU	Restructuring Unit
SOE	State Owned Enterprise
SPS	Sanitary and Phytosanitary
STE	State Trading Enterprise
TFBSO	Task Force for Business and Stability Operations (of the Department of Defense)
TFER	Task Force for Economic Reforms (of the Iraqi Prime Minister's Advisory Commission)
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
WB	World Bank
WTO	World Trade Organization

1. INTRODUCTION

1.1 Method of Approach

This report is identified as a deliverable in the *USAID/Tijara* International Trade/WTO Accession 2011-2012 Work Plan, Activity Reference 3.6: *Economic Assessment of Agricultural Reform Implementation.* The stated deliverables are:

- *Research and Prepare a Report on State Owned Enterprises (SOEs) in Iraq*
- *Preparation and submission of an activity/deliverable report.*

The method of approach was to undertake research and data collection including discussions and requests for information from a broad range of sources.

A report was prepared entitled ***Economic Assessment of Iraqi Agricultural Sector Reforms*** which includes Chapter 4: a report on *State Owned Enterprises (SOEs) in Iraq*. This fourth and final chapter forms part of this report.

1.2 Structure of Report

Section 1 provides a summary of the main findings, conclusions and a commentary on the current activities being taken to address the situation with respect to Iraq's state-owned enterprises.

Appendix A summarizes research and writing activities; appendix B the minutes of a meeting with the Deputy of the Ministry of Agriculture Dr. Mahdi Al Kaisey; and appendix C reproduces "State Owned Enterprises (SOEs) in Iraq" in its entirety.

This is the fourth and final chapter from an ongoing report "Economic Assessment of Iraqi Agricultural Sector Reforms," produced in chapter format by the *USAID/Tijara* International Trade/WTO Accession component. The chapters are as follows:

- *Chapter 1: Overall Economic Assessment, Update;* submitted August 2010
- *Chapter 2: Impacts from Changing Iraq's Agricultural Subsidy Regimes;* submitted August 2010
- *Chapter 3: Impacts from Changing Iraq's Agricultural Tariffs;* submitted December 2010*;*
- *Chapter 4: State Owned Enterprises (SOEs) in Iraq* finalized with this report in April 2011.

2. RESEARCH AND WRITING ACTIVITIES

2.1 Ongoing research, meetings and discussions with Government of Iraq (GoI) Ministry of Agriculture (MoA) Baghdad officials to determine status of Sanitary/Phytosanitary (SPS) regulations, subsidies and tariffs offers. During the course of these meetings discussions were held with MoA economics officials about data availability, state owned enterprises, agricultural tariffs and MoA internal economics analyses of proposed trade policy changes. (See Annex A for a full listing of Research and Writing Activities.)

2.2 Activity debrief and production of a detailed report Chapter 4: *State Owned Enterprises (SOEs) in Iraq* from the overall report "Economic Assessment of Iraqi Agricultural Sector Reforms." (See Annex C for the Full Report).

3. SOE SITUATION AND WAY FORWARD

3.1 Background

A summary of the Iraq-specific findings from the report is presented below. The full report complete with source references, background material and case studies is attached as Annex C.

> Like many other authoritarian and centrally planned economies, Iraq's economy was dominated by the state for nearly four decades prior to mid-2003. Public enterprises operated in key sectors of the economy under high protection; and input and output prices were controlled and heavily subsidized. Non-Arab foreign direct investment was forbidden, and with the UN sanctions since 1991 Iraq became essentially a closed economy. Most of Iraq's pre-2003 trade was through the oil-for-food program.
>
> A parallel economy managed by Saddam family members, who controlled significant segments of black markets, flourished during sanctions and had a negative impact on governance and the poor. Also there was a marked deterioration in the state of Iraq's SOEs including de-capitalization of assets, lack of access to modern technology and no incentives to increase productivity.
>
> SOEs, many of which are uncompetitive, are expected to bear the brunt of adjustment as Iraq transitions to a more market-oriented global economy. With high unemployment, the transition from SOEs to a market economy will inevitably result in significant job losses that will need to be managed to avoid the kind of social crises being experienced elsewhere in oil-producing countries. Indications are that, given their current financial state, SOEs are not likely to attract much interest from investors.
>
> The interim Iraq Government in 2004 was not in a position to dispose of SOE assets, and privatization was not a short-term option. Privatization may become a more viable option now that a new "representative and inclusive" government is in place and if a legal and regulatory framework for privatization can be implemented.
>
> It is true now, as in 2004, that SOE reform is an important issue that must be handled effectively if the Iraqi economy is to return to a position as one of the leading economies in the region. Reform will be necessary to meet the aspirations and expectations of the Iraqi people to live in a modern, successful economy that creates jobs and wealth, drives growth and allows open and equitable participation in the world economy.
>
> Other countries have faced similar problems and adopted a range of different approaches to SOE reform. The World Bank, USAID and myriad other international donors and international organizations have had extensive dialogue with Iraqi policy-makers on SOE reform options and dialogue on the subject continues.
>
> U.S. policymakers have attempted various strategies to bring Iraq's SOEs into a more competitive economic position. Paul Bremer, Coalition Provisional Authority (CPA), attempted to transform the Iraqi state-owned socialist economy into a model of Western-style free enterprise in 2003. At the core of this plan was to sell most SOEs to the highest bidder to bring in fresh capital, streamline operations and boost profits.

Foreign investors were not attracted to the uncertain political and security situation in Iraq and the hundreds of thousands of Iraqis' livelihoods depending on the state-run manufacturing plants. Virtually no state-owned enterprises were transitioned to private ownership and the Iraqi economy continued to languish.

In June 2006 Paul Brinkley then head of the Department of Defense Task Force for Business and Stability Operations (TFBSO) began a new strategy to revitalize Iraq’s SOEs by placing expatriate civilians with expertise in industrial operations and factory management on the ground in Iraq. The Task Force also provided funds for training Iraqi employees, upgrading equipment and preparing SOE factories for large-scale investment.

By 2009 TFBSO reported helping restart production at more than 60 Iraqi factories, facilitating contracts worth more than $1 billion between foreign private investors and Iraq’s SOEs and helping provide jobs for 250,000 Iraqis. Brinkley credited TFBSO with modest economic reform, reduced insurgency and a more stable, secure economic and social environment as first steps towards the revitalization of Iraq’s economy.

Other sources have indicated that some of the initial projects funded by TFBSO have since failed (freedom to fail is also a part of free enterprise) and the ongoing progress of SOE renewal is tepid and sporadic at best.

During an April 26, 2011 press conference Al-Maliki reiterated the message of reform. “The government might ask to dismiss a minister if we deem that his ministry is incapable of meeting reform objectives. We might also ask to dissolve the entire government, including Parliament, after the 100-day deadline if government fails to accomplish strategies for reform by the deadline.”

Because of the very high rate of joblessness – even without SOE reform – it is a matter of priority to prepare a range of measures to cushion workers from the effects of enterprise reform. These social-safety-net measures will likely include the following:

- Generous redundancy or severance payments;
- Retraining programs to impart or upgrade needed skills;
- A range of programs to assist workers to re-enter the job market – such as the establishment of employment agencies;
- Public works programs.

3.2 Way Forward

Taking account of the issues on the previous section, a Task Force for Economic Reforms (TFER) was set up in 2010 in the Prime Minister's Advisory Commission and including line Ministries and private sector representatives. TFER was mandated by the Government of Iraq to design and coordinate implementation of a comprehensive restructuring process that could effectively contribute to the transformation of some SOEs into viable commercial companies.

Within the framework of the Private Sector Development Programme for Iraq (PSDP-I) and in cooperation with 7 UN[1] agencies and the World Bank, an SOEs Restructuring Roadmap, was produced and received the approval of the Council of Ministers by Cabinet Decision #314 on August 31, 2010.

The main objectives of the Roadmap are:

- To improve the financial and operational performance of SOEs and contribute to their self-reliance;
- To contribute to Iraqi economic growth through enhanced competitiveness and trade; and
- To develop and implement social mitigation measures for employees and to contribute to job creation.

In order to implement the Roadmap certain institutional changes are planned within the line ministries. This includes the establishment of Restructuring Units (RUs) that will be organized into Business Development Units (BDUs) and Investment Units (IUs).

The mission of the BDUs will be to contribute to the revitalization of the SOEs by streamlining and enhancing business development in the wider context of private sector development of Iraq.

The initial work of the BDUs will focus on an initial diagnosis and classification of the SOEs. This diagnosis will be followed by a more comprehensive and in-depth diagnostic stage for the formulation of business, restructuring and social mitigation plans. SOEs will be classified according to the following headings:

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

Strategic partnerships and Public-Private-Partnerships (PPPs) will constitute priority areas to be addressed in the formulation of Business and Restructuring plans. Restructuring Units (RUs) will also lead the preparation of SOE Corporate Plans, Business Plans, Marketing Plans and assessments.

[1] UNDP, UNIDO, ILO, UNOPS, UNHABITAT, FAO, UNIFEM

The Investment Units (IUs) will be responsible for investment files, investment and partnership bidding processes.

Within this framework, the Ministry of Industry and Minerals (MIM) is already working with *USAID/Tijara* in introducing restructuring measures to some of its SOEs.

MIM and *USAID/Tijara* have selected eight SOEs (representing different industrial sectors) for business performance improvement and restructuring activities. These are:

1. State Company for Electrical Industries
2. State Company for Construction Industries
3. State Company for Leather Industries
4. State Company for Vegetable Oils Industries
5. Ibn Sina State Company
6. State Company for Industrial Designs and Consultation
7. General Systems Company
8. State Company for Information Systems

The technical assistance will focus on developing business opportunities for each enterprise by undertaking:

- Investment search (conducting a review of the business plan of each selected SOE);
- Site visits and discussions with SOE management;
- Training needs assessment and delivery of training;
- Market research (products, market segments, customers, marketing channels, value chain analysis, promotion, and others). This work will be undertaken in cooperation with MIM's Market Study Department;
- A detailed evaluation of the kinds of relationship that could be developed between the SOE and investors). The objective is to achieve PPP transactions that may be in the form of management contracts, joint ventures, strategic partnerships, technology transfer, industrial development cooperation and others. This work will be undertaken in cooperation with the MIM's Investment Department.

A *USAID/Tijara* program has been developed which foresees work starting on each SOE on a rolling one-month basis throughout 2011. At the same time, under the Roadmap the Private Sector Development Programme for Iraq (PSDP-I) will be classifying all the SOEs in Iraq.

Once all SOEs have been classified and the restructuring activities are completed it is planned for the establishment of an ***Agency for Corporatization (AFC)*** *under the Economic Reform Council (once established)*, which will eventually guide and manage the entire SOEs restructuring and corporatization processes in Iraq.

The tasks of the ARC will include the gradual acquisition and administration of the SOEs' assets, the consolidation and expansion of the SOEs corporatization processes (for transformation of the SOEs into public companies). Subsequently the SOE assets will be disposed to non-state entities according to procedures and methods to be properly regulated by specific governmental decisions. The AFC may retain shares in the capital of the SOEs (including for public-private mixed companies).

A wide range of reform methods is available including:

- Gradual privatization;
- Sale of businesses, assets and shares [likely at salvage value] by tender or auction;
- Maintaining shell SOEs as repositories for excess labor while reconstruction contracts and oil and gas production contracts are negotiated with domestic and foreign private sector contractors (this has been the path followed by Iraq since mid-2009);
- Sale of shares by public offer;
- Free distribution of shares to the population;
- Management or employee buy-out of enterprises;
- Concessions of enterprises or leasing of assets;
- Contracts for the management of enterprises;
- Other contracts for the provision of services.

Foreign investment is a critical contribution to the reconstruction process, both in general, and for SOEs in particular. WTO membership will lead to rule of law, foreign and domestic investor assurances and improved image as of Iraq as a member of the global investment community to attract the necessary foreign investment for the transition.

Based on the above options, the GoI will need to select a method and design a master plan to be reviewed on an annual basis. The plan should take into consideration other support programs such as sector reforms, legislative changes, and Iraq's privatization experience of the 1980s.

Since some methods are clearly better at achieving certain objectives than others, it is essential that the condition and needs of the enterprises strongly influence the method of reform. Consistent with the above options, current coordinated focus is on the SOEs Restructuring Roadmap and restructuring and corporatization of the most viable SOEs.

International initiatives will provide policy guidance and fund limited reform, but in the end, the investment decisions and policy directions will be Iraqi.

Table No. 1: Compendium of Annexes

Annex A

Research and Writing Activities

- Meeting with Deputy Minister of Agriculture, Dr. Mahdi Al Kaisey and MoA and Ministry of Trade (MoT) officials on March 29, 2010 to discuss when MoT would submit the Animal Health & Plant Quarantine Laws to the WTO, Agricultural Tariff Schedules and next steps regarding the SPS chapter (See Annex B: Meeting Notes)
  - Participants included Dr. Jameel M. Jameel, Ph.D. Economics Expert, Director General (DG) of the National Higher Commission on Iraq's Accession to the World Trade Organization (WTO), Ministry of Agriculture (MoA),
  - Dr. Abdul Hussein Al Hakim, Economist and Agricultural Advisor to the Minister.
- Meetings with Ron Verdonk, Agricultural Counselor and John M. Schnittker, Agriculture Economist/Ministry Advisor, and, United States Department of Agriculture (USDA) – Foreign Agriculture Service (FAS), U.S. Embassy, Baghdad, Iraq, March 2010 through present 2011,
- Ongoing calls and discussions with Dr. Jim Butler, Deputy Director General, and technical experts, FAO, Rome, March through July 2010,
- Contact and discussions with WTO officials working on the WTO accession of Iraq and the WTO Agriculture and Commodities Division,
- Researched and evaluated data bases at World Bank (WB), International Monetary Fund (IMF) and Foreign Agricultural Organization (FAO),
- Researched Izdihar and Tijara archive files for Larry Morgan, Ph.D., Senior Agricultural Advisor and Brian Glancy, Director, International Trade/WTO Accession regarding State Owned Enterprises and other topics relevant to this research document.
- Conducted extensive web-based research for "State owned Enterprises," "State Trading Enterprises," "China, State Trading Enterprises" and "WTO Grain Boards and State Trading Enterprises."
- Consultation with Donal Cotter, Chief of Party, *USAID/Tijara*, and
- Extensive editorial contributions by David Nelson, Public-Private-Partnerships Advisor, *USAID/Tijara.* Nelson authored *3.2 The Way Forward*, pages 5-7 and pages 31-33 in Chapter 4 of the final report.

2.2 Produced a detailed report, ***Economic Assessment of Iraqi Agricultural Sector Reforms*** final chapter, Chapter 4: *State Owned Enterprises (SOEs) in Iraq*. (See Annex C: Full Report).

Annex B

SUMMARY OF MEETING
Meeting at the Deputy of Minister Office, MoA
Dr. Mahdi Al Kaisey
10:40 AM Monday, March 29, 2010

Summary: *USAID/Tijara's* WTO Accession office had a very useful meeting with the Deputy of the Ministry of Agriculture Dr. Mahdi Al Kaisey and other members from the WTO Units in the Ministry of Agriculture with the Ministry of Trade attending. The main discussion was about the SPS Laws and when the Ministry of Trade can submit the Animal Health & Plant Quarantine Laws, agricultural tariffs and State Owned Enterprises, and what needs to be done for the Next Step regarding the SPS chapter.

Participants:

MoA: Dr. Mahdi Al Kaisey, Deputy of the Minister of Agriculture
Dr. Jamil M. Jamil, DG of the WTO Unit in the MoA , Economics Expert
Dr. Methaq Abdul Hussein, Animal Health Dept.
Dr. Abdul Hussein Al Hakim Economics and Agricultural Advisor of the Minister.
Ms. Asmaa Ibrahim, Lawyer in the Legal department.
MoT: Dr.Ali Abdull Razaq, Lawyer, Economics & Relations Dept./ WTO Unit
Ms. Sawsan M. Saihoud, Specialist in the SPS file.

USAID/Tijara: Chuck Lambert, Senior Economist and Agriculture Advisor
Saif Natiq, WTO Accession Program Specialist .

After completing the two Agriculture Laws -- the *Animal Health* and the *Plant Quarantine Law* -- the Ministry of Agriculture and the TIJARA/USAID requested that the Ministry of Trade submit those two Laws to the WTO. The trade people were concerned about sending files that include laws from more than one ministry, like the SPS file, as one package and proposed waiting until after the Ministry of Health completes its work.

This meeting was to introduce Mr. Charles Lambert as the New Economist and Agriculture Advisor for the *USAID/Tijara* project and to discuss these concerns. Each of the Participants introduced him- or her-self and give brief notes about current work.

The main topics covered and information discussed was as follows:

1. **Regarding SPS:** Dr.Jamil said that he believes that the MoA has now completed about 75% of their commitments to the WTO and they are now waiting for the Ministry of Trade to submit the Laws to the International Organization; Dr. Ali Abdul Razzaq added that they can't send the Animal Health and Plant laws to the WTO without the 2 Health Laws. Chuck Lambert advised that the Ministry of Trade can send the laws for the Animal Health and the Plant Law to the WTO now, then after finishing the Health laws they can forward them as Updated files. Saif Natiq told the Trade People that TIJARA will send them a clear email advising that they can send the Animal Health and Plant laws to the WTO now, and when the Health People finish their laws they can send them as Separate files to the WTO.

2. **WTO process:** Dr. Mahdi said that the People in the MoT need support and training regarding the WTO files and asked them to cooperate with the other ministries as much as possible. Saif Natiq then asked Sawsan and Dr.Ali to inform him about the Legislative Action Plan and the Laws that they have already submitted to the World Trade Organization. The laws that have been submitted from the MoT are as follows:

   a) The Legislative Action Plan
   b) ACC/4
   c) TBT Law
   d) IP Law
   e) Communications and information technicality Law and provisions of the law regulating the electronic signature and the Law on Computer and information's Network Crimes
   f) ACC8 Agricultural Tariff Schedule and Law on the Protection of Iraqi Products (Anti-dumping)
   g) Draft law on State Owned Enterprises (SOEs)
   h) Trade Regulation Law
   i) Marine agencies Law

   Future Plan: *USAID/Tijara* representatives requested that the Trade Ministry submit the Animal Health & Plant Laws to the WTO and agreed to send them a letter in clear words including that request. All parties agreed that after the Animal Health and Plant Health laws have been submitted to the WTO a discussion workshop will be hosted by *USAID/Tijara* in Erbil to discuss how to integrate language from the Ministry of Health once it is completed into the SPS package, and to address any questions about the agricultural language from the WTO.

Annex C

ECONOMIC ASSESSMENT OF IRAQI AGRICULTURAL SECTOR REFORMS

Chapter 4: State Owned Enterprises (SOEs) in Iraq

Background and Global Overview:
A government-owned corporation, state-owned enterprise, state enterprise, government business enterprise, or parastatal is a legal entity created by a government to undertake commercial activities on behalf of that government.

There is no standard definition for a government-owned corporation (GOC) or state-owned enterprise (SOE), and the two terms are used interchangeably. Regardless of name, SOEs have a distinct legal form and they are established to operate in commercial affairs. While they may also have public policy objectives, SOEs are different from government regulatory agencies that are authorized to conduct purely non-financial objectives. SOEs are also concerned with satisfying shareholders and with generating a return on investment.

SOEs can be fully owned or partially owned by a government. It is difficult to determine what level of state ownership qualifies an entity to be considered as "state-owned", since governments can also own regular stock. For example, the Chinese Investment Corporation agreed in 2007 to acquire a 9.9 percent interest in Morgan Stanley, but it is unlikely that Morgan Stanley is considered to be a government-owned corporation.

In most OPEC countries, governments own the oil companies operating within their borders. An increasing number of corporations are taking additional steps to protect their reputation for transparency and reducing exposure by identifying government-owned companies. Dow Jones has identified more than 100,000 government-owned or controlled corporations in its Anti-Corruption service. This number far exceeds earlier estimates by the Organization for Economic Cooperation and Development (OECD). [**Source***:* *Wikipedia, "Government-Owned Corporations," 2010.*]

OECD Guidelines for Governance of SOEs: In several OECD countries, SOEs still represent a substantial portion of Gross Domestic Product (GDP), employment and market capitalization. SOEs are often prevalent in utilities and infrastructure industries, including energy, transportation and telecommunications, where performance is critical to broad segments of the population and to other parts of the business sector. Consequently, sound governance of SOEs is critical to ensuring overall economic efficiency and competitiveness. OECD experience has also shown that good corporate governance is an important prerequisite for economically effective privatization, since valuation is enhanced as well-managed enterprises become more attractive to prospective buyers.

A number of non-OECD countries also have significant state-owned sectors, and in some cases SOEs dominate the economy. In many cases economies are reforming how SOEs are organized and managed and have consulted with OECD to support reforms at the national level. The rationale for state ownership of commercial enterprises varies among countries and industries and has typically included a mix of social, economic and strategic interests. OECD Guidelines are primarily intended to cover commercial enterprises under central government ownership. However, it is in the government's and the public's interest that all categories of SOEs be professionally run and apply good governance practices.

The OECD guidelines are presented in outline form as follows:

I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises

A. To avoid market distortions the legal and regulatory framework for SOEs should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete.

1. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for SOEs -- particularly market regulation.
2. Governments should strive to simplify and streamline operational practices and the legal form under which SOEs operate. The legal form should allow creditors to press claims and initiate insolvency procedures.
3. Any obligations and responsibilities that an SOE undertakes in terms of public services should be clearly mandated by laws or regulations. These obligations and responsibilities should be disclosed to the general public and related costs should be covered in a transparent manner.
4. SOEs should not be exempt from general laws and regulations. Stakeholders including competitors should have access to efficient redress and an even-handed ruling when they perceive that their rights have been violated.
5. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when necessary to achieve company objectives.
6. SOEs should face competitive conditions including access to financing. Relations with state-owned banks, state-owned financial institutions and other state-owned companies should be on a purely commercial basis.

II. The State Acting as an Owner

A. The state should act as an informed and active owner and establish a clear and consistent ownership policy to ensure that SOE governance is carried out in a transparent and accountable manner with professionalism and effectiveness.

1. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how ownership policy will be implemented.
2. The government should not be involved in the day-to-day management of SOEs and allow full autonomy to achieve defined objectives.
3. The state should let SOE boards exercise their responsibilities and respect their independence.
4. The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a coordinating entity, or more appropriately, by centralization of the ownership function.
5. The coordinating or ownership entity should be held accountable to representative bodies including Congress or Parliament and have clearly defined relationships with relevant public bodies including state audit institutions.

6. The state as an active owner should exercise ownership rights according to the legal structure of each company.

III. Equitable Treatment of Shareholders

A. The state and state-owned enterprises should recognize the rights of all shareholders and ensure equitable treatment and equal access to corporate information.

1. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how ownership policy will be implemented.
2. The coordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.
3. SOEs should observe a high degree of transparency towards all shareholders.
4. SOEs should develop an active policy of communication and consultation with all shareholders.
5. Access for minority shareholders' should be facilitated in shareholder meetings to allow participation in fundamental corporate decisions including board elections.

IV. Relations with Stakeholders

A State ownership policy should fully recognize SOEs' responsibilities to stakeholders and request regular reporting on stakeholder relations.

Governments, the coordinating or ownership entity and SOEs themselves should recognize and respect stakeholders' rights established by law or through mutual agreements.

1. Listed or large SOEs, as well as those pursuing important public policy objectives, should report on stakeholder relations.
2. SOE boards should develop, implement and communicate compliance programs for internal codes of ethics.
3. These codes should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

V. Transparency and Disclosure

A. SOEs should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

1. Coordinating or ownership entities should develop consistent and aggregate reporting on SOEs and publish an annual aggregate report.
2. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee.
3. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.
4. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to internationally recognized standards.

5. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and also focus on areas of significant concern for the state as an owner and the general public.

VI. Responsibilities of the Boards of State-Owned Enterprises

A. SOE boards should have the necessary authority, competencies and objectivity to carry out strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

1. SOE boards should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.
2. SOE boards should carry out their functions of monitoring of management and strategic guidance subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
3. The boards of SOEs should be composed so that they can exercise objective and independent business decisions. Good practice calls for the Chair to be separate from the CEO.
4. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.
5. When necessary, SOE boards should set up specialized committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.
6. SOE boards should conduct an annual performance evaluation.

[**Source***:* *Organisation for Economic Co-operation and Development, "OECD Guidelines on Corporate Governance of State-Owned Enterprises," 2005.]*

Private vs. State Owned Enterprises

Privatization: The basic economic argument for privatization of SOEs states that governments have few incentives to ensure that enterprises they own are well run. Proponents of privatization believe that market factors will deliver most goods and services more efficiently in response to free market competition than can governments. In general, it is argued that over time competition, not government planning, will lead to lower prices, improved quality, more choices, less corruption, less red tape, and quicker delivery.

If private companies and SOEs compete against each other the SOE may borrow money more cheaply from debt markets than private enterprises, because SOEs are ultimately backed by the taxation and monetary printing power of the state. Capital access and cost may provide the SOE an unfair advantage. On the other side, privatizing a non-profitable state-owned company may force the company to increase prices to become profitable. This would increase costs to consumers but remove the need for the state to provide tax money to cover company losses.

Many democratic and capitalist economies maintain some SOEs especially in the communications, energy, transportation and commodity marketing sectors. SOEs can be found in Commonwealth member countries, Austral-Asia, Canada, Europe, Peoples' Republic of China, India, Japan, Singapore, South Africa, Taiwan, the United States and Uruguay.

Public Ownership: Opponents of privatization believe that at least some public goods and services should remain primarily in the hands of government to ensure that everyone has access (law enforcement, health care, and basic education, for example.) There is a positive social effect, it is argued, when government provides public goods and services including defense and disease control to the general public. Natural monopolies are by their nature not subject to fair competition and therefore, also better administrated by the state.

Corruption and SOEs: In a society with substantial corruption, (Iraq is ranked 174 out of 178 among the most corrupt economies) privatization allows the government currently in power and its backers to siphon a large portion of the entire net present value of state assets away from the public and into the accounts of their favored power brokers. Without privatization, corrupt officials would have to more slowly collect corrupt earnings over time. As such, efficient privatization depends on a very low level of **current** corruption among government officials (a situation that is not the case in Iraq.)

Of course, corrupt government officials can also extract corrupt rents quite efficiently by borrowing extensively to engage in spending on contracts overly favorable to their backers (or on tax shelters, subsidies or other giveaways). In the end, the public is left with a government that taxes heavily and gives little in return -- while paying debt incurred for corrupt transfers made decades earlier. Debt repayment is enforced (or forgiven) by international agreements and agencies including the International Monetary Fund (IMF), and significant Iraqi debt accrued under the Sadaam regime has been written off by the international community. However, if current revenues are used to pay off old debt, infrastructure and upkeep is sacrificed - leading to a further decay in the economic efficiency of the country (also a current condition in Iraq).

SOEs are often associated with economies transitioning from centrally planned production and consumption to market-oriented functions in response to factors of supply and demand. Russia's privatization experience resulted in oligarchs when SOEs were taken private - at a dramatically lower price than net present value. The new owner [often a favored former government employee] gained huge windfalls when government officials reduced the sales price. These transactions resulted in hundreds of billions of dollars being (questionably) transferred from the public to the most favored designated takeover artists. [**Source*:*** *Wikipedia, "Government-Owned Corporations," 2010.*]

A Case Study: Evolution of China's State-Owned Enterprises:

After 1949, all business entities in China were created and owned by the government. During the late 1980s, the government of China began to adopt capitalist economic policies while maintaining communist social control and began to reform the SOEs. During the 1990s and 2000s, many mid-sized and small SOEs were privatized and went public. There are now a number of different Chinese corporate forms that result in a mixture of public and private capital. State-owned enterprises are governed by local governments and, within the central government under control of the national State-owned Assets Supervision and Administration Commission. Unlike Russia, China's privatization of SOEs has been gradual and more in response to economic forces.

Many would consider a present-day Chinese state-owned company to be only one of the 150 or so corporations that report directly to the central government. However, thousands more companies fall into a gray area, including subsidiaries of these 150 corporations, companies owned by provincial and municipal governments, and companies that have been partially privatized yet retain the state as a majority, or as an influential minority shareholder.

State-owned companies of all kinds have gradually lost part of the advantages from a close relationship with the government. Since the 1980s, the Chinese government and the ruling party have followed a policy of ***zhengqi fenkai***, which formally separates government functions from business operations. The policy has been applied gradually, first to the consumer goods industry, then to high tech and heavy manufacturing, and more recently, to banking as officials have attempted to strengthen domestic businesses and the economy to prepare for unfettered global competition.

As a result, government favoritism toward state-owned companies is fading. Chinese officials have started holding SOEs more accountable for successes and failures. Access to capital at below market rates has been severely limited and 3,658 state companies failed between 1994 and 2005. More such bankruptcies are likely.

As China's government progressively implements universal social security, the burden of providing health care and pensions is shifting from businesses to the state. Physical assets (for instance, hospitals and school buildings) that don't contribute to the core business are being sold on the open market at a profit. The government's pervasiveness in society gives China's SOEs freer rein to confront labor issues than counterparts in more open societies. The Communist Party controls both labor and management, eliminating the overt tensions that make public-sector reform difficult elsewhere. Over the past decade, tens of millions of workers have been laid off by China's SOEs in an effort to improve efficiency and become leaner organizations.

Today, China's SOEs, like China itself, are diverse. Many modern Chinese SOEs make better partners for multinationals than some private-sector counterparts. Openness, not ownership, is the key and one way to judge a Chinese state-owned company is to examine the openness of the organization. Experience in developed and developing economies shows that open companies, whether in the public or the private sector, have a greater chance of prospering. An open company is institutionally better able to understand the context of its business and to implement necessary responses to change.

One important indicator of a company's openness is its approach to talent. Open companies are willing to bring in external managers, including foreigners, as needed. Other indicators of openness are the efforts that companies make to broaden the investor base, to adopt best-practice governance systems, and to embrace new ideas no matter the source. Open companies are also more transparent and have a greater awareness of risk, particularly during overseas expansion, because they take part in a broader dialogue with stakeholders and are more willing to challenge internal leadership. Open companies are more likely to understand and adapt to different environments; closed companies are much less flexible.

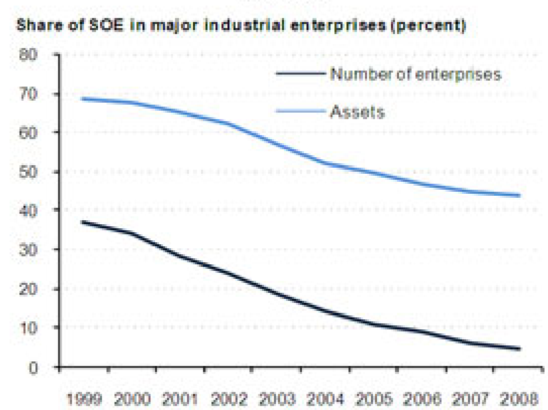
Open state-owned companies with ready access to capital are likely to increase investments in research and development (R&D), so breakthrough innovations from China will come more frequently. R&D spending has grown rapidly over the last few years. OECD estimates that in 2006, China became the second-ranking investor in R&D, passing Japan, but still behind the United States. China also placed second in OECD rankings for the number of researchers employed. Multinationals now jealously guarding intellectual property against theft in China may soon find that the real threat is obsolescence, not piracy.

Corporations outside China will increasingly view China's open SOEs as potential partners in global markets rather than only as conduits into the Chinese market. Such companies, with global aspirations and easier access to capital than their private-sector counterparts, will help to propel a larger, more sustained wave of Chinese cross-border acquisitions. Chinese SOEs should be accepted as peers capable of adding value to joint ventures around the world and as credible purchasers of assets.

Now that open companies—state owned and private sector alike—lead the development of China's corporate sector, the war for talent will intensify. Multinationals that do business in the country must radically improve talent to compete with successful, open state-owned companies that can offer high-performing Chinese workers an opportunity both to "serve the nation" and to receive good compensation in fast-growing businesses. Foreign talent too will be attracted to the challenge of nation building accompanied by good pay. [**Source:** *McKinsey Quarterly, "Reassessing China's state-owned enterprises," July 2008]*

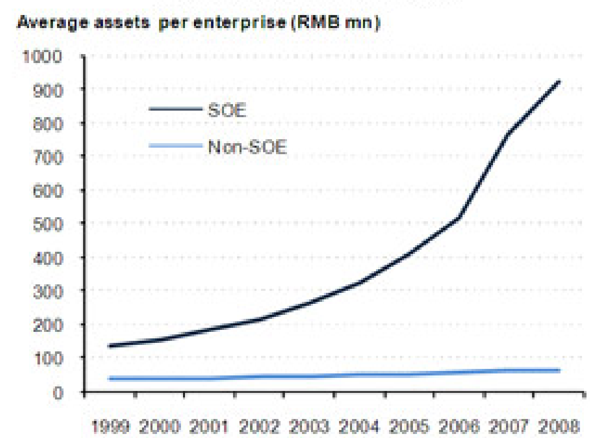
The shrinking share of SOEs in China's industrial sector is due to the stronger growth of non-SOEs, and the fact that more non-SOEs have crossed the sales threshold to be entered into the sample. Since the sample covers 90 percent of the industrial sector, and 39 percent of China's national economy, the diminishing SOE share in the sample clearly points to a bigger role played by non-SOEs in the Chinese economy.

Figure 1. Share of SOEs in the industrial sector has declined steadily in the past decade



Source: CEIC, and author's calculation.

Figure 2. Average asset size of SOEs and non-SOEs



Source: CEIC, and author's calculation.

Since 1999, the share of SOEs in China has declined from 37 percent to less than 5 percent in terms of numbers, and from 68 percent to 44 percent in terms of assets. This is to a large extent a result of SOE reform – specifically the “grasping the big, letting go of the small” strategy – carried out in the past decade. Since the reform started in late 1990s, most small SOEs have been privatized or filed bankruptcy to lessen the burden on the government, while larger ones have been subsidized (directly or implicitly) and/or merged to hopefully create stronger firms controlling the continued growth of the national economy.
[Source: http://www.worldbank.org/eastasiap/, “*State owned enterprises in China: How big are they?” January 2010.]*

China’s state-owned firms are now on a global shopping spree. Chinese buyers — mostly opaque, often run by the Communist Party and sometimes driven by politics as well as profit — have accounted for a tenth of cross-border deals in a value basis this year. Chinese SOEs have successfully bid for everything from American gas and Brazilian electricity grids to a Swedish car company, Volvo.

There is rising opposition to this trend in some quarters. The notion that capitalists should allow communists to buy companies is, some argue, taking economic liberalism to an extreme. But the spread of Chinese capital will not only bring benefits to direct recipients, it will also benefit the world economy as a whole.

Not long ago, China’s (and other countries’) government-controlled companies were regarded as half-formed creatures destined for full privatization. However, a combination of factors — huge savings in the emerging world, oil wealth and a loss of confidence in the free-market model — has led to a resurgence of state capitalism. About 20 percent of global stock market value is now held in SOEs, more than twice the level ten years ago.

The rich world has tolerated the rise of mercantilist economies before. Two examples: South Korea’s state-led development and Singapore’s state-controlled firms that are active acquirers abroad. Still, China is perceived as different. It is already the world’s second-largest economy, and in time is likely to overtake the U.S. China’s firms are giants that until now have been inward-looking, but are now starting to focus vast resources abroad.

Chinese firms currently own just 6 percent of global investment in international business. Historically, global leaders have peaked at a far larger share than that. Britain and the U.S. both topped out with a share of about 50 percent, in 1914 and 1967 respectively. China’s rise could be turbocharged by its vast pool of savings. Today China’s wealth is largely invested in rich countries’ government bonds and debt instruments; tomorrow it could be used to buy companies and protect China against devaluations and possible defaults.

Chinese firms are going global for the usual reasons -- to acquire raw materials, to get technical know-how and to gain access to foreign markets. But, alarmists say, these SOEs are under the guidance of a government that many countries consider a strategic competitor, not an ally. China appoints executives, directs deals and finances through state banks. Once bought, natural-resource firms can become captive suppliers to the Chinese economy.

Private companies have traditionally played a big role in delivering the benefits from globalization. Multinationals span the planet, allocating resources as they see fit and competing to win customers. The idea that an opaque government might come to dominate global capitalism is unappealing to some. In this case resources could be allocated by officials, not the market. Politics, not profit, might drive decisions. Such concerns are being voiced with increasing fervor. Australia and Canada, once open markets for takeovers, are creating hurdles for China's state-backed firms, particularly in natural resources. It is easy to foresee other countries beginning to follow this trend.

China is years away from posing any kind of threat and most of its firms are only beginning to implement global strategies. Even in natural resources, where China has been most active in deal-making, it is not close to cornering the market for most commodities. Chinese companies can safely be allowed to own energy firms, because in a competitive market customers can turn to other suppliers. If Chinese firms make subsidized investments around the world, that's fine too – America and Europe need the capital. The danger that cheap Chinese capital might undermine rivals can be better dealt with by strengthening competition law than by restricting investment.

As indicted earlier, China's system is not as monolithic as most foreigners often assume. State companies compete at home and decision-making is consensual rather than dictatorial. When abroad China's SOEs may have mixed motives, and some sectors — defense and strategic infrastructure, for instance — are too sensitive to allow them to participate. Such areas are relatively few.

Not all Chinese companies are state-directed. Some are largely independent and mainly interested in profits. Chinese SOEs can bring new energy and capital to struggling companies around the world, but the influence will not flow just one way. To succeed abroad, Chinese companies will need to adapt. That means hiring local managers, investing in local research and placating local concerns — for example by listing subsidiaries locally.

Indian and Brazilian firms have an advantage abroad thanks to their private-sector traditions and more open cultures. This fact has not been lost on Chinese state managers. China's advance may bring benefits beyond the narrowly commercial. As it invests in the global economy, China's interests will also become increasingly aligned with the rest of the world. As that happens China's enthusiasm for international co-operation will also increase. To reject China's investments would be a disservice to future generations, as well as a deeply pessimistic statement about capitalism's confidence and ability to compete. [**Source***:* *The Economist, "China buys up the world: The world should stay open for business," November 2010.]*

Agricultural State Trading Enterprises (STEs) and Developing Countries

State Trading Enterprises in the WTO Context: STEs are essentially SOEs with specific authority for marketing functions. About 75 percent of the STEs notified to WTO under General Agreement on Tariffs and Trade (GATT) Article XVII are involved in agriculture. The prevalence of STEs in agriculture "stems from the belief that state trading is an appropriate means by which governments can meet agriculture-related policy objectives" (WTO 1995, paragraph 5). Most of the STEs that play a significant role in global agricultural markets and almost all of the export-oriented enterprises are based in developed countries. In spite of the trend toward privatization in recent years, STEs remain important economic agents in developing countries, although few are large enough to influence international markets.

GATT Principles Regarding STEs: The Uruguay Round Understanding on the Interpretation of GATT Article XVII defines STEs as: "*Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports*."

The Article requires that STEs act in accordance with the general principles of non-discrimination prescribed in the Agreement. Specifically, GATT requires that purchases or sales involving imports or exports be made "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of other contracting parties adequate opportunity ...... to compete for participation in such purchases or sales". An exception is provided for STEs that have an import monopoly and are bound by the country's Schedule of Concessions under GATT Article II. Exporting STEs that serve to stabilize domestic prices for primary commodities are exempt from countervailing duties under GATT Article VI. Most STEs involved in agriculture qualify for one or both of these exceptions.

Types of Agricultural STEs: Statutory marketing boards, also known as statutory marketing authorities or control boards are the most common type of STE in the agricultural sector. These boards may have any or all of the following objectives: domestic price stabilization, market regulation, and control and promotion of exports. They are usually producer-controlled, state-sanctioned monopolies with exclusive authority for a wide range of market interventions, including regulation and purchase of domestic output, setting consumer and producer prices, controlling domestic distribution, and conducting foreign trade. STEs typically have control over the movement, pricing, quality standards, and marketing of the agricultural products they cover.

Other types of STEs generally have a narrower range of objectives and make fewer market interventions. Fiscal monopolies, for example, are largely concerned with the control of the production, marketing and distribution of commodities for which there are tax or public health implications: examples are salt, tobacco and alcohol.

Canalizing agencies have monopoly rights for the import or export of a specific product with the objective of stabilizing domestic prices or domestic supplies or rationing foreign exchange.

STEs in the Context of WTO Negotiations on Agriculture: The main issues regarding STEs during WTO negotiations on agriculture are associated with the potential to undermine the disciplines and transparency achieved in the WTO Agreement on Agriculture (AoA). The most vocal concern with respect to exporting STEs is voiced by firms and governments in countries that are competing against these STEs in commodity export markets and believe that state trading activities are being used to circumvent commitments on export subsidies.

The concerns voiced about importing STEs come mainly from exporters who believe they may be used to circumvent market access commitments, particularly in the administration of tariff quotas. A key question is whether activities of STEs in developing countries are necessarily trade-distorting. The extent of trade-distortion that may be caused by an STE depends, among other things, on: (i) the extent of market power it is able to exercise; (ii) its regulatory or institutional distance from the government; (iii) and its trade orientation. This typology is used to explore some of the issues that may be the focus of attention in the ongoing negotiations.

Market Power: Market power refers to the ability of an economic agent to exert monopoly or monopsony control in a market, either domestic or international. As mentioned earlier almost all of the exporting STEs with monopoly power are located in developed countries. Also, most of the monopoly importing STEs that are large enough to affect international markets are also in those countries. In developing countries, by contrast, the turnover of STEs is generally small relative to the world market, and thus they are unlikely to influence world prices or the agricultural terms of trade. They may create domestic distortions but are, in general, too small to affect the level of world prices.

Policy regime: The policy regime within which an STE operates generally reflects the degree of market power it is able to exercise. An importing STE that does not control prices and quantities traded domestically must have recourse to other policy instruments to regulate the internal market. In this respect, tariffs are the WTO favored policy instrument rather than quantitative controls, since tariffs are less distorting and easier to regulate.

Product range: The range of products for which the STE is responsible is also an important determinant of the degree of market control it can exercise. When the enterprise has control not only over an individual commodity, but also over the market substitutes for that commodity, its potential to distort trade is increased.

Similar opportunities for market manipulation arise if the control extends to upstream or downstream commodities. At the same time, it must be recognized that vertical and horizontal integration are common features of private enterprises, and may occur for sound commercial reasons and as a result of competitive pressure.

Market environment: The market environment in which STEs operate is also a crucial factor in determining whether state trading is appropriate. Most studies of STEs assume that international commodity markets are in other respects perfectly competitive. In reality, most commodity markets are characterized by large firms that deal with many countries and products, in a number of vertically integrated activities. It can thus be argued that STEs operating in an imperfectly competitive market may be justified on economic grounds as a way to counter the monopoly power of existing market agents.

Distance from Government: In the debate over ownership and management, it has been argued that the more an STE is independent of government, the more it will be subject to commercial criteria, and the less likely it is to distort trade. Clearly, STEs cover a wide spectrum ranging from enterprises that are directly owned and administered by an arm of government to those that are privately owned but operating under contract with government through which they are granted trading privileges. OECD (2000) contends that in most cases, any trade-distortion originates from the level of domestic prices and the choice of policy instruments set by governments, not the STE *per se*. Therefore an STE can be considered an instrument of government policy and not necessarily a cause of distortion. This suggests that measures to ensure that the activities of STEs conform to commercial criteria could limit their potential for distorting trade.

Trade Orientation: Whether an STE is concerned with commodity imports or exports influences the degree to which it may distort trade. Some countries have argued that the current WTO disciplines on imports by STEs are stricter than on exports and that this imbalance should be rectified.

E*xporting STEs:* Concerns about exporting STEs relate to the competitive advantages gained from special rights and privileges and official status. Exporting STEs may be able to cross-subsidize export sales from proceeds gained from their monopoly status and they may also use domestic price pooling to facilitate discretionary pricing in world markets.

Exporting STEs may also have greater certainty about sources of supply as a result of their legal mandate, and thus more ability to conclude discriminatory long-term agreements with importing countries. There may also be a greater ability for predatory pricing because of access to short-term government subsidies and the possibility of benefiting from discriminatory interest rates and other government subsidies. Export subsidies are theoretically limited by the AoA, but lack of transparency can enable export subsidy restrictions to be circumvented.

Importing STEs: Concerns about importing STEs focus on the extent that market access is distorted or restricted. The monopoly status of import STEs makes it difficult to determine whether imports are in response to market demand, or due to government policy or constraint. There could be discrimination, for example, with respect to the allocation of tariff rate quotas (TRQs) or the control of grades and standards. Because import STEs influence prices and quantities traded both domestically and internationally, there is a likelihood for concealing the true costs and returns and for disguising the degree of market distortion. Reforms to reduce the monopoly power of importing STEs and increase transparency of operations could reduce these concerns.

Role of STEs in Developing or Transitioning Countries: Objectives and activities of STEs in developing countries extend well beyond the control of external trade to encompass broader concerns including rural development and food security. Often, STEs compensate for market failure in these economies.

Poorly developed physical and information infrastructures (prominent in Iraq) and -- particularly in parts of sub-Saharan Africa -- the lack of an indigenous trading class, provide additional reasons for state trading activities. Historically, these infrastructure deficiencies have resulted in an intervention agency to implement necessary purchases and sales. Marketing boards in developing countries have been involved in providing marketing services, risk management and production inputs including credit and fertilizers, all of which may be inadequately provided by the private sector (and in many cases by the STE as well.)

The reasons for STEs notified to WTO by developing countries can be summarized under the following headings:

Poverty reduction: Concerns related to poverty reduction include food security and rural development, particularly by increasing the level and stability of farm incomes. Activities for poverty reduction include producer price stabilization and regulation of food supplies to urban consumers to ensure adequate supplies at affordable prices. Namibia's notification, for example, states that "*the control boards were established .... for the purpose of promoting domestic production so as to contribute to household food security and employment*." A floor price provides a safety net for rural incomes and an incentive to expand domestic production. In food-importing countries, border controls are common for regulating supplies and protecting domestic producers.

Operational efficiency: Efficiency gains may be possible especially in foreign trade where STEs can provide scale and lower institutional costs by pooling the efforts of potential exporters or importers. This action allows commodity export and import trade to be accomplished more efficiently through lower operating and handling costs. WTO notification by Trinidad and Tobago stresses, "*that the National Flour Mill's major strengths reside in: competent, innovative management working through skilled and dedicated personnel; competencies in grain management and grain processing, together with a pool of specialized skills in specific areas; and sophisticated plant and equipment, situated in a strategic geographic location*. "

Strategic considerations: Public health issues, natural resource management, and access to and control of investment resources are listed among strategic considerations. These include manipulation of the terms of trade and direct access to funds through direct taxation (in addition to tariffs) of imports and exports.

Experience with STE Reform: In sub-Saharan Africa, the impact from structural adjustment during the last two decades has generally been to substantially reduce market intervention and regulation. Economic reforms were implemented earlier in Latin America earlier and have had more impact. Reform in Latin America was driven more by a desire for greater openness in multilateral trade than by the consequences from domestic economic crises. In Asia the extent to which privatization and liberalization have been pursued during the last decade has varied substantially. Generally, there has been a move towards greater openness and reduction of monopoly powers, rather than abandonment of the principle of state involvement in commodity markets. The trend in developing countries has generally been towards less state control and greater transparency. However, STEs continue to play an important role in many instances.

It has been argued that the reduced activity by STEs in Africa related to structural adjustment programs has reduced the availability of agricultural inputs, particularly credit, because private sector creditors have not moved in to provide the service. However, when the private sector has evolved, as in Asia, private sector services have reduced margins and allowed greater returns to producers. Increased efficiencies and reduced costs have been demonstrated in a number of case studies where price transmission was found to be higher in the absence of marketing boards.

Examples of STE reform in developing countries (see box below) demonstrate that removing the State from distribution and marketing of agricultural commodities can improve the performance of the sector in some cases. Restricting the scope for STEs may not always be appropriate, when greater participation by the private sector are constrained. Developing countries therefore must determine whether or not STEs provide the most appropriate instrument for achieving official objectives.

While this is a matter for debate, the decision should be one for national governments, except where there are multilateral or regional obligations. It could also be argued that benefits from STE activities in developing countries may justify a degree of trade distortion as a matter of special and differential treatment.

Conclusions: Concerns about STEs are generally related to export subsidies, restrictions on market access and diminished transparency in the trading system. The ability of an STE to distort trade depends on its market power, its relationship to the government and the market environment in which it operates. Several points support the right for developing countries to continue state trading operations:

- Most STEs in developing countries are too small to influence world prices, and potential to distort international markets is minimal;
- Many developing countries have social objectives for state trading activities including food security and rural development that are not consistent with market incentives;
- Case studies clearly demonstrate that developing country STEs have increasingly opened pricing policies and many now “share” markets with private traders;
- Markets for agricultural commodities are often not perfectly competitive justifying some form of collective trading entity to increase local bargaining power and enable developing countries to offset monopolistic behavior of private sector agents;
- Prevalence of market failures in many developing countries, particularly when providing agricultural inputs, credit, and marketing services, often justify an ongoing role for state involvement in agricultural markets.

It may be debated whether state trading is appropriate for developing countries to use in pursuing objectives in the agricultural sector. Case studies point to situations where state trading has been beneficial, although that has not always been the case. Reducing state involvement in domestic agricultural marketing has improved the performance of the agricultural sector in some countries. However, it is inappropriate to apply the same approach everywhere, or in the international context where potential for small-scale private sector development is weak. The choice should remain with the developing countries, especially in the absence of significant trade distortions. For these reasons the authors of this paper believe that it is desirable for WTO rules to continue allowing developing countries the option of using STEs.

Table 1: Examples of STE Reform in Developing Countries

Indonesia: The Badan Urusan Logistik (Bulog) has the dual goal of stabilizing domestic prices for several food commodities, in particular rice, at levels affordable for consumers but adequate to stimulate production. Bulog historically had monopoly control of the international rice trade but never controlled more than 10 percent of the domestic market. While it has become an intermittent exporter and continues to stabilize domestic prices, it is no longer the sole importer and/or exporter of rice, sugar, wheat and wheat flour, soybean, and garlic and is therefore no longer granted exclusive or special privileges within the meaning of Article XVII of the GATT 1994.

India: The Food Corporation of India has a substantial remit with respect to most cereals (excluding feed grade maize) to stabilize domestic prices and control foreign trade. It is not a monopoly purchaser in the domestic market, but has monopoly control over cereal imports in order to realize economies of scale in trading operations and ensure adequate food supplies. Private traders may operate in foreign markets subject to license.

Ethiopia: The scope for market manipulation has greatly diminished and there has been a substantial shift towards greater openness, but the State retains a role in domestic marketing and price stabilization, in competition with the private sector. It also maintains a strategic grain reserve and provides a channel for the newly re-emerging cereal export surplus.

United Republic of Tanzania: The main STE involved with cereals, the National Milling Corporation, has been reformed since the late 1980s. Activities of the NMC are now confined to grain milling, although it no longer has a monopoly in this respect and the Corporation is scheduled for privatization. Responsibility for the strategic grain reserve has been transferred to the Food Security Unit of the Ministry of Agriculture. The Government has no mandate to intervene to stabilize prices, although it does purchase from more disadvantaged regions, where private traders are less active. Imports and exports are handled by private sector traders.

Malawi: The State maintains only a regulatory role in foreign trade, although it previously had monopoly control over all trading activities associated with both maize and fertilizers. In a difficult period of transition over the last decade, the responsibilities of the SOE have been substantially reduced to management of the strategic grain reserve and “buyer of last resort” with respect to maize, a role expected to diminish as private sector marketing increases.

Tunisia: The Grain Board has a monopoly over the import of wheat and barley. In addition, it purchases wheat on local markets at prices fixed by the Government, and sells at subsidized prices to consumers. Private traders may, under certain circumstances, import cereals on behalf of the Grain Board, in which case import prices are determined through commercial negotiation. The resale of imported cereals are valued the same as for local production.

Mali: Policy intervention by the Government via the SOE, Compagnie Malienne pour le Développement des Textiles (CMDT), has been credited with the rapid development of the cotton sector. The CMDT controls cotton production and manages all input supplies including seed, fertilizer, pesticides and extension services. Two features of the CMDT have contributed to this success: (i) it benefits from the minority stake-holding of a French textile conglomerate which has integrated research, production and marketing operations and provides a stable market and (ii) since 1988, it has operated as a commercial private sector organization under a performance agreement with the Government. The agreement includes: production and marketing quotas designed to maximize capacity utilization of CMDT processing plants; farm level price incentives to ensure that the quota is met; and organizational cost controls which include extensions to the growing season and interest on production credit. CMDT also aids the Government in attempts to buffer the sector against the volatility of the world market.

[**Source***: www.FAO.org, “Agricultural state trading enterprises and developing countries: some issues in the context of the WTO negotiations,” 2000.]*

Iraq SOE Reform – Historical Perspective:

In July 2004 the World Bank published a non official Working Paper titled "State Owned Enterprises Reform in Iraq" to highlight policy options for such reform and suggest ways forward in Iraq. The paper outlined prominent conditions at the time and in many ways those conditions are still prevalent as this paper is written in mid-2011.

Like many other authoritarian and centrally planned economies, Iraq's economy was dominated by the state prior to mid-2003. Public enterprises operated in key sectors of the economy under high protection; input and output prices were controlled and heavily subsidized. Non-Arab foreign direct investment was forbidden, and with the UN sanctions since 1991 Iraq became essentially a closed economy. Most of Iraq's pre-2003 trade was through the oil-for-food program, but some trade took place outside the program.

A parallel economy managed by Saddam family members, who controlled significant segments of the black markets which flourished after sanctions were imposed, developed with a negative impact on governance and the poor. In this environment, deterioration of Iraq's SOEs included de-capitalization of assets, lack of access to modern technology, and no incentives to increase productivity.

The paper projected that, "*Iraq's transition to greater openness to international markets and exposure to international competition will inevitably result in important adjustment costs in the non-oil sectors*." SOEs, many of which will be unable to compete, are expected to bear the brunt of that adjustment. With high unemployment, the transition from SOEs to a market economy will inevitably result in significant job losses that will need to be managed to avoid social crises experienced elsewhere in oil-producing countries. Indications are that, given their current financial state, SOEs are not likely to attract much interest from investors.

The interim Iraq Government in 2004 was not in a position to dispose of SOE assets, and privatization was not a short-term option. Privatization may become a more viable option now that a new "representative and inclusive" government is being seated if a legal and regulatory framework for privatization can be implemented.

It was true in 2004 and is true now that Iraq's SOE reform is an important issue that must be handled effectively if the Iraqi economy is to succeed and return to a position as one of the leading economies in the region. Reform will be necessary to meet the aspirations and expectations of the Iraqi people to live in a modern, successful economy that creates jobs and wealth, drives growth and allows open and equitable participation in the world economy.

Most Iraqi SOEs are in poor condition and variously suffer from under-capitalization, inefficiency, high production costs, over-staffing and physical degradation as a result of looting. New investment, modernization and improved management are urgently required in many cases but insurgency, lagging security, a culture of corruption and weak or absent investment regulatory framework have kept investors away. There are preliminary signs that these conditions may now be changing and continuation of past policies without reform is not an option.

As discussed earlier in this chapter, other countries have faced similar problems and adopted a range of different approaches to SOE reform. To assist in deciding which approach is most appropriate for Iraq -- the World Bank, USAID and myriad other international donors and International organizations have had extended dialogue with Iraqi policy-makers and dialogue on the subject continues.

For the people and economy of Iraq to regain prosperity and a position of leadership in the region, the dead weight of SOEs on the Iraqi economy must be reduced and eventually eliminated. This step has been successfully accomplished in many countries and represents an essential step in modernizing and rebuilding Iraq's economic strength.

Many SOEs – employers of an estimated 500,000 of the country's roughly 4 million
Job-holders in 2004 -- urgently require new investment, up-to-date technology, and improved management -- all ingredients that the hard-pressed Iraqi government has not been able to provide. The previous ban on non-Arab foreign direct investment and the effects of three wars and more than a decade of international economic sanctions have meant that something like 90 percent of Iraq's industrial capacity – the SOE share – is seriously decapitalized, asset-starved, obsolescent, inefficient, saddled with high production costs, over-staffed, and -- as a result of looting – in a state of physical degradation.

Most Iraq SOEs carry from 30-50 percent more staff than would normally be needed elsewhere for similar production. [**Source:** *World Bank Reconstructing Iraq Working Paper No. 2, "State- Owned Enterprises Reform In Iraq," July 26, 2004*.]

SOEs and their employees are therefore expected to bear the brunt of economic adjustment as Iraq transitions from a centrally planned to a more market oriented economy. It is clear, however, that many of the 192 Iraqi enterprises counted as SOEs by the World Bank and some of the 43 public/private enterprises will simply not be able to compete. To avoid a social crisis, reform measures will have to be complemented by a resilient social safety net for displaced workers and their families. Economic growth in private sectors other than petroleum – construction, housing, utilities, agriculture and agricultural processing, tourism, etc. – will be critical to gradually absorb excess labor as SOEs are reformed or abandoned.

Although almost all Iraqi SOEs are damaged, technologically obsolescent (with equipment mostly installed during the 1970s) and victims of years of insufficient reinvestment, maintenance, and repair, they have for a long time performed a key role in a wide variety of sectors. Iraqi SOEs have been the sole providers of essential public utilities and the leading providers of a large number of public goods and services as well as consumer and industrial products. All have suffered from distorted policies which have undermined their viability, while many have also been damaged and some destroyed by wars.

As shown by recent policies, most Iraqi SOEs will continue to sustain employment in the interests of peace and domestic security while major development contracts for expanding electricity production capacity, housing, retail and infrastructure construction and petroleum development have been awarded to international contractors.

As these contracts are implemented in Iraq, employment will gradually shift from the pool of excess labor at SOEs to private sector labor for contracting companies. Some managerial positions for these projects will be filled by international technical specialists, but by far the majority of the labor and mid-level management will be supplied by local Iraqis.

SOEs may be absorbed as part of these joint ventures or sold for the salvage value of their capital resources during the course of this transition. Foreign investment is a critical contribution to the reconstruction process, both in general, and for SOEs in particular. WTO membership will lead to rule of law, foreign and domestic investor assurances and improved image as of Iraq as a member of the global investment community to attract the necessary foreign investment for the transition.

Size, Performance and Reform Needs of SOEs: When grouped under eleven line ministries as shown by the World Bank (Table 1), Iraqi SOEs are relatively modest in terms of numbers (192), but many consist of several separate enterprises. There are also a number of other national and sub-national enterprises including 43 mixed-ownership firms, in which private companies, individuals, former Ba'ath party representatives and line ministries hold shares.

Table 2: Summary of Iraqi SOEs by Former Affiliation with Line Ministries

Ministry/Commission	Number of SOEs
Agriculture	10
Electricity	11
Finance	9
Health	1
Housing & Construction	15
Industry & Minerals (MIM)	48
Military Industrial Complex (now w MIM)	48
Irrigation	11
Oil	19
Trade	8
Transport & Communication	12
Total	**192**

[**Source:** *World Bank Reconstructing Iraq Working Paper No. 2, "State- Owned Enterprises Reform In Iraq," July 26, 2004*.]

Other sources, including U.S. Embassy Econ officials, have indicated that there as many as 273 Iraqi SOEs depending on how individual factories, mixed-ownership firms and subsidiaries of SOEs are defined.

U.S. policymakers have attempted various strategies to bring Iraq's SOEs into a more competitive economic position. Paul Bremer, Coalition Provisional Authority (CPA) took over the civilian administration of Iraq in 2003. Bremer attempted to transform the Iraqi state-owned socialist economy into a model of Western-style free enterprise in the Middle East. At the core of this plan was the sale of most SOEs to the highest bidder to bring in fresh capital, streamline operations and boost profits. That in turn was expected to drive the rest of the economy.

Foreign investors were not attracted to the uncertain political and security situation in Iraq and the hundreds of thousands of Iraqis' livelihoods depending on the state-run manufacturing plants. Virtually no state-owned enterprises were transitioned to private ownership and the Iraqi economy continued to languish. [**Source:** *Washington, United Press International, "Restarting The Factories Of Iraq," Pamela Hess, UPI Pentagon Correspondent, January 9, 2007.*]

In June 2006 Paul Brinkley then head of the Department of Defense Task Force for Business and Stability Operations (TFBSO) began a process to revitalize Iraq's SOEs by placing expatriate civilians with expertise in industrial operations and factory management on the ground in Iraq. The Task Force also provided funds for training Iraqi employees, upgrading equipment and preparing SOE factories for large-scale investment.

By 2009 TFBSO reported helping restart production at more than 60 Iraqi factories, facilitating contracts worth more than $1 billion between foreign private investors and Iraq's SOEs and helping provide jobs for 250,000 Iraqis. Brinkley credited TFBSO with modest economic reform, reduced insurgency and a more stable, secure economic and social environment as first steps towards the revitalization of Iraq's economy. [**Source:** *McKinsey Quarterly Report, "Stabilizing Iraq's economy: An interview with the DOD's Paul Brinkley," John Dowdy, Director, McKinsey London office, March 2010.*]

Other sources have indicated that some of the initial projects funded by TFBSO have since failed (free enterprise provides the freedom to fail in addition to the freedom for success) and the ongoing progress of SOE renewal is slow and sporadic at best. Most of the SOEs and factories assisted by TFBSO were within the Ministry of Industry and Minerals (MIM). Two agricultural projects were funded by TFBSO -- two helicopters equipped for aerial application of pesticides and construction of greenhouses throughout Iraq. It is also indicated that the number of Iraqi SOEs could be as high as 273 depending on how national and sub-national enterprises, firms with public and private mixed ownership, and individual factories are counted. [**Source:** *Personal conversation between Dr. Chuck Lambert and Dr. Sarmed Aal-Yassin, Economic Assistant-Trade and Investment, U.S. Embassy, Baghdad, and former TFBSO official, April, 2010.*]

Iraqi demonstrations protesting corruption and slack of public services during the spring of 2011 indicate that reform of utilities and other SOEs providing public services will be critical to maintaining domestic security and continued support for existing government structures. On February 27, Prime Minister Nuri Al Maliki gave the government's ministries and provincial administrations a 100-day deadline to assess their work and evaluate their capacity to succeed or fail. "Iraq's ministries will be subject to major changes according to the evaluation results," Maliki said.

During an April 26, 2011 press conference Al-Maliki reiterated the message of reform. "The government might ask to dismiss a minister if we deem that his ministry is incapable of accomplishing its projects. We might even ask to dissolve the entire government, including Parliament, after the 100-day deadline if government fails to accomplish the country's projects by the deadline. [**Source:** *http://www.alsumaria.tv/, "Malilki threatens to dissolve Iraq government after 100 day deadline," Iraq News, April 27, 2011.*]

Because of the very high rate of joblessness – even without SOE reform – it is a matter of priority to prepare a range of measures to cushion workers from the effects of enterprise reform. These social-safety-net measures will likely include the following:

- Generous redundancy or severance payments;
- Retraining programs to impart or upgrade needed skills;
- A range of programs to assist workers to re-enter the job market – such as the establishment of employment agencies;
- Public works programs.

It will be important to introduce these safety net measures in an integrated fashion so laid-off employees can benefit from them whenever and wherever necessary and in parallel to the reform of SOEs. Iraq must attract private investment for its SOEs if they are to survive, modernize and expand. The scale of the capital investments required is such that only private sources can be realistically relied upon.

Of course some SOEs are utilities, providing services such as electricity, telecommunications, water and ports. In reforming these enterprises, it will be necessary to address a range of specific sectoral policy and regulatory issues more complex to tackle than those involved with industrial or trading enterprises. Other SOEs form part of the oil sector, and these again will require separate treatment depending on the government's policy towards the oil sector.

Within a hard budget constraint, SOEs need greater freedom to take commercial decisions without first seeking approval from Baghdad. SOEs should have permission to commit funds and make purchases on their own account. Last but not least, environmental issues should also be examined with an approach to dealing with them built into the program. [**Source:** *World Bank Reconstructing Iraq Working Paper No. 2, "State- Owned Enterprises Reform In Iraq," July 26, 2004*.]

Choice of SOE Reform: Most Iraqi SOEs were shut down after 2003 as damage and looting interrupted normal operations. Many have not restarted, and those that have are, in most cases, operating only partially. Most SOEs need capital infusions to accomplish repairs and secure raw materials before they can restart at all, let alone break even.

From the *USAID/Tijara* analysis of state enterprises, the following conclusions emerge:

- Return on investment in SOEs is negligible. There is a huge loss of opportunity in terms of the revenue that the government could have generated on these investments.

- Even before the 2004-2008 hostilities, most SOEs were unable to generate sufficient resources for current operations or expansion of business. Because they are heavily dependent on Government budgetary support but generate little, if any tax revenue, SOEs feed fiscal deficits.

- Resources consumed by SOEs could be redeployed to very much better uses, such as new schools, new medical facilities, and improved water supplies.

Taking account of the issues on the previous section, a Task Force for Economic Reforms (TFER) was set up in 2010 in the Prime Minister's Advisory Commission and including line Ministries and private sector representatives. TFER was mandated by the Government of Iraq to design and coordinate implementation of a comprehensive restructuring process that could effectively contribute to the transformation of some SOEs into viable commercial companies.

Within the framework of the Private Sector Development Programme for Iraq (PSDP-I) and in cooperation with 7 UN[2] agencies and the World Bank, an SOEs Restructuring Roadmap, was produced and received the approval of the Council of Ministers by Cabinet Decision #314 on August 31, 2010.

The main objectives of the Roadmap are:

- To improve the financial and operational performance of SOEs and contribute to their self-reliance;
- To contribute to Iraqi economic growth through enhanced competitiveness and trade; and
- To develop and implement social mitigation measures for employees and to contribute to job creation.

In order to implement the Roadmap certain institutional changes are planned within the line ministries. This includes the establishment of Restructuring Units (RUs) that will be organized into Business Development Units (BDUs) and Investment Units (IUs).

The mission of the BDUs will be to contribute to the revitalization of the SOEs by streamlining and enhancing business development in the wider context of private sector development of Iraq.

The initial work of the BDUs will focus on an initial diagnosis and classification of the SOEs. This diagnosis will be followed by a more comprehensive and in-depth diagnostic stage for the formulation of business, restructuring and social mitigation plans. SOEs will be classified according to the following headings:

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

Strategic partnership and Private-Public-Partnership (PPP), among the activities of the BDUs, constitute priority areas to be addressed in the formulation of Business and Restructuring plans. Restructuring Units (RUs) will also lead the preparation of SOE Corporate Plans, Business Plans, Marketing Plans and assessments.

The Investment Units (IUs) will be responsible for investment files, investment and partnership bidding processes.

Within this framework, the Ministry of Industry and Minerals (MIM) is already working with *USAID/Tijara* in introducing restructuring measures to some of its SOEs.

[2] UNDP, UNIDO, ILO, UNOPS, UNHABITAT, FAO, UNIFEM

MIM and *USAID/Tijara* have selected eight SOEs (representing different industrial sectors) for business performance improvement and restructuring activities. These are:

1. State Company for Electrical Industries
2. State Company for Construction Industries
3. State Company for Leather Industries
4. State Company for Vegetable Oils Industries
5. Ibn Sina State Company
6. State Company for Industrial Designs and Consultation
7. General Systems Company
8. State Company for Information Systems

The technical assistance will focus on developing business opportunities for each enterprise by undertaking:

- Investment search (conducting a review of the business plan of each selected SOE);
- Site visits and discussions with SOE management;
- Training needs assessment and delivery of training;
- Market research (products, market segments, customers, marketing channels, value chain analysis, promotion, and others). This work will be undertaken in cooperation with MIM's Market Study Department;
- A detailed evaluation of the kinds of relationship that could be developed between the SOE and investors). The objective is to achieve PPP transactions that may be in the form of management contracts, joint ventures, strategic partnerships, technology transfer, industrial development cooperation and others. This work will be undertaken in cooperation with the MIM's Investment Department.

A *USAID/Tijara* program has been developed which foresees work starting on each SOE on a rolling one-month basis throughout 2011. At the same time, under the Roadmap the Private Sector Development Programme for Iraq (PSDP-I) will be classifying all the SOEs in Iraq.

Once all SOEs have been classified and the restructuring activities are completed it is planned for the establishment of an ***Agency for Corporatization (AFC)*** *under the Economic Reform Council (once established)*, which will eventually guide and manage the entire SOEs restructuring and corporatization processes in Iraq.

The tasks of the ARC will include the gradual acquisition and administration of the SOEs' assets, the consolidation and expansion of the SOEs corporatization processes (for transformation of the SOEs into public companies). Subsequently the SOE assets will be disposed to non-state entities according to procedures and methods to be properly regulated by specific governmental decisions. The AFC may retain shares in the capital of the SOEs (including for public-private mixed companies).

A wide range of reform methods is available including:

- o Gradual privatization;
- o Sale of businesses, assets and shares [likely at salvage value] by tender or auction;
- o Maintaining shell SOEs as repositories for excess labor while reconstruction contracts and oil and gas production contracts are negotiated with domestic and foreign private sector contractors (this has been the path followed by Iraq since mid-2009);
- o Sale of shares by public offer;
- o Free distribution of shares to the population;
- o Management or employee buy-out of enterprises;
- o Concessions of enterprises or leasing of assets;
- o Contracts for the management of enterprises;
- o Other contracts for the provision of services.

Foreign investment is a critical contribution to the reconstruction process, both in general, and for SOEs in particular. WTO membership will lead to rule of law, foreign and domestic investor assurances and improved image as of Iraq as a member of the global investment community to attract the necessary foreign investment for the transition.

Based on the above options, the GoI will need to select a method and design a master plan to be reviewed on an annual basis. The plan should take into consideration other support programs such as sector reforms, legislative changes, and Iraq's privatization experience of the 1980s.

Since some methods are clearly better at achieving certain objectives than others, it is essential that the condition and needs of the enterprises strongly influence the method of reform. Consistent with the above options, current coordinated focus is on the SOEs Restructuring Roadmap and restructuring and corporatization of the most viable SOEs.

International initiatives will provide policy guidance and fund limited reform, but in the end, the investment decisions and policy directions will be Iraqi.