

Iraqi Private Sector Development: Challenges and Opportunities

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Introduction

Iraq is one of the most oil-dependent countries in the world, with oil revenues accounting for more than 99% of exports, 85% of the government's budget, and 42% of gross domestic product (GDP)¹ over the last decade. The vast majority of state expenses go toward public sector salaries and expenses. Despite possessing a young and dynamic population with over 700,000 new graduates entering the job market every year, 15% of the estimated 44 million population is unemployed and lives in low-income households. Youth unemployment is even higher, with over 35% of youth either unemployed or not in education or training². Even under optimistic scenarios for oil production, continued reliance on oil alone will not generate sufficient jobs to guarantee the welfare of all Iraqis.

¹ World Bank – [The World Bank in Iraq](#)

² ILO – [Latest country indicator data](#)

The over-reliance on oil has meant that Iraq's economy has been prone to fiscal fragility and crises, as volatility in oil prices have had significant impacts on state resources. Vulnerability to oil price shocks has diminished efforts to rebuild infrastructure and provide consistent services to citizens, let alone ensuring jobs for young people, who represent over 40% of the population. The impact of COVID-19 on the Iraqi economy is one of the latter examples of the lack of resilience in the Iraqi economy. Iraq's GDP performance in 2020 was the worst in 20 years, contracting by an estimated 15.7% before recovering to pre-pandemic levels in 2022³. The unemployment rate shot up by 10%, exacerbating the impact on internally displaced people, women jobseekers, self-employed and informal workers.

Despite Iraq entering a period of relative stability after the defeat of ISIS, as well as the political unsteadiness and social unrest that followed, Iraq's oil revenues have failed to translate to wide-ranging efforts to transform non-oil sectors to contribute effectively to the economy, unlike what can be seen in Iraq's oil-rich neighbors. Beyond the rampant corruption and fragile political alliances underpinning the Iraqi government, oil windfalls during times of strong performance for global oil markets provide the opportunity for the Iraqi government to focus on developing the private sector, which at present plays a small role in the general economic development of Iraq.

As the world shifts away from fossil fuels amid the global climate transition, oil use and demand will decline, leaving Iraq's economy with a gaping hole that currently cannot be fulfilled by any other sector. The shift to a clean energy economy mitigates Iraq's exposure to not only transition risks from climate change, but also physical climate risks where Iraq is exposed to droughts, floods, heatwaves, and dust storms, negatively impacting the Iraqi environment, agriculture, and water availability. Not only can the private sector act as an accelerator in the non-oil economy, but it can also positively contribute to Iraq's long-standing economic exclusion and poverty issues, which disproportionately affect young people and women.

While the private sector suffers from multiple hurdles holding back its development, this paper analyses the potential role that the private sector can play. This begins with an overview of the sector in Iraq since 2003, followed by analysis of both challenges and opportunities in developing the private sector. Finally, the paper presents considerations on how Iraq can ensure the development of its private sector so it can contribute effectively to the economy.

³ Lloyds Bank – [The economic context of Iraq](#)

Overview of the private sector

The political transition post-2003 to a market-oriented economy has seen the emergence of a private sector, albeit an inadequate and ineffective participant in the Iraqi economy to date. The private sector is represented by a small number of major companies operating mainly in the agricultural, industrial, as well as trade and services sectors, yet largely dominated by either very small enterprises or microenterprises, with the majority of small and medium enterprises (SMEs) having only 20 or less employees. Estimations of industrial medium sized enterprises, which are more capable of making a significant contribution to exports, account for less than 1% of total industrial SMEs. Iraq's Central Statistical Organization (CSO) estimated the number of industrial SMEs to be around 26,435, of which only 181 are medium-sized enterprises⁴. These limited capabilities mean private companies cannot accommodate the large number of pre-existing unemployed Iraqis as well as the graduates who enter the job market every year.

Despite challenges and lack of competitiveness, the private sector accounts for roughly half of Iraq's total employment and is characterized by informality and low-skilled labor⁵. Informality refers to the lack of written contracts and legal agreements that recognize and declare employment, which is a condition of access to formal employment. Formal employment enables the arrangement of employment related benefits for employees, such as paid annual leave and social security provisions. With over half of all employment in the informal sector, informality poses a serious constraint on the development of formal enterprises. On the other hand, low-skilled labor means that Iraqi SMEs are often weak in relation to their business complexity. Most SME employees have little to no education, leading to reliance on the production of low value-added products and a lack of innovation.

Sectoral and regional differences are also present in the private sector. SMEs are predominantly in the trade and services sector, followed by the agricultural and industrial sectors. Regionally, private enterprises are concentrated in the capital city Baghdad, as well as in Diyala and Kirkuk. Following national trends of poverty and financial exclusion, women and younger people are disproportionately represented in SME ownership, with male adults forming the vast majority of SME employers.

⁴ GIZ – [Priority financing needs of Iraqi SMEs](#)

⁵ ILO – [A diagnostic of the informal economy in Iraq](#)

Challenges and roadblocks

There are several barriers and challenges to the development of the private sector in Iraq. Aside from the persistent security challenges that have hindered business operations and investments, private companies struggle with a lack of access to financing that enables growth, as well as insufficient institutional and regulatory support and inadequate infrastructure that holds back development.

Lack of financing is one of the key barriers for private companies and SMEs. Access to finance in Iraq is amongst the lowest in the world, represented by the *underbanking* of Iraqis, with only 19% of adults owning a bank account⁶. Bank account ownership has seen a recent uptake as a result of the electronic payments systems to disburse government salaries and welfare, enabling financial inclusion to several million Iraqis.

In terms of business and trade, Iraq ranks 172nd in the World Bank Doing Business 2020 Survey⁷, which highlights access to credit and resolving insolvency as particular areas of weakness. The banking sector, consisting of large state-owned banks and smaller private banks that have limited capital to finance private enterprises, is unable to meet the needs of private companies seeking growth opportunities.

One particular challenge for banks is the experience and skills to conduct credit risk and cash flow analysis, who instead have to rely on tangible assets for collateral and often demand higher collateral requirements. With over 80% of SMEs being owned by individuals that possess little to no assets to meet requirements for collateral, they are instead required to look elsewhere for funding. This significantly limits options for SMEs to access finance, with fewer than 5% of SMEs successfully securing bank lending. As a result, SMEs are required to rely on either self-funding or through their personal connections such as friends or family.

Other sources of financing include financial markets and the Iraqi stock market, yet both are also unable to drive private sector development. Private sector credit accounts for only 9% of GDP, indicating the lack of needed depth and liquidity, whereas the stock market is also small with total capitalization under 5% of GDP⁸.

The lack of governmental support for the private sector has also impeded the development of private enterprise. Insufficient institutional support for the private sector is evident through the dominance of state-owned enterprises (SOEs), which officially employ and expend large numbers of staff. The private sector additionally suffers from

⁶ World Bank – [Iraq Economic Monitor](#)

⁷ World Bank – [Ease of Doing Business in Iraq](#)

⁸ World Bank – [Iraq Economic Monitor](#)

the greater appeal of public sector jobs, owing to the latter's higher benefits, pensions, and guaranteed stability.

Additionally, there are sector specific challenges that hold back their development, including those relating to policy and regulatory issues. Agricultural businesses face challenges with their competitiveness in the domestic market, owing to a lack of trade and customs policies that mean that locally sourced goods are often undersold by imported ones. Trade sector businesses must contend with the weak network of trade routes and the fluctuation of the dinar's exchange rate, which exposes them to foreign exchange losses. Businesses in the industrial sector also face challenges with the lack of appropriate policies to protect new enterprises.

Iraq's long-term inadequate infrastructure means businesses face hurdles, whether it is through insufficient energy supply, weak transportation links and logistics, or internet connectivity. Deficits in power and transport hamper the development of businesses at scale and hold the private sector from producing or transporting in masses that can be exported profitably. Robust infrastructure is one of the key requirements for a growing private economy, with access to connectivity, energy and transport links a necessity to conduct and grow business.

Skill shortages form another barrier to private sector development, stemming from Iraq's multi-decade brain drain as well as an inadequate education system that fails to provide the skills and training needed for a productive, innovative, and competitive economy. Without a skilled workforce, businesses struggle to adopt new technologies, improve efficiency, and expand, ultimately limiting private sector growth and development opportunities.

The persistent security and instability issues that Iraq has faced in the twenty-first century have also not encouraged investment nor promoted confidence in the Iraqi market. Lack of security prohibits the private sector from attracting both domestic and foreign investors as a return on investment is unlikely in times of uncertainty. With the present political and security environment seeing a relative calm, an appropriate business environment can be achieved to bring about private sector development and growth.

Opportunities and signs of progress

The Iraqi government has become increasingly aware of the need to develop the private sector so that it can contribute meaningfully to the GDP and cover Iraq's dire employment needs. To this end, the government has published multiple strategies to enable progress,

as well as undertaken several initiatives to bridge the gap between the public and private sectors. There are also efforts from the international donor community to strengthen private sector development and encourage growth in sectors outside oil and gas.

Iraq's parliament, the Iraqi Council of Representatives, passed a law in 2023 on social security for private sector workers⁹, extending the legal coverage of the social security system for a significant number of employees, including informal and self-employed workers. It is the first time that maternity and unemployment benefits are included, as well as health insurance. By mirroring benefits seen in the public sector for private sector employees, the gap in appeal between the two is minimized and enables private enterprises to attract public sector employees. This law also brings Iraq in line with international practices and standards, while long awaited, it remains a clear indication of progress.

The government has also sought to establish initiatives that open financing opportunities for SMEs, most notably under the Central Bank of Iraq's (CBI) One Trillion Dinar Initiative. This initiative supported commercial banks to offer low-cost credit to SMEs by refinancing. While over 40 banks had participated by 2022, total disbursements only covered a maximum of 20% of market needs¹⁰. Despite a large number of SMEs receiving some sort of credit, only 16% of the funding went to SMEs, while the vast majority was used to lend to large corporate companies, as well as a significant portion toward real estate financing.

International and national governmental bodies, development agencies and NGOs also play a role in boosting the private sector. Examples include the multiple US Agency for International Development (USAID) programs, which have supported over 10,000 entrepreneurs since 2020 through the provision of business support services, such as assistance for setting up, formalizing, and scaling their businesses¹¹. Similarly, in a project partially funded by the European Union (EU) and commissioned by the German Federal Ministry for Economic Cooperation and Development (BMZ), over 20,000 young people received training and more than 950 micro, small and medium enterprises (MSMEs) took part in training courses focused on growth promotion¹².

Collaboration between the Iraqi government, civil society groups and international actors can support the private sector through advisory and training services, as well as the provision of loans and grants that enable economic development, private sector growth

⁹ ILO – [Iraq invests in building a social security system that protects workers](#)

¹⁰ GIZ – [Priority financing needs of Iraqi SMEs](#)

¹¹ USAID – [Private Sector Development](#)

¹² GIZ – [Creating a better economic future for young people in Iraq](#)

and job creation. Despite supporting thousands of entrepreneurs and SMEs, the majority of Iraqi SME owners remain unaware of financing initiatives and training opportunities, meaning the impact on the private sector is insufficient and does not go far enough to meet market needs.

Foreign direct investment (FDI) has seen remarkable activity in the last eighteenth months. Investments from Iraq's neighboring countries, such as Qatar, Saudi Arabia, Turkey and the United Arab Emirates contribute the bulk of investments. Sources indicate that inbound foreign direct investment reached an unprecedented USD 24 billion during the initial nine months of this year, surpassing more than double the previous annual record set in 2008¹³. Given the lack of local finance, foreign investment can be an effective vehicle to address market needs. With more than half of FDI flows going towards the oil and gas sector, the Iraqi government must ensure that foreign investments meet Iraq's development needs.

Conclusion

Structural policy and regulatory reforms as well as institutional backing is needed to enable the growth of SMEs, allowing private enterprises to operate in an environment where they can thrive and contribute more effectively to the Iraqi economy. Legal and regulatory frameworks that ease the process of lending to SMEs will create more opportunities for them to access finance, facilitating pathways to expansion and growth. The financial services sector and specifically the banking sector can be modernized and supported by allowing a level playing field between public and private banks. This should include priorities such as incentivizing digital services and promoting financial inclusion. Reforms will also help restore confidence in the financial sector and channel capital towards diversifying the economy.

Sector specific approaches with a focus on maximizing opportunities within sectors are also needed. The agriculture sector is one case study where there is a significant potential for the sector to contribute more to the Iraqi economy. Despite possessing abundant fertile land where a quarter of the total land area is suitable for intensive cultivation and animal husbandry, most of the agricultural activity is concentrated in the fertile lowlands in the Mesopotamian plains that are irrigated from the Tigris and the Euphrates, and include cereals, pulses, and dates. Iraq is still a net food importer, an indication of the challenges that the agricultural sector faces even though the sector is the second highest employer, only preceded by the government. The 2.9% contribution to the GDP can easily

¹³ Lloyds – [Foreign direct investment \(FDI\) in Iraq](#)

be developed as modern and productive methods are introduced and agricultural SMEs grow and expand in scale¹⁴. A credible approach to unlocking the agricultural sector would also see benefits beyond GDP growth, as the domestic production of food will contribute to the reduction of poverty and food insecurity rates.

The imperative to see a developed private sector in Iraq rests on the need to diversify the economy and reduce reliance on oil revenues, a move needed to meet short-term fiscal fragility in addition to adapting to long-term global trends. A developed private sector not only provides the opportunity to grow the non-oil economy, but also results in job creation and skill development as well as driving innovation and technology adoption.

¹⁴ World Bank - [World Bank national accounts data](#)

Sources:

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Image:

[news - FMO invests USD 31.5 mln in food security and revitalization of the private sector in Iraq - FMO](#)

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