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The Iraqi government has begun to privatize the electricity sector amid much skepticism. The issue of privatization has quickly become controversial one among political factions, especially after the vocal opposition of five southern provinces, namely Dhi Qar, Muthanna, Wasit, Diwaniyah, and Najaf.¹ Privatization is driven by well-established reasons, such as the failure of state owned enterprises, which have proved wasteful and inefficient, producing low quality goods and services at high costs.² Reforming the electricity sector is a necessity not only to address domestic needs, but also to attract investment, where lack of infrastructure is always cited as an impediment to investment. Furthermore, the shortage of electricity costs the Iraqi economy an estimated \$3-4 billion per year.³

Privatization in the electricity sector has been implemented in several countries that face similar challenges to Iraq. For example, the electricity sector in Latin American countries suffered from political interference, overstuffed state-owned utilities, low productivity levels, and highly subsidized prices. All these challenges halted the improvement of electricity, as well as its funding, which became “a heavy fiscal burden for the state.”⁴ Therefore, these countries launched into privatization programs during the 1980s. All these experiences could benefit Iraq in consolidating its nascent experience of privatization. However, with the

1. Salam Zidane, “Efforts to Privatize Electricity Face Resistance in Iraq,” Al-Monitor, <http://www.al-monitor.com/pulse/originals/2017/03/electricity-iraq-private-najaf-general-electric.html>.

2. Sunita Kikeri and John Nellis, “As Assessment of Privatization,” The World Bank Research Observer 19, no.1 (2004), 1.

3. Cezley Sampson, “Development of a Reform Roadmap for the Electricity Distribution Sector in Iraq,” 7.

4. Lenin Balza, Raul Jimenez, and Jorge Meracdo, “Privatization, Institutional Reform, and Performance in the Latin American Electricity Sector,” Inter-American Development Bank, December 2013, 6.

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consultation of the World Bank, Iraq developed a multi-phase strategy to reform electricity in a way that addresses domestic challenges.

This paper will present an overview of existing privatization efforts in Iraq; explain the underlying reasons for opposition from local politicians; provide an assessment of existing privatization efforts; and conclude with policy recommendations for consolidating privatization in Iraq.

Current state of play

The core problem with electricity supply lies in the exponential increase of demand, which is estimated to reach 35,000 MW by 2030. The shortage of electricity in Iraq is attributed to several factors, such as the decay of state-owned electricity enterprises because of two costly wars and international sanctions during the Saddam's regime; the public's wasteful consumption of electricity, the fractionalized nature of Iraqi politics; the lack of adequate security; the burden of the counter-ISIS campaign; and the decline of oil prices below \$50 a barrel.⁵

The electricity sector faces challenges in all its various aspects: distribution, transmission, production, and management. High theft of electricity is reported on the demand side and resulted from high levels of unmetered consumers, and absence of effective billing systems including high levels of non- or under-collection of billed electricity. On the supply side, the increase of government production of electricity did not succeed in addressing current demand. All these challenges pressured the government to seek alternatives, such as privatization, to reform the electricity sector.

Privatization is generally defined as “any material transaction by which the state's ultimate ownership of corporate entities is reduced.”⁶ This is usually done by transferring assets - not only activities - because the transfer of activities from State Owned Enterprises (SOEs) to private operators is normally not considered privatization.⁷ However, this does not necessitate the selling of an entire enterprise or an asset, especially because the landscape of privatization has shifted toward partial sell off of particularly large SOEs in the utilities.⁸ Therefore, Iraqi efforts

5. Luay Al-Khatteeb and Harry Istepanian, “Turn A Light On: Electricity Sector Reform in Iraq,” Brookings Doha Center, March 2015, 2 – 5.

6. Organization for Economic Co-operation and Development, “Privatisation in the 21st Century: Recent Experiences of OECD Countries,” January 2009, 5.

7. Ibid.

8. Ibid., 8.

are better understood as private sector participation, rather than privatization because it is limited to certain activities, rather than extended to sell off assets. However, these reform measures can be taken to facilitate the overall privatization of electricity in the future. Therefore, they came to be known in public discourse as “privatization.”

Iraq is working on reforming the distribution sector with the hope of generating revenue; reducing the consumption of electricity by 20%; curbing waste, which is estimated to be 37% of the electricity produced in 2013⁹; and ending the exploitation of consumers by the owners of neighborhood generators, where 90% of Iraqi household rely on them.¹⁰ On the other hand, it offered four power plants for investment to generate 8500 MW to address the shortage of supply. The Minister of Electricity Qasim Al-Fahdawi announced his confidence in the likelihood of success of this project in addressing the problem of electricity, especially after consultations with the World Bank.

The World Bank has recommended reforming electricity based on three phases: pre-transition, transition, and wholesale electricity market. It recommended specific measures to address the various challenges of reforming electricity in Iraq. After identifying the distribution sector as the most problematic with adverse effects on the entire electricity sector in terms of “financial sustainability, compromising the economic sustainability of the upstream generation and transmission businesses,”¹¹ the World Bank has identified it as the starting point for reform. It recommends several measures, including “the procurement of a private revenue cycle management firm (or firms) to contract for a pilot project in a selected geographical region within Iraq.”¹² Based on domestic challenges and the World Bank’s recommendations, the Iraqi government took the decision to privatize. However, this decision has been met with rejection of several provinces.

Domestic rejection

Five southern provinces and several political factions publically rejected privatization. Provincial councils argue that they were excluded from the process of implementing privatization, depriving them from their constitutional rights. Article 114 (2) of the Iraqi constitution states that “organizing sources of electricity and its distribution” are to be shared between the central government and the

9. Sampson, 7.

10. Ibid.

11. Sampson, 2-20.

12. Ibid., xviii.

provincial council. Also, they publically demanded two prerequisite conditions for the acceptance of privatization: subsidization of fees for the poor; and waving previously unpaid fees.

The opposition of provincial councils could be attributed to various factors, including economic, social, and political impacts. Public perception of privatization as a harmful policy, the slow materialization of its benefits, and fears of losing assets necessary to the operation of patronage networks are the main political obstacles for accepting these reforms. Opponents also cite the potential social and economic negative impacts, such as depriving poor and rural areas from access, reducing net employment and enriching a privileged few. All these potentially negative impacts are either unfounded in the context of the Iraqi case or could be addressed through the process of implementation, so it does not justify the outright rejection of these reforms, except for the political calculations.

The positive economic impact of privatization is very clear by decreasing the budget deficit and fueling economic growth. Privatization increases the resources available to the government after being spent on providing the services before their privatization. Also, privatization has a positive correlation with economic growth. For example, Davis and others confirmed this positive correlation, acknowledging that privatization “is not the sole cause of subsequent increases in growth rates.”¹³ On the contrary, the empirical experiences of privatization found that privatization reduces net employment, but provide same or higher wages to remaining staff. The Iraqi government addressed this problem by obligating investors to pay 80% of the salaries of those working in the distribution offices. Also, the government will not disband the Ministry of Electricity, which will be responsible for regulating and monitoring production, distribution, and transmission.

Concerning the social impact of privatization, McKenzie and Mookherjee found that privatization led to an increase in the access of services, especially for poorer consumers, who were previously deprived from access.¹⁴ This might be explained by the failure of state enterprises to provide services to poor and rural areas and the willingness of private owners to extend the coverage and quality of services to generate more profits.¹⁵ This should be true in the Iraqi case because the investor will get more profit by extending coverage to all consumers in their

13.. Ibid., 103.

14. Ibid.

15.. Ibid., 100.

designated zones, especially if the government subsidizes prices in areas with high poverty rates and low population densities, to cover the costs of extending the grid and enable poor people to afford connections. However, this issue could be addressed through the process of implementation of privatization, such as subsidizing fees in area with high indicators of poverty.

The World Bank mapped poverty in Iraq, highlighting five governorates as the poorest, namely Muthana, Qadisiyah, Thi-Qar, Missan, and Mosul. Aware of this issue, the government did not determine prices based on the cost of production only, but also the level of consumption, given that poor families do not have many appliances and hence consume less electricity. The cost of producing one kilowatt (kW) is 108 Iraqi dinars (IQD). However, it is subsidized based on consumption, where subsidies reach up to 94% as show in the following table.

Table I. Electricity prices based on 24hr supply

Consumption (kWh)	1000	1500	2000	3000	4000	5000
Price (IQD)	11,120	20,826	42,2020	119,923	242,560	445,120

Source: Ministry of Electricity: <http://moelc.gov.iq/index.php?name=Pages&op=page&pid=269> .

Privatization usually triggers fears of the capture of important assets by a privileged few through corrupt transactions. Given that Iraq does not have a strong private sector, this is a key concern for Iraqi citizens. Despite the efforts to minimize corruption by publicizing these opportunities, determining contractual terms, and overseeing their implementation by committees based on the representation of several governmental and non-governmental institutions, still these fears are legitimate and the Iraqi government should take several anti-corruption measures, such as demanding the disclosure of personal assets for those who grant these opportunities and oversee its implementation, as well as investigating the financial credential of these investors.

Political calculations seem the most important factor that explains the rejection of privatization. Given that the upcoming election of 2018 is approaching, local politicians are vying to win the support of their constituents. Therefore, they attempt to appease them by publicly rejecting privatization, demanding subsidies, and asking for unpaid fees to be waived. These politicians are aware

of the negative public perception, which is widespread and exacerbated by the negative coverage of media. However, publicizing successes should mitigate such perception and give momentum to proponents of reform.

Assessing Privatization

Given that the electricity sector is still in the pre-transitioning phase, it might be too early to assess the effectiveness of privatization in Iraq. However, privatization is usually assessed by the real end-user prices for residential electricity, percentage of households with access to electricity, electricity capacity generation, and electricity loss as a percentage of electricity production.¹⁶ Since the reform program mainly focuses on the distribution sector and the production sector partially, this paper will include several important indicators, such as reducing electricity consumption, curbing waste, and collecting fees, which are the goals of these reforms.

Based on the recommendations of World Bank, the Iraqi government has launched an initiative to reform the distribution sector, where Iraqi neighborhoods are distributed into 180 zones. The Ministry of Electricity publicized these investment opportunities through Iraqi media and newspapers. The process begins with an investor sending a letter of interest for investing in one of these zones or a number of them. Then, the ministry will provide them with all the necessary information about these zones, such as the number of connections. Also, the ministry will provide a list of 50 questions that need to be answered by the investor to assess its credibility and capabilities. Then, the ministry could proceed with contracting zones out to the investor, even if there are no other offers. The ministry provides the investor with 12.9% of the fees collected from consumers, and investors are obligated to curb waste, provide maintenance to the grid in their zones, and pay 80% of employees' salaries of the distribution office in their zones, and installing smart metering. The percent of 12.9% was determined by offering one zone twice for investment and determine the lowest offer. Furthermore, the Iraqi government has given investors the option to transform grids in their zones into underground grids to avoid waste.

The Ministry of Electricity is finalizing contracts for many of the 180 zones, including within provinces that have rejected these reforms. In an interview with the ministry's spokesperson, Musab Al-Mudaris asserted that all these contracts will be finalized by the end of 2017, except for provinces that are recently liberated

16. Lenin, 24.

from ISIS. He elaborated on the different stages of implementing this project. First, investors are required to curb all waste (administrative and technical) during the first six months. Second, investors have to fully implement the project (collecting 100% of fees) during the second six months. Third, smart metering systems should be installed during the third six months. These investment opportunities are extended to five years. Concerning oversight, Al-Mudaris states that there will be a committee based on the participation of the ministry, local councils, civil society organizations, and the financial audit directorate in every zone. This committee will assess the implementation of the project and determine whether to maintain or end the contract.

The experiences of several zones in Baghdad province, specifically in Yarmouk, Harithiya, Al-A'amiriya, Mansour, Al-Jama'a, and Al-Saydiya, have provided good indicators, such as reducing consumption of electricity by 30%, curbing 100% of waste, and collecting 100% of fees, as reported by the Ministry of Electricity. For example, after granting three zones (715, 712, and 714) in Zayoonah to an investor on April 2016, the consumption of electricity was reduced from 52 MW to 27 MW. Maintaining this level of performance will definitely address domestic needs, reduce budget deficits, promote the private sector, and facilitate investment.

Conclusion and Recommendations

The reform of the distribution sector has achieved good results, such as reducing consumption, curbing waste, and collecting fees. Also, limiting access to these investment opportunities to domestic investors will promote the local private sector. Therefore, the Iraqi government should ensure maintaining this level of performance with transparent transactions and equitable distribution.

In order to consolidate the privatization efforts in Iraq, this paper recommends that the Iraqi government ensures the following:

Producing and publicizing reports about the performance of the reform of the distribution sector to mitigate popular sentiments against privatization and inform authorities about progress.

Monitoring and evaluating the progress of the current reform initiatives.

Ensuring transparent transactions by publicizing investment opportunities, determining contracts terms, and demanding the financial disclosure of employees who are in charge of granting these opportunities and oversee its implementation.

Extend coverage to areas with low population densities and access to the poor through subsidies.

Given that many Iraqi sectors suffer from inefficiencies and poor performance, further studies should examine the prospects and consequences of privatizing struggling public services, such as water, sanitation and primary education. Reforming and delivering these basic services will definitely increase the legitimacy of the government, reduce budget deficits, promote the private sector, and facilitate investment.