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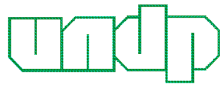

LESSONS IN PRIVATIZATION

CONSIDERATIONS FOR ARAB STATES

January 2002

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The views expressed in this paper do not necessarily reflect those of the United Nations Development Programme (UNDP)

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The question that should be paramount in the minds of policymakers and citizens in Arab countries is not *whether* to privatize but *how* to privatize state-owned enterprises (SOEs) and attract private participation in infrastructure. Arab countries have lagged far behind the rest of the world in terms of privatization and private participation in infrastructure (PPI), and they cannot afford to ignore the lessons from earlier privatizations. This report draws from the historical record the recommendations that are most relevant to the challenges that Arab States face in planning and executing successful privatizations.

Section 2 of the report argues that Arab states should privatize, that they should follow the advice of the classic sportswear advert to "Just do it." It also gives some recommendations on how Arab states can derive the greatest benefits from privatization and how privatization can be used not only to improve economic performance, but also, to improve the living conditions for all citizens. In particular, it discusses how privatization can be designed to benefit human development and to address basic social objectives. It also discussed how private participation can improve –and has improved- population access to essential public services (such as water, electricity, telecommunications) and the quality of these services, while making them more affordable, in particular to the poor.

Section 3 goes a step further and looks at the process of privatization and draws recommendations on how it can be implemented. It argues that it is not enough to privatize, but that it should be done well. This is easier said than done. For privatization to deliver sustainable long-term benefits to the economy and society, it has to be well managed both at the political and the technical levels. Objectives have to be clearly defined; the strategy for privatization and the method of privatization have to be selected wisely, with particular attention given to issues of market structure; the commitment of the political leadership to privatization has to be credible; the privatization process has to be transparent and fair to minimize the risks of corruption; and the essential elements for a successful privatization have to be put in place. Paramount among these "essential elements" is the liberalization and the introduction of competition, including in the provision of infrastructure services (power, telecommunications, transport). Another essential element is the establishment of an appropriate regulatory framework prior to privatization. This includes establishing capable and effective regulatory authorities to promote competition, deter anti-competitive practices, protect consumers, review and approve the setting of tariffs in non-competitive markets, and manage scarce resources (such as spectrum, right-of-way, etc.).

Privatization is a policy based on a set of empirically supported hypotheses. First, that "ownership matters," i.e, that economic performance is optimized when the firm is privately owned. Second, that "management matters," i.e., that private management pursuing its own interest and that of shareholders delivers a much better economic performance than do politicians or bureaucrats. Third, that "markets matter," i.e., that business decisions should be driven by demand in competitive markets, rather than

dictated exogenously by the same politics or bureaucracy with, at best, distorted market information. Fourth, that "competition matters," i.e., that competition in the market is good for the economy even though it may be detrimental to some firms. Fifth, that "freedom to fail matters," i.e., that the possibility of a firm going bankrupt and exiting the market is a necessary part of a competitive and healthy market. Finally, that "regulation matters" when markets fail because of information asymmetry or monopoly power, i.e., that effective regulation can balance the interests of firms and consumers in markets where competition does not exist.

The writing of the report coincides with renewed interest in privatization in the Arab countries. Old privatizers, such as Morocco, Jordan, and Egypt, have given new prominence to privatization as an economic priority. Privatization is no longer considered a taboo and now enjoys increased political acceptance. Governments have turned their attention to improving the implementation and the results of privatization. The report is also relevant to the relative newcomers to privatization in the region. The list of newcomers to privatization has expanded to include Algeria, once a bastion of state-owned socialism and *dirigiste* central planning, to Lebanon, once a paragon of *laissez-faire* liberalism. This list also includes oil-rich Gulf monarchies, which have long suffered from bloated public sectors and which are in dire need of reviving their fledgling private sectors. In those countries, the challenge is how to have successful privatizations. Finally, the report is also relevant to countries in the region that have ruled out privatization in favor of state enterprise reform. In Syria, for example, there is talk of state enterprise reform through performance contracts (or "*contrat-plan*"), an alternative to privatization that has failed to improve state enterprise performance in cases where it was implemented.

On the privatization front, Arab States face challenges that are, in many ways, similar to those faced by other countries. The lessons learned from other countries' experiences are relevant to this part of the world. This report is based on this premise, a premise that implies that Arab States can do a better job with privatization than they have done thus far.

1. Privatization

Privatization has been by far the most controversial instrument of economic policy of the past decade. That may be because it is less a question of economics than of politics, and people's attitudes towards privatization are grounded –unfortunately- more in ideology (either for or against) than in empirical facts. But this does not diminish the importance of privatization. Quite the contrary, it confirms the centrality of privatization as a policy instrument and as a process shaping the economies of the twenty-first century.

a. Defining Privatization

Privatization is an instrument of economic policy. It is the *transfer of property* or *control* of assets used to deliver goods or services from the public to the private sector. The narrow definition refers to privatization at the level of the firm or units within it. While there are different forms of privatization, a widely accepted definition of privatization encompasses the privatization of management as well as the privatization of ownership.

Broadly defined, privatization is the *abolition of barriers* to private sector provision of services or the infrastructure necessary for their delivery. The broad definition refers to privatization at sector level (e.g., telecommunication, electricity, social security, etc.). It is more complex than enterprise level privatization as it often involves restructuring of a whole sector and not just one firm. It involves giving the private sector the right to use or access the public domain (radio spectrum, land, right of way, etc.) to build and operate a network industry. It also involves defining the "public service" dimension and licensing the private sector to deliver such services. The broad definition of privatization requires putting in place legal and regulatory mechanisms to ensure that private providers do not overlook the public dimension of the services they are licensed to deliver and do not fail to meet pre-announced policy objectives (coverage, access, etc.).

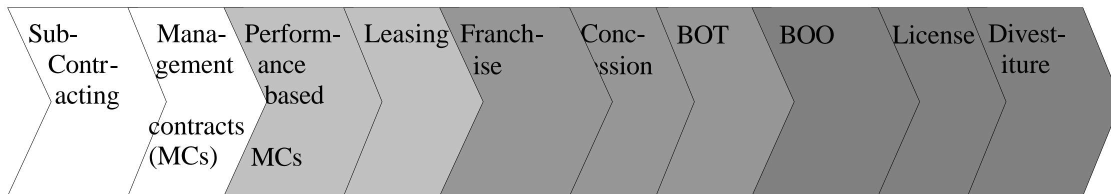
Privatization, however, can also be used to refer to those measures taken by a government to increase the role of the private sector in an economy. It is in this sense that privatization was, and is, used in the case of the former socialist economies in Central and Eastern Europe and the former Soviet Union. But it can also be used in the case of some Arab economies that are undergoing transitions, albeit of a different kind. Some countries, such as Egypt and Tunisia in the 1980s and Algeria today, are striving to move from a state-controlled and dominated economy to a market-based economy where the private sector plays a much greater role. Other countries, such as the oil rich countries in the Gulf, have begun to realize the importance of privatization in diversifying their economic base away from a heavy reliance on the energy sector.

A lot has been written about whether privatization is a means to an end or an end in itself. Clearly, it can be both. In the former republics of Eastern Europe and the Soviet Union, privatization –in the sense of a political and economic transformation to a market-based,

private sector-led economy- privatization was undoubtedly an end in itself[1]. In Latin America, on the other hand, privatization was most often a means to an end. The end was either to improve enterprise performance, to reduce the fiscal losses generated by SOEs, or to secure international financing and support for a broader economic program. But as sections 2 (e), 2 (f), and 3(g) of this report argue, privatization is most successful when it is designed to contribute to human development, to improve people's choices, and to contribute to the eradication of poverty.

There are various techniques or methods for privatization. Each method entails a different distribution of commercial, and other, risks between the state and the private investor. Each method requires a different minimum duration of privatization. The various methods are summarized in Figure 1-1 below.

Figure 1-1:
Risk Allocation in Contract Design



Public????Responsibility for investments and risk allocation????Private
0??????Duration (years) of private involvement?????????8

The choice of the method of privatization will vary depending on the company or sector to be privatized, the constitutional and legal constraints, the policy choices, and the objectives to be pursued.

b. Main Trends in Privatization

Privatization has been a growth business all over the world in the past decade. First, the compound annual average growth rate was around 10% between 1990 and 2000, with global privatization revenues jumping from $ 25 billion in 1990 to $ 200 billion in 2000. Second, the number of countries that have implemented privatization policies has exceeded 110. Third, privatization and private participation have touched almost every aspect of economic activity. Finally, and most importantly, after more than two decades of privatization, there is not one instance of a country that has started privatization and then reversed gear or even stopped halfway.

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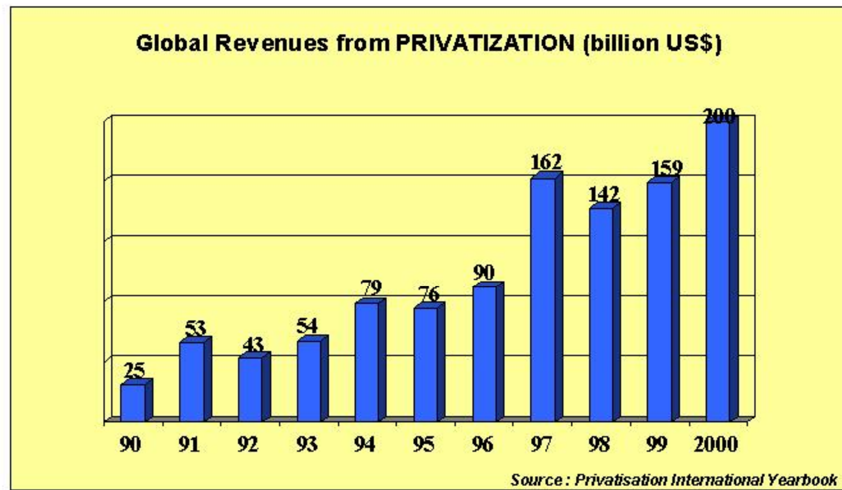
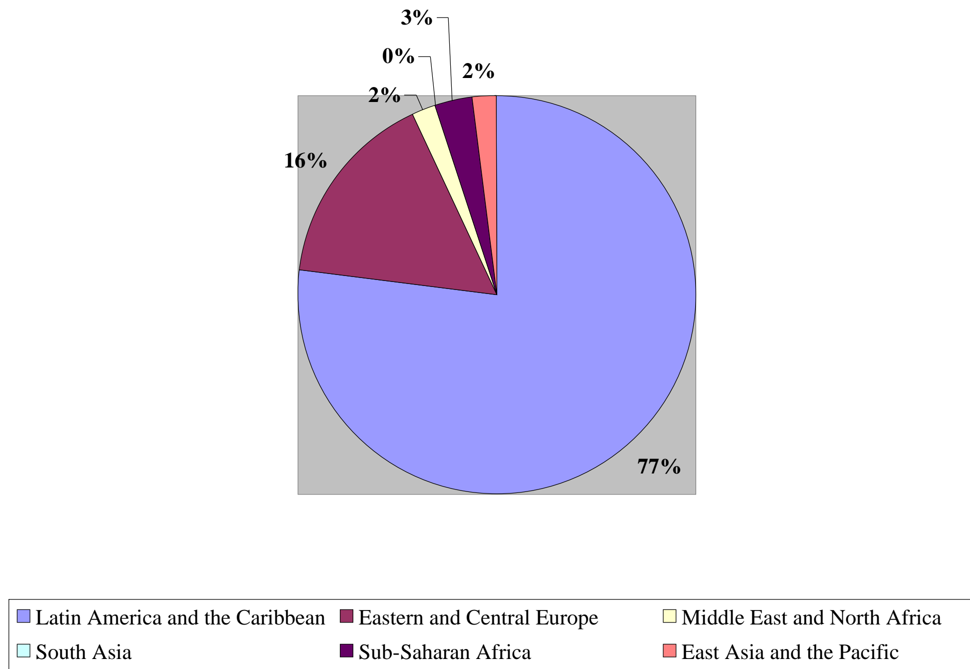
[1] For more on privatization in Eastern Europe, please refer to: Pohl et al (1997), Claessens and Djankov (1998)

Figure 1-2:



OECD countries account for the vast majority of the volume of privatization proceeds, with Latin America a distant second, followed by Eastern Europe.

Figure 1-3: Developing Country Privatization Revenues by Region 1998



Source: World Bank Database

Finally, privatization has covered all sectors of economic activity, with telecommunications, energy, and transport accounting for the largest shares of privatization revenues. Telecommunications alone has accounted for an average of 30% of total privatization proceeds in 1994-1997 and around 50% in 1998 and 1999.

c. Privatization in Arab States

Countries in the MENA region have begun to implement privatization belatedly and, at first, reluctantly. Morocco was the first Arab country to formally endorse privatization as a policy, and was quickly followed by Tunisia, Jordan and Egypt. It is significant that except for Tunisia, Arab countries that started on the path of privatization did so under some degree of pressure from international financial institutions.[2]

Until recently, privatization proceeds in the Arab States have been very modest (Table 1-1). It was not until 1999 that Morocco re-energized its privatization program. Egypt and Jordan followed suit in 2000, albeit with varying degrees of success. Lebanon and Algeria also joined the ranks of the declared privatizers. In practice, however, there has been very little progress to show for. Despite the passage of a privatization law in 1999, Lebanon has yet to implement a working formula for privatization that delivers transparency and fairness in the process, and professionalism in the execution of the

[2] More on the details of privatization in Jordan, Egypt, and Morocco, is available in Appendices 1-3

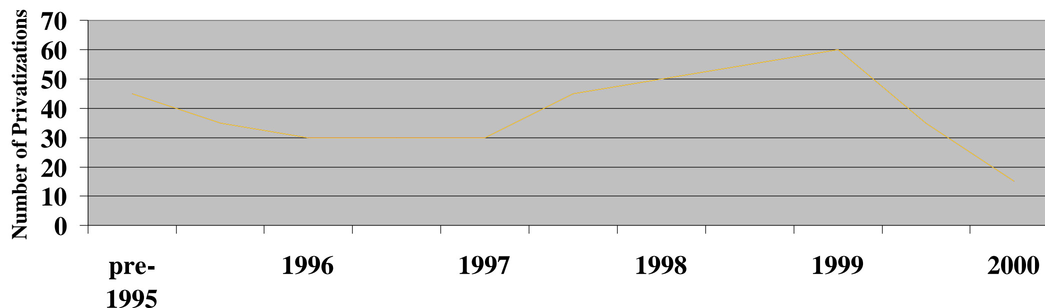
program. In Algeria, and despite statements in support of privatization from high-ranking officials, the only progress has been the voting of new legislation in 2001 centralizing decision-making concerning privatization and decentralizing implementation.

Table 1-1: Proceeds from Privatization in Selected Arab Countries (USD million)

Countries	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Algeria	-	-	9.3	-	-	45.8
Egypt	393.2	261.9	-	855.1	538.7	856.5
Jordan	-	14.7	11.3	32.7	5.1	-
Morocco	346.6	239.7	270.6	716.4	92.2	1,163.3
Tunisia	-	32.5	35.9	2.8	364.4	8.4

Source: World Development Indicators database

Figure 1-4: Progress of Privatization in Egypt



Source: Privatization International 2001

The slow pace of privatization has also been mirrored in the slow opening to private participation in infrastructure (PPI). The MENA region's share of the total investments in PPI in developing countries has averaged 3.4% in 1998 and 1999.[3] In the period 1990-1998, total private investments in telecommunications in the MENA region amounted to US$ 3 billion, less than 1.4% of the global total. But these numbers hide the fact that there has been progress in PPI even in the MENA region between 1994 and 1999. There have been, in the last few years, significant PPI transactions, starting in 1998 with the concessioning of the Rabat and Casablanca water and electricity distribution and the sale of two licenses for mobile telephony in Egypt. These transactions have been followed by the privatization of Jordan Telecom and Maroc Telecom in 2000 and 2001, respectively, and by the launching of Independent Power Producers (IPPs) in Egypt, Morocco, and

[3] All numbers are from the World Bank PPI Database

Jordan. In summary, the taboo on PPI has been demolished and Arab governments have realized that PPI is the surest way to endow their countries with a modern, competitive infrastructure, a critical component for further economic development.

Table 1-2: Infrastructure Privatization Proceeds by Sector in MENA ***(US$ millions)***

Countries and Regions	Energy		Telecommunications		Transport		Water and Sanitation	
	1994	*1999*	*1994*	*1999*	*1994*	*1999*	*1994*	*1999*
	-	-	-	-	-	197.7	-	-
Jordan	-	-	43	17.8	-	182	-	55
Lebanon	-	-	50	323	-	-	-	-
Morocco	2,300	4,819.9	-	1,240	-	-	-	4,050.9
Tunisia	627	265	-	-	-	-	-	-
Low and Middle Income Countries	40,411.26	140,782.5	49,634.1	181,962.6	25,626.5	71,894.7	8,794.3	24,294.3
MENA	3,131.5	5,784.9	118	3,809.5	-	647.2	-	4,105.9

Source: World Bank Indicators Database

The privatization trends support two propositions. First, that privatization will continue to grow in the coming decade, even in the Middle East. Second, that privatization in Arab States will move to infrastructure sectors, which, thus far, have been considered the exclusive domain of the public sector. Indeed, privatization and PPI are the most promising options that Arab governments have to catch up with the rest of the developing countries and improve the quality and competitiveness of their countries' infrastructure.

2. The Impact of Privatization

The first lesson of the past two decades of privatization is that privatization can work. Privatization has had, for the most part, a positive impact on the countries that have implemented it. This section reviews the impact of privatization on company performance, on fiscal adjustment, on foreign investment (both direct and portfolio), on capital market development, on employment and on poverty. It also reviews the policies that have to accompany privatization in order to deliver the desired effect.

In a landmark study, Galal et al. (1994) find that the welfare impact of privatization in eleven out of twelve cases studied was positive, i.e., that there was a net welfare gain from privatization. The cross-country study chose three companies in each of four countries (United Kingdom, Chile, Mexico, and Malaysia) privatized between 1982 and 1990. According to the study, the positive welfare effect of privatization resulted from productivity improvements, from optimizing investments, from efficiency pricing, and from increased flexibility in hiring. The study also shows that the key determinants of the success of privatization are competition in the marketplace into which the enterprise is being divested, effective regulation of non-competitive sectors, the credibility of government commitments, efficient capital markets, the relinquishing of control to the private sector, and transparency in the privatization process.

a. Company Performance

There is near unanimity that privatization has lead to improved company performance, both financial and operational. There is, however, much less consensus on the causes of improved performance. To some, "ownership matters," i.e., private ownership is superior to public ownership because it creates incentives for higher efficiency and better company performance. A review of over 50 empirical studies that cover several thousand companies from about 50 countries finds that "the studies cited […] almost unanimously report increases in performance associated with privatization" and that "divested firms almost always become more efficient, more profitable, increase their capital spending, and become financially healthier."[4] To others, ownership matters, but "market structure matters more," i.e., pressures from competition, and not the change of ownership, forces companies to improve performance. [5] This debate is important and should serve to warn about the pitfalls of monopolies and the necessity of reforming and liberalizing market structures in the lead up to privatization.

The impact of privatization on the performance of privatized firms has been measured by looking at the firm's performance indicators: profitability, efficiency or labor productivity, investments, output, dividends, exports and financial leverage. Improved performance is due, in large part, to the fact that once the private sector takes over an SOE, profitability objectives become paramount. Furthermore, privatization usually brings with it concentration of ownership structure within the firm and the appointment of qualified management. In some cases, however, where the managers are not the owners or where the owners are "insiders" with extensive political connections, there have been lower than average improvements in company performance.[6] Table 2-1 summarizes the literature.

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[4] Shleifer (1998), Megginson and Netter (2001), Boardman and Vining (1989), Boycko et al. (1996), Boubakri and Cosset (1998)

[5] Caves and Christensen (1980), Bishop and Kay (1989), Vickers and Yarrow (1991), Galal et al (1994)

[6] Havrylyshyn and McGettigan (1999), p.5.

Table 2-1: Impact of Privatization on Performance: Literature Review

Indicator	Impact	Condition	Study
Efficiency	Positive	• Second wave privatization (learning process) • Small and medium scale of operations • Competition in the market • Flexible labor markets • Full private ownership • Greater stress on profit goals and reduction of government subsidies	§ Harper (2000) § Lizal et al. (2000) § Savas (1977); Edwards and Stevens (1978) § Galal et al. (1994) § Boardman and Vining (1989 and 1992); Majumdar (1996) § Kikeri et al. (1992); Boycko et al. (1996)
	Negative	• First wave privatization • Large scale of operations • Monopoly market structure	§ Harper (2000) § Lizal et al. (2000) § Fare et al. (1985)
Labor Productivity	Positive	• Restructuring resulting from ownership and financing changes • Outside-ownership control over firm • Appointment of new managers • Concentrated post-privatization ownership structure • Outside-management ownership • Private ownership • Employee Ownership • Competition in the market • Wage increases and investment in retraining and new equipment	§ Pohl et al. (1997) § Frydman et al. (1999) § Claessens and Djankov (1999a) § Claessens and Djankov (1999b) § Earle (1998) § Ehrlich et al. (1994) § Djankov (1999a) § Hill (1982); Boardman and Vining (1989); Frydman et al. (1997) § Galal et al. (1994)
	Negative	-	-
Profitability	Positive	• Concentrated post-privatization structure • Appointment of new managers • Privatization at second wave • Small and medium-sized scale of operations • Foreign and employee ownership • Full competition • Private ownership	§ Claessens et al. (1997a); Claessens and Djankov (1999b) § Claessens and Djankov (1999a); Boubakri and Cosset (1998) § Harper (2000) § Lizal et al. (2000) § Smith et al. (1997) § Funkhouser and McAvoy (1979); Boardman and Vining (1989); Claessens et al. (1997b) § Boardman and Vining (1992)
	Negative	• Large scale of operations	§ Harper (2000); Lizal et al. (2000)
Revenue Generation/ Real Sales	Positive	• Outside owners associated with revenue growth • Outside investors propel product restructuring • Foreign and employee ownership • New owners and managers • Private share ownership raises real sales per employee	§ Frydman et al. (2000a) § Frydman et al. (2000b) § Smith et al. (1997) § Barberis et al. (1996) § Earle and Estrin (1998)
	Negative	• First wave privatization	§ Harper (2000)
Exports	Positive	• Foreign and employee ownership	§ Smith et al. (1997)
	Negative	-	-

The productivity of the workforce has increased following privatization especially in countries that have implemented employee stock ownership plans (ESOPs). Employee ownership has proven to be an important motivator for employees to work harder.

Efficiency increased when an SOE was divested in a competitive market, or when privatization was used to introduce competition to the market. The companies' quest to raise efficiency has sometimes resulted in layoffs. The implementation of performance-based pay schemes, wage structure improvement, and increased employment flexibility,

in addition to the previously discussed investment increase prior to privatization, have all contributed to increasing productivity after privatization.

Table 2-2: Performance of Newly Privatized Companies

Variable Measured	Number of Observations	Mean Value before Privatization	Mean Value after Privatization	Main Change due to Privatization	Percentage of firms with Performance Improvement
Profitability (*Return on Sales*)	78	4.9%[7]	11%	6.05%[8]	62.8%
Efficiency (*Real Sales per Employee*)	56	0.922	1.17	24.79[9]	80.4%
Investment (*Capital Expenditures/ Sales*)	48	10.52%	23.75%	13.22%[10]	62.5%
Output (*Real Sales, adjusted by CPI*)	78	0.969	1.22	25.3[11]	75.6%
Total Employment	57	10,672	10,811	139	57.8%
Leverage (*Debt/ Total Assets*)	65	54.95%	49.86%	-2.48%[12]	63.1%
Dividends (*Dividends/ Sales*)	67	2.84%	5.28%	2.44%[13]	76.1%

Source: Boubakri and Cosset (1998)

Privatization has also been strongly associated with improved product quality at more competitive prices, thereby increasing product competitiveness in foreign markets. As a result, exports have risen. Foreign ownership in several cases has also been a key element in the creation of an export market, and in claiming a share in the country's exports for the privatized companies.

There are, of course, significant variations from the overall trend observed which associates privatization with improved company performance. In some countries in Eastern Europe where voucher privatization (or mass privatization) was adopted, company performance did not improve with the same frequency as the general trend. Voucher privatization did not replace state ownership and control with a core group of investors with management expertise. The results on company performance, in many cases, were not consistent with the overall trend.

Summary: Privatization has improved company performance. Governments can ensure that privatization improves company performance first, by divesting into competitive markets; second, by putting in place commercial and corporate legislation that provides for good corporate governance mechanisms such as transparency, accountability of managers to owners, protection of the rights of minority shareholders, etc.; third, by adopting a method for privatization that gives a core of private owners (even if they own

[7] Significant at the 10% level
[8] Significant at the 1% level
[9] Significant at the 1% level
[10] Significant at the 5% level
[11] Significant at the 1% level
[12] Significant at the 5% level
[13] Significant at the 1% level

a minority of shares) management control of the enterprise; fourth, by giving the new management the flexibility to hire and fire; and fifth, by imposing a hard budget constraint on the new enterprise.

b. *Fiscal Adjustment*

Governments have often implemented privatization in response to serious fiscal pressures, either to reduce the burden of loss-making enterprises on public funds or to raise additional revenues to fill a financing gap. International financial institutions have included privatization in their conditionality to improve the likelihood of success of financial stabilization packages. It is noteworthy that most Arab governments that endorsed privatization early on –Egypt, Jordan and Morocco– did so as part of an IMF-backed package of reforms to consolidate their public finances, bring their budget deficits under control, and address external imbalances (typically, an unsustainable current account deficit). It is therefore important to see whether privatization contributed to fiscal consolidation.

The fiscal impact of privatization depends on the volume of proceeds and how they are channeled. Econometric studies suggest that privatization revenues channeled towards the budget have been saved and not spent, which is consistent with efforts to consolidate public finances. When combined with fiscal consolidation measures (reducing expenditures and increasing revenues), privatization revenues have contributed to closing budgetary gaps. In other words, deficit reduction measures were more effective when combined with privatization. The evidence also points to the fact that privatization proceeds transferred to the budget have been used almost entirely to reduce *domestic* financing, though in non-transition economies, 20% of the proceeds have been directed towards reducing *foreign* financing[14].

While there is scant evidence that privatization revenues alone have eliminated the problems associated with financing an unsustainable level of public indebtedness, there is strong evidence that privatization contributes to fiscal adjustment. Privatization revenues help to slow down the rate of growth of the public debt, i.e., the debt to GDP ratios will be more favorable with privatization proceeds than without them. Another direct impact of privatization is that it helps to lower interest rates, as public sector financing needs are reduced. The reduction of interest rates, in turn, alleviates the burden of financing outstanding public debt.

It is a common misconception that privatization causes only a one-off increase in revenues.[15] Detractors of privatization have compared it to "selling the crown jewels." While it is true that privatization proceeds *per se* are non-recurring, privatization itself can generate recurring revenues to the state treasury. First, privatization enlarges the tax base. SOEs, once privatized, become subject to corporate taxation. The tax base is further expanded if, in the course of privatizing infrastructure sectors, competition is introduced. Second, the privatization of infrastructure sectors also brings recurring

[14] Davis et al. (2000)
[15] A common but misleading metaphor likens privatization to a match that can only be lit once.

revenues in the form of license fees, radio spectrum fees, right-of-way fees, and other revenues associated with commercial management of the public domain. Third, by eliminating infrastructure bottlenecks in the medium term and attracting new investments that would not otherwise be made, privatization becomes a catalyst for the expansion of economic activity and the consequent rise in tax revenues.

A related policy question is how governments should use privatization proceeds.[16] Privatization proceeds should be budgeted as a financing item and not as a revenue item. Fiscal orthodoxy recommends, and many countries (Hungary, Mexico, New Zealand) have opted, that privatization revenues be used primarily to retire public debt to keep the government's net worth unchanged or to change the debt structure, which will lower the cost of the debt. Other countries have opted to use privatization revenues to cover the cost of privatization, i.e., the cost of the privatization transaction and the cost of reducing the enterprise's legal liabilities - debts or employment related liabilities, which is tantamount to reducing the public debt.

Some countries have gone even further and opted to use privatization proceeds to facilitate privatization. They have used proceeds to compensate losers from privatization (e.g., to pay for severance packages over and above what workers are legally entitled to) or to distribute more widely the benefits of privatization. Many countries in Latin America have done the latter and have shown their citizens the concrete benefits of privatization. Privatization proceeds have been used to fund the electrification of poor rural areas, to start socio-economic development projects, etc. Countries that opt to use privatization proceeds, or part thereof, to fund development projects, have to put in place safeguards to avoid the misuse of these funds. The funds should be used only for activities with social and economic returns that exceed the savings that otherwise would have been secured had the privatization proceeds been used to retire public debt. Ideally, the funds should go to projects with the highest rates of return. In Guatemala, for example, proceeds were used to guarantee municipal bond issues for public and social works that had a very high rate of return.

While few countries have chosen to use privatization proceeds to co-opt opponents of privatization, such an approach has its drawbacks as it makes the government vulnerable to political blackmail and extortion. Other countries, such as India, Egypt, and the Czech Republic have used privatization proceeds to restructure state-owned enterprises. That option, too, involves high risks since, historically, pre-privatization enterprise restructuring has had a very low rate of return; in other words, it has seldom worked.

Summary: Privatization has contributed to fiscal adjustment. Governments have to accompany privatization with parallel measures to manage the public debt efficiently and to reduce the budget deficit. If they choose to use part of the funds to finance development projects, they should put safeguards in place to avoid politically motivated and wasteful government spending

[16] Mahmood, 1999.

c. Foreign Investments

Privatization is one of the most effective policies that governments can use to attract foreign investments, both Foreign Direct Investments (or FDI) and foreign portfolio investments. Over 90% of FDI in developing countries has come from privatization transactions, especially private participation in infrastructure. Privatization and privatization-related activity accounts for much of FDI and foreign portfolio activity in Latin America and Eastern Europe.

Privatization and foreign investments are linked in three ways:

§ *Direct impact*: Privatization, especially when accompanied by measures to liberalize the market and open it up to competition, attracts foreign investors who not only acquire SOEs, the right to develop a new infrastructure facility (power plant, toll road, etc.), or the right to deliver infrastructure services (telecom, electricity, etc.), but also bring in new investments, thus increasing the FDI stock.

§ *Indirect impact*: Privatization leads to the development of capital markets, which, with the proper regulatory framework, attract foreign portfolio investments. Furthermore, the development of capital markets encourages FDI by providing investors with a liquid market (an exit strategy).

§ *Catalytic impact*: Privatization puts the developing country on the investors' "radar screen" and generates interest in it. Furthermore, the commitment to privatization and liberalization gives firm evidence to investors that the political and regulatory risks (of expropriation, restrictions on capital accounts and repatriation of profits, etc.) are being reduced. Finally, the "demonstration effect" of a successful privatization can convince other foreign investors to follow suit and participate in subsequent privatization transactions.

Arab countries have fared very badly in terms of attracting foreign investments. While the developing world's share of global FDI inflows peaked at around 39% in 1996 and 1997 and then dropped to 20.7% in 1999 and 18.9% in 2000, West Asia's share never exceeded 1.2% in 1997and fell to 0.3% in 2000 (Figure 2-1) [17]. The most important policy initiative that Arab governments can take to encourage foreign investments is to launch privatization and to open infrastructure sectors to private participation. This will also encourage the repatriation of Arab funds and help reverse the outflow of funds from the region (Table 2-3).

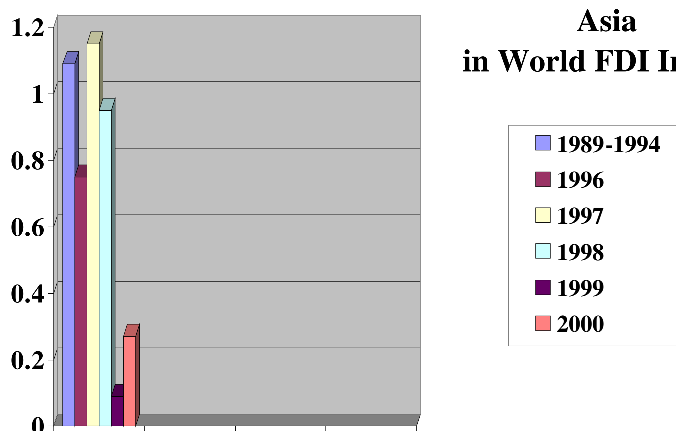
[17] World Investment Report, 2001.

Table 2-3: Foreign Direct and Portfolio Investments in the MENA region 1999[18]
(US$ million)

Country	Foreign Direct Investment	Portfolio Investment: Bonds and Equity Flows
Algeria	7	3
Egypt	1,065	650
Jordan	158	2
Morocco	3	56
Oman	60	11
Tunisia	350	240
Lebanon	250	(111)*
Syria	91	0
Yemen	(150)	0
MENA Region	1,461	851

Source: World Development Report, 2002
* () implies negative number

Figure 2-1:Evolution of the Share of West Asia in World FDI Inflows



Summary: Privatization has increased foreign investments in most countries. However, for privatization to be a useful instrument to attract foreign investments, governments have to eliminate restrictions on foreign investments and streamline associated administrative procedures. Furthermore, they have to upgrade the legal and judiciary environment for doing business and bring it up to international "best practice" standards.

[18] The MENA (Middle East and North Africa) region, as defined by the World Bank, includes Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Oman, Saudi Arabia, Syria, Tunisia, West Bank and Gaza, and Yemen. The use of the term in this paper will be limited to World Bank data.

d. Capital Market Development

Privatization has been the main factor behind the development of capital markets. It has led to the growth (in terms of market capitalization) and deepening (in terms of numbers of shareholders) of financial markets, as well as increasing their liquidity.[19] Share issue privatization was the main driver behind the development of capital markets worldwide. It is noteworthy that privatized firms are the most valuable companies in 7 of the 10 largest non-US stock markets, and in almost all emerging markets possessing stock exchanges.[20] Furthermore, 35 of the 42 largest common stock issues in history are either privatizations or capital increases by recently privatized firms. Finally, privatizations have not only increased the liquidity of stock markets, but they have exponentially increased the number of shareholders around the world.[21]

In some countries, the growth and deepening of financial markets has been a declared objective of privatization. Jordan, for example, identified the deepening of the capital markets as one of the main objectives of privatization.[22] Privatization has also encouraged the issuance of new financial instruments to raise capital (for instance, Global Depositary Receipts (GDRs) in Egypt). Finally, privatization has forced governments to undertake capital market reforms and to modernize them. Many governments around the world, including Egypt and Morocco, have taken measures to reform their capital markets in preparation for privatization. Table 2-4 summarizes the Moroccan experience.[23]

Table 2-4: Privatization-Fuelled Reform of Moroccan Capital Markets

Year	Measure	Implications
1994	§ Establishment of Securities and Exchange Rate Commission	Capital Market regulation: § Disclosure requirements § Regulations covering mutual funds
1995	§ Privatization of the Casablanca Stock Exchange	§ Reform of the domestic capital market
1995	§ Legislation allowing for capital mobility	§ Free movement of capital across borders § Accumulation of foreign investment § Repatriation of capital gains and dividends
1995	§ Approval of 13 mutual funds	§ Propelling foreign investment

Source: Adapted from Frémond, Olivier, *Morocco's Case-by-Case Privatization Program* (from Lieberman and Kirkness (1998))

To date, privatization has had a modest impact on stock markets in Arab countries (Table 2-5). The number of listed companies increased in Egypt, Jordan, and Tunisia and the value traded (as a percentage of GDP) has, on the whole, also increased.

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[19] Lieberman and Kirkness (1998)
[20] Megginson and Boutchkova (1999)
[21] Ibid.
[22] Amman Stock Exchange, 2001.
[23] Frémond (1998)

Table 2-5: Key Stock Market Indicators in Selected Arab Countries

Country	**Listed Domestic Companies**		**Value Traded (% GDP)**	
	1990	2000	1990	2000
Egypt	573	1,076	.3	10.1
Jordan	105	163	10.1	6.8
Lebanon	-	12	-	1.9
Morocco	71	53	.2	7.2
Tunisia	13	44	.2	2

Source: ERF, 2001; World Development Indicators, 2001

Summary: Privatization has spurred the development of capital markets worldwide. Governments have to upgrade the capital markets legislation and establish an effective financial regulatory authority. They also have to design their privatization transactions in such a way as to promote broad share ownership. Social security legislation often has to be revised to encourage the establishment of private pension funds that will bring liquidity to the market.

e. Employment

Governments have traditionally feared the impact of privatization on employment. In some countries, the concern about massive layoffs has led governments to side-step privatization and tinker, without much success, with public enterprise reform. Increasingly, however, governments realize the futility of public enterprise reform and the opportunity costs of delaying privatization (in terms of unrealized gains from privatization to society as a whole). Governments that have taken employment concerns seriously have devised labor strategies, and have been able to mitigate the adverse consequences of privatization.

The impact of privatization on employment is multifaceted and complex. The evidence is not clear on whether privatization has had a positive or negative effect. First, privatization has had a different impact on labor made redundant as a result of privatization, on labor retained within the privatized enterprise, and on labor markets. Second, the impact of privatization on employment can be measured both quantitatively (number of workers made unemployed, number of new jobs created, etc.) and qualitatively (working conditions, working hours, unionization, etc.), and the two indicators need not –indeed, rarely– move in tandem. Third, the impact of privatization on employment has depended primarily on the company's initial labor conditions, which in many SOEs are: overstaffing, higher wages than comparable jobs in the private sector– especially if the SOE does not face a hard budget constraint, generous non-wage benefits, rigid labor contracts or collective bargaining agreements, and high job security. Fourth, the welfare impact has varied depending on the measures that governments have taken, namely on whether they have put in place social safety nets. Fifth, the impact has varied depending on the privatization method (Table 2-6). Finally, the impact of privatization on employment will vary from industry to industry and depending on the macro-economic conditions. The complexity of the relationship between privatization and employment is such that there is no standard answer.

Table 2-6: Impact of Privatization on Employment

Privatization Method	Short run	Medium to Long Run
Public Sales/Auctions and Sales to Strategic Investors	Restructuring to make company profitable	Efficiency gains and overall economic improvement and hence, employment increase
Management/Employee Buyouts	No fresh capital or ideas and thus minimal effect on employment	Macroeconomic environment cushions adverse labor incidence that occurs gradually and hence employment increase/maintain
Management Contracts	Minimal impact on employment as contractor earns fixed fee	
Lease Contracts	Incentive to cut down on work force as lessor keeps extra proceeds net of lease payment	
Mass Privatization	Effect on employment depends on concentration of shareholding structure	

Source: Adapted from Gupta et al. (2001)

It is frequently observed that employment is reduced with privatization (either in preparation for, or after) and the accompanying restructuring due to the overstaffing that typically exists in many SOEs. Three large-scale studies, however, have documented significant *increases* in employment.[24] Galal et al. (1994) find that workers had a net welfare gain in ten out of twelve cases they examined, and that even laid-off workers were not worse off because of the social safety programs put in place (compensation packages, discounted shares, etc.) Boubakri and Cosset (1998) calculate an employment increase of no less than 10% in 57% of the privatized cases examined (Table 2-1). On the other hand, examples of significant job losses abound. In Argentina, the privatization of the railway enterprise, which began in 1990, involved the loss of nearly 80,000 jobs in less than five years. But prior to privatization, the company was losing $ 800 million a year and receiving $ 1.3 billion a year in subsidies and the company moved less than 10% of the total traffic. In 1995, the subsidy had dropped to $ 250 million a year, productivity had increased ten times, and urban commuter rail rider-ship increased by 45%.[25] In Mexico, the number of white and blue-collar employees was reduced by half in the four years before privatization in 218 SOEs.[26]

Labor force cuts are necessary in all enterprises –even SOEs, which suffer from over-staffing and labor inefficiencies (Figure 2-1). Political cronyism and patronage, however,

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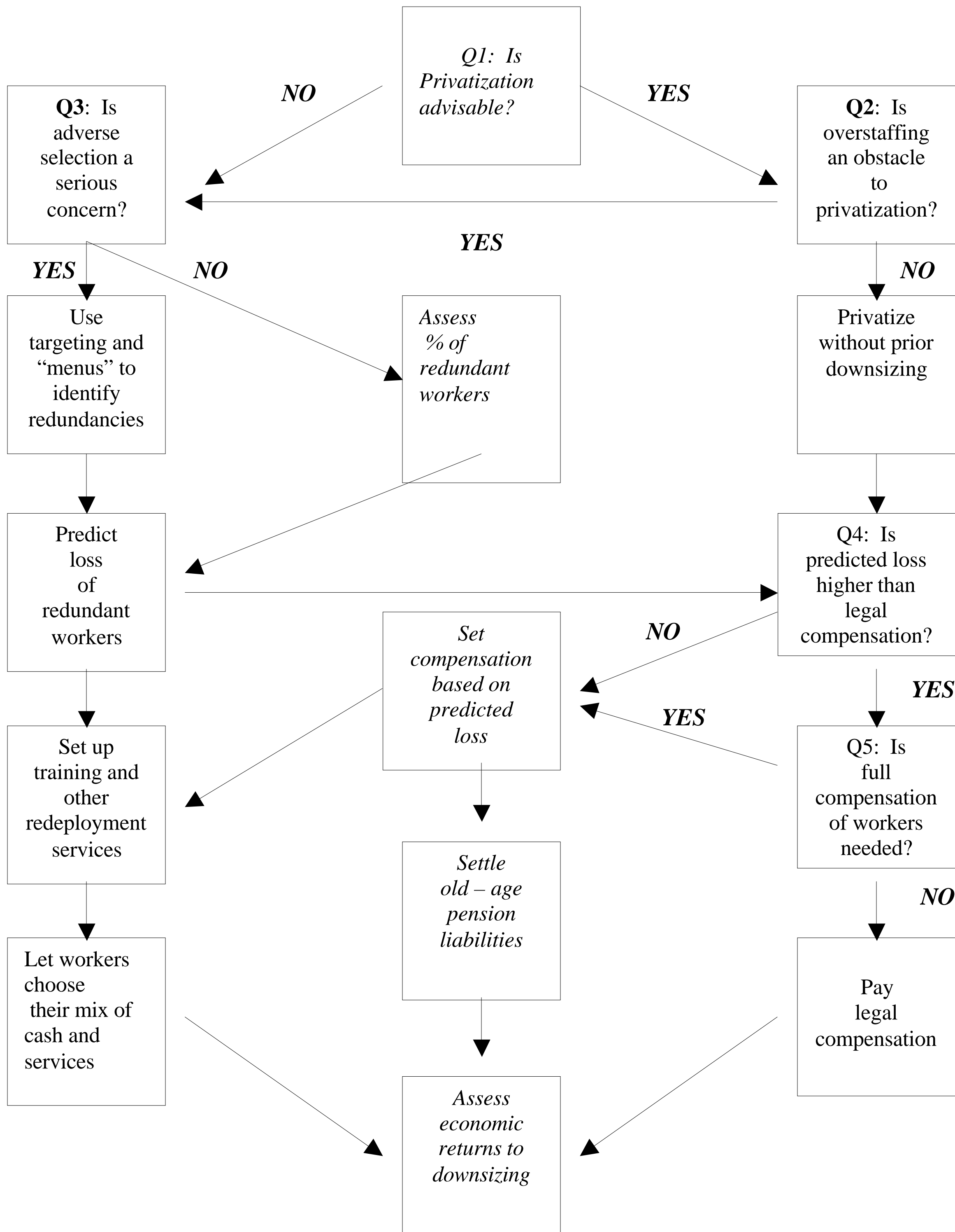
[24] Galal et al (1994), Shleifer (1998), Megginson and Netter (2001), Boubakri and Cosset (1998), Nash and Van Randenborgh (1994)

[25] Kogan, Jorge H., 1996, "The Role of Labor in Enterprise Restructuring and Privatization: Strategies and Implementation Techniques", Presentation at World Bank Seminar, June 3-4, Washington DC: The World Bank and Estache et al (1999)

[26] La Porta and Lopez-de-Silanes (1999)

often prevail and block the way to cuts in the labor force. In other cases, unproductive employment becomes a necessary substitute for the social safety net the public sector is unable to provide.

Figure 2-2: A Downsizing Decision Tree



Source: Rama (2001)

A review of labor retrenchment associated with privatization shows that "in cases where efficiency improvements require large scale labor force adjustments, privatization can proceed smoothly if governments take early steps to inform and involve labor unions and workers in the reform process, develop a menu of restructuring options, help workers on a targeted basis to reintegrate into the labor market, and eliminate obstacles to private job creation."[27] On the other hand, "workers remaining with privatized firms have often benefited by obtaining better-paying jobs, company shares, and improved training and career development prospects," as well as greater flexibility and upward mobility.[28] However, they have had to accept more demanding working conditions, a tougher management structure, and a weakening of union influence.

Labor considerations have weighed heavily in the privatization process in the Arab States. The strategies adopted by privatizers in these countries are summarized in Table 2-7. Egypt opted to implement privatization very slowly and gradually in order to minimize labor opposition. It adopted a strategy of voluntary early retirement, ESOPs, retraining, and micro-finance.[29]As a result, and while privatization was being implemented, the official unemployment rate has actually witnessed a gradual decline, from 8.8% in 1996/97 to 7.4% in 1999/2000.[30] In Tunisia and Morocco, governments have been sensitive to labor concerns and have sold their enterprises more or less with their labor force intact. In Jordan, the government postponed the labor problems by transferring employees from some overstaffed SOEs to others whose privatization was thought to be unlikely (primarily to the Jordanian Phosphate Mining Company). The strategy simply postponed the labor problem to another day, but it appears that this day has now come and the government has to face the challenge of SOE overstaffing.

[27] Kikeri,1998, p.vii. This is also supported by Estache et al (2000b).
[28] Ibid, p.viii; UNCTAD (1995); De Luca,(1997).
[29] Assaad (2001), The World Bank (1996), Egyptian Social Fund for Development (2000)
[30] Ministry of Economy and Foreign Trade, Monthly Economic Digest, December 2000, quoted in PCSU Quarterly Review October-December 2000.

Table 2-7:
Labor Strategies in Egypt, Jordan, and Morocco

Strategies	Egypt	Jordan	Morocco
Informing and involving trade unions and workers	Egyptian Trade Union Federation close to governing party but no formal consultation process Establishment of **Employee Stock Ownership Plans** (ESOPs)		Creation of a tri-partite council of labor, business, and government (1996), and the "**Commission des Sages**", to promote social dialogue and understanding
Targeted assistance for reintegration into the labor market	Establishing the **Social Fund for Development** (1991) to retrain redundant workers, create new labor opportunities, and issue credit to citizens to facilitate small new projects	**National Training Plan** (1993) organizes workshops and seminars to train civil servants **Career and Training Paths Project** (1997) plans the development of human resources in the public sector through administrative training **Jordanian Institute of Public Administration** (1968) develops resources of public sector employees	**National Employment and Skill Promotion Agency** offers employment training programs and is responsible for devising a **National Employment Promotion Strategy**
Eliminating obstacles to private job creation	**SDF**	The **Development and Generating Fund** issues soft loans of up to JD10,000 to individuals and households to set up small scale projects	**National Employment and Competency Promotion Agency** provides training for self-employment projects
Creating a social safety net for affected employees	Offer of early retirement, with compensation of LE12,000- LE35,000	**Social Productivity Package** expands cash transfers and benefits of the **National Assistance Fund** Early retirement incentives, including offers of 2/3 the salary for the period till the actual retirement age	Obligation to pay worker at dismissal only

There is a growing literature that draws on the experience of other countries, evaluates various measures to deal with employment-related problems, and proposes strategies for governments to mitigate the negative impact of privatization. [31]To this must be added the many studies on labor retrenchment, whether privatization related or not, and the studies on public sector employment reform.[32]

[31] Kikeri (1996), Gates and Saghir (1995), Rama (2001), De Luca (1997), Gupta et al (2001)
[32] Diwan (1994), Rama (2001), Haltiwanger and Singh (2001), Dar and Tzannatos (1999)

Summary: Though the impact of privatization on labor is unclear, it has been observed that privatization can have a neutral or even positive effect on employment. As long as governments couple privatization with adequate labor policy and social safety nets, in addition to implementing ESOPs, privatization can, and will, have a positive effect on labor. International experience with privatization suggests that:

- Governments can and should devise appropriate labor strategies to mitigate the adverse impact of privatization on employment;
- Governments should engage employees and their representatives early on in the design labor strategies. The particular form of engagement will have to fit the political, social, and economic system of the country;
- Governments should communicate the government's labor strategy to employees and to the public at large;
- Time has value and delays in restructuring are costly;
- Governments should implement minimal company restructuring and let the private sector restructure consistently with existing policies and legislation;
- Governments are better than the private sector at handling large-scale redundancies. They can minimize labor resistance and set the parameters for subsequent restructuring;
- Governments should beware of setting unsustainable compensation precedents or social safety nets;
- Voluntary programs, such as early retirement schemes, and Employee Stock Ownership Plans (ESOPs) help overcome labor opposition to privatization;
- Governments should reform labor legislation to make labor markets flexible. This will soften the adverse consequences of privatization and spur faster job creation.

f. *Poverty*

The impact of privatization on the least advantaged groups in society and on poverty is of particular importance. The privatization of enterprises in competitive sectors is likely to affect poverty through its effect on employment and through the linkages between privatization and the overall macro-economic situation. On the other hand, privatization in its broader sense –i.e., the abolition of barriers to private sector provision of services or the infrastructure necessary for their delivery- is likely to have a direct impact on poverty[33]. The macroeconomic linkages between PPI and poverty are summarized in Table 2-8.

[33] For a good overview of the impact of energy privatization and liberalization on consumers, see McGowan (2000)

Table 2-8: Macroeconomic Linkages between PPI and Poverty

Macroeconomic effect	Expected negative impact	Ameliorating factors
Economic growth	May result in difficult transition as a result of tariff rebalancing and service mix changes (more or less standardization) which does not address the needs of the poor, in particular when there are no safety nets in place	Over the medium to longer run, increased private sector participation in infrastructure should contribute to growth which in turn tends to reduce poverty levels
Reduction in employment	Workforce often reduced soon after privatization Wages may also decrease for some of the workers during a transition period	Depends to what extent poor households were employed by public enterprises and on the nature of the compensation provided to workers laid off
Reallocation of public expenditure	Reduction in overall subsidy allocation during transition as a result of fiscal adjustment may reflect lower priorities for privatized utilities	Privatization revenue and better targeting may ease financing of the needs of the real poor

Source: Adapted by Estache et al. (2000), from Foster (1999)

PPI also affects the poor through micro-economic linkages, summarized in the table below:

Table 2-9: PPI and the Poor – Microeconomic Linkages

Side effects of privatization	Possible sources of increase in cost burden for the poor	Possible mitigating factors and welfare gains for the poor
The cost of increasing formality	Revenue collection and discouragement of informal connections are likely to be more effective and result in an increase in the effective price paid.	§ A formal connection, even at a cost, may be a true aspiration of vulnerable households. § Safety likely to increase with the formalization of connections. § Informal connection may have been more expensive. § Reform can bring technology choices at lower costs.
The cost of tariff level adjustments	Average tariff levels can increase, due to cost recovery requirements and need to finance quality related investments.	§ Increase in average tariffs depends on pre-reform price levels and the distribution of the benefits of private participation between stakeholders. § Reform can cut cost significantly enough through improvements in efficiency or new technologies.
The costs of tariff structure adjustments	Tariff structures likely to be reformed in ways that could increase the marginal tariff faced by a poor household.	§ Competition likely to decrease average tariffs and may also compensate for any tariff rebalancing that affects the poor.
The costs of increasing the price of substitutes	Privatization may restrict access to some alternative services, especially if connection to public network is mandatory.	§ Access to other types of alternative services will not be affected if foreseen in contracts. § Availability of communal services may increase as a result of privatization.
The costs of increasing the price of complements	The cost of obtaining a connection to public network is likely to increase substantially.	§ The cost of obtaining other complementary equipment is likely to be unaffected by privatization, but will remain high.
The costs of improved quality of service	Quality of service likely to improve, but this may make network services unaffordable for the poor.	§ There is considerable evidence showing that poor households are willing to pay reasonable amounts to improve quality of service.

Source: Adapted by Estache et al. (2000) from Foster (1999)

The impact may vary from one extreme to another. There are legitimate concerns that privatization brings with it the imperative of guaranteeing the financial viability of service providers or of elimination of cross-subsidies, and thereby increasing tariffs. Box 1 illustrates the Chilean experience in replacing cross-subsidies in the water sector. In addition, the favorable effect of expanding access to essential services at affordable rates to poor and underserved areas through market mechanisms and effective regulation, instead of through direct state provision, is observed.

Box 2-1:
Replacing Cross-Subsidies in the Water Sector – Chile's Approach

Chile recently replaced its cross-subsidy system with a comprehensive subsidy scheme for low-income households, aimed at assisting with the purchase of a variety of public services. Every two years the Ministry of Planning conducts a detailed national survey to determine household poverty. On the basis of that survey, the Ministry determines how many households require subsidies, as well as the monetary volume of subsidies required by the municipalities. The finance ministry reviews this assessment and requests the necessary budget provision from Congress. Implementation of the subsidy scheme is the direct responsibility of the municipalities.

In the case of water the subsidy covers 25-85 percent for the first 20 cubic meters of consumption. The municipalities pay it directly to the service provider, rather than the households, on the basis of services actually provided (that is, on the basis of bills actually sent to consumers). The goal of the scheme is to ensure that water and sanitation services do not consume more than 5 percent of household income. Households failing to pay their share of the bill have their subsidy suspended. Initially, the onus of proving entitlement to the subsidies was laid on households. However, low take-up rates prompted water companies to collaborate in identifying needy customers by examining tariff payment records. It is now believed that all eligible households in urban areas (about 18 percent of the population) are covered by the scheme.

In addition, the water company provides loans to poor families to help pay for water connections, which can cost between US$ 200 and US$ 800 (the cost of connection to the system is often the greatest hurdle to expanding consumer access to infrastructure services in poor neighborhoods). A typical loan would require a 15 percent down payment, with monthly payments over 5 years at commercial interest rates.

While the Chilean model has numerous advantages and is being followed by other countries, such as Hungary, it relies on strong local administrative capacity coupled with high government commitment. It might therefore not be easily transferable in countries where such assets are lacking.

Source: Rivera (1996)

Infrastructure privatization affects the provision and quality of services positively by providing a service that otherwise would not be provided. It also affects access to, and pricing of, these services. Both access and pricing have distributional effects that are particularly significant to low and lower-middle income groups. Market structure, the introduction and sustainability of competition, and the effectiveness of enforcing and implementing regulatory commitments determine the extent to which privatization will have positive distributional effects, in other words, whether privatization will be beneficial to the vast majority of citizens and households.

The impact of privatization on prices will depend on the pre-privatization tariff level and the pricing formula, on the selection criteria, the privatization method, and the market structure. If the selection of the winning bid is based on the lowest tariff structure proposed, service users in general and the poor in particular will receive a greater share of the benefits from privatization and tariffs are even likely to decrease after privatization (Table 2-10). On the other hand, if the selection is based on the highest concession or license fee, or even on the level of investment that is to be made, then users are likely to face higher tariffs.

Table 2-10: Examples of Financial Proposals

Infrastructure transaction	Structure of financial proposal
• Peru: Lima electricity distribution privatization	→Highest dollar value offered for assets
• Argentina: Buenos Aires water concession	→Maximum dollar discount to existing tariffs
• Philippines: power-generation BOTs	→Lowest price (cents per kilowatt-hour) for power supplied
• Chile: south access to Concepcion toll road	→Minimum toll and minimum one-time subsidy
• Turkey: Istanbul electricity distribution concession	→Minimum margin on distribution required by the operator
• Venezuela: cellular concession	→Highest concession fee paid to government

Source: Kerf et al. (1998)

Market structure is also extremely important in determining the impact of PPI on poverty. Liberalization and the opening of the market to competition benefits the poor by ensuring that prices are at their lowest level

In many developing countries, privatization involves the transition from an informal to a formal provision of services. The formalization of the service may bring with it an increase in expenditure. This increase, however, may be compensated by the improved security of access and the property right that formal provision brings with it.

Governments committed to benefiting the poor have to implement special policies at an early stage to ensure that privatization and the reforms that can accompany it are an opportunity to correct the exclusion of the poor. First, governments should generate sufficient information to make an informed judgment as to the true potential impact of reform on the poor: the groups affected and the nature of the impact. Based on this information, governments can then formulate effective and efficient privatization strategies and regulatory reforms that include tariff design, investment plan specifications, and supply obligations. For example, setting quality standards or investment requirements too high for PPI (in the licenses or the contracts) may be harmful in that costs will be increased and tariffs will have to be increased accordingly, which, in several cases, excludes the poorer groups from the service. To illustrate, the water and sanitation concession in the Argentinean Province of Tucuman in 1995 required a large investment program, pushing the concessionaire (consortium of Compagnie Generale des Eaux and a local investor) to increase tariffs by 68%. Low consumption users organized a non-payment campaign, causing a financial crisis for the concessionaire. Provincial elections brought a new administration to office, but contract renegotiations were unsuccessful and the case went to international arbitration.[34]

Another instrument that governments can use to ensure that PPI benefits the poor is to include in the regulatory framework supply obligations. Supply obligations prevent a drop in the consumption of essential services (water, electricity, etc.) resulting from the failure of the market to deliver the socially optimal level of consumption. Regulators can

[34] Estache et al. (2000a)

impose **Universal Service Obligations** (USOs) to ensure that the poor have access at affordable rates to the public service.

USOs give access to the service to all members of the community at sufficiently low or affordable tariffs, hence giving them the possibility of reaching a socially acceptable consumption level at low tariffs. USOs can be financed through one or more of the following:

- Consumers: through direct transfers or cross-subsidies;
- Companies: through disbursements or product cross-subsidies or by lengthening the duration of the concession;
- Special Funds to which private operators contribute in proportion to their market share or the exclusivity granted; or
- General tax revenues.

It is important, though, that the policymakers prevent instances of free- riding and misuse while implementing these obligations and that they use efficient delivery and funding mechanisms.

Table 2-11: USO Versus OS

Obligatory Service is needed when:
§ There are location differences that increase supply costs for some consumers
§ Some consumers present "accessibility" problems (Physical/motor disabilities)
§ The degree of availability of certain privately supplied services is lower than the socially desired level (public telephones, special numbers…)
Universal Service Obligations are needed when:
§ The product is essential
§ There are groups of consumers that cannot gain access to a product or service at current tariffs
§ The lack of supply or impossibility of gaining access limits consumers in other markets or activities (labor market)
§ The impossibility of gaining access also entails the exclusion of the consumers from technological progress and the evolution of modern sciences (communications)

Source: Chisari and Estache (n.d.)

Summary: Privatization and PPI can lead to a measurable improvement in overall welfare. Private provision of infrastructure services can be more affordable and provide greater access to the poor than public provision if governments design the privatization process to meet these objectives. Governments can include service obligations in the contract or devise subsidy schemes to give a greater share of the benefits to the poor.

Regulatory policy can promote distributional objectives, such as ensuring that the poor benefit from privatization, by:[35]

- Setting investment targets to ensure access and provision of the services to population groups and geographical areas that, heretofore, have been underserved;

[35] World Development Report (2002), pp.161-167.

- Ø Being flexible with respect to price-quality combinations to take into account low-income groups' willingness and ability to pay;
- Ø Allowing liberal entry of informal infrastructure service providers to areas where infrastructure networks are underdeveloped or nonexistent;
- Ø Consultations with the community, including municipalities, NGOs, and other stakeholders to address the needs of the poorest citizens; and,
- Ø Providing targeted and measurable (cost) subsidies through efficient funding and delivery mechanisms to make the services affordable to the poorer households.

3. Managing Privatization

Privatization is a complex and demanding process. The strategy and institutional set up for its implementation have to be designed to meet the circumstances and the challenges of each country. There is no "right" way of implementing privatization. Nonetheless, there are key elements that will tip the balance between success and failure.

a. *Political Commitment from the Top Political Leadership*

Privatization is an intensely political process and political momentum is needed to overcome three types of obstacles to a successful transaction: opposition, bureaucratic inertia, and lack of coordination. There will undoubtedly be opposition to privatization even if it promises large benefits to the economy. Opposition is likely to come from those groups who have vested interests in keeping the *status quo*, from those who are ideologically opposed to privatization, or, naturally, from the government's political opponents. Not all opposition will be overt and much of the opposition coming from groups with vested interests will be camouflaged in more noble terms. But there will be opposition from those who are genuinely concerned that privatization might be used as an avenue of illicit enrichment and corruption.

Political momentum is needed to overcome the inertia that afflicts the public sector. SOEs, and especially ministries that are slated for corporatization and privatization, are not equipped for such large-scale transformations. Their internal procedures cannot cope with the demands of privatization. Requests for information are not answered, technical data about the company or the sector is incomplete, accounts are not maintained according to international standards, etc. Public sector employees' opposition to privatization may further exacerbate bureaucratic inertia.

Political momentum is also needed to ensure that government agencies coordinate their actions towards privatization and do not work at cross-purposes. The nature of the political coordination will vary from one country to the next and will depend on constitutional and legal provisions. However, for privatization to succeed, there must be coordination. This is particularly true in the case of infrastructure, where the sector traditionally falls under the authority of a minister, and where coordination with the other ministries concerned with privatization is a key to success.

Summary: Governments can overcome the most important obstacles to privatization mainly by providing political commitment to the process. The more committed to privatization governments are, and appear to be, the easier it is to deter and overcome opposition and inertia, and to elicit coordination. This political commitment to privatization has to be maintained throughout the process, while avoiding the temptation of micro-management.

International experience also suggests that governments can facilitate a successful privatization process by:[36]

- Demonstrating support for privatization by having the highest executive authority in the country oversee the privatization process, coordinate various government departments, and negotiate with privatization opponents;
- Building a case for privatization and articulating it to the public and to all stakeholders. Governments are advised to resort to professionals in communications to fine tune their message and influence how privatization is being perceived;
- Mobilizing support for privatization from those who are most likely to benefit from it (consumer groups, business associations, etc.). Governments ought to remember that it is easier for those who are likely to lose from privatization to organize (since they are known) than for those who are likely to benefit (since they are more diffuse);
- Adopting a labor strategy that addresses labor's legitimate concerns. (Please refer to section on employment 2(e) above);
- Following a transparent and fair privatization process to eliminate the possibilities of corruption. (For more on that, please see section 3(b) below);
- Hiring qualified professionals to prepare privatization transactions and holding them accountable for their performance. It is extremely important that qualified individuals, working for the government and with no conflict of interest, oversee the work of outside advisors (lawyers, investment banks, etc.), deal with international donors on technical and financial assistance to privatization, liaise with the private and the public sectors, and provide expertise as needed for political authorities to base their decisions on;
- Hiring world-class technical expertise as needed: legal, financial, regulatory, and technical (telecommunications, electricity, etc.). Good advisors do cost money, but it always pays to get good advice.

b. *Transparency and Fairness of the Privatization Process*

It is extremely important for the success of a privatization program that transparency is maintained in every transaction. The public should know if the program is being carried out in a fair and honest manner. A lack of transparency can lead to a perception of unfair

[36] For more on that, please refer to Shafik (1996)

dealing – even where it does not exist – and to popular opposition that could threaten not only privatization, but also the government's credibility in general.

Transparency is required at four levels. First, the laws and regulations supporting the program should mandate publicity and openness in the implementation of the program. Second, the selection of advisors should be public, competitive, and according to pre-announced terms of reference and selection criteria. Third, individual transactions should be conducted using well-publicized competitive bidding procedures, clear and simple selection criteria for evaluating bids, and disclosure of purchase price and buyer, in order to encourage the widest possible range of domestic and foreign investors to participate. Competitive bidding helps maximize sales proceeds while maintaining public confidence in the integrity of the process. Fourth, the individuals, or the unit in charge of privatization, should be identified and held accountable, they should follow precise, detailed, and publicly announced processes and procedures for carrying out privatization transactions, and they should have well-defined institutional responsibilities to ensure adequate monitoring and supervision of the program.

Box 3-1: Transparent Privatization Procedures

All transactions will be conducted in an open and transparent manner consistent with normal standards of commercial discretion. Subject only to existing legal obligations, such as the preemptive rights of existing shareholders, no direct sale or negotiation with a single party shall occur, except after publicly solicited bids have been obtained. All divestitures must be done through competitive bidding or through the stock exchange. At the completion of the sale, all aspects of the transaction will be made available to the public. The privatization process will be as transparent as possible at all stages, including notification that assets are available for divestiture, disclosure of financial and operating information, receipt and review of offers and negotiation of specific transactions; Specifically, this means that:

(i) A prospectus or offering memorandum will be prepared and publicized for each firm/asset to be sold;
(ii) Fair and equitable competitive bidding procedures will be established and followed;
(iii) Criteria for ranking bids will be defined and publicized in advance;
(iv) Bidders will be treated equally, with public receipt and opening of all bids and rapid notification and public announcement of the winner;
(v) Upon completion of the sale, all aspects of the transaction will be made available to the public, including the name(s) of the purchaser(s), the price paid, and the terms and conditions of sale; and
(vi) The valuation of the assets and the details of all offers received will be placed in the public domain.

Extracted from *Government of Lebanon Policy and Procedures for Privatization and Private Participation in Infrastructure*, July 2000

The lack of transparency is often associated with corruption in privatization. Corruption can take many forms, but there are remedies that governments can adopt to minimize it in all of these forms (Table 3-1).

Table 3-1: Types of Corruption in Privatization and Policy Recommendations

Privatization Method	Associated Form of Corruption	Policy Recommendation
Small- Scale	§ Blackmail of potential bidders designed to prevent them from participating in an auction or increasing their bids § Extorting a non-participation fee by speculators who promise to refrain from bidding or not to increase their price § Organizing "Dutch Auctions" with intimidating threats to serious potential investors § Forging documentation confirming the lease of an auctioned operation to one of the bidders and hence using the pre-emptive right to purchase § Participation of foreign natural persons and legal entities through intermediaries	§ Increasing the pace of privatization and shortening the transition period § Securing a homogenous government with parliamentary oversight § Bringing cases of corruption and extortion to courts
Large-Scale (Voucher Scheme)	§ Management can profit at the expense of shareholders and the privatization fund	§ Transparent management of fund § Auctions
Standard Privatization Methods		
Public Auctions and Tenders	§ Not making public the sale offer § Vague bidding criteria § Leaking information about competing bids § Evaluation committee not competent or not independent	§ Publication of privatization-related information § Clear, unambiguous, fair, and publicly known evaluation rules and criteria § Public opinion pressure § Advisory referred to eminent international firms
Direct Sales	§ Lack of competitiveness § Lack of transparency	§ Simple tenders § Clear and publicly known rules and criteria § Ex-post compliance verification § Compliance verification allowed
Employee Stock Ownership Plans	§ Top management and top union bosses monopolizing on shares	§ Rules setting ceiling of allowed shares/shareholder

Source: Adapted from Miklos (1995)

Summary: Transparency has a price, in terms of the speed with which transactions can be implemented. Transparency requires that transactions be well-prepared, and carried out through competitive procedures. The price is worth paying so long as the insistence on transparency does not become an excuse for inaction or unjustified delays. On the other hand, a transparent privatization process will attract greater interest from local and international investors and will help increase revenues from sales proceeds. The time and

effort put into ensuring transparency, if put to good use, are an investment in privatization.

c. *A Favorable Legal Environment*

Privatization requires an enabling legal environment. Existing rules and regulations pertaining to private business can either improve or reduce the value investors are willing to pay for an SOE. Governments should be aware of the legal hurdles to a smooth privatization and amend the legal environment in order to defuse any legal "landmines" that may cause damage later on in the process (Table 3-2) [37].

Table 3-2: Key Legislation and Privatization

Legislation	Relevant Features
Accounting rules	• Standards applied for purposes of taxation and regulatory oversight • Accounting and auditing procedures (for example, is audit by a public agency mandatory?)
Bankruptcy law	• Conditions and procedures for liquidation, bankruptcy, and insolvency • Protection afforded to the project company's creditors
Contract law	• Conditions for the formation of contracts (for example, contractual capacity of key customers and suppliers)
Company law	• Provisions on the establishment of companies • Limits to ownership forms (for example, with or without limited liability, and joint stock companies) • Ability to "unbundled" control and voting rights from the rights to dividends and income • Provisions for minimum capital requirements on the conditions of sale or transfer of shares and on the protection of minority shareholders
Financial law	• Ability to get financing from local banks, pension funds, and other financing sources
Foreign exchange rules	• Conditions of money convertibility, repatriation of profits, and so on
Foreign Investment law	• Determining whether law discriminates between local and foreign ownership • Privatization and foreign investment legislation to be in harmony
Import/export law	• Right to import materials and liabilities for import duties • Submission to export controls
Intellectual property rights law	• Protection of patent, know-how, and business secrets • Ratification of international conventions
International law	• Ratification of international conventions, for example on trade and investment, which affect other areas of the law (such as expropriation and currency convertibility)
Public procurement law	• Conditions of publicity, access, and competition (for example, is there a preferential treatment for state-owned enterprises?)
Transfer of Liabilities	• Regulation of transfer of liabilities • Rights of creditors

[37] The most comprehensive and insightful discussion of the legal aspects of privatization can be found in Guislain (1997), Ch2

	• Impact on prior financial restructuring
Securities law	• Conditions for the issuance and trading of shares and operation of financial intermediaries • Existence of a securities exchange market and regulatory body • Creation, perfection, and enforcement of collateral interests (see section 6.1)
Tax law	• Application of corporate income tax, real estate tax, value-added tax (for example, regarding tax withholding treatment, standards applied to transfer pricing, depreciation norms, tax exemptions, double taxation) • Tax administration procedures.
Labor law	• Flexibility to hire and fire • Contractual obligations on employer • Contractual rights of employees • ESOPs
Civil service law	• Contractual rights of employees • Civil service benefits • Transfer of employees • Termination of employment
Social security law	• Pension or end-of-service entitlements • Transfer from public to private ownership • Voluntary retirement packages • ESOPs
Dispute settlement	• Possibility of arbitration • Competence and efficiency of local court system • Constitutional provisions on sovereign immunity

Source: Adapted from Kerf (1998); based on Guislain (1997). Text highlighted added.

The legislative reform agenda should be set judiciously, starting with priority issues, and moving on to the lesser priorities. The drafting of a privatization law is often an opportunity for the government to go through this legal exercise and pre-empt legal problems before they arise.

In cases where privatization concerns an infrastructure sector (telecommunications, electricity, etc.) that is already governed by existing legislation, that legislation needs to be revised to allow private sector participation and to put in place an effective regulatory framework.

Summary: Privatization requires a supporting legal environment. Governments should ensure that the commercial, financial, capital markets, and labor legislation, provide the proper environment for privatization. Furthermore, the elaboration of a competition law and policy prior to privatization will help avoid many problems down the road.

d. *A Clear Strategy for Privatization*

Governments that have succeeded in privatization have gone to great lengths to prepare for each transaction and work out the best strategy for privatization (Figure 3-1). Privatization requires significant policy decisions that are best taken on the basis of formal proposals, following consultations with all the stakeholders.

The first major step in this process is to define the objectives of privatization in general and of the specific transaction in particular. Is the objective to improve the performance of the SOE or the sector? Is it to have a more competitive infrastructure? Is it to maximize the proceeds from privatization in the short run? Is it to attract foreign and local investments? In setting program and transaction objectives, governments should examine the trade-offs involved between the various objectives and make informed decisions. They should balance the objective of maximizing privatization proceeds with other more important priorities such as improving the competitiveness of enterprises and the economy as a whole, promoting competition, and developing capital markets.

The second major step is to ask whether the company or the sector needs to be restructured. Often, restructuring involves a time-consuming process of transforming a government department into a company or dismantling a state monopoly. Restructuring could also involve reducing the labor force to make the company more efficient and the labor force more productive. It could also involve financial restructuring. Financial restructuring is needed to clean up the company's balance sheet, to reduce its liabilities in order to make it more attractive to investors.

The degree and scope of restructuring will vary from one company to the next. It is advisable for the government to undertake the minimum restructuring needed to bring the enterprise to the market in the shortest possible time. This includes implementing politically difficult measures such as opening the way for labor cuts by negotiating with labor unions and reducing the social cost of restructuring. But governments should steer clear of large-scale investments (such as those required for plant modernization, etc.), as there is little evidence that they can recover the cost of this restructuring.[38]

Most importantly, governments should not succumb to the "siren song" of endless tinkering with enterprise reform in pursuit of a higher sale price or until such time as the enterprise or sector is "picture-perfect" and ready for privatization. The alternative to privatization, SOE reform, is hardly less demanding and has fewer chances of success.[39] This is corroborated by many studies that have evaluated performance contracts in many countries, including a cross-country comparison (Ghana, Korea, Philippines, India, Mexico, and Senegal) and a study of 12,000 enterprises in China.[40] These studies demonstrate that there is no robust positive association between performance contracts and productivity and that performance contracts have not had a significant contribution to improving company performance. Governments in the region that have opted for performance contracts for SOEs instead of privatization ought to re-think their choices. It is a mistake "… to think of privatization as totally distinct from reform of enterprises under continued state ownership. Rather, the two demand similar, politically costly reforms and tend to succeed or fail together."[41]

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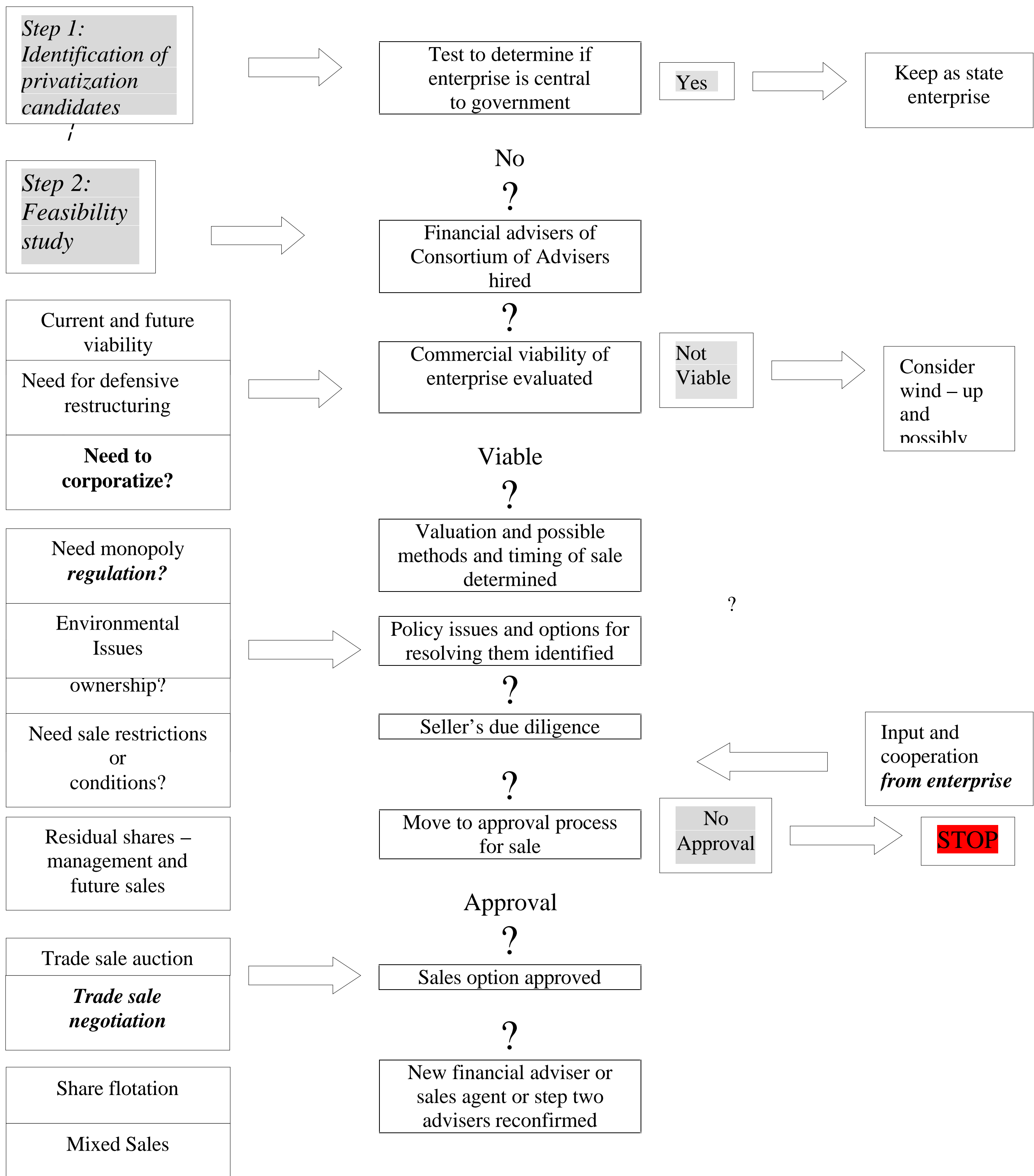
[38] Kikeri, Nellis, and Shirley (1992); See also Welch and Frémond (1998)
[39] Shirley (1998)
[40] Cited in Shirley (1998)
[41] Shirley, Mary, "Bureaucrats in Business: The Roles of Privatization versus Corporatization in State-Owned Enterprise Reform," p. 28 of unpublished draft. Quoted in Nellis (1999), p.22.

Figure 3-1: First Phase: Getting Ready



Source: Welch and Frémond (1998)

In light of the review of the candidates for privatization and after identifying the preparations needed for each transaction to go forward, governments should then define their overall privatization strategy. They should eschew detailed privatization masterplans. These quickly become outdated and impose unrealistic and artificial timetables. However, there will be a need for a strategy that addresses a number of issues:

- The candidates for privatization. Governments have followed various approaches to this question. Some have drawn up "positive" lists identifying the enterprises to be privatized, and in some cases have even attached these lists to legislation. Others have drawn "negative" lists, listing those enterprises or sectors that will not be covered by privatization. Each approach has its shortcomings. A better approach, which provides flexibility as well as predictability, would be to have annual or biennial programs, with identified privatization transactions;

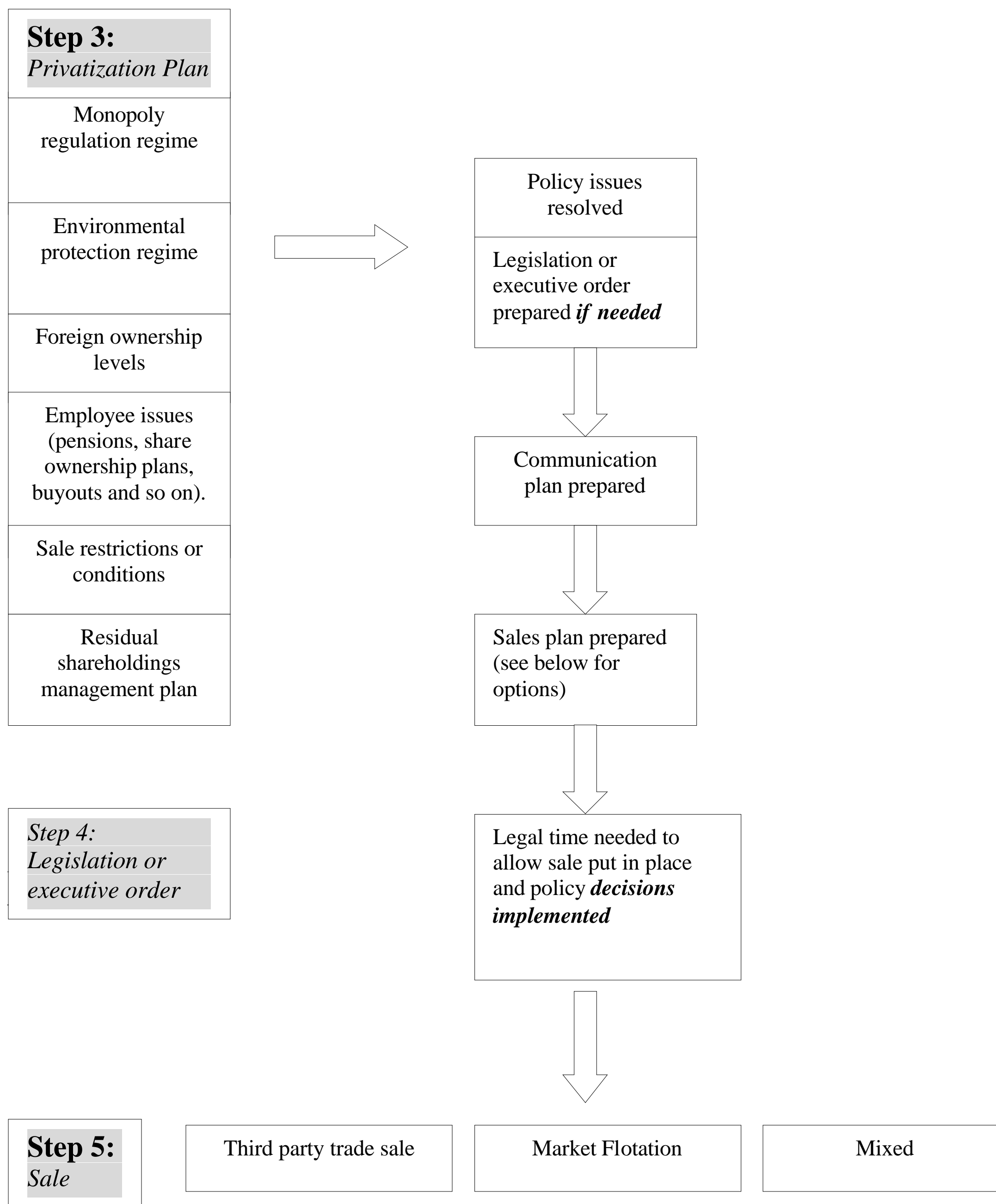
- The timeframe for each privatization. Each privatization requires preparations at the firm level (financial information, staff information, etc.), but also at the level of the economy and the regulatory framework. These preparations take time, but often, it is impossible to predict the time they will take (e.g., how long the legislature will take to approve a particular piece of legislation);

- The priorities for the overall program. Even when the political will exists, when there is no opposition, and when the enterprise is cooperating, the capacity of a government to manage a transaction in most developing countries is limited. To be effective, governments have to make choices and set priorities. Opinions differ on whether governments should start with an "easy" privatization –i.e., a simple transaction that requires very little in terms of collateral preparations- to go up the learning curve, or whether they should start with a "star" privatization –i.e., a profitable company whose privatization is likely to succeed- to develop support and momentum for privatization. Reality, however, may not give governments a choice on this matter. One of the most perceptive observers of privatization has noted that speed in privatization was the main consideration for many Eastern European reformers who wanted to lock in key reforms such as privatization before the return of communists to power.[42] In any case, priorities should be set after a careful assessment of both the importance of the transaction to the economy, and the feasibility of the transaction within the given timeframe.

Once the overall privatization strategy and the individual transaction strategies have been adopted, the government can then proceed to the next step (Figure 3-2).

[42] Nellis (2000), p.11.

Figure 3-2:Second Phase: Moving to sale



Source: Welch and Frémond (1998)

The next step requires that the government provides, *inter alia*, a vision and a roadmap on the future role of the state, the roles and responsibilities of the various participants (government departments as well as civil society and the private sector) in the privatization process, the policy for each infrastructure privatization (market structure, regulatory design, etc.), the use of proceeds, and social and labor concerns and how they will be addressed. Within this context, the government can then define the appropriate privatization method.

e. *Choosing the Appropriate Privatization Method*

There are many methods for privatization or PPI. There is no panacea or "one size fits all." The choice of the particular method of privatization or PPI has to be made in light of the sector or SOE characteristics, the government's policy objectives, and the state of the international market. The choice of method of privatization is particularly important in the case of infrastructure (Box 3).

Box 3-2: Principal Options for Private Sector Participation in Infrastructure

A. Management Contract

- Short-term (3-5 years) contract;
- Private company is responsible for Operations and Maintenance and has full managerial responsibility;
- Public sector bears losses;
- Investments are done by the public sector but could be managed by the management contractor on implementation fee;
- Private company could manage the investment program (procurement, supervision of preparation and implementation);
- Bills are collected by the private company;
- Tariffs and levels of service are decided by government and specified in the contract;
- Financial criteria for selection of the private company is based on management fee;
- Compensation is based on fixed fees (to cover cost of the management contractor) and, in performance-based management contracts, a performance bonus is added based on the results and/or achievement of specific service and performance targets/criteria defined in the management contract;
- Management contracts are lengthy and time consuming to develop and to enforce;
- Risks:
  - Little or no incentive to improve efficiency unless the performance-based reward is significant;
  - Contractor may run down the assets unless enforcement is effective;
  - Little or no incentive to train local counterparts adequately.

B. Lease Contract (Affermage)

- Medium-term (8-15 years) contract;
- Contractor is responsible for operations and management and for financing working capital and replacement of short-lived assets;
- Contractor bears full commercial risk of operations and maintenance and has thus incentives and often obligations to reduce costs and maintain long term value of the leased assets;
- Customers are clients of the private company, which usually collects the tariff revenue directly and returns an agreed portion to the state as a rental or license fee;
- Contractor profit is the difference between the gross revenues collected and the sum of operating costs and this fee;
- Investments are done by the public sector, which remains responsible for debt servicing;
- Tariffs are set by government and specified in the contract;
- Financial criteria for selection of the private company by percentage of net income and part of tariffs reserved to lease;
- Fees usually linked to performance and revenues
- Leasing requires fairly detailed preparation and staff reduction;
- Need to define service targets and what investments the government will finance;
- Risks:
  - Mismatch between investment policies and pricing
  - Mismatch between service targets and investment policies
  - Does not address the public sector's financing problem (high cost of capital, limited resources)

Box 3-2: Options for Private Sector Participation in Infrastructure (*Continued*)

C. Concession Contract

- Long-term (25-30 years) contract with a private company;
- Concessionaire is fully responsible for operation and maintenance of the system, including its commercial risk, and for the construction or rehabilitation of the system;
- Concessionaire finances the investment costs of the system, including replacement costs and the working capital required for its operation and maintenance;
- Selection of concessionaire is best if based on charging the lowest tariff to consumers while committing to meet service levels and performance targets and not on the highest concession fee, the highest net present value of future revenue streams, or the largest amount of new investments to be made;
- Concessionaire's compensation is based on tariffs, which are determined according to agreement set out in the concession contract. The tariff revenue should be sufficient to cover the operational expenses as well as debt services and depreciation on the concession's investment. Tariffs are usually reassessed every few years based on an updated investment plan and estimates of expenditures. An inflation index formula may be agreed upon in the contract;
- Concessionaire provides both expertise and capital;
- Concession contract and procurement require detailed preparation to create competition *for* the market (to substitute for the lack of competition *in* the market);
- Concessions require effective contract monitoring;
- Risks:
  - Badly designed contracts create problems between private firms and the state;
  - Cream skimming, i.e., providing coverage only where it is profitable. Strict service targets help mitigate this risk;
  - Exclusivity may not be commensurate with universal service obligations.

D. Divestiture

- Infrastructure owned by an incorporated entity (corporation);
- Corporation operates the infrastructure under a license of limited duration (15-20 years for telecommunications; more for other types of infrastructure);
- All or part of this entity is sold to private interests;
- Divestiture transfers ownership of assets to the private sector;
- Investments and working capital are financed by the corporation, which in turn may access capital markets;
- Requires a sophisticated, effective, and independent regulatory structure;
- Requires elaborate formulae for setting tariffs in non-competitive sectors;
- Divestiture envisages periodic renegotiation with the regulator.
- Risks:
  - Diminished competition unless alternative infrastructure is made available;
  - Regulatory capture if regulator is weak.

Infrastructure privatization differs from the privatization of other commercial enterprises in many ways. First, infrastructure services have strong "externalities," i.e., the socially optimal level of consumption of these services is usually greater than what market forces, if left unregulated, will deliver. Second, infrastructure is often used to deliver "public services" i.e., services that are considered essential and to which access, according to Western liberal thinking, should be provided *universally* and *at affordable rates*. Second, infrastructure networks have the defining characteristic of a "natural monopoly," i.e., they have declining marginal costs of production. In other words, monopolies are bound to emerge, as only one network can be profitable; though up until recently, governments have sought to protect this monopoly status by fiat (*de jure* monopoly status). Finally, infrastructure sectors, such as telecommunications, electricity, transport, and others, are

"capital intensive," i.e., the sunk cost is relatively large and the period for investment recovery is relatively long. Investors in these sectors are much more susceptible to political risks (appropriation, arbitrary price controls, etc.), which will be reflected in a higher cost of capital. The method of privatization, therefore, has to carefully balance the concerns of investors and consumers, so as to optimize the benefits of privatization.

The choice among PPI options imposes a different distribution of responsibilities between the private and the public sectors. (Table 3-3) Irrespective of the option for PPI, the state will be responsible for regulation or contract monitoring (although it is possible to subcontract this activity).

Table 3-3: PPI Options and Allocation of Key Responsibilities

Option	Asset ownership	Operations and Maintenance	Capital Investment	Commercial risk	Duration (*years*)
Service Contract	Public	Public and private	Public	Public	1-2
Management Contract	Public	Private	Public	Public	3-5
Lease	Public	Private	Public	Shared	8-15
Concession	Public	Private	Private	Private	25-30
SOT/BOO	Private and capital	Private	Private	Private	20-30
Divestiture	Private or private and capital	Private	Private	Private	Indefinite (may be Limited by license)

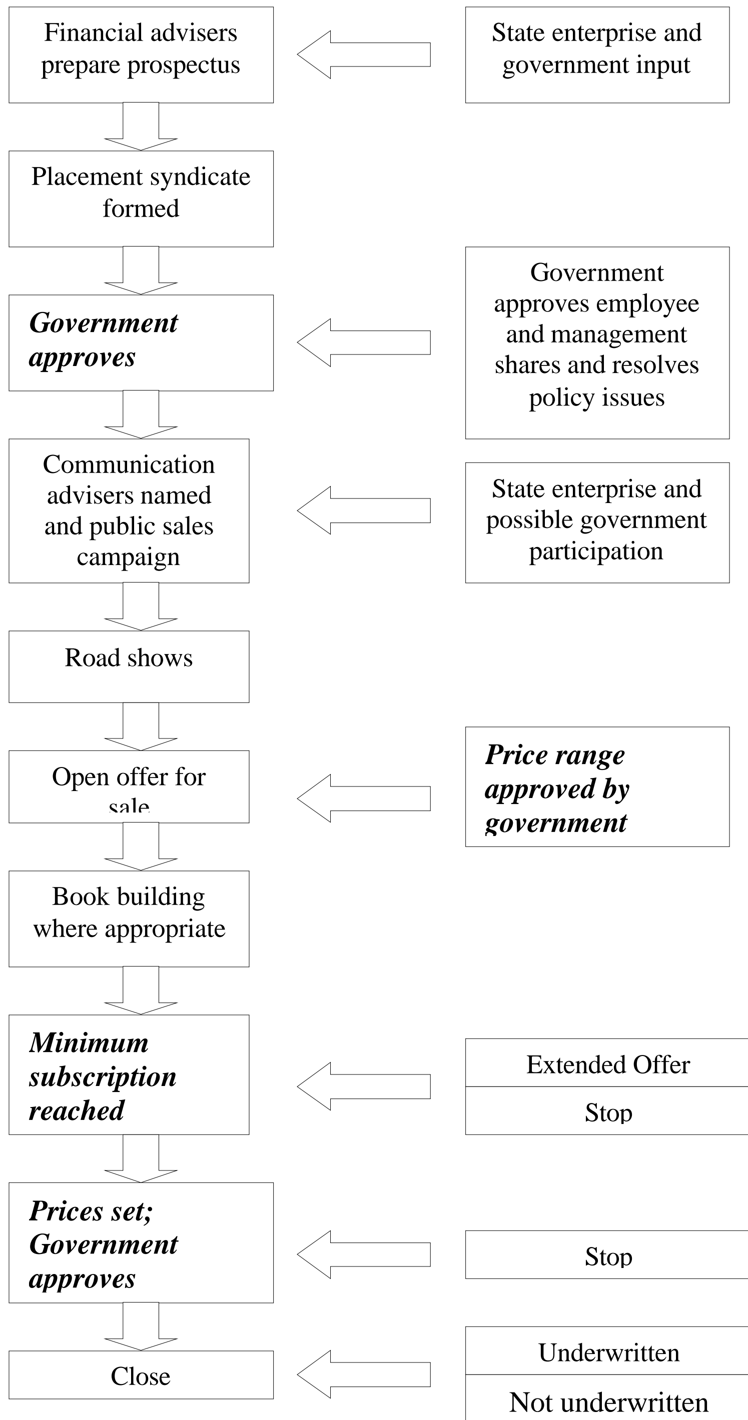
Source: Gray (1994)

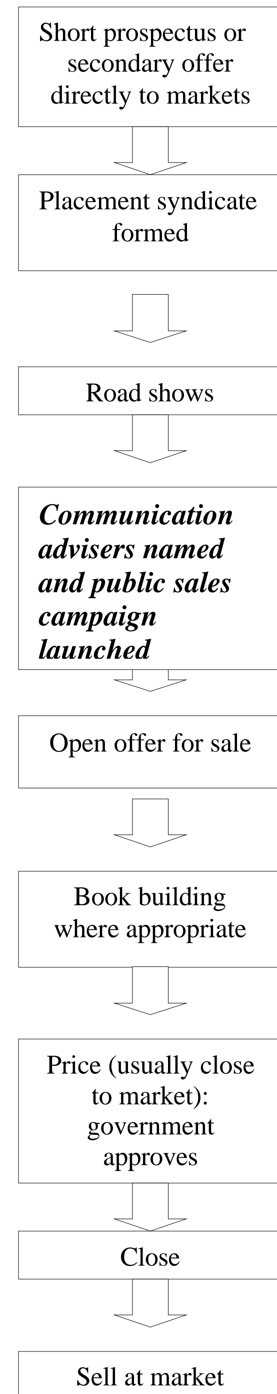
Summary: The choice of method and strategy of privatization is a very important determinant of the success of the transaction. The method has to be selected and the strategy designed to fit the particulars of the enterprise or sector being privatized.

f. *A Professionally Managed Transaction*

Once the government has selected a method, privatization moves into its final stage: the transaction. The process will vary depending on the method (Figures 3-3 and 3-4 below). In essence, there are two different processes depending on whether the privatization method selected involves going to the financial market (Initial Public Offering, or IPO, for the initial listing on the equity markets) or to a more restricted market where bidders are pre-selected according to technical criteria (companies with vast experience in the sector, financial indicators, etc.). Each process requires careful preparations and extensive – and costly – advisory work. It is best that, at this stage, political authorities maintain a supervisory stance and refrain from micro-management. The process has traditionally been more transparent and professional, and its chances of success have increased, when political authorities limited their role to strategic and policy issues. At every stage of the process, it is advisable to have in-house, dedicated experts overseeing the work of the outside advisors (investment banks, auditors, etc.).

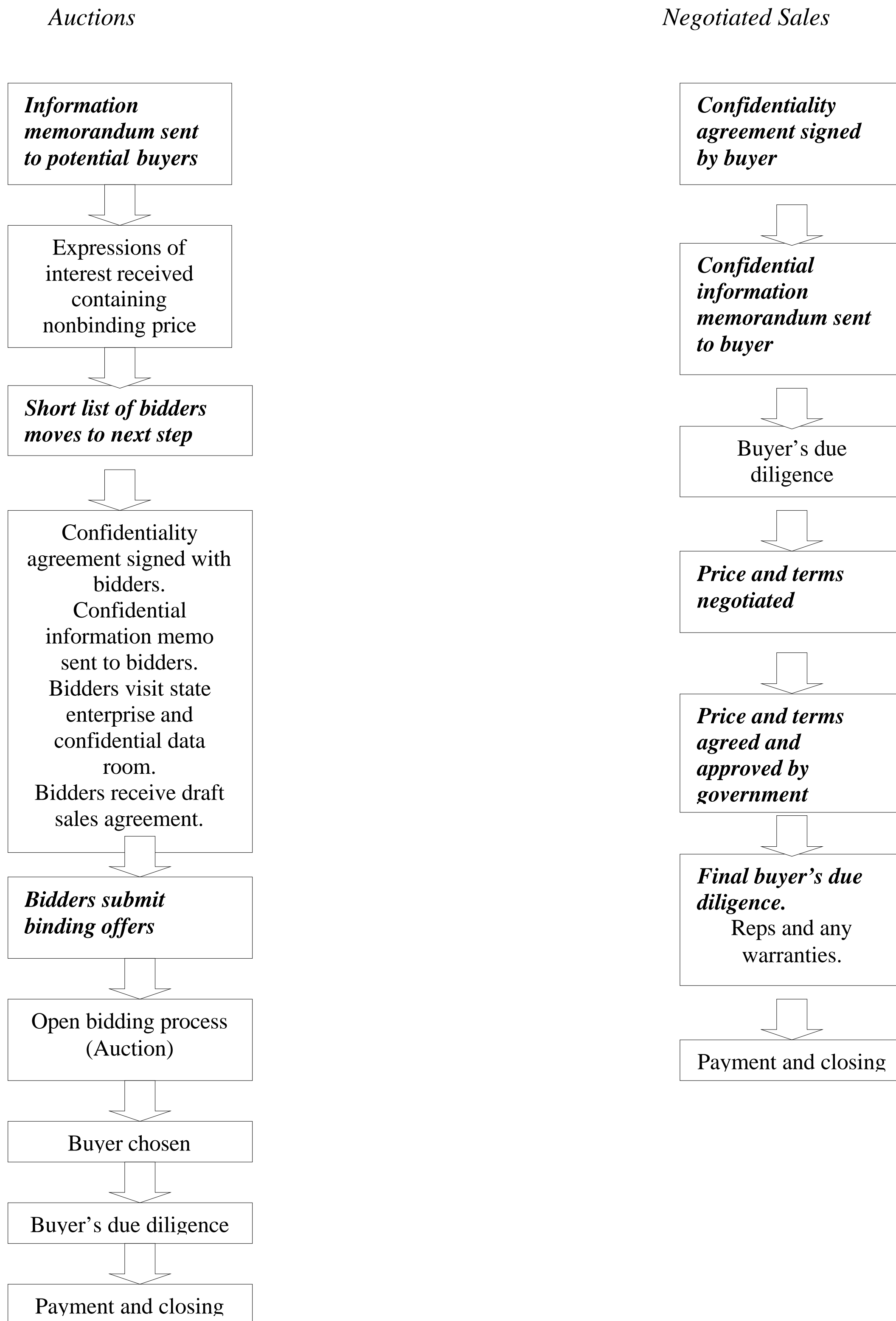
Figure 3-3: Market Flotations





Source: Welch and Frémond (1998)

Figure 3-4: Trade (or third party) Sales



Source: Welch and Frémond (1998)

Each process has its own requirements. IPOs have best performed when competent financial market regulatory authorities have existed, when markets were liquid, when corporate governance was favorable (transparency in accounts, rights of minority shareholders well-defined and protected, etc.) and when the listed company had good management. Where any one of these requirements was not present, IPOs have under-performed, company performance did not improve, and, in some cases, insider trading was involved. In such cases, a trade sale of a block of shares (25% or more) to a "strategic" (or core) investor – i.e., the investor was handed management control – have worked much better. Strategic investors were given both the incentives and the means to bring in good management and to turn the company around. Privatizations that have followed this process have seen share values increase within 18-24 months, corporate governance has improved, and the company was readied for an IPO.

For an auction (whether for the sale of a block of shares or the award of a license) to succeed in finding the most appropriate strategic partners, governments, with the help of their financial and legal advisors, have to define the pre-selection criteria, i.e., the criteria that will qualify interested investors to qualify for the auction. The criteria should be reasonable and announced prior to the pre-qualification.

Table 3-4: Prequalification Criteria for Privatization of Telecommunications Companies

Criterion	*Argentina (ENTEL)*	*Hungary (ETEV)*	*Peru (Entelperu and CPT)*	*Uruguay (ANTEL)*	*Venezuela (CANTV)*
Number of lines[43]		= 1 million	= 2 million[b]	= 2 million	> 6 million
Share of local digital exchanges					
Share of successful international calls			> 95%	> 95%[c]	> 65%
Waiting time for connection			= 85% within 30 days	= 90% within 30 days	< 1 month
Average repair time			= 75% within 24 hours	= 80% within 24 hours and 95% within 48 hours	< 16 hours
Contribution to capital by foreign operator	= 4.9%		= 51% of voting rights in consortium		
Assets of consortium partners	= 1 billion USD; 300 million USD for domestic partners				
Credit rating for long-term debt			= A+ (Moody's) or BBB+ (SandP)	= A+ (Moody's)	
Annual gross revenue		= 1 billion USD[d]	> 2 billion USD[b]	= 3 billion USD[d]	> 5 billion USD

Source: Guislain (1997), p.254

The auction process involves an exchange of information between the government and the market (investors and operators) (Box 3). The smoother and more complete this information exchange, the more likely that the auction process will deliver the required technical expertise and financial wherewithal to meet the expectations of the transaction.

[43] Installed or in service (or number of subscribers)
[b] Candidates had to meet either number-of-lines criterion or annual gross revenue criterion
[c] Including domestic long-distance calls
[d] Annual gross revenues from telecommunications services

Box 3-3:Information Flows for the Award of Concessions

Information Flows from the Government to the Bidders

- The process and the success criteria
- The duration of the contract or license
- The scope of the contract – operational or investment
- The regulatory framework that will apply
- The targets for the outputs (including quality)

***The output targets will vary across industries and over time but are likely to cover*:**

- § Coverage of the network;
- § Requirements to offer continuous service;
- § Improvements to the network;
- § Quality standards (for electricity: frequency of interruptions, etc.; for water: drinking water quality);
- § Environmental standards;
- § Safety standards;
- § Service quality standards; and
- § Penalties for non-performance

The license or contract should specify the time frame over which the targets are to be met, with penalties for non-compliance in particular cases. In setting the targets, the regulator must decide the appropriate mechanism of regulation as well as the appropriate level of the target.

Information Flows from the Bidders to the Government

- Volume forecasts by customer type
- Number of customer connections by customer type
- The cost of connection
- Disaggregated operating cost information
- Disaggregated investment information
- Key financial ratios
- Sensitivity analysis

The cost information should be as disaggregated as possible and should include:

- § Accounting for current costs
- § Classification of infrastructure expenditure
- § Contents of regulatory accounts
- § Analysis of operating costs and assets
- § Transfer pricing, between businesses

Adapted from Estache and Martimort (n.d.)

g. Liberalization and competition before privatization

Economists concur that the benefits from privatization are maximized when an enterprise is privatized in a competitive environment. This is even truer of infrastructure privatization. For all the reasons mentioned above, PPI requires that governments address the issues of market structure to realize the benefits from privatization. It is best that "such structural reforms should be evaluated and decided *before* any final decisions are taken on the ownership question: it is easier to change the framework of competition

Table 3-5: Unbundling Sectors into Their Component Activities

	Competitive components	**Monopolistic components**
Physical Infrastructure	§ Power stations § Wireless and long-distance networks § Warehouse, terminals	§ Power transmission and distribution § Water transport and distribution § Roads, rail track § Port quays and channels § Airport runways
Service	§ Telecommunications services § Passenger and freight transportation (all modes) § Stevedoring, handling § Equipment supply	§ Port or river dredging § Traffic safety (all modes)
Market options	§ Normally private § Competition in the market § No special regulation	§ Choice between private and public § Competition for the market § Detailed regulation

Source: Guislain (1997), p.214

and regulation before privatization."[44]

Introducing competition in infrastructure services often requires the vertical or horizontal unbundling of a sector. Horizontal unbundling separates the sector into competing entities in the same market segment (e.g., the break-up of AT&T into regional "Baby Bells"). Vertical unbundling separates the sector into various components, each at a different stage of the value chain (e.g., the separation of electricity production, transmission, and distribution). Unbundling is a lengthy process, but it has proven to be worth the time and effort that goes into it.[45]

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[44] Yarrow (1986), p.367.
[45] For more details, see Klein and Gray (1997)

h. *Establish Regulatory Framework*

The most difficult component of a successful privatization is to establish an effective regulatory framework.[46] To be effective, a regulatory framework has to provide for stable and clear "rules of the game," credible enforcement of these rules, and reasonable rules, i.e., rules that balance the interests of the private firm and those of the citizen/user. To ensure a fair and level playing field, the regulatory authority should be at equal distance from all the operators in the sector, including state-owned operators. The regulator also needs to have a clear mandate to issue and enforce regulations. In addition to a well-designed regulatory framework, effective regulation also requires "regulatory capacity." Regulatory capacity has to be found both "in-house," within the regulatory authority's permanent staff, or outside the regulatory authority, in which case it can be contracted. In either case, the development of a regulatory capacity requires financial resources that are predictable and sustainable.

The mission of a regulator is to ensure that the market that it is entrusted to regulate functions smoothly. The most important task of a regulator is to promote competition and to defend it. To that end, it should have the power to license new entrants to the market, to block and reverse anti-competitive practices and to sanction abuse of market power by an operator with significant market power. Utility regulators also have the responsibility of protecting consumers, of ensuring obligatory (and uninterrupted) service, of promoting universal service obligations (USO) (see Section on Poverty above), of managing scarce resources (radio spectrum, numbering plan, rights-of-way, infrastructure-sharing, infrastructure access, etc.) in an objective, transparent, and non-discriminatory fashion, and of avoiding conflicts and resolving them when they arise without having to go through lengthy legal procedures.

Governments can help establish effective regulatory institutions in a number of ways. First, they can adopt sector strategies and enabling legislation that transfer regulatory authority unequivocally to the regulatory authority. Second, they can embed their regulatory commitments in international agreements (e.g., the WTO's Fourth Protocol for telecommunications). Third, they can adopt sound regulatory practices consistent with international norms. Fourth, governments can design independent and financially autonomous regulatory institutions that are not subject to arbitrary political intervention. The regulatory authority should be able to finance its activities from fees and levies collected from operators. These measures will lower the regulatory risk associated with the sector to be privatized. This will lower the cost of capital of private investors, and, in the right regulatory framework, could be translated into lower tariffs to consumers.

Establishing effective regulatory authorities requires time and resources. It requires some foresight from governments to begin training the regulatory authority's staff early enough in the process. It also requires making some choices about the prerogatives of the regulatory authority, its organizational structure, and its financing.

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[46] See Aubert and Laffont (2000)

Historically, governments have been reluctant to cede regulatory responsibilities to an autonomous or independent authority. But experience has shown that independent regulators are more credible and more effective than regulators who depend on political whims. One of the first issues that governments face is whether to have a commission or an individual in charge of the regulatory authority (Table 3-4).

Table 3-6: Individual Regulators Versus a commission

Criteria	*Individual*	*Commission*
Speed of decision making	+	-
Accountability for decisions	+	-
Vulnerability to individual preoccupations	-	+
Vulnerability to improper influences by industry	-	+
Potential to stagger the terms of commission members in order to weaken links with particular government	-	+
Potential to reflect multiple perspectives	-	+

Source: Kerf (1998)

Arab countries that have established independent regulatory authorities (Jordan and Morocco) have opted from the commission model.

Another decision that governments have to make concerns the scope of the regulatory authority. Some countries have opted for the single-industry regulator, establishing a separate regulator for telecommunications, one for electricity, etc. A small number of countries has opted for a single, multi-sector regulator, establishing one utility regulator for telecommunications, electricity, etc. A third option is to establish sector regulators, such as a communications regulator for telecommunications, post, and broadcasting, an energy regulator for electricity and gas, and a regulator for transport. The choice between these various options has to be based on an appreciation of what is likely to work best and of what resources (human and financial) can be applied to regulation. Although much more research is needed on this question, the third option -the sector regulator- seems to best fit the needs and conditions of many Arab States.

In designing the regulatory framework, governments should beware of the risk of over-regulation. Regulation has to be just right to deliver a smooth, functioning market. Over-regulation will impose additional costs on the economy that will eventually be passed on to the consumer.

The role of utility regulators is to obtain accurate financial information from the bidders for a concession or a license and to evaluate their financial soundness both before the award and throughout the course of the concession or license. The cost information provided by the bidders or operators, together with the turnover information, should be unified in a financial model to provide forecasts of:

- The debt profile, both short-term and long-term
- Liquidity
- Dividend policy
- Target minimum rate of return

- Equity rate of return
- Interest cover
- Debt-equity ratio

Once the concession or the license have been awarded and the operator started delivering the service, regulators will continue to require this information. They will use it to compare outcomes to expectations (as presented in the bidding documents); to evaluate the cost of adverse shocks that may warrant a relaxation of the regulatory regime, preferably before the shocks arise; to evaluate whether lower costs than expected is due to better performance or the diminution of the outputs; and to properly evaluate the asset base and charge for the consumption of capital.

4. In Lieu of a Conclusion

If there are any conclusions that sum up the relevance of other countries' experience in privatization to Arab countries, they are the following:

- A well-designed and professionally executed privatization program can **work**: it can deliver improved company or sector performance, help with fiscal adjustment, attract foreign investments, and help develop capital markets;
- Governments can use privatization to increase people's choices and improve their standard of living. Private participation in infrastructure, especially if combined with liberalization and the introduction of competition, has improved the coverage of infrastructure services, their quality, and often even their cost. Privatization offers an opportunity to establish a genuine partnership between the public and the private sectors for the purpose of improving social conditions while creating the conditions for sustainable growth and development;
- Governments can mitigate the adverse consequences of labor cuts that may be necessary for privatization. They can also help provide, through labor legislation, social security reform, and other measures, an environment more conducive to job creation. The net effect of privatization, in the medium term, may very well be a net increase in employment;
- The privatization program can be tailored to fit the specific requirements of the country and the government's policy objectives. In Arab States, the real issue is not "gradualism" versus "mass privatization;" it is effective versus ineffective privatization;
- Privatization is not a panacea. However, it can be the engine that pulls other important reforms, whether financial or administrative.

This review has also identified a glaring gap in the knowledge and understanding of privatization in Arab countries. While some countries (e.g., Egypt, Jordan) have made important strides towards documenting their privatization program, there is, in the open literature, very little research that draws on this documentation. There is no

evaluation of the impact of privatization on company or sector performance in Egypt, Jordan, or Morocco. There is no analysis of the role of privatization in mobilizing new investments, including foreign investments. There is no assessment of the effectiveness of autonomous utility regulators in Arab countries. Finally, there is no ongoing effort to exchange information and expertise concerning privatization or infrastructure regulation between Arab countries. These and many others are topics for further research, which could yield important and policy-relevant recommendations.

Appendix 1 – Jordan

Legal Framework

Political	
Public Law	Constitutional
System	Constitutional monarchy Elected Parliament (House of Representatives) Appointed Senate Government appointed by the King and answerable to both the King and the legislature
Judicial	Pattern of Courts
Economic	
Property Rights	Secured by Constitution and law
General Legislation	1997 Securities Law n25: establishes the Capital Market Authority and regulates the stock market 1995 Investment Promotion Law n16: encourages foreign direct investment
Sector Legislation	1995 Telecommunications Law n13 1999 Electricity Law
Privatization Enabling Legislation	2000 Privatization Law n25: sets out provisions to regulate the privatization process, provides the ground rules for its transparency, and establishes the necessary institutions Companies Law: defines the types of registered companies and their establishment procedures

The Institutional Framework[47]

Institution & Membership Structure	Responsibilities
Privatization Council Chaired by the Prime Minister, with the membership of: § Minister of Finance § Minister of Industry/Trade § Minister of Planning § Minister of Justice § The "concerned" minister § Governor of the Central Bank § 4 Cabinet appointed experts	§ Laying down general privatization policies § Specifying the companies in which the Government holds shares, hence the public institutions or enterprises to be privatized, or restructured prior to privatization, hence implementing the appropriate methods § Approving sale, lease, and transfer decisions § Selecting qualified consultants § Facilitating the establishment of an independent regulatory commission § Monitoring and supervising the implementation of the Privatization Law and further issued regulations
Executive Privatization Commission Staff is 15 professionals with a broad range of skills	§ Carrying out studies on restructuring and privatization transactions and making recommendations to the Privatization Council § Following up the execution of restructuring and privatization transactions after obtaining the consent of the Council of Ministers and the resolutions of the privatization council § Other responsibilities related to restructuring and privatization assigned by the Privatization Council or the Council of Ministers
Steering Committees Set up for each entity to be privatized, headed by the "concerned" minister, with representatives from: § EPC § Company/enterprise to be privatized § Any necessary advisors	§ Monitoring and handling day-to-day supervision of the preparation and implementation phases of each privatization § Advising the Privatization Council regarding privatization decisions
Technical Committees Members mostly appointed by the Steering Committee, with representatives from, among others: § EPC § Concerned Ministry	§ Advising the Steering Committee about technical aspects of privatization strategy and valuation processes § Recommending potential advisor short lists
Special Tendering Committees Members appointed by the Cabinet, with representatives from, among others: § EPC § Concerned Ministry	§ Designing and supervising all bidding activities according to governmental tendering regulations § Evaluating bids from advisers and potential buyers

[47] Amended from Wagner (2001)

Privatization Implementation Procedure

The privatization methods implemented or considered in Jordan are:

- Sale of shares to a “core” or “strategic” investor
- Sale of shares to private owners, financial investors, or the public
- Long-term management contracts or leases
- Build-Operate-Transfer (BOT) type contracts

Generally, the privatization process in Jordan can be divided into four phases:

§ Approval:
The Privatization Council approves privatization candidates based on the recommendations of the EPC and the **Steering Committee** for each candidate company. The final approval is granted by the Council of Ministers.

§ Evaluation and analysis:
In cases of sale to a strategic investor, the **Technical Committee** and the Steering Committee of the company in question, and the Privatization Council, based on the recommendations of independent consultants, perform the evaluation and analysis. In other sale instances, the sale price is set according to the current market price for companies listed on the ASE, or is not set but rather determined by the best and most qualified bid.

§ Restructuring if necessary

§ Applying one of the aforementioned privatization methods

Privatization Projects Underway

§ **Royal Jordanian Training Center**: Council of Ministers approved Flight Safety Boeing Training International’s bid

§ **Royal Jordanian Air Academy**: Agreement signed between JORDINVEST and EPC to restructure the academy and study the best privatization option

§ **Petra Drilling Company**: The bids of five pre-qualified firms have been submitted

§ **Jordan Phosphate Mining Company** (JPMC): The preliminary selection process yielded five pre-qualified firms that will be contacted soon to resume the bidding procedure

§ **Assamra Water Treatment Plan**: The project’s technical committee is currently evaluating two bids for granting the final award

§ **Customs Department Warehouses**: The transaction is currently being concluded

§ **Electricity Sector:** The consultants to advise on the privatization have been selected following an international tender. The negotiations over the power generation concession are being finalized.

§ **Postal Sector:** A law transforming postal services into a shareholding company owned by the government has been endorsed

Major Privatization Achievements[48]

r	Enterprise	Sector	Privatization Procedure	Proceeds (USD million)	Buyer/Tenant/ Operator
2001	**Royal Jordanian Catering Ltd**	*Tourism*	§ 80% sold to strategic investor	§ 20.02 Annual payment of 8% of annual sales to Free Zones Corporation Annual investment allowance to the Civil Aviation Authority	§ Alpha Flight Services (UK)
2000	**Jordan Telecommunications Company (JTC)**	*Telecommunications*	§ 40% of shares sold to a strategic investor § 1% to the Provident Fund of the JTC & 8 % to the Social Security Corporation	§ 508 § 114	§ Consortium: France Telecom/Arab Bank § PF and SSC
2000	**Aqaba Railway Corporation (ARC)**	*Transport*	§ 25-year lease, investment and operating agreement, 40 km of extensions, estimated cost of 140 million USD	-	§ Consortium: Raytheon/ § Wisconsin Central (US)
2000	**Royal Jordanian Duty Free Shops**	*Tourism*	§ Anchor Investor (12-yr period of exclusivity)	§ 60.1 § Annual: .5 & 8% of gross sales	§ Aldeasa (Spain)
1999	**Water Authority of Jordan**	*Water*	§ 4-year performance-based management contract	§ Annual fee: 2.2	§ LEMA (joint venture of Suez Lyonnaise des Eaux and Montgomery Watson Arabtech Jardaneh)
1999	**Ma'in Spa Complex**	*Tourism*	§ 30-year lease and investment agreement	-	§ Accor (France) & Aramex (Jordan)
1998	**Public Transport Corporation (PTC)**	*Transport*	§ 10-year Management Contract (3 of 4 routes)	§ Annual fee: .5 (in total)	§ 3 Local Transport Companies
1998	**Jordan Cement Factories (JCF)**	*Cement*	§ 33% of shares sold to strategic investor § 14.5% floating on stock market 1999-2001	§ 102	§ Lafarge of France
1997	**Arab Potash Co. Ltd**	*Chemicals*	§ Minority IPO (3% of shares sold)	§ 32.7	§ Various investors
1996	**Jordan Holiday Company**	*Tourism*	§ Minority IPO (33.7% of shares sold)	§ 11.3	-
1995	**Jordan Hotels and Tourism Company**	*Hotel*	§ Anchor Investor	§ 14.7	§ Zara Investment Company (local)

[48] Source: Amman Stock Exchange, Embassy of Jordan in Washington DC (Jordan Commercial Center) & World Bank, 2000, EPC (2001)

Appendix 2 – Egypt

The Legal Framework for Privatization

Political	
Public Law	Constitutional
System	Republic Political Pluralism Elected Parliament (People Council) The Senate Government
Judicial	Pattern of Courts
Economic	
Property Rights	Secured by Constitution and law
General Legislation	1992 Capital Market Law n95: rehabilitates and reorganizes the Egyptian capital markets 1997 Law n3: encourages private sector participation in large projects 1997 Investment Law n8: provides guarantees and allowances to facilitate investment
Privatization Enabling Legislation	No specific privatization legislation; 1991 Public Sector Law n203: establishes holding and affiliated companies 1981 Company Law n159: basic corporate law 1991 Law n1471: establishes the technical office of the Minister of Public Enterprise

The Institutional Framework

The Egyptian government founded, in 1991, a ministry to specifically serve the privatization procedure, the **Ministry of Public Enterprise** (MPE). MPE is the entity responsible for establishing a database of the holding companies, and determining the strategies for the sale of the public enterprises listed. MPE is assisted by the **Public Enterprise Office** (PEO).

The overall policymaking for privatization and the supervision of all organizations working in the area is the task of the **Ministerial Committee on Privatization,** established in 1996. This committee is headed by the prime minister, and thus is *highly politicized*. The committee consists of members of 17 ministries, the Chairman of the **General Investment Authority**, the governor of the Central Bank, the Chairman of the **Capital Market Authority** (CMA), and a consultant at the MPE. Another committee is the **Quatro Committee,** founded to handle IPO privatizations, and comprised of the PEO, CMA, Central Auditing

Agency (CAA)[49], and Cairo Stock Exchange (CSE). Finally, the **Share Pricing Committee** consists of the CMA and CSE and is the sole authority for the revision and approval of share prices offered in IPOs.

Privatization Implementation Procedure

Egypt has followed a gradualist approach to privatization. The **Ministry of Public Enterprise**, through the **Public Enterprise Office**, has laid out a set of general procedures and guidelines for the government's privatization program, in addition to outlining the restructuring and reward system. A detailed privatization program, organized by company and execution duration, is prepared for every year.

Each public enterprise company is classified according to its performance, in order to determine the companies to be privatized, and the corresponding method of sale. Companies are classified in three categories:

§ Profitable companies: easily privatized

§ Companies facing manageable financial and technical problems that require financial assistance and restructuring prior to privatization

§ Companies facing extreme difficulties that are not "privatizable."

Privatizations are performed partially (up to 40% of shares sold via the stock market to ensure transparency), or wholly. Prior to the sale, an evaluation committee, established from the holding company, and a private consultancy office, perform an asset and share valuation. The valuation is submitted to the company board of directors for approval and is reviewed by a governmental accounting agency. Representatives from the **Capital Market Authority** (CMA), stock markets, and the **Public Enterprise Office** (PEO) review the values of the shares offered on the stock market. The typical steps in a privatization transaction are detailed in the following table.

[49] The CAA is an independent governmental body that audits the performance/evaluation of all companies of at least 25% public ownership and reports directly to the People's Assembly.

Typical Steps for a Privatization

Step 1	*Decision to Privatize*	Ministry of Public Enterprise
Step 2	*Preparation for the Sale*	Asset and Share Valuation performed by evaluation committee
Step 3	*Finalizing Sale Conditions*	Valuation submitted to company shareholders and directors board for approval, and to governmental accounting agency for revision
Step 4	*Finalizing Sale strategy*	Representatives from the CMA and PEO review the values of the shares offered on the stock market and MPE determines strategy for the sale
Step 5	*Publishing Privatization Program*	The Program lists the companies to be privatized per annum, categorized according to the nature of their economic activity A specific company's fact sheet is available upon request from the consulate, and the Ministry of Public Enterprise also provides complete detailed files

The privatization techniques that have been followed in Egypt have been:

§ 100% asset sales to **anchor investors**

§ Sales to trade unions and subsequent resale to employees through **Employee Stock Associations** (ESAs): Majority Sales to ESAs

§ Share sales on the stock market: Minority and Majority Public Offerings

§ Liquidations

§ Multi-year leases

§ Sales of Production Assets

Privatization Projects Underway

§ **Misr Hotels:** The tender for the company remains open

§ **Shepheard's Hotel:** Preliminary negotiations with interested investor

§ **Cleopatra and Sheherazade Hotels:** Legal considerations explored for their potential sale

§ **Abu Zaabal Fertilizers:** The Chemicals Holding Company has signed an 8-year lease/purchase agreement

§ **Red Sea Contracting:** Negotiations underway with an investor

§ **NEEASAE:** The tender process is ongoing and two expressions of interest from investors have been received

- **Al Nasr Steel Pipes:** The tender has been closed and negotiations are currently being conducted with a local investor
- **Al Nasr Gas and Crystal:** Five competitive bid offers have been offered and the winning bidders are negotiating with the Metallurgy Holding Company
- **Omar Effendi:** The tender for the company remains open
- **Nile and Al Ahram Retail Outlets:** Presentation for investors has been prepared
- **General Warehouses:** Valuation and cash flow analysis completed as company considered a candidate for sale to an ESA
- **Delta Spinning and Weaving:** Brochure prepared and interested investors are being contacted

Privatization Achievements: Transactions Summary up to 30 September 2001˜

	Majority Privatizations (>51% sold)					**Partial Privatizations/Leases**				
Year	**Anchor Investor**	**Majority IPO**		**Liquidation**	**Total**	**Minority IPO**	**Asset Sales**	**Leases**	**Total**	**Yearly Total**
1990				1	1					1
1991				3	3					3
1992				1	1					1
1993				1	1					1
1994	3		7	2	12	1			1	13
1995		1	3	2	6	6			6	12
1996	3	14		1	18	6	1		7	25
1997	3	14	3	3	23	2	1	2	5	28
1998	2	8	12	6	28	1	3		4	32
1999	9		5	7	21		4	8	12	33
2000	5	1		3	9		6	8	14	23
2001	3		2	2	7		3	2	5	12
	28	**38**	**32**	**32**	**130**	**16**	**18**	**20**	**54**	**184**

˜ Source: PCSU data

Privatization Achievements: Major Privatization Transactions[*] up to September 2001[~]

Name of Company	*Year of Sale*	*Sector*	*Privatization Method*	*Share transferred to Private Sector (%)*	*Share transferred to ESA (%)*	*Total Sale Value (million LE)*
Torah Portland Cement	*1995*	*Cement*	Sale to Anchor Investor	76.4	5	1,226
Helwan Portland Cement	*1996*	*Cement*	Majority Public Offering	95	5	1,202
Assiut Cement	*1999*	*Cement*	Sale to Anchor Investor	70	10	1,197
Paints & Chemicals (Pachin)	*1997*	*Petrochemicals*	Majority Public Offering	53.75	8	836
Ameriyah Cement[**]	*1998*	*Cement*	Majority Public Offering	61	10	768
Alexandria Cement	*1999*	*Cement*	Sale to Anchor Investor	93	0	760
Eastern Tobacco	*1997*	*Tobacco*	Minority Public Offering	28.7	5	549
Beni Suef Cement	*1999*	*Cement*	Sale to Anchor Investor	76	5	527
Egyptian Electrical Cables	*1997*	*Industry*	Majority Public Offering	95	5	321
Delta Industries (Ideal)	*1997*	*Industry*	Sale to Anchor Investor	90	10	311
Industrial & Engineering Projects	*1997*	*Engineering*	Majority Public Offering	80	10	299

[*] Classified in terms of proceeds generated

[**] 29% of Ameriyah Cement was sold to an anchor investor yielding 527 million, making it altogether the highest value privatization to date

Appendix 3 – Morocco

The Legal Framework for Privatization

Political	
Public Law	Constitutional
System	Constitutional Monarchy Elected Parliament Government appointed by, and answerable to, the King and parliament
Judicial	Pattern of Courts (including Commercial Courts)
Economic	
Property Rights	Intellectual and Industrial Property Rights Law: Complete regulatory and legislative system
General Legislation	1995 Investment Code: improves investment climate and encourages foreign participation in investment Labor Law: decreases firing flexibility Antitrust Law
Privatization Enabling Legislation	1990 Privatization Law

The Institutional Framework

The law defines the organizations responsible for privatization:

§ **Ministry of Privatization:** the main institution

§ **Transfer Commission:** made up of 5 ministers, advises on the most appropriate transfer means for each case

§ **Valuation Authority:** an evaluating body composed of 7 independent members and sets the bidding price for each company being privatized

Privatization Implementation Procedure

Privatization in Morocco has been what is labeled as a-la-carte, or step-by-step privatization. **The Privatization Law of 1990** identifies three means for privatization: sale through financial markets, bid invitation, and direct disposition of assets, or a combination of all three.

Typical Steps for a Privatization

Step 1	*Decision to Privatize*	Ministry of Privatization undertakes relevant feasibility studies
Step 2	*Process Initiation*	Report on sale options submitted to the Transfer Commission for approval
Step 3	*Preparation for the Sale*	Selection of a private firm to carry out the audit and evaluation for the transfer and prepare further sale options Companies prepared for privatization through work with their management, major shareholders, and employees, in addition to the supervisory ministry
Step 4	*Finalizing Sale Conditions*	Transfer Commission receives final audit and evaluation and finalizes conditions for sale: Time for the transfer set after consultation with advisers Price determined for the shares to be sold under each option
Step 5	*Advertising Campaign*	Public announcement of prospectus Launch of promotional campaign
Step 6	*Bid Evaluation*	Technical and Financial Bid Evaluation
Step 7	*Sale Closure*	Actual Payment or award of the tender
Step 8	*Announcement of the Sale*	Press release or press conference

Major Privatization Achievements 1993-1999[50]

Enterprise	*Year*[51]	*Sector*	*Privatization Procedure*	*ds (USD ion)*	*yer/Tenant/ Operator*
Banque Marocaine de Commerce Exterieur (BMCE)	*1995*	*Banking*	Public Offering Employee Offer	352.6	Nomura International Commerzbank
Societe Anonyme Marocaine de L'Industrie de Raffinage (SAMIR)	*1996*	*Petroleum*	Direct Sale Employee Offer Public Offering	275.5	Corral Petroleum
Societe Nationale d'Investissement	*1994*	*Insurance*	Public Offering	226.6	-
Societe National de Sidurergie (SONACID)	*1997*	*Steel*	Public Offering Direct Sale Employee Offer	138	Consortium led by Societe Nationale d'Investissement (SNI)
Societe Cherifienne de Petroles (SCP)	*1997*	*Oil Refinery*	Direct Sale Employee Offer	78.5	Corral Petroleum
Total Maroc	*1994*	*Gas Distribution*	Direct Sale	65.8	TOTAL Outre-Mer
Shell Maroc	*1993*	*Petroleum*	Direct Sale	46.6	Shell Petroleum International
SNEP	*1993*	*Petrochemicals*	Direct Sale Employee Offer	37.7	Group Dimitatit
CTM International Bus Company	*1993*	*Transport*	Public Offering Tender	26.8	(private & institutional investors)
Casablanca Hotel	*1994*	*Tourism*	Direct Sale	20	Interedec
Lyonnais des Eaux de Casablanca	*1997*	*Water*	Concession	-	(Foreign & local investors)
National Gaz	*1998*	*Gas Distribution*	Direct Sale	-	Repsol
Second GSM License	*1999*	*Mobile Telecom*	Auction	1.1 billion	Medi Telecom, consortium including Telefonica, Portugal Telecom, a local bank
Maroc Telecom	*2001*	*Telecoms*	Direct Sale	2.6 billion	Vivendi

[50] Source: World Bank Privatization Database, 2000
[51] Refers to the year in which the highest proceeds were generated in the privatization transaction concluded with the firm in question, according to the information available to date

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