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Distr.
GENERAL
E/ESCWA/ED/1995/8
13 December 1995
ORIGINAL: ENGLISH

UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL

Economic and Social Commission for Western Asia

PRIVATIZATION IN THE GULF COUNTRIES*

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Issued without formal editing.

95-0579

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ACCRONYMS

GCC	Gulf Cooperation Council
BOT	Build Operate and Transfer
SOE	State Owned Enterprises
BT	British Telecom
EC	European Community
BO	Build-Operate
SABIC	Saudi Basic International Corporation
BOOT	Built-Own-Operate-Transfer
P/E	Price-to-Earning
P/CF	Price-to-Cash Flow
KIA	Kuwait Investment Authority
KPC	Kuwait Petroleum Company
KD	Kuwaiti Dinar
KTC	Kuwait Telecommunications Company
OMC	Oman Mining Company
ALBA	Aluminum Bahrain
GIC	General Industry Corporation
DSM	Doha Securities Market
OWEC	Electricity and Water Joint Stock Company
BPC	Bubiyan Petrochemicals Company
IFC	International France Corporation
Balexco	Bahrain Aluminum Extension Company
UAE	United Arab Emirates

INTRODUCTION

Privatization of certain public sector enterprises is among the general objectives and strategic principles of the development plans in the various Gulf states.[1] Governments of the region are committed to increasing the role of the private sector in their economies. Privatization could reduce the financial burden on the governments and render several public sector institutions more efficient. The income generated from privatization could be used to retrain the national workforce and help assimilate them in the private sector, as well as, retire existing public sector debt.

In addition, some governments no longer have the capital resources needed to finance new projects such as power stations, desalination plants, airline fleet expansion and telecommunication facilities. Private capital has become the only way to make sure that these projects are implemented. Oman has initiated the first infrastructural project (Al-Manah Power Station) to be financed by the private sector on a build, operate and transfer (BOT) scheme. This will hopefully open the way for the other Gulf countries to consider implementing similar schemes as part of their privatization drive.

It is rather fortunate that the earlier adoption of privatization in many countries will make it possible for the GCC countries to study these experiences and draw important lessons that are consistent with the fabrics of the Gulf countries' economies. However, unlike many developing countries and those of Eastern Europe and the ex-USSR, there is no need to transform the economic system of the Gulf countries, generally considered a pre-requisite for the privatization process to take-off. The principles of free enterprise are well entrenched here. There exists as well a basic respect for the rights of the individual to own assets. Wealth is viewed as a recognition of private success.

None of the Gulf countries are being forced by the World Bank or the IMF to pursue privatization as part of an economic reform program, as it is the case in many developing countries. The call for privatization in the region has been necessitated by the need to expand private sector participation, reduce the financial burden on the governments and reorient the Gulf countries' economies from growth based on public sector initiatives to one where the private sectors take the lead. However, because there is no direct or indirect taxation in most of the Gulf countries, privatization of profitable public sector institutions will deprive the government from an important source of revenue. This is not the case in other countries where government can still benefit from profitable companies even after these are privatized through progressive taxation of profits. Privatization therefore, is expected to be implemented gradually and as a part of a more comprehensive structural reform plan aimed at boosting non-oil sources of revenues and re-orienting the economies of the GCC countries from growth based on oil and public sector activities to one where the private sectors take the lead.

Other concerns associated with privatization in the region include the impact on employment and on prices of goods and services. Employment is likely to drop while prices may end up higher when government owned companies are transferred to the private sector. The larger issue is the role that the governments in the region play in distributing wealth. Governments in the Gulf countries play a central part in redistributing oil revenues to a wide

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[1] Gulf States comprise Bahrain, Kuwait, Qatar, Saudi Arabia, United Arab Emirates and Oman. In the text these countries are also referred to as the Gulf Cooperation Council (GCC) countries.

sector of the population. The dominant role that oil plays in the GCC countries is bound to slow the privatization pace.

Table 1. Possible candidates for privatization in the Gulf

Country	Privatized Companies	Possible candidates for Privatization
Saudi Arabia	Sabic (30%)	* Electricity Companies * Saudia * Saudi Telecoms * Port Authority * Government stakes in quoted companies Estimated value of privatization candidates: $20 billion
United Arab Emirates	* Etisalat (40%)	* Emirates General Petroleum Corporation (EGPC) * Arab Bank for Investment & Foreign Trade * Companies owned by General Industry Corporation (GIC) * Abu Dhabi stake in Gulf Air * Mirfa and Taweelah B power stations * Rest of Etisalat Estimated value of privatization candidates: $12 billion
Kuwait	* Kuwait Food Company * Overland Transport Company * United Realty Company * Commercial Facilities Company * al Ahli Bank of Kuwait * Holiday Inn Crown Plaza * Kuwait Realty Company * Bubiyan Petrochemicals Company (new)	* Al-Ahleia Insurance Company * Government stakes in quoted companies * Kuwait Public transport Company * Assets of Santa Fe International of the US * Telecommunications * Shuaibah north power and water plant (BOT) * State water units * Kuwait Airways Corporation * Estimated value of privatization candidates: $13.5 billion
Oman	* Oman National Insurance Company * Oman Flour Mills * Oman Cement Company * Raysut Cement Company * Gulf Hotel * Manah Power Station (BOT)	* Muscat Waste Water (BOT) * Salalah Waste Water (BOT) * Barka Power Station (BOT) * Salalah Power Station (BOT) * government stake in Gulf Air * Various Hotels Estimated value privatization candidates: $1.5 billion
Qatar	* Qatar Electricity & Water Company	* Qatar National Bank (50%) * Government stake in Gulf Air * Qatar Telecommunications Corporation * Qatar Steel Company Estimated value of privatization candidates: $1 billion
Bahrain	* General Trading & Food Procession Company (20%) * Bahrain Aluminium Extrusion Company (Balexco) * Bahrain Hotels Company	* Government stake in Gulf Air * Aluminium Bahrain (ALBA) * Hidd Power Project (BOT) * Rest of Balexco (45%) Estimated value of privatization candidates: $2 billion

Source: MEED Money, May 5 1995, and various National and International Sources.

* Grand total of estimated value of GCC privatization candidates: $50 billion.

Note: BOT is build-operate-transfer schemes.

Despite all the pronouncements and the debate on privatization in the Gulf countries, very little has been achieved in this direction. In Kuwait, there has been a sale of a number of government holdings of tradeable stock to the private sector. The same is true in the case of Bahrain. In addition to selling its holdings in a number of companies, Oman was successful in promoting the first BOT

project in the Gulf. Privatization in the UAE and Saudi Arabia is still in the planning stage. Nevertheless, the potential in the region is huge. Table (1) lists those companies considered as possible targets for privatization during the coming few years. A total of at least $50 billion of assets owned by the Gulf governments could be offered to the private sector when the privatization process takes off.

II. Privatization Experience of Other Countries[2]

Privatization, although not simple, can work and has worked for a variety of enterprises in a large number of settings. Although many state owned enterprises (SOEs) have been productive and profitable, a large number proved to be economically inefficient, incurred heavy financial losses, and absorbed disproportionate share of domestic credit. In many countries, SOEs have become an unsustainable burden on the government budgets. Overextended and poorly performing SOEs, when protected by government subsidies, have slowed the development of the private sector. Experience from other countries has shown that privatization improves the performance of former state enterprises and encourages more efficient use of resources throughout the economy. It leads to a release of entrepreneurial activity and broadens the decision making process of the country.

Several countries in the industrialized and developing world, have been transferring assets worth tens of billions of dollars each year from government ownership into private hands. Since 1980, more than 2,000 SOEs have been privatized in developing countries and 6,800 world wide. Of those only 2.7 per cent were in the Middle East and North Africa (chart 1). According to the World Bank, from 1988 through 1993, governments unloaded state owned enterprises worth $270 billion world-wide. State sell-offs in Latin America, Asia and other developing countries raised a total of $96 billion during the period.[3] Proceeds from the sale of public enterprises for all the developing countries reached $18 billion in 1994. More than $50 billion was raised in international share offerings in 1994, with much of the money channeled into European and emerging market privatization.

Western Europe has been following the privatization path opened up by Margaret Thatcher in Britain in the 1980s. The French government announced recently plans to float a 23 per cent share in automaker Renault for $8 billion. This is one of 21 state enterprises to be privatized over the coming few years. Government owned companies to be sold in Europe are projected to bring in an estimated $100 billion in the five-year period ending in 1998, with sales of state telecommunication companies expected to constitute one quarter of the total. Some of Europe's best known and biggest corporate names Lufthansa, Deutsche Telekom, French PTT, Agip, British Railway and Postal Operations are all slated to be sold to the private sector, as well as, many other smaller companies.

In Asia, state owned utilities in Pakistan, Indonesia, Singapore and Thailand are scheduled to be privatized in the near future. India is expected to auction off state industries worth as much as $3 billion in 1995-1996. Highlights of last year's privatization deals included sales of Pakistan and Indonesia of telecommunications companies in two of the biggest single deals. Each country raised more than $1 billion from several privatization, while China raised $2.1 billion. In Latin America the enthusiasm for privatization is still considerable with Peru taking up the running from pioneers such as Chile, Mexico and Argentina. Sales of government assets in Peru netted $2.9 billion in 1994, compared to only 91 million a year previously. Argentina raised a total of $907 million bringing its total privatization proceeds since 1992 to more than $11 billion.

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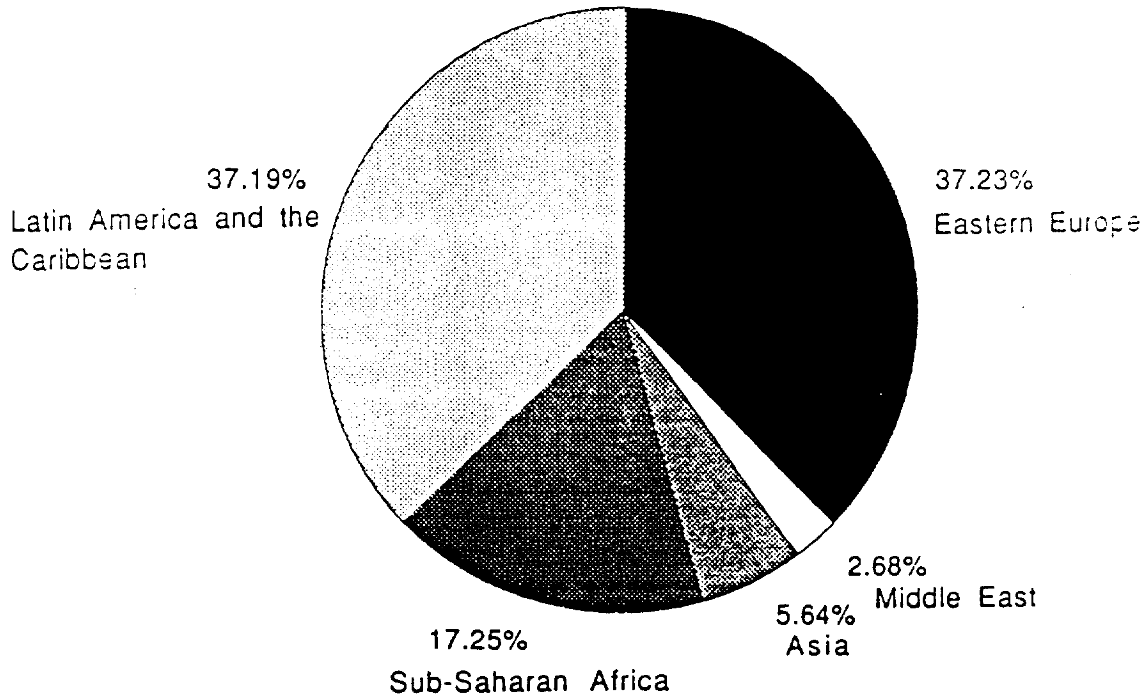
[2] For in depth analysis see Sunita Kikeri et. al., Privatization: The Lessons of Experience (Washington, World Bank, 1992).

[3] Frank Sader Privatization and Foreign Investment in the Developing World "1988-93", (World Bank Working Paper 1202, 1994).

Chart 1
Number of State Owned Enterprises Privatized in Developing Countries, by Region, 1980-1993

Total: 2,162



Source: World Bank, Country Economics Department, 1994.

Elsewhere, sales by governments in Africa and the Middle East raised a total of $2.1 billion, compared with just $683 million in 1993. And Eastern Europe and Russia sold off assets of more than $3 billion in 1993, even though many of its privatization programmes have been slow to materialize. Increasingly, governments from across the political spectrum have been won over by arguments for privatization.

The benefits from properly executed privatization programs have proved to be considerable, as is shown by cases in Latin America, Africa, and Asia, as well as in the industrial countries. Productivity went up and the expanded investment in production resulted in rapid growth in many of the firms studied. For example, the Chilean telephone company doubled its capacity in the four years following sale. Labor as a whole will not necessarily be worse off, even taking into account all the layoffs and forced retirements. The public workers are the main potential losers. A joint study by six European research institutes forecasts that 800,000 workers equivalent to 20 per cent of the labor force employed by candidates for privatization will lose their jobs by the end of 1998. However, a good portion of them will be re-employed in the expanding private sector if a proper training program is implemented.

Consumers were better off in a majority of cases. Studies and data from outside the World Bank also show that privatized companies grow more rapidly and are better able to contain their costs than before privatization. In forty-one firms fully or partially privatized by public offerings in fifteen countries, most of them industrial, but the list includes Chile, Jamaica, and Mexico, returns on sales, assets, and equity increased and internal efficiency improved because of better utilization of physical and human resources. The firms improved their capital structure and increased capital expenditures. Their work forces also rose slightly, thanks to larger investments by the privatized companies that generated higher demand for labour.

Privatization symbolizes government's intention to take seriously the need to instill a commercial spirit in the public sector and render SOEs more efficient. There are plenty of signs that it does. Since its 1989 sale, Aeromexico has emerged as one of Latin America's premier airlines. Another success story in this field is British Airways. After being privatized, the company turned around from being a money loosing operation to one of the most profitable airline companies in the world. British Telecom (BT) transformed itself into a dynamic competitor that has diversified at home and expanded overseas. A BT share that initially sold for 130 pence in 1984 has been trading recently at around 370 pence.[4]

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[4] Newsweek, October 3, 1994. pp. 36-37.

III. STRUCTURAL CHANGES AND ADJUSTMENT REFORMS IN THE GCC COUNTRIES

Experience from other countries shows that structural reforms should precede privatization, and that the benefits accruing from privatization are most sustainable where competition is free, the economy stable and the regulatory sector strong. The net proceeds from privatization would help retire internal debt and would offer an alternative for taxation as a means of tackling budget deficits. Moreover, it is possible to anchor an entire economic stabilization program on privatization. The sale of profitable public enterprises can end the need for subsidies, capital grants and loans to public sector. If foreigners are permitted to participate, privatization can also improve the country's balance of payments.

While the same results can be achieved by cutting budgetary expenditures and increasing prices for public sector outputs, over the long term, privatization is a more robust economic remedy. In the past, public enterprise reform has worked well for a while but then declined in effectiveness as conditions changed while the changes that come with privatization have proved more durable.

Argentina is a good example of a country in which large-scale privatization occurred simultaneously with macroeconomic liberalization with overall positive results.[5] In this instance, privatization was a principal element in the general turnaround strategy. Not only did it help with the budget deficit and balance of payments, it also helped build Argentina's economic credibility with private investors. Countries facing circumstances similar to those of Argentina in 1988 might profit from studying that country's joint macroeconomic and privatization reform strategy.

In countries with fairly stable economies, the question arises of how to sequence privatization with other liberalization measures (such as tariff reductions, elimination of quotas and licensing requirements, deregulation, etc.). Asian countries often liberalized their economic policy without much privatization. In Latin America, several countries chose to do both simultaneously. Since empirical evidence suggests that the introduction of competition is more important than the transfer of ownership, it would seem that liberalization and economic reform without privatization is preferable to privatization without liberalization and reform.

The GCC countries have had a long tradition of strong public sector involvement in the ownership of the means of production and the provision of goods and services at below-cost prices. Additionally, there have been tight restrictions on the foreign ownership of business, financial instruments and real estate. Such practices have in the past distorted consumption and investment decisions and generated some inefficiencies in certain cases.

To reduce the impact of fluctuations in world oil prices on the domestic economy and address the issue of rising internal indebtedness in several GCC countries, various policies are being pursued more forcefully. The most important of these is the re-orientation of the economies of the region from growth based on public sector initiatives to one where the private sectors take the lead. Another attempt to cut down on government expenditures is being made this year, following the cuts initiated in last year's budgets. Equally significant is the decision by Saudi Arabia, UAE and Oman to raise prices of electricity, water, gasoline, telephone calls and other items. This signals a structural change in fiscal policy, whereby non-oil revenues will now play a much important role than before, reducing

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[5] See Guillermo Barnes, Lessons From Privatization in Latin American Countries, (Washington, World Bank, Nov. 1994).

the Gulf countries' dependence on their volatile income from oil exports.

Besides raising non-oil revenues, the authorities' intentions are to reduce implicit and explicit subsidies and shift towards economic pricing of goods and services provided by the public sector. The paramount economic objective for the medium term is to create the conditions conducive for efficient private sector growth that would provide employment opportunities for the region's growing populations.

The heightened concern about the persistence of large fiscal deficits following the conclusion of the Gulf war led to the intensification of the adjustment process in the last two years. The growing realization of the need for greater fiscal discipline include the following:

First, the once very sizable foreign assets held by some countries of the region, especially Saudi Arabia and Kuwait, have fallen sharply in recent years. This reflected, in part, huge Gulf War-related expenditure and, in the case of Saudi Arabia, sizable and persistent current account as well as budget deficits since 1983. The governments of the GCC countries would prefer not to allow much further erosion of this international finance "cushion" in light of uncertainties facing them, at least in the near-term, particularly with regard to the unpredictable world petroleum market.

A second important consideration underlying the clearly recognized need for continued fiscal discipline is the desire by some governments of the region, particularly Saudi Arabia, to stop borrowing internationally and to contain growth of already sizable outstanding domestic debt. The combined service of both foreign and domestic debt has become a substantial portion of budget expenditure obligations in recent years. Such imbalances make it difficult to cut discretionary expenditure in the future, and would in turn restrict future adjustments measures, exert pressures on official foreign assets, crowd out the private sector, and be inimical to the long-term self-sustaining growth of the economy.

Although actual budget outcomes of the GCC countries frequently differ from planned budgets, the stronger fiscal discipline targeted for the coming years is reflected in the 1995's budgets. The aggregate deficit of all the GCC countries is projected to decline by around 35 per cent to $11.5 billion in 1995 from $17.6 billion in the previous fiscal year (table 2). This compares with a record deficit of $57.8 billion in 1991. Total expenditure were projected at around $69.3 billion in 1995, down from $71.4 billion in 1994 and $85.7 billion in 1992. The 1995 spending was the lowest since 1988, when expenditure dipped to around $58 billion as oil prices collapsed to below $10 per barrel. In 1994, Saudi Arabia slashed actual expenditure by nearly 15 per cent to $42.66 billion, from $50.1 billion in 1993. It again tightened spending in 1995 to $40 billion, slashing the projected deficit to $4 billion from around $10 billion in 1994.

Lowering government expenditures is only the first step in a process of state deregulation which will affect the life time habits of every citizen. Other measures currently being introduced in various GCC countries include privatization of public sector enterprises (Kuwait and Oman), the introduction of an excise tax targeting certain luxury items (Oman), a more economic pricing system for utilities, telephone charges, gasoline and various government services (Saudi Arabia and UAE), reduction of direct and indirect subsidies, controlling waste, rationalization of defense spending and gradual elimination of subsidized credit among others.

The tightened fiscal stance is supported by a prudent monetary policy and the reduction in the budget deficit is associated with a further shift toward nonbank financing of such deficits in order to not only ensure adequate credit to the private sectors but also to avoid any further significant decline in the net foreign currency position of commercial banks.

The Gulf countries have been operating under current account deficits for several years. The combined current account deficits of the six GCC states reached $53.4 billion in 1991, before dropping to around $9.4 billion in 1993 and an estimated $9.5 billion in 1994 (table 3). These deficits have so far been financed by drawing down on reserves and repatriation of private sector capital from abroad. Several attempts have been made to diversify exports away from oil, gas and aluminum towards higher value added products. This would help reduce the vulnerability of export earnings to fluctuation in world oil prices. Expatriates living in the GCC countries repatriate abroad every year billions of dollars, contributing to the deficit in the services and transfers balance. The governments of the region are looking into ways and means to make available for resident expatriates domestic investment channels in order to help domicile at least part of the annual transfers.

Table 2. Governments revenues, expenditures and budget deficits in the GCC states
(million dollars)

	Year	Saudi Arabia[1]	Kuwait[2]	UAE[3]	Qatar[4]	Oman[5]	Bahrain[6]	GCC
Revenues	1989	30,600	11,013	2,719	2,555	3,508	1,162	51,557
	1990		938	4,162	3,282	4,834	1,320	14,536
	1991	*84,420	2,239	3,981	2,519	4,121	1,358	98,638
	1992	45,226	8,059	4,805	2,848	4,368	1,358	66,664
	1993	37,706	9,007	4,233	3,365	4,463	1,492	60,266
	1994	32,000	8,702	4,794	2,985	4,505	1,593	54,579
	1995	36,000	9,018	4,887	2,297	4,799	1,380	58,384
Expenditures	1989	39,920	10,540	2,803	2,891	4,278	1,316	61,748
	1990		26,147	3,932	3,129	4,863	1,423	39,494
	1991	*122,000	21,140	4,151	2,912	4,857	1,417	156,477
	1992	56,346	13,421	5,369	3,234	5,872	1,550	85,792
	1993	50,106	13,067	4,240	3,534	5,714	1,659	78,320
	1994	42,666	13,662	4,410	3,651	5,287	1,792	71,468
	1995	40,000	14,158	4,601	3,250	5,609	1,704	69,320
Budget Deficits	1989	9,320	473	84	336	770	154	10,191
	1990		25,209	230	153	29	103	24,958
	1991	*(37,580)	18,901	170	393	736	59	57,839
	1992	11,120	5,362	564	386	1,504	192	19,128
	1993	12,400	4,060	7	169	1,251	166	18,053
	1994	10,666	4,960	384	666	782	199	17,657
	1995	4,000	5,139	286	953	810	324	11,507

Source: Annual report of Central Banks and Monetary Agencies, and budget statements.

* Two year 1990-1991

1. Actual revenues and expenditures except for 1994 and 1995, these are budget figures.

2. Kuwait's fiscal year starts July 1, so that 1994 in the table corresponds to 1994/95 and 1995 to 1995/96. All are actual figures.

3. Actual figures except 1994 and 1995 these are budget figures.

4. Actual figures except 1994/95 these are budget figures.

The fiscal year starts on April 1, so that 1994 in the table corresponds to 1993/94 and 1995 to 1994/95.

5. Actual figures except 1994 and 1995 these are budget figures.

6. Actual figures except 1994 and 1995 these are budget figures.

Every effort is being made to preserve the stability of the Gulf currencies vis-a-vis the dollar. If investors, whether Gulf or joint venture partners, perceive no exchange risk in holding the riyals, dinars or dirhams, capital flows seeking domestic investments will be maintained. The fact that most of the GCC countries follow a currency board mechanism with enough statutory foreign reserves helps support low inflation rates and protects the currency against sudden bursts of speculative attacks. Maintaining inflows of private sector capital is by far more important at this stage than any benefit that may accrue to the region if the currencies are to be devalued versus the dollar. The economies of the region have already benefited from the appreciation of the yen and the European currencies over the past few years. This has had a clear dampening effect on imports, the bulk of which comes from Europe and Japan. Besides, a drop in the value of the Gulf countries' currencies vis-a-vis the dollar will have little impact on major exports as most of these (oil, gas, petrochemicals, aluminum, steel, etc.) are denominated in dollars.

Privatization of certain public sector enterprises constitutes an important part of the ongoing adjustment process in the region. The private sector in the GCC countries will be given the opportunity to maintain and renovate many of the utilities currently operated by the government, on condition that this will result in lower cost, better performance and greater employment opportunities for the national workforce. Privatization and larger private sector participation could reduce the financial burden on the governments, render several public sector institutions more efficient and encourage repatriation of capital from abroad. The income generated from privatization could be used to retire existing public sector debt.

Table 3. Trade and Current Account Balances in the GCC Countries

($ million)

		1994	1993	1992	1991
Saudi Arabia	Trade Balance	12,870	19,020	16,801	21,656
	Current Account	10,000	14,218	20,967	27,589
United Arab Emirates	Trade Balance	2,810	3,950	6,510	7,627
	Current Account	400	183	3,043	970
Kuwait	Trade Balance	3,660	4,373	256	3,184
	Current Account	2,260	6,344	317	25,648
Oman	Trade Balance	1,600	1,336	1,928	1,759
	Current Account	900	1,069	496	244
Qatar	Trade Balance	970	1,355	1,825	1,490
	Current Account	900	497	9	100
Bahrain	Trade Balance	200	136	313	190
	Current Account	400	168	993	796
Total GCC	Trade Balance	22,110	29,898	27,007	29,158
	Current Account	9,540	9,425	19,105	53,407

Source: IMF, International financial Statistics July 1995, and our estimates for 1994.

Financial development is at the heart of the current economic changes being pursued. It is also essential for the success of privatization. If governments of the GCC countries are to elicit a more active private sector participation, then the region's capital markets need to acquire additional depth. The viability of public sector borrowing in the various Gulf countries has already been tested. The years ahead should see an increase in the volume of

various government bonds and bills issued, the fine-tuning of flows into the primary and secondary markets and a refinement of prices. Governments of the GCC countries should be able to sell their bonds and bills not only within their own domestic markets, but also throughout the region. This will increase the amount that can be borrowed and further contribute to the development of domestic capital markets.

As the region's financial markets gain depth, and following the pricing benchmarks that have been established by the government sectors, corporations and banks may be encouraged to issue their own debt instruments. Aluminum Bahrain is leading the way in this respective with its plan to issue seven year corporate bonds worth $50 million to be listed in the Bahrain exchange.

The reforms and adjustment policies being pursued require the governments to take a back seat role and act like a catalyst, laying the legal and administrative grounds for the private sector to participate more actively in the overall development process. The aim is to re-orient the economies of the GCC countries from growth based on public sector's initiatives to one where the private sectors take the lead. The new strategy would be helped by the fact that businessmen in these countries have ample liquidity and are eager to spearhead the process of economic development in the years to come.

IV. Objectives of Privatization in the Gulf

Privatization should not be viewed as a reaction to short-term financial difficulties but as part of a strategic program. The economic benefits of privatization are maximized when governments make improved efficiency their number one objective, i.e. using privatization to enhance competition and reduce cost of operation. Maximization of revenue should not be the primary consideration. It is better to eliminate monopoly power and to unleash potentially competitive activities than to maximize revenues from sales into protected markets.[6]

In the GCC countries, the objectives of a privatization programme are somewhat broader than in many other countries. This, of course, reflects the depth of state involvement in the economies of these countries which not only makes the divestment effort more difficult, but also heightens the concerns of its likely impact. Privatization has far reaching political and social implications. Several goods and services provided by state owned enterprises are subsidized and these enterprises employ a high percentage of nationals. In the following paragraphs, a generalized view of some of the objectives and concerns of privatization in the GCC countries is given.

1. Larger Private Sector Participation

Larger private sector participation in the economy is one of the key objectives of privatization in the GCC countries. At present the private sector accounts for 30 per cent to 40 per cent of GDP in the GCC countries.[7] However the governments in these countries are keen to see the private sector increase its share and play a leading role in the overall development process. Privatization will send the right signal to businessmen of their government's commitment to private sector growth and open new channels of investment for private sector capital.

Private sector investors in the GCC countries usually keep sizable portions of their capital in low risk, local and foreign interest bearing instruments. Estimated foreign assets of Gulf banks are believed to exceed $50 billion at the end of 1994. While non-monetary assets abroad are estimated at $200 billion.[8] Privatization will not only help repatriate capital in the GCC countries, but will also allow capital held within the region, which is not being put to productive uses, to be utilized more efficiently.

There is also a need to encourage a wider share of ownership in the region and create a motive for increasing private savings. The number of shareholders as a percentage of total adult population is still very low, on the average less than 5 per cent, compared to 20 per

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[6] Khalid Al Fayiz "Privatization in the Gulf" paper presented at the Gulf Economic Forum, Bahrain, April 1995.

[7] The GCC Secretariat, The Annual Statistical Bulletin, (Riyadh, 1995) (in Arabic).

[8] MEED Money, April 14, 1995. p.3.

cent to 30 per cent in the developed countries.[9] Privatization programs, if well executed could increase very substantially the number of shareholders, broaden the decision making base in the economy and revitalize the domestic stock markets.

2. Reduction of Budget Deficits

Reduced oil earnings, years of budget deficits and the Gulf war have hit the finances of the GCC countries severely. Privatization will help alleviate financial pressures on the governments, both by generating revenues from the sale of assets and in the case of loss making SOEs, reducing the financial burden on annual budgets. It will also help control the rise in public expenditure by trimming the civil service bureaucracy, encouraging nationals to work in the private sector and rethinking the various subsidies provided by the public sector. The aim would be to increase the social return on such subsidies and transfers and reduce excessive consumption expenditure in the economy. Privatization is attractive for the Gulf countries because it offers an alternative to taxation as a means of tackling budget deficits and rapidly swelling public debts.

The Maastricht accord's objective, which states that the size of the public debt should not exceed 60 per cent of GDP, has become a tangible benchmark not only for the European Community (EC) countries, but for governments worldwide. It also constitutes part of the motivation behind the presently implemented or envisaged privatization measures in Western Europe. Internal debt outstanding for the six Gulf countries is estimated at $112.6 billion by end of 1994 (table 4). The GCC countries have been experiencing a persistent increase in their internal debt with total debt to GDP ratios in Saudi Arabia and Kuwait already exceeding the benchmark of 60 per cent set by the Maastricht accord for the EC member states, but still way below those of Italy (119 per cent) and Belgium (145 per cent).

3. Gains in Efficiency

The most cited argument in favor of privatization is probably the one based on efficiency gains.[10] Accordingly, privatization is desirable because privatized firms are "more efficient". Privatizing public or mixed companies in the region, including power and water, airlines, telecommunications, service companies etc., should help improve efficiency, foster entrepreneurial dynamism, reduce the need for subsidies and transfers from the government, free activities from bureaucratic impediments and increase the return on infrastructural investments.

Privatization should also help improve corporate governance and lead to better management of SOEs. It brings in owners with the necessary resources and skills and a direct stake in the performance of the companies. It will provide the right motivation needed for public managers to seek employment in the private sector thus reducing existing distortions in the labour market.

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[9] NCB Economist, October 1993.

[10] David Clutterbuck, Going Private: Privatization Around the World (London, Mercury Books, 1991).

Table 4. Internal debt outstanding of the GCC countries: 1994
($ million)

	Internal debt	Internal debt to GDP ratio
Saudi Arabia	86,133*	70.8%
Kuwait	21,675**	95.4%
United Arab Emirates	3,305	9.2%
Oman	450	4.0%
Qatar	212	2.8%
Bahrain	879	20.3%
Total	112,654	

Source: Central Bank and Monetary Agency Reports and IMF country reports.

* Debt outstanding to the private sector of $17 million plus debt due to autonomous government bodies estimated at 69.1 billion.

** Including Commercial Banks' holdings of debt bonds of $10.9 billion issued by the government for settlement of the long standing debt arising from Al Manakh stock market crisis and the Iraqi occupation, as well as, treasury bills and bonds of $5.4 billion.

V. Concerns Associated with the Privatization Process

Notwithstanding the above objectives, the potential negative impact of privatization make Gulf governments reluctant to implement such programs.

1. Impact on Public Sector Employment

The main concern associated with privatization is its impact on employment, since over-staffed public sector entities would have to make people redundant when privatized in order to reduce costs and improve efficiency. Although it is argued that employment opportunities will increase in the long-term as a result of privatization, the short to medium-term impact of the process is more worrying and may pose obvious socio-political considerations.

A number of solutions have been proposed in this regards which can be implemented gradually during the period required for the completion of the process. Such social safety nets include using the proceeds generated from privatization to train national work force and absorb the excess labour in private sector establishments. Part of the proceeds could also be allocated to provide for early retirement, adequate severance pay, unemployment benefits and job search assistance. Social safety net programs are not costless but are in the long-run, less of a drain on an economy's real resources than the maintenance of inefficient state enterprises.[11]

The governments of the region attach considerable importance to providing nationals with employment opportunities. The unemployment issue will require serious consideration if it is not to constitute a major obstacle to the success of privatization.

A large percentage of the labour force in the state owned enterprises are nationals. Some are likely to lose their jobs once the SOEs are privatized. Private sector companies may end up increasing the proportion of expatriates employed, primarily because expatriates with equal experience as nationals tend to accept lower salaries. Private companies find employing expatriates convenient due to the flexibility provided by the laws in different GCC countries concerning hiring and firing. However the long-term effect of privatization on employment is likely to be positive due to growth in the private sector and the rise in efficiency associated with the better allocation of resources.

2. Loss of Government Control

Other concerns associated with the privatization process include loss of government control. There is the worry that privatization may create private sector monopolies and the economy as a whole may not benefit much from the process. Privatized companies are likely to allocate resources to achieve their strategic objectives which might not necessarily be the same as the state's national objectives. The governments in the GCC countries will need to pay greater attention to formulating the necessary laws that would address the monopolistic power that privatized companies in the field of utilities, telecommunications and air transport may end up having.

3. Higher Prices

Privatization is likely to lead to higher prices for the users of goods and services that are currently being provided by the public sector. The previously subsidized prices of the state firms

[11] Ibid.

will in most cases have to rise if the latter are to be profitable. In some GCC countries profitability of SOEs, especially utilities, is enhanced by government injections of cash at the end of the year. That may no longer apply once these ventures are privatized forcing owners to raise prices. This issue may be tackled by insisting on transitory periods following privatization in which prices are allowed to increase only gradually.

4. Excess Supply of Shares and Problems of Valuation

There is the concern that new supply of shares may lead to lower stock prices. A gradual approach should be followed in order not to flood the market with new shares that the market place may not be able to absorb. The few offering that have come to the GCC markets over the last few years have generally been oversubscribed, indicating there is ample funds seeking profitable investments in the region's equity markets.[12]

The lack of proper valuation of public shares is another factor stalling the drive towards privatization in the region. The valuation of public shares and the methods used to transfer them are issues that require absolute transparency and careful study of each individual case. The basic principle is that public companies should be sold through a competitive process that generates the highest price investors are ready to pay. This guarantees the transfer of public assets to those who place the highest value on them. Those investors are likely to be the ones that have the best plans to improve the commercial performance of the sold entities.

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[12] For example in Saudi Arabia, over the last three years, the amount actually subscribed for by investors was over seven times the amount of shares offered for subscription. The privatization of a profitable consumer finance company in Kuwait during the summer of 1994 was also several times over-subscribed.

VI. VARIOUS MECHANISMS OF PRIVATIZATION[13]

1. Stock Market Floatation

The primary advantage of selling SOEs through the stock market is that it can be used as a mechanism to increase the proportion of the share owning public. For governments to follow the stock market floatation route, procedures will need to be streamlined to make the process easier for all concerned. Pricing would be the key for the exercise to be successful. Investors would need to be convinced of future profits for them to participate in the floatation. The electricity companies, telephone companies, cement companies, industrial companies, banks, basic industries, example the Saudi Basic International Corporation (SABIC), and airlines can be partly or wholly privatized through this route.

2. Build Operate and Transfer

Build-Operate (BO) schemes offer a mechanism of private sector involvement in power, industrial and infrastructural projects. The BO model has a number of variants, such a Build-Operate-Transfer (BOT), and Built-Own-Operate Transfer (BOOT). A project undertaken on BOT basis is financed, executed and operated for a concession period by the private sector. The revenues earned during the concession period are expected to cover initial investment and a certain rate of return. At the end of the concession period, the project is transferred from the private operators to the host government. A BOOT contract is similar except after execution of the project the ownership of the assets is transferred to the private sector but is automatically reverted to the host government after an agreed upon time period.

The BO mechanism offers three main advantages for the government. Firstly, infrastructure projects are financed through private sector resources and with limited involvement of the public sector. The government is therefore not involved with the projects' commercial risks. Secondly, the private company undertaking the project acts as borrower and the government does not need to issue formal guarantee for the repayment of the debt. The project loan does not, therefore, raise the level of public debt. Thirdly, BO schemes increase efficiency in the economy by increasing private sector involvement in infrastructural and power sectors.

The BO concept is relatively new to the region, however such schemes are already underway. The Omani government has taken the lead in this respect. Sectors earmarked for BO type schemes include power, roads, sewerage and water supply. Kuwait, Bahrain and Qatar are also seriously considering BO type schemes for power generation.

3. Leasing out to the Private Sector

In a lease contract, the private party pays the government a fee to use the assets and assumes the commercial risk of operation and maintenance. This creates an incentive to enhance productivity, reduce costs and to maintain the long-term value of the assets. Leasing of infrastructure establishments and social services to the private sector is a realistic option for the region's governments. The main areas were this could be achieved include sea ports, airports, water supply, sewerage and maintenance establishments. In the social services sector schools, clinics and hospitals are prime contenders for leasing.

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[13] For more details see Joseph Saba, "Privatization a Practical Approach" paper presented to the Institute for International Research (IIR) Seminar on Privatization, Dubai, April, 1995.

There is tremendous scope for leasing in government establishments which provide multiplicity of services e.g. universities providing accommodation and meals to students where university canteens and hostels could be leased out. This could equally apply to defense establishments, hospitals, radio and television stations and other government buildings and establishments.

The Saudi government has already gone some way down that road accepting a package from Al-Rajhi Company to finance a number of schools on Ijar (leasing) basis. The scheme will allow Al Rajhi Company to finance and build the schools and hand them over to the government after five years. The authorities are now looking at doing the same thing for clinics. This could prove to be the first step and, sooner, it may develop in other sectors.

4. Commercialization of Public Enterprises

At the other extreme, privatization may refer, in effect, to rendering state-owned or run enterprises more efficient, without necessarily selling off assets, through "commercialization" of those enterprises. In other words, "management" of state-owned companies may be privatized without turning over ownership to private hands, particularly in the case of enterprises deemed extremely strategic, or as an initial step towards transfer of ownership in the case of non-strategic enterprises. Such a first step would be particularly relevant for loss-incurring state enterprises with a potential for becoming more efficient, therefore attractive to potential private investors, domestic or foreign. Commercialization of state enterprises, simultaneously permitting greater private-sector participation, can be achieved in several different ways, chief among which are contracting out operation and management to private sector companies and permitting joint venture operation in enterprises previously run solely by the state.

5. Trade Sales

This is another option which, primarily means the sale of enterprises to one or more specific investors through public tenders, closed tenders, direct sales or private placements and various forms of auctions. In some cases, minority stakes in state institutions turned over to the private sector mainly through stock market floatation have been sold through trade sales.

VII. PRE-REQUISITES FOR PRIVATIZATION[14]

Successful privatization requires the implementation of preparatory steps to pave the way for successful takeovers by the private sector as well as the establishment of legal and other infrastructure to ensure smooth evolution. Chief among these prerequisites are the following.

1. Where politically feasible, establishment of a privatization office could facilitate the process and allow it to run more smoothly. Such an office should have direct access to the highest authorities and be empowered to approve, without further consultations, measures related to privatization already legislated by the central authorities. In particular, this office should be allowed to cut through bureaucratic inertia by being enabled to authorize implementation of privatization measures that might involve more than one government ministry.

2. Wholly-owned state enterprises earmarked for privatization should ideally be restructured in a manner aimed at putting them on a more commercial footing. This would require proper asset valuation as well as adoption of internationally accepted accounting and budgetary procedures. Where possible state monopolies should be broken up with the objective of introducing greater competition among enterprises. Moreover, parastatals, especially utilities, could be transformed from direct government bodies into autonomous, self-financing entities with greater control over their own operations as a prelude to divesture.

3. Establishment of "safety nets" is a prerequisite, as previously discussed, to minimize dislocation of employees rendered redundant by divesture.

4. It is also necessary to rationalize, even if gradually, costs of inputs where the latter are heavily subsidized and remove price controls to permit future private sector owners to respond to clearer market signals and cover costs of production, thereby ensuring more efficient use of economic resources from a macro economic point of view.

5. Review of labour laws is also an essential prerequisite to a successful privatization program, particularly if a goal is to attract greater foreign direct equity investment in newly privatized entities. These revisions should do away with compulsory employment and make it easier for private sector managers to dismiss employees deemed clearly inefficient.

6. Last, but not least, the improvement of a legal and regulatory framework to guarantee property rights of both domestic and foreign investors, and lead to the rapid development of money and capital markets.

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[14] For more details see Charles Vuylsteke, Techniques of Privatization of State Owned Enterprises Vol. 1, (World Bank Technical Paper 88, Washington, 1988).

VIII. KEY STEPS FOR THE PRIVATIZATION PROCESS

1. Sequencing Privatization with other Structural Reforms

The transfer of public enterprises to the private sector is not in itself an automatic guarantee that the performance of the enterprise will improve. Clearly, ownership matters, but it is not enough. Privatization may provide buyers with high profits and sellers with substantial revenues while not leading to increase efficiency, growth or improved performance in the enterprise sold. To ensure these desired outcomes, policy and regulatory measures must be in place at the time of the sale, so that the transfer of ownership takes place under conditions that promote competition and discourage monopolies. Thus the government at this stage is looked upon to provide two things: to create the overall environment conducive to the success of private companies; and establish efficient transparent institutional and administrative processes for privatization.

Privatization works best when reforms dealing with macroeconomic stabilization, the liberalization of trade, tariff, prices, and competition policy, regulations to control monopolies, and some types of financial reform (including interest rate reform) are in place. When privatization is undertaken ahead of these reforms, there is a high risk to the outcome. However, governments generally have only a limited time to effect economic change, so that they should concentrate first on clarifying the rules governing private sector activity. Clear policies reassure both investors and private sector that privatization, whenever it takes place, will be governed by predictable rules. Privatization can also be used as an anchor for fiscal stabilization of the economy.

2. Strategic Review of Enterprises and Determination of Privatization Program

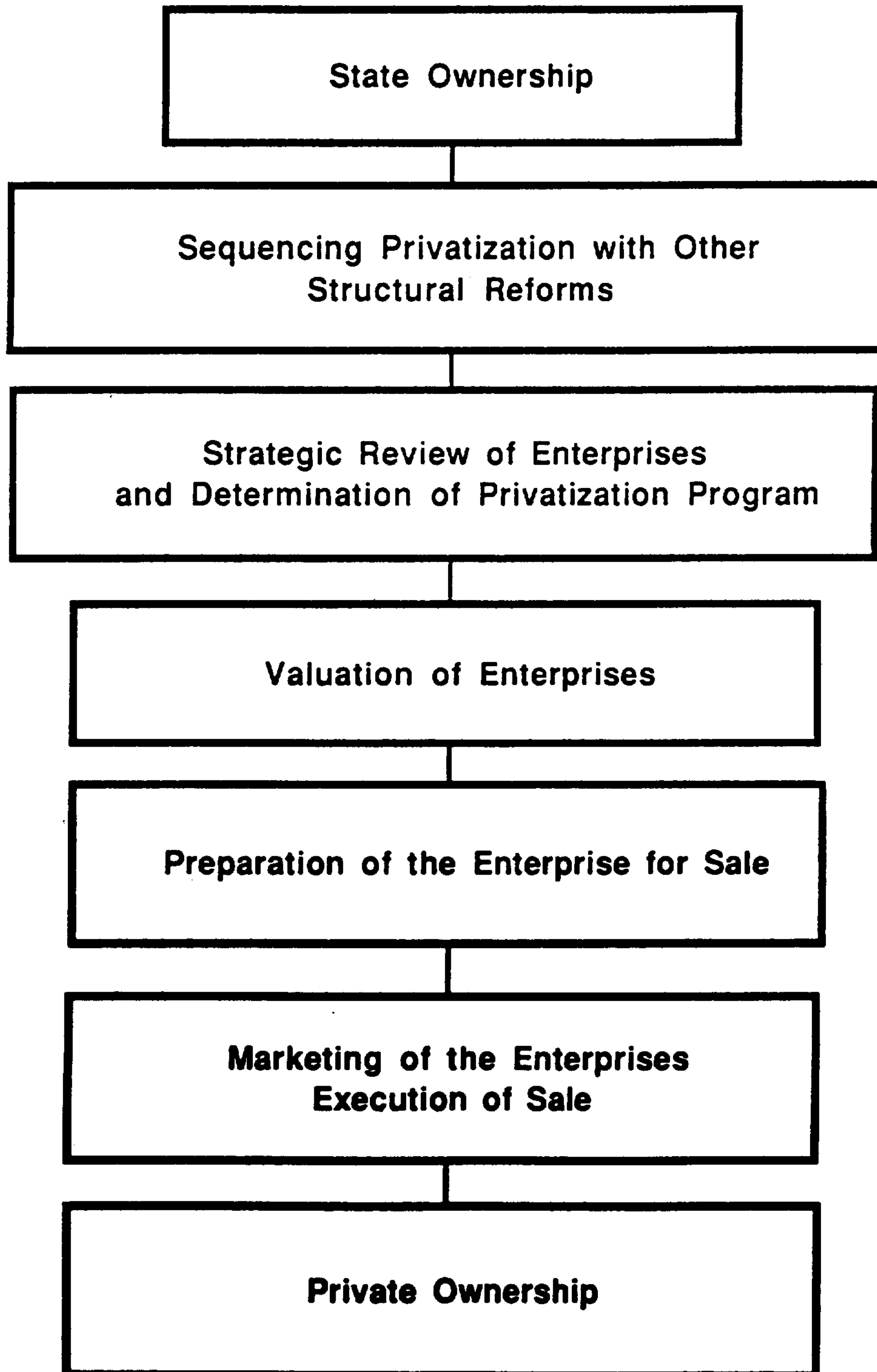
Pragmatic classification criteria are required to identify public enterprises that can best achieve the stated objectives and benefits of privatization while minimizing its potential hazards. Financial performance, degree of competition and linkage to other private sector activities are among the most important elements of such criteria. Public entities with a good financial record will be attractive to the private sector. Entities operating and performing well in a competitive environment will strengthen competition after the transfer of ownership to the private sector and are less likely to require protection or subsidies in order to survive since private management is likely to lead to even greater success. Finally, companies with strong linkages to other private companies will stimulate and strengthen the private sector for a while and serve a basic objective of privatization.

The government needs to undertake a comprehensive assessment of legal, political, economic, business and financial environment. Identify legislative action needed and the effect that privatization will have on various parties. A privatization program should be developed that includes the industries and companies selected for privatization, setting priorities, defining restructuring opportunities, building awareness and establishing and communicating an implementation schedule;

The privatization program my require drafting and enactment of new legislation and regulations and revamping of government activities and establishing a privatization office or team to implement privatization. It also requires putting in place guidelines for foreign investment that will assist in moving the process along.

CHART 2

Steps of Privatization Procees



3. Valuation of Enterprises

The purpose of valuation is to estimate sales price for the targeted enterprises. Various methodologies can be used to arrive at range values including the following:[15]

- Discounted cash flows: value equals sum of total cash generated in future years, discounted at rate that reflects time value of money and perception of risk. This is the method used most often and considered most reliable.

- Ratio analysis: existing industry market ratios such as price-to-earning (P/E) and price-to-cash flow (P/CF) serve as basis to estimate value.

- Comparable transactions: recent sales of comparable companies/assets are used as indicators of market value.

- Replacement value: cost of replacing assets of a business, adjusted for age of existing assets, provides another benchmark for valuation, particularly in capital intensive industries.

- Book value: net worth of a company as reflected in its balance sheet provides yet another measure of a company's value.

4. Preparation of the Enterprise for Sale

Privatizing large enterprises requires considerable preparation. It often involves separating complex activities and assets, and the introduction of a clear regulatory policy that encourages investment and protects the interests of consumers.

The critical issues that need to be addressed at this stage include:

- Should all or parts of the enterprise be offered for sale? and should it be sold as a whole or in separate parts?

- Should the enterprise be sold with or without debt?

- Should social assets be included in the sale as a requirement or as an option?

- Should labor force be reduced prior to sale?

- Should capital improvements be made prior to sale?

- What method of privatization should be used?

- Is there a need for new management?

- Should Government have a continuing role? if so, what should it be? shareholder, regulator, supplier, customer, etc.

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[15] International Finance Corporation, "Privatization of An Enterprise, A Practitioner's View of Critical Steps In The Process", paper presented to the Institute for International Research (IIR) Seminar on Privatization (Dubai, April 1995).

- Would foreign ownership be allowed?

5. Marketing of the Enterprise

The steps required to market the enterprise include: conducting preliminary market survey to understand the enterprises' current and potential position in the competitive market, and evaluate likely demand. This is followed by drawing up a list of prospective bidders, including foreign investors both institutions and individuals. Candidates prequalified to do the job are preselected according to their financial strength, operating performance, technical capabilities, experience, etc.

The next stage includes the preparation of an information memorandum/prospectus providing details on the investment opportunity, description of the company, market assessment and local political, economic and investment framework. The memorandum should also include legal documentations covering purchase and sales agreement, shareholders agreement, management agreement, marketing or offtake agreement, supply agreement and licensing and lease agreement, if any. The document is then distributed for bidders with a timetable and process to be followed. Several tools could then be used to properly market the company being privatized, these include advertising, road shows, third party agents or brokers, etc.

Adequate time should be allowed for bidders to respond with full proposal. Meanwhile, the government should make available a data room with detailed information for bidders review, e.g. operating results, maintenance records, patents and licenses, suppliers and market contracts, customer lists, personnel policies and records, etc.

IX. The Privatization Program of the Six GCC Countries

1. Saudi Arabia

The Saudi government plans to privatize some of its holdings in several public sector companies.[16] The objectives of the Six Development Plan (1996-2000) which starts January 1996 also make clear the need to draw the private sector into the management of public utilities and other basic industries. The plan states among its objectives "to study the feasibility of privatizing some of the State enterprises with a commercial nature" and "to expand the use of private sector capital in financing some government projects".[17] The Kingdom already has some form of joint public and private participation in 37 quoted companies, including the Saudi Basic Industries Corporation (SABIC) in which the government share is 70 per cent.

Saudi Arabia has the largest stock market in the region in terms of capitalization at SR 141 billion ($38 billion) by the end of 1994. The paid up capital of the listed companies amounted to SR 69.4 billion ($18.5 billion) by the end of 1994, compared to SR 65 billion ($17.3 billion) in 1993, an increase of 6.8 per cent. As a percentage of GDP, market capitalization reached 31 per cent last year.

Electricity companies account for the biggest share, with 44.1 per cent of total market capitalization; followed by industry firms, including cement companies (33 per cent), services (12.3 per cent), banks (7.9 per cent), and agricultural companies (2.7 per cent).[18]

There are 78 companies listed on the exchange, but only 68 are publicly tradable. The total number of shares outstanding by the end of 1994 was around 755 million, compared with 698 million the year before. Only shares of Saudi companies may be traded in the Kingdom and these are normally acquired by Saudi citizens. In special circumstances (e.g. 1984 Saudi Basic Industries Corporation (SABIC) issue and more recently the Tabuk Cement Company among 13 other Saudi companies), specified portions of the shares floated were made available to other Gulf Co-operation Council Citizens. Following the last GCC summit held in Bahrain in December 1994, a decision was made to allow GCC countries' nationals to own up to 25 per cent of all Saudi shares except those of banks and insurance companies.

So far there has been no hard evidence that immediate action on privatization is being taken. Nor are there signs that the government is reviewing certain policies (including those relating to subsidies and transfers) among others, that privatization would entail. Furthermore, the poor performance of the Saudi share market (the official index declined by 28.7 per cent in 1994) suggests that for the time being, there is not sufficient demand on the part of the investors to support large scale government asset sales. It is therefore unlikely that we will see privatization measures in the foreseeable future and the prospects are for the whole program to be implemented over a longer time span.

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[16] This was announced by King Fahd in May, 1994 when he said "the state intends to release government ownership in many productive and profitable state-owned entities to allow private participation in these firms".

[17] Arab News "Saudi Arabia's Six Development Plan Aims At Economic Efficiency, Privatization and More Jobs", July 5, 1995.

[18] For more details refer to Table 5.

The national carrier Saudia and the telephone system are frequently cited as prime candidates for privatization, however, the two companies are unlikely to be transferred to private hands before the expansion projects currently underway are completed. Saudi Telecom took the first privatization move when it turned over pay phone service to the private sector. Here, Saudi Telecom's role will be regulatory, while the private sector will be responsible for importing, installing, and maintaining pay phones. Many Saudi companies have pre-qualified with Saudi Telecom, and they expect to sell between 35,000 and 43,000 units over the next two to three years.

Table 5. Saudi Arabia: Government shareholding in joint stock enterprises by sector, 1994

	Total Capital (SR million)	Govt. share in capital (SR million)	Govt. share (%)	Market capitalization (SR million)	Market value of Govt. shares (SR million)
Banks					
Riyad Bank	2,000	580	29.0	10,960	3,178
Saudi Investment Bank	90	7	8.0	913	73
Saudi Cairo Bank	1,200	300	25.0	3,912	978
Saudi American Bank	1,200	300	25.0	12,744	3,186
Sectoral Total	4,490	1,187	26.4	28,529	7,415
Agriculture					
Saudi Fisheries	100	40	40.0	291	116
Tabuk Agricultural Company	200	16	8.2	232	19
Jouf Agricultural Company	200	3	1.5	158	2
National Agriculture Development Company	400	80	20.0	480	96
Sectoral Total	900	139	15.4	1,161	233
Cement and Construction Material					
Saudi Cement Company	2,040	159	7.8	3,713	290
Yamamah Cement Company	900	90	10.0	2,691	269
Qasim Cement Company	300	111	37.0	1,085	401
Yanbu Cement Company	700	84	12.0	1,806	217
Southern Cement Company	700	280	40.0	2,135	854
Eastern Cement Company	968	290	30.0	1,929	579
Saudi Ceramics	150	33	22.0	855	188
Sectoral Total	5,758	1,047	18.2	14,214	2,798
Industry					
National Gas & Industrialization Company	500	77	15.5	700	109
Jeddah Refinery (Saudi Refining Company)	150	113	75.0	196	147
Saudi Fertilizer Company	200	82	41.0	2,570	1,054
Saudi Basic Industries Corporation	10,000	7,000	70.0	26,900	18,830
Savola	300	22	7.4	2,052	152
Sectoral Total	11,150	7,294	65.4	32,418	20,292
Electricity					
Arir Electricity Company	15	9	59.9	21	13
Tabuk Electricity Company	8	3	33.3	8	3
Domat Al Jundal Electricity Company	10	8	80.0	20	16
Rafha Electricity Company	4	2	54.9	4	2
Eastern Electricity Company	5,000	2,450	49.0	5,300	2,597
Central Electricity Company	8,000	6,160	77.0	8,400	6,468
Western Electricity Company	8,000	6,720	84.0	8,080	6,787
Southern Electricity Company	4,000	3,940	98.7	3,920	3,869
Sectoral Total	25,037	19,292	77.0	25,753	19,755
Services					
Hotel Company	500	159	31.8	835	266
Saudi Real Estate Company	600	438	73.0	834	609
National Shipping Company	2,000	578	28.9	1,980	572
Taiba Investment and Development	3,000	330	11.0	2,020	222
Makkah Construction Company	1,355	93	6.9	3,469	239
Saudi Public Transport Company	1,000	300	30.0	1,290	387
Sectoral Total	8,455	1,898	22.4	10,428	2,295
Total	55,790	30,857	55.3	112,503	52,788

Source: Al-Attas Investment, Overview of the Saudi stock market for the year 1994.

Note: Market Capitalization figure relate to mid 1994.

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According to the 1993 statistical year book of the Ministry of Posts, Telegraphs and Telephones (PTT), there are around 1.5 million telephone lines in the Kingdom generating revenues of around SR 5.655 billion ($1.5 billion) in 1993. The cost incurred by government for allowing free internal phone calls is put at around SR 500 million annually. The $4.1 billion contract signed with the American company AT&T for the expansion of the Kingdom's telecommunications capacity (by adding 1.5 million new telephone lines and 200,000 mobile telephone lines) will be financed from the internal resources of PTT over a seven years period at around SR 2.29 billion a year. Privatization of the Telephone is unlikely therefore, to take place before three years from now, when part of the expansion project is completed and possibly not before seven years when the project is completed.

The same applies to Saudia which has placed an order worth $7 billion to buy 63 new aircrafts to upgrade its fleet. The carrier has a fleet of more than 111 aircrafts, and transported more than 12.4 million passengers in 1994. The airline receives government financial support of about SR 8,500 million ($2,270 million) annually to cover losses mainly caused by low price of domestic air fares. It is unlikely that Saudia will be privatized before the company is restructured and its financial health has been vastly improved.[19] What is likely to happen over the coming few years is the privatization of some of Saudia's services such as catering, baggage handling and aircraft cleaning.

A gradual approach to privatization is likely to be followed in Saudi Arabia. Each privatization issue would be studied carefully and independently. The capacity of the local stock market would be taken into consideration before government shares are transferred to private investors. To start, only shares of profitable entities should be sold in order to give confidence to the private sector and encourage wider participation. Foreign investors are unlikely to be allowed to participate in the Saudi privatization program at least in the early stages, even though this will deprive the country from additional resources that could bring in besides capital, technology and managerial skills.

Initially the government is likely to reduce gradually its holdings in companies whose shares are listed and traded on the stock market. The government owns shares in 37 companies listed on the Saudi stock market. The total capital of these companies is put at SR 56.3 billion, 55.4 per cent of which or SR 31.4 billion is held by the Public Investment Fund on behalf of the government (table 5). The market value of the companies' shares owned by the government exceeded SR 50 billion by end 1994. It is estimated that the government share in the capital of the eight electricity companies is around SR 19.3 billion, accounting for 77 per cent of the total capital of these companies. The government owns 70 per cent of SABIC, 25 per cent of Riyad Bank, 10 per cent of Saudi American Bank, 25 per cent of Saudi Cairo Bank, 8 per cent of Saudi Investment Bank. It also owns 15.4 per cent of the capital of four agricultural companies, 18.2 per cent of Cement and Construction material companies and 22.4 per cent of services sector companies.

SABIC is a prime candidates for companies where the government is likely to sell additional shares to the private sector. No decision has yet been made on the number of shares to be sold, the timing and procedure of such sales. However, there is a long standing official policy to reduce the government stake eventually to 25 per cent. SABIC shares have been trading over the past few months at around SR 370 ($100) each. If the government sells at that price 45 per cent of its stake in SABIC (bringing down its share from 70 per cent to the target level of 25 per cent), this will be worth SR 16,857 billion ($4.5 billion). SABIC has 100 million shares with a nominal value of SR 100 each.

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[19] Arab News June 19, 1995.

Privatization of government-owned companies will start with a Yanbu-based Ibn Rushd polyester plant affiliated to SABIC. The SR 3 billion plant, a joint venture company between SABIC and a consortium of nine companies, is targeted to be privatized. The process is likely to be in two stages. The first was already achieved with the setting up of the shareholding companies. The second phase will be the sale of company shares to the public after about three years.[20]

Commercially viable public sector establishments whose assets can be assessed to give estimates of share values will then follow. One of those establishments is the Saudi Ports Authority and the government may consider inviting the private sector to have up to 49 per cent share holding interest in it. Another candidate is the Saudi Arabian Railway Organization but this company has to become profitable first for the private sector to be interested in buying its shares. There are as well public sector companies that can be privatized through operation and maintenance contracts (lease contracts), such as public hospitals, airports and ports, as well as operation and maintenance work. Several new projects can be subcontracted to the private sector for a specific period of time on a build, operate and transfer schemes (BOT). These include power, water and sewage projects among others.

2. Kuwait

Kuwait has accepted in principle the main recommendations of a recent World Bank report which urged the privatization of 74 local industries including 62 companies in which the Kuwait Investment Authority (KIA) has share holding. The government holds stake in 36 companies out of the 48 listed on Kuwait stock exchange and the total value of its holding is put at KD 864 million ($2.9 billion) or 26 per cent of the market's total capitalization. Government stakes in 16 out of the 36 companies are between 50 per cent and 100 per cent. It has a share holding of between 25 per cent and 49 per cent in 6 of these companies and a share holding of less than 25 per cent in the remaining 15 (table 6).

There are several companies targeted for privatization that are not listed on the Kuwaiti stock market. It is estimated that the total value of the government's stake in the companies that are targeted for privatization (excluding oil sector companies) is around KD 4 billion ($13.5 billion), including KD 2.2 billion ($7.3 billion) in electric power and water facilities, KD 200 million ($666 million) in telecommunications facilities, KD 420 million ($1.4 billion) in Kuwait Airways Corporation and KD 800 million ($2.66 billion) representing KIA's share holdings in 62 companies some of which are listed on the stock exchange.[21]

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[20] Saudi Gazette July 1, 1995.

[21] National Bank of Kuwait, Economic and Financial Quarterly Fourth Quarter, 1994.

Table 6. Kuwait: Government shareholdings in joint stock enterprises, 1992

	Percentage government shareholding*
Bank	
National Bank of Kuwait	1.67
Commercial Bank	8.50
Gulf Bank	17.60
Al-Ahli Bank	8.50
Bank of Kuwait and Middle East	58.80
Burgan Bank	60.99
Real Estate Bank	33.68
Kuwait Finance House	32.58
Investment Companies	
Kuwait Investment Company	70.08
Kuwait Foreign Trading Contracting Investment Company	99.58
Kuwait International Investment Company	31.94
Insurance Companies	
Kuwait Insurance Company	7.52
Gulf Insurance	75.18
Al-Ahlia Insurance	20.29
Warba Insurance	55.82
National Industries	58.08
Metal Pipe Industries	17.84
Kuwait Cement	36.57
Kuwait Fisheries	55.83
Refrigeration Industries	60.42
Kuwait Shipbuilding & Repair yard	56.38
Kuwait United Poultry	56.38
Gulf Cable	28.81
Kuwait Pharmaceutical Industries	-
Transport	
Livestock Transport & Trading Company	54.53
United Arab Navigation	19.50
Overland Transport	-
Real Estate Companies	
Kuwait Reality	13.70
United Real Estate	57.85
National Real Estate	25.22
Kuwait Commercial Markets Complex	16.40
Service Companies	
Kuwait National Cinema	3.18
Kuwait Hotels	73.98
Kuwait Foodstuff	34.50
Agricultural Products	49.46
General Warehousing	53.00
Mobile Telephone Systems	50.44

Source: Ministry of Planning Central Statistical Office, Financial Statistics, 1992.

* Represents shareholdings by KIA and other governments institutions and agencies.

The privatization process is targeted to encompass a number of downstream oil companies including Kuwait Oil Tanker Company, Kuwait Aviation Fueling Company, Kuwait Foreign Exploration Company, Santa Fe International in the US, petrol stations owned by Kuwait National Petroleum Company and any new projects by the Petrochemical Industries Company. In 1994, the government sold to the private sector 20 new gasoline stations, some of which have not yet been operational. Also the natural gas factory and the lubricating oil factory have been slated to go to the private sector. The privatization project would be carried out through the establishment of a public share holding company, whose shares would be owned 20 per cent by the Kuwaiti Government with the remainder offered for public subscription. The 75 stations currently operating in Kuwait would be gradually sold to a number of specialized local firms to enable them to provide better services to the public.

The Kuwaiti government, however, did not agree with the World Bank's recommendation to sell 25 per cent of Kuwait Petroleum Company (KPC) and Kuwait National Petroleum Company to the private sector because of the strategic need to keep these companies entirely within the public sector. Instead a number of smaller companies owned by KPC namely Kuwait Oil Tanker Company, Santa Fe, Kuwait Aviation Fuel Company as well new petrochemical projects will eventually be privatized.

The Kuwait Investment Authority has announced plans to sell most of its portfolio of shares in more than 60 joint stock companies acquired following the collapse of the Kuwait share market in 1982. At the end of 1994, the value of these holdings was estimated at KD 800 million ($2,700 million). In 1994, the Kuwait Investment Authority sold a 52 per cent share in the local United Real Estate Company to the Kuwait Investment Projects Company (Kipco), a private sector investment firm. Kipco has agreed to resell 57 per cent of this (representing 30 per cent of the real estate company) to the private sector at a 7 per cent discount.[22] The Kuwait Petroleum Corporation (KPC) has also announced a decision to put up for sale the oil and gas explorations of its wholly-owned US-based subsidiary, Santa Fe International Corp. Santa Fe International's Oil and gas operations are primarily in the US.

The pace of privatization has quickened decisively in 1995. Since January, the KIA has successfully sold stakes in four companies. At the start of June 1995, it announced it would sell by auction 170 million shares worth almost KD 90 million ($300 million) in National Industries Company, a leading local manufacturing firm, in the most valuable share offering so far. This will raise the value of shares sold by the KIA since the start of 1994 to more than KD 220 million ($736 million). Expectations are mounting that further shares sales will take place. Candidates include Kuwait Aviation Catering Services Company owned by Kuwait Airways Corporation, Warba Insurance Company and Refrigeration Industries Company.[23]

State assets in the electricity and water sectors are targeted to be transferred to a new company and shares sold to the public. A similar procedure would be adopted for Kuwait Public Transport Corporation and Kuwait Airways Corporation. The privatization of the telecommunications sector is more advanced. A new company, Kuwait Telecommunication Company (KTC), was formed in 1992 to take over the Communication Ministry's responsibilities. Shares in the company, valued at around KD 150 million ($500 million) are expected to be offered to the public in 1995/96.

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[22] MEED, July 7, 1995.

[23] MEED Money, June 6, 1995.

KIA foresees three ways to proceed when privatizing companies it owns: (1) to float shares for subscription though the establishment of investment funds that would acquire KIA's assets in these companies; (2) the sale of shares through an open auction or through closed bids, and (3) through public share flotations.

Privatization through the establishment of investment funds and open auction had actually started. Since April 1994, two mutual funds have been established to acquire shares in companies and real estate assets held by the investment body. In May 1994, KIA sold its KD 10.4 million stake in the local Land Transport Company through an open auction, followed in December 1994 by the sale of 60 million shares of its holdings in Al Ahli Bank through open auction to Kuwaiti and GCC citizens. The sale realized around KD 10 million ($ 33.7 million) to the government. KIA was also successful in selling last year part of its stake in a profitable consumer finance firm called The Commercial Facilities Company during September this year. The public share offering was 5 times oversubscribed and KIA's share was reduced from 55 per cent to 38 per cent.

The successful flotation of 270 million shares in Bubiyan Petrochemicals Company (BPC) in April and May 1995 was a sign that the capacity of the Kuwait Stock Exchange was larger than previously supposed. BPC will hold a 10 per cent equity interest in Equate, which is a petrochemical joint venture between the state-owned Petrochemical Industries Company (55 per cent) and Union Carbide of the US (45 per cent). BPC is capitalized at KD 30 million ($103.4 million) and 90 per cent of the new company's 300 million shares, amounting to 270 million were offered for public subscription leaving 30 million shares to be held by Equate. The sale of the shares in BPC was restricted to Kuwaiti nationals and Kuwaiti private as well as government establishments, with priority being given to the private sector.

3. Oman

Oman has embarked on a relatively large scale privatization programme as part of a broader effort to reverse domestic capital outflows, as well as, to attract foreign investment. Two investment companies, the Oman-Emirates Holding Investment Company and the Trans Gulf Industrial Investment Company, with state and private share holding were launched in 1993 and given mandates to invest in shares of privatized companies.

The privatization process in Oman began in late 1993. Major shares which have been sold include 34 per cent of the Gulf Hotels company, 15 per cent of the Oman National Insurance Company and 20 per cent of National Bank of Oman. Remaining blocks of shares on the Muscat stock exchange comprise 60 per cent of the Oman Flour Mills company, 35 per cent of the Port Service Corporation, 35 per cent of Oman Aviation Services and a holding in Oman Cement Company. The government also has transportation, agriculture, telecommunication and refining interests, which, when taken together with the quoted stocks mentioned above, are probably worth about $1.5 billion.[24]

Oman's stock market is relatively small. When Muscat Stock Exchange was established in May 1989, there were 71 companies listed. Today there are 93 companies with total capitalization of $1.5 billion. Fifteen of these companies are not yet publicly traded and of the remaining 68 companies, 40 are listed on the main board and 23 on the secondary or parallel market. Companies which make losses for two consecutive years are automatically demoted to the secondary market.

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[24] Mahmoud Al Jarwani "Maximize your Investments by Profiting From the Current Privatization Projects in the Middle East" paper presented at the Institute for International Research (IIR) conference, Bahrain Nov. 1994).

Few emerging market funds have recently been established, aimed at investing in Omani stocks including those that are newly privatized. Blakeney Management, an offshoot of Barings, launched a $45 million Oman investment fund in 1994 in association with the local Oman National Insurance Company. The Japanese Investment bank, Nomura is expected to launch a fund during the second half of 1995. The local AIAhleia Portfolio has plans for a OR 5 million ($13 million) fund this year. Robert Fleming is also understood to be considering a Gulf-wide investment fund.

The first stage of privatizing Oman Cement Company, the country's largest cement producer was launched on June 25, 1994. A total of 15 million shares were offered for sale and the total amount collected reached OR 15 million ($39 million). This boosted the company's capital to OR 35 million ($ 91 million), of which 41.7 per cent is owned by the private sector. The government is considering selling its stake in the Muscat Intercontinental Hotel, the Seeb Novotel and the Salalah Holiday Inn. The Government has also implemented a program of transferring certain public operations to the private sector, e.g. billing and collection for water and electricity, maintenance and cleaning contracts, and operating contracts for water and power stations and hotels.

Sales of shares in Salalah Flour Mills Company, which took place in April 1995 helped raise part of the RO 6.8 million ($17.70 million) capital needed to establish the company. The offer was oversubscribed attracting up to RO 4 million($10.4 million). This was well over the sum required to supplement the funding which has already been secured. The company is due to start production in 1997 and will have a capacity of 60,000 tons a year.

Table 7. Oman:Government shareholding in joint stock enterprises, 1992

	Date of Establishment	Subscribed Capital (RO '000)	% of Shares Owned by Government
Central Bank*	1975	175000	100.0
Telecommunications*	1975	50000	100.0
Gulf Hotel	1974	2000	32.1
Oman Aviation Services	1981	7000	35.0
Bank of Agriculture & Fisheries	1981	19000	99.0
Oman Cement Company	1977	41429	99.9
Oman Development Bank	1977	10000	54.1
Oman National Fisheries	1989	12500	24.0
Oman Flour Mills	1975	10500	60.0
Housing Bank	1976	30000	61.0
Oman Mining Company	1978	25000	99.0
Oman National Insurance	1977	5000	15.0
Oman National Transport	1975	6000	99.9
Oman Refinery	1983	30000	99.0
Port Services	1975	4800	35.6
Raysut Cement	1981	8000	20.0
Marketing Agricultural Production	1985	9807	100.0
Salalah Hotel Company	1978	2500	99.9
Al Bustan Hotel*	1985	NA	100.0
Inshirah Restaurant*	1987	NA	100.0
Muscat Intercontinental Hotel*	1987	NA	100.0
Storage & Food*	1980	NA	100.0
Rusail Industrial Estate*	1983	NA	100.0
Seeb Novotel*	1982	NA	100.0

Source: The World Bank, Sultanate of Oman: Sustainable growth and economic diversification May 31, 1994.

* Organization and companies whose shares are not traded on the Muscat exchange.

Oman's long term privatization program aims at attracting private investments for infrastructural projects. Sectors earmarked for build, operate and transfer (BOT) schemes include power projects, roads, sewerage and water supply. None of these has seen private investment in the region before, as all infrastructure was built and owned by governments. Al-Manah power station is the first major project of its kind to be operated by the private sector. The United Energy Company (UPC) capitalized at $71.2 million was established to build and operate the project. It floated around 11 million shares worth $29.6 million for local and foreign investors (the share of non-Omanis not exceeding 49 per cent, while $41.6 million have been subscribed by the founding shareholders and the International Finance Corporation (IFC). Besides contributing 5.32 per cent of the capital, the IFC provided two loans worth $60 million as part of the total financing package for the project of $240 million.

The Oman Ministry of Electricity and Water will purchase power from UPC for 20 years after the start of operations. After 20 years, the plant will be transferred to the government for a nominal fee. The purchasing agreement between UPC and the government specifies the price at which the government will purchase electricity from the company. A fee paid in local currency but indexed to account for changes in exchange and inflation rates is included to cover the company's debt service payment.

Oman Mining Company (OMC) has appointed a privatization consultant in June 1995 to make recommendation on what form the privatization will take and what percentage of the state company will be offered to investors. Other projects intended for the private sector include two electricity plants in Salalah and Barka, a sewage project in Muscat at a cost of RO 205 million ($532 million), a similar project in Salalah at a cost of RO 53 million ($138 million) and a $200 million petrochemical complex.[25]

4. Bahrain

A well developed financial sector and a relatively sophisticated stock exchange have contributed to the success of recent attempts to privatize some government owned entities. Divestment of state assets in the manufacturing, agricultural and fisheries sectors have made progress. In January 1994, the government sold a 20 per cent stake in one of the country's largest food firms, the General Trading and Food Processing Company, on the Bahrain stock exchange for BD 3.9 million ($10.3 million).[26]

Prior to the Gulf crisis, 20 per cent of the Bahrain Aluminum Extrusion Company (Balexco) was privatized and a public share offer of a further 20 per cent is currently in the pipeline. This will reduce the government holding in this profitable firm to 25 per cent from 45 per cent by mid 1995. The government's divestment plans for the next few years also include a number of state trading and industrial ventures. However, in the future the emphasis will be on attracting private investment for new industries rather than selling off the government's limited remaining portfolio of assets.

A program to encourage private investment in power generation is under consideration. British gas is working on a plan to implement a 300 MW power station and desalination plant on a private financing basis. As a foreign investor, it is committed to take a sizeable portion of the equity, expected to be in the range of $150 million - $200 million. The government is also keen to see its share in Gulf Air and other joint Gulf organization's diluted through privatization. In 1994, Gulf Investment Corporation and Chase Manhattan Bank were awarded the mandate to prepare a report on privatization options of Gulf Air, but no concrete decision on selling the air line has yet been taken. Aluminum Bahrain (ALBA), the Gulf largest aluminum smelter which is majority owned by the government of Bahrain could be a long term candidate for privatization. The total value of privatized companies could reached $2 billion.

There are 34 companies traded on the Bahrain Stock exchange with total capitalization of $5.9 billion by end 1994. Among the companies who raised capital through public floatation recently was the Bahrain Leisure Company, a new company founded to promote tourism. A BD 2.75 million ($7.3 million) public share was issued on 6 June 1994. The rights offer by Al-Ahli Commercial Bank of

[25] MEED June 16, 1995.

[26] MEED, Feb 1, 1994.

Bahrain that came to the market in May 1994 was fully subscribed.

Foreign residents in Bahrain, are allowed to invest in the shares of local companies through mutual funds. These funds will eventually be opened to non-residents and will be listed on Bahrain Stock Exchange. One initiative under study at present is to permit other GCC companies to list their shares and bonds on the Bahrain Stock Exchange, and this could be followed eventually by the listing of bonds and shares of non-GCC countries[27] companies. Another important initiative that took place April 25, 1995, is a cross listing of private companies by the Bahrain and Muscat Exchanges. This offers equal access to the two markets for investors in both countries.

5. United Arab Emirates

UAE is carrying out a feasibility study to look into the privatization of certain government monopolies such as the Emirates General Petroleum Corporation which is a marketing and distribution agency. The Al Ain dairy farm is also a likely candidate for privatization. So far, only the telecommunication giant, Etisalat, has been partially privatized when 40 per cent of its capital of $1.5 billion ($408 million) was floated in 1984. Another institution the Arab Bank for Investment and Foreign Trade floated shares to raise its capital to Dh. 760 million ($207 million) in 1994, and a new joint stock company, Dubai Investments was established by floating shares in May 1995.

There are other possible privatization candidates in the UAE over the long-term. The chairman of Emirates airline, the international carrier launched in 1985 said in June 1995 that the privatization of the airline is unlikely to take place for another five years. Emirates recorded a profit of $25 million in the year ending March 1995 making it one of the most profitable airlines in the region. This would give it a market value of at least $200 million.[28]

The Abu Dhabi authorities are planning to privatize cement, agricultural and non-oil industrial concerns worth more than one billion dirham ($272 million).[29] A local bank is currently preparing studies for the sale of dairy and egg farms, and there is a good chance that these sales could proceed in the second half of 1995. However, it is not yet clear how these ventures will be sold, since there is no formal stock exchange in the UAE. Private placement would therefore be the easiest way to dispose of the companies, but this would not fulfill the authorities' aim of broadening share ownership in the Emirate. However, the sale of a few small ventures, even if only to a close group of investors, could be taken as part of a trend which would lead, in time, to public share flotations.

The impetus for privatization in Abu Dhabi does not come from a desire to raise funds as the authorities there are not in urgent need of additional revenues, and many of the companies which are to be put into the private sector are already run on a reasonably efficient basis. Broadening share ownership is therefore the principal object of the privatization program. There were two public share issues in Dubai in 1993 and a $95 million offer from the newly-formed Dubai Investment Company is due soon. These three issues, the only ones in the Emirates since the early 1980s, indicate that public share issues are not precluded by the absence of a formal stock trading system.

A recent study by Abu Dhabis' General Industry Corporation (GIC) has identified five

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[27] Non-GCC countries comprises to Egypt Iraq, Jordan, Lebanon, the Syrian Arab Republic, the West Bank and Gaza Strip and the Republic of Yemen.

[28] MEED Money 30 June, 1995.

[29] Arab News July 15, 1995.

companies as candidates for privatization: the Al-Ain Cement Factory, the Abu Dhabi Flour and Animal Feed Factory, the Abu Dhabi National Factory for Pipes and Bags, the Brick and Cement Factory based in al-Ain and al-Wathba, and the al-Ain Mineral Water Plant. The GIC study recommends that these five should be sold from the beginning of June 1995 and estimates their worth at Dh 722 million ($197 million).[30]

An informal stock market exists in the UAE but the creation of a formal exchange is now being studied. High government ownership coupled with a tendency for long-term investment and restriction of dealing to nationals have made turnover in the UAE the lowest in the Gulf. It stood at around one million dirhams ($272,000) a day in 1994, although the UAE is the second biggest in terms of market capitalization of around 35 billion dirhams ($10 billion). There are 77 joint stock companies now trading their shares in the unofficial stock market. Several companies have raised their capital in the past two years, however, most of the subscriptions have been confined to shareholders. Privatization will help revive the primary issue market and give share trading more depth and transparency.

6. Qatar

An official stock market, the Doha Securities Market (DSM) was set up in Qatar recently to organize share dealing and attract investment.

Qatar has around 20 companies trading their shares in addition to the giant Saudi Arabian Basic Industries Company, which trades its shares in all Gulf markets. Turnover has remained the smallest in the Gulf given the low number of trading institutions and the absence of a stock exchange. There is no discipline in Qatar's market nor is there any system to track the moves of shares and their prices. This has given rise to manipulation and scared away small investors. The Emiri decree establishing DSM said initially only Qatari financial instruments would be traded on the exchange but the cabinet may later allow trade in shares issued in other GCC states and Arab and foreign countries.

An early attempt at privatization was in fact made in 1990 when the Qatar Electricity & Water Joint Stock Company (OWEC) was created to takeover and manage the country's utility complexes including power generation and water desalination. It was 60 per cent privately owned and 40 per cent government but the take-over did not materialize. The government has recently made attempts to revive the venture. OWEC is supposed to invest in new power and water plants in Qatar and buy existing production capacity from the government. However, the company which was capitalized at QR 1 billion in 1991, has yet to make any investments and has recently offered shareholders, other than founder members, the option of withdrawing their money. There are several excellent candidates for privatization in Qatar. The primary one is Qatar Telecommunications, which would be the easiest to privatize because it is run fairly independently and is very profitable.

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[30] MEEDMoney 16 June, 1995.

Table 8. Structure of Gulf stock markets: 1994

	GDP ($billion)	Market size capitalization ($billion)	Annual turnover ($million)	Number of listed companies	Market index % change 1994	Accessibility to foreign investors
Saudi Arabia	120.8	38.0	6,632	67	-28.75	- Open only to Saudi Nationals, - Other GCC nationals can own up to 25% of listed companies - Shares traded over the counter through banks
Kuwait	21.5	11.3	1,950	47	-1.9%	- Open to GCC nationals - Non-Kuwaity residents are allowed to own shares through mutual funds in certain companies
United Arab Emirates	35.9	10.0	200	77	-5.0%	- Open to UAE nationals and partly to other GCC nationals
Bahrain	4.3	5.9	200	34	-21.2%	- Open to GCC nationals - Foreigners resident in Bahrain for at least three year may own up to 1% of the capital of a single company - Foreigners can trade shares in only four of the 32 listed companies
Oman	9.9	1.5	300	68	28.5%	- Open to GCC nationals - Open to foreign investors through mutual funds, up to 49% of listed companies

Source: National Commercial Bank (NBC), based on various national and international sources.

X. Conclusion and Recommendations

Privatization in the region will take time to be initiated and completed, possibly from three to eight years. The process is also quite complex, entailing a series of steps to be taken and should be implemented gradually in order not to flood the region's stock markets with public company shares. One should also keep in mind that the process is planned to be undertaken at a time when Gulf governments have been issuing competing high yield bonds to finance fiscal deficits.

When the actual privatization schemes are implemented, the private sector will look to both internal and external savings to fund the acquisition of the shares. Generally, we should expect domestic deposits to absorb most of the financing burden. This is another reason why the whole process should be gradual, otherwise the reduction in deposits could force banks to curtail lending and may lead to a credit crunch. While the aim is to bring forth larger private sector participation, a rush into privatization without careful planning could end up disrupting private sector activities.

Many countries began their privatization programs by selling small and medium size state owned enterprises in competitive sectors. Such sales are simple, they involve little restructuring or regulation, and are politically low-risk. Governments in the region should follow a learning by doing approach to privatization starting with the small companies and moving on to larger, more complicated transactions. This is the primary lesson of the successful experience in several developing countries.

There are several examples of companies where the government can easily sell part of its share holdings without disrupting the stock market (e.g government shares in banks, industrial, agricultural, cement and services companies). A few other companies may qualify at a later stage. These companies currently operate in a monopolistic setting as they are the only providers of the services that they offer. Clear and efficient rules for regulation of their behavior need to be in place before they can become candidates for privatization. Some of them need to be reorganized and nursed to profitability (e.g airline companies, telecommunications, port services and public transport companies among others).

There are companies that require special consideration because of their strategic status, monopolistic position, the size of the financial resources needed for their acquisition by the private sector and their dependence on subsidies and transfers from the government. A special study is required before any decision to privatize them could be made (e.g electricity, water, gas etc.). One of the major stumbling blocks in the way of privatizing wholly owned government enterprises in the GCC countries is the social and political implications. In particular, the impact on domestic employment is an important issue. A plan to retrain redundant labour must be formulated, and a transitional period which may include an income maintenance scheme may also be needed.

While one cannot generalize, some of the governments of the GCC countries are pricing national labour out of the reach of the private sector, thus weakening the relationship between productivity and wages in a number of government owned enterprises. Over protection of the local labour has given the private sector a disincentive to hire locals, an issue that needs to be addressed.

Governments should consider other mechanism of privatization, including built operate and transfer schemes, privatizing management or leasing out to the private sector. Under management contract, the government pays a fee to a private sector institution to manage the firm in question. If the contracts are correctly drawn up, the gains can be considerable but the scheme requires good supervisory capacity on the part of the government. Many of the governments' enterprises,

particularly those which provide a service to the citizens, survive on a major element of subsidy. This subsidy cannot be totally eliminated since it is a form of government income distribution. But private management can manage this subsidy more efficiently and will, eventually result in its reduction.

Finally, it should be noted that privatization does not necessarily mean the total transfer of ownership from the government to private owners. Many of the government's concerns cited may be partially addressed by retaining minority government ownership, as well as instituting efficient regulation. Partial government ownership should be transitional and it should not convey the notion that the government is guaranteeing private investment.

Several of the GCC countries governments are opting to launch their privatization programs with sales of large and often poorly performing public utilities, on the basis of the belief that divestiture of a major state enterprise will signal commitment to investors and markets, and that the economic returns of enhanced efficiency in a large firm will outweigh the potential risks. This strategy has most often been used in Latin America (especially in Argentina). However, this approach is unlikely to succeed if blindly copied in the GCC countries.

For the privatization programme to be successful, certain prerequisites need to exist. These include a fully functioning stock market supported with the necessary legislative infrastructure and sophisticated financial services. Compared to the emerging markets of Asia, Africa, Latin America and Eastern Europe, stock markets in the GCC countries are small. At the end of 1994, total stock market capitalization in the GCC countries was estimated at $66.7 billion of which Saudi Arabia accounted for nearly 57 per cent. Compared to this, total stock market capitalization in the major 38 emerging markets reached $1,000 billion at the end of 1994. As a percentage of GDP, market capitalization of the six GCC countries stood at around 35 per cent in 1994 compared to 50 per cent in other developing countries and 80 per cent in the developed world.

A well-functioning legal framework is especially important for successful privatization. Creating such a framework entails developing important aspects of business legislation (property law, competition law, corporate law, dispute settlement, environmental legislation, and provisions governing foreign ownership of assets), defining property rights, modifying the legislation of state owned enterprises to be divested, and developing laws for organizing the privatization process.

The establishment of Privatization Office may prove necessary to implement the programme. The office needs to be given powers to make all the decisions relating to the programme including which enterprises to be privatized, the timing of each divestiture, asset valuation, the appointment of government agents, including brokers, underwriters, banks, and accounting and law firms. The Privatization office would be given the mandate by the government to provide all the necessary information relating to the programme to all interested parties including those acting on behalf of the government and the public.

The region's banks can play an important role in the privatization process by providing evaluation and underwriting services to the government, and by incorporating shares of privatized companies in their already existing local equity funds. Specialized portfolio management will provide an easy means of participation in the regions equity markets (including stock of privatized companies) for local and foreign investors who are not capable of managing their own investments in these markets. The expertise provided by portfolio managers would ensure greater success than the non-professional investor could achieve on his own. By pooling resources mutual funds have the power to turn illiquid investments (e.g. small company stocks) into highly liquid ones.

Foreign participation will provide an added push to privatization. It will not only generate

capital inflows but also the introduction of know how (managerial, technological), ingredients which most developing countries would welcome. A careful analysis however, should be undertaken to evaluate the risks and rewards of foreign participation. Some enterprises are likely to benefit more from foreign participation than others, these need to be identified on a case by case basis. Foreign participation in privatization add depth to Gulf stock markets. If permitted with safeguards, including a cap on how much foreigners can jointly hold in any company, or allowing foreign investments through mutual funds, would boost demand for equity and encourage capital inflows.

To make privatization work, the governments of GCC countries must be able to analyze complex policy issues, make legal changes, choose among alternative privatization methods, and complete privatization deals with transparency. Experience elsewhere indicates, moreover, that privatization is more skill and information-intensive than other economic reforms. While prices, tariffs, or interest rates can be deregulated relatively easily, the expertise needed for government involvement in privatization cannot be achieved without significant study and preparation. The choice of public enterprises to be privatized is not only politically controversial but requires sophisticated technical analysis, as do financial restructuring, valuation, and the design of regulatory systems. In several of the GCC countries, both the skills and the requisite information are in short supply and this could make the whole privatization process more difficult.

A thriving industry of consulting firms has developed in recent years to assist developing countries with privatization, particularly with matters such as conducting classificatory studies of public enterprises, evaluating strategic options, preparing firms for sale, and carrying out sales. Besides complementing local analytical resources, foreign consultants help countries deliver their reports in a timely fashion. They can also assemble the full range of expertise required to analyze privatization issues and should be more objective than local consultants in their analysis. Foreign consultants, however, can fail to recognize local conditions and constraints or inspire distrust in the privatizing country. The government and local institutions should therefore, participate in the analytical studies and foreign consultants must be encouraged to work jointly with local partners or institutions in this respect.

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