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REVIEW OF THE COUNTRY PRESENTATIONS IN THE LIGHT OF A CROSS-COUNTRY ANALYSIS BY THE SECRETARIAT ON THE DESIGN, IMPLEMENTATION AND RESULTS OF PRIVATIZATION PROGRAMMES

Design, implementation and results of privatization programmes: a cross-country analysis of national experiences

Report by the UNCTAD secretariat

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CONTENTS

INTRODUCTION

1. This cross-country analysis has been prepared at the request of the Ad Hoc Working Group in connection with its review of country experiences (item 3 of the provisional agenda for its third session). It is a substantial revision of the document (TD/B/WG.3/7) submitted to the second session of the Ad Hoc Working Group. The revision has been made in order to take into account the country presentations which were received too late for the preparation of the earlier document, as well as those that were submitted to the second session of the Ad Hoc Working Group. The presentation of the analysis has also been reorganized in order to be able to accommodate the expanded material within a reasonable length, taking into account the prescribed page limit.

2. The analysis is based on the country presentations and statements of national experts submitted to the Ad Hoc Working Group from the following countries: Argentina, Australia, Bulgaria, Brazil, Colombia, China, Czech Republic, Egypt, Finland, France, Germany, Ghana, Greece, Hungary, Indonesia, Israel, Jamaica, Japan, Jordan, Lithuania, Malaysia, Morocco, the Netherlands, New Zealand, Niger, Nigeria, Pakistan, Peru, the Philippines, Poland, Portugal, Republic of Korea, Romania, Russian Federation, Senegal, Slovakia, Slovenia, Sri Lanka, Sweden, Thailand, Tunisia, Turkey, United Republic of Tanzania, United Kingdom, United States of America and Venezuela. Some examples from other country experiences have also been added for illustrative purposes.

3. The analysis is organized according to the structure of the work programme of the Ad Hoc Working Group adopted by it at its first session. It attempts to compare and synthesize the different elements contained in the country experiences with privatization, as described in the country submissions. It reflects the varying quality and quantity of the information provided, as well as the diversity of country experiences reflected, in them. Under each topic, a short statement of the issues raised by the country experiences and of related policy conclusions is provided, and illustrative examples are given showing how the issues have been or are being addressed. Since this is an exercise based on a comparison of experiences, every effort has been made to let the experiences "speak" for themselves. However, because of the wealth of material contained in the submissions and because some selectivity is needed, this paper cannot do full justice to it. In selecting certain illustrative examples in order to keep this paper within a reasonable length, every attempt has been made to choose examples which are interesting, different and useful and which at the same time reflect the widest possible range of situations among the countries concerned.

I. OBJECTIVES OF PRIVATIZATION AND RELATED ISSUES

A. Objectives

4. While the objectives cited by Governments for their privatization programmes contain some common elements, they also contain differences in emphasis or orientation, reflecting different country situations and

priorities. These differences are reflected in the wide variety of objectives enumerated below. While many of them are no doubt of more general applicability, some others may be country-specific.

5. The primary objective shared broadly by Governments is to promote economic efficiency. For the developing countries, there is another major objective, which is to reinvigorate, modernize and internationalize the economy, with all that the achievement of such an objective implies in terms of the changing roles of the State and the private sector. For the countries in transition of Eastern and Central Europe and of the former Soviet Union, in addition to the efficiency objective, there is a fundamental objective, which is to transform the economy from a planned to a market-oriented system by promoting structural change and building up the institutional framework of a modern market economy, with the private sector playing a key role in the transformation process. Another broadly-shared objective of Governments is to extend the benefits of economic growth to all sections of the population.

6. Within these general objectives, more specific objectives or, for some, the means to achieve them, are indicated by the countries concerned. These are, under the rubric of enhancing efficiency, to promote competition and the efficient allocation of resources; and to improve the performance, efficiency and competitiveness of enterprises or of productive sectors. The "institutional" objectives (which are also to promote efficiency) relating to institutional building or improvement for the transformation, modernization or internationalization of the economy are: to develop a strong private sector as the engine of growth; to accelerate market development; to strengthen entrepreneurial and managerial capacity; to improve the performance and profitability of public enterprises (PEs) by subjecting them to the discipline of private sector or market principles, including the raising of risk capital in capital markets; to promote an effective system of corporate governance; to strengthen financial markets and institutions; to create a climate for increased private investment, both domestic and foreign, including investment in infrastructural facilities, and to secure enhanced access to foreign markets, new technology and advanced business skills; and to facilitate a partnership between domestic and foreign private sector operators.

7. Those relating to the role of the Government and macroeconomic management include: to preserve the national patrimony; to reduce the role of the State in the economy (and thus to redistribute the functions between the public and private sectors); to reduce the administrative burden on the State, so that it can use its management resources in an optimal fashion and concentrate on running the vital business of Government and on providing a favourable environment for private sector development; to reorient industrial policy; to improve and secure fiscal balance by reducing the financial burden of PEs on the budget and/or by increasing Government revenue; to remove or reduce commercial risks related to PEs from the Government’s balance sheet; to secure additional sources of financing for development activities due to budgetary constraints; to reduce internal and external debt, including through the use of debt-equity swaps; and to improve and protect the environment.

8. Those relating to the distributional objective of extending the benefits of economic growth to all sections of society include: to widen and deepen share ownership (and, through it, to widen and deepen capital markets);

to broaden or democratize the ownership and control of productive sectors (or to protect "key industries" from being monopolized by a few); to promote decentralization, regional or rural development; to increase employment by improving the basis for long-term job creation; to generate funds for social safety net measures; to improve social and public services; and to improve the standards of living of citizens.

B. Strategy for privatization

9. Privatization implies fundamental change, since it involves changing or redefining the role of the State. Various sections of society are affected by this change: workers and managers of PEs; bureaucrats, for many of whom such enterprises are a power base and a source of patronage; politicians; and consumers. They will have to be convinced of the value of privatization if a broad-based consensus is to be achieved. Further, the divestiture of PEs normally involves sales to foreign investors; if such sales are on a large scale or if they lead to abuses because of insufficient safeguards, there is a risk of a political backlash. Moreover, if privatization takes place under unfavourable conditions, with adverse consequences, including unsuccessful sales or failed privatized enterprises, then its very credibility will be affected. For all these reasons, a strategy is needed that will address these matters. The strategy can also include elements to enhance the results of privatization, for example, effective marketing in order to enhance the value of assets to be sold and thus to maximize the revenue from privatization. For it to be effective, it will need to be part of an economic strategy which facilitates structural change and which is capable of cushioning any disruptive effects of privatization.

10. Such a strategy will need to include a number of elements. One, because privatization is first and foremost a political process, the strategy will need to define the extent of privatization, the objectives to be achieved, including social objectives, and the guidelines and procedures to be used for implementation. Among such procedures are those relating to the promotion of transparency and of the value of privatization to all the parties concerned in order to build up a broad-based consensus. Two, privatization entails the substitution of a private sector for a public sector culture; in the former, investment and commercial risks are assumed by the enterprise, while in the latter such risks are ultimately assumed by the State. In cases where public utilities or major public enterprises are involved, the sequencing of commercialization or corporatization to divestiture may be necessary in order to allow the private sector culture to take hold and to turn round the public enterprises before they are transferred to the private sector.

11. Three, effective marketing can help to add real value to an enterprise to be sold and will need to be consistently carried out. Four, the selling techniques will need to combine the objective of "popular capitalism" with the need to ensure effective corporate governance. Five, techniques will have to be adapted to take account of the objectives and of the different kinds of enterprises (by size, financial status, etc.) to be privatized so as to implement the privatization programme effectively and at least cost. For example, if the PEs are small ones and the objective is to achieve quick-low cost sales, then public auctions may be used. It should be remembered that

privatization transactions, particularly those involving public flotations, are costly exercises. Six, safeguards will have to be provided in order to prevent abuses, including guarantees written into sales contracts or the use of a "golden share" where important public interests are involved, as in the case of public utilities. Seven, adequate regulatory capacity in terms of laws and institutions will need to be established or strengthened for the regulation of privatized monopolies. Eight, the role and extent of foreign participation will need to be defined, particularly for public utilities and large-scale enterprises (LSEs) in order to avoid political complications regarding foreign ownership, although such complications do not normally arise for small and medium-sized enterprises (SMEs). Nine, some kind of monitoring procedure will need to be established in order to monitor compliance with commitments made, for example concerning investment or employment, and the results of privatization, including efficiency gains achieved and their translation into tangible benefits for consumers and for the economy. This is particularly important for privatized public utilities. And finally, arrangements will have to be made for putting in place properly-designed social compensation measures for retrenched workers, as well as services and mechanisms to improve skills, encourage labour mobility and facilitate job creation through enterprise development.

12. In practice, the nature of the strategy may be influenced by the size of the public sector and the resulting pressures on the pace of privatization. Thus, the need for reducing the public sector and for building up a private sector rapidly as the instrument of economic transformation, and the necessary institutional structure of a market economy, may call for a multi- and a fast-track approach. In Poland, for example, privatization has to take place within a democratic political framework ensuring the support of society as a whole and of company employees claiming the right to collective ownership in particular. It has had to be carried out on a number of levels: transformation of ownership, establishment of the legal and institutional framework, organization of political activities and creation of individual consciousness. The strategy envisages a multi-track approach, involving mass privatization (to cover 600 large and medium-sized PEs), corporatization of PEs followed by the sale of their shares to private investors, and liquidation followed by the sale of their assets, their transfer or leasing in parts or in whole to other companies. The strategy also allows for the rapid (fast-track) sale of PEs in their entirety when the legal ownership of land and other fixed assets under their control is established. Separate privatization paths are envisaged for the various categories of PEs concerned (State, municipal, cooperative-owned, private or semi-private and joint ventures), often with the simultaneous use of different techniques within each category. Further, 20 sectoral studies, including market analyses and perspectives of particular industrial sectors, are being undertaken to help the choice of strategy and method. To support the process, the Government has signed a tripartite pact with employers and workers. Under this pact, workers have the right to decide on the form of privatization over a six-month period: however, if they fail to make a proposal, the Ministry of Privatization has a free hand to do so.

13. On the other hand, in countries where such pressures do not exist, a more gradual approach is considered important, for example, for ensuring success without negative effects (as in Morocco); for promoting entrepreneurial

development (Portugal); or for converting PEs through commercialization and corporatization into commercially-run and stand-alone enterprises and turning them round before they are transferred to the private sector (the Netherlands).

14. Commercialization involves the reorganization of a PE and the introduction of commercial principles into its operations, including the application of user charges, commercial accounting and commercial performance objectives, with the aim of turning it into a commercially-viable and profit-making enterprise. Commercialization has been used extensively in Nigeria, where the commercialized enterprises are required to function commercially without Government subsidies. A crucial element is a Performance Agreement between the Government and the enterprise, in which the company management commits itself to the attainment of certain performance objectives in return for operational autonomy. It has also been used in other countries as a preparatory step to corporatization (as in Malaysia). Sometimes the terms "commercialization" and "corporatization" are used interchangeably; however, a distinction needs to be made between "commercialization" involving the conversion of a PE into a separate entity under statutory law and "corporatization" involving the conversion of a PE into a joint stock company (for LSEs) or limited liability company (for SMEs) under company legislation. To the extent that the commercial and investment risks are not fully transferred to the private sector, such reforms are not seen as privatization in the strict sense of the word.

15. The passage of PEs through corporatization has been an important aspect of privatization strategy in a number of countries, including Australia, Finland, France, Malaysia, the Netherlands and New Zealand. Corporatized enterprises are required to operate as stand-alone commercially-run corporations. While the Government may require that certain social objectives be pursued and explicitly pay for them (as in New Zealand), they are required to pursue commercial objectives alone and to maximize their profits and net worth. Corporatization has, in fact, been used successfully in respect of public utilities or large-scale PEs in these countries to restructure a PE, put it on a sound financial footing and to enhance its sales value before transferring it to the private sector.

16. In Morocco, the strategy for privatization has a number of elements: to create confidence and credibility in the process by public education and a promotional campaign and by focusing on public enterprises which are profitable or potentially profitable, which already have a legal corporate status, which have a major economic role without an important public service role, and which are already subject to competition; to build worker confidence in privatization and to maintain a social climate that favours investment and growth by choosing privatizables without major overstaffing problems; to build investors’ confidence by the abrogation of the Morocconization provisions of the 1970s, by practising fair pricing and by promoting transparency in the valuations and organizations of privatization projects; and to promote regional development and decentralization of shareholding (to complement the overall movement to decentralization) by including PEs which have a regionally diversified base.

17. In Cote d'Ivoire, after a first phase of divestitures involving 22 enterprises in the 1980s, characterized by several shortcomings, the Government in 1990 developed a strategy which helped to improve the design and implementation of the current privatization programme covering 54 PEs. Among other things, sales, rather than being ad hoc, have been part of a broad plan and guidelines and clear procedures have been established. Criteria have been established for choosing PEs for privatization, favouring those enterprises where privatization would boost their production, attract private investment for growth or generate financial resources for the State. Guidelines have been established for dealing with PEs facing severe financial problems and for achieving the State's total disengagement from certain sectors such as transport, tourism and agro-industry.

C. Resolution of conflicts of objectives

18. The process of privatization implies the need to clarify and balance different objectives which may sometimes be in conflict with each other. For example, the objective of raising maximum revenue from sales may conflict with the objective of promoting efficiency gains if, for example, monopolies are sold without regulatory or other measures to prevent abuse of monopoly power. The financial objective may also conflict with the social objective of protecting or generating jobs if priority is given only to revenue maximization without concern for future investment by privatized companies. If speed of implementation is the objective, valuation may be simplified, for example by using the book value which may diverge significantly from the real value, and various techniques, including negotiated sales without competitive bidding and internal privatizations like management and employee buy-outs (MBOs, EBOs), may be used. However, this may conflict with the objectives of efficiency, equity, transparency and of mass privatization. Public flotations may increase political and social acceptability and promote transparency, but they can slow down the pace or increase the cost of the process.

19. Further, the objective of promoting wide share ownership may conflict with the objective of promoting good corporate governance or dynamic enterprise development. For example, in Portugal, the concern has been expressed that, where stock markets are not well developed, thereby making it difficult to separate ownership from management, wide share ownership may conflict with the objective of reinforcing the vitality of firms and of entrepreneurship. The need to ensure the stability of capital of a privatized firm, the infusion of new capital or good corporate governance has led to various measures being adopted. Thus, wide share ownership by the price targeting of small investors is combined with the sale of blocks of shares to a core of institutional long-term investors, e.g. banks and insurance companies (as in France) or to a core corporate investor (Sri Lanka). Incentives (e.g. free bonus shares) to encourage small portfolios to retain their shares for a specified period are also used (France, United Kingdom). In Morocco, a 15 per cent discount is given on the share price to employees if the shares are kept for three years. A certain stability of small portfolios has been recorded (France). For the purpose of protecting the privatized firms from the volatility of the shareholdings of international institutional investors and for other public policy objectives, certain countries limit foreign participation in the equity of privatized companies (for example, France, 20 per cent; Malaysia, 25 per cent; United Kingdom, 15 per cent).

20. The question has been raised as to whether a rather demanding social plan to safeguard employment, such as the one used in Malaysia for its privatization projects, may involve a trade-off in terms of a lower sales price and therefore of reduced revenue. The question may also be raised concerning the business or industry development plan, including the scale of proposed investment and often a social plan, which potential investors have to provide in connection with their bids to buy firms (as in Australia, Ghana, Germany, Lithuania, Poland and Senegal). However, the choice between a good price, on the one hand, and a good business plan with important social safeguards, on the other, may be a false one; new investment generating growth and employment, as well as social stability in the long run, may compensate for temporary reductions in revenue. Some of the new investments can be considerable. In Sri Lanka, one of the first privatizations fetched US$ 22 million in investment, allowing the company not only to absorb the surplus labour but also to add 1,200 new jobs to the existing payroll of 3,000 employees within two years. In Peru, an iron ore company was auctioned for US$ 120 million to a foreign company, which committed an investment of $150 million over a three-year period. A copper deposit in the same country was auctioned for $12 million to another foreign company, which is expected to invest $560 million to fully develop the mine. In Lithuania, in considering bids, a good business plan, together with a social package, is in fact rated higher than the offer price.

21. In Lithuania, during the preparation of the programme, a conflict arose between commercial and distributional objectives. Those in favour of the former argued that only commercial privatization could provide efficient private owners. Those who favoured voucher or mass privatization argued that, in view of the limited private investment possibilities, commercial privatization would take a very long time and that the inefficiency of PEs would not be compensated by the efficiency of a small number of private firms, that such privatization would concentrate ownership in the wrong hands (the former nomenclature) and that the State must compensate for low wages paid under past policies and practices. The latter had wide popular support and Parliament has adopted it as the main principle of the privatization programme.

D. The role of social objectives

22. The importance attached to social objectives is reflected in their influence on the design and implementation of privatization programmes, including their "social provisions". These include allocations of a proportion of shares of privatized companies to employees free of charge or otherwise accompanied by discounts or special sale conditions, as well as allocations of a proportion of such shares to small investors (both being axioms of privatization policy in many countries), employee stock ownership programmes (where debts are assumed by a trust in order to allow the workers to purchase the enterprise), management or employee buy-out schemes (where only a certain amount of cash is required immediately), schemes of employment protection in privatized companies, privatization-related social safety net measures. In the countries in transition, mass privatization schemes have been used, involving population-wide distribution of vouchers or certificates free of charge or for a nominal fee which can be used to exchange for the shares of privatized enterprises or for the certificates of investment funds

holding such shares. These "social provisions", by giving employees, small investors, managers and the general population a stake in the equity of privatized companies, can help to build up support for the privatization process.

23. The importance attached to social objectives also stems from the realization that social problems arising from privatization can undermine the credibility or success of privatization. In Thailand, for example, where the majority of State employees enjoy better conditions of service than their private sector counterparts, the authorities consider the social aspects of privatization to be the number one problem. In Ghana and many other countries, where there is high unemployment and underemployment, the major concern has been the loss of employment of a large number of workers due to privatization.

24. In Malaysia, the social objective of protecting employment has very much influenced the design and implementation of the privatization programme. The policy decisions taken provide that: no staff of privatized firms may be retrenched within the first five years of privatization, except on disciplinary grounds; staff redundancy, if any, will be resolved through normal attrition, redeployment and expansion of activities; affected personnel, upon privatization, shall be offered a package of employment benefits on no less favourable terms and conditions of service than those enjoyed by them while in Government service; such personnel shall be given the option of joining or not joining the new company; those not wishing to join will be retired and given their rightful retirement benefits immediately; and those wishing to join will be offered two schemes of service, one which replicates the Government scheme of service and the other which is commercially-oriented, under which the employees are entitled, among other things, to purchase the firm’s shares and to enjoy such bonuses as the firm’s performance may warrant. In addition to offering shares to employees, employee stock ownership programmes and an employee loyalty share scheme may be considered, as in the case of the privatized electricity company. These schemes have been introduced to enhance the employees’ sense of loyalty and commitment to the company. In general, the packages offered by the Government have promoted cooperation from employees and reduced resistance to privatization.

25. Schemes to protect employment in privatized enterprises have also been introduced in other countries. In Pakistan, employment is assured for one year after privatization; employees whose services are terminated after 12 months are entitled to unemployment benefits for two years and may be provided with training and soft loans to facilitate their self employment. In Sri Lanka, employment in privatized companies is protected for two years after privatization. Likewise, schemes for employment protection in the privatized companies of up to two years after privatization have also been developed in certain Eastern and Central European countries. In Poland, social packages, individually tailored to each privatized enterprise, and negotiated with the participation of trade unions, usually contain a period where reductions in the workforce are limited to natural attrition, a requirement for the company to indicate the plan for the workforce after the expiry of this period, assurances on the company’s intentions should it go bankrupt after

privatization and sometimes arrangements whereby the investor agrees to help finance the reserved share acquisition for the company's employees. The Government stresses long-term thinking in bringing the negotiating parties together.

26. In Germany, a special scheme is being developed for public utilities to be privatized. Under such a scheme, employees of such enterprises would be asked to switch to private contractual arrangements. Those not willing to do so would be taken over by an ad hoc employment company which would maintain the old contractual arrangements and lease the labour to one of the successor companies.

27. In Senegal, there have been regular consultations and information meetings with the entrepreneurs and the labour unions. Legislative and practical measures have been adopted to safeguard employment, one of the important objectives of privatization policy, and the acquired social rights of the workers. Workers individually or collectively have acquired shares or assets of privatized firms. In the choice of buyers, criteria regarding viable business plans, commitment to employment protection or creation have been used in negotiations with potential buyers; other things being equal, preference will be given to buyers who take into account the preoccupations concerning the social aspects.

E. Relationship to other enterprise reforms

28. Earlier, mention has already been made of the use of commercialization and corporatization in preparing PEs for divestiture. This practice is often accompanied by financial restructuring in order to enhance the financial viability and market value of the firm. However, whether for policy or financial reasons, commercialization and corporatization may not lead to divestiture. Some 28 commercialized enterprises in Nigeria, some 37 corporatized enterprises in Finland, and several corporatized enterprises in Pakistan and the Netherlands remain under State ownership. Commercialization has been used as a matter of policy in order to improve the performance of certain PEs which are to remain in the public sector (Nigeria, United Republic of Tanzania). Corporatization has also taken place in Indonesia, followed, in some cases, by the selling of shares in the capital market. Other enterprise reforms include management privatizations. Thus, 35 of the 37 hotels and several of the firms slated for privatization in Morocco are already operating efficiently under contract to private management, and their divestiture is not expected to result in any significant change other than that of ownership.

29. In Australia, privatization is seen as an adjunct to microeconomic reforms designed to improve the performance of PEs through the adoption of corporate plans, financial performance objectives, a reduction in direct State control and improved quality of information for the assessment of their performance, as well as to strengthen competitive pressures on them. Enterprise reform in terms of the institution of a performance evaluation system for PEs is also to be found in countries like Indonesia and the Republic of Korea. In these countries, PEs are classified into several categories (three in each case) and the law provides for PEs which should be (partially) regulated by the Government through the performance

evaluation system and those which should be regulated by the market. In the Republic of Korea, regulation is left to the market where the State holding in the enterprise is less than 50 per cent. Obviously, such regulation can only take place effectively in a competitive environment. Privatization, by demonopolization, i.e. the breaking up of monopolies into smaller viable units, and by increasing the number of competitive actors, can help to enhance competition between PEs and private enterprises. Such competition, by facilitating performance comparisons, also helps the process of the evaluation of the performance of PEs by improving the availability of information on the performance and efficiency indicators of similar enterprises and related sectors.

30. In the Netherlands, corporatization of PEs, together with the strengthening of competition, may take the form of a public or private limited liability company (for commercial activities) or of a foundation (for non-profit making bodies). Post and telecommunications have been converted into a wholly State-owned holding company, with several subsidiaries, including one for postal services and one for telecommunications. The State plans to reduce gradually its share in the company to a minority holding, with the first sale of its shares in 1994. The new company has the right to raise capital on the private capital market. Courier services and terminal equipment are excluded from its monopoly. Its current monopoly on infrastructure may be restricted by new EC regulations designed to strengthen competition in both postal services and telecommunications. Corporatization of PEs, together with deregulation, has enhanced competition for the State-owned limited liability companies and for private sector companies. Corporatization may be followed by the sale of all or part of its interests (e.g. Postbank). This form of gradual privatization may be chosen on financial and economic grounds if corporatization, together with appropriate reorganizations, may be expected to increase their net worth and thus their market value after a certain period of time prior to sales (e.g. Postbank). This process, by subjecting the agencies to increased risks and responsibilities, as well as the scope for development, has provided a "cultural shock" to get the commercially-oriented organizational changes necessary for increased efficiency off the ground. Private financing of infrastructure (tunnels and bridges) is another form. Contracting out is mainly used for support services and ancillary activities. Commercializations in the field of arts and sports are also on the increase.

31. In France, a number of PEs have transited from the private sector to the public sector and back to the private sector quite successfully. In the passage through the public sector, several PEs have been restructured and placed on a sound footing before being returned to the private sector. When PEs are able to compete with private companies, privatization is the logical consequence of the reform process. Further, management teams, whether of PEs or of private firms, often have the same background or training. The major schools of management have provided managers for both sectors and this element can constitute a favourable factor for privatization.

32. Where the private sector is relatively small and/or inefficient, as in many low-income developing countries, it is often difficult to obtain efficiency gains in PEs prior to sales and the opportunities for their sale are often limited. In such a situation, it is all the more important that

the Government take steps to improve their performance by subjecting them to commercial disciplines, whether or not they are to be prepared for divestiture, and to strengthen the private sector by promoting competition and by providing a supportive environment, including its financial, legal and administrative aspects, for entrepreneurial and private sector development. Timing, the sequencing of reforms and the process of sales are crucial in such situations.

33. However, in many such countries, important constraints to parastatal sector reform or privatization remain. In the United Republic of Tanzania, the major constraints to progress at the technical level include: lack of clear guidelines on levels of State ownership; and lack of experience in negotiation, valuation, treatment of debt and handling of laid-off workers. The lack of a clear institutional framework has also been a constraint; partly to overcome this, the negotiation and approval process is being simplified through the establishment of a Parastatal Sector Reform Commission in 1992, vested with negotiation authority, with the support of the sectoral Ministries. The settlement of debts has been a hurdle for several negotiations under way, especially in the case of insolvent firms where the realization of the sales of the assets would not cover the amount of the unserviced debts. To turn them round, it is felt that a supportive environment is necessary, including continued reforms of the tax regimes. Other measures being undertaken include financial sector restructuring, long-term financing and capital market development and legal and regulatory reforms, including revision of the Company Law. However, progress is very slow. Only a small minority of the 300 commercial PEs have been affected; and deals are taking years rather than months to conclude. Likewise, in Niger, the insufficient number of economic operators in the industrial sector and the lack of information and of awareness have impeded progress. The drop in the meagre State resources, due to an unfavourable uranium market, drought and a general downturn in economic activity, has meant that the Government cannot meet the expenses of parastatal sector reform.

II. MACROECONOMIC CONSIDERATIONS

34. Practically all the privatization programmes have formed part of structural reforms or economic liberalization measures undertaken by the countries concerned. They have been aimed at: reducing the dominant role of the State relative to the private sector; modernization of the role and structures of the State to make it more supportive of the fundamental role of the private sector in national economic development; enhancing competition and efficiency; and internationalization of the national economy. More specifically, the objectives have included: development and strengthening of the financial markets and institutions, including through the privatization of commercial banks and pension funds; exchange rate and trade liberalizations; promoting deregulation, reforming the fiscal system, lifting domestic price controls and eliminating subsidies; attracting foreign investment and promoting exports; as well as turning round PEs and strengthening the private sector. For the countries in transition in Eastern and Central Europe and the former Soviet Union, privatization has formed an integral, if not the dominant part, of a comprehensive restructuring and institutional rebuilding of the economy in order to transform it into a market system.

35. The proper alignment or sequencing of structural reforms and liberalization measures can have an important effect on the privatization process. For example, the decontrol of prices in order to allow them to find their market-clearing level, together with the reduction or removal of subsidies for certain goods or services, may set off inflationary pressures, including through the wage-push phenomenon. Such price instability, together with any tightening of monetary policy in order to fight inflation, may create uncertainties and discourage private investment. Where there is already a shortage of goods, the problem of inflation will be further compounded, particularly if at the same time there is a "monetary overhang" over the economy. In such circumstances, the liberalization of trade and payments risks aggravating the balance of payments situation and exerting heavy pressure on foreign exchange reserves. Such a consequence, together with the continuing need to curb inflation, may make it necessary to maintain high interest rates; and the resulting uncertainties and market pressures will make it difficult to achieve successful privatizations either in terms of sales or of the survival of the privatized enterprises.

36. Thus, for privatization to succeed, it is important that structural reforms and liberalization measures be introduced so that a measure of macroeconomic stability is established early in the privatization process, including in its preparatory phase. High inflation distorts price signals, gives rise to uncertainties, including concerning asset valuations, and creates additional risks for investors. Investors may in fact prefer fixed-return financial instruments like bonds to stocks which may be negatively influenced in the future by monetary and fiscal measures to curb inflation. High interest rates resulting from a tightening of monetary policy may lead to a recession, rendering it difficult for the economy to absorb retrenched workers. Such a situation is hardly conducive to the creation of a climate of confidence for private investment and of optimum conditions for the sale of public enterprises. In the post-privatization phase, if inflationary pressures, high interest rates and tight monetary policy persist, privatized firms may face difficulties in raising the necessary capital. The development of SMEs may also be thwarted, thus blocking other possibilities for job creation. If, as indicated earlier, internal imbalances are compounded by external imbalances, import liberalization cannot be undertaken without imposing additional strains on foreign exchange availability; and continued import restrictions may mean depriving the market of the necessary dose of competition and privatized enterprises of their essential inputs or of inputs at international prices. Privatized firms may thus find themselves unable to compete internationally on equal grounds. Foreign investors may also stay away because of inflationary pressures and their effects on growth and because of import restrictions due to balance of payments difficulties. For example, in the Russian Federation, the programme of large-scale privatization was preceded in 1991-1992 by price and other liberalization measures. Recently, the pace of privatization has slowed down due partly to the political situation but also to the continuing economic difficulties. This last factor, together with inadequacies in infrastructure and in the regulatory and legal framework, has had a dampening effect on foreign investment which has not come up to expectations. Further, continuing high inflation, coupled by a steep devaluation of the rouble, and a growing popular mistrust of the privatization

programmes have led to a substantial drop in the value of mass privatization vouchers in the secondary markets, thereby jeopardizing the original objective of allowing the general population to share the national wealth.

37. The problems which high inflation or hyperinflation create for the privatization process are also illustrated by the case of Bulgaria. There, privatization is being planned in an unfavourable macroeconomic environment, with steep inflation (80 per cent in 1992), high interest rate (47 per cent in January 1993) and high unemployment (in agriculture, trade and construction). The effect of high inflation on asset values will be to render the distinction quite meaningless between branch privatizations by economic ministries (up to 10 million leva in value) and State privatizations by the Privatization Agency (over 10 million leva). It risks transferring many of the 289 units in the former category to the latter category, where 94 enterprises are listed for 1992/1993, and thus creating a considerable additional burden for the Privatization Agency. The steep inflation also calls for revisions of asset valuations, thus adding to the preparatory expenses. Further, high interest rates have a negative effect on the debts of public enterprises and will restrict the use of bank credit for privatization transactions. At the same time, since privatization has to be undertaken under political pressure, quick results are expected and are needed for the credibility of the process. In this and some other countries facing a similar situation, the choice is often between the bad and the worse.

38. In the case of Portugal, however, privatization has taken place in a very favourable macroeconomic context greatly due to benefits resulting from its accession to the EC in 1986, with the associated structural reforms and increased investment, including EC structural funds and increased flows of foreign direct investment.

39. An important factor in the success of a major privatization programme is its relation to the Government budget, particularly its short-term impact on public finance. In some countries, the Government often faces a difficult choice regarding the use of privatization proceeds: either to retire long-term debt and reduce budgetary deficits or to use them largely to finance socially-related support measures in order to minimize social difficulties. The use of transitional measures in order to organize an orderly transfer of PEs to the private sector can also have a significant budgetary cost (as in the United Republic of Tanzania). However, increases in budgetary revenue from the privatized firms may take a longer time to realize and may also depend on tax reforms, particularly of the tax base.

40. For privatization to achieve allocative efficiency, it is essential that privatized firms assume fully their commercial and investment risks, including the risk of bankruptcy. This presupposes that an appropriate regulatory and legal framework is in place and that the laws are enforceable. However, it also raises the issue of possible massive retrenchment of workers arising from the bankruptcies of such enterprises. The Government can step in by assuming the large debts involved, but at some budgetary costs. Such a situation is fairly frequent in Eastern and Central European countries where many trade-oriented firms have been weakened by the collapse of CMEA trade and for which the straight application of financial and commercial rules would

probably entail bankruptcy in the current situation. In these and other similar situations in developing countries, there is a need for facilitating the access of the countries and enterprises concerned not only to financial resources but also to markets in other countries.

III. THE ROLE OF THE STATE

A. Changing roles of the public and private sectors

41. The rebalancing of the public and private sectors implied by privatization means disengaging the State from those activities which are best done by the private sector so that the State can concentrate its energy and resources on its "core" functions and act where the market fails. Those functions which the Government is particularly well placed to do are: to promote competition and allocative efficiency through trade and competition policies and appropriate regulatory instruments; to provide a supportive and enabling environment for private sector development, technological innovation, structural change and productivity growth by means of appropriate macroeconomic, technological, industrial, human resources development and other policies, including policies to attract foreign investment for enterprise, industrial and infrastructure development; to protect the environment and to safeguard national security; and to provide vital economic and social services, as well as social security and poverty alleviation measures. The Government also has to compensate for market deficiencies, i.e. where investment is needed but lacking because it is too big or unprofitable for the private sector, for example investment in infrastructure or in certain research and development activities.

42. In the countries members of the European Community, a variety of EC regulations, including in the area of competition policy, are increasingly influencing the redefinition of the Government's role by putting an end to the protection of public enterprises and by strengthening competition and market disciplines in the public sector. Some of these countries, which are still lagging behind, are thus reducing the role of the Government and strengthening competition in order to facilitate the adaptation of their economies to the EC regulations, as well as to prepare themselves for the establishment of the Economic and Monetary Union towards the end of the decade.

43. Although the strengthening of the private sector, coupled with a redefinition or scaling down of the public sector, is no longer disputed, there are still differences among countries, concerning the nature of the strategic or vital services that the State should continue to provide. In fact, the definition of "strategic" sectors can become a moving political target, with those opposed to the privatization of a particular enterprise sometimes succeeding in having it classified as "strategic". In order to avoid such a situation, it is important that the extent of privatization be defined early in the process as part of the privatization strategy. Further, if the objective is to promote competition between PEs and their foreign competitors and therefore to allow for their privatization in the future for this purpose, it is important not to define "strategic" sectors too broadly.

44. In many countries, there are certain activities, notably the provision of public utilities like electricity, communications and water supply, for which the reasons for State involvement in the first place, including the scale and costs of the investments or the economies of scale and scope involved, are still valid. However, as will be seen later, while the State may have to continue to undertake such activities, there is scope for competition, as well as for (increased) private sector involvement. In fact, because of budgetary constraints, the latter may be necessary for the expansion or modernization of such activities.

45. There may also be difficulties for the State to disengage itself from its larger economic activities very quickly because of the shortage of private capital or of management and entrepreneurial skills. There may also be political constraints or administrative impediments (for example, lack of appropriate regulatory capacity) to the disengagement of the State in various activities. In such circumstances, for rebalancing to be achieved, the State may need to scale down its support to public enterprises or impose more stringent conditions for such support, pursue policies to improve their performance by subjecting them to competition, as well as to encourage the growth of the private sector, including through joint ventures. Similar policies have been pursued in various countries (as in China).

46. The variations in practice may be illustrated by the examples of various public utilities like telecommunications, electricity and railways. As stated earlier, such public utilities remain classified in many, particularly low-income, countries as strategic industries and are therefore not privatizable. In any case, without adequate legislation and regulatory capacity, which is often the case in many of these countries, it is questionable whether they should be privatized since doing so would simply mean transferring economic rents to the private sector. However, a number of countries have restructured and privatized them, as well as opened up competitive sectors in these industries to competition. Thus, Argentina, Malaysia, the Republic of Korea and Venezuela, among others, have privatized their telecommunications industries. In the United States of America, the industry is privately owned. In some cases, privatization extends to the promotion of competition in basic services, as well as in other sectors (Japan, New Zealand, the United Kingdom). In Colombia, the basic telecommunications services are contracted out to a private company. By contrast, in Jordan, the telecommunications company providing basic services is to be commercialized, with other services to be contracted out to private sector operators. In the electricity industry, electricity generation is open to competition in various countries (the Netherlands, New Zealand, Sri Lanka, the United Kingdom and the United States). In Cote d'Ivoire, electricity operations are leased out to a private operator. In the railways industry, while the networks are managed by the State in Colombia, the railway services are contracted out to a private operator. In Japan, as part of a privatization exercise, combined with the promotion of competition, the national railway company has been restructured into six regional companies and freight operations have been transferred to an independent national company with access to the same railway networks. Canada has licensed a private operator to compete with the State-owned railways company. In the United States, CONRAIL, the rail freight service, has been privatized.

47. Likewise, there are variations in practice concerning the provision of public services like solid waste collection and disposal, transit operations, urban renewal and road maintenance. While many countries consider these activities to fall within the public sector, some other countries like Colombia, the Netherlands, the United Kingdom and the United States contract out various of these activities to the private sector. Similarly, some countries like Indonesia, Malaysia, the Netherlands, Thailand and the United States encourage, with the help of operating concessions granted to private sector partners, the private development and operation of certain infrastructural facilities like toll roads and bridges.

48. In New Zealand, the application of private sector operating principles, though not profit objectives, has been extended to social services delivery agencies, notably hospitals and to a limited extent schools. To the extent practicable, elements of the same approach have also been applied to "core" (non-trading) entities. Thus they work to specified objectives, pay a charge on their assets and have considerable flexibility in choosing the most cost-effective inputs, including personnel. Their chief executives have an "arm's length" relationship with their Ministers in matters of administration. Gradually, some agency activities are becoming contestable. An example is the calling of tenders for the operation of two new prisons, previously the exclusive preserve of the Justice Department.

49. In the United States of America, where the economy is predominantly private, the privatization experience has emphasized the private provision of public services and facilities rather than the sale of PEs. Contracting out of public services is the most widespread form of privatization. These arrangements have covered solid waste collection and disposal, prison construction and management, transit operations and health care. The move towards private development of infrastructure has been driven by Government fiscal pressures, together with an almost 50 per cent decline in the share of GNP devoted to public works spending, a similar percentage decline in the Federal share of the nation's total spending on transportation infrastructure and taxpayers' preference for direct user charges over tax or fuel tax increases. Many infrastructure facilities can generate enough revenues from user fees and neighbouring commercial development to attract private financing. Those commonly targeted include toll roads and bridges, airports, high-speed inter-city rail systems and water treatment facilities. However, Government guarantees are sometimes needed in order to attract private financing.

B. Institutional changes

50. The privatization process, together with other structural reforms, has entailed institutional changes in terms of reshaping or modernizing the structures of Government, the creation of new institutions for privatization, regulation and other functions and, in the case of the countries in transition, the creation of the basic structures of a market economy.

51. In Germany, the transformation of a command economy in the eastern part into a market economy has another dimension than privatization as an effort to reduce the role of the State in certain areas of a mixed economy. The process has had to tackle the problem of mass privatization and of converting a whole

command economy into competitive private enterprise structures within a minimum period of time. The steps taken have involved: the creation of a monetary and economic union by extending the market economy rules of the former Federal Republic to the former German Democratic Republic (GDR); the conversion of the once-dominant 330 conglomerates into over 8,000 limited liability or joint stock companies by a single legal act; the establishment of a parastatal privatization authority (Treuhandanstalt) as the legal owner of almost all of the ex-GDR PEs; the further splitting of the 8,000 enterprises into some 13,000 firms in order to facilitate privatization and to foster competitiveness; and the establishment of close cooperation between the Treuhandanstalt and the Cartel Office in order to foster competition and to prevent abuse of market power. The result of this process has been an extremely rapid structural change.

52. In Colombia, emphasis has been placed on a redefinition of the role of the State and of the professional associations inside the productive sectors, as well as of the relationships of the latter with the State and the society in general, so as to rationalize their roles and promote effective concertation among all the parties concerned. This has involved the creation of various consultative mechanisms for Government-private sector policy dialogue, including an Industrial Council, a Standards and Quality Council and a National Council for Technological and Industrial Development (for centralizing the financing and promotion of national technology). Further, the Ministry of Economic Development, its Office of the Superintendent of Industry and Trade and its Office of the Superintendent of Companies have been restructured and their roles redefined, with the aim of achieving deregulation, removing obstacles to foreign trade and internal controls on firms, industries and markets, as well as strengthening private initiative, entrepreneurship, administrative efficiency, technological development and competition. The statutory function of the Institute for the Promotion of Industry is first to promote and finance investment projects and then to dispose of them; it has made an important contribution to the development and strengthening of private industry. In the area of technological development and quality standards, efforts are aimed at providing support to the acquisition and adaptation of technology, the promotion of quality, the reinforcement of technical training and of environmental protection. A Fund for Industrial Modernization and Technological Development (FOMITEC), with its own legal personality, has been created, to be financed by both public and private funds.

C. Competition and regulation

53. Privatization raises the issues of competition and of regulation. Without a competitive environment, privatization cannot achieve the efficiency gains it is meant to achieve. In fact, a major lesson drawn from privatization experiences suggests that, while ownership often matters, competition matters even more. The issue of competition is thus central to the process of privatization.

54. Where the market is competitive, i.e. where there are no barriers to entry, competition may be encouraged or strengthened through appropriate trade and competition policies and by providing a supportive environment, including its macroeconomic aspects, for the development of entrepreneurship and of enterprises, including SMEs.

55. Where a market is non-competitive or monopolistic, i.e. where a single firm can produce total industry outputs more efficiently than two or more firms, the issue is much more complex. Such a situation may arise because demand and cost/technological conditions or the small size of the market serve as effective barriers to entry. In this kind of "natural monopoly" situation, there is a potential conflict between cost efficiency and competition; while price competition might be enhanced by the presence of more firms in the market, more firms might lead to higher unit costs and thus to reduced cost efficiency. Thus, in privatizing a "natural monopoly", this competition/cost efficiency trade-off needs to be borne in mind. However, competition may be introduced by the liberalization of entry, including the removal of any statutory restrictions, and the opening up of the market to foreign competition. Sometimes threats of entry may be sufficient as a form of competitive pressure. However, depending on the nature of the market or of the enterprise, a period of adjustment may be needed, during which the enterprise may be corporatized and placed on a sound financial footing, before it is subjected to the full force of competition.

56. The issue of regulation applies particularly to public utilities, which, as indicated earlier, may include both "natural monopolies" and competitive sectors. The "transportation networks" of public utilities, e.g. electricity transmission lines, gas and water pipes, telecommunications or railway networks, are "natural monopolies" in the sense that their extensive investment or "sunk" costs or economies of scale act as effective barriers to entry. However, other sectors of public utilities may be open to competition through interconnection to the networks. Thus, in electricity, generation and retail supply are contestable. In telecommunications, competition may extend beyond interconnection to the establishment of new networks, supply of user equipment, value added services such as data transmission, etc. In railways, competition may be introduced, as in Canada, by the licensing of access to the railway network to a private sector operator to compete with the State-owned company.

57. In circumstances where contestability does not lead to reduced cost efficiency, competition in public utilities may be promoted by regulating the conditions of entry, including the terms of interconnection to the networks. Where a particular sector of a public utility is fully contestable, for example, the provision of value-added services or of user equipment in telecommunications, competition is the best regulator; however, appropriate competition policy may be needed in order to safeguard competition. Competition policy may also be needed in order to supplement the work of regulatory bodies for public utilities and to deal with any regulatory failures on their part. Thus, depending on the situation and on the particular sectors of a public utility, competition, competition policy and economic regulation can all play a role in regulating the industry for efficiency.

58. The regulation of public utilities may include a number of objectives - economic, technical, environmental and other aspects of public policy. Economic regulation is designed to protect consumer welfare in terms of prices, security and quality of service, as well as to promote efficiency, including through the promotion of competition where possible, and the encouragement of innovation and productivity growth. Price regulation and to

a lesser extent rate of return regulation are used for this purpose in many countries. Technical regulation is concerned with the observance of technical, health and sanitary standards, including, for example, health standards in drinking water. Such technical regulation may be part of quality regulation. In the cases of electricity and water, economic regulation is closely linked to environmental regulation including pollution control relating, for example, to power generation or to sewerage treatment and disposal. However, technical and environmental regulations are not confined only to public utilities. Regulation of public utilities may also include other aspects of public policy, including social or distributional objectives such as the subsidization (either through direct subsidies or otherwise) of essential services for certain social groups.

59. While many developed countries have a panoply of laws and authorities (fair trading, anti-trust and public utility regulatory bodies) to promote competition and to regulate public utilities and while they are able to attract the investment or the technology needed to enlarge the spheres of competition in public utilities such as telecommunications, this is not true for many developing countries or countries in transition. Such countries may have to opt for solutions adapted to their own circumstances, needs and resources. However, whatever the solutions adopted, they will need to build up an adequate regulatory capacity, including legislation and institutions for the promotion of competition and for the regulation of public utilities. Even if these countries may only wish to corporatize their public utilities or to contract them out to private management, such capacity will still be needed. An appropriate regulatory framework may also be needed in order to attract private financing for the development of the infrastructure of public utilities, as it can provide a form of guarantee to potential investors and help them to assess the financial returns and costs, as well as to draw up their investment and business plans.

60. In Australia, the recent restructuring of its telecommunications sector involved at once promoting competition and ensuring regulation in a "natural monopoly" industry. Three PEs were involved: Telecom, which operated the domestic telecommunications network; Overseas Telecommunications Corporation (OTC), which ran the international network; and Aussat, which supplied the domestic and international satellite services. Telecom also had responsibility for all regulatory functions. After having announced a series of reforms to promote competition in the industry, including the merger of Telecom and OTC into the Australian and Overseas Telecommunications Corporation (AOTC), the Government sold Aussat to a private company, Optus, and allowed it to compete with AOTC by establishing a second network. While AOTC still has monopoly power in some of its services, and the competition between it and Optus is still at the stage of duopoly, full competition is to be phased in by 1997. At the same time, Telecom’s regulatory functions were transferred to an independent regulatory body, Austel, which has the power to protect competitors from anti-competitive behaviour and consumers from abuse of monopoly power, as well as to enforce technical regulation and to promote efficiency within the industry. Thus, the situation where the owner/operator was also the regulator, a situation which can be inimical to fair competition, has been ended.

61. In the United Kingdom, the Government has established a system of independent regulation for the privatized utilities. For each of the sectors concerned, there is an independent regulatory body endowed with a wide range of powers and duties to promote the interests of consumers. Each of the privatized utilities has a price formula which in most cases limits annual price increases to no more, usually less, than the rate of inflation. In addition to efficiency gains in terms of lower prices, there are non-price benefits for consumers, including their entitlement to compensation if the utilities fail to meet any of the required standards. The Government has opted for price rather than rate-of-return regulation in order to provide a greater incentive to the companies to improve efficiency.

62. In Malaysia, new regulatory bodies to protect consumer welfare in terms of price, quality and availability of services have been established for telecommunications, the postal service, gas, electricity and railways. The existing bodies continue to undertake regulatory functions for ports and highways, while the State continues to be responsible for water supply. A regulatory body for airports is being planned. The role of the regulatory bodies is to ensure a proper balance between the objectives of protecting consumer welfare and of promoting a healthy development of the industries. In the medium term, the regulatory bodies will be merged to cover three areas: telecommunications, transport and utilities. The question of creating a single authority is under consideration. In Colombia, a Telecommunications Regulatory Commission has been established, responsible for promoting and regulating competition, the protection of consumer welfare, the granting of licences for the provision of basic services and for proposing the corresponding rates, fees or tariffs to be paid by the concessionaire. A regulatory body for ports has also been established to grant concessions, normally for a period of 20 years, to privately-owned regional port companies for the operation of port services, to promote competition and to determine a tariff-setting formula consistent with the achievement of internationally-competitive port services and the encouragement of new productive investment.

IV. TECHNICAL, LEGAL, FINANCIAL AND OTHER ASPECTS

A. Legal issues

63. A host of legal issues have to be addressed and the necessary laws enacted in connection with the privatization process. These concern, *inter alia*, the enabling legal framework, including the machinery, for privatization, the preparation and methods of privatization (e.g. the legal status of PEs, the Government employees concerned, their pension funds, procedure and conditions of privatization, selling or transfer techniques, the applicable laws, etc.), competition and regulation policies and structures and privatization-related social support measures. Where necessary, laws may also have to be enacted concerning the financial markets and institutions, foreign direct investment, joint ventures, property and contract rights, company laws, bankruptcy laws and legal enforcement procedures. These laws are part of the essential requirements for the development and growth of the private sector. Many of these issues require complex legal instruments which take time to

draft and to enact, and the whole process can be time consuming. It can be further aggravated by a complex procedure and machinery for privatization. The land ownership issue is important since, without the land title to serve as a collateral for bank loans, the viability of a privatized company may be seriously jeopardized.

64. In Turkey, it was found that the complex nature of legal instruments and the plurality of decision-making bodies had made the process time-consuming. For this reason, the Public Participation Administration has proposed (i) combining all laws into one law; (ii) streamlining the decision-making structure by appointing the Public Participation High Council as the sole decision-making body. The Public Participation Administration has also proposed the creation of an Unemployment Insurance Fund (with 15 per cent of privatization proceeds), a Debt Liquidation Fund (with 15 per cent of privatization proceeds) to write off partially or wholly the outstanding debts of certain firms to be privatized; and regulations concerning Government employees (transfer to other Government bodies, where possible, or to the private sector, etc.) or concerning the transfer of land ownership rights to the firm after it has been evaluated by the Treasury, thereby increasing the value of the assets of the firm.

65. In Portugal, each privatization involves a number of steps, including specific legislative acts. A two-phase privatization being very frequent, a period of up to 18 months may be required to implement it. In Ghana, the title to land, which was not always transferred to the public enterprises, has become an important legal issue. Delays have occurred due to delays in the transfer of title to land and to the need to convert PEs into limited liability companies. Other legal disputes have also affected the pace of privatization.

66. In Lithuania, more than 200 Government decrees and by-laws regulating the privatization process have been adopted. In Australia, Acts of Parliament have been passed to provide the necessary legislative and administrative and regulatory framework for resolving the legal issues prior to privatization. Consequently, the Government has experienced minimal legal problems during the implementation and follow-up of privatizations. In Pakistan, laws have been amended to facilitate privatization. Further, the process of privatization has been given legal protection against future reversal under the Protection of Economic Reforms Ordinance, 1991.

67. There are a number of areas where exchanges of experiences and of legal texts may prove useful, for example, the enabling legal framework for privatization; simplification or consolidation of laws governing various aspects of the privatization process; laws pertaining to the regulation of privatized monopolies, the establishment of regulatory authorities and experiences in this area; and legal texts and experiences relating to employee share ownership plans, management buy-outs, management buy-ins, etc. An indication of the priorities of the Ad Hoc Working Group will also help the secretariat in compiling a bibliography of the relevant national legal instruments used, as requested by the Ad Hoc Working Group.

B. Criteria for selection of enterprises for privatization

68. Various criteria are used for the selection of enterprises for privatization. In Morocco, for example, PEs are selected according to whether they are profitable or potentially profitable; they have a significant public participation; they are already subject to competition, particularly applicable to industrial and commercial firms; they have a major economic role without having an important public service role; they have no major overstaffing problems; they have a regionally diversified base; and they have a legal corporate form. In Turkey, PEs are selected on account of their reduced economic role (small size and market share) in their particular sectors and of the marketability of the State shares. In Portugal, priority has been given to banks and insurance companies because of their decisive importance and because of the existence of the necessary supervisory and regulatory instruments, including EC directives. In Pakistan, priority has been given to banks and industrial PEs. In Ghana, the programme began with small or loss-making PEs. Some such enterprises had been restructured or leased before they were sold. In Egypt, PEs to be selected, particularly in the first few years, will be those which would minimize economic disruption, i.e. profitable and viable PEs operating in competitive markets without the need for restructuring and without any significant overstaffing. In Greece, the selection of PEs for sale is governed by the objective to reduce Government losses by the sale of debt-burdened, over-staffed and loss-making SMEs or to increase Government revenue by the sale of profit-making PEs.

69. In Senegal, certain strategic PEs which contribute to the achievement of important socio-economic objectives are not privatizable. Among the non-strategic firms, those which have no economic or financial potential will be liquidated, while those which are profitable or potentially profitable will be transferred to the private sector. In the Republic of Korea, privatization is to be excluded where the public interest is more important than efficiency; the capital investment involved is exorbitant or prohibitive for the private sector; and where there is no prospect of profitability and thus no demand for the company’s share capital. In Bulgaria, the criteria for the selection of small firms for auction include: interest of potential investors; degree of readiness of the firms (legal status, documents, etc.); the social situation, both in the firms and in the region; and environmental questions.

C. Methods and sequencing of privatization: sale and transfer techniques

70. The forms of privatization described in the country presentations range from management privatization through commercialization and corporatization to capital privatization. Commercialization and corporatization have been applied generally to medium or LSEs. PEs may be commercialized (Nigeria, United Republic of Tanzania) or corporatized (Finland) without leading to divestiture. Some corporatized PEs have the right to raise capital on the private capital market (Finland, the Netherlands). Further, some PEs are able to involve the private sector in the increased capitalization of their enterprises (Senegal, Tunisia) or to acquire shares of private companies (Morocco), giving rise to some form of "rolling privatization". Capital privatization may also be preceded by management privatization, generally

in the case of SMEs (Ghana, Morocco and Senegal). However, management privatization may be used as an end in itself (Côte d'Ivoire, Ghana, Niger, Senegal, Sri Lanka, Togo). It is an important tool for the contracting out, sometimes combined with the private development, of public utilities (Argentina, Colombia, Côte d'Ivoire, Malaysia, Thailand, the United States). In general, the technique chosen depends on the enterprise needs in terms of new capital, management know-how, technology, market contacts and incentives of ownership, including good corporate governance.

1. Privatization of capital

71. A number of technical problems need to be addressed and resolved in connection with a sale. These include, among the most important ones: the valuation of assets (and auditing as well sometimes); the method and terms of sale, including pricing and ownership-sharing formulae; and enterprise restructuring, including financial rehabilitation, particularly the treatment of debts, prior to sales.

72. A common method used for valuation is to calculate the net present value of future cash flows discounted by the cost of capital (as in Sri Lanka, Turkey). However, other methods are used, including using the net asset value and the operating cash flow, together with an assessment of the market situation (Finland); as well as the asset value, the profits earned, the stock market share value, the existence of subsidiaries and future prospects (France, Morocco). Forecasts of earnings are based on projections submitted by potential investors (Ghana). In the case of public utilities, the valuation includes three basic elements: the expected price, the scale of future investment and the tariffs that can be applied (Argentina). The book value may also be used; however, it has the disadvantage that it does not always represent the true value, for example, in terms of future income streams.

73. Market valuation is difficult to achieve in those developing countries or countries in transition where capital markets are weak or absent. In such situations, the bidding procedure provides a useful instrument for giving market forces a say in the valuation of assets to be sold. Bidding, generally applied to SMEs, has the added benefit of providing transparency. However, where the enterprise is large or complex, valuation cannot be avoided. Even so, bidding may be used for certain parts of the enterprise to be sold; this can help to identify where the viable assets are located. Valuation is essential where there is only one prospective buyer. An effective organization of different types of auctions and tenders is necessary in order to prevent corruption in the privatization process.

74. There is a range of options open to Governments wanting to dispose of their enterprises or parts thereof. These include: public or closed auctions, usually for small firms; direct negotiated sales to general investors, with or without prior competitive bidding; private placement with "strategic" investors (i.e. investors operating in the same industry or joint venture partners) with or without competitive bidding; public share offer, full or partial; sale to management teams or employees; sale to investment

funds; and liquidation followed by the sale of assets. A sale option may also be combined with a contracting out arrangement; agreement on such an option at the beginning of the contract can give an incentive to the contractor to improve the efficiency of the enterprise.

75. With a number of exceptions, mass privatization has been used in the countries in transition in Eastern and Central Europe and in the former Soviet Union. It involves population-wide distribution vouchers or certificates free of charge or for a nominal fee. Such vouchers can be exchanged for the (majority) shares of PEs included in the mass privatization programme. Various methods have been used or are envisaged to allow voucher holders to convert their vouchers into company shares, including directly through auctions (Russian Federation) or computerized bidding (Czech Republic and Slovakia) or indirectly through the purchase of certificates issued by investment funds acting as holding or management companies for the privatized enterprises (Czech Republic, Poland, Romania, Slovakia). These funds normally hold a majority of the shares, with the State keeping a minority holding and a certain proportion allocated to employees. In some cases, in addition to vouchers, a cash quota is required for the purchase of privatized assets (Lithuania).

76. Some particular techniques are also used. In Malaysia, for example, the private sector may initiate privatizations of projects that are unique by submitting proposals. Such proposals are considered on a "first-come, first-served" basis in order to encourage innovation and entrepreneurship. If a proposal meets the guidelines regarding privatizability and uniqueness (i.e. it provides a unique, cost-effective solution to an economic problem, it brings with it certain patent rights or particular know-how, or an additional asset, to make privatization viable), a letter of exclusivity is given to the private sector party to conduct a feasibility study and to submit a complete proposal to the Economic Planning Unit in the Prime Minister’s Department. Should the proposal, after evaluation, be found to be acceptable, negotiation will follow and an award will be made when agreement is reached. In Argentina, in order to resolve as many issues as possible in the bidding documents, bidders are required to provide a signed copy of the contract together with the bid. Further, the bid is reduced to one figure - the highest price or the lowest tariff or subsidy. Bidding based on the lowest subsidy is used, for example, for railways where subsidies are granted, particularly for suburban railways, to be used for investments.

77. In Hungary, the State Property Agency has developed a model for self-privatization. Certain enterprises (with a staff of fewer than 300 and a turnover and gross property value of less than 300 million forints) can initiate privatization themselves provided that they employ one of the independent consulting and property evaluating companies selected by the Agency and do not violate legal regulations. However, the Agency, as the holder of the ownership rights of the State, needs to give its permission before an actual transaction can take place.

78. While the public offering of shares is commonly used, particularly for large enterprises (where the size of the sale justifies the additional cost involved and where transparency is a particularly important consideration), there are important variations in practice. One concerns the fixing of the

share price, which can range from a fixed price offer to a tender offer to a combination of a price and a tender offer (as in the United Kingdom, which pioneered an international global tender and domestic pricing arrangement for the sale of shares of British Telecommunications). Another concerns the targeted buyers, involving a variety of incentive schemes for small investors (different versions of bonus share schemes for long-term retention of shares by small portfolios, as in France and the United Kingdom) and for employees (ranging from limited allocations of free shares, as in Slovenia, Sri Lanka, Tunisia, and the United Kingdom to a fixed percentage, usually 10 per cent, of shares for employees, as in Brazil, France and Venezuela). There are also differences in approach in terms of small buyers, institutional and "core" investors. In the United Kingdom, in the case of some offerings, the "claw back" method allows the number of shares allocated to small investors, if they subscribe in very large numbers, to be increased at the expense of institutions. In France, subscriptions of small investors receive priority treatment and a 20 per cent discount is granted for shares held for more than four years. However, in some other countries like Sri Lanka, the allocation to small investors is invariably a fixed percentage of the public offering. As regards "core" investors, the practice in France is to sell blocks of shares, representing 20-30 per cent of the total, to several "core" institutional investors, selected on the basis of open public tenders. However, in Sri Lanka, where such operations are smaller, the majority holding is sold to a "core" corporate investor. In fact, the authorities in Sri Lanka seem to have settled on a fixed 60:30:10 formula for the public share offering of their PEs, i.e. 60 per cent to be transferred to a corporate investor through competitive bidding (the latter being an axiom of the country’s privatization policy), 30 per cent to small investors and 10 per cent free to employees.

79. Broadly speaking, there are three forms of restructuring of a PE: organizational, sometimes involving the splitting up of the enterprise into smaller units and often associated with corporatization and some labour shedding in the process in order to enhance its net worth or sales value before divestiture; financial, involving the treatment of the debts of the enterprise in order to provide a "sweetener" or to ensure the success of its sale: and operational, involving new investment in order to upgrade the enterprise’s physical capacity or its technology. Organizational restructuring with corporatization has helped to increase the net value of the PEs concerned (as in France, the Netherlands and New Zealand); however, it is not clear what the cost of such restructuring has been. As indicated below, financial restructuring may be needed because of heavy debts before sales can be contemplated. Where the debt liabilities are large, the State may have no choice but to absorb them or a major part thereof in order to safeguard the healthy development of the banking system. However, operational restructuring should be avoided; if it is needed but can be avoided before divestiture, it would be better to allow the buyer to do it. The simple reason is that the Government cannot "second guess" what the potential investor would do, and may therefore make the wrong kinds of decisions leading to costly losses. In New Zealand, for example, after $2.3 billion had been spent restructuring a steel company, it was subsequently sold for $300 million.

80. In practice, important debts of PEs have led to financial rehabilitation prior to sales. In Bulgaria, where the PEs are heavily indebted, it has been decided to convert part of Government credits into public debt. The State Fund for Reconstruction and Development provides funds for the consolidation and technological innovation of some PEs prior to privatization. In Argentina, PEs have been rationalized or restructured prior to privatization through the cancellation, consolidation or refinancing of their debts; in some cases, the State has assumed some of the debts in order to facilitate sales. In Tunisia, the case-by-case treatment of debts by the Fund for the Restructuring of Public Enterprises has helped to reduce the impact of the debt, for example, on banks and small suppliers. In Portugal, financial rehabilitation for some banks has been undertaken, including the injection of new capital, in order, inter alia, to create the necessary reserves for "credit risks" and to provide adequate financing of the pension fund. In Germany, the Treuhandanstalt in principle takes over all old debts of PEs, as well as 90 per cent of past environmental burdens. Preference is normally given to selling the viable assets of a PE and writing off its debt than to transferring the debt and the assets for a lower or even negative price.

2. Privatization of management

81. The privatization of the management of a PE through the granting of a management contract, a lease or an operating concession to a private sector business operator can be used as an end in itself or as a preparatory step to divestiture. The granting of operating concessions can also be used, together with build-operate-transfer schemes, to raise private financing for the development of infrastructure and thereby to reduce the financial burden on the State as well. This kind of arrangement, combining both capital and management privatizations, is a useful option when the State is faced with budgetary constraints for the development or modernization of infrastructure.

82. Management contracts are used in various sectors, including hotels (as in Niger and Togo), agro-industries (Cameroon, Côte d'Ivoire, Senegal) and manufacturing and mining (Ghana). They are also used for plantations in Sri Lanka, where contracts are awarded to private sector operators through competitive bidding and where strict performance criteria are applied in order to avoid asset stripping or short-term profit maximization at the expense of long-term development. In China, where management contracts are used widely and subject to competitive bidding, potential managers are required to submit a business plan, together with their bid for a management contract, with the business plan playing an important role in the awarding of the contract.

83. Leasing is often used where it is difficult to attract large amounts of capital for the rehabilitation or sale of PEs. It is used in various sectors, including electricity and water supply (Côte d'Ivoire), steel mill and refineries (Togo), manufacturing (Ghana) and hotels (Côte d'Ivoire, Niger). A particular form of leasing is the transfer of the leasehold of State-owned property, including hotels and farm holdings (Jamaica), which gives entrepreneurs with limited capital access to productive assets. In Jamaica, it has engendered many new entrepreneurs who have turned hotels round, upgraded their facilities and services and transformed idle land into productive agricultural areas, including for export crops.

84. In a number of countries in transition, the State is using investment funds as holding companies to provide management expertise and effective corporate governance for their PEs. In the eastern part of Germany, the Treuhandanstalt has also developed solutions involving transfer of management. The model for medium-sized firms is to establish a management company as the owner of the firms with the task of managing 5 to 15 firms. The Treuhandanstalt holds 99 per cent of the capital of the management company, its management organ holds the remaining 1 per cent. The latter is a limited liability company owned by the private managers. Another method is to transfer firms to venture capital corporations, either refinanced by the State and/or by private finance companies such as banks or insurance companies. So far, two State-financed venture capital corporations have been formed, and more are expected to follow.

3. Contracting out of public services

85. The contracting out of public services to the private sector is used by a number of countries and particularly by the United States of America where it is the predominant method of privatization. It combines the private provision of public services with competition. Such competition can spur improved public provision of services. Where competition is active and where there is genuine competitive bidding for the franchises, it can lead to the provision of competitive services in terms of price and quality. For hard-pressed State or local authorities, faced with budgetary constraints, it can provide a useful additional source or an alternative to public provision. However, effective competition is essential in order to prevent collusive bidding or the emergence of dominant firms which may eventually shut out other competitors. There may be a need to monitor the quality of the services provided.

4. Particular conditions attached to privatizations

86. Special conditions are sometimes attached to sales, such as the retention of a special or "golden share" by the Government in order to protect the business from an unwelcome take-over, for example on national security grounds, or to provide an opportunity for the management to adjust to the private sector culture. The Government’s practice of keeping a "golden share" in the telecommunications industry after privatization has been adopted in a number of countries (as in New Zealand, Turkey and the United Kingdom). In France, for reasons of national interest, the Government can take a particular action ("golden share") which would give the State the possibility, after a privatization exercise, to authorize any participation exceeding 10 per cent of the shares. In the case of PEs operating in the area of defence, any participation exceeding 5 per cent of the share capital is subject to the approval of the Minister of Defence. Other similar measures allow the Government to place a State-appointed Director in a privatized company (Portugal, Turkey). In the Republic of Korea, in order to prevent investors from monopolizing the financial sector, ceilings are placed (maximum of 5 per cent for firms, maximum of 5,000 shares for individual investors) on the ownership of shares in the privatized banks. Certain countries also place a limit on foreign equity participation (France, 20 per cent; Malaysia, 25 per cent; United Kingdom, 15 per cent). In addition, as indicated above, social conditions such as employment protection schemes are attached to sales

in certain countries. Other conditions applied by certain Eastern and Central European countries include the development of export markets and share retention by the buyer for a specified period in order to prevent the buyer from quickly turning over the enterprise to another party. Likewise, in Sri Lanka, foreign investors are not allowed to transfer a recently-acquired enterprise to another foreign investor without Government approval.

87. In New Zealand, in order to promote widespread ownership and to avoid situations where minority shareholders of companies would object to their sale (as was the case with the Bank of New Zealand and the Petroleum Corporation), new owners are required to float shares as a condition of sale. For example, in the case of the Telecommunications Corporation, now privately owned, 40.1 per cent of the shares had to be floated by the new owners within three years of the sale. Similarly, a public flotation of 30 per cent of the shares was part of the Air New Zealand deal in 1988.

D. Privatization plans

88. Many countries have some annual plan for privatization, listing the enterprises approved for this, although enterprises not on the list may be added, if necessary, subject to the normal approval procedure. Some of these plans are quite elaborate. In Bulgaria, for example, the annual privatization plan indicates the minimum objectives, the minimum number of PEs to be privatized, the priority sectors, the proceeds of privatization and their use, privatization-related expenses, etc. It is accompanied by a list of the PEs to be privatized in which changes may be made in terms of additions or deletions.

89. In Egypt, a six-year privatization plan for the period 1991/92 to 1996/97 has been established, with the target of privatizing at least 25 PEs per year over the plan period. So far, 85 PEs have been identified for the first three years of the plan. Malaysia’s Masterplan sets out the broad policy framework for privatization, including the objectives to be achieved, and discusses the main issues of privatization. The Masterplan has been widely publicized, and has helped to prepare the ground for the successful privatizations which followed. Its formulation was based on a large sample of PEs. Out of the 424 entities studied, 246 were considered privatizable. However, not all of them will be privatized. The Masterplan included the first Privatization Action Plan for 1991-1992, designed to help channel efforts to priority areas in a more systematic and organized manner in consonance with national macroeconomic policies and the development strategy, thus enabling the privatization programme as a whole to acquire momentum and credibility. The Action Plan, updated each year after an end-of-year review, is a two-year rolling plan, giving details of the PEs to be privatized and of those to be prepared for privatization.

E. Organization of privatization

90. The organization of privatization includes three aspects: the adoption by Parliament of the enabling legal framework and legislation for specific privatization programmes; the taking of decisions on actual transfers and their terms either by Parliament itself or by a designated body; and the organization, coordination and implementation of the process.

91. The decision-making authority reviews and prepares privatization programmes for approval by Parliament. It usually decides on the actual transfers and their terms. In certain countries, it may intervene in important areas, for example, State banks or large mining companies (as in Ghana) or with regard to assets exceeding a certain value (Bulgaria). Such an authority is often the cabinet (Bulgaria, Ghana, Portugal, Malaysia) or the Prime Minister himself. The latter is true of countries like Egypt (where the Prime Minister also assumes the portfolio of Public Business Sector Minister) and Tunisia (where the Prime Minister also presides over the Commission in charge of privatization). In Finland, the Parliament itself decides on sales upon the recommendation of the Ministerial Committee for Economic Policy. In Portugal, Parliament retains the power to intervene if the legal documents prepared by the Government do not conform to the enabling legal framework established by Parliament.

92. In addition, a central body is established, with policy responsibilities for the organization and coordination of the privatization process. This can be a Ministry or Minister (as in Greece, Hungary, Poland and Portugal), a Commission, Committee or Council (Brazil, France, Ghana, Lithuania, Morocco, Nigeria, Pakistan, the Philippines, the Republic of Korea, Senegal, Thailand and Tunisia) or an Administration or Agency (Bulgaria, Egypt, Germany and Turkey), a Unit in the Prime Minister's Department (Malaysia), an Investment Bank (Jamaica), an Investment Fund (Venezuela) or a Development Fund (Slovenia).

93. Responsibilities for actual implementation are sometimes vested in the same central body (Bulgaria, but only for assets beyond a certain value, Germany, Greece and Jamaica). However, in some other countries, they are assigned to a specially-designated Minister (Morocco), a Ministry, together with regional privatization agencies (Lithuania), or with an interdepartmental Committee (Tunisia), individual Ministries on a sectoral basis, working together with the central body (the Philippines, Poland and Portugal) a specially-designated Agency or Council (Hungary and Turkey) or to banks and financial institutions (France and Nigeria). In Hungary, the State Property Agency, as a seller of State-owned property, is vested with powers to act like any other traders on the market. Where implementation is decentralized, the technical tasks related to the preparation, including valuation, and modalities of sale, of enterprises to be privatized are shared among individual Ministries, sometimes with the involvement of the enterprises concerned. In Morocco, an independent Valuation Authority has been set up to prepare valuations of firms for the use of the Transfer Commission, the central privatization authority. In Portugal, advice on legal and technical aspects is provided to the Ministry of Finance, the central privatization body, and the cabinet by an independent Privatization Commission appointed by the Prime Minister. External consultants are often used in the preparatory stage, for example, foreign accounting firms to help with the valuation of enterprises and merchant bankers to advise on the modalities and terms of sale. In some countries like Bulgaria, external consultants have also been used for sector-specific studies.

94. Thus, there are variations among countries concerning the centralization or decentralization of implementation responsibilities. In Jamaica, after having had a long experience of decentralizing implementation responsibilities

to individual Ministries and Departments, the authorities have decided to centralize both policy and implementation responsibilities in one entity under the direct responsibility of the Prime Minister, namely the National Investment Bank of Jamaica. Such an arrangement is seen to have a number of advantages: (i) it avoids the "fragmented" approach of the past and ensures that privatization activities are better controlled and monitored; (ii) economies of scale can be achieved through the central hiring of all consultants needed under grant-funded contracts and the use of a core of experienced privatization personnel for the coordination of divestment activities; and (iii) centralization allows for greater use of consultants so that more transactions can be accomplished simultaneously. However, there are arguments in favour of decentralization, including speed of implementation and reduced workload on the central coordinating authority. The answer will depend on where the balance lies between cost efficiency and speed, with its costs and benefits, in each particular situation. In any case, even with decentralization, the central authority will need to supervise the process in order to ensure that the objectives set are met and that there are no abuses.

F. Information, promotion and marketing techniques

95. Special importance has been attached by countries to creating public awareness of the importance and objectives of privatization, promoting transparency and accountability, as well as marketing efforts in order to achieve successful sales both at home and abroad. Transparency is one of the axioms of privatization policy in practically every country, although some countries went through a learning process before accepting it. In certain countries, the law requires that advance announcement and publicity be given to public share offerings (Portugal). Generally, countries adopt a two-pronged approach, one of a general nature designed to educate the public and to built up support for the process, and the other of a company-specific nature targeted at potential investors both at home and in foreign capitals. Both are part of an important marketing exercise to promote the value of privatization to all the parties concerned and the value of specific enterprises. If done effectively, it can not only help to build up a broad-based consensus but also to add real value to the assets being sold.

96. The former may consist of televised discussions, newspaper articles, information booklets and workshops and conferences organized with the help of universities and research institutes on the issues of privatization, including its objectives, its effect on the economy, its social implications and so on. This public consciousness campaign has been organized in a number of countries (Bulgaria, Jamaica, Ghana, Morocco, Turkey); and has been conducted over an extended period prior to the launching of the privatization programme itself (Sri Lanka). In Nigeria, the privatization agency conducted a nationwide tour to inspect the PEs earmarked for privatization and to hold discussions with public leaders, enterprise managers, employees and other members of the business community.

97. Transparency concerning sales is promoted through newspaper articles in the national, regional and international press giving details of sales, the bidders, their bids, the successful bid and the amount achieved (Ghana). Privatization operations are preceded by publicity campaigns in the media,

which also give details of tenders and of sales (Portugal). Likewise, in the Netherlands, share flotations are preceded by intensive advertising campaigns at home and abroad.

98. Company-specific promotional efforts involve national and international advertising, direct mailing of information material to potential investors, as well as soft loans to investors or favourable prices and payment methods for the sale of firms in regions given priority in development (Turkey). They are targeted at potential investors, including employees who benefit from special advantages (Morocco).

99. In Argentina, after agreement was reached on which PEs should be privatized, information has been provided in order to attract potential investors. Offers have helped to determine what could be expected. Thus the package has been developed not in isolation from the market but by taking into account the interests of potential investors. Company- and region-specific exercises have also been undertaken, e.g. visits to Belgium (for the EC), Japan and the United States (for the North American market). Company or sector-specific seminars (e.g. on gas) have been held as part of the marketing campaign.

100. In Germany, special importance has been attached to transparency and marketing, including regular public offers of SMEs, selected according to branches; sales on the basis of a catalogue offer for small-scale enterprises (up to 50 workers) organized by savings banks and local communities; the standardization of sales, terms and conditions; offer of firms on so-called "firms stock exchanges", allowing a broad range of SMEs to participate; special efforts to attract the interest of foreign investors, including the use of international publications; the establishment of branches of the Treuhandanstalt in world trading centres such as Tokyo, New York and London; and participation in international trade fairs and expositions (leading to the sale of over 500 firms to foreign companies and fetching investments of around DM 15 billion).

G. Financing of privatization

101. The financing of privatization raises a number of issues relating to the mobilization of resources, both internally and externally, and the policy and institutional constraints thereto. As regards the raising of domestic resources, the broadening and deepening of share ownership, including giving priority or preferential treatment to small investors (as in France, Jamaica, the Netherlands, Nigeria and the United Kingdom), a fixed percentage to nationals, with minimum and maximum subscriptions (30 per cent in Sri Lanka, 40-60 per cent in Nigeria), a fixed tranche to workers (10 per cent in Argentina, France, Nigeria and Sri Lanka and 15 per cent in Poland), and schemes or incentives for the promotion of employee share ownership (Côte d’Ivoire, Sri Lanka) have been used as instruments not only to promote "popular capitalism", or "labour capitalism" for employees, but also to provide an alternative investment outlet to non-productive uses (such as hoarding gold), and thus to raise savings for productive investment. Consequently, the number of shareholders has increased in many countries. Where large-scale privatizations have taken place, the number of investors has increased quite dramatically, e.g. from 3 million in 1979 to 10 million

in 1992 in the United Kingdom, and from 1.5 million in 1986 to 6.5 million in 1992 in France. Whether there has been a significant privatization-led capitalization of idle resources, and whether there have been sustained capital gains of the shares of privatized enterprises, leading to increased discretionary income and savings, are questions that can only be answered empirically. What is clear, however, is that the public offerings of shares of privatized companies on the capital market, together with the broadening and deepening of share ownership, have in many cases led to significant increased capitalization and handling capacity of the stock market, rendering it more attractive internationally and making it easier to achieve successful share flotations. In these countries, there is no shortage of domestic buyers and, more often than not, the shares of privatized enterprises are over-subscribed many times over. A well-developed capital market can in fact have an important bearing on the structure, speed and implementation of the privatization programme.

102. Another important form of financing has been the mobilization of institutional savings. Chile, by privatizing the State pension system and associated life insurance companies, created the first group of institutional investors in Latin America. The privatized State pension system helped to provide adequate funding for the third successful phase of Chile’s privatization programme starting in 1984 which covered the country’s largest PEs. By selling the large PEs to the privatized pension system, the Government generated political support for the programme, contradicting the notion that privatization benefits only large foreign corporations. Private pension funds have also played a major role in the privatization programme of Brazil.

103. However, important problems remain for many countries in terms of achieving successful privatization sales. These include the problem of raising capital domestically for the sale of large-scale enterprises (as in Ghana, Peru, Poland, Senegal, Turkey and the United Republic of Tanzania) due to the low level of savings or of discretionary income, the limited number or interest of investors, the limited size or rudimentary nature of financial markets or the absence of a secondary market for company shares (which discourages small savers from acquiring shares). Various countries are taking steps to strengthen their financial markets so that they can play a leading role in the privatization process by providing long-term equity finance and a wide base of share ownership (Côte d’Ivoire, Ghana). Meanwhile, in some of these countries, foreign investors, sometimes in partnership with domestic firms, have been the main buyers of privatized large-scale enterprises (Ghana, Peru).

104. The strengthening of financial markets and institutions is a matter of priority concern for many developing countries and countries in transition. Privatization, by rebalancing the public and private sectors, requires that the financial markets and institutions be expanded for private sector development, since the privatized firms will not have the same privileged access to government loans previously available to them as PEs. For this purpose, and particularly where capital markets are thin, the number of potential investors is limited and the level of mobilized savings is low, greater attention needs to be given to the development and improvement of the network of financial intermediation, including informal linkages, in order to

improve the mobilization of domestic savings so that additional credit creation to meet the financing needs, particularly of SMEs (which may have less equal access to credit than their larger counterparts), can be achieved without inflationary consequences. Their development in the countries in transition can help to tap the "monetary overhang" in such countries in order to raise resources in support of privatization and enterprise development.

105. Due to their limited domestic financial market, many countries allow, or actively encourage as a major objective of their privatization policy and through their investment code, foreign participation in the privatization of their PEs, through joint ventures or by allowing foreign investors to acquire privatized assets, including ownership of majority shares (as in Sri Lanka). In Argentina, some 60 per cent of the assets sold to date have been bought by foreign investors from 19 countries. An important policy consideration is the recognition that foreign participation brings with it not only capital, but often also management skills, new technology and global or international linkages. In Malaysia, for example, while a limit is placed on foreign participation in the equity of a privatized company, this is permitted where: the expertise needed to improve efficiency is not available locally; it is required to promote exports; the supply of local capital is insufficient to absorb the shares offered; and the nature of the business requires global linkages and international exposures. However, certain countries seem to have failed to attract foreign capital. In Niger, for example, all the privatized companies have been sold to domestic investors.

106. In order to improve the financing of privatization projects, investment funds have been set up in a number of countries. In Morocco, an investment fund, INTERFINA, has been established as a joint venture between three Moroccan banks, together with two foreign banks and the International Finance Corporation, to provide financial support for privatization projects. Likewise, in Senegal, a private investment company has been established grouping the creditors of the State to allow the creditors to swap their loans for the equity of privatized companies. Turkey is examining the possibility of establishing a Fund for the Encouragement of Employee Savings in order to promote wide share ownership by investing 15 per cent of such savings in the share capital of privatized enterprises and other highly liquid assets. It has also launched a new financial instrument in the form of revenue sharing certificates of a Public Participation Fund which will allow the holders to benefit from the investments of the Fund in the development of infrastructure and regional projects, including the revenue of toll highways, power stations and other infrastructural facilities financed by the Fund.

107. Internal privatizations (sales to management teams or employees) are used as another source of financing in the countries in transition. However, since they require only a certain amount of cash immediately, additional capital and other inputs may be needed. Investment funds adapted to their particular situations have also been established in some of these countries, some created by private agents (as in the Czech Republic and Slovakia), some by the Government (Poland) and a mixture of both (Romania), in order to facilitate the transfer of the ownership of PEs to large segments of the population. These are basically operating as holding or management companies for the

PEs concerned. Whether they will evolve into the type of investment funds which exist in OECD countries and elsewhere, capable of mobilizing small savings for investment in corporate capital, as the household discretionary income in these countries grows, remains to be seen.

108. The management of large-scale privatizations is important in order not to destabilize the capital market by "crowding out" private sector investment demands and raising the long-term cost of finance. The share issues of such privatizations are often large compared to other equity issues and thus exert a heavy demand on private sector financial resources, which calls for a greater role for the various financial intermediaries and the stock market in mobilizing both debt and equity capital. Such mobilization would not only facilitate privatization but also promote further development of the capital market. In France, a total of FF 83 billion was raised in the 1986 privatization programme. In order to reduce the risk of "crowding out", this amount had been largely "recycled" on the financial market through the alleviation of State debt.

H. Enterprise- or sector-specific issues

109. Public utilities or infrastructure like communications and power are an important part of the supportive and enabling environment for private sector development. In fact adequate infrastructure is essential for the development of trade, financial, marketing and other services, innovation and productivity growth. The role and ability of the Government in providing adequate infrastructure, either by financing its own investment or in attracting private investment for the purpose because of budgetary constraints, is one of its "core" functions.

110. Reference has been made earlier to the issues of competition and regulation relating to the privatization of public utilities. In view of their size and importance in the economy, privatization also raises other important issues. They are considered in many countries as "strategic" industries which provide vital economic and social services. In some countries, the privatization of certain public utilities such as telecommunications would require a change in the national constitution (as in Brazil and Germany). Because of the size of the transaction involved relative to the size of the domestic capital market or of domestic savings, some countries may find it difficult to privatize their public utilities through public offerings. Thus, it may not be possible or easy to transfer full or majority ownership to the private sector. However, there are other options, including minority ownership transfer, commercialization, corporatization, contracting out arrangements and joint ventures. Where there is genuine competitive bidding for the franchises, contracting out can provide periodic competition for the industries concerned. A non-privatization option, which can also serve as a preparatory step to divestiture, is corporatization; such an option has been used effectively in some developed and developing countries (Australia, Malaysia, New Zealand and the United Kingdom) in order to prepare public utilities for their successful transfer to private ownership. Where public utility services are subsidized, there is also the question of the

treatment of subsidies. While general subsidies cannot be justified on allocative efficiency grounds, specific subsidies, for example, those to compensate for diseconomies of density in rural areas, can be justified on social grounds. If not offset by economies of density in built-up areas, they may be paid for directly.

111. The private development of public utilities raises certain other issues, including the relative merits and feasibility of different options, including build-operate-transfer schemes, joint ventures and collaborative ventures among a number of neighbouring countries, as well as the nature of government incentives and guarantees required to attract private sector participation and the particular industries in which such government support may be needed. While private infrastructure development can provide a number of benefits, e.g. new sources of capital, reduced time and cost to develop new infrastructure, improved operating efficiency and responsiveness to customers, efficient pricing of infrastructure services, and new tax revenues, there can be major obstacles, including the reluctance of financial markets to finance the first private projects without government financial support or guarantees, lack of sophistication on the part of public managers to attract privately-financed infrastructure projects, and local opposition and environmental regulation, which affect both public and private projects.

112. For the same reasons, the privatization of public utilities involves far more complex and costly operations than that of privatizing a trading company, for example. Questions such as valuation, enterprise restructuring and industrial segmentation in order to enhance competition, method, sequencing, timing and transparency of sale, underwriting, participation of foreign and "strategic" investors, safeguards (through, for example, the use of "golden shares") against undesirable corporate activity such as hostile take-overs and the concerns and interests of particular social groups (for example, rural populations) assume great importance and call for particular attention. The treatment of large accumulated debts of public utilities, for example, those of railways in Germany and Japan, also raises particular problems. In Japan, in addition to the restructuring of the national railways (see para. 46), a Settlement Corporation has been established to take over the railway’s long-term debt which could not be transferred to the regional companies, which would be repaid from the sale of land no longer needed by the industry and of the shares of the regional companies, as well as to help retrenched workers to find new jobs. In addition, there may be environmental aspects to be considered. For example, the private development of a motorway skirting a major city can result in the reduction of traffic congestion in the city, with beneficial effects on air pollution and fuel consumption. However, such benefits may need to be weighed against any disfigurement of the countryside. At the same time, because of their importance in the national economy and of the vital economic and social services which they provide, there is greater pressure than in a commercial privatization to show the benefits of privatization, as reflected in the increased supply and quality of services, their prices and in their economic impact (for example, on communications and other enterprise costs and thus on industrial and trade competitiveness).

I. Role of multilateral institutions and bilateral donors

113. A number of countries have reported receiving various kinds of assistance relating to different aspects of the implementation of their privatization programmes from both multilateral financial institutions and bilateral donors. Among the multilateral financial institutions, the World Bank has provided various kinds of loans, for the financing of structural adjustment programmes and the setting up of privatization agencies in many African countries, a social fund (Colombia) and a severance payments and voluntary retirement programme (Argentina). It has also provided technical assistance on the formulation of a privatization strategy for 15 large-scale infrastructure-related PEs (Thailand). Its private sector lending agency, the International Finance Corporation, has joined with two foreign banks and three Moroccan banks to establish an investment fund to support the privatization process (Morocco). The African Development Bank has helped the Government to set up a fund, together with part of the proceeds of privatizations, for the promotion of small- and medium-sized enterprises and industries (Senegal). The Inter-American Development Bank has financed privatization studies (Venezuela). The United Nations Development Programme (UNDP) has financed technical assistance, training and the purchase of equipment and part of the public relations campaign related to the privatization programme (Morocco). The EEC-PHARE programme has financed the services of foreign experts, advisory and consultancy services, as well as training and marketing activities (Poland).

114. Among the bilateral donors, examples of assistance include the grant aid provided by the Overseas Development Administration (ODA) of the United Kingdom for strengthening the secretariat of the Divestment Implementation Committee (Ghana); financing provided by a German donor agency for a privatization study of a particular PE (Ghana); privatization-related support provided by Canadian and German donor agencies (Morocco) and similar support provided by Canadian and French donor agencies (Poland, Senegal). The United States Agency for International Development (USAID) has financed valuations and audits of PEs (Morocco), technical specialized services not available in the National Investment Bank of Jamaica, the privatization agency, and the administration of a Jamaican Privatization Guarantee Facility (Jamaica). It has financed the training of Government valuation experts (Sri Lanka), sectoral studies, accountancy services and training (Poland) and valuation and strategy studies and marketing services (the Philippines). A Danish corporation, the Danish Industrialization Fund for Developing Countries, has provided equity, and to a lesser extent loan capital, to several privatized enterprises in Togo, where its financial participation was crucial in attracting private Danish firms to become partners in such enterprises.

115. These examples are indicative and there are many other instances of assistance, including those mentioned in statements to the first session of the Ad Hoc Working Group, and in subsequent replies sent in response to a request from the secretariat and made available to the Working Group, by a number of multilateral financial institutions, including the World Bank, the Asian Development Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development, as well as by other international or regional bodies such as UNDP, OECD, the Commonwealth Secretariat and the Andean Group.

J. Environmental issues

116. Environmental issues have been raised in the country presentations in terms of the environmental burdens of privatized or privatizable PEs in the eastern part of Germany, where 90 per cent of such burdens are absorbed by the Treuhandanstalt, and in some of the countries of Eastern and Central Europe (as in Bulgaria, where the improvement and protection of the environment is one of the objectives of its privatization policy), as well as in terms of environmental standards that may impact on privatization and of the manner in which they are being addressed.

117. In Jamaica, environmental concerns and standards are increasingly becoming an important part of privatization projects. Thus, where such projects involve major environmental considerations, one of the criteria used in the assessment of a proposal is whether it includes measures to ensure that the privatized company operates, as far as possible, in an environmentally-friendly manner. For example, where projects have a large chemical component or waste content (as in a textile or distillery factory), an environmental impact assessment is undertaken in order to identify the problems with regard to the company’s operations and to propose possible solutions. In addition, the Natural Resources Conservation Authority, a government agency, ensures that companies operate in conformity with good environmental practices and that privatizations incorporate such practices.

118. In Poland, an inter-Ministerial Environmental Unit has been established to deal with environmental issues arising from the privatization process, particularly those relating to liability and compliance. Among its principal objectives are to evaluate and propose relevant legislation and regulations, to obtain the necessary environmental data on companies to be privatized, to oversee environmental audits and to monitor the buyers’ contractual obligations concerning the environment.

119. In the United States, environmental considerations have not been a major issue for the contracting out of municipal services. Private service providers must comply with the same environmental laws and regulations as are applied to public providers and are subject to fines for non-compliance. By contrast, environmental regulations have been a barrier to private infrastructure development. Infrastructure facilities must undergo a rigorous environmental permitting process before construction can begin. This increases project costs and risks and can impair the ability to attract private financing.

V. SOCIAL IMPACT

A. Social effects

120. This is a vast and complex area which touches not only on employment issues but also more broadly on the social balance sheet of privatization in terms of the effects of privatization on employment, the provision of social infrastructure or services and the social benefits and costs linked to public utilities. For the purpose of this paper, and in the light of the information

received, this section will focus on the employment aspects relating to the privatization of PEs. Thus, it covers essentially only one aspect of the social balance sheet and in a rather limited way.

121. As far as employment is concerned, privatization can have both positive and negative effects. In the short term, the positive effects include improved terms of employment for managers and workers kept on the company’s payroll after privatization (as in Jamaica), and access, sometimes free of charge, to a proportion of the shares of the new company (an axiom of privatization policy in many countries). In the Netherlands, for example, privatization often leads to salary increases for managers and lower salaries for lower personnel. To soften the impact, a temporary net salary guarantee for the latter is normally provided. In the longer term, there may be employment gains resulting from increased investment and growth of the privatized companies.

122. The major negative impact is labour retrenchment linked to privatization. It should be noted, however, that retrenchment may also arise from other kinds of enterprise reforms, including commercialization and corporatization. In fact, it is often argued that since the Government is in a better position to handle surplus labour, it may be preferable to slim down a PE during corporatization before it is sold. Further, the overall impact on individual workers will depend on the benefits received, including severance payments, early retirement benefits, job placement, counselling and training services, as well as alternative employment opportunities, including self-employment through the setting up of businesses. Thus, the impact of retrenchment may be attenuated by privatization-induced socially-related support measures and may be offset by alternative employment opportunities, including those arising from job-creating growth of the privatized companies or of other enterprises stimulated by the privatization process. Moreover, such retrenchment is not part of an inevitable logic of privatization. Some countries have had no adverse employment consequences because privatization took place in a favourable employment market (Portugal). Others have used privatization policies to protect employment in the privatized firms for a specified period after privatization, ranging up to five years (Malaysia, Morocco, Pakistan, Sri Lanka). In Japan, out of 92,000 workers affected by the privatization of the national railway company, 32,000 were absorbed by the new companies, 20,000 took voluntary retirement, 30,000 were transferred to the Settlement Corporation which had to find alternative employment for them within three years and 10,000 were retrained and found jobs in private sector companies eligible for job-creation subsidies. Further, increased investment in the privatized enterprises or their improved performance has generated new jobs (Jamaica and the Philippines). In Sri Lanka, one of the first privatized companies, a textile mill, benefited from increased investment, enabling the company not only to absorb the surplus labour but also to create many new jobs. Likewise, in the western part of Germany, improved performance, including better management, has led to increased employment in two major privatized industrial groups, VEBA, from 74,597 in 1987 to 116,979 in 1991, and VIAG, from 33,427 in 1988 to 74,122 in 1991. However, in a number of countries in Africa and elsewhere, there has been a serious negative impact on employment. In the eastern part of Germany, 3.5 million out of a total 9.5 million jobs were lost, leading to 30 to 40 per cent unemployment or underemployment in some regions.

B. Socially-related support measures

123. Socially-related support measures designed to soften the negative social impact of privatization are part of the "social provisions" of the privatization process. Success in designing and implementing them can be crucial for ensuring the credibility and success of the process itself. To quote from the Netherlands contribution: "Creating a social safety net calls for clear principles to be established from the start; these might be set out in a social plan; these principles should be established as early as possible in the privatization process in order to secure the cooperation of all the staff. There is a general tendency at the start of a privatization operation to underestimate both the costs and the time involved."

124. Such support measures include, inter alia, redundancy or severance payments (as in Argentina, Ghana, Germany, Greece, Sri Lanka, Tunisia, Turkey, Venezuela), voluntary early retirement schemes (Argentina, Venezuela), retraining or vocational training (Benin, Colombia, Ghana, Japan, Portugal, Turkey, Venezuela), the promotion of entrepreneurship and the setting up of micro, small- or medium-sized enterprises (Colombia, Ghana, Jamaica, Senegal, Tunisia and Turkey). Germany has, in addition to vocational training, used early pension schemes, public work programmes and short-time working as part of a massive labour market policy to reduce unemployment in the eastern part, reducing its average rate to 16 per cent (compared to 30 to 40 per cent in some regions).

125. In some countries, the institutional support for job retraining and the promotion of entrepreneurship already existed (Ghana, Portugal). In some other cases, institutional support for retraining and/or entrepreneurial and enterprise development has been linked to privatization and provided by a fund established for the purpose (the Philippines, Tunisia); established with the help of a loan from a multilateral financial institution (Colombia); and established with such help, together with part of the proceeds of privatization (Senegal). Part of these proceeds has been used to finance end-of-service payments (Ghana) or will be used to finance a social fund (Bulgaria). In some cases, retraining of labour made redundant by privatization is handled by the focal point for privatization (Benin). In Germany, the Treuhandanstalt takes care of the financing of the necessary social plans in connection with any staff retrenchment.

126. As stated above, in some instances, the proceeds of privatization have been used to varying degrees to finance redundancy or severance payments or support for the development of entrepreneurship and of SMEs. They have also been used to invest in education and in physical infrastructure (Mexico, Venezuela). The question that arises is to what extent such proceeds should be used to finance job-creating measures in order to soften the negative social impact of privatization, as well as to invest in human resources development and other assets conducive to growth and job creation, as opposed to other uses. This matter is related to the importance of providing institutional support for the development of entrepreneurship and of micro-enterprises and SMEs as a supplementary measure not only to ensure the success of privatization but also to make full use of the experience and skills of redundant workers for the economic development of the country. In this connection, it is worth noting that, in Venezuela, the Privatization Act

provides that no less than 10 per cent of the proceeds should be devoted to technical innovation, industrial development and the development of micro-enterprises and SMEs and that no less than 15 per cent should be devoted to technical education and vocational training.

127. In Tunisia, particular attention has been accorded to the redeployment of the excess personnel which has acquired experience beneficial for the economic development of the country. Thus, in addition to the payment of indemnities, the employees released are given help and the necessary institutional support in order to enable them to set up small businesses which can themselves generate employment. This pragmatic approach represents the most important positive aspect in the sense that the first phase of privatization has been realized without social problems and sometimes even with the support of employees.

128. Strengthened institutional support for SMEs may be necessary in order to ensure the vitality of such firms, themselves generated by the privatization process, and the success of the process itself since they play a key role in fostering competition and in generating employment. Such support may comprise measures, including regulatory and fiscal reforms, to help them in a number of areas, including their access to finance, technology, government procurement, marketing and distribution channels, as well as information, training and advisory services.

129. Like the developing countries mentioned above, some of the countries of Eastern and Central Europe and of the former Soviet Union have taken or are taking measures, including the adoption of laws, to stimulate further development of the small business sector (as in Bulgaria and Lithuania). However, many obstacles remain, including lack of start-up finance, gaps in legal framework, unequal application of laws and bureaucratic inertia in business registration, lack of marketing, financial accounting and other management skills or information about basic business practices (Lithuania).

VI. RESULTS OF PRIVATIZATION AND THEIR EVALUATION

A. Assessment of results

130. Specific privatization objectives have been elaborated at various levels. In some countries, indicators for evaluating the achievement of these objectives have been specified (as in Portugal). Further, various types of results arising from privatizations have been reported. In some cases, the machinery for monitoring and evaluating the results of privatization programmes has been established. However, such evaluation machinery or procedure has still not been widely adopted, perhaps because there has not been a sufficiently long experience of privatization in many countries.

131. The responsibility for monitoring and evaluating the results of evaluation is vested in the Prime Minister’s Department (Turkey) or the Ministry of Finance (Portugal). In France, the results of the 1986 privatization programme have been evaluated by the State Accounting Authority (Cour des Comptes), a parliamentary commission and the Superior Council of the Public Sector. In Venezuela, a Coordinating Bureau has been

established to assess the impact of privatization. In Jamaica, an independent evaluation of the results of privatization has been conducted by a noted Jamaican political scientist.

132. In Portugal, the Ministry of Finance has specified evaluation indicators for each of the objectives. To quote a few examples, for assessing the performance of privatized companies, indicators used include the investment/employment ratio, in addition to standard indicators of profitability or of productivity. The percentage of privatized firms held by groups owned by nationals is used, among others, to measure the development of national entrepreneurial capacity.

B. Results of privatization

133. As regards the results of privatizations, it is recognized in some cases that it may be too early to make a systematic analysis and that the results of evaluation are not always quantifiable. Still, some assessments have been made.

134. According to the country presentations submitted to the Ad Hoc Working Group, there is evidence to indicate that properly-executed privatizations have yielded important benefits. These include, in relation to the objective of promoting economic efficiency, enhanced market competition in particular sectors (as in Malaysia, New Zealand and the United Kingdom); improved performance and competitiveness of privatized enterprises (Argentina, Greece, Jamaica, Japan, Morocco, the Philippines, Portugal); lower consumer prices charged by privatized firms and/or improved customer services provided by them (Japan, the Netherlands, New Zealand, the United Kingdom), expanded capitalization, investment and capacity of privatized companies, leading to greater security or growth of employment (Germany, Malaysia, Nigeria); improved access of privatized firms to capital, technology, skills and international linkages (Finland, Malaysia, New Zealand). Privatization has enlarged the circle of entrepreneurs (Jamaica); and increased the capitalization and handling capacity of capital markets (France, Malaysia, Nigeria, the Philippines, the United Kingdom). It has attracted foreign investment, including through joint ventures (Jamaica, where 94 per cent of foreign direct investment in 1987 was privatization-driven, Peru, Sri Lanka, Turkey, Venezuela). It has brought about intangible benefits such as the introduction of the discipline of private sector culture in the management of privatized firms which continue to have a share of State ownership (the Netherlands, New Zealand). The very act of preparing a PE (a telecommunications company) for privatization and of selling a minority share (25 per cent) of the enterprise has apparently had a positive effect on enterprise performance (Israel).

135. As regards the role of the Government and macroeconomic management, privatization has reduced the weight of subsidies to public enterprises (when loss-making enterprises have been sold off or when subsidies to public enterprises have exceeded the income foregone from such enterprises) as in Ghana, Jamaica, Malaysia, Nigeria and the Philippines. It has led to increases in government revenue (when the corporate taxes paid by privatized

firms have exceeded the revenue previously received from them), as in Argentina, Malaysia and Nigeria. The one-off proceeds from privatization sales, very substantial in some cases, have enabled Governments inter alia to reduce long-term debt and budgetary deficits (Argentina, France, Portugal, the United Kingdom, among others) or to finance human resources and infrastructure development (Mexico and Venezuela), enterprise development (Senegal), agrarian reforms for the benefit of landless farmers (the Philippines) and environmental activities (Germany). The private development of infrastructure has provided additional sources of financing for some of the "core" activities of the State, thus reducing infrastructural bottlenecks, easing budgetary constraints or releasing resources for other development projects (Indonesia, Malaysia, Portugal, Thailand). Privatization, together with other measures, has contributed to macroeconomic stabilization and to the creation of a climate of confidence in the economy, leading to the return of flight capital in certain countries (Argentina). In the United States, contracting out arrangements have realized important cost savings (10 to 40 per cent) in the provision of public services and produced other benefits, including higher quality services, as well as greater flexibility and shorter delivery time in the provision of such services.

136. However, these benefits have been achieved mostly in high or middle-income countries, sometimes at some social costs; and the efficiency gains such as lower consumer prices may have been due as much to the strengthening of competition, including that induced by privatization, as to ownership change itself. Further, in some low-income countries, privatization has been more difficult to achieve and, in some instances, privatization has been marked by the poor performance of the privatized companies, resulting in a loss of fiscal revenue and of jobs (as in Niger). Moreover, while privatization has broadened the base of share ownership in a number of countries (Argentina, France, Jamaica, Malaysia, the Philippines, the Republic of Korea, Sri Lanka, the United Kingdom), more research is needed on the income distribution effects. Mass privatization, as a means of sharing national wealth, has been applied more successfully in some countries in transition (Czech Republic, Lithuania and Slovakia) than in some other such countries (Russia).

137. In the countries of Eastern and Central Europe and of the former Soviet Union, where privatization is a core element of the transition to a market economy, the dynamics of the transformation process have a critical bearing on the privatization process. Most of these countries have recorded impressive results in terms of "small privatizations", particularly in services, retail trade and agriculture. However, the privatization of medium-sized and large enterprises in the manufacturing and banking sectors has advanced much more slowly than anticipated, even if the complexity of the task is duly taken into account.

138. Although these countries have approached privatization from different positions, consequently with a considerable variation in their privatization strategies, they have encountered rather similar impediments. Despite considerable progress in institution building, there are still gaps, particularly concerning the requisite legal instruments, access to finance and

the functioning of the public administration. Macroeconomic conditions, in particular monetary and fiscal policies, have often lacked a supportive element for privatization activities. It has become evident that the skills and business attitudes acquired previously in the "shadow economy" are not necessarily sufficient for successfully running large-scale enterprises under market conditions. Further, deficiencies in basic infrastructure, particularly communications, have frustrated potential private investors. Moreover, political instability and uncertainty in some of these countries about the direction and depth of the transformation process have inevitably contributed to a slowing down of the privatization process when progress is needed in order to give it credibility.
