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Presentations of national experiences with privatization

This volume contains the presentations made by national experts on their respective country's experiences with privatization, as submitted to the Ad Hoc Working Group on Comparative Experiences with Privatization at its second and third sessions.

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CHINA

STATEMENT BY THE CHINESE DELEGATION AT THE SECOND SESSION OF THE AD HOC WORKING GROUP ON COMPARATIVE EXPERIENCES WITH PRIVATIZATION

(9 JUNE 1993)

With the evolution of the world economy, countries continue to change their strategies for economic development and to reform their economic systems in order to adapt to the changing world economic situation. The forms of economic systems adopted by countries are becoming increasingly diversified, and there is no longer an unified model for economic development. However, no matter what economic system a country may choose, it must meet the needs of competition in the international market. The economy of private ownership is also a very important form of economy. It is necessary that UNCTAD has set up a Working Group in this area to act as a forum for this introduction and exchange of work and experience on this issue. The Chinese delegation has listened with attention to the experiences introduced by the participating countries and would like to take this opportunity to make a brief presentation of China's economic reforms and some of the results achieved.

China is a socialist country and its aim is the achievement of socialism with Chinese characteristics. The main features of socialism with Chinese characteristics are the following: making public ownership including enterprises owned by the state and those owned by collectives predominant, with individually-owned and privately-owned sectors and foreign-owned enterprises, as a supplement; multiple economic sectors being allowed to develop side by side for a long time, which includes the practice in a voluntary manner of a host of joint operations. Since the beginning of reforms and opening its economy in 1979, China has steadfastly adhered to this goal in its efforts to speed up economic development and carry out its economic reforms. The goal of China's reforms in its economic systems is the establishment of a system of socialist market economy. The next five years will be decisive in this respect. At present, we are stepping up the pace of this reform on all front so as to lay the ground-work for this new economic system within the 90's. Some people argued that China appears to contradict itself by holding on to socialism on the one hand and trying to develop a market economy on the other. This actually depends on how one interprets socialist economy and market economy.

We believe that both planning and markets are the economic means and not symbols of a particular social system. A socialist economy is not simply a matter of planned economy, it has two distinguishing features: 1) A high rate of efficiency in resource allocation and labour productivity and 2) Safeguarding of social

justice and the achievement of common prosperity. As two different methods of resource allocation, market economy is more efficient than planned economy. This is a major reason why China, while adhering to socialism, has chosen a market economy. It is socialist ideals to safeguard social justice and achieve common prosperity. Whether the system is based on public or private ownership, the public ownership of property, as distinct from the private ownership of property, is more in the interest of safeguarding social justice and achieving common prosperity. Hence, our insistence on socialist market economy implies that in terms of the form of ownership, we stress public ownership as the mainbody, while in the actual operations and institutions, we practice market economy.

It seems that the essence of the matter lies in whether market economy can be built on the basis of public ownership. Here our conviction is firm and unshakable, and we continue to explore in a positive way.

In the first place, the adoption of public ownership as the mainstay does not exclude the coexistence of private ownership. In future, my country will continue to allow and support the development of private enterprises and enterprises with foreign capital and encourage them to compete on an equal footing with public enterprises; Secondly, public ownership can assume diversified forms in practice: It can be state or collective owned, or with the state or collective as the majority share holder. At the same time a portion of the small-sized state enterprises can be sold or franchised to collective or individual operation. It can be seen that an enterprise system with clearcut responsibility and well defined property rights can likewise be built on public ownership as the mainbody.

The transition from a planned to a market economy is a complex process. The task of setting up a market economic system in a socialist country is one that has never been attempted before. In introducing reforms in our economic institutions, we have borrowed and learned from many foreign advanced methods of national economic management and operations which reflect the laws governing a market economy. Through learning and practice we now have a deeper understanding of the basic role played by the market in the allocation of resources. A key factor in market economy is property rights relations which are clear-cut and responsible. Then there are two additional factors: the reduction of government intervention so that the enterprises can have free access to the market and set up contact with its segments; the lifting of price control so that the market can decide the price. The above is our understanding of the theories behind some of the issues of reforms in my country. Actually, since 1979, our economic reform has always been carried out on this theoretical basis. The key link in economic reform is reform at the enterprise level, particularly the large-sized enterprises, since these are the major pillars of our national economy. Successful management of state enterprises is the key to the liberation and development of productive forces and to a stronger

national economic basis as well as to a better living standard for the people. The key to the enterprise reform lies in turn in institutional changes. For that purpose, the State Council issued last June "Regulations on Institutional Changes in State-owned Industrial Enterprises" which will play a significant role in pushing the enterprise reform to greater depth and granting them greater decision power in managing their own affairs with the view to encouraging greater market orientation, higher competitiveness and richer economic profits and ushering in another major stage in the national economic development.

New progress has been made in the efforts to deepen the enterprise reform and implement the State Council Regulations. For instance, Enterprises have been given greater decision power in running their business. About 650 large and medium-sized state industrial enterprises have now been granted the right to engage in foreign trade. Meanwhile, experiments are under way in applying multiple forms of ownership with a marked emphasis on the responsibility system, and pilot projects of share system are being standardized. By now there are around 3700 enterprises which issue shares, among which about 70 enterprises have their shares listed in stock exchanges. To put in practice a policy which regards the public ownership as the mainstay while encouraging a sustained joint growth of all economic operators, the State Industry and Commerce Administration has issued "Directives on Promoting the Development of Individual and Privately-owned Economic", which has spelt out new regulations in the direction of encouraging the development of those economies. To give an example to illustrate this new policy, when an individual in a remote and poor region applies for setting up his own enterprise, the authorities responsible for industrial, commercial and administrative affairs are to act according to the principle of "permission first, regulation later", which means that once being notified the authorities would allow the business to start without requiring license or tax and that registration will be made only when conditions become ripe at a large stage. In addition, when capable, individual owners and private enterprises are allowed to engage in multiple business outside the scope of their operations. Private enterprises are also encouraged to set up joint-ventures and jointly-managed enterprises with foreign partners. Thanks to those friendly measures, there has been a rapid expansion in individual and privately-owned enterprises. By the end of last year the number of individual industrial and commercial operators stood at 15.339 million throughout the employed as many as 24.677 million people. The growth of privately-owned enterprises is even more striking. By the end of last year, the registered number of such enterprises stood at 139.6 thousand with an employment figure of 2.318 million people. Added together, they employ what amounts to 4.5% of the active population and have a registered capital of 82.21 billion Renminbi yuan, which is the equivalent of 4.3% of the registered capital of state and collective enterprises. They also contributed 20.3 billion yuan to the state revenue, which accounts for 7.8% of the national industrial and commercial taxes and represents a historical record. Individual and private economies are of major

importance to meeting people's demands for employment and for daily necessities, such as the supply of vegetables and eggs, and in increasing the state tax revenues and promoting market development. Now the state is also turning some state enterprises into the hands of people while keeping their original form of ownership as a means of turning them from loss-making enterprises to profitable ones. And there have been many successful stories in this regard.

To keep pace with the ever-deepening reform at the enterprise level, government institutions also need to undertake their own reforms. Further streamlining of governmental apparatus, decentralizing in decision-making and limiting government's interference in running enterprises at the various levels are the only means of guaranteeing greater power for enterprises in managing their business operations and in seeking free market access. Another landmark an China's economic reform is the big step taken in the field of pricing reform. Last year, prices for 571 commodities were freed of governmental regulation. Market signals are playing an ever more skillful role in guiding the rational flow of resources.

Economic reform cannot be achieved overnight. Instead, they need to be improved steadily through practice. As a new experiment in reforming China's enterprises, the share-holding system is a case in point. When it comes to concrete measures, the distribution of shares calls for further study and the responsibility system itself is also marred by some defects. Incentives for the expansion of privately-owned enterprises will also produce some negative results. A set of legal regimes is therefore direly needed to redress the situation.

In pushing even further the reform at the enterprise level, we will be increasingly directing our attention to accelerating reforms in the regime of investment management with the view to ushering reforms to the planning, monetary and financing regimes, which hold the key to putting in place a market economy with macro-regulatory mechanisms. But such a reform is particularly difficult. We are confident, however, that with full popular support and with the help of our friends abroad this reformist undertaking is bound to succeed.

ISRAEL

מדינת ישראל
STATE OF ISRAEL

Ministry of Finance
Hakirya, Jerusalem

משרד האוצר
הקריה, ירושלים

ת.93-21372

BACKGROUND

In 45-year-old Israel, as is often the case with young nations, it was originally the State which provided the initial impetus for entrepreneurship, the establishment of public services and the creation of a national capability to compete on world markets. However, as the country's socio-economic system has matured, more room has developed for the emergence of private enterprise, operating in a free and reasonable sophisticated market. It therefore became increasingly appropriate for the government to begin to reduce its involvement in the business sector.

Public support for privatization of business oriented companies owned by the Israeli government has indeed developed considerably in recent years. The first actual privatization was effected in September 1986, when shares in Haifa Chemicals Ltd. were sold by private placement to a group of foreign investors, raising proceeds of about $14.7 m. Several further privatizations were implemented in the following years, but the privatization program received a genuinely positive push only in July 1991, when a special ministerial committee for privatization affairs (chaired by the Prime Minister) was established to lend active support to the privatization efforts initiated by the Government Companies Authority. Since then, dozens of decisions have been made in regard to the privatization of more than 20 companies. In most cases, the government intention is either to relinquish its majority control in the share capital of these companies or sell off its holdings entirely. In only a small proportion of cases is it planned to retain a controlling interest.

OBJECTIVES OF PRIVATIZATION

As in many other countries, privatization in Israel has had the macro-economic objective of reducing governmental intervention in the business sector, mainly so as to encourage more efficient economic activity and growth. In addition, though, it has also had certain secondary objectives, of which by far the most significant have been those of raising capital, on the one hand, and of developing stable capital markets, on the other.

Raising Capital

It is generally accepted that, through privatization, governments are enabled to recruit financial resources, mainly for the purpose of reducing the scale of their domestic debts. In Israel, the ongoing expenditures associated with maintaining national security, as well as those necessitated by other events occurring in recent years, have added to these kinds of traditional pressures. Since 1990, for example, the country has absorbed almost 500,000 new immigrants, chiefly from the former Soviet Union and Ethiopia (representing an addition of 12% to the population). To absorb these newcomers successfully and create employment for them, a major program of investment has been required. Privatization has been seen as a promising possible method for creating a proper atmosphere for such investments. It is hoped that selling government companies to the private sector, in a manner that increases their efficiency, will in due course result in the creation of more, badly-needed employment opportunities for the expanding population.

Developing and Stabilizing the Capital Markets

Some of the new issues to the public and offers for sale implemented in Israel in recent years in respect of business oriented government companies have been of unprecedented size in relation to the dimensions of the country's capital market. These offerings, significantly, led to new investors entering that market. The major increase in the recruitment of institutional savings for investment in the market has played a large part in helping to effect a gradual transfer of control from governmental to private hands. The privatization of government companies has also had a major impact on the overall scale of activity in the Israeli capital markets and has led to an increase in the number of new issues made by private companies on the Tel-Aviv Stock Exchange.

THE SCALE OF THE CHALLENGE

The Government of Israel holds shares in 170 companies and their subsidiaries, of which about 84 are business oriented. Its privatization program, however, is directed principally at 25 of those business-oriented companies - the ones in which it holds majority control.

In terms of their areas of activity, nature and size, most of these companies occupy a singular place in Israel's economy. Israel Chemicals Ltd processes most of the country's natural resources, El Al Israel Airlines Ltd is the country's sole international airline, Zim Israel Navigation Ltd is its largest shipping company and Oil Refineries Ltd is the only petroleum refinery complex in the country. Some of the government companies are natural monopolies, such as Israel Electric Company Ltd, Oil Refineries Ltd, Bezeq — The Israel Telecommunications Corporation Ltd, Petroleum Services Ltd, and others. Others, such as the country's largest company, Israel Aircraft Industries Ltd, are engaged, whether directly or indirectly, in areas of special importance to national security, over which Israel is extraordinarily sensitive. Yet others provide the country with unique services, so that their privatization entails special prior preparation, which will place the services they render onto a competitive basis, through the use of tenders, etc.

An idea of how important it will be to privatize these companies can be gauged from the fact that a mere 14 of them (and their subsidiaries) account for more than 75% of the aggregate business revenues earned, and more than 90% of all personnel employed, by all business-oriented government companies. Their aggregate revenues account for just under 17% of the revenues generated by the entire business sector in Israel, even though they employ only about 4.5% of the total civilian labor force. Their exports account for as much as 23% of Israel's total exports.

Developments in 1992, 1993

The most significant privatization of 1992 occurred in February, when two prospectuses were published for Israel Chemicals Ltd., a company with annual turnover in excess of US$1 bn. and a work-force approximating 6,000 employees. These prospectuses provided for an offer for sale to the public on the Tel-Aviv Stock Exchange, and an offer for sale to the employees of the Israel Chemicals group, of Ordinary shares held by the government in the company. Following their execution, the proportion of the company's share capital held by the government dropped from 100% to 80.026%. The proceeds raised by way of new capital amounted to about US$235.2 m., making the transaction the largest of its kind ever executed on the Tel-Aviv Stock Exchange to that date. It enabled the government to privatize about 20% of the capital of the 21 government companies and susbisidary government companies in the Israel Chemicals group, as well as of a further 35 companies included within the group's consolidated financial statements. A further sale of about 5% of the share capital of ICL was executed to institutional investors in January 1993.

Pursuant to its decisions, the government has decided to reduce its holdings to only 28% of Israel Chemicals' share capital. At present, the Government Companies Authority is preparing for the sale of 26% of the company's shares by way of a global public offering.

Also in February 1992, participation certificates for oil and gas exploration were issued to the public on the Tel-Aviv Stock Exchange by Naptha Israel Petroleum Corporation Ltd as the proposer and general partner of a limited partnership. The proceeds from the issue amounted to about US$ 5.0 m.

In March 1992, the Israel National Oil Company Ltd, as proposer and general partner of a limited partnership, issued to the public, on the Tel-Aviv Stock Exchange, by way of a rights issue to the holders of existing participation units, participation certificates in oil and gas exploration. The proceeds of the offering amounted to about US$4.0 m.

During the same month, The Ethylene Company Ltd (a wholly-owned subsidiary of Oil Refineries Ltd - ORL) and Polyethylene Petrochemical Industries Haifa Ltd (wholly owned by Israel Petrochemical Industries ltd - IPI) merged with Carmel Olefins Ltd (owned in equal proportions by Oil Refineries Ltd and IPI) with the result that the Ethylene Company's ethylene plant, which was one of Oil Refineries Ltd's most substantial facilities, was transferred to the ownership of an entity composed as to 50% by a non-government company in partnership with private shareholders.

In May 1992, in the first issue to be made by a government company operating in the area of security products, Ashot Ashkelon Industries ltd (a subsidiary of Israel Military Industries) published a prospectus providing for the issue to the public and to the company's employees of shares, warrants and convertible debentures. Following the completion of the issue, the proportion of the company's shares held by the government through Israel Military Industries, assuming full dilution, dropped to 70%. The proceeds raised by way of new capital from the public and employees amounted in total to about US$13.0 m. subsequently, somewhat later in the year, Ashot Ashkelon sold US$ 20 m. worth of debentures to investors overseas.

In June 1992, an agreement was signed between the government and Ormat Turbines (1965) Ltd, pursuant to which, inter alia, the government transferred responsibility for the management of Beit Shemesh Engines Ltd to Ormat Turbines, granting the latter an option, exerisable prior to June 1994, to acquire the 58% shareholding held by the government in the company.

A further sale of about 51% of Industrial Buildings Company Ltd. which generated over $200 m. took place in March 1993 in a "private sale" so as to complete the government's final exit from ownership in. Industrial Buildings Company Ltd. The shares of this company were listed on the Tel-Aviv Stock Exchange in 1988.

In total, during the 6 years up until December 31, 1992, a total of 12 companies have been wholly or partially privatized. Overall, the capital that the government has so far raised from its privatization program has amounted to more than one billion dollars.

Prospects for 1993, 1994

There follows a list of the companies which the Government Companies Authority plans to privatize during 1993:

1. Israel Chemicals Ltd. -- the further sale of up to 26% of the company's shares on global capital markets in the United States. Following the sale, the company, pursuant to definitions prescribed in the Government Companies Law, will cease to be a Government Company, becoming an Affiliated Company.

2. Bezeq - The Israel Telecommunication Corporation Ltd. - the further sale, to the public, of up to 23% of the company's shares, followed by the sale of additional shares, such that the proportion of the shareholding held by the government will decline, during the course of 1993, to 51% of the company's capital.

3. Malam Systems Ltd. (development of computerized information systems) - the sale of 100% of this company's shares in a "private sale."

4. Shekem Ltd. (department store chain) - the sale of shares, options and convertible debentures to the public in Israel; and, at a second stage, the sale of control in a "private sale" (not later than 1994).

5. Agridev Agricultural Development Co. (International) Ltd. (management of agricultural and agro-industrial projects) - the sale of 100% of the company's shares in a "private sale."

6. Afridar Ltd. (building construction) - the sale of 100% of the company's shares in a "private sale."

7. Tahal Engineers Advisors Ltd. (national water planning company) - the sale of 100% of the company's shares in a "private sale."

8. Environmental Services Company (Ramat Hovav) Ltd. (operation of a major waste disposal site) - the sale of 100% of the shares to a strategic investor or group of strategic investors, in a "private sale."

9. Zim Israel Navigation Co. Ltd. (shipping) - dilution of the government's shareholdings from its present 50%, to be effected by offers for sale and new issues to the public overseas, issues to the company's employees and sales to a group of investors.

10. I.D.E. Technologies Ltd. (design and manufacture of desalinization plants) - the sale of 100% of the company's shares in a "private sale."

11. Israel Government Coins & Medals Corp. Ltd. - the sale of 100% of the shares in a "private sale."

12. Housing & Development for Israel Ltd. - an offer for sale and a new issue of shares and convertible securities to the public in Israel. Upon implementation of said stage and assuming full dilution the government will no longer own shares in the company.

13. Tourist Industry Development Corp. Ltd. - the sale of all the company's shares in a "private sale."

In addition to the aforegoing, the Government Companies Authority follows up on the activities of M.I. Holdings in implementing the sale of the banks' shares held by the government pursuant to the special "arrangement" of 1983.

ISRAEL

In Israel, one can meet the public sector, or State involvement, in every aspect of the economy. The Israelis depend on the State entirely for their electricity, water supply and education, and nearly entirely for their health and in many other areas. The Israeli economy has a very centralised structure. The more highly centralised sectors are: banking, communications, electricity, energy, transportation, the defence industries, water and land.

In all of the foregoing sectors, the Government is decisively involved, both in control and in ownership, usually through the medium of state-owned companies.

The Government wholly or partially owns 170 state owned companies and state subsidiaries, of which 84 companies are business-oriented, and their aggregate total balance-sheet assets amount to about $17 billion. It is important to note that the total revenues recovered by the state-owned companies in 1992 accounted for about 17 per cent of the GNP (gross national product) for that year, while the number of their employees (about 72,600) constituted only 4.5 per cent of the total labour force.

The state-owned companies were incorporated primarily and originally to be the Government's long arm in the execution of its business activities. Some of the state-owned companies are 40 years old, others are younger.

As the country is socio-economic system has matured, more room has developed for the emergence of private enterprise, and it became more appropriate for the Government to reduce its involvement in the business sector. Indeed, despite the novelty of the term worldwide, privatization became very popular in Israel. However, we find the pace of privatization very slow and not satisfactory.

The privatization programme received a genuinely positive push in July 1991, when a special ministerial committee for privatization affairs, chaired by the Prime Minister, was established to lend active support to implement privatization.

It was only in mid-1992 that the Government set the key objectives of privatization, with the following priorities:

(1) To reduce significantly the Government's current extensive involvement in the business sector and to open that sector to increasing competition;

(2) To modernize and make more efficient the activities of monopolies held by the state, and in due course to open the monopolized sectors to competition;

(3) To attract investments from overseas and to cause the Israeli economy to become integrated into international economic-business activity;

(4) To obtain appropriate financial consideration for the companies sold, so as to raise funds which will finance a reduction in the country's internal debt and will release resources for investment in infrastructure and investment assets;

(5) On the one hand, to make the labour market more flexible and on the other hand, to involve the employees of the Government companies in share ownership; and

(6) To develop and extend the Israeli capital market.

Privatization and other reforms

It is important to stress that the results expected from the process of privatization are combined with several other economic structural reforms, all of which demonstrate a commitment to deregulation and promotion of the private sector. Among the more important reforms, we can describe the following:

(1) Tax reduction package:
- A 1 per cent reduction in VAT (from 18-17 per cent);
- A significant reduction in corporate income tax rate (from 61 per cent to eventually 36 per cent);

(2) Cutting industrial subsidies and deregulation:
- subsidies were cut drastically in 1985 from 11.5 per cent of GDP (gross domestic product) in 1980 to only 2 per cent in 1991;
- In addition, the Government relinquished responsibility for marketing and pricing i. a. grain, wheat, oil and eggs;
- The monopoly in citrus exports and the cartel of fuel distributors were also eliminated;

(3) Allowing exchange rate fluctuations:
The origin of this reform lies in 1977, when foreign exchange control was eliminated. In January 1989, Israel replaced its fixed exchange rate with one similar to the European Monetary System (EMS);

(4) Relaxing capital markets regulations:
Compulsory investments in Government bonds by institutional investors have been reduced;
Along with a credible low-inflation policy, these capital market reforms lowered real short-term private borrowing rates from 19.7 per cent in 1987 to 3.7 per cent in 1991;

(5) Privatization.

As previously stated, this reform aims to liberalize the economy and to promote private sector growth. It is hoped that not only state-owned companies will be privatized, but also other major state assets which are not incorporated as Government companies - especially real estate, various authorities, etc. It is further hoped that privatization will entail the reduction of the role of the Government in the bureaucratic approvals and licensing currently required for executing business.

Difficulties

As stated before, the pace of the process in Israel is not satisfactory. Israel's difficulties can be divided into three major levels:

(1) the political commitment and will are not satisfactory. One ought to understand that state-owned companies are good places for ministers to appoint political appointees, mainly as directors in those companies.

Privatization means letting this opportunity go, and not all politicians come to terms with this cost;

2) There is a built-in conflict of interests between the state-owned company and the Government as shareholder. This may seem odd and needs to be elaborated. As stated before, the state-owned companies were incorporated years ago, originally in order to implement the Government's business activity as its long arm. However, the true scope of the relationship between the Government and a state-owned company has never been clearly defined, nor, in some cases, have the assets transferred years ago from the Government ever been recorded or registered. But when the Government wants to privatize a state-owned company, it wants first to know exactly what it is selling, to shorten this relationship previously unlimited in time, and to put these services to the private sector. And this is the specific point where a built-in conflict of interests is illustrated in its full complexity. This is a conflict between the interests of the state-owned company, for which the directors are responsible and accountable, on the one hand, and the interest of the Government on the other hand. For example, the directors are obliged by their legal fiduciary duties to obtain the best agreement for their company, and it is for the Government to open the agreement for tender. How this issue of the trade-off between these conflicting interests was tackled by Israel, will be discussed later.

(3) There is no single organization which is responsible for privatization.

Since this is a very powerful process, many ministerial bodies want to be involved and to leave their stamp on this process. This difficulty is self-evident.

Some of these difficulties will hopefully be sorted out by legislation.

The Government is about to propose to the Parliament a draft law, whose overall purpose is to facilitate the implementation of Governmental decisions in regard to the relationship with state-owned companies. It is hoped that the need to precede privatization with a definition of sectoral policy and with prior execution of sectoral reforms will be made more possible and less complicated.

In order to execute a privatization efficiently, there is a need for close corporation with the company.

The new draft ensures a proper flow of information on the business dealings of the company to the Government. It grants the Government committee - the body which is supposedly in charge of privatization - the tools to seek such information, and most important the tools to deal with any company which fails to cooperate as closely as necessary.

The new draft gives this committee tools for dealing with a company as follows:

(1) The authority to convene general meetings of shareholders, for the purpose of executing structural changes;

(2) The authority to obtain information and documents from the company;

(3) Most important - the authority to issue a directive to a company that it execute any given act that may be required for the purpose of implementing a governmental decision to privatize the company.

The draft law introduces several checks and balances.

Some comments in regard to the techniques adopted in the process. The key words are transparency and equal opportunity. Usually two different independent value assessments of the company are being obtained so as to assure a fair valuation of the shares, and to ensure what exactly is being sold. If
the sale is a private sale, there is always a tender, and all bidders are informed in advance of the overall procedures of the sale, including all future steps contained in the process.

If the sale is to the public at large, it is executed through an offer carefully described in a prospectus issued to the public, and the shares will eventually be listed on the Tel-Aviv Stock Exchange, which is extremely well developed and computerized.

It should also be noted that the whole process is closely scrutinized by the comptroller of Israel and the finance committee of the Parliament.

JAPAN

Case studies on
the Reform of the Japanese National Railways and
the Nippon Telegraph and Telephone Corporation

PRESENTATION BY JAPANESE DELEGATION AT THE AD HOC WORKING GROUP ON COMPARATIVE EXPERIENCES WITH PRIVATIZATION

JNR Reform

1. The Importance of Railways as the Means of Transportation in Japan and its Railway System

1.1 In Japan, people concentrate around big cities and the density of population is high. The role of railways, which is the means of mass transportation, is important in the area of passenger transportation.

1.2 Before JNR Reform in 1987, Japanese railways consisted of three forms: (1) Japanese National Railways (hereinafter, referred as JNR), which operated trunk line railways connecting the cities, local lines and lines for commuting in big cities; (2) local self-governing bodies that operated mainly subways in big cities; (3) many private railway companies that operated mainly lines in the suburbs of big cities and played an important role in providing commuter services. In March 1987, JNR ran about 19440 km, local self-governing bodies ran about 449 km, and private railways ran about 3031 km respectively. For your reference, private railways, which ran the longest lines, ran about 595 km.

2. JNR History before the Reform

2.1 Until 1948, the nation-wide railway network in Japan was operated by the Ministry concerned. However in 1949 JNR was born as a public corporation with

490,000 personnel and 20,000 km of railways. Under this system after 1949, those railways were operated basically under the auspices of the JNR, but fares, investment planning, wages and personnel affairs were controlled by the Diet and the Government.

2.2 In the 1950's JNR was a very successful surface transportation monopoly.

2.3 In 1960, 51% of all passengers were carried by JNR, 39% of all freight was carried by JNR. JNR was a "giant" in the Japanese transportation market in those days. (See Chart 1)

2.4 However, in the 1960's and 1970's, railway monopolies declined due to the improvement in roads including highways and the increase of cars and trucks. For long-distance passenger traffic, air transportation rapidly developed and impacted JNR.

2.5 In 1980, the share of JNR passenger transportation was 25% and that in freight transportation was 8%.

2.6 JNR was unable to take quick and effective action in response to these changes. The main reasons for this are as follows;

(1) Under the public corporation system, cost consciousness was sadly lacking as there was little concern with the possibility of bankruptcy.

(2) JNR management was deprived of any right to determine wage standards. The union became more and more radical and the relation between JNR management and the union was extremely bad.

(3) JNR fares were determined by law. Because of this, it was difficult to revise fares in a timely manner.

(4) JNR operated a network of railways consisting of approximately 20,000 km of track. This organization was so gigantic that it was difficult to make policy decisions that could cope with the economic changes surrounding it or could meet the needs of respective regions.

2.7 As a result, JNR's profits gradually deteriorated. The firm went into the red in FY1964 and the deficits continued to increase. (See Table 1) The financial situation of JNR rapidly became worse and worse.

2.8 JNR and the Japanese Government made attempts to solve this problem. They increased fares and government subsidies. They also cut the number of employees, deferred long-term liabilities and eliminated unprofitable rural lines.

2.9 However, the situation could not be improved only from these measures and the annual losses of JNR continued to exceed one trillion yen in the 1980's.

During the seven year period between FY1980 and FY1986 the total amount of subsidies soared to ¥4.5 trillion.

3. A Motivation of the Reform

3.1 The Japanese government was in critical financial condition as a result of the decline in revenue growth caused by the economic recession that began in the latter half of the 1970's. In particular, government subsidies for the deficits incurred by JNR, national health insurance, etc. were having a negative impact on government finances.

3.2 In 1981 motivation for administrative reform helped to facilitate rationalization in many administrative areas, and the ad Hoc Commission on Administrative Reform was established as an advisory organization to the Prime Minister to study methods of official restructuring that would not involve raising taxes.

3.3 The Commission considered a wide range of areas. However the reform of JNR, which was burdened with gigantic deficit, was one of the most serious issues. There was also an argument concerning the Japan Monopoly Corporation and Nippon Telegraph and Telephone Public Corporation because their organizational structures are similar to that of JNR.

3.4 In 1982 the Commission recommended privatization of three public corporations - JNR, the Japan Monopoly Corporation and Nippon Telegraph and Telephone Public Corporation.

3.5 In June, 1983, based on the ad Hoc Commission's report, the JNR Reform Commission was established as there were so many items to be considered concerning JNR. In July, 1985 the JNR Reform Commission presented its final report to the Prime Minister.

3.6 The main points of the report are as follows; (1) the managerial failure of JNR was attributable to its nationwide uniform operation as a gigantic organization as a public corporation; (2) in order to overcome these structural problems and make the management more responsible and efficient, the only choice was to take drastic measures for privatizing JNR and dividing it into companies of manageable size. The report showed the measures to cope with JNR's huge debt and excessive work force.

4. An Outline of the Reform

4.1 In March, 1986, based on the views of the Commission, the Government submitted bills for JNR Reform to the Diet. The Diet passed the bills after a heated argument in November, 1986 and the JNR Reform was implemented in April, 1987. (See Chart 2)

4.2 The passenger operation was divided into six regional enterprises: East Japan, Central Japan and West Japan on the main island of Honshu; Hokkaido; Shikoku; and Kyushu. (See Chart 3) Freight operations were reorganized as an independent nationwide company, which would not have its own tracks and would pay a fee to the passenger railway companies for use of tracks.

4.3 All of these companies belong to the category of special companies. Although many regulations are abolished, some items are still controlled by the Government.

4.4 JNR Settlement Corporation was established as an entity that (1) shouldered JNR's long term debt, which could not be owned by any of these companies, and would repay that debt through income from the sale of land that would no longer be used for the railway industry and of stocks of these companies, etc; and (2) helped those who retired from JNR to find new jobs.

4.5 The Shinkansen Holding Corporation was established as an entity to hold the Shinkansen (Bullet train) tracks because the amount of future profits from the four Shinkansen lines was not known, and to lease these lines to main island passenger companies. For your reference, in 1991, these Shinkansen tracks were sold to the mainland passenger companies.

4.6 The Main problem of JNR reform was how to deal with the huge debt and excessive work force.

4.7 In March 1987, JNR had long-term liabilities of ¥37.1 trillion which was about 70% of the Japanese national budget. These debts were dealt with as follows: (See Chart 4)

(a) ¥5.9 trillion was assumed by three passenger railway companies on the mainland and Japan Freight Railway Company. This debt amount was thought to be payable if these companies could manage those business efficiently.

(b) Hokkaido, Shikoku and Kyushu railway companies whose earning power was weak because of those operating areas were exempt from taking over the long-term debt and, furthermore, the Management Stabilization Fund was established for these companies to help them to meet their annual costs with the accrued interest from the Fund.

(c) ¥5.7 trillion was assumed by the Shinkansen Holding Corporation. This was equivalent to the book value of four Shinkansen lines.

(d) The remaining long-term liabilities, ¥25.5 trillion, which includes ¥1.3 trillion for the Management Stabilization Fund, were borne by the JNR Settlement Corporation.

(e) The JNR Settlement Corporation was, as is mentioned above, to partially liquidate this debt, mainly, through the proceeds of the sales of land that had not been transferred to the railway companies and the proceeds of the sales of stocks.

(f) The remaining liabilities were to be borne by the Japanese people.

4.8 In 1980, the JNR had 414,000 employees. Through the efforts mentioned above (paragraph 2.8), the JNR cut the number of employees. In spite of these efforts, in April 1986 the JNR had 277 thousand employees. It was an excessive work force compared to that of a private railway company.

4.9 The Government adopted a measure for promoting retirement. Premium retirement payments were issued to workers who applied for retirement.

4.10 The Government also asked and encouraged JNR affiliated companies, the public sector and private enterprises to employ JNR workers.

4.11 As a result of these efforts, by April 1987, 53,000 workers retired. 201,000 workers were re-employed by the new companies, 24,000 workers were transferred to the JNR Settlement Corporation, which would help them find new jobs within three years.

4.12 The Corporation not only offered places of work but also provided vocational training. With the efforts of the Government and cooperation of private enterprises, 20,000 workers found new employment and had retired by April 1990. But some people rejected many job offers and wanted to work only in a JR company near their hometown such as JR Hokkaido and JR Kyushu, which already had enough workers. Since it was impossible for those companies to employ additional workers, the Corporation dismissed 1,047 workers on April 1990, and completed its placement program.

5. Result of the Reform and Remaining Problems

5.1 Six years have passed since JNR Reform. Traffic volume and financial results of JR companies have been quite favorable in this period.
(See Table 2, 3.)

5.2 In FY1991 passenger traffic of JR passenger companies was 247 billion passenger kilometers. This was 125% of FY1986 and the average annual growth rate was 3.6%. Freight traffic of JR Freight Company in FY1991 was 26.7 billion-ton-kilometers, which was 133 % of FY1986 and the average annual growth rate was 4.6 %.

5.3 With these traffic increases, total ordinary profits of JR companies in FY1991 was ¥306.3 billion. This was a great improvement compared to the net loss of ¥1,361 billion in FY1986. The total long-term debt of the JR companies which was transferred from JNR has been decreased.

5.4 These positive results are partly attributable to the buoyancy at the Japanese economy during this period. But the main reason for these results are the great efforts by the JR companies to raise productivity and improve railway services.

5.5 JNR raised fares eleven times during the thirteen years from FY1974 to FY1986. Before JNR Reform, each JR company was assumed to have to raise its fares several percent annually. However, fares of JR companies have not been raised during the past six years.

5.6 The JR companies have increased transportation capacity, and improved facilities of stations and passenger coaches. The attitude of JR employees towards passengers has also been improved. The Japanese people are satisfied with these improvements of railway services.

5.7 On the other hand, the long-term debts of the JNR Settlement Corporation has not been decreased.

5.8 The value of the land belonging to the JNR Settlement Corporation increased as the land prices in metropolitan areas rose very rapidly in 1987. However, in order to prevent a rise in land prices, the Government decided to suspend the land sales of JNR Settlement Corporation by open tender, which was the dominant way of selling. Because of this, the methods of the land sales and the number of buyers were conspicuously limited.

5.9 After 1991, land prices went down and the demand of land decreased. Consequently, the revenue from land disposal was always less than the expected revenue.

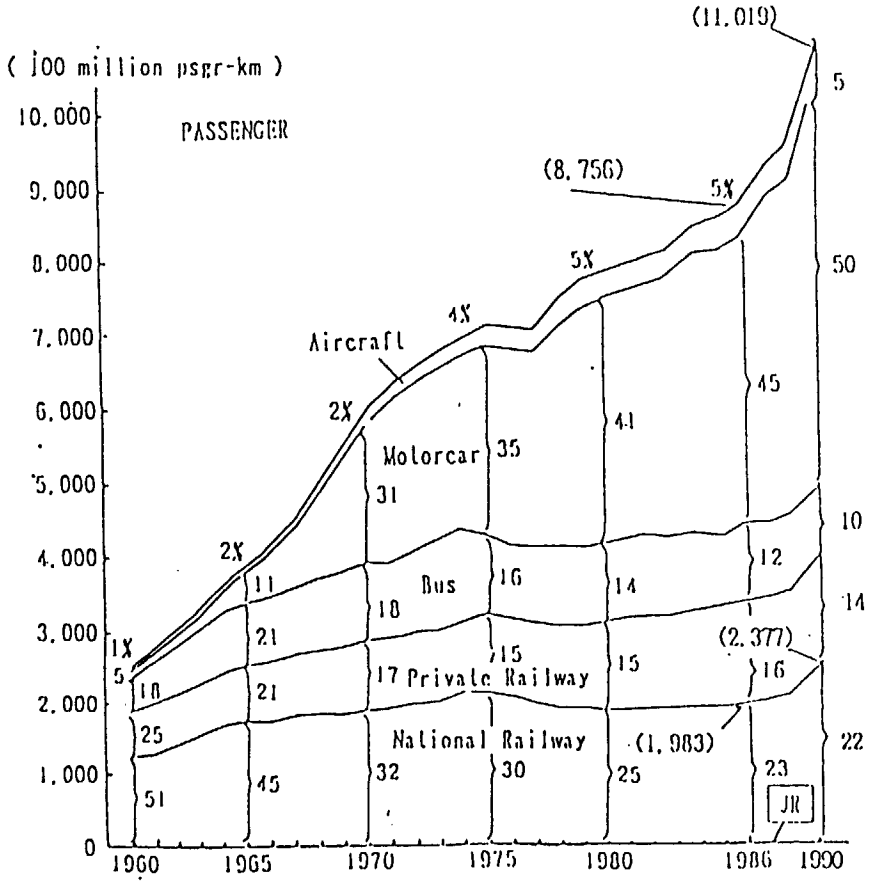
5.10 Three mainland JR companies were profitable and met the standards required for placing stocks on the stock market earlier than expected because of such efforts and the favorable economic situation. So, the sale of stocks of those JR companies was expected to begin from FY1991. However, the stock market was then in a severe depression and it was impossible to sell these stocks in FY1991 and FY1992. Now the Government is preparing to sell stocks in FY1993.

5.11 The repayment of debt of the JNR Settlement Corporation is important for the evaluation of JNR Reform. While the stock of JR is held by JNR Settlement Corporation, we cannot say that JNR

privatization has been completed. We are making great efforts to decrease the long-term debt to the fullest extent possible and complete the privatization of JR.

Chart 1.

TRAFFIC VOLUME BY MODE



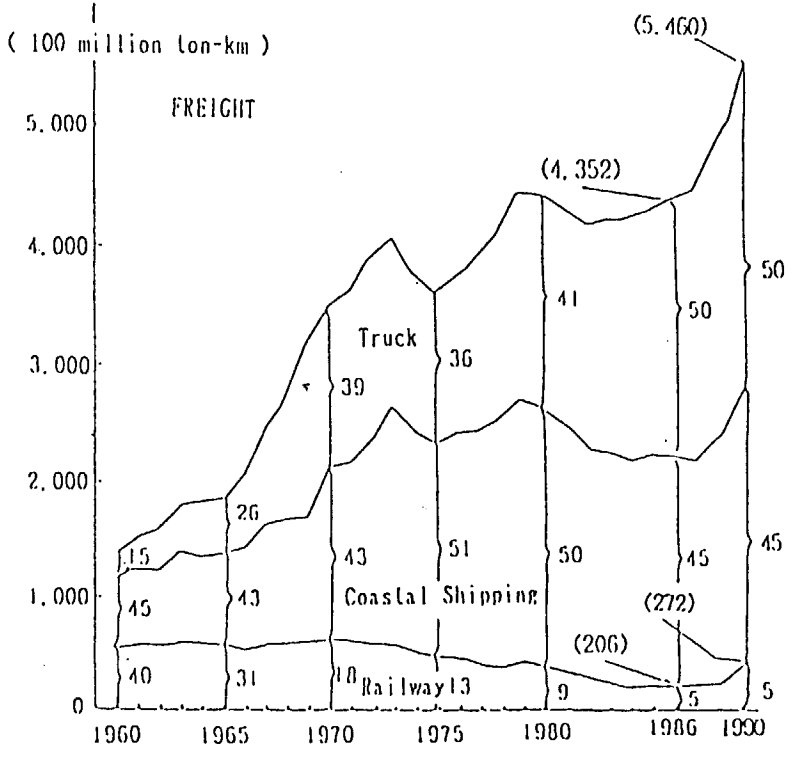
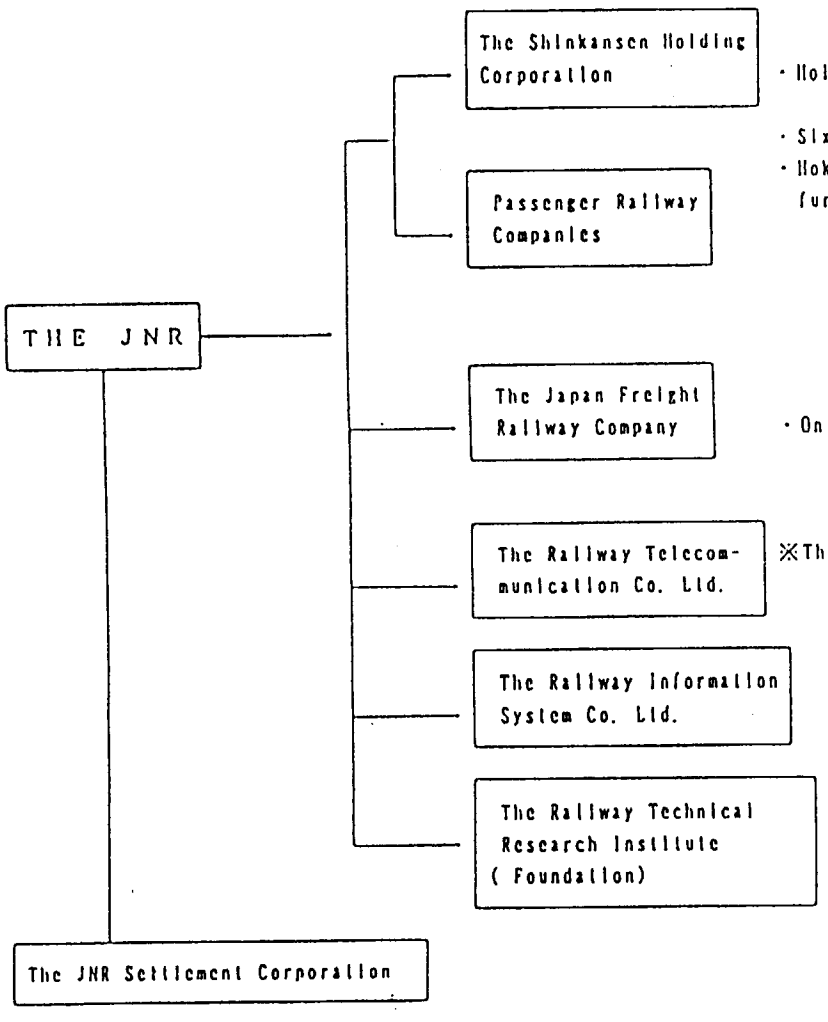


Chart 2.

TRANSITION INTO THE NEW MANAGEMENT STRUCTURE



- Holding Shinkansen lines and leaseing them to the three companies on Honsyu Island.
- Six companies (Hokkaido, East Japan, Central Japan, West Japan, Shikoku and Kyusyu)
- Hokkaido, Shikoku and Kyusyu are exempted from taking over outstanding debt, and furthermore, the Management Stabilization Fund is provided for each.
- Only one company for the whole country
- ※The Japan Telecom Co. Ltd. ('80.5～)
- Amortization of the long term debt
- Management and disposal of land and other assets
- Seeking employment for the surplus personnel(interim business)

Chart 3.

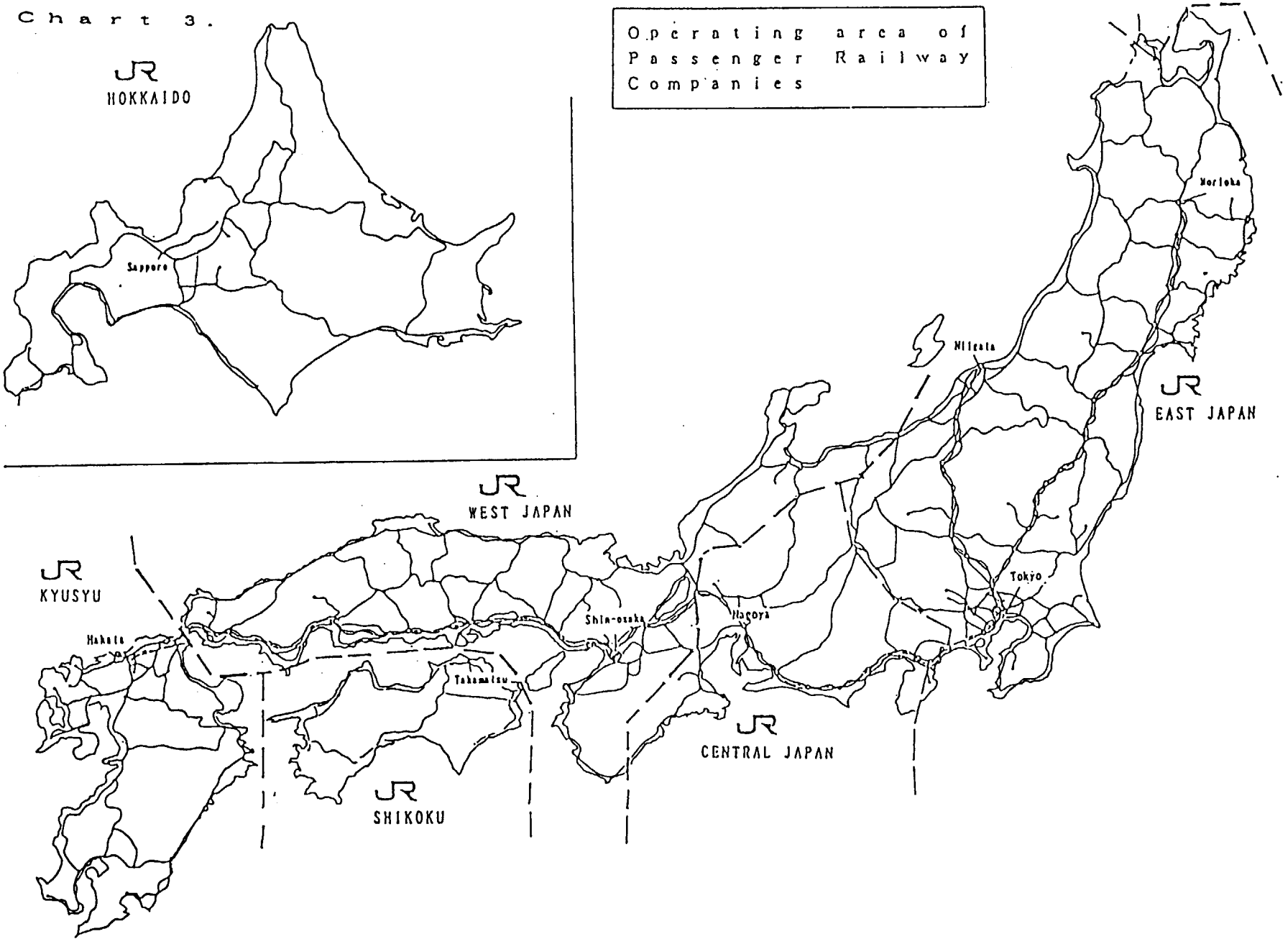

Operating area of Passenger Railway Companies
JR HOKKAIDO
Sapporo
JR EAST JAPAN
Morioka
Niigata
Tokyo
JR WEST JAPAN
Shin-osaka
Nagoya
JR KYUSYU
Hakata
Takamatsu
JR CENTRAL JAPAN
JR SHIKOKU

Chart 4 THE SCHEME OF THE JNR LONG-TERM DEBT TRANSFER

unit : trillion yen

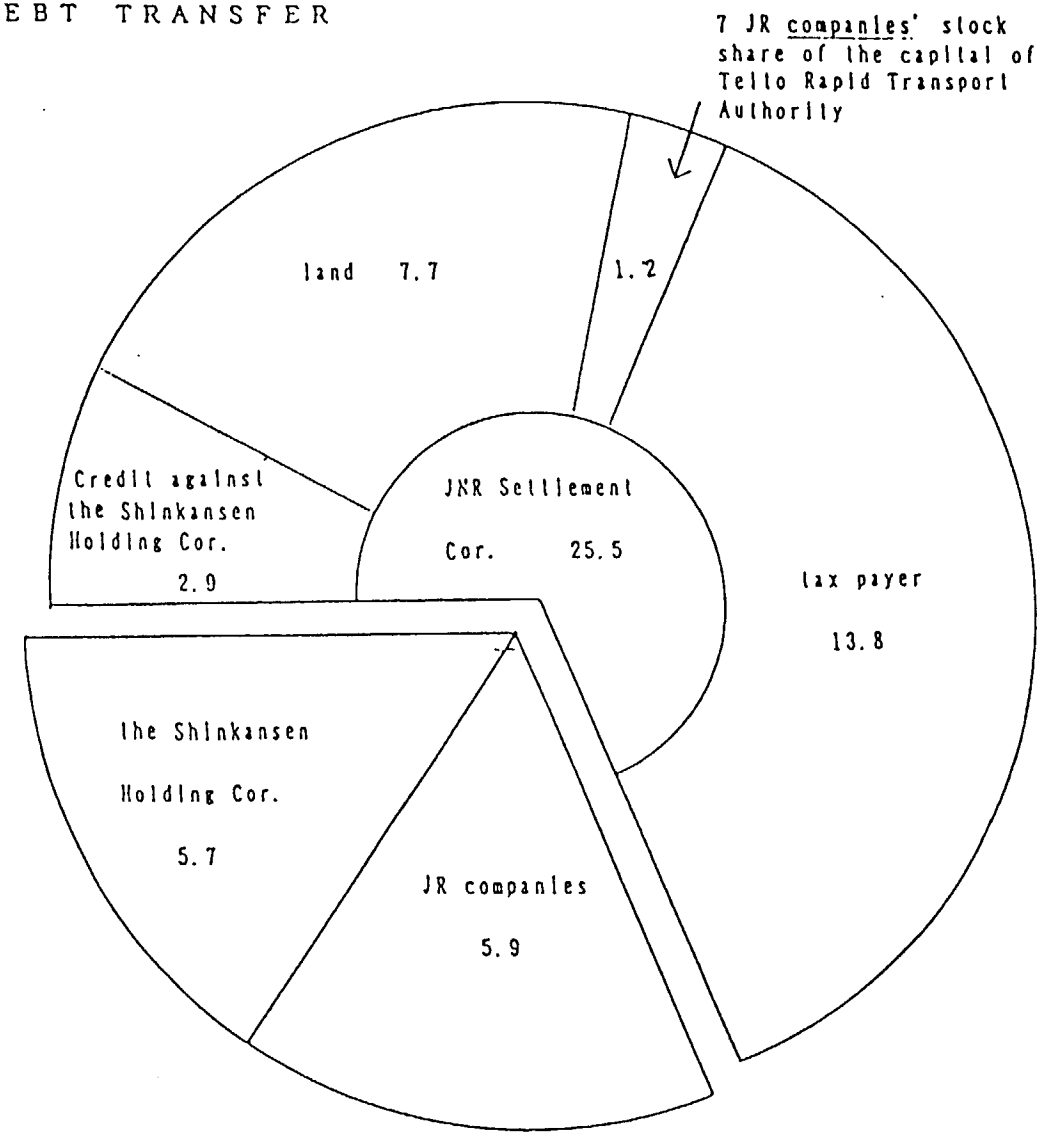


Table 1.

PROFIT OR LOSS OF THE JNR

(100 million yen)

FISCAL YEAR	1963	1964	1975	1980	1985	1986
REVENUE	5,687	6,002	18,209	29,637	35,527	36,051
EXPENSE	5,113	6,302	27,356	39,721	54,005	49,661
PROFIT OR LOSS	574	−300	−9,147	−10,084	−18,478	−13,610

Table 2. Traffic Volume of JR Companies

	Passenger Traffic							Freight Traffic
	HOKKAIDO	EAST	CENTRAL	WEST	SHIKOKU	KYUSU	TOTAL	
FY86 (JNR)	3.9	100.6	39.7	45.2	1.6	7.3	198.3	20.1
FY87	3.9 (100.8)	104.5 (103.8)	41.1 (103.7)	45.8 (101.3)	1.7 (103.8)	7.7 (104.7)	204.7 (103.2)	20.1 (100.0)
FY88	4.5 (113.7)	109.8 (105.1)	45.1 (109.6)	48.2 (105.3)	2.1 (126.7)	7.9 (103.1)	217.6 (106.3)	23.1 (114.9)
FY89	4.4 (98.1)	113.2 (103.1)	46.3 (102.7)	48.9 (101.4)	2.0 (96.0)	7.9 (99.9)	222.7 (102.3)	24.8 (107.4)
FY90	4.6 (105.9)	119.7 (105.7)	51.1 (110.3)	52.1 (106.7)	2.1 (102.2)	8.0 (101.3)	237.5 (106.7)	26.8 (108.1)
FY91	4.8 (103.6)	126.0 (107.1)	52.1 (102.1)	53.7 (103.9)	2.1 (102.4)	8.3 (104.3)	247.0 (104.2)	26.8 (99.9)

1. unit: passenger companies are in billions of passenger—km
   freight company is in billions of ton—km
2. figures in parenthesis is ratio to prior year

Table 3. Revennue and Earnings of JR companies

unit:billion yen

		HOKKAIDO	EAST	CENTRAL	WEST	SHIKOKU	KYHUSU	Freight	TOTAL
FY87	Operating Revenue	92	1,566	875	763	35	130	173	3,633
	Operating Profit	△54	296	72	71	△15	△29	11	352
	Ordinary Profit	△2	77	61	8	1	2	6	152
FY88	Operating Revenue	94	1,664	969	807	44	140	183	3,899
	Operating Profit	△53	323	102	79	△11	△29	11	423
	Ordinary Profit	△1	86	95	17	6	3	7	212
FY89	Operating Revenue	100	1,736	1,003	834	44	144	192	4,053
	Operating Profit	△53	281	114	91	△12	△29	10	403
	Ordinary Profit	0	103	108	40	6	4	6	268
FY90	Operating Revenue	105	1,851	1,101	892	48	151	205	4,354
	Operating Profit	△49	292	133	122	△9	△29	11	473
	Ordinary Profit	2	150	129	88	8	4	7	388
FY91	Operating Revenue	106	1,949	1,131	917	51	160	205	4,531
	Operating Profit	△48	292	288	128	△9	△28	11	691
	Ordinary Profit	2	150	117	66	7	4	7	306
Rout Length (km)		2,626	7,502	1,984	5,059	856	2,101	10,094	20,127
Employee (as of FY1092)		12,150	70,883	21,669	47,087	4,210	13,383	11,526	191,218
Capital Stock		9	200	112	100	4.5	160	19	459.5

NTT Public Co. Reform

1. HISTORY

Telecommunications began in Japan as a part of the modernization efforts following the Meiji Restoration of 1868. The first public telecommunications services started in the telegraph service between Tokyo and Yokohama in 1870.

Telecommunications services had since then been provided and spread by the Government as the monopolized services of the Ministry of Communications. Approximately one half of Japan's telecommunications facilities were lost during World War II and the number of telephone subscribers dropped to 540,000.

In 1952, in order to efficiently promote the restoration and expansion of public telecommunications facilities and equipment - especially telephones - Nippon Kokusai Denshin Denwa Co., Ltd. (KDD) was established to expand international public communications. Since then, the telecommunications business in Japan - which had long been monopolized by the Government - became the monopoly of NTT Public Corp. domestically, and that of KDD internationally.

With today's steadily increasing role of information, telecommunications are expected to play a larger part in establishing an advanced information society. It was against this backdrop that the Telecommunications Business

Law and the Nippon Telegraph and Telephone Corporation (NTT) Law went into force, effective April 1, 1985. These laws spelled the end of the telecommunications monopoly in Japan, which existed for more than 100 years. The nation's telecommunications business then entered an era of free competition based on the dynamism of the private sector.

2. BACKGROUND OF THE REFORM OF THE TELECOMMUNICATIONS SYSTEM

The privatization of telecommunications took place on April 1, 1985. This should be regarded as a revolutionary reform in the history of Japan's telecommunications.

The two leading objectives - to catch up with the heavy demand for telephones and to establish a nationwide automatic exchange system - were attained by March 1979. This made Japan one of the most advanced countries in the field of telecommunications. In this respect, we can say that Japanese telecommunications based on a public monopoly functioned effectively for the well-being of the Japanese public.

In parallel, however, with the rapid development of information and telecommunications technologies in recent years and with the constant development and implementation of the so-called "New Media" products, requirements for telecommunications services have become ever sophisticated

and diversified. In order to respond effectively to these new demands, it is believed that services through competition by a number of enterprises will certainly bring more benefit to users rather than by a single monopolistic power. This competition and privatization has largely transformed the environment for the telecommunications business and market in Japan, making it possible for private companies to use their technical and financial strengths in telecommunications services and at the same time, giving stimulus to NTT to increase the efficiency and dynamism of its management.

Meanwhile, Japan is transforming itself from a mere industrial society into a highly advanced information society. In this transition, telecommunications are expected to play a key and fundamental role. Having attained major telecommunications objectives, Japan has to establish a revolutionary telecommunications policy in a bid to achieve an advanced information society for the twenty-first century.

Under these circumstances, it was urgent to actively utilize the private sector's creative ideas to make the nation's telecommunications business more dynamic and more efficient by introducing competition to the field.

3. OUTLINE OF THE REFORMED TELECOMMUNICATIONS SYSYTEM

The new telecommunications system, based on the free competition was initiated on April 1, 1985. At that time

the Telecommunications Business Law and the Nippon Telegraph and Telephone Corporation Law became effective.

There are two major points that should be mentioned about this telecommunications system reform.

The first point is, of course, the introduction of competition. The doors to the telecommunications business were thrown open to private companies.

Up until then, companies other than the Nippon Telegraph and Telephone Public Corporation (NTT) and Kokusai Denshin Denwa Company (KDD) were not permitted in the telecommunications business. But in 1985, the policies shifted from a system based on a monopoly to a system based on competition. Then, users could freely choose the optimal product from a wide variety and source of services, thanks to the competition which was introduced in the telecommunications field at large.

The other point is that the Nippon Telegraph and Telephone Public Corporation was privatized to become the Nippon Telegraph and Telephone Corporation - a joint-stock company. Even after the reorganization became effective on April 1, 1985, NTT is still the backbone of Japan's telecommunications business. With a capitalization of ¥78 billion and a work force of 266,000, it is the largest business entity in this country. From that time on, the new NTT has tried to meet users' demands by providing services of high quality at low rates.

ROMANIA

ROMANIAN APPROACH ON LEGAL ASPECTS OF SALES

Rumania has embarked on a radical transformation of its economic system. The Government's programme for the transition to a market economy, approved by Parliament and accepted by the International Monetary Fund, aims at the rapid formation of a market system and the opening of the economy to private enterprise.

The main economic objectives in the short term are to ensure economic stability, to curb inflationary pressures, to restore general market equilibrium and to stimulate economic growth through market mechanisms.

These objectives are to be achieved through major reforms as follows.

The policy aim is to create an adequate market economy environment for producers and to accelerate and stimulate the creation of the private sector. The main laws adopted in this respect are Law no. 15/1990 regarding the reorganisation of state enterprises as commercial companies and regias autonomous, Law no. 31/1990 regarding the commercial companies and Law no. 18/1991 concerning real estate (land) property rights. The legal package of reforms was completed with the introduction on 14 August 1991 of Law no. 58/1991 on the privatization of commercial companies.

Main Provisions of the Privatization Law

The Law on the Privatization of Commercial Companies provides for:

1. The creation of six funds - five Private Ownership Funds (POFs) and one State Ownership Fund (SOF) - to hold and manage (and, in the case of the State Ownership Fund, eventually divest) the shares of commercial companies (joint-stock companies or limited liability companies).

2. The distribution, free of charge, to eligible Romanian citizens, through the five Private Ownership Funds, of an indirect 30% interest in each state-owned commercial company organised under Law no. 15/1990.

3. The establishment of procedures for the early privatization of commercial companies.

4. The setting of general guidelines and procedures for privatization through the sale of shares or assets.

The administration and sale of shares or other interests formerly owned by the State is to be undertaken by the public commercial and financial institution named the State Ownership Fund.

The State Ownership Fund will initially own 70% of the nominal share capital of all commercial companies. Each year the State Ownership Fund will be obliged to draw up a privatization plan for the forthcoming year that will include proposals for the privatization of at least 10% of the shares it initially held.

The distribution of the remaining 30% interest in commercial companies to Romanian citizens is to be initially achieved by the issue of Certificates of Ownership, which are effectively shares in the Private Ownership Funds.

Shares of commercial companies owned by the Private Ownership Funds and the State Ownership Fund may be sold to any investor (natural or legal persons, domestic or foreign) by means of public offering of shares, sale of shares through direct negotiation, or any combination of the above. Sales may be for cash or in exchange of Certificates of Ownership.

Commercial companies owing assets that represent distinct operating units capable of being organised and functioning independently have the right to sell such assets. The sale must be effected to the highest bidding price on the basis of a public auction or following receipt of sealed bids. Regulations concerning the sale of assets, approved by the Government, were issued by the NAP.

The NAP was authorised to select and privatise some commercial companies (not more than 0,5% of the total number of commercial companies referred to in the Privatization Law) by direct sale of shares before the State Ownership Fund and the Private Ownership Funds were organised and fully operational.

Commercial companies that have been privatised in this way were allowed to conclude technical assistance contracts with Romanian and foreign firms on competitive conditions. Technical assistance contracts with foreign firms must be approved by the NAP.

A. Sale of Shares of Commercial Companies

Shares of Commercial Companies owned by the POF's and the SOF may be sold to natural or legal persons, domestic or foreign, by means of the following:

a) public offering of shares;

b) sale of shares on an auction basis (open or limited to preselect bidders);

c) sale of shares through direct negotiation and

d) any combination of the foregoing.

The employees or management of a Commercial Company may participate in purchasing shares through any of the procedures above mentioned.

Shares in Commercial Companies to be sold by the State Ownership Fund through a public offering of shares or an auction will be offered for sale to the employees or to the management of such Commercial Companies on a preferential basis, as follows:

a) in a public offering of shares, the employees and the management shall have the right for a limited period to purchase up to 10% of the shares offered for sale at a discount of 10% to the public offering price;

b) in a sale of shares through an auction any employee and management member or a group comprised of such persons shall have the right to a preferential purchase of shares in the event that they offer a price not 10% lower than the highest price offered in the auction and they respect all the other conditions of the offer.

Shares in Commercial Companies to be sold by the State Ownership Fund through direct negotiation will be awarded to the employees and to members of the management of such Commercial Companies in the event that they offer purchasing conditions equal to those of other prospective purchasers.

The State Ownership Fund, pursuant to conditions established by its Board of Directors and based on commercial principles, shall have the right to grant facilities to the employees and to the members of the management as well as to retired employees who purchase shares in Commercial Companies as follows:

a) credits;
b) deferred payment;
c) payment by instalments;
d) other facilities, taking into account the specific aspects of the shares and the material conditions of the sale.

In order to obtain the approval for the selling, the State Ownership Fund is required to present to the NAP, prior to the sale, in written form, the main conditions of the sale.

The NAP is required to either approve or, according to each case, to reject the proposed sale within 30 days from the date the conditions are received.

In the case that natural or legal persons, domestic or foreign wish to purchase 100% of the shares of a commercial company, the State Ownership Fund will delegate to the Private Ownership Fund, to which the Commercial Company is allocated, the power to negotiate on its behalf the conditions of the sale.

The conditions for organizing and effecting the sale of shares and of presenting the proposed sale, as well as the criteria on the basis of which the NAP shall approve or reject the proposed sale is established by regulations issued by the NAP and approved by the Government Decision.

After the selection procedure, 30 Commercial Companies have been retained. The list was published in a special catalogue to be sent to foreign consulting firms to carry out pilot privatization.

16 Commercial Companies have been selected for starting the privatization process with foreign technical assistance financed by the PRIVATIZATION/PHARE Program (11 Commercial Companies), and the British Know How Fund (5 Commercial Companies). The foreign advisors were selected by auction. They were: Roland Berger, Ernst & Young, Samuel Montague, DRT International and Coopers & Lybrand.

For the first 11 companies prepared for privatization NAP has defined the strategy of privatization (for each Commercial Company)

Due to the features of the privatization in the present-day stage (fast economic changes, few facilities for employees and management in buying shares, no capital market in Rumania, low interest of foreign investors) and the problems encountered by the Commercial Companies (old equipments, low productivity, old technologies, lack of management and marketing experience), NAP has tried to accomplish the following goals:

- identification of strategic foreign investors interested in developing the company;
- developing of capital market in Rumania; and
- protection of existing jobs.

Actually only 19 companies were privatized, out of which 3 were sold to foreign investors, 2 were purchased by domestic investors and by the management and the employees of the commercial companies, and 14 were privatized by using the MEBO method.

In the process of negotiating and concluding the sales contracts some important conditions were taken into account:

-the maintaining of the company's object of activity;

-the realization, by the buyer, of important investment;

-the maintaining, for a certain period of time, of the number of jobs, in order to avoid the unemployment;

-clauses regarding the environment protection.

Compared to the other criteria used in the privatization process, the selling price was the last criterium taken into account by the NAP in its privatization strategy.

The 19 privatized companies have a total social capital of Lei million 7,793.6 -that means almost US$ 13 million at the actual exchange rate, of Lei 600/US$ (the companies were sold in different periods of time and, at a consequence, at different exchange rates). The total selling price was of US$ 10.6 million and a total amount of US$ 11.1 million was invested.

B. Sale of Assets of Commercial Companies

Commercial Companies owing assets that represent units that can be organized and function independently, have the right to sell such assets.

The assets, as defined by the Privatization Law, are parts of CCs that can be organized and operate independently, without affecting the general profitability or influencing the main activity. That means that the company can further carry on its main activity, without diminishing its profits. This is possible because there is an excess of fixed assets in many enterprises.

The sale of assets is regulated by a special methodology approved through a Government Resolution. This stipulates that the CCs, through the State Representatives Council, or any other interested natural or legal person may have the initiative for the sale of assets. The approval for including the asset on the list of sales is given by the State Representatives Council or by the Shareholders Meeting.

The sale of assets shall be effected on the basis of public auction or sealed bidding to the highest bid.

The sale of assets of Commercial Companies on the basis of public auction or sealed bidding to the highest bid will be carried out in accordance with provisions and regulations issued by the NAP and approved by the Government.

The regulations mentioned will is published in the Official Gazette of Rumania.

Any natural or legal persons, domestic or foreign, shall be eligible to participate in any sale of assets pursuing the provisions of this Law.

The persons that purchase assets under the present law do not have the right to sell or lease them or to transfer their use in any other way for a one year period from concluding the selling contract.

Public institutions, regias autonomous and Commercial Companies that are 100% state-owned do not have the right to participate in any sale of assets.

Employees except members of the management of the Commercial Company that sells assets as well as retired employees of this Commercial Company are eligible to participate at sales.

The sale will be effected for the benefit of the employees or retired employees, in the event that they are offering conditions for purchasing equal to those of the other prospective purchasers as well as to Romanian citizens which have concluded a leasing or management contract.

The Commercial Company that is selling, upon approval by the NAP, the Private Ownership Funds and The State Ownership Fund, pursuant to conditions established by their Board of Directors and based on commercial principles, may grant facilities to the employees or retired employees, in the event they purchase assets, as follows:

a) credits;
b) deferred payment;
c) payment by instalments;
d) other facilities, taking into account the specific aspects of the assets to be sold.

Other measures for the protection of the domestic capital include:

the organization of the auction in two steps: only domestic natural or legal persons can participate in the first phase (including Romanian citizens living out of the country and irrespective of the source of capital) and in case of failure to sell the assets, a second round is organized, in which foreign natural or legal persons can participate; and

the employees or retired employees, as well as persons that have entered a leasing or management contract with the CC making the sale will be preferred, in the event that they offer purchasing conditions equal to those of other potential purchasers.

Two official lists have already been published, including 6262 assets. The main industries (according to the number of assets to be sold) are the following:

•	domestic trade	3029 assets (shops, kiosks etc.)
•	tourism and catering	1772 assets
•	services	285 assets
•	industry	542 assets
•	agriculture	195 assets
•	transportation	43 assets
•	others	396 assets

The number of employees of the assets to be sold is around 41.936.

According to the adopted methodology, until now, 1964 assets were sold (with 9750 employees). The assets were sold both by public and by sealed envelope auctions. 80% of the buyers were natural persons and 20% were legal persons. Most of the assets sold were from the domestic trade (1163), tourism and catering (478) and industry (115) sector. The total amount of the proceedings from the sales is about Lei billions 23.75.

The sale of assets of Commercial Companies shall be considered finished at the time of the concluding of the selling contract in accordance with the Law.

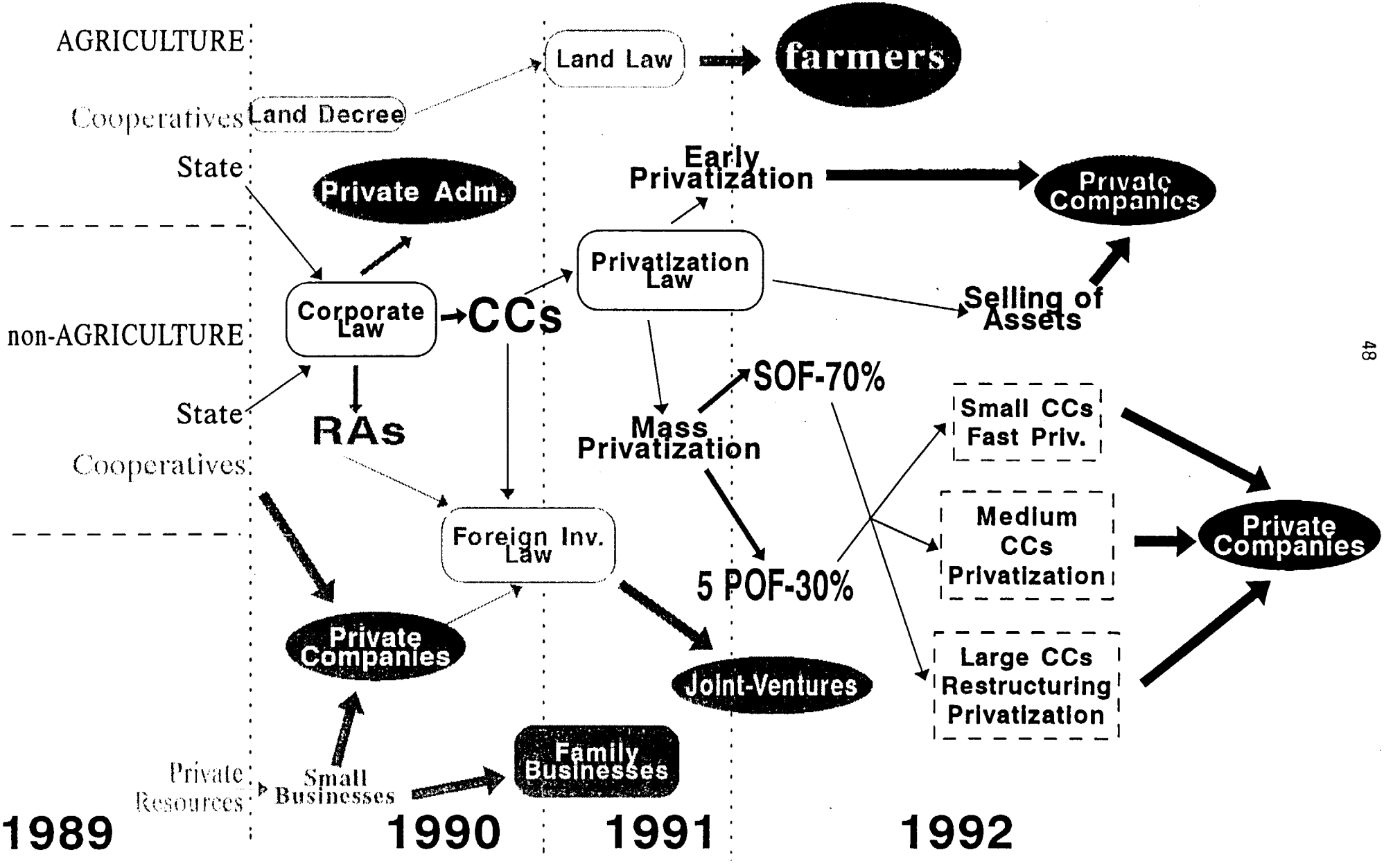
The amounts which result may be used by the Commercial Companies only for:

a) effecting new investments;

b) returning debts resulted from medium and long term credits for investments.

In Rumania, the direct sale of assets and shares is one of the most important way of transferring the ownership rights of the state-owned CCs to private owners. Based on the experience achieved in the past period, this process will continue in the following years and the main criteria taken into account in the privatization strategy will be followed also in the future.

Romania - to a Private Sector



ASPECTS INSTITUTIONNELS DU PROCESSUS DE LA PRIVATISATION DANS L'EUROPE CENTRALE ET DE L'EST

En ROUMANIE, le programme de privatisation est difficile à mettre en oeuvre, en raison des institutions concernés et des étapes successives à franchir dans le cadre de ce processus-là.

En ce qui concerne les institutions concernés, on peut dire que celles-là sont les suivantes :

° Le Parlement, qui fixe les régles et contrôle l'application et le rythme de ce programme,

° L'Agence Nationale pour la Privatisation (ANP), organisme gouvernementale, qui est chargé de cordonner le processus de privatisation,

° Le Fonds de la Propriété d'Etat (FPE), établissement public autonome à caractère commercial et financier, qui est le représentant de l'Etat (actionnaire unique, pour l'instant, et à l'avenir administrateur de 70% du capital social des sociétés commerciales, réorganisées conformément à la Loi 31/1990),

° Les Fonds de la Propriété Privée (FPPs), sociétés commerciales soumises au droit commun, qui sont des actionnaires privés pour 30% du capital des sociétés commerciales (fait qui démontre la flexibilité du processus de privatisation),

° Les entreprises elles-même,

° Les Ministères de tutelle, qui établissent la stratégie de privatisation sectorielle, sauf les problèmes de la propriété,

° Le Ministère des finances, qui a en charge le marché financier et l'épargne, tout aussi que la politique fiscale du Gouvernement,

° Les actionnaires, qui sont les porteurs des certificats de propriété,

° Les salariés,

° Les investisseurs étrangers,

° Les banques,

° ...

1. Le Fond de la Propriété d'Etat

Le FPE est:

- une personne morale indépendante du budget de l'Etat et de l'Etat même,

- une structure responsable face au Parlement, qui autorise le programme annuel de privatisation et en contrôle l'exécution.

Selon la Loi 58/1991, le FPE a une mission temporaire et limitée (7 ans), en vue de désengager l'Etat de ses charges, par la restructuration, réhabilitation, ainsi que par la privatisation des sociétés commerciales.

En vue d'accomplir ses chqrges:

- il va céder, chaque année, au moins 10% des actions détenues,

- il va favoriser l'actionnariat des employés et du management des sociétés commerciales,

- il va favoriser les porteurs de certificats et les personnes à la retraite,

- il va inciter la privatisation des grandes sociétés commerciales,

- il va soutenir les mesures d'accélération de la privatisation, proposées par les Fonds de la Propriété Privée.

Tout aussi, pour assurer sa mission, il peut bénéficier de l'assistance des structures existantes : ANP, Ministère des Finances, ministères techniques, organismes nationaux ou locaux, administrateurs des sociétés commerciales, banques.

2. Les Fonds de la Propriété Privée

Conformément à la Loi, les FPPs:

- ont une participation au processus de privatisation / restructuration / liquidation des sociétés commerciales,

- ont la gestion du mécanisme d'échange et de courtage,

- et la gestion de portefeuille.

* Evolution

Après une période de 5 ans, on va assister à la transformation des Fonds de la Propriété Privée dans des Fonds Mutuels. Il y a des aspects qui en manquent pour qu'ils puissent subir cette transformation dans des conditions normales:

- la confiance, pour laquelle il faut que ces FPPs deviennent un moyen de préserver les épargnes de la population et de faire fructifier ces épargnes, évitant de rester un morceau de papier, dont la population veut absolument se séparer. Pour cela on doit avoir un marché qui ait la confiance des investisseurs. Et pour avoir un tel marché on a besoin de transparence, liberté de vendre et d'acheter, valorisations réguliers, prix officiel de référence, égalité du traitement des porteurs de certificats.

Mais aujourd'hui il y a un méconnaissance générale des régles du marché; les certificats ont été distribués avant que le prix des unités soit déterminé et que le marché soit organisé et régulé.

En vue d'avoir un marché fluide et organisé des certificats, à la Banque Roumaine pour le Commerce Extérieur on a organisé le processus de vente-achat des certificats, jusqu'à la mise en travail de l'Agence Nationale pour les Titres de Valeur.

Chacune de ces institutions essaie d'intervenir dans chaque étape du processus de privatisation dans:

- l'établissement du programme annuel,

- la décision effective de privatisation,

- la restructuration,

- l'évaluation et le choix de la forme de vente,

- la fixation des prix,

- la mise sur le marché ...

La mise en oeuvre pourra être viable si on aura en permanence une coordination entre tous ceux qui, à un titre ou à un autre, sont concernés par le processus.

Et pour cela il sera nécessaire:

- d'avoir un organisme de coordination - l'Agence Nationale pour la Privatisation, qui doit assurer le correcte fonctionnent des mécanismes et le respect du calendrier en ensemble ou de chaque opération, agence qui, conformément à la Loi 58/1991, s'est en chargée.

Mais, elle ne doit pas se substituer aux organismes mis en place par la Loi et empiéter sur les pouvoirs et les responsabilités du FPE.

- de définir des rapports spécifiques entre le FPE et les FPPs, notamment pour la protection des actionnaires et d'éviter les conflits d'intérêt, en les réalisant par:

Le pacte des actionnaires, crée en vue de:

* coordonner les relations entre le FPE et les FPPs pour mettre en oeuvre la Loi de la Privatisation et renforcer les droits des FPPs dans les sociétés commerciales en tant qu'actionnaire minoritaire

* coordonner les actions de la privatisation:

(i) - partageant les responsabilités en matière de privatisation ("Grandes" sociétés commerciales - le FPE; sociétés commerciales "Moyenne" - les FPPs; "Petites" sociétés commerciales - une Commission regroupant des représentants de l'ANP, du FPE et des FPPs des agences locales de l'ANP);

(ii) - etablissant un programme annuel de privatisation du FPE en concertation avec chaque FPP et non limitatif pour les sociétés commerciales de petite et moyenne taille;

(iii) - en contrôlant, en cas de délégation, par le FPE, d'un mandat de privatisation au FPP, les modalités et le prix de vente des actions; tout différend sera réglé dans un délai de 30 jours, ayant l'accord de l'ANP;

(iv) - prenant en charge le coût des restructurations par le FPE, conformément à la Loi;

* conduire la politique de dividendes des sociétés commerciales;

* représenter les Fonds dans les Conseils d'administration des sociétés commerciales.

- de préciser les rapports entre FPE - FPPs et les entreprises à privatiser (rôle du Conseils d'administration, liaison avec le management, qui va assurer le contact avec le personnel, mais qui peut avoir, aussi, des intérêts divergents qui seront opposés aux objectifs de la privatisation),

- de répartir d'une manière précise les compétences entre les différents organismes pour éviter et atténuer les conflits d'attribution ou des doubles emplois,

- de déléguer les compétences ou les pouvoirs à des organismes spécifiques spécialisés:

* délégations régionales de l'ANP (petite privatisation),

* GIS spécialisés (les restructurations),

* organismes spécifiques (le secteur bancaire),

* banques commerciales (certaines financements).

Dans le sens le plus large, la liaison entre la privatisation et le Gouvernement sera fait par l'intermédiaire des organes chargés de la privatisation, mais qui doivent bénéficier d'une réelle autonomie et d'une large indépendance et qui vont assurer la cohérence avec la politique économique et sociale (notamment pour les problèmes des emplois).

On doit, maintenant, ajouter le rôle des sociétés commerciales dans le processus d'initier et d'implementer leur privatisation.

Conformément aux prévisions du cinquième chapitre de la Loi no. 58/1991, l'Agence Nationale pour la Privatisation peut sélectionner 0,5% du nombre total des sociétés commerciales en vue de les privatiser avant la création des FPE - FPPs.

Cette sélection est la suite de leur propre volonté et des recommandations des ministères de tutelle.

Après leur préparation en vue de les privatiser, les sociétés commerciales sont mises en vente et les salaries et la direction de ces sociétés peuvent obtenir des actions dans des conditions préférentiels, comme suit:

(i) - quand on vend une société par offre publique, ils peuvent manifester leurs options d'achat dans un certain délai, pour maximum 10% des actions en vente à 10% discount comparé au prix de l'offre publique;

(ii) - quand on vend une société par négociation directe, ils peuvent acheter un certain nombre d'actions à un prix à 10% discount comparé au plus haut prix négocié.

Une autre option serait celle des négociations directes (MEBO).

Les paragraphes 45 et 46 de la Décision gouvernementale no. 264/1991 envisagent la participation de l'Association des employés et de la direction d'une société commerciale en vue d'aguerrir un paquet majoritaire d'actions de la dite société:

- en exerçant leurs droits préférentiels, conformément au paragraphe no.48 de la Loi 58/1991;

- en achetant un paquet tout entier ou un paquet majoritaire d'actions de la dite société, par négociations directes.

L'association fondée par les employés et la direction de la société en vue de fournir les possibilités financières pour aguerrir les actions (et, dans une seconde étape, d'organiser un marché intérieur secondaire pour ces actions) est un "accord des actionnaires", valable du point de vue civil et commercial.

Pour les premières quatre sociétés qui sont en train d'être privatisées par la méthode MEBO - dans le cadre du programme de la privatisation pilote, initié par l'Agence Nationale pour la Privatisation avant la création du Fond de la Propriété d'Etat et des Fonds de la Propriété Privée - les associations des employés et de la direction de la société, crées pour aguerrir des actions, sont considérées ayant un statut légal non profit, conformément aux prévisions pour les associations de la Loi 21/1924, concernant les personnes juridiques.

Les pas à suivre en vue de créer ces associations sont:

(i) après avoir sélectionnés les sociétés en vue de les privatiser, un comité d'initiative doit organiser une assemblé générale pour créer cette association;

(ii) pour créer l'association, cette assemblé générale doit:

- décider l'emplacement de l'association;

- approuver le statut de l'association;

- élire le premier conseil d'administration de l'association;

(iii) la Cour, qui a sous juridiction la location de l'association, doit autoriser l'emplacement de l'association et lui conférer la personnalité juridique.

Bucarest, le 27.11.1992
MT / tm / 3 ex.

SLOVENIA

OWNERSHIP TRANSFORMATION IN SLOVENIA

The present text is intended as a short summary of the oral presentation on the current status of privatization in Slovenia, given by the author at the Second Session of the UNCTAD Ad-hoc Working Group on Comparative experiences in Privatization, held at Geneva June 7 - 11, 1993.

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The aim of the ownership transformation is to replace the previous system based on "Social Ownership" with the system known in countries of classical market economy and make the transition smooth and swift.

The previous system differs in many aspects of that prevailing in other East and Central European Countries. Its main characteristics relevant for the understanding of the transformation problems are the following:

- Enterprises were legal entities with their own management, formally independent from the Government, operating in a more or less competitive market environment. Unprofitable enterprises could face bankruptcy, in most cases, however, mergers or reorganizations were used to remedy the difficulties.

- Profits were distributed as salaries to the employees after taxes paid to the Government.

- The system operated without classical ownership rights i.e. the distribution of value added was carried out on the basis of "labour input" and not on the basis of ownership of the capital. Equally, the management was appointed basically by, and accountable to, the working force. There was virtually no owner.

- Political interference in business matters was present in a lesser extend than in ether ex-socialist countries.

Under the system a comparatively well skilled management structure developed; marketing practices, relatively modern technologies and good links to economic partners abroad are features encountered in many Slovene enterprises. Slovenia inherited from the previous system an export oriented economy and consequently comparative high quality standards of produced goods and services.

Until 1989 all industrial activity in the country was carried out by "socially owned" public enterprises. Only then establishment of private enterprises was allowed by the "Enterprise Law" and in parallel privatization of the industry slowly started.

After the political reforms resulting in the free elections in 1990, more radical approaches to the abolishment of the "social ownership" were articulated. In parallel with the, first gradual and in 1991 definitive, disintegration of the Yugoslav federation Slovenia developed her own approach to privatization.

There was a wide consensus reached among different political parties on the need to privatize the "social capital"; the modalities and techniques remained, however, topics for heated political debates over a long period of time. There were basically three basic approaches to solve the problem:

(a) To sell small parts of the shares of the enterprises to investors (external or internal in respect to the enterprise) and leave the rest in forms of preferred shares to the Government, at least for a certain period of time. The management should in this case be left to the new minority shareholders.

(b) To "nationalize" the enterprises i.e. bring them under direct governmental control and distribute the shares to the population through specially created investment funds.

(c) Distribute a great portion of the shares to the employees.

After a long period of debates in Parliament and among the public, a compromise was reached, resulting in adoption of the Law on ownership transformation of enterprises in November 1992.

The basic provisions are the following:

The law applies for all enterprises with the exception of:

- banks and insurance companies;
- public utilities;
- infrastructure;
- gambling;
- cooperatives;
- enterprises under bankruptcy procedure.

It also does not apply to enterprises who by agreement of the present management become "state owned", and are now managed by the Development Fund, which is an governmental agency entrusted with the rehabilitation and privatization of enterprises. It is assumed that these enterprises have already undergone the "ownership transformation", as they have the State as their owner.

An audited opening balance is to be declared by each of the enterprises, according to a prescribed methodology. The value of "Social Capital" appear from these balance sheets. Arable land, and forests which were previously "social property" are excluded as they were declared State Property and will be managed and privatized separately. Capital of private natural and legal persons will also appear in these balances it is however not considered as "social". Capital resulting from assets for which a restitution claim by former owners exists, or shares which are claimed by them, also do not make part of the "social capital".

For the "social capital" shares are to be issued and transferred according to the following principles:

20% for free distribution to the employees;

20% to the Development fund, earmarked for the Special investment funds;

10% to the Pension fund;

10% to the Indemnity fund from which compensation will be paid to previous owners of the nationalized industry that could not be restituted;

40% set aside for sale.

The sale could be effected by:

- internal sale to the employees in 4 years with 50% discount;
- public tender;
- public auction;
- public sale of shares.

The proceeds from sales go to the Government owned Development Fund.

It is also possible that the a potential investor expands the capital of the enterprise. If more than 10% of the present value of the enterprise is added as fresh capital part of the existing shares can be declared as preferred shares and retained by the Government in passive ownership.

Each enterprise has to prepare a Privatization Plan and submit it for approval to the Privatization Agency. The enterprise can combine different methods of privatization, it has take into account only the general provision. It can not distribute more than 20% of its shares it can however decide that the whole enterprise is sold. In this case the proceeds are distributed according to the preestablished percentage to the Investment funds, Pension fund and Indemnity fund.

In order to regulate the fair distribution of the social capital among the population, Ownership Certificates will be distributed to citizens in the value of SIT 100.000 to 400.000 (US $ 1.000 to 4.000) depending on their age on the date of enactment of the law. This will be done in a non-materialized form by opening of a special account for each citizen.

The certificates are nontransferable and the population will be able to exchange them for:

- shares on the free distribution scheme inside the enterprise the holder is, or was employed; (if non-utilized certificates are left to employees of a given enterprise, after 20% of the Social Capital of that enterprise has been distributed, employees can use them as payment in "Internal payment" schemes);

- shares of Special Investment Funds;

- shares offered to the population under the scheme of "Public Sale of Shares".

Should an enterprise not prepare its privatization plan within 18 months from enactment of the Law, it has to transfer all the shares for the Social Capital to the Development Fund. The same provision applies to the shares which are not privatized according to the plan in due time.

Some final remarks are added:

1. The speed of privatization is considered to be essential for the success of the operation. In fact, the delays which occurred due to discussions on the principles of the privatization legislation have provided possibilities for manipulating the privatization process as to bring illegitimate profits to some groups. The legislation provides possibilities for special audit of such cases and under certain conditions, restitution of the value and also procedure against the suspect.

2. It is not yet clear how the shares earmarked for the Investment funds are going to be distributed to private investment funds. There will be auctions on which eligible Investment funds will participate.

3. Former owners of nationalized property, which could not be restituted in kind, will get as a compensation bonds denominated in German Marks, payable in local currency, maturing in 20 years and bearing 6% interest. It is provided by the law that this bonds be exchangeable for the social capital in process of privatization. The rules governing this exchange are not yet ready.

4. It is not yet clear when the shares obtained in the privatization process will be tradeable. Some advocate a temporary freeze for such sales for up to two years till the development on the stock market will be known, other advocate an immediate release, to speed up the transactions and develop the capital market.

5. The privatization of public utilities is expected to follow soon. It is envisaged however, that this enterprises be privatized on one by one basis.

6. The banks are at present owned by the socially owned enterprises. They are in a rehabilitation process. It is not clear yet, wether, when and to what extend, new shareholders will be invited to participate in their privatization.

E. Pirkmajer

UNITED KINGDOM

The UK experience of Telecommunications Regulation

Contribution to the 3rd Session of the Ad Hoc Working Group on Comparative Experiences with Privatisation

The UK Experience of Telecommunications Regulation

by
Edward Harley
Department of Trade and Industry

UK CONTRIBUTION TO THE UNCTAD AD HOC WORKING GROUP ON COMPARATIVE EXPERIENCES WITH PRIVATISATION:
"LESSONS FROM THE UK EXPERIENCE OF TELECOMMUNICATIONS REGULATION"

1. I would like to offer some comments on the UK experience of privatisation and regulation, focusing on telecommunications. British Telecom (BT) was not broken-up upon privatisation. Instead, regulation has been relied upon to ensure the orderly development of competition. The aim is for regulation to be transitory - ie to fall away as competition develops in telecoms. The scope for such competition is great - technological developments mean that no area of telecoms operation can now be seen as a natural monopoly. This makes telecoms unusual among the regulated utilities.

2. Until competition is fully established and removes the need for regulation, a carefully chosen selection of BT's prices are subject to control. They can only increase by the rate of retail price inflation (RPI) minus some figure 'X'. Certain specific prices are also subject to their own controls.

3. This form of price regulation was chosen by the UK Government for a number of reasons:

a. first, it encourages BT to be efficient because it can retain profits resulting from efficiency gains beyond those assumed in the X figure;

b. second, it provides more information about the firm's efficiency than profit regulation;

c. third, it is less discretionary than profit regulation, reducing the scope for regulatory capture; and

d. fourth, it can easily be targeted to certain areas of the business.

4. This isn't to say price regulation is without its problems.

The regulator has to undertake a difficult balancing act: between regular price reviews - which allow the regulator to adjust to changing circumstances - and the need for continuity - to facilitate long term investment decisions. The more frequent the reviews (which are based largely on BT's profits) the more closely price regulation resembles profit regulation. Separate requirements have to be set for quality.

5. But as I have said, the regulator's remit is not just to regulate the incumbent; in the longer term it is also to reduce the need for regulation by promoting competition.

a. One key to effective competition in telecoms is the setting of interconnection agreements between BT and its competitors' networks at fair and efficient levels: ie interconnection prices should reflect the cost to BT of the interconnection and no more.

b. Another key is setting prices at similarly fair and efficient levels. BT should not be allowed to keep prices in (potentially) competitive areas artificially low, subsidised by higher prices and profits in areas where competition is less likely to emerge. At the same time, prices need to be set at a level that attracts new entrants without costing customers too much.

6. To fulfil these requirements the regulator has to have separate accounting information. He needs to know which areas of BT's activities are making what profits at what prices. The fundamental problem that regulators face everywhere is that the regulated firm holds the information the regulator needs, and not always in a form the regulator wants. Talks are currently under way between the regulator and BT to address this problem; and in particular the separate accounting of BT's network and retail activities.

7. On a more practical level, BT's freedom to cross-subsidise has been reduced by restrictions on the its ability to "rebalance" its prices within the selection that come under the

RPI-X umbrella. BT has traditionally subsidised its local and business rates from its international operations. But higher returns in the international sector have encouraged competition and forced BT to reduce its international prices. BT's scope for cross-subsidy has thereby been reduced, without BT being able to increase its local and business rates.

8. In compensation, BT receives "Access Deficit Contributions" (ADCs). These are paid by interconnecting operators, but can be waived, within limits, at the regulator's discretion to encourage new entry. The problem with the system is its complexity: it was workable for the duopoly, but has proved very difficult and inflexible to administer as the number of interconnecting parties has grown. This is another issue that is being discussed by BT and the regulator at the moment, and illustrates the need for regulation to be flexible to a rapidly changing environment.

9. Despite all the difficulties I have mentioned, regulation in the UK has been successful in winning some very real benefits for consumers: in terms of prices, service quality and choice. The UK is now on track to achieving a really competitive environment in telecommunications; one made feasible by technological developments themselves encouraged by regulation. Although BT is still a Goliath, carrying around 90% of UK telecoms traffic, more than half the City of London's outgoing traffic is now carried by Mercury. Radio-based technologies are competing with local networks and 34 new individual telecommunications licences have been granted in the past two years. A further 20 have been granted in principle. Many of these licences are for providers of specialised or regional services, but 7 are for new public telecommunications operators who will offer direct competition to BT and Mercury, 6 nationally and the seventh in the area bounded by the London orbital motorway.

10. The emergence of these new entrants, technologies and networks brings new regulatory challenges. The UK experience shows the regulator needs to be increasingly flexible to encourage innovation and win gains for consumers as competition emerges not just between companies,but also between technologies.