Distr.
GENERAL
E/ESCWA/ED/1996/3/Add.1
8 December 1996
ORIGINAL: ENGLISH

ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

SURVEY
OF ECONOMIC AND SOCIAL DEVELOPMENTS IN THE ESCWA REGION 1995

PART TWO

PRIVATIZATION IN THE ESCWA REGION

UNITED NATIONS
New York, 1997

97-0022

PREFACE

This study has been prepared by the Economic and Social Commission for Western Asia (ESCWA) in implementation of ESCWA subprogramme 3, activity (a) (i), on the publication of the Survey of Economic and Social Developments in the ESCWA Region, 1995, Part Two. The present study is mainly a consolidation of three studies published by ESCWA in 1995. The first study was entitled *Privatization in the Gulf Countries* (E/ESCWA/ED/1995/8), the second study (in Arabic) reviewed "Privatization in the ESCWA Countries with More Diversified Economies" (E/ESCWA/ED/1995/11), and the third study was entitled *Stock Markets in the ESCWA Region* (E/ESCWA/ED/1995/3/Add.1). Chapter V of the present study is a report on chapter IX of *Privatization in the Gulf Countries*, with additional updated information. The sections on privatization in Iraq and Lebanon in the present study are mainly translated from "Privatization in the ESCWA Countries with More Diversified Economies." The present study concludes with a number of recommendations for the consideration of decision makers in the region.

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Introduction

In most developing countries, the period during the 1960s and 1970s witnessed a marked expansion in the role of the public sector. This expansion was designed to accelerate economic growth, raise standards of living and redress inequalities in income distribution. To achieve these results, the public sector assumed a major role in investment. Overall government expenditure also increased substantially. The bulk of public sector investment allocations went to social services, health and education as well as infrastructure, including transport and communications. This expansion in expenditure took place against a backdrop of low domestic and national propensity to save. As a result, the escalating public spending led to escalating borrowing and debts. The international debt crisis of 1980 was to some extent the culmination of this process.

The worsening external debt situation in the majority of the developing countries, together with the widening fiscal imbalances resulting from increased budget deficits, forced many developing countries to introduce changes in their macroeconomic policies.

Thus, the 1980s witnessed major shifts in political and economic policies worldwide, including the developing countries. These changes affected the economic management in both developing countries and the transitional economies in Eastern and Central Europe. The concern of economic planners, therefore, has become how to transform the public sector-dominated economies into market-oriented economies where market forces play a fundamental role.

The 1980s also witnessed a sharp slow-down in economic growth in the developing countries. This was due partly to shortcomings in economic policies and partly to the unfavourable global economic environment. The overextension of government intervention in economic activities and the sharp rise in public spending led to high and unsustainable fiscal imbalances worldwide. This in turn led to a sharp drop in investment allocations and lower economic growth. Moreover, during the last three decades, the economic policies in a large number of developing countries were not very conducive to the participation of the private sector. Indeed this sector was subjected, in a number of developing countries, to complex sets of government regulations and an unfavourable macroeconomic environment. These two factors severely restricted the participation of the private sector in economic development. This is particularly evident in the centralized economies, where the operation of the private sector was seriously impeded.

The recent shift in economic policies has been brought about by both economic necessity and the conviction that previous economic policies were inadequate in a period characterized by rapid changes in the global economic environment. In addition, the globalization of the world economy characterized by the signing of the General Agreement on Tariffs and Trade (GATT) in 1994, and the creation of the World Trade Organization (WTO), called for economic deregulation, liberalization of trade and investment and the promotion of economic efficiencies which the public sector, by and large, has not been able to achieve.

The main objective of this study is to analyse the privatization experience in the member countries of the ESCWA region to provide the policy makers in these countries with an assessment of the privatization, especially since different approaches and methods have been used in formulating, implementing and monitoring privatization.

The experience of different countries can provide useful examples to those member countries that have not yet embarked on privatization. The present study, therefore, by showing the contrast between the privatization programmes in countries such as Egypt and the Syrian Arab Republic, would benefit those member countries that aim at similar or different economic and social objectives in their privatization programmes. In addition, the whole privatization process in the region is still in its very early stages; it would therefore be useful to study the different strategies, methods, and coverages of the various approaches applied and point out their advantages and disadvantages. The study also aims at formulating a set of policy recommendations based on the analysis of the experiences reviewed for the benefit of decision makers in the ESCWA member countries.

The present study is composed of an introduction and five chapters. The introduction and the first two chapters address the theoretical aspects of the privatization process.

Chapter I reviews the different objectives of the privatization process. It concentrates on the main four objectives usually aimed at in privatization, namely: promotion of economic efficiency; reduction of government involvement in economic activities; promotion of domestic capital markets; and competitiveness.

Chapter I also covers the privatization methods that have been applied in the region. This generally includes a direct sale, public tender, and privatization through domestic stock markets. The advantages and disadvantages of each of these methods are reviewed in the chapter.

In addition, chapter I examines the privatization strategy under which the privatization programmes are being implemented in the region. In analysing the strategy, the framework of the privatization programme is also reviewed, including objectives to be achieved, the methods adopted and implementation method. This analysis is particularly important because, as will be seen, applying the right strategy is a prerequisite for the successful implementation of the privatization programme.

Chapter II analyses the role of the stock markets in the privatization process; it does this by presenting a brief review of the role of the stock market in general and its role in implementing privatization programmes in the ESCWA region in particular.

The experiences of ESCWA member countries are reviewed in chapters III and IV. Chapter III addresses the experience of the countries with more diversified economies, and chapter IV addresses the experience of GCC member countries.

Chapter V presents the summary and conclusions together with a set of policy recommendations. It should be noted that this study relies heavily on three case-studies carried out for some ESCWA member countries in 1995. The first dealt with privatization in GCC countries; the second with more diversified economies; and the third with the role of the stock markets in the ESCWA region.

The present study synthesizes the earlier case-studies and the different experiences in formulating, implementing and monitoring privatization programmes in the region. In doing so the study aims, as mentioned above, to contribute to a better understanding of the issues concerned in privatization in general and the experience of the countries of this region in particular. It is hoped that the policy recommendations formulated in this study will underscore the need for implementing economic reform policies to enable the privatized enterprises to play effective roles in achieving sustainable economic growth.

Finally, it is also important to note that throughout the study no attempt is made to pass judgment regarding the superiority of one privatization method over another. It is still too early to make any clear judgment given the short history of the region in the privatization process.

I. PRIVATIZATION OBJECTIVES, METHODS AND STRATEGY

A. OBJECTIVES

Although privatization objectives vary from one country to another depending on the privatization strategy, methods applied and the state of economic and social development, there are common objectives that every country aims to achieve through the implementation of privatization programmes.

(a) To improve efficiency and increase productivity of the economy so as to promote economic growth and competitiveness.

(b) To scale down government involvement in economic activities, particularly in the productive sectors of the economy. The privatization policies should be directed towards allowing the private sector to engage in activities that can be undertaken more efficiently by the private sector, and to keep in the public sector those economic activities that the private sector is either not interested in or cannot implement more efficiently.

(c) To transform the centrally planned economy into a market-oriented economy based on competition, trade liberalization and free movement of capital and labour.

(d) To create a domestic capital market. Among the most widely applied privatization methods is the floating of shares of privatized public sector enterprises through the stock market. This in turn would lead to the development of domestic capital markets, which usually suffer from low absorption capacity. Privatization through the stock market is preferred by a large number of countries, owing to the fact that it is highly transparent compared with direct sale or sale to strategic investors.

(e) To promote the role of the private sector in economic growth and development. Privatization, when it is implemented in a stable and reformed macroeconomic environment, will lead to the expansion of the role of the private sector, the repatriation of savings from abroad and thus a reduction in capital flight. This would lead to an increase in the contribution of the private sector in gross capital formation and hence promote economic growth.

(f) To reduce the drain in the government budget and thus to contribute to fiscal consolidation. The privatization of part of the public sector enterprises, particularly those operating at a loss, reduces government subsidies provided to these enterprises and thus contributes to the reduction of the budget deficit. In addition, the proceeds from the sale of these public enterprises can increase government revenues and also lead to budget consolidation. However, Governments should not be overly encouraged by an increase in public revenues through the sale of public enterprises: such sales are only one-time transactions which should be used rationally for the restructuring of loss-making public enterprises and/or for reducing a country's public debt. Public revenues would rise in the future through the increase in income and corporate taxes of privatized enterprises.

(g) To reduce the country's external debt. This objective can be met through the debt-equity swap by allowing the private sector to exchange debt through equity. However, this usually involves giving a large discount to attract the private sector to exchange debt through equity in privatized enterprises. Several countries, particularly in Latin America, have pursued this privatization method. In Chile, for example, debt-equity swap accounted for about 80 per cent of the volume of foreign direct investment (FDI) to the

country during the period 1985-1989. This was achieved by giving a discount for Chilean debt of up to 60 per cent.[1]

(h) To achieve wider distribution of economic ownership. Privatization, particularly if carried out through the stock market, can contribute significantly to the widening of public sector ownership.

(i) To promote the inflow of FDI to bridge the investment gap between national saving and investment allocations. The importance of the FDI goes beyond the increase in the inflow of financial resources to the opening up of new markets, increasing employment opportunities, access to new technologies and the latest available management methods. This in turn would lead to increased competitiveness and hence export promotion, particularly during the era of economic globalization.

B. METHODS

There are several privatization methods that can be applied, depending on the objectives to be achieved. There is no single method that can be applied throughout the privatization process, as every transaction might need a different method from the one applied before, depending on the objective to be achieved. In general, however, the most important factor that should always be taken into consideration is transparency. Among the most widely used privatization methods are the following:

1. *Public offering through the stock market.* This is the most widely applied method in both the developed and developing countries. It involves floating of all, or parts of, shares of privatized enterprises through the domestic stock market. The most important advantage of this method is transparency as shares are sold through the market where access is available to interested buyers. However, this requires the availability of a developed stock market. In addition, it can only succeed in profit-making privatized enterprises as shares of loss-making enterprises do not attract buyers. It also requires the availability of data and information on the privatized companies including their financial positions, balance sheets and capitalization.

2. *Tender sales.* This method is easy to handle as it does not require the availability of a stock market and it is usually carried out through public announcements on the conditions, timing, place and procedures to be followed. However, the most important disadvantage of this method is the fact that it is less transparent than the public offering method. In addition, it requires large and complex administrative procedures in preparing for and conducting the public tender.

3. *Voucher privatization.* This method is mainly used in the privatization programmes in Central and Eastern Europe, particularly in the Czech Republic, Hungary and Poland. In these countries, each citizen is provided with a voucher, either free or at a nominal charge which can be used in buying shares of privatized companies. The main purpose behind applying this method is to achieve a comprehensive privatization programme in a relatively short time. The emphasis in applying this method is not on revenues but on quick transformation of the economy from a centrally planned into a market oriented one. The advantage of this method is that it reduces, to a great extent, public opposition to privatization.

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[1] Economic Commission for Latin America and the Caribbean, *Privatization in Latin America: From Myth to Reality (LC/L.880)*, privatization project on proposals for policy reforms by ECLAC and the Government of the Netherlands (Santiago, 1995), p. 19.

4. *Direct sale.* This method usually involves selling to strategic investors who either have experience to run the privatized project or can introduce new technologies and production methods to promote competitiveness. This method is generally preferred in the export sector where competitiveness, efficiency and access to a new market are of paramount importance to the Government. The main disadvantages of this method are lack of transparency and lack of competitiveness; therefore, the enterprises that are privatized through this method may be sold at below market prices.

5. *Public auctions.* This method is mainly applied to relatively small projects. However, its main advantage is to guarantee the Government the highest price possible for the privatized enterprise.

6. *Leasing out or contracting out.* This method differs from the above-mentioned methods as it keeps the ownership of the enterprises in government hands but it transfers the management of these enterprises to the private sector. This method has largely been used in those infrastructure projects which the private sector is either not interested in buying or when the Government is not willing to concede the ownership of these projects. The main objective of this method is to increase efficiency of public enterprises while keeping the ownership in the public sector.

7. *Joint ventures.* This method applies either to new projects or to projects where the Government is not willing to hand out to the private sector the total control of the project. This method involves the preparation of a document, like a contract, in which the role of both the Government and the private sector is clearly stated. This method, like the contracting out method, is mainly used in those infrastructure projects in which the public sector prefers to continue to have an influence on the activities of the project or in projects requiring large capital investment that the public sector is not able to mobilize alone.

8. *Management contract.* This method can best be described as partial privatization as the ownership remains with the public sector, while the operation of the project is leased to the private sector for fees. This method is mainly used in areas of services such as water and electricity where the generation is kept with the public sector while the distribution is leased to the private sector.

9. *Build, operate and transfer (BOT).* This method of privatization is applied only to the new projects that the public sector plans to build but lacks the financial resources to implement. It applies mainly to infrastructure projects such as roads, power plants and bridges. The private sector builds the project and runs it for a fee for a number of years before handing it back to the public sector. The most important advantage of this method is that it both reduces the financial burden of the Government and increases the contribution of the private sector in capital investment, particularly in the area of infrastructure.

10. *Management/workers buy-out.* This method involves the selling of the enterprises to the workers and management to reduce the public opposition to the privatization programme. It is generally applied in the case of small labour-intensive enterprises, particularly those that do not require the introduction of new production techniques. However, this method lacks transparency and competitiveness as the sale is limited to the management and employees and is off limits to the general public.

C. STRATEGY

The implementation of a successful privatization programme should be carried out under a clear, manageable and achievable strategy. The strategy should ensure coherence among the different and sometimes contradicting privatization objectives. It should also be flexible enough to provide the decision makers with adequate room for adjustment when things go wrong. The appropriate strategy depends on the

state of economic development in the country, the size of the public sector and the status of the private sector. It also depends on the size of the public sector enterprises that are to be privatized and the main objective of the privatization, whether it is to increase efficiency, expand public ownership or to have access to new technologies and FDI. The privatization strategy should allow for restructuring of loss-making public sector enterprises and for liquidation of non-viable enterprises that cannot be privatized even with restructuring. The strategy should also indicate the approach to privatization such as the gradual approach or the mass privatization approach, the time-frame and the number of enterprises to be privatized every year.

Moreover, privatization strategy should include an important element, namely the institutional arrangements which will formulate, implement and monitor the privatization programme. Institutional arrangements are the core of the implementation of the programme and a prerequisite to its successful conclusion. Finally, the strategy should call for close monitoring of the implementation of the privatization programme to ensure that the objectives are met within the set time-frame. The monitoring part ensures that privatization objectives are being achieved and that the programme is on course throughout the process. It also discovers, at the early stages, any mistakes and obstacles so that the authorities can deal with them at the lowest possible cost to the programme.

II. THE ROLE OF THE STOCK MARKETS IN THE PRIVATIZATION PROCESS

A. AN OVERVIEW

Stock markets are essential tools for the mobilization of resources and the provision of capital for companies and firms. They also provide investment opportunities in shares of privatized companies. In addition, they enable small investors to participate in the privatization process by buying shares directly on the stock market floor and thus contribute to the widening of public ownership which is one of the main objectives of the privatization process. Stock markets contribute to and facilitate the inflow of foreign investment to the economy through the stock market floor. However, for the stock markets to play their role adequately, the following conditions have to be met:

1. The stock markets must be developed and upgraded in order to absorb the flotation of a large number of shares;

2. The appropriate legal and regulatory framework must be established to facilitate and guarantee successful development of the supply of shares;

3. The listing requirements of companies should be flexible and simplified so as to attract the largest number of companies to the market floor. However, this should not be at the expense of maintaining adequate protection for shareholders.

4. Securities should be promoted through the flotation of new issues by the listed companies. However, this has to be balanced by the absorption capacity of these markets in order to avoid over-subscription.

5. An adequate and updated flow of information and data on the performance and financial position of listed companies and their future prospects must be provided on a regular basis, as it is of crucial importance to investors and can help them to make up a stock portfolio based on reliable sources of information.

6. Adequate monitoring and supervision mechanisms must be provided to regulate and oversee the operations of these markets.

7. Financial incentives such as income tax exemptions should be provided to stimulate investment, and the listed companies should also be provided with fiscal incentives such as tax breaks, for a limited period, particularly for newly-quoted companies in the market.

8. Qualified brokerages and other intermediary mechanisms should be established both to facilitate the market's operations and to help investors to compose their portfolios. The utilization of modern technologies, such as computers, and fast communications networks have become essential to the operations of these markets.

9. Competition should be encouraged between broker firms in order to minimize intermediary costs.

B. THE STOCK MARKETS IN THE ESCWA REGION[2]

Stock markets in the ESCWA region, with the exception of Egypt and Lebanon, are still in their infancy stage, lacking experience and with a relatively underdeveloped status, particularly in terms of laws, regulations and accounting systems. In the GCC countries, the first stock market was established in Kuwait in 1977, followed by the Bahrain stock exchange in 1989, and the Oman securities market in 1991. In the countries with more diversified economies, the first stock market was established in Egypt in 1903, followed by Lebanon in 1920 and Jordan in 1976. The rest of the ESCWA member countries are expected to follow suit in establishing their stock markets as part of their economic reform policies, which include more economic liberalization, deregulation and privatization. In terms of performance, most stock markets in the region are highly speculative and thus volatile. This stems partly from their underdeveloped status: the lack of solid data and information on public shareholding companies can lead to speculation and unfounded anticipation. Several stock markets in the ESCWA region are closed to foreign participation which, when allowed, requires prior government approval and is restricted to a certain percentage of the capital of traded companies. However, this situation may change as more countries have realized that without sound macroeconomic policies, which are both investment-friendly and provide a high degree of liberalization and deregulation, they would not be able to attract the targeted private sector investment. In this context, both Egypt and Jordan have opened their stock markets to foreign private sector participation.

The distinct observation here is that most of the stock markets in the region are dominated by the Governments in their respective countries through the control of the majority of stocks of traded companies. However, this situation is expected to change as the privatization process accelerates in the region. The following is a briefing on the nine active stock markets in the region:

1. Prior to the Gulf crisis, the Kuwaiti Stock Market had for years been the most sophisticated market in the ESCWA region since its organization by Company Law No. 15 of 1960 and other laws and regulations organizing the trading of shares, including Law No. 32 of 1970. The regulatory functions of the exchange were organized by a ministerial decree (No. 61) in 1976, and the exchange itself started operations in 1977.

2. The Amman Financial Market (AFM) provides a successful example in the region of capital market development in a capital-deficit economy. Its establishment goes back to 1976 when Law No. 31 institutionalized the procedures and control mechanisms for issuing and trading financial instruments. Other laws, such as the Company Law (1962), the Investment Promotion Law (1972) and the recently adopted Investment Promotion Law No. 16 (1995), the Public Debt Law and the Income Tax Law (1982), are essential components of the AFM legal and regulatory framework.

3. Egypt is distinguished by having experience with stock trading activity for more than a century, since the establishment of Alexandria's stock exchange by the private sector in 1881.[3] However, the socio-political developments of the 1950s and 1960s gave prominence to State ownership and control of economic activity, at the expense of the private sector, and paralysed stock exchange operations until the early 1980s. The functions of the securities commission are now carried out by a capital market authority which was established in 1979. The authority spearheaded the modernization of the legal and regulatory framework

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[2] This section is mainly a reprint from chapter I of the ESCWA study on *Stock Markets in the ESCWA Region* (E/ESCWA/ED/1995/3/Add.1). The study made up part two of the *Survey of Economic and Social Developments in the ESCWA Region, 1994.*

[3] *MEEDMONEY* 1, No. 4 (19 May 1995), p. 2.

within which stock market activity in both its primary and secondary segments currently operates. Most prominent in this context are Stock Market Law No. 121, Company Law No. 159, and Tax Law No. 157, all issued in 1981, as well as other legal amendments and regulations which were later introduced to enhance the mobilization of domestic savings and promote capital inflows.

4. The Muscat stock exchange in Oman was established by Royal Decree No. 53 in 1988 and started operations in 1989. Its modern legal and regulatory framework has benefited from the experiences of other markets in the region and was tailored to serve the domestic economy while proceeding cautiously towards the development of regional links to promote portfolio capital inflows.

5. The Bahrain stock exchange was established by Legislative Decree No. 4 in 1987. The legal and regulatory framework is also shaped by the Company Law of 1975 and a set of ministerial decrees designed to shape market developments in accordance with the country's ambition to play a regional financial role.

6. Saudi Arabia, which has the largest stock market in the ESCWA region, cancelled earlier plans for opening a trading-floor-based stock exchange in 1987. Share trading activity is now largely conducted through the electronic securities information system (ESIS), a computerized trading mechanism introduced in 1990 and operated by the Saudi Arabian Monetary Agency (SAMA).

7. The Baghdad stock market has reportedly been operative since April 1992, with biweekly trading sessions of shares of some 63 companies. A stock market law (No. 24) was issued in 1991 to organize the trading of shares and to promote domestic capital market development in addition to a modern company law (No. 36), in effect since 1983.

8. In Lebanon, the Beirut stock exchange, which was established in 1920 and closed during the period of civil strife, was reopened in late September 1995 and became operational in 1996. Recent measures initiated by Law No. 26 of 1982 gave legislative authority to the Government in this regard. Since then, more than 160 decrees have been issued to modernize the legal and regulatory framework, establish key financial institutions, and organize company ownership and the sphere of activities. In this context, Legal Decree No. 120 enlarged the role of the Beirut exchange to include commodities in addition to financial instruments.

9. In the United Arab Emirates, intensive efforts were made to establish an official stock exchange. Measured by market capitalization, the United Arab Emirates exchange will be the second largest in the ESCWA region after the Saudi Arabian market. Currently, the legal and regulatory framework is shaped by Company Law No. 8 of 1984 and a set of ministerial decrees issued since 1989 to organize domestic corporate activity.

The main objectives of the stock markets in the ESCWA region are:

(a) To facilitate market access to new businesses;

(b) To broaden the membership base through the wide distribution of shares;

(c) To balance between equity and long-term debt financing available to enterprises;

(d) To promote the role of the private sector through stock market privatization methods;

(e) To contribute to the mobilization of domestic private sector savings and provide mobility to the savings by creating attractive investment opportunities in equity.

C. THE ROLE OF THE STOCK MARKETS IN PRIVATIZATION

Privatization through floating of shares on the stock market floor is one of the essential privatization methods being applied by a large number of countries that have an operational stock market. The main advantage of this method is that it provides competitiveness and thus ensures the highest possible price for the Government. This method also provides the public with an opportunity to participate in the privatization process as the stock market is opened and not restricted; therefore, it also increases transparency, particularly if data and information are widely available. However, the main concern in applying this privatization method is that it applies, in general, only to profit-making companies: loss-making companies cannot attract private sector participation. Moreover, during periods of weak market performance, offering new stocks which will add to the supply may not attract investors; hence shares of privatized companies are traded below their real value and their offering prices. It is important for those countries carrying out privatization through the stock market to choose the most appropriate time for supplying the market with new shares.

In the ESCWA region, Egypt—which is implementing the most comprehensive privatization programme in the region—has relied mainly on privatization through the floating of shares in the stock market. Shares of the privatized companies are floated in the markets in tranches owing to the limited absorption capacity of the stock market and also to avoid an oversupply of shares which would lower prices below the initial offering price. Privatization through the stock market in Egypt led to a substantial expansion in the absorption capacity of the market. The number of daily traded shares jumped from just 70,000 on average in 1993 to a daily average of 106,000 in the summer of 1994. The market performance in 1994 was reflected by the official market index, which reached 140 per cent in 1994 in dollar terms, making it one of the fastest growing markets in the world in that year.[4] In October 1994, the market was faced with the problem of an unrealistic increase in prices including the prices of the loss-making companies. The market authority intervened and stopped trading in the shares of these companies. This negatively affected market performance and the index dropped by almost 55 points between October 1994 and the first quarter of 1996. The intervention was necessary to prevent an even bigger market crash. This situation arose because the market still lacks available reliable data and information about listed companies; the only way to prevent similar situations in future is to increase market transparency and to force companies to publish, on a regular basis, their balance sheets, financial positions and projected prospects. The value of shares traded on the market jumped to 3.8 billion Egyptian pounds (LE) in 1995 and to LE 5.5 billion in the first eight months of 1996. This sharp increase reflected the acceleration of the privatization process that the new Government has been pursuing since taking office in January 1996. In addition, the opening up of the stock market to foreign investment led to a sharp increase in its contribution to the market's activities in 1996, which was mainly induced by the improvement in the investment climate in Egypt, particularly in 1996, and the good recommendations the Egyptian bourse has been receiving from various international investment brokerage firms. Moreover, the continuous but gradual decline in interest rates on deposits helped the market as it reduced the attractiveness of the banking deposits as an alternative investment opportunity competing with investment in stocks.

In other ESCWA member countries, stock markets are also expected to play an important role in the privatization process. In Kuwait, the Kuwait Investment Authority (KIA), which is the government

[4] *International Herald Tribune*, 4-5 March 1995, p. 19.

investment agency, initiated in 1994 a three-to-five-year programme to transfer to the private sector part of its membership in 62 local companies.[5] Several of these companies are trading in the domestic stock market. Among the most important privatization methods applied by the KIA is the sale of shares in the domestic stock market, which has overcome the ramifications of both the Souk Al-Manakh crisis in 1982 and the Gulf crisis during the period 1990-1991. The activity of the market, which dropped in 1994, reflecting the reduction in government public spending, rose sharply during the first quarter of 1995. The KIA privatization scheme led to the sale of shares of 13 companies over a period of 22 months.[6] The scheme has been well received as there has been an over-subscription of shares of some companies, indicating an increasing public interest in the operations of the country's stock market.[7]

Saudi Arabia's stock market, the largest in the GCC countries in terms of market capitalization, has been negatively affected by the drop in government public spending in the last few years. The market official price index dropped by 5.2 per cent in 1993 and 29 per cent in 1994. The drop reflected the fact that the Government controls 40 per cent of the market capitalization and that, without an active privatization programme, the activity of the market will continue to be below potential. However, when the privatization programme in the country is implemented, the market is expected to boom. In addition, the sale through the stock market is expected to be the main privatization method in Saudi Arabia, particularly for the joint companies, including the giant Saudi Basic Industries Corporation (SABIC), in which the Government owns 70 per cent of its shares and has a market capitalization of 26.9 billion Saudi Arabian riyals (SRls) or about US$ 7.2 billion.

In Oman, the Oman stock market has played an active role in the privatization of several public enterprises. This includes the offering of 15 million shares of the Oman Cement Company in June 1994 and the sale of shares of the Salalah Flour Mills Company in April 1995.

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[5] See ESCWA, *Stock Markets in the ESCWA Region.*

[6] National Bank of Kuwait, *Economic and Financial Quarterly,* ii/1996, p. 39.

[7] Ibid.

III. PRIVATIZATION IN THE ESCWA MEMBER COUNTRIES WITH MORE DIVERSIFIED ECONOMIES

A. EGYPT

1. *An overview*

The Egyptian economy has been dominated by the public sector, which took over the management of the economy after a series of nationalization laws in the 1950s and 1960s. In the early 1960s, the public sector owned most of the production and distribution sectors of the economy, with the exception of the agricultural sector where production remained in the private sector. As was the case in the majority of the developing countries, the main objectives of the Government were to build the country's infrastructure, expand social services all over the country and achieve a more equitable income distribution. To achieve these goals, the Government mobilized the country's natural resources to implement the development objectives. In order to finance public sector investment, the Government relied on several income-generating sources including the introduction of a progressive tax system. However, with time the public sector in Egypt overextended itself and the economy started to enter a stage of macroeconomic imbalances, reflected particularly in chronic budget and trade balance deficits, high inflation, high unemployment and currency depreciation. In addition, owing to the close economic ties between Egypt and the GCC countries, economic conditions in Egypt were aggravated by the "spilling over" of the recession that prevailed in the GCC countries owing to the sharp drop in oil prices and revenues there.

During the second half of the 1980s, economic problems in Egypt reached a crisis level. The GDP growth rate dropped to only 1.9 per cent in fiscal year 1991/92[8] which is below the country's population growth rate. The trade balance also deteriorated, raising the deficit from US$ 6.65 billion in fiscal year 1987/88 to US$ 7.3 billion during fiscal year 1991/92,[9] reflecting a drop in commodity exports and a sharp increase in the country's imports. Fiscal imbalances also increased during the second half of the 1980s. The budget deficit reached almost LE 17 billion, reflecting mainly the 88 per cent increase in current expenditure. In addition, the external debt problem in Egypt reached a new record of about US$ 50 billion, representing more than 130 per cent of GDP, while the debt services reached US$ 6 billion, representing about half of the country's foreign exchange earnings.[10]

The first shift in the country's macroeconomic policy came in 1974, with the introduction of the open door policy, which gave incentives to the private sector to participate in the country's economic growth and development. The most important policy change was the relaxation of the foreign currency regulations and the granting of tax exemptions to the private sector. However, these changes fell short of the demands of the private sector as they did not touch upon other important monetary policies such as the currency's overvaluation and the negative real interest rates. Furthermore, the open door policy did not touch upon the institutional aspects of the economy and it was an isolated measure which was not part of a comprehensive economic reform package. It was more in the nature of crisis management rather than an economic reform programme. The 1990-1991 Gulf crisis worsened the economic problems in Egypt. The return of tens of

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[8] Central Bank of Egypt, *Economic Review*, vol. XXXIV, No. 1, 1993/94 (Cairo), p. 64.

[9] Ibid., p. 67.

[10] ESCWA, *Structural Adjustment and Economic Reform Policies in Egypt: Economic and Social Implications* (E/ESCWA/SED/1993/14), p. 6.

thousands of Egyptian workers from the Gulf overextended the social services in the country and added to the unemployment problem.

The worsening of the country's economic crisis led to the signing of an economic reform and structural adjustment programme with the International Monetary Fund (IMF) and the World Bank in 1991. The main objectives were: to reduce macroeconomic imbalances, eliminate policy distortions, promote the role of the private sector and reactivate economic growth. The programme addressed several policy issues such as the reform of the public sector, the reform of the pricing systems and the reform of the investment policies.

The pricing policies have been substantially changed as price decontrol was adopted for agricultural and manufacturing products, while the administrative prices have, to a large extent, been eliminated.

Investment policies have also been substantially altered as investment licensing requirements were eliminated with only a few exceptions for products that were protected because of national security, public health or religious reasons.

The economic reform package also touched upon the exchange rate regime. Initially, a dual exchange rate was adopted. The first (the primary rate) was applied for the Suez Canal dues, exports, official loans and transfers, while the second rate (the free market rate) was applied to all other foreign exchange transactions. Finally, the exchange rates were unified in October 1991. In the area of trade, non-tariff barriers have been reduced and most of the export restrictions have been removed.

In the area of fiscal consolidation, the budget deficit was reduced to only 3.5 per cent of GDP by fiscal year 1995/96. This is to be achieved through both a reduction in public spending and an increase in public revenues. Public spending is to be reduced by curtailing public investment and subsidies as well as restraining wages in the public sector. As for revenues, measures are to be taken to increase public revenues such as the introduction of a sales tax together with the increase in energy prices. In the area of interest rates, in January 1991 banks were given greater flexibility in determining interest rates for both loans and deposits in local currency, provided that interest rates on the three months deposit in Egyptian pounds should not be set below 12 per cent.[11] This measure helped to increase the volume of deposits in domestic currency and hence contributed to stabilizing the Egyptian pound.

Interest rate liberalization was accompanied by the lifting of the credit ceiling for the private sector in October 1992, and for the public sector in July 1993,[12] as part of the Government's expansionary monetary policy to promote investment, after several years of restrictive fiscal policy, to reduce the budget deficit to its intended goal of 3.5 per cent of the country's GDP.

The economic reform and structural adjustment programme in Egypt includes privatization as a major factor in promoting the country's economic growth and development. The Egyptian privatization programme, which is being carried out under Public Business Sector Law No. 203 for 1991, can be best characterized as limited in scope and gradual in approach.

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[11] Central Bank of Egypt, *Economic Review*, vol. XXXIV, No. 1, 1993/94 (Cairo), p. 69.

[12] Ibid., p. 70.

2. *The characteristics of the Egyptian privatization programme*

(a) The privatization programme in Egypt applies a gradualistic approach. The public sector enterprises are initially put under the umbrella of several holding companies which are responsible for the investment and operational plans, appointment of their board of directors and their managers and revision of their reconstruction plans, if needed, before privatization. The public enterprise office, which is responsible for the privatization programme, submits to the Cabinet the proposed list of candidates for political decision.

(b) The programme is limited in scope as it covers only a small part of the country's public sector enterprises. It covers only 15 per cent of the book value of the country's public sector or about LE 88 billion out of LE 600 billion.

(c) It is a market-based privatization, as it is being implemented mainly through the stock market to ensure transparency and competitiveness.

(d) The priority is given to small profit-making public sector enterprises with limited or no labour redundancy. This is to achieve quick privatization, as the profit-making companies are able to attract private investment and also reduce public opposition to the programme as the impact on labour is limited.

(e) It has been proceeded by a structural adjustment programme that provided for a stable macroeconomic environment which is essential to the success of the privatization programme.

(f) It has concentrated on the productive sector of the economy, and so far, has not touched upon the communications services or the banking sector.

(g) It has a social component to minimize its short-term negative impact, particularly on the poorest segments of the population. In this context, the Government established in 1991 the Social Development Fund (SDF) to provide assistance to small projects for new graduates and the unemployed. Since its establishment the Fund has mobilized about 2.5 LE billion and created 330,000 job opportunities.[13]

3. *The legislative authority*

Despite the fact that several laws have been enacted to provide for the legislative authority to the economic reform programme—such as the tax law, capital market law, import/export and customs law—the most important laws adopted have been Public Business Sector Law No. 203 for 1991 and Investment Law No. 230 for 1989. The first provides for the distinction between management and ownership and therefore opened the door for the implementation of the privatization programme. Moreover, the first law established the holding companies to replace the public sector authority. These companies, which are joint stock companies and operate in an environment similar to that of the private sector, are managed by their respective boards of directors. In addition, this law defines the affiliated companies as those where the holding companies own at least 51 per cent of their capital. This law, which reorganized the public sector enterprises, has been used by the Government as the legislative authority to implement its privatization programme, without resorting to changes in the country's Constitution.

[13] *Al Ahram* (Cairo), 14 October 1996, p. 24.

Law No. 230 for 1989 regulates the establishment of investment projects by the private sector, including Arab and foreign investors in Egypt. The most important incentive provided by this law is the 5 years tax exemption that can be extended to 10 years for those projects that are either of an industrial nature or in remote areas. The law also provides for exemption from the general income tax of up to 20 per cent of the profits after the original exemption period.

Owing to the importance of the stock market in the implementation of the privatization programme in Egypt, the Government enacted Law No. 95 for 1992, which established the capital market that regulates dealing in securities. The law also allows for the establishment of investment funds and is important as the country has applied flotation of shares in the stock market as the main privatization method and therefore required such a law to organize and regulate dealings in the stock market.

4. *Institutional arrangements*

The Public Enterprise Office (PEO) represents the main agency for the formulation, implementation and monitoring of the privatization programme in Egypt. The PEO is responsible to the Cabinet for policy formulation including the selection of privatization candidates, the timing of privatization and the privatization methods on a case-by-case basis. The PEO came into operation in November 1991 to implement the privatization segment of the Economic Reform and Structural Adjustment Programme (ERSAP).[14] The PEO is also responsible for selecting candidates for the boards of holding companies and their management, and reviews the business plans for these companies, as well as candidates for restructuring and/or liquidation. The PEO also works as a channel between the Government and the holding companies.

The second component of the institutional arrangements pertains to the holding companies that are created in accordance with Law No. 203 for 1991 to act as an umbrella for the public sector enterprises. The main role of these companies, which work in accordance with market rules, is to initiate, administer and implement the privatization of the affiliated companies.[15] While the PEO is responsible for the policy issue of privatization including strategy, methods and selection of candidates, the operational aspect of privatization is being undertaken by the holding companies. The holding companies propose to the PEO the list of the affiliated companies for privatization to be approved by the Cabinet before it is presented to the general assemblies of the holding companies for final approval.

Egypt is so far the only country in the ESCWA region that created a sole government entity with direct access to decision-making which provides for speeding up of decision-making, cutting down on bureaucratic procedures and thus saving time needed for decisions on privatization. The central office provides for direct government guidance and overall responsibility for the implementation of the privatization programme and therefore provides for the required political will to formulate, implement and monitor the privatization programme. It also reduces, to a great extent, the resistance by bureaucrats, particularly the general managers of the State-owned enterprises to the privatization programme.

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[14] Arab Republic of Egypt, Public Enterprise Office, *General Procedures and Guidelines for the Government's Programs of Privatization, Restructuring and Reward System*, p. 10.

[15] Ibid., p. 12.

5. *Egypt's privatization experience*

The privatization programme in Egypt commenced with the identification of 314 public sector enterprises, out of 399 public sector enterprises for restructuring. Initially, these enterprises were put under the umbrella of 17 holding companies. These companies were responsible for the management and operations of these enterprises, including the appointment of their boards of directors and general managers. The privatization programme in Egypt calls for both restructuring and evaluation of privatization candidates before the actual sale or liquidation of those enterprises that are not viable even after restructuring. To complete the evaluation on time, the Public Enterprise Office in Egypt solicited the assistance of international agencies and consultancy firms and by the end of 1995 the evaluation of 233 public enterprises out of the 314 was completed.

The first three years of the implementation of the privatization programme were characterized by a slow pace. This is justified by the fact that evaluation and restructuring are time-consuming and there was a sense of hesitation in the beginning out of concern over the short-term impact of the programme on unemployment, which is already a major economic problem in Egypt. Until the end of 1995 the total number of privatized companies reached 30, of which only 3 companies were completely sold to the private sector; 11 companies were sold to the employees and the rest were sold through the stock market.[16]

However, the pace of the privatization programme in Egypt has been accelerated since the new Government took office in January 1996. During 1996, 75 companies were expected to be sold, 14 of which to be completely sold to the private sector; 39 companies to have 51 per cent of their shares sold to the private sector and the rest to have 40 per cent of their shares sold. This Government seems to be more committed to carry out the privatization programme and has provided a wide range of incentives, including allowing the private investors to purchase the land on which their enterprise is built.

The revenues received from the sale of shares of the 14 companies that were totally privatized in 1996 reached about LE 1.08 billion, while the book value was only about LE 300 million. The revenues received from the sale of these companies were more than three times as much as the book value, which reflected the high demand for the shares of these companies.

The selling procedures differed among these companies. While El-Nasr Transformer and Electrical Industries Company was sold to a sole investor, the Alexandria Company for Pharmaceutical and Chemical Industries was totally sold to individuals through the stock market (table 1). Most of the companies sold, with the exception of four companies—Alexandria Company for Pharmaceutical and Chemical Industries, El-Nasr Transformers and Electrical Industries, Al-Ameria Cement Company and El Ahram for Beverages Company—sold parts of their shares to the employees. However, the share of the employees represented by the Employee Shareholders Association varied from 33.3 per cent in the Middle East Flour Mills to only 6.7 per cent in Kafr El-Zayat Insecticides and Chemical Company.

[16] Atif Abeid, Minister of Public Enterprise Sector and Minister of State for Administrative Development and Environment in Egypt, *Privatization, the Egyptian Experience*, February 1996, p. 20.

TABLE 1. EGYPT: THE IMPLEMENTATION OF THE PRIVATIZATION PROGRAMME FOR THE YEAR 1996

Company name	Number of shares					Total value in Egyptian pounds
	Individuals	Company	Investment funds	Employee Shareholders Association	Totals	
Middle Egypt Flour Mills	1 470 000	130 000	270 000	935 000	2 805 000	50 490 000
Madinat Nasr for Housing and Development	1 590 730	421 700	585 100	400 000	2 997 530	194 839 450
Societe Financièr at Industrielle Egyptienne	1 659 775	64 200	378 690	324 852	2 427 517	72 825 510
South Cairo Flour Mills	614 090	129 450	189 990	300 000	1 183 530	30 771 780
Alexandria Co. for Pharmaceutical and Chemical Industries	200 000	0	0	0	200 000	13 600 000
Egyptian Company for Starch and Glucose	1 880 775	157 675	256 710	460 000	2 755 160	96 430 600
El-Nasr Transformers and Electrical Industries	0	7 097 329	0	0	7 097 329	113 557 264
Al-Ameria Cement Company	214 570	601 000	1 677 000	0	2 492 570	114 658 220
El Ahram for Beverages Company	156 480	520 000	0	0	676 480	45 324 160
Misr Oil and Soap Company	1 521 800	726 025	415 000	600 000	3 262 825	101 147 575
Kafr El-Zayat Insecticides and Chemical Company	584 680	237 350	14 250	60 000	896 280	25 992 120
El-Nasr for Dehydrating Agricultural Products	364 560	5 040	26 150	80 000	475 750	18 078 500
The Nile Match Company	614 145	249 775	249 965	177 575	1 291 460	34 869 420
West and Middle Delta Flour Mills Company	2 629 400	709 175	34 650	750 000	4 123 225	164 929 000
			Grand Total			1 077 513 599

Source: Capital Market Authority, Information Center (Cairo), 1996.

Investment funds have also increased their participation in the Egyptian privatization programme; their holdings in the 14 companies privatized in 1996 ranged from 67.3 per cent in the Al-Ameria Cement Company to 19.5 per cent in the Madinat Nasr for Housing and Development and only 1 per cent in the West and Middle Delta Flour Mills Company.[17]

In addition, about 1,400 small-scale enterprises have been sold since the launching of the privatization programme. Moreover, agricultural assets worth about LE 1.1 billion were also sold to the private sector.

The privatization programme in Egypt is expected to accelerate in the coming few years. The 1997-1998 privatization programme in Egypt calls for the sale of another 52 companies: the majority of the stocks, for 40 companies, will be sold through the stock market. In the remaining 12 companies, only 40 per cent of the stock will be sold. If this is implemented as planned, by the end of 1998 about 157 public enterprises will have been sold, representing about 50 per cent of the total number of the 314 public sector enterprises selected for privatization.

6. *Problems facing the private sector in Egypt*

Despite the substantial progress made to provide the stable macroeconomic environment necessary to the participation of the private sector in economic development, and despite the success that has been achieved in the economic reform programme, several constraints still exist and need to be addressed. The three most important issues to be addressed are the following:

(a) The need for unified laws and regulations governing and regulating the activities of the private sector in order to formulate a comprehensive law to reduce confusion, time and effort for the private sector. This is particularly important for the entry laws, incorporation and licensing approvals. In addition, the judicial system, which is the most important factor in the expansion of private sector activity, needs to be updated to cope with the rapidly changing developments, particularly in the area of commercial disputes. Lack of or slow contract enforcement and inefficient property right laws negatively affect the participation of the private sector.

(b) The need to provide the private sector in Egypt with adequate financial resources. The country's capital market is small, with limited capacity to provide credit to the private sector, while the banking system does not provide long-term finance to the private sector. This lack of long-term finance tends to hinder the private sector from engaging in long-term projects.

(c) There is an urgent need to issue an anti-monopoly law and consumer protection law to promote the government's monitoring capability and to protect the consumer against any unjustifiable increase in prices or drop in quality of produced goods and services.

This problem can be solved through the establishment of a development bank with adequate capital to meet the financial needs of the private sector.

[17] Calculation based on data from the Capital Market Authority, Information Center (Cairo).

B. JORDAN

1. *An overview*

The Jordanian economy has benefited, directly and indirectly, from the oil boom era in the GCC countries. Both direct budget support, particularly from Saudi Arabia, and the employment of tens of thousands of Jordanian nationals in Kuwait, Saudi Arabia and the United Arab Emirates, provided the economy with the needed foreign exchange and hence contributed substantively to the implementation of ambitious development plans. However, the recessionary conditions that prevailed in the region in the mid-1980s and that were precipitated by a sharp drop in oil prices and revenues, spilled over to the Jordanian economy. The country suffered from a sharp drop in economic assistance from the major oil-exporting countries in the region as a result of the restrictive fiscal policies pursued by these countries and the return of a large number of expatriates from the Gulf region owing to the tightening of labour markets. The economic conditions in Jordan reached a crisis level in 1988 as a result of the sharp drop in the value of the Jordanian currency (the Jordanian dinar) and the subsequent rise in prices. Economic growth dropped to an average negative rate of 3.1 per cent during the period 1985-1993. This led the country to engage in an economic stabilization and structural reform programme under the auspices of both the IMF and the World Bank. As a result, the country's macroeconomic environment improved substantially. The GDP growth rate increased from a negative 13.4 per cent in 1989 to a positive 6.4 per cent in 1995.[18] The budget deficit also dropped from 18 per cent of GDP in 1991 to only 6 per cent in 1994,[19] reflecting mainly the tight fiscal policy pursued by the Government during the period. However, the budget deficit in 1995 was estimated to have increased to 6.4 per cent of GDP, owing mainly to the 12.6 per cent increase in the government expenditure against an increase of only 10.2 per cent in domestic revenues. Despite that, the country is still on course in implementing its structural adjustment and economic reform policy. External imbalances have also been reduced as the current account deficit dropped (as a percentage of GDP) from 14.3 per cent in 1990 to 6.3 per cent in 1995, reflecting mainly the improvement in the performance of exports, which increased by 67.8 per cent during the period 1991-1995, while imports rose by only 51.4 per cent. In line with the implementation of the economic reform policies in Jordan, and in order to encourage the participation of the private sector, the Government enacted a new investment law in 1995. Among the most important policy changes introduced by this law were the establishment of the Supreme Council for Investment Encouragement under the chairmanship of the Prime Minister. The main objectives of the Council are to provide the right investment environment, adopt national strategy for investment, adopt investment policy in Jordan and formulate investment promotion strategy to attract both domestic and foreign capital. In addition, the law calls for the creation of an establishment to encourage investment, with autonomous financial and managerial functions, and with the objectives of promoting confidence in the investment environment in Jordan and facilitating the procedural aspects of investment projects; the law also calls for the creation of an investment window responsible for project licensing. The most important element in the functioning of this proposed establishment is to reduce the approval time for investment projects to only 30 days, within which the investor will receive a reply; in the past this procedure used to take, in some cases, up to six months.

The most important incentives provided by Law No. 16 for 1995 are:

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[18] Central Bank of Jordan, *Monthly Statistical Bulletin*, vol. 32, No. 7, July 1996, p. 7.

[19] *IMF Survey*, 25 September 1995, p. 289.

(a) The law classifies the development areas into A, B and C according to the level of economic development in each area in a descending manner, starting with A, which is the most developed area of the country and C, which is the least developed area. The investment project is exempt for 10 years from income tax and social services tax according to the following criteria (article 7 of Law No. 16):

(i) 25 per cent if the project is in area A;
(ii) 50 per cent if the project is in area B;
(iii) 75 per cent if the project is in area C.

(b) The law provides exemptions from taxes and duties on the fixed assets of the investment project, provided that these assets have entered the country within three years of the project's approval (article 6 of Law No. 16).

(c) The law grants exemptions from tax and duties on spare parts of the investment projects provided that the value does not exceed 15 per cent of the fixed assets, and also provided that they are used in the project within 10 years of the production date of the project.

(d) The law provides exemptions from tax and duties on the project's fixed assets that are needed for the expansion of the project provided that it would lead to a 25 per cent increase in production capacity.

In addition to the adoption of a new investment law, the Government has introduced tariff reform through which the maximum tariff rate has been reduced by 10 per cent to reach 50 per cent,[20] except for luxury items such as cars. Basic tariffs exceeding 50 per cent were also reduced to only 50 per cent, except for three items.[21] However, the most important tax reform was introduced in 1994 when the consumption tax system was replaced by the General Sales Tax. The basic rate of the sales tax was 7 per cent, which was later increased to 10 per cent and a rate of 20 per cent applying to 30 luxury goods.[22] This reform package reflects the Government's determination to secure a stable macroeconomic environment that provides the private sector with adequate incentives to increase its participation in the economic development of the country.

2. *Privatization experience in Jordan*

Traditionally, the private sector has always played a major role in economic development in Jordan. However, the public sector still dominates a significant part of the economic activity in the country, where it is still the major employer: recent figures indicate that about 46 per cent of the workforce is employed directly or indirectly by the Government.[23] Moreover, the Government controls a substantial part of the public shareholding companies that belong to the private sector. In 1994 the share of the public sector in

[20] *IMF Survey*, 25 September 1995, p. 290.

[21] Ibid.

[22] Ibid.

[23] The *Jordan Times*, 15 September 1996.

the shareholding companies reached about 50 per cent of the shares of 20 per cent of these companies and over 10 per cent of the shares of 56 per cent of the remaining companies.[24]

The implementation of a privatization policy has been under review in Jordan since the mid-1980s, when economic growth dropped sharply and the budget deficit worsened, reflecting, in part, the drop in economic assistance from the Gulf oil-exporting countries, in particular Kuwait, Saudi Arabia and the United Arab Emirates.

The Government has been laying the ground for the implementation of the privatization programme. Investment Law No. 16 for 1995 represents the main legislative authority to expand the role of the private sector. The privatization policy of Jordan is similar, in many ways, to that of Egypt as it provides for the sale of part of the public sector to the private sector. However, it remains limited compared with the Egyptian experience and still lacks comprehensiveness. This is justifiable as Jordan's public sector is smaller than that of Egypt and economic growth in Jordan has achieved the planned targets for the past few years. In addition, public sector enterprises, with the clear exception of Royal Jordanian (the national airline) and the Public Transport Corporation, do not represent a sharp drain on the budget as they have in Egypt.

Moreover, in addition to the lack of legislative authority, the privatization policy in Jordan still needs institutional arrangements that would be responsible for policy formulation, implementation and monitoring of the privatization process. The Government is considering the establishment of a governmental agency linked to the Prime Minister's office. This body, when created, would be a clear indication that the Government is committed to the implementation of the privatization process, as this body would formulate policies and update laws and regulations that would accelerate the process and identify privatization candidates.

However, in practical terms, only limited steps have been taken to implement the privatization programme in Jordan. The first three public sector enterprises that are candidates for privatization, namely the Public Transport Corporation, Royal Jordanian, and the Jordan Telecommunication Corporation are still under consideration. The Government allowed the private sector to compete in the area of transport with the Public Transport Corporation to ease the transport problem, particularly between the country's major cities of Amman, Zarqa and Jerash. The feasibility study for the privatization of Royal Jordanian has been completed and the Government is currently considering raising the airline's capital from 70 million Jordanian dinars (JD) to JD 210 million. However, it is important to solve the airline's debt problem before privatization. In the area of telecommunications, the Government has allowed the private sector to participate in expanding the telephone network in the country and a private company is currently managing the first mobile telephone network in the country. Among the limited privatization steps that are being taken is transforming the Jordan Electricity Authority into the National Electricity Company. In addition, the Government has sold part of its stocks in several hotels, as well as 55 per cent of its share in the Jordan Hotels and Tourism Company to the private sector.[25] The Jordanian Government has also sold its shares in the Jordan Holiday Hotels and about 9 per cent of its share in the Jordan Paper and Cardboard Factories Company.

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[24] T. Kanaan, *Privatization in Jordan: between Policy and Practice*, Amman, 1995 (in Arabic).

[25] Statement made by the Director General of the Jordan Investment Corporation published in the *Jordan Times*, 3 September 1996.

However, the most important point to be noted here is the expanding role of the private sector in the area of education in Jordan. The private sector is successfully competing by establishing several private schools and universities in Jordan. This subject needs to be assessed further since Jordan is the only country in the region where the private sector has more universities than the public sector. This experience, if it proves successful, might represent a practical solution to the overextension of public sector education services in many countries in the region.

To sum up, the privatization process in Jordan, so far, can best be described as slow. Jordan has not formulated a comprehensive privatization process as has been the case in Egypt. However, the Government is committed to the privatization programme, which is part of its IMF-sponsored economic reform programme. The new Jordanian Government appears to be more determined to implement the country's economic reform programme, including accelerating the privatization process. Once the groundwork in terms of legislative authority and institutional arrangements is completed, the privatization process is expected to accelerate.

C. IRAQ[26]

1. *An overview*

After the end of the war between Iraq and the Islamic Republic of Iran in 1988, the Government engaged in a programme of economic liberalization, reflected in economic deregulation which included encouraging the private sector to participate in activities that had been off limits to it in the past. The programme also included the sale of several public sector enterprises to the private sector.

Among the most important institutional measures undertaken was the enactment of Arab Investment Law No. 46 for 1988, which gave Arab investors a wide range of tax and customs exemptions to help them to participate in the economic development in the country, particularly in the agriculture, manufacturing and services sectors. In addition, the Government issued Law No. 45 for 1989 to encourage the private sector, particularly in the area of trade.

2. *Privatization experience in Iraq*

The Government has, as a first step, transformed public sector enterprises engaged in economic activity into autonomous companies operating in competition with the private sector.

In addition, several non-strategic public sector enterprises have been sold to the private sector, particularly in the areas of tourism, retail trade (Government shopping centres), gas stations and auto services stations. Furthermore, in early 1989, six private and joint companies were established, in addition to the joint companies to manage the Sheraton Hotels in both Baghdad and Basrah, the joint company to serve Al-Habania Tourist Centre at Lake Habania. The Government also announced, at the end of 1989, the transfer of the Government-owned enterprises in the agricultural sector to the private sector.

The Government has adopted several privatization methods depending on the objective to be achieved in each privatization transaction. The methods mixed management contract, joint ventures with the private sector and the sale of public sector enterprises to the private sector.

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[26] This section is a translation from section 4 of the ESCWA study on privatization in Iraq (E/ESCWA/ED/1995/11) (in Arabic).

3. *Problems facing privatization in Iraq*

(a) Lack of credit, particularly in foreign currencies. The country has been subjected to United Nations economic sanctions since August 1990, which prevented it from receiving any economic aid, with the exception of humanitarian assistance;

(b) Lack of adequate infrastructure. The country's physical infrastructure was heavily damaged during the Gulf war of 1991 and the Government's efforts to restore the basic services has been hindered by the lack of spare parts;

(c) Lack of a stable macroeconomic environment. The country has been faced with a chronic inflation problem, a worsening budget deficit, high unemployment and a depreciating currency. These problems discourage the participation of the private sector in establishing economic projects. The activity of the private sector in Iraq has been concentrated on the purchasing of real estate and other properties to mitigate the adverse impact of high inflation.

D. LEBANON[27]

1. *An overview*

Lebanon's economy achieved a relatively high growth rate during the past four years, boosted by the large-scale reconstruction plan and the boom in the services sector in addition to the high growth in the agricultural sector. The country's GDP growth rate averaged about 6 per cent during the period 1992-1995. However, the country still suffers from a widening trade balance deficit as the imports of both capital and consumer goods increased during the past few years. The deficit rose by 310 per cent during the period 1989-1994, increasing from US$ 1.547 billion to US$ 4.802 billion,[28] reflecting mainly the 272 per cent jump in imports. The country's fiscal deficit also increased during the past few years, increasing from 465.5 billion Lebanese pounds (LL) in 1989 to LL 2,846 billion in 1994,[29] a jump of 611.4 per cent. However, in dollar terms, the fiscal deficit rose by only 193.6 per cent, i.e. from US$ 0.921 billion in 1989 to US$ 1.78 billion in 1995.

A large budget deficit is expected as the country implements an ambitious reconstruction plan and repairs basic services. A widening budget deficit negatively affects the inflation rate and the interest rate, and hence discourages the participation of the private sector. Lebanon needs a stabilization programme to reduce both internal and external imbalances. However, this can only be achieved after the completion of the reconstruction plan and the restoration of the basic services. The country also needs the participation of the private sector in the implementation of the reconstruction plan, particularly since financial assistance has been below expectations. For example, to finance the reconstruction plan for Beirut Central District the Government enacted Law No. 117 of 1991 establishing the Lebanese Company for the Restructuring of Beirut

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[27] This is mainly a translation from section 3 of the ESCWA study on "Privatization in the ESCWA Countries with More Diversified Economies" (E/ESCWA/ED/1995/11) (in Arabic), p. 31.

[28] Banque du Liban, annual report for 1994 (Arabic only), p. 79.

[29] Ibid., p. 64.

Central District (SOLIDERE) as a joint stock company with a capitalization of US$ 1.82 billion.[30] The shares of the company are divided into: class A with a total amount of US$ 1.17 billion and issued to the owners of properties in the Beirut Central District; and class B with a total amount of US$ 650 million issued for public offering.[31]

2. *The privatization experience in Lebanon*

The country's private sector plays an important role in economic development, while the public sector is small compared with both Egypt and the Syrian Arab Republic. After the end of the civil strife in Lebanon, the Government tried to introduce an economic reform programme to achieve a stable macroeconomic environment and sustainable economic growth. In this context, the Government established an intergovernmental committee to formulate policy-oriented recommendations to achieve the Government objectives. The committee submitted its report, which included a recommendation for the privatization of several public sector enterprises. The Cabinet, after having studied the report, established a ministerial committee to provide the Government with practical proposals for the implementation of a privatization process in the country.

From the debate that has been going on in Lebanon, two views have emerged. The first calls for the privatization of public sector enterprises, in particular the Telecommunications Company and the Tobacco Company. The second calls for the establishment of joint projects between the Government and the private sector, with the role of the Government limited to monitoring and control, while the management is implemented by the private sector.

The Government also issued a law aimed at reforming the public sector enterprises that deal with investment. The law provides for these government enterprises to work in an environment similar to that in the private sector. The Government also opened the Beirut stock exchange in 1995 to mobilize domestic and foreign savings.

The privatization process in Lebanon has been very slow and the preoccupation of the Government is still in the area of reconstruction to prepare the groundwork for the active participation of the private sector. The availability of a developed and modern infrastructure will certainly help to encourage the private sector to increase its participation in the country's economic activities. A modern infrastructure coupled with a stable macroeconomic environment that is market friendly is a prerequisite to the implementation of the privatization programme. In addition, political stability and in particular the conclusion of a just and comprehensive peace in the Middle East is an important factor in the inflow of foreign direct investment to the region including Lebanon. One of Lebanon's first privatization transactions has been in the area of public telephones. To ease the shortages of telephone lines, the Government assigned two contracts on a Build, Own and Transfer (BOT) basis to two foreign companies for 10 years. The Government is also considering the same privatization method for the paving of the Beirut-Damascus highway.

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[30] SOLIDERE, *Annual Report, 1995*, p. 1.

[31] *The Development and Reconstruction of Beirut Central District, Information Booklet, 1995* (Beirut, SOLIDERE), p. 4.

3. *Problems facing the privatization programme*

(a) A large number of public sector enterprises, particularly in the area of telecommunications, electricity and water, are loss-making companies, and are therefore not able to attract private sector investors. These enterprises are in need of restructuring plans before they can be privatized.

(b) Lebanese and foreign private sector investors are reluctant to invest in Lebanon before a comprehensive and just peace in the region is achieved.

(c) There is public resistance, particularly among the poorest segments of the population, to the launching of a privatization programme because of concerns about the resulting increases in prices of services during the economic hardships associated with the initial periods of such programmes.

(d) A part of the Lebanese private sector is still reluctant to engage in establishing investment projects in the country before the completion of the restoration of basic services, the development of the country's infrastructure and the settlement of the Middle East conflict.

E. Syrian Arab Republic

1. *An overview*

The Syrian economy has a relatively diversified economic base where agriculture, oil, tourism and manufacturing play a major role in economic growth and development. The agricultural sector is the most important sector both in terms of its contribution to GDP and employment. In 1994 the agricultural sector contributed 28 per cent of the GDP, followed by the wholesale and retail trade (27 per cent), the manufacturing sector (13 per cent) and government services (10 per cent).

Economic growth, as measured by GDP, has been satisfactory for the past four years. The GDP growth in 1985 prices ranged from 7.6 per cent in 1990, to 7.1 per cent in 1991 and 6.2 per cent in 1994.[32] The relatively high economic growth was boosted by the expansion in the agricultural sector (growth in the agricultural sector averaged 11.4 per cent during the period 1990-1994), the expansion in oil production, which increased from an average of 398,000 barrel per day (b/d) in 1990 to an average of 575,000 b/d in 1994, and the rise in number of tourists—from about 1.4 million in 1990 to about 2 million in 1994. The relatively strong economic growth and the fact that the Syrian Arab Republic's economy has not faced economic crises during the past few years can explain the gradual and cautious approach that the country is following to implement economic reform policies. In addition, there are concerns about the short-term negative impact that rapid economic reform could have on inflation and unemployment. The most interesting observation about the economic reform policies being implemented in the Syrian Arab Republic is that they are being implemented at the Government's own initiative without direct supervision from the World Bank and the IMF, as has been the case in both Egypt and Jordan. This gave the Syrian Government more flexibility in undertaking reforms on a step-by-step basis under the slogan of economic pluralism. Although currently the Government appears under no pressure to speed up the implementation of the economic reform policies, measures are being taken in the areas of fiscal consolidation, exchange rates and reform of the banking sector.

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[32] Calculated from the Syrian Arab Republic, Office of the Prime Minister, Central Bureau of Statistics, the Statistical Abstract, 1995 (in Arabic), p. 485.

In this context, the Government is seriously considering several measures, including gradually allowing the Syrian pound to depreciate to the level prevailing in the neighbouring countries and then fluctuate in accordance with the level prevailing in those countries. The second most important measure under active consideration is allowing Syrian residents to open bank accounts in hard currency. The most important objective of this move was to repatriate to the Syrian Arab Republic large sums of money deposited by Syrian nationals in bank accounts in the neighbouring countries, particularly Cyprus, Jordan and Lebanon.

2. *Legislative authority*

The most important legislative authorities under which economic reforms are being implemented in the Syrian Arab Republic are Law No.10 of 1991, which provides incentives for the private sector to expand its activities in the economy and Law No. 20 of 1994, which provides flexibility for the public sector in the areas of management and operations to work in an environment closer to that of the private sector, including the introduction, for the first time, of the element of economic rent as an objective for the public sector.

Law No. 10 of 1991 governs capital investment by the private sector, both Syrian and foreign. The law established the Supreme Investment Council, under the chairmanship of the Prime Minister. The Supreme Council meets at least once every two months to review and approve investment projects submitted to it by the investment office attached to the Vice President of the Council of Ministers for Economic Affairs and headed by a Vice-Minister. The law provides incentives to the private sector for agricultural, industrial and transport projects that are in line with the country's economic objectives, exploit available domestic resources to the maximum extent, provide employment opportunities for the Syrian labour force and provide for access to the latest available technologies and management techniques. The main functions of the Supreme Investment Council are to grant approval for the establishment of investment projects, determine the share of the public sector in the joint projects and give permission for the establishment of joint companies and corporations.

The most important incentives provided by Law No. 10 for 1991 are:

(a) The approved project is granted exemption from import duties, taxes and customs duties as well as other charges for the importation of all machineries, plants, equipment, cars and buses needed for the activities of the projects.

(b) The investor has the right to open an account in a foreign currency with the Syrian Commercial Bank and deposit up to 100 per cent of the project capital paid in foreign currency and 75 per cent of the export earnings of the project.

(c) The investor may borrow from the local banks in local currency for the activities of the project.

(d) Investment Law No. 10 of 1991 also organizes the establishment of joint ventures in which public sector holdings would be at least 25 per cent of the total. Joint ventures established under this law are exempt, in addition to the above-mentioned exemptions, from stamp duties on issuance of their capital shares. Furthermore, resident Syrians, Arab and foreign investors are allowed, after five years from the beginning of the project's operation, to transfer abroad, in foreign currency, the net value of the share of the project, provided that it does not exceed the capital initially brought to the country in foreign currency. If the project is not implemented, provided the failure is caused by circumstances beyond the investor's control, the investor can repatriate foreign capital abroad after six months from the initial preparation of the project. Moreover,

the investor has the right to transfer profits and interests earned from the investment of foreign capital in the country.

Furthermore, the Government issued Law No. 20 for 1994 which organizes the creation of public establishments, public companies and public corporations. This law provides for flexibility in the operations of these firms in the following areas:

(a) Establishment of branches in the country and abroad [article (4)A(1)];

(b) Signing of loan contracts with government, domestic and foreign financial institutions, provided that this does not contradict with the authority given to the Ministry of Planning [article (5) A(5)];

(c) The board of directors of the firm, company or corporation is the main authority in policy formulation to achieve the set objectives. In particular, the board has the widest authority for management, including planning and implementation of activities with the purpose of achieving adequate economic revenues in accordance with the country's economic policy and planning [article (10)].

(d) The board of directors is responsible also for the adoption of the annual investment, production and trade plans of the public establishment or corporation. Moreover, the board is responsible for the employment, planning and indicative budgets of the corporation [article 10 (5)].

In general, this law gives the public sector in the Syrian Arab Republic more flexibility in establishing and managing public sector enterprises to achieve adequate economic returns on capital. This approach differs from the previous mandate of the public enterprises, which was to provide public commodity services without taking into consideration the profit dimension of the operation of these enterprises. This law, which is issued to reform the public sector enterprises to work in an environment relatively close to that of the private sector, complements Law No. 10 of 1991, which organizes the activities of the private sector both domestic and foreign. Both laws provide the basic institutional and regulatory framework for the activities of both private and public sectors in the country.

3. *The role of the private sector*

Despite the predominant role of the public sector in the Syrian Arab Republic, the private sector has always played an important role in the economic development of the country, and the agricultural and retail trade sectors have traditionally been dominated by the private sector.

The importance of Law No.10 of 1991 is that it raises the ceiling under which the private sector in the country operates and it provides incentives for Syrian expatriates, Arab investors and foreign capital to take part in economic activities in the country. The law's main condition for approving the establishment of projects in the country is the transfer of capital from abroad in foreign currencies as a prerequisite to establishing this project in certain economic sectors such as agriculture, manufacturing and transport. The main beneficiaries of this law are the Syrian expatriates, Arab and foreign investors. In addition, the Government has opened new activities for the private sector to attract foreign capital such as electricity generation and marine transport. As a result of the adoption of the new economic policies, the private sector has expanded its share in the economic activities of the country. At the moment, the private sector dominates about 98 per cent of the agricultural sector, 95 per cent of land transport and almost two thirds of the manufacturing sector, with the exception of the oil industry, and about 55 per cent of the foreign trade, with the exception of oil exports. Among the most important steps adopted to enlarge the role of the private sector

in exports was the elimination of export licences; this allows the private sector to keep up to 75 per cent of the export earnings for the importation of raw materials and other inputs, while the rest is transferred into local currency at the rate prevailing in the neighbouring countries. Furthermore, the exporters of agricultural products can keep up to 100 per cent of their export proceeds. The production tax has been eliminated for both cotton and olive oil. However, the exportation of both cotton and wheat is still in the public sector, owing to the fact that these commodities are defined as strategic.

As a result of the implementation of Law No. 10 of 1991, the number of projects approved up to July 1996 reached 1,514, with a total investment cost of 358.5 billion Syrian pounds (LS) (table 2). These projects covered a wide range of economic activities in the country. The transport sector received the highest priority in the number of approved projects—1,834 projects or 55 per cent of the total and 25 per cent of the total investment cost—followed by the manufacturing sector, with 626 projects representing 41.3 per cent of the total number of projects and 68.9 per cent of the total investment cost. The new activities opened for the private sector for the first time were electricity generation, with two projects approved for the establishment of two power stations to be financed by businessmen from the Gulf region. In the area of marine transport, two projects were approved. The foreign currency components of the manufacturing sector projects represent about 76.2 per cent of the total; for electricity generation they represent 94.4 per cent, for marine transport 98.5 per cent and for the transport sector 63 per cent. The total number of approved projects is expected to generate 103,900 new jobs, which will contribute to easing the unemployment problem in the Syrian Arab Republic.

TABLE 2. THE SYRIAN ARAB REPUBLIC: TOTAL NUMBER OF APPROVED INVESTMENT PROJECTS ACCORDING TO INVESTMENT LAW NO. 10 FOR 1991

Sector	Number of projects	Investment cost (millions of Syrian pounds)
Agriculture	48	21 541
Manufacturing	626	247 047
Electricity and power	2	1 739
Land transport	834	86 584
Marine transport	2	1 197
Others	2	399
Total	1 514	358 507

Source: Syrian Arab Republic, Office of the Prime Minister, The Investment Office.

However, despite the rapid expansion of the role of the private sector in the economic development in the country, more progress in expanding economic reform and liberalization policies is needed, particularly in unifying the exchange rates of the Syrian pound and the reform of the banking sector, both of which are needed to boost the contribution of the private sector by providing a stable macroeconomic environment with a real exchange rate and positive interest rates.

The Government has embarked upon further liberalization policies in this direction, though they are limited in scope. Among the recent measures to be taken is raising the exchange rate of the Syrian pound gradually, to the prevailing level in the markets of the neighbouring countries. This will reduce, and later

on eliminate, the gap between the Syrian pound's level in the country and in these markets, particularly since the new rate is not fixed but fluctuates according to its levels in these markets. In addition, Syrian residents would be allowed to open bank accounts in foreign currency with the Syrian Commercial Bank. Therefore, measures which are expected to be implemented soon would further encourage the private sector to participate in the economic development of the country. These measures, together with the gradual unification of the currency exchange rates and the liberalization of the interest rates, would speed up the liberalization of the monetary policy of the country and thus promote the contribution of the private sector to economic development. The unification of the exchange rates is particularly important for the private sector, as it is now competing on an unequal footing with the public sector in terms of hard currency, as the private sector is buying the hard currency at commercial rates that are available in the neighbouring countries while the public sector gets it at the official rate.

The reform of the banking system is apparently progressing slowly. The latest government target is to establish an export promotion bank. However, in general, the banking system in the country is still directed towards satisfying the credit needs of the public sector where more than 80 per cent of credit is provided to the public sector, including government borrowing. The banking system, which is composed of the Central Bank and five specialized banks, needs to be reformed in order to meet the increased credit requirements of both the public and private sectors and promote opportunities for foreign direct investment. The reform of the banking system should touch upon the credit ceiling, liberalization of interest rates, the issuance of government bonds and the introduction of the competitive element in the operations of the banking system.

The establishment of a stock market in the country does not seem to be on the list of priorities in the Government's economic reform and liberalization policies. Upgrading and liberalizing the banking system receives more attention, at the moment, from the creation of a domestic stock exchange. This is understandable since the Government is not planning to sell part of the public sector enterprises to the private sector.

The Syrian privatization experience can be characterized as cautious, applying a gradual approach, particularly in these areas that would directly affect prices and unemployment. The Government is strongly concerned about the impact of rapid and uncalculated economic reform on the living standard of the poorer segments of the population. At the moment, it seems there are no compelling reasons for the Government to change its cautious approach towards economic reform policies. As the Government is not under any kind of pressure from the international financial organizations and the donor countries, and as the country is not facing any economic crisis that would put pressure on the Government to speed up the implementation of reform, it prefers to withdraw slowly from certain economic activities such as the agricultural and transport sectors, and open the door for the private sector in almost all economic sectors to compete with the public sector. The Syrian experience differs, in certain aspects, from the Egyptian experience, particularly in the following areas:

(a) The Syrian economic reform is not being implemented according to an approved comprehensive programme for economic reform such as is the case in Egypt.

(b) The Syrian experience is domestically generated, implemented and monitored, while Egypt's programme is being implemented in cooperation with the IMF and the World Bank.

(c) The Syrian privatization programme does not include the selling of part of the public sector (privatization from above) and is limited to providing the private sector with financial and tax incentives to

expand its role in the economic development of the countries (privatization from below). While Egypt is implementing both types of privatization, it is selling part of the public sector enterprises to the private sector and providing incentives to the private sector to expand its role in the economy.

(d) The Syrian Arab Republic has not established a specific agency for privatization as it has not decided on a divestitive approach towards privatization, while in Egypt the government has established the Public Enterprises Office as the Government's main privatization aim. The PEO is mandated to formulate, implement and monitor the privatization programme in Egypt under the direct supervision of the Prime Minister.

(e) The economic reform policies in the Syrian Arab Republic have been implemented at a slower pace than in Egypt. In Egypt, the privatization programme represents the second stage of the economic reform policies, which started with the structural adjustment programme to correct macroeconomic imbalances and create an economic environment conducive to the participation of the private sector.

The Syrian Arab Republic is pursuing a more continuous approach towards economic reform and the main objectives at the beginning are to encourage the private sector to expand its role in the economy and provide the public sector with flexibility in the areas of management and operational activities to compete with the private sector.

(f) Both countries are providing incentives to the Arab and foreign private sector to participate in economic development. However, since the economic reform policies in Egypt have been more comprehensive and the privatization programme allows for the divestitive approach, the participation of foreign direct investment in Egypt is more active, particularly through the Egyptian stock exchange.

The Syrian Arab Republic needs to do more to attract the needed foreign investment, particularly in the areas of exchange rate, inflation and the reform of the banking system, especially since it is not yet planned, for the time being, to establish a stock market.

(g) The main philosophical difference between the two experiences is that the Syrian Arab Republic still considers the public sector as the main sector through which the government development objectives can be achieved, and that both the private and public sectors complement each other. In addition, an increase in efficiency, which is the main objective of the privatization programme, is believed to be attainable through the reform of the public sector and by providing it with the necessary incentives to work in an environment closer to that of the private sector. Egypt, on the other hand, believes that privatization is the most important factor in increasing efficiency, providing access to foreign capital, technologies, modern production methods and new markets for exports.

IV. PRIVATIZATION IN THE GCC COUNTRIES*

A. BAHRAIN

A well developed financial sector and a relatively sophisticated stock exchange have contributed to the success of recent attempts to privatize some government-owned entities. Divestment of State assets in the manufacturing, agricultural and fisheries sectors has taken place. In January 1994, the Government sold a 20 per cent stake in one of the country's largest food firms, the General Trading and Food Processing Company, on the Bahrain stock exchange for 3.9 million Bahrain dinars (BD) (US$ 10.3 million).[33]

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

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

There are 34 companies traded on the Bahrain Stock Exchange with a total capitalization of US$ 5.9 billion at end-1994. Among the companies which raised capital through public flotation recently was the Bahrain Leisure Company, a new company founded to promote tourism. A BD 2.75 million (US$ 7.3 million) public share was issued on 6 June 1994. The shares offered by Al-Ahli Commercial Bank of Bahrain, which came on the market in May 1994, were fully subscribed.

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

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* This chapter is a reprint of chapter IX of the ESCWA study on *Privatization in the Gulf Countries* (E/ESCWA/ED/1995/8).

[33] *Middle East Economic Digest* (MEED), 1 February 1994.

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[33] *Middle East Economic Digest* (MEED), 1 February 1994.

B. KUWAIT

1. *An overview*

Economic growth in Kuwait picked up during the last few years, boosted by a massive reconstruction plan, higher oil prices and an increase in consumer spending. The GDP is estimated to have grown by 2.9 per cent in 1995, up from a negative growth rate of 0.4 per cent in 1994.[34] The country has also succeeded in reducing its budget deficit in the fiscal year 1995/1996 mainly through an increase in public revenues. The budget deficit is estimated to have dropped to 1.3 billion Kuwaiti dinars (KD), down from KD 1.5 billion in fiscal year 1994/95.[35] The narrowing of the fiscal imbalance will help the Government to eliminate the budget deficit by the year 2000. Although the inflation rate picked up in 1995 compared with 1994, it remains relatively under control as has been the case in the rest of the GCC countries. The main factor behind the slight pick-up in the inflation rate in 1995 was higher consumer spending. However, the Government's efforts to reduce the budget deficit will help to control the budget deficit in the coming years.

2. *Privatization experience in Kuwait*

Kuwait has accepted in principle recent World Bank recommendations which urged the privatization of 74 local industries including 62 companies in which the Kuwait Investment Authority (KIA) has shares. The Government holds shares in 37 companies out of the 48 listed on the Kuwaiti stock exchange and the total value of its holdings is put at KD 864 million (US$ 2.9 billion) or 26 per cent of the market's total capitalization. Government stakes in 16 out of the 37 companies are between 50 per cent and 100 per cent. The Government holds shares of between 25 per cent and 49.99 per cent in seven of these companies and has shares of less than 25 per cent in the rest (table 3).

There are several companies targeted for privatization that are not listed on the Kuwaiti stock market. It is estimated that the total value of the Government's shares in the companies that are targeted for privatization (excluding oil sector companies) is around KD 4 billion (US$ 13.5 billion), including KD 2.2 billion (US$ 7.3 billion) in electric power and water facilities, KD 200 million (US$ 666 million) in telecommunications facilities, KD 420 million (US$ 1.4 billion) in Kuwait Airways Corporation and KD 800 million (US$ 2.66 billion) representing KIA shares in 62 companies, some of which are listed on the stock exchange.[36]

The privatization process is targeted to encompass a number of downstream oil companies including Kuwait Oil Tanker Company, Kuwait Aviation Fuelling Company, Kuwait Foreign Exploration Company, Santa Fe International in the United States of America, petrol stations owned by Kuwait National Petroleum Company and any new projects by the Petrochemical Industries Company. In 1994, the Government sold to the private sector 20 new gasoline stations, some of which were not yet operational. The natural gas factory and the lubricating oil factory have been slated to go to the private sector. The privatization project would be carried out through the establishment of a public shareholding company, 20 per cent of whose

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[34] *Survey of Economic and Social Developments in the ESCWA Region, 1995* (United Nations publication, Sales No. E.96.II.L.18), table 8.

[35] Ibid., chap. IV.

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

shares would be owned by the Kuwaiti Government with the remainder offered for public subscription. The 75 stations currently operating in Kuwait are to be gradually sold to a number of specialized local firms to enable them to provide better services to the public.

TABLE 3. KUWAIT: GOVERNMENT SHARES IN JOINT STOCK ENTERPRISES, 1992

	Percentage government shareholding*
Banks	
National Bank of Kuwait	1.67
Commercial Bank	8.50
Gulf Bank	17.60
Al-Ahli Bank	8.50
Bank of Kuwait and Middle East	58.80
Burgan Bank	60.99
Real Estate Bank	33.68
Kuwait Finance House	32.58
Investment companies	
Kuwait Investment Company	70.08
Kuwait Foreign Trading, Contracting and Investment Company	99.58
Kuwait International Investment Company	31.94
Insurance companies	
Kuwait Insurance Company	7.52
Gulf Insurance	75.18
Al-Ahlia Insurance	20.29
Warba Insurance	55.82
National Industries	58.08
Metal Pipe Industries	17.84
Kuwait Cement	36.57
Kuwait Fisheries	55.83
Refrigeration Industries	60.42
Kuwait Shipbuilding & Repair Yard	56.38
Kuwait United Poultry	56.38
Gulf Cable	28.81
Kuwait Pharmaceutical Industries	n.a.
Transport	
Livestock Transport & Trading Company	54.53
United Arab Navigation	19.50
Overland Transport	n.a.
Real estate companies	
Kuwait Realty	13.70
United Real Estate	57.85

TABLE 3. (*continued*)

	Percentage government shareholding*
National Real Estate	25.22
Kuwait Commercial Markets Complex	16.40
Service companies	
Kuwait National Cinema	3.18
Kuwait Hotels	73.98
Kuwait Foodstuff	34.50
Agricultural Products	49.46
General Warehousing	53.00
Mobile Telephone Systems	50.44

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

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

n.a. = Percentage not available.

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

The Kuwait Investment Authority announced plans to sell most of its portfolio of shares in more than 60 joint stock companies acquired following the collapse of the Kuwait stock market in 1982. At the end of 1994, the value of these holdings was estimated at KD 800 million (US$ 2,700 million). In 1994, the Kuwait Investment Authority sold a 52 per cent share in the local United Real Estate Company to the Kuwait Investment Projects Company (Kipco), a private sector investment firm. Kipco has agreed to resell 57 per cent of this (representing 30 per cent of the real estate company) to the private sector at a 7 per cent discount.[37] The Kuwait Petroleum Corporation (KPC) has also announced a decision to put up for sale the oil and gas explorations of its wholly-owned United States-based subsidiary, Santa Fe International Corp. Santa Fe International's oil and gas operations are primarily in the United States.

The pace of privatization has quickened decisively in 1995. Since January, the KIA has successfully sold shares in four companies. At the start of June 1995, it announced it would sell at auction 170 million shares worth almost KD 90 million (US$ 300 million) in the National Industries Company, a leading local manufacturing firm, in the most valuable share offering so far. This will raise the value of shares sold by the KIA since the start of 1994 to more than KD 220 million (US$ 736 million). Expectations are mounting that further sales of shares will take place. Candidates include Kuwait Aviation Catering Services Company owned by Kuwait Airways Corporation, Warba Insurance Company and Refrigeration Industries Company.[38]

[37] *MEED Middle East Business Weekly*, 7 July 1995.

[38] *MEED Middle East Economic Money Weekly*, 6 June 1995.

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

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

Privatization through the establishment of investment funds and open auction has actually started. Since April 1994, two mutual funds have been established to acquire shares in companies and real estate assets held by the investment body. In May 1994, KIA sold its KD 10.4 million shares in the local Land Transport Company through an open auction, followed in December 1994 by the sale of 60 million shares of its holdings in Al Ahli Bank through open auction to Kuwaiti and GCC members' citizens. The sale realized around KD 10 million (US$ 33.7 million) for the Government. In 1994 KIA was also successful in selling part of its shares in a profitable consumer finance firm, the Commercial Facilities Company, during September 1996. The public share offering was oversubscribed fivefold and the KIA share was reduced from 55 per cent to 38 per cent.

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

In total, the KIA sold 1,066.6 million shares in 13 local companies between September 1994 and June 1996, which represented about 79 per cent of its shares in these companies (table 4). This included the sale of KIA total holdings in four companies, namely the Commercial Markets Complex, the National Real Estate Company, the Palms Agro Production Company and the Industrial Investments Company.

The privatization programme in Kuwait has, so far, been limited to the sale of shares in companies in which the private sector is already participating. At the time of this writing, the public sector enterprises had not been offered for sale.[39] The scope of the speed of the privatization programme in Kuwait will depend on whether the Government allows the privatization of public sector enterprises.

[39] National Bank of Kuwait, *Economic and Financial Quarterly*, ii/1996, p. 39.

TABLE 4. SALE OF KIA SHARES IN LOCAL COMPANIES THROUGH 30 JUNE 1996

Name of the company	Date of sale	Total number of outstanding shares at time of sale (millions)	Number of shares owned by KIA before sale (millions)	Number of shares sold (millions)	Value of shares sold (millions of KD)	Method of sale
Commercial Facilities Company	September 1994	177.1	98	70.5	40.3	Public Subscription
Al-Ahli Bank of Kuwait	December 1994	554.1	89	60	10.23	Auction
United Real Estate	February 1995	427.3	268	220	27.5	Auction and Public Subscription
Al-Ahlia Insurance Company	April 1995	111.8	23.3	21	7.46	Auction
Commercial Markets Complex	May 1995	115.1	17.9	17.9	2.7	Auction
National Real Estate Company	May 1995	360.5	190	190	28	Auction and Public Subscription
National Industries Company	June 1995	347.5	271	170	193.8	Auction and Public Subscription
Palms Agro Production Company	July 1995	50	43.7	43.7	1.35	Auction
Securities House	January 1996	50	45.5	45	7.95	Auction and Public Subscription
Gulf Cables and Electrical Industries	February 1996	61.9	17.3	16	16.28	Auction and Public Subscription
Al-Tamdeen Real Estate	May 1996	158.9	151	140	23.72	Auction and Public Subscription
Industrial Investments Company	May 1996	150	52.5	52.5	6.7	Public Subscription
Gulf Insurance Company	June 1996	113.1	84	20	12.6	Auction

Source: National Bank of Kuwait (NBK), *Economic and Financial Quarterly*, ii/1996.

C. OMAN

1. *An overview*

Oman has achieved the highest economic growth among the GCC countries during the past few years, boosted by higher oil prices, economic reform policies being implemented in the country and an active privatization programme. The GDP growth rate was estimated to have reached 4.5 per cent in 1995, up from 3.5 per cent in 1994.[40] The inflation rate, which is the lowest in the GCC group, remained under control at only 1 per cent in 1995. The budget deficit rose slightly in 1995 to reach 312 million rials Omani (RO), up from RO 300.9 million in 1994, mainly as a result of the 6.2 per cent increase in government expenditure. The budget deficit is being financed by drawing on reserves, issuing of government bonds and external borrowing.

To promote private investment the Government has established a special committee to cut the bureaucratic red tape, expand tax incentives and allow for full foreign ownership in certain sectors.[41] This represents an important part of the country's economic reform programme, which is the most active among the GCC group as the Government has established a stock market, freed interest rates and improved the investment environment in the country.[42]

2. *Privatization experience in Oman*

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

The privatization process in Oman began in late 1993. Major shares which have been sold include 34 per cent of the Gulf Oman Hotels Company, 15 per cent of the Oman National Insurance Company and 20 per cent of the National Bank of Oman. The remaining blocks of shares on the Muscat Stock Exchange comprise 60 per cent of the Oman Flour Mills Company, 35 per cent of the Port Services Corporation, 35 per cent of the Oman Aviation Services Co. and holdings in the Oman Cement Company. The Government also has transportation, agriculture, telecommunications and refining interests, which, when taken together with the quoted stocks mentioned above, are probably worth about US$ 1.5 billion.[43]

Oman's stock market is relatively small. When the Muscat Stock Exchange was established in May 1989, there were 71 companies listed. Today there are 93 companies with total capitalization of US$ 1.5

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[40] *Survey of Economic and Social Developments in the ESCWA Region, 1995* (United Nations publication, Sales No. E.96.II.L.18), table 8.

[41] Ibid., chap. II.

[42] Ibid.

[43] Mahmoud Al Jarwani, "Maximize your investments by profiting from the current privatization projects in the Middle East", paper presented at the Institute for International Research Conference, Bahrain, November 1994.

billion. Fifteen of these companies are not yet publicly traded and, of the remaining 68 companies, 40 are listed on the main board and 23 on the secondary or parallel market. Companies which operate at a loss for two consecutive years are automatically demoted to the secondary market.

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

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

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

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

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

The Oman Mining Company (OMC) appointed a privatization consultant in June 1995 to make recommendations on what form the privatization will take and what percentage of the State company will be offered to investors. Other projects intended for the private sector include two electricity plants in Salalah

and Barka, a sewage project in Muscat at a cost of RO 205 million (US$ 532 million), a similar project in Salalah at a cost of RO 53 million (US$ 138 million) and a US$ 200 million petrochemical complex.[44]

TABLE 5. OMAN: GOVERNMENT SHARES IN JOINT STOCK ENTERPRISES, 1992

	Date of establishment	Subscribed capital (thousands of rials Omani)	Percentage of shares owned by Government
Central Bank*	1975	175 000	100.0
Telecommunications*	1975	50 000	100.0
Gulf Hotel	1974	2 000	32.1
Oman Aviation Services	1981	7 000	35.0
Bank of Agriculture & Fisheries	1981	19 000	99.0
Oman Cement Company	1977	41 429	99.9
Oman Development Bank	1977	10 000	54.1
Oman National Fisheries	1989	12 500	24.0
Oman Flour Mills	1975	10 500	60.0
Housing Bank	1976	30 000	61.0
Oman Mining Company	1978	25 000	99.0
Oman National Insurance	1977	5 000	15.0
Oman National Transport	1975	6 000	99.9
Oman Refinery	1983	30 000	99.0
Port Services	1975	4 800	35.6
Raysut Cement	1981	8 000	20.0
Marketing Agricultural Production	1985	9 807	100.0
Salalah Hotel Company	1978	2 500	99.9
Al Bustan Hotel*	1985	NA	100.0
Inshirah Restaurant*	1987	NA	100.0
Muscat Intercontinental Hotel*	1987	NA	100.0
Storage & Food*	1980	NA	100.0
Rusail Industrial Estate*	1983	NA	100.0
Seeb Novotel*	1982	NA	100.0

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

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

Oman, which has embarked upon the most active privatization programme in the GCC countries, is expected to speed up the implementation of this programme in the coming years. The legal and regulatory framework has, to a large extent, been completed while foreign private sector participation has been encouraged.

[44] *Middle East Economic Digest*, 16 June 1995.

D. QATAR

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

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

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

E. SAUDI ARABIA

1. *An overview*

The Saudi Arabian economy is estimated to have improved in 1995 compared with 1994. The country's GDP was estimated to have achieved a growth rate of 1.7 per cent compared with a 1.1 per cent negative growth rate in 1994. The improved growth in 1995[45] was attributed mainly to the improvement in oil prices and revenues. The country's inflation rate remains relatively contained despite the jump witnessed in 1995. The country's fiscal imbalance was reduced in 1995 to SRls 15 billion, down from SRls 40 billion in 1994 and SRls 55 billion in 1990.[46] The drop in the fiscal deficit may be attributed to the rise in oil revenues and the revenue-raising measures introduced by the Government in 1995. In addition, the Government was expected to finance the 1995 deficit through the issuance of government development bonds and not through external borrowing.

2. *Privatization experience in Saudi Arabia*

The Saudi Arabian Government plans to privatize some of its holdings in several public sector companies. The objectives of the Sixth Development Plan (1996-2000) also make clear the need to draw the

[45] *Survey of Economic and Social Developments in the ESCWA Region, 1995* (United Nations publication, Sales No. E.96.II.L.18), chap. II.

[46] Ibid., table 26.

private sector into the management of public utilities and other basic industries. The plan lists among its objectives the study of the feasibility of privatizing some of the State enterprises of a commercial nature and the expansion of the use of private sector capital in financing some government projects.[47] The Kingdom already has some form of joint public and private participation in 37 quoted companies, including SABIC, in which the government share is 70 per cent.

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

Electricity companies account for the biggest share, with 44.1 per cent of total market capitalization, followed by industry firms, including cement companies (33 per cent), services (12.3 per cent), banks (7.9 per cent), and agricultural companies (2.7 per cent) (see table 6).

There are 78 companies listed on the exchange, but only 68 are publicly tradable. The total number of shares outstanding by the end of 1994 was around 755 million, compared with 698 million the year before. Only shares of Saudi Arabian companies may be traded in the Kingdom and these are normally acquired by Saudi Arabian citizens. In special circumstances, specified portions of the floated shares of several companies were made available to citizens of other GCC countries. Following the GCC summit held in Bahrain in December 1994, a decision was made to allow nationals of GCC countries to own up to 25 per cent of all Saudi Arabian shares except those of banks and insurance companies.

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

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

According to the 1993 statistical yearbook of the Ministry of Posts, Telegraphs and Telephones (PTT), there are around 1.5 million telephone lines in the Kingdom generating revenues of around SRls 5.655 billion (US$ 1.5 billion) in 1993. The cost incurred by the Government for allowing free internal phone calls is put at around SRls 500 million annually. The US$ 4.1 billion contract signed with the American company AT&T for the expansion of the Kingdom's telecommunications capacity (by adding 1.5 million new telephone lines and 200,000 mobile telephone lines) will be financed from the internal resources of PTT over

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

TABLE 6. SAUDI ARABIA: GOVERNMENT SHAREHOLDING IN JOINT STOCK ENTERPRISES BY SECTOR, 1994

	Total capital (millions of SRls)	Government share in capital (millions of SRls)	Government share (percentage)	Market capitalization (millions of SRls)	Market value of Government shares (millions of SRls)
Banks					
Riyad Bank	2,000	580	29.0	10,960	3,178
Saudi Investment Bank	90	7	8.0	913	73
Saudi Cairo Bank	1,200	300	25.0	3,912	978
Saudi American Bank	1,200	300	25.0	12,744	3,186
Sectoral total	**4,490**	**1,187**	**26.4**	**28,529**	**7,415**
Agriculture					
Saudi Fisheries	100	40	40.0	291	116
Tabuk Agricultural Company	200	16	8.2	232	19
Jouf Agricultural Company	200	3	1.5	158	2
National Agriculture Development Company	400	80	20.0	480	96
Sectoral total	**900**	**139**	**15.4**	**1,161**	**233**
Cement and construction material					
Saudi Cement Company	2,040	159	7.8	3,713	290
Yamamah Cement Company	900	90	10.0	2,691	269
Qasim Cement Company	300	111	37.0	1,085	401
Yanbu Cement Company	700	84	12.0	1,806	217
Southern Cement Company	700	280	40.0	2,135	854
Eastern Cement Company	968	290	30.0	1,929	579
Saudi Ceramics	150	33	22.0	855	188
Sectoral total	**5,758**	**1,047**	**18.2**	**14,214**	**2,798**
Industry					
National Gas & Industrialization Company	500	77	15.5	700	109
Jeddah Refinery (Saudi Refining Company)	150	113	75.0	196	147
Saudi Fertilizer Company	200	82	41.0	2,570	1,054

TABLE 6. (*continued*)

	Total capital (millions of SRIs)	Government share in capital (millions of SRIs)	Government share (percentage)	Market capitalization (millions of SRIs)	Market value of Government shares (millions of SRIs)
Industry (continued)					
Saudi Basic Industries Corporation	10,000	7,000	70.0	26,900	18,830
Savola	300	22	7.4	2,052	152
Sectoral total	**11,150**	**7,294**	**65.4**	**32,418**	**20,292**
Electricity					
Arir Electricity Company	15	9	59.9	21	13
Tabuk Electricity Company	8	3	33.3	8	3
Domat Al Jundal Electricity Company	10	8	80.0	20	16
Rafha Electricity Company	4	2	54.9	4	2
Eastern Electricity Company	5,000	2,450	49.0	5,300	2,597
Central Electricity Company	8,000	6,160	77.0	8,400	6,468
Western Electricity Company	8,000	6,720	84.0	8,080	6,787
Southern Electricity Company	4,000	3,940	98.7	3,920	3,869
Sectoral total	**25,037**	**19,292**	**77.0**	**25,753**	**19,755**
Services					
Hotel Company	500	159	31.8	835	266
Saudi Real Estate Company	600	438	73.0	834	609
National Shipping Company	2,000	578	28.9	1,980	572
Taiba Investment and Development	3,000	330	11.0	2,020	222
Makkah Construction Company	1,355	93	6.9	3,469	239
Saudi Public Transport Company	1,000	300	30.0	1,290	387
Sectoral total	**8,455**	**1,898**	**22.4**	**10,428**	**2,295**
Total	**55,790**	**30,857**	**55.3**	**112,503**	**52,788**

Source: Al-Attas Investment, Overview of the Saudi stock market for the year 1994.
Note: Market capitalization figures relate to mid-1994.

a seven-year period at around SRls 2.29 billion a year. The privatization of the telephone services is therefore unlikely to take place until part of the expansion project is completed and possibly not before the completion of the entire project in about seven years.

The same applies to Saudia, which has placed an order worth US$ 7 billion to buy 63 new aircraft to upgrade its fleet. The carrier has a fleet of more than 111 aircraft, and transported more than 12.4 million passengers in 1994. The airline receives government financial support of about SRls 8,500 million (US$ 2,270 million) annually to cover losses mainly caused by the low price of domestic air fares. It is unlikely that Saudia will be privatized before the company is restructured and its financial health has been vastly improved.[48] What is likely to happen over the coming few years is the privatization of some of Saudia's services such as catering, baggage handling and aircraft cleaning.

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

Initially the Government is likely to reduce gradually its holdings in companies whose shares are listed and traded on the stock market. The Government owns shares in 37 companies listed on the Saudi stock market. The total capital of these companies is put at SRls 55.7 billion, 55.3 per cent of which—or SRls 31.4 billion—is held by the Public Investment Fund on behalf of the Government (table 6). The market value of the companies' shares owned by the Government exceeded SRls 50 billion by end-1994. It is estimated that the government share in the capital of the eight electricity companies is around SRls 19.3 billion, accounting for 77 per cent of the total capital of these companies. The Government owns 70 per cent of SABIC, 25 per cent of the Riyad Bank, 10 per cent of the Saudi American Bank, 25 per cent of the Saudi Cairo Bank, and 8 per cent of the Saudi Investment Bank. It also owns 15.4 per cent of the capital of four agricultural companies, 18.2 per cent of cement and construction material companies and 22.4 per cent of services sector companies.

SABIC is a prime candidate among the companies for which the Government is likely to sell additional shares to the private sector. No decision has yet been made on the number of shares to be sold, and the timing and procedure of such sales. However, there is a longstanding official policy to reduce the government stake eventually to 25 per cent. SABIC shares were trading during mid-1996 at around SRls 370 (US$ 100) each. If the Government sells at that price 45 per cent of its stake in SABIC (bringing down its share from 70 per cent to the target level of 25 per cent), this will be worth SRls 16,857 billion (US$ 4.5 billion). SABIC has 100 million shares with a nominal value of SRls 100 each.

Privatization of government-owned companies will start with a Yanbu-based Ibn Rushd polyester plant affiliated to SABIC. The SRls 3 billion plant, a joint venture company between SABIC and a consortium of nine companies, is targeted for privatization. The process is likely to be in two stages. The first was

[48] *Arab News*, 19 June 1995, Jiddah (in Arabic).

already achieved with the setting up of the shareholding companies. The second phase will be the sale of company shares to the public after about three years.[49]

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

F. UNITED ARAB EMIRATES

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

There are other possible privatization candidates in the United Arab Emirates over the long-term. The chairman of Emirates Air, the international carrier, launched in 1985, said in June 1995 that the privatization of the airline was unlikely to take place for another five years. Emirates recorded a profit of US$ 25 million in the year ending March 1995, making it one of the most profitable airlines in the region. This would give it a market value of at least US$ 200 million.[50]

The Abu Dhabi authorities are planning to privatize cement, agricultural and non-oil industrial concerns worth more than Dh 1 billion (US$ 272 million).[51] However, it is not yet clear how these ventures will be sold, since there is no formal stock exchange in the United Arab Emirates. Private placement would therefore be the easiest way to dispose of the companies, but this would not fulfil the authorities' aim of broadening share ownership in the Emirate. However, the sale of a few small ventures, even if only to a close group of investors, could be taken as part of a trend which would lead, in time, to public share flotations.

The impetus for privatization in Abu Dhabi does not come from a desire to raise funds as the authorities there are not in urgent need of additional revenues, and many of the companies which are to be put into the private sector are already run on a reasonably efficient basis. Broadening share ownership is therefore the principal object of the privatization programme. There were two public share issues in Dubai

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[49] *Saudi Gazette*, 1 July 1995, Jiddah.

[50] *Middle East Economic Digest* (MEED), Money, 30 June 1995.

[51] *Arab News* , 15 July 1995, Jiddah (in Arabic).

in 1993 and a US$ 95 million offer from the newly formed Dubai Investment Company is due soon. These three issues, the only ones in the Emirates since the early 1980s, indicate that public share issues are not prevented by the absence of a formal stock trading system.

A recent study by the Abu Dhabi General Industry Corporation (GIC) has identified five companies as candidates for privatization: the Al-Ain Cement Factory, the Abu Dhabi Flour and Animal Feed Factory, the Abu Dhabi National Pipes and Sack Factory, the Brick and Cement Factory based in Al-Ain and Al-Wathba, and the Al-Ain Mineral Water Bottling Factory.

An informal stock market exists in the United Arab Emirates, and the creation of a formal stock exchange is now being studied. A high percentage of government ownership, coupled with a tendency for long-term investment and restrictions on dealing by non-nationals, has made the turnover in the United Arab Emirates the lowest in the Gulf. Turnover was around Dh 1 million (US$ 272,000) a day in 1994, although the United Arab Emirates is the second biggest country in the GCC in terms of market capitalization—around Dh 35 billion (US$ 10 billion). There are 77 joint stock companies now trading their shares on the unofficial stock market. Several companies have raised their capital in the past two years; however, most of the subscriptions have been confined to shareholders. Privatization will help to revive the primary issue market and give share trading more depth and transparency.

TABLE 7. STRUCTURE OF GULF STOCK MARKETS: 1994

	GDP (billions of US dollars)	Market size capitalization (billions of US dollars)	Annual turnover (millions of US dollars)	Number of listed companies	Market index percentage change 1994	Accessibility to foreign investors
Saudi Arabia	120.8	38.0	6,632	67	-28.75	- Open only to Saudi nationals - Other GCC nationals can own up to 25% of listed companies - Shares traded over the counter through banks
Kuwait	21.5	11.3	1,950	47	-1.9	- Open to GCC nationals - Non-Kuwaiti residents are allowed to own shares through mutual funds in certain companies
United Arab Emirates	35.9	10.0	200	77	-5.0	- Open to United Arab Emirates nationals and partly to other GCC nationals
Bahrain	4.3	5.9	200	34	-21.2	- Open to GCC nationals - Foreigners resident in Bahrain for at least three years may own up to 1% of the capital of a single company - Foreigners can trade shares in only four of the 32 listed companies
Oman	9.9	1.5	300	68	28,5	- Open to GCC nationals - Open to foreign investors through mutual funds, up to 49% of listed companies

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

V. SUMMARY AND RECOMMENDATIONS

A. SUMMARY

1. Privatization, in a narrow definition, is the sale of part of the public sector enterprises to the private sector in that it involves the transfer of public sector assets to the private sector. However, in a broader sense, it includes the deregulation and commercialization of economic activities to prepare the ground for greater participation of the private sector in economic activity.

2. Privatization has become a global phenomenon as it has been implemented in both developed and developing countries. It is an important part of the shift in economic policies to reduce excess government intervention in economic activity which, in the majority of developing countries, led to a slow-down of economic growth. In addition, privatization policies have been an important element in the economic stabilization and structural reform policies being implemented by a large number of countries. This represents a sharp departure from the centrally planned economics of a large number of developing countries during the 1960s and 1970s.

3. The shift in economic policy was precipitated by the overextension of the public sector in the developing countries which led to deep internal and external macroeconomic imbalances, reflected, in particular, in sharp fiscal deficits, trade balance deficits, high inflation rates and overvalued domestic currencies. The increased borrowing by the majority of the developing countries, particularly in the 1970s, to finance the investment gap and in many cases to finance imports led to a worsening of their external debt situation. This led in 1982 to the emergence of the international debt crisis, which triggered the introduction of economic stabilization programmes by a large number of the developing countries.

4. The main objectives of the privatization programmes being implemented in the developing countries and in countries of Central and Eastern Europe are: (a) to increase economic efficiency, productivity and output and thus sustainable economic growth; (b) to have access to foreign direct investment, the latest available technologies, production methods and management techniques; (c) to scale down government involvement in economic activity, particularly in the productive sector, and concentrate upon the upgrading and developing of the social services; (d) to widen public ownership by allowing the private sector to buy shares of assets of public sector enterprises selected for privatization; (e) to develop a domestic capital market that can provide the private sector with needed credit to contribute effectively to economic development; (f) to reduce the budget deficit by reducing or eliminating subsidies to the loss-making public sector enterprises either by privatizing those that can attract private sector investors or by liquidating non-viable enterprises. Budget revenues can be promoted by increasing corporate taxes levied on privatized public sector enterprises.

5. Privatization does not mean the total withdrawal of the public sector from economic activities. The role of the State will continue to be important either in production or employment, particularly in the area of strategic sectors which will not be privatized or in extending the social services to the largest segment of the population. In addition, the role of the Government will continue to be of utmost importance in providing for a stable macroeconomic policy that is conducive to economic growth and the participation of the private sector.

6. There are several conditions to be met in order to achieve a successful privatization programme. They are listed below.

(a) The right macroeconomic environment that eliminates distortions, corrects internal and external macroeconomic imbalances and reactivates economic growth.

(b) The political commitment at the highest level to the implementation of the privatization programme. This commitment may be reflected in the adoption of a comprehensive privatization programme by the highest political authority and the creation of a central agency for the implementation of this programme that can have direct access to the decision makers in the Government.

(c) The popular support essential to the successful implementation of the privatization programme. This can be achieved in several ways, including a continuous dialogue between the Government trade unions. It can be also achieved by minimizing its impact on the poorest segments of the population and reducing the number of workers laid off, as well as through appropriate social safety nets that can compensate adequately for the short-term negative impact of the programme.

(d) The adoption of adequate privatization methods that take into account the country's economic conditions, the status of the domestic private sector, the availability of the domestic capital market and the status of the public sector enterprises. There is no single method that can be applied in every privatization transaction; therefore, Governments should adopt several privatization methods depending on the objectives and the availability of managerial and entrepreneurial skills.

(e) The adoption of a set of laws and regulations that protect private ownership: anti-trust law, corporate law, tax law, capital market law, investment law, consumer protection law and anti-monopoly law.

7. Privatization in the ESCWA region is still in its early stages and will take time to be implemented, especially if it continues at its present slow pace. A number of countries are still debating whether to apply it or not. In others, although the political decision to apply it has been taken, the actual implementation has been slow. There are still concerns about the possible short-term negative consequences of the privatization process on employment and inflation.

In a number of countries, however, efforts are being made to prepare the ground for a successful implementation of privatization. This has included introduction of stabilization policies, reform programmes and other elements required to establish the right macroeconomic environment for the operation of an active private sector.

8. Some ESCWA member countries, particularly the Syrian Arab Republic, do not consider selling the public sector, or even parts of it, as the right approach to sustainable economic development. They believe that the public and the private sector should complement each other. The best policy in this approach is to provide a stable macroeconomic environment to induce effective participation of the private sector, and at the same time reform the public sector to enable it to operate in the same environment.

9. Other ESCWA member countries, notably Egypt, have pursued a twofold policy. On the one hand, this policy has created a macroeconomic environment conducive to the participation of the private sector in economic development, and on the other hand it transferred ownership of part of the public sector to the private sector to through privatization.

10. To see the magnitude of the operation in the right perspective, it would be useful to know that in Egypt there are 314 public sector enterprises for privatization. This represents around 15 per cent of the book value of the public sector in Egypt. Thus, compared with privatization in Eastern European and Central American countries, the Egyptian privatization programme can at best be described as modest. Nevertheless, the Egyptian privatization programme, so far, is the largest and most comprehensive programme in the ESCWA region.

11. In Jordan, the Government is still in the process of preparing the ground for implementing a privatization programme. It has been implementing structural adjustment and economic reform policies, aimed at liberalizing trade and investment laws and regulations, reducing internal and external imbalances and encouraging participation of the private sector. In this regard, to encourage investment, the Government enacted Law No. 16 for 1995; it also amended the income and corporate tax laws and is considering reforming the rules and regulations governing the operations of the Amman Financial Market.

12. In general, one can say that the privatization strategies in the region have been directed to privatizing small profit-making public sector enterprises that attract the interest of the private sector. There are, however, several differences in the priority sectors. Thus, while Egypt's programme concentrates on the productive sectors of the economy, Jordan's has been focusing on the services sector, industry, tourism and telecommunications. In the GCC countries, Oman included power generation in its privatization process.

13. In conclusion, it should be noted that the tendency to privatize profit-making enterprises is logical; such enterprises need little or no restructuring and their impact on unemployment and inflation tends to be limited.

B. RECOMMENDATIONS

1. There is a need for a continuous implementation of economic reform policies to create an adequate and stable macroeconomic environment conducive to the participation of the private sector. In particular, there is a need for liberalization and deregulation of trade and investment laws, stable and real exchange rates, reform of the legal and administrative systems, and the development of a domestic capital market.

2. There is a need for intensive efforts to promote public support for the implementation of economic reform programmes including the widening of public sector ownership. Continuous dialogue between Governments and trade unions and other popular organizations is essential for broadening public support for the implementation of economic reform programmes. However, to promote public support, Governments should minimize the economic and social impact of these programmes on the living conditions of their populations through, among other things, the creation of adequate social safety nets.

3. Despite the implementation of privatization programmes and the expansion of the role of the private sector in economic development, the public sector will continue to be the most important sector. However, there is a need for the reform of the public sector to reduce inefficiency and the consequent drain on the budget. This should include allowing the public sector to work in an environment similar to that of the private sector. The public sector should compete with the private sector on an equal footing and those enterprises that cannot survive under such a competitive environment should be liquidated.

4. There is a need to promote the regulatory and monitoring role of the Government to ensure that the private sector's activities are within the Government's overall economic priorities and objectives. In addition, Governments should continue to provide stable macroeconomic environments that encourage the participation of the private sector.

5. Governments should provide political support for the private sector in its dealings with other countries, particularly in the area of export promotion. Governments should help to open new export markets for the private sector and increase access to foreign capital. Supporting the private sector to increase exports should be an integral part of these countries' foreign policy.

6. Governments should provide the private sector with adequate credit to be able to contribute effectively to the economic development of the country.

7. Privatization should not be taken as an end in itself but as a policy to achieve efficiency, fiscal consolidation, widening public ownership and providing access to external financial resources, modern technologies and management techniques.

8. Governments in the region should apply a gradual approach towards privatization. It is not advisable to encourage mass privatization schemes without proper evaluation and restructuring of public sector enterprises. The gradual approach has many advantages, particularly in providing Governments with time to correct any mistakes made. Such an approach also allows for the proper evaluation of the assets of public sector enterprises and therefore ensures that Governments obtain a fair price. In addition, it allows for the restructuring of those public sector enterprises that are in need before privatization. The gradual approach better suits the developing countries that lack both managerial and entrepreneurial skills and in which the domestic private sector is small, with limited experience and lacking the financial resources to participate in a large and rapid privatization programme. Moreover, the gradual approach reduces the negative impact of privatization on employment and prices as it usually starts with small profit-making companies where worker redundancy is limited.

9. Governments should utilize more effectively the proceeds from the sale of public sector enterprises. They can finance the restructuring of the loss-making companies, pay compensation for employees laid off, and create safety nets for the poorest segments of the population who are the most affected by the negative impact of privatization. In addition, the proceeds can be used to conduct training programmes for workers laid off as a result of the privatization programme.

10. Governments should promote consumer protection laws, and anti-monopoly laws to protect consumers from unjustified price increases and ensure that products meet minimum quality standards.

11. Successful privatization requires the creation of a well-functioning legal and regulatory framework including business legislation such as corporate law, property laws, competition laws and dispute settlement laws. In addition, it requires the creation of active and effective institutional arrangements with direct access to the highest level of policy makers in the Government.

12. The formulation of a clear and achievable privatization strategy is a prerequisite to the implementation of an effective privatization process. A privatization strategy should take into consideration the status of the economy, the capacity of the domestic private sector, the status of public sector enterprises to be privatized, and the availability of privatization mechanisms such as a developed stock market.

13. The establishment of adequate social safety nets (a social component in the privatization) is of utmost importance to the implementation of a successful privatization programme. It reduces public opposition to the programme, particularly among the trade unions, and provides for the creation of job opportunities or training programmes for the workers laid off. In addition, it reduces the short-term negative impact of the privatization on the poorest segments of the population.

14. The objectives of the privatization should be kept modest so as not to raise, unrealistically, the expectations of the population. The privatization process remains relatively new and its implications, particularly in the ESCWA region, are still unclear. The issue has to be addressed with caution and as a necessary economic policy to boost economic growth.

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