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CONCEPT PAPER

PRIVATIZATION

JUNE 1987

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

CAIRO, EGYPT

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PRIVATIZATION

TABLE OF CONTENTS

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A. Introduction and Problem Analysis:

Senior government officials in Egypt are beginning to accept privatization as a possible strategy to address their overwhelming budgetary problems. Privatization is beginning to be recognized as a potential tool to: increase productivity of non-performing government assets, reduce or eliminate budget deficits, and stimulate the economy by increasing investment, particularly by the private sector. Privatization fully suppports the government's stated goal to increase the role of the private sector in the economy.

In the 1980's the Egyptian business climate has not been conducive to encouraging significant private sector investment. Recently, the Government of Egypt publicly acknowledged that the need for change is clear. Evidence of the Government's focus on its problems has been the introduction of major macro-economic reforms. To signal a willingness to start the process of getting out of business, senior-level officials are now carefully studying the potential application of privatization in Egypt. There exists an aching wish for inspired leadership within both the public and private sectors. Candid and direct communication between business and government representatives is underway to improve the private sector environment and diminish the tangible, palpable threats to a viable private sector.

Egypt suffers from a litany of problems related to public enterprise dominance in the productive economy. Public sector company traits include: inefficiency, low productivity, operating deficits, and dependence on government subsidies to maintain operations. A Ministry of Cabinet Affairs representative has written in Al Ahram Iktisadi (June 8, 1987): "The Egyptian government on an annual basis now supports over 130 losing firms and must absorb over LE 2.2 billion in losses and transfer payments every year which represents approximately 33 per cent of the current budget deficit............Since the Egyptian government can no longer continue to endure the large deficits that the losing state-owned firms are accumulating, liquidation and privatization are now among the most widely discussed debates of the decade. Privatization or liquidation can rid the government of the considerable losses and transfer payments that it must endure as it continues to support unprofitable state-owned enterprises."

Assuming strong political support from the national leadership, there are still serious threats or constraints to privatization. Most importantly:

1. There is a lack of understanding of the concept, benefits, and

alternative methodology of privatization. Therefore, a potential obstacle to the program is resistance from mid-level national and local government officials and, particularly, from employees in public sector enterprises. Another threat to the program's implementation is from the general public which may be used to block privatization activities due to a lack of understanding of the concept.

2. The political opposition may launch an effort to block the privatization program or, at least, cause frequent and lengthy delays in its implementation. Another political impediment is the rivalry that exists between governmental agencies that precludes cooperation and bureaucratic efficiency.

3. Prior to actual transfer of government-owned assets to the private sector, there is a need to develop mechanisms whereby independent and accurate assessments or valuations of assets can be established. Therefore, a facility or tool is needed to modify or restructure (legally and/or financially) these government assets to make the transfer possible.

4. Additional institutional mechanisms are required to expand equity and venture capital facilities and thereby increase capital resource mobilization. That is, the capital/equity market must be enhanced to support private investors.

5. A program or mechanism is needed to assure a smooth transition for the employees as the enterprises adapt to private sector management policies. Employees should be offered an opportunity to attend training courses to develop new skills and technical knowledge.

B. Background and Situation Analysis:

1. Policy Directives:

To encourage private investment and expand ownership by the people, the Ministry of Local Government's Popular Development Organization (PDO) introduced in 1984 the possibility of transferring governorate-owned projects. The Second National Conference for Local Government, in June 1985, endorsed the concept and recommended immediate implementation of the program. This recommendation was affirmed by the Prime Minister at the Higher Council for Local Government (December 1985) and the Governors Council (September 1986). In June, 1986 a Prime Ministerial Decree (No. 601 for 1986) formed a Higher Committee for Local and People's Development and launched an effort to initiate the transfer of governorate-owned projects to the people.

The directives issued (during the previous government) in conjunction with the June, 1986 decree were the basis upon which to commence implementation of the "popularization" of governorate-owned projects/companies. It is noted that within Egypt, the term "popularization" is most often a synonym for "privatization". The government's strategy was to start at lower levels of government in a low-key manner to test resistance to privatization and to experiment with the requisite policies and procedures. A national-level working committee was formed to provide policy guidance and support for the governorate effort. Each of the twenty-six (26) governorates received a request to identify at least two projects for "popularization". Forty-six (46) projects were submitted to the committee for valuation and possible privatization.

2. Working Committee Members:

In February 1987 the Ministry of Local Government issued a decree that unilaterally established a committee to implement the "popularization" program. The working committee is comprised of representatives from the Ministry of Local Government, Ministry of Finance, Capital Markets Authority and USAID. Although the committee does not have a designated chairman, the key operational participants are the Ministry of Local Government's Popular Development Organization (PDO) and the Capital Markets Authority (CMA).

Committee activities commenced in early 1987 and by April the PDO prepared a draft of a scope of work whereby a task force could be contracted to conduct an indepth analysis or valuation/appraisal coupled with a plan to popularize (privatize) the aforementioned forty-six (46) projects. This draft proposal is currently being refined. Simultaneously, a similar but much smaller activity is underway. Governor Yehia Hassan (Menofeya) agreed to review (with the approval of Deputy Prime Minister Wally and Minister of Local Government Salama) an unsolicited proposal from Misr Iran Development Bank to conduct a valuation of approximately thirty (30) poultry farms and a feed mill plus develop a financial/marketing plan to transfer ownership and/or management of these governorate-owned assets to the private sector. Many of the policy issues and divestiture procedures to be addressed in Menofeya should facilitate the broader proposed work described in the PDO scope of work. The bank's proposal is scheduled for delivery in June and must ultimately be approved by the Amana (the Ministry of Local Government's technical secretariat).

In contrast to earlier experience, recent coordination between PDO and CMA, particularly at the working level, has improved. However, direct communication and coordination between the senior officials of these two agencies is still lacking.

The CMA is having meetings with the Prime Minister to organize a symposium to be held later this year. It is envisioned that the symposium will offer a forum for the Prime Minister and other Ministers to reconfirm national government support for the concept of privatization and, specifically, the governorate-level activities.

Representatives from the private sector and public sector met in late 1986 to define a strategy and plan for implementation. It was recommended that the CMA should be responsible for review and approval of the appraisals of the governorate-owned projects submitted by the

PDO to the working committee.

3. USAID Activities To Date:

USAID support, to date, can be described as catalytic, i.e., promoting an exchange of views among the interested agencies in the government and the private sector banking/investment community. Additionally, USAID is providing information about worldwide experience with privatization to these same groups and individuals.

In late 1986, USAID obtained for CMA a privatization expert, through AID/Washington's Center for Privatization in the PRE Bureau, to assist in valuation. Mr. Jalil Shoraka came to Egypt on two separate occasions. During his first trip he visited a sample of governorate projects proposed for popularization. He concluded that some of these proposed projects could be transferred to the private sector by immediate direct sale or disposed via an auction. Others would need legal and/or financial restructuring. His report emphasized that the majority of the projects are not presently organized in a company form and detailed accounting records, most often, are not available.

Mr. Shoraka also confirmed the presence of local accounting and investment banking firms capable of handling the technical valuation responsibilities and marketing activities. He presented the CMA with a general outline of the content of an appropriate valuation/appraisal. Shoraka highlighted the internal conflict and competition between the CMA and PDO as the more problemmatic issue. USAID and Shoraka organized a meeting at USAID's office to bring together all of the interested parties to open-up the lines of communication and spark a discussion of the popularization strategy and status of activities conducted by PDO and CMA. Participants included the CMA and PDO Chairmen and senior-level executives from investment and accounting organizations, e.g., Misr Iran Development Bank, Egypt Investment Finance Corporation, Hazan Hassan Accountants, American University of Cairo, et al.

Three similar meetings were held subsequently. At the suggestion of USAID, this informal group recommended that a sample of six projects be identified to complete a valuation as case studies. The intent is to surface the generic policy and operational issues to be confronted. Then, the generic issues could be presented to key policymakers during the CMA-sponsored symposium to seek relevant decisions regarding strategic and policy issues. Three private sector organizations offered staff personnel to assist in the pilot efforts.

Following the December 1986 meetings, some of the momentum diminished due to various bureaucratic problems within the two key agencies, CMA and PDO. Further delays occurred as a result of national elections in early April and Ramadan in May. USAID is now attempting to revive the momentum through arranging meetings with PDO and CMA plus conducting discussions with other government agencies, e.g., Ministry of Finance, Ministry of Industry, Ministry of Planning & International Cooperation, Ministry of Tourism, Ministry of Cabinet Affairs, et al, and the private sector organizations, e.g., Misr Iran Development Bank, Egypt Investment Finance Corporation, private sector entrepreneurs, et al. USAID has accompanied PDO and MIDB during their site visits to governorate projects and meetings with governors and governorate staffs.

USAID's goal is to sustain the orientation toward action while underscoring the identity of the program as an Egyptian activity. At every opportunity, it is emphasized that USAID must avoid the perception of a leadership role. If USAID is perceived as a leader, it will be easy for the Egyptian political opposition to create an image of privatization as an American program.

In the near term, the plan is to obtain the services of Jalil Shoraka to assist the CMA in the organization and management of the symposium. This contract will be financed through the CMA component of the USAID-funded Business Support & Investment project. PDO is requesting funding from the USAID-financed Local Development II project to analyze a sample of six governorate projects to establish case study material for the symposium. This sample activity can then be broaden to encompass the balance of the previously identified forty-six (46) governorate projects. Members of the Cabinet have stated that their plan is to use the case study materials, the lessons learned and the overall policies and procedures developed in the governorate-level program to prepare a proposal for a discrete national privatization program.

4. Relationship to CDSS, GOE Priorities and Other Donors.

Referring to USAID's support for divestiture of governorate-owned projects, the Mission's FY 1989 Country Development Strategy Statement (CDSS) states: ".....we may consider establishing a fund to help in the financial restructuring and sale of these public sector industries. If it is successful, we will pursue enlarging the privatization program to the larger, central government industries." (CDSS, page 28).

The proposed project is fully in accord with this statement.

5. Relationship to GOE Plans and Priorities.

The Prime Minister issued a decree in June 1986 launching the program to transfer governorate-owned projects to the private sector. Recent endorsement and support for this program have been received from Deputy Prime Minister Youssef Wally and other Ministers in the Cabinet. Discussions between the Prime Minister and CMA Chairman are taking place to plan the national-level symposium.

In a meeting with USAID in May 1987, Deputy Prime Minister and Minister of Agriculture Youssef Wally expressed his support for privatization at both the governorate and national level. He encouraged immediate commencement of the governorate program with Governor Hassan (Menofeya) and Governor Gouili (Damietta) and advocated expeditious replication in the other governorates. He volunteered that his name be freely used to demonstrate national government endorsement of the program. Other Ministers have disclosed that the Cabinet is discussing privatization as a method to address the national government budget problems. Consequently, in the near term, it appears that the GOE openly acknowledges the need for both a governorate and national program and recognizes the significant benefits to be derived therefrom. In the absence of vocal political opposition, the GOE is expected to assert a more public leadership role.

C. Proposed Privatization Project Components:

1. Program Purpose:

To establish alternative institutional mechanisms for privatization, reduce government-owned industries, plus strengthen the role of the private sector in Egypt. To build the foundation upon which action can be taken to broaden the privatization program from the local to the larger nationally-owned industries.

2. Proposed Strategy and Program Components:

a. Policy and Legislation:

Clear policy and legislative consent are prerequisites for establishing an environment for long-term change. The project will provide resources to assist the GOE to define basic policy, priorities, strategy and appropriate privatization legislation. The commitment of government to privatization must be widely understood and the program must be nationally promoted by distributing information and initiating educational activities that are directed to the entire Egyptian nation.

Other preconditions will include:

1. Governorates will agree not to create additional public sector projects that may compete with the private sector or replace the projects previously transferred by establishing comparable projects.

2. The GOE must assign authority and responsibility to a Minister to coordinate privatization activities and promulgate national policies and procedures. Evidence must exist that the GOE is committed to moving the privatization program quickly.

3. The governorate's first effort to sell a project will be directed to the local residents and employees of the project. A concerted attempt will be made to diversify the ownership and avoid a concentration of assets in the hands of the local elite. One tool that can be used is the introduction of Employee Stock Ownership Plans (ESOPs).

4. Direct government involvement in the project/company must terminate

upon the transfer of ownership and/or management.

5. A transfer of assets must not produce large financial losses to the government. Concommitantly, the investors should not be expected to absorb present or future losses due to the current financial status of the asset.

6. Special consideration must be given to the present employees of the project/company. If they choose to leave following the transfer of the asset, then a program for providing alternative employment should be offered.

b. Institutional Services:

The methodology for privatization will vary by sector, by project and by geographic area. The goal is an orderly and timely transfer of projects to the private sector. However, it is understood that most governorate-owned projects will not have the legal structure and accounting records to facilitate a quick valuation and sale. Also, there may be a need to restructure the financial condition of the project prior to concluding a sale. Prior to direct transfer of assets and management to the private investors, issues concerning the project's employees must be addressed. An intermediary purchase/transfer of many of the projects, but not all, is expected to mitigate the problems confronting a private sector investor.

Once a portfolio of projects is brought to a condition in which ownership can be transferred, a market must be developed for the sale to the private sector. One of the proposed project's components will assist the GOE in organizing an institutional arrangement with existing banking and investment firms to manage the valuation, restructure the project/company, and negotiate the ultimate sale to the private investor. To surmount legal and financial obstacles confronting the investor, it may be necessary to expeditiously transfer the assets and liabilities to a temporary buyer who will act as a conduit to the final purchaser.

To the extent possible, fees for services earned by the bank and/or investment firms will be included in the final sales price.
During the brief, interim period, it is anticipated that the proposed project will need to grant finance most of the services. The fees would be charged to the privatization project.

Succinctly, one of the Privatization Project's components is a marketing mechanism, i.e., the <u>Asset Privatization Trust</u>. It will acquire, when the need is clear, the government-owned project/company, reorganize the legal and financial conditions of the firm including negotiation of existing and/or new debt, manage the marketing activities plus negotiate the ultimate sale to private sector investors. For example, until Egypt's capital market is greatly enlarged, the privatization program needs a facility to arrange the provision of loans, guarantees and equity to restructure the government-owned projects/companies and make them attractive to the investment community. Criteria must be developed to make the financial resources of the Asset Privatization Trust available to the investment market. All loans, guarantees and equity provided by the Trust are anticipated to be of a transitional nature with a specified period for liquidation of equity shares, most likely within a year, but not to exceed five years. Egypt's existing banking and investment institutions are capable of organizing and managing the financial restructuring details as well as the marketing effort.

c. Organization and Management of the Asset Privatization Trust:

It is envisioned that the President will appoint a Minister as the coordinator of national and local government privatization. It is currently recommended that the Minister of Cabinet Affairs be the designated coordinator to present senior-level government endorsement of the privatization program.

Also, the President will form a Committee on Privatization (COP) with a proposed composition consisting of five of the following ministries: Minister of Cabinet Affairs and Administrative Development (Chairman), Minister of Local Government, Minister of Industry, Minister of Finance (or Central Bank), Minister of Agriculture, Ministry of Planning & International Cooperation, and Minister of Tourism.

Restricting the membership to five is based upon proven experience that when a committee exceeds that number, efficiency and productivity rapidly diminishes. Large committees rapidly withdraw into a world of analysis and complexity. Public and private sector bureaucracies typically confront issues by analyzing, complicating, and debating them to death. Successful and effective managers keep the bureaucrats away from their productive people.

The COP's functions and responsibilities are:

> To identify government assets to be transferred from government-ownership to the Asset Privatization Trust (APT).
>
> To determine which assets should be privatized or otherwise deposed.
>
> To establish policy guidelines for the disposition, interim conservation, or rehabilitation prior to sale of assets by the APT.
>
> To generally monitor and review the entire divestment and privatization program.

The COP's term, funding and meetings:

> The COP should exist for a limited number of years. Approximately $1,000,000 may be authorized to cover committee

expenses (for example, to meet expenses related to consulting fees, travel, meetings, training and educational fees, et al).

It is proposed that an Asset Privatization Trust (APT) be created that will be composed of five Trustees recommended by the COP and appointed by the President.

The APT's most important function will be to act as the disposal unit in the process, i.e., it will take title to, provisionally manage, and dispose of the specified assets. Its span of operations may also be for a limited number of years with, ideally, five full-time trustees recruited from the private sector. Initially, the APT can focus primarily on assets held by the twenty-six (26) governorates and, shortly thereafter, expand its activities to nationally-owned companies, corporations, and/or parastatals identified for privatization by the COP.

APT functions and responsibilities would include:

To formulate and implement, after approval by the COP, a program for the disposition of assets previously acquired by it, within a designated time period not to exceed five years.

To set price, terms of payment and identify the buyer for each asset.

To manage assets pending disposition.

APT term and funding:

The APT shall exist for a limited number of years and should complete its mandate in that time. Trustees will serve full-time. The APT may be funded with approximately $100,000,000 and subsequent annual increases will be authorized based upon need and performance. External funding in the form of loans or grants may be obtained from multilateral, bilateral or domestic sources, both government and private.

D. Finance Requirements:

Line Item	Amount in US Dollars
1. Resources for various marketing & financial mechanisms.	100,000,000
2. APT/COP Operational Expenses	2,000,000
3. Technical Assistance and Training.	1,000,000
4. Evaluation	500,000
5. Contingency	500,000

TOTAL 104,000,000

Financial resources, initially in the amount of $100 million, to be increased conditioned upon need and GOE performance, will be allocated primarily to acquisition and financing of divestiture. Until Egypt's capital market experiences significant growth, a variety of techniques or marketing devices can be implemented to achieve privatization. For example, the project's resources can be used to assist the GOE in the creation of a mutual fund, issuance of government treasury bills at auction, the issuance of revenue participation certificates for state-owned enterprises, e.g., the Suez Canal, the High Dam, Egypt Air, Cairo International Airport, et al., and the legislation and, perhaps, capitalization needed to broaden and develop stock brokerage firms and leasing companies which will have a major effect on the Egyptian securities market.

In the near term, the project's $100 million can be directed to the activities associated with the Asset Privatization Trust. GOE's Ministry of Local Government through its Popular Development Organization prepared an estimate of total governorate investment in agriculture/food security projects and companies. The approximate investment value, in March, 1987, was LE 470 million. A very rough exercise was conducted in early 1987 by the PDO to estimate the book value and market value of twenty-eight (28) governorate-owned projects.

Based upon a potential privatization of more than 250 governorate projects, it is conceivable that the initial availability of $100 million can be expeditiously utilized by the APT. Simultaneously, the program will seek avenues of privatization assistance to other ministries, e.g., Tourism, Agriculture and Industry, that may lead to quick disbursement of the project's funds. The Project Identification Document (PID) team will provide further justification for the project's initial obligation.

E. Issues to be Confronted and Potential Problems:

The author in the previously referenced Al Ahram Iktisadi article, states that: "The political constraints confronting liquidation and privatization are many. First, Egypt does not have a well-developed mechanism to justify the need for liquidation and privatization to interest groups such as unions, taxpayers, members of parliament, government employees and other direct beneficiaries. Second, consideration must be given to what happens to the subsidies when key industrial firms are liquidated or privatized. Third, pricing decisions will be needed for an array of basic commodities that will be transferred to the private sector when privatization of certain industries takes place."

The Project Identification Document (PID) design team should address the following issues:

1. There is a lack of strong political will and discipline to

establish clear policy and provide legislation that sustains support for privatization.

2. It is possible some government officials will attempt to relegate or restrict privatization to the governorate level and delay program implementation with state-owned enterprises.

3. Investors express uncertainty concerning the possibility of the government reinstituting government-subsidized, competing industries.

4. At the governorate-level, local council resistance to privatization may occur. Local Council acceptance of asset values may be delayed and they may create other obstacles to prevent transfer of ownership and/or management.

5. Government employees (labor and management) may oppose the program, particularly in the event of severance and the related amount of severance compensation.

6. Current laws and government procedures for transfer of ownership and/or management may need amendment or new legislation introduced.

7. Even after legal reorganization and financial restructuring, a market may not exist for these government-owned assets. Will the public accept dissolution of these enterprises?

8. What steps can be taken to assure that the governorates do not hold back their more successful projects from privatization?

9. In the event the state-owned enterprises and/or governorate projects possess excess land, what steps can be taken to either sell it or use part of it for other activities?

ANNEX: THE PROPOSED ASSET PRIVATIZATION TRUST

It is envisioned a Presidential Decree will be issued to create a Committee on Privatization (COP) and an Asset Privatization Trust (APT). The COP will be a cabinet-level committee. Composition of the committee should be restricted to five members that may possibly include: Minister of Cabinet Affairs and Administrative Development (Chairman), Ministry of Industry, Minister of Local Government, Minister of Finance (or Central Bank), Minister of Tourism and Minister of Agriculture. The COP will be responsible for proposing to the President which assets will be transferred to the APT (or other institution) for disposal. The COP will also have the option to rehabilitate an asset in addition to its approval authority regarding final sale of assets.

The APT will act as the disposal unit in the process, i.e., it will take title to, provisionally manage, and dispose of the specified assets. It will have a limited span of operations with, ideally, five full-time trustees recruited from the private sector.

Most likely the APT will initially focus primarily on assets held by the twenty-six (26) governorates and, shortly thereafter, expand its activities to nationally-owned enterprises and/or parastatals identified for privatization by the COP.

Essential provisions of the proposed Presidential Decree may include:

1. Creation of the Committee on Privatization (COP).

Purpose: Disposal of governorate projects, state-owned enterprises and other government assets with maximum cash recovery. Assets should include institution's receivables, real and personal property, shares of stock and investments as well as the institutions themselves.

COP Composition: Approximately five ministers appointed by the President.

Functions and Responsibilities:

To identify non-performing assets and government entities to be transferred from government ownership to the APT.

To determine which assets should be privatized or otherwise disposed.

To establish guidelines for the disposition, interim conservation or rehabilitation of assets by the APT.

To approve or disapprove the sale of assets recommended by the APT, and, if applicable, rehabilitation pending disposition. Such approval will require a majority vote of the COP.

To exercise rights of ownership with respect to the identified assets.

To generally guide, monitor and review the entire divestment and privatization program.

Term and Funding: The COP may exist for a limited number of years, perhaps five. Approximately $1,000,000 will be authorized to cover committee expenses, to be charged against the $2,000,000 project funds intended for capitalization of the APT under the proposed decree.

2. Creation of the Asset Privatization Trust.

Composition: Five Trustees recommended by the COP and appointed by the President.

Functions and Responsibilities:

To formulate and implement, after approval by the COP, a program for the disposition of assets transferred to it within the designated time period of approximately five years.

To set price, terms of payment and buyer for each asset subject to written COP approval.

To manage assets pending disposition.

To file lawsuits, if needed, for the recovery and protection of such assets.

The APT will be accorded flexibility and autonomy in its operations in the interest of rapid divestment.

A majority vote by the Trustees will be required of proposals for the disposition or rehabilitation of assets.

Term and Funding: The APT may exist for a limited number of years, ideally five, and should be able to complete its mandate in that time. Trustees may serve full-time for up to five years. The Trust will be initially funded with $100,000,000 and subsequent annual increases will be authorized based upon need and performance. External funding in the form of loans or grants may be obtained from multilateral, bilateral or domestic sources, both government and private.

Other Operationsl Provisions:

The APT will be authorized to reorganize trusteed entities and, in particular, to convert non-stock companies into stock corporations with approval from the COP. The COP and APT will appoint Chairman and members (five) of the trusteed entities.

Cost reduction measures and other management changes (e.g., pricing policies, labor policies, accounting systems, legal structure, etc.) may be implemented by the APT. It may also create mergers, spin-offs, divestiture and other forms of reorganization.

All control and authority over the assets will be transferred from the government (governorates/ministries) to which they were previously attached to the APT.

Except for fraud, breach of misrepresentation, the sale decisions of the APT are binding and incontestable.

Net proceeds from the sale of assets shall form part of the general revenue accounts of the governorates or national government.

The APT and all assets held by it shall be exempt from all transfer/sales taxes, fees, etc. However, obligations secured by tax liens shall be satisfied.

The APT shall be granted immunity from court injunctions that may delay the sale of assets.

LEP

July 2, 1987

MEMORANDUM

TO: Distribution

FROM: PPP/P, Vivikka Molldrem

SUBJECT: Decisions from Executive Committee Review of the Privatization Concept Paper, June 25, 1987

The Concept Paper was approved for PID development. The Executive Committee gave the following guidance for design of the PID:

1. Don't get out in front of the government. As the Concept Paper noted, privatization must be the GOE's initiative, not USAID's. It is important for USAID to be supportive, but not to be taking the lead in this area from the government. There is already a great deal of interest in privatization, or popularization as the GOE prefers to call it, among high government officials. IS should boil down the concept paper into a page or two, and arrange for informal meetings with the key Ministers to discuss the idea. This would help to ensure understanding and approval of the concept by the Economic Cabinet early on, and to obtain their inputs into further design. The paper should also be renamed, because "privatization" has politically sensitive connotations. IS will come up with a more acceptable name.

2. The Government should share the cost of the asset privatization trust. This would demonstrate its commitment to the activity. Since the trust will be dealing in LE, it is reasonable to assume that the GOE could contribute a healthy share of the trust through the Special Account.

3. The PID should discuss the project's disbursement mechanism. For example, USAID would probably not want to review each transaction of the Trust. Disbursement of funds might be against plans or on some other basis.

4. The PID should examine alternative models for the Trust. For example, should the Trust be merely a broker between the government and the private sector, or should it take a larger role? Governorate projects cannot be sold without some restructuring -- they need to be incorporated, and to have separate accounting procedures established. For such firms, the Trust would have to play more than a brokerage role.

15

One alternative discussed at the meeting would be a straight cash transfer for each government industry sold. But Congress is tying so many strings to ESF cash transfer that this may not be an attractive option.

Another alternative might be a one-time law allowing governorates to privatize at a loss. But legislation would require raising the subject at the People's Assembly, and this may not be advisable.

Another alternative is to set up the Trust in a way that encourages it to borrow from the Banks whenever it can. One caution here is that the Trust should not be allowed to develop a corporate identity, which would then cause it to look only for profitable transactions.

In any case, these and other alternatives should be discussed in the PID.

5. The PID should discuss what influence USAID should have on the criteria used by the Trust to evaluate businesses. For example, are prices paid to transfer ownership of firms to be based on market value or book value, or some other valuation? Should the trust base its decisions on financial criteria only, or on economic criteria as well? The latter may be quite different because of price distortions in the economy.

6. The PID should define the universe of target firms that might be involved, and the trust's priorities for privatization. There was a great deal of discussion -- and confusion -- on this point at the meeting. Should the trust focus on the "dog" projects? What if the trust knows a firm is a loser from the start and will have to be liquidated, at a loss to the Trust? Should the Trust be willing to take on very large industrial projects, or should it stick to the smaller ones? Should it deal with both governorate and national industries, even through there is a need for a very different approach to the two types?

The PID should provide a profile of the government companies the project is likely to deal with. (E.g. how many are there? How many employees do they have?)

7. The project needs sufficient evidence of GOE commitment that we can be assured government agencies won't just go back into business once the project is completed. Ministerial or governorate promises are not adequate assurances. A project of this nature is always risky because changes in government philosophies cannot be predicted. One real advantage of an

16

asset trust is that it can make a real effort to broaden equity and popularize ownership, through such vehicles as employee ownership. Broadening ownership of these industries is the best way to ensure that they will not be nationalized later.

8. The PID should explain what happens to the Trust at the end of the project. If the Trust ends up with a profit, what happens to it? The Trust is not intended to be a permanent organization. How can we assure that it will be temporary? What should be the total life of the Trust? Perhaps a "sunset law" is needed to ensure that the Trust does not continue indefinitely.

9. The PID should address how the Project will deal with displaced industry personnel. The Concept Paper states that the project will need to provide training/alternative opportunities for employees whose jobs are jeopardized by privatization. This would not necessarily be done by the Trust -- the project has other elements. But it is essential to deal with negative employment impacts if privatization is to be accepted. Worldwide, the impact of privatization has been to increase employment, but there will certainly be some temporary displacements.

Clearances:

IS, P. O'Farrell (draft)
PPP/P, J. Conly (draft)

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