FINAL REPORT

Privatization Phase II Program Evaluation

(Contract No. 180-0014)

IQC No. AEP-0085-I-00-3003-00, Delivery Order No. 3

Submitted to:

EUR/PDP/PA
Agency for International Development
Washington, DC

Submitted by:

A Joint Venture

Development Economics Group/
Louis Berger International, Inc.
&
Checchi and Company Consulting, Inc.

July 30, 1993

TABLE OF CONTENTS

EXECUTIVE SUMMARY

From mid-1991 through February 1993, AID has obligated $44.5 million under the "Privatization and Enterprise Restructuring Project" for 54 privatization projects in 11 countries. In the three countries that are the focus of this study -- the Czech Republic, Poland, and Hungary-- AID has financed 44 activities totaling more than $31 million or about two-thirds of total program funding.

This study evaluates the effectiveness and efficiency with which AID funds have been invested in privatization activities in these three countries. On a general level, it examines the extent to which AID assistance has helped governments develop a legal and institutional framework for privatization. At the firm level, it looks at whether the project has assisted firms in strengthening management and adjusting to open, competitive markets, principally through accomplishing privatization.

At both levels, the key questions posed in this evaluation include:

- Which projects have been successful and which have not?

- Can we identify a pattern that helps predict success?

- What are the key lessons learned and recommendations for future program activities?

While these questions are straightforward, the answers provided in this evaluation are not. They necessarily involve interpretative analysis, most of which is qualitative and subject to debate. Contrary to the expectations of many AID managers and outside observers, defining success in these projects is not just a simple matter of analyzing the number of privatizations and transactions that take place. There are strong political and policy-making elements to the program that must also be taken into consideration.

Even in those cases where privatizations take place there is a wide range of opinion on how long and what effect AID assistance had in making the privatization take place (i.e. "impact attribution"). Some argue that after, in some cases, more than two years of project implementation, it is still too early to expect completed privatizations. Counterarguments to this state that if a program cannot clearly show concrete "results" after about two years, it should not be continued.

As is the case in many evaluations, the truth lies somewhere in between these two extremes. Hopefully, this analysis will better illuminate the factors for success and areas in which AID assistance seems to be having a positive influence and should continue to provide support.

A. MAJOR FINDINGS

The results of AID's privatization initiatives in the Czech Republic, Poland and Hungary have been predominately successful with, in some cases, more mixed results. Out of a total of $31.3 million dollars obligated for projects, it is estimated that over 70% of the expenditures have either resulted in outright successes (52%) or mixed success (20%). The remaining objectives were either too incomplete to define or resulted in no tangible political or economic benefits. The Czech Republic percentage of successful or mixed success results is 80%, for Poland the percentage is 64% and for Hungary 85%.

AID assistance has been most successful in providing specialized transaction assistance (96% outright successes), in institutional support (89% outright successes) and in policy/program support (80% outright successes). By contrast, most of the firm-specific projects (47%) have not been successful, and only 44% of the sectoral studies have shown enough impact to date to be considered successful.[1]

Some of the more notable successful projects have included: 1) specialized transactional support rendered to the Czech Ministry of Privatization through Crimson Capital/D&T, 2) assistance to the Mass Privatization Program in Poland 3) work with the Czech Savings Bank in the Czech Republic, 4) development of ESOPs program in Hungary, 5) financial sector regulation assistance in Poland, and 6) support to the State Property Agency in Hungary.

These projects either: 1) helped effect or speed up actual privatizations; 2) established necessary financial, institutional structures for future privatizations and market development; 3) established operational procedures critically needed for future privatizations; 4) achieved concrete economic benefits (e.g. increased purchase prices, investment); or 5) provided unanimous and tangible political benefits such as strong host government appreciation and/or demand for more AID-financed services.

Key "factors of success" associated with these projects include:

- **Strong Government and AID Support:** All the successful projects had clear government support and a willingness to act, without other factors, usually political, paralyzing this will. In addition, although not always present, in most of the successful prospects, support from AID/Washington and the local AID/Rep was coordinated and flowed smoothly without disruptive starts and stops.

- **Focused Towards the Middle or End of the Privatization Cycle:** Successful projects, particularly firm-specific ones, were generally undertaken in the middle of the privatization sequence (e.g. development of procedures or policy guidelines) or even

[1] The details of these "success ratios" and a discussion of ranking methodology are contained in Appendix 3 Summary of Project Expenditures, Cost-Effectiveness and Performance Indicators. Detailed "case study" discussions of each project are presented in Appendix 4, "Case Study Analysis of Projects".

towards the end when privatization proposals are being implemented. Assistance for initial market/sector analysis were often subject to floundering and had a low success rate because the targets were scattered.

- **Development of Privatization Policies, Processes and Procedures:** AID assistance has been most effective when it deals at the policy/program or institutional support level or when it is focused on one stage of the privatization process -- e.g. transaction negotiations -- and can be rendered to many firms, rather than trying to provide assistance at various stages to a select number of firms.

We found it possible to classify the privatization assistance rendered by AID contractors into five categories as listed below, plus training as a sixth category. Each of these categories has its own important characteristics. Each has its own level of success probability, with the first three, policy/program support, institutional support, and specialized transactional support being more likely of success than the fourth and fifth: firm-specific transaction assistance and sectoral assistance.

For each type of privatization assistance approach--policy/program support, institutional support, specialized transactional support, firm-specific assistance, and sectoral assistance there are many trade-offs. The arguments for and against a policy/program support initiative include[2]:

Pros	Cons
• Important to top level government concerns	• Hard to quantify impact
• Permits integrated long and short term assistance	• Other donors--e.g., IBRD and EC PHARE--have more resources which could provide competitive advantages
• Most pervasive way to establish transparency	• Long time horizon to achieve results
• Deals with a program from start to finish.	

[2] It should be noted that while the IBRD and EC PHARE have more resources with which to leverage policy reforms, their procurement procedures take longer than AID's which can lead to delays. Consequently, A.I.D. does not believe that the amount of IBRD and EC PHARE resources gives them a "competitive advantage", nor should the availability of resources from these two donors be used as an argument against AID funding policy/program support activities.

The strengths and weaknesses of providing institutional support include:

Pros	Cons
• Processes are easy to define	• Hard to quantify impact
• Permits alternating long and short term assistance	• Good long term advisors hard to locate and contract
• Helps establish credibility and consistency	• Hard to keep projects focused.
	• Without political consensus, may add to bureaucracy without speeding things up.

Specialized transactional support is a category primarily relating to the facilitating of transactions supplied by Crimson Capital in the Czech Republic. Transactional support also exists in the Pri-Man project in Hungary. Like firm-specific assistance it deals with individual enterprises one at a time, but like institutional support, its focus is on certain specific process steps in the government privatization procedure. The success ratio is also more similar to that experienced under institutional support.

The pros and cons of this specialized transaction support include:

Pros	Cons
• Greatly sped up privatization	• Only a few of the steps in a many step process. Therefore somewhat narrow in scope.
• Specialization permits efficient and effective use of high level expatriate skills	• There are limits to the obstacles that this activity can overcome.
• Familiarizes government officials with objectives of foreign investors.	• Hard to measure attribution
• Has improved the number of foreign investor privatizations and the amount of favorable terms to the government.	• Hard to transfer specialized skills to local officials.

Finally, support for firm-specific assistance and sector studies are sufficiently similar to have the same trade-offs as follows:

Pros	Cons
• Most direct way to make privatization happen.	• Low rate of success
• Improves enterprise management skills.	• Costly; not cost-effective
• High visibility to government	• Long time to bring to fruition.

B. LESSONS LEARNED

1. **Facilitating the privatization process is better than promoting a single company.**

AID is best at "facilitating" privatization processes rather than "promoting" one particular privatization transaction. Some of the more successful programs have been assistance to institutions or specialized transaction support in which AID contractors provide specific assistance -- e.g. transaction negotiations -- to a multitude of firms. Firm-specific, "promotion" activities are resource intensive and take longer to achieve their objectives than facilitation activities.

2. **Long term advisors can provide highly effective assistance, although quantifying their achievements can be difficult.**

Almost all the long term advisors placed overseas have been considered "critical" or "very useful" to the operation of privatization programs by government officials and clients. Long term advisors often develop a strong understanding of the capability of government officials they are supporting, provide continuity when there are changes in Ministry staff, and establish credibility for the government with outside investors and for AID with the government.

3. **Advice early on in a policy/program cycle helps establish credibility.**

Initiating advice early in a policy/program cycle can create credibility and give a jump start to a policy/program, as has occurred with several policy/program assignments in Hungary and the Czech Republic.

4. **AID privatization assistance should be focused yet still diversified.**

Making privatizations happen is risky business. There are many economic and political tradeoffs and choices that have to be made regarding types of companies to assist and objectives to be achieved.

Most notably, AID assistance is especially qualified to supply foreign transaction assistance, but this should not be to the exclusion of also rendering domestic privatization support. Project emphasis on foreign investors can produce quick, short term economic benefits. But they should not be carried out to the point that longer term domestic issues and constraints are overlooked (e.g. restructuring, promotion of domestic investment).

5. **Projects work best when there is strong coordination and a clear consensus of objectives among AID/Washington, the AID representative in the field and the contractor. At times the division in contract management between AID/Washington and the field has resulted in less than optimum coordination and has impeded project timeliness.**

Conversations with AID representatives and AID/Washington personnel reveals an underlying tension and debate as to which group should manage the privatization program.

Currently, contract management is centered in AID/Washington which has consistently been understaffed, had high turnover rates, and not always had the funds to visit the field on a regular basis. These constraints, along with fast changing demands in the field, have led to some disagreements over project objectives and delays in funding which have hurt AID credibility. As a result, the field staff have felt that the lack of decentralized decision-making, and especially implementation, has, at times, tied their hands and made it difficult to promise or fulfill promises of timely assistance to the host government. (See Appendix 8 for more specific examples of coordination issues).

6. **An ad hoc, reactive privatization strategy can be convenient and positive in the short run, but problematic thereafter.**

A decentralized, reactive privatization strategy in which program initiatives are defined by government demands and/or marketing efforts of contractors in country can help generate political support and goodwill. It also can be useful for testing a variety of experimental interventions.

However, the continued application of an ad hoc, "buckshot" strategy can eventually lead to dissipation of resources and in the absence of concrete results, weakening of political support for a program. Also, having the host government set the rules for project conduct is not always a reliable guide. Often times, governments have too many mixed agendas on their minds.

C. RECOMMENDATIONS

The differing patterns of "success ratios" for the different categories of projects mean that in the future, AID will need to be more selective in how it targets its investments. This will require the development of country strategies with annual funding targets, clearly defined priorities and objectives.

AID should implement a country strategy. In the three countries, enough diversity exists or has been developed, so that we feel they can only respond successfully to a country-oriented strategy, rather than one that is regional or global.

AID must be responsive to host country requests. Being responsive, however, does not mean that AID should become "demand-driven" or allow its contractors to market new initiatives without some guidance. Past experience shows that being reactive and following a "buckshot" approach to identifying projects and firms can lead to disagreement over objectives. At the same time it is recognized that effective aid is interactive. Interactivity requires each party, host government and AID, to take account of the other's objectives and preferences.

Future areas of AID assistance in all three countries visited should include: additional "facilitating" work helping with transactions and negotiations, and with policy-formulation and institution-building; development of bankruptcy/workout units; more structured on-the-job training with an eye to promoting greater coordination with other donors, particularly EC PHARE; continued financial sector development and support to mass privatization programs through "back office" support[3] ; and, if needed, public information campaigns.

To the greatest extent possible, AID should try to leverage its resources by:

- Transferring the successful experience in one project from one country to another -- this would be appropriate for the Crimson Capital/D&T work as well as the financial sector development going on in Poland and Hungary,

- Expanding into new services by building off the experience AID currently has with institutions it is assisting -- e.g. development of workout units in the Czech Savings Bank,

- Financing small "seed" projects in new experimental privatization methodologies and keeping an eye out for quickly expanding those projects that look most promising-- e.g. like the Self-Privatization or ESOPs projects and,

- Working in close coordination with other donors, particularly in the areas of training and high risk areas of assistance like social programs and restructuring.

- Delegate additional implementation authority to the field, while still retaining policy decision control in AID/Washington.

In the Southern Tier and Baltics --"Stage I" countries -- in which privatization development is not as far along, AID should try to transfer some of the concepts and skills developed in its specialized transactional support, institutional support and policy/program support initiatives in the Czech Republic, Poland and Hungary.

Specifically, AID should try to achieve the following objectives:

- **Establish credibility.** Do whatever is necessary to make sure that the country is able to successfully privatize. This could include a "Crimson Capital/D&T" type of assistance to facilitate deals between foreign investors and some of the stronger domestic companies.

---

[3] The term "back office" support means the development of support systems to issue and keep track of securities transactions (e.g., buying and selling of vouchers, stocks, etc.). It is primarily an accounting function intended to make sure that any transactions are properly documented. It does not involve policy or strategic analysis.

- **Provide consistency.** AID can help develop consistency in the privatization process by establishing institutional procedures and processes. This could be done for government agencies (e.g. Ministry of Privatization).

- **Promote transparency.** AID has extensive experience in helping establish an appropriate regulatory and legal framework. The experience collected to date should be transferred to other countries.

1. INTRODUCTION

Congress passed the SEED Act which authorized and funded AID's involvement with the emerging democracies of Central Europe in late 1989. A buy-in to a separate central AID/PRE project funded initial privatization assistance by Price Waterhouse. In late 1990, AID decided to amend three IQC contracts (Indefinite Quantity Contracts) to implement its Privatization and Enterprise Restructuring Project, Contract No. 180-0014. These three contracts were awarded in the summer of 1991, with the first delivery order under them providing technical assistance starting in the fall of 1991.

Under the Contract, 54 privatization projects in eleven countries have been initiated with funds of approximately $45 million allocated through February, 1993. By March, 1993, these projects have matured sufficiently to evaluate their course and impact. Especially for those in the Czech Republic, Poland, and Hungary, where $31.3 million, - two-thirds of the total - has been allocated.

The Scope of Work for this evaluation (see Appendix 1) requires "an assessment of the impact and effectiveness of AID's Privatization & Enterprise Restructuring Project (180-0014) in the CSFR (subsequently limited to the Czech Republic), Poland and Hungary." Furthermore, this evaluation must "build upon the ongoing, Phase 1 assessment of country privatization programs in these countries under the Price Waterhouse study, "Evaluation of Privatization in Central and Eastern Europe", February, 1993.

Paraphrasing the above, the Phase 1 assessment was to study the wisdom and effectiveness of the privatization programs of the three countries. This successor study reviews the wisdom and effectiveness of the privatization projects that AID and its contractors have executed.

Our study deals with such questions as:

- What types of projects have been successful and which have not? Which project approaches have been able to follow the activities and accomplish the objectives set for them?

- How do country-specific conditions differ and affect the successful implementation of AID privatization assistance? What programs or projects are advisable for the near future?

- What has been the impact of AID assistance? What criteria can be used to define the impact and success of AID assistance?

- What are the key lessons learned and recommendations for future program activities in the three countries visited as well as in the Southern Tier and Baltic States?

1.1 Key Issues in Privatization

Experience throughout the world has shown that the presence of political will is the key ingredient in privatization. The countries of Central Europe, especially the three countries considered in this report, are in one sense unique. More than almost any where else in the world - especially outside of Western Europe, North America, and parts of East Asia, most notably Japan - these new democratic governments have turned their backs on the command economies of their past in search of an effective market oriented economy. More than in most other countries, there has emerged a popular will of the people that their governments to do this. Therefore, these governments - however falteringly on occasion and with many missteps - have a powerful political mandate to privatize and restructure in order to achieve a free market economy.

Even though the situation in each country is unique, there are common problems to be faced. The road to privatization is always difficult; each country must make critical choices for its privatization program. Some of the common key issues that always have to be faced and the strategy and sequence selections that have to be made are as follows:

Program Objectives: The objective of this evaluation, and that of the privatization assistance that AID renders, is to emphasize economic objectives: for example, will the privatization of a company create new sales and investments that will improve its performance? However, in the real world, governments of privatizing countries must also consider political questions and balance them against economic questions. Often a choice must be made; often political questions dominate an issue. Outside technical assistance does not make the choice between politics and economics; that is for a government to do. But if outside assistance is to be rendered intelligently, it must be sensitive to the fact that such choices exist.

Project Activities: Every privatization program must decide how to distribute its activities. Should it emphasize the development of policies and programs before it builds supporting institutions? Should it focus on transactions or on institution building? Should it alternate its attention on a variety of activities and in what sequence? Effective assistance must be aware of these trade-offs. As this report will show, the three countries have made quite different choices in dealing with this issue, and their decisions have taken them down three different paths.

Target Groups: When dealing with firm-specific assistance, what kinds of enterprises should be given priority? Should a country focus its resources on assisting best case "winner" firms, or should it target problematic middle-tier companies that need to be restructured? Should a country approach the privatization of companies individually, or in groups on a sectoral basis? Is there a preferred method of selecting individual target companies?

Even this brief account of objectives indicates that a host government will and should be concerned with a variety of different forces: political, economic, social, and personality-oriented. AID and its technical assistance contractors must be sensitive to all these factors. But its primary input, we believe, has to be advice that is based on sound economic doctrine. We have less to offer in telling a country how it should deal with the other factors.

These basic issues, and the degree to which one objective is favored over another, must be faced as part of any privatization strategy. Some of the key strategic questions raised by these trade-offs include:

Type of Strategy: Should a country program develop a cohesive strategy, or should it be ad hoc and flexible in order to respond to a variety of requests?

Type of Sequencing: How should project activities be sequenced? Is it necessary to work on policy reform before firm-specific assistance be provided? Should a program focus on privatizations before, after, or in conjunction with restructuring activities?

Investment Time Horizon: How long should it take for assistance to achieve its intended result (e.g. a completed privatization)? How much money should be spent on a type of assistance (e.g. sector studies)? There is little consensus or definition of what the time horizon for investment payoffs and benefits should be. This lack of agreement leads to differing expectations and advice about when AID-financed activities should produce results.

This report describes how each of the three countries faced these issues and evaluates the consequences of what they did.

1.2 Overview of AID's Privatization Program in Central Europe

The three summary charts listed below and the detailed charts in Appendix 2 show the distribution of project work for each country.

Total number of projects and funding obligated by country are:

	# of Projects	**Funding (millions)**
Czech Republic	16	$13.4
Poland	15	10.7
Hungary	13	7.2
Total	44	$31.3

Correlating these expenditures with such indicators as population or GNP reveals that the proportion of funds allocated to the Czech Republic and to Hungary are somewhat in balance, whereas the funds for Poland are significantly less. This is a reflection of several factors: a) Hungary's privatization program got started first, b) the Czech voucher program, a massive undertaking, has required a major response, and c) early on, there was a stronger consensus among the Czech and Hungary field representatives and AID/Washington about what programs to finance.

Distribution of projects by type of activity (numbers in millions) are:

	Czech Republic	**Poland**	**Hungary**	**Total**	**%**
Policy & Program	$2.0	$2.6	$2.1	$6.7	21.4%
Institution Support	0.1	0.5	3.7	4.3	13.7%
Specialized Transactional Support	7.1	0.0	0.3	7.4	23.6%
Firm-Specific Assistance	2.8	1.5	0.1	4.4	39.6%
Sector Assistance	1.4	6.1	1.0	8.5	27.3%
Total	$13.4	$10.7	$7.2	$31.3	
% of Total	43%	34%	23%	100%	

These different activities are discussed in Section 2. During the first year of program expenditures in the Czech Republic and Poland, and to a lesser extent in Hungary, AID assistance focused primarily on firm-specific assistance. In the Czech Republic, the selection of targets was initially quite random. In Poland, the major emphasis was on a sector approach. However, by the end of 1992, AID assistance in all three countries was directed more towards providing institutional or specialized transactional support or establishing new policies and programs.

Distribution of work among contractors by country and in total (numbers in millions) are:

	Czech	Poland	Hungary	Total	%
Deloitte & Touche	$7.8	$2.6	$5.0	$15.4	49%
Price Waterhouse	2.0	3.6	-	5.6	17%
KPMG	2.9	3.9	0.3	7.1	23%
Coopers & Lybrand	0.2	0.1	0.8	1.1	4%
Inter-Agency	0.5	0.1	-	0.6	2%
Other	-	0.4	1.1	1.5	5%
Total	$13.4	$10.7	$7.2	$31.3	

The four principal contractors under the IQC have conducted 90% of the project work. Deloitte & Touche has conducted about half of the work, principally in the Czech Republic and Hungary. KPMG and Price Waterhouse are about even, each almost having half of Deloitte's share, and the others have minor amounts. The method of contractor selection for projects is usually by competitive submissions and based on the client's perceived excellence of the proposal, not by quota or low bid.

1.3 Evaluation Methodology

The evaluation was accomplished by a team of consultants formed in a joint venture between Louis Berger International, Inc. and Checchi & Company. Each firm provided two members -- Mr. Paul H. Elicker, Team Leader, Mr. Charles H. Bell, Dr. Allen LeBel, and Mr. Arthur Wielkoszewski. Mr. Bell is an employee of Louis Berger International; the other three are independent subcontractors.

Following preparatory discussions in Washington D.C. with AID officials and contractor home offices, the survey team departed for Central Europe on February 23, 1993 and returned on March 17, 1993, spending a week in each country. Field time was spent interviewing government officials, public and private bankers and officials in privatizing and non-privatized enterprises, as well as other significant players in the privatization process such as foreign contractors, lawyers, and representatives of other donors. A list of those interviewed appears as Appendix 5. Field work consisted of visits to the above individuals' various offices and, importantly, to company plant and headquarters locations. Each interviewee had a special point of view toward their experience with privatization, and the survey team purposely contacted a wide variety to get a balanced and rounded point of view.

The local AID representatives and the on site representatives of the four principal contractors were especially helpful in giving their insights and in making appointments. Local facilitators hired in each country on site were also very helpful.

1.4 Structure of the Report

This report follows the broad categories of questions presented in the evaluation scope of work (see Appendix 1). General issues are covered in Section 2, while country-specific issues are presented in Section 3.

Section 2 evaluates the trade offs among the various approaches and the questions raised in the "General Issue" section of the scope of work. Section 3 reviews AID's role in each of the country's privatization programs. This section answers questions raised in the "Country Specific Issues" section of the scope of work as well as reviews the major issues and conclusions presented in the Phase I country assessments carried out by Price Waterhouse.

Section 4 presents a detailed discussion on what the impact of privatization assistance has been, the criteria used for defining success and suggestions on how AID can monitor impact in the future. Finally, Section 5 discusses the general conclusions, lessons learned and recommendations for future activities in each of the three countries visited. It also provides general guidelines to be followed in developing privatization programs in the Southern Tier countries and the Baltics.

2. ALTERNATIVE PRIVATIZATION APPROACHES

2.1 Overview on Five Basic Approaches

The scope of work states that AID has followed four general approaches for carrying out privatization activities. These include assistance:

1) at the policy level,
2) to public and private entities engaged in facilitating privatization,
3) with individual transactions and
4) for follow-on enterprise development (monitoring, training, etc.).

This evaluation builds on these approaches and recharacterizes them into six categories as follows:

1) Assistance at the Policy/Program Level

This includes general assistance for specified privatization programs including: mass privatization, privatization through restructuring and financial sector reform. The main objectives of this type of assistance are to set up procedures/processes for a new program with many intermediaries (e.g. stock exchange) or to serve as a model for future activities in other institutions (e.g. Czech Savings Bank).

Projects in this category include:

Czech Republic	•	Czech Savings Bank
Poland	•	Privatization through Restructuring (in part)
	•	Ancillary Assets
	•	National Investment Fund Support
	•	Banking Regulations
Hungary	•	Financial Sector Redeployment
	•	ESOP
	•	COMPASS

2) Assistance to Government Agencies

This concentrates on making an individual agency better equipped at handling one activity or a set of activities. This assistance responds affirmatively to the question: "Is the assistance intended to strengthen and develop the service capacity of a government agency?" Its primary focus is on developing institutional capabilities, and not necessarily on completing specific privatizations.

Projects in this category include:

Poland	•	SEC Assistance
Hungary	•	D&T Assistance to the State Property Agency

3) Specialized Transactional Support

This support focuses on accomplishing specialized transactional steps in the privatization process. It is firm specific, focused on completing transaction deals, but it also involves providing direct support to government institutions (e.g. Ministry of Privatization) involved in the transaction process. Unlike assistance to government institutions, however, its primary purpose is not institution building or strengthening. Rather, it seeks to complete deals -- but within the context of a government institution.

Projects in this category include:

Czech Republic	•	Crimson/D&T Assistance to the Ministry of Privatization
Hungary	•	Assistance to Pri-Man/Decentralization Project (a subproject under the SPA project)

4) Firm-Specific Assistance

In this category, AID resources are concentrated on comprehensive assistance to individual firms. Its ultimate objective is to provide resources to one or several firms in an effort to assist them in privatization (e.g. develop financial management systems, privatization plans, etc.).

Projects in this category include:

Czech Republic	•	Skoda-Pilsen
	•	T.A. to five companies (PW--Koli, Holice, etc.)
	•	T.A. to four companies (PW--Ferox, Barrandov etc.)
Poland	•	Huta Warszawa
	•	LOT Airlines
Hungary	•	Quick Form

5) Sector Assistance

This consists of constructing a privatization plan by systematically considering a whole industry and all of the major participants in it, rather than focusing exclusively on pre-selected individual firms. It has been adopted in all three countries, but especially in Poland. It is, in effect, a variation of Firm-Specific Assistance.

Projects in this category include:

Czech Republic	•	Assistance to metallurgy firms
	•	Utility-Telecom sector studies (in part)
Poland	•	Glass Sector
	•	Furniture and Particle Board Sector
Hungary	•	Monor State Farm

All projects are identified by name and number in Appendix 2, which also contains certain other data by project.

6) Training Support

This last category is the most pervasive in the AID portfolio, as well as the most undefined activity. In most projects there is an element of training (e.g. counterpart, seminars, etc.). Typically, training has been viewed as a secondary objective of a larger project. To date, there have been only a few programs that are considered generic management training or privatization training projects.

There is some overlap among these categories. AID work orders tend to contain elements of more than one of these types of assistance. For example, we define assistance for the Czech Savings Bank as "program support" since it is intended to help serve as a model in the implementation of the Czech government's mass privatization program. Others, however, might view such assistance as firm-specific since it is focused on one bank. Similarly, the work of Crimson Capital/D&T on transactions might be viewed as "firm-specific assistance" since the consultants work on completing transactions with individual companies. But we view it as a specialized transaction-oriented support since its focus is on negotiating transactions with a multitude of firms as part of the privatization process within the Ministry of Privatization.

As mentioned in Chapter 1, we estimate the distribution of AID assistance by type of activity as follows:

Policy/Program Support	$ 6.7 million (21%)
Institution Support	$ 4.3 million (14%)
Specialized Transactional Support	$ 7.4 million (23%)
Firm-Specific Assistance	$ 4.4 million (14%)
Sectoral Assistance	$ 8.5 million (27%)

This breakdown was determined by reviewing the governing PIOTs and the actual nature of the work conducted on site. Our detailed findings are covered in Sections 2.2, 2.3, 2.4, 2.5 and 2.6 and in Appendices 3 and 4.

Each type of assistance can be implemented at one or more stages in the privatization process. Broadly speaking, we have identified three key stages:

Stage I -- "Upstream" Initial Analysis:

During this stage, assistance is focused on identifying privatization constraints and opportunities. For example, in sector studies upstream assistance consists of reviewing market trends, identifying the major companies in the market, and reviewing the overall prospects for privatization. In government agency support projects, this assistance typically consists of defining agency roles, structures and processes. "Upstream" policy and program guidance focuses on analyzing institutional, policy and regulatory constraints.

Stage II-- "Midstream" Development of Procedures and Proposals:

The next stage of assistance consists primarily of preparing concrete proposals for privatization (firm-level), institutional responsibilities and flow of activities, and policy/program guidelines.

Stage III--"Downstream" Implementation:

The final stage consists primarily of completing privatization deals and implementing the institutional or policy guidelines defined in Stage II.

As shown in Table 1, much of the AID assistance has been concentrated on "midstream" support to firms, government agencies and programs ($14.6 million). Equally large amounts of money were spent on "upstream" sectoral studies ($7.3 million), as well as on "downstream" assistance to both firms and government agencies ($9.4 million).

Much of the "raw material" of facts and findings for each of the projects discussed in Sections 2.2 through 2.7 that follow is contained in Appendix 4 which reviews the facts and issues involved in each major project.

2.2 Policy and Program Support

2.2.1 Overall Effectiveness and Impact of Assistance

AID has invested $6.7 million, or more than 20% of its funds, on policy/program support. Assistance in this area has been spread fairly evenly among the three countries, with Poland (38%) receiving the most, followed by the Hungary (32%) and the Czech Republic (30%). (See Appendix 3)

AID funded assistance at the policy/program level has been found to be effective and attractive, and can make a desired impact. If properly executed, policy/program assistance can result in many privatizations, or establish procedures required to maintain an orderly capital market. It is cost effective because often this assistance can be delivered for the cost of privatizing one firm. Policy/program assistance is attractive since it often provides technical assistance of uniquely American expertise, expertise that the host country prefers to be American, or which is in our best interest that it be American. Its impact, while sometimes difficult to quantitatively measure, is greatly appreciated by government officials and essential to future privatizations.

Among the major lessons learned concerning policy/program assistance are the following:

- **Targeted policy/program assistance is the most successful**

An assistance program is most effective when it is targeted and tied to a specific institution or clear objective, as occurred in Poland with the ancillary assets program and in Hungary with the ESOP project. Indeed good policy/program assistance often resulted in deliverables and ad hoc assistance being provided, both often in greater than quantity the scope of work called for.

Table 1 – Matrix of AID Privatization Projects

Type of Assistance / Stage of Assistance	I Initial Analysis e.g. Sector Studies, Institutional/Policy Analysis		II Development of Procedures and Proposals e.g. Privatization Plan, Definition of Guidelines		III Implementation e.g. Negotiations, New Accounting System
Sectoral Assistance $8.5 milliod	P/Glass Sector (#2622122) P/Furniture & Particle Board (#2622121) H/State Farms (#2622101)	C/Util/Telecom* (#1183406) C/Non–Ferrous Metal* (#2622107)	H/Monor State Farm (#1183480)		
Firm – Specific Assistance $4.4 million	P/Task Force Company Assist. (#2622106)		C/PW Tech Assist (#1183486) C/Municipal waste (#2622100) C/Small & Medium T.A. (#1183482,83,84,88) P/Huta Warszawa (#2622106) H/Quick form (#2622118)	P/LOT Airlines* (#2622103)	C/Skoda Pilzen (#1183488)
Specialized Transactional Support $7.4 milliod					C/Crimson (#2622106) H/Self Priv.–Pri–Man (#3622073)
Institutional Support $4.3 million			C/Ministry of Economics (#2622125, #1183108) H/Investment Promotion (#2622111) P/SEC (#2622113)	H/SPA* (#1183482)	
Policy/Program Support $6.7 million	P/Econ Restruct. & Privatization (#1183478) P/Tech Studies (#0183479) H/Financial Sector Reform	H/COMPASS* (#2622133)	P/Privatization through Restructuring (#2622132) P/Ancillary Assets (#2622114) P/RICs & NIFs (#2622110) P/Bank Regulations (#2622104)	C/Czech Savings Bank* (#2622108) H/ESOP* (#2622112) H/Franchising* (#2622136)	
	$7.3 million	$2.0 million	$6.4 million	$8.2 million	$9.4 million

Legend: C = Czech Republic; P = Poland; H = Hungary; # = PIO/T Work Order
* These projects were evenly divided between two stages of activities.

- **Advice early in a policy/program cycle helps establish credibility**

Initiating advice early in a policy/program cycle usually creates credibility and can give a jump start to a policy/program, as has occurred as occurred in the Czech Republic with the Czech Savings Bank and may prove helpful in Hungary with the Compass Program. Conversely, late starts often result in picking up the pieces of a not completely focused program, as was the case in Poland with Regulated Investment Companies. Even a good program, like Hungary's Financial Sector Redeployment, suffered when a government official decided to issue his own plan rather than wait for the delayed AID assistance to begin. Much time had to be spent convincing government officials that this plan was inadequate and misfocused before the project could proceed.

- **Programs should be country-specific and, to the greatest extent possible, managed by the AID field office**

Host government privatization policies/programs are becoming increasingly differentiated, therefore any regional privatization strategy for policies/programs at higher than a country level is not advisable. The considerable diversity in type of effort supplied supports this conclusion. In some instances, it is possible to set up a cost sharing arrangement with the recipient of the assistance, as is the case with the Czech Savings Bank.

The AID field office should have the ability to authorize funding of policy/program assistance, and/or at a minimum the flexibility to amend authorized funding. The lack of this local authority has, at times, held up host country requested assistance, especially in Poland. (See Appendix 8 for detailed examples).

- **Long term advisors provide needed continuity and flexibility**

Policy/program assistance works well when a long term advisor is assigned to the project and is stationed in country. Such stability is especially significant given the high turnover of personnel in ministries, which has occurred in all countries, particularly in Poland.

Long term advisors can get a handle on the personality and capability of government officials they are supporting, provide continuity when there are changes, and establish credibility for the policy/program. Long term advisors can develop their credibility by providing ad hoc advice, which occurred at the National Bank of Poland when the NBP was faced with its first bank failure crisis. Indeed, in that case and in others, several recipients of policy/program assistance expressed a desire to have their advisors available for more ad hoc assistance.

* * * * *

The sections that follow provide a brief analysis on policy/program support initiatives in all three countries. Section 2.2.2 provides an overview on the most successful activities by country. Section 2.2.3 focuses on mass privatization issues and compares each country's approach in that area. Section 2.2.4 reviews the problems encountered in trying to develop a program for "privatization through restructuring" in Poland. Section 2.2.5 then compares each country's efforts to develop appropriate financial sector policies and institutions. Finally Section 2.2.6 reviews other issues and programs in the area including: experimental programs, such as "health care" in the Czech Republic, overall coordination among other donors, and other AID initiatives not financed by the Privatization contract.

2.2.2 Country Overviews

Czech Republic

Privatization support by AID in the policy/program area has had a very high success ratio of 98%, especially recently (See Appendix 3). The effective training program in fund management in the Czech Savings Bank is one of the key elements that can make the Czech Republic's mass privatization program a long-term success.

AID policy/program assistance in the Czech Republic has been minimal, in part because it decided to develop its policies/programs with little outside assistance. The Czechs have zealously guarded their prerogatives in the policy/program area, and in large part have made excellent decisions. Additionally, in the capital markets field, other donors, especially the Know How Fund, have been active. Indeed, with the exception of the assistance to the Czech Savings Bank, the Czech Republic has not carried through with requests for such assistance, even though the local AID office has met with the appropriate ministries to see if policy/program assistance was required.

While the Czech Republic should be commended for its independent approach, the lack of clearly defined policy/program assistance by donors could end up hindering the overall privatization effort. For example, the Czech Republic still does not have a functioning stock market or a useful bankruptcy law. Both of these might have been set up by now had the Czech Republic carried through on its requests for assistance and had AID been given the opportunity to provide support.

Poland

Poland has received the largest amount of policy/program assistance. In part, this is due to the large number of policy/program initiatives the Polish Government has been willing to develop. Here also the success ratio has been high, 76%. AID funded assistance has supported the privatization through restructuring program, spinning off ancillary assets, corporate accounting and reporting requirements, as well as back office support at the MPP and bank supervision at the National Bank of Poland. With the exception of the first, all of these have proven to be effective and well received.

The only program not discussed below is the ancillary assets program. This program was successful at fine tuning a large company's plan to privatize its ancillary assets (e.g. sports clubs, apartments, kindergartens, etc.). The consultants hired by AID in effect played a validation role for the company. The documentation and manual prepared by the consultants were worthwhile, cost-effective and will serve as a model for any future ancillary privatizations contemplated by the government and other firms. (see Appendix 4 for detailed case study discussion).

Hungary

Policy/program assistance in Hungary has also been active with 66% consisting of known successes. Next to the Poland program, Hungary has experimented with a variety of new program initiatives, most of which have proven to be successful.

AID funded policy/program support initiatives include: 1) initial support to the State Property Agency (SPA) when an AID-funded advisor helped lay out program objectives, 2) development of an Employee Stock Ownership Program (ESOPs), 3) financial sector redeployment, and 4) Consulting of the Office of the Minister for Privatization-Agricultural Sector Support (COMPASS).

Of these, the most successful projects were the ESOPs, discussed below, and financial sector redeployment, (discussed in Section 2.2.5). Both are further detailed in Appendix 4.

ESOPs are a tool of privatization which fulfill the host government's desire to give more ownership to workers, also getting rid of the old enterprise (workers') councils. And whereas over 70 countries have some employee ownership legislation, ESOPs, especially in their tax aspects, are an almost uniquely American idea. Only the U.K. and the U.S. and now Hungary have ESOP legislation, but the U.K.'s is more restrictive and thus less popular.

AID funded assistance was essential to establishing an ESOP law and the technical infrastructure required to make ESOPs work. As a result of this assistance, Hungary is the third country to have an ESOP law, with over 20 companies having achieved approved ESOP status, and over 100 in various stages of adopting an ESOP. Without AID assistance, Hungary would not have any ESOPs. It should be noted that this program was established without prominent strong advocates within the government, which runs counter to one of our general conclusions that the more successful programs have strong government advocates. Rather, the program was approved because it made general political sense.

2.2.3 Mass Privatization

Mass Privatization Programs (MPPs) are an attempt to provide wide ownership of formerly state owned assets to the general public. At the same time, MPPs allow governments to privatize large numbers of enterprises rapidly without searching for potential individual buyers, either foreign or domestic. The Czech Republic and Poland have developed their MPPs fundamentally differently, while Hungary is just now considering developing a MPP with still different features. All three programs are candidates for assistance and each country's approach reveals the area to which AID should tailor its assistance.

Czech Republic

The Czech MPP was designed to privatize large segments of Czech enterprises quickly and provide ownership in these to Czech citizens. The "first wave" resulted in 2,000 privatization proposals, out of 8,500 submitted, being approved. A "second wave" is scheduled to review more than 4,500 proposals.

The Czech MPP was designed as a "bottoms up" privatization program whereby all Czech citizens could buy a voucher booklet at a nominal fee, and use the vouchers to buy shares of firms being privatized in the MPP. Mutual funds, called Investment Privatization Funds (IPFs), were created offering extraordinary returns to anyone who traded in their vouchers to the funds.

With the exception of the major training assistance to the Czech Savings Bank, AID has not been involved with any other aspect of the Czech MPP. Evidently the Czech government did request assistance for their MPP, but it appeared that this would interfere with the assistance already being provided by the British Know How Fund. The request came just before last year's elections; trying to implement it quickly as it was submitted could have created problems. Accordingly this was a good example of when assistance should have been and was denied.

The question arises whether AID assistance with American expertise could have helped make the MPP more successful, and indeed might have even prevented significant problems. For example, although over 1000 firms have been privatized through the vouchers, a functioning Stock Exchange is still not in place, although this concept is well along from a technical standpoint.

Additionally, although the mutual funds greatly popularized the voucher program, they do not appear to be adequately supervised. Indeed, the government has already taken steps to control them. Likewise, corporate governance issues concerning the newly privatized firms and their new owners do not seem to have been addressed.

Poland

In contrast to the Czech MPP, the Polish MPP is a "top down" approach, whereby about 20 mutual funds are to be established by the government, each primarily responsible for around 30 companies, and having minority interests in some 570 other firms.

The objectives of the Polish MPP are to privatize about 600 middle size companies quickly, provide them with access to foreign capital and foreign technical know how, and give Polish citizens ownership in all 20 diversified portfolios.

The host government's desire to have foreign experts run the investment funds has had a profound effect on the nature of the support work. For example, very little government-funded training is required. Also having institutional support for the MPP from the Ministry of Privatization is very important. Ultimately, its success will be measured by the ability of the Western fund managers to raise new capital.

The staff of the Polish MPP is funded by EC PHARE, while the British Know How Fund, through S.G.Warburg, is providing advice on the mutual funds and the companies. AID is supporting this effort by focusing on back office issues, such as the distribution and trading of certificates. This coordinated support allows AID to support a major program at a lower funding level, yet make a profound contribution in shaping the final program.

Accordingly, AID's involvement does not have to be expanded at this time beyond the back office support, since other donors are already supporting other aspects of the MPP. Yet, AID's impact will remain. Going forward, AID's support might evolve toward more of an infrastructure role, such as assisting in establishing an OTC market, or towards more of an operational support role. Additionally, once the MPP is implemented and fund managers selected, AID should consider supporting the back office operations of some of the U.S. fund managers.

This back office project is another good example of how AID assignments need to be flexible. The original scope of work focused more on providing general advice for what were then called Regulated Investment Funds. It evolved so that the fundamentals of an American style capital market could be introduced into the Polish MPP.

This change might prove critical for Poland. Not only is the American model more attractive to Americans and American institutions - and thus American capital - it is also capable of raising far more fresh capital and handling far more transactions than the continental model for capital markets.

Having a well placed AID funded consultant who is extremely well qualified for this position, proved to be crucial. By advising on the details of a capital market from the outset, the consultant was able to steer his counterparts to making necessary policy decisions.

Hungary

Hungary has recently received support from the Know How Fund to study the feasibility of a voucher style MPP, to be called 'credit certificates'. In brief, the program appears to be taking on a shape closer to the Czech MPP, except that Hungarian citizens will be required to pay back to the government over long period of time - perhaps 12 years - the funds that they borrowed to buy their vouchers.

Other than through the IMPACT project (See Appendix 4), no AID involvement has been requested. It would be beneficial for AID to try and place a back office advisor in the Hungarian MPP similar to the Polish MPP support.

2.2.4 Privatization through Restructuring

Privatization through Restructuring is a program implemented only in Poland, that is intended to assist companies in restructuring before or during the privatization process. At present, the AID project is stalled, an example of how changing host government requirements could not be met by the present set up of controlling the financial decision-making in AID/Washington.

Poland initiated its privatization efforts by trying to adopt a sector approach. By reviewing all enterprises within a sector, the government thought it could better understand which firms could readily be privatized, how and for what cost. At the same time, firms would be identified that could be privatized by first restructuring them, whereas others would require privatization through liquidation.

In the capital privatization program, "trade sales" of healthy companies began almost at once, sometimes occurring within the sectoral approach, sometimes outside of it. In an attempt to launch the restructuring program, AID was approached to fund a project that would set up a model for firm restructuring by working with five firms.

From the start, the project ran into trouble. It took about eight months for AID/Washington to approve the project, during which time the Polish Ministry of Privatization requested some changes in the program. This led to disagreement over the objectives of the program with the host government in which the government viewed the project as "transaction" oriented and focused primarily on signing management contracts. The contractor, on the otherhand, thought that the project was primarily focused on developing a prototypical "model" for completing future management contracts without necessarily completing the deals themselves.

During this time, the government set up a parallel project, funded by the World Bank, using a different consulting firm. With competing programs and disagreement over objectives, the host government, in an attempt to get the results it wanted, interfered with the selection process of the enterprises agreed to in the AID contract, and instead, went ahead and selected the firms that would be targeted for restructuring.

By that point, the government only wanted to complete contracts with management firms that would be hired to transform the enterprises. In order to do so, the government requested that the AID contractor promote interest by placing advertisements. Due to a number of delays caused by miscommunication and misunderstanding, however, final permission for the advertising expenditures was not approved until several months later. The end results were some confusion and accusations by the government, the contractor and A.I.D. about what each party's priorities and responsibilities were [4].

This project reveals that AID should use caution before offering its assistance for Privatization through Restructuring and Privatization through Liquidation programs. It appears to us that both of these privatization methods do not have much political support, or at least there is no political agreement as to what these programs mean or how they should be carried out. At the same time, while caution is advised, the issues involved are important and will become increasingly top priorities for governments. As such there may be increased demands for outside assistance.

2.2.5 Financial Sector Programs

Banking is a prime candidate for policy/program assistance because of its special characteristic of being central and crucial to the economy. No healthy economy can function without a vibrant banking sector that redistributes a country's savings to those sectors of the economy where they are most needed, and does this with transparency.

Unfortunately, under communism, banks were reduced to being mere conduits for implementing five year plans, without concern for credit risk, market analysis, automation, or customer service. As the countries of Central Europe made the switch to democracy and free markets, their state owned banks were ill-equipped to follow suit.

Not only do the banks suffer from the typical problems of other state enterprises, such as a lack of automation, being undercapitalized and overstaffed, they were also stuck with numerous loans that will never be repaid. Dealing with these bad loans looms as a major initiative in itself.

Recapitalizing and restructuring the banks is an absolute necessity for a country to effect transition to a free market economy successfully. As such, additional emphasis will have to be placed on the banks in general, and their privatizations in particular.

A major issue in the development of the financial sector is the sequencing problem: do you first privatize the banks and then make them face up to their bad loans, or vice versa; do you recapitalize the banks directly, or recapitalize the bankrupt firms so that they can pay off their bank debts? There are no easy answers. All that can be done is to experiment with different approaches and monitor which ones work best.

---

[4] There was widespread misunderstanding as to why the project was delayed. According to the government, the main problem was that AID/Washington delayed in giving timely approval for the $20,000 expenditures. AID/Washington, however, states that the Government of Poland was originally responsible for providing the $20,000, but that it failed to follow through. After the AID/representative urged AID/Washington to finance the expenditure, additional delays were caused by the contractor's central office not notifying its Polish office about the change. In any case, this project highlights the problems that can arise when there is not clear political support for an initiative.

AID is already involved in an indirect way with bank restructuring through its interagency agreement to fund the Treasury Department's assistance to the state banks. Additionally, AID has funded several financial programs - at least one in each country - under its privatization program. The scope of this report does not cover the Treasury program; only the privatization funded programs were evaluated.

Of special note is the involvement of other donors, in particular PHARE. PHARE wants to be active in bank restructuring, work outs, diagnostic studies, and formal training. It is not interested in new banking initiatives such as investments and investment funds.

Czech Republic

Currently, the only bank program in the Czech Republic is with the Czech Savings Bank. Bad loans are a problem that has yet to be addressed. Even if the Czech banks are in better shape than their Polish and Hungarian counterparts, nonetheless their bad loans could exceed their capital, making them insolvent. Additionally, a bankruptcy law has not yet taken effect and thus bankruptcies have yet to start in large numbers.

AID is funding an extremely well received long term program at the Czech Savings Bank (CSB). Two very senior executives were placed as long term consultants to develop credit risk management, establish a foreign currency capability, restructure internal financial management, and provide technical assistance for implementing the CSB's investment funds for privatization.

The CSB is extremely receptive to the consultants' help, so much so that it has agreed to enter into a complementary government-financial separate credit management contract. Going forward, it is possible that eventually the entire cost of these programs might be borne by the CSB.

Assistance to the CSB was decided upon because of the need for the country's citizens to have confidence in their banking system, the unique role CSB plays in being the depository of over 90% of all private savings with over 2000 offices, and the high level of public confidence that the CSB holds.

Additionally, the CSB operates the country's largest investment fund, as over 15% of all vouchers were tendered to it. In the loosely regulated arena of these mutual funds, it is extremely important that this fund be managed properly.

On the other hand, there are issues that arise that complicate a decision to duplicate this program in other countries. By supporting the CSB, we are in effect helping it perpetuate its monopoly on savings. Furthermore, instead of concentrating on making it function like a Western savings institution, we are moving it into commercial and investment fields. Recognizing that the CSB is a universal bank, it seems nonetheless premature to focus on these new fields and not on its core business.

As an example, while it is true that the CSB has the largest voucher investment fund, in part this might be a result of the CSB's allowing its investment fund members to use their vouchers as collateral for new personal loans. The vouchers have been valued at an assumed book value of the underlying assets of 10,000 crowns, which then can be used to secure a loan of up to 60% of this book value, or 6,000 crowns, whereas the vouchers were purchased for only 1,000 crowns.

Accordingly, although the assistance being provided to the CSB is of the highest caliber and is being very well received, it is difficult to foresee a similar combination of the factors that would make this program successful in other countries.

Poland

Poland is preparing for the restructuring of its financial sector through a systematic approach. Accordingly, financial sector support in Poland involves two successful programs: assisting the National Bank of Poland (NBP) to prepare a bank inspection manual, and assisting the Securities Commission to develop reporting requirements.

The NBP is not directly involved in bank privatization as that is the role of the Ministry of Finance as owner of the state banks. Rather, the NBP has an indirect role supervising the banks and maintaining a sound banking system. In particular, the NBP General Inspector of Banking Supervision is concerned that bank privatization maintain the banks' minimum capital adequacy and liquidity ratios after all foreseeable write offs. Accordingly, an AID-funded program was established to develop a bank monitoring system, documentation and related training.

The NBP feels that the bank inspection manual is the key deliverable. Without AID's assistance, the NBP would not be able to develop this manual. U.S. assistance is especially desired based on the diversified nature of banking in America, including our recent experiences with problem banks. Poland's liberalized bank law permitted many banks to be established prior to the law being changed last year when more appropriate qualifying requirements were introduced.

The NBP is very satisfied with the assistance it is getting, although it has not yet received the manual. If anything, the NBP would like to use its AID advisors more on an ad hoc basis, especially as it faces new dilemmas which probably already have precedents in the West. It is especially pleased with the fast reaction time that a consultant on its premises can provide. The NBP feels it needs further assistance in preparing "prudential regulation" on solvency, liquidity, and classifications of and provisions for bad loans.

The programs at the Polish Securities Commission and the Anti-Monopoly Commission have similar characteristics. Both were relatively short term programs, require deliverables in terms of reports or manuals, and have a training component. Both Commissions noted the usefulness of a long term advisor and the convenience of obtaining ad hoc advice quickly.

Hungary

Although Hungary created its two-tier banking system in 1987, serious bank reform has only recently been undertaken. AID's recent efforts have been to concentrate on assistance to the banking sector. This is a most appropriate area for concentration as discussed in Section 3.4.3 and is parallel to a similar concentration in the Czech Republic and in Poland. The work is being done in coordination with a senior U.S. Treasury Consultant, but is funded under this contract. Phase I of this activity was welcomed by GOH even though delayed authorization deprived the AID work of an opportunity to direct policy initiatives from the outset. Phase II, not yet authorized or started, is aimed directly at such pending major questions as bad loan losses and bankruptcy administration. Early implementation should be of the highest priority and AID is in a position to play a leadership role while still coordinating with other donors.

Hungary is still in dire need of assistance in restructuring and recapitalizing its state banks.

2.2.6 Other Programs and Issues

2.2.6.1 Health Care

In the Czech Republic, a proposed new program will deal with the prospects of privatizing health care. We feel that support for this program needs to be carefully thought out before AID gets more involved with it. First, a significant amount of money will probably have to be spent to reform the Czech health care system, and AID will have to be prepared to allocate these funds if it wants to pursue this new initiative. Second, health care is a particularly sensitive issue with the population, and one for which there might be no easy solution. AID should consider the pay off -- or the lack of one -- before associating itself with a program that might fail to solve a sensitive problem. Next, health care reform is not a particularly strong American field of expertise, nor one that has had a record of privatization success in third world countries. Lastly, the EC apparently wants to approach the health care issue and perhaps AID should allow PHARE to tackle this sensitive area or work closely, as it has in the Mass Privatization Program in Poland, in clearly defining its area of assistance.

2.2.6.2 Other donors

There is no policy or program area where AID is the major donor. Accordingly it is desirable to use AID funding to supplement or complement other donor expenditures, especially for programs that involve American expertise or self interest.

Coordinating AID assistance with other donors is also attractive as all three host governments perceive the other donors as requiring that their assistance be tied-in to their special protectionist interests. The host governments perceive AID's assistance to be less restrictive.

The other major donors include EC PHARE, the British Know How Fund, the IFC, the World Bank, the IMF, and the EBRD. The later three operate principally by providing loans rather than grants, and the IFC also is not a grant agency; it operates on a for profit basis. In general, there is little opportunity, nor do we see the need to make work with these agencies a major objective as they do not provide grants.

PHARE was characterized by several sources as being big, broad in scope, and with lots of money, but bureaucratic and slow. By its own admission, PHARE has a problem procuring long term experts. PHARE informed us that they like to staff governments, like at the Polish Ministry of Privatization's MPP section, and to concentrate on training. In the future, PHARE expects to be heavily involved with bank workouts.

The British Know How Fund was praised by several sources, and perhaps AID should look at it more closely to see how it operates. This is also the case with some of the other country programs.

Donor coordination was described to us as being weak and bureaucratically hobbled. Nonetheless, we found several cases where AID on its own did a good job of coordinating its assistance. For example, in Hungary with the COMPASS program - where parts of the original scope of work were deleted because of PHARE involvement; in the Czech MPP - where AID did not pursue a role because the British Know How Fund was already providing support that was similar to what the host government requested; and in Poland's MPP - where America's expertise in securities operations successfully complements, at a much lower cost, PHARE's financing of the staff and the Know How Fund's underwriting S.G.Warburg's large support program.

2.2.6.3 Other AID Projects

Although our Scope of Work was to evaluate specifically the Privatization and Enterprise Restructuring Project (180-0014), some of the General and Country-specific issues required us to review other Economic Restructuring and Private Sector Development projects.

In some instances, we also found an apparent cross over of program support for assistance that might ideally be funded under a different project, as with some of the financial sector programs. We find nothing wrong with this; rather we feel AID funds should be used broadly to support privatization without bureaucratic strict rules for assigning projects to specific funding allocations.

For example, assistance for the Development of Polish Securities Markets and Corporate Governance Structures is provided under Business Services, whereas Polish Securities Commission assistance is part of Privatization and Enterprise Restructuring. Similarly, financial sector support is provided under Business Services - for senior advisors to the Ministry of Finance, the National Bank of Poland, and several state owned banks - and for Bank Training, as well as for Bank Regulation and Supervision under Privatization and Enterprise Restructuring.

We feel that the IRIS project in Poland is very important. IRIS is a program of establishing and codifying rules on collateral and liens and as such is part of the essential legal framework needed. It is important not just for small businesses in Poland but also -- and perhaps even more so -- for foreign investors, for new private companies and privatized state enterprises regardless of size, as well as for the banks. The IRIS project should be continued until all significant legal and regulatory constraints have been reasonably identified and reform initiated.

Likewise, the work of the IESC, the Business Advisory Service, the Peace Corps, the MBA Enterprise Corps and the GEMINI project seem to us to be very attractive, especially in privatizing small, local enterprises owned by voivodships and municipalities, as well as assisting new private entrepreneurs. All of these programs should be expanded and extended so long as the local need for small privatizations remains.

Lastly, we feel that AID will need to concentrate more on the financial sector in the future. In all three countries, we found a growing awareness of the depth and complexity of the issues facing this sector. Significant new programs are required to undertake bad loan work outs and write offs. Donor coordination will be crucial since these programs will be expensive and require several years to implement. Moreover, bank restructuring and a functioning regulated banking infrastructure are required not only for bank privatization, but more importantly in general commerce, if privatization is to succeed.

2.3. Assistance to Government Agencies

2.3.1 Overall Effectiveness

AID has invested something less than $5 million, or about 15% of total privatization funding, in providing assistance to government agencies. About 85% of this has gone towards institutional support in Hungary, technical assistance to the State Property Agency (SPA). In addition, small projects have been carried out for the self-privatization and investment promotion programs in Hungary and the Securities Exchange Commission (SEC) in Poland.

With some minor exceptions, these institutional support projects have been successful in facilitating privatizations and, in the case of the SEC project, developing adequate regulatory structures. AID support to the SPA has been general in nature and not easily identifiable in terms of quantitative impact. This project has helped establish AID credibility and leveraging of other donors' assistance.

The following sections focus on the assistance to the State Property Agency, the program that has received the most institutional support assistance, and the Securities Exchange Commission assistance in Poland.

2.3.2 State Property Agency (SPA)

2.3.2.1 Description of the SPA

The State Property Agency (SPA) of Hungary was created in January 1990 to "regulate and encourage" privatization. AID, through another global privatization contract it had with the Center for Privatization, contracted a long term advisor in December 1990 to provide policy and program guidance during establishment of the SPA.

For the period 12/89 to 12/92, AID has spent a total of $3.8 million on long term technical assistance, short term training, and procurement of equipment and materials for the SPA. The breakdown by category includes:

Long Term Advisor	-- $0.7 million
Long Term Training Advisor	-- $0.13 million
Equipment	-- $0.424 million
Training Programs	-- $0.9 million
Private Sector Information System	-- $0.8 million
Compensation Notes Program	-- $0.36 million
Public Relations	-- $0.261 million

Project Management	-- $0.05 million
Support to Other Programs:	
Investment Promotion	-- $0.165 million
Self-Privatization/Pri-Man	-- $0.018 million
(See Section 2.4.2 for details)	

The assistance to the SPA can be divided into three general phases of implementation. At the outset (1989-90) AID assistance was more focused on policy/program development and institutional support issues. During this time, the long term advisor was involved in developing a strategic plan for the SPA. He, with short term assistance, helped design and present to the government the SPA's operating philosophy, concept pieces on transparency and professionalism, and an assessment on training needs. Especially important during this phase was the establishment of a capability to help coordinate donor aid, particularly from the EC/PHARE program. Also, the contract permitted the team to purchase $424,000 of computer equipment and software and other office equipment.

During the period 1991-92, AID assistance became more involved in establishing procedures and providing general institutional support. The team helped to establish a comprehensive monitoring system -- "Privatization Information System" -- which tracked all proposals and privatization contracts signed. They also initiated a contract to provide a long term Investment Promotion Advisor who helped coordinate the promotion of foreign investment in the International Trade and Promotion Agency of the Foreign Affairs Ministry.

Finally, during the period 1992-93 AID focused its efforts on providing training, training advisory support and strategic planning for the EC/PHARE training programs. Major activities included: 1) overall training needs assessment, 2) development of training unit policies and procedures manual, 3) establishment of terms of reference for EC PHARE funded short term training consultants, 4) definition of required skills and training responses, and 5) organization of training programs.

Besides training initiatives, the SPA assistance also helped finance the development of evaluation criteria for the GOH Self-Privatization program. Deloitte & Touche is developing methodologies for Pri-Man to rank consulting firms interested in managing privatized small/medium-size firms (see Section 2.4.2 for details). Finally, the SPA also used short term advisors to help set up a program for restitution-related compensation notes.

2.3.2.2 Analysis of SPA

The nature of the long term SPA assistance has been different from that provided by the long term advisors in the other two countries. The SPA assistance has been more general and diverse. On both an ad-hoc and programmed basis, the long term advisor has competently advised and helped build an institutional structure capable of processing privatization proposals. Major tasks, in approximate order of time spent have included: a) development of information systems, b) establishment of operating procedures and processes, c) support for other programs (e.g. Self-Privatization, Investment Promotion), d) procurement of equipment, e) provision of counselling and advice to top and middle management levels and, f) assistance in donor solicitations.

It is difficult to assess the impact of these tasks both because they are so varied and because the effort contributed to a wide range of interrelated institutional processes, rather than a stand-alone intervention. Most measures of success are limited to qualitative statements. For example, all interviewed agreed that the long term advisor and other short term advisors performed their jobs competently. Most of the projects assisted by the team turned out satisfactorily.

Perhaps the most significant achievements of the assistance was that it generated significant goodwill within the government for our aid. The long term advisor's assistance helped run interference for the Agency and, in doing so, saved SPA officials a lot of delays and headaches. Furthermore, the advisor provided AID with access by which it could leverage its funds against other donor funds, particularly the EC PHARE.

On the downside, the presence of a long term advisor did not prevent the SPA from becoming politicized and also bureaucratic. AID assistance helped ensure that the technical review of privatization proposals was done in a consistent, transparent manner. But it did not affect the decision-making process once a proposal went to a final approval committee. Many investors complained that committee review procedures were ad hoc, confidential and subject to many political factors and considerable delay. High turnover in the SPA often prevented the technical review of proposals from being processed quickly.

2.3.2.3 General Conclusions

AID assistance to the SPA has helped establish credibility with the Government of Hungary, allowed AID to establish itself as a high profile broker of donor assistance and served as a seed fund for other experimental ventures (e.g. self-privatization, investment promotion). This flexibility and long term relationship has helped AID lay the foundation for future assistance. It also has allowed AID, for the most part, to provide timely assistance-- a characteristic that has often been lacking in other countries.

But this general type of institutional assistance has its limitations. First, it is difficult to clearly measure results. By its nature, institutional support of a general type (as opposed to more targeted facilitation of privatization transactions in the Crimson Capital case) can not be directly tied to direct transactions. The only way by which success can be defined is in the quality of the coordination, procedures and processes established.

AID assistance most assuredly helped to make the SPA a well organized institution. It also helped to train a wide range of technical support staff. But it was not designed, nor was it able to resolve political meddling in the privatization review process. During its tenure, many would argue that the privatization process slowed down as the SPA became larger and more developed (as an example they would point to the fact that the SPA staff for facilitating large firm transactions is nearly twice as large as that of Poland which employs 36 people). It would be unfair, however, to try and correlate AID assistance to any perceived slowdowns. Just as it would be difficult to state that AID assistance resulted in a specified number of transactions, so would it be inappropriate to claim that AID assistance helped to create a more bureaucratic institution which resulted in a specified reduction in transactions.

2.3.3 Securities Exchange Commission/Poland

AID provided a little less than $500,000 for technical assistance to the Securities Exchange Commission in Poland. Most of this assistance was conventional in that it consisted of seminars, development of reporting formats and a manual for following reporting requirements. Still, it was considered very useful by the SEC client and a good niche in which the U.S. had a comparative advantage.

The main task requested by the Polish Securities Commission was the preparation of reporting requirements for all newly listed Polish public companies. Additionally, the consultants helped to prepare a manual listing these reporting guidelines and provided training to financial managers and accountants within the commission and in the public companies. A total of 20 personnel received training in the commission and an additional 40-50 from public companies.

Without AID's assistance the Commission felt that neither the reporting requirements, the manual nor the training could have been adequately prepared or conducted, since such expertise does not exist in Poland. Other donors could not be responsive to the Commission since none had a program which could adequately meet the Commission's needs in a timely manner and since the U.S. provides the model for a stock exchange regulatory body.

2.4 Specialized Transactional Assistance

AID has invested $7.4 million or 23% of total privatization funding in a specialized transactional assistance especially predominant in the Czech Republic. It is a technically specialized transactional assistance in the privatization process that is part of the procedural steps in the MOP privatization process and deals with specific enterprises one at a time. As such, it can be looked at as a hybrid between institutional support and individual firm assistance. We consider this type of activity and results produced unique; support for the creation of a stand-alone foreign investment department in the Ministry of Privatization, presently targeted as to its function, and filling a needed niche.

2.4.1 Crimson Capital/Deloitte & Touche

2.4.1.1 Description of Crimson Capital/D&T

Crimson Capital/D&T performs one somewhat limited but important function in the investment banking process in the Czech Republic: that of facilitating deals between the Government and an investor in a state owned enterprise (SOE) when it is being privatized.

The Crimson project was formulated in August 1990, and started operation in January, 1991, which is early in the history of Czech privatization. At first, Crimson Capital worked with a Deloitte subcontractor; it is now directly subcontracted to Deloitte. Both Crimson Capital and Deloitte & Touche provide assistance to the Department of Foreign Investment in the Ministry of Privatization.

Specifically, the Crimson Capital/D&T group reviews proposed transactions and performs certain steps in the process of closing for each privatization involving outside investment. Almost all of this investment involves foreign investment; about 75% of the transactions in which it participates are those where foreign investment is the controlling partner. It currently employs about 20 Crimson/Deloitte people, the principals being full-time employees hired, many out of retirement, from previous experience with Western investment banking firms.

Crimson Capital/D&T's initial duties were limited to analyzing bids made by prospective investors for privatizing SOEs occasionally seeking out potential bidders from the West. Assumption of these duties occurred just at the time when the privatizations from Czechoslovakia's First Wave Privatization were being processed.

The Crimson Capital/D&T's current duties have been expanded so that in some instances its scope is broader than in others. Nevertheless, its principal function is that of facilitating: bringing buyer and seller together by effecting compromise on terms. For some, but not all proposals, it conducts negotiations on these terms between Government and bidder. It also continues, on occasion, to solicit bids. In all of these duties, it serves as the representative of the Ministry of Privatization.

The results of the Crimson Capital/D&T's assistance have been very positive. There have been 63 contracts that have run through the Crimson Capital/D&T group and closed, and there are about 40 more in the pipeline. These represent, at present exchange rates, $750 million of purchase price and an additional $930 million of investment commitment. (These figures do not include the three largest privatization-investments, excluded to avoid distortion. Please refer to Section 4 -- Summary on Impact of AID Assistance -- for more details on impact data.)

Without trying to attribute the precise degree of relative contribution, it appears that this assistance has been cost-effective. Up through the current expiration date of September, 1993, AID has authorized $7.0 million for this activity. On that date, the contract will be up for possible extension or possible competitive rebid. The average cost per transaction facilitated is about $70,000 per transaction fully or partially processed to date. (In citing this figure, it should be emphasized that Crimson does not perform the full investment banking function but only some of the steps in the chain.) If the Czech Government adheres to its present schedule, Crimson expects that its function can be curtailed and handed over to local expertise in the first half of 1994.

2.4.1.2 Analysis of Crimson Capital/D&T

AID's experience with the Crimson Capital/D&T project has been largely positive. It has been high profile, very targeted at the end of the privatization process and has had a large impact that can be quantified (although with some caveats attached-- see Section 4.2.2 for details).

The emphasis of Crimson's activities on foreign investments is appealing for several reasons. First, it is an area in which the host government has very little expertise. Secondly, it focuses on a resource base that is crucial to making privatizations successful. Foreign investors bring in new capital, management expertise, technology and access to markets. Thirdly, the project helps to defend the government against political attacks that they are selling off the "state jewels" at a high discount. The Crimson Capital/D&T group has done well at ensuring the government the following benefits: fair purchase price, adequate investment commitment, employment guarantees and resolution of environmental liabilities. Finally, the placement of foreign advisors in the Ministry of Privatization makes it easier for foreigners, particularly American firms, to deal with all the processes and procedures they must follow.

For the most part, the Crimson Capital/D&T group has helped to provide more consistency and credibility to the whole process. While it performs at a stage generally too late in the process to participate in the initial basic fashioning of the deals, it has been able to create a smooth work flow out of what had been a bottleneck. Furthermore, the presence of long term Crimson advisors has helped to provide continuity. This is especially important when turnover in the Ministry of Privatization has been high and foreign investors, complain that other countries with similar high turnover rates but no Crimson group of advisors, result in their having to spend an inordinate time reexplaining proposals to new personnel.

Despite the convergence of all these factors, there are several constraints and weaknesses associated with the program. Conversations with investors, advisors and local companies point out these issues:

- **Lack of consistent and clear criteria:** The Crimson Capital/D&T group is not always able to close foreign investment deals. Currently, there is a bottleneck in the National Property Fund. Also, some investors and advisors complain that it is not always clear what the final criteria for evaluating the proposal will be. There are accusations (some of which may be due to the normal course of negotiations) that the terms of agreement are changed late in the negotiations.

- **Varying Impact on "Upstream" and "Downstream" Problems:** The experts in Crimson Capital/D&T and outside investors all point out that the current structure for processing proposals is not always consistent or as efficient as it could be. Often times there are problems that result from intervention by the Founding Ministries (early in the process) and/or the National Property Fund (late in the process). Since the Crimson group is not placed in either organization, it is not always able to resolve potential misunderstandings that arise from agreement terms.

- **Little Impact on Politicized Deals:** The Crimson Capital/D&T group is not always able to resolve deals that become highly politicized. For example, in Prazska Cukerny, a Czechoslovak sugar company, the combination of a reluctant buyer, poor industry prospects, changing Ministry jurisdictions each with a different outlook, and a shortage of capital and credit have combined to lower each successive bid and make the outlook increasingly hopeless. With an enterprise subject to minimum and declining value and one in which various branches of government are at odds, foreign technical assistance can no longer hope to be successful at present and further involvement should be avoided.

  In such poor, deteriorating situations, speed of action to resolve is of the essence. However, without clear authority, neither the Ministry of Privatization, much less the Crimson Capital/D&T group, can be expected to resolve these issues.

- **Hard to Measure Attribution:** The end results of the Crimson group's efforts are easy to measure-- i.e. deals completed, purchase price, investment committed etc. But the extent to which Crimson's involvement made a difference is subject to varying opinions. At one end, there are those that say that the deals would not have been completed without the assistance of Crimson's support. These advocates point to Poland and Hungary to show how foreign investment deals can easily get politicized and rejected for public fear that foreigners are "taking over" domestic assets. At the other end, there are those that believe such assistance is "useful" but not "critical". These critics point out that foreign investors that who have shown an interest in a deal will do whatever it takes to consummate the deal.

  Most likely the truth lies somewhere between the two extremes. At a minimum the presence of a Crimson Capital/D&T serves as an insurance policy to make sure that the government is getting the best deal possible. At its best, the group serves as a focal point from which foreign investments are pushed through an otherwise cumbersome, problematic bureaucratic process.

2.4.1.3 Conclusions on the "Crimson" Program

1. Targeted programs like this can with relative ease develop clear and measurable objectives. In these types of projects the objective is "body count" of privatizations, minimum processing time, cost effectiveness per transaction, and maximization of purchase terms.

2. Such assistance supplied by foreigners with special expertise is of most help when the target is composed to a significant degree of potential foreign investors.

3. AID's role in this program is very important but highly focused and limited. The alternative to this approach -- i.e. the creation of an agency with a targeted objective -- is to station a full-time advisor in the relevant ministry. This is not necessarily more effective and sometimes it is not wanted by the host government. The task of locating and placing full-time advisors is a critical undertaking. The right man must be found and must be committed for a substantial period of time. This can be expensive.

4. Foreign investors are usually interested in medium-sized or large enterprises, not in very small ones. (This is true even in Pri-Man, discussed in the next section, which deals primarily with small enterprises.) Smaller enterprises are much more susceptible to domestic purchase, and to MBOs and ESOPs.

5. This type of specialized transactional support typically fills its role very effectively. This is especially the case when working out a deal between a willing seller and a willing buyer.

6. The focus of support when supplying this kind of service is to concentrate primarily on helping the owner, which is the government, negotiate as many deals possible with the best purchase terms possible.

7. Especially as time moves on, the service supplied becomes less and less indispensable as an AID-supplied service. Eventually this service should graduate into cost-sharing and

ultimately to a service competently conducted without foreign assistance. In Crimson, the service will become increasingly locally supported and conducted and/or Crimson will run out of work because its task will be completed.

2.4.2 Self-Privatization/Pri-Man Project/Hungary

2.4.2.1 Description of Pri-Man

In September, 1991, the Hungarian government, under the auspices of the State Property Agency, created a new program whose purpose is to speed up and introduce a more domestic orientation into small privatizations. It does this by getting around the legally required bottleneck that the SPA must sign off on all privatizations. It delegates this function to consultants. The name of this program is "self-privatization" or "decentralization". As shown above, AID's assistance to this program has been minimal; but the results of this program look promising and may warrant increased assistance by AID.

The SPA established a wholly owned but separate "subsidiary" -- Pri-Man with a staff of 20 employees -- to supervise all transactions. The reasons why Pri-Man is a separate organization are not entirely clear, but relate to its resulting ability to escape from certain regulations and from budget and manpower caps applying to SPA, and to Pri-Man's desire in any case to operate independently. This independent subsidiary reviews, selects and supervises the execution of proposals submitted by consulting firms, mostly domestic. The fee payment basis for the consultants is as follows: up until the privatization takes place the enterprise pays the consulting firm. After privatization takes place, payment is only on a "success fee" basis at 5% to 8% of the purchase price.

Since the establishment of Pri-Man, AID's role in developing the institution has been limited. Initially, Deloitte & Touche, was hired by SPA to carry out certain limited tasks, some of them relating to equipment and systems procurement. D & T was late securing authorization to act, however, and was not able to deliver on its equipment assignment. In the meantime, Pri-Man was able to begin operations without assistance. Consequently, D&T's role has been limited to providing assistance in evaluating consulting firms that wish to bid on firms.

The development of evaluation criteria is important for ensuring that Pri-Man contracts with reliable consulting firms. There have been as many as 132 consulting firms on the list, almost all of them domestic, but this list is now reduced to 84 firms. 35 of them are judged as performing satisfactorily. All the others are facing some problems, primarily regarding their stated capabilities. Consultants have been inclined to exaggerate their skills and many are weak in completing valuations.

From the outset the demand and results of the program have been impressive. 700 SOEs wanting to privatize joined this program voluntarily. At first the only eligible companies were small ones with sales not over $3.5 million a year, later this was raised to $12.5 million. There are also other restrictions as to maximum size. To date, Pri-Man has completed 100 privatizations. The principal elements of another 220 are known and it can be assumed these also will go through. The average purchase price for the completed deals is $50,000.

Pri-Man is chartered for existence until March, 1995, by which time it expects to have processed about 1000 enterprises and its job will then be completed.

2.4.2.2 Analysis and Conclusions for Self-Privatization/Pri-Man

AID had an early involvement in this program, but does not yet have a heavy involvement. Allocated funds, which are under the long term advisor umbrella, now total up to $300,000. There was considerable AID procedural delay in getting started and perhaps as a consequence, AID's role today is somewhat secondary.

Perhaps as a result of authorization delays for D&T's assistance in procuring computer hardware and its own high self-esteem, Pri-Man does not rate Deloitte & Touche input as particularly significant. Still, according to Pri-Man's chief executive, Pri-Man "needs help, but he is too busy to analyze what help is needed"!

The principal stumbling block in this Self-Privatization program so far has been the capability of the consultants and low bidding prices for firms. Less than half of the approved list or consulting firms are judged as competent. An estimate of all the privatizations processed through consultants so far is that about 25% of the privatizations were technically judged as "good" jobs, 50% as "acceptable", and 25% as deficient. It is clear that there is a learning curve and that consultant capability must be raised. Also, there is a perceived need to try and raise the bid levels of consulting firms. In Pri-Man's judgment, there have been many bids received for their client privatizing enterprises but they have all tended to be low.

The Self-Privatization program is experimental and if it proves to be successful, there may be a third wave of the program. The primary future challenges faced by the program, and ones in which AID assistance may be productive include:

- It is anticipated that many of these newly-privatized companies will go bankrupt. There is still no plan for dealing with these and other companies outside the program that go bankrupt.
- There remains the disposition of the SOEs that do not volunteer for the Self-Privatization program. They will be dealt with later, perhaps by changing the General Managers of these enterprises.

2.5 Assistance to Individual Enterprises

This section reviews AID assistance in firm-specific privatization projects. Assistance to large firms, especially the limitations of this kind of support, are discussed first in Section 2.5.1. The same is then done in Section 2.5.2 for small and medium-sized firms looking at several government-sponsored approaches. Section 2.5.3 then covers some special considerations regarding foreign investments. Finally Section 2.5.4 gives some general remarks on the problems associated with AID's administration of firm-specific assistance.

AID has invested about $4.5 million, or about 14% of all privatization funding in firm-specific assistance. The largest amount has been allocated in the Czech Republic, most of it at an early stage. About half of the Czech amount has been allocated in Poland, principally on

LOT Airlines, and very little has been allocated in Hungary. These allocations should be looked at in total with sectoral assistance, discussed next in Section 2.6, since that is also firm-specific. In combination, these two categories account for $12.9 million of allocations, over 40% of the total, with almost 60% in Poland, 33% in the Czech Republic and relatively little in Hungary.

2.5.1. Assistance to Individual Enterprises - Large Firms

2.5.1.1 Overall Effectiveness

Much of AID's initial firm-specific investments focused on large firms. Beginning at the end of 1991, a total of $2.8 million was spent on five large firms: Huta Warszawa, LOT Airlines, Sandomierz Glass, Monor State Farm and Skoda-Pilsen. (In addition, three large firms under the jurisdiction of Crimson Capital were reviewed in detail and show a similar profile and are discussed in Section 2.4.1.)

To date, assistance to large individual enterprises has not generally been successful in bringing about privatization promptly and cost-effectively[4]. However, despite the overall inconclusive outcome in such complex undertakings, AID-sponsored facilitation between the parties and its role in negotiation has been effectively performed.

A person considering in the abstract the likelihood of success of different kinds of technical assistance in privatization might well conclude that assistance in individual company transactions would have the greatest likelihood of success. Such assignments would be material, ones that one could "get one's teeth into", dealing with tangible company problems rather than with the vague concepts of assistance to policies, programs, or governmental institutions.

Investigation of the facts shows the exact opposite to be the case.

Of these five large firms assisted by AID, only one has been privatized, Huta Warszawa, although not as a result of AID assistance. For one other, the prospects of privatization soon are good. Two of the other three (with the exception of LOT) appear to be unsuccessful, with each of them in or near bankruptcy. These results are mixed, particularly when it is considered that most of the assignments to work with these institutions began some time ago, early in the country programs.

Assistance to large companies has not resulted in consummated deals, but even if they had been successfully privatized, this type of assistance would not have been a cost-effective route to privatization. It is difficult to estimate the cost of successful privatizations when so few of them have yet been brought to conclusion. As detailed in Appendix 3, under the "best case" as to number of privatizations expected, the AID-assisted cost for any of these sizeable privatizations would run at least $1 million, perhaps much more. The funds already spent on these firms also support this conclusion.

In most cases, privatizations of large enterprises are almost invariably slow in being consummated. Invariably, these enterprise-specific situations and the problems that surround them are numerous and complex. The more they are top down, government-initiated, the more this is the case.

2.5.1.2 Complicating Factors in Large Firm Privatizations

1. As always, the principal impediment to success in large company assistance is the absence of political will.

- In Skoda-Pilsen, the overhanging fear of the loss of 35,000 jobs has induced a paralysis to action.

- In Huta Warszawa, there was general uncertainty as to whether and under what circumstances foreign acquisition should be permitted.

- In Monor State Farms, a change in law and policies, combined with an emerging fear of foreign takeover, has caused a scrapping of privatization plans and led to bankruptcy for this formerly healthy enterprise.

2. Assistance to individual enterprises will always be ineffective in the presence of poor management.

- The three companies mentioned above had incompetent management for an extended period of time.

3. In privatization assignments with large enterprises, some restructuring is almost always necessary. Especially when this is attempted before privatization, accomplishing this successfully under Government management is dubious of success.

4. Large firm privatizations seem to be inherently complex undertakings. These large enterprises are frequently conglomerate in nature and there is usually the need to split the enterprise into several pieces, often into many separate entities. These entities will have different objectives and different strategic considerations. Powerful political forces relating to these key enterprises will be impacting the government. Numerous players from different jurisdictions are involved: government, the enterprise and prospective buyers, with a host of advisors to each. The usual presence of foreign participants adds to the difficulties of cultural interface. The procedure for required tenders is complicated.

- There are about five other SOEs like Skoda-Pilsen in the Czech economy, at least several of them in the same kind of trouble as is the case with Skoda-Pilsen.

- In the privatization of Sandomierz, a Polish glass company, and the sale of majority ownership to Pilkington Glass, there is joint financing by several participants, heavy additional investment required, many government ministries involved, and various changes in capitalization as the plans evolved.

There are certain enterprises where the complexities are so considerable that no amount of assistance, regardless of how skillfully pursued, can hope for success. In such poor, deteriorating situations, speed of action to resolve is of the essence.

5. A great many privatization projects, especially those that are large and troubled individual transactions, are taken on because the host government, having an urgent problem,

requests help. After all, the reasoning goes, we want to be responsive to host government needs as they perceive them. We do have to do some of this. It should be recognized, however, that the call for help in a damaged situation is rarely successful.

- In Hungary, the First Privatization Program selected 20 enterprises in early 1990 at the inception of the Government's privatization program. The objective was that these would be privatized by 1991. Only three of the companies were ever privatized, all of them very late to schedule. A more specialized Second Privatization Program met a similar fate and a Third Privatization Program never got off the ground.

2.5.2 Assistance to Individual Enterprises - Small and Medium Firms

Assistance to small and medium sized firms has been rendered in all three countries, more in the Czech Republic at an early stage than elsewhere. Included have been such projects in the Czech Republic as the early Czech Technical Assistance, Management Contracts, and a series of individual enterprise examinations for the Czech and Slovak American Enterprise Funds (CSAEF); Restructuring in Poland, and Quick Form in Hungary. All such work has had a low level of effectiveness for reasons described below.

2.5.2.1 Overall Effectiveness

Similar to assistance to large enterprise transactions, privatization assistance to small and medium-sized enterprises has not been very cost-effective either. The approach to these has usually been too imprecisely targeted or arbitrarily targeted based on political considerations.

In total, AID has worked with a large number of small and medium firms in the three countries. The most popular approaches for targeting firms can be characterized as follows:

- "Buckshot" Approach: This occurs when firms are randomly selected by contractors seeking to provide assistance or by governments that select firms for targeted assistance, often on the basis of political considerations.

- Sector Approach (Discussed further in Section 2.6): This approach has been most popular in Poland. For each sector the Government selects a consulting firm to analyze the sector and select a "short list" of firms for more specialized assistance.

Each of the above approaches has been affected by one or both of the following problems. First, the random or arbitrary selection of firms results in technical assistance being spent on problematic and, in some cases, on the least attractive firms. In the absence of strong management commitment, such an allocation of funds can easily be dissipated. Another problem is that there often is not enough money to assist a firm from the beginning (e.g. preparation of a privatization plan) to the end (e.g. negotiating a deal). Like the larger individual transactions for privatization, these smaller ones are not particularly cost effective. They are not subject to the same degree of complication as the larger transactions; still the steps in individual transactions, even when their smaller size simplifies them, all take a certain unavoidable minimum amount of time.

2.5.2.2 Complicating Factors in the "Buckshot" Approach

The "buckshot" approach to privatization, used more frequently with small and medium-sized firms, is one where the enterprises to be considered for privatization are selected out from their universe at random-- either by contractors or governments-- without regard to probable success or significance. This selection usually takes the form of a list of privatization candidates being arbitrarily composed, sometimes with investigation as to privatization probability of each enterprise as a second step.

This approach is typical of approaches to country privatization programs when they are in their early stages. Almost by definition, their "hit record" in identifying a solid privatization prospect has a low success ratio.

Experience shows that when governments pick out the candidate targets for privatization, they prove not to be very good at it. This is because the government has a great many other considerations on its mind, many of them political. As one example, they tend not to pick out prospects likely to succeed in privatization, but conversely are prone to unload their "problem" enterprises.

- KPMG's assignment in the Czech metallurgical industry: The assignment was characterized by a random selection of this industry by the Government on personal rather than strategic grounds and a random selection of three firms in the industry ranging from one with good prospects to one with poor prospects. The key was this random selection of enterprises; it suffered from the same disadvantages as those discussed above.

In other cases, contracting firms were given authority to look for promising candidates to assist. This was often done during the early stages of privatization when governments and AID were interested in getting privatization off to a "flying start". Contractors were allowed to locate privatization candidates and develop scopes of work and budgets. Some successful privatizations were executed, but whether they were worth doing, especially for the money involved, is a good question. But many of these arbitrary candidates were never privatized at all. Some of them did not at the time want to privatize.

- In the Czech Republic, Price Waterhouse made contact with a major film company, Barrandov, and assisted its management group in the development of a privatization plan. While competitors had access to the same data prepared by PW, all other bids, with the exception of that of the management group, were unresponsive. Full success for the winning management group depends on a related future real estate venture. Meantime, financing of the takeover of the present enterprise was facilitated by liberal terms permitting payment for the present business to be made out of projected future earnings.

  This experience raises the question of whether AID money, especially in privatization's more mature stages, should be used in transactions with preferential financing, and where there is profit that is not preceded by investment, this also is open to question.

- The Czech and Slovak American Enterprise Funds similarly were given a mandate in its earlier days to look for candidates. In this case, there is somewhat more reason for this autonomy since it is their role to use their funds to foster small enterprise and stake it to achieving an eventual return. Still, early attempts at finding "winners" quickly ran into political obstacles that made each of the initial interventions unsuccessful.

Even when attractive candidates were selected, it is then open to discussion whether AID money should be used for privatizations that might take place in any case. For the most part, AID's role in assisting small/medium enterprises is sandwiched between troubled enterprises whose privatization it should avoid financing and those attractive enterprises that will attract investor attention in any case.

A final issue concerning assistance to small/medium enterprises is the lack of communication between government agencies and the companies. The larger transactions involve a great deal of interchange between a large number of persons as the complications of a transaction unfold. By contrast, the smaller enterprises seem to be kept much more in the dark by their "owners" (the state) as to progress on the privatization of their employing entity.

- The two top members of management of Krakzklo, a medium-sized enterprise that is Poland's largest manufacturer and distributor of mirrors, have been participating in the steps leading up to the privatization of the enterprise. They know that the decision on the new owner will be made soon between two bidders. They have no idea, however, which one will be selected and have not been consulted as to their opinion. They prepared on request a memorandum on desirable terms but they do not know the price offers or any other contract commitment requirements decreed by the Government or what are the offers made by the two prospective acquirers. They understand the Government's attitude to be that it, after all, is the owner and can therefore sell its property as it wishes.

[Note: We have been asked to comment on Treuhand, the German privatization agency that represents an alternative approach for both large and small companies, but especially small ones. Comment is contained in Appendix 6.]

2.5.3 Foreign Investment

2.5.3.1 Potential Services for Facilitating Foreign Investment

Foreign investment, of course, is principally related to transactions: a potential investor is attracted to an enterprise that may be available for some transfer of ownership and his interest is such that he proceeds, step by step, to be involved in an investment possibility.

There are various stages in the foreign investment process where a potential investor can receive assistance. These include:

1. The service of locating the investor in the first place as a likely prospect.

2. Providing the potential investor with factual, financial, and statistical data on the prospect enterprise, packaged attractively, and in a format with which he is familiar. In many initial instances, contractor personnel have prepared the country's initial information memoranda.

3. Providing a physical locale, perhaps under Embassy jurisdiction, that can serve as a geographic contact point.

4. Acquainting the prospective investor with the legal and procedural requirements of the host government and identifying the governmental and other principal players with whom contact is required. Locating other specialized advisory help, legal council familiar with local requirements, for example.

5. Serving as a go-between with all the opposing parties at interest -- i.e. serve as the "facilitator" among government agencies and targeted domestic companies.

6. Helping to resolve differences between the parties: the negotiating function.

7. Seeing the process through to closure.

In each of these areas, AID and other donors can be of special help. Particularly in Central and Eastern Europe, the provision of these services by foreign consultants can be useful in understanding what investors need and presenting information to investors in a familiar form. AID assistance in these areas can be useful from both the host government point of view and from the point of view of the US economy.

2.5.3.2 AID-Financed Investment Services

Of the three countries, only one, Hungary, has set up a special investment advisory service for potential foreign investors that has expatriate staffing. It is part of a section first created in the Foreign Affairs Ministry. Staffing financed by AID consists of one expatriate individual. In fact, the job was tailored to the special capabilities of the individual who happened to be available and may not be renewed now that his service period has expired.

Besides this service, AID assistance to foreign investors under the privatization contract has been indirect, focusing on assistance to governments. Projects like the Crimson Capital/D&T and firm-specific assistance to LOT airlines require constant interaction with foreign investors. In each case, however, the main client of these services is the host country government. Still, foreign investors benefit as a result of the increased transparency, and more consistent technical standards that the foreign advisors provide to governments.

2.5.3.3 Issues Pertaining to Foreign Investment

One of the most pervasive problems concerning foreign investment is the often misguided public perception that foreign investment will "take over" the country or "steal" the country's assets. This all-too-common phenomenon is present in each country in varying degree. Whatever its degree of intensity, it is always tempered to some extent by the urgent fiscal and investment needs of each country and the lack of sufficient domestic resources to fill the need. Both management and labor in each of the three countries recognize the benefits associated with foreign investment: new technology, capital needs, know-how, especially marketing know-how, and access to hard currency customers.

It is interesting that the country that first went the farthest in encouraging foreign investment and in making it a substantial reality, Hungary, is now the country having the most severe backlash on the issue of "selling out the country to foreigners". The backlash is, of course, political in origin. Several of Hungary's recent investment promotion initiatives, notably the Self-Privatization program, are constructed so that domestic investment will be further encouraged and accommodated. In Poland and in the Czech Republic, privatization contains a provision for employee ownership (20% and 10% respectively) that among other purposes increases the domestic ownership component.

Given these positive potential contributions, it is advisable to help promote both foreign and domestic investment. It also would be advisable to develop, where possible, public awareness programs. To date, only one country (Rumania, outside the immediate scope of this report) has a PIOT for a public awareness program. While such a program may not have as its basic motivation a rebuttal to the "foreign takeover" issue, it can play an important role to accustoming the public to foreign investment.

2.5.4 Overall Administration of Firm-Specific Transactions

Despite the overall low cost-effectiveness of small/medium size transactions, in all three countries, recipient firms (and government officials as well) gave substantial praise to the expertise of AID consultants' work and the professionalism with which it was executed. Only in Poland was this mixed with some complaints about the caliber of some of the consultants' work.

One issue that arose in implementing firm-specific assistance was the overall administration of the scopes of work. At times there were disagreements or misunderstandings between the AID/representative, AID/Washington and/or the Contractor.
In every case we inspected, when differences as to the scope of work developed in the minds of the various parties, the assignment produced less effective results.

- There was an instance of a contractor intra-jurisdictional dispute in Huta Warszawa that the host government felt shut off control over the work that they felt they legitimately should possess.

- There was the question of differences of interpretation of scope on some projects-- such as LOT Airlines, Huta Warszawa, Skoda-Pilsen and Privatization through Restructuring-- with local consultants, local AID, AID/Washington and host government officials each sharing in creating some of these differences.

- There was one case (Huta Warszawa) where a final report was rendered to the subject company only in English.

- And lastly, there were the many instances of technical assistance being excessively delayed due to late authorizations (e.g. Financial Sector Redeployment/Hungary, Securities Exchange Commission/Poland, Huta Warszawa/Poland). This does not relate to the caliber of the work, but unlike the Czech Republic and Hungary, AID assistance in got off to a slow, and therefore a bad start in Poland. This undermined credibility generally and probably contributed to the negative attitude present in some quarters.

• In Huta Warszawa, the steel company in Poland, the need for the valuation work requested to be timely was especially urgent because it was tied to acquisition negotiations that were proceeding rapidly. Several delay factors combined: the effective date of the new IQC contracts, jurisdictional confusion within the contractor's shop and arbitrary de facto changes in the scope of work caused the enterprise to reject some of the work and to conclude that, "standby agreements are subject to at least as much delay as tenders".

Finally, the question has been raised whether privatization should be AID financed and pursued when the jurisdiction over an SOE is at less than the federal level. Except for the above remarks about lessened cost-effectiveness at a local level that features mostly smaller enterprises, there is no reason why there should be any other difference in eligibility for AID support. In fact, two-thirds of all the number of SOEs in Poland are at the decentralized administrative district level (called vovoidships). Therefore, some involvement at the local level is inevitable at least in Poland. Also, many of the municipal service activities are potentially important candidates for privatization and are governed at this level.

2.6 The Sectoral Approach

The Sectoral Approach, which takes on privatization for the enterprises in an entire industry, suffers from the same disadvantages as taking on transactions individually. It may ultimately prove to have merit, but so far it can only be recognized as expensive.

Projects included in the Sectoral Approach include the Glass Sector and the Wood Products and Furniture Sector in Poland, Non-Ferrous Metal Companies and the Utility/Telecom Sector Studies in the Czech Republic, and Monor and other State Farm Work in Hungary.

Here, even more than with firm-specific privatization efforts, the success ratio has been low. As shown in Appendix 3, about $8.5 million has been allocated, about 28 to 66 SOEs were considered to be serious privatization candidates, with one large privatization imminent, and two more probable privatizations. There possibly will be a few more in the coming weeks that may also come to fruition.

2.6.1 Description and Rationale

The Sectoral Approach is a method of privatization that has been employed principally in Poland which has accounted for over 70% of sectoral allocations. It involves the following features:

• An industry, or industries, are selected and data is assembled as to the enterprises composing its important participants.

• Profiles are drawn up on the industry in general and on a substantial number of the individual enterprise participants. The industry profile is designed to reveal the major factors for success in that industry.

- Enterprises are selected for privatization priority. This priority is based principally on deciding which enterprises are the most likely to appeal to prospective investors, principally foreign, but also domestic.

- Privatization then proceeds on an individual transaction basis.

To date, 35 industries have been identified in Poland as subject to this approach and about 20 have been let out by bid to privatization advisor companies, mostly foreign. These 20 are in varying stages of completion of a sectoral study. The glass industry, awarded to Price Waterhouse, was the first sector assignment to an AID contractor and is overall the farthest along. We visited two companies in this industry and two included in a separate study by KPMG of the furniture and particle board industry. To date, only a handful of the total of the estimated 800 case-by-case privatizations have been effected through sectoral studies. We know of four in the detergent industry and three in the pulp and paper industry and believe that is all so far.

The rationale behind this approach is based on the beliefs that:

- A wiser disposition of the industry can be made if its total configuration is understood.
- As a result, a pattern can be set for the industry so that in the latter stages one-by-one transactions can be speeded up.

2.6.2 Cost-effectiveness

These concepts may ultimately prove to have some validity. This has not been the case yet. Perhaps there has not yet been enough time, although the project has been long-standing. Experience so far is that the Sectoral Approach is subject to some of the same problems of cost effectiveness that have affected the Firm-Specific Assistance route (See Appendix 3 for details). There is inefficiency in considering a group of candidates for privatization many of whom prove not to be well adapted to it at present. There is actually additional up front time required to first assemble the industry profile.

Above all, investment banking, which is the nature of these transactions, is inherently expensive. It is hard to estimate costs per transaction in the middle of the sectoral process before it is known how many transactions are going to fall out from the work done in common on an industry. Our rough estimate of the number of privatizations that will result in the Glass and in the Furniture industries without further significant expenditure by AID is about five in each of these industries. If so, the cost per transaction would be about $600,000. (See Appendix 3 for further discussion) Depending on the consultancy cost in the detergent and pulp and paper industries, which is not known to us, the cost per transaction there may have been somewhat less.

We have identified that the main component contributing to a cost higher than desired occurs at the front end. It just has taken too long to survey the industry and get down to the stage of preparation of the individual prospects for privatization. In the case of the glass industry, this phase took over six months [4]. It was anticipated that experience would permit this industry analysis phase to be reduced, and in the Furniture Sector it was reduced to about three months. Nevertheless, the overall cost per transaction was still very high. We believe a reasonable objective for the industry analysis phase is no more than two months.

Especially in the case of the Sectoral Approach, our conclusions, while valid as of now, may ultimately require modification if favorable results eventually emerge. The Sectoral Approach is comprehensive and of an especially long time frame. (This is one of the factors making it expensive.) It got started late. The outlook is not especially promising, but it may turn out to be more effective than presently appears to be the case. (One of the contractors feels that his ultimate number of sectoral privatizations will be modestly higher than shown in Appendix 3.)

As with the Firm-Specific Assistance approach, having the government indicate the candidates for examination is sometimes necessary to consider but often can prove unreliable.

2.6.3 A Pilot Operation

There has been one engagement in Hungary that we have classified as a "Sectoral Approach" rather than as a "large firm-specific approach". This is the assistance given to Monor State Farms. The sector is Agriculture, more particularly that portion of agriculture represented by some 120 state farm SOEs. The particular aspect of this assignment that is of interest is that it approaches the industry by having selected one enterprise as a pilot case.

- Monor State Farm was selected as representative of this somewhat more homogeneous industry category. Monor, typical of state farms, is engaged in farming and animal husbandry, but also in a variety of other agribusiness activities. Agriculture is an important and potentially world competitive Hungarian industry. It seemed particularly important to construct a new privatization pattern to take the place of the established practice of "czak soport", a form of joint-venture subsidiary spinoff that siphoned off parent enterprise profits and was rife with graft and abuse. Monor was an enterprise that particularly wanted to privatize and it was hand-selected by the SPA and the Ministry of Agriculture.

Despite the fact that no privatization resulted, there is no reason to fault its original selection as a target. Monor had the usual complex and convoluted history typical in such cases. In the end, privatization probably could have occurred if prompt execution could have taken place before various political and management failures intervened. AID delayed work authorization for completion and Monor's involuntary bankruptcy under the Bankruptcy Law of April, 1992 was the final straw that scared off investors. Monor is no longer recoupable as a privatization candidate. The cost to AID was about $250,000 and is estimated that it would have cost an additional $100,000 to complete the privatizations.

---

[4] In fairness, some of this initial delay was GOP-instituted for its purposes of gaining confidence in and familiarity with the contractor.

In the Monor case, the contractor was able to get a prompt start despite the delay in authorizing the IQC procurements, because work could be early authorized under an existing agricultural authorization.

2.7 Assistance in Monitoring and Training

2.7.1 Summary of Section

The AID portfolio of privatization projects has no direct training projects. There are, however, a few large projects that could be considered to be predominantly training vehicles. For example, both the assistance to fund managers in the Czech Savings Bank and the assistance to Hungary's State Property Agency all have a heavy emphasis on training. Still, most of the training in the portfolio is an ad hoc conveyance by counterparts who provide on-the-job training in the course of their other duties.

In the future, AID should follow a more structured approach to on-the-job training as well as training in certain specialized areas such as bankruptcy workouts and financial sector policy. It should also look to leverage its programs by working closely with formal training programs being developed by PHARE. Finally, it should develop a monitoring system which will allow it to better identify training needs and track the results of training activities.

2.7.2 Amounts and Types of Assistance Rendered

Training activities account for 17%, or just over $5 million, of the total $31.3 million authorized for privatization activities. This total does not include the learning that takes place on an indirect basis whenever one person communicates with another in a project.

Most of this money is spent for training, with little spent on monitoring. With the exception of the SPA project in Hungary, there is no program for following up and monitoring training activities or newly privatized companies. There is, therefore, no system for determining post-privatization results of AID projects.

Table 2 shows, by PIOT, the kind of training assistance that has been provided to date. A quick review points out that:

- Training within government agencies has been ad hoc and mostly conveyed through counterpart advisors. Only the SPA in Hungary has a systematic program with some structure to it.
- Formal training plans do not exist except in the SPA,
- Worker job descriptions were not found at any of the projects,
- No monitoring or evaluation of training has occurred except in the SPA project, and
- No incentive systems were found that reward training performance.

TABLE 2.1
INVENTORY OF MAIN TRAINING ACTIVITIES

COUNTRY/PROJECT	Formal Courses Off-Job ≤ 8 wks.	Formal Courses Off-Job ≥ 8 wks.	Internship 1-6 Months	Study Tours	Seminars/ Conferences 1 to 3 Weeks	Workshops On/Near Job 1-2 day Increm.	Counterpart Training (Ad Hoc OJT)	On-Job Training: Structured Or Planned
A. CZECH REPUBLIC								
1. Crimson Capital Technical Assistance (#2622100)								
a. Ministry of Privatization (CMOP)							X	
b. National Property Fund (NPF)								
i. Backlog of Transactions								
ii. Post-Transaction Role								
c. Founder Ministry								
d. Office of Economic Competition								
e. Economic Council								
2. Czech Savings Bank (CSB) (#2622108)							X	
a. Creation of Investment Funds						X	X	
i. Corporate Governance								
b. Credit Risk Management								
c. Process International Transactions								
d. Internal Financial Management								
3. Skoda-Pilsen (Restructuring) (#1183489)							X	
4. Barrandov Film Studios (Management buyout) (#1183485)							X	
5. Kovohute Rokycany (#2622107)							X	
6. Other								
a. Corporate Governance								
b. Bankruptcy Legislation								
B. POLAND								
1. Bank Regulation & Supervision (#2622104)								
a. Bank Inspection Manual (70% of total effort)					X	X		
b. New Regulation Implementation					X	X		
2. Huta Warszawa Business Valuation (#2622105)								
3. Antimonopoly Office (Interagency effort)						X	X	
4. TA to Polish Securities Commission (#2622113)								
a. Train Commission Staff						X		
b. Train listed Companies						X		
c. Train Companies to be listed						X		
5. Lot Privatization & Partnership (#2622103)							X	
6. Privatizing Ancillary Assets (#2622114)							X	
7. Privatization through Restructuring (#2622132)							X	
8. TA for Mass Privatization (#2622110-120)								
a. System								
b. Supervisory Boards of Mutual Funds						Planned		
c. Supervisory Boards of Companies						Planned		
9. Economic Restructuring and Privatization Process (#1183476)						X	X	
10. Privatization of Polish Furniture Sector (#2622121)							X	
C. HUNGARY								
1. TA-State Property Agency (SPA) (#1183482)	X	X	X	X	X	X	X	-
2. TA-Investment & Trade Promotion Agency (#2622111)								
3. TA-Redeploy Financial Assets at Banks (#13822071) Currently in Phase I, training to be specified in subsequent phases.								
4. Privatize Small/Medium Firms ("Quick Form") (#2622115) No Training Specified								
5. Agricultural Sector Support (COMPASS) (#2622133) No Training Specified								
6. TA to Privatize through Employee Ownership (#2622112)						X	X	
7. Monor State Farm Preparation for Privatization (#1183460)								

= PIO/T Work Order

TABLE 2.2
TYPES OF MONITORING AND EVALUATION METHODS

COUNTRY/PROJECT	MONITORING METHODS: Schedule Conformance to Training Plan	Attendance %	Training Plan	TA Years	EVALUATION METHODS: Participant Appraisal	Supervisor Appraisal	Measure Job Skills Change	Training Unit Staff	(Written) Job Descriptions	Incentive System fo Training
A. CZECH REPUBLIC										
1. Crimson Capital Technical Assistance (#2622100)										
a. Ministry of Privatization (CMOP)										
b. National Property Fund (NPF)										
i. Backlog of Transactions										
ii. Post-Transaction Role										
c. Founder Ministry										
d. Office of Economic Competition										
e. Economic Council										
2. Czech Savings Bank (CSB) (#2622108)										
a. Creation of Investment Funds										
i. Corporate Governance										
b. Credit Risk Management										
c. Process International Transactions										
d. Internal Financial Management										
3. Skoda-Pilsen (Restructuring) (#1183489)										
4. Barrandov Film Studios (Management buyout) (#1183485)										
5. Kovohute Rokycany (#2622107)										
6. Other										
a. Corporate Governance										
b. Bankruptcy Legislation										
B. POLAND										
1. Bank Regulation & Supervision (#2622104)										
a. Bank Inspection Manual (70% of total effort)	X		-			X				
b. New Regulation Implementation	X		-			X				
2. Huta Warszawa Business Valuation (#2622105)										
3. Antimonopoly Office (Interagency effort)	-	-		2/Calendar Year						
4. TA to Polish Securities Commission (#2622113)				320 Days						
a. Train Commission Staff										
b. Train listed Companies										
c. Train Companies to be listed										
5. Lot Privatization & Partnership (#2622103)				320 Days						
6. Privatizing Ancillary Assets (#2622114)										
7. Privatization through Restructuring (#2622132)				300 Days						
8. TA for Mass Privatization (#2622110-120)										
a. System										
b. Supervisory Boards of Mutual Funds										
c. Supervisory Boards of Companies										
9. Economic Restructuring and Privatization Process (#1183476)	X	X			X					
10. Privatization of Polish Furniture Sector (#2622121)										
C. HUNGARY										
1. TA-State Property Agency (SPA) (#1183482)	X	X	X	3.4	X	X	-	1 Full-Time		none
2. TA-Investment & Trade Promotion Agency (#2622111)				Part of 1.a.						
3. TA-Redeploy Financial Assets at Banks (#13822071) Currently in Phase I, training to be specified in subsequent phases.										
4. Privatize Small/Medium Firms ("Quick Form") (#2622115) No Training Specified										
5. Agricultural Sector Support (COMPASS) (#2622133) No Training Specified										
6. TA to Privatize through Employee Ownership (#2622112			X							
7. Monor State Farm Preparation for Privatization (#1183480)										

= PIO/T Work Order

TABLE 2.3
EVALUATION TEAM RECOMMENDATIONS

A. CZECH REPUBLIC	
1. Crimson Capital Technical Assistance (#2622100)	
a. Ministry of Privatization (CMOP)	Training should be structured rather than unplanned.
b. National Property Fund (NPF)	
i. Backlog of Transactions	Needs TA structured to complement Crimsons's work in CMOP to close deals faster.
ii. Post–Transaction Role	Needs TA structured to complement Crimsons's work in CMOP to close deals faster.
c. Founder Ministry	Needs TA structured to complement Crimsons's work in CMOP to close deals faster.
d. Office of Economic Competition	Needs a complete workplan including training.
e. Economic Council	Not a training target
2. Czech Savings Bank (CSB) (#2622102)	
a. Creation of Investment Funds	A training plan should be derived from a yet–to–be developed plan for the structure and operation of CSB's investment funds.
i. Corporate Governance	A training plan is needed for investment fund and company boards.
b. Credit Risk Management	CSB will soon have an inherent conflict of interest as both creditor of and new owner of firms through its mutual funds; hence new management systems and training related to privatization are needed.
c. Process International Transactions	Privatization will increase international transactions, and private owners will demand efficiency adding to urgency of training.
d. Internal Financial Management	CSB will soon have an inherent conflict of interest as both creditor of and new owner of firms through its mutual funds; hence new management systems and training related to privatization are needed.
3. Skoda–Pilsen (Restructuring) (#1183489)	Project is completed; training was a minor component.
4. Barrandov Film Studios (Management buyout) (#1183485)	Project is completed; management bought firm.
5. Kovohute Rokycany (#2622107)	Project completed; no joint venture partner yet; to be privatized in Wave II.
6. Other	
a. Corporate Governance	
b. Bankruptcy Legislation	Judges and bank officials need training.
B. POLAND	
1. Bank Regulation & Supervision (#2622104)	
a. Bank Inspection Manual (70% of total effort)	Establish plan to train trainers and other staff
b. New Regulation Implementation	Establish plan to train trainers and other staff
2. Huta Warszawa Business Valuation (#2622105)	
3. Antimonopoly Office (Interagency effort)	Develop training plan with case studies to train trainers
4. TA to Polish Securities Commission (#2622113)	Consolidate training plan to permit analytic review.
a. Train Commission Staff	Develop an M&E plan based on current train trainer plan.
b. Train listed Companies	
c. Train Companies to be listed	
5. Lot Privatization & Partnership (#2622103)	A plan is needed to formally document training.
6. Privatizing Ancillary Assets (#2622114)	Structure the experiment within a training plan.
7. Privatization through Restructuring (#2622132)	The project and resulting management contracts could have training plans.
8. TA for Mass Privatization (#2622110–120)	
a. System	A training plan is needed to implement the system.
b. Supervisory Boards of Mutual Funds	
c. Supervisory Boards of Companies	
9. Economic Restructuring and Privatization Process (#1183476)	This effort created an initial awareness in the Ministry of Privatization of training uses.
10. Privatization of Polish Furniture Sector (#2622121)	Have a training plan to upgrade local skills systematically.
C. HUNGARY	
1. TA–State Property Agency (SPA) (#1163482)	Continue OJT orientation, focusing on Structured OJT.
2. TA–Investment & Trade Promotion Agency (#2622111)	
3. TA–Redeploy Financial Assets at Banks (#3622071) Currently in Phase I, training to be specified subsequent phases.	
4. Privatize Small/Medium Firms ("Quick Form") (#2622115) No Training Specified	
5. Agricultural Sector Support (COMPASS) (#2622133) No Training Specified	
6. TA to Privatize through Employee Ownership (#2622112)	Project completed tasks in SOW related to training implementation through trained trainers, seminars & manuals; independently operating ESOP consultants confirms project effectiveness.
7. Monor State Farm Preparation for Privatization (#1183480)	

= PIO/T Work Order

Table 2 does not reflect any training that might take place in companies. Nevertheless, there are two kinds of training that take place within SOEs or privatized SOEs. First, there are those companies that receive training on Western management as a result of a sale or joint-venture partnership. This training is, necessarily, job training and is directed toward the new enterprise's specific needs and goals. A second type of training is indirect and might take place as a result of AID or other donor assistance in sector studies or firm-specific assistance. Unfortunately, this type of training, albeit indirect and not an intended objective, is the only form of training received by firms that do not have direct access to foreign partners.

2.7.3 Training Assistance by Country

Czech Republic

There are three projects that contain substantial direct or indirect training:

- The Crimson Capital/D&T project involves some on-the-job training. Training beneficiaries include locals who have been hired by Crimson, various Government officials that have taken part in a deal, principally in the Ministry of Privatization, and the managers of the companies being privatized. With all these people, however, it is uncertain to what extent there is long-lasting knowledge transfer.

- A more purposeful source of training has occurred in the Czech Savings Bank. Training is currently being given in four functional areas in the CSB. But only training related to the creation and operation of the investment funds is considered part of privatization work. This training is partly classroom and partly counterpart training, or unstructured on-the-job training.

- Price-Waterhouse has periodically conducted four back-to-back two day courses in Board Room Crisis Management. These sessions utilize the case method to train government MOP personnel, SOE directors and managers, and more recently, board members and managers of privatized companies in corporate decision-making.

Poland

Training in Poland has involved:

- Technical assistance for mass privatization has, like its counterpart in the Czech Savings Bank, a training emphasis. It differs only in that it is not as precisely focused since it covers a variety of the "back office" operations necessary to make the National Investment Funds (NIFs) function.

- KPMG is working with the Bank of Poland on a Bank Supervision Manual. When finished, this manual will be a training document aimed at regulating and restructuring banks.

- Technical assistance to the Polish Securities Commission involved a series of formal classroom seminars for officials of the Commission and of the 17 companies listed on the Warsaw Stock Exchange. This training focused on internal accounting at the Exchange,

Exchange reporting and public company reporting. An end objective is to develop a manual that can be used for future training.

- It should be noted that the Phase I work, completed in connection with the Sectoral Approach, represents another kind of job-related, training on the subject of analytical company assessments. Since the recommendation is made elsewhere in this report that sector studies not be pursued further, this form of access to training is not recommended.

Hungary

Activities in Hungary that involve training include:

- The work begun on Phase II of the financial sector redeployment project to restructure public sector debt,

- Development of methodologies for the non-cash sale of relatively less profitable companies to be privatized, and the development of a department within the SPA to utilize these methodologies on a sectoral basis,

- The training work under a skilled training supervisor that is taking place as part of the SPA project. Even if the advisory part of this work is discontinued in September, 1993, the training component and the training supervisor should be continued under local SPA supervision. At such time as the SPA is terminated, this training function could be transferred either to AVRT or it could be phased into PHARE's work.

- Institutionalization and implementation of a new ESOP law.

2.7.4 Impact and Results

It is difficult to monitor the impact of training, even when it is done in a structured manner with clearly defined objectives. Even more difficult is trying to measure the impact and results from indirect, on-the-job training.

Training to date has focused on privatization and private sector support institutions: securities exchanges, ministries of privatization, and banking and legal institutions. Virtually no training has occurred in privatized companies themselves, except through foreign owners or partners. Areas in which training has occurred include the facilitation of investment banking functions, credit analysis, environmental liability, ESOP and other legal regulations related to commercial law.

In general, the strongest training in all three countries came from a long term advisor working in the policy/program or institutional support areas. The SPA project, in particular, had the most structured, complete and probably most effective training. AID assistance, combined with PHARE funding, has resulted in more than 600 people being trained. Some of the areas in which training has been carried out include: environmental liability, commercial law, negotiation skills, export marketing, investment promotion, trade development, general management skills, computer skills, secretarial skills and bankruptcy management.

Both the supervisors and those trained in the SPA state that they prefer on-the-job training. The supervisors believe that most workers are too busy to take time out for any other kind of training. Low attendance (67%) at five day off-site courses confirms this view. By contrast, job-related, two-day workshops that use one day of a weekend resulted in 100% worker attendance. Job-related working meetings at lunch also result in high attendance ratings.

Besides the SPA, conversations with people that have indirectly received training by working with long term advisors shows inconclusive impact. These trainees say that their experiences have been valuable, but it is uncertain as to whether they are capable of carrying out any of the tasks performed by the advisors.

2.7.5 General Conclusions and Recommendations

Future training should stress structured on the job training (OJT). It should also try to address some of the major skills gaps that, in the absence of training, could easily slow or jeopardize the privatization process. These include: bankruptcy and workout analysis in the banks, marketing and accounting in firms, corporate governance, and the continued management of investment funds.

AID assistance should focus on training public officials to manage the privatization process; rather than trying to target individual firms or spread its resources too thinly among the private sector. Where possible, AID should try to leverage its help in these areas by working more closely with the PHARE and other donors with greater training resources. Finally, it will be important to establish more effective follow-on monitoring activities that provide insights into training needs and overall project impacts (see Section 4.3 for more details).

1. Structured On-the-Job Training

It will be important to reorient existing on-the-job training so that it is more structured. "Structured on-the-job training" is a common term in the world of training. It is a system of training whereby the specific curriculum, the use of the curriculum, and the responsibilities of trainees and trainers are fully specified together with monitoring and evaluation criteria before the training occurs. Appendix 7, "A Proposed Framework for Structuring, Delivering and Managing Structured On-the-Job Training", provides details on this approach. The greatest risk associated with structured OJT training is that the long term technical advisors will not want to implement it. It is estimated that this approach might occupy between 5% and 30% of the technical advisor's time. Advisors typically like to advise, not train. If the structured approach does occupy more of the advisor's time, it may require more advisors to complete the necessary advisory and training tasks. In any case, it might be necessary to hire skilled trainers to train the technical advisors in training.

2. Bankruptcy and Workouts

Another new subject that should be taken up as a training topic is the forthcoming emphasis on bankruptcy regulation and the related subject of work-outs. This work, however, cannot begin until a complete government policy on bankruptcy becomes law.

3. Corporate Governance and Management Skills Training

The privatized companies, especially those not associated with a foreign investor, need training in a number of subjects that can be summarized as corporate governance and skills training, particularly in the areas of marketing and accounting. Some of this may be conveyed through the boards of directors that emerge in the Czech Republic, although these boards are not likely to have had experience running companies. If the mass privatization program eventually emerges in Poland, and it does so in its proposed form, those funds will be composed of foreign fund managers who will hopefully possess corporate governance skill.

The program in the Czech Republic training board members and managers in crisis management is the only organized training program in post-privatization corporate governance. It is a difficult subject in which to give training, is much needed, and is judged enthusiastically by recipients as highly effective.

Nevertheless, training in corporate governance or skills for individual companies remains an unsolved problem, but, due to its scale and complexity, can only be addressed by AID on a strictly experimental basis. There is also the possibility of merging the effort with proposed PHARE training programs for enterprises.

4. Off the Job Classroom Training

Off-the-job classroom training should be continued for special purposes. Short-term legal training and secretarial courses in the USA, for example, are very popular in the SPA. It will continue to occupy a supplementary role to structured OJT and should be handled through its own administrative system if the period of training exceeds six weeks. This topic is addressed in Appendix 7.

5. Follow On Monitoring System

AID, in coordination with other donors, should develop an effective follow-on system that will identify manpower shortages and surpluses that exist or that develop in each firm that has been privatized. Such a system could also be used to monitor the impact of privatization assistance (e.g. number of workers trained, types of training carried out). Once needs are identified, perhaps through the reporting systems that USAID is developing for the securities exchanges, training packages can be developed.

6. Leveraging of AID Training Resources

Leveraging would involve sharing the training task with other donors such as PHARE and accomplishing the task with organizations such as the International Executive Service Corps, MBA Enterprise Corps, and the Peace Corps Free-Enterprise Transition Consortium.

2.7.6 Country Specific Conclusions and Recommendations

Czech Republic

1. Examine ways to expand training programs into the National Property Fund, the Founder Ministries, and the Office of Economic Competition. Training for the National Property Fund is particularly important because a) it has a backlog of privatization projects to complete and b) as owner of many firms it must develop monitoring activities to exercise its responsibilities as a caretaker of these firms. This type of training should only be done if it receives the full support of the NPF.

2. Develop a project, with OJT training, to restructure the debt of the banks and SOE's. Such a program should probably be housed in the Central Bank with linkages at the Cabinet level to the Ministries of Finance, Privatization, and other relevant Ministries.

3. Continue training in the Czech Savings Bank for the management of investment funds. Such training, however, should be more structured and more tied to objectives set in advance than it has been in the past.

4. Continue training lecture and case-study sessions in privatized company governance.

5. Develop a regular reporting system for public companies. Reporting data could be specified which would help determine if companies that do not have joint venture partners need marketing assistance or help with credit or training. This reporting system could also be used to determine if joint venture partners are keeping their contractual commitments to their local partners.

Poland

1. Develop a more structured training program built around the Bank Supervision Manual. AID should try to establish a program to train trainers to a) teach external bank examiners how to use the Bank Supervision Manual and to b) teach bank staff how to respond to new ad hoc regulations issued by the Central Bank.

2. Continue more structured on-the-job training for technical assistance for mass privatization program. If enabling legislation is passed, a more structured approach might require new counterpart staff in sufficient numbers for the counterparts to provide the required training.

3. Modify the public company reporting system that is being developed in the Polish Securities Commission to that it can be used to develop a monitoring program for privatized companies. The reporting data could help to identify training needs of companies, and the extent to which joint venture partners are meeting their contractual commitments.

Hungary

1. In concert with PHARE, develop a structured on-the-job training program to strengthen the training by counterparts and to expand into needed new training areas.

2. Expand training programs for later phases of KPMG's advisory work restructuring debt in the public sector banks.

3. COUNTRY SPECIFIC ASSESSMENTS

3.1 Overview

Each of the three countries in which AID privatization assistance was evaluated has followed distinct paths. As shown in the table below, the Czech Republic and Hungary have emphasized policy and program assistance and institution support or specialized transactional support, while Poland has focused its efforts more on firm-specific assistance and sector studies.

	Czech Republic	Poland	Hungary	Total
Policy & Program	$2.0	$2.6	$2.1	$6.7
Institution Support	$0.1	$0.5	$3.7	$4.3
Specialized Transactional Support	$7.1	$0.0	$0.3	$7.4
Firm-Specific Assistance	$2.9	$1.5	$0.1	$4.4
Sectoral Assistance	$1.4	$6.1	$1.0	$8.5
Total	$13.4	$10.7	$7.2	$31.3
% of Total	43%	34%	23%	

While some similarities exist, the overriding lesson learned from this evaluation and previous ones (e.g. Price Waterhouse) is that the privatization process (and AID assistance) has to be reviewed in the context of country-specific constraints and opportunities. This involves taking into consideration political and economic factors. It also requires looking at the evolution of privatization policies and programs, rather than taking a snapshot and reviewing a program at one particular point.

In the sections below, we analyze the distribution of AID program activities in the Czech Republic (Section 3.2), Poland (Section 3.3) and Hungary (Section 3.4). We also review how this assistance fits into the overall country strategy as described by previous evaluations (mainly the Phase I country assessments) and findings during this evaluation. Finally, each country review includes a summary of future issues that should be considered in the course of developing new programs and implementation strategies.

3.2 Czech Republic

3.2.1 Distribution of Program Activities

Since August 1991, AID has financed a total of 16 projects or work orders totalling (in obligated funds) $13.4 million dollars. The breakdown of these projects by type of assistance is:

Policy/Program Support	$2.0 (15%)
Institutional Support	$0.1 (1%)
Specialized Transactional Support	$7.1 (53%)
Firm-Specific Assistance	$2.9 (21%)
Sectoral Assistance	$1.4 (10%)
Total:	$13.4

Early on, the emphasis of the AID program was evenly divided between assistance to companies and the other kinds of assistance. Most of the 1991 work orders focused on the execution of sector studies or the development of privatization plans for individual companies. Concurrently, there was a dramatic increase in funding specialized transaction support: for Crimson Capital/D&T, to assist the Ministry of Privatization in negotiating trade sales with foreign investors.

By 1992 the program developed new programs in support of mass privatization and the financial sector. This was primarily executed through one institution, the Czech Savings Bank. Assistance to individual companies was curtailed, while continuing support was provided to the Ministry of Privatization through Crimson Capital/D&T.

Overall, AID has spent more than half its funds on specialized transactional assistance, through the efforts of Crimson Capital/D&T. This was different from the distribution of investment in Poland and Hungary. The early emphasis on assisting companies resulted in about one-third of total expenditures being spent on firm-specific and sectoral assistance. This is significantly above that spent in Hungary (15%) but also well below what Poland spent on firm-specific and sectoral assistance (71%).

3.2.2 Comparison with Phase I Country Assessment Conclusions

The Czech Republic's privatization strategy has followed the most decentralized, "bottom up" approach of the three countries visited. Strong presidential authority has allowed the Czech government to encourage laissez-faire, relatively unregulated privatizations to take place.

The more salient characteristics of this approach confirmed by both the Phase I country assessments and this evaluation include:

- **Rapid Development of Privatization Plans:** SOEs were responsible for preparing privatization plans by October 1991. During this stage, the government encouraged competition by accepting proposals from all interested parties -- management, employees, outside buyers. In most cases, however, the management's proposal was found to be the most acceptable.

  The Founding Ministry then approved these plans, usually not paying much attention to the quality (e.g. business/market analysis, proposed reorganizations) of the analysis. Once approved, the plan then went to the Ministry of Privatization which decided on the type of privatization.

- **Promotion of a Market Driven, Decentralized, Unregulated Mass Privatization Program:** The Czech Government developed a voucher program which gave low cost vouchers (bearing an administrative charge equal to 25% of 1 month's salary) to all Czech citizens. These vouchers could be freely "invested" in individual companies or in Investment Privatization Funds (of which more than 400 were formed). The development of vouchers and investment funds was rapid and involved the public early on.

- **Promotion of Foreign Investment in the Privatization Programs:** The Czech government has openly encouraged and facilitated foreign ownership (mostly majority) in the privatized companies.

The results of this strategy have been impressive -- at least on the surface. Through mid-January of 1993, the Ministry of Privatization had evaluated nearly 8,600 of the roughly 11,300 privatization projects submitted in the first wave, of which 2,000 have been approved. Most of these privatizations were part of the voucher mass privatization program. Today, nearly three-quarters of all eligible citizens have participated. In terms of foreign investment, there are 220 enterprises under negotiation, with 63 having been approved (see Section 4.2.1 on the results of the Crimson Capital/D&T project) amounting to revenue and new investment of more than $1.6 billion.

A major issue associated with the Czech program, however, is the quality of the privatizations. A privatization by legal transformation does not necessarily mean that there will be a significant change in ownership or in capability to reposition a company. There is very little attention paid to the possibility that vouchers could lead to a highly dispersed ownership of enterprises and the absence of a major shareholder in a position to influence enterprise policy.

Also, there is a legitimate question as to the social and economic equity of the mass privatization program. Many of the better companies found foreign partners before the vouchers were issued. Therefore, some of the remaining companies available for voucher "investments" are highly risky and subject to future bankruptcy. In the absence of prudential regulation, investment funds could corner large blocks of vouchers. Also, the existing institutional structures for managing the Investment Privatization Funds (IPFs) are inadequate. In short, the assumption of "let the buyer beware" may lead to significant political and economic fallout once it becomes clear which companies are viable or bankrupt, and once the market determines which IPFs are competently managed and which are not.

Finally, it is uncertain what will happen to companies that are not privatized or cannot survive the implementation of a new bankruptcy law. Currently, the law states that all transformed companies are transferred to the National Property Fund. However, it can take the NPF up to 5 years to privatize. The NPF's policy to "privatize not administer" means that there will be a long period of weak governance. Furthermore, in the absence of a single dominant and active shareholder, many of the companies in the Investment Privatization Funds (IPFs) will likely go bankrupt and have to be liquidated or restructured. Currently, there is no government assistance in place to respond to these demands.

3.2.3 AID's Role in the Privatization Process

In the Czech Republic, AID has not had to worry about developing a political consensus for privatization. Still, it has rightfully had to help guard against the political fallout that can come from implementing a rapid, relatively unregulated privatization program. Also, in the case of individual enterprise assistance, it is clear that political factors have intervened (e.g. selection of companies, purchase price recommendations) which have slowed and made firm-specific assistance relatively ineffective.

From the outset, AID was able to develop a responsive and timely assistance program. This was in large part due to the fact that a privatization project officer from AID/Washington was in the Czech Republic when initial assistance needs were being formulated. Upon her return to Washington, this manager was able to quickly push the proposed projects through the approval process. This was unique to the Czech Republic and was important to establishing AID credibility with the Government. (Unlike the case in Poland where initial delays proved to be highly damaging to the credibility of AID. See Section 3.3 for details).

In 1991 AID assistance followed a "buckshot" firm-specific approach that emphasized assistance to individual firms or to sector studies with the objective of developing individual privatization strategies. Most of this assistance took place in 1991 and was initiated through the marketing efforts of individual contractors.

As mentioned in Section 2.5, most of this assistance has been unable to achieve its primary objective-- privatization. This is due to a number of conditions. First, individual company assistance is easily complicated by a number of factors:different end objectives, reluctant buyer or seller, poor prospects, changing government jurisdiction, shortage of credit and equivocal attitude of government. In the case of Skoda Pilsen, individual assistance was made ineffective by the presence of poor management and government indecisiveness. In the sector studies, it was found that strategic studies concentrated too many resources "upstream" identifying winners and not allowing for enough resources to complete deals.

Beginning in 1992, however, AID has shifted away from assisting individual firms, to focusing more on assisting institutions and targeted transactional assistance. The two primary recipients of AID resources have been the Ministry of Privatization and the Czech Savings Bank.

In both programs, AID has successfully supported "facilitator" activities. In the Ministry of Privatization, Crimson Capital/D&T have focused assistance on assisting the MOP to negotiate deals with foreign buyers. The MOP work has helped the government gain better benefits in terms of: purchase price, investment, environmental obligations and employment guarantees. The assistance has helped saved money and processing time. Also, according to interviews with foreign investors, the presence of foreign advisors in the ministry has provided continuity where ministries have suffered from high turnover. Finally, in the public's eye, the negotiating process has protected the Czech government from accusations of "selling the family jewels" at an undervalued price.

In the Czech Savings Bank, KPMG advisors have helped train managers for the investment funds. This assistance will help ensure that the leading fund in the voucher program will be able to handle the responsibilities and protect investor interests competently. This assistance has been worthwhile because: it is central to the economy and to government privatization strategy, the CSB has significant funds, the CSB plays an important role in the voucher program, and CSB has high public trust.

Both programs have helped the Czech government to establish credibility and consistency in the management of its privatization program. This is particularly important early in a privatization program when new approaches are being tested and public trust is tenuous. The success of both programs is due to several contributing factors: 1) clearly defined activities and narrow focus, 2) strong government support, 3) not having to analyze, screen and select "winners", 4) providing help "downstream" in the privatization process (e.g. after firms have found foreign partners, or managing existing investments) rather than "upstream" (e.g. carrying out initial market or sector studies), and 5) adequate coordination between AID/Washington and the AID representative in the Czech Republic.

3.2.4 Future Issues

The challenge for future AID assistance will be in helping the Czech government make the transition to the next stage of privatization. To date, assistance has helped in facilitating the processing and management of firms that have "self-selected" themselves to be participants in the privatization program.

In the coming years, AID assistance will have to focus increasingly on helping the Czech government manage the "losers" and/or the struggling "middle tier" firms in the privatization transition. There are many firms in the Czech economy that are not attractive to foreign buyers, nor do they currently have the existing capability to remain profitable. In the absence of debt renegotiation, restructuring or management assistance, many of these firms will fall victims to a new bankruptcy law likely to be implemented this year. In the face of these hardships, public support for the program might waver and actually turn against the government's privatization programs.

Specific issues that have been mentioned in the evaluation scope of work and commented on by government and private officials are presented below.

1. Development of Voucher Program and Capital Markets

AID should continue to support the voucher program by providing assistance to the Investment Privatization Funds (IPFs). To date, AID assistance has primarily has been focused on the Czech Savings Bank, one of the largest fund managers.

In the future, AID should plan to spin off any training programs it develops in the Czech Savings Bank to other holding companies. In this way, AID will avoid being accused of favoring only one institution. Such assistance, however, should be selective and focused on the institutions that are best able to effectively utilize the assistance.

A related issue to the voucher program is the development of capital markets. There are many projects initiated in Poland that should be considered for financing in the Czech Republic. Some of the more important would include: development of regulatory framework, anti-monopoly assistance, establishment of a SEC reporting system. As mentioned earlier, one of the biggest challenges that the Czech Republic will face will be in regulating and managing the political risks associated with rapidly growing voucher trading.

2. Complementarity and Transferability of the Voucher Program

AID's focus on facilitating foreign investments through the Crimson Capital/D&T project as well as assisting the voucher program through one institution is well founded. The program is soundly balanced between foreign and domestic investment, thereby protecting itself from accusations that it is unfairly favoring the promotion of foreign investments at the expense of ignoring the development of domestic privatizations.

Just as the Czech Republic can and should draw upon the lessons learned from Poland in terms of establishing a regulated capital market framework, certain elements of the Czech voucher program can and should probably be transferred to other countries, most notably Hungary, the Southern Tier and Baltics (Poland already has its own mass privatization program under development). The major lesson learned from the Czech experience is the need to balance "supply side" development of the program-- i.e. concerning the quantity and quality of submitted privatization projects -- with "demand side" issues like establishing regulations for Investment Funds and developing sound institutional structures.

3. Foreign Investment Disincentives

Conversations with foreign investors did not reveal the lack of clear tax liabilities as being a major disincentive. Rather it was the time involved in clearly defining environmental liabilities and other representations and warranties that most preoccupied foreign investors. Along these lines, there was general frustration that even with the Crimson Capital/D&T assisting in negotiations, the process at times tended to be time consuming and full of complications involving many government agencies. (It should be noted, however, that most investors agreed that without AID assistance the processing time would have been even longer and more problematic).

It is unclear whether future foreign investment will be deterred by a lack of investment incentives or an overall lack of attractive investment opportunities. As foreign investment interest declines, AID might consider developing (either in the privatization contract or some other contract) an aggressive, targeted investment promotion program. Such a program would combine work on the policy front with institutional support for investor outreach services.

In general, however, given the magnitude of domestic and regulatory issues that will most likely affect the Czech privatization program, additional assistance in foreign investment should be considered secondary to those programs focused on supporting mass privatization and the development of bankruptcy/workout assistance programs.

4. Managing the Fallout from Privatizations

Throughout the region, a major challenge will be in managing the adverse consequences of bankruptcies resulting from privatizations and declining government support for enterprises.

AID has considered and should focus on the following: helping the banks to develop "workout" units that can work directly with adversely affected firms, and assisting the National Property Fund in managing its assets (contingent, of course, on the NPF demonstrating an interest in receiving assistance).

Unfortunately, there is very little experience in the region from which to draw on in the design of these programs. With the exception of Hungary, none of the countries visited has implemented and, equally important, enforced a bankruptcy law. (There have been a substantial number of bankruptcies declared in Hungary in 1992 following passage of a bankruptcy law.

However, the law was flawed and needed substantial improvement to make it an effective and appropriate instrument. We understand the law has recently been amended to make it more flexible; for example, it provides for work out procedures.) Consequently, none of the countries has had to resolve the consequences resulting from enforcing bankruptcy legislation. All this suggests that AID should move quickly in developing experimental programs in each country, all the while trying to learn from each country's experience so that the positive elements of one program can possibly be transferred to another country. Of course, any lessons learned should be tailored to the country-specific constraints and opportunities concerning institutional capabilities, political support and the stage of privatization.

5. Other Issues

The AID office in the Czech Republic is considering a program to help privatize the health sector. As mentioned in Section 2.2.6, there are several issues concerning the implementation of such a program. First, it will probably take a significant amount of money which AID may not have. Secondly, the reform of health care, as evidenced by the U.S. experience to date, is complicated and full of political and social ramifications. It is unclear whether the Czech government will have the willpower to follow through on such a program. All these factors suggest that AID should seek to develop a consensus among the donor community so that it does not become the primary source of funding. Also it should proceed carefully, making sure that there is strong political support for any new initiatives.

3.3 Poland

3.3.1 Distribution of Program Activities

Since 1990, AID has financed a total of 13 projects or work orders totalling $10.66 million. The breakdown of these projects (in millions) by type of assistance is:

Policy/Program Support	$ 2.6	(24%)
Institutional Support	$ 0.5	(5%)
Specialized Transactional Assistance	$ 0.0	(0%)
Firm-Specific Assistance	$ 1.5	(14%)
Sectoral Assistance	$ 6.1	(57%)
Total:	$10.7	

On a per capita basis, Poland has received a disproportionately small amount of AID assistance for Privatization and Enterprise Restructuring. With a population of approximately 39 million, Poland's assistance on this basis would be at least triple the amount provided the Czech Republic or Hungary. Additionally, of the three countries, Poland's industrial base is generally considered to be in the worst shape. This would indicate that on a needs basis, Poland should receive proportionally more assistance. While this macro analysis does not take into consideration other AID expenditures in related fields, it does suggest that AID should review its overall spending on Privatization and Enterprise Restructuring to ensure Poland receives AID funded assistance in an equitable balance and consistent with its needs.

Poland has considerably higher expenditures for Firm-Specific and Sectoral Assistance, in combination, than the other two countries. This is entirely due to funding the Sectoral

Approach, which was not used nearly so extensively in the other two countries. Poland also has about average Policy and Program expenditures. This does not represent any one large program, although several programs relating to the financial sector make up a sizable amount. It is also a reflection that Poland has the broadest privatization strategy, encompassing various programs. Poland has lower expenditures for Institutional Support, having no project comparable in size to the SPA support in Hungary or to the transaction-oriented Crimson Capital program in the Czech Republic.

Some of the more pertinent characteristics of AID support in Poland are cited below.

1. General Technical Assistance & Institutional Support

In contrast to the other countries, Poland has not received long term technical assistance similar to that provided to the SPA or to the Ministry of Privatization through Crimson Capital. Such assistance was never requested. In retrospect, it appears that such institutional support might have been desirable to establish stability and continuity, especially in view of the numerous changes of governments, programs and personalities. On the other hand, the role of senior advisors in such a changing environment could easily have been become politically compromised.

2. Financial Sector Support

Two projects totaling $924 thousand have been spent on financial sector support: one for Bank Regulation and Supervision at the NBP; the other for assistance to the Polish Securities Commission. These projects complement AID's Bank Training and Financial Sector Advisors projects, both channeled through the Treasury Department, as well as related projects for Tax Policy and Administration, channeled through the IRS and Treasury, and for Antimonopoly/Competition Law and Policy Development, channeled through the Federal Trade Commission and the Justice Department. In total, the commitment to the financial sector has been significant, well executed and appreciated by the host country.

3. Mass Privatization

As of the writing of this report, Poland's MPP had suffered a setback as the Polish Sejm (Parliament) failed to approve legislation for the MPP. We have since learned that the government of Madame Suchocka re-introduced this legislation and it was passed.

AID's support of this program has been well received and has made a strong impact in shaping both MPP policy and its form. Two technical support projects completed in 1990 and 1991 have been followed by funding a long term "back office" technical advisor. AID's support complements nicely PHARE's funding of the MPP staff and the British Know How Fund's funding of the "front end" of the MPP, including selecting companies and fund managers.

In an evaluation, it is normal to concentrate on the program and not on the consultant or the consulting firm. But in this case, there has to be an exception. The high qualification of the consultants has made a tremendous impact. Issues that have not even been considered by the host country (or the other donors and consultants) are being presented by the consultant with suggestions for the best possible solutions, some rather complex and innovative. Accordingly, even though AID's funding is significantly less than that of the other donors, its assistance is extremely influential.

4. Sectoral Privatization

Poland is the principal country where AID has funded a sectoral approach, in part because Poland was the only country specially emphasizing this methodology. On the surface, a sectoral approach appeared to be desirable since the government had very little knowledge of the shape of most of its industries. It therefore seemed logical to establish base lines for privatizing companies within given industry sectors, and the government could thus find out which firms need restructuring before privatization and which should simply be liquidated.

In retrospect, the Sectoral Approach does not appear to have been a cost effective expenditure of funds, especially if evaluated on the basis of cost per privatized firm (See Appendix 3). Perhaps such an evaluation is not quite valid as the government also received information about the firms that cannot be readily privatized. Nonetheless, many sectoral studies were done not on a grant basis but on a success fee basis. Additionally, it appears that those firms that were targets for privatization would have been privatized anyway, and the government has yet to implement a successful program dealing with those firms requiring restructuring or liquidation.

5. Privatization through Restructuring/Liquidation

The Privatization through Restructuring program has not been successful, in large part the victim of the Government of Poland's and to a lesser degree AID's bureaucracy. It took AID/Washington about eight months to approve the program, by which time the host government decided to change the scope of work. The request for these changes was not responded to in a timely manner, nor in manner considered appropriate by the host government. The program has been stalled for several months.

As a government program, Privatization through Restructuring, as well as its parallel program Privatization through Liquidation, is not proceeding well. In this case, therefore, the slowness with which it has taken effect may not, in the end, be a minus. This program is the only one in the three countries that addresses the difficult issue of what to do with state enterprises that simply cannot make it on their own in their present condition. In Poland, this issue has become highly politicized, especially with the changes in governments.

While this background clearly contributed to the lack of success in AID's project, the inability of AID and the Government to arrive at a consensus on the objectives and approach for achieving those objectives has resulted in a lost opportunity. The project was an experiment that was questionable at best. But an opportunity has been lost to come up with solutions, or at least, a better understanding of how to effect restructuring.

6. Firm-Specific Assistance

AID has funded only two major firm-specific assistance programs in Poland: Huta Warszawa and LOT Airlines. Huta Warszawa was a small expenditure intended to help the government in the proposed sale of this "dinosaur" steel works to an Italian steel conglomerate.

Although the expenditure was small, the Huta Warszawa project seemed an excellent vehicle on which to build credibility and create a presence. Unfortunately AID/Washington did not respond in a timely manner, frustrating the host government. When the funding was finally approved, the privatization had progressed to the point that AID's assistance was not only not necessary, it also did not make sense. What turned out to be a small expenditure leveraged to make U.S. assistance look good, became an albatross that made U.S. assistance seem undesirable.

The LOT Airlines assistance seems to be a good project. We question it primarily in its cost effectiveness, and because it appears that without AID's assistance, LOT would probably have paid for the assistance. Nonetheless, LOT is a politically sensitive enterprise, and from the host government's point of view, AID's involvement is important and appreciated.

7. Ancillary Assets

Poland is the only country that launched a formal program to study the problem of ancillary assets. These are all the non-production assets that were held by large conglomerates, such as recreation facilities, hotels, hospitals, schools, etc. With AID's assistance a manual was prepared to help the Government and other companies spin off their ancillary assets. This program was well conceived and executed. No follow up appears necessary at this time.

3.3.2 Comparison with Phase I Country Assessment Conclusions

Our evaluation basically validated the findings presented by Price Waterhouse in the Phase 1 Evaluation of Privatization in Central and Eastern Europe as they pertain to Poland. Some general observations and comments as they pertain to the Phase 1 assessment are listed below.

1. The Framework for Privatization

Poland's transformation of its political, legal and economic framework for privatization was shaped by two factors: the Solidarity movement that successfully wrestled control from the communists; and the mess left by the legacy of over 40 years of communist rule.

The latter factor meant that the new Solidarity government immediately had to tackle very difficult economic issues. For example, in the run up to the 1989 election that they lost, the communists basically opened the purse strings in an attempt to "buy" the election from the workers. And when they lost, the lame duck communist government kept the flood gates open. By the time Balcerowicz implemented his plan, Poland was on the verge of hyperinflation. This inflation did occur, but only very briefly, with a massive devaluation of the zloty - from around 3000 Zl/$ at the time of the change in government in September, to 9,500 Zl/$ as of January 1, 1990. The resulting catch up inflation hit Poland in January, but immediately started subsiding in February.

The former factor meant that as Solidarity started to exert its political power, it realized that it was more of a political movement, founded on the necessity to oppose communism rather than to advance a cohesive new political agenda. As Solidarity began to put a program together, it recognized that its roots were in varying different social and economic strata, which resulted in its splintering into several factions, later into separate parties.

The Solidarity legacy also ushered in Lech Walesa as the country's new president, but without a real political party supporting him. For years, Solidarity and Walesa had learned to operate very efficiently as the opposition. Neither was prepared to lead and govern.

Indeed, Walesa's call for presidential elections in the spring of 1991 had nothing to do with a need to replace General Jaruzelski - who had receded into playing a low-profile, non-interfering role as president, but was more a protest against some of the pain being felt by the workers from the Balcerowicz plan, and a misperceived notion that getting rid of communism would automatically usher in a Swedish style of social capitalism. If indeed a change was necessary to get rid of the old communists who were impeding change -- as Walesa charged -- then a new parliament was required.

The confusion and fragmentation caused by Walesa's desire to claim the presidency dealt a near fatal blow to the privatization process. When parliamentary elections were finally called, the split up of Solidarity was finalized as some 40 parties won seats to the parliament (including a Beer Lover's Party!). This parliamentary fragmentation was exacerbated by a holdover provision of the old constitution that favored small party representation, a feature favored at times by both the communists and by Solidarity.

Poland's political morass can be interpreted as being part of the political maturing process. Parliamentarians realized that they owe their loyalties not to some vague concepts or to the people at the top of the political process, but to the electorate. The coalition of Madame Suchocka is a tenuous one, composed of seven political parties, but she has learned how to keep the coalition together, and the coalition members have learned that they must govern by being for a program, as a opposed to being simply against one.

Poland will be much better served with a new constitution followed by new parliamentary and presidential elections. Parliamentarians have learned to spend long debates tackling philosophical issues -like abortion, teaching religion in schools, etc. - because for some of them, these issues are in fact the most important ones that need to be addressed first, whereas for others, they are a convenient way of postponing painful economic choices. In the meantime, we should remember that at least Poland has a freely elected government trying to figure out how a free government should be run and a transformation to a free market economy be made.

This political backdrop obviously affects the legal and economic transformation. Every change is debated to an almost absurd point. But at least the political process is working, however slowly. In the meantime, the people are not waiting for parliament. It is estimated that over 55% of Poland's work force now works in the private sector; and this estimate might prove conservative as no one in Poland has yet been able to adequately measure the strength of the private sector, especially as some of it still remains unreported. Probably the best indicator is what is not happening: the government is not caving in to wild cat strikes; the population as a whole does not support these strikes; mass starvation is not to be found; and no one is calling for revolutionary changes.

2. Corporate Governance

Starting 1981, corporate governance in Poland was effected through the Workers' Councils. Since these Councils were an outgrowth of the Solidarity strikes, it is easy to understand that the workers are not enthusiastic about shedding a political right which they had won under such difficult circumstances.

Ironically, one of the most effective motivating reasons cited for the workers giving up this right is to get around what is called "popiwek", the excess salary tax. This tax was introduced under the Balcerowicz reforms to kill inflationary salary increases: any salary increase over inflation is accessed a tax that can be up to several times the excess increase. (There are similar provisions for SOEs and a similar escape route in the Czech Republic and Hungary as well.) After having their salaries held back for several years, Polish workers are starting to reluctantly give up their rights to a Workers' Council by agreeing to at least undergo "commercialization". This occurs when an SOE converts to either a limited liability company or joint stock company status.

At this point, a new Board of Directors is appointed to take over corporate governance. For most firms, this Board is composed of local business and banking officials, not unlike the composition of many small, local companies in the U.S. The Board must be approved by the government at the time a firm is commercialized. Only the biggest, most politically sensitive SOEs seem to have a problem with corporate governance.

Another important feature in Poland's corporate governance affects the general manager issue. When the new parliament was elected in the fall of 1991, it mandated that all general managers stand new elections to their positions by the Workers' Council. This resulted in the dismissal of many general managers who were old communist "nomenklatura". It also brought into power many young managers who are eager to explore and learn new ideas on how to run a business, and possessing a sensitivity that the business' success cannot be attained by walking over the workers who had just elected them.

3. Internal Privatization

Poland has taken the broadest approach to privatization methodology. This is primarily due to a couple of contributing factors. First, this is a response to the numerous changes in governments, each of which has different priorities and demands. Second, it is a result of an underriding philosophy in the government to let privatizations take whatever courses are necessary to make things work.

In this environment, the results have been favorable. While the contribution of SOE privatization has to be minor, the World Bank now estimates that over 55% of the Polish workforce is in the private sector producing over 45% of GNP output. In the services area in particular, virtually the entire service economy is in private hands.

While official statistics on privatizations of large SOEs are disappointingly small, many of these SOEs have been busy restructuring themselves out of necessity. Under the Balcerowicz reforms, all state subsidies were cut off (although some indirect subsidies remained for energy and transportation). Accordingly, Polish SOEs had to start behaving like private companies even though they had not yet been privatized.

4. Mass Privatization

A key differentiating feature of the Polish MPP is its insistence on bringing to the Polish companies in the MPP foreign governance and access to foreign capital. Both goals are reached by having a foreign fund manager appointed to run each of the 20 investment funds that will be set up. Additionally, less than 10% of Polish companies were selected for the MPP under criteria that included only profitable firms. Another key feature is that for those citizens who hold their bearer certificate to maturity, it represents risk diversification and professional fund management. Certificate holders will not have to chose in advance which firms they feel might be successful.

Poland's approach to the MPP has been described as top down. To many, this has a negative connotation. Yet when the program is reviewed in its totality, it appears to be a very prudent approach that takes into consideration the companies in the MPP and the citizens who buy the bearer certificates.

5. Lessons Learned

The lessons learned from Poland's privatization experience tend to focus on projects that are still not complete. This in turn tends to cast the programs in a negative or undefined state. Still, the Polish experience demonstrates the positive effect of experimentation. Trying different approaches and having long open debates on the privatization process might prove healthy for a country in the long run. We should be prepared for set backs in the privatization process, and not be disappointed by them. Each country must reach its own conclusions; in order to be effective, Western advisors must be country-literate and bring with them the highest technical credentials.

Many roads to privatization should be taken. New private enterprises are as much a part of the privatization process as are transformation of SOEs. Likewise, small privatizations of municipally owned firms or spin offs of ancillary assets are also an important part of privatization. Institution and infrastructure building is a very important part of the privatization process.

3.3.3 AID's Role in the Privatization Process

The Polish government does not have a completely favorable perception of AID assistance. Early on in the program, the host recipient was angry or confused. The core reason for this had to do with AID/Washington, AID-field working relationships. Specifically, we found AID/Washington to be slow in responding to host government and AID/field office requests for assistance, and appearing to be arbitrary in its approval process.

When AID assistance was first offered to Poland, field visits to Poland were made by AID/Washington and the government of Poland was led to believe -- as it should have -- that AID assistance would be quickly forthcoming. In fact, many projects were delayed, modified or simply not acted upon, leaving many in the government to loose faith in AID. Huta Warszawa is a good example of this.

Since that ominous start, several well executed projects have helped repair the damage. Examples of this include the SEC assistance, the MPP support, and the NBP assistance. However the response time even to these programs was slower than what it could have been. The problems of providing timely responses still continue, especially for requests to set up new projects and to modify existing ones. An example of this is the suspended status of the Privatization through Restructuring project due to delay's in AID/Washington approving a minor expenditure for advertising.

Perhaps out of proportion to their specific importance are the impressions made on us and on the Polish Government by the reviews now going on that relate to the details of Poland's Quick-Form Privatization Program. There is a name change at issue (this does involve a change in the scope of work, although in our opinion, not a significant one) and various other authorizations, administrative in nature, with the result that all progress has been suspended while an incidental $20,000 of advertising expense to locate potential investors is evaluated in Washington (and by Contracts, who is hardly capable of judging the issue). We have not run down all the ramifications of this but, as with a similar suspension of Poland's Privatization through Restructuring project, it certainly seems an example of over-centralization and not in accord with common sense. [Note: at press time, this expenditure had just been approved.]

Similarly, AID/Washington still makes decisions that appear to be arbitrary or that run counter to host country and AID field office recommendations. An example of this is the decision to not approve additional funding for the Glass Sector Privatization project at a point when the government perceived such assistance to be critical to the privatization of Sandomierz, the largest firm in the sector.

3.3.4 Future Issues

Specific issues mentioned in the evaluation scope of work and ones that AID needs to consider for future programs are cited below.

1. Financial Sector

Future AID assistance will have to concentrate more on the financial sector. This is a logical outgrowth, since other easier issues are being addressed and resolved, whereas the problem of bad loans -- which will take a long time and a lot of effort to resolve -- has yet to be addressed. Bank privatization should not be aggressively pursued until a solution to the bad loans is mutually agreed upon.

From a sequencing point of view, enterprises should be privatized as soon as possible: not only is it easier and faster to privatize individual firms, banks should have a healthy loan portfolio before they are privatized. In effect, bank privatization should be the last step of the privatization cycle, and resolving the bad loan issue the next to last step. In a sense, this sticks the banks with some of the problems of the privatization process, but an economy making such a dramatic transformation in such a short period of time needs this "safety valve".

Significant, long term work needs that should be considered in the financial sector, both in the banking and the non-banking fields, include:

Banking: 1) Bank restructuring, 2) Bank regulation, 3) Functioning interbank infrastructure, 4) Intercompany debt work out, 5) Bad loans work out, 6) Bank recapitalization, and 7) Bank privatization.

Outside of banking assistance, AID should consider providing technical assistance for projects that support the establishment of a functioning capital market. The Polish economy will need to raise significant amount of monies to transform Poland's industry, far more than either the banks or even foreign donors can support. Only a flourishing free capital market will be able to meet this demand. Accordingly such successful projects as those at the Stock Exchange, the Securities Commission, and the Antimonopoly Agency should be continued. Primary areas to be considered include:

> **Non-banking:** 1) Warsaw Stock Exchange, 2) NASDQ type of OTC market, 3) Brokers 4) Fraud, 5) Antimonopoly, 6) Insurance, 7) Pension Funds, 8) Fund Management.

2. Mass Privatization Program

Although the MPP initially suffered a temporary legislative set back, the program has now been passed by the parliament. As a result there are many back office issues that need to be resolved.

AID support of the MPP should continue along its current path. In a way, the delay caused by the parliament's temporary failure to approve the MPP has provided additional time to sort out these issues. Additional AID involvement beyond its present scope of work does not seem necessary at this time as other donors are supporting other aspects of the MPP.

Going forward, AID should evolve towards more of an infrastructure building role -- for example to assist in establishing an OTC market and mechanism -- or towards an operational support role to ensure that trading proceeds smoothly. Additionally, once the MPP is implemented and fund managers selected, AID should consider supporting the back office operations of U.S. fund managers.

3. Corporate Governance and Privatization through Restructuring

The issue of corporate governance is very important. While elsewhere we commend a relatively small program in the Czech Republic on corporate governance, we still question whether any large scale AID assistance to improve the efficiency of Boards of Directors of SOEs would accelerate the governance process. As a general comment, becoming an effective member of a Board takes years of background; it is not something that can be learned from a training course. However, there could be some information concerning Board mechanisms and recent applicable laws which might be appropriate for a training course.

Obviously for SOEs that have not yet transformed themselves, this is a moot point since these SOE's do not have a Board of Directors but rather a Workers' Council. For those SOEs that have transformed themselves, the government should not remain a majority owner for an extended period of time; thus any such assistance will not be cost efficient since the Board will most likely be replaced by the new owners. Foreign buyers will bring in their own foreign

Board Members; firms that go into the MPP will have foreign fund managers controlling the Boards.

For any transformed SOE that does not pass to majority private ownership, it might be more cost effective and easier for the government to contract for a management team to run these firms rather than to concentrate on the Board. This has already been attempted through the privatization through restructuring program. This program was perhaps a good idea, but one not easily put into effect and one that can easily be politicized. As mentioned in Section 2.2, AID's experience to date with the Restructuring program has not been good. On the other hand, the department in charge of these programs seems to be satisfied with the services being provided and financed by the World Bank. Consequently, AID's assistance in this area should not be needed. However, if it is requested, AID should be cautious and insist on establishing mutually acceptable, clearly identifiable goals that help the program. Also, it should focus on developing the institutional procedures for managing this program, rather than firm-specific analyses. Similarly, AID should also be cautious in providing assistance to the "Privatization through Liquidation" program. However laudable the goals of this program may be, AID should be sure that its role focuses on setting up an institutional mechanism, rather than providing firm-specific assistance.

4. Facilitating Foreign Investment

AID has not played a role in facilitating foreign investment. However, it has identified and begun to address some of the major disincentives to foreign investment.

One major disincentive to investors is the lack of a clearly defined legal framework, particularly in the areas of property rights and tax assessments. In the former area AID through its IRIS project (financed under another project) is helping to define collateral laws and develop the necessary infrastructure support (e.g. setting up a computerized and centralized system for tracking liens). This support is absolutely critical and should be continued.

Additional technical assistance is also required for tax policy. Currently many state owned enterprises are not paying taxes, causing a large budget deficit. To close this deficit, the Polish government has raised taxes on private, tax paying firms. If this trend is allowed to continue, the profitable private firms will either go bankrupt, or will devise tax avoidance strategies -- either legal or illegal -- which will further complicate the budget crisis. Similarly, import duties and customs charges, which also were raised to cover the deficit, are at such a point that they are protectionist in nature. This will cause problems when Poland will need to lower its duties to join the EC.

Other areas mentioned by AID officials included the weak banking sector, political instability and the strength of the trade unions. As already mentioned, AID has provided help in the banking sector. The other two areas do not lend themselves to direct project assistance.

Finally, the success of AID assistance to the Czech MPP through Crimson Capital/D&T suggests that similar support to the Polish MPP could provide tangible results. An example of this might be a transaction unit to help pull together all the "sellers", or a senior long term advisor to the Minister. Such assistance, however, will clearly depend on the desires of the government and the extent to which it fully supports such assistance.

5. Support to Municipalities

AID should continue its support of privatizing of municipally governed firms which can be transferred to the private sector without central government approval. Such programs as the Peace Corps, the MBA Enterprise Corps, the IESC, IBIS and GEMINI provide essential, varied, bottoms-up privatization mechanisms at the local level. These projects extend legitimacy and transparency to this process, and allow for good U.S. and AID visibility throughout the country.

6. Other Privatization Methods

AID should be open to support additional privatization methods. One that is being used successfully in Hungary, with AID's assistance, is ESOPs; another possibility is a program to provide low interest credits for individuals to buy existing enterprises.

7. Follow on Training and Monitoring

Privatization is a process, and it does not end with a privatization. Training for management, finance and MIS are just a few of the future needs. Monitoring will be required to ensure that privatized firms will succeed and not suddenly go bankrupt, and that the private buyers of these firms - both foreign and domestic - do not strip the firms for their own benefit and then walk away from them.

8. Firm-Specific Assistance

The lessons from Huta Warszawa and LOT Airlines point to a policy of restraint regarding future AID assistance for firm-specific assistance.

- The main lesson from AID's assistance to Huta Warszawa is that the decision making needs to be decentralized to the field. (see Section 2.5 for more details). While the request for assistance was minimal and could have provided AID with good publicity early in its privatization assistance, disagreements and a lack of communication between AID/Washington and the field resulted in excessive delays.

- Lessons from the LOT Airlines assistance might be premature since LOT has not yet been privatized. To date it seems that AID assistance played a useful, but not critical role, in helping the company restructure itself and set up joint ventures with foreign partners (e.g. AMR--ticket handling and baggage handling; SAS--food service contracts). Still, such assistance is expensive (more than $1 million spent) and takes a long time to achieve results. Additionally, AID should consider whether it should support firms that could possibly pay for part of the assistance on their own. LOT, as a major national enterprise, may be a case that is special; it certainly differs from some of the other huge enterprises that are in serious trouble.

3.4 Hungary

3.4.1 Distribution of Program Activities

Since August 1991 AID has financed a total of 13 projects or work orders totalling (in obligated funds) $7.2 million dollars. The breakdown of these projects by type of assistance is:

Policy/Program Support	$2.1	(29%)
Institutional Support	$3.7	(52%)
Specialized Transactional Assistance	$0.3	(4%)
Firm-Specific Assistance	$0.1	(2%)
Sectoral Assistance	$1.0	(13%)
Total:	$7.2	

Hungary is the smallest of the three countries and has been allocated the least amount of funds. It has, however, the longest privatization program history. More than half of the funds have been for "Institutional Support", almost completely through the provision of a long term advisor and other short term tasks in the State Property Agency. In fact, these contracts (PIOT #0183478, #1183479, #1183482, #3622073) make up 60% of all the privatization work authorized by AID for Hungary. Together, "institutional support" and "policy/program support" represent 80% all the work done in Hungary. This is in marked contrast to the distribution of effort in the Czech Republic and Poland, where the percent of total work done in these two categories has been 16% and 29% respectively. Finally, unlike the other countries, Hungary has spent the least amount on "Firm-Specific and Sectoral Assistance" only 15% compared to 32% in the Czech Republic and 71% in Poland.

More specifically, some of the more pertinent characteristics of AID assistance in Hungary include the following:

1. General Technical Assistance to SPA

The nature of the Long Term Advisor's work has been very different from that of the advisors in the other two countries. As stated, their work has been very focused; in Hungary, the Advisor's work has been very diverse. By its nature, the work of a long term advisor is continuous over a period of time and is therefore long term. But in Hungary's case, the Long Term Advisor was successively engaged in a series of finite tasks so that from a task basis, much of his work, about 80% of it, has been on projects that were short-term, in that they had a beginning and an end and then the advisor went on to another task.

These tasks have been primarily related to programs and procedures rather than directly to policy formation, although some policy assistance was involved in helping to make the Agency function. In approximate order of size of effort, the Long Term Advisor has been involved in a) designing and bringing on stream information systems, b) helping establish steps in operating processes and procedures, c) supporting certain specific programs, some of them consultant assignments that are described below, d) procuring equipment, mostly computer equipment (over $400,000 of it; a function not performed by AID in the other two countries), e) providing training himself and from his staff, f) counselling and advising at both top and middle management levels, more recently, g) providing support to the Self-Privatization Program, and h) assisting in donor solicitations.

2. Limited Assistance to Self-Privatization

Recently, AID assistance has played a contributory role in the Self-Privatization Program, both with SPA and with Pri-Man. (For a description and further discussion of this program, see Section 4.2 of this report.) Not a lot of money has yet been spent, partly because the program has only recently become important and partly because of the secondary role that we have played.

3. Start Up of New Privatization Initiatives

Even more recently, in response to a Government decree of December, 1992, the SPA is investigating the feasibility of new programs to speed up privatization. AID has financed initial work and is considering a proposed follow-on PIOT (first called COMPASS and now IMPACT, see Appendix 4) to evaluate and help implement some of these programs. At this stage, these are all experimental. They include leasing, installment sales, and potentially of considerable importance, a credit certificate, i.e. voucher program.

4. Financial Sector Assistance

Also, of considerable potential importance is work in the financial sector, in this case concentrating in the area of intercompany debt. Only the introductory Phase I of this work has been done.

5. Development of ESOPs

Hungary is only the third country in the world to pass an ESOP law. AID has financed both preparatory and follow-on work for this law. 20 transactions have been completed and more are in process. Of all of the kinds of projects in which AID has been engaged, ESOPs are one of the hardest to mount and carry through to conclusion. Therefore, these achievements are both very impressive and unprecedented. (See Appendix 4).

6. Limited Firm-Specific and Sectoral Assistance Work

AID has also engaged in some a limited amount of firm-specific and sectoral work in Hungary. A program called Quick-Form is presently stalled for reapproval in Washington. It is, however, a typical random set of small enterprise transaction proposals and as such is not especially important or promising.

More importantly in term of dollars spent, is Hungary's only large firm transaction, Monor State Farm. (Described further in Section 2.6.3 and in Appendix 4) We have described this as a Sector Study, because the project was intended to be a pilot for the State Farm Sector. (120 of them in Hungary.) As a sectoral approach, this was a good idea that had limited success and was therefore expensive. The usual combination of national politics, inept local management and government mismanagement combined to reduce this promising prospect to a bankrupt case now with only minimal value and probably beyond rescue, at least at the level at which it could have been. AID/Washington played a delaying role in authorization that in retrospect is to be criticized because a good case can be made that prompt action and a better sense of timing might have brought about a significant success. That opportunity passed us by.

3.4.2 Comparison with Phase I Country Assessment Conclusions

Especially when Hungary's privatization program is compared to those of the Czech Republic and Poland, it can be described as very much subject to "top down" government direction. This came about as a reaction. Following the revolution, a process of spontaneous privatization had come into full flower. This was a type of privatization in which the only deciding principals were a buyer, an SOE Workers' Council, and the management, with no existing restraints from government or any third party. Some legal loopholes existed and some abuses occurred. But perhaps more importantly, there was widespread public perception that spontaneous privatizations were self-serving and not in the public interest. The SPA was created to deal with this and charged with promoting privatization and regulating it. Strong governmental restraints ensued, and while these were later eased and modified, various restraints still persist to this day.

Under these circumstances, the fast start in privatization that Hungary enjoyed initially has slowed down. Perhaps this is inevitable in this kind of a directed approach. Also, perhaps a greater proportion of the "jewels" in Hungary attractive to foreign investors are now gone, more so than in the other two countries. Certainly except in the field of retail privatization (a success in all three countries) the efforts that the Government has made to initiate major transactions have generally been met with failure.

The main difference, of course, is that Hungary does not have a mass privatization program in operation or even very far along in concept (this in marked contrast to the Czech Republic and Poland, each of which have passed a mass privatization law).

Despite this slow down and loss of momentum in Hungary, a sense of proportion should apply. Compared to what it could have been, Hungary's privatization program is not impressive in its speed, but it can at least be described as at a respectable level. It has moved faster than all but a few other countries in the third world. Statistics in the Phase I Report show that while it is behind the Czech Republic in progress, as measured by number of privatizations and percent of the economy privatized, it is ahead of Poland. See further discussion at the end of Section 3.4.4.

Compared to the other two countries, Hungary is obsessed with the position that there must be payment received for privatization value transferred. It is relevant that Hungary has the highest per capita debt of any country in Europe, at least outside the N.I.S. We note also that Hungary, more than the other two countries, is wedded to book value as the basis for fair market transfer. All of the countries try to achieve a book value price, if only to avoid criticism, but book value as a benchmark is strongest in Hungary.

Lastly, Hungary has recently been the victim of a strong political reaction to the "invasion and take over" by foreign capital. This has, in turn, caused a reaction from the Government which is trying to achieve greater domestic content in future privatizations and to stimulate programs that will promote this.

3.4.3 AID's Role in the Privatization Process

AID's role has been positive in Hungary, albeit difficult to quantify. Unlike Poland, but perhaps not as much as in the Czech Republic, there seems to be significant goodwill generated by the program and an ability to leverage AID resources with other donor financing. Furthermore, AID has been able to be part of (in some cases with a large role, in others a small role) several successful new privatization initiatives -- namely, the ESOPs program and the Self-Privatization program. Most of these accomplishments have been achieved, even though AID management of the privatization projects has at times been problematic. These issues are discussed below.

1. Goodwill Generated

Through its assistance to the SPA and related programs in the SPA, AID has been able to develop a reasonably good image as a timely provider of valuable assistance.

While it is difficult to assess the worth of the eclectic tasks carried out by the Advisor to the SPA, one important by-product is that the work of the long term advisor generated a great deal of good will within the Government for our aid. Government officials in close contact with the advisor speak very highly of him. They recognize that he ran interference for the agency and saved them a lot of delays and headaches.

In addition, AID has been able to provide good "seed" money for promoting the ESOPs program. The success with this venture has prompted officials in the SPA to look to AID for continuing support and assistance in developing new privatization initiatives.

2. Donor Coordination

Donor coordination in Hungary has been the strongest of the three countries visited. More than the other countries, AID in Hungary has been the most successful at adapting its programs to fit around the edges and in the niches of other donor-financed programs. This is most pronounced in the case of assistance to the State Property Agency.

The most successful coordination has been with the EC/PHARE. In Hungary, PHARE's annual appropriation for privatization is around $6,000,000 annually and building up. AID spends around $2,000,000 and this may, in the future, be subject to some reduction. The profile of PHARE shows that its interests lean toward:

- training, especially formalized classroom training
- organizing its work in projects. This means a tendency toward working on transactions.
- placing advisors, or even groups of people, in individual ministries on long-term residency. PHARE cites procuring enough competent people on this longer term basis as one of its biggest personnel problems.

Our work has been and should be accordingly complementary to the role they will fill.

It is possible that Hungary will represent the pattern of the future as far AID's relative role goes: one in which PHARE, or even the Know-How Fund, becomes the more prominent principal player and we take a lesser, more selective role.

Notwithstanding this, in comparing the world of donors, and despite some of our mistakes, we come off comparatively very well in the opinion of the host governments. At least at present, or until PHARE improves, we appear more responsive. We also have the reputation of being less self-seeking, requiring less trade reciprocity or sales tie-ins than other donor nations.

3. Problematic AID Management

As mentioned previously, a lack of coordination between AID/Washington and the field has at times resulted in delays, many of which have had an unfavorable effect on project continuity, timeliness, and effectiveness. Slowness in clearing many of the PIOTs, especially as of fiscal year end or in response to budget cuts, and micromanagement of line item budgets and detailed expenditures have all taken their toll. Fortunately for Hungary, the AID office has had a number of outstanding authorized non-IQC contracts that could be utilized to get some projects going or to sustain them while decisions on work orders under the privatization contract were under review.

Some examples of management problems are presented below.

- Lack of flexibility on the line item amounts within a total project allocation, even when it is not proposed to change the total, has the a bad effect on efficiency of program.

- In the financial sector, AID was unable to respond in timely fashion to GOH requests to review their banking sector. As a result, short term experts were not provided until after the government had already formulated an initial and flawed financial sector development strategy.

- The contractors for the COMPASS project have been carrying out activities, even though their original scope of work has changed and necessary contract modifications have been sitting in AID/Washington contracts office for several months. While all the principal parties (government, AID, contractors) have agreed to the change in scope, the contractor risks not receiving payment if the modifications are not approved by mid-April. Conversely, if the contractor had decided not to continue with its assistance for 3 to 4 months, AID could have severely damaged its reputation with the SPA.

3.4.4 Future Aid Issues

There are several areas in which AID should contemplate terminating existing work, expanding new initiatives, or developing new programs of assistance. These are presented below.

1. Assistance to SPA

We have been asked whether AID support of the SPA should continue past September 1993. This corresponds with the termination date of the incumbent Long Term Advisor's contract. The question is whether to renew him and if so, for how long.

The GOH's stated intention is that SPA is not to be a permanent agency and that it wind up most of its operations by early spring of 1994. In fact, some of those operations that will last beyond about that time have been, or will be transferred to a more permanent sister agency, the AVRT. This is an agency that will be the caretaker for those continuing activities related to privatization, principally those 163 SOEs presently in the strategic sector and scheduled to remain a Government ward for some time. (Half of the assets in this "strategic sector" are power companies, another quarter are oil and gas.)

We think the goal for the dissolution of SPA is a bit optimistic, but not way out of line. We understand the present incumbent Long Term Advisor is willing to stay past September 1993 if needed, but we think the service has served its purpose and run out its natural course and can be discontinued.

The remaining question is whether some similar long term advisorship should be repositioned within one or more ministries. This would be limited, as we see it, to the AVRT, the Ministry of Finance, or the Ministry in charge of Privatization.[5]

The two important questions are whether the Government wants the service supplied in that way and whether we can contract a highly qualified individual. We have seen that the latter consideration is particularly important in long term advisors.

The AVRT has not shown any interest in having an advisor placed with it. (In fact, all three countries have the same split between the privatization agency and the caretaker agency and none of the latter have expressed any significant interest in receiving assistance. We think we should push the AVRTs in at least one area -- bankruptcy, discussed below.)

The possibility of placement in the Ministry of Finance should depend on the progress and outcome of the financial sector work, therefore, absent any request, this should not be decided until next summer.

The possibility of an advisor placement in the Ministry in charge of Privatization in one sense would be the closest thing to extension of the present long term advisorship. It would be at a higher governmental level. The possibility should be explored to determine interest.

---

[5] The correct title for the highest ranking official in charge is Minister (without portfolio) in charge of --- with several functions such as Privatization, AVRT, etc. following, depending on the function being dealt with. The relevant Law 54 of 1992 states that "the Property Agency (sic) shall be directed by the Hungarian Government through its Minister in charge of privatization. The Minister has a small staff of his own and a department of the SPA detailed to him. Technically there is no "Minister of Privatization" and no "Ministry of Privatization". In actual working relationships there is no major difference. The Czech Republic and Poland each have a Minister and a Ministry of Privatization and each has a sperate agency somewhat similar to the AVRT.

2. Support to the Financial Sector

Throughout this and other sections we have strongly endorsed the work being developed by KPMG in the financial sector. This financial work is similar to that being performed in Poland. Both these two work assignments have been excellent and have helped establish the validity and worth of this type of work. Even more, while it was brief, Phase I of the Hungarian financial assignment was excellently performed, almost a model of what such an assignment should be. The best proof of this is the fact that the GOH was swayed in midstream to change its initial financial sector reform strategy by this accurate, but late-entry advice. The prospect is that it will be even more influenced by Phase II. We think this work is excellent and should have the highest priority to continue.

3. Development of a "Crimson" Assistance in the SPA

The question has been raised whether a Crimson type operation should be started up in SPA, given the success enjoyed with Crimson in the Czech Republic. We of course endorse replicating it. However, given Hungary's particular situation, it should not only process foreign investment transactions but domestic ones also in anticipation that foreign investment opportunities will soon decrease in volume. There is another serious note of caution. If SPA is in fact to be out of business as early as the end of 1993, we question whether such a function, initially staffed by foreigners with the objective of training locals to take their place, can be up and running by that time.

The work with Pri-Man has been conceptually similar to the Crimson model before it. Ways should be sought not only to continue this support but involve our aid more centrally in this project.

4. Support to New Privatization Methodologies

As to the new experimental speed-up programs, we have some seemingly contradictory advice. At present, they are just that -- experimental and we think some of them are at present dubious of success. The Government has as its goal that these programs, collectively, should account for 75% of some 1000-1200 privatizations to take place during the next year. At present, this seems quite unlikely, except for the possibility that the voucher program could take off. So we urge caution at present as to the amount of time devoted to these experimental programs. AID should carefully assess the feasibility of programs before investing significant resources. If it looks as if certain of the programs are winners, then we urge, even with some risk, that involvement begin and at a somewhat heavier level than has been the practice in the past. The purpose of this is to position ourselves more centrally in programs that are likely to be important.

This is particularly the case with the possibility of a voucher program. The Government is being urged by its citizens to go faster in privatization and to give the domestic sector, i.e. the public, a bigger share. People are well aware of the Czech program and don't see why they shouldn't participate, if not on a basis that is free, at least at bargain rates. An election is coming up in a year. All these factors make some kind of a voucher program so politically compelling that the odds are that any half-reasonable program will go through Parliament and be welcomed. AID and its contractors, however, have perhaps the largest pool of knowledge about mass privatization of any agency in the region. It would be a waste not to apply the lessons that have been learned to a new situation where the broad issues are the same that have already been dealt with in the other two countries.

We urge that a program be developed and persuaded to the GOH for AID to provide expertise on any possible forthcoming voucher program and that this be done sooner rather th. later. At the risk of some false start or waste, we think it is worth being out in front on this one.

5. Dealing with Bankruptcy and Intercompany Debt

In all three countries, we think there is one big looming issue forthcoming. That is what to do about inter-agency debt and the related subject of the specter of indicated bankruptcy for many firms when accounts are finally squared or resolved. The financial sector work scheduled for Phase II in Hungary is aimed right at this problem and to some extent it is also so aimed at in AID's assistance program in Poland. All three countries are braced for this problem. Perhaps characteristically, the Czech Republic is not taking preparatory steps, while Poland and Hungary are.

In each country, the two agencies most directly concerned are the Ministry of Finance and the agency that inherits the caretaker function downstream from the Ministry of Privatization, which in Hungary may be either the residue of the SPA or the AVRT (there are different names for this caretaking organization in each of the three countries). We think that AID work on bankruptcy and debt problems already scheduled in Hungary (but not yet cleared as to authorization) should proceed and similar work should be urged on the Finance Ministries in the other two countries. At the time of our visit, the bankruptcy law in Hungary was inadequate and needed work. We understand that just recently this has been corrected to provide greater flexibility of work-out, just as we have with Chapter 11 in the USA. The bankruptcy law is still inadequate in the other two countries.

Another aspect of this broad bankruptcy question is the question of work outs. If 30% of all the original lists of SOEs will go bankrupt (an estimate we have heard mentioned) that means work outs for some portion of about 4000 enterprises in all three countries, substantially more than half of them still state-owned, will be candidates for assistance. PHARE has expressed an intention to work on these work outs, on a "transaction" basis -- that means individually, enterprise by enterprise. We think this approach to the work will be subject to the same cost-effectiveness difficulties that we have observed in work that AID has done on individual privatization transactions. We would rather see AID working at the policy level on the bankruptcy question, with the actual work outs left to others to pursue.

6. Final Comment on the Question: "Is Hungary privatizing too slow"

In 1990, when the privatization program began, the GOH announced that its objective was to privatize 50% of its state owned assets that accounted for about 88% of the country's non-agricultural GNP and to do so within three years. While the starting date was never specified, it certainly was the objective to accomplish this goal earlier than the end of 1993.

At the end of 1991, 7% of the state owned asset value had been privatized. At the end of 1992, 17.7% had been privatized. This was stated to be well ahead of target. It is anticipated that 25% will be privatized by the end of 1993. A straight extrapolation says it will be two or three years before the original goal is reached, at best, 1995, if some of the new initiatives materialize.

Does it matter if it takes this long, a few years longer than originally forecast? Probably not. However, in order to achieve the second 25%, it will be necessary to tackle some of the big, vital assets that at present the government intends to reserve to itself for the indefinite future. The 163 enterprises that the GOH intends to reserve as "strategic assets" probably represent something approaching half of the missing remaining 25% that the Government needs to privatize in order to achieve its original goal, or, alternately, to have an economy whose main components are each predominantly subject to the forces of a market-driven economy. Tackling the privatization of this kind of asset has proven especially difficult in other countries, and experience in the rest of the world tells us that governments are almost always slow and timid about privatizing this class of assets. In any case, the Government proposes to hold on to anywhere from 5% to 100% of these enterprises.

So the danger is not with the speed or slowness of the present rate of privatization; it is rather with the danger that the slowdown experienced as the program seems to run out of gas will slow down further as we get down to the tougher candidates. This is despite any boost from new privatization initiatives funding AID or other donors which could turn out to have only a minor effect.

This suggests that even a secondary fillip coming from a voucher program is the stimulus needed to put the economy predominantly into the privatized camp.

4. SUMMARY: HAS AID ASSISTANCE MADE A SIGNIFICANT DIFFERENCE?

Fundamental to the evaluation of any program is an analysis of the impact of AID assistance. At some point during program implementation, people raise these relevant questions:

-- How successful were the projects?
-- What was the impact of AID assistance?
-- In a "without AID" assistance scenario, would the same results have occurred?

Before answers to these questions can be provided, there are other more basic questions that need to be analyzed. For example, how does one measure success? Should success be defined in economic terms (e.g. increase in employment and government revenues)-- or should political factors (e.g. importance to government, greater public acceptance) be taken into consideration?

This section of the report addresses these issues. In accordance with the scope of work, this evaluation has identified both qualitative and quantitative indicators to measure the progress of privatization activities. Section 4.1 presents those indicators that were considered appropriate to analyze **before** the evaluation team collected field information as well as the modified set of indicators the team considered important **after** the team interviewed beneficiaries, government and AID officials. Section 4.2 then reviews the actual results and classification of projects, according to three categories: successful, mixed success and low success. It also briefly discusses the projects' impact on employment,social and gender issues. Finally, section 4.3 proposes indicators that might be used for future monitoring.

4.1 Measurement of Impact

The evaluation team developed a set of indicators to measure project success both before and after it traveled to the three countries to collect project-specific information. The first set of indicators focused predominantly on quantitative criteria. During the course of the evaluation, however, it became apparent that either: 1) most of the projects did not focus on these objectives; 2) many of the projects included a multitude of other, less "bottom-line" and more intermediate target objectives (e.g. development of manuals, definition of privatization procedures; 3) and/or it was too early to definitively quantify the impact of a project. Consequently, the second set of indicators used to evaluate success became much more qualitative in nature.

4.1.1 Initial Evaluation Impact Criteria

The evaluation team first developed evaluation impact criteria for two levels of analysis (see Appendix 3 for a list of impact indicators submitted to AID/Rep offices for comments.) On a general level, some of the country-specific indicators considered to be most relevant included: number of privatizations (by size, industry, country, investor), revenue generated by privatizations, foreign investment generated, change in employment (overall, gender specific), new investment committed and technology improvement. At the firm-specific level, some of the more relevant areas of analysis to judge success might include: change in productivity (sales/employees), return on assets employed, change in sales (domestic vs. export, by country, by product mix), change in capacity utilization, change in earnings, change in market share, number of training programs and trainees (by subject area, country, private vs. public, location).

With few exceptions (the Crimson Capital/D&T project being the prime one, see Section 4.2.2 for details), the evaluation team was unable to collect the above quantifiable indicators. None of the projects had yet resulted in any of the above outputs. Nor were any of the AID or contractor staff in the countries visited able to provide any detailed intermediate indications of what the impact might be.

The only information available was on a country-wide level. Building from the privatization statistical data collected under the Phase I country assessments, it is estimated, as of the end of or near the end of 1992, that the overall number of privatizations and level of foreign investment by country is as follows[6]:

	Czech Republic	Poland	Hungary
1. # of Privatizations:	2,676	800	430
a. Case by Case	1,398	800	430
b. Mass Privatization	836	0	0
c. Other	442		
2. Book Value ($ US billions)	$9.1	N.A	7.2
3. Foreign Investment ($ US billions)	$1.1[7]	$.74	$3.7

A logical question with regard to all these indicators is: "What role did AID assistance have in producing these results?" The answer is that since many of AIDs successes were primarily in the policy/program area and procedural assistance, its contribution to the above statistics was, for the most part, indirect. However, in the Czech Republic, where AID provided specialized transactional support through Crimson Capital/D & T, AID did have significant

[6] Source: Privinfo, February, 2, 1993, a semi-official Hungarian publication, partly owned by the SPA and handling publication of its official notices.

[7] Probably includes, in relatively small amount, some earlier investment in what is now Slovakia.

impact on foreign investment (see Section 4.2.2 for additional details) In individual firm-specific assistance and sectoral assistance, its impact has been slight overall, at least so far.

4.1.2 Final Evaluation Impact Criteria

Due to the lack of correlation with the country-wide statistical data and the type of projects AID was financing, the evaluation team had to develop more intermediate, "proxy" indicators of impact and success. It quickly became apparent that the development of privatization programs is both an economic as well as social and political transformation. In all areas -- economic, social and political -- there is ample room for defining strengths and weaknesses of program assistance without necessarily distilling such definitions down to concrete figures. As a result, the evaluation team developed more qualitative criteria broken down into two broad categories, "economic impact criteria" and "impact on host government criteria".

The economic impact criteria consist of the following: 1) number and size of privatizations, 2) improved revenue and/or purchase terms, 3) policy/regulatory/legal framework in place, 4) privatization procedures/structures in place, and 5) overall cost-effectiveness. The host country impact criteria include: 1) overall host country attitude toward services rendered, 2) extent to which the project changed the government's privatization priorities, 3) extent to which the government/client requested more services, 4) government attitude toward AID/U.S. Government, 5) establishment of fairness and transparency in the privatization process, and 6) extent to which AID assistance helped leverage other donor funds.

As shown in Appendix 3, each of the projects was analyzed in terms of the extent to which they achieved high impact in one or more of the above categories. A "high impact/successful" rating was applied to those projects in which AID assistance was "critical" in having an impact in at least one "economic impact" and one "host country impact" category. A "medium impact/mixed success" rating was given to those projects in which AID assistance was "very useful", but not "critical" in any one of the categories. Finally, a "low/not successful" classification was applied when AID assistance, on occasion, was considered "useful" but with no apparent impact or with negative impact.

All assessments of AID assistance were derived from interviews with clients in which the question was asked: "What would have happened if AID assistance had not been available?" In all the "successful" cases, there were generally unanimous favorable opinions regarding the benefits and assessments of what happened as a result of AID assistance. "Mixed success" projects included those in which opinions regarding the achievement of the above objectives were either mixed -- i.e. some positive or negative -- or qualified in some manner. Finally, projects considered to be "indefinite" or "not successful", were those in which the general consensus seemed to be generally negative or the objectives of the original scope of work were not yet achieved.

4.2 Actual Impact and Distribution of Success

4.2.1 Overall AID Impact

On balance, the results of AID's privatization initiatives in the Czech Republic, Poland and Hungary have been favorable to mixed. Out of a total of $31.3 million dollars obligated for projects, it is estimated that over 72% of the expenditures have either resulted in outright successes (52%) or mixed success (20%) as shown in the following and in further detail in Table 2 of Appendix 3.

	$ (MM)	%
Success	$16.2	52%
Mixed	6.4	20%
Not Successful	6.8	22%
Indeterminable or too early	1.9	6%
	$31.3	

Each of the three countries studied had a "success plus mixed success" ratio of better than 60% of total expenditures. Hungary registered the highest level of "successful" expenditures -- 79% of total funds obligated compared to 23% in Poland and 68% in The Czech Republic. Poland had the highest level of "mixed success" expenditures -- 47% compared to 12% in Czech Republic and 7% in Hungary.

As discussed in detail in Appendix 4 the most successful projects have included:

Czech Republic:

- Specific transactional support rendered to the Ministry of Privatization through Crimson Capital/Deloitte & Touche (D&T)
- Development of fund portfolio investment management in the Czech Savings Bank

Poland:

- Assistance to the Mass Privatization Program (MPP) through the National Investment Funds (NIFs)
- Assistance to the Securities Exchange Commission
- Assistance for the Ancillary Assets program

Hungary:

- Development of an Employee Stock Ownership Program (ESOPs)
- Placement of long term advisor in State Property Agency (SPA)

As described in greater detail in the case studies presented in Appendix 4, each of these "successful" projects along with "mixed success" projects achieved one or more of the following objectives:

- Helped effect or speed up actual privatizations;
- Established necessary financial institutional structures for future privatizations and market development;
- Established operational procedures critically needed for future privatizations;
- Achieved concrete economic benefits (e.g. increased purchase prices, investment)
- Provided tangible political benefits in terms of generating significant goodwill for AID/U.S. government and establishing fairness and transparency in the privatization process.

Where rankings were high or medium, the reasons given for the rankings were[8]:

Economic Impact Criteria:	No. of times cited
Policy/regulatory/legal framework in place	9
Privatization procedures/structures in place	8
Number and size of privatizations has high or medium	6
Improved revenue and/or purchase terms	4
Was cost-effective overall	2

Impact on Host Government Criteria

Overall favorable host country attitude toward services rendered	12
Project changed government priorities	9
Established fairness and transparency	8
Leveraged other donor funds	1

Where rankings were low, the reasons given for the rankings were: (in two cases, reasons were unknown)

Economic Impact Criteria

Number and size of privatizations small or non-existent	6
Was not cost effective	5
Policy/regulatory/legal framework not in place	2
Privatization procedures/structures not in place	2

Impact on Host Government Criteria

Host country attitude toward services rendered neutral or unfavorable	5
Project change government priorities	3
Fairness and transparency not favorably affected not generated	2

[8] Appendix 4 contains 21 case write-ups. There are more than 21 reasons because in most cases more than one reason was cited.

As noted frequently throughout this report, policy/program and institutional support programs and transactional assistance programs tended to be successful; firm-specific and sectoral assistance often did not. The frequent favorable citations as to policy/programs and procedures being put in place follow as a matter of course.

We applied the cost-effectiveness criterion only to transactional, firm-specific and sectoral assistance. Five unfavorable citations in these categories, two favorable, of which one is no better than low-medium, is impressive evidence of the frequent lack of success in these areas.

It should be noted that these evaluations are subjective and were made by us as consultants. (As mentioned previously, details of these evaluations are set forth in the case studies in Appendix 4.) Overall rankings are very much influenced by the fact that there were many "successful" assessments for the Czech Republic and Hungary, whereas the big sectoral projects in Poland were ranked as "mixed success".

4.2.2 Quantifiable Success Story -- Crimson Capital/D&T

The most quantifiable data came from the Crimson Capital/D & T support provided to the Ministry of Privatization in the Czech Republic. This assistance has focused on a total of 102 transactions with purchase price proceeds estimated to amount to more than $780 million and new investment commitment of more than $930 million.

What role did the advisors play in either increasing financial and other non-financial commitments? And, even more significantly, what role did the advisors have in making the deals possible in the first place?

Anecdotal evidence from interviews with companies shows that the advisors were greatly appreciated for providing technical consistency in an otherwise unclear, high turnover environment within the Ministries. In one company (Ferox), the advisors were able to significantly increase the purchase price and environmental liabilities. In another (Cukerny), however, the advisors were not able to overcome political battles between ministries, and an initial investor offer eventually was withdrawn as market conditions and the financial status of the company deteriorated.

A review of the files shows that in many cases, the advisors were able to ensure more favorable terms for the government. Benefits include (based on a partial sample of negotiated deals):

Increase in Purchase Prices-- More than $44 million; Achieved price increases in more than 40% of the deals negotiated.

Increase/Strengthening of New Investment -- More than $68 million in new investments; Improved or strengthened investment commitments in 50% of the deals.

Maintenance of Employment Levels -- Strengthened investor commitments to maintain employment levels in more than 40% of the deals negotiated. In one case, persuaded company to agree to retraining of 453 employees.

Improved Environmental Liabilities -- In numerous negotiations, the advisors established commitments by investors to assume environmental liabilities and/or reduced the environmental indemnity claim period against the government.

Increased Ownership by Czech Citizens -- The advisors played a role in increasing the voucher component, an important element of the Czech mass privatization program, in at least eight deals.

Other Benefits -- Besides the above benefits, the advisors have also been instrumental in guaranteeing the transfer of technology, management know-how. They also have obtained commitments to reinvest profits and maintain facilities.

4.2.3 Employment and Social Issues

One of the most disruptive consequences of privatization is an increase in unemployment, and along with that, a decrease in social services. To date, AID assistance, with some exceptions, has not developed a strategy or project for addressing these issues.

The severity of the unemployment problem varies by country. In the Czech Republic official unemployment is the lowest of the three countries, estimated at around 3% nationally. It is likely to get much worse, however, in the next year or two. To date, many firms -- privatized and state-owned -- have not begun to lay off workers. In the case of privatized firms, particularly those involving foreign investment, agreements with the government include employment guarantees for, on average, one year. In the case of state-owned enterprises, the lack of a bankruptcy law has not required the government to make politically difficult layoffs.

In Poland, the structural adjustment process is perhaps the furthest along, and with it the most severe unemployment problems. In late 1989 the Polish government took dramatic steps towards reducing subsidies to SOEs. Today, national unemployment is around 14%, although in some small towns it is closer to 25%. While unemployment may not increase as dramatically as the Czech Republic, it will remain a problem as privatization progresses and firms cut jobs. Also, similar to the Czech Republic, Poland is still in the midst of drafting a bankruptcy law, which when passed and enforced will probably result in significant unemployment.

In Hungary current unemployment is not quite as high as Poland's, but higher than in the Czech Republic. It is stated to be 12% - 13%. This is at a level that should cause concern, especially since there are substantial regional variations. For example, unemployment is at 6% in Budapest, but is as high as 25% in some industrialized provincial areas. Not surprisingly, unemployment will grow in Hungary for two reasons. First, Hungarians were slow in fully recognizing the full impact of the breakdown in the COMECOM markets. As late as 1992, some of the subsidiaries were still making their traditional deliveries of products to larger firms which formerly passed the goods on to COMECOM countries. The larger firms are now refusing these products, but decisions concerning other courses of action, including layoffs, have not worked their way through the system yet. Second, significant numbers of jobs are likely to be lost as the less profitable SOEs are privatized. Finally, even though Hungary has passed a bankruptcy law, at least until the most recent May amendments, it was not adequately flexible or responsive to all bankruptcy problems. Consequently, similar to the other two countries, unemployment will increase if and when the law is properly enforced.

AID assistance has in some instances helped to cushion the negative social impact of privatization. For example, the Crimson Capital/D&T group consistently includes employment guarantees in its negotiations with foreign investors. As mentioned previously, nearly 40% of the deals have resulted in strengthened employment guarantees. In Poland, Price Waterhouse involvement in the Sandomierz Glass Company resulted in the development of a $1 million retraining fund for displaced workers. Finally, Deloitte & Touche's work on ancillary assets in Poland has resulted in a format and pilot program for privatizing social assets (e.g. kindergartens, theaters, housing,etc.). This model should help future companies in developing strategies that are efficient and not disruptive.

These programs suggest that AID can play a positive role, particularly at the negotiation stage with foreign investors, in developing programs and employment guarantees. Still, for the next stage of privatization-- i.e. dealing with domestic firms and bankruptcies-- AID will face an unprecedented number of social issues, most of which will require significant resources to address.

In dealing with social issues and unemployment, AID will have to weigh different approaches, none of which are necessarily exclusive of one another. One approach would be to focus on developing privatized social programs or a government approach for providing social services. This approach would include assistance being considered by AID in the Czech Republic for privatizing the health sector.(see Section 2.2.6.1 for details).

Another approach would be to focus on helping domestic firms to survive, thereby reducing the likelihood of massive layoffs and decrease in tax revenue. There are three areas in which AID could focus its efforts: 1) technical training, 2) management of debt and development of new credit, and 3) development of regional and export markets. All of these are overwhelmingly needed, but it is difficult to say where and how AID might focus its resources.

AID assistance could be used to identify and develop pilot programs in industry sectors that meet the following criteria: provide "basic needs" goods, have assured trade relationships, have some capable firms and are labor intensive. Of course, the risk of this is similar to the risks encountered in other sector approaches -- high up front costs, disparate political support, uncertain firm commitment, and a long time lapse before completion.

AID could also help to develop broad programs -- such as export promotion or seminars on strategies for managing debt -- that would be available to those firms that are interested and willing to follow through on new initiatives. This approach might be more cost-effective and politically more appealing than an industry approach.

A third area of support which would help domestic firms would be to extend and expand the macro-level debt restructuring work being undertaken by KPMG in Hungary to Poland and the Czech Republic. The purposes of this effort would be to (a) have the governments consolidate publicly created debt outside the current banking system, (b) rebuild a banking system that can lend effectively to privatized firms. One particular approach would be to combine a bankruptcy reform initiative with a macro policy that reduces interest rates to privatized firms, thereby reducing their debt burden.

Finally, any preparations made to provide training to conserve employment in privatized firms should involve leverage. As noted in other sections, the need should depend on the actions of other donors such as PHARE and AID's priorities for certain economic sectors. Preparations should involve leveraging AID's resources through existing programs such as the: International Executive Service Corps,MBA Enterprise Corps, and the Peace Corps Free-Enterprise Transition Consortium.

4.2.4 Gender Impact

The evaluation scope of work asks whether there is a need to raise the sensitivity of host government officials and private sector counterparts to issues of gender equity. It also asks what the gender impact has been for current privatization experience.

Evidence from interviews indicates that gender equity issues are not a major concern of government officials or private sector companies. In most cases, managers did not base their decisions on the basis of gender. Also, none of the government officials had analyzed or formulated opinions concerning the role of women in privatization or the impact the process had on women.

This is not to suggest that women might not be disproportionately affected. Anecdotal evidence reveals a mixed picture on the role of women in privatization. In the Czech Republic, the managers of two privatized companies mentioned that the technology transfer that occurs after privatization (particularly when there is a foreign investor) typically "requires" the services of men, rather than women, to manage new production lines. In another case in Hungary, a manager mentioned that some of the easiest cuts in staff can be made in the administrative office where there may be more secretaries and support staff that are women and not needed. On the other hand, interviews in Poland show that women are on the worker's councils and play a role in deciding the future fate of companies.

In view of the lack of official statistics and overall lack of host country concern for the issue, it will be necessary for AID and other donors to examine these issues in more detail so that, together, they can map out a strategy for assisting population groups affected by privatization. This would apply to the displaced labor force in general, as well as to women in particular.

4.3 Proposed Indicators for Future Monitoring of Impact

The evaluation team's experience in assessing the impact of the privatization projects points to the need to improve the future monitoring of privatization activities. In order to provide timely and meaningful management guidance, any proposed indicators should be easily: definable, obtainable and attributable.

In AID project design parlance there are essentially two key levels of indicators that can be monitored. The highest level are "goal" related indicators which track developments at the macroeconomic level, and if possible, try to define the impact of AID assistance in the context of country wide developments. Some possible indicators include:

1. % of GDP in Private Sector
2. % of Employment in Private Sector

These indicators are useful to show whether AID is contributing to a positive or negative macroeconomic trend. They are also inexpensive to collect. But they rarely can be directly attributable to AID assistance. The larger the economy the more unlikely it is that AID assistance will be large enough to significantly affect macroeconomic trends.

The next level down in project design, and the level which is most attributable to AID managers are "purpose-level" indicators. These indicators are intended to directly measure the impact of AID assistance. Some recommended "economic" indicators would include by type of assistance:

"Bottom Line", Top Five Indicators:

1. Number of privatizations (including spinoffs from companies)
2. Increase in investment (foreign and domestic)
3. Maintenance/expansion of employment
4. Increase in revenue
5. Level of environmental liabilities

Other Indicators by type of assistance would include:

Policy/Program Support:

1. Number of new policy or program initiatives established
2. Percentage of bad loans worked out/renegotiated

3. Extent to which policy/regulatory/legal framework is put in place (e.g. high = operational, medium = policies defined and approved, low = only conceptual framework defined)

General Institutional Support:

1. % Turnover
2. % Trained personnel
3. Processing time required to complete privatization-related procedures.

Training:

1. Level of technical assistance (in days, months or years)
2. Percentage of training course attendance that completes the course and does so on time
3. Percentage attendance at training seminars
4. Appraisals (participant, supervisor)
5. Job skills change

Firm-Specific Assistance:

1. Change in corporate governance
2. Change in productivity
3. Return on assets employed
4. Change in sales (domestic and export, by country, by product mix).
5. Change in debt/equity ratios

Besides these indicators, AID might also try to track the extent to which project initiatives help promote improved political relations and support from host governments for privatization reform. Specifically, the indicators to track would be those used by the evaluation team in assessing the impact of projects: 1) overall host country attitude towards services rendered (e.g. extent to which the government/client requests and pays for additional services and/or the extent to which the project enhances AID/U.S. government's reputation), 2) extent to which the project changed the government's privatization priorities, 3) establishment of fairness and transparency in the privatization process, and 4) extent to which AID assistance helped leverage other donor funds -- e.g. ratio of AID expenditures to other donor expenditures in a program.

5. CONCLUSIONS, LESSONS LEARNED AND FUTURE RECOMMENDATIONS

5.1 Conclusions

Our findings reveal that AID assistance has been most successful in developing the institutional and financial structures required to facilitate future privatization transactions and in finding transactional niches within this structure. More problematic has been assistance to individual enterprises and sectoral assistance.

AID assistance was most effective in projects in which there was:

a) strong host country government support from the outset
b) transactional assistance targeted towards the end of the privatization process rather than at the beginning
c) a focus on developing clearly defined procedures and policies important to the privatization process.

These success factors are described below:

- **Strong Government and AID Support:**

Successful projects have clear government support. The Government is willing to act without letting other factors - usually political - interfere. In addition, in the more successful projects, support from AID/Washington and the local AID/Rep is well coordinated and flows smoothly without disruptive starts and stops.

- **Focused Towards the Middle or End of the Privatization Cycle:**

The more successful firm-specific projects were undertaken in the middle of the privatization sequence or towards the end. Projects undertaken at the beginning, particularly sector/market analysis, were often subject to floundering and have a low success rate because the targets are scattered.

- **Development of Privatization Policies, Processes, and Procedures:**

AID assistance has been most effective when it is focused on one stage of the privatization process -- e.g. transaction negotiations -- and can be rendered to many firms, rather than trying to provide assistance at various stages to a select number of firms. Besides transactional support, AID assistance has also been effective in providing policy/program support early on in a government's privatization program when the legal and regulatory framework is not clearly defined. Conversely, one of our more surprising findings was that firm-specific assistance has a low success ratio and is generally not cost effective.

For each type of privatization assistance approach--policy/program support, institutional support, specialized transactional support, firm-specific transaction assistance, and sectoral assistance there are many trade-offs. The arguments for and against a policy/program support initiative include:

<u>Pros</u>	<u>Cons</u>
• Important to top level government concerns	• Hard to quantify impact
• Permits integrated long and short term assistance	• Other donors--e.g. IBRD and EC PHARE have more resources which can provide a competitive advantage
• Most pervasive way to establish transparency	• Long time horizon to achieve results
• Deals with a program from start to finish.	

The strengths and weaknesses of providing institutional support include:

<u>Pros</u>	<u>Cons</u>
• Processes are easy to define	• Hard to quantify impact
• Permits alternating long and short term assistance	• Good long term advisors hard to locate and contract
• Helps establish credibility and consistency	• Hard to keep projects focused.
	• Without political consensus, may add to bureaucracy without speeding things up.

Specialized transactional support is a category unique to the facilitating of transactions supplied by Crimson Capital in the Czech Republic. Like form-specific assistance it deals with individual enterprises one at a time, but like institutional support, its focus is on certain specific process steps in government privatization procedure. The success ratio is also more similar to that experienced under institutional support.

The pros and cons of this specialized transaction support include:

<u>Pros</u>	<u>Cons</u>
• Greatly sped up privatization	• Only a few of the steps in a many step process. Therefore somewhat narrow in scope.

• Specialization permits efficient and effective use of high level expatriate skills	• There are limits to the obstacles that this activity can overcome.
• Familiarizes government officials with objectives of foreign investors.	• Hard to measure attribution
• Has improved the number of foreign investor privatizations and the amount of favorable terms to the government.	• Hard to transfer specialized skills to local officials.

Finally, support for firm-specific assistance and sector studies are sufficiently similar to have the same trade-offs as follows:

Pros	Cons
• Most direct way to make privatization happen.	• Low rate of success
• Improves enterprise management skills.	• Costly; not cost-effective
• High visibility to government	• Long time to bring to fruition.

5.2 Lessons Learned

It is interesting to note that the most successful projects, with few exceptions, began 6-9 months after the Privatization IQC contracts were started. Most of the early investments in sector studies or firm-specific assistance were either inconclusive or mixed in their results.

It seems that with experience, AID was able to self-correct a lot of the initial problems it encountered in its initial year. Increasingly, AID assistance shifted away from firm-specific transactions to policy/program support and institutional support.

Some lessons learned regarding portfolio and project strategy, project design, AID management, and project implementation are mentioned below.

1. Privatization Strategy

- In a "bottom-up" privatization in which the government adopts a laissez-faire, decentralized approach and companies are left to their own initiative to privatize, it is important to put in place procedural and regulatory safeguards. In particular, this applies to the Czech Republic.

- In a "top down" process in which governments are more involved in selecting and privatizing companies, it is important to make sure that procedures are efficient and based on technical criteria, thereby ensuring that processes are not politicized or subject to undue delay. This applies to Poland and Hungary.

- An ad hoc, reactive privatization strategy - in which program initiatives are defined by government demands and/or marketing efforts of contractors - can help generate political support and goodwill. It also can be useful for testing a variety of experimental interventions.

  However, the continued application of an ad hoc, "buckshot" strategy can eventually lead to dissipation of resources, and in the absence of concrete results, a weakening of political support for a program.

- The privatization process can be viewed as a two stage process. In Stage I, it is important for governments to establish **credibility** (e.g. register some "success stories"), **consistency** (have procedures in place) and **transparency** (establish a fair and open operating environment). AID has been successful in developing the first two objectives -- credibility and consistency; it has been less effective in establishing transparency, and related to this issue, in clearly defining the responsibilities and relationships between government agencies.

  Stage II (which the three countries are now entering) is full of challenges. It will require a programmatic emphasis on: restructuring/corporate governance, bankruptcies, and effective training programs. A major challenge is how should AID assist middle-tier, struggling companies.

2. Project Design

- AID has to be responsive to the priorities of a host government. However, having governments set the rules for project conduct is not always a reliable guideline; governments have too many mixed agendas. At the same tine, effective programs are usually interactive between host government and AID. Interactivity requires each party to take account of the other's objectives and preferences.

  Being responsive is only useful when it is timely.

- Strong coordination among donors can help to leverage AID funds. AID coordination with the EC/PHARE in the early stages of the SPA assistance in Hungary helped to leverage AID funds significantly. Given AID's limited resources, similar opportunities should be pursued in the future, especially with regard to restructuring programs.

- Project emphasis on foreign investors can produce quick, short term economic benefits, and it is an area in which AID is qualified to provide effective assistance. But this should not be carried to the point that domestic issues and constraints are overlooked (e.g. restructuring, promotion of domestic investment, etc.).

3. AID Administration

In all three countries visited, there was an underlying tension and debate as to whether AID/Washington or the AID/representative should manage the program. The AID/Washington staff rightfully cite that the management structure for the privatization program (and other EUR Bureau programs) was decided by the State Department. They openly acknowledge that they have had to make the best of a situation in which they have not always had sufficient staff or financial resources to properly manage the program. For example, the Office of Management Budget (OMB) was more than five months late in providing resources for FY 1993.

The field staff generally feel that the program should be managed by them, with minimal reliance on AID/Washington input. They are uncomfortable, frustrated and, at times, embarrassed by their being put in a position of responsibility with no authority. They feel that their hands are tied and that they are unable to make or quickly fulfill any promises made to the host government.

This tension has resulted in periodic delays and mistrust with regard to the mobilization of technical assistance and modification in work orders (see Appendix 8 for specific examples). In terms of government relationships, particularly in Poland, the lack of coordination early on jeopardized AID's credibility. The lesson learned is that effective AID management of the program is <u>important</u> to successfully implementing a project, and <u>critical</u> to establishing credibility with host country governments.

Our recommendations on this issue appear below.

4. Project Implementation

- With a few exceptions, the technical competence and acceptability of the work performed has been good. When compared to the work of other donors, this professionalism has resulted in a "good image" for the U.S. government.

- AID has been proven to be best at "facilitating" privatization processes rather than "promoting" one particular privatization transaction. Industry specific, "promotion" activities are resource intensive and take longer to achieve their objectives than facilitation activities. Their "success ratio" so far has been poor.

  We should avoid direct involvement in firm-specific transactions, especially if they are large and complex and appear to be "no win" situations.

The sectoral approach is not cost effective and contains no particular advantage. AID should avoid long detailed market and firm-specific analyses as a method of picking "winners".

- Long term advisors are a useful mechanism if they are expertly staffed and if the host government clearly wants them and listens to them. They are particularly useful when focused on a particular critical sector or a clearly defined activity.

5.3 Recommendations: Proposed AID Assistance Strategy

In the future, AID will need to be more selective in how it targets its assistance. Country strategies should be developed with annual funding targets, clearly defined priorities and objectives, yet still be responsive to host country requests. Being responsive, however, does not mean becoming laissez-faire "demand-driven" or allowing contractors to market new initiatives without guidance.

To the greatest extent possible, AID should try to leverage its resources by:

- Transferring the successful experience in one project from one country to another. It would be appropriate to transfer the Crimson Capital/D&T work in the Czech Republic to other countries, as well as transferring the financial sector development going on in Poland and Hungary and the "mass privatization" work in the Czech Republic and Poland.

- Expanding into new services and types of assistance by building on assistance to existing institutions -- e.g. development of new workout units in the Czech Savings Bank.

- For new initiatives, financing small "seed" projects in new experimental privatization methodologies-- e.g. like the Self-Privatization or ESOPs projects.

- Closely coordinating with other donors, particularly in the area of training and in high risk areas of assistance like social programs and restructuring.

For privatization assistance in any country, AID should attempt to follow these broad guidelines:

- **Minimize Unnecessary Management Risk Factors:** Unknown market and political forces make privatization assistance a risky business. It is essential to minimize project management risk by clearly defining project objectives, thus ensuring that government officials and all AID parties agree on the objectives, and then developing appropriate procedures for supervising and funding project activities.

- **Delegate Additional Authority to the Field:** In an effort to limit the number of intermediaries and potential areas of conflict, the evaluation team suggests that there be some expansion of authority to field offices permitting them to make implementing decisions such as:

-- approve modifications of contracts (particularly if they are minor in scope; e.g. $20,000 expenditure approval);

-- budget and give final approval for project work orders;

-- immediately initiate activities approved while waiting a final sign-off from contracts in AID/Washington.

Within this framework, AID/Washington's primary role should be in defining policy and providing technical support to field implementation. There is a wealth of knowledge that the staff in AID/Washington can and should be collecting regarding project impact and implementation. From field trips, evaluations and conversations with experts the AID/Washington staff should serve as a "quality control", monitoring and evaluation resource for the AID/representatives. In those instances in which political considerations originating from Washington need to be integrated into the programs, the AID/Washington staff should work closely with the AID/representatives in incorporating political priorities into the programs.

- **Focus on the Facilitation of Many Transactions:** As previously stated, AID money is most effectively spent on "facilitating" privatization processes, rather than "promoting" one particular privatization transaction from start to finish and that is where the focus should be. AID has successfully been able to provide assistance at one stage in the privatization process (e.g. negotiations) to a multitude of firms. Industry specific, "promotion" activities are resource intensive and take longer to achieve their objectives than facilitation activities.

- **Develop More Focused, Structured Training Programs:** Training is an effective form of privatization aid providing it is focused, is job-related, and conducted principally on-the-job. We should leave formal, generalized classroom-style training to other donors, except where the content is uniquely related to American experience. (e.g. SEC type regulations, ESOPs.)

5.3.1 Types of Assistance to Continue or Expand

AID should continue its assistance for facilitating negotiations with foreign investors (e.g. Crimson Capital/D&T), developing financial institutions and policies, supporting mass privatization, and assisting new privatization methodologies -- e.g. ESOPs and Self-Privatization in Hungary.

For a detailed list of types of assistance to continue or expand, refer to country-specific recommendations in Sections 5.4.1 through 5.4.3.

5.3.2 Types of Assistance to Discontinue or Postpone

Firm-specific assistance and sector studies tend to be costly and should be discontinued or postponed. Sector studies take a long time to achieve their objectives, in part because the assistance takes place too far "upstream" with general analysis, identification of partners, etc. While these studies may eventually reach their goals, institutional patience has often worn thin and new more immediate needs have developed.

Specific examples include:

Czech Republic: Metallurgy "sector", Management contracts, and Skoda-Pilsen.

Poland: LOT Airlines (although this still might prove to be a success) and Privatization through restructuring.

Hungary: Monor State Farm and Quick-Form pilot privatizations

Also on this list is the discontinuation of a long term advisor in the SPA (after the current contract expires in September 1993). While this project was successful in achieving its objectives, the advanced level of institutional development and the shrinking future role of SPA should preclude further funding of a long term advisor in this agency.

5.3.3 New Initiatives or Complementary Assistance

In the future, AID will need to focus its efforts on bankruptcy/workouts, provide more structured on-the-job training, and expand its training activities in institutions currently receiving assistance (e.g. Czech Savings Bank, Ministry of Privatization). Where possible, it should also actively solicit and try to leverage its programs off additional donor resources. This was done successfully in Hungary working with the PHARE, and could be further promoted in all three countries.

In addition, all three countries might be in need of public awareness and information campaigns. These might be required to ensure that privatization programs do not become derailed due to uninformed public distrust. Also, each country should develop a monitoring system for tracking foreign investment commitments and, if possible, identifying training needs and the impact of privatization on various social groups.

Finally, as initial foreign investment wanes and the better domestic companies are bought, AID might develop a targeted investment and export promotion program. Such a program would focus on finding new markets for domestic producers and on bringing in new capital and technology.

5.4 Country Specific Strategies

5.4.1 Czech Republic

- Continue support to Crimson Capital/D&T into 1994. If requested, expand operations into the National Property Fund.
- Continue training program in Czech Savings Bank (CSB). Focus on developing more structured training.
- Increase involvement, as appropriate and requested, in the voucher program.
- Initiate assistance for bankruptcy issues.
- Continue periodic corporate governance case study workshop sessions. Desirable to expand to other countries.

5.4.2 Poland

- Continue "back office support" for the MPP.
- Expand financial sector policy and program reform.
- Curtail involvement in future individual transactions and sectoral work. New transactions should not be initiated, but ongoing transactions should not be cut off.
- Initiate assistance for bankruptcy issues.
- Provide additional Securities Commission support if requested
- Continue assistance for privatization of municipally owned companies (determine if this can be done in other countries).
- Determine feasibility of Institutional Support for the Ministry of Privatization.

5.4.3 Hungary

- Continue support for financial sector development.
- Provide limited support for new privatization methodologies (IMPACT project).
- Determine need to support Mass Privatization if it is approved.
- Expand support to the Self-Privatization program.
- Initiate involvement in bankruptcy issues.
- Do not extend existing long term technical assistance contract in the SPA.
- Refocus SPA support towards facilitating privatization closings. If a transactions unit is set up, it should closely work with Hungarian counterparts, and on both foreign and domestic investments.
- Determine possibility of a long term advisor in the Ministry in charge of Privatization, the Ministry of Finance or the State Holding Company (AVRT). This should be done only if the government wants an advisor and his area of expertise is clearly defined.

5.4.4 Southern Tier and Baltics

In the Southern Tier and Baltic countries in which privatization development is not as far along, AID should be able to transfer the concepts and skills developed in its institutional support and policy/program support initiatives developed in the Czech Republic, Poland and Hungary.

In "Stage I" countries just beginning their privatization programs, AID's overriding objective should be to establish **credibility** by helping push through to privatization some of the stronger firms that might still face significant bureaucratic delays; **consistency** by establishing general institutional procedures and processes for facilitating privatization; and **transparency** by helping establish the financial sector and an appropriate regulatory and legal framework.

Also, financial sector support should begin sooner, with particular emphasis on controlling inter-company debts and developing work out procedures for existing bad loans held by the banks.

5.5 Future Issues

In the future, AID will have to be concerned with a variety of potential issues. Past experience shows that AID support can inadvertently run into several potentially conflicting objectives. For example, in the Czech Savings Bank there is the potential conflict of having a savings bank handle investment funds. On a tactical level, we have already recommended that assistance to the Czech Savings Bank, particularly more structured training, be continued until the objectives cited in the PIO/T are achieved. This project has achieved some worthy objectives and can continue to do so with AID support. On a strategic level, however, it is difficult to recommend that AID try to duplicate the asistance it is providing to the Czech Savings Bank in other countries.

The U.S Savings & Loan experience suggests that AID should be careful in overextending the objectives of banks, particularly one that is just learning the ropes of managing assets in a market economy. Furthermore, there is the issue of how much AID support should be focused on one "private" institution. Public funds should be ideally focused on helping all private institutions to prosper and compete fairly. By providing assistance to one institution like the CSB, AID runs the risk of being accused of providing unfair subsidies.

Besides this issue, there are other areas in which AID should carefully consider its options:

1. **Cost-sharing** -- In some instances AID might be able to begin charging companies (or more specifically, request upfront government contributions since the companies are state-owned and profits are retained by the government) for assistance rendered. The evaluation team found several instances in which larger firms were paying for assistance

similar in scope to services provided by AID to other firms. Charging for services is a useful screening device for selecting one firm over another, particularly for firm-specific assistance (e.g. development of accounting systems, preparation for privatization). These charges could be used as an indicator of a government's willingness to transform a particular company. Discussions with AID/representatives reveals that the circumstances under which this will be possible are limited. Most likely, such a policy would be limited to larger firms.

2. Success Fees -- Related to cost-sharing, is the idea of integrating management and success fees into AID assistance. AID has already, with varying degrees of success, incorporated management fees into some restructuring programs in Hungary and Poland, as well as in the voucher program in the Czech Republic. The Self-Privatization experience in Hungary is a good example of how management fees (combined with a type of success fee in which the management company receives a percentage of the sale price after a company has been privatized) can be a powerful incentive to attract private management companies.

The use of success fees in privatizations has been more limited. A couple of contractors have been able to negotiate success fee contracts with host-country governments. These contractors believe that AID could better leverage their funds and complete more transactions by requiring the governments to pay success fees. In effect, AID could provide a "retainer" and pay a daily rate for initial services rendered; and then the government would take responsibility for paying a percentage of the final sales price which would serve as renumeration for the services provided and risk accepted by the contractor after it completes its AID-funded work. Such an arrangement could be and has been applied to any size company in any sector. Its application would have to be done on a case-by-case basis.

The appeal of this arrangement is that it identifies up front what AID's financial commitment is without, in some cases for a long time, waiting for and expecting the assistance to result in a completed transaction. It also could diminish AID's overall expenditures on firm-specific assistance (an area of assistance that the evaluation team does not recommend as it is currently structured) and make such assistance more appealing. Finally, similar to the cost-sharing concept, it would help screen companies and allow AID to prioritize its firm-specific assistance.

But there are issues associated with these arrangements which would require precautionary safeguards. First, in the absence of clearly defined contracts with AID, there is a potential for "double-dipping" in which the contractor receives payment for the same service from AID and the government. Second, there could be a potential conflict of interest if the contractor represents the government -- the seller -- and also has business ties to a foreign investor -- the buyer.

3. Inter-Company Debts -- This is a huge problem that will affect all three countries. To date, no country has developed a successful policy for handling inter-company debts, although AID in Hungary has made a significant beginning on this subject.

4. Bankruptcy and Workouts -- AID needs to develop an effective strategy for dealing with this large and pervasive problem. Different approaches to this issue should be carefully monitored.

5. Gender and Other Social Impact Issues -- There is very little information on the impact that privatization programs have had and will have on women and other groups in society. AID should develop a better understanding of these potential issues and examine future strategies for dealing with them.

APPENDICES

1. Evaluation Scope of Work
2. List of PIOT Work Orders for the Czech Republic, Poland and Hungary
3. Summary of Project Expenditures, Cost-Effectiveness and Recommended Performance Indicators
4. Case Study Analysis of Projects
5. List of People Interviewed
6. Description of the Treuhandanstalt Privatization Program
7. A Proposed Framework for Delivering, and Managing Structured On-The-Job Training
8. Program Coordination Issues

Appendix 1 - Evaluation Scope of Work

APPENDIX 1

Scope of Work, Evaluation of Privatization and Enterprise Restructuring Project (180-0014)

The Consultant will provide an assessment of the impact and effectiveness of AID's Privatization & Enterprise Restructuring Project (180-0014) in the CSFR (the Czech Republic), Poland and Hungary. This builds on the ongoing, Phase 1 assessment of country privatization progress in these countries under the Price-Waterhouse study, Privatization in Central Europe, A Preliminary Assessment, September 1992. To date, a total of $43.7 million has been obligated for project 180-0014.

BACKGROUND
As of September 25, 1992, 43 projects in 10 countries (at a cost of about $37.5 million) have been approved. (See ARTI monthly status report, Sept. 25, 1992 this project, page 26). A number of these have been completed with final or progress reports available for review. (Please refer to DELIVERABLES below.)

Over 2 years have passed since the initial obligation of funds for this activity. While the broad, regional approach was the agreed strategy at the time to address targets of opportunity, a readjustment of the project to meet country-specific requirements may now be in order. It is also important at this juncture to identify the elements of AID assistance which have had positive impact and establish the means to measure them. (See TASKS below.)

Since the Contractor will not have time to examine all of the completed or ongoing activities in the region, the Team will concentrate on the three major recipients of AID resources: the Czech Republic of the CSFR, Poland, and Hungary. AID activities in these three countries are the most advanced, and the Contractor will utilize the valuable information assembled under the Phase 1 country progress assessment. (See below.)

TASKS
The mutually reinforcing purposes of the Economic Restructuring/Privatization project are: a) to assist Eastern European governments in establishing the legal and institutional framework for privatization, and b) to assist individual firms in strengthening management and adjusting to open, competitive markets.

The Contractor's overriding objective is to examine the range of approaches utilized by AID in this sector -- from policy advice at the ministerial level to assistance to individual enterprises -- and assess their impact country-by-country. At this stage in project implementation, this information is crucial in order to concentrate AID assistance if, and where, it may be necessary to do so.

Within this overall objective, there are three main elements to this evaluation. First, the Consultant will identify the positive and successful elements of AID assistance to date along with quantitative and qualitative indicators (foreign investment, changes in real wages, for example) to measure progress. Secondly, the Consultant will examine the lessons learned in the region from the Phase 1 Sector Assessment to determine if AID assistance should be redeployed or reallocated in certain countries. (For instance, in cases where large scale privatization is blocked, should AID concentrate on the privatization of small enterprises?) Third, the Contractor will highlight those portions of AID support in the Northern Tier countries that are applicable to the Southern Tier and Baltic countries.

The specific issues/questions that the Contractor will address are grouped into 2 categories: a) general, to be answered for each country; and b) specific to one particular country.

A. General issues

1) Identify and evaluate the trade-offs between 4 alternative approaches for AID support: a) assistance with individual privatization transactions; b) assistance at the policy level; c) assistance to indigenous public and private entities engaged in facilitating privatization; and d) assistance more linked to follow-on enterprise development (monitoring, training, etc.).

2) Evaluate the processes by which assisted enterprises were selected. Develop quantitative and qualitative measures of impact and test them against the enterprises targeted for assistance. Identify cases in which country objectives conflict, e.g. objectives of maintaining or expanding employment vs. restructuring or liquidating enterprises; or accelerating the pace of privatization vs. maximizing revenue to the Treasury. Assess how such conflicts were resolved in the type of assistance delivered. Evaluate the concern that the most attractive enterprises have already been sold, and assess assistance strategies designed to dispose of the bulk of large-scale enterprises which cannot be sold quickly. Assess the objectives and progress of AID's grant to the IBRD that was designed to establish an analytical framework for selecting enterprises to be privatized. Recommend ways in which enterprise selection criteria and types of assistance should be reoriented, if necessary, to increase the impact of project funds.

3) Through ministry and firm interviews, assess the categories of trained host country personnel available in the private sector and as candidates for employment by the newly created government privatization agencies. Identify categories of business development and privatization skills in which gaps persist, limiting the speed and success of privatization. Recommend skill categories that should receive more emphasis in AID-financed training (short- and long-term, in the privatization project and in regional training projects). Where trained personnel are available, but not retainable in the public sector (e.g. in view

102

of wage and benefits differentials), recommend the appropriate mix of private and public assistance for the deployment of AID privatization and related training resources. For example, within the constraints of resources and staff, should the training in skills involved in privatization -- accounting, marketing, finance, banking, administration -- receive higher priority?

4) Assess impact from experience to date in AID collaboration with the IBRD, EBRD, EC, IFC, and other donors in specific privatization ventures and related policy assistance.

5) Given the rapid changes in the region, assess whether AID assistance should be demand driven. This means more resources will be earmarked for Poland. Assess this against the host country concern that AID assistance has been supply-driven, i.e., by contractors and AID officials.

6) Based on our experience with SPA in Hungary, at what level and to what extent should AID pursue major technical assistance and training support for key privatization agencies? Assess experience to date to determine whether there is a risk that such support will be counterproductive (e.g. could slow the pace of privatization) by strengthening vested interests within the agencies for maintenance of a continued role in the economy (e.g. becoming or spinning off state holding companies). Does country-specific institutional framework pit production ministries against the privatization ministries?

7) Is there a need for AID to do more to raise the sensitivity of host government officials and private sector counterparts to issues of gender equity? Assess the gender impact of current privatization experience (e.g. land privatization legislation precluded female inheritance of land in Albania, employee stock ownership plans have gender impacts in the context of male/female labor force patterns within industries, etc).

B. Country-specific issues

CSFR (Czech Republic)

1) In the context of country-level opportunities and constraints in voucher privatization, and impacts on enterprise management and individual asset holdings of voucher trading, assess whether AID should start to support development of capital markets, and the likely impact of alternative ways of providing this assistance, for example, by providing assistance to the State Savings Bank (manager of the largest voucher stock fund) and other holding companies.

2) Identify and document the lessons learned from CSFR success in attracting foreign investment, assess the complementarity of AID's assistance to the voucher program, and examine the

conditions under which these lessons are transferable to other countries.

3) The lack of clear tax liabilities due to each level of government has reportedly been a disincentive to foreign investment in privatization. Assess the severity of impact of this and other disincentives, and recommend whether (and if so how) AID technical assistance to fiscal reform should be strengthened to address this bottleneck (outside of this project if necessary).

POLAND

1) In view of the political appeal of indirect privatization, and its economic benefits, assess the need to support aspects of Poland's mass privatization program beyond the current "back office" support for share transfer custodianship, depository functions, and shareholder relations. Evaluate whether AID financing should be used to assist in the operations of the new investment funds.

2) Assess the quantitative and qualitative impact of AID assistance on reducing barriers to foreign investment in the Polish policy/regulatory environment. Identify policy/regulatory areas that require intensified technical assistance. In this connection, assess likely impact of AID support to IRIS -- which works on more precise laws to protect property owners.

3) Assess whether AID assistance to the GOP to improve the efficiency of Boards of Directors of SOE's would accelerate the privatization process. Evaluate the proposed program for "privatization through restructuring."

4) Should future AID assistance concentrate more on the financial sector, specifically, the privatization of banks and their loan portfolios? Evaluate the impacts to date on assistance absorption caused by the "sequencing problem" of the need to privatize both state-owned enterprises and the financial sector.

5) What are the lessons learned from AID assistance to the Huta Warzawa Steel Mill and LOT airline? Evaluate the requests for this assistance and the appropriateness of AID intervention in these two state-owned companies.

6) Should AID provide support for the privatization of municipal firms which can be transferred to the private sector without central government approval? Should AID provide assistance to the program of "privatization through liquidation"?

HUNGARY

1) Is the decision to end AID support of the SPA at the end of FY 93 sound? Examine German plans for privatization of much of

Treuhandanstalt's

~~Trenhundenstaldt~~'s activities by that time as a model, and assess its applicability to the Hungarian context. Assess the effectiveness of the SPA as the principal GOH privatization player. Are there other alternative institutional players with which AID could work to accelerate privatization?

2) How many SOE's have actually been privatized as a direct result of AID's assistance to individual privatization transactions? What has been the total revenue from those sales, total employment saved or generated, total foreign investment attracted, value of new trade relationships established, etc.?

3) Is the AID policy of establishing transaction units within banks likely to speed the process of privatization? Would impact be greater if transaction units with industrial specialties were created?

4) Examine proposals for technical assistance in the liquidation of SOE assets in cases of insolvency, and compare the cost effectiveness and impact of such assistance with alternative assistance strategies, e.g., assistance to emerging new private sector business.

METHODOLOGY

At a minimum, the Contractor will interview staff of the following organizations:

AID project managers and staff in the three countries
Representatives from other international and bilateral donors
Foreign and local buyers, local and foreign banks
local groups involved in privatization, such as ESOP in Hungary
Agency for Foreign Investment and Cooperation CSFR
Min. of National Property Administration and Privatization, CSFR
Officials of the SLIVER, KOLI, CREMONA, HOLICE and PETROF Cos., CSFR
State Property Agency, Hungary
Ministry of Privatization, Poland
Anti-Monopoly Office, Poland
Ministry of Finance, Poland
Warzawa Steel Mill and LOT airline, Poland

The Contractor will establish criteria for selecting a sample of firms to be interviewed in each country, to include those that have been privatized with AID assistance, and those that have been privatized without AID assistance, and firms that unsuccessfully attempted privatization with and without AID assistance. Contractor criteria for sample selection must be submitted to EUR/PDP and EUR/RME for concurrence prior to their use. At a minimum, the sample will include: a) a sample of small, medium, and large firms, and b) firms located both inside and outside of the capital city.

The Contractor will field a four person team, including a macroeconomist expert in privatization policy (serving as Team Leader), and three business management/restructuring experts with combined experience in training, privatization, political science/sociology, and finance. One or more team members should also have development program management experience. The Contractor will employ up to 2 local hires in each country to arrange interviews, handle logistics, and provide information. The Team leader will spend 5 days in Washington, starting on or about January 25, 1993, for briefing from AID/W, contractor staff, and other donors, prior to departure. Other team members in the Washington D.C. area will join the Team Leader for the last 2 days, if possible.

The four person team will spend one week each in Hungary, Czech Republic, and Poland, beginning not later than February 24, 1993. In the first country visited, the team will develop and test the prototype interview schedules and evaluation methodology to be employed in the remaining two countries.

DELIVERABLES

- Prior to departure, Contractor will submit a draft work plan to EUR/PDP/PA for concurrence.

The Contractor will propose measures for testing the impact, effectiveness and efficiency of assistance delivered and test them against the cases sampled.

In the light of documented support to date, the Contractor will outline an AID assistance strategy in privatization and restructuring for each of the three countries. Based on this, and in the context of concentrating AID's privatization resources, the Contractor will: a) recommend types of assistance that could be continued or expanded in each country, based on sample findings; b) identify types of assistance that could be discontinued or postponed; and c) where appropriate, recommend new initiatives or complementary assistance to be undertaken.

The Contractor will also specify conditions under which the recommendations may be applicable to the Southern tier and Baltic countries.

Immediately after return from the field, draft summary findings and conclusions will be submitted to EUR/PDP/PA (i.e. draft Executive Summary). A draft final report will be submitted not later than March 24, 1993 for AID/EUR review. AID's comments will be given to the Contractor on or about April 7, 1993. Twenty-five copies of the final report, not to exceed 100 pages (with an Executive Summary of findings and conclusions not to exceed 10 pages) will be submitted by April 15, 1993. Additional material may be submitted in Annexes, if necessary.

DOCUMENTS

EUR/PDP will provide the team with the following background material: Project paper, Eastern Europe - Economic Restructuring, dated August 3, 1990; latest ARTI monthly report on Privatization and Enterprise Restructuring Project; Privatization in Central Europe, A Preliminary Assessment, September 1992; final reports for the following completed activities: State Property Agency, Hungary (PIO/T 1183479); Monor State Farm, Hungary (PIO/T 1183495); Huta Warzawa Steel Mill, Poland (PIO/T 2622105); Ministry of Privatization, CSFR (PIO/T 1183110); Solid Waste Management Services (PIO/T 1183497).

Privatization Phase 1 Country reports are also available. Phase I evaluation findings will be available in draft by January 4, 1993.

101

Appendix 2 - List of PIOT Work Orders for the Czech Republic, Poland and Hungary

APPENDIX 2

LIST OF PROJECTS COMPLETED AND IMPLEMENTED

CZECH REPUBLIC:

YEAR	PIO/T #	TITLE	$ AMOUNT	CONTRACTOR
1991	1183485	Czech Technical Assistance	$1,689,820	PW
	2622100	Municipal Solid Waste Collection	$280,388	PW
1992	1183108	TR to Ministry of Economics for Mgmt Contracts	$72,530	KPMG
	1183110	Czech Ministry of Privatization Phase I	$479,250	D&T
	1183489	Skoda Pilzen	$500,000	IFC Grant
	1183492	Koli Fruit Processing	$101,600	C&L
	1183493	Cremona Instruments	$81,350	D&T
	1183494	Petroff Pianos	$79,261	D&T
	1183496	Util/Telecom Sector Studies	$683,200	D&T
	1183498	Sliver Machines	$82,430	C&L
1992	2622106	Ministry of Privatization Phase II	$4,585,000	D&T
	2622107	Non-Ferrous Metal Company	$710,350	KPMG
	2622108	Czech Savings Bank	$1,815,880	KPMG
	2622125	TA to Czech Ministry of Economic Policy	$133,510	KPMG
	2622125	Amendment Czech Ministry of Economic Policy	$99,710	KPMG
	2622138	Czech Mass Privatization Phase III	$2,000,000	D&T

APPENDIX 2
LIST OF PROJECTS COMPLETED AND IMPLEMENTED
(CON'T)

POLAND:

YEAR	PIO/T #	TITLE	$ AMOUNT	CONTRACTOR
1991	1183490	TA for Privatization	$2,204,486	PW
	2622103	LOT Airlines Privatization	$762,100	D&T
	0183479	Technical Studies	$210,000	Wharton
	1183476	Economic Restructuring/Privatization	$183,841	Wharton
	1183477	Task Force Company Assistance	$125,000	UNDP
	2622105	Huta Warszawa	$106,533	C&L
1992	2622104	Bank Regulation and Supervision	$446,030	KPMG
	2622110	Regulated Investment Companies	$420,920	KPMG
	2622113	SEC Assistance	$478,000	D&T
	2622114	Ancillary Assets Privatization	$656,800	D&T
	2622120	Regulated Investment Companies II	$495,000	KPMG
	2622121	Wood Products & Furniture Sector 1	$1,300,035	KPMG
	262122	Glass Sector Privatization	$1,415,430.16	PW
	2622131	LOT Airlines Phase II	$310,100	D&T
	2622132	Privatization Through Restructuring	$342,660	D&T

110

APPENDIX 2
LIST OF PROJECTS COMPLETED AND IMPLEMENTED
(CON'T)

HUNGARY:

YEAR	PIO/T #	TITLE	$ AMOUNT	CONTRACTOR
1991	1183479	Incremental Fund	$299,700	D&T
	1183482	Contract Extension	$2,477,197	D&T
	2622101	State Farms	$686,680	ACDI
	2622111	Investment Promotion	$468,997	D&T
	0183478	Economic Restructuring/Privatization	$200,000	Scientex
	1183480	Monor State Farms	$180,760	Chemonics
	1183495	Monor Farm	$83,921	C&L
1992	2622112	ESOPS Program	$423,758	C&L
	2622115	Quick Form Pilot Privatization	$117,675	D&T
	2622133	COMPASS Project	$293,820	C&L
	2622135	Franchising Privatization	$249,829	D&T
	3622071	Financial Sector Redeployment	$327,790	KPMG
1993	3622073	Amendment SPA Chick Twyman	$1,425,480	D&T

Appendix 3 - Summary of Project Expenditures, Cost-Effectiveness and Recommended Performance Indicators

APPENDIX 3

SUMMARY OF PRIVATIZATION EXPENDITURES, COST-EFFECTIVENESS AND PERFORMANCE INDICATORS

1. Introduction

A fundamental evaluation question posed for any A.I.D. program is: "Which projects are successful and which ones are not successful?"

While this question is straightforward, the answers provided in this evaluation are not. This study necessarily involves interpretative analysis, most of which is qualitative and subject to debate. Contrary to the expectations of many AID managers and outside observers, defining success in these projects is not just a simple matter of analyzing the number of privatizations and transactions that take place. There are strong political and policy-making elements to the program that must also be taken into consideration.

Even in those cases where privatizations take place there is a wide range of opinion on how long and what effect AID assistance had in making the privatization take place (i.e. "impact attribution"). Some argue that after, in some cases, more than two years of project implementation, it is still too early to expect completed privatizations. Counterarguments to this state that if a program cannot clearly show concrete "results" after about two years, it should not be continued.

This appendix seeks to provide a framework for defining success. Section 1 describes the criterion used for defining project success. Section 2 presents the overall ratings and distribution of program expenditures by type of project, country and level of success. Section 3 then looks at the cost-effectiveness of two types of project approaches: sectoral studies and firm-specific assistance. Finally, section 4 reviews the performance indicators proposed to evaluate program impact at the beginning of the evaluation and the recommended performance indicators for future program monitoring.

2. Definition of Impact Criteria

As shown in Table 3-1, "Definition of Impact Criteria", the evaluation team's methodology for ranking the projects in A.I.D.'s privatization program is based on two sets of criteria: "economic impact" and "impact on host government" criteria. The economic impact criteria consist of the following: 1) number and size of privatizations, 2) improved revenue and/or purchase terms, 3) policy/regulatory/legal framework in place, 4) privatization procedures/structures in place, and 5) overall cost-effectiveness. The host country impact criteria include: 1) overall host country attitude towards services rendered (e.g. extent to which the government/client requests and pays for additional services and/or the extent to which the project enhances AID/U.S. government's reputation), 2) extent to which the project changed the government's privatization priorities, 3) establishment of fairness and transparency in the privatization process, and 4) extent to which AID assistance helped leverage other donor funds [1].

---

[1] A previous draft of this evaluation included two additional criteria: 1) government/client requests and pays for more services, and 2) extent to which the project enhances AID/U.S. government's reputation. These two were incorporated into the criterion cited above -- government attitude toward services. After careful review of each project, the evaluation team has found that no substantive changes have occurred in project ratings as a result of the consolidation.

This is true for a couple of reasons. First, there was a high correlation among the three criteria. Whenever a project was cited as having a "high" rating for criterion "government attitude" it also received a "high" rating for criterion "requests more services" and/or "enhances

Each of the projects was analyzed in terms of the extent to which they achieved high impact in one or more of the above categories. A "high impact/successful" rating was applied to those projects in which AID assistance was "critical" in having an impact in at least one "economic impact" and one "host country impact" category. A "medium impact/mixed success" rating was given to those projects in which AID assistance was "very useful", but not "critical" in any one of the categories. Finally, a "low/not successful" classification was applied when AID assistance was considered "useful" with no apparent impact.

All assessments of AID assistance were derived from interviews with clients in which the question: "What would have happened if AID assistance were not available?" In all the "successful" cases, there were generally unanimous favorable opinions regarding the benefits and assessments of what would have happened without AID assistance. "Mixed success" projects included those in which opinions regarding the achievement of the above objectives were either mixed -- i.e. some positive or negative -- or qualified in some manner. Finally, projects considered to be "indefinite" or not successful, were those in which the general consensus seemed to be generally negative or the objectives of the original scope of work were not yet achieved.

AID/U.S. government reputation". There were no instances in which a project rating was "mixed" or undecided due to different ratings for each of the three criteria mentioned above. Second, many of the projects had other factors which were considered important. The other criteria (e.g. extent to which the project changed the government's priorities, promoted fairness and transparency, etc.) were typically mentioned as one of the key factors in each project's success or lack thereof.

TABLE 3-1. DEFINITION OF IMPACT CRITERIA (1)

ECONOMIC IMPACT CRITERIA (2):	HIGH; SUCCESSFUL	MEDIUM; MIXED	LOW; NOT SUCCESSFUL
1. Number and size of privatizations	Significant; Achieved project targets.	Limited; Achieved most project targets	Non-existent; Underachieved project targets
2. Improved revenue and/or purchase terms	Significant gains for the government	Some gains for the government	No revenue or improved purchase terms
3. Policy/legal/regulatory framework in place	Established operational regulatory/policy environment for future privatizations	Policy/regulatory framework defined but not operational; or of limited future use	Policy/regulatory framework not defined, or not appropriate for future use
4. Privatization procedures/structures in place	Established operational procedures & structures; will be critically needed for future privatizations	Procedures/structures initiated, not fully operational, or of limited future use	Procedures/structures non-operational, not defined, or not needed in future
5. Cost Effectiveness (3)	Results (or outlook) cost-effective	Results (or outlook) marginal or difficult to access	Results (or outlook) not cost-effective or very difficult to access
IMPACT ON HOST GOVERNMENT CRITERIA:	**HIGH**	**MEDIUM**	**LOW**
1. Government attitude toward services	Very favorable; Govt. paid for more services and/or Project greatly enhanced AID/U.S. Govt. reputation.	Moderately Favorable; Govt./client expressed an interest in additional services and/or Project slightly enhanced AID/U.S. Govt. reputation.	Neutral/negative response by government; Govt./client curtailed services and/or expressed negative feelings about the services.
2. Change in government priority	Project significantly increased government attention on project issues.	Project moderately increased government attention on project issues.	Project did not change or negatively affected government attention on project issues.
3. Establishment of fairness & transparency	Project helped establish fairness & transparency.	Project defined conditions for improved fairness and transparency.	Project had no/negative effect on improving fairness and transparency.
4. Assistance helped leverage other donor funds	AID Project funds greatly leveraged other agency funding.	Project worked well with other donors' projects, but no obvious leveraging.	Project had no apparent synergy with other donors' projects.

FOOTNOTES:

(1) For each classification -- e.g. "high", "medium", "low" -- it is assumed that there is an identifiable level of impact attribution concerning AID assistance: A "high" classification implies that AID assistance was considered "critical". For "medium", AID assistance was considered "very useful", but not critical. Finally, for "low" classification, AID assistance is considered "useful", with no apparent impact.

(2) In addition to these criteria, there are two other "secondary" criteria which could have been included. One is "Project Objectives/Outputs" achieved. This is relevant for those projects which did not focus on one of the above "primary" criteria, but still had many less ambitious objectives. Another classification is "Too Early to Determine". This is pertinent to those projects that have just started or those that are not yet expected to have achieved any results.

(3) Applicable to firm-specific assistance projects and sectoral assistance projects only.

2. Distribution of Project Expenditures and Success (By Country and Type of Project Approach)

Appendix 4, "Case Study Analysis of Projects", presents a detailed description of each project's activities, level of impact and future issues associated with the assistance. A summary of these project rankings and overall project expenditures by country, type of project approach and level of success are presented in Tables 3-2, 3-3, 3-4 below.

Table 3-2 shows the dollars allocated by country and in total by type of project as defined in the body of the report: policy/program support, institutional support, specialized transactional assistance, firm-specific assistance, and sectoral assistance. It shows that firm-specific assistance and sectoral assistance, which taken together are similar in nature and outcome, accounted for 41% of all dollar allocations; policy/program support and institutional support, also somewhat alike in nature and outcome, accounted for 35% of all dollar allocation; and specialized transactional support, the largest single category, accounted for 24% of all dollar allocations. This split differs substantially by country.

Table 3-3 shows the "success ratio" by country and in total, with 52% of the project dollars allocated resulting in outright successes, 20% resulting in mixed success, 22% being of low success and the balance indeterminable or too early to tell. Again, the results differ by country.

Table 3-4 shows the "success ratio" by type of project, with high results for specialized transactional assistance, policy/program support and institutional support, and mixed or low results for firm-specific assistance and for sectoral studies. These Tables are summarized in the Executive Summary and Chapter 4 of the main text.

Table 3–2
Dollars Allocated by Country by Type of Project

	Czech Republic $(000)	%	Poland $(000)	%	Hungary $(000)	%	Total $(000)	%
Policy/Program Support	1,969	14.7	2,585	24.3	2,107	29.1	6,661	21.3%
Institutional Support	117	0.9	478	4.5	3,742	51.7	4,337	13.9%
Specific Transactional Support	7,064	52.7	0	0	317	4.4	7,381	23.6%
Firm–Specific Assistance	2,861	21.3	1,475	13.8	118	1.6	4,454	14.2%
Sectoral Studies	1,393	10.4	6,119	57.4	952	13.2	8,464	27.0%
Total	13,404		10,657		7,236		31,297	

Table 3–3
Dollars Allocated by Country by Success Ranking

	Czech Republic $(000)	%	Poland $(000)	%	Hungary $(000)	%	Total $(000)	%
Success	9,114	68.0	2,446	22.9	4,672	78.6	16,232	51.9%
Mixed	1,533	11.5	4,355	40.9	481	6.6	6,369	20.3%
Not Successful	2,404	17.9	3,337	31.3	1,070	14.8	6,811	21.8%
Other	353	2.6	519	4.9	1,013	14.0	1,885	6.0%
Total	13,404		10,657		7,236		31,297	

Table 3–4
Dollars Allocated by Country by Success Ranking by Type of Project

	Success $(000)	%	Mixed $(000)	%	Not Successful $(000)	%	Other $(000)	%	Total $(000)	%
Policy/Program Support	5,300	79.6	387	5.8	0	0	974	14.6	6661	21.3%
Institutional Support	3,868	89.2	0	0	0	0	469	10.8	4337	13.9%
Specific Transactional Support	7,064	95.7	317	4.3	0	0	0	0.0	7381	23.6%
Firm–Specific Assistance	0	–	1,922	43.2	2,090	46.9	442	9.9	4454	14.2%
Sectoral Studies	0	–	3,743	44.2	4,721	55.6	0	0.0	8464	27.0%
Total	16,232	51.9	6,369	20.3	6,811	21.8	1,885	6.0	31297	

117

3. Cost Effectiveness: Costs and Results of Firm-Specific Assistance and Sectoral Assistance

One of the principal conclusions of this report is that the Firm Specific approach, and also that version of it referred to as the Sectoral Approach has not been "cost effective". As the material that follows shows, the data presented does not permit scientific precision either as to results obtained or as to what input caused what result. Nevertheless, despite the imprecision, we believe the conclusion as to lack of cost effectiveness is clear.

"Cost effectiveness"is a relationship that attempts to establish whether the money spent produced a result justifying the amount of expenditure. If, as is the case here, the money spent is a sizable portion of the funds available and the results are meager, then the undertaking was, overall, not cost effective.

Tables 3-5 and 3-6 present the costs and results associated with firm-specific assistance and sectoral studies. In Column 1 is listed the amount allocated to projects (in some cases estimated parts of projects) that we judged to be firm-specific, i.e., aimed at guiding specific SOEs through the entire privatization process, from first being designated as a serious candidate for privatization to its becoming wholly, or partly, privatized. By this definition, complete success is attained only if a privatization occurs.

We used "dollars allocated" rather than "dollars expended" because they were more readily available to us and because there would be a time lag in passing judgement if it had to await final numbers.

While the dollar figures are exact, the remaining numbers are in some cases estimates. First we identified which of the various privatization possibilities considered were, on initial screening, judged to be realistic candidates. This procedure tends to increase the evaluation of effectiveness by limiting it to those candidates on which most of the time was spent. The "maximum" and the "minimum" represent our understanding of the range of serious privatization candidates for assistance. We cannot obtain more precise data without a disproportionate amount of research. Moreover, we consider that the conclusions are so compelling as not to require it.

The same is the case with the "best case" and "worst case" estimate of privatizations completed or to be completed. Included in "best case" are those instances where more than one activity has been or is to be hived off as a privatization. The "best case" includes, in addition, those cases where we believe privatization will result even without any further expenditure of AID money. Where we have heard of additional privatizations resulting from AID projects with reasonable, but not absolute reliability, we have included these in the count also. As to "worst case", we only know absolutely of two privatizations that have taken place where AID financing was involved and have limited the "worst case" to these instances only.

We estimate the total "best case" number at not more than 13. This leads to the following conclusions:

1) The "success ratio" of companies successfully privatized to those seriously considered is less than 1 in 10 and actual results to date are worse than that.

2) Expenditures to date have been very high per successful transaction, but even if and when all additional transactions are included, the cost per successful transaction is almost $1,000,000. By any standard the cost is high (see further discussion below).

3) The costs per transaction and the success ratio for sectoral approach candidates has been worse than for firm-specific candidates.

4) The costs per transaction and the success ratio for large companies has been worse than for small companies.

It is obvious that these statistics do not deal with the countries' overall privatization program, but only with these AID supported projects that were firm-specific oriented and cover the whole privatization process from start to successful privatization or abandonment of effort.

Are the above results worthwhile from the point of view of the amount of money spent? One could argue that the raw figures are sufficiently convincing to demonstrate the lack of cost effectiveness so that they need not be proven further. But knowing that privatization is very often expensive, we have looked at them further to support our judgement that it is not a good area for AID expenditure. We base the conclusion as to lack of cost effectiveness on two different lines of reasoning:

-- First, making a comparison between the AID approach to this kind of assistance and some comparable alternative approach is inexact because, for example, an investment banker called in would not do the same work and if he did, would not perform it in the same way. He would proceed more efficiently since the appropriateness of the candidate for privatization would have already been determined. He would not do the preliminary investigative work that AID performs, he would come in at the "deal" stage and most of his charge would be tied to a "success fee", a percentage of the transaction value. Success would be more assured, but the charge could be as much or even more.

The most comparable investigatory work occurs when one of the direct parties in a privatization, usually the buyer, does this work for his own account. The work consists of:

a) Projection and examination of future income statements and balance sheets;

b) Investigation of liabilities, often assisted by legal council; and

c) Local help being guided through required government procedures.

Recent corroborative checks in Eastern Europe with investment bankers confirm that to private parties these costs (about which they complain) have been from $ 300,000 up in some few cases to as much as $500,000, clearly less than the cost per transaction set forth above.

-- Secondly, looked at from quite a different angle, we note that AID's annual budget has averaged about $ 10 million per year and may even decline in the future for these countries. Assuming that all of the funds had been spent on firm-specific or sector work, by extrapolation we arrive at a privatization count of from five to a maximum of 33 privatizations at a cost of $31.3 million. With many of the privatizations necessarily being small ones, such a small result is clearly less transforming of the economy than, for example, the role play by Crimson Capital, which has played its part in 63 privatizations so far at one-fifth the amount of money.

The limitation of funds makes the firm-specific type of support not as cost effective as other types of support.

Table 3–5
Firm Specific Assistance: Costs and Results

	$ Allocated (000)	Serious Candidates		Privatizations Completed or to be completed	
		Maximum	Minimum	Best Case	Worst Case
Czech Republic					
Czech Technical Assistance	$1,699	20	10	5	1
Municipal Solid Waste Collection	280	1	1	1	0
Ministry of Economics – Management Contracts	37 (part)				
Skoda–Pilsen	500	7	3	0	0
Koli	102	1	1	0	0
Cremona	81	1	1	0	0
Petroff	79	1	1	0	0
Sliver	83	1	1	0	0
	$2,861	32	18	6	1
Poland (1)					
LOT	$1,072	3	1	0 (2)	0
Privatization through Restructuring	171 (part)	5	3	0	0
Task Force Company Assistance	125	?	?	?	?
Huta Warszawa	107	1	1	1 (3)	1
	$1,475	9	5	1	1
Hungary					
Quick Form	$118	5	5	0	0
	$118	5	5	0	0
TOTALS	$4,454	46	28	7	2

Table 3-6
Sectoral Assistance: Costs and Results

	$ Allocated (000)	Serious Candidates		Privatizations Completed or to be completed	
		Maximum	Minimum	Best Case	Worst Case
Czech Republic					
Utility – Telecom	$683	5	2	0	0
Non-Ferrous Metals Companies	710	3	3	1	0
	$1,393	8	5	1	0
Poland (4)					
Glass	$3,619	15	10	3	0
Wood Products	2,500	27	8	2 (5)	0
	$6,119	42	18	5	0
Hungary					
State Farms	$687	12	4	0	0
Monor	265	4	1	0	0
	$952	16	5	0	0
TOTALS	$8,464	66	28	6	0
GRAND TOTAL, Firm-Specific and Sectoral Assistance	$12,918	112	56	13	2

(1) Note also spin-off of 10-15 ancillary assets, plus large number of flats. This project not considered firm-specific
(2) Some management contracts included
(3) Privatization not the objective of AID assignment
(4) Seven privatizations, possibly more, known to have been privatized as result of sectoral studies, but not in the part financed by AID.
(5) In two cases, privatization through foreign investment was in process prior to start of sectoral study. Not yet known to be completed.

4. Proposed Performance Indicators/Impact Criteria

4.1 Initial Evaluation Impact Criteria (Submitted to AID/Representatives)

The evaluation team first developed evaluation impact criteria for two levels of analysis. On a general level, some of the country-specific indicators considered to be most relevant included: number of privatizations (by size, industry, country, investor), revenue generated by privatizations, foreign investment generated, change in employment (overall, gender specific), new investment committed and technology improvement. At the firm-specific level, some of the more relevant areas of analysis to judge success might include: change in productivity (sales/employees), return on assets employed, change in sales (domestic vs. export, by country, by product mix), change in capacity utilization, change in earnings, change in market share, number of training programs and trainees (by subject area, country, private vs. public, location). The specific criteria included:

OVERALL PROGRAM/COUNTRY INDICATORS:

* 1. Number of Privatizations

- a) By Size (# of employees, level of sales)
- b) By Industry
- c) By Country (and by district within country)
- d) By Investor

* 2. Revenue Generated (for Govt. Treasury) by Privatization

* 3. Foreign Investment Generated

* 4. Change in Employment

- a) Overall
- b) Gender specific (if available)

5. New Investment Committed (Projected and Actual)

6. Technology Improvement

* 7. Number of Training Programs and Trainees

- a) By Subject Area
- b) By Country
- c) Private vs. Public
- d) By Location: (on-the-job, in-country, third country, U.S.)

* 8. AID Expenditures as a Percentage of Other Donor's Expenditures

FIRM-SPECIFIC INDICATORS:

* 1. Change in Productivity (Sales/Employees)
* 2. Return on Assets Employed
* 3. Change in Sales

a. Domestic and Export
b. By country
c. By Product Mix

4. Capacity Utilization
5. Change in Earnings
6. Change in Market Share

PROGRAM MANAGEMENT INDICATORS:

* 1. Number of Days (Projected and Actual)Required Between the Following Stages:

a. Country Request	to	Formal PIO/T Submission
b. PIO/T Submission	to	PIO/T Approval
b. PIO/T Approval	to	Start Up of Work Order
c. Start Up	to	Completion of Work Order

* 2. Allocation of Funds (By country,By Year and By Type of Assistance):

a. Budgeted
b. Obligated
c. Expended

3. Timeliness and relevance of quarterly work plans

4. Timeliness and relevance of annual strategy papers

5. Number and relevance of follow-up/exit reports

NOTE: * indicates top priority indicators and ones that we feel most confident about collecting.

With few exceptions (the Crimson Capital/D&T project being the prime one, see Section 4.2.2 for details), the evaluation team was unable to collect the above quantifiable indicators. None of the projects had yet resulted in any of the above outputs. Nor were any of the AID or contractor staff in the countries visited able to provide any detailed intermediate indications of what the impact might be.

4.2 Final Recommended Impact Criteria

In the future, AID should try to focus on monitoring a set of "purpose-level" indicators that show whether the technical assistance is achieving the goals mentioned in the PIO/T scopes of work. These indicators are intended to directly measure the impact of AID assistance. Many of the proposed indicators are taken from the list mentioned in the section above. These indicators are considered important enough to warrant constant attention by AID managers. Among the most significant, or "bottom line" indicators are:

1. Number of privatizations (including spinoffs from companies)
2. Increase in investment (foreign and domestic)
3. Maintenance/expansion of employment
4. Increase in revenue
5. Level of environmental liabilities

Besides these, there are numerous other indicators that can be grouped according to the type of impact expected: policy/program reforms, institutional support and training, and firm-specific assistance. These include:

Policy/Program Support:

1. Number of new policy or program initiatives established
2. Percentage of bad loans worked out/renegotiated
3. Extent to which policy/regulatory/legal framework is put in place (e.g. high = operational, medium = policies defined and approved, low = only conceptual framework defined)

General Institutional Support:

1. % Turnover
2. % Trained personnel
3. Processing time required to complete privatization-related procedures.

Training:

1. Level of technical assistance (in days, months or years)
2. Percentage of training course attendance that completes the course and does so on time
3. Percentage attendance at training seminars
4. Appraisals (participant, supervisor)
5. Job skills change

Firm-Specific Assistance:

1. Change in corporate governance
2. Change in productivity
3. Return on assets employed
4. Change in sales (domestic and export, by country, by product mix).
5. Change in debt/equity ratios

Finally, AID should also consider tracking and reporting on the extent to which project initiatives help promote improved political relations and support from host governments for privatization reform. Specifically, the indicators to track would be those used by the evaluation team in assessing the impact of projects: 1) overall host country attitude towards services rendered (e.g. extent to which the government/client requests and pays for additional services and/or the extent to which the project enhances AID/U.S. government's reputation), 2) extent to which the project changed the government's privatization priorities, 3) establishment of fairness and transparency in the privatization process, and 4) extent to which AID assistance helped leverage other donor funds.

Appendix 4 - Case Study Analysis of Projects

125

APPENDIX 4

Case Study Analysis of Projects

This appendix consists of our review of the PIOT project assignments presented in "case study" format under headings consistent with the matrix summary that heads up this appendix. The matrix summary provides an overview of what took place in the execution of each project. We have included "case study" coverage for each of the projects except those that were very small in amount (less than $200,000), or where the data were too incomplete or unknown to permit an adequate assessment.

The purpose of these "case studies" is to set forth what we learned through interviews with those involved in each of the projects. These interviews along with reviews of project documents form the basis for the facts and conclusions presented in this report. These findings, in turn, are the justification for our assessment of the relative success of each project.

By way of introduction, the first page of this appendix, "Definition of Impact Criteria", sets forth the different kinds of effects impacting projects and defines what we mean when we say the impact was "High" (successful), "Medium", or "Low" (unsuccessful). Also preceding the case write-ups is a summary of the key factors for each project.

DEFINITION OF IMPACT CRITERIA (1)

ECONOMIC IMPACT CRITERIA (2):	HIGH; SUCCESSFUL	MEDIUM; MIXED	LOW; NOT SUCCESSFUL
1. Number and size of privatizations	Significant; Achieved project targets.	Limited; Achieved most project targets	Non-existent; Underachieved project targets
2. Improved revenue and/or purchase terms	Significant gains for the government	Some gains for the government	No revenue or improved purchase terms
3. Policy/legal/regulatory framework in place	Established operational regulatory/policy environment for future privatizations	Policy/regulatory framework defined but not operational; or of limited future use	Policy/regulatory framework not defined, or not appropriate for future use
4. Privatization procedures/structures in place	Established operational procedures & structures; will be critically needed for future privatizations	Procedures/structures initiated, not fully operational, or of limited future use	Procedures/structures non-operational, not defined, or not needed in future
5. Cost Effectiveness (3)	Results (or outlook) cost-effective	Results (or outlook) marginal or difficult to access	Results (or outlook) not cost-effective or very difficult to access

IMPACT ON HOST GOVERNMENT CRITERIA:	HIGH	MEDIUM	LOW
1. Government attitude toward services	Very favorable; Govt. paid for more services and/or Project greatly enhanced AID/U.S. Govt. reputation.	Moderately Favorable; Govt./client expressed an interest in additional services and/or Project slightly enhanced AID/U.S. Govt. reputation.	Neutral/negative response by government; Govt./client curtailed services and/or expressed negative feelings about the services.
2. Change in government priority	Project significantly increased government attention on project issues.	Project moderately increased government attention on project issues.	Project did not change or negatively affected government attention on project issues.
3. Establishment of fairness & transparency	Project helped establish fairness & transparency.	Project defined conditions for improved fairness and transparency.	Project had no/negative effect on improving fairness and transparency.
4. Assistance helped leverage other donor funds	AID Project funds greatly leveraged other agency funding.	Project worked well with other donors' projects, but no obvious leveraging.	Project had no apparent synergy with other donors' projects.

FOOTNOTES:

(1) For each classification -- e.g. "high", "medium", "low" -- it is assumed that there is an identifiable level of impact attribution concerning AID assistance: A "high" classification implies that AID assistance was considered "critical". For "medium", AID assistance was considered "very useful", but not critical. Finally, for "low" classification, AID assistance is considered "useful", with no apparent impact.

(2) In addition to these criteria, there are two other "secondary" criteria which could have been included. One is "Project Objectives/Outputs" achieved. This is relevant for those projects which did not focus on one of the above "primary" criteria, but still had many less ambitious objectives. Another classification is "Too Early to Determine". This is pertinent to those projects that have just started or those that are not yet expected to have achieved any results.

(3) Applicable to firm-specific assistance projects and sectoral assistance projects only.

127

Project Name/#	Main Objectives	Results	Economic Impact	Impact on Host Gov't	Allocated Cost (000)	Cost-Effectiveness	Ranking	Problems/Issues
A. CZECH REPUBLIC								
1. Czech Technical Assist. (e.g. Ferox, Barrandov) (#1163485)	1. Identify privatization candidates 2. Assist in privatization	1. One privatization, possibly more 2. AID involvement "useful", not critical	Low to Medium	Low to Medium	$1,699	Low, could become Medium	Low to Medium	1. Identification of candidates was random; selection criteria politicized 2. Fairness/Transparency questionable (e.g. Barrandov) 3. Not cost-effective
2. Min. of Priv. Phase I & II (#1163110) (#2622106) (#2622138)	1. Installation and Start up of Crimson Capital 2. Accelerate Privatizations 3. Improve technical capacity of MOP staff	1. Set up procedures 2. Crimson Capital operating effectively 3. Completed over 60 transactions 4. MOP very pleased	High	High	$479 $4,585 $2,000	n.a.	High	1. Were objectives specific enough? 2. Degree to which MOP staff trained is limited 3. Faced difficulties outside particular area of assistance 4. Transition to GCCR will be required
3. CSAEF Assist. (Kol, Cremona, Petroff, Silver) (#1163492-94,96)	1. Provide CSAEF with investment evaluations 2. Help privatize enterprises	1. Completed, evaluations mostly 2. No privatizations	Low	Low	$102 $81 $79 $83	Low	Low	1. Early efforts 2. Not good privatization candidates
4. Non-Ferrous Metal Companies (#2622107)	1. Identify and privatize 3 metallurgical SOEs 2. Identify potential foreign investors 3. Assist them in their operations	1. No privatizations as yet 2. Partially accomplished 3. Partially accomplished	Low	Low	$710	Low	Low	1. Method of identification poor 2. At least two candidates unsuitable
5. Municipal Solid Waste Collection (#2622100)	1. Privatization of Municipal Waste Collection	Unknown	Unknown	Unknown	$280	Unknown	Unknown	--
6. Czech Savings Bank (#2622108)	1. Assist in investment fund objectives 2. Assist in "back office" procedures 3. Assist in credit risk management 4. Establish foreign payment processing procedures	1. Accomplished and continueing 2. Back office procedures working 3. Task turned over to private contract 4. Unknown	High	High	$1,816	n.a.	High	1. Objectives not specific enough 2. Necessity to handle future mass privatization "waves" 3. Privatized bankruptcies a future problem
7. Skoda Pilzen (#1163489)	1. Help SP with privatization plan 2. Accounting changes for tool division for certain PS units	1. No overall privatization plan being pursued 2. Completed	None as yet	Low	$500	Low	Low	1. SP politically and economically complex; limited political will 2. Limited management effectiveness 3. Present Tool Division's efforts narrow in scope; impact will be secondary and take a long time
8. TA to Min of Econ for Management Contracts (#1163106)	1. Let out management contracts to run SOEs	1. Not Accomplished	Unknown	Unknown	$73	Very little but Low cost	Unknown, probably low	1. An experimental program 2. Program stalled 3. GOCR interest has waned
9. T.A. to Min. of Econ. Policy (#2622125)	1. Facilitate foreign contracts 2. Improve donor coordination 3. Assist financial policies 4. Develop strategic studies in privatization plans	1. Center for Foreign Assistance set up 2. Somewhat improved 3. Attention focused on financial sector 4. This project no longer focused on these broad objectives	Medium,	High GOCR appreciates financed focus	$234	n.a.	Medium to High	1. Project in a beginning stage 2. Focus on financial sector excellent 3. Privatized bankruptcies a future problem
10. Util/Telecom Sector (#1163496)	1. Prepare regulatory framework 2. Complete, future privatizations	1. Completed 2. In process	Medium, Limited Initial Results	Medium	$683	Medium, not yet determinable	Medium	1. Project difficult and long time-frame 2. Problem in selecting foreign partner

128

Project Name/#	Main Objectives	Results	Economic Impact	Impact on Host Gov't	Allocated Cost (000)	Cost-Effectiveness	Ranking	Problems/ Issues
B. POLAND								
1. Glass Sector Study (#1183490,2622122)	1. Accelerate privatization 2. Prepare & recommend privatization 3. Privatize companies	1. In process 2. Completed 3. Sandomierz major project. Not yet privatized, but expected soon. Others in process.	Low/Medium	Medium. Work well received, GOP distressed at cut off of funds (Sandomierz)	$3,619	Currently Low, some results expected	Low/Medium	1. Long time frame 2. Initial study of sector adds to time required 3. Random selection of candidates 4. Transaction for major candidate complicated and costly
2. Wood Sector Studies (#2622121)	1. Accelerate privatization 2. Prepare & recommend privatization 3. Privatize companies	1. In process 2. Completed 3. No privatizations, but several in process	Low/Medium	Medium; Well received	$2,500	Currently Low, some results expected	Low/Medium	1. Long time frame 2. Initial study of sector adds to time required 3. Random selection of candidates 4. Some privatizations could have been done without AID
3. Technical Studies – Wharton Economic Restructuring/ Privatization – Wharton (#0183479, 1183476)	Unknown	Unknown	Unknown	Unknown	$393	Unknown	Unknown	Early generalized effort
4. Task Force Company Assistance – UNDP (#1183477)	Unknown	Unknown	Unknown	Unknown	$125	n.a.	Unknown	1. Performed by UNDP request
5. Huta Warszawa (#2622105)	1. Prepare business valuation report	Complete	Low	Low	$107	Very little, but low cost	Low	1. Usefulness minimal due to late start 2. Poor coordination by contractor
6. LOT Airlines Privatization (#2622103, 2622131)	1. Help produce master privatization plan 2. Establish alliance with foreign partner 3. Assist in obtaining financing 4. Provide managment training	1. Plan prepared. AID assistance limited. 2. Foreign partner search continues 3. Unknown 4. Some on-the-job training provided	Medium	Medium	$1,072	Low	Medium	1. Contractor not close to management concerns 2. Current level of effort more limited than PIO/T objectives
7. Bank Reg. & Supervision (#2622104)	1. Assist National Bank of Poland with privatization interface 2. Prepare and field test manual on problem banks	1. Advice well received and utilized 2. In process at early stage	Potentially high, Too early to evaluate	High	$446	n.a.	Medium Potentially high	1. Manual completion has long time frame 2. Client would like greater flexibility in ad hoc use of consultants.
8. Regulated Investment Companies (#2622110, 2622120)	1. Assist with MOP "back office" procedures for Mass Privatization Program (MPP)	1. In process, on target	High	High	$916	n.a.	High	1. GOP late in passing MPP 2. Focus on forthcoming bankruptcy is on target
9. SEC Assistance (#2622113)	1. Review regulatory reporting requirements 2. Conduct workshops 3. Prepare manual	1. Completed 2. Completed 3. In Process	High	High	$478	n.a.	High	None
10. Ancillary Assets (#2622114)	1. Recommend and review policy 2. Develop procedures 3. Prepare manual	1. Completed 2. Completed 3. Completed	High	High	$657	n.a.	High	1. SOE Director General was prime mover in program 2. Contractor verified and prepared manual 3. Manual has not yet been widely distributed and applied
11. Privatization by Restructuring (#2622132)	1. Develop methodology for restructuring using management contracts 2. Let contracts	1. Uncompleted	Low	Low	$343	n.a.	Low	1. Experimental 2. Selection of candidate firms politicized 3. Hampered by authorization delays 4. Disagreement over objectives

Project Name/#	Main Objectives	Results	Economic Impact	Impact on Host Gov't	Allocated Cost (000)	Cost–Effectiveness	Ranking	Problems/ Issues
C. HUNGARY								
1. SPA Assistance (#0183478, 1183479, 1183482, 3622073)	1. Install management and administrative procedures 2. Develop computer systems 3. Establish financial management system 4. Provide training 5. Assist Pri–Man program	1.Completed 2. Completed 3. Procedures in place; mgmt./asst. continueing 4. Ongoing 5. In process; Helping Pri–Man in secondary areas	High	High	$4,[illegible]01	n.a.	High	1. Assistance may be too diverse 2. SPA too bureaucratic? 3. Contribution substantial although hard to measure
2. Investment Promotion (#2622111)	1. Promote foreign investment interest	1. Hard to determine	Hard to determine	Unknown	$469	n.a.	Unknown	1. Hard to measure attributable impact
3. Monor State Farms (#1183480, 1183495)	1. Privatize Monor State Farms	1. Not privatized, attempts abandoned	Low	Low	$265	Low	Low	1. Program late in gathering momentum 2. Limited SOE management effectiveness 3. Privatization intent abandoned by GOH 4. Financial condition deteriorated
4. State Farms ACDI (#2622101)	1. Develop model for privatization of state farms	1. Attempt abandoned by GOH	Low	Low	$687	Low	Low	1. GOH changed policy in state farms 2. This and Monor are lost opportunities
5. ESOPS Program (#2622112)	1. Assist in structuring ESOPs law 2. Assist with ESOPs privatizations	1. Completed, Law passed 2. 20 ESOPs privatized, more in process	High	High	$424	n.a.	High	1. An excellent result in a field hard to accomplish 2. ESOPs have high in–country public relation value
6. Quick Form Pilot Privatization (#2622115)	1. Experimint with fast track privatization methods	1. Program has been stalled	Low	Low. GOH not pleased with program so far	$118	Low	Low	1. Clarification of candidates was random; selection criteria politicized
7. COMPASS Project (#2622133)	1. Help devise new fast track privatization methods	Too early to determine	Too early to determine	Too early to determine	$294	n.a.	Too early to determine	1. More work recommended focusing on mass privatization
8. Franchising Privatization (#2622135)	1.Promote franchising as privatization initiative	1. Conference held	Not known	Not known, but conference well received	$250	n.a.	Not determinable	1. Influence of conference not known and hard to measure
9. Financial Sector Redeployment (#3622071)	1. Policy advice on control of banking sector 2. Develop loan consolidation proposal	1. Initial phase valuable although late. 2. Some recommendations adopted.	Medium impact considerable, although limited by lateness	High, GOH listened to advice	$328	n.a.	Medium/High	1. Next phase potentially very valuable 3. Focus on forthcoming bankruptcies is on target

CZECH REPUBLIC

Project Title:

Czech Technical Assistance (# 1183485)

Introduction:

The evaluation team discussed three of the candidate enterprises identified under this project. However, the team went into detail and reviewed matters with only one company, Barrandov Film Studios, the only SOE, to our knowledge, that has been privatized under this project.

Barrandov is a conglomerate of moderate size but large within its industry which is the film industry. Major activities consist of film studios, a photoprocessing lab, and ownership of real estate.

Main Objectives:

Objectives involved the contractor in a number of ways. First, he was to identify likely privatization candidates. Then, in subsequent phases, he was to assist them in privatizing.

The sequence employed was different than was the case on later projects the contractor was first awarded the money and was instructed to locate and then work with proposed candidates. This is the opposite of the procedure later employed in which the enterprise to be the subject of assistance was identified first, with the funds being allocated after that.

The one successful privatization completed was an MBO in response to a Government request to bid.

Results:

To our knowledge only one privatization was accomplished under this project, but there may have been more that took place later that have not been identified by or connected with the contractor.

The successful bid for Barrandov was entered by a management group reconstituted with some but not all of the management of the former SOE and with a new General Manager who had previously been the Finance Manager. The contractor prepared the first draft of the privatization plan and reviewed subsequent drafts. An important part of the contractor's role was the documentation of industry practice for similar film companies in the West. They also made certain that the bid was responsive to what the Government wanted.

An important contribution of the contractor was creating credibility for the winning bid. It was stated that the presence of the contractor was "useful" but not critical.

Economic Impact:

Low to medium:

* Limited number of privatizations
* Currently low cost-effectiveness

Only one known candidate was privatized. When this is compared to the funds allocated, the project was not cost-effective.

Impact on Host Government:

Low to medium:

* Neutral government appreciation
* No/negative effect on improving fairness and transparency

Government has not expressed an attitude toward the project and does not appear to view the project as representing significant activity.

Allocated Cost (000):

$ 1,699

Cost Effectiveness:

Low, could become medium if, in the end, more privatizations result. This does not seem likely.

Ranking:

Low to medium.

Problems/Issues:

1. This is an example of the random method of selecting privatization candidates. The relative lack of success of this method is discussed in the report text. Of the three SOE candidates known to have been considered, the two other than Barrandov were clearly not suitable candidates, nor did they want to be considered for privatization.

2. There were some questions regarding the transparency and fairness of terms and assistance in the Barrandov privatization. The contractor prepared the bid for the one successful group, but not for other competing groups. It is stated that other groups had access through the Ministry of Culture to the assistance work performed by the contractor, but the degree to which this levelled the playing field is open to question.

It is further alleged that the Ministry clearly favored this group from the very beginning. It is true that the other bids were not responsive, the bidders principally being interested primarily in the acquisition of the real estate.

3. The successful bidders were permitted discounts and installment terms such that cash projections showed the purchase payments being entirely financed from future earnings. Whether AID should, in effect, underwrite such terms is a question. The investors were, however, required to put in substantial investment, in a separate financing of relatively unrelated real estate expected to appreciate.

Project Title:

Ministry of Privatization, Phases I & II (# 1183110, 2622106, 2622138)

Introduction:

These projects are the establishment, operation, and extension of Crimson Capital. They focused on providing transaction assistance in the Ministry of Privatization. The contractor, Crimson Capital/Deloitte & Touche, developed procedures and provided assistance in negotiating privatization deals with foreign investors.

Crimson Capital/D & T is an investment review function principally directed by expatriate investment bankers and accountants. Whereas there is a popular impression that Crimson/D & T is "in charge" of all phases of foreign investment, this is not the case. Rather, its function is confined to the final defining of terms to foreign investors and the negotiation of these terms. Its activities, therefore, come one step later in the sequence of the privatization process.

In effect, Crimson/D & T is the representative of the Government, principally the Ministry of Privatization, to all private parties concerned in a privatization, principally the foreign investing company. 75% of its transactions involve foreign control. Most bids on which they work are the result of a single bidder. Sometimes, especially at first, but not often, Crimson/D & T also assisted in locating likely investors.

At first, at the time of the "first wave" of privatization, Crimson's function was sorting out and making sense of the required SOE privatization submissions. More recently, its role has shifted to bringing the parties together. In addition to negotiating the price itself, the major negotiating positions include: agreements on maintenance of specified employment levels, amount of investment to which the investor will be obligated, and amount and limit of environmental liability, in approximately that order of importance.

Crimson is also responsible for steering agreements that have passed through the MOP through the Economic Council (an all-ministerial conclave) and the cabinet, neither of which are in any way rubber stamp operations.

We inspected in detail three candidate companies from the Crimson log book, two of them resulting in successful privatizations, one of them not.

Main Objectives:

1. To start up, and subsequently to operate the process of foreign investment and privatization.

2. To accelerate the privatization process by efficient execution of its facilitating steps in the clearance process.

3. To improve the technical capability of the MOP staff in dealing with foreign investors. There is an on-the-job training objective as part of this project.

Results:

Results have been excellent. Crimson/D & T was set up early and without delay. It is operating efficiently. It selected 204 enterprises out of the "first wave" of privatization for concentration on potential foreign investment. This was subsequently narrowed down to 104, of which, as of mid-March 1993, 63 enterprises had signed agreements, with more well on the way. This represents $ 2 billion dollars or 21 bn Kcs of sale price. In addition, 26 bn Kcs of investment commitment has been secured.

Economic Impact:

High:

* Significant number of large scale privatizations
* Significant revenue and purchase term gains to the government

Crimson/D & T has increased the amount of money flowing to the Government and improved investment terms over what they would have been. Its high track record of successful privatizations is directly attributable to the financing provided by AID. Both Crimson/D & T's specific function and the capability of the MOP have benefitted from the services provided by Crimson/D & T.

Impact on Host Government:

High:

* Greatly appreciated by the government
* Greatly enhanced US/AID Reputation
* Government requested additional services
* Helped establish greater fairness and transparency

Allocated Cost (000):

$ 479
$ 4,585
$ 2,000

Ranking:

High

Problems/Issues:

1. Initially, objectives were not specific enough, but they evolved gradually into sharper definition.

2. The degree to which Crimson has been able to train the MOP staff has some limitations.

3. Crimson can and does negotiate effectively. It has speeded up the privatization process, but there are limits to its ability to do this. It cannot always speed up the MOP. It can only rely on persuasion to convince a potential buyer that the proposed terms are fair. It cannot control the many external political and economic factors influencing a prospective investment.

4. A transition from the present method of operation will be required. The Crimson/D & T contract is up for extension or rebid in September 1993. It is intended that by May, 1994, after the "second wave" of privatization is completed, it should be possible and desirable to switch the Crimson/D & T function over to state-conducted staffing and control. Our recommendations on this are in the body of the report.

5. The successor custodian of privatization, the National Property Fund, has not expressed an interest in being provided the Crimson/D & T service from foreign sources.

6. Many of the past privatizations and those forthcoming may be faced with potential bankruptcy problems in the relatively near future.

CZECH REPUBLIC

Project Title:

CSAEF Assistance (Koli, Cremona, Petroff, Sliver) (# 1183492-94, 1183498)

Introduction:

These were four separate projects, for the purpose of evaluation, to evaluate four SOEs as to their suitability for investment by CSAEF (Czech and Slovak American Enterprise Funds). While the narrow objective was confined to such advice, it was understood and stated that the measure of full success would be the successful privatization of the entities. Cremona and Petroff (and another firm, Amati) are involved in the musical instrument field. (violins, pianos and wind instruments, respectively) -- a field in which the Czech Republic has a position of some world importance. Technical assistance requests were made not by the firms themselves, but by their US distributors.

Koli is a fruit juice concentrate company with interest from a potential US investor interested in the unique taste of local apples.

Sliver is a division of a large conglomerate. It manufactures thread.

An enterprise named Holice was briefly discussed also.

Main Objectives:

1. Provide CSAEF with investment evaluations.

2. Help privatize enterprises.

Results:

Low, since these were relatively small firms and no privatizations resulted.

Cremona and Petroff were held up by a desire on the part of management not to "sell out" and by a conflict between family and management interests, respectively. Amati was just not interested since it already had ties with prospective investors in Germany.

Koli is held up by restitution claims. Sliver fell through. Holice was an MBO attempt, in which no real interest developed for CSAEF investment.

Economic Impact:

Low:

* No privatizations
* Low cost-effectiveness

Project focused on unsuitable candidates with no investment or privatization interest developing.

Impact on Host Government:

Low:

* Neutral response from government
* No known effect on government demand or attitude towards AID.

Allocated Cost (000):

$ 102
81
79
83

Cost Effectiveness:

Low. While the cost of each individual project was low, there were no identifiable beneficial results and the candidates were poor choices for possible privatization.

Ranking:

Low.

Problems/Issues:

1. Technically, part of the objective was achieved in that the enterprises were evaluated, mostly negatively, for future CSAEF investment. But the overall ranking was considered low, since nothing concrete happened.

2. These were early efforts and they suffered from the frequent, if understandable faults of that era: poor, random methods of enterprise selection, without sufficiently early identification of real interest or possibility.

3. It is not intended that this approach will be used in the coming second wave of privatization, especially with regard to small enterprises such as these. If it were attempted, the T.A. might have learned from experience and achieved more concrete results. On the other hand, final privatization might have been more difficult, because many such enterprises would now be closer to bankruptcy.

CZECH REPUBLIC

Project Title:

Non-Ferrous Metal Companies (# 2622107)

Introduction:

This involved the selection of four SOEs from the metallurgy industry for privatization. The four candidates were subsequently reduced to three, of which one was a fair prospect, the other two were not.

The most likely prospect was Bridlicna, a moderately sizeable aluminum rolling mill with 500 employees. The other two, Rokusceni and Bruntal, consisted respectively of a foundry producing semi-finished tubes, wire, and strip and a largely vacant zinc and tungsten powder producer.

Main Objectives:

1. Identify and privatize three metallurgical SOEs

2. Identify potential foreign investors.

3. Assist each in its operations.

A basic objective was to produce, early on, a privatization "success story". This was the Czech Republic's first and only attempt at what was in affect a variation of the sectoral approach.

Results:

No privatizations have occurred, although one is at least possible although perhaps not probable. Identification of potential foreign investors was accomplished although without end result and there was some assistance to the operations of the enterprises.

Bridlicna had a fairly good market position although it suffers from some technical and environmental problems. Investors were seriously interested. Progress has been stalled for some time. AID work was finished up, but an information offering memo has not been prepared.

The other two enterprises had a lot of problems and unrealistic expectations and goals. Help was rendered, but the contractor informed AID that further expenditure would be a waste.

Economic Impact:

Low:

* No privatizations as yet; limited potential number
* Low cost-effectiveness

No privatizations have occurred or are very likely

Impact on Host Government:

Low:

* Government has lost interest in this project

This assignment was in large part politicized as the Government allowed a junior governmental official to decide which firms would receive assistance. It turned out that these selections were not very promising. The Government has either been dissuaded by this diagnosis or has lost interest.

Allocated Cost (000):

$ 710

Cost Effectiveness:

Low.

Ranking:

Low.

Problems/Issues:

1. The method of identification of privatization candidates was poor in two respects: a) The designation of candidates was random, signifying poor cost-effectiveness, and b) was plagued by the mixed motives that are sometimes a characteristic of candidates pre-designated by the government.

2. At first glance, this looks like a sectoral approach. It was not consciously designed as such, since the focus of the project was on responding to a government official's interest and not the sector for which he was responsible. It did, however, suffer from many of the ills of that approach, including a long start up time for the contractor to become familiar with the industry.

3. These were much more "work out" situations than attractive investment opportunities.

CZECH REPUBLIC

Project Title:

Czech Savings Bank (#2622108)

Introduction:

1. Czech Savings Bank (CSB) should be recognized as a unique client, uniquely capable of fulfilling an important role in the financial and investment sectors.

-- It is most influential, being the largest savings bank in the country and having achieved the largest share of the citizen deposits of privatization vouchers.

-- Its operations are massive. Its Investment Department, with which this project is primarily concerned, had four employees at the start of the first wave of privatization and is now at 100. Of these, 25-30 are investment analysts with future staffing projected at 40-60 persons. In addition, under the Mass Privatization Plan, some 400 stocks will need to be followed plus another 200-300 eligible for possible trading investment. CSB will have by far the largest portfolio.

In addition to all this, an extensive dealer organization must be created, maintained and trained in working relationships.

2. The volume of transactions to be dealt with must be estimated with reasonable accuracy and all of the bank internal regulations and procedures for handling this mass of transactions must be designed and put into operation.

3. In addition, there are some 300 existing government regulations that must be abided by.

4. A massive computer network and program to handle this must be procured and programmed, with employees trained in its use.

Main Objectives:

1. Help set investment fund objectives.

2. Assist in "back office" procedures.

3. There is need throughout for a sizeable and complex employee training program. The entire project can be looked on as a massive training program.

4. Parallel to this, there was, from the outset, the need to set up accountancy to make these operations possible and orderly. Only Westerners would have experience in doing this.

5. There is also a need for major training in corporate governance, since CSB, in its position as the largest lead fund representative, will carry the principal burden in this area as well. There has been little training yet in this area, except that under this same project a different contractor has repeated a number of short seminars in "corporate crisis management" that are much needed and have been well received.

6. Many of the same employees will need training in credit capability and there is work to be done in bank reorganization, since the CSB is shifting from being a savings bank to one that will also be an investment bank. It has been arranged that the latter activity will be handled by the US Treasury (with AID funds) and the former will be accomplished by a commercial contract with the same contractor doing the CSB training work.

7. The PIOT also specifies that foreign payment processing procedures will be established.

Results:

Setting up investment fund parameters is accomplished and continuing. The transactions resulting from first wave privatization transactions were adequately estimated and provided for. "Back office" procedures are working. Provision for all other objectives (with the possible exception of #7 not yet being addressed) has been made and is in process.

Economic Impact:

High:

* Established operational procedures and structures which will facilitate mass privatization program.

The impact of this program is very high. The first wave of the mass privatization program is a very comprehensive and dynamic program. The impact is both tremendous and orderly; it could not have been accomplished without AID assistance.

Impact on Host Government:

High:

* Both the government and client (CSB) greatly appreciate the services
* Client has requested additional services

The Czech Government appreciates fully the magnitude of the task and the competency with which it is being handled.

It is significant that this program was conceived and proposed by the contractor.

Allocated Cost (000):

$ 1,816. This project is by its nature major, and therefore costly, but well worth it. It is also of long duration. The contractor estimates that completion will require at least five years and perhaps even longer for the corporate governance portion.

Ranking:

High. Perhaps the best compliment to the program is that it is being widely copied in the NIS and elsewhere.

Problems/Issues:

1. Several persons have raised the question whether objectives, operating procedures and training programs have been spelled out in enough detail. This is a valid observation. We note that training programs are, relatively, moderately well structured and set forth in detail.

2. The start up of the program, by the contractor's own evaluation, was a bit slow. There was much more than the normal amount of background knowledge that had to be acquired by contractor and employee alike.

3. There is some conceptual difficulty over the fact that our assistance is advantaging one competitor to the disadvantage of the others, and that the beneficiary of the assistance is the strongest competitor in the field. There also is the forthcoming problem of the potential conflict of interest between the CSB employee as an enterprise director and his role as a fund manager. CSB will attempt to deal with this by "chinese wall" techniques.

4. The volume crush from the first wave of privatization will be equalled by the second wave of privatization that needs to be handled with equal competency.

5. The anticipated wave of forthcoming bankruptcies will pose problems for both fund manager, director, and enterprise manager alike, as well, of course, as for stock trading and a stock exchange. It is anticipated that the originally assigned value of the vouchers is low enough to accommodate any "water" in most balance sheets, but of course trading prices will be affected, probably unfavorably.

Project Title:

TA for Ministry of Economics for Management Contracts (# 1183108)

Main Objectives:

Identify candidate SOEs where there is a need for restructuring preceding any possible privatization and let out management contracts to accomplish this. The contracts might conceivably be let to present management, but more likely to outside persons or teams, for whom a financial sharing in the operating improvements accomplished would be arranged.

Results:

Some candidates were surveyed but contracts have not been authorized or let.

Economic Impact:

Unknown.

The exact status of impact is unknown because the project is very much on the back burner, but it is probable that it is very low since no significant milestones were attained.

This was in any case a very small project.

Impact on Host Government:

Unknown, but probably low.

There was considerable delay in authorization from Washington, not expected by the Czech Government, which added to the Government's disappointment with the project. Also, in a development that is not necessarily related to the delay, the Government is no longer interested in the management contracts or the restructuring aspects of the project, but merely in getting the candidates privatized.

Allocated Cost (000):

$ 73.

Cost Effectiveness:

Very little, but low cost.

Problems/Issues:

1. This was an experimental program. Experience in other countries shows that projects to restructure have a very low success record, so the experiment was somewhat dubious in any case.

2. The program has been delayed, at first by AID as a result of late authorization, then by the Government which has lost interest in the concept and has therefore changed the scope of the project.

CZECH REPUBLIC

Project Title:

Utility/Telecom Sector (# 1183496)

Introduction:

Work in this area has been principally in Telecom, with some progress in the power sector as well.

Telecom: The contractor did a short early study of the regulatory framework to be applied to Telecom that was later referred to frequently as a useful background paper.

The first moves were organizational. First, the postal service was separated from Telecom, since it is not a candidate for privatization. Then Telecom was split into its two natural units, telephone operations (SPT Telecom) and the State Administration of Radio Communication, Spravada (SR), which is the transmitting network providing services on microwave. This is, of course, a classic split. JP Morgan has been appointed advisor to SPT, by means of a private contract, and Deloitte & Touche was concluding a similar arrangement with SR at the time of our visit.

Power: 30% of the power company has been privatized by means of the first wave voucher system. Power distribution operations have been privatized.

Main Objectives:

The Government wishes SR to be privatized; it expects the state monopoly of the telephone system to continue for a while. It is resisting surrendering control of the power generation network.

Following on the early regulatory survey of Telecom by the contractor, the objectives, in sequence, are:

-- Complete the regulatory framework and set up in operation the Government regulatory body.

-- Secure essential loans from the World Bank and the EBRD.

-- Complete organizational split preparatory to raising capital at the end of 1993.

-- Proceed with privatization.

Progress has been slow and will continue to be at a slow pace given the need for raising very substantial amounts of capital.

There are a number of important regulatory concepts that need to be finalized, for example, regulation to introduce competition and anti-monopoly concepts.

The contractor's immediate assignment for SR is to conduct an audit, make market valuation, and find a foreign partner.

We view this assignment as a special kind of sectoral study in the firm-specific category. Of necessity, it also has strong policy/program overtones.

Results:

Initial regulatory background study has been completed. Program for SR as outlined above is in process.

Economic Impact:

Medium:

* Regulatory framework defined

Initial results have been understandably limited and as yet there has been no major economic impact. The program is moving along and significant results are expected.

Impact on Host Government:

Medium:

* Government willing to pay for additional services
* But, Government expressed some doubts about using the contractor to identify foreign investors.

GOCR's is its willingness to sign a contract for continuing services with the contractor under which it will pay future costs is a reflection of the Government's satisfaction with contractor performance.

It is felt that AID assistance has made a difference in that forward movement would probably have occurred, but more slowly, without it.

Allocated Cost (000):

$ 683.

Cost Effectiveness:

Medium, outlook favorable but not yet determinable.

Problems/Issues:

1. Privatization in "strategic sectors" like telecom and power is especially difficult, usually subject to much governmental hesitation, and has an especially long time frame.

2. Special care is also needed in the selection of a foreign partner.

3. There is a special need for multinational coordination among consultants, donors and loaning institutions. Given the magnitude of capital requirements, the presence of many of all of these institutions is essential. They will naturally, on occasion, have differing views as to what ought to be done and resolution can be difficult and time-consuming.

148

Project Title: **CZECH REPUBLIC**

Skoda-Pilsen (#1183489)

Introduction:

Skoda-Pilsen is a huge conglomerate employing 38,000 people and dominating the city of Pilsen. Its principal product divisions and the principal sources of major losses are nuclear power, power equipment, and locomotives.

Skoda-Pilsen was created very much in the Soviet style of organization. Moreover, it is in businesses of which some, notably nuclear power, are very difficult to conduct profitably. It was, therefore, almost inevitability inefficiently run and still is.

Main Objectives:

Original objectives were to survey the SOE operations to determine where and whether there were "jewels" that would be appealing for foreign investment, and at the same time to make a general survey of operations to determine into what component parts the SOE might be restructured and how the components might evolve in a master privatization plan.

Later, the objective was to locate and evaluate various investment "deals" of which there were at least three requiring major consideration. Work on all these tasks has been concluded. Still later, and the only open current project, is to revise the structure and organization of the Tool Division so that is can later serve as a model for privatization.

Results:

No privatization has resulted nor is any privatization plan under active consideration. A master break-up plan splitting the company into four major parts was prepared by the consultant and stated as agreed to by the management. A few minor organization changes ensued, but at this point, both government policy toward privatization of Skoda-Pilsen and a management change of CEO, both less favorable to privatization, were installed.

The accounting changes in the more recent Tool Division project are in process. Changes in sales activity and other reorganization changes are planned but not ready to be implemented for some time.

Economic Impact:

Low:

* No privatization has occurred; underachieved project targets.
* Low cost-effectiveness.

Since there has been no definitive major action, and no privatization has occurred, economic impact is low.

The consultants found that Skoda-Pilsen was in fact bankrupt, a conclusion not disagreed with by Government or management.

Impact on Host Government:

Low:

* Project has not changed government attitude towards privatization.

GOCR has been irresolute in its attitude toward privatizing Skoda-Pilsen. It is understandably concerned about the impact of unemployment from this major employer. It has, at two critical junctures, changed the CEO, the first time downgrading the caliber by substituting a non-performing political appointee, and second time removing him for non-performance.

Allocated Cost (000):

$500. This could have been more, but was wisely narrowed substantially in scope when positive results were not forthcoming.

Cost Effectiveness:

No results, therefore low. Some benefit may be derived from the Division work but this is secondary in the larger picture. Prospects for overall change in the foreseeable future are poor.

Ranking:

Low

Problems/Issues:

1. The Government's overriding concern is the unemployment issue potentially facing this enterprise. This seems to have periodically paralyzed the will to act.

2. Skoda-Pilsen has a massive debt load that results in its de facto bankrupt position. This is caused by the losses from the major product lines and the unwillingness or inability of its customers, also government-owned, to pay their debts. Hanging over all of this is the fact that there has been no work-out plan for Skoda-Pilsen's bankruptcy, and at least until recently no law or mechanism making workout feasible. AID has been among those urging that this bankruptcy problem be addressed and in fact it is probably not possible to deal with the restructuring of SOEs like SP (there are at least five) until this Policy/Program issue is first dealt with.

3. Skoda-Pilsen has had critical periods in which is has not had good top management.

4. This kind of a complex of operating and financial problems, all with strong political overtones, is typical of the state of the large, Soviet-style conglomerates in Eastern Europe. As discussed in the body of the report, it is this condition that makes it so difficult to produce privatization or other economic improvements in projects that are large firm-specific privatization projects.

5. Certain of the specific investment deals proposed to SP that consultants have been asked to evaluate involve questions of fairness and transparency. MOP currently recognizes this.

6. The current limited assignment with the Tool Division is so secondary to the overall problems of SP that whether work with this limited scope should continue is questionable.

7. These kinds of large scale assignments that can and should have clear objectives are appropriate to be funded by cost-sharing. In the case of Skoda-Pilsen, feeling in some employee quarters has been reported that the advice is free, so there is no motivation to action.

Project Title:

Glass Sector Study (# 1183490, 2622122)

Introduction:

This is a sectoral study. The sectoral study approach has been predominant only in Poland and it is described and discussed in the report. Sectoral studies have been let to and performed by AID contractors and for other donors as well. The Glass Sector study was one of the first to be commissioned and was one of the more complex.

There are 34 enterprises in the Polish glass industry, divided into several segments. 12 of the 34 have been identified as potentially attractive to investors. Most of the work has been on the privatization of Sandomierz, one of the largest glass concerns that will, when completed, be the third largest privatization to date. We also inspected Krakzklo, a smaller concern, but the largest mirror company in Poland. Reference is made here to each of these. A few other privatizations can possibly be expected.

Sandomierz: The company is a $ 20 million (US dollars sales) concern. The dominant party in the privatization is the British company Pilkington, who is committed to invest $ 170 million to create a new flat glass plant, which will be the second and largest in Poland. They will do this by licensing their patented float glass technology for the new plant, which will be a major technological step forward for Poland.

MOP concluded that the privatization route to be selected would be liquidation, to be preceded by transformation, now accomplished. Ownership in the reconstituted privatized company will be 40% to Pilkington, 30% retained by GOP, and 30% held by the three loaning institutions, IFC, EBRD, and a Polish Bank. This was the first privatization to be attempted by liquidation. The procedure is complex and it is time consuming, in part because of the public tender and other transparency requirements.

This privatization plan had actually been preceded by a plan for an MBO by management, with ownership shared between them and the other parties. Of course the management of Sandomierz would have preferred this route and much time was spent trying to arrange it. It turned out not to be possible because of the IFC's insistence that ownership be backed by equity to a degree not financially possible to the management.

At the time of our visit, 13 detail agreements remained to be finally settled upon and signed by all parties. It was hoped, but not assured, that this would be routine.

Krakzklo: In this privatization process, MOP has also adopted the liquidation-transformation route and Krakzklo has passed through the transformation process. As a result, there is a new Board. 20% of the ownership has been reserved for workers at a 50% price discount.

Negotiations are now at the stage where eight bids have been received with two finalists, the others having been rejected as non-responsive.

Krakzklo is operating reasonably near capacity, but has a bad equipment imbalance and needs sizeable capital input.

Main Objectives:

To go the full privatization route with as much foreign investment and as many privatizations as feasible. It is hoped that with so much ground work covered, the sectoral approach will, in these final stages, be productive and accelerated.

Results:

It is probable that the two subject enterprises will be successfully privatized in the near future. Appendix 3 shows an estimate of approximately three privatizations to be expected from this sector.

Economic Impact:

Low/Medium:

* Limited number of privatizations expected; one of substantial size
* Some gains for the Government in limited number of privatizations negotiated
* Policies and procedures in liquidation privatization pioneered

None yet, but there will be considerable impact if these two privatizations are concluded, and even more if the industry as a whole succeeds in becoming predominantly privatized.

In addition, it appears that a change in industry configuration is emerging. The switch to float glass may become general. One other small flat glass company has already been sold to foreign investors. There appears to be room for about four float glass producing plants in Poland. Several industry participants indicate their willingness to shift to Sandomierz as the dominant future domestic supplier.

Impact on Host Government:

Medium:

* Favorable; moderately positive appreciation by government
* Project moderately increased government attention on project issues
* Project defined conditions for improved fairness and transparency

The nature of the contractor's work for both companies has been that of facilitator, much the same for the whole privatization process as the work of Crimson Capital/D & T in the Czech Republic has been in a more limited application but in a great many more cases. This work was both significant and much appreciated by all parties. Without this assistance, privatization would have been slower, and at least in the case of Sandomierz, might not have occurred.

The role of the Workers Councils in both cases should be noted. The Workers Councils in effect voted themselves out of existence when they approved transformation. One reason they did so was their realization that when the entities were privatized, they would not be subject to the wage controls that apply to SOEs. The other aspect indicating the significance of the role of the Workers Councils is the prominence of guaranteed employment levels in the negotiations.

Allocated Cost:

$ 3,619.

Cost Effectiveness:

While some results are certainly expected, the amount of expenditure has to rank the cost effectiveness of these efforts as low (see discussion of cost effectiveness in Appendix 5). For Sandomierz, the contractor itself concurs in this judgment.

Ranking:

Low to medium.

Problems/Issues:

1. As is covered more fully in the report, the sectoral approach has been of long time frame and expensive. The routes to privatization available in Poland are complex, the liquidation and foreign investment route especially so. Contractors report the sectoral information hard to come by, with SOEs reluctant to surrender the data, with the Government initially wanting to test the expertise of the contractors, and with considerable local industry knowledge needing to be acquired. There were particular complications in the Sandomierz privatization. First, two routes to

privatization were worked on, joint venture and subsequently liquidation (i.e. buyout). A number of conditions were imposed by the loaning institutions. These complications added to time and cost.

2. Given these high costs, it might be argued that in some cases a greenfield approach to modernized facilities might be preferable. This is true, but from the point of view of maintenance of employment, not politically acceptable to government.

3. The necessary industry study required by this approach adds to the time requirement. It was inordinately long in the case of the Glass sector study, which was the first one. Since not all industry participants are going to be attractive to privatization, some of the project work will not produce positive results. This decreases cost effectiveness.

4. Because of continuing high costs and issues as to contract administration, AID/Washington has cut off any further funding of this project. GOP views this as precipitate and is distressed. The contractor hopes to maximize the number of privatizations resulting from this work by picking up a success fee contract from GOP.

5. Recipient appreciation of the contractor's work has been noted. Both SOEs commented that the frequent presence of the contractor on the scene, removed from Warsaw, gave them the feeling of having a "friend in court". The importance of contractor continuity in firm-specific privatizations was further highlighted by the high rate of personnel turnover in the relevant Government ministries.

POLAND

Project Title:

Wood Products and Furniture Sectors (# 2622121)

Introduction:

This is the second major example of the sectoral approach. The Wood sector is more fragmented than the Glass sector, with 54 furniture companies and 16 panelboard companies identified. The industry is labor intensive and export oriented, both characteristics implying potential foreign investor interest, of which there definitely is some from Germany. About two-thirds of the enterprises are under local vovoidship supervision.

In this sectoral study, the contractor made greater use of submitted questionnaire responses and financial data. About two-thirds of the enterprises were visited by the contractor, most only once. We visited the two enterprises currently most likely to be privatized: Czerskie Fabryki Mebli and Goscicinska Fabryka Mebli.

Main Objectives:

To go the full privatization route with as much foreign investment and as many privatizations as feasible. It is hoped that with so much ground work covered, the sectoral approach will, in these final stages, be productive and accelerated.

Results:

No privatizations yet, but several in process. Two are considered in the final stages with two more hoped for soon. Target was eight by June 30, 1993, but this will probably not be achieved.

The two enterprises nearest to being privatized are both being courted by the same German company, whose interest was present even before this sectoral study began. In these two cases, therefore, it is entirely possible that privatization would have taken place even without AID assistance.

Economic Impact:

Low-Medium

* Low number of relatively small privatizations
* Cost-effectiveness very marginal so far.

No appreciable impact yet. There would be considerable impact if the industry became predominantly privatized, although perhaps less than is the case in the Glass industry.

136

Impact on Host Government:

Medium:

Moderately positive appreciation by the government.

Project work well received by participants.

Allocated Cost (000):

$ 2500.

Cost Effectiveness:

While some results are certainly expected, the amount of expenditure has to rank the cost effectiveness of these efforts as low, (See discussion of cost effectiveness in Appendix 5).

Ranking:

Low to medium.

Problems/Issues:

Many of the problems/issues discussed under the preceding case study on the Glass sector are common to this sector as well, especially those that are inherent in the sectoral approach. They are not repeated here; see the preceding case study.

1. The time spent on industry familiarization was cut down significantly from that expended in the Glass sector study, from eight months to two or three, principally due to the more systematic and less pioneering approach that was possible from lessons learned from the first project.

2. There was significant delay, beyond that expected or committed, in authorization and hence in getting started. While in balance this was always unfavorable, in this case, the passage of time did permit an increased efficiency in approach.

3. This sector being a fragmented industry, it was able to escape the many political considerations often present in large firm-specific privatization assistance projects.

Project Title: **POLAND**

LOT Airlines (#2622103, #2622131)

Main Objectives

To help prepare a privatization plan and assist in the privatization. To locate a foreign partner within the industry for investment. Recently, while the scope has not been officially narrowed, consultant assignments have been confined to presentation of the airline to prospective foreign investors.

Results:

The consultant has rendered assistance on a number of component tasks, in varying degrees. There has not been privatization, not is there near-term likelihood. There have been some spin-offs of activity by contracting outside for baggage handling and catering. LOT alleges that this did not result from consultant input. While there has been foreign contact, no foreign investor has been located and the search continues.

There was delay in the authorization, first of the work and subsequently of the IQC mechanism. LOT judges this as critical because initially that would have been negotiating from the results of the good year of 1989, whereas 1990 was not as good.

LOT had initially wanted to use other consultants, especially those with industry expertise, but funding rules, with some justice, prevented this. The first consultant product was not so much a "privatization plan" as it was a diagnosis of restructuring changes needed and with heavy emphasis on operational matters. LOT characterizes the report as sub-standard and therefore not very useful, nor was much of it followed. (Principal informant on this point was the in-house consultant, whose attitude may be biased.)

Economic Impact:

Medium:

* Limited; achieved some project targets. Some spin-off privatizations.

It is significant that the consulting work in this case was let by LOT from a series of competitive bids in which AID was bidding against other firms and other donors. One of its bidding strong points was relative ease of financial access. This was not delivered in full and is stated as one reason for some disfavor in LOT's eyes.

Impact on Host Government:

Medium:

* Neutral to negative response from client
* Project moderately increased governemnt attention on project issues

Allocated Cost (000):

$1,072

Cost Effectiveness:

Low. This is admittedly another complex undertaking; one that has produced some results, if not yet the desired major aim. These results are not in all cases resulting from or in accord with consultant recommendations. This project would have a satisfactory end result if, partly as a result of AID project work, privatization should occur with little or no further AID expenditure. At present, this does not seem likely.

Ranking:

Low to Medium.

Problems/Issues:

1. This is another of the familiar examples of the large scale privatizations that are difficult because of the many cross-currents, not the least of them being political. In this case, while the Ministry of Privatization considers the privatization of and foreign investment in LOT to be in the highest national interest, the Department of Transportation does not hold this view and the airline management does not see privatization as being in its interest. Moreover, the latter two parties did not work well together during this period.

2. LOT is relatively sophisticated in its use of consultants and prefers to deal with those that are especially knowledgeable about the airline industry. Most accounting firms cannot shine with these credentials and at LOT they are therefore at some disadvantage.

3. As a result, the contractor is not close to what are the central concerns of management and has, as a result, been confined to somewhat limited miscellaneous tasks.

POLAND

Project Title:

Bank Regulation and Supervision (# 2622104)

Introduction:

This project consists of policy/program assistance to the National Bank of Poland (NBP). It is significant that the contractor, KPMG, identified the need and proposed the service, which was accepted.

NBP is not directly concerned with privatization, either of enterprises or of banks. The latter is the concern of the Ministry of Finance. NBP is concerned with the links of enterprises to the stock exchange, the financial soundness of the banks, the structure of bank recapitalizations when necessary and the maintenance of appropriate solvency ratios. Policy/program advice has been rendered in these areas.

The contractor has been providing NBP and banks with US model periodic bank reports. Currently, and by agreement, 70% of project time is being spent on preparation of a manual for control of banks, especially problem banks. Three chapters are in preparation, one key one on credit risk, out of a total of 18-24 anticipated. They will be field tested as completed. All of this work has been periodically supplemented by classroom instruction and seminars.

Main Objectives:

1. Initial objective was policy/program assistance in bank control.

2. Currently, the main objective is preparation of the bank control manual.

Results:

1. Policy/program advice and preparation of guidelines, while ongoing, is considered completed.

2. Three chapters of bank control manual in preparation. Some of the later chapters may be sub-contracted.

Economic Impact:

Potentially High:

* First phase of establishing operational regulatory/policy environment for future privatization accomplished.

The impact of this kind of task is by its nature indirect, in that if successful, it strengthens the tools and abilities of the institution being assisted. In this case, the economic impact is potentially high; it is somewhat early to evaluate, but all indications are favorable.

Impact on Host Government:

High:

* Very favorable; greatly appreciated by government
* Project significantly increased government attention on project issues
* Government requested additional services
* Project greatly enhanced AID/US Government reputation

Favorably received by NBP. NBP has stated flatly that the manual could not be prepared without AID assistance. A satisfactory manual is required by certain GOP loan agreements.

Allocated Cost (000):

$ 446.

Ranking:

Medium; potentially high.

Problems/Issues:

1. The preparation of the manual is important, a massive job, and therefore of long time frame.

2. The project is useful not only for what it has done, but also because it leads into important areas to satisfy important needs. The forthcoming need in all three countries, the pending occurrence of bankruptcies, is being dealt with at an early stage in this project. Prudential regulations not yet being dealt with, but needed, are regulations on solvency, liquidity, classification of loans, provisions for loans, and most importantly, the relationship of interest rate to risk.

3. One of the keys to the contractor's successful introduction into these subjects is that their approach included the subcontracting of prestigious, very capable experts to deal with the complex subjects being addressed.

4. This type of assistance, when successful, builds as credibility is established. NBP, recognizing this, wants authority for greater flexibility in its use of the consultants on an ad hoc basis as its needs arise or evolve.

POLAND

Project Title:

Regulated Investment Companies (# 2622110, 2622120)

Introduction:

1. This project is concerned with developing the concept of distributing and trading voucher shares, the method of their conversion into other shares, putting the shares on the stock exchange, setting up fiscal agents, and building up "back office" capability.

2. As contrasted with similar support to the Czech Savings Bank in the Czech Republic, it is more focussed on policies and operating requirements, while the Czech work is more focussed on portfolio management.

3. The policies and procedures for three successive share formats are dealt with: the voucher-shares distributed which are bearer instruments, their conversion into National Investment Fund (NIF) Treasury instruments, and the ultimate individual company instruments.

4. Volume estimates of the requirement for share handling have been designated as essential, as have paperwork requirements and systems for each. Ultimately shares for some 600 companies will exist.

5. A specialized requirement is the handling of the 10% special shares of each company designated for workers.

6. As to corporate governance, the dominant holding fund will have the control position on the company boards. It is intended, unlike the system in the Czech Republic, that the leading fund managers will be experienced foreigners.

7. It is expected that the distribution and conversion of the present round of share certificates will be complete in 1994.

8. The advisors' method of operation has evolved into a committee with each member representing one of the advising firms. The committee meets regularly to advise the MOP or his deputies.

9. In the relatively near future, this same structure intends to deal with bankruptcy problems.

Main Objectives:

1. In addition to the immediate operating objectives listed in 1. above, the contractor has a longer term objective development of the capital market and the steering of it toward the mass handling concepts typical of the US system which can raise large amounts of

capital. Ability to raise such capital will be one of the ultimate measures of success of this consultancy.

2. In the beginning, the objective of the project was more oriented toward fund management, as in the Czech Republic. Actually, Warburg is the GOP prime advisor on mass privatization.

3. The market for the present certificates is estimated to be $200 million which is estimated to expand by four to six times over the next several years.

Results:

All aspects of these programs are in process and on target. It is significant that the advisor is a dedicated individual who is highly qualified in exactly the segment of work that is now the main activity: the creation, distribution, trading and "back office" handling of various securities of voucher origin.

Economic Impact:

High:

* Number of privatizations estimated ultimately to be high
* Policy/legal/regulatory framework in place
* Privatization procedures/structures in place

The impact is, by its nature, of an indirect nature.

Impact on Host Government:

High:

* Very favorable, greatly appreciated by government
* Project significantly increased government attention in project issues
* Government requested additional services
* Project helped establish fairness and transparency

Allocated Cost (000):

$ 916. This has a high cost-benefit relationship.

Ranking:

High

Problems/Issues:

1. The contractor has chosen to interpret the assignment as focussing on infrastructure issues rather than on transactions.

\\6?

2. As the program moves along, the precise kind of expertise needed will change. For example, a future need will probably focus somewhat more on computer capability.

3. This is one of the very few projects where the contractor was changed, in this case, at an early stage and at GOP initiative.

4. It is **important** to note that all this work has been undertaken on the assumption that the enabling legislation would be put in place. Just after our return, the parliament (Sjem) failed to pass the enabling bill and it was withdrawn. Reintroduction in something like the present form subsequently occurred and has just been passed. Up until now all project work has consisted of advance planning and in that sense is **theoretical**, as compared, for example, with **actual practice** in the Czech Republic.

5. Our discussions in Warsaw were confined to possible modifications of provisions that were important but did not change the basic shape of the program. Whether this will still be the case in the future, we do not know.

6. Longer run, it is also possible that there will be more than one wave of voucher distribution and trading.

7. Another future need is the training of a large group of broker salesmen.

8. This program should ultimately evolve into methods of dealing with pending bankruptcy problems. Poland and Hungary are doing more advance planning for dealing with this than the Czech Republic is.

9. As presently constituted, the Polish fund model relies on fund managers of foreign origin to be responsible for corporate governance through their fund holdings. This lessens the severity of the future corporate governance problem, but there will still be many important governance issues to be dealt with.

POLAND

Project Title:

SEC Assistance (# 2622113)

Introduction:

This project is of a narrow and specific focus on financial reporting to be required of publicly listed Polish private companies of which there are 18 listed on the Warsaw Stock Exchange. The project is a training assignment directed toward officials of these companies and employees of the Polish Exchange Commission. As in the US, this is an independent regulatory body.

The work has been accomplished in two sets of organized classroom sessions, conducted by a sub-contracted Polish-speaking professor of US origin. One session was held last fall with two days for two or three officials from each of the listed companies and three days for 25-30 staff members out of the 80 employees of the Commission. This was to be supplemented in April with five day and fifteen-day sessions respectively. (subsequently postponed to July). As a final project deliverable, the contractor will complete and deliver a manual on reporting requirements.

Main Objectives:

The objectives are to:

-- train firm managers

-- train accountants who prepare the statements

-- train some of the staff of the Polish Exchange Commission.

Also, to prepare reporting requirements and to deliver a manual for companies on these requirements.

Results:

The training sessions were held. The manual is to be delivered. We interviewed Commission executives and reviewed some written comments supplied by participants and their verdict was satisfactory.

Economic Impact:

High:

* Established operational regulatory/policy environment
* Established operational procedures and structures; will be critically needed for future privatizations

The impact of these workshops, as with any training assignment, is hard to measure because the impact is indirect. By virtue of the subject matter covered and the reaction of recipients, we believe it to have been high.

There was a delay in starting the program because the contractor had to resolve certain potential conflicts of interest. This delay changed the scope of the program somewhat but does not seem to have damaged it.

Impact on Host Government:

Believed to have been high.

* Very favorable; greatly appreciated by government
* Project significantly increased government attention on project issues
* Projects greatly enhanced AID/US Government reputation
* Project helped establish fairness and transparency

If AID funding had not been available, a course would have been held anyway, but the availability of AID funds made it financially feasible to include attendance by company representatives.

Allocated Cost (000):

$ 478.

Ranking:

High

Problems/Issues:

None

POLAND

Project Title:

Ancillary Assets Privatization (# 2622114)

Introduction:

Ancillary assets are "social assets" ancillary rather than central to the business and consist principally of activities related to employee fringe benefits. In the former Soviet bloc, they were usually acquired and administered in a manner resulting in substantial losses.

Zaclady Azotowe is a large SOE in the city of Tarnow in southern Poland principally engaged in the manufacture of agricultural chemicals. It acquired a substantial roster of ancillary assets that were increasingly a drag on operations.

In early 1991, Director General Andrzej Kasznia, a forceful leader, determined that the enterprise should be relieved of this burden. He asked several ministries in Warsaw for assistance but received none. He decided to move ahead on his own. Midway in the program he was put in touch with the contractor and MOP requested that assistance be rendered. The role of the contractor was one of documenting, of providing a "second opinion", of making comparisons with Western practice, and, importantly, of agreeing to prepare and help distribute a manual making program replication possible.

The Zaclady program is now largely complete. Activities dealt with and their disposition is as follows:

Activity	Disposition
Kindergarten	Donated to the town
Schools	Donated to relevant city school department
4 Holiday resorts	Reorganized into 4 ltd liability cos, still, by design, co. owned. All profits to be reinvested for 3 yrs. Now profitable.
2200 apt flats	1200 sold to inhabitants in first yr. Have raised purchase price but permitted deposit commitments. Later, apts auctioned at higher price.
House of Culture	Transferred to a new Foundation. Run on a business basis. Jobs cut from 52 to 20.
Sports facilities	Donated to sports club, operated on profit center basis. Not all facilities disposals yet resolved.

\\\\?

Restaurants, hotels	Separate companies created, one for each facility.

A manager was put in charge of each entity, sometimes a company employee, sometimes not.

Main Objectives:

1. Recommend and review policies and transactions.

2. Prepare manual and help MOP distribute it so that this SOE experience can serve as a guide for future ancillary asset privatization.

Results:

1. Program validated and completed.

2. While the SOE Director General views the company's role as predominant, there is at least no question but that the enterprise management was the driving force in the program. There were a few differences of opinion between enterprise and consultant; these were all resolved, probably in the enterprise's favor. The consultants' supportive role was important and appreciated and there is every reason to believe the objective will be attained.

3. Manual just recently delivered, distribution has not yet been made.

4. The SOE's program would have been accomplished even if there had been no AID assistance, but the manual, if it had been prepared at all, would not have been as effective a document.

Economic Impact:

High.

* Achieved project targets
* Established operational regulatory/policy environment for future privatizations

Principal benefit will be when the manual becomes a useful guide. During the period of its preparation, there were 10 or 15 inquiries from interested parties.

Impact on Host Government:

High:

* Favorable; appreciated by government
* Project increased government attention on project issues
* Project helped establish fairness and transparency

While the Director General considers the documentation as supplemental to his SOE efforts, he states that it was professionally done and helpful.

Allocated Cost (000):

$ 657.

Ranking:

High

Problems/Issues:

1. In its drive to create the program, the Director General believes that some of the dispositions may have been technically illegal, but he believes no reversals will occur.

2. The key to effective operation of the newly formed units lies in the designation of a "general manager" for each. A supervisory board has been created for each enterprise, one of whose members is a member of the trade union. Mr. Kasznia has a place on each board. The board (or in practice Mr. Kasznia) appoints the manager and sets his salary and can remove him. He receives a fee based on his enterprise's improved financial condition. He has authority to spend up to one-fifth of the enterprise capital on his own, beyond which the supervisory board needs to authorize expenditures.

3. Some of the program had to fight union opposition. It has also been hard to break the workers' attitude that these ancillary assets are "the workers' property".

POLAND

Project Title:

Privatization through Restructuring (# 2622132)

Introduction:

This is a program conceived by MOP as a response to their belief that a number of presently unprivatizable SOEs can be privatized by first restructuring and accomplishing this by letting management contracts, in most cases to outsiders.

Contractor was selected by competitive bidding. In fact, there were two contract lets with programs for two sets of enterprises. The first was won by an AID contractor, the second, on which at least two AID contractors bid, by ITCA, an EBRD sponsored contractor.

The operating steps were conceived of as, first, the preparation of business profiles of the selected enterprises, then soliciting managerial teams through advertisement in the press, and finally drafting and agreement on managerial contracts. Both projects are now at the soliciting stage, the AID project having been delayed in starting and by the need for AID/Washington approvals of certain sequential steps. ITCA has moved faster and caught up.

Main Objectives:

1. Develop methodology for restructuring management contracts.

2. Let contracts to selected candidates from predetermined list.

3. Later, GOP dropped contracts approach and confined objectives to privatizing the designated enterprises.

Results:

Uncompleted. Most of the AID money has been spent and the project is not far enough along for it to complete within budget. The contractor believes that MOP could complete the project on its own.

Economic Impact:

Low:

* Non-existent; underachieved project targets
* Policy not defined and not appropriate for future use
* Procedures/structures non-operational, not defined, and not expected to be needed in the future.

Uncompleted and in our opinion based on experience elsewhere, dubious of success.

Impact on Host Government:

Low:

* Negative response by government
* Project did not change government attention on project issues
* Government curtailed additional assistance

GOP makes the comparison between AID work and ITCA work to our disfavor because of a nine month delay in starting, approval delays in process, and no indication yet of positive results. GOP also contends that the AID project has been comparatively more expensive because ITCA has had greater success using lower cost local consultants.

Allocated Cost (000):

$ 343.

Ranking:

Low

Problems/Issues:

1. EBRD did not experience the same program delays and difficulties that AID did. It should be pointed out that this is definitely not always the case. There have been many cases in reverse where other donor reputations have been hurt or ours have been enhanced.

2. Selection of target enterprises was government-designated and apparently at random, with all the difficulties in this method of selection that the body of the report identifies. AID was directed to five enterprises of which the contractor now identifies three as very good and hopes that they will be privatized. ITCA was directed to 20 enterprises of which they were told to select 10.

3. We have indicated that we think the chances of success in this project, even if smoothly executed, are dubious.

4. MOP from the beginning viewed this as a pilot experimental project. It has, at the current stage of the project, changed its objectives. Partly because of delays, but mostly for other reasons, it now deemphasizes the management contract aspects and its prime objective now is to see the enterprises privatized.

Project Title: **HUNGARY**

SPA Assistance, #0183470, #1183479, #1183482, #3622073

Introduction:

In late 1989, in order to get an early start, assistance requested by GOH was responded to with an analytic study that resulted in creation of the State Property Agency, and described its recommended duties and procedures.

This evolved into a program of continuing support and assistance rendered by a Long Term Advisor. Charles Twyman arrived early in 1990, before SPA was officially created and as its fourth employee.

Mr. Twyman estimates that his time over the past three years has been spent, in descending total amount of time, on the following activities: a) development of information systems, b) establishment of operating procedures and processes, c) support for other programs e.g. self-privatization, Investment Promotion, d) procurement of equipment, e) providing counselling and advice to top and middle management levels, and f) assistance in donor solicitations. Analysis of his work tasks support this breakdown. More recently, the advisor and sub-contractors have been involved with new initiatives of Pri-Man on self-privatization and with assisting the Controller of SPA to exercise financial control over cash management. Most of the above tasks involved a training component.

Of the three long-term advisory assignments, one in each country, (Czech Savings Bank, Regulated Investment Companies, SPA) their degree of focus is in that order, with the tasks performed for the SPA being the most diverse and the most ad hoc.

Main Objectives:

The broad objectives were to put the State Property Agency (SPA) arm of Government created to encourage and also regulate privatization, in operation with established procedures operating under sound policies consistent with Government objectives.

Initial work dealt with the concept of the Agency, outlining its basic policies and methods of operation. It was established early that consultancy was most effective if provided by a long term advisor (LTA) in continuous residence. This advisor, Charles Twyman arrived early in 1990.

At first, when the activity was starting up, the work was heavily in the Policy and Programs area. As the project matured, it increasingly took on the character of Institutional Support.

JV

Results:

The policies of the SPA have been put in place and have stood up without major challenge. Operations proceed slowly but systematically. Computer equipment has been purchased (an AID function unique to Hungary) and operates smoothly. Every SPA employee we spoke to on the subject was highly complimentary on the work that has been done. As a "facilitator and implementor", the LTA broke a many log jams.

Economic Impact:

High:

* Established operational regulatory/policy environment for future privatizations
* Established operational procedures and structures

As a service that is now principally engaged in providing institutional support to the SPA, and because of the diverse nature of the services provided, this project is especially hard to evaluate. That the SPA has had a major impact in shaping Hungary's privatization program in undeniable (see further discussion below). It is almost equally clear that the LTA has had a major part in shaping and operating SPA procedures, this conclusion being reached by common consent.

Impact on Host Government:

High:

* Very favorable; greatly appreciated by government
* Project significantly increased government attention on project issues
* Government requested additional services
* Project greatly enhanced AID/US Government reputation
* Project helped establish fairness and transparency
* AID project funds greatly leveraged other agency funding

Most tasks set as objectives have been accomplished and with reasonable speed. GOH reaction, as noted, very favorable.

Allocated Cost (000):

$4,401 over a three and two-thirds year period. Money well spent; providing along-term advisor, by its nature, is more expensive than most finite projects, involving considerable family and office support.

Ranking:

High. As indicated elsewhere, work in the Policy and Programs and Institutional Support areas, is, by our terms, indirect in its ultimate influence on privatization.

Problems/Issues:

1. SPA has been widely accused of being bureaucratic and there is some justification for this. Did the operations of the LTA and the procedures for which he is responsible contribute to creating this bureaucracy? It is our opinion that this is not the case. We think it is caused rather by the intention of the parliamentary-controlled government to regulate in considerable detail (now loosening up somewhat with the new self-privatization programs). In support of this opinion, is the fact that most "top-down", government-instituted privatization programs have turned out to be cumbersome in most countries.

2. There were some delays in authorizing the various phases of the LTA program. Since authorized funds to conduct the work were available, delay was in the renewal of the LTA's contract, during which waiting period he was able to keep working and no serious disruption to programs occurred.

3. Included in the above expenditure is about $200,000 for training, this being in about the same proportion as allocated overall out of the $31.3 million. But this training is commendably more formalized and much more structured than most other training tasks in the three countries. In addition, there is also a strong component of ad hoc on the job training.

4. It would be desirable if the service could be more at the forefront of new initiatives. GOH new explorations in various forms of self-privatizations programs and in formulating a possible mass privatization program are two good examples. We are providing some important, but none the less secondary support for the evaluation of self-privatization consultants and through COMPASS hope to work in the second area. One practical limitation, of course, is that GOH must respond favorably to proposals for assistance.

5. SPA is intended to have a finite life, the majority, at least, of its activities ending sometime in 1994. The present LTA contract ends September, 1993. There are two alternatives: transfer the service to another jurisdiction, most likely the Office of the Minister in Charge of Privatization, or terminate the service. Our recommendation, covered in the body of the report, is to explore the first alternative this summer, but if this is not worked out, to terminate.

HUNGARY

Project Title:

Monor State Farms (#1183480, 1183495)

Introduction:

Monor is typical of a certain sector of Hungarian agriculture when, under the Communist Government, a portion, but not all of agriculture was organized into 120 state farms. The biggest of these was Balbona, which tended to be the preferred enterprise to receive favorable GOH treatment and awards.

Under the communists and today, agriculture is a preferred sector of Hungary's economy. It accounts for 52% of GNP and can be reasonably competitive in world food markets.

Monor is about average in size, consisting of 11-12,000 hectares (one hectare = 2.2 acres) originally with about $ 12 million of revenue, although more recently it has declined substantially from that level. Again, typical of state farms, about 50% of its activity was in agriculture-industrial pursuits, including food processing, pet foods, gas stations, and a foundry. It was specifically attractive because 25% of its business was export, principally to Italy.

The contractor was selected because it had access to AID funds and could start a project without delay, which it did. The assignment was to make a business assessment, prepare a privatization plan and see the enterprise through to privatization.

Monor was selected as the pilot privatization because it was typical, because it had a management that was capable and was pro-privatization, and because there was a privatization study and plan already in existence from an earlier time, although it was by then considered flawed and has been rejected.

To understand the Monor situation and this earlier plan and its flaws, it is necessary to be aware of the practice, widely practiced under the Communist Government, of "zak choport". The laws regulating Enterprise Council (i.e. workers councils) enterprise permitted creation and unrestricted operation of subsidiaries. Monor was eligible for and engaged in this widespread practice. In reality this was a way for management to deal itself an unrestricted, and usually graft-ridden opportunity and it resulted in a syphoning off of assets from the more closely state controlled parent enterprise. The prior study recommended continuation of this activity in a series of joint venture forms and this approach was to be banned when the democratic government came in.

Preparation and submission of a new privatization plan proceeded, but so did a number of high level events, including national elections, land laws, change in party control of the Ministry of Agriculture, and later, the enactment of the bankruptcy law. In the end, this left Monor in the following untenable position:

-- a change in the Ministry of Agriculture's attitude to being anti-privatization for state farms. Therefore support for the program to which Monor was committed was withdrawn.

-- a worsening of farming conditions such that the financial condition of Monor was seriously impaired, and, with the later passage of the bankruptcy law, declaration of bankruptcy was mandatory.

-- Monor could then not extricate itself because, being on file for privatization, it could not legally sell off any assets.

-- as part of the change in command at the MOA, there was wholesale replacement of state farm managers, with the general manager of only Balbona, Monor, and one other being spared. A little later, however, the capable manager was replaced by an incompetent party functionary who fit the new mold of being anti-privatization.

Monor's operational health has continued to decline and it cannot presently be financially considered as a viable privatization candidate.

Main Objectives:

The original objective was to privatize Monor and have this serve as a model for other state farm privatizations. This intent has been abandoned.

Results:

Not privatized, attempts abandoned.

Economic Impact:

Low:

* Non-existent; underachieved project targets
* Policy/regulatory framework not defined, not expected to be used in future
* Procedures/structures non-operational, not defined, not expected to be used in future

It should be noted that this project displayed an almost textbook case of the various political, economic and management problems that can impede privatization. Later, it also brought to light the various problems of impending bankruptcy.

176

Impact on Host Government:

Low:

* Project negatively affected government attention on project issues
* Government curtailed additional assistance
* Project had no effect on improving fairness and transparency

Small Holders Party, one of the GOH coalition partners, and speaking primarily for farmers, has been unfavorably inclined to state farm privatization. The replacement manager was a politician from that party.

Allocated Cost (000):

$ 265. While this project was not completed, the money spent would not have been inordinate. It is variously estimated that at a certain time from $100,000 to $300,000 would have been sufficient funds for completion. It should be noted that AID did also spend $687,000 in a co-sponsored, closely related product to privatize, all the state farms.(State Farms ACDI #2622101)

Cost Effectiveness:

Low, because there were no beneficial results.

Ranking:

Low

Problems/Issues:

1. Of the three countries, Hungary has worked the least with firm-specific or sectoral assistance. This project has, of course, not enhanced this approach in the eyes of those on the scene.

2. Monor is a prime example of the difficulties that arise when there is an absence of political will or a major change in government attitude or objective. These obstacles were insurmountable. Monor was caught committed to a plan that had no backing.

3. Monor was inflicted, at just the fatal time, with politicized, poor top management.

4. For a brief time, however, there did exist a "window of opportunity". If, in the light of hindsight, early progress could have been speeded up, privatization might have gotten through before the climate changed.

5. This was an early pilot program. Early pilot programs can easily contain extra hazards. Keeping this and the other external

factors in mind, the program, at least in its application specifically to Monor, was fortunately not unduly expensive.

6. Monor was also caught up in a number of larger-issue economic factors: credit interactions, debt restructuring, and bankruptcy. Monor might possibly have restructured to get out of bankruptcy and into privatization, but the declaration of bankruptcy under a new, not well-understood law, frightened away potential investors.

7. There was severe jurisdictional disputes and difference of outlook and objectives between the Ministry of Agriculture and the ministry in charge of privatization.

8. Monor was initially a good candidate for privatization, but by now is a spoiled enterprise where the chance for privatization has passed.

HUNGARY

Project Title:

ESOPs Program (# 2622112)

Introduction:

An ESOP (Employee Stock Ownership Company) company is an enterprise that is structured to have substantial employee ownership. A trust is set up whose credit is employees' future earnings and which can borrow buy-out money with this credit. For an ESOP to attain its full meaning, one of its features is the tax advantages to various parties, including the employees. U.S. ESOPs had their origin in US tax law, and contain these features. The Hungarian law also contains these features.

The assignment given to the contractor was a) prepare model statutes, b) prepare form of loan guarantees, c) prepare drafts for forthcoming legislation, d) hold a series of conferences to promote the concept, e) provide training for those involved.

The following are sources of funds to the ESOP:

-- 10% of the stock to the employees at a 90% purchase price discount.

-- Beyond this, a 50% discount up to 10% of total capital.

-- 20% of profits. This can be used either to credit against the loan payment due the bank or to pay for blocs of shares to SPA, the GOH owner.

-- employee dividends.

Average overall pretax credits for a sample of the initial ESOPs is 30% to 40%. There will also be, increasingly, lower interest cost.

Main Objectives:

1. Assist in structuring the ESOPs law.

2. Assist with Esops privatizations

Results:

1. Law passed and is adequate.

2. 20 ESOP authorized, more on the way. This exceeds expected objectives. Most applications have been in the retail sector and for smaller service companies. Government almost always remains a co-owner.

3. ESOPs are much more difficult to put into operation than it might at first appear. There are a great many cross currents in such programs and a great many different influential points of view. Hungary is only the third country in the world, after the US and Great Britain to have a full-blown, tax-benefit ESOP law. Appreciation of this fact makes the achievement just that much more impressive.

4. The contractor wisely put his major early emphasis on the legal aspects: devising statutes that could be passed. Any time spent in devising ESOPs is largely wasted if an ESOP law is not going to be passed.

5. Devising ESOP laws and regulations and crafting the actual individual ESOPs is a highly technical undertaking. The contractor applied first rate specialized legal talent.

Economic Impact:

High:

* Significant; achieved and exceeded project targets
* Significant gains for the governemnt
* Established operational regulatory/policy environment
* Established operational procedures and structures

Will be considerable and cumulative as time goes on. Degree of momentum that will build is currently not known.

Impact on Host Government:

High:

* Very favorable; greatly appreciated by government
* Project significantly increased government attention on project issues
* Project greatly enhanced AID/US Government reputation
* Project helped establish fairness and transparency

It can be argued that the political benefits of the presence of ESOP programs is just as important as the economic benefits. Such benefit has been attained. In most countries, many government officials are apprehensive about ESOPs, especially majority-controlled ESOPs. Average in the US is for ESOPs to be about 15% of total share capital. The political pressure is stronger in these countries and consequently the ESOP percentage in Hungary will be higher, probably between 30% and 35%.

Trade unionists especially often have initial negative reactions to ESOPs.

Allocated Cost (000):

$ 424.

Ranking:

High.

Problems/Issues:

Primary needs for the ESOP program will soon change in emphasis. A forthcoming major need is the development and procuring of software to handle ESOP processes.

Project Title:

COMPASS Project (# 2622133)

Introduction:

COMPASS is a new-initiative privatization program. It took its name from its original intent: Committee for Mass Privatization in the Agricultural Sub-Sector. The project was devised by privatization officials as a response to Government Decree # 3592 that methods be devised to speed up privatization. The project was to report to a "think tank" originally set up to report to an advisory council to the Ministry of Finance. It was at first to concentrate in the agricultural sub-sector to increase the demand for agricultural assets, importantly excluding land. Potential demand for investment was assumed to be heavily concentrated in food processing.

GOH approached AID to participate in developing such initiatives. AID money was transferred over from funds unused for Monor projects. There have been organizational changes and the activity now reports to a specially created department in the SPA.

The most developed program to date is one called "leasing the shares". This is a form of management contract with the fee structured so that at the end of the lease period ownership can transfer to the lessee at zero cost. Lease period would be six to ten years, with the fee designed to cover the purchase price and with the quarterly payments to be indexed at half the inflation rate. Eight management contracts have been allowed as an initial program and seven of them have now been contracted out.

A related natural successor program, not yet authorized or funded is IMPACT, standing for Improving Privatizations to Accelerate the Closing of Transactions. At present, this is no more than the commitment of additional staff time to develop new initiatives. Another program to be developed is "Privatization through Asset Management" to be designed to deal with those SOEs that are near bankruptcy.

Another important not yet developed program is a voucher credit notes program. Using the word "credit" in its name reflects the GOH conviction that if and when a voucher program is implemented, recipients will have to pay more than token amounts.

Main Objectives:

To help devise and implement new, fast-track privatization methods.

Results:

Too early to determine.

Economic Impact:

Too early to determine.

Impact on Host Government:

Too early to determine.

Allocated Cost (000):

$ 294. If successful, this would probably be a first phase.

Ranking:

Too early to determine.

Problems/Issues:

1. The creation and letting of this project is in response to a political situation. There is pressure to speed up privatization, make implementation more flexible, and make it more appealing to domestic ownership even at the expense of foreign investment. There is especially strong public interest in a voucher distribution.

2. The GOH-responsible group estimates that from now on out, only 25% of privatizations will be by the traditional routes involving all cash and 75% will be from these new initiatives currently being crafted. This seems optimistic to us. However, if successful, it could help close the gap that currently exists between GOH's original privatization timetables and the present rate of progress, which, without new methods to accelerate, will clearly fall short.

3. It is intended in all or some of these programs that investors can use compensation certificates (restitution awards) and/or vouchers.

4. This program is new and clearly in an experimental, exploratory stage. It was intended that the new initiatives be under way by March 31, 1993, a deadline that was not met.

5. Crafting of the new initiatives has strongly featured questionnaires and field testings to determine what citizen beneficiaries want.

6. "Leasing the shares" and perhaps some of the other programs are clearly ways of getting around to installment sales which the GOH had previously shunned.

7. While leasing will be legally open to anyone, it is clearly designed as a program to appeal to domestic investors.

8. It is encouraging and important that AID is involved at the creation of these new initiatives. In the body of the report we

have remarked that taking chances that are still financially modest is desirable in these cases.

9. Request for authorization as a no-cost extension was sent to AID/Washington in mid-December. As of mid-March, approval had not yet been received. There are several options as to how to authorize and implement but how this will be done and what its implications are is still unclear.

184

HUNGARY

Project Title:

Financial Sector Redeployment (# 3622071)

Introduction:

This is a program urgently requested by the Minister of Finance. Appeal was to AID in hopes of quick response. There was, however, a delay in authorization of six months.

When AID-financed experts were then put in place, they were high-level and extremely well qualified, especially to deal with the fundamental policy matters that are the subject of this project. Three experts came to Hungary three times, each staying about a week.

The program proposed was a program of change-off of government loans to SOEs to be replaced by Government bonds. Work-out is proposed, with any ultimate loss borne by the GOH. Given the lateness of timing, this was the that time completed not so much a new proposal as it was a critique and amendment of the new Minister of Finance's program.

A now-proposed new 1993 program deals with:

- -- bad loan work-outs
- -- creating bank regulatory capability with "teeth" to enforce regulations
- -- attention to the asset side of bank balance sheets; who finances companies and how?
- -- loan agency structure.

Contractor views this as a three year program. It had not yet been authorized at the time we left.

It is understood that on the US Government side, primary responsibility is with the US Treasury. A Treasury representative is the primary on-site advisor. AID is funding him and the project.

Main Objectives:

For the 1992 "Phase I" program as it evolved, it was a critique with proposed alterations of the MOF's loan consolidation program. The 1993 "Phase II" program has to do with work-outs and loan disposition.

Results:

Phase I valuable. Although late, some of the recommendations could still be adopted.

Economic Impact:

Medium:

* Significant; achieved most project targets
* Significant gains for the governemnt
* Establish operational regulatory/policy environment

This kind of policy/program assistance is always indirect in its impact. It was very sound and valuable work but is still considered medium in its impact. This was due to the fact that in order to achieve "high" impact the assistance should have been more timely.

Impact on Host Government:

High:

* Very favorable; greatly appreciated by government
* Project significantly increased government attention on project issues
* Government requested additional services
* Project enhanced AID/US Government reputation
* Project helped establish fairness and transparency

GOH listened to advice and altered its plans to some extent.

Allocated Cost (000):

$ 328.

Ranking:

Medium tending to high because of importance of subject matter.

Problems/Issues:

1. The delay starting this program had a particularly strong impact because:

-- there was an urgent request for speedy response from the Minister of Finance personally

-- given the high-level qualifications of the advisors, these were people who could not be kept in constant readiness waiting for authorization. Therefore, when authorized, there was some further delay fielding competent people.

2. The high caliber of the experts fielded were what made this Phase I project a success.

3. Funding for Phase II should be a very high priority. Such funding should help address the major pending problems of bankruptcy work-out and a controlled and properly regulatory banking system.

Appendix 5 - List of People Interviewed

187

APPENDIX 5
LIST OF PEOPLE INTERVIEWED
(In Alphabetical Order)

I. WASHINGTON, D.C.

A. A.I.D., Bureau for Europe

1. Clark, Mari -- Evaluation Coordinator, Office of Women in Development
2. Karns, Mark -- Chief, Privatization and Finance Division, Office of Economic Restructuring, Regional Mission Bureau
3. O'Farrell, Paul -- Director, Office of Program Development and Planning
4. Prindle, Deborah -- Chief of the Program Office of Program Development and Planning

B. Contractors

1. Davis, Robyn C.-- Manager, KPMG Peat Marwick
2. Leeds, Roger -- KPMG Peat Marwick
3. Mastranangelo, Teresa B.-- Deloitte Touche Tohmatsu International
4. McPhail, Robert, J.F. -- Deloitte Touche Tohmatsu International
5. Rourke, Robert -- Coopers & Lybrand
6. Waddell, James -- Price Waterhouse
7. Warman, Arthur -- Deloitte Touche Tohmatsu International

II. CZECHOSLOVAKIA

A. USAID

1. Bedner, James -- Program Manager
2. Rogers, John. -- Private Sector Officer
3. Roussel, Lee -- AID Representative

B. Contractors

1. Colman, Jeremy -- Price Waterhouse
2. Cromack, John -- Coopers & Lybrand
3. Drake, Joseph -- Senior Advisor, KPMG Peat Marwick
4. Drayton, Catherine -- Manager, Coopers & Lybrand
5. Dube, Alain -- Deloitte & Touche
6. Farmer, Ran -- Senior Manager, KPMG Peat Marwick
7. Haswell, Carleton -- Senior Manager Banking, KPMG Peat Marwick
8. Hraska, Gustav -- Partner in Charge, Deloitte & Touche
9. Keith, Alastair -- Crimson Capital

10. Kwan, Clarence -- Partner, Deloitte & Touche
11. Lister, Douglas -- Investment Officer, Corporate Finance Services, International Finance Corporation
12. Tischler, Peter -- Crimson Capital
13. Wallinger, Trevor -- Deloitte & Touche

C. Government Officials

1. Ackerson, Sarah -- Advisor, Ministry of Finance, Slovak Republic
2. Bukac, Mr. -- Czech Savings Bank Investment Privatization Fund
3. Curin, Mr -- Sprava Radiokumunukaci
4. Drake, Joseph -- Advisor, Ceska Sporitelna a.s.
5. Hilsinger, Jeanne -- Senior Advisor, Center for Foreign Assistance, Ministry of Economy
6. Josefiova, Vladimira -- Director, Ministry of Privatization, Department on Foreign Investment
7. Petr, Vladimir -- Ministry of Industry
8. Princ, Jan -- Deputy Director, Fund of National Property
9. Rozsypal, Pavel -- Director, Center for Foreign assistance, Ministry of Economy
10. Stary, Lubomir -- Deputy Director, Ministry of Economy of the Czech Republic

D. Companies

1. Blazek, Jaroslav -- General Manager, Zelezarny Vamberk, a.s.
2. Bulac, Ing. Vladimir -- Director, Sporitalny Investieni Spolicnost
3. Chahipa, Ing. Jan -- Director, Investments, Sporitalny Investieni Spolicnost
4. Douglas, Les -- Managing Director, Schindler
5. Hrusa, Vladimir -- Director of Finance, Barrandov Film Studios
6. Janda, Jiri -- General Manager, Prazska Cukerni Spolecnost
7. Klapal, Jaroslav -- Member of the Board of Management and Deputy General Manager and Member of the Board of Prague Stock Exchange, Ceska Sporitelna
8. Krupicka, Vaclav -- Manager, Foreign Trade, Kovohute Rokycany
9. Kuderik, Mr. -- Vyahy Praha
10. Kula, Jiri -- Financial Manager, Zelezarny Vamberk, a.s.
11. Smolik, Ludvik -- General Manager, Kovohute Rokycany
12. Stransky, Pavel -- Technical Director, Osan Praha
13. Vlasek, Victor -- Senior Advisor, Ceska Sporitelna a.s.

E. Others

1. Arbess, Daniel -- White and Case
2. Barta, Rudolf -- Country Director, IESC

3. Burger, James -- Center for Economic Research and Graduate Education
4. Gibian, Paul -- President,. Czech & Slovak American Enterprise Fund
5. Kosman, Karel -- Country Director, IESC
6. Mejstrik, Ing. Michal -- Acting Director, Center for Economic Research and Graduate Education
7. Richards, Whit -- Investment Officer, Czech & Slovak American Enterprise Fund
8. Seipel, Alex -- Bankers Trust

III. POLAND

A. USAID

1. Anderson, Eve W.-- Private Sector Coordinator
2. Chen, Melanie Mamrack, Project Development Officer
3. Dubejko, Maciej -- Project Specialist
4. Joslin, William -- AID Representative
5. Rogowska, Paulina -- Project Development Specialist

B. Contractors

1. Baldwin, Jeffry, Partner, Deloitte & Touche
2. Bulkley, Jonathan A., Senior Advisor, KPMG Peat Marwick
3. Butt, John N., International Privatization Group, Price Waterhouse
4. Foley, John -- Price Waterhouse
5. Kester, James, Privatization Specialist, Policy Economics Group, KPMG Peat Marwick
6. Kurtz, Mariann, Senior Consultant, Policy Economics Group, KPMG Peat Marwick
7. McFarlane, Jennifer -- Privatization Specialist, Policy Economics Group, KPMG Peat Marwick
8. Madigan, Timothy -- International Privatization Group, Price Waterhouse
9. Murdoch, Neil, International Privatization Group, Price Waterhouse

C. Government Officials

1. Adamkiewicz, Zbigniew, Director, Corporate Finance Division, KPW Polish Securities Commission
2. Bednarski, Piotr -- Inspector for Bank Supervision, National Bank of Poland
3. Cylwik, Andrej -- Vice President, Anti-Monopoly Office
4. Grzeiszczak, Boguslaw -- Advisor to the Minister, Ministry of Industry and Trade
5. Pietrzak, Rafal -- Project Manager for Trading Mass Privatization Program, Ministry of Privatization

6. Podgorski, Andrzej, Ph.D. -- Director, Ministry of Privatization
7. Repa, Antoni -- Supervising Project Manager, Mass Privatization Department, Ministry of Privatization
8. Sidorowicz, Jan -- Director, Department of Privatization Through Restructuring, Ministry of Privatization
9. Sleszynska-Charewicz, Ewa -- Director, Inspector General for Bank Supervision, National Bank of Poland
10. Tarnowski, Artur -- Project Manager, Ministry of Privatization

D. Companies

1. Bartosz, Stanislaw -- Director, Goscicinska Fabryka Mebli
2. Bogutyn, Tomasz -- Manager, Corporate Development Department, LOT Airlines
3. Chingwa, Mr. -- General Manager, Sandomierz, S.N.
4. Ciepola, Mr. -- Krakzklo Mirror
5. Kasznia, Andrzej -- Director General, Zaklady Azotowe, S.A.
6. Kaldunski, Krysztof -- Managing Director, Czerskie Fabryki Mebli
7. Podoletska, Paulina -- Chief Accountant, Krakzklo Mirror

E. Others

1. Conrath, Craig -- Attorney, Anti-Trust Division, U.S. Department of Justice
2. Cotterill, Harold -- President, Amerbank
3. Freeman, Barry -- U.S. Federal Trade Commission
4. Harder, Stephen -- Associate, White and Case
5. Hirst, Allen -- Director, Citibank
6. Laszlob, Dr. B.A. Alfred -- Senior Advisor, Foundation for the Development of the Financial Sector , EC/PHARE
7. Nettekoven, Dr. Lothar -- Senior Advisor, Industrial Development Agency, Commission of the European Communities Delegation Poland

IV. HUNGARY

A. USAID

1. Cowles, David -- AID Representative
2. Likor, Mitsi -- Project Officer, AID

B. Contractors

1. Asmon, Itil -- Manager of Technical Services, Central and Eastern Europe, Chemonics

2. Benford, Stephen Y. -- Senior Project Administrator, Central and Eastern Europe Operations, Chemonics
3. Dewey, William M. III -- Advisor for Banking Reform, Minister (without portfolio)
4. Morabito, Vincent -- Partner, Chemonics
5. O'Connor, Brian -- Investment Advisor Investment and Trade Promotion Agency
6. Stamm, Charles -- Partner, Deloitte & Touche
7. Twyman, Charles -- Deloitte & Touche
8. Vitez, Andras -- Deloitte & Touche

C. Government Officials

1. Both, Janos -- Director, Self-Privatization, SPA
2. Hetzel, Martin -- Advisor, State Property Agency SPA
3. Kazar, Peter -- Director, Compensation Notes Program, SPA
4. Koczian, Dr. Jozsef -- Economist, Ministry of Industry and Trade, Republic of Hungary
5. Kovacs, Gyorgy -- Managing Director, Pri-Man (Privatization Management Company Limited)
6. Lajtai, Dr. Gyorgy -- Economic Director, SPA
7. Lazlo, Andros -- Director of Privatization, Ministry of Finance
8. Lukacs, Dr. Erzebet -- State Property Agency
9. Lukacs, Janos -- Executive Director, SHARE - Participation Foundation
10. Morenth, Andras -- Advisor to the President/CEO on International Cooperation, Hungarian State Holding Company
11. Srilagyi, Mrs. -- Manager of Privatization, Ministry of Industry

D. Companies

1. Kostyal, Stephen F. -- Executive Director, Ganz-Hunslet, Rolling Stock Production

E. Others

1. Clark, Howard -- Economic Section, U.S. Embassy
2. Csikos, Istvan -- C&W Software KoG.
3. Czirjak, Laszlo -- General Manager, Bankers Trust
4. Eisenberg, David -- Associate, White & Case
5. Hughes, Patrick C. -- Assistant Commercial Attache, Embassy of the United States/Budapest, Hungary
6. Rogerson, Andrew -- Manager, Central European Services, World Bank
7. Thomas, Hon. Charles -- U.S.A. Ambassador to Hungary
8. Vardy, Nicholas Attila -- Associate, White & Case

Appendix 6 - Description of the Treuhandanstalt Privatization Program

193

APPENDIX 6
DESCRIPTION OF THE TREUHANDANSTALT PRIVATIZATION PROGRAM

A. The Treuhand Privatization Method

Treuhandanstalt is the German Government corporation in charge of privatization of SOEs inherited from Eastern Germany. We have been asked to comment on this model and its degree of applicability elsewhere.

B. Description of Treuhand

Treuhand has 3700 employees and is organized by industry. It is transaction-oriented; its object is to privatize the East German state-owned apparatus as rapidly as possible. As a first step, as of July 1,1990, all SOEs were transformed and transferred to Treuhand ownership.

Treuhand's industry experts decide case by case on the disposition of SOEs based on a privatization plan required from each entity. This plan must include a listing of all likely acquiring prospects.

The Treuhand analyst instigates privatization negotiations immediately. In 95% of the cases it makes more than one contact, it being the initiator. The search for potential investors is active and is conducted with the help of a number of Treuhand offices all over the world. At first, sales were predominantly to West Germans, who were the only active buyers on the scene, but now it is worldwide.

A fresh valuation is made and decision taken on the disposition of liabilities. The alternatives are restructure, "silent liquidation" (liabilities paid off by the Government), asset sale, or declaration of bankruptcy. Contingent liabilities are set up in a reserve agreed upon by Treuhand and the buyer. Up to the reserve amount, the actual liability is absorbed 100% by the buyer. Beyond this the charge is shared but only up to a certain predetermined ceiling amount.

Government sets the price and other important conditions such as investment required and employment commitment. The Government may give guarantees and special rates as it sees fit. It can change the management if it judges that to be appropriate.

All basic decisions are made by Treuhand staffers and by them only, except that beyond a certain size enterprise they must be referred to top Treuhand supervision. Sometimes outside consultants are used, but not often. Occasionally there are success fees to outsiders. Managers of the subject SOEs are not present at the negotiations. 15% of the transactions have been MBOs.

Treuhand started with 9000 SOEs. After splits and separation of subsidiaries, this count became 12,500. 8000 of these have been privatized, 2000 have been liquidated and 2500 remain in the portfolio to be dealt with. Treuhand is scheduled to complete its work and go out of business by the end of 1994.

C. Analysis of Treuhand and its applicability elsewhere.

1. The entire emphasis is on speed; getting the job done is paramount, even if many corners are cut to do it.

2. The accusation has been made that Treuhand has sold too low This accusation so commonly accompanies privatization worldwide that it must usually be looked on with some suspicion. The German Government says this is not the case and we have not investigated further.

3. This is a very top-down, effective, but dictatorial approach to privatization to an extent that it is probably not politically replicable elsewhere. Treuhand has absolute authority over the transactions, with no appeal, no interaction, and very little transparency beyond publishing the end results.

4. It is also a very expensive way to solve the problem. The staff and the total cash outlay is enormous, although Treuhand employee salary cost is only .2% of the accumulated revenue to the state. Attitude to liabilities is to wipe the slate clean rapidly. Germany's answer to this is that it has the money to deal with the problem expeditiously and that in the end the quickest solution is the most economical solution.

Appendix 7 - A Proposed Framework for Delivering, and Managing Structured On-The-Job Training

APPENDIX 7

A Proposed Framework
for
Delivering and Managing

Structured On-the-Job Training

I. Purpose of Structured On-the-Job Training

The primary purpose of structured on-the-job training (OJT) is to train workers as effectively as possible using job-related staff and materials, particularly technical advisors.

II. Definition of Structured On-the-job Training

Structured OJT is a system of training whereby the specific curriculum, the specific context in which the curriculum will be used and responsibilities of trainees and trainers is fully specified together with monitoring and evaluation criteria before training occurs. The efficiency and relevance of structured OJT is that it occurs on the job and uses the technical advisors as the principal trainers. Technical advisors are the logical source of technical expertise since they determine the bulk of the task content of their jobs and those of their counterparts. On the other hand, they've never been particularly good trainers; witness years of development experience with weak counterpart training. If technical advisors can be made into good trainers, which is a goal of structured OJT, then the highest level of job related expertise will be harnessed for worker training.

III. A Suggested Framework for Structuring, Delivering and Managing Structured OJT

As shown in Exhibit 5-1 (model management system for structured on-the-job training), on-the-job training can be effectively delivered through one prime contractor who may use subcontractors at its discretion. The contractor will implement the training through:

1. **Technical Advisors (TAs)** who will deliver the training on a daily basis through **<structured>** work assignments with counterparts in each job,

2. **A Manpower Team of one or two TAs** will work out of a Human Resources Unit and will:

   _ Assist all TAs by:

   + Developing and applying a formal methodology to measure worker skills and skill gaps, that is, differences between worker skills and job skill needs,

   + Developing a methodology to structure OJT with

198

the assistance of each TA for the work groups to receive OJT, and with the assistance of the M&E Specialist who is discussed subsequently,

+ collecting baseline information on worker skills and skill gaps and annually thereafter; these data are needed to both structure training and for monitoring and evaluation,

- Monitor the progress of all TAs and work groups involved in OJT using a computerized system to record time and milestone targets by work group,

- Participate in periodic evaluations, partly by remeasuring worker skills each year to record progress in skills development,

- Jointly determine with TAs the need and appropriate timing of off-the-job training for specific jobs (all off-the-job training associated with an OJT program should be of six weeks duration or less to avoid budget confusion with other forms of training),

- Work with Public Service Commissions to develop pay scales that provide incentives for OJT and other forms of training, and to develop a process to give workers ad hoc awards for exceptional service,

- Train counterparts in the Civil Service Commission to perform these tasks.

3. A **project manager** who will:

   - Identify jobs in Ministries that require additional training to accomplish privatization objectives, and devise strategies to meet these needs with the assistance of the Manpower Planning Team of two TAs,

   - Devise strategies to improve the effectiveness of the project's OJT with the assistance of the manpower planning team,

4. An **Annual Work Plan (AWP)** will be drafted within three months after the long-term TAs begin their assignments, reviewed by USAID during the next two weeks, and finalized with USAID approval within four months of project inception. The AWP will list the tasks and sub- tasks for which each TA is responsible that are to be completed during the next 12-18 months depending on the contractor's

199

preferred planning period. The AWP will set forth the substantive work to be accomplished during the planning period, and the number of work groups to be involved in OJT work efforts with each TA.

5. A monitoring and evaluation specialist **(M&E Specialist)** will work for six to eight weeks (depending on the number of TAs and the complexity of the AWP) after the AWP is completed. This specialist will be hired by the contractor, work under the guidance of the Project Manager and, in conjunction with the Manpower Team and each TA, review each TA's work effort to date in relation to the AWP to:

- Help structure the OJT for each work group,
- Develop a monitoring and evaluation plan and specify the system in which it will operate,
- Develop and apply a methodology to prioritize the training embodied in the AWP that is to be completed during the planning period.

The monitoring and evaluation specialist will work in a collaborative manner with the Manpower Team, with the project management, with each TA, and with USAID. The M&E specialist must satisfy the needs of these four groups who will jointly receive midterm and final debriefings and a comprehensive final report from this specialist.

The M&E Specialist will be hired as an M&E Specialist for Training and have the words "OJT Training" written in every element of her/his scope of work. Nevertheless, this specialist will be expected to have sufficient technical skills and background to review substantively the work plan of each TA in detail in order to:

- help specify the overall **Annual Work Plan** in more detail for each TA, the relationships between the tasks of the various TAs, and possibilities for rotating the assignments of the different TAs over the contract period,
- point out the need for specific collaboration between advisors due to complementary functions or the need to avoid duplication of their work,
- Help structure the OJT of each TA, and
- Suggest a plan for prioritizing training during the year

200

- Suggest specific, but tentative monitoring milestones for training that are to be finalized and modified subsequently as necessary with the concurrence of the TAs, the Manpower Team, Project Management and USAID,

- Suggest specific, but tentative evaluation criteria based on the project's objectives,

- Propose a system for regular collection and analysis of monitoring and evaluation data by the Manpower Team for regular dissemination to Project Management and scheduled presentation to USAID, and provide illustrative applications of its use.

The M&E specialist's **M&E Plan** will be finalized after her/his departure with USAID concurrence. **The M&E specialist's overall role is to serve as a catalyst to structure OJT through an expansion of the AWP, design an M&E system that is transparent to all participant and management interests, propose a methodology to prioritize OJT, and a strategy for deploying and rotating TAs.**

Each year for four weeks the M&E specialist will review training progress with each TA to update and refine the M&E plan, again with the collaboration and concurrence of Project Management, the Manpower Team, the TAs and USAID. Again, each year all participants will attend the M&E specialists final debriefing and a comprehensive final report will be expected of this consultant.

The use of the M&E specialist will give the project added flexibility to redeploy its assets each year if necessary through a collaborative process. Presumably each TA will be hired carefully and have the capability to do her/his job. Nevertheless, some TAs may find themselves ineffective in a certain position for any number of reasons. Through the M&E Specialist's detailed analysis of each TAs activity each year, project management can identify where successes or needs are greatest and suggest that management redeploy underemployed TAs there.

Substantive qualifications that the M&E Specialist needs to perform this job include skills in:

- Manpower training and planning, particularly OJT,
- Privatization methodologies,
- Sample survey design,
- Data collection and analysis,
- Management Information systems,
- Financial analysis,
- Public sector personnel/incentive systems,

201

- Collaborative analysis and planning with TAs.

This mixture of skills will help ensure that the M&E Specialist can serve as a resource person to the TAs in extending the specification of their Annual Work Plans.

6. Third party contractors will perform mid-term and final evaluations of the project based on the monitoring and evaluation plan that is eventually developed by the Project with the assistance of the M&E Specialist. These evaluations are to be scheduled after three and five years of project operation.

7. All training for the first six months of the project will be OJT. During these first six months the TAs will fully establish their work plans, gain enough experience to appraise specific expertise needed in their assignments, have the Manpower Team measure skill gaps in their counterparts and observe the overall performance of these counterparts.

8. After the first six months, off-the-job training can begin to be offered to those counterparts who have appropriate skill gaps and who have also received appropriate job performance ratings from their supervisors and the TAs. Off-the-job training is to be considered both a form of training and a reward for outstanding job performance. All off-the-job training shall be job-related and for six weeks or less. Moreover, as additional preconditions for training, provision must be made to reassimilate trained workers into their jobs when they return from training, and the government will assure that, on their return, these workers will have appropriate office space, furniture and whatever equipment they may need to perform their jobs.

9. The Manpower Team will work with the appropriate Ministry including the proper authority for setting salary scales and authorizing incentives to modernize worker evaluation systems, payroll classifications, and the education, training and experience specifications for promotions in order to ensure that OJT is reflected in the pay incentive system.

10. TAs will review the work performance of their OJT trainees with the trainees every six months and

give each trainee a formal evaluation every 12 months. Each ministry in the project will agree that trainees will only be allowed to remain in training if they receive at least a satisfactory rating from the TAs on an annual basis. USAID will negotiate this agreement with each ministry on behalf of the contractor.

11. Training in excess of six weeks will remain the responsibility of the USAID office, and not the contractor responsible for OJT.

Appendix 8 - Program Coordination Issues

704

APPENDIX 8

PROGRAM COORDINATION ISSUES

A central issue in the privatization program in Central and Eastern Europe is the relationship between AID/Washington staff and AID staff in the field. In all three countries visited, there was an underlying tension and debate as to which group should manage the program.

The AID/Washington staff rightfully cite that the management structure for the privatization program (and other EUR Bureau programs) was decided by the State Department. Program management was decided by outside decree, not by some internal review. They openly acknowledge that, at times, they have been understaffed and short of financial resources. For example, the Office of Management Budget (OMB) was more than five months late in providing resources for FY 1993. Throughout the program, there has been some problems with staff turnover. Still, the AID/Washington staff believe that they have done the best they could given all the constraints of managing a program from afar.

The field staff generally feel that the program should be managed by them, with minimal reliance on AID/Washington input. They are uncomfortable, frustrated and, at times, embarrassed by their being put in a position of responsibility with no authority. No matter what the request, the AID/representatives have to first receive approval from AID/Washington which sometimes results in delays in mobilizing contractor personnel. They feel that their hands are tied and that they are unable to make or quickly fulfill any promises made to the host government.

A review of all the projects and interviews with AID staff, Contractors and Government officials reveals a wide range of coordination issues. Some problems arise from a lack of timely communication between AID/Washington and the field staff. Others come about due to country conditions and policy changes. Some of the more general, undocumented but recurring comments regarding AID/Washington and AID/field coordination are cited below:

- Contractors felt like they had to deal with many AID "bosses". One comment made was that it was always uncertain whether a new project initiative developed by the Contractor would be funded. If the AID/Representative said "no", then the project would not be funded. If he/she said "yes", then it only had a 50% chance depending on what AID/Washington thought. This situation led to multiple discussions with many project "managers".

- AID/Washington staff pointed out that the reporting of project activities was not always timely or properly prepared. They did not always feel up to date or well informed about what a project was achieving.

- Some AID field staff found the AID/Washington visits to be more like "state" visits -- i.e. not very substantive or in-depth. This was combined with a general feeling that the AID/Washington staff were unable to make sufficient number of field visits to adequately manage the projects.

- There was some criticism that the IQC mechanism -- designed to provide assistance within 2-4 weeks of a request -- was anything but timely. AID field staff mentioned several instances in which project requests or modifications took months rather than weeks to approve.

- One country representative mentioned that the IQC mechanism made it difficult to procure commodities or provide short term training resources. The IQC work orders are primarily used to hire individuals. It was difficult and time consuming to integrate requests for computers and training courses into the work order.

- While not a focus of this scope of work, some AID staff and contractors in the Czech Republic mentioned that the AID management structure led to unfulfilled promises in Slovakia. The existing project cycle consists of the contractors designing projects, the AID/representatives screening the proposals and AID/Washington giving final approval. Such a system can unduly raise expectations on the part of the host government during the design stage; it also can weaken AID/representative credibility if after approving a project proposal, AID/Washington decides to not finance or is unable to due to budgetary constraints.

- All three AID representatives stated that without having a country quota or global budget allocation, it was difficult to plan. The process by which the AID/representatives competed with one another for project approvals from AID/Washington was felt to be unsatisfactory. All the representatives felt it would be better to have a nominal budget from which they could screen projects and submit to AID/Washington for final approval.

Besides these general comments, there are several other more project-specific examples which reveal a less than ideal level of coordination between AID/Washington and the AID representatives.

- Huta Warszawa/Poland: One of the first privatization initiatives in Poland encountered significant delays. A request for technical assistance was first made in mid-Sept., but a work order was not signed until early December. By the time the team arrived in December, its terms of reference were obsolete and they were requested to carry out some other activities not originally contained in the work order.

- Sandomierz/Poland: There was a misunderstanding among the Contractor, AID/Washington and the AID/representative about extending the end-of-project deadline. Funding for the project ended in September. AID/Washington signed an extension of the contract with no additional funding. The Contractor, in consultation with the AID/representative thought that there was going to be an extension and an increase in funding.

- National Bank/Poland: There was a 6 month delay in mobilizing this technical assistance. This was in large part due to a change in governments.

- Securities Exchange Commission/Poland: This project took 7 months to mobilize the technical assistance. The evaluation team was unable to ascertain the exact reasons for the delay.

- Privatization through Restructuring/Poland: This project has been problematic from the outset. Initially, it took 8 months to sign a contract with the government. Once implemented, the project ran into significant delays regarding the utilization of $20,000 for advertising -- an expenditure not originally defined in the scope of work. It took more than 3 months before contracts in AID/Washington was able to approve the expenditure [1].

- Financial Redeployment/Poland: This project took 6 months to mobilize. The contractor felt that the delays were due to AID/Washington not processing the request in a timely manner.

- COMPASS/Hungary:The contractors for the COMPASS project have been carrying out activities, even though their original scope of work has changed and necessary contract modifications have been sitting in AID/Washington contracts office for several months. While all the principal parties (government, AID, contractors) have agreed to the change in scope, the contractor risks not receiving payment if the modifications are not approved by mid-April. Conversely, if the contractor had decided not to continue with its assistance for 3 to 4 months, AID could have severely damaged its reputation with the SPA.

With few exceptions, most of the delays presented above are due to bottlenecks occurring in and between AID/Washington and the field. Each of the parties involved -- AID/Washington, AID/representative, and the Contractor -- has its own views and explanation of the delays.

A central problem is not that any one party necessarily was at fault; but that the system set up to handle the administration of the contracts is inherently weak. Trying to manage, screen, mobilize and modify contracting requests made in the field by AID/Washington staff is difficult at best. Each group has different expectations on how work orders should be presented, what the technical assistance requirements should be, and how long it should take to process the work orders. These differences inevitably lead to delays, and worse, unproductive accusations.

In an effort to limit the number of intermediaries and potential areas of conflict, the evaluation team suggests that future efforts provide some expansion of authority to field offices permitting them to make implementing decisions such as:

-- approve modifications of contracts (particularly if they are minor in scope; e.g. $20,000 expenditure approval);

-- budget and give final approval for project work orders;

-- immediately initiate activities approved while waiting a final sign-off from contracts in AID/Washington.

Within this framework, AID/Washington's primary role should be in defining policy and providing technical support to field implementation. There is a wealth of knowledge that the staff in AID/Washington can and should be collecting regarding project impact and implementation. From field trips, evaluations and conversations with experts the AID/Washington staff should serve as a "quality control", monitoring and evaluation resource for the AID/representatives. In those instances in which

---

1 There was widespread misunderstanding as to why the project was delayed. According to the government, the main problem was that AID/Washington delayed in giving timely approval for the $20,000 expenditures. AID/Washington, however, states that the Government of Poland was originally responsible for providing the $20,000, but that it failed to follow through. After the AID/representative urged AID/Washington to finance the expenditure, additional delays were caused by the contractor's central office not notifying its Polish office about the change. In any case, this project highlights the problems that can arise when there is not clear political support for an initiative.

political considerations originating from Washington need to be integrated into the programs, the AID/Washington staff should work closely with the AID/representatives in incorporating political priorities into the programs.