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TRENDS AND BENEFITS OF A.I.D.'S PRIVATIZATION PROGRAM

Dudek & Company
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I. THE ROLE OF PRIVATIZATION IN ECONOMIC DEVELOPMENT

A. Introduction and Summary

A.I.D.'s formal policy on privatization was first announced by the Deputy Administrator, speaking for the Administrator, at the International Conference on Privatization in February, 1986. It was announced there that Missions in 40 countries would begin active discussions on privatization with the governments with the goal of being involved in at least two privatization activities by the end of FY 1987. Appendix A lists the countries whose Missions were expected to implement formal privatization programs. Details of the new program were provided in a subsequent cable to all Missions.

These guidelines were later formalized in Policy Determination (PD-14), "Implementing A.I.D. Privatization Objectives," issued on June 16, 1986. PD-14 concisely described the purpose of privatization, briefly reviewed the various techniques and listed the resources that AID/W would make available to the Missions to assist them in meeting the new objectives. Missions were also required to provide an annual report to AID/W in the form of a "Privatization Narrative" as part of their Annual Budget Submission. To date, four such submissions have been produced by most Missions, spanning the fiscal years 1988 to 1991.

This report provides an overview of A.I.D.'s privatization program from its formal inception in 1986 through mid-1989 when the Missions' last privatization reports were submitted. The purpose of the report is to describe the program and determine, within broad parameters, the extent to which it succeeded, and what changes might be made in the future to improve it.

The privatization narratives of the annual budget submissions from the designated Missions, together with Mission action plans where appropriate, comprise the bulk of the resources used to compile this report.

It is our opinion, after a careful review of the annual reports submitted by the forty Missions tasked with formal privatization programs, that the program was a success and that the Missions' staff did an excellent job in implementing a complex task under difficult circumstances. With any such program there is a temptation to attempt to quantify the success by some easy to understand measure, such as the number of actual divestitures in any country or throughout the program. However, as noted on several occasions in this report, any such attempt would lead to misleading results because the short time horizon - just over three years - and the complicated nature of the exercise would lead to few outright successes so early in the process.

For these reasons, we recommend that the individual Mission programs be reviewed as a "process" and that their successes be measured by the extent to which they aggressively pursue the opportunities available, the obstacles that they overcome, and the response they make to changed circumstances. For example, one Mission may have no privatizations to show for its work, but it may have been instrumental in getting the government to create a Presidential Privatization Task Force and to enact legislation that will facilitate privatization. In this case the future payoff could be quite substantial.

We have also made numerous recommendations as to how AID/W can provide additional technical assistance to the Missions and how the reporting from the Missions can be improved and standardized to allow AID/W to take a more active role in ensuring that each Mission adequately pursues the opportunities that are available to it and to assist them with specific advice that may be unique to the program they have developed.

B. Why Privatization?

A.I.D.'s emphasis on privatization as an important tool of economic development and growth reflects the dramatic change in attitude that took place within the development profession in the late 1970s and early 1980s concerning the proper role of the public sector in promoting economic growth and prosperity. Through much of the postwar era, experts in the newly-developed discipline of economic development generally recommended statist solutions to the problem of underdevelopment. Central planning, forced savings, heavy regulation, trade restrictions, import substitution, government ownership of enterprises and controlled prices often became the the predominant theme of expert advice to the leaders of the developing countries. Such advice may well have reached its nadir in Gunnar Myrdal's widely-read Asian Drama which advised the use of coercion in the event that private citizens might be reluctant to participate in various centrally directed schemes for economic change.

By the late 1970s, it became apparent that the dirigiste strategy for economic development and growth left much to be desired and that countries that had adopted such strategies in one form or the other had precious little to show for their efforts. Moreover, there was growing evidence, albeit anecdotal, that countries which ignored the conventional wisdom of the time and instead relied to a considerable extent on free markets and private enterprise had recorded impressive measures of economic performance.

In many respects the postwar era became a massive social science experiment in comparative economics. The political changes that swept the world in the years following World War II led to an unprecedented number of countries that had an opportunity to embark upon new social, political and economic arrangements. Many newly independent countries, freed from decades and centuries of colonial rule were given a fresh start, while many formerly independent countries fell under an almost colonial-like control and had new institutional arrangements imposed upon them. Between these two polar extremes many other changes occurred as some countries opted for an expansive government role while others kept the public sector in check.

After several decades of performance, the results of this unintentional experiment became widely observed with relatively consistent results. In general, countries that opted for measures of economic freedom and open markets did substantially better than those that did not, while those countries that fell in between the policy extremes also had middling measures of performance. By the early 1980s, several scholars took this raw material and subjected it to rigorous economic and statistical analysis to determine if the observed anecdotal differences were in fact statistically significant and attributable to the institutional arrangements that characterized each of the countries.

The pioneering study to quantify this difference in performance was by Keith Marsden of the World Bank ("Private Enterprise Boosts Growth", Journal of Economic Growth, Vol.1. No.1, 1986) who uncovered a significant relationship between a country's level of taxation and the rate of growth of its per capita income. Not long after this Ramgopal Agarwala, also of the World Bank, published "Price Distortions and Economic Growth in Developing Countries" (World Bank Staff Working Paper 575, 1983). Agarwala took several forms of regulatory distortions, categorized them by their degree of intrusion and then related then to measures of economic performance. In virtually every case, the countries with the fewest regulatory distortions recorded the best performance while countries with significant distortions performed the worst. Several years later, Gerald W. Scully, in the "Institutional Framework and Economic Development," (Journal of Political Economy, 96, No. 3, June 1988, pp. 65262) developed an index of economic and political freedom and related it to measures of economic performance. According to his finding, countries with substantial measures of economic and political freedom experienced rates of economic growth that were three times higher than that of countries with limited freedoms. As a result of this evidence, perceptions about the sources of economic growth and prosperity began to change within the development profession.

Largely based on its own experience and partly in response to the market reform trends then sweeping the U.S., A.I.D. was one of the first donor agencies to emphasize the development of free and open markets, a thriving entrepreneur class and limited government interference as prerequisites to prosperity. Through a variety of directives and technical reports that were distributed to staff over the past decade, A.I.D. instructed its Missions to implement such strategies in the countries of their responsibility. The privatization program, announced early 1986, was one facet, albeit an important one, in A.I.D.'s overall strategy to encourage market solutions to economic development.

It is apparent from reading the Mission reports from the forty designated countries that private sector/free market development has been an important goal of the staff and that private sector emphasis predates the 1986 Policy Determination at many of the Missions. In some cases it is apparent that such interest extends back into the 1970s, as, for example, the annual privatization narratives from Bangladesh demonstrate. For the Missions, privatization *per se*, is just one of the many tools and solutions that they bring to bear on the economic problems confronting these countries. Tax reform, deregulation, property rights, budgetary reform, financial stability, price decontrol, open entry into business and freer trade are among the important, pro-market policy reforms that the Missions are attempting to implement. As is discussed in the next section, privatization can be an important component of any attempt to implement some of these other market-based reform initiatives.

C. The Role of Privatization in Development.

Privatization is the process whereby public assets, enterprises or responsibility for services are transferred from the state to owners and providers in the private sector. Consisting primarily of the techniques and tools defined as divestiture, vouchers and contracting out, the process of privatization offers governments the opportunity to exchange an inefficient and costly public monopoly for an efficient, service-oriented, lower cost private sector provider. For the many nations of the world that have allowed the public sector to grow too large, the technique of privatization offers them a responsible and constructive way to diminish the scope of government and dismantle the state by transferring those functions that are commercial in nature to private sector providers and owners who possess the capacity and incentive to better manage the operations. Where privatization has been applied on a consistent basis such as in Great Britain with its aggressive divestiture program, and in the United States, with its extensive reliance upon vouchers and contracting out to provide basic government service and welfare support, the results are almost universally positive. On average, the cost savings associated with contracting out in the United States consistently amount to about 30 percent over what the government had paid previously, with no diminution in the quality of service. In Britain, the estimated cost savings is in the range of 20 to 40 percent for the enterprises that have been divested.

In the developing world, however, the purpose of privatization often goes well beyond the need to just save money, although that might well be a critical reason for its adoption. For these countries, privatization is also closely related to the fundamental restructuring that they must implement if they are to reorganize their resources in a way that will generate self-sustaining rates of economic growth and higher incomes. In many developing countries, major manufacturing and service enterprises are operated by the state under conditions of limited or no competition. As a consequence, these enterprises are inefficient, costly and absorb scarce resources. Where such enterprises are a part of a nation's strategic infrastructure such as its telephone or energy systems, their inefficiencies tend to hobble other industries and enterprises that must rely on these sectors for vital inputs and service. All Argentine businesses, for example, no matter how efficient they may be operated, suffer from the dysfunctional telephone system upon which they must rely. By privatizing these inefficient state monopolies and subjecting them to the competitive pressures of the marketplace, such liabilities become assets, and economic growth and prosperity move forward.

As important as these restructuring benefits are to a struggling country attempting to raise its standard of living, the potential cost savings through operating efficiencies can also make an important contribution to development goals, indeed far more so than they would in a developed country such as the United States and Great Britain. In market-based countries where commercial enterprises are privately owned, such enterprises produce products that consumers willingly purchase, earn a profit and pay a portion of the profit to the government in the form of taxes. Thus, in these systems enterprises are important creators of wealth and a significant source of revenues to the government. Precisely the opposite process occurs in most developing countries where the commercial enterprises are owned by the state. In most such countries, these enterprises produce an unsatisfactory product, lose money doing so, and necessitate persistent and costly subsidies from the state. Operating in this fashion, these enterprises are destroyers of wealth.

In a number of countries such subsidies amount to a significant portion of the national budget, upwards of 20 to 30 percent. Thus, revenues that might otherwise go to fund vital national programs such as health care and education must be used to bail out commercial enterprises. That, however, is only the beginning of the problem. These subsidies enlarge the government's budget deficit, and because these countries have a limited ability to borrow domestically or abroad, these deficits must generally be financed by printing money. This, of course, contributes to accelerating inflation, which, in turn, undermines the entire financial and economic systems of these countries. Only through aggressive and meaningful privatization can such countries break out of the vicious circle of financial deterioration and economic decay.

At one point or another over the past few years, Argentina, Poland, Bolivia and Peru have found themselves in this hyperinflationary predicament, and all are looking at privatization as a key component of the solution. In Bolivia, for example, a country that until recently had one of the highest inflation rates ever measured, the losses attributable to the SOEs accounted for two-thirds of the government's overall budget deficit late in the decade. Thus, the need to privatize can extend well beyond the goal of cost efficiency and may affect, in a very fundamental way, the entire macroeconomy.

Another potential social cost associated with subsidy induced deficits is that it delays needed tax reform. Many developing countries maintain tax systems that are hostile to enterprise and entrepreneurial initiative through exceptionally high marginal tax rates that kick in at relatively low levels of income. But saddled with large deficits, most governments fear the potential for further fiscal deterioration as a consequence of any meaningful tax rate relief. As a consequence, many developing countries continue to impose tax systems that are inimical to enterprise and wealth creation.

D. Causes of Public Sector Growth As They Relate to Privatization.

Although a large public sector with many parastatals and state owned enterprises is a common profile of the typical developing country served by A.I.D., the reasons for this situation vary quite significantly, and these reasons can play an important role in determining the proper approach to privatization and the likelihood of success. Based on the Mission reports that we reviewed, there are three chief reasons to explain the growth of government into commercial areas of the economy.

The first is ideological. Many nations nationalized their existing privately owned enterprises or created new enterprises that were publicly owned since inception. The reasons for this stem from a belief in the superiority of public or collective ownership over privately owned, for-profit activities. Such cases tend to be the most difficult to privatize because the act of privatization is often viewed as an assault on the very foundation of the country's leadership and the wisdom of its founders. Egypt is a good example of this, as is Tanzania, Peru and Pakistan, to name just a few where the process of nationalization is linked to economic and social theories promulgated by prominent politicians and early leaders. In Egypt, extensive public ownership is a legacy of the Nasser era of socialism, and thus is a topic that necessitates extreme sensitivity when considering private alternatives. While such origins of public ownership impose obstacles, they are not insurmountable, as several of the Missions have demonstrated. The Mission in Egypt has worked with the current government to develop an imaginative program which uses a process of incremental privatization, leases and joint ventures with foreign and domestic firms to achieve needed operational reforms while still adhering to the "essence" of the socialist legacy. The successful efforts of the Mission in Egypt might serve as a useful guide for Missions operating under similar circumstances which characterize many of the developing countries.

Another way in which governments acquire a large number of state-owned enterprises is through sheer accident, as is the case with much of what the government of the Philippines owns today. In the recent past, government financial entities were forced to "lend" to the private companies operated by the friends of the leadership. With government money freely available, there was little incentive for the owners to properly manage their companies. In time, most failed, and the government, as chief creditor, reluctantly took them over to preserve what it could of its investment. Assets acquired this way pose few political obstacles in the path of privatization. The Mission there is now working with the government to divest the involuntary acquisitions. A related cause might be severe economic stress which pushes many private enterprises to insolvency and induces the government to take them over in an effort to preserve jobs. Other than the fact that such enterprises usually tend to be in need of costly rehabilitation, the political obstacles to their privatization are not very great and divestment programs in these countries should achieve success.

Falling between these two extremes are those countries where a large number of the enterprises became publicly owned as a result of the flight or ostracization, whether voluntary or involuntary, of an outside ethnic group active in commerce. State-owned enterprises in Uganda, Mozambique, Liberia, Bangladesh and Indonesia, and to a lesser extent in many of the other former colonies, were acquired in this fashion. As time has passed and government mismanagement takes its toll, governments become increasingly eager to unload these enterprises in order to limit the adverse impact on the government budget. Whereas the privatization of these types of holdings was once difficult because their seizure is associated with the country's struggle for independence and self-determination, the resistance is diminishing and programs of privatization are now underway. Uganda and Mozambique began to privatize these entities in the late 1980s and recently the government of Indonesia announced an aggressive privatization program of their SOEs, many of which were once owned by ethnic Chinese. In all cases the A.I.D. Missions are actively working to support these efforts through technical assistance.

II. A.I.D.'S PROGRAM

A. Introduction

As noted in the previous section, A.I.D.'s formal policy on privatization was first announced in February, 1986. Missions in 40 countries began active discussions on privatization with the governments and prepared short and long-range strategic plans for implementation. Details of the new program were provided in a subsequent cable to all Missions, later reproduced as Policy Determination (PD-14), "Implementing A.I.D. Privatization Objectives."

PD-14 concisely described the purpose of privatization, briefly reviewed the various techniques and listed the resources that AID/W would make available to the Missions to assist them in meeting the new objectives. Missions were also required to provide an annual report to AID/W in the form of a "Privatization Narrative" as part of their Annual Budget Submission.

B. Defining A.I.D.'s Privatization Program

A.I.D.'s action-forcing policy document was the cable sent in early 1986 and reproduced as "Implementing A.I.D. Privatization Objectives." We have carefully reviewed this document, as well as several others produced by AID/W, and conclude, for the most part, that these documents are of sufficient quality and well-suited for the task at hand. "Implementing . . .," for example, is one of the best and most concise explanations of privatization and the major techniques that can be used to implement it.

In reviewing the primary techniques for privatization, the report states that a successful privatization process involves the selection and implementation of an appropriate privatization technique and that this, in turn, depends upon the country strategy for privatization and the reasons privatization is being undertaken. Privatization can take on a range of forms, some of which involve change in ownership status and transfer of decision-making authority from public to the private sector while others entail only the transfer of decision-making authority with the ownership of the assets remaining in government hands. The report then describes four such recommended techniques in somewhat greater detail. They are:

1. Complete Divestiture. With this approach a state owned enterprise is sold, operationally intact, to a private sector entity such as another firm, individual investors, the firm's own managers or workers, a foreign company, or the general public through a public stock offering. Alternatively, when the enterprise is not worth saving, it may be terminated or liquidated with all operations halted and the assets sold piecemeal. AID/W advised all Missions that complete divestiture was the preferred approach to SOE privatization.

2. Partial Divestiture. In this case the host government may enter into a joint venture with private investors with the government maintaining only a minority ownership position and no operating or management responsibilities. Alternatively, a partial divestiture may involve the separation of an SOE into a purely commercial component and a component that maintains responsibility for whatever public or governmental functions that may have been the responsibility of the SOE. In this latter case, the public functions could be absorbed by government while the commercial operations are transferred to the private sector through the same mechanisms as that for a complete divestiture. Although not covered in the policy determination but actively practiced by some of the Missions is the use of partial privatization as a stepping stone to complete privatization as the government reduces its holdings over time.

3. Contracting Out Service Delivery. Contracting out is the process whereby the government maintains the responsibility for making sure that some particular service is provided and may also continue to own any physical assets involved in providing the service, but hires a private firm to actually provide the service. In the U.S., municipal trash collection, for example, is something that local governments typically contract out,

although the government maintains responsibility for the service, pays the contractor and manages contractor performance. These arrangements are generally governed by such mechanisms as service contracting, franchise agreements or a facilities lease.

4. Partial Privatization. Through this technique Missions are encouraged to reduce the role of the public sector by way of the privatization of some of the specific activities of an SOE such as management, production and finance through separate contract arrangements with individual private entities. Additionally, a partial privatization may entail entire subsidiaries of vertically integrated firms, such as distribution, importation or retailing. A.I.D. prefers that this technique be viewed as an interim or short-term approach, and should be utilized as part of a longer-term process leading to complete divestiture within the life of a particular privatization project.

5. Choice of Technique. Which of the above techniques to use depends upon a variety of factors, including the judgement of the Mission staff. Many of the factors in a host country will influence the privatization strategy as well as the techniques chosen. These factors may include the purpose for undertaking the project, the business climate, the commercial viability of public enterprises, availability of capital, availability of local managerial and technical talent and the socio-political environment of the country. It is because of these many different factors and the variety of ways that they can influence a Mission's strategy and performance that we recommend, in Section IV, and in concurrence with the thrust of the advice offered in PD-14, that Missions be judged by the privatization process that they establish rather than some set of quantitative goals or targets.

6. Other Options and Guidance. It was in appreciation of these nuances and differences that Missions were encouraged by AID/W to be innovative and realistic in developing their privatization projects. In those instances where the host government has stated that it is unwilling to divest SOEs to the private sector, the Mission should work around this constraint by attempting to create competition to the SOE through deregulating the markets or encouraging reforms within the country's policy environment. Such reforms include the elimination of all market entry and protectionist

barriers, subsidies and other measures that reduce competition, reduce government monopolies, and force SOEs to operate more like private entities in a free and competitive market environment.

Where the host country forbids a private sector alternative and where the SOE or parastatal is not likely to perform competitively or be privatized, Missions were urged to withdrawal from or avoid such sectors of the economy and to shift to those areas where A.I.D. may operate more effectively.

In addition to learning and implementing the various privatization techniques, Missions were also urged to be cognizant of the policy conditions that may be necessary to conduct a meaningful and productive privatization program. The commitment to privatization, regardless of technique or form, must be accompanied by the adoption of a policy environment that allows for competition and the operation of market forces in the sector in which the enterprise exists or an activity is performed. Governments must be made aware that if industries are protected from market forces, little will be gained from privatization. The policy conditions needed for privatization to be successful include market based prices or a commitment to eliminate price controls; low, common tariff levels and the elimination of other forms of protectionism; prompt and fair enforcement of contracts; equal application of controls and regulations; equal access to credit and foreign exchange; market based interest rates; and the reform of employment and labor codes. Other important changes include the reform of the legal framework, investment code, licensing procedures and the tax code.

A.I.D. also directed the Missions' attention to the possibilities associated with the privatization of the delivery of traditional government services. The conventional approach to providing many such services is for government to collect the revenues needed to support the service, often through user fees, and to actually provide the service as well through government facilities and workers. The rationale for such an approach is that municipal and public services are public goods that must be produced and paid for collectively. But as A.I.D. has noted, these goods and services are often commercial in nature with specific, identifiable users, who are the services' main beneficiaries. Such services are good opportunities for privatization. Where goods and services are public in nature, partial privatization through contracting out may be appropriate.

As will be discussed in some detail later in the section devoted to the Missions' response to AID/W's directives, it is obvious from reviewing the Mission reports that the majority of the Missions possessed a good understanding of both the considerable opportunities and complexity associated with a comprehensive privatization program, and were resourceful in attempting to implement such programs under a variety of less than ideal circumstances. We believe that this positive response is attributable in part to the guidelines, advice and direction provided to the Missions through "Implementing A.I.D. Privatization Objectives."

In implementing their privatization programs, Missions were urged to encourage the private sector, whether foreign or domestic, to undertake the full range of privatization activities without relying on A.I.D.. Where that may not be possible, the Missions may offer technical assistance and financial assistance in the form of loans or grants. The different kinds of technical assistance that may be offered include sector and enterprise analysis, and project design, implementation and evaluation related to privatization. A.I.D.'s financial assistance is limited to loans and grants for specific purposes such as serving a catalytic role or assisting a private sector buyer/investor rather than the government. These forms of assistance will be discussed in greater detail in Section III and part D of this section.

C. Supplementary Policy Guidance and Documents

The supplementary documents which were developed between 1985 and 1989 to provide further guidance and advice to the Missions on the many different facets of a successful privatization program were also judged to be of suitable quality and appropriate coverage, although there were a few gaps. These include "Private Enterprise Development," "Financing Privatization Under Limited Capital Conditions," "Privatization: A Technical Assessment," "Critical Issues in Privatization: Politics, Institutions and Labor," "Innovative Uses of A.I.D. Funds in Financing Privatization," "Financial Markets Development" and Privatization and Development. Together, these documents cover, in sufficient detail, most of the key issues that Mission staff should be familiar with in order to manage and conduct a major privatization program.

A.I.D.'s Office of Policy Development and Program Review provided the Mission offices with a series of technical reports and policy guidance to educate and direct its officers about what "privatization" means, how the concept has been employed in other developed and developing nations, and what strategies can be used to facilitate its implementation. These reports are meant to provide the necessary guidance that Missions need to carry out the agency's privatization objective.

Our review of these documents leads us to the conclusion that, in general, A.I.D. has provided high quality background research material and technical information about privatization to the agency Missions. Overall, the materials are highly informative, readable, comprehensive and accurate. They are, in most cases, consistent with -- in both their descriptions of current privatization practices and in their technical recommendations -- the vast current literature on privatization.

In particular, we believe that these documents are noteworthy in three areas. First, they provide a solid framework for understanding privatization -- its strengths and its pitfalls, its proponents and opponents, and its appropriateness under a multiple range of political circumstances. This is especially valuable for Mission personnel who may not be familiar with the rapid developments in this area throughout the world.

Second, altogether the reports and books cover most of the important issues in privatization (with a few notable exceptions, discussed later). Chronologically, the reports cover background issues first and then more sophisticated, technical problems that may be encountered in implementing privatization in later reports. We found this to be handled in a logically consistent order, which helps to demystify the privatization concept for field officers.

Third, several of the reports contain detailed case studies which we judged to be well done. The case studies provide informative anecdotal material about how to put in place a privatization program in a developing country. We believe that this case study approach serves a vital and practical step by step "How To" role for Mission officers not previously acquainted with the many techniques of privatization. Moreover, because one of the unavoidable problems with these types of general resource materials is that each Mission faces highly unique circumstances, these case studies provide Mission officers with needed information about the various privatization strategies that might need to be employed. (We do, however, believe that some modifications, additions and updates to the case studies should be made to further improve their usefulness. Section VI will present some specific recommendations in this area.)

The following is a brief summary of the contents and the major points of emphasis of the policy guidance and reports we reviewed:

1. Private Enterprise Development

Released in March, 1985, the purpose of this policy paper, stated simply, is to establish that private enterprise and free markets are primary precursors to economic growth. The paper instructs Missions to use A.I.D. funds in a manner that "promotes movement toward a democratic, free market society." It directs regional bureaus and field Missions to "engage in specific direct program actions to eliminate legal, regulatory and other constraints to private enterprise development."

The report explains to the Missions how privatization corresponds with this broader objective of A.I.D. The move toward privatization in developing countries is mentioned as one of many methods to expand the private sector role in the LDC economy and thereby foster economic expansion. Others include loosening trade restrictions, reexamining import substitution strategies, lifting economic regulations, and establishing a system of secure property rights.

The report establishes three principles as part of A.I.D. development policy:

a. Superiority of the Free Enterprise System

The most efficient allocation of scarce resources occurs in a country when "individuals seek to increase their incomes in an environment characterized by open competition in the supply and exchange of goods and services." Nations overburdened with excessive government involvement in the economy tend to be those experiencing "slow growth, heavy budget deficits and rising debt burdens."

b. Public Ownership of Assets and Economic Growth

Public ownership and control of assets has failed to deliver promised results. In the 1950s and 1960s public enterprises were defended on the grounds that they would promote "economic self reliance and equity objectives" while correcting "assumed inefficiencies of the private market." In practice, parastatals have become a "liability to economic growth" resulting in "considerable financial and economic costs."

c. A.I.D.'s Role in Encouraging LDCs to Become More Reliant on the Private Sector

The primary function of A.I.D. Mission resources is to expand private sector involvement in the developing countries economies. A.I.D. funds should also be used to encourage the development of a fully competitive market place.

2. Financing Privatization Under Limited Capital Conditions

This research report details the difficulties of raising capital for privatization ventures in third world countries. A major reason cited for the reluctance of private sector lenders and investors to finance privatization schemes in LDCs is the lack of mature financial markets in these countries. This study examines the alternative methods of raising capital for privatization in LDCs with emphasis on the role that A.I.D. Missions can play in identifying these support mechanisms for LDC governments. It serves as a resource guide to Mission officers in overcoming the obstacle of limited capital for privatization.

The report highlights three major themes:

a. How Missions Can Determine the Financial Viability of a Privatization Plan

"Weak financial markets" have tended to be a major hindrance to implementing privatization in the developing world. For this reason government officials must first determine whether an asset could be "financially viable in the private sector." This will depend on such factors as: the existence of markets for the product, the amount of debt burden the private firm will have to absorb, whether management will or can be replaced, and whether the country's legal structure can protect the financial interests of private owners. A.I.D. Missions can increase the likelihood of successful privatization programs in an LDC by communicating to the government the types of legal and regulatory changes necessary to "make the business environment more favorable for investment."

b. Attracting Foreign Investment to Finance Privatization

If a country can attract foreign investers to finance a privatization opportunity, the problems associated with a lack of indigenous capital sources can be surmounted. Missions should help identify barriers to outside capital in an LDC. These might include: maximum foreign ownership provisions, limitations on the repatriation of profits, restrictions on the employment of foreign workers, imposition of double taxation, requirements that domestic inputs be used, and prohibitions against foreign ownership of the land.

Although some nations provide various incentives -- such as tax holidays -- to attract foreign investment, A.I.D. Mission officers should stress to these governments that "such incentives can never substitute for the fundamentals: investment climate, political security, and profit potential."

c. How A.I.D. Can Promote Privatization in Countries Where Capital Markets Are Weak

Several "alternative financial mechanisms" can be used to finance privatization in LDCs with underdeveloped capital institutions. These include: leveraged buyouts (LBOs), debt-equity-swaps, employee buyouts, and giving away the shares of a money-losing operation to private investors who may be able to turn the firm around, a mechanism referred to as an uncompensated transfer of ownership.

3. Privatization: A Technical Assessment

This research report is designed to serve the crucial function of helping A.I.D. Missions develop viable privatization strategies for LDCs. It discusses such issues as: how other countries have privatized services and assets, how to minimize public employee opposition to privatization, how to value the assets of a firm targeted for privatization, and what forms of privatization should be pursued by the Missions. Privatization is correctly emphasized as "essentially a political decision" even more than an economic one for many LDC governments.

This document more clearly defines the Missions' role in privatization than does earlier reports. Missions are urged to participate in different capacities during the various evolutionary stages of the privatization process. In the first stage, the agency's role is "informational." This means the Missions can help identify SOEs and services that might be amenable to privatization and "explain the fiscal advantages of privatization while at the same time point out the pitfalls that may result from inadequate planning." During the second phase, once a privatization plan has been adopted, the Missions are asked to provide "technical assistance necessary for company evaluation, legal preparation for change of ownership, and locating suitable buyers." The Mission is permitted to assist both the seller and the buyer as a "disinterested participant."

One crucial issue is the role of A.I.D. personnel in preparing the government enterprise for privatization. Many governments mistakenly believe that a revenue producing firm can be placed up for sale with minimal preparation and financial advice. This is a recipe for failure. Hence, A.I.D.'s most important function is in helping the host government determine:

- What technique should be used to sell the firm?
- How will the privatization plan be financed?
- Should the government strive for complete, or partial, divestiture?
- Who should the firm be sold to?
- What price, if any, should be charged for the enterprise?

This report stresses a point made in earlier policy documents: A.I.D. direct financial aid should be offered only under limited circumstances -- that is, when privatization will not proceed without it. The Missions are directed to promise support funds sparingly. The Missions are further instructed to provide continuous technical assistance (to the extent that it is sought by the LDC government) throughout the privatization process. When Mission personnel are replaced, "efforts should be made to see that successors have substantial skills in privatization in order to maintain the government's confidence in the Mission's support."

Finally, the Missions are also requested to work with other international donor agencies, such as the World Bank and the IMF, to facilitate a coordinated privatization strategy.

4. Critical Issues in Privatization: Politics, Institutions, and Labor

This 1989 report discusses many of the critical privatization issues not analyzed in the previous study. It thus serves as a logical companion document. The report focuses on three aspects of a successful privatization initiative: (1) resisting political obstacles to change; (2) implementing necessary institutional changes in the country's legal, constitutional and regulatory environments to pave the way for privatization; and (3) overcoming the objections of the government labor force, which traditionally views privatization as a threat to jobs and/or wages. The report serves as a training manual for Mission officers in coping with each of these "impediments to privatization."

It is the responsibility of the Mission officers to work with host governments interested in privatization and to assist in developing strategies to overcome the "political risk" and "employee hostility to privatization." Missions are instructed to assign "one Mission officer who will be responsible for the work on privatization over as long a period as possible and will be able to devote full attention to the program."

The main technical points of the report can be summarized as follows:

a. Minimizing the political risk of privatization

Political opposition to privatization may emanate from several potential sources, including opposition political parties, the legislature, political interest groups with a stake in preserving the status quo, the bureaucracy, and the military (which traditionally argues that SOEs are vital to the national security of the nation.)

Overcoming these political risks can be achieved by adopting a politically pragmatic privatization strategy that addresses all of the political as well as economic considerations involved in devising a viable privatization plan. The goal of this strategy is to "reduce the risk to a politically acceptable level while still leaving the government in a position to achieve a successful privatization program."

This can be accomplished in several politically pragmatic ways such as limiting purchases of SOEs to citizens, engaging in a public education campaign on the advantages of privatization, carefully timing the privatization to reduce political risk, selling privatization as "competition", and compensating political losers in the privatization process.

b. Laying the Legal, Financial, and Regulatory Groundwork for Privatization

Privatization will only be successful if the government has put in place the proper legal protections for private buyers, standard accounting practices to come up with a realistic valuation of the firm; and deregulation to allow the privatized firm to operate efficiently. Unless this fundamental groundwork is laid, few private owners will show interest in taking over a government enterprise. A.I.D. technical assistance is particularly appropriate in these areas.

c. Overcoming Labor Force Objections to Privatization

Opposition "by labor leaders and the rank and file membership of trade unions to privatization is a major deterrent to more rapid progress in privatization." This is true even though labor's complaints about privatization are often overstated. Governments can protect the interests of affected workers through such strategies as educating labor about privatization and the jobs that will be created, protecting the jobs of "redundant workers", retraining, insuring that pension rights will be honored, encouraging employee ownership of the new firm, and offering a lump sum "buyout" payment to affected workers.

5. Innovative Use of A.I.D. Funds in Financing Privatization

This recent A.I.D. report on privatization discusses the various ways that agency funds can be used by Missions to advance an LDC's privatization program. The report emphasizes that "A.I.D. resources can only be stretched to meet a very small part of the overall needs" in promoting privatization in developing nations. Techniques to ensure that A.I.D. Missions secure maximum impact from limited finances include:

- Devoting funds to "smaller, more narrowly focused programs in privatization" where large amounts of finances are not necessary and yet in which other donors, such as the World Bank, are not likely to be interested.
- Providing technical, rather than direct financial assistance. Technical assistance funds have been used successfully in the past to help governments decide "what assets should be privatized, in what order, and over what period of time." Funds are also typically used for public education programs and developing strategies to meet the objections of powerful interest groups, such as organized labor.
- Assisting LDC governments to identify and consult trained outside experts in areas of finance, accounting, legal property rights, and management. These might be either private sector resources or other donor agencies.

Finally, this report briefly identifies privatization programs that Missions may consider implementing in the future. These could include improving the image and understanding of the private sector, attracting new forms of financial investment in the LDC to expand the number of potential buyers, and expanding privatization activities to include more than just SOEs -- including privatization of agriculture, publicly-held land, and even social services (such as health services and education.)

6. Financial Markets Development

Although not specifically related to A.I.D.'s privatization program, the policy paper "Financial Markets Development" covers an area of critical importance to any successful privatization program -- a country's financial markets and how they might be improved. Absent a functioning financial market, a Mission's privatization strategy will be severely limited, as will any private sector-oriented development program.

In appreciation of both the importance of the issue and its all too frequent neglect the paper notes that, "A.I.D. too often has designed and implemented projects without taking into account the broader issues involving financial systems in developing countries." The paper attempts to rectify this neglect by describing A.I.D.'s policy on financial market development and by providing guidance on the development of A.I.D.'s program and projects in financial markets.

The paper strongly endorses freely functioning financial markets subject to limited government interference, and notes with favor that several developing countries have recently begun to liberalize their heretofore government-controlled credit markets. The paper argues in favor of competition and free entry, private ownership of financial enterprises, and market-determined interest rates.

In support of these goals, the Missions are expected to serve as a catalyst for financial market liberalization and should encourage the country to design, adopt and implement policies conducive to the development of efficient, deep and integrated financial markets that rely on market rates of interest to encourage savings and efficiently allocate scarce resources. For A.I.D., the primary source of capital for growth should be the domestic economy. The countries are also encouraged to promote competition between private, profit-making entities.

To achieve these goals, the Missions are provided with a comprehensive set of guidelines and principles with which to implement the program. Missions are urged to begin with the overall macroeconomic policy environment within which the financial markets are just one part. Foreign investment should be encouraged as should domestic savings. Missions are encouraged to channel their resources through private financial intermediaries and to offer technical assistance to help these private institutions develop the necessary banking skills. Missions may work to create new financial institutions, although working with and reforming the existing system is preferred. Missions are also encouraged to assist in the development of securities markets for equities, innovative debt and equity instruments, venture capital activity, and debt/equity conversions.

While a valuable and helpful document, "Financial Markets Development" provides no specific guidance for financing privatization. Indeed, there is no explicit mention of the process at all, the various techniques to finance a privatization and where and how they might be applied.

7. Privatization and Development

Perhaps the most comprehensive and innovative of the materials provided by A.I.D. to the Missions, Privatization and Development was meant to serve as a "how-to" manual of privatization techniques and processes. Edited by Steve Hanke of The Johns Hopkins University and published by the International Center for Economic Growth, the book is a compilation of the papers presented by some of the world's leading privatization experts at a 1986 A.I.D.-sponsored conference on privatization in Washington. Consisting of twenty-three chapters organized by five major themes, the book offers practical guidance on a wide variety of issues likely to confront Mission staff as they attempt to implement their privatization program.

The first section offers a broad overview of the issue, expressing privatization in the general terms useful for establishing a constructive dialogue with the host country's government. The second section narrows the focus but still takes the broad approach by limiting the discussion to fundamental issues affecting the policy environment as it relates to politics and property rights. Part three gets into the planning details -- finance, taxes, marketing and developing detailed strategies, while Part four covers different segments of the economy -- agriculture, public services and financial markets. A series of case studies concludes the substantive sections of the book, and the last part brings the reader back to the broad philosophical issues with a chapter by the editor expressing the concept of privatization in terms of a "people's capitalism."

Unlike most of other materials available on privatization, this is an innovative and comprehensive guidebook to the nuts and bolts of privatization. If Mission staff survive the politics of getting the process underway, the book then offers a detailed check list of what must be done to accomplish a successful privatization. Following this, separate chapters are offered on the key technical areas that are included on the check list. The check list also includes a discussion of the concept "targets of opportunity", and the section of the book after this provides several specific choices that might typically be found in a developing country attempting to dismantle the state. Combined with the other materials provided by AID/W, Privatization and Development fills in most of the gaps and provides a series of creative step-by-step approaches for the practitioner of privatization.

D. Other Support and Assistance

Although A.I.D. did not make any additional financial resources available to the Missions to assist them in fulfilling the new privatization objectives, it did offer them other important sources of supplemental support that many Missions found useful. These alternative forms largely amounted to technical assistance and information needed for achieving successful privatizations. These include privatization resources available from the Bureau of Program and Policy Coordination (PPC), the Bureau of Private Enterprise (PRE), the Bureau for Science and Technology (S&T) and the Bureau for Africa.

1. PPC Resources. PPC offers a variety of independent assistance to Missions in their efforts to conduct privatization programs, including a privatization specialist to respond to requests from Missions for advice. This specialist had worked with several Mission privatization programs in advance of the formal policy determination. PPC was also responsible for several of the reports that were reviewed in the previous section.

2. PRE Resources. PRE contracted with several private sector sources for assistance in policy dialogue, strategy development, and technical assistance. Included in this program was the contract with the Washington-based Center for Privatization which possessed the capability to offer short-term technical assistance to many Missions and host governments over the next several years. Areas of concentration included organization, production processes, finance, audit, product marketing, personnel, asset valuation and disposition.

3. S&T Resources. S&T offers services in employment and enterprise policy analysis, labor markets, ESOPs, retraining, tax reform, and contracting out programs. Services are often provided through private contractors and are available by way of Mission buy-ins.

4. Africa Mission Resources. Special technical assistance for African Missions was made available through a group of private companies led by Coopers and Lybrand in Nairobi. Other companies in the group included Morgan Grenfell Bank, Arthur D. Little, and Technoserve. These companies are prepared to offer a full range of consulting services to assist Missions in conducting their privatization programs.

Although an evaluation of their work is beyond the scope of this report, it should be noted here that the Missions appear to find these consultants to be a valuable resource that is used extensively and creatively under a variety of circumstances. The consultants from the Center for Privatization, the Washington-based organization funded by AID/PRE, are mentioned frequently by the Missions in Asia, North Africa and Latin America. In Sub-Saharan Africa the work of the accounting firm Coopers and Lybrand is mentioned frequently and often with praise. See in particular the review of Coopers and Lybrand's work in Madagascar as described in that Mission's privatization narrative.

E. Mission Reporting Requirements

Anticipating that privatization would become an integral part of each Mission's program, AID/W established guidelines for both short- and long-term reporting requirements. At the outset, Missions were asked to provide an overview of their plans for meeting the privatization objectives. The overview was to list current privatization activities and the strategy and schedule for implementing the new program.

In the short term, Missions were asked to provide details including targets of opportunity, the proposed strategy and the projected time frame. An essential first step was to identify the local institutions that would be involved in the process and how they might be influenced and assisted. In the long term, the Missions were expected to integrate their privatization programs into their annual budget submissions and their action plans. The annual budget submissions became the chief vehicle whereby the Missions reported their plans and progress to AID/W. Because these reporting requirement instructions were so general and cryptic, actual Mission reports varied substantially in scope and detail.

F. The Missions' Response to the Program

In the final analysis, the proof of the quality and effectiveness of any directive and the accompanying support is how the target audience reacts to the request, and the quality of its response. Judged this way, we believe that the directives and support provided by AID/W were well-suited to the objectives of the program. On average, the Missions responded to the request by developing and implementing, often within just a few months, solid privatization programs for the countries of their responsibility. The term "on average" is of significance because the quality and responsiveness varied over a very wide range, and this will be discussed later.

For the typical Mission, four reports were submitted to AID/W over a period of three years. The first was submitted in approximately July, 1986, while the last, included with the FY 1991 Annual Budget Submission, was submitted around June, 1989. As a result, A.I.D.'s recorded Mission privatization performance to date spans only three years. Given the short period of time to develop and execute a complex and dramatically different program, the performance of the average Mission was quite impressive. Most had developed (and provided the details to AID/W) a thoughtful and appropriate plan within a few months of the formal request in early 1986. It should be noted here, though, that several Missions had privatization programs underway well in advance of the 1986 policy change. See, for example, Bangladesh's annual budget submission and the review of the Jamaica program in Section V.

Some Missions, of course, fell short of this, but most performed in an exemplary fashion. In large measure, the Missions created solid programs containing good ideas, set clear objectives and brought to bear on the task a variety of creative tools and techniques, including several that were not discussed in any of the policy papers, to bring these ideas to fruition under a variety of adverse circumstances. Section V offers several summary descriptions of case studies drawn from the Mission reports.

G. How to Judge the Mission's Performance

In any privatization program there is the temptation to judge performance by the number of privatizations that occur during a particular year or in a particular country relative to those that take place in another. While the original goals in "Implementing A.I.D. Privatization Objectives" were expressed in both qualitative and quantitative terms, some of the early emphasis seemed to be on quantitative goals with each Mission strongly encouraged to engage in two privatizations by the end of the year, an objective that many Missions ignored. Underscoring A.I.D.'s early emphasis on quantitative measures, AID/W's earlier attempts to summarize the results of the Mission reports were in the form of lists of country activities in the process of being privatized.

Establishing such quantitative goals and judging the Missions by them may have been helpful to spur the Missions into action but it does not offer a very useful gauge by which to measure subsequent performance because of the complex web of factors, often independent of Mission staff, that will influence privatization progress and performance. Other factors that limit the ability to gauge performance include the absence of any required reporting standard and a lack of information (at least for these reviewers) on the resources available to the Missions. It should be noted that the lack of a specific reporting standard was done intentionally so as to allow the Missions sufficient discretion in establishing a new program to fit local circumstances, and a preference not to force them all into one format that may later turn out to be inappropriate. However, now that the program is moving into a more mature phase of operation and that numerous reporting formats have emerged from the Missions, the implementation of some standards seems desirable. Section IV and VI provide some suggestions for establishing common reporting standards that could help to better guide the program.

Missions were asked to provide a narrative report each year on their privatization program with the format and the amount of information required left largely at their discretion. As a consequence, some reports covered less that a single page while others went on for twenty or more. Such differences may not tell us much about performance inasmuch as the former may be substituting exhaustive reporting for inadequate performance, while the later might have been so busy implementing and managing field activities that there was little time for report writing. Also, the reviewer has no information about the extent to which staff is responsible for other pressing duties as a result of limited Mission resources.

Of greater importance, though, is the political and economic environments in these countries. It is apparent from the Mission reports that a positive economic environment characterized by positive growth, moderate inflation and no severe product shortages is more conducive to making progress in privatization than one in which some or all of these economic variables are substantially negative. On several occasions, as a Mission's report will indicate, a seemingly good privatization program may get sidetracked as a result of economic stress caused by drought or a decline in the price of a key export commodity. In such cases, the limited government and Mission resources are devoted to dealing with the more pressing problem while institutional reforms and privatization are put off until a more conducive time.

Likewise, political change and instability are important factors in creating (or destroying) an environment conducive to privatization. In several cases reported by Missions, an otherwise attractive privatization program was put on hold as the government faced elections or as government personnel changed as a result of some political disturbance. Such factors can deter privatization despite the efforts, talents and resources of Mission staff.

Even assuming the political climate is stable, Mission staff can only go as far as the host government (or bureaucracy) will permit, although it is recognized that a highly skilled Mission staff could help to change these attitudes and overcome obstacles. Countries such as Peru, Pakistan, Indonesia and the Sudan have governments that appear to have been adamantly opposed to privatization, often for ideological or cultural reasons, during the period covered by the reports. Thus, Missions in these countries had little to show for their efforts, but this outcome is independent of their skills and perseverance. Similarly, even when a government is committed to privatization or is willing to experiment, progress will depend upon the skills and interest of those ministers and officials responsible for implementing and executing the program. In several cases, an otherwise thoughtful and innovative privatization program aggressively pushed by Mission staff will go nowhere because of insurmountable political obstacles or bureaucratic ineptitude. Elsewhere, good to middling programs may achieve considerable success because of the enthusiasm and talents of those in the government responsible for executing them. In either case, judgements about the privatization program can often tend to be more a judgement about the government officials in a country than that of the Mission's work.

For these and other related reasons, Mission (and A.I.D.) performance on privatization should be judged as a process that is closely related to the opportunities and obstacles that confront each Mission, and not necessarily as a series of quantitative goals that have been achieved. Included in the qualitative measurement of such processes are issues such as: How comprehensive was the Mission's agenda? Was it innovative in selecting both targets and techniques? Does the Mission evidence a good understanding of the process and the opportunities available? How did it respond to obstacles and adversity? To what extent did the government come to respect and rely upon Mission and assistance? These should be the key accountabilities that AID/W uses to evaluate the performance of the program and of the individual Missions. Each country is substantially different, as are the inherent talents and skills of the Mission staff, and judgements about success should be on the process established, or the extent to which the Mission staff aggressively pursued the opportunities available to them with whatever resources were at hand.

Another source of difference between Missions was the implied scope of their activities. A number of Missions seemed to have limits on the scope of their program imposed upon them from some source, either internal or external, although the limits were seldom mentioned or made explicit. For example, several of the African Missions noted that because their extant development focus is exclusively on the poor, rural agricultural population in their country, their privatization program would have the same focus as well. Thus, in such Missions, privatization targets tend to be limited to such items as seed production and distribution, road repair, fertilizer distribution and crop marketing programs. Largely ignored are mining and manufacturing parastatals, financial institutions and municipal services, privatization opportunities that almost certainly exist in the typical African country. Elsewhere, including other primarily rural countries in Africa, the Missions have taken on fairly expansive responsibilities that extend well beyond those activities directly related to agriculture. The programs described in the privatization narratives of the

ABS from Nigeria and Zaire, comparably situated countries in Africa, illustrate an extreme version of this difference, with the Mission in Zaire taking on a broad range of activities and enterprises while that in Nigeria focusing exclusively on contraceptive distribution.

Obviously, any judgement and evaluation method that does not rely on easily quantifiable measures of performance will be somewhat subjective and open to discretion. Nonetheless, such a judgement process can still be fair and accurate provided that the evaluators receive the proper information in the appropriate format. Although AID/W never established a standard reporting format and largely left the nature of the report to the discretion of the Mission, several Missions did provide A.I.D. with excellent programs and reports that provided extensive information on the scope of their work, why the targets were chosen, how they will be pursued, what will determine success and what changes may be needed to respond to obstacles or altered circumstances.

What distinguishes a good program and report from the lesser ones is the extent to which the Mission clearly presents its goals within the context of the opportunities and obstacles that confront it, and then provides the information on how these goals are to be reached, what will be the measure of success and how much progress has been made over time. In a effect, a good report adequately describes the process underway, demonstrates that the Mission is aggressively pursuing its goals regardless of circumstances, and that the Mission is capable of changing both strategy and tactics in response to changed events and unforeseen obstacles.

Despite any specific directions on either programs or reporting, several of the reports/programs generally met this ideal. In Africa, the programs and reports of the Missions in Cameroon, The Gambia, Madagascar, Malawi, Mozambique and Zaire are of particular note. In the ANE region, programs of note include Egypt (in the early years), Jordan, Morocco, Nepal, Pakistan, Tunisia, and Thailand. Nepal's report is a good resource on small country privatizations inasmuch as a number of other Missions and countries used smallness as an excuse for doing little. Tunisia is useful as a guide for an aggressive program for the divestiture of state-owned enterprises. In Latin America, the better programs and activities appeared to be in Bolivia, Costa Rica, the Dominican Republic, Honduras and Jamaica. As the best of the best, we would rate Zaire, Egypt, Tunisia, Bolivia and Jamaica as programs and reporting formats that could be emulated by other Missions if reporting standards along common lines are adopted by AID/W.

As good as these programs and reports are, in one way or the other each is deficient in some critical area as it relates to A.I.D.'s ability to manage and evaluate the overall privatization program and determine the extent to which each Mission is taking full advantage of the opportunities available in each country. Although the next section of this report discusses the basic components of what should be contained in a report, one almost universal deficiency in the Mission reports submitted to date is an absence of any mention of changed performance on the part of the privatized activity or enterprise. Although one can advocate privatization on purely ideological grounds, A.I.D.'s practical interest in the process, as well as that of the developing countries that it works with, is that the shift of an enterprise from public ownership operating under monopoly conditions to private ownership in a competitive market leads to a substantial improvement in performance as it relates to both the quantity, quality and cost of the service or product. In this regard, and from the country's perspective, the act of privatization is really the beginning of the process, not the end.

Unfortunately, few Missions have provided much information on post-privatization performance, although the reports from the Missions in Belize and Honduras are two partial exceptions. This is an unfortunate deficiency because such information is both a useful guide to success as well as important data that can be provided to skeptical governments contemplating privatization. In fairness, the three year time span which this survey covers would not yet offer many good examples. Nonetheless, some follow up should be made in the near future of the many individual initiatives described in the Mission reports. The results of this survey could be used to construct a list of privatization successes as defined by subsequent performance.

H. Role Of Other Organizations.

In many instances A.I.D. is one of several external donor or assistance groups that are working in a particular country to assist it in privatizing some of its enterprises. In about half the reports the Mission makes note of the other groups and the extent to which A.I.D. and the other donor organizations are coordinating their activities and/or dividing up the targets. The International Bank for Reconstruction and Development (IBRD), in particular, is often active in privatizing SOEs as part of its comprehensive structural adjustment programs. Where several such groups are present, the Mission will generally note in its report that the efforts by the various groups are being coordinated. In some cases A.I.D. might be in a leadership role while in other instances its efforts are dwarfed by the IBRD.

Knowing the extent to which other groups are participating is important for purposes of judging a Mission's program and for developing models of cooperation that might be applied elsewhere. For example, some very limited programs may be due to the fact that most of the opportunities are being directed by a multilateral donor or by an assistance program from another donor country. Several of the African Missions noted that their focus is exclusively on agriculture because the IBRD or another donor has taken responsibility for the non-agriculture privatization opportunities. Elsewhere, the Mission and other donors have coordinated their activities with A.I.D. providing the technical assistance while the multilateral donor provides the financial resources to implement the plan.

III. GENERAL TRENDS IN A.I.D.'S PRIVATIZATION PROGRAM

As noted earlier, making any general evaluation of the A.I.D. privatization program to date confronts a variety of analytical difficulties. The newness of the program, the absence of detailed information on the targets of opportunity in any country, lack of standardized reporting, what kinds of obstacles, political or economic, are confronted and the resources available to Mission staff all work to shape the programmatic outcome in ways beyond the control of the Mission. Nonetheless, there are a number of general programmatic trends in activity and progress that appear in a significant number of programs and reports, and these are described in this section by broad themes of activity.

A. Policy Dialogue: The Provision of Basic Information and the Encouragement of Constructive Institutional Arrangements.

"Implementing A.I.D. Privatization Objectives" urged Missions to ". . . develop a conceptual dialogue with the host government . . ." and many of them did so, using a variety of techniques to establish a constructive "consulting" arrangement with the appropriate officials in the host country. Such arrangements varied by circumstances and most yielded some success using a variety of different approaches. In some cases a dialogue was initiated by way of a major conference taking place in the host country. In Tunisia and Morocco, for example, the Mission sponsored conferences where leading privatization experts came to present and discuss the many facets of privatization and to address the concerns of the leaders of the government and the private sector.

In the case of Tunisia, the conference convinced many of the participants that privatization was an essential tool of government and growth and began the process that led to the creation of an ambitious divestiture program in that country. During that time, the Mission advised and directed the educational process and offered encouragement and assistance to move forward. Several such conferences were held in other countries, although not always with the same positive results.

In other cases, the Mission staff itself served as teachers and advisors to government commissions, departments or ministries and to ministers and other leaders, including local business organizations. In some instances the experts from the Center for Privatization were brought in to conduct the policy dialogue and develop overall strategy, in contrast to their more typical role of technical advice.

As other mechanisms to promote a better understanding and appreciation for privatization, Missions have sent government officials abroad to privatization conferences, including the major ones held in London and Washington in 1986. Responding to a unique opportunity among those interested in privatization in the Islamic countries, the Missions sent many officials to a Middle East privatization conference hosted by Turkey. In other cases, custom privatization tours have been arranged, such as the case where officials in Bangladesh were taken to Thailand and Korea for a study of the market process at work in an Asian country. In other situations the Mission might sponsor a seminar or conference in one country, as it did in Uganda.

While the payoff to such a dialogue and education process can be swift and positive, as it apparently was in Egypt and Tunisia where significant privatizations began to occur, elsewhere such efforts confronted the predictable obstacles to reform. In Peru, for example, A.I.D. was instrumental in creating and advising a privatization task force staffed by high level government officials. Unfortunately, when it came time to act, the task force demurred and nothing much happened by way of formal government commitment or action. Such results, however, should not be deemed failures. As noted several times before, the time period under review in this report is a relatively brief one for an issue as complex and controversial as privatization. The ideas and proposals planted in such forums may ultimately bear fruit under different circumstances, such as a change in government or through a structural adjustment program imposed by a multinational donor.

B. Technical Assistance

As recommended by AID/W, Missions are encouraged to use a variety of forms of technical assistance as the chief means by which to assist the host country in meeting its privatization objectives. Once a satisfactory policy environment is created, Missions are expected to begin the process of privatizing the targets of opportunity identified in their country strategy and to offer whatever assistance is suitable to the task and available for use. For the most part, such assistance is generally in the form of technical assistance although sometimes technical assistance is in the form of financial assistance when outside experts and consultants are brought in and the Mission pays the fee. The technical assistance that is offered, and the forum through which it is presented, vary widely from country to country. In some cases the technical assistance is of a general form, assisting countries to create an overall strategy for privatization. The Center's work in Thailand, Tunisia and Peru was of this sort and is more commonly associated with countries in the very early stage of privatization, as was the work of Coopers and Lybrand in Madagascar. The Mission's staff, depending upon its talents, can also play this role, as in Tunisia, Pakistan, Guatemala and Morocco where it made a strong case to the government on the benefits of privatization and was instrumental in getting the government to commit to an ambitious program.

More commonly, however, the technical assistance is offered on a project specific basis, which usually involves the divestiture of a specific state owned enterprise or a collection of such entities. Again, such assistance may be offered by Mission staff or by outside consultants. To the extent that there are any general trends, they are that Mission staff itself generally performs the technical assistance for many of the agriculture related privatizations and divestitures in Africa and the poorer Asian countries. The divestiture of seed production, fertilizer marketing and distribution, as well as the sales of certain agriculture outputs, which are the typical targets of opportunity in those regions, are apparently done largely by Mission staff in those countries. This is not surprising in as much the focus of those Missions is on rural and agriculture development, and staff should possess expertise in that area.

Once the privatization effort moves from agriculture and related initiatives and to the larger commercial enterprises involved in manufacturing and mining, the more typical trend is to seek the assistance of an outside consultant. The reason for this is that such a privatization exercise involves highly technical business skills which include market analysis, asset valuation, finance and accounting, and labor relations. Such skills are not often available in the Missions or in the host country, and usually must be acquired in the form of a team of outside experts possessing a variety of specialized skills. The Mission's work in Jamaica was of this sort where it brought in, and paid, a team of experts from N. M. Rothschild to do the National Commercial Bank and then the Caribbean Cement Company. Other examples include the privatization of ADMARC in Malawi that was assisted by Deloitte, Haskins & Sells, and the ambitious divestiture program in Honduras that was advised by experts from the Center for Privatization. Other project-specific consultancies include the airline in Jordan and SOEs in Costa Rica.

C. Financial Assistance

Although financial assistance is treated in this report as a separate form of support, in fact much of the technical assistance from the outside experts that was discussed above received extensive financial support from the Missions. This is due largely to the fact that many of the developing countries do not possess the resources needed to fund such costly assistance, or are reluctant to spend what resources they do have on a program that may not have their full support. Therefore, in an effort to spur the program forward, the Mission may have to finance a good bit of the initial activity.

Beyond the use of funds to provide technical assistance, Missions have used financial assistance as an incentive to encourage the host country government to engage in specific privatization activities. Many Missions report the skillful use of such incentives to encourage countries to take steps that they might otherwise not want to do. Economic Support

Funds, for example, have been used by several Missions as the "carrot" to move the government forward. Jamaica is another example of this, although the Mission makes it clear, reflecting the delicate nature of the process, that the relationship between dollars and action is an implicit one that reflects an "understanding" rather than a formal agreement. In some other countries, the connection is more direct and ESF money is used as a reward for meeting specific privatization targets, and released in increments as predetermined benchmarks are met. The Mission's work in the Dominicar Republic is an example of this.

Of more general use are the resources available to the Missions by way of Titles I, II and III of P.L. 480. Many Missions, particularly those located in the poorer countries, link P.L. 480 support with the attainment of privatization progress, or, more creatively, use the flow of resources available through the program to accomplish specific privatization goals. In reviewing Mission privatization narratives, there are two key ways in which Missions use the program to encourage action. First, they will link the release of the commodities or funds to specific accomplishments, often providing incremental "payments" in response to incremental progress. Second, it is sometimes used as a lever to force action by requiring certain market conditions to be met before resources are released. In a number of African countries, the Missions insist that P.L. 480 commodities must be imported and distributed through private sector entities. Where none exist, the host country must create them. Morocco, Ecuador, Mozambique, Ghana, Zambia and Bangladesh are examples of this, and rice and fertilizer are typically used as the Mission wedge to force into existence a private sector in the retail and wholesale trade business. Some Missions take this a step further and use the local currencies raised through the sale of the commodities to the private distributors as a financial resource to fund other privatization activities, thereby getting a double impact from a single resource. This policy of no privatization/no food appears to work with success where it has been utilized.

Elsewhere, Missions have used what financial resources they have to assist the countries in their privatization activities. Mission funds were used to finance Jamaica's Divestment Secretariat and Honduras'

Divestiture Implementation Unit. Although "Implementing . . ." mentions the use of loans and loan guarantees as a way the Mission may assist in the process, few Mission reports contained examples of such support. Egypt was the exception where A.I.D. provided loans to several parastatals that were in the process of partial privatization.

D. Political Action

It is in the politics of privatization where the Mission confronts its most sensitive task. The Missions are warned to use caution and most A.I.D. staff do because they are well aware of the delicate position they occupy in the host countries. For this reason, some Missions conduct their privatization work in a very discreet fashion to avoid the appearance of foreign influence in such sensitive issues. In some cases, and Morocco is a good example of this, the government, after being spurred on by Mission staff, terminates formal contact with Mission staff once the program is under way so as not to jeopardize its success by giving the appearance that it is acting at the behest of foreign advisors.

In a few cases, however, Mission staff has directly confronted the domestic critics of the program by conducting special outreach programs to directly address the critic's concerns. In Thailand, the Mission developed a special program to educate organized labor on the benefits of privatization once it was recognized that labor's opposition to the privatization program posed an obstacle to its success. For the most part, though, such overt efforts are rare. Based on a review of annual budget submissions, where Missions are active in privatization they generally avoid the political aspects except on a discreet basis.

E. The Rural Focus in Africa

In reviewing Mission reports it quickly becomes apparent that there are essentially two different kinds of privatization programs underway in the forty countries targeted for Mission attention. One program might be referred to as a "general" program covering a wide variety of economic areas and privatization techniques, while the other consists of rural and agriculture-based activities, and involves only a narrow range of techniques and activities. This latter type of program is typical of the poorer countries in the three regions, with the greatest concentration in Africa. Based on Mission reports, this focus stems from both the resource limits in these countries, i.e. the lack of a financial market and and a weak private sector, and the Missions' traditional food production roles in these countries.

It is in these rural societies where much of the P.L. 480 initiatives are because of the primitive nature of the distribution systems and the continuing need for food aid. Targets of opportunity in these countries pursued by the Missions generally include such agriculture activities as seed production and distribution, fertilizer importation/production and distribution, crop marketing, forestry, irrigation, crop storage facilities and water well drilling and maintenance. Related activities include road maintenance and overland transport to reduce isolation and lower the cost of transport to urban markets. These are not as common as the farm activities but still appear in several Mission reports. An unrelated activity, but still somewhat common in the rural societies, is Mission efforts to create a non-government system of health clinics managed by PVOs and funded on a fee for service basis.

F. Divestiture of SOE Targets

Although the process of complete divestiture is the technique preferred by AID/W, it is the technique that is the most difficult to implement, at least based on many of the Mission reports that we reviewed. Although there were some notable country successes -- Honduras, the Philippines, Jamaica, and Costa Rica are three where several SOEs were divested -- for the most part the ambitious divestiture plans of many had yet to be executed. This need not be viewed as a failure. Divestiture is a complex and time consuming process and it is possible that many of the plans that were unfulfilled as of mid-1989 when the last report was submitted may now be in the process of implementation.

Nonetheless, it is apparent from the reports that many of the plans that were developed bogged down in bureaucratic inertia, political obstacles, economic adversity and a lack of will by the leadership once it came time to actually sell the facility. In Africa, Niger, Kenya, Zaire and Senegal are countries that developed very ambitious divestiture plans early in the program but had yet to act on much of them by 1989. Still, there were enough successes under adverse circumstances to suggest that the AID/W's emphasis on divestiture be continued and that Missions be provided with additional technical support and other assistance to move these plans forward. The enterprise divestitures by way of a public sale of shares in Kenya and Malawi serve as useful models of what can be accomplished in countries with unsophisticated financial markets. Also, the ESOPs used in Egypt and Malawi are indicative of the creative solutions to developing country financial market problems that the Missions are capable of developing.

IV. BENEFITS/SUCCESSES

As noted earlier, measuring the success of the A.I.D.'s privatization program or that of any Mission by some quantitative goal that counts divestitures and other explicit acts of privatization may not always provide good judgements about Mission or program performance because of the complex web of factors that influence privatization progress and performance. These factors have already been discussed in some detail in Section II.G.

Briefly in review, one very important factor that may hobble or help a Mission's program is the political and economic environment in these countries. A positive economic environment characterized by positive growth, moderate inflation and no severe product shortages is more conducive to making progress in privatization than one in which some or all of these economic variables are substantially negative. Alternatively, a good privatization program might go nowhere as a result of economic stress caused by drought or a decline in the price of a key export commodity.

Political change and instability are important factors in creating or limiting an environment conducive to privatization. Such factors can deter privatization despite the efforts, talents and resources of Mission staff. Even assuming the political climate is stable, Mission staff can only go as far as the host government (or bureaucracy) will permit. And even when a government is committed to privatization or is willing to experiment, progress will depend upon the skills and interest of those officials responsible for implementing and executing the program.

Nonetheless, despite these problems, and the short time in which the program has operated, considerable progress has been made in these countries, both in achieving greater acceptance for the concept of privatization and in completed privatizations as well as the many that are in progress. As has been mentioned in the previous section and will be covered in the next, several countries have conducted an impressive number of full or partial divestitures. Bangladesh, Jamaica, Honduras, Costa Rica have all privatized more than a half dozen enterprises apiece since their programs began. Jamaica may represent the most impressive performer during the 1980s. It sold most of its hotels, most of its cement company, a major commercial bank, a portion of the telephone company and several agriculture estates. Many of these have been by way of public share offerings which have led to a significant improvement in Jamaica's capital markets that will, in turn, lead to improvements for all businesses. In each of these instances, Mission staff was actively involved in advising the host country governments and in providing some of the financial resources needed to ensure success.

Beyond these obvious successes are many other countries and Missions who managed to divest one or two enterprises. Kenya, Malawi and the Dominican Republic are a couple of those who have achieved an impressive success or two and who hold the promise of achieving much more in the future. The Dominican Republic contracted out all waste collection services in Santo Domingo to private firms. Rice marketing has been privatized, government land will be sold to private tourism developers, and government sugar lands have been leased to private farmers for the cultivation of other crops for export. Malawi has been engaged in a major agricultural enterprise, including a seed company and an oil processing facility. An ESOP may be used to facilitate a privatization in this area.

Although there have not been that many actual divestitures, many countries have spent the last few years developing detailed, comprehensive strategies for the divestiture of many of their SOEs. In Africa, ambitious divestiture plans have been developed by or for Niger, Kenya, Senegal, Zaire and Madagascar. The Mission in Zaire has successfully privatized a seed production facility which quickly exceeded its production targets. Senegal has targeted forestry projects, rice distribution, fertilizer, seed production and distribution, management of peanut stocks, transportation and cereals marketing. While each of these efforts confront obstacles at the present, it is possible that progress will ultimately be made.

Also, in Africa and in the other countries with an agriculture-based economy, progress has been made in transferring portions of the supply and marketing operations to the private sector. As noted earlier, the three and a half years in which the program has been in existence is much too short a time to adequately evaluate something as complex and time consuming as the full divestiture of a government enterprise. Great Britain, for example, had only a few actual successes within the first three years of its program, and now, ten years later, is still slowly working its way through a large inventory of SOEs and other government-owned and operated commercial activities.

Divestitures are the most obvious accomplishment and the technique preferred by AID/W. Other alternatives include contracting out a government service and leasing a commercial operation to a private sector management entity. Another acceptable alternative is the creation of a private sector to compete with a government monopoly. Kenya, the Dominican Republic, Jamaica and a few others have contracted out some municipal services in their capital cities. In Niger, the Mission helped create a system of private pharmacies to compete with the government ones. Of the 54 state owned enterprises, the government of Niger plans the complete or partial privatization of 22 SOEs. However, 25 have been deemed "strategic" and will remain in the hands of government. In Mali, the Mission created a private trucking system to haul cotton from the farm to the city in competition with government transport. Once in operation, more than 80% of the cotton was hauled by three private transporters.

As these and many other similar operations grow and demonstrate success, the trend is likely to spread to other activities within the industry and the country at large. To date, however, these are too new to have much of a sense of their survival and performance relative to that which they replaced. Thus, it is essential that these programs continue to be monitored so that the gains can be recorded and reported as they occur.

The real measure of success and performance is not the actual act of privatization but the improvements in operation that are expected to occur. Privatization is a tool of development and a means to an end, not an end in itself. By replacing inefficient, government-managed monopolies with competitively-driven and entrepreneurially-managed enterprises, costs are expected to fall and quality to rise. Unfortunately, the Missions seldom report such an outcome, partly because it is still too early to take such measures, but also because no one asked them to include this information in their requested privatization narratives.

In the few instances where Missions have provided the information, the results are impressive. The Belize banana plantation, a Honduran saw mill and the Costa Rican sugar mill are three instances where Missions or others have provided detailed measures of vastly improved, post-privatization performance. In Belize, the privatization of the banana plantation led to increased acreage, higher yields and improved export earnings. Efforts are now underway to nearly double the amount of land under cultivation. In Honduras the privatization of the forestry and sawmill parastatal led to an 80% increase in production, a 577% increase in lumber exports and a 257% increase in net revenues. Employment increased from 340 to 510 workers. All of this occurred within a single year. In Costa Rica, the privatized sugar mill went from a $2.4 million loss in one year to a profit of $1.4 million one year later.

Beyond this, the only other such reports were from a few African Missions that reported improved seed production and lower fertilizer costs from those activities where privatization has occurred. It is for these and other reasons -- the short duration of the program and the limited information available from Mission reports -- that the report precludes a comprehensive assessment of the extent to which the privatization programs led to widespread business ownership, enhance competition, improved capital markets and quantitative measures of job creation, debt reduction, and/or lowered product costs. To some extent, however, these issues are discussed in the next section on case studies. In Section VI we recommend that A.I.D. alter the reporting requirements to obtain more such measures of performance from the Missions.

Although specific, well-defined quantitative measures of success are elusive, nonetheless we can express a country or Mission's progress by way of a series of milestones that define various stages in the process toward privatization accomplishments. In conjunction with AID staff, we have defined the process as comprised of chronological eight steps which are:

1. Information and assessment
2. Develop country strategies
3. Contextual discussion and policy debate
4. Marketing to attentive public
5. Technical assistance
6. Privatization in progress
7. Completed privatization
8. Post privatization evaluation

Accordingly, based upon information provided in Mission reports available through mid-1989, we have categorized the Mission by its stage attained in the privatization process. It should be noted that a country may fit several categories at any point in time, but that we will limit each to the highest level attained. Where appropriate, some brief comments have been offered to further clarify the activity.

1. <u>INFORMATION AND ASSESSMENT</u> (2 Missions):
   Cape Verde, El Salvador

2. <u>DEVELOP COUNTRY STRATEGIES</u> (0 Missions)
   Most Missions have gone through this phase and have moved on to other, more involved privatization initiatives.

3. <u>CONTEXTUAL DISCUSSION AND POLICY DEBATE</u> (16 Missions):
   Burundi, Djibouti, Ghana, Guinea, Liberia (gov't has not been very cooperative, although Mission seems to be making strong efforts), **Madagascar** (gov't is hesitant, although Mission has been aggressive), **Mauritania, Zambia, Zimbabwe, Burma, Indonesia** (Mission reports in 1988 possibility of regional conference, no later mention. Gov't doesn't seem to have asked for technical assistance yet.), **Morocco,** (gov't doesn't seem willing to accept TA, probably for political reasons), **Nepal** (however, Mission has conducted extensive research into legal and

regulatory context of for private and public enterprise, some forestry work), **Oman** (gov't plans divestment of fishing industry), **Pakistan**, **Peru** (has received some TA from Center for Privatization).

4. MARKETING TO ATTENTIVE PUBLIC (1 Mission):
Uganda

5. TECHNICAL ASSISTANCE (17 Missions):
Botswana (TA for Botswana Development Corporation), **Chad** (TA for rock crushing plant), **Nigeria**, **Rwanda**, **Somalia**, **Sudan**, **Swaziland**, **Tanzania**, **India**, **Jordan** (provided technical assistance to Jordan Electric Authority, not much actual privatization seems to be going on), **Sri Lanka** (provided assistance in sugar industry privatization study, conducted studies of other industries, TA helping the gov't to develop a comprehensive strategy), **Thailand** (conference held 85, general TA to gov't), **Ecuador** (provides various gov't agencies with privatization strategies and advice), **Guatemala** (1989 goals were to have one full privatization and at least one partial privatization. 90/91 reports do not provide much detail on progress), **Haiti** (assisted gov't in policy of contracting out health services), **Panama**, **Paraguay** (TA for privatization of cement plant).

6. PRIVATIZATION IN PROGRESS (8 Missions):
Lesotho (Water systems and fertilizer distribution), **Mali** (major agricultural enterprise), **Mozambique**, **Niger**, **Zaire** (seed production), **Egypt** (Mission assisted with development of ESOP in 1989), **The Philippines** (conference held, studies on the private corporate sector, assisting the gov't to develop privatization strategy and implementation framework), **Yemen** (plan is in early implementation stage to privatize 22 fruit tree nurseries, Mission has already assisted in establishment of three private sector nurseries.)

7. COMPLETED PRIVATIZATION (10 Missions):
Cameroon, **Gambia**, **Malawi** (divestiture of ADMARC), **Kenya** (successful share offering for a portion of major commercial bank), **Senegal** (assisted in partial privatization of reforestation activities),

Togo (seems that Mission has been involved in actual privatization projects earlier in decade), **Bangladesh** (extensive privatizations through 1982, but has since slowed down as only the difficult targets remain.), **Tunisia** (conference held in 87, technical assistance to National Restructuring Commission. In 1991 ten activities have been privatized but report doesn't indicate Mission's involvement), **Bolivia** (conversion of seed processing plants to private production), **Dominican Republic** (privatization achieved in CEA, Inespre, and Corde).

8. <u>POST PRIVATIZATION EVALUATION</u> (4 Missions):
Belize (evaluated the privatized banana plantation), **Costa Rica, Honduras, Jamaica** (Evaluations indicate significant improvements in employment, production, quality and the elimination of government subsidies. Jamaica evaluations focus largely on gains in public share ownership.)

V. CASE STUDIES

In this section, presented by major regions, is a series of brief case studies of the programs implemented and managed by the Missions. While each of these represent programs with above average measures of success, their chief reason for inclusion is to illustrate the diversity of technique, scope and accomplishments within the program.

A. Latin America and the Caribbean

1. Dominican Republic

Except for sugar, state-owned enterprises in the DR do not dominate the productive sectors, but are significant when measured by the number of workers employed, the amount of government subsidies needed to operate them, and the impact they have on limiting private sector growth. The major state enterprises and functions which are candidates for privatization include A) CEA, the state's sugar council; B) INESPRE, the price stabilization institute; C) CORDE, a holding company of various light manufacturing and consumer goods industries; D) CDE, the Dominican Electric Company and, E) a range of public services including water and sewage, health services and forestry development.

CEA, the state owned sugar board is the largest SOE and plays and important role in the Dominican economy. This is largely due to the numbers of people employed by the industry (50,000) and the fact that sugar accounted for as much as 35% of the country's total export earnings. Additionally, CEA controls 170,000 hectares of land, or 11% of the country's cultivated area.

INESPRE, the price stabilization board has a dominant role in the distribution and marketing of many crops, and a monopoly over rice and corn trading. INESPRE's intervention in crop marketing and distribution is inefficient, and results in late payment to farmers and millers, and increased post-harvest losses. Farmers' planting decisions often are distorted because of their expectations regarding INESPRE purchases and because of INESPRE's price control policies. INESPRE's power and market influence has tended to drive the private sector out of the production and marketing of essential commodities resulting in further inefficiencies and decreased productivity.

CORDE, the holding company for SOEs consists of 32 industrial, agricultural and commercial enterprises in which the GODR owns a majority share. Additionally, CORDE companies include 19 other enterprises through a minority position. These enterprises produce such things as cigars and cigarettes, liquor, milk, cement, cardboard boxes, shoes leather, flour and paint, as well as tires and auto parts. CORDE also owns the national airline.

CDE, the Dominican Electric Corporation, has a government monopoly for the generation and transmission of electrical power. While its role in the development and growth of the Dominican economy is crucial, the organization lacks the resources to maintain or improve its services. Thus, it is unable to maintain power generating and transmission equipment or collect revenues owed.

A.I.D.'s strategy in the Dominican Republic is to promote private sector led export growth and the diversification of agriculture out of sugar and into the production of non-traditional crops with greater long-term potential. One bit of leverage that the Mission had is a condition in the Economic Support Fund (ESF) program which required the GODR to modify its policies to increase the amount of CEA lands available to private investors for alternative crops and to streamline the administration procedures to gain access to this land. In what follows is the Mission's strategy for each of the major enterprises.

For INESPRE, the Mission achieved GODR's agreement on a policy change to eliminate INESPRE's monopoly over the import and distribution of rice and oil imported under the PL 480 Title I program and to open the marketing of these commodities to the private sector.

The Mission's strategy with respect to CORDE was to encourage the GODR to divest itself of these enterprises, or to eliminate the privileged position which these companies have that hinder private sector growth. The Mission assisted the GODR to plan for the divestiture of these enterprises by carrying out a study that 1) investigated the legal, financial, organizational, and operational structure of these enterprises, 2) analyzed the institutional and financial structure of the organizations to determine their efficiency and productivity, 3) identified the privileges that CORDE companies have that provide a competitive disadvantage to the private sector and means of changing this, and 4) developed a strategy for the GODR which provides detailed recommendations on methods through which CORDE enterprises might be more efficiently managed, closed or operated through private participation.

In the area of public services, a number of the services currently provided by the GODR can be better carried out by the private sector. Mission's policy is to involve the private sector in the provision of selected services that it can provide in a more efficient manner on a cost recovery basis, thus allowing the government to focus on more important issues.

The implementation of the policy reforms supported in A.I.D. have led to: more than 17,000 hectares of sugar land leased to private investors for alternative crops offering substantial employment for former sugar workers and often employing more workers per hectare of land than when under sugar cultivation; transfer of title of 1,700 hectares of sugar land from CEA to the Central Bank for sale to private sector investors in tourism projects; and the development of diversification plans for an additional 13,000 hectares of CEA land.

The Mission played a leading role in obtaining GODR agreement on a policy change to eliminate INESPRE's monopoly over the importation and distribution of rice and oil imported under the PL-480 Title I Program and to open the marketing of these commodities to the private sector. The new administration transferred responsibility for rice marketing to the Agricultural Bank and, at the same time, removed the consumer subsidy as an interim step. A year later it was transferred to private firms.

A.I.D. efforts to encourage privatization of public services focused on the collection of waste and the provision of health services. The Municipality of Santo Domingo, with A.I.D. assistance, undertook a feasibility analysis of the privatization of Waste Management services. The study proposed three alternative strategies for privatizing the waste management services, and the next year the system was contracted out to private firms.

A team sponsored by the Center for Privatization was requested by A.I.D. to identify and study one CORDE company which would be a likely candidate for privatization. The team identified the Fabrica de Clavos Enriquillo and suggested that privatization should take place through a buy-in under which employees would become shareholders in the company.

2. Costa Rica

Most all of the targets for divestiture are subsidiaries of CODESA, the government's parastatal holding company. Alunasa, a large aluminum-processing company, was sold by CODESA at the end of 1985 to FINTRA, a private sector trust which has been set up to facilitate divestiture activities. FINTRA is funded by local currency made available by the GOCR in connection with ESF dollar transfers. FINTRA is currently packaging and marketing Alunasa with the help of First Boston Corporation investment bankers and the Mission expects that at some point Alunasa will be sold as a going concern to a private operator.

Other targets include CEMPASA, a large cement producer, and FERTICA, the national fertilizer company. Because of the "strategic" nature of the activities of these CODESA subsidiaries, the Costa Rican legislature has been unwilling to permit the sale of any more than 40 percent of their shares. It was agreed, however, that the eventual private purchasers of these shares could be awarded management contracts in order to insure the private management of the businesses. The GOCR has agreed that the necessary changes in the articles and by-laws of the two companies will have to be made.

CATSA is the largest sugar processing company in Costa Rica. The law which provides for the divestiture of CATSA's shares by public bid stipulates that cooperatives would be the only eligible bidders. The GOCR has agreed to the divestiture of CATSA's shares, and a private cooperative, formed by sugar growers who are members of the Liga de la Cana, will be organized in order to purchase CATSA shares at public bid. Also, CODESA transferred to private ownership its holdings in Subproductos de Cafe, a processor of coffee waste, in connection with an A.I.D. project.

The Consejo Nacional de Produccion (CNP) is a government body originally created to promote agricultural production in Costa Rica and to stabilize prices of basic grains has had the distortive effects typically associated with such control. The Mission identified three functions of the CNP that could be privatized or semi-privatized. The first of these is the operation of the CNPAC Rice Mills, the second is the importation of Title I, PL 480 grains and the third is the operation of the CNP's stores for the distribution of basic goods. The Mission has initiated informal policy dialogue with the CNP in these areas and is contracting an evaluation of the CNP that will determine the feasibility of these three initiatives, and analyze other potential areas of privatization.

With the Mission's encouragement, the GOCR specifically committed itself to: -the sale or liquidation of CODESA's interests in all of its smaller subsidiaries, -the sale or liquidation of CATSA (sugar), CEMPASA (cement), ALCORSA (cotton) and FERTICA (fertilizer), -the transfer of TRANSMASA (buses) to the Ministry of Public works and Transportation (MOPT), of the Free Zone Corporation (CZF) to the Centro para la Promocion de Exportaciones y las Inversiones (CENPRO), of MINASA (mines) to the Ministry of Industry, Energy and Mines (MIEM), and FECOSA (railroad) to INCOFER. (These CODESA subsidiaries are viewed as "public utilities" to be transferred out of CODESA to other GOCR Agencies.)

Some early progress was made in the privatization program. ALUNSA, the large aluminum processing company, was sold by CODESA to FINTRA, which was to be assisted in the resale by the First Boston Corporation. The GOCR agreed to transfer ALCORSA (cotton) to the private sector or to liquidate its assets no later than September 1987. A group of growers and textile producers was interested in purchasing ALCORSA.

Atunes De Costa Rica (a tuna fishing company) was sold to private operators for about $1.5 million in May, 1987, and for Tempisque Ferry Boat, a group of workers has shown some interest in the purchase of the concession -- and the new/nearly new ferry to be bought or leased.

From a total of 42 subsidiaries and affiliates in 1985, CODESA, with A.I.D. Mission assistance, has sold nine to the private sector, liquidated 17 and transferred five, as mandated by law, to other public sector ministries. Seven are in the process of liquidation and three are in the process of total or partial sale to the private sector. CODESA by law is required to maintain its minority position in the securities exchange.

As a Mission designated success story, the most recently sold company, the sugar mill and sugar cane plantation, was turned over to FINTRA. Operating profits soared from a US$2.4 million loss in 1987 to a US$1.4 million profit 12 months later following complete organizational restructuring including manpower reduction, and institution of proper management and accounting controls.

3. Honduras

The Mission's privatization plan provides for assistance in the divestiture, liquidation or reduction of state-owned enterprises in order to help reduce dependence on the state, foment the development of private enterprise, create employment opportunities, and reduce the fiscal drain of state-owned enterprises on the treasury. The plan links policy dialogue regarding privatization with ESF negotiations and program, and complies with the Central American Initiative of reducing public sector participation in commercial enterprises in order to free scarce resources and make them available to the productive private sector.

The GOH has enacted legislation to permit the privatization or liquidation of state-owned enterprises. The Mission provided technical assistance in the drafting of this legislation, which has paved the way for the development of a privatization program. Honduras is one of the first developing nations to have a complete program grounded in legislation, and institutional framework and a technical assistance program developed to privatize its state-owned enterprises.

As a result of early privatization work, the Honduran Banana Corporation (COHBANA) was sold at the end of 1986. The National Basic Product Supplier (BANASUPRO) continues to move towards support for its owner-operated retail store franchises, in lieu of an expansion of its fully-owned retail chain. The Mission worked with the GOH to privatize, reduce or eliminate the non-banking functions of the National Agricultural Development Bank (BANADESA). BANADESA began a search for private sector investors to sell or lease the Sula Dairy plant, and for mechanisms to close down or transfer its input stores network to the private sector.

For several years the Mission has been engaged in a policy dialogue process with the GOH regarding the forestry sector. It believes its persistence paid off when the government transferred the second largest sawmill in the country -- Forest Industry of Agua Fria, Inc. (FIAFSA) -- which had been losing almost $2 million annually, to a private investor for $2.75 million. New lumber export procedures, supportive of a decisive role for competitive private enterprises and consistent with A.I.D. suggestions, have been approved. The Honduran Forestry Development Corporation (COHDEFOR) will now focus its actions on forest management and protection.

A technical assistance team contracted by PRE's Center for Privatization worked with A.I.D. in identifying other candidates for privatization. A list of target companies was developed for COHDEFOR and the National Investment Corporation (CONADI). These two corporations have a number of companies from which short-term targets of opportunity for privatization exist.

The Mission's strategy for privatization was to initially concentrate on the COHDEFOR- and CONADI-held companies, which are those the GOH seems most favorably disposed to privatize. They also are the most onerous in so far as the financial burden they represent to the GOH. At present, the Mission is looking at the possibility of privatizing three COHDEFOR and 61 CONADI companies based on criteria which include financial savings to result from privatization, ease of implementation, degree of GOH exposure, as well as social and economic impact. The Mission intends to assist in privatizing if a window of opportunity presents itself.

The A.I.D.-supported Privatization of State-owned Enterprises project financed the establishment and operation of a Divestiture Implementation Unit to be physically located in CONADI, but will be independent with its own budget and personnel. The Mission believes that if it were to confine its efforts to the 64 companies presently under review, the time frame would be 5 to 7 years, with most of the companies privatized and/or liquidated within 3 to 5 years of initiation of the process.

The Honduran forestry parastatals, COHDEFOR, privatized its export lumber yard, SEMSA, through a lease arrangement. SEMSA will improve efficiency in the handling and marketing of lumber, enabling Honduras to stop losing its market share and obtain the maximum benefits from its export volume. This has been the experience of another COHDEFOR company, FIAFSA, the second largest sawmill in the country which was privatized earlier under a similar arrangement.

Comparative figures of the operation of FIAFSA under private sector management for the period May through December 1986 show that production increased from 6.3 to 11.3 million board feet or 80%. Exports increased from 1.3 to 8.8 million board feet, a 577 percent increment over the same period the year before under COHDEFOR management. Net revenue for COHDEFOR experienced a 257 percent increase. The employment generated by FIAFSA's operations under COHDEFOR amounted to a total of 340. Now under private management, FIAFSA generated employment for 510 persons.

The Honduran Development Corporation (CONADI) privatized Sistems Internacionales de la Construccion (SIC) a cement and wood material panel manufacturer, through a lease arrangement. A permanent technical assistance team has been contracted through the A.I.D.-supported Center for Privatization. The team assisted the GOH in conducting the necessary financial and economic analyses, corporate and asset valuations, development and implementation of privatization strategies for individual companies, a marketing program and other privatization related tasks.

Investor interest has grown with the program and at present CONADI received letters of intent to purchase three companies, FUCENSA, a steel foundry, CONTESSA, a manufacturer and exporter of high quality furniture and SIC, a plant for the manufacture of prefabricated panels. Negotiations were also conducted for the divestiture of three other enterprises that represent an approximately $22 million exposure of CONADI.

Following this, the Honduran Government approved two new privatizations -- Azucarera Yojoa (sugar lands and refinery) and PACARSA (a partially completed paper mill). Their sale generated a net inflow to the National Development Bank, CONADI, of $4.6 million in cash plus the retirement of $4.0 million of its foreign commercial debt. The Azucarera Yojoa, purchased by local investors, resulted in full recovery of CONADI's original investment of $2.9 million, plus $1.65 million in capital gains and dividends. This is the first time in the history of CONADI that the parastatal has recovered its entire investment and made a profit. Scott Paper Company's Costa Rican subsidiary used a debt-for-asset swap mechanism to acquire the paper mill and will invest an additional $4.0 million to complete the plant, creating over 200 new permanent jobs. Also, $250,000 worth of sawmill equipment of a COHDEFOR company, CASISA, has been sold, and CONTESSA, a furniture manufacturer, was auctioned off through a Debt-Asset Swap.

Recently, an evaluation of the program was conducted by the International Science and Technology Institute (ISTI). The evaluators concluded that the government has demonstrated the political will to put into place and sustain the necessary legal framework for a successful privatization project. Preliminary figures on the impact of the privatizations carried out to date by the GOH indicate a $6.3 million net reduction of GOH external debt with commercial banks has been achieved, and approximately 200 new jobs have been created. Exports from two of these firms are expected to exceed $15.0 million within 3-4 years.

The ISTI team that evaluated the project estimated that the impact of privatization through calendar year 1990 would result in the reduction of $91.0 million in the foreign debt of the country; a $33.0 million improvement in the balance of trade; $17.0 million in new investment; 1100 new jobs and a $60.6 million increase in the Gross Domestic Product (GDP), or 0.8% of the country's GDP.

Most recently, the government executed the sale of Fundiciones Centro Americanas (FUCENSA) -- a state-owned iron foundry partly built in 1981 that was closed the same year before it was fully completed and became operational -- through a debt-equity swap. However, indications are that it has not yet become operational.

4. Jamaica

The Mission has worked closely with the GOJ since the early 1980s to develop and implement a workable privatization plan. On an interim basis and as suggested by PD-14, the majority of GOJ enterprises privatized were done initially through leasing, with the expectation that they would ultimately be sold, as turned out to be the case for most of the targets.

A.I.D. has had three basic inputs into the GOJ's privatization program: 1) funding to assist the Divestment Secretariat; 2) ESF funding and conditionality designed to advance the privatization of specific GOJ-owned enterprises; and 3) a more general, ongoing policy dialogue with the GOJ on privatization as a means of financing needed public infrastructure and of relieving government officials of tasks that could be take over by the private sector.

Jamaica made substantial progress early on by transferring ownership and/or control of state enterprises to the private sector. By 1986 it had achieved perhaps a greater measure of success than any other country covered by A.I.D.'s program. Accomplishments by then included:

--the leasing of 9 of 11 GOJ-owned hotels.

--The leasing of agricultural lands under the aegis of Agro 21, which has targeted 51 government properties on a total of 39,000 acres for privatization. Of these 51, 22 properties have been privatized (with a total acreage of 18,000), seven (with 5,000 acres) await final cabinet approval for privatization, and 22 (with 16,000 acres) are still available for privatization.

--Beginning the process of privatizing 30 enterprises which were the responsibility of the Divestment Secretariat, the technical committee established to evaluate proposals for enterprises selected for privatization, 2 have been privatized and 11 are in an advanced stage of privatization (see below). It is anticipated that 6 of the enterprises will be sold outright, 21 leased, with the remainder yet to be decided.

--Leasing of 59 of 69 rural agricultural markets.

--Signing of management contracts with the British sugar producer Tate and Lyle to operate the two biggest sugar estates.

--Partial privatization of Seprod Limited, formerly a wholly-owned subsidiary of the Coconut Industry Board involved in the manufacturing of soap products, cooking oil and margarine, by issuing a substantial part of its equity to outside interests through private placement and by listing on the stock exchange.

--Privatizing the government bus company in Greater Kingston and Montego Bay.

--Preparing a framework under which 4 government-owned radio stations are to be leased to private operators and four hours of television per day are to be sold to a private operator or operators.

--Contracting out for street cleaning and garbage collection in Greater Kingston.

--Drafting of contracts for the private sector provision in government-owned hospitals of services such as laundry, cleaning, and food preparation.

An independent report concluded that the funds provided by A.I.D. helped the Divestment Secretariat to rectify initial difficulties and enabled it to perform the necessary fact-finding, advertising and negotiation tasks on a full-time basis.

With this impressive record behind it, the GOJ announced its intention to sell two-thirds of its equity in the National Commercial Bank (NCB). The sale of this equity through the stock market would be by far the largest public issue of shares or securities by a company in Jamaica. The plan was to structure the sale to maximize the role of small investors along the British Telecom model. The Mission financed the technical assistance to develop the plan. Other targets included GOJ-owned enterprises such as the National Hotel and Properties (which owns 11 hotels), which were first leased, and the Caribbean Cement Company.

The Mission succeeded by getting the GOJ to concur in earlier ESF agreements to investigate the possibility of private ownership participation in the larger state owned enterprises and to study the feasibility of private equity participation in the hotel industry. ESF conditionality became an important instrument in the Mission's privatization strategy, although the approach that was the most effective in Jamaica was to reach agreement in advance of formal negotiations and use the ESF disbursements as ex post facto support for decisions the Government has already taken.

The highly successful share offer of the National Commercial Bank (NCB) represented a major breakthrough for a developing country and for the Jamaica program. The share offer, which involved selling 51 percent of the stock of the NCB, or 30.6 million shares at a price of J$2.95 per share for a total of J$90 million, was oversubscribed by 175 percent with just over 30,000 applications. In all, a total of 84 million shares valuing J$250 million were applied for. The largest number of persons to have supported a share issue in Jamaica in the past was 10,000.

The NCB share offer demonstrated that Jamaica's Stock Exchange could be used as a vehicle for selling the larger state owned enterprises, while building a stronger and deeper capital market in Jamaica and widening the number of shareholders. USAID/J funded the technical assistance provided by the investment banking firm of N. M. Rothschild to the National Investment Bank of Jamaica (NIBJ), the GOJ entity responsible for this privatization.

Based upon the success of the NCB privatization, the Mission agreed to extend the contract with Rothschild to do the background work needed for the share offering of the Caribbean Cement Company. Also, the sale of the 13 government hotels was undertaken. In addition, the international telecommunications firm of Cable and Wireless agreed to purchase shares to a level of twenty percent of ownership in the newly formed holding company for the recently merged Jamaica Telephone Company and JAMINTEL. The shares held by the government in Radio Jamaica Ltd. were to be divested to a selection of organizations to maintain its present structure.

Air Jamaica was also seen as a longer term possibility pending the attainment of normal levels of profitability. However, its balance sheet indicates an untenable debt-equity ration of about 15 to 1. While it achieved a positive operation profit, its heavy interest charges result in overall losses.

In June 1987, over 70 percent of the Caribbean Cement Company was purchased through a share offer where 91 million shares were sold to 24,000 buyers, including 99 percent of the company's employees. This share offer was almost twice the size of the highly successful National Commercial Bank share offer.

The GOJ also went forward with the share offer of Telecommunications of Jamaica (TOJ). The 105 million shares available to the public was oversubscribed by almost 25 percent. The share offer represents the largest sale of shares ever carried out in Jamaica. In addition, 92 percent of the employees of the Jamaica Telephone Company (JTC) and JAMINTEL (the subsidiaries of TOJ), took up shares in the offer, with the employee shares trust taking up the balance of the 21,100,000 shares reserved for employees. The TOJ privatization, which features the first underwriting of a share offer in Jamaica's history, reduced the GOJ's ownership from 53 to 40 percent, thus removing it from the rolls of public sector enterprises. When added to the number of shareholders in TOJ prior to the offer, the company will have approximately 17,000 shareholders. Following the allocation of shares, 60 percent of the company will be owned by the private sector, of which 39 percent is owned by Cable & Wireless (West Indies) Ltd. An additional 34 enterprises are also in various stages of privatization.

Another major GOJ initiative involves the private contracting of ancillary health care services in public hospitals. Janitorial and portering services and catering services had been privately contracted in three major public hospitals. The GOJ is currently in the process of divesting maintenance services in those hospitals and in expanding the services in other hospitals. Finally, the GOJ divested most of the hotels that it had leased out to private management companies.

B. Asia and Near East

1. Bangladesh

The newly formed nation of Bangladesh emerged from the 1971 civil war with a strong socialist bias and a decimated managerial class. It vigorously pursued a set of policies that encouraged large-scale nationalization of Pakistani-owned industries, regulation of private trade, and subsidies that encompassed food grains, credit, and agricultural inputs. Public sector control and management of the economy was pervasive.

Against this backdrop, the success of Bangladesh's efforts over the past decade to denationalize public enterprises, remove the impediments to the free play of market forces, and generally increase the scope of private sector participation in the economy have been remarkable. Bangladesh was recently characterized as a "champion performer in the world of privatization and divestiture, . . . far and away the leader of the divestiture parade in the less developed world."

Beginning in 1975, the BDG began to give a greater role to the private sector and gradually began to return a number of small businesses to private hands. The number of industries reserved for the public sector was reduced to eighteen. Under this policy, 116 units were turned over to the private sector between 1976 and 1982. As a result of the large-scale denationalization and the rapid growth of the private sector at the same time, the public sector currently owns only about 40% of fixed assets (as against 90% of fixed assets in 1972) and employs not more than 20% of the labor force in modern manufacturing. Only about 160 industrial units remain in the public sector. This sweeping reform occurred with remarkable speed, lack of disruption in production and little public protest.

The critical role that A.I.D. played in support of these policy initiatives is amply documented. Over the past years, A.I.D. has been able to commit successfully a large portion of its portfolio to programs that have increased the scope of private sector participation in the economy and encouraged the free flow of market forces. Specifically, the Mission has encouraged policy and administrative reforms in key areas of the economy -- fertilizer marketing, banking and finance, and food grain pricing and marketing. In addition, the Mission has encouraged competition between the public and private sectors in the delivery of crucial family planning services through the Social Marketing Project, A.I.D.'s largest and most successful contraceptive retail sales program. The Mission also introduced private sales of oral rehydration solution (ORS) through the SMP.

A.I.D.'s primary privatization objective was to catalyze the indigenous (and where possible, foreign) private sector to expand productive employment opportunities, one of Bangladesh's most urgent development priorities. In addition, Mission intended to assist the BDG in its effort to divest additional public enterprises, stimulate competitive delivery of goods and services by both the public and private sectors, and respond to targets of opportunity to encourage access to foreign capital, technology and marketing experience.

Progress was expected to be slow, however. The extremely rapid push to denationalize public enterprises that began in 1982 recently abated, partly as a result of the new elections, and perhaps because the "easy" industries had already been targeted. While the governing party still proclaims its renewed support for further privatization through disinvestment of the remaining nationalized commercial banks (NCBs), conversion of public corporations into holding companies, and permitting 49% shares in the equity capital of certain public enterprises, including the fertilizer and jute industries, the recent steps taken have been more tentative than in the past.

To better focus the government's attention on the opportunities, the Mission conducted, with government approval, research to determine exactly where further privatization is possible. The Center for Privatization was engaged to provide an overview of privatization in Bangladesh and to determine the factors influencing the Government's shift in policy to privatization; recent changes to the Government's industrial policies; the performance of private and public sectors; programs, nature and extent of donor influence of the Government's privatization policy; a prospectus for the future; and conclusions and recommendations for the Government, private sector and donors.

In addition to the privatization study, an assessment of the private sector in Bangladesh was performed by a team provided under the Private Enterprise Bureau's private enterprise development project. The report pointed out that the privatization process had been strongly criticized by many in the private sector because, in their view, the Government had not been totally impartial in the sale of shares in denationalized enterprises. For this and other reasons, the Government's privatization efforts have become somewhat controversial and the report cautioned that A.I.D. "might not wish to be directly identified" with the present process.

The Government has also indicated that it would like the Stock Exchange to play a more active regulatory role and it may be given additional powers. At present, however, the Dhaka Stock Exchange is not equipped to carry out these functions effectively. The Asia Foundation expressed an interest in providing technical assistance to the Dhaka Exchange in collaboration with A.I.D. and developed a proposal and submitted it to A.I.D. for review.

The Mission's Feeder Roads Maintenance and Improvement Project developed appropriate technical and management standards for "preventive" and "routine" road maintenance in rural Bangladesh. The Mission entered into dialogue with central ministries and local government, strongly encouraging use of private contractors for preventive maintenance and offering support for experiments in contracting out routine maintenance as well. Contracting out of preventive maintenance will be required in A.I.D. project areas.

The Mission succeeded in partially privatizing the state-owned Bangladesh Agricultural Development Corporation (BADC) through the Fertilizer Distribution Improvement (FDI) Project. A new marketing system ended Government control of fertilizer retail prices, expanded the number of fertilizer retail dealers and their retail market share, and increased the economic incentive for dealers to merchandise and promote fertilizer use. With the new system, sales of fertilizer were 19% higher than sales during the previous year, in part due to the greater role of private sector wholesalers. The PL 480 Title III Program was used to further privatize the public food grain distribution system by eliminating subsidies to two major higher income groups.

The Mission remains optimistic about future prospects. In a recent interview, President Ershad invited Western industrialists to invest in his country, and said that his administration had been privatizing large sections of industry which had historically been in public hands. "Not a single factory will remain in the public sector," he boasted, "except for a fertilizer plant."

2. Egypt

The Mission's report for Egypt provided excellent detail on the process whereby the country came to nationalize much of its industry, and the difficulties that arise in trying to undo the damage. Throughout the Nasser period (1952 to 1970), the government established its almost total dominance of the economy through monopoly control of principal agricultural activities (input supply and procurement of major crops), nationalization of existing industries and massive public sector investment in new industries, infrastructure and services. In addition, the government introduced a system of subsidies and price controls on most commodities and many non-essential commodities.

The first meaningful modification of the Nasserist policies was the "Open Door" concept of President Sadat, announced in 1974. This policy, and the now famous Law 43 through which it was implemented, sought to attract foreign investment into joint ventures with Egyptians to augment the stretched resources of the GOE. In 1978, legislation similar to Law 43 was passed for one hundred percent Egyptian owned firms (Law 159).

Throughout the late 70's and early 80's, investments under Laws 43 and 159 occurred, but their cumulative effect represented a relatively small portion of economic production and services. While the laws themselves are attractive to investors, the economic and bureaucratic climate in Egypt was (and remains) a significant countervailing disincentive. There were too few areas of the domestic market which permitted an attractive return on private sector investment because of the dominance of the public sector and the structure of subsidies and price controls.

Hindering privatization was the GOE's announced policy that it would not sell any public sector corporations owned by the national government. Furthermore, it would not close public companies regardless of their economic viability. The very large companies are ingrained in public opinion as national treasures, symbolic of Egypt's independence and capacity to start up and operate world-class operations. However, the economic difficulties of the country, particularly with respect to foreign exchange, have left the GOE with little or no ability to expand and modernize public firms. Consequently, there is increased GOE interest and willingness to structure new public sector investment under Law 43 as joint venture with private investors.

Perhaps reflecting a change in the mood, the GOE, by the late 1980s, began to show an interest in contracting with the private sector for services which it traditionally provided. For example the Ministry of Tourism contracted with a private firm to clean the beaches at Alexandria. There is considerable scope for further contracting of public services, particularly in the maintenance of water and sewer systems and roads. Elsewhere in the tourist industry, where contracts with recognized hoteliers such as Sheraton and Oberoi have been executed in order to link these government-owned facilities to the worldwide system of their hotels. While there is no interest by the government to sell its tourist facilities, the Ministry of Tourism is very anxious to see the private sector carry out a large percentage of the future investments in this sector.

The problem of privatization in the agriculture sector is at least as difficult and challenging for the GOE as privatization of industries. Like industry, agriculture is an integrated system of input monopoly and controlled output. Cropping patterns are mandated. Many agricultural products must be sold to the government at below market prices as inputs to public sector agro-industries, or for resale through publicly controlled markets.

Notwithstanding the many political and legal constraints in Egypt, the Mission's privatization strategy was developed to encompass the following themes:

1. Support changes in macroeconomic policy which move the Egyptian economy toward a market basis.

2. Terminate the government monopoly in selected agricultural inputs and products.

3. Support full or substantial divestment of selected public enterprises.

4. Assist the government in its desire to divest firms owned by local government units.

5. Assist in privatizing, or at least contracting out to the private sector, selected "public services" such as trash collection and curative health services.

Putting the plan into operation, A.I.D. supported the substantial shift of automobile production from the public sector to the private sector. This process started with the one hundred percent privately owned GME truck plant in October 1985 and continued with the GOE approval of the General Misr Car Co. (GMCC).

The Mission supported the development of a private sector solid waste management system for Cairo, financed entirely by fees for services and resale of recyclable materials. It also worked to reduce the level of the government's provision of curative health services by expanding the availability of private medical facilities. The Mission also encouraged the local government units to contract with the private sector for operation and maintenance of water and sewer systems, road repair and other community services.

In support of the program, the Mission continued with the education and exposure of GOE personnel by sending participants to privatization conferences/workshops and providing videos and articles on relevant topics. Some thirty-six GOE officials were sent to privatization-related conferences and workshops abroad. As a result, the concept and positive worldwide experience were better understood and in July 1988, the Minister of Economy chaired the first open discussion on privatization in Egypt with participation of other key ministers, the media, and members of Parliament. In 1989, the government and private sector leaders participated in the first of a series of Middle-East privatization conferences, hosted by Turkey. It also promoted discussions among GOE ministries and the private sector; and provided an advisor to prepare an assessment of Egypt's privatization program; prepare a report on the opportunities and obstacles of the program; and assist in the organization of a planned GOE workshop to review concepts, examine a sample of governorate projects for sale, discuss generic issues, and reconfirm GOE support.

The GOE publicly announced a "popularization" program by issuing a decree, from the Ministry of Local Government (MLG) which authorizes direct sale of governorate-owned productive assets (owned by local government units) or "projects/companies" to the private sector. There are approximately 400 projects, such as poultry farms, cattle feed lots, dairies, fish farms, transport companies, etc. In support the Mission provided a consultant from PRE's Center for Privatization to advise on methods of valuation of assets and other program issues.

In the tourism sector, the government sold one hotel (managed by Sheraton in Hurghada) and is currently seeking a sale of another (managed by ETAP in Port Said). Management of six public sector hotels has been turned over to private management in the near future. Eventually all public sector hotels will be under private management. The role of the Egyptian General Authority for Promotion of Tourism is being diminished and the private sector is being asked to assume its responsibilities. Two very large conference facilities now under construction will be turned over to a private company for management. Large tracts of land are being made available to the private sector for development as tourism facilities. The duty-free shops in the new international terminal building at Cairo Airport, previously under state owned Egypt Air, have been leased to the private sector.

In the area of Public/Private Joint Ventures, the Ministry of Industry has granted permission to some public companies to expand under private sector oriented Law 43 with GOE ownership limited to 30 percent. Examples include General Nasr Car Company, Trenco Radial Tires, Trenco Carbon Black, and Sinai Manganese Gypsum Board. Six other suggested joint ventures from the mining and refractories holding company were approved for development.

In addition, the Mission helped develop a project that will assist the GOE in restructuring the financial condition of the governorate firms so that they can be purchased by the private sector. It is envisioned that an "asset privatization trust" can be created to act as a transition unit in the privatization and sale process, i.e., it will take title to, provisionally manage, and dispose of the assets. Initially, the "trust" will focus primarily on assets held by the governorates plus the government-owned firms identified for privatization by the Ministry of Tourism.

Finally, A.I.D. assisted in the development of one of the first Employee Share Ownership Plan (ESOP) in a major firm. The establishment of this ESOP provided considerable public discussion which generated significant demand for additional programs in both the public and private sector. Local currency financing for two additional ESOPs in two public sector companies was earmarked.

3. Philippines

In the Philippines the movement from a generally private sector oriented economy towards a mixed economy with a growing and inefficient public corporate sector gained impetus more than fifteen years ago. The government owned the only airline, banks, steel mills, cement corporations, mining corporations, shipping lines, oil corporations, refineries, urban bus companies and trucking firms. On top of this mass of chartered public businesses, the government's domination of financial and capital markets, and the liberal use of sovereign guarantees to shore up private credits, gave the government enormous exposure to the nominally private businesses operated by the cronies of the leadership.

As the defaults to the government banks cascaded, with single company defaults triggering the collapse of holding companies and corporate shells to which many of the government loans had been extended, the size of the public sector portfolio grew apace. Today, the public sector, chartered and acquired, absorbs a quarter of the national budget. The formation of public sector companies quadrupled from 65 in 1970 to 264 in 1986.

President Aquino and her economic cabinet officers have given high priority to divestiture and privatization, a priority that has been underscored by the donors. The IBRD has required divestiture and restructuring plans for public financial corporations and for non-financial (industrial and service) companies as a condition for program loans. A.I.D. has tied food aid to privatization conditions in the agricultural and food processing area. These efforts have been relatively well-received by the economic technocrats of the GOP who share the donor's sense of urgency in staunching the budgetary bleeding into the public corporate accounts and in restoring leadership to the private sector in most industrial and corporate activity.

The Mission's goal was to get the government to relieve itself of this financial burden, and to eventually divest itself of financial institutions such as the Development Bank of the Philippines (DBP), Philippine National Bank (PNB), the Land Bank (LB), the Philippine Export and Foreign Loan Guarantee Corp. (PEFLGC), and numerous insurance and special purpose financial firms because of their drain on the budget.

Both DBP and PNB have undergone financial restructuring as part of the conditionality attached by the IBRD to its Economic Recovery Program Loan. Government financial institutions acquired hundreds of assets in the form of private companies that defaulted on their loans. The case for divesting these assets has been evident to the domestic and international financial community for many years.

The Aquino administration issued Proclamations 50 and 50A in December 1986, formally launching a program for the expeditious disposition and privatization of certain government corporations and/or assets thereof. Proclamation No. 50 created the Committee on Privatization (COP) and the Asset Privatization Trust (APT) and 50-A, issued shortly thereafter, refined the requirements of the original Proclamation. About 390 assets have been turned over to the APT for disposition. APT's target amount for the sale of all 390 assets is 23.7 billion pesos (about US$1.13 billion). Since APT operations actually got underway, the APT has sold 158 of the 390 assets, as of mid-1989. Of these, 109 were fully privatized and 49 sold partially. Total revenues from these sales have amounted to 13.6 billion pesos ($647.6 million).

The IBRD has been a vital force in promoting privatization in the Philippines. It conditioned its $310 million economic recovery loan on reforms in the government financial institutions, including the establishment of a mechanism for the privatization of acquired assets and the restructuring of the DBP and PNB. In addition, the IBRD has developed a $150 million Public Corporate Sector Rationalization loan, to privatize selected non-financial government corporations and increase the operating efficiency of the remaining public corporations. In response the GOP developed comprehensive guidelines on the privatization and disposition of 125 public sector corporations.

The Mission's major contribution to the privatization process was to assist the GOP to develop its privatization strategy and implementation framework. The Mission's approach adheres to the principle that the process of privatization generally, and divestiture specifically, is a market process which must be implemented by private sector entities qualified to do so, i.e. private investment/merchant banks, accounting and consulting engineering firms, lawyers, etc.

The initial thrust of the Mission's privatization plan was to act as a catalyst to focus the GOP's policymakers on the need to divest the government of non-performing and public corporate assets in an expeditious but orderly manner. Initially, the Mission funded several studies on the public corporate sector in the Philippines which were used by the IBRD in its appraisals for the economic recovery and public corporate sector loans. Subsequently, the Mission used the PRE Bureau contract with the Center for Privatization for a key study performed by the First Boston Corporation entitled "Recommendations on the Privatization Program for the Republic of the Philippines". This study provided significant input to the GOP's decision not to undertake a massive physical and financial rehabilitation of assets prior to their sale because costs incurred would probably not be recovered. The study furthermore stressed the importance of centralization, simplicity, flexibility and speed for the GOP to succeed in privatization.

Since the Mission's development thrust is agriculture and rural development, special emphasis was given to the privatization of government agribusiness and agri-marketing firms such as NFA and the commodity marketing firms such as the Philippine Cotton (PCC), Dairy (PDC) and Tobacco (PTC) Corporations. The former Minister of Agriculture formally requested advisory services to establish a framework for the divestiture of NFA. A review of the NFA non-grain business operations was made, their commercial viability assessed, net worth and fair prices ranges were established and an action plan for divestment developed and recommended.

C. Africa

1. Cameroon

The USAID/Cameroon's privatization plan included elements of policy reform, institutional development, utilization of the private sector, and privatization of parastatals. In Cameroon, the private sector, private enterprise and private initiative are confined largely to the small farmer and people in rural areas who represent three out of four of the country's working population.

The Mission's privatization program consists of seven specific projects. The central goal of the Mission's strategy -- increase food production and develop the rural sector -- implies a long-term perspective. The outstanding private sector activity of USAID/Cameroon has been the Credit Union project. A major client of the credit union has been the small rural entrepreneur, dealing in consumer goods, supplies of rural/village goods and services. The project led to 237 credit unions with membership of 69,000 and increased savings of $27 million.

Another activity was the North Cameroon Seed Multiplication project which sought eventually to devolve seed production and multiplication for maize, sorghum and cowpeas in Northern Cameroon to private entrepreneurs, thus creating a private sector niche in seed production which heretofore had not existed. The project is both a direct privatization of services and production as well as institutional development intervention. The Mission's largest single privatization activity was the Agriculture Inputs and Marketing project which had the purpose of the elimination of subsidies and the privatization of agricultural input markets. Through the project, subsidies were cut substantially and are expected to be eliminated by 1991.

The Maternal Child Health/Child Survival project sought to place greater emphasis on private preventive health care delivery, private manufacture and distribution of certain health products and commodities, and will also propose a private sector-type cost recovery through user fee system.

The Mission also intended to initiate a full-scale diagnostic study of the key policies, laws, regulations and administrative procedures that presently impede the development of the private sector. This analysis facilitated the Mission's decisions regarding the most appropriate and important areas of future intervention.

2. Gambia

Gambia's program began in 1983 with the study of Gambia Marketing Board (GPMB) -- the largest enterprise in the nation. Prior to A.I.D.'s new focus on privatization the Mission had required privatization of the rice trade as condition of emergency food aid. This led to a considerable improvement in the rice market. The Mission also instigated the removal of the fertilizer subsidy and its privatization. Food aid and funds are tied to privatization "benchmarks". Release of food aid and local currency funds is tied to the achievement of specific policy measures and institutional benchmarks indicative of progress towards full privatization.

The Mission also urged the use of the lease method as the first step in the privatization of a sawmill, which will be sold when viable. Two consultants provided through AFR/PRE completed a study delineating the steps involved in the divestment by sale of the sawmill (i.e., its sale to a private entrepreneur). The Mission is working with the National Investment Board (NIB) to implement the privatization plan recommended in the consultant's report. Moreover, the Mission has provided technical assistance to the NIB in order to help it develop a national plan and strategy for divestment and privatization of state-owned enterprises.

In the area of financial services the GOTG has already implemented several specific reforms which include: 1) the parastatal Gambia Commercial and Development Bank (GCDB) ended its practice of granting preferential access to credit to other state-owned enterprises; 2) the GPMB has stopped its practice of paying higher rates to the parastatal Gambia Cooperative Union (GCU) than it pays to private traders; and 3) the GCDB is granting credit to public enterprises and private entrepreneurs on the same terms and at the same rates.

The Mission worked with the National Investment Board (NIB) to implement The Gambia's national plan and strategy for divestment and privatization of state-owned enterprises (SOEs). In addition, the NIB requested the Mission to assist with the privatization of the Gambia River Transport Company. Also, based on a private sector survey now being conducted by an AFR/PRE consultant, the Mission will design a private sector development strategy and a plan for working with the NIB to promote private investment in The Gambia.

The Mission also conducted a feasibility study as the first step towards preparing for the privatization of the Agricultural Mechanization Unit of the Ministry of Agriculture (e.g.,tractor plowing services, irrigation pump maintenance services, etc.).

3. Malawi

Much of the economic progress which Malawi has achieved since its independence in 1964 is the result of Government's conscious decision to develop the country's agricultural potential, especially for the export market, and the development of the private non-agricultural economy, despite the absence of an indigenous entrepreneurial group. The former was accomplished by creating and maintaining a strong incentive environment for agricultural production. To accomplish the latter and to increase Malawian participation in the economy, three large holding companies, Press Holdings, Malawi Development Corporation (MDC) and the Agricultural Development and Marketing Corporation (ADMARC), were created as SOEs.

According to the Mission, these companies played the leading role in the establishment of medium and large scale private businesses and in attracting foreign investment to Malawi. More recently the Investment and Development Bank (INDEBANK) has been added as a source of investment capital. However, between 1978 and 1982, Malawi went through a period of severe economic recession and its impact on these SOEs turned them into major liabilities.

A corollary to improving the policy environment are the steps being take by Government to restructure, reduce and limit parastatal holdings such as Press, ADMARC, MDC, Spearhead and others. A major effort was begun to divest ADMARC's investment portfolio through the sale of the assets and shares to the private sector. This complements the previous restructuring of MDC and Press. A.I.D. was requested by the Government of Malawi to participate in the divestiture of ADMARC and it agreed to support the privatization of ADMARC through a combined program of budgetary and technical assistance. An American CPA firm was contracted for three years at a cost of $750,000 to help the GOM and ADMARC devise a strategy for rationalization of ADMARC's portfolio, including divestiture of at least two-thirds of its investment holdings and transfer of any remaining assets into a separate holding company on a strictly commercial basis, and with maximum private sector participation. Under A.I.D.'s parastatal divestiture program, $15.5 million will be released as divestiture progresses.

The Mission also fostered the provision of health, family planning and sanitation services through the private sector. This includes in-service personnel training and facility expansion of the Private Hospital Association of Malawi which operates on a fee-for-service basis.

The technical assistance contractor for ADMARC -- Deloitte Haskins & Sells -- initially developed a divestiture strategy which analyzed each asset and proposed actions to be take on them (full or partial privatization; restructuring; retention). Once approved by Government at the highest level, the program moved forward steadily. Good progress was made on the privatization of estates and priority assets. Several estates, two large agricultural development projects, an engineering works firm, an oil processing company and the National Seed Company were fully or partially divested.

Efforts were also initiated to privatize several other important ADMARC assets, including the country's largest milling operation, the major bus company, the only formal commercial fishing enterprise, a produce canning company, a cattle feedlot and the tobacco auction holding company.

In March 1989, the program was evaluated by a team of privatization specialists and financial analysts. The team concluded that: ". . . the ADMARC Divestiture program has been a success to date. While the program has at least another year to go, its success may be measured chiefly by the already visible improvement in ADMARC's liquidity and the manifest improvement in the ability of management to concentrate on ADMARC's basic function. Other evidences are the growing interest of GOM officials in privatization and the private sector, and the significant injection of capital and technical and management skills in many of the properties sold or to be sold."

One concern of the Mission was that most of the ADMARC assets being divested are beyond the financial reach of the individual Malawian investor because of the absence of a functioning capital market that would permit the flotation of small increments of equity. To address this constraint, a special lending facility was established, using program-generated local currencies, for the purchase of agricultural estates Malawi's first Employee Stock Option Plan (ESOP) was being developed to enable a buy-out of one of the assets. The country's first-ever prospectus was drawn up for another asset, and a combination auction/lottery system will be used to maximize price while broadening ownership base.

VI. RECOMMENDATIONS

The recommendations we suggest mostly concern additional materials that should be sent to Missions and the nature of the information sent by Missions to AID/W. We believe that changes in the latter could lead to significant improvement in the program and more directed central guidance.

A. Suggested Updates and Supplements to Reports and Policy Guidance

As noted in Section II, the reports, policy guidance and analytic papers provided by AID/W to the Missions to assist them in their privatization efforts covered most of the important issues in a highly useful fashion. Nonetheless, after reviewing these reports and the many privatization narratives submitted by the Missions since 1986, we believe that several of these papers should be updated and that several new ones should be developed.

"Financing Privatization Under Limited Capital Conditions" is one of the most important of the reports provided the Missions and one that should be updated and expanded in response to the experience gained by A.I.D. in operating a global privatization program. Although the report is of good quality and covers most of the important points, it was written at the outset of A.I.D.'s big privatization push and, thus, included few case studies or references to successful techniques or models for emulation. Over the last three years, much has been accomplished by the Missions and several have put into practice many of the techniques advocated in the report, while some Missions have devised new ones or interesting wrinkles on the old.

It is our recommendation that an updated financing report be issued and that the new version include many cases studies drawn from the Mission successes that have occurred since the original was published. Missions and governments that have creatively overcome financing obstacles include Jamaica, Malawi and Kenya, and these successes could serve as models for others. The A.I.D. Policy Paper, "Financial Markets

Development", published in mid 1988, is also a useful document but it is more oriented toward establishing guidelines rather than offering innovative solutions to complex problems. Also, it includes no case studies and does not directly address the issue of privatization.

We believe that such an update is essential given that the existence of inadequate capital markets is often used as an excuse by many governments and Missions to explain why they have not gone as far as they could in implementing an aggressive privatization program, particularly as it relates to the divestiture of state owned enterprises (SOEs). Perhaps a reissue of the report, updated with success stories from a variety of situations, may spur some of the others into action by demonstrating that common obstacles can be overcome. Likewise, the same should be done with the section on dealing with political obstacles in the report "Critical Issues in Privatization: Politics, Institutions and Labor", which could be updated to reflect the successes that have occurred in developing politically attractive privatization programs. Again, Jamaica stands out as an good example of a positive program, and the efforts of the Mission in Thailand to formally reach out to Thai labor organizations to explain the government's comprehensive program are worthy of review and possible emulation elsewhere. Egypt, in particular, has skillfully managed to make tangible progress while giving the appearance of adherence to the essence of its socialist legacy.

We also felt that additional reports should be prepared to apprise the Missions of opportunities with techniques and in areas that were not extensively covered in the reports prepared to date. These include contracting out, infrastructure opportunities, the fallacy of the strategic sector and creating/privatizing the banking/financial system, although it is our understanding that a financial institutions report is underway and will be available in 1990. While the process of contracting out is described and promoted in the supporting documents provided to the Missions by A.I.D., it took a second or third place to the various SOE divestiture techniques, which PD-14 stated was the first priority, and many of the Missions responded accordingly. However, as the annual budget submissions from the Missions clearly reveal, successful divestitures are complicated, time consuming and subject to considerable political opposition, while contracting out for basic government services avoids many of these problems because it deals with less visible activities and entities.

At the same time, a program of contracting would nicely complement the Missions' small business/entrepreneur development programs. Such service contracts would generally go to the small, newly formed businesses and would be a considerable help in getting them started and developing the skills and resources needed to survive in a competitive market economy. As many Missions have correctly noted, the capital and entrepreneurial markets in some of the poorest countries may be too thin to allow for the effective privatization of large and complex enterprises. However, contracting would be suitable for such situations, and would also help the small businesses grow to large businesses and thus deepen and expand the structure and system of private enterprise. Again, despite the brief mention of such opportunities in the AID/W directives and supplemental materials, many Missions have aggressively pursued contracting programs, particularly in Africa where they have been used to begin the privatization of such traditional government services as health care, seed production and marketing and fertilizer sales and distribution, to name a few of the consistent targets of opportunity. These would serve as good case studies for an updated technical report devoted exclusively to contracting opportunities that would be prepared by AID/W and sent to the Missions.

In many developing countries, the basic economic infrastructure, the roads, bridges, water systems, irrigation, are nearing collapse as governments are unable to devote the attention or resources to their repair, management or expansion. Contracting offers an ideal opportunity to improve these public works at less cost and with fewer management problems. A number of Missions have helped to establish a system of private road repair in recognition that inadequate roads are one of the greatest obstacles to the effective development of the rural-based agriculture economy. More such opportunities exist, particularly in the area of basic municipal services. Only a few Missions have focused on such opportunities but those that have report success. The Missions in both

Kenya and the Dominican Republic have assisted the governments there in creating a private system to pick up and dispose of solid waste in the capital cities. Such services are commonly contracted for in the U.S. and would serve as ideal small business development projects in many of the developing countries that are attempting to stimulate entrepreneurship. Gabriel Roth's The Private Provision of Government Services in Developing Countries, which was sent to the Missions addressed many of these issues but something more closely targeted to the Missions and updated with more recent case studies would be helpful.

Another issue that should be the subject of a separate report is what could be referred to as the "fallacy of the strategic sector," an excuse to do nothing that all too many Missions seem willing to accept when it is presented by the governments. Typically, developing countries embarking on a program of parastatal divestment will divide up the existing parastatals and SOEs into those that are strategic and those that are not, and limit divestment and privatization to the non-strategic category, arguing that those SOEs viewed as strategic are too important to be left to private management. See the Kenya and Ghana Mission privatization narratives as typical examples of this distinction.

In such cases, the SOEs in the strategic sector tend to be the energy companies, telecommunications, transportation and natural resources, precisely those enterprises that have important ramifications for the economy as a whole and the many other industries and firms that they serve. The irony of this distinction is that by virtue of a government's willingness to implement a program of divestment, the government is admitting that public management leaves much to be desired and that privatization leads to improved operations and lower costs. However, while the governments implicitly agree with such an assertion, such governments then take the illogical step of limiting efficient production and good management only to unimportant companies while the incompetent management is to be reserved exclusively for those enterprises that are truly important to the nation. While such actions make no sense when expressed this way, a good number of the Missions report such arrangements without concern or comment. Kenya is a case in point, although many more countries make such a delineation. The frequency of its appearance suggests that it could merit some response from AID/W.

Another important gap in the advisory materials had been in the topic of the establishment or privatization of financial intermediaries. Although a report had been prepared on the different ways in which such entities might be taxed, so few of them exist in the developing world that a potentially more useful product would be a report on how to create them. As noted earlier, the quality of a country's financial markets is an important contributor to the privatization environment in any country, and the thinness of the developing world's financial markets is often an obstacle to the transfer of large enterprises and activities to the private sector. Moreover, where such enterprises exist, they tend to be government owned and a part of the "strategic sector." Given the unique aspects associated with the privatization of financial intermediaries or the creation of a largely private banking system, A.I.D.'s recent release of "Liberalizing and Privatizing of LDC Financial Institutions: Case Studies" should help fill this gap.

B. Changes in Reporting Requirements

One source of variability in program coverage and comprehensiveness between Missions is the Missions' perception of the opportunities that confront them and the difficulty for AID/W to determine the extent to which those perceptions are accurate. In a number of instances, a Mission will respond to A.I.D.'s privatization directive by noting that privatization is not especially appropriate to its country because the country has a free market orientation and there is not much to privatize. The reports from Botswana and Uganda contain elements of this. Elsewhere a Mission may make no judgement about the economic orientation of a country, but will present a very limited agenda, suggesting, with the absence of an ambitious program, that there are, indeed, few opportunities. But as subsequent reports and alternative sources sometimes indicate, the opportunities may be greater than initially believed. In order to better determine the extent to which Missions are taking advantage of the opportunities available and to improve AID/W management by providing it with the information needed to better direct Missions to potential targets, we suggest the development of a simple "country profile" report that would provide AID/W with a summary overview of a country's basic division of economic activity between the public and the private sector. Recognizing that writing additional reports and filling out another form may not be the most productive way for Mission staff to spend its time, we believe that a simple two-page, checkoff type form could be developed to contain all of the pertinent information. And once completed, updates would be required no more than every other year, given the slow pace of such change in most countries.

Such a proposed check list would devote a line to each of the key areas of enterprise and commercial-like functions that might typically be found in a developing country. These functions could be further assembled by major industry grouping, say agriculture, infrastructure, transportation, municipal services, energy & mining, manufacturing, finance & banking and health care, with the appropriate subheadings included under each. For example, under agriculture the appropriate subheadings would be land ownership, seed production & distribution, fertilizer production & distribution, irrigation (development & maintenance), other inputs, product marketing (allow space for each key product, i.e.. bananas, sugar cane, coffee, etc. to be filled in.)

On the row with each heading would be four check-off items that might be written as follows:

TRANSPORTATION

Urban Mass Transit: Public____, Private____, Mixed____, Other____.

Overland Transport: Public____, Private____, Mixed____, Other____.

Airlines: etc.

For each sub-heading Mission staff would have to fill in the blank with a rough estimate of the percentage of activity devoted to each. If the government or one of its parastatals was the exclusive distributor of seed, then "100" would be placed in the blank after "Public". The "Other" designation could be used for whatever nuance the Mission might need to convey. Using the example of seed distribution, suppose the government has a monopoly but an outside donor organization, say the FAO, imports and distributes seeds as part of its own program of assistance. In this case, while there is no private sector, the public sector does not have a complete monopoly. Two sides of a single sheet of paper would be sufficient to cover the major areas of economic activity that are likely to offer targets of opportunity for privatization. Several important management advantages would be derived from such information. First, AID/W and the regional offices would have a better estimate of the potential opportunities confronting each Mission. Thus, when a Mission asserts that a country is committed to private enterprise and there is not much to be done by way of privatization, then the required country profile would have to factually report such an assertion. If it did not, then the Mission would have to explain why its proposed course of action differed from the factual record. In other cases where Missions make no specific assertions about the nature of their country but do propose programs that are very limited in scope, the country profile would allow AID/W to offer alternative direction and additional targets of opportunity, including those drawn from the information sharing system, as discussed in the next section.

Missions whose privatization narratives serve as good examples of the way such background information can be usefully and concisely presented include Ghana, Zaire, Egypt, Bolivia and the Dominican Republic.

Information on the extent to which other donors are involved in privatization should be included in the Mission's report to provide AID/W with the information needed to assess performance as it relates to opportunity. Also, instances of successful coordination could make good cases studies that might be shared with other Missions to help in improving their own programs.

C. Creating a Mechanism for Inter-Mission Information Sharing

In reading through the Missions' annual reports to AID/W, it is apparent that many of the Missions have uncovered and are pursuing similar sets of opportunities because of their importance to the country's development and because of the ease with which they can be accomplished by a government not yet familiar with the concept. In Africa, for example, many of the Missions have focused their attention on seed production and distribution, fertilizer production (or importation) and distribution, health clinics, and the storage and marketing of crops. The actions described in the case study of Cameroon in the previous section are typical of an African Mission's program. To a lesser extent, several of these Missions are also working to privatize road repair, transport, irrigation maintenance and well drilling. Given the apparent high payoffs from privatizing these functions, it would be appropriate to disseminate this information, as well as some of the techniques used with success, to those similarly situated countries that are not now pursuing these opportunities, as indicated in their annual report and country profile. Such information would also be helpful in the development of supplementary reports on various privatization topics, techniques and case studies that A.I.D. could send out to all Mission staff as part of a continuing education program.

D. Need for Ongoing Progress Reports.

Related to the above section is the need for follow through in each of the annual reports. Although many Missions did provide follow-through information to some extent, many did not and this makes it difficult to determine whether goals are being accomplished. This requirement could easily be integrated within the annual reports and narratives now being provided with the annual budget submission. One of the many reasons for citing the Missions in Zaire, Egypt, Tunisia and Jamaica as having excellent reports is that they took the time each year to provide summary detail on the progress being made on those targets that were noted in the previous year's submission. Such progress reports are also essential to overcome what we identified earlier in this review as an important gap in the Mission reporting system: to wit, that there is very little mention of enterprise performance after privatization. As a review of the reporting requirements described in PD-14 indicate, such information was not requested of the Mission in their annual reports.

Such information is essential to help make the case for privatization to skeptical governments and managers. Privatization is not the end of the process, but rather the beginning of what is hoped will be a substantially improved performance in terms of product/service quantity, quality and cost. Without this information, reports on privatization success may be misleading, as when, for example, a privatized firm fails and has to be liquidated. Although there is nothing wrong with this outcome if the enterprise was beyond hope, the implicit presumption in any privatization is that the enterprise will go on to to become a more efficient creator of wealth and jobs.

Although a few Missions provided this information, most did not, although they implicitly had an opportunity to do so in response to AID/W's request that success stories be included in the narrative for the FY 1991 budget submission. In this regard it is troubling to find that AID/W did not require privatization narratives after FY 1990 from the Missions in South America. They were asked to continued to report on privatization through the action plans but such reporting was extremely spotty and cryptic compared to what had been provided through the ABS privatization narrative. Given that these economies are more advanced than many of those in Africa and parts of Asia, it is likely that the privatization programs in these nations would have yielded successes and valuable lessons that could have been applied elsewhere. To take advantage of this opportunity, AID/W should either resume the reporting requirement or at least make some effort to follow up on the projects underway in these countries as of their last report.

E. Description and Justification of Targets.

Mission reports should list the privatization targets that it has selected to work on along with a brief description of each. Although most Missions do provide such information, as was requested in the reporting requirements listed in PD-14, several did not. These Missions may simply note, for example, that they are currently working on some number of possible divestitures. Others may make note of the enterprise, but offer no rationale for its selection, how it expects to conduct the exercise and what kind of outcome is expected. Without this information, A.I.D. has little in the way of judging the extent to which a Mission is adequately pursuing the opportunities available and what kind of progress is being made. Moreover, it precludes A.I.D. from offering useful technical assistance in cases where a Mission plans to tackle a project that was accomplished successfully in another country either by A.I.D. or another donor organization.

F. Other Suggested Changes in A.I.D. Assistance to Missions

Although we rate the overall quality of the supplementary documents and other support for privatization as quite good, we do believe, however, that in some areas the reports and other forms of assistance can be improved to assist Missions in promoting privatization. These improvements can made by clarifying certain points, by emphasizing other points more forcefully, and by introducing some additional concepts in privatization that were not covered. We also suggest that A.I.D. prepare, or contract for several updated reports on subjects not yet covered in existing documents.

Our review of the documents leads to the following seven recommendations.

1) Demonstrate how privatization fits in with A.I.D.'s overall mission in LDCs.

A.I.D.'s general legislative mission is to "provide bilateral development assistance to help the poor majorities in developing countries to participate in a process of equitable growth." In its 1985 policy advisory, A.I.D. correctly determines that this goal can best be achieved by promoting free markets and private enterprise. Yet, it is not clearly enunciated how privatization fits in to this larger overall objective. To some professionals in the field with a long commitment to privatization, the connection may seem obvious, but we did not find any discussion of how privatization directly ties in with the agency objective of development. Only in one report was there a discussion of the connection. The May 1989 document points out that privatization is a part of A.I.D.'s "fundamental policy . . . aimed at a reduction in the economic role of the state." Another report emphasizes that "privatization should be integrated with other aspects of a Mission's program." This point is sufficiently important that it should be highlighted and further explained to Mission personnel.

2) The documents do not provide adequate information about some forms of privatization.

Privatization means more than divesting state-owned enterprises. For example, in his book The Private Provision of Government Services in Developing Countries, Gabriel Roth identifies dozens of types of services that are candidates for privatization in the third world, including: electricity, water supply, transportation, telecommunications, health care, social security and education. Moreover, privatization means more than simply selling assets. It can refer to vouchers, deregulation, competitive contracting for government-funded services, and private financing of public sector infrastructure. These techniques are also covered in Steve H. Hanke's 1987 book Privatization and Development.

We believe that although most of these forms of privatization are mentioned in various A.I.D. documents, the reports deal with them only briefly and the overall guidance and policy directives emphasize divestiture. (The one major exception to this conclusion is in the area of contracting for management of SOEs, which is discussed at length in Privatization: A Technical Assessment. The technical aspects of successfully contracting out or implementing a voucher system, for instance, are at least equally as unknown to LDC officials as those aspects of selling a government enterprise. As noted earlier, contracting out has advantages -- such as small business development -- that may not always be realized through other privatization techniques. Moreover, it is less likely to meet the political obstacles that divestiture does.

We suspect that Mission officers do not receive from the existing documents the necessary background information about these alternative forms of privatization to be able to competently advise government officials about them. This situation should be redressed since A.I.D. policy calls for Mission encouragement of "all forms of private sector participation in the provision of traditional government services."

3) Missions may need to know more about the successful implementation of privatization in other countries.

Some of the reports provide detailed and useful case studies on privatization initiatives in LDCs. Yet these only discuss the successful process the government adopted to implement a privatization plan. What is rarely covered in these case studies is the impact of these initiatives once they were adopted. Did these privatization ventures save the government money? Were the companies turned into profitable enterprises? Did employees respond positively to the sale? Was the quality of the service or product improved after privatization? The success or failure of these case studies is left unanswered. (See for example the case studies in Privatization: A Technical Assessment, pages 74-75.) We recognize that it may have been too soon to include such results given the newness of the program and the time it takes to get these projects underway. Nonetheless, by now enough successes have occurred so that some impact can be measured.

4) The importance of developing an overall country-specific privatization strategy is underemphasized.

The one prominent lesson of virtually all countries that successfully carried out a privatization agenda during the 1980s has been the primacy of developing a detailed political strategy. (See, for example, books by Marsden, Pirie and others.) Privatization, where it has met success, has been approached in the context of an overall strategy for expanding the role of the private sector in the economy, as opposed to a project by project basis. One of A.I.D.'s 1989 reports hints at this by stating: "Privatization is not just selling discrete industrial enterprises." A second document raises the issue of developing a "long range privatization strategy." Yet, in our opinion this message does not come through in most of these resource documents.

The initial privatization venture should be approached in a manner that lays the political groundwork for further divestitures and competitive contracting. The reports need to stress further to Missions that an ill-conceived or ineptly executed initial privatization project can stall any future enthusiasm or progress for the concept. Developing countries should be encouraged to establish privatization task forces to develop the most viable long-term plan for moving SOEs and other government services into the private sector. Several Missions have done this and their experience could serve as a model for others.

5) The price commanded for government assets is overstated as a concern.

A corollary to the above criticism is that, in our opinion, these reports place too much emphasis on the selling price of an SOE. To be sure, this will be a critical consideration to government officials who desire to use funds raised from privatization for other social/political objectives, and who will wish to protect themselves from the charge that they are selling the assets at "fire sale rates." In several cases, A.I.D. seems to be advising LDCs to sell assets at their "true value."

As one A.I.D. case study points out, however, selling at a lower than book value price can garner wide political support. Jamaica "gained political advantage by pricing the share offering of the National

Commercial Bank at a level that attracted immense interest and produced immediate gains to purchasers." By doing so, supporters of privatization gained important political advantage. Selling shares of an SOE at a discount to citizens, management, workers, service users, and other interested parties can convert political opposition into vocal privatization support. Moreover, the main goal of privatization in the LDCs from a development standpoint is not to maximize the price of the SOE, but rather to transfer these enterprises into the private sector quickly and efficiently. Government officials should be reminded that once in private hands these former government assets will begin providing tax revenues to the public coffers and will require fewer direct and indirect government subsidies. We believe this point, rather than valuation, should be stressed.

6) Privatization should be marketed primarily as a means of increasing competition for government products and services.

One of the principal advantages of privatization is that it eliminates a government monopoly and replaces it with an enterprise that will, in most cases, have to compete in the market place. Mission personnel should not, in many cases, try to promote privatization on ideological grounds -- i.e. the superiority of private versus public sector service provision -- but rather as a pragmatic approach to improving the competitive environment for products and services. This message is consistent with the 1985 A.I.D. policy statement that privatization is part of a larger agency agenda to "encourage competition and entrepreneurial activity." In some cases, the A.I.D. technical reports make this point. For example, one report correctly emphasizes that LDCs should be careful not to "replace an official inefficient monopoly for an equally inefficient private monopoly." We believe that A.I.D. reports should elevate the profile of this message.

7) A.I.D. must more clearly define the benchmarks it uses to measure the success of Mission privatization efforts.

Missions' A.I.D. privatization initiatives are expected to "have identifiable benchmarks upon which substantive progress towards divestiture can be measured . . .". The selected benchmarks must represent substantial evolutionary progress in moving the parastatal toward market-based operations." Does this mean that Missions establish their own benchmarks? We believe that for the A.I.D. privatization mission to be more effective, the policy office should assist in establishing meaningful and objective benchmarks based on progress toward the free market, be prepared to evaluate the progress toward goals, and offer direction and guidance when goals are not met or when progress slows. The creation of better bench marks could be part of the improved reporting discussed earlier.

In addition to emphasizing the above points in subsequent communications to the Missions, we also recommend a few more studies and reports to fill gaps in the existing documents on privatization. Three suggested reports are discussed below.

1) Privatization of Government Services in LDCs

We made note of the fact that the most notable omission in the six studies we reviewed was a thorough discussion of privatization of services. We suggest that A.I.D. devote an entire report to privatization in the service sector, as opposed to privatization of government owned enterprises. This should cover a wide range of services: both traditional municipal government services -- such as garbage collection and street cleaning -- as well as social services -- such as health care, education, and housing. This will also require a primer for Mission personnel on various innovative techniques for privatization of services including competitive contracting, vouchers, self-support programs, and deregulation.

Because the potential for contracting out services in LDCs has great potential for improving service delivery, lowering costs, and developing new small business opportunities, we believe that special emphasis should be devoted to this option. Contracting out may warrant a report devoted exclusively to it and the unique political problems that must be overcome with competitive contracting schemes.

2) Privatization Case Studies: Update and Impact

The privatization documents contain more than a dozen highly informative case studies on privatization programs in LDCs. These focus mainly on the implementation stage of the programs. What is now needed is an update that takes advantage of the considerable activity that has occurred since 1986. Such a report should answer such questions as: What problems have developed in making privatization a success? What impact has privatization had on the quality of service, prices, subsidies, and level of competition? Has privatization met the major goals it set out to achieve? How have special interest groups responded to privatization? Will the privatization project create political momentum for other initiatives?

3) Financing Privatization in Countries with Limited Capital Markets.

As mentioned previously, one of the primary obstacles to privatization in LDCs is the lack of mature financial markets. Our review of the Missions' progress reports further confirms this problem. Several of A.I.D.'s support documents touch on this problem, but do not provide sufficient technical advice as may be necessary to help overcome it.

The report should cover in some detail alternative financing methods. A.I.D. personnel should be brought up to date with the success or failure of the innovative financing techniques that have been tested in Chile, Jamaica, and several African nations and discussed in earlier A.I.D. documents. This new report should also suggest steps that countries, or the private sector alone, may take to develop an indigenous capital market. For instance, many nations have fledgling capital markets through the creation of credit unions and several Missions have been active in creating such systems. This kind of information would be useful for Mission personnel assisting LDC governments to develop new privatization programs. Similarly, as noted earlier, information should be made available on strategies to develop a banking system.

Appendix A

MISSIONS SUBJECT TO GUIDANCE

AFRICA	ANE	LAC
Botswana	Bangladesh	Bolivia
Burkina Faso	Egypt	Costa Rica
Cameroon	India	Dominican Republic
Ghana	Indonesia	Ecuador
Kenya	Jordan	El Salvador
Lesotho	Morocco	Guatemala
Liberia	Nepal	Haiti
Malawi	Pakistan	Honduras
Mali	The Philippines	Jamaica
Mauritania	Sri Lanka	Panama
Niger	Thailand	Peru
Senegal	Tunisia	RDO/C
Somalia	Yemen	
Sudan		
Swaziland		
Zaire		
Zambia		
Zimbabwe		