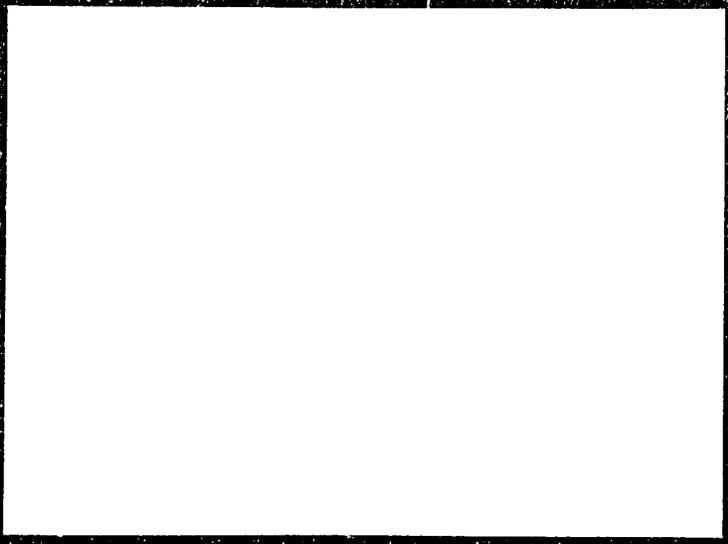


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*Price Waterhouse L.L.P.*



**HAITI PRIVATIZATION**

**ASSESSMENT**

**DRAFT**

**JUNE 1993**

**Under contract with the Bureau of Private Enterprise  
U.S. Agency for International Development**

PRIVATIZATION ASSESSMENT  
SUMMARY

A. OVERVIEW

Fully one quarter of the monetization of the fiscal deficit is attributable to the state enterprises and it is clear that reform of the enterprises is a matter of urgency. Many of the enterprises can only be resurrected with vast infusions of capital and know-how. The alternatives available for raising capital other than by privatization, namely taxation, borrowing or inflationary deficits, will clearly be unacceptable.

Fundamental to the conduct of a successful privatization program is political will and resoluteness. The Aristide administration reportedly believes that private sector involvement in the state enterprises is critical and that the population will be supportive of privatization responsibly carried out.

B. PROPOSED STRATEGY

Due to the inadequate information about the present conditions of the enterprises it is not possible for potential investors to justify investment decisions nor for the Constitutional Government to establish the worth of the enterprises. Therefore, no meaningful work can be commenced immediately to privatize through mechanisms involving ownership, however contracting out is a mechanism that can be put into effect at an early date.

Thus the short term plan is to prepare management contracts in respect of enterprises where massive additional capital is not a prerequisite to continued or restarted operations and to have plans capable of early implementation which will facilitate privatization through changes in ownership. The short-term plan can be followed by a medium-term privatization program where core investors are found for some of the enterprises with the Government retaining some of the shares for the accomplishment of another goal, public share offers to involve a large number of citizens in the mainstream economy.

C. PRIORITY PROGRAM ASSISTANCE AND IMPLEMENTATION ISSUES

1. Preparation of bid documents for management contracts and possible assistance in evaluation of bids and negotiations.
2. Legal and institutional study of state enterprise sector.
3. Planning a monitoring unit.
4. Developing industry and regulatory framework for electricity, telecommunications and water.
5. Developing industry and regulatory framework for the financial sector, particularly commercial banking.
6. Developing a Fair Competition Act.
7. Developing a privatization policy.  
(This, it can be said is nearly complete. It remains for the institutional arrangements to be decided and for the technical skills to operate the program to

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be identified.)

8. Developing a plan for the strengthening of the capital markets

#### D. MEDIUM-TERM ASSISTANCE

9. Establishing the public enterprise monitoring unit.
10. On-going technical assistance in privatization in accordance with the policy.
11. Establishing capital market mechanisms.
12. In addition to technical assistance, consideration might be given to encouraging the speedy infusion of capital and the later broadening and deepening of the local market, by a risk sharing device. In such a case an international funding agency would guarantee, say, 50% of the funds invested in a privatization scheme by the private sector.

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## PRIVATIZATION ASSESSMENT

### A. OVERVIEW

There have been a number of studies concerning the Public Enterprises in Haiti which have concluded that the economic cost of these enterprises is enormous and that they are not achieving useful social purposes. The main cause of their failure has been attributed to corruption, reputed to have been the purpose of their very establishment under the Duvalier regime, and poor management. The Aristide administration brought the enterprises under better control and some enterprises once again became net contributors to the fiscal budget. With 15% of the GDP being represented by bank accommodation to the public sector (one quarter of which or 4% of GDP is applicable to state enterprises), and with the increase in net borrowings by the state enterprises in the last 12 months from the central bank alone being 350 million Gourdes, it is clear that reform of the enterprises is of paramount importance and a matter of urgency.

Given the state of some of the enterprises, they can only be resurrected with vast infusions of capital and know-how. The alternatives available for raising capital other than by privatization, namely taxation, borrowing or inflationary deficits, will clearly be unacceptable. Privatization thus offers a solution that does not require a call on the treasury or other sacrifices by the public. Privatization can also achieve other objectives which will be beneficial to the country.

Fundamental to the conduct of a successful privatization program is political will and resoluteness. Haitian politicians state that the main concern of the people is to gain access to an adequate supply of goods and services at reasonable prices. However, the politicians themselves fear that state enterprises will, in the event of privatization, fall into the hands of the few families that have traditionally controlled the economy. The Aristide administration members with whom we met believe that, in their present state, the enterprises cannot again be quickly turned around in a way similar to the turnaround which took place during their short administration, by government alone. It is maintained by them that private sector involvement in the state enterprises is seen as being critical by the top levels of the Aristide government.

As far as the population at large is concerned, nationalization of the enterprises achieved nothing positive and, since the transfer of the enterprises from the private sector to the state was done relatively recently, state ownership is not seen as the natural state of affairs.

Nevertheless there will be a need to ensure that the program is accepted by the public at large as being well conceived and that it will be carried out with integrity to meet sound objectives. A policy should be formulated by Government which should consist of three main elements: (i) the objectives of privatization (ii) the criteria for determining the eligibility of enterprises for privatization and (iii) the institutional arrangements and technical procedures to be followed in formulating and executing transactions. These are further discussed below.

Some of the more important enterprises are:

Telco, which provides domestic and international telephone service. While demand for service is estimated to be 96,000 lines by 1994, there is now only a 59,000 line capacity. To meet the shortfall alone, a capital program of US\$37 million is indicated but there will also be a massive additional capital expenditure requirement to rehabilitate and modernize the existing system. Many businesses must now resort to two way radios for communications. The Central Bank owns most of the shares in the

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company and buys the net settlements earned by Teleco from international traffic. At March 1993, Teleco owed the central bank 126 million Gourdes, a 103 million Gds deterioration in the past 18 months, in part due to the current freeze of the company's US assets. The company's work force is at least three times the optimal size compared to other telephone systems.

EDH, the electricity supplier, does not have the operational capacity to adequately supply the needs of the country and the supply is unreliable. Businesses are forced to purchase standby equipment and cite the energy shortfall as their most important complaint. The output from hydro is projected to decline over the next few years. There is a shortfall of about 40 to 80 Mw. at present, some of which has resulted from a lack of adequate maintenance of existing facilities. EDH's overdraft with the central bank deteriorated by 48 million Gds in the 18 months to March 1993. The company has distribution line losses of 50% to 60% from theft.

APN, the Port Authority, is vastly overstaffed and labor practices are inefficient. Much of the equipment is obsolete or not functional because of cannibalisation. Contraband is rampant and some very large customers do not pay their bills. The wharfage charges in Haiti are the highest in the Caribbean and Central America and inefficient practices increase demurrage costs. APN's net accommodation from the central bank has increased in the last 12 months by 104 million Gourdes.

Minoterie, the 135,000 metric ton flour milling facility, was finally closed in January 1992. If it is again able to access PL480 raw materials and rehabilitate and modernize its facilities it is expected that profitable operations could be achieved.

Cimant, the Cement Company is not now in production. It has produced 240,000 tons of clinker and 430,000 tons of cement. Since its closure, somewhat surprisingly, its overdraft with the central bank increased by some 44 million Gds. An estimate of rehabilitation costs is US\$7.7 mn.

BNC, the state owned commercial bank shows profits and net assets, but the quality of the financial statements is suspect particularly in regard to loan losses.

Other state enterprises are the two water organizations (CAMEP and SNEP which provide water for Port Au Prince and the rural areas respectively), an edible oil facility which has been closed, a sugar refinery, automobile insurance, an agricultural credit bank, a lottery, television and radio stations, the airport and others. Of these, CAMEP has received 28 million Gourdes from the central bank in the past year and, inexplicably, BNDAI (the agricultural credit bank) has been given 107 million in that period although it is supposedly closed.

Given the dangerous macroeconomic consequences of a continuance of this state of affairs, there is need for short term corrective measures to be ready and implementable immediately on the return of a constitutional government. At the same time work should also begin to put in place a longer term program of reform.

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## B. PROPOSED STRATEGY

Reforms usually come about by encouraging more commercial operations (i) under continued state ownership or (ii) under private ownership. Given the peculiar circumstances of Haiti, it will be impossible for potential investors to justify investment decisions due to the lack of access to pertinent information whilst the enterprises are controlled by the defacto government, and it will not be possible for the Constitutional Government to establish the worth of the enterprises in order to fulfill their fiduciary responsibility to maximise the price at the time of sale. Therefore, no meaningful work can be commenced to privatize by sale or lease any of the individual enterprises nor can it be expected that any such investment activity will take place for 6 months to a year after access to information is finally possible. However contracting out is a mechanism that can be put into effect at an early date following a restoration of constitutional government.

It is tempting to take the view that the need to get on with privatization is so urgent that it would be economically beneficial to dispose of small enterprises on any terms for the sake of speed, but this would provide a rallying point for opponents of privatization and jeopardize the chances of the program being carried out in relation to the large enterprises. In some countries a "reckless" start has caused privatization programs to be aborted.

Thus any short term plan for reform involving the private sector can only contemplate management contracts, and then only in respect of those few enterprises where massive additional capital is not a prerequisite to continued or restarted operations. The short-term plan can be followed by a medium-term privatization program where core investors are found for some of the enterprises with the Government retaining some of the shares for the accomplishment of another goal, public share offers to involve a large number of citizens in the mainstream economy.

## C. PRIORITY PROGRAM ASSISTANCE AND IMPLEMENTATION ISSUES

It is envisaged that these may be commenced immediately and hopefully all but completed by the time of a restoration of constitutional government. In general, the short term measures are planning steps which will equip the Constitutional Government to act quickly on restoration to implement the measures. The measures proposed are:

### Management contracts

It is recommended that work should begin immediately to solicit managers for some aspects of some of the state enterprises. Although it is unlikely that contracts will be signed prior to the restoration of constitutional government, work can commence on preparing the bid documents and it may even be possible for representatives of the constitutional government to commence negotiations with bidders prior to the restoration. The enterprises which lend themselves to a contract management phase prior to privatization would be:

#### o EDH, in respect of generation.

There is a dire need for adequate maintenance, sound procurement and inventory management, despatch and rational load shedding. Although it is doubtful that a contractor would be willing to take on the task of collecting from those who are now stealing electricity, the level of technical line losses can be reduced by a contractor.

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o The Port Authority, in respect of operations

Provided that some accommodation with the union is possible, a management contractor should be able to restore efficient handling operations. Again, it is not reasonable to suppose that a contractor will be prepared to take on the task of collecting receivables because of the probable physical danger of doing so.

o The international airport

This would perhaps be the easiest activity to contract out quickly. There are a number of experienced operators in the field.

o Minoterie, Ciment and edible oils

Because these are closed and access to information about them is harder to obtain, and because in all three cases it appears that significant rehabilitation work is required, a management contract alone without funding will not present a solution. Nevertheless initial expressions of interest should be solicited, perhaps without the preparation of a formal document. There is in fact active interest in the edible oils enterprise already.

The solicitations for contractors should be international. An advantage of management contracts is that they provide operators with the opportunity to become familiar with the enterprises and the environment and thus at a later stage they may become potential investors.

Assessing the legal and institutional framework

Consideration can be given to the framework currently governing the enterprises so that amendments to laws can be drafted, and ready for enactment upon restoration, to deal with cases where the framework inhibits commercial behavior by state owned enterprises. Such inhibiting factors could include the incorporating legislation, the appropriateness of the arms of government that own them, methods of appointing directors, wage and employment rules and structural deficiencies of the oversight mechanism.

Present compensation practices do not necessarily reward responsibility and performance because the assessment is political. Oversight by the Cour Supérieur des Comptes (which is established under the Constitution) has proven to be counter-productive, since it must approve various commercial acts prior to their occurrence, even to the extent of prior approval being required to dispose of individual motor vehicles. The Commission des Finances Publiques, a standing parliamentary commission, appears to have adequate post-facto oversight authority. Since the Cour Supérieur is a creature of the Constitution, any change in its nature or its abolition will be hard to achieve.

The study should also result in recommendations concerning the need, if any, for legislation pertinent to the process of privatization taking into account the uncertainties referred to later in this paper.

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### Planning for a monitoring unit

In order for the Government to take control of the enterprises prior to privatization, work should commence on the design of a public enterprise monitoring system for all state enterprises so that it is ready for implementation on the restoration. This system should embrace the definition of performance indicators applicable to each enterprise and the preparation of a compensation system that rewards managers, possibly under performance contracts, and the information system that will measure such performance can be designed to a large extent from information currently available. Whilst the results of implementing such systems in other countries have not usually lived up to expectations in the long-term, some improvements and economic payback can be expected in the short period during which the enterprises are being readied for privatization. The institutional arrangements and the funding for the operations of the unit can also be set up so as to be implemented quickly.

### Development of a regulatory framework to deal with monopolies and special industries

This is perhaps the most substantive of the short-term measures recommended. Work can commence immediately to design an industry and regulatory framework for the utilities, namely electricity, telephone and water. Not only will the framework promote more commercial behavior by the utilities, it will be essential to facilitate later privatization.

The study would recommend whether some of the entities should be split (eg. electricity generation, transmission and distribution or the domestic and the international telephone systems) and how they should be regulated (the institutions, performance standards and rate-making). Depending on when restoration takes place, it might be possible for the immediate presentation of legislative proposals to install the framework.

As part of this exercise, proposals can be formulated for a fair trading act or fair competition act so as to establish safeguards in respect of non-utility enterprises that may be privatized and which, like cement and flour, are defacto monopolies. Free imports can, of course, ensure competition but it may be necessary to design a system for countervailing duties to deal with dumping.

The regulation of financial institutions including banks should also be the subject of a study so that soon after restoration new measures can be put into effect. This will facilitate the privatization of state-owned banks.

### Development of a privatization policy

During the mission we discussed a possible framework with members of the Constitutional Government which covered the objectives of privatization and the institutional and operational aspects of the process. This now needs to be taken further so that an agreed policy is put into effect as soon as possible after restoration.

### Developing a plan for the capital market

At present the capital market is primitive. A plan of action can be designed for implementation following the restoration. Savers now earn negative interest and have no real option since banks do not offer local accounts denominated in hard currency and there is no equity market. The few local equity offers that have been made have been small (the largest being for US\$7 million) and the largest number of applicants so

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far is 320. Whilst it is possible to have a widespread share offer absent a stock market, some provisions should be made to facilitate trading prior to doing a widespread privatization share offer.

#### D. MEDIUM-TERM ASSISTANCE

Following restoration, the above short-term plans should be implemented without delay, particularly the management contracts. Though the accomplishment of privatization transactions requiring investment cannot be expected to be swift, some one-on-one transactions with core investors can also be commenced in the early medium term. Haiti has a very unsophisticated capital market and an unstable political history, which will combine to make the attraction of large local and foreign investment very difficult. Nevertheless a privatization program should be announced accompanied by policy details as soon as possible after the restoration, or even prior thereto as part of a manifesto, depending on political conditions at the time. In considering the means of implementing privatization involving investment (as opposed to a management contracts) we took into account several factors and views which are discussed below.

##### Legal authority for privatization

It appears that La Cour Superior des Comptes which is established under Article 200 of the Constitution must be involved in the process. Article 200-4 indicates that the Court must be consulted on all projects, contracts, accords and conventions which have a commercial or financial characteristic to which the state is a party. The Court's members are appointed by the Senate and have a 10-year term. In the past it has been used for obstruction instead of fulfilling a "checks and balances" function and this would present a serious bottleneck in the privatization process.

In addition, Article 98 -3 3), which requires the National Assembly to approve or reject all international treaties and conventions, has been used to require preapproval of a commercial contract involving Club Med's operation in Haiti, even though a literal reading of the article indicates that treaties and conventions such as bilateral tax agreements or airline safety conventions were the intended subject. The precedent having been set, it is likely that privatization transactions will be considered to be caught by this article. This would be unworkable.

It has been suggested that a general law concerning privatization which sets out the objectives, institutional arrangements and methods could, if passed, obviate the need for the Cour Supérieur des Comptes or the National Assembly to vet each transaction - however we are not convinced that this would be the case. This is another reason for there to be a thorough assessment of the usefulness, theoretical and practical, of the Cour, in the legal and institutional study recommended as one of the short-term measures. Legal advice as to how to deal with the unfortunate precedent set by the interpretation of Article 98-3 3) is also needed.

We see the virtue of a privatization law which sets out broad objectives and procedures, as long as it is not prescriptive in terms of percentages (say for employee ownership or ownership limitations), absolutes (such as the maximum period allowed for franchises or licences) or methods. Generally more flexibility could be provided by another instrument, like a Ministry Paper, since there would be no requirement for a parliamentary majority to effect amendments when needed from time to time.

Regardless of whether the Court or the National Assembly must be involved in the process on each and every occasion, or whether a law or some other instrument is used

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to establish the privatization program, there are basic features which should exist in the institutional framework and operating rules to promote confidence in the process whilst not being unduly obstructive.

**Privatization policy**

The first step should be for the Government to formulate a policy which in turn will provide the guidelines for drafting any legal instrument on privatization. Though the word "privatization" has been used throughout this document for convenience, we were advised that the term "diversification" (of ownership) will be more acceptable. The Aristide administration officials with whom we met deny that the semantics indicate a lack of commitment, pointing to the fact that the word "float" instead of "devaluation" was used in relation to the reform of the foreign exchange system. The word "privatization", given the current sensitivities in Haiti, connotes the transfer of ownership to the existing oligarchy whilst the intention is to provide ownership opportunities to a broader, more diverse, base.

**Objectives**

During the mission we worked closely with some members of the Aristide administration to formulate what might be acceptable as the main objectives of a privatization program in Haiti. In relation to the policy, it can be stated that no privatization will take place unless it achieves one or more of the following objectives:

o Improve the general efficiency of the economy

If enterprises are restored to operations there will be an increased supply of goods and services and, if enterprises are managed with better technology and along commercial instead of political lines, prices should be competitive.

o Curtail the drain on Government resources

The enterprises currently make losses which are now paid for by the people through tax and inflation. Even enterprises that may have made profits are nevertheless not achieving their potential and not providing an adequate rate of return on resources devoted to them by the state. Under private ownership, enterprises will be taxpayers and contribute to the treasury and subsidies will cease.

o Allow the Government to focus on core objectives

Apart from the drain of financial resources away from the provision of government services such as health and education, the operation of diverse commercial enterprises now distracts the higher level Government employees from the achievement of the core objectives of governance.

o Gain commitment of the private sector to the future of Haiti

Those who devote large amounts of private capital to long-term, capital-intensive industries thereby make a commitment to the country itself. In many cases, funds will be repatriated or not exported in the first place or brought into the country by foreign investors along with a

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transfer of technology. In its broadest sense the private sector consists of all Haitians and, by empowering as many persons as possible through the process, many more persons will have a tangible stake in the success of the economy and act accordingly.

o The democratization of ownership

Privatization can be used to offer to the broadest cross-section of the population, in their hundreds of thousands, the opportunity to be shareholders in large enterprises. Until now there has never been such an opportunity. At present, ordinary people must utilize savings accounts paying negative real interest as their only means of savings. Real estate requires a large capital outlay that is beyond the reach of many. Shares however, being subdividable into small units, can offer them the chance to invest in what can be an inflation-hedged asset.

o Raise resources to address the social agenda

The capital sums realized in the process can be deployed to meet other imperatives.

**Tests for eligibility**

Whilst it is fair to contend that nothing should be ineligible, it is politically beneficial (though admittedly capable of abuse) for a Government to somehow convey that it is not pursuing privatization as a matter of slavish adherence to an ideology or that it is an involuntary requirement thrust upon the country as a conditionality of outsiders and demonstrate that it is in control of the process. These tests were discussed and agreed with members of the Aristide administration:

- o There must be no compelling reason for continued state ownership
- o A change in the composition of ownership will not cause unacceptable disruption in the supply of goods or services
- o The private sector must be able to supply the goods or services more efficiently
- o There must be an appropriate institutional and regulatory framework to deal with situations where monopolistic profits or performance standards are a danger

The first three tests can be passed by any enterprise given political will and the fourth will be a question of fact. At the moment there is no regulatory structure for utilities and it will be essential for such to be established prior to privatization from the investors' point of view as well as for reasons of good public policy. The constitutional administration is also keen that there should be a fair competition law to deal with defacto monopolies.

**Institutional arrangements and technical procedures**

Until there has been an opportunity for the persons in the constitutional administration with whom we met to obtain feedback from the leadership and other elements of that administration, the practical reporting relationships cannot be recommended. Ideally,

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the Prime Minister's office should be in charge of the process given the need to reconcile the interests of the sector ministries.

A formal implementation unit staffed by local and international technical personnel should be established, and funded by international funding agencies. The unit should be headed by a local "champion" of privatization who is trusted by all key sectors of the economy, is technically competent and has a direct reporting relationship with the highest level of the political directorate. The unit will undertake the technical work such as evaluating enterprises, recommending modalities, soliciting and evaluating bids and negotiating with bidders.

After the enterprise has been declared eligible, the technical team will evaluate the enterprise to determine its potential. Bids will not be accepted prior to this exercise, but will be solicited by means of public advertisements. Bids will be reviewed and ranked in order of suitability and negotiations will be held with the top-ranked bidders. The recommendations of the technical unit will then be made to the authorities defined in the proposed legislation and, upon approval, the transaction will be effected.

The permitted methods for structuring transactions (modalities) will be set out in the policy and legislation or ministry paper and will include:

- o Outright sale of assets or shares
- o Long term leases
- o Contract management
- o "Build-Own-Operate" or "Build-Own-Operate-Transfer" schemes

The modality selected in each case should be the one providing the best optimal mix of:

o Transparency

Public share offers provide the highest degree of transparency and will be the preferred option, so long as the risk of a decline in value is unlikely. If a public share offer is not appropriate, a large number of competitive bids should be obtained and evaluated by the team of technical experts in terms of the objectives described above.

o Maximizing the proceeds of the divestiture

The proceeds of a divestiture may consist of a combination of a capital sum, a stream of future income from (for instance) a lease, expected improvements in earnings which accrue to Government's residual ownership, if any, incremental tax revenues and other factors. The experts will evaluate the implications and determine which provides the best offer in present value terms.

o Assuring that demand for the service is met efficiently

A vital consideration in the evaluation of the proposals will be whether bidders, based on their credentials and experience in the particular industry and based on business plans which must be submitted as part

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of the bid documentation, are likely to operate the business efficiently.

o Expediiousness

The delays occasioned by some modalities may have an unacceptable cost and in some cases this will be an important factor in determining the method to be used.

Valuation issues will have to be comprehensively dealt with in the policy so as to ensure that expectations are realistic. Replacement values seldom have relevance to investors and governments sometimes have difficulty appreciating the need for going concern valuations to be the primary method for determining negotiating targets. In general, an investor will only pay the present value of cash flows assuming rehabilitation at an appropriate discount rate minus his projected outlays for rehabilitation work and working capital.

The medium term plan proposed would consist partly of a phase of implementing the measures designed in the immediate future and then a phase where privatization through widespread share offers would be the main goal. A prerequisite should be to establish a mechanism for the trading of local equities.

To satisfy Government that reconcentration of ownership will not be a feature of privatizations by widespread share offers, the "golden share" device might be utilized to entrench certain provisions in the articles and bye-laws of an enterprise. This is a device used in several countries. The golden share (or "special share" as it is formally known), has the power to veto shareholder resolutions to expand or abolish percentage limits on ownership by any party or connected parties. After a period it is usual for a government to have the share redeemed if the power no longer seems to be required.

#### TECHNICAL ASSISTANCE

If the projects are agreed, terms of reference should be drafted in the near future.

#### Priorities

1. Preparation of bid documents for management contracts and possible assistance in evaluation of bids and negotiations.
2. Legal and institutional study of state enterprise sector.
3. Planning a monitoring unit.
4. Developing industry and regulatory framework for electricity, telecommunications and water.
5. Developing industry and regulatory framework for the financial sector, particularly commercial banking.
6. Developing a Fair Competition Act.
7. Developing a privatization policy.  
(This, it can be said is nearly complete. It remains for the institutional arrangements to be decided and for the technical skills to operate the program to be

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identified.)

8. Developing a plan for the strengthening of the capital markets

Medium-term

9. Establishing the public enterprise monitoring unit.

10. On-going technical assistance in privatization in accordance with the policy.

11. Establishing capital market mechanisms.

#### GENERAL ASSISTANCE

In addition to technical assistance, consideration might be given to encouraging the speedy infusion of capital and the later broadening and deepening of the local market, by a risk sharing device. In such a case an international funding agency would guarantee, say, 50% of the funds invested in a privatization scheme by the private sector.

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