ASIAN DEVELOPMENT BANK **SST: STU 2001-15**

SPECIAL EVALUATION STUDY

ON THE

PRIVATIZATION OF PUBLIC SECTOR ENTERPRISES:

LESSONS FOR

DEVELOPING MEMBER COUNTRIES

December 2001

ABBREVIATIONS

ADB	–	Asian Development Bank
BOT	–	build-operate-transfer
DMC	–	developing member country
EBRD	–	European Bank for Reconstruction and Development
ECNZ	–	Electric Corporation of New Zealand
GDP	–	gross domestic product
IFC	–	International Finance Corporation
IPO	–	initial public offering
JEDB	–	Janatha Estate Development Board
NGO	–	nongovernment organization
OECD	–	Organisation for Economic Co-operation and Development
PDMC	–	Pacific developing member country
PDR	–	People's Democratic Republic
PPIAF	–	Public-Private Infrastructure Advisory Facility
PPP	–	public-private partnership
PSE	–	public sector enterprise
RPC	–	regional plantation company
SLSPC	–	Sri Lanka State Plantation Corporation
TA	–	technical assistance
UK	–	United Kingdom
UNDP	–	United Nations Development Programme

NOTE

In this report, "$" refers to US dollars.

Operations Evaluation Department, SS-50

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EXECUTIVE SUMMARY

Privatization is a process for change of ownership and control. Differences in approach and outcome are the prime reason for this special evaluation study, namely, to provide more comprehensive understanding of privatization and guidance on how it should be managed. The study is part of the review process of the Asian Development Bank (ADB) for evaluating its operations.

At concept stage, it was envisaged that the study would be conducted so as, first, to understand the global lessons drawn from privatization and relate the experiences to the different economic and political circumstances, approaches, and methods applied; second, to assess ADB's involvement and developing member country (DMC) experience; and third, to draw insights for strategizing future assistance and for identifying principles and critical issues relating to privatization design.

To assess the global experience, a review of the published experiences of governments, multilateral and bilateral funding agencies, university research, and literature generally was undertaken. Assessment of ADB's support for privatization involved an analysis of all ADB loan and technical assistance projects since 1984, with the view to determining whether or not privatization was a direct or indirect objective. To assess the DMC experience, a survey questionnaire was sent to ADB's 37 active borrowers. The purpose was to understand (i) why DMC governments privatize, (ii) what constraints prevent faster privatization, (iii) the approach and methods adopted, (iv) the major lessons of their experience, (v) the perceived operational results, (vi) which public sector enterprises (PSEs) should not be privatized, (vii) how social issues that arise should be dealt with, and (viii) each DMC's future divestment program. Missions to 10 DMCs were arranged to discuss questionnaire answers with government representatives and the managements of divested enterprises.

Study Findings. Beginning with Chile in the mid-1970s, and continuing with the United Kingdom in 1979, New Zealand and France in 1984, Singapore and Malaysia in 1985, and Latin America and other European countries in the 1990s, the global push to privatization has heralded a change in governance practices.

Unsustainable budget deficits, high taxation, and burdensome funding are common factors precipitating the need to privatize. But while fiscal crisis has been a prime reason in many countries, including several in Asia, justification is also driven by ideology and efficiency grounds. In general, countries have privatized industries to achieve several objectives. These include (i) raising revenue for the government, (ii) raising investment capital for the industry or company being privatized, (iii) reducing the government's role in the economy, (iv) promoting wider share ownership, (v) increasing efficiency, (vi) introducing greater competition, (vii) exposing firms to market discipline, and (viii) decreasing government subsidies. For some countries, capital market development has been an explicit objective of privatization.

The United Kingdom's experience with privatizing monopoly enterprises provides evidence for the importance of regulation and competition, while privatization through the voucher system in Eastern Europe shows the importance of the institutional framework and operating environment. Other experiences demonstrate the importance of issues concerning public and corporate governance, banking deregulation, capital market development, and the need for more appropriate social welfare policies and compensation to mitigate negative impacts of privatization.

The general pattern among DMCs has been to privatize retail businesses (e.g., hotel and resort accommodation); followed by manufacturing (e.g., textiles, construction, and engineering); and road transport services, before privatizing monopoly and oligopolistic entities such as banks, airlines, telecommunications, electricity and water utilities, ports, and energy enterprises.

Numerous evaluations and empirical studies have documented the overwhelming success of privatization as part of good governance reform leading to improved operational efficiency, higher investment, and stronger economic growth. Consumer benefits are derived in the form of increased output, improved quality, increased range, and generally reduced prices.[1] Governments benefit from the savings in capital and subsidy expenditure and enhanced capacity to increase social services, retire international and domestic debt, and meet current expenditures.

No single institutional framework stands out as the best for privatization. Studies show, however, that for privatization to be successful, it is essential to define the roles and powers of participants, and ensure that legal, regulatory, and enforcement mechanisms precede divestment. In the banking sector, privatization without deregulation seriously disrupts effectiveness, as does privatizing monopoly enterprises before restructuring (to create competition) and before introducing regulation.

Demonstrating the impact of privatization on capital market development is the growth in capitalization of the main stock exchanges, which in the last five years have grown in Europe by a factor of two to four and in some Latin American countries nearly 30 times. Capital markets increase the available financing sources for firms to fund new investment, improve efficiencies in investment banking, increase pressures to allow pension funds to make direct stock market investments, and enhance corporate transparency.

The privatization link with poverty reduction stems from the relative ineffectiveness of public ownership to fulfill economic growth needs. Under private ownership, consumer demand from the poorest members of society is met sooner, while lower government expenditure on PSEs in terms of subsidies and capital investment provides governments with an opportunity to increase expenditure on poverty-reducing social services.

No established framework is evident as to how nongovernment organization participation should be structured into the planning and implementation of privatization. Study observations suggest that nongovernment organizations can be the most effective in the design and implementation of social awareness campaigns, retraining, and compensation for displaced employees and communities.

The study lists some 30 lessons drawn from global experience, which have relevance to ADB's operations and DMC privatization programs. It is clear that privatizing PSEs has often taken precedence over implementing higher priority reforms necessary for effective market operations of the private sector.

Proceeds from privatization in Asia are estimated to exceed $30 billion. Early ADB support emphasized improving the operational and financial performance of PSEs through strengthening management autonomy, commercializing activities, and pricing reforms. These efforts were reinforced with wider macroeconomic liberalization policies for promoting

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[1] Where subsidies were prevalent before privatization, higher prices have generally followed. For many enterprises, including telecommunications, textiles, agro-industries, tourist and hotel accommodation, chemical manufacture, and bus services, lower prices have generally followed.

competition, removing protection, and during the 1990s with governance reforms and strengthening the financial and capital market sectors. The number of ADB's public sector loans and advisory technical assistance grants directly or indirectly supporting privatization has significantly increased in the past 15 years. This has been complemented by ADB's direct assistance to the privatization in the form of loans without government guarantee and equity investments totalling almost $2 billion.

The DMC experience of privatization is judged positive, but to date, privatization has proceeded largely without attention to the sequencing of reforms and appropriateness of approach for maximizing its effectiveness. DMCs' growing political commitment to privatization provides scope for repositioning ADB's country strategies and programs. Most needed is assistance for (i) developing the policy, legal, and regulatory framework; (ii) establishing the institutional framework for privatizing; (iii) organizing workshops and advisory sessions; (iv) funding implementation including support for the separation of noncore activities; and (v) restructuring and retraining.

Several crucial points emerge from the study including (i) a tendency for ADB and DMCs to support privatization while ignoring the need for a more comprehensive approach to carrying out political, legal, institutional, and economic reforms; (ii) the importance of sequencing in the design of privatization programs/projects; (iii) a preoccupation with regulation before creating competition; (iv) the counterproductive aspects of excessive regulation; (v) the merits of rapid privatization; (vi) the ineffectiveness of some forms of public-private partnership (PPP) as a method of privatizing; and (vii) social barriers and the need for more comprehensive welfare programs.

Comments on Study Findings. Although the notion of sequencing and need for a more integrated approach received a high degree of support in responses to the preliminary findings of the study, a number of concerns were raised. These were related to (i) accepting that DMC experience parallels the wider global evidence and lessons, though lagged in time and scale; (ii) accepting that privatization leads to improved enterprise efficiency; (iii) understanding advantages of rapid privatization; (iv) seeing the appropriateness of deregulating the banking sector before privatizing PSEs; (v) seeing the benefits of privatization for capital market development; (vi) accepting notions concerning PPPs, regulation, and foreign investment; and (vii) skepticism about the sufficiency of privatization to fully meet social requirements. These concerns reflect the need to enhance understanding of the privatization process in the DMCs through comprehensive awareness campaigns.

Outlook. The positive efficiency impact, spur to economic growth, and growing commitment of DMC governments make it likely that privatization in DMCs will follow the global momentum, which shows annual proceeds have increased since 1990 from $33 billion to approximately $180 billion, of which 25 percent is from privatization in developing economies. Most DMCs have divestment programs indicating enterprises earmarked for privatization with targeted disposal dates. Notwithstanding the gathering global momentum, privatization among DMCs is likely to remain a political issue. A cautious approach is dominant and tends to undermine the effectiveness of privatization.

Recommendations. The study's findings in relation to its objective of providing guidance on how privatization should be managed highlights the importance of sequencing and a more integrated approach to implementing privatization. The need to understand more comprehensively the privatization process is another major finding of this study.

ADB is encouraged to review its strategy for assisting DMCs with privatization, taking into account the need for a more integrated approach to reforms to promote economic and private sector development, the importance of sequencing, and the need for more comprehensive social welfare assistance. Attention is drawn to the problems of PPPs and the need for more appropriate mechanisms for (i) dealing with social welfare services that are not core to PSE activities, and (ii) making future pricing adjustments on PPP activities.

DMCs are encouraged to adopt policy reforms that take into account (i) the global lessons for prioritizing the legal framework and institutional requirements, (ii) the need to restructure to infuse competition, (iii) the need to regulate only where competition is limited, and (iv) the need to ensure that accompanying social programs are comprehensive and fully supported by the community and persons affected.

I. BACKGROUND

A. International Agenda

1. The privatization of public sector enterprises (PSEs) has been a recurrent theme on the international development agenda since the early 1980s. Assistance for this purpose from international aid agencies has been cautious, placing priority first on supporting stabilization programs and improving existing operational efficiencies. Assistance has also taken the form of technical and financial support for institutional strengthening, enhancing autonomy, and price reforms. Although international aid has been successful in promoting economic and social development that would not have been supported by commercial funding, international aid agencies and governments have been unable to keep pace with funding requirements and technology advances. Supply constraints have been in evidence, particularly in nonurban areas, and technical innovation and economic growth have been curtailed. These situations contrast with the evidence from reform-minded economies where more conducive operating environments exist, and privatization reforms have led to higher national levels of investment, higher economic growth, increased outputs, and improved availability and quality of goods and services.

2. The International Finance Corporation (IFC), the Organisation for Economic Co-operation and Development (OECD), and the World Bank have promoted privatization in structural policy reforms since the mid-1980s. Monitoring and evaluation of experience have provided a valuable global perspective while identifying changes in the operating environment necessary for privatization reforms. Mixed and often seemingly unpredictable results revealed early the need for a liberal macroeconomic framework, deregulation of banking, and reforms to enhance competition and enforce good governance. Appropriate policy reform for capital market development, together with better management of pension funds and other assets, has become part of the evolving process for effective privatization.

B. Asian Development Bank Privatization Support

3. Beginning around 1984, the Asian Development Bank (ADB) integrated privatization as a goal into its operational strategies and assistance plans for its developing member countries (DMCs). The process of privatization is defined as any action that helps reduce the level of public ownership and control, i.e., broader than just divestment in existing PSEs. In the broader context of restructuring before divestment, privatization includes preparatory reforms aimed at facilitating private sector operations and any action that increases participation in market-driven activities, such as removing subsidy support, commercializing operations, and introducing enabling policy reforms.[2] ADB's Medium-Term Strategic Framework 1992-1995 identified

[2] Reforms aimed at improving the enabling environment that are part of the privatization process include economic stabilization, trade liberalization, strengthening the institutional framework for implementation, governance, and credit recovery. The privatization process, before partial or whole divestment, may also include preparatory measures aimed at enhancing the commercial viability of PSEs, such as removing subsidy support, separating noncore welfare activities, strengthening financial management, and contracting to the private sector noncore activities such as maintenance.

privatization as a desirable strategy to help meet economic growth objectives.[3] In the late 1990s, renewed attention was given to developing strategies for effective reduction of poverty. In 1999, ADB's Board approved a poverty reduction strategy that set poverty reduction as ADB's overarching goal.[4] In 2000, ADB's private sector development strategy was approved to help promote growth and support poverty reduction efforts;[5] and in 2001, ADB's long-term strategic framework encompassing these two strategies and the integrated goals of international aid agencies was finalized.[6]

4. ADB support began with some of its larger DMCs, notably Bangladesh, India, Pakistan, and Philippines. Support for privatization among the smaller DMCs is more recent, e.g., Papua New Guinea and Sri Lanka. For transition economies such as Lao People's Democratic Republic (PDR), Viet Nam, and the republics of the former Soviet Union (Kazakhstan, Kyrgyz Republic, and Uzbekistan), interest in privatization became a more explicit ADB policy consideration in the second half of the 1990s, with an aim to strengthen institutional capacity and build a better enabling environment. In small countries such as Bhutan, Maldives, Nepal, and Pacific developing member countries (PDMCs), privatization has been limited. Even so, there exist select examples of privatization, such as the divestment of minihydro operations in Nepal, contracting of roadworks in the PDMCs, and contracting of electricity distribution maintenance in Sri Lanka. For DMCs such as the Republic of Korea (henceforth Korea), Malaysia, and Singapore, privatization has proceeded largely without ADB assistance. In the case of Indonesia, ADB documentation avoids reference to privatization, even though there exists long support for the concepts of privatization through improved autonomy measures, better management information systems, removal of price controls, introduction of more responsive pricing systems, and promotion of deregulation and competition. Since the 1997 Asian financial crisis, the need to improve governments' financial and operational efficiencies, governance, and management of pensions has emerged as important issues among DMCs.

C. Special Evaluation Study

5. The special evaluation study originated as part of ADB's review process for evaluating its operations and relevance for strategy development, country strategies and programs, and new projects.[7] The overall objective is to provide a more comprehensive understanding of the privatization process and guidance on how the objectives of privatization should be managed and incorporated into project designs.[8]

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[3] Five development objectives were defined: (i) economic growth as the main engine of growth, (ii) poverty reduction with emphasis on raising living standards of the poor, (iii) women in development with emphasis on equality of opportunity, (iv) population control with emphasis on family planning, and (v) environmental protection.

[4] R179-99: *Fighting Poverty in Asia and the Pacific: The Poverty Reduction Strategy of the Asian Development Bank*, 19 October.

[5] R78-00: *Private Sector Development Strategy,* 30 March.

[6] Moving the Poverty Reduction Agenda Forward in Asia and the Pacific, The Long-Term Strategic Framework of the Asian Development Bank (2001-2015), approved on 14 March 2001.

[7] The study was prepared by Mr. Timothy M. Hutton, Evaluation Specialist (Mission Leader); Dr. Alister McFarquhar, Professor Dieter Reineke, and Dr. Norbert Schmitz (consultants).

[8] The study follows TA 5753-REG: *Developing Best Practices for Promoting Private Sector Investment in Infrastructure*, for $600,000, approved on 7 October 1997, that produced five reports discussing global experiences for power, water supply, expressways, ports, and airports. Best practices covered sector policy issues such as pricing and competition, legal and regulatory frameworks, and restructuring.

6. Because ADB's direct involvement with divested enterprises is limited,[9] it was considered that the most meaningful way to achieve the study aim was first to understand the global lessons drawn from experience and to relate them to the different economic and political circumstances, and to the approaches and methods adopted. Appendix 1 summarizes the focus of privatization efforts by the World Bank, OECD, and the United Nations Development Programme (UNDP).[10] First, global experience with privatization is reviewed. Second, ADB's involvement and DMC experience are assessed. Third, based on the global experience, lessons learned, aid agency focus, and identified DMC needs, insights are drawn for strategizing ADB assistance, principles for effective privatization are developed, and critical issues relating to privatization design are discussed.

7. To review the global experience (including that in DMCs), an evaluation was undertaken which took into account the published experiences of governments, international and bilateral funding agencies, university research, and case study experiences reported in official published journals. From this review, the principal lessons of experience were identified and collated under one of four categories: politics, framework and institutions, economics and efficiency, and social welfare.

8. To obtain more specific details of the DMC experience and progress toward privatization, a survey questionnaire was sent to 37 active ADB borrowers. The questionnaire was designed to gather information on (i) the prime reasons DMC governments choose to privatize; (ii) the constraints affecting faster privatization; (iii) the approach and methods adopted; (iv) the major lessons of experience; (v) operational results; (vi) which PSEs should not be privatized; (vii) how social issues should be dealt with; and (viii) future DMC divestment plans. In addition, missions were arranged to 10 DMCs to discuss answers with government representatives and the managements of divested enterprises.[11] The DMCs selected were chosen so as to obtain a sample set reflective of differences in economic size, known privatization experience, ADB involvement by way of loan or technical assistance (TA), and to obtain a sample of divested enterprises from all economic sectors.

9. To understand the extent of ADB's involvement in privatization, the study made an analysis of all ADB loans and TA projects since 1984. The analysis extended to examining the objectives and scope of each loan and TA project, with a view to identifying whether privatization had been a direct or indirect objective, or not an objective at all. At the same time, a review was undertaken of stated intentions under each DMC's development plan and ADB's operational strategy. In addition, ADB in-house interviews were conducted with staff involved for their views of the strengths and weaknesses of the DMCs and the operations of ADB.

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[9] ADB's involvement in supporting privatization aims has largely been toward commercializing activities, removing subsidy support, strengthening operational efficiencies, and introducing enabling policy reforms. Involvement in the design, planning, and funding requirements for divestment has been limited.

[10] Case study information of IFC, OECD, and the World Bank on privatization and lessons of experience is extensive. The World Bank and IFC globally disseminate their case study experiences. OECD, through an annual symposium of members and nonmembers, reviews the problems and best practices of regulation, competition, and privatization. Reports by other international development agencies (Canadian International Development Agency, Department for International Development of the United Kingdom, Kreditanstalt für Wiederaufbau of Germany, UNDP, and United States Agency for International Development) are few, though all these agencies have considerable experience with loan and technical assistance support aimed at commercializing and strengthening PSE operational efficiencies. UNDP has placed special emphasis on improving governance through decentralization and developing stronger and more effective local government. Bilateral lending agencies have tended to concentrate on the start-up and development of small businesses under the broader aims of private sector development. Institutional documentation of the global privatization experience is also available from other sources, for example, universities, which have been the forerunners in theorizing privatization, and publish extensively on case study experiences.

[11] The DMCs visited were Bangladesh, India, Korea, Lao PDR, Malaysia, Maldives, Pakistan, Philippines, Singapore, and Thailand.

II. GLOBAL EXPERIENCE

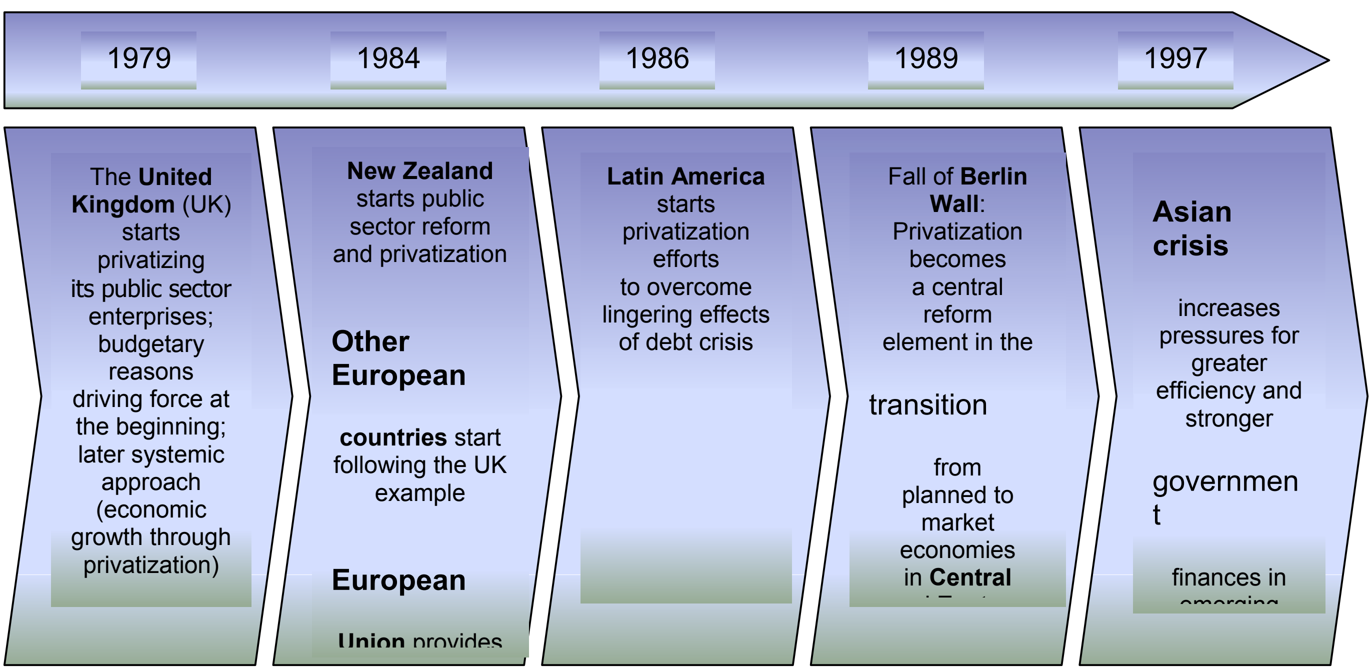
10. This section gives an overview of the global development toward privatization, results of empirical studies, significant institutional and sector developments, and global lessons.

A. Country and Regional Experience

11. Appendix 2 provides a comparative overview of the essential features and results of the world's privatization programs. The overview includes country information on the economic and political status prior to privatization, and approaches and methods applied.

12. The push for privatization started with Chile in the mid-1970s and the United Kingdom (UK) from 1979. Large budget deficits, high taxation, unemployment, and burdensome funding to meet PSE expansion requirements precipitated the need to privatize in both cases. Other European countries, led by France, followed the UK example. In 1984, New Zealand, faced with high inflation and balance-of-payments difficulties, introduced radical fiscal, monetary, and labor regulation reforms leading to a fast-track program for privatizing from 1987. In 1986, the Latin American economies looked toward privatization to overcome problems of growing internal budget deficits, and in 1989 privatization became a central reform element in the transition from planned to market economies in Central and Eastern Europe and in the former Soviet Union. The Asian financial crisis led to increased pressure for enterprise restructuring and stronger government finances among DMCs. Figure 1 summarizes the historical milestones in global privatization.

Figure 1: Milestones in Global Privatization



13. For most African countries, privatization and private sector development have been a part of broader economic reforms, but progress has generally not gone beyond privatizing small business manufacturers, agro-industries, and tourism enterprises. As with the initial Latin American experience, many African countries are finding it difficult to sustain program reforms. Zambia and Egypt are in the middle of extensive privatization programs. Large privatizations in telecommunications and airlines are planned for Morocco and South Africa as well as Jordan and Oman in the Middle East.

14. Most Asian economies see privatization as ideologically inspired, but several, including Bangladesh, Pakistan, and Sri Lanka, began denationalizing their manufacturing and retail operations in small businesses, textiles, and agro-industries from the mid-1970s. With the notable exceptions of Korea, Malaysia, and Singapore, Asian governments have tended to retain government ownership and management of their infrastructure and large manufacturing industries. Only in the last four years have PDMCs introduced policy reforms that allow broad privatization programs.

B. Empirical Results

15. Numerous studies document the effects of privatization. The common measures of economic impact include gross domestic product (GDP), government revenue, the budget, and economic efficiency in terms of productivity and pricing. Other common measures include the effects of privatization on overall availability and quality of goods and services, on employment, and on incomes.

16. The overall impact of privatization reforms has been dramatic. While policy reforms were similar, total government expenditure as a proportion of GDP fell, in the case of New Zealand from 18 percent of GDP to around 16 percent, and in Chile from about 23 percent of GDP to 10 percent.[12] The contrast in impact reflects differences in how subsidies, other transfers, and capital expenditure were used. Significantly, in low-income economies, the share in GDP of PSEs has fallen from around 16 percent to around 6 percent, and in middle- to high-income economies from around 9 percent to around 5 percent. Table 1 shows the estimated annual savings in government capital expenditure following privatization for selected countries reviewed in the study.

[12] Associated changes with privatization reform reflect different time periods.

Table 1: Privatization Proceeds and Public Capital Expenditure Savings

Country/Region	Total Proceeds[a] ($ billion)	Estimated Annual Savings in Capital Expenditure % of GDP[b]	$ billion[c]
New Zealand	14	2.8	1.5
United Kingdom	120	3.3	42.8
Continental Europe			
France	69	1.1	13.6
Hungary	12	1.9	1.0
Latin America			
Chile	51	4.0	3.1
Mexico	32	1.2	7.2
Transition Economies			
Czech Republic	5	3.6	2.0
Poland	12	4.9	7.4
Asian Economies			
Philippines	2	0.2	0.1
Singapore	14	5.0	4.2

GDP = gross domestic product.
[a] Accumulated proceeds to end 1999.
[b] Savings reflect general trend changes.
[c] Based on GDP for 1999.

17. Perhaps the most significant impact has been the impact on foreign investment. Gross investment quadrupled as a proportion of GDP in Latin America, nearly tripled in New Zealand and the UK, and increased from zero to more than 30 percent of GDP in the Central and Eastern European transition economies. There has been little or no change in most Asian economies with the exception of the Philippines (where investment doubled to around 13 percent of GDP) and Singapore (also doubling, to around 26 percent). Allowing foreign investors to take part in privatization is seen to increase the pool of qualified buyers, technology transfer, privatization proceeds, and foreign exchange. Appendix 3 provides further background indicators relating to privatization.

18. At the enterprise level, privatization has positive effects on incentives, profitability, operational efficiency, and consumer benefits in a relatively short time. Consumer benefits typically arise in the form of enhanced quality and availability of goods and services, increased range, and reduced prices (footnote 28). The measured effectiveness is strongly dependent on (i) the elimination of regulatory distortions, and (ii) restructuring to create competition. Institutional reforms are confirmed as necessary to ensure that the legal, banking, and financial environments are conducive to private sector market operations. Privatization is also more effective where capital market development exists and where regulatory controls are transparent and unambiguous. Table 2 summarizes key results for a selection of empirical studies. The results of further studies for different enterprise sectors and countries are shown in Appendix 4.

Table 2: Some Key Results of Empirical Studies

Study [a]	Impacts from Privatization
1994-1999 Jones, Megginson, and Nash Study of 18 countries, 32 industries	• Increases output (real sales, operational efficiency, profitability, capital spending, dividend payments). • Increases profitability (net income divided by sales) from an average of 8.6 percent to 12.6 percent. • Increases efficiency measured by sales per employee. • Increases capital investment spending from an average of 14 percent of sales to 19 percent. • No evidence of decline in employment. • Significant changes in firm directors.
1998 Serra, Holder Studies of Chile and the United Kingdom	• Where privatization resulted in the direct introduction of competition, the benefits (price, quantity, quality range) to consumers were considerable. • Where privatization was not followed by the introduction of competition, the benefits to consumers were significantly less.
1998 Salej, Stefan Study of Brazil	• Significant to the effectiveness of privatization is the sequence (conception, restructuring, regulation, divestment). • Restructuring should occur before regulation.
1998 Saba, Paolo Study of competition policy	• Putting a regulatory framework in place before privatization is one of the most important prerequisites for the successful privatization of infrastructure industries.
1998 Weiss, Nitikin Study of banks	• The voucher system approach in transition economies revealed the problem of insufficiently regulated privatization. • Citizens diversified their risk by selling to investment funds controlled by banks and, in turn, the State. Bankruptcy law and enforcement was weak, and credit typically was rolled over, leading to covert practices diminishing the need for financial market discipline.
2000 La Porta, Shleifer Study of 92 countries, banks	• Government ownership is more extensive in the poorest countries. • Government ownership retards financial system development. • Government ownership restricts economic growth rates.

[a] Refer to Appendix 4 for details of study references.

C. Emerging Institutional and Sector Developments

1. Legislation and Regulation

19. No single institutional framework stands out as best for privatization. However, studies of the success of privatization show that it is essential to define the roles and powers of participants, and to ensure that legal, regulatory, and enforcement mechanisms precede privatization. Two predominant institutional structures emerge: (i) a centralized model where all decision-making powers are vested in a single autonomous institution, and (ii) a decentralized model where the privatization process is split among the branch ministries responsible for the enterprises to be privatized. Some case studies of privatization illustrate the benefits of delegating responsibility to an independent commission with powers to restructure and divest, free from insider resistance.

20. The desirability of a general law governing privatization depends on the existing constitutional order, political environment, administrative capacity, and intended scope of privatization. A general law sets a framework on the conditions of sale, the institution responsible for referrals, and scope of executive powers to restructure the entity concerned,[13] and enable divestment. A general law may also define the type of privatization, the special rights of the state after privatization, provisions for employees, and foreign ownership, and set incentive schemes for small investors. Alternatively, a specific privatization law may legislate on these areas.[14]

21. Most countries adopt legislation on corporate governance of PSEs covering reporting obligations; rules on the selection and responsibilities of directors; timely disclosure for financial statements and transparency; compliance with general policies of the government; evaluation of management performance; budgeting, accounting, auditing; and other internal monitoring systems such as staff management and control issues. Special regulatory contracts may apply to infrastructure monopolies that are privatized and remain monopolistic. Regulatory contracts cover granting licenses; approving charges for services provided by the enterprise; monitoring service quality; and meeting satisfactorily expansion, quality, and service requirements.

2. Banking

22. Governments have adopted different approaches to retaining banks as a policy instrument. Some countries treat their banking sector as infant industries by encouraging local ownership and by limiting foreign competition. However, market diseconomies, the advent of technological advances in communications, and the lack of world linkages reduce the competitiveness of local ownership. Crucial, overall, for the efficacy of banking is the capacity of the regulatory and supervisory institutions and the general need for consolidation.[15]

23. The consequences of bank failure are generally recognized.[16] Except in countries undergoing a rapid transition to privatization, the preferred approach is to proceed with bank privatization immediately after the institutional and regulatory framework is established,[17] and before privatization of nonbanking enterprises. If the banking sector is not privatized, then the empirical evidence points to the need to deregulate the banking sector and infuse competition.

24. The privatization of Creditanstalt in Austria shows how a local bank can join the 100 biggest banks in the world. A similar pattern was followed in Italy, but bank ownership was transferred ultimately to foreign investors. The Czech Republic, Hungary, and Poland are other examples where privatization was pursued with the intention that the banks would remain

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[13] Including the separation of commercial and noncommercial activities.

[14] Legislation for privatization was seen as necessary in France but not in all European countries. Spain, like New Zealand, opted for powers governing privatization to be set under budget laws. In Australia, corporate governance regulations are covered by legislation affecting all corporations, whether public or private.

[15] Good examples of the differences in banking reforms are the Czech Republic, Estonia, Hungary, Poland, and the Russian Federation. In Hungary, most banks were privatized with the participation of foreign strategic investors and privatization was generally successful. Poland opted to attract foreign strategic investors and at the same time encourage consolidation of the banking industry. The Czech Republic and the Russian Federation favored domestic ownership, and the privatization of banking has been the least effective there.

[16] Experience suggests that a high degree of bank exposure to privatization-related loans can lead to a systemic crisis, as in Chile during the early 1980s. The level of lending and resultant defaults in many transition economies of Central and Eastern Europe also proved counterproductive. On the other hand, the absence of finance from banks can significantly inhibit the effectiveness of privatization and any stimulus to economic growth.

[17] Another pertinent observation is the impact of stabilization on strengthening the macroeconomic situation and law and order in the economies of the Czech Republic, Hungary, and Poland, which, in turn, increased the attraction of banks to bidders and secured much better prices for the governments.

predominantly local entities. However, a surge in the volume of bad debt portfolios resulted in the lifting of restrictions on foreign investment. Consequently, privatization deals were concluded with foreign participants in all three countries.[18]

3. Infrastructure Enterprises

25. The trend toward privatizing natural infrastructure monopolies has evolved from technology advances in telecommunications, liberalization that promotes competition, deregulation of financial markets, capital market development, market restructuring to remove vertical integration, and regulation for enterprises that remain monopolistic after privatization.[19]

26. The method of divestment for infrastructure enterprises depends on the strength of the country's capital market and legal infrastructure, on the size and number of similar enterprises to be transferred, and on the need for a strategic investor.[20] Commonly, the divestment methods involve (i) an initial public offering (IPO) followed by the sale of the controlling interest to a strategic investor, (ii) trade sales to strategic investors,[21] (iii) sale by tender, and (iv) management buy-outs. Asset sales are also common with liquidations and/or restructuring, as well as the introduction of competitive units in the market. Joint ventures, build-operate-transfer (BOT) investments (and variations thereof), and/or production-sharing agreements are also used to increase private sector involvement.

27. The emergence of the international and combined service company has been an unexpected consequence of privatization. In the power and energy sector, oil and gas companies have become electricity companies; domestic regional utilities have become multinational electricity companies; electricity distribution companies have become power generation companies; and power generation companies have become distribution and transmission companies. Many telecommunications enterprises have merged after privatization with a global technology partner. There has also been a tendency after privatization for airlines to merge operations with other airlines serving larger international links. Thus, while national policy reforms have emphasized competition by breaking up monopolies, global market forces have a tendency to reintegrate operators.

4. Capital Market Development and Pension Reform

28. Underlying the significance of privatization for capital market development is the expansion in capitalization of the main stock exchanges, which in five years to August 2000, grew in Europe by a factor of two to four. In some Latin American countries, expansion in capitalization over the same period was nearly 30 times. The 10 largest, and 30 of the 35 largest, share offerings in history have been privatizations (Appendix 3).[22]

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[18] In Hungary, the Hungarian Credit Bank was acquired 90 percent by ABN-AMRO; the Hungarian Foreign Trade Bank 50.8 percent by Bayerische Landesbank and 17 percent by the European Bank for Reconstruction and Development (EBRD); and the Budapest Bank 58.9 percent by GE Capital and EBRD.

[19] A notable exception occurred with the privatization of British Gas, which was divested as a monopoly, and with a regulatory body to protect consumer interests. Discrimination complaints followed, and rulings against British Gas were made, but to no good effect. Eventually, the monopoly structure of British Gas was dismantled.

[20] A strategic investor is a term commonly used to describe an investor from the same industry who invests for management control.

[21] Trade sales refer to sales made to investors operating in the same industry or trade.

[22] The 10 share offerings were all larger than the biggest nonprivatization share offering of $10.76 billion for ATT Wireless stock in April 2000.

29. An important spin-off from privatization has been the increasingly liquid and efficient nature of capital markets, which has increased financing opportunities for firms to fund investment. Capital market development promotes investment and economic growth, consolidation and economies of scale in investment banking, and improves corporate transparency. For some governments, capital market development has been an explicit objective of privatization.

30. Most privatizations include a strong, small-investor component. Deliberate underpricing of IPOs, together with shareholder incentives, are prominent design features that have led to a significant overall increase in the number of private shareholders.

31. Equity raised from privatizations (and subsequent rights issues) has expanded the number of funding sources and investors. One outcome has been to increase the onus on pension reform to allow investments by pension funds in IPOs.[23] In some countries, particularly those with underdeveloped capital markets, privatization has provided pension funds with a broader range of equities for diversifying portfolios. At the same time, pension funds have become an important influence on corporate governance, through, for example, their participation at shareholders' meetings and providing underwriting support.

5. Poverty Reduction and Nongovernment Organization Participation

32. The link between privatization and poverty reduction stems from the relative failure and ineffectiveness of public ownership. Not only are privatization reforms associated with higher economic growth, capital market development, and promotion of an equity culture, but the responsiveness of privatized PSEs to meeting consumer demand from the poorest members of society is met sooner.[24] Savings on PSE subsidies and capital investment expenditure have enabled some governments to allocate increased budget expenditure to social services in the fields of health and education.[25] A fairly important impact of privatizing through IPO is that it helps redistribute the concentration of wealth and increases the availability of commercial opportunities for the private sector generally.

33. Nongovernment organization (NGO) involvement in privatization issues has been largely associated with their demanding a more participatory approach to planning and implementing privatization. Among the various criticisms of the top-down approach to privatization have been insufficient attention to human development as well as social, gender, and environmental impacts. Regulatory frameworks are also seen as needing a better balance covering private and social interests. How NGOs should be involved in the planning and implementation of privatization follows no established pattern. Study observations suggest involvement in the design and implementation of social awareness campaigns, retraining, and compensation packages for displaced employees and communities is where NGO assistance can be most effective.

[23] Pay-as-you-earn pension schemes performed poorly up to the end of year 2000 in relation to stock markets. In some countries (e.g., Bolivia), pension reform has required a specific proportion of the proceeds from privatization to be used to support pension funds which undertake to reinvest in the stock market.

[24] Supply constraints evident for meeting electricity, water, gas, and telecommunications demand are commonly cited examples.

[25] The potential for reallocation can be large. Estimates for India, of diverting direct subsidies from PSEs to basic education, suggest the diversion would allow increased expenditure on education of about 500 percent.

D. Global Lessons

34. The following lessons are identified from the global experience according to four dimensions: politics, framework and institutions, economics and efficiency, and social welfare:

1. Politics

(i) In general, governments have privatized industries to achieve one or more objectives. These include (a) raising revenue for the government, (b) raising investment capital for the industry or company being privatized, (c) reducing the government's role in the economy, (d) promoting wider share ownership, (e) increasing efficiency, (f) introducing greater competition, and (g) exposing firms to market discipline.

(ii) In most countries, privatization has been a long-term process of policy changes and institution building. A few countries with market-conducive policies, strong administrative capacity, and strong private sectors have tried rapid privatization. Most countries in the former eastern bloc countries have also adopted a rapid approach to privatization.

(iii) Privatization has been hardest to achieve in low-income countries, where political commitment to privatization is weak and where the environment is not conducive to permitting market-oriented activities.

(iv) Foreign share ownership bringing new capital, management, and technology leads to a higher performance than does pure domestic ownership.

2. Framework and Institutions

(i) Six common techniques are used to privatize PSEs: (a) share issues, (b) trade sales, (c) asset sales, (d) management buy-outs, (e) public-private partnerships (PPPs), and (f) voucher privatization.

(ii) Common to the inferior results of rapid mass privatization approaches in the Russian Federation and Central and Eastern Europe is the lack of complementary institutions to ensure that the environment for conducting private transfers is competitive, regulated, and transparent. Notable failings include (a) no enforcement system for contracts, (b) no operative bankruptcy procedures, (c) inappropriate accounting systems, (d) no mechanisms by which credible information is given to new investors, and (e) poor governance practices in securities markets.

(iii) Risks and risk sharing between the public and private sectors are critical in PPP projects (e.g., BOT models). These projects are difficult to design so that the risks are shouldered without unduly disadvantaging either the public or investor interests. Projects require careful and rigorous formulation to ensure that an appropriate balance of private incentives with public interest is preserved.

(iv) Deregulation of the banking sector before (rather than after) privatization is found to work best. Restructuring an enterprise to create competition and ensure a clear separation of commercial and social functions is of prime importance prior to privatization.[26]

(v) Delaying the introduction of competition after privatization or rationing it by tightly limiting entry tends to lessen the benefits of privatization.

(vi) Regulation is critical where restructuring cannot ensure a fully competitive industry. There should be a clear division of responsibilities between central government and local authorities. At the same time, regulation should be designed with the flexibility to cope with *force majeure* circumstances operating against the spirit and objectives of regulation.[27]

(vii) Governments play a central role in shaping the legal, institutional, and regulatory framework by which good governance systems develop. If the framework conditions are not in order, the governance regime is unlikely to be either.

(viii) Privatization programs that aim to raise capital through the creation of cross-shareholdings with other PSEs diminish the longer-term benefits of privatization.

(ix) The interests of the public are best served by a regulator focused on ensuring that competition prevails.

(x) Transparency in the divestment process is critical for the economic and political success of privatization.

(xi) The absence of a stock market diminishes the potential effectiveness of privatization, but not so much that privatization is a nonviable policy option.

3. Economics and Efficiency

(i) Privatization works best when it is part of a larger program of reforms promoting markets and efficiency. Chiefly, these include reforms for removing subsidies and protection, and liberalizing trade, as well as stabilization programs that peg inflation and float the exchange rate.

(ii) Countries that have launched large privatization programs through the stock market have experienced rapid growth in their national stock market capitalization and trading volume. Those that have not, or have emphasized trade sales and vouchers over IPOs, appear to lag behind in market development.

[26] Where the separation does not occur prior to privatization, subsequent attempts to separate commercial and noncommercial activities have commonly led to conflict between the privatized enterprise and regulator.
[27] As might be brought about through change caused by unforeseen exchange rate movements or unreasonable requirements that might cause deterioration in the quality of services.

(iii) National benefits from privatization are derived in the form of lower consumer prices,[28] increased outputs, higher tax revenues, reduced fiscal deficits, and social benefits.

(iv) The impact of wholly privatized companies seeking to expand in countries freed from stringent regulatory requirements has been a positive factor in the global momentum toward privatization.

(v) Private ownership is associated with a higher level of enterprise performance, and the higher the private ownership stake the greater the performance improvement.

(vi) Majority ownership by outside investors tends to generate a greater level of enterprise performance than any form of insider control.

(vii) Enterprises controlled by nonemployee investors make bigger restructuring improvements than employee-owned enterprises.

(viii) Privatization with competition benefits consumers and the economy more than privatization with limited competition. Prices generally fall, at least in real terms.[29] Services improve and, in most cases, exceed the minimum quantity and quality standards set at the time of privatization. The range of products available to consumers (both industrial and retail) increases, and the economy benefits from better maintained infrastructure.

(ix) Privatization without competition and a weak regulatory environment reduces the effectiveness of privatization, and can result in a contraction of benefits to consumers and the economy.

(x) The banking sector in transition and developing economies is invariably crippled with nonperforming loans to insolvent PSEs. Experience reveals that one-off restructuring aimed at quickly dissolving outstanding debt is preferable to debt rescheduling, and to applying and adopting more commercial internal practices.

4. Social Welfare

(i) The fears of employees and dependent communities over the detrimental impact of privatization programs on their personal future have often been a major deterrent. In many transition economies, the social cost and disruption have been generally overlooked, and/or insufficiently addressed.

(ii) The most successful privatization programs take account of the historical, cultural, religious, and social framework of a country. Accompanying social programs are needed to offset the negative employment effects, and the loss of fringe benefits, pension rights, and displacement costs associated with relocation. Negative social impacts on the local community should also be addressed.

[28] However, where subsidies were common before privatization, higher prices have generally followed. For many enterprises, including telecommunications, textiles, agro-industries, tourist and hotel accommodation, chemical manufacture, and bus services, lower prices have generally followed.

[29] Where tariffs are subsidized, and/or the quality of the product or service is greatly improved, actual prices may increase.

(iii) Broad-based ownership helps overcome resistance to privatization. Broad information and communication campaigns on the objectives and benefits of privatization programs have also been effective for trade sales.

III. DEVELOPING MEMBER COUNTRY EXPERIENCE

35. In this section, ADB's involvement, the status before privatization, and perspectives of privatization in selected DMCs are presented. The section is based on ADB's loan support for privatization, analysis of a written survey in which 21 DMCs participated, and follow-up missions to 10 of the 21 DMCs. The 21 participating DMCs were Bangladesh; Bhutan; Cambodia; Fiji; Hong Kong, China; India; Kazakhstan; Korea; Lao PDR; Malaysia; Myanmar; Nepal; Pakistan; Philippines; Samoa; Singapore; Solomon Islands; Sri Lanka; Taipei,China; Thailand; and Tonga.

A. Asian Development Bank Involvement

36. ADB's operational support for privatization reflects the wide differences among DMCs in terms of their size, wealth, natural resources, stage of development, economic performance, and capacity to mobilize resources. Country programming missions, which are fielded annually, include intensive discussions with DMC governments to reaffirm the status, progress and thrust of each DMC's development plan, reassess resource constraints, review current and prospective economic conditions, and agree on a three-year rolling assistance program. Assistance for private sector development is an integral part of such program.

37. ADB's support for privatization began around 1984. It was tailored to meet the individual needs of DMCs appropriate to their stage of development and took into account strategic considerations reflecting the limited resources of ADB, and purposes considered most critical in promoting economic development. Between 1984 and the early 1990s, the development plans of DMCs showed an increased focus on industrial development through the private sector. ADB's loan and TA support was dominated by a sector focus toward increasing agriculture and agro-industry production; expanding energy, transport, and communication infrastructure; and enhancing the availability of credit for private sector development. In the process, the complexity and scope of project/program design increased with more attention given to improving operating entity performance and strengthening institutional capacity. Devolvement of public sector responsibilities to the private sector for various activities such as construction and maintenance of roads, provision of stevedoring services, and maintenance and servicing of power facilities became common in project design. Strengthening management autonomy in PSEs became also a common feature, as did attention to improving management information systems and commercial orientation of PSEs, including enhancing the financial viability of PSEs through price reform and the removal of subsidies. TA advisory studies for tariff adjustments were common.

38. The early directional role of ADB privatization assistance was evident in the form of TA advisory studies attached to loans to various DMCs such as Fiji, India, Lao PDR, Nepal, Pakistan, Philippines, Samoa, Sri Lanka, Thailand, and Tonga. These studies were mostly enterprise or sector specific, and helped increase awareness of the potential for privatization as well as the need for accompanying reforms in legislation, governance, financial regulation, and capital market development to enhance the effectiveness of privatization.

39. Under ADB's Medium-Term Strategic Framework 1992-1995 (para. 3), which continued to serve as an operational guide till 1999, privatization was identified as a desirable strategy for achieving economic growth objectives. There was a notable increase in loans and TAs supporting financial governance reforms, capital market development, power sector restructuring and PPPs. For new transition economies such as Kazakhstan, Kyrgyz Republic, and Uzbekistan that followed voucher privatization between 1989 and 1993, ADB's loan and TA

support has been largely directed at strengthening corporate and public governance. Under ADB's Long-Term Strategic Framework 2001-2015 (para. 3), ADB's involvement with the private sector is expected to increase substantially. The need to improve governance and the enabling environment for private sector operations and PPPs is recognized.

40. Table 3 shows the upward trend in ADB's support for privatization. In particular, the number of standalone advisory TAs with privatization aims has increased dramatically since 1985. Such TAs have typically included studies for (i) capital and stock market development; (ii) developing and strengthening the regulatory framework; (iii) reform of pension and provident funds; (iv) corporatization; (v) restructuring financial, monetary, and banking systems; (vi) strengthening corporate and public governance; and (vii) establishing privatization coordination units. There is still room for expanding the scope of ADB assistance, e.g., for public awareness campaigns to explain the scope and method of privatization, conditions, support structures, and social support programs necessary for success (paras. 58, 60, and 70).

Table 3: ADB's Increasing Support for Privatization

Year	Loans[a]		TAs	
	Number	% of the Total	Number	% of the Total
1985	4	8	1	3
1990	9	16	13	11
1995	12	17	22	14
2000	13	18	39	25

ADB = Asian Development Bank, TA = technical assistance.
[a] Including attached TAs.

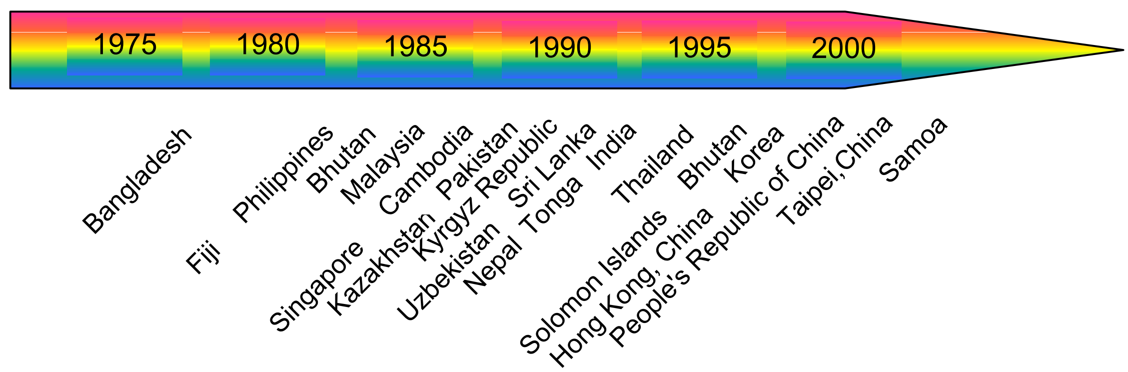
41. The public sector loans and advisory TAs discussed above have been complemented by ADB's direct assistance to the private sector in the form of loans without government guarantee and equity investments. As of the end of 2000, such assistance had reached about $2 billion, distributed among almost 150 projects and investment funds. Further details of ADB's involvement in privatization support are discussed in Appendix 5.

B. Progress and Rationale

42. Figure 2 shows the chronology of privatization in DMCs. For Bangladesh, experience with privatization began in the mid-1970s with the return of nationalized small businesses to their original owners and the sale of others. Privatization in DMCs increased substantially after the financial crisis of 1997, and several countries have made large divestments. Except for Malaysia and Singapore, political pressure resulting from the financial crisis is the main impetus to privatization. The most important reason for privatization is the expected improvement in the government's budgetary position. Increased efficiency is another important reason, followed by increased size and dynamism of the private sector (Figure 3). Reduction of corruption, access to foreign expertise and technical skills, and poverty reduction are generally viewed as minor justifications. Even so, the main rationale differs significantly among DMCs. Access to foreign

technology and capital is the prime motive of Sri Lanka.[30] In Singapore, willingness to privatize followed huge surpluses accumulated by the statutory boards under which PSEs were managed.[31] Significant divestments announced in Singapore's privatization program in 1985 have been achieved with a very strong emphasis on gradualism and partial privatization. Malaysia announced its privatization master plan in 1985 which, after further review, was approved for implementation in 1989. Actual implementation has been slow and also with a strong emphasis on gradualism and partial privatization. The approach of Malaysia differs from Singapore in that little attention has been paid to infusing competition before privatization.

Figure 2: Start of Privatization Activities in Selected Developing Member Countries



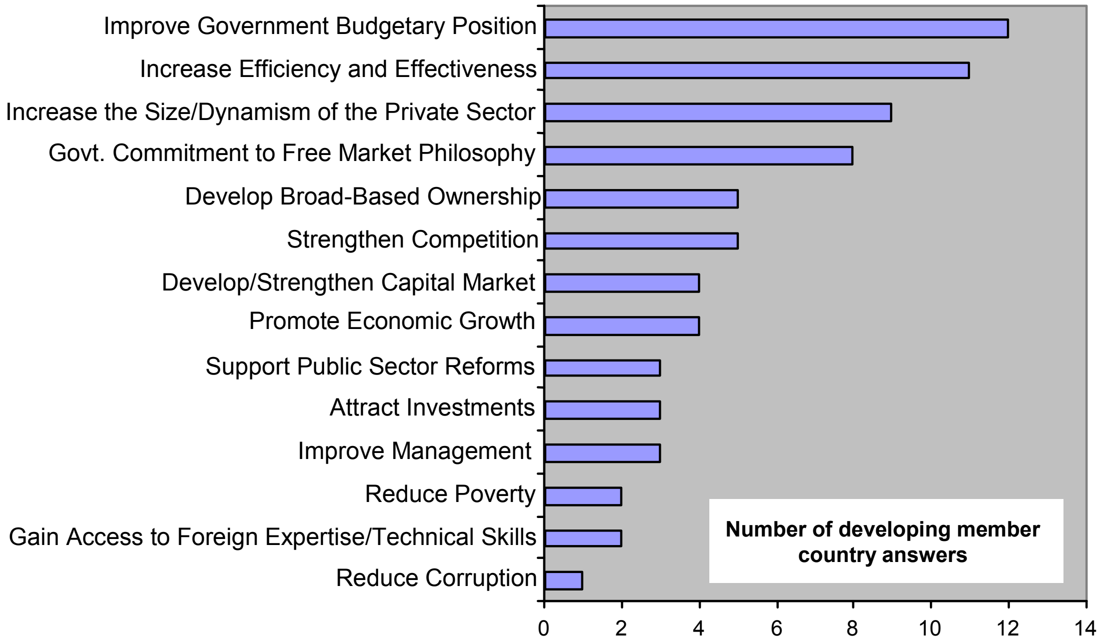
43. DMCs have different views of how privatization will help the economy. In Bangladesh, the monopoly enterprises experience significant operating losses and require substantial expansion and rehabilitation support. Respondents there expect privatization to provide budget relief. Those in Cambodia anticipate that state subsidies to PSEs will be reduced, and the proceeds invested in infrastructure development. Pakistan respondents expect that privatization will reduce the financial burden caused by persistent PSE losses, and this will enable the Government to invest more in social sectors. Those in Hong Kong, China expect that privatization will improve the international standing and stability of its stock exchange, and that the proceeds will ease the burden on budget revenues. In the Central Asian transition economy of Kazakhstan, respondents anticipate that privatization will provide increased job opportunities and stronger economic growth, while those in Korea expect that privatization will help restore foreign investor confidence, increase efficiency in management and the economy, and attract foreign technology. Nepal respondents expect that privatization will benefit the economy by increasing productivity, mitigating the financial and administrative burden on the Government, encouraging private sector participation in economic development, and removing loss-incurring PSEs. The current Philippine privatization program is expected to achieve higher levels of efficiency and resource use, help develop the domestic capital market, and broaden the ownership base of public assets.[32]

[30] As, for example, in the privatization of Sri Lanka Telecom. By 1996, the waiting list for telephones was larger than the number of lines in existence. It was estimated that to achieve a reasonable penetration rate of five telephones per 100 people, the Government would have to invest more than $500 million. In addition, qualitative indicators showed that Sri Lanka Telecom urgently needed to upgrade its facilities and apply new technology.

[31] These accumulations were causing an undue drain on domestic liquidity while the high taxes and statutory charges needed to support growth were undermining Singapore's competitiveness.

[32] The initial (1986) Philippine privatization program was intended to reduce the budgetary drain of the PSEs and generate revenues for the Government.

Figure 3: Governments' Understanding of the Rationale/Justification for Privatization in Selected Developing Member Countries



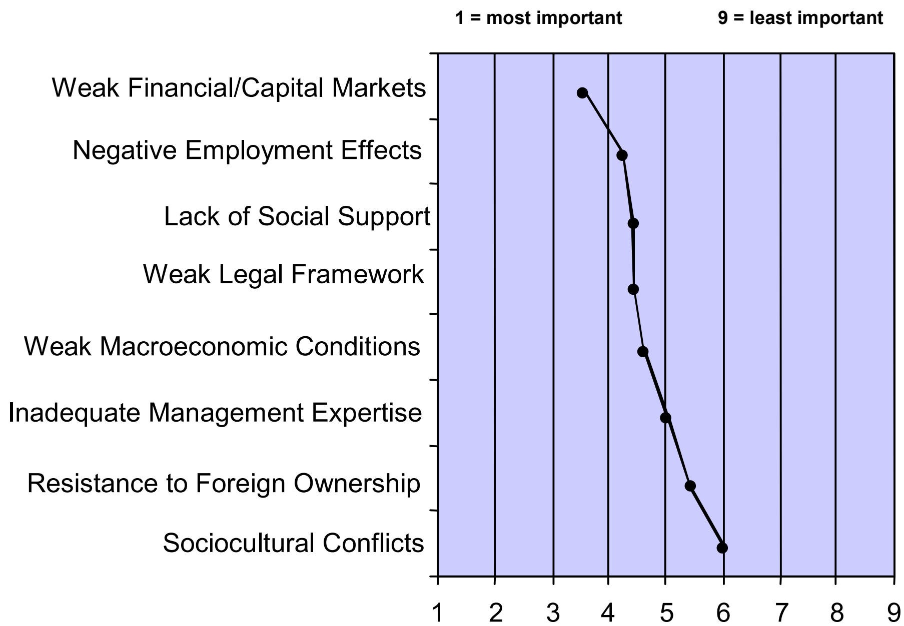
44. The Lao PDR, like a number of DMCs, has no stock exchange. To date, privatization efforts have been largely directed at restructuring and commercializing the operations of the Government through contracting out services to the private sector. Currently, the Government is focusing on a transfer of the management function to the private sector in preference to privatization. A study of the feasibility for a stock exchange in Vientiane has been completed.

C. Perceived Impediments

45. The respondents regard weak capital markets as the biggest overall impediment to privatization, and sociocultural conflicts the least important (Figure 4). However, among specific DMCs, the situation varies. In Korea, Pakistan, Sri Lanka, and Thailand, social resistance to privatization dominates,[33] while in the Philippines, privatization is widely favored. Lack of political commitment and a weak investment climate are also major impediments in Pakistan and a few other DMCs, including India (but there the political consensus of the major parties in 1999 supported privatization and sped up the process). In Singapore, none of the suggested impediments was considered to apply. The biggest problem in Singapore is finding strategic partners with sufficient financial resources to buy out the PSEs and add value to the enterprises.

[33] Research surveys released by the Office of State Enterprises in Thailand in 2001 suggest that public opinion is shifting toward supporting privatization.

Figure 4: Perceived Impediments Constraining Privatization



D. Approaches and Methods Applied

46. Most DMCs follow a straightforward approach with a common understanding that sector reforms should precede privatization. One common approach to privatization is privatization by attrition, whereby new development is open to tender from private investors.[34] Only a few countries consider that rehabilitation is necessary prior to privatization: the Philippines implements predivestment restructuring only for "big-ticket" enterprises. In Samoa, decisions on restructuring are made on a case-by-case basis. In India, it is current policy in the public sector to restructure and revive potentially viable PSEs.

47. Sales through IPO and listing of shares, open tender, private placement, and auction are the most frequent privatization methods. Privatization of small companies is generally made through trade sales or public tender, while large PSEs are privatized through the capital market.[35] The Philippines and Taipei,China have experience in all frequently used methods. In Korea, privatization has been mainly through the capital market, with shares of large PSEs sold to overseas financial markets through American Depositary Receipts.[36] Domestic IPOs have been used to sell shares in tobacco and gas companies. In Malaysia, four main modes of implementing privatization have been applied, namely, sale of assets or equity; lease of assets; management contracts; and BOT for new infrastructure. In Thailand, most privatization has

[34] As is common to meet new expansion requirements in electricity generation, gas production, and water supply.
[35] Where local markets are weak or small, IPOs are tailored accordingly. Records show that the initial offer can be less than 5 percent of the total enterprise equity.
[36] The Ministry of Commerce, Industry, and Energy raised $753.6 million from the sale of 62.8 million American Depositary Receipts. The Government raised nearly $2.5 billion from the sale of a 12 percent stake in Korea Telecom. Another substantial privatization effort was the sale of American Depositary Receipts in Pohang Iron and Steel Company (Posco), resulting in proceeds of $1 billion. Korea Gas Corporation raised $845 million from its domestic share offering, having abandoned discussions to sell a strategic stake to a foreign investor.

been through concessions, e.g., water utilities and ports, but equity offerings are expected in the future to predominate. Leasing is the leading method in Bhutan.

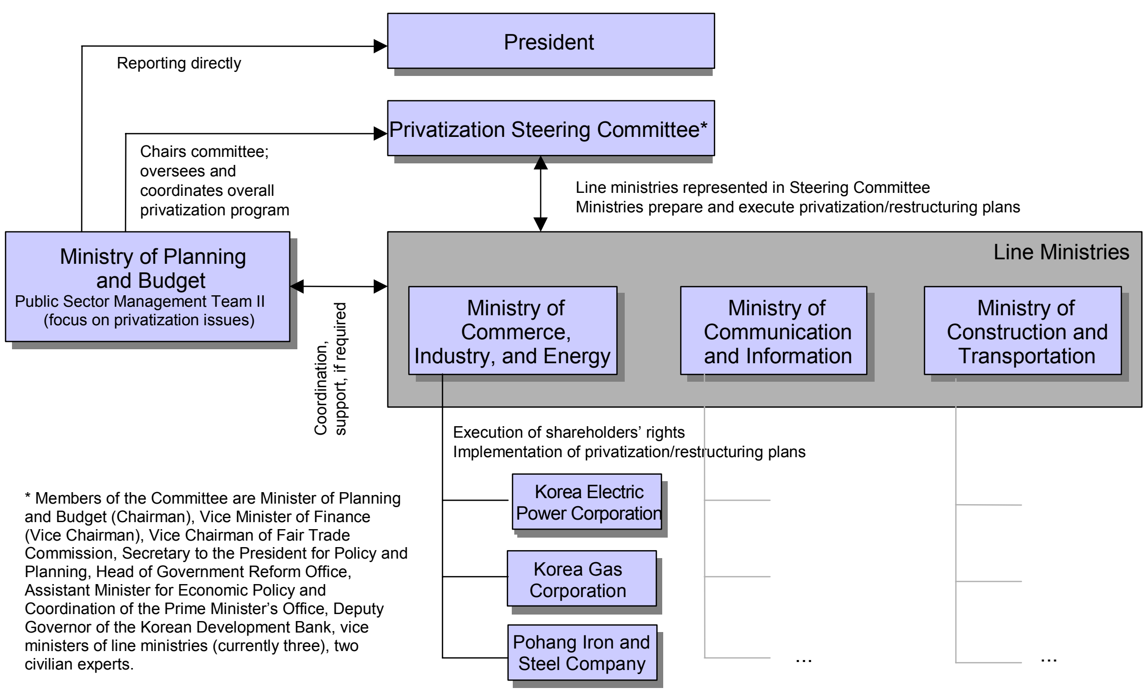
48. Most DMCs open their privatizations to foreign participation (e.g., Bangladesh, Singapore), but most restrict the proportion of ownership allowed (e.g., Korea, Philippines, Sri Lanka, Thailand). Cambodia is the only country in the study survey not open to foreign participation. "Golden share" arrangements, which allow the government, in the event of a conflict with public interest, to assume control where the government's shareholding is less than 50 percent, apply in Malaysia and Sri Lanka. Where privatization has been pursued through the stock market, most DMCs have devised special programs and incentives to support small investors.

49. Where social and labor considerations are a constraint on privatization, DMCs address these issues with a variety of measures, including public information programs, participatory involvement of employees, financial compensation for displaced employees, and retraining for others. Retained employees are often offered a significant wage increase. Even so, the study found clear examples where compensation packages regarded as generous by respondents, did not sufficiently meet the welfare concerns of PSE staff.

E. Institutional Framework

50. Two predominant models among the DMCs can be recognized (para. 19). Figure 5 shows the centralized organizational structure for privatization in Korea. The Privatization Steering Committee oversees the overall privatization program. The line ministries are in charge of developing and implementing privatization plans for their PSEs.

Figure 5: Organizational Structure for Privatization in Korea



* Members of the Committee are Minister of Planning and Budget (Chairman), Vice Minister of Finance (Vice Chairman), Vice Chairman of Fair Trade Commission, Secretary to the President for Policy and Planning, Head of Government Reform Office, Assistant Minister for Economic Policy and Coordination of the Prime Minister's Office, Deputy Governor of the Korean Development Bank, vice ministers of line ministries (currently three), two civilian experts.

51. In Thailand, a decentralized model is applied. Each privatization transaction is facilitated on a case-by-case basis and managed by a separate committee chaired by the line ministry

with representation from the enterprise, the Ministry of Finance, and other agencies. For the larger privatizations (e.g., Petroleum Authority of Thailand), financial advisors assist in the preparation of the privatization plan to be submitted to the Cabinet for approval. The Office of State Enterprises within the Ministry of Finance has a coordinating function.

52. Privatization commissions in Bangladesh, Myanmar, and Pakistan are vested with overall responsibility to implement the privatization of PSEs referred by the government. Processing generally requires evaluations and recommendations back to the government for approval before divestment.[37] The Committee on Privatization in the Philippines fulfills a similar function but, in addition, has a mandate to approve the sale and divestment of assets.

F. Results and Impacts

53. Respondents from most DMCs judge the overall impact of privatization as positive. A few state that it is too early to evaluate the impact. Seventy percent of the DMCs declared that availability and quality of output and services improved after privatization, and the other DMCs that it remained the same. In isolated cases, the quality and range of output and services fell, reflecting deficiencies in competition structure and regulatory supervision. A few DMCs considered that privatization increased capital investment, technology development, and job creation.

54. Forty percent of the DMCs in the survey declared that prices increased after privatization. Twenty-five percent reported that prices remained the same, and another 25 percent were unsure. The remaining 10 percent said that prices fell due to competition. Two main reasons were given for the price increases: the first was that most of the goods and services produced and sold by the PSEs were subsidized, and with privatization, these subsidies were removed; the second was the associated increase in costs for improvements in the quality and range of goods and services.

55. Two common conclusions in the survey were that privatization was often linked to powerful political and business interests, and that transparency and competitive bidding were key elements of privatization but were not easily secured.

56. Some countries have carried out evaluation studies on the impact of privatization. In Malaysia, achievements are (i) efficiency gains;[38] (ii) enhanced economic growth;[39] (iii) reduction in the Government's financial burden;[40] and (iv) wealth redistribution.[41] The benefits are less significant for private-public infrastructure projects involving highways, mass transit systems, and sewage systems where generated revenues have been lower than projected. In Taipei,China, a postprivatization study of seven PSEs showed that all surveyed companies diversified and downsized after privatization. Annual sales were subject to business cycles but labor productivity significantly improved. Postevaluation in Sri Lanka showed that private management of government-owned coconut, rubber, and tea estates significantly improved

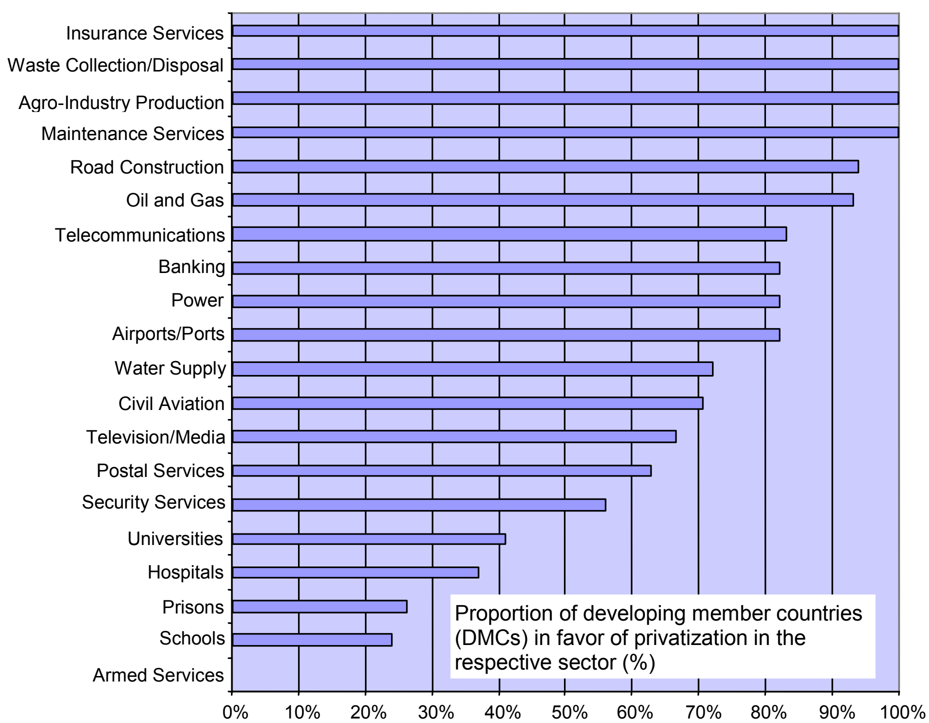
[37] At present, no specific sectors or enterprises are targeted for privatization in Myanmar.
[38] As seen, for example, in a 24 percent reduction in average vessel turnaround time at a container port within two years of privatization; improved telecommunications services after corporatization of the national telecommunications company; and completion of a large water supply project significantly ahead of schedule.
[39] Identified with providing greater opportunities to the private sector.
[40] The deficit in the public sector account was reduced from 3.4 percent to 0.7 percent of GDP during 1983-1999.
[41] Evidenced by the argument that as most privatizations involved at least 30 percent Bumiputra participation, privatization furthered interethnic wealth redistribution objectives.

productivity. With privatization, lease management, and listing on the Colombo Stock Exchange, tea productivity increased over four or five years by around 38 percent (Appendix 6).

G. Future Plans

57. The perception of most DMCs is that most public sector activities can be privatized (Figure 6). Most have divestment programs, with companies earmarked for privatization at targeted disposal dates. Cambodia does not have a specific divestment plan; nor does Hong Kong, China, but privatization of the Mass Transit Rail Corporation is proposed. Singapore plans privatizations in power, media, and ports operations when market conditions strengthen. The Government of Malaysia wants to privatize only its loss-incurring PSEs, and wants the profit-making, income-generating companies to stay in government hands. Pakistan's privatization program is part of the Government's two-year economic plan 2000-2001 and includes 53 PSEs in the power and energy sectors. Taipei,China is planning to privatize its transport and utilities sectors. Sri Lanka is focusing on public utilities, and further divestments in plantations and manufacturing enterprises. Tonga has assessed its government investment portfolio and will make recommendations for privatization.

Figure 6: Perception in DMCs of What Should be Privatized



H. Developing Member Country Need for Support

58. DMC experience with privatization parallels the wider global evidence and lessons, though lagged in time and scale. Background, methods, and approaches are similar to Europe and Latin America. Political commitment, proper preparation and planning, transparency, and clear decision lines, as well as an empowered privatization unit within an enabling environment, are critical factors. Weak domestic capital markets and financial sectors are a predominant

feature of DMCs. The institutional and regulatory framework for privatizing PSEs is also weak. DMCs expressed the view that ADB should address the following needs:[42] (i) policy and legal framework; (ii) regulatory framework(s); (iii) capabilities of the privatization unit; (iv) privatization awareness programs; (v) training for officers involved in privatization; (vi) study tours for labor and political leaders as well as concerned agencies; (vii) lessons of global experience; (viii) regional workshops on privatization; (ix) funding for upfront costs of restructuring (e.g., advisory services); (x) funding for the financial restructuring of PSEs; (xi) funding for (re-)training schemes for affected employees; (xii) funding for voluntary retirement/separation schemes; and (xiii) postprivatization monitoring capability.

[42] The Ministry of Finance of Thailand advised that TA provided directly to PSEs for the purposes of restructuring and reform is of less value in terms of outcomes than assistance provided to coordinating agencies.

IV. INSIGHTS FROM STUDY

A. Strategy for Development

59. The growing political commitment among DMCs to privatize provides scope for further positioning of ADB's strategic objectives and assistance. Different DMCs require different approaches relating to (i) their stage of development and strength of legal and financial institutions; (ii) the capacity of domestic investors, stock market, and institutions to support PSE divestment; and (iii) the size and organizational structure of PSEs being considered for divestment. Strategies should reflect the different privatization stages and need for support.

60. Three stages of privatization merit support, namely early, intermediate, and advanced reform. Figure 7 summarizes the three stages and support needed. Most needed is assistance for (i) developing the policy, legal, and regulatory framework; (ii) establishing the privatization unit and starting its operations; (iii) organizing workshops and advisory sessions; and (iv) funding restructuring and advisory costs. These can be essentially met by ADB, OECD, the World Bank, and others—but only a few governments are aware of the support available—and most are unaware of the importance of sequencing (para. 64).

61. DMC experience suggests that aid agencies should emphasize and support policy reforms, competition, and the regulatory environment, in preference to providing equity or loan assistance to wholly or partly divested enterprises.[43] TA might typically help in restructuring enterprises, establishing an institutional and regulatory framework, and meet social welfare needs. Loan assistance might be provided for mitigating social costs, and programs for dealing with displaced workers. Program loans before divestment might facilitate enabling reforms, establish regulatory authorities, set up consumer protection and investment trusts, and meet interim and residual costs of separate noncore activities including hospitals, housing, and community facilities that require liquidation and/or temporary continuation.

[43] Advisory assistance from investment banks, while expensive, is generally favored for the divestment of large infrastructure and commercial banking enterprises.

Figure 7: Privatization Stages and Need for Support

Early Reform Stage:
- Legal and institutional framework lacking
- No consensus over privatization strategy
- Little privatization experience
- Enterprises to be privatized are mainly small enterprises in the processing and services sector
- Sale mainly to nationals or return to previous owners
- Wait-and-see attitude of potential investors
- Relatively wide support among the public

Intermediate Reform Stage:
- Legal/economic framework inconsistent
- Privatization strategy realized
- Privatization experience available
- Medium and large enterprises to be privatized
- Foreign investors admitted, but only those familiar with the country
- Public support decreases with negative consequences of privatization (unemployment and decrease in production)

Advanced Reform Stage:
- Institutional framework is consistent
- The private sector dominates
- Enterprises to be privatized include monopolistic and strategic enterprises (defense industry, transport, telecommunications, power)

Need for Support:
- Privatization strategy, legal, and institutional framework
- Privatization agency and operations
- Accompanying macroeconomic measures
- Transparency of educational campaigns
- Initial formulation for public awareness

Need for Support:
- Strengthening legal and institutional framework
- Privatization studies
- Promotion of investment
- Creation of capital market institutions (e.g., investment and unit trust funds)
- Accompanying macroeconomic policies
- Cushioning of negative privatization effects
- Separation of noncommercial and social welfare activities

Need for Support:
- Implementation of privatization studies, continued introduction of rehabilitation and privatization expertise
- Strengthening of capital market institutions
- Supervision and regulation
- Funding for separated noncommercial activities

B. Principles for Effective Privatization

62. Based on the global lessons (section II) and the survey results of DMC experience (section III), the following principles for privatization and strategy development emerge (see Box). The principles are considered an essential checklist for evaluating the comprehensiveness of privatization program/project designs, and ensuring the effectiveness of privatization.

C. Critical Issues

1. Enabling Environment

63. There is a tendency to support privatization with a selective and isolated approach, and to ignore the need to introduce privatization as an integral part of economic reforms and strategy for implementation. Related to the need for policy reforms is the finding that reforms pertaining to public and corporate governance, commercial redress, and credit recovery are, in practice, difficult to implement and enforce. These findings point to the need for programs that

give more emphasis to the macroeconomic framework and to strengthening institutional enforcement capacity.

Privatization Principles

- Privatization should be viewed as a good governance reform.
- There must be commitment by government politically and within line ministries.
- Privatization programs must be an integral part of a country's economic policy.
- Privatization programs must include a strong institutional and regulatory framework.
- The environment must be competitive, regulated, and transparent.
- Deregulation of the financial sector should precede privatization.
- Restructuring to create competition and ensure a separation of commercial and social functions should precede divestment.
- Regulation is required only where restructuring is unable to ensure a fully competitive industry.
- Rehabilitation prior to privatization should be avoided.
- Privatization programs should be accompanied by extensive public awareness campaigns.
- Privatization programs should be complemented by comprehensive social welfare programs.

2. Sequencing

64. ADB's loan and TA programs need to keep in mind sequencing of implementation in the design of privatization programs/projects. The need for political commitment and the right institutional framework is of paramount importance to avoid delays and implementation constraints. Economic stabilization and trade liberalization programs are essential for success. Deregulation of the banking sector; legal, judicial, and enforcement reform; public governance reforms; capital market development; restructuring to induce competition; and regulation should precede the divestment process, in this order, for best privatization results. Significant too is the need to carry out public governance reforms before corporate governance reforms.

3. Regulation

65. DMC experience reflects a preoccupation with regulation without first considering the scope for competition and how to increase it to minimize regulation.[44] In the process, subsequent actions by the regulator may create major conflict, which detracts from the effectiveness of privatization.[45] The larger regulatory authorities are typically structured with a mandate to approve prices, operating expenditure, accounts, quality of output and investments, and to monitor compliance with concessionaire agreements. Where competition has been established, small regulatory authorities consisting of no more than an appointed commissioner and secretarial staff (often covering several sectors) seem to work best. Some merit is seen in transferring the responsibility of regulators for consumer interests to a separate anticompetition trust authority. This limits the role of the regulator to monitoring and ensuring compliance with agreed operational and investment contracts.

66. Overregulation reduces profit and the incentive to invest, a situation that has occurred both globally and in some DMCs. Restructuring to infuse competition helps avoid regulation and offsets political strategies aimed at maintaining government control. With regulation, maintaining pricing reflective of least-cost development and normal profits is of paramount importance in the success of privatization.

4. Rapid Privatization

67. For most DMCs, the idea of rapid privatization runs counter to the caution of political leaders and government administrators. While there still remains the need for comprehensive preparation, not readily appreciated is the windfall capital that is raised and available for alternative investment.[46] Enterprise and national efficiency, as well as economic growth, are enhanced on a major scale. Output is expanded, range and quality improved, and prices generally reduced. Industry capacity to export and compete with imports is also found to expand faster following rapid privatization.

5. Public-Private Partnerships and Welfare Transfer

68. Some types of PPPs have proven difficult. They are typically structured so that the government retains ownership of the land and fixed assets. Problems that arise relate largely to overregulation and an emphasis on maintaining tariff levels without timely adjustment for variations in factor prices, *force majeure* circumstances, physical contingencies, and restructuring to create competition. Sometimes, PPPs are unnecessary, and a reflection of opposition to privatization. The example of privatizing, as a lease operation, the plantation estates in Sri Lanka demonstrates the lesser effectiveness of PPPs (Appendix 6). Total

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[44] Regulatory authorities often become a de facto government department and can seriously undermine the autonomy of management (which privatization was intended to safeguard), thereby removing the benefits of privatization and competition.

[45] In the power sector for example, separating through corporatization, or other means, the operations of generation, transmission, and distribution is not enough and much more can be done to ensure that the deintegrated components also operate within a competitive regime.

[46] Capital is raised from net privatization proceeds, ongoing capital development expenditure is avoided, and loan servicing and subsidy support are reduced.

privatization—as is generally the case—would have been more effective. PPPs are particularly appropriate where the capital costs of new projects are high relative to operating returns.

69. The tendency of governments to foist, with the sale of PSEs, welfare activities that are not core to PSE operations also enters the politics of privatization. Typical welfare attachments include hospitals, theaters, sports facilities, sponsorship programs, community residences, and schooling. If welfare services are to be provided, then the additional operation and maintenance costs should be factored in as a subsidy. The practice of privatizing without appropriate pricing, adjustment, or subsidy is unrealistic, and the prime cause of public-private conflict.

6. Social Barriers/Incentives

70. Social obstacles to privatization vary between countries, reflecting differences in historical background, culture, religion, and social framework. Across DMCs, there are marked differences over which government assets and services should be retained. Singapore supports the interplay of competitive market forces. In countries like Bhutan, government enterprises function in an environment where the incomes of beneficiaries are so low that the supply of services can be provided only with a subsidy.[47] In many DMCs, resistance to privatizing represents an aversion to transferring assets and services to society members who would be enriched by the transfer. These differences emphasize the need for extensive public awareness programs in DMCs for leaders, constituents, government agencies, and PSE staff on the benefits of privatization.

71. Tacit agreement for privatization often goes with a lack of commitment within government. This situation arises from misconceptions of the consequences of selling too cheaply, without adequate rehabilitation, without retaining a vested interest, without regulatory controls, and without appropriate due diligence. Prominent staff often defend the capacity of management to operate PSEs efficiently and are not interested in the wider benefits of privatization. These factors point to the need for vesting decision-making powers in an autonomous institution (para. 19), and ensuring that privatization programs are packaged with appropriate community/staff support and widely promoted.

D. Recommendations

72. In meeting its objective of providing guidance on how privatization should be managed, the study has identified the importance of sequencing and the need for a more integrated approach to implementing privatization. Some respondents had difficulties in (i) accepting that DMC experience parallels the wider global evidence and lessons, though lagged in time and scale; (ii) accepting that privatization leads to improved enterprise efficiency; (iii) understanding advantages of rapid privatization; (iv) seeing the appropriateness of deregulating the banking sector before privatizing PSEs; (v) seeing the benefits of privatization for capital market development; (vi) accepting notions concerning PPPs, regulation, and foreign investment; and (vii) believing that with privatization, social requirements can be fully met. In this regard, the need to enhance understanding of the privatization process in the DMCs is a major finding of this study and an important task for ADB to pursue.

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[47] These tend to be basic services covering national highway maintenance, airline services, electricity supply, water supply, telecommunications, health, and schooling where the population base is small, there is little or no industrial development, subsistence production is predominant, and the money system is not fully developed.

73. ADB, through its operations departments, is encouraged to review its strategy for assisting DMCs with privatization, taking into account the need for a more integrated approach to reforms to promote economic growth and private sector development, the importance of sequencing, and the need for more comprehensive social welfare assistance.

74. DMCs are encouraged to adopt policy reforms that take into account (i) the global lessons for prioritizing the legal framework and institutional requirements, (ii) the need to restructure to infuse competition, (iii) the need to regulate only where competition is limited, and (iv) the need to ensure that accompanying social programs are comprehensive and fully supported by the community and persons affected.

APPENDIXES

OTHER INTERNATIONAL AID AGENCY EFFORTS

1. In conjunction with macroeconomic liberalization and stabilization programs, international aid agencies have promoted privatization as an extension of structural reforms.

2. The World Bank Group's work on privatization has been to help governments meet the challenges of privatization and increase the quality and number of bidders. The International Finance Corporation focuses on the latter, while the World Bank tries to create a climate conducive to the completion and success of these transactions. Client countries are assisted with privatization programs in four ways: (i) advice on policy; (ii) technical assistance loans to help develop the policy, institutional, and legal framework; (iii) adjustment loans to help governments offset the one-time costs associated with privatization, e.g., separation payments; and (iv) investment loans, usually providing capital to the banking system to help privatized companies restructure. In the postprivatization environment, the services are offered to (i) help enterprises adjust to new situations; (ii) find ways to develop equity and debt financing and other capital market mechanisms for private and newly privatized enterprises; and (iii) assist in the areas of enterprise governance, labor retrenchment, and the improvement of property ownership rights. In a second area of involvement, the World Bank provides support for private sector participation in infrastructure, reflecting the fact that globally, governments are increasingly transforming their roles from suppliers of infrastructure services to facilitators and regulators of services provided by private firms. Areas of assistance include advice, finance, risk mitigation, knowledge and information, and dispute settlement. In addition, the Public-Private Infrastructure Advisory Facility (PPIAF) has been set up to assist client governments improve the quality of their infrastructure through private sector involvement. The PPIAF is a multifunding agency facility, which provides technical assistance to governments and identifies and disseminates emerging notions of best practice in a rapidly evolving area. A second support organization, the International Forum for Utility Regulation, is improving utility regulation in member countries through training and knowledge sharing.

3. Since 1986, the Organisation for Economic Co-operation and Development (OECD) has monitored developments in corporate affairs covering regulation, competition, and privatization. Under the Center for Cooperation for Nonmembers, OECD has annually brought together administrators and privatization experts from OECD member countries, nonmember countries, international organizations, and research institutes, to discuss privatization experiences and problems faced. These have proved useful for understanding best practices associated with implementing privatization.

4. The United Nations Development Programme has, since 1997, helped countries in Central and Eastern Europe focus on six areas: (i) democratic governance and public sector reform aimed at creating enabling legislation; (ii) decentralization and strengthening the capacity of local government; (iii) support for parliaments through enhancing the capacity, effectiveness, and efficiency of parliamentary structures; (iv) ombudsman-type institutions concerned with basic human rights issues; (v) participation and strengthening civil society through promoting grassroots participation, including that of nongovernment organizations, in governance; and (vi) strengthening audit and evaluation capacity through promoting transparency, accountability, and effective management.

5. Other monitoring and information dissemination is organized through the Asian Development Bank Institute,[1] the European Investment Bank's Evaluation Cooperation Group, and individual government ministries. These groups supplement university research studies, which assess the best privatization-related approaches, levels of effectiveness, impediments, and solutions to problems.

[1] The Asian Development Bank Institute was established in Tokyo in December 1997, and is jointly sponsored by the Asian Development Bank and Government of Japan for the purpose of disseminating appropriate development paradigms.

GLOBAL EXPERIENCE

1. **Chile and New Zealand.** In Chile and New Zealand, progress with privatization was achieved against a background of extreme macroeconomic imbalance and the need for stabilization. Both economies were governed with extensive interventions across market sectors, and experienced high inflation and balance-of-trade deficits.[1] The common approach was to reduce government interventions in fiscal management of the economy, and increase the role of markets and private firms. The goods market was first liberalized to eliminate tariffs, price controls, and subsidies. Devaluation was used to stem import expenditure and stimulate resource transfers to the export sector, and major tax reforms were also put in place.[2] Next, finance markets, foreign exchange controls, and labor markets were deregulated, and lastly a program for divesting and reducing government ownership in public sector enterprises (PSEs) was followed.

2. The extent and speed of policy reforms stand out. The actual divestment program was faster for New Zealand and substantially complete in four years. In Chile, early privatization involved the sale of small stakes in banking and industrial groups. More complete privatization began in 1984 with mining, forestry, electricity, and telephone companies. In both countries, privatization used auctioning to a strategic shareholder. In New Zealand, where PSEs could operate in competition, the approach was to divest up to 50 percent to the public through the stock market, prior to divesting the balance to a strategic operator by way of closed tender. In the case of New Zealand Telecom, the Government retained a “golden share” to ensure that agreed policies for residential telephone services continued to be observed.[3] In order to demonopolize the Electric Corporation of New Zealand (ECNZ), generation, transmission, and distribution were separated; and monopoly in local distribution was eliminated. To create a competitive power generation sector, ECNZ was initially divided into two companies, in 1998 into four companies, followed by strategic investor sales in each to three foreign utilities. Sales of the New Zealand Government’s strategic holdings in PSEs went largely to foreign investors.

3. For Chile, the proceeds from divestment were used primarily to support the domestic budget; while in New Zealand, the proceeds were used almost exclusively to reduce the Government’s international debt.

4. **United Kingdom.** The United Kingdom (UK) privatization program was introduced with already developed stock exchanges and effective banking law enforcement. Like Chile and New Zealand, privatization was introduced at a crisis time of high inflation, high taxation, and persistent internal and external balance-of-payments disequilibria.[4] Although privatization

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[1] By late 1973, inflation in Chile was more than 300 percent per year, the money supply (M2) was increasing at a similar rate, the fiscal deficit was 22 percent of gross domestic product (GDP), unemployment stood at 5 percent, the current account deficit represented 7 percent of GDP, and international reserves had fallen to 1.2 months of imports. In 1985, inflation in New Zealand was 15.4 percent per year, M2 was increasing at an annual rate of 32 percent, the internal budget deficit was 8 percent of GDP, unemployment was at 9 percent, the current account deficit stood at 15 percent, and international reserves had fallen to less than two months of imports.

[2] The exchange rates of Chile and New Zealand were handled differently. In Chile, devaluation until 1978 was linked to movements in the current account and the difference between domestic and foreign inflation. After 1978, a monthly crawling peg system was introduced; and in 1979, the peso was pegged to the US dollar. New Zealand devalued by 25 percent against the US dollar before floating the exchange rate, and shortly thereafter experienced a de facto devaluation of another 25 percent.

[3] Golden shares known as “kiwi shares” were also issued for Air New Zealand and Radio New Zealand. Investor undertakings are enforceable by the Government through court injunction proceedings.

[4] Disconcerting economic performance indicators were inflation running at 16 percent, interest lending rates at around 15 percent, productivity growth of around 0.5 percent per annum, and a growing uncompetitiveness of industries compared with European and Japanese counterparts.

coincided with a serious macroeconomic imbalance, the motivation to privatize was largely ideologically inspired and based on the need for a more equitable capital sharing of assets. The initial emphasis was on the sale of government-subsidized low-cost housing.

5. More than 1 million homes were sold during 1979-1981, and only the Government's interests in British Petroleum (44 percent) and Cable and Wireless (94 percent) were divested. In subsequent terms of office, the Government emphasized privatizing PSEs.[5] Early experience pointed to the need for deregulating the UK's banking and financial sector to open trading to a wider range of financial institutions, including foreign banks.

6. The general order of privatization was housing, industrial firms, infrastructure, and utilities—the latter being privatized as complete monopolies or with limited competition. The general approach was to float these enterprises on the stock exchange before selling the controlling shareholding of the Government to a strategic investor. For monopolies with limited competition, regulation was introduced to protect the public interest and ensure that surrogate elements of competition prevailed. Share prices to the public were generally cheap, and provided windfall gains to these investors. Management buy-outs were the next most common method of privatization with, for example, the National Freight Corporation, British Shipbuilders, and the National Bus Company. Significant in the UK case is the time (more than two decades) that the privatization program has taken. It is continuing for the management of immigration controls, prison services, police and inland revenue records, pension funds, health insurance, and local government.

7. To date, total proceeds from privatization exceed $120 billion. The earliest privatization proceeds were used to finance the exchequer's budget deficit attributable to rising unemployment.[6] Thereafter, receipts have been part of consolidated revenue.

8. **Latin America.** Apart from Chile, other Latin American countries, including Argentina and Uruguay, were also preoccupied in the 1970s with reducing inflation, improving resource allocation, and economic recovery. Adjustment programs included announcements to divest nationalized industries.[7] However, unlike Chile, other countries did not consistently follow through the macroeconomic reforms planned. Some reforms, including removal of protection and plans for privatization, were stalled or reversed for lack of political confidence. The hesitant approach to privatizing arose from the fear of unemployment and social unrest. But by the end of the 1980s, privatization was widely accepted.[8] Brazil, in 1990, created a National Privatization Program as an integral part of its economic reforms. In the first five years, the Government stressed privatizing companies in production including the steel, fertilizer, and petrochemical sectors. Some 83 companies were privatized with total proceeds amounting to $8.5 billion.[9] Significant in this approach was the end to discrimination against foreign investment and the use of public sector debt securities to meet initial loan financing requirements of privatized enterprises. From 1995, emphasis was placed on privatizing the power, transport,

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[5] Beginning with the selling of British Airways, British Gas, British Shipbuilders, British Leyland, Rolls Royce, and Amersham International (medical services); then coal mines, steelworks, water and power industries, nuclear power generation, hospitals, printing, ports, railways, and telecommunications.

[6] Unemployment increased from 1.2 million to 3.0 million from 1979 to 1982.

[7] The adjustment programs also included reducing protection, depreciating the exchange rate, lowering export tax, removing regulatory restrictions on the operations of firms, opening access to international capital flows, and freeing price controls on labor and key commodities. PSEs were also to be privatized.

[8] In June 1993, after a series of privatizations begun in 1985, Argentina's divestment program for the petroleum industry was completed with the sale of its shareholding in oil and gas giant Yacimientos Petroliferos Fiscales for $3.0 billion.

[9] During the 1980s, the Government reprivatized small companies with proceeds amounting to $780 million.

telecommunications, and financial sectors. Since 1990, privatization proceeds (including those in Chile) have raised more than $67 billion, budget deficits have been contained, and proceeds used to raise government expenditure as a proportion of gross domestic product.

9. **Continental Europe.** Privatization in Western Europe other than the UK began seriously in 1986.[10] Industry privatization was the principal form, though some governments also looked to the sale of government housing. The institutional framework, methods, and approach to privatizing were similar to those of the UK. The French program from 1986 to 1988 provided for the privatization of 66 PSEs: 42 in banking, 13 in insurance, 9 in the industry sector, and 2 in telecommunications. About one third of the program was completed before the October 1987 stock market crash and a new President brought a halt to the program in 1993. Most other Western European governments faced political controversy, and privatization of industry was slow until 1989 when technical advances in telecommunications forced the issue. Privatization, covering all economic sectors, proceeded throughout the 1990s and included large utility monopolies. In Germany, Chancellor Kohl's Government disposed of the central stakes in VEBA (energy), Volkswagen, VIAG (metals and chemicals), and Salzgitter (steel and engineering)—raising DM10billion—and reduced its holding in Lufthansa to 50 percent. Governments in Belgium and the Netherlands, Norway, and Sweden followed with privatizations of SSAB (steel), LKAB (ore mining), Vattenfalls (electric power), and Procordia (food, tobacco, and pharmaceuticals). In 1989, Portugal expanded its 1986 plan for privatizing 510 enterprises including those in steel, petrochemicals, paper, cement, banking, insurance, air transport, post, and telecommunications. The 15 biggest enterprises represented one third of Portugal's gross domestic product. Italy privatized AGIP (oil and gas exploration); SNAM (gas pipelines); Nuovo Pignone (turbines and engineering); and in the banking sector ENI, Banca Commerciale Italiana, and Credit Bancario San Paola di Torino (Italy's fifth largest bank). Other PSEs, including those in electricity, telecommunications, and insurance, followed. The proceeds from privatization in Western Europe (excluding the UK), amounting to more than $290 billion equivalent since 1990, were primarily used to reduce budget deficits, improve institutional efficiencies, and meet the social costs of privatization.

10. The experience of the transition economies of Central and Eastern Europe illustrates the poor efficacy of privatization programs when insufficient attention was paid to institutional frameworks, banking reform, and regulation to ensure that surrogate elements of competition prevailed. Approach, scale, speed, and outcomes are in stark contrast to the way in which privatization progressed elsewhere. Justification for rapid privatization was the belief that private ownership through securitization of property rights[11] would provide incentives for efficient restructuring and a rapid transition to capitalism. In the Russian Federation, over 15,000 medium and large companies were privatized in only two years. In the Czech Republic, over 18,000 companies were privatized in less than four years, while between 1991 and 1996, 14 countries adopted similar rapid programs leading to the privatization of over 30,000 medium and large companies. These programs were commonly implemented using a voucher approach.[12] Some Central and Eastern European countries, including Estonia, Hungary, and Poland are considered successful models, but the efficacy of rapid privatization programs did not everywhere lead to the outcomes that advocates had predicted. The Russian Federation, for

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[10] After initiation in 1961 by German Chancellor Adenauer, when initial public offers were made for shares in VEBA and Volkswagen.
[11] Property rights have broad relevance and extend to the right of voting, behavioral rules, and incentives.
[12] The voucher approach involved distributing vouchers to all the population for free, or a nominal charge, as proxies for shares (stocks) in PSEs. The vouchers were transformed into certificates for share ownership through agents for investment funds and state-controlled auctions. The auction clearance price determined the capital value of a firm.

example, suffered depressed development. Hungary and Poland, where privatization planning took into account the need for complementary institutional restructuring, achieved higher and more sustainable economic growth than the Czech Republic.[13]

11. Another unique rapid privatization program was initiated with the unification of Germany. A central trust institution (Treuhandanstalt) was established with ownership rights to all companies in eastern Germany and with the mandate and powers to effect their rapid privatization. The Treuhandanstalt's *modus operandi* also included provision to make decisions for the prior restructuring of companies, and/or for providing for their closure. The emphasis was put on implementing privatization as rapidly as possible, and in the space of two and a half years, the Treuhandanstalt privatization process resulted in the divestment of 11,234 companies and parts of companies,[14] 28,694 hectares of cultivable land, and 13,788 properties. These divestments generated DM40.6 billion in privatization proceeds, DM173.2 billion in investment pledges, and 1.4 million jobs. Without the Treuhandanstalt process, the object of integrating the former Federal Republic of Germany and the Democratic Republic of Germany so as to achieve political, social, and economic equality would not have been possible. Proceeds from privatization were used to help meet the costs of infrastructure development and rehabilitation, as well as the social costs of retrenchment, retraining, and relocation.

12. **Asia.** Several countries have made progress with privatization, but less so than in Europe, Latin America, and the Pacific Rim. Some Asia-Pacific nations (e.g., Bhutan, Kiribati, and Solomon Islands) have experienced little or no privatization. Others (e.g., Bangladesh, Pakistan, and Sri Lanka) have denationalized small businesses and secondary industry in the same way that marked privatization in Latin America. Apart from Korea, Malaysia, Philippines, and Singapore, most Asian nations are just beginning to address the privatization of banking, infrastructure, transport, and welfare services.[15] In Singapore, partial privatization prevails across all economic sectors. For the transition economies of Cambodia, Myanmar, Viet Nam, and the Central Asian republics, emphasis is on building a more enabling environment.[16] (Further details of the progress on privatization among the Asian Development Bank's developing member countries are discussed in section III of the main text.) Total proceeds from privatization up to year 2000 are estimated to exceed $30 billion. These have predominantly been used to meet recurrent expenditures, fund capital development, and reduce governments' international debt.

[13] The Russian Federation and the Czech Republic failed to heed the regulatory importance of institutions in ensuring that privatization is implemented within an enabling environment.
[14] Including more than 2,000 companies that were privatized as management buy-outs.
[15] Korea's privatization program raised $3 billion in 1999, including $2.5 billion from the sale of American Depositary Receipts in Korea Telecom. Government ownership was reduced to 59 percent. Other transactions included the sale of its 70 percent interest in Seoul Bank and 5 percent in Korea Electric Power.
[16] Most Central Asian republics have already participated in the divestment process under mass voucher programs. With the collapse of the former Soviet Union, many of the privatized enterprises foundered as a result of diminished or collapsed market demand.

PRIVATIZATION STATISTICS
Table A3.1: Country Breakdown of Amount Raised from Privatization[a]
($ million equivalent)

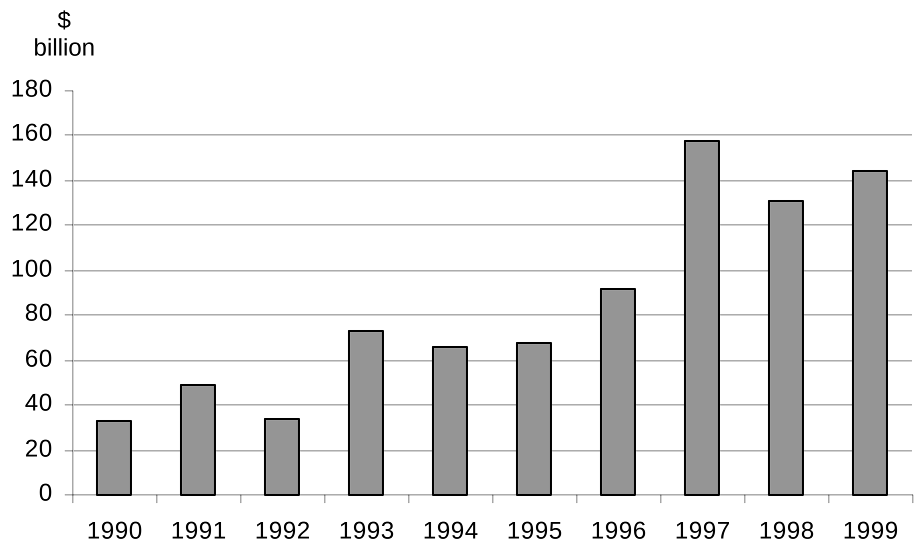
Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999[b]	Total
Australia	19	1,042	1,893	2,057	2,055	8,089	9,052	16,815	7,146	15,048	63,216
Austria[c]	32	48	49	142	700	1,035	1,300	2,654	2,426	138	8,524
Belgium	0	0	0	956	549	2,748	1,222	1,817	2,277	0	9,569
Canada[d]	1,504	808	1,249	755	490	3,998	1,770	0	11	0	10,585
Czech Republic[e]	—	—	—	—	1,077	1,205	994	442	469	781	4,968
Denmark	644	0	0	122	229	10	366	45	4,502	19	5,937
Finland	0	0	0	229	1,166	363	911	835	2,068	3,645	9,217
France	0	0	0	12,160	5,479	4,136	5,099	8,189	12,951	9,509	57,523
Germany[f]	0	325	0	435	240	0	13,228	1,125	364	6,734	22,451
Greece	0	0	0	35	73	44	558	1,395	3,892	4,880	10,877
Hungary	38	470	720	1,842	1,017	3,813	1,157	1,966	353	88	11,464
Iceland	0	0	21	10	2	6	0	4	129	229	401
Ireland	0	515	70	274	0	157	293	0	0	4,846	6,155
Italy[g]	0	0	0	1,943	6,493	7,434	6,265	27,719	13,619	25,611	89,084
Japan	0	0	0	15,919	13,773	0	6,379	4,009	6,641	14,856	61,577
Korea	0	0	0	817	2,435	480	1,866	539	600	2,705	9,442
Luxembourg	0	0	0	0	0	0	0	0	0	0	0
Mexico	3,124	10,757	6,864	2,531	766	170	73	2,670	987	291	28,233
Netherlands	716	179	0	780	3,766	3,993	1,239	831	335	1,481	13,320
New Zealand	3,895	17	967	630	29	264	1,839	0	441	1,331	9,413
Norway	73	0	0	0	118	521	660	35	0	454	1,861
Poland	23	171	373	433	725	1,101	1,442	2,043	2,079	3,422	11,812
Portugal	1,192	1,198	2,326	500	1,132	2,425	3,002	4,930	4,260	1,624	22,589
Spain	172	0	820	3,223	1,458	2,941	2,679	12,522	11,618	964	36,397
Sweden	0	0	378	252	2,313	852	785	1,055	172	2,071	7,878
Switzerland	0	0	0	0	0	0	0	0	4,426	0	4,426
Turkey	486	244	423	566	412	572	292	466	1,020	38	4,519
United Kingdom[h]	12,906	21,825	604	8,523	1,341	6,691	7,610	4,544	0	0	64,044
United States	0	0	0	0	0	0	0	3,650	3,100	0	6,750
Total OECD	**24,824**	**37,599**	**16,757**	**55,134**	**47,838**	**53,048**	**70,081**	**100,300**	**85,886**	**100,765**	**592,232**
of which: EU 15	15,662	24,090	4,247	29,574	24,939	32,829	44,557	67,661	58,484	61,522	363,565
Other Countries	**8,516**	**11,605**	**17,458**	**17,983**	**18,436**	**14,551**	**22,026**	**57,155**	**45,153**	**44,000**	**256,883**
Global Total[i]	**33,340**	**49,204**	**34,215**	**73,117**	**66,274**	**67,599**	**92,107**	**157,455**	**131,039**	**144,765**	**849,115**

— = not available, EU = European Union, OECD = Organisation for Economic Co-operation and Development.

[a] The amounts shown are gross proceeds from direct privatizations.
[b] Provisional.
[c] Statistics refer only to privatizations by the central government.
[d] There were no federal privatizations in 1997 and 1999. Provincial data are not available.
[e] The cumulative amount for the period 1991-1993 is $2,240 million.
[f] Up to 1997, information on trade sales is not available.
[g] Including convertible bond issues of $2,055 million in 1996 and indirect privatizations raising $2,658 million in 1996, and $2,620 million in 1997.
[h] Debt sales for years 1990-1997 (fiscal years) amounting to £5,347 million, £7,924 million, £8,189 million, £5,453 million, £6,429 million, £2,439 million, and £4,500 million, respectively.
[i] Is not all inclusive, e.g., excludes former Soviet Union republics.

Source: World Bank Economic Indicators, 2000; 1999 data are OECD estimates.

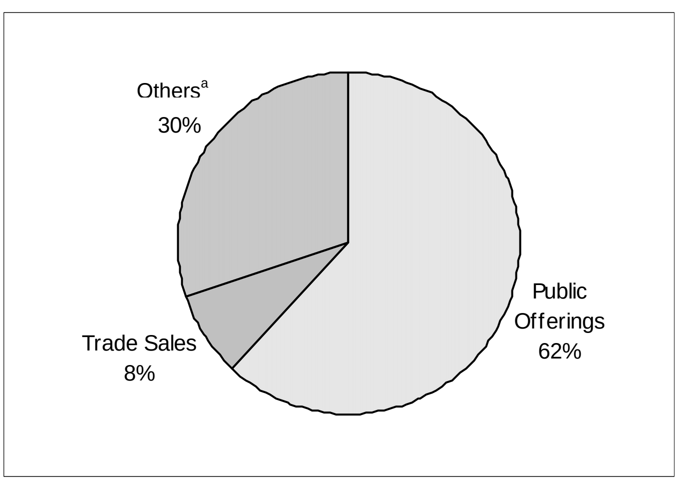
Figure A3.1: Global Amounts Raised from Privatization[a]



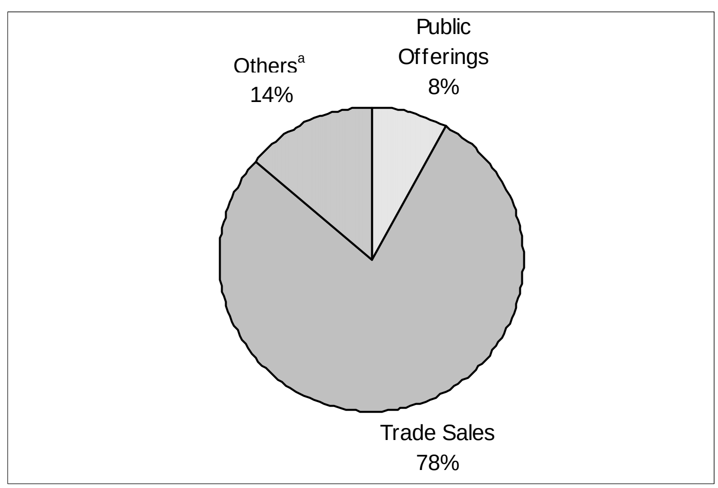
[a] Excluding amounts raised from former Soviet Union republics.

Figure A3.2: Percentage of Total Raised by Method, 1990-1999

Members of Organisation for Economic Co-operation and Development



Other Countries



[a] Including management buy-outs.

Table A3.2: Details of the World's Largest Share Offerings[a]

	Date	Company	Country	Amount ($ million)
1.	Nov 1987	Nippon Telegraph and Telephone	Japan	40,260
2.	Oct 1988	Nippon Telegraph and Telephone	Japan	22,400
3.	Nov 1999	ENEL	Italy	18,900
4.	Oct 1998	NTT DoCoMo	Japan	18,000
5.	Oct 1997	Telecom Italia	Italy	15,500
6.	Feb 1987	Nippon Telegraph and Telephone	Japan	15,097
7.	Nov 1999	Nippon Telegraph and Telephone	Japan	15,000
8.	Jun 2000	Deutsche Telekom	Germany	14,760
9.	Nov 1996	Deutsche Telekom	Germany	13,300
10.	Oct 1987	British Petroleum	United Kingdom	12,430
11.	Apr 2000	**ATT Wireless**	**United States**	**10,600**
12.	Nov 1998	France Telecom	France	10,500
13.	Nov 1997	Telstra	Australia	10,530
14.	Oct 1999	Telstra	Australia	10,400
15.	Jun 1999	Deutsche Telekom	Germany	10,200
16.	Dec 1990	Regional Electricity Companies[b]	United Kingdom	9,995
17.	Dec 1991	British Telecom	United Kingdom	9,927
18.	Jun 2000	Telia	Sweden	8,800
19.	Dec 1989	United Kingdom Water Authorities[b]	United Kingdom	8,679
20.	Dec 1986	British Gas	United Kingdom	8,012
21.	Jun 1998	Endesa	Spain	8,000
22.	Jul 1997	ENI	Italy	7,800
23.	Apr 2000	**Oracle Japan**	**Japan**	**7,500**
24.	Jul 1993	British Telecom	United Kingdom	7,360
25.	Oct 1993	Japan Railroad East	Japan	7,312
26.	Dec 1998	Nippon Telegraph and Telephone	Japan	7,300
27.	Oct 1997	France Telecom	France	7,080
28.	Jul 1999	Credit Lyonnais	France	6,960
29.	Feb 1994	Elf Acquitaine	France	6,823
30.	Jun 1997	**Halifax Building Society**	**United Kingdom**	**6,813**
31.	Jun 1998	ENI	Italy	6,740
32.	May 1994	**Autoliv Sverige**	**Sweden**	**5,818**
33.	Oct 1996	ENI	Italy	5,864
34.	Oct 1998	Swisscom	Switzerland	5,600
35.	Jul 1999	**United Parcel Service**	**USA**	**5,500**

[a] As at 15 August 2000. The 10 largest issues (and 30 of the 35 total) are offerings of shares in privatized firms. Private sector offerings are presented in bold type. Amounts reported are at the time of the issue.

[b] Indicates a group offering of multiple companies that trade separately after the initial public offering.

Source: Megginson and Netter. 2000. "From State to Market: A Study of Empirical Studies on Privatization," *Journal of Economic Literature* .

RESULTS OF EMPIRICAL STUDIES ON PRIVATIZATION
Summary of Recent Academic Studies of Privatization that Examine the Relative Performance of State-Owned Versus Privately-Owned Companies

Study	Sample Description, Study Period, and Methodology	Summary of Empirical Findings and Conclusions
1 Boardman and Vining (1989)	Examines the economic performance of the 500 largest non-United States firms in 1983, classified by ownership structure as state owned, privately owned, or MOEs. Employs four profitability ratios and two measures of efficiency.	Finds that state-owned firms and MOEs are significantly less profitable and less productive than privately-owned companies. Also finds that MOEs are no more profitable than pure state-owned companies—so full private ownership is required to gain efficiency.
2 Boardman and Vining (1992)	Asks whether ownership “matters” in determining the efficiency of state-owned enterprises, or whether only the degree of competition is important. Presents a performance model using 1986 data from the 500 largest nonfinancial Canadian companies—including 12 PSEs and 93 mixed enterprises.	After adjusting for size, market share, and other factors, finds that private firms are significantly more profitable and efficient than MOEs and PSEs, though now finds that MOEs outperform PSEs. Thus, ownership has an effect separable from competition alone.
3 Levis (1993)	Examines long-run returns on 806 UK IPOs during 1980-1988. Sample includes 12 public sector IPOs, accounting for 76 percent of total IPO value.	While private sector IPOs underperformed the market by over 10 percent over three years, public sector IPOs outperformed the market by over 15 percent.
4 Menyah, Paudyal, and Inganyete (1995)	Examines initial and long-term returns on 40 UK public sector IPOs and 75 private sector IPOs executed on the London Stock Exchange between 1981 and 1991.	Finds a significant positive 33 percent market return for public sector IPOs versus an insignificant 3.5 percent return for private sector IPOs.
5 Ramamurti (1996)	Survey studies of one toll-road, two airline, and four telecommunications privatization programs in Latin America during 1987-1991. Also discusses political-economy issues, and methods used to overcome bureaucratic and ideological opposition to divestment.	Concludes that privatization is very positive for telecommunications, partly due to scope for technology, capital investment, and attractiveness of offer terms. Much less scope for productivity improvements for airlines and roads, and little improvement observed.
6 Boles de Boer and Evans (1996)	Estimates the impact of the 1987 deregulation and 1990 privatization of Telecom New Zealand on the price and quality of telephone services. Also examines whether investors benefited.	Finds significant declines in the price of telephone services, due mostly to productivity growth and a significant improvement in service levels. Initial shareholders also benefit significantly.
7 Petrazzini and Clark (1996)	Using International Telecommunications Union data through 1994, tests whether deregulation and privatization impact the level and growth in teledensity (main lines per 100 people), prices, service quality, and employment by telecommunications in 26 developing countries.	Both deregulation and privatization are associated with significant improvements in the level and growth in teledensity, but have no consistent impact on service quality. Deregulation is associated with lower prices and increased employment; privatization has the opposite effect.
8 Barberis, Boycko, Shleifer, and Tsukanova (1996)	Surveys 452 shops sold in the Russian Federation in the early 1990s to measure the importance of alternative channels through which privatization promotes restructuring.	Finds that the presence of new owners and managers raises the likelihood of value-increasing restructuring. Finds that equity incentives do not improve performance; instead, points to the importance of new human capital in economic transformation.

IPO = initial public offering, MOE = mixed-ownership enterprise, PSE = public sector enterprise, UK = United Kingdom.

Study	Sample Description, Study Period, and Methodology	Summary of Empirical Findings and Conclusions
9 Eckel, Eckel, and Singal (1997)	Examines the effect of the privatization of BA on the stock prices of competitors. Also tests whether fares on competitive routes declined after privatization. Such findings would suggest a more competitive BA resulting from privatization.	Stock prices of US competitors declined on average by 7 percent on BA's privatization, and fares on routes served by BA and its competitors fell by 14.3 percent after divestment. Compensation of BA executives increased and became more closely related to performance.
10 Newberry and Pollitt (1997)	Performs a cost-benefit analysis of the 1990 restructuring and privatization of the CEGB. Compares the actual performance of the privatized firms with a counterfactual, assuming CEGB had remained state owned.	The restructuring/privatization of CEGB was "worth it," leading to a permanent cost reduction of 5 percent per year. Producers and shareholders capture all this benefit and more. Consumers and the Government lose.
11 Claessens, Djankov, and Pohl (1997)	Examines determinants of performance improvements for a sample of 706 Czech firms privatized during 1992-1995. Tests whether a concentrated ownership structure or the presence of an outside monitor (bank or investment fund) is superior to dispersed ownership.	Finds that the more concentrated the postprivatization ownership structure is, the higher the firm's profitability and market valuation. Large stakes owned by strategic investors are particularly value enhancing.
12 Smith, Cin, and Vodopivec (1997)	Using a sample with 22,735 firm-years of data drawn from the period of "spontaneous privatization" in Slovenia (1989-1992), examines the impact of foreign and employee ownership on firm performance.	Finds that a 1 percentage point increase in foreign ownership is associated with a 3.9 percent increase in value added, and for employee ownership with a 1.4 percent increase in valued added. Also finds that firms with higher revenues, profits, and exports are more likely to exhibit foreign and employee ownership.
13 Dyck (1997)	Develops and tests an adverse selection model to explain the Treuhandanstalt's role in restructuring and privatizing eastern Germany's state-owned firms. In under five years, the Treuhandanstalt privatized more than 13,800 firms and parts of firms and, uniquely, had the resources to pay for restructuring itself—but almost never chose to do so. Instead, it emphasized speed and sales to existing western firms over giveaways and sales to capital funds. Rationalizes the Treuhandanstalt's approach.	Shows that privatized eastern German firms were much more likely to have transferred western (usually German) managers into key positions than were companies that remained state owned. Also finds that the Treuhandanstalt emphasized sales open to all buyers rather than favoring eastern Germans. Principal message: privatization programs must carefully consider when and how to carry out managerial replacement in privatized companies. Plans that are open to western buyers and that allow management change are most likely to improve firm performance.
14 Earle (1998)	Investigates the impact of ownership structure on the (labor) productivity of industrial firms in the Russian Federation. Using 1994 survey data, examines differential impact of insider, outsider, or state ownership on the performance of 430 firms—of which 86 remained 100 percent state owned, 299 were partially privatized, and 45 were newly created. Adjusts empirical methods to account for tendency of insiders to claim dominant ownership in the best firms being divested.	Regressions show a positive impact of private (relative to state) share ownership on labor productivity, with this result due primarily to managerial ownership. However, only outsider ownership is significantly associated with productivity improvements. Stresses that leaving insiders in control of firms, while politically expedient, has very negative long-term implications for the restructuring of industry in the Russian Federation.
15 Davidson (1998)	Studies 1-, 3-, 5-, and 10-year market-adjusted returns for SIPs from five European countries (Austria, France, Italy, Spain, and UK) through March 1997.	Finds that, after a long period of underperformance, averaging 1-1.5 percent per year, SIPs outperformed European market averages during the previous 12 months.

BA = British Airways, CEGB = Central Electricity Generating Board, SIP = share-issue privatization, UK = United Kingdom, US = United States.

Study	Sample Description, Study Period, and Methodology	Summary of Empirical Findings and Conclusions
16 Foerster and Karolyi (1998)	Examines long-run return for 333 non-US companies that list stock on US markets in the form of ADRs during 1982-1996. Compares returns for 77 SIPs (38 IPOs, 39 existing) with private offers.	Finds insignificantly positive three-year abnormal returns for the 77 SIPs compared to (insignificantly) negative returns of -1.7 percent for the full sample of 333 non-US companies.
17 Verbrugge, Megginson, and Lee (1998)	Studies terms of offer and share ownership results globally for 65 banks fully or partially privatized from 1981 to 1996. Then compares pre- and postprivatization performance for 32 banks in Organisation for Economic Co-operation and Development countries and five in developing countries.	Finds only moderate performance improvements in Organisation for Economic Co-operation and Development countries. Ratios proxying for profitability, fee income (noninterest income as a fraction of total), and capital adequacy increase significantly, while the debt leverage ratio declines significantly. Finds significantly positive initial returns to IPO investors.
18 La Porta and López-de-Silanes (1999)	Tests whether the performance of 218 PSEs privatized across 90 countries through June 1992 improves after divestment. Compares performance with industry-matched firms, and splits improvements documented between industry- and firm-specific influences.	Output of privatized firms increased by 54.3 percent, while employment declined by half (though wages for remaining workers increased). Firms achieved a 24 percentage point increase in operating profitability, eliminating the need for subsidies equal to 12.7 percent of gross domestic product. Higher product prices explain 5 percent of the improvement; transfers from retrenched workers, 31 percent; and incentive-related productivity gains, the remaining 64 percent.
19 Weiss and Nikitin (1999)	Performs econometric analysis of the effects of ownership by investment funds on the performance of 125 privatized Czech firms during 1993-1995. Assesses these effects by measuring the relationship between changes in performance and changes in the composition of ownership at the start of the privatization period.	Finds that ownership concentration and composition jointly affect performance of privatized firms. Concentration of ownership in the hands of a large shareholder, other than an investment fund or company, is associated with significant performance improvements (for all measures of performance). Concentrated ownership by funds did not improve firm performance.
20 Claessens and Djankov (1999)	Examines the relationship between ownership concentration and corporate performance for 706 privatized Czech firms during the period 1992-1997. Uses profitability and labor productivity as indicators of corporate performance.	Finds that concentrated ownership is associated with higher profitability and labor productivity. Also find that foreign strategic owners and nonbank-sponsored investment funds improve performance more than bank-sponsored funds.
21 Frydman, Gray, Hessel, and Rapaczynski (1999)	Compares the performance of privatized and state-owned firms in the transition economies of Central and Eastern Europe, and asks the question: “When does privatization work?” Examines the influence of ownership structure on performance using a sample of 90 state-owned and 128 privatized companies in the Czech Republic, Hungary, and Poland. Employs panel data regression methods to isolate ownership effects.	Privatization “works,” but only when the firm is controlled by outside owners (other than managers or employees). Privatization adds over 18 percentage points to the annual growth rate of a firm sold to a domestic financial company, and 12 percentage points to a firm sold to a foreign buyer. Privatization to an outside owner also adds about 9 percentage points to productivity growth. Finds that insider-controlled firms are less likely to restructure, and that outsider-controlled firms grow faster.

ADR = American Depositary Receipt.

Study	Sample Description, Study Period, and Methodology	Summary of Empirical Findings and Conclusions
22 Djankov (1999a)	Investigates the relationship between ownership structure and enterprise restructuring for 960 firms privatized in five newly independent states and the Russian Federation between 1995 and 1997. Employs survey data collected by the World Bank in late 1997 from Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russian Federation, and Ukraine.	Show that foreign ownership is positively associated with enterprise restructuring at high ownership levels (>30 percent), while managerial ownership is positively related to restructuring at low (<10 percent) or high levels, but negative at intermediate levels. Employee ownership is beneficial to labor productivity at low ownership levels, but is otherwise insignificant.
23 Djankov (1999b)	Using the same survey data as in Djankov (1999a) above, studies effects of different privatization modalities on the restructuring process in Georgia (92 firms) and Moldova (149 firms). Georgia employed voucher privatization, while the majority of Moldovan firms were acquired by investment funds (and numerous others were sold to managers for cash).	Privatization through management buy-outs is positively associated with enterprise restructuring, while voucher-privatized firms do not restructure more rapidly than firms that are still state owned. Implies that managers who gain ownership for free may have less incentive to restructure, as their income is not solely based on the success of the enterprise.
24 La Porta, López-de-Silanes, Shleifer (2000)	Using data from 92 countries, examine whether government ownership of banks impacts the level of financial system development, rate of economic growth, and growth rate of productivity.	Finds that government ownership is extensive, especially in the poorest countries, and that these holdings retard financial system development and economic growth rates, mostly due to impacts on productivity.
25 Wallsten (2000)	Performs an econometric analysis of the effects of telecommunications reforms in developing countries. Using a panel dataset of 30 African and Latin American countries from 1984 to 1997, explores the effects of privatization, competition, and regulation on telecommunications performance.	Competition is significantly associated with increases in per capita access and decreases in cost. Privatization alone is not helpful, unless coupled with effective, independent regulation. Competition with privatization is best. Increasing competition is the single best reform. Privatizing a monopoly without regulatory reforms should be avoided.
26 Boardman, Laurin, and Vining (2000)	Compares the three-year average postprivatization financial and operating performance ratios to the five-year preprivatization values for nine Canadian firms privatized from 1988 to 1995. Also computes long-run (up to five-year) stock returns for divested firms.	Finds that profitability, measured as the return on sales or assets, more than doubles after privatization, while efficiency and sales also increase significantly (though less substantially). Leverage and employment decline considerably, while capital spending increases appreciably. Privatized firms also significantly outperform the Canadian stock market over all long-term holding periods.
27 Frydman, Hessel, and Rapaczynski (2000)	Examines whether privatized Central and Eastern European firms controlled by outside investors are more entrepreneurial—in terms of ability to increase revenues—than firms controlled by insiders or the state. Study employs survey data from a sample of 506 manufacturing firms in the Czech Republic, Hungary, and Poland.	Finds that all state and privatized firms engage in similar types of restructuring, but that product restructuring by firms owned by outside investors is significantly more effective, in terms of revenue generation, than product restructuring by firms with other types of ownership. Concludes that the more entrepreneurial behavior of outsider-owned firms is due to the incentive effects, rather than the human capital effects of privatization—specifically, the greater readiness to take risks.

Study	Sample Description, Study Period, and Methodology	Summary of Empirical Findings and Conclusions
28 Harper (2000)	Examines the effects of privatization on the financial and operating performance of 174 firms privatized in the first wave, and 380 firms divested in the second wave, of the Czech Republic's voucher privatizations of 1992 and 1994. Compares results for privatized firms with those that remained state owned. Employs Megginson, Nash, and van Randenborgh (1994) methodology and variables to measure changes.	Finds that the first wave of privatization yielded disappointing results. Real sales, profitability, efficiency, and employment all fell significantly. However, second-wave firms experienced appreciable increases in efficiency and profitability and the decline in employment, though still considerable, was much less than after the first wave (-17 percent versus -41 percent).

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ADB INVOLVEMENT IN DMC PRIVATIZATION

1. Privatization in developing member countries (DMCs) of the Asian Development Bank (ADB) has varied in political commitment and extent of reform. ADB support for privatization began around 1984 as a reflection of the individual development plans of DMCs, and guided by strategic considerations reflecting the limited resources of ADB for promoting economic development. Between 1984 and the early 1990s, most DMC development plans showed an increased focus on industrial development through the private sector. Improving the enabling environment so that the private sector could operate more effectively became an integral part of ADB's loan and technical assistance (TA) support.

2. Development plans of Bangladesh, Malaysia, and Pakistan in the mid-1980s included specific provision for privatization. In the case of Bangladesh, many jute and textile mills had already been divested, and it was planned to transfer undertakings of a commercial value among the statutory corporations to the private sector. In Malaysia, the privatization of major public sector activities included plans for airline divestment, and for the leasing of management operations for Port Klang to the private sector. Legislation that would enable to transfer the assets, rights, and liabilities of telecommunications to a successor corporation from the private sector was also planned. Pakistan's Sixth Five-Year Plan (1983/84-1987/80) included provision for a divestment commission to identify public sector enterprises (PSEs) to be sold to the private sector, and a deregulation commission to reduce restrictions on the setting up of industries, remove unnecessary controls, and privatize power distribution. The general approach of ADB to these DMC plans for privatization was to support the need for economic restructuring and to give priority to lending and TA that addressed economic stabilization, as well as showed promise to enhance agricultural production and self sufficiency in essential food grains and/or promoted export revenues. Priority was also given to developing the energy sector, physical and social infrastructure, and improving the availability of finance to expand industrial production.

3. Unlike Malaysia, progress toward privatization reform and divestment of the monopoly enterprises in Bangladesh and Pakistan has been slow. Lack of political commitment and general resistance from the bureaucracy and labor unions of the PSEs have impeded progress. Even so, privatization remains a stated commitment. In Bangladesh, the government has declared a policy of allowing private sector power generation companies to set up, produce, and sell power to publicly-owned utilities. The telecommunications sector is being privatized slowly and a number of private mobile operators have established businesses. The government is currently considering private sector participation in improving existing ports and developing new ports, and has agreed to partly privatize its national flag carrier (Biman Airways). Reforms are under way for privatizing public sector banks and insurance companies. In the case of Pakistan, privatization by attrition has increased the number of independent power producers to 19. The government retains ownership and management operations of the major ports, railways, airlines, gas and oil production and distribution, power transmission and distribution, the major operations of the banking sector, and telecommunications. Presently, the Privatization Commission is overseeing the divestment of government holdings including 93 percent in Pakistan Petroleum Limited, 35 percent in Pakistan Oilfields, 35 percent in Attock Refinery, and 26-51 percent in Oil and Gas Development Corporation. Associated with the government's intention to divest its holdings in the oil and gas sector has been the establishment of an independent regulator in the National Gas Regulatory Authority. The monopoly of Pakistan Telecommunications Corporation Limited is planned to end in 2002.[1] In the transport sector, the restructuring and privatization of the Pakistan Railways and Pakistan National Shipping

[1] Twelve percent was divested in 1994.

Corporation is under preparation. For the financial sector, the Government has concrete plans for the sale of its interests, but delays have become commonplace. Two large commercial banks, Muslim Commercial Bank and Allied Bank, were privatized in 1991 and Banker's Equity in 1996. Habib Credit and Exchange was approved for privatization in 1997 through sale to strategic investors either in whole or in parts, but several deadlines for expressions of interest have passed without credible buyers emerging. Several more PSE banks have been scheduled for privatization in 2000 and 2001. The poor macroeconomic situation, policy environment, and high-risk perception by international investors are the main reasons hampering the privatization process in the financial sector. ADB's loan and TA support to Bangladesh and Pakistan has focused on enterprise restructuring, legal redress, governance, and capital market development. Advisory studies for developing regulatory systems have also been supported. On a broader macroeconomic front, ADB has, in conjunction with the International Monetary Fund's stabilization programs, provided important policy-based loans aimed at restructuring the financial, oil and gas, and power sectors. The loans have included specific provisioning for privatization.

4. Similar reasoning to promote economic development has applied to the Philippines and Thailand. The Philippines development plan of 1984-1987 included plans to privatize the Philippine National Oil Company, the National Food Authority, the Fertilizer and Pesticides Authority, and the Philippine National Bank. Successive governments gave emphasis to the quick and efficient divestment of some 600 PSEs and nonperforming assets. Further prominent examples include Fort Bonifacio property ($1.5 billion), 60 percent of Petron Corporation ($970 million), Philippine Airlines, and National Steel Corporation. In recent years, in order to meet the large capital expenditure requirements in the utilities and transport sector, promotion of public-private partnerships has been favored. ADB has promoted predivestment support for the restructuring and privatization of Manila Ports Authority, and Manila Waterworks and Sewerage System. Direct loan and advisory support, together with an innovative political risk insurance, was provided for the Manila North Tollway. Thailand's five-year development plan for 1986-1991 did not reflect the same state of readiness for privatization, but included a program for continuing to focus on restructuring the economy, and retrenching the public sector. Plans also included promoting the private sector to achieve increased export revenues, and complementary loan support was provided by ADB to promote the private sector's participation in shrimp aquaculture. In 1998, the Government of Thailand approved a master plan for State Enterprise Sector Reform involving the privatization of PSEs in telecommunications, transport and energy sectors, along with the privatization or partial divestiture of a further 29 PSEs in the commercial and industrial sectors. ADB has financed preparatory studies for the privatization of electricity distribution, oil production and distribution, and water supply.

5. Sri Lanka in the mid-1980s expressed commitment to private sector development, including privatization, but with no specific development program. Privatization gained impetus in 1992, assisted by ADB's loan and TA support for the divestment of 14 regional plantation corporations on the Colombo Stock Exchange (Appendix 6). Development strategy of the Republic of Korea stressed economic liberalization and the promotion of private initiative as a necessary condition for sustaining economic growth. Policy reforms included freeing import restrictions, lowering tariffs, deregulating interest rates, and discontinuing credit allocation to select industries and sectors. Privatization per se was not contemplated but private sector development was to be encouraged through channeling ADB and other donor funds through development finance institutions for industrial and private sector expansion. Restrictions on public sector investment, accompanied by extending responsibility to the private sector, was a stated intention. The Republic of Korea ceased to be an active borrower from ADB from 1988

until the financial crisis of 1997 when ADB's major financial sector loan included provision for progressing privatization reforms.[2]

6. The smaller DMCs such as Lao PDR, Maldives, Nepal, and Papua New Guinea, variously stressed in their development plans support for self sufficiency in food production and improvement in basic infrastructure including transport, communications, power generation, and distribution. The Maldives and Nepal also gave emphasis to development of the tourist sector as a priority to address foreign exchange imbalances. ADB's loans and TAs supported medium-term stabilization, infrastructure development, agriculture development (except Maldives), and resource management.

7. India's development plans for an already large and diversified economy focused during the mid-1980s on accelerating economic growth with an emphasis on creating employment, improving efficiency, and productivity. Though trade liberalization was planned, India's development plans initially were largely structured for implementation through a closed economy. ADB's operations were designed to assist the government in its industrialization efforts by providing finance for rehabilitation and modernization. Within manufacturing, preference was given to private sector finance. Divestment of India's PSEs was initiated in 1990. In 1999, the government reinforced its commitment to privatization with planned gradual divestments in Air India, telecommunications, and National Power Corporation. The privatization of PSEs in the fertilizer industry, engineering, chemical shipbuilding, and mining are also planned. ADB's recent loan and TA support toward privatization has been directed at capital market development and institutional strengthening of key infrastructure enterprises.

8. The development plans of Indonesia during the 1980s focused primarily on facilitating economic growth through productivity improvements and diversification in the agricultural sector. Emphasis was also placed on expanding infrastructure for roads, energy, housing and water, and strengthening the capacity of public executing agencies. Improving the financial viability of public entities was a stated objective, but little attention was paid to promoting private sector development, or expanding and improving the industrial sector, which operated behind high protective barriers and with often substantial excess capacity. Concerted efforts to open the economy commenced in the late 1980s, particularly through liberalization of the trade and investment regimes as well as of the financial sector. Both of these areas received extensive ADB support. ADB's loans and TAs mirrored support for the government's development plans. After 1996, an increasing focus was given in the government's development plans for creating a more enabling environment for private sector participation including the financing and operation of infrastructure facilities. ADB's support is evident in loans aimed at enhancing the competitiveness of small and medium enterprises, and TAs for reforms in financial management, governance, and deregulation. Apart from moves to deregulate Indonesia's banking sector, the required political commitment for divesting PSEs has not been unanimous.

9. When the People's Republic of China became a member of ADB in 1986, the government was emphasizing the process of reforming the structure of the economy. Reforms included improving PSE management and incentives; increasing management autonomy in production, pricing, and employment; increasing competition and accountability for performance; and reforming human resource policy. The government's plans also included divesting small PSEs to collective or individual management. ADB's assistance supported these goals through loan assistance for enhancing the efficiency of PSEs in the energy and industry sectors, and advancing credit to banking institutions for development investment. TA was predominantly for

[2] Loan 1601-KOR: Financial Sector Program, for $4 billion, approved on 19 December 1997.

institutional strengthening in the same areas. After 1995, ADB's TA included advisory support for build-operate-transfer projects in power and water supply, restructuring of insolvent PSEs, power sector restructuring, as well as capital market and trade law reforms.

10. A generally stated intention to improve the efficiency of PSEs through privatization has been a feature of the development plans of several Pacific DMCs since the mid-1980s. The plans also focused on monetary policy and economic stabilization reforms. ADB's TA support included studies for the privatization of PSEs, capital market development, and commercialization and corporatization of monopoly enterprises. Whole or partial divestment has since occurred for airlines, forestry, communications, civil aviation, water and ports (mainly Fiji).

11. The Central Asian Republics and Mongolia, all newer DMCs, are countries where the consequences of mass privatization in the 1990s did not live up to expectations and resulted in social hardships. Empirical studies attribute failings to the insufficient attention to the need for structural reforms in governance, judicial, banking, and regulatory frameworks. ADB loans and TAs have predominantly aimed at rectifying weaknesses in these areas.

12. Specific assistance toward privatization of PSEs has accompanied ADB private sector operations, through the provision of both loan and equity finance. Recent examples include the Bhutan National Bank, SBI Capital Markets (India), Karachi Electric Supply Corporation, Hopewell Power (Philippines) Corporation, Batangas Power Corporation, Maynilad Water Services (Philippines), Manila North Tollways Corporation, the Trade Development Bank of Mongolia, and Uzbekistan Telecommunications. Of significance is the increasing need among DMCs for advisory assistance as a prelude to providing loan and equity finance.

PRIVATIZATION RESULTS FOR SRI LANKA ESTATE PLANTATIONS

1. Traditionally, tea, rubber, and coconut play an important economic role in Sri Lanka. Currently, tea accounts for around 75 percent of the total export revenues generated by the country's three plantation crops. The plantation industry was nationalized during 1972-1975, and the management of nationalized estates placed in the hands of two government-owned corporations, Sri Lanka State Plantation Corporation (SLSPC) and Janatha Estate Development Board (JEDB).

2. Heavy taxation and weak financial discipline led to a deterioration in the performance of SLSPC and JEDB, which had to rely heavily on long-term loans to meet working capital requirements. The debt-equity ratios of the two entities were between 200 percent and 300 percent in 1992, and operating losses were approximately SLRs1.5 billion per annum.

3. In 1992, the Government began the process of privatization. The first phase completed that year was the privatization of the management of government-owned tea, rubber, and coconut land. Four hundred and sixty-five estates managed by SLSPC and JEDB were constituted into 23 regional plantation companies (RPCs), and management of these companies was privatized on the basis of a five-year contract in 1992. The ownership of the companies remained with the Government. Subsequently in 1994/95, the Government went ahead with privatizing the RPCs by transferring a 50-year lease of the government-owned land to the RPCs and divesting the RPCs to the private sector. The privatization was carried out by offering the management agents of all RPCs the option to purchase 51 percent of the shares of their respective companies at a market-clearing price.

4. Under private sector management from 1991 to 1998, average tea yields increased from 1,086 kilograms (kg) per hectare (ha) to 1,495 kg, an increase of 38 percent. At the national aggregate level, total production of tea increased from 231 million kg in 1993 to 280 million kg in 1998, or by 30 percent.[1] Labor productivity, which before privatization was the lowest among tea-producing countries, improved from 3.2 to 2.5 persons per ha.

Table A6.1: A Pre- and Postprivatization Comparison —The Example of Sri Lanka's Tea Plantation Industry

Performance Indicator	Before Privatization[a]	Six Years After Privatization	Change (percent)
Average yield per ha	1,086	1,495	+37.7
Total production in million kg	205	280	+36.6
Exports in million kg	210[b]	272	+29.5
Labor per ha	3.2	2.5	-22.0

ha = hectare, kg = kilogram.
[a] 1992 figures.
[b] 1993 figure.

[1] Source: Planters' Association of Ceylon.

5. Sri Lanka's rubber production increased from 106 million kg in 1995 to 113 million kg in 1996, but a declining trend has followed since. The reason for this decline is the collapse of the international rubber markets following the Asian financial crisis and the resultant devaluation of the currencies of Indonesia, Malaysia, and Thailand.

6. Coconut production and exports show a similar trend, with production increasing from 2,546 million nuts in 1996 to 2,631 million nuts in 1997, and thereafter declining to 2,547 million nuts in 1998.

7. Fourteen of the 23 RPCs are quoted on the Colombo Stock Market and have added value to the market by increasing total market capitalization. However, the overall effectiveness of privatization is not as good as it could have been. Prior to privatization, the plantation estates were heavily in debt to the state banks and unable to service mortgages. With privatization, the land and fixed assets remained under government ownership and the plantation operations were leased to the private sector. As the state banks were already overexposed to the plantation sector, further lending for plantation development was unavailable and dependent on the leaseholder infusing capital raised on external collateral. This method restricted not only the availability of bidders but also curtailed the scope of plantation development needed. At the same time, the debts of the Government to the state banks remained and, indirectly, restricted the availability of local funding for general private sector development. From the perspective of freeing up capital in the economy, privatization would have been more effective if the land and fixed assets had been divested.

8. Asset transfer constraints apart, private sector knowledge and capital, along with funding from agencies, helped spur productivity through soil regeneration, new planting of high-yielding teas, systematic application of fertilizers, systematic replanting and infilling, better plucking practices, and linking wage increases to worker productivity.