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Bank Lending for Divestiture

A Review of Experience

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Divestiture, often used as a synonym, is only one aspect of privatization. Bank involvement has been timely and supportive, but experience indicates that the design and implementation of divestiture are complex and time consuming due to a web of contextual and practical factors.

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This paper — a product of the Public Sector Management and Private Sector Development Division, Country Economics Department — is part of a larger effort in PRE to (1) review past efforts in institutional development, (2) determine where these efforts have succeeded and where they have done poorly, and (3) suggest how the World Bank and its borrowers can better create and strengthen an appropriate institutional framework for economic development. An earlier version of this paper was presented at a conference on Institutional Development and the World Bank, held in Washington DC in December 1989. Copies of this paper are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact Gloria Orraca-Tetteh, room N9-069, extension 37646 (43 pages with graphs and tables).

After reviewing Bank support for divestiture in 70 operations in 35 countries, Kikeri concludes that divestiture operations are best tailored to country conditions. Other conclusions reached in this review of Bank experience:

Sometimes divestiture yields minimal results. For example, small and medium-sized public enterprises (PEs) may be divested, reducing the government's burden (and increasing revenues) little; partial divestments may mean continued government interference; governments may assume liabilities higher than the sale price; or new investors may be given privileges and monopoly rights that produce more inefficiency. Kikeri spells out appropriate criteria and methods for better divestiture design and implementation.

Sometimes (especially in Sub-Saharan Africa) the best policy may be to improve the environment in which PEs function, avoiding an overemphasis on divestiture. Ownership changes are only one element of broader PE reform, the implementation of which could create a better climate for divestiture later. And the threat of divestiture could improve PE efficiency.

The Bank could assist by spelling out the institutional set-up for managing divestiture. Some guiding principles: avoid overbureaucratization by limiting the number of institutions involved; ensure quick access to top decision-makers; make available the necessary technical expertise; set up guidelines for the disposition process. Kikeri describes how the Bank can help as countries progress to more complex divestitures.

Meanwhile, divestiture can be staff-intensive where the program is large — and Bank staff shortages must be addressed at the management level.

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* Assistance in the preparation of this paper was provided by Polly Means.

BANK LENDING FOR DIVESTITURE: A REVIEW OF EXPERIENCE[1]

I. INTRODUCTION

A. OBJECTIVES

1. The terms "divestiture" and "privatization" have come to be used interchangeably. This paper draws a distinction between the two and focusses on the former.[2] A narrower concept than privatization, divestiture is defined as: (i) the partial or full transfer of ownership and/or control of public enterprises (PEs) to the private sector; and (ii) closures and liquidations of PEs. Other aspects of privatization -- such as economic and industrial liberalization, the deregulation of natural and de facto monopolies, and the contracting out of the delivery of public services to the private sector -- are not dealt with in this paper, but are treated separately in ongoing work on private sector development in the World Bank's Country Economics Department.

2. Policy makers in countries with widely differing political and economic systems have begun to shift development strategies away from state ownership and control to a greater reliance on market forces. Stemming largely from growing public finance pressures and the continued poor performance of many PEs, the Bank has responded to these changing strategies by supporting the divestiture of state-owned companies in as many as 70 operations in 35 countries, as of June 1989. Divestiture is a condition in at least 45 policy-based loans; a number (25) of companion technical assistance loans and public enterprise loans also provide institutional support for the preparation and execution of such reform. Bank involvement has been timely and supportive of the growing divestments to date. However, recent experience indicates that the design and implementation of divestiture have been more complex and time-consuming than anticipated, and that the efficiency and fiscal gains potentially arising from such reform have not been fully realized due to a combination of practical and contextual factors.

3. In light of the growing Bank involvement, the objectives of this paper are to: (i) describe the rationale for and key components of Bank support for divestiture; (ii) examine the documented experiences and reform outcomes, and highlight the key implementation and management issues facing

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[1] I would like to thank Mary Shirley and John Nellis for their valuable comments and inputs in the preparation of the paper. Several other Bank staff also made helpful contributions over the various review stages of the paper.

[2] The distinction is based on the one proposed by Elliot Berg and Mary Shirley, in Divestiture in Developing Countries, World Bank Discussion Paper 11, June 1987.

borrower governments and the Bank; and (iii) draw some conclusions for the future role of the Bank in this reform area.

B. METHODOLOGY

4. The review concentrates on lending operations that consider divestiture in the context of the overall macroeconomic adjustment process and the rationalization of the PE sector as a whole. These include:

(a) structural adjustment loans (38), and a sample of industry sector adjustment loans and export recovery loans (5);

(b) public enterprise loans (14), which include PE rationalization/rehabilitation loans, PE sector adjustment loans, and PE institutional development loans;

(c) technical assistance loans (11),, all but one of which (Sudan) are accompaniments to SALs; and

(d) a small number (3) of private sector development loans (Table 1; tables are provided at the back).

Traditional investment projects that focus on the restructuring and divestiture of individual enterprises,[3] and sector adjustment loans that focus on the broader concept of privatization, for example, deregulation of agricultural services are excluded from the review. The decision to eliminate these projects reflects: (i) the coverage, in the present review, of the bulk of the Bank's involvement in divestiture; and (ii) the emphasis on deriving the specific lessons of utilizing divestiture as a tool for overall sector rationalization and efficiency improvements.

5. The review is a desk study, based on project documents (President's and appraisal reports, supervision reports, and project completion reviews) and other reports prepared by Bank staff and consultants. Interviews with operational staff were also held. On the whole, available data tend to focus on the number of divestments rather than on the nature of the transactions or the divestiture process itself. Information on the characteristics of divested enterprises are quite sparse, and systematic evaluation of the financial and economic impact of ownership and/or management

[3] Under the Kingston Metropolitan Regional Urban Project in Jamaica, for example, the bus company was dissolved and franchises awarded to private enterprises for the operation of the system. In Guinea, Cote d'Ivoire, and Senegal, Bank projects have addressed or are addressing the leasing ("affermage") of water services. And in Malaysia, full port operations were contracted out under Bank financing.

change are lacking. The importance and timeliness of this topic demands a review of the issues, despite the relative newness of the reform area for Bank lending and the existing data constraints.[4]

6. Section II of the review describes the rationale for the increasing Bank involvement in divestiture, and presents the magnitude and nature of Bank support. Section III assesses the divestiture experience. Divestiture outcomes are presented. The analysis focusses on: (i) the process of divestiture, including the selection of a strategy, choice of candidates and modalities, institutional arrangements for managing reform, and financing capacities; and (ii) selected operational or management issues for the Bank, such as the timing and sequencing of reform, the use of divestiture conditionality, and the monitoring and evaluation of reform. Section IV offers conclusions for the future role of the Bank in divestiture.

II. OVERVIEW OF BANK LENDING FOR DIVESTITURE

A. RATIONALE FOR DIVESTITURE[5]

7. Member governments and the Bank have utilized divestiture as a tool of PE reform for many different reasons. The first and most frequently cited objective, particularly in the countries of sub-Saharan Africa, is to rationalize the size of overextended and poorly performing PE sectors in order to reduce the financial and administrative pressures on governments. The closure of inefficient and loss-making PEs and the divestment of those where state participation is no longer essential are measures to reduce the flow of scarce financial and managerial resources to such PEs. These savings, combined

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[4] Several Bank-wide efforts are being undertaken to fill the current information gaps. In FY90-91, CECPS will undertake a research project on the ex post performance of selected divested firms in a sample of four to six countries. As more Bank experience is accumulated over time, CECPS will also prepare Guidelines for Divestiture in FY91. Follow-up studies incorporated in some operations (CAR, Togo, Mali, Niger, and Philippines for example) are recently resulting, or will result, in more detailed assessments of the implementation process.

[5] The factors leading governments to divestiture have been discussed previously in a number of other CECPS papers and are treated very briefly here. Among others, see Mary Shirley, The Reform of State-Owned Enterprises: Lessons from World Bank Lending, PRS 4, World Bank, 1989; John Nellis, Public Enterprise Reform in Adjustment Lending, PPR, WPS 233, August 1989; John Nellis and Sunita Kikeri, "Public Enterprise Reform: Privatization and the World Bank," World Development, Vol.17, No.5, May 1989: Ahmed Galal, Ex-Post Performance of Divested Enterprises, Research Proposal, May 1989.

with revenues from the divestment of PEs, can then be utilized more productively to improve the performance of critical PEs and other economic sectors. Second, divestiture is viewed as a tool to improve PE efficiency.[6] Although the causal link between ownership and efficiency has not been clearly established, it is argued that private owners and managers would increase efficiency by virtue of the incentives provided by clearer and "atomized" property rights systems, and other factors such as less political interference, a hard budget constraint and the risk of effective bankruptcy, and evaluation on the basis of commercial profitability by self-interested shareholders.[7]

8. A variety of other factors have also led policy makers to accord greater prominence to divestiture, including: its potential role in fostering entrepreneurship and capital market development; the relatively limited impact of past enterprise-level reform efforts short of ownership change; the demonstration effects of widespread divestiture efforts in industrialized countries; and its role in reducing the foreign debt of the country, particularly where new owners assume the foreign debts of the PE, or where divestment takes place through debt/equity swaps. Finally, the promotion of "popular capitalism" and the widespread distribution of ownership have also been motivating factors for many governments.

B. MAGNITUDE AND NATURE OF BANK LENDING FOR DIVESTITURE

9. Between 1983 and June 1989, 71 approved operations in 35 countries contained divestiture components (Table 2).[8] Bank involvement is, on the whole, relatively recent: approximately 60% of the operations were approved in 1987 or later; 24 were approved in the past 18 months alone (Graph 1). Slightly over half of all operations are SALs, eleven of which are supported by TALs. Close to 20% of all operations focus exclusively on the PE sector, either for sector rationalization/rehabilitation or as technical assistance support for PE adjustment operations (Graph 2). These usually

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[6] The broader theoretical debate of the relationship between ownership and efficiency has been covered in other studies and is not the focus of attention here. See Richard Hemming and Ali M. Mansoor, Privatization and Public Enterprises, IMF, OP 56, January 1988; Simon Domberger and John Piggott, "Privatization Policies and Public Enterprise: A Survey," The Economic Record, June 1986.

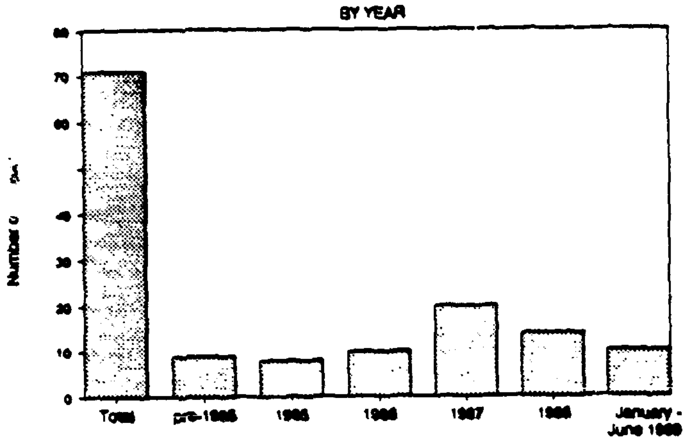
[7] These arguments, however, hold better ground for the divestment of PEs operating in competitive markets rather than monopolistic environments, where a host of other factors complicate the relationship between efficiency and change of ownership.

[8] Several operations with divestiture components are under preparation. These include a large number of SALs in sub-Saharan Africa; private sector development operations in Benin, Congo, Madagascar, and Bolivia; and PERLs in Nigeria, Sri Lanka, and Argentina.

provide more in-depth assistance for divestiture and typically follow a prior history of adjustment lending.

GRAPH 1

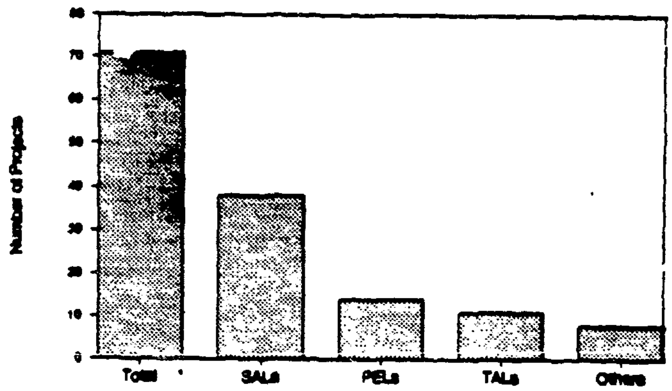
NUMBER OF BANK PROJECTS WITH DIVESTITURE COMPONENTS: BY YEAR



Source: Table 1 of Annex

GRAPH 2

NUMBER OF BANK PROJECTS WITH DIVESTITURE COMPONENTS: BY LENDING INSTRUMENT

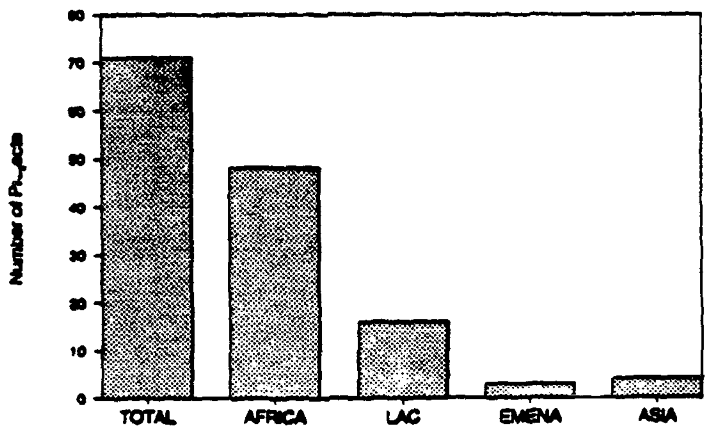


Source: Table 1 of Annex

10. The majority of the operations are found in sub-Saharan Africa (Graph 3). Twenty-one countries in the region account for close to 70% of

GRAPH 3

NUMBER OF BANK PROJECTS WITH DIVESTITURE COMPONENTS: BY REGION



Source: Table 1 of Annex

all loans with divestiture components. Operations are concentrated in a few countries, including Togo, Ghana, Guinea, Niger, and Senegal. The preponderance of Bank involvement in Africa reflects a variety of factors, including the existence of large, overextended, and loss-making PE sectors; pressing public finance and debt pressures in many countries; ready markets for the divestiture services the Bank is most suited to provide (e.g., studies); greater Bank leverage in the region; and the availability of public sector management staff in the Africa operational complex. Prior to 1987, Latin America (LAC) was the only other region with Bank involvement in this field. To date, eight of the sixteen approved operations in this region with divestiture components are found in Jamaica and Panama; Mexico and Uruguay also have significant divestiture components. Bank involvement in the remaining LAC is relatively minor. Since 1987, nine operations with divestiture components have been approved in the Europe, Middle East and North Africa (EMENA) and Asia regions.[9] The PELs in Morocco and the Philippines are the largest in scope. Several factors may limit Bank involvement in these regions, including fewer policy based operations, greater country ability to handle divestiture programs, and resistance to external involvement in this sensitive area.

11. The operations under review provide different types of divestiture support.[10] On a global level, SALs help establish the policy dialogue and framework for reform, and release tranches against the implementation of specific divestment targets. On a more specific level, the Bank supports three main aspects of divestiture. (Table 3 provides a case-by-case tabulation). First, a large number of operations center on laying the foundations for a rethinking of the state policy on PEs, and developing a strategy for reform. Some fifty operations in 28 countries thus support PE studies and audits, classification exercises, and action plans which help: (i) collect essential PE data and assess viability; (ii) decide which PEs should remain in public hands, be privatized (partially or fully), or liquidated; and (iii) establish a time-frame for implementation. Second, a number of operations also provide institutional support to strengthen government capacity for managing divestiture. Some 30 operations help define the organizational structure for implementation, and finance short and long-term technical assistance for a variety of tasks (asset valuation, resolution of

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[9] Many countries have, however, carried out or are in the process of carrying out such reform without direct Bank involvement or project assistance. Bangladesh, Malaysia, Thailand, and Jordan are important examples. In some cases, such as Malaysia and Thailand, Bank staff have conducted analytical work and begun policy dialogue on divestiture.

[10] Bank support for divestiture is usually employed in conjunction with other measures that aim to improve the overall environment within which PEs operate. These include policy and institutional reforms related to credit, financing, pricing, and labor, and government/PE relations. These issues are treated in a separate background paper. See Ahmed Galal, Public Enterprise Reform and the World Bank: Approach, Practices, and Challenges, November 1989, CECPS.

legal matters, preparation of the sale prospectus, identification of partners, and establishment of the regulatory framework after sale).

12. Third, "facilitating" measures to help prepare PEs for divestiture and to help finance the transaction costs are also covered in Bank operations.[11] Minimal support is provided for physical rehabilitation, which is usually left to the new investors for the following reasons: the risks of inflation of the sale price and not necessarily the increase in the value of the PE; the contraction of additional and potentially irrecoverable government investments; and/or a loss in government commitment to sale due to the new conditions.[12] Thus, in Togo and Venezuela, no new investments are to be made prior to divestment; in the Philippines, they must be included in the annual investment budget and taken only where they would lead to a justifiable increase in price and "saleability." But several SALs and PERLs support the financial restructuring of PEs. While such restructuring is usually taken on a sector-wide basis irrespective of divestiture, some loans (such as those in Niger, Cameroon, the CAR, Congo, Guinea, and Mali) support the restructuring of PEs specifically slated for divestiture, including developing action plans to identify and eliminate their arrears and cross-debts. While the Bank does not provide direct financial support for such restructuring,[13] SAL counterpart funds and budgetary resources have been used through restructuring funds to finance associated costs. These funds have also been used to settle employee liabilities, where termination has occurred prior to or after divestiture.

III. AN ASSESSMENT OF EXPERIENCE

13. What have been the quantitative and performance outcomes of Bank support for divestiture? What have been the key problems and issues in implementation? What operational and management issues emerge out of the Bank's lending approach for divestiture? These questions are discussed in the sections below. A few caveats are in order. First, it is difficult o separate Bank-supported actions from those undertaken by governments prior to or

[11] General reforms supporting the "commercialization" of PEs, that are expected to put PEs on a sound footing for eventual divestment, are not considered here.

[12] As part of the general PE restructuring efforts in Bank operations, however, financing may be made available for the rehabilitation of PEs that could be targets for divestiture in the future.

[13]. The International Finance Corporation (IFC), on the other hand, has provided equity investment and loans to privatized companies. IFC has made equity investment in privatized companies in Tunisia, Swaziland, Mozambique, Liberia, Togo, Trinidad and Tobago and Venezuela. In addition, strategic planning advice has also been provided to several other countries.

without Bank support. But as the data are derived from loan documents, they are assumed to have been taken as part of the Bank-supported adjustment program. Second, preliminary performance outcomes are available at this time. They are presented, nevertheless, as the paper is intended to be a review of implementation experience rather than a rigorous assessment of the benefits and costs of divestiture.[14] Finally, the discussion pertains to a wide range of countries with sufficient implementation experience, including the Congo, Ghana, Guinea, Niger, Senegal, Togo, Jamaica, Mexico, Panama, and the Philippines. Thus, there is a possibility that a global review of this sort may mask the specific characteristics of the divestiture program or transactions in a given country.

A. DIVESTITURE OUTCOMES

14. The Quantitative Record. Despite the technical and political complexity of such reform (see below), the record in terms of numbers of divestments is quite large in several countries.[15] (Quantitative results for a selected group of countries is presented in Annex 1.) Jamaica, Guinea, Togo, Mexico, and the Philippines offer cases in point. Guinea, for example, closed some 70 publicly owned units (although a large majority of these are small retail outlets; see below). Togo, Mali, Madagascar and Benin each liquidated 12 to 15 firms. And in the Philippines, five government corporations have been closed. Several examples of ownership change are also available. Jamaica divested over J$500 million of PE assets, exceeding the loan tranche target of J$150 million. Both Guinea and Togo sold a significant number of industrial PEs. In Mexico, as of March 1989, 260 PEs had been liquidated, 180 sold, 70 merged, and 25 transferred to local governments. And in the Philippines, 26 government corporations have been sold (10 partially) at the time of writing. At the same time, countries such as Ghana and Senegal have achieved few results.

15. Performance Outcomes. Preliminary findings[16] offer some early insights. First, while the absolute number of enterprises divested may be quite large, the magnitude or impact of these divestments in terms of total PE

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[14] Research on these issues is currently under way in CECPS for a sample of four countries. See Ahmed Galal, op. cit.

[15] For a survey of world-wide divestments, see Charles Vuylsteke, Helen Nankani, and Rebecca Candoy-Sekse, The Techniques of Privatization of State-Owned Enterprises, Volumes 1, II and III, World Bank Technical Paper No. 89, 1988.

[16] Data are gathered from supervision reports, President's Reports, and other Bank reports.

assets or budgetary transfers may be relatively small. In Mexico, for example, the number of industrial, energy and mining PEs under the Ministry of Energy, Mines and Public Industry (SEMIP) were reduced from 398 to 90 (77%), but they represented 23% of total SEMIP assets (and an even smaller percentage of total PE sector assets) and 20% of government transfers to SEMIP. In Guinea, the bulk of the 70 liquidations represented small and non-operating retail outlets. And in the Philippines, twenty-seven of the 121 government corporations slated for privatization have been completed, although several of them are partial divestments or divestments of non-operating assets (some big divestments have, however, been completed).

16. Second, anecdotal bits of information signal some performance improvements. In Jamaica, for example, the divestiture of the telephone holding company led to a 55 percent increase in outgoing international calls. In Mexico, the divested petrochemical companies increased investments by 75% of gross sales revenues in a three-year period; and turn-over ratios increased. In the auto parts industry, divestiture led to increased technological development and capacity utilization, overall cost reductions, and better management. However, these performance gains must be balanced against other findings. Monopoly rights and other special privileges raise questions about the impact on economic efficiency in some cases (see below). Moreover, the effects of partial divestiture must also be considered.[17] The divestment of majority shareholding through a joint venture or other techniques involving a strong technical partner, partial divestment can be a useful first step in improving efficiency.[18] But the divestment of minority shareholding can lead to few changes in managerial behavior and operational performance. Although not included in the review, the case of Bangladesh is instructive. Government policy of divesting 49% of selected manufacturing enterprises -- through a combination of public share offerings and employee participation schemes -- led to increased revenues and widened share ownership, both important divestiture objectives. However, managerial

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[17] Some operations support the partial divestiture of enterprises that are to remain in the public sector in the medium to long term. These are not considered here. The Philippines PERL includes the sale of tankers in the oil corporation, the use of build-operate-transfer schemes to generate power, and the hiving off of assets of other government corporations. The Jamaica PERL supported partial divestments in the transport sector, including shipping and railways. Examples can also be found of ports and transport companies in Guinea and the Congo.

[18] An analysis of this strategy would be highly worthwhile given its popularity, and could be conducted in the case of Guinea, the Philippines, and the Congo. In Guinea, for example, eleven of twenty-three industrial divestments involved majority foreign participation, with the remaining share capital distributed between private Guinean investors and the government. In the Philippines, ten of the twenty-seven privatizations have been partial, with government retaining minority participation, in the social security system, energy, shipping, and banking sectors. And in the Congo, opening of the share capital of twelve enterprises resulted in majority private ownership. Presumably management control was also transferred to the private sector.

performance and operational efficiency remained unaffected as majority ownership allowed government interference to continue.

17. Third, data on gross proceeds are becoming available.[19] While these may be large in some cases (Mexico, Philippines, for example), the net financial gain for most governments can be small for several reasons: sale, to date, of the smaller, low-value enterprises; the assumption of the domestic and foreign debt, which often outweigh the market value of the assets, by the governments in most cases; the valuation of enterprises without clear methodology; and the use of proceeds to pay large amounts of severance, particularly where overemployment required significant retrenchment.

18. Factors leading to these divestiture outcomes are discussed below. As will be shown, political will and country conditions are no doubt important,[20] but practical issues related to the process of divestiture, the institutional capacity to execute the program in an effective and transparent manner, and the sequencing of divestiture with other reform areas are also critical.

B. PRACTICAL ISSUES IN IMPLEMENTATION

1. Formulation of a Strategy: A Sector-Wide vs Case-by-Case Approach

19. Sector-Wide Approach The sector-wide approach is used when rationalization of the size of the PE sector is the major divestiture objective. The majority of the operations under review -- such as in the

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[19] Some data on gross proceeds are becoming available. In Mexico, for instance, 136 transactions raised Mex$ 796.3 billion (US$ 765 million); and three large transactions in late 1988 generated an additional US$ 1.8 billion in gross revenues. In Togo, ten privatizations yielded direct revenues to the government of CFAF 230 million from the sale of shares and CFAF 1,339 million annually from the leases of privatized companies. The lease arrangements on some of Air Jamaica's equipment resulted in a net foreign cash flow improvement of US$4.58 million in FY87/88. In Guinea, the privatization of cement, beer and central oils alone raised approximately CFAF 8.2 million. And in the Philippines, the divestments to date have raised approximately Pesos 1.2 billion.

[20] Broad country factors -- such as the nature of the political system and varying macroeconomic environments -- have no doubt been influential; and they have been dealt with in a number of other studies. See Simon Commander and Tony Killick, "Privatization in Developing Countries: A Survey of the Issues," in Paul Cook and Colin Kirkpatrick, eds., Privatization in Less Developed Countries, New York, 1988; N. N. Susungi, The Caveats on Privatization as an Instrument of Structural Adjustment in Africa, African Development Bank Research Paper, Cote d'Ivoire, 1988; Samuel Paul, Privatization and the Public Sector: Emerging Issues, CECPS, November 1987;

Congo, Guinea, Mali, Senegal, Togo, Tunisia, Morocco, and the Philippines -- employ such an approach. The classification exercise provides a useful operational tool in helping governments confront the policy issue of which activities should continue to remain in the public sector, and which should be turned over to the private sector or liquidated. Action plans are then established, either for individual PEs or the sector as a whole, followed by implementation.

20. The major advantage of the sector-wide approach is that it addresses the fundamental question of a reorientation of the state's role in economic activities. But the potential political and technical constraints of this approach must also be considered. In most developing countries, natural and de facto monopolies and other "strategic" PEs (such as utilities, railroads, telecommunications, postal services, mining companies, for example) are usually[21] retained in the public sector due to economies of scale, weak regulatory capacity, and/or social welfare and defense concerns. Leaving these aside, cost/benefit analyses and viability assessments would, on economic grounds, indicate that among the commercial enterprises operating in competitive markets the viable (or potentially viable) ones be classified for privatization; and the inefficient, financially insolvent, and unviable ones -- i.e. those which perhaps should never have been created in the first place -- be classified for liquidation.

21. In practice, however, governments have often deviated from a classification based only on economic criteria. This may be due to: (i) the multiplicity of PE objectives; (ii) the large number of actors involved in the decision-making process; and (iii) the sharing among many different groups of the costs and benefits of divestiture.[22] Socio-political factors -- such as employment generation, regional equity, and the continued provision of goods at low prices -- are thus frequently considered, leading governments to make certain trade-offs: to retain firms that are politically strategic though economically unviable; or to attempt the sale rather than closure of unviable firms, given the employment ramifications of the latter. While the economic costs to the society as a whole of continuing to keep inefficient firms alive can be high, governments make these trade-offs to improve the political feasibility of undertaking divestiture. These issues may require a certain amount of flexibility in cases that are particularly sensitive. The case of the cement plant (SNC) in Niger under SAL I is illustrative. The government was proposing a large new investment for the plant that, on technical grounds, was inherently unviable and therefore suited for liquidation. On the basis of demonstrations of the substantial economic costs of making the new investment, and on the basis of the prevailing political pressures, a decision was taken

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[21] But not always. For example, the governments of Mexico, Argentina, and Sri Lanka are considering proposals to divest their telecommunications firms, while mining companies are to privatized in the Philippines .

[22] For a detailed discussion of these points, see <u>The Political Economy of Public Enterprise Divestiture: A Benefit/Cost Approach</u>, by Leroy Jones, P. Tandon, and I. Vogelsang, Draft, June 1989.

to drop the new investment but to allow the plant to remain in operation as long as it covered its variable costs.

22. The process of classifying the PE sector at once can also be technically and administratively demanding, particularly where data scarcities are severe and where the sector is relatively large. While it is true that a number of PEs can be easily classified without detailed analysis, several PEs may require careful viability assessments prior to reaching a decision. Many of the developing countries lack the data or the technical resources required for such analyses.

23. Given the political nature of the sector-wide approach, and the potential technical difficulties, classification can be a two-year process. Where government commitment is high or where a relatively small number of enterprises are to be classified, the process has, however, been shorter (Niger and the Congo, for example). And where ideological and political factors have been particularly prevalent, or where the sector has been particularly large, the process has been longer (four years in Senegal; three years in the Philippines).

24. Greater emphasis may be placed on reaching agreement with governments on the criteria or broad principles of classification, rather than on the nuts and bolts of the classification itself. A strong argument in favor of this is the fact that classifications change over time, as a result of changing political, economic, and enterprise conditions, or as a result of previously ill-conceived decisions. In the Philippines, for example, several reconsiderations have been made in the original classification. The first classification in Togo resulted in the retention of a large number of financial institutions and commercial PEs; this was subsequently modified to classify them for divestiture. Similar instances have prevailed in other countries. In short, precious time and effort may be wasted on reaching agreement on a full classification, only to have it changed the next time around.

25. Case-by-Case Approach. A few operations -- in Panama, Honduras, Costa Rica and Malawi, for example -- focus on a case-by-case approach to divestiture, selecting individual PEs for divestment without directly considering the rationalization of the PE sector as a whole. The case-by-case approach has the advantage of easily and quickly targeting critical PEs for divestiture without going through a potentially lengthy and controversial classification exercise. The choice of PEs is particularly important. Where big and important PEs are selected for divestment, such an approach can lead to significant efficiency and fiscal gains. Where the enterprises selected are small and marginal, an over-emphasis on a case-by-case approach, without addressing the underlying issues of sector rationalization or overall efficiency improvements, can yield minimal benefits. In Panama, for example, five smaller PEs were selected for divestiture. Similar experiences in Benin and Gabon led to the follow-up of case-by-case approach with a more global divestiture strategy.

26. A Combined Approach. Some Bank projects proceed with classification and case-by-case implementation simultaneously, recognizing that governments need not wait to complete the accounting for the entire sector before it begins with the divestment of individual PEs. The strategy of treating sector-wide rationalizations as a longer-term exercise, with operational targets focussing on the immediate divestment of carefully selected, priority candidates, is both operationally expeditious and outcomes oriented. The Jamaica PE loan, for example, successfully employed such an approach. The immediate divestment of PEs (among them Air Jamaica, Jamaica Broadcasting System, a shipping company, and a few smaller enterprises) carefully selected to obtain short-term fiscal relief was supported under the loan, although within the context of a longer-term strategy to consolidate and classify the entire sector for future rationalization.

2. The Process of Divestiture

27. Selection and Sequencing of Candidates. The selection of the initial candidates is critical to the success of the divestiture program. The most logical and expedient approach is to begin implementation with the divestment of commercial PEs operating in competitive markets, while leaving the more complex cases (quasi or full monopolies) for the second stage. The reasons for this are many: (i) such candidates offer greater chances of initial success, a critical factor for the future of the divestiture program; (ii) the divestments are technically relatively simple, providing a useful learning curve for governments; and (iii) they avoid complex regulatory and distributional issues. Viable and profitable candidates, in turn, are likely to have the greatest chances of success. The strategy of selecting "winners" as first candidates paid off in the Philippines, for example, where the early divestment of banks and real estate companies provided an impetus to the program. Similarly, early successes were registered in Guinea and Togo by the divestment of beer, cement and airline companies have elicited the desired supply response and fetched a good price.

28. Nevertheless, some countries, especially those experiencing implementation problems, display the tendency of selecting the smaller and less attractive PEs for immediate sale. Senegal, Morocco, and Ghana are examples where ideological and socio-political factors, and the reluctance to privatize firms which generate revenues for the government, affected the choice of initial candidates and delayed implementation. In Senegal, the more interesting firms were excluded from the divestiture list. Moreover, the selected candidates (26) represented only 2% of state participation in the sector. In Morocco, only three of the 106 PEs classified for divestiture were selected for immediate sale; several competitive or potentially competitive

PEs in construction and transport remained in the public portfolio.[23] The selection of the smaller and practically defunct PEs for liquidation is also evident in some countries. In Guinea, the large majority of the 70 liquidated PEs were non-operating retail outlets. In Mali, the CAR and Congo, the closed PEs represented small bookstores, yogurt factories, and banks.

29. Poor sequencing of divestiture candidates can lead to negative results. First, potential investors may demonstrate little interest in acquiring unviable and loss-making PEs, delaying the pace of the program. Or purchasers are interested in only buying them with concessions and special privileges that produce efficiency-limiting distortions in the long run (see below). Second, PEs in poor condition could require prior restructuring if a good price is to be achieved. This takes time and money. Third, the net costs of selling inefficient PEs as going concerns, when in fact they should have been liquidated and assets disposed separately, can be high in terms of time spent in arranging satisfactory sale or management contracts for firms in poor condition, the future viability of the operation and continued government bail-outs, and the better use of resources elsewhere in the economy. Finally, the expected fiscal and efficiency gains are not likely to be derived from closing or selling the small and low-value PEs in the commercial sector, although the long-term financial and administrative costs of keeping even the smaller PEs alive justify their divestment.

30. Specifying Techniques. Bank operations do not specify in advance the technique of divestiture, except in the broad sense of "liquidations" and "privatizations." The choice of divestment techniques is thus left to the government. While this is indeed a good strategy, given the need for flexibility and consideration on a case-by-case basis, the lack of guidance on the broad criteria for selecting specific divestiture options have led to implementation problems where the fit between the selected techniques and prevailing country conditions is weak.[24]

31. Governments propose or utilize a variety of techniques. Where an enterprise is to be sold, sale as a going concern and public share offerings are most frequently proposed. The latter is used as a tool to broaden share ownership -- increasing its political attractiveness -- and expand local capital markets. Examples of sales as going concerns are found in most of the countries under review (Panama, Guinea, Congo, Togo, and the Philippines, for example). Public share offerings are found in Jamaica (National Commercial Bank) and the Philippines (Philippines National Bank), although they have been carried out in a large number of countries not under review.

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[23] At the same time, a 1989 draft law has been submitted by the King for parliamentary debate and approval; it proposes that all but six priority PEs will be divested over time.

[24] See Charles Vuylsteke, op.cit, for a detailed discussion on the choice, requirements and uses of divestiture techniques.

32. However, in some sub-Saharan African countries, sale as a going concern may be difficult in view of weak local private sectors, government-imposed restrictions on buyers, and the poor condition of most of the PEs chosen for sale. In such instances, liquidation followed by sale of assets may be most appropriate, although governments have sought to avoid this solution in the case of large and operating PEs for political and employment reasons. The mis-fit between country conditions and the politically preferred method of public offerings has also delayed implementation in a few instances. A prime example is Senegal, where past insistence on this technique, despite an embryonic capital market and weak financial institutions, poor financial performance and long-term prospects of the selected PEs, and the absence of technical expertise, was one of the factors contributing to the lack of movement on the divestiture side of the PE reform program.

33. Where full sale is difficult for whatever reason, divestment of management has taken place through the use of management contracts and leases.[25] Examples of the former may be found in service industries such as hotels and airlines in Togo, Niger, Jamaica, Guinea, and the Congo. Lease arrangements have been concluded in for the dairy and steel mills, and an oil refinery and storage enterprise in Togo, for example. Prior specification could be beneficial in countries lacking the conditions for other divestiture techniques, resulting in less time spent trying to arrange satisfactory sales. Few operations specify franchising and the contracting out of services as alternatives to ownership transfer, which may also be viable options where sale is ruled out. Traditional or sector specific projects may, however, contain such measures.

34. Meeting the Costs of Divestiture. The costs entailed in the process of divesting the larger firms can be quite high. Delays have been encountered in some countries due to difficulties in obtaining funds to pay creditors; the Congo, Ghana and Togo are examples. Where foreign debts are high, the problem is even more acute. At the same time, debts have often been assumed by the governments to move the liquidation or sale process ahead (the budgetary costs are another matter). Employee liabilities, however, must be paid, where retrenchment takes place prior to sale (as most private investors want to avoid taking such actions themselves) or as a consequence of liquidations. Notwithstanding the political difficulties of employment reductions, the lack of budgetary resources for severance pay has been an obstacle in a few instances. Ghana is a prime example. The cost of laying-off 5,000 staff in 28 PEs amounted to approximately 2 billion cedis (in 1987). This large sum reflected the generous severance and retirement benefits for involuntary departures in the labor union agreements since public pension schemes are inadequate. (This is a major labor issue, however, and not just a divestiture issue). Combined with the fact that the public pension programs were underfunded, this resulted in delays in retrenchment and in the overall divestiture program.

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[25]. See Sven Hegstad and Ian Newport, Management Contracts: Main Features and Design Issues, World Bank Technical Paper No. 65, July 1987.

35. While the Bank cannot provide direct financial support for the settlement of liabilities, some countries have used SAL counterpart funds (and funds from other donors) to settle liabilities, despite the reluctance on the part of the Bank to use such funds for unproductive purposes. Guinea, Mali, Sudan, and Niger are examples. Other financing mechanisms have also been devised to help speed up the settlement of employee liabilities. Operations in Ghana and Madagascar, for example, establish Divestiture Accounts to handle the proceeds from the sale of assets, part of which goes toward resolving PE liabilities. However, the lack of seed money and completed sales has meant that these funds have remained empty, thereby minimizing their effectiveness. Restructuring Funds have been set up to support severance payments in Mali, Niger, Guinea, Togo, and Tunisia, for example. There is as yet no evaluation of how these have worked.

36. Granting Special Privileges. Monopoly rights, favorable financing terms, and protection from imports have been granted in some instances. These have often been outside the import tariff structure and investment code established as part of the overall reform program. In Guinea, for example, six of the fifteen completed transactions accorded the purchasers more favorable terms than those foreseen under the new Investment Code. The cigarette manufacturer received a monopoly on both production and imports; the soft-drinks company obtained an eleven year monopoly on the sale of Coca Cola and other soft drinks, plus a limit on the production of its competitors; and the match company received a ten year monopoly on production, with no minimum tax for five years. In addition, subsidized loans were granted to finance working capital needs, and assets were sold at low prices repayable in local currency without interest over a long-time period. In Togo the leased steel mill (STS) obtained government obligations to repurchase at book value any new investment made by the lessor during the lease period, and duty free imports of raw materials, machinery and equipment. Similar concessions were granted to the other privatizations in Togo as well.

37. The issue of special privileges is a complex one. Governments, deal-makers, and purchasers argue that concessions have been necessary to attract and compensate investors (both foreign and domestic) for high-risk situations and poor asset conditions ensure the future profitability of the firm, and generate downstream effects in the long-run by balancing special privileges with special obligations (to support local production of raw materials in Guinea, for instance). But while high levels of protection can yield financial improvements, they risk creating new sources of economic inefficiency and distortions. While it is still early to assess the full impact -- i.e. whether private owners are using the resources more efficiently, whether privatization has led to greater competition, and whether prices have changed -- the net economic impact of such transactions, and of the poor balance between divestiture and liberalization, is a critical issue that requires further study.

38. Subsequent bank operations have responded to these concerns. Togo SAL III and Guinea SAL II call for agreement on a timetable for reviews/amendments of special privileges granted in previous deals, and the elimination of monopoly and other special privileges granted to privatized

enterprises beyond the provisions of the new Investment Code. In Guinea, a National Investment Commission has been set up to ensure that future agreements remain within the framework of the Investment Code. The Commission will receive TA from the proposed Second Economic Management project. More recent operations emphasis on ex ante rather than ex post measures to prevent such transactions.

3. Managing Divestiture: Institutional Arrangements and Capacity

39. Decentralized vs. Centralized Arrangements. Almost all of the countries under review have created high-level committees to undertake the strategy, policy guidance, approval, and monitoring functions. These committees usually comprise of key ministers and representatives from other parts of the government and, sometimes, the private sector. Two different institutional strategies for handling operational or implementation functions have been followed: delegation of these functions to sector ministries and holding companies, or their centralization in a single focal point. In part, the choice depends on the scope of the reform program; in part, it depends on the prevailing institutional set-up for PE reform.

40. A number of countries (such as Tunisia, Guinea, Uganda, Panama, Jamaica, and the Philippines) have delegated these tasks to sector ministries or holding companies on the assumption that they are in the best position to evaluate the condition of the PE and propose a course of action, or given the large scope of the program. In some cases, these decisions have been de facto, evolving from the absence of a central institutional set-up for overall PE reform or, conversely, given the strengths of a particular ministry. Such an approach works well where sector ministries and holding companies are committed to reform, where they have (or have access to) technical expertise, and where there is some central mechanism capable of providing advice, support and momentum to the program. In Tunisia, for example, the process has apparently been highly satisfactory, with a minimum of duplication and time loss and good guidance by CAREPP, the central policy committee. In the Philippines, National Development Corporation moved rapidly in divesting its enterprises. And in Chile, the technical ability of CORFO (the holding company accounting for the bulk of state holdings) led to successful divestment of a large number of enterprises. In these instances, the availability of good technical expertise and commitment were critical factors in success.

41. On the whole, however, the involvement of several different implementing units has led to: (i) unevenness in pace and approach; (ii) the lack of consistency in deal-making practices; (iii) the spreading of scarce technical skills thinly across several implementing units; and (iv) inadequately specified lines of authority and institutional conflicts, and the inadequate functioning of the coordinating committee. Moreover, bureaucratic and political resistance on the part of sector ministries to divest their portfolios and thereby sacrifice rents, power, and control, combined with a reluctance of PE managers to assume greater responsibility and accountability and give up job security, have, in some instances, been impeding factors. In

short, vested interests and other factors have hampered quick decision-making and overall coordination.

42. In Guinea, for example, while the Ministry of Industry moved quickly and dynamically to privatize a large number of enterprises, the interministerial committee originally charged with providing strategic divestiture guidance instead became involved in operational tasks. Moreover, its lack of executive authority over the ministries weakened the decision-making process; sector ministries were able to bypass the committee in obtaining approval for deals that were conducted in an ad hoc manner. Similarly, the exclusion of the Ad Hoc Secretariat from the divestiture dialogue in the Congo led to legally contestable transactions concluded by the "tutelle" ministry. In the Philippines, poor coordination among the numerous implementation units on bidding procedures led to a loss of credibility at the start of the program.

43. The centralization of decision-making in divestiture "focal points" has been seen by some governments as a way to rectify some of these problems, achieve greater speed and coordination in implementation, and preempt patronage. Other institutionally specific factors have also been considered in the setting up of such units. In Ghana, for example, the Divestiture Implementation Committee and its technical arm was established as a focal point partly for these reasons, but also as a compromise between the competing State Enterprises Commission and the Ghana Investment Center, both of which wanted to manage the divestiture program. The Ministry of State Enterprises serves as the focal point for all divestments in Togo. Similar units have also been established in the Gambia and Madagascar. Countries with predominantly decentralized arrangements have also set-up central bodies. In the Philippines, for example, a central coordinating team has been established to set uniform marketing and bidding strategies, oversee implementation, and centralize information (all of which were problems under a purely decentralized arrangement). Similarly, in Mexico, the PE Sales Unit in the Ministry of Finance was strengthened to counter balance the lack of transparency resulting from decentralization.

44. Focal points are most effective where: (i) they are small and staffed with high quality people with a range of contacts, clout, experience, and adequate skills; (ii) there are safeguards to ensure that members abide by formal procedures for the divestment of state assets; and (iii) the responsibilities of the central unit vis-a-vis those of the different ministries are clearly delineated. In the absence of these conditions, they can become characterized by bureaucratization, the lack of transparency from the concentration of power, or the exclusion of the central unit from the divestiture process. In Madagascar, for example, the Ad Hoc Committee for Divestiture (CAH) was initially created to ensure openness and a competitive atmosphere in implementation. But its role has been reduced to a technical advisory function for only a few divestiture actions. Moreover, responsibility for the liquidation aspect of the program was transferred from this body to yet another one.

45. One issue transcends those related to the official organizational structures set up for divestiture. Bank staff indicate that in

several cases the official institutional arrangements have not been effective in surmounting the tendency to centralize all decision-making powers at the highest levels, and not to delegate to lower levels. While such decision-making patterns are beyond the Bank and are broader issues of overall public administration, Bank operations have, at best, tried to provide the formal institutional structure for divestiture.

46. Adherence to Formal and Legal Procedures. A number of countries (Ghana, Philippines, Togo, Madagascar, Venezuela, Morocco, and Tunisia, for example) have set divestiture guidelines prior to implementation, clarifying the institutional arrangements and processes for managing the reform, establishing rules and legal requirements for liquidation and the disposal of assets and/or shares, and enunciating the need for transparency and objectivity in bidding procedures. Early evidence indicates, however, that these procedures have been ignored or bypassed in some cases. In the Congo and Benin, for example, PEs were closed without formal authorization; in Guinea, the legal framework for the sale of the assets of the liquidated firms was bypassed.

47. In the case of sales, while experiences vary widely, concern has been expressed about the ad hoc nature of the procedures and the lack of transparency. Some early sales in the Philippines were characterized by inconsistent decisions regarding the minimum number of bids and swap conditions. Divestiture has come to be viewed as a way to enrich well-connected individuals. Moreover, in several countries, sales have been made to dubious purchasers; i.e., ruling party politicians and other "well-connected" individuals lacking in business experience and technical expertise (Panama, Guinea, Congo). In Madagascar, the more attractive PEs were disposed of privately without public tendering. In Panama, one PE was originally sold to a shell company comprised of a group of ruling party politicians. The company went bankrupt and was repossessed by the Agriculture Development Bank, which subsequently auctioned off the assets piecemeal.

48. A certain measure of flexibility may be required on a case-by-case basis to forestall bureaucratic delays. But the overall disregard for formal procedures and the resulting lack of transparency raise serious concerns for both the Bank and divesting governments. Despite the fact that the Bank does not and cannot control the divestiture, the association of all divestiture actions with the Bank-supported adjustment program can make the Bank an easy target for blame, leaving the institution with a bad name and with the charge of ideological bias. And, the chances of future success are jeopardized. In response to these concerns, Bank operations are emphasizing the need to: (i) focus attention on the divestiture strategy, rather than on specific deals; and (ii) tighten, systematize, and render transparent divestment procedures. In the Congo, for example, the PE ID project is financing an international investment bank to establish and strengthen the a priori rules and procedures for asset disposal. And operations in Benin, Gabon, CAR, and Mexico call for the design of standardized procedures prior to implementation. Simultaneously, the enforcement of the procedures is expected through strengthened institutional arrangements.

49. *Technical Assistance*. Divestiture requires technical expertise of a type often not found in borrower governments or even local private sectors in some countries: accountants, lawyers, and financial analysts, for example. These skill shortages, in addition to the lack of highly specialized skills such as investment banking, can lead to major implementation delays. Poorly paid public officials rarely have the expertise in the highly technical aspects of some types of divestiture. The slow staffing of the Divestiture Implementation Committee (DIC) and its technical sub-committee in Ghana was a key factor delaying the attainment of SAL II divestiture targets, for example; similar circumstances apply in Senegal and elsewhere. Moreover, poor access to external resources and inadequate linkage with the stock exchange leave important issues such as pricing, timing, and size of issue either sidestepped or not fully understood by the implementing parties.

50. Thirty of the 71 operations finance TA to strengthen the capacity of the managing institutions to execute divestiture targets in a timely and effective way (Table 4). The majority of these operations provide assistance for preparatory activities (enterprise audits, classification exercises, and the development of action plans). Some twelve operations finance assistance for specific implementation tasks, including legal matters; pricing issues; negotiating the terms and conditions of the sale, management contract or leases; identification of private partners; and regulation after sale. These operations are found in countries in which the scope of reform is relatively large: the Congo, Madagascar, Gambia, Ghana, Togo, Uganda, Morocco and Venezuela, for example. The remaining operations either use unallocated funds from existing TA, or provide no TA at all. This could reflect a variety of factors: the small scope or early stage of reform in these countries; the availability of grant money or assistance from other donors (USAID and Asian Development Bank in Philippines, USAID in Jamaica, for example); time and resource constraints in the preparation of new projects; and country resistance to external involvement in this politically sensitive area.

51. Bank staff face certain difficulties in designing and implementing TA for divestiture: (i) identification of qualified yet affordable technical assistance in this new lending area;[26] (ii) the time-pressures in taking loans to the Board; and (iii) the often long lag between operations (in Senegal, for instance, where specific institutional needs have been identified, but there is a potential lag between TAL II, which has been extended, and the proposed Parapublic III project, the preparation of which has been delayed due to the lack of staff resources.) The poor quality of technical assistance has, in some cases, contributed to implementation delays (Senegal and Ghana, for example).

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[26] The cost vs quality dilemma is often posed: specialized firms (merchant and investment banks, for example) are most qualified to undertake privatization tasks but they demand high fees. Moreover, they may be difficult to involve given weak investment opportunities in many of the less developed countries. At the same time, their services are perhaps less critical, and more easily replaceable by qualified individual consultants, in smaller countries which are not selling in international markets.

4. Financing Divestiture

52. A crucial factor in many countries is the relatively limited capacity of the indigenous private sector and local capital markets to respond to divestiture. Poor domestic resource mobilization, a weak tradition of local equity investment, low investor confidence, overvalued and unstable exchange rates, and financially strapped banking systems have led to potential financing constraints, particularly in the case of the bigger privatizations. This combination of factors has led to foreign participation in a number of countries. In Guinea, for instance, foreign partners obtained majority ownership in fifteen industrial enterprises including tobacco, beer, and cement; and in Togo, 70% of the share capital of newly divested enterprises is foreign. However, the restrictions on certain purchasers (foreign and certain local groups), combined with limited local capacities can be a major bottleneck to the implementation of larger divestments.

53. The question of financing mechanisms for divestiture has been directly addressed in only a few Bank operations. In Togo, technical assistance is provided to the Ministry of Economy and Finance under the Enterprise Development project to establish a Mutual Investment Fund. As a financial intermediary holding and issuing shares to individual and institutional investors, the Fund is expected to play a key role in facilitating the participation of Togolese investors in the privatization process and in deepening financial markets. In Morocco, technical assistance is provided under the PERL for advice on stimulation of the stock market, introduction of new financial instruments and promotion of brokerage institutions. (Assessment of the effectiveness of these experiments is lacking.) And in Senegal, an Investment Fund is being set up to address financing issues. The majority of operations, however, pay minimal attention to developing innovative financial instruments -- such as debt/equity swaps and the use of government bonds, strengthening the ability of banks and other financial institutions to sell shares and subsequently transfer them, utilizing pension funds, tapping cross-border investments and setting up schemes nationals residing abroad, developing employee participation schemes and so on -- that are particularly critical as the larger and more complex divestments come to the implementation stage. The Cofinancing and Financial Services Department (DFS) has begun work on this topic and is proposing to accelerate its work program on the use of debt/equity swaps in privatization.

5. Divestiture and Labor

54. The resistance of labor to divestiture is often posed by governments as a serious obstacle to divestiture. Of course, labor concerns are not just a divestiture issue. They are also related to the broader adjustment measures of public sector rationalization and public expenditure

reform. Indeed, these latter measures may generate greater labor opposition than that directly attributable to divestiture. Nevertheless, labor opposition can indeed slow the pace of the divestiture program, particularly in countries where past employment and pay policies have granted job security and relatively high wages to large and excess numbers of employees and where there is an absence of alternative employment opportunities elsewhere in the economy. Other countries have, however, found ways to mitigate labor opposition. In the Philippines, for instance, where overstaffing has been less of a problem, 80% of the workers were rehired by the divested companies. Generous severance packages were provided to the laid-off staff. Similar experiences have been recorded in Panama and Malaysia.[27] In Mexico, employment concerns were ameliorated by the early involvement of workers unions, who became partners in eleven of the newly divested companies. Other countries such as Bangladesh and Malaysia have minimized the potential negative impact of restructuring by reserving shares for disadvantaged groups.

55. The employment ramifications of liquidations, in particular, have been high. In Benin, for instance, 3,000 employees of liquidated PEs became unemployed; in Mali, 700 employees have so far been terminated; and in Tunisia, the liquidations to date have involved 1,600 lay-offs. Training and Redeployment funds have been established to soften the social impact of adjustment (including divestiture) in several operations. For example, a reinsertion fund has been established under Senegal SAL III to ease the transition of laid-off workers and to provide resources for small-scale projects in agriculture, industry, fisheries, commerce and services. Similar programs are employed in Mali, in Ghana -- where, in addition, divested state-owned land is allocated to retrenched workers -- and Benin. Togo SAL III finances studies of staff reconversion and retraining programs and alternative sources of income and employment such as employee/management repurchase of enterprises through leverage buyouts, and/or lines of credit to assist in the start-up of small businesses.

56. While it is still too early to assess how these have worked (indeed, any assessment goes beyond the narrow issue of divestiture), scanty evidence indicates that such funds, while they may help alleviate the short-term adjustment problems by providing severance pay and retraining, are likely to achieve little if the overall macroeconomic situation is poor, if the local private sector is small and lacking in dynamism, and unemployment rates are

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[27] In the privatization of the Port Authority in Malaysia, for example, the workers were given three choices: (i) they could opt to terminate their employment and receive severance pay; (ii) they could opt to join the new company, but remain as employees of the Port Authority; (iii) they could opt to terminate their employment with the Port Authority and become employees of the new company, on terms no less favorable than those currently enjoyed. Ninety-nine percent of the workforce opted to join the new company, reducing the Port Authority's payroll by almost 900 workers. At the same time, the new company gained concessions: lifetime job security was no longer guaranteed, and compensation and promotions would be linked to work performance. See Roger Leeds, Malaysia: Genesis of a Privatization Transaction, Harvard University, December 1988.

already high. Thus, measures to address the social costs should also focus on the creation of jobs in the overall economy and on the identification of substitute jobs in other sectors (which may, obviously, be a rather long-term matter). The situation is not hopeless. In the Gambia, for example, participation by public employees in the redeployment program was low, reflecting good absorption rates by the private sector due to buoyant economic growth. And in Guinea and Niger, employees of liquidated banks were rapidly redeployed in the private or public sector where specialized skills such as accounting were in short supply. Nevertheless, in view of the importance of these issues, more research is required on developing adequate incentive packages for lay-offs specifically through divestiture and tracking of the laid-off employees.

C. SELECTED MANAGEMENT ISSUES FOR THE BANK

1. The Lending Instrument: Timing and Sequencing

57. The process of divestiture has been more time-consuming and institutionally intensive than originally anticipated. The political economy of such reform, combined with the technical complexity of design and implementation, imply that overall PE sector rationalization is a relatively long-term process and one that requires support over a mix of operations that simultaneously provide the needed policy and institutional support. To date, quick-disbursing SALs have been commonly utilized as vehicles for such reform. Indeed, SALs play a critical and necessary role, providing the needed leverage and encompassing macroeconomic policy reforms without which the supply response to and expected benefits of divestiture may be minimal. Sales and management contracts, for example, would have little efficiency impact under distorted pricing and trade policies, and foreign exchange allocation systems. In short, liberalization, simplification of the regulatory framework, and increased commercialization of the PE sector as a whole -- all typical elements of a SAL package -- are critical to creating the appropriate environment for the efficient operation of the divested companies. At the same time, SALs are not sufficient for divestiture reform in view of the commonly acknowledged problems of the: mismatch of time-horizons and their fast-disbursing nature; inability to provide longer-term institutional support for implementation; high political visibility; and focus on quantitative targets. In short, SAL emphasis on speed and quantity can lead to undesirable negative results. While these shortcomings have been overcome by stretching out reform over successive SALs and utilizing TALs to provide the needed institutional support, the greater use of loans focussed on the PE sector -- including PE SECALs and PERLs -- and the development of more innovative, slow-disbursing facilities would be critical to providing more in-depth support for divestiture.

58. The question of sequencing divestiture with other reforms is also important, particularly in the case of monopolies and in countries where the conditions for divestiture are lacking. Poor macro or industrial

strategies, inadequately developed capital markets, and the preponderance of poorly performing PEs have increased the risks of implementation failure and led to potentially negative economic consequences. Given these factors, divestiture constraints have been (or could be) particularly difficult in sub-Saharan African countries, although, ironically, it is these countries in which the Bank has most frequently proposed such reform. Reform measures to commercialize PE operations -- including promoting financial discipline, reforming labor laws, providing more autonomy in pricing and other operational decisions -- can, in these countries, play a critical role in screening the most viable candidates for future divestment and putting the most inefficient ones out of business, even without the politically painful medicine of divestiture. In Togo, for instance, broad policy limits on government expenditures and other financial discipline measures had the effects of employment reductions and PE closures, both of which facilitated the implementation of the divestiture program.

2. Design of Divestiture Conditionality

59. Approximately 42 of the 71 operations specify the divestment of PEs as a condition for the release of funds (Table 5). Is such conditionality appropriate and what have the outcomes been?[28] Different strategies have yielded different results. Divestment actions fall on a continuum ranging from "hard" to "soft," varying in the type of actions to be taken and their levels of specificity. At the "hard" end, approximately ten operations require(d) the divestment of specific PEs to be completed in time for tranche disbursement (Guinea, Togo, Congo, and Panama, for example). While the use of conditionality for the completion of liquidations can be relatively less problematic, setting hard targets for sales and management contracts has proved to be counterproductive for several reasons: (i) unrealistic or specified deadlines could give investors unfair advantages in bargaining on both the sale price and special concessions; (ii) complex transactions, requiring the settlement of a range of sensitive issues, could be hastily concluded over the short tranche periods; and (iii) factors beyond the control of government can delay completion and jeopardize overall SAL success. Conversely, the pressure to make the numbers look good can lead to "quick and dirty" deals.

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[28] The broader issue of the compliance with conditionality is not addressed here. Most countries tend to meet the quantitative targets set out in the reform program. Few if any loans are canceled for non-compliance; and only a handful of cases postpone seriously tranche release. Practically all supervision and tranche release reports use phrases such as "substantial progress achieved," "subsequent projects expected to accelerate the program," "in accordance with intent of conditions," and "conditions have been satisfactorily met." In cases of difficulty, unmet conditionality is simply rolled over into action plans under subsequent SALs.

60. Consequently, some loans adopt(ed) broader quantitative targets, requiring governments to divest a certain amount of PE assets, with the choice of specific PEs left to the government. In Jamaica, for instance, the conditionality required the divestment of "at least J$150 million" of total PE assets; in the Philippines, second tranche conditionality called for the completion of all steps to get 30 PEs in a "vendible form", representing at least 20% of the gross value of assets to be privatized. Such targets are, however, relevant only in cases where there are a relatively large number of PEs for divestment (as was the case in both Jamaica and the Philippines). Where there are but a few PEs for divestment, quantitative targets can be tantamount to specifying the divestment of individual PEs.

61. For these reasons, recent Bank loans appear to be moving toward "softer" targets focussing on the initiation and completion of the procedural steps required prior to actual divestment. Such conditionality, it is argued, focusses on the "best efforts" of the government in moving toward sector rationalization, rather than on the achievement of specific targets that are difficult to define and supervise. Thus, some twenty operations require the "initiation" of divestment procedures, specifying, for example, that: enterprises be "brought to the point of sale" and/or offered for sale; the search for potential investors be established; and the institutional set-up for implementation be put in working order. Experience with this approach has yet to be determined. While it resolves the difficulties associated with "hard" targets, the trade-off is that it may result in all but the final -- and most meaningful -- action. For instance, a condition of SAL III in Senegal was that enterprises be offered for sale. While this was done, none of the enterprises have yet been sold (although it is not clear that the sales would have occurred had the conditionality been harder).[29]

3. Monitoring and Evaluation

62. Support for divestiture, particularly where the scope of reform is large, can entail a significant monitoring and evaluation burden on Bank staff, so much so that it is ineffectively done. In Togo, for example, the initial leasing arrangements of the steel mill were not carefully examined by the Bank, although today much concern is voiced about the long-run costs of this arrangement to the country.[30] In the case of Guinea, one Bank staff member indicated that infrequent and superficial supervision led to the Bank being "taken by surprise" at the generous terms and conditions granted in the divestments. Supervision difficulties arise from the: (i) reluctance of governments to involve the Bank staff before specific transactions are completed; (ii) tight staff resources vis-a-vis the time required to follow-up

[29] The difficulties of designing divestiture conditionality are also covered in John Nellis, Public Enterprise Reform in Adjustment Lending, PPR, WPS 233, August 1989.

[30] See Togo, SAL I, Program Performance Audit Report, Report No. SecM88-876, July 22, 1988.

on individual transactions; (iii) lack of expertise to assess specific transactions (industry specialists, experts in regulatory economics, etc.); and (iv) complexity and/or the relative position of the component in the overall adjustment program, leading to prioritization in supervision missions.

63. With growing operational experience and the maturing of Bank projects, supervision reports are covering the divestiture component in greater amount of detail. Valuable information is provided not only on the numbers of enterprises divested but also on the type and value of assets being divested, the amount of revenues raised through sales, the extent of foreign participation, and the institutional procedures in implementing reform. In the Philippines, a regularized monitoring system has been established under the PERL so as to ease the supervisory burden at the Bank's end. The importance of adequate monitoring and *ex post* evaluation cannot be overemphasized, particularly in the case of the larger programs yielding potentially big efficiency gains. Togo SAL III, for example, supports a reassessment study of the divestiture program to date. Similar studies and reviews are also supported in Niger, CAR, and Mexico.

IV. CONCLUSIONS

64. The above analysis demonstrates the following conclusions regarding the use, in Bank operations, of divestiture as a tool of PE reform. Since Bank support for divestiture may be construed as involvement in the internal politics of borrower countries, and since the political and economic conditions vary from country to country, a fundamental conclusion of this study is that the Bank cannot use a single design and implementation blueprint for all countries. Bank operations should be flexible, paying careful attention in strategy formulation to prevailing country conditions.

65. In addition to the need for country specificity, other conclusions and suggestions for improving the design, implementation, and management of Bank operations supporting divestiture are offered. First, while there have been a relatively large number of divestments in several cases, the divestiture actions have not have yielded the full potential of the expected fiscal and efficiency gains. In some cases, they may, in fact, have led to negative consequences. Several factors account for these results: (i) the divestment of predominantly small- and medium-sized enterprises that are neither the biggest portion of the financial burden on the government nor a likely source of significant sales revenue; (ii) the use of partial divestments of commercial PEs operating in competitive markets for strategic and other reasons that could lead to continued government interference and few improvements in operational efficiency; (iii) the assumption by governments of liabilities that are often higher than the sale price; (iv) the granting of special privileges and monopoly rights to attract new investors, which create new sources of inefficiency.

66. The lack of significant outcomes can be traced in part to the political constraints facing member governments. In part, they can be traced to weaknesses in design and implementation of the reform program. Improvements in the divestiture process would therefore seem desirable, with greater Bank involvement in specifying clearly the criteria or principles for the: (i) selection and targeting of candidates and techniques, taking into account country conditions (use of management contracts and joint ventures where outright sale is difficult, for example); (ii) preparation of PEs for sale, including financial restructuring, shedding of excess labor, and managerial improvements; (iii) development of appropriate methodologies for asset valuation; (iv) resolution of outstanding liabilities of the PEs to be divested, particularly the larger ones; (v) deal-making process, including competitive bidding, avoidance of special privileges and concessions, etc; and (vi) liquidations of enterprises where sales have proved difficult.

67. Second, the bulk of Bank involvement to date has taken place in sub-Saharan Africa. Clearly, the scope for the divestiture of the small- and medium-sized commercial enterprises exists in these countries. But the combination of distorted macro environments, weak local private sectors, and inadequate institutional capacities demonstrate that Bank operations pay particular attention to the sequencing of divestiture with other macro and PE sector reforms in this region. Thus, the divestiture of some PEs, especially those of large PEs being divested into monopolistic or nearly monopolistic markets, is best coordinated with the removal of existing distortions and the creation of the necessary regulatory and institutional framework. Moreover, strict financial discipline and commercial policies would also result in the closure of inefficient PEs without having to go through the politically painful steps of outright liquidations. In short, the best policy in some cases may be to create the appropriate environment for the efficient functioning of PEs, and avoid an overemphasis on divestiture *per se*. Ownership changes are only *one* element of the overall reform program, the implementation of which could foster the appropriate climate for divestiture at a more opportune moment. And the threat of divestiture could itself serve to increase PE efficiency.

68. Third, inadequately specified organizational arrangements and the lack of technical expertise have resulted, in some cases, in significant institutional problems in the implementation of divestiture. This has led to many problems, including the lack of transparency and the lack of adherence to formal procedures. Where the scope of the program has been large and where local capacities are limited, the problems have been especially severe. Greater care could be taken in Bank operations to delineate, a priori, the institutional set-up for executing divestiture in a timely and transparent fashion. While these are bound to be highly country-specific, experience demonstrates some important guiding principles: avoidance of excessive bureaucratization by minimizing the number of institutions involved; ensuring quick access to top decision-making levels; making easily available the necessary technical expertise; and establishing, *ex ante*, clear guidelines for the deal-making process.

69. Fourth, as countries progress to larger and more complex divestitures, there would be a need for Bank operations to: (i) provide more

implementation assistance for asset valuation, selection of technique, establishment of the regulatory framework, and the like; (ii) arrange financial resources to meet the transaction costs, including employee liabilities and the settlement of liabilities; (iii) address the labor issues more directly, devising attractive severance packages and other mechanisms to mitigate potential opposition; and (iv) develop financing mechanisms, such as debt/equity swaps, use of government bonds, and mutual investment funds, to facilitate the implementation of large divestitures in countries with relatively weak private sectors. These demands would require greater use of lending instruments other than quick-disbursing SALs. These could include public enterprise loans, private sector development loans, as well as conventional projects. In addition, new slow-disbursing facilities specifically geared to meeting the needs of divestiture may also need to be created.

70. Fifth, the preparation and supervision of divestiture reform can be staff intensive in terms of time and expertise where the program is large. Operational staff, who are often overstretched with responsibilities spanning two to three countries, emphasize the difficulties in identifying and obtaining the needed technical resources from other parts of the Bank and IFC for preparation, appraisal, and supervision. The poor fit between an institutionally intensive reform program and shortages of appropriate staff resources clearly needs to be addressed at the management level. Moreover, the monitoring and evaluation of divestiture actions -- the need for which is unquestionable -- is also likely to place further strains on staff resources.

71. Finally, future research efforts should focus on conducting more in-depth case studies to: (i) gather more factual data on the numbers and types of enterprises being divested, the magnitude of divestment in terms of the overall sector, the techniques utilized, etc; (ii) analyze the process of such reform, who is doing what, how are decisions made, etc.; and (iii) analyze the several unanswered questions with regard to the financial, economic and distributional outcomes of divestiture reform.

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Table 1

NUMBER OF BANK PROJECTS WITH DIVESTITURE COMPONENTS
(Approved as of June 1989)

Region	Country	SALs	SECALs a/	TALs	PELs b/	PSD	TOTAL
AFRICA	Benin	1			1		2
	Burundi	2					2
	Cameroon	1					1
	CAR	2		1			3
	Congo	1			1		2
	Gabon	1					1
	Gambia	2				1	3
	Ghana	2	1		1		4
	Guinea	2		1			3
	Guinea Bissau	2					2
	Madagascar		2	1			3
	Malawi	1					1
	Mali				2		2
	Mauritania				1		1
	Niger	1			2		3
	Sao Tome & Prin.	1					1
	Senegal	2		1			3
	Sudan			1			1
	Togo	3		2		1	6
	Uganda		1		1		2
	Zaire	1		1			2
	SUB-TOTAL	25	4	8	9	2	48
LAC	Chile	1		1			2
	Costa Rica	1					1
	Honduras	1					1
	Jamaica	3		1	1		5
	Mexico				1		1
	Panama	2		1			3
	Uruguay	2					2
	Venezuela	1					1
	SUB-TOTAL	11	0	3	2	0	16
EMENA	Morocco				1		1
	Tunisia				1		1
	Turkey	1					1
	SUB-TOTAL	1	0	0	2	0	3
ASIA	Indonesia					1	1
	Nepal	1					1
	Philippines		1		1		2
	SUB-TOTAL	1	1	0	1	1	4
	GRAND TOTAL	38	5	11	14	3	71

a/ Includes industrial SECALS, economic recovery and export rehabilitation loans.

b/ Includes Public Enterprise Rationalization/Rehabilitation Loans, Public Enterprise Sector Adjustment Loans, and Public Enterprise Institutional Development projects.

Table 2

BANK PROJECTS WITH DIVESTITURE COMPONENTS
(Approved as of June 1989)

Region	Country	Operation	Board Approval	Loan Amount
AFRICA	Benin	PE Rehab.	86/12	15.0
		SAL	89/05	45.0
	Burundi	SAL I	86/05	15.0
		SAL II	88/06	90.0
	Cameroon	SAL	89/06	150.0
	CAR	Econ. Management	88/12	13.2
		SAL I	86/09	14.0
		SAL II	88/06	40.0
	Congo	PE ID	87/07	15.2
		SAL	87/07	70.0
	Gabon	SAL	88/04	50.0
	Gambia	Enterprise Dev.	88/12	10.0
		SAL	86/08	5.0
		SAL II	89/06	23.0
	Ghana	Ind. SECAL	86/03	28.5
		PEL	87/10	10.5
		SAL	87/04	34.0
		SAL II	89/04	120.0
	Guinea	SAL I	86/02	25.0
		SAL II	88/06	65.0
		TAL I	85/03	9.5
	Guinea Bissau	SAL	87/05	10.0
		SAL II	89/05	23.4
	Madagascar	Econ. Management	88/12	22.0
		Ind. and Trade	87/06	67.0
		PS Adj.	88/06	125.0
	Malawi	SAL III	85/12	30.0
	Mali	PE ID	88/06	9.5
		PE SECAL	88/06	40.0
	Mauritania	PE TAL	85/03	16.4
	Niger	PE ID	87/07	5 5
		PE SECAL	87/06	60.0
		SAL	86/02	20.0
	Sao Tome & Prin.	SAL	87/06	4.0
	Senegal	SAL II	86/02	20.0
		SAL III	87/05	45.0
		TAL II	83/07	11.0
	Sudan	TAL	87/05	9.0
	Togo	Pvt. Ent.	87/09	11.5
		SAL I	83/05	40.0
		SAL II	85/05	27.8
		SAL III	88/03	45.0
		TAL II	82/06	3.5
		TAL III	85/05	6.2
	Uganda	PE Project	88/11	15.0
		Econ. Recovery	87/09	65.0
	Zaire	SAL	87/06	55.0
		TAL	87/06	12.0

Table 2

BANK PROJECTS WITH DIVESTITURE COMPONENTS
(Approved as of June 1989)

Region	Country	Operation	Board Approval	Loan Amount
LAC	Chile	SAL II	86/11	250.0
		TAL	85/03	11.0
	Costa Rica	SAL	85/04	80.0
	Honduras	SAL	88/09	50.0
	Jamaica	PE SECAL	87/06	20.0
		SAL I	82/03	76.2
		SAL II	83/06	60.2
		SAL III	84/11	55.0
		TAL II	85/03	9.0
	Mexico	PE Reform	89/06	500.0
	Panama	SAL I	83/11	60.2
		SAL II	86/12	100.0
		TAL	83/11	5.0
	Uruguay	SAL I	87/06	80.0
		SAL II	89/06	140.0
	Venezuela	SAL	89/06	402.0
EMENA	Morocco	PEL	87/05	240.0
	Tunisia	PEL	89/06	130.0
	Turkey	SAL V	84/06	376.0
ASIA	Nepal	SAL	87/03	50.0
	Indonesia	PSD	89/05	350.0
	Philippines	Econ. Recovery	87/03	300.0
		Govt. Corps.	88/06	200.0

Table3

BANK SUPPORT FOR DIVESTITURE

Loan		Preparing for Divestiture				Institutional Framework			Actual Divestments		Social Consequences
		Studies	Classif. Exercise	Action Plans	General Strategy	Strengthening Exist.Arrang.	Create New Arrang.	Bank T.A.	Liquida.	Privat.	
AFRICA REGION											
Benin	PE		X	X					X		
	SAL								X	X	X
Burundi	SAL I	X	X	X					X		
	SAL II	X		X					X		
Cameroon		X	X						X	X	X
CAR	Econ.Mgt.	X						X	X	X	
	SAL I	X	X	X					X	X	
	SAL II	X	X	X						X	
Congo	PE ID	X	X					X	X	X	
	SAL	X	X	X					X	X	
Gabon	SAL	X	X						X	X	X
Gambia	Ent.Dev.			X				X		X	
	SAL I	X	X	X						X	
	SAL II					X					
Ghana	SECAL	X		X							
	PEL	X	X	X	X						X
	SAL I	X	X	X	X		X	X	X	X	X
	SAL II								X	X	
Guinea	SAL I		X	X					X	X	
	SAL II				X	X			X		
	TAL I		X	X		X		X			
Guinea Bissau	SAL		X								
	SAL II						X				
Madagascar	Econ.Mg	X					X	X			X
	Ind. & Trade			X				X			
	PS Adj.			X					X	X	X
Malawi	SAL III	X		X							

Table 3

BANK SUPPORT FOR DIVESTITURE

Loan	Preparing for Divestiture				Institutional Framework			Actual Divestments		Social Consequences
	Studies	Classif. Exercise	Action Plans	General Strategy	Strengthening Exist.Arrang.	Create New Arrang.	Bank T.A.	Liquida.	Privat.	
Mali PE ID	X	X	X		X		X	X		X
PE SECAL	X		X					X	X	
Mauritania PE TAL		X	X							X(minimal)
Niger PE ID	X		X		X		X			
PE SECAL	X	X						X	X	
SAL	X	X	X					X	X	
Sao Tome & Prin.		X	X							X
Senegal SAL II			X				X	X	X	
SAL III								X	X	
TAL II	X	X								X
Sudan TAL	X		X							
Togo Pvt. Ent.		X	X							
SAL I		X	X					X	X	
SAL II		X	X					X		
SAL III	X									X
TAL II	X									
TAL III					X		X			
Uganda PE Project	X	X			X	X	X	X	X	
Econ.Rec.		X	X							
Zaire SAL	X	X		X				X		
TAL	X									
LAC REGION										
Chile SAL II	X									
TAL	X						X			
Costa Rica									X	
Honduras			X							

Table 3

BANK SUPPORT FOR DIVESTITURE

Loan	Preparing for Divestiture				Institutional Framework			Actual Divestments		Social Consequences
	Studies	Classif. Exercise	Action Plans	General Strategy	Strengthening Exist.Arrang.	Create New Arrang.	Bank T.A.	Liquida.	Privat.	
Jamaica PE SECAL	X	X	X					X	X	
SAL I								X	X	
SAL II								X	X	
SAL III										
TAL II					X		X			
Mexico					X					
Panama SAL I								X	X	
SAL II								X	X	
TAL					X		X	X	X	
Uruguay SAL I										
SAL II										
Venezuela		X	X			X	X			
EMENA REGION										
Morocco	X	X	X		X		X			
Tunisia				X	X		X	X	X	X
Turkey SAL V										
ASIA REGION										
Indonesia				X						
Nepal		X	X							
Philippines ERC	X		X	X		X	X	X	X	
Govt. Corps.		X						X	X	

Table 4

BANK-FINANCED TECHNICAL ASSISTANCE FOR DIVESTITURE

Country	Broad Studies	Prep/implem. of classif., action plan	Div. strat., Criteria, Procedures	Diagnostics Audits, Liq. plans for sel.PEs	Cross-debts studies	Implem. (advice, find partners, neg. deals, coord. reform)	Restr. Ms., incl. credit, wrking cap., forex reqmts. cost-cutting	Create new unit	Trg. and Redept.	Fin. Instrus
Benin PE				X					X	
Burundi SPPF		X								
CAR TAL II						X				
CAR SAL II				X						
CAR Econ.Mgt.	X		X							
Congo PE ID				X	X	X				
Gambia SAL SPPF			X							
Gambia Ent.Dev.		X				X			X	
Ghana PE				X		X		X		X
Ghana Ind.SECAL	X	X								
Guinea TAL		X	X			X	X			
Madagascar ITPA		X								
Madagascar EconMgt			X							
Mali PE ID			X			X				
Niger PE ID		X		X		X				
Sudan TAL		X		X						
Togo TAL II/III	X impac		X	X		X			X study	
Togo Pvt. Ent		X				X				X
Uganda PE			X	X						
Zaire TAL		X	X		X					X
Chile TAL			X							
Honduras SAL		X								
Jamaica TAL II						X (min)				
Mexico PE	X									
Panama TAL I, II			X (min)							
Venezuela SAL				X		X				
Morocco PERL				X		X				X
Phils. ERTAP			X			X		X		
Phils. Govt. Corps										

Table 5

DIVESTITURE-RELATED CONDITIONALITY IN BANK OPERATIONS

Timing	PREPARATORY ACTIVITIES Info base, Audits, Dossiers, Viab.studies	Classif. PEs	Prep./ Agreement/ comp of sec. AP	Prep./ Agreement/ comp AP for PEs	Submit 1st agrmt on PEs for Div.	Settle debts/ arrears	INSTITUTIONAL & LEGAL FRAMEWORK Instl. Arrangements	Legal Framework	OTHER ACTIVITIES Establish Div. Account	No special privileges	Address social impact	Review of progress
A. MONITORABLE ACTIONS												
Action Already Taken/ Effec. Condition	Gambia I Ghana PE Ghana I Sao Tome&Prin Togo I Togo III Morocco	Ghana ISAC Guinea II	Burundi I Gambia EntDev Guinea-Bissau Senegal II	Benin PE Mali PE Uganda PE Mexico PE Venezuela I	Ghana I Guinea II Senegal II Zaire Mexico Tunisia	Mali PE Morocco	Gambia I Ghana I Ghana PE Uganda PE Venezuela Mexico	Congo Zaire I	Ghana PE		Guinea II Mali PE Zaire I	CAR II Togo III
Tranche Condition	Mali PE Niger I Jamaica PE	Zaire Morocco	Burundi II Gambia I Ghana II Sao Tome&Prin Uganda PE Uganda ERC Morocco PE Nepal Venezuela	Burundi II Cameroon CAR II Ghana II Guinea I Madagascar PS Malawi III Togo II Costa Rica Jamaica PE Jamaica I Honduras Philip. GC	Gabon Senegal III Togo I Togo II Venezuela Philip. GC	CAR II Congo Gabon Mali PE	Gambia II Philip. ERC	Uganda ERC Philip. ERC Philip. GC		Burundi II	Gabon I Mali PE Senegal III	CAR II Togo III Mexico PE
B. NON-MONITORABLE ACTIONS												
	Gambia CAR Econ.Mgt.	CAR I Ghana I Guinea I Niger PE Indonesia		Senegal II Madagascar PS Uganda ERC	Ghana I Ghana PE	CAR II Gabon Niger PE Senegal II Togo III	Madagascar PS Zaire	Congo I CAR II Uganda ERC Zaire Turkey V Indonesia	Madagascar PS		Gabon Ghana I Madagascar PS	

Table 5

DIVESTITURE-RELATED CONDITIONALITY IN BANK OPERATIONS

Timing	DIVESTITURE TARGETS					
	Implem. of AP for PEs	Implem. of AP as agreed; satisfactory progress	Initiate Liqs. of Specific PEs	Complete Liqs. of Specfic PEs	Initiate Ptz. of Specific PEs	Complete Ptzs. of Specific PEs
A. MONITORABLE ACTIONS						
Action Already Taken/ Effec. Condition		Benin I	Burundi I Congo Mali PE Niger PE Togo I Zaire Costa Rica	Benin I Burundi II Panama II Senegal II Costa Rica		Benin I Costa Rica
Tranche Condition	Cameroon Togo II Philip. GC	Benin I Congo Ghana II Guinea-Bissau Madagascar PS Mali PE Chile II Jamaica PE Mexico PE Uruguay II	Ghana I Guinea I Togo I	CAR I Congo Mali Niger PE Senegal III Togo II Jamaica PE Jamaica I	Ghana I Senegal III Togo II Panama II Venezuela Philip. ERC Philip. GC Tunisia	Congo Guinea II Chile II Jamaica III Jamaica PE Panama II Tunisia
B. NON-MONITORABLE ACTIONS						
			Congo I Guinea I Madagascar PS Niger I Togo I Togo II Jamaica I	Tunisia	CAR I CAR II CAR Econ.Mgt. Congo I Gabon Guinea I Madagascar PS Senegal II Togo I Togo II Panama I	Niger SAL Niger PE Jamaica I Jamaica PE Panama I Panama II Tunisia

DIVESTITURE OUTCOMES

Loan/Report	Loan Effective or Tranche Targets	Status	Comments
Benin [Staff Appraisal Report for SAL, 5-89]	SAL: Satisfactory progress in implementing PE sector restructuring plan.	Action prior to Loan: Dissolution/liq. of 12 PEs (TAB, TRANSBENIN, IBETEX, SODIMAS, CIB, SOTRACOB, SONATRAC, SOGECOB, etc.) Privatization of 6 PEs (SONAE, OBECI, ONAÏMO, AGB, RAVINAR)	Proceeds insufficient to pay employee claims
CAR [Back-to-Office Report 4-89]	SAL II: Preparation of ptz./liq. report for 1988. Reduce liq. expenses and complete liqs. by Dec. 1989 Pursue ptz. of 8 PEs Econ Mgt: Complete negotiations on SEGA, SIRIRI Pursue negotiations on 6 other PEs Study ptz. of other PEs	Liq. Report & Privatization report prepared 10 PEs in process of liq.(3 banks, transportation, tourism, public works, bookstore) 3 PEs in process of ptz.(wood processing, slaughterhouse, leather) 6 PEs ptzd. (shipping, food processing, public works, insurance, mechanical and bookstore)	Liquidation Report not satisfactory; new report being prepared Audits just beginning; will not meet 2nd Tranche release date
Congo [Supervision Report ______]	Implementation of PE divest program as agreed Progress in implementation of settlement of debts of PEs to be liq/ptz/rehab.	Full privatization of 3 PEs (UAB, SIAP, SOCOME) Opening of capital for 14 PEs (textile, industry, agriculture, food processing, etc.) Liquidation of 10 PEs (hotels, yogurt, ship building, etc.)	
Gabon [Back-to-Office Report 4-89; Back-to-Office Report 5-89]	Decisions on PEs for liq. and/or privatization	Decisions made concerning ptz/liq of Gabon-Informatique, SHD, SHM, SOTEGA(textiles), SNTH(hotel) Decisions made as to reform of 6 PEs(OPRAG, SONATRAM, CNI, ASECNA, Ciments du Gabon, BNCR) Govt. is to reduce shareholding of SNGB (wood marketing) Action prior to loan: 6 liq. in 1987-88: Pizo (gas dist.), Sotravil (urban petro. explor.), CODEV and SOGACCO (comm. distr.), Petrogab (petro. explor.), and SONADECI (agri.)	Govt. will need reinforcement of team in charge of parastatal reform (only 3 persons currently involved)

DIVESTITURE OUTCOMES
con't.

Loan/Report	Loan Effective or Tranche Targets	Status	Comments
Gambia	Ent. Dev.: PE progress review and implem. plan for div. program. SAL II: Satisfactory performance review, incl. assessment of progress in implem. of PE divestiture program.	Prepared valuations for several holdings. Minority holdings of Standard Chartered Bank, CFAO (trading co.) and Brikana Ice offered for public sale. Steps initiated for div. of minority holdings of Seagull Coldstores and African (Sunwing) Hotel Holdings for Standard Chartered Bank, CFAO and Old Atlantic Hotel sold.	
Ghana	SAL I: 5 PEs will be offered for sale/liq. Proceedings for another 5 PEs will be initiated. Divestiture Committee created. PEL: Complete dossiers for 5 PEs. Initiate div. on 10 PEs. SECAL: Begin div. of selected industrial SOEs SAL II: Implem. of 1989 div. program. Agreement on 1990 div. program Div. 10 PEs by 1989, inc. State Fisheries.	32 SOEs advertized for sale: • 10 have dossiers prepared for ptz. • 6 have Govt. commitment to sell its interest in joint venture 10 PEs are at final stage of liq.	Delays may undermine credibility of SEC and overall divestiture program, IFC is recommended for assistance in identifying private partners. Delays in divestiture program due to lack of adequate and qualified staff; unlikely that 1989 targets can be met.

DIVESTITURE OUTCOMES
con't.

Loan/Report	Loan Effective or Tranche Targets	Status	Comments
Guinea	SAL I: Govt. will have begun implem. of liq. program for primary banks. Govt. will establish AP for restruc. of non-industrial PEs, including divestiture. SAL II: Agreement with Govt. on list of PEs for divest., including timetable for implementation.	Privatized PEs: 29 industrial, 2 commerical, 1 service. Liquidated PEs: 10 industrial, 51 commercial, 8 service. PEs to be ptz/liq: 5 industrial, 7 commercial, 2 service.	PEs on list which are not ptzd. by end of 1989 will be liq. Retrospective review of ptz/liq. program to be undertaken with Bank financing.
Madagascar [Supervision Memo 7-89]	PE SECAL: Satis. progress in implem. of AP for 20 PEs, incl. div. 3rd tranche release requires 20 more PE action plans. Ind & Trade: Preparation of AP for PEs.	Liquidation begun: 9 PEs Liquidated: 18 PEs Disengagement started: 9 PEs Disengagement complete: 7 PEs	Necessary documentation concern-divestiture actions not received or incomplete - falls short of tranche release conditionalities Legal diff. still exist relating to ability to complete liq. actions; likely to worsen.
Mali	Complete liq. of 10 listed PEs (2nd tranche). Liq. remaining 5 PEs (3rd tranche). Study of 22 remaining PEs to establish APs.	15 PEs already dissolved, awaiting liq. proceedings (Air MALI, SHM, SAT, SCAER, SEBRIMA, SOCOMA, LPM, SOCORAM, SOMBEPEC, SOMIEX, SONEA, SONETRA, OCIMAN, CMTR, EMAB). Liq. proceedings well advanced for a number of companies (Air Mali). Majority control transfered to private sector on 2 PEs (ITEMA, SEPOM)	Government intends to retain majority ownership on only 6 out 35 PEs in div. program
Niger	PE SECAL: Complete liq. of UNCC and SONIFAM	13 PEs privatized 2 PEs integrated w/Govt. agencies 1 PE liquidated	Govt. agreed to complete implem. of agreed div. program
Senegal [Project Comple-tion Report 6-89; SAL IV Initiating Memo 2-89]	SAL II: Progress in implem. of div. plans of PEs studied in SAL I (9 PEs). Agreement on schedule for div. 10 more PEs. SAL III: Offer sale of 6 PEs. Partial sale of 4 PEs. Identify 10 more PEs for ptz. Complete liquidation of 7 PEs, 2 public establishments.	List of PEs for ptz/liq. adopted March 1986 (SAL II). List of 10 additional PEs for ptz. presented (no sales as of June 1989) Liquidation of 6 PEs & 2 public establishments completed April 1988.	SAL IV Initiating Memo: lists preparation of list on PEs to be privatized (and preparation for sale of 1st group from this list) as condition for Board presentation.

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Loan/Report	Loan Effective or Tranche Targets	Status	Comments
Togo	SAL II: Substantial and satisf. progress in implem. div. plans for PEs studies under SAL I.	10 privatizations: SNS, STH, SOPROLAIT, IOTO, Huileries Togolaises, SODETO, SOPROMA, SOTCON, ITP, Sucrerie d'Anie, SBHT(steel, sugar, oil, dairy).	Consultant responsible for view fell ill; decision not replace him, but to await h return.
	Agreement with IDA on satisf. div. schedule for approx. 10 more PEs	Liquidation of 5 PEs(SOMAT, SOTOMA, SODETO, TOGOFROM, SOTCOM) with 6 more underway (ITT,TOGOTEX, AGETU, STALPECHE, SOTOTOLES, CAAN).	
		7 PEs awaiting funding for debts (IOTO, SALINTO, SOTEXMA, TOGOFRUIT, Cie de Benin,SOTOPROMER,Le Moteur)	
	SAL III:adoption of TOR for retrospective review of privatization program	Review delayed; conditionalities revised by Bank.	
Jamaica (Agric. Sector Adj. Operations Initiating Memo, 11-88; Adj. Under Changing Conditions 4-89)	SAL I: Programs for 3 PEs: JRC, Jam. Omnibus, Banana Co.)	Dissolved Jam. Omnibus. Divested Caribbean Cement, Natl. Commercial Bank and Telecommunications of Jamaica	Land divestiture involved as well.
	SAL II: Restructuring of sugar sector, with leasing to private firms	Restructured sugar industry (has involved closing some factories)	
	SAL III: Div. of parts of Banana Co.	Divested 7 agro-industrial and agricultural PEs (sale of assets & long-term leasing) 1980-87; 3 more in 1989	
	SECAL: Assess ptz. of TRANSJAM, JMM, & JRC (transport); JTC, JBC, (telecom.); Hotel Oceana.	TRANSJAM ptz. discussions ongoing. JRC operations improved/no ptz. necessary. JMM sold Atlantic operation. JTC sold 45% interest (exceeds cond.). JBC ptz. prep. at advanced stage. Hotel Oceana not ptzd; should reduce losses thru conversion to training facility.	Delay in SECAL 2nd tranche lease due to delay in final report of PE assets and liab.
	Divestiture Program: satisf. progress toward achievement of stated div. program, with completed div. of 20 PEs with assets of at least J$150m.	Sale of 78% of CCC (cement) Sale of 32 PEs for J$500m., total sale of assets exceeds J$870m.	Divestiture program, in some cases, exceeds conditionali
Mexico	Satisfactory progress in implementation of Disengagement Program consisting of 199 PEs.	Actions prior to loan: Of 706 PEs divested: 226 sold 78 merged 374 liquidated 28 transferred to local govts. 449 PEs still retained	

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Loan/Report	Loan Effective or Tranche Targets	Status	Comments
Philippines	Reform Program for GCs: Offer for sale 30 targeted PEs. Finalize plans for 100 PEs. 3rd Tranche, offer 30 more PEs for ptz.	In all, 122 GCs approved for ptz.: 29 GCs privatized (10 partially) 7 offered unsuccessfully 20 GCs have decisions pending 10 GCs have been reviewed for final recommendation. Govt. monitoring program so as to meet target date of August '89 for the 20% div. required for tranche release. Govt. decision to ptz. 30% of Philippines Natl. Bank as of 6-89	Privatization plans for several GCs still needed; may hold up 2nd tranche release because of needed T.A. T.A. and studies of 15 GCs are being finance under USAID grant. About 130 GCs are to be abolished, regularized or converted to private foundations; plans for 20 are already prepared, but 100 total are needed for second tranche release.
Tunisia	Govt. will bring to sale a group of PEs, satisf. to Bank. Submit review including further candidates for ptz.	Sale of 6 hotels, 2 textile (SITER, SITEX) and smaller holdings (inc. 3 construction subsidiaries of Batiment). Liq. of STIA (car assembly), SMMT (mech. workshop) and virtually all of SOTEMI's iron ore mines.	Govt. aims at div. 10 PEs per year, but makes no firm commitment to that number.

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