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Public Enterprise Reform

A Challenge for the World Bank

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How can the Bank refine its help to countries embarking on reform of public enterprises?

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: (i) review past efforts in institutional development, (ii) determine where these efforts have succeeded and where they have done poorly, and (iii) 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 (47 pages with tables).

Public enterprises (PEs) — state-owned or state-controlled productive entities whose output is sold mostly in the marketplace — earn an average 10 percent of GDP in developing countries (17 percent in African countries, 12 percent in Latin American countries, and 3 percent in Asian countries).

Many governments are reexamining the role of the state, so questions about whether to divest PEs or make them more efficient are likely to intensify. The Bank will increasingly be called upon for advice and financial support in managing the transition period. Galal recommends that the Bank:

• Maintain its focus on rationalizing the size of PEs, by liquidating nonviable PEs and transfering their ownership or control to the private sector, if that will make them more efficient. In helping countries improve the efficiency of PEs that remain public, the Bank should emphasize both policy framework and institutional set-up, and restructuring of individual enterprises.

• Extend its analysis of PEs to the socialist economies, explore the relationship between PEs and the private sector, and study how best to phase and sequence PE reforms.

• Refine PE reform components and tools, especially in terms of the phasing and sequencing of price liberalization and competition; the budgetary impact of PEs (their costs versus their revenues — and here Galal discusses the "waterbed effect," how holding down costs in one area raises costs in another); and the valuation of PEs for divestiture.

• Learn more systematically from experience by analyzing the outcomes of PE reforms; the performance of divested PEs; the effects on efficiency of staff reductions; and the effectiveness of program contracts on enterprise efficiency.

PUBLIC ENTERPRISE REFORM AND THE WORLD BANK: Approach, Practices and Challenges

Ahmed Galal

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INTRODUCTION/EXECUTIVE SUMMARY

1. Public Enterprises (PEs) are productive entities which are owned and/or controlled by the state and the bulk of whose output is sold in the market place (Jones, 1975). As a sector, PEs play a significant role in mixed economies, averaging 10% of GDP in developing countries worldwide, with PEs in African countries higher than the average (17%), Asian countries at the lower end of the scale (3%), and Latin American countries somewhere in between (12%). (Swanson and Wolde-Semait, 1989). They dominate important sectors in most countries (e.g. infrastructure, heavy industries, etc). Furthermore, PEs are major borrowers in domestic and international markets; they draw extensively on government budgets, and often employ a large segment of the labor force. Therefore, attempts to improve their performance are critical to the macroeconomic performance of most countries.

2. In recognition of the importance of PEs, and their generally unsatisfactory past performance record, the World Bank has devoted attention to assist its borrower countries in their efforts to improve the operating and allocative efficiency of PEs. To this end, progress has been made on two fronts. First, the Bank has developed and disseminated a sector-wide approach to PE reform. In this approach, PEs are viewed, as the name implies, as enterprises whose managers are supposed to respond to market signals, and as public entities whose managers are supposed to respond to their governments as the owner and regulator. Therefore, measures to increase the effective functioning of markets have been treated as a necessary condition to improve the operating and allocative efficiency of PEs. Reforming PEs' institutional set-up, to supplement and compensate for deficiencies in market conditions and to persuade managers to respond to correct market signals, has been treated, together with market-related reforms, as a sufficient condition without which the desired supply response may not be forthcoming. More recently, divestiture has increasingly been utilized as a tool of public policy to rationalize the size of the sector in such a way as to maximize the benefits from government intervention to correct for market failure, and to minimize the costs of such intervention resulting from bureaucratic or organizational failure. The rehabilitation and restructuring of individual PEs have continued throughout to constitute an integral part of the Bank's approach to PE reform.

3. Second, the Bank has increasingly provided financial support to its member countries embarking on PE reform programs. Increasing Bank support is evident from the growing number of adjustment lending operations focusing exclusively on PE reform (often referred to as PELs), or operations in which PE reform constitutes a major component, i.e. structural adjustment loans (SALs), sectoral adjustment loans (SECALs), or technical assistance loans (TALs). By June 1989, the total number of operations in which PE reform was a major component was 147, of which 24 operations were approved by the Board in the last year alone (July 88-June 89).

4. Systematic empirical evidence regarding the impact of reforms on the performance of PEs has been relatively scarce; in part because of the short time horizon during which PE reforms have been attempted on a sectoral

basis (the 1980s). More recently, however, preliminary Bank analysis suggests that the overall effect of these reforms, where they have been implemented, is moderately positive. First, there are indications that the size of the PE sector has declined (or has been curtailed), for example, in the Philippines, Mexico, Jamaica, Togo and Guinea, thus implying greater room for private sector initiatives. Second, the profitability of PEs has improved in countries such as Thailand and Turkey. In other countries (e.g. Mauritius, Niger, Mali), PEs' consolidated losses, excluding subsidies and taxes, have declined. Profitability improvements and/or reduction in losses partially reflect output price increases, but they also reflect better allocation and use of resources. Third, available empirical evidence regarding the budgetary impact of PEs (which is broadly defined as the difference between the flow of funds from the Treasury to PEs minus the flow of funds from PEs to the Treasury) suggests that profitability improvements and/or reduction in losses have largely meant less dependency on the government's budget for financing (e.g. Mauritius, Thailand). PEs' budgetary burden worsened in other cases (e.g. Senegal, Malawi). Where the effectiveness of reforms to reduce PEs' budgetary burden has been limited, attempted measures have been inadequate and/or unaccompanied by the liquidation of non-viable PEs, the divestiture of those better run by the private sector, and the restructuring of viable PEs. Even in these cases, however, it could be argued that the budgetary burden could have been worse in the absence of reforms.

5. Notwithstanding this progress, new challenges are emerging. At the conceptual level, recent developments in socialist economies --in particular as some of these economies are moving toward greater decentralization and reliance on market forces-- suggest the need to extend the Bank's approach to PE reform to socialist countries. The increasing emphasis on the private sector as an important engine of growth--yet its dependency on PEs--suggests that the analytical approach to PE reform should consider their crowding out and crowding in effects on the private sector. Thirdly, to maximize the effectiveness and sustainability of PE reform, attention should be given to the question of phasing and sequencing of these reforms. At the operational level, the feedback from experience suggests the need to sharpen the tools of PE reform, refine its components, and systematically consolidate the process of learning from experience. The most pressing issues in this regard concern: the phasing of price reform and competition, the budgetary impact of PEs, enterprise valuation for divestiture, outcomes of PE reforms, the efficiency consequences of staff reduction, the effectiveness of performance contracts at the micro level, and the ex-post performance of divested firms.

6. The need to address these challenges is gaining urgency given that many governments around the world are increasingly reexamining the role of the state. As a result of this reexamination, it is expected that questions of divesting PEs and attempts to improve the efficiency of those remaining in the public domain are likely to intensify, rather than diminish, in the near future. In the process, the Bank will increasingly be called upon for advice and support in managing the transition period. To meet the expected demand, concerted effort is necessary. Within the Bank, this requires collaboration between the Policy, Research & External Affairs (PRE) complex and the four operational regions. PRE is well positioned to provide an inter-regional perspective. Operations (i.e., the Technical and Country Departments of

different regions) can provide regional patterns, country-specific experiences, and operational direction for the needed research. In addition, valuable insights can be gained from the academic community and other development institutions.

7. The rest of this paper will: (1) briefly summarize the Bank's approach to and experience in reforming PEs; (2) identify more concretely some of the challenges lying ahead; and (3) suggest, on the basis of findings, an agenda for future work on PE issues. Before proceeding further, however, one remark is order. This paper is written for the Bank's conference on institutional development. Yet, it addresses PE reforms in general, of which institutional reforms constitute but one component. The wider focus was favored because it emphasizes that institutional reforms should be treated as an integral component, but not a substitute for, policy reforms in PE reform programs.

I. THE WORLD BANK's APPROACH TO PE REFORM

A. Evolution

8. The World Bank's approach to PE reform has evolved over time. Until the late seventies, in the context of its project work, the Bank focused on the creation, strengthening, and restructuring of individual PEs. Since then, the Bank has increasingly moved toward a sector-wide approach to PE reform. In part, the shift reflects the fact that PEs in diverse activities (e.g. infrastructure, industry, agriculture) share common problems, many of which are the product of public ownership. To solve these problems, a common framework is required. In part, the shift mirrors the Bank's increasing emphasis on the role of the overall policy and institutional environments in the adjustment process at the macro level. When this emphasis is translated to PEs, it implies that the root cause of their poor performance lies to a large extent in their distorted and rigid incentive structure, inappropriate institutional set-up, and over-extended role in economic activities.

9. Increasing Bank emphasis on a sector-wide approach to PE reform has not meant that the rehabilitation, strengthening or restructuring of individual PEs is no longer necessary Rather, it has meant that restructuring was to supplement the sector-wide approach, focusing in particular on PEs whose performance is critical to the success or failure of other actors in the economy. It has also meant that greater emphasis is now placed on the liquidation of non-viable PEs, the sale of those better run by the private sector, and the rehabilitation of the others.

B. Theoretical Foundation of Approach

10. The theoretical foundation for the Bank's sector-wide approach to PE reform is succinctly summarized in the following quotation:

> " the efficiency of an enterprise - public or private - is highest when the enterprise strives to maximize profits in a competitive

market, under managers with the autonomy, capacity, and motivation to respond to competition, and when enterprises that cannot compete go bankrupt". (Shirley, 1989a)

Since PEs seldom face such conditions, largely for reasons of public ownership, the Bank's approach to their reform is focused on assisting its member countries in providing a more efficiency inducing set of conditions.

11. The origin of this framework cannot be found in neo-classical microeconomic theory, in which ownership is seldom discussed.[1]/ Rather, it finds its origin in extensions to PEs of the arguments developed by property rights, public choice and X-efficiency schools (e.g. Alchian, 1965, Williamson, 1975, Leibenstein, 1970). The basic argument of this literature, which presumes extended or selective rationality instead of the presumed rationality in the standard theory of the firm, can be stated as follows: In large private corporations, ownership is divorced from management, thus a wedge is created between the principals (the owners) and their agent (the managers).[2]/ Depending on the room for discretion, which increases in sheltered (uncompetitive) markets, managers of these corporations are likely to maximize objectives differing from, and often incompatible with, profit maximization. Monitoring managers and replacing them is costly. Therefore, the principals are often ready to accommodate a tolerable level of managerial discretionary behavior, with adverse effects on efficiency. When managers, or individuals within the firm, choose to devote less than maximum effort (for reasons of inertia and limited incentives), X-efficiency theory argues that the resulting output will be less than optimal for a given input mix.

12. In PEs, ownership is also divorced from management. Therefore, PE managers could be expected to maximize objectives differing from profit maximization, or to simply lead a tranquil life. And indeed several authors have suggested alternative objective functions for PE managers (e.g. Niskanen, 1971, Aharoni, 1981, Baldwin, 1975, Galal, 1986, Levy, 1987).[3]/ Details aside, the basic point of this literature is that PE managers are likely to deviate from profit maximization to a greater extent than their private counterparts for several reasons. First, from an institutional point of view, politicians

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[1]/ To be sure, a textbook theory of the firm suggests a role for the government to play in order to compensate for incidents of market failure (e.g. externalities, public good, increasing returns, asymmetrical information, future markets etc.). This theory leaves, however, the form of government intervention open to include direct ownership of resources, regulation, and subsidy and tax schemes.

[2]/ Extended rationality refers to situations in which managers maximize objectives other than profits, e.g. their utility. Selective rationality or X-efficiency theory questions whether individuals maximize at all.

[3]/ Niskanen suggests that PE managers maximize their budgets; Aharoni suggests they maximize their autonomy; Baldwin, Galal and Levy suggest that they maximize their utility with different arguments in their utility functions and different political and bureaucratic constraints.

tend to use PEs to achieve political ends, e.g. appointing loyalists to managerial positions (e.g. party members, generals), setting prices to satisfy certain interest groups (including gaining votes for the party in power in a democracy, Boneo, 1981), and using PEs for employment generation, or regional development.[4] The multiplicity of and conflict between objectives often mean the satisfactory achievement of none; failure to achieve one objective is often blamed on attempts to achieve the rest.[5] Even more, efficiency losses tend to persist, largely because politicians are rarely voted out of office for reasons of poorly performing PEs.

13. Second, the problem of multiple objectives is exacerbated even further by the problem of "plural principals". The latter problem refers to the observation that the ownership of PEs is either diffused or ill allocated. Unlike private shareholders who can trade their shares and claim dividends, shareholders of PEs are not usually well specified.[6] Hence, many government agencies/ministries attempt to perform the ownership function.[7] They place conflicting demands on PEs and interfere in their operations to the point where they become an extended part of the government bureaucracy, rather than commercial entities.

14. Third, one consequence of the multiplicity of objectives and plurality of principals is that public agents tend to be unable, and at times reluctant, to devise and implement efficient monitoring and incentive mechanisms. The limitations of public agents to devise such mechanisms stem, in addition, from their complicated hierarchical arrangements, information asymmetry (whereby managers are the ones who know the most about their PEs) and the nature of management within the civil service. In particular, civil servants tend to be procedures rather than outcomes oriented, interventionist (in the day-to-day operational decision-making of PEs), and to possess skills less suited for promoting business-like behavior. The reluctance on the part of bureaucrats to devise efficient monitoring and incentive systems is believed to arise in principle from their desire to maintain ambiguity so that they can retain control, evade accountability and possibly form coalitions with PE managers to secure better pay, power and prestige.

15. Fourth, from a market point of view, PE managers are likely to deviate from profit maximization to a greater extent than their private

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[4]/ Boneo (1981) observed, for example, that upward price revisions of the output of PEs in Argentina systematically followed elections.

[5]/ Jones (1985) has shown, in Egypt and elsewhere, that attempts to control PE prices in order to benefit the poor turned out to benefit the rich.

[6]/ At one extreme, ownership is allocated to "society" (e.g. Yugoslavia). At best, it is allocated to a holding company (e.g. Italy).

[7]/ Typically, the Ministry of Finance attempts to maximize revenue form PE operations; the Ministry of Labor attempts to maximize employment; the Technical Ministries attempt to increase their power and prestige through the expansion of PEs under their domain.

counterparts because PEs tend to operate, by and large, in sheltered markets (which are either natural --decreasing cost industries-- or policy induced --protection and the like). They usually escape the discipline of financial markets; particularly because they have access to government funds and credit from the banking system and abroad, often at preferential terms. Moreover, they operate behind barriers to exit; that is, they are seldom liquidated even when they prove to be costly to society.

16. The implication of this literature is straightforward: ownership matters; it has consequences for enterprise efficiency. Public ownership and management of resources of enterprises producing tradable commodities and operating in relatively competitive or potentially competitive markets entail costs associated with bureaucratic failure that go largely uncompensated for by any gains from reductions in market imperfections. Therefore, private ownership of such activities should usually be preferred. The same conclusion does not strictly apply, however, to non-competitive firms, i.e. firms which may be in a position to exercise some monopoly power. For this subset of PEs, the net benefits from and feasibility of regulating private monopolies have to be weighted against the net benefits from and feasibility of retaining them in the public domain and reforming them. Assuming that a decision is made in favor of retaining this subset of PEs in the public domain, this literature suggests, in order to reduce the room for managerial discretionary behavior and reduce political interference, that: PEs should pursue commercial objectives; their managers should be appropriately selected and induced to pursue these objectives; and they should have the autonomy to respond to market signals, in return for which they should be held accountable for outcomes and rewarded or penalized accordingly. PEs should, in addition, face greater competitive pressure and financial discipline. Non-viable PEs should be closed down.[8]/

C. Components of Approach[9]/

17. The Bank's sector-wide approach and best practice solutions to PE reform correspond to the above recommendations. In its endeavor to assist its borrower countries to improve the efficiency of their PEs, the Bank supports reforms to: (1) rationalize the sector's size, (2) improve the PE market-related environment, (3) streamline the institutional set-up governing the

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[8]/ Theoretical assertions apart, similar conclusions are reached by a number of country studies and inter-country comparisons. One such study, which focuses on the determinants of performance of PEs in a sample of 13 developed and developing countries, concluded that the most important determinants of the performance of PEs were: competition, managerial and financial autonomy, and accountability. The countries covered by the study are: Austria, Brazil, France, Ghana, India, Israel, Italy, Norway, Pakistan, Portugal, Sweden, Tunisia, and Zambia. For details, see: Ayub and Hegstad, 1986.

[9]/ For a detailed review of the Bank's approach to PE reform, reform components, best practice solutions, and examples, see Shirley, 1989a.

relationship of PEs with their governments as the owner and regulator, and (4) assist in the rehabilitation/restructuring programs of viable PEs. These issues are briefly elaborated below.[10]

18. Rationalizing The Sector's Size: Excessive government intervention in the form of direct ownership of resources implies that the efficiency of PEs will suffer for two basic reasons. First, the government's scarce administrative capacity will be spread too thinly across too many activities, which, in turn, diminishes the government's capacity to perform its ownership function efficiently. Second, PEs will exist in activities in which society is likely to better-off, for reasons given below, if they are left to the private sector (e.g. tradable commodities in general).[11]

19. To rationalize the size of the sector, the Bank supports divestiture (in the form of liquidation, sale of assets, contracting-out the delivery of public services to the private sector or franchising) when such an action is expected to promote efficiency.[12] Efficiency gains are expected when divested firms operate, or are made to operate, in competitive or contestable markets. The presumption is that the transfer of ownership will enable private entrepreneurs to operate freely from problems inherent to PEs; political interference, multiplicity of and conflict between objectives, plurality of principals, and rigid and inappropriate control structures. The new owners will, in addition, face the threat of merger and bankruptcy, and will have to borrow on their own merit. In short, divestiture will internalize the costs of and benefits from ownership. As a result, self-motivated private entrepreneurs will exert greater effort to improve efficiency at the enterprise level. In the case of divesting non-competitive PEs, the Bank supports such an action when it is accompanied or preceded by the enactment of an effective regulatory system. Short of instituting such a system, it is feared that private monopolists may exploit the consumers without necessarily

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[10] In implementation, it is possible to find deviations from the recommended approach. The implementation experience is reviewed in section II below.

[11] Activities in which the costs of bureaucratic failure are likely to be large have the characteristics of: being small relative to the product and factor markets, requiring decentralization of establishments and decision-making, involving the production of non-standardized goods, not requiring lumpy capital, and being relatively labor-intensive. For further details on these issues, see Jones and Mason, 1982.

[12] Governments may pursue divestiture for reasons other than or in addition to increasing efficiency; for example: capital market development, promoting competition, resource mobilization, distribution of ownership, diffusing the strength of trade unions and the like. These objectives are important in their own right. Yet, they are viewed as positive byproducts from divestiture when they occur. Moreover, it should be emphasized that they could, perhaps more effectively, be achieved via alternative instruments; e.g. financial sector reform, deregulation, trade liberalization, and subsidies and tax schemes.

attaining any gains in efficiency.[13] But even then, the costs and feasibility of instituting regulatory mechanisms have to be weighted against the costs and feasibility of retaining PEs in the public hand and reforming them.

20. <u>Increasing Competition and Financial Discipline</u>: Even after measures have been taken to rationalize the size of the sector, the likelihood is high that some PEs (especially natural monopolies producing non-tradable commodities and possibly others) will remain public. As noted, the efficiency of those is likely to suffer when government policies diminish or preclude competition in the product, input, factor or financial markets. Competition reducing policies include: barriers to entry of new firms and exit of inefficient ones, widespread monopoly rights, excessive protection, price control, uneconomic investment decisions, rigid labor and wage policies, and economically unjustified access to the banking sector, government funds and foreign credit.

21. To reduce the adverse effects of such policies on the efficiency of PEs, the Bank supports measures to promote competition and reduce the anti-or-pro PE bias.[14] To promote foreign competition, the Bank supports greater openness to foreign trade (largely using instruments other than PE reform programs) and export rivalry. Domestic competition is promoted by abandoning monopoly rights, breaking-up large monopolies, facilitating entry of new firms and liquidating PEs that cannot survive on their own.[15] Measures to reduce the bias against or in favor of PEs include the elimination of preferential access to and terms of credit and foreign exchange. They also include measures to reduce/eliminate PEs' access to government funds; i.e., operational subsidies and the like. (The latter measure is motivated by efficiency as well as fiscal considerations).

22. In addition, the Bank supports <u>price</u> liberalization, especially for products produced in competitive markets, and price revision, on the basis of long-run marginal costs, for non-tradable commodities that are produced in non-competitive markets. Price reforms are intended to: correct for relative price distortions, and allow managers the flexibility/autonomy to respond to market signals; both of which should lead to better allocation and use of resources. Cost-plus formulas are discouraged on the ground that they promote

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[13] Hemming and Mansour, 1988, Nellis and Kikeri, 1989, and Galal, 1989a elaborate on the <u>a priori</u> conditions under which efficiency improvements are expected from divestiture.

[14] Competition policies may neither be feasible nor desirable where economies of scale or scope are so large that only a monopolist could attain them. In such cases, appropriate control mechanisms are especially recommended. These recommendations are reviewed below under the heading "the institutional set-up".

[15] For further details on competition policies, see: Frischtak et. al., 1989.

inefficient behavior at the enterprise level and impose a burden on the consumers and/or tax-payers.

23. As many PEs are overstaffed and face rigid labor and wage policies, the Bank often supports staff reductions and changes in the rules of hiring, firing and compensation. The objective of these reforms is to encourage efficiency by ensuring an optimal mix of capital and labor, and a stronger link between labor productivity and compensation. To alleviate the adverse welfare effects resulting from lay-offs, the Bank supplements its support to these changes by funding and assisting its borrower countries to implement training, severance payments, and redeployment programs.[16]

24. The Institutional Set-up: Increasing competition, reducing price distortions, and eliminating the anti-or-pro PE bias will pave the way to force PE managers to behave more efficiently. Without parallel reforms in the institutional framework to increase PE autonomy to respond to market challenges and to hold managers accountable for outcomes, market-related reforms may not necessarily stimulate the appropriate supply response at the enterprise level. PEs will not respond to increased competition and removal of distortions with increases in efficiency if the Government-PE institutional relationship is one in which PE managers are forced to: (1) pursue multiple and conflicting objectives, (2) respond to too many government agencies (principals), (3) face ineffective monitoring and reward systems, and (4) have limited managerial and financial autonomy in operational decisions of a sort largely left to managers of private firms; e.g. pricing of products produced in competitive markets, firing redundant workers and attracting and retaining those with the appropriate skills, procurement and distribution, etc.

25. The Bank, in addressing each of these issues in turn, supports reforms to clarify enterprise objectives, better specify the role of the government as the owner and regulator change the control structure from ex-ante to ex-post, hold managers accountable for outcomes and reward them on the basis of achievements. Commercial PEs are encouraged to pursue profit maximization. Non-commercial objectives should be pursued by other instruments, such as direct taxes or subsidies. In cases where PEs are the most effective vehicle to attain these objectives, the Bank supports their quantification and explicit compensation to PEs. Concerning the role of the government as the owner, it has been suggested that this role should be limited to functions similar to those exercised by a head office in a multidivisional private firm.[17] These functions are: setting enterprise objectives, appointing the managing director, evaluating performance, rewarding or penalizing managers accordingly, approving investment decisions when they require government funds, planning and coordinating across units and activities, and --most importantly-- doing nothing else. The role of the government as a regulator should be assigned to a government agency different

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16/ For a review of the Bank's experience in public sector pay and employment, see: Nunberg, 1988.

17/ The list of government functions as the owner is first compiled by Jones and further elaborated upon by Galal, 1989b and Shirley, 1989a.

from that performing the ownership function; mixing the two risks producing a conflict of interest.[18] The regulatory function should be designed to compensate for incidents of market failure (e.g. provide information, regulate monopoly pricing, support infant industries, etc.), supplement rather than supplant markets (e.g. collecting and disseminating information about markets, technology, setting product specification for health and other similar public concerns), and be ownership neutral (i.e., no distinction should be made between public or private enterprises). Operational decisions should be left to the managers of PEs.

26. The above reforms often require searching for appropriate agencies to perform the ownership and regulatory functions, modifying the laws and procedures that are inconsistent with recommended settings, phasing out some superfluous or counterproductive supervisory institutions, strengthening others, and/or creating new ones, training and technical advice. The magnitude, scope and nature of the required changes in a given country depend on the existing setting and how far it deviates from the desired arrangements. Therefore, the details are often considered on a case-by-case basis. To ensure the sustainability of attempted reforms, however, the Bank frequently supports the implementation of mechanisms, such as program contracts or signalling systems, the objective of which is to facilitate the process of holding managers accountable for results and rewarding them accordingly.[19]

27. PE Rehabilitation/Restructuring: Problems at the individual enterprise level may still block efficiency improvements, thus rendering the above reforms (policy and institutional) ineffective. For a given enterprise, these problems could be the result of, among other things: uneconomic investment decisions, technological bottlenecks, distorted financial structures, poor management of inventory, weak marketing capabilities, and/or lack of skilled and motivated workers and managers. Of course some PEs cannot be helped; i.e., those that are neither able to cover their variable cost, nor have the potential to do so. In such cases, the Bank supports their liquidation. Other PEs legitimately need assistance and can be turned around. Here, the Bank, as noted, supports their rehabilitation and restructuring, focusing on PEs whose performance is critical to the performance of other actors in the economy. Regarding commercial PEs that operate in competitive

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[18] Assigning the ownership and regulatory functions to separate government agencies has been suggested in socialist economies, but the same notion is equally applicable in mixed economies.

[19] "Program Contracts" and the "Signalling System" are conceptually the same. Both are negotiated agreements specifying the government's obligations toward the PE (e.g. financial obligations, pricing formulas) and the obligations of the PE toward the government (e.g. performance targets). They are intended to facilitate the process of evaluating PE managers against agreed targets and compensating those who show superior achievements. In implementation, the two may differ. This point is discussed below. For further details regarding Program Contracts, see: Nellis, 1989. For further details regarding the Signalling System, see: Jones, 1981 and Shirley, 1989b.

markets, the Bank supports the transfer of their ownership to the private sector.

II. REFORM EXPERIENCE

A. Documentation of Reform

28. On the basis of the PE sector-wide approach, the Bank had, by June 1989, approved 147 projects in support of PE reform, of which 24 operations were approved during the last year alone (July 88-June 89). (See Table 1). Most of these reforms were associated with structural adjustment loans (67 projects), followed by technical assistance loans (34 projects), and sectoral adjustment loans (33 projects). In addition, 13 loans focus exclusively on PE reform (PELs).[20]

29. Bank support for PE reform has been concentrated in Africa, which alone accounted for 54 % of the total number of PE lending operations, followed by the Latin American and Caribbean region (LAC), the Europe, Middle East and North African region (EMENA) and, finally, the Asian region. The widespread and apparent incidence of market and bureaucratic failures in African countries in comparison with others, and the excessive size of the PE sector in this region largely account for the concentrated effort.

Table 1: Number of PE Reform Projects a/

Region	Technical Assistance	Structural Adjustment	PELs b/	Sectoral Adjustment	Total
Africa	21	36	8	15	80
LAC	10	16	2	4	32
EMENA	3	8	2	11	24
Asia	0	7	1	3	11
Total	34	67	13	33	147

Notes: a. Approved as of June 1989.
b. Includes PE rationalization/rehabilitation loans, PE institutional development projects, and PE sector adjustment loans.

Source: Statistical Annex.

20/ Public enterprise loans (PELs) include PE rationalization/rehabilitation loans (PERLs), PE institutional development projects, and PE sector adjustment loans.

30. The principal components of Bank-supported PE reforms and their distribution by country and lending instrument are given in the attached statistical annex. On the basis of available information, some general observations can be made: First, the components of reform correspond to the Bank's sector-wide approach to PE reform. Most operations deal with: the sector's size (through liquidation and divestiture), the policy environment in which PEs operate, their institutional set-up, and the liquidation, sale or rehabilitation of individual PEs. This observation reflects the extent of dissemination and wide acceptability of the approach. Second, despite the similarity in coverage of issues across operations, some variations in project design can still be detected. To some extent, these variations appropriately reflect country-specific circumstances. For example the magnitude of the problem of the state/PE and the PE/PE cross-debts and the excessively interventionist institutional set-up in the Moroccan case led to a focus on these issues in the PEL operation. To some extent, however, some variations in diagnostic studies reflect government's reluctance to undertake some reforms (e.g. divestiture in India). There are also examples of mistaken diagnosis, such as the early phase of PE reform in Senegal, in which the TA project focused too much on control mechanisms and less on divestiture and PE-policy related issues.[21]/ Third, the bulk of attempted reforms concerns the government/PE relationship. The emphasis on institutional reforms can be explained in terms of: (a) the weak and often inappropriate institutional arrangements governing the government/PE relationship in most countries, and (b) the fact that the overall policy and market-related reforms are often addressed by the Bank under other umbrellas (e.g. structural adjustment loans, trade loans, export promotion loans, sectoral loans). Fourth, the Bank's support for divestiture is extensive, the evidence of which is apparent from a recent Bank review pointing out that the Bank has supported divestiture in as many as 35 countries through some 70 operations, by the end of June 1989. (Kikeri, 1989).

B. Reform Outcomes

31. PE reforms should, first, lead to a reduction in the size of the PE sector. Governments, as they adopted import substitution strategies in the sixties and seventies, overextended their involvement in the direct ownership and management of resources.[22]/ Reforms should correct for this overextension. Second, PE reforms should improve the operational efficiency of PEs. They support a more competitive environment and more flexible institutional arrangements, both of which should pressure PE managers to strive for improved performance and enable them to do so. Finally, PE reforms should increase the contribution of PEs to the government's budget because, as efficiency and profitability improve, remitted dividends and taxes should go up, and their dependency on the budget for subsidies and other transfers should decline. The question is whether attempted reforms have led to these outcomes.

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[21]/ For a detailed assessment of the early phase of the PE reform in Senegal, see: The Project Completion Report for PPTA1, 1985.

[22]/ Occasionally, with the active support of the Bank.

32. Thus far, systematic empirical evidence regarding the impact of PE reforms on outcomes has been relatively scarce, in part because of the short time horizon during which PE reforms have been attempted on a sector-wide basis (only in the 1980s). More recently, however, some preliminary Bank reports are beginning to address this question. The findings of these reports, which are summarized below, have to be interpreted with caution for two reasons. First, it is difficult to isolate the effect of attempted PE reforms from the effect of other factors (e.g. policy changes at the macro level, external shocks and the state of economic activity). Second, it is also difficult to establish the counter-factual story; what would have been the case without attempted reforms?

33. Bearing these caveats in mind, some tentative conclusions can be drawn.[23]/ In short, PE reforms appear, where they have been implemented, to have on the whole brought about positive improvements. Further details and examples follow.

34. The Size of the PE Sector: Attempts to reduce the size of the PE sector have been made in the Philippines, Jamaica, Mexico, Togo, Guinea, Mali, Madagascar, Benin, and elsewhere. Most of these attempts have been made in Africa. Available empirical evidence regarding the impact of these reforms on the size of the PE sector in relation to GDP is inadequate to assert that PEs now play a less significant role in the economic activity than in the past.[24]/ The evidence seems, however, to point in this direction. For example, the Philippines has sold almost 25% of the state's 1985 portfolio. Mexico, as of March 1989, had sold 180 PEs, liquidated 260, merged 70, and transferred 25 PEs to local governments. Tunisia has sold some 25 holdings. Jamaica divested J$500 million worth of assets. Togo and Guinea have sold, put under management contracts or leased a significant portion of their industrial PEs. Guinea closed some 70 PE units. Togo, Mali, Madagascar and Benin have each liquidated 12-15 firms (Kikeri, 1989).

35. Against these accomplishments, the divestiture process has been relatively slow in other countries. For instance, in Senegal, despite the government's announced policy of "withdrawal of the state" in 1985, hardly any PEs have in fact been sold as of early 1989. In Turkey, where a large and costly preparation for divestiture has been undertaken, very modest actual divestiture has taken place. Moreover, the process is likely to be slower and more complex in the future. In the first wave of divestiture, Governments focused on the sale of profitable, small or medium-scale enterprises. In the

[23]/ Clearly, more systematic empirical evidence is necessary before passing a sound judgment about the effect of PE reforms. The LAC region's on-going study regarding the impact of PE reforms in Chile, Argentina and Mexico is a beginning in this direction. Other regions of the Bank should initiate a similar exercise.

[24]/ To assert that the size of the PE sector in relation to GDP has declined, one would have to rely not on the number of divested firms, but on the sector's value-added in relation to GDP, its share in total capital stock, investment, and/or employment.

second phase, as larger PEs come up for sale, the process will be slowed by limitations imposed by domestic aggregate savings, sensitivity to foreign buyers, labor redundancy and the weak administrative capacity to regulate private monopolies. In addition, greater restraint would be necessary to avoid the temptation of granting undesirable concessions (tax exemptions and the like) to sweeten the deal.

36. From the Bank's perspective, some preliminary conclusions are emerging. First, divestiture is better viewed as an instrument of public policy, which may or may not improve efficiency, depending on the conditions of the sale, the market structure facing the enterprise in question, and whether or not the transfer of ownership is accompanied by the creation of effective regulatory mechanisms in the case of divesting non-competitive firms. Holding the alternative view (i.e., that divestiture is an end in and of itself) risks portraying the Bank to be ideologically biased. Second, the bulk of divestiture, as noted, has taken place in Africa. Paradoxically, the conditions prevailing in most African countries appear to be less suited to undertake effective divestiture programs; most notably, several of these countries have relatively underdeveloped capital markets, limited competition and scarce entrepreneurial talents. Therefore, further Bank support to divestiture in these countries should emphasize liberalization of the economy and financial sector reforms prior to the sale of assets to the private sector. Third, divesting monopolistic firms is proving difficult because many LDCs have weak regulatory capacity. Therefore, attention to building such capacity should be emphasized in the future. But even then, given the less than satisfactory performance of regulatory agencies in developed countries, it would be important to weigh the costs of and benefits from divestiture-cum-regulation versus those of maintaining PEs in the public hands and reforming them. Fourth, the process of implementing divestiture programs is proving to take longer than anticipated; time is required to prepare a strategy, select candidate enterprises, evaluate their assets, select appropriate modality, announce and screen applications, and strike the deal. Therefore, it may be necessary for the Bank to employ or devise a lending mechanism that spans over a longer period of time than is, for example, permitted under SAL operations.

37. Operational Efficiency: Available empirical evidence for a sample of countries suggests frequent, but not universal, association between the implementation of PE reforms and improvements in the sector's operational efficiency. The evidence from Africa shows that the financial performance of PEs has been improving over time.[25]/ "Out of a sample of 18 countries, 8 have shown an improvement as early as 1985 (e.g. Mauritius, Ghana, Niger), 8 are showing mixed results, and two are showing a deterioration (e.g. Ivory Coast, Senegal)". (Swanson and Wolde-Semait, 1989). In Thailand, where direct lending for PE reform did not take place but implemented reforms are consistent with those recommended in Bank reports on Thai PEs, aggregate profits of the non-

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[25]/ Financial profitability and operational efficiency are used interchangeably in the text. The two will diverge, however, when changes in profitability reflect, for example, greater subsidies or higher output prices. Since available data do not allow such verification, the conclusions of this sub-section have to be interpreted with caution.

financial PEs went up from Baht 11.1 billion in 1983 to Baht 19.4 billion in 1988. (World Bank Report No. 7787-TH, 1989). By contrast, net aggregate losses (profits -losses) of the non-financial PEs in Senegal (excluding taxes and subsidies) have increased from CFAF 12.3 billion in 1982 to CFAF 17.8 billion in 1986. (World Bank Report No. 7774-SE, May 1989).

38. Changes in the operational efficiency of PEs are in part the product of implemented policy and institutional reforms. Regarding the immediate PE-policy framework, price liberalization or increases have taken place in almost all PE reform programs, for example, in Turkey, Jamaica, Togo, the Ivory Cost, Morocco and Niger. (See Table 4 in the attached statistical annex for details). Significant staff reductions have been implemented in Ghana, Niger, Togo, Panama, Jamaica, the Ivory Coast, and elsewhere. Reforms of investment and credit policies and procedures have been introduced, for example, in Congo, Ghana, Jamaica, Mexico and the Philippines.

39. Despite the desirability of these reforms, it is cause for concern that price liberalization has not always been introduced in tandem with or prior to introducing measures to increase domestic competition. In the majority of cases, attempts have been made, through trade liberalization, to increase competition in the import and export markets. Yet, evidence is lacking to support the notion that measures to increase domestic competition in markets where PEs operate (by breaking-up large monopolies, facilitating entry and exit of firms and the like) have been addressed systematically. (A few exceptions can be noted. In Hungary, for example, price reforms, bankruptcy laws, deregulation of entry, etc. have been dealt with.[26]/ In the Niger SAL, tax exemptions for PEs have been abolished). Finally, it appears that the generous severance pay arrangements in face of restrained government budgets are causing difficulties in implementing staff reduction plans, for example in Ghana. More importantly, it is not clear how redundant workers have been identified. Short of any rigorous documentation, it is feared that enterprise efficiency may have suffered in case the remaining work force did not possess the desired skill mix.

40. Reforms on the institutional front figured prominently in almost all PE reform programs, for example, in the Philippines, Mexico, Morocco, Ghana, Togo, Niger and Ivory Coast, and elsewhere. Attempts have been made to strengthen information gathering and auditing, create focal points for policy formulation and supervision of performance, alter the supervisory function to become ex-post rather than ex-ante oriented, and to institute performance evaluation and incentive mechanisms.

41. These reforms seem to have achieved most, but not all, of their intended objectives. In Pakistan and South Korea, the implementation of a signalling system appears to have had a positive impact on the efficiency and managerial motivation of PEs (Shirley, 1989b and 1989c, Song, 1988). In Senegal, information gathering and auditing have been substantially improved. In Morocco, the support given to the Directorate of PEs of the Ministry of

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[26]/ For reasons discussed in section III, bankruptcy laws have not led to noticeable actual exit of firms in Hungary.

Finance (to supervise program contracts, draft divestiture legislation, advise on policy formulation, coordinate training programs, build MIS, and clean-up arrears) is showing positive results (Nellis, 1989).

42. Against these achievements, some deficiencies remain. The implementation of program contracts in Senegal has been hampered by the fact that the government did not fulfill its financial obligations (Nellis, 1988). The minimum content of an effective program contract has not always been specified.[27] In such cases, it is feared that the bargaining process may not have always led to optimal contracts. The applicability of the signalling system, especially in African countries, is limited because the system demands detailed, audited and reliable information. Institutions which were supposed to act as buffers between different government agencies and PEs proved in some cases to be an additional layer to the existing bureaucracy (e.g. the holding companies in Egypt, and possibly in Pakistan). Finally, institutional reforms are proving to be both difficult and time-consuming, largely because they involve altering behavior. (For example, introducing a performance evaluation in Ghana and the Philippines is taking years, not months).

43. Budgetary Impact: Attempts to reduce the budgetary burden of PEs have been made in a wide range of countries (e.g. Thailand, Turkey, Mauritius, Malawi, Congo, Senegal, Morocco, Mexico and elsewhere) by means of reducing/eliminating operational subsidies, clearing cross-debts, and commercializing PEs' access to credit from the banking sector. The evidence on the budgetary impact of these reforms is inconclusive. On the one hand, the non-financial PE sector in Thailand, for example, has remitted to the government more than it has received during the period 1983-1988. In other words, PEs remitted more dividends, income tax, and loan repayment to the Treasury than they received in the form of subsidies and loans. (World Bank Report, op. cit.). In Mauritius, the PE budgetary impact improved between 1983 and 1985, net transfers from the treasury to PEs went down from Rs 290 million in 1983 to 160 in 1985 (Swanson and Wolde-Semait, 1989).[28]

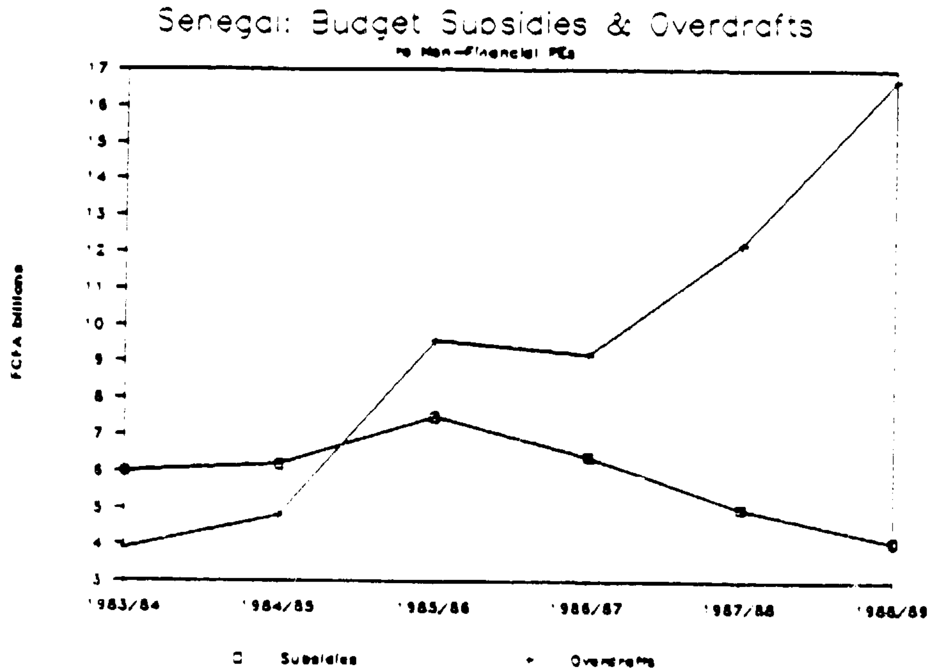
44. These attempts have not been as effective in other countries. In Malawi, for example, while the budgetary impact of PEs improved between 1980 and 1985, net budgetary transfers from the Treasury to PEs declined from K 75 million in 1980 to K 13 million in 1985, but worsened again in 1986 (up to K 112 million). The case of Senegal is most illuminating. In this country, the non-financial PEs have increasingly relied on government financing for their

[27] One exception is the way Program Contracts have been specified in India, where they are known as the Memoranda of Understanding. In this case, appropriate criteria, criteria value and compensation systems are all explicitly specified. For further details, see: Trivedi, 1989.

[28] The fact that PEs in the countries referred to have remitted positive returns to the Treasury does not necessarily mean that these returns were equivalent to the foregone earning opportunities for the government elsewhere in the economy. If that were to be true, further reforms would be necessary.

saving-investment gap. The net budgetary burden has gone up from FCFA 16.3 billion in 1981, to FCFA 27.1 in 1986. (World Bank Report No. 7774-SE, 1988). Direct operational subsidies (specifically that portion coming out of the government budget and defined as the base for the subsidy reduction program under SAL conditionality) have declined from FCFA 6.2 billion in 1985/86 to FCFA 4.1 billion in 1988/89. At the same time, however, 10 major loss-making PEs have received an increasing amount of resources - in the form of overdrafts - from 10 money-making PEs. (See Graph 1). Since recipient PEs were in no position to pay back these overdrafts, the government had to carry the responsibility of settling them. In essence, therefore, the temporary budgetary relief, resulting from subsidy reductions, was offset by future outlays.[29]

GRAPH 1



[29]/ The Government of Senegal decided, in the context of the current SAL IV, to cease all cross-subsidies among PEs in the future.

45. Where attempts to reduce the PEs' budgetary burden have been less effective, the following factors seem to have contributed to the result. First, subsidy reductions have not been matched by a program of restructuring at the enterprise level. As a result, enterprise financial problems resurfaced elsewhere in the economy: in the form of subsidies from alternative sources (e.g. Senegal), in the form of accumulated arrears (e.g. Argentina), or in the form of excessive borrowing from the banking sector (e.g. Kenya). Second, attempted reforms focused only on one component or the other of the flows of funds from the Treasury to PEs, neglecting the fact that what matters, from a fiscal point of view, is the net budgetary impact of PEs (i.e. total flow of funds from PEs to the Treasury minus the total outflow of funds from the Treasury to PEs). Finally, perhaps the most important elements of the budgetary impact of PEs are implicit (exemptions and preferential treatments of all kinds). But, the elimination of these distortions has proved to be more difficult.

C. Prerequisites for and Constraints to Better Implementation

46. Despite the positive effects of PE reforms in several countries, some prerequisites/constraints appear to limit the effective implementation of these reforms. Some of these constraints have been discussed above. Others of a more general nature are elaborated upon below.

47. For PE reform programs to be effective, they require that the macroeconomic framework be in order. In a highly distorted macroeconomic environment (the symptoms of which include: overvalued exchange rate, negative real interest rate, excessive protection, and widespread price controls), PE reforms (including managerial autonomy) may encourage responses to the wrong signals and lead to undesirable effects.[30]/

48. PE reforms are politically sensitive. They entail the liquidation of some PEs and the sale of assets to the private sector. They diminish or eliminate the room for rent-seeking activities. They often involve staff reductions and reallocation of power. And they frequently include price increases and/or subsidy reductions. Therefore, they are resisted by a variety of different interest groups; e.g. workers, bureaucrats, some politicians and even some in the private sector who stand to lose from reforms (since they would have to compete in open markets). An important prerequisite for the effective implementation of PE reforms, therefore, is a strong political will.

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[30]/ The Bank has generally adhered to this premise. Most PE reforms have been preceded by or introduced in conjunction with attempts on the part of governments to set the macroeconomic framework in order. In cases where these conditions were not met, the Bank has refrained from supporting PE reform on a sectoral basis. A case in point is Egypt, where an industrial sector loan focusing on PE reform was kept on hold because the Government was reluctant to move satisfactorily on the macroeconomic front. By contrast, sound macroeconomic management in Turkey and the Philippines made PE reform both feasible and desirable.

49. Assuming a solid macroeconomic framework and the political will to introduce PE reform, the proper design of PE reform programs is critical for these reforms to produce their desired effects. As noted, observed variations in project design are at times justified when they correspond to country-specific circumstances (e.g. the more recent PE reform programs in the Philippines and Mexico). These variations are inappropriate, however, when they are the result of a mistaken diagnosis (e.g. the early phase of the PE reform in Senegal). (This observation raises a more general question regarding the appropriate phasing and sequencing of PE reforms, which is addressed in section III below).

50. PE reform must ultimately stimulate efficiency (else why do it?) at the enterprise level. Country case studies suggest that, while there are several necessary conditions (i.e. reforms of the sector's size, its policy and institutional environment, and restructuring of individual PEs), no one condition alone is sufficient to attain the desired results.[31]/ Therefore, the noted inadequate attention to promote domestic competition in markets where PEs operate appears to be one area deserving greater emphasis in PE reform programs.

III. CHALLENGES AHEAD

A. Overview

51. To sum up thus far: the Bank has developed a rigorous approach to PE reform which is well founded in theory. The outcome of attempted reforms, albeit not sufficiently analyzed, appears to be positive in several countries. The question is: what next?

52. As many governments around the world are increasingly reexamining the role of the state, it is expected that the Bank will correspondingly be called upon for advice on managing the transition period. To meet the expected demand, the Bank needs to extend its PE analytical approach to incorporate emerging challenges, especially in Eastern Europe, further refine the components and tools of the approach, and to consolidate in a more systematic fashion the process of learning from experience. This section elaborates on some of these issues under three headings: (A) conceptual challenges, (B) reform components and tools, and (C) learning from experience. The objective is to propose a list of topics for further investigation.

B. Conceptual Challenges

53. Conceptual challenges stem primarily from observed developments in socialist economies, and the increasing emphasis on the private sector as an

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[31]/ On the one hand, Egypt tried several institutional reforms leaving the PE policy framework largely unchanged. The PE performance has been disappointing. In contrast, Hungary attempted several policy reforms with limited institutional reforms. As noted, the performance of the industrial sector has been modest.

important engine of growth. In addition, observed variations in PE project design and their limited effectiveness in some cases call attention to the possibility that reform programs may not have been properly packaged. Therefore, it is important to address the question of proper phasing and sequencing of PE reforms more systematically. To meet these challenges, further analytical work seems warranted. The rest of this sub-section elaborates on the nature of these challenges.

54. <u>Socialist Economies</u>: In recent years, socialist economies have undergone substantial reforms, the basic features of which are greater decentralization and reliance on market forces (e.g. Hungary, China, Poland and Yugoslavia). These reforms have not yet produced much change in behavior. The problem is illustrated by the following examples: bankruptcy laws have been decreed to facilitate the exit of inefficient PEs, yet, hardly any PEs have gone bankrupt. Financial sector reforms and attempts to harden the budget constraint have been undertaken to increase the financial discipline of PE managers. Yet, limitations on private ownership, inertia and government commitment to social objectives have rendered these reforms largely ineffective. Attempts have been made to equip PE managers with sufficient autonomy in operational decision-making. Yet, many of them have continued to seek approval from the center, in part so that they could blame poor performance on decisions taken outside their domain. Attempts have been made to differentiate wages on the basis of productivity. Yet, self-management arrangements have diminished the effectiveness of these measures. Fear of inflation and possible abuse at the enterprise level have, in addition, led some socialist governments to impose wage ceilings. In short, while many reforms have been attempted, an appropriate supply response at the enterprise level has not been forthcoming.[32]/

55. The approach to PE reform current in the Bank suggests that PEs in socialist economies, just as PEs (or private sector firms) in mixed economies, are likely to function more efficiently when they face competition in the product, input, factor and financial markets, when their managers are held accountable for quantified objectives, when they have the capacity and motivation to behave efficiently, and when non-competitive enterprises go bankrupt. Therefore, to stimulate the desired supply response at the enterprise level in socialist economies, policy-makers in these countries should be encouraged to alter the conditions facing their PEs to coincide with those recommended in mixed economies.

56. While the approach devised for PEs in mixed economies appropriately describes the alterations which PEs in socialist economies must adopt to become efficient, the path socialist economies have to follow to reach these conditions is likely to be different for several reasons. First, a private sector hardly exists in socialist economies. Therefore, the question of individual property rights has yet to be defined. Second, these economies lack well functioning capital markets. Therefore, financing divestiture

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[32]/ In Hungary for example, despite the substantial reforms introduced in the 1980s, the industrial sector grew at only 1.3% during the period 1980-86. For details, see Nagaoka, 1989.

programs is made even more difficult. Third, the magnitude of the transfer of ownership is at a much larger scale than in mixed economies, thus posing questions regarding the limitations imposed by aggregate savings. Fourth, attempted reforms are obliged to pay attention to equity considerations, perhaps to a larger extent than in mixed economies. (After all, socialism has been founded on the basis of equity). Fifth, the transition from a command economy to a market oriented economy is unprecedented, which raises questions regarding the appropriate phasing and sequencing of reform. Finally, the widely applied self-and collective management arrangements in socialist countries impinge on managerial behavior in a distinct fashion; their reform requires special attention. On most of these issues, the mixed economy approach can provide guidance and techniques drawn from the experience of mixed economies. But the applicability and relevance of these lessons and techniques have to be verified and modified to suit socialist country circumstances. (This subject is now being considered by PRE and the EMENA region).

57. Do Public Enterprises Create Barriers to or Provide Incentives for Private Sector Development? In the past few years, increasing emphasis has been placed on the role of the private sector as an important engine of growth in developing countries. Yet, the Bank's approach has thus far insufficiently stressed the fact that PEs, by their mere existence, could constitute a barrier to or a vehicle for private sector development.

58. For example, PEs may act as a barrier to private sector entry, even if such entry is not prohibited by regulation, if the output of PEs is underpriced to the point where private enterprises could not be profitable. Conversely, PEs may act as a vehicle for private sector entry, for example, when PEs are the providers of infrastructure and inputs of production to private producers. A more subtle (and not uncommon) scenario is one in which the output of PEs is overpriced. In this case, even an inefficient private enterprise, producing in the same price-controlled markets, would still be profitable.

59. The story could be made more complex if one were to allow for various oligopolistic behavioral models; e.g. cartel, price leader etc. The main point, however, is that the approach to PE reform needs to be extended to more systematically analyze this relationship, and to identify ways to reduce the crowding out effect of PEs and to maximize their influence in crowding in efficient private enterprises. (This issue is currently being addressed in the context of the on-going initiative on private sector development in the Bank).

60. Phasing and Sequencing of PE Reform: Identifying the components of PE reform is one thing. Packaging these components and selecting an appropriate speed and intensity of introducing them is another. The problem is that, unlike trade reforms where significant knowledge on sequencing has been accumulated, the issue of sequencing PE reforms remains largely unaddressed in a systematic fashion. Consequently, it is plausible that some of the variations in project design and their limited success in improving the efficiency of PEs could be attributed, at least in some cases, to this vacuum. Moreover, it is feared that, in the absence of such knowledge, reforms could

be easily reversed, and the elimination of one market distortion, leaving others unchanged, may lead to inferior solutions.

61. A few examples will illustrate the point. Policy reforms (e.g. prices, wages and incentives, investment, trade etc.) are important ingredients in any PE reform program. Yet, policy reforms will not have their full impact on the efficiency of PEs without simultaneously reforming their institutional set-up, and vice versa. (The deterioration in the performance of PEs in Senegal and the modest improvement in the performance of the industrial sector in Hungary appear to be consistent with this view). While price liberalization may be desirable in and of itself, such a measure, if not accompanied or preceded by measures to increase competition or regulation in the case of private monopolies, may indeed be counterproductive. Similarly, managerial autonomy is an important element if PE managers were to respond effectively to market challenges. Yet, autonomy without accountability may be a recipe for abuse. The examples are numerous. The point is the same.

62. To avoid the likely adverse repercussions resulting from improperly packaged PE reform, further work should focus on establishing the logical interdependencies among PE reform components. The product of such an exercise would be part of the answer to the question of how to phase and sequence future PE reform.

C. Reform Components and Tools

63. The need to refine PE reform components and tools is not caused so much by the lack of knowledge of what needs to be done, nor ignorance concerning the principles underlying needed reforms. Rather, the challenges are caused by the need to define better ways to implement known principles and techniques. Issues of this nature include: sequencing price liberalization and measures to increase competition, effective measures to reduce the budgetary burden of PEs, and valuation of enterprises for divestiture. These issues are elaborated upon below.

64. Price Deregulation: The rationale for price deregulation is relatively well known; (1) market determined prices better reflect the relative scarcity of goods and services, (2) price decontrol is consistent with the notion that PE managers should be given the autonomy to respond to market signals, (3) price liberalization will improve the financial profitability of PEs, as many of them are forced to sell below average costs, (4) higher profitability will, in turn, reduce PEs' dependency on the government's budget, and (5) market determined prices, in contrast with cost-plus arrangements, are likely to induce greater efficiency at the enterprise level. Equally well known is the principle that price deregulation should be accompanied or preceded by measures to ensure market competitiveness, or at a minimum market contestability. What is less known is how to move from the state of controlled prices to a state of liberalized prices. Inappropriate sequencing of price liberalization and competition may cause PEs, as much as private enterprises, to exploit their monopoly power, with adverse consequences on the consumers and inflation. Therefore, it is important to develop an operational approach specifying the details of price liberalization-cum-increasing competition, and to demonstrate the approach's

applicability. (A draft paper on this issue is currently being finalized in the Bank).

65. Reducing the Budgetary Burden of PEs: "The Water-bed Effect": As noted, numerous attempts have been made in Bank supported programs to reduce the budgetary burden of PEs. This objective has been pursued by reducing explicit operational subsidies to PEs and in many instances by scaling down investment funds.

66. In implementation, two problems have emerged. First, while subsidy reductions have been adhered to, PEs have generally found alternative sources to finance their deficits, e.g. the banking sector, customers and clients, foreign borrowing, or cross subsidization. (This is the so-called water-bed effect, holding down one area causes expansion in another). The second problem concerns investment cuts. These cuts, while arguably necessary on fiscal grounds, have tended, when they were applied to marginally productive project, to have adverse repercussions on the ability of the economy to grow in the medium-term.

67. To minimize the possibility of transferring the financial problems of PEs from one actor to another in the economy and to reduce the cost of the trade-off between fiscal balance and medium-term growth objectives, it is therefore important to: (1) investigate, initially on the basis of multiple case studies, the extent to which the water bed problem exists, and whether the trade-off involved is significant, and (b) suggest ways and means to remedy these problems.[33]/

68. Enterprise Valuation for Divestiture: As divestiture intensifies, one central question that governments have to address is how much to sell an enterprise as an on-going concern for. If a government decides to merely sell the enterprise's assets, thus carrying the responsibility for liabilities, the question is how much it should charge for these assets. If a government opts to sell part of an enterprise's equity in capital markets, the question is how much the share is worth. On all these questions, the Bank has not yet developed a recommended methodology. Rather, the exercise has largely been left to investment bankers, accounting firms or bureaucrats. As a result, enterprise valuation has been determined on the basis of a variety of methodologies; for example: the price:earnings ratio, negotiation, the highest bid, the replacement cost of capital, or the discounted stream of future costs and benefits.

69. While each methodology has it own merits, it is not clear whether applied methodologies correspond to developing country conditions or reflect the well-being of society; especially in situations where capital markets are

[33]/ In a recent paper, Lacey (1990) analyses the different elements of the PE budgetary burden. He argues that needed macroeconomic reforms are likely to affect the finances of PEs negatively in the short-term and that substantial expenditure may well be required to enable PEs to survive in a more competitive environment, thus adding one more reason to support the need to explore the budgetary impact of PEs.

underdeveloped and relative prices are distorted. To assist its borrower countries in this regard, the Bank will need to develop and disseminate an operational approach to divestiture decisions, which should then be routinely applied in a manner similar to the way cost/benefit analysis is now being applied to project evaluation.[34]/

D. Learning From Experience

70. As noted, empirical evidence regarding the impact of attempted reforms on the performance of PE is relatively scarce. Similarly the effectiveness of some of the reform components remains largely un-analyzed. At this stage, sufficient time has elapsed to permit a systematic assessment of the experience to date. The most important aspects deserving further investigation include: the outcome of PE reforms, the ex-post performance of divested firms, the efficiency consequences of involuntary resettlement of labor, and the effectiveness of program contracts on the performance of PEs at the micro level. This sub-section elaborates on these issues.

71. Outcome of PE Reforms: With a few exceptions, most Bank assessments of PE reform either address the degree of compliance with conditionality, the effectiveness of the instruments used, or the problems encountered in implementation. Rarely has the effect of PE reform been assessed in terms of outcomes; e.g. profitability, productivity, exports, budgetary impact, crowding out the private sector etc.

72. As noted, it may not have been possible in the past to measure the effect of PE reforms in terms of outcomes, in principle because of the brief period during which PE reforms have been attempted on a sectoral basis. It now appears, however, that sufficient time has elapsed, at least in a few cases, to permit such a study. The objectives would be to detail the outcome of attempted reforms, and provide insights and feedback from experience to improve future attempts at reforming PEs. Notably, a study of the nature described here is underway for three Latin American countries; Chile, Argentina and Mexico. It would be desirable to mount similar regional studies in the rest of the Bank.

73. Ex-Post Performance of Divested PEs: Divestiture as a device for improving the contribution of PEs to a country's economic development has increasingly been used by developing and developed countries. It has been supported by the Bank in 35 countries in over 70 PE reform operations.

74. The intensified use of divestiture rests on two empirically verifiable propositions; first, it will improve productive efficiency and, second, it will reduce the budgetary burden of PEs. There has been no systematic empirical verification of these propositions, especially drawing upon the experience of LDCs, nor has there been an attempt to produce an

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[34]/ A theoretical welfare-based approach to divestiture decisions has been developed by Jones et. al. (Forthcoming). Further work may be necessary, however, to make the approach more operational and adaptable to various modes of divestiture and varying country circumstances.

empirically-based set of stylized facts about the conditions under which divestiture will or will not work.

75. To address these questions, the Bank has launched a research project which is expected to be completed by June 1991. On the basis of a sample of divestiture experience in 4 countries, the project is intended to: (1) quantify the effects of the change in ownership on economic efficiency and the budget, (2) attempt to attribute the outcome of divestiture to its causal factors, and (3) on the basis of the findings, make recommendations regarding future divestiture programs.

76. Involuntary Resettlement of Labor in PEs: It has long been observed that the performance of PEs is adversely affected by redundant workers. Therefore, attempts to reform PEs have often included measures to reduce the labor force. To alleviate the adverse effects on workers resulting from lay-offs, programs to reduce the labor force in PEs have often been accompanied by training, redeployment and severance payments.

77. Despite these attempts, it is not clear how redundant workers have been identified in the past, what has been the impact on the enterprises in which these reforms were undertaken, and what safeguards were introduced to ensure that the enterprise's remaining work force possesses the appropriate skill mix. Put differently, while the approach to workers' redundancy has been appropriately welfare based, the approach's efficiency consequences have not been sufficiently analyzed. To address these questions, it would be desirable to analyze a few case studies in which workers resettlement has taken place, with a view to making recommendations to ensure that staff reductions are implemented in the future in a manner that is consistent with efficiency considerations.

78. Micro-Level Assessment of Program Contracts: It is obvious that not all PEs will be divested. For these, a mechanism of one sort or another will have to be put in place to ensure the accountability of their managers to the government as the owner. Program contracts have been used, especially in Africa, but increasingly in India, the Maghreb, and some Latin American countries, as well as an instrument to clarify enterprise objectives, to ensure managerial autonomy and accountability, and ultimately to improve the performance of PEs. To date, we do know that performance has not improved or that when it has it cannot be rigorously traced to the execution of program contracts, especially at the micro level of investigation.[35]/ Given the uncertainties surrounding their outcomes (due to the problem of information asymmetry), and their continued intensive application, it is important to analyze their effect on enterprise efficiency and managerial motivation on a sample basis, with a view to determining their impact and drawing lessons for future application of this instrument.

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[35]/ Programs contracts have recently been assessed at the aggregate level in developed (e.g. France) and developing countries (e.g. Senegal and Morocco) (Nellis, 1988).

CONCLUDING OBSERVATIONS

79. As noted, many governments around the world are reexamining the role of the state. Questions of divesting PEs and attempts to improve the efficiency of those that will remain public are likely to intensify, rather than diminish, in the near future. In the process, the Bank will increasingly be called upon for advice and financial support in managing the transition period.

80. To meet the anticipated demand, three main observations are noted. First, the Bank's focus on the rationalization of the size of PEs, through the liquidation of non-viable PEs and the transfer of ownership and/or control to the private sector when such actions are expected to promote efficiency, should continue. In assisting its borrower countries to improve the efficiency of PEs remaining public, the Bank should continue to emphasize the PE policy framework as well as their institutional set-up. Countries which tried one without the other have, as already noted, achieved only modest gains, if any, in the performance of their PEs.

81. To increase the effectiveness of Bank supported PE reforms, the second observation concerns the need to extend the analytical approach, refine reform components and tools, and learn from experience. To reiterate from section IV, further work is necessary to:

1. Extend the PE analytical approach to:
   - Socialist economies,
   - The relationship between PEs and the private sector, and
   - The issue of phasing and sequencing of PE reforms.
2. Refine PE reform components and tools, especially regarding:
   - The phasing and sequencing of price liberalization and competition,
   - The budgetary impact of PEs, and
   - The valuation of enterprises for divestiture.
3. Learn more systematically from experience by analyzing:
   - The outcomes of PE reforms and their causal factors,
   - The *ex-post* performance of divested PEs and its determinants,
   - The efficiency consequences of staff reduction, and
   - The effectiveness of program contracts on enterprise efficiency at the micro level.

82. The list of proposed topics is not exhaustive, but is still extensive. Therefore, it should be viewed as a medium-term agenda. It too requires some phasing and sequencing. More importantly, it requires, within the Bank, concerted effort and collaboration between PRE and the four regions. PRE is well positioned to provide inter-regional perspectives. Technical and Country Departments can provide regional patterns, country-specific experiences, and operational direction for the needed research. Additional insights can be gained from collaborating with the academic community and other institutions concerned with the same issues.

83. The third, and final observation concerns: (1) the lending instrument, (2) the duration of PE loans, and (3) the quality of project design. Regarding the lending instrument, it has been noted that most attempts to reform PEs have used SALs as their vehicle, rather than PELs. No doubt the choice of instrument should be considered on a case by case basis. Yet, as PE problems are complex, and as SALs generally have to be selective and macro-oriented, it may be desirable to use PEL operations more frequently than has been true in the past.[36]/ Concerning the duration of PE lending operations, it has also been noted that several components of PE reforms take longer to implement (e.g. divestiture, institutional reforms) than permitted under a typical SAL disbursing period (approximately 12-18 months). Moreover, PE loans often involve TA components and finance both imports and investment. Therefore, it may be more appropriate to extend the disbursement period of PE reform loans beyond the average time for SALs, say to 3-4 years. Finally, two recommendations can be made to improve the quality of project design. First, PE sector reviews should, to the extent possible, precede mounting the lending operation. In such reviews, the aim would be to identify the root causes of the PE problems and to recommend appropriate solutions. Second, in order to bring inter-regional perspective into PEL operations, it may be desirable to devise a procedure involving PRE at an early stage of project design. (Prior to the reorganization, a lead advisor mechanism was in place).

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[36]/ The assumption here, which has yet to be verified, is that PEL operations will permit, better than SALs, adequate focus on PE issues, which should in turn increase the effectiveness of PE reform programs. This also assumes that macro reforms under a SAL precede the PEL.

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STATISTICAL ANNEX

Table 1: DISTRIBUTION OF SALS WITH PE COMPONENTS BY REGION

AFRICA

Benin I
Cameroon I
CAR I
CAR II
Congo
Cote d'Ivoire I
Cote d'Ivoire II
Cote d'Ivoire III
Gambia
Ghana I
Ghana II
Guinea I
Guinea II
Guinea-Bissau I
Guinea-Bissau II
Kenya I
Malawi II
Malawi III
Mauritania
Mauritius I
Mauritius II
Niger
Sao Tome and Principe
Senegal I
Senegal II
Senegal III
Togo I
Togo II
Togo III
Zaire

LAC

Bolivia
Chile III
Costa Rica I
Costa Rica II
Dominica
Honduras I
Jamaica I
Jamaica II
Jamaica III
Panama I
Panama II
Uruguay I
Uruguay II
Venezuela I

EMENA

Pakistan
Turkey II
Turkey III
Turkey IV
Turkey V
Yugoslavia

ASIA

Korea II
Nepal II
Philippines I
Thailand I
Thailand II

Note: Approved as of June 1989

Table 2: SECTOR ADJUSTMENT OPERATIONS WITH PE COMPONENTS

Country	Operation	Ln/Cr Amount (US$m)
Tanzania	Export	50.0
Sudan	Agriculture	50.0
Ghana	Export	76.0
Morocco	Agriculture	100.0
Turkey	Agriculture	300.0
Morocco	Second ITPA	200.0
Ecuador	Agriculture	100.0
Zambia	Industrial	20.0
Ghana	Industrial	28.5
Hungary	Industrial	100.0
Pakistan	Export	70.0
Kenya	Agriculture	20.0
Zambia	Recovery Program	50.0
Nigeria	Trade Policy and Export	452.0
Haiti	Economic Recovery	40.0
Philippines	Economic Recovery	310.0
Bangladesh	Industrial	190.0
Madagascar	Industrial and Trade	67.0
Turkey	Energy	325.0
Colombia	Power	300.0
Ghana	Financial	100.0
Hungary	Industrial	200.0
Kenya	Industrial	102.0
Madagascar	Public	125.0
Turkey	Financial	400.0
Chad	Transport	60.0
Bangladesh	Energy	175.0
Tunisia	Agriculture	84.0
Pakistan	Agriculture	200.0
Somali	Agriculture	70.0
Kenya	Financial	120.0
Mexico	Financial	500.0
Pakistan	Financial	150.0

Note: Approved as of June 1989

Table 3: VALUE OF PE COMPONENTS IN TALS
(in $ million)

Country	Total loan/ credit amount	PE amount of loan/ credit	PE as a percentage of total loan/credit
Senegal I	6.3	6.3	100
Senegal II	11.0	11.0	100
Turkey	7.6	7.6	100
Zaire	20.0	20.0	100
Uruguay II	6.5	5.4	83
Sudan	9.0	4.5	50
Ecuador	8.0	3.3	41
Burundi	7.5	3.0	40
Malawi I	1.0	0.4	40
Mali	10.4	4.0	38
Chile	11.0	4.1	37
Togo III	6.2	2.0	32
Panama	5.0	1.4	28
Jamaica I	6.1	1.6	26
Madagascar	5.7	1.4	25
Brazil	29.0	6.4	22
Peru	10.2	2.2	22
Malawi II	1.5	0.3	20
Kenya	5.0	0.8	16
Congo I	11.0	1.7	15
Cote d'Ivoire	16.0	2.4	15
Pakistan II	7.0	1.0	14
Argentina	18.5	2.5	14
Guinea-Bissau	6.0	0.8	13
Cape Verde	4.7	0.6	13
Togo II	3.5	0.4	11
Jamaica II	9.0	1.0	11
Guinea	9.5	1.0	11
CAR II	8.0	0.8	10
Mauritania II	4.6	0.4	9
Congo II	4.0	0.3	8
Pakistan I	7.0	0.5	7
Rwanda	4.8	0.3	6
Costa Rica	3.5	0.2	6
Average	7.8	2.9	37

Note: Approved as of June 1989

Table 4: PRINCIPAL COMPONENTS OF PE REFORM PROJECTS

A. GENERAL POLICIES

Pricing	Labor	Credit and investment	Government/PE Debts	Divestiture
Benin (PEL)	Benin (PEL)	Congo (PEL)	Congo (PEL)	Benin (PEL)
Cape Verde (TAL)	Congo (PEL)	Ghana (PEL)	Ghana (PEL)	Congo (PEL)
(study)	Ghana (PEL)	Jamaica	Jamaica (PEL)	Ghana (PEL)
Congo (PEL)	Mali (PEL)	Mali (PEL)	Mali (PEL)	Jamaica
Ghana (PEL)	Niger (PE SECAL)	Mexico (PEL)	Mauritania (PEL)	Mali (PEL)
Jamaica (PEL)	Niger (PE TAL)	(study)	Morocco (PEL)	Mexico (PEL)
Madagascar	Philippines (PEL)	Niger (PE SECAL)	Niger (PEL)	Niger (PE SECAL)
(review)	Sudan	Philippines (PEL)	Tunisia (PEL)	Niger (PE TAL)
Mali (PEL)	Tunisia (PEL)	Senegal		Philippines (PEL)
Mexico (PEL)				Tunisia (PEL)
Niger (PEL)				
Morocco (PEL)				
Panama				
(study)				

B. GOVERNMENT/PE RELATIONS

Improving control agencies	Diagnostic surveys	Information and monitoring systems	National level training	Contract plans and similar agreements	Board of directors	Review/ revision in legal framework
Argentina	Argentina	Benin (PEL)	Argentina	Benin (PEL)	Argentina	Argentina
Benin (PEL)	CAR	Brazil	Brazil	Burundi	Mali (PEL)	Cameroon I
Brazil	Congo (PEL)	Burundi	Burundi	Cameroon I	Morocco (PEL)	Cape Verde (TAL)
Burundi	Ghana II	Congo	Chile	Cape Verde (TAL)		Chad
Chile	Guinea-Bissau	Congo (PEL)	Ghana (PEL)	Congo		Congo (PEL)
Congo (PEL)	Mali	Ecuador	Madagascar	Ghana (PEL)		Ecuador
Guinea-Bissau I	Mexico (PEL)	Ghana (PEL)	Mali	Ghana I		Ghana (PEL)
Jamaica	Morocco (PEL)	Jamaica	Mali (PEL)	Cote d'Ivoire		Guinea-Bissau
Mali	Niger (PEL)	Jamaica (PEL)		Mali (PE SECAL)		Jamaica
Mali (PEL)	Panama	Mali (PEL)	Niger (PEL)	Mali (PE TAL)		Jamaica (PEL)
Mexico (PEL)	Peru	Mexico (PEL)	Senegal	Mauritania (PEL)		Lao
Morocco (PEL)	Tunisia (PEL)	Morocco (PEL)	Senegal II	Mauritania II		Mali (PE SECAL
Niger (PEL)		Niger (PEL)		Mexico (PEL)		Mali (PE TAL)
Pakistan		Pakistan		(study)		Mauritania (PE
Pakistan II		Pakistan II		Morocco (PEL)		Mexico (PEL)
Peru		Panama		Niger (PE SECAL)		Niger (PE SECA
Philippines (PEL)		Peru		Niger (PE TAL)		Niger (PE TAL)
Senegal		Senegal		Senegal II		Pakistan
Senegal II		Senegal II		Togo II		Philippines (P
Sudan		Sudan		Tunisia (PEL)		Sudan
Togo II		Togo III				Tunisia (PEL)
						Tunisia
						Venezuela

Note: Section A. of the table includes technical assistance loans (TALs) and public enterprise loans approved as of June 1989. It excludes SALs and SECALs.

Table 5: PRINCIPAL COMPONENTS OF PE REFORM IN STRUCTURAL ADJUSTMENT LENDING

A. POLICY-RELATED REFORMS

Increase/ liberalize prices/tariffs	Liberalize trade	Scrutinize expenditures and borrowings; increase interest charges; reduce automatic access to credit
Benin	Benin	Benin
Bolivia	Burundi I	Bolivia
Burundi I	Cameroon	Burundi II (study)
Burundi II (study)	CAR I	CAR I
Cameroon	Congo	CAR II
CAR	Costa Rica I	Chile III
CAR II (study)	Cote d'Ivoire II	Congo
Congo	Cote d'Ivoire III	Costa Rica II
Costa Rica I	Ghana II	Cote d'Ivoire I
Costa Rica II	Guinea I	Cote d'Ivoire III
Cote d'Ivoire II	Guinea II	Gabon
Cote d'Ivoire III	Guinea-Bissau I	Gambia I
Gambia	Guinea-Bissau II	Gambia II
Guinea I	Jamaica I	Ghana I
Guinea-Bissau I	Jamaica II	Guinea I
Guinea-Bissau II	Jamaica III	Guinea II
Jamaica I	Kenya I	Guinea-Bissau
Jamaica II	Korea	Korea II
Jamaica III	Lao I	Niger
Korea II	Malawi III	Panama I
Malawi I	Mauritius II	Senegal II
Malawi II	Nepal I	Togo III
Nepal	Nepal II	Tunisia
Niger	Niger	Turkey I
Panama I	Panama I	Turkey II
Panama II	Panama II	Turkey III
Sao Tome & Principe	Sao Tome & Principe	Turkey IV
Senegal III	Senegal II	Venezuela I
Thailand I	Thailand I	
Thailand II	Thailand II	
Turkey I	Togo III	
Turkey II	Turkey V	
Turkey V	Zaire	
Uruguay I		
Uruguay II		
Venezuela I		
Yugoslavia		
Zaire		

Note: Approved as of June 1989

Table 5 (contd)

B. GOVERNMENT/PE RELATIONS

Employment and salary practices	Management and financial audits	Improve information and monitoring systems	Improve SOE management	Implementation of action plans/ recovery plans	Liquidation	Divestitu
Benin	CAR II	Burundi I	Burundi II	Burundi II	Benin	Burundi I
Burundi II	Cote d'Ivoire I	Burundi II	CAR II	Cameroon	Burundi I	CAR I
Cameroon	Cote d'Ivoire III	CAR I	Chile	CAR I	Burundi II	CAR II
CAR I	Gabon	CAR II	Congo	CAR II	Cameroon	Chile II
CAR II	Ghana I	Cote d'Ivoire II	Cote d'Ivoire II	Chile III	CAR I	Cong
Congo	Ghana II	Dominica	Dominica	Congo	CAR II	Costa Rica I
Cote d'Ivoire I	Guinea II	Gabon	Gabon	Cote d'Ivoire I	Congo	Gabon
Dominica	Jamaica I	Ghana I	Ghana I	Cote d'Ivoire III	Costa Rica I	Gambia I
Gabon	Jamaica III	Ghana II	Ghana II	Dominica	Gabon	Gambia II
Gambia I	Malawi I	Guinea II	Guinea II	Gabon	Ghana I	Ghana I
Gambia II	Mauritius II	Kenya I	Guinea-Bissau I	Ghana I	Guinea I	Ghana II
Ghana II	Niger	Malawi I	Korea II	Guinea I	Guinea II	Guinea I
Guinea I	Senegal III	Nepal II	Malawi II	Guinea II	Guinea-Bissau II	Guinea II
Guinea II	Togo I	Niger	Mauritania	Guinea-Bissau I	Niger	Jamaica I
Guinea-Bissau I	Togo II	Pakistan	Niger	Guinea-Bissau II	Panama I	Jamaica II
Jamaica II	Togo III	Senegal III	Senegal II	Honduras I	Panama II	Jamaica III
Mauritius I		Togo I	Senegal III	Jamaica I	Senegal II	Malawi III
Mauritius II		Togo III	Thailand II	Jamaica II	Senegal III	Nepal I
Nepal I		Turkey III	Togo II	Jamaica III	Togo I	Nepal II
Niger		Turkey V	Togo III	Malawi I	Togo II	Niger
Senegal I		Uruguay I	Turkey II	Niger	Togo III	Panama I
Tunisia			Turkey V	Philippines I	Uruguay II	Panama II
Turkey II			Uruguay I	Sao Tome & Principe	Zaire	Sao Tome & Principe
Turkey III			Uruguay II	Senegal II		Senegal II
Turkey IV				Togo III		Senegal III
Uruguay II				Uruguay I		Togo I
Zaire				Uruguay II		Togo II
				Venezuela (review)		Togo III
						Turkey V
						Venezuela I
						Zaire

Note: Approved as of June 1989

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Benin	Diagnostic studies, liquidation, and privatization of selected SOEs; civil service reduction program; financial sector restructuring, including liquidation; new laws defining government/PE relationship.	45.0
Bolivia	Increase tariffs and prices; monitor expenditures and borrowings of major SOEs.	50.0
Burundi I	Liquidations; rehabilitation; create national service in charge of PEs; prepare diagnosis of private sector; prepare strategy plans for PEs; develop information system; implement sectoral policies including price liberalization, increase decentralization. Create intervension fund.	15.0 16.2
Burundi II	Adoption of PE decree on legal framework; liquidate 4 PEs; sign performance contracts; rehabilitation programs for 4 PEWs; hotels; studies on price/tariffs, incentive system, privatization, financial flows between State/PE; implement MIS; strengthen MINIPLAN; strengthen civil service; strengthen Ministry of Labor.	90.0
Cameroon	Signature of performance contracts for key SOEs; action plans for liquidation and restructuring of key banks; legal reforms of "Loi de Finances" to permit restructuring.	150.0
Central African Republic I	Divestiture/restructuring and rehab. action plans; eliminate arrears and restore financial discipline; improve PE efficiency; ceiling on personnel growth; strengthen Government's monitoring ability.	14.0 16.0
Central African Republic II	Performance analysis of major PEs; PE audits; freeze on new PEs; reduce staffing; settle cross debt; clarify responsibility for preparing 3-year PIP; tariff policy; action plan for institutional legal framework study; standard procedure for privatization; continue privatization for agreed PEs; liquidate; rehabilitate 3 PEs; train civil servants; transfer redundant civil servants and freeze staffing plans; reinforce wage bill; reorganize ministries of Plan, Commerce, Industry, Rural development and SMI .	
Chile	Coordination of SOE investment plans and macroeconomic policies; study on SOE management.	250.0
Chile II	Continue divestiture program.	250.0
Chile III	Banking sector study.	250.0
Congo	Divestiture; financial restructuring and discipline; banking sector reforms; staff reduction and personnel management; adopt legislation for management contracts, new procurement procedures. redefine PE statutes, Govt. relations and oversight structures. Rehabilitation measures for selected PEs.	70.0

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Costa Rica I	Completion of action plan on divestiture of CODESA portfolio. Prep. of action program to improve the management and marketing of FERTICA and strengthen mgt. of CATSA under TAL; complete program of reorganization and policy improvements under TAL. Tariff levels to be adjusted periodically to a level sufficient to cover operational expenditures, debt service, and reasonable share of investment.	80.0
Costa Rica II	Reduce levels of arrears to SOE banks; limit subsidized credit to SOE banks; end government monopoly on imports.	100.0
Cote d'Ivoire I	Institute financial controls and limit external borrowings; realign salaries; divest shares in SOEs; audits of selected SOEs; implement enterprise action plans.	150.0
Cote d'Ivoire II	Price liberalization; improve information/monitoring system; rationalize government/SOE relations, including legal framework, recovery plans, program contracts, and tutelage sytem; improve management; restructure agricultural SOEs.	250.7
Cote d'Ivoire III	Targets for reducing transfers from government to private enterprise sector; restructuring plans for 5 PEs; extend system of contract programs to 4 PEs; improve accounting system, reinforce system of "Tableaux de bords" for 31 key SOEs; decentralize procurement procedures.	250.0
Dominica	Implementation of appropriate public sector to wage policy; organization to increase productivity, examine program to merge manpower requirements; IDC, Tourist Board; strengthen PSIP; strategy for upgrading agricultural extension service.	3.0
Gabon	Submission of budgets to Ministries of Planning, Economy; Air Gabon program contract; study of parapublic sector; liquidation/privatization of 9 PEs; studies of 34 PEs; restructuring for parapublic sector; staff freeze; negotiations on contracts; salary reduction in parapublic and civil service.	50.0
Gambia I	Divestiture and rationalization plan, economic and feasibility studies, and actions to secure majority private equity participation in venture; performance contracts with 3 SOEs. Tariff increase.	5.0
Gambia II	Satisfactory progress in performance reviews, with restructuring to enhance efficiency; implementation of PE divestiture program; restructure Ministry of Agriculture, privatizing its commercial activities; signature of performance contracts on selected SOEs.	23.0

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Ghana I	Rationalization plan of COCOBOD - prepare budget, retrench plantation workers, divest 52 plantations; freeze on new SOEs; action plan for pricing autonomy; identify SOEs to be incorporated; divestiture plan for 30 SOEs; establish new State Enterprise Commission; corporate plans for 14 SOEs; identify arrears and cross debts for 14 SOEs; rationalize civil service salaries; develop skill mobilization scheme; approve 1987 retrenchment program; establish Project Management Unit; high level SAL team.	34.0
Ghana II	Updating of performance contracts on 14 priority SOEs; implementation of 1989 SOE divestiture program; action plan for 1990 SOE divestitures.	120.0
Guinea I	Prepare and approve divestiture strategy and action plan for industrial SOEs; liquidate 19 industrial and 4 non-industrial SOEs and EPCOAs; agree SOE working capital, credit, and foreign exchange provisions; suspend Air Guinea's international services; review statutes of public utilities; revise autonomy provisions in port, airport and railway statutes; revise mining sector legal and taxation arrangements; revise Air Guinea's statute; review and enhance incentives for private sector job creation; remove SOE employees from civil service rolls.	25.0
Guinea II	Liquidation decree; privatize agreed SOEs; commission to recommend privatization; restructure SOEs in hotels transport; imporve legal, institutional framework; revise civil service statute.	
Guinea-Bissau I	Comprehensive diagnosis of PE sector; reduce real wage bill through reducing civil service; strengthen EAGB (electricity firm) increase tariff; abolish state monopoly on crop purchases - reform parastatal trading firms; transfer parastatal retain outlets to private sector; encourage expansion of private sector trucking; strengthen National Bank capabilities.	10.0
Guinea-Bissau II	Divest, restructure major PEs; eliminate cross debts; phase out transfers; introduce legislative improvements to PE management; creation of Ministry of Economic Coordination to monitor PE reform; specific action plan for electricity PE, including management and financial improvements.	23.4
Honduras	Comprehensive review of public expenditures; reduce consolidated public sector deficits; action plan for divestiture programs for industrial and forestry SOEs; action plans for streamlining and institutional changes of major PEs; institutional and financial restructuring of electricity SOE.	50.0
Jamaica I	Increase prices; divest unprofitable SOEs; management audits of selected SOEs; implement enterprise action plans.	76.2
Jamaica II	Increase prices; implement enterprise action plans; privatize selected SOEs; reduce staffing; limits on new SOEs.	60.2

Table 5: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Jamaica III	Increase prices and tariffs; implement action programs for six SOEs; management audits of selected SOEs; review and revise financial targets; divest unprofitable SOEs. of financial targets; divestment of	55.0
Kenya I	Improve monitoring system; issue guidelines on growth of SOE sector.	55.0
Kenya II	Improve procedures for evaluating SOEs for Treasury investments.	130.9
Korea II	Improve public sector efficiency, managerial autonomy in budgeting, personnel and procurement; develop performance evaluation system; transfer some SOEs to private sector; eliminate subsidized credit to SOEs; increase prices.	300.0
Lao	Continue policy of not subsidizing SOE budgets; identify SOEs to be restructured and rehabilitated; increase SOE autonomy.	40.0
Malawi I	Increase prices and tariffs; management audits of selected SOEs; implement enterprise action plans; liquidate some SOEs; improve information/monitoring system.	45.0
Malawi II	Implement studies for operational and financial improvement of SOEs; annual reviews of financial accounts; ;increase tariffs and user charges.	55.0
Malawi III	Tariff increases; improve effectiveness of DSB in monitoring financial operations; action plan to remove PE deficits; asset rationalization; monitor MDC's performance; medium-term corporate plan prepared.	30.0 40.0
Mauritania	Study of state portfolio and action program; improve channels for public competitive bidding and management decision processes.	15.0 27.4
Mauritius I	Redeploy personnel in three major SOEs; restructure goals; improve efficiency.	15.0
Mauritius II	Redeploy personnel in three major SOEs; management audits of selected SOEs; implement new accounting system.	40.0
Nepal I	Action plan for privatization and/or managerial reform of PEs; awards and penalties for managers.	50.0
epal II	Continuation of sector strategy of handing over management of small and medium public irrigations projects to farmers; study of commercial bank problems and development of strategy for rehabilitation and/or privatization.	60.0
Niger	Personnel statute for PEs; revise parastatal labor laws; legislation to adjust ministries; rehabilitate 2 PEs - final decision on 3 PEs; reduce products subject to price controls; eliminate cross debts; decision on consolidating responsibilities of NIGELEC and OFEDES; complete CNCA audit; improve debt collection; cost recovery study; civil service study.	

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Pakistan	Implement system for evaluating SOE performance, provide incentives, including parastatal labor laws; information base and performance indicators. and enterprise performance indicators.	140.0
Panama	Reduce domestic cement price; terminate pricing arrangement between cement companies; liquidate and privatize selected SOEs; study cost reduction.	60.2
Panama II	Close and divest SOEs.	100.0
Philippines	Formulate industrial restructuring program for 5 major sectors.	200.0
Sao Tome & Principe	New tariff structure for electricty, water; plan to restructure viable PEs; uniform accounting system.	4.0 3.0
Senegal I	Privatize selected SOEs; implement program-contracts; staff reduction plans; reform agriculture sector by reducing State intervention (changes in credit, financial assistance to farmers).	60.0
Senegal II	Privatize/liquidate PEs; improve data, reporting; clarify government sector relations; reconcile cross arrears;finalize contract-plans;improve controls of SOEs.	20.0 44.0
Senegal III	Strengthen management and institutional setting for PE sector; Privatize/liquidate; implement audit restructuring; redefine role of BOD; program to strengthen internal planning, control systems, financial accounting; reduce subsidies; contract-plans; reconcile arrears; reform supervision system.	45.0 40.0
Thailand I	Increase tariffs.	150.0
Thailand II	Increase prices; efficiency, management improvements; liquidate unprofitable SOEs.	175.5
Togo I	Privatize/liquidate selected SOEs; management audit selected SOEs; improve programming, revenue monitoring and expenditures; annual report on SOEs; accounting system and initiate regular audits.	40.0
Togo II	Improve management, government/SOE relations; survey domestic arrears of SOEs and restructure, privatize or liquidate SOEs; annual report on major SOEs; audits and studies of SOEs.	10.0
Togo III	Reorganize MISE - reevaluate regulation of PEs; supervise SAL program; elaborate MIS for SOEs; reassess privatization strategy and identify priorities for 1989-90; privatize select PEs - legal audit of 16 PEs, restructure arrears; debt swapping agreements; continue audit for 16 PEs - audit accounts for OPAT - reduce operating costs and adopt new structure; revise state role in light of SOE needs; negotiate management of hotels; rehabilitate CFT; abolish monopoly on rice, sugar, tobacco; reorganize CEET (energy).	45.0
Tunisia	Control real wage growth in public sector - limit subsidies and restructure economic justification for major public sector projects.	150.0

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

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Togo I	Privatize/liquidate selected SOEs; management audit selected SOEs; improve programming, revenue monitoring and expenditures; annual report on SOEs; accounting system and initiate regular audits.	40.0
Togo II	Improve management, government/SOE relations; survey domestic arrears of SOEs and restructure, privatize or liquidate SOEs; annual report on major SOEs; audits and studies of SOEs.	10.0
Togo III	Reorganize MISE - reevaluate regulation of PEs; supervise SAL program; elaborate MIS for SOEs; reassess privatization strategy and identify priorities for 1989-90; privatize select PEs - legal audit of 16 PEs, restructure arrears; debt swapping agreements; continue audit for 16 PEs - audit accounts for OPAT - reduce operating costs and adopt new structure; revise state role in light of SOE needs; negotiate management of hotels; rehabilitate CFT; abolish monopoly on rice, sugar, tobacco; reorganize CEET (energy).	45.0
Tunisia	Control re i wage growth in public sector - limit subsidies and restructure economic justification for major public sector projects.	150.0

Table 6: CONTENT, LOCATION AND VALUE OF PE REFORMS IN SALS

Country	Reform Measures	Loan Amount (US$m)
Turkey I	Eliminate government controlled prices, use market forces; improve efficiency and productivity of SOEs.	200.0
Turkey II	Liberalize prices; reduce drain on public funds; reduce staffing; improve management (selection on merit, competitive pay) and delegation of authority; sector organization changes; depoliticize government/SOE relations, management selection and behavior.	300.0
Turkey III	Reform law to liberalize employment and salary practices; limit hiring; improve information/ monitoring; publish audited accounts.	304.5
Turkey IV	Set parameters for new legal and institutional framework, with focus on decentralization; liberalize employment, salaries; limit employment growth; attention to accounting and auditing.	300.8
Turkey V	Review of selective privatization of SOE assets; liberalize prices and imports; improve monitoring system; personnel regime; introduce modern management techniques, planning and training.	376.0
Uruguay I	Maintain real public enterprise prices; restructure railway, water companies; legislation to associate PLUNA (airlines) with private carriers; action to strengthen banking.	80.0
Uruguay II	Privatization of failed banks following their rehabilitation; liquidation; periodic increases in PE tariffs in step with inflation; develop management improvement program and performance indicators for 3 major PEs.	140.0
Venezuela	Establishment of interministerial commission to review and approve privatization and restructuring proposals; classify PEs as to privatization or liquidation; training in areas of privatization, restructuring PEs; studies of Venezuelan Investment Fund's role in face of PE reform; review of institutional and legal framework governing PEs so as to improve transparency, and management.	402.0
Yugoslavia	Price liberalization; improve financial accountability of enterprises.	275.0
Zaire	Reassess capital; prepare legislation; external auditing; liquidation; oversight structure; privatization; study crossed debts; restructure PEs; system for appointing, paying managers.	55.0 94.3

Table 7: NUMBER OF BANK PROJECTS WITH DIVESTITURE COMPONENTS

Country	SALs	SECALs a/	TALs	PELs b/	TOTAL
AFRICA					

Benin	1			1	2
Burundi	2				2
Cameroon	1				1
CAR	2				2
Congo	1			1	2
Gabon	1				1
Gambia	2				2
Ghana	2	2		1	5
Guinea	2		1		3
Guinea-Bissau	2				2
Madagascar		2]			2
Malawi	2				2
Mali				2	2
Mauritania				1	1
Niger	1			2	3
Sao Tome & Prin.	1				1
Senegal	2				2
Sudan			1		1
Togo	3		2		5
Uganda		1			1
Zaire	1		1		2
Zambia		1			1
SUBTOTAL	26	6	5	8	45
LAC					

Chile	1		1		2
Costa Rica	2				2
Haiti		1			1
Honduras	1				1
Jamaica	3		1	1	5
Mexico				1	1
Panama	2		1		3
Uruguay	1		1		2
Venezuela	1				
SUB-TOTAL	11	1	4	2	18
EMENA					

Morocco				1	1
Tunisia		1		1	2
Turkey	1				1
SUB-TOTAL	1	1	0	2	4
ASIA					

Laos	1				[illegible]
Nepal	2				2
Pakistan		2			2
Philippines		1		1	2
SUB-TOTAL	3	3	0	1	7
GRAND TOTAL	41	11	9	13	74

Note: a. Includes only industry, economic recovery, and export rehabilitation SECALs.
b. Includes private enterprise rationalization loans, public enterprise sector adjustment loans, and public enterprise institutional development projects.

Projects approved as of June 1989.

Table 8: BANK PROJECTS WITH DIVESTITURE COMPONENTS

Country	Operation	Loan Amount (US$m)
AFRICA		
Benin	PE Rehab.	15.0
	SAL I	45.0
Burundi	SAL I	15.0
	SAL II	90.0
Cameroon	SAL I	150.0
CAR	SAL I	14.0
	SAL II	40.0
Congo	PE ID	15.2
	SAL	70.0
Gabon	SAL	50.0
Gambia	SAL I	5.0
	SAL II	23.0
Ghana	Export Rehab.	40.1
	Ind. SECAL	28.5
	PEL	10.5
	SAL I	34.0
	SAL II	120.0
Guinea	SAL I	25.0
	SAL II	65.0
	TAL I	9.5
Guinea Bissau	SAL I	10.0
	SAL II	23.4
Madagascar	Ind. and Trade	67.0
	PS Adj.	125.0
Malawi	SAL II	55.0
	SAL III	30.0
Mali	PE ID	9.5
	PE SECAL	40.0
Mauritania	PE TAL	16.4
Niger	PE ID	5.5
	PE SECAL	60.0
	SAL	20.0
Sao Tome & Principe	SAL	4.0
Senegal	SAL II	20.0
	SAL III	45.0
Sudan	TAL	9.0
Togo	Pvt. Ent.	11.5
	SAL I	40.0
	SAL II	27.8
	SAL III	45.0
	TAL III	6.2
Uganda	Econ. Recovery	65.0
Zaire	SAL	55.0
	TAL	12.0
Zambia	Ind. Reorient.	20.0

Table 8: BANK PROJECTS WITH DIVESTITURE COMPONENTS

Country	Operation	Loan Amount (US$m)
LAC		
Chile	SAL II	250.0
	IAL	11.0
Costa Rica	SAL I	80.0
	SAL II	100.0
Haiti	Econ. Recovery	40.0
Honduras	SAL I	50.0
Jamaica	PE SECAL	20.0
	SAL I	76.2
	SAL II	60.2
	SAL III	55.0
	TAL II	9.0
Mexico	PERL	500.0
Panama	SAL I	60.2
	SAL II	100.0
	TAL	5.0
Uruguay	SAL II	140.0
	TAL II	6.5
Venezuela	SAL I	402.0
EMENA		
Morocco	PERL	240.0
Tunisia	ASAL II	84.0
	PERL	130.0
Turkey	SAL V	376.0
ASIA		
Lao	SAL I	40.0
Nepal	SAL I	50.0
	SAL II	60.0
Pakistan	Export Development	70.0
	Financial SECAL	150.0
Philippines	Econ. Recovery	300.0
	Government Corporations	200.0

Note: Approved as of June 1989

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