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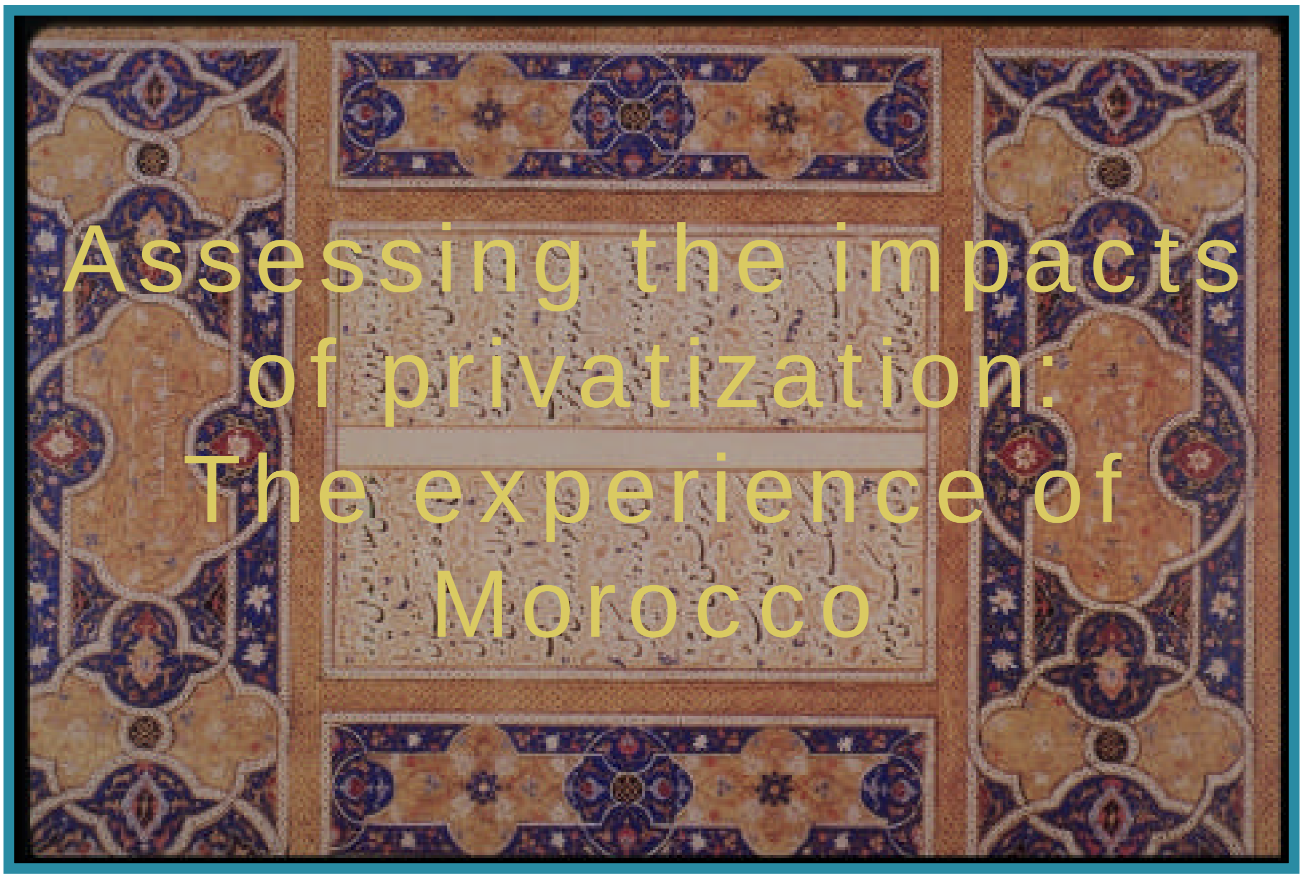

Assessing the impacts of privatization: The experience of Morocco

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Preface

Privatization of state-owned enterprises has been at the core of economic restructuring efforts in a wide range of countries. Its proponents have marshaled strong economic as well as political arguments that private ownership and management of productive assets will restore or enhance the financial health of the state-owned enterprise sector, do away with distortions and special privileges, and contribute to equitable economic growth. Somewhat surprisingly, though, it has turned out to be rather difficult to deliver conclusive empirical proof for these claims. Numerous studies have sought to assess the impacts of privatization and explain their magnitude and incidence. For some impacts, in particular enterprise performance, researchers have in fact succeeded in demonstrating quantitatively the positive impacts of privatization. Yet on the whole, the understanding of how privatization policies and procedures affect outcomes and impacts remains too tenuous to guide program management in a given political and institutional setting.

The problems with establishing conclusive empirical evidence are both conceptual and practical. At the conceptual level, it is difficult to attribute changes in a complex environment to one factor, such as privatization. Privatization does not proceed as a controlled experiment, but is taking place in a dynamic context. It almost always forms part of broader economic policy reforms. Attributing impacts to privatization therefore inevitably implies some conjecture about the state of the world in the absence of the program itself. In some instances, the attribution is obvious: one can claim with some confidence that any creation of wealth in the form of shareholdings among small investors is a direct result of set-asides and special facilities in the privatization program. In other instances, the counterfactual argument (what would have happened in the absence of privatization) is less evident; the choice of the reference case may greatly influence the findings.[1]

The practical difficulty is the dearth of reliable empirical information. Although researchers have made considerable progress in compiling data sets on company performance within and across countries, coverage remains limited. Given the ranges of likely impacts of privatization and of intervening factors, any analysis that can cope fully with the complexity of the questions demands a wealth of longitudinal data. It is safe to say that there few privatization programs anywhere in the world that have attempted to track indicators across the range of impacts that are of political or programmatic importance. In fact, provisions to record data on a program itself in a systematic fashion are the exception (although there is a growing recognition of the importance of such data). Statistical and quantitative tools capable of determining and explaining policy impacts in a non-experimental setting therefore are generally of little help.

Yet policy makers and program managers need feedback and guidance on the impacts of privatization and how they are shaped by their decisions and actions. The US Agency for International Development (USAID) therefore has sponsored this study to devise and apply a systematic procedure for assessing the impacts of privatization and the factors influencing them. The approach combines a conceptually sound and comprehensive framework for the analysis with a pragmatic approach to data collection and analysis that takes into account resource and time constraints typical of the real world. USAID saw Morocco as an ideal testing ground for such an appraisal of the impacts of case-by-case privatization in

[1] This aspect is best illustrated by a story attributed to Robert McNamara, then President of the World Bank: His son came home one day and proudly announced that he had saved a quarter by walking rather than taking the bus. McNamara replied: "You could have saved $2 by *not* taking a taxi."

a mixed economy. The Moroccan privatization program is generally regarded as a successful program in terms of scope and performance.

The study team would like to thank all of our interlocutors who generously provided their time, information and views. This kind of study depends on such cooperation. In particular, we would like to thank the USAID Mission in Morocco for their active support and guidance, and the Cognizant Technical Officer in USAID/Washington, Penny Farley.

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1 Study mandate and approach

1.1 Principal concerns

The mandate for this study in effect addresses two principal concerns —structuring a pragmatic approach to the evaluation of a privatization program, and applying it to the case of Morocco, in part as an input into the country's current deliberations over the future course of its program. The emphasis is on assessing impacts across the entire spectrum of privatization objectives, rather than focusing on a few selected issues in depth.

The objectives of privatization that emerge from policy statements, public debate and program implementation span a wide range, from general notions of boosting the role of the private sector to sector and enterprise-specific changes sought. Any comprehensive attempt to assess the impacts of privatization necessarily reflects this richness of concerns. Yet covering the complete spectrum of impacts also means dealing with the full panoply of factors and forces that influence them, in the context of structures and behaviors that are undergoing often radical change.

In principle, though, these challenges faced by the appraisal of the impacts of privatization are no different from those for any policy or program evaluation. In all instances, the impacts themselves are complex, as are the forces that determine them. The structure that links them is changing in fundamental aspects, in part as a result of the interventions and accomplishments of the program that is being evaluated. The dynamic interactions between the program and its environment blur the distinction between exogenous and endogenous elements. By affecting its environment and its structural characteristics, the program redefines conditions for downstream performance. In other words, an evaluation of the impacts of privatization designed to contribute to continuing program design and implementation must treat the objectives themselves in a dynamic context — they are shaped by the economic and social context, and evolve as the context changes, in part as a result of program interventions and accomplishments.

Dealing with this complexity and structural change over time with methodological rigor would call for relatively sophisticated "data-hungry" analysis techniques. In privatization programs, as in many other policy initiatives in developing countries, satisfactory longitudinal data are rarely available to meet that hunger — implying the need to revert to second or third-best analytical approaches that seek to extract useful insights from the limited data available. Placing such approaches in the context of a clear conceptual framework makes the task easier and strengthens the validity of findings.

1.2 The analytical framework

1.2.1 Overview

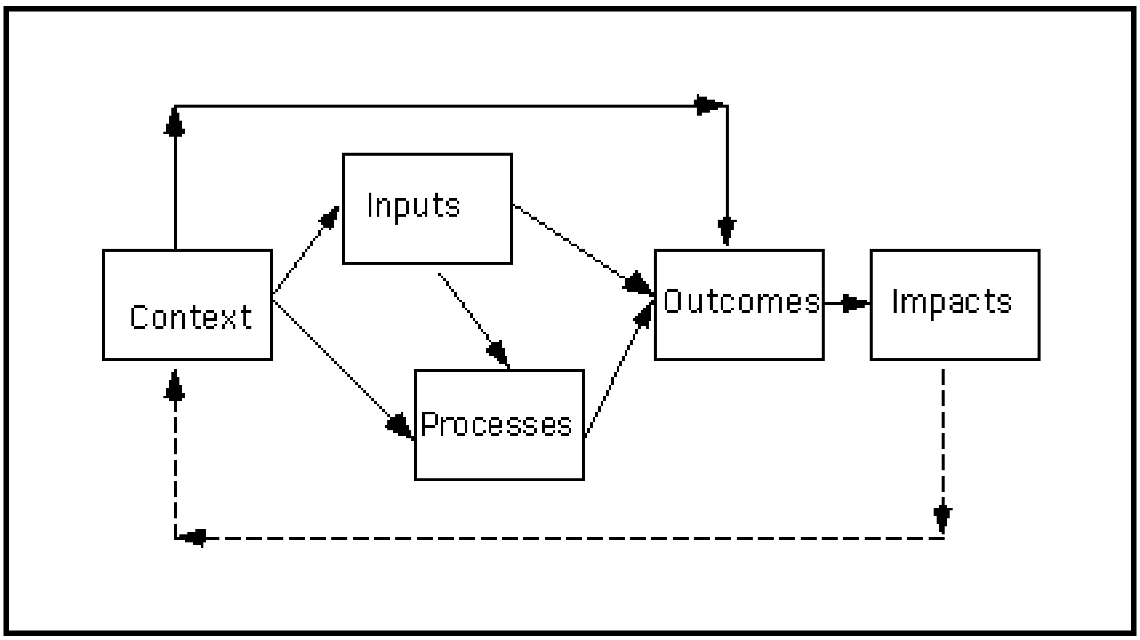
The concepts and techniques developed for policy appraisal and policy impact assessments in a wide variety of settings prove useful in structuring the appraisal of privatization impacts.[2] The following elements form a general analytical framework:

[2] The relevant literature includes Weiss (1997),, Worthen et al. (1996), Rossi and Freeman (1993), Wholey et al. (1994), and Orr (1998).

- context;
- inputs;
- process;
- process achievements or outcomes; and
- impacts.

Exhibit 1-1 sketches a simple schematic of this analytical structure in static form, although we apply it to a dynamic phenomenon. Privatization is a continuing process, building on earlier reforms, reshaping its own environment, and influencing events and performance far downstream. The feedback loop from the impacts to the context attempts to capture this dynamic interaction. The context at the beginning of period 2 is a function of the context at the beginning of period 1 and of the program's accomplishments during that period.

Exhibit 1-1: Analytical framework



1.2.2 Context

The overall economic, political and social environment determines the explicit and implicit objectives for the privatization program, and imposes constraints. The analysis of the context cannot be limited to an assessment of the conditions when the program was launched. Instead, it requires a dynamic approach: both antecedents of the program, such as prior reforms of the state-owned enterprise sector, and its interplay with forces and developments beyond the control of the program managers during implementation are crucial in shaping the course, outcomes and impacts. In effect, objectives are stated in terms of desired changes in context characteristics; impacts are observed changes in such characteristics that can be attributed to the program. The analysis of the evolution of the program context over time therefore is in effect synonymous with the appraisal of the impacts of the program.

Linking the context analysis and the appraisal of impacts also addresses the issue of attribution. In a real-world situation, observed changes are the result of a myriad of factors. Privatization interacts with other events and developments to shape the impacts. While options for counterfactual analysis or statistical causal analysis may be limited, a sound analysis of the (dynamic) context of the program lays the groundwork for approaching these questions in a judgmental manner.

1.2.3 Inputs

Within the constraints defined by the context, the program manager chooses the amount and characteristics of resources devoted to implementation. Of particular interest here is the mobilization of technical and managerial expertise to prepare and carry out the transfer of state-owned enterprises to private ownership.

1.2.4 Processes

Together, the context and available inputs shape the choice of processes and procedures, the way in which the program's *functions* are carried out. These functions include enterprise selection, valuation, choice of privatization modalities, selection of investors, creation and strengthening of the legal and regulatory framework, development of institutions, communications, and impact mitigation measures.

The focus on the functional aspects of program procedures introduces a "fractal flavor" into the analysis. Each procedure or function can in turn be regarded as its own program, with a given context (set of objectives and constraints), inputs and procedures, outcomes and impacts, etc., down the line.

An important aspect in the process evaluation is the appraisal of the underlying principles that shape the "program culture." These principles include such elements as decisiveness, openness, transparency, and participation in the choice and management of privatization-related procedures.

1.2.5 Process accomplishments or outcomes

This category refers to the direct results of the privatization program. It includes the value of assets transferred, the shares issued and their distribution, the proceeds raised, the conditions of sale, and other direct results of the privatization program.

1.2.6 Impacts and impact categories

Program impacts refer to the *changes in the context* attributable to the program outputs — to what extent has the program achieved its objectives and alleviated constraints? The appraisal of impacts constitutes the core of any program evaluation. For privatization programs, the major impacts of interest can be in terms of the stakeholders affected:

- for the government, the short and long-term *fiscal impacts*;
- for the enterprises themselves, impacts on *financial health and performance*;
- for the investors, including strategic, institutional (portfolio) and small investors, *returns on investment*;
- for the workers of the privatized enterprises, effects on *employment levels and employment-related benefits*;
- for the broader business environment, impacts on the *legal and regulatory framework*, on *corporate governance*, and on *institutions*;

- for consumers, changes in terms of *price, quality and availability of goods and services*; and
- for the business partners of the enterprises, especially suppliers, effects on the *demand* for their goods and services.

Some studies have chosen to seek an aggregation across impact categories by expressing impacts in terms of changes in welfare.[3] Given the qualitative nature of some key impacts, and the limits on data availability, the analysis here treats impacts side by side.

1.2.7 Interaction and feedback

Documenting and measuring the context, process choices, inputs used, outcomes and impacts is basic to any program evaluation. Addressing both the conceptual and practical issues in a satisfactory manner provides policy makers in the country and elsewhere with an appreciation of the accomplishments of the program. Yet any evaluation also has a formative element — to guide programmatic choices to achieve the best possible results. This task calls for an analysis of the linkages among the elements of the analytical framework outlined here, in particular the relationship between programmatic choices (processes and inputs) and the impacts of the program, given the evolving context. If sufficient quantitative data on specific aspects are available or can be collected, such an analysis can employ statistical techniques (some variant of regression analysis). Several studies have examined selected aspect of privatization programs in this manner, providing valuable insights.[4] However, assessing the full spectrum of impacts renders such statistical approaches difficult if not impossible. The analysis of linkages must therefore rely on a range of methods, including qualitative techniques.

1.3 Study approach

The application of the framework to the case of Morocco was the task of a study team that comprised four members focusing on economic aspects, financial performance and employment-related impacts, respectively. Much of the data gathering occurred in the field during two visits to Morocco in September/October 1998 (all), and in November/December 1998 (Team Leader only). In addition to efforts to pull together the available statistical and financial information for quantitative analysis, the study team conducted a series of interviews with experts and participants in the privatization program, including interviews with individuals who could provide a sectoral perspective. We complemented that with visits to several enterprises to interview company management.[5] Finally, we arranged for group interviews (or “focus groups,” although the sessions did not fully follow a strict focus group protocol) with workers of privatized enterprises to obtain their views and reactions.[6]

Based on our experience with the employees of privatized companies, we would counsel that studies of the impact of privatization on workers not overlook the workers themselves as sources of information and judgment. They add a different dimension to any insights gained from interviews with government

[3] For example, Jones et al. (1990), and Galal et al. (1994).

[4] These examples include Lopez-de-Silanes (1997), Megginson et al. (1994), Jones et al. (1996), or Frydman et al. (1997).

[5] We also drew on the results of similar interviews conducted in 1995 in the course of a mid-term evaluation of USAID’s assistance to the privatization program.

[6] We also assisted the Ministry of the Public Sector and Privatization in developing a questionnaire for a survey of all of the privatizable enterprises, both privatized and not. This survey is to be carried out in the near future.

officials, management representatives or outside observers. The organization of focus groups provides an excellent forum for the expression of workers' views. We found it easy to establish rapport with the workers and to elicit their responses. Within each focus group there seemed to be general agreement on the views expressed by any individual on most issues. Workers seemed to be at ease and all participated in the discussions though in each case, there was a tendency for one individual to assume a more active role as spokesperson.

An important source of information on the treatment of labor-related issues and any mitigation measures as well as the buyers' investment commitments should be the conditions of sale, spelled out in the *cahiers des charges*. The privatization authorities generally did not make these documents public or share them (or at least the relevant provisions) with the workers affected, although they formed part of the tender documents. The study team did not have access to them, with one exception. All financial appraisals and valuations of enterprises, prepared by outside advisers, remain confidential.

One very useful source of background and sometimes detail information was a collection of articles on CD-ROM, published by *L'Economiste* between 1991 and 1997. A search under the keyword "privatization" yielded some 1,311 entries. Many of these articles and mentions provided a contextual perspective of issues and choices.

1.4 Assembling quantitative data

Somewhat against expectations, the study team found no well-organized and comprehensive data base for the "privatizable" companies either before or after privatization. The dearth of data was particularly acute with respect to the analysis of the financial performance of the privatizable companies (both those privatized and those on the list not yet privatized), and for the appraisal of employment-related impacts.

In an attempt to fill the gaps, we therefore relied on a number of sources:

- The Ministry of the Public Sector and Privatization (MPSP) disposes of elements of a data base on the privatizable companies, but the data we obtained do not appear to cover any years after 1993. Moreover, the information requires considerable effort to reorganize and structure it before it could be used for any kind of analysis. Given their limited coverage, the effort did not appear warranted.
- The *Direction des Etablissements Publiques et des Participations* (DEPP) in the Ministry of Economy and Finance maintains an up-to-date data base on state-owned companies. However, coverage is limited, and ends once the companies are privatized. The DEPP provided tabulations of pre-privatization indicators for selected companies targeted for privatization.
- The privatized companies are not required to report financial or other information, unless they are listed on the Casablanca Stock Exchange. For the latter group, good financial data are available for companies listed on Casablanca Stock Exchange, both before (in the prospectus — *notice d'information*) and after the share issue (in required annual reports).[7]

[7] Virtually all studies of the impacts of privatization on enterprise performance rely on data for publicly traded firms. In Morocco, listed companies are required to file annual reports with the *Conseil Déontologique des Valeurs Mobilières* (CDVM), which made copies of this information available to us for 1995 and 1996. However, the copies were in large part

- Share prices of listed companies are available from the Casablanca Stock Exchange.[8]
- The Ministry of Commerce, Industry and Handicraft provided some employment data — for privatizable manufacturing firms — in the form of special tabulations of its annual employment surveys.

2 The context for Morocco's privatization program

2.1 The political context

Privatization is always a political process. Politics determines not only whether privatization goes forward at all, but also how it is handled. Understanding the impacts of privatization and their causes therefore demands an appreciation of the political context, during both design and implementation.

While it may not always be possible or sometimes necessary to delve deeply into the political environment for a privatization program, some basic questions need to be answered. *Bureaucrats in business* (1995) — which in fact focuses on the political dimension of privatization — cites three necessary political conditions for successful reform or privatization of state-owned enterprises:

- Reform must be politically *desirable* to the leadership and its constituencies. Reform becomes desirable to the leadership and its supporters when the political benefits outweigh the political costs. This usually happens with a change in regime or coalition shift in which those favoring the status quo lose power. It may also happen when an economic crisis makes SOE subsidies so costly that reform becomes preferable to the status quo.
- Reform must be politically *feasible*. Leaders must have the means to implement change and to withstand opposition to reform.
- Promises central to state-owned enterprise reform must be *credible*. Investors must believe that the government will not renationalize privatized firms; SOE employees and others who fear that they may lose out in reform must believe that the government will deliver on any promises of future compensation.

Generally, attention focuses on the political context to the extent that it defines obstacles to and constraints on privatization. From this perspective, Guislain (1995) lists the following factors that impinge upon the design and implementation of privatization programs by shaping the enabling legislation and evolving regulatory framework:

> … i) the defense of national sovereignty or independence; ii) the desire to maintain national control over certain activities or certain interests considered strategic; iii) the protection of the "public interest;" iv) the intent to avoid a concentration of wealth or power in the hands of (a few) individuals; v) mistrust of the private sector or certain segments of that sector.

These features of the political landscape are crucial to understanding the level and incidence of privatization impacts. Equally important is the *interaction* between the privatization program and its

illegible because of microscopic print size and copy quality. A Casablanca-based company, FINACCESS, kindly provided both balance sheets and income statements for the listed privatized companies for the post-privatization years in electronic form.

[8] We would like to acknowledge the help of Upline Securities, which provided data on the share prices of companies listed on the CSE in electronic form.

political environment. Proper management of the process can demonstrate the beneficial effects of privatization and alleviate concerns about its costs, in effect forging its own enabling environment. Changes in the political context therefore rank among the key impacts of privatization.

The factors cited by Guislain certainly applied in the Moroccan context. As in other countries in the region, state ownership of enterprises had been seen as an affirmation of sovereignty after Morocco gained independence. Any privatization efforts involving strategic sectors were sufficiently sensitive to leave these enterprises off the original list of companies targeted for privatization. The attitudes of the Moroccan polity with respect to the other factors listed by Guislain tended to reflect their closeness to French culture and thought, which stress the public interest and social obligations, look with favor on policies with a more egalitarian flavor, and typically do not place much confidence in the private sector. These views posed a challenge for the pioneers of the privatization program, and continue to shape evolving policies toward privatization and private sector participation.

Given these factors, the adoption of Morocco's privatization program was the culmination of a long process of public sector reform that had started back in the 1970s. Some concerns had emerged in the early 1970s about the growth and performance of the state-owned enterprise sector. As the phosphates boom fizzled in the latter part of the decade, the enforced austerity lent a sense of urgency to initiatives to reform the sector. By 1980, several major studies of state-owned enterprises stressed the need for improving their performance through increased autonomy, enhanced corporate governance, and greater reliance on market principles. Privatization of public enterprises became a key option in the drive to restructure the sector and achieve better results. The expected political benefits of privatization began to outweigh the perceived political costs.[9]

In the course of the 1980s, policies continued to evolve, in part supported through a Public Enterprises Rationalization Loan from the World Bank (1986). Privatization emerged as a key option in the drive to restructure the sector and achieve better results. In a speech to Parliament in 1988, King Hassan II endorsed the idea of privatizing state-owned enterprises. This milestone was followed by the adoption of the 1989 Privatization Law[10] Earlier in 1989, a repeal of the country's policy of "Moroccanization" of the economy, which relied primarily on public enterprises, had opened many sectors to foreign ownership.[11]

The political commitment to privatization was buttressed by outside support from a variety of sources that helped make privatization feasible. The credibility of the initiative was further enhanced as the government launched reforms in major state-owned enterprises, such as the phosphates giant OCP (Office Chérifien des Phosphates) that changed their way of doing business.[12]

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[9] For one view of the political economy of Morocco's privatization program, see Khosrowshahi (1997).

[10] Law Nr. 39-89 authorizing the transfer of public enterprises to the private sector, adopted on December 11, 1989.

[11] This policy reversal was partly a response to the creation of the Maghreb Arab Union; it was not until 1993, however, that the petroleum sector was opened to foreign ownership.

[12] In the July 1997 Board meeting, the CEO of OCP (a company with annual sales in the neighborhood of $1.5 billion) announced that Ernst & Young would audit the financial reports of the company within two years. This step would put an end to decades of opacity and difficulties in evaluating the actual performance of the enterprise. Observers saw this as a further sign that OCP is no longer a state within a state.

2.2 Economic conditions and trends

Deteriorating economic conditions are typically the driving force behind privatization. As government budgets are no longer able to sustain inefficiencies and socially motivated activities in the state-owned enterprise sector, pressures for reform grow, and privatization becomes a desirable and feasible option. Thus, fiscal necessities typically drive the decision to launch the privatization program. These factors shape priorities and approaches, and therefore help determine the impacts. Fiscal factors certainly provided much of the impetus in the evolution of the Moroccan privatization program.

Yet the relevant economic context goes far beyond the fiscal realm, comprising both macroeconomic conditions — overall growth, monetary, fiscal, and trade policies, employment and unemployment — and the microeconomic foundations of enterprise performance. The latter include sectoral policies, infrastructure development, and support mechanisms such as specialized research institutes or standards organizations. Many of the key economic conditions are defined in terms of the legal, regulatory and institutional framework, which sets the rules and establishes the incentives. As the general economic environment evolves over the course of the privatization program, it affects investor interest, shapes post-privatization enterprise performance, and influences the extent and incidence of social (primarily employment-related) impacts.

In the Moroccan context, the key economic concern is employment. The country has achieved much in the area of macroeconomic stabilization and structural reform over the last decade or so. Yet economic growth has fallen short of the levels needed to cope with the country's persistent employment problem. There is a sense that much remains to be done to complete the economic reform agenda to enable the country's economy to embark upon a path of accelerated growth.

Over the past six years, the annual rate of GDP growth has been disappointing, averaging 1.4 percent, too low to accommodate a labor force growing at approximately 2.5 percent per year.[13] The overall performance is heavily weighted by sharp declines in agricultural production due to droughts in 1992, 1995, and 1997 that could not be offset by modest growth in the rest of the economy. A result of this sputtering growth has been rising urban unemployment rates during the past decade, peaking at over 18 percent in 1996. An extraordinarily sharp recovery in 1996 reduced the unemployment rate to just under 17 percent in 1997, leaving it uncomfortably high.[14]

In other respects, the macroeconomic environment has shown improvements during the current decade. Rates of inflation of 5-6 percent earlier in the decade have been reduced to 3 and 1 percent in 1996 and 1997. Government finances have seen considerable improvement over the experience of the 1980s, but the budget deficit continues to vacillate around 3 percent of GDP, the financing of which may result in the crowding out of the private sector in credit markets and contribute to a slower rate of investment and growth. Recent levels of investment and savings at 20 and 16 percent of GDP do not compare favorably with those of faster growing economies. Furthermore, the efficiency of investment has been lower than in countries in which private investment plays a greater role. Morocco's incremental capital-output ratio (ICOR), at about 5, is higher than one finds in countries that have completed broad reforms that included the opening of markets to competition.[15]

[13] The World Bank, *Morocco at a Glance*. October 1, 1998.

[14] *Activité, Emploi et Chômage 1997*, p.25.

[15] Cf., for example, World Bank (1996), pp.5-10.

Exports are still heavily weighted with agricultural products and minerals. In spite of enjoying preferential access to the markets of the European Union, manufactured exports have experienced slow growth, raising questions about the competitiveness of Morocco's industrial sector. Its textile and clothing industry is already feeling the effects of competition from other countries in its traditional export destinations. As a proportion of total exports, manufactured goods have declined from 25.1 percent in 1986 to 20.1 percent in 1997.[16] Morocco has already implemented important reforms in its trade and exchange system and is committed to reducing further trade barriers to imports from the EU in the context of the Euro-Mediterranean Partnership, which grants certain trade privileges and offers assistance. These changes will pose significant challenges to domestic producers, and require a concerted effort to improve the performance and competitiveness of the economy as a whole.[17]

The investment climate has improved substantially with the provision of generalized investment incentives, and reductions in marginal tax rates on corporate profits. The Moroccan authorities have introduced performance objectives and fuller disclosure requirements for public enterprises to encourage greater efficiency and a lessen the reliance on the government's budget for operational and capital subsidies.

2.3 The employment situation

2.3.1 Unemployment

Persistently high levels of unemployment, officially 16-17 percent of the labor force, with much higher rates for the young, pose the most serious economic policy problem for Morocco.[18] Legal provisions tend to create impediments to labor mobility or raise the price of labor above its opportunity cost.[19] Both may be considered market imperfections that inhibit employment in the formal sector of the economy. For example, Moroccan law governing dismissals or layoffs does not permit individual firing for economic or technological reasons. Collective layoffs for economic reasons must first gain the approval of regional authorities. A royal decree also provides for generous severance allowances, though it is held that the actual cost to employers is clothed in uncertainty since trade union intervention frequently results in allowances in excess of the legal requirement. Employers compensate for the rigidities imposed by law by resorting to hiring temporary workers, employable for less than one year. While affording some cost relief, the practice also has a downside since it poses a disincentive to invest in training, penalizes productivity, and may have disincentive effects on the performance of workers who know they are expendable.

While overall job prospects are dim, job experience makes a difference, as illustrated by data on the duration of unemployment. Among those unemployed with previous work experience 58 percent had been unemployed more than twelve months. Among those with no experience, more than 90 percent

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[16] *Morocco at a Glance.*

[17] Useful background information and news on the Euro-Mediterranean Partnership are provided on Arabia On-Line (http://corp.arabia.com/pres/euromed).

[18] There are also significant differences by level of education. The average unemployment rate among workers without a grade school diploma averaged slightly below 10 percent while that for higher levels of completed education hovered around 25 percent. This may reflect differences in expectations, but also a reporting bias.

[19] World Bank (1996), *pp. 15-19* and various Bank and IMF memoranda.

were in this category. Duration of unemployment was also shorter for job seekers with less than a completed primary school education.[20]

2.3.2 Earnings

Comprehensive data on earnings in Morocco's economy are lacking. Information gathered from individual firms and from a private wage survey suggests that low-skilled but experienced permanent workers in modern sector firms earned between 2,500 and 3,000 DH per month in 1996. Temporary workers averaged earnings 15-20 percent above the legal minimum wage.[21]

In enterprises with 10 employees or fewer, average monthly earnings for 1996 were estimated as 1,361 DH per month.[22] This is moderately below monthly earnings at the urban legal minimum wage of approximately 1,510 DH[23]. Young workers earn substantially less, between 30 and 60 percent of the legal minimum.

The laws affecting the price of labor also pose disincentives to employment. Legal minimum wages are set well above the opportunity cost of workers. In a recent survey, over 55 percent of unemployed workers indicated that they were willing to accept a wage less than the minimum wage; this proportion rises among young workers and those with little formal education. Payroll taxes that amount to 17 percent of the wage bill further raise the cost of labor. Finally, public sector firms imbued with a "social function" provide additional fringe benefits, such as housing, which add further to the cost of labor and discourage hiring. The cost and lack of flexibility provide enterprises with an incentive to substitute capital for labor, resulting in more capital-intensive production techniques — precisely the opposite of what is needed to begin to cope with the serious unemployment problem.

2.3.3 Fringe benefits and social safety nets

State-owned enterprises typically offer rather generous fringe benefits and coverage under special retirement systems for the public sector as a whole or "proprietary" to the enterprise. Morocco's general social security regime covers industry, commerce, liberal professions, agriculture and the handicraft sector. The system is managed by the *Caisse Nationale de Sécurité Sociale* (CNSS), financed by worker and employer contributions, assessed on the basis of the gross monthly earnings (salaries). The *Caisse* uses part of the funds to finance its operations; the remainder is deposited with the *Caisse de Dépôt et de Gestion* (CDG), in effect a manager of financial assets of pension funds.

In addition, there is the *Caisse Marocaine de Retraites* (CMR) for public sector employees, and the *Régime Collectif d'Allocation de Retraites* (RCAR) for non-permanent public sector employees ("*agents temporaires, occasionnels et vacataires de l'état*") and employees ("*agents*") of public

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[20] All data on characteristics and status of the unemployed are drawn from *Activité, emploi et chomage 1977: Rapport de synthèse.* Again, some of these indicators may reflect reporting bias, with workers with less education or with job experience more likely to move into the informal sector if they lose their job.

[21] Earnings data for 1993-96 for several classes of employees are available from a private survey undertaken annually by the *Chambre Française de Commerce et d'Industrie du Maroc*. These are summarized in "3 ans d'enquêtes de la CFCIM" *L'Economiste*, December 18, 1997.

[22] "Développement de la micro-entreprise et demande potentielle de micro-crédit au Maroc?"

[23] Calculated on the basis of 44 hours per week and 4.3 weeks per month

enterprises ("*établissements publics*"). The RCAR is administered by the *Caisse Nationale de Retraites et d'Assurance*.

As of December 31, 1995, the system of mandatory coverage (*l'ensemble des régimes obligatoires de prévoyance sociale*) — CNSS, CMR, and RCAR included 1.9 million out of a total workforce (employed active population) of 8.5 million, for a global coverage rate of 22.3 percent. This number does not include the workforce of public enterprises that have their own social security systems — OCP (phosphates), ONE (electricity), RAD (*Régie Autonome de Distribution*), ONCF (railways), ODEP (water), *Régie des Tabacs*, *Banque du Maroc*. The social security system managed by the CNSS covered 899,000 individuals, that is, 47.2 percent of all those covered by mandatory systems.

The *Caisse Interprofessionnelle Marocaine de Retraites* (CIMR) covered 3,114 enterprises in 1996. Some 214,769 workers contributed. It is a voluntary system; the decision to join is up to each employer. It is common practice in large enterprises to provide employees with supplementary retirement benefits under the CIMR.In participating enterprises, workers can choose among 5 contribution rates (based on gross salary, including overtime, etc., with a fixed ceiling, currently 543,000 DH per year). The system is mixed — capitalization and redistribution (*répartition*): worker contribution goes to an insurance company where it earns 4.5 percent, the employer contribution goes to the CIMR where it is used on a PAYGO basis. If the insurance company gets more than 4.5 percent, 90 percent goes to the CIMR and 10 percent to the insurance company.

Those 60 years of age or older at the time of retirement from a state-owned enterprise are eligible for a pension from the national social security system as long as they have served in covered employment for 3,240 days, or approximately 10.4 years. The pension is equal to the average basic wage of the previous 36 or 60 month interval, whichever favors the retiree more. For every additional 216 days of covered service, a retiree is entitled to an additional 1 percent up to a maximum of 70 percent of the last rate of earnings. However, an individual drawing a pension is barred from paid employment.[24]

Morocco offers little in the way of a safety net for workers displaced from employment. Unemployment insurance and other forms of income support are absent. The most important support offered those who lose their jobs is a severance allowance. Established by royal decree in 1967, this severance payment varies as a function of the average basic salary over the twelve months preceding separation and the length of employment with the enterprise. The following table presents the schedule of allowances:[25]

Exhibit 2-1: Provisions for severance pay

Length of Employment	Allowance per year of employment	Total allowance at end of each five-year period
First five years	48 hours per year	240 hours
Next five years	72 hours per year	600 hours
Next five years	96 hours per year	1,080 hours
Over 15 years	120 hours per year	

[24] *Ibid.*,pp. 105-06.

[25] *Labor Legislation: A Practical Guide, Updated Edition*," prepared by Mrani Alaoui Abdelali, p. 86.

Thus, a worker dismissed after 15 years of service would be eligible for a severance payment equivalent to 135 days pay, or approximately five months. It is common practice for state enterprises to supplement the legal requirement, granting as much as two months wages per year of service.

Employees of privatized firms may be protected from discharge for some interval following passage to the private sector. The privatization law does not provide for any employment guarantee. Nevertheless, it has been customary for the sale contract to commit the private employer to maintaining the level of employment for a period of up to three years. Such provisions do not necessarily bar discharges as long as the severed workers are replaced. However, no monitoring or enforcement mechanism has been put in place so that compliance generally depends on the good faith of the private employer.

There is nothing to bar enterprises from discontinuing some in-house operations that render some workers redundant and encouraging these same workers to form a cooperative to which the same operations could be contracted. While not a feature of the Moroccan scene to date, it is one that may become significant in the future.

2.3.4 Training and job search assistance

Morocco offers little in the way of active labor market policies that might ease the re-employment of workers retrenched from privatized firms. The government has established a network of placement bureaus, *Centres d'information et d'orientation pour l'emploi*, but these are intended to serve primarily the young unemployed rather than those released from jobs.

Their effective contribution is likely to be minimal. Hiring is typically the product of personal contacts and referrals rather than the result of a systematic canvassing of potential employees. Therefore, it is likely that the placement bureaus are not really cost-effective. The government does offer training programs financed by a 1.6 percent tax on payrolls. However, given the volume of unemployment, the existing labor market rigidities, and the modest expansion of the economy, it would be unrealistic to hope that these measures can make a significant contribution easing the transition from retrenchment to reemployment.

2.4 The legal, regulatory and institutional framework

The legal and regulatory framework in the country defines the operating rules for the privatization manager. As in many other instances, the principal reference is the specific privatization law (Law 39/89) that defines basic objectives and modalities of the program. The Moroccan approach did not require legislative approval on a case-by-case basis in the form of any enterprise-specific laws, often used elsewhere in the case of "strategic" industries like infrastructure.

Like any special privatization law, however, the Moroccan law fits into a broader context defined by the full range of business laws — including corporate law, bankruptcy law, labor code, investment code, tax laws, accounting and financial disclosure standards, or environmental provisions.[26] The context appraisal needs to highlight any weaknesses in the overall legal and regulatory framework that affect the objectives of the program. As in other areas, a main concern of the impact appraisal is the dynamic link between the program context and its impacts. As the direct outcomes of the privatization effort mesh

[26] Guislain (1995) explores the different legal categories in greater detail.

with other forces, they contribute to adjustments in the legal and regulatory structure, thereby redefining the conditions for subsequent performance of the program and of the privatized entities.

Similar considerations apply to the treatment of institutional capabilities and weaknesses. Prevailing conditions will obviously determine the range of options for achieving the objectives of the program, but the program in turn results in new arrangements that open new possibilities. A standard example is the interaction between the development of capital markets and privatization. A widely accepted premise asserts that privatization can foster the development of capital markets by introducing new listings and new instruments and by creating demand for new services. The development of capital markets in turn becomes key to achieving the objectives of the program. In fact, capital market development — the creation of new institutional capabilities and operating rules — can become an integral part of the privatization program itself. The experience of the British privatization program, which was preceded by a major effort to strengthen the capabilities of what was then one of the world's most developed capital markets, provides an object lesson in this regard.

2.5 Objectives and constraints

This overview of the context analysis suggests that both objectives and constraints are in effect desired changes in the context. The difference between the two categories is that policy makers attach some value to objectives, while constraints and changes in them are of interest because they affect the achievement of the objectives.

The objectives of any privatization program thus emerge from the political and economic context. In their study of the experience of privatization in Africa, Campbell White and Bhatia [1998, p. 22] identify the following categories of objectives that emerge from government policy statements:

- reduce fiscal burden;
- develop the private sector;
- broaden ownership of productive assets;
- increase economic efficiency;
- reduce administrative burdens;
- develop capital markets;
- access markets, capital, and technology; and
- raise revenues for the treasury.

These objectives apply in different configurations and with different priorities across countries. Their relative importance is of course driven by the prevailing conditions. For example, raising revenues for the treasury only makes sense as an objective only if the state-owned companies are actually profitable. Otherwise, the gain is simply the "fiscal burden" averted.[27]

Campbell White and Bhatia [1998, p. 21] further argue that privatization programs should be measured in terms of their stated objectives:

[27] While this argument appears quite obvious, it is not always easy to convince officials or opponents of privatization of the simple point that loss-making enterprises are unlikely to generate any revenues.

> … to assess the success of a program, outcomes need to be measured against the objectives that governments had set for privatization. Objectives are usually articulated in policy statements. They guide implementers and inform the public about what a privatization program is designed to achieve and how the program will achieve its aims. Hence, as statements of what is desired to be achieved, they should provide the litmus test for judging the success of privatization.

Policy statements, however, rarely address the full range of objectives and concerns that govern privatization programs. Protection of jobs and expansion of employment is typically an overriding concern. Any evaluation of the impacts of privatization must therefore go beyond official statements to understand the full range of relevant objectives as they emerge from the context analysis.

Morocco's privatization program has been an important part of the economic reform agenda. Its stated objectives were to

- stimulate economic growth and job creation,
- create new opportunities,
- strengthen international competitiveness, and
- enhance equity in the distribution of income and wealth across social groups and across regions.

The program faced a number of constraints that included:

- the country's capital markets were weak, with a small stock exchange that saw little action and a financial sector dominated by state-owned banks, exhibiting all the signs of financial repression;
- there was no history of share ownership, which presented a challenge to efforts to assure adequate local participation and to achieve the program's distributional objectives;
- the state-owned enterprise sector was characterized by complex ownership arrangements, with the state often owning less than 100 percent of the share capital; moreover, in many instances state ownership was indirect, through the holdings of other state-owned enterprises;
- several of the larger state-owned enterprises constituted natural or effective monopolies, raising concerns about effective regulation once they would pass into private hands; and
- the administration lacked the capabilities for structuring and implementing a credible privatization program.

3 Processes and resources

3.1 Process options and choices

The analysis of the processes used and resources applied in the privatization process is critical to any impact appraisal. As long as the evaluation aims at helping program managers in the country and elsewhere, any impacts need to be explained in terms of privatization approaches and modalities. This part of the analysis focuses on the elements under the control of the privatization manager, subject to the given objectives and constraints. Relevant process characteristics include the following aspects:

- designation and selection of enterprises for privatization;

- scope and focus of any restructuring efforts prior to privatization, or as part of the privatization process (such as phasing of privatization actions to create maximum value);
- recruitment of staff and advisers to carry out technical analyses, manage any restructuring and handle the actual transactions;
- the degree of publicity given to programmatic choices and schedules, as well as to the modalities and conditions associated with the privatization, in particular with respect to communications with stakeholders;
- procedures for ensuring transparency and accountability;
- the choice among privatization options — full or partial divestiture, concession, management contracts, etc. — and the combination of privatization modalities — public tender, private placement or direct negotiation, or share issues for divestitures, including set asides for or prohibitions on the participation of selected groups;
- identification and implementation of needed changes in the legal, regulatory and institutional context to alleviate constraints or remove particular obstacles;
- determination of bid procedures, including such issues as prequalification and establishment of a minimum price;
- bid evaluation criteria, including financial and technical aspects, as well as post-privatization obligations of the private partner;
- valuation procedures used either for orientation purposes, for pricing share issues, or for establishing any minimum prices;
- procedures for addressing distributional aspects (broadening share ownership and asset formation) and provisions for mitigating social impacts; and
- post-privatization monitoring, enforcement of conditions of sale, and continuing regulatory oversight.

These categories overlap to some extent. As in the other parts of the impact analysis, there is no general structure that fits all. Some of these issues may not apply in a particular situation, while procedural aspects may require further refinement in other settings.

In his analysis of the determinants of proceeds in the Mexican privatization program, López-de-Silanes (1997) summarizes a range of hypotheses from the literature regarding procedural options and their likely effects on one measure of the success of privatization, the privatization net price: "The measure of net price is PQ, or "Privatization Q," which is … calculated as the value of the Government's Net Privatization Price (GNPP) [nominal sale price minus the cost of restructuring, the cost of government commitments, and subsequent adjustments to the sale price] adjusted by the percentage of SOE shares sold plus total liabilities of the SOE at the time of privatization, divided by total assets of the SOE at the time of privatization." (p. 973).[28] The analysis focuses primarily on options for restructuring the enterprise prior to privatization, as shown in Exhibit 3-1:

[28] The PQ measure is an adaptation of Tobin's Q, which is essentially a "market-to-book" ratio, or the ratio of the market value of a firm's assets (measured, for example, by the current share price times the number of shares outstanding) to the replacement value of these assets.

Exhibit 3-1: Factors influencing net prices of privatized enterprises

Independent variables	**Hypotheses**	**Empirical predictions of the effect on PQ [see text]**
	I. Company and industry characteristics	
…		
Control versus noncontrol privatizations	Residual rights of control are the critical determinant of resource allocation. Therefore, privatization that give control to the buyer will have higher PQs than those privatizations of minority packages of shares …	Higher PQ for control privatizations
	II. The auction process and its characteristics	
…		
Speed (length) of each process	The announcement of privatization triggers deterioration of incentives and performance, similar to that of firms in financial distress …	Negative effect
	Once privatization is announced, improved stakeholders' incentives may boost company performance, as in the case of the U.K. …	Positive or no effect
Auction competition	Increases likelihood that some bidder perceives the good's value and reduces danger of collusion	Positive effect
Auction restrictions on foreign investment	Foreign participation increases competition and reduces the scope for collusion, particularly in oligopolistic industries in developing countries …	Positive effect
Auction requirements of bidder prequalifications	Prequalification of bidders increases the quality of the auction and gives certainty to the whole privatization program …	Positive effect
Cash-only auctions	Liquidity constraints may prevent a bidder from acquiring the SOE at its highest value …	Negative effect
	III. Prior restructuring policies	
Management changes	Exclusion of experienced management may be unwise as many of them "are likely to be the best informed and the most able managers of the particular SOEs they are running" …	Negative effect

Exhibit 3-1 (continued)

Independent variables	Hypotheses	Empirical predictions of the effect on PQ [see text]
	Old management team has the wrong human capital to face competition and new market conditions …	Positive effect
Firing workers or contract renegotiation or both	Public unions can influence the future of politicians who care about votes. Therefore, the government has less bargaining power	Negative effect
	The public sector may be better at bargaining with unions if it has mechanisms to assist displaced workers.	Positive effect
Debt absorption	"There is rarely any advantage in passing debt across to the private investor — because for every dollar of debt (with adjustments for present value, etc.) the bid price will be a dollar lower" …	No effect
	SOEs could be financially distressed but economically viable … Debt write-offs allow new owners to optimally redesign the capital structure …	Positive effect
	Absorbing debt may have a negative effect on net prices if the borrowing terms for the private buyer are worse than those for the government (SOE). In effect, the buyer would be able to profit at the expense of preexisting creditors when debt is left in place.	Negative effect
Efficiency improvement programs	Asymmetric information may cause bidders to underbid. Easy-to-solve bottleneck problems could be solved before the sale …	Positive effect
	Managerial theft could take place. Managers have incentives to get resources for the last time and waste them …	Negative effect

Exhibit 3-1 (continued)

Independent variables	Hypotheses	Empirical predictions of the effect on PQ [see text]
Investment measures	"Long-planned and careful expansions, especially for well-run SOEs …" as well as those investments associated with transforming large firms into viable units to improve matching opportunities with bidders may take place …	Positive effect
	The investment might not fit the winner's plan, or the government might do the wrong investment based on political concerns …	Negative effects
De-investment measures	Cutting the flow of resources will prevent the firm from undertaking or continuing positive net present value projects.	Negative effect
	Managers may be wasting resources or investing the wrong assets …	Positive or no effect

Clearly, this is not an exhaustive list of the relevant procedural aspects and choices, since it focuses on one particular measure of the success of a privatization program — what is considered as a program outcome here. At the same time, not all of factors listed by López-de-Silanes may be applicable in a given situation. Even so, the table provides a useful indication of the range of considerations in examining privatization procedures.

3.2 Characteristics of the process in Morocco

3.2.1 Overall features

Morocco's privatization program was launched in late 1989 with the passage of the privatization law. Preparatory work for the first privatizations took three years. The first enterprise, SODERS, a producer of yeast, was privatized via international tender followed by a private placement in early 1993. The first share-issue privatization, that of CTM-LN, a bus line and courier service, took place in June 1993. The last privatization action to date, a public issue of shares of SMI, a silver mine, concluded in June 1997.[29]

The program employed competitive tenders, public share issues on the Casablanca Stock Exchange (CSE), private placement and sales to workers in varying combinations. The choice of modalities depended on the situation of the enterprise, the success with different methods, and the specific objectives, such as increasing participation. In a number of instances, the shareholdings were allocated

[29] Since then, there has been a tender for a stake in BNDE, the national development bank, but the results were judged "not conclusive" and no action was taken. The Ministry has since announced that it is prepared to enter into negotiations for private placement of 51 percent of the shares of the bank. A stake has been sold to the pension fund of the Royal Army (*l'association des œuvres sociales de l'Armée Royale*). Over the last year, sales of two hotels reportedly brought in 500 million dirhams.

between a “hard core” (*noyau dur*), including the strategic investors with the needed expertise, who would agree to hold their stake for a period of at least three years, and general investors.

One unique feature of Morocco’s privatization program has been the use of *privatization bonds*. These bonds combined elements of regular bonds issued by the Treasury (albeit at relatively attractive rates) and convertible bonds. Holders of these bonds could exchange them for shares in privatized companies introduced on the CSE; they had priority over cash purchasers. In principle, the privatization bonds constitute a means to spread out revenues from larger privatizations over time. They also provide an additional avenue for marketing participation in share issue privatizations to new investor groups. Altogether, some 2.7 billion dirhams (in two tranches of 1.7 billion and 1.0 billion dirhams) of privatization bonds were issued, a volume that exceeded privatization shares since then offered on the CSE by a significant margin. As a result, only two thirds of the bonds were actually converted into shares. The bonds themselves were traded on the Casablanca Stock Exchange.

Much of the technical work involved in due diligence, valuation, assessment of privatization options, investor outreach, etc., was handled by investment banks or financial advisers working under contract. The Ministry staff served as “general contractor,” supervising and guiding the process. As a rule, in seeking strategic investors, the program made every effort to have as wide a participation as possible to encourage competition.

The Moroccan government established post-privatization obligations of investors in a document — the *cahier des charges* — that became part of the sales contract. The obligations covered primarily investments and employment. The *cahiers des charges* were part of the tender documents; however, they were being treated as confidential, and were not available to the public at large or to some of the intended beneficiaries of the provisions, the workers (see also Section 7.1.4.3). We understand that the final provisions in the sales contract were subject to further negotiations between the Government and the successful bidders. Obligations laid out in the *cahiers des charges* were in principle enforceable through penalties. However, there was no systematic effort to track compliance with these provisions, or to monitor the post-privatization performance of the privatized enterprises, which made enforcement on the whole a moot point. The Ministry noted that it is systematically advised of any decision or action by the new owner that would result in a “massive reduction” in employment, but it does not have any regular reporting mechanisms.[30]

While we did not find any indication that the privatization process used a formal prequalification step, the outreach efforts and the *cahiers des charges* in effect served to prequalify investors, since only investors capable of meeting the criteria outlined in these documents would be competitive in their bids.

The bid evaluation considered a range of criteria in addition to the price offered, such as the qualifications of bidders, the proposed business and investment plan, or the proposed treatment of employees. In general, any bids that failed to meet the minimum price established by the Valuation Authority (see below) would not be considered further. If all bids failed to meet the minimum price, the government would proceed to direct negotiations for private placement (*attribution directe*).[31]

[30] A recent survey conducted by the Ministry, with some assistance in the questionnaire design from the study team, was designed to lay the groundwork for more systematic monitoring of post-privatization performance.

[31] Such follow-up negotiations still retained a competitive element, since the government would announce that it was opening negotiations, but not necessarily restricted to a single investor.

3.2.2 The selection of enterprises for privatization

Morocco's Privatization Law 39-89, adopted by Parliament in 1989, laid out the structural framework for the privatization program. Its attached list of 112 — later increased to 114 — state-owned enterprises designated as "privatizable" has been widely interpreted as a *target* list to be privatized by the end of 1995 (later extended to the end of 1998). Yet it was apparently intended to *contain* the scope of the program by precluding the privatization of any state-owned enterprise *not* on the list. Without such a list, the Parliament evidently felt, the privatization program might put any of the state enterprises — including those considered strategic — on the block.

The 1989 Privatization Law presented a list of 112 "privatizable" public enterprises — out of a larger universe[32] — that met certain criteria. In drawing up the list for Parliamentary approval, the Government sought to choose the better prospects. The enterprises selected had to meet certain criteria, including (actually or potentially) profitable operations, absence of serious overstaffing, no public service responsibilities, a significant share of state ownership, and a role in regional development. Adding to this "selection bias," the actual privatization effort subsequently narrowed the range to the most promising ones on the list.

The enterprises selected had to have the legal status of a corporation (*société anonyme*), operate in a reasonably competitive environment, be either profitable or offer the potential of achieving profitability, not exhibit signs of serious overstaffing, have no public service responsibilities, have a significant share of state ownership, and play a role in regional development. The weighted average public sector stake in the enterprises on the list was 73 percent. In 87 of the 112 companies, the public sector owned more than 50 percent.[33]

Since many of the enterprises on the list had some ownership stake in other companies, the total number of enterprises affected was estimated to be 300 (out of a total of 680).[34] The 112 enterprises on the list were to be privatized by the of 1995; a 1995 amendment extended the deadline until December 1998, and added two enterprises to the list. Some saw the 1993 changes as a policy shift that contradicted earlier assurances that the government would not transfer firms in "strategic" sectors. With little debate, the parliament designated one such firm (the major refinery, SAMIR) as privatizable.

About one-third (37) of the companies on the original list were hotels, with a total of 7,800 beds (out of 43,500 beds for the country as a whole, that is, about 18 percent). Manufacturing accounted for another 38 percent (43 enterprises), with the remainder spread across other sectors.

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[32] The determination of the number of "public enterprises" is a fairly complex task. In fact, some observers have commented that with multiple holdings and cross-holdings the government does not always know what it owns. On the one hand, the portfolio of the state managed and supervised by the *Direction des Etablissements Publics et des Participations* (DEPP) of the Ministry of Finance includes many administrative units. On the other hand, public enterprises often hold stakes in "private" companies that can give considerable influence over the management of those companies. (The DEPP is currently attempting to assess the "second-order" privatization impacts — how many companies became fully privately owned as a result of the privatization of enterprises owning some significant portion of their shares.) The general consensus appears to be that there were originally around 300 public enterprises with a commercial mission, and that some 200 remain, although the state-owned sector today is highly concentrated, with the ten largest companies — including the Office Chérifien des Phosphates (OCP), power, telecommunications, and Royal Air Maroc — accounting for the lion's share of activity.

[33] Bouachik (1995), p. 131.

[34] *Ibid*., p. 130; as noted elsewhere, the determination of the exact number of "public enterprises" is difficult, both in terms of the ownership threshold (what is the minimum share ownership by a public entity to make an enterprise "public"), and in terms of the definition of "enterprise" as a commercial entity.

The 75 enterprises other than the hotels employed a total of 35,800 people, had total sales of some 35 billion dirhams, produced a value added of 9 billion dirhams — about 6 percent of Morocco's GDP in 1989 — and paid some 2.6 billion dirhams in salaries.[35]

It is unlikely that the hotels, most of them very small units, accounted for more than 10,000 employees. The urban labor force averaged 4.992 millions in 1997 according to data originating in a quarterly survey of urban households.[36] Thus, the workforce of the privatizable enterprises represented less than one percent of the urban labor force. Indeed, in 1997, urban employment in public and semi-public enterprises, at approximately 139,000, amounted to no more than 3.3 percent of the employed urban labor force.[37] Finally, the non-hotel enterprises that have been privatized employed a total workforce of approximately 15,000 in 1989.

3.2.3 Key institutions in Morocco's privatization program

The Ministry of Privatization (its status and name have changed over time[38]) has been responsible for managing the process, bringing in consultants and investment banks as needed. An interministerial Transfer Commission (*Commission des Transferts*), whose five members were appointed by the King, advised the Ministry of Privatization on privatization modalities for each type of enterprise and the selection of investors for open tenders or private placements. An independent seven-member independent Valuation Authority (*Organisme d'Evaluation*), also appointed by the King, was charged with reviewing enterprise valuations and setting minimum prices. The minimum prices were published with the tender documents (which also included the *cahiers des charges* or conditions of sale). The role of these two institutions, imbued with the authority associated with the royal appointment, was seen as critical in guaranteeing the transparency and integrity of the process.

3.3 Resources

In general, the analysis of the resources used needs to cover the entire range of the program, from preparation to any post-privatization commitments by the government, including monitoring and enforcing compliance of buyers' obligations. A main concern is the mobilization of human resources to prepare and carry out the privatization, both within the government, and through contracting with outside advisers and consultants. There is also some interest in looking at the source of financing, since the fiscal impacts of the program depend in part on the ability to mobilize outside (donor) funding, in terms of both conditional budget support and technical assistance. Alternatively, the government may rely on success fee mechanisms, or some mix of fee-for-service and success fee arrangements in remunerating outside advisers handling due diligence, business valuation, investor outreach, and related tasks.

Morocco's Ministry of Privatization operated with a relatively small — but highly qualified — staff, relying heavily on outside consulting firms and investment banks. The in-house staff was assembled

35 *Ibid*.

36 Ministere de la Prevision Economique et du Plan, Direction de la Statistique, *Activite, Emploi et Chomage 1997; Rapport de Synthese*, p. 61.

37 *Ibid.*, p 45.

38 The current name, *Ministère du Secteur Public et de la Privatisation*, signals the intent of the new government to manage public enterprises more actively for better performance prior to privatization.

through a special recruitment drive, buttressed by competitive remuneration schemes. The program received significant financial and technical support from USAID, the UNDP, and more recently the World Bank and others.

The Moroccan authorities had “privatized the privatization process” by relying primarily on outside consultants for preparing and completing the transactions, keeping the bureaucracy in the Ministry of Privatization small. A World Bank report (1996, p. 28) concluded that “[t]his method is fast and results in high quality work. It is also expensive, and will become more so as transactions get larger and more intricate.”[39] Given the emphasis on a range of bid evaluation criteria transcending price alone, the remuneration of outside advisers apparently relied primarily on fee-for-service arrangements.

3.4 Program “culture” and transparency

A key element overall of any privatization is the *transparency* of the process. Scrupulous attention to open and fair competition both in procuring advisory and transaction support services and in seeking bids for the companies themselves can play a major role in enhancing the credibility of the program, of the government’s economic policies, and of the economy as a whole. In many instances, privatization may be a first serious point of contact with the economy or particular sectors for major international investors and intermediaries. If they perceive that the government is committed to an even-handed treatment of bidders in its privatization program, other investment decisions are likely to be affected. Doing privatization “right” therefore often offers a unique opportunity to present the economy in the international investor community.

Institutions such as the World Bank and the International Finance Corporation (IFC) have concluded that transparency is best served by simplicity in the process of divestiture. Ideally, the government would make perfect information available to all the bidders, have a pure and unambiguous bidding rule (the highest price wins), and not engage in any substantive negotiations after the bid competition. Complex bidding rules often give rise to suspicions and perceptions that the process was unfair. Did the scoring of technical proposals favor one bidder over another, did the evaluation assign proper weights to technical vs. financial factors, or did negotiations with the winning bidder result in modifications of the technical requirements that would have changed conditions for the original competition?

The simple approach — the same conditions and information for all bidders, and a decision on price alone — would largely address such concerns. However, such an approach is rarely feasible, in part because it tends to defeat the purpose of privatization, to leave the management of the enterprise to private initiative. Imposing conditions — for example, with respect to rehabilitation or expansion investments or regarding the resolution of employment-related issues — to ensure uniformity among bidders on the technical side contradicts the basic premise of the program.

The next-best solution therefore is to retain flexibility in the final provisions, but to structure the process as clearly as possible, taking pains to ensure that every interested (qualified) party gets access to the same information, that there are no privileged discussions, that bidding and evaluation rules are straightforward and plainly stated at the outset, and that there clearly defined limits on negotiations with selected bidders.

[39] It is not clear why handling the transactions in-house would result in lower cost, especially if the government seeks to reach beyond the “regular” cadres to attract the talent and experience needed.

The overall record of Morocco's privatization program in these regards is positive, although not perfect. The program designers and managers made special efforts to ensure impartiality, as reflected in the separation of operating responsibilities, general oversight and the sensitive valuation decisions. As a result, the program generally established a record of transparency and even-handedness of the treatment of investors. While there have been questions and some allegations, there appears to be a reasonable consensus among local and international investors that the program was managed in a professional and reasonably open manner. A review of the treatment of privatization-related issues in the local business press confirms this impression. However,

4 Program outcomes

4.1 Program outcomes

The analysis of the outcomes, or process achievements, is in effect only a prelude to the impact analysis. The outcomes of the privatization program refer to the immediate results of the efforts and transactions. They include such measures as the number of companies privatized by whatever method, the value of assets transferred to the private sector, gross and net proceeds, distribution of shares sold, and the provisions of sales contracts signed or obligations accepted by the private investors.

4.2 Enterprises privatized

Overall, some 56 enterprises (including 22 hotels)[40] have been privatized; the program has also resulted in an estimated 125 "indirect privatizations" of companies in which privatized enterprises had held a stake. In other words, over the six "active privatization" years (1993 to 1998), the program succeeded in privatizing an average of nine companies a year. That must be considered as an accomplishment for a case-by-case privatization that relied heavily on public tenders and share issues at the Casablanca Stock Exchange.

[40] Most recent figures provided by the Ministry of Public Sector and Privatization; they include two hotels privatized in 1998.

Exhibit 4-1: The privatized companies

Company	Activity/Sector	Stake (%)	Date	Method	Buyer	Price paid (DH millions)
BMCE	Finance — Commercial banking	14.01	12/94	Bourse	Moroccan	455.3
		26.00	04/95	Tender	Consortium of Moroccan & international financial inst.	1.243.4
		3.00	12/94	Employees	Moroccan	82.9
CHELCO	Garments	32.00	04/93	Private placement (right of first refusal)	UK, Courtaulds	10.2
CIOR	Cement	51.00	08/93	Tender, followed by private placement	Holdercim, subsidiary of Holderbank (Switzerland)	614.0
		34.00	12/93	Bourse	99,1% Moroccan	329.2
		1.22	01/95	Employees	Moroccan	10.0
CMH	Distribution of petroleum products	50.00	03/94	Tender, followed by private placement (right of first refusal)	Moroccan, Hogespar	100.1
CNIA	Insurance	78.57	05/97	Private placement	Morocco/Bahrein	310.2
Crédit EQDOM	Finance-Consumer credit	18.00	06/95	Bourse	Moroccan	72.0
		1.54	11/95	Employees	Moroccan	5.2
CTM-LN	Passenger surface transport and courier services	35.00	07/93	Tender	Consortium of Moroccan & international financial inst.	111.6
		40.00	06/93	Bourse	99,5% Moroccan	94.3
		2.60	12/93	Employees	Moroccan	5.2
		18.46	09/94	Bourse	Moroccan	48.7
CTT	Mine - Cobalt	40.00	01/97	Tender, followed by private placement	Moroccan, Société Métallurgique d'Imiter (SMI)	88.0
Dragon-Gaz	Distribution of petroleum products	50.00	02/94	Private placement (right of first refusal)	Italy, Dragofina	0.85
FERTIMA	Fertilizer	35.00	10/96	Bourse	98.8% Moroccan	120.1
FPZ	Lead smelter	26.00	04/97	Private placement	Moroccan, CMT and Touissit	39.0
General Tire	Tires	20.00	10/94	Private placement	Consortium of Moroccan financial institutions	46.0
		2.21	10/94	Employees	Moroccan	4.3

Exhibit 4-1 (continued)

Company	Activity/Sector	Stake (%)	Date	Method	Buyer	Price paid (DH millions)
ICOZ	Textiles and threads	97.44	06/95	Private placement (Company in difficulty)	Moroccan-International Consortium	10.0
MAPROC	Leather, shoes	28.57	06/96	Private placement (Company in difficulty)	Moroccan-Libyan Consortium, Salima Holding	1 DH
MOBIL Maroc	Distribution of petroleum products	50.00	05/94	Private placement (right of first refusal)	US, Mobil Petroleum Corporation	110.0
MODULEC	Electro-mechanical equipment	76.34	08/94	Private placement (Company in difficulty)	Moroccan, Ouazzani	1 DH
		8.48	08/94	Employees	Moroccan	Free
PETROM	Distribution of petroleum products	51.00	07/93	Tender	Moroccan, Groupe Bouaida	145.0
SAMINE	Mine-Fluorspar	35.00	01/97	Tender, followed by private placement (right of first refusal)	Moroccan, Société Métallurgique d'Imiter (SMI)	38.5
SAMIR	Petroleum refinery	30.00	03/96	Bourse	99,7% Moroccan	1.504.8
		1.11	06/96	Employees	Moroccans	47.3
		60.99	05/97	Tender	Saudi Arabia, Corral Petroleum	3.157.5
SCP	Petroleum refinery	66.33	05/97	Tender	Saudi Arabia, Corral Petroleum	425.7
SHELL	Distribution of petroleum products	50.00	12/93	Private placement	UK, Shell Petroleum International	450.0
Sico-Centre	Garments (ready to wear)	30.00	06/95	Private placement (right of first refusal)	Moroccan, Mohamed Rahmani	1.62
SIMEF	Gas/diesel/electrical motors	89.98	07/95	Private placement (Company in difficulty)	International Consortium (Morocco/Belgium/Tunisia)	1 DH
		10.00	07/95	Employees	Moroccan	Free
SMI	Mine — Silver	36.07	09/96	Tender, followed by private placement (right of first refusal)	Moroccan, Managem, Groupe ONA	234.5
		13.00	06/97	Tender, followed by private placement	Moroccan, Managem, Groupe ONA	84.5
		20.00	06/97	Bourse	Moroccans	130.3

Exhibit 4-1 (continued)

Company	Activity/Sector	Stake (%)	Date	Method	Buyer	Price paid (DH millions)
SNEP	Production of chlorine, soda and PVC	90.00	10/93	Tender	Moroccan, Groupement Dolbeau-Dimatit- Holding Ynna (Groupe Chaâbi)	364.3
		5.31	--	Employees	Moroccan	In process
SNI	Financial Holding	15.63	10/94	Bourse	Moroccan	361.1
		51.00	11/94	Tender	Consortium of Moroccan & international financial inst.	1,669.0
Sochepress	Newspaper distribution	40.00	07/95	Private placement	Moroccan, Abdellah Lahrizi	24.0
SODERS	Fabrication de levure	33.34	02/93	Tender, followed by private placement (right of first refusal)	Moroccan and French (Lesaffre)	27.0
		2.39	02/93	Employees	Moroccan	1.6
SOFAC/ Crédit	Consumer credit	35.00	04/94	Tender, followed by private placement	Consortium of Moroccan financial institutions	89.3
		18.37	04/94	Bourse	Moroccan	40.0
		0.81	08/95	Employees	Moroccan	1.5
SOMAS	Distribution of petroleum products	56.04	05/96	Private placement	Moroccans, consortium of 8 petroleum product distributors	78.4
SOMIFER	Mine — Copper	34.20	01/97	Tender, followed by private placement (right of first refusal)	Moroccan, Société Métallurgique d'Imiter (SMI)	68.4

Exhibit 4-1 (continued)

Company	Activity/Sector	Stake (%)	Date	Method	Buyer	Price paid (DH millions)
SONASID	Steel	35.00	06/96	Bourse	98,3% Moroccans	420.4
		62.00	10/97	Tender, followed by private placement	Morocco, SNI and Spain, Martial Ucin	837.1
		3.00	3/98	Employees	Moroccan	30.6
Sotrameg	Production of alcohol from molasses	60.00	09/95	Tender	Moroccan, Groupe Fouad Fahim et Cie.	8.65
TOTAL Maroc	Distribution of petroleum products	50.00	05/94	Private placement (right of first refusal)	France, TOTAL Outre-Mer	300.0

Exhibit 4-2: Privatized hotels

Hotel	Date	Method	Buyer	Price paid (Dh millions)
Amandiers	02/93	Private placement (lessee)	Moroccan, Société Floride	5.0
Azghor	01/95	Tender	Moroccan, Société Touristique de Ouarzazate	14.55
Basma	09/93	Tender, followed by private placement	Consortium Maroco/Libyen, Bassamate	50.0
Casablanca (Hyatt Regency)	12/94	Private placement (lessee)	Moroccan, INTEREDEC-Maroc	180.0
Les Iles	06/94	Tender, followed by private placement	Moroccan, Sté de Gestion Hôtelière Expertotel	20.0
Tour Hassan	05/95	Private placement (lessee)	Moroccan, Kasbah Tours Hotels	50.0
Doukkala	04/95	Tender	Saudi Arabia, Abdulmajid Abu Aljadayel	22.17
Friouato	09/95	Tender, followed by private placement	Moroccan, Abdellatif Abouhafs	13.0
Les Mérinides	05/95	Private placement (lessee)	Moroccan, Kasbah Tours Hotels	30.0
Malabata	09/94	Tender, followed by private placement	Saudi Arabia, Sté. Malabata International	55.0
Oukaïmeden	04/95	Tender	Moroccan, Société Hôtelière Louka	3.01
Rissani	09/94	Tender	Moroccan, Sté. SHAT	8.1
Splendid	09/96	Private placement (lessee)	Moroccan, Radia Benamar et Ahmed Lamaâni	0.3
Tarik	03/93	Tender	Moroccan, United Moroccan Hotels	15.2
Toubkal	04/94	Tender	Moroccan, Beach Club	38.5
Transatlantique-Meknès	05/94	Tender, followed by private placement	Moroccan, Société Tikida-Ismaïlia S.A.	41.0
Volubilis	04/94	Tender	France, FRAM	35.0
Zalagh	12/94	Tender	Moroccan, Sté. Dar Si Aissa	17.25

Note: These tables were adapted from the information provided by the Ministry of the Public Sector and Privatization on its web site (November 1998). Aggregate figures provided later (March 1999) by the Ministry do not always correspond to summary data derived from these tables. Since we were unable to reconcile the differences, we have left the tables in their original form, but have used the more recent figures from the Ministry elsewhere in the report.

Even so, 62 enterprises (including 19 hotels) on the list, designated as “privatizable” for almost a decade, have yet to be privatized. The actual number of these companies now is somewhat smaller, since some of the companies on the list, in particular in the sugar sector, have merged.

4.3 Privatization proceeds

The privatization program generated some 15.7 billion dirhams ($1.7 billion[41]) in proceeds (as a rough approximation, about 3 percent of total government revenues over the period 1993-97); the

[41] All conversions use the current rate of approximately 9.23 dirhams = $1. The figures reported here, including the distribution by privatization method below have been derived from data provided by the Ministry of Public Sector and Privatization, even though they do not always fully agree with the summary data posted on the Ministry’s web site, which were used in the tables above.

privatization of hotels accounts for slightly roughly 4.5 percent of that total. On average, the government share divested in the companies other than hotels was 67.4 percent, with a minimum of 19.5 and a maximum of 100.0 percent.[42] The total price tag of 15.0 billion dirhams ($1.6 billion) for this stake implies a market value of the privatized companies (other than hotels) of 22.3 billion dirhams ($2.4 billion). In some cases, the state retains some indirect stake. Finally, the program also brought in 6.6 billion dirhams ($715 million) in investment commitments.

Competitive tenders accounted for some 24.2 percent of total proceeds. Share issues at the CSE accounted for 22.7 percent. Private placement involved four situations: transfer of shares to employees (1.6 percent of total privatization proceeds); follow-up to an unsuccessful open tender (15.2 percent), an existing right of first refusal (5.1 percent), or for other reasons, with a competitive element[43] (31.2 percent). The distribution of total proceeds by method used is shown in Exhibit 4-3.

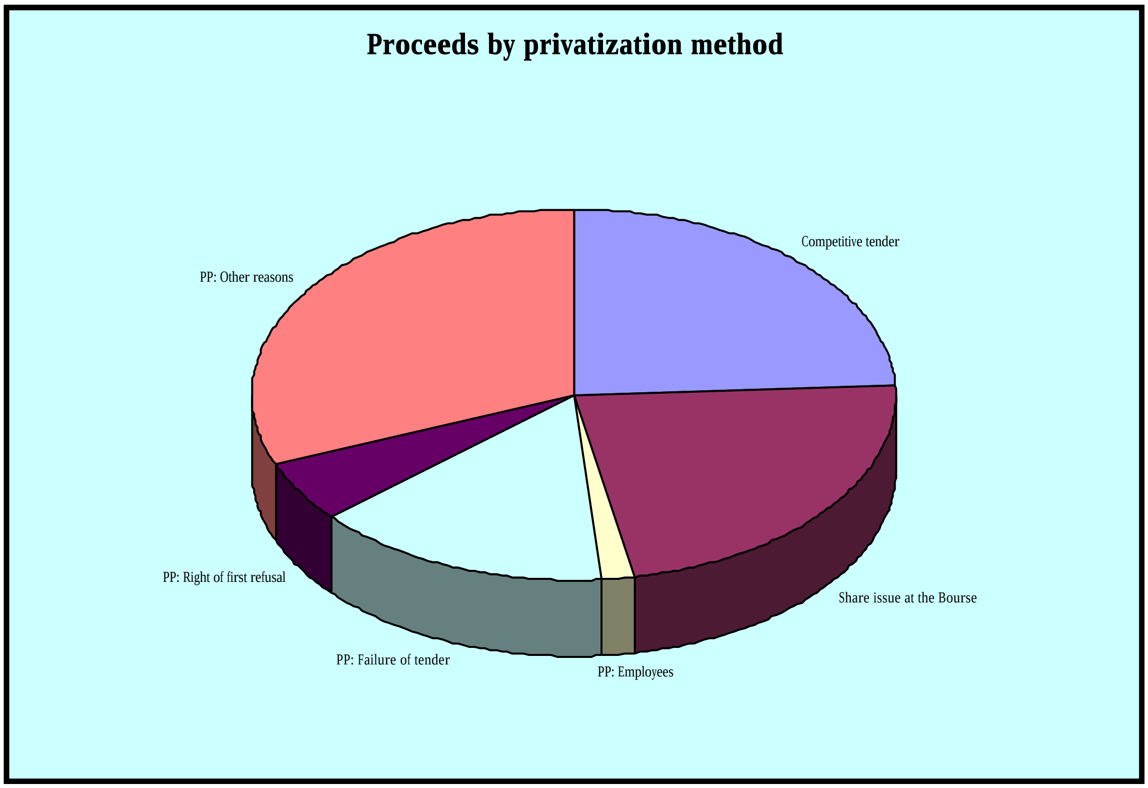

Exhibit 4-3: Total proceeds by method of privatization

The program sought to attract foreign investors — which was one of the drivers for improving the coverage and reliability of financial information for the privatization candidates and later for the economy as a whole. Foreign investors were invited to bid as strategic investors (part of the *noyau dur*). As a result, fifteen of the thirty-four companies and three of the seventeen hotels were sold totally or partially to foreign investors. Together, foreign strategic and portfolio investors account for some 45.4 percent of total proceeds; if the share issues on the CSE are excluded, the foreign share drops slightly to 44.3 percent. The foreign strategic investors include Holderbank, the Swiss cement group, Courtaulds, a

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[42] In some cases, the state retains some indirect stake.

[43] *Appel à la concurrence*.

British textile producer, Lesaffre, a French yeast producer, FRAM, the French tour operator, and several international petroleum companies: Shell (UK), Mobil (US), Total (France), Corral Petroleum (Saudi Arabia/Sweden), Martial Ucin (Spain), and Dragofina (Italy). Major foreign portfolio investors include Samba Finance, Morgan Stanley, Morgan Grenfell, Quantum Emerging Growth Fund, Morocco Fund, Banque Pictet and Framlington Maghreb Fund. Exhibit 4-4 illustrates the geographic distribution of investors participating in Morocco's privatization program.

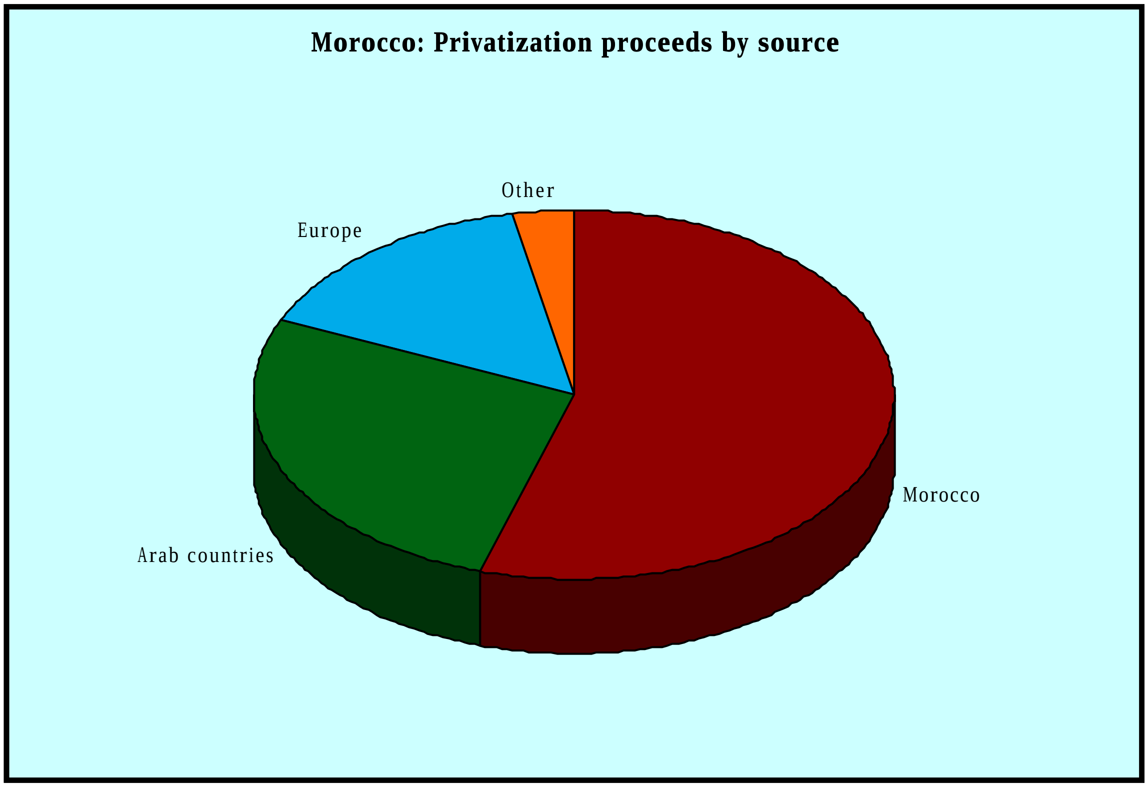

Exhibit 4-4: Privatization proceeds by country of investor

5 Macroeconomic and fiscal impacts

5.1 Issues

Assessing the macroeconomic impacts of privatization poses a number of theoretical and empirical problems. Several studies have sought to capture this dimension,[44] but both theory and evidence remain limited. A major problem is that of attribution: as privatization proceeds in combination with other economic policy reform efforts, observed changes at the macroeconomic level cannot be attributed to any single policy element.

Privatization affects macroeconomic performance through the changes it triggers at the microeconomic (firm) level. It is expected to improve economic efficiency in two ways. First, its immediate result is expected to be enhanced *allocative efficiency*, resulting from the redistribution of asset ownership

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[44] These studies include World Bank (1995), Lüders and Hachette (1993), and Serven et al. (1994).

between the public and private sectors. The literature offers persuasive arguments that government ownership and control of productive resources weakens incentives for efficiency at the microeconomic level. This agency view incorporates both a political (distortions in objectives and constraints) and a managerial (lack of adequate monitoring of managerial performance) perspective.[45]

In addition, though, privatization can also be instrumental in improving what North (1992) calls "*adaptive efficiency*:"

> "… I argue that it is the way institutions evolve that shapes long-run economic performance. By institutions I mean formal rules — political and economic — and informal constraints — such as conventions and norms of behavior as well as the characteristics of enforcement of both,"
>
> … Adaptive efficiency is concerned with the willingness of a society to acquire knowledge and learning, to induce innovation, to undertake risk and creative activity of all sorts, as well as to resolve problems and bottlenecks of the society through time. … Adaptive efficiency encourages the development of decentralized decision making processes that will allow societies to explore many alternative ways to solve problems. …" (ibid., p. 5)

Privatization can have a powerful effect on the development of institutions that enhance adaptive efficiency in the economy. The analysis here addresses these aspects in greater detail in the context of impacts on the legal and regulatory framework and institutions below. However, tracing changes in macroeconomic indicators to changes in the institutional framework is an extremely difficult undertaking.

Given these difficulties, much of the discussion of the macroeconomic impacts of privatization programs has focused on fiscal aspects, the implications for government revenues and expenditures. However, even in this more narrowly defined realm, the task of delineating and measuring impacts is certainly not a trivial one. Other aspects that have been treated in the literature concern impacts on employment or on the development of the financial sector, which we address in subsequent sections.

5.2 Importance of the state-owned enterprise sector

One basic expected impact of any privatization program is a reduction in the size and relative importance of the state-owned enterprise sector. The evidence for Morocco suggests that the privatization program — accomplishments notwithstanding — has not made a major dent in the importance of the state-owned enterprise sector in the economy. Although we do not have up-to-date figures, available statistics indicate that the share of the state-owned enterprise sector in total GDP, salaries and investment has actually *increased* between 1990 and 1995. This phenomenon reflects in part the continuing importance of the "strategic" enterprises (OCP, and infrastructure services) that remain in government hands, and the modernization efforts of these enterprises that are reflected in investment patterns. Exhibit 5-1 illustrates a comparison of key indicators for 1990 and 1995.

[45] See Sheshinski and López-Calva (1999), pp. 11-16 f or a summary of these perspectives.

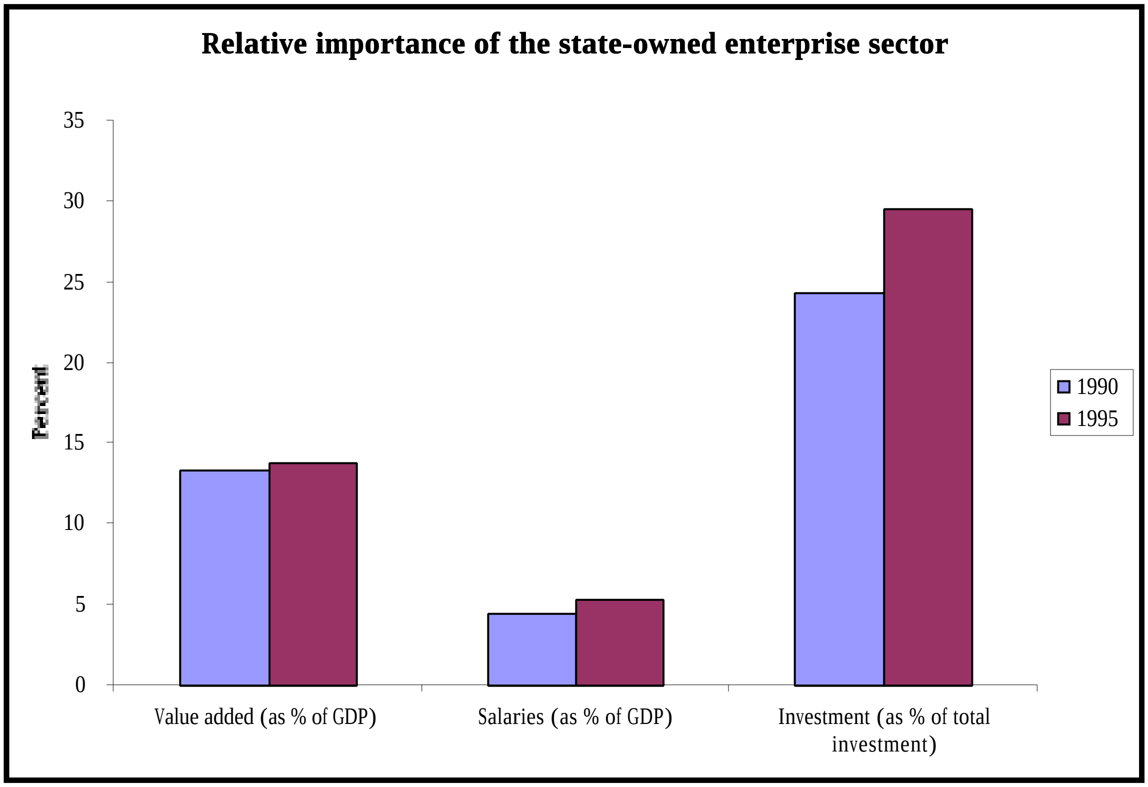

Exhibit 5-1: Share of the state-owned enterprise sector, 1990 and 1995

Moreover, while the privatization program has resulted in a reduction in the stakes held by such quasi-governmental entities as the *Caisse de Dépôt et de Gestion* (CDG), these institutions continue to play a significant role in key sectors. Just recently, for example, the CDG raised its stake in the privatized cement company CIOR to 6.3 percent. Similarly, the CDG continues as a participant in the hotel sector, although its long-term strategy is to withdraw from that sector.[46]

5.3 Fiscal impacts

The standard argument asserts that the fiscal impact of a privatization transaction is neutral:

> … privatization is a simple liquidity transformation of the government's net worth. In the simplest baseline case of an arm's-length sale of state equity to the private sector in an economy characterized by fully efficient capital and money markets, full and costless information and neutral tax structures, the price at which the asset is sold will be the sum of the discounted future profits generated by the assets. (Adam, Cavendish & Mistry, 1992, p. 9)

This argument implies that the value of the enterprise — measured by the discounted future cash flow (rather than profit) stream — is the same under government and private management. That notion is of course somewhat at odds with the basic premise of privatization that private sector management adds value, that is, raises future cash flows. Hence, an investor with better management and marketing technology and different incentives presumably would generate more value with the same assets than the

[46] The CDG sold its majority stake in the Hilton (formerly Hyatt Regency) hotel in Rabat, thereby adding another privatization.

government.[47] If investors bid for the assets according to their valuation, the fiscal impact would be positive.[48]

However, two other factors influence the relationship between value and price offered by investors. First, investors may not bid a price corresponding to the value they place on the enterprise because of strategic considerations. If there are no other bidders, or if the investor believes to have a unique capability to add value, the bid price will be below the estimated value. In private placements, therefore, investors will offer a price that is less than the value they place on the enterprise. This is essentially the basis for the argument in favor of "auction competition" cited by López-de-Silanes (1997). Even in open tenders, however, bids are likely to reflect strategic "shading."[49]

The most common response to such bid strategies is the establishment of a reference (floor) price. To establish such a reference price, the government and its advisers attempt to value the enterprise to reflect likely performance gains under private management. Since they do not have access to the information that only potential bidders possess — expertise and access to markets, technology and financing — any such valuation is subject to considerable uncertainty. Ironically, overshooting in estimating the value to a private-sector buyer is often more likely: managers of public sector enterprises tend to blame bureaucratic restraints for less than stellar performance, and have sometimes exaggerated expectations of future growth once freed from these restraints.

Valuation and the resulting determination of reference prices rarely consider the effects of uncertainty and delays. Uncertainty is sometimes introduced in the form of scenarios describing the future business development. The policy maker can then examine these scenarios to establish expectations of the most likely range of values of the enterprise to private buyers. Alternatively, the financial model used in the valuation may incorporate these expectations explicitly to simulate the expected performance of the enterprise across a range of conditions, generating a distribution that shows the likelihood that the value of the enterprise falls above or below certain values.

Valuations and any related action on setting reference prices also need to take into account the likely impact of delays in the privatization. Executed properly, such appraisals can help policy makers in understanding the costs of delays, as performance of the enterprise may deteriorate, or gains from gathering additional information.[50]

The second aspect concerns the pricing strategy of the government, especially for share issue privatizations. The government may quite deliberately accept a sales price below the value of the

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[47] As noted, differences in value reflect both asymmetrical information and different incentive or governance structures. Normally, a government does not look at the value of an enterprise in terms of discounted cash flows (DCF). A DCF valuation of the enterprise therefore is meaningful only in the context of privatization. The value for investors may also be influenced by strategic considerations. For example, an investor who owns electricity generation plants and distribution networks in country A would be likely to place a higher value on power sector assets in an adjacent country B than a competitor without such holdings.

[48] This argument does not involve any reference to taxes. In the simple case, the fiscal impact is tax-neutral. If the enterprise is generating a profit (revenues to the Treasury) under government management, a portion of that revenue corresponds to taxes. If the enterprise is losing money, the (negative) value should include taxes foregone. For the private investor, the value of the enterprise is net of taxes, that is, the discounted value of future cash flows after taxes.

[49] Recent work on the application of auction theory, such as Milgrom (1998), suggests that bidding rules can be structured to enhance open competition and maximize allocative efficiency and generate higher revenues for the seller. For a more skeptical view on the usefulness of auction theory in privatization practice, see Feldman and Mehra (1993).

[50] See Dixit and Pindyck (1994) for a systematic treatment of the appraisal of investment opportunities under uncertainty.

enterprise to accomplish other objectives. For example, underpricing is a common practice in share issue privatizations that target small investors.[51] Rapid appreciation is seen as stimulating interest, expanding participation and building political support. Similarly, governments often accept a lower sales price in exchange for investor commitments regarding employment and future investments. Aggressive underpricing, however, may also open the door to charges that the government is squandering national assets. In the case of Morocco, the evaluation of bids was not only based on price, but also took into consideration the technical and managerial qualifications of bidders and the proposed investments. Such commitments may have fiscal consequences in terms of social safety net expenditures[52] and future tax revenues.

The net fiscal impacts of privatization therefore are the result of a complex interplay of economic, financial and strategic factors. One simple indicator is the relationship between the value of the enterprise under government management and the sales price.

In the case of Morocco, we did not have access to the valuation documents and the information on minimum prices established by the Valuation Authority.[53] We can therefore only venture some conjectures about any net fiscal gains or losses based on the actual experience with different privatization modalities.[54]

Of the 28 public tenders used in Morocco's privatization program for companies other than hotels (not counting the recent BNDE tender), eight were followed by private placement. It appears reasonable to surmise that the successful tenders yielded prices at or above the minimum, while bids for the ones followed by private placement did not reach the minimum prices established. If the minimum prices adequately represented the value of these companies to the Government, and successful tenders involved bids at or above the minimum prices, the fiscal impact of the tender privatizations would have been on balance slightly positive or neutral. For hotels, the program used 11 tenders, nine of which were followed by private placements, and may therefore be assumed to have failed. If the reason for the failed tenders was the failure to obtain the minimum price, either the valuation or the pricing strategy for this sector was less successful than for the other enterprises.

It is likely that private placement (often chosen because a public tender was not possible) generally yielded bids below the original "minimum prices." However, the incidence or extent of any such fiscal impacts is impossible to determine.

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[51] Jones et al. (1996) cite the attribution of "the widely observed underpricing of IPOs of private sector enterprises … to an adverse selection problem that results from asymmetrically informed investors. Specifically, the less informed investors understand that the number of shares allocated to them will approach the requested number only when the well informed investors decline participation in the offer because they believe it to be overpriced. Thus, the less informed systematically bid below the expected initial market price to compensate for exposing themselves to this 'winner's curse.'" (p. 2)

[52] For example, studies have suggested that subsidies to buyers to maintain employment in the German privatization program cost less than unemployment compensation.

[53] In its comments on the draft, the Ministry of the Public Sector and Privatization noted that the valuation documents (prepared by renowned Moroccan and international consulting firms) are subject to strict confidentiality and cannot be shared with third parties.

[54] The tender documents furnished to potential investors included the minimum price stipulations and conditions of sale (the *cahiers des charges*). We understand that these documents are in the archives of the Ministry of the Public Sector and Privatization, but we were not given access to them (with one exception, the *contrat de cession* for ICOZ, a troubled company that has suspended production which we obtained from union representatives).

For the flotation of shares on the CSE, all indications are that many of the issues were deliberately underpriced to ensure a positive response and encourage broad participation. The success of this policy is reflected in oversubscriptions ranging from 1.6 times to 9.4 times (see Exhibit 5-2), and the rapid appreciation of shares on the Bourse (see below). On average, the share prices of privatized companies rose by 30 percent within 6 months after their issue on the CSE (at an annual rate of 60 percent). If we somewhat arbitrarily attribute half of that average short-term gain to deliberate underpricing, the total fiscal impact would be a loss of the order of 536 million dirhams, equivalent to 3.7 percent of the total proceeds of 14.5 billion dirhams for the companies other than hotels.[55] It is perhaps appropriate to regard this "loss" as the price of pursuing the social objectives of privatization.

Exhibit 5-2: Share issue privatizations

Enterprise	Date of share issue	No. of investors	Factor of oversubscription
CTM-LN	June 1993	11,238	4.57
CIOR	December 1993	16,241	7.69
SOFAC/Crédit*	April 1994	15,158	3.93
SNI*	October 1994	45,758	6.20
BMCE*	January 1995	51,485	6.09
General Tire*	February 1995	15,365	9.41
Crédit-EQDOM*	June 1995	22,013	3.46
SAMIR	March 1996	59,560	2.13
SONASID	July 1996	11,449	1.64
FERTIMA	October 1996	11,960	4.46
SMI	June 1997	14,153	5.87

* Already trading on the CSE.

Proceeds from privatization were not earmarked for a particular purpose, but apparently counted simply as part of the total fiscal revenues. Similarly, revenues from the privatization bonds were treated essentially the same as revenues from other bond issues or T-bill (*bons du Trésor*) auctions.

[55] This figure, based on an estimate of total proceeds from privatization share issues on the CSE of 3.6 billion dirhams is clearly a crude approximation. It is net of any tax receipts, since they are discounted in the valuations by both the Government and the investor(s). There is also an estimated 41 million dirhams "lost to the Treasury" that went as 15-percent discounts on the share prices to the employees of the enterprises.

6 Enterprise performance

6.1 Enterprise performance

The concept of value in terms of discounted future cash flows is key to assessing the impacts of privatization on the financial performance of the companies. In summary, the net impact is simply the difference between the value of the enterprise under government management (pre-privatization) and under private sector ownership and management (post-privatization). In reality, the line between pre- and post-privatization tends to be blurred. Privatized companies may have been listed on the stock exchange prior to privatization, for example, and therefore have been subject to pressures to maximize shareholder value. In other instances, privatization may have been partial, with the company in effect remaining under public sector control.[56] Even so, a careful interpretation of the pre- and post-privatization results can provide some guidance on the performance impacts of privatization.

Any assessment of the effects of privatization on the financial performance of the companies involved would also use standard financial ratios. What ratios can in fact be determined depends on the available financial (pre- and post-privatization) information. In the case of the Moroccan program, we examined five key ratios for a selected group of enterprises for which financial data were available:

- **leverage**: the *debt-equity ratio* (total long-term debt divided by total equity) compares capital provided by creditors with that supplied by owners; a higher ratio indicates greater risk exposure for creditors;
- **efficiency**: the *working ratio* (operating costs less depreciation divided by operating revenues) is one rough measure of overall productivity of the operation; “sound” financial management generally requires that this ratio be approximately 50 percent;
- **liquidity**: the *current ratio* (current assets divided by current liabilities) is the most commonly used measure of short-term solvency, and indicates to what extent short-term creditors are covered by assets that can be converted to cash in a period corresponding to the maturity of claims;
- **profitability**: the *return on sales* (net income after taxes divided by operating revenue) indicates the size of the operating margin which the firm achieves on its sales; the lower the margin, the greater the volume of sales that must be achieved to make an adequate return on investment; and

  the *return on assets*, or return on investment (earnings before interest and taxes divided by total assets) is the single most significant measure of corporate profitability and efficiency.

6.2 Financial performance

A growing number of studies of the microeconomic impacts of privatization on the financial performance (and other performance characteristics) of the enterprises involved is making a convincing case that the predicted effects in fact materialize. Based on company-specific data for four countries (UK, Chile, Malaysia, Mexico), Galal et al. (1994) find that total welfare improved, for the

[56] In Morocco, for example, the state-owned phosphate giant OCP still owns 70 percent of the “privatized” fertilizer company Fertima.

most part significantly, for 11 out 12 enterprises. A number of studies, including Megginson et al. (1994), Jones et al. (1996), Frydman et al. (1997) and Claessens and Djankov (1998), have used cross-sectional data for share-issue privatizations to assess the impacts of privatization on financial performance. Other studies, including López-de-Silanes (1997) and LaPorta and López-de-Silanes (1998) for Mexico, have used single-country data sets for the same purpose. Together, these studies have produced "robust evidence"[57] of significant gains in terms of financial performance indicators. The studies found that profitability increased significantly. In the case of Mexico, LaPorta and López-de-Silanes (1998) find that profitability increased by 24 percent, with productivity increases accounting for 57 percent of the total gain, reductions in employment for 33 percent, and price increases for 10 percent. Overall, the evidence seems to indicate that efficiency gains are greater and faster in competitive industries.

The use of data for share-issue privatizations may color the findings. Generally, companies selected for share issues tend to be the better performers to start out with. That certainly was the case in Morocco. Yet data on the other enterprises (both pre and post) are effectively impossible to obtain. There is no general system for the privatized companies to report on their financial performance. As a result, post-privatization financial information is available only on the privatized companies that are listed and traded on the Casablanca Stock Exchange. For the more detailed analysis of financial performance, we therefore used a case study approach, focusing on six companies — a bank (BMCE, December 1994[58]), a cement factory (CIOR, August 1993), a transport company (CTM-LN, July 1993), a mine (SMI, September 1996), and two consumer finance companies (Eqdom, June 1995, and Sofac/Crédit, April 1994). For these companies, reliable information on their financial status and performance prior to privatization is available from their prospectuses (*notice d'information*). Since they are listed on the CSE, they also report regularly according to the standards established. For these companies we therefore have acceptable financial data ranging over several years (1991 to 1997 in the best cases).

Obviously, three years prior to privatization and at best a few years after do not allow for any trend analysis, or assessment of shifts in trend. Even so, the available data (albeit with a number of gaps due to the eclectic nature of the data) provide some insights. Exhibit 6-1 summarizes the available financial indicators for the companies.

It is difficult to spot any systematic changes in these numbers. With respect to the debt-equity ratio, three of the five companies for which we have this information for 1997 remain highly leveraged. The working ratio appears to have worsened somewhat for CTM and Sofac, but has improved for BMCE. Overall, the companies' solvency, measured by the current ratio, has improved somewhat or has remained the same (BMCE). On average, the return on sales indicator appears to have declined somewhat, while the return on assets shows a slight improvement. varied, but neither shows any systematic changes.

The study team also used the available evidence to project cash flows for the six companies under a pre- and a post-privatization scenario. We in effect simulated a valuation exercise using a discounted cash flow model. While the results are very sensitive to the assumptions (which in turn depended to some extent on the post-privatization history[59]), we found that the value of the post-privatization companies

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[57] Sheshinski and López-Calva (1999), p. 27

[58] Date of first privatization action.

[59] For example, for SMI, which was privatized in 1997, the post-privatization assumptions were more guesswork than for the others; we drew on an investment analysis provide by the Casablanca Finance Group.

typically exceeded that for the pre-privatization companies. However, given the sensitivity of the results to even minor variations in assumptions, and the necessarily arbitrary nature of these assumptions, the results should be treated as illustrative rather than definitive. The pre-privatization results also confirmed the extent of underpricing of share issues,[60] although the difference between the values we obtained in the simulations and the valuation on the basis of the share price narrowed considerably after a few months of share price appreciation.

[60] With these valuations in hand, subscriptions for many of the IPOs would have looked very attractive indeed. The subsequent share price appreciation confirmed that assessment.

Exhibit 6-1: Financial indicators for selected companies

	1990	1991	1992	1993	1994	1995	1996	1997
Debt-equity ratio								
BMCE		0.58	0.44	0.50				
CIOR				1.20	0.91	1.41	0.55	1.26
CTM	0.53	0.40	0.22			0.81	0.55	0.52
Eqdom		1.92	2.52	0.68	1.01	1.27	1.15	1.84
SMI				0.14	0.04	0.02	0.01	0.00
Sofac						0.99	1.28	2.44
Working ratio								
BMCE		0.86	0.83	0.84	0.76	0.74	0.69	
CIOR				0.76	0.76	0.76	0.76	0.75
CTM	0.65	0.70	0.69			0.89	0.90	0.86
Eqdom		0.58	0.66	0.69	0.62	0.41	0.53	0.52
SMI				0.66	0.56	0.63	0.66	0.67
Sofac		0.65	0.59	0.66		0.76	0.77	0.79
Current ratio								
BMCE		0.87	0.87	0.87	0.89	0.91	0.92	0.92
CIOR				0.59	0.51	0.60		
CTM	6.76	9.89	1.84					
Eqdom		1.71	2.06	1.46	1.86			
SMI				2.24	2.05	2.30	2.57	
Sofac		1.23	1.27	1.29				
Return on sales								
BMCE		0.12	0.13	0.12	0.13	0.15	0.15	
CIOR				0.19	0.17	0.13	0.09	0.12
CTM	0.19	0.14	0.12			0.11	0.08	0.09
Eqdom		0.41	0.32	0.30	0.37	0.34	0.29	0.27
SMI				0.12	0.21	0.16	0.10	0.18
Sofac		0.34	0.40	0.33		0.16	0.15	0.14
Return on assets								
BMCE			0.01	0.01	0.01	0.01	0.01	0.01
CIOR					0.14	0.09	0.10	0.16
CTM		0.16	0.14			0.08	0.07	0.10
Eqdom			0.05	0.06	0.09	0.17	0.10	0.09
SMI				0.14	0.29	0.20	0.11	0.19
Sofac			0.08	0.06		0.05	0.04	0.03

Source: *Notices d'information*; reports filed (data provided by FINACCESS).

We understand that the investment commitments of the bidders in open tenders and in private placements influenced the selection of the winning bidder or the sale-purchase contract provisions. However, we were unable to determine how any tradeoffs between price offered and investment had been handled, or how investment commitments influenced the value of the companies. Since the Ministry of the Public Sector and Privatization did not and still does not have the resources to verify compliance with investment commitments, there is a question about the utility of this element as a criterion for the evaluation of any bids.

Exhibit 6-2: Illustrative valuation results for selected companies

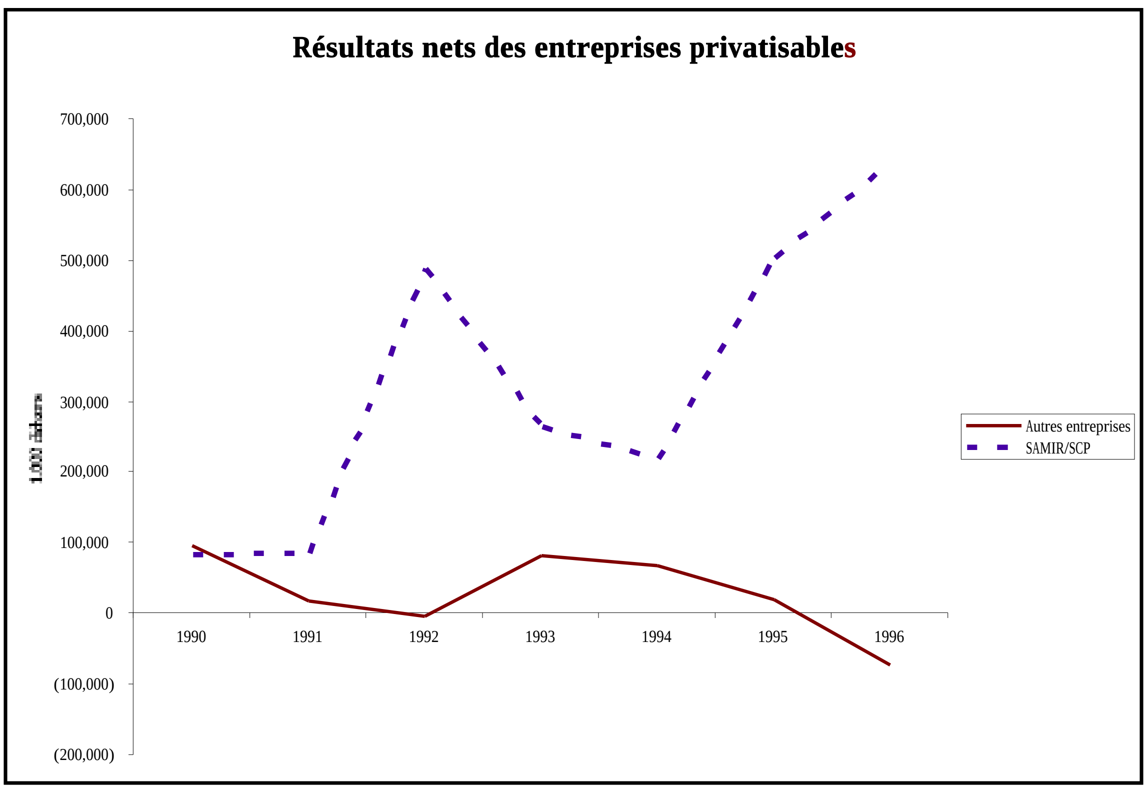
	Pre-privatization		Post-privatization	
	MAD 1,000	$1,000	MAD 1,000	Difference
BMCE	4,885,490	542,831	5,090,681	4.2%
CIOR	1,923,976	213,775	2,244,030	16.6%
CTM	477,330	53,037	492,079	3.1%
Eqdom	1,285,039	141,993	1,380,132	7.4%
SMI	1,046,471	116,924	1,198,034	14.5%
Sofac	326,052	36,228	328,008	0.6%

Note: Values shown are based on a 15-percent discount rate; the estimated Weighted Average Cost of Capital fell into the 11 to 12-percent range.

Source: Simulations carried out by the study team.

For the enterprises designated as "privatizables" in 1989 but not privatized, the impacts on performance may well have been negative. Data for a sample companies on the list that were not privatized provided by the DEPP, illustrated in Exhibit 6-3, show a positive trend for the two oil refineries, but an overall decline for the other sectors (mostly sugar refineries).

Exhibit 6-3: Net operating profit for selected privatizable enterprises



Source: Tabulations by the DEPP

From the date of their privatization to December 31, 1998, 15 enterprises have increased their capital base by between 6 and 837 percent, for an average increase of 34.4 percent or a total value increase of 1.7 billion dirhams. In the finance and services sector, the capital base expanded by between 6.1 (CNIA) and 183.1 percent .[61]

In addition to these overall findings, we obtained more detailed information on plans of and prospects for the case study companies, both through interviews with their management and from secondary sources. On the whole, this information tends to support a more optimistic view of the future of these enterprises.

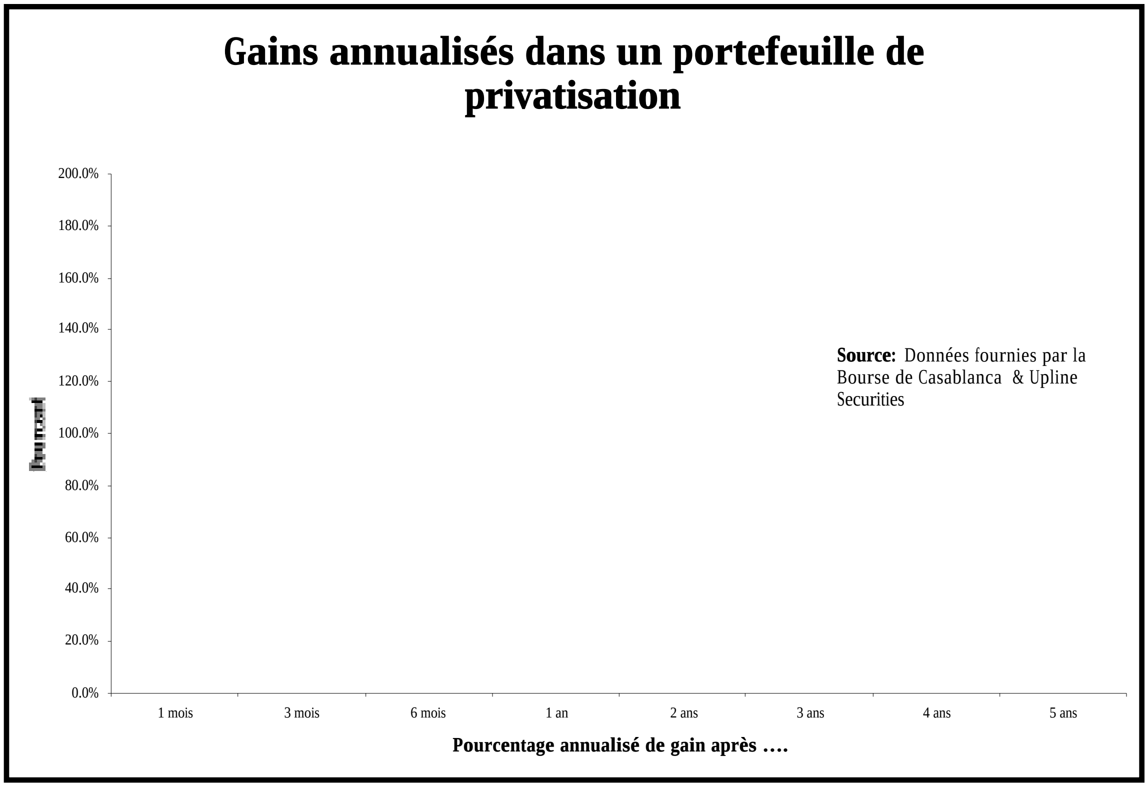
6.3 Return to investors

Since there has been no systematic reporting on the post-privatization performance of companies transferred to private ownership and management, it is impossible to substantiate general conclusions on the return to strategic investors. Only for the publicly traded companies can we get some sense of how investors fared.

The general conclusion is that they fared very well indeed. On (unweighted) average, the share prices of privatized companies appreciated rapidly after introduction at the CSE. Within one month, the average share price appreciated by roughly 15 percent (or almost 180 percent on an annual basis). After 3 months, the shares had appreciated by close to another 10 percent (or 94 percent on an annualized basis). After 6 months, the average gain was another 5 percent, for a total of over 30 percent (or 64 percent on an annualized basis). After a year, the average share in a privatized company had gained 65 percent, which is a respectable return by any standard. Holding on the shares for more than a year resulted in a more modest annual return of between 28 and 37 percent — still considerably better than any alternative investment.

[61] Source: Survey conducted by the Ministry of the Public Sector and Privatization, March 1999.

Exhibit 6-4: Privatization portfolio performance



To some extent, these results reflect the deliberate underpricing of several key share issues to attract a broader range of investors. For example, the last privatization involving an IPO at the CSE was that of SMI, a silver mining company. The shares of appreciated by 71 percent between their first issue in June 1997 and the end of that year. The results also reflect the dynamics of the Moroccan stock market as a whole over the period 1993 to 1998. The average annual gain for the share index was 30.2 percent for 1993-94, and 38.2 percent for 1995-98 (boosted by a gain of 58.1 percent in 1997). Thus, in the short run — within a year —privatized companies outperformed the market almost 2:1. Beyond that initial time period, though, the performance of a privatization portfolio mirrors that of the market as a whole.

Some international portfolio investors now believe that the Moroccan market is overvalued, in part because there are few other outlets for Moroccan investors, and in part because the slowdown of the privatization program has also meant a slowdown in the growth of the number of listed companies.[62]

A different take on the performance of a portfolio of privatized companies suggests that these companies have remained attractive to investors. If an investor had bought one share of each of the privatized companies on June 18, 1997, the date of the last IPO for a privatized company on the CSE, the portfolio would have performed as follows:

[62] Moroccan market participants, including the Bourse, are of course fully aware of the problem: "*manque des titres*" is a commonly heard complaint.

Exhibit 6-5: Performance of privatization portfolio since June 1997

Time period (from June 18, 1997)	Annualized portfolio gain
After one month	17.2 percent
After three months	36.0 percent
After six months	12.4 percent
After one year	34.3 percent

The CSE share index gained 25.0 percent between October 1997 and October 1998.

The privatization program succeeded in broadening share ownership. The available evidence indicates reasonable participation by investors from he different regions of the country, although share ownership remains concentrated in the Rabat/Casablanca region. A contributing factor to attracting new investors were the discounts offered to employees of the privatized companies, at a total estimated cost of 41 million dirhams.

Exhibit 6-6: Regional participation in share issues

	CTM-LN Tranche 1		CIOR		SOFAC/Crédit		CTM-LN Tranche 2	
Region	# of requests	Shares	# of requests	Shares	# of requests	Shares	# of requests	Shares
South	4.3%	6.4%	3.0%	1.6%	0.9%	0.9%	4.6%	5.6%
Tensift	2.1%	2.2%	1.6%	0.5%	0.3%	0.4%	3.6%	5.0%
Center	64.3%	71.3%	55.3%	77.1%	82.6%	82.6%	72.3%	65.3%
Northwest	8.3%	7.4%	12.2%	8.1%	6.2%	7.8%	6.0%	9.0%
Center-North	8.1%	4.7%	9.1%	5.6%	4.9%	4.7%	4.6%	5.8%
Eastern	6.4%	3.9%	11.5%	5.6%	0.6%	1.4%	6.2%	7.5%
Center-South	6.6%	3.6%	7.2%	1.4%	4.5%	2.1%	2.6%	1.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Saulniers (1995), p. 144

The commercial banks apparently also played a role in encouraging broader — albeit short-lived — participation in the stock market by offering loans to small investors to purchase shares, hold them for short-term appreciation, sell them, pay off the loan and pocket the difference. While we have no quantitative information on the extent of these arrangements, they were apparently sufficiently common to attract the attention of the Central Bank, because banks were in effect engaging in money creation.

7 Employment-related impacts

7.1 Employment impacts

The literature on outcomes associated with the privatization of state-owned enterprises has given relatively little systematic attention to the welfare consequences for workers, even though these concerns figure prominently in the political economy of privatization. Real and perceived threats to jobs and employment-related benefits for SOE employees typically engender spirited opposition to privatization plans. Impacts on this stakeholder group therefore should be of special concern in any evaluation, as well as in the design and implementation of privatization programs.

Part of the problem stems from the fact that privatization has different consequences for different groups of workers. Furthermore, the consequences will vary enormously depending on the economic and institutional context within which privatization takes place. Finally, the technical challenges and costs associated with any attempt to measure the consequences empirically are formidable and help account for the relative dearth of such studies.

Given this importance of these issues, the discussion here explores employment-related aspects of the impact analysis in greater detail. A first step is the articulation of a suitable analytical framework as a systematic treatment of the variables that are likely to affect outcomes. This framework needs to reflect the relative importance of different labor issues that matter in the political economy of privatization.

7.1.1 Jobs and job-related benefits

Much of the political resistance that has stymied or slowed, and sometimes reversed, privatization in many countries has been rooted in fears and concerns about social impacts — primarily expected losses of jobs and employment-related benefits. The notion that the state-owned enterprise sector is characterized by excess labor is virtually axiomatic in the policy debate. Redundancy is of course a relative concept; it means that the enterprise employs more workers than it needs, *given* its level of activity and efficient production practices in the industry. Technically, redundancy implies that the marginal contribution of such workers to the revenues of the firm (the marginal revenue product) is less than their wage. Several factors combine to make the existence of redundant labor a likely feature of government ownership of productive enterprises:

- The absence of profit maximization as an objective of a public enterprise weakens the incentive to operate efficiently and permits the continued employment of surplus labor. In many developing countries, the creation of public enterprises was imbued with a "social function" in addition to the economic one of production. In such cases, SOEs were expected to serve a labor absorptive function to mitigate poverty or unemployment, often in lagging regions.
- State-owned enterprises also tend to assume the responsibility for providing workers with housing, a variety of social services, as well as access to subsidized goods and services. Because such employment conditions frequently imply the payment of large economic rents to employees, jobs in state enterprises are greatly coveted and pressures to expand employment are exerted without regard to need. In the command economies of Eastern Europe, these types of arrangements found their fullest expression. In such a context,

releasing workers to an uncertain fate in the labor market is troublesome to both managers and public officials.

- The nature of the incentives governing managers' performance may give rise to redundancy. In socialist countries of Eastern Europe, for example, managers had every incentive to hoard labor since their success was measured by their ability to meet output goals with little consideration for the cost of achieving them.
- The legal framework governing employment relationships may impede the discharge of redundant workers as economic conditions change. In Malaysia, employees are vested with property rights in their positions for the life of the enterprise.[63] Permanent contracts which imply an employment guarantee were typically found in Socialist countries as well as in many developing countries. Until recently several African countries were obliged by law to provide (public-sector) employment for particular classes of workers, such as high school graduates or army veterans.[64] In many Latin American countries, while the labor codes provide for discharge of workers "for cause," redundancy is not always accepted by the authorities and labor courts as qualifying as a legitimate cause. Furthermore, the legal and time costs to the enterprise of defending the layoff of unneeded workers loom so great as to be prohibitive. Government edicts have been known to contribute to redundancy. In Kenya, a presidential decree in 1978 required all privately-owned firms to increase their employment by ten percent.
- Public enterprise employment has also served the political purpose of those in power, using the distribution of jobs as a means of solidifying political support for the regime.
- Finally, redundancy may also result from technological changes that substitute capital for labor or from an enterprise's inability to respond to a shrinking market for its product.

The continued existence of excess labor in state-owned enterprises is possible only because of high levels of protection that negate any competitive pressures. It also depends on the willingness and ability of governments to bear the burden of enterprise deficits or on their tolerance of low rates of return on the investments made. The same applies to the issue of benefits granted to SOE employees in excess of what is feasible in a competitive environment. Privatization implies coming face-to-face with the problem of these rents accruing to the enterprise workforce. It normally entails increased competition and reduced protection, and therefore is likely to lead to a loss of privileges, including jobs.

Concentrating solely on negative impacts runs the risk of overlooking the possible positive outcomes of privatization for workers. Indeed, part of the justification advanced for privatization is that it will improve performance, including increased activity and therefore increased employment. However, in most cases these positive consequences will unfold only in the longer run while the time horizons of political leaders and workers are likely to be very short. Furthermore, the benefits of future growth may accrue not to the redundant workers released from the privatized firms but to others better prepared to

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[63] Steve Hanke and Stephen J. K. Walters, "Privatization and Public Choice Lessons for LDCs," in D. J. Gayle and J. N. Goodrich, eds, *Privatization and Deregulation in Global Perspective* (New York: Quorum Boks 1990), p.105

[64] Jan Svejnar and Katherine Terrell, *Reducing Labor Redundancy in State-Owned Enterprises*, WPS 792 (Washington, D.C.: The World Bank 1991), pp.12-13.

adjust to new technologies and to a changing culture of the workplace. Nevertheless, there are situations in which even the short-term consequences of privatization may be favorable.[65]

Of course, not all privatized firms will necessarily prove viable. For those that fail, the prospects of the workers released will be governed by the same labor market conditions affecting workers released prior to or immediately following privatization.

7.1.2 Indirect effects

In the mid to long term, any short-run losses may be the price for substantial gains for workers as a class. In a favorable macroeconomic environment, privatizations may provide a spark that propels the economy along a faster growth path. In Chile, with major macroeconomic reforms already completed, the second wave of privatizations was accompanied by behavioral changes in individual households as well as in the productive sectors. The household savings rate and the share of investment in GDP increased to new highs, and privatized firms were able to mobilize capital resources for investment not only in their own enterprises but in activities outside their traditional sector.[66] Not only did employment increase in privatized firms, but their activities had a favorable indirect impact on employment.

Finally, privatization also has a strong demonstration effect: swift implementation in a transparent fashion increases the confidence of potential foreign investors in the commitment of governments to reduced intervention in markets. It lends credibility to the reform policies, thus encouraging additional investment activity that adds to the creation of employment opportunities. Hachette and Lüder's account of the Chilean experience ends with the end of the second wave of privatizations in 1989. Since then, the economy has consistently registered among the highest rates of growth in the world, and the levels of savings and investment have far surpassed the record levels reported for 1989. In 1997, gross fixed investment and domestic savings achieved levels of 29 and 26 percent of GDP respectively.[67] However, Chile's successes cannot be attributed solely to the process of privatization; it is the whole constellation of economic (reform) policies that determines the development trajectory of an economy.

7.1.3 Intervening factors: The economic environment

For given characteristics of the enterprise, the actual net effects of privatization on employment depend on both the economic context and on specific procedures adopted in the implementation of the program. With respect to environmental conditions, several key variables are likely to influence outcomes. Some of these are particular to enterprises themselves, others refer to the economic and institutional environment in which privatization takes place.

- **The macroeconomic environment.** The discussion of concerns and approaches for the context appraisal above touches on macroeconomic conditions. These conditions will influence the impact of privatization on both those workers who retain their jobs following privatization and those who lose them is the macroeconomic environment. An economy characterized by consistent

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[65] In the early days of Sri Lanka's privatization program, USAID had set aside a fund to finance severance pay and other compensations for workers displaced by the transfer to the private sector. Initial privatizations, however, resulted in increased employment, leading USAID to reprogram the funds to facilitate the acquisition of shares by workers.

[66] Hachette and Luders, *op. cit.*, pp.06-111.

[67] Economic Commission for Latin America and the Caribbean, *Preliminary Overview of the Economy of Latin America and the Caribbean* (Santiago, Chile: 1997), pp 16-17.

and moderate to rapid growth offers more favorable prospects for all workers. Unfortunately, privatization has frequently become an objective of policy precisely because rates of growth have been unsatisfactory and the public sector has come to be viewed as a drag on growth so that in only a minority of countries is the macroeconomic environment likely to favor a painless transition.

How a country relates to the global economy and any changes that may be taking place in that relationship also matter in defining the macroeconomic environment. Many of the countries are liberalizing their trade regimes, creating greater openness to foreign trade in both directions. Liberalization reduces protection, and therefore increases competitive pressures.

The quality of fiscal and monetary management forms another important element that affects the macro environment since it will affect the ability of firms to estimate real rates of return and thus rates of investment. The stage in the development of capital markets and the soundness of the financial system are critical variables in predicting outcomes.

Changes in the macroeconomic context can have significant impacts on the employees of firms that remain in the public domain as well as affecting the prospects of those in privatized or privatizable firms. In an environment in which reforms are in progress in the macroeconomic sphere it becomes difficult to disentangle those changes in the welfare of workers that are due to privatization from those stemming from the broader reforms.[68] For example, the economic reforms undertaken in Chile had significantly transformed public enterprises, increasing their efficiency and profitability prior to privatization. A comparative analysis of the performance of private and public enterprises detected no significant differences in their performance when they operate under similar sets of rules and regulations.[69]

The importance of the macroeconomic environment should not be underestimated. Much of the high unemployment characterizing the countries of Eastern Europe in the early 1990s is attributable more to macroeconomic shocks to output than to any reallocation of resources across firms. A consequence has been that the high unemployment has served as an obstacle to further restructuring of the economy and privatization. Those rendered unemployed as a result of reforms have faced bleak prospects.[70] These prospects will, of course, be influenced by one other feature of the macroeconomic environment, the rate of unemployment. The prospects of easy reintegration into employment of retrenched workers (as well as for any other unemployed worker) will be inversely related to the volume of unemployment.

[68] Indeed, there are those who argue that the implementation of economic reforms that promote competitive markets and accountability of public enterprises can yield improvements in enterprise performance similar to those privatization is expected to yield. Cf., for example, Paul Cook and Colin Kirkpatrick, eds., *Privatization Policy and Performance* (New York: Prentice Hall 1995), pp. 20-21; In the same volume see K.S. Jomo, "Malaysia's Privatisation Experience," pp. 240-242.

[69] Dominique Hachette and Rolf L_ders, *Privatization in Chile: An Economic Appraisal* (San Francisco:: International Center for Economic Growth 1993), pp. 126-28. However, the authors warn that public choice theory suggests that such results may be unstable, that in the longer-run that political pressures will be brought to bear to change the rules to accommodate patronage objectives or to offer "low" prices. p. 132.

[70] Simon Commander and Fabrizio Coricelli, *Unemployment, Restructuring, and the Labor Market in Eastern Europe and Russia* (Washinton, D.C.:The World Ban, 1995), p. *xiii*.

- **The economic environment particular to the enterprise.** The more competitive the environment within which an SOE operates, the less disruptive the process of privatization is likely to be in terms of necessary retrenchments. Surviving in a competitive with significant levels of labor redundancy is tough. For example, the second round of privatization in Chile during the second half of the decade of the 1980s followed a decade of reforms that created a competitive environment by lowering tariffs, freeing prices, legislating anti-monopoly laws, and providing for free entry. Transition to private ownership thus required no retrenchment. Instead, employment expanded in the privatized firms. In ten firms privatized after 1984, employment in 1989 stood at a level 37 percent above that of 1984.[71] Ghana, Mexico, and Tunisia are among other countries that have been able to privatize competitive enterprises with little impact on employment.[72]

  Conversely, enterprises enjoying a sheltered monopoly status or which are geared to respond to output goals with little regard for cost, as in command economies, are most likely to be faced with painful adjustments on passing to private ownership. In Argentina, the privatization of large public enterprises in telecommunications, steel, railways, energy, and water and sanitation required massive retrenchments. The post-privatization labor forces of seven such enterprises were reduced to fifty percent of their pre-privatization levels.[73] Cook and Kirkpatrick cite other cases of employment losses ranging from 40 to 50 percent in Bangladesh and Pakistan following privatization.[74]

  Campbell White and Bhatia (1998) report indicators of excess employment in privatized enterprises in selected African countries as shown in Exhibit 7-1.

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[71] Dominique Hachette and Rolf L_ders, *op. cit.*, pp.63 and 119-120.

[72] Sunita Kikeri, *Privatization and Labor;What Happens to Workers When Governments Divest?* (Washington, D.C., The World Bank 1998), p. 5.

[73] *Ibid.*, p. 6. Similarly large reductions were reported for protected sectors in Bangladesh, Mexico, and Brazil.

[74] *Op. cit.*,p. 21.

Exhibit 7-1: Job losses in privatizations in Africa

Country and period	Number of privatized firms in sample	Employment at privatization	Employment, first quarter 1996	Net change in employment	Percentage change
Benin, 1988-95	8	1,872	1,197	-675	-36.1%
Burkina Faso, 1991-95	10	895	901	6	0.7%
Ghana, 1990-95	7	5,363	4,431	-932	-17.4%
Togo, 1984-95	19	2,882	2,338	-544	-18.9%
Zambia, 1993-96	10	6,150	5,733	-417	-6.8%
Total	54	17,162	14,600	-2,562	-14.9%

Source: Campbell White and Bhatia, (1998), p. 94

Conditions in product markets also matter. Workers in sectors facing growing or unsatisfied excess demand obviously enjoy better prospects than those in stable or declining markets. Public utilities in developing countries frequently face an unsatisfied demand for their services. For want of investment resources, they are unable to expand capacity to adequately serve their markets. A privatization that includes the commitment to invest to satisfy demand offers prospects of limited retrenchment in the short run and significant employment expansion in the medium to long run. Recent privatizations of telecommunications enterprises in Peru, El Salvador, and Guatemala would fit in this category. In fact, Megginson et al. (1994) and Jones et al. (1996) find modest, though significant, increases in employment.

Conversely, in environments characterized by stable or declining demand, workers who are displaced are likely to move to unemployment status or into the informal sector either as self-employed providers of services or as wage-employees. As a rule, informal sector employment carries with it a loss of earnings as well as a loss of other non-wage benefits, e.g., housing, participation in a social security program, access to health services, family allowances, etc.

Finally, the privatization of firms that have failed, are barely operative or in effect inoperative is likely to have a positive impact on labor. For example, privatization in Guyana was unambiguously associated with increases in employment reflecting inadequacies of working capital, unutilized capacity , and a chronic shortage of skills in the privatizable enterprises. Following privatization many entities have been able to raise wages as well as increase employment.[75] Similarly, in Honduras, the privatization of 16 SOEs had a positive impact on employment, an increase of 126 percent, because most had been inoperative at the time of divestiture or were operating well

[75] Carl B. Greenidge, "Privatization in Guyana," in V.V. Ramanadham, *Constraints and Impacts of Privatization* (New York: Routledge, 1993), p. 162.

below capacity. Indirect employment effects were estimated at 2.5 jobs for every one created in the privatized firms.[76]

- **Labor market flexibility**. The degree of flexibility in the labor market is likely to be an important determinant of the ease with which released labor can be absorbed in other activities. Wage rigidity and immobility of workers dim prospects for absorption. In Eastern Europe, years of pricing housing at below-market-clearing prices has led to severe limits on the availability of housing and serves as an obstacle to geographic mobility.[77] This poses particularly difficult obstacles to the reemployment of workers released from large enterprises located in one-company towns in isolated regions. Where SOEs have provided housing as part of the remuneration package, mobility is also inhibited.

  High and rigid legally-set minimum wages may also inhibit the absorption of workers released from privatizing enterprises. In Russia, Commander and Coricelli noted an inverse relationship between the level of employment and nominal wages across oblasts.[78] Minimum wages in excess of the reservation price of the unemployed may be expected to result in a smaller volume of employment in the modern or formal sector. For example, in Morocco, a household multiple purpose survey found that almost 56 percent of the unemployed would willingly accept a wage below the legal minimum while among those with incomplete or complete primary schooling 71 and 63 percent were so willing.[79] While high minimum wages may be appreciated by those workers lucky enough to hold jobs, their gains may come at the expense of the unemployed. Real wage flexibility in the Ghanaian labor market has been credited with having facilitated the sectoral reallocation of labor that was sought by the government's economic reform program and contributed to the achievement of the macroeconomic improvements observed during the 1980s[80].

  Legal restrictions on the freedom of employers to lay off or discharge workers is often viewed as serving to discourage hiring since any subsequent separation of unneeded workers becomes costly or even impossible. Modifying or eliminating such measures should contribute to easing the employment consequences of major restructuring or privatization as is reported to have been the case in Peru in the early 1990s.[81]

- **Social safety nets**. General safety nets in the form of unemployment insurance, severance payments, public employment programs, or income support programs can cushion the impact of

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[76] *Evaluation of Project 522-0289: Privatization of State-owned Entetrprises in Honduras* (Arlington, Va.: Carana Corp. September 1991), pp. 15-16. See also Neal S. Zank, "Perspectives on Privatization in LDCs:Encouraging Growth and Economic Efficiency," in *Privatization and Economic Efficiency,* Attiat Ott and Keith Harley, eds. (Brookfield, Vermont: Edward Elgar 1991), pp. 174 and 178.

[77] Simon Commander and Fabrizio Coricelli, *op. cit.*, pp. 98-99; ironically, the privatization of housing stock may have contributed to immobility, since apartments may constitute the principal asset of families, and real estate markets are undeveloped.

[78] *Ibid.,*, pp. 175-76.

[79] Ministere de la Prevision Economique et du Plan, Direction de la Statistique, *Activite, Emploi et Chomage en Milieu Urbain* 1991.

[80] P. Beaudry and N. K. Sowa, "Ghana" in Susan Horton, Ravi Kanbur, and Dipak Mazumdar, *Lbor Markets in an Era of Adjustment, Volume 2* (Washington, D.C.: The World Bank 1994), pp. 395-402.

[81] World Bank, *World Development Report 1995.*

retrenchment on workers. Older workers who are deemed redundant are frequently offered early retirement and generally withdraw from the labor force. Unemployment insurance is more typically associated with developed countries and, more recently, the transition economies of Central and Eastern Europe. Seemingly paradoxical is the observation that the availability of unemployment insurance tends to retard the active return to employment of recipients.[82] While this worker response is commonly reported to exist in the OECD countries, and to a limited extent in the Czech Republic, it does not seem to have discouraged job search among the unemployed of most transition economies. However, the duration of benefits is typically shorter than in the OECD countries, and exit from these programs to social assistance programs is not automatic; where it does occur, the benefits are far from replacing average wage income (only 20 percent in Bulgaria).[83]

In the typical case of mixed economies in developing countries, social safety nets tend to be spotty. In fact, the social mandate of SOEs can often be traced to efforts to establish some form of social support. In many instances, special arrangements and privileges associated with public-sector employment can be traced to colonial times.

Social safety net provisions may include general public employment programs. Chile introduced a Minimum Employment Program during the 1970s when unemployment rose sharply in the wake of the early restructuring and privatization of the economy following the fall of the Allende government. This program provided for employment of the unemployed in public works for a period of six months, but was ill-adapted to deal with long-term unemployment. In the early 1980s an additional Program of Employment for Heads of Families was adopted in response to a severe crisis.[84] But by the time of the second round of privatizations during the latter part of the1980s no significant retrenchments occurred since the prior macroeconomic reforms had already reshaped the SOEs into lean and efficient enterprises.

In 1991, the Czech Republic adopted a program to provide short-term employment in "publicly useful jobs" as part of an active labor market policy. Workers least likely to be employable were referred to this program. Like the Chilean program, it is intended to provide only short-term employment, for a maximum of six months, though some labor offices apparently do permit reemployment after a brief interval of unemployment.[85]

As discussed below, many of the mitigation measures that have been adopted in privatization programs resulting (or expected to result) in significant retrenchments seek to extend or complement existing general provisions. For example, severance allowances are a common feature of general labor market policies in both developed and developing economies. In many countries, there are general legal provisions governing the size of severance allowances; in instances of retrenchments associated with privatization, the payments may substantially exceed the legal requirement.

[82] Robert J. Flanagan, "Labor Market Responses to a Change in Economic System," *Proceedings of the World Bank Annual Conference on Development Economics 1994*,p.408; John Ham, Jan Svejnar, and Katherine Terrell, "Czech Republic and Slovakia." In Commander and Coricelli, *op. cit.,* pp.126-128.

[83] Commander and Coricelli, *op. cit.,* pp. 377-379.

[84] Hachette and Luders, *op. cit.,* pp. 22 and 25

[85] Commander and Coricelli, *op. cit.,* pp.134-136.

- **Other considerations**. If the workforce of the privatizing sector accounts for large percentage of the total labor force, re-employment of displaced labor is likely to be more difficult. For example, in Russia in 1993, only ten percent of employment was in private enterprises, and many of these were considered precarious as demonstrated by the high rates of firm and labor turnover.[86] Similarly, the faster the rate of privatization the more difficult will be the absorption of displaced labor and potentially the larger their welfare loss.

  Finally, it is important to distinguish between short- and long-run impacts. While the immediate impact of privatization is a welfare loss among displaced workers, to the extent that the privatized sector proves more dynamic than it was under state ownership, employment in the future may expand more rapidly than it would have. Of course the beneficiaries of that dynamism may not be the workers displaced in the process of privatization though workers as a class would gain.

7.1.4 Intervening factors: Mitigation measures

Privatization programs typically include provisions to protect jobs and mitigate other negative employment-related impacts. Mitigation methods can be summarized in terms of "the 5 Cs:"

- *continuation*: conditions of sale seek to maintain employment at some level, or may ensure the continued provision of special benefits after privatization;
- *compensation*: employees are compensated partly or in full for the loss of jobs or employment-related benefits; options include an ad-hoc social safety net— special severance packages, training, or subcontracting opportunities — to cushion the impact of any lay-offs, or the promotion of employee participation and share ownership;
- *communications*: since ignorance and rumors often feed fears and foster resistance, there is a need for effective communications with the workers as key stakeholders to ensure transparency, gain acceptance and build support;
- *conversion*: proceeds of privatization can be used for social ends, addressing needs of either the employees and their families or the broader community;
- *compulsion*: there may be instances where the government has no choice but impose certain changes and disregard opposition, for example, by curbing union powers or limiting strikes.

In assessing the employment-related impacts of privatization, any observed changes (or lack thereof) need to be linked to mitigation measures taken.

7.1.4.1 Continuation

Requiring private investors in privatized firms to maintain the inherited level of employment, usually for a year or more, is a common feature of privatization programs. However, this is likely to be an acceptable condition for a buyer only if the extent of worker redundancy is modest or if the government provides the firm with some sort of subsidy during that interval. Even so, job guarantees (and promises to create additional jobs through new investments) are typically included in sales contracts.

Of course, the effectiveness of such a guarantee depends on the ability of government to monitor and enforce the agreement. Without an adequate monitoring system, including adequate personnel and

[86] Commander and Coricelli, *op. cit.*, pp.62-63.

resources, enforcement becomes haphazard, typically subject to the initiative of third-party beneficiaries which is likely to vary from case to case. Unless credible monitoring and enforcement procedures are in place, conditions of sale — such as required job guarantees — are likely to entail costs by deterring qualified strategic investors and lowering proceeds, without yielding commensurate benefits.

Most developing countries lack the administrative capacity to police the performance of privatized firms effectively. To the extent that specific obligations are assigned to third-party beneficiaries, such as the employees, the monitoring task can be largely, though not completely, left to them. Even in these cases, however, credible backup by a qualified privatization monitoring unit is essential.[87]

7.1.4.2 Compensation

Privatization program managers can draw on a range of options to compensate workers for any negative impacts. For workers laid off in the course of privatization, either during preparatory restructuring or by the new owner, compensation schemes may include special severance packages over and above what is generally required by law. Alternatively, special incentives may be offered to encourage voluntary separation, although they may have the undesired effect of getting the strongest response from the best workers who have better opportunities on the outside.

In fact, where opposition to privatization has been strong, very generous payment formulas have been adopted. One inventory of severance payments across countries found a range of from the equivalent of six month's salary to 4.3 years.[88] However, severance allowances rarely take explicit account of the value of non-salary benefits that may be lost as a result of separation.

Financial compensation schemes are often combined with "active labor market policies," such as job search and placement services, training, wage subsidies, and mobility assistance. The experience with such measures is decidedly mixed. They are no substitute for insufficient demand. As Flanagan has noted, training and related measures may alter the position of individuals in the job-seeking queue but cannot increase the number of vacancies. Particularly in most of the transitional economies the problem of absorbing displaced workers is one of inadequate demand.[89]

Most of the evaluations of the returns to training have been performed in developed countries. In general, they have been found to be less cost-effective than job search assistance. Training programs for displaced workers have resulted in modest gains in employment probabilities, though in most cases the benefits have not justified the costs.[90] Unfortunately similar studies are lacking for developing countries. However, what we know generally about training in developing countries would suggest that it is unlikely to improve employment prospects of most of the unemployed. Most training offered by public institutions is supply- rather than demand-driven, underfunded, of poor quality, and not designed to respond to skill needs of employers or existing job vacancies.

India's experience in attempting to respond to the needs of retrenched workers is instructive. In 1992, the Government of India established a National Renewal Fund to cover the costs of severance payments and provide counseling and retraining support for workers adversely affected by the industrial sector

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[87] In some instances and sectors, it may be possible to structure the supervision for the transition period as part of an evolving regulatory structure. An example may be the petroleum sector in Morocco, as discussed below.

[88] Kikari, *op.cit.,* p. 14.

[89] Flanagan, *op. cit.,* 410-411.

[90] Kikari, *op. cit.,* p. 25.

reform program. While the fund has successfully made severance payments it experienced considerable difficulties in implementing counseling and redeployment activities as a result of lack of budget, institutional incapacity, and inadequate technical assistance to the agencies that were intended to carry out the program. By the time the programs became effective, many workers had either retired or had found alternative employment. Of the workers retrained only 20 percent were redeployed with the agencies' participation. The small number of trainees resulted in high training costs per unit.[91]

In Sub-Saharan Africa several attempts have been made to design and implement redeployment schemes, mainly in Benin, Cape Verde, Ghana, Guinea, Madagascar, Senegal, and Zambia. In the latter country, offers of training in job search and business development were made to 5,000 workers in anticipation of redundancies. Two training programs were implemented in Benin, but their impact has been minimal since less than one percent of the retrenched staff benefited.[92]

Finally, there is the so-called signaling problem that may limit the effectiveness of active programs designed to help the unemployed. Because employers cannot know how productive potential workers will be, superior workers may seek to signal their superiority in ways that are not available to lesser workers. One way to signal is to refrain from participating in publicly sponsored programs to aid the unemployed. Flanagan reports that there is evidence that employers also prefer to hire unsubsidized workers reflecting their belief that public redeployment programs are patronized by less qualified workers. In Eastern Europe private sector firms are reported to hire almost exclusively from among employees of state firms, avoiding any reliance on the newly established labor offices.[93] This reflects the belief of private employers that the unemployed workers who have been released from SOEs are likely to have been the least qualified or desirable workers.

Privatization programs may include specially targeted public employment programs. For example, Germany instituted a subsidized employment program to absorb some of the workers released in the wake of the privatizations in the eastern part of the country.

In some countries, workers who wished to use their severance allowances to start businesses have been offered assistance in the form of training and credit arrangements. While careful evaluations of such schemes are lacking, the experience in Sub-Saharan Africa and Latin America suggest that they have rarely brought benefits. Several such programs were adopted as a form assistance to employees separated as a result of downsizing of central government bureaucracies. Loan repayments quickly fell in arrears and recovery rates proved to be very low. Most of the programs were soon abandoned. In any case, only a very small proportion of the displaced workers proved interested enough to apply.[94]

On the basis of the German and other experiences in OECD countries, wage subsidies as a tool to promote the employment of workers displaced by privatization is not encouraging. Too frequently subsidies go to subsidize employees who would have been hired even in the absence of the subsidy. In addition, subsidized workers have been found to displace other workers, thus yielding no net increase

[91] Kikeri, *ibid.*, p. 26. Kikeri cites as his source for these comments, B.B. Patel and Hiroaki Suzuki, "Safety Net for Wrokers in India Counseling: Retraining and Redeployment of Displaced Workers under the national Rnewal Fund," paper submitted to The World Bank, 1977 bythe Ghandi Labour Institute, Gujarat.

[92] Oliver C.. White and Anita Bhatia, *Privatization in Africa* (Washington, D.C.: The World Bank 1998), p.99.

[93] Flanagan, *op. cit.*, p.410.

[94] Barbara Nunberg and John nellis, "Civil ServiceReform and the World Bank," paper delivered at a Conferenmce on Civil Service Reform, April, 1990, pp. 15-16; *World Development Report 1995*, 17.5.

in employment.[95] However, wage subsidies may play a useful role in isolated one-company towns following the privatization of the dominant employer until other measures can usefully be brought to bear to integrate the separated workers.

Privatized companies seeking to streamline their operations may create a protected markets for the services of displaced workers. For example, the enterprise may offer to subcontract out certain functions to enterprises formed by the separated workers. In Argentina, the privatized oil company, YPF, entered into service contracts with 210 companies formed by 5,300 former employees. Worker cooperatives were formed to perform rolling stock repairs for the railways. In Congo, a wide variety of functions have been subcontracted out to former employees. Other countries in which similar schemes have been reported include Guinea, Benin, Egypt, and Peru. While little is known about the longer-term evolution of such programs, they would seem to offer an approach worthy of wider consideration.[96]

One option frequently used in share-issue privatization to provide some compensation for employment-related impacts is promotion of small shareholdings, in particular among the workers of the privatized companies. Several countries, including Bangladesh, Bolivia, Chile, Ghana, Mexico, Mexico, Morocco, Mozambique, Pakistan, Turkey, France, the United Kingdom, and several of the transition economies of Eastern Europe, have reserved a proportion of the shares of privatized enterprises for distribution to employees on favorable terms.[97] To the extent that the privatized firms prosper, the wealth position of employees who retain them may be significantly enhanced. One of the great virtues of worker participation in the ownership of privatized enterprises is that it reduces opposition to privatization, thus easing the transition process.

Small shareholder promotion as part of the privatization process may also involve special provisions to facilitate secondary trading. Banks or brokers, for example, may offer low-cost services aimed specifically at the small shareholder.

7.1.4.3 Communications

Effective communications to maintain transparency and build acceptance of and support for privatizations can be an important element of efforts to mitigate impacts on key stakeholder groups, in particular employees, including management. Attempts to implement a privatization program in a shroud of secrecy, usually to try and keep any potential opposition in the dark and disorganized, invariably foster rumors and heighten fears.

Attitudes toward privatization among employees typically reflect (mis)perceptions and beliefs, rather than informed opinion. These beliefs translate into fears about layoffs, deteriorating work conditions, or loss of privileges. The effect of these feared consequences of privatization can rival the real impacts. Effective communications therefore targets these beliefs, rather than being restricted to transmitting factual information.

Communications can also be key to encouraging active participation, especially in conjunction with other mitigation measures. For example, effective communications can enhance the effects of offering shares in the privatized company by stressing participatory aspects rather than simple asset transfers.

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[95] Commander and Coricelli, *op. cit.*, p. 380.

[96] Kikari, *op. cit.*, p. 19.

[97] Kikari, *op.cit.*, p.22; V.V. Ramanadham, "Privatization:Constraints and Impacts," in Ramanadham, *op.cit.*, p.43, and in the same volume, Jerry Cieslik, Privatization in Poland," p. 106.

Finally, good communications with workers throughout the privatization process will help them understand the obligations of both sides in the transaction. They are therefore more likely to keep their "end of the bargain." But they will also assume some of the responsibility for monitoring the compliance of the new owners with any obligations, thereby lifting some of the monitoring burden.

7.1.4.4 Conversion

The conversion of proceeds, earmarking them for special purposes, can be a powerful tool for mitigating negative impacts for key stakeholders. Using the proceeds for compensation measures (combined with adequate communications) emphasizes the link to the benefits of privatization.

7.1.4.5 Compulsion

Governments have used compulsion in one form or another to respond to resisted motivated by concerns about social impacts. Not exactly a mitigating measure, compulsion may take the form of limiting strikes, preventing riots, or curbing union powers. A government may face situations in which compulsion is advised to move the privatization process along and prevent further damage to stakeholders. But the price in terms of social costs can be high.

7.1.5 Shares in privatized firms

In an effort to encourage more wide-spread share ownership, Morocco's privatization program provided for an allocation of shares in privatized firms to employees at a 15 percent discount from the sale price per share, although the practice is not required under terms of the privatization law. The lesser of 10 percent of the enterprise' share capital or 20 percent of the state's holding may be reserved for employees with tenure of at least one year. Workers who acquire shares are committed to holding them for at least three years. Disposal of shares prior to the expiration of this interval obligates the seller to reimburse the government for the 15 percent discount.

7.2 Impact on employment levels

Overall, employment-related impacts of Morocco's privatization program appear to have been negligible. An analysis of available time series of total employment for privatizable manufacturing enterprises[98] (see Exhibit 7-2) shows virtually no change in aggregate employment for the companies actually privatized: for this group, total employment *increased* by 1 percent over the period 1989-1996, although there were of course variations across companies. For the privatizable manufacturing enterprises that have yet to be privatized, total employment declined by close to 2 percent per year or by 12.7 percent between 1989 and 1996.[99]

A recent survey by the Ministry for the Public Sector and Privatization suggests that Morocco's privatized firms have created employment. According to the results of the survey provided by the Ministry, the

[98] These data were provided as a special tabulation of annual manufacturing industry surveys by the Ministry of Commerce, Industry and Handicraft.

[99] A significant subset of the group of "non-privatized privatizables" are the sugar refineries. Their total employment declined by 11 percent between 1989 and 1996.

enterprises and hotels report that employment has increased from 15,924 to 16,959, corresponding to a gain of 6.5 percent.[100]

These results are likely to reflect a selection bias (privatizable meant no serious overstaffing), but also compliance with conditions of sale. The new owners were committed to maintaining employment for some defined interval, usually three years, although no mechanism is in place to monitor and exact compliance with that commitment.[101] Moreover, private investors operating in the Moroccan context are used to respect permanent employment relationships.

Of course, any observable variations in employment cannot simply be attributed to privatization. Real variables may be at play. For example, firms in the garment industry typically produce garments under contract to European firms. This is an industry notorious for its instability. The loss of a contract from a major buyer can spell a sharp contraction in output and employment for the sub-contractor. Such factors explain the variations in employment for firms like CHELCO in Exhibit 7-2. In this firm, employment had actually increased within this time interval before falling sharply and then gradually recovering. Two other privatized firms reporting declines in employment, MODULEC and SIMEF were on the brink of bankruptcy when they were privatized (according to some observers because of relative neglect after they had been designated as "privatizable"). In the latter of these, declines in employment were already under way prior to privatization.

The figures in Exhibit 7-2 refer the employment only of permanent workers. To the extent that large numbers of temporary workers are employed, the variations in employment observable in the numbers of permanent workers may be either offset or intensified by changes in the employment of temporary employees. Temporary employees are likely to be an important feature of enterprises in settings in which the legal obligations of permanent employment are viewed as onerous and costly as is the case in Morocco. They provide an inexpensive way to adjust employment to changing levels of production.

While overall impacts appear to have been negligible, public perceptions are largely shaped by special cases. For example, union representatives cited the experience with one firm that had locked out over a thousand employees in its two plants as evidence of the nefarious impacts of privatization on employment. If the accounts provided are an accurate portrayal of what happened, it would appear that the new owners engaged in asset-stripping and what amounts to fraudulent behavior. Since the firm only suspended production, it has avoided incurring any liabilities to its workers, since they are technically still employed.

Given employment commitments and other factors, some of the restructuring measures that would affect employment levels are scheduled for later. For example, the buyers of the two refineries, SAMIR which accounts for 80 percent of total output and SCP, have plans to merge the two operations. Such a merger is likely to result in some retrenchments.

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[100] We have not seen the actual results of the survey, and therefore do not know where the gains occurred, and in what labor categories.

[101] We have not been able to determine the nature and extent of employment-related conditions of sale, nor their enforcement, because we were unable to gain access to the *cahiers des charges*.

Exhibit 7-2: Employment in privatizable manufacturing enterprises

Manufacturing enterprise	1989	1990	1991	1992	1993	1994	1995	1996	% change per year
CELLULOSE	468	436	427	420	403	378	367	346	-4.2%
COTEF	1,700	1,426	1,403	1,388	1,339	1,300	1,278	1,242	-4.4%
IBOVAL	60	120	120	120	120	120	120*	120*	14.9%
MAPROC	213	195	151	250	113	160	120	145	-5.3%
SALAM	29*	41	40	40	140	190	16	350	43.0%
SCIF	617	696	597	770	718	590	590	147	-18.5%
SETAFIL	104	242	256	265	299	193	192	194	9.3%
SFPZ	757	386	386	386	386	347	483	486	-6.1%
SICONE	1,141	1,050	825	897	1,075	1,120	1,100	1,100	-0.5%
SOMACA	891	1,012	910	899	997	933	903	889	0.0%
SUBM	262	251	248	240	239	233	240	235	-1.5%
SUCRAFOR	210	213	213	211	209	200	200	200	-0.7%
SUCRAL	179	186	186	181	182	165	182	176	-0.2%
SUNAB	336	336	308	308	336	261	242	226	-5.5%
SUNABEL	185	196	195	191	193	190	195	195	0.8%
SUNACAS	162	169	179	174	175	175	180	182	1.7%
SUNAG	469	500	483	485	482	478	472	472	0.1%
SUNAT	282	286	287	279	286	277	260	255	-1.4%
SURAC	192	191	191	195	191	191	191	193	0.1%
SUTA	750	727	713	698	669	638	635	563	-4.0%
VETNORD	600	650	698	600	650	650	660*	671*	1.6%
All non-pvtzd.	9,607	9,309	8,816	8,997	9,202	8,789	8,626	8,387	-1.9%
CHELCO	833	900	900	900	➔ 1,000	188	520	649	-3.5%
CIOR	609	630	630	630	➔ 783	770	778	764	3.3%
FERTIMA	390	373	373	373	373	775	775	➔ 370	-0.7%
GTR	528	529	500	511	740	➔ 578	719	626	2.5%
ICOZ	979	979	981	1,018	1,018	1,016	➔ 1,021	1,025	0.7%
MODULEC	60	60	54	54	60	➔ 60	45	40	-5.6%
SICO CTR	360	289	424	424	356	415	➔ 390	382	0.9%
SIMEF	390	401	385	385	401	345	327	309	-3.3%
SNEP	474	472	470	467	➔ 472	477	484	490	0.5%
SODERS	137	139	150	155	➔ 150	155	152	156	1.9%
SONASID	592	600	615	629	577	581	581	➔ 578	-0.3%
SOTRAMEG	49	84	61	78	57	71	74	67	4.6%
All pvtzd.	5,401	5,456	5,543	5,624	5,987	5,431	5,866	5,456	0.1%
Total	**15,008**	**14,765**	**14,359**	**14,621**	**15,189**	**14,220**	**14,492**	**13,843**	**-1.1%**

Source: Special tabulation by Ministry of Commerce, Industry and Handicraft; ➔ = year of privatization; * estimated.

Most of the firms selected for the first round of privatization were considered to be reasonably well-managed and free of substantial amounts of redundant labor. Furthermore, as a condition of sale, the new owners were committed to maintaining employment for some defined interval, usually two or three years, although no mechanism is in place to monitor and exact compliance with that commitment. Our interviews suggested that any redundancies in the privatized firms were minor. Only one firm acknowledged that it was encouraging redundant workers to leave by negotiating an attractive severance package or offering early retirement. This same firm, however, was hiring new employees with different and higher skill levels than those of the departed. In another firm, older employees were being offered early retirement on attractive terms. But in none of the firms interviewed was there a detectable drop in total employment beyond that that would be associated with normal turnover.

One firm, Fertima, however, foresaw a substantial future reduction in workers directly in its employ. This is a processor and distributor of fertilizers. As a publicly owned firm it was obliged to maintain distribution facilities within easy reach of all farmers even though they could not cover their costs. As privatization proceeds the firm plans to discontinue this distribution function. Rather it contemplates negotiating service contracts with groups of separated workers who would assume the distribution function in the capacity of private contractors. While such workers would lose access to some of the fringe benefits provided by the firm, the nature of the change in their overall economic welfare is unpredictable; it could either increase or decrease.

Our findings also suggest that managers are reluctant to take drastic measures to deal with any redundancies. This attitude prevailed in particular in enterprises located away from urban centers. For example, one firm that wished to purchase a government-owned mine was obliged also to assume ownership of a mine that was close to the exhaustion of any economically recoverable mineral. This mine was scheduled for closure 15 months after privatization. Of the 250 employees, a majority were transferred to other mines or activities of the holding company that had purchased the mine. Since it was preparing to exploit recently discovered mineral deposits and to expand its refining capacity it could presumably employ these workers productively. Of the 112 that remained, 90 declined reassignment and were offered either early retirement or severance pay equal to thirty days pay per year of employment, a settlement far more generous than the legally required payment.

In many cases, such a paternalistic attitude could survive thanks to continuing protection. But as protection declines in the course of further liberalization, that approach may no longer be viable. The adherence of Morocco to the Montevideo treaty and its special relationship to the European Economic Union will require a gradual erosion in the degree of protection

All of the management officials we interviewed viewed the economic environment facing their firms as very favorable. They either had plans to undertake investment in plant expansions or to offer new services or were already well on the way to doing so. In most cases, these activities reflected decisions taken after privatization. Indeed, we were told that during the period of government ownership, it was extremely difficult to get government approval of new investment proposals. In part, this was due to the constant turnover in government officials responsible for the operation of enterprises as well as to the many layers of decision making. One firm related that a proposal to invest in plant expansion had been pending for 15 years and was only acted upon after privatization. Greater flexibility may thus lead to increased investment, at least in some cases, and thereby conceivably to increased employment. There had not been sufficient time since privatization to assess such impacts.[102]

7.3 Employment-related benefits

Among the firms we interviewed, all but one held that its cash wage level was either equal to or higher than that of comparable firms. The one firm that believed its wage level was slightly below the average for similar institutions asserted it was in the process of narrowing that difference. Most of the firms offered housing, housing allowances, or subsidized credit for the purchase of housing. Other benefits ranged from free lunches to free gasoline. In addition are the losses of benefits associated with coverage under the CNSS. A worker who becomes unemployed or finds a job in a non-covered employment stands to lose a substantial amount in cash and services. Workers losing their jobs should lose immediately their family allowances, though, because of the lags in updating the computers of the *Caisse*, workers will continue to receive allowances for up to a year. In addition to the family allowances, workers lose access to medical services. Finally, they may lose their contributions to the retirement system if they have not or do not complete 10.4 years of covered employment.[103]

Other issues concern the expected loss of special benefits, such as subsidized housing. The country's major refinery SAMIR, for example, like many state-owned enterprises, had provided subsidized housing for its workers. Specifically, it had provided credit at a nominal rate of interest to construct homes for workers. The new management, citing government decisions, has declined to continue such support. Finding a resolution for this contentious issue is hampered by apparent weaknesses in communications between the two sides.

Generally, though, we found that the new owners were making efforts to soften any negative impacts and smooth the transition. Thus, they would opt for the supplemental national retirement scheme (CIMR) to complement what is available under the mandatory CNSS provisions. Similarly, they would seek accommodations with workers to phase out such special benefits as unlimited overtime pay, reducing overtime in exchange for wage increases. In short, even without specific provisions in the *cahiers des charges*, the new management typically would seek mutually acceptable solutions in tune with the culture.

7.4 Share distributions to workers

As we have observed earlier, privatization need not imply losses to workers employed in privatizable firms. Workers who remain in the employment of the privatized firm may experience gains in earnings and/or improvements in working conditions. In those cases in which workers acquired shares in the enterprise, the possibility of large gains in wealth may follow. In Morocco, a number of privatizations reserved shares for workers. As of early 1997, 12 companies had afforded their employees an opportunity to acquire shares. The purchase agreements had left to the individual enterprises to decide whether or how they would facilitate the purchase of shares by their employees. Some of the enterprises

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[102] Public sector managers have a tendency to blame bureaucratic oversight for investment inertia; however, there may have been good reasons that investment proposals were not approved. Undertaking these investments after privatization therefore does not necessarily ensure success.

[103] More detailed and reliable information about the experiences of any displaced workers requires longitudinal observations. Appendix XX illustrates the potential analytical use of such information.

offered their employees loans at zero or below-market interest rates to purchase shares (cf. Exhibit 7-3). CIOR facilitated purchase on an installment plan but without any subsidy. In two cases, MODULEC and SIMEF the shares were distributed at no cost to employees. The former had been shut for some time prior to privatization while the latter had undergone a substantial restructuring (with some blaming the designation as “privatizable” without swift follow-through, which had put the companies in a kind of limbo). In view of their financial difficulties, the distribution of shares for these companies to employees may prove to have little more than a symbolic value.[104]

The response of employees has apparently been favorable. Workers understood what the shares represented and that a market for shares existed.[105] Seven of the firms reported 100 percent participation by employees as of this reporting date. Three reported participation rates of 61, 37, and 48 percent. In SNEP, the distribution has not yet been effected because of a controversy over financing arrangements while at General Tire, the new majority shareholder chose to make his own arrangement, regarding which information is lacking. The favorable response of workers demonstrated here is consistent with the comments made to us by our focus group workers, all of whom viewed stock ownership in a favorable light.

Workers receiving shares who have held on to them have seen handsome gains in share prices. Shareholders in the cement company, CIOR, and the consumer finance firm, Credit-EQDOM, have seen the price of their shares soar to over five times their purchase price. Holders of shares in BMCE, CTM-LN, SOFAC and SONASID have seen increases of between two and three times the purchase price. Finally, shares in SAMIR have almost doubled. The values of the shares of unlisted firms are not known.

[104]3 “41 millions de DH en moins pour le Trésor,” *L’Economiste*, Number 236, June 27, 1996.

[105] The workers we interviewed said they would be disposed to hold on to shares, especially if the price of the shares were to rise. In response to the question of how stock ownership might affect their attitudes toward the firm or their job performance, one worker replied that it would provide an incentive to increase production while another responded that increasing production should be a matter of commitment to the company and to professional responsibility rather than a response to stock ownership.

Exhibit 7-3: Employee participation in share issues

Firm	Number of Employees	Shares Distributed	Offering Price (DH)	Price October '98	Terms
BMCE	2,331	300,000	276.30	713	15% discount; loan at 0% interest
CIOR	203	51,362	195.50	1,150	15% discount; payment facilities provided
Credit-EQDOM	60	17,024	306.00	1,570	15% discount
CTM-LN	306	24,525	212.50	427	15% discount; loan at 0% interest
General Tire	527	7,411	N.A.	191	15% discount; loan at 0% interest
MODULEC	45	1,500	Free	Unlisted	Free; enterprise in difficulty
SAMIR	559	228,969	206.60	380	15% discount; loans
SIMEF	344	27,000	Free	Unlisted	Free; enterprise in difficulty
SNEP	N.A.	85,000	215.05	N.A.	Not completed yet; 15% discount
SOFAC/Crédit	52	6,084	246.50	618	15% discount; loan at 2% interest
SODERS	127	5,520	297.50	Unlisted	15% discount; loans at 3% interest
SONASID	560	117,000	261.80	780	15% discount

Source: Ministry of Public Sector and Privatization; the distribution prices were obtained from, "Guide to Morocco's Privatization Programme" (Ministry of Privatization and Public Enterprises, September, 1995), p. 27. The October 1998 prices were obtained from published data of the Casablanca Stock Exchange.

Since share prices of most enterprises have increased substantially since privatization it is not uncommon for workers to wish to turn a quick profit. According to company managers with whom we spoke, some workers have already sold their shares in violation of their commitment to hold them for the specified interval. Since the shares were bearer shares and no monitoring procedure was established to ensure compliance penalties have been avoided. Apparently some firms have requested permission from the Ministry of Privatization for their workers to sell their shares prior to the expiration date without penalty. It is not known whether these requests have been acted upon. We found it impossible to determine the proportion of shares still in the hands of employees.

7.5 Workers' perceptions of privatization

While the evidence suggests relatively limited impacts on employment and employment-related benefits, workers apparently perceive them to be more negative. Trade union officials[106] indicated that they believed that privatization did not promote the interests of workers. They averred that they had been

[106] We met with officials of the *Confédération Démocratique de Travail du Maroc* (CDTM).

skeptical about the benefits of privatization but that they had not actively opposed it. They had some specific complaints about the process of privatization, focusing on a few well-known problem cases.[107] These complaints seemed to revolve more around the process, especially communications or lack thereof, than around actual impacts. Workers' representatives saw the program as being carried out without any consultation with the workers concerned.

Union officials asserted that it was impossible to find out the terms of enterprise sales, in particular with respect to employment commitments. There appears to be some justification to such complaints: the logic of including provisions in the sales contracts that benefit certain stakeholder groups (here the employees), but denying the beneficiaries access to the agreement is not immediately obvious. Union officials also argued that there was no monitoring of the privatized firms so that violations of the purchase agreements, where they occur, go unnoticed and uncorrected. While the government had promised to use the proceeds of privatization for purposes of economic development, instead they were applied toward the budgetary deficit. There was also some concern about the subsequent addition of two "strategic" enterprises — the two refineries — to the list of privatizable companies attached to the privatization law.

On the whole, the workers whom we interviewed perceived no significant changes in the work environment following privatization, but expressed some concerns about the possibility of losing certain benefits in the future.[108] They believed — with some justification — that privately owned firms would be less willing than the publicly owned to provide such special benefits as housing. Yet to date, no significant changes had occurred.

7.6 Communications

Communications, especially with the employees of the enterprises, appear to have been one of the weaker elements of the program. Although the privatization program has been hailed for its transparency, it apparently was carried out with little or no consultation with the workers concerned. We were struck by the frequency with which workers and their unions have appealed to the Ministry of Privatization for information or clarification of obligations assumed by owners. According to our respondents, not a single response or acknowledgment of the workers' inquiries has been received.

Union officials assert that it was impossible to find out the terms of enterprise sales, especially with respect to any commitments regarding employment. Efforts to secure access to the sales contracts from the Ministry of Privatization have been to no avail. Even if this unresponsiveness is only perceived, it clearly affects the image of the program as a paragon of transparency, and may hamper the successful transition to a privately owned and managed competitive enterprise. The failure to communicate has contributed to uncertainty and apprehension on the part of the workforce. It also has allowed the

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[107] Buyers of a firm in the textile industry (ICOZ) have become embroiled in a dispute with the government over payment of customs duties and investment commitments, and have suspended operations. They had locked out over 1,000 employees in its two plants. The company has filed a suit against the government, while the government has recently requested that the sales contract be annulled. The matter is now in the courts.

[108] One of the two focus groups was in Fertima, a fertilizer producer and distributor, which floated only 30 percent of its share capital o9n the Casablanca Stock Exchange, while the phosphates giant OCP stills owns 70 percent. The concern here was that full privatization might have more severe impacts on employment and employment-related benefits. Most of the interviewed workers expect to exercise the option, offered OCP, to shift to another of the latter's productive facilities in order to safeguard their acquired rights and benefits in the case of full privatization of Fertima.

problems with a few companies that have been widely publicized to overshadow the performance in the average case.

The absence of an effective dialogue with the workers of the privatized enterprises is not uncommon for privatization programs, in spite of the growing evidence that ignorance and mistrust stiffen resistance, and that efforts to involve workers can make for a much smoother process. But such a dialogue requires a commitment to full transparency, and the resources to pursue that dialogue. It takes time and effort (although we actually found it surprisingly easy to set up group sessions with workers.)

8 Impacts on the business environment and institutions

8.1 A diffuse range of impacts

The task of measuring and analyzing the impacts on the legal and regulatory framework, on corporate governance and institutions faces the twin challenge of choosing appropriate indicators, and of accounting for the close interaction between the framework and the performance of the program. This part of the impact appraisal therefore is generally likely to rely primarily on qualitative analysis.

Finally, privatization may also affect consumers. For a state-owned enterprise that harbors a considerable amount of redundant labor to survive, it must either enjoy a monopoly position in its market, be subsidized by the government at the expense of taxpayers, or both. In the former case, part or all of the monopoly rents potentially accruing to the firm are being distributed to workers. If privatization is accompanied by a removal of the enterprise's monopoly power, either by a liberalization of product markets or by public regulation, consumer surplus should increase as the price of the product declines and output expands.

In other cases, state-owned enterprises — such as public utilities — may be required by the government to price their output at less than the average cost of producing it, with the result that public subsidies are required to ensure their survival. Earnings shortfalls virtually ensure that such an enterprise will lack resources for the maintenance of existing capacity, let alone for new investment to expand capacity. The result is excess demand for the firm's product at the imposed price or the quality of the product will leave much to be desired. Evidence of such conditions can be found in the waiting lists for telephones that extend to several years or in frequent interruptions in the delivery of electric power that are characteristic of some developing countries. Privatization of such enterprises can be expected to improve the efficiency of existing resources by, among other things, dispensing with redundant labor, thus lowering costs. By committing to new investments to expand capacity and modernize existing plant, as is frequently required under the sales agreement, excess demand will be absorbed and the reliability or quality of the product or service improved.

To the extent that the SOEs constitute a drain on the government's budget, the general public may stand to gain as government subsidies to inefficient enterprises are replaced by positive tax revenues from privatized firms. A reduction of the fiscal deficit may contribute to greater macroeconomic instability if budgetary deficits are reduced or may permit an increase in resources allocated to increased and improved services to the public, e.g., education or health. In the case of a heavy subsidy burden, such earmarked budget shifts are often advanced to build support for the privatization effort.

Finally, privatization also affects the relationships of the enterprise with its business partners, in particular its suppliers. In a typical situation, privatization and the shift to the rule of market forces is likely to mean the disappearance of a protected market for suppliers. The new owners may be able to seek their inputs and upstream services through a competitive process. Some programs adopt interim obligations vis-à-vis suppliers to give them time to adjust. If the enterprise itself is part of a product chain, privatization may mean the loss of protected markets for its own products. For example, if the main client of the enterprise was another state-owned enterprise, which is now free to choose other suppliers, the shock may be difficult to handle. Again, privatization programs often seek interim arrangements to avoid such shocks and ensure a smoother transition. Since these kinds of effects tend to be idiosyncratic to the sectors and enterprises involved, their treatment typically involves more of a case study approach.

8.2 Improving adaptive efficiency

The argument advanced by North (1992) stresses the importance of adaptive economic efficiency in the evolution of a more competitive and productive economy. This concept relates to the existence of institutions (beliefs, rules, procedures, standards, organizations, etc.) that provide the incentives and the capability to acquire and use knowledge in the performance of economic activity. The very breadth of the concept makes it difficult to delineate and measure changes, yet these problems do not diminish its importance.

As one of the most visible expressions of the commitment to economic policy reform, and as the key process redefining the roles of the private sector and the government, privatization can have a profound impact on the systems of institutions. From a macroeconomic point of view, privatization-induced gains in microeconomic efficiency in a mixed economy like Morocco's can be important, but are likely to be overshadowed by improvements in the economy's adaptive efficiency. These improvements include better functioning of financial markets, in particular the stock exchange, more effective systems of corporate governance that subject managers throughout the economy to greater scrutiny and rewards good and penalizes poor performance, the replacement of command-and-control approaches with market-oriented regulatory mechanisms, and the gradual evolution toward more formalized interactions of economic agents.

In the Moroccan privatization experience, much has been accomplished in this regard. Privatization has been instrumental in the emerging transformation of Morocco's business culture. Yet much remains to be done.

8.3 Casablanca Stock Exchange

The privatization program has contributed significantly and prominently to the development of the country's capital markets and its regulatory framework and procedures. Weaknesses in the capital markets represented one of the key constraints for the implementation of the program. The CSE was a sleepy institution, there was little tradition of share ownership, trading systems were inadequate to cope with any significant increases in volume, and regulatory oversight was weak.

All that has changed, to a large extent because the privatization program provided the impetus, and expanded the number of listings on the *Bourse des Valeurs de Casablanca*. By October 1998, the capitalization of the CSE had grown from 5 billion dirhams in 1989 to 149.4 billion dirhams. More importantly, the privatization program was also a major factor in moving the *Bourse* from a quiet backwater (with 0.5 million shares traded per session) to a more vibrant institution, with daily trading reaching 123.7 million shares. Privatized companies figure prominently among the select group that is traded on a continuous basis.

The privatization program has also contributed to other actions to strengthen the role of the private sector, including the transfer of majority stakes from quasi-public investors, such as the *Caisse de Dépôt et de Gestion* (CDG).[109]

Moreover, the *Bourse* has introduced microstructures (trading systems) appropriate for the current levels of activity. While other factors clearly have played a role in these developments, we found a strong consensus that progress would have been feeble without the contribution of the privatization program.

The changes introduced by the privatization program have had a moderate impact on the interest among privately held companies to issue shares on the exchange. Even so, we were told that there is a growing recognition of the "cachet" associated with a listing on the CSE.

8.4 Credibility

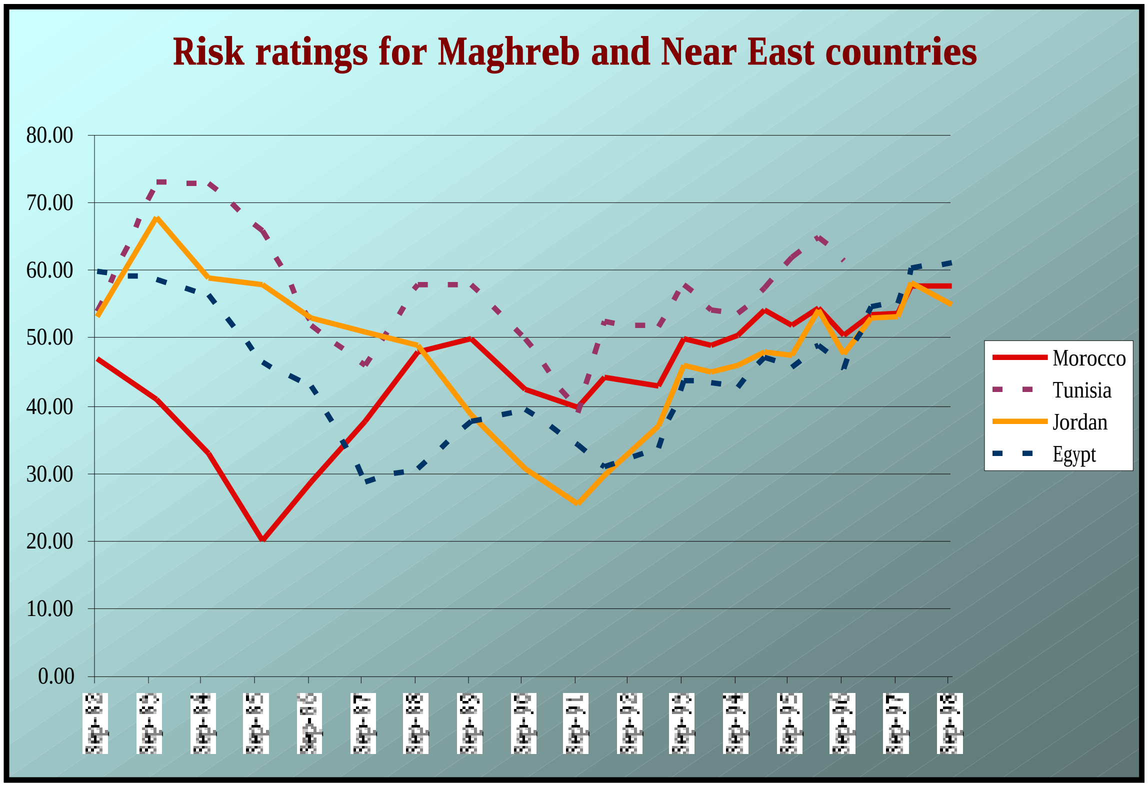
The transparency of the privatization process is generally judged to be satisfactory, While some questions and complaints have come up, the program overall has been managed in a reasonably transparent and credible manner, although the organizational structure set up to ensure transparency and coordination may have been more cumbersome than necessary. Foreign investors generally regard Morocco as having run a transparent privatization program. Even so, in 13 cases out of the 52 privatizations, an initial tender failed and was followed by direct negotiations. In another 30 cases, the privatization program proceeded directly to private placement.

Foreign investors feel that the shares on the CSE are currently overvalued, partly because of internal pressures, since Moroccan investors have few outlets. Moreover, after stimulating investor interest in share ownership, the privatization program has slowed down (there have been no privatizations in over a year) and has failed to contribute to the increase in the number of listed companies. There are a number of privately held companies that have launched IPOs, but their size and number does not make up for the lack of listings from the privatization program.

In terms of the country's risk rating relative to that of other countries in the North Africa region, shown in Exhibit 8-1, it is difficult to discern any major impact of the privatization program. The ratings for Morocco show a reasonably steady upward trend from 1991 onward, but that trend applies to Egypt, Jordan and Tunisia as well.

[109] The CDG has been, and to some extent continues to be, a major investor in the tourism/hotel sector. However, it is now committed to leaving that sector, and has sold many of its holdings, including the Hyatt Regency (now the Hilton) hotel in Rabat.

Exhibit 8-1: Country risk ratings



Source: *Euromoney* country risk ratings

8.5 The legal and regulatory framework

Increased activity stimulated the development of an appropriate legal and regulatory framework, including the restructuring of the stock exchange into an operating element and a regulatory oversight agency. The reform of the country's capital markets has spawned the promulgation of legislation and regulatory texts regarding the following institutions:

- as noted, the Casablanca Stock Exchange (CSE or *Bourse des Valeurs de Casablanca*, BVC), a private institution owned by the licensed brokers;
- the regulatory oversight institution, the *Conseil Déontologique des Valeurs Mobilières* (CDVM), responsible for monitoring compliance with rules and regulations governing the behavior of market participants;
- mutual funds and other collective investment instruments, the *organismes de placement collectif de valeurs mobilières* (OPCVM);
- the establishment of a second market on the CSE for a second tier of companies who may not meet the listing requirements for the principal market; and
- the establishment of a central depositary (*Maroclear*) for all securities.

In addition, the privatization program has contributed directly to the evolution from a command-and-control approach in key sectors to a more market-oriented regulatory oversight. The prime example is the petroleum sector, which accounts for some 40 percent of total proceeds from privatization. Both the country's entire refinery capacity and its distribution networks have been privatized. Through that process, the role of the Ministry of Energy and Mines as the cognizant government authority has been shifting from direct management to an oversight function. To be sure, the oversight is still rather heavy-handed. For example, distribution companies must obtain the approval from the Ministry to open new service stations, and the approval is apparently influenced by considerations whether a given area is already adequately serviced.[110] Similarly, the government sets the prices of all petroleum products, and requires all distribution companies to purchase from the refineries. Yet the system is evolving. For example, the distribution companies are seeking greater freedom in choosing their suppliers; similarly, we were told that the new refinery management is interested in getting into the retail (service station) business itself. As a result of these pressures, a gradual movement to a more market-oriented, regulated system is likely.

8.6 Corporate governance

The program helped set standards for financial disclosure and accountability. The appraisal and valuation of enterprises in the course of preparing them for privatization triggered the development of much more stringent standards for financial reporting and disclosure. Audit requirements tightened. As a result, there is now greater transparency regarding the financial status of enterprises. Private-sector agents, such as financial intermediaries, have begun to handle much of the surveillance of corporate and managerial performance. Investment advisers now publish periodic appraisals of the performance of publicly traded companies.

In addition, more intensive contacts with foreign investors and investment banks had indirect effects on the evolving legal, regulatory and institutional framework. While it may be difficult to document this conclusion, there appears to be general consensus that the privatization program has been a major cause for the opening of the economy and the consequent adoption of standards that are much closer to international norms.

Although not directly part of the privatization program, one decision illustrates the changes well. The giant phosphates company, OCP, with annual sales are in the neighborhood of $1.5 billion had traditionally been regarded as "a state within the state," providing little information on its performance. At the July 1997 Board meeting, its CEO announced that within two years an international accounting firm would audit the financial reports of the company. This step, encouraged in part by the company's efforts to link up with foreign partners on specific ventures, marks a sea change in the country's business climate.

8.7 Other impacts

The study team explored with our respondents whether there had been any impacts of the privatization program on *consumers* or *suppliers/business partners* of the privatized enterprises. Aside from some general conjectures about what the impacts *should* have been, we obtained no information that would lend itself to clear conclusions.

[110] Thus, there are no major intersections where Shell and Mobil or Total might be competing directly with each other.

9 Conclusions and recommendations

The overall conclusion is twofold: at the microeconomic level, there have been modest gains in accordance with expectations, and few apparent adverse effects; at the macroeconomic level, the management of the privatization program, including deliberate underpricing, has contributed to the emergence and strengthening of institutions that enhance the economy's adaptive efficiency. The main emphasis in the coming months and years should be to regain the momentum, which has been lost, and to focus on building the structures, especially regulatory structures and capabilities, needed to support and sustain private sector participation, in particular in the infrastructure sectors.

Other conclusions of the appraisal of the impacts of Morocco's privatization program can be summarized in the form of ten propositions and associated recommendations:

(1) Given the complexity of the program in terms of range of demands that were placed on it, the performance has been respectable, with an average of 10 companies privatized per year during the "active phase" of the program (1993-97). Morocco allocated significant resources, including the creation of a new Ministry dedicated to the task of privatization, and received additional support from donors.[111] By relying on consulting firms and investment banks, the Government leveraged these resources. Even so, the scope of the program was ambitious in terms of the number of companies to be privatized on a case-by-case basis, and in terms of the modalities of privatization — a preference for public tender, detailed valuation, consideration of investment commitments, protection of jobs and employment-related benefits, etc. The resources available to the program managers were the not commensurate with the scope of the program.

- The solution is likely to lie in a more realistic approach. Only a few key enterprises demand the detailed attention typical for a case-by-case privatization. Especially now that Morocco has experience with privatization, many of the smaller cases and divestiture of partial state ownership can be handled in a more standardized and expeditious manner. Simplifying the evaluation criteria and standardizing the tender process can yield better results for the privatization effort — revenues relative to the transaction cost. Relying on standardized approaches, documents and procedures would allow for a greater volume of transactions. The notion of relying on a small core staff is appropriate, but implies a role as program manager and supervisor rather than as an agent involved in all aspects of the process. With the growing sophistication of domestic and international investment banks and financial advisers active in Morocco, the attention should shift to designing systems of incentives and supervisory mechanisms to achieve the objectives of privatization through private sector mechanisms. For example, strategic investors could now handle IPOs at least as effectively as the government.

(2) The privatization program has had a major impact on the development of the Casablanca Stock Exchange in terms of market capitalization, trading activity, participation, corporate governance and performance. Privatization provided the impetus for improved financial disclosure standards

[111] The privatization effort in Tunisia, which faces many of the same challenges, presents an interesting contrast. Tunisia attempted to run its privatization program out of a *cellule* in the Ministry of Plan, which was simply overwhelmed. As a result, the progress on the privatization front depended to a large extent on the *Ministère de tutelle*. For example, the Ministry of Tourism, which had considerable privatization experience based on its divestiture of hotels successfully pushed for the privatization of a mineral water bottling company, while other enterprises took much longer.

and regulatory reforms. In our view, the privatization program has contributed significantly to improvements in "adaptive efficiency" of economic institutions. It is worth noting that we found it easier to obtain detailed financial and other information on publicly traded companies from private sources rather than from the public institutions. We see that as a sign that disclosure and surveillance have become part of the business environment, albeit limited to certain layers of the economy.

- The major challenge in the coming years is to build on these accomplishments by expanding the number and range of companies traded on the Bourse, and to continue to strengthen the supervisory mechanisms critical to containing systemic risks and ensuring transparency.

(3) Other impacts show a mixed picture. Fiscal impacts probably were negative, implying a net transfer from the public to the private sector, in large part as a result of deliberate underpricing in pursuit of broader social objectives. An analysis of a sample of publicly traded companies suggests that the financial performance of the privatized companies improved, but we did not find significant trends or shifts in selected financial indicators.

- While there is nothing wrong with accepting reduced proceeds in exchange for "social benefits," the tradeoffs should be made explicit. Relying solely on valuation for setting prices for share issues at the Bourse involves considerable uncertainty (since valuation rests on projections of performance). It should be complemented by other techniques, such as book-building. Alternatively, the process can be further streamlined by tasking strategic investors with the preparation and implementation of subsequent IPOs.

(4) With one major exception, a company embroiled in a dispute with the Government, we found no significant impacts on employment and employment-related benefits. As a group, privatized manufacturing enterprises showed no change in total employment over the period 1990 to 1996, and more recent evidence suggests that total employment in the privatized companies actually increased by 6.5 percent. This result is partly due to selection bias (lack of serious overstaffing was a criterion of selection), partly to provisions in the conditions of sale (*cahiers des charges*), and partly to a traditional respect for employment relationships. Employees in a number of companies benefited from efforts to facilitate their participation in the privatization. However, communications with workers and their participation in the process were inadequate, especially given the commitment to transparency on the one hand, and the emphasis on protecting workers' rights and privileges on the other.

- The program needs reach out to the workers as a matter of course to familiarize them with the process and make them part of the privatization process. Effective communications with the stakeholder group most directly affected should be an integral part of all privatization efforts. It becomes part of the drive to change the business culture and enhance adaptive efficiency.

(5) The scope of the privatization program, as outlined in the enabling legislation, was rather ambitious, given the insistence on a carefully prepared case-by-case approach. While the list of "privatizables" may have been intended to define the universe for privatization, it has been widely interpreted as a target list, with specific deadlines. That may have affected perceptions of the success of the program, but also shaped the operating environment for companies that remained "on the block" for nine years without being privatized. With an uncertain status and a lame-duck management, the performance of these companies is likely to have suffered. We do not believe that the answer is a one-year program of targets, as proposed. There are always unforeseen opportunities and complications, and mid-stream adjustments confuse investors and management. Nor is the answer to keep the targets secret (as Tunisia has sought to do), because information will leak, and rumor and confusion are likely to be the result.

- A reasonable compromise is a “rolling” three-year target list that is updated every year, with rolling one-third of the companies assigned a priority for the first year. At the same time, efforts should be made to lower the profile of the respective *Ministère de tutelle* and expose the enterprises to competition and allow them to respond to competition in a market-oriented manner. Privatization should proceed in tandem with continuing reforms of the rules and procedures governing the management of state-owned enterprises, including increased transparency and accountability.

(6) The privatization program has focused on the sale of assets wholly or partly owned by the government. Using four main methods, it has sought to ensure transparency by stressing tenders and share issues on the stock exchange, reverting to private placement whenever necessary. To our knowledge, the program has had only marginal involvement with other privatization initiatives in the Kingdom of Morocco, notably private sector participation through concessions in infrastructure sectors (water, electricity) or other forms of private-public partnerships.

- We support current efforts to approach all forms of privatization in a coherent framework; however, we would caution that these efforts not delay swift progress on privatization initiatives now under way in infrastructure sectors. The main emphasis now is on the development of appropriate regulatory structures and capabilities to complement the growing involvement of the private sector.

(7) There has been no adequate monitoring of the performance of the privatized companies, apparently not even with respect to their commitments under the sales contracts (*cahiers des charges*), such as job protection — although large-scale layoffs would become known very quickly. While the program has established a reputation for transparency and fairness, it is easy to imagine situations in which an investor fails to live up to certain commitments and therefore in effect invalidates the reasons for selection.

- If the scope and complexity of the program expand because the Government feels compelled to insist on a range of criteria and conditions, there must be sufficient resources to monitor and enforce compliance. Without such provisions, the potential for (actual or perceived) abuse exists.

(8) A similar proposition applies to investment commitments. Seeking such commitments and using them in the evaluation of bids is a commonly accepted element of privatization programs. The post-privatization role of such investment commitments, however, has typically been problematic, even if adequate resources can be allocated to monitor the investment performance of the new owners (as in Germany). Actual investments are not always easy to confirm. Moreover, any investment plans over an extended period of, say, five years are subject to revision as market conditions change. Whether the adjustments are reasonable within the scope of the contract then becomes a matter of negotiation between the government and the investor — opening the door to discretionary actions.

- As long as only qualified, reputable bidders are allowed to participate in a tender (typically through an appropriate prequalification), planned investments become part of their own business plan and therefore part of their valuation, which in turn determines the price they are willing to offer. Substituting bureaucratic judgment for the judgment of the investor by using investment commitments as an evaluation criterion raises certain questions — especially when the resources for monitoring and enforcement are scarce. However, if proposed investments factor in the evaluation and selection of bids, mechanisms must be in place to ensure that investors honor these commitments, or that adjustments are negotiated in an open and transparent manner.

(9) Proceeds from the privatization program have been treated in effect as part of the “normal” revenues of the Treasury. That approach foregoes an opportunity to demonstrate the beneficial impacts of privatization by earmarking proceeds for some concrete purpose, either debt reduction or selected social investments. Moreover, it can complicate the Treasury’s cash management and unsettle the market for government securities. The use of privatization bonds or similar instruments can further contribute to this problem. While they are in principle useful tools in smoothing out cash receipts from privatization, they require careful coordination between the Treasury’s management of government securities and the sale of real assets.

- To exploit opportunities to build further political support for privatization and to protect government securities markets against disturbances, proceeds from privatization should be treated as extraordinary revenues and earmarked for special purposes.

(10) The management of share issues has been marked by largely deliberate underpricing, yielding sometimes spectacular oversubscriptions, and ensuring rapid appreciation immediately after privatization. Such an approach often results in a “flowback effect,” when investors, especially small investors, sell their shares to cash in on their windfall gains.[112] This effect has been limited in Morocco, in part because the market as a whole has been buoyed by the mobilization of domestic investment capital, lack of placement alternatives, and the relatively small number of traded companies.

- As these conditions change, future privatizations may require different approaches to pricing, and provisions to protect against excessive price swings, in particular the flowback effect.

[112] See Frémond (1998) for suggestions to manage such price swings.

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