

CREATING A SUSTAINABLE PRIVATISATION PROGRAMME IN THE GCC

LEARNING LESSONS FROM PAST FAILURES

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Privatisation has consistently shown to grow output, raise profitability and increase efficiency. These improvements, in turn, increase growth in GDP – the source of prosperity of all. The experience of other countries shows that private gains need not erode the provision of public goods: competition can improve outcomes for all. Nor does increased efficiency necessarily lead to foreign control – this decision is ultimately in the hands of the government. Yet, despite the obvious benefits, the history of privatisation in the GCC is littered with stalled efforts and outright failure. This paper examines why this has been the case and what can be done to ensure future privatisation efforts in the region succeed.

PRIVATISATION – A STRATEGY FOR ECONOMIC AND SOCIAL DEVELOPMENT

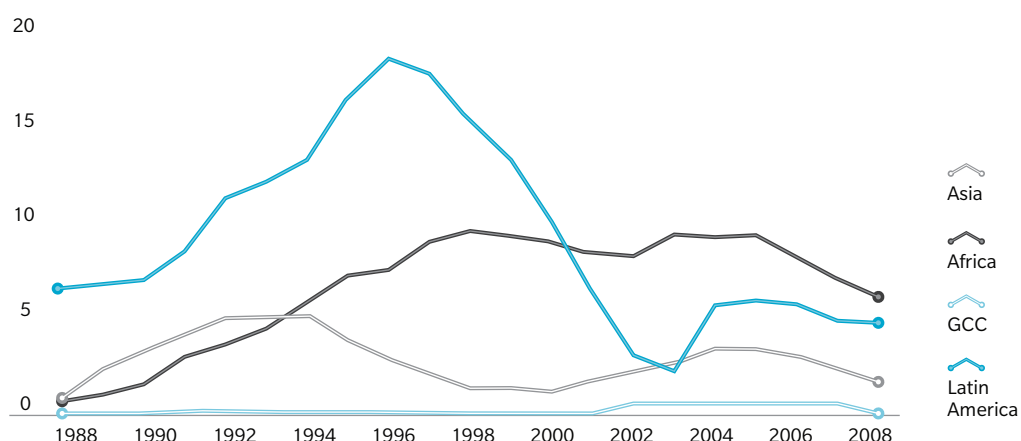
Privatisation, when well executed, can bring clear benefits to the economy in terms of economic growth, higher employment, and an improved fiscal balance for the government. Shifting assets to the private sector can reduce government costs by removing inefficient and unprofitable companies from a state's balance sheet. Privatisation can also provide governments with the opportunity to inject money into the treasury in the short term and help make corporate tax initiatives more profitable in the longer term.

While often viewed purely in fiscal terms, privatisation can also provide important economic and social improvements. Economic benefits include those of introducing or enhancing market competition, attracting local or foreign investment (by extending technological and management know-how) and developing capital markets¹. Social benefits can include enhancing provision of a good or service to the public, and involving citizens in the ownership of the economy through the distribution of shares.

Since the 1980s, there has been a worldwide trend toward privatisation. The trend began in advanced economies, notably with the privatisation programme in the United Kingdom under the then Prime Minister Margaret Thatcher. This was followed by privatisation initiatives in Latin America, Asia and then Africa. As Exhibit 1 shows, GCC countries have remained largely absent from the privatisation trends initiated in emerging economies. As a result, state ownership of the economy remains high in the GCC region.

Exhibit 1: Privatisation trends by geographic region

SOE PRIVATISATIONS IN EMERGING REGIONS, 1988-2008
SOE ASSET SALES AS % GDP



Source: Author calculations. Data from World Bank Privatisation Database (2015); IMF World Economic Outlook Database (2016)

1. "Economic Diversification in the Oil-Producing Countries: The Case of the Gulf Cooperation Council Economies", United Nations, ESCWA, New York, 2001

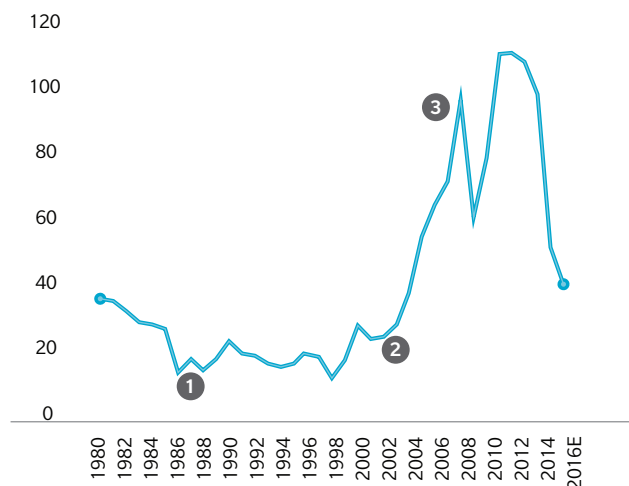
PRIVATISATION IN THE GCC – A SORROWFUL TALE SO FAR

Until now, GCC countries have mostly not joined in with the global trend toward privatisation, though there have been some efforts in this direction.

During the 1990s, after a sustained period of low oil prices, GCC governments sought to diversify their economies and reduce their dependence on oil revenues. Thus began the initiation of active talks of privatising state owned entities as this offered the opportunity to improve their fiscal position. In 1994, for example, Oman and Saudi Arabia both included privatisation goals within their short and mid-term development plans. Two years later Kuwait requested a World Bank study on the potential benefits of privatisation for the Kuwaiti economy. Little came of these efforts, however.

Exhibit 2: Oil price movements drive commitment for privatisation in GCC

OIL PRICE EVOLUTION
IN US\$ PER BARREL, 1980–2016, YEARLY, NOMINAL RATE



PRIVATISATION EFFORTS

- 1 • Oman and KSA include privatisation goals in development plans
• Kuwait requests World Bank study on privatisation benefits
- 2 • KSA formulates dedicated privatisation strategy and specifies services to be privatised
- 3 • Privatisation progress stalls in all GCC countries

Source: Bloomberg, BP, Oliver Wyman Analysis

There are two main reasons for this. The first is motivation. Efforts toward privatisation in the GCC have been largely correlated with downward movement in the oil price (see Exhibit 2). When low prices lead to fiscal pressures, privatisation is pursued as one option among a range of measures to offset lost revenues. Given the GCC economies' reliance upon income from oil, diversification makes sense in this context. However, once oil prices rise past the fiscal break-even point, the pressure to reform quickly dissipates and the privatisation plans are quietly dropped.

The second reason why privatisation has stalled in the GCC is that a number of previous, high profile attempts proved unsuccessful. These failures act to discourage further efforts, as privatisation is now widely seen as a potential political risk. In each of the failed attempts a combination of factors worked against the privatisation being successful. Most notable among these was the overall lack of political commitment to the process, the consequent failure to produce favourable agreements on the terms and conditions for potential investors, the lengthy and overly complicated nature of the process itself (including too much “red tape”), and fears about the impact of the agreement on the workforce (see examples below in Exhibit 3). An additional political risk concerns the views of citizens, many of whom fear that privatisation may result in the loss of control of industries that are mandated to provide essential public services like water and electricity. This worry is amplified when essential utilities are sold to foreign firms.

Exhibit 3: Failed privatisations

COUNTRY	PRIVATISATION PROJECT	YEAR	REASONS FOR FAILURE
Oman	Salaleh Airport & Seeb International Airport	2000–2004	• Excessive bureaucracy and lengthy discussions • Unattractive terms of agreement for investors • Lack of transparency in government decisions
Saudi Arabia	Saline Water Conversion Corporation & Saudi Electricity Company	2004–today	• Lack of political commitment • Fear over adverse effects on labor market • Slow progress in institutional infrastructure
Kuwait	Kuwait Airways	2010–2012	• Restrictive contract terms on employee’ wages and working conditions • No final agreement with interested companies on asset value • Lack of political commitment

Source: Kuwait (Chazan (2012). Privatisation: Business questions state’s commitment); Oman (Jasim Ali (2004). GCC Insights. Oman’s privatisation drive suffers setback); Saudi Arabia (World Commerce Review (2010). Privatisation of Public Enterprises in Saudi Arabia: Why the process is slow)

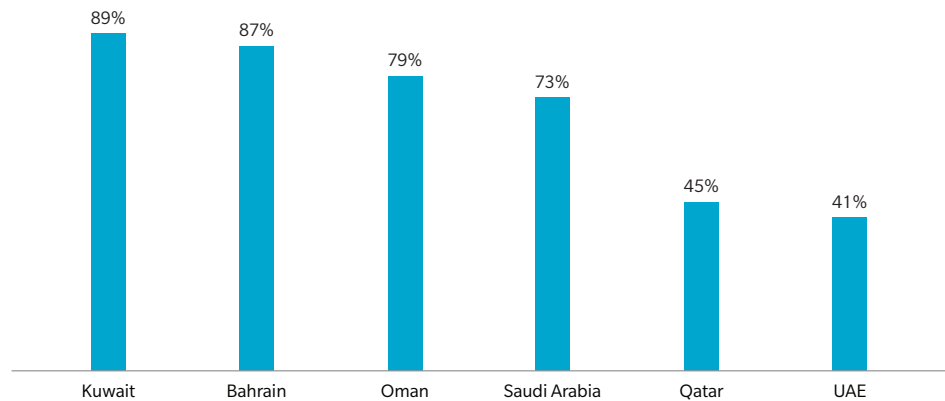
THE STAKES ARE HIGH

Diversification is critical for many GCC countries which are overly reliant upon the sale of oil for government revenues (see Exhibit 4). Currently, Kuwait is the most depend of all with 89% of all its government revenues derived from oil. In the United Arab Emirates, the most economically diverse country in the GCC, oil still represents 41% of all government revenues².

2. “Regional Economic Outlook Update: Middle East and Central Asia, Statistical Appendix, Middle East and Central Asia Department,” International Monetary Fund, 2016

Exhibit 4: GCC governments' dependence on oil

GCC OIL REVENUES AS % OF GOVERNMENT REVENUES
%, 2015



Source: Bahrain MoF, UAE MoF, Qatar MoF, analyst reports, Oliver Wyman analysis

Given this reliance, the recent declines in crude oil prices have led to a deterioration in the fiscal positions of GCC countries. Each country has responded by incorporating aggressive cost-cutting and revenue-generating strategies (from non-oil sources) within their overall economic transformation plans. In this context, privatisation has the potential to be an integral part of such reform, given that a large percentage of each of these economies is currently in the public sector.

Exhibit 5: Potential effects of privatisation on GCC

SIZE OF GCC PRIVATISATION PROGRAMMES

POTENTIAL BENEFITS OVER 15 YEARS
ACROSS GCC

SALE OF 25% OF GOVERNMENT ASSETS	1	Create value in GDP terms of approx. US\$100 billion
	2	Shift 300,000 public sector jobs of GCC nationals to the private sector
	3	Permanently reduce GCC government budgets by 5%

Source: SOE assets. These effects exclude the privatisation of state oil companies and oil assets. If included, the benefits would be far greater

Our analysis suggests that the privatisation of 25% of government-owned assets (equivalent to 1/4 of government entities) is an achievable target for GCC governments, over a fifteen year period³. This would include the privatisation of state owned enterprises that are already operating in competitive sectors as well as key infrastructure, like power generation and transport infrastructure, but not oil exploration, country oil reserves or public services, such as schools or hospitals. Selling these assets has the potential to raise the aggregate GCC GDP by US\$100 billion (equivalent to 7% of 2015 GCC GDP)^{3,4} (Exhibit 5).

This increase in GDP is driven by two effects privatisation has on the economy. First, newly privatised companies are encouraged to pursue profit maximisation strategies that are often expansionary. Second, the barriers to entry in the newly privatised industries will be lower than was previously the case, when these industries were solely in the public sector. This makes it easier for competing firms to challenge incumbents, which increases aggregate spending and investment in the sector, and accordingly accelerates growth.

Given that certain currently unprofitable firms are reliant on government subsidies at the moment, privatisation also has the potential to permanently reduce government budgets by 5%, while transferring 300,000 government national employees from the public to the private sector (equivalent to 9% of total 2015 GCC public sector workforce)³.

If GCC oil producers were to be included as candidates for privatisation, the benefits would be even larger. An IPO of 5% of Saudi Aramco alone is reported to have the potential to raise US\$100 billion⁵, equal to ~20% of the country's net foreign reserves. Even if such a sale were to be less profitable than the analysts predict the funds would nonetheless help alleviate the fiscal imbalances the country faces in the wake of low oil prices.

Perhaps more important than its fiscal effects is that privatisation has the potential to offer a number of economic and social benefits. Of critical importance is that privatisation is regularly shown to help increase efficiency, both in terms of how companies are run and how capital is allocated. Public entities are often inefficient, as they may be required to pursue political objectives such as ensuring employment, as opposed to profit maximising strategies. Privatisation also increases the profit motive, which can enhance decision making in organisations and can improve the quality of goods and services by fuelling innovation and placing the emphasis on attracting and retaining customers. With regard to capital, privatisation reduces the need for government investment and increases the amount of private investment in the economy. This shift can in itself have positive effects, as private capital is generally allocated more efficiently than public money which could be better invested in social policy (e.g. education and healthcare).

It should also be noted that the potential benefits of privatisation align with the overall objectives of GCC governments in that they are seeking to create dynamic, diversified economies. Privatisation could potentially form a central plank in these transformation plans and would be complementary to initiatives in labour market reform, tax policy and investment in private sector competitiveness.

3. Oliver Wyman analysis based on project experience

4. Barnett, "Evidence on the Fiscal and Macro Economic Impact of Privatisation," International Monetary Fund, 2000

5. A. Dipaola & W. Mahdi, W., "Saudi Aramco", Bloomberg Quicktake, 2016. Retrieved at: <https://www.bloomberg.com/quicktake/saudi-aramco>

WHY IS IT SO DIFFICULT?

Past failures suggest that there are four primary obstacles to implementing a successful privatisation programme in GCC countries (see Exhibit 6).

Exhibit 6: Four obstacles represent major challenges to successful privatisation

1		Lack of sustained political commitment	- Government agendas change due to different circumstances or new key players - Institutional prerequisites are not implemented in due time and thus stall progress
2		Public sector role in labour force	- Labour market might not be able to absorb redundant workers - Resistance from labour force can be significant
3		Private sector role and capacity	- Domestic private sector is not prepared and lacks experience for major investments - Foreign ownership rights are insufficiently assured and foreign investments are restricted
4		Bureaucratic processes, government resistance & red tape	- Conflicting agendas in the government hinder progress - Lack of experience with regulatory tasks vis-à-vis control over operations

Lack of sustained political commitment: Establishing a privatisation programme requires substantial political commitment by the government, particularly when aligning the interests of the numerous stakeholders. Sustaining such commitment can prove challenging over the longer term, however, because many of the political costs of privatisation are often incurred in the short term, particularly in regard to the impact on the workforce, while the benefits to the population, in terms of improved productivity and competitiveness may be realised only in the longer term. This is all the more true in cases where such benefits are accrued only after the point when the Ministers concerned have left office.

Public sector role in the labour force: In GCC countries, the public sector is the primary employer of their citizens. The share of nationals in the public sector is 72% in Saudi Arabia⁶, 86% in Kuwait and 87% in Qatar and in excess of 90% in the UAE⁷. This data includes government-linked companies. In each country, nationals employed in the public sector enjoy high wages and job security. These entities are, in effect, often acting as a substitute for a welfare state. Until recently, for example, Kuwait Airways had ~5,000 staff while operating ~10 planes⁸, a staff-to-plane ratio of 600:1, which is much higher than other national carriers such as American Airlines (108:1) or United Airlines (119:1)⁹ and far higher than low cost airlines like AirAsia (37:1)¹⁰.

6. M. Baldwin-Edwards, "Labour immigration and labour markets in the GCC countries: National patterns and trends", LSE Kuwait Programme on Development, London, 2011

7. Ragui Assaad, "Making sense of Arab labour markets: the enduring legacy of dualism," IZA Journal of Labour & Development (3.1), 2014

8. "State-Owned Enterprises in the Middle East and North Africa: Engines of Development and Competitiveness?" OECD Publishing, Paris, 2013

9. "Employees Productivity data," MIT Airline Data Project, 2016. Retrieved at: [http://web.mit.edu/airlinedata/www/Employees & Productivity.html](http://web.mit.edu/airlinedata/www/Employees&Productivity.html)

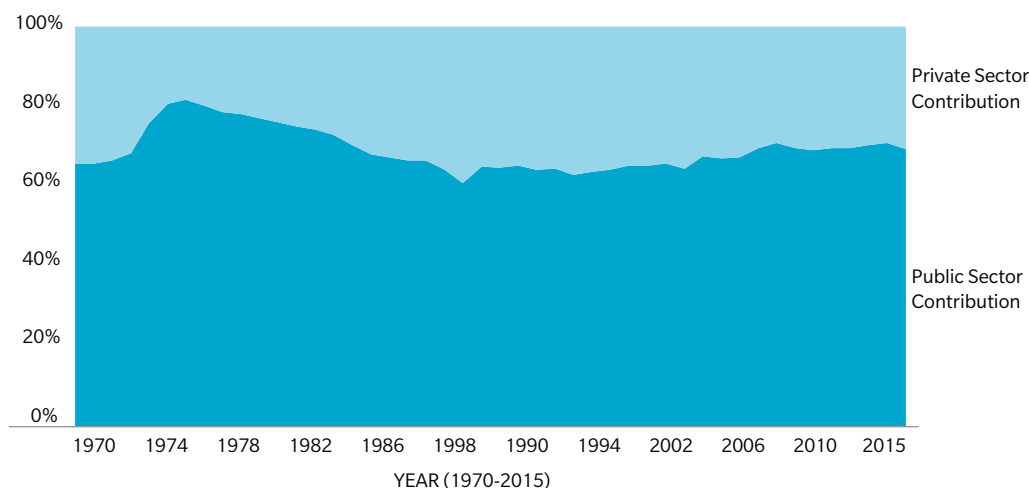
10. "Five-year financial highlights, AirAsia", 2015. Retrieved at: <http://www.airasia.com/my/en/about-us/ir-5-year-financial-highlights.page>

Privatisation, through stimulating competition and profit seeking, can also result in a reduction of the labour force. This poses two problems. First, it can result in resistance from those workers who risk losing their jobs. Second, it can have a negative effect on employment overall and, by extension, on economic output if other sectors of the economy are not ready to absorb workers who have been made redundant. Privatisation initiatives must therefore overcome any short-term effects on labour and output if they are to be successful.

Private sector capacity and capability: The share of the private sector in most GCC countries is small (see Exhibit 7 for the example of Saudi Arabia, by far the largest GCC market). Overall, GCC countries are perceived to have weak private sectors, both from a competitive point of view and a regulatory perspective¹¹. Domestic companies are seen as uncompetitive as a result of the cumbersome regulations related to foreign ownership and management, inadequate access to private capital markets, high wage rates for domestic employees and low productivity levels. These factors stem from the fact that the private sector in all GCC economies is comparatively small and dominated by a few firms. Given this situation, the domestic private sectors of GCC countries are unlikely to have the capacity to invest in newly privatised firms. This makes it likely that the governments concerned will be required to sell assets to foreign buyers. This can further complicate privatisation initiatives, given that the prospect of foreign ownership can make it more challenging for the political leadership to sell the privatisation to the public. Furthermore, weak institutions will make it difficult to regulate the industries once they are privatised. Thus, even in instances where privatisation might be desirable, these institutional factors inhibit reform.

Exhibit 7: Private and public sector contribution to GDP in Saudi Arabia

GDP COMPOSITION



Source: Saudi Arabia Monetary Agency (2016), Oliver Wyman Analysis

11. Steffen Hertog, "The private sector and reform in the Gulf Cooperation Council." Research paper, 30, LSE Kuwait Programme, London, 2013

Inertia in the administrative process, inter-departmental resistance and red tape:

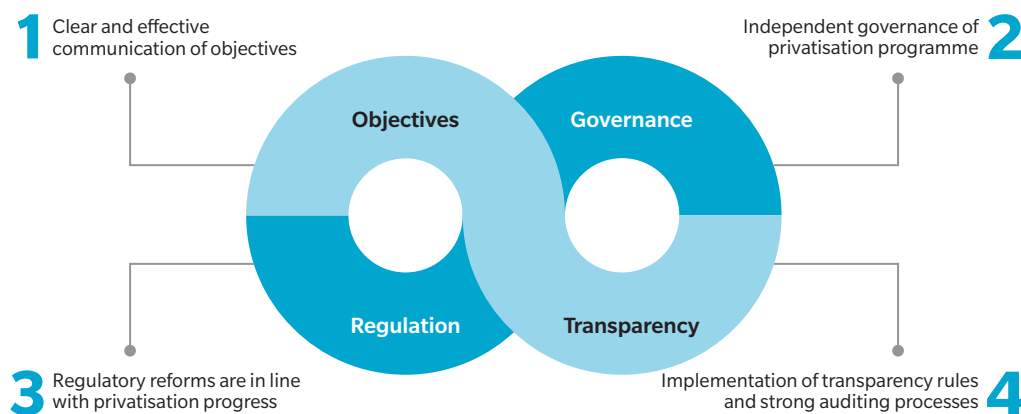
Inter-departmental disagreements over whether and how to privatise public assets can occur within the government executive. For example, while the finance ministry's goal might be to reduce public spending by privatising a port, this might conflict with the transport authority's perceived ability to manage shipping. Similarly, while the ministry responsible for power and water supply might agree to sell assets, there can be inter-ministry disagreement about which government entity has the authority to dictate the terms of the sale – and the very sale of electricity and water services to the private sector may conflict with the security objectives of the ministry of interior. Conflicting agendas within the government present a key challenge to privatisation and can often lead to inertia within the administrative process. These obstacles are frequently compounded by “red tape”. For example, in Saudi Arabia, the largest GCC country, opaque regulation and cumbersome procedures have made it difficult for foreign investors to enter the market, or to obtain visas for foreign workers once they are in the market. While the law does not stipulate partnering with local companies, as a result of this complex web of regulations, the easiest way to do business in the Kingdom is still seen to be working through a well-connected, prominent business or family¹².

12. A. Allam, “Saudi red tape frustrates foreign investment,” Financial Times, London, 2016. Retrieved at: <https://www.ft.com/content/3c6413ce-a381-11e3-aa85-00144feab7de>

KEY SUCCESS FACTORS FOR A PRIVATISATION PROGRAMME

An institutionalised privatisation programme is required to overcome these powerful obstacles and to help ensure that the privatisation initiatives continue even if political resolve evaporates, employees show resistance, local businesses oppose international competition, or the administration resists change (Exhibit 8).

Exhibit 8: Four dimensions are crucial to ensuring effective privatisation



CLARITY OF OBJECTIVES AND EFFECTIVE COMMUNICATION WITH ALL STAKEHOLDERS

Setting clear objectives is the first step in any effective privatisation programme. Well-defined objectives will help determine the ultimate direction of the privatisation. The objectives need to be tied to strong and consistent messages that are communicated to all stakeholders. These two goals go hand in hand. For example, while the privatisation initiatives in the GCC need to have a strong fiscal component, given the current budgetary situation, the initiatives should be structured so that they also leverage potential social and economic benefits, such as spurring competition in the non-government sector or increasing citizen's participation in the economy through share ownership.

The government needs to develop a clear, unified communication strategy that focuses on the long-term benefits of the structural reforms. Clearly articulating the objectives of the privatisation initiative can help unite stakeholders around the benefits by showing them areas where their interests align. The communication must engage all the relevant stakeholders, especially the unions and other groups that may oppose the initiatives.

The government will need to communicate a clear plan to explain how it will address the concerns of stakeholders who might be affected negatively by privatisation. It is crucial to manage expectations, issuing a consistent message that focuses on the longer term. The communications should articulate clear, realistic outcomes that are measurable and that can be tracked throughout the process.

A successful communication strategy engages all stakeholder groups, increases transparency and aligns actors with seemingly conflicting agendas. This is important even when the privatisation programme is successful, as is exemplified by what happened in Jordan. Though Jordan implemented a successful privatisation strategy in the 1990s, one that brought about fiscal, economic and social benefits for the population (see Exhibit 9), it is not viewed favourably by all stakeholders, despite its success, because the strategy was not well communicated to its citizens.

Exhibit 9: Jordan's privatisation law addressed the key objectives of the programme

Fiscal	• Alleviating the debt burden of the treasury by ceasing its obligation to offer aids and loans to unsuccessful and unprofitable enterprises
Economic	• Raising the efficiency, productivity and competitiveness of economic enterprises • Improving the management of economic enterprises with modern methods which include the use of advanced technology to enable them to create stable markets and to penetrate new markets through their ability to compete in international markets • Contributing to the encouragement of local, Arab and international investments by providing a favorable investment environment
Social	• Stimulating private savings and directing them towards long-term investments to strengthen the local capital market and the national economy

Source: World Bank (2012). Privatisation: Learnings from Jordan & Oliver Wyman Analysis

EFFECTIVE GOVERNANCE OF THE PROGRAMME

To ensure the effective governance of privatisation, the government needs to do two things: put in place laws to guide the process and create a central body to steer it.

Privatisation law: Putting in place laws to govern privatisation offers three primary benefits. First, they ensure better transparency by establishing the “rules of the game”. This can help reduce opportunities for corruption or nepotism and decrease the likelihood of the privatisation initiative being derailed by vested political interests. Second, such laws help bring consistency to the process, including in the areas of decision making, in countries that otherwise do not have a history of privatisation – this can be an important consideration for investors. A privatisation law can, for example, clarify the methods by which transfer of assets can occur (IPO, trade sale, concession, etc.). Third, the law can help ensure that the money from the sale of the assets is only used to meet the goals of the privatisation programme.

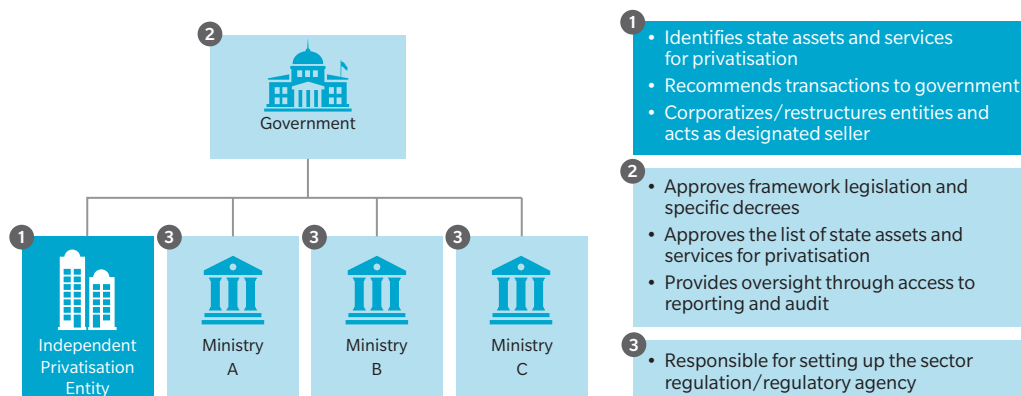
Dedicated central body to drive the process: The government will need to develop a dedicated privatisation body to better define, prepare and execute its privatisation agenda (Exhibit 10). This central body will be mandated with a well-defined set of tasks:

- Ensure coordination of the privatisation strategy
- Provide precise and strong guidance for enacting the privatisation
- Transfer knowledge through “learn by doing” – with the goal of ensuring that the knowledge required in the process does not remain housed in the ministries but is transferred across all the entities involved in the process

Exhibit 10: An independent privatisation entity is crucial for effective follow-up of privatisation strategy

BEST PRACTICE GUIDELINES ON PRIVATISATION GOVERNANCE

TASKS OF ENTITIES



Source: OECD (2010), Privatisation in the 21st century, Oliver Wyman Analysis

Centralising the privatisation initiatives through the creation of a dedicated entity will help ensure that the government’s strategy is well coordinated. The experiences of a wide range of countries, including those of Germany, Jordan, Malaysia and Singapore, have shown the effectiveness of putting in place such a body (see Exhibit 11). Though the organisational structures and processes of the privatisation entity in each country differ to some extent, they all share a number of similarities: each entity is independent, reporting directly to a high ranking individual in the government, they manage the timeline and overall process of the privatisation programme, and are responsible for administering the tendering process.

The examples of these countries suggest that when empowered with a strong mandate, a dedicated privatisation entity can help overcome the conflicting agendas of different government ministries and improve the overall transparency of the privatisation process. Importantly, the presence of such an entity can make the bidding process more transparent to investors, thereby attracting greater interest in the privatisation programme.

Exhibit 11: Dedicated privatisation entities

COUNTRY	NAME OF ENTITY	ORGANISATIONAL FUNCTION(S)	MAIN TASKS
Germany	Trust Agency (1990)	Reports directly to the government	- Decide which companies to privatise - Oversee restructuring and selling of state-owned assets - Administer tendering process, review investments plans and select investor
Jordan	Executive Privatization Unit (1996)	Reports to the Higher Ministerial Committee for Privatisation lead by the Prime Minister	- Select privatisation projects and appropriate privatisation form - Account for project/asset valuation - Negotiate privatisation transactions and give recommendations for contract winners
Malaysia	Interdepartmental Committee on Privatisation and Privatisation Task Force (1991)	Reports to the Prime Minister's Economic Planning Unit	- Plan, coordinate, monitor, and evaluate implementation of the privatisation programme - Monitor progress of feasibility studies and coordinate privatisation process of companies
Singapore	Public Sector Divestment Committee (1985)	Reports to the Cabinet of Ministers	- Decide on assets to privatise and the extent of government assets reduction - Develop and monitor compliance with time horizon to achieve overarching privatisation goals - Coordinate execution of privatisations through "Privatisation Project Teams"

Source: Carlin, W. & Mayer, C, "Privatisation and Deindustrialisation in East Germany; Privatisation – Lessons from Jordan", World Bank, 1995; "Privatisation in Jordan", Amman Stock Exchange; Shankar an Namibia, "Revisiting privatisation in Malaysia: The Importance of Institutional Process," Malaysian Institute of Economic Research, July 2009; M. Shamsul Haque, "Public Administration and Public Governance in Singapore"; Oliver Wyman Analysis

It should be noted that the creation of such a body can produce certain drawbacks. It can initially slow down the privatisation process, since assets from the various ministries first need to be transferred to the new central entity. Those staffing the entity might also be confronted with a steep learning curve, as they may lack specific sector knowledge relevant to the assets being sold. These drawbacks can be overcome, however, if the entity is provided with the resources it requires, in terms of personnel and finance, to achieve its goals.

For countries that do not have previous experience of privatisation, as is the case in the GCC, the creation of a central privatisation entity can create many important synergies, becoming the institutional memory for how to enact privatisation successfully.

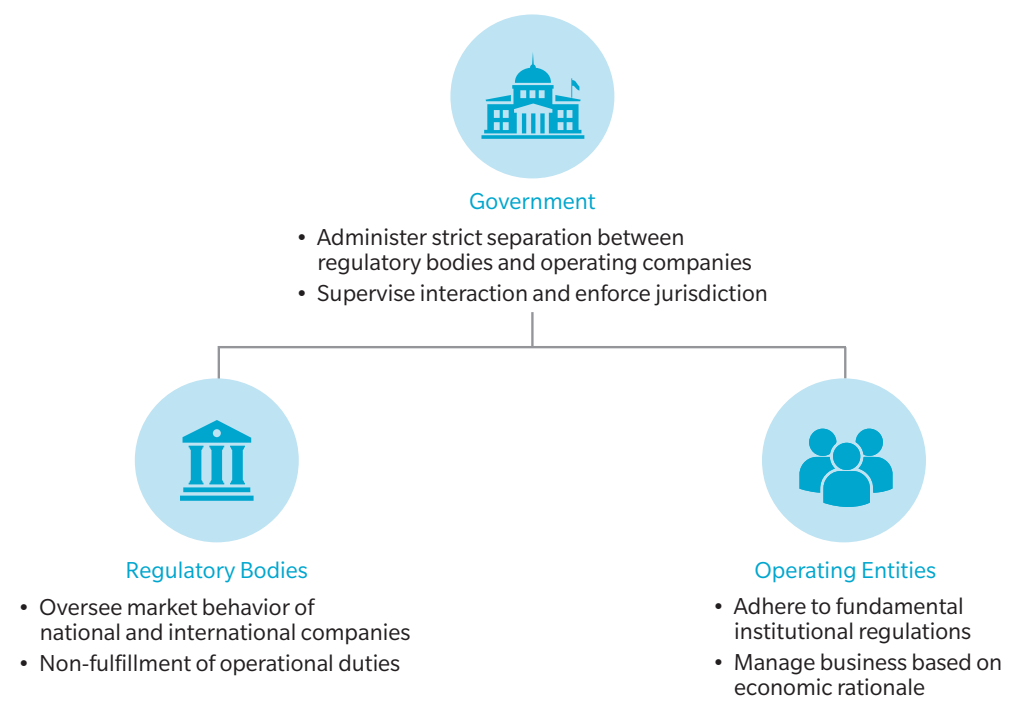
REGULATORY REFORM IN LINE WITH THE PRIVATISATION PROCESS

In general, GCC countries have an underdeveloped regulatory environment. Before an entity can be privatised it is imperative to understand the requirements for the effective regulation of the newly independent entity. This entails the clear separation of the entity to be regulated from the regulatory body (see Exhibit 12).

The enhancement of the regulatory environment will need to take account of broad-based regulation, such as those of competition law and environmental requirements, as well as regulations that apply specifically to the sector or industry in question. Establishing appropriate sector regulation takes a significant amount of time and effort, especially when starting from scratch.

The importance of establishing an appropriate regulatory framework is underlined by the failed privatisation of Senegal's national electric power company, Senelec. In 1998, the entity was sold to a Canadian consortium Elyo/Hydro-Quebec. However, the privatisation was enacted without first establishing the regulatory framework necessary to govern the newly privatised entity, including price caps and service guarantees. As a result, the privatisation lacked legitimacy in the eyes of the public, as well as in certain political circles. As a consequence of this the government decided to renationalise the entity in 2000¹³.

Exhibit 12: The government has to ensure that regulatory bodies work independently of operating companies



13. J. C. Berthélemy et al., "Privatisation in Sub-Saharan Africa: Where Do We Stand?", Development Centre Studies, OECD Publishing, 2004

Exhibit 13: Guiding principles for designing an effective regulator

	Long term focus	• Has its own objectives and duties, clearly defined, communicated and not subject to change based on short term goals of the government
	Independence	• Political: Takes autonomous decisions independently from any political influence and the short term goals for elected officials • Financial: Annual budget allocation with autonomy in the use of the budget with sufficient human and financial resources • Operational: Legally and functionally independent from any other public or private entity
	Effectiveness	• Proactive in creating and reviewing policies • Effective design of policies to avoid limiting economic growth and red tape
	Transparency	• Transparent in communicating policies • Non-discriminatory in both supervision and enforcement

There are a number of well-established guiding principles for establishing an effective regulator (see Exhibit 13). Key among these is that the regulatory structure must be clearly separated from the owners of the entities, i.e. those empowered with enacting the privatisation process should not own the assets. For example, if the energy ministry is empowered with privatising the state electricity distributor, it is imperative that the electricity regulator be a distinct and separate entity and should not be in any way responsible to or be part of the energy ministry. A common approach to ensuring that the regulatory function is separate from the ownership function is to move the assets that are up for sale from the ministry concerned into an independent holding company that is responsible for their sale, while keeping the regulatory function within the ministry.

Failure to separate the regulatory function from the ownership function can create conflicts of interests in the privatisation process, including the possibility that the ministry concerned might enact regulation favourable to the buyer (and unfavourable to the public at large) in order to ensure a higher market price for the sale. Successful regulation, in contrast, will help improve the government's control of the privatisation process.

IMPLEMENTATION OF TRANSPARENCY RULES AND STRONG AUDIT PROCESSES

It is essential that there is a high level of transparency in the privatisation process if potential investors are to be able to make informed decisions about whether or not the assets being privatised by the government are being sold at a fair price. This requires full disclosure of information used to determine the value of the assets, including that regarding the market and regulatory environment. Ensuring transparency in this manner can help reduce the opportunities for corruption by guaranteeing that the selection criteria for awarding tenders are clear-cut and non-discriminatory.

Failure to ensure transparency can have three negative effects. First, it can reduce the willingness of investors, in particular foreign investors, to bid for government assets. Reducing competition in this way is likely to lower the price at which the government assets are sold. Second, it can create the perception that the country is not getting a fair price for its government's assets, thereby reducing overall public acceptance of the entire privatisation process. Third, the lack of transparency can lead to ambiguity regarding the expected outcomes of the privatisation, which can have negative effects for the policy and create uncertainty in the markets. Transparency allows all parties, including the government, the public and the private sector to plan for the impending privatisation: this can increase the likelihood of its success.

One way to improve transparency is to ensure that the privatisation programme is monitored and audited by a well-financed, independent agency, which would report directly to parliament or some other ultimate authority. Auditing provides legitimacy to the privatisation and ensures both investors and the public that any transactions agreed upon have been conducted in an optimal and fair manner.

The United Kingdom's National Audit Office is an example of one such independent body. The Audit Office is overseen by a parliamentary committee that comprises Members of Parliament and scrutinises all government expenditures, including those related to privatisation, on behalf of taxpayers. By engaging in the privatisation process, NAO can provide unbiased advice to parliament on the efficacy of a privatisation initiative (see Exhibit 14). For example, in 1991 the UK government considered fully privatising two entities, National Power and PowerGen, which at the time generated most of the electricity produced in England and Wales. Based on the findings of the UK National Audit Office regarding the potential benefits of phased sales, the treasury decided instead to sell only 60% of the utilities' shares at that time¹⁴.

Exhibit 14: Transparency – individual transaction audit in the UK

	Context of the sale	Explains the context, company's role in delivering universal services and government sale objectives
	Restructuring the business	Examines the work to transform the company's performance and the effects on the government's balance sheet
	Advisors, transaction alternatives and valuation	Examines the appointment of advisors, selection of IPO process and valuation of the company
	Book-building, final demand and pricing	Examines how demand increased during the book-building process and how the share price and ownership of the company changed after the sale

Source: UK National Audit Office, (2014), Oliver Wyman Analysis

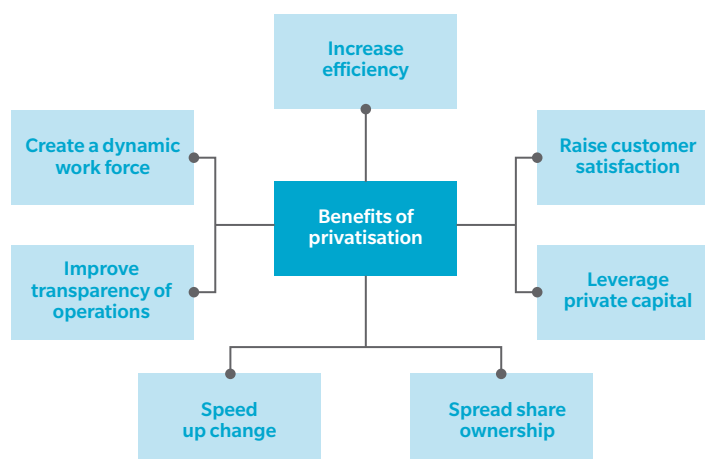
14. EUROSAT – ARABOSAT, New ways of providing public services – privatisation, EUROSAT Private finance (PFI and PPP), 2006

BENEFITS OF BUILDING A SUSTAINABLE PRIVATISATION PROGRAMME

Setting up and establishing a privatisation programme takes a long time. Jordan started in 1996, but it was not until five years later in 2001 that tangible results were noticed.

The longer-term nature of such programmes sometimes discourages governments from embarking upon privatisation. It should be noted, however, that privatisation can not only help improve the fiscal situation for GCC governments in the wake of lower oil prices but that it can also lead to a number of much needed social and economic and benefits that are difficult to achieve by other means. Privatisation can:

Exhibit 15: Benefits of privatisation



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- **Increase efficiency:** Public entities are often inefficient, since they may be required to pursue political objectives such as ensuring employment, as opposed to profit maximising strategies. Privatisation increases the profit motive, which improves the efficiency of organisations
 - **Create a dynamic work force:** Public sector workers in the GCC often operate in an uncompetitive system that favours seniority over skills and effort. The privatisation of assets or management can allow entities to create hiring and promotion strategies that are more meritocratic. It can also allow firms to reduce costs by eliminating redundant jobs and by making more efficient use of labour
 - **Improve transparency of operations:** Private firms in the GCC (particularly those that are publically traded) are often required to report more detailed business accounts than those of public sector companies. Transparency can help reduce opportunities for corruption, as described by the World Economic Forum¹⁵

- **Speed up change:** GCC's private sector is less hampered by bureaucracy, so it is frequently able to implement change more quickly than public entities can. More adaptable firms adjust better to market changes and often provide more innovative solutions to customers
- **Spread share ownership:** Privatisation in the GCC has the potential to increase the extent to which citizens are invested in the societies in which they live
- **Raise customer satisfaction:** Privatising an industry can improve competition, which fuels innovation and produces an emphasis on attracting and retaining customers, resulting in improved outcomes for all. Note that this benefit is contingent upon ensuring privatised firms operate within an appropriate regulatory environment
- **Leverage private capital:** Privatisation reduces the amount of government investment and increases the amount of private investment in the economy. This shift can have positive effects as private capital is generally allocated more efficiently, and the money saved can be invested in improving social outcomes, such as in education or healthcare

Given its potential benefits, privatisation should be on the agenda of all GCC economies. Already, a number of countries in the region have started to take important steps toward embarking upon fresh privatisation initiatives. Kuwait, for one, has made privatisation a key component of its Fiscal and Economic Reform agenda and has drawn on international best practices in setting up a dedicated privatisation entity. The task for Kuwait, as for all other GCC countries, is to ensure that it sees through this lengthy process in order to realise its full benefits. This paper has sought to outline the steps that need to be taken on that journey, as well as some of the hurdles that need to be crossed along the way.

For a number of widely understood reasons, privatisation has until now had a somewhat problematic history in the GCC. This should not hold back the present initiatives. Given the required commitment, privatisation has the potential to inject vigor and energy into the reshaping of the GCC economies, so that they come to be characterised by dynamic, diversified and competitive private sectors.

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