

1 Perspectives on state-owned enterprise reform and privatization in the MENA region

An overview

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Introduction and background

In the mid-1990s, a more reformist and outward-looking policy perspective has emerged in the Middle East and North Africa (MENA) region. While this may partly be viewed as a response to the unsatisfactory growth record in the previous decade, it also seems to reflect coalition realignments seeking a faster trade integration with the world economy, greater scope for private sector development and wider access to international capital. In the new policy setting, the revitalization of state-owned enterprise (SOE) reform and privatization gains a critical importance. The unprecedented surge in world-wide privatization also provides a supportive international context for robust public-sector reforms in the MENA region.

In Western Europe, privatization has become a socially acceptable policy element in the reform agendas of governments after the vigorous implementation of the United Kingdom's (UK) privatization programme in the mid-1980s, the rationale of which is now endorsed by the British Labour Party. In Latin America, where state entrepreneurship has a long tradition, privatization was introduced as part of fiscal adjustment to the debt crisis in the early 1980s, following the early start in Chile in the post-Allende period. In the 1990s, privatization has come to be viewed as the cornerstone of structural policies in Latin America, which aim to improve resource allocation in a rapidly changing world economic environment.¹

After the collapse of communist regimes in Central and Eastern Europe and the former Soviet Union, the SOE reforms and privatization, together with a wide range of liberalization measures, have become central elements of a comprehensive transformation process to create market economies based on private property rights. Notwithstanding the unchanging nature of its political regime, China is considered as 'one of the leading practitioners of infrastructure concessions, in both electric power and toll roads' (Poole Jr 1996: 1–2). It is also reported that China endorsed in the Fifteenth Party Congress in September 1997 'radical reform for state enterprises, including outright divestiture of the state's stakes in all but the biggest firms' (Lieberman and Kirkness 1998: 1).

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These world-wide trends in privatization imply a massive transfer of ownership and/or control rights to the private sector, which may be underscored by the estimated value of US\$468 billion worth of state asset sales around the world (excluding give-aways under voucher schemes) over the ten-year period from 1984 to 1994 (Poole Jr 1996). In conjunction with other major trends (such as political liberalization, deregulation and advances in communications technology), the world-wide privatization has set in motion a far reaching dynamic process that is likely to induce deep changes in institutional relationships, behavioural patterns and market conditions at the local and global levels.

For developing economies, a notable consequence of this process has been the sharp rise in their long-term external finance from private sources, and diminishing role of official development assistance. Net long-term private flows to all developing countries increased from US\$42 billion in 1990 to US\$247 billion in 1996, reaching 87 per cent of total net flows. Foreign direct investment (FDI) has become the dominant form of net private flows, exhibiting a strong response to active privatization programmes in developing countries, mainly in Latin America and East Asia. During 1990–6, foreign investors (including FDI and equity investors) provided nearly 45 per cent of the total proceeds (US\$156 billion) from privatization sales in all developing economies (World Bank 1998).

For advanced market economies, the *ex-post* assessments of privatization point to its notable impact on the efficient functioning of markets and enterprises, widening share ownership and rebalancing of control between trade unions and management.² It is also stressed that privatization facilitates a more precise identification of the public-good elements of state enterprises (Bishop, Kay and Mayer 1994). This is an important contribution to the redefinition of the role of the state in a rapidly transforming economic environment. In practice, fiscal relief appears to have been an objective of secondary importance. The UK privatization experience also provides a strategic lesson to late reformers. The post-privatization regulatory control is generally inefficient, and the benefits of privatization are more fully realized when competition is introduced into 'previously monopolized and regulated network utilities' (Newberry 1996: 1).

In the transition economies, the impact of privatization has been more difficult to assess, because the process started within the unfavourable setting of trade disruptions and macroeconomic disorder, which resulted in the collapse of output and disarray in sectoral structures in the early 1990s.

The big-bang approach to privatization received considerable criticism in much of the earlier research, which stressed the merits of incremental reforms and the start-up of new private enterprises (Milor 1994, Akyuz 1994). In turn, proponents of rapid privatization were more concerned with the risks of reform reversals, diversion of state property (by managers and workers) in an ownership vacuum and prolonged drift in corporate governance in the course of slow and hesitant privatization (Sachs 1991).

More recent analysis of former socialist economies indicates that consistent policies for financial discipline, domestic competition and macroeconomic control have fostered a more rapid growth of private firms as well as improved performance in state enterprises (World Bank 1996 and Sachs 1996). In this context, Stiglitz makes a noteworthy observation: 'China has sustained high growth by extending the scope of competition without privatizing state enterprises. In contrast, Russia privatized extensively without doing much to promote competition, and the economy suffered' (Stiglitz 1997: 3).

As for developing countries, the evaluation of their SOE sectors and reform experiences has always been a tricky and challenging task for researchers. In most cases, the SOE sectors have been established to serve a multiplicity of objectives in political, economic and social spheres, calling for interdisciplinary approaches to their analysis. A heavy reliance on SOEs as an institutional vehicle of national development has typically resulted in extensive political patronage, labour redundancy, highly segmented financial and labour markets, and firmly entrenched interest groups. Thus, the SOE reform initiatives have encountered more intense opposition in developing country environments.

The SOE reform experience of the developing world is comprehensively evaluated in the World Bank (1995) report entitled *Bureaucrats in Business: The Economics and Politics of Government Ownership* (briefly, the BIB Report). This study conceptualizes SOE reform as a broad process, entailing five components: divestiture (asset sales, liquidation or giveaways), competition, hard budgets, financial reforms and changes in institutional relationship (or incentive structure) between SOEs and governments. The political desirability, political feasibility and credibility of reforms are explicitly explored, and the issue of contracting is accorded a special treatment.

By using the SOE financial returns, productivity and saving-investment deficits as indicators of success, the BIB Report evaluates the performance and reform record of sample countries. Its major conclusion is: 'The more successful reformers (Chile, Korea and Mexico) made the most of all five components' of the SOE reform process and divested more (World Bank 1995: 5). The attempt to increase managerial autonomy and improve the incentive structure were common to all reformers, but their impact has not been significant in the absence of reform accomplishments in other areas. The less successful reformers have been mainly constrained by political difficulties in maintaining the government's support base and overcoming legal and administrative obstacles in the implementation process.

The BIB evaluation also discloses a number of noteworthy trends. Despite increasing divestiture, the share of SOEs in developing countries gross domestic product (GDP) (excluding transition economies) has not declined in the 1980s and remained around 11 per cent. The relative size of the SOE sector is higher in low-income countries (14 per cent of GDP). The available evidence shows that large SOE sectors tend to hinder the growth process at the aggregate level.

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The MENA countries generally have large SOE sectors as well as large civil service and military establishments. During 1978–91, the GDP share of non-financial SOEs was 17 per cent in Morocco, 30 per cent in Egypt, 31 per cent in Tunisia, 48 per cent in Sudan and 58 per cent in Algeria, markedly exceeding the 11 per cent average for all developing countries (World Bank 1995: 268–71). Although the GDP share of SOE sectors is not a fully satisfactory measure of their relative position and significance, the above-average size of SOE sectors in the MENA region points to the existence of acute structural constraints on aggregate growth as suggested by the cross-country evidence marshaled in the BIB Report.

Conventional wisdom emphasizes the low productive efficiency and inferior financial performance of SOE sectors in order to explain their adverse impact on the growth process. While such an emphasis is justified, the unique nature of the MENA region's vulnerability to external shocks should also be considered carefully.

In various episodes of the post-1980 era, the region's economies faced severe shocks stemming from declining oil revenues and associated fall in remittance incomes and other financial transfers. The growth momentum could have been preserved by a strong structural response to external shocks through a major effort to reallocate resources toward tradable sectors, the expansion of which provides a greater scope for productivity improvements as well as non-traditional export earnings. The region's response to new challenges has been inhibited, however, by the heavily protected productive structures of public industries, and private sector's preference for investments in non-tradable sectors (such as housing and real estate) as aptly stressed by Page (1998). The stagnation of per capita income has been avoided in countries (notably, Morocco and Tunisia), where export performance has been relatively stronger.

From the mid-1980s to early the 1990s, the region's inability to restore long-term growth resulted in an unfavourable domestic context for SOE reforms. Depressed real wages and limited new job opportunities reduced the political desirability of scaling down overstuffed SOEs. The SOE reform attempts through modified institutional arrangements were generally ineffective in the absence of other reforms (Ayubi 1997).

Notwithstanding the important differences in country conditions, a more reformist policy approach was observed in the MENA region from the mid-1990s onward.³ This seems to have coincided with strong signs of output recovery, which benefited from macroeconomic stabilization that has been achieved with considerable support from international financial institutions (El-Erian *et al.* 1996, Economic Research Forum (ERF) 1996). In the new setting, reforms need to be sequenced in such a way as to yield tangible gains in the earlier phases, build credibility and avoid overloaded reform agendas for policy institutions and legislatures. If trade reforms are firmly introduced at the outset, a greater public concern with competition, market efficiency and trade logistics will generate additional pressures for SOE reforms and privatization.⁴

The present volume brings together a number of scholarly articles on SOE performance, reform issues and the changing context of privatization in the MENA region. The volume originated from a workshop on 'The changing size and role of the state-owned enterprise sector in the MENA region', organized by the Economic Research Forum for the Arab Countries, Iran and Turkey (ERF) in cooperation with the World Bank at Amman (Jordan) in May 1996. Besides offering a selection of articles based on papers presented at the workshop, the book also includes invited contributions that report the findings of empirically based original research.

The book is divided into two parts. Chapters 2–6 in Part I contain research contributions on broad reform issues, cross-country perspectives and strategic approaches to privatization as they relate to the MENA region. In turn chapters 7–12 in Part II present country-specific research on various aspects of SOE performance and reform in Egypt, Jordan, Sudan and Turkey.⁵ The case studies do not cover the entire region, but are highly representative of policy approaches and outcomes in most MENA countries.⁶ The salient features of this volume's contributions are highlighted in the following section of this introductory chapter.

Overview of contributions

Broad issues and region-wide perspectives

Why has there been a status quo bias in SOE reforms? How can more pressure be generated for privatization? In Chapter 2, Mustapha Nabli develops a unified conceptual framework for the institutional economics analysis of SOE reform, which ingeniously combines the approaches based on transaction costs and political economy considerations. In Nabli's framework, the welfare cost of the SOE sector plays a crucial role in explaining interest group pressures for or against the reform. This cost is considered to be a function of not only the relative size of the SOE sector but also its costs and inefficiencies in the wider economic context.

Upon a careful review of factors that impact on the welfare cost of the SOE sector, Nabli delineates possible ranges of this cost, over which pressure for or against reform may dominate. Nabli observes that most of the countries in the MENA region display SOE characteristics that indicate a strong bias in favour of little or no privatization. Within his unified conceptual framework, Nabli also explores interactions of SOE reform and other reforms, and suggests that reforms should be sequenced in such a way as to produce maximum results with least resistance and make the SOE sector's costs more transparent to the general public. In his chapter, Nabli also argues that a substantial amount of divestiture is 'itself a prerequisite for possible improvement of the performance of what may remain in the public sector'.

Despite the rapid expansion of data based on world-wide privatization, the subject has not been sufficiently researched as a positive economic problem.

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In Chapter 3, Sahar Tohamy and Peter Aranson make a novel contribution to the literature by developing a theoretical model and testing its predictions in a world-wide context. In their theoretical model, politicians maximize the net total surplus (or support) of workers and investors in making choices on privatization under different methods. Their model differentiates a number of institutional arrangements for public firms and generate varying patterns of support for, or opposition to, privatization. The empirical testing of the authors' model shows that the likelihood of privatization increases as public firms' debt becomes smaller and government spending for social security and welfare gets larger.

For the MENA region, the empirical findings of Tohamy and Aranson suggest that issues surrounding hard budget constraints (implying low SOE debt) and adequate social security arrangements (or unemployment benefits) should be addressed prior to privatization. Their theoretical model predicts that restrictions against employment cuts reduce the likelihood of enterprise sales to private investors, but increase the probability of worker or manager buy-outs. Workers' gain would be larger in profit maximizing firms, implying less labour resistance to privatization after market liberalization. These results provide support to the inferences drawn from Nabli's conceptual framework regarding the appropriate sequencing of reforms, which suggested policy-regime changes to enhance domestic competition in earlier phases of the overall reform process.

The unsatisfactory pace of new job creation has been a major source of political difficulties faced in the earlier episodes of privatization. In Chapter 4, John Page presents a coherent reassessment of the MENA region's previous privatization attempts in the context of its sluggish employment performance, narrow trade orientation (excluding oil) and limited fiscal resources for labour redundancy policies. Page's assessment establishes a clear link between faster trade integration and accelerated economic growth, which is a prerequisite of more supportive labour market conditions for divestiture of large SOEs with redundant workers.

Page notes that the potential benefits of a greater trade orientation have been recognized in almost all countries in the region, where substantial trade liberalization is already in progress. The trade agreements with the European Union also offer new opportunities for export promotion. While strongly endorsing the direction of recent trade reforms, Page argues, with a great deal of supportive evidence, that infrastructure deficits are substantial in lower-income economies of the region. Infrastructure bottlenecks are 'the primary impediment' to increased investment and nontraditional exports. Page recommends that the generalized privatization programmes of the mid-1990s be 'strategically reoriented' toward trade-related infrastructure with a view to accelerate the MENA's integration with the world economy.

In response to a variety of strategic considerations, the size and significance of infrastructure privatizations have indeed shown an unprecedented rise in the 1990s. During 1990–6, infrastructure-related sell-offs (mainly in

telecommunications and power) accounted for 42 per cent of the total privatization proceeds (about US\$156 billion) in all developing countries (World Bank 1998). What lessons can we draw from the world-wide practice in infrastructure privatization, and how can they be applied to the MENA region?

In Chapter 5, Jamal Saghir provides a thorough evaluation of the objectives, methods and principles of infrastructure privatization, and examines their significance for the MENA economies. The contributions of Page and Saghir have strong complementarities, and crystallize the strategic benefits of infrastructure privatization in strengthening trade performance, capital market development and mobilizing additional resources for domestic investment.

At a more operational level, Saghir distills useful lessons from the world-wide experience in infrastructure privatizations and private participation in infrastructure projects. Previous experience shows that it is much more difficult to introduce changes in sectoral structures after privatization, 'when there are private shareholders with contractual rights'. In the pre-privatization stage it is a sensible strategy to identify potentially competitive elements and separate them from natural monopolies; establish regulatory frameworks, where necessary; and resolve issues concerning labour redundancy, tariff adjustments and consumer protection. In the post-privatization stage the distinction between policy and regulation is crucial.

For the MENA region, Saghir puts an emphasis on legal reforms for property rights protection and dispute resolution mechanisms, including international arbitration. The private investors need to be solidly assured of their contractual rights in order to enable them to take risks that are not unduly high by cross-country standards. Otherwise, they will demand 'higher returns to compensate for higher risks', which are ultimately financed by higher prices for the consumers. Effective guarantees from the governments and international financial institutions can further improve the creditworthiness of long-term infrastructure projects.

In a long-term perspective, savings mobilization and productivity improvement are central to a sustained growth process. While foreign savings, official grants and remittance income contribute to economic growth through a number of channels, domestic savings normally constitute the bulk of total savings available for domestic investment. The countries that have large SOE sectors are typically characterized, however, by low domestic savings ratios. In this context, the relevant question is: what are the potential gains in savings from enterprise reforms and privatization? This question and related issues have not been explicitly examined in the recent literature. In Chapter 6, Ahmed Galal presents an empirically-based analysis of savings and privatization, using the Egyptian database for public enterprises. Although his numerical results apply to Egypt, his innovative methodology and general findings have wider implications.

In his review of the initial conditions, Galal notes that the savings-investment gap of his sample, which represents about a third of the value

added of Egypt's public enterprise sector, declined in the post-1987 period and turned into surplus in the early 1990s. This has been achieved, however, by investment reduction rather than increased saving, which is hardly conducive to increased productivity performance. For the analysis of possible future paths of savings, the author defines two counterfactual scenarios in addition to the no-reform (or factual) scenario. His two counterfactuals are the commercialization and privatization scenarios.

In Galal's simulations, future profits of enterprises, and hence their savings, are influenced by assumptions on productivity improvement and additional investment beyond the benchmark paths specified for the no-reform scenario. Galal exercises considerable caution on the numerical assumptions that crudely reflect reform outcomes observed elsewhere. A hypothetical reform programme combining 50 per cent commercialization and 50 per cent privatization yields an annual increase in savings with a magnitude of 2.4 per cent of the base year (1994) GDP. If these savings are extrapolated to the rest of the sector, additional savings could be as high as 7 per cent of GDP.

In his chapter, Galal also undertakes a sensitivity analysis, which underscores the potential benefits of new investments in privatized enterprises. The author concludes that 'care must be taken to secure, where appropriate, the commitment of new owners to an investment program'. In the privatization of large and overstaffed SOEs, the investment initiatives of the new owners may be constrained, however, by a number of factors, including the extent to which the authorities have addressed labour redundancy issues in the pre-privestiture stage.

Country studies

As emphasized by Page and by Tohamy and Aranson in their chapters, labour redundancy is a major impediment to privatization, especially in economies that cannot absorb new labour force entrants. In most cases, the existing labour legislation makes involuntary layoffs impossible. In Chapter 7, Ragui Assaad presents an in-depth research on the design of voluntary severance programmes for redundant workers in Egypt's public enterprise sector. These programmes aim to achieve the target exit rates while remaining voluntary in nature. This can be done by 'compensating workers for the rent they receive by being in the public enterprise sector'.

In the absence of survey data on actual displaced workers, Assaad carefully pursues indirect approaches to determine worker-specific rents that are based on sectoral earnings equation estimates and plausible assumptions on non-wage benefits. A worker's rent is defined as 'the difference in the expected streams of total compensation in the public and private sectors up to the age of mandatory retirement'. The author's calculations show that the average rent of a public enterprise sector worker is equal to 108 average monthly wages in 1988 prices. Rents for female workers are found to be 68 per cent

higher than those of males, because of their less promising employment prospects in the private sector.

In his chapter, Assaad also gives estimates of alternative compensation programmes that achieve a 30 per cent reduction (366,000 workers) in the total public enterprise labour force (1.21 million workers in 1988). The estimated total fiscal cost ranges from 4.6 per cent of GDP (for the programme that matches compensation payment exactly to the worker-specific rents) to 8 per cent of GDP (for the flat payment scheme, where no indexation is used). These findings show that fiscal cost of providing voluntary severance packages are substantial in Egypt's highly overstaffed public enterprise sector.

The case of Jordan is presented in Chapter 8 by Taber Kanaan. Jordan has a large public sector, but the GDP share of SOEs, excluding the government services, remained around 14 per cent in the early 1990s. While Jordan's SOEs have dominant positions in public utilities and natural-resource-based monopolies, two major government institutions hold a wide range of minority shareholdings in commercial enterprises. The available evidence shows weak performance in public utilities and inferior financial efficiency in government-associated enterprises. Kanaan observes serious weaknesses in the management and control pattern of public shareholding companies in which the government has high equity participation.

In his chapter, Kanaan outlines Jordan's privatization strategy (announced in 1996), which places an emphasis on restructuring and divestiture of substantial capacity in power and telecommunications, and selling large equities to strategic partners in other sectors.

While favouring the restructuring of SOEs with modern management systems, the author argues that change of ownership patterns should be considered 'only if and when they can help liberalize markets or reduce their imperfections, and/or contribute significantly to the improvement in the efficiency of enterprise management'. Kanaan observes that market-supportive reforms may also be applied to certain government services, and proposes such a reform for official universities, taking into account social policy objectives in financing well-defined categories of students.

The case of Sudan poses enormous challenges to researchers, who have to contend with sparse information on policy and performance in an economy that has suffered from civil strife since the mid-1980s (Elbadawi 1998). The protracted political conflict has also sharply reduced the country's access to international assistance.

Public enterprises have played a major role in Sudan's historical development process, and contributed about 48 per cent of its GDP in 1978-91 (World Bank 1995). In Chapter 9, El-Khider Ali Musa evaluates Sudan's experience with the reform of public enterprises, drawing upon available data on recent privatization transactions. In his retrospective on public enterprises, Musa stresses the multiplicity of their goals, including regional development and the provision of social services in rural areas, which have not been conducive to commercial operations. As part of the policy response to acute

fiscal crisis, privatization was initiated in the early 1980s under international pressures. However, the process proceeded on a purely *ad hoc* basis, and was disrupted by political instability and outbreak of civil war in the South.

In his chapter, Musa gives a detailed account of Sudan's privatization drive in the 1990s in the context of the government's comprehensive adjustment strategy, which emphasized economic liberalization and private sector development. Although the necessary legal and institutional frameworks have largely been established, the author reports that 'the implementation has been flawed in several respects': lack of transparency, under-valuation of state property and excessive official leniency with delayed payments from private investors. For low-income economies with large public sectors, Sudan's experience shows that the effectiveness of privatization suffers from political instability and the absence of international technical and financial assistance.

Because of extensive data availability, Turkey's experience with public enterprises provides a greater scope for empirically-based analysis. From the policy standpoint, the Turkish case is also interesting, because Turkey has switched to an outward-oriented growth strategy with notable success, notwithstanding the sluggish progress in privatization. The various facets of Turkey's SOE sector and its performance are examined in three chapters contributed by different authors.

In Chapter 10, Merih Celasun and Ismail Arslan present a broad evaluation of Turkey's non-financial SOE sector against the background of major shifts in economic strategy and policy regimes. The available indicators show that the SOE sector has fallen behind the private sector, which played a leading role in Turkey's export drive in the post-1980 era. In the mid-1980s, the SOE investments were shifted from manufacturing to energy, telecommunications and transport sectors to break the infrastructure bottlenecks in the outward-oriented growth process.

Despite their narrowing contribution to aggregate output, Turkey's SOEs have, nevertheless, remained a convenient vehicle for populist policies of a political nature. The authors' analysis brings out the strong sensitivity of SOE financial performance to changes in policy stance on income distribution, real wages and modes of deficit financing. After the 1994 financial crisis, SOE deficits have been substantially reduced under hard budget constraints. During 1995–7, Turkey's high inflation persisted, however, mainly due to the government's inability to deal with growing social security deficits and a high interest burden on the budget.

In their chapter, Celasun and Arslan also assess the legal setbacks and administrative weaknesses that have impeded the process of privatization, which yielded only US\$2.8 billion in total gross revenues in 1986–95 (and a cumulative US\$3.7 billion by the end of 1997). With the establishment of a more enabling legal framework in 1996, growing public support and closer attention to labour issues, Turkey's privatization is likely to accelerate, in conjunction with more extensive private sector participation in infrastructure projects.

In Chapter 11, Suleyman Ozmucur provides a comparative analysis of productivity and financial performance of public and private enterprises, utilizing a rich database on the 500 largest industrial firms in Turkey, which collectively generated 43 per cent of value added in Turkish industry (mining, manufacturing and power utilities). The author's study shows that labour and capital productivity are, respectively, 65 and 83 per cent higher in private enterprises than corresponding levels in public enterprises over the 1982–94 period. The analysis of profitability indicators reveals the inferior financial efficiency in public enterprises.

Furthermore, Ozmucur's study finds important differences in the behavioural response of private and public enterprises to changes in macroeconomic conditions. During inflationary periods, the private sector lowers its output, and increases its mark-up and sales profitability. During periods of GDP expansion, private enterprises increase their production. No such systematic behaviour is observed in the public sector.

Ozmucur's findings point to the existence of considerable potential for additional domestic savings in response to improved productivity and the financial performance of public enterprises as suggested by Galal's simulation study (in Chapter 6) on savings and privatization. The measurement of potential gains in savings requires, however, further research on public enterprises that generally operate in more capital-intensive sub-sectors, which reflect on their comparatively lower output–capital ratios.

In Chapter 12, Osman Zaim and Fatma Taskin adopt a highly elaborate methodology to explore the possible effect of ownership on efficiency trends in Turkish manufacturing (excluding mining and electricity output). Zaim and Taskin employ stochastic and non-stochastic techniques of production function estimation, which views deviations from the frontier as measures of technical inefficiency. The authors use an extensive data set on twenty-eight sub-sectors in large manufacturing, where public and private production are registered separately from 1974 to 1991.

The empirical results of Zaim and Taskin show that the pure technical efficiency in large manufacturing is on a declining trend in Turkey. The performance of the public sector was somewhat superior relative to that of the private sector prior to 1982, but the efficiency level of public enterprises exhibited a decline after 1982. The latter decline may be attributed, as noted by the authors, to reduced investments in public manufacturing in the post-1980 era of economic liberalization and relatively high trade-orientation.

Viewed as a whole, the research findings on Turkey have an important implication. The post-1980 changes in the sectoral structure of public investments warrant a more integrated framework of analysis. Reduced investments in public manufacturing provided room for increased public investments in infrastructure sectors, which facilitated Turkey's export-led recovery from its severe debt crisis in the late 1970s. On the other hand, the structural deficiencies in manufacturing investments have been offset mainly by real

exchange rate depreciations and real wage reductions that enhanced the price competitiveness of Turkish exports at a considerable social cost. The related issues concerning the sustainability of Turkey's export expansion are important, but have been explored elsewhere (Togan 1998, Arslan and Celasun 1995).

Concluding remarks: the way ahead

The available evidence shows that the productivity and financial performance of the SOE sector is generally low in the MENA economies. The experiences of Egypt and Turkey indicate that the SOE deficits can be lowered under hard budget constraints, but this has usually been achieved by investment cuts and real wage reductions, which cannot be regarded as long-term remedies. The attempts to improve SOE performance through changes in institutional relationships have not been successful in the absence of robust reforms in trade and finance. In the future, the SOE reform directions are deeper commercialization and privatization that primarily aim at increased market efficiency, improved savings performance and more efficient capital allocation to support a trade-oriented growth process.

In the MENA region, privatization gained a considerable momentum in the mid-1990s in conjunction with the emergence of a relatively more supportive social and political environment. The cross-country evidence suggests that privatization proceeds more rapidly when labour issues are addressed in earlier phases and enterprises operate under competitive conditions.

Given the more favourable political conditions in the region, the limited size of domestically held private wealth and relatively narrow capital markets will pose a major constraint on large-scale divestitures. The attraction of the return of flight capital, foreign investment and private capital flows from the Gulf remains, therefore, a key challenge to the region's reforming countries with low savings. This challenge can be met more effectively in a dynamic growth environment supported by macroeconomic stability and sound legal and institutional frameworks that are compatible with contemporary norms and practices at the international level.

To accelerate aggregate growth, the region's economies need to move much faster to increase their non-oil trade integration with the world economy. This requires a well-coordinated policy effort in a number of directions.⁷ Robust trade reforms are needed upfront to realign incentives in favour of export-oriented sectors. A greater emphasis is warranted on the improvement of the quality of human capital and technological capabilities. In the intermediate run, it is also essential to remove infrastructure bottlenecks that impede trade-oriented activities in the growth process. The new policy setting offers strategic opportunities in infrastructure privatization and private sector participation in infrastructure to improve trade logistics and enable a wider access to international finance.

Infrastructure privatization requires, however, rigorous structural, legal

and regulatory arrangements in the pre-privatization stage. Capacity building in the economics of regulation is a region-wide challenge. International technical cooperation and assistance can play a highly fruitful role in this direction.

From the perspective of long-term development, it also needs to be emphasized that outward-oriented growth strategies and privatization should be complemented by internal reforms to promote 'the development of human resources, equality of opportunities, transparency in governance, strong local demand and sustainable environment' (Sirageldin 1998: 1).⁸ In the final analysis, it is up to the citizens of the region to choose and implement reforms that will integrate them with the global economy in a rewarding manner. Hopefully, research presented in this book will contribute to a broader understanding of issues surrounding SOE performance and reforms that are an important component of the overall reform process in the MENA region.

Notes

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- 1 See Glade (1991) for comprehensive assessments of privatization experiences in Latin American economies.
- 2 The literature of the country experiences with privatization is vast. See, for example, OECD (1996) for reviews of various aspects of privatization in selected OECD and non-OECD countries; Vickers and Yarrow (1988) and Bishop *et al.* (1994) on the UK's privatization experience and policy lessons; Anderson and Hill (1996) on world-wide privatization; World Bank (1995) on SOE reform and privatization in the developing world; Akyuz (1994), Milor (1994), Sachs (1991, 1996) and World Bank (1996) on privatization and related issues in transition economies and reforming communist states; and Ayubi (1997), Anderson and Martinez (1998) and Luciani (1997) for previous contributions on statism, privatization and private sector development in the MENA region.
- 3 See Handoussa (1997) and Shafik (1998a, 1998b) for in-depth assessments of the MENA region's economic future, social issues and policy perspectives on closer integration with the world economy. Sirageldin (1998) argues for the adoption of coordinated internal and outward oriented development strategies, and examines the nature of deeper internal reforms needed in Arab countries. Waterbury (1998) critically explores feasible reform paths in the context of political issues and institutional patterns.
- 4 As argued by Rodrik (1996) and Safadi (1997), international disciplines and restrictions placed on domestic policies by membership in the World Trade Organization and trade agreements with the European Union will present opportunities to lock in trade reforms and provide stable and transparent incentives for the domestic industry.
- 5 Some of the contributing authors of this volume use the acronym 'PE' for public enterprise (rather than SOE for state-owned enterprise), reflecting the common usage in their countries.

- 6 The aggregate World Bank statistical database for the MENA region does not cover Turkey, unless indicated otherwise.
- 7 For a coherent analysis of the nature of growth-oriented economic reforms in the process of global integration see Sachs and Warner (1995).
- 8 See, for example, Handoussa and Kheir-El-Din (1998) for a case study on Egypt's long-term development vision, which treats external and internal reform perspectives in an integrated manner.

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