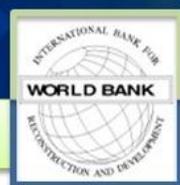


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## Quick Notes Series

# PRIVATIZATION: LESSONS FROM JORDAN

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**Introduction:** While many governments in the Arab world have undertaken some privatizations since the early 1990s, many retain surprisingly large portfolios of fully, majority, or minority state-owned enterprises (SOEs). As in other parts of the world, privatization often causes concerns among citizens. Workers fear loss of employment and benefits; consumers worry about price increases; and voters mistrust government officials.

Jordan's experience during 1998 - 2008, when the Government of Jordan (GOJ) privatized fourteen SOEs - in telecommunications, electricity, air transport, mining and other sectors - with technical assistance program financing from the U.S. Agency for International Development (USAID) demonstrates both how privatization can provide a wide range of benefits to society and how to implement a privatization program.

**Jordan's Privatization Program:** The aforementioned privatization transactions substantially strengthened Jordan's fiscal position. These privatizations generated \$2.3 billion in sales proceeds, which were mostly used to buy Paris Club debt in 2008 at a discounted price. By supporting reductions in GOJ debt from 100 percent of GDP in 2000 to 89 percent in 2004 and 60 percent in 2008, the privatizations supported by the Program contributed to macroeconomic stability. Part of the substantial increase in annual payments (e.g., taxes) from these privatized firms to the Treasury can also be attributed to privatization. Firms restructured

and privatized with Program support have shown substantial gains in their financial performance and productivity. Consumers have also benefited, for example from major service improvements and reduced connection charges and tariffs; increases in electricity supply with no real (i.e., inflation-adjusted) increase in average tariffs; and improvements in air service frequencies and services as a result of airline restructuring and privatization. As for workers, the GOJ avoided involuntary retrenchments. SOEs privatized with Program support witnessed only a 2 percent net loss in employment (448 positions), which were more than offset by an estimated 25,000 new jobs in telecommunications and IT-enabled businesses. Workers who remained at privatized firms experienced real wage gains in most cases, as well as better benefits and greater training opportunities. Local communities have benefited from the corporate social responsibility programs (and spending) by the new owners of privatized firms.

Firms privatized with support from the Program saw additional follow-on capital investment of \$1 billion, representing 11.4 percent of foreign direct investment (FDI) for the period 2000 - 2007. In contrast to FDI that went into real estate development, this FDI served to increase the capacity and productivity of Jordan's industrial and service sectors - all without any guarantees or contingent liability for the GOJ. Firms privatized with Program support also experienced major gains in labor productivity, to which privatization was a contributing factor. Lastly, these privatizations supported development of the Amman Stock Exchange and Jordan's overall capital market development.

**Key Lessons from Jordan's Privatization Program:** Jordan presents a useful and relevant model for

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other MENA governments considering a greater commitment to privatization or interested in the details of how to design and implement a privatization program. Lessons from Jordan's privatization program likely have broader applicability as well, including for governments in South Asia and Africa. Key lessons from Jordan's privatization program include the following:

- a) ***Need for government commitment.*** Jordan, despite a number of changes in government over the past 10 - 15 years, remained solidly committed to implementation of privatization and public-private partnerships (PPPs). This sustained commitment reflected a collective sense of urgency on the need to turn annual fiscal outflows (e.g., for subsidies) into inflows and to maximize privatization proceeds available for paying down an uncomfortably high level of debt. This sense of urgency made it easier for officials and legislators to agree on a workable privatization law, on a centralized privatization agency, and on the terms of major transactions.
- b) ***Need for a clear strategy.*** Governments should set priorities in terms of what they are attempting to achieve. Privatization - in particular - is likely to involve tradeoffs among maximizing sales proceeds, protecting workers, enhancing enterprise competitiveness, developing capital markets, and sharing wealth with citizens. GOJ's revealed priorities were privatization sales proceeds, competitiveness gains, and worker protection. It will be important for the effectiveness of a nation's privatization program to establish priorities in cases where such program goals conflict.
- c) ***Need for sufficient legal authority.*** Jordan's 2000 Privatization Law gave sufficient authority for a new Executive Privatization Commission (EPC) to retain external advisors, undertake investor search according to agreed tender procedures, and negotiate privatization transactions - subject to oversight by a high-level GOJ Privatization Committee. This 2000 law provided an adequate legal basis for a series of privatization transactions beginning with

the mixed-capital initial privatization of Jordan Telecommunications Company in 2000 through a strategic sale and public share offering.

By contrast, except for water, power, and some other PPPs subject to sector-specific legislation, Jordan continues to lack an adequate legal basis for innovative small/medium PPPs. A number of PPP-related rights and obligations - such as a private developer's right to collect fees that would otherwise go to the GOJ - still need to be codified in a special-purpose PPP Law. The lack of such a law has halted at least some small PPP transactions.

- d) ***Need for a centralized privatization agency.*** Blessed with sufficient budget and staffing, EPC was able to build in-house capacity and institutional memory on the numerous detailed operational issues involved in organizing and implementing a successful privatization program (e.g., advisor selection, review of advisor work product, negotiation). Concentrating responsibility for privatization implementation in one central agency - rather than among multiple line agencies - hastened the accumulation of a critical mass of privatization program development and implementation skills. It is important for the privatization agency to have efficient local staff who can work efficiently with external consultants. External consultants are good if their local staff counterparts are good. Hence, capacity building for local staff should be given top priority.
- e) ***Need for intra-governmental coordination.*** Jordan's large and successful privatizations - including the telephone company, airline, and power sector restructuring and privatization transactions as well as the Amman airport build-operate transfer (BOT) transaction - required close coordination between the EPC, line ministries (e.g., for communications, transport, energy), newly-established regulators, and capital market institutions. Poor working relations with any one of these would have disrupted a

mixed-capital privatization transaction in any one of these regulated sectors.

The privatization agency must be able to respond quickly to requirements set by external advisors and obtain timely government decisions. Investors often have opportunities in multiple countries, and an entire transaction can fail if a government decision takes longer than it should. To avoid this, working committees should be given broad decision-making authority within pre-specified committee mandates.

- f) ***Need for highly-qualified external advisors.*** Jordan's large privatization and PPP transactions involved complex preparations. The privatization agency's readiness and ability to hire leading international firms to advise and assist on such detailed implementation matters is essential. Hence, the consultant selection process should be open and be based on full competition. The committee responsible for selecting an external advisor should be given full freedom of choice without any outside pressure.
- g) ***Need for adequate preparation.*** Enterprise restructuring, if needed, should be completed prior to privatization. Pre-privatization enterprise restructuring should be based on some sort of a privatization plan. There should also be some enterprise screening in order to exclude non-viable enterprises from privatization. In the case of a PPP, a thorough feasibility study should be completed before selecting a Program for PPP. Otherwise, transaction efforts may go for naught if it subsequently turns out that a Program is infeasible. Needed regulatory arrangements, such as establishment of an independent regulator, should be put in place before starting work on a transaction.
- h) ***Need to ease out redundant labor.*** As part of enterprise preparation, the GOJ sought to avoid disadvantaging redundant SOE staff. As a matter of policy, GOJ avoided involuntary retrenchments in favor of voluntary early-retirement packages (with lump sum severance) and support for health insurance/pension premiums until

retirement age. Especially in cases of SOEs that are severely distressed and/or highly over-staffed, it will be important to design severance/retrenchment packages carefully and – if need be – to draw on international financial assistance to fund severance and interim health/pension premiums.

- i) ***Need for sufficient funding.*** Sector restructuring, development of regulatory frameworks and capacity, labor retrenchment, and transaction support are extremely expensive. It will be essential for a government embarking on a privatization program to make sure that it has developed a realistic projection of overall privatization program costs and lined up sufficient funding (e.g., from internal government budgets, development agency grants, or international financial institution credits) to cover projected program costs.
- j) ***Need to avoid conflicts of interest.*** Those involved in a privatization or PPP program or transaction should have no conflict of interest. These include senior officials, privatization agency staff, and external advisors and their families and business partners.
- k) ***Need to monitor impact.*** Privatization is contentious, and it can be difficult to demonstrate the benefits. To do so, it would be useful to establish a pre-privatization baseline in terms of the enterprise performance results, employment effects, fiscal effects, investment, and competitiveness to be expected in a counterfactual case where the enterprise remains under state-ownership.
- l) ***Need for patience.*** Privatization/PPP transactions usually take a long time to do properly – often much longer than expected at the outset. Any number of factors – including needs for enterprise restructuring, enabling legislation and capacity development or adverse market sentiment and investor disinterest – can delay transactions. For example, while RJ Airlines was ready for privatization, potential investor interest disappeared in mid-

September 2011. To its immense credit, USAID remained patient and supportive throughout the long life of this Program, which paid off both in terms of successful outcomes and in establishment of valuable lessons and institutional frameworks for future success.

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